CHAPTER ONE

INTRODUCTION

1.1 GENERAL BACKGROUND:

Government like any other legal entity can take out loans, issue bonds & make financial investments. Governments may borrow to meet temporary needs, as when estimated revenue falls below or is exceeded by estimated expenditures. Governments incur such debt because of an unwillingness to limit spending or increase tax for fear of political consequences. (Cavanaugh, 1996)

Public debt, indebtedness of a central government expressed in money terms, often referred to as national debt. (Columbia Encyclopedia). Government debt also known as public debt or national debt; is money or credit owed by any level of government; either by central government, federal government, municipal government or local government. As the government represents the people, government debt can be seen as the indirect debt of the taxpayers. (Wikipedia, 2009). The accumulated amount of what the government has borrowed to finance past deficit is called Public Debt. (Samuelson, 1964). Public debt refers to obligations of government, particularly that evidence by securities to pay certain sums to the holders at some future date. (Encyclopedia Britannica, 2009)

A deficit is the difference between government spending and revenues. The accumulation of deficits over time is the total public debt. Deficit finance allows government to smooth tax burdens over time, and gives government an important fiscal policy tool. Government can pay for spending by borrowing. The government borrows for financing the budgetary deficits. Deficit financing is estimated as a gap between expected revenue plus foreign grants minus expected government expenditure.

Deficit =expenditure-(revenue +foreign grant)

Expenditure is estimated for a targeted rate of growth. Saving investment gap and slow growth of revenue as compared to growth in government expenditure causes this deficit. (Gyawali & Bajracharya, 2004)

The budget deficit could be financed through the sale of securities, i.e. increasing interest bearing public debt. further, the securities could be sold to (or funds could be borrowed from) the non banking public such as individuals, companies or institutional investors, commercial banks, or the central bank or a combination of them. Since the fiscal deficit would, have to be financed through the domestic private sector surplus (i.e., the excess of saving over investment of the private sector), foreign saving or external borrowing, or borrowing from the central bank, or by some mix of the three.(Basyal, 2006)

Government debt or public debt can be categorized as Internal Debt, owed to lenders within the country & External Debt owed to foreign lenders. Internally, the government can borrow from individuals, commercial banks, financial institutions, central bank. Externally, the government can borrow from foreign government, foreign people, and international financial institutions.

The phenomenon of public debt was originated in United Kingdom in the 17′th century. Where a group of city merchants provided grant and loan 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. After the World War II, Public Debt seemed a very vital source of development expenditure. Most of the countries in the world started to borrow systematically and still borrowing to develop their economies. (Joshi, 1982)

In Nepalese context, some historical events suggest that public debt is not altogether a new practice. In the past Kings/Prime ministers used to take resource of public debt. King Prithivi Narayan had borrowed from the public for financing the war in 1768 A.D. The Rana Prime minister Chandra Shamsheer had also borrowed money from Pashupatinath temple for the Kamaiya Mochan around 1925 A.D.

With the enforcement of Public Debt Act 1960, domestic public debt in forms of Treasury Bills, Development Bonds, and National Saving Certificates were issued in 1962, 1963/64, and 1984 respectively. These Bonds and bills are of regular nature. Some of them are issued as deficit financing while others are issued with a view to deepen the money market.

The persistence of fiscal deficit in Nepal is due to less receipt of revenue and foreign grants as compared to the level of expenditure. Fiscal deficit, the result of imbalance between expenditure and non-debt resources, is being financed through foreign loan, domestic borrowing and cash balance. (Economic Survey, 2009)

Nepal received its first foreign aid in 1951 from the U.S.A. under the Point Four Program. It was followed by India in the same year, from China in 1956, and by the then USSR in 1958. It was followed by the International Development Association providing the loan to the country for the purpose of telecommunication facilities in the country and then by the Asian Development Bank. The volume of foreign assistance has accelerated further since the formation of Nepal Aid Group in 1976.

Public debt has been the important source of funds to finance the development plans of the government of Nepal, as the budgetary situation of the government has always remained in deficit. Some portion of the deficit is met through domestic and foreign borrowing. As a result, the volume of the debt has also increased quite sharply in recent years. For a country like Nepal, public borrowing helps in achieving a growth rate. It allows for higher level of investment than its saving can meet. It narrows down the gap between saving and investment required for a targeted growth rate. The types of bond and treasury bills used by the government of Nepal to collect the Internal Debt are Treasury Bills, Development Bonds, National Saving Bonds, Civil Saving Certificates, and Special Bonds.

However, over-reliance on domestic borrowing would mean high real interest rate, which would discourage private investment. There are limits to a rapid accumulation of domestic debt as, at some point, the public will be willing to hold more money at higher interest rates, thereby further increase the cost of debt service. Even though raising sufficient funds in the form of public debt is important for sustained economic growth and to end prolonged poverty, a failure to meet debt obligations could lead to a serious economic crisis.

1.2 STATEMENT OF THE PROBLEM:

Most economists agree that financing the debt is appropriate when revenue sources are not enough to meet current needs or when the tax burden to raise money to carry out a project would be overly burdensome. However, there is debate on such questions as how large the national debt may safely be allowed to grow, how and when public debt should be retired, what effect public borrowing has on the economy and even whether government should borrow at all or should finance all expenditures from current revenues.

In Nepal, government expenditure is increasing very fast as compared to increase in revenue. As a result budget as well as fiscal deficit are widening in each year. There is a need for public debt in Nepal for several reasons; increasing saving-investment gap, increasing budgetary deficit, widening current account deficit. Another reason for the need of public debt is the increasing outstanding debt, which increases the debt burden with high debt servicing obligations. The aggregate public debt in 1988/89 was only Rs.42104.8 million whereas it has reached to Rs. 366004.9 million (about 45% of GDP) in 2007/08. This faster rising debt servicing obligations for the nation, which, in turn can lead the country towards demanding more public debt to meet the debt obligation. Then the country will be entangled into the vicious circle of debt trap.

Looking at the budgetary operation for the past few years, the government has very less rupees left in its treasury after spending on regular expenditure. This shows that it has a little resource for development activities, and needs to depend on domestic and external borrowing. The growth of public debt is several times higher than that of the economic growth. Given the narrow base for domestic resource mobilization and exports, the continued and rapid growth of debt could invite the problem over the sustainability of public debt.

Generally, external borrowing is used for meeting the saving investment gap and internal borrowing to meet the budget deficit and to meet shortfall in the cash flow. The domestic portion of the government debt has great significance in the financial system as the government securities provide convenient investments for the financial institutions and the public. However, internal borrowing can crowd out the resources that would otherwise have been available to the private sector, so that internal borrowing is not usually favored for meeting development expenses. While in case of excess liquidity this constraint may not remain. While external debt is mobilized for meeting the saving investment, gap and will result into additional cash injection in the economy. Therefore, if additional supply cannot be generated, such an increase in aggregate demand will result into inflation.

In Nepal, fiscal deficit has been increasing in each year. Moreover, to finance such deficit, both external and internal debt has been increasing rapidly in each year. However, the portion of internal borrowing has been increased more than external debt, in past few years. Increasing trend of net public debt is likely to increase further, as the country has became a Federal Democratic Republic Country. At present, the process of state restructuring is going on. And, in the near future, the newly born states need a huge investment for their establishment.

High public debt is a cause for concern in Nepal. Not only does this high level of public debt raises the risk of a fiscal crisis, but it also imposes costs on the economy by keeping borrowing costs high, discouraging private investment, and constraining the flexibility of fiscal policy. Excessive debt could be quite harmful for the economy for the reason of disturbing macroeconomic stability and increasing the burden of debt servicing. Regarding debt servicing there is a risk of increasing this burden over the period primarily due to currency depreciation. Growth of domestic debt leads to a sharp increase in debt-service payments. Ultimately, it weakens the public sector's ability to service its external debt.

The payment of the public debt improves the national credit by installing public confidence. Which usually leads to economic growth. But the pace of capacity of the country to repay debt is not increasing to meet the debt obligation. However, the ultimate security of the public debt lies in the willingness of the people to pay and the ability of the government to collect the taxes.

1.3 OBJECTIVE OF THE STUDY:

In context of increasing Internal Debt of Nepal, this study attempts to examine the composition of internal debt, and its implications on Nepalese economy. Therefore, the main objective of the research is to analyze the trend and structure of internal debt and impacts of overall debt servicing on the economy.

The specific objectives of the study are:

1. To analyze the size, magnitude, composition of Public Debt with special reference to Internal Debt for the period of 1988/89 to 2007/08.
2. To evaluate the burden of overall Pubic Debt and the problem of Debt servicing for the period of 1988/89 to 2007/08.
3. To empirically assess the effects of overall Public Debt on economic growth of Nepal.
4. To reflect the Resource Gap in Nepal.

1.4 SIGNIFICANCE OF THE STUDY:

In the past, many researches have been conducted in order to analyze the public debt in Nepal. Most of them have analyzed the trend, pattern and burden of debt. However only a few studies have concentrated about the internal debt.

In this context this study is especially focused on the role of internal debt; as well as the trend & structure of public debt, resource gap & burden of public debt in the Nepalese economy.

1.5 LIMITATION OF THE STUDY:

The findings of the study will be useful for all those who are interested to know about the Nepalese economy and its debt situation.

This study has following limitations:

1. This study covers only the period of 1988/89 to 2007/08.
2. This study totally depends on the secondary data and information published from various institutions. The reliability of those data is not examined.
3. This study has not attempted to examine the effect of public borrowing on some macro economic aspects such as money supply, price level, employment, inflation and poverty alleviation.

1.6 RESEARCH METHODOLOGY

1.6.1 RESEARCH DESIGN

This research is designed to analyze the impact of public debt on the economic development of Nepal. To meet the aforementioned objectives quantitative tools has been used. The nature of the study is descriptive. And the study is totally based on secondary data.

1.6.2 SOURCES OF DATA

The study is primarily based on secondary data, which are collected from various official records. The main sources of data used in this study are the Ministry of Finance, Nepal

Rastra Bank, National Planning Commission, Central Bureau of Statistics, and economic information by other national and international organizations.

1.6.3 TIME PERIOD OF STUDY

The empirical analysis is made covering the period of 20 years from 1988/89-2007/08. The time is designed taking into account the availability of data.

1.6.4 DATA ANALYSIS PROCEDURE

The available data and information collected from various relevant sources are processed. Those collected data are classified, tabulated, analyzed and presented according to the objective of the study. Simple statistical tools like percentage, ratio, and average are made with the help of calculator.

1.7 SCHEME OF THE STUDY

This study is divided into five chapters.

In the First chapter, general background, objectives, rationale of the study, limitation of the study and research methodology have been explained.

Second chapter constitutes the literature review. In this chapter, the theoretical concepts, role as well as empirical findings on public debt on both Nepal and international context have been provided.

The third chapter focuses on the overall trend, structure and practice system of public debt in Nepal.

The fourth chapter focuses on the debt-servicing situation of Nepal.

Finally, summary, conclusions and recommendations are presented along with the bibliography and appendices.

CHAPTER TWO

LITERATURE REVIEW

2.1 THEORETICAL PERSPECTIVE

Classical economists opposed the public debt. They were in favour of minimum role of government into the economic activities. According to them public debt creates burden on the economy because of its unproductiveness. And in between taxation & borrowing, they favored taxation.

> Classicists had negative attitude towards public debt and they did not plead for increasing economic role of government. Instead, they said that "let money fructify on the pocket of people". According to them state has to perform its limited activities, maintenance of law and order, justice and social security. Classical economists like J.B. Say, J.S. Mill, and T.R. Malthus have given their argument that, "Debt creates burden on the economy because of its unproductive nature". (Harris, 1974)

> Classical view is criticized because governments not every expenditure is always unproductive. Therefore, that public debt may not be always burden on the economy. And their view regarding the shifting of the debt burden is not correct. The real burden of public debt must be borne in the initial period of debt creation when government borrows for meeting development requirements. Hence, government attracts resources from private use and put into the public project in the initial period. (Joshi, 1982)

However, classical economists were not against of all types of public debt. They supported public debt for productive purposes; that is, for capital projects since the fruits of such principal did not necessitate additional taxation. These are called self-liquidating projects.

> In the word of Musgrave, (Musgrave, 1959) “Self-liquating projects may be defined narrowly as investment in public enterprises that provide a fee or sales income sufficient to service the debt incurred in their financing: or they may be defined broadly as expenditure projects that increase future income and the tax base. Such projects permit servicing (interest and amortization) of the future level of tax rates”.

> Classical economist, James Stuart propounded the view that public debt should function as balancing wheel of the economy. Stuarts view as presented by Walter F. Stetner is "public borrowing must be adjusted to the conditions of trade at the particular time. Government Borrowing is inappropriate as long as 'circulation is full' because then it would only raise the rate of interest and have undesirable consequences for commerce. On the other hand, when circulation is stagnating in one part of the economy and there is unemployment and a slackening of trade industry the state should absorb this excess and through its expenditure throw it into new channels of circulation. Thus, the use of Public Credit is conceived as the balance wheel in the economy. It keeps resources fully employed, and prevents stagnation in any part of the economy for having and adverse effect elsewhere. In addition Public Credit is a necessary instrument of war finance". (Singh, 1952)

After the great economic depression of 1930s, a new way of thinking emerged in the writings of John M. Keynes in the economic world. He challenged the classical concept of a free market economy and advocated for the active government role in economic activities by accepting deficit financing. Keynesian thought of public debt is income generating and so it is not burden for the economy.

In the dominant economic policy generally ascribed to the theories of J.M. Keynes; generally called Keynesian economics, there is tolerance for high levels of public debt to pay for public investment in lean times, which if boom times follow, can then be paid back from rising tax revenues. (Wikipedia, 2009)

> In the **Keynesian view** if the government does not take any corrective action the resources in the private sector might remain unemployed for relatively longer time. In such a situation when resources are unemployed on large scale, government employment of these resources does not deprive the private sector. On the contrary, increasing government spending by using idles men and materials are likely to raise level of aggregate output and income. Hence need not necessarily be unproductive, inflationary and burdensome. Therefore, Keynesian strongly prescribed to increase the public expenditure even by undertaking deficit financing or borrowing. (Musgrave, 1959)

> A.P. Lerner, (Lerner, 1995) a post second world war economist and one of the profounder of functional finance approach, views that, Public Debt maintains that the government should borrow only when it wants to make people hold more bonds in place of money. He perceived that if debts are internally held, and then there is nothing to worry about their size.

According to **post Keynesian** view, public borrowing does not always deprive private sector from the use of resources. It depends on circumstances; in the time of widespread unemployment, it may be productive while borrowing in a period of full employment it may be inflationary.

> According to Richard Goode, (Goode, 1984) domestic borrowing is a use of national saving. The act of borrowing by the government makes it unavailable to private sector for investment. So financing of consumption by internal borrowing will cause a curtailment of national saving and investment. In other hand, borrowed money when used to finance public investment causes no such

reduction; all that will happen is the change in the consumption of the capital formation.

In the contemporary economic world, public debt as a fiscal instrument is very much applied for the economic development. Modern economists as well have different views regarding public debt.

2.2 INTERNATIONAL CONTEXT

The most important aim of public debt raised by government is to fill the gap between the revenue received by government and proposed expenditure during the year. The government may borrow money from internal or external sources whenever the income of the government falls short of its expenditure. This income of the state is over and above all taxes and other revenue resources. However, the debt incurred is the income of the state for the year alone. Hence, it will have to be rapid through taxation or other resources. The government borrows money from internal as well as from external sources in order to meet the gap between the revenue and expenditure. (Lekhi, 2001)

Public debt is used to finance spending in excess of current tax revenues. So taxation is actually the most pervasive way of financing public spending. The problems induced by the tax financing of public spending also have to be considered if one wants to achieve a comprehensive analysis of the economic impact of fiscal outcomes. The point is that, while the issuance of public debt to finance public spending has serious potential problems, so do alternative forms of financing. (Pereira Rodriguez, 2002).

According to Raja J. Chelliah, (Chelliah, 1992) "the ideal situation is one in which first revenue will meet subsidies, other transfers, interest payments and the greater part of current expenditure; debt finance will be used for meeting the governments non-remunerative capital formation, a proportion of current expenditure designed to increase social capital and productivity and requirements of financial investment. And second , the total of domestic borrowing will be determined in such a way that, given the rate of domestic saving, the non government sector will be able to obtain a due share of saving and that there will be no need to borrow from the central bank more than current amount.

Romer, (Romer, 2003) views that budget deficit and it's financing in many developing countries, are very important parameters for analyzing monetary effect as well as the fiscal effect in the country's overall economic development. Many industrialized countries face similar long-term budgetary challenges like developing countries and have run persistently large budget deficits in recent decades. These large and persistent budget deficits have generated considerable concern. There is a widespread perception that they reduce growth, and could lead to a crisis if they continue for long or become too large. Thus, it is important to examine the sources and effects of budget deficits.

Dornbush and Fischer, (Dornbush and Fischer, 1990) explained that an understanding of the financing of fiscal deficit is also important because there are different implications of the method of debt financing in the economy. They cited that economic theory tells that if debt financing is met by borrowing from central bank, it is inflationary; if borrowing is from commercial banks; there is a possibility of crowding out of private sector investment. Again, if it is met by issuing bonds, the cost of debt financing will be high. Therefore, debt financing and the method of its management are important issues. In general, deficit financing is met by expanding monetary base. Debt financing by issuing bond is less popular than the money creation.

