CHAPTER I

INTRODICTION

1.1General Background:

The government borrowing is not defined yet uniformly. Some economists have focused on all kinds of financial obligation including the currency of the states. But other argued on the view that government borrowing does not include the currency but it includes all kinds of financial liabilities on the part of government to pay the money back to the person and institution from whom it has been obtained. There are two sources of public borrowing which are:

1 internal borrowing and

2 external borrowing

Internally, the government can borrow from individuals, commercial banks, financial institutions, charitable trusts and the central banks in a country. Externally, the government may borrow from individual's banks and international financial institutions and foreign governments it is know as external borrowing or debt. In other word, the public loan taken with foreign government, foreign people, and institution is known as external debt. According to Dalton "The loan taken with individual and institution that were out of the control of public authority is known as external debt."

If we roll the economic history of various countries, it is seen that almost every advanced countries of modern world had to rely on foreign capital to speed up the process of economic development. In 17^{th} and 18^{th} centuries the phenomenon of external borrowing was originated. After the world war, it seemed a very vital source of development most of the countries in the world started to borrow systematically and still borrowing to develop their economic at a faster pace to meet their expenditure. After finishing first and Second World War large amount of loans were borrowed for the reconstruction, rehabilitations and maintained. In underdeveloped countries, there is a small capacity of saving owing to a low level of real income. Low level of income in reflection of low productivity, which is usually due to the lack of appropriate technology and capital equipment and the capacity to use them to the best advantage (barman, 1986:4).

Developed countries were provided the loans from their people even in 18th century in a very systematic way. But in case of Nepal, people had no power and inclination to provide the money as a loan. They traditionally provided the human labor and goods to their ruler people had compulsory to contribute to overcome several emergency situations. But now, the government responsibility has been increasing with limited resources. To fulfill that responsibility Nepal has also started to borrow from abroad since 1964.The loan, grants and ant kinds of financial obligation to board is being used to bridge the budgetary deficit and lack of resources gap.

The government of developing countries like Nepal has to face the problem of revenue gap. As a result, government generally runs a deficit budget policy. Such countries domestic resources are inadequate to meet the financial requirements for economic development due to the various constraints. Therefore, almost all countries have to choose some form of public borrowing as a fiscal instrument to supplement their tax revenue. The present level of capital formation of those countries is too low and ant substantial increase in saving is not possible due to extreme low level of income and wide spread poverty. Tax base is varying low. Most of the taxes are indirect in nature. This limits the possibility of mobilizing the tax revenue. So that, there is very little scope of public borrowing on accounts of very low income per capita, under development of money and capital market etc.

The deficiency of capital in underdeveloped countries is one of the serious bottlenecks in attaining desirable growth rate. Public borrowing compensates the breaking of vicious circle of poverty created by capital deficiency and the requirement of heavy doze of development expenditure in developing countries. As W.W. Rostow has emphasized “Underdeveloped countries are facing the deficiency of capital in relation to their population and natural resources. Most of the developing countries are characterized by deficiency of capital. To beak the vicious circle of poverty and uplift a country with a self-sustaining growth, a large amount of initial investment is necessary. Thus he underdeveloped countries should emphasize stimulate and accelerate capital formation" (Rostow, 1952:3).

As almost all developing countries have objective of high and sustainable growth rate, Nepal has also set the same objective in its different periodic plans. People planning for economic development were initiated in 1956. Since then the magnitude of development efforts has been growing continuously. To attain this goal, the government has to make increasing investment every year. As a result there has been increasing requirement of fund for development programmes.

At this critical juncture, the only alternative to pull the economy out of vicious circle of poverty is the foreign capital. Thus foreign capital is gainful for the acceleration of the growth mechanism in the under developed countries. So government borrows found from external sources namely:

1 Borrowing from friendly nation (known as bilateral agency) and

2 Borrowing from international financial institution such as IMF, World Bank, ADB etc, (known as multilateral agency)

Foreign loans are to create positive effect on the economy. The government need foreign loan for following purpose:

1. They make it possible to import capital goods, improved technology, and raw material. There are immense of helps to a policy of industrialization which is necessary for accelerating the pace of economic development.
2. Foreign loans help to import goods which are in short supply in the domestic market and there by help in main training balance between there demand and supply .It would prevent the price of such goods escalating.
3. Availability of external loans has the saving of scarce foreign exchange resources.

But foreign capital should be noted that an external source is not permanent solution to bridge the gap between government revenue and expenditure. so rational debtors countries must used properly so that it should promote domestic growth and long term economic development and transformation .Therefore, debtor countries eventually need no such assistance in future . Foreign exchange scarcity has been well recognized as one of the major worlds on the economics growth of many developing countries .One way of dealing with this constraints has to resort to foreign borrowing either for purpose of smoothing the consumption path in the face of transitory shocks or as a means of supplementing domestic saving to expand productive capacity and raise long term growth rate (Gill and Pinto, 2004).

Foreign loans are to create effort on the economy positive as well as negative. If external loans are not utilized productively and prudently, they will create unfavorable consequences for the economy and would become a burden for the country. However incase of Nepal; it is really found so. Thus on the one hand, the burden of the public debt is mounting and on the other hand it is facing the problem of macro economic imbalance.

2.1 Statement of the Problem:

Underdeveloped country like Nepal, expenditure of government is growing very fast as compared to the increase in their income. As a result, budget deficit as well as fiscal deficits are widening in each year. Moreover, saving investment gap, increasing current account deficit and increasing high debt servicing has been also increasing. But that gap serving can be bridged by imposing more taxes or by borrowing the economy from internal and external sources. However, there is a certain limit to cover up the deficit or gap without having adverse effect on the economy. Internal borrowing is subject to various constrains such as underdeveloped money and capital market low income per capita etc. thus external borrowing is only the most reliable source of financing development expenditure.

Economic condition of people is very poor and is characterized by low productivity, low income and high marginal propensity to consume (mpc) and low saving. Therefore it creates the low opportunity to take internal debt in Nepal. So that Nepal is more dependent on external debt. Huge amount of borrowing from external source for financing development may be justified but the resultant effect of greater volume of public will be danger if they used in unproductive sector. Though, the burden of external debt has been increasing. Yet, its viable impact is seen in term of debt servicing leading to the situation of debt trap. Nepal is also to a large extent, facing even increasable trade deficit and investment domestic saving gaps which are most significant indicators of macro economic imbalances. These make necessity for exclusive dependency upon foreign assistances. Thus, these all factors have forced to increase foreign dependency.

In Nepal, there is the problem of debt burden because government has taken large amount of loan for peace and securities which are unproductive sectors. If the external debt is incurred for productive purpose such as to import complementary materials for the development of industry and agriculture and other sector of the economy. Nepal will receive the fruits for accelerated economic growth and additional income to repay old debt without feeling any real burden of such debt.

2.2 Objectives of the Study:

The general objective of this study is:

1. To examine the trend and structure of external debt in Nepal.

The specific objectives of this study are:

1. To examine the role of external debt in economic growth (GDP)
2. To analyze the burden of external debt and debt servicing problem of country.

1.4 Significance of the Study:

There are many researches which have been conducted to analyze the public debt in Nepal. Among them, all have analyzed the trend, pattern and burden of the debt. However, there are only a few studies which have concentrated about the external debt. In Nepal, external debt accumulation is ever increasing which has raised the question in researcher mind like what are the elements that are responsible for raising it. Unlike the past studies, this study has specially analyzed the role of external debt on economic growth (GDP) empirically through appropriate tools.

This study examines the realistic picture of previous 25 year. This study will also helpful for those who want to get knowledge about external debt in Nepal. It is also written hoping that it will be a bit more reference for the budgetary system and policy makers and financial management.

External debt is increasing, so it is more relevant to study. Scholars and academicians are concentrated in this burning issue. The burring issue of external debt is one of the important aspects of macroeconomic management of Nepal. So its study is more relevant.

1.5 Limitations of the Study:

1 This study has covered only the period of 25 years. Because of there isn’t available of GDP at factor cost from the fiscal year 2006/07 to till running fiscal years.

2 This study is totally based on the secondary data and information. There has not attempted to check the reliability of published data.

3 While analyzing the role of foreign debt on GDP, its effect on other macroeconomic variables like income, employment, investment, price level, money supply, inflation and poverty alleviation.

1.6 Organization of the Study:

This study is divided into six chapters. The first chapter introduction of the study, stay the problem, objectives, advanced, and limitation of the study. The second chapter entitle “literature review” provides some theories relating to the topic and also discusses some relevant literature which are made in national and international context. The third chapter discusses about sources of data and technology of analyzing, there are used in the study. The fourth chapter analyzes the trend and structure of external debt in Nepal. The fifth chapter examines the burden of external debt in Nepal. Finally, summary, conclusion and recommendations are presented in the seven chapters.

CHAPTER II

LITERATURE REVIEW

2.1 Theoretical Background

The government borrowing is not the new and but it is keen matter for the student of economics and finance. Public debt is a modern invention and was not heard prior to the eighteenth century. Public debt as an instrument of fiscal policy is a legal obligation of government to pay back to person, institutions or countries from whom it has been obtained. Public debt as a tools of fiscal policy, has assumed great importance to meet the budgetary deficits. It is the accumulated amount of what government has borrowed to finance for deficit. An external debt is owed by a nation to foreign country or other internal agencies, then it posses burden. An internal debt is borrowed by a nation to its citizen and it posses only internal burden.

Public debt is changing according to time period; there are different views about public debt. Some economists are in favor of public debt and some are against of it. Particularly, the classical economist like Adam Smith, David Ricardo, J.B. Say, T.R.Malthus and A.C.Pigou opposed the public debt and in favor of minimum government expenditure, regulation and balance budget. They said that public debt take only for productive programme and believed that it is only accepted for self-liquidating projects. They believed it is a burden for future generation due to their concept of lassies fair policy which was criticized by Keynes and modern economist including J.M. Keynes, Harris, Hansen, Buchaman, Musgrave and other have challenged the version of classical economist and hold opposite vision on the subject of public debt. In their view, public debt is required for economic stabilization to operate monetary and fiscal measurement.

The debate of public debt as burden depends upon the nature of investments productive or unproductive. If it is productive there will not be burden because of creation of real asset in the economy which further generates income of the people there by increasing national income. If it is unproductive, the situation will naturally be burden some of the government. Public debt is the major instrument for economic development it is widely accepted tools. There are different views towards public debt, which are following:-

Auromovic et al. provides a useful frame work for examination of external borrowing in terms of country debt servicing capacity. Assuming the country borrow only helps to finance will conceive developing programme. Auromovic et al. (1964) visualize three stages in external date cycle which are as follows:-

1 The countries saving are below desire level of investment if it borrows from abroad to finance part of its investments and also to service the external debt. The burden to debt servicing is continuously differed and the debt increase rapidly
2 Saving has grown enough to finance all domestic investment however country continuous to borrow abroad to cover service cost of debt. The external debt goes but in a slower rate in the first stage, at the end of second stage it reaches maximum
3 The country stops borrowing abroad to cover interest payment and begins to reduce the external debt. A very poor country can take a long time to move through the first and second stage, if the written is a capital obtained by foreign borrowing is low relative to the interest rate, it may never reach third

Domar (1944) defines the public debt as the ratio of the total debt to the national income. He lays down the condition under the burden would increase or decrease over time.

$T = Di$

Where,

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

i = ratio of interest paid on debt

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

Then

$T = Di$

If‘t’ be the fraction of income ‘Y’ taken through tax to pay interest then,

$t = T/Y = Di/ Y$

From the equation, it follows that tax rate is necessary to pay interest on debt depends on the ratio of size of debt multiplied by the rate of interest to income. The tax rate may be related to growth of income and budget deficit. Therefore, the relevant equation is

$$T = 1/ (1/I) (G/b) = i * b/G$$

Where,

G = ratio of growth of income

b = ratio deficit to income

This equation shows the burden of debt that would increase or decrease when either ratio of deficit to income or rate of interest paid on debt increases then the burden of debt will also be increase. Or the burden of debt (t) and the ratio of deficit to income (b) and rate of interest paid on debt have positive relationship. Likewise, the burden of debt (t) and rate of growth of income (G) has negative relationship.

Munla (1992) in his article entitled, has analyzed the origin of debt and explained about it. The debt crisis had its origin in the substantial rise in the external liabilities of the development countries during the second half of the 70's and early in an environment of large scale recycling of the oil exporter's surplus, rising world inflation and negative real interest rate. At the time many viewed this recycling of funds and as the positive development creditors were able to identify new investment out lists and debtors could acquire funds needs for development purposed.

He further tried to explain the reasons for external debt crisis which are as follows:-

1 A drastic deterioration in external economic environment in the form of higher interest rates, lower commodity price and server recession in the industrialized economics
2 Economics mismanagement and policy errors in debtors countries
3 Excessive lending by commercial banks to some countries, with little regard to country risk limits

In his article Munla concluded towards, principles of debt strategy a pointed out three fundamental principles which are as follows:-

1 Debtors countries need to pursue strong adjustment programme, supported by determined structural reforms, aimed at increasing domestic resources mobilization attracting non-debt creating flows and reducing impediments to growth
2 Creditors and donors need to ensure to provision adequate external financing in support of such programs on a case by case basis
3 The international economics environment must be conductive to the success of these efforts

Benedict Clements et al. (2005) has based on external debt, these effects are transmitted, giving special attention to the indirect effects of external debt on growth through its impact on public investment.

The inter-linked between external debt and economic growth has focused largely on the harmful effects of a country's "Debt overhang" the accumulation of the stock of debt. It depresses the growth by increasing investor's uncertainty about actions the government might take to meet its onerous debt servicing obligations. Moreover, when they do invest, they are more likely to opt for projects with quick returns rather than for projects that enhance growth on a sustainable basis over the long run.

Higher output in turn, would make at easier for a country to service its dept. But large debt stock negatively affect growth by dumping both physical capital accumulation and total factor productivity growth higher external interest payments can increase a country's budget deficit, there by turn may either drive up interest rate or crowd in the credit available for private investment, depressing economic growth. Larger debt servicing payments can also inhibit growth by squeezing the public resources available for investment in infrastructure and human capital.

From an article, mixed support has found for the debt overlay hypothesis. All determinants of growth have presumed that the stock of debt affects growth both directly by reducing a government is incentives to undertake structural reforms and indirectly by dampening investments. But relatively few studies have assessed the direct efforts of the debt stock on investment in low income countries.

Ishart (1991) has discussed the case of Asian developing countries in managing their external debt burden presented a contrast to Latin American and African countries. For the better group, the combinations of inward oriented strategy, poor quality of macro economic policies on investment unproductive ventures contributed a great deal towards the final outcomes. A study of twelve highly indebt countries carried out by the world bank in the mid 80’s, concluded that the quality of economic management in these countries themselves was the decisive determinant them toward the path of debt crisis.

The following major findings are included by him:-

1 Most of the borrowed and locally raised funds were investment in productive uses that raised the capacity of the economy to repay the debt
2 They made quick adjustment to external shock by expenditure switching expanding exports and curtailing consumption
3 Asian countries, with a few expectations, pursed an outward oriented started prudent macro economics policies.

