

CHAPTER - I

INTRODUCTION

1.1 General Background

Public debt is an important source of revenue to the government. When a government raises loan internally or externally from banks, individuals or financial firms or from foreign government, it incurs public debt. So, public borrowing is an obligation on the part of the government to repay the principle sum borrowed plus a stipulated rate of interest on it at a specified future date.

In developing countries, public debt is taken as balancing item for increasing trends of fiscal deficit. It is a source of resource mobilization for financing ever increasing development outlay. The present level of capital formation of developing countries is too low and any substantial increase in saving is not possible, due to extreme low level of income and wide spread poverty. Tax base is very low. This limits the possibility of mobilizing the tax revenue. To escape from the complex situation, the government can utilize borrowing as the alternative method.

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

Classical economists were against borrowing and they favored the minimum role of the government. They were in the favor of the productive type of borrowing. After the great depression of 1930s, the

intervention of the government in the economy became an important tool. The government has to play the role to push the economy upward and it must contribute a large amount of budget. Prof Keynes introduced the concept of deficit budget. To meet the deficit budget government needs to under -take the public debt, which need not necessarily unproductive and inflationary.

Public debt includes internal and external debt of the government. Internal debt refers borrowing through securities such as development bonds, national saving certificates, treasury bills and offers special bonds. Those securities are to be repaid within a specified time. Whereas external debt comprises obligation of country to foreign nationals or international institutions.

The words public debt and economic development are complementary in an economy. Since the scope of domestic borrowing in underdeveloped countries is very limited, external borrowing has become alternative for development. Although the use of external borrowing for development through bilateral and multilateral sources has been a matter of controversy where often the practical diplomatic and economic issues are mixed up the reliance of developing economies on external borrowing. This links to their balance of payments and to the problem of inflation.

"Developing countries like Nepal use borrowing as a mechanism to address the gap between the government revenue and its investment and export import gap. Such borrowing adds to the total resource available to the government, over a given period and enables the government to make higher expenditure than would otherwise be possible. If properly utilized such resources, can benefit for the borrowings countries and contribute to

economic growth and poverty reduction. However, when efficiency allocated the cost of borrowed external resources can contribute to macroeconomic management problems in the form of high or even unsustainable levels of external debt servicing obligations." (Thapa: 2005)

Public debt plays important role in developed as well as developing countries to meet the budgetary deficit. But it has positive as well as negative aspects. On the one hand, it has been major part of development budget, without budget we cannot even imagine development. On the other hand the country is failing into debt trap causing the increasing trend for debt servicing in the form of interest and principle payment.

Public debt is the total debt of internal as well as external. Nepal is heavily depending on internal as well as external public debt for economic development. In internal sources, financial sectors dominate others and in external debt, it is received from both bilateral and multilateral sources. The trend of borrowing through external source is very high in Nepal as compared to internal source. Hence in both developed as well as developing countries are making public debt as a main source of resource mobilization to meet budgetary deficit. Now it is widely accepted means for financing deficit. The role of public debt is increased significantly by the planned economic development. Nepal is facing a serious problem of financial resource gap in one hand and increasing population growth and inflation in another. It is sure that, if the trend of foreign debt goes on same speed Nepal will be in debt trap near the future.

1.2 Statement of the Problem

In Nepal, effective management of public financing is a challenging proposition. Government expenditure is increasing rapidly each year, but government revenue is not growing at the same pace. Hence, the deficit is widening each year, thus Nepal is facing the serious problem of financial resource gap. The persistent feature of Nepal's budget is that there exists a huge deficit budget.

In developing countries, generally private sector is reluctant to involve in long term investment for building infrastructure, such as telecommunication, road and power and development of social sector such as education, health and drinking water because return on such investment would be in the long period of time. Government collects public debt for such investment. So, public debt helps to increase the growth rate of the economy, generating more employment opportunities, reducing inequalities in income and wealth and bringing regional balance in the economy.

Not only high public debt raises the risk of a fiscal crisis in Nepal, but also imposes costs on the economy by keeping borrowing costs high, discouraging private investment and constraining the flexibility of fiscal policy. Historically, Nepal has not generated large enough primary budget surplus to ensure the sustainability to their public debt. The inability to generate adequate primary surpluses appears to stem from the characteristic of the fiscal system; weak revenue bases and less elective at controlling expenditures.

In recent year, it seems that Nepalese economy has lost its productive capacity due to present condition of political instability. Large

and persistent level of public debt push up interest rates, reduce investment and create a burden of indebtedness that is difficult for the government and tax payers to bear. So, strong ideas in favor of contractionary fiscal policy instead of expansionary fiscal policy also emerging. But for developing countries like Nepal where infrastructures are not well develop, public debt is most. So, present increasing size of Nepal's public debt is a matter of great concern for all.

The burden of public debt is very controversial issue. If public debt is utilized optimally burden will be limited, otherwise it would be increased and it negatively affects the economy. The total outstanding debt is around 55 percent of GDP and more than 50 percent of development budget is shared by foreign loan in each periodic plan. So that Nepal is heavily dependent on foreign assistance and that is likely increase further. On such foreign assistance the external debt accounts large share of public debt.

The composition of budgetary expenditure has also undergone a dramatic change. In 1990, regular expenditure contributed around one third of total expenditure which has increased to nearly half of the budget. Now a days, government is taking foreign aid, not only for development expenditure but also for regular expenditure. In FY 2006/07, share of regular expenditure in total resources is nearly 58%. So, the debt management is the great problem of Nepal.

Hence, Nepal has become an aid dependent country. Foreign aid has become a main source of financing budgetary deficit. It is not only facing the problems of revenue-expenditure gap, but also export-import gap and saving-investment gap which all are the major macroeconomic indicator. To break the vicious circle of poverty and improve social

condition of the people, there is greater debt demand of which the government is borrowing. Government borrowing itself is not a medicine, if it is not utilized properly. Therefore government borrowing may be the unnecessary evil for developing countries like Nepal.

1.3 Objectives of the Study

The following objectives are determined for the study:

- * To analyze the trend and structure of public debt in Nepal.
- * To analyze the burden of debt in Nepal.
- * To recommend the appropriate suggestions.

1.4 Importance of the Study

In recent time, public debt is an economic issue of a country. On the one hand the role of public debt is increase the growing concept of globalization and liberalization and on the other hand to increase volume of debt servicing. That pulls the country into debt trap. So, studies of trend, structure and burden of public debt became matter of concerned, especially after the restoration of democracy.

The study is totally concerned with Nepalese public debt and its trend. It provides several information of Nepalese debt to those who are interested to know about it. It is also useful for researchers, policy makers and general students. The study provides some information related to our budgetary system and contribution of debt on it. It deals about sources of debt, its present situation and some recommendation related to debt. It provides several indicators relating to the public debt in Nepal.

Finally, this study is helpful for those who want to get knowledge about government borrowing in Nepal. It is applicable for the people and

institution to purchase government securities. It is also written hoping that it will be little reference for the budgetary system.

1.5 Research Methodology

1.5.1 Sources of Data

This study is based on secondary sources of data and information, which have been issued and published in books, magazines, journals etc. Most of the data are taken from:

- * Economic survey from 1991/92 to 2006/07 of ministry of finance.
- * Various issues of economic reports of Nepal Rastra Bank
- * Different publications of CBS.
- * Various budget speeches of GON.

1.5.2 Analysis of Data

This study is based on qualitative analysis such as descriptive and analytical. Some statistical tools such as percentage distribution, average annual growth rate and trend analysis etc has been employed. Likely some ratios of access burden of debt and debt servicing capacity have been estimate.

1.6 Limitation of the Study

This study only covers the period from 1991/92 to 2006/07. Because of budget and time constraint this study is not related to examine the effect of public debt on macro economic variables. This study is based on the secondary data, but the reliability of those data will not be examined.

CHAPTER- II

LITERATURE REVIEW

2.1 Introduction

Public debt refers the obligation to pay money back to person, institution or countries from whom it has been obtained. Public debt as an instruments of fiscal policy, has assumed great importance to meet the budgetary deficits. Public debt is accumulated amount of what government has borrowed to finance for deficit. An internal debt is owed by a nation to its citizen and it posses only internal burden. And external debt is owed by a nation to foreign country or other internal agencies, the n it posses burden.

In modern era, the objective of public debt in developing countries is an instrument to mobilize saving of the people which would otherwise have gone to wasteful consumption. To meet such objective and use as an instrument, public debt have to use productively. If it is not so, than many problems will be created and it will be destructive and devastative for the future generation on monetary impact. The effect will not affect to the tax payer only but also decrease productivity, demand for goods and commodities will be decreased due to increasing amount of taxation. The economy may come in to phase of recession.

In the literature of public debt, there are different views about public debt. Some economists are in favors of public debt and some are against. Especially, classicists had generally negative attitude towards borrowing and they want to minimize the role of government. They opined that "let the money fructify in the pocket of the people" according to them state has to perform its limited activities maintenance, law and order, justice and social security. Classical economist like J.B.Say, J.S.

Mill, T.R. Malthus, C.F. Bastable have given their arguments that public debt creates burden on the economy because of its unproductive nature. But Keynesian and modern economist including J.M. Keynes, Harries, Hansen, Buchanan, Musgrave and other have challenged the version of classical economist and hold opposite opinion on the subject of public debt, its size and use. In their view, public debt is required for economic stabilization, to operate monetary and fiscal measurement.

