CHAPTER – ONE

INTRODUCTION

1.1 Background of the Study

Public debt is an important source of government financing. Almost all governments face budget deficit due to high expenditure and fewer revenues. Governments can get revenue by increasing taxes, printing money, domestic or external borrowing and using previous budget surplus. When the government decides to borrow instead of introducing additional tax measures, to finance the budget deficit, it creates a liability on itself known as public debt. The government of the country gets its income from two sources namely, public revenue and public debt. Public revenue therefore consists of the money that the government is not obliged to return to the every individual from whom it is obtained. But public debt/borrowing taken by government is an obligation of repayment of principal sum borrowed plus a stipulated rate of interest after its maturity period to persons, institutions and foreign countries. Public debt comprises of both internal and external source. Internal sources include borrowing from individuals and from banking sector. External sources include foreign loans, grants and from bilateral and multilateral agencies.

Nepal is one of the low income countries in the world with a per capita income of $ 929 (Approach paper 14th Plan 2016). Statistics on social sector development such as life expectancy, infant mortality, and literacy also indicate poor status compared with many other SAARC countries. Poverty alleviation and improved quality life is emphasized as the important objective in the current plan of the country. Thus borrowing should be directed to relevant sectors, and efficient utilization of external resources should be accorded due 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 underdeveloped 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, which is usually due to lack of appropriate technology of capital equipment and the capacity to use then to the best advantage.

Government follows debt financing because it provides a relief to the current taxpayers and shift the burden of present tax to future generation reducing further the political costs of the government. A debt management policy improves the quality of decisions, provides justification for the structure of debt issuance, identifies policy goals, and demonstrates commitment to long-term financial planning, including a multi-year capital plan. Debt management policies are written guidelines and restrictions that affect the amount and type of debt issued by a government, the issuance process, and the management of a debt portfolio. An effective debt management policy provides guidelines for a government to manage its debt program in line with those resources and minimizing the cost of borrowing while reducing the risk. Adherence to debt management policy signals to rating agencies and the capital markets that a government is well managed and should meet its obligation in a timely manner. Public debt is the major source of fund for development activities basically in developing countries. Nepal is facing a serious and growing resources gap problem on the one hand and increasing inflation and population growth on the other. As internal revenue generation such as tax revenue, surplus of public undertaking are inadequate in comparison to resource requirements, government takes public debt from both internally and externally. Therefore, the need of public debt as a source of resource mobilization for development financing and to strengthen the economy is a comparatively modern phenomenon and has come into existence with the development of a democratic form of government.

Taxation is no doubt, the most important source of government financing to build up socio economic infrastructure such as health, education, electricity transportation, communication, drinking water etc. for economic development. But it is quite impossible to raise adequate fund through taxation in underdeveloped countries because of poor tax payable capacity of the people. The only way to collect the needed fund is public debt. Debt can be taken from citizens as well as foreigners. Hence, public debt is taken as balancing items of increasing trends of fiscal deficit.(Sung sup 2005)

The government has various alternatives to borrow for the purpose of financing fiscal deficit. One way is to borrow directly from the central bank which is equivalent to printing of money. The other alternatives are: borrowing from domestic commercial banks, borrowing from domestic non-bank sector and borrowing from external sources. Each method has its own implications for various aspects of the economy. Government usually adopts a mixed strategy and utilizes a number of options at the same time that have more beneficial for the present situation of the country.(CEMID, 2012)

Growing public debt is a worldwide phenomenon. It has become a common feature of the fiscal sectors of most of the economies. Almost all developing countries are under minor or high public debt situation. Sustainable debt is a level of debt where debt ratio turns down or remained unaffected, and the fiscal deficit is not necessarily to be at zero but it should not push the debt ratio to increase or move faster than growth rate of GDP. Research findings support that foreign aid (including loans) is also effective if appropriate debt management policies are in place. The debt burden of a country inevitably imposes a number of constraints on its growth prospects. However, it is assumed that such problems are not likely to be solved unless an aggressive approach is applied. Government’s prudent debt management would ensure that revenues are not diverted from growth enhancing investments, but they are redirected towards investments in infrastructure, drinking water, basic education and health which consolidate and accelerate the diversification of the economy. Financial Comptroller General Office (FCGO) under the Ministry of Finance (MOF) is the main government agency responsible for treasury management of the Government of Nepal. FCGO is mandated in undertaking several functions in the areas of public financial management. Of which, public debt management is one of the core function of FCGO. The structure of the government finance in Nepal clearly indicates the important role of public debt, both internal and external, in meeting the resource gap. Public debt has been used in Nepal as a regular mechanism of deficit financing since last six decades. Public debt management comprises of projection for debt requirements, receipt of debts, utilization of debts, repayment of debts (principal plus interest) and maintaining of records of the receipts, repayments and liabilities. Nepalese economy heavily relies on short-term domestic debt and concessional foreign loans, particularly multi-lateral agencies like The World Bank Group, ADB, IFAD, etc., of long maturity. More than 65% of domestic debt has maturities of one year or shorter, and less than 9% of domestic debt has maturities of 10 years or longer. The bulk of the cheap foreign loans have maturities of longer than 30 years and account for more than 57% of the financing of the budget deficits in Nepal. Concessional foreign loans have been the best source of financing, which will not be available forever. The high stock of debt, slow growth rate of economy and outflow of considerable amount of resources in the form of debt servicing have raised questions that whether foreign borrowing on current terms is beneficial for developing economies or not? Therefore, the problem of debt management is increasingly important for the Nepalese economy.

1.2 Statement of Problem

High levels of sovereign debt are common features of modern economies. With the sophistication and liberalization of financial markets, this has made the problem of debt management one of the most important issues in economic policy. The optimal volume and sustainability of sovereign debt are important issues with regard to sovereign debt management. However, sustainability of sovereign debt may be more important than its management, particularly for an underdeveloped economy with a relatively large burden of sovereign debt such as Nepal. It should be noted that effective sovereign debt management increases sustainability.

Developing countries like Nepal are always facing the problem of resource gap. Government collects funds from internal and external borrowing. The external borrowing is increasing more rapidly than internal debt due to wide gap between saving and investment, revenue and expenditure and exports and imports. In Nepal, every year budgetary deficit is growing in which effective management of available resources are needed. The proposition of government borrowing and debt servicing obligation are increasing rapidly. To maintain the resource gap, debt is only one solution, which helps to increase the amount of debt. In the context of Nepal the increasing size of public debt to maintain fiscal deficit is challenging proposition. So, public debt in Nepal is a matter of concern.

In the underdeveloped countries like Nepal, domestic resources are inadequate to meet the financial requirement for the economic development due to low income, low saving and low capital formation. So it creates the low internal debt in Nepal. Thus, Nepal is more dependent on external debt than internal one. This ever increasing trend of debt servicing of the country creates a great problem for debt management and becoming a major challenging issue for the country. Foreign assistance has become major source of financing for development expenditure.

The burden of public debt is very controversial issue because government has taken loan for peace and securities which are unproductive sectors. The total outstanding debt is around 55 percent of GDP and more than 50 percent of development budget is shared by foreign loan in each periodic plan. So, Nepal is heavily dependent on foreign aid. To break the vicious circle of poverty and socio economic development of Nepali people, there is greater demand of debt. So the current situation of public debt on our country makes us to think seriously about it.

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

The study deals with following issues,

- What is the trend and structure of public debt of Nepal?
- What are the debt servicing problems of Nepal?
- What types of debt instruments are available in Nepalese economy?
- Is Nepalese public debt sustainable?

1.3 Objectivesof the Study

The major objective of the study is to examine and analyze the trends, structure and burden of public debt in Nepal. The specific objectives are as follows:

- To analyze the role of public debt in Nepalese context.
- To examine trend and structure of public debt.
- To assess the debt sustainability.

- To explore the debt servicing problem in Nepal.

1.4 Significance of the Study

Public debt has been the single most important source of funds to finance the development plans of the Government of Nepal. Raising sufficient funds in the form of public debt is, therefore, important for sustainable economic growth and to end prolonged poverty. Since a failure to meet debt obligations could lead to a serious economic crisis, managing public debt within a sustainable level is an important policy issue in itself. Higher debt levels could contribute to higher growth, but it could also increase the probability of default. This paper examines the debt sustainability of Nepal in a consistent macroeconomic framework to provide a balanced view of the sustainability of debt and economic growth.

For economic development of Nepal government must invest on various sectors such as education, health, transportation, communication, power etc. To build up such overhead capital there is need of heavy fund, which is possible only through government borrowing due to low tax payable capacity of the people. Similarly, to break the vicious circle of poverty and to improve economic condition of the people, there is greater need of public debt.

As the revenue surplus has not been adequate to meet the development expenditure, the deficit budget has remained the prime feature of Nepalese fiscal policy. Due to this reason, the value of total loan has been rising and the burden of debt servicing has been increasing year by year. This situation leads the government to become more indebted from external as well as internal borrowing.

The study of public debt concerned to maintain high level of employment, a reasonable degree of price level stability, balance in foreign accounts and an acceptable rate of economic growth. This study will also be concentrated of the mobilization of financial resource through appropriate utilization of public debt. It is also applicable for the people and institution to purchase government securities.

1.5 Limitation of the Study

- This study is fully based on secondary data and information such as economic survey, budget speech, and other publications of ministry of finance, FCGO, NRB, CBS etc.
- No attempt has been made to check the reliability of the data.
- The result and the interpretation are completely rigid from the view point of the researcher.
- This study deals with limited financial and statistical tools only.

1.6 Organization of the Study

The study is divided in five chapters. Prior to the body of this several pages of preliminary materials such as title page, approval sheet, viva sheet, acknowledgements, table of contents, list of tables, list of figures, abbreviation used etc. have been presented.

Chapter one is the introduction of the study. It includes background of the study, statement of problem, research objectives, significance of the study, and limitation of the study and organization of the study.

Chapter two is review of literature, which 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 three is research methodology. It contains the methodology used in this research to find the result for meeting the objectives set in chapter one. It includes research design, population and sample, sources of data, data collection techniques, and data processing procedures and data analysis tools.

Chapter four is presentation and analysis of data. It includes the presentation of data in various ways and its interpretation which are collected from various sources.

Last chapter is the summary, conclusion and recommendation, which includes summary of the study, conclusion and recommendation. At the end of the study bibliography is presented as supplementary materials.

CHAPTER – TWO

LITERATURE REVIEW

Review of literature is basically a stock taking of available literature in the field of research. It supports the researcher to explore the relevant and true facts for the reporting purpose in the field of study. In the course of research review of the existing literature would help to check the chances of duplication in the present study. Thus on can find what studies have been conducted and available.

2.1 Conceptual Review

Public debt management can be defined as open market operations carried out by the government in order to change the composition of the outstanding stock of government-issued debt instruments. Public debt management focuses only on changes in the composition of the outstanding public debt and takes the size of the public debt as given. The composition of public debt is usually characterized by the outstanding debt's maturity structure and public debt management is mainly concerned with changes in the maturity structure. The aim of public debt management is to minimize the cost of public debt, as a part of the economic policy making, to control aggregate demand. The basic idea behind public debt management as a tool for economic policy making is the following; in order to induce investors to hold the new mix of government-issued debt instruments, changes in the structure of relative asset yields are necessary.

Various economists have given the concept of public debt. Tayler (1971) has defined "the debt is the form of promises by the Treasury to pay to the holders of these promises a principle sum and in most instances interest on that principle. Borrowings are restored to in order to provide funds for financing a current deficit."

Dalton (1984) have 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 persons or institutions outside this area.

The public debt is not the new and keen matter. From the very beginning of 19th century economists have been arguing and discussing for and against it. Particularly the classical economists such as Pigou, T.R. Malthus, J.B.Say, C.F.Butable visualized their views against the government debt, where as post Keynesians and the modern economists have stood up for the government debt, but they all alternatively poured their sufficient statement upon its size and use (lekhi,1995)

Wikipedia (2016), defines Government debt (also known as public debt and national debt) is the debt owed by a central government. (In the U.S. and other federal states, "government debt" may also refer to the debt of a state or provincial government, municipal or local government.) By contrast, the annual "government deficit" refers to the difference between government receipts and spending in a single year, that is, the increase of debt over a particular year.

Oxford dictionary states that public debt is “the amount of money the government needs to borrow every year to pay for public spending, if money from taxes is not enough. It is borrowed from the banking system and other sources, and is considered an addition to the National Debt.”

In the literature of public debt different economists have different views regarding the public debt. Generally, classical, Keynesian and post Keynesian economists have different aspect towards public debt.

2.2 Theoretical Review

Classical Review

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

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

a. Deficit financing means as increase in public debt. Since it is an easy method to obtain income, government is likely to be extravagant and irresponsible. Consequently, public debt will definitely become a burden to the economy.

b. Payment of interest on public debt and refunding of the principle will require additional taxation. It might prove to be difficult since government's power to tax is not unlimited.

c. Deficit financing might produce currency deterioration and price inflation.

However the classical economists were not against all type of public debt. They favored public debt for self liquidating projects. In the words of R.A. Musgrave, "Self liquidating projects may be define narrowly investment in public enterprises that provide the fee or sales income sufficient to service that debt incurred in their financing or they may be defined broadly as expenditure projects that increase future income and the tax base. Such projects permit servicing (interest and amortization) of the debt incurred in their financing without requiring an increase in the future level of tax rates." (Musgrave, 1959)

Recent Review

After the great depression of 1930s new way of thinking take place in the writing of J.M. Keynes who 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 in the 1950s a development process of developing countries took place significantly. The growing need of fund was realized for meeting development requirements. Capital deficiency resulted in increasing volume of budgetary deficit. The great depression of 1930s and the Keynesian revolution paved the way for the development of the modern theory of public debt as a part of functional finance.   Those who follow Keynes are of the view that public debt is income generating and so it is not burden of the community.

The Post Keynesian economist like Learner also shares the view that “Internal debt inflicts no burden simply because it is a transfer of fund from one pocket in the other from the left hand to the right hand.” He further maintains, “An inter-personal of international loan yields the borrower a real benefit, it enables him to consume or invest more than he is earning or producing. And when he pays interest or repays the loan he must tighten his belt, reducing his consumption or his investment. In the case of national debt were have neither the benefit nor the burden, the belt cannot be let out when borrowing need not be tightened when repaying. (Poudel, 2005).

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

According to Professor S. E. Harric(1947) “ It assure elasticity in many supply and agreed that government expenditure could be productive and need not necessarily be wasteful and so case for public borrowing is strengthened .“

According to modern economist Raja J. Chelliah (1961) observes that. “If revenue will meet subsides, other transfers, interest payments and the grater the part of current expenditure; debt finance will be used for meeting the government’ non-remunerative capital formation; and the total domestic borrowing will be determined in such a way that, given the rate of domestic saving, the non-government sector will be able to obtain a due share of saving and that there will be no need to borrow from the central bank more than the correct amount of saving and the there will be no need to borrow from the central bank more the correct amount of seignior age, it is the ideal situation for borrowing.

It can be presented in another ways also:

The level of government borrowing is the function of ability and willingness of person and business to lend and the government's power and intention to tax. Maximum level of debt can be expressed in terms of the following equation: (Singh, 2004)

$$D = \frac{Y_t - E}{r}$$

Where,

D = maximum sustainable national debt

E = constant expenditure of ordinary government operation

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

r = contractual interest rate of government debt.

However, the burden of debt depends upon the nature of investment, productive or unproductive. If it is productive, there will not be a burden because of certain of real asset in the economy which further generates income of the people thereby increasing national income. If it is unproductive, the situation will naturally be burdensome on the government.

Historical background of Public Debt

The idea of public debt is not the new and keen matter for the students of economics and finance. The concept of public debt was originated in the Great Britain in the seventeenth century, where a group city merchant provided grants and loans to the government. In return, they received the privilege of royal charter to fund the bank of England, which become the country's central bank. Public debt had developed simultaneously with the needs of the state's development. Historically, during the period of world war, the government borrowed large amount of loans to meet its expenditure. Economists have been arguing and discussing for and against it. Classical economist (Pigou, TR Malthos, JB say Stood against the Public debt where as Keynesians and modern economists developed the concepts for it.

After first and Second World War large amount of loans were borrowed for the reconstruction and maintenance. Formally, the state only had to maintain peace and prevent external disruption. But now every state should look after the economic development and public welfare in addition to conventional work activities.

Therefore, the public debt has become one of the most useful instruments to generate income and to maintain the welfare state and economic development.

In the context of Nepal, even in the eighteenth century the general public had no power to provide to loan. They could provide human labor and goods for the government.

M.C. Regmi has stated in his publication entitled. “Economic History’’ that there was no public debt but government provided some regulations to maintain public finance before eighteenth century. Some instances of public debt in Nepal has been held during the time of RanaBahadurShaha who borrowed a large sum of money (Rs. 60,00,000)from Indian merchants. In 1803 the government was forced to meet its internal expenses. A cash levy was imposed on a country wide basis to finance the repayment of debts incurred by kingRanaBahadurShaha.Prime Minister JangaBahadurRana came in power and the development work was not incurred out. They had collected the revenue for the people. After the dawn of democracy, the first five years plan was introduced in the year 1956. In this plan, most of the expenditure was incurred with the foreign grants. During that plan period, some deficit amount of Rs. 2708 million was from surplus balance account and loan from Nepal Rastra Bank.

