An Assessment of the Impact of External Debt on Economic Growth of Nepal

Gunakar Bhatta*

Countries at early stages of development have small stocks of capital and require foreign borrowing for their investment needs and meet their external resource gap. Nepal's dependence on foreign assistance, nearly for the last five decades, can be viewed from the same perspective. The present article is a preliminary work in the direction of analyzing the relationship of external debt and economic growth of Nepal. The examination of debt burden indicators suggests the increasing burden of external debt, with a significant increase in the size and magnitude of such debt during 1990s. The empirical observation shows the external debt flow having positive effect on economic growth. This indicates that external debt should not be viewed only as a burden but also as a major source of financing for a developing economy like Nepal. However, the analysis of external debt stock and debt servicing shows that the equally important that external borrowing be made to supplement but not replace domestic savings in the long run.

1. INTRODUCTION

The need for public financing results because of the resource gap, i.e. savings as well as the trade gap. This compels a government to confront with the choice between the sources of financing: external and domestic. The choice depends on the availability of financing, the economic environment, the institutional framework and the degree of development of domestic financial markets. Economists say external financing, i.e. borrowing in foreign currency from nonresident creditors, is attractive because of lesser crowding-out effects on private investment and reduced risks of inflationary pressures (Beaugrand, Loko and

* Assistant Director, Nepal Rastra Bank, Research Department.

Mlachila, 2002). Likewise, it can induce greater fiscal and monetary discipline since it eliminates any incentive the government might have to generate inflation in order to reduce the real debt burden. However, these theories need highly restrictive conditions to establish these advantages, while empirical studies suggest that external financing is not a panacea for governments. In contrary to these manifest advantages of external debt financing, a rising external debt tends to weaken the economy. First, foreign borrowing increases vulnerability to external conditions. When debt is contracted at a floating rate, higher foreign interest rates lead to an increase in debt servicing costs. This raises budgetary outlays, which may translate into a larger deficit or a reduction of non-debt outlays. Similarly, a depreciation of the currency leads to increased debt servicing and has the same effects as those mentioned earlier. Second, when the government borrows to cover a growing deficit, foreign borrowing leads to an unsustainable level of debt, an excessive share of debt service in overall government expenditure, and substantial use of foreign exchange to service the debt. In the long run, this may lead to a debt crisis (Beaugrand, Loko and Mlachila, 2002). From the development perspective as well, the impact of an unsustainable debt is very disastrous for an economy [8].

The crucial role of capital in the production process is well-known. The international flow of capital-borrowing and lending across political borders dates back at least to the ancient civilization of Mediterranean. At the end of the 1940s, the flow of capital to developing countries was negligible. But the early post-war reflections on the problems of developing countries led to the identification of insufficient capital stock as a cause of their low income. Among the notable economists who made such suggestions are Hans Singer and Ragner Nurske. According to Nurske, there was a vicious circle of poverty, which could be broken by increasing savings. The role of increased savings in facilitating capital accumulation was further advocated by Arthur Lewis, 1954 and Rostow, 1985 (Were, 2001). It was noted that the volume of savings in developing countries was too low on account of the low income and, therefore, domestic savings should be supplemented by foreign resources. This shifted the issue from whether external resources are useful to developing countries to how much was sufficient to help them realize their growth potential. The need for foreign resources in developing countries has been justified by the two-gap approach developed by Hollish B. Chenery and others (Were, 2001)[9].

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[8] Unsustainable debt, through several mechanisms, represents a major stumbling block towards economic and social development and poverty reduction. The most obvious stumbling block is the cash flow implication of debt service obligations, the so-called crowding-out effect. It is obvious that in such a case the government has to pay large sums of money to foreign creditors, thereby less can be spent on recurrent social expenditure or essential investments, such as infrastructure, health and education.

[9] They remark that, in the short run, the effectiveness of external resources depends on their use to relieve shortages of skills, savings and imported commodities while in the long run, the fate of these countries depends on the use that is made of the initial increase in the output. It has been the case in most of the Sub-Saharan and Latin American countries.

Economic theory suggests that reasonable levels of borrowing by a developing country are likely to enhance its economic growth (Pattillo, Poirson and Ricci, June 2002). Countries at early stages of development have small stocks of capital and are likely to have investment opportunities with rates of return higher than those in advanced economies. As long as they use the borrowed funds for productive investment and do not suffer from macroeconomic instability, policies that distort economic incentives, or sizeable adverse shocks, growth should increase and allow for timely debt repayments. The best known explanation comes from "debt overhang" theories, which show that if there is some likelihood that, in the future, debt will be larger than the country's repayment ability, expected debt service costs will discourage further domestic and foreign investment and thus harm growth. Potential investors will fear that the more a country produces, the more it will be taxed by creditors to service the external debt, and thus they will be less willing to incur costs today for the sake of increased output in the future. Some considerations suggest that, at reasonable levels of debt, further borrowing would be expected to have a positive effect on growth. Others stress that large accumulated debt stocks may be a hindrance to growth. Both these elements together imply that debt is likely to have non-linear effects on growth (Pattillo, Poirson and Ricci, June 2002).

