CHAPTER I

INTRODUCTION

1.1 Background of the study

In the contest of Nepal, appropriate technology, capable manpower, adequate investment and instability of the government are the main barriers in the development process. It is facing 'vicious circle of poverty' in 21^{th} century. About 23.8 percent of the peoples are forced to live below the poverty line. Statistics on social sector development such as life expectancy, infant mortality, and literacy also indicate poor status compared with many other SAARC countries. To enable people to feel change in their livelihood and quality of life by supporting poverty alleviation and establishment of sustainable peace through employment centric, inclusive and equitable economic growth is the main objective in the current three years plan (2067/68 – 2069/70) of the country. Thus, borrowing should be directed to relevant sectors, and efficient utilization of resources should be accorded due to attention.

In developing countries, economic development is widely accepted as major goal of national policy, whereas economic growth as a major goal of the industrialized countries. Economic development is viewed as a process which implies the series of changes in social, technological and economic forces which are useful in accelerating the pace of the development. In developing countries, one of the tasks foremost to the state is to stimulate the growth and escape from 'vicious circle of poverty'. There is small capacity of saving owing to a low level of real income. Low income is a reflection of low productivity, low mobilization of resources which is usually due to lack of appropriate technology of capital equipment and the capacity to use then to the best advantage.

The lack of capital is resulted largely from the small potentiality of saving. Lower the saving creates the low investment. Hence, low investment creates inadequate capital, low productivity, low real income level and low purchasing power, inadequate inducement to save and to invest and in adequate capital gain. This justifies that capital deficiency in the developing countries is a serious bottleneck in the development. Under developed countries are facing the deficiency of capital in the relation to their population and natural resources. Most of the developing countries are characterized by deficiency of capital. To break vicious circle and uplift a country with a self-sustaining growth, a large amount of initial investment is necessary. For that we search or manage for resources.

The revenue which is the main source of public expenditure has increased approximately by 20 percent annually. As a result, some big projects of national importance have been initiated and investment has been increased in social services and security sector by the domestic resource. Domestic borrowing and budget deficit have been kept at desired level.

Nepal is an agriculture based economy. Agriculture is the main source of Nepalese economy which provides employment for about 74 percent of the country. So, to reduce poverty and to enhance economic development government requires investing big amount of capital in the field of transportation, communication, power, road and other basic infrastructure. To invest in all these areas government need higher amount of revenue but the source of revenue in the Nepalese context is very small and limited. Nepalese people are not capable to paid tax to the government. The government needs to manage debt from internal and external sources. The government of the country gets income from two sources namely pubic revenue and public borrowing (debt). Public debt carries with the obligations to pay back to person, institution or countries from which it has been obtained but there is not any repayment obligation in taxation.

The phenomenon of the public debt was originated in Great Britain in the seventeenth century when a group of city merchants provided grant and loan to the government. In return, they received the privilege of Royal Charter to fund the Bank of England which becomes the county's central bank. After the Second World War, public debt seemed a very vital source of development expenditure; most of the countries in the world started to borrow systematically and are still borrowing to develop their economies at faster pace. After the first and Second World War, large amount of loans were borrowed for the reconstruction, rehabilitations and maintenance.

Nepal remained almost a debt free country till 1961/62. The accumulation of the debt began since 1963. Since then government of Nepal has been managing public debt from both internal and external sources. In internal sources financial sectors dominates others and in external debt it is receiving from bilateral and multilateral sources. The trend of borrowing through the external source is very high in Nepal as compared to internal. Developing countries like Nepal are always facing the problems of fund; tax payable capacity is very low which leads to low level of government revenue. Low level of revenue and increasing demand for development expenditure has forced to resort for borrowing. It is an instrument to collect the needy fund.

Nepal is basically an aid dependent country which is not able to attract bank lending, and has to depend mainly on foreign aids for the required capital imparts. Since the credit worthiness of a particular country depends upon the economic condition and performances, Nepal does not have credit worthiness that can attract the bank lending from the abroad. The main sources of external borrowing for Nepal are western developed countries. Foreign aid as a source of financing development plans has been increasing in Nepal since the inception of planning. In the recent year, several techniques of financing for economic development of developing countries has come to significant role in the context of planned economic development. Public borrowing has to be undertaken within the country. The scope of domestic borrowing in these countries is very limited. Therefore, only external borrowing remains the alternative to these countries.

In the first two five year plans, the major goal was to collect the information about the economic variables. From the 1970s, The government started investing directly in productive activities, which increased the volume of government expenditure. The demand for the goods and services also increased due to increased government expenditure it lead to inflationary situation appeared. But on the other hand government revenue could not increase to fulfill the required expenditure. So, the government has to relying upon public debt as other sources are limited.

Hence, both developed and developing countries are availing public debt as a major source of resource mobilization to meet the budgetary deficit. Now, it is widely accepted means for financing deficit. The role of public debt is increased significantly by the planned economic development. The persistent feature of Nepal is that public debt has been increasing rapidly each year. The trend of external debt is increasing more rapidly than internal debt. Nepal has been facing deficit budget since the first budget 1952 to till now. The government of Nepal is fulfill such deficit by several ways.

First sources are tax and other revenue. In Nepal, most of the people lie under the poverty line. They are unable to pay taxes. In other words the earning of the most people is below the taxable income. Therefore, certain amount of revenue comes from tax sources.

Second sources are subsidies and external debt. It is said that basically, Nepal depends upon the aid for required capital imparts. However, the subsidies are not strong sources, because it depends upon the vision, attitude capacity and interest of donor. External debt also is not an easy way to get sufficient fund. The main sources of external debt for Nepal are western developed countries. External debt is very costly loan because it has to repay to the foreigners in term of gold silver or some other hard currency acceptable to them.

Third sources are internal debt. The government takes loan from its own people as well as financial institution to full the budgetary deficit. This type of loan is called internal debt collected as a median of Treasury bill, development bonds, special bond etc.

Public debt management, in general, is the process of establishing and executing a strategy for managing the government's debt in order to raise necessary funds from the lending markets with minimum cost and prudent risk and keeping the debt liabilities at sustainable level and paying back the loan without hampering in credibility and the prospect of necessary borrowings in the future.

1.1.1 Importance of public Borrowings management

Internal debt is one of the several means of procuring public funds. When taxation solely fails to meet the needs of resources, the government enters in the money market in search of fund just as a private borrower. The need of public borrowings in Nepal streams from the necessity of financing the numerous developmental projects for which the government cannot raise adequate tax revenues. Moreover, the prudent and efficient IDM also initiates numerous facilities and products for the development of money and capital markets. However, the importance of public borrowings management can be summarized in the following points:

- To mobilize adequate resources for developmental activities and Infrastructure developments.
- To stabilize the economic swings and ensure high and sustainable growth.
- To provide revenues of investment to individuals and institutions.
- To provide marketable instruments for the development of money and capital markets.
- To enhance saving habits among people and provide fixed income Instruments.
- To protect the nation from vulnerability of international financial shocks as extreme exposure on external debt increases global financial contagion.

- To develop and maintain an efficient market for government securities and financial system.

1.2 Statement of the problem

The volume of budgetary deficit is increasing. The revenue mobilization is not increasing to that extent to cover the total budgetary outlay. The debt should be repaid with interest in the future. Therefore, the excessive public debt to finance the deficit budget may create a debt trap situation for the country. For the economic sustainability, the public debt management, the export earnings, the revenue growth and the real interest rate structure should be in favorable condition in the future to pay off the debt. All these aspects are governed by so many other economic factors. Therefore, a careful evaluation of public debt position is extremely necessary for any country. In this context, it will be relevant to examine that whether our country has adopted the prudential norm in raising the debt or not. For this, the government should also have a look over the practices adopted by other country for the better public debt management.

It has been observed that there are some golden rules and fiscal disciplinary measures set by the legal framework in the other countries to restrain the growth in the level of debt. Therefore, the adoption of such fiscal discipline measure would be helpful for the country before entering into a problematic situation. Lack of study and information in this regard may be one of the constraints for the policy makers to initiate appropriate measures and strategy in public debt management.

This study is an attempt to study this problem by providing some information in these aspects. Therefore, the study of public debt management especially focusing on practices of debt management, indebtedness of debt and sustainability of debt in Nepal, is a small attempt to fill the gap.

In Nepal, effective management of available resources is a challenging proposition. In every fiscal year proportion of budget deficit is in increasing trend due to rapidly increasing gap between government revenue and expenditure. The proposition of debt servicing charge is also in increasing trend. To maintain the resource gap, debt is only one solution which helps to further increase in the size of debt. It is generally observed that increasing size of public debt in Nepal is a matter of concern.

In Nepal, the government expenditure is increasing rapidly each year, but government revenue is not increasing at the same pace. It is quite clear that a rise in the magnitude of public debt must be accompanied by and increases in the debt servicing capacity.

The composition of budgetary expenditure has also undergone a dramatic change. Until early 1990s, regular expenditure constitute around one third of the total expenditure. By mid 1990s, it increased to nearly half. Now – a – days, the government is taking foreign aid to meet the regular expenditure also. So, debt management is the big problem for Nepal.

In foreign aid, proportion of grants is in the decreasing trend where as proportion of loan is increasing. Thus, the situation indicates that trend of per capita debt is growing which have negative impact for the future generation. Until 1980s, the annual servicing of foreign loan consumed below percent of annual disbursement. It exceeded 30 percent by 1994 and is presently over one forth since then. Foreign debt servicing which observed a very small share of regular expenditure until 1980s has hit one fourth by mid 1990s. Similarly, per capita debt burden increased by over two fifth between 1990 and 1997. During this period internal loans increased by 5.3 percent where as external debt burden increased over ten times faster than the internal debt. The trend of revenue saving is also declining over the year. This indicates that Nepal's dependency on foreign debt is increasing rapidly. Thus, the heavy debt servicing creates a negative impact on development process because more resources go for debt servicing in future.

The persistent feature of Nepal's budget is that there exists a huge fiscal deficit. The deficits are widening in each year since growth rate of government expenditure and revenue are not growing on the same pace. The growth rate of expenditure has outpaced the growth rate of resources availability. Over the year only 20-30 percent of development expenditure has been financed through the revenue saving and the rest through mobilizing external assistance and internal borrowing. This shows that our development expenditure if mostly dependent on borrowing.

The increasing dependency of the country upon the external borrowing is due to poor and inadequate internal resource mobilization. Both the scarcity of internal resources as well as necessity of external resources have caused for such massive increase in external borrowing. Ever increasing external debt and debt servicing obligations will create a serious problem in the economy like balance of payment difficulties, debt trap, political instability etc. In short, there may appear macro economic imbalances and this makes excessive dependency upon foreign assistance. All these factors have forced the government to increase foreign dependency.

Similarly, foreign borrowing has become the major source of financing deficits in the government budgets. It accounts near about 40 percent of budgetary deficit. This is an indicative of Nepal has been also depends on foreign assistance and that is likely to increase further. More than 40 percent of total debt has been maintained through the external borrowing. So, we can say that Nepal is also indebted on external debt.

1.3 Justification for the study

Deficit budget has become an unavoidable phenomenon from last several decades in Nepal. The deficit budget is financed by the borrowings from internal as well as external sources. The increased volume of public debt highlights the national concern and raises the issues such as debt servicing capacity, level of indebtedness, debt sustainability, and debt trap situation of the economy. Therefore, the management of public debt is the great concern for both the managers and economists as well.

Most of the economists strongly recommended that public debt should be used on the productive schemes and programs. It must be noted at the outset that a government should not borrow for the sake of unproductive purposes.

Most of them have remarked that the expensive debt should be discouraged at a large extreme. They state it is sheer idiocy to use the external public debt in battle, administrative expenses, for army and police organization, donation and charity or on many other unproductive programs. They all have argued that unsustainable level of public debt may cause of economic decrepitude of the nation. Despite these warnings, Nepal Government is making borrowings in the large extent from both external and internal sources to finance the budget deficit. The debt should be paid at any time in the future and the interest should be paid yearly. Therefore the debt servicing capacity of the government is whether increasing or decreasing from the existing practices, whether we are following the prudential fiscal norms on borrowings has been the matter of discussion among the researchers.

In this context, this thesis has tried to examined the practices and fiscal discipline exercised in other countries and to examine whether the practice exercised in Nepal is in the line of international practices or not. Similarly, this study has also examined whether the level of debt is sustainable to the economy or not and whether the debt trap position has occurred or not in the economy on existing situation and try to prescribe some suggestions.

1.4 Objectives of the study

The main objective of the study is to analyze the present condition of management of public debt in Nepal. The specific objectives of the study areas are as follows:

1. To analyze the structure and trend of public debt in Nepal.
2. To examine the role of management of public debt in Nepalese budgetary system.
3. To identify the debt servicing and per capita debt in Nepal.
4. To identify the problems and uses of public debt in productive sectors.
5. To project the trend of managing public debt in Nepal, in coming year.

1.5 Significance of the study

Collection and proper utilization of public borrowing is very important for economic development of the nation. This study is not only helps to know the trend and structure of public debt in Nepal but also suggests valuable recommendation to the government in the collection and utilization of public debt. Hence, the main significance of the study is to know the structure and trend of public debt management in Nepal and also to provide valuable suggestion, for the effective utilization of public debt what has been managed.

For economic development of developing countries, the government must invest in various sectors such as education, health, transport, communication etc. To build up such social overhead, capital there is need of heavy investment so that importance and scope of debt is increasing over time. It is not limited only in developing countries. It uses as a reliable source of financing deficit for development countries.

Management of Public debt is now considered to be an important instrument of monetary and financial management. For the more economic analysis public debt relates with inflation, income redistribution and overall resource allocation in the economy.

In the development of resource and technology, new ideas of globalization liberalization and privatization increased the role of debt. Only Nepal cannot escape from it, Nepal is facing various, socio-economic constrains. Debt management is needed for economic development, Which uplift the life standard and per capita income, But effective and appropriate utilization of debt is the matter of concern.

1.6 Terminology

Public Debt: - Total public debt includes an obligation of the government.

Internal Debt: - It is the government borrowing from domestic banking sector and individuals.

External Debt: - It is the government borrowing from international sources, agency or autonomous public bodies through bilateral and multinational sources.

Debt Servicing: - Debt servicing is the interest payment of loan and repayment of principal after maturity.

Debt Trap: - The situation of when a new fresh loan is used for the repayment of interest.

1.7 Limitation of the study

The main limitations of this study are as follows:

1. This study has covered only 10 years period data.
2. This study is based on secondary data and information and no attempt has been made to examine the reliability of data
3. This study has not attempted to examine the effect of public debt on macro economic variables such as national income, employment, investment, general price level etc.
4. This study is limited to Nepalese context only.

1.8 Organization of the study

The study has been divided into five chapters. Preliminary materials such as title page, approval sheet, viva sheet, acknowledgements, table of contents, list of tables, list of figures and abbreviations used have been presented.

Chapter I Introduction

This chapter consists of the background of the study, importance of public borrowing, limitations of public borrowings, statement of the problem, justification of the study, objectives of the study, significance of the study, terminology and limitations of the study and organization of the study.

Chapter II Literature of Review

This chapter consists of historical background of public debt, theoretical aspects, review from international context and review of previous studies, role of public debt, fiscal policies and capital formation, deficit financing and economic development, public borrowing and research gap.

Chapter III Research Methodology

Chapter three is research methodology and it contains research design, population and sample, source of data and data analysis tools.

Chapter IV Presentation and Analysis of Data

Chapter four is presentation and analysis of data, which contains presentation of data, in various ways and its interpretation.

Chapter V Summary, Conclusion and Recommendations

Last chapter is the summary, conclusion and recommendations. After the body of the thesis bibliography and appendices are presented as supplementary materials.

CHAPTER II

REVIEW OF LITERATURE

2.1 Conceptual framework

The history of the public debt in the world reveals that the idea was originated in the Great Britain in 17th century, a group of merchants provided grants and loans to the government. In return they received the privilege of royal charter to found the Bank of England which became the country's central bank. Public debt had been developing simultaneous with the increasing role of the government for development. During and after the world war, the government borrowed large amount of loans to meet its expenditures (Joshi, 1982).

After the First and Second World War large amount of loan were borrowed for the reconstruction and maintenance. In the previous time, the state only had to maintain the internal peace, law & order and prevent external disruption. But now a day’s every state should be aware of for overall economic development and public welfare programmed in addition to the previous works. So the public debt becomes one of the most useful instruments of generating income to maintain the welfare state and economic development.

In the context of Nepal, the government debt statistics indicate that the country remained debt free nation till 1950s. However, the foreign and domestic borrowing has been alternative means of debt financing in Nepal after inflation of planned economic development.

There was no existence of public debt before eighteenth century, but the government provided some regulation to public finance. For instance, public debt held in Nepal during the period of Rana Bahadur Shah. He borrowed a large amount of money (Rs 60, 000, 00) from the Indian merchants even to meet internal expenses. Cash levy was imposed on countrywide basis in 1804-1806 to finance the repayment of debt incurred by the king Rana Bahadur Shah. (Regmi, 1971). Prime Minister Jung Bahadur Rana came into power and no development work was carried out. They had collected the revenue for their own expenses. They never thought the need of economic welfare for the Nepalese people. Thus 104 years passed off a way without significant development activities were not launched out. After the democracy, the first five years plan was introduced in the years 1956. In this plan period most of the expenditure was incurred with the foreign grants. During the plan period, some deficit amount of Rs 2708 million was met from surplus balance account and loan from Nepal Rastra Bank (NRB, 1996).