2.2 Theoretical Review

2.2.1 Review of Classical Thinking

The classical economists were generally against the public borrowing and favored the minimum role of government into economic activities. They further believed that, any government intervention to the economic activities result into rigidity and disrupt the smooth functioning of market mechanism. The optimum allocation of resources, the achievement of full employment and maximum output are best without government intervention. Classical economists like J.B.Say, J.S.Mill, T.R.Malthus and C.F.Bastable have the strong faith that "Debt creates burden in the economy because of its unproductive nature." (Harris, 1974)

The classical theory is criticized mainly on two grounds. Firstly, every government expenditure is not always unproductive. Hence, public borrowing may not always burden upon the economy. Secondly, the traditional view regarding the shifting of the debt burden is not correct. The real burden of public debt must be borne in the initial period debt creation when government borrows for meeting development requirement. Hence, government attracts resources from private use and put in to the public project in the initial period. (Joshi: 1982)

Classical economists were not against all types of public debt, they favored public debt for productive purpose, that is for the capital project since it generates resources by selling the fruit of such projects to buyers and debt servicing and refunding of principal did not necessary additional burden of taxation. These projects are called "self liquidating projects". In the words of R.A. Musgrave "self liquidating 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 further income and tax base-such projects permit servicing of the debt incurred in their financing without requiring an increase in further level of tax rates." (Musgrave, 1959)

2.2.2 Review of Keynesian Thinking

Unlike the classical economist, Keynes did not accept the notion of free enterprise economy, which is self equilibrium at full employment level. He advanced the concept of underemployment equilibrium.

Keynes argued that resources in the private sector might remain unemployed for relatively longer time period if the government does not undertake corrective or compensatory action. In a situation when resources are unemployed on large scale, government's employment of these resources does not necessarily deprive the private sector of anything. On the contrary, increasing government spending by using idle men and materials is likely to raise the level of aggregate output and income. Hence, public debt need not necessarily prescribed to increase the public expenditure even by undertaking deficit financing or borrowing. (Musgrave, 1959)

For Keynesian, if debts are internally held, there is nothing to worry about their size. They viewed that such debt involves merely a series of transfer payment and they cancel out for the economy as a whole. Hence, the only concern was on high level of income and employment. The deficit budget even by undertaking public debt would be powerful during the time period of stagnation or depression.

After the great depression of 1930s, J.M. Keynes advocated for increasing government role in the economic activities by adopting deficit financing, so that effective demand is created in the economy ensuring employment opportunities. The need of increasing fund was realized for meet the development requirements. So, keynesian view is replacement of the traditional government budget by a national government budget. Receipts and outlays of government only a part of nation's budget which is a broader economy. "Government should seek a balance the nations budget at a level of consistent with full employment, regardless of what this should mean in the government sector proper the economy's performance rather than trend of public debt, should be the guide for all times." (Singh, 2001)

2.2.3 Review of Post Keynesian Thinking

Post Keynesian economists accepted the large part of modification of the classical debt theory as brought about by the Keynesians. They advanced their ideas by focusing the transfer and management aspects of public debt and money supply. They also think about the developing countries, which have a very low income, saving and investment.

Post - Keynesian economists further say that without increasing the rate of this crucial factor, no country could achieve steady growth. "Borrowed money when used to finance public investment cause no such reduction

all that will happen is the change in the consumption of capital formation, The inference is that failure to restrict borrowing to finance of investment will retard economic growth. A weakness of the government is that not all outlays classified as investment actually contribute to growth while some expenditure usually classified as government consumption promotes growth." (Goode, 1984)

The post-Keynesian did not reject the entirely classical notion regarding to public debt rather put in a better perspective.

- (a) According to them, public borrowing does not always deprive the private sector for the use of resources. As for example, during the time period of wide spread unemployment, it may be productive as well as essential.
- (b) Because, it is not accepted now that borrowing in the period of full employment must be inflationary than taxation.
- (c) A large public debt if internally held poses many problems for the economy. It complicates the monetary policy and creates difficulties of management and so on.
- (d) In resorting to borrowing, government should be guided by macroeconomic variable.

2.2.4 Review of Recent Thinking

Recent thinkers opined that heavy growth of public borrowing is dangerous for the economy because of two reasons:-

- (a) Growth of debt ratio may lead crowding out of public investment.
- (b) Government spending out of borrowed funds might be unproductive. (posner, 1992)

They observed that part of public debt is burdensome whose servicing falls entirely or mostly on tax revenue. If its servicing does not

fall entirely on tax revenue, it is not burdensome rather it is productive. Because it itself generates resources for its debt service besides income, employment and output. Therefore all debts are not burdensome.

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

The level of government borrowing is a function of the ability and willingness of person and business to lend and the government's power and intention to tax. Maximum level of debt can be expressed in terms of the following equation.

$$D = \frac{Yt - E}{r}$$

Where D = Maximum sustainable national debt

E = Constant expenditure for ordinary government operation.

t = Maximum ratio of tax receipts to national income (y)

r = The contractual interest rate of government debt.

2.2.5 International Review

Public debt is the major tool for economic development. It is widely accepted tool. There are different view towards public debt which are following:

According to new Palgrave Dictionary of Economics 1988, "Public debt is a legal obligation on the part of government to make interest or amortization of payment to holder of designated claims in accordance with a defined temporal schedule. It is created through the government borrowing from individual, corporation, institutions and other government. It refers to loan raise by government within the country or outside the country. Every government like individual has to borrow when its expenditure exceeds revenue. The receipts from the sale of financial instrument by the government to individual or firms, in the private sector, to increased to private sector release manpower and real resource and to finance the purchase of those resources or to make welfare payments or subsidies."

Philip E (1998) in his book entitled "The Economics of Public Finance" has analyzed the nature and burden of public debt upon the economy on of the pillars upon which fiscal policy must stand, without it the financing of public emergencies would be impossible. Public debt is desirable, no matter what its burden when incurred for the purpose of securing benefits which outweigh the burden. In this sense debt is a necessary evil, like cost of production; if the benefits could be secured with fewer burdens the alternatives would be preferable.

Hansen (1941), observes that public debt is one of the very important built in stabilizer. In his article entitled "An Effect of Public Borrowing on Redistribution of Income" where net transfer of resources from lower income group to upper income group. He states "in so far as the government can borrow small severs and increase in public debt will not be proved unfavorable to an equitable distribution of wealth, but if the growth in public debt is very rapid, it will not be possible for relatively smaller savers to take any large proportion of new securities issued. A

rapid growth in public debt is likely to intensify inequalities in wealth distribution" (Hansen, 1941).

Chhelli (1991) enumerates the following points which indicate public debt useful on behalf of

- for macro economic stabilization
- financing emergency expenditure
- for smoothing out tax rate
- inter generational justice

Samuelson and Nordhaus observe that a large public debt creates an adverse effect on national income; a large government debt can clearly be detrimental to long run economic growth. As debt accumulates over time, more and more private capital is displaced. People save by purchasing government debt and assets like houses, shares, stocks and bonds of corporations, saving accounts etc. With growing public debt, people accumulate government debt instead of private capital. This leads to the displacement of private capital stock by public debt resulting in lower national output. Likewise, additional taxes are levied to pay interest on rising debt stock resulting in inefficiencies this leads to further lower output. Rise in external debt also lowers national income by raising the proportion of national income going to servicing the external debt. "Taking all the effects together output and consumption will grow more slowly than they would have there been no large government debt and deficit." (Singh; 2002)

According to K.Barman "public debt is defined as a kind of tax through which public enjoys the advantage of public expenditure. Since it becomes greater than current revenue collection, it refers to those

obligations of the state promises to pay the amount borrowed by the lender with the interest after a given period of time."

Domar (1944), defined public debt as the ratio of total to the national income. He writes the condition under which the burden would decrease or increase over time.

Let

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

I = rate of interest paid on debt

T = amount of tax necessary to cover the interest charge on debt

Then $T = Di$

If t be the fraction of income (Y) taken through tax to pay interest, then

$$t = \frac{T}{y}$$
$$= \frac{Di}{Y}$$

From the above equation, it follows that the tax rate is necessary to pay interest on debt depends on the ratio of the size of the debt multiplied by the rate of interest of income.

IMF working paper (2000), entitled "the choice between external and domestic debt in financing budget deficits; the case study of central and west African country" has developed a simple analytical framework and should that highly concessional external debt is usually a superior choice to domestic debt in terms of financial cost and risks, even the face of probable devaluation. The paper has stressed the importance of the availability and terms of financing and of overall long-term debt sustainability. It reviews the principles and practical considerations

involved in the choice between foreign and domestic financing of fiscal deficits.

According to R.K.Lekhi (2001), "the most important aim of public debt raised by government is to fill the gap between revenue received by government and proposed expenditure during the year. The government may borrow from internal or external resources 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. But the debt incurred is the income of the state for the year alone. Hence, it will have to be a rapid through taxation or other resources. The government borrows money from internal as well as external sources in order to meet gap between the revenue and expenditure."

The United Nations conference on trade and development review in "Multilateral debt of the least development countries since the crises of early 1980s" has discussed on problem of multilateral debt as sustainability, liquidity and accumulation of large scale areas that has also evaluated recent scheme to provide debt relief and suggested possible measure to strengthen and improve existing schemes as well as present other innovative alternatives. The paper focused mainly on the least developed countries.

Bhatiya (2000), has indicated the currency as a public debt. According to him "the entire currency circulation in the market can be part of a public debt only if the central bank is classified as a part of the government sector." But he added also that in any currency obligation normally remain dormant and inactive and the government does not pay of them.

