Assessment of Nepal’s public debt

Kshitiz Dahal
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Why public debt matters

Public debt can contribute to economic growth and development.

High levels/unsustainable levels of fiscal deficits and public debt can have pernicious impact on the economy, welfare, and force the state to alter its priorities.
Nepal’s outstanding public debt

Total outstanding public debt: 2013.3 billion NRs.
Total outstanding internal debt: 987.5 billion NRs.
Total outstanding external debt: 1025.8 billion NRs.
Nepal’s outstanding public debt

Nepal’s total outstanding debt

Nepal’s outstanding public debt (internal and external)

NRs. billion


NRs. billion


Internal debt External debt

NRs. billion
Nepal’s debt to GDP: historical trends

Evolution of Nepal's debt to GDP

Evolution of domestic and foreign borrowings

Domestic | Foreign

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Nepal’s public debt: recent trends
Nepal’s public debt structure

Composition of internal debt

- Treasury Bills: 34.72%
- Development Bonds: 64.29%
- Citizen Savings Bonds: 0.96%
- Foreign Employment Saving Bonds: 0.02%

<table>
<thead>
<tr>
<th>% (of GDP)</th>
<th>Internal debt</th>
<th>External debt</th>
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<tr>
<td>21.1</td>
<td></td>
<td>21.1</td>
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<tr>
<td>34.7%</td>
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<td>64.3%</td>
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Outstanding debt of non-financial state-owned enterprises (SOE): 6.5% (already accounted for)
Loan guarantees: 0.6% (already accounted for)
Contingent liabilities arising from PPP: not reported

Source: World Bank-IMF joint assessment
Indicators of debt (un)sustainability

**Gross debt positions (% of GDP)**

Data: PDMO

**Interest payment trends**

Interest payment trends are shown for both internal and external debts, with data from 2014/15 to 2021/22. The graph displays the trend of interest payments over the years, with a particular focus on the years 2018/19 and 2019/20.

**Nepal’s debt servicing payments**

The graph shows the total debt servicing (NRs. Billion) and the change in debt servicing payments (%) over the period from 2014/15 to 2021/22. Data: PDMO

**Debt service to exports**

Data: PDMO

**Change in debt servicing payments (%)**

Data: PDMO

**External debt to exports**

Data: PDMO

**Data:** PDMO
Is Nepal veering towards unsustainable debt accumulation?
(Literature review)

• 3% of gross domestic product (GDP) for the government deficit and 60% of GDP for government debt (the Maastricht criteria)

• Reinhart and Rogoff (2010): 90 percent of GDP

• Varying level of optimal debt stock in the literature: e.g. Égert (2013) finds a negative association may kick in at debt levels as low as 20 percent of GDP

• Country context is important: growth prospects, the level of exports, government effectiveness, and vulnerability to shocks
Is Nepal veering towards unsustainable debt accumulation?

- Nepal’s current debt to GDP level not too high

- IMF-World Bank find a low risk of debt distress (however debts may be unsustainable in the medium-to-long term if followed by export shocks, economic growth shocks, and risks related to contingent liabilities.)

- Historical evidence suggests that defaults can occur at a much lower debt to GNP ratio (even 40%).

- A crucial question: how transformative has Nepal’s rapidly rising accumulation of public debt been? (the returns on persistent fiscal deficits and rising public debt?)
Drivers of rising public debt
1. Over ambitious growth and development plans (without the necessary state capacity)

• Target growth rate: 10.1 percent per annum over the five-year period of the plan (FY 2019/20–2023/24); ambitious targets in other socio-economic areas as well

• A significant role of public investment envisioned

• Inflated budget

• Limited state capacity—weak project selection and execution, poor state of capital expenditure, ineffective implementation of plans and policies, slow pace of reforms
2. Federalism as a driver of expenditure/deficits

Total federal government expenditure

Federal government expenditure (% of GDP)

Data: MoF
Structural change in fiscal deficit after federalism

MoF
Issues in the implementation of federalism

Direct federal expenditure (excluding intergovernmental transfers)

Trends in different categories of federal expenditure

Data: MoF
3. Rise in social security expenditure

Data: Budget speech
4. Changing landscape of the official development assistance

Data: MOF
Potential loss of concessionality

World Bank’s operational cutoff for IDA loans and Nepal’s GNI per capita

<table>
<thead>
<tr>
<th>Bank's fiscal year</th>
<th>FY19</th>
<th>FY20</th>
<th>FY21</th>
<th>FY22</th>
<th>FY23</th>
</tr>
</thead>
<tbody>
<tr>
<td>Data for calendar year</td>
<td>2017</td>
<td>2018</td>
<td>2019</td>
<td>2020</td>
<td>2021</td>
</tr>
<tr>
<td>Operational cutoff (GNI per capita, US$)</td>
<td>1,145</td>
<td>1,175</td>
<td>1,185</td>
<td>1,205</td>
<td>1,255</td>
</tr>
<tr>
<td>GNI per capita for Nepal (US$)</td>
<td>970</td>
<td>1,110</td>
<td>1,220</td>
<td>1,180</td>
<td>1,220</td>
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</tbody>
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Terms and conditions of IDA loans