Nepal, being one of the least developed countries of the world, is far behind in the level of social and human development. The Human Development Report, 2002 has placed Nepal in the 142^{nd} rank out of the total 173 countries included in the report (HDR, 2002). Foreign aid contributes to domestic savings and thus to resource mobilization, capital accumulation, and industrialization (Chowdhary, 2002). A substantial portion of Nepal's development expenditure averaging about 55 percent per annum has been financed through foreign aid (His Majesty's Government of Nepal (HMG/N), Foreign Aid Policy, 2002). The external debt financing alone contributed significantly to the development expenditure of Nepal, which was nearly 35 percent during 1996/97-2000/01. However, the increasing burden of debt service has drained resources by curtailing the investment from socio-economic development and infrastructure building. The debt servicing has been consuming almost 30 percent of the regular expenditure for the last 15 years. Moreover, the external debt servicing has dominated the debt service in the last few years. The external debt service alone drains nearly 13.0 percent of the government revenue which is almost more than 14.0 percent of the regular expenditure and is approximately 8.0 percent of the total government expenditure of a fiscal year. This trend, on an average, has been continuing for the last five to six years. Similarly, the per capita external debt burden at the end of 2001 was approximately Rs. 8,600, which was nearly 50 percent of the per capita GDP (i.e. Rs. 17,718) of that year (Bhatta, 2002/2003). Though most of the external debt of Nepal is of concessional nature obtained from multilateral agencies and Nepal has partially liberalized its capital account; necessary surveillance over the composition, classification, accumulation and servicing of the external debt is important. It is particularly because of the significant amount of the development expenditure financed through foreign aid on the one hand and the increased size and magnitude of external debt on the other. Further, it is also important because of the move of the Nepalese economy towards further liberalization probably the liberalization of capital account in the future and the ongoing process for Nepal's accession into the WTO. Given this reference, a study on external debt and its impact on economic growth of Nepal is considered to be relevant both from the economic development perspective and for ex-ante measures for preventing possible debt crisis.

In view of the increasing external debt of Nepal, the present paper attempts to examine the composition and disbursement of external debt, and its implications on economic growth. Specifically, the objectives are:

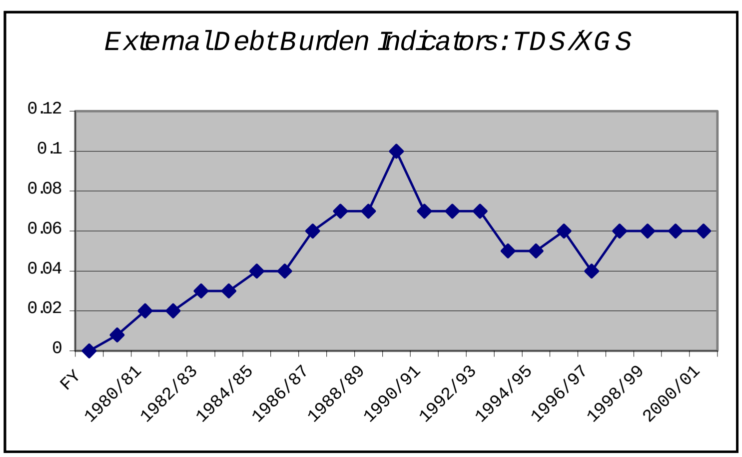
1. Analyze the inter-linkages of external debt and national resources,
2. Examine the size, magnitude, composition and disbursement of Nepal's external debt, and
3. Empirically assess the effects of external debt on economic growth of Nepal.

2. BACKGROUND INFORMATION

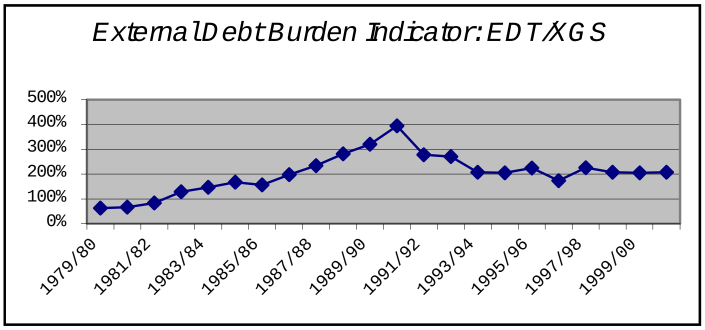
Inter-linkages of External Debt with National Resources

The relationship of external debt with gross national product (GNP) and export earnings is examined in this section using some of the commonly used debt burden indicators, which are: TDS/XGS (external debt service payments as a ratio of total export of goods and services), EDT/XGS (external debt to exports ratio), EDT/GNP (external debt to GNP ratio) and INT/XGS (interest paid on external debt to exports of goods and services ratio). These indicators are used to measure the effect of external debt on national income and export earnings.

As presented in Table 1, the examination of the TDS/XGS ratio shows that external debt servicing was too low to cause concern up to FY 1979/80. This ratio started to increase from FY 1980/81 in which it abruptly rose to 2 percent and reached the peak of 10 percent in FY 1989/90. During nineties, this ratio remained

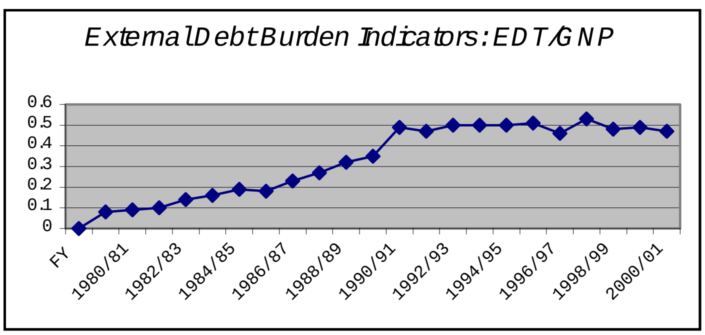


at 6 percent on an average. Thus, this ratio reveals that a significant portion of the exports earnings has been used for debt servicing purpose.