Based on his analysis he recommends following measure for avoid of debt crisis for Asian countries.

1 Strict monetary and fiscal policies along with flexible exchange rate to be maintained.
2 Industrial and trade policy should be included private investment promoted manufacturing sector and manufactured and reduce distortions.

Bhatia (2003) has discussed on public debt in his point of view. He pointed the currency as a public debt. According to him “The entire currency circulation in the market can be a part of public debt only. If the central bank is classified as a part of the government sector." But he also added that in any care currency obligation normally remain dormant and in active and the government does not pay of them.

IMF (2006) has stated the relationship between government debt and long term interest rates. Likewise, this paper has examined empirical evidence using panel data for 19 industrial countries. Further, it found the stimulated and estimated interest rate effects of government debt tend to be small. However, an increase in government consumption and debt leads to considerably large effects. It also argues that although the interest rate effects of pure crowding out may be limited, the economic impact of accumulating government debt cannot be ignored.

In conclusion part of this paper, it shows that interest rate effects of government debt depends on the structural parameters of the economy most notably birth rate and time preference. The result suggests that although the interest rate effects of government debt alone tends to be small, increases in government consumption and debt leads to a considerably larger effect. The accumulation of government debt can be expected to entail real crowding out of productive capital.

Builter (2001) observes, "The government borrows only to finance public sector capital formation cannot be easily rationalized in terms of generally accepted economics principles. At worst it could become a straight jacket on the fiscal and financial strategy, it also risks inducing a misplaced sense of complacency about accumulation of public investment related to public debt. Debt must be serviced through future higher current revenues or lower public spending regardless of what motivated its issuance."

2.2 Classical view

Classical economists were generally against borrowing. They preferred the minimum role of government into the economic activities. According to them economy is always equilibrium in full employment and economic activities are best under private sector because they have the greed of profit through which allocation of resources would be more efficient. On the other hand, government does not have such greed. Due to this it fails to operate efficiently. Due to this they are in favor of limit size of public sector like maintenance of law and order justice and social security and to reduce the function of government to the minimum possible extent. They further assumed that individual and business employ's resources more efficiently. Under a fully employed economics, government can acquire resources by borrowing only at the private sector where they are more fruitfully engaged. In this way classical economists had negative attitude towards public borrowing and they did not plead for increasing economic role of government. Instead the opined that" Let Money fructify in the pocket of the people." The classical economist like J.B Say, J.S Mill and T.R Malthus have given their arguments that public debt creates burden on the economy because of its unproductive nature.

It is not true that classical writer's were against any form of government expenditure. What they favored was minimum public expenditure. In between taxation and borrowing they favored taxation for the following reasons:-

- Deficit financing means an increasing in public debt since it is an easy method to obtain income, government is likely to be extravagant and irresponsible. Consequently, public debt will definitely become a burden to the economy
- Payment of interest on public debt and refunding of the principles will require additional taxation. It might prove to be difficult since governments power to tax is not unlimited
- Deficit financing might produce currency deterioration and price inflation

However, the classical theory is criticized mainly on two grounds. Firstly, every government's expenditure is not always unproductive. So that, public debt may not be always burden upon the economy. Secondly, the traditional view regarding the shifting of the burden is not correct. The classical economists though that public debt creates adverse effects on taxation upon the ability and willingness to work and the real burden of public debt must be born in the initial period of debt creation. When government borrows from private use and put into public projects in the initial period.

However, classical economists were not against all types of public debt. They favored public debt for productive purpose. They supported public debt for productive purpose that is for capital projects since it generates resources by selling the fruit of such projects to buyers and debt servicing and refunding of principles didn't necessitate additional burden or taxation. These projects are called "self-liquidating projects". According to 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 as they may be defined broadly as expenditure projects that increase further income and tax base. Such projects servicing of the debt incurred in their financing without requiring an increase in future level of tax rates."

The classical economists Edge Worth viewed the government should not raise the public debt for consumption on activities. Economists R.A. Musgrave & P.B Musgrave holds "Tax raised to finance this payment impose a burden does not arise because resources are withdrawn from the economy." In this context they also state that "Debt accumulation during war may be so drastic as to lead to fiscal and debt repudiation in the post war period." (Musgrave, 1992)

2.3 Keynesian View

In the classical thought all private income is spent on either consumption or investment. Full employment is secured automatically. Price level stability is maintained if the money supply is held stable or is increased at the same rate at which real income grows. Keynes, who stood against the concept of classical economist and propounded different view in his book, 'General theory' in 1936. He did not accept the classical notation of a free enterprise economy which is self equilibrating at a full employment level. He advanced the concept of under employment equilibrium and who effected a truly significant revision in the theory of public debt.

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 employment of these resources does not necessarily deprive the private sector of anything. On the contrary, increasing government spending by using idles men and materials are likely to raise the level of aggregate output and income. Hence, public debt need not necessarily be unproductive, inflationary and burdensome. So, Keynesian strongly prescribed to increase the public expenditure even by undertaking deficit financing or borrowing (Musgrave: 1959).

Keynes also analyzed that if debts are internally held, there is nothing to worry about their size. Such a debt involves merely a series of transfer payments and they cancel out for the economy as a whole. So the only concern should be about economic stability at high levels of income and employment. The deficit budget even by undertaking public debt would be a powerful tool during the time period of stagnation. Keynes also stressed and challenged the version of classical economists and hold opposite opinion on the subject of burden of public debt. He submits that there is no shift of the basic burden to the future generation because the same posterity that pays the additional taxes will be benefited from the repayment of the debt.

Another view of Keynesian is replacement of the traditional government budget by a national government budget. Receipts and outlays of government constitute only a part of nation's budget which is a broader summation for all parts or sectors of the economy, "Government should seek to balance the nations budget at a level consistent with full employment, regardless of what this should mean in the government sector proper the economy's performance rather than the trend of public debt, should be the guide for times" (Singh: 2001).

A .P. Learner, a profounder of the functional finance approach to public debt, maintains that government should borrow only when it wants to make people hold more bonds in place of money. This action will raise the rate of interest by lowering value of bonds and will prove to be anti-inflationary. In the event of following aggregate demand and shortage of funds for productive investment, government should lend to the private sector or increase its own expenditure to arrest the fall in real income and employment. Debt servicing posses no problem since it is always open to the government to borrow from the central bank. Since the function, finance maintains a correct level of aggregate demand corresponding to available output, there is no danger of inflation (Singh: 323).

2.4 Post Keynesian View

During the World War II and post world war period, the size of public debt and debt servicing increased enormously. This has made the economist to make revision on the aspect of public debt. The post Keynesian development was emphasized however the transfer and management aspect as well as interlink between public debt and money supply.

According to post Keynesian, public borrowing does not always deprive the private sector from the use of resources. During the time period of widespread unemployment, it may be productive. Besides it now that borrowing in a period of full employment must be inflationary. It depends on the circumstances. If borrowing taps funds otherwise spent on consumption, it is not more inflationary than taxation. A large public debt, if internally held, posses many problems for the economy. It complicates monetary policy and creates difficulties of management.

According to Rilchard Goode, a better argument in form of internal borrowing should be avoiding borrowing to pay for government consumption expenditure. Domestic borrowing is a use of national saving. The act of borrowing by the government makes it unavailable to private entrepreneurs for private investment. So, financing of consumption by internal borrowing will causes a curtailment of national saving and investment. In the 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 capital formation. “The inference is that failure of restrict borrowing to the finance of investment will retard economic growth. A weakness of the argument is that not all outlays classified as investment actually contribute to growth, while some expenditure usually classified as government consumption promotes growth.” (Goode: 1984)

2.4 Recent View

According to post Keynesians and World War II economist, public borrowing plays a prominent role in underdeveloped countries. It helps the mobilization of resources for the economic development schemes.

Micheal Posner points that growth in the debt ratio cause alarm for two reasons. First growth in debt ratio might lead to crowing out of private investment, second and more important is the assumption that government spending put of the borrowed funds might be unproductive. (Ponser, 1992:2004)

Modern economist Raja J. Chelliah observed that " The ideal situation is one in which first revenue will need subside, other transfer 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 the requirements of financial investments and second, the total of domestic borrowing will be determined in a such 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 the current amount of seigniarage." (Chelliah, 1992:2008)

According to V.M Dandekar views that a country enters in a debt trap falls when its capacity to take loans falls short of interest payment obligations. Hence, all public debt is not burdensome.

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

$D = Y_t - E / r$

Where,

D = maximum sustainable national debt

E = constant expenditure for ordinary government operation

Y_t = maximum ratio of tax receipts to national income (Y)

r = the constant interest rate government debt

However, the burden of public debt depends upon the nature of investment productive. In case of foreign debt, the situation is different from internal debt. For external debt, it needs foreign exchange for its debt servicing for which foreign exchange earning sector must be created effective.

2.6 Nepalese Context

In the situation of Nepal public borrowing was started in 1931 A.D. Before 1950, there was not only special provision for borrowing. Public debt has great importance particularly in the developing countries like Nepal. In view of increasing magnitude of fiscal year imbalance, rational utilization of debt is necessary for to save the economy from depression. Therefore, public debt must have to be productively used if it is not so then many problems will be created.

According to the economic history of Nepal, it is not a new concept several rulers of Nepal to take loan from both national and international sources that is necessary to up lift the economic but there are various attitude towards debt that is described in different literature of public debt of Nepal.

Ananthakrishna (1998) has focused about why is debt necessary? In this context he expressed his view that a developing country does not normally have adequate domestic saving to invest in its infrastructure and development projects. Therefore external borrowing plays the vital role to bridge the gap between export and import of goods and services and between domestic saving and investment.

This article also makes an attempt to understand about the meaning of debt management in this perspective, he has examined five basic function of debt management in the scenario of Nepal's debt which are:-

- Policy
- Regulator
- Operational
- Accounting
- Stastical analysis

Further more, he has also explained about benefit of debt management and observed that "Effective debt management helps a country to keep the debt at a sustainable level." Effective debt management will yield as stated by following benefits:

- Maximums utilization of loans already committed
- The cancellation of unutilized portion of loans, there by reducing commitment fee cost.
- New commitments will be properly dovetailed into an ideal portfolio
- Comparison of two or more offers to enable Nepal to reduce service costs
- Weeding out of existing expensive loans
- Efficient planning of investment by central bank to match the currency and timing of debt service payments, there by reducing exchange losses.

Khatiwada (1998) study with monetary implication of public debt which are dealing 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 the 1990

He further predicts the situation is more alarming as foreign loan in the long term nature is maturing out faster rate and exchange rate of the Nepalese rupees is depreciated very fast multiplying the debt obligation as well as debt servicing requirements. Source of foreign grant drying up which is properly accumulation of foreign debt with larger development spending of the government through foreign aids, interest rate on internal loan is very high. Making internal debt servicing, taking affair most of the internal debt is short term nature but there is less likelihood of an improved budgetary situation of the government on the near future.

Based on his analysis, Khatiwada recommended debt management policy for Nepal is as follows:-

1 Rescheduling of some of the matured foreign debt for the next 10 or 20 years would be an alternative measure for the country can not afford high debt amortization at a time when more investment commitment is being made in the social sector in the wake of a resource crunch in the country.
2 Nepal should be made for her economic diplomacy to set foreign loans written off on a case by case basis.

Bhatt (2003) has analyzed the inter-linkages of external debt and national resources. He has tried to examine the size, magnitude, composition and disbursement of Nepal's external debt.

It attempts to examine the relationship of external debt with debt burden indicators. It is important that the external borrowing be made to supplement but not replace domestic saving in long run. Further, it is also necessary to notice that the external debt is mainly from World Bank and Asian development bank in concessional terms and therefore, the debt flow has not hampered the growth. The result could have been different if there would have been the significant amount of commercial loan.

He concludes that unless a country grows fast enough to sustain debt obligations and maintain domestic investment, indefinite external indebtness could have a very detrimental effect on the growth of economy and on the welfare of the citizens. It is also equally important for Nepal to take initiatives for getting the rescheduling writing off and cancellations of external debt. Nepal should urge for its inclusion in the heavily indebted poor countries (HIPC) program to maintain a strong link between debt relief and poverty reduction.

Sharma (1988) has observed the positive role of government borrowing for the sound economic growth and prosperity on hand and on the other hand, he has alarmed the state not to disburse the debt unproductively.

The objectives taken by him are as follows:

- To find out the increasing budgetary deficits of H.M.G / N
- To analyze the increasing trend in the magnitude of internal and external

borrowing

- To analyze the debt servicing problem of H.M.G / N

To fulfill the above maintained objective he has used the secondary data from various publications. For analysis purpose he has taken simple mathematical tools like ratio, percentage, average etc.

After he analyzed above mention objective the major findings of study are:

- Nepal is facing the debt servicing problem. The government must allocate certain amount for it in its annual budget. The most remarkable fact is that the servicing amount is also increasing year by year
- Because of increasing volume of expenditure the amount of deficit has been persistently increasing which has necessitated the growing need of public debt in Nepal

After giving some finding, he concludes the excessive dependency upon external loan may lead the nation into a debt trap, if the terms of trade are not moved in fever of the debtor's country that is why extra care should be exercise in procuring such loan.

Finally, he recommends on the following points which are as follows:

- Internally raised funds are to be spends on the construction of particular projects which may provide benefits for longer period of time. This will reduce the burden of debts in the long run.
- Public debt is to be utilize effectively so as to increase productivity in the economy and the increasing rate of national income is to be greater than the rate of increase in national debt

Acharya (1998) has discussed the evolution of public debt in Nepal both internal and external. His study focused on:-

- Saving investment gap,

- Budgetary development and
- External gap

These are factors affecting public debt in Nepal further more; he has analyzed various causes leading to an excessive public debt burden which are partly domestic and partly external.

1. Domestic factors are as follows:
   a. Inappropriate or expensive fiscal policy.
   b. Very low tax effort.
   c. Over regulated prices that dampen incentives to export oriented production resulting in failing exports and revenue and increase imports.
2. External factors are as follows:
   d. Adverse external condition such as deterioration in the terms of trade.
   e. Inadequacies in external debt management such as poor majority mix and exchange rate mix alignments.
   f. Over lending by creditors commercial banks.

Finally, he has concluded that the situation of widening saving investment gap, persistently growing share of regular expenditure, GDP and government revenue, per capita debt burden, increase in trade gap. All those factors clearly show the ever increasing debt burden.

Based on his analysis Acharya recommended followings measures for the burden of public debt for Nepal which are as follows:

1. Maintain credibility of government policy,
2. Reduce deficit by raising the income elasticity of taxes and by increasing fee and users charges or by stabilizing the ratio of GDP with respect to government capital information and current expenditure relating to social capital.

Khanal (2002) has tried to study debt situation with followings objectives:

- To analyze trend and structure of debt in Nepal.

- To examine the roll of public debt in the Nepalese fiscal system.
- To analyze the burden of public debt and the problem of debt servicing from 1974/75 to 1997/98.

