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Nepal's Indicators in the Context of Debt Relief Initiative for the Heavily-Indebted LDCs

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Abstract

A least developed country (LDC) with a per capita income below US$ 350, Nepal's socio-economic development endeavors and outcomes have remained modest. The modernization process of the economy is quite slow. The socio-physical infrastructure bottlenecks still haunt the economic transformation process. The export sector has been weak and the economic growth rate has remained unsatisfactory. It is disheartening to note that the last one decade saw lower share of capital outlay vis-à-vis that of the recurrent expenditure in the total expenditure of the government while the reliance on the foreign aid for financing the capital expenditure has been quite high. The resource mobilization and utilization as well as the project management capacity in the public sector await much improvement.

Nepal has been listed as one of the eight pre-decision point countries that may wish to be considered for the HIPC debt relief as these economies have met the income and indebtedness criteria based on end-2004 data. However, the process for listing Nepal under the HIPC Initiative has not moved forward. Since Nepal had a limited debt owed to the IMF at 2004-end, there would also not be much resource available for use in the pursuit of the MDGs even if the debt relief is operationalized by the IMF under the MDRI-I Trust. Nepal's bulk of the external debt (over 90 percent) lies with the multilateral institutions like the IDA and the ADB. Hence, Nepal would be immensely benefited if the MDRI through the IDA could be operationalized similar to the case of MDRI-I Trust that the IMF has implemented for Cambodia and Tajikistan (non-HIPCs with per capita income at or below US$ 380. Even if the mechanism for the international debt relief initiative could not be implemented for Nepal, the bilateral and multilateral donor community is urged to support Nepal through arrangement of the necessary resources in the form of highly increased level of grants available with the least conditionalities attached.

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Fiscal Deficit

Nepal's current Three-Year Interim Plan (TYIP) has envisaged a total expenditure of Rs 511.38 billion (at the FY 2007/08 constant prices) during the Plan period (FY 2007/08 through FY 2009/10). Of this, expenditures for the recurrent, capital and principal repayment are targeted at Rs. 285.48 billion, Rs. 178.99 billion and Rs. 46.91 billion, representing 55.8 percent, 35.0 percent, and 9.2 percent of the total expenditure respectively. Among the sources of financing the expenditure, revenue would amount to Rs. 318.89 billion and the foreign grants Rs. 84.84 billion, comprising 62.3 percent and 16.6 percent of the total expenditure respectively. Hence, Rs. 403.73 billion (or 78.9 percent of the total expenditure) would be financed through the sources of non-debt nature. The balance (Rs. 108.35 billion or 21.1 percent of the total expenditure) would remain deficit, to be financed through the debt sources, of which Rs. 56.52 billion would come from the foreign loan and Rs. 51.83 billion would come from the domestic loan, comprising 11.1 percent and 10.1 percent of the total expenditure respectively. So, the fiscal deficit during the TYIP period would amount to Rs. 108.35 billion, of which the foreign loan would finance 52.2 percent and the domestic loan would finance the rest 47.8 percent.

Assuming the total gross domestic product (GDP) of Rs. 2,312.81 billion during the three years of the Plan period, the expenditure ratios in terms of the GDP would be recurrent 12.4 percent, capital 7.7 percent, and principal repayment 2.0 percent, aggregating 22.1 percent. Among the sources of financing the expenditure as ratios to the GDP, revenue would be 13.8 percent and the foreign grants 3.6 percent. Hence, expenditure equivalent to 17.4 percent of the GDP would be financed through the sources of non-debt nature. The balance expenditure (Rs. 108.35 billion) would remain deficit, to be financed through the debt sources. In terms of the GDP, the foreign loan will finance 2.5 percent of the deficit while the domestic loan will finance the rest 2.2 percent. So, the fiscal deficit during the TYIP period would average 4.7 percent of the GDP. During the final year of the TYIP, namely, FY 2009/10, among the ratios in terms of the GDP, the recurrent expenditure would be 11.6 percent, capital expenditure 8.0 percent and principal repayment 1.9 percent, aggregating 21.5 percent. Among the sources of financing the expenditure as ratios to the GDP in FY 2009/10, revenue would be 13.6 percent and the foreign grants 3.6 percent. Hence, expenditure equivalent to 17.2 percent of the GDP would be financed through the sources of non-debt nature. So, the fiscal deficit/GDP ratio during the final year of the TYIP would be 4.3 percent, the foreign loan financing 2.5 percent and the domestic loan financing the rest 1.8 percent. For the TYIP period, the revenue growth target has been 16.0 percent while the net domestic loan (gross minus repayments) has been targeted at 0.5 percent of the GDP.

