CHAPTER ONE
INTRODUCTION

1.1. General Background

The fundamental purpose of economic life is the satisfaction of human needs in relation to limited resources. Economic resources are inadequate in relation to the demands to their alternative uses. One the one hand, in a society their wants of varied interests, on the other hand, there are resources at our disposal which are scare. The main problem of every society is the allotment of limited resources to the satisfaction of human needs in a manner that brings maximum satisfaction.[1]

Landlocked between India and China, Nepal has a population of about 23 million and covers an area of 147,181 sq. km. Nepal is an underdeveloped county with the renowned for its social cultural diversity of more than100 ethnics, 92 languages and 9 religions (CBS, 2001). Underdeveloped countries are those countries which are comparatively poor and where people do not enjoy on an average normal standard of living and where therefore, per capita real income is very low. In underdeveloped countries not only the capital stock very low but the current rate of saving is also very low. As they have to reach the stage of self-sustaining growth when their saving along would not suffice to meet the overall developmental outlay, they have to fill up this gap by means of large foreign aid.[2] Stimulating the economic growth with stability is one of the major goals of developing countries, like Nepal. In Nepal private sector is not well developed to run all the economic activities hence government of Nepal is not involving only in welfare activities like providing education, health facilities, constructions of roads and bridges, development of technology and communication but also directly engaging in productive activities.

[1]Tondon, B.C., Economic Planning, pp.2-3
[2]Tondon, B.C., Economic Planning, pp 270-288

For these the government expenditure obviously increases. Then there required the large volume of government income.

The government can bridge the gap of budget deficit or can generated the income from different sources like increasing the revenue through increasing in the existing tax rate or introducing new taxes or borrowing from the public (internal and external) or issuing new currency. Change in tax rate or introducing new taxes suffer from certain drawback and creating new money may also cause change in the rate of general price level both in developed and underdeveloped economy.

In these ground public debt is the useful tool for the economic development. “Public debt is a comparatively modern phenomena and has come into existence with the development of democratic form of government in the world” (Prof. J. K. Mehta) A government can borrow from internal as well as external sources. Thus public debt is the sum total of internal and external debt. Internally government can borrow from its citizens, commercial banks, financial institutions, charitable funds and from the central bank of the country. On the other externally government can borrow from internationals banks, international financial institutions and from the foreign governments.

Government debt (also known as public debt or national debt) is money (or credit) owed by any level of government; either central government, federal government, municipal government or local government. As the government draws its income from much of the population, government debt can be seen as an indirect debt of the taxpayers. Government debt can be categorized as internal debt, owed to lenders within the country, and external debt, owed to foreign lenders. Governments usually borrow by issuing securities, government bonds and bills. Less creditworthy countries sometimes borrow directly from supranational institutions. Some consider all government liabilities, including future pension payments and payments for goods and services the government has contracted but not yet paid, as government debt.[3]

[3] Wikipedia, Web Dictionary

According to the Encyclopedia Britannica "Public debt refers to the obligation of government, particularly those evidences by securities to pay certain sums to the holders at the same future date."

The scope of internal debt in developing countries like Nepal is very limited because of the low rate of saving caused by the low rate of capital formation and less employment opportunities followed by the less income. In such case developing nations are externally depended in case of public debt.

In Nepal public debt plays the very crucial role for the economic development. It is widely accepted as a tool of deficit financing measures to reduce the balance of payment deficit, trade deficit and resources gap. In Nepal like other development countries there are limited areas of taxation and it is neither desirable nor justice to raise the volume of taxation as well because most of the people are suffering from lack of basic needs. The imposition in tax means curtailment of their consumption capacity which may cause serious effect in the general public. Here public debt may be considered as the effective tool to raise the government revenue.

To utilize the unutilized resources in Nepal huge dose of investment is needed which can be generated through the means of internal and external debt. Recently the internal as well as external debt of Nepal is increasing rapidly. The trend of external debt is increasing more than that of internal debt. The developing countries need lump sum of foreign currency while importing goods and services from abroad, for these also they need to take debt because their import is many times higher than export.

Public debt in Nepal has positive as well as negative impact. On the one hand public debt is being a revenue raising instrument which has working as the fuel to the economic development. On the other hand there is the possibility of debt trap. Any way in present world no country can be imagine without the public debt. Not only underdeveloped nations but also developed nations are also depending somehow in public debt. It is the very important tool for the economic stability as well as price stability along with promotion of the agriculture sector, industrial sector and territory sector. ".. no specific can be too great that required to preserve national security and independence and a loan expanded on armies or fleets employed for such a purpose is quite as well and profitably employed as if it had been laid out on agriculture or in promoting manufactures or trade." [4]

1.2. Statement of the Problem

To gain the fruit of growth from public debt, effective management of public debt is needed, but in Nepal there lacks the effective management. To address the wider resource gap and boosting up population each year the amount of public debt in Nepal is increasing.

Nepal is suffered by the mass poverty, mass unemployment which causes low productivity, low income that is link with the low rate of marginal propensity to save or higher marginal propensity to consume. So Nepal is more dependent in foreign debt. Though both internal and external debt in Nepal has been increasing rapidly, external debt has been leading to the internal debt. The foreign loan ratio is leading to the foreign grant ratio in these years which may cause the excess burden to the future generation.

The burden of public debt depends upon the nature of investment. If the public debt is used for development purpose or in productive activities it may create real assets and there will be fewer burdens. But if it has been used for recurrent expenditure or in unproductive sector like security it may badly affect or it causes the excess burden. In Nepal the magnitude of public debt is increasing rapidly, but the redemption on public debt is almost negligible especially in the case of external debt.

The government of Nepal is spending public debt in the unproductive sector as well which causes the excess pressure in the economy. The economy may fall in debt trap, that is, borrowing to pay the loan. Our country Nepal is heavily indebted and the general price level is in running pace (in two digits) and the debt servicing capacity of

[4] Findlay Shirras, Public Finance

the government is declining. Hence it causes the greater challenge for the management of public debt.

To the increasing population and unemployment, the pace of development is not taking place. In such scenario is it not reasonable to thing about the increase in the taxation and saving ratio. So the internal resources are obviously low. So the only way is to depend upon the external sector. The history prevails the government of Nepal is fulfilling the more than 75 percent of budgetary deficit has financed by external debt in most of the fiscal year.

The increase in the public debt and decrease in the debt servicing may cause the serious effect in the economy in the coming future so the government of Nepal should be conscious enough to curtail the increasing trend of public debt and improve the debt servicing trend. For this effective management of public debt can't be ignored.

1.3. Objectives of the Study

a. To analyze the trends and structure of public debt in Nepal
b. To study about the resource gap and identify the burden of public debt in Nepal
c. To assess the effective measures for the debt management

1.4. Significance of the study

Developing Countries like Nepal are suffering from low rate of saving, investment, employment opportunities, and which cause the low living standard. The poor infrastructure and growing population causes the excess pressure on the resources and causes the various serious effects. In Nepal more about 28 percentage of population are below the poverty line. It is unjust to hope saving from them because they even struggling to fight against their appetite; disguise unemployment is deeply affected especially in primary sector and rate of inflation is in two digits.

The state activities in developing countries like in Nepal are in increasing trend. The government must make huge invest in those sectors where private sectors insist of invest as well as to serve the fundamental rights of the people it has been investing in various sectors such as education, health, local development, defense, agricultural and industrial development, transportation and communication. That is the needs are growing and means to satisfy those needs are limited in such scenario public debt is common and appropriate tool for resource mobilization to break the vicious circle of poverty, prevailed inequality , growing unemployment and underemployment as well as for the social and cultural transformation.

This study focuses on the present scenario of public debt, its trends and structure, necessity of public borrowing and consequences of the outstanding public debt in Nepalese economy. And it would be equally helpful to get the knowledge about internal and external borrowing of the Government of Nepal, Sources of public debt and its existing situation. So it might be helpful topic for the researchers, policy makers and learners.

1.5. Research Methodology

Methodology is the justification of the existing stock of knowledge and obviously it is an outcome of rational mind. It is the finding of truth with the help of analysis, observation and experiment. It provides the overall framework or plan for the collection, presentation and analysis of data required to fulfill the objectives of the study. This includes the research design, methods of data collection, tools and techniques of data analysis and definition of variables.

1.5.1. Research Design

Research design is a process or an outline to achieve targeted goal. The research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research propose with procedure. This research is designed to examine the trend and structure of public debt.

1.5.2. Sample Size

In order to examine the trend and structure of public debt 18 years' data (FY 1990/91 to 2007/08) have been taken into study.

1.5.3. Method of Data Collection

This research is based on the secondary data, which have been issued and published in books, magazine, reports, journals etc. And the major sources of data are budget speeches MOF/GON, various issues of Economic Surveys of MOF/GON, NRB, CBS, ADB and other relevant organization. The value of numeric variables such as such as total debt, internal debt, external debt, GDP, outstanding debt etc. has been taken from economic surveys MOF/GON.

1.5.4. Method of Data Analysis

The study is analytical and descriptive. Priority has been given to the recent published data for the requirement of the objectives of the study. Simple statistical tools are used for analyze the data. This research is based on tabular analysis, graphic analysis, percentage, average, time series analysis etc.

1.5.4.1. Simple Regression Analysis

This establishes the relationship between dependent and independent variable like GDP, total debt and internal debt. Simple ordinary least square linear regression model has been used to analyze the role of public debt in economic growth.

The statement of regression model is that GDP depends upon the internal debt, external debt and total debt. This shows the relationship between GDP, internal debt, external debt and total debt. Symbolically,

i) GDP = a + b ID

ii) GDP = a + b ED

iii) GDP = a + b TD

Where,

GDP= Gross Domestic Product

ID = Internal Debt

ED = External Debt

TD = Total Debt

'a' and 'b' are the parameters.

1.5.5. Definitions of Terminology

Several variables used in this study for data analysis. Most widely used variable are as follows:

- Public Debt: total loan raised by a government within the country or outside the country
- Internal Debt: the loan raised by the government within the country form individuals, commercial banks, financial institutions, charitable funds and the central banks
- External Debt: government borrowing from external sources that is bilateral and multilateral source
- Gross Domestic Product (GDP): measure of the total output of goods and services at factor prices
- Debt Servicing : payment of interest and principal amount after maturity

1.6. Limitations of the Study

1. This study is based upon secondary data of the various publications and the reliability of those data has not been examined.
2. The study covers only the period from 1990/91 to 2007/08.
3. The study is not attempted to examine the effect of public debt on macro economic variables like in money supply, inflation, employment, national income due to time and resource constraint.

1.7. Organization of the Study

This study has included five chapters. The first chapter deals with the *introduction and methodology* used in the research. The second chapter is *Literature*. The chapter three is the *Trend and Structure of Public Debt in Nepal*. Chapter four gives the *Burden of Public Debt in Nepal* and fifth chapter includes *Summary, Conclusion and Recommendation*. At last there is the list of *Bibliography*.

CHAPTER 2

LITERATURE REVIEW

2.1. Introduction

Public debt is newly invented phenomena and was not heard prior to 18^{th} century. In the ancient time the monarchs used to accumulate treasure in peace to be used in the times of need the practice of raising loan grew gradually. In the middle ages there was a strong sentiment against borrowing. Till the 19^{th} century under the influence of 'laissez faire' philosophy the function of the government was limited only to unavoidable minimum duties. Public debt was not so common in practice. However borrowing became common in England and France with an increase in cost of the government.

But today borrowing by the government has become a normal feature of government finance along with the other sources of public finance like taxes, fees etc. In all the countries the public debt tendency has been increasing. In regard public debt, in underdeveloped countries there the dominance of external debt and on the other in developed countries internal debt cover the most percentage.

A journal[5] published by Springer Berlin (March, 2007), subject related to Business and Economics has discussed about classical economists and public debt. The major findings of journal include:

- The classical economists had developed advanced theories of public debt. These theories, however, have received less attention compared with those of value and distribution.
- Classical theories of national debt at best receive cursory consideration and are only used to offer further justification to modern theories.

[5] Springer Berlin /Heidelberg. "International Review of Economics", Volume 54, Number 1/March, 2007, pp 1-12

- Smith's discussion of the unproductive role of the state and the Ricardian equivalence theorem are examples that are found routinely in the books of public finance or macroeconomics.

The classical economists were against the public debt. They propositioned that individual, consumer or business firm employ the resources more efficiently under fully employed economy government acquire the resources by borrowing only at the cost of private sector when they are more fruitfully engaged for production process. They approved that public debt is only for the productive process, so that the debt servicing and refund of principal do not add additional taxation.

The World Great Depression of 1930's was created due to the over production and the failure of classical notion of public finance because classicalists believe that the budget should be balanced. It was Keynes who succeed to overcome the great depression by advocating the laws of public finance that the aggregate demand should increased by spending more money on the public by deficit financing. The government should use the resources which may unproductive in private sector. Hence public borrowing need not worry about their size because resources are transferred from private sector to government sector.

Learner, A.P. [6](1946) founder of the function finance approach to public debt further explained that public borrowing should be judged in terms its effect and aggregate demand and government should not be distributed another size of the debt, because debt servicing posses no problem, since it is always open to the government to borrow from central banker take resources to printing press to pay interest charges and reply the principal at it measured.

2.2. International Context

A latest regional survey[7] conducted by UNESCAP is a very good survey in fiscal deficit and public debt sustainability in South Asia. It points out that high levels of

[6] Learner, A. P. (1946), "Economics of Employment", Oxford University Press, London
[7] Economic and Social Survey of Asia and Pacific 2008, (27 March, 2008), UNESCAP

public debt in South Asia remain a burden. Similarly it says that lowering high public debt ratios is essential to avoid adverse economic and social consequences.

The major findings of that survey include:

- Both domestic and external public debts carry concerns of higher interest rates and lower private investment.
- While the share of domestic public debt in total debt is on the rise in most countries, domestic debt has received relatively less attention despite its serious economic and social implications.
- Across South Asia, debt has been a focus of government policy.
- South Asia's public debt sustainable would require controlling fiscal deficits, expanding government revenues, and prioritizing development spending on key areas.
- Public expenditure, as a priority, should promote pro-poor growth, and basic services such as education, health, sanitation and housing.

The survey shows that in 2006 in Sri Lanka, public debt stood at 93 per cent of GDP-the highest in the sub-region and the result of years of high fiscal deficits. In India public debt is estimated at 82 per cent for fiscal year 2006. A credible debt reduction strategy and faster economic growth reduced the public debt burden of Pakistan from 84 per cent of GDP in 2000 to 57 per cent by 2006. In Bangladesh, the level of public debt has stabilized below 50 per cent of GDP and is estimated at 47 per cent in 2006. In Nepal, public debt stood at 56 per cent of GDP in 2005.

The survey warns that Sri Lanka may face an unstable situation if GDP growth and primary balances continue at average of the last decade, an already high debt-to GDP ratio would continue rising. On a positive note, if India's high GDP growth and fiscal consolidation continue then the debt-to-GDP ratio will fall by ten percentage points over the next five years. The survey also notes that in the case of Pakistan the improvement in the ratio of domestic public debt to GDP since 2001 appears to have bottomed out. For Nepal, no reduction in the debt-to-GDP ratio is expected in the medium term.

Christina Daseking and Julie Kozack[8] (2003) make a study about low-income countries and analyze that low-income countries face serious challenges in meeting their development objectives, embodied in the Millennium Development Goals (MDGs). The authors point that some features that characterized many low-income countries actually work in their favor, but others limit these countries' capacity to borrow on a sustainable basis as;

- Many low income countries receive hardly any private capital and very little foreign direct investment (FDI) but, instead, depend on official grants and consessional loans to finance investment. As a result, these counties are largely insulated from the instability of the private capital flows.
- Investment and debt dynamics in low-income countries-more so than in other countries-are subject to a number of pitfalls.
- Finally with narrow and highly volatile production and export bases, low-income countries are particularly vulnerable to exogenous shocks that may significantly alter their debt dynamics.

The study further states that in a world of limited development aid, countries need to strike a careful balance between the financing they require to meet their development objectives and the debt service they are able to afford. Since low-income countries' economic and social needs are generally high, governments may be tempted to borrow large sums up fond to generate the benefits as quickly as possible. The study says that a durable borrowing strategy must incorporate such considerations, which generally pose themselves in the form of five types of constraints on low-income countries' ability to generate the resources necessary too service their debts:

- *Total resource constraints*, given that debt service must be met out of a country's gross domestic product.