To fulfill the above mention objectives he has used simple statistical tools like percentage, average, ratio etc for the study has based on secondary data and information obtained from various sources such as budget speeches, economics surveys and publications of ministry of finance, Nepal Rastra bank, simple regression equation also have used in his study.

The major finding in his are as follows:-

- Nepal is passing though a critical phase of inadequate mobilizations of internal sources thus; managing public finance has been challenging preposition. As a result of this extreme situation fiscal deficit revenue deficit are widening day by day
- Share of internal debt servicing in total debt servicing has been greater, than of external debt servicing.
- The burden of internal debt in terms of total revenue, regular expenditure and G.D.P has increased considerably over the period.

He has concluded that the system of public debt is one of the best ways financing development expenditure of the government which helps to control inflation and to mobilize the internal financial resources in countries economy. Trade deficit, saving-investment gap and large amount of fiscal deficit have 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.

Finally, he recommends that the government should use external borrowing in productive purpose if this can be done the national income will increase and consequently the debt servicing ability will increase. The magnitude of public debt and interest is increasing rapidly, but the addressing capacity for redemption of the debt is not increasing in the same rate. Government borrowings are increasing and have been used for unproductive sectors. Government borrows the fresh loan to pay the previous one. So the country is highly indebted and the rate of inflation is rising and debt servicing capacity of the government is declining.

Sharma (1998) has analyzed in his article that the increasing debt in Nepal and its services has really created the situation, which is driving the country towards the debt trap because of the following reasons:

- Large proportion of loan is allocated for meeting expenses within the development expenditure.
- The amount of borrowed fund is used for debt servicing.
- Volume of borrowed amount exceeds the maximum legal limit of borrowing.

In case of Nepal, both of the development and the regular expenditures are growing very fast, and former is mainly financed through the foreign aid. As around 50 percent of the development expenditure is met through foreign assistance and more than 70 percent of the aid composed of the loans. He further says that only 50 percent of the debt is used for the capital formation where as the tendency of the borrowing is increasing and the burden of debt servicing is increasing. It leads that Nepal is not able to promote the economy without aid nor has she been able to avoid the risk of becoming the victim of aid intoxication. Even though it is not for the country will run into the debt trap.

In his article, he also describes about the problem of resources gap and challenging environment of the supply side of world resources. In his vision, low income countries have neither a suitable economic structure, governance, practices and traditions nor do they have a strong export base. In such a situation, the common or universal objectives which were officially articulated for each nation can really be attained. Such objectives are:

- To accelerate growth through resources efficiency,
- To encourage the inflow of foreign capital,
- To reduce fiscal deficit, inflation and instability,
- To standardize the operation of market forces,
- To make growth consistent with distributive justice and
- To reduce public burden arising from official adjustment of market prices.

Nepal is facing a paradoxical situation. He makes conclusions that the saving capacity of the economy is limited to 10 percent of GDP. Public sector debt is even more alarming.

Neupane (2007) has tried to observe the debt situation with following objective:

1 To analyze the trend and structure of public debt,
2 To examine the role of public debt in economic growth (GDP) and
3 To analyze the burden of public debt to debt servicing problem of country.

To meet above maintained objective he has taken simple statistical tools to analyze the data such as average, percentage ratio etc and he has also used simple regression equation in his study. This study has based on secondary data and information obtained from various sources such as budget speeches, economic survey and publication of ministry of finance Nepal Rastra Bank

His major findings are as follows:-

- During the study period, multilateral loan had dominated in the structure of total external loan. In an average percentage basis, multilateral and bilateral loan has covered 87.2% and 12.8% respectively
- The average annual growth rate of internal debt servicing to total revenue regular expenditure and GDP have been 21.2%, 27.6% and 2.3% respectively over the period of review which shows the burden of internal debt in terms of total revenue and regular expenditure has increased not considerably over the period the except GDP.
- The increase in external debt is accompanied by gradual increase in imports of goods and services
- There is strong and positive relation between public debt and GDP of Nepal. It implies that the increment or decrement in GDP depends upon the public debt and impact of internal debt on GDP is stronger than external debt at current time period.

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 has been excessive flow of foreign loans to bridge up these gaps consequently burden of debt and debt servicing obligation are increasing rapidly in each year but debt servicing capacity of the economy is not increasing in the same pace.

On the basis of finding the following are the purposed recommendations which are:-

- The government should try to get grants more and more as far as possible. There is more domination no bilateral grants. The government also should maintain such external policy so that more grants should be received rather than the loans.
- The level and direction of export is limited with in few products and a few countries. So there is need to export promotion and diversifying trade both country wise and commodity wise. And there should be controlled to import luxuries goods and services by adopting suitable import policy and reduce huge trade deficit by promoting the export oriented industries and there by narrowing the ever increasing gap between total export and import.
- To increase the debt servicing capacity, government should increase GDP growth revenue growth and export earning growth in sustainable path so that country will not trapped on debt servicing problem
- The government should be active enough to maintain the strong policy of monitoring, evaluation and super vision which helps to reduce corruption and to increase on accountability, responsibility, and implementation.

CHAPTER III
METHODOLOGY

3. Introduction

In this research work, the research design is made to analyze the role of debt on GDP, its debt's servicing problem and burden and trend and structure. Along with the objectives outlined earlier has led this study to adopt the following methodology.

3.1 Research Design:

Research design is the frame of investigation conceived so as to obtain answer to research questions. This study has divided into two parts. The first part presents the descriptive analysis of the trend and pattern of external debt. Similarly, the second part concerns to the quantitative analysis.

3.2 Selection of Study Period:

In order to analyze the trend and structure, role, burden and servicing of debt. The study period is taken from fiscal year 1981/82 to 2005/06 into account because of time is certain and researcher does not get GDP at factor cost.

3.3 Sources of Data:

Analysis of this study is based on secondary data. The necessary data are accumulated by various sources like published in books, magazines and reports, journals etc. Most of data are taken from:

1. Economic survey published by ministry of finance,
2. Quarterly Economic Bulletin published by Nepal Rastra Bank,
3. Budget Speech published by Ministry of Finance,
4. Red Book published by Ministry of Finance,
5. Publication of International Monetary Fund,
6. Publication of Central Bureau of Statistics,
7. Publication of Nepal Human Development Report,
8. Publication of World Bank and
9. Publication of World Development Report

3.4 Method of Data Analysis:

Simple statistical tools are used for analyzing data. The data collected from various relevant sources is processed according to the need of the study. The available data from various documents are collected, classified, tabulated, analyzed and presented according to the objective of study. For this analysis various statistical tools are utilized to establish the relationship between economic variable.

3.4.1 Regression Equation:

Regression equation has been used mainly to analyze the relationship between dependent and independent variable like GDP, bilateral debt, multilateral debt and other related variables. It is used to show the degree and the direction and it also provide the mechanism for the prediction. Here, to examine the role of external debt on economic growth a simple ordinary least square(OLS) linear regression model as well as double log linear modal has been used. Also different test like t-test, f- test,R-square & adj.-R-Square are employed to identify the significant of the result.

The theoretical statement of this regression model is that gross domestic product (GDP) depends upon the bilateral debt, multilateral debt & total external debt. This shows the relationship between these variables. Mathematically, this can be written as:

- $GDP = a_0 + a_1 TED$
- $l_n GDP = a_0 + a_1 l_n BD + a_2 l_n MD$

Where,

GDP = Gross Domestic Product

BD = Bilateral Debt

MD = Multilateral Debt

TED = Total External Debt

$a_{0,}$ a_1 and a_2 are the parameters

3.5 Working Definition of Terminology

- Public Debt: Total public debt sums of external obligation of a public debtor and national obligation of public debtor.
- External Debt: External debt is the government borrowing from external source through bilateral and multilateral sources.
- Internal Debt: Internal debt refers to the public loan floated with in the country.
- Bilateral Debt: Bilateral debt refers to loan from government and their agencies.
- Multilateral Debt: Multilateral debt refers to the loan and credit from multilateral agencies.
- Gross Domestic Product (GDP): GDP is the measure of the tha total domestic output at factor.
- Debt Serving: Interest payment of loan & repayment of principle after maturity.
- Burden of Debt: Burden of the debt is the sacrifice of the community through a rise in taxation at the time of repayment and for paying the annual interest on the government loans.
- Debt Trap: The situation when a new fresh loan is used to repayment of interest.
- Export of Goods & service: It is the amount of goods and service sold to another country.
- Imports of Goods & Service: It is the purchases of goods and service from another country.

CHAPTER IV

TREND AND STRUCTURE OF EXTERNAL DEBT

4.1 Introduction:-

The debt is useful resource for economic development of underdevelopment countries. To get the objective of economic development, there is need of heavy investment to build up socio-economic infrastructure such as health, education, transportation, communication etc. External debt is widely accepted as a means of deficit, imbalance and resource gap. The role of external debt has been increased significantly due to the planned economic development.

External debt is the result of mismatch between revenue and expenditure over time period. The gap is growing due to limited sources of revenue mobilization. A widening investment saving gap, persisting high demand for public expenditure accompanied by sticky revenue ratio have pushing the size of debt in Nepal.

Every country in one or other form borrows resources from other countries. The onset of the global institutions, Bretton Woods Organization and multi-national have popularized the process than ever before external borrowing make up an important facet of macro economics policy and in particular, balance of payments policy of the government. The Size of the borrowing and the degree of its importance depends upon country's development stage, domestic resource situation and overall economic policies followed by the government Nepal started to receive aid since 1951.

In fact up to 1960/61, all foreign assistant were completely in the form of grant. Nepal was debt free country until 1961. Since 1961/62 that Nepal started to receive foreign loans. Until 1969 when Nepal became a member of the IDA and ADB, she used to borrow on a causal basis mostly from the bilateral sources. Today, Nepal acquires loans from a number of bilateral and multilateral sources.

External resources contribute to development by supplementing domestic saving and by financing imports. They also permit flexibility in managing the balance of payment. The reasons for increasing the external loan are mainly

- Rapid increase in development expenditure and comparatively slow pace of revenue and grant assistance expansion,
- Substantially higher interest on internal loan as compared to the interest rate on external loan,
- Increased need of foreign exchange to meet the cost of capital imports induced by capital intensive infrastructure projects as well as to meet the increased cost of petroleum products,
- Easy accesses to concessional external loan,
- Smaller base and slower growth of export compared to imports,
- Maintain the deficit budget and emergency period of crisis and
- To sustain the economic and monetary stability.

Thus external borrowing makes an important facet of macroeconomic policy and in particular balance of payments policy of government. The size of the borrowing and the degree of its importance depend upon the country's development stage, domestic resource situation and overall economic policies followed by the government.

4.2 Trend of Fiscal Deficit and Budget Deficit:

Due to unfair custom and tax administration, corruption lack of nationalism etc., Nepalese government is unable to keep the growth of total expenditure and revenue in the same pace. In such situation a method of financing economic development that is easier than taxation and domestic borrowing is deficit financing by the money creation. Tax revenue and non-tax revenue are the more important sources of development finance. But, Nepal government always failed to collect revenue for her expenditure. Therefore, to tackle all the problems deficit financing are more suitable for underdeveloped countries. Beside this, developing countries have traditionally been net importers of capital; their domestic savings are generally insufficient to meet their investment need. So that government received loans and grants from home and abroad to face the problems of fiscal and budget deficit.

Table 4.1: Trend of Fiscal Deficit and Budget Deficit (Rs in Million)

Fiscal Year	Government Revenue	Government Expenditure	Fiscal Deficit (GE-GR)	Foreign Grants (FG)	Budget deficit (GR+FG-GE)
1981/82	2679.5	5361.9	2681.8	993.3	1688.5
1982/83	2841.6	6979.2	4137.6	1090.1	3047.5
1983/84	3409.3	7437.3	4028	876.4	3151.6
1984/85	3916.6	8394.8	4478.2	923.4	3554.8
1985/86	4644.5	9797.1	5152.6	1172.9	3979.7
1986/87	5975.1	11513.2	5538.1	1285.1	4253
1987/88	7350.4	14105	6754.6	2076.8	4677.8
1988/89	7776.9	18005	10228.1	1680.6	8547.5
1989/90	9287.5	19669.3	10381.8	1972.5	11260
1990/91	10729.9	23549.8	12819.9	2164.8	10654.3
1991/92	13512.7	26418.2	12905.5	1643.8	11261.7
1992/93	15148.4	30897.7	15749.3	3993.3	11956
1993/94	19580.8	33597.4	14016.6	2393.6	11623
1994/95	24575.2	39060.0	14484.8	3937.1	10547.7
1995/96	27893.1	46542.4	18649.3	4825.1	13824.2
1996/97	30373.5	50723.7	20350.2	5988.3	14361.9
1997/98	32937.9	56118.3	23180.4	5402.6	17777.8
1998/99	37251.0	59579.0	22328.0	4336.6	17991.4
1999/00	42893.8	66272.5	23378.7	5711.7	17667
2000/01	48893.6	79835.1	30941.5	6753.4	24188.1
2001/02	50445.5	80072.2	29626.7	6686.1	22940.6
2002/03	56229.8	84006.1	27776.3	11339.1	16437.2
2003/04	62331.0	98442.6	27116.6	11283.4	15828.6
2004/05	70122.7	102560.4	32437.7	14391.2	17846.5
2005/06	72282.1	110889.2	38607.1	13827.5	24779.6
Average Annual Growth Rate	14.1	13.1	12.5	15.7	13.8

Source: Various Issue of Economic Survey of MOF

Table 4.1 depicts about the fiscal deficit and budget deficit. The entire fiscal year fiscal deficit is found increasing due to the increasing volume of total expenditure. The revenue and expenditure both are continuously increasing each and every year. The increasing trend of total expenditure is higher than total revenue which shows increasing tendency of fiscal deficit. The amount of total expenditure was Rs 5361.3 million in fy 1981/82 has gone up to Rs 110889.2 million in fy 2005/06, whereas total revenue has increased from Rs 2679.5 million in fy 1981/82 to Rs 72282.1 million in 2005/06. This shows the public expenditure dominated to government revenue.

The total revenue and expenditure were Rs 2679.5 million and Rs 5361.3 million respectively in fy 1981/82. So, the revenue gap was Rs 2681.8 million in the same period. The government expenditure was continuously increasing than government revenue. In fy 2005/06 the total expenditure was Rs 110889.2 million which increased from Rs 5361.3 million in fy 1981/82. This predicts that the problems of resource gap are serious problem.

In the review year the growth rate of total expenditure has been increased 13.1 percentages per annual whereas annual growth rate of total revenue has been increased 14.1 percent. It shows that the growth rate of revenue is greater than expenditure but in absolute terms the table shows the horrible increment of resource gap that was increased from Rs 2681.8 million in fy 1981/82 to Rs 38607.1 million in fy 2005/06 and the average annual growth rate is 12.5 percent.

