AN ANALYSIS OF PUBLIC DEBT IN NEPAL

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LETTER OF RECOMMENDATION

This thesis entitled AN ANALYSIS OF PUBLIC DEBT IN NEPAL has been prepared by Ms. Rita Silwal under my guidance and supervision for the partial fulfillment of the requirement for the Master of Arts in Economics.

I hereby, recommend this thesis for its evaluation and approval.

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APPROVAL LETTER

This is to certify that this thesis submitted by Ms. Rita Silwal entitled AN ANALYSIS OF PUBLIC DEBT IN NEPAL has been approved by this department in the prescribed format of the Faculty of Humanities and Social Sciences. This thesis is forwarded for the evaluation.

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Ms. Rita Silwal

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ABBREVIATIONS/ACRONYMS

AAGR	-	Average Annual Growth Rate
AGR	-	Average Growth Rate
AD	-	Anno Domini
ADB	-	Asian Development Bank
BOP	-	Balance of Payment
CBS	-	Central Bureau Statistics
CEID	-	Center for Empowerment Innovation and Development
CDECON	-	Central Department of Economics
ED	-	External Debt
Exp.	-	Expenditure
EU	-	European Union
FD	-	Fiscal Deficit
FY	-	Fiscal Year
GDP	-	Gross Domestic Product
GNP	-	Gross National Product
Govt.	-	Government
GoN	-	Government of Nepal
ID	-	Internal Debt
IMF	-	International Monetary Fund
MoF	-	Ministry of Finance
NRB	-	Nepal Rastra Bank
SAARC	-	South Asian Association for Regional Co- operation
SD	-	Standard Deviation
SE	-	Standard Error
SEE	-	Standard Error of Estimate
TD	-	Total Debt
UK	-	United Kingdom
USSR	-	United Soviet Socialist Republic
UNDP	-	United Nations Development Program
WB	-	World Bank
WHO	-	World Health Organization

CHAPTER I

INTRODUCTION

1.1 Background of the Study

Public debt is a modern invention and was not heard prior to 18th century. Public debt is the creation of the last three centuries. It was originated in Great Britain in the 17th century. After the first and second world war, public debt becomes very popular for reconstruction and maintenance. Most of the countries in the world started tomorrow systematically and still borrowing to develop their economic at a faster rate. But in the modern times the growth of public debt is the result of changing economic and political situation of all countries.

Generally, public debt refers to loan raised by a government within the country or outside the country. Every government like individuals has to borrow when its expenditure exceeds its revenue. But it is not source of revenue like taxes. In wider sense the term public revenue covers all types of income. Hence, public revenue includes the money borrowed by government during any given year constitutes the income of the year, so we can say, public debt as 'revenue' of the government, it adds to the total resources of the country.

Nepalese government has not a very long history of budgeting started in 1951. After that, we have frequent experience of deficit budgeting. Public debt has been an important tool of the Nepalese fiscal policy. However, public debt in Nepal was taken after 11 years of initiation of budgetary practice. Thus, our history of public debt is not so long. Government started to take domestic loan in 1962 where as it started to take foreign loan in 1963. The first foreign creditors of Nepal were former USSR and UK (Aacharya, 1998) after that government budget.

Today's borrowing by the government has become normal feature government finance along with the other sources of public finance like taxes, fees etc. In all the countries of the world, public debt tendency has been increasing. Public debt has important effects on the operation of the economic system of the country. There are many objectives of raising loan by the government. The major objectives include: to collect the resources to the government to meet the revenue – expenditure, to bring change in the investment pattern in the country, to maintain the fiscal stability, to accelerate the growth rate of the economy, to develop the socio-economic infrastructures, to finance the immediate problems of the country, like natural calamities and war to avoid the unpopularity of taxation, to reduce the inequitable distribution of the wealth, to finance the public enterprises, to solve the balance of payment (BOP) difficulties, and so on.

Historically there is great debate among the economists about the role of public debt. The classical economists were generally, against the public debt/borrowing. They assumed that in the long-run, actual GDP automatically adjusts to the potential GDP. Due to this reason, classical economists were not in favor of counter-cyclical fiscal policy. But Keynes was against the view of classical economists. He argued that resources in the private sector may remain unemployed for long period, if corrective or compensatory action is not employed by the government.

In Nepal, on the one hand, the level of government expenditure is increasing over time. On the other hand, the slope of taxation is seriously limited to collect the sufficient resources to finance the government expenditure. In such complex situation public debt is an important instrument of mobilizing the resources for economic growth and development of the country.

The government of Nepal has specific legal team work for the collection of resource through the public debt. The Interim Constitution of Nepal 2006 provides the foundation for mobilizing the resources through the public debt. There is the provision of consolidated fund in the present constitution. The resources raised through the public debt are credited to that fund.

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

The main objective of public debt is to promote economic growth in poor countries and thereby lift people out of poverty. Nepal, being one of the least developed countries of the world, is far behind the level of social and human development. The human development report 2014 has placed Nepal in 148th rank out of 177 countries. Nepal has lowest human development among the SAARC countries (MoF, 2014). Public debt contributes to domestic saving, resource mobilization, capital accumulation and industrialization. Public debt should be used in productive sectors to escape from vicious circle of poverty. The small capacity of saving because of low level of income which reflect low level of investment, low level of productivity, low level of real income, low level of purchasing power and huge resource gap (Bhandari,2014). This problem can be solved only by large scale of investment from public as well as private sector. Nepalese private sector has not well developed so the government of Nepal has invested huge amount of money. Government expenditure of Nepal has been increasing day by day because of development actives (Thapa, 2010).

Developing countries usually mobilize part of their resources by borrowing from internal as well as external sources to finance their development activities. These sources gradually build up the debt stock of the country. Such debt stock demands regular debt servicing, that is, principal and interest payment, which consumes scare resources that can be used for financing development. Therefore, excessive deficits and heavy borrowing to finance that deficit drain out the resources of the developing countries. Liquidity is also involved while borrowing and servicing. Thus, both of these transactions are conducted in such a way that the country concerned always finds itself in a comfortable position with regard to the liquidity, which is known as the debt management (Khatri, 2013).

1.2 Statement of the Problem

Economic condition of Nepal is very poor. Nepal is facing the problem of ever-increasing domestic resource gap because government expenditure is increasing rapidly but government revenue is not increasing at the same pace. The major source of government revenue is taxation. But in a developing country like Nepal where the per capital income of people is low, taxation alone is not sufficient to raise enough founds for financing its expenditure. Moreover, revenue collection through taxation becomes highly unpopular and produces undesirable consequences.

In Nepal, both internal and external borrowing/debt has been increasing rapidly each fiscal year. The external borrowing/debt is increasing more rapidly than internal borrowing/debt. Since developing countries like Nepal always need foreign currencies to import many capital goods required for development, these countries have to depend more on external borrowing the internal (Guru gharana, 1996). Increasing pattern of public debt and debt servicing obligations are also increasing rapidly. Nepalese economy is characterized by various kinds of macro-economic imbalances like revenue-expenditure gap, saving-investment gap, and expert-import gap. To fulfill this gap, public debt is important. Ever increasing debt and debt servicing obligation will create serious problem in an economy.

The effect of public debt in the economy is very large. If ever increasing debt, it creates the serious problems in the economy like debt-trap, colonization, internal public instability and so on. Increasing pattern of public debt in Nepal, which is serious problem of the nation.

Properly managed government debt is essential for the found functioning of an economy. But improperly managed government debt brings many problems such as the instability in the domestic financial market, imbalance in money supply, influence on inflation, and impact on country’s balance of payment and so on. Hence, it is worthwhile to make an analysis of the government debt. In recent years, Nepal has been raising public debt from external and internal sources and the public debt has rapidly increased, particularly after 1990 when multiparty democratic system has reinstated in Nepal. It is important to have a close look at the magnitude of the public of the public debt of Nepal because debt stock needs to be accompanied by debt servicing capacity to avoid/prevent any undue financial problems in the economy (Nijanand, 2010).

Some research questions are as follows:

- Is there any resource gap in the financing of capital expenditure in Nepal?

- How can the effects of public debt in Nepalese economy measure?
- What is the pattern and composition of public debt in Nepal?
- How can the empirical relationship between public debt and GDP examine?

1.3 Objectives of the Study

The general objective of the study is to analyze the trend, pattern and burden of public debt in Nepal. Some specific objectives are as follows:

- To find out the resource gap in the financing of capital expenditure,
- To measure the effects of public debt in Nepalese economy,
- To analyze the pattern and composition of public debt in Nepal,
- To examine the empirical relationship between public debt and GDP.

1.4 Significance of the Study

This research aims on making clear vision towards the current issue of internal government borrowing through NRB as the central bank of Nepal as well as external crowing. Internal borrowing is the way of government financing. Basically internal debt used to fulfills the gap of deficit budget. Occurs when government expenditure exceed government revenue.

Nepal is not only landlocked, small and beautiful country too, but also it is a poor and undeveloped country in the world. Such types of countries economic planning is taken as the main instrument for economic development. During the planning for development, various objectives are made. To meet the objectives of public debt is necessary due to low level of tax paying capacity of the people, mostly in developing countries. In order to remove vicious circle of poverty and improve socio-economic condition of the people, there is increasing need of heavy investment, which is totally impossible in current situation. In such situation public debt is common and reliable source for resource mobilization. So government borrowing (public debt) has been necessary for developing countries like Nepal.

The economic justification of a widely held public debt is considerable in the maintenance of high level of consumption, holding of high liquid government bonus by small income receivers represents accumulated assess which may be liquidated for expenditure in emergencies the importance of public debt is desirable. Public debt is important tools for fulfill the resources gap in the economy.

The process of modern economic development in Nepal started with the implementation of the first five years plan in 1956. Since then the magnitude of development outlays has been increasing because of the growing demand for fund. Fiscal deficit of Nepal is continuously increasing due to lack of income management to meet the increasing pattern of government expenditure and public debt is shrinking the gap between revenues of government and expenditure. Public debt is playing a crucial role to physical capital formation and human capital formation, which gives favorable impact on economy.