The revenue/GDP ratio during the final year of the Plan would average 13.6 percent, as stated above. During the year, the recurrent expenditure and principal repayment will represent, as percent of GDP, 11.6 percent and 1.9 percent respectively (totaling 13.5 percent), leaving revenue equivalent to just 0.1 percent of the GDP for the capital expenditure. The other sources for financing the capital expenditure as percent of the GDP are foreign grants 3.6 percent and loan 4.3 percent (foreign loan 2.5 percent, and domestic loan 1.8

percent). The sources for financing the capital expenditure as its components are revenue surplus 1.4 percent, foreign grants 45.2 percent, foreign loan 30.8 percent, and domestic loan 22.6 percent. During the three-year period of the Plan, revenue net of the recurrent expenditure will be insufficient to finance the whole of principal repayment (Rs. 46.91 billion) as only 71.2 percent of the principal repayment will be financed by the revenue, the rest (28.8 percent or Rs. 13.50 billion) to be financed by the domestic loan. The components of the sources for financing capital expenditure during the Plan period would average domestic loan 22.4 percent, foreign grants 47.0 percent, and foreign loan 31.6 percent. Therefore, the revenue to be mobilized during the Plan period would be insufficient to finance the whole of recurrent expenditure and principal repayment. This scenario will increase the reliance on the foreign resources as well as the domestic loan for financing the capital expenditure, thereby increasing the government's vulnerability to higher indebtedness and the associated debt servicing obligations. So, for better fiscal management, more resources than envisaged in the Plan needs to be mobilized in the form of revenue while efficiency in the resource management, expenditure prioritization, and project management should be improved through substantial capacity enhancement in the public sector.

The revised estimates for FY 2007/08 show the recurrent, capital, and principal repayment expenditures at Rs. 91.41 billion, Rs. 55.51 billion, and Rs. 16.39 billion respectively, aggregating Rs. 163.31 billion. As percentages of GDP (gross value added) amounting to Rs. 792.13 billion, the ratios of the recurrent, capital, and principal repayment expenditures have been 11.5 percent, 7.0 percent, and 2.1 percent respectively, aggregating 20.6 percent, lower than the TYIP average of 22.1 percent. The revenue grew by 22.6 percent to Rs. 107.55 billion in comparison to the previous year's growth of 21.3 percent to Rs. 87.71 billion. The revenue was also higher by 3.7 percent in comparison to the budget target of Rs. 103.67 billion for FY 2007/08. As a percent of the GDP, the revenue figure represented 13.6 percent, modestly lower than the TYIP average target of 13.8 percent. Foreign grants (Rs. 22.74 billion)/GDP ratio was 2.9 percent, lower than the TYIP average target of 3.6 percent. However, fiscal deficit (Rs. 33.02 billion)/GDP ratio remained at 4.1 percent, lower than the TYIP average target of 4.7 percent and also the TYIP final year target of 4.3 percent. Foreign loan mobilized (Rs. 11.32 billion) represented 1.4 percent of the GDP, lower than the TYIP average target of 2.5 percent. Domestic loan mobilized (Rs. 20.50 billion) represented 2.6 percent of the GDP, higher than the TYIP average target of 2.2 percent. The remaining portion of the deficit (Rs. 1.20 billion or 0.1 percent of the GDP) was financed through the use of surplus cash. During the year, revenue net of recurrent expenditure financed Rs 16.14 billion or 98.5 percent of the principal repayment (Rs. 16.39 billion), requiring the rest (Rs. 0.25 billion or 1.5 percent of the principal repayment) to be met through the domestic loan. Of the capital expenditure (Rs. 55.51 billion), foreign grants and loans (Rs. 34.06 billion) financed 61.4 percent while the domestic loan including the use of cash surplus financed 39.1 percent, signaling lower dependence on the foreign sources of financing compared to the 78.6 percent share as projected in the TYIP. Of the total expenditure in FY 2007/08, 34.0 percent was capital expenditure compared to the Plan target of 35.0 percent. This underscores the need for increasing the share of capital expenditure. It may especially be noted that the prevailing trend of recurrent expenditure

