

Role of External Borrowing in the Economic Development of Nepal

Maheshwor Man Shrestha *

Introduction

Underdeveloped countries are characterised by acute poverty, low per capita income, inequitable distribution of wealth, very low standard of living and low taxable capacity. The scope of additional taxation for financing the development expenditure is limited due to the very nature of the UDC's. Besides, heavy taxation in such a situation would hamper the very purpose of development by curbing consumption and discouraging the productive incentives. Moreover the huge amount of development expenditure is so heavy that in no circumstances, it can be met by taxation. The expenditure requirement of the government is growing due to significant increase in government activities, both intensively and extensively. Modern welfare state has to perform numerous developmental functions to meet the rising aspirations of people for development.

Government expenditure as a percentage of GDP during the Fourth and Fifth Plan period were 9.4 and 13.3 percent respectively. Development expenditure during the Fourth plan period increased by an annual average rate of 16.3 percent and during the Fifth Plan period by 19.2 percent Revenue receipt as a percentage of GDP, was 4 per cent during the Fourth Plan period which became 8 per cent in the Fifth Plan period. The regular expenditure grew by 16.5 per cent at current price and by 11.7 per cent at constant price during the Fifth Plan period. The development expenditure at the current price and constant price increased by an annual average of 19.2 per cent and 13.5 per cent respectively. During the Sixth Plan period development expenditure is estimated to grow by an annual average rate of 21.3

* Mr. Shrestha is a lecturer in Economics at Prithivi Narayan Campus, Tribhuvan University.

Table 1
Expenditure, Revenue and Resource Gap in Nepalese finance
(1970-71 to 1979-80)
(Rs. In Million)

| Year | Regular Expenditure | Development Expenditure | Total Expenditure | Revenue | Resource | | Resource | |
|---------|---------------------|-------------------------|-------------------|---------|----------|-------|----------------|-------|
| | | | | | Gap A | Gap B | Foreign Grants | Gap B |
| 1970-71 | 304.5 | 465.0 | 769.5 | 459.7 | 309.8 | 270.7 | 39.1 | |
| 1971-72 | 325.0 | 564.6 | 829.6 | 553.4 | 336.2 | 242.0 | 94.2 | |
| 1972-73 | 374.2 | 608.6 | 982.8 | 615.8 | 367.0 | 188.2 | 186.8 | |
| 1973-74 | 474.8 | 751.5 | 1226.3 | 766.4 | 459.9 | 222.6 | 237.3 | |
| 1974-75 | 546.5 | 967.2 | 1513.7 | 1008.4 | 505.3 | 282.8 | 222.5 | |
| 1975-76 | 674.5 | 1238.9 | 1913.4 | 1115.6 | 797.8 | 359.7 | 438.1 | |
| 1976-77 | 832.1 | 1498.3 | 2330.4 | 1322.9 | 1007.5 | 392.5 | 615.0 | |
| 1977-78 | 866.9 | 1808.0 | 2674.9 | 1582.0 | 1092.9 | 466.6 | 626.3 | |
| 1978-79 | 1041.7 | 1978.8 | 3020.5 | 1881.9 | 1138.6 | 599.3 | 539.3 | |
| 1979-80 | 1162.1 | 2308.6 | 3470.7 | 1880.0 | 1590.7 | 805.6 | 785.1 | |

Note: Resource Gap A = (Expenditure--Revenue)

Resource Gap B = Expenditure - (Revenue + Foreign grants)

Source: Various issues of *Economic Survey*, Ministry of Finance, HMG, Nepal

per cent. Table 1 presents the growth of expenditure, revenue and resource gap in Nepalese finance from 1970-71 to 1979-80.

It reveals that revenue receipt has increased substantially during the past years. The revenue receipt of the government was 6.4 per cent of GDP in 1975-76, which increased to 7.9 per cent of GDP in 1979-80. However, at the same period both regular and development expenditures increased more sharply in comparison to the revenue. The resource gap A (table-1) reveals the fact clearly and justifies other means of financing government expenditure which may be foreign grants, deficit financing and public borrowing. Resource needs for less developed countries are reflected by two-gap analysis. First is the *Saving gap* which refers to the inability of a poor country to raise its saving rate as required by its investment programmes. Second, there is a *trade-gap*: it refers to the need of a country to import specific goods necessary for the development programmes. These gaps can be filled by foreign resources and help to promote growth in UDC's. Resource gap B is the case for external loans. Moreover, the finance of development expenditure by loans is justified on the ground that they are productive, and their benefit would be enjoyed by future generation, and hence, the burden should also fall on them. Secondly, benefit of these projects are spread over time and can easily be financed by loans.

The purpose of this article is to analyse Nepal's external borrowing situation and indicate an urgency to formulate realistic and practical policy alternatives to utilize borrowed funds.

