PUBLIC DEBT IN NEPAL: AN ASSESSMENT

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Abstract

Public debt is the instrument of financing budget deficit. One important macroeconomic problem of Nepalese economy is prevailing resource gap. Due to such situation, with the increase in size of government budget, the size of public debt is also increasing. With the increase in public debt, it is worthwhile to study how macroeconomic indicators are changing over the time. This study is based on the descriptive analysis. For this purpose, the period of 1975/76-2010/11 is considered. In this period, public debt has increased, on average, by 18.86%. The share of external loan, on average, seems to be relatively higher, i.e. 58.85% whereas such share of internal loan is 41.15%. However, in the latter period, the share of internal loan has significantly higher than the share of external loan. For example, during the period of 2005/06-2010/11, the average share of internal loan is 68.01% whereas such share of external loan is 31.99%. In spite of increased budget and increased public debt, the growth rate of economy is relatively low. On average, it is 4.28%. But, the rate of inflation is, on average, 8.31%. Thus, Nepalese economy is facing the problem of low rate of economic growth and high rate of inflation

Keywords: *Inflation, Nepalese economy, Public debt, Real GDP, Resource gap*

1. INTRODUCTION

Nepal is one of the least developed countries (LDCs) of the world. One major problem of all LDCs is the acute shortage of resources to finance the public expenditure. In such situation, they require to borrow money. However, in the modern world, not only for the LDCs but for developed countries also, public borrowing is becoming an important technique of government finance along with other sources of revenue, e.g., tax and non-tax revenue. When an individual's income cannot meet his/her expenditure, he/she should borrow money from somewhere. In the similar manner, government should also borrow, when its revenue cannot meet the expenditure. Nepalese government has not a very long history of budgeting. Budgeting started in 1951 AD. After that, we have frequent experience of deficit budgeting. There are three sources of deficit financing available to the government of Nepal, viz. foreign loan, internal loan and change in cash reserves. So, public debt has been an important tool of the Nepalese fiscal policy. However, public debt in Nepal was taken after 11 years of initiation of budgetary practice. Thus, our history of public debt is not so long. Government started to take domestic loan in 1962 whereas it started to take external loan in 1963. The first foreign creditors of Nepal were former USSR and UK (Acharya, 1998). After that public debt has important role in the government budget.

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Deficit financing has very important role in the yearly budget of the government of Nepal. On average, the yearly deficit financing is 29.64% of the government budget. Deficit financing is increasing yearly, on average, by 19.86%. On average, deficit financing is 6.06% of real GDP. Among the three sources of financing government debt, the share of foreign loan seems to be highest in the deficit financing, which is followed by internal loan and then the change in cash reserves (Bhattarai, 2012).

Thus, resource gap is a big problem in Nepalese economy. Within the study period of 1975/76 to 2010/11 (i.e., within 36 years), there is the continuous fiscal deficit in the country. As a result of which, government is also continuously taking loan. The net outstanding public debt is increasing significantly over this period of time. Within this period, the net outstanding foreign public debt decreased only in three fiscal years, viz. 2004/05, 2006/07 and 2009/10. In the rest of the fiscal years, it has continuously increased. During the study period (1975/76-2010/11), the average growth rate of net outstanding foreign public debt is 21.05%. The data suggest that the net outstanding foreign public debt increased by highest rate in the fiscal year 1990/91 by 61.70% whereas the lowest growth rate was 1.29% in the fiscal year 2010/11. Similarly, it decreased by highest rate in the fiscal year 2009/10 by 7.51% whereas decreased by lowest rate in the fiscal year 2004/05 by 5.64%. In 2011/12, the per capita outstanding public debt is Rs 18,866.80. The total volume of such debt was Rs 414.70 billion in 2010/11, whereas in 2011/12 it is Rs 509.50 billion. The data from fiscal year 2002/03 to 2011/12 show that the average share of outstanding domestic public debt is 31.07% whereas the average share of net outstanding foreign debt is 68.93% (GON, 2012).