Nadim (1992), in his article entitled "External debt policy" has analyzed the origin of debt problems. The debt crisis had its origin in the substantial rise in the external liabilities of the developing countries during the second half of the 1970s and early 1980s, in an environment of large scale recycling of the oil exporter's old inflection and negative real interest rate at that time many viewed this recycling of funds as a positive development creditors were able to identify how investment out less and debtors could acquire funds needs for development purposes.

He again explained that an external debt crises was due to

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

2.3 Nepalese Context

2.3.1 Dissertation Review

"A case study on public debt in Nepal" is the first work of study on public debt by Acharya in 1968. In this M.A. thesis, he analyzed features, problems and pattern of public debt. He concludes that public debt in these days because of payment of debt on maturity can be adjusted through the issue of fresh public debt instrument. But 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.

Khanal, Shree Bhadra (2000) has prepared a thesis on "Public debt in Nepal: A study of its structure and burden", observes that the public debt helps to reduce the gap of investment and saving, deficit finance, deficit trade. He has concluded that the system of public debt is one of the best ways of financing development expenditure of the government which helps to control inflation and to mobilize the internal financial resources in the productive sector of the countries economy. Trade deficit, investment saving gap and large amount of fiscal deficit has been fundamental issues and constrain to increase foreign dependency in the Nepalese economy. There has been excessive flow of foreign loans to bridge up these gaps (fiscal deficit, trade deficits and domestics investment-saving gap).

Rajbansi Chandra Das (1987), in his M.A. dissertation entitled "External Borrowing in Nepal" analyzed about the trend of external borrowing and indebtness of a country. According to him "External debt has become one of the main concerns for the developing countries, since the beginning of seventies and Nepal has also started to fell this burden since seventies oil price hike. There after, now the burden of external borrowing in Nepal increasing continuously due to the continuous increase in outstanding borrowing."

Basnet, Nirajan (2004), in his thesis of M.A. entitled "A study on public debt in Nepal" has examined the role of public debt in Nepal and impact of debt on mobilizing the domestic resources. He concluded that share of external borrowing is higher than internal borrowing. He observed that foreign grant has dominant role for financing fiscal deficit and burden of public debt is also growing year by year since 1991/92 to 2000/01. He has concluded that government should maintain fiscal imbalance by applying strong fiscal and monetary policy. And to reduce

foreign dependency export promotion, tourist attraction and import substitution policy should be emphasized and import of capital goods should be increased for the productive purposes.

"Public debt in Nepal: An analysis of trends and pattern" (2006) is a dissertation prepared by Bhandari Rajendra for the degree of Master of Arts in economics. In his thesis, he shows the debt servicing capacity is lower than the total debt and debt obligation. As such the average growth rate of debt service obligation is higher than the growth rate of GDP, revenue, total revenue and export earnings. The redemption of the debt is not in time.

Hamal, Harka (2007), in his M.A. dissertation entitled "public debt in Nepal" has analyzed the trend and structure of public debt in Nepal. He expresses his view that being a least developed country, Nepal is incurring public debt. Although, the trend of continuous increase in public debt is not good to economy indicator for Nepal. Public debt is an important source to mobilize resources as well as socio-economic development of the country.

Nepuane, Rajendra (2007), in his M.A. dissertation entitled "A study on role and burden of public debt in Nepal" observed that government borrowing has been increasing unhealthily and is financed mostly on the unproductive sectors including uncertainties, high expenditure in the hence government always lacks resources than borrows the new loan to previous ones. That's why, the public debt and its interest is mounting rapidly, but addressing capacity for redemption the debt is not increasing in the same pace.

2.3.2 Articles and Reports Review

Public debt has great importance particularly in developing countries like Nepal where, increasing magnitude of fiscal imbalances. In Nepal, the revenue of government has only fulfilled in the regular expenditure. There is main problem of the investment due to the lack of internal revenue or lack of resource mobilization. So, far the government activity that gives the high internal rate of return, the government has required the public debt. In context of Nepal, public borrowing was started in 1951 A.D. Before 1950s there was not only special provision for borrowing. Since 1964, government started to use the deficit financing in Nepal.

Guna Nidhi Sharma (1998), in his article entitled "The Growing Fiscal Imbalance In Nepal; Are We Really Falling In to The Debt Trap?" analyzed that the ever increasing debt in Nepal and its servicing has really created a situation that in driving the country towards debt trap by the following reasons large amount of loan is allocated for meeting expenses with in the development expenditure, a good amount of borrowed fund is for debt servicing and volume of borrow amount exceeds the maximum legal limit of borrowing.

An article on "the Role of Foreign Aid In Economic Development And Poverty Alleviation" by Gurugharana (1996), presented data of the percentage share of outstanding foreign debt in GDP at factor cost and up foreign debt servicing in regular expenditure. He found long-term upward trend of increasing of that values under his study period. He concluded that "Although foreign loan is relatively much softer terms for Nepal compare to India and China, the very low rate of return and increasing

share of loan in foreign add imply that aid slowly pushing Nepal toward a debt crisis in the coming years."

Bhatta, Ganakar (2003), "An Assessment of the Impact of External Debt on Economic Growth of Nepal" has tried to examine the composition and disbursement of external debt and its implication on economic growth. According to him, continuous dependence on external financing may not be productive and sustainable and may not necessarily spur the growth of the economy. The external debt burden of Nepal has increased significantly since the year 1979/80. It is because of the increased investment need for government. In addition, lower resource on the government part have also contributed to debt burden.

Khatriwada (1998), in his article "Public debt management and macro economics" deals with monetary implication of public debt.

- Heavy bank borrowing by the government contributed significantly for the expansion of money in 1990s.
- Excess monetary expansion indirectly resulted in high rate of inflation and deterioration of current accounts situation.
- Public debt has crowded out resources available for private sector investment.
- Debt servicing resulting to higher budgetary deficit which further contributes to monetary expansion.
- Public debt has exerted upward pressure on the market rate of interest.

Thapa, Govinda Bahadur (2005), in his article entitled "Deficit Financing Implication and Management" observed that "Although Nepal's debt burden and its servicing should not be called as excessive, on the basis of its level of development, it is quite burdensome. Debt

burden has reached this level even to achieve such major development. Nepal has not taken high growth path so far and once it takes it will require enormous amount of investment and that investment will have to be made through borrowing from both domestic as well as the external sources. At that time, Nepal will have to borrow an unlimited amount of financial resources from both the sources. Therefore, until our growth rate takes momentum, we should be extremely judicious while borrowing to finance the budget deficits."

CHAPTER-III

TREND AND STRUCTURE OF PUBLIC DEBT IN NEPAL

3.1 Introduction

The phenomenon of public debt was originated in Great Britain in 17th century where city merchants provided grants and loans to the government. In return, they received the privileges of a royal charter to found the Bank of England, which later becomes the Central Bank of England. Concepts and needs of public debt arose simultaneously with the need of community development. In previous, most of the emperors take loan by the public for war financing. After the end of 2nd world war many countries made free from colonial rule then there is need of funds, which pushed forward on the needs of debt.

Public debt is the result of mismatch between revenue and expenditure over time period. The gap is growing due to limited sources of revenue mobilization. Nepal being a least developed country has been facing the problems of fund, where level of government revenue is very low because of low tax payable capacity of people but the level of government expenditure is in the form of regular and development expenditure is increasing rapidly. Since government revenue is increasing slowly and government expenditure is increasing rapidly, public borrowing becomes important to bridge the fiscal deficit of a country.

Nepal started to collect external debt from 1963/64 and internal debt from 1964. In fiscal year 1963/64, the government for the first time floated securities for mobilizing saving to finance the country's economic development. Specially "After the enforcement of public act 1960, public debt for the first time was issued in Nepal in 1962 through treasury bills

amounting to Rs.7 million. The next instrument of public debt, development bond, was first issued in fiscal year 1963/64, amounting to Rs.131.0 million. National saving certificate is being issued since 1984, which was Rs. 250 million" (Acharya, 1998).

"Nepal has been incurring fiscal deficit with the evolution of budgetary development in the first budget of the country in 2008 B.S. revenue was Rs. 30.5 million incurring thus the fiscal deficit of Rs. 22 million" (Thapa, 2005). This trend has continued uninterruptedly until now. Such condition really forced government borrowing. Foreign loan is accepted by Nepal since the first five year plan (1956/57-1959/60) and started to raise the debt since the year 1961/62 through the means treasury bill that amounted of million and carried one percentage of interest rate. In the FY 2064/65, the government issued public debt regulations and practical is still managed with this regulation. Since the amount of external borrowing of Nepal are the government of developed countries, international financial institutions, mainly IMF, WB and ADB.

There are mainly four reasons for the rise in government borrowing.

- i. to recover the deficit budget.
- ii. to recover emergency expenses.
- iii. to sustain the economic and monetary system.
- iv. to accelerate the economic and monetary stability.

3.2 Resource Gap

A common phenomenon, resource gap has always seen in Nepalese economy due to limited mobilization of internal resource of the development program in Nepal. Nepal is facing serious and growing problem of resource gap, since the starting of systematic budgeting

system in Nepal. This is because of the growth trend of the total expenditure and its revenue generation capacity. Every individual as well as government needs fund to maintain their daily expenditure but importance of fund is much more essential for government due to the concept of national development. To finance for the development works government must be collect fund through the taxation and other sources of revenue. However, government revenue is inadequate to meet the expenditure because of limited sources of revenue generation. To collect needy funds, government must be increased in the tax rates and fees which is unjustifiable for the point of social welfare. In Nepalese economy, resource gap has been always a common phenomenon, since the start of the systematic budgeting system in Nepal. Nepal is experiencing a serious and growing problem of resource gap. This is because the trend of revenue collecting is increasing in lower rate than the rate of expenditure, which is growing rapidly year to year. Thus revenue expenditure gap is growing in every fiscal year. On the other hand, a foreign aid cannot be received as expected, export trade tendency is not so encouraging which also leads budgetary deficits. The extent of financial resource gap in the context of Nepal has shown in the table 4.1.

