Academic Voices
A Multidisciplinary Journal
Volume 4, No. 1, 2014
ISSN 2091-1106

TREND AND IMPACT OF PUBLIC DEBT IN NEPALESE ECONOMY

Yadab Raj Sharma
Department of Economics, TU, Thakur Ram Multiple Campus, Birgunj, Nepal
Email: *yadabrajsharmaa@yahoo.com*

Abstract

The public debt or public borrowing in Nepal is considered to be an important source of income of the government. Public debt helps to achieve targeted economic growth and to narrow down the gap between expenditure and revenue. However, the country is falling into debt trap in the form of interest and principal payment. In this article an attempt has been made to find out the situation, trend and impact of public debt on Nepalese economy.

Key words

Public debt; deficit financing; resource gap; growth trend; foreign aid; debt trap

Introduction

With the development of the concept of welfare state, responsibilities of government have been increasing drastically. The social welfare functions are increasing gradually through international pressure too. Government should face budget deficit due to high expenditure and fewer revenues. Increasing taxes, printing money, domestic or external borrowings of using previous budget surplus are the sources of government revenue. But the expenditure on various economic activities and security is increasing rapidly as compare to national income. It is not possible to meet the increasing expenditure of the government only through revenue collection. Accumulated amount what the government has borrowed to finance past deficit is called public debt (Samuelson, 1964). The classical economists were generally against borrowing and they favored the minimum role of the government. But after the great depression of 1930s, the government intervention in the economy increased due to the increase in public expense which promotes the public debt. Thus, the intervention of the government in the economy becomes an important tool. J.M. Keynes is in favor of government regulated economy that push government deficit. To meet the deficit, government needs to undertake the public debt which need not necessarily unproductive, inflationary and burdensome.

The structure of government finance in Nepal indicates the important role of public debt, both internal and external, in meeting resource gap. Public debt has been used in Nepal as a regular mechanism of deficit financing since last five decades, Nepalese economy depends heavily on short term domestic debt and on concessional foreign loans. More than 65 percent of domestic debt has maturities of one year or shorter. Nepalese economy receives concessional foreign loans particularly from multilateral agencies like the World Bank, ADB etc. These loans are of long maturities of more than 30 years and account for more than 57 percent of the financing of the budget deficit in Nepal. The high amount of debt and slow growth rate of economy have raised question that whether foreign borrowing on current terms is beneficial for developing economies or not. The public borrowing for the productive purposes are considered as self liquidating such debt liability will be repaid through the revenue generated on completion of such projects, while the unproductive debts are those which do not add to the productive capacity of the economy. As such, the unproductive debts are not considered as necessarily self liquidating. The principal and interest of such loan will have to be paid from other sources of revenue, generally tax revenue, and therefore such debts are taken as burden to the national economy. The trend of borrowing external debt is very in Nepal as compared to internal debt. Thus, particularly after 1970 the budgetary deficit has been increasing. So Nepal is facing a serious problem of financial resource gap on one hand and increasing population growth and inflation on another. If the trend of foreign debt goes on increasing like this, one day Nepal will be in the worse situation of debt-trap. Heavily dependent into debt will be the challenge for the Nepalese economy. Gap between expenditure and revenue collection needs to be minimized for the fiscal balance. In this scenario, it is necessary to study about the trend and impact of public debt in economic development of Nepal.

Public borrowing is considered very useful to remedy a depression. Many economists like Keynes have advocated increased public expenditure financed through borrowing and not through taxation, for while taxation will reduce incomes and demand still further, borrowing will have no such effect/ Besides, loans enable the government to make use of idle and unutilized funds of the public. Thus, there is a strong justification in favor of public borrowing to cure unemployment. (Sundharam & Andley, 1988).

Guru Gharana (1996) has analyzed the burden of public debt as debt servicing cost in Nepal and concluded that " Although foreign loan is relatively much softer terms for Nepal compares to India and china, the very low rate of return and increasing share of loan in foreign aid imply that aid slowly pushing Nepal towards debt crisis in the coming years".

