STRUCTURE AND ANALYSIS OF INTERNAL DEBT FINANCING IN NEPAL

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RECOMMENDATION

This is to Certify that the Thesis

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and forward the thesis to be the original work of the prescribed format. We recommended the thesis to be accepted as partial fulfillment of the requirements for Master's Degree in Business Studies (MBS).

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DECLARATION

I hereby declare that the work, reported in this thesis entitled “Structure and Analysis of Internal Debt Financing in Nepal" submitted to research department of Prithiwi Narayan Campus, Bagar-1, Pokhara, Faculty of Management, Tribhuvan University, is my orginal work done in the form of partial fulfillment of the requirement for the degree of Master of Business Studies under the supervision of Dr Puspa Raj Sharma.

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ABBREVIATION

ADB	=	Asian Development Bank
AG	=	Annual Growth
CBI	=	Central Bureau of Statistics
DE	=	Development Expenditure
DS	=	Debt Servicing
ED	=	External Debt
EDS	=	External Debt Servicing
FY	=	Fiscal Year
GDP	=	Gross Domestic Product
Gov	=	Government
ID	=	Internal Debt
IDS	=	Internal Debt Servicing
IMF	=	Internal Monetary Fund
LDC	=	Least Development Country
MOF	=	Ministry of Finance
NG	=	Nepal Government
NRB	=	Nepal Rastra Bank
PUBP	=	Public Debt
RE	=	Regular Expenditure
Rs	=	Rupees
T-Bills	=	Treasury Bills
TD	=	Total Debt
TDS	=	Total Debt Serving

Chapter - I
INTRODUCTION

1. 1 Background of the study

Sandwiched between the two gigantic countries china & India, Nepal abounds 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 interests 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 (News letter ,NRB 2000;8).

The government gets its income mainly from two source namely public revenue and public debt. A government owes public debt to people and institutions within its own borders(Internal debt) and or to foreign creditors as external debt. Public debts are based upon the credit of the concerning government unit. These units have promised to pay certain sum of money of specified dates in the future . Basically , public debt is the result of mismatch between revenue and expenditure over a time frame and it carries with the obligation of the state to pay bank its interest and principal within stipulated time period, to person, countries or institutions from it has obtained (Lekhi,1990:190).

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 tax and non tax revenue as well as public borrowing. Since the government funds with its total liability, it is also called public debt or government debt (MOF,2008:12).

Government makes the budget annually. Firstly, the expenditures are estimate in the budget. 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 has taken as the excess of spending over revenue. This is the phenomenon mainly of the post World War II World. Before the trend was 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.

Nepal ranks among the world's poorest countries, with per capita income of around $470 in 2009. Based on national calorie/GNP criteria, an estimated 31% of the population is below the poverty line (MOF,2009:15).

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 (MOF,1996:42).

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 (News letter NRB,2004:8).

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 (MOF, 1996:48)

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 m110ay 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(Report ADB,2008:35).

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.

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 .

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 (Public Debt News letter,2008;18).

1.2 Statement of problem

The current decades of planned development of Nepal have 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 has financed through foreign aid and debt which guides wider gap between government revenue & government expenditure. 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 than foreign debt. Mainly, the developing countries depend on import. 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. 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.

1.3 Objectives of the study

The study has undertaken to fulfill following objectives:

1. To study the source of government financing.
2. To analyze the structure of government internal financing.
3. To determine the cost of government internal financing.
4. To find the relationship between government internal financing and inflation trend of the economy.
5. To suggest the government for further planning in the field of internal debt financing.

1.4 Significance of the study

Rapid population growth against slow rate of economic progress has emerged as a serious problem in the Nepalese context. It is observed that per capita income has not been able to increase significantly due to rapid population growth, lack of proper budgeting & financing and slow rate of economic progress. This problem 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.

Due 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 is limited to public debt or internal borrowing only, hence may not represent the problem of the nation in general.
2. Analysis is based on the inferences of secondary data. So, all the limitations of this technique do equally apply to the study.
3. The study covers only the period of 10 years.
4. The time and money constraints do also limit the scope of the study.

1.6 Organization of the study

This dissertation has divided into five chapters.

Chapter 1

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 critically 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 overall the study, and gives conclusion and recommendations after scanning the problems of the study.

Chapter –II

THE LITERATURE REVIEW

2.1 Introduction

.The idea of public debt has 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 (Joshi,1982:23). Public debt particularly in developing countries have a significant importance due to the increasing magnitude of budgetary deficits. So, knowingly or unknowingly the flow of debt will be inseparable form human civilization in the days to come. Since last few decades the indebts ness of developing countries are in increasing concern. After realizing the importance of public borrowing many writers wrote on public debt management in the context of Nepal, in the form of books, magazine, newspaper and in various publications. The students also submitted dissertation referring to the public debt for the fulfillment of master's degree. For the present purpose, the portion of literature review has been divided into parts.

i) International context

ii) Nepalese context

2.2 International context

Number of economist put forth the views and studied about the international debt situation. Zunit Iqbal and Rabi kanbur in their presented papers at the IMF and WB conference on external financing for low-income countries in 1996 highlighted that, "Threshold debt ratio derived for developing countries in general may not be fully applicable to HIPC (Heavily Indebt Poor Countries) because these countries are recipients of large inflows of foreign assistance in the form of both grants and confessional loans. Hence, the debt serving capacity of HIPC depends not only on their ability to generate foreign exchange through exports but also on how much foreign assistance is expected to be forth coming in the future" so they emphasized on the external debt to low income countries for generating debt-serving capacity (Iqbal and Knabar 1996).

Avramovic and colleagues provided a useful framework for the examination of external borrowing in terms of a country's debt servicing capacity. Assuming that the country borrows only to help in finance and it has three stages in the external debt cycle. In first stage the country's saving is below the desired level of investment. It borrows from abroad to finance part of its investment and also to service the external debt. The burden of debt servicing is continuously differed and the debt increases rapidly. In second stage saving has grown enough to finance all domestic investment however the country is continuing to borrow abroad to cover service cost of the debt .The external debt grows at a slower rate in first stage but at the end of second stage it reaches maximum and in the third stage the country stops borrowing. Generally, very poor country can take a long time to move from the stage first to second, and the return on capital obtained by foreign borrowing is low relative to the interest rate. So, there is a chance that it may never reach at the stage third (Avramovic and colleagues, 1964)

Klein and verbeek used to examine debt-servicing capacity of any country in relation to export earnings gross national product and government revenue at any time. Period 't' as following equation :

$$D = I_{(t)} + I_{m\,(t)} - X_t \;\; D_{t-1} \text{------------------------} I$$

Where,

D_t = Debt servicing capacity

$I_{m\,(t)}$ = Current account deficit

$I_{(t)}$ = the average interest rate changed on external debt in the period

$D_{t-1} =$ the size of stock of debt of previous year.

It deficits that debt servicing capacity depends upon the variable (Im(t)-X(t)),It and

D(t-1),d(t) will be high if It is high of if current account deficit is high relative to the

stock of debt of previous period i.e. Dt-1 the relation (I) therefore deficits a larger stock of debt larger interest payments are required (Klien and Verbeek 1995)

E.D. Domar in (1944) defined public debt as the ratio of the total debt to the national income. He lays down the condition under which the burden would increase or decrease overtime he proposed a relation as following.

Let,

D = amount of debt outstanding at a beginning of a year

T = amount of taxes necessary to cover the interest change on debt

I = ratio of interest paid on debt

So,

T = Di -------------------------------------(ii)

Let, t = fraction of income (y) taken through tax to pay interest

Therefore,

T= D/Y = ID/Y -------------------------(iii)

From the equation (iii) it follows that tax rate is necessary to pay interest on debt depends on the ratio of the size of debt multiplied by the rate of the interest to income the tax rate may be related to growth of income and the budget therefore the relevant equation is

T = I (I/i)(G/b)= ib/G

Where,

G = ratio of growth of income

b = ratio of deficit to income

Michael P. Todaro necessities to introduce basic transfer problem before tracing out origins and prospects for the third world debt crisis the basis transfer equation denoted by BT is given by

BT = dD = rD -----------------------(iv)

Where,

d = percentage rate of increase in total debt

D = total accumulated foreign debt

r = average rate of interest

Dd = the net capital inflows is the rate of increase of total external debt

rD= Total annual interest payment on debt

BT is positive if d>r country will be gaining foreign exchange

Bt is negative if r>d country will be losing foreign exchange

Different factors affect to lower 'd' and raises 'r' in BT equation with the net result that the over all BT becomes highly negative and capital flows from the UDCS to developed world. Then debt crisis becomes self rein-forcing and heavily indebted third world countries are forced into a down ward spiral of negative BT equations dwindling foreign reserve and stalled developed prospects.

Hanson has written an article on effect of public borrowing 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 but it the growth in public debt is very rapid it will not be possible for relatively small savers to take any large proportion of new securities issued, they will be absorbed by the rich and the well to do and by large corporation a rapid growth in public debt is therefore likely to intensify inequalities in wealth administrations." (Hanson, 1941)

The UN conference on trade and development in 1980 reviewed in multilateral debt of least development countries " discussed on problem of multilateral debt as sustainability liquidity and accumulation of large -scale arrears. Gerald M. Meier presented a paper in the conference evaluated the current schemes to provide debt -relief and suggested possible measure to strengthen other innovative Obtains.

2.3 Nepalese context

A study made by Acharya tried to explain about the features, problems and pattern of public debt in Nepal of those days. He reached on the conclusion that public debt was very popular those days because of the payment of the maturity can be adjusted through the issue of fresh debt bond. He had emphasized to develop the secondary market for the government so that public can buy, sale and hold the bonds (Acharya ,1968: 36).

According to the study on Internal Public Debt in Nepal by Chhetri, from the second plan period to the sixth plan period, the internal debt as percentage of development expenditure were ranged between 3.5 percent to 12.7 percent. He found that the growth of national income was less than the rate of growth of public debt. As being the interest rate structure in the lower side, he remarked that 'interest cost of this order in relation to income did not appear too burdensome.' The ratio of interest payments to tax revenue was ranged between 0.8 percent to 6.8 percent during the study period. He concluded with the view that the proportion of tax revenue absorbed by debt servicing could not be very small. While analyzing the pattern of ownership of government bonds, he found that Nepal Rastra Bank had the major holding of around 54 percent of total outstanding government bonds. At last, he recommended for building the government bond market and use of bond instrument for monetary management. (Chhetri, 1984)

Public Debt Management and Macro Economic Stability provided the conceptual framework on public debt management, existing scenario of public debt, external and internal debt servicing status of the government, budgetary imbalances and public debt accumulation along with some comparison of other countries in term of revenue to GDP, fiscal deficit to GDP and source financing. In his study, he also examined the relationship between government borrowing and money supply; crowd out effect of government borrowing on private sector credit, public domestic borrowing and domestic savings, foreign borrowing and current account balance through various equations. According to him, "the foregoing discussion exhibits that public debt has not so far been a destabilizing factor from the view point of current account deficit, exchange rate depreciation, and discouragement to domestic savings (Khatiwada, 1998)

Nevertheless, at the same time it has:

- Exerted excess monetary expansion which has directly resulted high rate of inflation and deteriorating current account situation,
- Posed a pressure on debt servicing of the government resulting in higher budget deficit which also impinges on monetary expansion having subsequent effect on the internal as well as external sector stability,
- Crowed out resources available for private sector investment,
- Exerted upward pressure on the market rate of interest.

The future is more alarming as:

- Long-term foreign loans are maturing in the faster rate,
- Depreciation of exchange rate of Nepalese rupees is multiplying the debt obligation as well as the debt-servicing requirement,
- As the source of foreign grants are drying up, propelling the accumulation of foreign debt is higher with larger development spending of the government through foreign aid,
- Interest rate on domestic borrowing is very high,
- Most of the domestic debt is of the short term,
- Automatic monetization of the budgetary deficit has made redundant the effort for prudent monetary management for macro economic stability.

" Keshav P. Acharya in his article Burden of Public Debt in Nepal analyzed the relevancy of public debt from 1965 to 1997. In his paper, he has explained the volume of public debt in Nepal, public debt situation in Nepal, volume of foreign assistance, factor affecting public debt in Nepal, debt service burden, per capita debt burden, burden of internal and external debt as well as effectiveness of public debt in Nepal. In his paper, he provided some arguments for public debt as well as against it. The factors affecting public debt in Nepal, he has the view that 'need of public debt arises when domestic savings fall short of investment requirement.' Within his study period, the saving investment gap has ranged between 4.6 percent of GDP to 12.8 percent of GDP. He found that whenever the gap narrows it is due to more of the faster relative rise in the saving ratio rather than a fall in the investment ratio. Similarly, on the budgetary development fronts, he has found three problems in Nepalese context. Those are:

- Rising proportion of regular expenditure,
- Falling capacity of revenue surplus to support development expenditure both as direct allocation to projects and as a part of counterpart resources to foreign aided projects,
- Falling share of grants in total aid inflows.(Keshav Prasad Acharya, 1998:25)

While analyzing the burden of internal debt, it was found that about 38 percent of the internal debt is spent in its own servicing. Internal debt servicing is consuming 1.6 percent of the GDP and 17 percent of regular expenditure. He concluded that the historical trend of these indicators suggested a further escalating debt burden in the future. Finally, he explained that, 'at present there is no mechanism available on how to optimize the effectiveness of foreign aid. A simple comparison of growth of public debt with that of GDP presents not a very good scenario, in most of the years, GDP growth rates fell far below the growth rate in public debt. Such relation is much poorer with external debt than with internal debt.'