The government at the first time issued the securities (Treasury bills) in the fiscal year 1961/1962 and in the fiscal year 1963/1964. The government for the first time floated securities (long- term loan) for mobilizing saving to finance the country's economic development programmed and for giving compensation of the forest and Brita land (Joshi, 1982)

Similarly, the government floated development bond of Rs 13.1 million carrying on interest rate of 6 percent per year with maturity period of 5 years. In the same year, the government issued compensation bond for the land acquisition with the interest rate of 3 percent per annum with the maturity period of 10 years amounting Rs 407 thousands and composition bond for the land acquisition with one percent interest rate per annum with the maturity period of 20 years amounting 5.56 million. The other component of borrowing was from NRB as guaranteed loans and special bond. Since 1984 the government also started to borrow by issuing national saving certificate which amounted Rs 500 million that after. Similarly in 1991 the government started to borrow by issuing CB pass and other bond, which amounted to Rs 8,478. Million there after. Now, there are treasury bills, development bonds national saving certificate, citizen investment certificate and special bonds as the, main source of internal borrowing.(Feb-12, 1964)

In the context of evaluation of foreign assistance, Nepal's first experience of foreign economic assistance was heralded by the POINT FOUR program agreement signed on 23rd Jan 1951.The U.S government assistance of Rs 22 thousand provided under president Henry Truman's POINT FOUR program was soon followed by assistance from India in October the same year. It was then followed by China (1956) and U.S.S.R (1958), membership of Colombo plan (1955) widened the number of donor countries and agencies. Formation of Nepal aid group (1976) also named as "Paris club" began to accelerate the quantum of foreign aid move significantly in a planned way.

Similarly, Nepal has also started to borrow from external sources since 1964/65.Since then Nepal has started to borrow from external sources to bridge financial gap on the budgetary position. Since then the amount of external borrowing has contributed to increase each year. The main sources of the external borrowing of Nepal are the government of developed countries, International Agencies and Commercial banks mainly I.M.E, World Bank and Asian Development Bank etc.

2.2 Role of public debt management

Public debt now is considered to be an important tool of monetary and financial management, extending in space from a simple source of supplementing budgetary resources for the government. Public debt has become sine- qua-non for economic development because the factors of economic development like a plenty of natural resources, technically trained labor, a spirit of entrepreneurship, dedicated civil servants, capable planners are the major problem of economic development. So, the capital formation in mobilization of all resources is possible only through the public debt (Jhingan, 2001).

In the past, the way of living was very simple and borrowings were very small. The government also followed the policy of non-intervention in economic system. But in modern time, especially after the world depression of 1929/30, the public authorities started to take keen interest in economic development of their respective countries. Thus public borrowing has become 'sine-qua-non' for the economic development of the nation (Lekhi, 1995).

For developing countries like Nepal, it has so vague areas where resources are abundant but those are not in use. People have no adequate incentives to save and also have no opportunities to save. The government policy to promote development is less effective. Despite such problems, the non-bank financial intermediaries offer high interest rate and divert funds to speculative trade unproductive private expenditure and abstract in the way of mobilization of financial resources. Likewise, non-availability of markets and capital markets on non-urban uses create trouble in resource mobilization.

2.3 Fiscal Policies and Capital Formation

Fiscal policy with tools taxation, expenditure borrowing to act rapid economic growth shouldering with stable monetary policy serves to forward ejection of capital formation and stability maintenance. So the focus of developing countries is capital formation. The sheer poverty of underdeveloped countries makes the raising of the propensity to save as well as inducement to invest necessary part of fiscal policy (Higgins, 1959).

Public debt is a useful tool for diverting resources from unproductive to productive channels. Public debts, with joint ventures where by foreign investors bring technical knowhow along with capital and they train local labor and enterprises which adds in the capital formation (Jhingan, 2001).

2.4 Deficit Financing and Economic Development

Deficit spending by the country on development projects leads to increased employment, output and income. The increased income tends to raise the demand for consumer goods; on the monetary side government meets the increasing demand for money through deficit financing. i.e. expansionary effect in the economy is essential (Jhingan, 2001).

In Nepalese context, deficit financing has a crucial role in development plans. It has been regarded as a means to cover the gap in financial resources to achieve the targets of different short term and long term plans.

2.5 Public Borrowing and Resource Mobilization

No doubt, to uplift the economic development, public borrowing has been playing the significant role. Nevin observed a vital importance role of public debt in underdeveloped territory is to secure funds not for the government itself, but in order to established a regular acceptable channel by which private investor may obtain access to funds which would otherwise have been last to invest within that territory (Nevin, 1963).

In developing countries, the expanding developments activities cannot exclusively out of own resources of the government. Taxation and saving are also inadequate for development financing. It is neither desirable nor possible to raise funds though taxation beyond a certain limit. People also react unfavorably to the imposition of taxation as it reduces their income. Alternatively, there is no substitute left for public loan or borrowing. It is an effective measure for mobilizing private saving. Often, private saving where the rate of profitability is higher. As a result, pattern of investment is not comparable with balance development of the economy. It pushes private saving in the government filled to mobilize the some productive channel.

Developing countries like Nepal have characterized by market imperfection. There is immobility of resources, which lead to elasticity's of supplies. There is also lack of large volume of fresh resources which is created by increased government deficit spending is fulfilled by foreign loan. Income increases as a result of deficit spending. There are not sufficient domestic resources to carry out infrastructural and social development programs; so public borrowing plays a major role in overall economic development of the country.

2.6 Theoretical Aspect

Public debt is a legal obligation on the part of government to make interest and / or amortization of principal to holder of designated claims in accordance with a defined temporal schedule. It is created through the government borrowing from individual, corporations, institutions and other governments. It refers to loan to raised by government within the country or outside the country. Every government like individual has to borrow when its expenditure exceeds its revenue.

Opportunities for the government borrowing at home are limited in most developing countries due to low level of income and saving. This in turn is resulted from the low level of investment. This justifies that capital deficiency in the developing countries is a serious bottleneck in the development. Developed countries are facing the deficiency of capital in the relation of their population and natural resources. Most of the developing countries are characterized by deficiency of capital. To break vicious circle and uplift a country a large number of initial investments are necessary. Thus underdeveloped countries should emphasize to stimulate and accelerate capital formation.

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

The government borrowing is not the new and keen matter. From the very beginning of the 19^{th} century economist have been arguing and discussing for and against the public debt. Particularly the classical economist such as Pigou, T.R. Malthus. J. B. Say, Ricardo, Adam Smith, C. F Bastable visualized their views against the public debt saying" Nation once begins to borrow would be resist until it reached the point of bankrupt". Whereas post Keynesian and the modern economists including J.M. Keynes, Harris, Hansen, Buchanan, Musgrave, Davis, Kopt, and other have challenged the version of classical economists and hold opposite opinion on the subject o public debt, its size and use.

The debt is the form of promises by the Treasury to pay to the holders of these promises a principal sum and in most instances interest on that principal.

Borrowings are restored to in order to provide funds for financing a current deficit (Taylor, 1971)

Similarly public debt or government borrowing as a receipt from the sale of financial instruments by the government to individual or firms, in the private sector to induce the private sector to release man power and real revenue and to finance the purchase of those resource or to make welfare payments or subsidies (Shoup, 1982)

Dalton (1984) had cleared about public debt and divided it by external and internal and defined them as a loan is internal, if subscribed by persons or institutions within the area controlled by the public authority which raises the loan; external if subscribed by person or institutions outside this area.

From the four last decades, public debt is sharply increasing with the increasing role of government .In this context, the theoretical aspect underplaying the need and uses of public debt have reviewed.

2.7 Literature review in international context

Public debt, particularly in development countries, has great importance in the view of the increasing magnitude of budgetary deficits. In the literature of public debt some economists have put forth some issue regarding burden of the public debt. So the argument generally gives whether public debt inflicts burden on the economy and it can be shifted to the future generation or not.

In this context, this issue of the burden of public debt is divided between primary burden or financial burden and secondary burden or real burden of the debt. The financial burden may be taken as the loss of income of the people that arises because of taxation for meeting the servicing cost of the debt. The financial burden of the national debt is to measure by the effects of the interest charges and the taxes levied to meet them. The relation with the taxes for interest bear to the national money income is the question of primary importance (MC. Wright).

The secondary burden of debt emerges on account of the adverse effects of taxation upon the ability and willingness to work and on the capacity and willingness to save. This is real burden to the public debt. This burden of public debt can be explained in term of “Pigou Effect" or "Asset Effect" and "Kaldor Effect".

Pigou effects suggest that due to the purchase of government securities the financial asset of the investor increases that adversely affects has propensity to save in the economy. It may prove to be a boom in a depression but it is not always true in developing countries.

Holding of the larger debt any adversely affects the willingness to work and invest, an increase in the national debt can make the owners of government bond less willing to work. One of the reasons for working, the earning of money to put away of the rainy day is weakened because there is more put away already for rainy days (Kaldor effect).

The classical Economists were generally against the public debts. But they accepted the public borrowing (debt) any for self-liquidity and return generating projects. Here self-liquidity project means that in the words of Musgrave,(1959) Self- liquidity project may be defined narrowly as investment on public enterprise that provide a fee or sales income sufficient to the debt incurred in their financing; or they may be defined broadly as expenditure project that increase future income and the tax base. Such project permit servicing (interest and amortization) of the debt incurred is their financing without requiring on increase in the future level of tax rates.

They favored minimum public expenditure and between taxation and borrowing, they favored taxation for the following reasons:

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

Lerner (1946) pointed out that, The internal debt may not have direct money burden on a community as a whole, since the payment of interest and increase to meet the debt burden involved simply transfer the purchasing power from one group of person to another to the extent the creditors and tax payer are the same. There may not be any net burden at all on the community But to extent the creditors and tax payers belongs to different income groups the change in the distribution of the income among different section of the community may take place. Generally the government bonds and securities holders are mostly rich people where as the burden of taxation fall both the rich as well as poor section of the community.

The classical economists have negative attitude towards public debt and as they did not pealed for increasing economic role of government instead they said that “Let the money fructify in the pockets of the people". According to their analysis public borrowing found no significant place. So government or state has to perform its limited activities of maintenance or law and order, justice and social securities. Classical economists like J.B. Say, J.S. Mill, T.R. Multhas and C.F.Bastable pointed their argument that "Debt creates burden on the economy because of its unproductive nature".

According to classical system, all private income is spent on either consumption or investment. Full employment is secured automatically. Price level stability is maintained if the money supply is held stable or is increased at the same rate at which real income grows. However classical theory is criticized after the great depression of the 1930s, and new wave of thinking took place. Keynes, who stood against the analysis of classical economists and propounded quite different view in his popular book, "The general theory of employment, interest and money" in 1936, He advocated for increasing government role in the economic activities by adopting deficit financing so that effective demand is created in the economy ensuring employment opportunities. He did not accept the classical notion of a free market economy, which self- is equilibrating at a full employment level. He advanced the concept under employment equilibrium and who effected a truly significant revision in the theory of public debt.

In the 1950s a development process in developing countries took place significantly. The growing need of fund was realized for meeting development requirements. Capital deficiency resulted in increasing volume of budgetary deficits. The great depression of 1930s and the Keynesian revolution paved the way for the development of the theory of public debt as a part of the national finance. Those who follow Keynes are of the view that public debt is income generating and so it is not burden of the community, Keynes argued that if debts are internally held, there is nothing to worry about their size. Such debt involves merely a series of transfer payments and they cancel out for the economy as a whole. Hence only concern should be about economic stability at high levels of income and employment.

Holding the same argument, an internal debt is owned by a nation to its own citizens and it imposes no burden. An external debt is owned by a nation to foreigners and it is burdensome (Samuelson, 1964).

Post Keynesian economists think that the developing countries have a very low income, saving and investment. They further say that without increasing the rate of these three crucial factors, no country could achieve steady growth. So the overall aim of the borrowing is not to equalize income in the different countries but to provide every country with an opportunity to achieve steady growth, on the other side, people of the developed countries are enjoying high prosperity, high standard of living, and high educational facilities.

Post Keynesian economist Goode (1984) views that borrowing should be avoided to pay for government consumption expenditure, which will cause a curtailment of national saving and investment. On the other hand borrowed money when used to finance public investment causes no such reduction; all that will happen is the change in the composition of capital formation. According to him, “the inference is that failure to restrict borrowing to the finance of investment will retard economic growth. A weakness of the argument is that not all outlays classified as government consumption promote growth.

Hanson (1941) has written an article on effect of public borrowing on redistribution of income where net transfer of resource take place from lower income group to upper income group. He further states that "In so far the government can borrow from small saver and increase in public debt will not prove unfavorable to an equitable distribution of wealth. But if the growth in public debt is very rapid, it will not be possible for relatively small savers to take any large proportion of new securities issued. They will be absorbed by the rich and lead to inequalities in wealth a distribution".

Now a day's public debt is applied, especially in under developed countries, as a fiscal instrument to raise the effective demand, which ultimately leads to accelerate the pace of economic development. It also acts as an effective instrument of inflation generation in the process of growth and ensures growth with stability. In the period of depression when aggregate demand is not enough to accelerate the level of production and employment, compensatory fiscal policy suggest increase in public expenditure and public borrowing to create effective demand and promote an economic recovery (Barman, 1986).

Challiah (1961) had observed that the ideal situation is one which first revenue meets subsidies, other transfer, interest payments and the greater part of current expenditure. Debt finance will be used for meeting the government non remunerative capital formation, a portion of current expenditure designed to increase social capital and productivity and the requirement of financial investment, Second, the total domestic saving, the non government sector will be to obtain a due share of saving and that there will be no need to borrow from the central bank that move current amount of Seigniroage.

Posner (1992) had pointed out that growth in the ratio causes alarm for two reasons. First, growth in debt ratio may curtail private investment. Second and more important is the assumption that government spending out of the borrowed funds might be unproductive.

Harric (1947) pointed that it assure elasticity in money supply and agreed that government expenditure could be productive and need not necessary be wasteful and so case for public borrowing is strengthened. Those who follow can take into account the income generating aspect in the public debt and reject any possibility of internal debt being burden upon the community.

Avramovic and Gulhati (1958) had provided a useful framework for the examination of the external borrowing in terms of country's debt servicing capacity. Assuming that the country borrow only to help finance will conceive development programs. Avramovic and his co- authors visualized three stages in the external debt cycle. In the first stage, the country's saving is below the desired level of investment. It borrows from abroad to finance part of its investment and also to service the external debt. The burden of the debt servicing is continuously deferred and the debt increases rapidly. In the second stage, saving has grown enough to finance all domestic investment however the country continues to borrow from abroad to cover service cost of the debt. The external debt grows but at a slower rate in the first stage, at the end of second stage it reaches maximum. In the third stage, the country stops borrowing abroad to cover interest payments and begins to reduce the external debt. A very poor country can take a long time to move through the stage first and second, if the return on capital obtained by foreign borrowing is low relative too the interest rate, it may never reach stage third.

Domor (1944) defined the public debt as the ratio of the total debt to the national income. He lays down the condition under which the burden would increase or decrease over time.

Let,

D = Amount debt outstanding at a beginning of a year.

I = Ratio of interest paid on debt.

T = Amount of taxes necessary to cover the interest charge on debt.

So,

$T = Di$

t = Fraction of income (y) taken through tax to pay interest.

$T = T/Y = I * D/Y$

From the above equation it follows that tax rate is necessary to pay interest on. Interest on debt depends on the ratio of the size of debt multiplied by the rate of the interest to income. The tax rate may be related to growth of income and the budget deficit. Therefore the relevant equation is:

$$T = \frac{1}{(1/i)\ (G/b)}$$

$$= I \times b/G$$

Where,

G = ratio of growth of income

b = ratio of deficit to income

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

From 27 September 1987 to 2 October 1987, the University of Munster carried out a congress on Latin America and Europe in dialogue international indebtness being parts of the workshop on economics. It focused on origins, consequences and development of debt crises, problems of managing debt, deficiencies of world monetary system and the interrelationship between indebtedness and growth.

The United Nation conference on trade and development review paper entitled"multilateral debt of the least development countries since the crises of early 1980s", discussed on problem of multilateral debt as sustainability, liquidity and accumulation of large-scale areas. The paper has also evaluated recent scheme to provide debt relief and suggested possible measures to strengthen and improve existing schemes as well as present other innovative abstains. The paper focused mainly on the least development countries (LDCs).

To examine the debt servicing capacity in the relative export earning gross national product and government revenue Klein and Verbeek (1995) used the following equation

$$d(t) = I(t) + [Im(t) + X(t)]\ Dt\text{-}1$$

Where,

Xt = Export sharing production goods and services that are sold to non residents

Imt = Sharing the utilization of income for imported goods and services (except for interest payment on foreign debt).

It = the average interest rate chanred on external debt in period (t).

D (t-1) = the size of stock of debt of the previous year.

It focuses the factors that makes debt grows faster or slower that is, larger or smaller values of [d (t)]. First [d (t)] will be high if the average interest rate [(It)] is high or if the non interest current account deficit [IM (t)-X (t)] is high relative to the stock of debt of the previous period [D (t-1)]. The size of the stock debt is crucial with a large stock of debt larger interest payments are required. Of course the fundamental causing debt to rise is the reliance an external resource to finance capital formation.