exceeding the capital expenditure that began since FY 1998/99 needs to be reversed so as to raise the level of productive investments in the government sector. There is also a constant need to attain progress in revenue mobilization so as to finance, on a sustained and stable framework, the expenditure requirements associated with the rising development expectations of the people

According to the budget statement for FY 2008/09 as presented to the legislature-parliament on September 19, 2008, the estimates of the recurrent, capital, and principal repayment expenditures are Rs. 128.52 billion, Rs. 91.31 billion, and Rs. 16.18 billion respectively, aggregating Rs. 236.01 billion. As percentages of the GDP (gross value added) of Rs. 910.95 billion (Rs. 792.13 billion in FY 2007/08 projected to rise by 15.0 percent in FY 2008/09), the ratios of the recurrent, capital, and principal repayment expenditures will be 14.1 percent, 10.0 percent, and 1.8 percent respectively, aggregating 25.9 percent, much higher than the TYIP average of 22.1 percent and the highest so far Nepal's budgetary history. The revenue is estimated to rise by 31.8 percent to Rs. 141.72 billion in comparison to the growth of 22.6 percent to Rs. 107.55 billion in FY 2007/08. As a percent of the GDP, this revenue will represent 15.6 percent, higher than the TYIP average target of 13.8 percent and also the highest in the budgetary history. Foreign grants (Rs. 47.09 billion)/ GDP ratio will be 5.2 percent, highest in the budgetary history and also higher compared to the TYIP average target of 3.6 percent. The fiscal deficit (Rs. 47.20 billion)/GDP ratio will rise to 5.2 percent, higher than the TYIP final year target of 4.3 percent as well as the TYIP average target of 4.7 percent. Foreign loan (Rs. 18.70 billion) will represent 2.1 percent of the GDP, lower than the TYIP average target of 2.5 percent. Domestic loan (Rs. 25.0 billion) as percent of the GDP will be 2.7 percent, higher than the TYIP average target of 2.2 percent. The remaining portion of the deficit (Rs. 3.50 billion or 0.4 percent of the GDP) will be financed through the use of the surplus cash. During the year, revenue net of recurrent expenditure will finance Rs 13.20 billion or 81.6 percent of the principal repayment (Rs. 16.18 billion), requiring the rest (Rs. 2.98 billion or 18.4 percent of the principal repayment) to be met through the domestic loan. Of the capital expenditure (Rs. 91.31 billion), foreign grants and loans (Rs. 65.79 billion) will finance 72.1 percent while the domestic loan (including the use of surplus cash) will finance the rest 27.9 percent, signaling lower reliance on the foreign aid, though higher than the respective ratio in FY 2007/08, in comparison to the ratio of 78.6 percent as projected in the Plan. Of the total projected expenditure in FY 2008/09, 38.7 percent will be the capital expenditure, larger than the TYIP target of 35.0 percent. On the basis of these indicators, it could be observed that the total size of the budget has been increased significantly to finance which the reliance on the foreign grants has been raised while the revenue mobilization has also been projected at a higher side. If these estimates turn out to be unrealistic, the reliance on the domestic loan could go up in addition to disturbing the budgetary structure and macroeconomic soundness and stability of the economy. This could add to the public debt vulnerability, besides reducing the efficiency and effectiveness of the public sector management along with generating weaknesses and instability in the overall macroeconomic management.