On the other hand, grant is the most potential source of foreign currency, which is solid instrument for government to import the capital goods, to pay the interest and principle of external debt. So, grants were also increasing every year i.e. Rs 993.3 million in fy 1981/82 to Rs 13827.5 million in fy 2005/06. But, foreign grant is not found increasing as it should be. A little bit improvement in foreign grant was seen from 2002/03 (Rs 11339.1 million) but it does not raise according to the need of the time and remained only Rs 13827.5 million in 2005/06. Its average annual growth rate is 15.7 percent.

Similarly, if we considered budget deficit by including grants in total revenue which was not found encouraging. In this case, the budget deficit was fluctuating. The amount of budget deficit was Rs 1688.5 million in fy 1981/82 which increased to Rs 24779.6 million in fy 2005/06. Its average annual growth rate was 13.8 percent.

Resource gap as percentage of GDP is shown on table 4.2.

The table 4.2 shows the fiscal and budget deficit as percentage of GDP. From the table it evident that fiscal deficit as the percentage of GDP is in fluctuating trend. This shows the inelasticity of revenue performance in relation to GDP. The fiscal deficit as a percentage of GDP was 8.7 percent in fy 1981/82, it reduced to 5.7 percent in fy 2003/04, Nepalese economy is capable to generate capital and further it increased to 6.9 percent in fy 2005/06. Its average annual growth rate during the review period was 8.5percent.

Similarly, budget deficit as a percentage of GDP was found to be fluctuating. The budget deficit as a percentage of GDP was 5.4 percent in fy 1981/82 and it decreased to 3.3 percent in fy 2003/04 and it increased to 4.4 percent in fy 2005/06. Its average annual growth rate during the review period was 6.5 percent. So, the trends were not seen in its systematic pattern. Because of following caused:

a. Due to the political delays,
b. Absence of institutionalization of development and administration,
c. Due to corruption and
d. The improper management of the development projects.

Therefore, for financing the fiscal deficit, external source of borrowing has been adopted. So, external debt has been the main source of financing fiscal deficit in Nepalese fiscal system.

Table 4.2 Resource Gap as Percentage of GDP (Rs in Million)

Fiscal Year	Budget Deficit	Fiscal Deficit	GDP at Factor Cost	BD as % of GDP	FD as % of GDP
1981/82	1688.5	2681.8	30988	5.4	8.7
1982/83	3047.5	4137.6	33761	9.0	12.3
1983/84	3151.6	4028	39390	8.0	10.2
1984/85	3554.8	4478.2	44441	8.0	10.1
1985/86	3979.7	5152.6	53215	7.5	9.7
1986/87	4253	5538.1	61140	7.0	9.1
1987/88	4677.8	6754.6	73170	6.4	9.2
1988/89	8547.5	10228.1	85831	10.0	11.9
1989/90	11260	10381.8	99702	11.3	10.4
1990/91	10654.3	12819.9	116127	9.2	11.0
1991/92	11261.7	12905.5	144933	7.8	8.9
1992/93	11956	15749.3	165350	7.2	9.5
1993/94	11623	14016.6	191596	6.1	7.3
1994/95	10547.7	14484.8	209976	5.0	6.9
1995/96	13824.2	18649.3	239388	5.8	7.8
1996/97	14361.9	20350.2	269570	5.3	7.5
1997/98	17777.8	23180.4	289798	6.1	8.0
1998/99	17991.4	22328.0	330018	5.5	6.8
1999/00	17667	23378.7	366251	4.8	6.4
2000/01	24188.1	30941.5	394052	6.1	7.9
2001/02	22940.6	29626.7	406138	5.6	7.3
2002/03	16437.2	27776.3	437546	3.8	6.3
2003/04	15828.6	27116.6	474919	3.3	5.7
2004/05	17846.5	32437.7	508651	3.5	6.4
2005/06	24779.6	38607.1	557869	4.4	6.9
Average Annual Growth Rate	13.8	12.5	11.3	6.5	8.5

Source: Various Issue of Economics Survey of MOF

4.3 Debt for Financing Fiscal Deficit:

After the brief discussion about the fiscal and budget deficit of government about the trend of public debt in financing fiscal deficit is considered both internal and external sources of borrowing have been adopted. So, public debt has been the main source of financing fiscal deficit in Nepalese system which has been increasing rapidly since 1981/82 for meeting the requirement of fiscal deficit.

Table 4.3 shows the fluctuating trend of total public debt of government during the review period. Except the year 1991/92 and 2003/04 internal debt indicates the increasing tendency whereas external debt shows the more fluctuating trend. The data explain that external debt has rapidly increased in fy 1981/82 to 1993/94. After that, it increased slowly for some years (1991/92 to 1993/94 to 1997/98 to 1999/00) and thereafter it has followed the decreasing path as from fy 2001/02 onwards. However, the increasing trend of external debt is too rapid as compared to internal debt. Internal debt was Rs 500 million in fy 1981/82 and had gone up to Rs 11834.2 million whereas external debt was Rs 729.9 million and increased tremendously smoothly.

The table also depicts also about the percentage share of internal and external debt to fiscal deficit. The data has showed the fluctuating trend of percentage share or contribution of both internal and external debt to fiscal deficit. The contribution of internal debt to fiscal deficit was 18.6 percent in 1981/82 whereas external debt was 27.2 percent. But, the share of internal debt and external debt to fiscal deficit is 30.7 and 21.3 percent respectively in the year 2005/06 which has showed the increasing contribution of internal debt and decreasing contribution of external debt to their fiscal deficit.

These absolute terms of above table shows the growing reliance on external loan for meeting ever increasing fiscal deficit. It also shows that during the last 25 year of the economic performance has not been conductive enough to reduce growing reliance on external loan. This situation has led to think seriously about this alarming situation.

Table 4.3: Public Debt as Percentage of Fiscal Deficit (Rs in Millions)

Fiscal Year	Fiscal Deficit	Total Debt	Internal Debt	External Debt	ID as % of Fiscal Deficit	ED as % of Fiscal Deficit
1981/82	2681.8	1229.9	500	729.9	18.6	27.2
1982/83	4137.6	1985.8	1000	985.8	24.2	23.8
1983/84	4028	3247.8	1576	1670.9	39.1	41.5
1984/85	4478.2	3554.8	1799.9	1754.9	40.2	39.2
1985/86	5152.6	3904.5	1403.4	2501.1	27.2	48.5
1986/87	5538.1	4350.5	1644.7	2705.8	27.7	48.9
1987/88	6754.6	4945.8	1130	3815.8	16.7	56.5
1988/89	10228.1	6996.7	1330.3	5666.4	13.0	55.4
1989/90	10381.8	8109.6	2150	5959.6	20.7	57.4
1990/91	12819.9	10808.9	4552.7	6256.7	35.5	48.8
1991/92	12905.5	8895.7	2078.8	6816.9	16.1	52.8
1992/93	15749.3	8540.9	1620.0	6920.9	10.3	43.9
1993/94	14016.6	10983.6	1820.8	9163.6	13.0	65.4
1994/95	14484.8	9213.3	1900.0	7313.2	13.1	50.5
1995/96	18649.3	11663.9	2200.0	9463.9	11.8	50.7
1996/97	20350.2	12043.6	3000.0	9043.6	14.7	44.4
1997/98	23180.4	14454.5	3400.0	11054.4	14.7	47.7
1998/99	22328.0	16562.4	4710.0	11852.4	21.1	53.1
1999/00	23378.7	17312.2	5500.0	11812.2	23.5	50.5
2000/01	30941.5	19044	7000.0	12044	22.6	38.9
2001/02	29626.7	15698.7	8000.0	7698.7	27.0	26.0
2002/03	27776.3	13426.4	8880.0	4546.4	32.0	16.4
2003/04	27116.6	13236	5607.0	7629	20.7	28.1
2004/05	32437.7	182041.1	8938.1	9266	27.6	28.6
2005/06	38607.1	20048.6	11834.2	8214.4	30.7	21.3
Average Annual Growth Rate	12.5	13.8	19.8	13.5	22.5	42.6

Source: Various Issues of Economic Surveys of MOF

4.4 Growth Trend of Government Debt in Nepal:

Nepal is facing the economic problems like as fiscal imbalance, foreign exchange gap or external imbalance and saving investment gap as well as peace problems etc, the expenditure are increasing rapidly whereas sources of revenue is not growing as the rate of expenditure. Due to this causes budgetary deficit is also growing year by year. The government is not able to mobilize internal resources as it is needed. Tax payable capacity of the citizens is also very low due to the low per-capita income so that every revenue deficit is growing in the Nepalese budgetary system. Therefore, the key sources of financing are grants and borrowing (internal and external). The trend of government borrowing is shown in table 5.4.

Table 4.4 shows that the government borrowing and its annual growth rate in Nepal during the period 1981/82 to 2005/06. This shows that both internal and external debt has been increasing trend with average annual growth rate 19.8 percent and 13.5 percent respectively. As the table also indicates that the total government borrowing has increased with an average annual growth rate of 13.8 percent from Rs 1229.9 million in fy 1981/82 to Rs 20048.6 million in fy 2005/06 which about 2.2 folds.

The share of internal debt as percentage of GDP and external debt as percentage of GDP was 1.61 percent and 2.36 percent respectively in fy 1981/82 which reached to 2.12 percent and 1.47 percent of internal debt/GDP and external debt/GDP ratio respectively in fy 2005/06. The average annual growth rate of external debt as percentage of GDP was 3.67 percent. But, it was continuously decreasing over last five years. The main cause of decreasing of external debt is political instability, insurgency and terrorism. Similarly, the average annual growth rate of total debt as percentage of GDP is 5.65 percent and the average annual growth rate of internal debt as percentage of GDP is 1.93 percent.

Table 4.4 also indicates the external borrowing increase more than internal borrowing in absolute terms under the period of review. Although, the trend clearly shows that the government borrowing is increasing in both absolute and relative terms. The percentage share of external borrowing and internal borrowing is 41.0 and

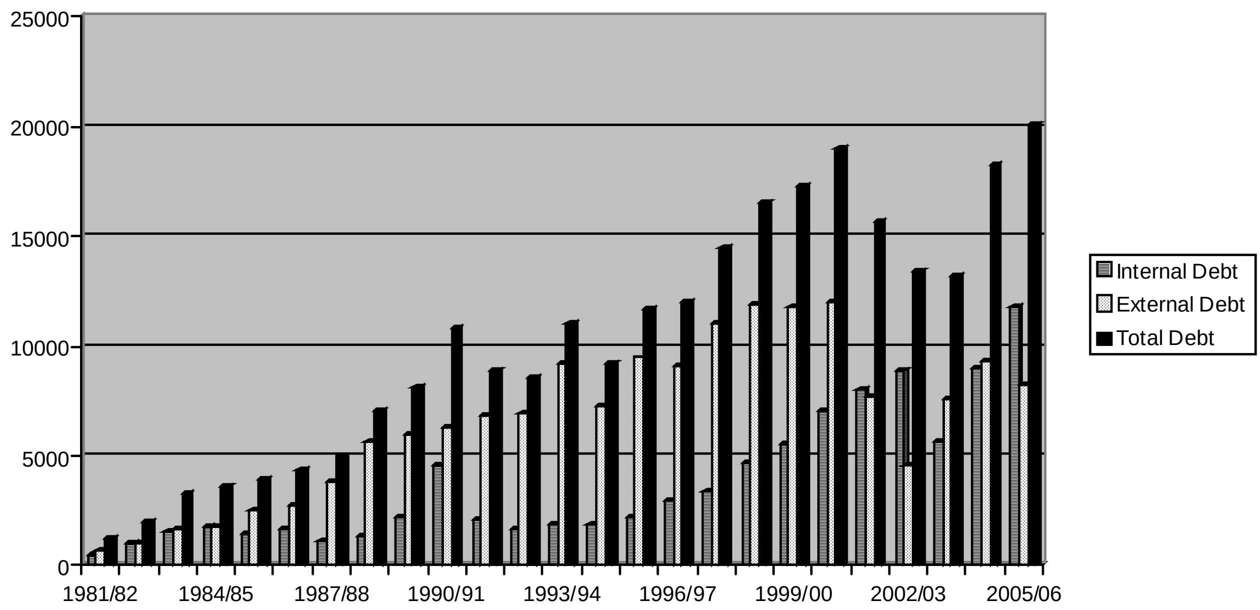
59.0 percent in 2005/06, which shows that the figures are just opposite to that of the year 1991/92.

Table 4.4 Trends in Government Debt and Annual Growth Rate (Rs in Millions)

Fiscal Year	Internal Debt (ID)	External Debt (ED)	Total Debt (TD)	% share of ID in TD	% share of ED in TD	GDP at factor cost	ID as % of GDP	ED as % of GDP	TD as % of GDP
1981/82	500	729.9	1229.9	40.7	59.4	30988	1.61	2.36	4.97
1982/83	1000	985.8	1985.8	50.4	49.6	33761	2.96	2.92	5.88
1983/84	1576	1670.9	3247.8	48.5	51.5	39390	4.00	4.24	8.24
1984/85	1799.9	1754.9	3554.8	50.6	49.4	44441	4.05	3.95	8.00
1985/86	1403.4	2501.1	3904.5	35.9	64.1	53215	2.64	4.70	7.34
1986/87	1644.7	2705.8	4350.5	37.8	62.2	61140	2.69	4.43	7.12
1987/88	1130	3815.8	4945.8	22.8	77.2	73170	1.54	5.21	6.76
1988/89	1330.3	5666.4	6996.7	19.00	81.0	85831	1.55	6.60	8.15
1989/90	2150	5959.6	8109.6	26.5	73.5	99702	2.16	6.00	8.13
1990/91	4552.7	6256.7	10808.9	42.1	57.9	116127	3.92	5.39	9.31
1991/92	2078.8	6816.9	8895.7	23.4	76.6	144933	1.43	4.70	6.14
1992/93	1620.0	6920.9	8540.9	19.0	81.0	165350	0.98	4.19	5.17
1993/94	1820.8	9163.6	10983.6	17.0	83.0	191596	0.95	4.78	5.73
1994/95	1900.0	7313.2	9213.3	20.6	79.4	209976	0.90	3.48	4.39
1995/96	2200.0	9463.9	11663.9	18.9	81.1	239388	0.92	3.95	4.87
1996/97	3000.0	9043.6	12043.6	24.9	75.1	269570	1.11	3.35	4.47
1997/98	3400.0	11054.4	14454.5	23.5	76.5	289798	1.17	3.81	4.99
1998/99	4710.0	11852.4	16562.4	28.4	71.6	330018	1.43	3.59	5.02
1999/00	5500.0	11812.2	17312.2	31.8	68.2	366251	1.50	3.23	4.73
2000/01	7000.0	12044	19044	36.8	63.2	394052	1.78	3.06	4.83
2001/02	8000.0	7698.7	15698.7	51.0	49.0	406138	1.97	1.90	3.87
2002/03	8880.0	4546.4	13426.4	66.1	33.9	437546	2.03	1.04	3.07
2003/04	5607.0	7629	13236	42.4	57.6	474919	1.18	1.61	2.79
2004/05	8938.1	9266	182041.1	49.1	50.9	508651	1.76	1.82	3.58
2005/06	11834.2	8214.4	20048.6	59.0	41.0	557869	2.12	1.47	3.59
Average Annual Growth Rate	19.8	13.5	13.8	34.4	64.6	11.3	1.93	3.67	5.65

Source: Various Issues of Economic Survey of MOF

Figure of 4.1 Trends in Government Debt in Nepal



Percentage of share of external debt in total debt occupies a greater share. The government expenditure basically depends upon the external debt so external debt plays an important role in the government expenditure as well as capital formation.