Schinke and Borchert (1990) examined the debt equity swaps to improve the creditworthiness of the present debtor countries and they're by to create move favorable climate for investment particular in the case of the Chile.

With the efforts of the global financial crisis on commodity prices, such a goal has in fact moved further out of reach, unless more generous and flexible action is undertaken under the heavily indebted poor countries initiative. The decline in commodity prices which are projected to remain depressed over the next several year-is likely to dampen export prospects for many LDCs thus further weakening their debt servicing capacity.

Munla (1992) has analyzed the origin of debt problems and explained. The debt crisis had its origin in the substantial rise in the external liabilities of the developing countries during the second half of the 1970s and early 1980s, in an environment of large-scale recycling of the oil exporter's surpluses, rising world inflation and negative real interest rate. At the time many viewed this recycling of funds as a positive development. Creditors were able to identify new investment outlets and debtors could acquire funds needs for development purposes. He again explained that an external debt crisis was due to;

- A drastic deterioration in external economic environment in the form of higher interest rate, lower commodity prices and severe recession in the industrialized economies.
- Economic mismanagement and policy errors on debtor countries; and
- Excessive lending by commercial bank to some countries, with little regard to country risk limits

In this article Munla contributed towards principle of the debt strategy as pointed out, three fundamental principles were

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

2.8 Review of previous studies

In review of literature on public debt in Nepalese context some of students of master level specially say, have or university and some writer have preceded to mail their dissertation and article on public debt. This study includes review of some articles, thesis and projects reports. They are as follows:

2.8.1 Review of Articles

Gurugharana (1996) had analyzed the burden of public debt as debt servicing cost in Nepal and concluded that Although foreign loan offered at relatively much softer terms for Nepal compared to India and China, the very low rate of return and increasing share of loan in foreign aid imply that aid slowly pushing Nepal toward a debt crisis in the coming years.

Sharma (1998) had analyzed that the ever increasing debt in Nepal and its servicing has really created a situation. It is driving the country towards debt trap because of the following reasons:

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

Acharya (1998) had pointed the situation using ever widening saving investment gap, persistently growing share of regular expenditure with respect to total expenditure, GDP and clearly indicate the ever-increasing debt burden. On the other hand he concluded that the poor performance of the economy has failed to create productive capacity for meeting the situation. At the end of his article he has some raised issues for debate. Does the present generation have the right to burden the future generation with debt even before they are born?

Khatiwada (1998) found out that public debt has:

- Exerted excess monetary expansion, which has indirectly resulted in high rate of inflation and deterioration of current account situation.
- Has pressure on debt servicing to the government resulting in higher budgetary deficit which further contributes to monetary expansion having subsequent repercussion on the internal as well as external sector stability.
- Has crowded our resources available for private sector investment.
- Has exerted upward pressure on the market rate of interest. He has further analyzed the situation as more alarming as foreign loan of the long term nature is maturating at out faster rate and exchange rate of the Nepalese Rupee is depreciating very fast multiplying the debt obligation as well as the debt servicing requirements. Sources of foreign grant is drying up which is properly accumulation of foreign debt with larger development spending of the government through domestic debt servicing. Most of the domestic debt is of short term nature but there is less likelihood of an improved budgetary situation of the government in the near future.

Koirala (2002) had viewed and concluded that if debt is not handled properly, our future generations may tire paying back ancestral loans. In this perspective, he prescribed some policies to mitigate the pain of the adverse effects of ever increasing trend of public debt in Nepal.

- Loan assistance should be utilized selectively, after careful scrutiny of the purpose. Cost and benefits of such projects and programs should be carefully analyzed in order to reduce burden of external debt while contribution to accelerating growth meeting socioeconomic objectives.
- The Medium Term Expenditure Framework (MTEF) should be implemented effectively.
- Increase the share of tax and reduce 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 macroeconomic stability of the country while accepting short-term and long-term loans.
- Proper attention should be given to cost benefit analysis when using public debt.

Thapa (2005) had analysis that efficiency development of an efficient security market is a must. The borrowing amount should be invested in the productive sector. The financial return to government out of these investments should be greater than the cost. The assets created out of such borrowing (yield) should be at the higher level. The borrowing cost and return should be widened every time. The objective of borrowing should not be for making easy money for the government. If the return is less than the borrowing cost, this will result in the gradual deterioration in the paying capacity of Government and finally the public will have less confidence towards Government.

The borrowing instruments can be used for maintaining monetary balance as well as for Government's financing. So, there should be a cordial co-ordination between fiscal and monetary policy maker and debt manager. They should share their common interests to attain the goals.

The borrowing should not be for the payment of interest and principal amount. It should be invested in the productive sector so that the return from such investment will be sufficient for repayment. Hence, an efficient monitoring mechanism should be developed. Likewise, the effective and efficient uses of such borrowing are more crucial. For the implementation of the Issue Calendar, a very cordial co-ordination is needed between the fiscal manager and domestic debt manager of the country. Through the primary issue of the government securities, liquidity will be drained and there will be a decline in the reserve position in the financial system. So, the fiscal manager should be aware of this effect on the monetary sector. Likewise, the monetary authority should also bear in mind that it is also used for fiscal management of the government.

2.8.2 Review of previous thesis

Acharya (1968) had discussed features, problems and pattern of public debt and reached the conclusion that public debt was most popular in these days because of the payment of debt on maturity can be adjusted through the issue of fresh public debt. But the habit of purchasing bond issued by the government should be developed among the people so that no difficulty may be faced in getting bond sold in money market.

Joshi (1982) had analyzed the structure of public debt in Nepal and importance of public debt in financial development.

Singh (1983) found most inflationary nature of internal borrowing, which increases inflation in the economy. So the impact towards rapid increase money supplies resulting in an increase in demand for goods and services, which leads to a rapid increase in imports. So the unlimited burden falls on balance of payment situation.

Koirala (1997) had analyzed the trend and structure of public debt in Nepal. He expressed his view that exclusive dependency on foreign loan for development expenditure is persistence because of poor mobilization of internal resources. Macroeconomic imbalance such as ever widening trade deficit, investment saving gap and larger amount of fiscal deficit has been the main issues before NG. These are the factors contributing to the foreign aid dependency syndrome. These has been   excessive flow of foreign loan to bridge up three gaps (fiscal deficit, trade deficit and investment saving gaps. Therefore the substantial increase in foreign debt has increased its burden of debt servicing but debt-servicing capacity of the economy is no increasing satisfactory. He has found out that the average annual growth rate of GDP; export earning is considerably as compared with the rate of magnitude of debt and debt servicing requirements. It clearly shows that the debt servicing capacity of Nepal is very poor which is also responsible for increasing debt obligations. He has further said that though this problem of debt servicing is worldwide yet Nepal should have to take urgent action in creating servicing capacity.

Sharma (2001) in his research work stated that the annual growth rate of the total debt within the study period was 12.9 percent; annual growth of grant 18.4 percent, annual growth of internal debt was 14.23 percent and annual growth rate of external debt 16.25 percent. The ratio analysis exhibited that the total debt in total deficit 50.88 percent, internal debt in total debt was 27.34 percent and external debt on total debt was 72.66 percent. The public debt as percent of GDP within the study period was on average of 6.38 percent and out of this internal debt to GDP was 1.83 percent and external debt to GDP was 4.54 percent. He concluded that the interest of investors and their education are dependent to each other. Similarly, the interest of both poor and rich investor in the government security is not significantly different, the investors of the urban area are more aware to the government securities than the investors of the rural area, there is association between the interest of investors and their occupation and who do not have sufficient to run the private enterprises and who are not dexterous to grab the opportunity in the market i.e. unskilled to apply the good entrepreneurship are more interested in the government securities.

Acharya (2003) concluded that government borrowing has increased rapidly and financed mostly on the unproductive sector and hence government always lacks the resources, and then borrows the new loan to pay the previous ones. The research had also argued on excessive dependency upon external loan may lead the nation into debt trap, if the terms of trade are not improved. Therefore extra care should be exercised in procuring such loans".

It was found that classical economists were against public borrowing and favored the minimum expenditure from the government side. However, they were not against all types of public debt. They liked to approve public debt only for productive purposes and believed that debt servicing did not necessitate additional taxation. The classical economists preferred self-liquidating project that generate required income to serve the incurred debt.

Keynes argued against a free market economy, which is self-equilibrating at full employing level propounded by the classical economists. Keynesian and modern 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 necessarily be unproductive, inflationary and burdensome.

Mobilization of resources for financing ever increasing development outlay is an extremely difficult task in a developing country like Nepal. In this context the emphasis goes to taxation but it has limited scope. If the limit is crossed, it creates serious problems on the whole economy. To escape from this serious situation the government can utilize the public borrowing method to drum up resources. But attention should be given its size and use. Long-term debts with lower rates of interest are more beneficial for country rather than short-terms loans with higher rates. Economic theory suggests that reasonable levels of borrowing by a developing country are likely to enhance its economic growth.

Joshi (2009) had analyzed the trend of resources gap and deficit financing in Nepal. Impact of deficit financing on money supply and price level. And study the impact of government expenditure on deficit financing. She suggested that to reduce deficit financing there should be built inelastic in the tax system. Therefore long term tax policy should be formulated in order to sustain the public revenue.

Shrestha (2010) expressed his view the share of bublic debt is proportionate increasing . The government should be innovative and concerned to support this factor to reduce the volume of external debt. To reduce the pressure of internal debt over the GDP, the government of Nepal should effectively formulate the plan, policies and procedures to invest the debt in productive sector. He also suggested that, debt management should be done effective manner. A separate department headed by expert of the public debt management should be given authority and responsibility to manage the debt.

2.9 Research gap

Many researches were done government debt practices and issue system. Most of researches were based on post secondary data. Major thesis focused on the trend analysis of public debt. Some researcher had attempted to analyze the primary data classifying them into the category institutional and individual group but had not tried to analysis the primary data based on their income bracket, profession, who, he or she belong to further one's research work studies the structure analysis of government borrowing, fiscal deficit, inflation, domestic resources gap, external borrowing, which is crucial matter of public debt. It shows the interest of various investors on specific types of government securities. Most of the previous researcher had analyzed the current trend and structure of public borrowing.

Hence review the related literature in this regards and considering the several gap as above. This research has attempt to analysis the current trend of internal borrowing as well as future trend of internal borrowing of Nepal and structure analysis obtaining recent data to find out the objectives of this research works.

CHAPTER III

RESEARCH METHODOLOGY

Conceptual Framework

Research is a systematic method of finding right solution for the problem where research methodology refers to various steps taken by the researcher to find out the optimal solution. So research methodology is the way to solve systematically the research problem. Research methodology refers to the various sequential steps adopted by a researcher in the studying a problem with certain objective in view. It is the way to study systematically about the research problem (Kothari, 1994). Thus the overall approach to the research is presented in this chapter. This chapter consists of research design, population and sample size sources of data and processing techniques and tools.

3.1 Research design

A research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine reference to the research purpose with economy in procedure. The research design followed to analysis the public debt and debt servicing in public sectors in Nepal. Analytical and descriptive approaches are used to evaluate the public debt and debt servicing in public sector on the basis of secondary data financial statement. To fulfill such target several tools have been used.

3.2 Population and sample

Population refers to all items that have been chosen for study. Population may be definite or infinite. A small portion chosen from the population for studying its properties is called sample size. A sample is the representative of the population. The total trend, structure and debt servicing in the public sectors is the population of the study, out of them 10 years

(2003/2004 to 2012/2013) trend, structure and debt servicing in the public sector are the sample size.

3.3 Sources of data

This study is totally based on secondary data. The main sources of secondary data comprise textbooks, Economic survey, Budget speeches, various publications of Nepal Rastra bank, related case study and thesis work etc. The data and information are collected from different library such as library of Nepal commerce Campus and T.U. central library.

3.4 Data analysis tools

In order to make the study more reliable and authentic, financial indicators and statistical tools have been used which are believed to make the analysis more convenience. A brief explanation of the data analysis indicator and tools in the study are as follows: -

3.4.1 Financial tools

These tools will focus on proportional analysis of public debt with total debt servicing. Composition of public debt, internal debt with total debt and it's servicing, external debt with total debt and it's servicing. The financial indicators used in this research study are as follows:

a) Percentage

Percentage can be calculated as follows:

i) Total Debt to Total Deficit $= \dfrac{\text{Total Debt}}{\text{Total Deficit}}$

ii) Internal Debt to Total Deficit $= \dfrac{\text{Internal Debt}}{\text{Total Deficit}}$

iii) External Debt to Total Deficit $= \dfrac{\text{External Debt}}{\text{Total Deficit}}$

iv) External Debt Servicing to Total Debt Servicing $= \dfrac{\text{External Debt Servicing}}{\text{Total Debt Servicing}}$

v) Internal Debt Servicing to Total Debt Servicing= $\frac{\text{Internal Debt Servicing}}{\text{Total Debt Servicing}}$

vi) Internal Debt Servicing to Total Revenue = $\frac{\text{Internal Debt Servicing}}{\text{Total Revenue}}$

vii) External Debt Servicing to Total Revenue = $\frac{\text{External Debt Servicing}}{\text{Total Revenue}}$

viii) Internal Debt to Regular Expenditure = $\frac{\text{Internal Debt Servicing}}{\text{Regular Expenditur e}}$

ix) External Debt Servicing to Regular Expenditure = $\frac{\text{External Debt Servicing}}{\text{Regular Expenditur e}}$

3.4.2 Statistical tools

a) Mean

The sum of the entire observation is divided by the number of observation is called mean

$$\text{Mean } (\overline{X}) = \frac{\sum X}{N}$$

Where,

X = Sum of all values of the variable 'x'

N = Number of observations

X = Variables involved

b) Coefficient of correlation

Correlation is an analysis of the co-variation between two or more variable. It deals to determine the degree of relationship between two or more variable. The degree of relationship between two variables is known as simple correlation. Simple correlation is computed as:

Simple correlation coefficient (r)

$$r = \frac{n\sum xy - (\sum x)(\sum y)}{\sqrt{n\sum x^2 - (\sum x)^2}\sqrt{n\sum y^2 - (\sum y)^2}}$$

c) Analysis of Trend

Trend is future direction in which the situation is changing of developing on particular things. The main purpose of this chapter is to analyze the future direction of public Debt.

For this purpose a widely and most commonly used method to describe the trend has been followed. That is known as Least Square Method.

Let the trend line between the dependent variable y and independent variable x (i.e. time) be represented by:

$$Y = a + bx$$

Then for any given value of independent variable x, the estimate value of y denoted by yc given above equation is

$$Yc = a + bx$$

Where,

a = y intercept or value of y where x = 0

b = Slope of the trend line or amount of change that comes in y for unit change in x

To determine the straight line trend, the value of a and b is calculated by following way,

$$a = \frac{\sum y}{N} \qquad b = \frac{\sum xy}{\sum x^2}$$

CHAPTER IV

PRESENTATION AND ANALYSIS OF DATA

4.1. Trend and Structure of management of public debt in nepal

4.1.1. Introduction

Management of Public debt is an important component of the government budgetary system. It is taken as a great instrument of the government to fulfill its budgetary deficit. The government of a country may borrow because current revenue may not be sufficient to meet its expenditure. The government borrowing is necessary to fill the gap between the tax and non-tax revenues and the growing expenditure. The loan operation of the modern government especially in LDCs has been increased due to the government's active participation in the economic development one hand and the limited availability of funds for investment from the private sectors on the one other hand. Thus, the investment for accelerating the role of capital formation for development purpose has led to the government to expend resources through public borrowing externally and internally.

Now a day's public borrowing is considered as an effective instrument. There are two major source of public borrowing external and internal. Internally a government can borrow from individual, financial institutions, non-financial institutions, commercial banks and central bank. Similarly the main sources external borrowing is; Firstly, International financial institution likes, IME, World Bank, IDA and ADB etc. These institutions give loan to member countries for a short term for covering the temporary balance of payment difficulties and for long term for the development projects. Secondly, friendly countries also provide loans for the development projects.

The objective of public debt management in developing countries is that the public debt should be used as an instrument to mobilize saving of people which would otherwise have gone to idle or wastefully consumption. Public debt should be advocated for creating capacity and producing capital equipment. Generally government borrows for the creation of infrastructure in the economy, since it requires huge investment initially, which cannot be meet through only revenue collection. The aim of the management of public debt policy should be to help in strengthening the money and capital market, which is turn accelerate development and price stability.

Internal borrowing is the source of public borrowing. It is applied as a means of mobilizing internal resources in the development process of the country in a wide perspective. It has been taken as a means of revenue generation as well as economic stabilizer. As a fiscal measure it is source of revenue of the government as it mobilizes saving from public to the state. As a monetary measures, it is a weapon in the hands of the central banks to regulate the economy, so that the inflation generated in the process of economic growth may not take the form of hyperinflation, but these methods are applied in two different ways;

i) Borrowing from non-bank lenders as individuals or groups known as real borrowing or real debt creation which takes place only if some individual or group in the economy deliberately exchanges current purchasing power for government obligation to provide an income refers in the future periods.
ii) Borrowing from the central bank and with its support from the commercial banks is known as unreal borrowing or disguised money creation. Under this methods the banking system provide with an interest income in exchange creating additional currency, for any sacrifice of the purchasing power for liquidity but interest for carrying out the operation that is especially within the constitutional power of the government.

