Chapter - I
INTRODUCTION

1. 1 Background of the study

Nepal is a developing country with natural beauty, languages, culture and numerous such other features. However, the geographical structure, socio-economic condition and financial constraints are major obstruction for the advancement in sectors prerequisite for the development. The westerners are tremendously proceeding for the exploration beyond the earth where as Nepal is progressing ahead gradually. With this regard a nation, need adequate skilled work force, advance technology, proper investment, and enough capital for the economic prosperity. The developing country like Nepal is facing the main challenge of inadequacy of capital for the investment in development activities. The government of any country is liable for running the development activities, maintaining the law and order of country, and working for the interest of helpless and poor people. The government thus has to raise the necessary funds through the tax and non-tax revenue as well as public borrowing. Since the government borrows the funds with its total liability, it is called the public debt.

The government of any country is liable for running the development activities, maintaining the law and order of the country, working for the interest of helpless and poor people, arranging for health, education, road, drinking water etc. the regular revenue of the developing countries are not adequate to provide all afore said services to the people's the government, thus has to raise the necessary funds through the ax and non tax revenue ads well as public borrowing. Since the government funds with its total liability, it is also called public debt or government debt.

Government makes the budget annually. Expenditures are estimated in the budget first. Then to meet those expenditures, tax and non-tax sources of revenue stipulated. Because of the inadequacy of the revenue from tax and non-tax sources alone, the government seeks the required funds through foreign aid and other kinds of debt for the sake of stipulation in the annual budget. In other words, government makes the deficit budget almost every year. To bridge that deficit or gap, the government raises the debt. Deficit budget is taken as the excess of spending over revenue. This is the phenomenon mainly of the post World War II World. Before the trend was of the balance budget. Then, the governments were not allowed to spend more than their means. The classical economist mainly Adam Smith and others had warned the government not to incur budget deficit. During World War I, countries involved in war had no other choices than to go for budget deficit. Even during the War, countries like England tried to mobilize additional revenues to defray War expense than going only for deficit financing. Introduction of income tax system is the glaring example for this. In peacetime, the governments seemed to have refrained from spending more than the revenue.

Since Nepal is a developing country, it has some limitations of revenue collection. Tax is the main source of revenue of the country to meet the requirement of regular expenses. However, taxation has also its own limitations. Industry and commerce plight of the country is not sound enough to be the taxable source of revenue viable. Employment rate of the country is also very low. Most of the Nepalese people are below the taxable income. Taxation is the most important source of non-inflationary finance for development. However, it is quite possible to state that taxation has a certain limit beyond which it is undesirable. Moreover, the regular expenditure of the government is increasing so rapidly that very small amount of fund is left for development expenditure.

The process of economic development in Nepal was started with the implement of the first five-year plan in 1956. Since then the magnitude of development outlays has been increasing because of the growing demand for fund. Particularly after 1970, the volume of budgetary deficit has been increasing. For meeting those deficits, HMG has been raising funds from both external and internal sources. As a result, the magnitude of development efforts has been growing substantially.

There are two major sources of public borrowing, external and internal sources. Internally a government can borrow from individuals, financial institutions, non-banking financial institutions, commercial banks and the central bank. Similarly, the main source of external borrowing are, firstly international financial institutions like IMF, World Bank, IDA and ADB etc. these institutions give loans to the member countries for a short-term for covering the temporary balance of payment difficulties and for a long-term development projects. Secondly, the countries of good relations also provide the loans for the development projects[1].

Government borrowing is applied for the maintenance of the balance between the expenditure and revenue for financing economic development. Since the developing countries always face the problem of fund. Which is reflected in a large latent and as ever increasing financial resource gap in the government budgetary? Therefore, the selection of appropriate method for success of a developing plan. Various other methods to be adopted mobilizing financial resources and their implication for the economy are among the leading issues in economic development. Financial aspects are important as the other aspect of economic development and their study should receive proper attention.

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[1] "Nepal's Economy and External Assistance Requirements", Ministry of finance, April 1996, Pg. 48

The developing country like Nepal is always characterized by deficiency of funds. If voluntary savings from the people is mobilized by the extension of financial institutions, there could by substantial scope for increasing investment. However, government may borrow from the market or from the central bank. Borrowing from the market may increase capital accumulation; where as borrowing from central bank may increase inflationary pressure. Hence, it is desirable to increase market borrowing to increase the pace of development.

The proper utilization of available resources in the country is the prerequisite for the social as well as economic consolidation. Nevertheless, not all the countries are able to do so. For the sake of mobilizing the natural and human resource, scientific planning is essential to co-ordinate the adequate capital and advance technology to implement the budget, competent management is the prior requirement. Not these all requirements are within the easy access of the developing countries like Nepal. In such a situation, development activities should be conducted based on foreign aid is also an important aspect of economic principle, since the domestic savings and investment of the country is not enough, is a compulsion of foreign aid.

Public debt in modern age is not confined only to raise government fund, but it is equally used to manage fiscal as well as monetary policy. Public debt is conceived as the fundamental part of macroeconomics since every borrowing affects the government fund, deficit financing, saving mobilization, inflation curbing, liquidity injecting, resources distribution etc. Government borrows to assist the economy on its growth activities via capital accumulation and anti cyclical measures. On other hand central bank, manage the primary and secondary markets of the government debt securities so that the budgetary targets of itself can also be achieved through its dealing.

Public debt is considered as subjugated issue of the government in terms of raising and disbursing the fund from borrowing both internally and externally. Within the ceiling of proclamation at relevant act, ordinance, and budget, government can raise up to the limit either at once or at installments as per the necessity. There are two types of instruments used for raising the internal debt. Long-term instruments consisting the bonds, which are redeemed after one year or more. Short-term instruments have been issued as the form of treasury bills and by name; they are for the period of less than one year. 364 days, 182 days, 91 days, and 28 days treasury bills are activating the vital role in money market with their primary and secondary trading[2].

Being an economic adviser of the government, Nepal Rastra Bank provides the deliberation on both presently hold external debt and same to be raised. However, in case of government internal debt it is wholly responsible to maintain debt account and records, as the bank is sanctioned the entire responsibility in relation to the management of the public debt. By act, it is entrusted to the bank on such terms as may be agreed upon between His Majesty's Government and the bank. Not only maintaining the accounts and records NRB is equally responsible to handle and promote the government security market.

1.2 Statement of problem

Internal borrowing or public debt financing can be taken as a major tool to avoid this kind of gap by increasing magnitudes of public debt. It is better to take internal debt for the better implementation of internal resources to obtain sustainable development in the case of capital rather

[2] "Public Debt Newsletter," Nepal Rastra Bank, Sep/Oct 2004, Pg. 28

than foreign debt. Mainly, the developing countries depend on import . Public debt can be taken as to mobilize savings, economic development, for the balance of payment, utilization of ideal capital, control over inflation and fulfilling of low budget. However, this study has been directed towards poor debt servicing capacity of the country. The five decades of planned development of Nepal has yielded some positive gains, but overall growth rate of the economy has been far from satisfactory. Due to budgetary deficit the growth rate of government, expenditure & revenues are not growing in the same pace. Lack of main sources of financing more than fifty percent of the expenditure is financed through foreign aid and debt which guides wider gap between government revenue & government expenditure.. Therefore, to import the huge amount of goods from foreign the government need huge amount of foreign exchange and the government has the responsibility to perceive the public in case of peace and security and building life style. The government does not fulfill these needs only from the income of tax. Therefore, the government always takes debt from the public and foreign countries for the capital. Therefore, the main objective of the government taking internal debt to mobilize internal savings and avoiding foreign debt for the development projects for the better operation of fiscal policy.

1.3 Objectives of the study

The study has undertaken to fulfill following objectives:

1. To study the public debt administration in Nepal.
2. To evaluate the public debt financing practice in Nepal.
3. To examine the correlation between tax collection & public debt.
4. To suggest and recommend the stakeholders for more planning to manage public debt.

1.4 Significance of the study

It is pragmatic that per capita income has not been able to increase extensively due to rapid population growth, lack of proper budgeting & financing and slow rate of economic progress. This quandary can be solved only if the government manages its budget in proper way and the public debt is the main tool to do so. With this view, the study is undertaken primarily to examine problems of public debt and its structure, which are pioneers of economic change.

Owing to this very reason, public debt is intricately inter-related to the dynamics of economic change and vice versa. Different means of public debt financing will have will have near reaching implications on development efforts. With this view, the study is undertaken primarily to examine problems and structure of public debt.

1.5 Limitations

1. The study will be limited to public debt or internal borrowing only.
2. Study is based on the inference of secondary data. So all the limitations of this technique do equally apply to the study.
3. The study covers only the period of 15 years.
4. The time and money constraints do also limit the scope of the study.

1.6 Organization of the study

This dissertation is divided into five chapters.

<u>Chapter 1</u>

It provides information on general background of the study. This includes statement of problem, objectives, and significance of the study. This chapter also sets out limitations for the study.

Chapter 2

This chapter significantly reviews relevant literature for the study. It examines the history of the study and shows the theoretical debate about the study.

Chapter 3

It describes in detail the methodology taken to carry out the study. Similarly, this chapter clearly shows the research design, sources of data and technique used in the study.

Chapter 4

This chapter constitutes the backbone of the study. The chapter presents data collected through visiting related offices and analyses the data using different statistical tools including major findings.

Chapter 5

This is the last chapter of the study, summarizes major findings of the study, and gives conclusion and recommendations after scanning the problems of the study.

Chapter –II

THE LITERATURE REVIEW

2.1 Theoretical Debate

The idea of public debt was originated in the Great Britain in seventeenth century, where a group of city merchants provided grants and loans to the government. In return, they received the privilege of royal charter to fund the bank of England, which became the country's central bank. Formally, the state only had to maintain peace and prevent external disruption. Now every state should look after the economic development and welfare in addition to conventional work activities. Therefore, the public debt has become one of the most useful instruments to generate income and to maintain the welfare state and economic development.

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

[3]M.C. Regmi has stated in his publication entitled," Economic History" that there was no public debt but government provided some regulations to maintain public finance before eighteenth century. Some instances of public debt in Nepal can be held during the time of Rana Bahadur Shad who borrowed a large sum of money (Rs 60, 00,000) from Indian merchants. In 1803 the government was forced to meet its expenses. A cash levy was imposed on a countrywide basis to finance the repayment of debts incurred by King Rana Bahadur Shah. Prime Minister Junga Bahadur Rana came in power and the development work was not incurred

[3] Regmi M. C., "Economic History," First Edition,(Asia Publications, Kathmandu, 2056 B.S.) Pg. 7 – 8

out. They had collected the revenue for their own expense in luxurious life. There was no need of economic welfare for the people. After the dawn of democracy, the first five year plan was introduced in the year 1956. In this plan, most of the expenditure was incurred with the foreign grants. During that plan period, some deficit amount of Rs. 27.8 million was from surplus balance account and loan from Nepal Rastra Bank.

The government issued the first time securities Treasury bills in the fiscal year 1961/62 and in the Fiscal year 1963/64, the government for the first time floated securities (long-term loan) for mobilizing saving to finance the country's economic development programmed and for giving compensation of forests and Birta land.

On February 12. 1964, the government floated development bond of Rs 13.10 million carrying on interest rate 06 percent per year with Maturity period of five year. In the same period, the government issued compensation bonds for land acquisition with the interest rate of 3 percent per annum with the Maturity period of 10 years amounting Rs 407 thousands and composition bonds for land acquisition with one percent interest rate per annum with the Maturity period of 20 years amounting Rs. 5.56 million. The other component of the borrowing was from Nepal Rastra Bank as guaranteed loans and special bonds. The government also started to borrow since 1984, by issuing national saving certificate, which amounted Rs 500 million those years. Similarly, in 1991, the government started to borrowing by issuing CB pass and other bonds, which amounted to Rs 8478.10 million that year. Now, there are treasury bills, Development Bonds, National saving certificates, and special bonds as the main sources of internal borrowing[4].

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[4] "Public Debt Newsletter," Nepal Rastra Bank, Sep/Oct 2004, Pg. 44 – 45

Similarly, Nepal has also stared to borrow from external sources since 1964\65. Since then Nepal has to bridge financial resource gap in her budgetary position contributed to increase each year. The main sources of the external borrowing of Nepal are the government of the developed countries, international agencies, and commercial bank mainly the IMF, World Bank, Asian Development Bank.