4.5 Trend of External Debt in terms of Disbursement by major sources:

After the restoration of multiparty system, the scope of government has been increasing and investing more on developmental expenditure where the private sectors do not give any interest so the government has to make investment on social services like drinking water, education, health, and infrastructure development. In this way for the developmental and infrastructure expenditure, government has to spend a large amount but the sources of revenue are limited. To rely only on taxation is not possible to finance the above stated expenditure so Nepal is facing large and growing financial resource gap in the government budgetary. In this way external borrowing needs for supplementing this resource gap and now a day's government has to borrow large amount of loans to meet the fiscal deficit and to finance development expenditure.

There are two sources or types of foreign debt in Nepal namely bilateral and multilateral. Bilateral sources consist the different friendly nations. Up to the end of the fifth plan period (1975-1980), bilateral donors had been the main sources of financing in Nepal's development effort. In the beginning time period, the entire external assistance provided by bilateral sources was in the form of grants assistance. But in later years, donors started providing combination of grants and loans assistances as well. The first loan assistance was provided by USSR in 1961. Later on, other countries also followed this trend started to provide loan to Nepalese government. Yet the proportion of bilateral loan in relation to grant assistance was small till 1970s. In 1980s, bilateral loan started to increase but its share in total loan is very small till now.

Multilateral loans refer to loans and credit from which is channeled through international agencies like UN, ADB, OPEC, WB, EU etc. As Nepal became the member of IDA and ADB in 1969. It started to acquire loans from this source too. Unlike the bilateral sources, the component of foreign assistance of the multilateral source is in the form of loans (Acharya, 1998). Now, there is more than two dozen of financial institution providing more than 90 percent of total external loan in Nepal. The structure of external debt in terms of disbursement by major sources is shown in table 4.5.

Table 4.5: Trend of External Debt in Terms of Disbursement by Major Source (Rs in Millions)

Fiscal Year	Bilateral sources	Multilateral sources	Total external debt	%share of BS in TED	%share MS in TED	GDP at factor cost	BS as % of GDP	MS as % of GDP	TED as % of GDP
1981/82	109.9	620	729.9	15.1	84.9	30988	0.35	2.00	2.36
1982/83	66.3	919.5	985.8	6.7	93.3	33761	0.20	2.72	2.92
1983/84	217.7	1453.2	1670.9	13.0	87.0	39390	0.55	3.69	4.24
1984/85	399.4	1353.6	1753	22.8	77.2	44441	0.90	3.05	3.95
1985/86	498.9	1872	2370.9	21.0	79.0	53215	0.94	3.52	4.46
1986/87	299.7	2062.2	2361.9	12.7	87.3	61140	0.49	3.37	3.86
1987/88	462.5	2631.8	3094.3	17.9	85.1	73170	0.63	3.60	4.23
1988/89	507.8	3686.9	4194.7	12.1	87.9	85831	0.59	4.30	4.89
1989/90	1000.6	3627.7	4628.3	21.6	78.4	99702	1.00	3.64	4.64
1990/91	1602.8	2757.2	4360	36.8	63.2	116127	1.38	2.37	3.75
1991/92	2389.8	3879.6	6269.4	38.1	61.9	144933	1.65	2.68	4.33
1992/93	1307.6	4654.1	5961.7	21.9	78.1	165350	0.79	2.81	3.61
1993/94	582.9	8580.7	9163.6	6.4	93.6	191596	0.30	4.48	4.78
1994/95	717.3	6595.0	7313.2	9.8	90.2	209976	0.34	3.14	3.48
1995/96	460.0	9003.9	9463.9	4.9	95.1	239388	0.19	3.76	3.95
1996/97	850.7	8192.9	9043.6	9.4	90.6	269570	0.32	3.04	3.35
1997/98	1314.5	9740.0	11054.5	11.9	88.1	289798	0.45	3.36	3.85
1998/99	584.0	11268.4	11852.4	4.9	95.1	330018	0.18	3.41	3.59
1999/00	757.9	11054.3	11812.2	6.4	93.6	366251	0.21	3.02	3.23
2000/01	586.7	11457.3	12044.0	4.9	95.1	394052	0.15	2.91	3.06
2001/02	87.0	7611.6	7698.6	1.1	98.9	406138	0.02	1.87	1.90
2002/03	657.2	3889.2	4546.4	14.5	85.5	437546	0.15	0.89	1.04
2003/04	66.0	7563.0	7929.0	0.9	99.1	474919	0.01	1.60	1.61
2004/05	126.5	9139.6	9266.1	1.4	98.6	508651	0.02	1.80	1.82
2005/06	40.6	8173.7	8214.3	0.5	99.5	557869	0.01	1.47	1.47
Average Annual Growth Rate	40.3	15.9	13.5	12.5	87.4	11.3	0.47	2.90	3.23

Source: Various Issue of Economic Survey MOF

Table 4.5 shows that the trend of external debt in terms of disbursement by major sources. The table reflects that the total external debt has grown year by year. In total debt share of multilateral sources in very high than bilateral sources.

External debt was Rs 729.9 million in fy 1981/82 which increased to Rs 8214.3 million in fy 2005/06. In fy 1981/82, Rs 109.9 million from bilateral source and Rs 620 million from multilateral source were collected where the share was 15.1 percent and 84.9 percent respectively. In fy 2005/06, the bilateral loan has been decreasing to Rs 40.6 million and multilateral loan has been increasing to Rs 8173.7 where the share was 0.5 percent and 99.5 percent respectively. The average annual growth rate of bilateral and multilateral loan were 40.3 and 15.9 percent respectively under the review of study. Within study period, we have seen the multilateral debt increasing rapidly than bilateral debt in total external debt. At the current movement most of the loan will be getting through the multilateral agencies, so bilateral debt will be decreasing at the current period.

The ratio of bilateral sources/GDP is 0.35 percent in 1981/82, which is decreased to 0.01 percent in fy 2005/06. Similarly, the multilateral resource to GDP ratio was 2.00 percent in fy 1981/82, which also decreased to 1.47 percent in fy 2005/06.There is high fluctuation in the both sources of external debt to GDP ratio. The average annual growth rate of bilateral sources as percentage of GDP ratio was 0.47 percent and average annual growth rate of multilateral sources as percentage of GDP ratio was 2.90 percent. Hence the annual average growth rate of total external debt as percentage of GDP was 3.23. At last, we have seen the external debt on GDP that is showing increasing as well as decreasing in fluctuating trend. Nepal is facing the problem of terrorism this is because of it can not manage properly its internal as well as external capital resources on development sector. Nepal spends all resources on regular expenditure and stability for security.

Figure 4.2 Trend of External Debt in Terms of Disbursement by Major Sources

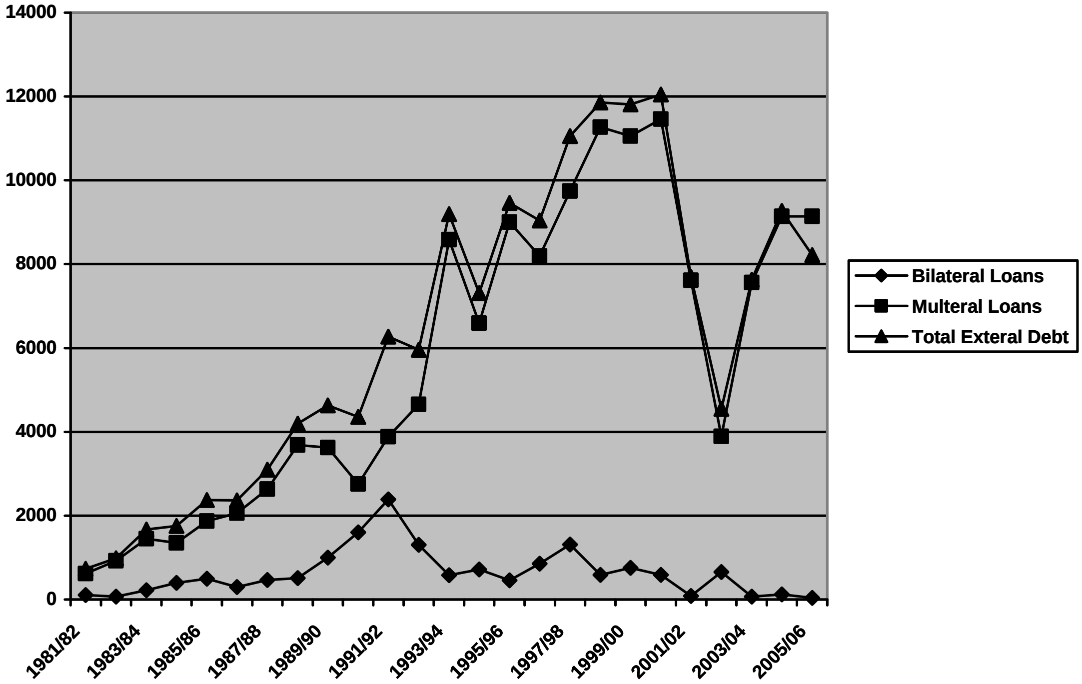


Fig 4.2 shows the trend of total external borrowing, bilateral loans and multilateral loans during the period 1981/82 to 2005/06. Figure also shows that the share of multilateral loans to external loan is very high as compared to share of bilateral loans. The amount of bilateral loan has seen decreasing year by year and that of multilateral loan has seen increasing rapidly every year except few years.

4.6 Sectoral Allocation of External Debt:

In developing countries like Nepal, there is need of heavy investment to build up socio-economic infrastructure such as agriculture, transportation, communication etc.To fulfill the objective of economic development. It is not possible through the individual; there is an essential of government finance. In order to meet the national goal government may impose tax on public heavily but it is impossible in developing countries because of poor tax payable capacity of the people. Therefore, the only one way to collect the needed fund is public debt.

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

In bilateral source, the largest donor of Nepal, Japan, mainly focus its loan in the area of forestry, environment, electricity, health culture and education. Belgium and Austria have been providing the loan in the form of commodity to the social sector mainly in drinking water. Similarly, England's loan and Norwegian loan is geared more towards poverty and implementation of local governance activities. In multilateral donors, ADB has the highest share of 93.28 percent in total outstanding multilateral debt with one percent rate of interest for the year 200/05. It has mainly focused on the objective of promoting economic growth, enhancing human development and protecting as well as improving the environment. These include agriculture, transport and social sectors (Acharya, 2003). The second largest multilateral donor, IDA, contributed 6.67 percent of total outstanding multilateral loan mainly emphasizing on agriculture sector and infrastructural development. However the contribution of the other agencies like OPEC, NDF, IFAD etc, cannot be ignored for the sectoral development of the country. Nepal has used borrowing in different sectors which is shown on the table 4.6.

Table 4.6 shows, the use of external borrowing in different sectors economy such as in agriculture, irrigation and forestry, transportation, power and communication, industry and commerce and social service. Transportation, power and communication sector has got highest amount of loan whereas agriculture, irrigation and forestry, social service and industry and commerce has got lowest amount of loan respectively. So that, it indicates that industry and commerce sector is neglected by using low amount of loan and no amount of loan in some fiscal years as shown in the table above. Table 4.6 reveals the sectoral allocation of external debt. As Nepal embarked a planned development in 1956, there was an indisputable need to build infrastructure. Thus, transport, power and communication emerged as the priority sectors for investment during the first four development plans (1956/57-1974/75) (Shrestha, 1990). This sector as well as agriculture, irrigation and forestry got further high priority in fy 1981/82 (40.3) up to 20002/03 (32.8). Transport, power and communication got the top priority except other sector during the study period.

Table 4.6 Sectoral Allocation of External Debt (Rs in Millions)

Fiscal Year	Total Debt	External Debt	Agriculture, Irrigation and Forestry	Transportation, Power and Communication	Industry and Commerce	Social Services
1981/82	1229.9	729.9	294.1 (40.3)	247.5(33.9)	104.9(14.4)	83.4(11.4)
1982/83	1985.8	985.8	347.6 (35.3)	324.6(32.9)	150.8(15.3)	161.8(16.4)
1983/84	3247.8	1670.9	507.5 (30.4)	544.2(32.6)	449.9(26.9)	169.3(10.1)
1984/85	3554.8	1753	733.4 (41.8)	752.1(42.9)	141(8)	111.5(6.4)
1985/86	3904.5	2370.9	1068.7(45.1)	845.2(35.6)	232.6(9.8)	224.6(9.5)
1986/87/	4350.5	2361.9	834.5 (35.3)	1097.5(46.5)	120.3(5.1)	289.3(12.2)
1987/88	4945.8	3094.3	1067 (34.5)	1598.6(51.7)	191.6(6.3)	228.4(7.4)
1988/89	6996.7	4194.7	1255.4(29.9)	2447.9(58.4)	145(3.5)	334.7(8)
1989/90	8109.6	4628.3	1294.8 (28)	1758.6(38)	645.9(14)	922.5(19.9)
1990/91	10808.9	4360	1112.1(25.5)	1531.8(35.1)	1270.7(29.1)	932.5(20.40
1991/92	8895.7	6269.4	1632.1(26)	2010.1(32.1)	2143.7(34.2)	483.5(7.7)
1992/93	8540.9	5961.7	1465.4(24.6)	3299.6(55.3)	663.3(11.1)	533.4(8.9)
1993/94	10983.6	9163.6	4904.8(53.5)	3273.1(35.7)	234.5(2.6)	751.1(8.2)
1994/95	9213.3	7312.3	2429.8(33.2)	3103.6(42.4)	359.3(4.9)	1419.6(19.7)
1995/96	11663.9	9463.9	3054.4(32.3)	4461.4(47.1)	3.5(0.04)	1784.3(18.9)
1996/97	12043.6	9043.6	2201.6(24.3)	5131.5(56.7)	17.5(0.2)	1693(18.7)
1997/98	14454.5	11054.5	2543.5(23)	5813(52.6)	167.9(1.5)	2530.1(22.9)
1998/99	16562.4	11852.4	2925.1(24.7)	6179.7(52.1)	391.6(3.3)	2312.3(19.5)
1999/00	17312.2	11812.2	2693.4(22.8)	6039.5(51.1)	283.8(2.4)	2795.1(23.7)
2000/01	19044	12044	3242(26.9)	6012.6(49.9)	0(0)	2283.6(19)
2001/02	15698.7	7698.6	2560.8(33.3)	3593.3(46.7)	49.5(0.6)	1495(19.4)
2002/03	13426.4	4546.4	1488.9(32.8)	1080.5(23.8)	28.3(0.6)	1738.4(38.2)
2003/04	13236.0	7629	1490.5(19.5)	1843.9(24.2)	0	4287.6(56.2)
2004/05	182041.1	9266.1	1214.7(13.1)	2836.8(30.6)	0.1(0)	5212.5(56.3)
2005/06	20048.6	8214.3	971.9(11.8)	2669.5(32.5)	0(0)	3901.4(47.5)

Source: Various Issues of Economic Surveys MOF

Note: figures in parentheses are percentage distribution

Although some disbursement was made for industry and commerce during the study period, it had still remained low priority. In fy 1981/82, the percentage share of external debt in this sector was 14.4 where as in fy 2005/06 the percentage share of external dent in this sector reached 0%. So, the lower priority for external loan is this sector was probably of the low import content of those programs requiring large recurrent expenditure.