The study has the exiting scenario of public debt of the economy. It will provide several information of in Nepalese public debts to them who are interested to know it. This study will also be useful for researcher, policy makers and general students. This study provides some information related to our budgetary system and contribution of debt on it.

This study will be beneficial for those who are interested in various aspect of public debt. They can get a clear concept and idea about various aspects of public debt.

1.5 Limitations of the Study

This study has been based on the following limitations:

- This study is totally based upon the published secondary data and information.
- This research study covers only 15 years data from FY2000/2001 to 2014/2015.
- The validity of secondary data relies on the accuracy of their sources.

1.6 Organization of the Study

This study has been organized in to five chapters. The first chapter is introducing part which consists of the background of the study, statement of the problem, objectives of the study, significance of the study, limitations of the study. The second chapter comprises the review of literature. The third chapter covers the research methodology of the study. The fourth chapter includes pattern and composition of public debt and it also covers effects of public debt in Nepalese economy. The fifth chapter includes empirical analysis of results. Finally, the sixth chapter involves summary of major findings, conclusion and recommendations.

CHAPTER II

REVIEV OF LITERATURE

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

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

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

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

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

2.1 Theoretical Review

2.1.1 Conceptual Definition

- **Public Debt**

Public debt refers to loan raised by a government within a country or outside the country. A government resorts to public debt when its expenditures exceed its revenue. Public loans are collected by the government from banks, institutions and individuals on the conditions given in writing that these would be repaid and interest would be paid regularly as per the terms of the loan. Governments borrow to finance their operations and to regulate the volume of aggregate activity in the economy. Public debt involves the issues of short terms and long terms securities.

- **Internal Debt (ID)**

Internal debt refers to public loan raised within the country from domestic or internal sources. The government borrows money domestically from individuals and financial institutions.

- **External Debt (ED)**

External debt occurs when a borrowing unit acquires money from international resources. It refers to international transfer made at confessional terms rather than at market rates for promoting economic development of the nation. Alternatively, external debt refers to the obligation of a country to foreign agency or government through bilateral and multilateral sources.

- **Debt Servicing**

Debt servicing refers to interest payment against loan and repayment of principal after maturity.

- **Debt Trap**

A debt trap is a situation in which a country (debtor) will have to borrow more and more to pay even the interest obligation.

- **Bilateral Debt**

Bilateral debt is the debt based on a direct arrangement between two countries. Bilateral debt occurs when a debt unit acquires money or a quantity or goods and services from the government of other country.

- **Multilateral Debt**

Multilateral debt results when a debt unit acquires money or goods and services from the union of nations or governments institutions; business person and consumers or international organizations (such as WB, IMF, EU etc.)

- **Gross Domestic Product (GDP)**

GDP is the measure of the total domestic output at factor price. GDP is the final value of goods and services produced in a country in any specific period of time normally a year.

- **Gross National Product (GNP)**

GNP is the total money value of all final goods and services produced annually in a country including net factor income from abroad.

- **Export of Goods and Services**

It is the amount of goods and services sold to another country.

- **Imports of Goods and Services**

It is the purchase of goods and services from another country.

- **Burden of Debt**

Burden of debt is the sacrifice of the community through a rise in taxation the time of payment and for paying the annual interest on the government loans.

2.1.2 Classical Review

Classical economists (economist of 18th and 19th century) are generally against public borrowing/debt. They assumed that individual, consumer and the business firm employs the resources more efficiently. They were against the role of the state and they had the philosophy that the government is the best which governs the least. According them state has to perform its limited activities; maintenance of law and order, justice and social security. Classical economists like J.B. Say, TR Malthus, and Bastable have the strong faith that "Debt creates burden in the economy because of its unproductive nature" (Harris, 1974).

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

However, classical economists were not against all types of public debt and approved public debt for productive purpose i.e. for capital projects that they called self-liquidating projects. Self-liquidating projects are the projects which generates sufficient income to service the debt incurred in their financing. Such projects increase future income and tax base (http://amazon.com/books).

In conclusion, the classical economist had negative attitude towards public debt, they didn't plead for increasing economic role of government. The opined that state should perform its limited activities like maintenance of law and order, justice and social security.

2.1.3 Keynesian Review

The classical economists were against the public borrowing and they favored balanced budget. The economy is always in full employment equilibrium and whatever earned is automatically spent. But during 1930's, Keynes came up with different ideas. In his general theory he did not accept the free enterprise economy and self-equilibrating economy. He advanced the new concept of under employed equilibrium economy. He argued if the government becomes unconscious; the resources of private sector might remain unemployed for relatively longer time. In such a situation, increasing government expenditure by employing the idle resources and materials is likely to raise the level of (aggregate demand) and there by output and hence income, employment. Hence, public debt need not necessary unproductive, inflationary and burdensome. Therefore, Keynes strongly prescribed to increase the public expenditure even by undertaking deficit financing (Acharya, 2015).

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

2.1.4 Post-Keynesian Review

Post-Keynesian economists think about the developing countries have a very low income, saving and investment. They further say that without increasing the rate of these crucial factors, no country could achieve steady growth. So the overall aim of borrowing is not to equalize income in different countries but to provide opportunity to every country to achieve steady growth. On the other side, people of the developed countries are enjoying high prosperity, high standard of living and high education facilities etc. population growth problem so serious in those countries. Harris (1974) maintained that Public debt assures elasticity in money supply and agreed that government expenditure could be productive and need not necessary be wistful and so case for public borrowing is strengthened. Those who follow can take in to account the income generating aspect in the public debt and reject any possibility of internal debt being burden upon the community.

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

Goode (1984) viewed that borrowed money when used to finance public investment causes no such reduction, all that happen is the change in the consumption of capital formation. The inference is that failure to restrict borrowing to the finance of investment will retard economic growth. A weakness of the argument is that not all outlays classifieds investment actually contributes to growth, while some expenditure usually classified as government consumption promotes growth.

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

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

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

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

2.1.5 Recent Thinking on Public Debt

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

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

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

The ideal situation is on which first, revenues will meet subsidies, other transfers, interest payments & the greater part of current expenditure, debt finance will be used for meeting the government non remunerative capital formation, a proportion of current expenditure designed to increase social capital and productivity the requirements of financial investment & second, 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 seignior age(Singh, 2004).

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

2.2 International Context

Goode (1984) viewed that borrowed money, when used to finance public investment causes no such reduction, all that will happen is the change in the consumption of capital formation. The inference is that failure to restrict borrowing to the finance of investment will retard economic growth. A weakness of the arguments I that not all outlays classified as investment actually contributed to growth, while some expenditure usually classified as government consumption promote growth.

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

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

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

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

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

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

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

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

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

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

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

2.3 In Nepalese Context

In review of literature on public debt in Nepalese context some of the student of master level and some writers have preceded to male their dissertation and article on public debt. Some of these have focused its structure and important whereas others have focused on its burden and impact in inflation, employment and national solvency, etc. These thesis papers and articles have also enriched the importance, role, need and scope of public debt in macro economy. The students of economics try to make a thesis on such context but it emphasizes the Nepalese system and practice on public debt of Nepal.

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

Sharma (1998) examined that even increasing debt in Nepal and its servicing has really created a situation which is driving the country towards debt trap because of the following reason.

- Huge amount of loan is allocated for meeting expenses within the development expenditure.

- A good amount of borrow fund is for debt servicing.
- Volume of borrowed amount exceeds the maximum legal limited of borrowing.

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

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

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

Ghimire (2008) concluded that the average annual growth rate of GDP, revenue and export earnings are considerably low as compared with rate of debt and its servicing obligation and most of the borrowed funds are using in unproductive sectors. Because of the misuse of borrowed funds other things remaining the same there are symptoms of stability falling into the debt trap. The angle amount of the debt and poor servicing capacity of the government compel to think the sinking condition of the economy. It arises several questions about the capacity of debt servicing and existing of the nation. Excessive dependency on foreign assistance makes the balance of payment on the favor of creditors which is horrible situation to get rid of. Any way it can play the useful role for the economic development of every nation and it is widely accepted measured also for financing government expenditure.

Regmi (2008) found out that Nepal is in critical phase of managing public finance because of inadequacy of internal resources. Fiscal or revenue deficit is widening every year. In order to finance the deficit, the government is borrowing internal and external debt. The portion of external debt is too higher as compared to internal debt.

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

Joshi (1982) presented the poor performance of the nation's topography and the poor performance of the human capital. He concludes the debt is only one sources of fulfilled the resource gap of the budgetary expenditure of the nations and internal debt is the essential phenomena for the development of the capital as well as the entire money market.

Subedi (2057) started that Aid serves three main objectives political, economic and humanitarian. The blanket justification of aid is promotion of economic development of recipient countries. Although Nepal is receiving a higher per capita aid than some of her neighbors, the aid divided GDP ratio and per capita aid amount are still far below the threshold level which could bring about rapid and visible changes in the economy. That ratio is 10 percent; the GDP could not go up as per the aid increment. It seems that foreign aid has been playing a substitute role for domestic saving. He suggested the effective and the productive utilization of the foreign debt.

Bhattarai (2007) examined that the trend and structure of public debt, the practice and legal framework of Nepal and other countries regarding fiscal rules on public debt. He also examined that the indebt ness, debt servicing capacity and debt sustainability of Nepal.

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

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

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

2.4 Research Gap

This research helps to the reviewers to find the updated and changed situation in the economy. Above research worked mainly concerned with the public debt of Nepal.

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

CHAPTER III
RESEARCH METHODOLOGY

3.1 Research Design

A research design is the arrangement of conditions for collection and analysis of data in a manner that aims at combine relevance to the research purpose with economy in procedure. It is a plan; structure and strategy of study of obtain answer to research questions. This study deals with the descriptive analysis of public debt and GDP growth in Nepal. This study has been prepared by collecting information through various publications, books, articles, journals, unpublished theses, searching through the internet and other information.