Public Debt

Total outstanding debt of the government in mid-July 2007 had amounted to Rs. 320.4 billion (foreign debt Rs. 216.6 billion and domestic debt Rs. 103.8 billion, comprising 67.7 percent and 32.4 percent of the total respectively). The debt stock/GDP ratio was 46.0 percent (foreign debt 31.1 percent and domestic debt 14.9 percent). In mid-March 2008, the total debt stock reached Rs. 323.9 billion (foreign debt Rs. 216.2 billion and domestic debt Rs. 107.7 billion, with the respective shares in the total at 66.7 percent and 33.3 percent), representing a rise of 1.1 percent from the mid-July 2007 level. In mid-March 2008, the debt stock/GDP ratio fell to 40.8 percent (foreign debt 27.3 percent and domestic debt 13.5 percent). Total outstanding debt of the government in mid-July 1975 had amounted to Rs. 861.1 million (foreign debt Rs. 346.1 million and domestic debt Rs. 515.0 million, sharing 40.2 percent and 59.8 percent of the total respectively). The total debt stock/GDP ratio was 5.2 percent (foreign debt 2.1 percent and domestic debt 3.1 percent). During the period spanning 33 years from mid-July 1975 through mid-July 2008, the total debt stock rose at an annual average of 19.7 percent (foreign debt rose at 21.5 percent and domestic debt rose at 17.6 percent). Accordingly, the share of foreign debt rose over the years, reaching 67.7 percent of the total in mid-March 2008. The nominal GDP, total government expenditure, government revenue, and merchandise exports in FY 1974/75 had amounted to Rs. 16,601.0 million, Rs. 1,513.8 million, Rs. 1,008.4 million, and Rs. 889.6 million respectively. The average annual growth rates of these aggregates during these 33 years were GDP at 12.5 percent, total government expenditure at 15.2 percent, government revenue at 15.2 percent, and merchandise exports at 13.7 percent. Among these aggregates, the nominal GDP growth rate has been found the lowest.

Total debt servicing (principal and interest) in FY 2006/07 amounted to Rs. 22.9 billion. Of this, foreign debt servicing amounted to Rs. 9.6 billion while the domestic debt servicing amounted to Rs. 13.3 billion, with the respective shares of the debt servicing at 41.9 percent and 58.1 percent of the total. As to the foreign component, the principal (Rs. 7.5 billion) and interest (Rs. 2.1 billion) shared 78.1 percent and 21.9 percent of the total respectively. As to the domestic component, the principal (Rs. 9.2 billion) and interest (Rs. 4.1 billion) shared 69.2 percent and 30.8 percent of the total respectively. The total debt servicing represented 3.3 percent of the GDP which amounted to Rs. 697.0 billion, 17.1 percent of the total government expenditure at Rs. 133.6 billion, 24.8 percent of the recurrent expenditure plus the amount of principal repayment at Rs. 93.9 billion, 24.1 percent of the exports of goods and services at Rs. 95.0 billion, and 26.1 percent of the government revenue at Rs. 87.7 billion.

Debt Sustainability

Public debt dynamics are assessed using the Low-Income Country Debt Sustainability Analysis (LIC-DSA) framework, which was jointly prepared by the International Monetary Fund (IMF) and the World Bank (WB). According to the joint DSA prepared by the staffs of the IMF and the WB as part of the Staff Report for the 2008 Article IV Consultation with Nepal, the initial net present value (NPV) of the debt has improved compared to the previous

DSA, which could be attributed to the appreciation of the Nepalese currency and lower than projected loan disbursements during the period. In view of the improved debt indicators, Nepal's external debt dynamics are assessed to be subject to a moderate risk of debt distress compared to the previous DSA which classified Nepal at a high risk of debt distress. A key feature of the LIC-DSA framework is that it compares debt burden indicators to indicative policy-based thresholds. The thresholds are based on the empirical finding that low-income countries with stronger policies and institutions tend to have a higher debt carrying capacity. The indicative thresholds of the NPV of debt in percent of exports, GDP, and revenue are 150 percent, 40 percent, and 250 percent respectively. The indicative thresholds of the debt service in percent of exports and revenue are 20 percent and 30 percent respectively. According to the comparison of the debt burden indicators during 2004-06, Nepal was classified as a medium performer.