Dhungana analyzed the importance of internal debt in Nepal, principle of internal debt management, approaches to internal debt management, and issues of internal debt along with issues on sustainability of debt in Nepal. He has analyzed the data related to internal debt and total debt of the government from 1981 to 2000. To measure the sustainability of debt in Nepal he examined the necessary and sufficient conditions through following ratios (Dhungana, 2000:18)

- Internal debt/ real GDP
- Internal debt/ nominal GDP
- External debt/ real GDP

- External debt/ nominal GDP
- Total debt/ real GDP
- Total debt/ nominal GDP
- The averages of growth rates between debt and nominal GDP
- A comparison between the real GDP growths with real interest rates
- An analysis to examine whether the primary saving is equal or greater than interest payments or not
- He analyzed the sustainability of debt through measuring two conditions, i.e. necessary conditions and sufficient conditions.

It was found that the internal debt to GDP ratios were within the sustainable levels within the study period but those was increasing in the alarming way. The internal debt to nominal GDP ratio was also increasing substantially within his study period. While examining the conditions of sustainability, he found that internal debt to GDP ratio was not exhibiting the favorable situation. Other two indicators to test the sustainability of debt such as on growth rates on real GDP and the real interest rate of internal debt, the growth rates on real GDP was found higher than that of real interest rates in the internal debt, which proved that the necessary condition was favorable to the debt level in the sustainable level. Moreover, the primary saving was positive throughout the period. These two indicators have highlighted the favorable condition for sustainability test. On the other hand, the analysis of sufficient condition showed that nominal growth rate of debt was higher than that of nominal growth rate in the GDP, signifying the internal debt growth to be unsustainable. Total debt to nominal GDP ratio was average 65 percent within the last five years of his study period. Therefore, he has concluded that the over all debt in Nepal was not at the sustainable level in the last five years of his study period.

Daya Ram Sharma (2001) in his research work stated that the annual growth rate of the total debt within the study period was 12.9 percent; annual growth of grant 18.4 percent, annual growth of internal debt was 14.23 percent and annual growth rate of external debt 16.25 percent. The ratio analysis exhibited that the total debt in total deficit 50.88 percent, internal debt in total debt was 27.34 percent and external debt on total debt was 72.66

percent. The public debt as percent of GDP within the study period was on average of 6.38 percent and out of this internal debt to GDP was 1.83 percent and external debt to GDP was 4.54 percent. He concluded that the interest of investors and their education are dependent to each other. Similarly, the interest of both poor and rich investor in the government security is not significantly different, the investors of the urban area are more aware to the government securities than the investors of the rural area, there is association between the interest of investors and their occupation and who do not have sufficient to run the private enterprises and who are not dexterous to grab the opportunity in the market i.e. unskilled to apply the good entrepreneurship are more interested in the government securities. It was found that the person with the academic background of economics, finance and management are more aware to the government securities (Sharma ,2001).

Gokul Ram Thapa (2005) in his article 'domestic debt management' analyzed about public debt. He illustrated that; to manage the government borrowing efficiency development of an efficient security market is a must. The borrowing amount should be invested in the productive sector. The financial return to government out of these investments should be greater than the cost. The assets created out of such borrowing (yield) should be at the higher level. The borrowing cost and return should be widened every time. The objective of borrowing should not be for making easy money for the government. If the return is less than the borrowing cost, this will result in the gradual deterioration in the paying capacity of Government and finally the public will have less confidence towards Government. The borrowing instruments can be used for maintaining monetary balance as well as for Government's financing. So, there should be a cordial co-ordination between fiscal and monetary policy maker and debt manager. They should share their common interests to attain the goals. The borrowing should not be for the payment of interest and principal amount. It should be invested in the productive sector so that the return from such investment will be sufficient for repayment. Hence, an efficient monitoring mechanism should be developed. Likewise, the effective and efficient uses of such borrowing are more crucial (Thapa,2005).

For the implementation of the Issue Calendar, a very cordial co-ordination is needed between the fiscal manager and domestic debt manager of the country. Through the primary issue of the government securities, liquidity will be drained and there will be a decline in the reserve position in the financial system. So, the fiscal manager should be aware of this effect on the monetary sector. Likewise, the monetary authority should also bear in mind that it is also used for fiscal management of the government.

2.4 Role of Public Debt Financing

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

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

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

2.5 Fiscal Policies and Capital Formation

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

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

2.6 Deficit Financing and Economic Development.

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

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

2.7 Public Borrowing and Resource Mobilization

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

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

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

2.8. Policy & Procedure Reformation on Internal Debt Management in Nepal

The fiscal rules and fiscal deficit of Nepal are determined by the budget speech of the government. The annual plans and programs are covered in the budget speech, which is also approved by the parliament. The budget speech also comprises of the amount of internal borrowings and foreign loans. For the internal debt component a separate act, named 'Act for raising of public debt' is passed each year. The act that determines the borrowing from the Nepal Rastra Bank is, Nepal Rastra Bank Act, 2002. The new Nepal Rastra Bank

Act, 2002, section 75 has a provision for extending credit to Government of Nepal and provision relating to the purchase of Government bonds. The NRB Act promulgated in 1956 has not made such provision and also any restriction to the government to borrow funds from the Nepal Rastra Bank, but the new NRB act has incorporated prudent limits for the government borrowings from the central Bank. The Act states that" subject to limit, specified in the act, the bank may extend credit to Government of Nepal with a condition to repay within one hundred eighty days." For this purpose the government should issue government bond after such specified date in **prevailing market interest** rate. And the act also specifies that" At no time the amount of over draft provided by the bank to Government of Nepal shall be more than five percent of the revenue of Government in the preceding fiscal year. While computing such revenue income, the amount of borrowing, grants, or any other form of financial assistance or income received from the sale of property shall not be included while computing the revenue income. In this context, Nepal has begun to adopt fiscal disciplinary rule recently for government borrowings from the central bank. Some major acts, rules and by-laws formulated to strengthen the capacity of the financial sector are listed below (MOF, 2008:225)

- Bank and Financial Institutions Debt Recovery Act 2002
- Nepal Rastra Bank Act 2002
- Public Debt Act 2003
- Secured Transaction Act 2006
- Public Procurement Act 2007
- Bank and Financial Institutions Act 2006
- Insolvency Act 2006
- Company Act 2006
- Competition Promotions and Market Protection Act 2006
- Money Laundering Prevention Act 2008
- Banking Frauds and Punishment Act 2008

By-laws and Regulations

- Public Debt by-laws 2003
- NRB Credit Information by-laws 2003

- NRB Inspection by-laws 2003
- Know your customer directives 2006
- By-law relating to Insolvency 2008
- Regulation relating to Prompt Corrective Action of Bank and Financial Institutions.

Besides these, there are numbers of circulars and directives by Government and Nepal Rastra Bank for the management of overall financial situation of the country.

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 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 (Public Debt Act,2002, NRB).

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

SDRMS 2000 (Common Wealth Secretariat Debt Recording and Management System) 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 (News letter NRB, 2008:21).

2.8.2 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, 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.

2.8.3 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.

2.8.4 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.

2.8.5 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.

2.9 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 (Monetary & Fiscal Management, 2059 B.S,NRB, BTC Pg. 94 – 95.)

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.

"Public debt may be internal or external when it is held by the subjects of the indebted government ,it is an internally held debt. In this case, the community owes this debt to some of its own members. The debt will be external, it the creditors are foreigners and there is a drainage of national resources in favor of foreign countries when the debt is served, it is clear that if loan obligation are allowed to change hands." (Bhatta, 2000:28).

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.

2.10 Research Gap

Many researchers were done government debt practices and issue system. Major thesis focused on the trend analysis of public debt.. Further no one's research work studied the structure, analysis of government borrowing, fiscal deficit, inflation, domestic resources gap, external borrowing and cost of internal borrowing, which is crucial matter of public debt. It shows the interest of various investors on specific types of government securities. Hence, review the related literature in this regard, and considering the several gap as above, this research has attempted to analysis the internal debt financing in Nepal and its structural analysis obtaining recent data to find out the objectives of this research works.

Chapter-III

RESEARCH METHODOLOGY

3.1 Introduction

In this chapter, the methodology 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

This study will attempt to visualize the availability of internal borrowing and its structure. 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, reports and enternet search. 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 collect 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 fiscal deficit, 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 and cost of debt etc.

(a) Annual Growth Rate of Deficit, Internal and External Borrowings and Fiscal Deficit

To analyze the general trend in deficit, internal borrowings, and external borrowings the growth rate is calculated for the study period by using mathematical relation, Annual growth rate of deficit, internal borrowing and external borrowing of particular FY =

(b) Cost of Debt

To calculate the cost of internal borrowing is calculated for the study period by using following formula.

$$\text{Cost of Debt} = \frac{\text{Interest payment for the period}}{\text{Principal amount}} \times 100$$

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(Gupta,2000:78)

. The average is calculated as:

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

Where, X = variables used

N = no of observations

(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 (Richard and Davis,1999:114). Correlation is a statistical tool with help of 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 2009, 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 (Richard and Rubin,1999:607). 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.

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 is defined as a strategy for prudently managing sovereign debt to reduce long term costs of debt and containing risk within an appropriate level. Indeed, the ultimate objective of sovereign debt management is to minimize long – term costs of debt, while taking into account the implied cost/risk trade-off associated with various strategies. The scope of debt management includes both the level and structure of sovereign debt such as maturity structure, currency composition and so forth. It also involves designing efficient infrastructures for the government bond markets such as auction mechanisms, trained platforms, and settlement and depository institutions. Public debt management may also be define 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 (Rhee,2004:4).

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 (Rhee,2004:6).

The objectives of the debt management are as follows:

- To ensure that the government's financing needs and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk.
- To ensure the government's continued access to financial markets, while broadening the range of government debt instruments.
- To influence the size and maturity of debt.
- To influence the appropriate pattern of interest rates.
- To affect the type of holder of the debt
- To achieve short-term stabilization of bond prices
- To limit debt service cost
- To create capital market
- To give priority to domestic over foreign issues on domestic market
- To give priority to public sector borrowing.

Types of risks existing in public debt

There are different types of risks in public debt management. First, there is debt-survive-cost risk due to unexpected fluctuations in debt-service-cost as a consequence of the shifts in the term structure of interest rate. The second is liquidity or roll-over risk associated with a large redemption coinciding with a temporary high level of interest rates or a period when the government has to refinance on particularly unfavorable market terms. The third is market-value risk. It is the risk that the value of the debt will fluctuate as a consequence of the fluctuations in interest rates and exchange rates. Finally, there also exist other type of risk such as corner-party credit risk, operational risk, and legal risk, and so forth.

Following instruments are used to achieve the mentioned objectives of the debt management (MOF, 2008:212)

- Open market operation
- Timing of issues
- Authorities and banks coordinate issues
- Bonds innovations tailored for issues
- Queuing
- Pressure to favor government bonds
- 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. Currently, the government giving emphasis to collect fund from charging tax on many area.

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 Government expenditure and Sources of internal financing

Government makes the budget annually. Firstly, the expenditures are estimate in the budget. 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 kings 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 has taken as the excess of spending over revenue. This is the phenomenon mainly of the post World War II world. Before the trend was the balance budget.(Regmi,2004:12)

The governments were not allowed to spend more than their means. raises the debt, Deficit budget 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.

4.4.1 Trend of Revenue and Fiscal Deficit

The scarcity of adequate internal resources has been the main constraint in the realization of development program in Nepal. The annual growth rate of the total expenditure and that of its revenue are not increasing in the same space. The annual growth rate of government expenditure has outpaced its revenue collection resulting financial resources gap in budgetary of the government. This fact has explained in the table No.4.1 which shows the growing resources gap in the Nepalese fiscal system. The first kind of resources gap has shown as the different between the total expenditure and the total revenue receipt of government. The second kind of resources gap shows the difference between total expenditure and total revenue receipt of government and grants from friendly countries.

