Assessment of Nepal’s public debt

Kshitiz Dahal

South Asia Watch on Trade, Economics and Environment (SAWTEE)

1 September 2023

Why public debt matters

Public debt can contribute to economic growth and development.

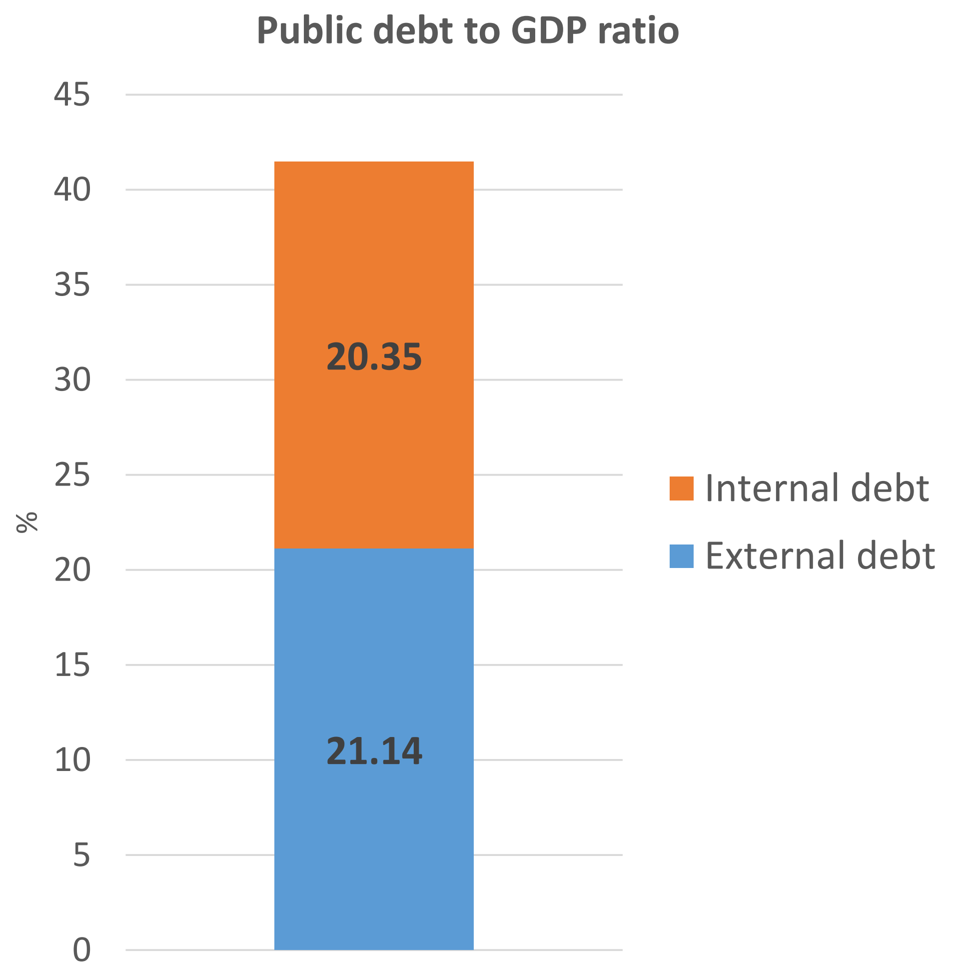
High levels/unsustainable levels of fiscal deficits and public debt can have pernicious impact on the economy, welfare, and force the state to alter its priorities.