[8] Christina Daseking and Julie Kozack (2003),“ Avoiding Another Debt Trap”, Finance and Development, December

- *Foreign exchange constraints*, reflecting the limited degree to which domestic factors of production can be transformed into a foreign exchange required for debt service and financing of imports.
- *Fiscal constraints*, reflecting governments' limited ability and capacity to levy taxed to meet debt service on top of other expenditures priorities.
- *Rollover constraints*, reflecting reliance on primarily official creditors and donors to refinance lumpy debt-service-payments.
- *Political and moral considerations*, such as those associated with the resources allocated to debt service in relation to social or poverty related expenditure.

Kappagoda, Nihal[9] (2001) wrote very good paper for effective public debt management. He postulated some priorities that should given consideration when establishing a framework for debt management.

- Government should set clear objectives for public debt management. Such as;
    - ensure the financing needs of the Government;
    - minimizing borrowing costs;
    - keep risks at an acceptable level;
    - support the development of domestic markets.
- Governments should establish a clear legal framework for public debt management setting out in unambiguous terms the responsibilities of agencies authorized to borrow, issue guarantees and undertake financial transactions, such as on lending, on behalf of the government.
- Governments should ascertain the full extent of their contingent liabilities, disclose them and make adequate provision in the budget for likely losses.
- There should be effective coordination of policy formulation among staff responsible for debt management and for the fiscal and monetary policies of the government while maintaining separate responsibility for each of the activities.

[9] Kappagoda, Nihal (2001), "Public Debt Management: A New Priority", Asia-Pacific Perspectives 2001/2, ESCAP, United Nations

- Government should establish guidelines for managing risk in the loan portfolio that embody the strategy adopted by public debt management offices for achieving their stated objectives.

An article “Complex Challenges in Developing Country- Debt”[10] (2005) prepared after surveying significant changes in developing-country finance since the mid-1990s, focus on current trends in external debt in emerging-market economies. The interplay between external and domestic debt and the special challenges of managing a mixed portfolio are the subjects.

The major findings of this article include;

- Overall external indebtedness has improved.
- The composition and nature of external debt has changed.
- Domestic debt markets have grown rapidly in emerging-market economies, lending to new uncertainties about the scale of the overall debt burden in many countries.
- The policy environment has improved in many countries, notably the East Asian countries that were the focus point of the recent crises.
- Progress has been made on the international framework governing debt.

The article states that external and domestic financing practices influence each other, and both are affected by the overall policy environment of individual countries. For this recommendations are;

- The public sector’s fiscal position must rest on efficient revenue collection and well-aligned spending plans that factor in contingent liabilities.
- A strong institutional framework is needed to manage the nation’s financial infrastructure.
- Lower external debt improves the terms on which foreign-source capital may be obtained and reduces the overall vulnerability of developing countries to shocks from the external financing environment.

[10] “Complex Challenges in Developing Country – Debt”, Global Development Finance, 2005

- Both external and domestic indebtedness require diligent monitoring.

Svaljek, Sandra [11](1997) evaluated the sustainability of borrowing policy in the republic of Croatia. A comparison of the basic debt indicators calculated for the Republic of Croatia with indicators of the same kind for a sample of countries as

- The share of interest on public debt in total revenues of consolidated central government.
- The share of interest on public debt in total expenditure of consolidated central government.
- The share of interest on public debt in GDP.
- The share of deficit in total expenditures of consolidated central government.
- The share of deficit in GDP.
- The share of public debt in GDP
- The share of internal public debt in GDP and
- The share of external public debt in GDP.

The sample contains 13 countries such as Ireland, Malta, Cyprus, Turkey, Spain, Portugal, etc. And the study was made by taking 1994 as reference year.

Sandra Svaljek found the following;

- The share of public debt in GDP differs considerably from one country to another, acquiring values ranging from 18.71 percent in the Czech Republic to very high 103.78 of GDP in Greece and 147.82 in Bulgaria. The Croatian debt is somewhat higher than the one in low-debt Malta and Slovakia.
- Croatia has a relatively low share of interest rates in government revenues and expenditures, i.e. in GDP. In comparison with Croatia, only Bulgaria has a lower proportion of interest in total revenues, expenditures and GDP respectively.

[11] Svaljek, Sabdra (1997), "Public Debt Boundaries: A review of Theories and Methods of the Assessment of Public Debt Sustainability", Economic Trends and Public Policy, No. 61, pp34-64

- The public debt structure of the developed countries, there still prevails internal public debt, which is much more favorable for the external stability of a country.
- Croatia belongs to the countries whose citizens and businesses have a higher burden of paying taxes to the central government.
- Indicator of the tax burden on the general government level in the Republic of Croatia represents the highest value of this indicator.

The implications of the obtained results for the future borrowing policy of the republic of Croatia had been given follows;

- Taxes and loans should be observed as alternative sources of financing public needs. If a country opts for financial needs by taxes, borrowing requirements should be lower and vice versa.
- Croatia, being a country with a higher tax burden, should be able to meet its public financing needs from collected tax revenues.
- In addition, public debt should first of all be used for stabilization purposes, i.e. in periods of major crises, wars, and political strives, so as to enable the smallest possible drop in available income.

Sutton, D. Gregory [12](2005) examined for a group of 30 developing countries the determinants of their foreign currency sovereign credit ratings using two different econometric techniques. First, an equation relating the average rating given the national government by the two main rating agencies to a number of potential determinants is estimated by ordinary least square under the assumption that all of the explanatory variables are exogenous. Another highly significant variable is the ordinary least square analysis is a measure of the maturity structure of international banking claims against both private and public sector entities in the country.

Based on his analysis, the principal finding included:

- The highly statistically significant variables include a corruption perceptions index; the time elapsed since the resolution of the most recent default by the

[12] Sutton, D. Gregory (2005), “ Potentially Endogenous Borrowing and Developing Country Sovereign Credit Ratings”, Financial Stability Institution, Bank for International Settlement

government on its foreign currency debt and debt service on public and publicly guaranteed external debt measured to exports.

- The ratio of short-term international banking claims against entities in the country to total international banking claims against those same entities, is included as a proxy for various omitted variables related to sovereign credit ratings. The conjecture is that a relatively high value of this variable suggests that entities in the country are having difficulty obtaining long-term financing at reasonable rates.
- A high amount of short-term international banking claims against both public and private sector entities of a particular country might also directly influence the credit ratings assigned to the national government.

Husain, Ishrat[13](1991) discusses the case of Asian Developing counties in managing their foreign debt burden presents a contrast to Latin American and African Countries. To understand the relationship between macroeconomic policies and external indebtedness, this study focuses on four sub-groups of Asian Developing counties during the past twenty years, a) the ASEAN-4(Indonesia, Malaysia, Philippines and Thailand); b) South Asia c) China and D) Korea.

The major findings of Ishrat are;

- The Asian countries, with a few exceptions, pursued as outward-oriented strategy, and prudent macroeconomic policies. They made quick adjustment to external shocks by expenditure switching, expanding exports and curtailing consumption.
- Most of the borrowed and locally raised funds were invested in productive uses that raised the capacity of the economy to repay the debt.
- In Latin American countries, the governments expanded external borrowing to offset the effects of external shocks. Again, in counties where funds were borrowed specially for investment purposes and in fact invested

[13] Husain, Ishrat (1991), “ How did the Asian Countries Avoid the Debt Crisis?.”, World Bank

rather than consumed, much of the investment yielded low or negative economic returns.

- In the ASEAN-4, China, India and Korea, the investment rates were relatively high, financed mostly out of domestic savings and the foreign borrowing was used judiciously and widely as a complement to domestic savings.

Based on his analysis, Mr. Husain recommends following measures to avoid the debt crisis for Asian counties;

- Attention has to pay for price stability which reduce the uncertainty and strengthen investor confidence.
- A tight monetary and fiscal policy with flexible exchange rate is required.
- Industrial and trade policies induce private investment, promote manufacturing sector and manufacture exports and reduce price distortions.

A recently published book[14] (2008) examines Uganda's obligations and tends in external borrowing and the extent to which public borrowing and debt management conform to laws and policies for efficient public finance management.

The study ends with the following conclusions:

- Government projects are not well analyzed before borrowing, which results into delays in implementation and/or cancellation of some project components.
- Government is flouting its own laws by signing loan agreements without Parliament's approval, which eventually result into delays in the use of the very loans.

Form the analysis the UDN recommends the followings;

- It is important to cap the fiscal deficit on a yearly basis and set a limit to the stock of debt since the transitory deficit adds to the stock of debt annually and

[14] "Regularity Framework for Public Borrowing and Public Debt Management in Uganda", UDN, September 2008

is sometimes the reason for high interest rates and the high cost of servicing domestic debt.

- Ensure consistency between the level of external financing and the wider macroeconomic objectives of fiscal consolidation and reduced aid dependency.
- Achieve the desired and appropriate level of external financing at minimum cost to Government, in terms of programme/project implementation and direct financial costs.
- Put pressure on Government agencies to analyze projects more seriously and borrow for priority projects/sectors.

Togo, Eriko[15] (2007) conducted a paper with the major objective to fulfill the gap in the literature and to establish public debt management as a separate policy with a different from those of fiscal and monetary policies and to integrate public debt management into broader macroeconomic framework of analysis.

The major findings of Togo include;

- This paper discussed the desirability of policy separation between fiscal policy, monetary policy and debt management. The asset and liability management framework assist in identifying and managing the macroeconomic risks of uncoordinated policies.
- Debt management should not be used to support monetary policy or poor fiscal policy.
- Debt management can buy time, but procrastination of policy adjustment can be much more costly over the longer term than the case where short-term fiscal expediency is not allowed to dominate debt management.
- The initial debt to GDP ratio should be lower, or the desired primary surplus should be higher, the higher the risk premium charged and/or the higher the vulnerability arising from poor debt structures.

[15] Togo, Erick (2007), "Coordinating Public Debt Management with Fiscal and Monetary Policies: An Analytical Framework", The World Bank, Banking and Debt Management Department, September

A discussion paper[16] (March 2008) prepared by Panizza, Ugo discusses alternative definitions of external and domestic debt and then introduces a new dataset in domestic and external public debt. The paper also identifies possible challenges and opportunities arising from the new debt management strategy adopted by several emerging and developing countries and points out that there are conceptual and practical issues with the traditional external/ domestic debt dichotomy.

Ugo Panizza's conclusions and recommendations include the following;

- The traditional dichotomy between external and domestic debt does not make much sense in a world characterized by open capital accounts and that, although the recent switch to domestic debt borrowing has important positive implications for debt management.
- The choice of the optimal debt structure involves important trade-offs and as weakness with the current system are often identified after a fiscal crisis starts to unravel policymakers should be aware of possible new vulnerabilities.
- Donors can play a major role in helping developing countries to improve their capacity to record and disseminate information on the structure of total public debt.
- Better data are necessary because debt sustainability analysis should focus on total debt and study the implication of debt structure.

2.3. Nepalese Context

In the present stage of globalization, no country can survive without the support from other countries of the world. As Nepal is in the process of transition in all spheres of development, it requires more resources.

At a time when there is no possibility to generate adequate resources on its own, multi-lateral and bilateral aid are the only means to fulfill the country's resource gap.

[16] Panizza, Ugo (2008), "Domestic and External Public Debt in Developing Countries", No. 188, March, UNCTAD

In this section the selected literatures have been considered from the published books, articles and Masters' Degree Thesis.

Almgir, Mohiuddin and Ra, Sungsup[17] (2005) undertook an analysis of public debt sustainability of Nepal in order to improve debt management by the government of Nepal, provide inputs for the Tenth Plan (FY2003–FY2007) and assist ADB articulate its lending policy for Nepal based on country risk analysis.

More specifically, objectives of debt sustainability analysis include

- providing inputs regarding requirements for borrowing, domestic and foreign, for the Tenth Plan;
- improving public debt management, including public domestic debt;
- making recommendations for Government borrowing policies;
- linking debt management policies to macroeconomic policies;

The major conclusions of the study includes

- Given the narrow base for domestic resource mobilization and exports for Nepal, it is important to monitor continuously the sustainability of public debt-that is, the country's ability to meet its medium and long-term obligations.
- Nepal's internal debt and external debt burden is manageable. The level of external debt was modest and critical ratios improved during 1990s.
- Multilateral creditors, especially ADB, increased their share while the share of bilateral creditors declined.
- The majority of loans and loan amount was contracted on concessional terms, yet a significant number was contracted on non-concessional terms.
- The agriculture sector including irrigation and rural development dominated the foreign loan portfolio of the government.
- Negative trade balance was the most important factor in the growth of external debt.

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[17] Almgir, Mohiuddin and Ra, Sungsup (2005), " Nepal Public Debt Sustainability Analysis", ADB, October

- Nepal's public debt position is projected to remain manageable but vigilance will be prudent on account of questions related to fiscal sustainability and currency composition of exports and foreign reserves.

A number of policy recommendations are made for consideration of the government of Nepal as;

- Broadly speaking, Nepal should closely monitor the evolution of debt stock, debt service burden, and the development of fiscal and external repayment capacity;
- The debt strategy should seek coordination with monetary and fiscal policies, and adhere to the principles of transparency, public disclosure and accountability;
- The Government should seek grant and concessional loans with grant element greater than 35 percent;
- A careful review of non-concessional loans is in order to determine which could be eliminated or for which a softer term could be renegotiated;
- The Government of Nepal should enter into a dialogue with the Government of India to yield and convertibility of its Indian currency reserves soon;
- Nepal should continue to pursue strong policies to preserve the current macroeconomic stability;
- New external debt should be contracted only if it is consistent with the Tenth Plan, the medium-term expenditure framework and a longer term perspective plan;
- The private sector should be promoted and the Government should guarantee private sector loans after careful scrutiny of proposed activities;
- The Government should move forward with structural reforms (e.g., the recently legislated land reform) and sector reforms especially financial sector reform and good governance;
- In light of the special relationship, Nepal should harmonize its own monetary policies with India in order to ensure stability of its foreign exchange regime;

- To broaden the holder base of domestic debt instruments, a strong media campaign has to be launched. Educational programs on mass media combined with training seminars and workshops would help educate the public about various debt instruments and their importance for their own future and the future of the country.

Purushottam Acharya, [18] (1968) prepared MA thesis. The thesis produced the following major conclusions;

- Through the issue of public debt idle money lying with the people is put into action use by canalizing it into productive propose for speeding up the economic development of the country.
- Public debt is easy to collect since desired amount can be collected on a very short period as it is repayable in a future fixed date and carries handsome interest.
- Issue of bond is an up-to-date and more appropriate tool of getting funds that any other source of financing development projects provides it should be utilized with great care.

On the basis of above analysis the suggestions were given as;

- Top priority must be given on the development of financial institutions and their extension into the rural sector of the economy.
- Small scale deposit institutions must be opened in the rural areas.
- The issue of bonds must be adjusted to the preferences of the general public and of the financial institutions small denomination and large denomination bonds having short term, middle terms and long terms maturity are necessary to issue.

Chandra Das Rajbansi[19] (1987) has prepared MA thesis by analyzing the data from 1974/75 – 1983/84 and produced the following major results;

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[18] Acharya, Purushottam (1968), “A Case Study on Public Debt in Nepal”, (Unpublished MA thesis), TU, Kritipur,

- The burden of external borrowing in Nepal is increasing continuously due to the continuous increase in the outstanding borrowing.
- In Nepal, the increasing government expenditure mainly development as well as the deficit in the current account balances is taken to the main factors for increase the external borrowing.
- For the maintained of the debt either export has to be increase or the level of national income has to be increased substantially

Kamal Prasad Upadhyay[20] (1989) in his article study about deficit financing and postulated that the treasury has five ways of financing deficit financing;

- The treasury can draw down its demand deposits checking account balances at the commercial banks which directly transfer ownership of part of the money supply to the public increasing the public's net financial assets but does not change reserves and leaves monetary sector unaffected.
- The treasury can sell bonds to the non-bank public which will not affect the reserve and thus leaves monetary sector unaffected.
- The treasury can sell bonds to the commercial banks which will not change the reserves and thus leaves monetary sector unaffected.
- The treasury can fiancés the defaults by selling bonds to the central bank in exchange for the deposits and
- The treasury can finance the deficit by drawing down its balances at the central banks also.

On the basis of above explanation Mr. Kamal Prasad Upadhyay concludes the following;

- The involvement of government in the economic activities in the name of development and welfare program accompanied by increase in its other activities in recent years has been increasing the government expenditure in very developing counties. Since the tax base of such counties is low, they

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[19] Rajmansi, Chandra D. (1987),"External Borrowing in Nepal", (Unpublished MA thesis), CEDECON, TU, Kritipur,
[20] Upadhyay, Kamal P.(1989), " Some Aspects of Deficit Financing in Developing Countries", The Economic Journal of Nepal", September 1989

cannot exact their expenditure through sum, consequently they face the situation of budget deficit.

