CHAPTER I

INTRODUCTION

1.1 Background

Public debt is a legal obligation of the part of a government to make interest or amortization payments to holders of designated claims in accordance with a defined temporal schedule (Palgrave Dictionary). Public debt is defined as a kind of tax through which public enjoy the advantage of public expenditure. After the Second World War, public debt seemed a very vital source of development expenditure, most of the countries in the world started to borrow systematically and still borrowing to develop their economics at a faster pace (Joshi: 1982).The phenomenon of public debt was originated in Great Britain in the 17th century where a group of merchants provided grants and loans to the government. In return, they received the privilege of royal charter to fund the Bank of England which becomes the country's Central Bank. There are discrete references to the great king, Prithvi Narayan Shah, raising revenue and even borrowing from the public for the purpose of unifying the kingdom of Nepal. Even Chandra Shamsher is reported to have borrowed money from Pashupati Nath Temple to resettle the emancipated slaves around A.D. 1925(Sharma: 1998).

In the context of Nepal, the government debt statistics indicates that Nepal remained debt free nation till 1950. But unfortunately Nepal being a developing country, could not be free from debt burden after the 1961/62. After 1990, it has increased to Rs. 2939 million in FY 2002/03. About 38% of the Nepalese people are below the poverty line even it is beautiful, small and covered with natural resources. Government has to invest huge amount in the field of physical infrastructure to reduce poverty.

The government of a country may borrow because current revenue may not be sufficient to meet its increasing expenditure. In the context of UDCs like Nepal has been passing through the critical phase of equilibrium trap, vicious circle of poverty and huge resource gap. This problem can be solved not only by the investment from private sector but also by the deliberate actions of the government in the field of transportation, communication, power, Road, other basic infrastructure and directly productive activities. For this the regular sources of government revenue are insufficient to meet the required expenditure. So, government has to make deficit budget. Which depend upon borrowing from internal and external sources. External sources include foreign loan and grants from bilateral and multilateral agencies whereas internal sources include individuals, financial institution, non banking financial institution, commercial banks, central bank etc.

In recent years, the subject matter of public debt is concerned with economic and social development of the country. There are several technique of financing economic development that are put into operation in the process of economic development of underdeveloped countries. Thus, public debt is considered as an effective instrument of fiscal as well as monetary policy which helps to increase revenue generation, saving mobilization and control the inflation. Public debt is usually more familiar with underdeveloped countries rather than developed countries because the scope of domestic borrowing in these countries is very limited due to the lack of internal resources gap. At the same time, most of the UDCs face the shortage of foreign exchange. Therefore, only external borrowing remains the alternative to undertake by these countries.

The persistent features of Nepal’s public debt both internal and external have been increasing rapidly each year. The trend of external debt is increasing more rapidly in absolute terms than internal debt. Since developing counties like Nepal always need foreign currencies to import many capital goods that are required for development. These countries have to depend more on external borrowing than internal borrowing. Like other UDCs, Nepal is also indebted from the external debt and seems likely to increase further. Hence Public debt in underdeveloped countries can be considered the surest weapon to kill all economic ills.

1.2 Statement of Problem

Developing countries like Nepal are moving around the vicious circle of poverty. Nepal is facing problems of financing ever-increasing resource gap because government expenditure is increasing rapidly but government revenue is not increasing in the same pace. The government needs revenue to maintain the administration, law and order, protection against foreign aggression and for overall economic development. To cope with this taxation alone is not possible to raise sufficient funds for the development of UDCs due to low per capita income. Even tax is most important source for finance but it is impossible to raise adequate fund in this present scenario. Where people's wants are increasing day by day. Consequently, Nepal, being an underdeveloped country is facing the problem of acute financial resource gap on the one hand and increasing inflation on the other.

In Nepal, about 80 percent of the budgetary deficit was financed by external borrowing in most of the fiscal year but it never think about the repayment. Therefore, it can be said Nepal is heavily indebted from external debt. The increasing dependency of the country upon the external borrowing is due to poor and inadequate internal resources mobilization to meet the growing needs of the development funds. Both the scarcity of internal resources as well as necessity of foreign capital have caused for such massive in external borrowing. Ever increasing external debt and debt service obligations will create a serious problem in the economy. The single factor for raising those problems is poor management of the domestic economy. Thus, Nepal is going to face debt crisis in future which debt bearing obligation would become major implements to the balanced management of the economy. Nepal has less ability to develop its economic and social condition by itself from the present level of domestic saving. In order to break the vicious circle of poverty and to improve social condition of the people, there is a greater debt of government borrowing. But government borrowing itself is not the medicine if it is not properly utilized.

Therefore, government borrowing may be the unnecessary evil for developing countries like Nepal.

In recent years, Nepal has been raising public debt from external and internal sources which has been increasing very rapidly particularly after 1990, when multiparty democratic system was reinstated in Nepal. Nothing is changed besides economic crisis, inflation, internal conflict tax burden, unemployment, inequality etc. due to the rapid growth of unnecessary debt. Nepal is also, to a large extent, facing ever increasing trade deficit and investment domestic saving gap, which are must significant indicators of macro economic imbalances. These make necessity for excessive dependency upon foreign assistance. Thus, these all factors have forced to increase foreign dependency. That's why there one saying "Nation once begins to borrow would be resist until it reached the point of Bankrupt".

The share of public borrowing to improve our economic condition has been increasing with some fluctuation since 1990. What is the effect of public debt in the development sector? Has there not been significant effect of debt in social sector? These are some of the pertinent question that needs to be answered. Hence it has inspired me to undertake this research.

1.3 Objectives of the Study.

The major objectives of this study are to:

- Analyze the structure of public debt in Nepal for the period 1989 - 2004
- Examine the burden of public debt and the problem of debt servicing.
- Recommend for optimal utilization of debt.

1.4 Significance of the Study.

The process of economic development in Nepal has started since the first five year plan in 1956. Since then the magnitude of development expenditure has been increasing because of the growing demand for fund. Particularly after 1970 the volume of budgetary deficit has been increasing. For meeting these deficits GON has been raising funds from both external and internal sources.

On the one hand, Nepal is facing serious and growing fiscal deficit and on the other hand, problem of inflation. In this situation, only the internal sources are unable to meet the growing of public demand into the fiscal as well as monetary sector. Therefore public borrowing is important to trace out the public willingness, social necessities, economic progress etc. Public debt stimulates and create appropriate long run plan for the growth of money and capital markets in an economy. In the UDCs both the money and capitals markets are unorganized and in the very primitive stage of development. But the proper development aspect of public borrowing program helps to develop both the money and capital market. With the expansion of treasury bills the money market develops. Similarly, with the expansion of bonds the capital market developed. In this regard, the government will not be interested merely in borrowing at minimum possible cost but it may also endeavor to create such atmosphere, which might encourage the growth of money and capital market in the economy. After reading this thesis report, next generation would get a perfect knowledge about debt and its role on the development prospect, and it also implies in which perspective public debt is beneficial or not.

1.5 Methodology

In this study, adopted methodology is descriptive in nature and mainly based on the secondary source of data.

1.5.1 Source of Data

This study is primarily based on secondary data and information is obtained from various sources as budget speeches (1990-2004), Economic survey, publication of Ministry of Finance and Nepal Rastra Bank, Central Bureau of Statistics etc.

1.5.2 The Research Design

The goal of this study is analyzed the role and effectiveness of public debt especially after 1990 and trace the trend of growth of borrow in development sector. So this study is done an exploratory as well as explanatory type. Data collected from different sources are presented systematically to use inductive method and other careful information and necessary interpretation is cleared in descriptively.

1.5.3 Methods of Data Analysis

The collected data from various relevant sources is processed according to the need of the chapters. The available data from various documents are collected, classified and tabulated to meet the needs of the study. Mathematical tools are not used for analyzing the data because this study is in descriptive method.

1.5.4 Tools for Analysis

The study is basically based on simple tools, such as percentage, average annual growth rate, and arithmetic mean etc. Similarly, the ratio to excess burden of debt and debt services problem has been estimated which are as follows:

(a) Resource gap.
  - i. Revenue deficit.
  - ii. Fiscal deficit.
  - iii. Domestic resource gap.

(b) Ratio of resource gap to GDP.

(c) Deficit financing.

i. Ratio of internal loan.

ii. Ration of external loan.

(d) Ratio of annual total debt servicing to GDP.

(e) Ratio of annual total debt servicing to government revenue.

(f) Ratio of annual total debt servicing to regular expenditure.

(g) Factor affecting public debt in Nepal.

i. Ratio of domestic saving to GDP.

ii. Ratio of domestic investment to GDP.

iii. Gap between saving and investment.

(h) Compound rate of growth of all variables.

1.5.5 Definition of Terminology

Public Debt

Public debt refers to loans raised by a government within the country or out side the country.

External Debt

It is the government borrowing from international sources, agency or autonomous bodies through bilateral and multilateral agreements.

Internal Debt

It is the government borrowing from domestic banking sector and individuals.

Budget Deficit

It is the revenue gap between the total expenditure minus total revenue plus foreign grants. In other words, it is the excess of government's total expenditure over its income.

Fiscal Deficit

It is the gap between total expenditure minus total revenue of the government.

Debt Servicing

It is the international payment on loan and repayment of principal after maturity.

Debt Trap

When the government borrows new loan to pay the previous one is called debt trap

Gross Domestic product

It is the measure of the total domestic output at factor price.

Gross National Product.

It is the measure of the total domestic and foreign output claimed by residents of an economy less the domestic output claimed by non-residents. GNP does not include deduction for depreciation. Data on GNP are taken from socio-economic data unit of the World Bank's and international economic data department.

Current Account

Transactions where the payments are income for the recipient. A country's balance of payment on current account includes trade in goods, or visible; Trade in, or invisible payments of factor income including dividends, interest and migrants, remittances from earning abroad; and internal transfers, that is gifts. Current account is contrasted with capital account where transactions do not give rise to incomes. Represents changes in the form in which assets are held

Current Account Deficit

It is an excess of expenditure over receipts on current in a country's balance of payments.

1.6 Limitation of the Study

The major limitations of this study are as follows.

- This study covers fiscal year 1989- 2004 because of limited time, budget and resources.
- This study carries on secondary source of data.
- This study does not cover the effects of public debt on some macroeconomic variables like money supply, price level etc.

CHAPTER II

REVIEW OF LITERATURE

The classical economists were against public borrowing and favored the minimum expenditure from the government side. From the very beginning of the 19th century, economist have been arguing and discussing for and against the public debt. Classical economists such as Pigou, T.R. Malthus, J.B. Say, Ricardo, Adam Smith, C.E. Bastable visualized their view against the government borrowing saying, "Nation once began to borrow would be resist until it reached point of bankrupt". In stead they said that, 'Let money fruiting on the pockets of the people'. The classical economists preferred self-liquidating project that government required income to serve the incurred debt.

Chelliah (1914) observed that, "The ideal situation of one in which first revenue will meet subsidies other transfer, interest payment and the greater part of current expenditure, debt finance will be used for meeting the government's non ruminative capital formation, proposition of current expenditure designed to increase social and productivity requirement of financial investment and second the total of domestic borrowing will be determined in such way that given the rate of domestic saving, the non-government sector will be to obtain a due share of saving and that there will be no need to borrow from the central bank more than current amount of seignior age. He enumerates the following points which indicate public debt useful on behalf of:

- For macro economic stabilization.
- Financing emergency expenditure.
- For something out tax rates.
- Inter general justice.

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

$$D \text{ X} \frac{Y_t \text{ Z0}}{r}$$

Where,

D = Maximum sustainable national debt.

0 = Constant expenditure for ordering government operation.

Y_t = Maximum ratio of tax rate receipts to national income.

r = The contractual interest rate of government debt.

However, the burden controversy depends upon the nature of investment, productive or unproductive. If it is productive, there will not be a burden because of creation of real asset in the economy. This further generates income of the people thereby increasing national income. If it is unproductive, the situation will naturally be burden some on the government. (S.K. Singh, 2001: 367).

Post Keynesian economist advanced their idea that government borrowing does not always deprive the private economy of resources as, for instance, in a period of widespread unemployment. They suggested public borrowing is not necessary in the period of full employment, then it will invite inflationary gap. In this situation, internal resources should be mobilized in the maximum form. A large public debt, if internally held, poses many problems for the economy. They thinks that income, saving and investment are the crucial factor to achieve steady growth for developing countries. So, the overall aim of borrowing is not to equalize income in different countries but to provide every country with an opportunity to achieve steady growth, on the other side, people and the developed countries are enjoying high prosperity, high standard of living, high educational facilities etc. population problem is also not to serious in such economies.

According to **Godde**, “Borrowed money when used to finance public investment cause no such reduction, all that will happen is the change in the consumption of capital formation, the inference is that failure to restrict borrowing to the finance of investment will retard economic growth. A weakness of the agreement is that not all outlays classified as investment actually contribute to growth, while some expenditure usually classified as government consumption to promote growth. Michael Posner points that growth in the debt ratio caused alarm for two reason and growth in debt ratio might lead to crowing out of private investment and more important, is the assumption that government spending out of the borrowed finds might be unproductive. Harold G. Moulton considers, “Public debt as a national assets rather than liability and lays that it is essential for the prosperity of the country.

J.M. Keynes After the great depression of 1930’s, , who advocated for increasing government role in the economic activities by adopting deficit financing so that effective demand is created in the economy ensuring employment opportunities. He advanced the concept of under employment equilibrium and who effected a truly significant revision in the theory of public debt. Keynes argued that debts are internally held, there is nothing to worry about their size, such debt involves merely a series of transfer payments and they cancel out for the economy as a whole. Hence the only concern should be about economic stability at high level of income and employment. Keynes also stressed challenged the version of classical economists and opinion on the subject of burden of public debt. He submits that there is no shift of the debt burden to the future generation because the same posterity which pays the additional taxes will be benefited from the repayment of the debt.

Hanson (1941) has written an article on effect public borrowing on redistribution of income where net transfer of resources from lower income groups to upper income groups. He further states that, “If government borrowing to taken from the small savers, the increase in the size of public debt will not prove unfavorable to an equitable distribution of wealth. But if the growth of it is very rapid, it will not be possible for relatively small savers to take any large proportion of new securities issued. They will be absorbed by the rich and the well-to do and by large corporations. A rapid growth in public debt is therefore likely to intensify inequalities in wealth distribution".

Harris (1947) says, "It assumes elasticity in money supply and agreed that government expenditure could be productive and need not necessarily be waste full and so case for public borrowing is strengthened. Those who follow can take into account the income generation aspects of the public debt and reject any possibility of internal debt being burden upon the community. Debt creates burden on the economy because of its unproductive nature".

Groves (1950) wrote that James Stuart propounded the views that public debt should function as the balance wheel of the economy. Stuart's view as presented by Walter F. Setter is as under, "Public borrowing must be adjusted to the condition of trade at the particular time. Public borrowing is in appropriate as long as 'circulation is full' because it would only raise the rate of interest and have undesirable consequences is stagnation in one part of the economy and there is unemployment and a slackening of trade and industry, the state should absorb this excess and through its expenditure throw it into new channels of circulation. Thus, the use of public credit is conceived as the balanced wheel in the economy. It keeps resource fully employed and prevents stagnation in any point of economy from having an adverse effect else where. In addition, public credit is a necessary instrument of war finance"**,)**

Lerner (1955), the classical economist, viewed, "The internal debt may not have direct money burden in a community as a whole, because it is a transfer of fund our pocket to the other from the left hand to right hand". He further says, "An internal person or international loans yields the borrower a real benefit. It enables him to consume or invest more then he is earning or producing. In addition, when the pays interest or repays the loan he must tighter his belt, reducing his consumption or his investment. In the case of national debt, we have been let out when borrowing and need not be tightened when repaying."

Barman (1986) observes that now a day; especially in developing country, public debt is used as a fiscal instrument to raise the effective demand, which ultimately leads to accelerate the pace of economic development. It also acts as an effective instrument of monetary policy for combating with inflation generated in the process of growth and ensures growth with stability. Therefore, it is known as a balancing wheel that controls the tempo of business cycle. The compensatory fiscal policy suggests increase in public expenditures and public works by mobilizing idle saving through public borrowing to create effective demand and to promote economic recovery.

Burden of debt emerges an account of the adverse effect of taxation upon the ability and willingness to work and on the capacity and willingness to save is the secondary one, which is the real burden to the public debt. The secondary burden of public debt can be explained in terms of "Pigou Effect" or "Asset effect" and "Kaldor Effect". According to Pigou effect, "Due to purchase of government securities the financial asset of the investor increases that adversely affect the prosperity to save in the economy. It may prove to be a boom in a depression but it is not always the case in developing countries." According to kaldor effect, "Holding of the larger debt not only adversely effects willingness to save but it also adversely effects the work in invest on increase in the national debt man make the owners of government bond less willing to work. One of the reason for working , the earning of money to put away of the rainy day in weakened because there is more put away already for rainy days."

Adam smith also favored balance budgeting and rejected unrestricted borrowing. Two conditions were put by smith to adopt debt, which are;

a. For war finance.
b. For establishing social and economic infrastructures.