Nepal’s outstanding public debt

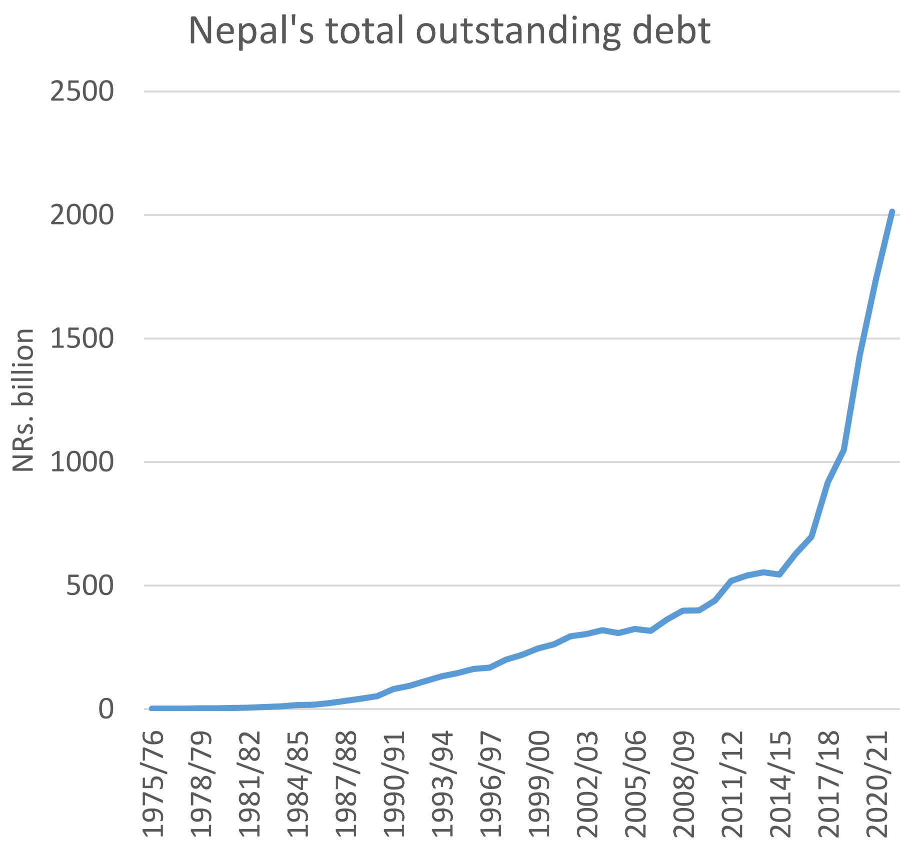
Total outstanding public debt: 2013.3 billion NRs.

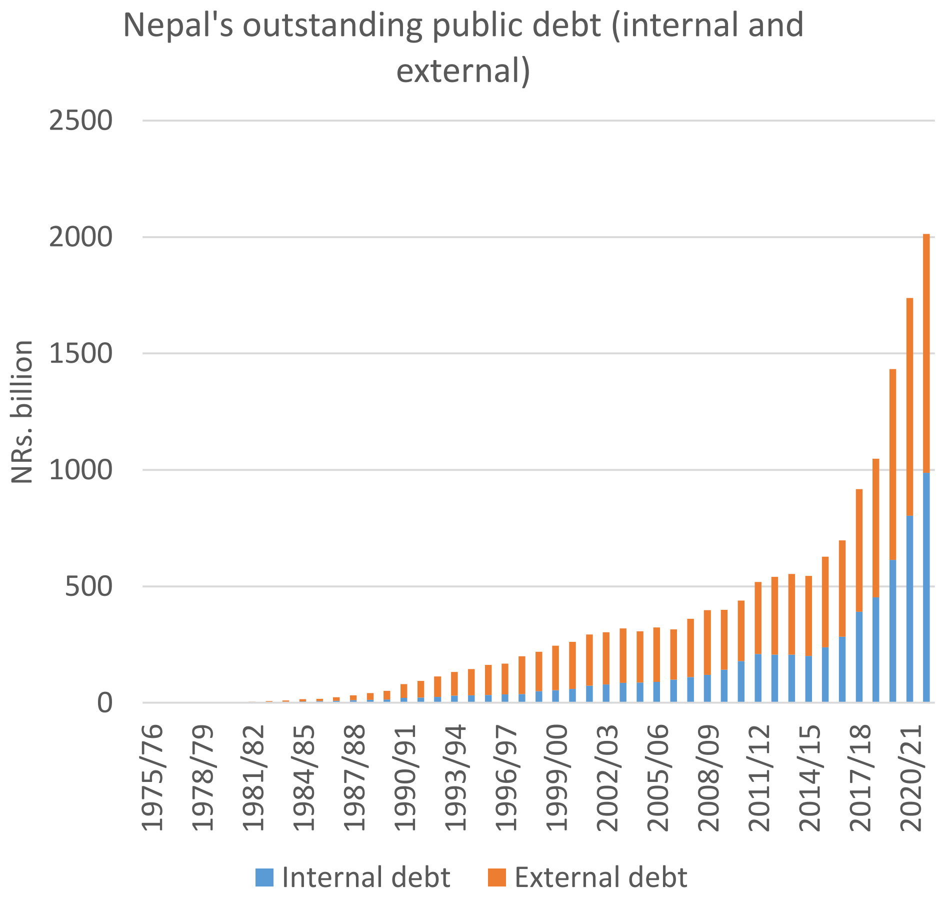
Total outstanding internal debt: 987.5 billion NRs.