Similarly, two of the four key indicators: EDT/XGS ratio and EDT/GNP ratio have increased significantly in FY 2000/01 in comparison to those in the FY 1979/80. The EDT/XGS ratio was 63 percent in FY 1979/80 and came up to 207 percent in FY 2000/01. This ratio reached the peak of 395 percent in FY 1990/91 and began to come down in the subsequent years, remaining in the range of 200 percent during the last five years of nineties.

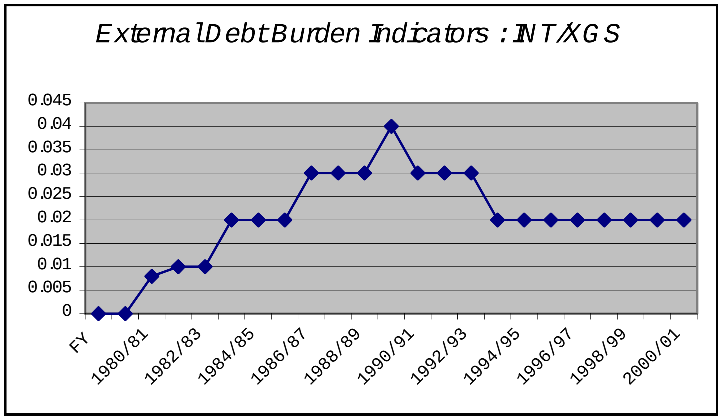
Likewise, the EDT/GNP ratio was only 8 percent in FY 1979/80 and reached 47 percent in the FY 2000/01. This ratio rose to 49 percent in FY 1990/91 from 35 percent of the previous year's level and was at the peak of 53 percent in FY 1997/98.



The Table 1 shows that when the GDP had recorded the negative growth of 3 percent, the EDT/XGS ratio increased from 84 percent to 129 percent and the EDT/GNP ratio from 10 percent to 14 percent in FY 1982/83. However, the GDP recorded the growth of 6.4 percent in FY 1990/91while the EDT/XGS ratio and EDT/GNP ratio increased at the higher rate. Despite this positive relationship maintained in FY 1990/91, the growth recorded a contraction in FY 1997/98 from the level of the previous year along with the growth in EDT/XGS ratio and EDT/GNP ratio (Table 1).

Another debt burden indicator, INT/XGS, as presented in Table 1, shows that the interest payments on external debt drained 2 percent of the exports earnings during

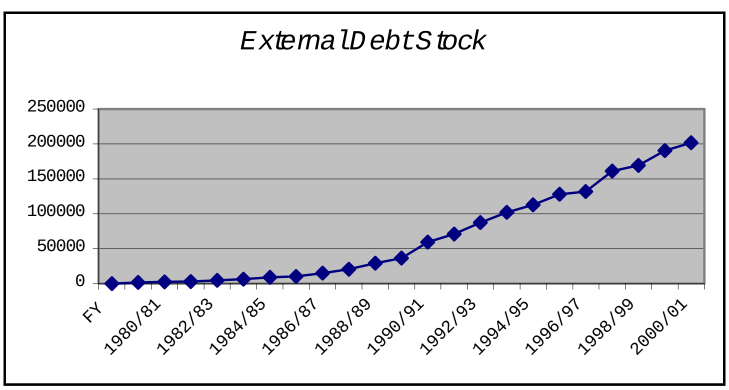
1983/84-2000/01 with those of the exceptions during 1986/87-1992/93. Such interest payments consumed 3 percent of exports earnings during 1986/87-1992/93, again with an exception of 4 percent in FY 1989/90. The debt servicing was at the highest level of 10 percent in FY 1989/90. This analysis shows that normally one-third of the debt servicing consists of interest payments, which means a significant amount just used for the cost of the debt.



Based on this background, it is evident that Nepal's external debt burden and its share in national earnings is increasing over the years. The debt servicing capacity to be examined on the basis of EDT/XGS ratio and EDT/GNP ratio can not be outlined as the robust ones. Similarly, the significant amount to be used for debt servicing could have been allocated for consumption and investment purpose. In the long run, this may act as strong disincentive not only to invest but also to partake in the programs aimed at increasing growth.

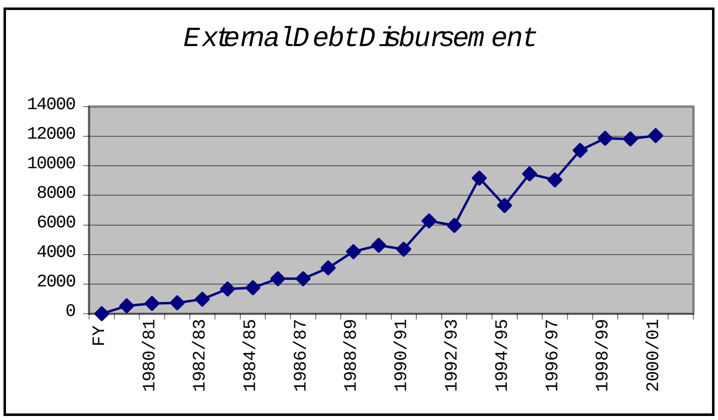
Size and Magnitude of External Debt

Table 2 shows the size of Nepal's stock of external debt, debt disbursement and debt service payments during 1979/80-2000/01. The outstanding external debt and