Nepal’s experience in public debt, in an ongoing and documented basis, is fairly recent. In the process of obtaining public dept, (1962) by a year, the first foreign creditors being U.S.S.R.and the U.K. public transactions in Nepal falls under domain of public Debt Act 1960, and public Dept By-law 1963.After the enforcement of public Dept Act 1960, public dept for the first time was issued in Nepal 1962 through treasury Bills amounting to Rs.7 million. The text instrument of public debt, Development Bond, was first issued in fiscal year 1963/64, amounting to Rs. 250 million. Beginning Jan. 1992, Nepal Rastra Bank Bond began to be issued with the sole objectives of excess liquidity. It, however, has been suspended since April 1996.

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 scone followed by assistance from India in October the sane year’. It was then followed by China (1956) and the

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' begin 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 to bridge financial resource gap in her budgetary position contributed to increase each year. The main sources of the external borrowing of Nepal are the government of the developed countries. Like International Agencies and Commercial Bank mainly the IME, the World Bank and Asian Development Bank.

2.3 International Review

Bhargava (1956:191) viewed thatthe government borrowing is also useful to combat against inflation because in this situation demand is more than the available supply of goods and services and here the government transfers extra purchasing power from the hands of the people. Thus, a sensible debt policy can be used to check a depression or a boom.

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

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

- The raising of taxes for debt retirement by a regressive tax system will take funds for those less able to pay and transfer these funds to bond holders who gain relatively little benefit from their receipt.

- Reduction of expenditure useful government function will impose burden upon prior beneficiaries of those function.
- Taxes to repay debt held by the bank may result in net destruction of a part of the circulating medium.

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

- The magnitude of annual transfers for debt service.
- The pattern of debt ownership within the economy.
- The type of tax system.
- The level of national income.

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

According to new Palgrave dictionary of economics 1988, “Public debt is a legal obligation on the part of government to make interest of amortization of payment 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 government. It refers to loan raise by government within the country or outside the country. Every government like individual has to borrow when its expenditure exceeds revenue. The receipts from the sale of financial instruments by government to individual of firms, in the private sector to induced the private sector, to release manpower and real resource and to finance the purchase of those resources or to make welfare payments of subsides."

Shoup (1982) defines 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.

Trippen, (1990), in his article pointed out that debt of the banks in 1980s prevented the international financial system from collapsing; still there was not financial situation of debt problem in sight yet. He observed capital flight from Latin American countries was a symptom of seriously economic, social and capital problems in consequence of the debt crises. The debt crises had its origin in the substantial rise in the external liabilities of the 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 identifying now investment out less and debtors could acquire funds needs for development purposes.

He again explained that as external debt crises was due to:

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

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

Buiter (2001), observes, “The government borrows only to finance public sector formation cannot be easily rationalized in terms of generally accepted economic principles. At worst it could become a straight jacket on the fiscal and financial strategy. It also risks inducing a misplaced sense of complacency about the accumulation of public investment related to public debt. Debt must be serviced through future higher current revenues or lower public spending regardless of what motivated its issuance.”

Milhani(2004), observed, “Public debt is considered when the government floats loans and borrows from the public. Government needs to borrow when current revenue is short of public expenditure”.

2.4 Nepalese Context

2.4.1 Article Review

Acharya (1988) in his article entitled “*Burden of Public Debt in Nepal”* has analyzed the debt situation in Nepal. He also pointed out the various factors that cause leading to an excessive internal and external debt burden. In which domestic factors are;

a) Inappropriate or expansive fiscal policy
b) Very low tax effort
c) Poor maturity mix debt burden
d) Over- regulated prices that dampen incentives to export oriented production resulting in falling exports and revenue, and increased import.
   External factors to dead excessive debt burden are;
a) Adverse external conditions such as deterioration in the terms of trade (e.g. Oil shocks)

Inadequacies in external debt management such as poor maturity mix and exchange rate misalignment.

Sivakoti (1997) in his article, "*The Issuance and Payment process of Public debt in Nepal*", has analyzed government should not borrow the public debt to meet even a minor budgetary insufficiency s far as possible. However the government should raise the debt internally if it is imposed to maintain the capital without levying and charging the additional taxations. He further considers the internally raised debt is preferable instead of external debt for strong and sound economic betterment. He has understanding explained the following;

a) Theoretical aspects and principles of issuance of public debt.
b) Action system that has been followed by NRB to collect the debt internally
c) Issuance and payment process of short-term government securities as well as long –term securities.

Khatiwada (1998) in his article "*Public Debt Management and Macro Economic Stability*" deals with monetary implication of public debt. He has found that;

a) Heavy bank borrowing by the government contributed significantly for the expansion of money supply in 1990.
b) Excess monetary expansion, which has indirectly resulted in high rate of inflation and deterioration of current account situation.
c) Public debt has crowed out recourses available for private sector investment.
d) Debt serving resulting to higher budgetary deficit which further contributes to monetary expansion
e) Public debt has high exerted upward pressure on the market rate of interest.

He further analyzes the situation is more alarming as foreign loan in the long term nature is maturing out faster rate and exchange rate of Nepalese rupee is depreciated very fast, multiplying the debt obligation as well as the debt servicing requirements. He further said that as the government falling into domestic debt trapped appears more imminent that falling into the domestic trap and as a averting the former is in the policy domain of the fiscal authorities, a serious rethinking on domestic borrowing has to be made while exercising budgetary numbers.

Upreti (2006) has written the article on Public Newsletter titled "*A Theoretical Discussion on Crowding out Effect of domestic Debt*" that the concept of domestic debt emerged from the concept of deficit financing. A monetarist stated, resources are transferred from one sector to another within the country in domestic debt phenomenon. Indeed, current purchasing power is transferred form the hand of individuals or institutions to the government in process of domestic debt. But, it does not imply any additional resources in the economy. Likewise, in the repayment, internal debt servicing does not act for any reduction in the real resources within the country.

Aryal (2007) has written the article" *The Role of Foreign Aid in Economic Development of Nepal: An Econometric Analysis*" in 52nd anniversary newspaper that foreign aid is significantly playing a positive role to increase the GDP per capita in Nepal. Such a positive role of aid in GDP per capita growth leads to the conclusion that increased foreign aid help to increase the rate of GDP per capita. Therefore foreign aids need to increase in the country. A big amount of aid does not necessarily mean a greater number of foreign aid agreements. Aid agreement could be less in numbers but disbursement has to be higher. He further writes that foreign aid is that recipient has to repay interest as well as principle If the aid is received as loan. More loans are always a big responsibility to recipient country because exchange rate could make the country to repay the loan and its interest in a higher amount in the future.

Dahal (2012), in his article entitled *"Need for public debt management in Nepal."* States that public debt management is the process of establishing and implementing a strategy for prudently managing the government's debt in order to meet government's financing needs efficiently, ensure that government portfolio is managed according to the government's cost and risk objectives and developing and maintain an efficient government security markets.Therefore, until growth rate takes momentum, we should be extremely judicious whileborrowing to finance the budget deficits.

Thapa (2013), in his article entitled *"Domestic Debt Management Analyzed about Public Debt"*. He illustrated that; to manage the government borrowing 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.

Ghimire (2015), in his article *"Public Debt Management: Concept and Practice with special reference to Nepal"*Debt management is framework, system or process through which government collect funding resources to meet the budget deficit. The main goal of debt management is to ensure that the government's financing needs and its payment obligations are met at lowest possible cost over the medium to long term, consistent with a prudent degree of risk.

2.4.2 Thesis Review

Joshi (1998) has submitted a dissertation paper titled "*Structure of Public Debt in Nepal*". In his thesis, he has pictured the poor economic performance of nation, which is due to nation's natural topography and human behavioral limitations. He concludes the internal borrowing is the most essential to develop the money and capital market in the nation and external borrowing is mainly for the rapid economic development. He described the external debt as supplementary tool for the resource gap in the country's budgetary expenditure.

Sharma (2001) in his M.A. thesis entitled "*Public Debt: System and Practice in Nepal*" concluded that government borrowing has been increased unlikely and financed mostly on the unproductive sector and hence government always lacks the resources, then borrows the new loan to pay the previous ones. Reforming the tax and customs policy, reviewing the managerial and bureaucratic system, reducing the ludicrous expenses and principally making the tax and customs administration fair, active and agile, and government may not lack the financial resource henceforth forever.

Bhattarai (2003), in his M.B.S. thesis entitled "*Problems and Prospects of Debt Market Growth in Nepal*" has concluded that there are numbers of problems in due to which the debt securities market of Nepal is not growing smoothly. Mainly the problems are the lack of public awareness, limited supply of quality bonds, investors increasing attraction towards common stocks and also towards the banking sector's securities, difficult process of issuing debenture, insufficiency of legal provisions, infrastructure of capital market, and narrow area of government securities market.

Poudyal (2004) has submitted a dissertation paper titled *"Trend and structure of public debt in Nepal"* has analyzed borrowed fund from external resources produce expectable items and there should be constituted a committee to supervise and narrator and to control unnecessary foreign borrowing. Thus the government should adopt appropriate economic policy. The government should give attention in all sectors of the economy with high economic growth rate by reducing excessive external dependency and internal resource mobilization for the development purpose and the economy will be capable to move in a self-sustaining growth path.

ThapaMagar (2005) has submitted a thesis entitled *"Public debt servicing in Nepal"* states that 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 from 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.

Pandeya (2010) in her thesis *"Public debt situation in Nepal"*analyzed that public debt management is an open market operations carried out by the government in order to change the composition of the outstanding stock of government-issued debt instruments. It focuses only on changes in the composition of the outstanding public debt and takes the size of the public debt as given. The composition of public debt is usually characterized by the outstanding debt's maturity structure and public debt management is mainly concerned with changes in the maturity structure. The aim of public debt management can, e.g., be to minimize the cost of public debt or, as a part of the economic policy making, to control aggregate demand. The basic idea behind public debt management as a tool for economic policy making is the following; in order to induce investors to hold the new mix of government-issued debt instruments, changes in the structure of relative asset yields are necessary.These changes might have attendant effects on, e.g., the firms' cost of capital and the agents' consumption-investment decisions, and accordingly on the real economy. The almost permanent budget deficits in many countries during the last two decades have led to a rapid growth in public debt that has stimulated the interest in public debt management. To finance these deficits many governments have been forced to introduce new types of debt instruments and to deregulate financial markets. The growth in debt and the richer menu of debt instruments have increased the scope for using public debt management as a tool of economic policy making.

Shrestha (2012) in his thesis *"Public Debt Situation in Nepal (its trend, structure and burden)"*reached the conclusion that "Government borrowing has increased rapidly and financed mostly on the unproductive sector and hence government always lacks the resourcesand then borrows the new loan to pay the previous ones". He argued "such 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".

Dhakal (2015) in his thesis *"Debt Management Analysis of Public Debt: The Nepali Evidence"*Nepal is indebted by both internal and external loans. Thus, its proper management has been a challenging task for Nepal. So the government should be responsible to utilize the public debt in productive sector rather than unproductive sectors. The government regulates the better fiscal policy and concern in the proper implementation. Otherwise, Nepal is going to face debt crisis in the future in which debt bearing obligations would become impediments to the balanced management of the economy.

2.5 Research Gap

Research means to investigate or to search again about a phenomenon under study. Very few researchers have been made on topic "Public debt" with its structure, trends and burden. Most of the researcher was conducted regarding system and procedure, problem and prospects of debt growth market etc. Some researcher focus only in internal debt burden and some are for external which can't be covered the all area of public debt and its burden.

This research covers the trends, structure, composition and burden of, both internal and external public debt, where there is research gap since last few years. This study also analyzes the sustainability of Nepal's public debt management. This research has cover all the area of trends, structure, composition, burden and attempt to fulfill the research gap remained in previous year.

CHAPTER – THREE

RESEARCH METHODOLOGY

Research methodology is the plan, structure and strategy of investigation conceived to answer the research question or test the research hypothesis and to control variances (Kerlinger, 1960: 19). 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). It describes the process and methods applied in the entire aspects of the study. Research methodology also refers to various sequential steps adopted by a researcher in studying a problem with certain objectives. 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. To meet the earlier mentioned objectives, the study has used both quantitative and qualitative analysis. The nature of the study is descriptive and the study is based on secondary data.

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 some years (2011/12 to 2017/2018) trend, structure and debt servicing in the public sector are the sample size.

3.3 Sources of Data

This study is based on secondary sources of data and information. The secondary sources of data are those that have been used from published sources or used by someone previously. The main sources of secondary data which are used for this study are economic survey of various years published by ministry of finance (MoF), financial statements published by financial comptroller general office (FCGO), budget speeches, articles published in newspapers and journals, publications of Nepal Rastra Bank (NRB), Central Bureau of Statistics (CBS),International Monetary Fund (IMF), The World Bank, UNCTAD, Asian Development Bank (ADB), dissertation available at the library of central department of Economics and central library of T.U.

Formal and informal talks to the concerned authorities were helpful to obtain the additional information of the related problem.

3.4 Method of Data Analysis

The collected data from various relevant sources is processed according to the need of the chapter. The available data from various documents are collected, classified and tabulated to meet the needs of the study. Some financial and statistical tools such as ratio analysis, average annual growth rate and trend analysis are used for analyzing the data when they are necessary.

3.4.1 Financial Tools

This study is basically based on certain tools such as percentage distribution, ratio, average annual growth rate etc. they are the qualitative tools.

- $\text{Ratio of Pubic Debt to GDP} = \frac{\text{Public Debt}}{\text{GDP}}$
- $\text{Ratio of Revenue Deficit to GDP} = \frac{\text{Revenue Deficit}}{\text{GDP}}$
- $\text{Ratio of Fiscal Deficit to GDP} = \frac{\text{Fiscal Deficit}}{\text{GDP}}$
- $\text{Ratio of Resource Gap to GDP} = \frac{\text{Resource Gap}}{\text{GDP}}$
- $\text{Ratio of External Debt Servicing to GDP} = \frac{\text{External Debt Servicing}}{\text{GDP}}$

It is the relationship between public debt, revenue deficit, fiscal deficit, resource gap, external debt servicing and GDP. GDP is the main indicator of the performance of the economy, which includes different components of the economy, and shows their performance.

- $\text{Ratio of Internal Public Debt to Fiscal Deficit} = \frac{\text{Internal Public Debt}}{\text{Fiscal Deficit}}$

- $\text{Ratio of External Public Debt to Fiscal Deficit} = \frac{\text{External Public Debt}}{\text{Fiscal Deficit}}$

Public debt is the main source for financing fiscal deficit in Nepalese fiscal system. Fiscal deficit is difference between total revenue and expenditure. Government obtained loan from internal source and external source. The relationship between internal debt and external debt to fiscal deficit shows share of internal and external debt in total debt.

- $\text{Ratio of Annual Total Debt Servicing to GDP} = \frac{\text{Total Debt Servicing}}{\text{GDP}}$
- $\text{Ratio of Debt Services to Total Revenue} = \frac{\text{Total Debt Services}}{\text{Total Revenue}}$
- $\text{Ratio of Total Debt Servicing to Total Expenditure} = \frac{\text{Total Servicing}}{\text{Total Expenditure}}$

Ratio of total debt servicing to GDP and total debt servicing to total revenue both indicates the servicing capacity of the government.

- $\text{Ratio of External Debt Servicing to Export Earning} = \frac{\text{External Debt Servicing}}{\text{Export Earning}}$

- $\text{Share of Principle Servicing to Total Debt} = \frac{\text{Principle Servicing}}{\text{Total Debt}}$
- $\text{Share of Interest Servicing to Total Debt} = \frac{\text{Interest Servicing}}{\text{Total Debt}}$

The relationship between total debt and debt servicing shows that payment capacity.

- $\text{Share of Internal Borrowing to Total Debt} = \frac{\text{Internal Borrowing}}{\text{Total Debt}}$
- $\text{Share of External Borrowing to Total Debt} = \frac{\text{External Borrowing}}{\text{Total Debt}}$

The relationship between internal borrowing and external borrowing to total debt shows that the capacity of domestic borrowing.

- $\text{Ratio of Import to GDP} = \frac{\text{Import}}{\text{GDP}}$
- $\text{Ratio of Export to GDP} = \frac{\text{Export}}{\text{GDP}}$
- $\text{Ratio of External Debt Servicing and Export Earning} = \frac{\text{External Debt Servicing}}{\text{Export}}$

Export and import shows the situation of foreign trade. They play the vital role in the economy.