Therefore it is difficult to borrow from the internal source due to many constraints and on the other hand, country need foreign currency to import capital goods for development project and to finance the balance of payment deficit, These make the country to depend more on foreign borrowing than on internal one. Like other countries, Nepal is also indebted from the external debt and seems likely to increase further.

4.1.2. Resources gap in Nepalese economy

Resource gap in Nepalese economy has been always a common phenomenon since the start of the systematic budgeting system in Nepal. Nepal is experiencing a serious and growing resource gap. This is because the annual growth rate of the total expenditure and revenue is not increasing in the same pace. The growth of expenditure has resulted to increase in higher percent than the revenue generation. Therefore, in order to fulfill the gap between the revenue and expenditure government need to borrow from external as well from internal source. The following table shows the different scenarios of financial resource gap in Nepalese budget.

Table 4.1

Different Scenarios of Resource Gap

(Rs. In million)

Fiscal	Total	Growth rate	Total	Annual G.R.	Deficit	A.G. rate	Foreign	A.G.	External	A.G. rate	Internal	A.G. growth rate of I.L. (%)	Fiscal Deficit
Year	Revenue	Of T.R. (%)	Expenditure	Of T.E. (%)		Of Deficit(%)	Grants	Of F.G. (%)	Loan	Of E.L. (%)	Loan		[T.E. - (T.R.+F.G)]
2003/04	62331		89442.6		27111.6		11283.4		7629		5607.8		15828.2
2004/05	70122.7	12.50	102560.4	14.67	32437.7	19.65	14391.2	27.54	9266.1	21.46	8938.1	59.39	18046.5
2005/06	72282.1	3.08	110889.2	8.12	38607.1	19.02	13827.5	-3.92	8214.3	-11.35	11834.2	32.40	24779.6
2006/07	87712.1	21.35	133604.6	20.48	45892.5	18.87	15800.8	14.27	10053.5	22.39	17892.3	66.14	30091.7
2007/08	107622.5	22.70	161349.9	20.77	53727.4	17.07	20320.7	28.61	8979.9	-10.68	20496.4	14.55	33406.1
2008/09	143474.5	33.31	219662	36.14	76187.5	41.80	26382.8	29.83	9968.9	11.01	18417.1	-10.14	49804.7
2009/10	177991.8	24.06	227107.3	3.39	49115.5	-35.53	38545.9	46.10	11223.4	12.58	29914	62.43	10569.6
2010/11	198376.3	11.45	257495.4	13.38	59119.1	20.36	45922.2	19.14	12075.6	7.59	42515.8	42.13	13196.9
2011/12	244374.1	23.19	294850.7	14.50	50476.6	-14.62	40810.3	-11.13	11083.1	-8.22	36418.7	-14.34	9666.3
2012/13	296021.2	21.13	302053.8	2.44	6032.6	-88.05	35229.8	-13.67	11969.4	7.99	19042.9	-47.71	-29197.2
Average Annual G.R (%)		19.19		14.87		-1.43		15.19		5.86		22.76	

Source: Financial Comptroller General Office (2013/14)

Table 4.1 shows the resources gap of the government, which is the difference between revenue and expenditure of the government. The resources gap is increased from Rs27111.6 million in fiscal year 2003/04 to Rs. 76187.5million in fiscal year 2008/2009 and decreased to 49115.5 million in fiscal year 2009/10 and increased to 59119.1 million in fiscal year 2010/11. Similarly, decreased to 6032.6 million in fiscal year 2012/13.In average annual basis, it remained at -1.43 percent. However, the revenue of government has been increased Rs. 62331 million in Fiscal Year 2003/04 to Rs. 296021.2 million in 2012/13. In average annual it was 19.19 percent. But the expenditure has been increased more rapidly than the revenue which is Rs. 302053.8 million in FY 2012/13.

Thus, it shows the rapid growing tendency of budget deficit since 2003/04 to 2010/11, except in FY 2011/12 and FY 2012/13. But however this deficit is fulfilled by three elements that are: Grants, External Loan and Internal Loan.

Grants are the most potential source of foreign currency, which is the best instrument for the government to import the capital goods and to pay the interest and principle of external debt. Moreover, it can be used on capitalization itself. It does not give burden to the economy. But the table 4.1 shows the up-swing and downswing tendency of grant component. In fiscal year 2003/04, the total grants received by the government worth Rs. 11283.4 million, which fluctuated after that and reached to Rs. 35229.8 million in fiscal year 2012/13.

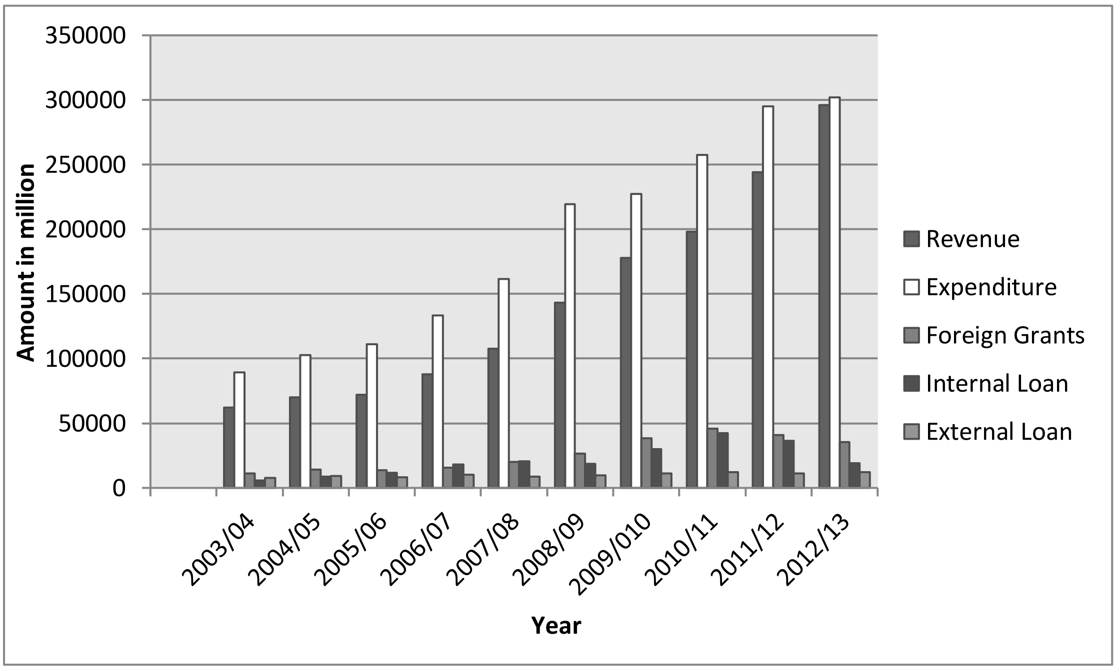
During the review period, amount of bilateral and multilateral grants has not been increased sufficiently, which has created a sort of constraints in the scenario of state's economy as a whole. Hence NG has staunchly compelled to reduce the unproductive expenses, though considering the achievement we cannot get the satisfactory impacts on aggregate economy of the nation.

The second element of resources, the external loan was Rs. 7629 million in 2003/04 but it reached Rs. 11969.4 million in 2012/13, which is 5.86% increase in average from 2003/04 to 2012/13. On the other hand, the internal debt amounted from 5607.8 million in 2003/04 to Rs. 19042.9 million in 2012/13. In average annual basis it was 22.76 percent.

And the final column shows the fiscal deficit (TE- (TR+ FG). Which has increased from Rs. 15828.2 million in starting year of review period 2003/03 to Rs. 49804.7 million in 2008/9 and decreased to -29197.2 million in 2012/13.

However, the table 4.1 can be clear with help of the diagram which is presented below:

Figure 4.1



Different Scenario of Resource Gap

From the diagram 4.1, we can see that revenue has been increased from fiscal year 2003/04 to 2012/13 but the expenditure has been increased more rapidly than that of the revenue. This creates the resource gap and this gap is fulfilled by the three elements: Foreign Grants, External Loan and the Internal Loan as shown in the above diagram.

Table 4.2
Analyze the future direction of Public Debt

(Rs. In Million)

Year	X	Y	X=2(X-5.5)	X^2	XY
2003/04	1	5607.8	-9	81	-50470.2
2004/05	2	8938.1	-7	49	-62566.7
2005/06	3	11834.2	-5	25	-59171
2006/07	4	17892.3	-3	9	-53676.9
2007/08	5	20496.4	-1	1	-20496.4
2008/09	6	18417.1	1	1	18417.1
2009/10	7	29914	3	9	89742
2010/11	8	42515.8	5	25	212579
2011/12	9	36418.7	7	49	327768.3
2012/13	10	19042.9	9	81	171386.1
		$\sum Y$ = 211077.3	$\sum X$ = 0	$\sum X^2$=330	$\sum XY$ = 573511.3

Sources: calculated from Table 4.1

Let the the trend line between the dependent variable y and independent variable x (i.e. time) be represented by:

Y = a+ bx …………….(1)

Then for any given value of independent variable x, the estimate value of y denoted by Yc given above equation is

Yc = a+ bx

Where,

a = y intercept or value of y, where x = 0

b = Slope of the trend line or amount of change that comes in y for unit change in x.

To determine the straight line trend, the value of a and b is calculated by following way,

Here, $\sum Y = 211077.3$, $\sum X^2 = 330$ $\sum XY = 573511.3$

Since $a = \frac{\sum Y}{N} = \frac{211077.3}{10} = 21107.73$ and $b = \frac{\sum xy}{\sum x^2} = \frac{573511.3}{330} = 1737.91$

Therefore, Yc = 21107.73 + 1737.91X,which is the best line of fit by Least Square Method.

we calculate the expected public debt in FY2013/14, 2014/15, ……2017/18 and 2019/20.

When, x =13 then, X = 2(x -5.5) =2(13 – 5.5) = 15

Then,Yc = 21107.73+1737.91x15 =Rs47176.38

When, x =14 then, X = 2(x -5.5) =2(14 – 5.5) = 17

Then,Yc = 21107.73+1737.91x17 =Rs50652.2

When, x =15 then, X = 2(x -5.5) =2(15 – 5.5) = 19

Then,Yc = 21107.73+1737.91x19 =Rs54128.02

When, x =17 then, X = 2(x -5.5) =2(17 – 5.5) = 23

Then,Yc = 21107.73+1737.91x23 =Rs61079.66

When, x =18 then, X = 2(x -5.5) =2(18 – 5.5) = 25

Then,Yc = 21107.73+1737.91x25 =Rs64555.48

When, x =19 then, X = 2(x -5.5) =2(19 – 5.5) = 27

Then,Yc = 21107.73+1737.91x27 =Rs68031.3

On the basic of above calculation, the public borrowing will be Rs. 47176.38 Million in fiscal year 2013/14 and increasing trend it will be Rs. 50652.2 Million in fiscal year 2014/15, Rs. 54128.02 Million in fiscal year 2015/16, Rs. 61079.66 in fiscal year 2017/18,Rs. 64555.48 Million in fiscal year 2018/19 and Rs.68031.3 Million in fiscal year 2019/20. Base in the past trend calculated above, public borrowing will be increasing in coming year.

4.1.3. Growth Trend of Grants and Government Borrowing

The dependency on the taxation only cannot meet the expenditure of the government, therefore in order to fulfill the financial deficit the government must rely on the internal as well as external loan and the foreign grants. The different scenario of grants and government borrowing is presented in the following table 4.2

Table 4.3
Annual Growth Rate of Grants and Government Borrowing

(Rs. In million)

Fiscal Year	Total Debt	Annual Growth Of TD (%)	Grants	Annual growth rate of Grants (%)	Internal Debt	Annual growth rate of I D (%)	External Debt	Annual growth rate of ED (%)
2003/04	13236.8		11283.4		5607.8		7629.0	
2004/05	18204.2	37.53	14391.2	27.54	8938.1	59.39	9266.1	21.46
2005/06	20048.5	10.13	13827.5	-3.92	11834.2	32.40	8214.3	-11.35
2006/07	27945.8	39.39	15800.8	14.27	17892.3	66.14	10053.5	22.39
2007/08	29476.3	5.48	20320.7	28.61	20496.4	14.55	8979.9	-10.68
2008/09	28386	-3.70	26382.8	29.83	18417.1	-10.14	9968.9	11.01
2009/10	41137.4	44.92	38545.9	46.10	29914	62.43	11223.4	12.58
2010/11	54591.4	32.71	45922.2	19.14	42515.8	42.13	12075.6	7.59
2011/12	47501.8	-12.98	40810.3	-11.13	36418.7	-14.34	11083.1	-8.22
2012/13	31012.3	-34.71	35229.8	-13.67	19042.9	-47.71	11969.4	7.99
Average Annual GrowthRate		13.19		15.19		22.76		5.86

Source: - Financial Comptroller General Office *(2013/14)*

Table 4.3 shows the trend of the government borrowing and dependency each other, when the percentage use of internal debt increases (increase/decrease) then percentage use of external debt (increase/decrease) and grants(increase/decrease) are decreases. It also shows the heavy reliance on foreign grants. Indeed the grants are not the debt but everlasting reliance on it definitely arises a question upon capability on internal resource mobilization and industrialization. It is because the grants have reached to Rs. 45922.2 million in fiscal year 2010/11 from Rs. 11283.4 million in 2003/04 and decrease to Rs. 40810.3 million in 2011/12 from Rs. 45922.2 and Rs . 35229.8 million in 2012/13.These result clearly show that foreign grant goes in decreased ways.

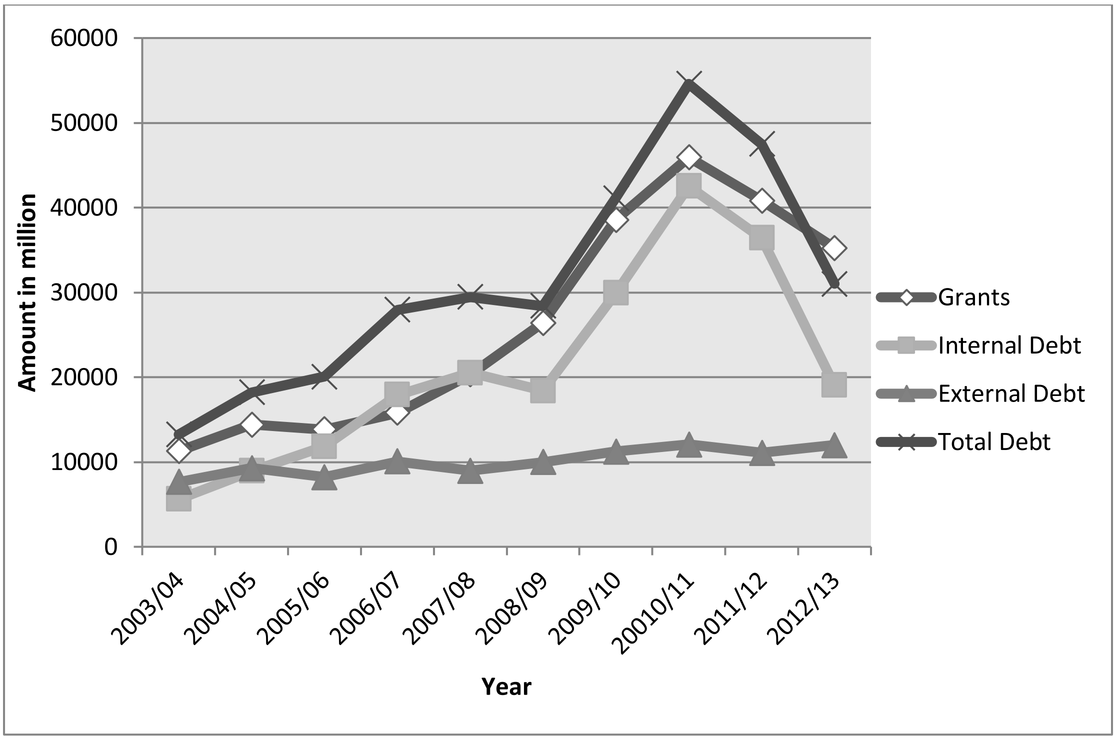
Similarly internal borrowing has reached to Rs. 42515.8 million in fiscal year 2010/11 fromRs. 5607.8 million in 2003/04. Later decreased in 2011/12(36418.7 million)and in 2012/13 (19042.9 million). It has average annual growth rate of 22.76percent. External borrowing was only Rs. 7629 million in 2003/04 to Rs. 12075.6 million, in 2010/11. Later decreased in 2011/12(11083.1million) and increased in 2012/13(11969.4million). It has 5.86 percent of average annual growth rate, which is remarkably less than average annual growth rate of internal debt. It indicates that government prefers internal loan then external loan, which is not good symptoms for the economy as it crowds out private investment.

Likewise, the table 4.2 indicates that the total debts (internal debt + external debt) amounted to Rs. 31012.3 million in 2012/13 from Rs. 13236.8 million in 2003/04. It has 13.19 percent of average annual growth rate. It obviously indicates the increasing trend of government borrowing year by year.