3.2 Nature and Sources of Data

Since the data for this study come from secondary sources, the nature of the study has been descriptive as well as analytical. The data have been mostly taken from the publication of Nepal Rastra Bank (NRB), the Ministry of Finance (MOF) of the government of Nepal, World Bank (WB), Quarterly Economic Bulletin published by NRB, other bulletins publications like the budget speech. The main sources of data for the study are the economic surveys published by the Ministry of Finance, and the Economic Bulletin and the banking and financial statistics published by NRB and other sources.

3.3 Tools and Techniques of Data

This study is based on simple tools, such as percentage distribution, average annual growth rates and average rates. To meet research objectives find to accurate result, different statistical and mathematical tools and techniques, computer programmed Microsoft Excel and SPSS has been used.

3.4 Analysis and Presentation of Data

Analysis and presentation of the collected data is the core of the research work. In the process of data analysis, data are presented with the help of tables, bar diagrams and other diagrams and analyzed in descriptive manner according to the requirement of the study the description is given the table so that it has been easy to understand.

3.5 Statistical Methods

3.5.1 Regression Analysis

It attempts to establish the nature of relationship between dependent and one or more independent variables. It also provides a mechanism for prediction or forecasting. The regression of Y_{GDP} on X_{debt} is used to estimate the value of the dependent variable Y_{GDP} for any given value of independent variable and vice versa.

To examine the relationships between independent and depend variables, the estimated equation is:

$$Y = a + bX$$

Y = depend variable (GDP)

X = independent variable (Public debt)

a = constant   b = coefficient

The regression equation of GDP is estimated on total public debt. For this estimate, it is used as equation:

$$Y = a + bX$$

Y = GDP   X = total public debt

A = regression constant   b = regression co-efficient

3.5.2 Statistical Test of Significance

Standard errors of estimates SEE, like SD, measure the reliability of the estimating equation and estimating coefficients. The larger the SEE, the greater happens to be the dispersion of scattering of given observations around the regression line (or coefficients) and no better the estimates. On the other hand the smaller value of SEE, better the regression line (or coefficients) and the better the estimated based on the equation for this line. With help of SEE, it is possible to ascertain how good and representative the estimated regression line (or coefficients) are as a description of the average relationship between two series. For this study, the SEE, for regression coefficients have been calculated by using package software.

3.5.3 Test of the Goodness of Fit (R^2)

After estimating the regression parameters, R^2 is used for judging the explanatory power, which measures the dispersion of observation around the regression line. It is essential, because the closer the observation to the line, the better the goodness of fit, that is the better explanation of the variations of Y by the change in the explanatory variables. R^2 shows the percentage of the total variation of the dependent variable that can be explained by the independent variables of the multiple determinations and is the square of the correlation coefficient. The formula to derive R^2 is mentioned below:

$$R^2 = \frac{\hat{b}_1 \sum y_{x1} + \hat{b}_2 \sum y_{x2} + \cdots + \hat{b}_n \sum y_{xn}}{\sum y^2} \qquad \text{or, } R^2 = \frac{SSR}{SST}$$

Where,

$y = Y - \overline{Y}$ $\qquad$ $x = X - \overline{X}$

3.5.4 Test of Significance of the Parameters Estimates

It is applied for judging the statistical reliability of the estimates of the regression co-efficient. The following tests have been performed to test the hypothesis of the study.

t-test

This test performs in order to identify the statistical reliability of the estimates of the regression co- efficient and the formula for calculating the value is:

$$t = \frac{\hat{b}}{SE(\hat{b})}$$

Where, $\hat{b}$ = estimated value of b, SE($\hat{b}$) = standard error of b,

$$SE(\hat{b}) = \sqrt{\text{var}\hat{b}}$$

The calculated t- values are compared with tabulated t- values at a certain level of significance, for a given degree of freedom. If the calculated t- value exceeds the tabulated value, it is inferred that estimated co- efficient is significantly different from zero.

F- test

F–test is used to examine the overall significance of the model

The formula for calculation is $F = \frac{R^2/_{k-1}}{(1-R^2)/_{N-K}}$

Where, R^2 = co-efficient of determination

K = Number of explanatory variable

N = Number of observation in the sample

The calculated F-variance ratio is compared with the tabulated value at a specific level of significance with (K-1) and (N-K) degree of freedom.

If $F_{cal}<F_{tab}$, we accept null hypothesis

If $F_{cal}>F_{tab}$, we reject null hypothesis or we accept alternative hypothesis

CHAPTER IV

ANALYSIS AND INTERPRETATION OF DATA

Public debt is one of the major tools for the government to meet its expenditure. When government expenditure is higher than revenue the resource gap is fulfilled by debt internally or externally. Government raises loans internally from banks, individuals, other financial institutions like IMF, WB and ADB etc. It is important to meet saving investment gap, export – import gap, revenue deficits, fiscal deficits etc. public debt is an essential issue for sustained macro stability of Nepalese economy. The main resource for borrowing by a sovereign country like Nepal is to smooth then public expenditure over time and to allow a country to invest more or less of a sacrifice of current consumption.

Public debt is the result of mismatch between revenue and expenditure, over time frame. The gap is growing due to the limited sources of revenue mobilization. A widening investment saving gap, persisting demand for public expenditure accompanied by sticky revenue ratio have pushing the size of debt in Nepal.

Government borrowing is interrelated with the basic government fiscal flows of taxation and expenditure. When the volume of government expenditure exceeds that of the government revenue, the deficit budget provides the fundamental precondition for debt creations. Such created debt needs interest payments to maintain the debt and refinancing operations of the debt.

Nepal has accepted the foreign loan since the first five year plan was FY 1956/57-1960/61. But it has systematically started to raise the debt since the fiscal year 1961/62 through the means of Treasury bill that is amounted by Rs.7 million and carried one percent of interest rate. After this the government firstly floated the development bond of Rs. 131 million in FY 1963/64. In the same year, the government issued the ‘public debt regulation’ and practice was managed with the regulation.

Public debt is interlinked with the Fiscal Flows of taxation and expenditure of government. If the volume of government expenditure exceeds the volume of tax revenue and other non-tax revenue then a deficit budget exits. Such a deficit budget provides the fundamental pre-condition having once been created debt is to beyond the material of existing securities.

In Nepal, there are mainly five reasons for raising the government borrowing.

- To recover the deficit budget.
- To tackle the emergency period of crisis.
- To sustain the economic and monetary stability.
- To accelerate the pace of economic development.
- To alleviate poverty.

Nepal has been borrowing heavily from external sources mainly to balance the budgetary deficit. To fulfill the objective of the economic development, there is need of heavy investment to build up socio-economic infrastructure such as health, education, transportation; communication etc. for this, there is no possible means for government revenue. So public debt is needed for it, it is widely accepted as a means of deficit financing measures to reduce as gap between excepted government expenditure minus expected revenue plus foreign grant. Thus,

Budget Deficit = Expenditure – (Revenue + Foreign grants)

Expenditure is estimated for a targeted rate of growth. Saving – investment gap and slow growth of revenue as compared to growth in government expenditure causes this deficit. Saving – investment gap will prompt the government to borrow for creative socio – economic infrastructure required also for promotion invested from the private sector investment.

4.1 Resources Gap in Nepalese Economy

Resource gap is different between total expenditure and total revenue of the government of a country. When a country is spending more than its internal resources, there will be a resource gap in the economy. To find out the resource gap in the economy the annual budget documents of the government analyzed. The total outlay of the government is classified in to current expenditure, capital expenditure and principal repayment expenditure. The revenue side of the government shows the internal revenue, foreign aid and deficit – financing component.

The management of internal resources mobilization is the main obstacle of development program in Nepal, because the tax and custom administration is not fair, transparent and efficient. So that government cannot collect the revenue as it predicts. The annual growth of total expenditure and that of its revenue are not increasing in the same pace. The annual absolute volume of government expenditure has outpaced its revenue collection resulting financial resources gap in budgetary system.

The extent of financial resource gap has shown in table 4.1 hence mainly of resources gap are found in the Nepalese budgetary system.

Table: 4.1

Different Scenarios of Resource Gap in Nepal

(Rs. in million)