- Budget deficits are mostly met through foreign aid, borrowing (both internal and external) and deficit financing.

Mahesh Raj Joshi[21] (1982) has prepared MA thesis, taking into account of data from 1970 to 1980.

Mr. Joshi produced the fooling major results;

- The proportion of soft loan is increasing very fast in the development expenditure of budget of Nepal.
- The system of public debt is one of the best systems of financing development expenditure of the government which helps to control inflation in the country.

Briju Prasad Sharma [22](1988) conducted the study after analysis the data from 1974/75 to 1986/87 and her major findings can be enlisted here;

- Because of the increasing volume of the expenditures the amount of deficit has been persistently increasing which has necessitated the growing need to public debt in Nepal.
- The burden of public debt is seen in its redistribution effect in favour the rich.
- In order to increase the volume of small saving the government has to increase the present rate of interest on treasury bills which is 5 percent only.
- The expansionary impact of the ownership pattern of government securities has contributed to the inflationary spiral in the country. And hence it has caused a severe real burden of public debt.

Gundanidhi Sharma[23] (1998) in his article analyzed that the ever increasing debt and its servicing has leading the country towards the debt trap by the following reasons:

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[21] Joshi, Mahesh Raj (1982), " Structure of Public Debt in Nepal", (Unpublished MA Thesis), CEDECON, TU, Kritipur

[22] Sharma, Briju P. (1988), " Burden of Pubic Debt in Nepal" , , (Unpublished MA Thesis), CEDECON, TU, Kritipur, April 1988

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

- Gajendra Wagle[24] (1999) conducted his thesis by analyzing the data from 1974/75 to 1996/97.

Wagle produced the following results;

- The widening resources gap in recent years has been because of the cumulative effect of the deficiencies, in the investment areas and the continued absence of government's fiscal norms.
- Annual increase of government expenditure has exceeded that of revenue collection in Nepal.
- The burden of internal debt in terms of total revenue, regular expenditure and GDP has increased considerably over the period.

Keshar Bahadur Kunwar[25] (2002) prepared MA thesis. He analyzed the data from 1984/85 to 198/99 and concluded the following major results;

- Nepal has been passing through a critical face of inadequate financial resources, while its duties and responsibilities are widening day by day. But public funds available for the administration and development are limited. The government therefore, adopts the policy of borrowing internally and externally.
- The study clears that the rich and poor and educated and uneducated investors are equally interested to government security. And it further shows that who has not the sufficient time and are unskilled to run the

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[23] Sharma, Gundanidhi (1998),"The Growing Fiscal Imbalance in Nepal: Are We Really Falling into the Debt Trap?", Katmandu
[24] Wagle, Gajendra (1999), " An Analysis of Public Debt Situation in Nepal", , (Unpublished MA Thesis), CEDECON, TU, Kritipur

[25] Kunwar, Keshar B. (2002), " Government Borrowing System and Practice in Nepal", , (Unpublished MA Thesis), CEDECON, TU, Kritipur, April

private enterprises competitively are more interested to government security.

Naresh Bahadur Basnet[26] (2003) prepared MA thesis under considering the date from 1984/85 – 2000/01. The finding includes;

- Government borrowing has been increasing unlikely and financed mostly in the unproductive sectors including, uncertainties, lack of well balanced civil services, inadequate checks and balance in the political and budgetary pressure and corruption, high general expenditure and hence government always lacks the resources, and then borrows the new loan to pay the previous one.

Ms. Shrestha advocated the following major results;

- Foreign grants has dominant role for financing fiscal deficit.
- The contribution of external loan to fiscal deficit is outpaced the share of interest but the growth rate showing the decreasing trend of internal and external debt as percentage of fiscal deficit and share of external debt to total debt.
- During the period of study the gap between disbursement and commitment of external debt is in fluctuating trend.
- The degree of the external debt has increased due to the poor mobilization of internal resources, widening investment saving gap, export import gap and large amount of fiscal deficit.

Nirmal Kumar Thapa[27] (2007) submitted the MA thesis. His major findings are;

- There is excessively increase in government expenditure than government revenue which leads to increase in revenue gap.
- The rapidly increasing government expenditure leads to increase the economy in fiscal deficit.

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[26] Basnet, Naresh B.(2003), "Public Debt of Nepal", , (Unpublished MA Thesis), CEDECON, TU, Kritipur
[27] Thapa, Nirmal K. (2007), "Public Debt: Its Trend, Pattern and Impact in Nepalese Economy", (Unpublished MA Thesis), CEDECON, TU, Kritipur

- The role of foreign aid to bridge the resource gap in Nepal has been crucial which is estimated to be more than 60 parentage of total resource gap.

Sushil Prasad Sharma[28] (2006) wrote an article for financial comptroller office of GON focusing on the external debt management in Nepal and concludes the following;

- Though at present debt sustainability is not yet a major threat for Nepal, the possibility itself makes it necessary to continue checking it. Nepal is trying to introduce a medium-term fiscal management plan as a checking framework. Presently, Nepal is facing a great saving/investment gap along with huge fiscal and trade deficit. Though revenues remain buoyant, they are still inadequate to supplement development activities. Thus, there is the need to increase the elasticity of taxation by mobilizing additional resources and improving the efficiency of tax administration without increasing the actual tax rates.
- Improved human capital, poverty reduction and sustainable economic growth with an environment of macroeconomic stability are great targets that have to achieve before 2015. This will lead us with large resource requirements to invest in the social and infrastructure sectors. Presently, we are directing our resources to these sectors after deducting our present and future debt obligations and that is leading us to a "debt-stressed" situation to overcome. Each year these stressed obligations are increasing so that gap is broadening in the same way. We are decreasing our efforts to that strength also in other sectoral investments so that development of social and infrastructure sectors can be achieved well. In regard of this scenario, HIPC Initiative shall be an opportunity prevailing us to shake our hands to handle the gap and deficit problems. This debt forgiveness opportunity will give us a chance to increase our investments towards poverty reduction and sustainable economic growth.
- The legal and institutional framework for public debt management in Nepal is composed of specific laws without any coherence among them. Each one contemplates a specific issue of the debt management functions without any

[28] Sharma, Sushil P.(2006), “ External Debt Management in Nepal: Legal and Institutional Arrangement”

worry on the compatibility or coordination with the others. It is difficult to figure out how the decisions have been taken, by whom and what level for debt management perspectives**.**

- It indicates the necessity to restructure the decision-making framework that will allow the choice of a debt strategy in line with the macroeconomic development priorities, the establishment of a legal and regulatory framework, and a policy for hiring and retaining skilled staff, as well as a clear support policy for the computerized system to be used in the operational debt management functions. Presently it seems that the need of this is being felt in Nepal and some efforts have been taken place right now. These efforts are not sufficient and required further enhancements towards the establishments of a proper, modern, sound and accountable debt management institution in Nepal.

The above reviewed literatures show the different concluding from various researchers and study persons. The present study focuses on the present scenario of public debt, its trends and structure, necessity of public borrowing and consequences of the outstanding public debt in Nepalese economy. And it would be equally helpful to get the knowledge about internal and external borrowing of the Government of Nepal, Sources of public debt and its existing situation.

CHAPTER - THREE

TREND AND STRUCTURE OF PUBLIC DEBT IN NEPAL

The chapter shows the trend and structure of pubic debt in Nepal by analyzing the data of survey period. Here, different tools and techniques as mentioned in research methodology section have been practically applied to analyze the data.

3.1. Introduction:

"The progress of the enormous debts which at present oppress, and will in the long-run probably ruin, all the great nations of Europe, has been pretty uniform."[29] Although this was said almost two hundred and thirty five years ago, it is still equally applicable. In almost all the countries, public debt is accumulating and is still considered as a calamity for macroeconomic stability; in many countries, especially the ones that have experienced debt crisis, it causes fear of great disturbances and the breakdown of the state. However, due to a number of advantages over taxes, countries unwillingly renounce debt as a source of financing, especially in periods of extremely high, although short-term demand for public expenditures (wars, natural disasters, economic crises). The attraction of debt on the one hand and the danger waiting as a consequence of excessively enjoying in the benefits of the debt on the other hand, require constant caution and attention when using this fiscal policy instrument.

A government can finance its spending and development efforts by borrowing, by taxing output, or by printing money. Three reasons explain why public debt may be better than taxation:

[29] Smith, Adam (1776) “An Enquiry into the Causes and Nature of the Wealth of the Nations”, Volume 5, Chapter 3

Tilting: Allowing a more equitable manner in which country can exploit investment opportunities with long gestation periods. In a growing economy, it would be inequitable to tax current (poorer) generations to pay for investments that will benefit future (richer) generations.

Smoothing: Allowing a more efficient manner for conducting counter-cyclical policies or meeting emergency spending needs. Raising and lowering taxes frequently may entail efficiency losses and generate economic uncertainty.

Stability: Excessive reliance on printing money could lead to high and volatile inflation, which obscures the information content of relative prices and hurts investment.

Public debt, both internal and external, has been the single most important source for financing fiscal expenditure in Nepal. Since the First Five year Development Plan was launched in 1956, the Nepal government has initiated economic development plans to end prolonged poverty. In the process, insufficient domestic saving due to low income has inevitably led the government to rely on public debt as an important financing instrument. Public debt supplemented Nepal’s insufficient domestic savings in mobilizing resources for economic growth. It has also been an important financing resource for poverty reduction and social development.

Sovereign debt can help developing countries. It enables their governments to facilitate growth take-offs by investing in a critical mass of infrastructure projects and in the social sectors when taxation capacity is limited, or when the alternative would be to print money and compromise macroeconomic stability. Debt also facilitates tax smoothing and counter-cyclical fiscal policies, essential for reducing output volatility; and it permits an equitable alignment of benefits and costs for long-gestation projects by shifting taxation away from current generations.

Nepal has been borrowing rapidly mainly to balance her budgetary deficit. A large number of infrastructures are needed to run the country in the pace of development. Obviously, for this large volume of fund is required. Beside this expert people, adequate natural and technical resources are essential. And Nepal lacks these things. For this as well public debt is inevitable. Hence, public debt started to fulfill the resources gap in planned development of Nepal and still continued in rising trend.

3.2. Trend of Fiscal Deficit and Budget Deficit

The main sources of revenues collection of Nepal's Government are taxes, fees and charges, royalties on natural resources and the sale of state owned goods or services or from public goods. It also receives income from investment and often from debt. These revenues are used for recurrent and capital expenditures. But in Nepal resource gap is always being a common phenomenon after the starting of the systematic budgetary systems. Managing the available internal resources is the great problem of the country. The expenditure and the revenue collection are not increasing in same pace.

Due to defective custom and tax administration, corruption, lack of patriotism, etc. Government of Nepal is unable to keep the growth of total expenditure and revenue in the same pace. The yearly volume of government expenditure has overlapped its revenue collection resulting fiscal deficit. Similarly weak performances of export trade, low tax capacity and insufficient external borrowing or grants have lead to increasing budgetary deficit.

Table 1 shows the scenario of fiscal deficit and budget deficit in Nepal. In almost all the year fiscal deficit is found increasing due to the increasing volume of total expenditure. Fiscal deficit is the difference between government expenditure and government revenue as shown in column three and it is also the resource gap. And we find the budget deficit by summing government revenue and foreign grants and deducting the sum from government expenditure which has been shown in fifth column in the table. The amount of total government expenditure was RS. 23549.8 million in FY 1990/91 and it has increased to Rs. 161349.9 in FY 2007/08.

Table 1: Trend of Fiscal Deficit and Budget Deficit

Rs. in Million

Fiscal Year	Government Revenue (1)	Government Expenditure(2)	Fiscal Deficit (2-1)	Foreign Grants (3)	Budget Deficit (2)-(1+3)
1990/91	10729.9	23549.8	12819.9	2164.8	10655.1
1991/92	13512.7	26418.2	12905.5	1643.8	11261.7
1992/93	15148.4	30897.7	15749.3	3793.3	11956
1993/94	19580.8	33597.4	14016.6	2393.6	11623
1994/95	24575.2	39060.0	14484.8	3937.1	10547.7
1995/96	27839.1	46542.4	18703.3	4825.1	13878.2
1996/97	30373.5	50723.7	20350.2	5988.3	14361.9
1997/98	23937.9	56118.3	32180.4	5402.6	26777.8
1998/99	37251.0	59579.0	22328	4336.6	17991.4
1999/00	42893.6	66272.5	23378.9	5711.7	17667.2
2000/01	48893.6	79835.1	30941.5	6753.4	24188.1
2001/02	50445.5	80072.2	29626.7	6686.1	22940.6
2002/03	56229.8	84006.1	27776.3	11339.1	16437.2
2003/04	62331.0	89442.6	27111.6	11283.4	15828.2
2004/05	70122.7	102560.4	32437.7	14391.2	18046.5
2005/06	72282.1	110889.2	38607.1	13827.5	24779.6
2006/07	87712.1	133604.2	45892.1	15800.8	30091.3
2007/08	107622.5	161349.9	53727.4	20320.7	33406.7
Average Annual Growth Rate	**11.5**	**14.2**	**9.9**	**18.7**	**1.7**

Source: Various Issues of Economic Survey of MOF/GON

Similarly the amount of government revenue has increased from Rs. 10729.9 million in FY 1990/91 to Rs. 107622.5 million in FY 2007/08. This type of trend seen in government revenue and expenditure indicates that public expenditure has dominated the government revenue.

The growth rate of government revenue during the period under study has been 11.5 percent per annum whereas the annual growth rate of expenditure has been 14.7 percent. In the survey period the average annual growth rate of fiscal deficit, foreign grants and budget deficit is 9.9 percent, 18.7 percent and 1.7 percent respectively.

Figure 1: Trend of Government Revenue and Government Expenditure

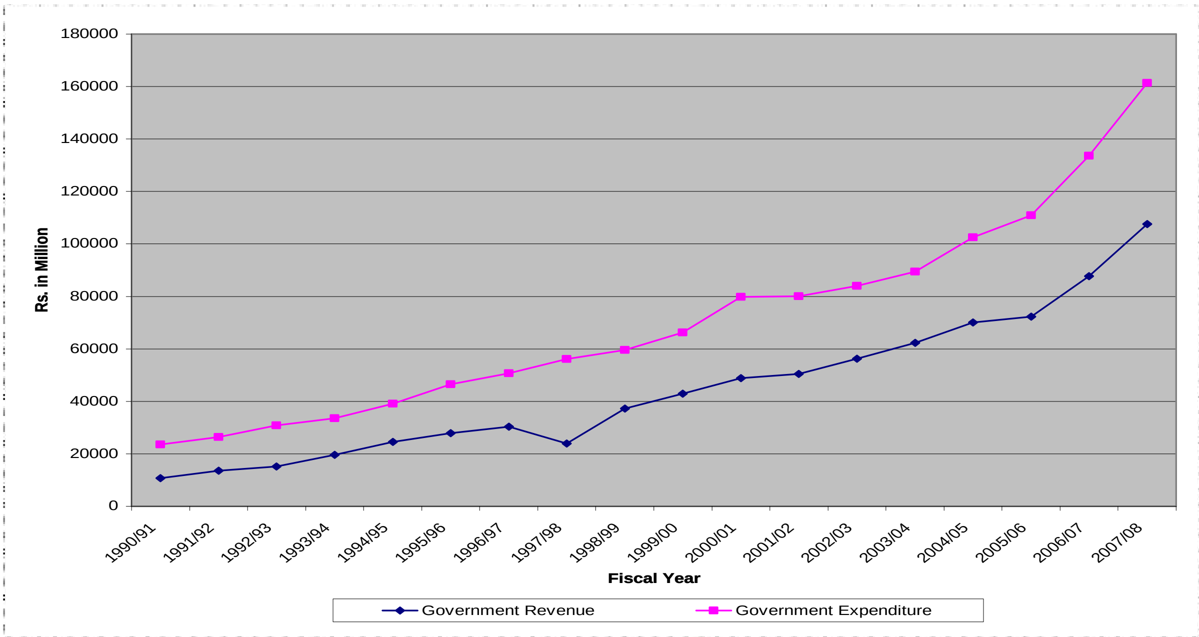


Figure 1 shows the trend of government revenue and government expenditure of Nepal. Government revenue has been increasing in each year except in 1997/98 but it has been increasing in slow pace where as government expenditure has been increasing in each year with greater extent. It clearly shows the need of public borrowing because the grants amount and revenue themselves inadequate to meet all the expenses of the government.