The above table 4.2 can be clearer with the help of the following Line Chart 4.2

Figure 4.2

Annual Growth Rate of Grants and Government Borrowing



From the above figure we can see the increasing trends of government borrowing, except fiscal year 2008/09 and later 2011/12, 2012/13. Though the total debt of the government has been increased from year 2003/04 to 2007/08 and decreased in 2008/09, thereafter it has been increased rapidly for two year and then decreased thereafter. The Internal loan of the government has been increased more rapidly than that of the external loan as shown in the above figure. That means government has been given more focus on the internal loan which is not good symptoms for the economy as it crowds out private investment.

Beside the debt government has also heavily dependent on the foreign grants. As shown in the above figure the government grants have been increased in faster rate from 2003/04 to 2010/11 thereafter decreased. Which is not good symptoms for the economy, it create loan load to us. Foreign donor are not interested to give grants, it shows they wants to cut ups later a year.

4.1.4 Debt as Percentage in Government Deficit and Total Debt

As per the increasing role of the government in the development activities, the government expenditures has been increasing every years but the revenue has not been increased in the same ratio as the expenditure. Therefore, the country is facing the resource gap. Though the revenue is the prime instruments of the government to meet its expenditure, government has always failed to collect the required revenue for its expenditure. The tax and custom administrations are not transparent and able so that government cannot collect the revenue as it predicts. Therefore, government has always faced the problem of budgetary deficit.

In this very persistent condition the government follows four of sources meet deficit financing:

- Printing money
- Drawing down foreign exchange reserve.
- By Grant from home and aboard
- Borrowing from home and abroad

Most of the countries do not want to print money and make drawing from the foreign exchange reserve for the fulfillment of budget deficit as it make inflationary and much other adverse effect to macro economy. Besides this, government has also received grants and loan from home and abroad to face the problem of budgetary deficit. Let's see the debt as percentage in Government deficit and total debt in following table:

Table 4.4

Debt as Percentage in Government Deficit and Total Debt

(Rs. in million)

Fiscal Year	Deficit	Total Debt	% Of T. D. In Deficit (TD/Dx100)	Grants	Internal Debt	External Debt	Debt as % of Deficit		Internal & External Debt as % of T.D.	
							Internal Debt	External Debt	Internal Debt	External Debt
2003/04	27111.6	13236.8	48.82	11283.4	5607.8	7629	20.68	28.14	42.36	57.63
2004/05	32437.7	18204.2	56.12	14391.2	8938.1	9266.1	27.55	28.57	49.09	50.90
2005/06	38607.1	20048.5	51.93	13827.5	11834.2	8214.3	30.65	21.28	59.03	40.97
2006/07	45892.5	27945.8	60.89	15800.8	17892.3	10053.5	38.98	21.91	64.03	30.47
2007/08	53727.4	29476.3	54.86	20320.7	20496.4	8979.9	38.15	16.71	69.54	30.46
2008/09	76187.5	28386	37.26	26382.8	18417.1	9968.9	24.17	13.09	64.88	35.12
2009/10	49115.5	41137.4	83.76	38545.9	29914	11223.4	60.91	22.85	72.72	27.28
2010/11	59119.1	54591.4	92.34	45922.2	42515.8	12075.6	71.92	20.42	77.88	22.12
2011/12	50476.6	47501.8	94.11	40810.3	36418.7	11083.1	72.15	21.96	76.67	23.33
2012/13	6032.6	31012.3	-514.08	35229.8	19042.9	11969.4	-315.67	-198.41	61.40	38.60
Average Annual%			6.601				6.94	-0.34	63.76	35.68

Source: Financial Comptroller General Office (2013/14)

Table 4.4 we can find out the budgetary deficit of the government and this deficit has been fulfilled by the total debt (internal debt + external debit) and the grants. In the above table from Rs27111.6 million in fiscal year 2003/04toRs76187.5 in fiscal year 2008/09, there is a increasing trends of the the government deficit. Then after there is fluctuing(increasing/decreasing) to fiscal year 2012/13. The main cause of increasing the deficit from Rs. 27111.6 million to Rs. 76187.5 million is due to the increase in the government expenditure with that of the revenue collection. It clearly shows that the government heavily depends on grants and debts; as these both are the easy instruments for financing the deficit budget.

Heavily reliance on grants and loan indicates capital scarcity on the one hand and in the other it shows inefficiency in proper mobilization of internal resources. Over the study period between fiscal year 2003/04 to 2008/09 total debt also increased from Rs. 27111.6 million to Rs. 76187.5 million. Hence, the total debt increased by 13.19 times in average during the review period.

Similarly, the table presents the annual average percentage of total debt to total deficit. On an average it is more than 50 percent of the total deficit (from 2003/04 to 2011/12). But it was not in fiscal year 2012/13. In fiscal year 2012/13, appropriate expenditure is very low which was not good for the economic development of the country. Rest amount of budgetary deficit is shared by grants and cash balance. It is being argued that reliance on foreign debt is better than reliance on external grants because it may have adverse impact on the national sovereignty.

Internal debt has occupied 20.68 percent of total deficit in starting year (2003/04) of review period and increased to 72.15 percentages in fiscal year 2011/12 but in fiscal year 2012/13 there is negative %, it is due to that budget was not properly used and budget is returned back. In an aggregate, internal debt has 42.79 percent share in total deficit during review period except 2012/13. Similarly external debt has increases Rs. 11969.4 million in 2012/13 from Rs7629 million in 2003/04 fluctuating up and down swing.. It occupies

21.66 percent of share out of total deficit on an average except fiscal year 2012/13..

However the percentage of internal debt to total debt was higher in 2001/02 with that of external debt. In 2001/02 the percentage of internal debt to total debt was 50.96 whereas the percentage of external debt was only 49.04. But however the ratio of internal debt increased to 77.88% in 2010/11 whereas the ratio of external debt came into only 22.12% in 2010/11. This shows that the government is heavily dependent upon the internal debt than the external debt.

Government Deficit and Total Borrowing - An Analysis

Government budgetary deficit has always been fulfilled by internal as well as external source. Therefore government deficit and the total debt are correlated. Government deficit is a dependent variable(X) as it is dependent on the total debt(Y). The correlation between Govt. Deficit and total borrowing (Total Debt) is analyzed with the following data presented in table 4.4.

Table 4.5

Correlation analysis between Govt. Deficit and Total borrowing:

(Rs. in Millions)

Fiscal year	Govt. Deficit(X)	Total Debt(Y)	x=X-$\bar{X}$	y=Y-$\bar{Y}$	xy	x^2	y^2
2003/04	27111.6	13236.8	-16759.2	-17917.3	300279614.2	280870784.6	321029639.3
2004/05	32437.7	18204.2	-11433.1	-12949.9	148057501.7	130715775.6	167699910
2005/06	38607.1	20048.5	-5263.7	-11105.6	58456546.72	27706537.69	123334351.9
2006/07	45892.5	27945.8	2021.7	-3208.3	-6486220.11	4087270.89	10293188.89
2007/08	53727.4	29476.3	9856.6	-1677.8	-16537403.5	97152563.56	2815012.84
2008/09	76187.5	28386	32316.7	-2768.1	-89455857.3	1044369099	7662377.61
2009/10	49115.5	41137.4	5244.7	9983.3	52359413.51	27506878.09	99666278.89
2010/11	59119.1	54591.4	15248.3	23437.3	357378981.6	232510652.9	549307031.3
2011/12	50476.6	47501.8	6605.8	16347.7	107989636.7	43636593.64	267247295.3
2012/13	6032.6	31012.3	-37838.2	-141.8	5365456.76	1431729379	20107.24
	∑X= **438708**	∑Y= 311541			∑xy= 917407670	$\sum x^2$= 3320285535	$\sum y^2$= 1549075193

Source: Economic survey *(2013/14)*

$$\overline{X} = \frac{\sum X}{N} = \frac{438708}{10} = 43870.8$$

$$\overline{Y} = \frac{\sum Y}{N} = \frac{311541}{10} = 31154.1$$

Correlation coefficient according Karl Pearson's

$$R = \frac{\sqrt{xy}}{\sqrt{x^2}\sqrt{y^2}} = \frac{917407670}{\sqrt{3320285535}\sqrt{1549075193}}$$

$$= \frac{917407670}{57621.92\ X\ 39358.29}$$

$$= \frac{917407670}{2267900385}$$

= 0.40

From the above calculation we have found out that the correlation between the government deficit and the total debt is 0.40.Hence it seems that the relationship between these two variables is low degree positively correlated. That means the increase in the government deficit also lead to the increase in the total debt and vice versa.

4.1.5 Pattern of Ownership of Public Debt in Nepal

Due to the huge amount of the disparity between the government revenue and expenditure there occurs widening gap between saving and investment. Small proportion of development expenditure is made by the revenue surplus and remaining large segment of development expenditures is made from the internal and external borrowing.

The internal borrowing for the first time was issued out in Nepal in 1961/62 through treasury bills after the enforcement of Public Debt Act 1960. Nepal has been borrowing the internal debt to bridge the resource-gap and mobilizing the internal resources and strengthening capital market. The government raises the internal debt by using various securities like, Treasury Bill, Development Bond, Special Bond and National Saving Certificate etc.

The systematic record first external borrowing was from the USSR for the establishment of Birgunj Sugar Factory and Janakpur Cigarette Factory in 1963/64. Only the bilateral debt was borrowed previously than the fiscal year 1961/62. After than both bilateral and multilateral debt have been borrowed till now" (Thapa, 2000:7)

(I) Sources of Internal Debt

One of the major sources of the government to fulfill its budgetary deficit is the internal debt. The government can borrow through internal debt mainly by four instruments: Treasury bill, National Saving Certificate, Development bonds, Special bonds and citizen saving certificate. By selling these instruments government can borrow internally from banking and non banking sources.

Table 4.6

Source of Internal Debt

(Rs in million)

Fiscal Year	I D	Treasury Bills	Development Bonds (Ag-13.82%)	National Saving Certificate	Citizen Saving Certificate	Special Bonds
2003/04	86133.7	49429.6	17549.2	9029.8	1178.9	8946.2
2004/05	87564.2	51383.1	19999.2	6576.7	1428.9	8176.3
2005/06	94710.8	62970.3	17959.2	3876.8	1678.9	8225.6
2006/07	103776	74445.3	19177.1	1516.9	1391	7245.7
2007/08	116039.5	85033	21735.4	1116.9	3014.4	5139.8
2008/09	125674.1	86515.1	29478.5	216.9	4433.6	5030
2009/10	148059.7	102043.7	35519.4	0	5126.9	5369.7
2010/11	184205.7	120340.7	43519.4	10680	4636.5	5029.1
2011/12	213991.4	131624.1	57519.5	15680.1	4139	5028.7
2012/13	220347.2	136468.1	51610.9	15680	3242.7	13345.5

Source: Nepal Rastrya Bank

Table 4.6 shows out the five source of the internal debt: Treasury Bills, Development Bonds, National Saving Certificate, citizen saving certificate and Special Bonds.

Treasury Bills is the short-term loan as these are raised for the period of less than one year. Other remaining securities are called long-term securities as they are issued for the period of more than one year. Normally treasury bills are floated for the period of 91 days. Similarly government bonds and national certificates have 3-15 years periods of maturity. Accordingly these are identified as long-term securities.

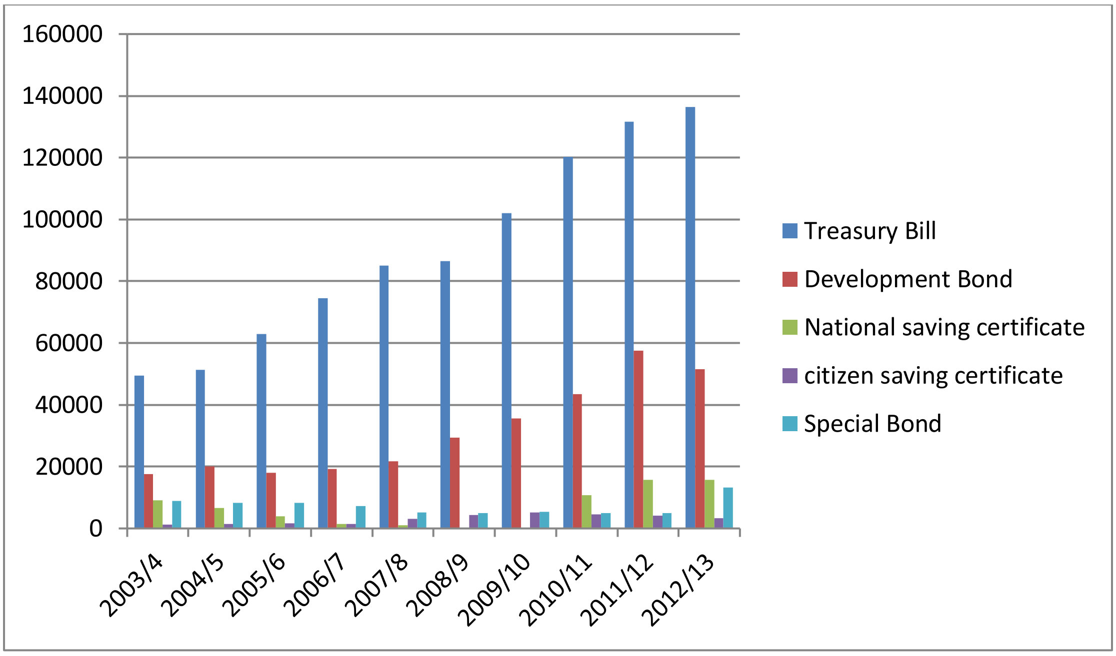
Treasury bills increased to Rs. 136468.1 million in fiscal year 2012/13 from Rs. 49429.6 million in Fiscal Year 2003/04. Similarly development bonds increased to Rs. 51610.9 million in fiscal Year 2012/13 form Rs. 17549.2in Fiscal Year 2003/04. National saving certificate amounted Rs. 15680 million in fiscal Year 2012/13from Rs. 9029.8 million in 2003/04. Special bond reached to 13345.5 million in fiscal year 2012/13 from 8946.2 million in 2003/04. Similar citizen saving certificate amounted to Rs. 3242.7 million in fiscal year 2012/13.

The Treasury bills have dominating place in the structure of total outstanding internal debt in the study period. The treasury bills are mostly inflationary in nature. Since these are mostly owned by commercial banks, financial institutions and Nepal Rastra Bank. It is concluded that the government become lethargic in managing its finance prudently as there is easy access for funding the source of finance in the form of borrowing and grants.

The above table can be made clear with the help of the figure 4.3

Figure 4.3

Source of Internal Debt



From the figure 4.3 also we can assume that the Treasury bill has played the important role in the government internal borrowing. Since Treasury bills are issued for a short period of time, most of the financial institutions and others are interested to invest in the Treasury bill. After Treasury bill development bonds has occupied the dominant role in the government internal debt and so on.

I.A. Growth Rate of Internal Debt and Its Components

The annual average growth rate of internal debt for the study period from fiscal year 2003/04 to 2012/13 are22.76%. The average growth rate of DB, TB, NSC, CSC, and SB are 13.82%, 12.18%, -21.02%, 17.67% and 12.74%. Among the instruments used for raising internal debt, growth rate of Citizen saving certificate outstanding is very high as comparing to other .Banks and the financial institutions are the major holder of TB,DB and SB. Therefore , fund raising composition has not been balanced between the individuals and institutional sectors. Normally, individuals buy hold the instrument until maturity but banks and institutions liquidate it when the rate of interest rises in the capital market. Long term bonds are advantageous to the government when low interest rate can be booked for longer periods and short term bonds are advantageous when there is a continuous rise in the interest rate structure. Today the interest rate in the market is very low as compared to previous years and in order to have a cost advantage on borrowing the government needs to borrow the internal loan for a Long period of time also.