3.4.2 Statistical Tools

1. Means (Average)

A mean is the average value or the sum of all the observations divided by the number of observations and it is denoted and given by formula.

$$\text{The arithmetic average mean } (X) = \frac{x_1 + x_2 + \dots\dots + x_n}{n} = \frac{1}{n}\sum_{i=1}^{n} x_i$$

Where,

x = no. of variables

n = Total no of years

2. Percentage

Different values are converted in terms of hundred means in percentage.

$$\text{Increase or Decrease Percentage} = \frac{\text{Increase or Decrease Number}}{\text{Previous Number}} * 100$$

3. Regression Equation

Regression analysis is also the techniques of studying how the variances are one series are related to variations in other series. It shows that how the variable are related. Thus, it is the estimation of unknown values or prediction of one variable from known values of other variables. So it is the mathematical measure of the average relationship between two or more variables in terms of the original units of the data.

Simple Regression Equation

The regression analysis confined to the study of only two variables at a time is called simple regression. In this regression line are taken as statistical tool:

Regression Equation of Y on X

Let the line of regression be $y = a + bx + cx^2$

By using method of least square, the normal equations are:

$y = \ na + b \ x + c \ x^2$

$xy = a \ x + b \ x^2 + c \ x^3$

$x^2y = a \ x^2 + b \ x^3 + c \ x^4$

Where,

x = given year (From 2011/12 to 2017/18) i.e. 1 to 6.

y = Estimated variables

CHAPTER –FOUR

PRESENTATION AND ANALYIS OF DATA

4.1 Global Context

The Highly Indebted Poor Countries (HIPC) Initiative, launched jointly by the World Bank and the International Monetary Fund in 1996, has highlighted the great relevance that high external debts has for economic performance. The presence of a large indebtedness has different effects on poor countries, not only related to their macroeconomic performance, but also to political and institutional aspects. High debts could undermine the effectiveness of structural reforms aimed to enhance growth and poverty reduction. "The permanent fiscal crisis and the heavy administrative burden due to the number of rescheduling and different creditors (at least 31, in HIPCs) and to the large number of currencies (at least 26) in which debt is denominated can undermine the development of sound institutions, capable of making strategic choices"[Moss and Chiang, 2003]

According to the most widely used debt sustainability indicators like net present value (NPV) as percentage of exports (three year average) or debt service as percentage of current year exports, Nepal is well below critical levels. In terms of debt sustainability indicators, Nepal compares favorably with other selected developing countries of Asia and Africa. The World Bank classifies Nepal as a less indebted country. However, given the narrow base for domestic resource mobilization and exports, it is important to continuously monitor the sustainability of public debt of Nepal - that is, the country's ability to meet its medium and long-term debt obligations. The sustainability of foreign debt approach, and its societal expenses and fiscal gains, depends mainly on the domestic policies which shape the matching part of foreign adjustments process. Any outstanding budget deficit is financed through an issuance of internal or external debt or by monetization. Macroeconomic variables such as inflation, GDP growth, constraints or limitations on issuance of debt implied by persistent creditworthiness and solvency, all impose limitations on every financing technique.

Therefore, debt sustainability is primary requisite for macroeconomic stability and persistent growth of an economy. Usually, high stock of public debt create funds outflow which could crowd out highly required public expenditure. Public debt becomes unsustainable, if it rises persistently as percentage of GDP or if debt servicing starts absorbing the resources of economy. An assessment of public debt sustainability depends upon trend in interest rate, growth rate of economy, revenue and expenditure of government and etc. Sustainability of public debt becomes more important when debt servicing reaches to the level of government revenues.

4.2 Regional Scenario

The macroeconomic circumstance of the overall South Asian Region has been changed considerably over the past decade. Compared with the performance of many other emerging markets, growth performance in South Asian countries have been generally less successful and more volatile, however, the economic performance of the region had improved as growth for the region averaged approximately 7.5 percent, part of which was attributable to the positive trends in the global economy. Moreover, there is general consensus that better macroeconomic policies served to improve the resilience of the region to adverse shocks. It is readily recognized that new debt management practices aimed at improving debt profiles have contributed to reducing macroeconomic vulnerabilities. This has certainly helped to create a more stable environment for growth and investment.

According to the World Economic Outlook published by International Monetary Fund (IMF) in 2018, World Economic Growth was increased by 3.8 percent in 2017 whereas it is projected to increase by 3.9 percent in 2018. During the period, European countries are expected to experience some economic contraction while economic activities in other countries are expected to expand.

The Indian economy which grew by 6.7 percent in 2017, is expected to expand by 7.4 percent in 2018. The Chinese economy which grew by 6.9 percent in 2017, is projected to limit within 6.6 percent in 2018. It is also projected that the economic growth will expand in South Asian countries in 2018 except for Nepal, Bangladesh and Afghanistan. IMF projects that the inflation in developed economies remains at 2.0 percent in 2018, whereas it was 1.7 percent in 2017. Likewise, inflation in emerging and developing economies that was 4.0 percent in 2017 is projected to be 4.6 percent in 2018. Inflation is projected to rise in emerging and developing economies due to the rise in commodity prices including the rise in energy prices. Among the South Asian countries, the inflation in Maldives and Sri Lanka is projected to be minimal in 2018 as compared to that of 2017. The inflation in Bangladesh, Bhutan, Nepal, India and Pakistan is projected to be somewhat higher in 2018 as compared to 2017.

Nepalese economy is estimated to expand by 5.9 percent in the current FY 2017/18. It was 7.4 percent in FY 2016/17. In the current FY, the growth of overall agriculture production is estimated to limit within 2.8 percent mainly because of the paddy production, the major contributor having the share of 20.8 percent of total agriculture production, decreased by 1.5 percent due to unfavorable monsoon and floods in Terai. Due to the improvement in trade and service sector, non-agricultural sector is estimated to expand by 7.1 percent in FY 2017/18. Overall economic activities are oriented towards positive directions as a result of conducive environment in investment due to stable government formed after the election of three tiers of government.

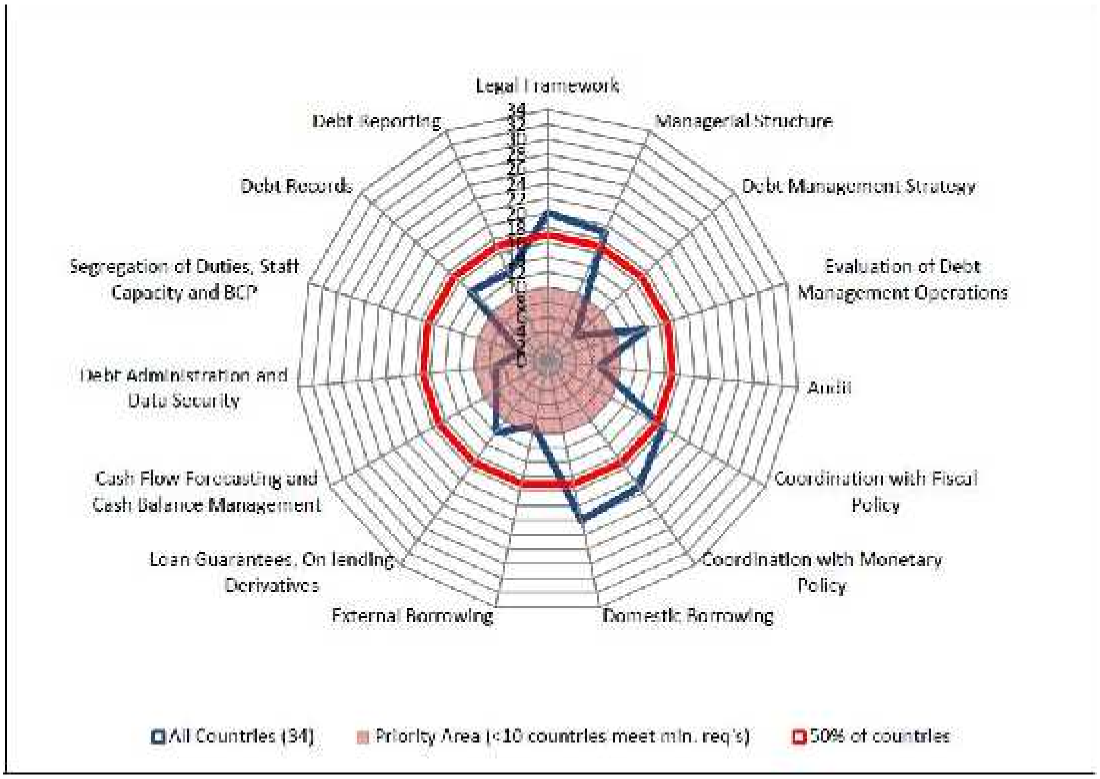
The annual economic growth has remained 4.3 percent on an average in the last decade. In this period, the average annual growth rate of agriculture and nonagricultural sector remained 2.9 percent and 4.9 percent, respectively. 1.7 In the last decade, the contribution of agricultural sector to GDP has decreased annually. In the current FY 2017/18, the respective contribution of agricultural and non-agriculture sectors to GDP is estimated to remain at 27.6 and 72.4 percent. In the FY 2016/17, the contribution of agricultural and non-agriculture sector to GDP was 28.8 percent and 71.2 percent, respectively. Total consumption to GDP ratio which was 88.0 percent in the FY 2016/17, is estimated to shrink by 3.0 percentage point to remain at 85.0 percent in the current FY. Total consumption to GDP ratio averaged 89.1 percent annually in the last ten years. The respective consumption to GDP ratio of government, private sector and non-profit institutions is estimated to be 11.7 percent, 71.6 percent and 1.7 percent in current FY 2017/18.

In the current fiscal year, the share of government and private sector’s consumption to total consumption is estimated to remain at 13.7 percent and 84.3 percent respectively. In the previous year, such shares were 12.9 percent and 85.1 percent respectively. Also, the share of consumption of non-profit institutions to total consumption is estimated to remain at 2.0 percent in the current fiscal year. The food consumption has covered almost two-third of the total private consumption. The share of foodstuff, non-foodstuff and services to total private consumption is estimated to remain at 64.5 percent, 25.5 percent and 10.0 percent respectively in current FY 2017/18. Of private sector consumption, the household consumption has decreased. The gross capital formation (Investment) is estimated to grow by 28.8 percent to reach Rs. 1556.43 billion in the current FY 2017/18. It was increased by 58.3 percent in FY 2016/17. The investment to GDP ratio is estimated to remain at 51.7 percent in current FY 2017/18 as against the 45.7 percent in last fiscal year. In current FY 2017/18, gross fixed capital formation at current prices is estimated to be Rs. 1025.65 billion with 22.0 percent growth. The share of gross fixed capital formation to GDP, which stood at 31.8 percent in previous FY, is estimated to remain at 34.1 percent in FY 2017/18. The share of private and government sectors to gross fixed capital formation is estimated to stand at 77.2 percent and 22.8 percent respectively in the current fiscal year. Such shares were 79.8 percent and 20.2 percent, respectively, in the FY 2016/17. The ratio of gross domestic savings to GDP, which stood at 11.9 percent in FY 2016/17, is estimated to be 15.0 percent with an increase of 3.1 percentage point in the current FY 2017/18. The ratio of gross national savings to GDP that remained at 45.3 percent in the FY 2016/17 is estimated to stand at 43.9 percent in the current FY 2017/18. Over the last decade, the annual average ratio of gross domestic savings and gross national savings to GDP is 10.9 percent and 40.8 percent, respectively, in the FY 2016/17.

4.2.1 Existing Public Debt Scenario

The budgetary situation of the government has remained in deficit for the last four and half decades or so. A part of the deficit is being met through domestic and foreign borrowings. The instruments of domestic borrowing are treasury bills, development bonds, national saving certificates, special certificate and overdraft from the central Bank.

Analysis of Institutional Framework in Developing Countries



Source: The World Bank, WP 5372, 2013

The above analysis is the result of the assessment conducted by the World Bank during November 2010 - December 2012 through a comprehensive set of 15 performance indicators spanning the full range of government debt management functions in 34 countries. It shows that less than 10 countries out of 34 have met the minimum priority area requirements.

4.3 An Overview of Nepalese Economy

Table 4.1

Selected Macroeconomic Indicators

Indicators	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Real GDP at current price (%)	11.7	11.0	15.9	7.94	11.0	15.9	7.94
Rate of inflation (%)	8.3	9.9	9.0	7.2	9.9	9.0	7.2
Total revenue (%)	23.2	21.7	20.5	13.7	21.1	20.5	13.7
Total government expenditure (%)	14.6	5.7	11.4	33	5.7	11.4	33
Revenue/GDP (%)	16	17.5	18.2	19.1	19.1	18.2	19.1
Total government expenditure/GDP (%)	22.2	21.2	20.3	25.1	25.1	20.3	25.1
Foreign grants/GDP (%)	2.7	2.1	2.1	1.8	2.1	1.8	1.8
Budget deficit/GDP (%)	3.4	1.5	0.0	4	1.5	0.0	4
Foreign loan/GDP (%)	0.7	0.7	0.9	1.2	0.7	0.9	1.2
Domestic loan/GDP (%)	2.4	1.1	1.0	2.0	1.1	1.0	2.0
Total outstanding debt (Rs. in Billion)	523.20	545.31	553.50	544.91	545.31	553.50	544.91
Outstanding domestic debt (Rs. in Billion)	214	211.9	206.7	201.7	211.9	206.7	201.7
Outstanding foreign debt (Rs. in Billion)	309.3	333.44	346.81	343.3	333.44	346.81	343.3
Total outstanding debt/GDP (%)	34.3	32.2	28.2	25.7	32.2	28.2	25.7
Outstanding domestic debt/GDP (%)	14.0	12.5	10.5	9.5	12.5	10.5	9.5
Outstanding foreign debt/GDP(%)	20.2	19.7	17.7	16.2	19.7	17.7	16.2

Source: Economic Survey, (MoF)

4.4 Public Debt Situation in Nepal

4.4.1 Public Debt in Government Financing

The public debt has been playing a vital role in the government finance structure of Nepal. Over the years a significant portion of the development expenditures have been financed through the public debt, both domestic and foreign loans. This has been a reliable base for deficit financing in Nepal. Table 4.2 gives a comparative view on the contribution of public debts in meeting the budget deficits. In FY 20010/11 Rs. 46 billion raised through public debts for meeting the capital expenditures and principal repayments. Of which, Rs. 11 billion through external loans and Rs. 36 billion raised through domestic loans. Table 4.2 clearly indicates greater proportion of the domestic loans against the foreign loans during the period from FY 2011/12 to 2017/18. It is expected that this trend will be continued in future. This gives clear evidence that public debt will be a critical component in financing the government expenditures in future.

Table 4.2

Sources of Financing for Capital Expenditures and Principal Repayment

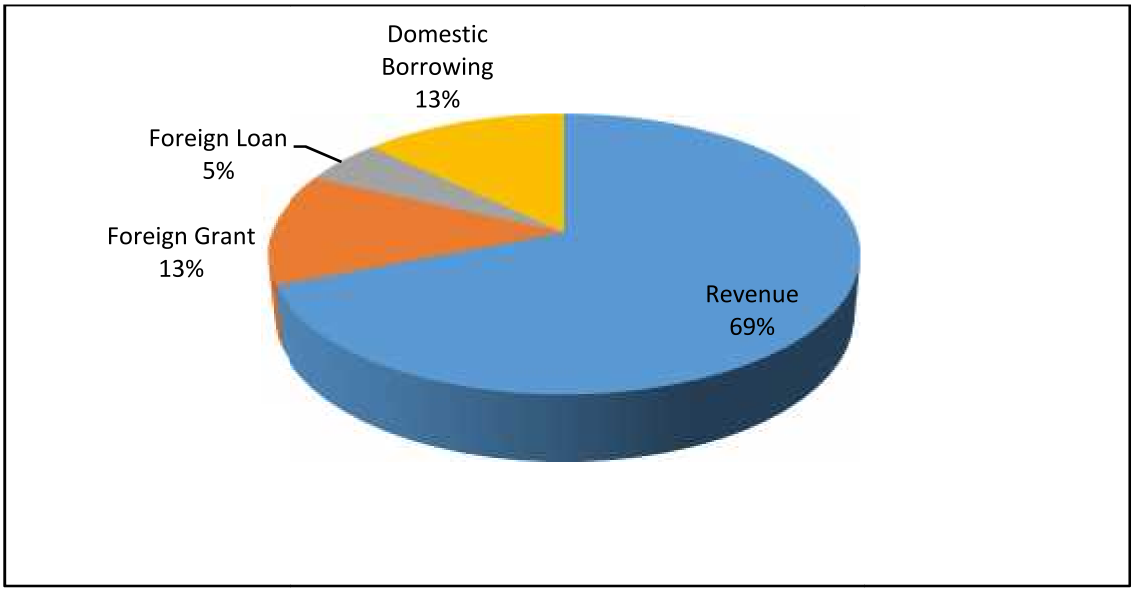
Rs. In billions

S.N.	Sources of Finance	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
1	Revenue	205	256	356	405	481	609	730
2	Foreign Grant	26	38	33	36	32	31	25
3	Deficit Financing	(49)	(41)	(49)	(51)	(24)	(82)	(218)
3.1	Foreign Loan	11.08	11.96	17.91	25.61	39.59	59.02	51.03
3.2	Domestic Borrowing	36	19	19	42	87	88	94
3.3	Changes in Reserves	22	1	(5)	(4)	(6)	0	(18)