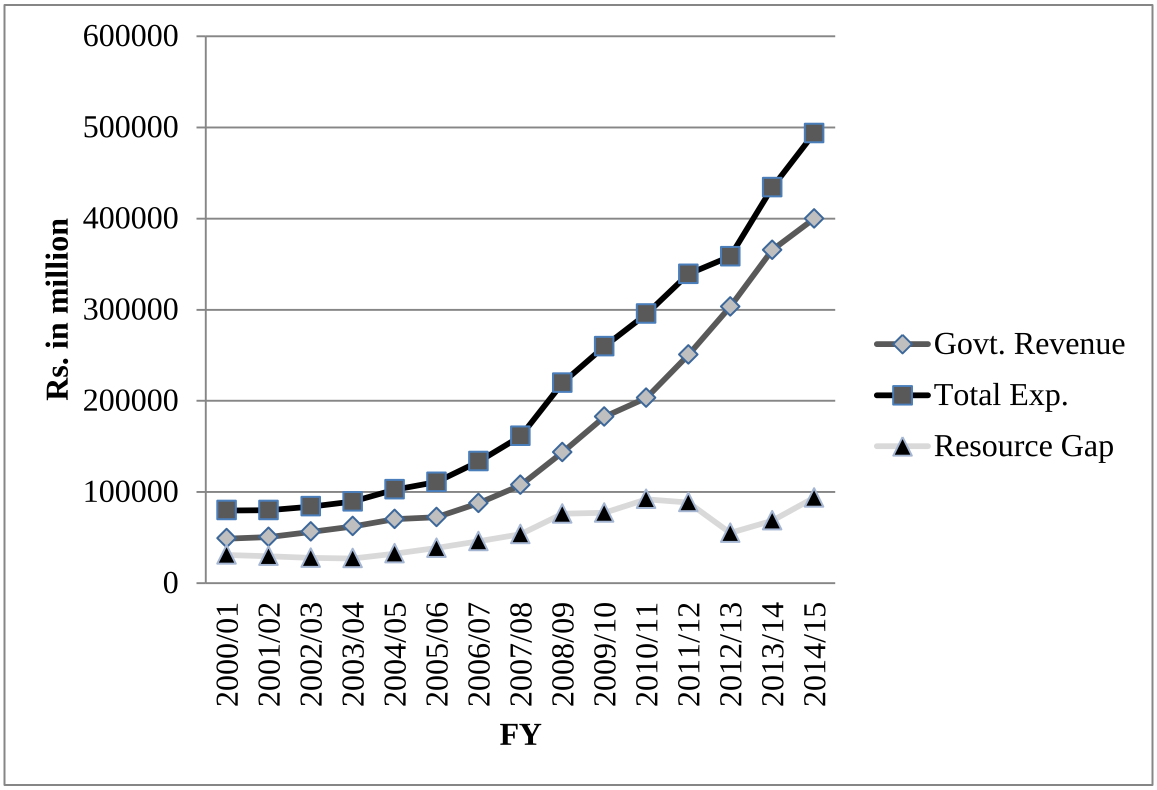
FY	Govt. Revenue	Annual Growth Rate of Govt. Revenue	Total Exp.	Annual Growth Rate Of Govt. Exp.	Resource Gap	GDP	Revenue As % of GDP	Exp. as % of GDP	Resource Gap as % of GDP
2000/01	48893.6	14	79835.1	20.5	30941.5	441519	11.1	18.1	7
2001/02	50445.5	3.2	80072.2	0.3	29626.7	459443	11	17.4	6.4
2002/03	56229.8	11.5	84006.1	4.9	27776.3	492231	11.4	17.1	5.6
2003/04	62331	10.9	89442.6	6.5	27111.6	536790	11.6	16.7	5.1
2004/05	70122.7	12.5	102560.4	14.7	32437.7	589412	11.9	17.4	5.5
2005/06	72282.1	3.1	110889.2	8.1	38607.1	654084	11.1	17	5.9
2006/07	87712.2	21.3	133604.6	20.5	45892.4	727995	12	18.4	6.3
2007/08	107622.9	22.7	161349.9	20.8	53727	816083	13.2	19.8	6.6
2008/09	143461.3	33.3	219662	36.1	76200.7	989093	14.5	22.2	7.7
2009/10	182482.8	27.2	259689.1	18.2	77206.4	1193835	15.3	21.8	6.5
2010/11	203285.8	11.4	295363.4	13.7	92077.6	1368135	14.9	21.6	6.7
2011/12	250448.1	23.2	339077.2	14.8	88629	1528206	16.4	22.2	5.8
2012/13	303292.6	21.1	358404.6	5.7	55111.9	1696309	17.9	21.1	3.2
2013/14	365467.6	20.5	434027.9	21.1	68560.3	1942274	18.8	22.3	3.5
2014/15	399821.6	9.4	493489.8	13.7	93668.2	2124848	18.8	23.2	4.4

Source: various issues of Economic Survey, MOF, 2014/15.

Table 4.1 shows that, the pattern/trend in revenue and expenditure in Nepal. The sixth column shows the revenue expenditure gap in which we can see the increasing tendency mainly because of increasing volume of total expenditure than revenue. The amount of total expenditure was Rs.79835.1 million in FY2000/01 has gone up to Rs. 493489.8 million in FY2014/15; whereas total revenue has increased from Rs.48893.6 million in FY 2000/01 to Rs.39982.6 million in FY 2014/15.Thus , the resource gap is RS.30941.5 million in FY2000/01. The resource gap is continuously increasing each FY up to 2010/11 but after FY 2010/11 resource gap is decreasing continuously to FY 2013/14 and again it is increasing. We can show the different scenario of Resource Gap in Nepal in the following figure.

Figure - 4.1

Different Scenario of Resource Gap



Source: Based on Table 4.1

Figure 4.1 shows different scenario of resource gap. It shows that both revenue and expenditure are increasing year by year but the increasing rate if expenditure is higher than revenue. So, the gap between revenue and expenditure is very high in the every Fiscal Year but in last two year it is decreasing then after increasing.

The resource gap shows that the growth rate of revenue is greater than expenditure but annual growth rate of expenditure has increased rapidly then annual growth rate of revenue. This indicates the horrible situation of increasing trend/pattern of resource gap coming future.

After the restoration of multiparty system, the scope of government has been increasing and investing more, so the government expenditure is increasing. The reliance on taxation is not possible in view of the large amount of 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.

4.2 Public Debt for Financing Fiscal Deficit

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

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

The government meets the budgetary deficits by the following means:

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

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

The share of Nepal's internal and external debt is summarized in the given table.

Table: 4.2

Internal and External Debt as Percentage of Fiscal Deficit

(Rs.in million)

Fiscal year	Fiscal deficit (1)	Total Debt	Internal Debt (2)	External Debt (3)	(2) as percentage of (1)	(3) as Percentage of (1)
2000/01	30941.5	19044	7000	12044	22.62	38.93
2001/02	29626.7	15698.7	8000	7698.7	27.00	25.99
2002/03	27776.3	13426.4	8880	4546.4	31.97	16.37
2003/04	27111.6	13236.8	5607.8	7629	20.68	28.14
2004/05	32437.7	18204.2	8938.1	9266.1	27.55	28.57
2005/06	38607.1	20048.5	11834.2	8214.3	30.65	21.28
2006/07	45892.4	27945.8	17892.3	10053.5	38.99	21.91
2007/08	53727	29476.3	20496.4	8979.9	38.15	16.71
2008/09	76200.7	28386	18417.1	9968.9	24.17	13.08
2009/10	77206.3	41137.4	29914	11223.4	38.75	14.54
2010/11	92077.6	54591.4	42515.8	12075.6	46.17	13.11
2011/12	88629.1	47501.8	36418.7	11083.1	41.09	12.51
2012/13	55112	63835.5	38000	25835.5	68.95	46.88
2013/14	68560.3	41110.0	19980.0	21130.0	29.15	30.82
2014/15	93668.2	102270.0	52750.0	49520.0	56.32	52.87

Source: Economic Survey 2015/16, MOF

Table 4.2 shows that increasing trend of public debt from both internal and external sources, which was Rs. 19044 million in FY 2000/01, and has increased to Rs.102270 million in FY 2014/15. In FY 2014/15, debt increasing rapidly than previous FY, this is due to natural disaster in Nepal (earthquake of 2072).

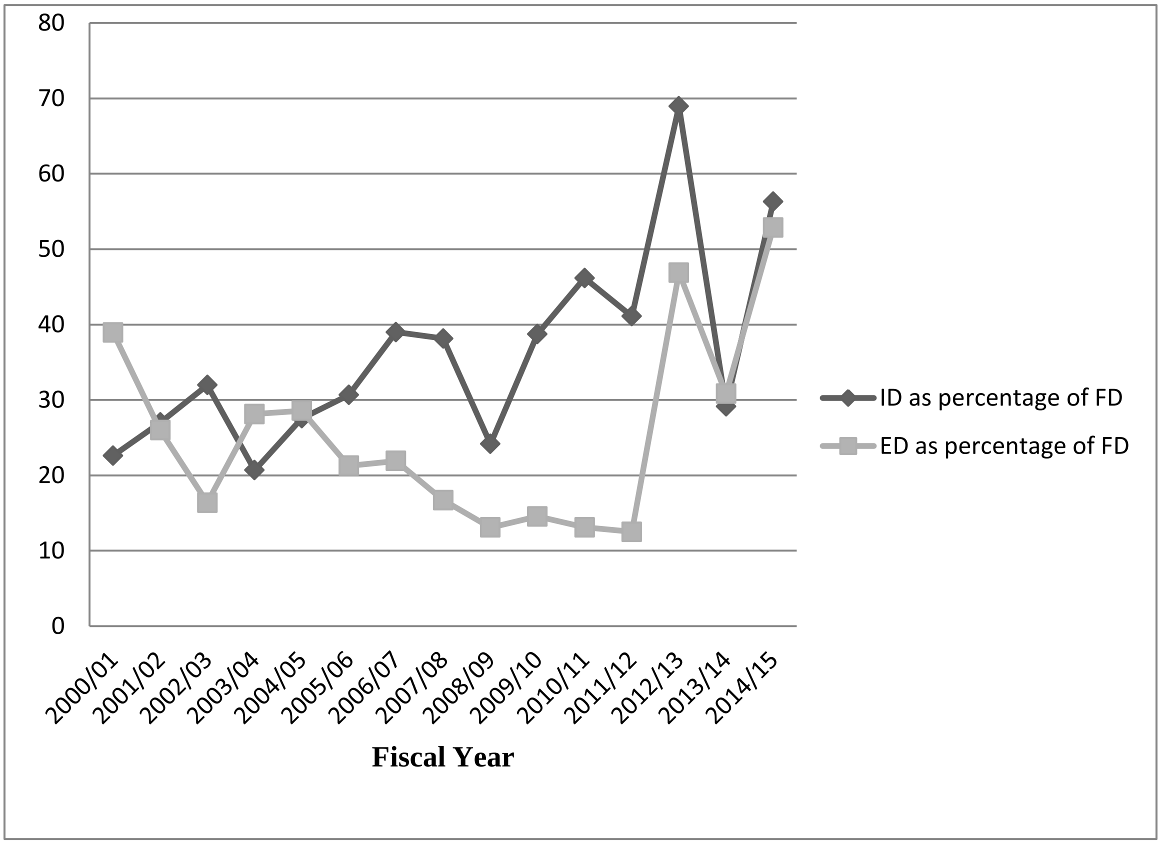
Internal debt was Rs. 7000 million in FY 2000/01 and gone up to Rs. 52750 million in FY 2014/15, whereas external debt was Rs. 12044 million in FY 2000/01which has gone up49520 million in FY 2014/15. This shows the tremendous increasing trend.