Public debt has important effects on the operation of the economic system of the country. There are many objectives of raising loan by the government. The major objectives include: to collect the resources to the government to meet the expenditure-revenue gap, to bring change in the investment pattern in the country, to maintain the fiscal stability, to accelerate the growth rate of the economy, to develop the socio-economic infrastructures, to finance the immediate problems of the country, like natural calamities and war, to avoid the unpopularity of taxation, to reduce the inequitable distribution of the wealth, to finance the public enterprises, to solve the balance of payments (BOP) difficulties, and so on.

Historically, there is great debate among the economists about the role of public debt. The classical economists were, generally, against the public borrowing. They assumed that in the long-run, actual GDP automatically adjusts to the potential GDP. So, due to this reason, classical economists were not in favour of counter-cyclical fiscal policy. They further assumed that private sector can employ resources more efficiently than the public sector. They were, generally, in the favour of balanced budget. But, Keynes was against the view of classical economists. He argued that resources in the private sector may remain unemployed for long period, if corrective or compensatory action is not employed by the government. So, in such situation, when government borrows the idle resources from the private sector, it would not be unproductive but rather would have positive effects on the income of the country.

The alternative to raising loan is taxation. It is generally said that, if possible, it is better to finance the government expenditure through the taxation. It is because the taxed amount should not be refunded but loan should be refunded; foreign loan can create the interference in the domestic economic and political issues; if the size of borrowing is large, ultimately it calls for heavy taxation; and due to the easiness to borrow money, government may fail to maintain the fiscal discipline. However, in LDCs, like Nepal there are many limitations on raising resources through the taxation. Low levels of income of people, low level of economic transactions, possible inflationary effect, etc. are the limiting factors in the collection of tax revenue in Nepal. On the other hand, as a least developed country, Nepal can get foreign loan at relatively lower rate of interest. So, if the economy can utilize the foreign loan in efficient way, it will create more opportunities for the people. Another thing, loan (foreign loan) provides the resources in foreign currency, which the government cannot get by means of taxation. As Nepal is capital deficient economy, foreign currency is necessary to import foreign capital, which is very important to accelerate the growth rate of the economy. In Nepal, on the one hand, the level of government expenditure is increasing over time. On the other hand, the scope of taxation is seriously limited to collect the sufficient resources to finance the government expenditure. In such complex situation, public debt is an important instrument of mobilizing the resources for economic growth and development of the country.

The government of Nepal has specific legal framework for the collection of resources through the public debt. The interim constitution of Nepal 2063 provides the foundation for mobilizing the resources through the public debt. There is the provision of consolidated fund in the present constitution. The resources raised through the public debt are credited to that fund. According to the interim constitution of Nepal 2063 (Nepal Law commission):

> "*No loan shall be raised and guarantee given by the government of Nepal except in accordance with law. Except for the reserves of religious endowments (Guthi), all resources received by the government of Nepal, all loans raised on the securities of revenues, all money received in repayment of any loans made under the authority of any act and any other moneys received by the government of Nepal shall be credited to a government fund to be known as consolidated fund*."

Apart from the interim constitution of Nepal, there are other acts, rules and regulations that form the legal framework for the public borrowing in Nepal, which include: Nepal Rastra Bank Act, 2059; Loan and Guarantee Act, 2025; Rastra Rin Uthaune Ain, 2068; Procedure for Foreign Employment Saving Certificate (Baideshik Rojgar Bachatpatra Karyabidhi), 2069; Primary and Secondary Market Management Rule (Prathamik tatha

Doswro Bazar Wawasthapan Niyamawali), 2061; Public Debt Management Guideline (Rastra Rin Wawasthapan Margadarshan), 2060; and Public Debt Act, 2059 (with first amendmend, 2061). Among these constitution, acts, rules and regulations, the Loan and Guarantee Act, 2025 provides the legal authority for the government for external borrowing. On the other hand, the Public Debt Act, 2059 provides such authority of the government for internal borrowing.

2. OBJECTIVES OF THE STUDY

The main objective of the study is to analyze the trend and composition of Nepalese public debt whereas the specific objectives are to analyze the growth pattern of internal, external and overall public debt; and to make the comparative study of growth of public debt with growth rate of real GDP and rate of inflation.