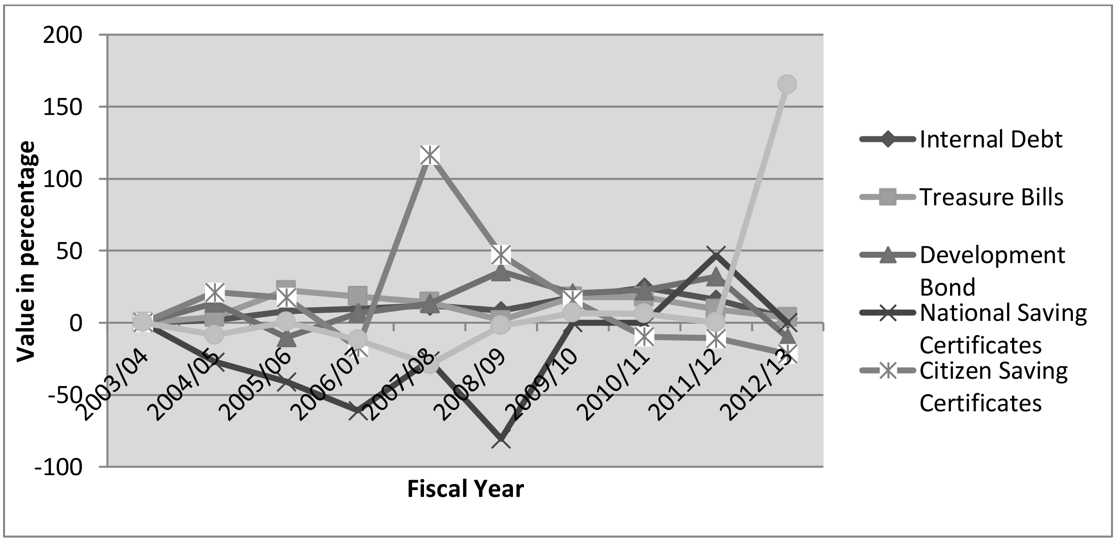
Table 4.7
Growth Rate of Internal Debt and Its Components

Fiscal Year	ID	Treasury Bills	Development Bonds	National Saving Certificate	Citizen Saving Certificate	Special Bonds
2003/04	-	-	-	-	-	-
2004/05	1.66	3.95	13.96	-27.17	21.21	-8.61
2005/06	8.16	22.55	-10.20	-41.05	17.5	0.60
2006/07	9.57	18.22	6.78	-60.87	-17.15	-11.91
2007/08	11.82	14.22	13.34	-26.37	116.71	-29.06
2008/09	8.30	1.74	35.62	-80.58	47.08	-2.14
2009/10	17.81	17.95	20.49	0	15.64	6.75
2010/11	24.41	17.93	22.52	0	-9.57	6.34
2011/12	16.17	9.38	32.17	46.82	-10.73	-.01
2/12/13	2.97	3.68	-10.27	0	-21.65	165.39
	11.20	12.18	13.82	-21.02	17.67	12.74

Calculated from table4.6

Figure 4.4

Growth Rate of Internal Debts



I.B. Share of Debt Instruments on Total Debt

The share of component of internal debt is changing over the year. The share of short term instruments like Treasury bill on total internal debt outstanding was 34.42% and the rest 65.58% was covered by long term instruments like development bond, national saving certificate , citizen saving certificate and special bonds in fiscal year from 2003/04 to 2012/13. In the fiscal year 2010/11 TB has covered 17.93% and the rest was covered by others. Treasury bill is more liquid instruments in the market. There is secondary market in the NRB to liquidate it at any office day for banks and the financial institutions. Therefore, there is the liquid risk to the NRB towards government borrowing. There is another liquidity risk for the government also, that when commercial banks will have enough opportunity to lend in higher rate and will find other investment opportunity, then they will not buy the TB in a big volume like today. In such a case, there will be a possibility of difficulty in raising funds through internal loan in a low interest rate. The share of each instrument on total debt is presented in the table below:

Table 4.8

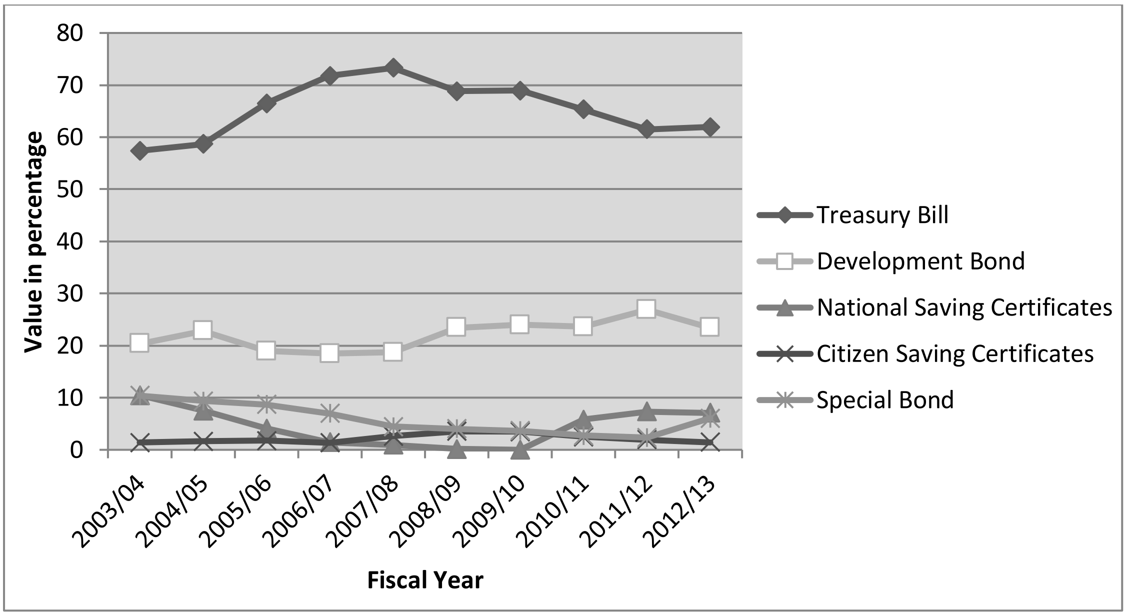
Share of Debt Instruments on Internal Debt

Fiscal Year	Treasury Bills	Development Bonds	National Saving Certificate	Citizen Saving Certificate	Special Bonds
2003/04	57.39	20.37	10.48	1.37	10.39
2004/05	58.68	22.84	7.51	1.63	9.34
2005/06	66.49	18.96	4.09	1.77	8.68
2006/07	71.74	18.48	1.46	1.34	6.98
2007/08	73.28	18.73	0.96	2.60	4.43
2008/09	68.84	23.46	0.17	3.53	4.00
2009/10	68.92	23.99	0.00	3.46	3.63
2010/11	65.33	23.63	5.80	2.52	2.73
2011/12	61.51	26.88	7.33	1.93	2.35
2012/13	61.93	23.42	7.12	1.47	6.06
Average %	65.41	22.07	4.492	2.16	5.86

Source: Calculated from table 4.6

Figure 4.5

Share of Debt Instrumet of ID



I.C Pattern and Ownership of Internal Debt Instruments

Government issues various types of bonds in order to raise the internal debts. In Nepalese context, government has issued TB, NSC, DB and SBs. Government of Nepal raise the funds from banking and non-banking sectors. The implication of borrowing from banking and non-banking system is different. Borrowing from banking system may have credit crunch in the economy but such effects will not happen if the funds are borrowed from the hand of public. The table below shows the pattern and ownership of internal debt instruments.

Table 4.9

Pattern and ownership of IDs

Fiscal Year	NRB	Commercial Bank	Other Institution Including Individuals	Total
2003/04	22.22	50.85	26.93	100
2004/05	19.92	55.45	24.63	100
2005/06	16.69	62.15	21.16	100
2006/07	19.37	63.44	17.19	100
2007/08	20.41	62.17	17.42	100
2008/09	22.98	57.25	19.77	100
2009/10	26.09	56.06	17.86	100
2010/11	19.84	57.51	22.65	100
2011/12	15.46	60.28	24.26	100
2012/13	13.19	66.82	19.99	100

Source: Nepal Rastrya Bank *(2013/14)*

Figure 4.6

Pattern and Ownership of IDs

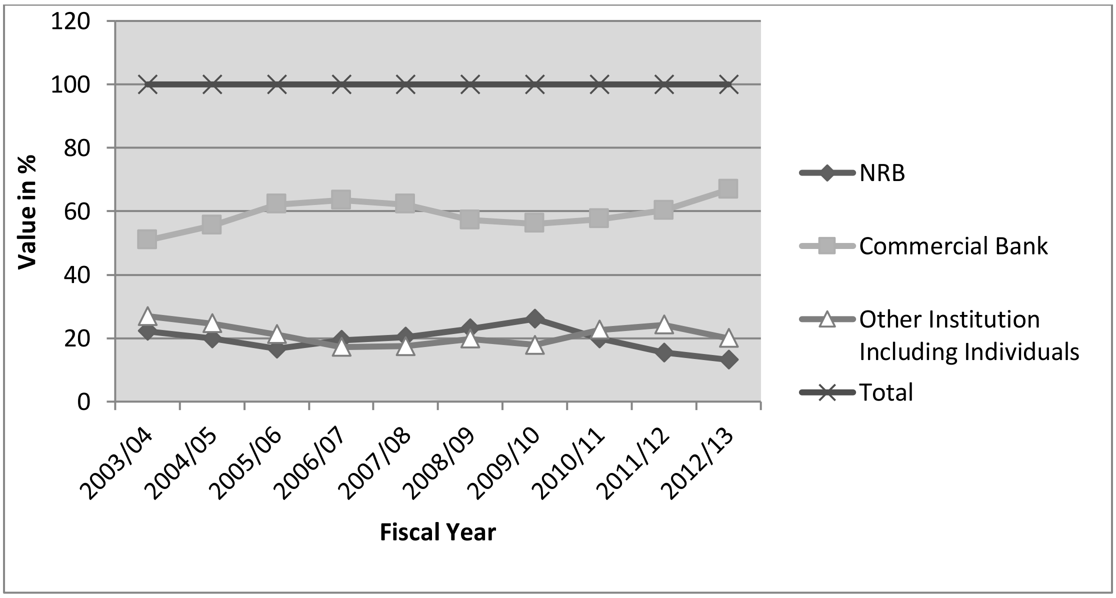


Table and figure above depicts that the ownership pattern of government bonds by NRB was 22.22% in FY 2003/04 which came 13.19% in the FY 2012/13. The commercial banks have begun to show their interest in purchasing the government bonds. Commercial banks were holding 50.85% of government bonds in fiscal year 2003/04, which increased to 66.82% FY 2012/13. However the holding pattern of others was 26.96% FY 2003/04, which came 19.99% FY 2012/13. So, in recent years, ownership pattern shows that the commercial banks holding are increasing significantly.

(II) Structure of External Public Debt in term of Disbursement by Major Sources

The major sources for foreign currency for Nepal are grants, foreign assistance and loans. Nepal a basically in aid dependent country. It has to depend mainly on foreign assistance, grants and loans for the required capital imports. Moreover at the same time, terms of trade of the developing countries like Nepal are unfavorable, it has to borrow from outside in order to finance the balance of payment deficits.

Nepal has started borrowing the foreign loan from Fiscal Year 1964/65 and till now, we have the burden of 11969.40 million in 2012/2013 of foreign loan.

External loan can be divided into following two parts:

1. Bilateral external debt.
2. Multilateral external debt

Bilateral loans are the loans from foreign government and their agencies, loans from autonomous bodies and direct loans form official expert credit agencies. Similarly, multilateral loans are, loans and credits from multilateral agencies such as World Bank, International Monetary Fund, Regional Development Banks and other multinational and inter government agencies.

Table 4.10

Structure of External Public Debt in Terms of Disbursement by Major Source

(Rs. in million)

Fiscal Year	**Total External Loan**	**Bilateral Debt**	**Multi Lateral Debt**	**% Of Bilateral Debt**	**% Of Multilateral Debt.**
2003/04	7629	66	7563	0.87	99.13
2004/05	9266.1	126.5	9139.6	1.37	98.63
2005/06	8214.3	40.6	8173.7	0.49	99.51
2006/07	10053.5	9004.6	1048.9	89.57	10.43
2007/08	8979.9	632.1	8347.8	7.04	92.96
2008/09	9968.9	612.9	9356	6.15	93.85
2009/10	11223.4	4550.6	6672.8	40.55	59.45
2010/11	12075.6	4112.4	7963.2	34.06	65.94
2011/12	11083.10	3254.4	7828.7	29.36	70.64
2012/13	11969.40	2574.5	9394.9	21.50	78.50
Average Annual growth rate				23.10	70.90

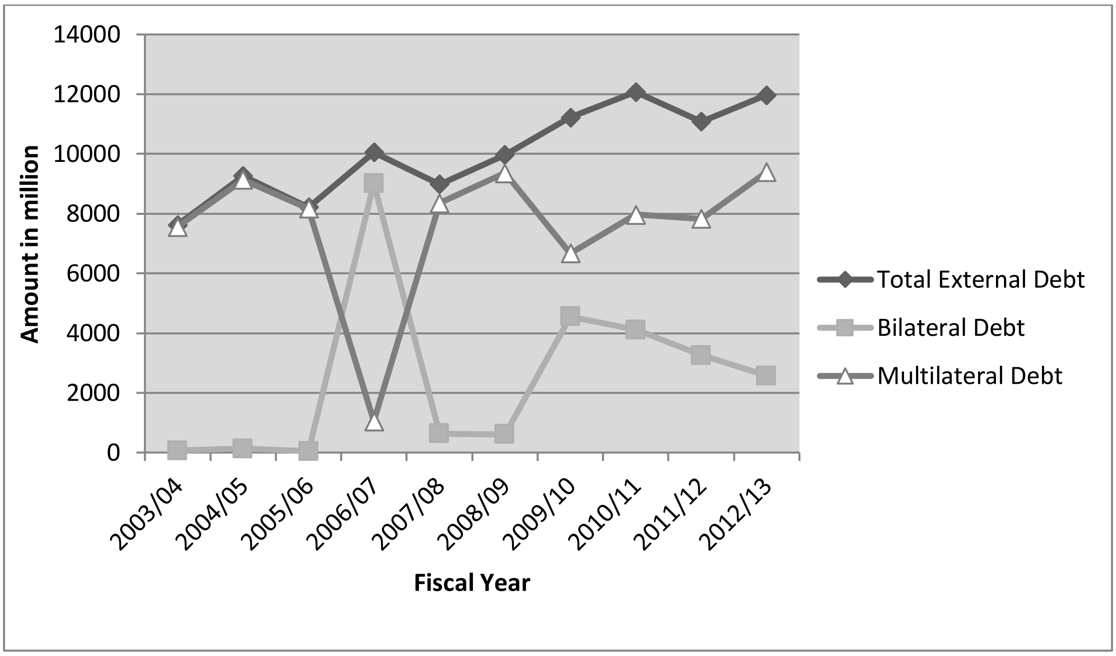
Source: Financial Comptroller General Office)

Table 4.10 shows structure of external debt in term of disbursement by major sources.

During the study period between fiscal year 2003/04 to 2012/13 the multilateral external debt has dominated the bilateral debt in the structure and composition of external debt in Nepal. In the starting year of review period (2003/04), the percentage share of bilateral and multilateral loans on total external debt was 0.87 and 99.13respectively. And by the end of study period (2012/13) it remains respectively 21.50 percent and 78.50 percent of share out of total external loans.

Figure 4.7

Trend on Total External Debt of Multilateral and Bilateral Debt



From the figure 4.7 also we can conclude that the multilateral debt has a dominant role in the external Debt. Though the multilateral debt has been decreased heavily in fiscal year 2006/07 and bilateral debt has been increased heavily in same fiscal year 2006/07. But both has occupied a major role in the management of external debt of the government.

4.1.6 Net Outstanding Public Debt in Nepal

If we look at the budget of each fiscal year of Nepal, the deficit amount has been mounting up except 2012/13. It further leads to increase the debt portion of the government. Here, an attempt has been made to analyze the trend of increased volume of public debt. The following table clearly presents the net outstanding public debt in Nepal, up to the final year of study period.

Table 4.11

Net Outstanding Public Debt in Nepal

(Rs. in Million)

Fiscal Year	Total Public Debt	Internal Public Debt	External Public Debt	%of Internal Debt in TD	% of external Debt in TD	A.G. Rate of T.D.	A.G. Rate of I.D.	A.G. Rate of E.D
2003/04	303986.4	86133.7	217852.7	28.34	71.66			
2004/05	324787.5	87564.2	237223.3	26.96	73.04	6.84	1.66	8.89
2005/06	307021.7	94710.8	212310.9	30.85	69.15	-5.47	8.16	-10.50
2006/07	320404.9	103776.0	216628.9	32.39	67.61	4.36	9.57	2.03
2007/08	366004.9	116039.5	249965.4	31.70	68.30	14.23	11.81	15.38
2008/09	402714.5	125674.1	277040.4	31.21	68.79	10.02	8.30	10.83
2009/10	404303.0	148059.7	256243.3	36.62	63.38	0.4	17.81	-7.5
2010/11	403757.5	184205.7	259551.8	35.72	64.28	-0.13	24.41	1.29
2011/12	523278.5	213991.4	309287.1	40.89	59.11	29.60	16.16	19.16
2012/13	529634.3	220347.2	309287.1	41.60	58.40	1.21	2.97	0
Annual Average Growth rate				33.63	66.37	6.78	11.20	4.40

Source: Financial Comptroller General Office.

Table 4.11 shows the net outstanding loan including internal and external loan and their average annual percentage growth. The net outstanding public debt is in increasing trend and the average growth rate is 6.78 percent from fiscal year 2003/04 to 2012/13.The total public debt outstanding till 2012/13 amounted to Rs. 529634.3 million.

The average annual share of internal and external loan is 33.63 percent and 66.37 percent respectively in total net outstanding debt. Internal loan has increased with an average annual growth rate of 11.20%, have been indebted by foreign loans to a considerable extent. Therefore government should take the serious attention towards the burden of external debt.

4.2 Role of Public Debt in Nepalese Budgetary System

4.2.1 Introduction

The word budget is said to have its origin from the French word baguette, which means small leather bag. In 1773, when Walpole was the chancellor of exchequer, he used to keep his documents in a leather bag. Today, bag itself is not a vital importance but people are anxious to see what the bag contains. Therefore, the bag contains economic bill presented by the finance minister in the parliament house annually. In the modern times, governments are welfare oriented. They have made some vigorous efforts to maximize the welfare of the society. In order to achieve it, government has to perform various socio-economic activities. This requires proper manipulation in the budgetary policy of the government. A budget, therefore, is not only a financial statement of actual and anticipated revenues and outlays of the government but it is also documents of detailed programmers and policies of action which they desire to pursue in the coming years to raise the level of economic activities.