Pyakuryal (2002) has suggested about effective use, reduction in aid dependency and quality enhancement, if no inability to enhance aid utilization can drag the country into the debt trap.

This study emphasizes about the government borrowing in Nepal, its trend and overall impact of public debt in Nepalese economy.

Method

Secondary data have been collected from various sources like Economic surveys of different years, Ministry of finance (MOF), World Bank (WB), Quarterly Economic Bulletin published by Nepal Rastra Bank (NRB), Human Development Report (HDR), World Development Report (WDR) and publications of National Planning Commission (NPC).

Results and discussion

The discussion of results have been presented under trend and structure of public debt; debt trap in Nepal and impact of total debt on GDP.

Trend and structure of public debt

Nepal was a debt free country until 1951 A.D.

With the enforcement of public debt Act 1960, domestic public in the forms of treasury bills, development bonds, and national saving certificates were issued in 1962, 1964 and 1984 respectively. From Second Three-year plan (1962/63-1964/65), Nepal started to obtain the external debt from 1963/64. The amount of external borrowing of Nepal has been increasing every year. The main sources of external borrowing of Nepal are bilateral sources, mainly America, Japan, Norway, China, India and etc. and multilateral sources like IMF, WB, ADB etc.

World Development Indicators (2010) show the international comparison of public debt situation. The revenue of Nepal as a percent of GDP was 10.9 million with the expense 14.7 million and there were 1.6 million deficits. But in India the deficit ratio was greater than Nepal which was 2.8 million. Likewise in Pakistan the deficit was 4.2 million and 7.2 million in Sri Lanka. So, Nepal had fewer deficits than India, Pakistan and Sri Lanka.

Resource gap in Nepalese economy has always been a common phenomenon since the starting of the systematic budgeting system in Nepal. The annual growth rate of total expenditure and the collected revenue are not increasing in the same pace. Thus, revenue expenditure gap is growing in every fiscal year. According to Economic Survey of Ministry of Finance, the amount of total expenditure was Rs. 9797.1 Million in F/Y 1988/89 has gone up to Rs. 133604.6 million in 2009/10; whereas total revenue has increased from 4644.5 million in F/Y 1988 /89 to Rs. 87712.1 million in F/Y 2009 /10. This shows the public expenditure has dominated the government revenue. This indicates that the resource gap is serious problem in Nepal. In the F/Y 2009/10 the growth rate of total expenditure has been 10.8 percent per annum whereas annum growth rate of total revenue has been 12.6 percent. It shows that the growth rate of revenue is greater than expenditure but annual growth rate of expenditure has been increased rapidly than annual growth rate of revenue. This indicates the horrible situation of increasing trend of resource gap in coming future.

The government has to borrow large amount of loans to meet the fiscal deficit. According to Economic Survey of Ministry of Finance, the government borrowing and annual growth rate from the period 1988/89 to 2009/10 shows that the contribution of both external and internal debt to the total debt has been in increasing trend. The average annual growth rate as percentage share of internal debt and external debt to total debt are 34.4 percent and 65.2 percent respectively. The total debt has been increased from R. 3909.5 million in F/Y 1988/89 to Rs. 27945.8 million in F/Y 2009/10.

The government is receiving internal debt from various sources by means of issuing treasury bonds, treasury bills, development bonds, national saving certificates and special bonds. The contribution of treasury bills is larger because its average annual growth rate is 35.4 percent which is larger than others. The share of treasury bills, development bonds, national saving certificates and special bonds to total net outstanding is Rs. 3080.0 millions, Rs. 2290.0 million, Rs. 1500.0 million and Rs. 320.0 million respectively in F/Y 1988/89. In the F/Y 2009/10, it has been increased to Rs. 74445.3 million Rs, 19177.1 million, Rs. 1516.9 million and Rs. 7225.7 million respectively. The percentage share of treasury bills, development bonds, national saving certificates and special bonds, national saving certificates special bonds are 72.7 percent, 18.7 percent, 1.5 percent and 8.1 percent respectively. It shows the share of treasury bills has dominated in the mobilization of internal debt.