Public borrowing is applied for the maintenance of the balance between the expenditure and revenue. It is applied for financing economic development since under developed countries always face the problem of funds, which is reflected in a large extent and as ever increasing financial

Resource gap in the government budgetary. As a fiscal measure, public debt for resource mobilization is of recent origin. Classical economists advocated balanced budget and therefore in their analysis the public borrowing was only for the productive purposes and permanent improvement but not for the current purposes. In terms of the orthodox theory of public finance, the current expenses of the government should be financed entirely out of taxes and government expenditures, devoted to producing capital equipment the fruit of which will subsequently be sold to purchasers for fees, should be financed by loans. Nevertheless, in an economy where the policy of public debt becomes an integral part of a compensatory fiscal policy, it will not be possible to stick this Orthodox conception of public finance for the maintenance of economic stability. Financing of public expenditure through loans in the context of a trade depression in an advanced country will be highly advantageous even if it does not result in the creation of productive capital equipment. Thus in the Keynesian theory of public debt is emphasized. Keynes' revolution brought change in the role of public borrowing. Keynes held the view that increases in the public debt through multiple effects would raise the national income. It is because Keynes correlated public borrowing with deficit financing. He authorized the government to borrow for all purposes so that effective demand may also increase.

The developing countries like Nepal has to engage for socio-economic, infrastructures development like health, drinking water, transport, irrigation, communication and power which need huge initial investment. Here the government should also involve in other directly productive economic activities like establishing factories and running them. With the increasing role of government, the government expenditure exceeds revenue; a deficit arises in the budget of the government. The most appropriate method of debt finance preferred by all states for mobilizing financial resources to bridge fiscal deficits in the government budgetary.

Michael Pusher points that growth in the debt ratio caused alarm for two reasons and growth in debt ratio might lead to crowding out of private investment and more important, is the assumption that government spending out of the borrowed funds might be unproductive. As professor S.E. Harris mentions, “it assure elasticity in money supply and agreed that government expenditures could be productive and need not necessarily be wasteful and so cause for public borrowing is strengthened.

The loan operation of modern government especially in the developing countries has been increased due to the government’s active participation in the economic development of their countries on the one hand and the limited availability of funds for investment from private sectors on the other hand. Thus, the investment from accelerating the role of capital formation for development purpose has led to the government to expand resources through public borrowing externally and internally.

It is widely accepted that the mobilization of internal resources is an important factor for the development of economic condition of nation.

Internal resources can be mobilized from the two sources. First, by collecting revenue (tax and non-tax) and second is internal borrowing.

The classical economists were generally against the public borrowing but they approved public debt for self-liquidating projects. In other words of R.A.Musgrave[5], "self liquidating projects may be defined narrowly investment in public enterprises that provide a fee or sales income sufficient to service that debt incurred in their financing, or they may be defined broadly as expenditure projects that increase future income and the tax base. Such projects permit servicing interest and amortization of the debt incurred in their financing without requiring an increase in the future level of tax rate (Musgrave 1959, p- 569).

James Stuart propounded the views that public debt should function as the balance wheel of the economy. Stuart's view is, "public borrowing must be adjusted to the conditions of trade at the particular time". Public borrowing is inappropriate as long as circulation is full because it would raise the rate of interest and have undesirable consequences for commerce. On the other hand, when circulation is stagnation in one part of economy, there is stagnation in one part of the economy, there is unemployment, and a slacking of trade and industry the state should absorb this excess and through its expenditures throw it into new channels of circulation. Thus, the use of public debt is conceived as the balance wheel in the economy. It keeps resource fully employed and prevents stagnation in any part of the economy from having an adverse effect elsewhere. In addition, public debt is a necessary instrument of war finance (Groves- 1950, p 616).

Public sector saving is mainly dependent on the classification of current and capital expenditures. Excess of current revenue over current

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[5] Musgrave R. A. (1959), "The Theory of Public Finance", MC Grow – Hill Book Co, New Work. Pg. 529

expenditure in the government budget is considered as the government saving. Similarly, excess of expenditure over revenue is called budget deficit. Such budget can be made through various means. One of such method of meeting budget deficit is internal borrowing.

A.H. Hanson[6] has written an article on effect of public debt on redistribution of income where net transfer of resources from lower income groups to upper income groups. He states, “in so far as the government can borrow from small savers and increase in the public debt will not prove unfavorable to an equitable distribution of wealth. However, if the growth in public debt is very rapid, it will not possible for relatively small savers to take any large proportion of new securities issued. They will be absorbed by the rich and the well to do and by large corporations. A rapid growth in public debt is therefore likely to intensify inequalities in wealth distribution (Hanson, 1941, p-179).

A discussion paper was prepared by United Nation conference on trade development “Multilateral debt of developed countries”. It has reviewed development in multilateral debt of least developed countries since the debt crisis of the early 1980s. This paper has discussed on problem of multilateral debt as sustainability liquidity and accumulation of large-scale arrears. The discussion paper has also evaluated recent schemes to provide debt relief and suggested possible measures to strengthen and improve existing schemes as well as present other innovative obtains. The analysis focused mainly on the least developed countries (LCDs). The World Bank an IMF classifies Thirty-seven of these 29 of them as heavily poor countries. There are 48 countries classified in 1995 by the United Nation as least developed countries. (Sabater, 1945; 2-24).

[6] A.H. Hanson (1941), “Effect of Public Debt,” A Journal. Pg. 179

In case of under developed countries, taxation should cover at least current expenditure on normal government services. Borrowing is particularly appropriate to finance government expenditure which is otherwise directly productive .The government of under developed countries can raise resources through public loans in terms of two important methods .First, selling government security to the public that are bought and sold in the capital and money market and of which market process are quoted. This may be called market borrowing. In addition, the second is the funds borrowed by the issue to the public. Which is not negotiable and is called non-market borrowing?

The level of government borrowing is a function of the ability and willingness of persons and business to lend and the government's power and intention to tax.

2.2 Nepalese Context

Number of intellectuals has made the several studies and research in the field of public borrowing. Some of those articles, thesis, and project report related to the subjects and included in this thesis are as follows:

Purushottam Acharya has prepared a dissertation entitled "A case study on public Debt in Nepal (1968)". His study includes different kinds of debts. Feature of different and redemption of bonds, pattern ownership of bonds and aims and effects of public debts in economy. He descried that the issue of public debt puts idle money lying with the people put into active use by channel sing it into productive purpose for speeding up the economic development of the country. He reached on the conclusion that public debt is most popular these days because of the repayment of debt on maturity can be adjusted through the issue of public debt. Therefore, the fact is the habit of purchasing bonds issued by the government, should be developed among the people so that no difficult may be faced in getting the bonds purchased by the public[7].

Mahesh Ram Joshi has prepared a thesis report on “Structure of public Debt in Nepal” in 1982; his study has a period between 1961\1962 and 1980\1981. In his study, he examined the structure of public debt in Nepal and the importance of public debt in financial development. He reached on the conclusion that system of public debt is one of the best ways of financing development expenditure of the government, which helps to control inflation in the country, and it has helped to mobilize the internal financial resources in the production sector of the economy[8].

R.D.Singh has prepared a dissertation entitled “A study on the impact of internal borrowing in Nepal” (1983) has analyzed the trend of revenue, expenditure and deficit and effect of under borrowing on money supply, inflation and import. He also analyzed the structure of internal public debt and impact of it on the economy. He found most inflationary nature of internal borrowing to increase inflation in the economy[9].

An article on “the role of foreign aid in economy development and poverty alleviation” by Dr. Kishor Kumar Gurugharana, presented data of the percentage share of outstanding foreign debt in GDP at factor cost and of foreign debt servicing in regular expenditure (1984|85-1993|94). He found long-term upward trend of increasing of that values under his study period. He concluded that “although foreign loan is relatively much softer terms for Nepal compared to India and China, the very low rate of return and increasing share of loan in foreign aid implies that aid slowly pushing

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[7] Acharya Purusottam (2025 B. S.), “A Case Study on Public Debt in Nepal,” A Thesis, T.U. Kirtipur, Pg. 15

[8] Joshi Mahesh Ram, “ Structure of Public Debt in Nepal,” A Thesis, T.U. Kirtipur, Pg. 3

[9] Singh R.D. (1983) “ A Study on the Impact of Internal Borrowing in Nepal”, A Thesis, T.U. Kirtipur, Pg. 28 – 30

Nepal toward a debt crisis on the coming years." Gurugharana (1996; 107-116).

Guna Nidhi Sharma published an article on, "The Growing Fiscal Imbalance in Nepal. Are we falling into the Dept Trap (1982)2".He analyzed that the even increasing debt in Nepal and its servicing has really created a situation, which is driving the country towards debt trap.

Keshav p. acharya (1968) in his article entitled," Burden of public Debt in Nepal"analysed the situation using ever-widening saving investment. Persistently growing share of regular expenditure with respect to total expenditure. GDP and government revenue per capital debt burden increasing trade gap. Their factors clearly indicate the ever-increasing debt burden. On the other hand, he concluded that the poor performance of the economy of the economy has failed to create productive capacity for meeting the situation.

Urmila Adhikari (1996) in her article entitled," Foreign Debt Servicing, A case study" analyzed the foreign debt-servicing problem in Nepal. She found out substantial increase in foreign debt servicing between the periods of 1974\75 to 1993\94. She prescribed effective implementation of liberalization policy in all areas of investment. This can bring a great relief to the country by creating capacity for foreign exchange, which can reduce burden of debt servicing substantially in the years to come.

2.3 Policy & Procedure Reformation on Internal Debt Management in Nepal[10]

Public debt in modern age is not confined only to raise government fund, but it is equally used to manage fiscal as well as monetary policy. Public debt is conceived as the fundamental part of macroeconomics since every borrowing affects the government fund; deficit financing, saving mobilization, inflation curbing, liquidity injecting, and resources distribution etc. government borrows to assist the economy on its growth activities via capital accumulation and anti cyclical measures. On the other hand, central bank manages the primary, secondary markets of government would be supported, and monetary targets of itself can be achieved through its dealing.

Being an economic adviser of the government, Nepal Rastra Bank provides the deliberation on both presently hold external debt and same to be raised. Nevertheless, in case of government internal debt it is widely responsible to maintain debt account and records, as the bank is sanctioned the entire responsibility in relation to the management of public debt. By act, it is entrusted to the bank on such terms as may be agreed upon between His Majesty's Government and the bank. Not only maintaining the accounts and records NRB is equally responsible to handle and promote the government security market. Nowadays, Nepal is attempting various reforming programmers so that the entire accounts and records of internal debt transaction would be more clear and scientific.

Public debt is considered as subjugated issue of the government in terms of raising and disbursing the fund from borrowing both internally

[10] Shrestha Shiva Raj, "The Concept of Scripless Government Securities", Rastra Rin Khabarpatra Vol 2,(2004), March/ April, Pg. 7 – 10.

and externally. Within the ceiling of proclamation at relevant act, ordinance, and budget, government can raise up to the limit either at once or at installments as per the necessity. The government receives the recommendation from Nepal Rastra Bank about the volume of debt, marketability of debt instruments, interest rate, maturity of debt etc so as to bring crucial for HMG and NRB because public seldom at different manner but at same manner more frequently.

We have two types of instruments used for raising the internal debt. Long-term instruments consisting the bonds, which are redeemed after one year or more. Short-term securities have been issued as the form of treasury bills and by name; they are for the period of less than one year, 364 days, 182 days, 91 days and 28 days treasury bills are activating the vital role in money market with their primary and secondary trading.

As like the private firms pay interest to their lender either at single installment or at multiple as per the compromise or condition they made, the government in a same way makes the payment of interest mostly on periodic basis on its borrowing. However, in case of treasury bill-auction discount amount is paid at maturity at a single installment. Similarly, the principal payment would be made at maturity or the series of instruments would have to be renewed at the same date. Entire domestic banking net is authorized to pay the principal and interest amount of government bonds, for that commission at the rate of 0.25% while paying interest enhances them. Nepal Rastra Bank, the apex of this net is liable to reimburse for the payments they made under its directives.

Besides these all, Nepal Rastra Bank, as proclaimed at public debt act, 2002; Regulations 2002 and the various agreement made between HMG and NRB, is not only entrusted to manage the whole primary and secondary transaction of HMG bond market for accounting of enhancement of capital market. Hence, Nepal Rastra Bank has been handling the primary and secondary trading of treasury bills and bonds. However, market maker banks and finance companies are also entrusted to operate the primary and secondary transaction of government bonds under the terms and conditions accorded to them by NRB[11].