In fy 1981/82, the percentage share of social service out of external debt was 11.4. After the restoration of multiparty system in 1990, idea about the loan disbursement has been changed. Donor's country started to give the priority to social sector while disbursing the loan. Thus, the social sector got the significant amount during the fy 2003/04 (56.2) to 20004/05 (56.3) except the other sector.

Figure: 4.3 Sectoral Allocation of External Borrowing

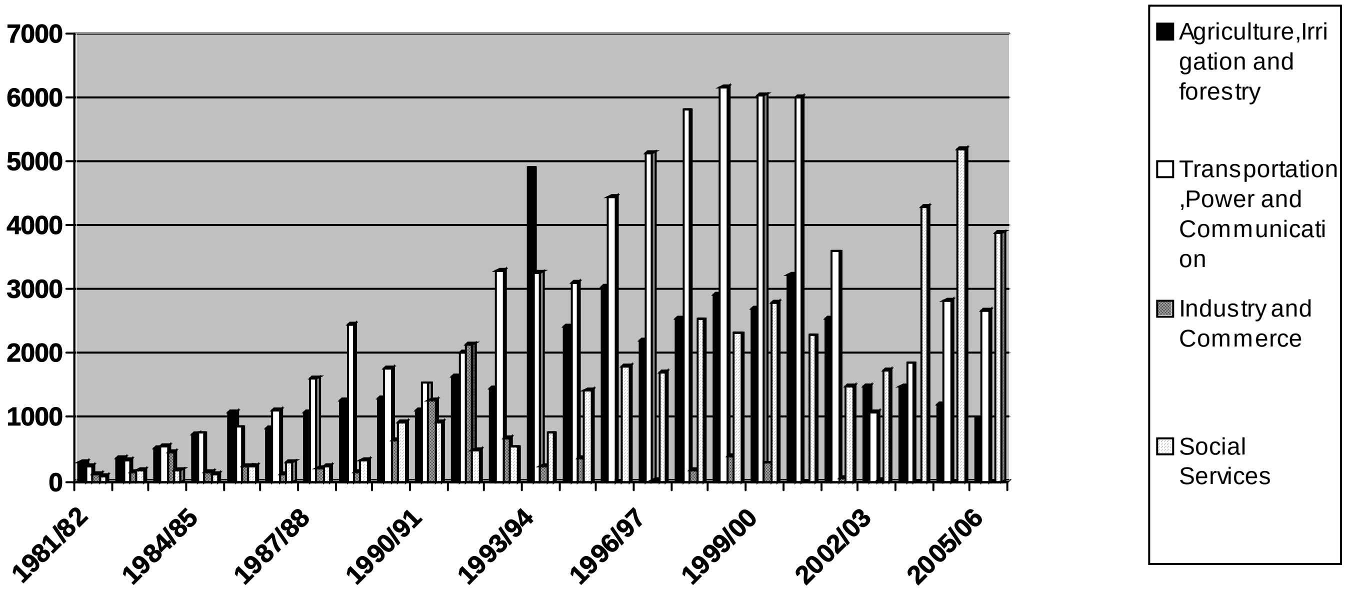


Fig. 4.3 shows the percentage share of external debt in different sectors of economy such as in agriculture, irrigation and forestry; transportation, power and communication, industry and commerce and social service during the period 1981/82 to 2005/06. Figure shows that the percentage share of transportation, power and communication sector has got highest amount of loan whereas agriculture, irrigation and forestry; social service and industry and commerce has got lowest amount of loan respectively.

CHAPTER: V

BURDEN OF EXTERNAL DEBT IN NEPAL

5.1 Introduction:

The burden of external debt refers to cost or disadvantages that are imposed upon the economy when public outlays are loan financed rather than tax financed. In another word, the burden of external debt refers to the sacrifice and affects on the community through a rise in taxation, necessitated at the time of repayment and for paying the annual interests on the government loans (Lekhi, 2004). To put it in differently, every government is bound to repay the public borrowing whether internally or externally with interest. Burden of debt may be direct or indirect, monetary or real and it may tend to face either present or sometimes on future generations. Burden of debt can be divided into two types:

1. Internal burden of debt and
2. External burden of debt

According to Dalton, he holds the view internal debt burden as not much significant as payment of principal amount and its interest involves taxes to another. In other words, money does not flow out of the national money market.

External burden imposes real burden on the economy because it reduces national welfare. External debt is paid not only in money terms but also in real terms, in terms of goods and services, which are exported to the creditor country for the settlement of the debt. This process will continue during the whole period of loan because the borrowed country has to pay interest charges.

Nepal, being an underdeveloped country, is facing various serious problem like scarcity of domestic capital formation, foreign exchange, poverty, unemployment, lack of infrastructure and its macroeconomic indicators show very low even negative growth rate and declining economic performance. Scope of domestic borrowing of Nepal is very limited. So external borrowing is the main sources for development process. Nepal has to invest huge amount of expenditure in unproductive activities like security in present situation. So, Nepal will have to depend upon foreign assistance. This indicates that borrowing is rapidly increasing year by year in Nepal. A rise in external indebtness should be accompanied by in increased in debts seeming capacity so that this may be undue strain in the balance of payment owing to outflow of funds through debt services which may lead to the country to the heavy burden of debt and debt crisis in the future.

External debt services have obvious impact on domestic capital formation and leads to reduction in the domestic standard of living unless the loans are used for financing profitable investment which yield is enough to satisfy creditors' claims for debt servicing. So, the true burden of debt services depends to a substantial extent in how the borrowed fund from external sources can be transformed into productive investment. If the foreign loans are used in unproductive sectors that provide present consumption with more goods than being produced in the country. Then, they are not created the capacity to serve foreign debt servicing. But they are used in productive purpose, the national income will increase and consequently the debt servicing ability will increase.

The only one way to reduce the debt burden is to spend it in productive investment which raises income, output, employment and the rate of capital formation by multiplier effect. Thus, the country has to be earned foreign currency through increasing volume of exportable goods and services, for the purpose of foreign debt servicing. If this is not done, it really becomes burden for next generation. Therefore, it is very essential factor that the real income of the economy should be faster than the transfer of resources resulting from its external debt servicing for this requires ever growing flow of foreign trade and proper utilization of foreign loans.

5.2 Net Outstanding External Debt and GDP:

The total amount of external debt after deducting repayment of principal and interest is called net outstanding external debt. The volume of external debt is growing over the time simultaneously while discussing about the burden of debt, to analyze the trend of outstanding external debt and GDP, and comparison between them is necessary.

Ratio of outstanding external debt to GDP measures the stock position of indebtedness. This indicator has also been used as part of the measure of foreign presence in an economy because external debt outstanding represents past reliance on contractual foreign capital inflows (Nowzad and Williams, 1991, p. 47). The very high value of this indicator implies that the earnings of the foreign currencies from the export are not enough with the increasing borrowing of capital from abroad.

Table 5.1 shows the increasing trend of annual growth rate tremendously except 2004/05 with the amount of total external outstanding debt was Rs 3177.8 million in 1981/82 and had gone up to Rs 233968.6 million in 2005/06 with 20.00 percent of average annual growth rate. Its annual growth rate was 48.45 percent in 1981/82 but after than it is declining to 3.16 percent in 1996/97 and slowly increasing to 9.84 percent in 2001/02 as well as rapidly decreased to 5.64 percent in 2004/05.

But, the increasing average annual growth rate of GDP shows fluctuating and not desirable economic performance because GDP is a pillar of national economy. GDP had increased from Rs 30988 million to Rs 557869 million with 11.0 percent of average annual growth rate under the review period. The growth rate of GDP is smaller than external outstanding debt. After the multiparty system restoration, the annual growth rate of GDP is not satisfied and become 3.1 percent growth rate in 2001/02 compare with previous year, which was threatened to national economy.

As can be observed from the above table, the outstanding external debt was Rs 3177.8 million in fy 1981/82 and its share in GDP was 10.25 percent. This increased to Rs 233968.6 million in fy 2005/06, reaching about 42 percent of GDP. The increase in external debt outstanding was largely because of successive devaluation as well as for meeting investment needs particularly and social investments needs. The outstanding external debt is increasing rapidly over the years. The situation of heavy debt in the subsequent years indicates that the country is heading towards “Debt Trap”. In the 1981/82, external debt contribute only 10.25 percent of GDP, after that it is continuously increasing up to 54.20 percent in fy 2001/02, slowly decreasing to 41.92 percent of the GDP in fy 2005/06.

The ratio of external debt to GDP was 10.25 percent in 1981/82 and had amounted up 54.2 percent in 2001/02 and further decreased to 41.92 percent in 2005/06 with 40.7 percent of average annual growth rate. This indicates clearly about the burden of external debt is quiet reducing but it is not sufficient. The ratio of outstanding debt to GDP is increasing rapidly which lead to the country to external crisis in future. So, external loans have to use for productive sector or proper utilization of it.

Table 5.1 Net Outstanding of External Debt and GDP (Rs in Millions)

Fiscal Year	Net Outstanding of External Debt	Annual Growth Rate of NOED	GDP at Factor Cost	Annual Growth Rate of GDP	NOED as % of GDP
1981/82	3177.8	_	30988	-	10.25
1982/83	4717.6	48.45	33761	8.9	13.97
1983/84	6321.1	33.99	39390	16.7	16.05
1984/85	9203.2	45.59	44441	12.8	20.72
1985/86	10330.2	12.25	53215	19.8	19.41
1986/87	15171.9	46.87	61140	14.9	24.82
1987/88	20826	37.27	73170	19.7	28.46
1988/89	29216.9	40.29	85831	17.3	34.04
1989/90	36800.9	25.96	99702	16.2	36.91
1990/91	59505.3	61.70	116127	16.5	51.24
1991/92	70923.9	19.19	144933	24.8	48.94
1992/93	87420.8	23.26	165350	14.1	52.87
1993/94	101966.8	16.64	191596	15.9	53.22
1994/95	113000.9	10.82	209976	9.6	53.82
1995/96	128044.4	13.31	239388	14	53.49
1996/97	132086.8	3.16	269570	12.6	49.00
1997/98	161208.0	22.05	289798	7.5	55.63
1998/99	169465.9	5.12	330018	13.9	51.35
1999/00	190691.2	12.52	366251	11	52.07
2000/01	200404.4	5.09	394052	7.6	50.86
2001/02	220125.6	9.84	406138	3.1	54.20
2002/03	223433.2	1.50	437546	7.7	51.07
2003/04	232779.3	4.18	474919	8.5	49.01
2004/05	219641.9	-5.64	508651	7.1	43.18
2005/06	233968.8	6.52	557869	9.7	41.92
Average Annual Growth	-	20.00	-	11.3	40.7

Source: Various Issue of Economic Survey of MOF

5.3 Trend of External Debt Servicing:

The first and foremost impact of the growth of external public debt results in debt servicing burden. Nepal is bearing heavy burden of external debt. So, it leads to rise in debt servicing charge. External debt is rising every year in high rate. Table 6.2 shows Nepal's debt servicing trends.

As shown in 5.2 table, the level of total debt servicing has been increasing regularly. The total debt servicing has researched Rs 9151.4 million in 2005/06 from Rs 74 million including (interest payment). The external debt servicing itself implies that such obligations should be made in foreign currencies which means the economy should have capacity to generate saving domestically and convert it into foreign currencies. Therefore, the growth of debt servicing in relation to government revenue and exports of goods and services would give the impact in the economy as well as all sector affected by external debt servicing. It reduces the development expenditure in all sectors.

The ratio of total debt servicing to government revenue has increased from 2.76 percent in 1981/82 to 14.07 percent in 1992/93 as well as the ratio of total debt servicing to government revenue has decreased from 14.07 percent in 1992/93 to 11.55 percent in 2004/05. This implies that about percent of the government revenue generate the capacity to spend on external debt servicing increasing.

In theory, a high level or rapid increase in this ratio indicated the emergence of excessive consumption and problems with the productivity or efficiency of investment. As foreign resources are directed to consumption rather than investment programme, the cost of foreign financing becomes greater than its return, thus, expansion in revenue collection of a country becomes relatively low. This low level of return cause to high level of taxation to pay the interest of debt which reduces the willingness to invest and ability to investment. Thus, the rising of ratio ultimately implies that the debt burden is increasing day by day.

Table 5.2: Principle Payments and Interest Payments in External Debt Servicing

(Rs in Millions)

Fiscal Year	Principle Payment	Interest Payment	Total Debt Servicing	Government Revenue	TDS/GR
1981/82	35.7	38.3	74	2679.5	2.76
1982/83	47.5	47.2	94.7	2841.6	3.33
1983/84	55.5	72.7	128.2	3409.3	3.76
1984/85	69.2	120.3	189.5	3916.6	4.84
1985/86	160.5	125.2	285.7	4644.5	6.15
1986/87	250.5	236.4	487	5975.1	8.15
1987/88	297.5	293.5	591	7350.4	8.04
1988/89	388.6	312.7	701.3	7776.9	9.02
1989/90	701.8	421.8	1123.6	9287.5	12.10
1990/91	589	497.5	1086.5	10729.9	10.13
1991/92	942.2	722.7	1664.9	13512.7	12.32
1992/93	1252.9	879	2131.9	15148.4	14.07
1993/94	1468.2	1020.5	2488.7	19580.8	12.71
1994/95	1828.2	1156.5	2984.7	24577.2	12.15
1995/96	1987.7	1316.6	3304.3	27893.1	11.85
1996/97	2102.4	1247	3349.4	30373.5	11.03
1997/98	2780.2	1421	4201.2	32937.9	12.75
1998/99	3196.5	1549	4745.5	37251	12.74
1999/00	3681.1	1640	5321.4	42893.8	12.41
2000/01	4500.6	1700.8	6201.4	48893.6	12.68
2001/02	4751.4	1816.1	6567.5	50445.5	13.02
2002/03	5497.5	2021.7	7519.2	56229.8	13.37
2003/04	5767.1	2141.8	7908.9	62331	12.69
2004/05	5954.5	2146.8	8101.3	70122.7	11.55
2005/06	6987.5	2163.9	9151.4	72282.1	12.66

Source: Various Issues of Economic Survey of MOF

5.4 External Debt Servicing, Export Earnings and GDP:

The debt service ratio can be interpreted as indicating the proportion of country's annual exports of goods and services that would be absorbed by debt service payments and thus, is a measure of the debt burden. The indicator also provides a liquidity measure analogue to cash flow indicators for a firm. According to this, as the ratio increases, a debtor's ability to cover debt servicing obligation declines which is viewed by potential investors as a threat sustaining reforms and as a potential cause of a higher inflation tax to meet debt-service requirement.