Source: Financial Statements (FCGO)

Figure 4.1

Sources of Financing



4.4.2 Composition of Public Debt Disbursement

Table 4.3

Composition of Pubic Debt Disbursement

(Rs. In billions)

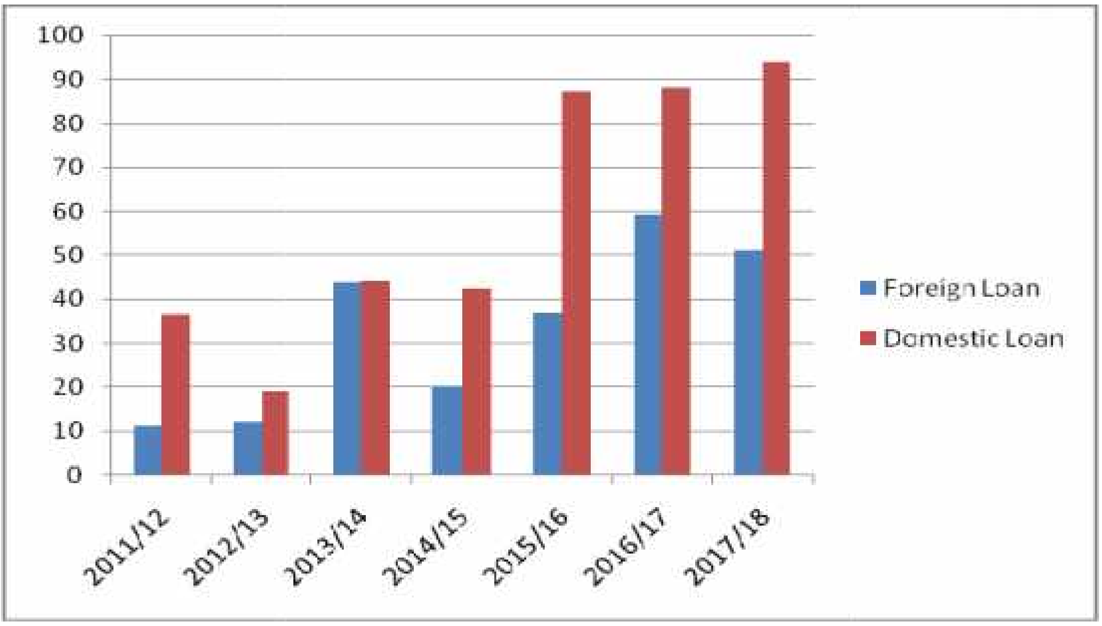
Financial Year	Foreign Loan	Proportion	Domestic Loan	Proportion	Total
2011/12	11.083	23.33%	36.418	76.66%	47.501
2012/13	11.969	38.60%	19.042	61.40%	31.011
2013/14	43.700	49.83%	44.000	50.17%	87.700
2014/15	20	32.04%	42.41	67.96%	62.42
2015/16	36.59	29.61%	87	70.39%	123.59
2016/17	59.02	40.15%	88	59.85%	147.02
2017/18	51.03	35.19%	94	64.81%	145.03

Source: Financial Statements (FCGO)

The composition of public debt consists of both the domestic and foreign borrowings. Of which the proportion of domestic borrowing has remained higher as compared to foreign borrowing over the years (Table 4.3). Domestic borrowings represented above 50 percent of the total borrowings between FY 2011/12 to FY 2017/18.

Figure 4.2

Composition of Public Debt



4.4.3 Composition of Foreign Debt Liability

Of the total foreign debt liability, larger portions are through multilateral borrowings. Table 4.4 presents a comparative situation on the composition of foreign debt liability. In FY 2011/12, of the total foreign debt liability, about 90 percent were received through multilateral and only about 10 percent were received from bilateral donors. But in 2011/12 the portions of multilateral borrowings is about 92 percent and bilateral is about 8 percent and it is about 91 percent average in FY 2012/13,2013/14,2014/15 and 2016/17 multilateral and 10 percent bilateral. The key multilateral donors providing external loan were ADB, IDA, OPEC, EEC, IFAD and NDF. While the key bilateral donors providing external loan were Japan, Kuwait Fund, Saudi Fund, France, Russia, Belgium, India, South Korea, Austria and China.

Table 4.4

Composition of Foreign Debt Liability

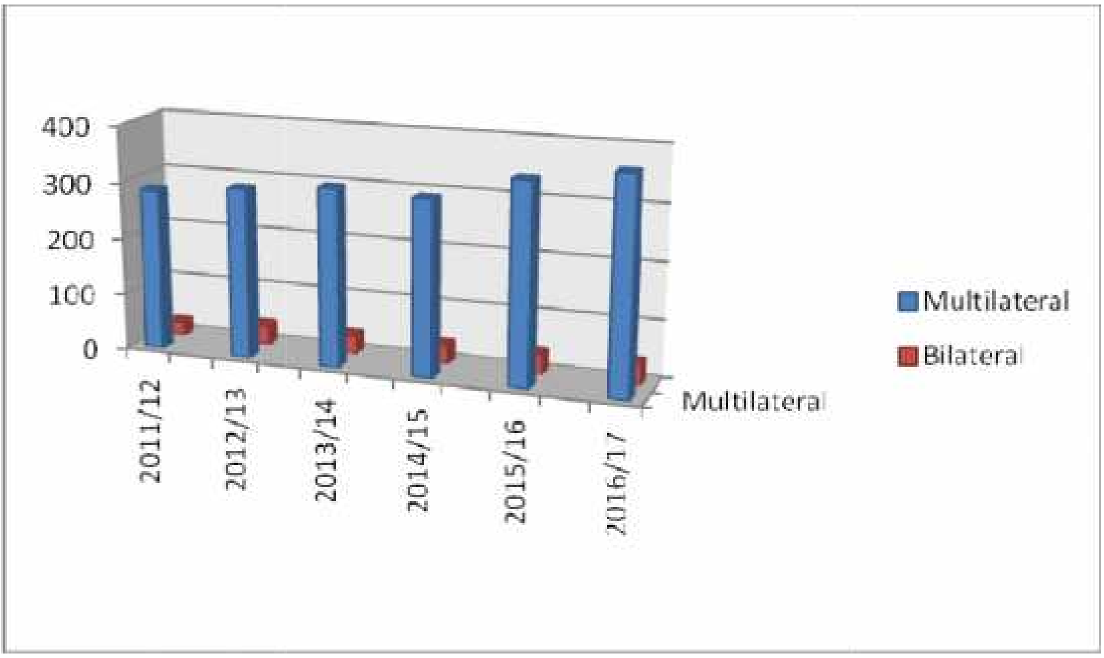
(Rs. In billions)

Financial Year	**Multilateral**	**Bilateral**	**Total Foreign Debt Liability**
2011/12	285 (92.25%)	24 (7.75%)	309.30
2012/13	299.29 (90.97%)	34.14 (9.03%)	333.44
2013/14	313.59 (90.5%)	33.22 (9.5%)	346.81
2014/15	308.91 (90%)	34.34 (10%)	343.26
2015/16	352.50 (90.68%)	36.25 (9.32%)	388.76
2016/17	375.99 90.82%	37.98 9.18%	413.97

Source: Financial Statements (FCGO)

Figure 4.3

Composition of Foreign Debt Liability



4.4.4 Composition of Domestic Debt Liability

Of the total outstanding domestic debt liability development bonds treasury bills consist of the highest proportion (57%) followed by treasury bills (38%), national savings certificates (0.31%), citizen saving certificates (2.8%) and others (2%). This clearly shows excessive dependence on treasury bills and to some extent development bonds in the domestic borrowing markets (Table 4.5). Other types of domestic debt instruments are not found to be saleable in the markets.

Table 4.5

Composition of Domestic Debt Liability

Rs. In millions

S.N	Type of Bonds	Outstanding Liability	Percentage
1	Treasury Bills	110409	38.91
2	Development Bonds (of the total)	163900	57.77
3	National saving certificates	906	0.31
4	Citizen Saving Certificates	7965	2.80
5	Foreign Employment Saving Certificates	529	0.18
Total		184128	100

Source: Financial Statements (FCGO)

4.5 Trend and Structure of Public Debt in Nepal

Nepal has been borrowing new fresh loan mainly to balance her deficit budget however other causes may exists with it. It is applied for the maintenance of the balance between the expenditure and revenue. It is also applied for financing economic development since under developed countries always face the problems of funds which is reflected in large extents as ever increasing financial resource gap in the government budgetary.

While talking about fiscal policy of Nepal, Nepal has suffering the huge fiscal and budget deficit since many years. Government expenditure is increasing rapidly but revenue is not increasing in the same pace. This indicates, Nepal is facing the problem of ever increasing resource gap year by year. To fulfill this resource gap, Nepal had been borrowing external and internal loan. But Nepal's debt servicing capacity has not increasing in the expected pace. So, burden of public debt has been increasing and became a burning issue of Nepal.

For this reason, we have studied about the topic of Trend and Structure of Public Debt in Nepal to analysis and show the situation of public debt in Nepal and propose some recommendations.

4.5.1. Government Borrowing and Annual Growth Rate

Table 4.6

Government Borrowing and Annual Growth Rate

Rs. In billions

Fiscal Year	Total Debt (1)	External Debt (2)	Internal Debt(3)	(2) as % of (1)	(3) as % of (1)
2008/09	28.385	9.968	18.417	35.12	64.88
2009/10	41.137	11.223	29.914	27.28	72.72
2010/11	54.590	12.075	42.515	22.12	77.88
2011/12	47.502	11.083	36.419	23.33	76.67
2012/13	31.012	11.969	19.043	38.59	61.41
2013/14	87.700	43.700	44.000	49.83	50.17
2014/15	54.48	34.32	20.16	62.99	37.01
2015/16	62.21	38.79	23.41	62.35	37.65
2016/17	69.68	41.31	28.37	62.99	37.01
2017/18	84.28	45.46	38.82	59.28	41.71
Annual Average Growth Rate	10.88	15.17	7.45	5.23	-4.41

Source: Economic Survey (MoF)

After the restoration of multiparty system, the scope of government has been increasing and investing more from 1990, so the government expenditure is increasing. The reliance on taxation is not possible in view of the large amount financial resources required for government expenditure due to the administration is not fair, and transparent. So Nepal is facing large and growing financial resource gap in the government budgetary. In this context, the government borrowing both external and internal needs for supplements this resource gap. The government has to borrow large amount of loans to meet the fiscal deficit, which is shown on Table 4.6.

Table 4.6 shows that government borrowing and annual growth rate of external and internal debt to total debt. As table shows that trends of total government borrowing is fluctuating. Total government borrowing has increased from Rs.28.38 billion in 2008/09 to Rs.84.28 billion in 2017/18.

In 2008/09, Total government borrowing is Rs. 28.38 billion and has increased in 2009/10 and decreased in 2013/14. In 2011/12 the total debt is Rs. 47.50 billion and its is increased in 2009/10 an decreased in 2011/12 and 2012/13 again decreased to Rs.31.012 billion and start increasing and reached to Rs. 84.28 in 2017/18.Similarly external borrowing and internal borrowing is in fluctuating trend.

Thus these trend clearly shows that the government borrowing is increasing in both absolute and relative terms and also shows that the increasing reliance on external borrowing and internal borrowing.

Figure 4.4

Trend of Total, External, Internal Debt

Figure 4.5

Trend of Total Debt

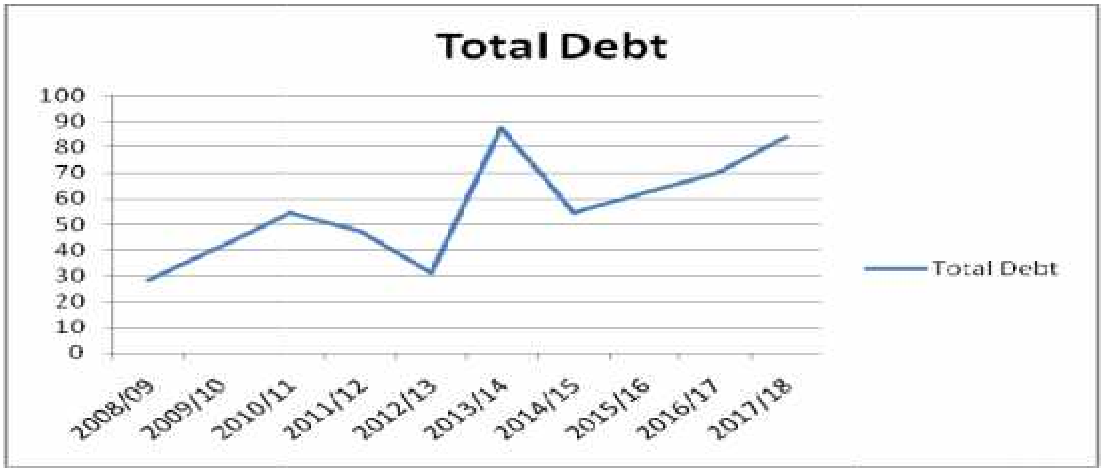


Figure 4.2 shows that the trend of Total Debt is in increasing trend.

4.5.2 Financing of Fiscal Deficit

Public debt has been the main source for financing fiscal deficit in Nepalese fiscal system. Although for financing of fiscal deficit both internal and external sources of borrowing have been adopted in any underdeveloped economy. The total public debt has been increasing rapidly since the restoration of multiparty system for meeting the requirement of fiscal deficit.

Table 4.7 indicates the increasing trend of public debt from both internal and external sources, which was Rs. 33 billion and has increased to Rs. 87 billion under the period of study. The table shows that the increasing trend of public debt in which the increasing trend of external debt is so rapidly then internal debt till 20015/16. But total debt was decreased from 2012/13 due to the decreasing tendency of external debt which was Rs. 47.502 billion in 2011/12 has to decrease to Rs. 31.012 billion by 2013/14.

Table 4.7

Internal and External Debt as Percent of Fiscal Deficit

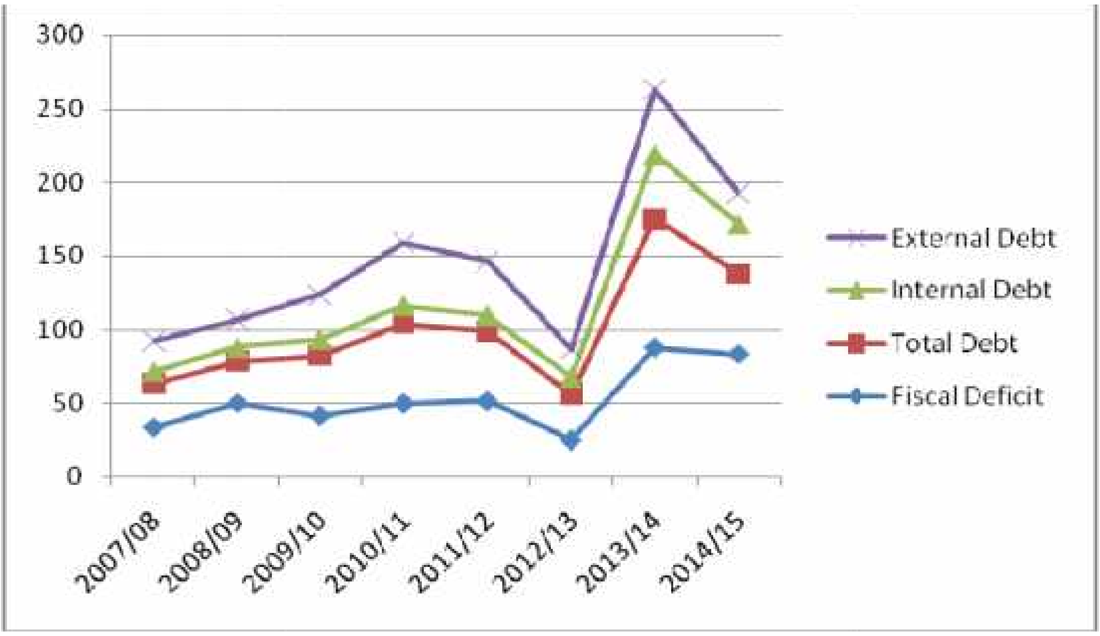
Rs. In billions

Fiscal Year	Fiscal Deficit (1)	Total Debt (2)	Internal Debt(3)	External Debt (3)	(2) as % of (1)	(3) as % of (1)
2007/08	33.406	29.475	8.979	20.496	61.35	88.23
2008/09	49.804	28.385	9.968	18.417	36.98	56.99
2009/10	41.197	41.137	11.223	29.914	72.61	99.85
2010/11	49.622	54.590	12.075	42.515	85.68	110.01
2011/12	51.184	47.502	11.083	36.419	71.15	92.81
2012/13	24.710	31.012	11.969	19.043	77.07	125.5
2013/14	87.700	87.700	43.700	44.000	50.17	100
2014/15	83.22	54.49	34.33	20.43	65.47	41.25
Annual Average Growth Rate	16.51	17.75	23.36	13.72	-2.4	1.06

Source: Economic Survey (MoF)

Figure 4.6

Trend of Fiscal Deficit, Total Debt, Internal Debt, External Debt



4.5.3 Different Scenarios of Resource Gap

Table 4.8

Different Scenarios of Resource Gap

Rs. In billions

Fiscal Year	Govt. Revenue (1)	Govt. Expenses (2)	Revenue Deficit (1-2)	Foreign Grants (3)	Fiscal Deficit
2009/10	179.945	259.689	79.744	38.545	41.197
2010/11	198.346	295.363	97.017	45.922	49.622
2011/12	244.374	339.167	94.793	40.810	51.184
2012/13	296.021	358.630	62.609	35.229	24.710
2013/14	354.500	517.240	162.74	69.536	87.700
2014/15	450.41	531.55	81.14	36.374	83.22
2015/16	481.96	601.01	119.05	32.47	72.72
2016/17	609.17	837.24	81.14	31.93	184.38
2017/18	730.10	1083.0	353.10	25.21	47.65
Average Annual Growth Rate	15.56	15.88	16.53	-4.71	1.61

Source: Economic Survey (MoF)

Table 4.8, the first scenario shows the revenue deficit, in which we can see, the increasing tendency which is Rs. 79.74 billion in 2009/10 and increased up to Rs. 353.10 billion in 2017/18.