2.3.1 CSDRMS 2000 (Common Wealth Secretariat Debt Recording and Management System)

CSDRMS 2000 is simply a computer software programmed being adopted by common wealth countries, which consists all records of government debt of past and present. Both HMG and NRB are to apply this programmed to outperform the management of public sector debt. It reveals all sorts of accounting and recording system of debt management. It assists to analyze indebt ness, debt substantially, debt growth rate ratio etc. Nepal Rastra Bank is liable so far to manage the internal debt only; it is to install the software for internal debt management. On the other hand, HMG, financial comptroller general office has been operating for both internal and external debt with this program.

2.3.2 Bill and Bond without Scrip

Bonds and bills issuing by HMG\N are possessed in paper form. In addition, they carry their own tradition in formatting the face and design. People sometimes may feel so tedious to own for a long. Moreover, paper certificates are inconvenient to transfer their ownership and maintain its record. It takes so many time and cost to deal even a minor transaction, such as selling, purchasing, pledging, paying, reimbursing,

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[11] "Public Debt Act, (2002)," Nepal Rastra Bank, Pg. 38

servicing and many more. Nepal Rastra Bank has recently prepared the conceptual format about the scrip less bonds\bills and it has been submitted to the government to be approved. According to conceptual format submitted to HMG, the scrip fewer securities are issued in data entry form without a paper certificate. “The existing securities, which are in scrip form, will also be converted into scrip less form within a sort’s span of time after the new system commences operation.”

Notwithstanding, we are committed to issue scrip less government debt securities and to convert scrip certificate into scrip less securities, most of the certificate holders are totally unknown about the scrip less system. Consequently, they hold with the written vow of governor, Nepal Rastra Bank.

2.3.3 Bond Auction

91 days and 364 days treasury bills are conventionally being issued at auction since 1988. 28 days and 182 days treasury bills were introduced very recently and they are issued at auction. All long-term government securities (Development Bond, special Bond, National Saving Certificate, and Citizen saving Certificate) are issued at par value with fixed coupon. With inclination of providing the market oriented interest also to the long-term bonds, Nepal Rastra Bank has drafted a manual, named “primary issuance of HMG bill and bond and secondary transaction regulation” and it has been proceeded towards getting approval of HMG, in which all procedure regarding to bond-auction are clearly mentioned out.

2.3.4 Bond to be listed in NEPSE

Economics conceive that the cost of capital generally depends upon its availability and necessity. Supporting to the notion spelled out right before; short-term government securities treasury bills are also sold at discounted price, determined by the market through the auction system. Long-term securities on the other hand, are issued at par value and this sort of securities carry fixed interest that is scripted on their interest warrant certificate. According to present practice, once determined interest can never be amended up to its maturity. Favoring this practice, both bond owner and government may be suffered one by one if the liquidity position in the market would go up or down, comparing with the position at issue period. Considering above these all, Nepal Rastra Bank is going to issue the bond at discounted price and then, people may sell and purchase the bond at discounted price in secondary market. Very beginning of commencement of this system it has to be listed in NEPSE.

2.3.5 Standing Liquidity Facility (SLF)

Nepal Rastra Bank has recently declared standing liquidity facility. Largely SLF is alike version of Repot (Repurchase Agreement). SLF is related with monetary management rather raising the debt. According to the monetary policy stance for fiscal year 2004|2005, SLF quota is determined by NRB. SLF is provided to the banks and financial institutions against the HMG bonds and bills they pledge at NRB. Open market operations committee is responsible to determine SLF rate having the substance of weighted average discount rate of lately issued 91 days Treasury bill.

2.4 Debt and Monetary Management

Generally, the government debt securities offer minimal credit risk, high levels of liquidity, a broad range of maturities and well-developed market infrastructure. Therefore, government debt securities may play important roles in financial markets that private sector securities may not fulfill. The roles of government debt securities most commonly identified include providing benchmark interest rates for pricing other fixed coupon securities, managing financial risk, providing a low risk, long-term investment vehicle and acting as a “safe haven” during periods of financial instability. Hence, the public debt management is the process of establishing and implementing a strategy for prudently managing the government’s debt in order to achieve the government’s risk and cost objectives. The main objective of the sovereign debt manager is typically set to manage the risks incorporated in the debt portfolio taking due account of the trade-offs between cost and risk. For the developing country like Nepal, the objectives are broader, including fostering the development of the domestic debt markets.

Monetary policy and public debt management are areas to which the NRB has started to pay more attention in light of the sound monetary management and macro economic stability. The maturity structure of the domestic debt falls in the domain of public debt management while the interest rates offered on public debt instruments are determined by monetary policy. Improvements in public debt management may contribute to the government’s fiscal adjustment efforts and lower the constraints on monetary policy. The domestic debt is generated either to finance a fiscal deficit or to sterilize capital inflows. If the objective were the former, then changes in the size of debt would require budget deficits or surpluses making it a by-product of fiscal rather than monetary policy.

However, if the target is the latter, closer co-ordination between fiscal and monetary policies becomes inevitable. Public debt management is important in both cases because the volume and the maturity structure of domestic debt affect future fiscal and monetary policy decisions[12].

The issue of ensuring the debt management and monetary policy work in a consistent manner is as old as government borrowing itself. Traditionally, it is often depicted in terms of conflict. For instance, excessive debt issuance may lead to monetization of the debt and from there to inflation, unless the central bank has sufficient instruments at its disposal to sterilize the effects. Such incidents led to the conclusion that debt management policy should be subordinated to monetary policy. However, the industrial framework provides the central bank a strong say in most matters of debt policy. The NRB has often tried to maintain its influence, arguing more or less explicitly that ability to fulfill its objectives could be impaired unless it retains the final word on debt policy. In most cases where the issues have been thoroughly analyzed, the NRB has ultimately lost such battles. The NRB would always try to limit the domestic borrowing by presuming as harmful to monetary policy. The public debt management department argues for a system of governance in debt management, which reduces the role of the central bank. However, it is wrong to interpret these efforts in terms of winners and losers. Ultimately, both policy areas and both institutions, i.e. government and NRB gain. Both institutions are forced to refine their objectives and their roles in a way that improves the likelihood that they can deliver what the public want from them, via, price stability from the NRB and a debt policy characterized by low costs and due regard to risks from debt managers.

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[12] "Monetary & Fiscal Management," (2059 B.S.), Nepal Rastra Bank, Bankers Training Centre, Pg. 94 – 95.

The sound financial policy requires that the government fully fund its budget deficit by issue of government securities to the private sector at market interest rates not borrow from the central bank. Many countries have an appropriate legislation to deliver this outcome. Nevertheless, the public debt (Domestic Debt) act, 2059 fully allows delivering the sound debt management practices in Nepal; it is effectively achieved by agreement between the Ministry of Finance (MOF), HMG\N, and the NRB. This arrangement is supposed to have separation between monetary policy and government's debt management with the MOF directly responsible for the latter and the NRB responsible for the former. It is not possible to ensure that issues of government securities to the market exactly match the budget deficit daily. However, the issues generally occur only weekly. To overcome this mismatch between daily spending and financing, the MOF maintains cash balances with the NRB used to cover periods when an unexpectedly large deficit exhausts cash balances.

According to public debt act 2059, the objective of debt management policy is to ensure that the cost of the debt is as low as possible given a well-balanced choice of risk and funds are collected in stipulated time. There is nothing in the objective that necessarily should cause concern from the point of view of monetary policy. The basic role of monetary policy is to set short-term interest rates in a way that is consistent with medium term price stability. In a country with reasonably well developed financial markets, it is possible for central banks to control short-term interest rates independently of how debt management policy is conducted. Nevertheless, areas of tension can arise. The debt managers have to be aware that they are often dominant players in domestic financial markets. This implies that the changes in debt management policy can affect interest rates and often more importantly exchange rates. Thus, the government debt management policy is special often with the magnitude of the transactions involved relative to the size of the markets in which the government is acting.

Chapter-III

RERSEARCH METHODOLOGY

3.1 Introduction

In this chapter, the tactic used for collecting and analyzing data will be discussed. Every research study can reach towards the proper conclusions adopting the proper methodology regarding the subject matter of the study. A research study can produce the fruitful results if an appropriate methodology is taken under consideration to highlight and evaluate the different aspects of the study. Being a novice researcher, it should be kept under considerations that the wings of methodology should not be misdirected. The methodology should be adopted in such a way that the leakages and errors of the study could be minimized. Thus, the quality of the study depends upon the methodology used by the researcher.

3.2 Research Design

These studies will effort to picture the availability of internal borrowing and its arrangement. For the purpose, the study will in the basis of historical research methodology as well as the government revenue and public debt with the factors to affect the debt management of the government.

3.3 Nature and sources of data

The study is primarily based on secondary data as the main source of information. Some primary data also will be used to support the analysis.

The undertaken study is a descriptive and quantitative one, hence empirical.

The secondary data will be collected from booklets, magazines and reports. The analysis will mostly based on data provided by Nepal Rastra Bank, Annual Report published by Ministry of Finance, National Planning commission and various economic surveys. The data at the national level were collected through different government\ non-government organizations and various publications.

3.4 Tools of data analysis

Different statistical tools will be employed for interpretation of the data like financial tools and mathematical analysis for the sake of fulfilling the objectives of the study.

3.4.1 Financial tools

This tool will focus on proportion analysis of direct tax with total revenue, composition of tax revenue, internal debt with total debt and Gross Domestic Product (GDP), internal debt servicing with internal outstanding debt, government revenue with total expenditure, and total expenditure with GDP etc.

3.4.2 Statistical tools

(a) Average Method

One of the most important objectives of statistical analysis is to get one single value that describes the characteristic of the entire mass of unwieldy data. Such a value is called the central value or an average. For example, we often talk of average boy in a class, what it means that he is neither very good nor very bad, just a mediocre type of student. However, in statistics the term average has a different meaning. It may be defined as that value of a distribution that is considered as the most representative or typical value for a group. Such a value is of great significance because it depicts the characteristic of the whole group. Since an average represents the entire data, its value lies somewhere in between the two extremes, i.e. the largest and the smallest items. An average can be used to get one single value that describes the characteristic of the entire group. An average gives us a point, which is most representative of the data. It is known as the point of central tendency, because its value lines in between in two extreme observations of the entire data and represents the whole group[13]. The average is calculated as:

$$\text{Average} = \frac{\sum X}{N}$$

Where, X = variables used

N = no of observation

(b) Correlation Analysis

If the two quantities vary in such a way that movements in the other accompany movements in one, these quantities are correlated. In other words variables are so related that the change in the value of one variable is accompanied by the change in the value of the other variable, then they are said to have correlation[14]. Correlation is a statistical tool with help of

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13 Gupta. S.C.(2000), " Fundamental of Statistics," Himalaya Publishing House, Delhi India. Pg. 78

14 Levi. Richard L and Rubin. Davids, "Statistics for Management," (Prentice Hall of India Pvt Ltd, New Delhi, 1999),Pg. 114

which we can determine whether two or more variables are correlated. Correlation analysis thus, is defined as the statistical technique, which measures the degree of relationship or association between variables. Correlation analysis helps us in determining the degree of relationship between two or more variables; it does not tell us anything about cause and effect relationship. Even a high degree of correlation does not necessarily mean that a relationship of cause and effect exists between the variables or, simply stated, correlation does not necessarily imply causation or functional relationship though the existence of causation always implies correlation.

The correlation is calculated as under

$$r = \frac{N\sum XY - (\sum X)(\sum Y)}{\sqrt{N\sum X^2 - (\sum X)^2}\ \sqrt{N\sum Y^2 - (\sum Y)^2}}$$

Where r = correlation factor

X = variable X

Y = variable y

N = No. of observation

(c) Time series analysis

One of the most important tasks before economists and businessperson these days is to make estimates for the future. For example, a businessperson is interested in finding out his likely sales in the year 2005, so that he could adjust his production accordingly and avoid the possibility of either unsold stocks or inadequate production to meet the demand. Similarly, an economist is interested in estimating the likely population in the coming year so that proper planning can be carried out with regard to food supply, jobs for the people etc. however; the first step in making estimates for the future consists of gathering information from the past. In this connection, one usually deals with statistical data, which are generally referred to as Time Series. Thus when we observe number of data at different points of time the set of observations is known as time series. A time series analysis is defined as an arrangement of statistical data taken at its time of occurrence[15]. In the analysis of time, series time is the most important factor because the variable is related to time, which may be year, month, week, day, and hour. Time series analysis is of great significance in understanding past behavior, planning future operations, evaluating current accomplishments and facilitates comparison. It affects the dynamic pace of a phenomenon over a period.

$$Y_c = a + bx$$

Short term cyclical variations = $y - y_c$ percent of trend = $\frac{y}{y_c} \times 100$

Where y_c = Estimated value of y for any given value of independent variable X

a = y intercept or value of y when X = 0

b = slope of the trend line or amount of change in y per unit change in y.