Debt sustainability is an essential condition for macroeconomic stability and sustained economic growth. Most often, high public debt levels create repayment flows that can crowd-out much-needed public spending, and can generate adverse incentives for private investors to engage in activities that spurt long-term growth. An excessive level of public debt can make the nation vulnerable to interruption in aid flow or to sudden shifts in domestic financial market sentiment. A narrow export and production base and various structural, political, and institutional factors that reduce returns on investment aggravate these problems. (ADB, 2006).

2.3 NEPALESE CONTEXT

A number of students, economists, policy maker and donor communities have prepared thesis, dissertation and researches about the Nepalese public debt.

Purushottam Acharya, (Acharya, 1968) had done the first exercise on public debt, writing a thesis that was submitted to Tribhuvan University in 1968. He presented a case study titled, “A Case Study on Public Debt in Nepal”, including features, problems and pattern of public debt. He concluded that "Public debt is most popular in these days because of payment of debt on maturity can be adjusted through the issues of fresh public debt instruments. But the fact is that habit of purchasing bond issued by the government should be developed among the people so that no difficulty may be faced in getting the bond purchased by the people."

Mahesh Raj Joshi, (Joshi, 1982) in his M.A. dissertation entitled "Structure of Public Debt in Nepal", has shown the importance of public debt in the financial sector development of the country, by analyzing the actual condition of internal and external debt and its impact in Nepalese economy.

Shree Bhadra Khanal, (Khanal, 2000.) in his MA Thesis dissertation, entitled "Public Debt in Nepal: A Study of its Structure and Burden" states that Nepal is passing through a critical phase of inadequate mobilization of internal resources, thus managing public finance has been challenging proportional. He has discussed the effects of public debt identifying the factors contributing to increase in public borrowing. He writes trade deficit, ‘I-S’ gap, large amount of fiscal deficit have been fundamental issues and constraint to increase foreign dependency in the Nepalese economy. There has been excessive flow of foreign loan to bridge up these gaps.

Sarad Raj Acharya, (Acharya, 2003) in his MA Thesis dissertation, entitled "Trend and Structure of Public Debt Situation in Nepal", has made the conclusion that, government borrowing has been increased rapidly and financed mostly on the unproductive sector and hence government always lacks the resources then borrows the loan to pay the previous ones. He argued that such excessive dependency upon external loan might lead the nation into debt trap, if the term of trade is not improved. Therefore, extra care should be exercised in purchasing such loan.

Birju Prasad Sharma, (Sharma, 1997) in his MA Thesis dissertation, entitled "Burden of Public Debt in Nepal" has shown the relationship between public borrowing, development expenditure and budgetary deficit. According to him, increasing demand for development had necessitated the government to depend on both types of borrowings internal and external. Since developing countries like Nepal always, need foreign currency to import many capital goods required for development activities. These countries have to depend more on external borrowing than internal borrowing, because of low level of saving. At the same time, the terms of trade of developing countries are unfavorable; there is need of borrowing from outside in order to finance the balance of payments deficit.

Rajendra Neupane, **(**Neupane 2007) in his MA Thesis dissertation, entitled "A Study on Role and Burden of Public Debt in Nepal" has observed the debt situation of the country. He has concluded that the degree of indebtness of the external debt has increased, due to the poor mobilization of internal resources widening investment-saving gap, export import gap, revenue expenditure gap and large amount of fiscal deficit. so there have been excessive flow of foreign loans to bridge up these gaps consequently burden of debt an debt servicing obligation are increasing rapidly in each year, but debt servicing capacity of the economy is not increasing in he same pace.

R.D. Singh, (Singh, 1983) in a report entitled "Internal Borrowing and Its impact on the Economy" has discussed the structure of internal debt and its impact on the economy. He concludes that the nature of internal borrowing is quite inflationary. The proportion of unreal borrowing in total internal borrowing is greater than real borrowing. So that the impact of rapid increase in money supply resulting in an increase demand for goods and services, which lead to rapid increase in imports. So the ultimate burden falls on balance of payments situation.

Chintamani Shivakoti observes in his article, entitled "The Issuance and payment process of public Debt in Nepal". Government borrowing, to meet even a minor budgetary insufficiency as for as possible, however the government should raise the debt internally if it is incapable to maintain the capital without levying and charging the additional taxations. According to him, internally raised debt is preferable instead of external debt. It helps to mobilize domestic resources for productive sector and does not create dependency to other countries and avoid high cost of debt servicing.

Keshav Prasad Acharya, (Acharya, 1998) has discussed the evolution of Public Debt in Nepal both Internal and External. And he has made the following recommendations on his writing, entitled “Burden of Public Debt in Nepal”-

- Meet subsidies, other transfers, interest payments and the greater part of current expenditure by the revenue. Government’s non-remunerative capital formation, a part of current expenditure that increases productivity can be financed by debt.
- Reduce deficits by :
  a. Raising the income elasticity of taxes and by increasing fee and user charges
  b. Stabilizing the ratio of GDP with respect to government capital formation; current expenditures relating to social capital.
  c. Increasing the returns to net lending by the government

d. Decreasing interest burden on budget.

Yuba Raj Khatiwada, (Khatiwada, 1998) in his research, entitled "Public Debt Management and Marco Economic Stability" basically discussess the monetary implication of public debt which dealt with following point

1. Public debt has exerted upward pressure on the market rate of interest.
2. Debt servicing resulting to higher budgetary deficit, which further contribute to monetary expansion.
3. Public debt has crowded out resources available for private sector investment.
4. Exerted excess monetary expansion, which has indirectly resulted in high rate of Inflation and deterioration of current account situation.
5. Heavy bank borrowing by the government contributed significantly for the expansion of money supply in 1990.

According to him the situation is more alarming as foreign loan in the long term nature is maturing out faster and exchange rate of Nepalese rupees is depreciated very fast multiplying the debt obligation as well as debt servicing requirements.

Based on his analysis, he has recommended debt management policy for Nepal as follows

1. Rescheduling of some of the matured foreign debt for the next 10 or 20 years would be an alternative.
2. Nepal should make her economic diplomacy to set foreign loans written off on a case-by-case basis.

Guna Nidhi Sharma, (Sharma, 1998) in his article, entitled "The Growing Fiscal Imbalance in Nepal: Are We Falling into the Debt Trap" has analyzed that Is Nepal falling into debt trap? According to him, foreign aid in Nepal has killed local initiative for community participation and resource mobilization. “Almost every sector of the economy depends on assistance from the government which negotiates for foreign aid. Given the fact that the proportion of internal loans to GDP is constant at around two percent (or 22.2 percent of total loans) for the last several years, the importance of foreign loan as a source of financing the increasing trade deficit and development expenditure is increasing day by day. The high level of aid misuse caused by the presence of corruption and low quality manpower in the implementing agency has also raised the scope for encouragement to the aid mafia. The inflow of aid, therefore, is increasing over time".

Ananthakrshnan, (Ananthakrshnan, 1998) on Debt Management presents five basic functions of debt management in the context of Nepal's debt:

- Policy
- Regulatory
- Operational
- Accounting
- Statistical Accounting

His conclusion is that the collection and computerization of data are the most difficult tasks, which lay the foundation for efficient debt management. And the effective debt management helps a country to keep the debt at sustainable level.

Alamgir and Ra, (Alamgir and Ra, 2002) in their research on 'Public Debt Sustainability Analysis' has observed that given the narrow base for domestic resource mobilization and exports for Nepal, it is important to monitor continuously the sustainability of public debt—that is, the country's ability to meet its medium and long-term debt obligations. Their research examined that Nepal would have to raise real GDP growth rate substantially over coming years, raising the rate of investment well above the recent trend of 22% of GDP at market prices to be financed by a combination of increased savings and borrowing, domestic and external.

Debt management, the process of administering national debt by providing for the payment of interest and arranging the financing of maturing bonds, aims at keeping down the expected cost of debt and its servicing along with ensuring that funds are available when needed. Debt management includes forecasting when net borrowing will be needed, choosing the type of securities to be issued or redeemed, and timing the maturity dates of outstanding debt to prevent excessive concentration of the redemption payments at a particular date, which might give rise to difficulties in funding them. Debt, the total outstanding borrowings of the government, represents the stock of borrowing as opposed the annual in total borrowing, as represented by the fiscal deficit. (Basyal, 2005).

The government of Nepal has issued and serviced domestic debt securities since 1962. However, the Nepalese debt market is still too primitive to secure government financing needs with low costs and a prudent degree of risk. The major instruments for domestic debt financing have been treasury bills with less than one-year maturity. There are other debt instruments such as development bonds, special bonds, and saving certificates with maturity over one year to five years. But as of 2003, they account for less than 23 percent of total domestic debt. The underdeveloped Nepalese domestic debt market fails to provide economic agents with alternative options to banking, in allocating their savings. It also makes the transmissions mechanism of monetary policy of the central bank ineffective. (Ministry of Finance, HMG/N and Asian Development Bank, 2005)

Gokul Ram Thapa, (Thapa, 2005) in his article, entitled "Domestic Debt Management" has analyzed the concept and pattern of domestic debt management of public debt and challenges and suggestions for debt management. He has said that, the required expenditure of the nation has to be met by the government through revenue and borrowing. It is the regular phenomenon of the developing country that every time the government expenditure suppressed its income, the situation of deficit of resources may exist. In such situation, the government fulfills its needed expenditure through other sources like borrowing. The sources of borrowing may be internal and external. However, external borrowing may not be reliable for the nation. He has focused on domestic borrowing and well debt management.

Laxmi Bilas Koirala, (Koirala, 2001) in his article, entitled "Effective Public Debt Management in Nepalese Perspective" has stated that Debt is a useful resource for economic development. However, several inverse consequences were found by it's over use. The debt crisis of nineteen eighties is widely known as the result of over use. The World Bank had established Multilateral Insurance Guarantee Agency (MIGA) and the International Monetary Fund had minted Special Drawing Rights (SDRs) to curb the crisis in the third world. He further says that we have had only two options; either mobilize more foreign debt to invest for economic development or put the hand on hand doing nothing. Briefly, we should have a debt management plan for its better use of regular servicing. The government debt has simple relationship with the government deficit or a higher economic growth requires a higher level of investment that is not possible simply from taxation so that government seeks public borrowing.

Krishna Gyawali and Bhuban Bajracharya, (Gyawali & Bajracharya, 2004) in an article, entitled "Public Debt Management in Nepal" analyzed the weak management system of debt, which creates difficulties in Nepalese economy. It is high time that some more concrete efforts taken and institutions be developed for management the debt which can now extend to private sector borrowing from abroad. There is a need for some legislation to regulate the fiscal management including that for Public debt. The external borrowing is found increasing from the long period and the growth of external debt is found to be several times higher than internal borrowing. In the last decade, there was more than three folds increment in the internal borrowing. The burden of internal borrowing has increased more than ten percent of total government expenditure. This faster rising debt ratio increases debt-servicing obligations for the nation, which in turn can lead the country towards demanding more public debt to meet the debt obligation.

CONCLUDING REMARKS

Public Debt is a term for all of the money owed at any given time by any branch of the govt. It. is the outstanding amount of money the government has borrowed to cover its spending. Public debt is an important source of financing in developing countries such as

Nepal. As internal resource, mobilization (revenue mobilization) is inadequate in comparison to resource requirements; public debt has been the alternative.

Public debt includes internal and external borrowing of the government. It also covers loans received by public enterprises against government guarantees. Deficit financing or the utilization of cash balances made available by Nepal Rastrsa Bank is also regarded as part of the public debt.

Internal debt consists of borrowing through securities such as Development Bonds, National Saving Certificates, Treasury Bills and other Special Bonds. These securities are to be repaid within a specified time. External debt comprises loans and credits made available on concessional, semi-concessional or commercial terms from multilateral and bilateral sources. These loans include project loans, non-project loans, commodity loans, relief loans and balance of payment support loans.

Public Debt is an important financial instrument for the government to finance expenditures not covered by current revenue. It is a widely accepted tool all over the world. However, the concept of Public Debt has been changed according to time. There are different views about it. Some economists are in favor of it and some are against of it.

CHAPTER THREE

PUBLIC DEBT: TREND, STRUCTURE, AND PRACTICE IN NEPAL

3.1 INTRODUCTION

Along with the traditional duties like maintaining law and order within the country, protecting the country from external attack, construct infrastructures for the development, economic and social development; now a days to run a welfare state; government needs expenditure. Including these expenses, all other expenditures made by the government for its any kind of work is considered as public expenditure.

Public expenditure is the expenditure made by the government for the welfare of people through the fund collected through tax and revenue, internal and external borrowing, foreign grants and all other receipts by the government. The main motive of the public expenditure is the overall welfare of the people and the nation.

Objectives of the public expenditure:

- Poverty reduction and alleviation,
- Overall development of the country,
- Maintain internal law and order and protect from external attack,
- Maintain high economic growth,
- Run Welfare activities,

Due to rapid population growth, increase in peoples wants, needs and necessities, price growth, leakages, misuses, weak controlling system and huge investment on low return projects Public expenditure is increasing every year. The main reasons responsible for public expenditure can be categorized as:

- Establishment of welfare state,
- Development of democratic system,
- Construction of basic infrastructure,
- Social development,
- Maintaining law and order,
- Population growth,
- Rise in price level,
- Effect of globalization,

Government spends a huge amount of money for uplifting the living standard of its people in a sustainable manner along with the implementation of economic development. In addition, the ever-increasing aspiration of the people for the development activities needs the huge expenditure every year.

As the growing government expenditure is not possible to finance only through internal revenue, government borrows the money from both internally and externally. A government can borrow from both within and abroad creating public debt that need to be borne by the people at large. Such loans should be repaid in the due date with interest amount. Therefore, there is increasing need for supplementing it by borrowing.

Generally, Government borrows for smoothening out the tax rates, for macro economic stabilization i.e. to control inflation, to check fluctuations of business cycle etc., for financing war and unexpected emergency expenditure, for investing in the backward sectors of the economy, for proper allocation of resources. In other words, The main reasons for borrowing by a developing country like Nepal is to smooth public expenditure over time and to allow the country to invest more with less sacrifice of current consumption.

Government of Nepal has been borrowing huge amount of money in each fiscal year due to failing large and growing financial resource gap in the government budget. There is a need for public debt in Nepal for several reasons; increasing saving investment gap, increasing budgetary deficit and widening current account deficit and increasing public outstanding debt with increasingly high debt servicing obligation.

Therefore, the main reasons for raising the government borrowing can be categorized as:

- To collect necessary fund,
- To recover budgetary deficit,
- Import knowledge and technology,
- Collect fund for infrastructure development and economic development,
- Sustain the economic and monetary stability,
- Avoid extra burden of taxation to the people,
- Meet the emergency and special expenses,
- Increase production,
- Create employment opportunity,

For a country like Nepal, public borrowing helps in achieving a growth rate not permitted by its own saving level for investment. It allows for higher level of investment than its saving can meet. It narrows down the gap between saving and investment.

Some historical events suggests that Nepal's experience in public debt, is not altogether a new practice, however the systematic documentation is not very long. First domestic borrowing was raised in 1962 while the first external debt was received in 1963/64. Public debt transactions in Nepal fall under the domain of Public Debt Act 1960, and Public Debt By-Law 1963.

The recent recorded history of foreign aid in Nepal began in 1951 with its first aid received from the U.S.A. under the Point Four Program of President Harry Truman. It was followed by India in the same year, by China in 1956, and by the then USSR in 1958. Likewise, external debt was started since the two loans from USAID in 1963. It was followed by the International Development Association providing the loan to the country for the purpose of telecommunication facilities in the country and then by the

Asian Development Bank. The quantity of foreign assistance has accelerated further since the formation of Nepal Aid Group in 1976.

With the enforcement of Public Debt Act 1960, public debt in forms of Treasury Bills was issued in Nepal for the first time in 1962 amounting to Rs.7 million. Another instrument of public debt, Development Bond, was first issued in fiscal year 1963/64, amounting to Rs131.0 million. National Savings Certificate was first issued in January 1984 amounting Rs.250 million. With the sole objective of absorbing excess liquidity, Nepal Rastra Bank Bond was first issued in January 1992, which was suspended in April 1996. These Bonds and Bills; afore mentioned are of regular nature. Some of them are issued as deficit financing instruments while others are issued to deepen the money market. Besides, there are many other bonds such as; Special Bonds, Land Compensation Bonds (1964), Forest Compensation Bonds (1965), Interest Prize Bond (1991) and other various special bonds. Special Bonds include IMF Promissory Note, 10 year, 20 year, 25 year Special Bonds. Most of the Special Bonds are held by the Nepal Rastra Bank.

After November 1988 onwards the rate of Treasury Bills (T-bills) are determined by the interaction of market forces. Government's short term liquidity position determines the amount (quantity) of T-bills to be issued at the weekly auction, and overall liquidity position in the market determines its interest rate (price). Commercial Banks are the main market players. Going up further, from July 1994 onwards TB and NRB Bonds are also provided to the Secondary Market. Generally, TBs are issued with 90 day's maturity period. However, to expand the base of financial instruments, Nepal is also issuing TBs with maturity periods of 7 days, 31 days, 182 days and 364 days. From April 1997, authorities are also issuing Repo facility.