The growth rate of total expenditure during the period under review has been 15.88 percent per annum where as the annual growth rate of total revenue as been 15.56 percent. It shows that the growth rate of revenue is less than expenditure but in absolute term the table show the horrible increment of revenue deficit that was increased from Rs. 79.74 billion in 2009/10 to Rs. 353 billion in 2017/18 and the average annual growth rate is 16.53 percent.

The second scenario shows the type of resource gap or fiscal deficit by including grants but the result even in this case is not also encouraging. Grant is the most potential source of foreign currency, which is solid instrument for government to import the capital goods and to pay the interest and principle of external debt.

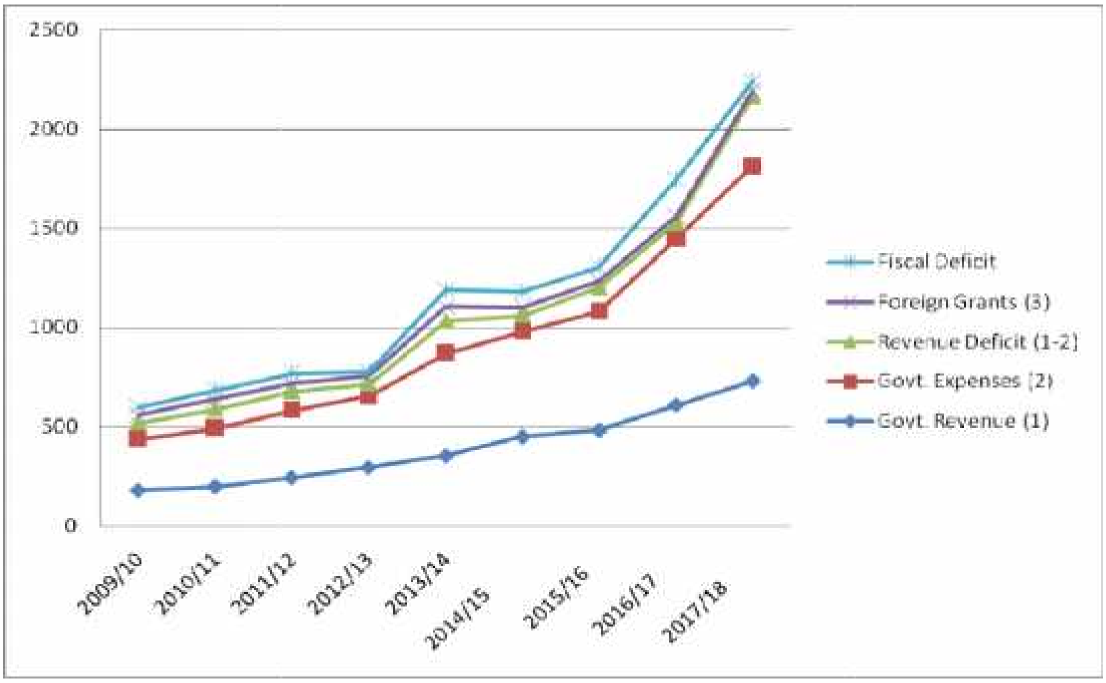
Foreign grants is not increasing in the desirable pace as it predicts, where Rs. 38.54 billion in 2011/12 to Rs. 25.21 billion in 2017/18. The average annual growth rate of fiscal deficit has 1.61.

During the review period, amount if bilateral and multilateral loans has increased tremendously which has created some sort if constraint in the performance of economy as a whole.

The inclusion of grant in government revenue may not be appropriate because the amount depends upon political consideration of friendly countries, which may have been fluctuating character because it is determining factors of various natures. Even then the amount included here, as it does not require repayment and therefore it may be taken as good as revenue

Figure 4.7

Trend of Government Revenue, Expenditure, Revenue Deficit, Foreign Grants



4.5.4 Outstanding of Public Debt in Nepal

The trend of ever growing fiscal deficit, the government has to borrow large amount of public debt to meet ever increasing financial resource gap. Usually public debt is used for the fulfillment of the government budgetary expenditure, but in case of

Nepal it is the main and reliable resources of meeting the government expenditure over from the years. So the volume of outstanding public debt has been increasing.

Table 4.9 shows clearly about the net outstanding public debt in Nepal, under the review of study.

Table4.9

Outstanding of Public Debt

Rs. In billions

Fiscal Year	Total outs. Debt (1)	External Outs. Debt (2)	Internal Outs. Debt (3)	(2) as % of (1)	(3) as % of (1)
2010/11	443.8	259.6	184.2	58.49	41.51
2011/12	523.3	309.3	214.0	59.11	40.89
2012/13	545.31	333.4	211.9	60.21	39.79
2013/14	553.50	346.81	206.7	61.05	38.95
2014/15	544.91	343.26	201.65	62.99	37.05
2015/16	622.10	388.0	234.20	62.36	37.63
2016/17	696.90	413.2	283.7	59.26	40.70
2017/18*	842.90	454.6	388.3	53.93	46.06
Average annual growth rate	8.01	7.03	9.32	-1.01	1.3

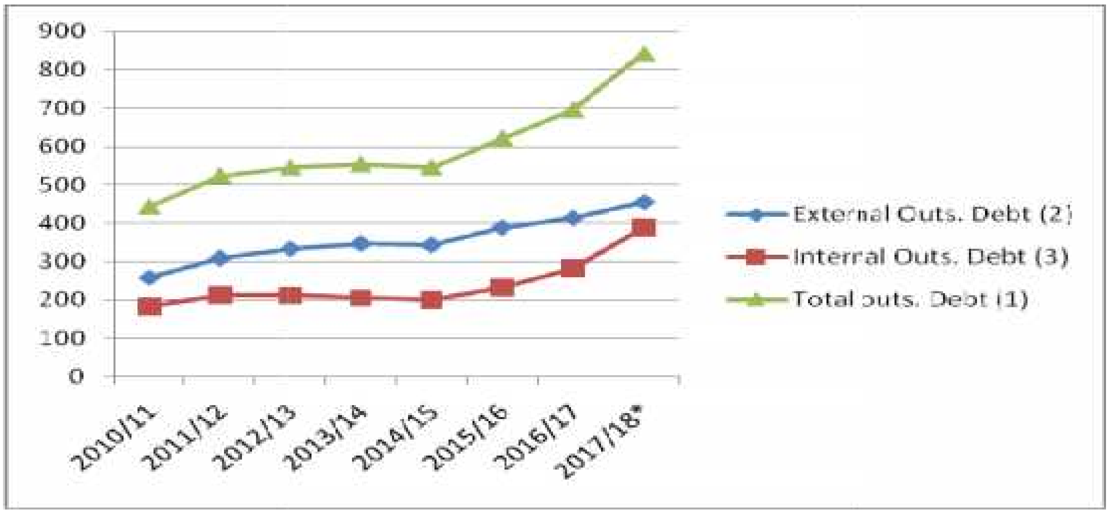
Source: Economic Survey (MoF)

The above table 4.9 seems as an elaboration of debt burden of Nepal in which the total outstanding public debt of Government of Nepal has increased from Rs. 443 billion in 2010/11 to Rs. 842 billion in 2017/18 with the rate of growth of 8.01 percent per annum. This trend of net outstanding public debt shows that we must sacrifice the volume of four annual budgets to get rid of the debt, but in reality I think it is impossible to do so.

Table 4.9 shows that the outstanding external loan has increased from Rs. 359 billion to Rs. 554.6 billion under the review period. It also shows that the average annual growth rate of outstanding external and internal debt, which are 7.03 and 11.76 percent respectively. This shows the trend of increasing outstanding of internal debt is higher than external.

Figure 4.8

Trend of Total Outstanding, External Outstanding, Internal Outstanding Debt



4.5.5 Resource Gap as Percentage of GDP

Table 4.10 reveals that the revenue deficit as percent of GDP and fiscal deficit as percent of GDP.

Table 4.10
Resources Gap as Percentage of GDP

Rs. In billions

Fiscal Year	GDP	Revenue Deficit	Fiscal Deficit	Revenue Deficit as % of GDP	Fiscal Deficit as % of GDP
2009/10	565.8	79.744	41.197	14.09	7.28
2010/11	587.5	97.017	49.622	16.51	8.45
2011/12	614.6	94.793	51.184	15.42	8.33
2012/13	635.9	62.609	24.710	9.85	3.89
2013/14	668.7	162.74	87.700	24.34	13.11
2014/15	694.3	81.14	83.22	10.64	10.92
2015/16	695.7	119.05	72.72	17.11	10.45
2016/17	747.10	81.14	184.38	10.86	24.67
2017/18	791.10	353.10	47.65	44.63	6.02
Average Annual Growth Rate	4.18	18.59	1.81	14.41	-2.3

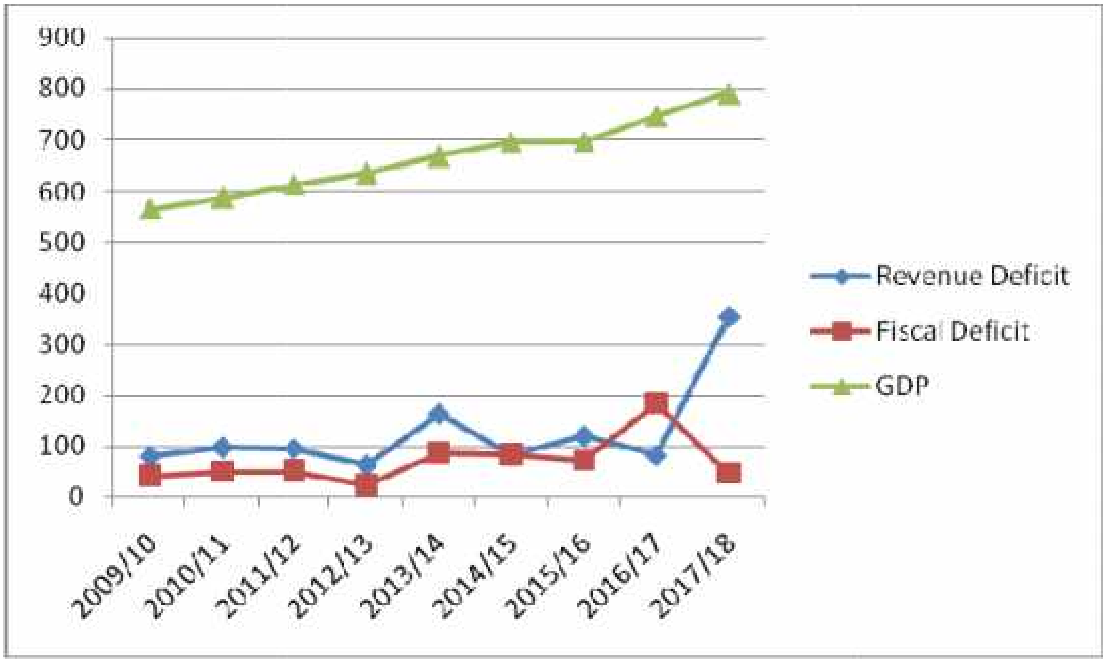
Source: Economic Survey (MoF)

To analyze the revenue deficit as percent of GDP is more important that the GDP is the main indicator of the performance of the economy, which includes different components of the economy, and shows their performance. In this context, revenue deficit as percent of GDP has increased in early years and decreased trend in 2012/13. But in 2014/15 it is increased. And average annual rate is 16.5 percent.

The fiscal deficit as percent of GDP, which has included grants, is also decrease. The inclusion of grants in government's revenue may not be appropriate because the amount of grant depends upon political consideration of friendly countries, which may have been fluctuation character. Because then the amount of grant is included here, as it doesn't require repayment and therefore, it may be taken as good as revenue.

Figure 4.9

Trend of GDP, Revenue Deficit, Fiscal Deficit



4.5.6 Source of Internal Borrowing

The government can borrow internal debt from banking and non-banking sources. Borrowing form banking system may be inflationary in which the government borrows from NRB and other banks and borrowing from non-banking sources is not being inflationary in which the government can borrow from except banking system like people.

Table 4.11 shows the sources of internal borrowing form banking and non-banking system and also amount of internal outstanding debt.

Table 4.11

Sources of Internal Borrowing from Banking and Non-Banking System

In Billion

Fiscal Year	Total Internal Borrowing (1)	Banking System (2)	Non-Banking System (3)	(2) as % of (1)	(3) as % of (1)
2012/13	211.9	149.482	62.41	69.85	37.59
2013/14	206.7	154.082	52.61	72.71	47.39
2014/15	201.65	156.633	45.17	75.77	54.83
2015/16	234.20	164.482	69.17	81.56	30.83
2016/17	283.7	210.01	73.06	65.53	34.47
2017/18	388.3	301.633	87.29	77.57	22.43

Table 4.11 shows that the source of internal borrowing from banking and non-banking system. In which the percentage share of banking system to total internal borrowing has increased from Rs. 149 billion in 2012/13 to 301.6 billion in 2017/18 where the share of percentage has changed from 69 percent to 77 percent. This shows slightly increasing trend. Share of non-banking system to total internal borrowing has also increased from Rs. 62 billion in 2012/13 to Rs. 87 billion in 2017/18.

4.5.7 Structure of Internal Net Outstanding Debt in Nepal

Nepal has carried out internal borrowing program since four decades. It is used for to meet the resources gap on the budgetary system and mobilizing financial resources for development.

Now the government mobilizes the internal borrowings by issuing mainly treasury bills, development bonds, national special certificate and special bonds which is shown in Table 4.12

Table 4.12

Structure of Internal Net Outstanding Debt

Rs. In Billion

Fiscal Year	Total Internal Outs. Debt	Development Bonds	Treasury Bills	National Saving	Special Certificate	Citizen Saving
2010/11	184.2	19.1771	74.4453	1.5169	7.2457	1.3910
2011/12	214.0	21.7354	85.0330	1.1169	5.1398	3.0144
2012/13	211.9	29.4785	86.5151	0.2169	5.0300	4.4336
2013/14	206.7	35.5194	102.0437	0	5.3697	5.1269
2014/15	201.65	43.5194	120.3407	10.6800	5.0291	4.6365
2015/16	234.20	57.5195	136.241	15.6801	5.0287	4.1390
2016/17	283.7	51.6109	136.4681	15.6800	13.3455	3.2427
2017/18	388.3	163	110.40	0.90	0.0	7.96
Average Annual Growth Rate	9.82	26.7	4.92	-6.52	8.72	21.20

Source: Nepal Rastra Bank

Table 4.12 shows the structure of internal net outstanding debt in which the government mainly mobilizes the internal resources by five sources. Where the contribution of treasury bill is larger. But the average annual growth rate of development bond is larger than others which is 26.7 percent.