15 Levi. Richard L and Rubin. Davids, "Statistics for Management," (Prentice Hall of India Pvt Ltd, New Delhi, 1999),Pg. 607

Chapter – IV

DATA PRESENTATION AND ANALYSIS

This Chapter presents the data of Government's Budget in tabular & graphic forms. It has been attempted to analyze the data of government's revenue, taxes, Public Borrowings, outstanding debt, & other economic characteristics to fulfill the objectives of the study. In the process, it is envisaged to establish a relationship, if any, between internal borrowing and level of government's revenue.

4.1 Characteristics of Internal Debt Management in Nepal

Public debt management may be defined as those official policies, which alter the size and composition (i.e. maturity and holders) of government debt. It is a peculiar area of public finance in that it bridges public finance proper (taxation and public expenditures) and strict monetary policy (the control of the supply of money and changes in the rate of interest). The public debt raises finance for government expenditures, as do taxes, but in doing so it influences the rate of interest and liquidity in the economy.

Public debt can be defined as very ways. The most comprehensive definition would encompass all claims against the government bonds, treasury bills, saving certificates, post office savings accounts, the deposit obligation of the central bank (the balance held by the central bank on behalf of other financial institutions) and finally all currency – which is the liquid claim on the government. This broad definition of the national debt can cover the whole spectrum of liquidity; it can be wholly liquid (e.g.; currency) or it can be almost totally liquid (i.e. irredeemable bonds).

Debt management can therefore be thought of as the control of this liquidity. Depending on the size of the national debt held domestically, it can be at the same time one of the most potent influences on the economy and one of the most opaque or difficult to understand.

A narrower definition of the national debt would include only government bonds and small savings. This, of course, can still cover the spectrum of liquidity from a day (a bond about to be redeemed) to the irredeemable, but it omits currency. It is this narrower definition, which national debt statistics usually refer to, though it is worth keeping in mind the larger emphasizes on liquidity.

The objectives of the debt management are as follows:

1. To influence the size and maturity of debt
2. To influence the appropriate pattern of interest rates.
3. To affect the type of holder of the debt
4. To achieve short-term stabilization of bond prices
5. To limit debt service cost
6. To create capital market
7. To give priority to domestic over foreign issues on domestic market
8. To give priority to public sector borrowing.

Following instruments are used to achieve the mentioned objectives of the debt management:

1. Open market operation
2. Timing of issues
3. Authorities and banks coordinate issues
4. Bonds innovations tailored for issues
5. Queuing
6. Pressure to favor government bonds

7. Restrictions on foreign access to the market.

In Nepal, domestic debt management is mainly being carried out with the objectives of maintaining appropriate interest rates, affecting certain type of holder of the debt and short-term stabilization of bond prices. The size is not currently being considered. Maturity of debt is sometimes taken care of, and to achieve these objectives, the first 3 instruments are being used. Open market operations of government treasury bills are being effectively conducted in Nepal Rastra Bank. The debt management committee represented also by the Ministry of Finance considers also the timing and the size of the bills to be transacted.

4.2 Mobilization of Resources

Every state or country collects funds for the development project from the operation of internal savings, donation & grants, internal & external debt financing, taxation etc. A developing country like Nepal raises funds from the internal debt to avoid budget deficit and the country most depends on external resources and internal debt.

As kantilya says, “The launching of all programmers depends on first and foremost on the treasury”. So every state needs resources, whatever to pay salaries to the government employees or to the developmental works, it needs huge amount of money called revenue.

The government revenue comes from different sources like borrowing, administrative income, business income, taxation and grants. The administrative income denotes the amount charged by the government for providing administrative services. Business income means the return various goods and services to the people. All these revenues are non-tax revenues.

Another source of government revenue is the taxation, customs, value added tax, corporate, and personal tax is the examples of the sources of tax revenues. The government passes the acts for getting tax revenues and collects the taxes as per the act.

Almost all developing countries have adopted development planning to accelerate the pace of growth. The crucial problem in development is the funding of the sources of development finance mainly:

- Current revenue surplus
- Foreign aid
- Foreign and domestic borrowing
- Deficit financing

Of these four sources, foreign grants turned out to be the largest source o finance in the development process of Nepal. However, in developing nations, foreign aid has produced better experiences as well as mixed consequences. Foreign aid is likely to be meaningful only when it is treated as a substitute for it. Borrowing is assuming the importance in the recent years. Nevertheless, the repayment of principal and interest is proving to be a net burden for many of the developing countries. Deficit financing has not been a major source so far since its use constrained by various factors.

The viable policy available to Nepal is mobilization of additional resources especially at the domestic front. Domestic resources in Nepal can be mobilized either through taxation consist of income from sale of natural resources like forest, minerals, water and public service utilities and return on investment and fees& charges for government services. The tax revenue consists of income tax; value added tax, customs, excise duty, land tax, registration fee, entertainment tax, property tax, house rent, contracts, hotel, roads, vehicle, air taxes etc.

4.3 Limitations of Mobilizing Resources

In the Nepalese context, the government's capability to raise additional resources is limited by several constraints. These constraints are mainly of structural administrative and technical nature. The main structural factors, which impede the mobilization of resources through taxation, are:

- The continuing dominant role of agriculture in gross domestic product.
- The low level of income as reflected in an average per capita income of the people and more than 50 percent of the people living below the poverty line.
- The predominance of non – monetized sector in the economy.
- The general stagnation of economy, particularly in agriculture and agriculture – based export sector, and
- The low ratio of international trade to the Gross Domestic Product.

Besides the above structural constraints, the resource mobilization is also constrained by technical and administrative resources. For example, the data and knowledge about the tax base is not fully available yet, as a result, it is very difficult to examine the casual relationship in taxation as well as to evaluate the effects of different taxes on other economic variable. However, the present tax administration is not as efficient as it should have been. There is a scarcity of trained workers and the tax – offices are not fully staffed. Moreover, there is 600 miles open border with India, which has the limited capacity to raise the duties on international trade beyond a certain point.

It is being increasingly recognized that financial institutions are effective instruments for accelerating the process of development through resource mobilization. However, the process experience has shown that public enterprises in Nepal are a drain on government finance rather than a source of government revenue.

There is thus, a limited scope to raise additional resources through tax and non – tax measures. However, Nepal's tax collection to Gross National Product is one of the lowest among all developing countries. Therefore, there is the scope of rationalization not only in tax rate structure, but in nature of taxation also. These measures are called not for only revenue but also on the equity ground.

4.4 Taxation as an Instrument of Resource Mobilization

A tax is a compulsory levy and those who are taxed have to pay it without getting corresponding benefits of services or goods from the government. The taxpayer does not have any right to receive direct people have expressed different views in satirical ways about the taxation. Some say, "Nothing is say", death and taxes are both certain – but death is not annual. Here it should be noted that not all-compulsory payment are taxes. For example, fines and fees are also compulsory payments without having direct benefit to the payer but it is not tax because its objective is not to collect revenue but to curb certain type of offences. The taxpayer does not receive equivalent benefits from the government. A tax is not a price paid by one for which he can claim goods and services. Tax is paid to the government for running it. In case of tax, the amount is spent for common interest of the people; the tax is collected from haves and spent for the interest of haves not in the society. A natural or an artificial person pays tax.

In short, it can be said that tax is a liability to pay an amount to the state. The basis for the payment is that the assesses have income of a minimum amount from certain specified sources or that they own certain tangible and intangible property or that they carry on certain economic activities which have been chosen for taxation.

As an instrument of resource mobilization, its principal function lies in raising the volume of public savings to be used for capital formation consistent with the growth of savings in the economy as a whole. The taxation leads to a rise in the rate of public savings but results in reducing the rate of overalls savings for the economy. Taxation is an instrument of resource mobilization does not have the same danger of adversely affecting the role of saving in the under – developed countries as in the advanced countries. The reason is that in the under – developed countries, voluntary savings are very low and a considerable proportion of it goes into boards, holding of precious metal and investment in real estate which do not increase the productive capacity of the economy.

Besides taxation as a compulsory form of savings especially commends itself to the under – developed countries for use on an extended scale because they have to build up an infrastructure to lay the foundation of a self – generating process of economic growth.

In order to raise an adequate volume of resources, the tax structure of the under – developed countries should be sufficiently diversified and should have a coverage both deep and wide. Such a tax system will be able to mobilize and to tap the tax potentials of the different sectors created because of the accelerated process of economic development.

The development role of taxation constitutes not only in maximizing the volume of resources for the public sectors but also in maximizing the growth of private investment and guiding it into the most useful and desirable channels. In order to seek out and impound resources that would otherwise be squandered on conspicuous and non – functional consumption, full use should be made of suitable tax resources. Commodity taxes in the forms of high ideally suited as instruments of such policy in under – develop countries. In many cases, personal income taxes with steeply progressive rates in the upper income brackets would operate as effective instrument for trapping such income.

4.4.1 Composition of Total Revenue

Total revenues of Nepal is composed of tax and non tax revenues a direct tax is really paid by the same person on whom it is legally imposed. Whereas indirect tax is imposed on one person but paid partly or wholly by another.

The composition of total revenue is shown as follow, which obviously indicates the increasing contribution of tax and non- tax revenue in total revenue.

Table 1.1

Contribution of tax and non – tax revenue as percent of Total Revenue

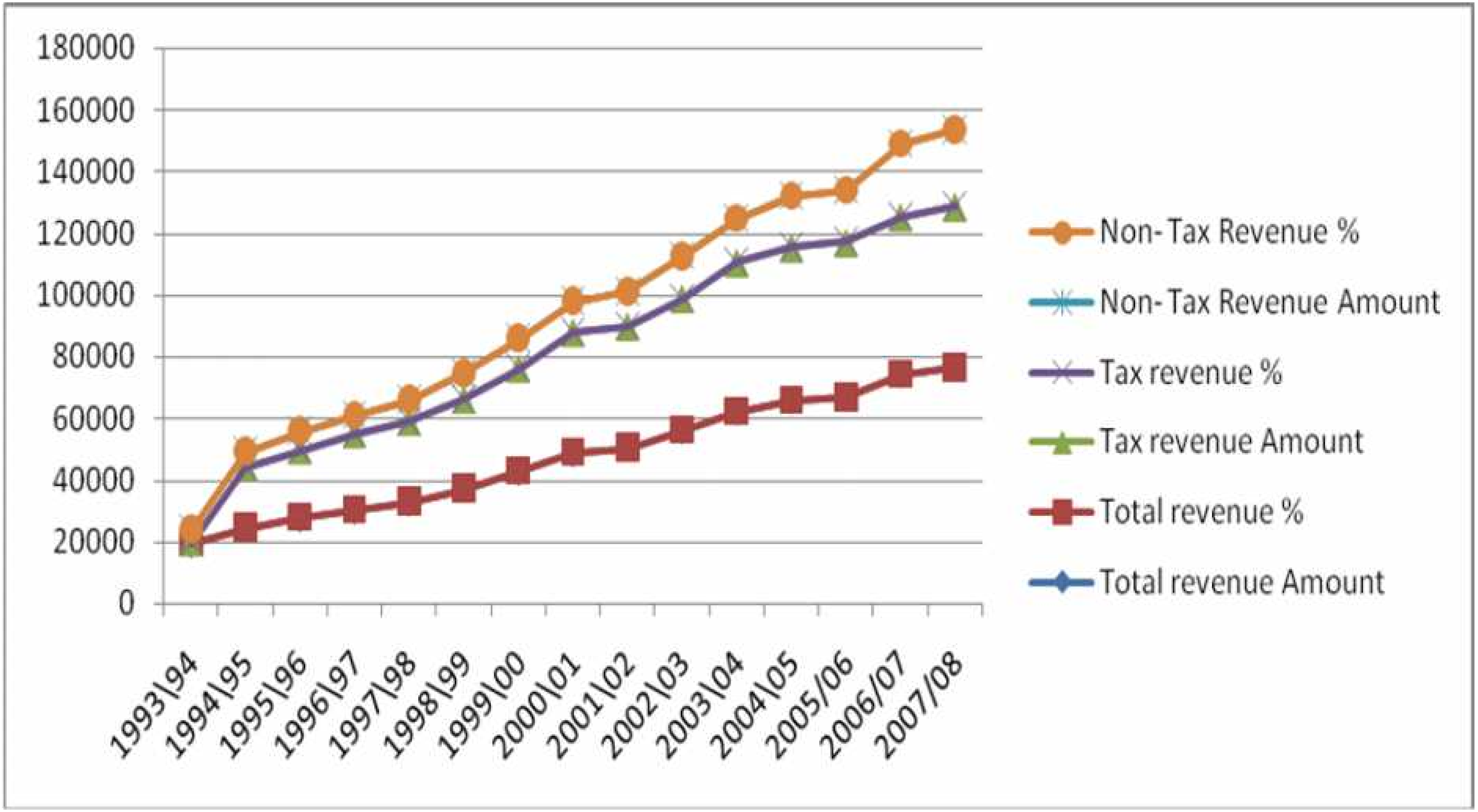
(Rs. In million)