Though Nepal obtained its first foreign borrowing more than half a century back in the modern history, it does not have a very good database of its external loan. Since Nepal Rastra Bank is responsible for managing domestic debt on behalf of the government, it maintains database for the domestic debt. The financial Comptroller Generals Office is responsible for maintaining records on both internal and external debt. However there is no agency to look at it combinedely.

The future return from the investment is supposed to be covered by the cost of borrowing. A country's debt burden is generally expressed in terms of its debt servicing obligations—the repayments of principal and interest due in a given year. However, high public debt can have a negative effect on economic activities.

3.2.1 PATTERN OF EXPENDITURE, REVENUE, GRANT AND DEFICIT

The Government, a soul of the state, is a supreme representative body entrusted with the responsibility of addressing the concerns and promoting and preserving the interests of the people and the nation as a whole. To execute the tasks and responsibilities determined defined and directed by the constitution and other laws, the government needs a huge fund for financing its various activities such as socio economic development activities, welfare of the people, national security, day to day general administration etc. For the purpose, government collects the fund through taxation and other various sources, receives the grants from foreign and the remaining portion occurs from public borrowing.

Because of ever-increasing expectation of the people, government expenditure is increasing more rapidly every year while the revenue is not sufficiently growing to meet the expenditure. This is the main cause of the ever-increasing revenue as well as fiscal deficit.

The following table 1 depicts the growth trend of revenue deficit and fiscal deficit. Revenue deficit is the difference between the government revenue and expenditure and fiscal deficit is the difference between revenue deficit and grants obtained. There is increasing tendency in both revenue deficit and fiscal deficit because of the increasing volume of total expenditure and low growth of foreign aid in Nepal.

The table shows that the total expenditure, total revenue and grants has increased each year, but the increasing rate of expenditure is rapid as compared to expenditure and grants, which is the main cause of huge fiscal deficit.

Table-1

Trend, Pattern of Revenue, Expenditure, Revenue Gap, Grant and Fiscal Deficit

Rs in Million

Fiscal Year	Total Revenue	Annual Growth Rate of Revenue	Total Expenditure	Growth Rate of Expenditure	Revenue Deficit	Growth Rate of Revenue Deficit	Grant	Annual Growth Rate of grant	Fiscal Deficit	Growth of Fiscal deficit
1988/89	7776.9	-	18005.0	-	10228.1	-	1680.6	-	8547.5	-
1989/90	9287.5	19.4	19669.3	9.2	10381.8	1.5	1975.4	21.7	8406.4	-1.6
1990/90	10729.9	15.5	23549.8	19.7	12819.9	23.5	2164.8	-9.4	10655.1	26.7
1991/92	13512.7	25.9	26418.2	12.1	12905.5	0.6	1643.8	-6.1	11261.7	5.7
1992/93	15148.4	12.1	30897.7	17.0	15749.3	22.0	3793.3	113.8	11956.0	6.1
1993/94	19580.5	29.3	33597.4	8.7	14016.6	-11.0	2393.6	-26.9	11623.0	-2.8
1994/95	24575.2	25.5	39060.0	16.2	14484.8	3.3	3937.1	64.5	10547.7	-9.2
1995/96	27893.1	13.5	46542.4	19.1	18649.3	28.7	4825.1	25.5	13824.2	31.1
1996/97	30373.5	8.9	50723.7	9.0	20350.2	9.1	5988.3	24.1	14361.9	3.9
1997/98	32937.9	8.4	56118.3	10.6	23180.4	13.9	5402.6	-9.8	17777.8	23.8
1998/99	37251.0	13.1	59879.0	6.7	22628.0	-2.4	4336.6	-19.8	17991.4	1.2
1999/00	42893.8	15.1	66272.5	10.7	23378.7	3.3	5711.7	31.7	17667.0	-1.8
2000/01	48893.6	13.9	79835.1	20.4	30941.5	32.3	6753.4	18.2	24188.1	36.9
2001/02	50445.5	3.2	80072.3	0.29	29626.8	-4.4	6668.2	-1.3	22940.6	-5.1
2002/03	56229.8	11.5	84006.1	4.9	27776.4	-6.2	11339.1	70.0	16437.3	-28.3
2003/04	62331.0	10.9	89442.6	6.5	27111.6	-2.4	11283.4	-0.5	15828.2	-3.7
2004/05	70122.7	12.5	102560.4	14.7	32437.7	19.6	14391.2	27.5	18046.5	14.0
2005/06	72282.1	3.1	110889.2	8.1	38607.1	19.0	13827.5	-3.9	24779.6	37.3
2006/07	87712.1	21.3	133604.6	20.5	45892.5	18.9	15800.8	14.3	30091.7	21.4
2007/08	107622.7	22.7	161349.9	20.8	53727.2	17.1	20320.7	28.0	33406.5	11.0
Annual Average Growth Rate		15.04		12.4		9.8		19.03		8.7

Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

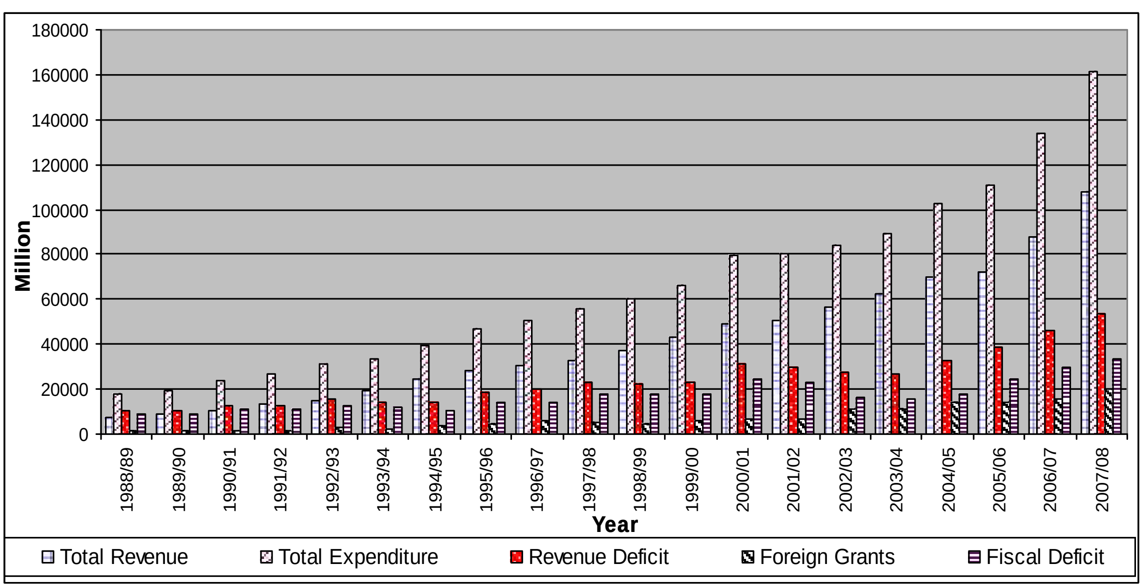
In the Fiscal year 1988/89, total expenditure was Rs. 18005.0 million while total revenue was Rs. 7776.9 million and thus the revenue deficit was Rs.10228.1 million, the government received Rs. 1680.6 million as foreign grants and the fiscal deficit became Rs.8547.5 million, which was financed through public borrowing.

In the fiscal year 2007/08, total revenue was Rs. 107622.7 while total expenditure was Rs.161349.9 million, thus the revenue deficit was Rs. 53727.2 and the government received Rs. 20320.7 million as Grant and the fiscal deficit becomes Rs. 33406.5 million.

The table shows that during the review period, the annual average growth rate of expenditure is 12.4%, while annual growth rate of revenue is 15.04%, and annual Growth rate of grant is 19.03%. The table shows the annual growth rate of revenue and grants is greater than the expenditure but they are not sufficient to meet the deficits. Because the annual average growth rate of revenue deficit and fiscal deficit is 9.8% and 8.7% respectively.

The following figure depicts the actual scenario of Expenditure, Revenue, Revenue Deficit, Foreign Grants and Fiscal Deficit in Nepal.

Figure 1: Trend, Pattern of Revenue, Expenditure, Revenue Gap, Grant and Fiscal Deficit



3.2.2 RESOURCE GAP

Resource Gap has been a major characteristic feature of the Nepalese economy from the very early year of systematic budget formulation. As the total revenue does not match the total expenditure for the same year. The phenomenon of resource gap is the difference between the government expenditure, government revenue plus foreign grants.

Table-2

Resource Gap as Percentage of GDP

Rs in million

Fiscal Year	GDP	Revenue Deficit	Revenue Deficit as% of GDP	Fiscal Deficit	Fiscal Deficit as % of GDP
1988/89	85831	10228.1	11.9	8547.5	9.9
1989/90	99702	10381.8	10.4	8406.4	8.4
1990/90	116127	12819.9	11.0	10655.1	9.2
1991/92	144933	12905.5	8.9	11261.7	7.8
1992/93	165350	15749.3	9.5	11956.0	7.2
1993/94	191596	14016.6	7.3	11623.0	6.1
1994/95	209974	14484.8	6.9	10547.7	5.0
1995/96	239388	18649.3	7.8	13824.2	5.8
1996/97	269570	20350.2	7.5	14361.9	8.3
1997/98	289798	23180.4	8.0	17777.8	6.1
1998/99	330018	22327.7	6.8	17991.4	5.4
1999/00	366251	23378.7	6.4	17667.0	4.8
2000/01	425454	30941.5	7.3	24188.1	5.7
2001/02	444052	29626.8	6.8	22940.6	5.2
2002/03	473546	27776.2	5.9	16437.1	3.5
2003/04	517993	27111.6	5.2	15828.2	3.1
2004/05	566579	32437.7	5.7	18046.5	3.2
2005/06	630301	38607.1	6.1	24779.6	3.9
2006/07	696989	45892.5	6.6	30091.7	4.3
2007/08	781262	53727.2	6.9	33406.7	4.3
Annual Average growth rate			7.6		5.7

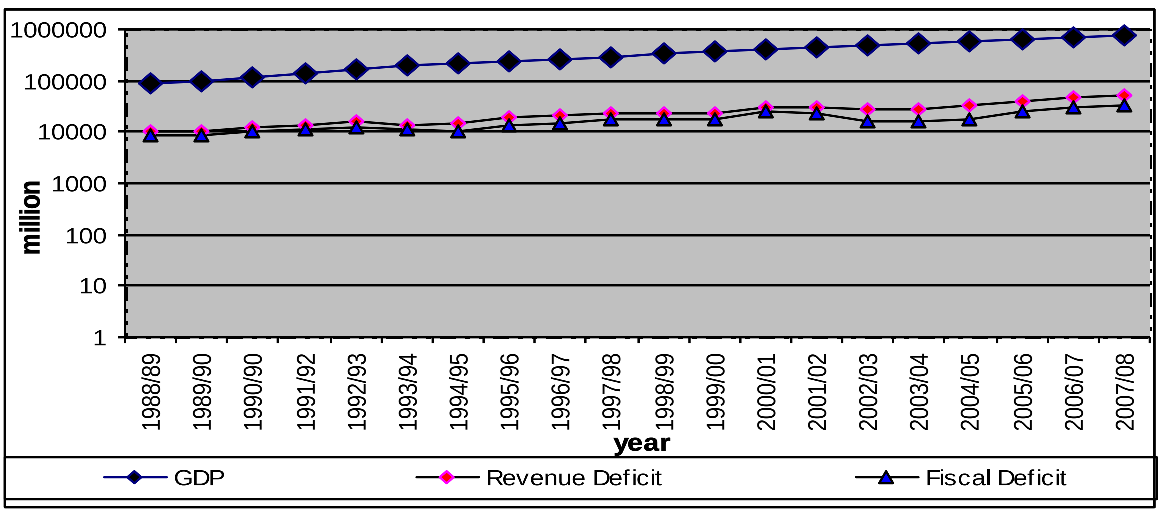
Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

GDP refers to the market value of all currently produced final goods and services within the geographical boundary of the country within a year. In the FY 1988/89 the GDP at factor cost was 85831 million, revenue deficit was 10228.1 million, which was 11.9% of the GDP, similarly fiscal deficit was 8547.5 million which was 9.9% of the GDP in the same year.

In FY 2007/08 increasing every year GDP has reached to Rs. 781262 million, revenue deficit has increased to 53727.2 million, which was 6.9% of the GDP, and fiscal deficit was 33406.7 million which was 4.3% of the GDP.

The annual average growth rate of GDP during the review period was 12.4%.On an average annual revenue deficit and fiscal deficit as percentage of GDP were 7.6% and 5.7% during the study period. Both revenue and fiscal deficit has lowered down significantly, which indicates the improvement in the economic condition of the country.

Figure 2: GDP, Revenue Deficit and Fiscal Deficit



3.2.3 TREND OF SAVING INVESTMENT GAP

Saving is the excess of the income over the expenditure on consumption. In other words saving is considered as the difference between income and expenditure or consumption spending. Saving depends upon the various factors such as country's percpita income, population growth rate, financial facilities and interest rate on saving, net factor income**.** Investment is the value of the part of the aggregate output for any given time period which takes the form of construction of new structure, installing of new capital equipment and positive changes in business inventories in the economy.

Mobilization of saving implies that transfer of resources from the hand of surplus unit to deficit unit. In Nepal, saving investment gap is increasing rapidly each year, which indicates that saving is not sufficient to finance investment for development activities.

Table-3

Trend of Saving Investment Gap

Rs in million

Fiscal Year	GDP	Total Investment (TI)	Gross Domestic Saving (GDS)	Saving-Investment Gap (I-S)	Annual Growth Rate of (I-S) Gap	TI as % of GDP	GDS as % of GDP	(I-S) Gap as % of GDP
1988/89	85831	19415	10150	9265	-	22.6	11.8	10.8
1989/90	99702	19076	8143	10933	18.0	19.1	8.2	10.9
1990/90	116127	25074	11514	13560	24.0	21.6	9.9	11.7
1991/92	144933	31619	16207	15412	13.7	21.8	11.2	10.6
1992/93	165350	39653	23172	16481	6.9	24.0	14.0	10.0
1993/94	191596	44644	29220	15424	-6.4	23.3	15.2	8.1
1994/95	209974	55321	32465	22766	47.6	26.3	15.5	10.8
1995/96	239388	68017	34426	33591	47.5	28.4	14.4	14.0
1996/97	269570	71084	39162	31922	-5.0	26.4	14.5	11.8
1997/98	289798	74728	41438	33290	4.3	25.8	14.3	11.5
1998/99	330018	70061	46563	23498	-29.4	21.2	14.1	7.1
1999/00	366251	92272	57577	34695	47.6	25.2	15.7	9.5
2000/01	425454	98649	51501	47148	35.9	23.2	12.1	11.1
2001/02	444052	93020	43600	49420	4.8	20.9	9.8	11.1
2002/03	473546	105383	42141	63242	28.0	22.2	8.9	13.3
2003/04	517993	131671	63064	68607	8.5	25.4	12.2	13.2
2004/05	566579	155907	68110	87797	28.0	27.5	12.0	15.5
2005/06	630301	175603	58727	116876	33.1	27.9	9.4	18.5
2006/07	696989	203741	71902	131839	12.8	29.2	10.3	18.9
2007/08	781262	262582	91716	170866	29.6	33.6	11.7	21.9
Average Annual Rate					**18.4**	**24.8**	**12.3**	**12.5**

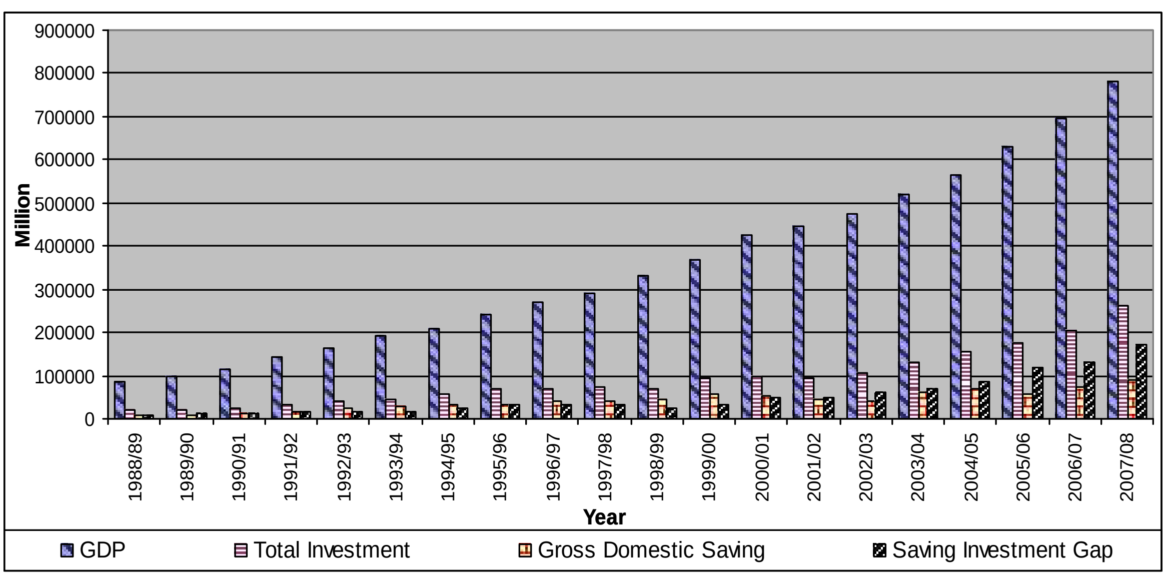
Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

In FY 1988/89, the volume of GDP was Rs. 85831 million which increased to Rs. 781262 million in FY 2007/08 with an annual average growth rate of 12.4%. In FY 1988/89, total Investment was Rs 19415 million i.e. 22.6% of GDP, which increased more than 13 times to reach Rs 262582 million in FY 2007/08 i.e. 33.6% of GDP. Similarly, Domestic Saving was Rs. 10150 million, i.e. 11.8% of GDP in FY 1988/89, which increased more than 9 times to reach Rs 91716 million, i.e. 11.7 of GDP in FY 2007/08. During the review period on an average total Investment was 24.8% of the GDP while the domestic saving was only 12.3% of GDP therefore the saving investment gap was 12.5% of the GDP.