This table also shows that the percentage share of internal and external debt to fiscal deficit. The contribution of both internal and external debt to fiscal deficit has been fluctuating. The contribution of internal debt to fiscal deficit was 22.62 Percent in 2000/01 whereas that of external debt was 38.93 percent in FY2000/01. In FY 2014/15 the share of internal debt to fiscal deficit was 56.32 percent whereas external debt was 52.87 percent. This table shows the fluctuating trend of both debts in different FY.

In absolute terms, however, the table shows our growing reliance on external loan for meeting the ever-increasing fiscal deficit with the exception of mid three years. Even during this period, the absolute volume of external debt has not gone down; which means our reliance on external debt in meeting the fiscal deficit remained static. It is indicative of the fact that our economic performance has not been favorable enough to reduce the growing reliance on external loan during the last years. It has led as to think seriously about this alarming situation.

Figure: 4.2

Public Debt as Percentage of Fiscal Debt



Source: Based on Table 4.2

Figure 4.2 shows that percentage share of internal and external debt to fiscal deficit. The figure depicts the fluctuating trend to percentage share of contribution of both internal and external debt to fiscal deficit. Above figure shows the increasing trend of internal debt to fiscal deficit and decreasing trend of external debt. After FY 2013/14 the figure shows the increasing contributions of both debts to their fiscal deficit.

4.3 Export – Import Gap

Nepalese economy is developing economy where one of the major problems is export-import gap. Nepal is least developed country with limited exportable goods without specialization such as food, grains, garment product, carpet and other raw materials. Nepal is exporting low quality of goods in low price which reduce the competitiveness of the product. Major exportable goods are raw materials and food grain but import goods are final as well as capital goods. So that year by year the gap is growing rapidly.

There is no possibility to reduce import of goods. So that, we must be promote export. The trend/pattern of export and import of Nepal is shown on the table 4.3 below.

Table 4.3: Pattern of Export – Import Gap

(Rs. in million)

FY	Export(X)	Import(M)	Export-Import (X-M)	Growth Rate Of (X-M)
2000/01	55654.1	115687.2	-60033.1	2.3
2001/02	46944.8	107389	-60444.2	0.7
2002/03	49930.6	124352.1	-74421.5	18.8
2003/04	53910.7	136277.1	-82366.4	9.6
2004/05	58705.7	149473.6	-90767.9	9.3
2005/06	60234.1	173780.3	-113546.2	20.1
2006/07	59383.1	194694.6	-135311.5	16.1
2007/08	59266.5	221937.8	-162671.3	16.8
2008/09	67697.5	284469.6	-216772.1	25.0
2009/10	60824	374335.2	-313511.2	30.9
2010/11	64338.5	396175.5	-331837	5.5
2011/12	74261	461667.7	-387406.7	14.3
2012/13	76917.1	556740.2	-479823.1	19.3
2013/14	91991.4	714365.9	-622374.5	22.9
2014/15	85319.1	774684.1	-689365	9.7

Source: Economic Survey, 2014/ 15, MoF/GoN

Table 4.3 shows that the pattern of export in review periods. In FY 2000/01 the export was Rs. 5565.4 million and import was Rs. 115687.2 million whereas the export gap (X-M) in the same year was Rs. 60033.1 million. The pattern of export has been increasing and became Rs. 85319.1 million in FY 2014/15 and the import also has been increasing and became Rs. 774684.1 million in FY 2014/15, whereas the export –import gap (X-M) has been increasing each and every year and became Rs. 689365 million in FY 2014/15. The growth rate of export- import gap has been fluctuating in the beginning of review periods, it was 2.3 percent and became minimum 0.7 percent in FY 2001/02 and became has in maximum 30.9 percent in FY 2009/10.

4.4 Pattern of Public Debt in Nepal

After the restoration of multiparty system, the aspiration of people has increased out of the state along with the realization that economic growth is the key to country's development. The country needs huge investments in all sectors to attain a decent economic growth. This is driving the government expenditures upwards. Reliance on taxation is not realistic to meet the increasing government expenditures due to weak tax administration and poor income base. Hence, the country is facing growing financial resource gap to meet the development challenges. Public debt has been the main source for financing fiscal deficit in Nepalese fiscal system. Both external and internal borrowings are needed to supplement this resource gap. Following table shows government borrowing for the period 2000/01 to 2014/15.

Table 4.4: Public Debt

(Rs. in million)

FY	Total Debt	External Debt	Internal Debt	ED as % of TD	ID as % of TD
2000/01	19044	12044	7000	63.24	36.76
2001/02	15698.7	7698.7	8000	49.04	50.96
2002/03	13426.4	4546.4	8880	33.86	66.14
2003/04	13236.8	7629	5607.8	57.63	42.37
2004/05	18204.2	9266.1	8938.1	50.90	49.10
2005/06	20048.5	8214.3	11834.2	40.97	59.03
2006/07	27945.8	10053.5	17892.3	35.97	64.03
2007/08	29476.3	8979.9	20496.4	30.46	69.54
2008/09	28386	9968.9	18417.1	35.12	64.88
2009/10	41137.4	11223.4	29914	27.28	72.72
2010/11	54591.4	12075.6	42515.8	22.12	77.88
2011/12	47501.8	11083.1	36418.7	23.33	76.67
2012/13	63835.5	25835.5	38000.0	40.47	59.53
2013/14	41110.0	21130.0	19980.0	51.40	48.61
2014/15	102270.0	49520.0	52750.0	49.49	51.58

Source: Economic Survey 2016/17, MoF/GoN

Table 4.4 shows that fluctuating pattern of total public debt of government during the review period. Expect the year 2000/01 and 2014/15 internal and external debt shows the fluctuating pattern. The data explains that external debt has increased slowly for some years and there after it has followed fluctuating path. Internal debt was also followed fluctuating path. In FY year 2014/15 both internal and external debt was increasing very fast, this is due to earthquake of 2072.

4.4.1 Pattern of External Debt in Nepal

The foreign assistance in term of grant and loans are the major sources of external financing in Nepal. Needs of external borrowing are growing due to the revenue deficit. Internal debt is not sufficient to government activities. Due to the low resource mobilization the fund collection is inadequate. So, external debt is the most essential source of revenue to the government. Nepal has borrowed the external loan through bilateral and multilateral sources. Bilateral loans are loans from official export credit agencies, loan from autonomous bodies and direct loans from official export credit agencies. Multilateral loans are loans and credits from multilateral agencies such as WB, IMF, and Regional Developmental Agencies. The pattern of bilateral and multilateral debt is shown in the following table.

Table 4.5: Pattern of External Debt in Nepal

(Rs in million)

FY	Bilateral Sources	Multilateral Sources	Total External Debt	Percentage Share of bilateral Sources	Percentage Share of Multilateral Sources	GDP	Bilateral Source as % of GDP	Multilateral Source as % of GDP	External Debt as % of GDP
2000/01	586.7	11457.3	12044	4.9	95.1	441519	0.13	2.59	2.728
2001/02	87	7611.6	7698.7	1.1	98.9	459443	0.02	1.66	1.676
2002/03	657.2	3889.2	4546.4	14.5	85.5	492231	0.13	0.79	0.924
2003/04	66	7563	7629	0.9	99.1	536790	0.01	1.41	1.421
2004/05	126.5	9139.6	9266.1	1.4	98.6	589412	0.02	1.55	1.572
2005/06	40.6	8173.7	8214.3	0.5	99.5	654084	0.01	1.25	1.256
2006/07	9004.6	1048.9	10053.5	89.6	10.4	727995	1.24	0.14	1.381
2007/08	632.1	8347.8	8979.9	7.0	93.0	816083	0.08	1.02	1.100
2008/09	612.9	9356.9	9968.9	6.1	93.9	989093	0.06	0.95	1.008
2009/10	455.5	6672.8	11223.4	4.1	59.5	1193835	0.04	0.56	0.940
2010/11	4112.4	7963.2	12075.6	34.1	65.9	1368135	0.30	0.58	0.883
2011/12	3254.4	7828.7	11083.1	29.4	70.6	1528206	0.21	0.51	0.725
2012/13	9918	15917.5	25835.5	38.4	61.6	1696309	0.58	0.94	1.523
2013/14	5100	16030	21130	24.1	75.9	1942274	0.26	0.83	1.088
2014/15	23100	26420	49520	46.6	53.4	2124848	1.09	1.24	2.340

Source: Various Issues of Economic Survey (2014/15), MOF

Table 4.5 shows that pattern of external debt in terms of disbursement by major sources. The table observed that bilateral loan is in decreasing trend and multilateral loan is in increasing trend and it also reflect that the total external debt has been increasing in each Fiscal Year.

External debt is Rs. 12044 million in FY 2000/01 which is increasing to Rs. 49520.0 million in FY 2014/15. In FY 2000/01 Rs. 586.7 million from bilateral sources and Rs. 11457.3 million from multilateral sources were collected. In FY 2014/15, the bilateral loan has been increasing to RS. 23100 million and multilateral loan has been also increasing to Rs. 26420 million where the share is 46.6 percent and 53.4 percent respectively. The ratio of bilateral sources to GDP is 0.13 percent in FY 2000/01, which is increased to 1.09 Percent in FY 2014/15. Similarly, the multilateral source to GDP ratio is 2.59 percent in FY 2000/01 which is also decreased to 1.24 percent in FY 2014/15. There is high fluctuation in the both sources of external debt to GDP ratio.