In the baseline scenario of Nepal, debt burden ratios are projected to fall between FY 2007/08 and FY 2027/28. As at FY 2006/07, Nepal's NPV of external public debt/exports ratio was estimated at 148 percent (the relevant policy-based indicative threshold being 150 percent). The ratio is projected to fall to 87 percent by FY 2027/28, with an average ratio of 116 percent during FY 2007/08 through FY 2027/28. The NPV of external public debt/ GDP ratio (threshold 40 percent) is projected to decline from 22 percent in FY 2006/07 to around 12 percent by FY 2027/28, with an average ratio of 15 percent during these two decades. The NPV of external public debt/revenue ratio (threshold 250 percent) is projected to decline from 163 percent in FY 2006/07 to the average of 114 percent during the period. The foreign debt servicing in FY 2006/07 represented 10.1 percent of exports of goods and services and 10.9 and percent of revenue, compared to the indicative thresholds of 20 percent and 30 percent respectively. The projected debt service averages between FY 2007/ 08 and FY 2027/28 are 7 percent in terms of the exports and 6 percent in terms of revenue. Given the high concessionality of external debt, the ratios of the debt service to exports and revenue are low, and at levels similar to, or lower than, most HIPCs after full HIPC debt relief. The ratio reflects debt service on existing debt and debt service on projected disbursements. With respect to the total public debt, as per the baseline scenario, the NPV of public debt/GDP ratio is projected to decline from 35 percent in FY 2007/08 to 26 percent by FY 2027/28. Over the same period, the NPV of public debt/revenue ratio would fall from 216 percent to 157 percent, and the public debt service//revenue ratio would decrease from 17 percent to 12 percent.

Sensitivity Analysis

Stress tests and alternative scenarios suggest vulnerability to shocks. Regarding the total public debt, a shock modeled as real GDP growth at historical average minus one standard deviation in FY 2009/10 results in the NPV of debt/GDP ratio increasing from 35 percent in FY 2007/08 to 41 percent in FY 2027/28; the NPV of debt/revenue ratio increases from 216 percent to 250 percent; and the debt service/revenue ratio increases from 17 percent to 23 percent. This scenario illustrates the importance of the peace dividend to be reflected in stronger real GDP growth. Alternative scenarios reveal vulnerabilities from maintaining

the 2007/08 fiscal stance (primary balance, that is, fiscal deficit before adjustment of the interest payment), which could result in the NPV of debt/GDP ratio increasing from 35 percent in FY 2007/08 to 44 percent in FY 2027/28.

Regarding the external debt, tests indicate that the NPV of debt/exports ratio is sensitive to shocks. Following a combined, half-standard deviation shock to export growth, GDP deflator, and non-debt creating flows, the NPV of debt/exports ratio increases significantly, peaking at near 300 percent in FY 2009/10, and stays above the threshold for most of the projection period. These results are partly driven by Nepal's volatile export performance in the past decade.

Based on the LIC-DSA, Nepal's external debt dynamics are subject to a moderate risk of distress. Since the last DSA in 2007, the initial NPV of debt has improved due to the appreciation of the Nepalese currency as well as the lower than projected loan disbursements in the interim, as noted above. In contrast to the previous DSA, the baseline scenario does not indicate a protracted breach of debt thresholds. However, tests reflecting shocks to export growth and non-debt creating flows could result in protracted breach of the debt thresholds. The sensitivity analyses underscore the need to implement sound macroeconomic policies and reforms, including through raising the real GDP growth rate and achieving higher export growth. Stronger and more stable growth in exports contributing to higher GDP growth combined with foreign financing at favorable terms--preferably through grants--would help Nepal make progress toward achieving its Millennium Development Goals (MDGs) targets while containing risks to debt sustainability.