3. METHODOLOGY OF THE STUDY

This study is based on the secondary data. These data were taken from the economic survey published by ministry of finance (MOF), government of Nepal (GON). The study is based on the time span of 36 fiscal years, i.e., from 1975/76 to 2010/11. The tabular presentation of data comprises four non-overlapping periods, among these first three are ten-year periods (1975/76-1984/85, 1985/86-1994/95, and 1995/96-2004/05) whereas the last one is six-year period (2005/06-2010/11). The reason behind the division of time span into four periods is to study the trend and composition of public debt in different decades (if possible) and to make the comparison among them. However, the fourth period includes only six years. Public debt is, clearly, related to the resource gap of the economy. So, the analysis of public debt is conducted in the light of existing resource gap.

4. RESULT OF THE STUDY

The discussion on Nepalese public debt is carried under different sub-headings.

A. Resource Gap in Nepalese Economy

Nepal has initiated the planned economic development in 1956 A.D. In spite of its planned efforts of 56 years, Nepal has failed to move in the direction of speedy economic growth and development. The macroeconomic indicators of the economy prove this. For example, in the fiscal year 2011/12, consumer price index increased by 7.7%, whereas growth rate of real GDP is only 4.6%. We have big deficit in international trade-during the period of 1975/76-2010/11. Trade deficit decreased only in the fiscal years 1983/84, 1997/98, 1998/99, and 2010/11; in the remaining years, it has continuously increased (GON, 2012). The pace of industrialization is very slow. Such low level of growth and development is contributing resource gap of the economy. The occurrence of resource gap in the economy can be seen in terms of fiscal deficit and gap between gross domestic saving and gross investment as percentage of GDP. To bridge-up such gap government should take loan.

The resource gap is increasing over the period. The average growth rate of fiscal deficit, during the period of 1975/76-2010/11 is 17.37%. The gap between gross domestic saving and gross investment as % of GDP is fluctuating over the period. Such gap, on average, in between 1994/95-2003/04 was -10.91% of GDP. On the other hand, in between 2004/05-2011/12, it was -20.99% of GDP. Thus, this gap is increasing in the latter period. Taking the period of 1994/95- 2011/12, it was highest in the fiscal year 2009/10, with a value of -26.8% of GDP, whereas the lowest was in the fiscal year 1998/99, with a value of -6.9% of GDP. On average, over this period of time, the gap between gross domestic saving and gross investment as % of GDP was -15.39% of GDP. Thus, resource gap in Nepalese economy is increasing every year and it is at high level (GON, 2004 & 2012).

B. Trend of Nepalese Public Debt

Over the study period, the public debt of government of Nepal has increased in most of the fiscal years. It decreased only in the fiscal years 1978/79, 1991/92, 1992/93, 1994/95, 1998/99, 2001/02, 2002/03, 2003/04, and 2008/09. In the remaining fiscal years, it increased. Over this period, the government expenditure continuously increased. Thus, the data suggest that in most of the fiscal years government revenue has not increased sufficiently to cover the expenditure. This shows the increased resource gap in Nepal. The growth rate of Nepalese public debt is shown in Table 1

Table 1: Growth Rate of Nepalese Public Debt

Period	Average growth rate of public debt (%)
1975/76-1984/85	35.06
1985/86-1994/95	11.64
1995/96-2004/05	8.31
2005/06-2010/11	21.49
1975/76-2010/11	18.86

Source: Author's calculations based on Economic Survey, 2011/12, Ministry of Finance, Government of Nepal.

Thus, the public debt increased significantly over the period. However, there is high level of fluctuations in the rate of change of public debt. While observing the case of individual fiscal years, the public debt has increased by highest percentage in the fiscal year 1975/76, i.e. by 69.56% whereas it increased by lowest percentage in the fiscal year 1996/97, i.e. by 3.26%.It decreased by greatest percentage in 1991/92, i.e. by 17.70% whereas it decreased by lowest percentage in the fiscal year 2003/04, i.e. by 1.41%. The average growth rate of public debt, during this period, is 18.86%.