Table 2: Resource Gap as Percentage of GDP

Rs. in Million

Fiscal Year	GDP at Producers Price	Fiscal Deficit as Percentage of GDP	Budget Deficit as Percentage of GDP
1990/91	120370	10.65	8.85
1991/92	149487	8.63	7.53
1992/93	171474	9.18	6.97
1993/94	199272	7.03	5.83
1994/95	219175	6.60	4.81
1995/96	248913	7.49	5.55
1996/97	280513	7.25	5.12
1997/98	300845	7.70	5.90
1998/99	342036	6.53	5.26
1999/00	379488	6.16	4.66
2000/01	411519	7.52	5.88
2001/02	459443	6.44	5.00
2002/03	492231	5.64	3.34
2003/04	536749	5.05	2.95
2004/05	589412	5.50	3.06
2005/06	654084	5.90	3.78
2006/07	728178	6.30	4.13
2007/08	818401	6.56	4.08
Average Annual Growth Rate	**11.34**	**7.01**	**5.15**

Source: Various Issues of Economic Survey of MOF/GON

Table two reveals the fiscal deficit and budget deficit as percentage of GDP. We consider GDP at Producers Price. As GDP is the major indicator of the performance of the economy the share of fiscal deficit and budget deficit to GDP and budget deficit to GDP has its own significant meaning. The share of fiscal deficit and budget deficit to GDP was 10.65 and 8.85 percent respectively in the 1990/91 and 6.46 percent and 4.08 percent respectively in the year 2007/08. This indicates that budget deficit as percent of GDP and fiscal deficit as percent of GDP has declined in the year 2007/08 as compared to the FY 1990/91. However the average annual growth rate of fiscal deficit to GDP is 7.01 percent and that of budget deficit to GDP is 5.15 percent during the study period. As a whole, if the total GDP is RS. 100, the sum equal to about RS. 12 from the total GDP has to be spent for deficit financing including fiscal deficit and budget deficit on average annually.

Figure 2: Fiscal Deficit and Budget Deficit

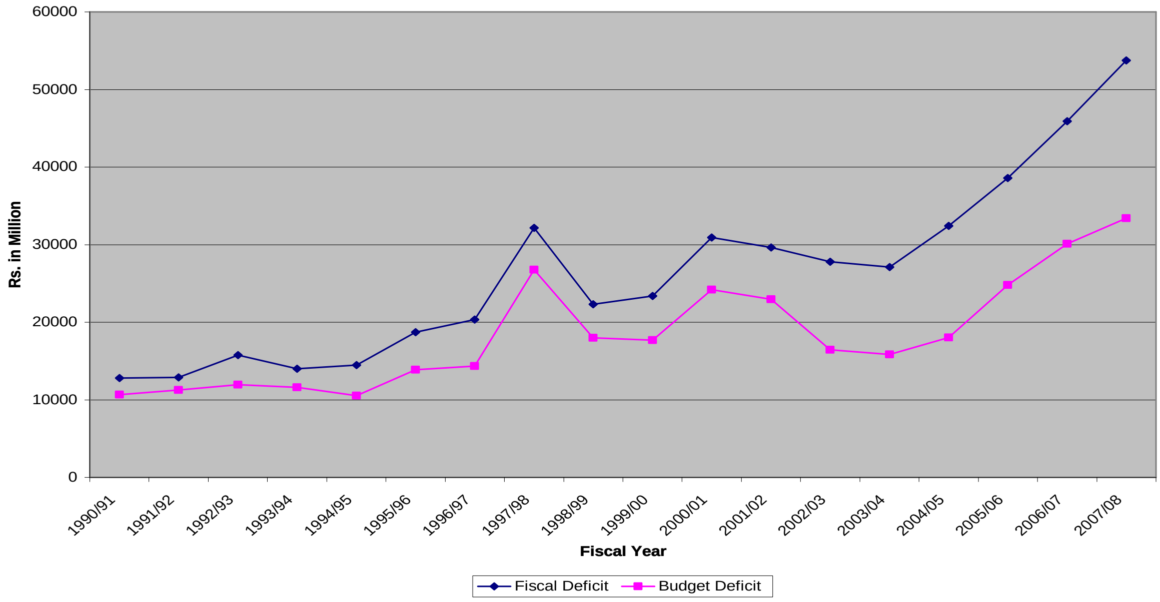


Figure 2 shows the trend of fiscal deficit and budget deficit. The budget deficit is in more fluctuating trend than that of fiscal deficit due to dependency in foreign grants.

After the brief discussion about the fiscal and budget deficit of GON, discussion about the trend of public debt in financing fiscal deficit is presented below.

3.3. Debt for Financing Fiscal Deficit

Table 3: Pubic Debt as Percentage of Fiscal Deficit

Rs. in Million

Fiscal Year	**Fiscal Deficit (1)**	**Total Debt**	**Internal Debt (2)**	**External Debt (3)**	**(2) Percentage of (1)**	**(3) as Percentage of (1)**
1990/91	12819.9	10809.4	4552.7	6256.7	35.51	48.80
1991/92	12905.5	8895.7	2078.8	6816.9	16.11	52.82
1992/93	15749.3	8540.9	1620.0	6920.9	10.29	43.94
1993/94	14016.6	10984.4	1820.8	9163.6	12.99	65.38
1994/95	14484.8	9212.3	1900.0	7312.3	13.12	50.48
1995/96	18649.3	11663.9	2200.0	9463.9	11.80	50.75
1996/97	20350.2	12043.6	3000.0	9043.6	14.74	44.44
1997/98	23180.4	14454.4	3400.0	11054.4	14.67	47.69
1998/99	22328.0	16562.4	4710.0	11852.4	21.09	53.08
1999/00	23378.7	17312.2	5500.0	11812.2	23.53	50.53
2000/01	30941.5	19044.0	7000.0	12044.0	22.62	38.93
2001/02	29626.7	15698.7	8000.0	7698.7	27.00	25.99
2002/03	27776.3	13426.4	8880.0	4546.4	31.97	16.37
2003/04	27116.6	13236.0	5607.0	7629.0	20.68	28.13
2004/05	32437.7	18204.2	8938.1	9266.1	27.55	28.57
2005/06	38607.1	20048.6	11834.2	8214.4	30.65	21.28
2006/07	45892.1	27945.8	17892.3	10053.5	38.99	21.91
2007/08	53727.4	29476.3	20496.4	8979.9	38.15	16.71

Source: Various Issues of Economic Survey of MOF/GON

Table 3 depicts the fluctuating trend of total public debt of GON during the review period. Except the year 1990/91 and 2003/04 internal debt shows the increasing trend and external debt shows the more fluctuating trend. The data explains that external debt has increased slowly for some years (1990/91 to 1993/94 and 1997/98 to 1999/00) and thereafter it has followed the decreasing path as from FY 2001/02 onwards. Internal debt was RS. 455.2 million in 1990/91 and has gone up to RS. 20496.4 million in FY 2007/08 whereas external debt was RS. 6256.7 million and increased to RS. 8979.9 million in the same period.

The table also exhibits about the percentage share of internal and external debt to fiscal deficit. The data shows the fluctuating trend of percentage share or contribution of both internal and external debt to fiscal deficit. The contribution of internal debt to fiscal deficit was 35.51 percent in 1990/91 where as that of external debt was 48.80 percent. But the share of internal debt and external debt to fiscal deficit is 38.15 and 16.71 percent respectively in the year 2007/08 which shows the increasing contribution of internal debt and decreasing contribution of external debt to their fiscal deficit.

In addition, it also indicates that during the last 18 years of the economic performance has not been conducive enough to reduce growing reliance on external loan. This situation has led to think seriously about this alarming situation.

3.4. Growth Trend of Government Borrowing in Nepal

The duty and responsibilities of government of Nepal has been increasing day by day to improve the social, economical, political and administrative enhancement of the country. Especially after the multi-party democratic systems, that is from 1990, huge sum of investment of internal resource mobilization is dependent mostly on borrowing as taxation alone can not finance fiscal and budget deficit of the government. Thus Nepal is facing large and growing sum of borrowing from different sources (Internal and External). The trend of government borrowing is shown in below table:

Table 4: Growth Trend of Public Debt

Rs. in Million

Fiscal Year	Total Debt	Internal Debt (2)	External Debt (3)	(1) as % of GDP	(2) as % of GDP	(3) as % of GDP
1990/91	10809.4	4552.7	6256.7	8.98	3.78	5.20
1991/92	8895.7	2078.8	6816.9	5.95	1.39	4.56
1992/93	8540.9	1620.0	6920.9	4.98	0.94	4.04
1993/94	10984.4	1820.8	9163.6	5.51	0.91	4.60
1994/95	9212.3	1900.0	7312.3	4.20	0.87	3.34
1995/96	11663.9	2200.0	9463.9	4.69	0.88	3.80
1996/97	12043.6	3000.0	9043.6	4.29	1.07	3.22
1997/98	14454.4	3400.0	11054.4	4.80	1.13	3.67
1998/99	16562.4	4710.0	11852.4	4.84	1.38	3.47
1999/00	17312.2	5500.0	11812.2	4.56	1.45	3.11
2000/01	19044.0	7000.0	12044.0	4.63	1.70	2.93
2001/02	15698.7	8000.0	7698.7	3.41	1.74	1.67
2002/03	13426.4	8880.0	4546.4	2.72	1.80	0.92
2003/04	13236.0	5607.0	7629.0	2.47	1.04	1.42
2004/05	18204.2	8938.1	9266.1	3.09	1.52	1.57
2005/06	20048.6	11834.2	8214.4	3.06	1.81	1.26
2006/07	27945.8	17892.30	10053.50	3.83	2.46	1.38
2007/08	29476.3	20496.40	8979.9	3.60	2.50	1.10
Average Annual Growth Rate	**7.33**	**17.52**	**5.32**	**4.42**	**1.57**	**2.85**

Source: Various Issues of Economic Survey of MOF/GON

The table 4 depicts the growth trend of public debt in Nepal during the period of FY 1990/91 to FY 2007/08. The study shows that the total public debt has been increasing with an average growth rate of 7.33 percent. The total debt has increased about thrice in 2007/08 as compared to the year 1990/91. Similarly, the average annual growth rate of internal and external debt is 17.52 percent and 5.32 percent respectively in the review period. In addition to this the study provides that the average annual growth rate of the share of total debt to GDP is 4.56 percent and that of internal and external debt is 1.49 percent and 3.09 percent respectively.

Figure 3: Growth Trend of Government Debt in Nepal

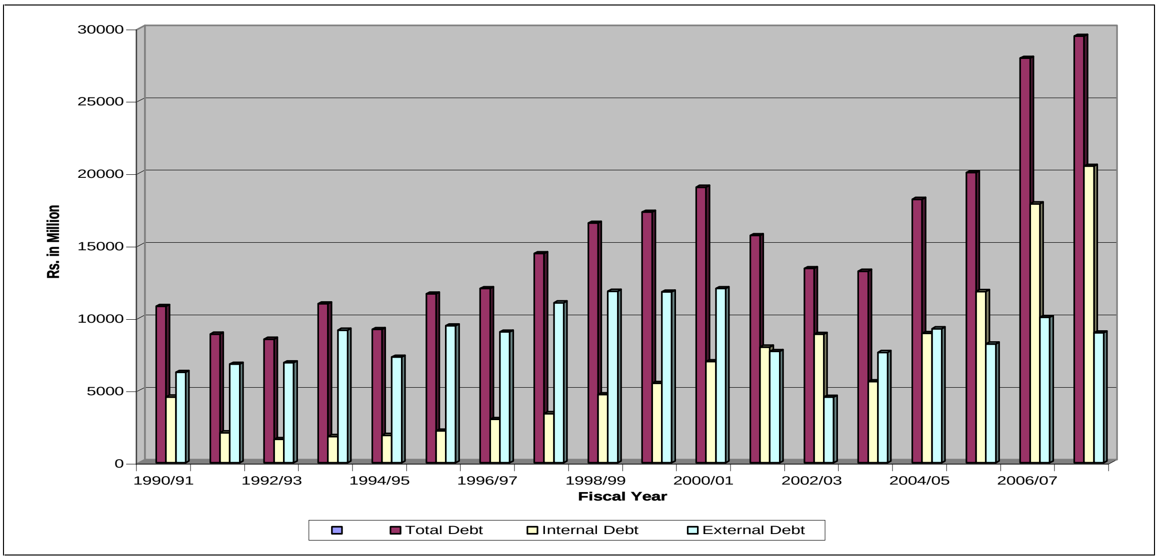


Figure 4 shows the fluctuating trend of total debt, internal debt and external debt. It explains that the government borrowing is increasing in both absolute and relative terms.

3.5. Trend of External Debt in Terms of Disbursement by Major Sources

Externally, Nepal has been borrowing loan through bilateral and multilateral sources. Bilateral loans refer to those loans from friendly government and their agencies, loans from official expert credit agencies. Multilateral loans refer to loans and credits from multilateral agencies such as WB, ADB, IMF, and others multinational and intergovernmental agencies. The pattern of external debt in terms of disbursement by major sources as,

Table 5: Trend of External Debt in Terms of Disbursement by Major Sources

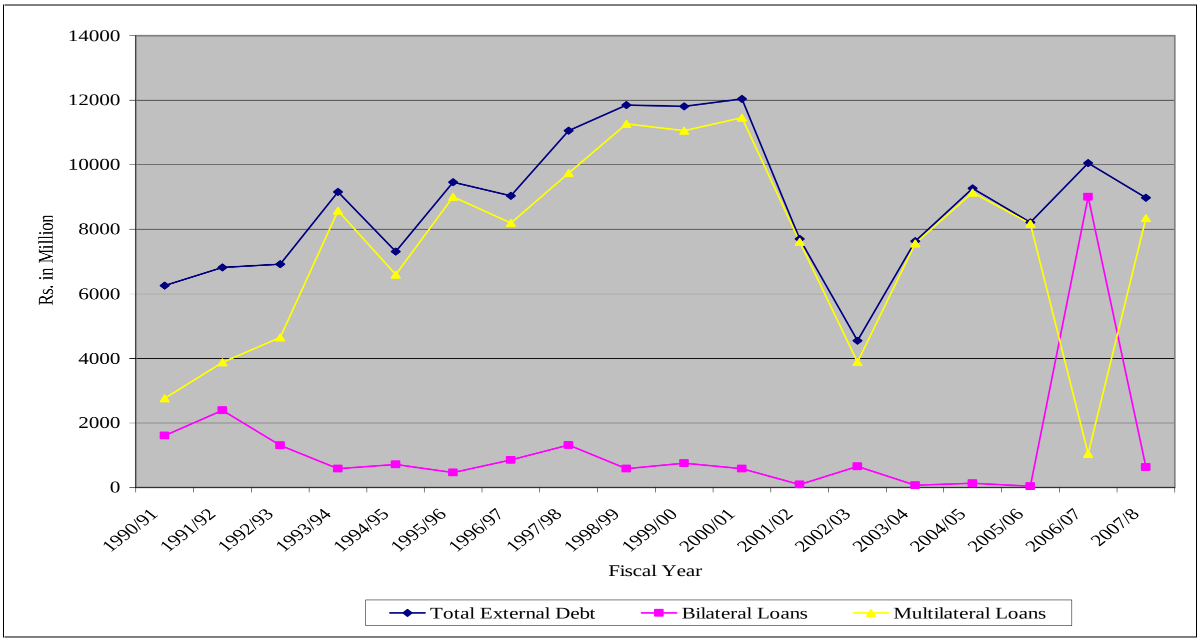
Rs. in Million

Fiscal Year	Total External Debt (1)	Bilateral Loans (2)	Multilateral Loans (3)	(2) as % of (1)	(3) as % of (1)	(1) as % of GDP	(2) as % of GDP	(3) as % of GDP
1990/91	6256.7	1602.8	2757.2	25.62	44.07	5.20	1.33	2.29
1991/92	6816.9	2389.8	3879.6	35.06	56.91	4.56	1.60	2.60
1992/93	6920.9	1307.6	4654.1	18.89	67.25	4.04	0.76	2.71
1993/94	9163.6	582.9	8580.7	6.36	93.64	4.60	0.29	4.31
1994/95	7312.3	717.3	6595.0	9.81	90.19	3.34	0.33	3.01
1995/96	9463.9	460.0	9003.9	4.86	95.14	3.80	0.18	3.62
1996/97	9043.6	850.7	8192.9	9.41	90.59	3.22	0.30	2.92
1997/98	11054.0	1314.5	9740.0	11.89	88.11	3.67	0.44	3.24
1998/99	11852.0	584.0	11268.0	4.93	95.07	3.47	0.17	3.29
1999/00	11812.0	757.9	11054.0	6.42	63.58	3.11	0.20	2.91
2000/01	12044.0	586.7	11457.0	4.87	95.13	2.93	0.14	2.79
2001/02	7698.7	87.0	7611.6	1.13	98.87	1.67	0.02	1.67
2002/03	4546.4	657.2	3889.2	14.46	85.54	0.92	0.14	0.80
2003/04	7629.0	66.0	7563.0	0.87	99.13	1.42	0.01	1.41
2004/05	9266.1	126.5	9139.6	1.37	98.63	1.57	0.02	1.55
2005/06	8214.4	40.6	8173.7	0.49	99.50	1.26	0.01	1.25
2006/07	10054.0	9004.6	1048.9	10.43	89.57	1.38	1.24	0.14
2007/8	8979.9	632.1	8347.8	7.04	92.96	1.10	0.08	1.02
Average Annual Growth Rate	**5.32**	**-183.56**	**11.57**	**9.66**	**87.44**	**2.85**	**0.40**	**2.31**

Source: Various Issues of Economic Survey of MOF/GON

Table 5 shows that the situation of external debt in the review period. In total debt the share of multilateral sources is very higher than of bilateral sources. The share of bilateral and multilateral loan out of external debt was 25.62 percent and 44.07 percent respectively in 1990/91 whereas 7.04 percent and 92.96 percent in 2007/08. The data further depicts that the share of multilateral loan has increased massively in recent years. The average annual growth rate of bilateral loan is 9.66 percent and multilateral loan is 87.99 percent. It shows that the share of multilateral loan is many times higher than that of bilateral loan. However, the annual growth rate of the share of total external debt to GDP, bilateral loan to GDP and multilateral loan to GDP is 2.85 percent, o.40 percent and 2.31 percent respectively. The share of multilateral source to GDP is higher than that of bilateral source to GDP. Both the share of bilateral and multilateral sources to GDP is found fluctuating. The percentage share of bilateral sources to GDP is in decreasing trend, highest share (1.60 percent) in 1991/92 and lowest (0.01 percent) in 2003/04. In most of the year the share of multilateral loan to GDP is found increasing, highest share 4.31 percent in 1993/94 and lowest 0.85 percent in 2002/03.