Fiscal Year	Total revenue		Tax revenue		Non- Tax Revenue	
	Amount	%	Amount	%	Amount	%
1993\94	19510.9	100	15301. 5	78.43	4209.4	21.57
1994\95	24605.1	100	19660	79.9	4945.1	20.1
1995\96	27893.1	100	21668	77.68	6225.1	22.32
1996\97	30373.5	100	24424.3	80.41	5949.2	19.59
1997\98	32937.9	100	25939.8	78.75	6998.1	21.25
1998\99	37251	100	28752.9	77.18	8498.1	22.82
1999\00	42893.7	100	33152.1	77.29	9741.6	22.71
2000\01	48893.7	100	38865.1	79.48	10028.6	20.52
2001\02	50445.5	100	39330.6	77.96	11114.9	22.04
2002\03	56229.8	100	42587	75.73	13642.9	24.27
2003\04	62331	100	48173	77.29	14158	22.71
2004\05	65930	100	49295	79.59	16635	20.41
2005/06	66869	100	50122	74.96	16747	25.04
2006/07	74373	100	50886	68.42	23487	31.58
2007/08	76661	100	51978	67.80	24683	32.20

Source: - Financial Comptroller General Office

Fig No.1

Contribution of tax and non – tax revenue as percent of Total Revenue



During the study period, fluctuating trend of the contribution of tax and non-tax revenue to total revenue was occurred. In the year 1993/94, the tax revenue is 78.43%, the trend increases as 79.90% in the year 1994/95, and then again, trend decreases in the years 1995/96, 2006/07 and 2007/08 respectively. The highest revenue collected in the year 2007/08 and the percent is 32.20% in comparison with other periods. The above chart also shows the fluctuating trend of tax – revenue and non – tax revenue.

4.4.2 Composition of Tax Revenue

Total tax revenue is composed of direct and indirect tax revenue. If the person paying and bearing the tax is same. It is called direct tax. The example of direct tax are land tax, House and Land registration fees, Income tax from public enterprises, vehicle tax etc. Whereas, the person paying the tax and the person bearing the tax is different, it is called indirect tax. The example of that tax is customs, Imports, exports, value added tax etc.

Table 1.2

Contribution of Direct and Indirect Tax Revenue as percentage of Total Tax

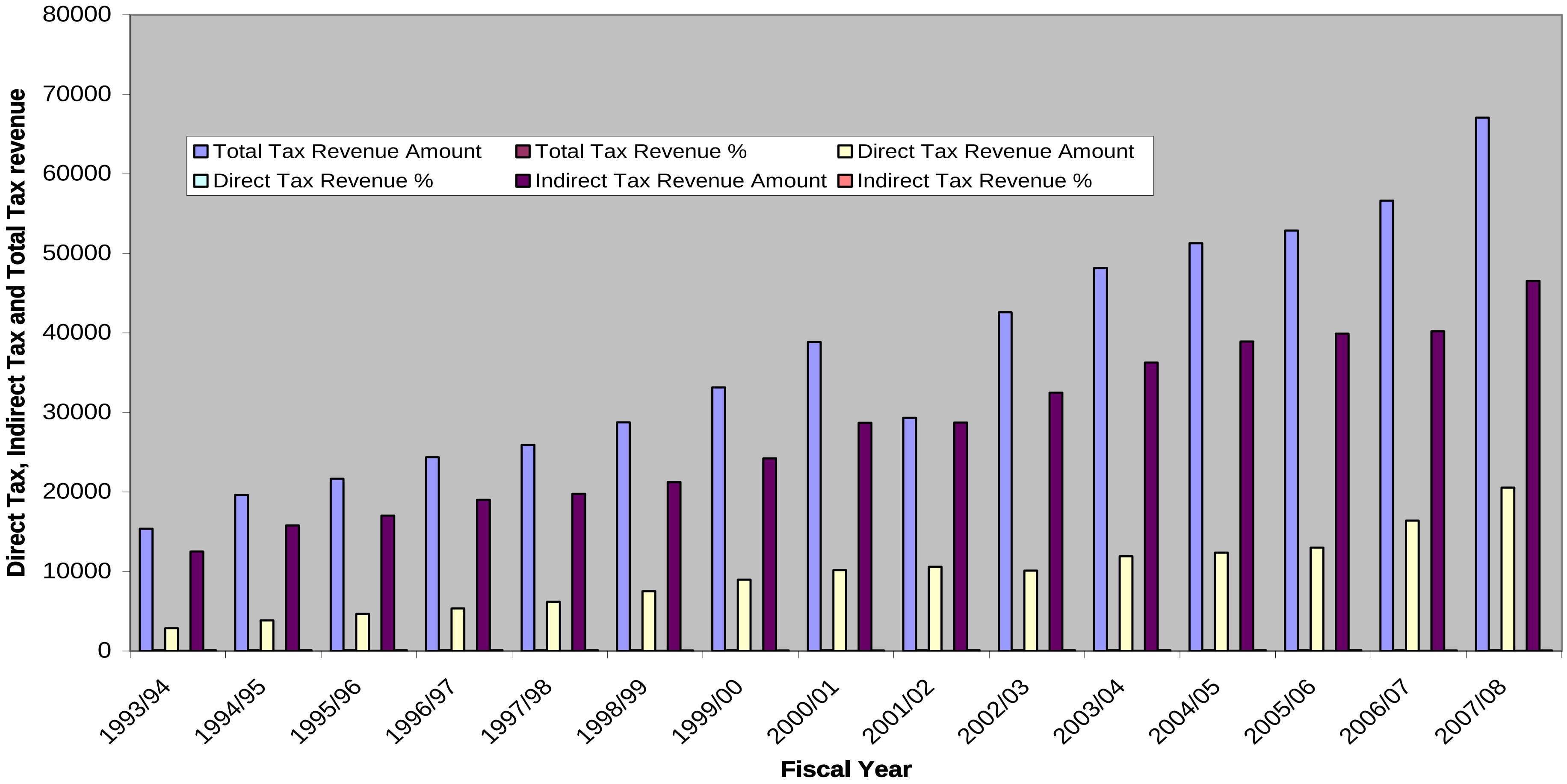
Rs. In Million

Fiscal year	Total Tax Revenue		Direct Tax Revenue		Indirect Tax Revenue	
	Amount	%	Amount	%	Amount	%
1993/94	15371.5	100	2855.3	18.58	12516.2	81.42
1994/95	19652.9	100	3849.3	19.59	15803.6	80.41
1995/96	21668	100	4655.9	21.49	17012.1	78.51
1996/97	24354.3	100	5340	21.93	19014.3	78.07
1997/98	25938.4	100	6187.2	23.85	19751.2	76.15
1998/99	28752.2	100	7516.1	26.14	21236.1	73.86
1999/00	33152.2	100	8951.5	27	24200.7	73
2000/01	38865.1	100	10159.4	26.14	28705.7	73.86
2001/02	29330.5	100	10597.5	36.13	28736	97.97
2002/03	42586.9	100	10105.7	23.73	32481.2	76.27
2003/04	48173	100	11912.6	24.73	36260.4	75.27
2004/05	51286	100	12362	24.10	38924	75.90
2005/06	52882	100	12984	24.55	39898	75.45
2006/07	56618.5	100	16394	28.96	40224.5	71.04
2007/08	67065.9	100	20546.3	30.64	46519.6	69.36

Source:- Economic Survey, Ministry of Finance, HMG 2007/2008

Fig No.2

Contribution of Direct and Indirect Tax Revenue as percentage of Total Tax



During the study period, there has been simultaneous increase in tax, indirect tax, and total tax revenue. In the initial period of the study, amounts of direct tax were Rs 2855.3 million, Rs 3849.3 million and 4655.9 million in the year 1993/94, 1994/95 and 1995/96 respectively. Likewise the indirect tax amounts were Rs. 12516.2 million , 15803.6 million and Rs 17012.1 million in the year 1993/94, 1994/95 and 1995/96 respectively. Direct and Indirect taxes are increasing but the percent of direct tax and indirect tax to the total tax is fluctuating. During the study period, the percent of direct tax was maximum in the year 2001/02 i.e. (36.13%). Whereas, that of the indirect tax was maximum in 2001/02 i. e. (97.97%).

Despite the many folds increment in direct tax, its share in total tax revenue is shrinking continuously, implying the increasing share of indirect tax revenue.

As the bulk of the population in the villages fall below the subsistence level, it is difficult to bring them within the bracket of direct taxes. In most of the villages, tax laws are not free from various loopholes, which could not help to bring the "hard – to – tax" group within the synthesis of direct taxes. That they are not conductive to the conditions warranted for successful use of direct taxes, some of the reasons are-

- There is no high standard of literacy among taxpayers.
- The Money economy does not have the full – fledged dominance.
- Deficiency in keeping the accounting records honestly and reliably.
- There is a lack of an honest and efficient tax administration etc.

Looking at the elements of table 1 – 2, we can tell that major part of the increase in total tax revenue has come through indirect taxes. This increasing reliance on indirect tax can be justified in administrative ground. Indirect tax requires less administrative effort for effective collection.

4.4.3 Trends of Resource Mobilization Through Direct Tax

In Nepal's tax structure, the premier components of direct taxes are income tax, land tax and registration duties. Direct taxes are equitable as per the property of income, certainly as per the process of payment elastic in nature etc. other example of direct tax are property tax, vehicle tax, inheritance tax interest tax and so forth.