Table No 4.1

Trend of Government Expenditure and Fiscal Deficit

(Rs. In Million)

Fiscal Year	Total Expenditure	Annual Revenue	Revenue Deficit	Grants	Annual Budgetary Deficit Amt.
1999/00	66273	42893.7	23379.3	5711.7	17667.6
2000/01	79835	48893.7	30941.3	6753.4	24187.9
2001/02	80072	50445.5	29626.5	6686.1	22940.4
2002/03	84006	56229.8	27776.2	11339.1	16437.1
2003/04	89443	62331	27112	11283.4	15828.6
2004/05	102560	70123	32437	4391	28046
2005/06	110846.78	72282	38564.78	13807.9	24756.88
2006/07	133343.73	87712	45631.73	13827.5	31804.23
2007/08	161349.89	107622.48	53727.41	20320.73	33406.68
2008/09	204667.30	143310	76874.10	34570.43	41616.97

Source: Various Budget Speech and economic Survey, MOF/Nepal

Figure no ; 4.1

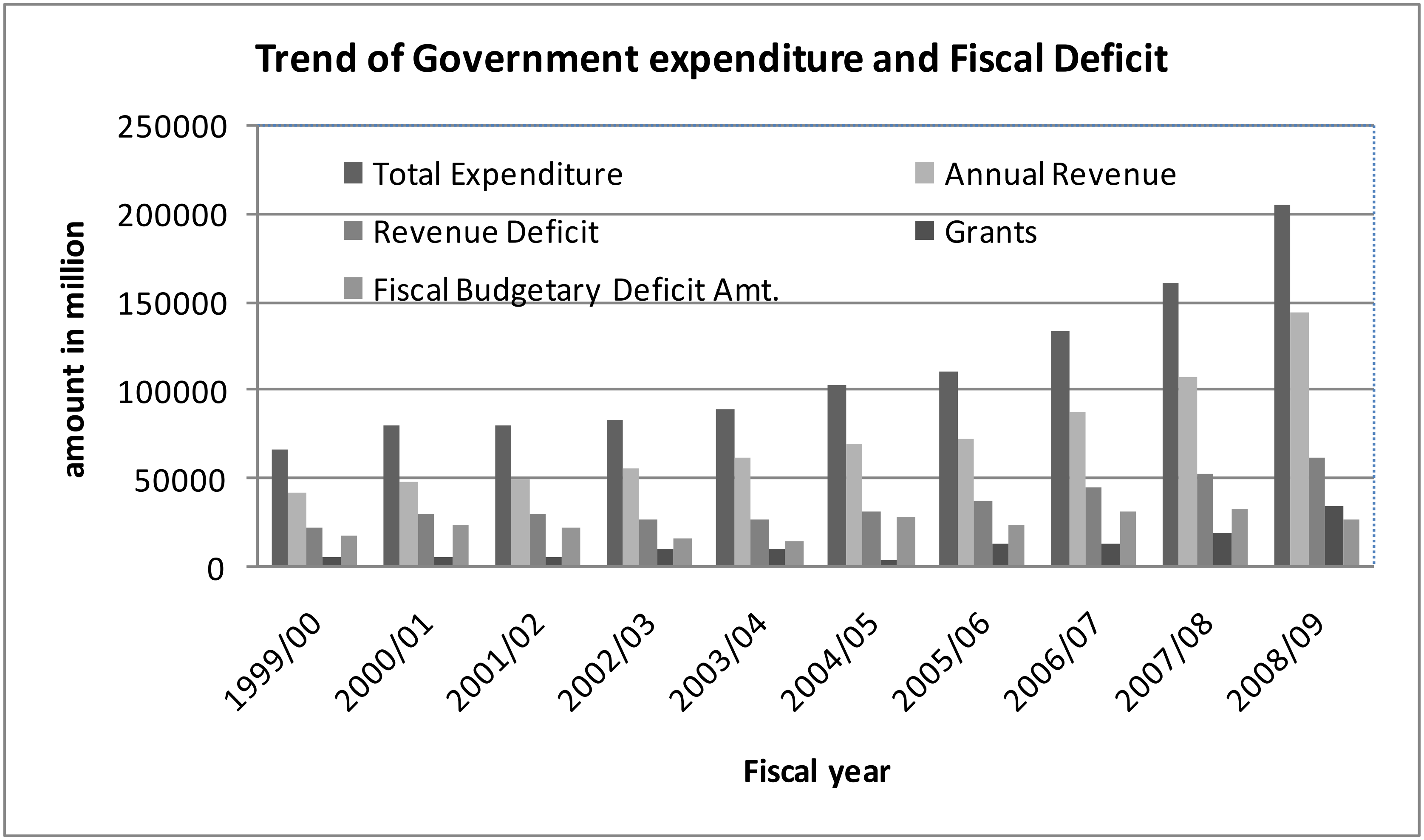

Trend of Government expenditure and Fiscal Deficit
250000
200000
150000
100000
50000
0
Total Expenditure
Annual Revenue
Revenue Deficit
Grants
Fiscal Budgetary Deficit Amt.
amount in million
1999/00
2000/01
2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
Fiscal year

Table 4.1 shows the first type of deficit and shows the increasing amount of revenue deficit mainly because of the increasing volume of total expenditure. The amount of total expenditure, which was Rs 66273 Millions in FY 1999/00 where as total revenue of government, has Rs 42893.7 Millions. The amount of Annual expenditure has increases Rs 66273 in FY 1999/00 to Rs 204377 million in FY 2008/09. The trend shows increasing trend as same annual revenue of the government has also increasing trend, which is Rs 48893.7 million in FY 2000/01, and it increased up to Rs 143310 million in 2008/09. Where as the fiscal deficit also increases up to Rs 26796.87 in FY 2008/09 million which was Rs 17667.6 million in FY 1999/00.

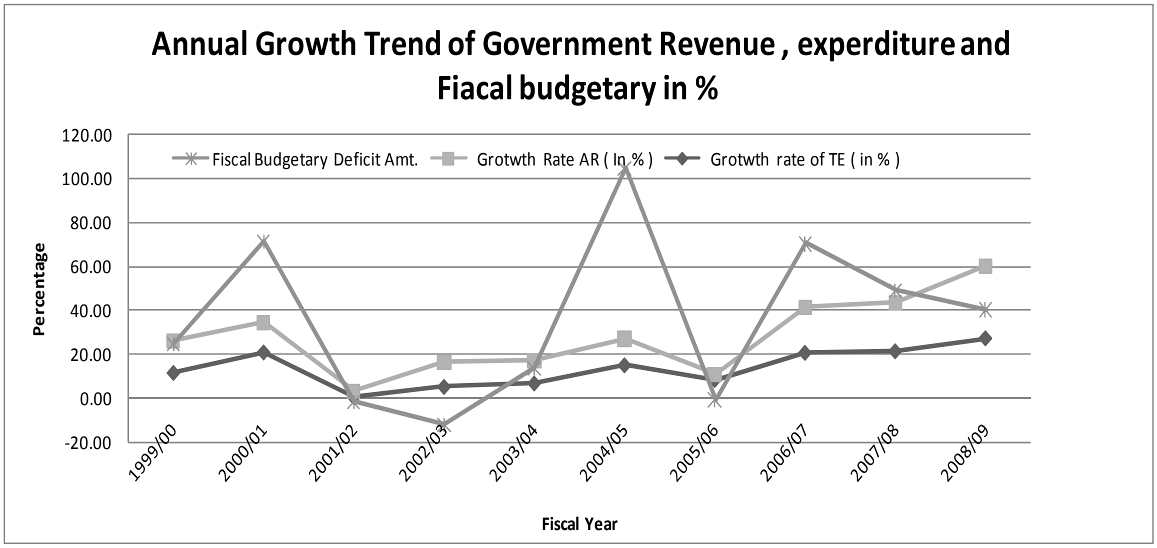
4.4.2 Annual Growth Trend of Government Revenue, Expenditure and Fiscal Deficit in Percentage.

Table No 4.2
Annual Growth Trend of Government Revenue, expenditure and Fiscal Budgetary Deficit (in %)

Fiscal Year	Growth rate of total expenditure (in %)	Growth Rate Annual Revenue (In %)	Growth Rate Fiscal Budgetary Deficit (in %)
1999/00	11.24	15.15	-1.80
2000/01	20.46	13.99	36.91
2001/02	0.30	3.17	-5.16
2002/03	4.91	11.47	-28.35
2003/04	6.47	10.85	-3.70
2004/05	14.67	12.50	77.19
2005/06	8.08	3.08	-11.73
2006/07	20.30	21.35	28.47
2007/08	21.00	22.70	5.04
2008/09	26.85	33.16	-19.79
Average	**13.43**	**14.74**	**7.71**

Source : Annex 2

Figure no : 4.2



The annual growth rate of total expenditure during the period under review has been 13.43 percent per annum whereas the annual growth rate of total revenue has been 14.74 percent. The trend of government expenditure is fluctuating trend, which is .30 percentages to 26.85 percentages. Where as the revenue of government revenue, growth rate is stated at 3 percentages to 33.16 percentages and the fiscal deficit growth trend stated at -19.79 to 77.1 percentages during the study period. The average growth rate of government fiscal deficit has been 7.71 percent in average during the study period.

4.4.3 Debt as source of deficit financing

The scarcity of adequate internal and external resource has been the main resource to fulfill the resource gap on budget. 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 has needed.

Table No. 4.3

Internal and External Debt as percent of Fiscal deficit

Rs. In Million

Year	Deficit amount	Total Debt	Internal Debt	External debt	Debt as percentage of Fiscal Deficit	
					% of internal Debt	% of External Debt
1999/00	17667.6	17312.2	5500	11812.2	31.13	66.86
2000/01	24187.9	18044	6003.6	12040.4	24.82	49.78
2001/02	22940.4	15998.7	8000	7998.7	34.87	34.87
2002/03	16437.1	13426.4	8880	4546.4	54.02	27.66
2003/04	15828.6	13237	5608	7629	35.43	48.20
2004/05	28046	18204	8938	9266	31.87	33.04
2005/06	24756.88	20048	11834	8214	47.80	33.18
2006/07	31804.23	27945.82	17892.3	10053.52	56.26	31.61
2007/08	33406.68	29476.28	20496.4	8979.88	61.35	26.88
2008/09	26796.87	26617.41	18412	8205.41	68.71	30.62
Average	24,187.23	20,030.98	11,156.43	8,874.55	44.63	38.27

Source:- Budget speeches, Ministry of Finance, NG

Economic Survey, Ministry of Finance, NG 2004/2005, 2006/07 and 2008/09

Note:

$$\text{Percentage of fiscal deficit} = \frac{\text{Internal/External}}{\text{Fiscal Deficit}} \times 100$$

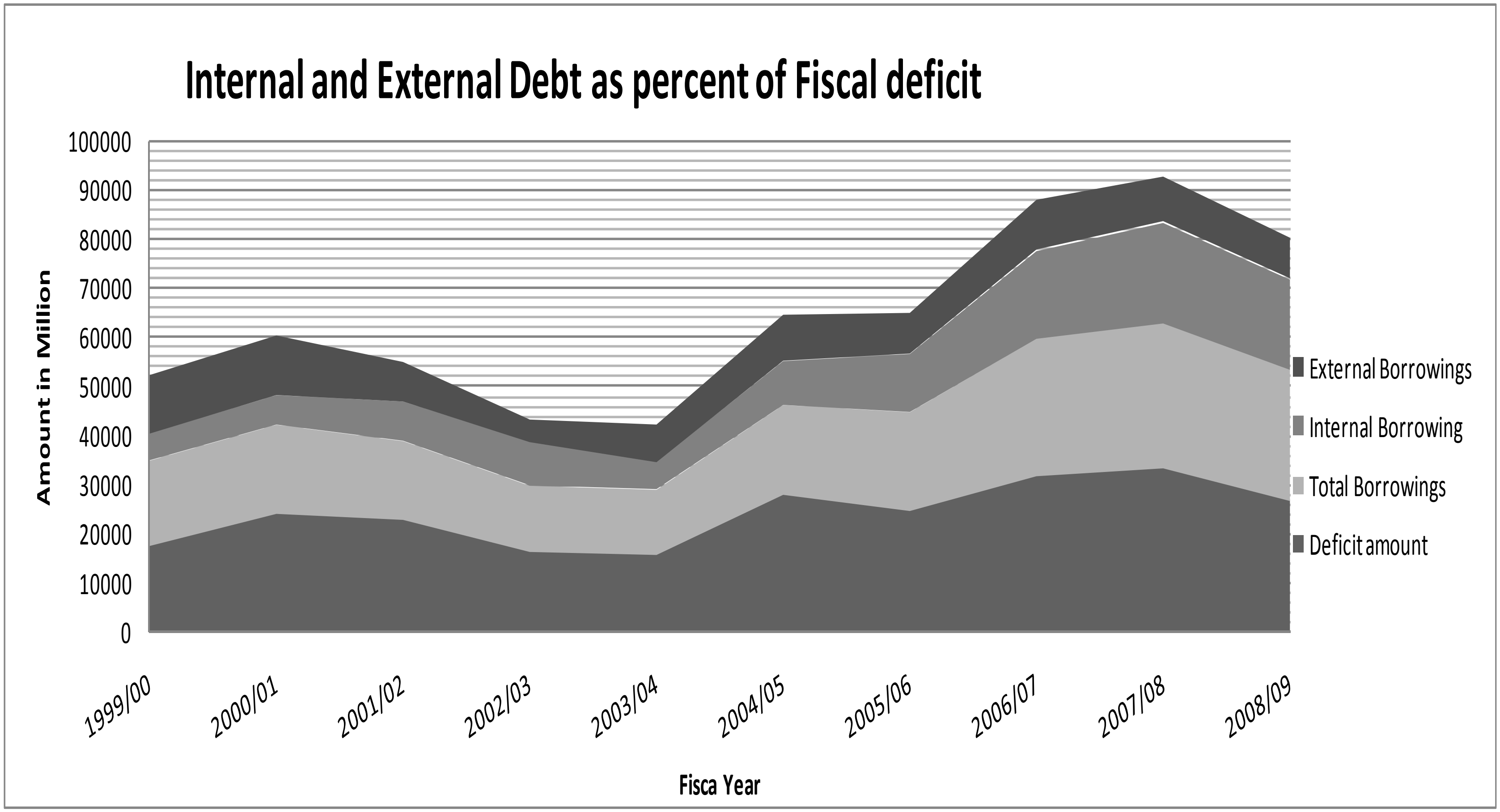
The table 4.3 shows the total public debt raised from internal and external sources was Rs. 17312.2 million in 1999/00 which was increased to Rs.26617.41 million in 2008/09. It is average annual growth amount over the study period is Rs 20030.98 million. Internal debt was amount Rs 5500 million in FY 1999/00 and it raised to Rs 20496 million at FY 2007/08 again it decreased to 18 million. Where as external debt was Rs 11812 million in FY 1999/00 which decrease to Rs. 8205.41 million in FY 2008/09 .