The above table shows that the saving investment gap has increased to Rs.170866 million that was 21.9% of GDP in 2007/08 from Rs. 9265 million that was 10.8% of GDP. During the review period, annual average growth rate of saving investment gap was 18.4%.

The following figure shows the actual scenario of GDP, Total Investment, Gross Domestic Saving and Saving Investment. Where Saving Investment gap is in increasing trend.

Figure-3: Trend of Saving Investment Gap



3.2.4 FISCAL DEFICIT AND PUBLIC DEBT

In Nepalese fiscal system, the fiscal deficit is financed through both internal and external borrowing. In Nepal the accumulation of debt is mainly due fiscal deficit financing.

Table-4

Ratio of Government's Annual Debt to Fiscal Deficit

Rs. in million

Fiscal Year	Fiscal Deficit	Total Loans	Domestic Loans Do	xternal Loans E	Debt as % of fiscal deficit		
					Total	Domestic	External
1988/89	8547.5	6996.4	1330.0	5666.4	81.9	15.6	66.3
1989/90	8406.4	8109.6	2150.0	5959.6	96.5	25.6	70.9
1990/91	10655.1	10809.4	4552.7	6256.7	101.5	42.7	58.8
1991/92	11261.7	8895.7	2078.8	6816.9	78.9	18.4	60.5
1992/93	11956.0	8540.9	1620.0	6920.9	71.4	13.5	57.9
1993/94	11623.0	10983.6	1820.0	9163.6	94.5	15.7	78.8
1994/95	10547.7	9212.3	1900.0	7312.3	87.3	18.0	69.3
1995/96	13824.2	11663.9	2200.0	9463.9	84.4	15.9	68.5
1996/97	14361.9	12043.6	3000.0	9043.6	83.9	20.9	63.0
1997/98	17777.8	14454.5	3400.0	11054.5	81.3	19.1	62.2
1998/99	17991.4	16562.4	4710.0	11852.4	92.1	26.2	65.9
1999/00	17667.0	17312.2	5500.0	11812.2	98.0	31.1	66.9
2000/01	24188.1	19044.0	7000.0	12044.0	78.7	28.9	49.8
2001/02	22940.6	15698.7	8000.0	7698.7	68.4	34.9	33.5
2002/03	16437.1	13426.4	8880.0	4546.4	81.7	54.0	27.7
2003/04	15828.2	13236.8	5607.8	7629.0	83.6	35.4	48.2
2004/05	18046.5	18204.2	8938.1	9266.1	100.9	49.5	51.4
2005/06	24779.6	20048.5	11834.2	8214.3	80.9	47.7	33.2
2006/07	30091.7	27945.8	17892.3	10053.5	92.8	59.4	33.4
2007/08	33406.7	29476.3	20496.4	8979.9	88.2	61.3	26.9

Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

The table 4 depicts how the country is increasingly depending on public debt. The amount of fresh debt that the government annually borrows rose from Rs.6996.4 million in the fiscal year 1988/89 to touch Rs.29476.3 million in 2007/08. The analysis on annual growth of fresh loan shows that its amount rose more than four times during the study period.

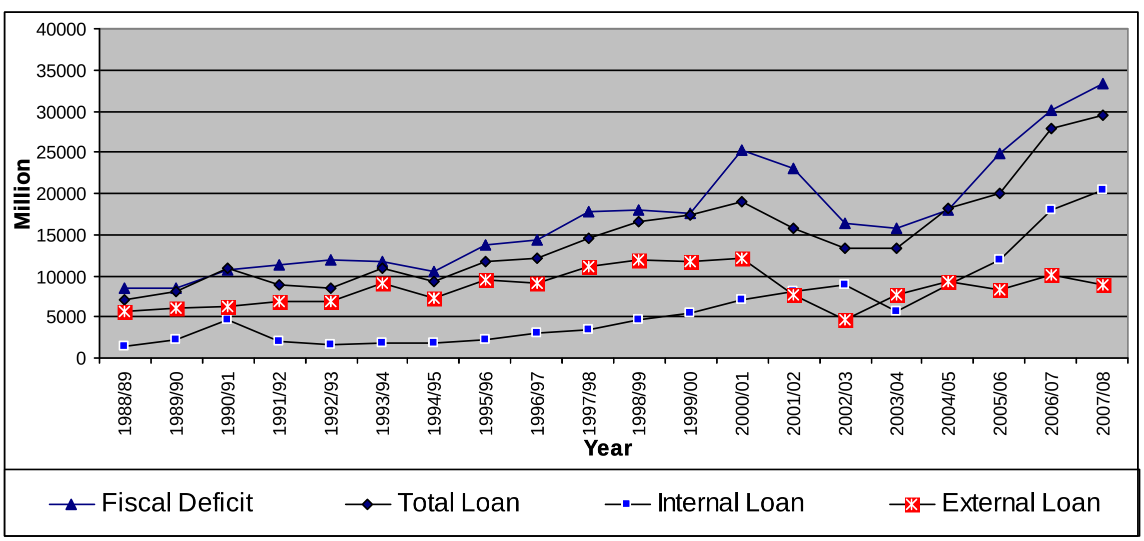
The growth of internal loan is much rapid than that of the external loan. Internal debt that was Rs 1330.0 million in 1988/89 rose to 20496.4 million in 2007/08. The government mobilized external loans of Rs 5666.4 million in 1988/89, while the amount was Rs 8979.90 million in 2007/08.

Of the total debt in 1988/89, the internal loan made up only 15.6 percent. Its share grew to 61.4 percent in 2007/08. On the other hand, the external debt that accounted for 66.3 percent in 1988/89 constituted 26.9 percent in 2007/08.

The scenario indicates that the government is growing reliance on domestic loan for meeting the ever-increasing fiscal deficit. During the 20 years, the economic performance was not conducive with low base of revenue and heightening regular expenditure, to minimize its dependency on loans to meet fiscal deficit.

The following figure shows that the government borrowing is increasing in both absolute and relative terms and also shows that the increasing reliance on internal borrowing.

Figure-4: Government's Fiscal Deficit Annual Loans



3.2.5 TREND OF GOVERNMENT BORROWING

Both external and internal borrowings have been increasing very rapidly in Nepal. Table 5 depicted government borrowing and annual growth rate between the period 1988/89 and 2007/08. As shown in the table 5 under the review period total government borrowing increased with an average annual growth rate of 9.4 percent from Rs.6996.8 million in 1988/89 to Rs.29476.3 million in 2007/08, there is more than 4 times increment in the annual borrowing of fresh loans.

Table-5

Government's Borrowing and Annual Growth Rate

Rs in million

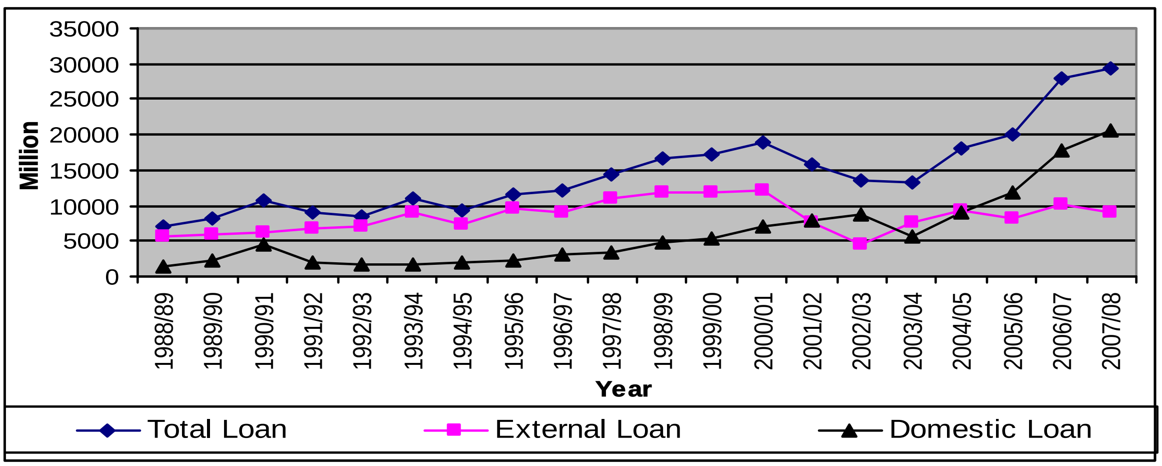
Fiscal Year	Total Loans (TL)	Annual Growth Rate of TL	External Loans (EL)	Annual Growth Rate of EL	Domestic Loan (DL)	Annual Growth Rate of DL	% Share of EL in TL	% Share of DL In TL
1988/89	6996.4	-	5666.4	-	1330.0	-	81.0	19.0
1989/90	8109.6	15.9	5959.6	5.2	2150.0	61.7	73.5	26.5
1990/90	10809.4	33.3	6256.7	4.9	4552.7	111.8	57.9	42.1
1991/92	8895.7	-17.7	6816.9	8.9	2078.8	-54.4	76.6	23.4
1992/93	8540.9	-3.9	6920.9	1.6	1620.0	-22.1	81.1	18.9
1993/94	10983.6	28.6	9163.6	32.5	1820.0	12.4	83.4	16.6
1994/95	9212.3	-16.2	7312.3	-20.3	1900.0	4.4	79.3	20.7
1995/96	11663.9	26.7	9463.9	29.5	2200.0	15.8	81.1	18.9
1996/97	12043.6	3.3	9043.6	-4.5	3000.0	36.4	75.1	24.9
1997/98	14454.5	20.1	11054.5	22.3	3400.0	13.4	76.5	23.5
1998/99	16562.4	14.6	11852.4	7.3	4710.0	38.6	71.6	28.4
1999/00	17312.2	4.6	11812.2	-0.4	5500.0	16.8	68.2	31.8
2000/01	19044.2	10.1	12044.0	1.9	7000.0	27.3	63.2	36.8
2001/02	15698.7	-17.6	7698.7	-36.1	8000.0	14.3	49.1	50.9
2002/03	13426.4	-14.5	4546.4	-40.9	8880.0	11	33.9	66.1
2003/04	13236.8	-1.5	7629.0	67.8	5607.8	-36.9	57.6	42.4
2004/05	18204.2	37.6	9266.1	21.5	8938.1	59.4	50.9	49.1
2005/06	20048.5	10.2	8214.3	-11.4	11834.2	32.5	41.0	59.0
2006/07	27945.8	39.4	10053.5	22.4	17892.3	51.2	36.0	64.0
2007/08	29476.3	5.5	8979.9	-10.7	20496.4	14.6	30.5	69.5
Average annual growth rate		9.4		5.4		21.5	63.4	36.6

Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

Similarly, external borrowing also increased with an average annual growth rate of 5.4 percent to Rs.8979.9 million in 2007/08, from Rs.5666.4 million in 1988/89. The amount of external debt that the government annually borrows is increasing at decreasing rate. The growth in internal borrowing was quite sharper. The government that borrowed Rs 1330.0 million as domestic loans in 1988/89, while it was Rs 20496.4 million in 2007/08, with an annual average growth of 21.5 percent.

The following figure depicts that the both external and domestic fresh borrowing is increasing. Where Domestic fresh loan is increasing higher than external loan in recent years.

Figure-5: Government's Borrowing and Annual Growth Rate



3.2.6 ANNUAL PUBLIC DEBT AS PERCENTAGE OF GDP

GDP is the market value of all currently produced final goods and services within the geographical boundary of the country within a year. According to World Bank GDP measures the total output of goods and services for final use produced by residents and non-residents regardless of the allocation of domestic and foreign claims.

The public borrowing is guided by the measure of the GDP. It is considered that for the economic betterment internal borrowing by the government should be in limit of 1 to 2 percent of the GDP, where there is no any standardized boundary for the external borrowing. Because it is believed that, the internal borrowing affects the private investment of the country in two ways, first it transfers the resources from private sector towards government sector and second it affects the capacity and willingness to save.

Table-6

Annual Public Debt as Percentage of GDP

Rs in million

Fiscal Year	GDP	Annual Growth Rate of GDP	Total Loan (TL)	Domestic Loan (DL)	External Loans (EL)	TL as % of GDP	DL as % of GDP	EL as % of GDP
1988/89	85831	-	6996.4	1330.0	5666.4	8.1	1.5	6.6
1989/90	99702	16.2	8109.6	2150.0	5959.6	8.1	2.1	6.0
1990/90	116127	16.5	10809.4	4552.7	6256.7	9.3	3.9	5.4
1991/92	144933	24.8	8895.7	2078.8	6816.9	6.1	1.4	4.7
1992/93	165350	14.1	8540.9	1620.0	6920.9	5.2	1.0	4.2
1993/94	191596	15.9	10983.6	1820.0	9163.6	5.7	0.9	4.8
1994/95	209974	9.6	9212.3	1900.0	7312.3	4.4	0.9	3.5
1995/96	239388	14.0	11663.9	2200.0	9463.9	4.8	0.9	3.9
1996/97	269570	12.6	12043.6	3000.0	9043.6	4.5	1.1	3.4
1997/98	289798	7.5	14454.5	3400.0	11054.5	5.0	1.2	3.8
1998/99	330018	13.7	16562.4	4710.0	11852.4	5.0	1.4	3.6
1999/00	366251	10.9	17312.2	5500.0	11812.2	4.7	1.5	3.2
2000/01	425454	16.2	19044.2	7000.0	12044.0	4.5	1.6	2.8
2001/02	444052	4.4	15698.7	8000.0	7698.7	3.5	1.8	1.7
2002/03	473546	6.6	13426.4	8880.0	4546.4	2.8	1.9	0.9
2003/04	517993	9.4	13236.8	5607.8	7629.0	2.6	1.1	1.5
2004/05	566579	9.4	18204.2	8938.1	9266.1	3.2	1.6	1.6
2005/06	630301	11.2	20048.5	11834.2	8214.3	3.2	1.9	1.3
2006/07	696989	10.6	27945.8	17892.3	10053.5	4.0	2.6	1.4
2007/08	781262	12.1	29476.3	20496.4	8979.9	3.8	2.6	1.1
Average annual growth rate		12.4				4.9	1.7	3.3

Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

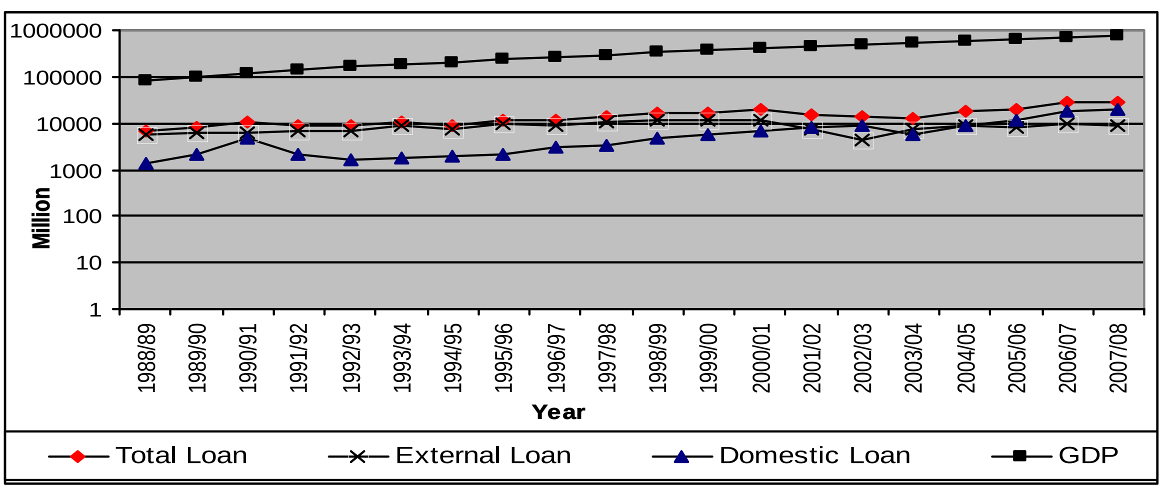
The above table shows that under the study period GDP at factor price increased with an annual average growth rate of 12.4% from 85831 million in FY 1988/89 to 781262 million in FY 2007/08.

The annual total fresh loan was Rs. 6996.4 million in FY 1988/89, which rose to 29476.3 million in FY 2007/08.Out of total annual fresh loan annual domestic fresh loan was Rs. 1330.0 million in FY 1988/89, which rose to 20496.4 million in FY 2007/08. And the external fresh loan was Rs. 5666.4 million in FY 1988/89, which was Rs. 8979.9 million in FY 2007/08.