Table 3.1
Different Scenario of Resource Gap (Rs. in million)

Fiscal Year	Total Revenue (1)	% Change in Revenue (2)	Total Expenditure (3)	% Change in Expenditure (4)	Revenue gap (5)=(1-3)	Foreign Grants (6)	Fiscal Deficit 3-(1+6)
1991/92	13512.7	-	26418.2	-	12905.5	1643.8	11264.7
1992/93	15148.4	12.10	30897.7	16.69	15749.3	3793.3	1195.6
1993/94	19580.8	29.29	33597.4	8.74	14016.6	2393.6	11623.3
1994/95	24575.2	25.51	39060.0	16.26	14484.8	3937.1	10547.2
1995/96	27893.1	13.50	46542.4	19.26	18649.3	4825.1	13824.2
1996/97	30373.5	8.89	50723.7	8.95	20350.2	5988.3	14361.9
1997/98	32937.9	8.44	56118.3	10.64	23180.4	5402.6	17777.8
1998/99	37251.0	13.99	59579.0	6.17	22328.0	4336.6	17991.4
1999/00	472893.8	15.15	66272.5	11.29	23378.7	5711.7	17667.0
2000/01	48893.6	13.99	79835.1	20.49	30941.5	6753.4	24188.1
2001/02	50445.5	3.17	80072.2	0.30	29626.7	6686.1	22940.6
2002/03	56229.8	15.04	84006.1	4.91	27776.3	11339.1	14637.2
2003/04	62331.0	10.85	89442.6	6.47	2711.6	11283.4	15828.2
2004/05	70122.8	12.5	102560.4	14.7	32437.6	14391.2	18046.5
2005/06	72282.1	3.1	110889.2	8.1	38607.1	13827.5	24779.6
2006/07	87717	21.35	133604.4	20.48	45887.4	15800.8	30086.6

Source: Various Issues of Economic Survey, MOF, GON.

Table 3.1 presents the trend of revenue gap and fiscal deficit. The revenue gap is increasing regularly because of increasing volume of total expenditure. This situation shows that present change in revenue is higher than expenditure, but the quantum of total expenditure is greater than total revenue and incurs revenue gap. In FY 1991/92, Rs. 26418.2 million was the total expenditure but total revenue was only Rs. 13512.7 million, there was gap of Rs. 12905.5 million. Which is 2006/07 to amount Rs. 133604.4 million total expenditure, Rs. 87717 million revenue and

revenue gap is Rs. 45887.4 million. This indicates that revenue gap is increasing year to year and very high in recent years.

The total revenue and expenditure are Rs. 13512.7 million and Rs. 26418.2 million respectively in FY 1991/92. So the revenue gap is 1205.5 million in the same period. The government expenditure is continuously increasing than government revenue. In FY 2006/07, total expenditure is Rs. 133604.4 million which is increased from Rs. 26418.2 million in FY 1991/92. This indicates that the problems of resource gap is a serious problem.

Foreign grant plays important role to meet the fiscal deficit but that cannot cover resource gap totally. Therefore, there is fiscal deficit of Rs. 11261.7 in fiscal year 1991/92 and of Rs. 30086.6 million in FY 2006/07 which shows that trend of fiscal deficit is increasing in every year. The trend of grant in table 3.1 shows increasing and decreasing tendency. In fiscal year 1991/92, there was Rs. 1643.8 million grants which is Rs. 15800.8 million in fiscal year 2006/07.

The table also presents that the quantum of fiscal deficit which shows upswing and down-swing tendency. In fiscal year 1991/92 the tendency of fiscal deficit was Rs. 11261.7 million and Rs. 30086.6 million in fiscal year 2006/07.

So, table indicates that trend of revenue and expenditure is increasing in review year, but quantum of expenditure is more than revenue. Which really forced to collect debt in order to meet resource gap in the country. Though foreign grant plays vital role to fulfill the resource gap but that cannot fully remove the gap and nation goes to collect public debt.

3.3 Export - Import Gap

One of the main economic problem of Nepalese economy is export-import gap. Nepal is a least developed country with limited exportable goods and without specialization such as food, grains, garment products, carpet etc. We are exporting low quality goods in low price which reduce the competitiveness of the product. Due to such scenario, there is not any possibility for current account balance. Major exports goods are raw materials and foods grains but import goods are final as well as capital goods so that year by year the gap is growing rapidly. There is no possibility to reduce import goods so that we must be made such policy which can initiate export. The trends of export and import of Nepal is shown on the table 3.2 below.

Table 3.2
Trend of Export and Import

(Rs. in million)

Fiscal Year	Export	Import	Export Import Gap	Growth Rate of Export Import gap
1991/92	13706.5	31940.0	18233.5	-
1992/93	17266.5	39205.6	21939.1	20.32
1993/94	19293.4	51570.8	3227.4	47.12
1994/95	19639.2	63679.	46040.3	42.63
1995/96	19881.1	74454.5	54573.4	18.63
1996/97	22636.5	93553.4	70916.9	29.94
1997/98	27531.5	89002.0	61488.5	-13.29
1998/99	35676.3	87525.3	51849.0	-15.67
1999/00	9822.7	108504.3	58682.2	13.17
2000/01	55654.1	115687.2	60033.1	2.3
2001/02	46944.8	107389.0	60444.1	6.8
2002/03	49930.6	124352.1	74421.5	23.12
2003/04	53910.7	136277.1	82366.4	10.67
2004/05	58705.7	149473.6	90767.9	10.2
2005/06	60234.1	173780.3	113546.2	25.09
2006/07	607958	191708.8	130913	15.29

Source: Various Issues of Economy Survey, MOF, GON.

Table 3.2 presents that, the total amount of export was Rs. 13706.5 million in 1991/92 which increases to amount Rs. 60795.8 million in 2006/07. On the another side, the total amount of import was Rs. 31940.0 million in 1991/92 which increases to amount Rs. 191708.8 million in 2006/07. The rate of growth of import is lower than export but the gap amounted to Rs. 130913 million in 2006/07, which was 18233.5 million in 1991/92. In export side there is fluctuating trend year by year, but in import side, the trend is increasing mostly. This condition states that larger amount of revenue is going to match the export - Import gap which pushes the economy for further internal and external debt. The figure of export and import shows that in the fiscal year 2000/01 the gap is decreasing due to caused by terrorism not by the export diversification.

Nepal is accelerating the process of trade liberalization that had commented in the mid - eights. This is reflected in membership of WTO, agreement of a frameword for a free trade area (FTA) in south Asian an interning on FTA with BIMST-EC. The trade liberlization in Nepal will have likely impact on import duties, which presently are an important source of government revenue contributing about one quarter of total tax revenue.

3.4 Public Debt as Percentage of Fiscal Deficit

Public debt is the valuable sources for financing the fiscal deficit in Nepal. Since the government expenditure is rapidly increasing which is unable to raise the revenue accordingly. Although for financing the government annual budgetary deficit both internal and external sources borrowing have been adopted. The government should borrow the internal debt within the limit of 1-2 percent of GDP for economic betterment. The external borrowing contains no such restrictions.

However, it must keep within limit of GDP. The higher amount of debt makes the economy totally dependent on foreign assistance and the debtor country becomes a short of the colony of debted country. The internal and external debt as percentage of fiscal deficit has been shown in the table 3.3.

Table 3.3
Percentage of Debt in Fiscal Deficit

(Rs. in million)

Fiscal Year	Internal Debt (ID)	External Debt (ED)	Govt. Revenue (GR)	Govt. Exp.(GE)	Total Debt	Deficit	Annual Growth Rate of Deficit	ID as % of Deficit	ED as % of Deficit	TD as % of Deficit
1991/92	2078.8	6816.9	13512.7	26418.2	88957	12905.5	0.0	16.1	52.8	68.9
1992/93	1620.0	6920.9	15148.4	30897.7	8540.9	15749.3	22.0	10.3	43.9	54.2
1993/94	1820.8	9163.6	19580.8	33597.4	10984.4	14016.6	-11.0	13.0	65.4	78.4
1994/95	1900.0	7312.3	24578.2	39060.0	9212.3	14484.8	3.3	13.1	50.5	63.6
1995/96	2200.0	9463.9	27893.1	46542.4	11663.9	18649.3	28.8	11.8	50.7	62.5
1996/97	3000.0	9043.6	30373.5	50723.7	12043.6	20350.2	9.1	14.7	44.4	59.2
1997/98	3400.0	11054.4	32937.9	56118.3	14454.4	23180.4	13.9	14.7	47.7	62.4
1998/99	4710.0	11852.4	37251.0	59579.0	16562.4	22328.0	-3.7	21.1	53.1	74.2
1999/00	5500.0	11812.2	42893.8	66272.5	17312.2	23378.7	4.7	23.5	50.5	74.1
2000/01	7000.0	12044.0	48893.6	79835.1	19044.0	30941.5	32.3	22.6	38.9	61.5
2001/02	8000.0	7698.7	50445.5	80072.2	15698.7	29626.7	-4.2	27.0	26.0	53.0
2002/03	8880.0	4546.4	56229.8	84006.1	13426.4	27776.3	-6.2	32.0	16.4	48.3
2003/04	5607.0	7629.0	62331.0	89442.6	13236.0	27116.6	-2.4	20.7	28.1	48.8
2004/05	8938.1	9266.0	70122.7	102560.4	18204.1	32437.7	19.6	27.6	28.6	56.1
2005/06	11834.2	8214.4	72282.1	110889.2	20048.6	386071.1	19.0	30.7	21.3	51.9
2006/07	17892.3	10053.5	87717	133604.4	27945.8	45887.4	18.9	39	21.9	60.9
Average Annual Growth Rate							9.0	21.1	40	61.1

Source: Various Issues of Economic Survey, MOF, GON.