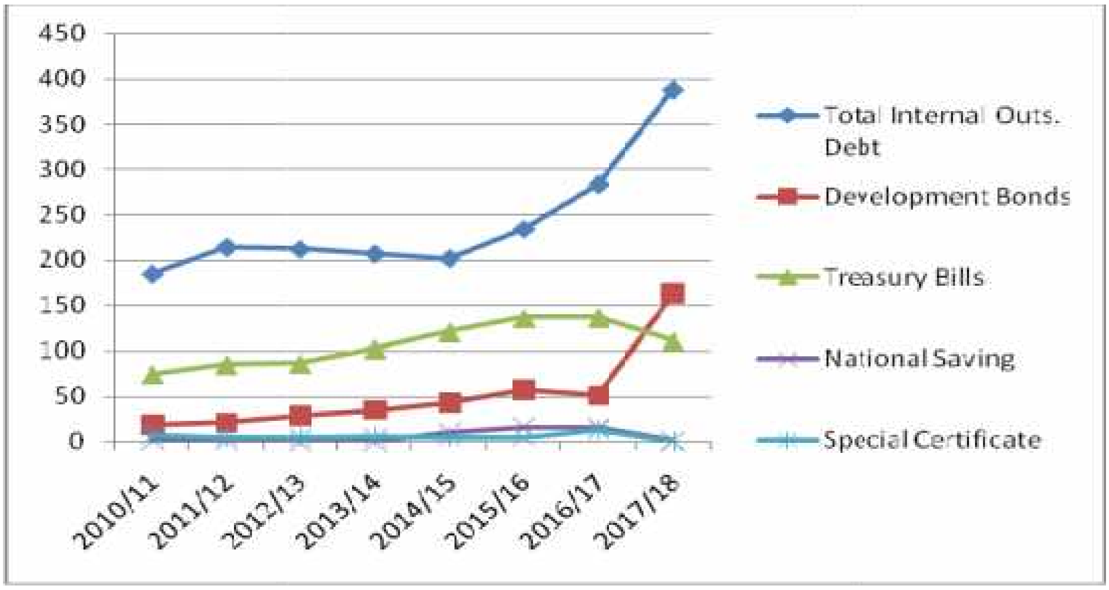
After the enforcement of Public Debt Act 1960, internal debt for the first time was issued Nepal in 1962 through treasury bills amounting to Rs. 7million. The next instrument of internal debt as development bond was first issued in FY 1963/64, amounting to Rs. 250 million.

Table 4.12 shows the share of treasury bills, development bonds, national saving, special saving certificate and citizen saving certificate to total outstanding net internal debtwhich has been increasing ever the review of this study.

We can reach the conclusion by above table that the volume of internal borrowing is increasing without increase in tax revenue collection proportionate the growth in the government expenditure. This action also will create the inflationary situation, which may lead us into debt crisis in future.

Figure 4.10

Trend of Internal Net Outstanding Debt



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

Nepal's first experience of foreign economic assistance was heralded by the POINT FOUR- program agreement signed on 23 Jan. 1951. In which the U.S. Government's assistance of Rs. 22 thousands was provided. But Nepal has started to borrow foreign loan since 1964/65. The foreign assistance grants and loans are the major source of foreign currency for Nepal.

Nepal has borrowed the external loan through bilateral and multilateral sources. Bilateral loans are loans from government and their agencies, loans from, autonomous bodies and direct loans from official expert credit agencies. Multilateral loans are loans and credits from multilateral agencies as World Bank, IMF, Regional Development Banks and other multinational and intergovernmental agencies. Now, we have the burden of Rs 454.6 billion in 2017/18 of foreign loan.

Table 4.13

Structure of External Debt in Terms of Disbursement by Major Sources

Rs. In Billion

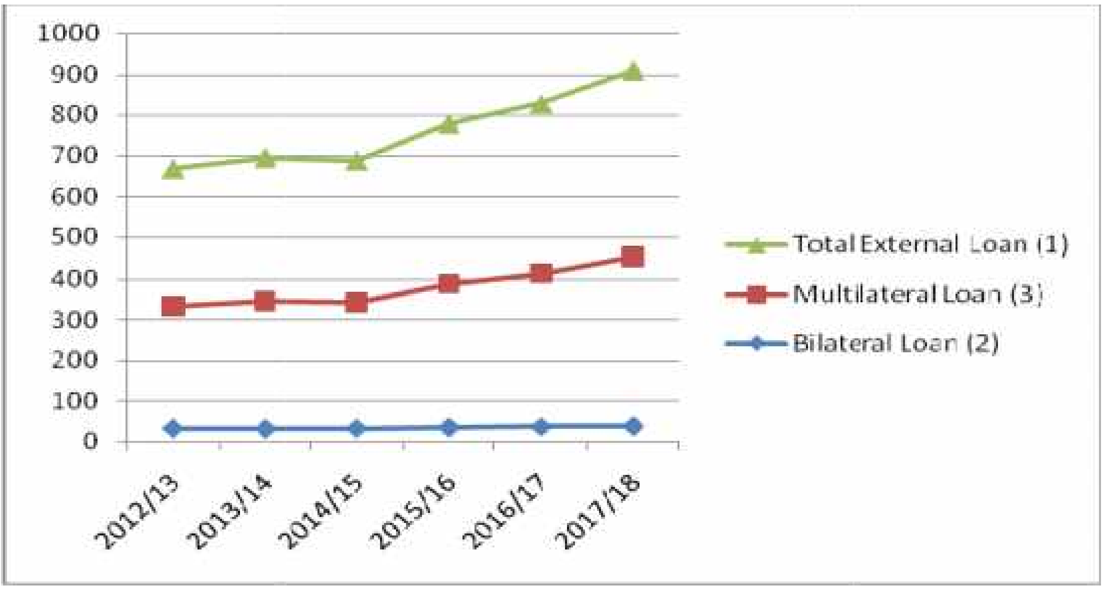
Fiscal Year	Total External Loan (1)	Bilateral Loan (2)	Multilateral Loan (3)	(2) as % of (1)	(3) as % of (1)
2012/13	333.44	34.14	299.29	10.23	89.77
2013/14	346.81	33.22	313.59	9.57	90.43
2014/15	343.46	34.34	308.91	9.99	90.1
2015/16	388.76	36.25	352.50	9.32	89.68
2016/17	413.97	37.98	375.99	9.1	90.9
2017/18	454.6	39.54	415.06	8.69	91.31
Average Annual Growth Rate	5.16	2.44	5.45	-2.7	0.28

Source: Economic Survey (MoF)

Looking at table 4.13, we can see the decreasing trend of bilateral loans and increasing trend of multilateral loans under the review period. The trend of bilateral loan is very fluctuating in some it decreased to zero. But multilateral loan is in increasing in trend.

Figure 4.11

Trend of Multilateral and Bilateral Debt



4.6 Burden of Public Debt in Nepal

4.6.1 Introduction

The burden of public debt refers to the sacrifice it will impose on the community through a rise in taxation, necessitated at the time of repayment and for paying the annual interests in the government loans. In other words, it refers every government is bound to repay the public borrowing whether internally or externally with interest. This it may tend to fall either on the present or sometimes of the future generation.

Burden of public debt can be divided into two parts: (i) internal burden of public debt (ii) external burden of public debt. The internal means that the greater part of the debt is held internally. Dalton (1949) takes internal public debt impact 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) points out, the internal debt may not have any direct money impact 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 tax payer belong to different income groups; the changes in the distribution of income among different section of the community may take place.

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

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

In case of shifting the impact of public debt to the future generation, there is always debate among the economists, some of the economists have viewed if the present generation reduces its saving in order to meet the debt finance and leaves a smaller amount of capital resources for the future, this will reduce the productive capacity of the coming generations and they will accordingly lose. In this way, impact of public debt may pass on to the future generation. But on the other hand, some economists have challenged the above version and opposite opinion on the subject of impact of public debt. They submit that here is no shift of the basic impact to the future generation because the state posterity, which pays the additional taxes, will be benefited from the repayment of the debt

Through above discussion, we can say that it is difficult to conclude a specific opinion in the issue. Thus, the question of shifting the burden of public debt to the future generation has remained an unsettled riddle so far.

In case of Nepal, outstanding of public debt is increasing rapidly each year that which become -67.0 percent of GDP. Large scale of public debts have been incurred in the pas for financing development programs, but debt servicing capacity has not increasing in the same pace so that there may be undue strain in the balance of payment owing to outflow of funds through debt services. Nepal has been borrowing new fresh loans to repayment old loans. This also has alarmed the situation of 'debt trap' in the future.

Here, this chapter has analyses the issue related to debt servicing and macro-economic indicators, burden of debt to GDP, investment saving gap etc.

4.6.2 Outstanding Total Debt

Nepal has to borrow huge amount of external as well as internal loans for meeting the deficit budget. And on the other hand, the tax revenue and no tax revenue are not increasing as it predicts and improper utilization of public debt and corruption, debt servicing capacity is not increasing so that impact of debt through the method of measure of impact of debt as the ratio of public debt to GDP.

Table 4.14

Outstanding Total Debt

Rs in billions

Fiscal Year	Total Public Debt Outs. (1)	External Debt outs. (2)	Internal Debt outs. (3)	Bilateral	Multilateral
2012/13	545.0	333.0	211.0	34.14	299
2013/14	553.50	346.81	206.68	33.22	313.59
2014/15	544.91	343.26	201.65	34.34	308.91
2015/16	627.78	388.76	239.02	36.25	352.50
2016/17	697.68	413.97	283.71	37.98	375.99
Annual increasing Decreasing Percent	4.23	1.5	-1.55	15.21	11.13

Source: Economic Survey (MoF)

Up to fiscal year 2016/17, total outstanding debt is NPR. 697,689.44 million and it was NPR 627,789.20 million in previous fiscal year. In this Fiscal year, total outstanding debt is increased by 11.13 percent compared to previous year's outstanding debt. Out of the total outstanding debt, internal debt is NPR283,710.64 million and external debt is NPR. 413,978.80 million. Proportion of internal and external debt is 41 percent and 59 percent respectively and among the total outstanding external debt, bilateral debt is 9.18 percent and multilateral debt is 90.82 percent.

Table 4.15

Donor Wise Outstanding External Debt

Npr. Million

Debt	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17**
Bilateral	**34146.67**	**33224.98**	**34346.92**	**36255.38**	**37982.6**
Austria	180.51	161.27	113.21	94.4	67.72
Belgium	1293.89	1260.26	113.21	943.94	849.06
China	4367.03	4846.47	982.4	8604.85	7987.9
France	1551.31	1242.87	9731.18	615.17	493.8
India	5014.84	4803.87	748.43	6204.23	7204.89
Japan	15086	13786.72	5605.35	12839.47	14440.96
Korea	5525.54	6086.72	11472.21	6204	5736.02
Kuwit	279.67	258.35	5708	12839	232.19
Russia	105.49	106.48	229.07	6014	0
Saudi	742.38	672.22	118.37	216.47	970.06
Multilateral	**299294.84**	**313594.12**	**308914.84**	**352507.4**	**375996.2**
ADB	143814.53	146560.04	140834.95	155907.34	160727.52
EEC	439.07	442.28	363.42	343.15	310.11
IDA	143262.27	154232.65	155310.87	182798.11	200455.57
IFAD	6956.69	7087.12	6928.17	7590.2	7635.37
NDF	2432.25	2618.15	2268.66	2326.55	2204.26
OFID	2390.05	2653.89	3208.75	3542.55	4575.98
TOTAL	**333,441.52**	**346,819.10**	**343261.76**	**388762.79**	**413.978.80**

Out of the total outstanding external debt, major portion of debt is received from International Development Association (IDA) followed by Asian Development Bank (ADB) and Japan which covers about 90 percent of total external debt. This table shows the multilateral debt is increasing trend.

4.6.3 Major Economic Indicator with GDP

Table 4.16

Ratio of major Economic indicators with GDP

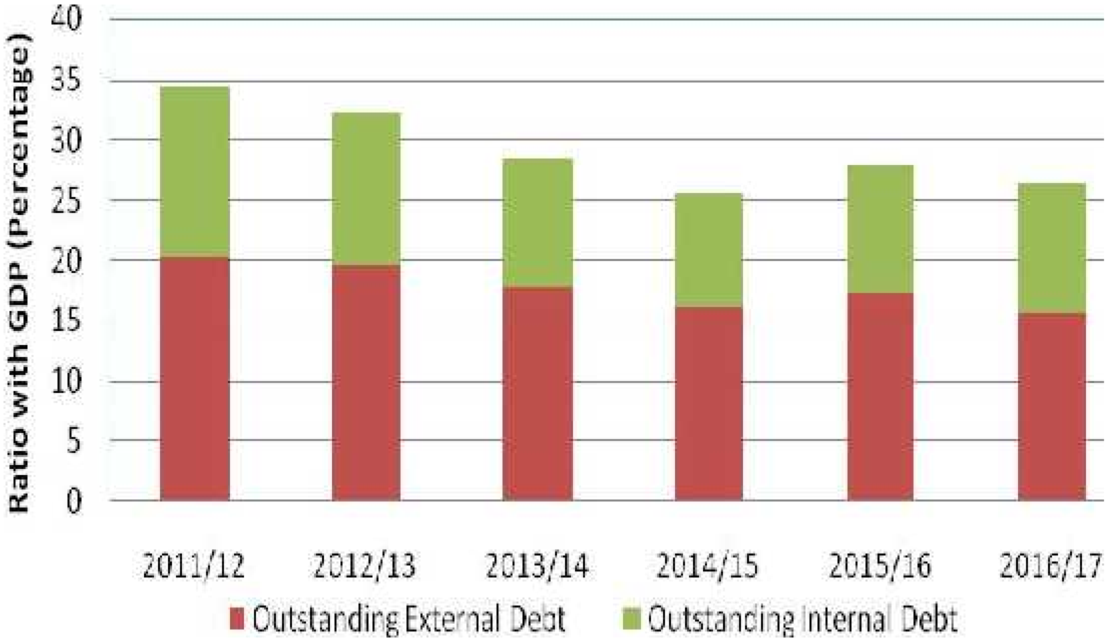
Figure in Percentage

Particulars	2012/13	2013/14	2014/15	2015/16	2016/17
Expenditure	21.16	22.41	25.02	26.74	31.68
Recurrent	14.60	15.63	15.97	16.52	19.63
Capital	3.22	3.43	4.18	5.48	7.90
Financing	3.34	3.34	4.86	4.74	4.16
Revenue	17.46	18.37	19.10	21.45	23.05
Budget deficit	1.37	1.46	3.82	3.24	6.98
Foreign Loan Receipt	0.98	1.09	1.38	1.95	2.20
Foreign Grant Receipt	2.17	2.25	1.71	1.92	1.52
Total Outstanding Debt	32.17	28.51	25.65	27.92	26.41
Outstanding External Debt	19.67	17.86	16.16	17.29	15.67
Outstanding Internal Debt	12.50	10.65	9.49	10.63	10.74
Total Debt Received	2.10	2.12	3.37	5.85	5.54
Disbursement of External Debt	0.98	1.09	1.38	1.95	2.20
Domestic Borrowing	1.12	1.03	2.00	3.90	3.34
Re-payment of External Debt	0.84	0.86	0.80	0.83	0.86
Re-payment of Internal Debt	1.24	1.30	2.23	2.24	1.46
Total Debt Servicing	0.81	0.62	0.44	3.45	2.70
Net Resource Transfer (External)	(0.13)	0.23	0.58	1.12	1.34
Investment -Share	0.53	0.49	0.49	0.57	0.69
Investment -Loan	0.74	0.70	0.86	1.10	0.92
Total Investment	1.27	1.18	1.36	1.67	1.61

The ratio of total expenditure to GDP is in increasing trend. In FY 2016/17, this ratio is 31.68%which was 26.74% in FY2015/16. Ratios of recurrent and capital expenditureto GDP has also increased in the FY 2016/17. In the FY 2012/13, theratios of recurrent and capital expenditure to GDP was 3.22% and 14.60% which reached to 7.90% and 19.63% in the FY 2016/17 respectively.

Figure 4.12

Debt Outstanding to GDP Ratio



Total outstanding debt to GDP ratio is in decreasing trend till FY 2014/15. From FY 2014/15 to FY 2016/17, this ratio has not changed much. In Fiscal Year 2011/12, total outstanding debt to GDP ratio was 34.26 percent but now it is decreased up to 26.41 percent. The average outstanding debt to GDP ratio is below the average ratio of international scenario. The Debt Sustainability Framework (DSF) indicators and thresholds for debt sustainability i.e. PV debt/GDP ratio ranges between 30 percent to 50 percent. This ratio shows that there is a lot of fiscal space for debt financing for development.

4.6.4 Issues of Debt Servicing in Nepal

Table shows the ratio of internal and external debt servicing to total debt servicing and their average annual growth rate and percentage of external and internal to total internal debt servicing.

Table 4.17

Share of External and Internal Servicing in Total Debt Servicing

Rs. In billions

Fiscal Year	Total Debt Servicing (1)	External Debt Servicing (2)	Internal Debt Servicing (3)	(2) as % of (1)	(3) as % of (1)
2013/14	53.91	20.09	33.82	37.26	62.74
2014/15	73.72	20.16	53.56	27.34	72.66
2015/16	77.62	21.93	55.69	28.25	71.5
2016/17	72.28	26.96	45.32	37.32	62.68
2017/18	32.78	11.01	21.77	33.58	66.42
Average annual growth rate	9.94	12.02	8.81	-2.07	-1.1

Source: Economic Survey (MoF)

Observing table 4.17 the amount of total debt servicing was Rs. 53.91 billion in 2013/14 and has increased to Rs. 72.28 billion in 2016/17 with average annual growth rate by 9.94 percent. This shows an increasing trend of total debt servicing.

The volume of external debt servicing was Rs. 20.09 billion and increased to 26.96 billion under the review period and internal was Rs 33.82 billion and increased to Rs. 45.32 billion. The percentage of internal debt outstanding of total debt outstanding is higher than external.