During the study period on an average annual total fresh loan as percentage of GDP was 4.9% where annual average domestic fresh loan and external fresh loan were 1.75 and 3.3% simultaneously.

The following logarithmic figure shows the actual situation of GDP and annual fresh loans. Where the GDP growth is very high and the domestic fresh loan has increased more than the external.

Figure-6 Annual Public Debt as Percentage of GDP



3.2.7 TREND OF OUTSTANDING PUBLIC DEBT (INTERNAL AND EXTERNAL)

Nepal started to raise the debt in 1961/62 systematically. From the very beginning of borrowing, it has kept the vital supporting role to meet the public expenditure.

However, now days the fiscal deficit of country has been ever growing. The result is increment in the volume of outstanding public debt. To meet the financial resource gap, the government has to borrow a large amount of loan. There is ever increasing trend of financial resource gap to fill the needs loan from both external and internal sources. There is ever increasing trend of financial resource gap, which needs more loan and repayment principal and interest for total borrowing in each year. It makes the outstanding public debt is in increasing trend.

Table-7

Trend of Outstanding Public Debt

Rs. in million

Fiscal Year	Total Outstanding Debt (TOD)	Annual Growth Rate	External Outstanding Debt (EOD)	Annual Growth Rate of EOD	Domestic Outstanding Debt (DOD)	Annual Growth rate of DOD	% of EOD in TOD	% of DOD in TOD
1988/89	42104.8	-	29216.9	-	12887.9	-	69.4	30.6
1989/90	51474.0	22.3	36800.9	26.0	14673.1	13.9	71.5	28.5
1990/91	80361.2	56.1	59505.3	61.7	20855.9	42.1	74.1	25.9
1991/92	94158.8	17.2	70923.9	19.2	23234.9	11.4	75.3	24.7
1992/93	112876.9	19.9	87420.8	23.3	25456.1	9.6	77.4	22.6
1993/94	132598.0	17.5	101966.8	16.6	30631.2	20.3	76.9	23.1
1994/95	145058.7	9.4	113000.9	10.8	32057.8	4.7	77.9	22.1
1995/96	162286.3	11.9	128044.4	13.3	34241.9	6.8	78.9	21.1
1996/97	167977.7	3.5	132086.8	3.2	35890.9	4.8	78.6	21.4
1997/98	199614.7	18.8	161208.0	22.0	38406.7	7.0	80.7	19.3
1998/99	219135.6	9.8	169465.9	5.1	49669.7	29.3	77.3	22.7
1999/00	245048.2	11.8	190691.2	12.5	54357.0	9.4	77.8	22.2
2000/01	260448.0	6.3	200404.4	5.1	60043.6	10.5	76.9	23.1
2001/02	293746.3	12.8	220125.6	9.8	73620.7	22.6	74.9	25.1
2002/03	308078.5	4.9	223433.2	1.5	84645.3	15.0	72.5	27.5
2003/04	318913.0	3.5	232779.3	4.2	86133.7	1.8	73.0	27.0
2004/05	307206.1	-3.7	219641.9	-5.6	87564.2	1.7	71.5	28.5
2005/06	328679.4	7.0	233968.6	6.5	94710.8	8.2	71.2	28.8
2006/07	320404.9	-2.5	216628.9	-7.4	103776.1	9.6	67.6	32.4
2007/08	366004.9	14.2	249965.4	15.4	116039.5	11.8	68.3	31.7
Average Annual Growth Rate		**12.8**		**12.8**		**12.7**	**74.5**	**25.5**

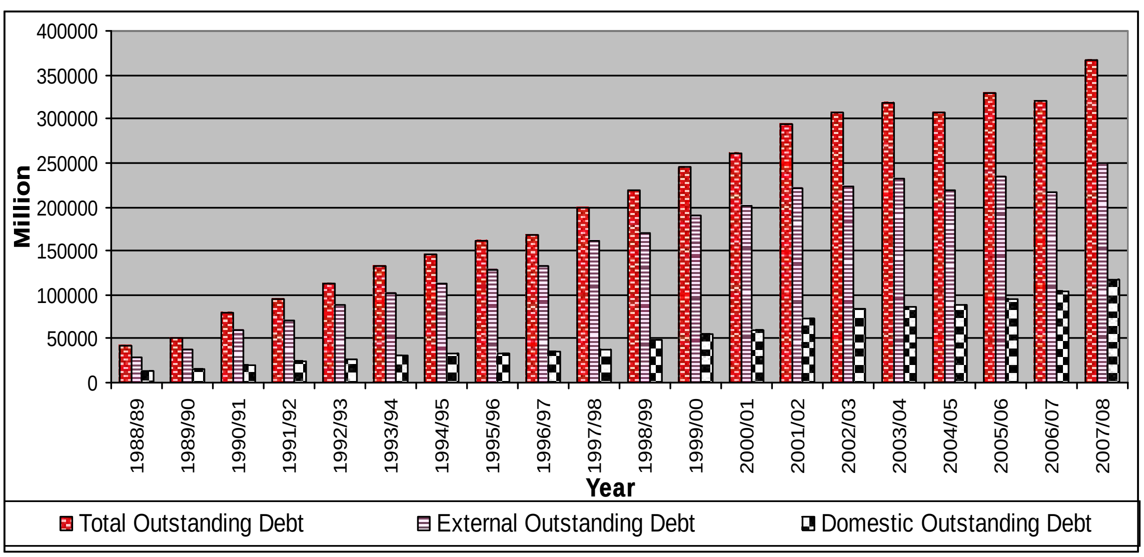
Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

Table 7 shows trend of outstanding external and internal public debt and annual growth rates between the period 1988/89 and 2007/08. On an average, the outstanding public debt rose by 12.8 percent annually. The country owed debt amounting to Rs 366004.91 million in 2007/08, steep up from Rs 42104.8 million in the year 1988/89. Of the total outstanding debt, the external debt has huge share, with accounting for 68.3 percent in 2007/08. Its share was 69.4 percent in 1988/89.

The trend shows that Nepal is indebted by foreigner to considerable extent. Likewise, the average annual growth rate of outstanding external public debt is almost equal to the outstanding internal public debt during the study period. Hence, the government should pay serious attention towards the burden of external debt.

The following figure depicts the outstanding debt situation in Nepal. Where both domestic and external outstanding debt is increasing but the increasing trend of external debt is higher than domestic.

Figure-7: Trend of Outstanding Public Debt



3.2.8 SHARE OF OUTSTANDING PUBLIC DEBT IN GDP

The measurement of GDP is statistically considered the significant source for interpretation of both micro and macro economy. The function of debt borrowing is also guided by the indices of GDP. Theoretically, it is assumed that government should borrow the internal debt in limit of 1-2 percent of GDP for the betterment of the economy. However, there is no any boundary in case of foreign borrowing however; it is considered keeping it within certain limit of GDP.

Public debt is mounting up in increasing trend. The internal debt has increased to Rs 116039.5 million in 2007/08, from Rs 12887.9 million 1988/89, while the external debt has reached to Rs 249965.4 million in 2007/08, from Rs 29216.9 million 1988/89 over the 20 years

Table-8
Outstanding Public Debt as a Percentage of GDP

Rs in million

Fiscal Year	GDP	Total Outs tanding Public Debt (TOPD)	Internal Outstandi ng Debt (IOD)	External Outstandi ng Debt (EOD)	TOPD as % of GDP	IOD as % of GDP	EOD as % of GDP
1988/89	85831	42104.8	12887.9	29216.9	49.1	15.1	34.0
1989/90	99702	51474.0	14673.1	36800.9	51.6	14.7	36.9
1990/91	116127	80360.2	20854.9	59505.3	69.2	17.9	51.3
1991/92	144933	94158.8	23234.9	70923.9	65.0	16.1	48.9
1992/93	165350	112876.9	25456.1	87420.8	68.3	15.4	52.9
1993/94	191596	132598.0	30631.2	101966.8	69.2	16.0	53.2
1994/95	209974	145058.7	32057.8	113000.9	69.1	15.3	53.8
1995/96	239388	162286.3	34241.9	128044.4	67.8	14.3	53.5
1996/97	269570	167977.7	35890.9	132086.8	62.3	13.3	49.0
1997/98	289798	199614.7	38406.7	161208.0	68.9	13.3	55.6
1998/99	330018	219135.5	49669.6	169465.9	66.4	15.1	51.3
1999/00	366251	245048.2	54357.0	190691.2	66.9	14.8	52.1
2000/01	425454	260448.1	60043.7	200404.4	61.2	14.1	47.1
2001/02	444052	293746.3	73620.7	220125.6	66.2	16.6	49.6
2002/03	473546	308078.5	84645.3	223433.2	65.1	17.9	47.2
2003/04	517993	312573.7	79794.4	232779.3	61.6	16.6	45.0
2004/05	566579	305106.9	85465.0	219641.9	54.2	15.4	38.8
2005/06	630301	327816.3	93596.3	234220.0	52.1	15.0	37.1

2006/07	696989	320404.9	103776.0	216628.9	46.0	14.9	31.1
2007/08	781262	366004.91	116039.5	249965.4	46.8	14.8	32.0
Annual average percentage					61.4	15.3	46.1

Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

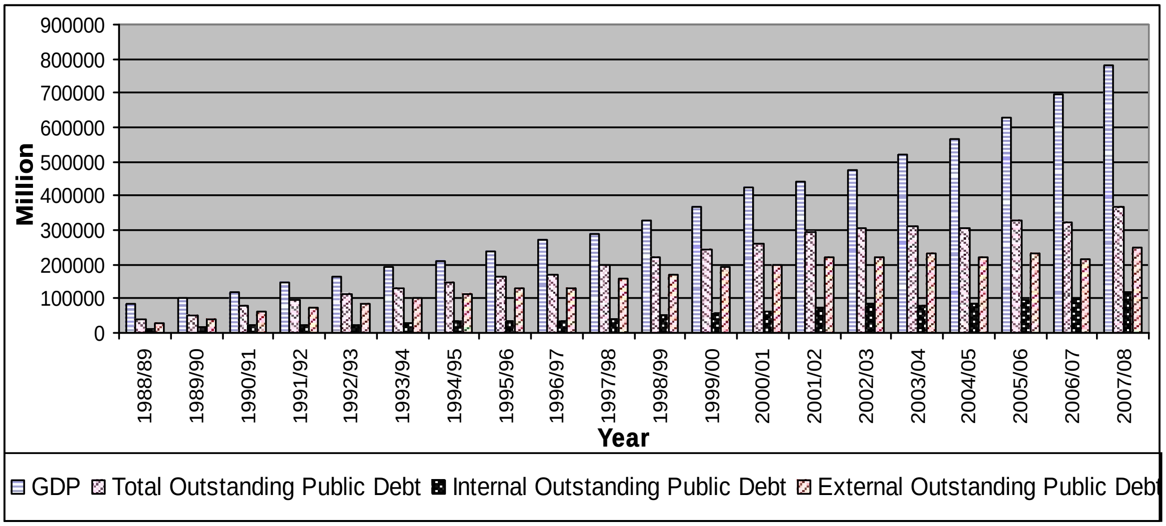
Table 8 shows the percentage share of external and internal outstanding public debt in GDP. The outstanding public debt at a rate of GDP has fluctuated from 49.1 percent in 1988/89, 69.2 percent in 1990/91 & 1993/94. Later, it decreased to 46.8 percent in 2007/08.

The part of external outstanding public debt as percentage of GDP was 34.0 percent in 1988/89 and fluctuating in various years touched to 55.6 percent in 1997/98 and lowered down to32.0 percent in 2007/08.

Internal debt however, does not cause a direct variation in resources availability for the country, but it may adversely affect on the economic phenomenon of the country, in case debt is too large and misused. The increasing trend of external public debt shows the dependency of country on the foreign loan. Moreover, the present holding of public debt can impose a burden upon the future generation. It, now a days, reduce saving to meet the debt finance and there by leaving a smaller amount of capital resources for future. Therefore, we should pay our attention for proper use of public debt so that we can generate the sufficient cash through financing the debt.

Comparing both domestic and external outstanding debt with the GDP, the following figure depicts the outstanding debt situation in Nepal.

Figure-8: Outstanding Public Debt as a Percentage of GDP



3.2.9 STRUCTURE OF OUTSTANDING INTERNAL DEBT

In Nepal, domestic borrowing has been systematically carried out since 1961. Domestic borrowing has been used primarily to meet the budgetary deficit and also to meet shortfall in the cash flow. The types of bonds and treasury bills used by the government to collect the internal debt are Treasury Bills, Development Bonds, National Saving Certificate, Civil Saving Certificates and Special Bonds. Treasury Bill was introduced in 1962, Development Bond was introduced in 1963/64, National Saving Certificate was introduced in 1984 and Citizen saving certificate was introduced in 2002. These bonds and bills are of regular nature. Some of them are issued as deficit financing instrument while others are issued with a view to deepen the money market. Besides there are many others bonds such as Special Bonds: Land compensation Bond 1964, Forest Compensation Bond 1965, Interest Prize Bond 1991 etc and other various special bonds.

Treasury bills are the short-term loan as these are raised for the period of less than one year. Other remaining instruments are considered as long-term loan as they are issued for more than one year. Generally, Treasury bills are issued for the period of 91 days and development bonds and national saving certificates are issued for 3 to 15 years.

So far, the ownership of the bonds and bills is concerned; the ownership can broadly classified into Nepal Rastra Bank, Commercial Banks, Public and Private Organizations, and Individuals and others. Until 2000, Nepal Rastra Bank remained the first and the

Commercial Banks second in ownership sharing in the total domestic public debt but after 2001 Commercial Banks are playing the lead role.

Net outstanding internal debt in FY 1988/89 was Rs. 12887.9 million which increased more than nine times to touch Rs. 116039.5 million in FY 2007/08 with an annual average growth rate of 12.7%.

The following table shows the structure of outstanding internal debt and its composition. Where Treasury bills and Special Bonds have great contribution than other.

Table-9
Structure of Outstanding Internal debt

Rs in Million

Fiscal Year	Total Out standing Internal Debt	Treasury Bills	Development Bonds	National Saving Certificate	Special Bonds	% Share of Treasury Bills	% Share of Development Bonds	% Share of National Saving Certificate	% Share of Special Bonds
1988/89	12887.9	1171.0	5088.6	2196.5	4431.8	9.1	39.5	17.1	34.3
1989/90	14673.1	1821.0	5388.6	2896.5	4567.0	12.4	36.7	19.7	31.2
1990/90	20854.9	2350.0	5482.3	3646.5	9376.1	11.3	26.3	17.5	44.9
1991/92	23234.9	3483.2	5132.2	4546.3	10073.2	15.0	22.0	19.6	43.4
1992/93	25456.1	4403.2	5132.2	4901.5	11019.2	17.3	20.2	19.2	43.3
1993/94	30631.2	5216.3	4732.2	5691.5	14991.2	17.1	15.4	18.6	48.9
1994/95	32057.8	6392.5	4122.2	6076.4	15466.7	19.9	12.8	19.0	48.3
1995/96	34241.9	7142.5	3672.2	7376.5	16050.7	20.8	10.8	21.5	46.9
1996/97	35890.9	8092.5	3042.2	8736.5	16019.7	22.5	8.5	24.3	44.7
1997/98	38406.7	7117.8	3302.2	9886.4	16035.6	19.6	9.1	27.2	44.1
1998/99	49669.6	17586.9	3872.2	10426.4	17784.1	35.4	7.8	21.0	35.8
1999/00	54357.0	21027.0	4262.1	11526.5	17541.4	38.7	7.8	21.2	32.3
2000/01	60043.7	27610.8	5962.2	12476.4	13994.4	46.0	9.9	20.8	23.3
2001/02	73620.7	41106.5	11090.7	12164.2	9259.3	55.8	15.1	16.5	12.6
2002/03	84645.3	48860.7	16059.2	10560.9	9164.5	57.7	19.0	12.5	10.8
2003/04	86133.7	49429.6	17549.2	10208.7	8946.2	57.0	20.2	11.8	10.0
2004/05	87564.2	51383.6	19999.2	8005.6	8176.3	58.7	22.8	9.1	9.4
2005/06	94710.8	62970.3	17959.2	5555.7	8225.6	66.5	18.9	5.9	8.7
2006/07	103776.1	74445.3	19177.2	2907.9	7225.7	71.7	18.5	2.8	7.0
2007/08	116039.5	85033.0	21735.4	4131.3	5139.8	73.3	18.7	3.6	4.4

Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

Note: For the year onwards, 2002 National Saving Certificate is calculated including Citizen Saving Certificate.
Citizen Saving Certificate was introduced in year 2002.