Highly-Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)

Though debt resources are extremely important for the government in carrying out the development programs for meeting the socio-economic infrastructure needs and other essential requirements of development, there are limits to a rapid accumulation of debt because of its rising servicing burdens. Eventually, excessive deficits must have to be brought down with cuts in expenditure or through higher taxes as, otherwise, the natural consequence would be the inflationary financing of the deficit along with the rise in the cost of funds for private investors, leading to unfavorable saving and investment climate and macroeconomic instability in the country. Looking at the poverty scenario and the development challenges confronting the developing countries besides the need for making their debt servicing sustainable, the donor community has devised some important measure to release the resources to be devoted to the debt servicing for helping low-income countries spur economic growth and reduce poverty. The Highly-Indebted Poor Countries (HIPC) Initiative was launched by the IMF and the WB in 1996 with the aim of reducing to sustainable levels the external debt burdens of the heavily-indebted poor countries by encouraging the voluntary participation and coordinated action of the international financial community, including multilateral institutions, governments, and the private sector. It was enhanced in 1999 to provide for faster, deeper and broader debt relief.

A country is considered potentially eligible for debt relief under the HIPC Initiative if the following conditions are satisfied: (a) it is eligible for the IDA (International Development Association of the World Bank) only, that is, having a per capita income up to $905 in 2006, and the PRGF (Poverty Reduction and Growth Facility of the IMF) and (b) its debt burden indicators are above the thresholds established for the HIPC Initiative. The thresholds are 150 percent for the ratio of the NPV of debt to exports of goods and services and 250 percent for the ratio of the NPV of debt to fiscal revenue. As a requirement of the second criteria, a country must have the ratio of exports of goods and services to GDP above 30 percent and the ratio of the fiscal revenue to GDP above 15 percent. At the decision point, the Executive Boards of the IDA and the IMF determine whether an eligible country qualifies for debt relief under the Initiative. To qualify for debt relief under the Initiative, an eligible country must (a) have debt burden indicators above the HIPC Initiative thresholds using the most recent data for the year immediately prior to the decision point, (b) establish a satisfactory track record of policy performance under respective IMF- and IDA-supported programs, and (c) put in place a poverty reduction strategy. A satisfactory Poverty Reduction Strategy Paper (PRSP) could be in the form of an Interim-PRSP, PRSP preparation status report, full-PRSP, or PRSP-annual progress report. At the completion point, the Executive Boards of the IDA and the IMF determine whether or not a country has met the requirements established at the decision point. If met, all creditors are expected to start providing debt relief on an irrevocable basis (moreover, upon reaching the completion point, countries become eligible for 100 percent debt relief on their eligible obligations toward the African Development Bank (AfDB), IDA, and the IMF under the Multilateral Debt Relief Initiative (MDRI).

So far, debt reduction packages have been approved for 33 countries, 27 of them in Africa, amounting to US$ 49 billion (in NPV terms) in debt service relief over time. Eight additional countries are potentially eligible for HIPC Initiative assistance. Among the 33 qualified countries, the 23 post-completion point countries (that is, those completing the requirements established at the decision point) are Benin, Bolivia, Burkina Faso, Cameroon, Ethiopia, The Gambia, Ghana, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Tanzania, Uganda, and Zambia. The 10 countries that are along the completion point are Afghanistan, Burundi, Central African Republic, Chad, Republic of Congo, Democratic Republic of Congo, Guinea, Guinea Bissau, Haiti, and Liberia. Eight are listed as the pre-decision point countries, namely, Comoros, Cote dIvore, Eritrea, Kyrgyz Republic, Nepal, Somalia, Sudan, and Togo. The overall cost of HIPC Initiative debt relief for the 41 HIPCs is estimated at US$ 67.7 billion in end-2006 NPV terms. Nearly one-half of this total cost represents debt relief for the 23 post-completion point countries, as mentioned above. The IDA already committed US$ 17 billion of debt relief under the enhanced HIPC Initiative, of which US$ 10.7 billion was provided to the 19 HIPCs as of July 1, 2006.