A budget is the compendium of annual plans with resources allocation. It is the financial plan covering the outlays and receipts of the government. Usually, it is embodied in a document that may be called the budget, but budget is much more than that. It is the outcome of a process that includes preparation of the financial plan, review of the plan by the legislature where there if one, execution of the plan and evaluation and pubic reporting of the results.

A budget is both political as well as economic documents because it contents both political as well as economic elements. Its political elements are good governance strengthening the democratic values and norms, etc through achieving the macroeconomic goals. Its economic elements are estimation of income and expenditure collection of taxes, allocation of public expenditures, etc.

The budget occupies a significant place in the modern financial system. It affects the working of the whole economy through its effect on aggregate demand. It is an important instrument to achieve macroeconomic goals or objectives. It has various purposes through which the macro goals or objectives can be achieved. The major purposes of budget are as follows.

1. It sets a framework for policy formulation. This requires decisions about the action to be taken to reach objectives. Choices must be made about which of many competing proposals should be adopted to further particular national objectives and about the extent to which various objectives can be advanced simultaneously. Thus, it provides guideline to formulate various policies.
2. Budgeting is the means for policy implementation. It provides guideline for policy implementation. It is the guide for management and at the same time budgetary procedures are instruments of administrative control.
3. Budget is the means for legal control. Once the budget passes from the house, it becomes the means for legal control.
4. Budget documents may be the good source of information on past activities, current decision and future prospects.

Some Observation of Nepalese Budget

1. For the last few years, regular expenditure seems to be greater than development expenditure; it slows down the process of economic transformation and the process of economic development. This is because

regular expenditure is consumption in nature, which does not have direct relationship to economic growth. This has increased the challenges to maintain the macroeconomic stability by rationalization the regular expenditure, streaming development expenditure to highly productive sectors, broadening the tax base, and reducing the size of deficit financing.

2. Nepal's budget is always a deficit budget. This is our compulsion and also a strategy to have deficit budget to mobilize the resources. This trend will continue in future if there is no specific effort to mobilize the resources.
3. Of the total deficit financing, the share of foreign loan is around 51 percent. As they are conditional, we cannot mobilize them according to our need and policy. Such excessive dependence on foreign loan is not productive for economic development.
4. Our budget is still traditional in nature. It is because it has adopted the traditional methods of resource mobilization and management. (such as traditional sources of revenues: borrowing, traditional tax system, etc.)
5. Amount of domestic loan and foreign loan are increasing year by year. This also shows the failure of government to mobilize the internal revenue.
6. Considering the development in the context of SAPTA/SAFTA and WTO, there may be reduction in the government revenue as tax rates are to be rationalized compatible to international standard/WTO criteria, there is urgent need to mobilize the internal resources compatible with the increase in GDP.

In the modern times, the expenditures of the governments are increasing very rapidly as compared to the increase in their incomes. It is due to the fact that government is welfare oriented, as a result of which, there is rapid increase in the services performed by the government. This results in budget deficit. That deficit can be bridged by imposing more taxes, or by borrowing the money from public or other agencies. However there is certain limit to which taxation can be used to cover up the deficit in the budget without having adverse effect on the economy. Similarly, external borrowing is subject to various factors as it is conditional.

The money, which the government raises in the form of loan domestically, is known as internal borrowing. The concept of internal borrowing began in the decade of 1930 in order to fight against the depression…Keynesians strongly recommended the increasing use of government expenditures even by undertaking the internal and external loans to bring the economy out of the depth of depression. This has increased the importance of internal borrowing.

Internal borrowing is one of most important way to mobilize the internal resources in under developed countries like Nepal, where size of savings are small; they are scattered; there are very low opportunities of investment for general public; private sectors are still in infant stage; etc. The resource, which the government collects in the form of internal borrowing, can be utilized on the socio economic development such as economic and social overhead capital. Hence, internal borrowing mobilizes the available saving even though they are scattered and they are of small size. Beside this, it increases the saving habit on general public. It avails the opportunity to the general public to participate in the process of nation building. To some extent, it is desirable than external borrowing as they are conditional and they have to be paid after maturity in the convertible foreign currency with interest.

External resources contribute to development by supplementing domestic savings and by financing imports. They also permit flexibility in managing the balance of payment. The reasons for increasing the external loans are mainly.

4.3 Public Debt Servicing in Nepal

The burden of internal debt means that the greater part of the debt is held internally. Beyond this it may be pointed out that large public sector deficit, which are financed by inflationary methods, serves to reduce the purchasing power of the economy. Government borrowing has been excessive and the burden of public debt increasing daily according to increases on the outstanding portion of the debt composition.

Large-scale of public debt has been incurred for the financing development programmers. While large-scale public borrowing for financing development expenditure may be justified, resulting rise in public debt raises several issues of which most important is the burden of public debt. The burden of public debt is one of the oldest controversial issues in the economics of public finance (Singh, 1983).

The total burden of public debt can be divided into two parts: (i) internal burden of public debt (ii) external burden of public debt. The internal burden means that the greater part of the debt is held internally. Dalton (1949) takes internal public debt burden as not much significant as the payment of principle amount and its interest involves taxation. It is merely transfer of purchasing power from one person to another or money does not flow out of the national money market. Similarly, Lerner (1946) pointed out that the internal debt may not have any direct money burden on a community as a whole, since the payment of interest and taxation to meet the burden of debt involved simply transfer the purchasing power from one group of person to another to the extent the creditors and tax payer are the same, there may not be any net burden at all in the community. But to the extent of the creditors and taxpayer belong to different income groups; the changes in the distribution of income among different section of the community may take place.

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

4.3.1 Internal debt servicing

The payment of interest and principle of public debt is known as debt servicing in economics and finance. The ratio of internal debt servicing to the total government revenue is an important indicator for estimating burden of internal debt servicing charge. The relation of internal debt servicing to government revenue clearly indicates the burden of servicing charge on the taxpayers.

The burden of internal debt can be examined also taking into consideration of national income (GDP), government revenue and expenditure etc. If the national income (GDP) increases due to the public debt at a faster rate than the debt servicing costs, the ration between the two will register downward trend and indicates falling burden of national debt. It will also show that society has benefited by the benefits of the public debt. But, if the service costs expand at a faster rate than the national income (GDP), the ratio between the two will rise and indicate increasing burden.

4.3.2. Issue of debt servicing in Nepal

The annual and average growth rate of total debt servicing and share of external and internal debt servicing in total debt servicing during the review period of fiscal year 2003/04 to fiscal year 2012/13are given in the following:

Table 4.12

Share of Internal and External Debt Servicing in Total Debt Servicing

(Rs. in million)

Fiscal Year s	**Total Debt Servicing**	**Annual Growth of TDS %**	**Internal Debt Servicing**	**Annual Growth of IDS %**	**External Debt Servicing**	**Annual Growth Of EDS**	**%of IDS to TDS**	**% 0f EDS to TDS**
2003/04	16890.9		8983.3		7907.6		53.18	46.82
2004/05	20280.2	20.07	12180.2	35.59	8100	2.43	60.06	39.94
2005/06	20830.8	2.71	11679.4	-4.11	9151.4	12.98	56.07	43.93
2006/07	22879.3	9.83	13284.8	13.75	9594.5	4.84	58.06	41.94
2007/08	22903.2	0.10	12888.5	-2.98	10014.7	4.38	56.27	43.73
2008/09	26988.12	17.84	14494.4	12.46	12493.72	24.75	53.70	46.30
2009/10	28413.01	5.28	15212.0	4.95	13201.01	5.66	53.53	46.47
2010/11	29957.03	5.43	16417.0	7.92	13540.03	2.57	54.80	45.20
2011/12	35320.1	17.90	18956.8	15.47	16363.30	20.85	53.67	46.33
2012/13	48866.87	38.35	31673.6	67.08	17193.27	5.07	64.48	35.52
Average Annual Growth Rate %		13.10		16.68		9.28	56.38	43.62

Source:Economic survey 2013/14

Table 4.12 reveals that the total debt servicing amount has increased to Rs.48866.87 million in fiscal year 2012/13 from Rs. 16890.9 million in the beginning year of review period (2003/4). Similarly the total debt-servicing amount has increased with an average annual growth rate of 13.10 percentages. The internal debt servicing has increased from Rs. 8983.3 million inthe starting year of study period 2003/04 to Rs31673.6 million in 2012/13. The external debt-servicing amount has increased to Rs.17193.27 million in 2012/13 from Rs.7907.6 million in 2003/04. From the above table we can conclude that the internal debt servicing has been increased more than as compared to that of external debt servicing.

In the starting year of review period, the internal and external debt servicing has placed 53.18 percent and 46.82 percent of total debt servicing respectively. The average growth rate of internal and external debt servicing seems to 56.38 percent and 43.62 percent respectively. It enforce on our conclusion that the internal debt servicing has been increasing. Table 4.13 presents the overall annual growth rate of internal and external debt servicing to total debt servicing which is 56.38 and 43.62 percentage respectively under the review period 2003/04 to 2012/13.

Table 4.13

Share of Interest and Principle Payment in Total Debt Servicing

(Rs. in Million)

Fiscal Year	Total Debt Servicing	Annual G.R% Of TDS	Principle Payments	A.G.R % Of P.P	Interest payments	A.G.R % Of I.P	% of Principle in TDS	% of Interest In TDS
2003/04	16890.9		10794.9		6096		63.91	36.09
2004/05	20280.2	20.07	13533.3	25.37	6746.9	10.67	66.73	33.27
2005/06	20830.8	2.71	14264.8	5.41	6566	-2.68	68.48	31.52
2006/07	22879.3	9.83	16752.3	17.44	6127	-6.69	73.22	26.78
2007/08	22903.2	0.10	16386.9	-2.18	6516.3	6.35	71.55	28.45
2008/09	26988.12	17.83	18833.92	14.93	8154.2	25.13	69.79	30.21
2009/10	28413.01	5.28	18432.3	-2.13	9980.71	22.39	64.87	35.13
2010/11	29957.03	5.43	17220.5	-6.57	12736.53	27.61	57.48	42.52
2011/12	35320.1	17.90	20159.3	17.06	15160.8	19.03	57.08	42.92
2012/13	48866.87	38.35	35130.2	74.26	13736.67	-9.39	71.89	28.11
Average Annual Growth Rate %		13.06		15.95		10.26	66.5	33.5

Source: Economic survey 2013/14

While observing table 4.13, we noticed a 13.06 percent of average annual growth rate of total debt servicing. The share of interest amount was Rs. 6096 million and has maintained up to Rs13736.67 million and share of principle amount was Rs10794.9 million and has gone up to Rs.35130.2 million under the review period of this study. The average annual growth rates of Principle payment and interest payment are15.95% and 10.26%respectively. This shows the increasing trend of principle payments than interest payments.

The share of interest and principle payment to total debt is 36.09% and 63.91% in fiscal year 2003/04. But in fiscal year 2012/13, the share of interest and principle payment to total debt is 28.11% and 71.89%.So we can conclude that the share of principle payment to total debt is higher than that of interest payment. Above table also presents the overall average of principle and interest to total debt servicing, which is 66.5 and 33.5%.

4.3.3 Annual Internal Borrowing and Debt Servicing

Proportional relationship between annual internal debt servicing and annual borrowing can be taken as important aspects of internal debt analysis.

Table 4.14
Annual Internal Debt Servicing as Percentage of Fresh Annual Internal Borrowing

(Rs in million)

Fiscal year	Internal Debt (fresh)	Internal Debt Servicing	A.G.R. of IDS	IDS as %of ID
2003/04	5607.8	8983.3		160.19
2004/05	8938.1	12180.2	35.59	136.27
2005/06	11834.2	11679.4	-4.11	98.69
2006/07	17892.3	13284.8	13.75	74.25
2007/08	20496.4	12888.5	-2.98	62.88
2008/09	18417.1	14494.4	12.46	78.70
2009/10	29914	15212.0	4.95	50.85
2010/11	42515.8	16417.0	7.92	38.61
2011/12	36418.7	18956.8	15.47	52.05
2012/13	19042.9	31673.6	67.08	166.32
Average A.G.R %			16.68	91.88

Table 4.14 shows the proportion of annual borrowing being spent on debt servicing. In the starting year of study period 2003/04-percentage share of internal borrowing was 160.19 percent. However, this proportion has decreased tremendously and reached 38.61 in the Fiscal Year 2010/11 and then it increased to 166.32 in fiscal year 2012/13. The annual average % is 91.88 during the ten fiscal year review period.

This shows that the government's ability to borrow from internal sources conducive to raise enough funds for development requirement. And this also shows that the increasing proportion of internal debt servicing is the manifestation of productive spending of borrowed fund.

The high reliance on internal borrowing for financing budgetary deficit may have some effects like

1. Huge amount of development fund is diverted for meeting debt-servicing charge annual which comes under regular expenditure.
2. Some borrowing portion, from NRB, will have effect on money supply and consequently it has direct impact in money supply and increased prices.
3. Likewise, borrowing from commercial banks will create Crowding for private sector investment.

4.3.4 External Debt Flow and Its Annual Servicing

Here an attempt has been made to compare the annual flow of external debt with annual debt servicing obligation. The ratio of external debt servicing to new borrowing is shown on the following table 4.15

Table 4.15

External Debt Flow and its Servicing

(Rs.in million)

Fiscal Year	External Debt (New Borrowing)	External Debt Servicing	Annual G.R of E.D.S.	Debt Servicing / External Debt
2003/04	7629	7907.6		103.65
2004/05	9266.1	8100	2.43	87.42
2005/06	8214.3	9151.4	12.98	111.41
2006/07	10053.5	9594.5	4.84	95.43
2007/08	8979.9	10014.7	4.37	111.52
2008/09	9968.9	12493.72	24.75	125.33
2009/10	11223.4	13201.01	5.66	117.62
2010/11	12075.6	13540.03	2.57	112.13
2011/12	11083.10	16363.30	20.84	122.17
2012/13	11969.40	17193.27	5.072	143.64
Annual Average Growth rate			9.28	113.03

Source: *Economic* survey 2013/14

Table 4.15 reveals the proportion of external debt servicing to total external debt. Hence the ratio of external debt servicing to new borrowing is 103.65% in the starting fiscal year 2003/04 which came into 143.64 % in the fiscal year 2012/13 after the up and down swing.

This states that the proportion of debt servicing to new external borrowing has been 113.03 percent over the review period whereas the annual rate of growth debt servicing has been 9.28 percent per annum. The indicator raises fear about its increasing burden because it is going to devour not only large proportion of exchange earning but rather large proportion of new borrowing too.

4.3.5 Per capita debt outstanding in Nepal

Per capita debt outstanding in Nepal swings up and down during the study period which is shown in the table below:

Table 4.16

Per Capita Debt Outstanding in Nepal

Fiscal Year	Population in Million	Total Debt Outstanding(Million)	Per Capita Debt (Rs)
2003/04	24.10	303986.4	12613.5
2004/05	24.50	324787.5	13256.6
2005/06	24.80	307021.7	12379.9
2006/07	25.20	320404.9	12714.5
2007/08	25.50	366004.9	14353.1
2008/09	25.90	402714.5	15548.8
2009/10	26.30	404303	15372.7
2010/11	26.50	403757.5	15236.1
2011/12	26.90	523278.5	19452.7
2012/13	27.20	529634.4	19471.9

Source: Financial Comptroller General Office.

Table 4.16 shows per capita debt outstanding in Nepal. During the study 2003/04 to 2012/13, the population and total public debt have been increased. From the starting year of review period 2003/04 to 2012/13 population has increased from 24.1million to 27.2 million. Likewise total debt outstanding has also increased from Rs.303986.4 million to Rs.529634.4 million in the review period of 2003/04 to 2012/13. Per capita debt swings up and down from fiscal year 2003/04 to 2012/13. In the starting year it was 12613.5 which came into 19471.9 in 2012/13 after up and down. This means total debt per head of Nepalese people has reached to 19471.9 in 2012/13 from 12613.5 million in 2003/04, which is too high. The increase in the per head debt of the Nepalese people is due to slow development of the country, low per capita income.

4.3.6 Debt to GDP Ratio

Total debt to GDP ratio is commonly used indicator to measure the indebtedness of a country. This ratio can be further segregated into internal debt to GDP and external debt to GDP. The following table shows the total debt (internal debt and external debt) to GDP ratio.