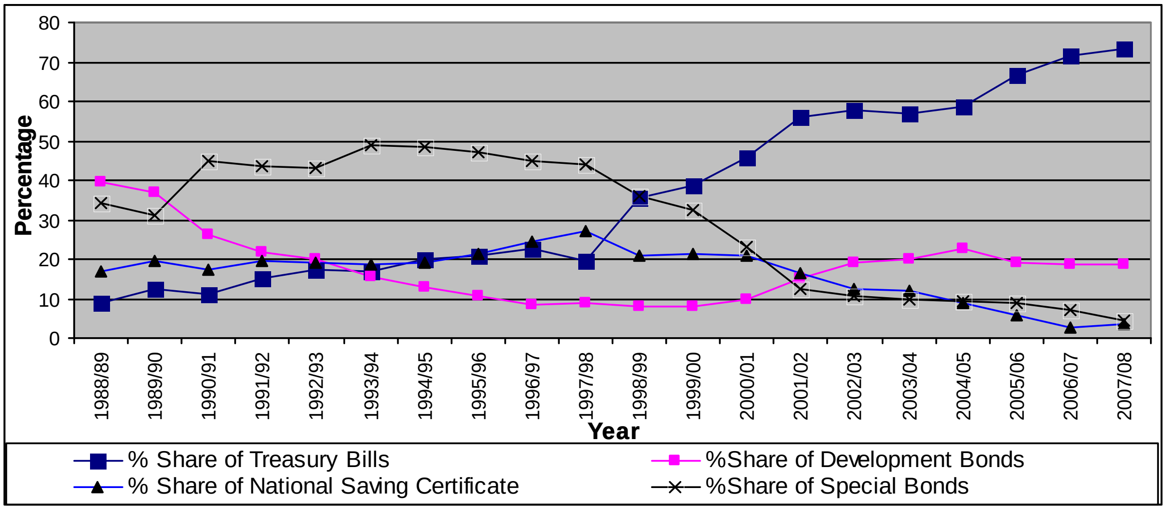
The contributing share of each bond and bill does not have uniform and certain dynamic tendency. Treasury bills, Development Bonds, National Saving Certificate, and Special Bonds were amounted Rs. 1171.0, Rs 5088.6, Rs. 2196.5, and Rs. 4431.8 million respectively in FY 1988/89. And fluctuating in various years increased to Rs. 85033.0, Rs. 21735.4, Rs. 4131.3 and Rs. 5139.8 million respectively in FY 2007/08.

The percentage share of treasury bills was 9.1% in FY 1988/89, which increased drastically to 73.3% in FY 2007/08. The percentage shares of Development Bonds were 39.5% in FY 1988/89, which fluctuating in various years and lowered down to 18.7% in FY 2007/08. The percentage shares of National Saving Certificate were17.1 percentage in FY 1988/89, which was maximum at 27.2% in FY 1997/98 and sharply decreased to 3.6% in 2007/08. Similarly, Special Bonds were 34.3% in FY 1988/89 it was at maximum at 48.9% in 1993/94 and decreased to 4.4% in FY 2007/08.

During the study period on an average Treasury Bills was 36.3%, Development Bond was 18%, National Saving Certificate was 16.5% and Special Bonds was 29.2% of the Total Outstanding Internal Debt.

The following figure shows the percentage share of various instruments of outstanding internal debt. Where share of Treasury Bills is in increasing trend.

Figure-9: Structure of Outstanding Internal debt



CHAPTER FOUR

DEBT SERVICING SITUATION IN NEPAL

4.1 DEBT SERVICING

The repayment of interest and principal of the public debt to the creditors is known as debt servicing. Due to the poor economic performance, Nepalese economy is heavily dependent upon public debt. For the existing debt servicing purpose the government has to spend a huge amount of money each year.

4.1.1 DEBT SERVICING IN NEPAL

The total amount of interest payments and repayments of principal on public debt is called debt servicing.

The annual growth rate of total debt is growing rapidly than domestic saving because most of the borrowing is expensed for regular expenditure rather than development expenditure. The rapidly increasing debt leads to increasing debt servicing problem. For the repayment of existing debt, the government is further taking loans and imposing extra taxes, which increase the financial and real burden for the nation.

The above table shows that the amount of the Total Debt Servicing in FY 1988/89 was Rs.1720.7 million, which increased to Rs.22760.5 in FY 2007/08 with an annual average growth rate of 15.3 %.

Table-10

Debt Servicing situation in Nepal

Rs. in million

Fiscal Year	Total Debt Servicing (TDS)	Annual Gro wth Rate of TDS	Internal Debt Servicing (IDS)	Annual Growth Rate of IDS	External Debt Servicing (EDS)	Annual Growth rate of EDS	%Share of IDS in TDS	%Share of EDS in TDS
1988/89	1720.7	-	1019.4	-	701.3	-	59.2	40.8
1989/90	2279.2	32.5	1155.6	13.4	1123.6	60.2	50.7	49.3
1990/90	2407.4	5.6	1320.4	14.3	1086.5	-3.3	54.8	45.2
1991/92	3797.1	57.7	2132.2	61.5	1664.9	53.2	56.2	43.8
1992/93	4560.5	20.1	2428.6	13.9	2131.9	28.1	53.3	46.7
1993/94	4855.1	6.5	2366.4	-2.6	2488.7	16.7	48.7	51.3
1994/95	6083.3	25.3	3098.6	30.9	2984.7	19.9	50.9	49.1
1995/96	6715.5	10.4	3411.1	10.1	3304.3	10.7	50.8	49.2
1996/97	7527.2	12.1	4177.8	22.5	3349.4	1.4	55.5	44.5
1997/98	7682.8	2.1	3481.6	-16.7	4201.2	25.4	45.3	54.7
1998/99	8823.0	14.8	4077.5	17.1	4745.5	12.9	46.2	53.8
1999/00	10032.8	13.7	4711.4	15.5	5321.4	12.1	47.0	53.1
2000/01	10388.4	3.5	4187.0	-11.1	6201.4	16.5	40.3	59.7
2001/02	12205.2	17.5	5637.7	34.6	6567.5	5.9	46.2	53.8
2002/03	16181.3	32.6	8663.4	53.7	7517.9	14.5	53.5	46.5
2003/04	17338.8	7.2	9431.2	8.9	7907.6	5.2	54.4	45.6
2004/05	19751.3	13.9	11651.3	23.5	8100	2.4	59.0	41.0
2005/06	20423.5	3.4	11272.1	-3.2	9151.4	13.0	55.2	44.8
2006/07	22916.3	12.2	13321.8	18.2	9594.5	4.8	58.1	41.9
2007/08	22760.5	-0.7	12745.9	-4.3	10014.7	4.4	56.0	44.0
Average Annual Growth Rate		**15.3**		**15.8**		**16.0**	**52.1**	**47.9**

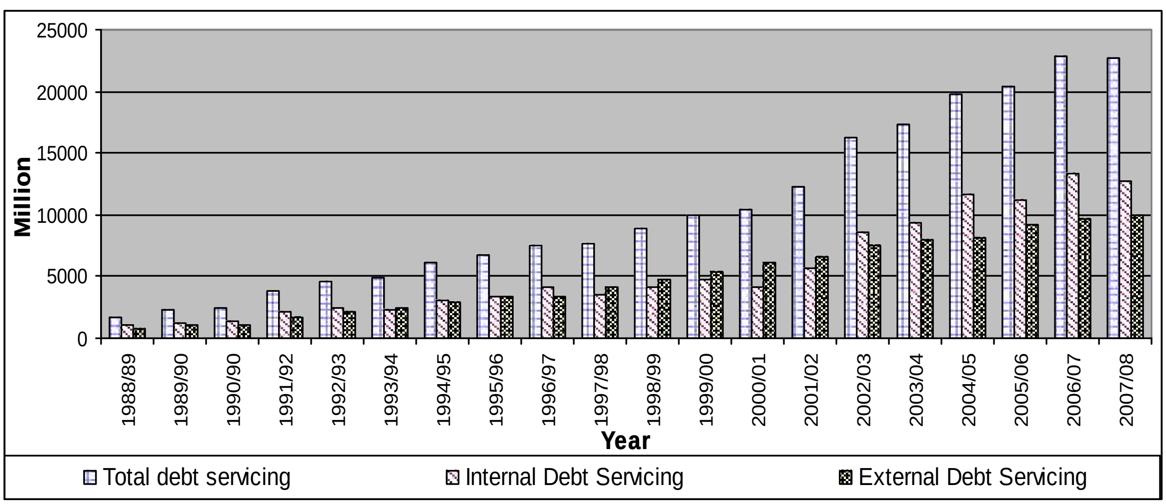
Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

The internal debt servicing in FY 1988/89 was Rs.1019.4 million which increased more than twelve times to reach Rs.12745.9 million in FY 2007/08 with an annual average growth rate of 15.8%. Similarly, external debt servicing in Nepal was Rs.701.3 million that increased more than fourteen times to reach Rs.10014.7 million with an annual average growth rate of 16.0%.

The percentage share of internal debt servicing and external debt servicing in Total debt servicing was 59.2% and 40.8% respectively in FY 1988/89 fluctuating in various years, which remained 56.0% and 44.0% respectively in FY 2007/08. During the study period on an average, 52.1% was the domestic debt servicing and 47.9% was external debt servicing in the total debt servicing.

The following figure clearly shows the debt-servicing situation in Nepal. Both internal and external debt servicing are increasing each year, where internal debt servicing is higher than external debt servicing.

Figure-10: Debt servicing situation in Nepal



4.1.2 PRINCIPAL AND INTEREST TO TOTAL DEBT SERVICING

The burden of debt servicing has been increased due to rapid increase in the debt servicing of both internal and external borrowing. Government spends a huge fund for the debt servicing purpose, which ultimately affects the welfare of the people.

Table-11

Principal and Interest Servicing to Total Debt Servicing

Rs in Million

Fiscal Year	Total Debt Servicing (TDS)	Principal servicing		Interest Servicing		Percentage of Principal Servicing to TDS		Percentage of Interest Servicing to TDS	
		Internal Debt	External Debt	Internal Debt	External Debt	Internal Debt	External Debt	Internal Debt	External Debt
1988/89	1720.7	145.5	388.6	873.9	312.7	8.4	22.6	50.8	18.2
1989/90	2279.2	100.5	701.8	1055.1	421.8	4.4	30.8	46.3	18.5
1990/90	2407.4	150.0	589.0	1170.4	497.5	6.2	24.5	48.6	20.7
1991/92	3797.1	264.8	942.2	1867.4	722.7	7.0	24.8	49.2	19.0
1992/93	4560.5	345.0	1252.9	2083.6	879.0	7.6	27.5	45.6	19.3
1993/94	4855.1	430.0	1468.2	1936.4	1020.5	8.8	30.2	39.9	21.1
1994/95	6083.3	825.0	1828.2	2273.6	1156.5	13.6	30.0	37.4	19.0
1995/96	6715.5	859.8	1987.7	2551.3	1316.6	12.8	29.6	38.0	19.6
1996/97	7527.2	1350.9	2102.4	2826.9	1247.0	17.9	27.9	37.6	16.6
1997/98	7682.8	1151.0	2780.2	2330.6	1421.0	15.0	36.2	30.3	18.5
1998/99	8823.0	1546.2	3196.5	2531.3	1549.0	17.5	36.2	28.7	17.6
1999/00	10032.8	1531.6	3681.1	3179.8	1640.3	15.3	36.7	31.7	16.3
2000/01	10388.4	1190.0	4500.6	2997	1700.8	11.5	43.3	28.8	16.4
2001/02	12205.2	1683.6	4751.2	3954.2	1816.1	13.8	38.9	32.4	14.9
2002/03	16181.3	4063.3	5496.2	4600.1	2021.7	25.1	34.0	28.4	12.5
2003/04	17338.8	5029.1	5765.8	4402.1	2141.8	29.0	33.2	25.4	12.4
2004/05	19751.3	7580.1	5953.2	4071.2	2146.8	38.4	30.1	20.6	10.9
2005/06	20423.5	7277.3	6987.5	3994.8	2163.9	35.6	34.2	19.6	10.6
2006/07	22916.3	9213.5	7583.8	4108.3	2055.7	40.2	32.9	17.9	9.0
2007/08	22760.5	8517.5	7869.4	4228.4	2145.3	37.4	34.6	18.6	9.4
Average Annual Percentage						18.3	31.9	33.8	16.0

Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance

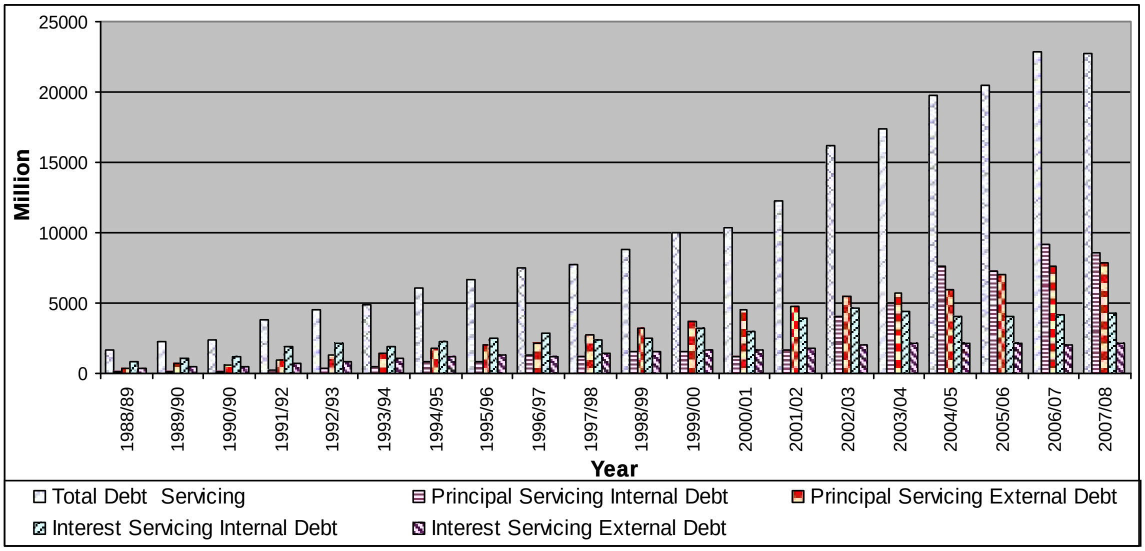
From the above table, it is clearly pictured that a large amount is going on as principal servicing for both internal and external debt. In 1988/89 principal servicing amount for Internal and external debt were Rs 145.5 million and Rs 388.6 million; which were 8.4 and 22.6 percentage of total debt servicing respectively. This has reached to Rs 8517.5 and Rs 7869.4 million in 2007/08; which were 37.4 and 31.9 percentage of total debt servicing respectively. It clearly shows that principal servicing for internal debt has grown up rapidly as compared to external loan. In the review period principal servicing for internal loan has increased more than 58 times whereas it has only 20 times increment to external.

In 1988/89 interest servicing amount for internal and external debt were 873.9 & 312.7 million; which were 50.8 and 18.2 percentage of total debt servicing respectively. This has reached to 4228.4 & 2145.3 million in 2007/08; which were 18.6 and 9.4 percentage of total debt servicing respectively. The interest rate of internal loan is usually higher than external loan so interest servicing for internal loan is higher as compared to the external.

During the review period on an average annually 18.3 and 31.9 percent of total debt servicing was spent on principal servicing of internal debt and external debt respectively. similarly, 33.8 and 16.0 percent of total debt servicing was spent on interest servicing of internal debt and external debt respectively.

The following figure shows the Interest and Principal servicing situation in Nepal. Where both interest and principal debt servicing for internal debt are increasing each year as compared to the external debt servicing.

Figure-11: Principal and Interest Servicing to Total Debt Servicing



4.1.3 SHARE OF EXTERNAL AND INTERNAL DEBT SERVICING AS PERCENTAGE OF GDP

GDP is the market value of all currently produced final goods and services within the geographical boundary of the country within a year. It also shows the performance of various sector of the economy. The principle and interest payment of public debt is known as debt servicing.

The burden of internal debt can be examined by taking consideration of national income, government expenditure and revenue. On the following table, an attempt has been made to analyze the internal debt-servicing situation with respect to GDP.

Debt servicing of foreign loan has double burden. First, debt servicing has the primary claim upon the allocation of national budget. To that extent priority for economic activities such as irrigation, drinking water, health education, road and electricity are deprived of resources. Secondly, debt servicing of external debt involves the scarcest resources, the foreign exchange. It curbs the capacity to import important capital goods needed for the country. The annual growth rate of the total debt servicing as percentage of GDP of the country is shown in the table 12.