Thus, the growth rate of public debt is relatively high. One important reason behind such high growth rate is increase in the size of budget significantly over the period. But, unfortunately country could not collect the resources sufficiently to cover the expenditure.

C. Composition of Nepalese Public Debt

There are different sources of public debt. These sources can be broadly divided into internal and external sources. Internally, government can borrow from individuals, financial institutions, and non- financial institutions. On the other hand, externally, it can borrow from foreign governments, international financial institutions, and regional financial institutions. The composition of Nepalese public debt is as given in Table 2.

Table 2: Composition of Nepalese Public Debt

Period	Internal loan within the period (Rs. in ten million)	External loan within the period (Rs. in ten million)	Average share of internal loan (% per year)	Average share of external loan (% per year)	Average growth rate of internal loan (% per year)	Average growth rate of external loan (% per year)
1975/76- 984/85	624.67	745.19	43.68	56.32	41.41	36.90
1985/86-1994/95	1962.96	5711.91	26.38	73.62	9.53	17.31
1995/96-2004/05	5723.59	9441.08	37.28	62.72	19.59	6.83
2005/06-2010/11	14106.98	6051.56	68.01	31.99	32.09	5.26
1975/76- 2010/11			41.15	58.85	24.94	17.83

Source: Author's calculations based on Economic Survey, 2011/12, Ministry of Finance, Government of Nepal.

The data suggest that in most of the fiscal years, in the first, second and third decade, the external loan is greater than internal loan. On the other hand, during the period of last six years, the internal loan is greater than external loan in each fiscal year. In the last six years, the internal loan is 2.33 times greater than external loan.

During the period of 1975/76-2010/11, the average share of external loan is 58.85% whereas such share of internal loan is 41.15%. However, such share has drastically changed in the last six years, i.e. within 2005/06-2010/11. Within this period, the average share of internal loan is 68.01% whereas the average share of external loan is 31.99%. In this period of time, the internal loan has increased by 24.94% per year, on average. On the other hand, the external loan increased, on average, by 17.83% per year.

The last six year's evidence shows that in the recent years the country is heavily depending upon internal loan.

The data suggest that in the first decade, the average growth rate per year of both internal and external loan were very high. The average growth rate of internal loan decreased on the second decade and then again increased. On the other hand, the growth rate of external loan has decreased in second and third decade as well as in the last six years. In the last six year period, the growth rate of internal loan increased significantly. The evidence shows that in the latter period, country's dependence has increased significantly on the internal loan.

D. Public Debt and Real GDP

One of the major objectives of raising public debt is to accelerate the growth rate of GDP. But, only taking public debt does not ensure the high rate of economic growth. To achieve high rate of economic growth, the borrowed money must be used in effective way. The effectiveness of the public debt varies across the countries. The occupancy of the public debt in real GDP and government budget of Nepal is shown in Table 3.

Table 3: Public Debt (PD) and Real GDP (RGDP)

Period	Average RGDP (Rs ten million)	Average PD/RGDP (%)	Average PD/Budget (%)	Average growth rate of public debt (%)	Average growth rate of RGDP (%)
1975/76-1984/85	15802.57	0.80	26.18	35.06	4.11
1985/86-1994/95	25761.64	2.92	35.63	11.64	5.03
1995/96-2004/05	40129.91	3.78	22.05	8.31	3.83
2005/06-2010/11	53201.53	6.21	17.42	21.49	4.05
1975/76-2010/11	31559.73	3.12	26.20	18.86	4.28

Source: Author's calculations based on Economic Survey, 2011/12, Ministry of Finance, Government of Nepal.

The public debt-real GDP ratio (PD/RGDP), on the average, has continuously increased in the first, second, and third decade as well as in the last six years. On average, it is 3.12%. In the last six years, on average, public debt is 6.21% of real GDP-which is the largest value in the study period. However, it is not significantly higher. So, size of Nepal's public debt is small and it is manageable. It shows that Nepal's public debt is sustainable and Nepal's debt carrying capacity is high (IMF, 2010).