Figure 4.13

Trend of Total, External, Internal Debt Servicing

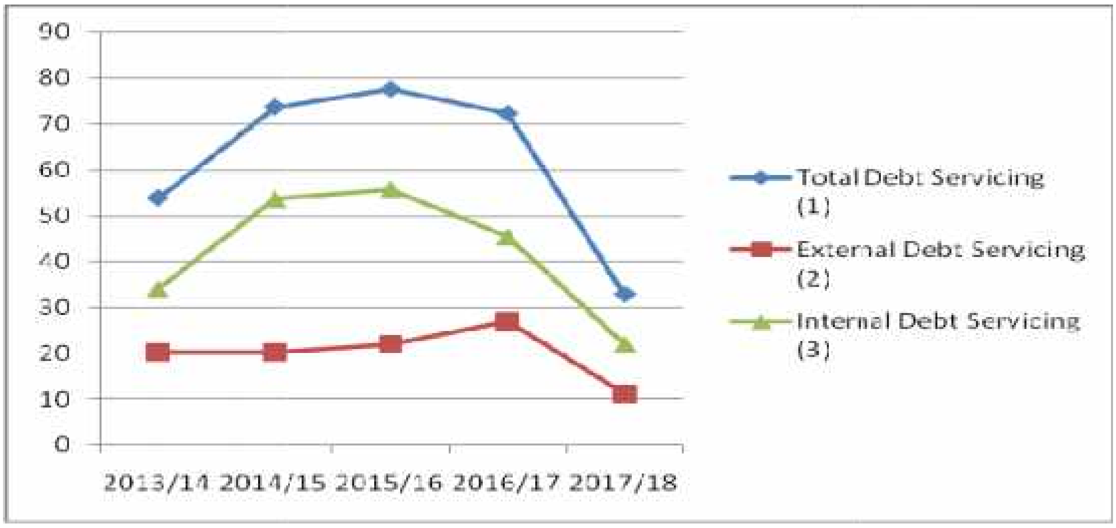


Table 4.18

Share of Interest and Principal Payment in Total Debt Servicing

Rs. In billions

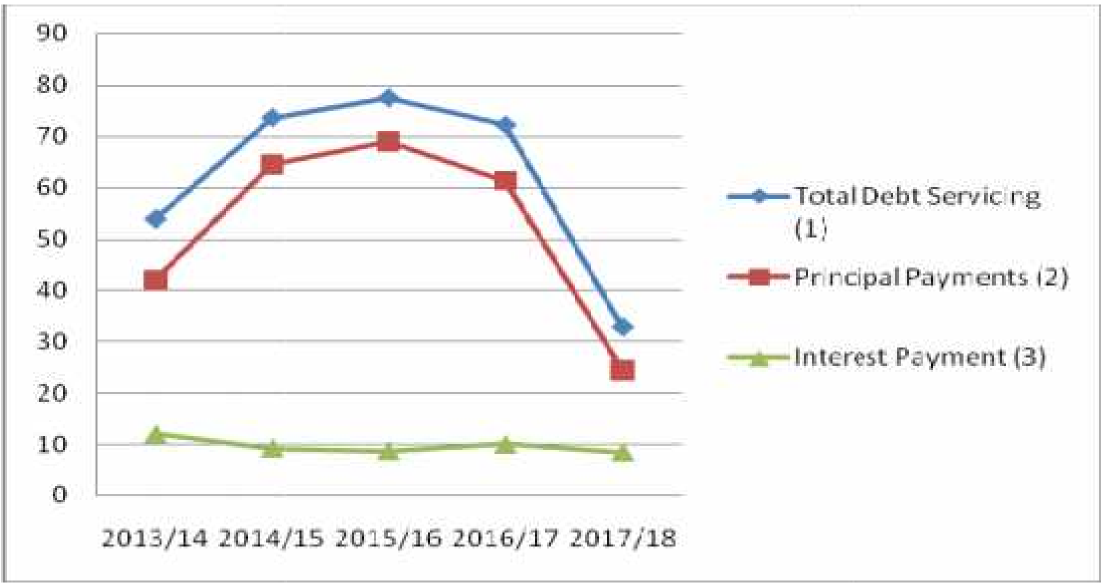
Fiscal Year	Total Debt Servicing (1)	Principal Payments (2)	Interest Payment (3)	(2) as % of (1)	(3) as % of (1)
2013/14	53.91	41.87	12.03	77.66	22.34
2014/15	73.72	64.45	9.26	87.42	12.58
2015/16	77.62	68.95	8.67	88.83	11.14
2016/17	72.28	61.26	10.02	84.75	15.25
2017/18	32.78	24.34	8.44	74.25	25.75
Average annual growth rate	9.94	10.84	7.08	-0.89	2.8

Source: Economic Survey (MoF)

While observing above Table we can see 9.94 percent of average annual growth rate of increasing trend of total debt servicing. Where share of interest amount was Rs. 8.67 and has maintained up to Rs.12.03 billion and share of principal amount was Rs. 41.87 and has gone up to Rs. 61.26 in 2016/17. The average annual growth rates of there are 10.84 and 7.8 percent respectively. This shows the increasing trend of principal payments is higher than interest payments and payment capacity is decreasing up to the study.

Figure 4.14

Trend of Total Debt Servicing, Principal Payments, Interest Payments



4.6.5 Ownership Pattern of Internal Debt Servicing Situation

The burden of public debt is measured by the ratio between the debt servicing and aggregate tax revenue and non-tax revenue or total revenue and the ratio between servicing cost and national income (GDP). This has been shown in Table.

The Table 4.19 shows the average annual growth rate and volume of regular expenditure, Total Revenue, GDP and internal debt servicing. It also shows the share of TR, RE and GDP as percentage of internal debt servicing.

Under the period of study, the magnitude of regular expenditure, total revenue, GDP and internal debt servicing was Rs. 243.5, Rs. 244.4, Rs. 614.6 and Rs. 18.16 billion in 2011/12 and has increased to Rs 739, Rs. 730.10, Rs. 791.10 and Rs. 21.77 billion in 2017/18 respectively.

Table also shows average annual growth rate of regular expenditure total revenue, GDP and internal debt servicing which are 3.34, 12.46, 15.62 and 0.99 percent respectively. It shows that the growth rate of internal debt servicing is more than growth rate of regular expenditure, total revenue and GDP. This indicates that the servicing capacity of the government has increasing as the same pace of regular expenditure and total revenue.

The trend of debt servicing as percentage of regular expenditure has been decreasing and fluctuating. Debt servicing as percentage of regular expenditure was 7.45 percent in 2011/12 and has been fluctuating. Trend of debt servicing as percentage of Total Revenue has been increasing, debt servicing as percentage of total revenue was 7.43 percent in 2011/12 has decreased to 2.98 percent under the period of study.

Table 4.19

Share of Internal Debt Servicing in Total Revenue, Regular, Expenditure and GDP

Rs. In billions

Fiscal Year	Regular Exp.	Total Revenue	GDP	Internal DS	DS as % of RE	DS as % of TR	DS as % of GDP
2011/12	243.5	244.4	614.6	18.16	7.45	7.43	2.9
2012/13	247.5	296	635.9	21.52	8.69	7.27	3.38
2013/14	303.5	356	668.7	33.82	11.14	9.5	5.05
2014/15	339.4	405.9	694.3	53.56	15.78	13.19	7.71
2015/16	371.3	482	695.7	55.69	14.99	11.55	8.01
2016/17	518.6	609.2	747.10	45.32	8.73	7.43	6.06
2017/18	739	730.1	791.10	21.77	2.94	2.98	2.75
Average annual growth rate	15.85	15.63	3.6	2.5	-13.28	-13.05	0.75

Source: Economic Survey (MoF)

Table 4.20

Outstanding of Public Debt, Development Expenditure and Debt Servicing

Rs. In billions

Fiscal Year	Total Public Debt (1)	Total Debt Servicing (2)	Dev. Exp. (3)	(1) as % of (3)	(2) as % of (3)
2012/13	540.4	48.9	54.6	9.89	89.56
2013/14	548.60	53.91	66.7	8.22	80.82
2014/15	540.1	73.72	88.8	6.08	83.01
2015/16	622.1	77.62	123.3	5.04	62.95
2016/17	696.9	72.28	208.7	3.33	34.63
2017/18	842.9	32.78	234.6	3.59	13.97
Average annual growth rate	7.4	6.6	24.29	16.88	-30.90

Source: Economic Survey (MoF)

Observing Table 4.20, we can see the volume of outstanding public debt was Rs. 540 billion in 2012/13 and has increased to Rs. 842.90 billion in 2017/18 with the 7.4 percent average annual growth rate. These show the real burden of debt of Nepal where total outstanding of public debt as percentage of development expenditure was 9.89 percent has decreased to 3.59 percent in 2017/18 of this study .

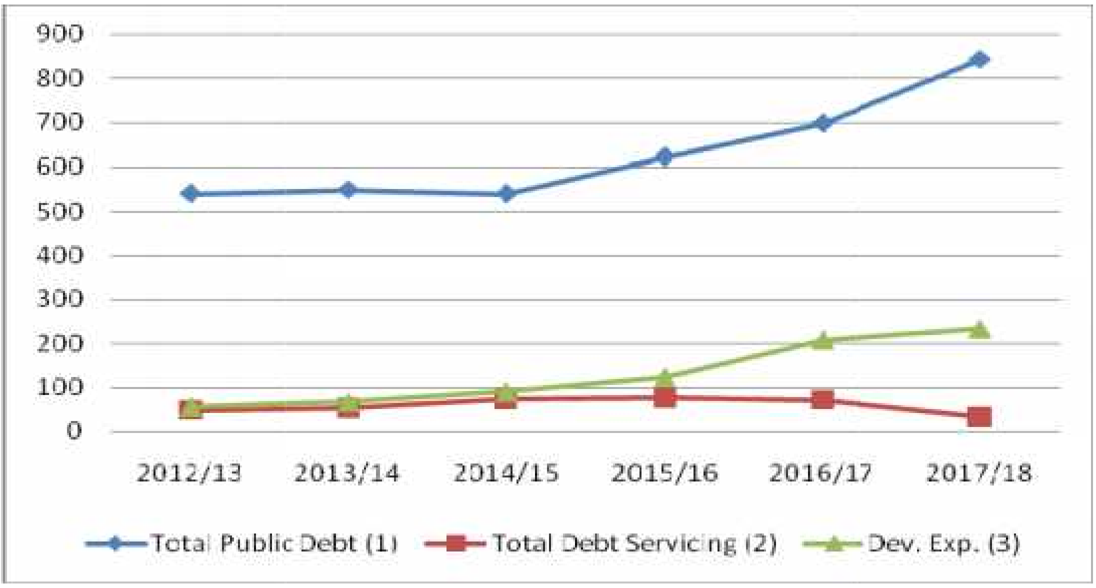
Development expenditure has also gone up to Rs.234.6 billion at end year of this study. This shows the increasing trend of development expenditure is less than outstanding public debt.

Likewise, total debt services was Rs. 540.4 billion in 2012/13 and has gone up to Rs. 842.9 billion in 2017/18 with 7.4 percent of average annual growth rate but it is more than the rate of outstanding debt. Total debt servicing as percentage of development expenditure has increasing from 89 to decreasing 13.97percent under the period of study.

While discussing about the impact of internal debt, the analyses of internal debt and annual internal borrowing are important aspect of it.

Figure 4.15

Trend of Total Public Debt, Total Debt Servicing, Development Expenditure



4.6.6 Trade and Balance of Payment

One of the serious problems of Nepal is the trade deficit and current account deficit, which has been increasing each year rapidly and to restoration it, the government has to do enough, improve on exports and imports. Nepal also has to review the Nepal-India Trade Treaty 1996.

One of the main features of Nepal's foreign trade is slow growth of exports and acceleration on imports, which is leading the trade deficit.

Shows the Percentage share of Exports and Imports to GDP

Table 4.21, shows the different aspect of the foreign trade and balance of payment of Nepal. In which the income of export was Rs. 60.82 billion in 2009/10 and has increased to Rs. 82.60 billion in 2017/18 with the 3.40 percent of average annual growth rate.

The table also shows that the annual growth rate of export has increased in 2009/10 but in 2015/16 it was decreased. As a overall the trend of export growth rate is declining. The share of exports as percentage of GDP has almost same in all year. But the share of imports as percentage of GDP has increased to 66.16 percent from 150.99 in year 2017/18.

The magnitude of imports payments has mounted up from Rs. 374 billion to Rs. 1194 billion with the 12.88 percent of average annual growth rate. It shows absolute amount of import payment is larger than export earnings but in the context of growth rate, increasing trend of growth rate of export earning is greater than import payment. This trend shows that situation of imports payment compare to exports earning which leads to trade deficits.

Table 4.21

Foreign Trade Situation

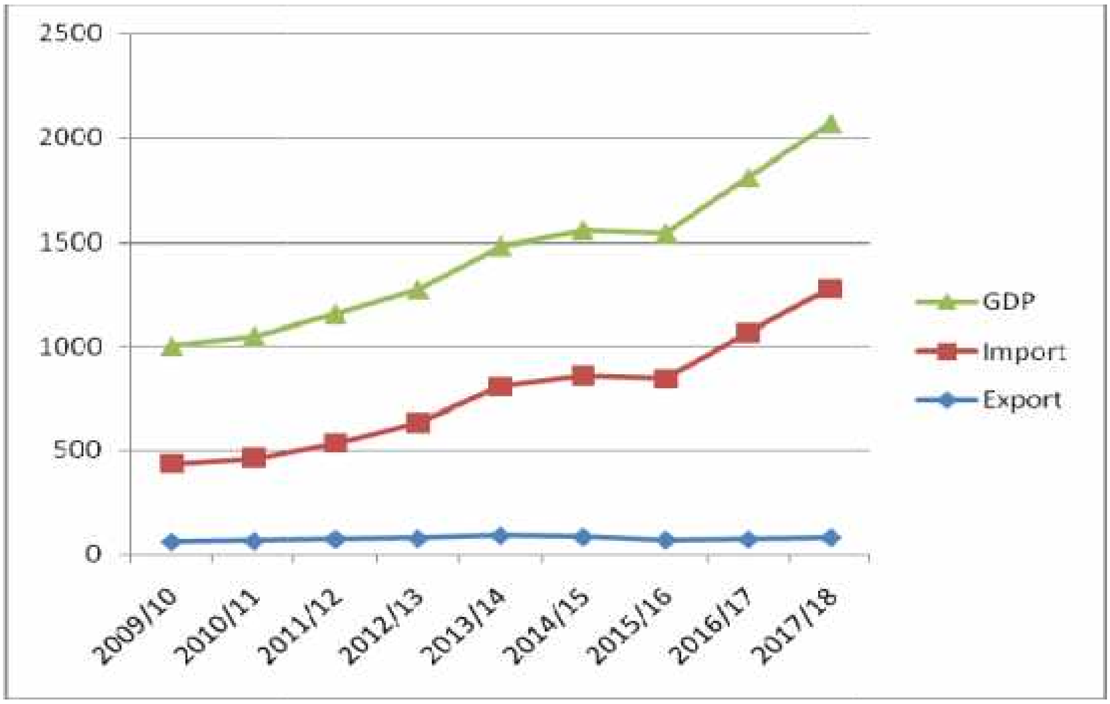
Rs. In billions

Fiscal Year	Export (1)	Import (2)	GDP (3)	(1) as % of (3)	(2) as % of (3)	Trade Deficit as % of GDP
2009/10	60.824	374.335	565.8	10.75	66.16	26.3
2010/11	64.339	396.176	587.5	10.95	67.43	24.3
2011/12	74.261	461.668	614.6	12.08	75.12	25.4
2012/13	76.917	556.740	637.8	12.10	87.55	28.3
2013/14	91.991	714.366	674.2	13.75	105.83	31.7
2014/15	85.319	774.684	694.3	12.28	111.5	32.4
2015/16	70.1	773.6	695.7	10.07	111.1	32.4
2016/17	73.2	990.1	747.1	9.79	132.5	34.7
2017/18	82.6	1194.1	791.1	10.4	150.09	37.0
Average annual growth rate	3.40	12.88	3.72	-0.36	9.10	3.7

Source: Economic Survey (MoF)

Figure 4.16

Trend of Export, Import and GDP



4.6.7 Issues of Foreign Loans

4.6.7.1 Background

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

Nepal is facing various problems like poverty, unemployment and Nepal's macroeconomic indicators show also negative growth rate and declining economic performance. Recently, Nepal has to invest huge amount of expenditure for security, which seems unproductive in present situation. Due to this reason, Nepal will have to depend upon foreign assistance and external loans. Owing to heavy reliance on external assistance in the form of borrowing in public account, Nepal's external public indebtedness has increased very much. A rise in external indebtedness should be accompanied by an increase in debts servicing capacity so that there may be undue strain in the balance of payment awing to outflow of funds through debt services, which may lead to the country to the heavy burden of debt and debt crisis in the future.

Although, foreign loans are main pillars for development process and to break out vicious circle of insufficient domestic capital formation, it has adverse effect on national economy when it's servicing, means that the scarce foreign exchange resources have to be transferred to creditor's countries.