The first part deals with aid inflow to Nepal. The second part with foreign loans disbursement by sectors; the third part with outstanding external loan position in Nepal.

Aid Inflow to Nepal

Foreign aid has been playing a significant role in development efforts in Nepal since 1951. Foreign aid and development expenditures have been presented in Table 2.

It reveals an increasing trend of aid inflow to Nepal. If we take the case of foreign loan alone the increasing trend is noted clearly. Foreign aid during the Fifth Plan period was 61.9 per cent in grants and 38.1 per cent in loans. The estimated share of foreign loan would rise to 48 per cent in the Sixth Plan period. The source-wise loan inflow to Nepal is presented in Table - 3.

Comparatively speaking the Table 3 reveals the diminishing trend of grants and increasing trend of loan in our foreign aid programmes. The increased am -

Table 2
Foreign Aid and Development Expenditure
in Nepal

(Rs. In Million)

| Period | Grants | Loans | Total | Development Expenditure | Per- cent |
|--------------------------|--------|--------|---------|----------------------------|--------------|
| Interim Period (1951-56) | 95.0 | — | 95.0 | — | — |
| First Plan (1956-61) | 282.9 | — | 282.9 | 212.5 | — |
| Plan Holiday (1961-62) | 69.6 | 1.4 | 71.0 | — | — |
| Second Plan (1962-65) | 432.4 | 45.9 | 478.3 | 596.8 | 80.14 |
| Third Plan (1965-70) | 905.2 | 14.6 | 919.8 | 1639.1 | 56.11 |
| Fourth Plan (1970-75) | 1198.4 | 310.7 | 1509.1 | 3356.8 | 44.95 |
| Fifth Plan (1975-80) | 2623.7 | 1617.1 | 4240.8 | 8870.6 | 47.80 |
| Sixth Plan* (1980-85) | 6790.0 | 6260.0 | 13050.0 | 21750.0 | 60.00 |

* Estimated

Sources : Various *Budget Speeches*, *Economic Survey Report*, Ministry of Finance, HMG, *Report of Economic Commission*, HMG, and *Nepal's Sixth Plan* (1980-85).

ount of loans may have qualitative and quantitative effects on the economy. Generally grants are preferred to loans where payment prospect in foreign exchange are dim because of difficulties in balance of payments. However, it can be argued that loans are used more efficiently than grants. The rationale behind it is that the government is supposed to be frugal with them. Loans have to be repaid and, therefore, they are expected to finance only productive activities. At the same time loans are easier than grants to justify. Another argument for loans is that they cost less than grants or nothing to the aid giving countries, because they get something back. Due to the dearth of necessary data on the use of relative efficiency of grants and loans we cannot favour one or the other. The preference of loans to grants is to avoid injuring of the national pride. We have a little choice, both of them may be a mixed blessing - economically and politically. But loans seem more business like than grants. The table also reveals that major proportion of loan comes from multilateral agencies, having grant element with them. The rising proportion of loan now being channeled through multilateral agencies is a good development, since their political motives are presumably less narrowly defined compared with those of individual donor countries.

Table 3
Source-wise Loan Inflow to Nepal
(1961-62 to 1979-80)

(Rs. In Million)

| Year (1) | Total (2) | Bilateral (3) | Multilateral (4) | 3 In per cent of (2) | 4 In per cent of (3) |
|--------------|---------------|------------------|---------------------|-------------------------|-------------------------|
| 1961-62 | 1.0 | 1.0 | — | 100 | — |
| 1962-63 | 11.6 | 11.6 | — | 100 | — |
| 1963-64 | 11.4 | 11.4 | — | 100 | — |
| 1964-65 | 5.9 | 5.9 | — | 100 | — |
| 1965-66 | 3.3 | 3.3 | — | 100 | — |
| 1966-67 | 3.7 | 3.7 | — | 100 | — |
| 1967-68 | — | — | — | — | — |
| 1968-69 | — | — | — | — | — |
| 1969-70 | 7.6 | 7.6 | — | 100 | — |
| 1970-71 | 32.5 | 32.5 | — | 100 | — |
| 1971-72 | 38.9 | 26.9 | 12.0 | 69.2 | 30.8 |
| 1972-73 | 47.4 | 22.2 | 25.2 | 46.8 | 53.2 |
| 1973-74 | 87.9 | 33.5 | 54.4 | 38.1 | 61.9 |
| 1974-75 | 103.9 | 31.9 | 72.9 | 30.7 | 69.3 |
| 1975-76 | 145.9 | 23.0 | 122.9 | 15.8 | 84.2 |
| 1976-77 | 164.4 | 26.1 | 138.3 | 15.9 | 84.1 |
| 1977-78 | 381.8 | 84.1 | 297.7 | 22.0 | 78.0 |
| 1978-79 | 390.1 | 81.4 | 308.7 | 20.9 | 79.1 |
| 1979-80 | 534.9 | 149.6 | 385.3 | 28.0 | 72.0 |
| Total | 1972.2 | 555.7 | 1416.5 | 28.2 | 71.8 |

Source: *Budget Specches*, HMG, Nepal.