The public debt-budget ratio (PD/Budget), on average, is fluctuating over this period of time. However, in the latter period it is in declining trend. In the last six years, on average, it is 17.42%. On one hand, the size of budget is increasing and on the other hand, the share of public debt on the budget is decreasing in the latter period, which shows that, if such trend continues in the future, in Nepal, public debt would be, to some extent, easier to manage for the government. It is certainly a good signal for the government.

The government of Nepal has implemented tax reform in November 16, 1997 AD. At that time, government has introduced value added tax (VAT) in Nepal. It has big share in the tax revenue of the government. In the fiscal year 2010/11, the share of VAT in the total tax revenue is 35.69%. It was levied to replace contract tax, entertainment tax, hotel tax and sales tax. "The average share of VAT on total tax revenue is greater than the average share of those four taxes in the past" (Bhattarai, 2013). Thus, government tax reform is going in right direction. It has positive impact to reduce the resource gap.

Similarly, the average growth rate of public debt and average growth rate of RGDP are also fluctuating over this period of time. However, the problem is that the growth rate of real GDP is very low compared to the growth rate of public debt. This raises question on the effectiveness in the use of borrowed money. To get the better result, the borrowed money should be used in the productive sector with the high level of efficiency.

E. Public Debt and Inflation

One of the major macroeconomic policy objectives of government of Nepal is to maintain low and stable rate of inflation. The appropriate rate of inflation is necessary to ensure the competitiveness of domestic goods and services as well as to improve the living standard of people. Public debt may have some influence on the rate of inflation. This study makes the comparison between public debt and rate of inflation in the Nepalese economy. The rate of inflation is based on the overall urban consumer's price index. The rate of inflation and growth rate of real GDP is shown in Table 4.

Table 4: Average Rate of Inflation

Period	Average growth rate of RGDP (%)	Average rate of inflation (%)
1975/76-1984/85	4.11	7.46
1985/86-1994/95	5.03	11.43
1995/96-2004/05	3.83	5.78
2005/06-2010/11	4.05	8.72
1975/76-2010/11	4.28	8.31

Source: Author's calculations based on Economic Survey, 2011/12, Ministry of Finance, Government of Nepal.

The rate of inflation is fluctuating significantly over the study period. It seems to be lowest, i.e. 2.4% in the fiscal year 2000/01, whereas highest, i.e. 21.1% in the fiscal year 1991/92. Within the study period, there is deflation, in only one year, of 0.7% in fiscal year 1975/76. In the rest of the fiscal years, there is inflation. The data suggest that the average rate of inflation in between the fiscal year 1975/76 to 2010/11 is 8.31%. Thus, the rate of inflation in Nepal is relatively high.

On one hand, the rate of economic growth is low. On the other hand, the rate of inflation is high. This is not a good macroeconomic circumstance. So, the efforts should be towards increasing the growth rate and maintaining the price stability. With the relative increase in level of income of the people, basically due to increased remittance, demand for goods and services is increasing. But, unfortunately, we are not able to increase the aggregate supply. So, country's efforts should be in increasing the aggregate supply of the economy. For this domestic and foreign investment should be promoted. It helps to reduce inflation and increase growth rate of the economy. Certainly, there is conflict between growth rate of economy and price stability; however with the help of proper monetary and fiscal policy, it may be possible to maintain the price stability.

5. CONCLUSION

The level of public debt is increasing in the Nepalese economy. The average growth rate of public debt is 18.86%. While talking about composition of public debt, the average share of external loan is greater than that of internal loan. However, in the latter period, the share of internal loan is significantly greater than that of external loan. The growth rate of economy seems to be relatively low. Low rate of economic growth and high rate of inflation is one major problem of the Nepalese economy. So, the efforts should be accelerating the growth rate so that more employment opportunities can be generated and income of the people can be increased. For this, those measures should be employed which increase the level of aggregate supply. For this, investment should be increased and use of new technology should be promoted. Efforts should equally be directed towards maintaining the price stability. As the study is based on the descriptive analysis, the cause and effect relationship between the variables could not be found. So, there is further scope to study such relationship between the abovementioned different variables.

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