The MDRI was launched in 2005 to further reduce the external debt of qualifying low-income countries by providing additional resources to help them meet the MDGs, which include halving the poverty by 2015. In June 2005, the Group of Eight (G-8) major industrial countries proposed that three multilateral institutions--IMF, IDA and AfDB--cancel 100

percent of their debt claims on countries that have reached, or will eventually reach, the completion point under the joint IMF-WB enhanced HIPC Initiative. The MDRI provides full debt relief so as to release additional resources to help these countries reach the MDGs. The MDRI is separate from the HIPC Initiative, but linked to it operationally. The implementation of the MDRI by the IMF commenced on January 6, 2006, and by the IDA and the AfDB on July 1, 2006. In March 2007, the Inter-American Development Bank (IaDB) also joined this Initiative. . In addition, the IMF has provided MDRI assistance to two non-HIPCs with a per capita income at or below US$ 380. In order to ensure that the use of the IMF resources be consistent with the principle of uniformity of treatment, the IMF Executive Board decided to provide all the countries with per capita annual income of US$ 380 or less (whether HIPCs or not) the MDRI debt relief financed by the IMF's own resources through the MDRI-I Trust. HIPCs with per capita income above that threshold will receive MDRI relief from bilateral contributions administered by the IMF through the MDRI-II Trust. MDRI relief now covers the full stock of debt owed at end-2004 that remains outstanding at the time the country qualifies for such relief.

As of March 2008, 25 countries have qualified for, and received MDRI relief, from the IMF. They are 23 HIPCs that have reached the completion point (14 eligible under the MDRI-I, with per capita income at or below US$ 380, and 9 under the MDRI-II, with per capita income above US$ 380) and 2 non-HIPCs (Cambodia and Tajikistan with per capita income at or below US$ 380) under the MDRI-I. Among the 10 countries that will be eligible once they reach the completion point under the HIPC Initiative, Guinea, Haiti, and Republic of Congo will be eligible under the MDRI-II while the rest seven will be eligible under MDRI-I. Among the eight countries that are listed as the pre-decision point countries for the HIPC Initiative, MDRI-I would cover Eritrea, Nepal, and Togo while the rest five will come under MDRI-II. The estimated total cost to the IMF of MDRI debt relief is US$ 3.8 billion in nominal terms at end-December 2008. Of this amount, US$ 3.3 billion has been delivered by end-March 2008. Of this, US$ 0.2 billion has been provided to two non-HIPCs, Cambodia and Tajikistan, while the rest US4 3.1 billion has been provided to the 23 HIPCs. The full cost to IDA, IMF, and AfDB for the MDRI stands at around US$ 50 billion, of which the total cost to the IDA is estimated at US$ 37 billion over 40 years. The G-8 has committed to ensure that proposed debt forgiveness does not undermine the ability of the three multilateral institutions to continue to provide financial support to low-income countries nor the institutions' overall financial integrity. The IMF and the WB are cooperating closely in the implementation and monitoring of the MDRI, particularly with respect to assessing qualification for MDRI relief and monitoring MDG-related spending following the provision of the debt relief.

It was expected that the overall debt stock of the economies under the debt relief would be substantially reduced. As a result, their debt service payments would decline, thereby giving them room to spend more on poverty-reduction and social expenditures. The delivery of HIPC Initiative and MDRI assistance would, therefore, contribute to long-term debt sustainability based on increased revenue mobilization, better public debt management, diversified production and export base, and strengthened institutional capacity to address the underlying vulnerabilities. Accordingly, the total outstanding external debt for the low