Table 1.3

Direct Tax - Trends and Structure

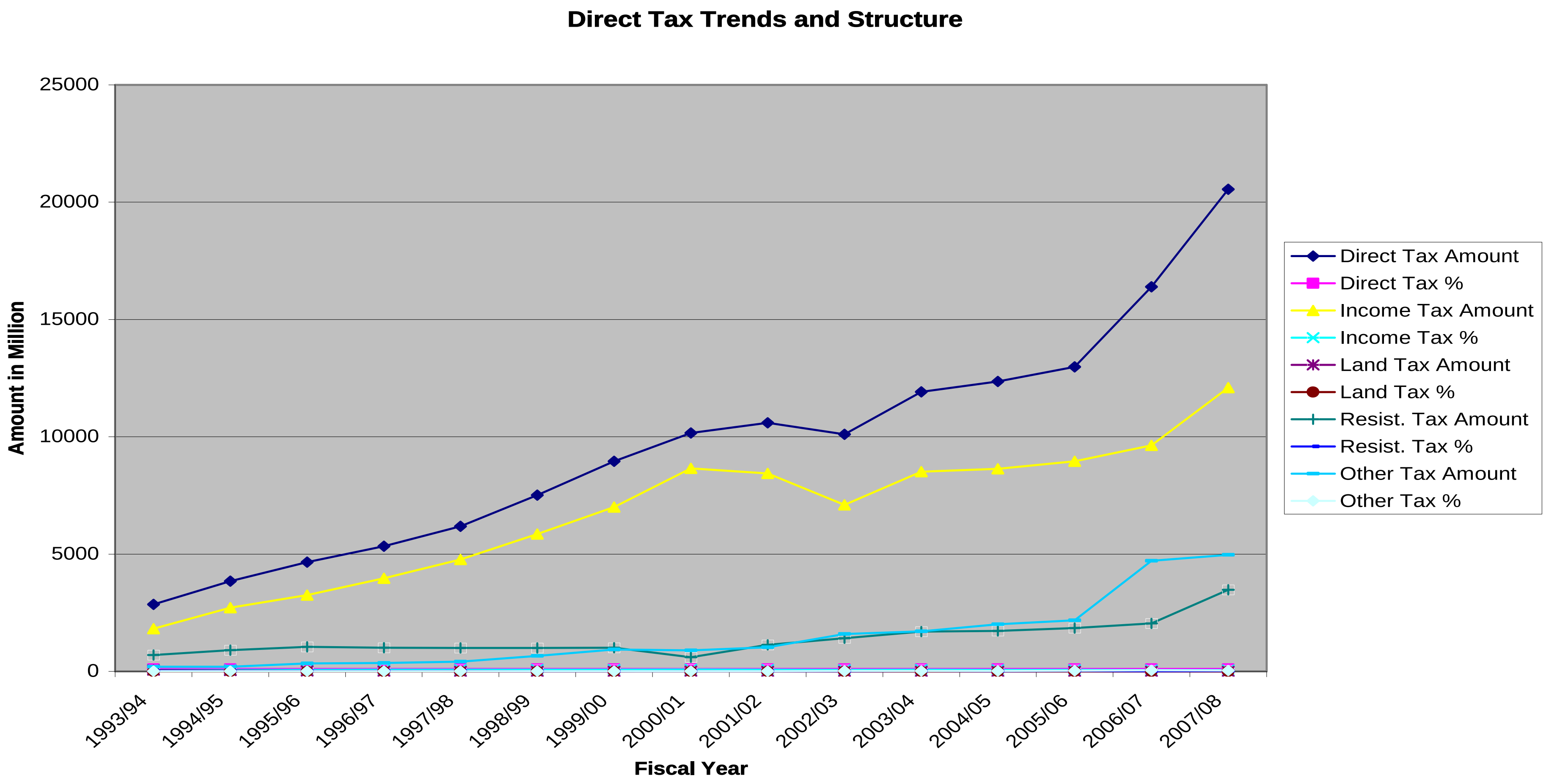
Rs. In Million

Fiscal year	Direct Tax		Income Tax		Land Tax		Resist. Tax		Other Tax	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1993/94	2855.3	100	1823.8	63.87	61	2.14	702.2	24.59	198.3	6.94
1994/95	3849.3	100	2711.6	70.44	34.9	0.91	902.8	23.45	200	5.2
1995/96	4655.9	100	3249.5	69.79	18.2	0.39	1048.4	22.52	339.8	7.3
1996/97	5340	100	3969	74.33	5.9	0.11	1009.5	18.9	355.6	6.66
1997/98	6187.2	100	4765.9	77.03	3.6	0.06	1000.6	16.17	417.1	6.74
1998/99	7516.1	100	5850.8	77.84	1.3	0.02	1001.8	13.33	662.2	8.81
1999/00	8951.5	100	7006.2	78.27	4.6	0.05	1011.3	11.3	929.4	10.38
2000/01	10159.4	100	8650.1	85.14	5.1	0.05	607.8	5.98	896.4	8.82
2001/02	10597.5	100	8436	79.6	0.8	0.01	1131	10.67	1029.7	9.72
2002/03	10105.7	100	7102.2	70.28	0	0	1414.3	14	1589.2	15.73
2003/04	11912.6	100	8512.5	71.46	0	0	1697.5	14.25	1702.6	14.29
2004/05	12362	100	8634	69.84	0	0	1724	13.95	2004	23.21
2005/06	12984	100	8951	68.94	0	0	1852	14.26	2181	24.37
2006/07	16394	100	9637	58.78	0	0	2048	12.49	4709	48.86
2007/08	20546.3	100	12094	58.86	0	0	3481	16.94	4971.3	41.11

Source:- Budget speeches, Ministry of Finance, HMG

Economic Survey, Ministry of Finance, HMG 2007/2008

Fig No. 3


Direct Tax Trends and Structure
25000
20000
15000
10000
5000
0
Amount in Million
1993/94
1994/95
1995/96
1996/97
1997/98
1998/99
1999/00
2000/01
2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
Fiscal Year
Direct Tax Amount
Direct Tax %
Income Tax Amount
Income Tax %
Land Tax Amount
Land Tax %
Resist. Tax Amount
Resist. Tax %
Other Tax Amount
Other Tax %

In the table 1.3, the composition of direct tax and their respective contribution has been shown. Direct tax is composed of income tax, property tax, and so forth.

The contribution of income tax is notable as shown by table 1.3. In the initial period of study 1993/94, the income tax, registration tax and other tax have contributed 63.87%, 24.59%, 6.94 respectively. In absolute amount, 1823.8, 702.2 and 198.3 million respectively. Income tax is in increasing trend until the year 2000/01 then after the income tax decreases to 8436 million, which is less than the year 1999/2000. The maximum income tax generate in the year 2007/08, Rs 12094 million and 58.86 %. In the other hand Land Tax is in fluctuating trend, in the first year of the study period it is maximum i.e. Rs. 61 million in 1993/94 and 2.14 %. The Land tax is in decreasing trend from the year 1993/94 until the end of study period. It was 2.14 % in the year 1993/94, which decreased to zero level in the year 2006/07 to 2007/2008.The registration tax, is rising from the initial phase of the study period until the end of the year 1995/96. it was Rs 702.2 million in the year 1993/94, Rs 902.8 million in the year 1994/95 , Rs 1048.4 million in 1995/96. Then after the registration, tax is decreased next two years and then fluctuating in the respective years. The higher percentage of registration tax is 24.59 % in 1993/94. Other tax is not in the steady trend. It was 198.3 million in the year 1993/94 (6.94 %). The contribution of other tax to direct tax is fluctuating and higher contribution is in the year 2006/07, i.e.48.46 % (Rs.4709 million).

4.4.4 Problems of Resource Mobilization through Indirect Taxation in Nepal

In the Nepalese context, the government's capability to raise additional resources is limited by several constraints. The constraints are mainly of structural administrative and technical nature. The main structural factors, which impede the mobilization of resources through indirect tax, are-

I. The continuing dominant role of agriculture in Gross Domestic Product (GDP).
II. The low level of income and 40 % of the people living below the proverty line.
III. The pre – dominance of non – monetized sector in the economy.
IV. The low ratio of international trade to the Gross Domestic Product.
V. Administrative problems of supervision, collection, leakage selection, and enforcement also act as the limitations of indirect tax. Leakages may result from underestimation of value, misclassification of items, forgoing of accounts and staying out reach of indirect tax network.
VI. The lack of education and tax paying habits also discourage the resource mobilization.
VII. The levying of indirect tax on production of development goods may limit the development activities. Because the indirect taxes will increase the cost of development works. Which adversely affect on resource mobilization?
VIII. The base of indirect tax is not wide. So the resource mobilization through indirect taxation is not effective, and

IX. Too much emphasis on indirect taxes may discourage the growth of infant domestic industries. The indirect tax should not raise the production cost, which will discourage domestic infant industries to compete with foreign products in national market. This process will reduce the resource mobilization.

Besides the above structural constraints, the resource mobilization is also constrained by technical and administrative sector. For example, the data and knowledge about the tax base is not fully available yet. There is limitation of trained labor and the tax offices are not fully staffed. Apart from these, there is 1000 kilometers open border with India that the capacity to raise the duties on international trade beyond certain points.

It is being increasingly recognized that financial instructions are effective instruments for accelerating the process of development through resource mobilization bur the experience has shown that public enterprises in Nepal are a drain on government finance rather than a source of government revenue.

Despite the limitations mentioned above, indirect tax remains an important source of revenue. It is easy to collect and administer in view of the fact that rates are generally based on quantity and number of taxpayers are small who pay large amount of taxes.

4.4.5 Efforts towards Resource Mobilization through Indirect Taxation.

In the Nepalese context, there are many problems of resource mobilization through indirect taxation. To mobilize the domestic resources much effort has to be taken to reduce such problems. The efforts towards resource mobilization through indirect taxation will be discussed below.

- ❖ To raise the resources through custom duties needs the control of leakage and valuation problems. In Nepal, leakage through smuggling is very high. Thousand-kilometer open border with India always helps the smugglers for smuggling. There is another problem of valuation, means low value of imported goods which adversely on custom duties. Therefore, the basic need is to control the open border smuggling and valuation problem, which will raise the resources through indirect taxation.
- ❖ To eliminate sales and excise tax problem, Value Added Tax (VAT) is alternative. The introduction of VAT with promulgation of value added act 2052 B.S. and regulations 2053 helps to curb the leakages and bring the increment in resource mobilization.
- ❖ The improvement of tax administration through computer system for record updating and the training for staffs is more essential.

His Majesty's Government has commenced the unified security search within the peripheries of borders, which has resulted the increment in revenue collection. However, the present plea of the country has been the main problem for this moment.

The above table shows the trend of growth of the government revenue. Government revenue in percentage and amount apparently indicate the growth trend of government revenue.

The above table indicates that government revenue increases by Rs. 1699.8 million (20.79%) in 1991/92, Rs. 1786.9 million in 1992/93, Rs. 3709 million in 1993/94 and Rs. 4281.4 million in 1994/95 respectively. Then after the growth trend of government, revenue is in fluctuating trend. The maximum growth in amount is in the year 2000/2001 by Rs. 5712.9 million. In the year 2004/05 the growth amount of government revenue is negative i.e. Rs. 16698.5 million. The low growth rate is 1.2% in the year 2001/02 and the average growth rate during the study period is 10.60%.

4.5 Government Borrowing for Resource Mobilization

Background

Generally, governmental borrows for the creation of infrastructures in the economy since it requires huge investment initially. Which cannot be met through only revenue collection? The government of developing country like Nepal tries to mobilize the saving of the community partly through the device of public borrowing in order to meet the financial need of its development programmes from internal and internal resources.

The scarcity of adequate internal resource has been the main constraint in the realization of development programmers in Nepal. The annual growth rate of the total expenditure and that of its revenue are not increasing in the same pace. The annual growth rate of expenditure has outpaced its revenue collection resulting financial resource gap in the budgetary of the government. To bridge that gap the public debt is needed.

Thus, internal borrowing is one of the sources of public borrowing. It is applied as the means of mobilizing internal resources in the development process of the country in a wide perspective. It has been taken as a means of revenue generation as well as economic stabilizer. As a fiscal measure, it is a source of revenue to the government as it mobilizes saving from the public to the state.

4.5.1 Growth Trend in Government Borrowing

The reliance on taxation is not possible in view of the large amount financial resources required for growing government expenditures and therefore, there is increasing need for supplementing it by borrowing internally and externally. Nepal is facing large and growing financial resource gap in the government budgetary.