In FY 1991/92, internal debt and external debt were Rs. 2078.8 million and Rs.6816.9 million respectively. Which gone up to Rs. 17892.3 million and Rs. 10053.5 million respectively in FY 2005/06. This shows the tremendous increasing trend of public debt by both internal and external sources.

The average annual percentage of total debt to fiscal deficit is 8.4 percentages. Rest of budgetary deficit has been fulfilled by grants and cash-balance. Above table shows that the internal debt had occupied 16.1 percent of deficit where as external debt has occupied 52.8 percentages in FY 1991/92. In overall, external debt has occupied 40 percentage of share out of total deficit whereas internal debt has occupied 21.1 percentages of shares out of total deficit during the study period of FY 1991/92 to 2006/07.

3.5 Trend and Structure of Internal Borrowing in Nepal

Internal borrowing is started to carry from fiscal year 1961/62. Nepal is borrowing the internal debt to meet the resource gap and to mobilize the internal fiscal resource for development from various sources such as Treasury Bill, Development Bond, National Saving Certificate and Special Bond. Internal public debt have important role in cash flow management and to support the expenditure for development activities. Now a days government is also receiving internal borrowing from citizen saving certificates. The trend and structure of internal borrowing is shown in the table 3.4.

Table 3.4
Trend and Structure of Internal Borrowing

Fiscal Year	Total Out Standing Internal Debt	Treasury Bills	Development Bonds	National Saving Certificates	Citizen Saving Certificates	Special Bonds
1991/92	23234.9	3483.2	5132.2	4546.3	-	10073.2
1992/93	25456.1	4403.2	5132.2	4901.5	-	11019.2
1993/94	30631.2	5216.3	4732.2	5691.5	-	14991.2
1994/95	32057.8	6392.5	4122.2	6076.4	-	15466.7
1995/96	34241.9	7142.5	3672.2	7376.5	-	16050.7
1996/97	35890.9	8097.5	3042.2	8736.5	-	16019.7
1997/98	38406.7	9182.5	3302.2	9886.4	-	16035.6
1998/99	49669.7	17856.9	3872.2	10426.4	-	17784.2
1999/00	54357.0	21026.9	4262.2	11526.5	-	17541.4
2000/01	60043.8	27610.8	5962.3	12476.4	-	13994.3
2001/02	73620.7	41106.6	11090.7	11536.3	628.1	9259.4
2002/03	84685.3	48860.7	16059.2	9629.8	931.1	9164.5
2003/04	83020.9	49429.6	17549.2	9029.8	1178.9	8946.2
2004/05	87564.2	51383.1	19999.2	6576.7	1428.9	8176.3
2005/06	94710.6	62970.3	17959.3	3876.8	1678.9	8225.6
2006/07	103776.0	7445.3	19177.1	1516.9	1391.0	7225.7

Source: Various Issues of Economic Survey, MOF, GON.

The above table shows that net outstanding internal debt and its variation into treasury bills, development bonds, national saving certificates and special bonds. In table total outstanding internal debt was Rs. 20855.9 million in FY 1991, which is increasing gradually and reached Rs. 103776.0 in FY 2007.

Treasury bills are short-term loan as these raised for the period of less than one year. In above table, amount of treasury bill is increased to

Rs. 74445.3 million in fiscal year 2007 from Rs. 2350.0 million in fiscal year 1991.

The other remaining securities are called long-term securities as they are issued for the period of more than one year. Government bonds and national saving certificates have 3 to 15 years periods of maturity accordingly these are identified as long-term securities. In the above table development bonds, national saving certificate and special bonds are upswing and downswing trend. It is concluded that the role of domestic borrowing for resource mobilization is increasing by the absence of growth in revenue collection as the proportion of growth in expenditure.

3.6 Trend of External Borrowing In Nepal

Nepal has not international relation before 1950's with rest of the world intimately which is changed after the 2007 B.S. revolution. Then foreigners are attracted to provide financial assistance for the socio-economic development of Nepal. Nepal has started to borrow from external sources from 1994/95. Internal debt is not to low resource mobilization, the fund collection is inadequate. So external debt is the most essential source of revenue to government. Basically, external borrowing can be divided in Bilateral and multilateral source. The friend and structure of external debt is shown in the following table.

Table 3.5**Pattern of External Debt in Term of Disbursement by Major Source**

Fiscal Year	Total External Debt	Bilateral Debt	Multilateral Debt	% of Bilateral External Debt	% of Multilateral External Debt
1991/92	6269.4	2389.8	3879.6	38.12	61.88
1992/93	5961.7	1307.6	4654.1	21.93	78.07
1993/94	9163.6	582.9	8580.7	6.36	93.64
1994/95	7312.3	717.3	6595.0	9.81	40.19
1995/96	9463.9	460.0	9003.9	4.86	95.14
1996/97	9043.6	850.7	8192.9	9.41	90.59
1997/98	11054.5	1314.5	9740.0	11.89	88.11
1998/99	11852.4	584.0	1268.4	4.93	95.07
1999/00	11812.2	757.9	11054.3	6.42	93.58
2000/01	12044.0	586.7	11457.3	4.87	95.13
2001/02	7698.6	87.0	7611.6	1.13	98.87
2002/03	4546.4	657.2	3889.2	14.45	85.55
2003/04	7629.0	66.0	7563.0	8.65	91.35
2004/05	9266.1	126.5	9139.6	1.36	98.63
2005/06	8214.3	40.6	8173.7	0.49	99.5
2006/07	10053.5	9004.6	1048.9	89.57	10.43

Source: Various Issues of Economic Survey, MOF, GON.

Table 3.5 shows that external debt has grown from FY 1991/92 to FY 2000/01. After FY 2001/02 foreign loan shows upswing and downswing trend. The total external debt was Rs. 6269.4 million in FY 1991/92 which increased and reached at Rs. 10053 in FY 2006/07. In table multilateral debt has dominated the bilateral debt up to 05/06. In 1991/92, Rs. 2389.8 million from bilateral source and Rs. 3879.6 million from multilateral where share is 38.12 and 61.88 percent respectively. The table also shows that the share of bilateral debt is decreasing and the share of multilateral debt is increasing up to FY 2005/06. But in FY 2006/07 data has totally changed, where share of Bilateral loan is 89.57 percent and multilateral loan is 10.43 percent. This shows that now a

days, the debt circular countries are satisfied from the returns of Nepal, what they had expected.

3.7 Net Outstanding Debt

A prime feature of Nepalese fiscal policy is the budget deficit due to revenue surplus cannot meet the development expenditure. The government has to borrow large amount of loans to meet ever increasing financial resource gap which needs large amount of loan and on the other hand there is low amount of repayment as compared with the total borrowing each year. Thus, there is increasing total net public outstanding debt each year. Net outstanding total debt means both internal and external debt after deducting repayment of principal and interest. The total debt stock of Nepal is shown in table below.

Table 3.6
Trend of Nepal's Total Debt Stock

Fiscal Year	External Loan	Internal Loan	Total Debt	GDP	Total Debt as % of GDP
1991/92	70923.6	23234.9	94158.5	144933.0	65.0
1992/93	87420.8	25456.1	112876.9	165350.5	68.3
1993/94	101966.8	30631.2	132598.0	191596.0	69.2
1994/95	113000.9	32057.8	145058.7	209974.0	69.1
1995/96	128044.4	34241.5	162286.3	239388.0	67.8
1996/97	132086.8	35890.9	167977.7	269570.0	62.3
1997/98	161208.0	38406.7	199614.7	289798.0	68.9
1998/99	169465.9	49669.6	219135.5	330018.0	66.4
1999/00	190691.2	54357.0	245048.2	366251.0	66.9
2000/01	200404.4	60043.7	261594.3	393563.0	66.5
2001/02	220125.6	73620.7	293746.3	405632.0	72.4
2002/03	223433.2	84645.3	308078.5	435531.0	70.7
2003/04	245211.4	83020.9	328232.3	472424.0	69.5
2004/05	219641.9	87564.2	307206.1	496026.0	60.24
2005/06	234805.6	94710.6	329516.2	509911.0	65.21
2006/07	216628.9	103776.0	320404.9	530890.1	60.4

Source: Various Issues of Economic Survey, MOF, GON.

Table 3.6 presents the total out standing debt of Nepal from fY 1991/92 to 2006/07, which shows that Nepal's total outstanding has reached a little more than two third of the national income of the country. In view of the level of the development and the per capita income of the country, this level of outstanding public debt should be taken as burden some.

The table also shows that both internal and external net outstanding public debt is increasing trend. In fiscal year 1991/92, internal and external outstanding debt are Rs. 23234.9 million and Rs. 70923.6 million respectively, which reached Rs. 103776.0 million and Rs. 216628.9 million in FY 2006/07. Growing trend of external debt is greater than internal debt. From above table, we conclude that net outstanding debt is growing due to the growing needs of socio-economic development and lower debt servicing trend.