When external debt services has obvious impact on domestic capital formation and leads to reduction in the domestic standard of living unless the loans are used for financing profitable investments whole yield id enough to satisfy creditors claims for debt servicing, Therefore, the true burden of debt service depends to a substantial extent in how the borrowed fund from external sources can be transformed into productive investment. If the foreign loans are used into unproductive investment projects that provide present consumption with more goods than being produced in the country then foreign debt servicing if the debt because quite impossible or the purpose of foreign debt servicing foreign currency has to be earned through increasing volume of exportable goods and services. If this is not done then the purpose of external loan is not fulfilled and it really becomes burden on next generation. Therefore, it is very essential that the real income of the national economy grows faster than the transfer of resources resulting from its external debt servicing for this requires ever growing flow of foreign trade and proper utilization of foreign loans.

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

4.6.7.2 Outstanding External Debt and GDP

While discussing about the burden of public debt, we analyze the trend of outstanding external debt and GDP, and compare between them is necessary, which gives the status of external debt to GDP. Table 4.21 shows the economic growth in terms of GDP and trend in external debt.

Table 4.22

Outstanding External Debt and GDP

Rs. In billions

Fiscal Year	Total Outs. External Debt	Annual Growth Rate	GDP	Annual Growth Rate	ED/GDP %
2009/10	256.2	-7.51	565.8	4.3	45.28
2010/11	259.6	1.33	587.5	3.84	44.19
2011/12	309.3	19.14	614.6	4.61	50.33
2012/13	333.4	7.8	637.8	3.8	52.27
2013/14	346.89	4.0	674.2	5.7	51.45
2014/15	343.26	-1.0	694.3	3.0	49.4
2015/16	388.76	13	695.7	0.2	55.8
2016/17	413.97	6.5	747.1	7.4	55.41
Average annual growth rate	5.99	-7.86	3.47	6.78	2.5

Source: Economic Survey (MoF)

Observing Table 4.22, we can see the increasing trend of annual growth rate tremendously. The amount of external outstanding debt was Rs. 256 billion in 2009/10 and has gone up to Rs. 413.97 billion in 2016/17with 5.99 percent of average annual growth rate. Its annual growth rate was -7.15 percent in 2009/10 but after than it is declining to -1.0 percent in 2014/15 and then fluctuating and increased up to19.14 in 2011/12and also decreased and reach to 6.5 percent in 2016/17. But average annual growth rate of GDP was increasing and also diminishing way and it shows also not desirable economic performance because GDP as a pillar of national economy. GDP has increased from Rs. 565.8 billion to Rs. 747.1 billion with 5.99 percent of average annual growth rate under the review period which growth rate is smaller than external outstanding debt. After the multiparty system restoration, the annual growth rate of GDP is not satisfied and become 3.47 percent growth rate in 2012/13 compare with previous year, which was threatened to national economy.

While compare the increasing trend of external indebtedness to increase in GDP or external debt to GDP was 45 percent in 2009/10 and has amounted up to 55.41 percent in 2016/17with 2.5 percent of average annual rate. This show clearly about the burden of external debt was quite heavy.

4.7 Major Findings

Nepal's budgetary system shows the trend of increasing deficit budget or fiscal deficit is wedding year by year. Nepal's revenue collections are limited due to the tax and custom administration not fair, transparent and agile. During the period between 2010/11 to 2017/18 the average annual growth rate of revenue collection and government expenditure is 22.08 percent and 21.33 percent respectively. Although the growth rate of revenue is higher than expenditure, the absolute amount of government expenditure is higher than revenue, which are Rs.730 billion and 1083 billion respectively in 2017/18. These indicators show that widening financial resource gap. In which fiscal deficit increased from Rs.30.091 billion to 87.700 billion with 16.51 percent of average annual growth rate under the period of study. And on the other hand, revenue deficit has increased from Rs.256 billion to Rs. 388 billion with 5.99 percent rate average annual growth rate.

Due to the limitation of internal resources mobilization and to fulfill ever growing financial resources gap, dependency of foreign assistance has been increasing. A foreign grant has been increasing. Foreign grants has been increasing from Rs. 15.800 billion to Rs. 69.536 billion with 25.58 percent of average annual growth rate under the period of study. In the same period the contribution of external loan has gone up from Rs.17.892 billion to 44.00 billion with 13.72 percent of average annual growth rate. This shows dependency up on foreign loans and assistance.

The total public debt has been increasing from Rs. 27.945 billion to Rs. 87.700 billion with 17.75 percent of average annual growth rate. The contribution of external loan to fiscal deficit is outpaced the share of internal but the growth rate showing the decreasing trend of external and increasing trend of internal debt as percentage of fiscal deficit.

Since, government has to invest all sector of economy and limitation of internal resources mobilization, dependency upon foreign assistance has increasing so that the burden of public debt is also increasing. Nepal is indebted by external and internal loans but further more by external outstanding debt. The total outstanding debt has been increasing with 8.86 percent of average annual growth rate, from Rs.320.40 billion to Rs.580.5 billion. In which the share of external outstanding debt has been increasing from 216.6 billion to Rs. 354.40 billion with the 7.29 percent of average annual growth rate. Similarly, the share of internal has been increasing from Rs.103.80 billion to 226.10 billion with 11.76 percent of average annual growth rate. Nepal is suffering more by burden of external debt then burden of internal debt to total burden of debt.

Due to the increasing trend of burden of debt, the trend of total debt servicing of Nepal is also increasing. Total debt servicing has been increasing, with 9.37 percent of average annual growth rate, from Rs. 13.491 billion to Rs. 23.096 billion. In which average annual growth rate of external and internal is 13.18 and 3.34 percent respectively. External debt servicing has been increasing from 7.538 billion to 15.846 billion under the period of study. Similarly the internal debt servicing has been increasing from 5.953 billion to Rs. 7.25 billion. Consequently, external debt servicing has become a current issue. And on the other hand, country's revenue and foreign exchange cannot increase in the same pace or country's sources can't meet external debt services payment. There will be need to borrow again external loans for debt servicing seen interested payment that may lead "debt trap" to the economy.

The average annual growth ratio of debt servicing to total revenue have been 15.62 percent over the period of review. This shows the burden of internal debt in terms of total revenue increasing considerably over the period.

The magnitude of export earning has increased from Rs. 59.383 billion to Rs. 76.917 billion with 4.41 percent of average annual growth rate and import payments has increased from Rs. 194.695 billion to Rs. 556.740 billion with average annual growth rate 19.14 percent under the period of study. Here, the growth of export is higher than import payments but trade deficit to GDP has increased 27.41 percent from 75.46 percent.

During the period of study between 2006/07 to 2013/14 the average annual growth rate of GDP revenue are considerably low as compared with that of debt and its servicing obligation. So we are going to be entrapped in the debt not only, but also we cannot escape ourselves from the terrific in debtless, if no effective programmed is set within time to carry out for financing economy.

This study has analyzed the impact of increasing trend of government borrowing on economic development. The government expenditure has increased more rapidly than government revenue due to limited sources of revenue. So the government has borrowed from internal and external sources. The growing trend of borrowing creates a great problem for debt management and becoming major challenging issue for the country. The borrowing money is unlikely financed on the non- monetized and unproductive sectors of the economy which in turn has the burden for the country.

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

In course of research, it was found that government borrowing has been increased unlikely and financed mostly on the unproductive sectors including uncertainties, high expenditures and hence government always lacks the resources then borrows the new loan to pay the previous ones. That’s why, the public debt and its interest is nothing rapidly, but addressing capacity for redemption the debt is not increasing in the same pace.

The study clearly shows the facts that the average annual growth rate of share of outstanding debt as percentage of GDP is 4.24 percent. It concluded that we are entrapped in the debt net. If debt management is not set effectively and effective programs for debt financing are not carried out, we shall not escape from the situation of debt trap.

During the period of the study between FY2010/11 to FY 2017/18, it is concluded that the average annual growth rate of GDP and revenue are considerably low as compared with that debt and its servicing obligation and the most of the borrowed funds are using in productive sectors. Because of misuse of borrowed fund, other things remaining same, there are symptoms of steadily falling into the trap soon. Any country and it is widely accepted measure for financing for financing government expenditure.

CHAPTER – FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Public debt has played a significant role in the financial resource for development activities. It is also widely accepted tool for financing government expenditure. It is the loan taken by the government to meet growing expenditure. Nepal is in critical phase of managing public finance because of inadequacy of internal resource.

The landlocked nature and mountainous topography of Nepal, Economically, Nepal is backward and its economic performance is not satisfactory. Now, Nepal is facing and acute resource gap problem which is also being expected to grow in coming years. Nepal is demanding more and more financial resources through public debt to bridge the growing resource gap in the budget. The fiscal deficit has been increasing in each year due to low tax payable capacity of people. This forced government to borrow budgetary deficit financing development activities and helps to achieve a higher growth rate of the economy.

One the most important objectives of this study is to examine the effect of public debt on the output and for this empirical relationship between public debt and aggregated GPD is made. Analyzing the relationship, it is found that total public debt has, not impact in GDP growth of Nepal. But the empirical results suggest that total public debt has contributed positively in total agriculture and Non-agriculture GDP. Hence it is positively contributing to the growth of national output.

Since, revenue expenditure gap export import gap as well as saving and investment gap are important factor for increasing borrowing trend, government is fulfilling such gap from two sources, internal & external. Internal debt is taken from treasury bills, special bonds, national saving certificates and development bonds through banking sector. External debt received from bilateral and multilateral sources, ADB, UNDP,IMF, World Bank etc. are the institutions of multilateral sources and the proportion of loan from such institutions is large in Nepal only through internal resources, it is not sufficient to promote the rapid development of the Nepalese economy. Thus external debt is also taken for development activities. Public debt is also taken to achieve the goals of high employment, price level stability, balance in foreign accounts and an acceptable rate of economic growth. Internal debt plays important role in the financing fiscal deficit and in the growth of monetary are not sufficient to meet such fiscal imbalance. Thus government has to depend upon external borrowing.

Almost developing countries like Nepal, the external borrowing increasing more rapidly rather than internal borrowings. Debt servicing obligations are also increasing rapidly but debt servicing capacity of the country has not been increasing with the same pace. Therefore Nepal is in early stage of development the widening resource gap itself would not have been 2 matter of serious concern, if it was related to grow and investment leading to capacity expansion in the economy but the situation has been quite adverse.

So, it is necessary to know the patterns and quantity of public debt (external and internal) as a major source of finance for development activities. This small study is attempting to investigate the pattern of public debt in Nepal. A brief theoretical perspective has also been taken into consideration white studying public debt and its ratio with GDP, revenue, total expenditure outstanding debt and debt servicing from the year 20011/12 to 2017/18.

Nepal is indebted by both internal and external loans buy highly indebted by external servicing. Thus, its proper management has been a challenging task for Nepal. So the government should be responsible to utilize the public debt in productive sector rather than unproductive sectors. The government regulates the better fiscal policy and concern in the proper implementation. Otherwise, Nepal is going to face debt crisis in the future in which debt bearing obligations would become impediments to the balanced management of the economy.

Being a least developed country, Nepal is incurring public debt. The trend of continuous increase in public debt is not good economic indicator for Nepalese economy. Public debt is important source to mobilize resource as well as socio-economic development of the country.

5.2 Conclusion

The system of internal public debt is one of the best ways of financing development expenditure of the government which helps to control inflation and to mobilize the internal financial resources in the productive sectors of the country economy. Poor mobilization of internal resources is the main cause for the dependency upon foreign assistance. There has been excessive flow of foreign loan to bridge up the resource gap. We can see substantial increases in the foreign debt over the past years which lead to increasingly heavy dependency on foreign loan.

The total debt and the total debt service obligation are increasing rapidly in each year but debt servicing capacity is not increasing in the same place. During the review period average annual growth rate of GDP revenue and export earnings are considerably low age compared with the debt and debt servicing obligation. This shows our debt servicing capacity is very poor to sustain increasing debt servicing obligation.

The businessman, student and retired person are less interested to purchase the government securities rather profitable investment opportunities. The higher income group people are less interested to purchase the government securities (i.e. risk less securities) because they think that to invest in risky securities is a prestige in the society. Similarly, the people of rural area are less aware towards the government securities due to lack of effective information and the people whose academic background are economics, finance, management and commerce are more towards the government securities due to the appropriate and essential knowledge about government securities from their subject.

5.3 Recommendations

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

- The size of revenue collection is very low and expenditure is very high which creates fiscal imbalance. To minimize this problem, the govt., expenditure has to be controlled and allocated the basis of national priority so that productivity may increase within stipulated time period. And for maximizing revenue collection, govt. should adopt transparent and effective tax policy and improving tax administration, which helps to reduce dependency on loans for financing development expenditure.

- Debt crisis must rely on both internal and external factors. Gradually over the years, Nepal's stock of outstanding foreign debt and its debt servicing obligations have risen but the addressing capacity for redemption; the debt is not increasing in the same pace. In this prospective, some recommendation are proposed to mitigate the pain and adverse effects of ever increasing debt in Nepal.

- The internal borrowing mobilizing for development purpose has come from banking sector and about 50 percent of it is owned by Nepal Rastra Bank, which creates inflation. So the govt, should initiate policies to attract maximum borrowing from non banking sector and there should be put legal ceiling on govt, overdrawing from the central bank. The govt, also issues development bonds and national saving certificates with discount rate and with some additional attraction and concessions to breakout inflationary situation.

- Foreign loan and assistance should be utilized selectively after careful scrutiny of the purpose, content and benefits of such projects and programs in order to reduce the burden of external debt which contributing to accelerating growth and meeting socio-economic objectives.

- The government should maintain balance between expenditure and revenue, developing country like Nepal where private sectors are still under developed. The government should adopt appropriate economic policy. The government should give attention in all sectors of the economy with high economic growth rate by reducing excessive external dependency and internal resource mobilization for the development purpose. And the economy will be capable to move in a self-sustaining growth path.

- The annual growth rate of GDP, per capita GDP, national saving and investment are still very low but the population has been increasing very fast. Besides even such infrastructure facility on transport, irrigation, education and health have failed to develop adequately. These are some of the factors responsible for the operation of the vicious of poverty in Nepal.

- The growth rate of investment is increasing and the rate of domestic saving is not increasing in the same pace and is also increasing investment domestic saving gap. Thus there is a need to reduce such gap by increasing the rate of total domestic saving through transparent and effective tax policy and improving tax administration.

- Privatization of govt, enterprises should be accelerated and the revenue received from privatization should be utilized as the debt equity swap strategy for debt relief.

- Trade deficit is the main feature of foreign trade of Nepal. For this there is need to export promotion and diversifying trade both country wise and commodity wise. And there should be controlled to import luxuries goods and services by adopting suitable import policy and reduce huge trade deficit by promoting the export oriented industries.

- Export promotion also helps to correct the balance of payment which helps to save foreign exchange and help reducing the dependency upon external borrowing which more essential for an extremely indebted country like Nepal. So, for export promotion, the govt, should be give special privilege to private entrepreneurs, which are engaging in the export businesses. And imports substitution industries should be encouraged but capital goods import should not be restricted.

- Borrowed fund from external sources must be spent on these projects which are of highly productive nature and can produce exportable items and there projects are to be kept under constant supervision and monitoring process..

- The government should try to get grants amount more and more as far as possible. But it also should maintain such an external policy. So that more of grants should be reviewed rater than loans.

- The net internal borrowing and GDP ratio should be maintained and government borrowing from t r should also be limited and amiability of resources to the private sectors should be ensure to purse necessary investment.

- Investment is regarded as a prime factor to increase the level of production, which is only possible through increasing the saving. In order to rise the present saving –GDP ratio, is necessary to create favorite environment. Nepal 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.

- The level and direction of export is limited in few product and a few countries. Emphasis should give on speeding up the growth of export and diversifying trade both country wise and commodity wise. There is need to formulate long term plan for export promotion and also coordinates various related activity such as product development, market promotion, export stabilization, quality improvement, export diversification etc. it will help to minimize huge trade defect by promoting the export-oriented industries and there by narrowing the ever-increasing gap between total export and import.

Effective debt management is essential for economic development. Building strong debt management institutions, developing clearly defined procedures and creating the capacity for rigorous analysis can help country to manage risks effectively, minimizing the cost of borrowing and ensuring a sustainable debt position into the future. Strong debt management can also encourage aid effectiveness. Accountability and governance can be increased by integrating public financial management and debt management under a comprehensive legal environment under the Ministry of Finance (MOF). Debt management decisions typically deal with the choice of instruments, issuing techniques and institutional arrangements that minimize debt-servicing costs, given a certain risk profile. Significant cost savings could be achieved if debt management were to be made more efficient. Therefore, it is important to define more specifically the objectives, guiding principles for public debt management that constitute a sound public debt management strategy, and how such a strategy can be designed and implemented. Guidelines for Public Debt Management should be:

- Debt management objectives
- Institutional framework and coordination
- Debt management strategy
- Risk management framework
- Transparency and accountability
- Development of an efficient local capital market for government securities

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