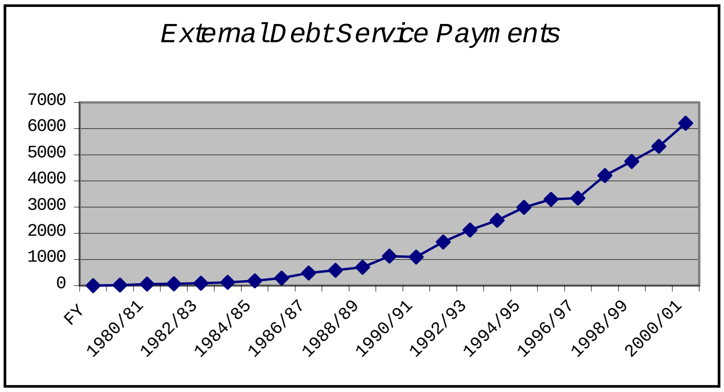


debt servicing rose dramatically during the decade of nineties. The nominal outstanding external debt, which was Rs. 1.80 billion at the end of the FY 1979/80, reached Rs. 36.80 billion at the end of the FY 1989/90. This is twenty-times increase in the outstanding amount of the external debt over the period of ten years. This external debt burden stood at Rs. 201.50 billion at the end of the FY 2000/01, which is one hundred and twelve-times increase from the level of FY 1979/80 and six-times increase from the level of FY 1989/90. These calculations show that the pace of such increase was extremely high during the eighties.

With respect to the flow of external debt, there is a significant increase in such a flow over the period of the last 20 years. The external debt disbursement was Rs. 693.3 million in FY 1980/81, Rs. 4.36 billion in FY 1990/91 and Rs. 12.04 billion in FY 2000/01. The growth rate of such debt remained highest in FY 1983/84 in which it increased by 69.5 percent. It also increased significantly by 54 percent in FY 1993/94. Such debt disbursement recorded a significant negative trend in FY 1995/96 in which it went down by 20 percent. Other years of negative growth in external debt disbursement were 1986/87, 1990/91, 1992/93, 1996/97 and 1999/00 in which the external debt disbursement went down by 0.3 percent, 6 percent, 5 percent, 4 percent and 0.3 percent respectively.

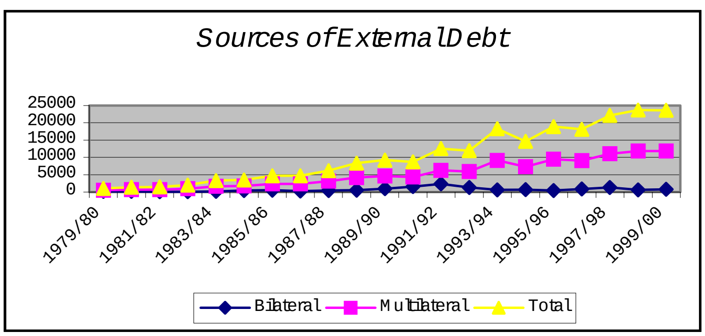


Likewise, the increasing burden of debt servicing, as shown in Table 2, reveals that the resources, which could have been used for the development of social sectors, are being consumed for debt servicing, a discouraging practice from the development perspective. While analyzing the trend of external debt servicing, the amount spent for external debt servicing was Rs. 23 million in FY 1979/80 and went up to Rs. 1.12 billion in FY 1989/90, a substantial increase in debt servicing over the period of 10 years. Further, this debt servicing drained Rs. 6.20 billion in FY 2000/01, which is nearly two hundred and seventy-times increase in debt servicing from the level of FY 1979/80 and six times increase from the level of FY 1989/90. In essence, the presentation made in Table 1 shows that the stock of external debt, flow of such debt and debt servicing burden have increased significantly.



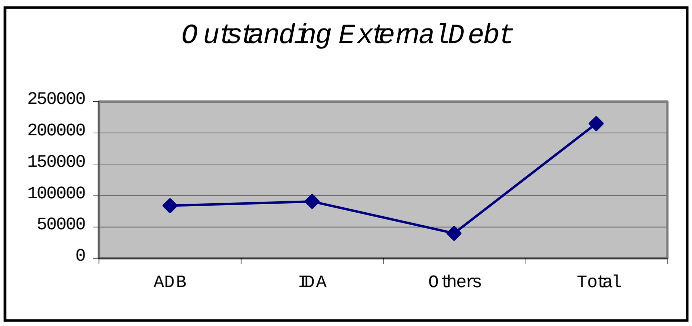
Structure, Type and Composition of External Debt

Most of the external debt of Nepal is public debt, which is agreed and received by the government. The maximum period of the debt repayment is 40 years. As shown in Table 3, Nepal's source of external debt consists of official debts (bilateral and multilateral). A decomposition of official debt disbursement shows it mainly from the multilateral sources. External debt disbursement from such sources was 79 percent in FY 1980/81 and always remained above the level of 75 percent during the analyzed period except for FY 1990/91 and FY 1991/92 in which it was 63 percent and 62 percent respectively. The disbursement of such debt from the multilateral sources was at the helm of 95 percent both in FY 1995/96 and FY 1998/99. On an average, external debt disbursement from multilateral sources during 1979/80/-2000/01 was 85 percent.