CHAPTER-IV

BURDEN OF PUBLIC DEBT IN NEPAL

4.1 Introduction

When public outlays are loan financed rather than tax financed shows that cost or disadvantages the economy is called burden of public debt. It refers every government is bound to repay the public borrowing whether, internally or externally with interest may tend to fall either on the present or sometimes on the future generation. Generally debt is taken with the obligation of repayment including with interest. Government borrowing has been excessive and the burden of public debt is increasing day by day according to increase on the outstanding portion of the debt composition. The total burden of public debt can be classified in to two groups; burden of internal debt and burden of external debt.

The burden of internal public debt means that the large part of debt in held internally. According to Lerner (1946), the internal debt may not have any direct many burden on a community as a whole, since the payment of interest and increased taxation to meet the burden of the debt involved simply transfer the purchasing power from one group of person to another, to the extent the creditors and tax payer the same, there may not be any net burden at all on the community. Learner (1946) has further pointed out that the great misconception lies on looking at only one side of debt i.e. credit relationship. Every debt has a corresponding credit and this fact is frequently over looked when considering the burden of public debt. So discussing the burden of debt, we have to bear in mind not only the amount of debt but also the corresponding credit.

The concept of external debt is entirely differs than external debt. It means the loan is lending from foreign country, institutions etc. It poses

real burden on the country by losing the economic welfare of the debtor community. The process goes for a long time until the loan is cleared because the debtor country has to pay not only the loan but also the interest charge on it.

In case of burden of public debt, different economists have different views. The classical view, under the "self liquidation" or 'pay-as-you use-approach', maintains that any loan which is incurred for a purpose that doesn't yield any direct monetary return a burden impose to the society. It is for the reason that additional taxation is needed to meet interest cost and to repay the principal. The conventional view maintains that public borrowing diverts for saving public use and thereby starves the private sector. The keynsian approach observed that public borrowing for the purpose of generating effective demand is no real burden because it would activate idle saving in the private sector and generate income, employment and output. Domar has gone a step further and integrated the keynsian view with the economic growth. He argued that public debt is a burden only when the rate of growth of the economy falls behind the rate of increase in interest costs.

Gunanidhi Sharma observe in his article entitled "The growth fiscal imbalance in Nepal; Are we really falling in to the Debt Trap ?" observed that Nepal is facing a paradoxical situation. She can neither promote her economy without aid nor has she been able to avoid the risk of becoming the victim of aid intoxication. Meanwhile, aid for long period has created a separate social group namely the rental class.

Keshav Prasad Acharya found in his entitled "Burden of Public Debt in Nepal" published in debt trap and its management in Nepal the historical trend of debt indicators, suggests a further escalating debt

burden in future. He concludes that in most of the years GDP growth rate fail or below the growth rate in public debt. Such a relation is much poorer with external debt than with internal debt.

About the Nepal, outstanding of public debt is increasing each year. Large scale of public debt have been incurred in the past for financing development programs but the debt servicing capacity, has not increasing in the same place so that there may be under strain in the balance of payment owing to out flow of the funds through debt service. Nepal has been borrowing new fresh loan to repay old loans. This also alarmed situation of "debt trap" in futrue.

4.2 Debt Servicing Issues in Nepal

The payment of interest and principle of internal as well as external public debt is known as debt servicing. Most of development activities, project depend upon the public debt. Nepal is taking huge amount of external and internal loan with the obligation of future repayment. In Nepalese context, foreign loan share is rapidly increasing which increase financial and real burden for the future generation. So debt servicing is one problems of Nepalese economy because most of the portion of revenue has been used to pay the interest of debt. Trend of internal and external debt servicing and growth rate of total, internal and external debt servicing are shown on the table below.

Table 4.1
Trend of Debt Servicing

Fiscal Year	Total Debt Servicing	% Change in Total Debt Servicing	Internal Debt Service	% Change in Internal Debt Servicing	External Debt Servicing	% Change in External Debt Servicing	% of EDS to TDS	% of EDS to TDS
1991/92	3797.1	-	2132.2	-	1664.9	-	56.15	43.85
1992/93	4560.5	20.10	2428.6	13.90	2131.9	28.05	53.25	46.75
1993/94	4855.1	6.46	2366.4	-2.56	2488.7	16.74	58.74	51.26
1994/95	6083.3	25.30	3098.6	30.94	2984.7	19.93	50.94	49.06
1995/96	5715.5	10.39	3411.2	10.10	3304.3	10.71	50.80	49.20
1996/97	7527.2	12.09	4177.8	22.48	3349.4	1.36	55.50	44.50
1997/98	7682.8	2.07	3481.6	-16.66	4201.2	25.34	45.32	54.68
1998/99	8723.0	13.54	3977.5	14.24	4745.5	12.96	45.60	54.40
1999/00	10032.8	15.02	4711.4	48.25	5321.4	12.14	46.96	53.04
2000/01	10355.4	3.54	4187.0	-11.13	6201.4	16.54	40.30	49.70
2001/02	12205.2	17.49	5637.7	34.65	6567.5	5.90	6.19	53.81
2002/03	16181.3	32.58	8662.1	53.65	7519.2	14.49	53.53	46.47
2003/04	17338.7	7.15	9431.2	8.87	7907.5	5.16	54.39	45.60
2004/05	19752.6	13.91	11651.3	23.53	8101.3	2.45	59.00	41.00
2005/06	20423.5	3.39	11272.1	-3.25	9151.4	13.00	55.20	48.80
2006/07	22916.3	12.20	13321.8	18.18	9594.5	4.84	58.13	41.87
Average Annual Growth Rate		12.20		15.32		18.85		

Source: Various Issues of Economics Survey, MOF, GON.

The amount of total debt servicing in 1991/92 was Rs. 3797.1 million which grew with the rate of 20 percent in 1992/93 with amount Rs. 4560.5 million. The total debt servicing amount has increased up to Rs. 22916.3 million in fiscal year 2006/07 from Rs. 3797.1 million in fiscal year 1991/92. The growth of internal debt servicing is larger than external debt servicing. Confessional nature of external loans, interest payment on internal loan is higher than principle. So it can be concluded that internal debt servicing has increased in some extent more than external debt servicing.

In fiscal year 1991/92, the internal and external debt servicing has placed 56.15 percent and 43.85 percent of total debt servicing. But last year of the review period 2006/07, it placed 58.13 percent and 41.87 percent of total debt servicing. This shows that internal debt servicing has increased in some extent in fiscal year 2006/07 than external debt servicing.

4.3 Internal Debt Servicing to GDP, Total Revenue and Expenditure

Internal debt is an important source to finance deficit budget. The burden of public debt is measured by the ratio between the debt servicing and aggregate tax revenue and non tax revenue and ratio between servicing cost and national income.

The share of internal debt servicing in relation to total revenue, expenditure and GDP has shown in the table 4.2.

Table 4.2
Share of Internal Debt Servicing to GDP, Revenue and Expenditure

(Rs. in million)

Fiscal Year	Internal Debt Servicing	GDP	Total Revenue	Total Expenditure	Recurrent Expenditure	Internal Debt servicing as % of GDP	Internal Debt Servicing as% of Revenue	Internal Debt Servicing as % of total Expenditure	Internal Debt Servicing as % of Recurrent Expenditure
1991/92	2132.2	144933.0	13512.7	26418.2	9905.	1.47	15.78	8.07	21.53
1992/93	2428.6	165350.5	15148.4	30877.7	11484.1	1.47	16.03	7.87	21.13
1993/94	2366.4	191596.0	19580.8	33597.4	12409.2	1.24	12.08	7.04	19.07
1994/95	3098.6	209974.0	24578.2	39060.0	19265.1	1248	12.61	7.93	16.08
1995/96	3411.2	239388.0	27893.1	46542.4	21561.8	1.42	12.23	8.24	15.82
1996/97	4177.8	269570.0	30373.5	50723.7	21181.1	1.55	13.75	6.20	17.28
1997/98	3481.6	289798.0	32937.9	56118.3	27174.4	1.20	10.57	6.28	12.81
1998/99	3977.5	330018.0	37251.0	59579.0	31944.2	1.21	10.68	7.10	12.45
1999/00	4711.4	366251.0	42893.8	66272.5	35579.1	1.29	10.99	5.24	13.24
2000/01	4187.0	393563.0	48893.6	79835.1	45837.3	1.06	8.56	7.04	9.13
2001/02	5637.7	405632.0	50445.5	80072.2	48836.9	1.38	11.18	5.24	11.54
2002/03	8662.1	435531.0	56229.8	84006.1	52090.5	1.98	15.40	10.31	16.63
2003/04	9431.2	472424.0	62331.0	89442.6	55552.1	1.99	15.13	10.54	16.98
2004/05	11651.3	496026.0	70122.7	102560.4	61686.4	2.35	16.62	11.36	18.89
2005/06	11272.1	509911.0	72282.1	110889.2	67018.0	2.21	15.60	10.17	16.81
2006/07	13321.8	530890.1	87717	133604.4	77122.2	2.50	15.28	9.97	17.27
Average Annual Growth Rate						1.61	13.31	8.19	16.04

Source: Various Issues of Economic Survey, MOF, GON

In table 4.2 shows that the share of internal debt servicing as percentage of GDP, total revenue total expenditure and recurrent expenditure. The share of internal debt servicing is Rs 2132.2 million in FY 1991/92 which is increased to Rs 13321.8 million in FY 2006/07. It indicates that each and every year the internal debt servicing is increasing rapidly. In 1991/92, the internal debt servicing as percentage to GDP was 1.47 percent but in FY 2006/07 it is 2.50 percent of GDP. It shows that the trend of servicing as a percentage of GDP and development expenditure has been increasing and fluctuating.