Figure 4: Trend of External Debt in Terms of Disbursement by Major Sources



The above figure shows the trend of total external debt, bilateral loans and multilateral loans during the period 1990/91 to 2007/08. Figure shows that the share of multilateral loans to external loan is very high as compared to share of bilateral loans. The amount of bilateral loan is seen decreasing year by year and that of multilateral loan seems increasing rapidly every year except few years like 2000 to 2003.

3.6. Sectoral Allocation of Public Borrowing

In developing countries like Nepal, there is need of heavy dose of investment to build up socio-economic infrastructure such as agriculture, transportation, communication etc. to fulfill the objectives of economic development. It is not possible through the individual; there is a need of government finance. That is to say deficit financing is the most useful means to promoting economic development in developing countries. It means as filling the gap caused by excess of government expenditure over its receipts, finance either by borrowing or by issuing new currency.

As Nepal initiated the development effort, the amount of sectoral allocation of foreign loan began in increasing trend. Such allocation of loan is mainly determined by the interest of donor countries rather than the interest of the debtor countries. That is to say, loan is tied through the tradition/ cultural influence of the donor countries in the recipient country, or through emphasis on project in areas in which the donor country has an identifiable advantage in supplying the required items. Nevertheless, foreign loan has played the significant role for the development of the different sectors of the economy.

Nepal has used external debt in different sectors such as Agriculture, Irrigation and Forestry; Transportation, Power and Communication; Industry and Commerce and Social Services which is shown on the below table.

Table 6 depicts the use of external debt in different sectors of economy in Nepal. It shows that the allocation of external debt in various sectors is in fluctuating trend. Transportation, Power and Communication sector has got highest amount of loan.

Social Services get moderate amount of external debt. And Industry and Commerce sector has got least amount of external debt. From 2000/01 and onwards it is nil except in FY 2001/02 and FY 2002/03.

Table 6: Sectoral Allocation of External Debt

Rs. in Million

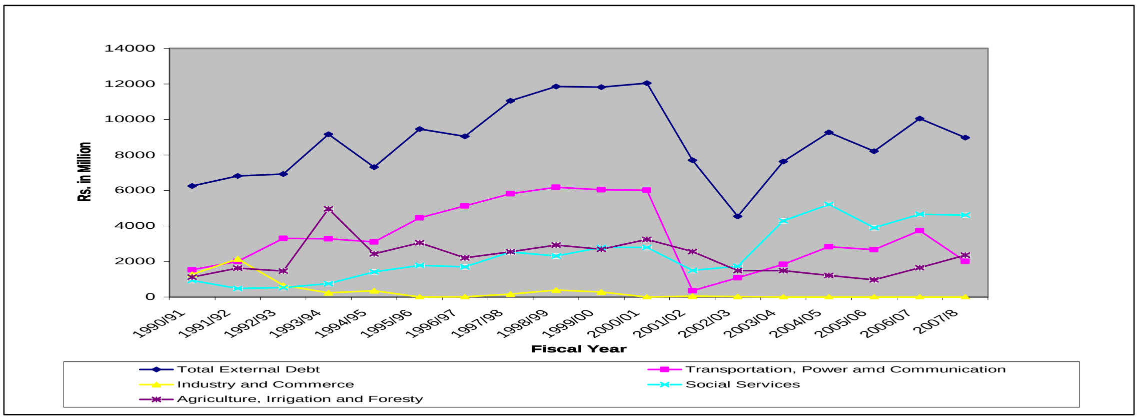
Fiscal Year	Total Debt	Total External Debt	Agriculture, Irrigation and Forestry	Transportation, Power and Communication	Industry and Commerce	Social Services
1990/91	10809.4	6256.7	1112.1 (17.78)	1531.8 (24.49)	1270.7 (20.40)	932.5 (14.90)
1991/92	8895.7	6816.9	1632.1 (23.94)	2010.1 (29.49)	2143.7 (31.45)	483.5 (7.09)
1992/93	8540.9	6920.9	1465.4 (21.17)	3299.6 (47.68)	663.3 (9.58)	533.4 (7.71)
1993/94	10984.4	9163.6	4964.8 (54.17)	3273.1 (35.72)	234.5 (2.56)	751.1 (8.20)
1994/95	9212.3	7312.3	2429.8 (33.23)	3103.6 (42.44)	359.3 (4.91)	1419.6 (19.41)
1995/96	11663.9	9463.9	3054.4 (32.27)	4461.4 (47.14)	3.5 (0.04)	1784.3 (18.85)
1996/97	12043.6	9043.6	2201.6 (24.34)	5131.5 (56.74)	17.5 (0.19)	1693 (18.72)
1997/98	14454.4	11054.4	2543.5 (23.01)	5813.0 (52.58)	167.9 (1.52)	2530.1 (22.89)
1998/99	16562.4	11852.4	2925.1 (24.68)	6179.7 (52.14)	391.6 (3.30)	2312.3 (19.51)
1999/00	17312.2	11812.2	2693.4 (21.02)	6039.5 (47.14)	283.8 (2.22)	2795.1 (21.82)
2000/01	19044.0	12044.0	3242 (33.26)	6012.6 (49.92)	0.0 (0.00)	2789.4 (23.11)
2001/02	15698.7	7698.7	2560.8 (33.26)	3593.3 (46.67)	49.5 (0.64)	1495.0 (19.42)
2002/03	13426.4	4546.4	1488.9 (32.75)	1080.5 (23.77)	28.3 (0.62)	1738.4 (38.24)
2003/04	13236.0	7629.0	1490.5 (19.54)	1843.3 (24.16)	0.0 (0.00)	4287.6 (56.20)
2004/05	18204.2	9266.1	1214.7 (13.11)	2835.8 (30.61)	0.1 (0.00)	5212.5 (56.25)
2005/06	20048.6	8214.4	971.9 (11.63)	2669.5 (32.50)	00.0 (0.00)	3901.4 (47.50)
2006/07	27945.8	10053.5	1656.8 (16.48)	3740.7 (37.20)	0.0 (0.00)	4656.0 (46.31)
2007/08	29476.3	8979.9	2358.4 (26.26)	2006.1 (22.34)	0.0 (0.00)	4615.4 (51.40)
Average Annual Growth Rate	**7.33**	**5.32**	**2.77**	**9.84**		**17.94**

Source: Various Issues of Economic Survey of MOF/GON

Note: Figures in Parentheses are Percentage Distribution

The percentage share of external debt to Agriculture, Irrigation and Forestry, Transportation, Power and Communication, Industry and Commerce and Social Services is 17.18, 24.49, 20.40 and 14.90 respectively in the FY 1990/91 whereas the percentage share in 2007/08 is 26.26, 22.34, 0.00, 51.40 respectively.

Figure 5: Total External Debt by Sectors



The figure 5 shows the total external debt and its share in various sectors. The figure clearly depicts that external debt as well as its share in economic sectors (Agriculture, Irrigation and Forestry, Transportation, Power and Communication, Industry and Commerce and Social Services) are in fluctuating trends.

3.7. Outstanding Public Debt in Nepal

Outstanding debt refers to the debt after deducting repayment of principal and interest. The government of Nepal has to borrow from internal and external sources to fill up the resources gap, which is revenue and expenditure gap. Total outstanding debt includes both internal and external debt after deducting repayment of principal and interest. The volume of outstanding debt in Nepal is growing over the time simultaneously with revenue deficit.

The table 7 shows the trend and structure of total outstanding debt, internal outstanding debt and external outstanding debt and their share in GDP. The total outstanding of Government of Nepal was Rs. 80361.2 million with Rs.59505.3 and Rs. 20854.9 external outstanding and internal outstanding debt respectively.

Table 7: Outstanding Public Debt in Nepal

Rs. in Million

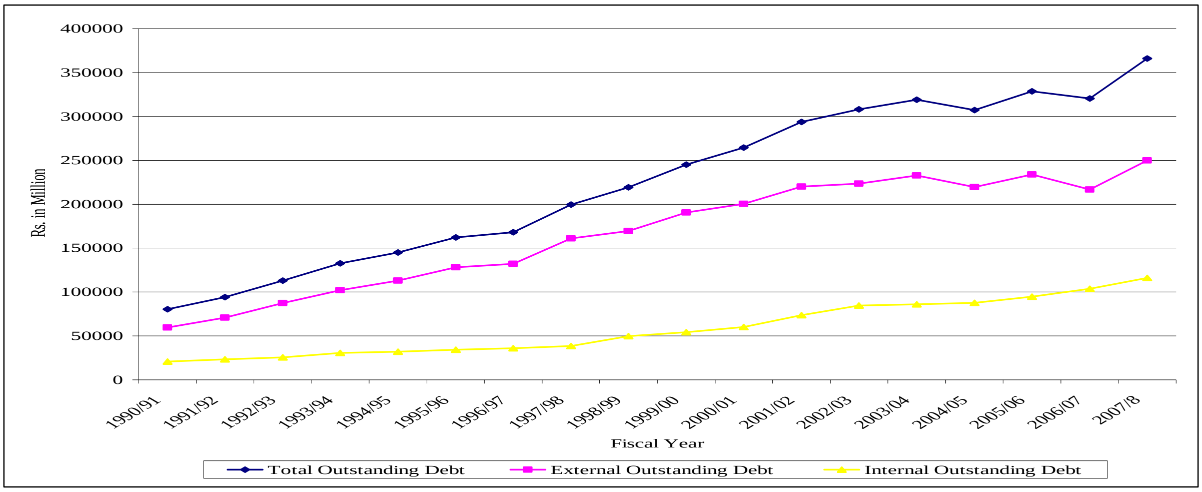
Fiscal Year	GDP at Producers Price	Total Outstanding Debt(1)	External Outstanding Debt (2)	Internal Outstanding Debt (3)	(1) as % of GDP	(2) as % of GDP	(3) as % of GDP
1990/91	120370	80361.2	59505.3	20854.9	66.76	49.44	17.33
1991/92	149487	94158.8	70923.9	23234.9	62.99	47.44	15.54
1992/93	171474	112876.9	87420.8	25456.1	65.83	50.98	14.85
1993/94	199272	132598.0	101966.8	30631.2	66.54	51.17	15.37
1994/95	219175	145058.7	113000.9	32057.8	66.18	51.56	14.63
1995/96	248913	162286.3	128044.4	34241.9	65.20	51.44	13.76
1996/97	280513	167977.7	132086.8	35890.9	59.88	47.09	12.79
1997/98	300845	199614.7	161208.0	38406.7	66.35	53.59	12.77
1998/99	342036	219135.6	169465.9	49669.7	64.07	49.55	14.52
1999/00	379488	245048.2	190691.2	54357.0	64.57	50.25	14.32
2000/01	411519	264474.4	200404.4	60043.8	63.29	48.70	14.59
2001/02	459443	293746.3	220125.6	73620.7	63.94	47.91	16.02
2002/03	492231	308078.5	223433.2	84645.3	62.59	45.39	17.20
2003/04	536749	318913.0	232779.3	86133.7	59.42	43.37	16.05
2004/05	589412	307206.1	219641.9	87564.2	52.12	37.26	14.86
2005/06	654084	328679.4	233968.6	94710.8	50.25	35.77	14.48
2006/07	728178	320404.9	216628.9	103776.0	44.00	29.75	14.25
2007/8	818401	366004.9	249965.4	116039.5	44.72	30.54	14.18
Average Annual Growth Rate	**11.34**	**9.00**	**8.64**	**10.24**	**60.48**	**45.62**	**14.86**

Source: Various Issues of Economic Survey of MOF/GON

Where as the total outstanding debt in FY 2007/08 has been stood at Rs. 366004.9 million and the share of external outstanding and internal outstanding debt is Rs. 249965.4 million and Rs. 116039.5 million respectively. The average annual growth rate of total outstanding debt, external outstanding debt and internal outstanding debt is 9.00, 8.64 and 10.24 percent respectively. This shows the increasing trend of external outstanding debt than that of internal outstanding debt.

Similarly, the given table shows the total outstanding debt, external outstanding debt and internal outstanding debt as a percentage of GDP. The total outstanding debt, external outstanding debt and internal outstanding debt constitutes 66.76, 49.44 and 17.33 percent in FY 1990/91 respectively whereas 60.48, 45.62 and 14.86 percent in FY 2007/08 respectively. It clearly shows that the contribution of external outstanding debt to GDP has more than that of internal outstanding debt. And one of the factors of increasing external outstanding debt is devaluation of Nepalese curriencies almost every year.

Figure 6: Outstanding Public Debt in Nepal



The figure 6 shows the total outstanding debt, external outstanding debt and internal outstanding debt. This figure indicates that except few years the total outstanding debt, external outstanding debt and internal outstanding debt are in increasing trend. And the external outstanding debt line is above the internal outstanding debt line shows the increasing trend of external outstanding debt more than the internal outstanding debt.

3.8. Internal Outstanding Public Debt in Nepal

Nepal's internal borrowing program has carried out since the 1961. It is used for to meet the resource gap on the budgetary system and mobilizing financial resources for development.

The government mobilizes the internal borrowing by issuing financial instruments like Treasury Bills, Development Bonds, National Saving Certificate, Special Bonds and Citizen Saving Certificate. The maturity of these instruments ranges from 28 days to 20 years. They are either promissory or stock in nature. All the bonds are issued at coupon rate of interest and in face value. The Treasury bill is a government's short- term borrowing instrument. They are issued at a discounted auction price and the bill holder gets the payment in face value at maturity. The difference between to purchase price and received amount ate maturity is the yield of the Treasury bill. They all are promissory in nature.

Among the above mentioned instruments, the Treasury bill is the oldest instrument and the Citizen Saving Certificate is the latest on introduced in Nepal. The National Saving Certificate and Citizen Saving Certificates are issued either in stock or promissory types as individuals demand, whereas Special Bonds and Development Bonds are issued as stock only.

The given table (table 8) depicts the structure of internal net outstanding debt in which the government of Nepal especially mobilizes the internal resources by four sources. The table shows the largest share of Treasury Bills (with an average annual growth rate of 23.57 percent) than other instruments.

After Fiver years of establishment of NRB, the Public Debt Act-1961 was formulated and enacted. After the enactment of this Act, domestic borrowing was initiated in the country. For the first time in 1962, the government borrowed Rs. 70 million by issuing treasury bills of 90 days maturity period. Thereafter, the internal borrowing by the government has become a regular process in Nepal.