Table 1.4

Growth Trend in Government Borrowing

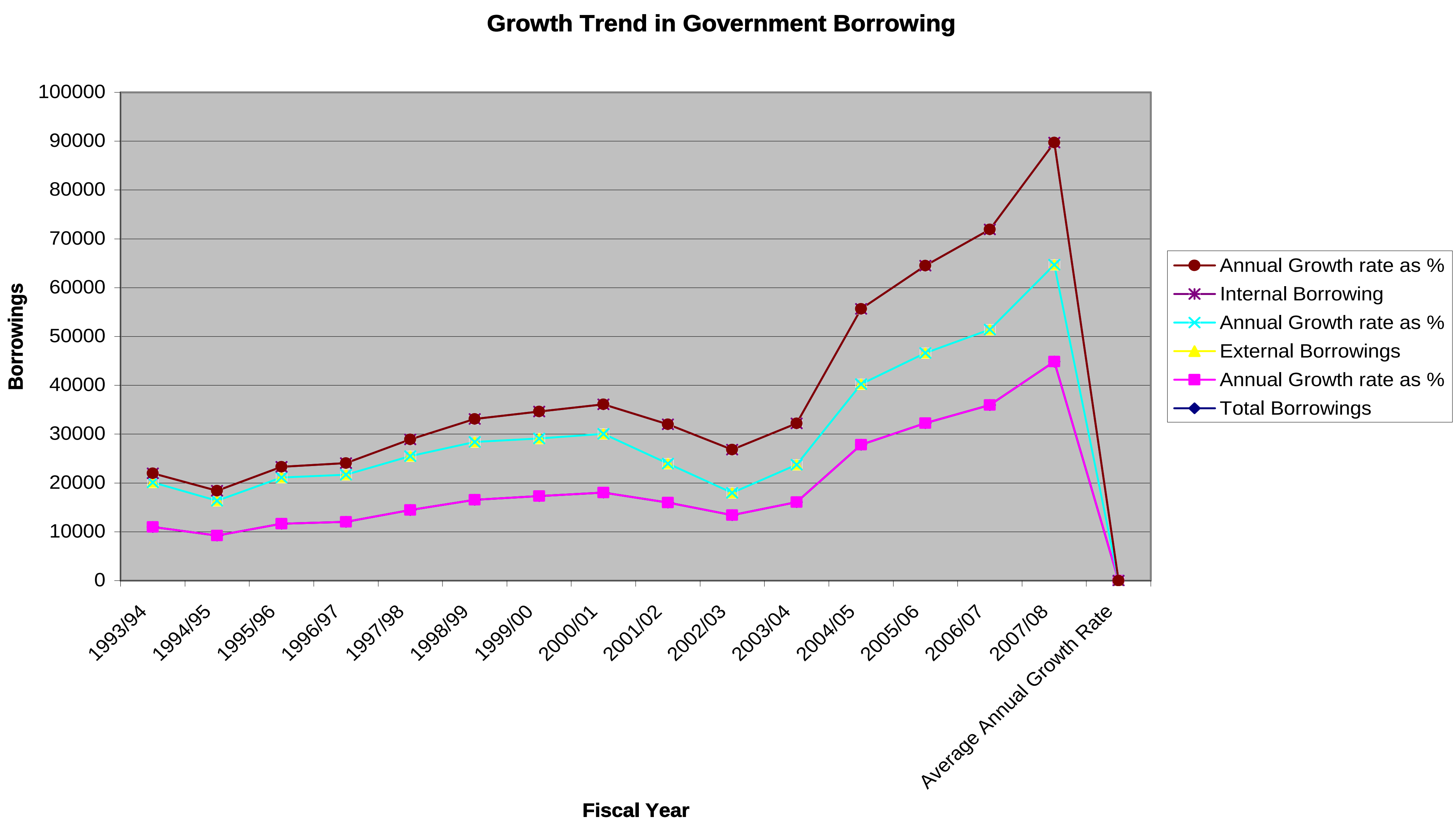
Rs in Million

Year	Total Borrowings	Annual Growth rate as %	External Borrowings	Annual Growth rate as %	Internal Borrowing	Annual Growth rate as %
1993/94	10983.6	0.00%	9163.6	0	1820	0
1994/95	9212.3	-16.13%	7132.3	-22.17%	2080	14.29%
1995/96	11663.9	26.61%	9463.9	32.69%	2200	5.77%
1996/97	12043.6	3.26%	9646.3	1.93%	2397.3	8.97%
1997/98	14454.5	20.02%	11054.5	14.60%	3400	41.83%
1998/99	16562.4	14.58%	11852.4	7.22%	4710	38.53%
1999/00	17312.2	4.53%	11812.2	-0.34%	5500	16.77%
2000/01	18044	4.23%	12040.4	1.93%	6003.6	9.16%
2001/02	15998.7	-11.34%	7998.7	-33.57%	8000	33.25%
2002/03	13426.4	-16.08%	4546.4	-43.16%	8880	11.00%
2003/04	16094	19.87%	7629	67.80%	8465	-4.67%
2004/05	27823	72.88%	12431	62.94%	15392	81.83%
2005/06	32261	15.95%	14369	15.59%	17892	16.24%
2006/07	35958.2	11.46%	15458.2	7.58%	20500	14.58%
2007/08	44857	24.75%	19857	28.46%	25000	21.95%
Average Annual Growth Rate		**11.64%**		**9.43%**		**20.63%**

Source:- Budget speeches, Ministry of Finance, HMG

Economic Survey, Ministry of Finance, HMG 2007/2008

Fig No.4


Growth Trend in Government Borrowing
Borrowings
100000
90000
80000
70000
60000
50000
40000
30000
20000
10000
0
1993/94
1994/95
1995/96
1996/97
1997/98
1998/99
1999/00
2000/01
2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
Average Annual Growth Rate
Fiscal Year
Annual Growth rate as %
Internal Borrowing
Annual Growth rate as %
External Borrowings
Annual Growth rate as %
Total Borrowings

The above table 2.1 shows the annual growth of government is borrowing between the reviews period 1993/94 to 2007/08. The average annual growth rate of total borrowing is only 11.64%, that of external borrowing is 9.43% and internal borrowing is 20.63%. External borrowing has been reduced to the great extent as per the government policy. External borrowing was Rest. 9163.6 million In fiscal year 1993/94, and it was increasing until the year 2001/02. However, it was very low Rest. 4546.4 million In the year 2002/03. In case of internal borrowing, we can see increasing trend. It was Rs.1820 million in the fiscal year 1993/94 and then after it is increasing continuously until the end of the year 2007/08. The higher amount of internal borrowing is in the year 2007/08 i.e. Rs. 25000 million and the lowest in the year 1993/94 i.e. Rs. 1820 million.

The average annual growth rate of external borrowing is 9.43%, which has caused also the lower annual average growth rate of total borrowing i.e.11.64 percentage. On the contrary, internal borrowing has 20.63% growth rate, which is the higher annual growth.

4.5.2 Time series Analysis of Internal Debt Borrowing

The time series analysis is used to measure the change of data over a period. It is an arrangement of statistical data taken at its time of occurrence. In other words if the values of the variables, are recorded at different period then the series so formed is called time series.

Table 1.5

Time Series Analysis of Internal Borrowing

Rs in Million

Years(X)	**Internal Debt(y)**	**x = (X - 1998)**	**xy**	**Trend Value Yc**	**Y - Yc**	**Y/Yc× 100**	**x2**
1994	1820	-7	-12740	6901	-5081	26.37	49
1995	2080	-6	-12480	8434	-6354	24.66	36
1996	2200	-5	-11000	9967	-7767	22.07	25
1997	2397.3	-4	-9589.2	11500	-9102.7	20.85	16
1998	3400	-3	-10200	13033	-9633	26.09	9
1999	4710	-2	-9420	14566	-9856	32.34	4
2000	5500	-1	-5500	16099	-10599	34.16	1
2001	6003.6	0	0	17632	-11628.4	34.05	0
2002	8000	1	8000	19165	-11165	41.74	1
2003	8880	2	17760	20698	-11818	42.90	4
2004	8465	3	25395	22231	-13766	38.08	9
2005	15392	4	61568	23764	-8372	64.77	16
2006	17892	5	89460	25297	-7405	70.73	25
2007	20500	6	123000	26830	-6330	76.41	36
2008	25000	7	175000	28363	-3363	88.14	49
	∑Y/n= 17631.98		**∑xy = 429253.8**				**∑x2=280**

The formula used for the purpose is:

$$Yc = a + bx \qquad b = \frac{\sum xy}{\sum x^2}$$

$$a = \frac{\sum y}{n}$$

Where Yc = Trend Value

a = mean value of internal debt

b = Change in y as per x or slope of the trend line

The above table 1.5 shows the trend of internal borrowing, its variations, and percent of trend. Yc shows the estimation of trend where as Y – Yc helps to find out the cyclical variations and percent of trend shows the trend of internal debt as percentage.

From the above table, it is apparent that line of the internal borrowing is different to the actual amount. When actual amount is Rs. 17632 million, the estimation is just Rs. 1820 million. However from the year 1994 to 2001 the trend of internal borrowing is below the estimation line. We can see that the trend is above the estimated trend line during the last six years from 2002 to 2007. Percent of trend also express the same that the estimation of trend is a line (i.e.100) and above 100 indicate the trend line above estimation.

4.5.3 Government Deficit and Total Borrowing – an Analysis

Government budgetary deficit necessitates borrowing from the internal and external sources. Government deficit is the church of government borrowing. Thus, government deficit and total borrowing is correlated the correlation between government deficit and total borrowing is analyzed through the following data presented in the table 1.6.

Table 1.6

Correlation Analysis between Government Deficit and Total Borrowing

Rs.in Million

Fiscal Year	Government Deficit (X)	Total Borrowing (Y)	XY	X^2	Y^2
1993/94	12824.2	10809.4	138621907.48	164460105.64	116843128.36
1994/95	12912.5	8895.7	114865726.25	166732656.25	79133478.49
1995/96	15749.3	8540.9	134513196.37	248040450.49	72946972.81
1996/97	14086.5	10983.6	154720481.40	198429482.25	120639468.96
1997/98	14190.3	9212.3	130725300.69	201364614.09	84866471.29
1998/99	18650.9	11663.9	217542232.51	347856070.81	136046563.21
1999/2000	23050.2	12043.6	277607388.72	531311720.04	145048300.96
2000/01	23180.3	14454.5	335059646.35	537326308.09	208932570.25
2001/02	28328	16562.4	469179667.20	802475584.00	274313093.76
2002/03	23378.7	17312.2	404736730.14	546563613.69	299712268.84
2003/04	30941.5	18044	558308426.00	957376422.25	325585936.00
2004/05	29626.7	15998.7	473988685.29	877741352.89	255958401.69
2005/06	27776.2	13426.4	372934371.68	771517286.44	180268216.96
2006/07	25828.2	16094	415679050.80	667095915.24	259016836.00
2007/08	16437.8	14674.8	241221427.44	270201268.84	215349755.04
Total	**∑X = 316961.3**	**∑Y = 198716.4**	**∑XY = 4439704238.32**	**$\sum X^2$ = 7288492851.01**	**$\sum Y^2$ = 2774661462.62**

$$r = \frac{N\sum XY-(\sum X)(\sum Y)}{\sqrt{N\sum X^2 - (\sum X)^2}\ \sqrt{N\sum Y^2 - (\sum Y)^2}}$$

$$= \frac{15 \times 4439704238.32 - (316961.3)(198716.4)}{\sqrt{[15 \times 7288492851.01 - (316961.3)^2]}\ \sqrt{[15 \times 2774661462.62 - (198716.4)^2]}}$$

$$= \frac{66595563572 - 62985408485}{\sqrt{[1.09327E+11 - 1.00464E+11]}\ \sqrt{[41619921939 - 39488207629]}}$$

$$= \frac{3820166087}{8862927067 \times 2131714310}$$

$$= \frac{3820166087}{1.88932E+19}$$

$$= 0.7912$$

= **79.12%**

4.5.4 Adjustment of Total Borrowing to Government Deficit

The government deficit derivates when total expenditure exceeds the total revenue of the government. In such a plight, the government fills that gap or deficit with aid from the bilateral or multilateral sources and remaining deficit is bridged by borrowing from multilateral organizations like IMF, ADB, World Bank etc. the country of good relationship and internally from public and bank financial institutions etc within the country.

4.5.5 Problems and Prospects of Government Debt in Nepal

Large-scale public debt has been incurred in the past for financing development programmers. While large sale public borrowing for financing development expenditures may be justified, the result rise in public debt raises several issues of which most important is the burden of public debt. The burden of public debt is one of the oldest controversial issues in the economic of public finance.

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

Owing to heavy reliance on external assistant in the form of borrowing on public account. Nepal’s external public indebtedness has increased very much. A rise in external indebtedness should be accompanied by an increase in debt servicing capacity so that there may be undue strain in the balance of payment. Owing to outflow of funds through the debt service, the burden of public debt refers to cost or disadvantages that are imposed upon the economy. Basic measure of burden of public debt is the ratio of public debt and gross domestic product. This ratio between total outstanding debt and gross domestic product is increasing every year.

Among the source of funds of the government, taxation is the almost important one but the present state of economy of the country is not good which is resultant for the low taxation and non – tax revenue. Another source of fund of the government is public borrowing, which include external and internal debt is viable in the present scenario. The government borrows from the domestic public and external sources. In the case of external borrowing, there is the need of foreign currency for repayment, which may cause the greater problem. The almost part of the borrowing may be spent for the servicing or repayment of the external borrowing. Thus, internal borrowing is the unscrupulous source of fund for the government of Nepal.

A higher rate of interest is generally offered for special issues meant for the public. Long – term loans are usually offered to public, while short – term and medium term loans are sold to banks and insurance prefers holding government paper for a long period, while the large private investor is more likely to hold government paper as a transitional investment and to dispose it off at any opportune moment.