External debt stated at Rs 8874 million in average during the study period where as internal debt was Rs11156 in average during the study period. During the period the data shows that initial period of the study the financing amount through internal debt was less then external debt and it became opposite in during since few last year. Internal debt was 31 percent in FY 1999/00 where as more then 66 percent borrowed by external sources. Overall, the average percent of internal debt has 44.63 and external debt has 38.27 percent.

The government growing reliance on internal loan for meeting the over increasing fiscal deficit. This also shows that during the last 10 years economic our economic performance has not been conducive enough to reduce growing reliance and internal loan. This situation has leaded us to think seriously.

Graphic Representation of Fiscal Deficit, Total Debt, Internal and External Debt

Figure no 4.3



4.4.4 **Trend of Government Borrowing and Growth Rate**

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 No 4.4

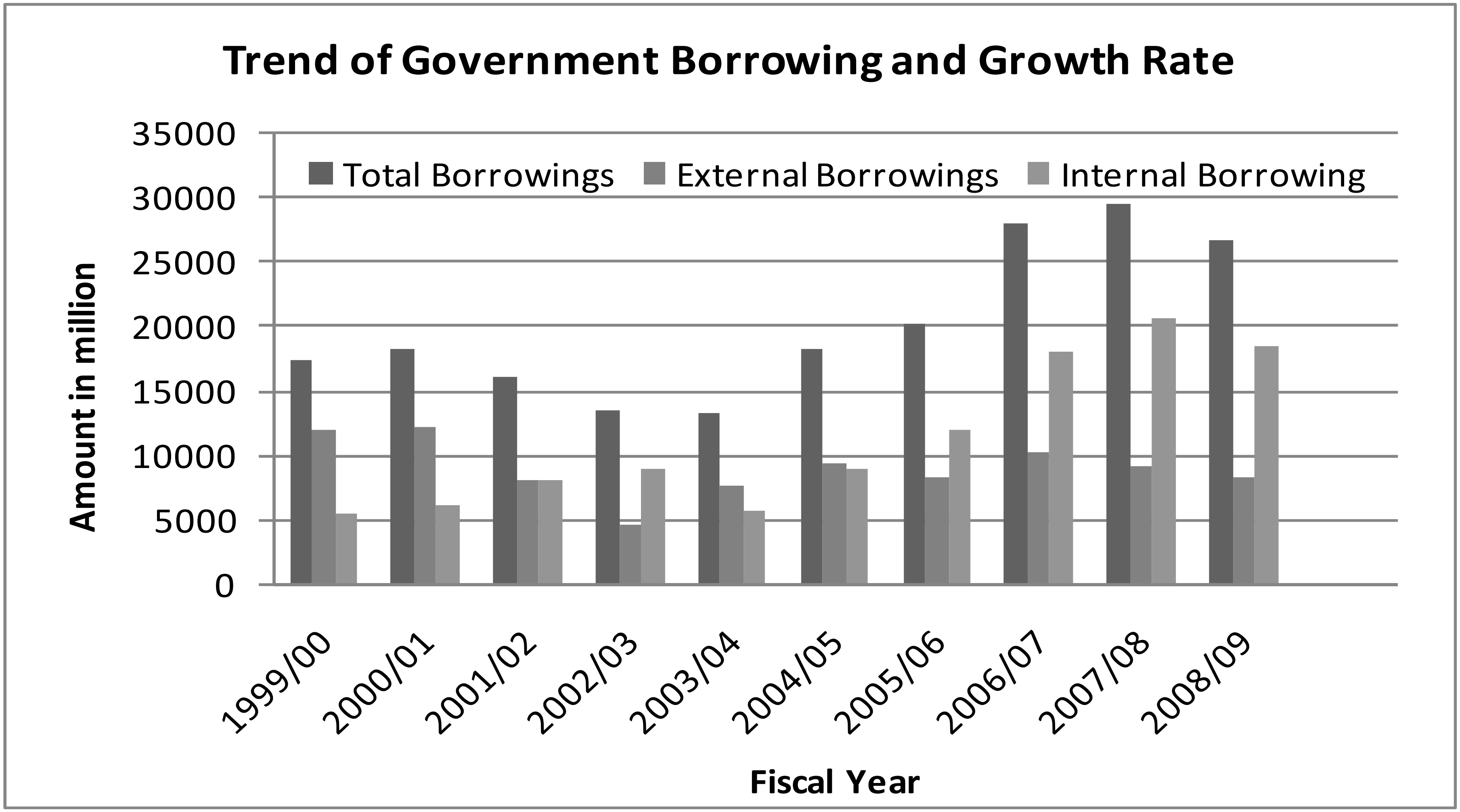
Trend of Government Borrowing and Growth Rate

Year	Total Borrowings	Annual Growth rate as %	External Borrowings	Annual Growth rate as %	Internal Borrowing	Annual Growth rate as %	% Shares of ED on TD	% Shares of ID on TD
99/00	17312	4.53	11812	-0.34	5500	16.77	68.23	31.77
00/01	18044	4.23	12040	1.93	6003.6	9.16	66.73	33.27
01/02	15999	-11.34	7998.7	-33.57	8000	33.25	50.00	50.00
02/03	13426	-16.08	4546.4	-43.16	8880	11.00	33.86	66.14
03/04	13237	-1.41	7629	67.80	5608	-36.85	57.63	42.37
04/05	18204	37.52	9266	21.46	8938	59.38	50.90	49.10
05/06	20048	10.13	8214	-11.35	11834	32.40	40.97	59.03
06/07	27946	39.39	10054	22.39	17892.3	51.19	35.98	64.02
07/08	29476	5.48	8979.9	-10.68	20496.4	14.55	30.46	69.54
08/09	26617	-9.70	8205.4	-8.62	18412	-10.17	30.83	69.17
Average		**6.28**		**0.59**		**18.07**	**46.56**	**53.44**

Source:- Budget speeches, Ministry of Finance, NG

Economic Survey, Ministry of Finance, NG 2004/2005, 2006/07 and 2008/09

Figure No 4.4



Trend of Government Borrowing and Growth Rate
Total Borrowings
External Borrowings
Internal Borrowing
Amount in million
35000
30000
25000
20000
15000
10000
5000
0
1999/00
2000/01
2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
Fiscal Year

The above table shows the annual growth of government is borrowing between the reviews period 1999/00 to 2008/09. The average annual growth rate of total borrowing is only 6.28%, that of external borrowing is only .59% and internal borrowing is 18.07%. External borrowing has been reducing to the great extent as per the government policy. External borrowing was Rest. 11812 million In fiscal year 1999/00, and it was increase following FY 2000/01 Rs. 12040 million after that the amount of external borrowing reduce until 2005/06 which is Rs 8214 million. It reduced up to Rs 8205 million in FY 2008/09. In case of internal borrowing, we can see fluctuating trend but it was increased compare with initial fiscal year of the study period. Which is Rs 5500 million in FY 1999/00 and it was increased up to Rs. 20496.4 million in FY 2007/08 and it decreased again to Rs 18412 million in FY 2008/09.

In percentage of growth rate of total debt is fluctuating trend. It was 4.53 percent of increase in FY 1999/00. It has seen the decreasing after FY 2000/01 and it continue until 2003/04. After that, it increased up to 39.39 percent in FY 2006/07. Where as if see the external borrowing growth rate that is only .59 percent in average during the study period and in the case of internal borrowing the average growth rate of during the study period is 18.07 percent.

Share of internal debt and external debt on total that was higher share of external borrowing in the initial period of the study and the end of the study period that seem opposite which 53.44 percent of internal borrowing in average during the study period and 45.56 percent of external borrowing in average.

4.4.5 **Growth Tendency of Domestic Resource Gap and Internal Borrowing**

The inability of curbing the increasing growth rate of regular expenditure has been a major cause of growing resource gap. The main cause for the significant increase in regular expenditure due to significant increase in debt service. Inevitable government employee's pay raise, association of the operating and maintenance costs of the complete projects under the regular budget, increasing expenditure in defense establishment etc.

Development expenditure has been increasing very significantly due to development activities in Nepal. This is turn resulted to larger increase in resource gap. The increase burden of public enterprises should be taken as another cause of widening resources gap in Nepal. Unnecessary bureaucratic control and over staffing under the political press one have been the major reasons for poor performance of public enterprises. Similarly, the rising in the price of good and services due to inflationary cause will lead to subsequent increase in the government expenditure in Nepal (MOF, 2008:31).

Domestic resource mobilization is an important factor in holding back the process of growth and improvement in living standard in the developing countries like Nepal. If the developing countries are to secure high and sustained rate of economic development, they have to mobilize more domestic resources to finance the request high level of investment. The government can mobilizes resources within the country mainly from two sources. One is by collection revenue and another is through internal borrowing. Curtailing the existing level of investment may also help in mobilizing the domestic resource.

Internal borrowing could be considered, as the attempt to cover the growing needs of domestic resource for the economic development of the country.

Internal borrowing have been adopted for financing domestic resource gap in Nepal. So, it is taken as the main source for financing domestic resource gap in Nepalese fiscal system. But, it should not forget that the internal debt could become an instrument of economic development only if the internal debt is used for productive purpose. So, increase in internal debt need not be discouraged so long as it helps in boosting up the productivity of the economy.

Internal borrowing is taken as the flexible method of accommodating budgeted deficit. It has been adopted as an instrument of resources mobilization by encouraging saving and investment potentiality of the country. Indeed for a resource deficit country, like Nepal, government borrowing can not be discouraged so long as it helps to boost up the productivity of the economy as well as saving of the community. Internal borrowing is expected to increase the productivity of the economy on the one hand and to channel lies the saving of the people for the development purpose on the other hand.

Cash balance is also taken as an appropriate tool to finance for the domestic resource gap in Nepal. If the collected resource from borrowing will not be sufficient to meet the domestic resource gap, government uses the cash balance to meet it. And if the collected resource from borrowing will be more then domestic resource gap, the extra resource remain as surplus. The contribution of internal borrowing and cash balance for the domestic resource gap is shown in the following table.

Table 4.5

Growth Tendency of Domestic Resource Gap and Internal Debt Financing

Amount in Million

Year	Deficit amount	External Borrowings	Domestic resource Gap	Internal Borrowing	Internal borrowing as % of DRG	Cash balance
1999/00	17667.6	11812.2	5855.4	5500	93.93	355.40
2000/01	24187.9	12040.4	12147.5	6003.6	49.42	6143.90
2001/02	22940.4	7998.7	14941.7	8000	53.54	6941.70
2002/03	16437.1	4546.4	11890.7	8880	74.68	3010.70
2003/04	15828.6	7629	8199.6	5608	68.39	2591.60
2004/05	28046	9266	18780	8938	47.59	9842.00
2005/06	24756.88	8214	16542.88	11834	71.54	4708.88
2006/07	31804.23	10053.52	21750.71	17892.3	82.26	3858.41
2007/08	33406.68	8979.88	24426.8	20496.4	83.91	3930.40
2008/09	26796.87	8205.41	18591.46	18412	99.03	179.46
Average					**72.43**	

Sources : Various Economy Survey .MOF/GOV.