For all the rest conditions, classical economists preferred taxes than debt for the following reasons.

i. Debt financing means an increase in public debt. Since it is an easy method of obtaining income which leads government to be extravagant and irresponsible, that's why public imposes definite burden on the economy.
ii. Debt servicing (payment of interest) and refund of the principle will require additional taxation. It might prove to be difficult since government power to tax is not unlimited.
iii. Deficit financing might produce currency deterioration and rise inflation.

Buchanan (1965) wrote that Distinguish between loan and tax, C.F. Bastable has clearly wrote, "A loan is voluntary and supplied by willing alike. To make things smooth for the present at the cost of the future is not the duty of the wise and far-seeing statement."

Samuelson (1992) holding the same argument, he states that, "An internal debt is owned by a nation to its own citizens and it poses no burden. An external debt is owed by a nation to foreigners and it is burdensome.

Posner (1992), a recent thinker**,** points that growth in the debt ratio causes alarm for two reason, First, growth in debt ratio might lead to crowing out of private investment, second and more important, is the assumption that government spending out of the borrowed funds might be unproductive.

Musgrave (1995) "self-liquidating projects may be defined narrowly investment in public enterprises that provide a fee or sales income sufficient to serve that debt incurred in financing, or they may be defined broadly as expenditure projects that increase, future income and the tax base. Such project permits serving of the debt incurred in their financing without requiring an increase in the future level of tax rate".

Hence, we can see the different view of different time period of economists. Here, we should not forget that scholar who was recognized by a great over a time period. They are follows as;

2.1 Reviews in International Context

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

Let,

T= Di

Where,

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

I= rate of interest paid on debt

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

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

$$t \,\mathrm{X} \frac{T}{Y}$$

$$\mathrm{X} \frac{Di}{Y}$$

$$\mathrm{X} I.\frac{D}{Y}$$

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

$$t \quad \mathrm{X} \quad \frac{1}{\frac{1}{i} \qquad \frac{G}{b}}$$

$$\mathrm{X} \quad i\,.\,\frac{b}{G}$$

Where,

G = rate of growth of income,

b = ratio of deficit to income.

This equation shows the burden of debt 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 increased. Or the burden of debt (t) and ratio of deficit to income (b) and rate of interest paid on debt has positive relationships. Likewise, burden of debt (t) and rate of growth of income (G) has negative relationship.

Avramovic and colleagues (1964) a book published from World Bank approached external borrowing in terms of a country's debt servicing capacity. They provided as useful framework for the examination of external borrowing: assuming that country borrows only to help finance well-conceived development programs. Avramovic and his co-authors visualize three stages in the external debt cycle. In stage one; the country's saving is below the desired level of investment. It borrows from abroad to finance part of its investment and also to service the external debt. The burden of debt servicing is continuously differed and debt increase rapidly. In the age two, saving has grown enough to finance all domestic investment however, the country continuous to borrow abroad to cover service cost of debt. The external debt grows but at a slower rate in stage one, at the end of the stage two it reaches a maximum. In stage three, the country stops borrowing abroad to cover interest payments and being to reduce the external debt. A very poor country may take a long time to move through stage one and two, if the return on capital obtained by foreign borrowing is low relative to the interest rate, may never reach stage three.

Munla (1992) in his article entitled, “External Debt Policy” has analyzed the origin of debt problems and explained. The debt crisis had its origin in the substantial rise in the external liabilities of the developing countries during the second half of the 1970s and early 1980s, in an environment of large –scale recycling of the oil exporter’s surpluses rising world inflation and negative real interest rate. At the time many viewed this recycling of funds as a positive development: creditors were able to identify new investment out less and deters could acquire funds needs for development purposes".

He again explained that an external debt crisis was due to ;

1. A drastic deterioration in external economic environment in form severe recession in the industrialized economics;
2. Economic mismanagement and policy errors in debtor countries; and
3. Excessive lending by commercial banks to some countries, with little regard to country risk limits.

In this article Munla contributed towards principle of the debt strategy and pointed out three fundamentals principles which are:

1. Debtor countries need to pursue strong adjustment programs, 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 of adequate external financing in support of such programs on a case-by-case basis; and
3. The internal economic environment must be conducive to the success of these efforts.

Sabater (1995) a Discussion paper was prepared by united Nation Conference on trade and development "Multilateral Debt of Least Developed Countries." This paper has discussed on problem of multilateral debt as sustainability, liquidity and accumulation of large-scale arrears. The discussion paper has also evaluated recent schemes to provide debt relief and suggested possible measures to strengthen and improve existing schemes as well as present other innovative obtains. The analysis focused mainly on the least developed countries (LDCs). Thirty seven of this countries registered multilateral debt arrears in 1993, 29 of them are classified by the World Bank and IMF as heavily indebted poor countries. There are 48 countries classified in 1995 by the United Nation as least developed countries.

Trippen in his article pointed out that debt of the banks in the 1980s prevented the international financial system from collapsing; still there was not financial solution of debt problem in sight yet. The observed capital flighty from Latin American Countries was a symptom of seriously economic, social and practical problem in consequence of the debt crisis. The national economic difficulties of the debt countries were aggravated by overvalued currencies and negative real interest rates **(Borchert and Schinke, 1990; 241).**

2.2 Review in Nepalese context

In review of literature on public debt in Nepalese context some of the students of master level specially say, have or university and some writers have preceded to male their dissertation and article on public debt. Some of these have focused its structure and importance where others have in its burden impact inflation, employment and national solvency etc. These thesis paper and articles have also enriched the importance, role, need and scope of public debt in macro economy. However, the student of economics and to make a thesis an such like context but it emphasis the Nepalese system and practice on public debt of Nepal.

Joshi (1982) has submitted a dissertation paper titled, “structure of Public Debt in Nepal” pictured the poor economic performance of the nation, which is due to nation's natural topography and human behavioral limitations. He concluded that internal borrowing is most essential to development money and capital market in the nation. External borrowing should be mainly for the rapid economic development. He describes the external debt as supplementary tool for three sources gap in the countries budgetary expenditure.

Adhikari (1996) in her article entitled, “Foreign Debt Servicing: A Case Study” analyzed the foreign debt servicing problem in Nepal. She found out substantial increase in foreign debt servicing. She prescribed effective implementation of liberalization policy in all areas of investment. This can bring a great relief to the country by creating capacity for foreign exchange earning which can reduce burden of debt servicing substantially in the years to come.

Reading all these previous report by different scholars, we have come to know that the main reason of borrow is to develop the rapid economic growth and causes of debt burden is that inappropriate or expensive fiscal policy, very low tax effort, poor maturity mix of the debt burden and borrowed money is used for debt servicing.

Guru Gharana (1996). An article on “The role of foreign aid in economic development and poverty alleviation” presented data on the share of out standing foreign debt in GDP at factor cost and of foreign debt servicing in regular expenditure (1984/85-1993/94). He found long term upward increasing trend of such ratios. He concluded that “Although foreign loan is relatively much softer terms for Nepal compared to India and China, the very low rate of return and increasing share of loan in foreign aid implies that aid is slowly pushing Nepal towards a debt crisis in the coming year.”

Sharma (1998), in his article on, “The growing imbalance in Nepal, Are we really falling into debt trap?” analyzed that the increasing trend of debt in Nepal and its servicing has really created a situation which leads the country debt-trap because of the following reason.

- Huge amount of loans is allocated for meeting expense within the development expenditure.
- A good amount of borrowed fund is for debt-servicing.
- Volume of borrowed amount exceeds the maximum legal limited of borrowing.

Acharya (1998) in his article entitled, “Burden of Public Debt in Nepal” analyzed the debt-servicing problem of Nepal. He expressed the situation using ever widening saving investment gap, persistently growing share of regular to total expenditure, Gross Domestic Product (GDP), government revenue, per capita debt burden and increasing trade gap. Three factors clearly indicate that the ever increasing debt burden. On the other hand, he concluded that the poor performance of the economy has failed to create productive capacity for meeting the situation. At the end of his article, he raised issues for debate; does the present of generation have the right to burden the future generation with debt even before they are born?

Khanal (2000) in his thesis report entitled, “Public debt in Nepal” has analyzed the crucial points about public debt. He argues that trade deficit, investment saving gap and large amount of fiscal deficit have been the fundamental constraints and issues to increase foreign dependency in the Nepalese economy. Therefore, there has been excessive flow of foreign loans to bridge up three gaps (fiscal deficit, trade deficit and investment saving gap). He has further says that the substantial increase in foreign debt has increased its burden of debt servicing but debt-servicing capacity of the economy is not increasing satisfactory. Therefore, he has recommended that through this problem of out standing debt servicing, Nepal should have to take immediately action in creating servicing capacity.

Kunwar (2002), in his dissertation entitled, “government borrowing: System and practice in Nepal” has analyzed that government of borrowing has been increased unlikely and financed mostly on the unproductive sector and hence government always lacks the resources, then borrow the new loan to pay the previous ones”. He argued that such excessive dependency upon external loan may lead the nation into a debt trap, if the terms of trade are not improved. Therefore extra care should be exercised in procuring such loans”. (k.B. Kunwar, 2002).

CHAPTER III

FISCAL MEASURES FOR RESOURCE MOBILIZATION

3.1 Introduction

The underdeveloped countries are caught in the vortex of what is commonly known as vicious circle of poverty, where poverty breeds poverty. To move out from such circle, capital formation, which is regarded as a prime mover of development, is necessary.

In the advanced countries, the automatic forces of capital formation finance the development. Under the free market economy, capital formation is mostly self propelling and unceasing. But this view of capital formation can not be transplanted in the soil of underdeveloped countries. If the underdeveloped countries rely on the automatic way to capital formation and nurture the policy of leissez-faire on the western model for their development, the economy will not flourish and it will be left at the same stagnation point from where it has remained. Hence, these countries cannot get rid of the vicious circle of poverty, so, the problem of mobilization of resources is somewhat different in underdeveloped countries from that of advanced countries.

It is difficult to consider any single factor as the prime mover in the process of economic development. Development conscious people, a reasonable abundance of natural resources, a sprit of natural resources, a spirit of enterprise, a technically trained labor force, well developed financial market and dedicated civil servants are the essential requirements for achieving rapid economic development, but capital formation or mobilization of financial resources is fundamental to the whole problem of economic development. To ensure adequate supply of capital without which economic progress cannot be achieved, appropriated methods of mobilizing financial resources have to be adopted. Financial aspects of the development is as important as other aspects of development and it warrants proper attention as Hicks mentioned, "choosing the appropriate methods of finance can not make a bad plan good but it can make it better. Using the wrong methods can wreck even the best plan". **(Hicks: 1965)**

When money and capital market (combined, known as financial market) and their networking is spread all over the country then the economy of all the regions are monetized, commercialized and made more productive use of local resources. What it said is, financial market is the life-line of the economy", because it canalizes resources from surplus unit to deficit unit.

The dominance of the non-monetized sector make mobilization of financial resource difficult, because there is no incentive and few opportunities to save, resource mobilization for development is comparatively difficult and also the policy measure of the country to promote development will be less effective. And some of the non-bank financial intermediaries (so called SAHU-MAHAJAN) which offer higher interest rate for attract and divert funds to speculative trade and unproductive private expenditure and came in the way to mobilization of financial resources for the developments.

In a developed economy, the level of income being high, saving is automatically generated and in such an economy, fiscal policy has nothing to do for stimulating capital formation expected providing tax incentives to savers. But, in a low income country, like Nepal, a vigorous fiscal policy must be adopted to maximize and mobilize domestic saving for required investment. The availability of capital funds can be increased through compulsory saving by the help of various fiscal instruments like taxation, borrowing deficit financing and import restriction

3.2 Fiscal Policy in developing Courtiers, and Capital Formation

Fiscal policy is a package of economic measures of government regarding its public expenditure, public revenue and public debt or borrowing. It also outlines the influence of the resource mobilization on the level of aggregate consumption and investment expenditure in the economy. Therefore it refers to the instruments in which a government tries to regulated or modify the economic affairs of an economy.

Dearth of capital is significant bottleneck of underdeveloped countries. Therefore, priority should be given into capital formation as well as growth with stability. To achieve rapid economic development with reasonable monetary stability, fiscal policy has to serve both the objective of capital accumulation and maintenance of stability. As Higgins observed "The sheer poverty of underdeveloped countries makes the raising of the propensity to save as well as inducement to invest a necessary part of fiscal policy". **(.Higgins: 1959)**

Thus in the context of developing economy the objectives of fiscal policy may be enumerated as follows:

1. To mobilized resources for financing the development through discouraging consumption and mobilizing hidden surpluses.
2. To siphon off the additional income generated in the process of development from those who are better off with such income rise in order to promote growth with stability.
3. To encourage innovational and technological change so that output can be expanded and input substitution is encouraged.
4. To bring about equitable distribution of income in course of development to create egalitarian social structure. For achieving this goal progressive fiscal measures must be implemented.

Volume of voluntary saving is disproportionately very low in developing countries. Therefore, the financing of development plans poses very difficult problem for the government. This problem can be solved to some extent by withdrawing those resources which are used for the purpose of unproductive conspicuous consumption and unproductive investment. In this context, both actual and hidden surpluses are to be mobilized effectively. It can also relieve some pressure from the dependency on foreign grants and loans. For mobilization of substantial volume of resources, it is necessary to withdraw resources from essential consumption. Therefore, the government of the developing countries is compelled to resort to the device of force-saving for mobilizing adequate volume of resources.

"Incremental saving-ration or the marginal propensity to save", as a crucial determinant of the economic growth. **(Nurkse: 1958)**

In developed economy, the level of income being high, saving is automatically generated and in such as economy, fiscal policy has nothing to do for stimulating capital formation except providing tax incentives to savers. But in a low-income country like Nepal a vigorous fiscal policy must be adopted to maximize domestic saving. The availability of capital funds can be increased through compulsory saving in the form of import restriction, taxation, borrowing and deficit financing.

3.3 Taxation: Its Role and Limitations

Taxation has become a main source of resource mobilization to meet the financial requirements for the government. The tax system should be helpful in income redistribution and economic stability. "Taxation is the most important source of development finance for direct contribution. It can make indirect effects on control and incentive with narrowing the gap for available income"**(Hicks: 1965).** John F. Due argued that "the taxation is the function of economic development to-combat inflation, reduce the gap between haves and have not, promote the national economy, mobilized the domestic resource for the economic development and save the domestic economy" **(Due 1979: 17).** Therefore, in an underdeveloped country, which has very low rate of voluntary saving, compulsory saving through high rate of taxation is considered as the best means of mobilizing resource for development.

The structure of Nepalese taxation has undergone great changes in the contest of reorienting the policy to the needs of economic planning. Taxation of income is considered by most of the developing economy as an important means of increasing revenue of the country. Income tax has an important place in the Nepalese tax structure not only because of its revenue potential, but also because of its contribution on equity and distribution justice. Taxation of foreign trade is another important source of revenue of the government. Mostly on the revenue account, the government received large amount of revenue from foreign trade taxation. With reference to Nepal the revenue is classified into two categories: tax revenue and non-tax revenue.

In adequacy of fund for development is the main problem in developing countries. Proper formulation of tax policy and its effective

3.4 Deficit Financing

If the internal saving is not enough to finance, huge developmental requirements is essential to the economy. Where the orthodox principle of balanced budget is strictly followed and investment is tied to the current level of saving. When the growth will be slower; government can finance the gap through borrowing from the central Bank or through withdrawing from cash balance i.e. by way of increasing the money supply in the economy. This type of financing of the government expenditure which causes expansion in the quantity of money is termed as deficit financing.

The nature of underdeveloped countries is such that sufficient private investment is not forthcoming due to the various social, economic and institutional factors. Deficit financing, as an instrument of economic development, has been given an important place in Nepal's development plans. It has been regarded as a means to cover the gap in financial resources for want of adequate internal and external monetary sources in order to fulfill the physical targets in the plans.

However, deficit financing always doesn't provide a viable long-term solution because of its establishing effects on the economy. Because heavy does of money infected in the economy through deficit financing has obliviously inflationary impact on the economy and also creates the problem of monetary stability, which makes the fruits of development meaningless.

So, greater stress needs to be placed on the mobilization of domestic resources for financing of development programs in Nepal. In this context, public borrowing can be taken as effective instruments for mobilization of domestic resources for development in Nepal.

3.5 Public Borrowing and Resource Mobilization

The fiscal measures of public borrowing for resource mobilization are of recent origin. Professor groves maintains, "Public borrowing in relatively modern development, it did not appear as a regular and important feature until the letter part of the 18^{th} century. He further holds the view that on account of certain favorable conditions such as the appearance of money and credit economy, development of industry and trade, the security of the creditors etc, public borrowing emerged as an important institution".

Mobilization of the resources largely is unavoidable for the proper economic growth of a country. In the absence of adequate resources, it becomes costly and difficult to undertake development works. Therefore, the dependence of the state on any particular source to finance development is not justified. It is essential that resources may be mobilized through all the possible sources in order to meet the growing financial needs of all economy. Taxation, public enterprises, deficit financing and foreign aid alone may not be sufficient to meet the required fund for financing the growing economic development of a country or in other hand we can say that public debt is a sovereign remedy of all economic ills (it is the grand panacea of the modern age). Therefore, it is proved that borrowing is supplementary resource to solve the difference economic gap.