Table-12

Debt Servicing as Percentage of GDP

Rs in million

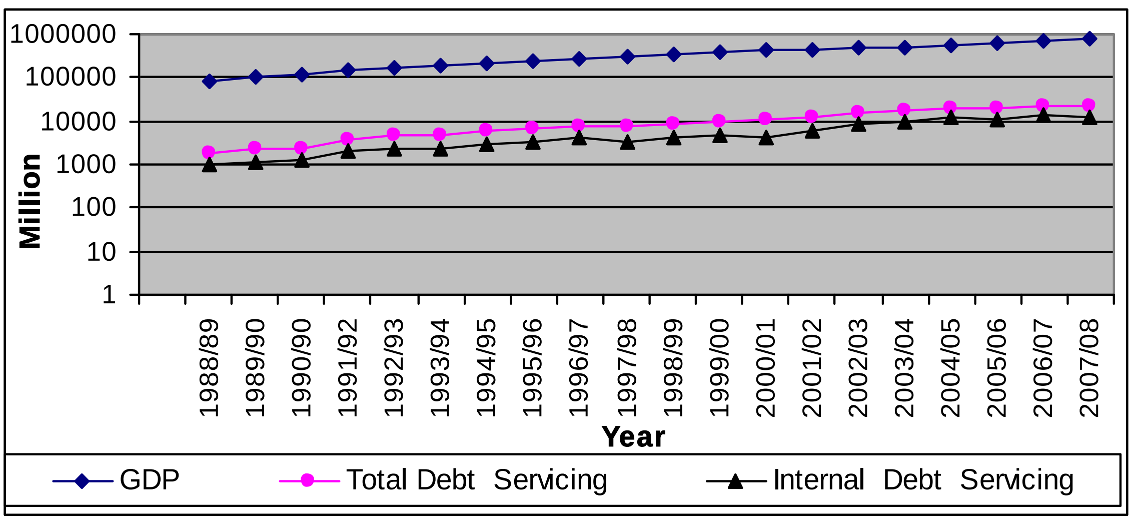
Fiscal Year	**GDP**	**Annual growth rate of GDP**	**Total Debt Servicing (TDS)**	**Annual growth rate of TDS**	**TDS as % of GDP**	**Internal Debt Servicing**	**IDS as % of GDP**
1988/89	85831	-	1720.7	-	2.0	1019.4	1.2
1989/90	99702	16.2	2279.2	32.5	2.3	1155.6	1.5
1990/90	116127	16.5	2407.4	5.6	2.1	1320.4	1.1
1991/92	144933	24.8	3797.1	57.7	2.6	2132.2	1.5
1992/93	165350	14.1	4560.5	20.1	2.8	2428.6	1.5
1993/94	191596	15.9	4855.1	6.5	2.5	2366.4	1.2
1994/95	209974	9.6	6083.3	25.3	2.9	3098.6	1.5
1995/96	239388	14.0	6715.5	10.4	2.8	3411.1	1.4
1996/97	269570	12.6	7527.2	12.1	2.8	4177.8	1.5
1997/98	289798	7.5	7682.8	2.1	2.7	3481.6	1.2
1998/99	330018	13.7	8823.0	14.8	2.7	4077.5	1.2
1999/00	366251	10.9	10032.8	13.7	2.7	4711.4	1.3
2000/01	425454	16.2	10388.4	3.5	2.4	4187.0	1.0
2001/02	444052	4.4	12205.2	17.5	2.7	5637.7	1.3
2002/03	473546	6.6	16181.3	32.6	3.4	8663.4	1.8
2003/04	517993	9.4	17338.8	7.2	3.3	9431.2	1.8
2004/05	566579	9.4	19751.3	13.9	3.5	11651.3	2.1
2005/06	630301	11.2	20423.5	3.4	3.2	11272.1	1.8
2006/07	696989	10.6	22916.3	12.2	3.3	13321.8	1.9
2007/08	781262	12.1	22760.5	-0.7	2.9	12745.9	1.6
Annual Average Growth Rate		**12.4**		**15.3**	**2.8**		**1.5**

Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

In absolute term, the Total Debt Servicing was Rs.1720.7 million in the year 1988/89. It reached Rs.22760.5 million in 2007/08, which experienced whopping growth of 1223 percent over the 20 years. On an average, its annual growth was 15.3 percent.

Higher debt servicing means debt is mounting each year. Average annual total debt servicing as percentage of GDP is 2.8 percent. This clearly shows that the average annual growth rate of total debt servicing is far higher than that of the average annual growth rate of GDP. It indicates that increasing portion of GDP is spent for debt servicing each year. There is no continuous increase or decrease in the trend of annual growth rate of total debt servicing. We found it in fluctuating form. Annual growth rate of total debt servicing is highest, i.e.57.7 percent, in fiscal year 1991/92. This may happen due to repayment of large amount of interest and principal of matured debt. Likewise, the annual growth rate of GDP is highest, i.e. 24.8 Percent in the same fiscal year. Similarly, the internal debt servicing as percentage of GDP was 1.2% in FY 1988/89 and remained 1.6% in FY 2007/08. The annual average growth rate of internal debt servicing as percent of GDP was 1.5%.

Figure-12: Debt Servicing as Percentage of GDP



4.1.4 ANNUAL PUBLIC DEBT AND ITS SERVICING TRENDS

Government of Nepal is spending a huge fund for the debt servicing purpose. Both internal and external debt servicing has been increased every year. For the repayment of internal and external debt, government is taking fresh loans. The growing trend of borrowing further leads to debt servicing problem.

The ratio of internal debt servicing to the government revenue is an important indicator for estimating burden of internal debt servicing charge. It also shows the governments ability to borrow and mobilize resources from internal sources.

Table-13

Annual Public Debt and its Servicing Trends

Rs in million

Fiscal Year	**Annual Internal Debt (AID)**	**Internal Debt Servicing (IDS)**	**IDS as % of AID**	**Annual External Debt (AED)**	**External Debt Servicing (EDS)**	**EDS as % of AED**
1988/89	1330.0	1019.4	76.6	5666.4	701.3	12.4
1989/90	2150.0	1155.6	53.7	5959.6	1123.6	18.9
1990/90	4552.7	1320.4	29.0	6256.7	1086.5	17.4
1991/92	2078.8	2132.2	102.6	6816.9	1664.9	24.4
1992/93	1620.0	2428.6	149.9	6920.9	2131.9	30.8
1993/94	1820.0	2366.4	130.0	9163.6	2488.7	27.1
1994/95	1900.0	3098.6	163.1	7312.3	2984.7	40.8
1995/96	2200.0	3411.1	155.1	9463.9	3304.3	34.9
1996/97	3000.0	4177.8	139.3	9043.6	3349.4	37.0
1997/98	3400.0	3481.6	102.4	11054.5	4201.2	38.0
1998/99	4710.0	4077.5	86.6	11852.4	4745.5	40.0
1999/00	5500.0	4711.4	85.7	11812.2	5321.4	45.1
2000/01	7000.0	4187.0	59.8	12044.0	6201.4	51.5
2001/02	8000.0	5637.7	70.5	7698.7	6567.5	85.3
2002/03	8880.0	8663.4	97.6	4546.4	7517.9	165.4
2003/04	5607.8	9431.2	168.2	7629.0	7907.6	103.6
2004/05	8938.1	11651.3	130.3	9266.1	8100	87.4
2005/06	11834.2	11272.1	95.2	8214.3	9151.4	111.4
2006/07	17892.3	13321.8	74.4	10053.5	9594.5	95.4
2007/08	20496.4	12745.9	62.2	8979.9	10014.7	111.5
Annual Average Rate			**101.6**			**58.9**

Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

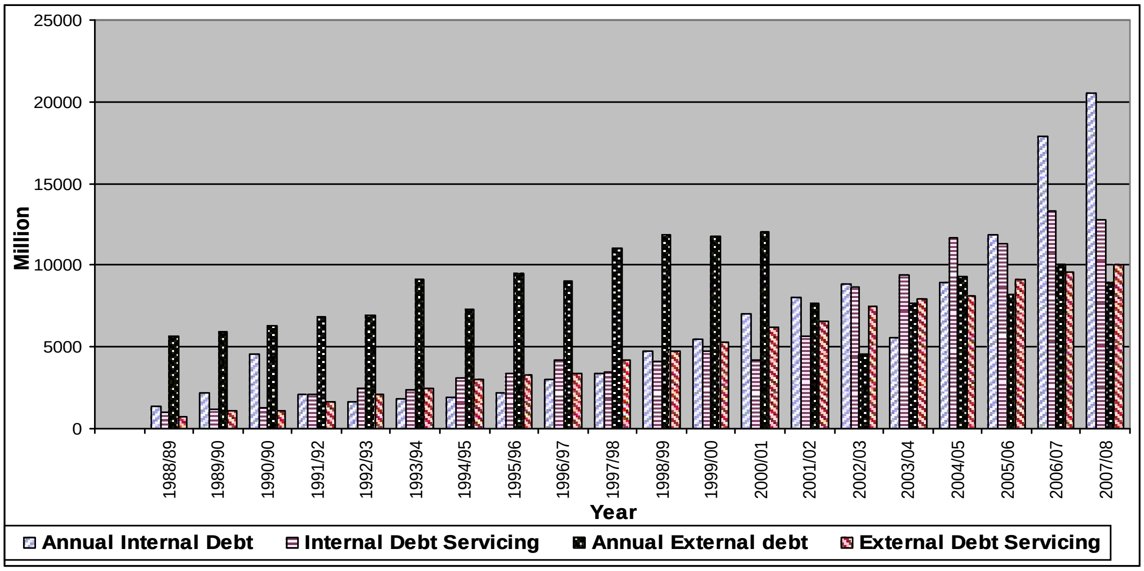
The internal debt was Rs. 1330.0 million in FY 1988/89, which raised more than 15 folds to 20496.4 million in 2007/08, with annual average growth of 21.5%.Internal debt servicing was Rs. 1019.4 million in FY 1988/89, which raised more than 12 folds to Rs. 12745.9 million in FY 2007/08 with annual growth rate of 15.8%.

During review period, the internal debt servicing, as percentage of internal debt was 101.6%, describing that government was repaying for more than that it annually borrowed as internal debt. The internal debt servicing as percentage of internal debt was its minimum at 29.0% in FY1990/90, and it was in its maximum at 168.2% in FY 2003/04.

On the other hand, Nepal is heavily dependent on external debt. The absolute volume of external debt is growing every year .The annual average growth of external fresh loan is 5.4% while the annual average growth of outstanding external debt is 12.85 during review period. The external debt was Rs. 5666.4 million in FY 1988/89, which has increased to Rs. 8979.9 million in FY 2007/08.external debt servicing was Rs. 701.3 million in FY 1988/89, which has increased to Rs.10014.7 million in FY 2007/08.
The external debt servicing as percentage of external debt was minimum at 12.4% in FY 1988/89, it was maximum at 165.4% in FY 2002/03 and declined to 111.5% in FY 2007/08. On an average 58.9% of external debt was spent on external debt servicing purpose during review period.

The following figure depicts the situation of debt and debt servicing. Where the share of internal debt and its servicing is increasing.

Figure-13: Annual Public Debt and its Servicing Trends



4.1.5 TREND OF REGULAR EXPENDITURE AND INTERNAL DEBT SERVICING

In annual budgetary process the total debt, servicing is a part of regular expenditure. The process of debt servicing has burden on the regular expenditure. The effect is on the head of people of Nepal.

Table-14

Regular Expenditure and Debt Servicing

Rs in million

Fiscal Year	Regular Expendit ure (RE)	Annual Growth rate of RE	Total Debt Ser vicing	Internal Debt Ser vicing	Total Debt Servicing as % of RE	Internal Debt Servicing as % RE
1988/89	5676.5	-	1720.7	1019.4	30.3	17.9
1989/90	6672.2	17.5	2279.2	1155.6	34.2	17.3
1990/90	7574.1	13.5	2407.4	1320.4	31.8	17.4
1991/92	9905.4	30.8	3797.1	2132.2	38.3	21.5
1992/93	11484.1	15.9	4560.5	2428.6	39.7	21.1
1993/94	12409.2	8.1	4855.1	2366.4	39.1	19.1
1994/95	19265.1	55.2	6083.3	3098.6	31.6	16.1
1995/96	21561.9	11.9	6715.5	3411.1	31.1	15.8
1996/97	24181.1	12.1	7527.2	4177.8	31.1	17.3
1997/98	27174.4	12.4	7682.8	3481.6	28.3	12.8
1998/99	31047.7	14.3	8823.0	4077.5	28.4	13.1
1999/00	34523.3	11.2	10032.8	4711.4	29.1	13.6
2000/01	42769.2	23.9	10388.4	4187.0	24.3	9.8
2001/02	48863.9	14.2	12205.2	5637.7	24.9	11.5

2002/03	52090.5	6.6	16181.3	8663.4	31.1	16.6
2003/04	55552.1	6.6	17338.8	9431.2	31.2	17.0
2004/05	61686.4	11.1	19751.3	11651.3	32.0	18.9
2005/06	67017.8	8.6	20423.5	11272.1	30.5	16.8
2006/07	83133.6	24.1	22916.3	13321.8	27.6	16.0
2007/08	92582.3	11.4	22760.5	12745.9	24.6	13.8
Average annual growth rate		16.3	**Average Annual Percentage**		30.9	16.2

Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

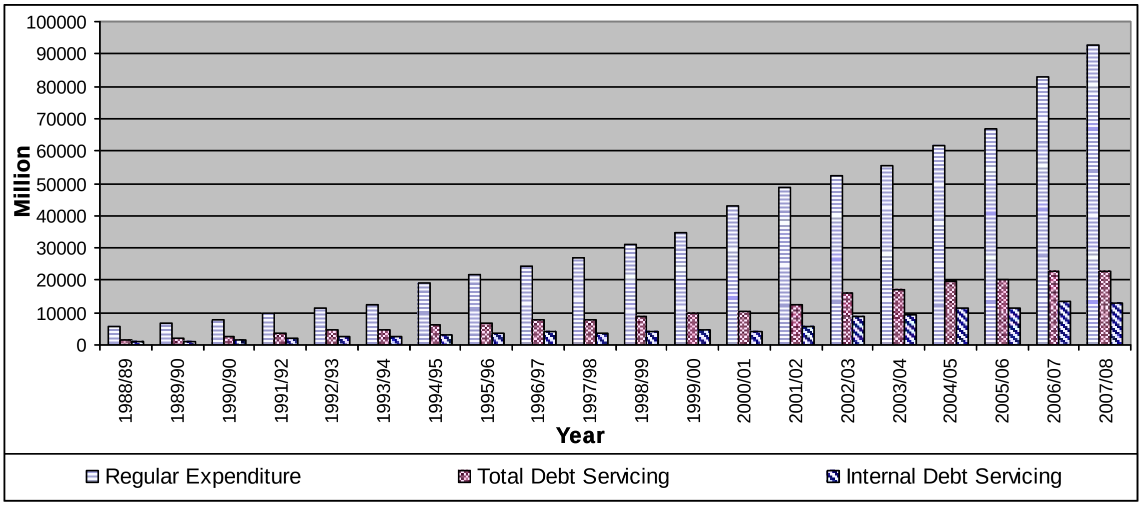
Table 14 shows the total debt servicing, total internal debts servicing, and their percentage share in regular expenditure. In the year 1988/89 total debt, servicing was Rs.1720.7million, which was 30.3 percent of regular expenditure of that year. Total debt servicing reached 39.7 percent of regular expenditure in the year 1992/93. It fell in the following years. On an average, the total debt servicing was 30.9 percent of regular expenditure annually over the study period of 20 years.

Average annual raise of regular expenditure was 16.3 percent, while the growth rate of debt servicing was 15.3 percent. The average annual growth rate of regular expenditure Was almost equal to the average annual growth rate of internal debt servicing.

The internal debt servicing was Rs.1019.4 million in the year 1988/89, which is 17.9 percent of total regular expenditure. The ratio of internal debt servicing to regular expenditure declined to 13.8 percent in 2007/08.

The following figure shows the situation of regular expenditure and debt servicing. In the figure the rate of increment of regular expenditure very high compare to debt servicing.

Figure-14: Regular Expenditure and Debt Servicing



4.1.6 TREND OF DEVELOPMENT EXPENDITURE AND DEBT SERVICING

The more the money goes for debt servicing; the government will have fewer budgets at the hand to invest in infrastructure development, base for future economic growth, and to spend on social issues.

The debt servicing growth is in alarming rate in comparison to development expenditure. On an average, the total development expenditure increased by 11.3 percent annually, while the total debt servicing jumped by over 15.3 percent.

Table-15

Development expenditure and debt servicing

Rs in million

Fiscal Year	Development Expenditure (DE)	Annual Growth rate of DE	Total Debt Servicing	Internal Debt Servicing	Total Debt Servicing as % of DE	Internal Debt Se rvicing as % DE
1988/89	12328.7	-	1720.7	1019.4	13.9	8.2
1989/90	12997.6	5.4	2279.2	1155.6	17.5	8.9
1990/90	15979.3	22.9	2407.4	1320.4	15.1	8.3
1991/92	16512.8	3.4	3797.1	2132.2	22.9	12.9
1992/93	19413.6	17.6	4560.5	2428.6	23.5	12.6
1993/94	21188.2	9.1	4855.1	2366.4	22.9	11.2

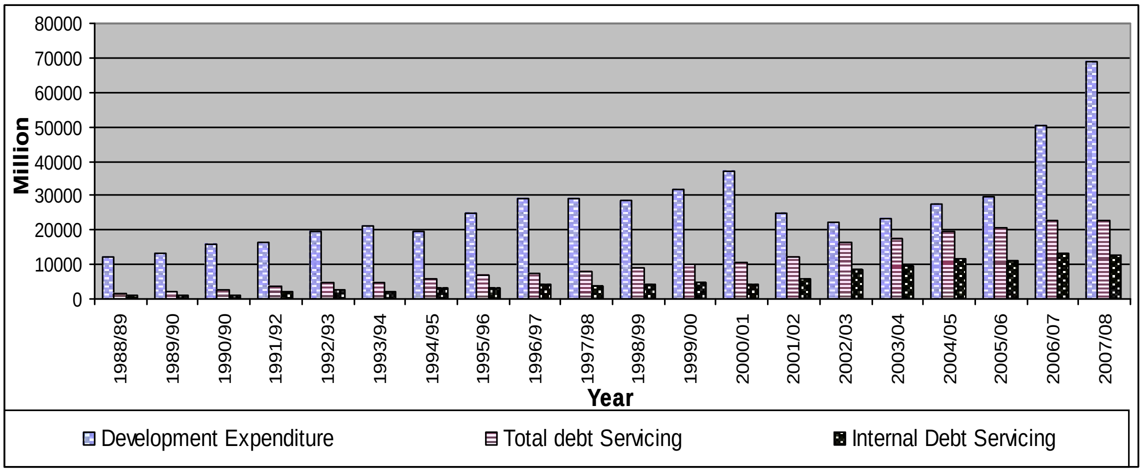
1994/95	19550.0	-7.7	6083.3	3098.6	31.1	15.8
1995/96	24980.2	27.8	6715.5	3411.1	26.9	13.7
1996/97	29242.6	17.1	7527.2	4177.8	25.7	14.2
1997/98	28943.8	-1.1	7682.8	3481.6	26.5	12.0
1998/99	28531.3	-1.4	8823.0	4077.5	30.9	14.3
1999/00	31749.2	11.3	10032.8	4711.4	31.6	14.9
2000/01	37065.9	16.7	10388.4	4187.0	28.1	11.4
2001/02	24773.4	-33.2	12205.2	5637.7	49.3	22.8
2002/03	22356.1	-9.8	16181.3	8663.4	72.4	38.8
2003/04	23095.6	3.3	17338.8	9431.2	75.1	40.9
2004/05	27340.7	18.4	19751.3	11651.3	72.2	42.6
2005/06	29606.6	8.3	20423.5	11272.1	69.0	38.0
2006/07	50471.1	70.5	22916.3	13321.8	45.4	26.4
2007/08	68767.6	36.2	22760.5	12745.9	33.1	18.5
Average annual growth rate		**11.3**	**Average Annual Percentage**		**36.6**	**19.3**

Source: Economic Survey 1994/95, 2001/02, 2008/09, GON, Ministry of Finance.