Note:

Domestic Resource Gap = (TE - TR - Grants - External Loan)

Internal Debt as Percentage of Domestic Resources Gap=

$$\frac{\text{Internal Borrowing}}{\text{Domestic Resources Gap}} \times 100$$

Cash Balance = (Budgetary Deficit - External Borrowing - Internal Borrowing)

Negative cash balance shows the surplus

Table 4.5 shows the domestic resource gap and financed by internal borrowing, in fiscal year 1999/00, the amount of domestic resource gap was Rs. 588.5 million that was 93.93 percent financial by rising internal borrowing. similarly, a fiscal year 2200/00, the amount was of domestic resource gap was Rs 12147.5 and internally financed 49.42 percent. Among the review period, the maximum percentage of financing from internal borrowing in fiscal year 2008/09 where 18412 million finance by internal borrowing, when the domestic resource gap was Rs. 18591.46 million. In this year internal debt was 99.03 percent of domestic resource gap. Similarly, the minimum percentage of financing from internal debt in fiscal year 2004/05, where Rs. 8938 million financed by rising internal debt when the domestic resource gap was Rs.18780 million. In this year the internal debt was 47.59 percent of domestic resource gap.

The average contribution of the internal debt to the domestic resource gap during the period under review has been 72.43 percent per annum.

4.4.6 Government Revenue and Internal Debt Servicing

Annual revenue consists of tax and non – tax both from of revenue. Debt servicing depends on the plenty of annual revenue. Annual revenue is the main constraint for debt servicing.

Table no 4.6

Government Revenue and Internal Debt Servicing

Year	Annual Revenue	Internal Debt Servicing	Internal Debt Servicing X 100 / Annual Revenue
1999/00	42893.7	4,712.60	10.99
2000/01	48893.7	4,186.99	21.08
2001/02	50445.5	5,437.80	10.78
2002/03	56229.8	8,663.40	15.41
2003/04	62331	9,431.20	15.13
2004/05	70123	11,651.30	16.62
2005/06	72282	11,272.10	15.59
2006/07	87712	13,321.78	15.19
2007/08	107622.48	12,845.87	11.94
2008/09	143310	14,494.40	10.11
Average			**14.28**

Source:- Budget speeches, Ministry of Finance, NG

Economic Survey, Ministry of Finance, NG 2004/2005, 2006/07 and 2008/09

The above table 4.6 shows the portion of annual debt servicing in the annual revenue. Due to the low annual revenue, it is constrained to repay the internal debt.

The above table shows that 10.99% of annual revenue has been spent for repayment of internal debt in the year 1999/00 and 21.08%, 10.78%, 15.41% , respectively FY 2000/001 to 2002/03. Likewise in FY 2003/04 this percentage is 15.13% and 16.62% , 15.59%, 15.19%, 11.94%, 10.11% in FY 2004/05 to 2008/09 respectively. On average, 14.28% of total revenue has been repaid for internal borrowing reduction during the study period.

Due to the diversified requirements of the government to be fulfilled by the annual revenue of the country debt-servicing rate has been low. That is why the outstanding internal debt is increasing every year.

4.4.7 Trend of Government Expenditure, GDP and Internal Debt Servicing

The universally expected norm regarding utilization of public debt is related to its burden on the economy and the productive capacity created by investing borrowed funds. In this context, it is appropriate to analysis the internal debt servicing situation in relation to government expenditure, and GDP.

Table no 4.7

Trend of Government Expenditure, GDP and Internal Debt Servicing

Fiscal Year	Total Expenditure	GDP	Internal Debt Servicing	IDS as % of GE	IDS as % of GDP
1999/00	66273	366251	4,712.60	7.11	1.29
2000/01	79835	394052	4,186.99	5.24	1.06
2001/02	80072	406138	5,437.80	6.79	1.34
2002/03	84006	437546	8,663.40	10.31	1.98
2003/04	89443	474129	9,431.20	10.54	1.99
2004/05	102560	474919	11,651.30	11.36	2.45
2005/06	110846.78	508657	11,272.10	10.17	2.22
2006/07	133353.73	509911	13,321.78	9.99	2.61
2007/08	161349.89	522660	12,845.87	7.96	2.46
2008/09	204677.3	689127	14,494.40	7.08	2.10
			Average	**8.66**	**1.95**

Source : Various Economic Survey

The table No. 4.7 reveals the internal debt servicing situation from the period 1999/00 to 2008/09. The table reveals that the total internal debt servicing amount was 4,712.60 million in 1999/00 which has increased to Rs. 14494.40 million in 2008/09. The share of internal debt servicing in total expenditure was 7.11 percent in 1999/00 which was reduce up to 7.08 percent in 2008/09 maintaining annual percentage share of 8.66 percent over the period under review. This reducing proportion of internal debt servicing to total expenditure is shown performance of internal debt. The growing trend in its proportion to total expenditure might be create tremendous burden on the budgetary allocation of resources of government in the long run. If appropriate and conducive policies is not formulated for proper and effective utilization of internally borrowed fund. It is also appropriate to compare the amount of internal debt servicing as percent of GDP. In the fiscal year 1999/00. The internal debt servicing was only 1.29 percent of GDP but gradually showing its increasing trend it has reached 1.95 percent on average during the 10 year study period.

4.4.8 Relationship between Internal Borrowing and Inflation

Total internal borrowing is the composition of real and unreal borrowing real borrowing means the borrowing from the non-banking sector including private sector and individuals sector unreal borrowing means the borrowing from the banking sector i.e. Nepal Rastra Bank and Commercial Bank. Real borrow reduces the supply of money and checks inflation, because it collect the saving amount of non-banking sector including private sector and individuals. When individuals purchase government security, the fund will be diverted from private use to government use. Individual may be able to subscribe to government securities either through curtailment of current consumption needs or through diversion of fund from their own business or diverting fund into government securities from corporate securities. Non-banking financial institution prefers government securities because of the security provided by the latter and due to their high negotiability and liquidity. However, unreal borrowing carries the inflationary nature as it collects the saving of banking sector. Commercial Bank take up government securities by creating additional purchasing power known as credit creation. Whenever the banking system has, excess cash reserve it absorbers an amount of government securities considerably greater then the excess cash reserve.

The center bank of the country also subscribes to government loan. The action is exactly similar to the system of creation of additional purchasing power by the commercial banking system. By purchasing government securities, the central bank credits the account of the government. It will be seen that borrowing from the central bank is the most expansionary of all the sources for not only the government secures funds for its expenditure, but also the commercial bank system get additional cash, which can be used as the basis for further credit expansion. So, real and unreal borrowing should be used as per the need of the economy. If the unreal borrowing increases then real borrowing the state has to face with inflation problem.

Table No 4.8

Annual Growth Rate of Internal Debt and Growth Rate of Inflation

Year	Internal Borrowing	Annual Growth Rate of Borrowing	Inflation
1999/00	5500	16.77	3.5
2000/01	6003.6	9.16	2.4
2001/02	8000	33.25	2.9
2002/03	8880	11.00	5.0
2003/04	5608	-36.85	4.0
2004/05	8938	59.38	5.2
2005/06	11834	32.40	8.0
2006/07	17892.3	51.19	6.4
2007/08	20496.4	14.55	7.7
2008/09	18412	-10.17	13.2
Average		**18.07**	**5.30**

Source : Various economic Survey of MOF, 2004/05, 2006/07, 2008/09

From the above table we can see internal growth rate and growth rate of inflation. Where the average growth rate of internal debt financing is 18.07 during the study period. And average growth rate of inflation is stated at 5.30 percent during the study period .

Table no 4.9
Correlation Co-efficient Between Internal Borrowing and Inflation

Year	Annual growth rate(X)	Annual Inflation (Y)	XY	X^2	Y^2
1999/00	16.77	3.5	58.70	281.33	12.25
2000/01	9.16	2.4	21.98	83.84	5.76
2001/02	33.25	2.9	96.43	1105.79	8.41
2002/03	11.00	5.0	55.00	121.00	25.00
2003/04	-36.85	4.0	-147.39	1357.69	16.00
2004/05	59.38	5.2	308.77	3525.92	27.04
2005/06	32.40	8.0	259.21	1049.82	64.00
2006/07	51.19	6.4	327.64	2620.83	40.96
2007/08	14.55	7.7	112.07	211.83	59.29
2008/09	-10.17	13.2	-134.24	103.42	174.24
	∑X =180.69	**∑Y= 58.30**	**∑XY= 958.18**	**$\sum X^2$= 10461.46**	**$\sum Y^2$= 432.95**

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

$N\sum XY$	9,581.80
$(\sum X)(\sum Y)$	10,534.227
$N\sum X^2$	104,614.60
$(\sum X)^2$	32,648.87
$N\sum Y^2$	4,329.60
$(\sum Y)^2$	3,398.89
$N\sum X^2-(\sum X)^2$	71,965.73
$N\sum Y^2-(\sum Y)^2$	930.60
$N\sum XY-(\sum X)(\sum Y)$	-952.427
$\sqrt{N\sum X^2-(\sum X)^2}\ \sqrt{N\sum Y^2-(\sum Y)^2}$	8,183.644
	-.0116

r_{XY} = -0.116

r_{XY} = -11.6%

Here, the correlation coefficient between the internal borrowing and inflation shows the low degree of Negative correlation. It reveals that the movement of internal borrowing and inflation will be in opposite direction. If the internal borrowing increase inflation will be decreased and if internal borrowing decrease the inflation will be increased. Therefore, to control inflation internal borrowing should be increases.

4.5 Internal Outstanding Debt

The outstanding debt to be paid is increasing each year because of the ever-widening financial resource gap of the government to be bridged. On the one hand there is ever increasing trend of financial resource gap which needs large amount of loans and on the other hand, there is low amount of repayment as compared with internal borrowing by issuing treasury bills, development bonds, National Bonds and Special bonds.

4.5.1 Pattern of Internal Net Outstanding

There is few type of internal debt source. Treasury bills, development bonds, national bonds, citizen saving bonds and special Bonds. Here the table shows the pattern of internal net outstanding debt.

Table No 4.10

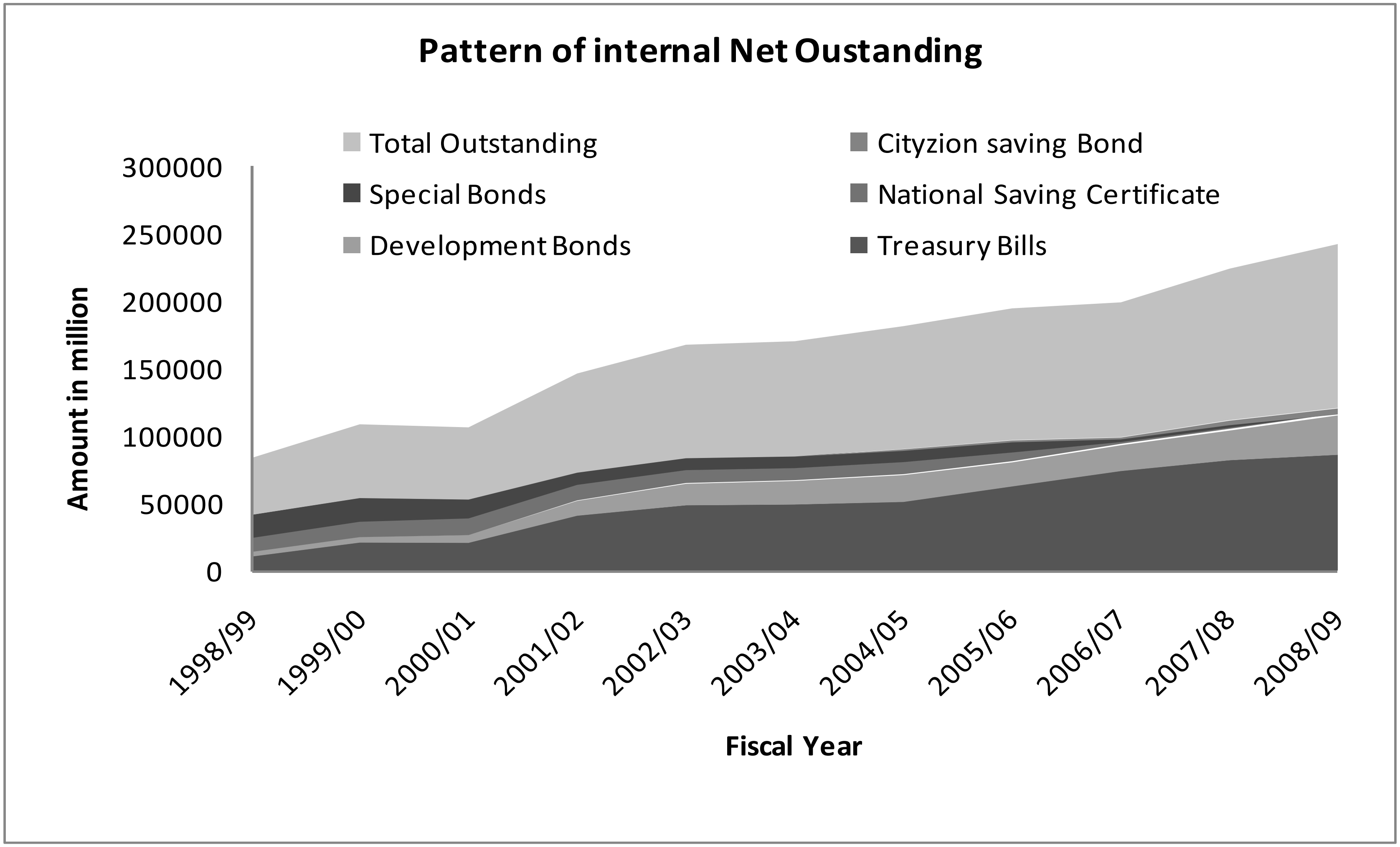
Pattern of Internal Net Outstanding

Rs in Million

year	Treasury Bills	Development Bonds	National Saving Certificate	Special Bonds	Citizen saving Bond	Total Outstanding	Annual % Increase
1999/00	21027	4262.2	11526.5	17541.3	NA	54357	29.73%
2000/01	20810.8	5962.2	12476.4	13994.3	NA	53243.7	-2.05%
2001/02	41106.5	11090.4	11636.1	9259.3	NA	73092.3	37.28%
2002/03	48860.7	16052.2	9629.8	9164.5	NA	83707.2	14.52%
2003/04	49429.6	17549.2	9029.8	8946.2	NA	84954.8	1.49%
2004/05	51383.1	19999.2	9029.8	8946.2	1178.9	90537.2	6.57%
2005/06	62970	17959.2	6576.8	8176.3	1429.9	97112.2	7.26%
2006/07	74445.3	19177.1	1516.9	2773.5	1391	99303.8	2.26%
2007/08	82460	22150	1150	2653	3350	111763	12.55%
2008/09	86515	29478.5	216.9	229.62	4433.64	120873.66	8.15%
Average Annual Growth Rate							**12.69**