Resource mobilization through public borrowing is important as a source of investment in the development works. Public borrowing when invested in some development works has positive implication over the growth of national economy. On this account, public borrowing need not be discouraged so long as it helps to increase the productive assets or productivity of the economy on the one hand and the real saving of the community on the other.

In modern era, public borrowing is applied in the development process of underdeveloped countries in a wider perspective. It is used not only for meeting the huge wasteful expenditure or for recovering the deficiency of effective demand but is used as an instrument of fiscal policy for mobilizing saving for development purpose and also as an effective instrument of monetary policy for combating inflation created in the process of growth, thus ensuring growth with stability.

Developing countries have increasingly resorted to sue of public borrowing mainly on the following grounds.

1. The paucity of fund to meet growing demand for funds has necessitated the borrowing process. So, government like other private concerns should issued securities to borrow funds from individuals or banking sectors to meet demand for funds.
2. The urgent need in developing countries is not augmentation of effective demand but expansion of the productive capacity. So, borrowing as a method of financing for development is quite suitable as it has less expansionary effect on the money supply than deficit financing.
3. Borrowing creates fewer burdens than taxation.
4. Public borrowing can be regarded as the most flexible as well as monetary measures. Taxation has its own which limitation, after certain limit it cannot be levied, deficit financing proves devolve in boom but borrowing may be accepted as analytical measure.
5. Public borrowing is a revenue generator as well as stabilizer. As a fiscal measure it is a source of revenue to the government as it canalizes saving from the public to the state, but as a monetary measure, it is a weapon in

the armory of the central Bank to regulated the economy so that the inflation generated in the very process of growth may not take the form of hyper inflation.

In Nutshell, public borrowing plays a significant role in development process not only by supplying required funds but also in other respects. Firstly, Public borrowing establishes regular and acceptable channel for private investment otherwise than capital may be drained to other countries. Secondly, investment in government securities is the safest investment, which not only provides liquidity to the investor but also profit by the investment. Thirdly, public borrowing plays an important role in the development of money and capital markets. Government Treasury bill sand bonds are the main instruments of financial market, which are raised for mobilizing resources in right place.

Moreover, external sources of debt are supplementary in nature as internal saving mobilization is stagnant. The foreign source in the only option to finance development activities as internal borrowing capacity of an economy is determined by internal saving capacity, development of financial market, rate of inflation, interest rate and faith of people upon government etc. Therefore, public borrowing seems to be safe and effective measure for mobilizing resources for development. However, the debt policy should be formulated on certain grounds.

1. It should be used as an instrument for mobilizing savings in the economy that would have gone otherwise in the form of hoards, conspicuous or wasteful consumption or in buying land and real estate in urban areas.
2. Public borrowing should be adopted for the productive purpose so that the burden may not fall on the future generation.
3. Public borrowing should be adopted for giving opportunity to the people for safer and high yielding investment.
4. Domestic saving is the only reliable way for financing economic development but unfortunately the rate of domestic saving is very low in Nepal because of many reasons. In this context Prof. Galbraith has said

that domestic saving is very painful and is difficult than extracting blood from stone.

3.6 Importance of Public debt

In this modern age, we can fill, understand and see the attractive role of public debt. Even in the context of Nepal there is innumerable function, which would only go ahead by the help of debt, it does not matter weather it is internal or external. Debt is debt; government must have to repayment.

Nepal is a small and beautiful country endowed with natural resources. Nepalese economy is passing through the critical phase of low income level equilibrium trap, vicious circle of poverty and huge resource gap. These problems can be solved not only by the investment from private sector but also by the deliberate actions of the government in the field of several basic infrastructures. For this, the regular source of government revenue is insufficient to meet the required expenditure. So, government has to depend upon borrowing from internal and external resources. There are several other functions which would only possible by public borrowing. Its main important are given below:

1. to meet budget expenditure.
2. to remedy a business depression.
3. to develop the economy.

Similarly, public borrowing is also important to economic stabilization in so far as it stimulates and creates appropriate milieu for the growth of money and capital markets in the economy. In the underdeveloped countries, both the money and capital markets are unorganized and in the very primitive stage of their development. But the proper development of public borrowing program helps to develop both the money and capital markets. With the expansion of treasury bills the money market develops and with the expansion of the bonds the capital market develops. In this regard, the government may not be interested merely in borrowing at minimum possible cost but it may also endeavor to create such atmosphere, which might encourage the growth of money and capital markets in the country.

Public borrowing may also contribute to the economic development of under-developed countries by creating suitable environment for the growth of monetary policy. Monetary policy to a substantial extent depends upon the growth of public borrowing with the proper growth of public borrowing; it becomes easier to make the monetary policy effective through the technique of debt management. Through this technique of debt management the monetary authorities' success in regulating the quality of money in the economy by influencing the existing rates of interest are sometimes lowered to suit the cheap money policy and sometimes rose to attract the investment through debt management **(Jha:1984)**

3.7 Resource Gap in Nepalese Economy

Nepal has experienced a serious and growing resource gap since the start of the systematic budgetary system in Nepal. This is because the annual growth rate of total expenditure and that of its revenue are not increasing in the same pace. From FY (1951- 1961), the government used to finance such gap with foreign grants. Since FY 1964/65, the government started to borrowing domestic as well as foreign to fill up the gap. The extent of financial resource gap has shown in Table 4.1. Here, mainly there types of resources gap are found in the Nepalese budgetary.

Table 3.1

Different Scenario of Resource Gap (1989/90 to 2003/04)

Rs. In Million

Fiscal year	Government Revenue	Government Expenditure	Scenario 'I' Revenue deficit (Government Revenue. - Government Expenditure)	Foreign Grants	Scenario 'II' Fiscal deficit (Revenue deficit - Foreign Grants)	External Loan	Scenario 'III' Domestic Revenue Deficit(Fiscal deficit- External Loan)
1989/90	9,312.8	19,670.1	10,357.3	1,975.4	8,381.9	5,959.6	2,422.3
1990/91	10,729.0	23,553.8	12,824.8	2,164.8	10,660.0	6,256.7	4,403.3
1991/92	13,512.7	26,418.2	12,905.5	1,643.8	11,261.7	6,816.9	4,444.8
1992/93	15,148.4	30,897.7	15,749.3	3,793.3	11,956.0	6,920.9	5,035.1
1993/94	19,580.9	33,597.4	14,016.5	2,393.6	11,622.9	9,163.6	2,459.3
1994/95	24,605.1	38,795.4	14,190.3	3,937.1	10,253.2	7,312.3	2,940.9
1995/96	27,893.1	46,544.0	18,650.9	4,825.1	13,825.8	9,463.9	4,361.9
1996/97	30,373.5	53,423.7	20,350.2	5,988.3	17,061.9	9,043.6	8,018.3
1997/98	35,751.0	56,118.3	20,367.3	5,402.6	14,964.7	11,054.5	3,910.2
1998/99	37,251.3	59,579.0	22,327.7	4,336.6	17,991.1	11,852.4	6,138.7
1999/00	42,893.7	66,272.5	23,378.8	5,711.7	17,667.1	11,812.2	5,854.9
2000/01	48,893..9	79,835.1	30,941.2	6,753.4	24,187.8	12,044.0	12,143.8
2001/02	50,445.6	80,072.2	29,626.6	6,686.2	22,940.4	7,698.6	15,241.8
2002/03	56,229.7	84,006.1	27,776.4	11,339.1	16,437.3	4,546.4	11,890.9
2003/04	62,331.0	89,442.6	27,111.6	11,283.4	15,828.2	7,629.0	8,199.2
Average annual Growth Rate	13.8	10.8	7.6	18.6	5.9	5.0	18.5

Source: MOF/GON Economic Survey, F/Y 2004/05

Scenario ' I'

In Table 3.1, the resource gap is the gap between total expenditure minus total revenue of the government. This first scenario shows the revenue deficit, where we can see, and the increasing tendency mainly because of the increasing volume of total expenditure. The amount of total expenditure was Rs. 19670.1 million in 1989/90 has gone up to Rs. 89442.6 million in 2003/04, where as total revenue of HMG/N has increased from Rs. 9312.8 million in 1989/90 to Rs. 62331.0 million in 2003/04. This shows the public expenditure has dominated to government revenue

the growth rate of total expenditure during the period under review has been 10.8 percent per annum where as the annual growth rate of total revenue has been 13.8 percent. It shows the growth rate of revenue is greater than expenditure but in absolute terms the table shows the horrible increment of revenue deficit that was increased from Rs. 10357.3 million in 1989/90 to Rs. 2711.6 million in 2003/04 and average annual growth rate is 7.6 percent.

Scenario ' II'

This scenario shows the fiscal deficit by including grants but the result even in this case is not also encouraging, this is existed by the revenue deficit minus foreign grants. It is also called fiscal budgetary deficit. Grant is must potential source of foreign currency, which is solid instrument for government to import the capital goods and to pay the interest and principle of external debt. Foreign grants is not increasing in the desirable pace as it predicts, where it was Rs. 1975.4 million in 1989/90 to Rs. 11283.4 million in 2003/04. The condition of foreign grants was good in two years (i.e. F/Y 2002/03 and 2003/04). Due to these types of condition fiscal deficit was 8381.9 million in 1989/90 and Rs. 15828.2 million in 2003/04. Where we can see the average annual growth rate, i.e. 5.9 percent. It is happened due to the fluctuation of foreign grants.

During the review period, amount of bilateral and multilateral loans has increased tremendously which was created some sort if constraint in the performance of economy as a whole. Under the period of review the external loan only Rs. 5959.6 million in 1989/90 to Rs. 12044.0 million in 2000/01, but in last three F/Y it has seen decreased i.e. 7698.6 million in 2001/02 to Rs. 7629.0 million in 2003/04. Due to this result, average annual growth rate of external loans is 5.0 percent. The causes of decreased external loan is may be the causes of increased foreign grants, which we can see the Table 4.1 (in F/Y 2003/04)

Scenario ' III'

The third scenario shows that the domestic resource gap. Which is determined (fiscal deficit - external loans), and these are to be financed from the government cash balance. The third of domestic gap resource gap is also increasing which was RS. 2422.3 million in 1989/90 and has gone up to RS. 8199.2 million in 2003/04 . It was high in FY 2001/02 i.e. 15241.8 million.

Table 4.2 reveals that the revenue deficit as percent of GDP and fiscal deficit as percent of GDP. (GDP at producer price, which is based on the price 1989/90.

Table 3.2

Resource Gap as Percentage of GDP

Fiscal Year	Revenue Deficit as % of GDP	Fiscal Deficit as % of GDP
1989/90	10.0	8.1
1990/91	10.7	8.8
1991/92	8.6	7.5
1992/93	9.2	7.0
1993/94	7.0	5.8
1994/95	6.5	4.7
1995/96	7.5	5.6
1996/97	8.2	6.1
1997/98	7.7	5.9
1998/99	6.5	5.3
1999/00	6.2	4.7
2000/01	7.5	5.9
2001/02	7.0	5.4
2002/03	6.1	3.6
2003/04	5.5	3.2
Average Annual Rate	7.5	5.8

Source; Budget speeches and Economic Survey, 2004/2005, MOF, Nepal

To analyze the revenue deficit as percent of GDP is more important that the GDP is the main indicator of the performance of the economy, which includes different components of the economy, and shows their performance. In this context, revenue deficit as percent of GDP has decreased from 10.0 percent in 1989/90 to 5.5 percent in 2003/04, and average annual growth rate is 7.5 percent. The fiscal deficit as percent of GDP, which has included grants, is also decreased from 8.1 percent in 1989/90 to 3.2 percent in 2003/04. The inclusion of grants in government's revenue may not be appropriate because the amount of grants depends upon political consideration of friendly countries, which may have been fluctuating character. Because it is determine by the various factors. Even then the amount of grant is included here, as it doesn't require repayment and therefore, it may be taken as good as revenue.

CHAPTER IV

STRUCTURE OF PUBLIC DEBT IN NEPAL

4.1 Introduction

Fiscal weapon has to play the role of revenue generation and also mobilizes savings for development purpose. Similarly as a monetary measure it helps to control inflation and ensure growth with stability. As Bhargava observes, "the government borrowing is also useful to combat against inflation because in this situation effective demand is more than the available supply of goods and services and here the government transfer extra purchasing power from the hands of the people through borrowing. Thus a sensible debt policy can be used to check a depression or a boom **(Bhargava: 1956)**

Nepal has accepted the foreign loan since the first five-year plan (1956/57-1959/60) but it has systematically started to raise the debt since the fiscal year 1961/62 through the means of Treasury bill that amounted RS. 7 million and carried one percent of interest rate. After this, the government firstly floated the development bond of Rs. 131 million in FY 1963/64. In the same year, the government issued the 'public debt regulation' and practice was still managed with this regulation.

Public debt is interrelated with the basic government fiscal flows of taxation and expenditure. If the volume of government expenditure exceeds the volume of tax revenue and other non-tax revenues then a deficit budget exists. Such deficit budget provides the fundamental precondition for debt creation. Having once been created debt requires interest payments to maintain the debt and refinancing operations of the debt is to beyond the maturities of existing securities.

Nepal has been borrowing new fresh loan mainly to balance her deficit budget. It is applied for the maintenance of the balance between the expenditure and revenue. It is also applied for financing economic development since under developed countries always face the problems of funds, which is reflected in a large extent as ever increasing financial resource, gap in the government budgetary. There are mainly three reasons for raising the government borrowing.

1. To recover the deficit budget.
2. To tackle the emergency period of crisis.
3. To sustain the economic and monetary stability.

Government borrowing in Nepal rapidly increase since the FY 1984/85 from when the government started to raise the borrowing with new long term security named 'national saving certificate'. After then the amount of public debt has been fluctuated in its size but in aggregate, it has been increase tremendously under the review period 1989/90 to 2003/04, but it amounted up to Rs. 13236.8 million in F/Y 2003/04. It obviously shows our achy and ever tormenting fiscal agonizing.

An article "The Investment Strategy in Nepal" published by World Bank in 1998 has also suggested keep the internal debt with in 2 % of GDP of the nation **(Upreti :1999)**

4.2 Financing of Fiscal Deficit

Public debt has been the main source for financing fiscal deficit in Nepalese fiscal system. Although for financing of fiscal deficit both internal and external sources of borrowing have been adopted in any under developed economy. The total public debt has been increasing rapidly since the restoration of multiparty system for meeting the requirement of fiscal deficit.

Table 4.1

Internal and External Debt as Percentage of Fiscal Deficit.

Rs. In Million

Fiscal Year	Fiscal Deficit	Total Debt	Internal Debt	External Debt	Loan as a % of fiscal deficit	
					Internal loan	External loan
1989/90	8,381.9	8,109.4	2,150.0	5,959.4	26.3	71.1
1990/91	10,660.0	10,809.4	4,552.7	6,256.7	42.7	58.7
1991/92	11,261.7	8,895.7	2,078.8	6,816.9	19.0	60.5
1992/93	11,956.0	8,540.9	1,620.0	6,920.9	13.5	57.9
1993/94	11,622.9	10,983.6	1,820.0	9,163.6	15.6	78.8
1994/95	10,253.2	9,212.3	1,900.0	7,312.3	18.5	71.3
1995/96	13,825.8	11,663.9	2,200.0	9,463.9	15.9	68.4
1996/97	17,061.9	12,043.6	3,000.0	9,043.6	17.6	53.0
1997/98	14,964.7	14,454.4	3,400.0	11,054.4	22.7	62.2
1998/99	17,991.1	16,562.4	4,710.0	11,852.4	26.1	73.9
1999/00	17,667.1	17,312.2	5,500.0	11,812.2	31.1	66.9
2000/01	24,187.8	19,044.0	7,000.0	12,044.0	28.9	49.8
2001/02	22,940.4	15,698.7	8,000.0	7,698.7	34.9	33.6
2002/03	16,437.3	13,426.4	8,880.0	4,546.4	54.0	27.7
2003/04	15,828.2	13,236.8	5,607.8	7,629.0	35.4	48.2
Average Annual Growth Rate	5.9	4.6	10.4	5.0	7.1	0.4

Source: MOF/GON, Economic Survey, F/Y 2004/05

Table 4.1 indicates the increasing trend of public debt from both internal and external sources, which was Rs. 8109.4 million in 1989/90 and has increased to Rs. 13236.8 million under the period of study. Once it became so high in FY 2000/01 i.e. 19044.0 million. Its average annual rate of growth over the review period is 4.6 percent. The table shows the increasing trend of public debt in which the increasing trend of external debt is so rapidly then internal debt. Internal debt was only Rs. 2150.0 million in 1989/90 and has gone up to Rs. 8880.0 million in 2002/03, but in 2003/04 it has decreased up to 5607.8 million. Where external debt was Rs. 5959.4 million and increased tremendously up to

Rs. 12044.0 million in 2000/01 and since then it has decreased to 7629.0 and since then it has decreased up to 7629.0 million in 2003/04.