4.4.2 Pattern of Outstanding Public Debt in Nepal

Nepal started to raise the debt since 1961/1962 systematically. From the very beginning of borrowing, it has kept the vital supporting role to meet the public expenditure. Now- a-days the fiscal deficit of country has been ever growing. The result is increment in the volume of outstanding public debt. To meet the financial resources gap, the government has to borrow a large amount of loan. There is ever increasing trend of financial resource gap to fill the needs loan from external and internal sources. There is ever increasing trend of financial resource gap which need more loan and repayment principle and interest vis-à-vis total borrowing in each year. It makes the outstanding public debt is increasing trend.

Table 4.6: Outstanding Public Debt in Nepal

(Rs. In million)

FY	Total Outstanding Debt (1)	AGR of Total Outstanding Debt	External Outstanding Debt (2)	AGR of External Outstanding Debt	Internal Outstanding Debt (3)	AGR of Internal Outstanding Debt	(2) as % 0f (1)	(3) as % of (1)
2000/01	260448.1	6.28	200404.4	5.09	60043.7	10.46	76.95	23.1
2001/02	293746.5	12.79	220125.6	9.84	73620.9	22.61	74.94	25.1
2002/03	308078.5	4.88	223433.2	1.50	84645.3	14.97	72.52	27.5
2003/04	318913	3.52	232779.3	4.18	86133.7	1.76	72.99	27
2004/05	307206.2	-3.67	219641.9	-5.64	87564.3	1.66	71.50	28.5
2005/06	328679.3	6.99	233968.6	6.52	94710.7	8.16	71.18	28.8
2006/07	320405	-2.52	216628.9	-7.41	103776.1	9.57	67.61	32.4
2007/08	353299.7	10.27	242060.6	11.74	111239.1	7.19	68.51	31.5
2008/09	397914.1	12.63	277040.4	14.45	120873.7	8.66	69.62	30.4
2009/10	399103	0.30	256243.3	-7.51	142859.7	18.19	64.20	35.8
2010/11	438880.2	9.97	259551.8	1.29	179328.4	25.53	59.14	40.9
2011/12	523618.5	19.31	309253.3	19.15	214365.2	19.54	59.06	40.9
2012/13	545351.6	4.15	333420.1	7.81	211931.5	-1.14	61.14	38.9
2013/14	553305.2	1.46	346795.2	4.01	206510	-2.56	62.68	37.3
2014/15	571314	3.25	354561.3	2.24	216752.7	4.96	62.06	37.9

Source: Various issues of Economic Survey, (MOF), quarterly economic bulletin (various issues) NRB

Here,

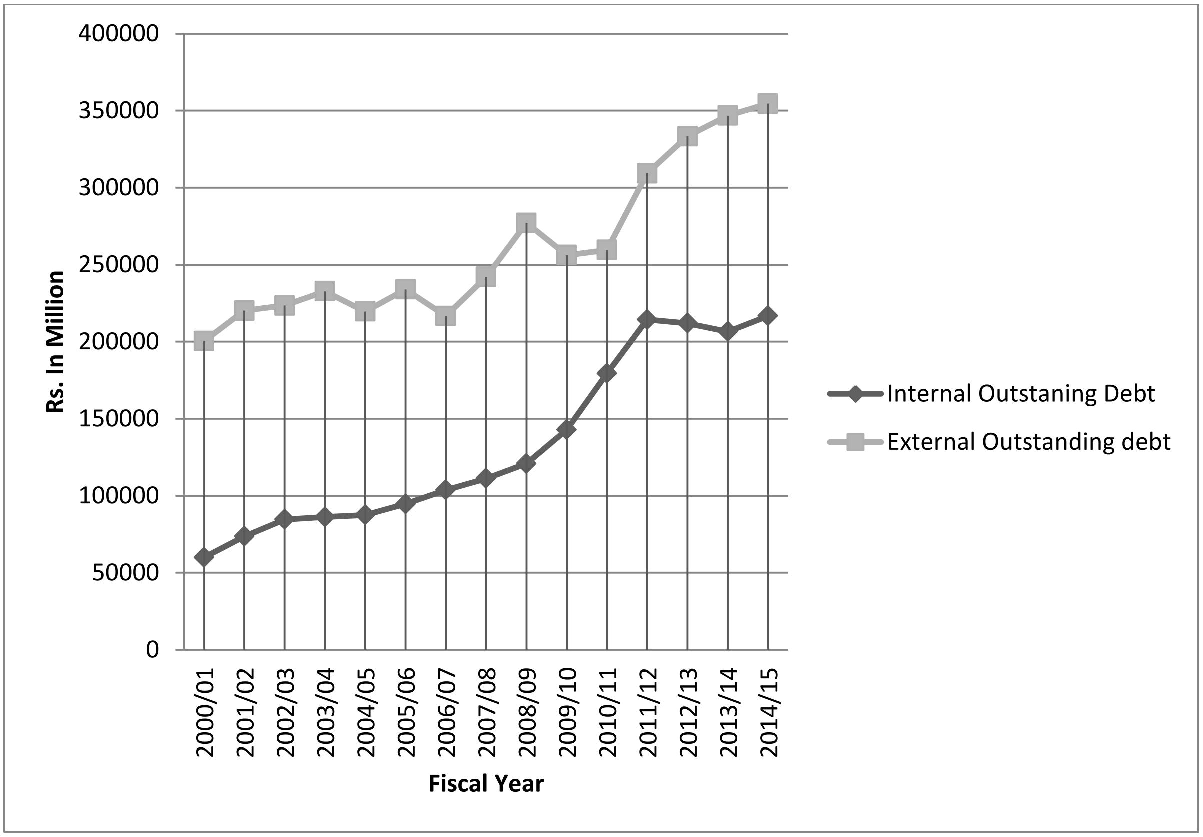
FY = Fiscal Year, AGR = Average Growth Rate

Table 4.6 shows that the total outstanding public debt has increased from Rs. 260448.1 million in FY 2000/01 to Rs. 571314.0 million in FY 2014/15.

Similarly, the outstanding external debt has increased from Rs. 200404.40 million in FY 2000/01 to Rs. 354561.3 million in FY 2014/15.

The outstanding internal debt has increased Rs.60043.70 million in FY 2000/01 to Rs. 216752.7 million in FY 2014/15. This shows that share of external outstanding debt in total outstanding public debt is higher than the share of internal outstanding debt in total outstanding public debt is higher than the share of internal outstanding debt in total outstanding public debt.

Figure 4.3: Trend of Outstanding Public Debt



Source: Based on Table 4.6

Figure 4.3 shows that trend of internal and external outstanding debt. It shows that both internal debt and external debt are increasing year by year but the increasing rate of external debt is higher than internal debt.

The role of public debt should be examined in terms of development concept embracing growth, distribution, survival and self- reliance. Debt has played a significant role in removing transport and communication bottlenecks, industrial backwardness, reduction poverty and agricultural backwardness. The inflow of internal debt to Nepal is in generally increasing trend the analysis period but there is no significant achievement in the Nepalese economy. External debt increased socio-economy and political dependency, reduce the self- reliance economic, increased heavy influence of foreign countries, unable to fulfill the resource gap in Nepalese economy. Debt liability is increase rapidly day by day. The utility of external debt can be positive involvement of the bilateral and multilateral source inefficient economic management. It would be rational received the external debt in the initial stage of the development and gradually decreased it influence. Indeed, which increased of external debt also increases heavy economic, political and social influence to Nepal.

4.5 Composition of Public Debt

Nepal started receiving foreign loans since the first year plan (1956/57-1959/60) but it systematically raised public debt since FY 1961/62 by issuing treasury bills of Rs. 7 million which carried one percent of interest rate. The government issued public debt regulation in FY 1963/64 which is still in practice. Since then, the amount of external borrowing has continued to increase every year. The main sources of external borrowing for Nepal are the governments of developed countries, international financing institutions, mainly the IMF, WB, and ADB.

Public debt is a useful tool for diverting resources from unproductive to productive sectors. Public debts, when used for joint ventures where by foreign investors bring technical know-how along with capital and then train local labor and enterprises, add in the capital formation.

Public debt is interrelated with the basic government fiscal flows of taxation and expenditure. If the volume of government expenditure exceeds the volume of tax revenue and other non- tax revenues then deficit budget exists. Such a deficit budget provides the fundamental precondition for debt creation. Once it is created debt requires interests' payments to maintain the debt and refinancing operations of the debt is beyond the maturities of existing securities.

In Nepal, there are mainly three reasons for raising the public debt:

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

Nepal has been borrowing fresh loans mainly to balance its deficit budget but they may be other reasons for public debt. 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 scarcity which is reflected in a large extent as ever government budgetary.

Nepal lacks the sufficient internal resources for the economic development. The huge amount of debt is inevitable. The debt proportion of the budget is relied upon the GDP of the nation, it is hence necessary to maintain the internal debt with in the limit of 2 percent of GDP.

4.5.1 Internal Debt Instruments of Nepalese Government

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

(i) Treasury Bill

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

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

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

(ii) Development Bonds

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

(iii) National Saving Certificate and Citizen Saving Certificate

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

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

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

4.5.2 Composition of Internal Net Outstanding Debt

Nepal has carried out internal borrowing program since four decades. It is used 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, special bonds and public saving cards from FY 2001/02.

Table 4.7: Composition of Internal Net Outstanding Debt

(Rs. In Million)

FY	Total Internal Outstanding Debt	Treasury Bills	Development Bonds	National Saving Certificate	Special Bonds
2000/01	60043.7	27610.8	5962.2	12476.4	13994.3
2001/02	73620.9	41106.5	11090.7	11536.1	9259.3
2002/03	84645.3	48860.7	16059.2	9629.8	9164.5
2003/04	86133.7	49429.6	17549.2	9029.8	8946.2
2004/05	87564.3	51383.1	19999.2	6576.7	8176.3
2005/06	94710.7	62970.3	17959.2	3876.8	8225.6
2006/07	103776.1	74445.3	19177.2	1516.9	7245.6
2007/08	111239.1	85033.03	21735.43	1116.92	5139.8
2008/09	120873.7	86515.1	29478.5	2169.5	5030
2009/10	142859.7	102043.7	35519.4	1015.6	5369.7
2010/11	179328.4	120340.7	43519.4	10680	5029.1
2011/12	214365.2	131624.1	57519.5	15680.1	5028.7
2012/13	211931.5	126468.1	51610.9	17522.4	5671.1
2013/14	206510	136468.1	47110.9	16586.5	5671.1
2014/15	216752.7	119858.1	57070	16586.5	5671.1

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

Table 4.7 shows that structure of internal outstanding debt. The government mainly mobilizes the internal resources by way of four instruments. The contribution of treasury bills is largest because its average annual growth rate is 31.2 percent, which is the highest of all.