Total outstanding external debt: 1025.8 billion NRs.

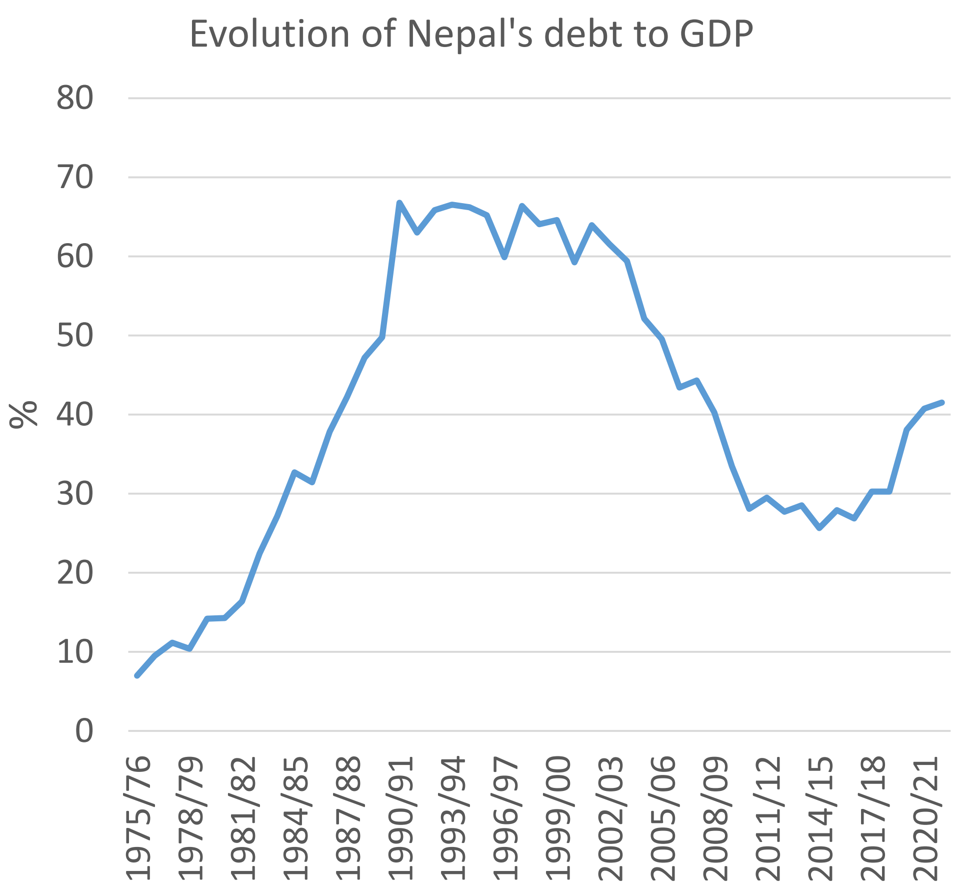


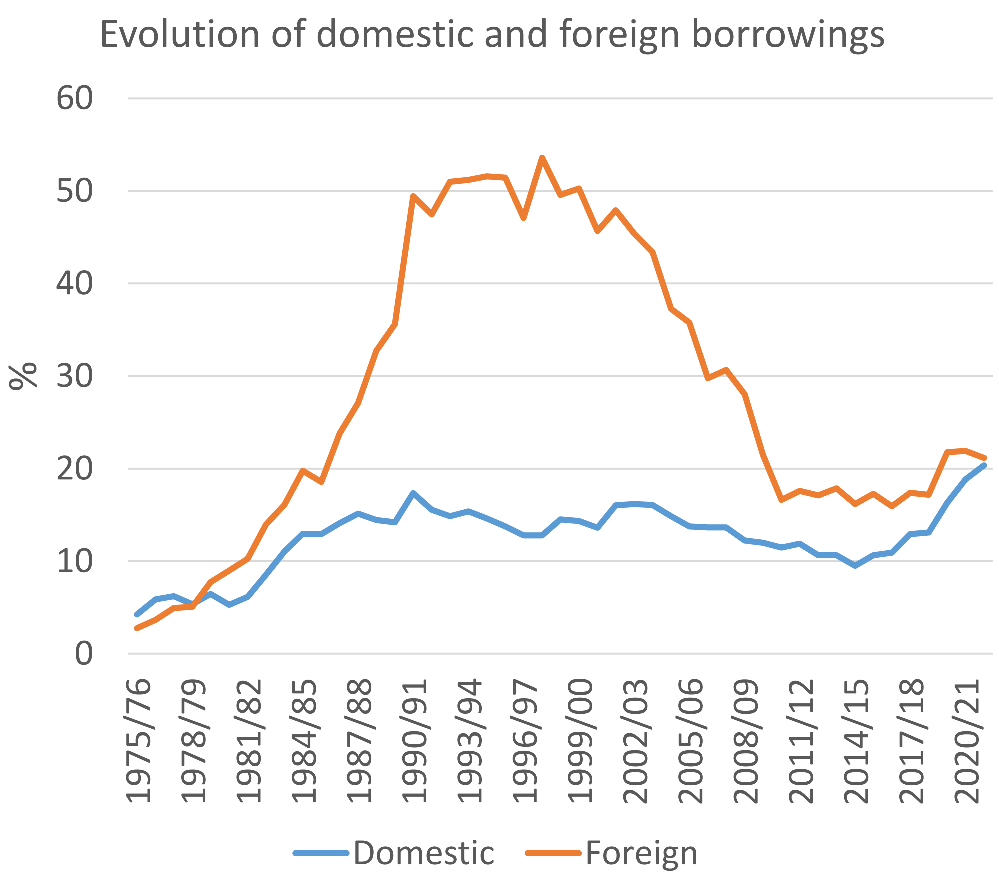
Nepal’s outstanding public debt