This Table shows that the percentage share of internal and external debt to fiscal deficit. In which the contribution of both internal and external debt to their fiscal deficit has been fluctuating. The contribution of internal debt to fiscal deficit was 26.3 percent in 1989/90 whereas external debt was 71.1 percent. But the share of internal is 35.4 percent in 2003/04 which shows increasing contribution and external is 48.2 percent, which shows the decreasing contribution to their fiscal deficit. The absolute terms of above table shows our growing reliance on external loan for meeting the ever-increasing fiscal deficit. This absolute term also show that (during the last 15 years) our economic performance has not been conducive enough to reduce growing reliance on external loan. This situation has led us to think seriously about this alarming situation.

4.3 Growth Trend in Government Borrowing

After the restoration of multiparty system, volume of government expenditure has been increasing. Only the reliance on taxation is not possible to cope with huge amount of financial resources that is required for the government expenditure. Nepal is facing large and growing financial resource gap in the government budgetary. In this context, the government borrowing both (external and internal) needs for supplements this resource gap. The government has to borrow large amount of loans to meet the fiscal deficit which is shown on Table 4.2

Table 4.2

Trends in Government Borrowing

Rs. In Million

Fiscal Year	Total Loan	External Loan	Internal Loan	External loan as a % of Total Loan	Internal Loan as a % Total Loan
1989/90	8,109.4	5,959.4	2,150.0	73.5	26.5
1990/91	10,809.4	6,256.7	4,552.7	57.9	42.1
1991/92	8,895.7	6,816.9	2,078.8	76.6	23.4
1992/93	8,540.9	6,920.9	1,620.0	81.0	19.0
1993/94	10,983.6	9,163.6	1,820.0	83.4	16.6
1994/95	9,212.3	7,312.3	1,900.0	79.4	20.6
1995/96	11,663.9	9,463.9	2,200.0	81.1	18.9
1996/97	12,043.6	9,043.6	3,000.0	75.1	25.0
1997/98	14,454.4	11,054.4	3,400.0	76.5	23.5
1998/99	16,562.4	11,852.4	4,710.0	71.6	28.4
1999/00	17,312.2	11,812.2	5,500.0	68.2	31.8
2000/01	19,044.0	12,044.0	7,000.0	63.2	36.8
2001/02	15,698.7	7,698.7	8,000.0	49.0	51.0
2002/03	13,426.4	4,546.4	8,880.0	33.9	66.1
2003/04	13,236.8	7,629.0	5,607.8	57.6	42.4
Average Annual Growth Rate	4.6	5.0	10.4	----	----

Source: MOF/GON, Economic Survey, F/Y 2004/05

Table 4.2 shows that the trends in government borrowing between the period 1989-2004. Under the review period total government borrowing has increased 1.6 folds with an average annual growth rate of 4.6 percent from Rs. 8,109.4 million to Rs. 13236.8 million. Similarly external loan has increased with an average annual growth rate of 5.0 percent from Rs. 5959.4 million to Rs. 7629.0 million under the period of study.

It was high once in FY 2000/01, which was, about two times fold. But in FY 2003/04, due to the decreased amount Rs. 7629.0 million, it is about 1.3 times fold from the beginning. And average annual growth rate of internal debt is 10.4 percent and increasing trend from Rs. 2150.0 million to Rs. 5607.8 million.

Table 4.2 also indicates that the external borrowing increased more than internal borrowing in absolute term 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 and internal borrowing in total borrowing is 57.6 and 42.4 percent respectively in 2003/04. Which indicates that external loan is in decreasing rate and internal loan is in increasing rate.

4.4 Outstanding of Public Debt in Nepal.

The government has to borrow large amount of public debt owing to meet ever increasing financial resource gap. Usually public debt is used to cope with government budgetary expenditure. However in Nepal, it is main and reliable resources of meeting the government expenditure over from the few years. So the volume of outstanding public debt has been increasing. Government has targeted of 20.79 percent of total expenditure will fulfill by public debt in 2004/05. Whereas about 24 percent of total expenditure was fulfilled by public debt in 2000/01. And about 15 percent of total expenditure was fulfilled by public debt in 2003/04. It shows that slightly decreasing direction but increasing trend in practice. (Gorkhapatra: 2005)

Table 4.3 shows clearly about the net outstanding debt in Nepal, under the review of study. The table shows an elaboration of debt burden of Nepal that the total outstanding public debt of GON has increased from Rs. 51,474.0 million in 1989/90 to Rs. 31,891.0 million in 2003/04 with the average annual growth rate of 13.6 percent. This trend of net outstanding public debt shows that we must sacrifice the volume of four annual budgets to get rid of the debt burden.

Table 4.3 shows that the outstanding external loan has increased from Rs. 36,800.0 million to Rs. 232,779.3 million under the review period, where its share in total outstanding debt was 71.5 percent in 1989/90 which has gone up to 73.0 percent in 2003/04. Whereas internal outstanding loan has increased from Rs. 14,673.1 million in 1989/90 to Rs. 86,133.7 million in 2003/04. Where the percentage share of its in total outstanding debt was 28.5 and 27.0 respectively. Table also shows that average annual growth rate of external outstanding debt is 13.9 and 13.0 of internal. The average annual share of internal outstanding debt and external to total outstanding debt is 23.1 and 76.2 percentage respectively under the period of the study. This Table indicates that the share of external debt to total outstanding public debt is higher 1 times than internal. So, in reality we have been indebted by foreign to considerable extent the government therefore should take the grim attention towards the burden of external debt.

Therefore, public debt is not good resources availability for the country in all sense, but it may adversely affect in the economic condition. When its volume is so large and misused by nation, we really fall into 'debt trap' whereas in fresh loan are needed for servicing the existing interest payment. So, we should pour our attention for proper use of public debt for bright future of next generation through generates the sufficient resources.

Table 4.3

Outstanding of Public Debt

Rs.In Million

Fiscal Year	Total Outstanding Debt	External Outstanding Debt	Internal Outstanding Debt	External Outstanding. Debt as a Percentage of Total Outstanding Debt	Internal Outstanding Debt as a Percentage of Total Outstanding Debt
1989/90	51,474.0	36,800.9	14,673.1	71.5	28.5
1990/91	80,361.2	59,505.3	20,855.9	74.0	26.0
1991/92	94,158.8	70,923.9	23,234.9	75.3	24.7
1992/93	112,876.8	87,420.8	25,456.1	77.0	22.5
1993/94	132,598.0	101,966.8	30,631.2	76.9	23.1
1994/95	145,058.8	113,000.9	32,057.8	77.9	22.1
1995/96	162,286.3	128,044.4	34,241.9	78.9	21.1
1996/97	167,977.7	132,086.8	35,890.9	78.6	21.4
1997/98	199,614.7	161,208.0	38,406.7	80.8	19.2
1998/99	219,135.5	169,465.9	49,669.6	77.3	12.7
1999/00	245,048.2	190,691.2	54,357.0	77.8	22.2
2000/01	260,448.1	200,404.4	60,043.7	76.9	23.0
2001/02	293,746.3	220,125.6	73,620.7	74.9	25.1
2002/03	308,078.5	223,433.2	84,645.3	72.5	27.5
2003/04	318,913.0	232,779.3	86,133.7	73.0	27.0
Annual Average Growth Rate	13.6	19.9	13.0	76.2	23.1

Source: MOF/GON, Economic Survey, F/Y 2004/05

4.5 Source of Internal Borrowing

The government can borrow internal debt from banking and non-banking sources. Borrowing from banking system may be inflationary in which the government borrow from NRB and other banks and borrowing from non-banking source is not being inflationary in which the government can borrow from except banking system like Nepal. Therefore, efforts should be toward internal borrowing mobilization through non-banking system. The volume of internal borrowing from banking and non-banking system has been shown by the following Table 4.4.

Table 4.4

Source of Internal Borrowing from Banking and Non-Banking Sectors.

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Rs.In Million

Fiscal Year	Banking Sector	Non-Banking Sector	Total Borrowing	Banking Sector as a Percent of Total Borrowing	Non-Banking Sector as a Percent of Total Borrowing
1989/90	1,450.0	700.0	2,150.0	67.4	32.6
1990/91	3,713.2	839.5	4,552.7	81.6	18.4
1991/92	1,178.8	900.0	2,078.8	56.7	43.3
1992/93	920.0	700.0	1,620.0	56.8	32.2
1993/94	1,000.0	820.0	1,820.0	55.0	45.0
1994/95	1,300.0	6,00.0	1,900.0	68.4	31.6
1995/96	750.0	1,450.0	2,200.0	34.1	65.9
1996/97	1,500.0	1,500.0	3,000.0	50.0	50.0
1997/98	1,600.0	1,800.0	3,400.0	47.1	52.9
1998/99	2,850.0	1,860.0	4,710.0	60.5	39.5
1999/00	3,300.0	2,200.0	5,500.0	60.0	40.0
Average Annual Growth Rate			10.4		

Source: MOF/ GON, Economic Survey, 2004/05

Table 4.4 shows that the source of internal borrowing from banking and non-banking sectors. Where internal borrowing from banking system has increased from Rs. 1,450.0 million in 1989/90 to Rs. 3,300.0 million in 1999/2000, where the share of percentage has changed from 67.4 to 60.0 percent. Share of non-banking system to total internal borrowing has also increased from Rs. 700.0 million in 1989/90 to Rs. 2,200.0 million in 1999/2000. In which percentage share increased from 32.6 to 40.6 percent. This indicates that the contribution of non-banking financial institution and others have been slightly increasing in process.

4.6 Pattern of Internal Net Outstanding Debt.

At first, internal borrowing programmed has carried out since the 1961 (before four decades), Since 1961 Nepal has been borrowing internally under the different plans for bridge the resource gap on the budgetary system and mobilizing financial resource for development. The government mobilizes the internal borrowing by issuing mainly treasury bills, development bonds, National Saving Certificate, Public Saving Card and special bonds, where public saving is new concept which has adopted since 2001/02

Table 4.5 shows the structure of internal net outstanding debt in which the government mainly mobilizes the internal resources by five sources. Among them Public Saving Card is started from 2001/02. Where the contribution of Treasury Bills is larger because its average annual growth rate is 26.4 percent, which is larger than others. After the enforcement of public debt Act 1960, internal debt for the first time was issued by Nepal in 1962 through Treasury Bills amounting Rs. 7.0 million. The next instrument of internal debt as development bonds was first issued in FY 1963/64, amounting Rs. 250.0 Million.

Table 4.5

Structure of Internal Net Outstanding Debt.

Rs.In Million

Fiscal Year	Treasury Bills	Development Bonds	National Saving Certificate	Public Saving Card	Special Bonds	Total Internal Outstanding Debt
1989/90	1,821.0	5,388.6	2,896.5	----	4,567.0	14,673.1
1990/91	2,351.0	5,482.3	3,646.5	----	9,376.1	20,855.9
1991/92	3,483.2	5,132.2	4,546.3	----	10,073.2	23,234.9
1992/93	4,403.2	5,132.2	4,901.5	----	11,019.2	25,456.1
1993/94	5,216.3	4,732.2	5,691.5	----	14,991.2	30,631.2
1994/95	6,392.5	4,122.2	6,076.4	----	15,466.7	32,057.8
1995/96	7,142.5	3,672.2	7,376.5	----	16,050.7	34,241.9
1996/97	8,092.5	3,042.2	8,736.5	----	16,019.7	35,890.9
1997/98	9,182.5	3,302.2	9,886.4	----	16,035.6	38,406.7
1998/99	17,586.9	3,872.0	10,426.4	----	17,784.1	49,669.6
1999/00	21,027.0	4,262.2	11,526.5	----	17,541.3	54,357.0
2000/01	27,610.8	5,962.2	12,476.4	----	13,994.3	60,043.7
2001/02	41,106.5	11,090.7	11,536.1	628.1	9,259.3	73,620.7
2002/03	48,860.7	16,059.2	9,629.8	931.1	9,164.5	84,645.3
2003/04	49,429.6	17,549.2	9,029.8	11,78.9	8,946.2	86,133.7
Average Annual Growth Rate	26.4	9.8	8.6	24.9	7.8	13.0

Source: MOF/ GON, Economic Survey 2004/05 and NRB Annual Report 2005

Note: Internal Outstanding = TB + DB + NSC + PSC + Special Bonds.

Table 4.5 shows the share of Treasury Bills, Development Bonds, National Special Certificate, Public Saving Card and Special Bonds to total net internal outstanding debt is amounted Rs. 1,,821.0 million, Rs. 5,388.6 million, Rs. 2,896.5 million, Rs. 0.0 million and 4,567.0 million respectively in 1989/90. Which has been increasing ever the review of this study amounted to Rs. 49,429.6 million with 26.4 percent annual growth rate, Rs. 17,549.2 million with

9.8 percent annual average growth rate, Rs. 9,029.8 million with 8.6 percent of average annual growth rate, Rs. 1,178.9 million with 3.5 percent of average annual growth rate and Rs. 8,946.2 million with 7.8 percent of annual average growth rate respectively in FY 2003/04.

The percentage share of Treasury Bills is 57.4 and of Development Bonds, National Saving Certificate, Public Saving Card and special bonds are 20.4 percent, 10.5 percent, 1.4 percent and 10.4 percent respectively in 2003/04. This shows that about half of internal net outstanding debt has mobilize through Treasury Bills.

We can reach the conclusion by above table that the volume of internal borrowing is increasing without increasing in tax revenue collection proportion to the growth in the government expenditure. This action also will create the inflationary situation, which may leads us into debt crisis in future.

4.7 Source of Foreign Loan

The POINT-FOUR program agreement sign heralded Nepal's first experience of foreign economic assistance on 23 Jan 1951. In which the U.S. government's assistance of Rs. 22 thousands was provided, but Nepal has started to borrow foreign loan since 1964/65. The foreign assistance grants and loan are the major source of foreign currency for Nepal. (Mirmire: 2004)

Nepal has borrowed the external loan through bilateral and multilateral sources. Bilateral loans are the, loans from government and their agencies (including Central Banks), loans from autonomous bodies and direct loans from official expert credit agencies. Multilateral loans are the, loans from multilateral agencies as World Banks, IMF, Regional Development Banks and other multilateral and intergovernmental agencies. (WD, Table 2, 1996) Table 4.6 shows the structure of external debt in terms of disbursement by major sources.

Table 4.6

Structure of External Debt in Terms of Disbursement by Major Sources.

Rs. In Million

Fiscal Year	Total External Loan	Bilateral Loan	Multilateral Loan	Bilateral Loan as a percent of Total External Loan	Multilateral Loan as a percent of Total External Loan
1989/90	4,628.3	1,000.6	3,627.7	21.6	78.4
1990/91	4,360.0	1,602.8	2,757.2	36.8	63.2
1991/92	6,269.4	2,389.8	3,879.6	38.1	61.9
1992/93	5,961.9	1,307.8	4,654.1	21.9	78.1
1993/94	9,163.6	582.9	8,580.7	6.4	93.6
1994/95	7,312.3	717.3	6,595.0	9.8	89.8
1995/96	9,463.9	460.0	9,003.9	4.9	95.1
1996/97	9,043.6	850.7	8,192.9	9.4	90.6
1997/98	11,054.5	1,314.5	9,740.0	11.9	88.1
1998/99	11,852.4	584.0	11,268.4	4.9	95.1
1999/00	11,812.2	757.9	11,054.3	6.4	93.6
2000/01	12,044.0	586.7	11,457.3	4.9	95.1
2001/02	7,698.6	87.0	7,611.6	1.1	98.9
2002/03	4,546.4	657.2	3,889.2	14.5	85.5
2003/04	7,629.0	66.0	7,563.0	0.9	99.1
Average Annual Growth Rate	7.6	37.8	10.4	13.0	87.0

Source: MOF/ GON, Economic Survey 2004/05

Looking at the Table 4.6, we can see the decreasing trend of bilateral loans and increasing trend of multilateral loans under the review period. In the beginning of the review period the share of bilateral loans to total external loan was Rs. 1,000.6 million (21.6 %) and multilateral loan was Rs. 3,627.7 million (78.4 %). and at the end of the year of this study the bilateral loan has been decreasing to Rs. 66.0 million (0.9 %) and multilateral loan has been increasing to Rs. 7,563.0 million (99.1%). But it has been high in the FY 2000/01 with Rs. 11,457.3 million (95.1%). The average annual growth rate of bilateral and multilateral loan is 37.8 percent and 1.04 percent respectively under the period of the study.

Table 4.6 refers that the multilateral external debt has dominated the bilateral debt in the structure of external debt in Nepal. Where average annual growth rate of multilateral loan is 10.4 percent and bilateral loan is -102.1 percent. The average annual growth rate of bilateral loan is increasing with 10.9 percent in 1997/98 but then it is declining and consequently reached high negative rate.