Sources: Various Economic Survey , 2004/05/, 2008/09

Fig No. 4.5



Pattern of internal Net Oustanding
Total Outstanding
Cityzion saving Bond
Special Bonds
National Saving Certificate
Development Bonds
Treasury Bills
300000
250000
200000
150000
100000
50000
0
Amount in million
1998/99
1999/00
2000/01
2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
Fiscal Year

The pattern or structure of outstanding internal debt is shown on the above table 9 for the study between 1999/00 to 2008/09. The internal debt of Nepal consists of treasury bills, development bonds, national saving certificate and special bonds. Citizen Saving Bond started in FY2008/09 and National Saving Certificate and Special Bond about to end during the end of the study period.

Such an increasing trend of internal borrowing indicates that the role of domestic borrowing for resource mobilization is increasing in the absence of the growth in revenue collection in proportion to the growth in the expenditure.

4.5.2 Ownership Structure of Internal Net Outstanding

Various types of Government bonds are issued to raise the internal debt. For this purpose, Government of Nepal, has issue many kind of bonds in the market. In Nepalese Context, government has issued treasure bills, National Saving Certificate, development bonds, Special bonds. Until last five years bank, government has a target to raise loans from the banking and non-banking sectors. Now such targets have been waived out. During those periods, treasury bills and development bonds were used to borrow form the banking system where as national saving certificates was used to borrow form the non-banking system is different. Borrowing form the banking system may have credit crunch in the economy but such effects will not happen if the funds are borrowed from the hands of public.

The pattern of ownership of government bonds is changing over the years. However, the Nepal Rastra Bank is trying to dispose its bond holding in the market, it has been able to achieved partial success in this regard. It will also be worthwhile to mention here that, NRB needs to holds the government bonds for many purposes. NRB needs to hold the government securities for monetary policy implementation for which treasury bills are used. On the other hand, some times it becomes necessary to the central bank to buy the bonds due to under-subscription by the market in the primary issue. Another component is secondary market operation of government bonds. In this process government bills and bonds are purchased by NRB form the market makers and performing REPO trade. This type of holding can be considered as investment portfolio. The other event is securitization of government overdraft taken form NRB.

Generally, the monetary policy is executed through open market operation (OMO. For this NRB uses to buy and sale of Government Treasury Bills. On the other hand, NRB is also holding Special bonds that have been accumulated through securitization of government overdrafts in the past and this type of bonds are in low interest with limited marketability. Especially the holding of these types of non-marketable bonds have not contribution to off-loading effort of NRB.(Khabar Patra-2008)

Table 4.11

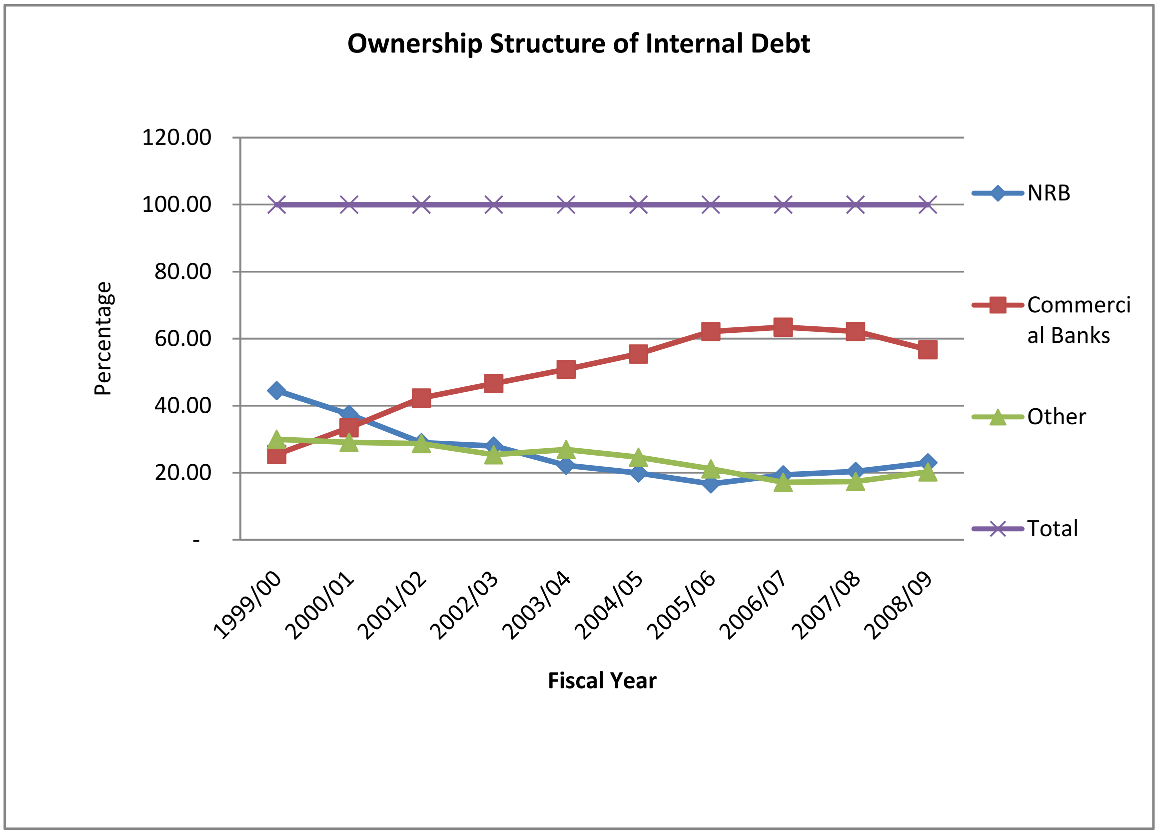
Ownership Structure of Internal Net Outstanding

Rs. In million

Fiscal Year	NRB Holding %	Commercial Banks Holding %	Other Holding %	Total
1999/00	44.53	25.49	29.99	100.00
2000/01	37.46	33.44	29.10	100.00
2001/02	28.98	42.29	28.73	100.00
2002/03	27.98	46.63	25.39	100.00
2003/04	22.22	50.85	26.93	100.00
2004/05	19.92	55.45	24.63	100.00
2005/06	16.69	62.15	21.16	100.00
2006/07	19.37	63.44	17.19	100.00
2007/08	20.41	62.17	17.42	100.00
2008/09	22.98	56.73	20.29	100.00

Source:- Economic Survey, Ministry of Finance, NG 2008/09

Fig No : 4.6



The above table 4.11 shows the owner structure of internal debt. From the above table we can say the trend of NRB holding of internal debt is decreasing year by year. The holding percentage by NRB is 44.53 in FY 1999/00. Which is decreased to 22.98 percentage in 2008/09. Commercial Banks holding percentage on internal debt is increasing trend which is 25.49 percentage in 1999/00 and it gows to 56.73 percentage in year 2008/09. Other financial institute and individual were holding only 29.90 percentage in year 1999/00 and it also decreased to 20.29 percentage in year 2008/09. Here the owernership pattern shown significantly increasing trend in commercial banks holding and decreasing of NRB and other financial institute and individual holding.

4.5.3 Total Outstanding Debt and Gross Domestic Product

The outstanding debt of the government is increasing very fast. The repayment of the debt will be ultimately affected by the national income of the country. The analysis of total outstanding debt and its ratio to the gross domestic product (GDP) has been made here with the help of following table.

Table 4.12
Total Outstanding Debt and GDP

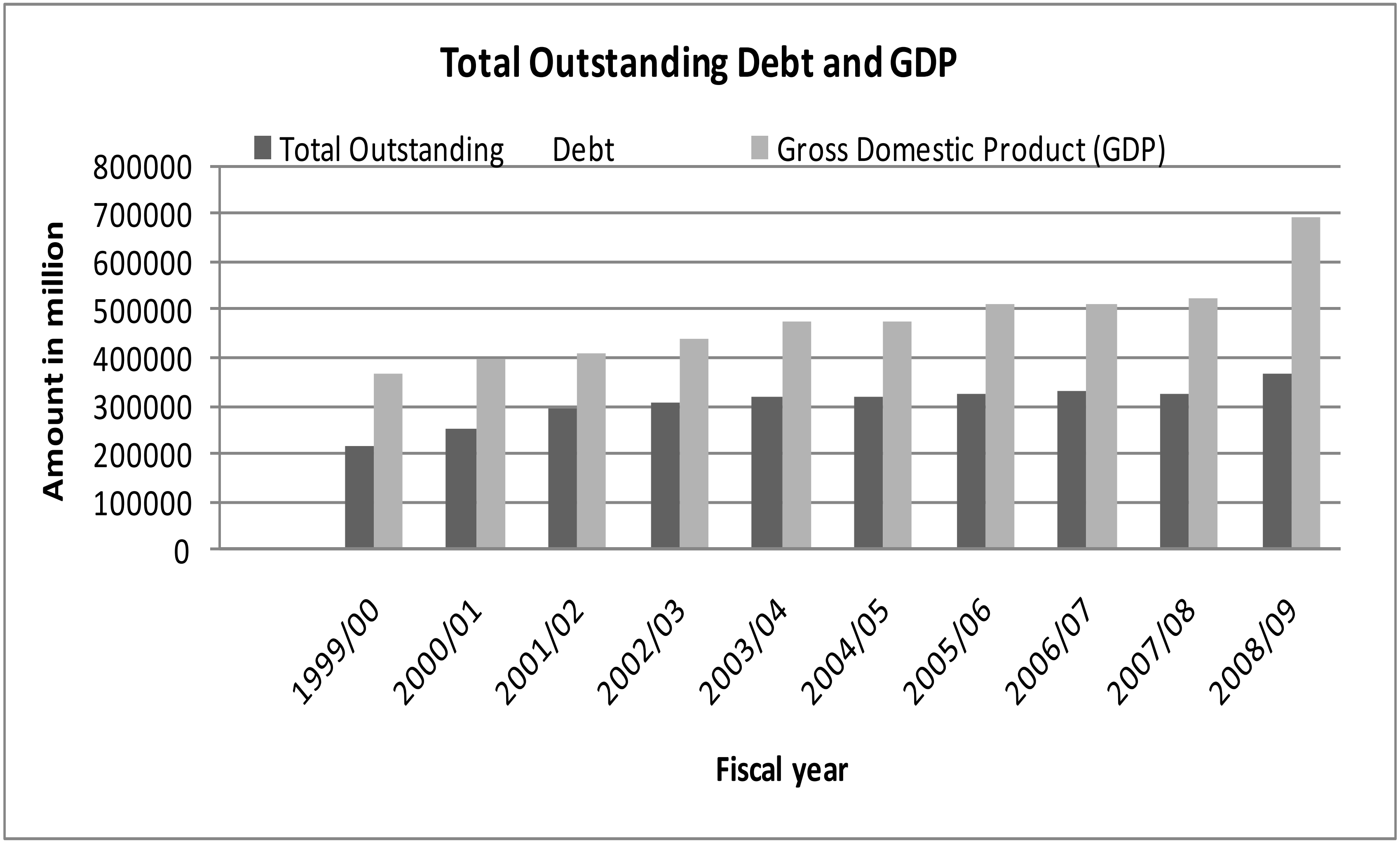
Rs. In million

year	Total Outstanding Debt	Gross Domestic Product (GDP)	$\frac{\text{Total Debt}}{\text{GDP}} \times 100$
1999/00	215048.2	366251	58.72
2000/01	253648.1	394052	64.37
2001/02	293217.9	406138	72.20
2002/03	307147.4	437546	70.20
2003/04	317734.1	474129	67.01
2004/05	320157.8	474919	67.41
2005/06	326560.9	508657	64.20
2006/07	333092.1	509911	65.32
2007/08	325092.10	522660	65.00
2008/09	366549	689127	62.22

Source:- Budget speeches, Ministry of Finance, NG

Economic Survey, Ministry of Finance, NG 2004/2005, 2006/67 and 2008/09

Fig No. 4.7


Total Outstanding Debt and GDP
Total Outstanding Debt
Gross Domestic Product (GDP)
Amount in million
800000
700000
600000
500000
400000
300000
200000
100000
0
1999/00
2000/01
2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
Fiscal year

The above table 4.12 shows the ratio between total debt outstanding of the government and Gross Domestic Product from the year 1999/00 to the fiscal year 2008/09. Here, total debt consists of internal and external both types of loans.