Nepal has borrowed the external loan through bilateral and multilateral sources. According to Economic Survey, 2010 of Ministry of Finance, the bilateral loan is in decreasing trend while multilateral loan is in increasing trend. External debt is Rs.2370.9 million in

F/Y 1988/89 which increased to Rs.10053.5 million in F/Y 2009/10. In F/Y 1988/89, Rs.498.9 million from bilateral source and Rs. 1872.0 million from multilateral sources were collected where the share were 21.0 percent and 79.0 percent respectively. In F/Y 2009/10, the bilateral loan has been increasing to Rs.9004.6 million and multilateral loan has been decreasing to Rs, 1048.9 million where the share were 89.6 percent and 10.4 percent respectively. The average annual growth rate as percentage share of bilateral and multilateral sources were 15.7 percent and 84.3 percent respectively. In F/Y 2009/10, net outstanding internal and external debt has been increased to Rs.93031.9 million and Rs.216200.7 million respectively. In the same year the deficit has been also increased to Rs.30091.7 million. The average annual growth rate as percentage of total debt to fiscal deficit was 9.0 percent.

Debt trap in Nepal

The condition of debt trap is a great challenge for developing countries like Nepal. Nepal is facing over increasing problem of resource gap. It has such situation because productivity is very low; less contribution by annually ever growing labour force; low quality of human resource available; a traditional nature in tax administration; the inflow of easy money through various channels and extreme capital deficiency.

Foreign assistance is seen so essential that each sector of the economy is completely dependent on it in Nepal. The trends of average annual growth rate of internal debt are 34.4 percent of total debt, but external debt is 65.2 percent of total debt.

The average annual growth rate of total outstanding public debt is nearly 58.1percent of GDP whereas the average annual growth rate of total debt servicing to GDP ratio is nearly 2.7percent. This shows that debt has been mounted in very high amount in each year. The average annual growth rate of debt servicing to regular expenditure is remained at 30.4 percent and only external debt servicing is 13.8 percent.

Impact of total debt on GDP

The relationship between GDP (dependent variable) and total debt (Independent variable) using regression equation is represented by the regressive equation of Y on X as: Y= -88061.3 + 29.725 X.

The equation shows that there is positive relationship between GDP (Y) and total debt (X). The intercept term (a_0) is -88061.3 which indicates that GDP (Y) would be -88061.3 if the independent variable X is zero. The result shows that MPC of total debt is 29.7, which explains that one unit increase in TD (X) causes GDP (Y) would increase by 29.7 units. The co-efficient of determination R^2 is 0.85 which means that 85 percent variation of GDP (Y) is determined by the explanatory variable, i.e., Total Debt. Adjusted value of R^2 is 0.84 which means 84 percent of total debt is influenced by GDP. Similarly, the calculated F-value was found to be 113.93 which is greater than the tabulated value 4.35 at .05 level of significance. It implies that the model is statistically significant. To test the significance of regression co-efficient, the t-test was used which yielded the calculated t value (-88061.3) which is greater than the tabulated value (2.080) at the .05 level of significance. Thus, the regression co-efficient is statistically significant.

Conclusion

The growing trend of borrowing creates a great problem for debt management and has become a challenging issue for the country. The borrowing money is unlikely financed on the non-monetized and unproductive sectors of the economy which in turn has proved to be a burden for the country. The degree of indebtedness of the external debt has increased due to the poor mobilization of internal resources, widening investment saving gap, export import gap, revenue expenditure gap and large amount of fiscal deficit. So, there has been excessive flow of foreign loans to bridge up these gaps. Consequently, the burden of debt and debt servicing obligations are increasing every year but debt servicing capacity is not increasing in the same pace. The government borrowing has been financed mostly on unproductive sectors and that is why, the public debt and its interest is mounting rapidly. Thus, the debt should be properly utilized on productive sectors otherwise debt trap will drag us to the path of difficult situation.

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