<table>
<thead>
<tr>
<th>Terms and Conditions</th>
<th>Regular Terms</th>
<th>Blend Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest charge (SDR)</td>
<td>No interest charge</td>
<td>1.25% (in addition to the service and commitment charges)</td>
</tr>
<tr>
<td>Amortization period</td>
<td>38 years</td>
<td>30 years</td>
</tr>
<tr>
<td>Grace Period</td>
<td>6 years</td>
<td>5 years</td>
</tr>
<tr>
<td>Service charge (SDR)</td>
<td>0.75%</td>
<td>0.75%</td>
</tr>
<tr>
<td>Commitment Charges</td>
<td>0%-0.50% per annum</td>
<td>0%-0.50% per annum</td>
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</table>

Source: World Bank/IDA
### ADB’s decision matrix of classification

<table>
<thead>
<tr>
<th>Creditworthiness</th>
<th>Per Capita GNI Cutoff</th>
<th>Group A (Concessional assistance-only)</th>
<th>Group B (OCR blend)</th>
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</thead>
<tbody>
<tr>
<td>Below Per Capita GNI Cutoff</td>
<td>LDC</td>
<td>1% during the grace period; 1.5% during the amortization period</td>
<td>2% interest per year</td>
</tr>
<tr>
<td>Above Per Capita GNI Cutoff</td>
<td>Other</td>
<td>1% during the grace period; 1.5% during the amortization period</td>
<td></td>
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<tr>
<td>Lack of</td>
<td></td>
<td>Policy-based loans</td>
<td></td>
</tr>
<tr>
<td>Concessional assistance-only (Group A)</td>
<td>OCR Blend (Group B)</td>
<td>25 years</td>
<td></td>
</tr>
<tr>
<td>Concessional assistance-only (Group A)</td>
<td>OCR Blend (Group B)</td>
<td>24 years</td>
<td></td>
</tr>
<tr>
<td>OCR Blend (Group B)</td>
<td>OCR Blend (Group B)</td>
<td>32 years</td>
<td></td>
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<tr>
<td>Limited</td>
<td></td>
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<tr>
<td>OCR Blend (Group B)</td>
<td>OCR Blend (Group B)</td>
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<td>OCR Blend (Group B)</td>
<td>OCR Blend (Group B)</td>
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<tr>
<td>Adequate</td>
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<td>OCR Blend (Group B)</td>
<td>OCR Blend (Group B)</td>
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<tr>
<td>Regular OCR-only (Group C)</td>
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### ADB’s terms and conditions of concessional loans

<table>
<thead>
<tr>
<th>Terms and Conditions</th>
<th>Group A (Concessional assistance-only)</th>
<th>Group B (OCR blend)</th>
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<tr>
<td><strong>Project Loans</strong></td>
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<tr>
<td><strong>Interest</strong></td>
<td>1% during the grace period; 1.5% during the amortization period</td>
<td>2% interest per year</td>
</tr>
<tr>
<td><strong>Maturity</strong></td>
<td>32 years</td>
<td>24 years</td>
</tr>
<tr>
<td><strong>Grace Period</strong></td>
<td>8 years</td>
<td>8 years</td>
</tr>
<tr>
<td><strong>Other Features</strong></td>
<td>Equal amortization; No commitment fee</td>
<td>Equal amortization; No commitment fee</td>
</tr>
</tbody>
</table>

Source: ADB publications
5. Sub-optimal administration of government expenditure: institutional issues

- Non-transparent, non-scientific, and wasteful budgetary practices
- Weak capacity to mobilize government expenditure
- Lack of appropriate institutional mechanisms
6. Narrow revenue band

• Superior revenue collection (revenue as a % of GDP) hides its unsustainable base

• Heavily import-based: import-based tax accounted for 48.1 percent of total tax revenue in FY 2020/21 and 54.3 percent of total tax revenue in FY 2021/22 (until mid-March) [revenue vulnerability laid bare last fiscal year]

• Narrow internal tax revenue--income tax accounts for only about a quarter of total tax revenue
Key takeaways

• Nepal’s debt level, while increasingly precipitously, is not at a level that causes serious debt distress.

• However, the precipitous rise, increasing financing obligations, and questionable rate of return, is a cause for concern.

• Growth shocks, export shocks, remittance shocks, could very well mean a risk of debt distress.

• Structural drivers of increasing public debt have to be addressed/managed—overambitious development goals (bloated government expenditure), sub-par implementation of federalism, changing ODA landscape, increasing social security expenditure (ad-hoc and electorally motivated), institutional paucity, etc.—partly addressed by a new legislation (but is it enough?)
Thank You!

sawtee@sawtee.org
Kshitiz.dahal@sawtee.org
+977 1 4544438