The share of internal debt servicing as a percentage of total revenue is 15.78 percentage in FY 1991/92, which is decrease to 15.18 percent in FY 2006/07. The share of internal debt servicing as percentage of total expenditure is 8.07 percent as percentage of total expenditure is 8.07 percent in FY 2006/07. The average annual growth rate of internal debt servicing as percentage of total revenue, total expenditure and GDP are 13.31, 8.19 and 1.61 percent respectively.

The data of table 4.2 also shows the trend of internal debt servicing as percentage of recurrent expenditure. The internal debt servicing as percentage of recurrent expenditure was 21.53 percentage in FY 1991/92 and has decreased to 17.27 percent in FY 2006/07.

From above table, the average annual growth rate of internal debt servicing is greater than growth rate of total revenue and GDP. This indicates that increasing trend of internal debt servicing as percentage of GDP and debt burden is increasing trend.

4.4 Share of External Debt Servicing and Export Servicing to GDP

Most part of total expenditure is fulfilled by external debt in Nepal. Since domestic resources are inadequate to meet financial requirement for the economic development, foreign debt is accepted. Here the attempt has been made about to compute the ratio of external debt servicing to export earning and debt servicing to GDP. In Nepal, the large proportion of GDP and export earning go to back to foreign countries for debt servicing.

Table 4.3 shows the share of external debt servicing to export earning and debt servicing to GDP ratio.

Table 4.3
Share of External Debt Servicing to GDP

(Rs. In Million)

FY	External Debt Servicing	Export	GDP	External Debt Servicing as % of Export	External Debt Servicing as % of GDP
1991/92	1664.9	13706.5	144932.0	1.15	12.15
1992/93	2131.9	17266.5	165350.5	1.29	12.35
1993/94	2488.7	19293.4	191596.0	1.30	12.90
1994/95	2984.7	17639.2	209974.0	1.42	16.92
1995/96	3304.3	19881.1	239388.0	1.38	16.92
1996/97	3349.4	22636.5	269598.0	1.24	14.80
1997/98	4201.2	27531.5	289798.0	1.45	15.27
1998/99	4745.5	35676.3	330018.0	1.44	13.30
1999/00	5321.4	49822.7	366251.0	1.45	10.68
2000/01	6201.4	55654.1	393563.0	1.57	11.14
2001/02	6567.5	46944.8	405632.0	1.61	13.99
2002/03	7519.2	49930.6	435531.0	1.72	15.06
2003/04	7907.5	53910.7	472424.0	1.67	14.67
2004/05	8101.3	58705.7	496026.0	1.63	13.80
2005/06	9151.4	60234.1	509911.0	1.79	15.19
2006/07	9594.5	60795.8	530890.1	1.80	15.78
Average Annual Growth Rate				1.49	14.03

Sources: Economic Survey 2005/06, MOF/GON

The table 4.3 shows that the share of external debt servicing as percentage of GDP and export earning. The trend of external debt servicing is continuously increasing year by year, in the review FY 1991/92, the external debt servicing was Rs. 1664.9 million which increased to Rs. 9594.8 million in FY 2006/07. In this review period it has been increased only 5.7 folds.

The data shows the external debt servicing as percentage of GDP is increasing year by year. The ratio of external debt servicing to GDP has increased from 1.15 percentage in fiscal year 1991/92 to 1.80 percent in FY 2006/07. The average annual growth rate of external debt servicing as a percentage of GDP is 1.49 percent.

The external debt servicing to export earning ratio is 15.78 percent in FY 2006/07 which is increased from 12.15 percent in FY 1991/92. The average annual growth rate of external debt servicing as percentage of export earning is 14.03 under the period of study. The external debt servicing as percentage of export and of GDP are fluctuating over the study period.

4.5 Share of Internal Debt Servicing to Annual Internal Debt

The analysis of internal debt and annual internal debt servicing are important aspects while discussing about the burden of internal debt. Internal debt servicing and internal borrowing are closely related in internal debt analysis. Internal debt curtails consumption and purchasing power of the people through taxation but it ultimately increases purchasing power of the people through supply of fund or money from banking sector.

Table 4.4
Annual Internal Debt Servicing as Percentage of Annual
Internal Debt

Fiscal Year	Internal Debt	Internal Debt Servicing	Internal Debt Servicing as % of I.D
1991/92	2078.8	2132.2	102.5
1992/93	1620.0	2428.6	149.9
1993/94	1820.0	2366.4	130.0
1994/95	1900.0	3098.6	163.0
1995/96	2200.0	3411.2	155.0
1996/97	3000.0	4177.8	139.0
1997/98	3400.0	3481.6	102.4
1998/99	4710.0	3977.5	84.4
1999/00	5500.0	4711.4	85.6
2000/01	7000.0	4187.0	59.8
2001/02	8000.0	5637.7	70.4
2002/03	8880.0	8662.1	97.5
2003/04	5607.0	9431.2	168.1
2004/05	8938.1	11651.3	130.1
2005/06	11834.2	11272.1	95.2
2006/07	17892.3	13321.8	74.5

Source: Economic Survey of Different Year MOF/GON/ Nepal.

In the starting year of study period 1991/92, percentage share of internal borrowing was 102.5. This proportion has increased gradually and reached up to 163.0 in FY 1994/95. After that the proportion has decline up to 2000/01. The percentage share of internal debt serving started to increase from FY 2000/01 and reached 168.1 percent in FY 2003/04. Similarly, it started to decrease and reached 74.5 percent in FY 2006/07.

This shows that proportion of internal debt servicing is the manifestation of productive spending of borrowed fund. It effects

investment on productive sector and ultimately it totally affects entire economy.

4.6 External Borrowing

Nepal being an underdeveloped country is facing very serious problem of scarcity of domestic capital formation, which is more essential for development process. And the country is also facing the problem of foreign exchange. So the country has to borrow public debt from both internal and external sources. Because of the scarce of internal sources, the scope of domestic borrowing of Nepal is very limited. So external borrowing is the main sources for development process of underdeveloped countries like Nepal.

Foreign capital plays an important role in the economic development of underdeveloped countries. It is helpful in accelerating the pace of economic growth in several ways. Foreign capital provides the recipient country with the mean for acquiring local resources for domestic investment. It supplies foreign exchange for economic development.

External debt services have obvious impact on domestic capital formation and leads to reduction in the domestic standard of living unless the loan are used for financing profitable investment which yield is enough to satisfy creditor's claims for debt servicing. Therefore, the true burden of debt services depends to a substantial extent in how the borrowed fund from external sources can be transformed in to productive investment. If the foreign loans are used in to unproductive investment projects that provide present consumption with more goods than being produced in the country. Then it is quite impossible for the foreign debt servicing. But if foreign loans are used in productive purpose, the

national income will increase and consequently the debt servicing ability will increase.

Therefore, for the purpose of foreign debt servicing foreign currency has to be earned through increasing volume of exportable goods and services. If this is not happen, external debt becomes burden for next generation and that hampers the Nepalese economy through growing flow of foreign trade.

4.7 Share of Principle and Interest Servicing to Total Debt Servicing

Table 4.5 presents the percentage share of principle and interest servicing to total debt servicing.

Table 4.5
Trend of Share of Principal and Interest Servicing to
Total Debt Servicing

(Rs. in million)

Fiscal Year	Total Debt Servicing	Principal Servicing		Interest Services	
		Internal debt	External debt	Internal debt	External debt
1991/92	3797.1	264.8	942.2	1867.4	722.5
1992/93	4560.5	345.0	1252.9	2083.6	879.0
1993/94	4855.1	430.0	1468.2	1936.4	1020.5
1994/95	6083.3	825.0	1828.2	2273.6	1156.5
1995/96	6715.5	859.8	1987.7	2551.3	1316.6
1996/97	7527.2	1350.9	2102.4	2826.9	1247.0
1997/98	7682.8	1151.0	2780.2	2330.6	1421.0
1998/99	8723.0	1446.2	3196.5	2531.3	1549.0
1999/00	10032.8	1531.6	3681.0	3179.8	1640.3
2000/01	10355.4	1190.0	4500.6	2997.0	1700.8
2001/02	12205.2	1683.6	4751.4	3954.1	1816.1
2002/03	16181.3	4062.0	5497.5	4610.1	2021.7
2003/04	17338.7	5029.1	5765.8	4402.1	2141.8
2004/05	19752.6	7580.1	5953.2	6217.3	2146.7
2005/06	20423.5	7277.3	6987.5	3994.8	2163.9
2006/07	22916.3	9213.5	7538.8	4108.3	2055.7

Source: Economic Survey of Different Year, MOF/GON/Nepal

Principal payment is Rs 9213.5 million. Whereas interest servicing is share by Rs 4108.3 million for internal loan and Rs 2055.7 million external loan. In conclusion we can say that principal debt servicing of external loan is growing rapidly then internal where as interest payment is growing rapidly for internal than external loan.

4.8 Annual External Debt and External Debt Servicing

Since the domestic resource mobilization is in adequate to meet the growing needs of development funds, the foreign assistance becomes ultimate solution. Here, the attempt has been made to compare annual flow of external debt and its servicing which is shown in the table 4.6.