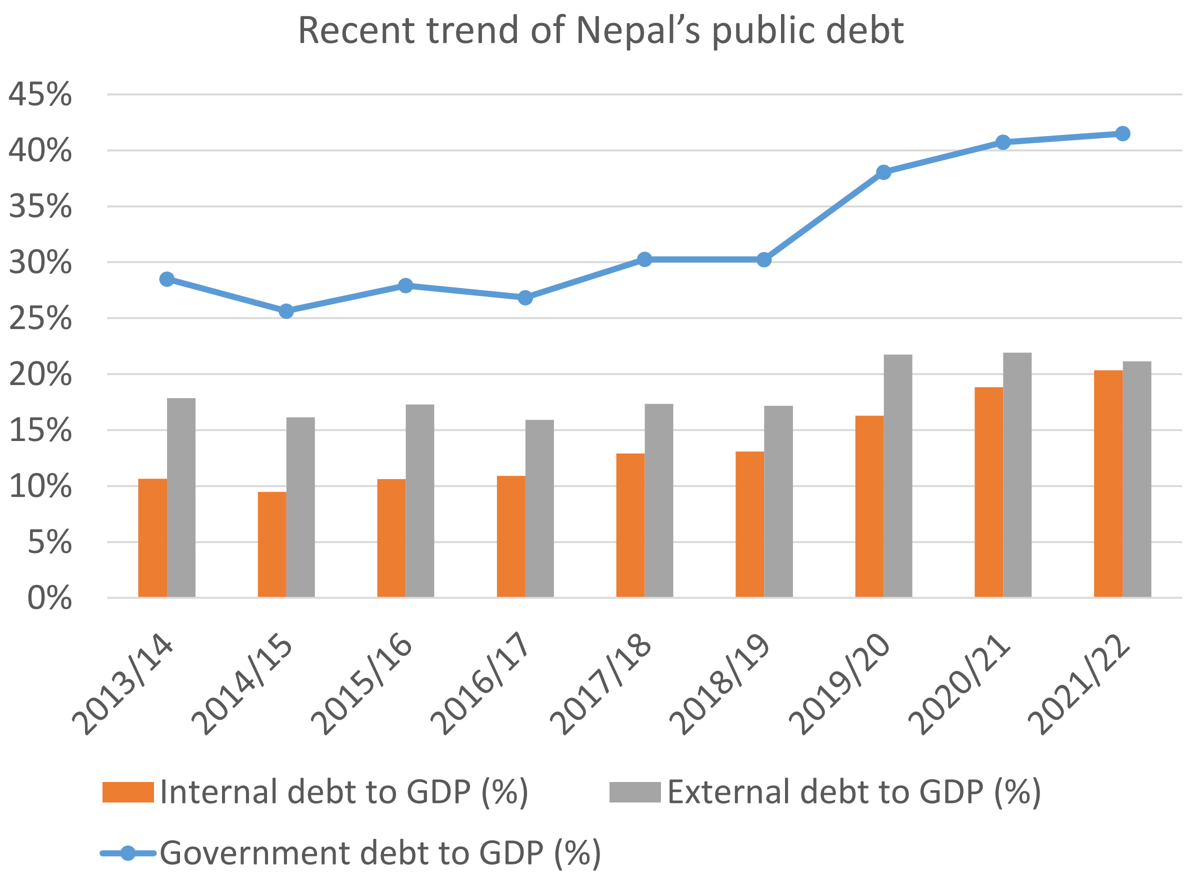


Nepal’s debt to GDP: historical trends

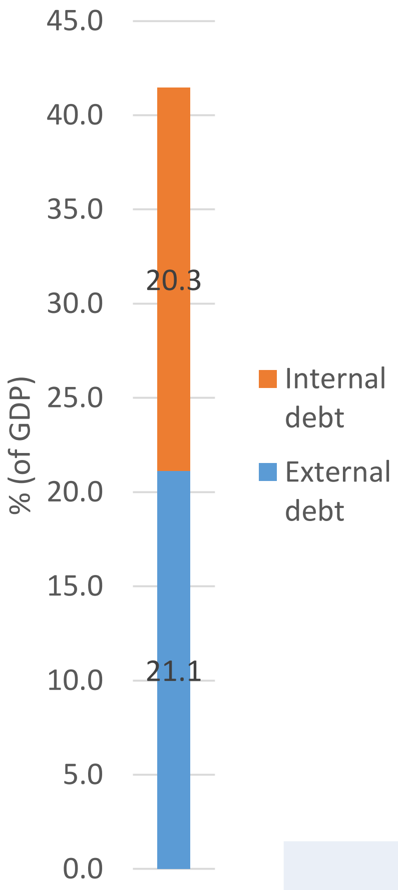


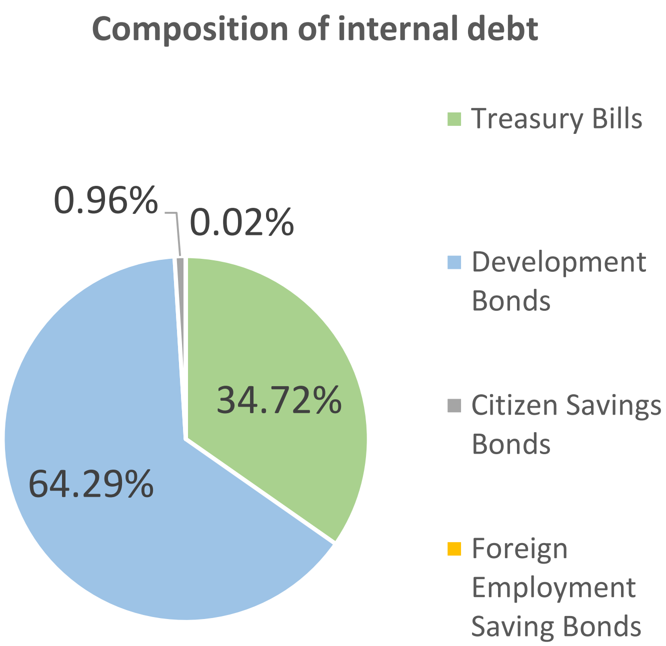