Under the period of review, the amount of grants has not been sufficiently increased, where only has gone up Rs. 1975.4 million to Rs. 11283.4 million, Which has not enough to cover the budgetary deficit (see Table 3.1). During this period, the amount of bilateral and multilateral loan has increased tremendously which has created some sort of constraint in the performance of economy as a whole.

CHAPTER - V

BURDEN OF PUBLIC DEBT IN NEPAL

5.1 Introduction

The burden of public debt refers to the sacrifice when it will impose on the community through a rise in taxation, necessitated at the time of repayment and fore paying the annual interest in the government loans. In other words, if it refers every government is bound to repay the public borrowing whether internally or externally with interest, this burden of public debt may be direct, indirect, monetary or real and it may tend to fall either on the present or sometimes on the future generation.

The total burden of public debt can be divided into two parts: (1) internal burden of public debt, (2) external burden of public debt. The internal means that the greater part of the debt is held internally. Dalton (1949) takes internal public debt burden as not much significant as the payment of principle amount and its interest involves taxation. It is an early transfer of purchasing power from on person to another or money market. Similarly, Lerner (1946) points out, the internal debt may not have any direct money burden on a community as a whole, since the payment of interest and increased taxation to meet the burden of debt involved simply transfer the purchasing power from one group of person to another to extent the creditors and tax payer are the same, there may not be any net burden at all in the community. But to the extent of creditors and tax payers belong to different income groups, the changes in the distribution of income among different section of the community may take place.

In case of external debt burden is however, completely different. External debt imposes real burden on the economy because it reduces national welfare.

External debt is paid not in money terms bur in real terms, in terms of goods and services. Which are exported to the creditor country for the settlement of the debt? The process will have to continue during the whole period of loan because the borrower country has to pay interest charges, but if external loan are used for increasing the productivity capacity of country, the debt repayment may not be a serious burden. The debtor country may pay off the debt and interest without any difficulty because of increased capacity of export oriented industries. If debtor country does not sufficiently increase the productive capacity, they will have to face the balance of payment problem.

Therefore, any borrowed country has to be spent the borrowed fund on creation of productive capacity which further generate income and increase the rate of capital formation then it is quite possible than the debt would not be burden to the society. If the borrowed fund spent otherwise and the government would have to borrow again to meet the requirements of development funds and for meeting the charge of debt servicing as will then it is quite possible that this process lead to bankruptcy of the government or debt crisis in the future.

Incase of shifted the burden of public debt to the future generation, there is always debate among the economists. Some of the economists have viewed if the present generation reduces its saving in order to meet the debt finance and leaves a smaller amount of capital resources for the future. This will reduces the productive capacity of the coming generation and they will accordingly lose. In this way, burden of public debt may pass on to the future generation. But on the other hand, some economists have challenged the above version and expressed opposite opinion on the subject of burden of public dent. They submit that here is no shift of the basic burden to the future generation because the sate posterity, which pays the additional taxes, will be benefited from the repayment of the debt.

Through above discussion, we can say that it is difficult to conclude a specific opinion in the issue. Thus, the question of shifting the burden of public debt to the future generation has remained an unsettled riddle so far.

In case of Nepal, outstanding of public debt is increasing rapidly each year that which become 64.4 percent of GDP in 2003/04. Large scale of public debts have been incurred in the past for financing development programs, but debt servicing capacity has not increasing in the same pace, so that there may be undue strain in the balance of payment owing to outflow of funds through dent services. Nepal has been borrowing new fresh loan to repayment old loans. This also has alarmed the situation of 'debt trap' in the future.

Here, this chapter has analyses the issue related to debt servicing and macro economic indicators, burden of debt to GDP, investment saving gap etc.

5.2 National Outstanding Debt and Its Share in GDP

The ratio of public debt to GDP is an important indicator of the manageability of public debt in an economy. The relative magnitudes of the public debt of the GDP should be taken into consideration for assessing the burden of growing public indebtedness. Nepal has to borrow huge amount of external as well as internal loans for meeting the deficit budget. And on the other hand, the tax revenue and non-tax revenue are not increasing as it predicts and improper utilization of public debt and corruption, debt servicing capacity is not increasing so that burden of outstanding debt is increasing. Here, Table 5.1 shows the burden of debt through the method of measure of burden of debt as the ration of public debt to GDP.

Table 5.1

Outstanding Debt and Its Share in GDP

Rs.In Million

Fiscal Year	External Outstanding Debt	Internal Outstanding Debt	Total Public Debt	GDP at Producer's Price	Share in Percentage of GDP		
					External Debt	Internal Debt	Total
1989/90	36,800.9	14,673.1	51,474.0	103,416.0	35.6	14.2	49.8
1990/91	59,505.3	20,855.9	80,361.2	120,370.0	49.4	17.3	66.7
1991/92	70,923.9	23,234.9	94,158.8	149,487.0	47.4	15.4	62.8
1992/93	87,420.8	25,456.1	112,876.8	171,492.0	51.0	14.8	65.8
1993/94	101,966.8	30,631.2	132,598.0	199,272.0	51.2	15.4	66.6
1994/95	113,000.9	32,057.8	145,058.8	219,175.0	51.6	14.6	66.2
1995/96	128,044.4	34,241.9	162,286.3	248,913.0	51.4	13.8	65.2
1996/97	132,086.8	35,890.9	167,977.7	280,513.0	47.1	12.8	59.9
1997/98	161,208.0	38,406.7	199,614.7	300,845.0	53.6	12.8	66.4
1998/99	169,465.9	49,669.6	219,135.5	342,036.0	49.5	14.5	64.0
1999/00	190,691.2	54,357.0	245,048.2	379,488.0	50.2	14.3	64.5
2000/01	200,404.4	60,043.7	260,448.1	411,275.0	48.7	14.6	63.3
2001/02	220,125.6	73,620.7	293,746.3	422,807.0	52.1	17.4	69.5
2002/03	223,433.2	84,645.3	308,078.5	456675.0	48.9	18.5	67.4
2003/04	232,779.3	86,133.7	318,913.0	495,,589.0	47.0	17.4	64.4
Average Annual Growth Rate	19.9	13.0	13.6	11.1	49.0	15.2	64.2

Source: MOF/ GON, Economic Survey 2004/05 and NRB Annual Report 2005

Observing Table 5.1, it shows the magnitude of outstanding debt, GDP and their ratio, which also assesses the burden of public debt.

This Table shows the ratio of internal and external debt to GDP in the Year between 1989/90 to 2003/04. The share of external debt in GDP was 35.6 percent, which has increased to 47.0 percent in the year 2003/04, showing gradual increases. Similarly, this Table also shows the share of internal debt in GDP. It has also increased from 14.2 percent in 1989/90 to 17.4 percent in 2003/04. It means burden of public debt is increasing. Where, total outstanding of public debt has increased from Rs. 51,474.0 million in 1989/90 to Rs. 318,913.0 million in 2003/04 and share of it to GDP has increased from 49.8 percent to 64.4 percent

This indicates horrible situation of burden of debt in Nepal. Table also shows that the burden of external outstanding debt is greater than internal which may be danger in the future generation. This magnitude of the burden of public debt may increase to alarming proportion of productive capacity is not created in the economy for increasing production. Here, comparing the Table 5.1 we can see that growth rate of GDP is less than growth rate of outstanding debt. It is the condition of bankrupt situation of Nepal.

5.3 Issues of Debt Servicing in Nepal.

Table 5.2 shows the ratio of internal and external debt servicing to total debt servicing and their average annual growth rate and percentage share of external and internal to total debt servicing.

Table 5.2

Share of External and Internal Debt Servicing in total Debt Servicing.

Rs.In Million

Fiscal Year	Total Debt Servicing	External Debt Servicing	Internal Debt Servicing	External Debt Servicing as a percent of Total Debt Servicing	Internal Debt Servicing as a percent of Total Debt Servicing
1989/90	2,279.2	1,121.9	1,157.3	49.2	50.8
1990/91	2,407.4	1,086.5	1,320.9	45.1	54.9
1991/92	3,797.1	1,664.9	2,132.2	43.8	56.1
1992/93	4,560.5	2,131.9	2,428.6	46.7	53.2
1993/94	4,855.1	2,488.7	2,366.4	51.3	48.7
1994/95	6,083.3	2,984.7	3,098.6	49.1	50.9
1995/96	6,715.4	3,294.3	3,421.1	49.0	50.9
1996/97	7,527.2	3,349.4	4,177.8	44.5	55.5
1997/98	7,682.8	4,201.2	3,481.6	54.7	45.3
1998/99	8,723.0	4,745.5	3,977.5	54.4	45.6
1999/00	10032.8	5,321.4	4,711.4	53.0	47.0
2000/01	10,388.4	6,201.4	4,187.0	59.7	40.3
2001/02	12,205.2	6,567.5	5,637.7	53.8	46.2
2002/03	16,181.3	7,519.2	8,,662.1	46.5	53.5
2003/04	17,338.8	7,908.9	9,429.9	45.6	54.4
Average Annual Growth Rate	15.2	14.6	16.8	---	---

Source: MOF/ GON, Economic Survey 2004/05

Note: External Debt Servicing = Repayment + Interest Payment

Internal Debt Servicing = Total Debt Servicing - External Debt Servicing

Total Debt Servicing = Interest Payment + Principle Repayment

Observing Table 5.2, the amount of total debt servicing was Rs. 2,279.2 million in 1989/90 and has increased to Rs. 17,338.8 million in 2003/04 with average annual growth rate by 15.2 percent. This shows as increasing trend of total debt servicing. The volume of external debt servicing was Rs. 1,121.9 million and has increased to Rs. 7,908.9 million under the review period and internal was Rs. 1,157.3 million and has gone up to Rs. 9,429.9 million under the same period. The average annual growth rate of external and internal debt servicing is higher than external. Till FY 2000/01, the average annual growth rate of external debt servicing is higher than internal, since than, internal debt servicing is increasing in high rate than external. In 2003/04 the percentage share of external and internal debt servicing to total debt servicing was 45.6 percent and 54.4 percent respectively. At the end of the year, government is doing well because it has increased its internal source to the debt servicing. It shows us a good condition of Nepal's debt servicing situation. Similarly Table 5.3 shows the servicing amount of interest payments and principal payments in total debt servicing amount.

Table 5.3

Share of Interest and Principal Payments in Total Dept Servicing.

Rs. In million

Fiscal year	Total Debt Servicing	Principle Payments	Interest Payments	Principle Payments as a Percentage Of Total Debt Servicing	Interest Payments as a percentage of Total Debt Servicing
1989/90	2,279.2	802.3	1,476.9	35.2	64.8
1990/91	2,407.4	739.0	1,668.4	30.7	69.3
1991/92	3,797.1	1,207.0	2,590.1	31.8	68.2
1992/93	4,560.5	1,597.9	2,962.6	35.0	65.0
1993/94	4,855.1	1,898.2	2,956.9	39.0	61.0
1994/95	6,083.3	2,,653.2	3,430.1	43.6	56.4
1995/96	6,715.4	2,847.5	3,867.9	42.4	57.6
1996/97	7,527.2	3,453.3	4,073.9	45.9	54.1
1997/98	7,682.8	3,931.2	3,751.6	51.2	48.8
1998/99	8,723.0	4,642.7	4,080.3	53.2	46.8
1999/00	10,032.8	5,212.7	4,820.1	52.0	48.0
2000/01	10,388.4	5,690.6	4,697.8	54.8	45.2
2001/02	12,205.2	6,435.0	5,770.2	52.7	47.3
2002/03	16,181.3	9,559.5	6,621.8	59.1	40.9
2003/04	17,338.8	10,794.9	6,543.9	62.3	37.7
Average Annual Growth Rate	15.2	20.2	11.3	----	----

Source: MOF/ GON, Economic Survey 2004/05

While observing Table 5.3, we can see 15.2 percent of average annual growth rate of increasing trend of total debt servicing. Where share of interest amount was Rs. 1476.9 million and has mountain up to Rs. 6543.9 million and share of principal amount was Rs. 802.3 million and has gone up to Rs. 10794.9 million under the period of study. The average annual growth rates of principal payments and interest payment is 20.2 and 11.3 percent respectively. This shows the increasing trend of principal payments is higher than interest payments.

The share of interest payments to total debt servicing is greater than principal payments till 1996/97. But then, the share of principal amount to total debt servicing is greater than interest payments till under the review period. The servicing amount of interest and principal payments indicates that large proportion of regular expenditure has gone to creditor countries. Which has hampered regular expenditure as well as development expenditure? In 2003/04, 15 percent of regular expenditure has gone to service of principle payments and interest payments; this indicates the seriousness situation about debt servicing and burden of public debt of Nepal.

5.4 Ownership Pattern of Internal Debt Servicing Situation.

The burden of public debt is measured by the ratio between the debt servicing and aggregate tax revenue and non-tax revenue or total revenue and the ratio between servicing cost and national income (GDP). This has been shown in Table 5.4

Table 5.4

Share of Internal Debt Servicing in Total Revenue, Regular Expenditure and GDP.

Rs. In Million

Fiscal Year	Regular Expenditure	Total Revenue	GDP	Internal Debt Servicing	Debt Servicing as % of Regular Expenditure	Debt Servicing as % of Total Revenue	Debt Servicing. as % of GDP
1989/90	6,672.5	9,312.8	103,416.0	1157.3	17.3	12.4	1.1
1990/91	7,573.9	10,729.0	120,370.0	1,320.9	16.2	12.3	1.0
1991/92	9,905.4	13,512.7	149,487.0	2,132.2	21.5	15.8	1.4
1992/93	11,484.1	15,148.4	171,492.0	2,428.6	21.1	16.0	1.4
1993/94	12,409.2	19,580.9	199,272.0	2,366.4	19.1	12.1	1.2
1994/95	19,245.4	24,605.1	219,175.0	3,098.6	16.1	12.6	1.4
1995/96	21,563.8	27,893.1	248,913.0	3,421.1	15.9	12.3	1.4
1996/97	24,181.1	30,373.5	280,513.0	4,177.8	17.3	13.7	1.5
1997/98	27,174.4	35,751.0	300,845.0	3,481.6	12.8	9.7	1.1
1998/99	31,047.7	37,251.3	342,036.0	3,977.5	12.8	10.7	1.2
1999/00	34,523.3	42,893.7	379,488.0	4,711.4	13.6	11.0	1.2
2000/01	42,769.2	48,893..9	411,275.0	4,187.0	9.8	8.6	1.0
2001/02	48,590.0	50,445.6	422,807.0	5,637.7	11.3	11.2	1.3
2002/03	54,973.0	56,229.7	456,675.0	8,662.1	15.7	15.4	1.9
2003/04		62,331.0	495,589.0	9,429.9		15.1	1.9
Average Annual Growth Rate		13.8	11.1	16.8	15.8	12.6	1.3

Source: MOF/ GON, Economic Survey 2004/05

The expenditure heads till FY 2003/04 were classified as regular and development. During FY 2004/05, such expenditure has been classified as recurrent expenditure amounted Rs. 55,552.1 million, capital expenditure amounted Rs. 23,095.6 million and Principal repayment expenditure amounted Rs. 10794 million in FY 2003/04. That's why here researcher did not submit the regular and development expenditure in FY 2003/04. So comparison is done between 1989/90 to 2002/03 in the regular and development expenditure).

Table 5.4 shows the average annual growth rate and volume of regular expenditure, Total Revenue, GDP and internal debt servicing. It also shows the share of TR, RE and GDP as percentage of internal debt servicing. Under the period of the study, the magnitude of regular expenditure, total revenue, GDP and Internal debt servicing was Rs. 6,672.5million, Rs. 9,312.8 million, Rs. 103,416.0 million and Rs. 1,157.3 million in 1989/90 and has increased up to Rs. 54,973.0 million (in FY 2002/03), Rs. 62,331.0 million, Rs. 495,589.0 million and Rs. 9,429.9 million in 2003/04 respectively. But due the classification of the expenditure head into regular and development expenditure its actual data could not find in FY 2003/04.

Table 5.4 also shows the average annual growth rate of regular expenditure (i.e. 13.6 percent till FY 2002/03), total revenue (i.e. 13.8 percent), GDP (i.e. 11.1 percent) and internal debt servicing was 16.8 percent. It shows that the growth rate of internal debt servicing is less than growth rate of regular expenditure, total revenue and GDP till FY 2000/01 but in FY 2003/04 the growth rate of internal debt servicing is high (i.e. 16.8 in average). It indicates that since FY 2001/02 to FY 2003/04, debt servicing rate is becoming high it shows there is going on the path with rectification and reformation.

The trend of debt servicing as percentage of regular expenditure, total revenue and GDP has been decreasing and fluctuating. Debt servicing as a percentage of regular expenditure was 17.3 percent in 1989/90 and decreased to 15.7 percent (till FY 2002/03), and total revenue was 12.4 and increased to 15.1 percent under the period of the study. Likewise, share of debt servicing to GDP is 1.1 and increased to 1.9 percent in FY 2003/04. It has fluctuated not more than two even not up to two percent. Similarly, the relation of public debt, development expenditure and total debt servicing has been shown in Table 5.5.

Table 5.5

Outstanding of Public Debt, Development Expenditure and Debt Servicing.