Table 8: Structure of Internal Net Outstanding Debt in Nepal

Rs. in Million

Fiscal Year	Total Internal Outstanding Debt	Treasury Bills	Development Bonds	National Saving Certificate	Special Bonds
1990/91	20854.9	2350.0	5482.3	3646.5	9376.1
1991/92	23234.9	3483.2	5132.2	4546.3	10073.2
1992/93	25456.1	4403.2	5132.2	4901.5	11019.2
1993/94	30631.2	5216.3	4732.2	5691.5	14991.2
1994/95	32057.8	6392.5	4122.2	6076.4	15466.7
1995/96	34241.9	7142.5	3672.2	7376.5	16050.7
1996/97	35890.9	8092.5	3042.2	8736.5	16019.7
1997/98	38406.7	9182.5	3042.2	8736.5	16019.7
1998/99	49669.7	17586.9	3872.0	10426.4	17784.1
1999/00	54357.0	21027.0	4262.2	11526.4	17541.3
2000/01	60043.8	27610.8	5962.2	12476.4	13994.3
2001/02	73620.7	41106.5	11090.7	11536.1	9259.3
2002/03	84645.3	48860.7	16059.2	9629.8	9164.5
2003/04	86133.7	49429.6	17549.2	9029.8	8946.2
2004/05	87564.2	51383.1	19999.2	6576.7	8176.3
2005/06	94710.8	62970.3	17959.2	3876.8	8225.6
2006/07	103776.0	74445.3	19177.1	1516.9	7245.7
2007/8	116040.0	85033.0	21735.4	1116.9	8033.4
Average Annual Growth Rate	**10.24**	**23.57**	**10.34**	**-2.91**	**0.15**

Source: Various Issues of Economic Survey, MOF/GON

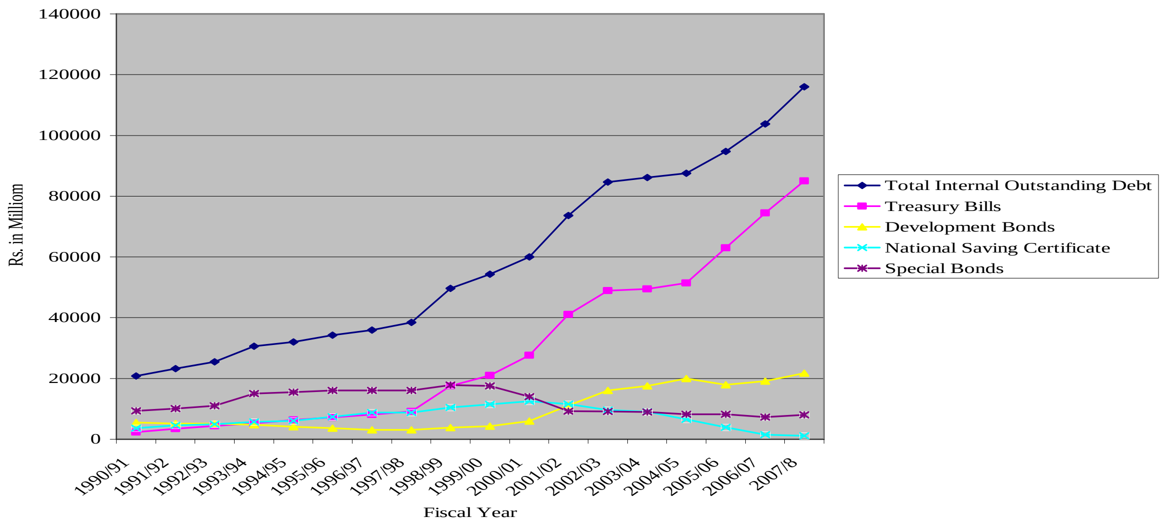
The table 8 indicates the share of Treasury Bill, Development Bond, National Saving Certificate and Special Bond to total outstanding internal debt. The share of Treasury

Bill, Development Bond, National Saving Certificate and Special Bond is Rs. 2350.0 million, 5482.3 million 3645.5 million and 9376.1 million respectively in FY 1990/91 where as in 2007/08 Rs. 85033.0 million, 21735.4 million, 1116.9 million and 8033.4 million respectively. In the review period we found that the amount of Treasury bill has been increasing whereas the share of other's instruments to total outstanding internal debt has been fluctuating.

The average annual growth rate of Treasury Bill, Development Bond, National Saving Certificate and Special Bond is 23.57 percent, 10.34 percent, -2.91percent and 0.15 percent respectively. The percentage share of Treasury Bill, Development Bond, National Saving Certificate and Special Bonds to total outstanding internal debt is 73.28 percent, 18.73 percent, 0.96 percent and 6.92 percent respectively in FY 2007/08. This shows that more than two third internal debts have been mobilized through Treasury Bill. On the other the share of Special Bond is almost negligible. In the review period it average annual growth rate is negative of -2.91 and it share to internal outstanding debt is less than one percent in FY 2007/08.

The conclusion from above table may derive that the volume of internal debt has been increasing each year without increasing tax revenue collection proportionately to the growth in the government expenditure. Such type of tends indicates the inflationary situation which may create debt crisis in the future.

Figure 7: Structure of Internal Net Outstanding Debt in Nepal



The figure 7 shows the total outstanding internal debt and amount of Treasury Bills, Development Bond, National Saving Certificate and Special Bonds to total outstanding internal debt. The figure shows that both outstanding internal debt and Treasury Bill's amount has been increasing rapidly whereas remaining are in fluctuating trends.

3.9. Empirical Analysis

It plays the vital role to show the relationship between dependent and independent variables of the study. To analyze the relationship between GDP (dependent variable) with internal debt, external debt and total debt (independent variables) simple regression model has been used.

3.9.1. GDP and Internal Debt

This analysis depicts the relationship between GDP and internal debt. For this the regression equation is:

GDP = a + b ID

The result of this equation is:

GDP = 161863.14 + 35.07 …………………………………… (1)

$R^2 = 0.85$

t = 4.378

Tabulated value of t = 2.110

Level of Significance: 5 percent

For D-W

d_L= 1.158 and d_U= 1.391

d= 0.567 (Level of significance = 5 %)

In function (1), GDP is dependent variable and ID is independent variable. The regression intercept coefficient 'a' is 161863.14, which shows that average GDP would Rs. 161863.14, if the independent variable, that internal debt be zero. The value of 'b' in the equation is 35.07, which shows that one unit increases in internal debt would lead to 35.07 unit increase in GDP.

The coefficient of determination (R^2) is 0.85 which reflects that 85 percent of the variation of GDP is determined by the explanatory variable that is internal debt. This shows the higher goodness of fitness on regression line.

As the calculated value of ‘t’ is greater than tabulated ‘t’, the internal debt is statistically significant. Similarly, from the Durbin-Watson table, we find that for n=18 and k’=1, that is only one explanatory variable, internal debt, at 5 % level of significance $d<d_L$ represents the positive auto correlation.

3.9.2. GDP and External Debt

This analysis indicates the relationship between GDP and external debt. For this, regression equation is given by:

GDP = a + b ED

The result of this equation is:

GDP = 264941.73 + 14.75 ED…………………………………. (2)

$R^2 = 0.022$

t = 1.865

Tabulated value of t = 2.110

Level of Significance: 5 percent

<u>For D-W</u>

d_L= 1.158 and d_U= 1.391 (d_L = Lower limit of d and d_u = Upper Limit of d)

d= 0.137 (Level of significance = 5 %)

Function (2) shows the relationship between GDP and external debt where GDP is dependent variable and ED is independent variable. The value of ‘a’ is 264941.73 in this equation which shows that GDP is Rs. 264941.73 if the independent variable becomes zero.

Impact of external debt in GDP is positive which shows by value of ‘b ‘. The value of ‘b’ is 14.75; it means that one unit increase in external debt leads to 14.75 unit increase in GDP.

Here, as value of (R^2), the coefficient of determinant is 0.022 only 2.2 percent of variation of GDP is determined by the explanatory variable, external debt. Hence, regression equation of external debt is insignificant.

In the above relation the calculated value of 't' is less than tabulated 't', so the external debt is statistically insignificant. And from the Durbin-Watson table, we find that for n=18 and k'=1, that is only one explanatory variable, external debt, at 5 % level of significance d is less than d_L represents the positive auto correlation.

GDP and Total Debt

This analysis shows the relationship between GDP and total debt (TD). For this, the regression equation is,

GDP = a + b TD

The result of this equation is:

GDP = -82121.11 + 30.91 TD ………………………………….. (3)

$R^2 = 0.79$

t = 10.227

Tabulated value of t = 2.110

Level of Significance: 5 percent

<u>For D-W</u>

d_L= 1.158 and d_U= 1.391

d= 1.175 (Level of significance = 5 %)

The function (3) states the relationship between dependent variable, GDP and independent variable, TD. The value of 'b' is 30.91 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 (TD) would lead to 30.91 unit increase in GDP. On the other the value of intercept (a) is -82121.11, which indicates that GDP is Rs. 82121.11, if independent variable TD is zero.

The coefficient of determination (R^2) is 0.79 which reflects that 79% of the variation of GDP is determined by the explanatory variable total debt. The regression equation is highly goodness to fit.

Similarly, in the above function the calculated value of ‘t’ is greater than the tabulated value of ‘t’ which shows statistical significant of total debt. On the other the value of d is greater than the value of $d_{U;}$ that is there is no positive autocorrelation.

From the above empirical analysis the study shows that there is positive relationship of GDP with internal debt, external debt and total debt. It means both internal debt and external debt contribute to increase the GDP. But the contribution of internal debt is very strong than that of external debt. Therefore, the government of Nepal should give much more emphasis to internal debt rather than external debt.

CHAPTER FOUR

BURDEN OF PUBLIC DEBT IN NEPAL

4.1 Introduction

Public debt has been the single most important source of funds to finance the development plans of the Government of Nepal. Raising sufficient funds in the form of public debt is, therefore, important for sustained economic growth and to end prolonged poverty. Since a failure to meet debt obligations could lead to a serious economic crisis, managing public debt within a sustainable level is an important policy issue in itself. Higher debt levels could contribute to higher growth, but it could also increase the probability of default[30]

Public debt burden in Nepal is increasing rapidly. Debt burden is the cost of servicing debt. Burden of public debt refers to the sacrifice and effect on the community through a rise in taxation at the time of repayment and for paying the annual interests on the government loans. In other words this indicates that every government is bound to repay the public debt whether internally or externally with interest. It may be fall to present generation and in some case even to future generation.

Classical economists viewed that any loan which is incurred for a purpose that does not yield any direct monetary return or those loan which are spent in unproductive sector like financing for war, imposes a burden on the society.

Keynesian approach examines that public borrowing for the purpose of generating effective demand is no burden because it would activate idle savings in the private sector and generate income and employment.

[30] Ra, Sungsup and Ree, Chang Y.(2005), " Managing the Debt: An Assessment of Nepal Public Debt Sustainability", ADB

Domar was of the view that interest payment on public debt should be taken to represent a burden of debt. He relates the interest payment to the level of the national income. In his view public debt is a burden only when interest on debt as portion of national income rises or when the rate of growth of the economy falls behind the rate of increase in interest costs.

Some other economists view that debt financing is burdensome as compared to tax financing because it involves future taxation to service the debt. The burden of public debt can be two types:

a.) Financial or Money Burden:

When a debt is incurred by the government, the level of taxation has to be raised in order to meet the interest charges and the income of the people is transferred to the government. Such a loss in the income of the people is called a financial or primary burden of public debt.

b.) Real Burden:

As the government levies taxes to meet the interest charges and repays the principal, the level of taxation rises. The higher the level of taxation due to public borrowing will have deep repercussions in the form of adverse effects on the capacity and willingness to work and willingness to save and invest, which is called the real burden or the secondary burden of public debt.

So burden of public debt refers to costs or disadvantages that are imposed upon the economy when public outlays are loan financed rather than tax financed. The burden that arises from a large public debt and large tax collection for interest payment mainly depends upon three things:

- The wastage that takes place in terms of costs of administering the tax collections and interest payments.
- A loss of maneuverability in the public budget and related constraints.
- Distributive effect of public debt.

The real troublesome burden of debt is the erosion of budgetary maneuverability. An increase portion of budgetary expenditure becomes a committed component and public authorities are not able to take policy decisions in full freedom. In case the debt is too large they fall in to a ‘debt trap’ wherein fresh borrowings are needed to service the existing debt.

In broad sense public debt burden can be viewed into two categories:

4.1.1 Burden of Internal Debt

The debt incurred by the government from the domestic sources or inside the country is known as internal borrowing. Internally, the government can borrow from individuals, commercial banks, charitable trusts, financial institutions, and the central bank in a country.

In case of internal debt there is no net money burden on the community since payment of interest and taxation simply involves transfer of purchasing power from taxpayers to bondholders. Direct money burden is equal to the amount of goods and services scarified by the people due to rise in taxes. Prof. Dalton[31] conveys that there can never be any direct money burden or direct money benefit of an internal debt if all transactions connected with an internal debt resolves themselves into a series of transfer of wealth within the community.

There may be redistribution of income, if the bondholders and taxpayers belong to different income group. Bondholders are generally rich people and taxpayers are both rich and poor. Taxes are generally imposed on active working population while debt is repaid to old age and leisurely class. In two cases there is net burden of taxation. Dalton points out that this may cause more direct real burden upon the people belonging to other sector than the weather class and the progressive taxation may not be so sharply progressive as to counterbalance among the wealthier classes, the income derived from public securities.

[31] H. Dalton, “Public Finance”

4.1.2 Burden of External Debt

At the time of contracting external debt, the debtor country either gets consumption goods or capital goods from the lender country as a form of real resources. At the time of repayment principal and interest an outflow of resource take place. If the country had acquired consumptions goods, it would not add to its productive capacity and so at the time of payments of loans, there will be a net loss of resources. Since loans add interest also there is net loss of resources over the inflow. On the other if foreign loan is used for investment proposes, like the plant and machinery and other resources, productive capacity of debtor country will increase out of which the debt repayment take place. Here there is no excess net burden.

If the loans have not been invested in export oriented industries or if the exports of the debtor country do not increase; then there will be balance of payment difficulties at the time of repayment. This has happened in many underdeveloped countries. Similarly if there is currency devaluation, the debt burden will increase because larger volume of domestic resources will have to be given up for the same amount.

In this ground, therefore, the country has to spend the borrowed fund for investment propose, which can generate the productive capacity and increase the volume of export; that increase the real capital formation, then it is quite possible that the borrowed fund would not have any burden to the community.

It is often claimed that the burden of public debt is shifted to future generation that is debt financing of current expenditure leads to a burden upon future generation of the society. There is always debate among the economists in this subject. The classical economists opined that through debt financing it is the present generation which suffers a loss of resources. The future generation will suffer if present generation reduces its savings to meet the debt finance and thereby leaves smaller amount of capital resources for the future. This will reduce the productive capacity of the coming generations. The present generation, by not reducing its consumption, is passing the burden on to future generations. But the modern economists present that there may not be no shift of the basic burden to the future generation because the same posterity which pays the additional taxes, will be benefited from the repayment of the debt.

Pigue viewed that whether tax fiancé or loan fiancé will shift the burden to future generation will depend upon the extent of real capital inherited by it; if the current consumption is not sacrificed, the capital cannot be formed to build up larger productive base for future generation.

Bowen, Davids and Kopt has defined present generations are those who grant loan to the government to undertake public project while future generations are those people who pay tax for repayment and interest payment. And they observed that the burden of the debt falls on the generation(s) alive at the time the loan is repays. J. M. Buchanan is one the few contemporary economists to argue that the real burden of public debt can be shifted to future generation.

Dr. H. L. Bhatia[32] (2004) concludes that public debt will put a burden on future generations if two conditions are satisfied:

- the current generation does not reduces its savings, and
- the government does not add to the capital stock and productive capacity of the country.

Although we made the above discussion it is really difficult to conclude that the burden of debt shift to future generations or not. Hence this proposition has remained an unsettled riddle so far.

4.2 Issues of Debt Servicing in Nepal

Nepal's economy suffered when the conflict intensified in 2001 and is now recovering. Nepal's neighbours – India and China - have huge economies and

[32] H. L. Bhatia, "Public Finance", Vikas Publication House Pvt. (Ltd), New Delhi, 2004

sustained growth, offering important markets which Nepal can benefit from. So strengthening economic links with its two main neighbours is a priority, particularly with India which accounts for two third of Nepal's trade. Nepal's main exports are garments and carpets. It also has opportunities to develop tourism further and develop its hydro-power resources. Similarly agriculture, which makes up a third of GDP, has significant potential, but is vulnerable to varying rainfall. Remittances from the 2 million Nepalese working overseas generate more foreign earnings than exports, and around 15 percent of national income. Foreign Direct Investment is very low at $6 million.