Various issues of *Economic Survey* Ministry of Finance, HMG/Nepal

Foreign Loans Disbursement by Sectors

Foreign loans disbursement by sectors is presented in Table 4.

Table - 4

Foreign Loans Disbursement by Sectors

(Rs. In Million)

| Sectors | 1975—76 | 1976—77 | 1977—78 | 1978—79 | 1979—80 |
|---|----------------|-----------------|-----------------|-----------------|------------------|
| 1. Agriculture, irri - gation & Forest | 39.6 (27.1) | 41.1 (25.0) | 79.0 (20.7) | 97.5 (25.0) | 102.1 (19.1) |
| 2. Transport, power & Communication. | 68.0 (46.6) | 72.1 (43.9) | 251.7 (65.9) | 242.5 (62.2) | 351.9 (65.8) |
| 3. Industry & Commerce. | 26.1 (17.9) | 28.3 (17.2) | 14.9 (3.9) | 12.5 (3.2) | 40.3 (7.5) |
| 4. Social Services | 12.2 (8.4) | 22.8 (13.9) | 36.2 (9.5) | 37.6 (9.6) | 40.6 (7.6) |
| Total | 145.9 (100) | 164.3 (100) | 381.8 (100) | 390.1 (100) | 534.9 (100) |

Note : Figures have been rounded off. Figures in parentheses are percentage.

Source : Ministry of Finance, HMG/Nepal.

The table reveals that the substantial proportion of external loans have been diverted towards transport, power and communication. As mentioned in the table 46.6 per cent in 1975—76 and 65.8 per cent in 1979—80 were diverted to this sector. Top most priority has been given to this sector in the plan. Some progress has been achieved in this sector.

Agriculture, irrigation and forest sectors have accounted for 27.1 per cent in 1975--76 and 19.1 per cent in 1979--80, showing a declining trend of loan assistance in this sector. A substantial amount of external loan has been diverted to this sector but the progress made is far from satisfactory. GDP during the Fifth Plan period increased only at the rate of 2.2 per cent per annum as against the target of 4.5 per cent.

The share of loan assistance to industry and commerce was 17.9 per cent in 1975-76 and 7.5 per cent in 1979-80, thus indicating a declining trend. And the share of loan assistance to social services remained almost constant.

Outstanding External Loan Position

Nepal's external loan position has been presented in table 5.

Table 5
External Loan (1980-81)

(Rs. In Million)

| Items | 1980-81 |
|-----------------------------|---------|
| Direct Debt | |
| Outstanding up to last year | 1751.6 |
| Borrowing | 705.1 |
| Repayment | 29.9 |
| Interest Payment | 27.9 |
| Net Outstanding | 2426.8 |
| Indirect Debt | |
| Outstanding up to last year | 25.7 |
| Borrowing | — |
| Repayment | 1.2 |
| Interest payment | 0.8 |
| Net outstanding | 24.5 |
| Total Debt | |
| Outstanding up to last year | 1777.3 |
| Borrowing | 705.1 |
| Repayment | 31.1 |
| Interest payment | 28.7 |
| Net outstanding | 2451.3 |

Source: The office of the Financial Controller General, HMG/Nepal.

The outstanding external loan (direct & indirect) amounted to Rs. 2451.3 millions in 1980-81 as against 1807.3 millions in 1979-80—an increase of 73.7 per cent. The share of direct external debt was 99 per cent. The table indicates that the volume of external loan is increasing, nevertheless, Nepal's external debt burden is relatively less as compared to other developing countries due to the soft terms and conditions of most of the borrowings from multilateral financial institutions. At present, the debt service on external loan amounted to about 5 per cent of the total foreign exchange earnings.

Conclusion

External resource is an integral part of a compensatory fiscal policy. External resource fills the gap created by domestic resource gap. It permits an imports of real resources, thereby enabling the government to provide additional facilities

without an immediate reduction in other uses of resource whether for consumption or capital formation. It also provides the foreign exchange needed to secure capital equipment that cannot be secured at home. The other gap is the gap of management, entrepreneurship, technology and skill which may come through the activities known as "project" loans. In our case, external resources have been playing a vital role in financing the development plan. In the Fifth plan, almost 48 per cent of the total expenditure has been financed by external resource and 60 per cent of the Sixth plan is estimated to be financed by external resources.

It has been clearly observed that the proportion of external loans is increasing. More recently loans have supported much of the development programmes in Nepal.