The above table is indicates towards the fact that the portion of national debt is increasing every year as the GDP of the country. The ratio between the total debt and GDP is 69.56% in the year 1999/00, 58.72% in 2000/01, 64.37. This raise up to 72.20% in 2001/02 which is the greater one and finally it comes to 62.22% in the year 2008/09.

4.5.4 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.4.13

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
2000	5500	-4	-22000	1959.35	3540.65	280.71	16
2001	6003.6	-3	-18010.8	4258.62	1744.98	140.98	9
2002	8000	-2	-16000	6557.89	1442.11	121.99	4
2003	8880	-1	-8880	8857.16	22.84	100.26	1
2004	5608	0	0	11156.43	-5548.4	50.27	0
2005	8938	1	8938	13455.7	-4517.7	66.43	1
2006	11834	2	23668	15754.97	-3921	75.11	4
2007	17892.3	3	53676.9	18054.24	-161.94	99.10	9
2008	20496.4	4	81985.6	20353.51	142.89	100.70	16
2009	18412	5	92060	22652.78	-4240.8	81.28	25
	∑Y/n= 11156.43		∑xy = 195437.70				∑x2=85

The formula used for the purpose is:

$Yc = a + bx$ $\qquad$ $b = \frac{\sum xy}{\sum x2}$

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

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 12 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. In Year 2000 when actual amount is Rs. 5500 million, the estimation is Rs. 1959.35 million that creates the variations of 3540.65 and 2001 to 2002 the trend of internal debt over the estimation line. We can see that estimated trend line from 2000 to 2003 is at above internal debt. We can see there in year 2004 and then with our year 2008 other year internal debt is under the estimation line. Thus 218.71%, 140.98% 121.99%, 100.26%, in 50.27%, 2000 to 2004 respectively. 67.43% in 2005, 75.11% in 2006, 99.10% in 2007, 100.70% in 2008, 81.28% in 2009 clarify the trend of internal borrowing is in fluctuating trend in comparison with estimated line

4.5.5 Cost of Internal Borrowing

Nepal is counting as poor economy country in the world. There are many political problems the expenditure of government increasing year by year and revenue is not increasing sufficiently to full fill the budgetary deficit. Government collects loan form internal source and external source. If we see, the data of repayment of loan is very low. When the government collects debt from different source different types of cost should bear government.

Types of cost:

- Interest amount on bond
- Discount amount of bond
- Commission to market maker of CSB
- Commission on commercial banks on CBS interest payment.
- Management cost paid to NRB.

Table no: 4.14

Annual Payment of Principle and Interest of Internal Debt

Rs in million

Fiscal year	Total internal net outstanding for the year	Principal payment for the year	Total principal amount	Interest payment for the year	Cost of internal debt
1999/00	54,357.00	1,532.80	55,889.80	3,179.80	5.69%
2000/01	53,243.70	1,190.00	54,433.70	2,996.99	5.51%
2001/02	73,092.30	1,683.60	74,775.90	3,754.20	5.02%
2002/03	83,707.20	4,063.30	87,770.50	4,600.10	5.24%
2003/04	84,954.80	5,029.10	89,983.90	4,402.10	4.89%
2004/05	90,537.20	7,580.10	98,117.30	4,071.20	4.15%
2005/06	97,112.20	7,277.30	104,389.50	3,994.80	3.83%
2006/07	99,303.80	9,213.50	108,517.30	4,108.28	3.79%
2007/08	111,763.00	8,617.50	120,380.50	4,228.37	3.51%
2008/09	120,873.66	8,713.90	129,587.56	5,780.50	4.46%
Average	**86,894.49**	**5,490.11**	**92,384.60**	**4,111.63**	**4.45%**

Source : Economic Survey, Ministry of Finance, NG 2008/09

Note: The government report clearly not showing the other cost paid against the debt. So, interest paid by government only calculated as cost of debt.

The above table 4.14 shows the cost of internal debt is 5.69% with out other cost in FY 1999/00. It was 5.51% in FY 2000/01 and 5.02%, 5.24%, 4.89%, 4.15% in FY 2001/02 to 2004/05 respectively. Again it decreased to

3.83%, in FY 2005/06 and it continued up to 3.51% in FY 2007/08. Last period of study period, it breaks the decreasing trend and goes to 4.45%.

The government should bear commission and other management cost yearly. Therefore, the cost of internal debt is show high and it dangerous for the government.

4.5.6 Internal Outstanding Debt and Its Servicing

The annual growth rate of internal as well as external debt increasing every year, but the servicing of debt has been difficult due to the low annual revenue of the country. Here, annual growth rate of internal borrowing, its annual growth rate and its servicing has been shown in the below presented table.

Table no 4.15

Internal Outstanding Debt and Its Servicing

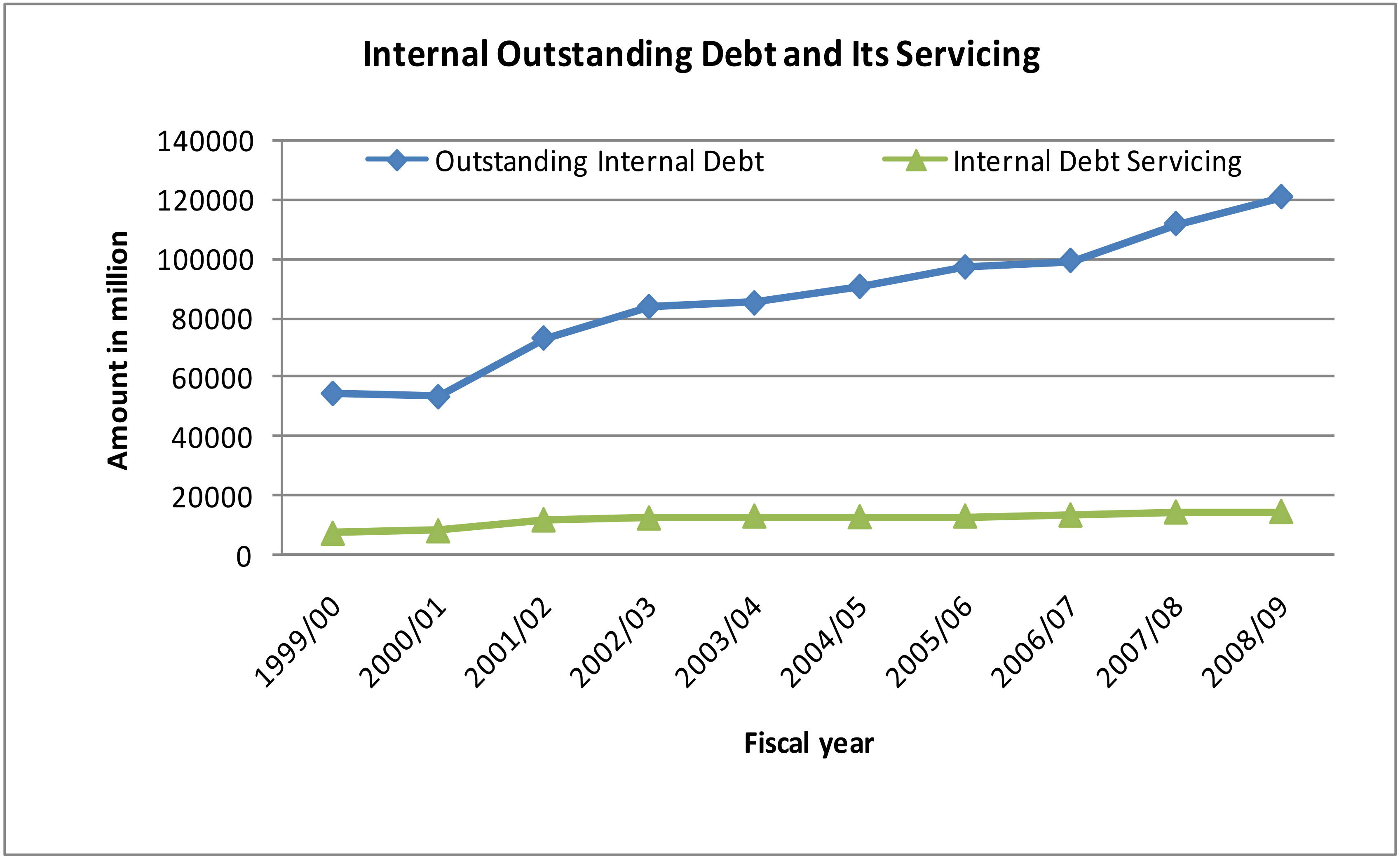
Rs in Million

Year	Outstanding Internal Debt	Annual Growth Rate	Internal Debt Servicing	Internal Debt Servicing x 100 Outstanding Internal Debt
1999/00	54357	29.73	7282.3	13.4
2000/01	53243.7	-2.05	8113.3	15.24
2001/02	73092.3	37.28	11848.6	16.21
2002/03	83714.2	14.53	12501.9	14.93
2003/04	84954.8	1.48	13142.2	15.47
2004/05	90537.2	6.57	12898.3	14.25
2005/06	97112.2	7.26	13151	13.54
2006/07	99303.8	2.26	13517	13.61
2007/08	111763	12.54	14531.1	13
2008/09	120873.66	8.15	14710	12.17
Average		**11.77**		**14.18**

Source:- Budget speeches, Ministry of Finance, NG

Economic Survey, Ministry of Finance, NG 2004/2005, 2006/07, 2008/09

Figure no 4.8


Internal Outstanding Debt and Its Servicing
Outstanding Internal Debt
Internal Debt Servicing
Amount in million
140000
120000
100000
80000
60000
40000
20000
0
1999/00
2000/01
2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
Fiscal year

The above table 4.15 shows the trend of annual growth of outstanding internal debt, internal servicing, and debt servicing (repayment) percentage in outstanding internal debt for the year.

The above table indicates the facts that the internal outstanding debt of the country is in the increasing trend, but the rate of growth is not same. It has the greater variability in growth rate of internal debt outstanding. It is 13.4% in the year 1999/00, Decreased by 2.05% (53243.7M) in the year 2000/01. It is seen from table that the higher growth occurred in the year 2001/02, i.e. 37.28% and the average growth rate of the outstanding internal debt is 11.77%.

The debt servicing (repayment) also the increase in outstanding debt. Debt servicing of internal debt is Rs. 7282.3 million in 1999/00, which reached to Rs. 14710 million in 2008/09. However, the percentage of debt servicing out of outstanding for the year, is very lower i.e. 12.17% in 2008/09. The highest percentage of debt servicing out of outstanding is in the year 2001/02, i.e.16.21%.

The government repays the loan both external and internal but the share of internal debt servicing in total debt servicing has been greater than that of external debt servicing. However, the grave challenge before the government regarding internal debt is due to the following reasons:-

- The stock of debt is of a short-term nature.
- Even the debt of large maturity period has now come to a stage of redemption.
- The interest rate on such debt is high for some of the debt.

4.6 Adjustment of Total Borrowing to Government Deficit

The government deficit derivates when total expenditure exceeds the total revenue of the government. Peace process of Nepal still not is end process so the unstable government and expending only operational work Nepal government facing always budgetary problem. 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.

4.7 Problems and Prospects of Government Debt in Nepal

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.

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.

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.

4.8 Major Findings

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 is not sufficient. The annual revenue of the government does not cover even the regular expenditures alone.

From the analysis of data collected from various secondary sources. Following findings can be made.

- Nepal is passing through a critical phase of inadequate mobilization of internal sources, thus managing public finance has been challenging proportional. Because of this extreme situation, fiscal deficit is widening day by day. Despite the control in expenditure, the average annual growth rate of total expenditure and the revenue collection remained at 13.43 percent 14.74 percent respectively over the period 1999/00 to 2008/09.

- The proportion of fiscal deficit is 7.71 percent in average and average grand on resource is depend increasing grant financing on government budget is 38.87% in average during the 10 years period.

- The proportional of internal debt of fiscal deficit has increased from 31.13 percent in 1999/00 to 68.71 percent in 2008/09. The proportion of external debt to fiscal deficit has decreased from 66.86 percent in 1999/00 to 30.62 percent in 2008/09.