The external debt disbursement from bilateral sources remained 15 percent, on an average, during 1979/80-2000/01. However, it remained significant both in FY 1990/91 and FY 1991/92 in which it was 37 percent and 38 percent of total debt disbursement respectively. The external debt disbursement from bilateral sources suddenly came down to 5 percent of total official debt disbursement in FY 1995/96 and remained low in the subsequent years.

Table 4 presents the total outstanding external debt of the government for the period ending July 16, 2002. This Table shows that out of the total outstanding debt, the debt owed to the multilateral creditors is substantial, nearly 85 percent of the total outstanding amount. Such debt owed to the Asian Development Bank (ADB) and International Development Association (IDA) only is almost 82 percent. Of the total outstanding debt, the debt owed to ADB is 39.4 percent and to IDA 42.3 percent. Nepal's other multilateral creditors are: European Economic Commission (EEC), International Food and Agriculture Development Association (IFAD), other Nepal Development Forum (NDF) members and Organization of the Petroleum Exporting Countries (OPEC). The debt to be owed to these other creditors is nearly 2 percent, which is significantly low in comparison to the outstanding obligations to the ADB and IDA.



The debt owed to the bilateral creditors consists of 15 percent of the total outstanding debt. Japan is the largest bilateral creditor of Nepal. Nepal owes 11.5 percent of the total outstanding debt to Japan. Other bilateral creditors of Nepal are Australia, Belgium, Finland, France, Korea, Kuwait, Russia, Saudi Arab and the USA. The debt owed to all these creditors is nearly 3.5 percent of the total outstanding debt obligations.

Background of Foreign Aid and Policy Guidelines

Nepal's first experience of foreign economic assistance was heralded by the point-four program agreement signed on January 23, 1951. The US government's assistance of Rs. 22,00,000 provided under President Harry Truman's point-four program was soon followed by formal economic assistance from India in October of the same year. China and the then USSR came into the Himalayan country's foreign aid scenario in 1956 and 1958 respectively. Nepal joined the Colombo Plan in 1952, participated in the first non-aligned conference in 1955 in Bangdung and became a member of the United Nations and thus attracted the interest of the developed as well as developing nations in its economic development efforts (Sigdel, 1996)[10].

Nepal has been utilizing the foreign aid as an instrument of financing socio-economic development since the mid-fifties, when Nepal embarked on the process of planned development with the launching of the First Five Year Development Plan 1956-61. Since then, a substantial portion of development expenditure averaging about 55 percent per annum has been financed through foreign aid. Currently, foreign assistance remains around 5-6 percent of Gross Domestic Product (GDP) annually, and finances about 25-30 percent of total government expenditure. In terms of sectoral distribution of foreign aid, agriculture, forestry and fisheries have received the largest share followed by energy, transport, health, social development, and human resource development (HMG/Nepal, Foreign Aid Policy, 2002)[11].

HMG/N has shown its concern over the increasing external debt of the country in the Foreign Aid Policy 2002, which remarks that over the years, HMG's stock of outstanding foreign debt and its debt servicing have risen, as a result of utilizing foreign loans. Although these loans are concessional in nature with high degree of grant element, they still constitute a growing burden to the budget. Therefore, Nepal needs to be highly selective and productive in utilizing such loans. This Policy has laid down a number of policies with a view to meet the objectives as envisaged thereon. Among others, the policy on concessional loan states that loan assistance would be utilized selectively, after a careful scrutiny of the purpose, content and benefits of such projects and programs in order to reduce the burden of external debt, while contributing to accelerating and meeting socio-economic objectives. Nepal would encourage a closer partnership between the government and multilateral donors so that they can jointly examine the implications of these loans in terms of their contribution to economic and social development. Measures to be adopted in this regard include: (i) utilizing foreign loan assistance in projects and infrastructure development promising high returns on investments, (ii) analyzing the various implications of each new loan before accepting it, (iii) focusing loan assistance on areas that help generate private sector activities and

[10] Nepal's participation in the Conferences of the non-aligned countries in the subsequent years and her neutral stand in the then duopolarized world helped to expand the aid programs. Additionally, the formation of Nepal Aid Group in 1976 increased the quantum of foreign aid to Nepal (see Sigdel, 1996).

[11] Considering the increased role of foreign aid in the development endeavors of the country, His Majesty's Government of Nepal brought out the Foreign Aid Policy in 2002. The Foreign Aid Policy highlights the significance of foreign aid as it helps to: (i) supplement and enhance Nepal's meager domestic saving so as to mobilize increasing resources for poverty alleviation, (ii) channel increased resources towards priority sectors of the economy to accelerate development activity, (iii) create an environment for attracting foreign direct investment and promoting private sector investment, and (iv) improve the nation's capacity to identify, evaluate and adapt technology to accelerate production and productivity of the economy, which is one of the basic conditions for achieving the poverty alleviation objective.

promote external sector transactions that enhance the foreign exchange earnings capability, (iv) exploring ways of reducing the loan liability of HMG by protecting against exchange rate fluctuations. To reduce the potential debt burden, the government will also: (v) stop the use of loans for higher studies and study visits, (vi) minimize the expenditure on consultants and foreign experts out of loan assistance, (viii) not take any commercial and suppliers' credits (however, it will not preclude mixed credits), and (viii) not guarantee foreign loans for HMG-owned or other institutions.