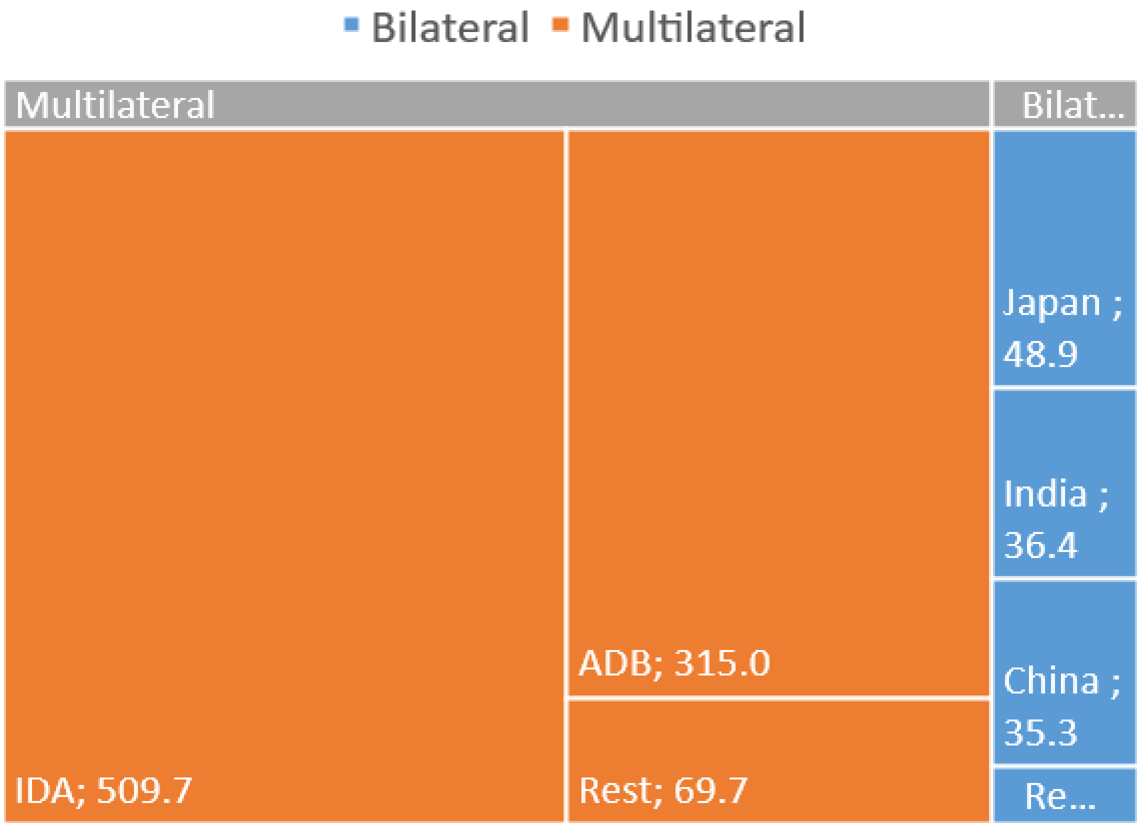
Nepal’s public debt: recent trends



Nepal's public debt structure



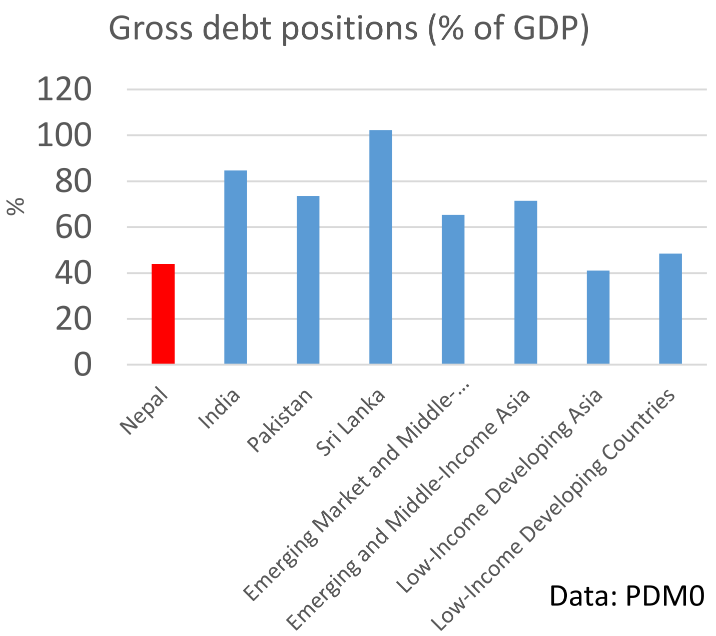




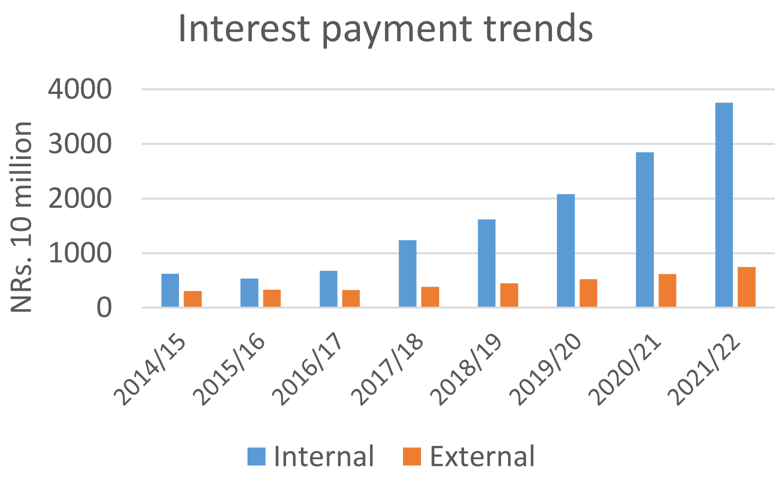