- The percentage share of external debt to total debt has 68.23 percent and the percentage share of internal debt to total debt has 31.77 percent in the fiscal year 1999/00 but in fiscal year 2008/09 30.83 and 69.17 percent respectively. This shows the dependency upon foreign assistance is gradually decreasing. Similarly, total debt has increased from Rs. 17312 million to Rs. 26627 million during the review period. Over the period internal debt increased with significant percentage. This indicates that internal debt has increased more rapidly then external debt during the review period.

- The percentage share of internal debt with domestic resource gap is stated from 47 to 99% during the study period, it has increased with average 72.43 percent.

- The proportion of the internal debt-servicing amount to government revenue in the year 1999/00 was 16.98 percent, it was increase to 23.49 percent in the year 2001/02, and it decreased to 10.26 percent. In average, it stated at 18.06 percent during the study period.

- The proportion of internal debt servicing in total expenditure was 7.11 percent in 1999/00, which was decrease to 7.08 percent in 2008/09 maintaining annual average share of 8.66 percent over the period under review. This reducing proportion of internal debt servicing to total expenditure is shown performance of internal debt. In the fiscal year 1999/00, the internal debt servicing was only 1.29 percent GDP but gradually showing its increasing trend it has reached 2.10 percent in2008/09 and it stated at 1.95 percent during the study period.

- The growth rate of internal borrowing stated at 18.07 percent where as inflation rate was 5.30 percent during the study period.

- The correlation coefficient between internal borrowing and infatuation shows the low degree of negative correlation. If shows that relation between internal borrowing and infatuation is negative. Therefore, to control inflation internal borrowing should be increase.

- The government has borrowing public fund through the different type of government securities to meet the deficit budget of the country. Treasury bills development bond, national saving bond, special bond and citizen saving certificate from Nepal Rastra Bank are the major instruments to borrow or to called the internal public debt.

- During the 10 year (1999/00 to 2008/09) the government borrow Rs. 549594 million from treasury bills (highest among the different instruments. Similarly the government borrow the Rs. 167482 million, Rs. 83215 million, Rs. 98768 million and Rs. 11783 million through the development bond, National saving bond, special bond and citizen saving certificate respectively.

- The issuance of total government securities is in increasing trend. The earn show the upward sloping from the beginning of studies period.

- The annual average growth rate of outstanding debt is 11.77%, the ratio of total outstanding debt to gross domestic product (GDP) shows the burden of total debt to the nation.

- The servicing rate of internal outstanding internal 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 analysis of internal debt repayment out of annual revenue has shown in the table 4.6. The percentage of internal debt out of annual revenue is 10.99% in 1999/00, this trend comes to 10.26% in 2008/09. On average, this ratio is 14.28%. 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.

Chapter – V

SUMMARY, CONCLUSION AND RECOMMENDATION

In this chapter, tries to summarize, conclude and provide recommendation covered on the overall study.

5.1 Summary

Almost all developing countries have adopted government budgetary system as tool is accelerating the pace of economic growth. This is considered essential to raise the standard of living of the majority of people at the shortest possible time. The process of government budgetary system was initial in Nepal with down of democracy in 1951. Nepal has a long history of deficit budgetary system. The first budget 1951 of Nepal was the deficit budget. Since the first budget, each and every budget shown the deficit, till now.

Nepal is facing the problem of financing ever-increasing resource gap because government expenditure is increasing rapidly, easier but government revenue s not increasing in the same pace. The widening resource gap in resent year has been cumulative effect of the deficiencies in the investment areas and the continued absence of government's fiscal norms.

For the developing country like Nepal, the external and internal borrowing increasing more. Increasing trend of internal financing, debt-servicing obligations are also increasing rapidly but debt-servicing capacity of the country has not been increasing with the same pace.

Nepal is in early stage of development, the widening resource gap itself would not have been a matter of serious concern, if it was related to growth and investment leading to capacity expansion in the economy but the situation has been quite adverse and so Nepal facing the problem ever increasing financial resource gap. So, It is necessary, to know the condition and trend of internal debt as a major source of finance for development activities. This study is attempting to investigate role of internal debt in Nepal.

A brief historical perspective has also been taken in to consideration while studding internal debt and its proportion with fiscal deficit, total debt, GDP, Revenue, expenditure, etc, since the fiscal year 2008/09.

The annual income of the Nepali economy is not sufficient fulfilling the need of resource on budget. The internal and external debt is major resource to fulfill the gap. The external assistance (loan and Grants) play all obvious function in the development force for financial resources. Concerning foreign assistance, grants have big role to play in salving the resources gap in the country's budgetary expenditure.

Several researches have been conducted on the issue of government securities, practice and perception of the investors. The results of this study have revealed that the public borrowing is growing rapidly. In the government borrowing , the internal debt covers the significant portion at present. The annual average growth rate of internal net outstanding debt is 12.69 percent; the ratio of total outstanding debt to gross domestic product (GDP) shows the burden of total debt to the nation.

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.

5.2 Conclusion

Internal financing has played a significant role in the financial resource for developing expenditure as well as in the growth of money and capital market and it facilities the effective implementation of monitory policy. Internal financing is one of the best ways of financial, which people to control infatuation and to mobilize the internal financial resources in the productive sector of the country's economy. If exceeds the maximum legal limit of internal borrowing increase the state has to face inflation problem. So internal borrowing should be used as per the need of the economy.

Internal debt is not utilizing effectively in Nepal because it is not contributing to increase productivity in the economy. The internal debt is increasing then the external debt but inflation is still growing it shows that the involvement in private sector is less to government securities. The increasing rate of national income and GDP is lower then the rate of increase in internal debt. Internal borrowing and debt servicing obligation are increasing trend but debt servicing capacity of the country has not been increase with the same space. During the review period, average annual growth rate of revenue is low as compared with the debt and debt servicing obligation. This shows our debt servicing capacity is very poor to sustain increasing debt servicing obligation.

Because of insufficient revenue resources to meet the deficit budget, lack of regular commitment of foreign and donor agencies on development of the country, it can be assumed that the growth of internal debt in Nepal in coming year will be increased in same space.

5.3 Recommendations

On the basic of the findings of this study, following recommendations has been made: -

I. 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 revenue collection need to make more board and simplified policy and tax administration are also necessary for reducing the volume of borrowing from internal and external sources.

II. 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 unutilized creating additional burden of debt servicing.

III. It is the compulsion rather than more need of the Nepal Government 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. This may provide benefits for longer period. This will reduce the burden of debt in the long run.

IV. The internal borrowing for short – term should be minimized and long – term borrowing has to prioritize more. The government should try to maximize the mobilization of internal resources for development purposes, excessive dependency upon foreign assistance for development program should be reduced, and it should be confined to the desired extent. The cost of debt should reduce by issuing the long – term debt.

V. Investment is an important factor increasing the growth rate of production. Investment cannot grow without rate increase in saving. This increase in saving is a must for increasing investment. In order to raise the present saving rate of GDP, it is necessary to create favorable environment. There is also increasing investment domestic saving gaps since investment growth rate and saving growth rate are not in the same space. Thus there is need to reduce such gap by increasing the rate of total domestic saving.

VI. The government should try to get grants amounts more and more as for as possible. The government also should maintain such an external policy. So that more of grants should be received rather than loans. The main reason for increasing the government expenditure and increasing external borrowing in the investment in economic and social infrastructure development.

VII. Large proportion of internal borrowing comes form banking sector particularly from the central bank, which is expansionary therefore this aspect of internal borrowing is to be kept within limitation.

VIII. The requirement of public debt in coming years seems more vital then previous year. Internal debt more comfortable then the external borrowing for the nation. Hence more focus should be given as internal borrowing rather then the external borrowing.

IX. Borrowing from banking sector must be minimized since it is must inflationary of internal borrowing. The government should influence individuals to use their idle money on government security because this stimulates the investments.

X. The policy on public debt should be made based on the fiscal and monitory policy analyzing the inflation rate, investment opportunities in the country to cope the requirement of the fund for the development of nation through the advice of NRB.

Annex 1

Government Revenue Status

Rs in million

Fiscal Year	**Tax revenue**	**Non- Tax Revenue**	**Total revenue**
1999/00	33,152.10	9,741.60	48,893.70
2000/01	38,865.10	10,028.60	50,445.50
2001/02	39,330.60	11,114.90	56,229.80
2002/03	48,688.10	13,642.90	62,331.00
2003/04	55,965.00	14,158.00	70,123.00
2004/05	49,295.00	20,828.00	70,123.00
2005/06	57,427.01	14,855.09	72,282.10
2006/07	71,126.65	16,585.35	87,712.00
2007/08	85,155.46	22,467.02	107,622.48
2008/09	119,012.00	24,298.00	143,310.00

Source: MOF/Nepal

Annex 2

Trend of Government Expenditure and Fiscal Deficit

Fiscal Year	Total Expenditure	Growth rate of total Expenditure (in %)	Annual Revenue	Growth rate Annual Revenue (in %)	Annual Budgetary Deficit Amt.	Growth rate of Fiscal Budgetary Deficit (in %)
1999/00	66273	11.24	42893.7	15.15	17667.6	-1.80
2000/01	79835	20.46	48893.7	13.99	24187.9	36.91
2001/02	80072	0.30	50445.5	3.17	22940.4	-5.16
2002/03	84006	4.91	56229.8	11.47	16437.1	-28.35
2003/04	89443	6.47	62331	10.85	15828.6	-3.70
2004/05	102560	14.67	70123	12.50	28046	77.19
2005/06	110846.78	8.08	72282	3.08	24756.88	-11.73
2006/07	133343.73	20.30	87712	21.35	31804.23	28.47
2007/08	161349.89	21.00	107622.48	22.70	33406.68	5.04
2008/09	204667.30	26.85	143310	33.16	41616.97	-19.79
Average		13.43		14.74		7.71

Source : Various Speech of Gov Nepal

$$\text{Growth Rate} = \frac{\text{Current Year Amount.} - \text{Previous Year Amount}}{\text{Previous Year Amount}} \times 100$$

Annex 3

Ownership Structure of Internal Net Outstanding

Rs. In million

Fiscal Year	NRB Holding amt.	Commercial Bnks Holding Amt	Total Financial Sector Holding	NRB Holding %	Commercial Banks Holding %	Other Holding %	Total Amount
1999/00	24,205.17	13,855.60	16,296.23	44.53	25.49	29.99	54,357
2000/01	19,945.09	17,804.69	15,493.92	37.46	33.44	29.10	53,243.7
2001/02	21,182.15	30,910.73	20,999.42	28.98	42.29	28.73	73,092.3
2002/03	23,421.27	39,032.67	21,253.26	27.98	46.63	25.39	83,707.2
2003/04	18,876.96	43,199.52	22,878.33	22.22	50.85	26.93	84,954.8
2004/05	18,035.01	50,202.88	22,299.31	19.92	55.45	24.63	90,537.2
2005/06	16,208.03	60,355.23	20,548.94	16.69	62.15	21.16	97,112.2
2006/07	19,235.15	62,998.33	17,070.32	19.37	63.44	17.19	99,303.8
2007/08	22,810.83	69,483.06	19,469.11	20.41	62.17	17.42	111,763
2008/09	27,776.77	68,571.63	24,525.27	22.98	56.73	20.29	120,873.66

Source:- Economic Survey, Ministry of Finance, NG 2008/09

Annex 4

Calculation of Correlation Co-efficient Between Internal Borrowing and Inflation

Year	Annual growth rate(X)	Annual Inflation (Y)	XY	X^2	Y^2
1999/00	16.77	3.5	58.70	281.33	12.25
2000/01	9.16	2.4	21.98	83.84	5.76
2001/02	33.25	2.9	96.43	1105.79	8.41
2002/03	11.00	5.0	55.00	121.00	25.00
2003/04	-36.85	4.0	-147.39	1357.69	16.00
2004/05	59.38	5.2	308.77	3525.92	27.04
2005/06	32.40	8.0	259.21	1049.82	64.00
2006/07	51.19	6.4	327.64	2620.83	40.96
2007/08	14.55	7.7	112.07	211.83	59.29
2008/09	-10.17	13.2	-134.24	103.42	174.24
	$\sum X$ =180.69	**$\sum Y$= 58.30**	**$\sum XY$= 958.18**	**$\sum X^2$= 10461.46**	**$\sum Y^2$= 432.95**

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

$$r_{XY} = \frac{10 \times 958.18-180.69 \times 58.30}{\sqrt{10x10461.46-(180.69)^2}\ \sqrt{10x432.95-(58.30)^2}}$$

$$r_{XY} = \frac{9580.80 - 10534.227}{\sqrt{10x10461.46-(180.69)^2}\ \sqrt{10x432.95-(58.30)^2}}$$

$$r_{XY} = \frac{-952.427}{\sqrt{104614.6-32648.876}\ \sqrt{4329.5-3398.89}}$$

$$r_{XY} = \frac{-952.427}{\sqrt{71965.724}\ \sqrt{930.61}}$$

r_{XY} = -.0116

r_{XY} = - 11.6 %

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