Debt servicing refers to payment of interest and principal after maturity. The debt servicing issue is debated topic in case of Nepal. Each year the share of external debt to total debt has been in increasing trend, which increases the financial and real burden to the coming generations. To pay the existing debt even we are taking borrowing from internal and external sources. The annual growth rate of total debt is rapidly increasing. In survey period it is found that 7.33 percentage.

Nepal is receiving mostly multilateral loans of terms as long as 30-40 years. All the loans are soft loans with semi-annual repayment arrangements after maturity. As bulks of external loans are concessional, Nepal has little choices in creditors/lenders, currencies and even terms and conditions of the borrowings limiting the significance of debt management. However, it is significant as an instrument of financing the development expenditure, particularly to meet the saving-investment gap as well as large fiscal & trade deficit and foreign currency gap in Nepal.

The amount of internal debt is relatively smaller compared to external borrowings. However, the external debt is in concessional rates where as internal borrowing is normally at market rate**.** As a result repayment amount of internal debt is greater than that of external one. The public debt of Nepal is still less burdensome, as foreign loans are available at subsidized rate.

The trend of total debt servicing, internal debt servicing and external debt servicing can be shown in given table:

Table 9: Trends of Debt Servicing in Nepal

Rs in Million

Fiscal Year	Total Debt Servicing (TDS)	Internal Debt Servicing (IDS)	External Debt Servicing (EDS)	IDS as percentage of TDS	EDS as Percentage of TDS
1990/91	3493.9	2407.4	1086.5	68.9	31.1
1991/92	5462.0	3797.1	1664.9	69.5	30.5
1992/93	6692.4	4560.5	2131.9	68.1	31.9
1993/94	7344.2	4855.5	2488.7	66.1	33.9
1994/95	9068.0	6083.3	2984.7	67.1	32.9
1995/96	10019.8	6715.5	3304.3	67.0	33.0
1996/97	10876.6	7527.2	3349.4	69.2	30.8
1997/98	11884.0	7682.8	4201.2	64.6	35.4
1998/99	10273.2	5527.7	4745.5	53.8	46.2
1999/00	11674.2	6352.8	5321.4	54.4	45.6
2000/01	12089.2	5887.8	6201.4	48.7	51.3
2001/02	14021.4	7453.9	6567.5	53.2	46.8
2002/03	18204.3	10685.1	7519.2	58.7	41.3
2003/04	19481.9	11573.0	7908.9	59.4	40.6
2004/05	21899.4	13798.1	8101.3	63.0	37.0
2005/06	22587.4	13436.0	9151.4	59.5	40.5
2006/07	24972.1	15377.6	9594.5	61.6	38.4
2007/08	24905.9	14891.2	10014.7	59.8	40.2
Average Annual Growth Rate	**13.1**	**12.9**	**14.5**	**61.8**	**38.2**

Source: Various Issues of Economic Survey, MOF/GON

The table represents that the total debt servicing of Nepal is increasing rapidly. In the FY 1990/91 it was Rs. 3493.9 million and positioned to Rs. 24905.9 million in FY2007/08 with the average annual growth rate of 13.1 percent. In FY 1990/91 the internal debt servicing and external debt servicing is Rs. 2407.4 million and Rs.

1086.5 million respectively and increased to Rs. 14891.2 million and Rs. 10014.7 respectively. It was found that both internal debt servicing and external debt serving are increasing. The average annual growth rate of internal debt servicing is 12.9 percent and of external debt servicing is 14.5 percent during review period.

The above table also depicts that the share of internal debt servicing to total debt servicing is higher than that of external debt servicing except in FY 2000/01. The share of internal debt servicing to total debt servicing was 69.9 percent in FY 1990/91 and that of external debt servicing was 31.1 percent. In FY 2007/08 the contribution of internal debt servicing is 59.8 percent whereas the contribution of external debt servicing is 40.2 percent. The average annual share of internal debt servicing to total debt servicing is 61.8 percent and of external debt servicing is 38.2 percent. This analysis shows that the share of internal debt servicing to total debt servicing is in decreasing trend and the share of external debt servicing to total debt servicing is in increasing trend.

Figure 8: Trend of Debt Servicing in Nepal

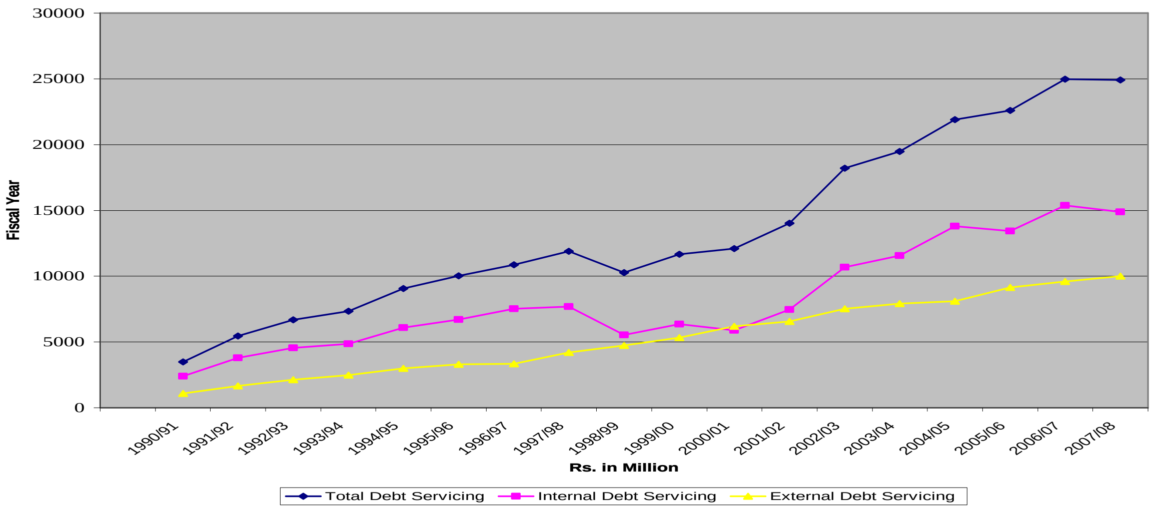


Figure 8 shows the trend of total debt servicing, internal debt servicing and external debt servicing in Nepal. It shows that both internal debt servicing and external debt servicing have been increasing but internal debt servicing has been increasing in fluctuating rate whereas external debt servicing has been increasing smoothly. The trend line of internal debt servicing is above the external debt servicing which shows that the amount of internal debt servicing is higher than that of external debt servicing.

4.3 Internal Debt Servicing as Percentage of GDP, Regular Expenditure and Total Revenue

The burden of internal debt is measured by the ratio between the internal debt servicing and government revenue (both tax and non tax revenue) and ratio between servicing cost and national income (GDP). The share of internal debt servicing in relation to total revenue, total expenditure and GDP can be shown in given table 10.

The table 10 shows the volume of Internal Debt Servicing, GDP at Producer Price, Total Revenue and Recurrent Expenditure along with average annual growth rate. It also shows the IDS as percentage of GDP, TR and RE.

In FY 1990/91 the size of GDP, total revenue, recurrent expenditure and internal debt servicing was Rs. 120370 million, Rs. 10729.9 million, Rs. 7574.1 million and 2407.4 million respectively and it has increased to Rs. 818401 million, Rs. 107622.6 million, Rs. 91446.9 million and 14891.2 million in FY 2007/08 respectively. The average annual growth rate of internal debt servicing, GDP, total revenue and recurrent expenditure is 12.9 percent, 11.34 percent, 14.8 percent and 18.6 percent respectively.

The table also exposes the decreasing and fluctuating trend of internal debt servicing as percentage of GDP, total revenue and recurrent expenditure. The internal debt servicing as percentage of GDP was 2 percent in FY 1990/91 and it remains in 1.8 percent in FY 2007/08 with annual average of 2.2 percentages. Similarly the internal debt servicing as percentage of total revenue was 22.4 percent in FY 1990/91 and rests at 13.8 percent in FY 2007/08 with an average annual change of 20.3 percentages. On the next side the internal debt servicing as percentage of recurrent expenditure was 31.8 percent in FY 1990/91 and remains at 16.3 percent in FY 2007/08.

Table 10: Share of Internal Debt Servicing to GDP, Total Revenue and Regular Expenditure

Rs. in Million

Fiscal Year	Internal Debt Servicing (IDS)	GDP at Producers Price	Total Revenue (TR)	Recurrent Expenditure (RE)	IDS as % of GDP	IDS as % of TR	IDS as % of RE
1990/91	2407.4	120370	10729.9	7574.1	2.0	22.4	31.8
1991/92	3797.1	149487	13512.7	9905.4	2.5	28.1	38.3
1992/93	4560.5	171474	15148.4	11484.1	2.7	30.1	39.7
1993/94	4855.5	199272	19580.8	12409.2	2.4	24.8	39.1
1994/95	6083.3	219175	24575.2	19267.1	2.8	24.8	31.6
1995/96	6715.5	248913	27893.1	21561.9	2.7	24.1	31.1
1996/97	7527.2	280513	30373.5	24181.1	2.7	24.8	31.1
1997/98	7682.8	300845	32973.9	27174.4	2.6	23.3	28.3
1998/99	5527.7	342036	37251.0	31944.2	1.6	14.8	17.3
1999/00	6352.8	379488	42893.6	35579.1	1.7	14.8	17.9
2000/01	5887.8	411519	48893.9	45837.3	1.4	12.0	12.8
2001/02	7453.9	459443	50445.6	48863.9	1.6	14.8	15.3
2002/03	10685.1	492231	56229.7	52090.5	2.2	19.0	20.5
2003/04	11573.0	536749	62331.0	55552.1	2.2	18.6	20.8
2004/05	13798.1	589412	70122.7	61686.4	2.3	19.7	22.4
2005/06	13436.0	654084	72282.0	67017.8	2.1	18.6	20.0
2006/07	15377.6	728178	87712.2	77122.4	2.1	17.5	19.9
2007/08	14891.2	818401	107622.6	91446.9	1.8	13.8	16.3
Average Annual Growth Rate	**12.9**	**11.34**	**14.8**	**18.6**	**2.2**	**20.3**	**25.2**

Source: Various Issues of Economic Survey, MOF/GON

4.4 Outstanding Public Debt, Capital Expenditure and Debt Servicing

The relation of outstanding public debt, total debt servicing and capital expenditure has been shown in table.

Table 11: Outstanding Public Debt, Capital Expenditure and Debt Servicing

Rs. in Million

Fiscal Year	Total Outstanding Debt (TD)	Total Debt Servicing (TDS)	Capital Expenditure (CE)	TD as % of (CE)	TDS as % of (CE)
1990/91	80361.2	3493.9	15979.5	502.9	21.9
1991/92	94158.8	5462.0	16512.8	570.2	33.1
1992/93	112876.9	6692.4	19413.6	581.4	34.5
1993/94	132598.0	7344.2	21188.2	625.8	34.7
1994/95	145058.7	9068.0	19794.9	732.8	45.8
1995/96	162286.3	10019.8	24980.5	649.7	40.1
1996/97	167977.7	10876.6	26542.5	632.9	41.0
1997/98	199614.7	11884.0	28943.9	689.7	41.1
1998/99	219135.6	10273.2	22992.1	953.1	44.7
1999/00	245048.2	11674.2	25480.7	961.7	45.8
2000/01	264474.4	12089.2	28307.2	934.3	42.7
2001/02	293746.3	14021.4	24773.4	1185.7	56.6
2002/03	308078.5	18204.3	22356.1	1378.1	81.4
2003/04	318913.0	19481.9	23095.6	1380.8	84.4
2004/05	307206.1	21899.4	27340.7	1123.6	80.1
2005/06	328679.4	22587.4	29606.6	1110.2	76.3
2006/07	320404.9	24972.1	39729.9	806.5	62.9
2007/08	366004.9	24905.9	53516.1	683.9	46.5
Average Annual Growth Rate	**9.0**	**13.1**	**7.9**	**861.2**	**50.8**

Source: Various Issues of Economic Survey, MOF/GON

The table 11 shows that the amount of total outstanding public debt went up from Rs. 80361.2 million in FY 1990/91 to Rs. 366004.9 million in FY 2007/08 with annual average growth rate of 9.0 percent. This shows the real burden of debt of Nepal whose total outstanding of public debt as percentage of capital expenditure was 502.9

percent with fluctuating has remained 683.9 percent in FY 2007/08.

Capital expenditure becomes Rs. 53516.1 million at the end of survey period from Rs. 15979.5 million in FY 1990/91 with 7.9 percent average annual growth. This shows the increasing trend of capital expenditure is less than outstanding public debt. Similarly total debt servicing rises to Rs. 24905.9 million at the end of survey year, from Rs. 3493.9 million at the beginning of the survey period. The annual growth rate of total debt servicing is 13.1 percent which is higher than the annual change in outstanding public debt. Total debt servicing as percentage of capital expenditure rose up to 84.4 percent in FY 2003/04 from 21.9 percent in FY 1990/91 and rests at 46.5 percent in FY 2007/08.

These trends show the greater dependency on public debt for financing development programs of Nepal.

4.5 Annual Internal Debt and Internal Debt Servicing

The proportional relationship between annual internal debt servicing and annual borrowing can be taken as important measure of internal debt analysis. The given table shows the aspects of internal debt servicing and proportion of annual borrowing which has spent in debt servicing.

Table 12 shows that the aspects of internal debt servicing and proportion of annual borrowing is spent in debt servicing. The table depicts that the volume of internal debt has gone up to Rs. 20496.4 million at the end of survey year from Rs. 4552.7 million in FY 1990/91 with average annual growth rate of 17.52 percent. Likewise internal debt servicing stood at Rs. 14891.2 million in FY 2007/08 from Rs. 2407.4 million in FY 1990/91 which has been increased with average annual growth rate of 12.9 percent. The volume of internal debt was greater than that of internal debt servicing in FY 1990/91.

Till FY 1999/00 from FY 1992/93 the magnitude of internal debt was smaller than internal debt servicing. Again in FY 2000/01 and 2001/02 the internal debt's volume led to the internal debt servicing. Form FY 2002/03 to FY 2005/06 the magnitude of internal debt servicing was higher than that of internal debt. But form FY 2006/07 the internal debt has been leading to internal debt servicing.

Table 12: Annual Debt Servicing as Percentage of Annual Debt Borrowing

Rs. in Million

Fiscal Year	Internal Debt (ID)	Internal Debt Servicing (IDS)	IDS as % of ID
1990/91	4552.7	2407.4	52.9
1991/92	2078.8	3797.1	182.7
1992/93	1620.0	4560.5	281.5
1993/94	1820.8	4855.5	266.7
1994/95	1900.0	6083.3	320.2
1995/96	2200.0	6715.5	305.3
1996/97	3000.0	7527.2	250.9
1997/98	3400.0	7682.8	226.0
1998/99	4710.0	5527.7	117.4
1999/00	5500.0	6352.8	115.5
2000/01	7000.0	5887.8	84.1
2001/02	8000.0	7453.9	93.2
2002/03	8880.0	10685.1	120.3
2003/04	5607.0	11573.0	206.4
2004/05	8938.1	13798.1	154.4
2005/06	11834.2	13436.0	113.5
2006/07	17892.3	15377.6	85.9
2007/08	20496.4	14891.2	72.7
Average Annual Growth Rate	**17.52**	**12.9**	**169.4**

Source: Various Issues of Economic Survey, MOF/GON

The share of internal debt servicing to the total internal debt servicing was 52.9

percent in FY year 1990/91 and it became 72.7 percent in FY 2007/08 with average annual change of 169.4 percentages.

The above analysis shows that the internal debt and its servicing are fluctuating trends. So debt burden becomes changeable at various periods of study. It also indicates that lack of effective management of internal debt and government ability to borrow from internal resources is the not beneficial to raise the sufficient funds for development of the economy.

4.6 Annual External Debt and External Debt Servicing in Nepal

Nepal is bearing large burden of external debt. Due to the insufficiency of domestic resources to meet the increasing demand of public expenditure, the government of Nepal has been funding by lending form external sources. Each year the volume of external debt has been increasing. In the same pace it is necessary to increase the amount of external debt servicing. Here, the scenario of annual flow of external debt and its servicing has been presented.