The table 15 shows how the development expenditure has become victims of growing debt servicing. The total debt servicing accounted for 13.9 percent of development expenditure in 1988/89. However, it rose rapidly over the years to reach 75.1 percent in 2003/04. And declined to 33.1 percent in 2007/08. The average ratio of total debt servicing to the development expenditure remained at 36.6 percent. The ratio of domestic debt servicing to development expenditure grew by more than two folds over 20 years. It accounted for 8.3 percent in 1988/89 and rose to make up 18.5 percent in 2007/08. On an average the annual internal debt servicing was 19.3% of the Development expenditure during the study period.

The following figure shows the actual situation of development expenditure and debt servicing in Nepal. Where the development expenditure is fluctuating while the total debt servicing is increasing in trend every year.

Figure-15: Development expenditure and debt servicing



4.2 SITUATION OF DEBT TRAP IN NEPAL

Debt Trap is a situation where a country adds on a new debt in order to pay an existing debt, (Wikianswers). The situation where a country borrows fresh loan in order to repay the existing debt due to insufficient internal revenue is called Debt Trap, (Karki, 2006). The condition of debt trap is the great challenge for developing countries like Nepal. When the country loses principal payment capacity and interest payment capacity there raises a situation that whole-borrowed money will be used for debt obligation payment. The ever increasing amount of debt servicing may lead the country into the debt trap, (Pokhrel, 2010). Nepal faces the problem of fiscal deficit, (Table 1).

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

- Very low Productivity
- Less contribution of annually growing labor force
- Low quality of available human resources
- Traditional nature of tax administration
- Inflow of easy money through various channels

- Sluggish change in the traditional economic structure
- Extreme capital deficiency

The average internal outstanding public debt is 15.3 percent of GDP, but external outstanding public debt is 46.1 percent of GDP, (Table 8). Present scenario shows that the outstanding public debt is nearly 61.4 percent of GDP in one hand, and debt servicing to GDP ratio is nearly 2.8 percent, (Table 12). This shows that debt is mounting in very high amount in each year. The ratio of total debt servicing to regular expenditure remained above 30.9 percent while the ratio of internal debt servicing was 16.2 percent, (Table 14).

The average annual ratio of debt servicing to GDP is 2.8 percent but average annual growth rate of total debt servicing is 15.3 percent, (Table 12) and total outstanding debt to GDP is nearly 61.4 percent, (Table 8). The debt servicing as percentage of regular expenditure is 30.9 percent, (Table 14). The borrowing that Nepal has raised braced increasing trend. It took fresh loan of Rs 6996.8 million in 1988/89 and Rs 29476.3 million in 2007/08, (Table 5).

Analysis reflects that resources gap is increasing rapidly with the growing trend of regular expenditure and development expenditure, (Table 1 and 2). Around 60% of the development expenditure is financed through foreign aid. Less than 50 percent of development expenditure is allocated for capital formation and large amount of loan is devoted to meet recurring expenses within the development expenditure, (Pokhrel, 2009). So less amount of loan is spread for increasing the productive capacity of the Nepalese economy.

A country is considered felled in debt trap if the following conditions are aroused. Corruption in the every aspect of the society, use of low quality work force, misuse of the high amount of aid, stagnant in the economy, increasing import and decreasing export, low level of return of development projects, decreasing production and productivity, noncompetitive products. Due to such weakness, the government of Nepal may fall into debt trap. These symptoms are definitely alarming for the Nepalese economy, (Karki, 2006).

4. 3 PROBLEMS OF PUBLIC DEBT IN NEPAL

In the under developed countries like Nepal the use of public borrowing in order to mobilize the saving of the community has some special problems. Large-scale public borrowing for financing development expenditure may be justified, but the continued growth in public debt raises the burden, (Pokhrel, 2010).

Most of the financial institutions are concentrated in the urban areas and urban saving is mobilized through these institutions, (Thapa, 2009). Therefore, a large-scale mobilization of saving for capital formation through public borrowing policy is largely dependent on the development and extension of financial institutions into urban areas. But the rural sector's saving cannot be mobilized through taxation because a portion of the income in those sectors does not flow through monetary channels.

Both external and internal borrowings have been increasing very rapidly in Nepal, (Table 5). A rise in the magnitude of public debt must be accompanied by increase in the debt servicing capacity, (Karki, 2006). Owing to out flow of funds through debt services, there may not be unnecessary increase in the tax rate to meet requirement of internal debt servicing charge.

The ratio of internal debt to GDP has slightly lowered down compare to past, however its growth rate is still very high. There will be no immediate effect of it on the economy however; it will gradually increase the burden of debt to future generation, (Pokhrel, 2010).

The high rate of interest in Nepal is considered to create an adverse effect on private sector's investment. High rate of interest involves a risk in investment, causing problems of public borrowing. If the interest rate of loan is high, then there will be high burden of tax on the people. In addition, if the interest rate is low, the desired amount of loan may not be collected easily, (Pokhrel, 2010).

Excessive borrowing of debt may create the situation of debt trapped, unproductive investment, monetary instability and trade deficit in the economy and dependency on foreign countries, (Karki, 2006). In recent years, it is observed that rapidly increasing size of Nepal's public debt, (Table 7) is a matter of serious concern. Therefore, it needs a careful look on the increasing magnitude of public debt and proper care to be taken to increase the debt servicing capacity of the country.

The necessity and rationality of public debt should be analyzed based on debt management capability. The focus should be there where the borrowed money is being utilized; whether the return of investment is greater or lower than the cost of borrowing but not on how much to borrow internally, (Pokhrel, 2010).

CHAPTER FIVE

SUMMARY, MAJOR FINDINGS AND RECOMMENDATION

5.1 SUMMARY

Nepal a developing economy, lies in between the China and India, two emerging superpower of the world economy. Nepal with a per capita income of $ 420 is one of the poorest, least developed, and slowest economically moving countries in the world. The major features of the contemporary Nepalese economy are slow growth of exports based on very few export items, unproductive use of increasing remittances and consumption oriented import structure.

Like as in other developing countries, to fulfill the ever-increasing aspiration of the people, government of Nepal is also trying to formulate such projects that results more quickly to the people, which needs more resources than the government has in its hand. That is why budget deficit is increasing rapidly each year.

As the estimated budgetary expenditure of the government exceeds the domestic revenue fund, the government borrows the money as alternative resource. In such situation government borrows internally an the form of promissory note, treasury bill, national saving certificate, and other bonds and externally borrows from bilateral or multilateral agencies.

Generally, internal borrowing is made to fulfill the budgetary deficit, regulate the market while the external borrowing is made for capital formation, and fulfill the need of foreign exchange.

The main base of our public expenditure is our internal revenue growth; though contribution of domestic sources for deficit financing is still less as compared to the external sources. As its general principle, we are not directing the deficit budgeting towards infrastructure development, increase productivity, social justice, export increase; we are not successful to uplift the living standard of the people.

5.2 MAJOR FINDINGS

Nepal is in critical phase of managing public finance because of inadequacy of internal resources. Fiscal or revenue deficit is widening every year. The overall Fiscal Deficit was 5.7 percent of GDP and Revenue Deficit was 7.6 percent of GDP in the review period.

Nepal has been experiencing massive resource gap in recent years. This is due to lop-sided government expenditure over revenue generation from domestic sources. The amount of revenue deficit has grown more than 5 times from 1988/89 to 2007/08. And the annual average growth rate is 9.8 percent. This is a clear indication of the poor performance in resource mobilization in the domestic side. As a result, dependency of internal as well as external borrowing has inordinately increased in the budgetary structure of Nepal.

Resource gap is becoming critical in recent years. The proportion of internal borrowing in the total debt increased from 19.1 % in 1988/89 to 69.6 % in 2007/08, while external borrowings decreased from 80.9.4 percentage in 1988/89 to 30.4 % in 2007/08. External borrowing has been decreasing while internal borrowing is increasing, reflecting growing dependency of Nepal on internal loan. While domestic resource mobilization has improved since the early 1990s, receipts are still far too low.

The public debt has burden on the different macro economic indicators like GDP, revenue, government expenditure, foreign exchange reserve etc, as the government has to allocate a creation amount in paying back principal and interest each year.

The outstanding public debt soared to reach Rs 366004.9 million in 2007/08, steep up from Rs 42104.8 million in 1988/89.The outstanding public debt as percent of GDP was 49.1 percent in 1988/89 which fluctuating in various years lowered down to 46.4 percent in 2007/08.

On an average, annually around 2.8 percent of the GDP was spent for debt servicing. The annual growth rate of nominal GDP remained at 12.4 percent. However, debt service's growth rate was much higher at 15.3 percent. The burden of debt service is on the rise. The country spent Rs 1720.7 million in debt servicing in 1988/89. However, the amount edged up to 22760.5 million in 2007/08.

The economic growth of country depends on the amount invested in development activities. If the budget of Nepal is analyzed, it is found that the share of development expenditure is decreasing while the share of regular expenditure is increasing.

Regular expenditure under which the money for debt servicing is allocated, has a major portion of debt servicing. On an average, during the 20 year study period, 30.9 percent of the regular expenditure went for debt servicing.

The debt servicing budget had taken toll on building infrastructure and developing social services. Over the study period, the debt servicing budget was around 36.6 percent of the total development expenditure (Table 15). If the money used on debt servicing was used for running infrastructure and social projects, it could have made a great contribution for the development.

The debt servicing growth is far ahead of revenue's increment rate. On an average, the revenue collection grew by 15.04 percent, while the debt servicing went up by 15.3 percent. Approximately 25.1 percent of the revenue was used for debt servicing.

5.3 CONCLUSIONS

This study has analyzed the trend and structure of government borrowing on focusing on internal debt. High public debt is a serious matter of concern in Nepal. The public debt ratio is 61.4 percent of GDP. If it keeps up growing very fast in the years to come, not only will the high level of public debt raise the risk of a fiscal crisis, but it also will impose costs on the economy by keeping borrowing costs high, discouraging private investment, and constraining the flexibility of fiscal policy.

The analysis in this study suggests that, historically, our economy has not generated enough primary budget surpluses to ensure the sustainability of the country's public debt.

The inability to generate adequate primary surpluses appears to stem from the characteristics of the fiscal systems: governments has weak revenue bases with lower yields and higher volatility and are less effective at controlling expenditures.

While the sustainable level of public debt varies between countries—depending on the characteristics of each country—for the typical least developed economy like Nepal it is often quite low. For example, some researches made by some economists in the past suggested that the sustainable public debt level for a typical developing economy may only be about 25 percent of GDP. Nepal’s debt burden far exceeds this sustainability limit.

The annual average growth rate of internal borrowing is 21.5 percent while the external borrowing is only 5.4 percent. It shows that the country is mobilizing more and more internal resources as compared to the past. However, the average annual contribution of external outstanding loan as percentage of total debt is 74.5 percent where as the average annual contribution of internal outstanding loan is 25.5 percent. This shows that we are heavily indebted by external debt than internal debt.

It suggests that we are entrapped in the debt net. If debt management is not set effectively and effective programs for debt financing are not carried out we shall not escape from the situation of debt trap.

Similarly, the annual average rate of total debt servicing as percentage of regular expenditure is 25.1 percent. In addition, average annual percentage of total debt servicing as development expenditure is 36.6 percent. Such growths of debt servicing indicate the grim symptom for the economy.

The mounting of public debt has raised the question to the government for its excessive dependency on public loan. It may lead the nation into debt trap in near future. For pouring loan, government should be conscious to earn more foreign currencies either by trade reforms or by consuming less currency for imports or by promoting the further development of tourism industry.

The major possible reasons behind these findings might have been following:

- Borrowed money is used for repayment of principal and payment of interest.
- Borrowed money is spent on unproductive sectors.
- Borrowed money is not spent on said project and leakage of borrowed money.
- Large amount of loan is allocated for regular expenses.
- Borrowed amount of money is not invested on employment generation activities, tax increase policy and on infrastructure development.
- High portion of loan is set-aside for meeting recurrent expenditure.

The main conclusion drawn from this analysis is that the outstanding debt and its servicing have been coming up with growing economic difficulties and becoming hindrance to the economic growth.

5.4 RECOMMENDATIONS

Public debt is considered as the very useful instrument for the government due to its benefits and effectiveness. As it helps the government to solve the various economic, monetary and budgetary problems. In addition, it makes people feel glory in their financial contribution to the nation through the public debt.

Based on above findings following recommendations are suggested which may help to address the problem of public debt in Nepal.

1. The government should not be extravagant and at the same time should curtail unnecessary expenditures.

2. The size of budgetary deficit, excluding grants, has remained very high due to low revenue and high expenditure. Budgetary deficit is fulfilled through external as well as internal borrowing. It is very dangerous for long run. Government must reduce increasing trend of public borrowing. Revenue collection should be increased substantially in order to attain self-sufficiency in the long run. The better way to revenue collection is through tax rationalization and expanding tax bases, and improvement in the tax policy and tax administration and control corruption.

3. The government should try to mobilize the internal resource at maximum level for development purpose through internal source and excessive dependency upon foreign assistance must be minimized by encouraging the domestic capitalist. Government should proper mobilize its resources in every field of the economy such as building infrastructure, hydropower, communications, transportation, agriculture, industries health education etc.

4. If the government takes a loan, then the loan should strictly utilized to meet the National priorities. The loan should never be used for regular expenditure.

5. By selling various financial instruments government is borrowing internally from banking and non-banking sector. Where more than 80 percent share is owned by banking sector and remaining other is owned by non-banking sector. The internal borrowing from banking sector must be minimized since it is the most inflationary source. The government should target at individuals to finance their idle money on government securities because it stimulates the saving and investment and this non-inflationary borrowing process.

6. The increasing trend of domestic contribution as compared to external source to deficit financing, shows the country's less dependency on external sources. The annually increasing domestic borrowing might be counter productive for the economy. If the current trend of high regular expenditure and a very low development, expenditure remains few years.

7. The private sector is capable of investing in economic and social infrastructure development if a suitable atmosphere is created. This will help to reduce ever-increasing government expenditure and the borrowing. Therefore, government must take the initiative to finance on infrastructure projects and should try to involve the private sectors through appropriate and initiative policies. The ultimately burden of government to invest such sectors will be reduced.

8. The government should give emphasis to unconditional grant amount more and more. whatever they are through bilaterally or multilaterally. The grant should not be accepted if it is not in accordance with the needs of the nation. The government policies should reform for grant collection. The absorptive capacity of the foreign loan should be increased.

9. The limit of the internal borrowing must be determined in such a way that there would not be adverse effect in the overall economic stability, but encourage the existing liquidity and saving in the economy.

10. Government must demonstrate that their overall debt burden is manageable, and that it is likely to remain so under most circumstances. Building this credibility requires not only the implementation of effective fiscal reforms, but also a record of adhering to these reforms through upturns and downturns. The strengthening of fiscal institutions has a very important role to play in this regard. There must be coordination between monetary policy and public debt management.

11. In Nepalese economy there is rapidly increasing in saving investment gap. Where the growing trend of saving is lower than the growing trend of investment, which creates the imbalance in economic growth. Thus to reduce the huge saving investment gap the government must work to increase the rate of total saving.

12. In Nepal, the grant received by the government from both bilateral and multilateral agencies is considered as the revenue. But the grant received from foreign is not the result of domestic economic activities. So it may be risky to include such grants in revenue item.

13. External borrowing is unavoidable for a poor developing country like Nepal. But there should be limit in it and the borrowed money must be invested in infrastructure development and high return projects.

14. Government should maintain fiscal balance by applying strong fiscal disciplinary policy. Ever growing unproductive and useless expenses must be controlled. All the governing parties towards this issue should make a strong political commitment. Political intervention must be stopped in economic activities. So that the Central Bank and other concerned institutions can work freely for the betterment of the country.

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