As to the burden of external loans, initially they are beneficial as they augment the resource available to the country. But at the time of repayment and servicing, it creates a burden to the country. It impoverishes posterity, for there will be a real transfer of resources to foreign countries at the time of repayment resulting consumption effect and welfare effect by reducing the total amount of domestic resources available to the community. Further, it leads to the drain of foreign exchange reserve, the export sector being inelastic. So external debt should be within the limits in accordance with the absorptive capacity of our economy. Moreover, additional loans create demand for counter-part domestic resources. Even then, external borrowing is advantageous if the borrowed funds are infact used to achieve economic growth and stimulate export enough to cover the borrowed funds and service charges.

The recent pattern of loans i.e. growing volume and diverse nature, suggests that it requires appropriate coordination for the effective use of external resource to meet country's development need. A proper debt management policy is imperative for it. At the same time, we must be cautioned enough by the gloomy position of some of the underdeveloped countries which are caught in the debt-web. The World Bank Country Study commented that Nepal has reached a critical stage in its development. "The country is caught in a vicious circle of poverty, and as difficult as it is to break this circle, the next five to ten years may represent Nepal's last chance to do so without having to become completely dependent upon the good will of aid donor."

We should not forget that the primary role of external assistance is to support domestic saving as a means of increasing public investment. Hence, it should be only a temporary pillative not a substitute to domestic resources.

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A Note On :

The Japanese Approach to Business

(A Case of Spectacular Success)

Govinda P. Acharya *

The case of spectacular success of the Japanese business has become a widely talked subject and their activities have been viewed internationally with a mixture of admiration, envy and fear. Japan's invasion of western markets has received widespread publicity in recent years. Trading companies of Japan have indeed shown spectacular success not only in the traditional markets but they have also conquered new fields and markets previously dominated by powerful competitors of the western world. Western world as being the loser of the target market has started viewing the style of Japanese business as a threat or, a sense of fear. On the contrary, however, a wider coverage of the target market of the west as well as of the east, during a short span of time has even forced the rest of the world to view the activities of the Japanese business as a source of admiration. Does not matter, whether the business community of the rest of the globe see the Japanese approach to business as a source of admiration, envy or fear. What does really matter is working on the principle that 'if you can't beat them, join them', the western business community has begun to study closely how the Japanese system works.

This small article aims at throwing some insights on such major elements which seem to create special attitudes and relationship in Japanese Companies leading them to be able to hold their ground both in traditional and highly competitive international markets. The contributors or pillars of the Japanese business system which have taken the Japanese business to an important position in the World's business map can better be viewed from the angle of management techniques or personnel policies having some major differences as compared with their western business counterparts.

* Lecturer in the Institute of Management, Nepal Commerce Campus.

Before pointing out such pillars of the Japanese system, it wouldn't be out of context here to say a few words about how and what, the Japanese think and accept 'work ethics' in their way of life, 'Confucianism', which is understood in Japan as an ethics rather than a religion has created a special culture leading to immense commercial success.

This culture is concerned with the relationship of one man to another or to the community to which he belongs; it is hardly concerned with the assessment of individual conduct or behaviour in itself, according to some absolute principles.

Policy of life-time employment : Majority of large companies in Japan seem to have practised a policy of life time employment. Life time employment policy there means, when people join an enterprise after the completion of their schooling or university education, they can expect to remain with the same organisation they have joined until they retire. This age retirement comes to effect usually at the age of fifty five or sixty. Such policy of life time employment, in effect, thus provides in return the job security for life for the employees. Indeed, the chance of employees being fired is usually non-existent unless there is any serious misconduct.

This way the life of an employee is closely associated with the life of the organisation. Redundancy or the lay-off of the employees never comes in seen irrespective of the economic conditions being faced by the organisation. No doubt, such phenomenon may be inevitable only in a case of an enterprise being demised. Otherwise in all other circumstances, even in times of business recession, an employee working for a Japanese company is free from the fear of being laid off or made redundant. This phenomenon in Japan is a very strong factor which has become a plus point for Japanese business success. Bearing this point of life time employment policy of Japanese companies as compared to the case of other industrially developed countries of the world, where the policy of redundancy or layoff has become very common and also being treated as an important element of personnel policy; has become a solace for the grand success of Japanese business. To be more specific, there has been a clear evident of the fact that, the Japanese worker always identifies closely with his company and feels intense loyalty to it, as a result of this practice of job security for life. A Japanese worker always works hard because he feels that working hard for the company means to safeguard his interest and polishing his own future career. The great saying 'work is worship' is found to have worked in Japan. As a result of this, it is not surprising that devotion to one's company is considered a great virtue in Japan. Work ethic thus enhanced by such policy in Japan prepared human resources to put their firm's interests before those of his own and the family.