4.5.6. Major Findings of the Study

The government of Nepal is facing the problem of budgetary deficit due to the low regular revenue of the country. The regular (general) expenditure source of tax and non – tax revenue is not increasing due to the present conflict in the country. The status of government revenue and supplementary government borrowing to bridge the resource gap in the budget of HMG/ Nepal has been analyzed in this study and based on these analysis, the following conclusions have been drawn:

- The public borrowing has been used not only for productive expenditure but also in the consuming sector, which will be the facilitator for inflationary rise.
- There has been excessive flow of foreign loans to bridge the resource gap, but internal borrowing is not emphasized as much as foreign loans.
- The internal borrowings seem the best way of financing development expenditure of the government, which helps to control inflation and to mobilize the domestic resource dispersed in the country.
- The tax revenue of the country is in the decreasing trend in the present years and the size of general expenditure is growing greater than total tax revenue of HMG/N.
- Even for fulfillment of general expenditure, the borrowing is essential for last 8 years.

Chapter – V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

According to data released by the NRB (Nepal Rastra Bank) of total borrowing, the government drew loans worth of Rs. 5.47 billion through the issuance of the treasury bills (T-bills) and three billion rupees through the issuance of development bonds.

In order to finance the widening budget deficit, the government raised around Rs. 9.03 billion in domestic borrowings, just 30 million rupees short of the target for current fiscal year.

Likewise, it issued national saving certificate worth Rs. 217.9 million, national citizenship saving certificate worth Rs. 250 million and special bonds valued at Rs. 90 million to take internal loans during the current fiscal year.

The government has set a target to take domestic loans totaling Rs 9.06 billion for this fiscal year as a whole.

Notwithstanding the slower than expected budgetary expenditures, the government this year went ahead in domestic borrowings, nearly matching its target, thanks to steep reduction in receipt of the foreign loans and grants. Led by the slowdown in the development expenditures, the government had been raising domestic borrowing to the levels less than that of its budgetary projections, over a couple of years.

The government had set a target to borrow domestic loans amounting to Rs. 11.5 billion over the last fiscal year 2003/04, but was able to borrow only Rs. 8.5 billion.

The slowdown in the flow of both foreign loans and grants compelled the government to focus on domestic to fund its budgetary programs.

The latest figure of the Financial Comptroller General Office demonstrates that the net domestic borrowing crossed Rs. 86 billion in mid June. The sum comes to be around 18 percent of the Gross Domestic Product.

Meanwhile, the government renewed the T-bills worth Rs. 10.13 billion through auction.

Of the total amount, the government renewed 91-day T-bills worth Rs. 590 million, and the 364-day T-bills valued at Rs. 9.54 billion.

The figure of the NRB shows that the government received bids worth Rs. 1.25 billion for 91-day T-bills from 12 investors. Its discount rate stood at 3.73 percent.

Likewise, it received the bids worth Rs. 12 billion for the 364-day T-bills, which carried discount rate of 4.75 percent.

5.1 Summary and Conclusion

The developing country like Nepal is facing the main challenge of inadequacy of capital for the investment in development activities. The government of any country is liable for running the development activities, maintaining the law and order of country, and working for the interest of helpless and poor people. The government thus has to raise the necessary funds through the tax and non-tax revenue as well as public borrowing. Since the government borrows the funds with its total liability, it is called the public debt.

The government of any country is liable for running the development activities, maintaining the law and order of the country, working for the interest of helpless and poor people, arranging for health, education, road, drinking water etc. the regular revenue of the developing countries are not adequate to provide all afore said services to the people’s the government, thus has to raise the necessary funds through the ax and non tax revenue ads well as public borrowing. Since the government funds with its total liability, it is also called public debt or government debt.

Nepal is facing the problem of financing ever – increasing resource gap because government expenditure is increasing rapidly, but government revenue is not increasing in the same pace. The widening resource gap in the recent years has made the cumulative effect of the deficiencies in the investment areas and the continued absence of government's fiscal norms. For the fulfillment of the required expenditure for regular and development purposes, the annual revenue (tax and non – tax) is not sufficient. The annual revenue of the government does not cover even the regular expenditures alone. The government revenue is on average of 34153.18 M, which is 6.67% of Total Revenue. The government gets revenue from tax and non – tax source.

The contribution of tax revenue seems more than that of non-tax – revenue in the table 1.1. The tax revenue is not increasing trend during the study period. Direct tax of the country is composed of income tax, land tax, registration tax and other tax (Property tax and Vehicle Tax). The comparative study shows that the contribution of direct tax is lower than that of indirect tax. Direct tax collection needs the good administration that is why; it is hard to collect the direct revenue more. On the other hand, indirect tax contributes more than direct tax to the total revenue. The indirect tax is composed of custom duties, sales tax/VAT, excise duty, and other tax. The contribution, on average of custom duties is 43.08%, sales tax (VAT) is 38.76%, excise duty is 14.13%, and other tax is 4.66% respectively.

The mobilization of resource through indirect taxation is constrained by many problems. Some of them are presence of agricultural economy, low level of income of the people ,lack of education and paying habits, pre-dominance of non – monetized sector in the economy , congested base of indirect tax, open border with India etc. the ratio for total tax to the gross domestic product (GDP) is not noteworthy. Though the government have the source of tax and non – tax revenue, it is not enough to cover all the general and development expenditures. The budgetary deficit of the government is a regular feature. The expenditures are predicted first and the source to cover those expenditures are sleeked out. The gap between the total expenditures and total revenue is bridged by borrowing from the external and internal sources. The government borrows externally from the multilateral and bilateral sources, while internally from public, banks, and financial institutions.

The reliance on taxation is not possible in view of the large amount financial resources required for growing government expenditures and therefore the government borrowing is increasing year to year. The annual average growth rate of total borrowing is 11.64% that of external borrowing is 9.63%. While internal borrowing is increasing at the rate of 20.43% on average. The internal borrowing is composed for treasury bills, development bonds, and national saving certificate.

The servicing rate of internal outstanding debt is grater than that of external outstanding debt. The servicing capacity of the country is challenged by short – term debt stock, even the debt of larger maturity period now coming to a stage of redemption and so on. Annual revenue is a major determinant for servicing the internal debt.. The regular revenue of the government is not sufficient to cover the development expenditures of the country. So that deficit between the expenditures and total revenue is bridged by borrowing from external and internal sources.

5.2 Recommendations

The major findings of this study suggest to make the following recommendations: -

1) It is the compulsion rather than mere need of the HMG/Nepal to raise the internal borrowing. Internal borrowing is help for the mobilization of domestic resources. Nevertheless, Nepal has been trapped by the large amount of outstanding internal borrowing without any consideration for future. It has already been late to think in the long run internally raised funds are to be spent on the contribution of particular projects and industries. Which may provide benefits for longer period of time. This will reduce the burden of debt in the long run.

2) The internal borrowing for short – term should be minimized and long – term borrowing is to be prioritized more. The government should try to maximized the mobilization of internal resources for development purposes and exccessive dependency upon foreign assistance for development programmes should be reduced and it should be confined to the desired extent.

3) The government should maintain fiscal balance and strong fiscal discipline through control of unproductive expenditure and maximizing revenue mobilization. Government's efforts should be directed towards internal revenue and thus reduce dependency on loans for financing development expenditure for the purpose, the base of tax collection need to make more board and simplified tax policy and tax administration are also necessary for reducing the volume of borrowing from internal and external sources.

4) It is necessary to create absorptive capacity in the economy for effective utilization of loan. Borrowed fund from both internal and external sources is to be spent on those projects which are capable for producing exportable commodities within shortest possible time period. It is known fact that large volume of loan obtained from external sources has remained unutilised creating additional burden of debt servicing.

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Annex 1

Ownership Pattern of Government Bonds and Treasury Bills

Rs. In Million

Description	Mid July							Mid March
	1998	1999	2000	2001	2002	2003	2004	2005
1. Treasury Bills								
a. Nepal Rastra Bank	0	4696.7	2795	3050.5	15263.9	15817	9804.4	11786.4
b. Commercial Banks	6062.8	10059	15686	22267	23029.8	31174	36154.3	36900
c. Others	1055	2831.2	2546	2293.3	2812.8	1870	3470.9	2401.7
Sub Total	**7117.8**	**17586.9**	**21027**	**27610.8**	**41106.5**	**48861**	**49429.6**	**51088.1**
2. Development Bonds								
a. Nepal Rastra Bank	1526.7	1526.7	1522.5	2272.2	2266.2	1796	3298.3	1560.2
b. Commercial Banks	1211.6	1658.6	1549.1	2184.4	5426.6	7240.9	6587.4	6587.4
c. Financial Institutions	110.5	133.5	401.1	539.1	1404	3621.7	3903.7	3903.6
d. Provident fund	0	0	0	0	500	1250	1797.6	1797.6
e. Govt. Business Enterprise	0	100	175	175	75	12.5	12.5	12.5

f. Private Business Enterprise	1	1	0	10	11	101.5	289.5	289.5
g. Individuals	0	0	549.1	553.1	1205.1	1165.7	925.6	2113.8
h. Non- profit Organizations	452.4	452.4	65.4	228.4	202.8	870.9	734.6	734.6
Sub Total	**3302.2**	**3872.2**	**4262.2**	**5962.2**	**11090.7**	**16059**	**17549.2**	**16999.2**
3. National savings Certificate								
a. Nepal Rastra Bank	663.3	368.7	764.4	343.2	20.7	63.1	404	110
b. Commercial Banks	154.5	154.5	154.5	154.5	117.8	110	110	0
c. Financial Institutions	1371.7	1111.2	771.2	987.9	608.9	574.7	211.6	209.9
d. National Insurance Company	1246.1	1473.2	1331.7	713.7	788.2	579.5	525.8	420.7
e. Provident Fund	1567.1	1384.9	1231.1	1475.6	1455.6	1158.1	1063.1	980
f. Govt. Business Enterprise	823.9	973.4	805.8	573.9	725.9	480.8	380.8	300.3
g. Private Business Enterprises	411.7	429.8	439.9	343.8	342.2	282.5	154.6	138.6
h. Individuals	793.4	1031.2	929	1268.1	1059.7	551.7	463.8	453.3
i. Non - Profit organizations	2854.7	3499.5	5098.9	6615.7	6417.1	5829.4	5716.1	5947
Sub Total	**9886.4**	**10426.4**	**11526.5**	**12476.4**	**11536.1**	**9629.8**	**9029.8**	**8559.8**
4. Public Saving Card					3.1	0	45.8	47.6
a. Personal area					625	931.1	1133.1	1131.3
Sub Total					**628.1**	**931.1**	**1178.9**	**1178.9**
5. Special Bonds								

a. five Years Special Bonds	80.2	32.8	0.0	0.0	0.0	0.0	0.0	0.0
b. IMF Promissory Note	2992.7	3860.0	3650.0	3888.1	4171.7	4171.7	4722.3	4722.3
c. CB PASS 20 Years Special Bonds	12962.7	13891.3	13891.3	10106.2	5087.6	4992.8	4223.9	3584.4
1. Nepal Rastra Bank	10702.2	11630.8	11630.8	7845.7	2396.7	1838.0	864.0	185.0
2. Commercial Banks	787.0	787.0	787.0	787.0	787.0	944.6	944.6	944.6
3. Employees Provident Fund	1473.5	1473.5	1473.5	1473.5	1473.5	1473.5	1473.5	1473.5
4. Individuals	0.0	0.0	0.0	0.0	430.4	736.7	941.8	981.3
Sub Total	**16035.6**	**17784.1**	**17541.3**	**13994.3**	**9259.3**	**9164.5**	**8946.2**	**8306.7**
6. Total								
a. Nepal Rastra Bank	15965.1	22115.7	20362.7	17399.7	24122.3	23685.7	19138.8	18411.5
b. Commercial Banks	8215.9	12659.1	18176.6	25392.9	29361.2	39469.3	43796.3	44432.0
c. Others	12161.0	14894.8	15817.7	17251.1	20137.2	21490.3	23198.6	23289.2
Grand Total	**36342.0**	**49669.6**	**54357.0**	**60043.7**	**73620.7**	**84645.3**	**86133.7**	**86132.7**

Note : Including CBPASS 20 years special bonds and forest compensation special bonds

Source : Nepal Rastra Bank