The table 13 shows the trend of external debt servicing as percentage of external debt. In the first year of survey period the external debt and external debt servicing was Rs. 6256.7 million and Rs. 1086.5 million respectively and reached to Rs. 8979.9 million and Rs. 10014.7 million in FY 2007/08 with an average annual growth rate of 5.3 percent and 14.5 percent respectively. In the starting years of review period the external debt is higher than that of external debt servicing but from FY 2002/03 except FY 2004/05 and FY 2006/07 the magnitude of external debt servicing is higher than external debt. This shows the positive symptoms. If such conditions go further there won’t be any external debt burden.

Table 13: Trend of External Debt Servicing as Percentage of External Debt

Rs. in Million

Fiscal Year	External Debt (ED)	External Debt Servicing (EDS)	EDS as % of ED
1990/91	6256.7	1086.5	17.4
1991/92	6816.9	1664.9	24.4
1992/93	6920.9	2131.9	30.8
1993/94	9163.6	2488.7	27.2
1994/95	7312.3	2984.7	40.8
1995/96	9463.9	3304.3	34.9
1996/97	9043.6	3349.4	37.0
1997/98	11054.4	4201.2	38.0
1998/99	11852.4	4745.5	40.0
1999/00	11812.2	5321.4	45.1
2000/01	12044.0	6201.4	51.5
2001/02	7698.7	6567.5	85.3
2002/03	4546.4	7519.2	165.4
2003/04	7629.0	7908.9	103.7
2004/05	9266.1	8101.3	87.4
2005/06	8214.4	9151.4	111.4
2006/07	10053.5	9594.5	95.4
2007/08	8979.9	10014.7	111.5
Average Annual Growth Rate	**5.3**	**14.5**	**63.7**

Source: Various Issues of Economic Survey, MOF/GON

4.7 External Debt Servicing and Export in Nepal

In Nepal due to in inadequacy and insufficiency of internal resources to meet overall expenditure, the economy has been using external debt as an alternative source. And the volume of external debt is increasing year by year; in same pace it is necessary to increase the external debt servicing to reduce the public debt burden. On the other ground the export earning is very limited. She has been exporting very few goods. Here, large volume of export earning and GDP has been used while servicing external debt. Here, attempt has been made to show the ratio of external debt servicing to export earning and GDP.

Table 14: Share of External Debt Service to GDP and Export Earning

Rs. in Million

Fiscal Year	External Debt Servicing(EDS)	GDP	Export Earning	EDS as % of GDP	EDS as % of Export Earning
1990/91	1086.5	120370	7387.5	0.9	14.7
1991/92	1664.9	149487	13706.5	1.1	12.1
1992/93	2131.9	171474	17266.5	1.2	12.3
1993/94	2488.7	199272	19293.2	1.2	12.9
1994/95	2984.7	219175	17639.2	1.4	16.9
1995/96	3304.3	248913	19881.1	1.3	16.6
1996/97	3349.4	280513	22636.5	1.2	14.8
1997/98	4201.2	300845	27513.5	1.4	15.3
1998/99	4745.5	342036	35676.3	1.4	13.3
1999/00	5321.4	379488	49822.7	1.4	10.7
2000/01	6201.4	411519	55654.1	1.5	11.1
2001/02	6567.5	459443	46944.8	1.4	14.0
2002/03	7519.2	492231	49930.6	1.5	15.1
2003/04	7908.9	536749	53910.7	1.5	14.7
2004/05	8101.3	589412	58705.7	1.4	13.8
2005/06	9151.4	654084	60234.1	1.4	15.2
2006/07	9594.5	728178	59383.1	1.3	16.2
2007/08	10014.7	818401	59266.5	1.2	16.9
Average Annual Growth Rate	**14.5**	**11.34**	**14.8**	**1.3**	**14.3**

Source: Various Issues of Economic Survey, MOF/GON

The table 14 depicts the external debt burden in relation to GDP and export earnings. The external debt servicing is in increasing trend with an average annual growth rate of 14.5 percent during review period. The data further reveals that the external debt servicing as percentage of GDP is in fluctuating trends with the average annual change of 1.3 percent. The external debt servicing as the percentage of GDP was 0.9 percent in FY 1990/91 and increases till FY 1994/94 then took the decreasing trend up to FY 1996/97; it become 1.4 percent in FY 1997/98 and remain at same rate up to 2000/01. From 2003/04 it took the decreasing trend and remains at 1.2 percent at the last year of the survey period.

The external debt servicing to export earning ratio was 14.7 percent in FY 1990/91 and it is 16.9 percent in FY 2007/08. With the average annual change of 14.3 percent it is also in fluctuating trend.

4.8 Outstanding External Debt and Import in Nepal

In total international trade volume of Nepal import occupies 80 percent. It shows that the internal trade of Nepal is import oriented. For this propose every large portion of national income has been used for import payment. It is not good for the welfare of the economy. Here the attempt has been made to show the relationship between external outstanding debt and import payment.

Table 15 shows the relationship between external debt burden and import payment and the ratio of import payment to external outstanding debt. The data reflects the increasing trend of the total external outstanding debt with 8.6 percent of average annual growth rate. It indicates the increase burden of external debt in the economy.

The magnitude of import payment has been increasing with 14.8 percent of annual growth rate during survey period. It was Rs. 23226.5 million in FY 1990/91 and remains at Rs. 221937.7 million in FY 2007/08. This shows that larger portion of foreign exchange has been paid for the imported goods and services. Similarly, the ratio of import payment to outstanding public debt is in increasing trend wit some fluctuation. It was 39.0 percent in FY 1990/91 and till 1996/97 took the increasing trend and became 70.8 percent in same FY. There was fluctuation from FY 1996/97 to FY 2001/02, then after it is in increasing trend and it becomes 88.8 percent in FY 2007/08. The average annual change of import payment as external outstanding debt is 59.6 percent during study period.

Table 15: External Outstanding Debt and Import Payment

Rs. in Million

Fiscal Year	External Outstanding Debt (EOD)	Import Payment	Import Payment as % of EOD
1990/91	59505.3	23226.5	39.0
1991/92	70923.9	31940.0	45.0
1992/93	87420.8	39205.6	44.8
1993/94	101966.8	51570.8	50.6
1994/95	113000.9	63679.5	56.4
1995/96	128044.4	74454.4	58.1
1996/97	132086.8	93553.4	70.8
1997/98	161208.0	89002.0	55.2
1998/99	169465.9	87525.3	51.6
1999/00	190691.2	108504.9	56.9
2000/01	200404.4	115687.2	57.7
2001/02	220125.6	107389.0	48.8
2002/03	223433.2	124352.1	55.7
2003/04	232779.3	136277.1	58.5
2004/05	219641.9	149473.6	68.1
2005/06	233968.6	173780.3	74.3
2006/07	216628.9	194694.6	89.9
2007/08	249965.4	221937.7	88.8
Average Annual Growth Rate	**8.6**	**14.8**	**59.5**

Source: Various Issues of Economic Survey, MOF/GON

4.9 Problem of Debt Servicing and Its Management in Nepal

Nepal is in the process of development and it is facing the deficiency of capital in relation to her production and natural resources. The economy of Nepal has attributed with mass poverty, mass unemployment, and illiteracy, lack of social and economic infrastructure. To break such vicious circle and move the country to the self reliant economy a large sum of initial investment is necessary. But domestic resources are inadequate and insufficient to meet the over all expenses. The only way out is to depend over internal and external borrowing. For this, Nepal is borrowing huge sum, internally and externally. But such a rise in debt amount has created several discuss about its burden, servicing and redemption.

Nepal is facing the problem of financing due to the over increasing resources gap. Budgetary deficit is growing each year on the one hand and on the other hand grants amount is decreasing trend, which ultimately increase the debt burden. Both internal and external debt has been increasing year by year which further creating the debt servicing problems. The volume of export is very low and that of export earning also been financing for the debt servicing, which may create the balance of payments problem because import payments has been increasing each year. So that effective debt management is required. There should be effective revenue and expenditure policy and loan in unproductive sector must be curtailed.

There are some factors which have been causing highly dependency in foreign debt which should be improved, like political instability, expenditure in unproductive sector, existence of dual economy, corruption, improper use of resources, lack of banking and financial institutions in the rural sectors etc. Due to which each year debt burden has been increasing.

“Actually, foreign aid, in itself, is not the problem. The problem is with its management. Had Nepal managed the foreign assistance properly, the situation of the country would have been different. As Nepal borrowed a large amount of money over the years to initiate development activities in the country, the debt burden is getting higher at a faster pace than ever before."[33]

For the effective management of debt and saving mobilization, both money and capital market play the vital role. For these urban center banking and financial institutions should be provide their services even in rural sectors and encouragement should be given for the small scale saving. So that large portion of expenditure can be fulfilled by domestic resources and economy can be monetized.

It is felt that the increase trend of public debt in Nepal is a matter of serious concern and if attention has not paid for proper management, it will create the severe effect in the economy, country may fall in debt trap. So it is necessary to give eyesight to the increasing magnitude of public debt and debt servicing has to be increased.

[33]Sharma, Guannidhi (2004), "Nepal: Low Equilibrium Trap", Nepal Centre for Contemporary Studies ,Kathmandu

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

5.1.1 Resource Gap in Nepal

Nepal is facing the problem of financing due to the over increasing resources gap. Fiscal deficit and budget deficit has been increased with an average annual growth rate of 9.9 percent and 1.7 percent during review period. The fiscal deficit has increased from Rs. 12819.9 million in FY 1990/91 to Rs. 53727.4 million in FY 2007/08 and budget deficit has increased from Rs. 10655.1 million in FY 1990/91 to Rs. 33406.7 million in FY 2007/08. The ratio of fiscal deficit to GDP has decreased from 10.65 percent to 6.56 percent in FY 1990/91 to 2007/08. The average annual change of ratio of fiscal deficit to GDP is 7.01 during survey period. The ratio of budget deficit to GDP has decreased from 8.85 percent in FY 1990/91 to 4.08 percent in FY 2007/08. The ratio of internal debt to fiscal deficit was 35.51 percent in FY 1990/91 and it becomes 38.15 percent in FY 2007/08 and the ration of external debt to fiscal deficit remains 16.71 percent in FY 2007/08 whereas it was 52.82 percent in FY 1990/91. Annual increase in government expenditure has exceeded the revenue collection in Nepal. The total revenue and total expenditure was Rs. 10729.9 million and Rs.23549.8 million in FY1990/91 respectively and becomes Rs.107622.5 million and Rs. 161349.90 million at the final year of survey period. The average annual growth rate of total expenditure and total revenue during survey period remains 14.2 percent and 11.5 percent respectively.

5.1.2 Trend of Government Borrowing in Nepal

The average annual growth rate of total debt, internal debt and external debt has been 7.33 percent, 17.52 percent and 5.32 percent respectively during survey years. The ratio of total debt to GDP, internal debt to GDP and external debt to GDP was 8.98 percent, 3.78 percent and 5.20 percent in FY 1990/91 in respectively and has become 3.60 percent, 2.05 percent and 1.10 percent in FY 2007/08 respectively.

5.1.3 Outstanding Public Debt in Nepal

The total outstanding public debt, external outstanding debt and internal outstanding debt was Rs. 80361.2 million, 59505.3 million and 20854.9 million respectively at the first year of survey period and has become Rs. 366004.9 million, 249965.4 million and Rs. 116039.5 million respectively at the final year of survey period. The average annual growth rate of total outstanding public debt, external outstanding public debt and internal outstanding public debt has remained 9.00 percent, 8.64 percent and 10.24 percent respectively. The share of outstanding internal debt to GDP was 17.33 percent in FY 1990/91 and with some fluctuation has remained at 14.18 percent in FY 2007/08. The share of external outstanding debt to GDP was 49.44 percent in FY 1990/91 and has become 30.54 percent in FY 2007/08. The ratio of external outstanding debt to GDP is also in fluctuating trend.

5.1.4 Sectoral Allocation of Public Debt

Out of total debt in FY 1990/91 in Agriculture, irrigation and forestry, in transportation, power and communication, in industry and commerce and in social services 17.18 percent, 24.49 percent, 20.40 percent and 14.90 percent respectively had been allocated; and 24.68 percent, 52.14 percent, 3.30 percent and 19.51 percent has been allocated in FY 2007/08 respectively.

5.1.5 Internal Borrowing in Nepal

The government of Nepal mainly collected internal borrowing by four instruments as treasury bills, development bonds, national saving certificate and special bonds. The treasury bills, development bond, national saving certificate and special bond has yielded Rs. 85033.0 million, Rs.21735.4 million, Rs.1116.9 million and Rs.8033.4

million respectively in FY 2007/08 and average annual growth rate has been remained 23.57 percent, 10.34 percent, -2.91 percent and 0.15 percent respectively.

5.1.6 Trend of External Debt in Terms of Disbursement by Major Sources

The share of bilateral loan and multilateral loan to GDP was 1.33 percent and 2.29 percent respectively in FY 1990/91 and has become 0.08 percent and 1.02 percent respectively in FY 2007/08. With fluctuation the average annual growth rate of bilateral and multilateral debt has remained 0.4 percent and 2.31 percent during survey period.

5.2 Conclusion

The general conclusion is that Nepal's public debt position is projected to remain manageable but caution will be far-sighted on account of questions related to fiscal sustainability and currency composition of exports and foreign reserves. Internal debt has been substantially increased and external debt has been increasing in fluctuating trend, during the survey years but as percentage of GDP, they remained somewhat stable. Internal debt increased five times between FY1990/91 and FY2007/08 from Rs. 4552.7 million to Rs. 20496.40 million. As percentage of GDP, it remained between 1 to 3 percent. External debt increased from Rs. 6252.7 million to Rs. 12044.0 million between FY 1990/91 to 2000/01, with some fluctuation it has stood at Rs. 8979.9 million in FY 2007/08. Form FY 2000/01 as percentage of GDP, external debt remained around 2 percent.

The debt service burden of internal debt of Nepal is found to be high; in annual average 20.3 percent of total revenue and 25.2 percent of regular expenditure have been spend for internal debt servicing. The internal debt has been increasing at an average annual growth rate of 17.52 percent whereas internal debt servicing is by 12.9 percent. Domestic debt service burden, though increasing, has remained modest over the period under consideration. The external debt has been increasing with an annual growth rate of 5.3 percent and external debt servicing has been increasing with an average annual growth rate of 14.5 percent, which is positive symptom. If same condition prevail in future even there won't be any external debt burden.

The average annual growth rate of GDP, revenue and export earning are considerably low as compared with public debt and its debt servicing. It was found that the recurrent expenditure is greater than capital expenditure. The average annual growth rate of recurrent expenditure and capital expenditure has become 18.6 percent 7.9 percent respectively during survey period. The recurrent expenditure increased from Rs. 7579.1 million in FY 1990/91 to Rs. 91446.9 million FY 2007/08 respectively where as capital expenditure increased Rs.15979.5 million to Rs. 53516.1 million in same periods. It shows that the most of the borrowed funds have been using for unproductive proposes.

5.3 Recommendations

The following are the proposed recommendations

- Slow growth, a subsistence economy and, limited scope for the collection of revenue and political instability are affecting revenue mobilization. Resource constraints, compounded by reduced foreign assistance and, the situation of the country has seriously controlled development. There is a need to ensure the most efficient use of available resources and political stability. Continuous monitoring, transparency, abatement of corrupt practices and, proper auditing, including social auditing should help to attain the goal of prosperous Nepal.

- Government should maintain balance between total expenditure and total revenue. Government should focus to rural sector as well to end the existing dual economy. For this there should be public private partnership is required. The number of banking and financial institutions should be expanded and set up even in rural sector to monetized and collect the scatter saving and mobilize the financial resource. So that invest saving gap can be minimized along with economic development.

- A greater focus needs to be applied to the promotion and diversification of exports in terms of both commodity composition and destination (away from India).

- Coordination must be promoted between planning and executing bodies through mutual operations, networking and the exchange of information.

- The government should adopt the policy of more grants and less loan. The external borrowed fund should be spent on such projects from which higher returns can be obtained and no more tax obligation is need to repay the loan.

- The government debt securities need to be diversified by studying investors' demands. In other words, varied government bonds like Insurance Bonds, Pension and Provident Fund Bonds, Municipal Bonds, Floating Rate Bonds and other Special Bonds can be issued to channalize the surplus funds from the targeted groups. All the government securities should be allowed to trade in the secondary market at competitive market price. This will encourage investors investing in the government securities market, which ultimately reduces the cost of government debt by ensuring risk free investment environment.

- Tight monetary and fiscal policies along with flexible exchange rate management are required. Industrial and trade policies should induce private investment and promote manufacturing sector.

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