Rs. In Million

Fiscal Year	Total Outstanding Public Debt	Development Expenditure	Total Debt Servicing	Total Outstanding Public Debt as a percentage of Development Expenditure	Total Debt Servicing as a percentage of Development Expenditure
1989/90	51,474.0	12,997.6	2,279.2	396.0	17.5
1990/91	80,361.2	15,979.3	2,407.4	502.9	15.1
1991/92	94,158.8	16,512.8	3,797.1	570.2	23.0
1992/93	112,876.8	19,413.6	4,560.5	581.4	23.5
1993/94	132,598.0	21,188.2	4,855.1	625.8	22.9
1994/95	145,058.8	19,550.0	6,083.3	742.0	31.1
1995/96	162,286.3	24,980.2	6,715.4	649.7	26.9
1996/97	167,977.7	29,242.6	7,527.2	574.4	25.7
1997/98	199,614.7	28,943.8	7,682.8	689.7	26.5
1998/99	219,135.5	28,531.3	8,723.0	768.0	30.6
1999/00	245,048.2	31,749.2	10,032.8	771.8	31.6
2000/01	260,448.1	37,065.9	10,388.4	702.7	28.0
2001/02	293,746.3	31,482.2	12,205.2	933.0	38.8
2002/03	308,078.5	29,033.0	16,181.3	1061.1	55.7
2003/04	318,913.0		17,338.8		
Average Annual Growth Rate	13.6	5.0	15.2	-----	-----

Source: MOF/ GON, Economic Survey 2004/05

The expenditure heads till FY 2003/04 were classified as regular and development. During FY 2004/05, such expenditure has been classified as recurrent expenditure amounted Rs. 55,552.1 million, capital expenditure amounted Rs. 23,095.6 million and Principal repayment expenditure amounted Rs. 10,794 million in FY 2003/04. That's why here researcher did not submit the regular and development expenditure in FY 2003/04. So comparison is only done between 1989/90 to 2002/03 in the regular and development expenditure).

Observing Table 5.5, we can see the volume of outstanding debt was Rs. 51,474.0 million in 1989/90 and has increased to Rs. 318,913.0 million in 2003/04 with the 13.6 percent of average annual growth rate. These show the real burden of debt of Nepal. Where total outstanding of public debt as percentage of development was 396.0 percent that has maintained up to 1061.1 percent up to FY Year 2002/03. This shows Nepal is going down day by day into the depth of the debt burden.

Development expenditure has also gone up to Rs. 29,033.0 million in FY 2002/03, which in the beginning of the study period was Rs. 12,997.6 million. Table shows that development expenditure is decreasing in trend at the end of the study period. It causes may be due to the Maoist confliction. Till FY 2000/01, its annual average growth rate was 10.0 percent, but it has decreased down to 5.0 percent in FY 2002/03. It clearly shows us our development process is not increasing in up growing path. In FY 2003/04 our total expenditure has classified into there heads where capital expenditure is Rs. 23095.3 million, it is less than recurrent expenditure i.e. Rs. 55,552.1 million. This shows the increasing trend of development expenditure is less than outstanding public debt.

Likewise, total debt servicing was Rs. 2,279.2 million in 1989/90 and gone up to Rs. 17,338.8 million in 2003/04 with 15.2 percentage of average annual growth rate. It is greater than outstanding of public debt. But, till FY 2000/01 average annual growth rate of outstanding public debt is greater than growth rate of debt servicing. But at the end of the year, it is going towards reformation, renaissance and awareness. If same situation is remaining on long run, one day Nepal would be free from dependency. Total debt servicing as percentage of development expenditure has increased from 17.5 to 55.7 percent under the period of study (till 2002/03) it is slightly increasing in process.

While discussing about the burden of internal debt, the analysis of internal debt and annual internal borrowing are important aspect of it. The Table 5.6 has shown the proportional relationship between annual internal debt servicing and annual borrowing.

Table 5.6

Annual Internal Debt servicing as Percentage of Annual Internal Borrowing.

Rs. In Million

Fiscal Year	Internal Debt	Internal Debt Servicing	Internal Debt Servicing as Percentage of Internal Debt
1989/90	2,150.0	1,157.3	53.8
1990/91	4,552.7	1,320.9	29.0
1991/92	2,078.8	2,132.2	102.6
1992/93	1,620.0	2,428.6	149.9
1993/94	1,820.0	2,366.4	130.0
1994/95	1,900.0	3,098.6	163.1
1995/96	2,200.0	3,421.1	155.5
1996/97	3,000.0	4,177.8	139.3
1997/98	3,400.0	3,481.6	102.4
1998/99	4,710.0	3,977.5	84.4
1999/00	5,500.0	4,711.4	85.7
2000/01	7,000.0	4,187.0	59.8
2001/02	8,000.0	5,637.7	70.5
2002/03	8,880.0	8,662.1	97.5
2003/04	5,607.8	9,429.9	168.1
Average Annual Growth Rate	10.4	16.8	

Source: MOF, HMG/N, Economic Survey, Various Issues. NRB Report 2004/05

Observing the above table, we can find out the volume of internal debt was Rs. 2,150.0 million in 1989/90 and has gone up to Rs. 5,607.8 million in 2003/04 with 10.4 percent of average annual growth rate under the period of study. Likewise, internal debt servicing is also gone up from Rs. 1,157.3 million to Rs. 9,429.9 million with 16.8 percent of average annual growth rate.

The volume of internal debt is higher than internal debt servicing in 1989/90 to 1990/91, but after 1990/91 the magnitude of internal debt servicing exceed the amount of internal debt till FY 1997/98. But at the end of the study period, volume of internal debt service is greater than volume of internal debt. Till FY 2002/03, this situation indicates that the internal borrowing being spent on debt servicing and also shows that the government ability to borrow from internal sources is not conducive to raise enough funds for development requirement and this also shows that the increasing proportion of internal debt servicing is the manifestation of unproductive expanding of borrowed fund. But at the end of the study period, it became hopeful to develop capital formation by borrowing funds. Even, the proportional of internal debt servicing to the internal debt is declining until 2002/03. Which reached from 102.4 percent to 97.5 percent, it became 168.1 percent in 2003/04. This indicated internal fund is going up and gradually it will strong. However, this is good at the end of the year but in the past year, it was not good. Thus, the high reliance on internal borrowing for financing budgetary deficit may have some causes.

1. Huge amount of development fund diverted for meeting debt servicing charges, which comes under regular expenditure.
2. Some borrowing portion from NRB will have effect on monetary supply and consequently it has direct impact on money supply and increased prices.
3. Likewise borrowing from commercial Banks will create crowing out of private sector investment.

Similarly, we can see the external debt and external debt servicing as a percentage to the external debt in Table 5.7.

Table 5.7

Annual External Debt Servicing as Percentage of Annual External Borrowing.

Rs In Million

Fiscal Year	External Debt	External Debt Servicing	External Debt Servicing as Percentage of External Debt
1989/90	5,959.4	1,121.9	18.8
1990/91	6,256.7	1,086.5	17.4
1991/92	6,816.9	1,664.9	24.4
1992/93	6,920.9	2,131.9	30.8
1993/94	9,163.6	2,488.7	27.1
1994/95	7,312.3	2,984.7	40.8
1995/96	9,463.9	3,294.3	34.8
1996/97	9,043.6	3,349.4	37.0
1997/98	11,054.4	4,201.2	38.0
1998/99	11,852.4	4,745.5	40.0
1999/00	11,812.2	5,321.4	45.0
2000/01	12,044.0	6,201.4	51.4
2001/02	7,698.7	6,567.5	85.3
2002/03	4,546.4	7,519.2	165.4
2003/04	7,629.0	7,908.9	103.7
Average Annual Growth Rate	5.0	14.6	---------

Source: MOF, GON, Economic Survey, Various Issues. NRB Report 2004/05

Table 5.7 shows the ratio of external debt servicing was greater than ratio of external debt in 1989/90. But due to high increasing rate, external debt was high in 2000/01 with Rs. 12,044.0 million and was greater than external debt servicing but at the end of the year external debt became less than external debt servicing and the percentage share to external debt has increased from 18.8 percent to 103.7 percent. All these trend shows Nepal's forthcoming days will be change into free of debt burden if these situation is running up continuously.

5.5 Trade and Balance of Payments

One of the serious problems of Nepal is trade deficit and current account deficit. Which has been increasing each year rapidly and to restoration it, the government has to do enough improve on export and imports. One of the main features of Nepal's foreign trade is slow growth of exports and acceleration on imports. This is leading the trade deficit. Table 5.5 shows the percentage share of export and imports to GDP.

Table 5.8
Foreign Trade Situation

Rs. In Million

Fiscal Year	Export	Imports	GDP	Export as a Percentage of GDP	Imports as a Percentage of GDP	Trade Deficit as % of GDP	Current A/C Deficit as % of GDP
1989/90	5,106.2	18,324.9	103,416	4.9	17.7	12.8	7.4
1990/91	7,387.5	23,226.3	120,370	6.1	19.3	13.2	7.9
1991/92	13,705.8	31,940.0	149,487	9.2	21.4	12.2	6.7
1992/93	17,266.5	39,205.6	171,492	10.1	22.9	12.8	5.8
1993/94	19,293.4	51,570.8	199,272	9.7	25.9	16.2	4.0
1994/95	17,639.2	63,679.5	219,175	8.0	29.0	21.0	5.4
1995/96	19,881.1	74,454.5	248,913	8.0	29.9	21.9	8.6
1996/97	22,636.5	93,553.4	280,513	8.1	33.1	25.3	5.9
1997/98	27,513.5	89,002.0	300,845	9.1	29.6	20.4	5.0
1998/99	35,676.3	87,525.3	342,036	10.4	25.6	15.2	0.1
1999/00	49,822.7	108,494.9	379,488	13.1	28.6	15.5	2.7
2000/01	55,654.1	115,687.2	411,275	13.5	28.1	14.6	4.9*
2001/02	46,944.8	107,389.0	422,807	11.1	25.4	14.3	4.3*
2002/03	49,930.6	124,352.1	456,675	10.9	27.2	16.3	2.5*
2003/04	53,910.7	136,277.1	495,589	1.09	27.5	16.6	2.9*
Average Annual Growth Rate	19.1	15.5	11.1	-----	-----	16.5	

Source: MOF/ GON, Economic Survey 2004/05 and Quarterly Economic Bulletin, NRB, Mid April-2005

Note: Export and Import is calculated on the basis of SITC

SITC = Standard of international trade classification.

GDP is calculated at the producer's price

Trade deficit = M - X

** = Including Worker's Remittance and Pension*

Table 5.8shows the different aspect of foreign trade and balance of payment of Nepal. In which the income of export was Rs. 5,106.2 million in 1989/90 and has increased to Rs. 53,910.7 million in 2003/04 with 19.1 percent of average annual growth rate.

The table also shows that the annual growth rate of export has increased not more than import payment. The magnitude of imports payment has mounted up from RS. 18,324.9 million to RS. 136,277.1 million With 15.5 percent of average annual growth rate. The table indicates that the absolute amount of import payment is larger than export earning but in the context of growth rate, increasing trend of growth rate of export earning is greater than import payments. Here, import payments as percentage of GDP is also increasing from 17.7 percent to 27.5 percent during the study period. This trend shows that situation of imports payment compare to export earning, that leads to trade deficits.

Ratio of trade deficit to GDP was 12.8 percentages and has increased to highest point 25.3 percent in 1996/97 and slowly declining and reached 16.6 percent at the end of the year. While discussing about the current account balance till 1999/2000 government did not submitted worker's remittance and foreign pension due to the beyond of control. That could not be estimated in the previous year that is why our current account balance was always remained negative. With the suggestion of IMF government has started to submit the worker's remittance and pension since 2000/01. Therefore, since then our current account balance is remained positive under the study period. In forthcoming year, government is exercising to submit the more than 80 percent of remittance on its account. Now it has submitted approximately 80 percent of remittance that's why its amount is Rs. 14,598.0 million in 2003/04.

After discussing all this, we can say that remittance plays a vital role to develop the country's economy. That is why government should make a flexible policy to work in abroad. There is only one reason of positive account i.e. remittance and we can feel proud of that. Nevertheless, we should retreat, why the government could not estimate the remittance before FY 2000/01. Why it did not focus the remittance in the previous year? All the new process has been done with the suggestion of IMF.

Table 5.8 also shows that current account deficit expressed as percent of GDP has been in the range of 0.1 to 8.6 percent. Where, the account deficit to GDP has shown negative aspect till FY 1999/2000. However, since then, the ratio of account deficit to GDP is positive at the end of the study of period. Because, there has been submitted remittance since 2000/01. That is why the current account deficit ratio to GDP is positive since the 2000/01. Therefore, remittance is a responsible factor to create a positive account. Where, at the end of the year, our current account balance is Rs. 14,598.0 million including with remittance and pension. (See Appendix-3)

5.6 Issues of Foreign Loans.

An underdeveloped country like Nepal is facing the serious problem of scarcity of domestic capital formation, which is more essential for development process. And these countries are also facing the shortage of foreign exchanges. So, these countries have to borrow public debts from within the country as well as from the external sources like foreign countries and internal agencies to breakout the vicious circle of insufficient capital formation and development bottlenecks. The scopes for domestic borrowing in these countries are very limited, because internal resources are scarce. So, only external borrowing remains the alternative to be undertaken by these countries.

Nepal is facing various problems like poverty, unemployment and Nepal's macro economic indicators show also negative growth and declining economic performance. Last year, in FY 2004, Nepal's Human Development Indicator and

Human empowerment Indicator was 0.461 and 0.459 respectively, it proved the poverty of Nepal. Recently, Nepal has to invest huge amount of expenditure for security, which seems unproductive in present situation. Our current year's Budget is 25.71 percent more than last year's budget but revenue is not increasing in the same pace. Due to this reason, Nepal will have to depend upon foreign assistance and external loans. Owing to heavy reliance on external assistance in the form of borrowing in public accounts, Nepal's external public indebtedness has increased in geometric approach. A rise in external indebtedness should be accompanied by increased in debts servicing capacity. So, that there 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?

Although, foreign loans are main pillars for development process and to break out vicious circle of insufficient domestic capital formation. It has adverse effect on national economy when it's servicing, means that the scarce foreign exchange resource have to be transferred to creditors countries.

When external debt services this has obvious impact on domestic capital formation and leads to reduction the domestic standard of living unless the loans are used for financing profitable investment, then whole yield is enough to satisfy creditors claims for debt servicing. Therefore, the true burden of debt service depends to a substantial extent. In which the borrowed fund from external sources can be transferred into productive investment. If the foreign loans are used into unproductive investment projects that provide present consumption with more goods than being produced in the country then foreign debt servicing is possible.

For the purpose of foreign debt servicing, foreign currency has to be earned through increasing volume of exportable goods and services. If this is not done then the purpose of external loan is not fulfilled and it really becomes burden on next generation. Therefore, it is very essential that the real income of the national economy grow 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.

Samuelson (1964) has suggested for use of foreign capital in the process of development of developing countries. He has said that, "If there are many difficulties in the way of domestic financed of capital formation, why not rely more heavily on foreign sources". He further said, " Doesn't economic theory tells that a rich country which has used up all its own high investment projects can benefit itself and at the same time benefit a poor country abroad. If only it will shift investment to the high internal project, it will be benefited to the investor or indebted country

5.7 Foreign Outstanding Debt and GDP.

While discussing about the burden of public debt, we must analyze the trend of outstanding external debt and GDP, and compare between them is necessary. This gives the status of external debt to GDP. Table 5.9 shows the economic growth in terms of GDP and Trend of outstanding debt.

Observing Table 5.9, the increasing trend of growth rate of outstanding debt and GDP is seemed. The amount of outstanding debt was Rs. 232,779.3 million in 2003/04 with 13.9 percent of average annual growth rate. Its annual growth rate was 61.7 percent in 1990/91 but after then it is declining to 1.5 percent in FY 2002/03 and slowly increasing to 4.2 percent in 2003/04. But increasing trend of average annual growth rate of GDP shows diminishing and it also shows undesirable economic performance because GDP as a pillar of National economy. Where, GDP has increased from Rs. 103,416.0 million to Rs. 495,589.0 million with 11.1 percent of average annual growth rate.