All developed countries have positive balance of payments due to export specialization but, the condition is opposite in the context of developing countries. One of the serious problems of Nepal is also slow growth of export and accelerated growth of import. Nepal, large share of GDP and export earning has transferred or gone to back to foreign countries while servicing its foreign debt.

The debt service ratio can be interpreted as indicating the proportion of a country's annual exports of goods and services that would be observed by debt service payments and thus is a measure of the debt burden. The indicator also provides a liquidity measure analogue for cash flow indicators for a firm. According to this as the ratio, increase a debtors ability to cover debt servicing obligation declines which is viewed by potential investors as a threat sustaining reforms as a potential cause of a higher inflation tax to meet debt servicing requirement.

Here, the attempt has been discussed about the ratio of external debt servicing, export earning and external debt servicing to GDP. Table 5.3 depicts this matter.

Table 5.3 shows the external debt burden in terms of export earning and debt servicing. The table shows, the magnitude of export earning was Rs 1335.8 million in fy 1981/82 which has met to Rs 60234.1 million in fy 2005/06 with 19.5 percent of average annual growth rate whereas external debt servicing was Rs 74 million in fy 1981/82 which has increased to Rs 9151.4 million in fy 2005/06 with an average annual growth rate of 21.7 percent. This indicates that Nepalese government is spending its large share of foreign exchange earning to pay debt servicing. This is because almost all loans given to Nepal are soft in nature, that is, interest rate charged on debt is nominal.

The ratio of external debt servicing to export earning was 6.52 percent in fy 1981/82 and has increased to 21.79 percent in fy 1989/90. After that period there is fluctuating trend. The average annual growth rate of this ratio is 13.0 percent under the review period.

The debt servicing to export earning ratio was higher, 21.79 percent in the middle period of fy 1989/90 and but then after this ratio has not been restored yet. This implies that about 7% to 21% of export earning is needed for debt servicing in the study period. As a rule of thumb, the debt service ratio below 20 percent is not dangerous but such a result may not be leading if we don't examine this ratio in conjunction with other factors such as growth rate and composition of exports and imports. Thus the analysis of a country's debt servicing is related to various factors like international reserves, the growth rate of export as well as the ratio of its imports etc. Similarly, the ratio of external debt servicing to GDP has increased from 0.24 percent in fy 1981/82 to 1.64 percent in fy 2005/06 which shows the increasing burden for the further generation. However, the average annual growth rate of GDP or export earning is very low than average annual growth rate of debt servicing.

The debt service to export ratio doesn't take concern to what extent and which export earnings are needed to finance non debt payments. The imports payment is a non-debt payment, which has to be financed through the export earnings. Thus, trade deficit has to be increased to increase the debt service burden. The above indicators introduce difficulties and affect the rate of capital formation in economy because of the growing magnitude of interest payment and repayment in terms of the foreign exchange.

Table 5.3 Ratio of External Debt Servicing, Export Earning and GDP (Rs in Millions)

Fiscal Year	Export Earning (EE)	External Debt Servicing	Annual growth rate of EE	Annual growth rate of EDS	GDP at Factor Cost	EDS as % of EE	EDS as % of GDP
1981/82	1135.8	74	-	-	30988	6.52	0.24
1982/83	1709.9	94.7	50.55	27.97	33761	5.54	0.28
1983/84	2746.4	128.2	60.62	35.37	39390	4.67	0.33
1984/85	3085.7	189.5	12.35	47.82	44441	6.14	4.27
1985/86	3078	285.7	-2.50	50.77	53215	9.28	0.54
1986/87	2991.4	487	-2.81	70.46	61140	16.28	0.80
1987/88	4114.6	591	37.55	21.36	73170	14.36	0.81
1988/89	4195.3	701.3	1.96	18.66	85831	16.71	0.82
1989/90	5156.2	1123.6	22.90	60.22	99702	21.79	1.13
1990/91	7387.5	1086.5	43.27	-3.30	116127	14.71	0.94
1991/92	13706.5	1664.9	85.54	53.24	144933	12.15	1.15
1992/93	17266.5	2131.9	25.97	28.05	165350	12.35	1.29
1993/94	19293.4	2488.7	11.74	16.74	191596	12.90	1.30
1994/95	17639.2	2984.7	-8.57	19.93	209976	16.92	1.42
1995/96	19881.1	3304.3	12.71	10.71	239388	16.62	1.38
1996/97	22636.5	3349.4	13.86	1.36	269570	14.80	1.24
1997/98	27513.5	4201.2	21.54	25.43	289798	15.27	1.45
1998/99	35676.3	4745.5	29.67	12.96	330018	13.30	1.44
1999/00	49822.7	5321.4	39.65	12.14	366251	10.68	1.45
2000/01	55654.1	6201.4	11.70	16.51	394052	11.14	1.57
2001/02	46944.8	6567.5	-15.65	5.93	406138	13.99	1.62
2002/03	49930.6	7519.2	6.36	14.49	437546	15.06	1.72
2003/04	53910.7	7908.9	7.97	5.18	474919	14.67	1.67
2004/05	58705.7	8101.3	8.89	2.43	508651	13.80	1.59
2005/06	60234.1	9151.4	12.96	-12.96	557869	15.19	1.64
Average Annual Growth Rate	-	-	19.5	21.7	11.0	13.0	1.4

Source: Various Issues of Economic Survey of MOF

5.5 External Debt Flow and Its Servicing:

One of the main features of budgetary system in Nepal is deficit budget in which large proportion of it is fulfilled by external loan. This is also proved by the increasing trend of average annual growth rate of external debt by 13.5 percent under the period of study.

Table 5.4 shows the comparisons between the annual flow of external debt (new borrowing) and annual external debt servicing obligations. The ratio of external debt servicing to new borrowing is shown on 5.4 table.

From table 5.4 the new external borrowing was Rs 729.9 million in 1981/82 and has met to Rs 8214.4 million in 2005/06 with 13.5 percent average annual growth rate. Similarly, debt servicing was Rs 74 million in 1981/82 and has gone up to Rs 9051.4 million in 2005/06. Its average annual growth rate was 21.7 percent.

Here, the ratio of external debt servicing to new borrowing has increased rapidly 10.14 percent in starting year of review fy 1981/82 to 165.39 percent in 20002/03. This indicates that huge amount of new fresh loan is used to repay the old ones. This also predicts that new borrowing transfer to the creditor countries to service the external debt per annum which hampered the development expenditure of the country.

This states that the Average annual growth rate of external debt servicing to new external borrowing has been 42.2% over the review period. The indicated raise fear about its increasing burden because it is going to devour not only last proportion of exchange earning but rather proportion of new borrowing too.

From the table it can be said that average annual growth rate of external debt servicing is 21.7 % and new borrowing is only 13.5% which shows that external debt servicing occupies large proportion of new borrowing to debt servicing. The growth of external debt servicing has also been phenomenal.

Table 5.4 External Debt Flow and Its Servicing (Rs in Millions)

Fiscal Year	External Debt (new borrowing)	External Debt Servicing	EDS as % of ED	Annual growth rate of ED	Annual growth rate of EDS
1981/82	729.9	74	10.14	-	-
1982/83	985.8	94.7	9.61	35.05	27.97
1983/84	1670.9	128.2	7.67	69.51	35.37
1984/85	1754.9	189.5	10.80	5.03	47.82
1985/86	2501.1	285.7	11.42	42.52	50.77
1986/87	2705.8	487	18.00	8.18	70.46
1987/88	3815.8	591	15.49	41.02	21.36
1988/89	5666.4	701.3	12.38	48.50	18.66
1989/90	5959.6	1123.6	18.85	5.17	60.22
1990/91	6256.7	1086.5	17.36	4.99	-3.30
1991/92	6816.9	1664.9	24.42	8.95	53.24
1992/93	6920.9	2131.9	30.80	1.53	28.05
1993/94	9163.6	2488.7	27.16	32.40	16.74
1994/95	7313.2	2984.7	40.82	-20.20	19.93
1995/96	9463.9	3304.3	34.91	29.42	10.71
1996/97	9043.6	3349.4	37.04	-4.44	1.36
1997/98	11054.4	4201.2	38.00	22.23	25.43
1998/99	11852.4	4745.5	40.04	7.23	12.96
1999/00	11812.2	5321.4	45.05	-0.33	12.14
2000/01	12044	6201.4	51.48	1.96	16.51
2001/02	7698.7	6567.5	85.31	-36.08	5.93
2002/03	4546.4	7519.2	165.39	-40.95	14.49
2003/04	7629	7908.9	103.67	67.80	5.18
2004/05	9266	8101.3	87.43	21.46	2.43
2005/06	8214.4	9151.4	111.41	-11.35	-12.96
Average Annual Growth Rate	-	-	42.2	13.5	21.7

Source: Various Issues of Economic Survey of MOF

5.6 Outstanding External Debt and Import:

Lager amount of goods and services are imported in Nepal from foreign countries. Nepal has to be paid back the large amount to the exported countries .The increasing train of import payment reduces the economic development , economic welfare and status of the people.

Table 5.5 shows the relation ship between external debt Borden and import payment and their average annual growth rate with the ratio of import payment to external debt.

While observing table, it can be found that the external outstanding debt has been increasing with 20.00 percent of average annual growth rate, which indicates the serious problem of external debt burden of Nepal. On the other hand, the magnitude of import payment was Rs 4948.0 million in 1981/82 and has gone to Rs 173780.3 million in 2005/06 with 14.6 percent of average annual growth rate. This shows the large proportion of foreign exchange transfers to foreign countries for service import payments of goods and service.

Under the review of study period, trade deficit was Rs 3812.2 million in 1981/82 and sharply increased Rs 113546.2 million in 2005/06 which has to be financed by foreign exchange earning. On the other hand, outstanding external to import ratio was 155.70 percent in 1981/82 and has become 74.28 percent in 2005/06, implying that the growth rate of outstanding external debt is greater than import. But, export being a main source of foreign exchange earnings, should be sufficient to finance to trade imbalance as well as outstanding external debt. Export earnings are not bearing those problems.

However, as maintain above, the absolute amount of import is larger than export. Thus export earnings can not be used for debt servicing in Nepal. The rising debt servicing requirements along with stagnant exports has meant either defaulting on payment of parting with scare foreign exchange badly needed for imports required for production and investment (Ajaji, 1996). Therefore, a small debt servicing to export ratio can also be a burden for a country like Nepal, where, there is large trade deficit and low growth rate of the economy.

Table 5.5 Outstanding External Debt and Import (Rs in Million)

Fiscal Year	Outstanding External Debt	Import Payment	IP as% of OED	Annual growth rate of OED	Annual growth rate of IP
1981/82	3177.8	4948	155.70	-	-
1982/83	4717.6	6332.8	134.20	48.45	27.99
1983/84	6321.1	6533.5	103.40	33.99	3.17
1984/85	9203.2	7742.1	84.12	45.59	18.50
1985/86	10330.2	9341.2	90.43	12.25	20.65
1986/87	1517.19	10905.2	71.88	46.87	16.74
1987/88	20826.00	13869.6	66.60	37.27	27.18
1988/89	29216.9	16263.7	55.67	40.29	27.26
1989/90	36800.9	18324.9	49.79	25.96	12.67
1990/91	59505.3	2330226.5	39.03	61.70	26.75
1991/92	70923.9	31940.00	45.03	19.19	37.52
1992/93	87420.8	39205.6	44.85	23.26	22.75
1993/94	101966.8	51570.8	50.58	16.64	31.54
1994/95	113000.9	63679.5	56.35	10.82	23.48
1995/96	128044.4	74454.5	58.15	13.31	16.92
1996/97	132086.8	93553.4	70.83	3.16	25.65
1997/98	161208.00	890020.00	55.21	22.05	-4.87
1998/99	169465.9	87525.3	51.65	5.12	-1.66
1999/00	190691.2	108504.9	56.90	12.52	23.97
2000/01	200404.4	115687.2	57.73	5.09	6.62
2001/02	220125.6	107388.9	48.79	9.84	-7.17
2002/03	223433.2	125352.1	56.66	1.50	15.80
2003/04	232779.3	136277.1	58.54	4.18	9.59
2004/05	219641.9	149473.6	68.05	-5.64	9.68
2005/06	233968.6	173780.3	74.28	6.90	16.26
Average Annual Growth Rate	-	-	68.2	20.00	14.6

Source: Various Issues of Economic Survey of MOF

5.7 Empirical Analysis:

Empirical analysis is most important to show the relationship between dependent and independent variables of the study. In this study, regression equation is used to analyze the relationship between GDP with bilateral debt, multilateral debt and total external debt. Regression equations are made as well as calculated by using SPSS program.

5.7.1 GDP and total external debt:

This analysis shows that relationship between GDP and total external debt. For this purpose, we have made the regression equation. The regression equation is:

$$GDP = a_0 + a_1 TED$$

The result of this equation is:

GDP = 65465.71 + 25.42145TED

Se = (7.722355) (55364.81)

t = (3.29) (1.18)*

P> (t) = (0.003) (0.239)

F = 10.84

R –squared = 0.8703

Adj.R-squared = 0.8607

D.W = 0.7572202

* Significant at 10% Level of Significance

The above equation shows the relationship between gross domestic product and total external debt whereas TED is independent variable and GDP is dependent variable. Impact of total external debt on GDP is positive because when one unit increase in total external debt then GDP would increase by 25.4 units. The regression constant or intercept form (a_0) is 65465.71, which implies that GDP is Rs 65465.71 if independent variable TED is zero. The co-efficient of determination (R^2) is 0.87, which reflects that is determined by the explanatory variable total external debt. The value of Adj.R-squared shows the higher goodness of fitness. In case of F-test tabulated value of ‘F’ is smaller than calculated F-value; there is also positive auto correlation, so the regression line is significant.

5.7.2 GDP with Bilateral Debt and Multilateral Debt:

This analysis shows that relationship between GDP with bilateral debt and multilateral debt. The impact of bilateral debt and multilateral debt can be shown by following regression equation which is:

$l_nGDP = a_0 + a_1 l_nBD + a_2 l_nMD$

The result of this equation is:

$l_nGDP = 11.02166 - 0.3823157 l_nBD + 0.3811 l_nMD$

Se = (0.1933955) (0.169688) (1.303889)

t = (-1.98) (2.29) ** (8.45)*

P> (t) = (0.06) (0.032) (0.000)

F = 3.08

R – squared = 0.7890

Adj .R – squared = 0.7679

D.W = 0.7778136

* Significant at 1% Level of Significance

** Significance at 5% Level of Significance

As shown in equation, GDP is depended and BD & MD are independent variable. The regression constant or intercept coefficient (a_0) is 11.02166 which indicate that GDP would Rs 11.02166, if the independent variables BD and MD are zero. The coefficient of BD (a_1) is 0.3823157, which means that one unit change in BD causes 0.3823157 unit changes in GDP or then GDP would decrease by 0.3823157 units, if MD is zero. Similarly, the coefficient of MD (a_2) is 0.3811, which explains that one unit change in MD causes 0.3811 changes in GDP if BD is zero. Hence, it shows there are positive impact as well as negative impact of multilateral debt and bilateral debt on GDP.