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. 7 million. First issued in FY 1963/64, the next instrument of internal debt was development bond amounting to Rs. 250 million.

Above table shows the share of treasury bills, development bonds, national special certificate and special bond to total outstanding net internal debt. Treasury bills, development bonds, national special certificate and special bond amounted to Rs. 27610.8 million, Rs. 5962.2 million and Rs. 13994.3 million respectively in 2000/01.

On the table total outstanding debt is reached to Rs. 216752.7 in FY 2014/15. It reflects the highly indebted economy with low economic standard of citizens.

Treasury bills are increased from Rs. 27610.8 million in FY 2000/01 to Rs. 119858.1 million in FY 2014/15. Development bonds are increased from 5962.2 million in FY 2000/01 to Rs.57070 million in FY 2014/15. In case of national Saving Certificates it can be seen that it is raised fluctuating. The special bonds are also fluctuating. By the above table, we can conclude that the volume of internal borrowing has been increasing without corresponding increase in tax revenue collection viz-a-viz growth in the government expenditure. Such phenomena will also create the inflationary situation, which may lead us to debt crisis in future.

4.6 Internal Debt and External Debt Servicing in Nepal

Debt servicing of loan entails double burden. First, debt servicing has the primary claim upon the allocation of national budget. To that extent priority for economic activities such as irrigation, drinking water, health education, road and electricity are deprived of resources. Secondary, debt servicing of external debt involves the scarcest resource, the foreign exchange. It curbs the capacity to import and important capital goods needed for the country. Nepal has taking huge amount of external and internal loan with the obligation of future repayment. In Nepalese context, foreign loon context share is rapidly increasing which increase financial and real burden for the future generations. So the debt servicing is one of the problems of Nepalese economy because most of the portion of revenue has been used to pay the interest of internal and external debt.

Table 4.8: Internal Debt and External Debt Servicing in Nepal

(Rs. in million)

FY	TD Servicing	ED Servicing	ID Servicing	GDP	ID Servicing as % of GDP	ED Servicing as % of GDP	TD Servicing as % of GDP
2000/01	10388.4	6201.4	4193.2	441519	0.95	1.40	2.35
2001/02	12205.2	6567.5	5637.8	459443	1.23	1.43	2.66
2002/03	16181.3	7519.2	8663.4	492231	1.76	1.53	3.29
2003/04	17338.8	7552.2	8915.5	536790	1.66	1.41	3.23
2004/05	19751.3	7677.5	9164.8	589412	1.55	1.30	3.35
2005/06	20423.5	7908.9	9429.9	654084	1.44	1.21	3.12
2006/07	22916.3	8099.9	11651.4	727995	1.60	1.11	3.15
2007/08	22760.6	9150.8	11272.7	816083	1.38	1.12	2.79
2008/09	26988.3	9594.5	13321.8	989093	1.35	0.97	2.73
2009/10	28413.6	10014.7	14742.1	1193835	1.23	0.84	2.38
2010/11	29957.6	12494	14494.3	1368135	1.06	0.91	2.19
2011/12	30879.7	13201.1	15212.5	1528206	1.00	0.86	2.02
2012/13	31986.5	13540	16417.6	1696309	0.97	0.80	1.89
2013/14	32897.8	16363.2	17865.4	1942274	0.92	0.84	1.69
2014/15	34658.9	17013.4	17989.9	2124848	0.85	0.80	1.63
Average Annual Growth Rate					1.26	1.102765	2.564444

source: various issues of economic survey.

Table 4.8 shows that ratio of internal and external debt servicing to total debt servicing and their percentage share to GDP during the period 2000/01 to 2014/15. Above table shows the total servicing is increasing rapidly. In FY 2000/01, total debt servicing was Rs. 10388.4 million which has increased to Rs. 34658.9 million in FY 2014/15.

4.7 Burden of Public Debt in Nepal

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

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

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

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

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

In case of Nepal, outstanding of public debt is increasing rapidly each year. Large scale of public debts have been incurred in the past for financing development programs, but debt servicing capacity has not increased in the same pace so that there may be undue strain in the balance of payment owing to out flow of funds through debt services. Nepal has been borrowing new fresh loans to repay old loans. This also has alarmed situation of ‘debt trap’ in the future. Hence, proper utilization of debt is necessary to reduce the debt burden.

4.8 National Debt and its Share in GDP

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

Debt and rampant corruption. Here, table 4.1 shows the burden of debt through the method of measure of burden of debt as the ratio of Public Debt to GDP.

Table 4.9: Outstanding Debts and its share in GDP

(Rs in millions)

Fiscal Year	Total Outstanding Public debt	External Outstanding Debt	Internal Outstanding Debt	GDP	Share in Percentage of GDP		
					Total Debt	External Debt	Internal Debt
2000/01	260448	200404	60043.7	441519	58.99	45.39	13.60
2001/02	293747	220126	73620.9	459443	63.94	47.91	16.02
2002/03	308079	223433	84645.3	492231	62.59	45.39	17.20
2003/04	318913	232779	86133.7	536790	59.41	43.37	16.05
2004/05	307206	219642	87564.3	589412	52.12	37.26	14.86
2005/06	328679	233969	94710.7	654084	50.25	35.77	14.48
2006/07	320405	216629	103776	727995	44.01	29.76	14.26
2007/08	353300	242061	111239	816083	43.29	29.66	13.63
2008/09	397914	277040	120874	989093	40.23	28.01	12.22
2009/10	399103	256243	142860	1193835	33.43	21.46	11.97
2010/11	438880	259552	179328	1368135	32.08	18.97	13.11
2011/12	523619	309253	214365	1528206	34.26	20.24	14.03
2012/13	545352	333420	211932	1696309	32.15	19.66	12.49
2013/14	553305	346795	206510	1942274	28.49	17.86	10.63
2014/15	571314	354561	216753	2124848	26.89	16.69	10.20

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

Table 4.9 shows that the magnitude of outstanding debt, GDP and their ratio, which also assesses the burden of Public Debt. Total outstanding of Public Debt has increased from Rs. 260448 million in 2000/01 to Rs. 571314 million in 2014/15. And its share of GDP has decreased from 58.99 percent to 10.20 percent. The table also shows that the share of external debt has decreased from 45.39 percent to 16.69 percent and share of internal debt has increased from 13.60 percent to 10.20 percent respectively under the review period.

Observing table, the burden of external outstanding debt is greater than internal which may be anger in the future generation. In the table, GDP is also increasing from Rs.

441519 million in 2000/01 to Rs. 2124848 million in 2014/15 its growth rate of GDP is less than growth rate of outstanding debt.

Table 4.9 clears that the public debt to GDP ratio in Nepal is increasing very rapidly during the period between 2000/01 to 2014/15. It means that the burden of public debt is increasing.

4.9 Situation of Debt Trap in Nepal

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

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

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

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

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

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

a) Borrowed money is used for repayment of principal and payment of interest.
b) Large amount of loan is allocated for regular expenses.
c) The borrowed amount exceeds the debt bearing capacity of the country or the maximum legal limit (1-2 percent of GDP for internal debt).
d) High portion of loan is set-aside for meeting current expenditure.

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

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

CHAPTER V

EMPERICAL ANALYSIS AND INTERPRETATION OF DATA

Empirical analysis is the most important to show the relationship between dependent variable and independent variables of the study. It is the qualitative analysis of our research work. In this study, regression equation is used to analyze the relationship between GDP (dependent variable) and total debt, external debt, and internal debt (independent variables). Simple regression model has been used. Now, we have estimated the linear equation to determine the contribution of public debt in GDP. The regression carried out with 15 years of data from FY 2000/01 to 2014/15. However, no attempt has been made to correct the problem of serial correlation. All the statistical values are computed from computer via excel and SPSS program.

5.1 GDP and Total Debt

This analysis indicates the relationship between GDP (dependent variable) and total debt (independent variable). For this regression equation is given by:

GDP = a+bTD

The result of this equation is:

GDP= 286189.4+21.025TD…………………………………..(1)

Std. error (279186.13) (6.55)

R^2 = 0.7942

F-value = $(652.02)^{**}$ $(4.67)^{**}$

t- value = $(0.9196)^{**}$ $(2.145)^{**}$

** = Significant at 5 percent level of significance.

Function (1) shows the relationship between GDP and total debt where GDP is dependent variable and TD is independent variable. The value of b is 21.025, which show the positive impact of total public debt in GDP of Nepal or the economic growth of Nepal. It shows that one unit increase in total debt would lead to 21.025 unit increase in GDP. On the other hand, the value of intercept a is 286189.4, which indicates that is Rs. 286189.4, if independent variable TD is zero.

The coefficient of determination (R^2) is 0.7942 which indicates that 79.42 percent of the variation of GDP is affected or determined by the explanatory variable (total debt). The value of R^2 shows the goodness of fitness.

Similarly, the calculated F value (652.02) is greater than tabulated F value (4.67) so the regression line is significant, we reject the null hypothesis. And in the above function the calculated value of‘t’ (0.9196) is less than the tabulated value of‘t’ (2.145) which shows statistical significant of total debt at 5 percent level of significance. So, null hypothesis is accepted.