Table 5.9

External Outstanding Debt and GDP

Rs. in Million

Fiscal Year	Total External Debt	Annual Growth Rate	Gross Domestic Product	Annual Growth Rate	External Debt as Percentage of GDP
1989/90	36,800.9	-----	103,416.0	-----	35.6
1990/91	59,505.3	61.7	120,370.0	16.4	49.4
1991/92	70,923.9	19.2	149,487.0	24.2	47.4
1992/93	87,420.8	23.3	171,492.0	14.7	51.0
1993/94	101,966.8	16.6	199,272.0	16.2	51.2
1994/95	113,000.9	10.8	219,175.0	10.0	51.5
1995/96	128,044.4	13.3	248,913.0	13.6	51.4
1996/97	132,086.8	3.2	280,513.0	12.7	47.1
1997/98	161,208.0	22.0	300,845.0	7.2	53.6
1998/99	169,465.9	5.1	342,036.0	13.7	49.5
1999/00	190,691.2	12.5	379,488.0	10.9	50.2
2000/01	200,404.4	5.1	411,275.0	8.4	48.7
2001/02	220,125.6	9.8	422,807.0	2.8	52.1
2002/03	223,433.2	1.5	456,675.0	8.0	48.9
2003/04	232,779.3	4.2	495,589.0	8.5	47.0
Average Annual Growth Rate	19.9	13.9	11.1	11.1	--------

Source: MOF/ GON, Economic Survey Various Issues, 2004/05

The annual growth rate of GDP is not satisfied and became 2.8 percent growth rate in 2001/02. Compare with previous year, it was threatened to national economy. While compare the increasing trend of external indebtedness to increase in GDP or external debt to GDP was 35.6 percent in 1989/90 and has mountain up to 47.0 percent in 2003/04 with 49.0 percent of average annual rate. This show the burden of external debt was quite heavy. Table 5.9 also shows the average annual percentage share of external outstanding debt is 49.0 percent of GDP, which may lead to country to external debt crisis in future. So, external loans have to use for productive sector or think about proper utilization.

5.8 External Debt Flow and Its Annual 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 5.0 percent under the period of the study. Here the ratio of external outstanding debt to GDP has grown up and creating adverse situation in the economy, which requires serious thinking for its solution.

Table 5.10

External Debt Flow and Its Servicing.

Rs. In Million

Fiscal Year	External Debt	External Debt Servicing	External Debt Servicing as a Percentage of External Debt
1989/90	5,959.4	1,121.9	18.8
1990/91	6,256.7	1,086.5	17.4
1991/92	6,816.9	1,664.9	24.4
1992/93	6,920.9	2,131.9	30.8
1993/94	9,163.6	2,488.7	27.2
1994/95	7,312.3	2,984.7	40.8
1995/96	9,463.9	3,294.3	34.8
1996/97	9,043.6	3,349.4	37.0
1997/98	11,054.4	4,201.2	38.0
1998/99	11,852.4	4,745.5	40.0
1999/00	11,,812.2	5,321.4	45.0
2000/01	12,044.0	6,201.4	51.5
2001/02	7,698.7	6,567.5	85.3
2002/03	4,546.4	7,519.2	165.4
2003/04	7,629.0	7,908.9	103.7
Average Annual Growth Rate	5.0	14.6	-----

Source: MOF/ GON, Economic Survey Various Issues, 2004/05

Table 5.10 shows the comparison between the annual flow of external debt and annual external debt servicing obligations. Here, the new borrowing external debt was Rs. 5,959.4 million in 1989/90 and has mountain up to Rs. 12044.0 million in 2000/01 and decreased to 7,629.0 million in 2003/04. This is the great improvement in our Nepalese History. We must accept it being a 5.0 of average annual growth rate and once we must salute this type of mishap. The amount of external debt servicing has increased from Rs. 1,121.9 million to Rs. 7,908.9 million with 14.6 percent of average annual growth rate under the period of the study. This shows that the proportional of external debt servicing to new external borrowing has been 9.6 percent over the period. These indicators threaten about its increasing burden because it is going to not only large proportion of exchange earning but also rather large proportion of new borrowing. Or till 2000/01, more than half of new annual external borrowing or 51.5 percent of new borrowing transfer to the creditor countries to service the external debt per annum. But in FY 2003/04 more than 100% of external debt servicing is transferred to external debt. But there always remain one question how it is possible? Is it a magic? Then how it became possible? It proved that if we use foreign loan in the productive sector then it is possible to repayment and remittance has also played a vital role to develop our economy in the current year.

5.9 External Debt Servicing, Export Earning and GDP Ratio.

Here, the attempt has been discussed about the ratio of external debt servicing to export earning and debt servicing to GDP. In Nepal, the large proportion of GDP and export earning has transferred or go to back to foreign countries while servicing. Table 5.11 concerns the following heading with export earning, debt servicing and ratio to GDP.

Table 5.10

Ratio of External Debt Servicing, Export Earning and GDP

Rs. In Million

Fiscal Year	External Debt Servicing	Export	GDP	External Debt Servicing as a Percentage of Export	External Debt Servicing as a Percentage of GDP
1989/90	1,121.9	5,106.2	103,416.0	22.0	1.1
1990/91	1,086.5	7,387.5	120,370.0	14.7	1.0
1991/92	1,664.9	13,705.8	149,487.0	12.1	1.1
1992/93	2,131.9	17,266.5	171,492.0	12.3	1.2
1993/94	2,488.7	19,293.4	199,272.0	13.0	1.2
1994/95	2,984.7	17,639.2	219,175.0	16.9	1.4
1995/96	3,294.3	19,881.1	248,913.0	16.6	1.3
1996/97	3,349.4	22,636.5	280,513.0	14.8	1.2
1997/98	4,201.2	27,513.5	300,845.0	15.3	1.4
1998/99	4,745.5	35,676.3	342,036.0	13.3	1.4
1999/00	5,321.4	49,822.7	379,488.0	10.7	1.4
2000/01	6,201.4	55,654.1	411,275.0	11.1	1.5
2001/02	6,567.5	46,944.8	422,807.0	14.0	1.5
2002/03	7,519.2	49,930.6	456,675.0	15.1	1.6
2003/04	7,908.9	53,910.7	495,589.0	14.7	1.6
Average Annual Growth Rate	14.6	19.1	11.1	-----	-----

Source: MOF/ GON, Economic Survey Various Issues, 2004/05

Table 5.11 shows the magnitude of export earning was Rs. 5106.2 million in 1989/90 that has mountain up to Rs. 53910.7 million in 2003/04 with the 19.1 percent of average annual growth rate which has increased about 10.7 times under the review of the study. Where as external debt servicing volume was Rs. 1121.9 million and it has increased to Rs. 7908.9 million with 14.6 percent of average annual growth rate under the period of review. Or it has been increased only 7.0 folds.

While discussing about the ratio in percentage of external debt servicing to export earning, its magnitude was 22.0 percent in 1989/90 and has decreased to 14.7 percent in 2003/04. The average annual rate of this ratio is 14.4 under the period of study. The debt servicing-export earning ratio was higher i.e. 22.0 percent in 1989/90, but since then, this ratio of percentage has not been restored yet.

Similarly, the ratio of external dept servicing to GDP has increased from 1.1 percent to 1.6 percent in 2003/04. Its average annual ratio is 1.3 percent.

The above indicators introduce difficulties and affect the rate of capital formation in the economy because of the growing magnitude of interest payments and repayments in terms of the foreign exchange nut scarce in underdeveloped countries like Nepal.

5.10 Outstanding External Debt and Import

Table 5.12 shows the relationship between external debt burden and import payments and their average annual growth rate and the ratio of imports payments to external debt.

Table 5.12

Ratio of External Outstanding Debt and Import Payments.

Rs. In Million

Fiscal Year	External Outstanding Debt	Import Payments	Import Payments as a Percentage of External Outstanding Debt
1989/90	36,800.9	18,324.9	49.8
1990/91	59,505.3	23,226.3	39.0
1991/92	70,923.9	31,940.0	45.0
1992/93	87,420.8	39,205.6	44.8
1993/94	101,966.8	51,570.8	50.6
1994/95	113,000.9	63,679.5	56.3
1995/96	128,044.4	74,454.5	58.1
1996/97	132,086.8	93,553.4	70.8
1997/98	161,208.0	89,002.0	55.2
1998/99	169,465.9	87,525.3	51.6
1999/00	190,691.2	108,494.9	56.9
2000/01	200,404.4	115,687.2	57.7
2001/02	220,125.6	107,389.0	48.8
2002/03	223,433.2	124,352.1	55.6
2003/04	232,779.3	136,277.1	58.5
Average Annual Growth Rate	19.9	15.5	-----

Source: MOF/ GON, Economic Survey Various Issues, 2004/05

While observing Table 5.12, we can find the increasing trend of external outstanding debt with 13.9 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 payments was Rs. 18,324.9 million in 1989/90 and has gone up to Rs. 136,277.1 million in 2003/04 with 15.5

percentage of average annual growth rate. This shows the large proportion of foreign exchange transfer to foreign countries for import service payment of goods and services.

Table 5.12 also shows import payments as percentage of external outstanding debt, which was 49.8 percent in 1989/90, then its increasing trend shows tremendous and has gone up to 70.8 percent in 1996/97, which indicates 3/4 percent of external debt has transferred to foreign countries for import payments. This indicators show that purpose of external debt is not going right direction and balance of payments hampered. In 2003/04, import payments as percentage of external debt is 58.5 percent and its average annual growth rate is 53.2 percent. This indicates the more than half of external debt has transferred for import payments showing gradual increase in import of goods and services from abroad. This is also the causes of affected balance of payments.

5.11 Factors Affecting Public Debt in Nepal.

Nepal in an underdeveloped country and in the development process for this, the government has to push heavy doze of investment. On the other hand, our domestic resources mobilization is inadequate and insufficient to meet growing needs of investment funds. Then ultimately, there has been creating a resources gap, which is shown in Table 5.13.

Table 5.13

Domestic Saving-Investment Gap as percentage to GDP

Rs. In Million

Fiscal Year	Saving as % of GDP	Investment as % of GDP	Saving - Investment Gap
1989/90	7.9	18.4	10.5
1990/91	9.6	20.8	11.2
1991/92	10.8	21.1	10.3
1992/93	13.5	23.1	9.6
1993/94	14.7	22.4	7.7
1994/95	14.8	25.2	10.4
1995/96	13.8	27.3	13.8
1996/97	14.0	25.3	11.3
1997/98	13.8	24.8	11.0
1998/99	13.6	20.5	6.9
1999/00	15.0	24.3	9.3
2000/01	15.0	24.1	9.1
2001/02	12.1	24.2	12.1
2002/03	12.0	26.1	14.1
2003/04	12.3	27.2	14.9
Average Annual Growth Rate	12.9	23.6	10.7

Source: MOF/ GON, Economic Survey Various Issues, 2004/05.

Table 5.13 shows the domestic saving and investment as percentage of GDP. While observing this table, the percentage share of investment to GDP was 18.4 percent in 1989/90 and tremendously has gone up to 27.2 percent in 2003/04. Its average annual rate is 23.1 percent under the period of study.

The magnitude percentage share of saving to GDP has tremendously increasing from 7.9 percent to 15.0 percent till 2000/01 and 12.3 percent in 2003/004 with 12.9 percent of average annual rate. These indicators show that the increasing trend of investment to GDP is about two times greater than saving.

When investment is greater than saving then create an investment saving gap or resources gap. Table 5.12 shows the resource gap as percentage of GDP, which was 10.5 percent in 1989/90 and has gone up to 14.9 percent in 2003/04, which is highest resource gap and lowest 6.9 percent in 1998/99. Its average annual rate is 10.7 percent.

The above indicators show that the growing rate of investment has outpaced the growing rate of saving to GDP creating resource gap. Then ultimately, there has been increasing reliance on foreign assistance to meet growing need of resource gap. That is the main factor, which affects the public debt in Nepal.

5.12 Problems in Public Debt

Foreign borrowing can be highly beneficial to promote the economic growth and otherwise it becomes high cost to the debtor country, if it is used in unproductive field. The main cost associated with the accumulation of a large external debt is "debt-servicing". Debt servicing is the payment of amortization (i.e. liquidation of the principle") and accumulated interest. It is a contractually fixed charge on the domestic real income and saving. As the size of the debt grows or interest rate rises, debt-service charge increases.

Debt service payment must be made with foreign currencies. In other words, the large amount of debt service payments can not be met only through export earning. Then, it must curtail imports and further external borrowing. Under normal circumstances, most of country's debt service obligations are met by its export earning. However, in the context of Nepal's import payment is higher than export earning. Debt crisis is often preceded by extreme pressure on the balance of payments, a relatively high rate of inflation sizeable deficits in the government budget, capital flight and in a certain instances heavy borrowing from abroad on hard terms. This tend created the impression of the mismanagement of the economy has been a contributing factor to debt crisis. (UNCTAD, 1972)

The extreme case of a debt-servicing problem is the situation where a country finds its debt obligation and its total commitments because of imports exceeds the foreign exchange resources currently at its disposal. (UNCTAD, 1974)

Therefore, large scale of public borrowing for financing development may be justified but the resultant rise in public debt raises several issues of which the most important is the burden of public debt. In Nepal, in the beginning of the debt era, a sinking fund was established aiming at clearing debt (Budget speech by 1964/65) but later, it was either dropped or left to collapse. It could not materialize even though it was continuously stated on plan documents. In the absence of sinking fund, debt servicing is becoming difficult. Limited export earning has not been enough for servicing foreign debt. In this relation, the mobilization of resources is a painstaking task. Debt problem are especially the result of policy shortcoming. However, we have to keep up our commitment and obligation before our debtors, both internal and external.

Here, in 17 July 2005, our annual budget has announced and it was Rs. 126.8 billion but it also cleared that estimated deficit is Rs. 15.9 billon. Here, it is generally observed that one third of the total development outlay is fulfilled by debt (both external and internal). Due to high growth rate of population, government has to increase its deficit on the budget. Similarly, the average annual growth rate of debt and repayment are considered too high. This is why, it is necessary to have a careful look on this increasing trend of debt crisis and must be careful on debt servicing. We have bad habit i.e. only we remember in taking but forget in return, which leads us in dark vacuum.

CHAPTER-VI

Summary, Conclusion and Recommendations.

6.1 Summary and Major Findings

The landlocked nature and mountainous topography are the major constraint for development in Nepal. Economically Nepal is back ward and its economic performance is not satisfactory. Now, Nepal is facing an acute resource gap problem, which is also being expected to grow in coming year. Nepal is demanding more and more financial resources through public debt to bridge the growing resources gap in the budget.

Almost developing countries like Nepal, the external borrowing is increasing more rapidly rather than internal borrowing. Nepal is facing the serious problem of inadequate mobilization of internal resources. On the one hand, government has to invest in almost ass sectors of economy where as on the other hand; there is a challenge to mobilize additional resources for meeting the growing expenditure. The international comparison of macro economic indictors shows that Nepal's position is extremely counterpale. Because, debt-servicing obligation are also increasing rapidly but debt servicing capacity of the country has not been increasing with the same pace. Therefore, Nepal is in early stage of development. The widening resource gap itself would not have been a matter of serious concern, if it was related to growth and investment leading to capacity expansion in the economy but the situation has been quite adverse.

Nepal's budgetary system shows the trend of increasing deficit budget or fiscal deficit is widening year by year. Therefore, it is necessary to know the pattern and quantity of public debt (external and internal) as a major source of finance for development activities. This small study is attempting to investigate the pattern of public debt in Nepal. A brief theoretical perspective has been taken into consideration while studying public debt and its ratio with GDP, revenue, total expenditure, outstanding debt and debt servicing etc., from the year 1989/90 to 2003/04.

Internal public debt has played a significant role in the financial resources for development expenditure as well as in the growth of money and capital market, and facilities the effective implementation of monetary policy. But the domestic resources are not sufficient to promote the rapid development of the Nepalese economy. The external assistance plays all obvious functions in the development forces for financial resources. Concerning foreign assistance grants have or big role to play in solving the resources gap in countries budgetary expenditure.

Now, Nepal is indebted by external and internal loans but further more by external outstanding debt. Consequently, external debt servicing has become a current issue. In the context of Nepalese economy question may arise whether our country's revenue and foreign exchange availability can sustain or not that increasing external debt service payment or not. If our country's sources cannot meet external debt service payment, there will be need to borrow again external loans for debt servicing in "Debt for Debt Servicing Trap". Nepal is passing through a critical phase of inadequate mobilization of internal resources, thus managing public finance has been challenging proportional. Because of this extreme situation, fiscal deficit is widening day by day.

Revenue and Fiscal Deficit

Looking the average annual growth rate of revenue collection remained 13.8 percent where as expenditure remained at 10.8 percent over the period 1989/90 to 2003/04. Although the growth rate of revenue collection is hither than expenditure, the absolute amount of government expenditure is hither than revenue. Which are Rs. 8, 9442.6 million and Rs. 62,331.0 million respectively in 2003/04. This indictor shows that widening financial resource gap. In which the fiscal deficit increased from Rs. 8,381.9 million to Rs. 15,828.2 million with 5.9 percent of average annual growth rate under the period of study. On the other hand, revenue deficit has increased from Rs. 10,357.3 million to Rs. 27,111.6 million with 7.6 percent of average annual growth rate in the period of review.

But ratio of fiscal deficit to GDP has decreased from 8.1 percent to 3.2 percent and ratio of revenue deficit to GDP has decreased from 10.0 percent to 5.5 percent during the same period. Gain the ratio of internal loan to fiscal deficit has increased from 26.3 percent in 1989/90 to 35.4 percent in 2003/04. The ratio of external loan to fiscal deficit has decreased from 71.1 percent to 48.2 during the same period.