The coefficient of determination R-squared is 0.7890 which reflects that 78 percent of the variation of GDP is determined by the explanatory variables. The value of Adj.R-squared shows the higher goodness of fitness. Similarly, F- value is greater than tabulated F-value. There is positive auto correlation. So, the overall regression line is significant and it shows an association between the variables in the equation.

In conclusion, both equation, the relationship between GDP and total external debt & multilateral debt are positive. Both debts support to increase in GDP. But bilateral debt is negative relation on GDP. At last this empirical findings show that impact of multilateral debt on GDP is stronger than bilateral debt at current time period. So Nepal should take consideration in taking multilateral debt in comparison to bilateral debt.

CHAPTER VI

SUMMARY, CONCLUSION AND RECOMMENDATIONS

6.1 Summary:

External debt is the total debt of bilateral debt as well as multilateral debt. External debt is taken with the obligation of future repayment including with certain rate of interest. When government requires funds for development program and security it by selling borrowing instruments. So, it is the result of mismatch between expenditure and revenue. External debt is a widely accepted measure for financing fiscal deficit. Every year the government expenditure is increasing rapidly. But, the revenue is not growing in the same pace so external debt is the major source for deficit financing.

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, external dent 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 in public expenditure.

Basically, the study shows that there is lack of sufficient fund for development financing. We have limited source like in GDP, per capita income, lack of infrastructure, increasing saving –investment gap, fiscal deficit, widening budgetary deficit, widening current account deficit, increasing outstanding debt with increasing high debt servicing obligations etc. So, the domestic resources are not sufficient to promote the rapid development of the economy. All these factors are major causes to increase external dependency.

The study of the budgetary trend of past 25 years of Nepalese economy shows that the budget deficit is increasing each year. The reliance on external assistance is increasing more than 50 percent of development expenditure as this type of expenditure is being financed through foreign assistance in most of the tears between 1981/82 to 2005/06. External borrowing has been the major source of financing deficit in government budgets. Since the external debt accounts more than 85 percent of total debt, Nepal is heavily indebted from external debt.

Nepal is also facing the problem of debt servicing, the government budgetary deficit is growing rapidly in every fiscal year and trend of grants is decreasing, which also further increased debt burden. External borrowing is growing in higher rate than internal borrowing, increasing trend of borrowing also increased debt servicing obligation. In the early stage of development higher resource gap it self would not have been serious problem because of foreign grants but now the situation is just reverse. So, the trend of continuously increased in borrowing and debt servicing obligation is not good economic indicator for developing country like Nepal. Obviously, there are not any alternative sources for financing budgetary deficit so that the government is unable to reduce socio–economic development of a nation, the government should take some measures to check it in time. The major findings of the study are summarized as follows:

- In the study period the government revenue has increased from Rs 2679.5 million to Rs 72282.1 million with the average annual growth rate of revenue is 14.1 percent between periods in fy 1981/82 to fy 2005/06. In the same period, the expenditure is increased from Rs 5361.3 million to Rs 110889.2 million with the average annual growth rate of 13.1 percent. But the growth rate of revenue is not sufficient for financing increased government expenditure. This shows the widening financial resource gap because of political instability and terrorism problem.
- The gap between revenue and expenditure or fiscal deficit is Rs 2681.8 million and Rs 38607.1 million in fy 1981/82 and fy 2005/06 respectively. The gap is increased by year by year.

- The budget deficit has increased from Rs 1688.5 million to Rs 24779.6 million respectively over the period 1981/82 to 2005/06 with an average annual growth rate of 13.8 percent.
- Budget deficit as the percentage of GDP has decreased from 5.4 percent in fy 1981/82 to 3.3 percent in fy 2003/04. This shows the fluctuating trend. Similarly, the fiscal deficit as percentage of GDP has also shown the fluctuating trend. It has decreased from 8.7 percent in fy 1981/82 to 5.7 percent in fy 2003/04. However, the average annual growth rate of fiscal deficit to GDP 8.5 percent and that of budget deficit to GDP is 6.5 percent during the study period.
- The total government debt has increased with an average annual growth rate of 13.8 percent. The total debt has increased from Rs1229.9 million in fy 1981/82 to Rs 20048.6 million in fy 2005/06. Similarly average annual growth rate of internal and external debt is 19.8 percent and 13.5 percent respectively in the review period. The amount of internal debt was Rs 500 million in fy 1981/82 and increased to Rs 11834.2 million in fy 2005/06. Similarly, the amount off external debt increased from Rs 729.9 million in fy 1981/82 to Rs 8214.4 million in fy 2005/06. But the share of internal debt was in increasing year by year at high rate.
- Average annual growth rate of total debt as percentage of GDP is 5.65 percent where as the average annual growth rate of internal debt and external debt as percentage of GDP are 1.39 and 3.67 percent respectively.
- External loans consist of bilateral and multilateral loans in which the amount of multilateral loans has been increasing day by day. Total external debt was Rs 729.9 in fy 1981/82, in which Rs 109.9 million was taken from bilateral and Rs 620 million was taken from multilateral source. It has gone up to Rs 8214.3 million in fy 2005/06, in which Rs 40.6 million from bilateral and Rs 8173.7 million from multilateral sources.
- Average annual growth rate of total external debt is 13.5 percent in which the average annual growth rate of bilateral loan and multilateral loan are 40.3 percent and 15.9 percent respectively. The government received more than 90 percent of external debt from multilateral sources and less than 10 percent external loan from bilateral sources. This shows that the external

debt is heavily depended upon multilateral debt is heavily depended upon multilateral sources.

- In the period of review, shows the magnitude of outstanding debt, GDP and their ratio which also assess the burden of external debt. This shows the ratio of external to GDP in the year between fy 1981/82 to fy 2005/06. The amount of external outstanding debt was Rs 3177.8 million in1981/82 and has gone up to Rs 233968.6 million with 20.00 percent of average annual growth rate. The share of outstanding external debt is increased enormously, which is the matter of consideration so that remedial action should be adopted to reduce the remarkably increased external debt. The share of outstanding external debt to GDP was 10.25% in fiscal year 1981/82 which increased to 41.9% in fiscal year 2006, showing gradually increased with 40.7% of average annual growth rate. This indicates clearly about the burden of external debt is quite heavy.
- The government is spending high amount to pay interest and principle of the total outstanding external debt .In which principle servicing of external debt was Rs. 35.7 million in fiscal year 1981/82 and has gone up to Rs.6987.5 million in fiscal year 2005/06. Similarly, interest payment was Rs 38.3 million in 1981/82 which reached to Rs. 2163.9 million in fiscal year in 2005/06. 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 miss use of funds.
- The external debt servicing to export earning ratio has increased from 6.52% in fiscal year 1981/82 to 15.19% in fiscal year 20005/06 with 13% average annual growth rate. The external debt servicing as percentage of GDP is 0.24% in fiscal year 1981/82 has gone up to 1.64% in fiscal year 2005/06. Its average annual growth rate is 1.4%. The 1.4% share of GDP has gone payment for the external debt servicing. This indicator raises fear of increasing external debt servicing problem. That further implies that larger amount of foreign exchange has been observed by debt service payment.
- The external debt service as percentage of external debt was 10.14% in fiscal year 1981/82 and it reached 111.41% in fiscal ear 2005/06 with

42.2% of average annual growth rate. Similarly, average annual growth rate of external debt the external debt servicing 13.5% and 21.7% respectively. The indicators raise fear about its increasing burden berceuse it is going to devour not only large proportion of exchange earning but also large proportion of new borrowing too.

- The payment on import has increased from Rs. 4948 million in fiscal year 1981/82 to Rs 173780.3 million in fiscal year 2005/06 with 14.6% average annual growth rate. This clearly shows that the increase in external debt is accompanied by gradual increase in goods and services.
- It is found that debt servicing capacity is lower than the total debt and debt obligation. As the average growth rate of debt obligation is higher than the growth rate of GDP, revenue and export earning. The borrowing is increasing faster and higher but the redemption of the debt is not in time.

6.2 Conclusion:

There is enormously increase in foreign debt every 25 years which makes the country to be more dependent on foreign aid. So, every sector of the economy depends on debt. The government negotiates for foreign aid. However, foreign debt is increasing which seems likely to increase further. Nepal may face debt crisis in the future time which is the matter of consideration.

For maintenance of the debt either foreign trade or the level of national per capita income has to be increased substantially. During the review period of study (1981/82 to 2005/06) the average annual growth rate of GDP revenue are comparatively low with the debt and debt service obligations. It indicates that the large proportions of GDP and export earnings have gone back to foreign countries from Nepal while servicing its foreign loan. The expanding roles of government in most of the underdeveloped countries are increasing day by day. But lack of dynamism of the domestic resource mobilization has encouraged the developing countries to take resource of foreign loans in the present context. These are symptoms of steadily falling into the debt trap.

The analysis of the role of external debt on economic growth reveals that there exist significant positive relationship between external debt and GDP. Higher external debt is associated with higher economic growth and vice–versa. Separately, external debt into bilateral and multilateral components empirical result suggests that both type of debt has not positive impact on the economic. Bilateral debt has negative impact on economy but multilateral has positives on economy growths. So, multilateral debt is better for economics growth than bilateral debt.

6.3 Recommendation

The burden of external is increasing enormously, which is the great matter so that remedial action should be apply to reduce the remarkably increased external public debt. Hence, the measure issue is how to make productive used of external borrowing. If this could be used productively, the debt servicing would not be real burden of external debt. If debt is not handle properly, our future generation would not get rid of debt.

On the basis of above findings, the following are the purposed recommendation which can be helpful for checking the external debt management in Nepal.

1. The size of overall budgetary deficit except grants has remained high mainly due to revenue and very highs expenditure. This has led to heavy borrowing from internal and external sources. So, for reducing the volume of borrowing revenue, collection is to be increased substantially in order to attain self- sufficiently in the long run. This can be done by improving effective policy and tax administration. This also include simplification of tax rate, government should increase heavy import duty on luxurious goods, harmful goods. Government should impose progressive tax in income, property etc.
2. Government should replace towards fiscal imbalance and strong fiscal discipline through control of unproductive expenditure and maximizing revenue mobilization.

3. Government has to take more internal loan than external loan to reduce the loss of Nepalese currency to service foreign debt.
4. Government effort should be directed towards internal revenue mobilization motive for develop financing which can reduce external dependency.
5. It has been a most common problem particularly among the underdeveloped countries like Nepal that there is not tight monitoring and inspection towards the progress of newly launched projects. So, government should be consideration to maintain the strong policy of monitoring, evaluation and supervision. This is also why foreign lender and donors always try for their own management for the projects conducted with their financial and technical cooperation. Additional care should be poured upon the time duration and quality and expenditure factors of the projects. Regular reviewing must be made on the return of the project so that the study may be the analytical base for the further ones.
6. The level and direction of export is certain within few products and limited countries. So, there is need to export promotion and diversifying trade both countries wise and commodity wise. There should be control to import luxuries goods and service by adopting effective import policy and reduce huge trade deficit promoting export oriented industries and there by narrowing the ever increasing gap between total export and import. Government should implement policy which protects the domestic industries.
7. The government should try to get more grants as far as possible. There is dominated by bilateral grants. The government should develop such external policy which receives more grants rather than loans.
8. Government should use external loan in such projects which are highly productive and can contribute to pay back principle and interest which help to generate the capital formation. For this project with home work before its implementation and to reduce the cost of the projects, accountability and transparency is to be needed.

9. Government should try to minimize borrowing from banking sector which is to create inflationary situation and to protect it none banking sectors which stimulate domestic saving and investment.
10. Proper attention should be given to balance macroeconomic stability of the country when taking borrowing.
11. Another way to cut down external debt is to invite foreign capital for investment by creating conductive environment for it. If the government can do so, it can cut down a significant part of its external borrowing because the required external capital will be met through such investment, such investment will help to increase the national income level, which in turn will make the debt servicing ability of the country more strong.
12. Nepalese economy is less attractive in terms of her ability to increase FDI and she has the limited size of her credit worthiness due to the several uneconomic and economic factors which have alarmed the dependence on foreign loan. Thus, government has to undertake the programme and policies that help to accelerate the inflow of FDI is the best way to cut down the external debt. It becomes more helpful to increase the national income level which in turn, will make the debt servicing ability of the country stronger. Moreover, government should give the equal rights and opportunities to the non-residence Nepalese (NRN) who are interested to invest in Nepal.

APPENDIX I

Factor Affecting in GDP (in Rs Million)

Fiscal Year	Bilateral Debt	Multilateral Debt	Total external debt	GDP at factor cost
1981/82	109.9	620.0	729.9	30988
1982/83	66.3	919.5	985.8	33761
1983/84	217.7	1453.2	1670.9	39390
1984/85	399.4	1353.6	2501.1	44441
1985/86	525.2	1975.9	2705.8	53215
1986/87	343.6	2362.2	3815.8	61140
1987/88	568.6	3247.2	5666.5	73170
1988/89	685.6	4672.3	5959.6	85831
1989/90	1287.3	3954.2	6256.7	99702
1990/91	2302.5	4219.7	6609.5	116127
1991/92	2389.8	5405.2	6712.8	144933
1992/93	1307.6	8580.5	9163.6	165350
1993/94	582.9	6595.0	7313.2	191596
1994/95	717.3	903.3	1363.3	209976
1995/96	460.0	8192.9	9043.6	239388
1996/97	850.7	9740.0	11054.5	269570
1997/98	1314.5	11268.4	11852.4	289798
1998/99	584.0	11054.3	11812.2	330018
1999/00	757.9	11457.3	12134.0	366251
2000/01	586.7	7611.6	8481.6	394052
2001/02	870.0	1872.0	7698.6	406138
2002/03	32.1	3889.2	4546.4	437546
2003/04	66.0	7563.0	7929.0	474919
2004/05	125.5	9139.6	9265.1	508651
2005/06	40.6	8173.7	8214.3	557869

Source: Various Issues of Economic survey MOF

APPENDIX II

LINEAR REGRESSION MODEL

S.N	Variables			Result Regression Coefficient			R^2	Adj.R^2	t-test			F-test
	Dependent	Independent		a_0	a_1	a_2			a_0	a_1	a_2	
1	GDP	TED	-	65465.71	25.42145	-	0.87	0.86	3.290	1.18	-	10.84
2	GDP	BD	MD	11.02166	-0.3823	0.3811	0.78	0.76	-1.98	2.29	8.45	3.08

GDP = Gross Domestic Product

TED = Total External Debt

BD = Bilateral Debt

MD = Multilateral Debt

R^2 refers to coefficient of multiple determinations

Adj.R^2 refers to coefficient of multiple determinations

Source: Appendix I

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