CHAPTER VI

SUMMARY OF MAJOR FINDINGS, CONCLUSION AND RECOMMENDATIONS

6.1 Summary of Major Findings

Through this research about the pattern, composition and effect of public debt in Nepalese economy especially to the output major findings can be discussed in following manner .Public debt is one of the widely accepted measures for financing government expenditure. It is loan raised by the government within a country or outside the country to meet growing expenditure. In the context of developing countries like Nepal public debt is playing a prominent role for socio economic development of the nation. Each and every year the government expenditure is increasing rapidly but the revenue is not growing in the same pace. So public debt is a source of deficit financing because economically Nepal is backward and its economic performance is not satisfactory. Now Nepal is facing an acute resources gap problem, which is also being expected to grow in coming years. Nepal is demanding more and more financial resources through public debt to fulfill the resources gap in budget.

Borrowing is taken from two sources: internal and external. In the internal sources treasury bills, special bonds, development bonds and national saving certificates are include. Large portion of internal debt is taken from banking sectors. Similarly, in external sources Nepal has been receiving borrowing in the form of bilateral and multilateral sources such as ADB, UNDP, WB, WHO, IMF, etc.

For the financing economic development of Nepal, both internal and external debt plays significant role. Public borrowing has to be undertaken within the country as well as abroad. It is not sufficient to promote the rapid development of the Nepalese economy, only through internal resources. Thus, external debt financing contributes significantly to the economic development of Nepal. The share of outstanding external debt in total outstanding debt is more than the internal debt. It seems that government could not raise enough internal borrowing due to its limited sources and the presence of non-monetized sectors. Now, Nepal is indebted by external and internal loans but further more by external outstanding debt. Consequently, external debt servicing has become a current issue. In the context of Nepalese economy, question may arise, whether our country's revenue and foreign exchange availability can sustain or not that increasing external debt servicing payment. If our country's sources cannot meet external debt service payment, there will be need to borrow again external loan for debt servicing in "Debt for debt servicing trap."

Resource gap in Nepalese finance has been always a common phenomenon since the systematic budgeting system in Nepal, which is only due to mismatch between the annual growth rate of government expenditure and that of its revenue. The widening resource gap in recent years has been cumulative effect if the deficiencies in the investment areas and continues absence of government's fiscal norms. Internal public debt has played a significant role in the financial resources for development expenditure as well as in the growth of money and capital market, and it facilitates the effective implementation of monetary policy. The domestic resources are not sufficient to promote the rapid development of the Nepalese economy. Therefore, external assistance (loans and grants) plays all obvious functions in the development force for financial resources. Concerning foreign assistance, grants have vital role to play in solving the resource gap for the country's budgetary expenditure.

Summary of major findings are as follows:

- There is excessively increase in government expenditure which leads to increase in fiscal deficit. In FY 2014/15 fiscal deficit is Rs. 93668.20 million which was Rs. 30941.50 million in FY 2000/01.
- Major source of financing deficit are loans and grants. In loan share of external borrowing is higher than internal borrowing. In FY 2000/01 the share of external loan was Rs. 12044.0 million whereas the share of internal borrowing was 7000.0 million. In FY 2014/15 the amount of external debt is Rs.49520.0 million and the amount of internal debt is Rs. 52750.0 million. It shows that both sources of borrowing are increasing rapidly. But, in FY 2014/15 share of internal debt are more than external due to earthquake of 2015.

- In the period of review total outstanding debt increased from Rs. 260448 million in FY 2000/01 to Rs. 571314 million in FY 2014/15.
- Fiscal deficit (TE-TR) was Rs. 30941.5 million in FY 2000/01, which increased to Rs. 93668.2 million in FY 2014/15.
- In the study period export import gap are grow. Import is higher than export. In FY 2000/01 import is 15687.20 whereas export is 55654.10, In 2014/15 which is 774684.1and 85319.10 respectively.
- Share of total debt, internal debt and external debt on GDP shows the increasing trend. Share of external debt is more in GDP than internal debt. It means the burden of external debt is more than internal debt in GDP. In some last years of study period, share of external debt shows decreasing trend. It is because of worse political condition of country but not due to strong and sustainable development of the country. This shows increasing public debt burden over the head of each Nepalese people.
- Annual growth rate of government revenue is 14 percent in FY 2000/01, which is 9.4 percent in FY 2014/15. Similarly, annual growth rate of government expenditure is 20.5 percent in FY 2000/01, which is 13.7 percent in FY 2014/15.
- Within the study period multilateral external loan dominates the bilateral external loan. Also the increasing trend of direct loan shows the increasing external debt born. Also the share of external loan in GDP is higher than internal loan. Per capita burden of both external and internal loans are increasing. Internal debt service ratio shows that Nepalese government is compelled to cut down development expenditure to cover recurrent expenditure, which is most. Also the external debt service ratio shows significant amount of export earning is used to pay principal and interest of external loans.

6.2 Conclusion

Nepalese economy characterized as three kinds of macroeconomic imbalances saving – investment gap, export – import gap, and revenue – expenditure gap. These fundamental gaps represent the foreign dominance in Nepalese economy, while saving – investment and revenue – expenditure gaps are mainly consequence of excess activities in economic matters. To fulfill these gaps public debt in the form of either internal or external is inevitable. The growing pattern/trend of the 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 indebtedness of the external debt has increased due to the poor mobilization of internal resources, widening investment-saving gap, export-import gap and revenue- expenditure gap and large amount of fiscal deficit. So there has been excessive flow of foreign loans to fill up these gaps. Consequently burden of debt and debt servicing obligation are increasing rapidly in each year but the debt servicing capacity of economy is not increasing in the same pace.

In course of research, it was found that government borrowing has been increased rapidly and financed mostly on the unproductive sectors including high expenditure, uncertainties, 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 mounting rapidly, but addressing capacity for redemption and debt is not increasing in the same pace.

During the period of study between FY 2000/01 to FY 2014/15, it is concluded that the average annual growth rate of GDP and revenue are considerably low as compared with that of debt and its servicing obligation and the most of the borrowed funds are using in unproductive sectors. Because of these misuses of borrowed funds, other things are remaining same; there are symptoms of steady falling in to the debt trap soon. Anyway the public debt plays vital role in socio-economic development of the country and it is widely accepted measure for financing government expenditure.

6.3 Recommendations

On the basis of above findings, the following recommendations are proposed, which can be helpful for to check the problems of debt finding in Nepal:

i. On the country, the maximum export-import gap is the main feature of foreign trade deficit of Nepal. For this, there is a need for export promotion and diversification of trade both country wise and commodity wise. The establishment and operation of export processing zone would be great help to enhance the export of Nepalese goods.

ii. Government should maintain fiscal balance by applying strong fiscal monetary policy, which might contribute to control growing unproductive and useless expenses in one side and increased revenue on the other side. Government efforts should be directed towards mobilizing internal resources and thus to reduce dependency on loans for financing development expenditure.

iii. The size of revenue collection is very low and expenditure is very high which creates fiscal imbalance. This has leads to heavy borrowing from internal and external sources. So, for reducing the volume of borrowing and maximizing revenue collection, government should adopt effective tax policy by improving tax administration.

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

v. To increase the debt servicing capacity, government should increase GDP growth, revenue growth and export earn growth in sustainable path so that country will not trapped on debt servicing problem.

vi. Internally raised funds are to be spent on the construction of particular projects, which may provide benefits for longer periods of time. This will reduce the burden of public debt in the long-run.

vii. The internal borrowing for short-term should be minimized and long-term internal borrowing should be given priority.

viii. To reduce the foreign dependency various measures must be applied such as export promotion, import substitution and tourist attraction policy/strategic management foreign employment, the major sources of foreign exchanges in Nepal. Government should proper mobilize its resource in every field of the economy such as building infrastructures hydro power, communication, transportation, agriculture, industries, health, education etc.

ix. The policy to discourage capital flight should be developed and conductive environment need to be made for foreign direct investment to accelerate national development and at last, proper attention should be given by NRB to the macroeconomic stability of the country while accepting external loans.

x. To reduce the foreign dependency various measures must be applied such as export promotion, tourist attraction, and import substitution policy should be emphasized and import of capital goods should be increased for the productive purpose.

xi. Nepal is indebted day by day with external debt and debt payment burden. Therefore, country should generate new sources to stop external borrowing.

xii. Government should be conscious of falling in to debt trap. To prevent the country from debt trap; the government should create new debt servicing capacity. The inflowing loan should be utilized in productive and foreign currency earning areas.

xiii. And proper attention should be given to maintain macro-economic stability of the country while borrowing.

Effective mechanism should be to complete the development projects on time, so that interest burden should be minimized and recovery can be accelerated. Lack of appropriate utilization mechanism of debt would definitely lead to the increasing burden. Thus, such debt burden might create a situation where the economy could not be able to bear the burden. It would be a disaster, more debt it's taken to pay the principle and interest amount. Time has come to be "prudent" in debt management.

ANEX - A

TOTAL DEBT AND GDP

(Rs. in million)

Fiscal Year	Total debt X	GDP Y
2000/01	19044	441519
2001/02	15698.7	459443
2002/03	13426.4	492231
2003/04	13236.8	536790
2004/05	18204.2	589412
2005/06	20048.5	654084
2006/07	27945.8	727995
2007/08	29476.3	816083
2008/09	28386	989093
2009/10	41137.4	1193835
2010/11	54591.4	1368135
2011/12	47501.8	1528206
2012/13	63835.5	1696309
2013/14	41110	1942274
2014/15	102270	2124848
Total	535912.8	15560257

ANNEX –B

Variable		Result of Regression Coefficient		R^2	t-test	f-test
Dept.	Indept.	b_0	b_1			
GDP	TD	286189	21.025	0.7942	0.9196	652.02

Where,

Dept. = Dependent Variable

Indept. = Independent Variables

R^2 = Coefficient of Determinant

GDP = Gross Domestic Product

TD = Total Debt

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