Debt Situation

The external debt has been increasing from Rs. 8109.4 million to Rs. 13236.8 million with 4.6 percent of average annual growth rate. In which the share of internal debt has increased with 10.4 percent average annual growth rate, from Rs. 2150.0 million to Rs. 5607.8 million during the period of study. The external and internal debt as percentage of fiscal deficit is 71.1 percent and 26.3 percent in 1989/90 and internal has gone up to 35.4 percent and external is decreased to 48.2 percent and the average annual rate is 26.8 percent and 58.8 percent respectively. This shows the contribution of external loan to fiscal deficit is outpaced the share of internal but the growth rate showing the decreasing trend of external and increasing trend of internal debt as percentage of fiscal deficit. Or share of external loan to total loan has been decreasing from 73.5 percent to 57.6 percent and share of internal loan has been increasing from 26.5 percent to 42.4 percent under the review period.

Debt Servicing.

During the period of study between 1989/90 to 2003/04, the share of external debt servicing in total debt servicing has decreased from 49.2 percent to 45.6

percent respectively. Similarly, the share of internal debt servicing in total debt servicing has increased from 50.8 percent to 54.4 percent respectively over the period of study. These indicate that the share of internal debt servicing in total debt servicing has been greater than external.

The ratio of internal debt servicing on average, the total revenue has remained 12.6 percent, the regular expenditure 15.8 percent and GDP has been 1.3 percent over the period under review. These factor shows that the burden of internal debt. In terms of total revenue, regular expenditure and GDP have increased considerably during the period of study between 1989/90 to 2003/04.

The average annual growth rate of total debt servicing has been 15.2 percent over the period under review. Similarly, the external debt servicing considerably increased with an average annual growth rate of 14.6 percent. Likewise, the average annual growth rate of internal debt servicing has been 16.8 percent during the period between 1989/90 to 2003/04.

Outstanding Public Debt.

The average annual growth rate of outstanding total public debt has been 13.6 percent during the period of study between 1989/90 to 2003/04. Similarly, the average annual growth rate of external and internal is 13.9 percent and 13.0 respectively. Where the external outstanding debt was Rs. 36,800.9 million in 1989/90 and has gone up to Rs. 232,779.3 million in 2003/04. Similarly, internal outstanding debt is Rs. 14,673.1 million and 86,133.7 respectively in 1989/90 to 2003/04.

The share of internal debt in total debt decreased from 28.5 percent to 27.0 percent during the period under study. And the share of external debt in total debt has increased from 71.5 percent to 73.0 percent during the same period. This shows that tremendous fluctuation has not occurred in this sector. The magnitude of public debt has been increasing the ratio of outstanding debt to GDP has increased considerably from 49.8 percent to 64.4 percent during the period of study between 1989/90 to 2003/04. Similarly, the ratio of internal outstanding debt to GDP has also increased from 14.2 percent to 17.4 percent and the ratio of external debt to GDP has been 35.6 percent to 47.0 percent during the same period. These indicated heavy indebtedness by the external outstanding debt, which is higher than internal outstanding debt.

Loan

In the structure of total loan, we get, the multilateral loan has dominated the bilateral loan during the period of study between 1989/90 and 2003/04. The total loan disbursement Rs. 4,628.3 million, multilateral loan amounted Rs. 3,,627.7 and bilateral loan amounted Rs. 1,000.6 million, where percentage share of multilateral loan to total loan is 78.4 percent and bilateral loan to total loan is 21.6 percent in 1989/90. Whereas the total loan disbursement is RS. 7,629.0 million, multilateral loan amounted to RS. 7,563.0 million and bilateral loan amounted to RS. 66.0 million With 99.1 percent and 0.9 percentage share to total loan respectively.

GDP and External Outstanding Debt.

The trend of external debt was amounted to RS. 36,800.9 million In 1989/90 that increased to RS. 232,779.3 million In 2003/04 and its annual growth has been 13.9 per annum. Similarly, the trend of GDP has also increased from RS. 10, 3416.0 million to Rs. 495,589.0 million at producer's price in 2003/04; and its annual growth rate has been 11.1 percent annually during the same period. Here the increasing trend of annual average growth of GDP is less than external outstanding debt. It is not the fair in our economy. It indicates, gradually we are fall in depth of the economic crisis.

6.2 Conclusion

In course of research, it was found that government borrowing has been increasing unlikely and financed mostly on the unproductive sectors including uncertainties, lack of a well-trained civil service, inadequate checks and balance in the political and budgetary process. In addition, corruption, high simple expenditure and hence government always lacks the resources, and then borrow the new loan to pay the previous ones. That is why the public debt and its interest is mountain up day by day, but the addressing capacity for redemption, the debt is not increasing in the same pace.

During the same period of study between 1989/90 and 2003/04, the average annual growth rate of GDP and revenue are considerably low as compared with that of debt and its servicing obligation.

So, we are going to be entrapped in the debt not only but also we can't escape ourselves from the terrific indebtedness, if no effective programmed is set within time to carry out for debt financing economy.

That is why, even; borrowing from other is grand panacea of the modern age and debt is sovereign remedy of all economic crisis; it is proved that it has been misfired in the context of our economic phenomenon

6.3 Recommendations.

Debt crisis must be relying on both internal and external factors. Gradually over the years, Nepal's stock of outstanding foreign debt and its debt-servicing obligation have risen but the addressing capacity for redemption, the debt, is not increasing in the same pace. In this perspective, some recommendations are proposed to mitigate the pain and adverse effect of ever-increasing debt in Nepal.

- The size of revenue collection is very low and expenditure is very high which creates fiscal imbalances. To minimize this problem, the government expenditure has to be controlled and allocated the basis of national priority so that productivity may increase with in stipulated time. And for maximizing revenue collection, government should adopt transparent and effective tax policy and improve the tax administration. This helps to reduce dependency on loans for financing development expenditure

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- The internal borrowing mobilization for development purpose has come from banking sector and Nepal Rasta Bank, which creates inflation, owns about 50 percent of it. Therefore, the government should initiate policies to attract maximum borrowing from non-banking sector and there should be put legal ceiling on government overdrawing from the central bank. The government also issues development bonds and national saving certificates with discount rate and with some additional attraction and concessions to break out inflationary situation.

- The annual growth rate of GDP, per-capita GDP, national saving and investment are still very low but the population ha\s been increasing very fast. Besides even such infrastructure facility on transport, irrigation, education and health have failed to develop adequately. These are some of the factors responsible for the operation of the vicious circle of poverty in Nepal.

- Privatization of government enterprises should be accelerated and the revenue received from privatization should be utilized as the debt-equity-swap strategy for debt relief.

- The trade deficit is the main feature of foreign trade of Nepal. For this, there is need to export promotion and diversifying trade both country wise and commodity wise. And there should be controlled to import of luxurious goods and services and reduce huge deficit by promoting the export oriented industries.

- The growth rate of investment is increasing and the rate of domestic saving is not increasing in the same pace and is increasing investment domestic saving gap. Thus, there is need to reduce such gap by increasing the rate of total domestic saving through transparent and effective tax policy and improving tax administration.

- Export promotion also helps to control the balance of payment that help to save foreign exchange and help reducing the dependency upon external borrowing which is more essential for an extremely indebted country like Nepal. Therefore, for export promotion, the government should be give special privilege to private entrepreneurs, which are engaging in the export business. Moreover, import substitution industries should be encouraged but capital goods import should not be restricted.

- External loan should not contain the element of conditionality. External loan negotiation must be made because of necessity of the economy and project specific. Domestic experts are to be employed instead of foreign experts to save foreign exchange.

- The government should adopt the external policy of received grants rather than the loans.

- Borrowed fund from external sources must be spent on those projects, which are of highly productive nature and can produce exportable items and there should be constant committee to supervise and monitor and to control unnecessary foreign borrowing.

- The role of government is dominating in all sector of the economy. Thus, the government should maintain balance between Urban and Rural sector, Agriculture industry and Trade sector of the country. Because of that, the economy will be capable to move in a self-sustaining growth path.

- Proper attention should be given to the macro-economic stability of the country while accepting short-term and long-term loans.

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Appendix-1

Government Revenue and Annual Growth Rate - (1989/90-2003/04)

Rs. In Million

Fiscal Year	Tax Revenue	Non-Tax Revenue	Government Revenue	Annual Growth Rate of Govt. Revenue	GDP	Revenue in % of GDP
1989/90	7,283.9	2,028.9	9,312.8	-----	103,416.0	9.8
1990/91	8,175.8	2,553.2	10,729.0	15.2	120,370.0	8.9
1991/92	9,875.6	3,637.1	13,512.7	25.9	149,487.0	9.0
1992/93	11,662.5	3,485.9	15,148.4	12.1	171,492.0	8.8
1993/94	15,371.5	4,209.4	19,580.9	29.3	199,272.0	9.8
1994/95	19,660.0	4,945.1	24,605.1	25.7	219,175.0	11.2
1995/96	21,668.0	6,225.1	27,893.1	13.4	248,913.0	11.2
1996/97	24,424.3	5,949.2	30,373.5	8.9	280,513.0	10.8
1997/98	28,752.9	6,998.1	35,751.0	17.7	300,845.0	11.9
1998/99	28,752.9	8,498.4	37,251.3	4.2	342,036.0	10.9
1999/00	33,152.1	9,741.6	42,893.7	15.4	379,488.0	11.3
2000/01	38,865.1	10,028.8	48,893..9	14.0	411,275.0	12.9
2001/02	39,330.6	11,115.0	50,445.6	3.2	422,807.0	11.9
2002/03	42,587.0	13,642.7	56,229.7	11.5	456,675.0	12.3
2003/04	48,713.0	14,158.0	62,331.0	10.8	495,589.0	2.8
Average Annual Growth Rate	13.8	14.5	13.8	13.8	11.1	----

Source: MOF/ HMG/N, Economic Survey Various Issues, 2004/05

Appendix - 2

Government Expenditure (1989/90 - 2003/04)

Rs In Million

Fiscal Year	Regular Expenditure	Annual growth Rate	Development Expenditure	Annual growth Rate	Total Expenditure	Annual growth Rate
1989/90	6,672.5	---	12,997.6	---	19,670.1	----
1990/91	7,573.9	13.5	15,979.3	22.9	23,553.8	19.7
1991/92	9,905.4	30.8	16,512.8	3.3	26,418.2	12.2
1992/93	11,484.1	15.9	19,413.6	17.6	30,897.7	17.0
1993/94	12,409.2	8.0	21,188.2	9.4	33,597.4	8.7
1994/95	19,245.4	55.1	19,550.0	-7.7	38,795.4	15.5
1995/96	21,563.8	12.0	24,980.2	27.8	46,544.0	20.0
1996/97	24,181.1	12.1	29,242.6	17.1	53,423.7	14.8
1997/98	27,174.4	12.4	28,943.8	-1.0	56,118.3	5.0
1998/99	31,047.7	14.2	28,531.3	-1.4	59,579.0	6.2
1999/00	34,523.3	11.2	31,749.2	11.3	66,272.5	11.2
2000/01	42,769.2	23.9	37,065.9	16.7	79,835.1	20.5
2001/02	48,590.0	13.6	31,482.2	-15.1	80,072.2	0.3
2002/03	54,973.0	13.1	29,033.0	-7.8	84,006.1	4.9
2003/04					89,442.6	6.5
Average Annual Growth Rate					10.8	10.8

Source: MOF/GON, Economic Survey, 2004/05

Appendix - 3

Structure of Trade and Account Balance (Growth Rate in Percent)

Rs. In million

Fiscal Year	Export	Annual Growth Rate	Imports	Annual Growth Rate	Trade Deficit	Annual Growth Rate	Account Balance	Annual Growth Rate
1989/90	5,106.2	---	18,324.9	---	13,218.7	---	-7,643.6	----
1990/91	7,387.5	44.7	23,226.3	26.7	15,838.8	19.8	-9,499.7	-19.5
1991/92	13,705.8	85.5	31,940.0	37.5	18,234.2	15.1	-10,074.0	-5.7
1992/93	17,266.5	26.6	39,205.6	22.7	21,939.1	20.3	-9,971.8	1.0
1993/94	19,293.4	11.7	51,570.8	31.5	32,277.4	47.1	-8,027.2	24.2
1994/95	17,639.2	-8.6	63,679.5	23.5	46,040.3	42.6	-11,786.1	-31.9
1995/96	19,881.1	12.7	74,454.5	16.9	54,573.4	18.5	-21,542.2	-45.3
1996/97	22,636.5	13.9	93,553.4	25.6	70,916.9	29.9	-16,508.0	30.5
1997/98	27,513.5	21.5	89,002.0	-4.9	61,488.5	-13.3	-15,188.2	8.7
1998/99	35,676.3	29.7	87,525.3	-1.7	51,849.0	-15.7	235.1	6560.3
1999/00	49,822.7	39.6	108,494.9	23.9	58,672.2	13.2	-8,965.8	-102.6
2000/01	55,654.1	11.7	115,687.2	6.6	60,033.1	2.3	20,148.5*	***
2001/02	46,944.8	-15.6	107,389.0	-7.2	60,444.2	0.7	18,161.1*	-10.9
2002/03	49,930.6	6.4	124,352.1	15.8	74,421.5	23.1	11,614.7*	-56.4
2003/04	53,910.7	8.0	136,277.1	9.6	82,366.4	10.7	14,598.0*	20.4
Average Annual Growth Rate	19.1	19.1	15.5	15.5	14.3	14.3		

Source: Source: MOF/GON, Economic Survey, 2004/05

Note: - Before FY 1999/2000 there has not been submitted the Worker's Remittance and pension, so, in those days current account balance is negative but since 2000/01 government has started to submitted the estimated Worker's Remittance. Therefore, since FY 2000/01, our current account balance is remained positive).

** = Including Worker's Remittance and Pension.*

Appendix - 4

GDP, Investment and Saving-Current Price Based on 1989/90

Fiscal Year	GDP	Total Investment	Gross Domestic Saving	Total Investment as a % of GDP	Gross Domestic Saving as % of GDP	Investment-Saving Gap as a % of GDP
1989/90	103,416.0	19,076.0	8,143.0	18.4	7.9	10.5
1990/91	120,370.0	25,074.0	11,514.0	20.8	9.6	11.2
1991/92	149,487.0	31,619.0	16,207.0	21.1	10.8	10.3
1992/93	17,1,492.0	39,653.0	23,172.0	23.1	13.5	9.6
1993/94	199,272.0	44,644.0	29,220.0	22.4	14.7	7.7
1994/95	219,175.0	55,231.0	32,465.0	25.2	14.8	10.4
1995/96	248,913.0	68,017.0	34,426.0	27.3	13.8	13.8
1996/97	280,513.0	71,084.0	39,162.0	25.3	14.0	11.3
1997/98	300,845.0	74,728.0	41,438.0	24.8	13.8	11.0
1998/99	342,036.0	70,061.0	46,563.0	20.5	13.6	6.9
1999/00	379,488.0	92,272.0	57,577.0	24.3	15.0	9.3
2000/01	411,275.0	99,301.0	62,018.0	24.1	15.0	9.1
2001/02	422,807.0	102,174.0	51,281.0	24.2	12.1	12.1
2002/03	456,675.0	119,048.0	54,778.0	26.1	12.0	14.1
2003/04	495,589.0	134,791.0	61,230.0	27.2	12.3	14.9
Average Annual Growth Rate	11.1	14.5	15.5	---	---	---

Source: Source: MOF/GON, Economic Survey, 2004/05

Note: GDP at Producer's Price

Appendix - 5

Fiscal Deficit, Budgetary Deficit and Public Borrowing

Fiscal Year	Fiscal Deficit As a % of GDP	Fiscal Deficit As a % of Total Expenditure	Budgetary Deficit as a % of GDP	Budgetary Deficit as % of Total Expenditure	Proportional of External Borrowing in Budgetary Deficit	Proportional of Internal Borrowing in Budgetary Deficit
1989/90	8.1	42.6	10.0	52.6	57.5	20.7
1990/91	8.8	45.2	10.0	54.4	48.8	35.5
1991/92	7.5	42.6	8.6	48.8	52.8	16.1
1992/93	7.0	38.7	9.2	51.0	43.9	10.3
1993/94	5.8	34.6	7.0	41.7	65.4	13.0
1994/95	4.7	26.4	6.5	36.6	51.5	13.4
1995/96	5.6	29.7	7.5	40.1	50.7	11.8
1996/97	6.1	31.9	8.2	43.1	39.2	13.0
1997/98	5.0	26.7	6.8	36.3	54.3	16.7
1998/99	5.3	30.2	6.5	37.5	53.1	21.1
1999/00	4.6	26.6	6.2	35.3	50.5	23.5
2000/01	5.9	30.3	7.5	38.7	38.9	22.6
2001/02	5.4	28.6	7.0	37.0	26.0	27.0
2002/03	3.6	19.6	6.1	33.1	16.4	32.0
2003/04	3.2	17.7	5.5	30.3	28.1	20.7
Average Annual Growth Rate						

Source: Source: MOF/GON, Economic Survey, 2004/05

Note: GDP at Producer's Price

Fiscal Deficit = Revenue Deficit - Grants

Budgetary Deficit = Revenue - Expenditure

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