The Foreign Aid Policy, 2002 emphasizes on the grant aid since it does not constitute the burden for the future generations and also does not constrain the already tight fiscal structure of HMG. Nepal needs to encourage aid more in such form and utilize them most effectively. So, the government's policy will be to seek grants first and, in the event grant assistance is not forthcoming, seek highly concessional loans. Action will be taken to facilitate arrangements to obtain concessional loans. By reviewing the guidelines mentioned in the Foreign Aid Policy 2002, it is also obvious that HMG is worried for the external debt burden and, therefore, has adopted the policy of reducing such debt obligations in the future.

3. Empirical observation and analysis

Empirical Observation

An attempt is made in the previous section to examine the interrelationship of external debt with those of the GNP and exports and to study the size and magnitude of external debt in the last twenty years along with reviewing the guidelines regarding the foreign borrowing envisaged in the Foreign Aid Policy 2002. In the present section, the effectiveness of external debt on economic growth is examined through the estimation of the ordinary least square (OLS) regression equation. For this purpose, the required data of 1979/80-2000/01 have been included. The regression equation is based on the model used by Maureen Were (2001) and is specified as:

$$GDPGR=a_0+a_1\,DEDTGDP+a_2\,EDTGDP+a_3\,DDSR+ ut$$

Where,

GDPGR = Real GDP growth rate

DEDTGDP = Flow of external debt to GDP

EDTGDP = External debt stock to GDP

TDSXGS = External debt servicing as percentage of exports of goods and services

ut = Error term

The channels through which the indebtedness affects growth have been identifies as: DEDTGDP to show the impact of external borrowing on stimulating growth, EDTGDP to show the past debt accumulation which impacts negatively on growth and the debt servicing which affects the crowding out effects.

The results of the OLS regression equations are:

Variable	Coefficients	Std. Error	t-Statistic	Prob.
	-0.000393	0.000373	-1.052214	0.3074
EDTGDP	0.026096	0.012680	2.058130	0.0552
DTGDP	0.000395	0.000509	0.775742	0.4486
DSXGS	-0.446633	0.491340	-0.909010	0.3761

R-squared = 0.240648

Analysis

The analysis is based on the evidences put forward by the OLS regression equation as presented above. However, a note of caution in terms of limited data set, application of limited explanatory variables and low degree of freedom should be taken into account while interpreting the result and, therefore, the present result could be taken as indicative only.

The independent variable DEDTGDP has an estimated regression coefficient of 0.026, which suggests that a 1 percent increase in DEDTGDP is associated with a 0.026 percent increase in the dependent variable, GDPGR. The independent variable EDTGDP has 0 estimated regression coefficient, which suggests that a 1 percent increase in EDTGDP has 0 percent increase in the dependent variable GDPGR. The third independent variable TDSXGS has a negative regression coefficient of -0.446, which suggests that a 1 percent increase in TDSXGS will lead to a 0.446 percent decrease in GDPGR. These observations indicate that the current flow of debt has some positive effect on GDP growth. The debt accumulation, however, has no effect and the debt servicing has a negative effect on GDP growth.

To test the significance of regression coefficient, the t statistics is used with 17 degrees of freedom at 5 percent level of significance. The calculated values of t statistics are found to be less than the tabulated value. However, the t statistics for DEDTGDP is approximately closer to the tabulated value indicating a positive relationship between the current flow of foreign debt and GDP growth. The t statistics for EDTGDP and TDSXGS are not significant. Further, to judge the movement of regressors in the regression equation, the R squared is calculated. The R squared, which is 24 percent, suggests that only one fourth of the variation in GDPGR could be explained by the movements in explanatory variables: DEDTGDP, EDTGDP and TDSXGS.

Thus, the empirical observation shows that the flow of external debt has positive impact, the debt accumulation has no impact and the debt servicing has a negative impact on GDP growth. The result relating to the flow of debt to GDP supports the view that, at the reasonable levels of debt, further borrowing would be expected to have a positive effect on growth. However, the results obtained relating to the debt stock to GDP supports the view that large accumulated debt stocks may not contribute to the growth in the long run. At the same time, it would be very difficult to define the reasonable level of debt for a developing economy like ours whose resource base, i.e. the government revenue, is not stable and substantial and depends highly on foreign assistance not only to meet capital expenditure but also for revenue expenditure.

4. SUMMARY AND CONCLUSION

There is no doubt that a country needs financing for its economic development and the appropriate choice of financing depends upon the availability of resources, level of the economic development, budgetary situation of the government and the robustness of the external sector. Most of the Least Developed Countries (LDCs) face both savings gap and trade gap and seek for external financing. Nepal, as being the LDC, also falls in this category and has relied on the foreign aid for the last four decades or more for its development endeavors. In spite of this, continuous dependence on external financing may not be productive and sustainable in the long run and may not necessarily spur the growth of the economy.

The external debt burden of Nepal has increased significantly since the FY 1979/80, with a high pace of growth in such a burden since FY 1990/91. The significant growth in debt burden is basically because of the increased investment need of the government for infrastructure building, macroeconomic adjustment and structural reform. This investment need is keenly addressed by the foreign creditors along with the liberalized economic policy adopted by the country in the mid-eighties in general and after the restoration of multiparty democracy in 1990 in particular. In addition, lower resource mobilization and higher revenue expenditure on the government's part have also contributed to debt burden.