Table 4.6
External Debt and Its Servicing Trends

(Rs in Million)

FY	External Debt Servicing	External Debt	EDS Rs% to ED
1991/92	1664.9	6816.9	24.4
1992/93	2131.9	6920.9	30.8
1993/94	2488.7	9163.6	27.2
1994/95	2984.7	7312.3	40.8
1995/96	3304.3	9463.9	34.9
1996/97	3349.4	9043.6	37.0
1997/98	4201.2	11054.4	38.0
1998/99	4745.5	11852.4	40.0
1999/00	5321.4	11812.2	45.1
2000/01	6201.4	12044.0	51.1
2001/02	6567.5	7698.7	85.3
2002/03	7519.2	4546.4	165.4
2003/04	7907.5	7629.0	103.7
2004/05	8101.3	9266.0	87.4
2005/06	9151.4	8214.4	111.4
2006/07	9594.5	10053.5	95.4

Source: Economic Survey of Different Year, MOF/GON/Nepal.

The share of debt servicing to external debt is 24.4 percent, which is increased by 4 fold in 16 years both external new debt is growing rapidly but growth rate of debt servicing is very high as compare to new debt. In fiscal year 2006/07 total new external debt is 10053.5 million where as debt servicing charge is 9110.0 million. The indicator raised fear about its increasing burden because it is going to devour not only large proportion of exchange earning but rather large proportion of new borrowing also.

CHAPTER-V

SUMMARY, FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The concept of public debt grew after the end of world war-II because of independence of Asian and African countries from the colonial rule of center. But it does not mean that public debt was not exist before second world war, most of classicists were against borrowing because they thought individual can effectively used resource than government. They were not totally against the borrowing, they prefer effective utilization of loan or borrowing must be used on productive activities. Later on, after the great depression of 1930s role of government on the economy increased which leads to increase in debt also.

In the context of developing countries, it is playing vital role for socio-economic development because they have limited size of funds which is not sufficient for development financing. In case of Nepal, the land locked nature and mountains topography are the major constrains for development of Nepal. Nepal is economically backward and also its economic performance is not satisfactory. Nepal is demanding more and more financial resources to bridge the growing resources in budget. So, public debt is playing crucial role for development and fulfill the gap between income and expenditure. The study shows that the government borrowing is growing year by year along with the rise is public expenses.

Borrowing is taking from two sources internal and external. In the internal sources treasury bills, special bonds, development bonds and national saving certificates are included. Large proportion of internal debt

is taken by banking sectors from very beginning of the debt program. Similarly, in external sources Nepal is receiving borrowing in the form of bilateral and multilateral sources such as ADB, UNDP, WB, WHO, IMF etc.

Internal debt plays important role to fulfill deficit financing and to promote monetary policy but domestic resources are not sufficient to meet such fiscal imbalance and government have to depend upon external borrowing.

Nepal is also implementing periodic plan for smooth development of a country. Such plan demands heavy fund for infrastructure development as well as fulfilling various objectives of the plan. Since internal sources are not sufficient, government collects needy fund from external sources. The trend and structure of internal and external borrowing is increasing due to increasing trend of fiscal deficit.

Nepal is facing the problems of financing to ever increasing resource gap. The widening resource gap in the recent year has been cumulative effect on the deficiency of investment.

Budgetary deficit is growing rapidly in every fiscal year and trend of grants is decreasing which further increased in debt burden. Such factor helps to raise internal and external debt. Although, the trend of continuous increase in public debt is not good economic indicator for Nepal, public debt is an important source to mobilize resource as well as socio-economic development of the country.

5.2 Findings

* In FY 1991/92, import-export gap Rs 18233.5 million and in FY 2006/07, it is Rs. 130913 million. Where as the amount of export

was Rs. 13706.5 million and import was Rs. 31940.5 million in FY 1991/92 and in FY 2006/07 export is Rs 60795.8 million and import is Rs 191708.8 million.

- * The sources of financing deficit are loan and grants, in loan share of external debt is higher than internal debt. In fiscal year 1991/92, the share of internal debt was Rs. 2078.8 million and share of external debt was Rs. 61816.9 million. In fiscal year 2006/07, the amount of external debt is Rs. 10053.5 million and amount of internal debt is Rs. 17892.3 million.
- * Foreign grant also plays important role to meet fiscal deficit. In fiscal year 1991/92, the total amount of grant was Rs. 1643.8 million which is increased to Rs. 15800.8 million in 2005/06.
- * In FY 1991/92, government received internal debt of Rs. 3483.2 million from Treasury Bills, Rs 5132.2 million from development bonds, Rs. 4546.3 million from National Saving Certificates and Rs. 10073.2 million from special bonds. But in FY 2006/07, it is Rs 74445.3 million from Treasury Bills, Rs 19177.1 million from Development Bonds, Rs 1516.9 million from National Saving Certificates, Rs. 1391.0 million from citizen saving certificates and Rs 7225.7 million from special bonds. This shows that the trend of internal debt is rising in all those sources.
- * Total external debt was Rs 6269.4 million in FY 1991/92, in which Rs 2389.4 million was taken from bilateral and Rs 3879.6 million was taken from multilateral sources. It has gone up to Rs 10053.5 million in FY 2006/07 in which Rs 9004.6 million from bilateral and Rs. 1048.7 million from multilateral sources.
- * The total debt amount is increasing from Rs 144933.0 million in FY 1991/92 to Rs 530890.1 in FY 2006/07. The total as percentage of GDP was 65.0 percent in FY 1991/92 and in FY 2006/07, it is

60.4. In the study period, total debt as percentage of GDP lies between 60 to 70 percent.

- * The total debt servicing amount is increasing with an average annual growth rate 12.20 percent from Rs. 3797.1 million in FY 1991/92 to Rs. 22916.3 million in FY 2006/07. The internal debt servicing is increasing with an average annual growth rate of 15.32 percent which gone up from Rs 2132.2 million in FY1991/92 to Rs 13321.8 million in FY 2006/07. Similarly, the average annual growth rate of external debt servicing is 18.85 percent, which has gone up from Rs. 1664.9 million in FY 1991/92 to Rs. 9594.5 million in FY 2006/07.
- * The GDP was Rs 144933 million in FY 1991/92 which is increased to Rs. 530890.1 million in FY 2006/07. The external debt as percentage to GDP was 1.15 in FY 1991/92 which is increased to 1.80 in FY 2006/07. Similarly, the internal debt as percentage to GDP was 1.47 in FY 1991/92 which is increased to 2.50 in FY 2006/07.
- * The government is spending high amount to pay interest and principle of the total outstanding debt. In which principle servicing of internal debt and external debt was Rs. 264.8 million and 942.2 million respectively in FY 1991/92 and has gone up to Rs. 9213.55 million and Rs 6987.5 million respectively in FY 2006/07. Similarly, interest payment of internal debt and external debt was Rs. 1967.4 million and Rs. 722.5 million respectively in FY 1991/92 which has gone up to Rs 4108.3 and 2055.7 million respectively in FY 2006/07. Hence, burden of interest payment is higher than the burden of principle payment. But total amount of debt is increasing due to high interest payment rate and misuse of funds.

- * Internal debt servicing as percentage to internal debt was 102.5 in FY 1991/92 is decreased to 74.5 in FY 2006/07. Similarly, external debt servicing as percentage to external debt was 24.4 in FY 1991/92 which has gone up to 95.4 in FY 2006/07.

5.3 Conclusion

Public debt refers to the obligation to pay money back to the persons, institutions, or country from whom it has been obtained. It plays a valuable role in socio-economic development of a nation. Nepal started obtaining internal debt since FY 1961/62 and external debt since FY 1963/64 with the objectives of national development. Nepal's most development activities are depending upon the public debt especially external debt.

There is excessive increase in revenue gap which leads to increase fiscal deficit. The revenue gap has increased fiscal deficit. The revenue gap has increased from Rs. 12905.5 million in starting year of review period 1991/92 to Rs 45887.4 million in last year of review period 2006/07. Thus fiscal deficit [TE - (TR + Grant)] has increased from Rs 11261.7 million in starting year of review period 1991/92 to Rs. 30086.6 million in final year of review period 2006/07.

The trend of percent change in revenue is greater than the trend of percentage change in expenditure but the quantum of expenditure is greater than quantum of revenue. So higher rate of growth in revenue is not sufficient for financing increased government expenditure.

During the study period, it was found that government borrowing has been increased unlikely and financed mostly on the unproductive sector including uncertainties, high expenditures and hence government

always lacks the revenue then borrows the new loan to pay the previous one. that's why, the public debt and its interest is growing rapidly. But addressing capacity for redemption the debt is not increasing in the same place.

It is concluded that the average annual growth rate of GDP, revenue and export earning are considerably low as compared with that of debt and its servicing obligation and the most of the borrowed funds are using in unproductive sectors. Because of the misuse of borrowed funds, other things remaining the same there are symptoms of steadily falling in to the debt trap.

5.4 Recommendations

The size of public borrowing is increasing year by year due to the size of fiscal deficit is increasing every year. So that proper utilization and minimization of public debt is necessary. The following recommendations are purposed to address the problem of public debt in Nepal.

- * Government should use both external and internal debt on highly productive sectors which can contribute to pay back of the principle and interest and to help to generate the capital formation.
- * Borrowing should not be used for the payment of interest and principal amount. It should be invested in the productive sector so that return from such investment will be sufficient for repayment.
- * Government should try to collect foreign grant instead of foreign debt.
- * Borrowing should be invested according to people's desire and needs so that return from such investment would be high.

- * Appropriate environment and policy should be made to attract foreign direct investment.
- * Tax collection system should be made effective and sources of revenue should be developed to substitute public debt.
- * The government should be active enough to maintain the strong policy of monitoring, evaluation and supervision which help to reduce corruption and to increase to accountability, responsibility and implementation.
- * Poor attention should be given to macro economic stability of the country while taking both internal and external debt.
- * Government should adopt the policy of trade but not aid for the economic development.
- * Government should replace the remittance instead of external debt in different economic activities.

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