and middle-income countries in Middle East and North Africa as well as the Sub-Saharan Africa fell to $141.3 billion in 2006 from $167.3 billion in the case of the former and to $173.5 billion in 2006 from $ 236.3 billion in the case of the latter. This stock in the non-HIPC regions, however, rose. For example, the stock in East Asia and Pacific rose to $660.0 billion in 2006 from $455.6 billion in 1995. Such amount for South Asia rose to $227.3 billion in 2006 from $151.7 billion in 1995. Total outstanding external debt as percent of the gross national income (GNI) in the low and middle-income economies as an aggregate came down from 38.9 percent in 2000 to 26.4 percent in 2006. This ratio for East Asia and Pacific fell to 18.4 percent in 2006 from 35.5 percent in 2000. The ratio for South Asia fell to 19.8 percent in 2006 from 32.0 percent in 2000. The biggest fall in the ratio was witnessed in Sub-Saharan Africa where it came down to 26.2 percent in 2006 from 77.9 percent in 2000. As country groupings, the decline in the form of percentage points during the last 11 years was 12.2 in South Asia, 17.1 in East Asia and Pacific, 36.5 in Middle East and North Africa, and 51.7 in Sub-Saharan Africa. This means that increasing amount of resource has been mobilized through sources like the foreign direct investment (FDI) and international capital market. The ratio of debt service as percent of exports of goods and services has accordingly come down. There has been the highest fall in the debt/ GNP ratio in the Sub-Saharan Africa over the last 11 years. Such dramatic fall in the external debt burden in Sub-Saharan Africa could be attributed to the large number of countries from this region being included for the debt relief and the progress so far achieved in this direction.

Conclusion

Nepal's progress in socio-economic development endeavor has been inadequate. Nepal's per capita income is one of the lowest in the world and the lowest in South Asia. The progress and status regarding the socio-physical infrastructure development has remained modest. Nepal's hydro-power potential is considered as the second highest in the world but the country is troubled by the frequent power outages. The country is considered as possessing the best tourism potential in the world but this sector is also suffering from inadequate infrastructure and lack of marketing strategies. The population growth rate is high while the economic growth rate is slow. Domestic resource mobilization has been low, foreign aid disbursement ratio has remained unsatisfactory, and the project management in the public sector has been characterized by a host of constraints and problems, mainly attributed to the lower capacity level in the public sector. The private sector has also not been able in tapping the productive potentialities of the economy through directing resources toward these pursuits to a desired extent. Foreign aid has comprised a major chunk of the capital outlays of the government though the aid has not been effective, as anticipated, in tackling the economic under-development and laying a solid foundation for a sustainable growth of the economy. The foreign aid seems to be entangled on unsubstantial issues and concerns, exerting limited impact on the country's economic transformation process and the economic life of an average Nepalese. Attaining the MDGs, thus, remains the biggest challenge for the country.

The HIPC Initiative aims at reducing the external debt burdens of heavily-indebted poor countries to sustainable levels. To qualify for debt relief under the Initiative, eligible countries need to establish a satisfactory track record of policy performance under IMF- and IDA-supported programs and through putting in place a poverty reduction strategy. Another mechanism, namely the MDRI, was established in 2005 to further reduce the external debt of qualifying low-income countries by providing additional resources to help them meet the MDGs. The low-income countries participating in the debt relief initiative have been able to reduce their debt burden as well as the debt servicing cost. Nepal has been listed as one of the eight pre-decision point countries that may wish to be considered for the HIPC debt relief as these countries have met the income and indebtedness criteria based on end-2004 data. However, the process for listing Nepal under the HIPC Initiative has not moved forward. Since Nepal had limited debt owed to the IMF at 2004-end, there would also not be much resource available for use in the pursuit of the MDGs even if the debt relief under the MDRI is operationalized through the IMF. Nepal's bulk of the external debt (over 90 percent) lies with the multilateral institutions like the IDA and the ADB (Asian Development Bank). Hence, Nepal would be immensely benefited if the MDRI through the IDA could be arranged similar to the case of MDRI-I that the IMF has implemented for Cambodia and Tajikistan (non-HIPCs with per capita income at or below US$ 380). If the ADB could also be a part of the MDRI like the AfDB and IaDB, then Nepal would be further benefited. It is believed that positive consideration of these donors in this direction will be instrumental in meeting the MDGs in Nepal. Even if the mechanism for the international debt relief initiative could not be implemented for Nepal, the bilateral and multilateral donor community is urged to support Nepal through arrangement of the necessary resources in the form of highly increased level of grants available with the least conditionalities attached.

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