The present paper attempts to examine the relationship of external debt with those of the GNP and export earnings. For this purpose, some debt burden indicators: outstanding external debt as a percentage of exports of goods and services (EDT/XGS), outstanding external debt as a percentage of GNP (EDT/GNP), external debt servicing as a percentage of exports of goods and services (TDS/XGS) and interest payments on external debt as a percentage of exports of goods and services (INT/XGS) are used. All these examined debt burden indicators have increased significantly during the last twenty years obviously indicating the increased indebtedness trend of Nepal. These debt burden indicators demonstrate severity over solvency of the economy during 1989/90-1990/91. However, such an extreme trend has been tackled and all the debt burden indicators have remained more or less stable in the subsequent years. In the nineties, it is also revealed that the gross national product and export earnings have maintained the increased pace of foreign debt though could not outpace it.

Regarding the effect of external debt, as a source of financing investment, on economic growth, the empirical study does not reveal the large impact of external debt on growth. However, it shows that the economic growth in Nepal has not been deterred due to the external debt as it had been the case in most of the low income countries, particularly in Latin America and Sub-Saharan Africa. The empirical study shows the positive impact, though of very small size, of the debt flow on economic growth. Given this, it can be noted that inflow of the foreign resources may assist the economic growth since the financing in the large-scale development projects in the country provides employment opportunities, warms up the business climate, creates investment-conducive environment and stimulates people for more consumption and investment. This fact may also be coincided with regard to the IDA and ADB financing in many large-scale projects in Nepal. At the same time, the external debt stock and the debt servicing do not reveal the same relationship as shown by the debt flow. Thus, it is equally important that the external borrowing be made to supplement but not replace domestic savings in the long run. Further, it is also important to notice that the external debt is mainly from the World Bank and Asian Development in concessional terms and therefore the debt flow has not hampered the growth. The result could have been different if there would have been the significant amount of commercial loan.

Though Nepal's external debt is of highly concessional nature and has the long term maturity, certain factors such as the continuous depreciation of the Nepalese currency vis-a-vis the US Dollar, increased debt servicing resulting in the higher budget deficit, crowding out effects of such debt servicing on private sector investment (Nepal Foundation for Advanced Studies (NEFAS), 1998), higher portion of loans than grants, substantial multilateral credits than bilateral ones and the inflationary effect of foreign borrowing, among others, should be watched carefully. In this regard, it is also important to note that unless a country grows fast enough to sustain debt obligations and maintain domestic investment, indefinite external indebtedness could have a very detrimental effects on the economy' s growth and on the welfare of the citizens. Nepal should abide by the guidelines recently envisaged in the Foreign Aid Policy 2002 regarding the procurement and use of the external borrowing. It is also equally important for Nepal to take initiatives for getting the rescheduling, writing-off and cancellations of external debt. Moreover, Nepal should urge for its inclusion in the Heavily Indebted Poor Countries (HIPC) program of the World Bank and the IMF. This program, in addition to deeper, faster and broader debt relief, also maintains a strong link between debt relief and poverty reduction.

Table 1. Nepal's debt burden indicators and real GDP growth rate (%)

FY	EDT/ XGS	DT/GNP	EDT/ GDP	TDS/ XGS	INT/ XGS	INT/ GNP	DP growth rate
79/80	63%	8%	7.7%	0.8%	0	0	-2.3%
80/81	67%	9%	9.6%	2%	0.8%	0.10%	8.3%
81/82	84%	10%	10.3%	2%	1%	0.10%	3.8%
82/83	129%	14%	13.9%	3%	1%	0.15%	-3.0%
83/84	147%	16%	16.0%	3%	2%	0.20%	9.7%
84/85	168%	19%	19.8%	4%	2%	0.25%	6.2
85/86	157%	18%	18.5%	4%	2%	0.20%	4.6%
86/87	198%	23%	23.8%	6%	3%	0.40%	1.7%
87/88	234%	27%	27.0%	7%	3%	0.40%	7.7%
88/89	281%	32%	32.7%	7%	3%	0.35%	4.3%
89/90	320%	35%	35.6%	10%	4%	0.40%	4.6%
90/91	395%	49%	49.4	7%	3%	0.40%	6.4%
91/92	278%	47%	47.4%	7%	3%	0.50%	4.1%
92/93	271%	50%	51%	7%	3%	0.50%	3.9%
93/94	207%	50%	51.2%	5%	2%	0.50%	8.2%
94/95	205%	50%	51.6%	5%	2%	0.50%	3.5%
95/96	224%	51%	51.4%	6%	2%	0.50%	5.3%
96/97	174%	46%	47%	4%	2%	0.40%	5.3%

97/98	226%	53%	53.6%	6%	2%	0.45%	2.9%
98/99	207%	48%	49.5%	6%	2%	0.45%	4.5%
99/00	205%	49%	50.2%	6%	2%	0.40%	6.2%
00/01	207%	47%	49.1%	6%	2%	0.40%	4.8%

Source: Author's calculation.