Table 4.17

Debt to GDP ratio

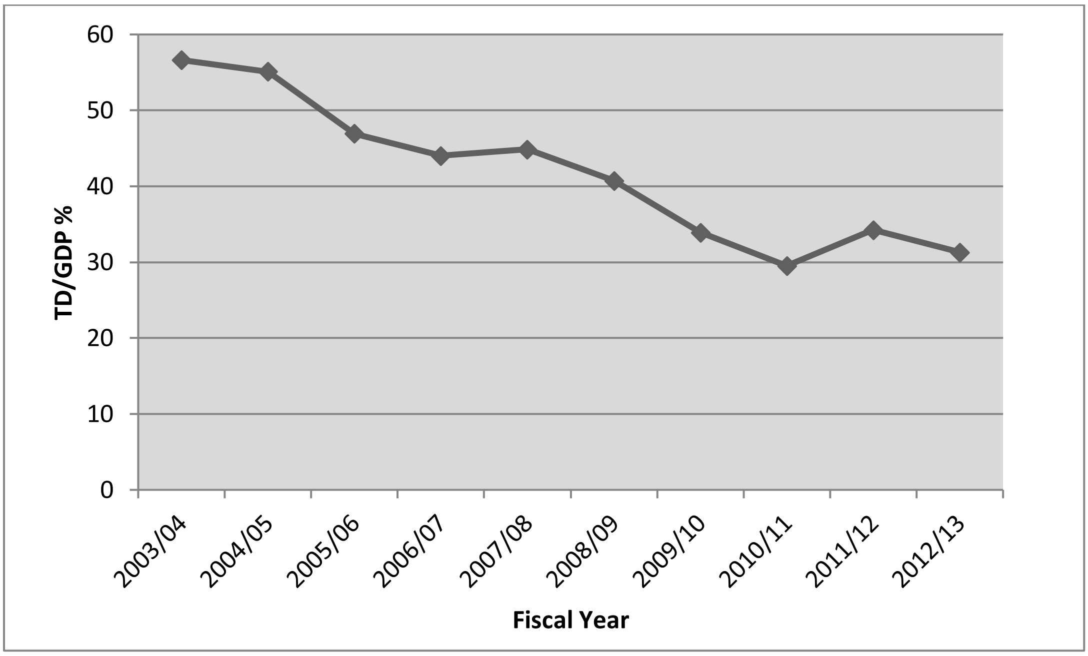
Fiscal Year	Total Debt Outstanding(Million)	GDP at Current Prices(Million)	TD/GDP %
2003/04	303986.4	536800	56.63
2004/05	324787.5	589400	55.10
2005/06	307021.7	654100	46.94
2006/07	320404.9	727800	44.02
2007/08	366004.9	815700	44.87
2008/09	402714.5	988300	40.75
2009/10	404303	1192800	33.89
2010/11	403757.5	1366900	29.52
2011/12	523278.5	1527300	34.26
2012/13	529634.4	1692600	31.29

Source: Economic survey 2013/14

The table4.17 depicts the debt to GDP ratio. Total debt outstanding includes both internal debt outstanding and external debt outstanding. The total debt to GDP is fluctuating during the study period. In 2003/04 TD/GDP was 56.63%, which becomes 31.29% in 2012/13. This shows that the current gross domestic production of the economy is enough to cover only 31.29% of the debt obligation. The prudent limit fixed for the debt is 60% of GDP within Maastricht criteria. Moreover, other economist also suggests limiting the debt outstanding within 60% limit. Considering the ceiling, Nepal’s indebtedness has exceeded the prudential limit during the year2003/04 to 2004/05. In 2003/04 TD/GDP was 56.63%, which comes to be 55.10% in 2004/05.

Figure 4.8

Ratio of TD Outstanding as a Percentage of GDP



The above figure shows the rise and fall in the TD to GDP. The TD/GDP is higher in the fiscal year 2003/04, then after starts to decreases and 31.29 % in Fiscal Year 2010/11.

4.3.7 Ratio of External Debt Outstanding to Export

This concept also helps to measure the indebtedness of a country. High value of the debt outstanding to export definitely shows the increasing trends and high level of indebtedness. The high value of debt outstanding to export for different years implies the earnings of the foreign currencies is not enough to cope up with the increasing borrowing from abroad. The ration external debt outstanding to export for fiscal year 19990/00 to 2008/09 is presented in the table 4.17:

Table 4.18

Ratio of External debt outstanding to export

Fiscal year	External Debt Outstanding	Export(E)	EDO/E
2003/04	217852.7	50428.9	4.32
2004/05	237223.3	63428.7	3.74
2005/06	212310.9	54719.3	3.88
2006/07	216628.9	59350.4	3.65
2007/08	249965.4	59233.5	4.22
2008/09	277040.4	67697.5	4.09
2009/10	256243.3	60824	4.21
2010/11	259551.8	64338.5	4.03
2011/12	309287.1	74169.6	4.17
2012/13	309287.1	71428.9	4.33

Soure : Economic survey 2013/14

Figure 4.9

Ratio of EDO to Export

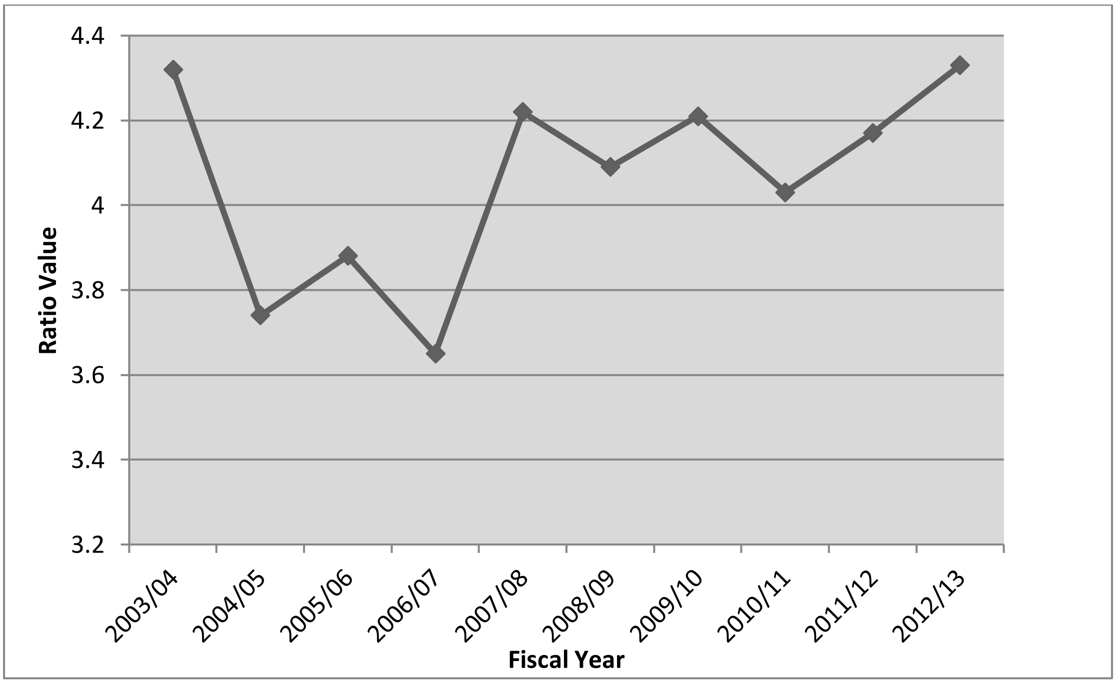


Table 4.18 and above figure we can see the ratio of EDO to export. EDO/E was 4.32 times in the fiscal year 2003/04, which fluctuates during the study period and comes to 4.33 times in the fiscal year 2012/13. In comparison

to the beginning year the EDO/E is higher which is not good for the economy. The higher the EDO/E ratio indicates that earning of the country from the export is not sufficient to repay the debt.

4.3.8 Problem of public debt in Nepal

The Landlocked nature and mountainous to Geography are the major constraints for development in Nepal. Economically, Nepal is backward and its economic performance is not satisfactory. Now, Nepal is facing an acute resource gap problem, which is also expected to grow in coming years. Nepal is thus, compelled to borrow more and more public debt to bridge the growing resource gap in the budget.

Large-scale public debt has been availed in the past for financing development programs. While large-scale public borrowing for financing development expenditures may be justified, the resultant rise in public debt raises several issues of which most important is the burden of public debt. The burden of public debt is one of the oldest controversial matters in the economics of public finance.

Owing to heavy reliance on external assistance in the form of borrowing on public account, Nepal’s external public indebtedness has increased very much. A rise in external indebtedness should be accompanied by an increase in debt servicing capacity so that there may not be undue strain in the balance of payment, owing to outflow of funds through debt servicing.

In Nepal both internal and external borrowing has been increasing rapidly. It is very common that a rise in the magnitude of public debt must be accompanied by an increase in the debt servicing capacity so that there may not be undue strain on the balance of payments owing to outflow of funds through debt servicing and there may not be unnecessary increase in the rate of taxes for meeting requirement of internal debt servicing charge.

It is generally observed that the present increasing size of Nepal's public debt is a matter of concern. It is necessary to have a careful work on the increasing magnitude of public debt and proper care must be taken to increase the debt servicing capability of the country.

4.4 Major findings

The major finding of the study is as follows:

- Revenue deficit (TE-TR) has increased with an average rate of 9.24% except 2012/13. The revenue deficit has increased from Rs .27111.6million in the starting year 2003/04 and reached to Rs 50476.6 million in the fiscal year 2012/13,and fiscal deficit (TE-(TR+Grants) has increased from Rs. 15828.2 million in the starting year of the review period 2003/04 to 9666.3 million in the fiscal year of the review period 2011/12 being up & down swing.
- The share of external debt servicing in total debt servicing during the study period (2003/04 to 2012/13) has decreased from 46.82% to 35.52%. Similarly the share of internal debt servicing to total debt servicing in the fiscal year 2003/04 was 53.18% which comes to be 64.48% in the fiscal year 2012/13. This indicates that the share of internal debt servicing has been greater than that of the external debt servicing throughout the period.
- The foreign grant for 2003/4 is 11283.4 million to 35229.8 million in 2012 being up and down swing.
- The share of annual average internal debt servicing & external debt servicing is 56.38 % and 43.62 % during the review period.
- Average annual growth rate of total debt servicing (TDS) has remained 13.10 % over the review period. Likewise, the external debt servicing increased considerably with an annual growth rate of 9.28%. Similarly the internal debt servicing has increased significantly with an average annual growth rate of 16.68 % over the review period.
- At present, up to the fiscal year 2012/13 the total debt outstanding of the government amounts to Rs.529634.3 million that consist Rs.309287.1 million as an external debt outstanding and Rs.220347.2 million as a internal debt outstanding.

- During the study period 2003/04 to 2012/13 multilateral loan has dominated in the structure of total loan. On an average, multilateral loan and bilateral loan has covered 70.90% and 23.10 % of total external debt respectively.
- From the study it has been found that there are few instruments to raise the internal debt in Nepal. These instruments consist of TB, DB, NSC and SB. Under this practice Treasury bills and development bonds were targeted instruments for raising debt from banking system and saving bonds from non-banking system. The proposition of TB and DB have stood 87.48 % and other instruments stood 12.54%
- The ratio EDO to Export in the fiscal year 2012/13 is 4.33, which implies that the earning from export is not sufficient to cover the increasing borrowing of capital from abroad.

CHAPTER – V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

Public debt management has become a priority for many developing and transition economy countries, which is change from the early 1980. When the debt crises emerged in 1982, government that undertook debt management focused their attention on controlling and recording median and long term public debt. Different institution within governments dealt with domestic and external loans. In developing countries public debt has become a median of economic development, but in the contest of Nepal, it is being a sources of fulfill the budgetary deficit.

Nepal is facing the problem of financing ever-increasing resources gap because government expenditure is increasing rapidly in each and every year but the revenue is not growing in the same pace. So, Nepalese economy has been passing through a critical phase of inadequate financial resources. But public funds availability for filling up the resource gap is limited. Therefore, government adopts the policy of borrowing internally and externally.

After introduction of democracy in 1951, Nepal could not maintain the sufficient financial resources even to meets its regular expenditure. Accordingly it was compelled to present the deficit budget at the very commencement of the budget system. But fortunately the deficit was made up by the bilateral grants till the 1960s. The government started to raise the internal loan in FY 1961/62 by issuing the Treasury bill and was indebted by external loan in FY 1963/64, which was from U.K. and USSR. We are indebted incessantly till now and it obviously indicates towards our hereditary indebtness for a long period to come. This has let to borrow the new loan for the redemption of old ones.

Internal debt plays a significant role in the development expenditure as well as in the growth of financial market standing the effective implementation of monetary policy. As the domestic resources are not sufficient to meet the development needs of the under developed countries like Nepal, external assistance (both loans and grants) plays obvious role. They help to solve the resource gap in the country's budgetary system.

Burden of public debt and debt servicing has been increasing continuously which is in fact the accumulation of net borrowing of different years. The total outstanding debt is Rs. 403757.5 million by the end of 2010/11. Consequently, external debt servicing has become a current issue. In this context question may arise whether Nepal can sustain or not with the alarming increasing in debt servicing obligation. If Nepalese internal resources cannot meet external debt payment, there will be need to borrow again and the country is likely to fall into debt trap, i.e. new debt for servicing old debt

5.2 Conclusions

Public debt has played an important role in the financial resources for developing expenditure as well as in the growth of money and capital markets. It facilitates the effective implementation of monetary policy. Public debt is one of the best ways of financing which minimize the borrowing cost and to mobilize the internal financial resources in the productive sector of the country's economy.

The size of overall budgetary deficits excluding grants has remained high mainly due to low revenue and very high expenditure. This has led to heavy borrowing form internal and external sources. In fact the public debt itself is neither worse nor it impairs the economy. The financing of accumulated fund on productive programs and redemption made through such like programs, the public debt may be the quite beneficial to the nation as it outstrip the national economy as whole. But situation is quite adverse because the impact of the investment of borrowed fund on output has remained unsatisfactory.

Nepalese economy is characterized by three kinds of macro economic imbalances viz-saving-investment gap, export-import gap and revenue expenditure gap. These fundamental gaps represent the foreign domination in Nepalese economy. The saving-investment and revenue-expenditure gap are mainly the consequence of excess government activities. To fill up these gaps public debt (external and internal) is required. As other sources are limited, emphasis goes on loans for transfer technology and trade, which has created high degree of indebtness and consequently, debt servicing obligations increasing. In the meanwhile, the loan is not self-liquidating. The debt repayment capacity is not increasing in the same pace. The ultimate effect of lower capacity falls on capital formation and development process. Mismanagement of fund has resulted on lack of self-liquidating project. These conditions create a question that "Is Nepal really falling in debt traps?' After the study, it is concluded that Nepal has not fallen in debt trap yet but if the process continues for years, there will be no other s result.

5.3 Recommendations

On the basis of above finding the following recommendations are suggested to address the problem of public debt in Nepal.

1. Public debt is one of the most important internal resources for economic development. So the government should make effective plans to proper uses its. Government efforts should be directed towards mobilizing internal resources and thus to reduce dependency on loans for financing development expenditure.
2. Government should maintain fiscal balance and strong fiscal discipline through control of unproductive expenditure and maximizing revenue mobilization.
3. Due to low revenue and very high expenditure, the size of overall budgetary deficit has remained high. This has led to heavy borrowing

from internal and external sources. So, for reducing the volume of borrowing, the tax administration should be active, agile and transparent.

4. The total debt outstanding ratio on GDP has been decreasing, which is not in favorable condition, so the government of Nepal should effectively formulate the plans, policies and procedure to invest the debt in productive sector.
5. Revenue mobilization needs to be enhanced through measures directed as simplified sales taxes, effective implementation of VAT and expanding the tax net and base.
6. Debt management should be done in effective manner. A separate department headed by expert of the public debt management should be given authority and responsibility to manage the debt. The department should monitor the usage and payment of public debt. It also should be calculated the risk, return and borrowing cost.
7. Excessive dependency upon foreign assistance for development expenditure is persistence due to poor mobilization of internal borrowing and internal revenue. The internal borrowing mobilization for development purpose has also been fluctuating and banking sector has dominated the total internal borrowing. Government should initiate policies to attract maximum borrowing from non-banking sector, as it is considered as anti-inflationary measures of fiscal policy because it only transfers ideal saving from people to the government for development purpose.
8. The loan assistance should be utilized selectively, after careful scrutiny of the purpose, content and benefits of such project and programs in order to reduce the burden of external debt while contributing to accelerating growth and meeting socio-economic objectives.
9. Investment is regarded as a prime factor to increase the level of production, which is only possible through increase in the saving. In order to raise the present saving-GDP ratio, is necessary to crate favorable environment. Nepalese economy is passing through huge domestic

saving- investment gap due to mismatch between growth rate of saving and investment. Thus, there is need to reduce such gap by increasing the rate of total domestic saving.

10. To avoid the debt-servicing burden and also to cope with the existing level of fiscal deficit, government should try to get more grants as far as possible. This efforts, however, depends upon the policy of the donor country but the government also should maintain such an external policy that the more grants should receive rather than the external loans.
11. The level and direction of export is limited to few products and a few countries. Emphasis should be given on spending for the growth of export and diversifying trade both countrywide and commodity wise. There is need to formulate long term plan for export promotion and to coordinate various export related activities such as product development, market promotion, export stabilization, quality improvement, export diversification etc. It will help to minimize huge trade deficit by promoting to export-oriented industries and there by narrowing the ever-increasing gap between total export and import.
12. In order to reduce the debt problems, government should increase GDP growth, revenue growth and export earning growth in sustainable manner so that country will not be trapped on debt servicing problem.
13. And, proper attention should be given to the macro-economic stability of the country while accepting short-term and long-term loans.
14. The trend of public borrowing is increasing in coming year so, the government should formulate strategic plan and policy for effective utilization of public debt in near future.
15. As revenue mobilizing is based on the efficiency of tax administration, effectiveness and professionalism, imparting the training for the human resource to effect structural changes in tax administration seems inevitable.

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