Table 2. Trends of external debt stock, debt disbursement and debt Servicing

(Rs. in million)

FY	Outstanding external debt	% change	Amount of external debt disbursement	% change	Amount of debt servicing	% change
79/80	1807.3	-	534.9	-	23	-
80/81	2451.3	36%	693.3	30%	59.8	160%
81/82	3177.8	30%	729.9	5%	74	24%
82/83	4717.6	48%	985.8	35%	94.7	28%
83/84	6321.1	34%	1670.9	69.5%	128.2	35%
84/85	9203.2	46%	1753	5%	189.5	48%
85/86	10330	12%	2370.1	35%	285.7	51%
86/87	15171.9	47%	2361.9	-0.3%	487	70%
87/88	20826	37%	3094.3	31%	591	21%
88/89	29216.9	40%	4188.7	35%	701.3	19%
89/90	36800.9	26%	4628.3	10.5%	1123.6	60%
90/91	59505.3	62%	4360	-6%	1086.5	-3%
91/92	70924	19%	6269.4	44%	1664.9	53%
92/93	87420.8	23%	5961.7	-5%	2131.9	28%
93/94	101967	17%	9163.6	54%	2488.7	17%
94/95	113001	11%	7312.2	-20%	2984.7	20%
95/96	128044.4	13%	9463.9	29%	3304.3	11%
96/97	132087	3%	9043.6	-4%	3349.4	1%
97/98	161208	22%	11054.5	22%	4201.2	25%
98/99	169465.9	5%	11852.4	7%	4745.5	13%
99/00	190691.2	13%	11812.2	0.3%	5321.4	12%
00/01	201550.6	6%	12044	2%	6201.4	17%

Source: Economic Survey, HMG/MoF, Nepal

Table 3. External debt disbursement by sources (Rs. in million)

FY	Bilateral	Multilateral	Total	% of Bilateral in total	% of Multilateral in total
1979/80	149.6	385.3	534.9	28%	72%
1980/81	151	542.3	693.3	21%	79%
1981/82	109.9	620	729.9	15%	85%
1982/83	66.3	919.5	985.8	7%	93%
1983/84	217.7	1453.2	1670.9	13%	87%
1984/85	399.4	1353.6	1753	23%	77%
1985/86	498.1	1872	2370.1	21%	79%
1986/87	299.7	2062.2	2361.9	13%	87%
1987/88	462.5	2631.8	3094.3	15%	85%
1988/89	507.8	3680.9	4188.7	12%	88%
1989/90	1000.6	3627.7	4628.3	22%	78%
1990/91	1602.8	2757.2	4360	37%	63%
1991/92	2389.8	3879.6	6269.4	38%	62%
1992/93	1307.6	4654.1	5961.7	22%	78%
1993/94	582.9	8580.7	9163.6	37%	63%
1994/95	717.3	6595	7312.2	10%	90%
1995/96	460	9003.9	9463.9	5%	95%
1996/97	850.7	8192.9	9043.6	9%	91%
1997/98	1314.5	9740	11054.5	12%	88%
1998/99	584	11268.4	11852.4	5%	95%
1999/00	757.9	11054.3	11812.2	6%	94%
2000/01	586.7	11457.3	12044	5%	95%

Source: Economic Survey, HMG/MoF, Nepal

Table 4. Outstanding balance of external debt (by lender and by currency)
As of July 16, 2002 (last date of the FY 2001/02)(Amounts in million)

S.N.	Lender	Currency	Outstanding Debt	Exchange rate	Equivalent Nepalese Rupees	As percentages of total
1	ADB	USD	140.5897192	78.6	11613.38	5.4%
2	ADB	SDR	716.5309071	101.01	72377.5	34%
3	IDA	USD	188.7650914	78.6	14836.94	6.9%
4	IDA	SDR	752.530927	101.01	76013.9	35.4%
5	Australia	USD	4.6013693	78.6	361.7	0.2%
6	BEL	BEF	182.5	1.94	354.0	0.2%
7	EEC	FRF	5.142225	11.929	61.34	0.03%
8	EEC	BEF	10.119450	1.94	19.63	0.009%
9	EEC	DKK	1.237680	10.45	12.93	0.006%
10	EEC	DEM	4.864200	40.01	19.46	0.009%
11	EEC	GBP	1.217592	122.34	148.96	0.06%
12	EEC	IEP	0.011220	99.357	111.48	0.05%
13	EEC	ITL	596.725800	0.0404	241.07	0.1%
14	EEC	LUF	0.318450	1.94	0.618	0.0002%
15	EEC	NGL	1.344750	35.508	47.75	0.02%
16	FINISH	USD	5.53128286	78.6	434.76	0.2%
17	FRANCE	EUR	44.31189013	78.25	3467.4	1.6%
18	IFAD	SDR	38.26936226	101.01	38.65	0.02%
19	IFAD	USD	7.63176174	78.6	599.86	0.3%
20	JAPAN	JPY	36816.485891	0.676	24887.94	11.5%
21	KOREAN	KRW	11847.887710	0.066	782.79	0.36%
22	KUWAIT	KUD	2.25620965	261.939	591	0.3%
23	NDF	SDR	15.16821266	101.01	15.32	0.007%
24	OPEC	USD	16.01549879	78.6	1258.82	0.59%
25	RUSSIA	RUB	0.701855	2.5	1.75	0.0008%
26	SAUDI	SAR	61.96425943	20.8	1288.86	0.6%
27	USA	NPR	3.15360181	1.0	3.15	0.001%
28	USA	USD	0.01755211	78.6	1.38	0.0006%
		Grand Tot			*214783.95*	*100%*

Source: HMG/MoF, FCGO, Nepal

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