	% of GDP
Outstanding debt of non-financial state-owned enterprises (SOE)	6.5% (already accounted for)
Loan guarantees	0.6% (already accounted for)
Contingent liabilities arising from PPP	not reported

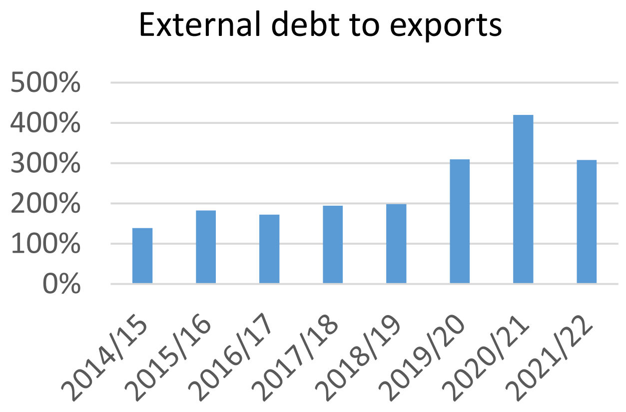
Source: World Bank-IMF joint assessment

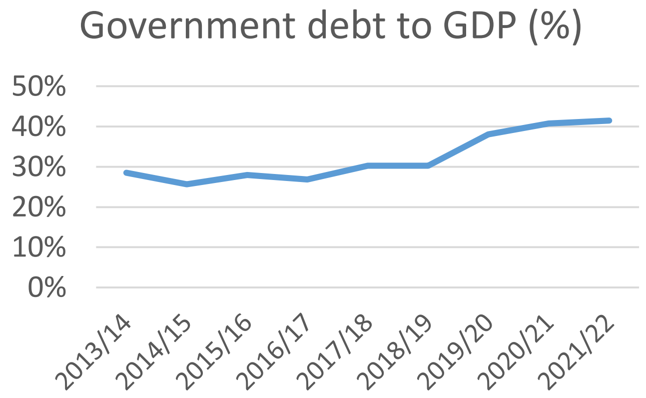
Indicators of debt (un)sustainability



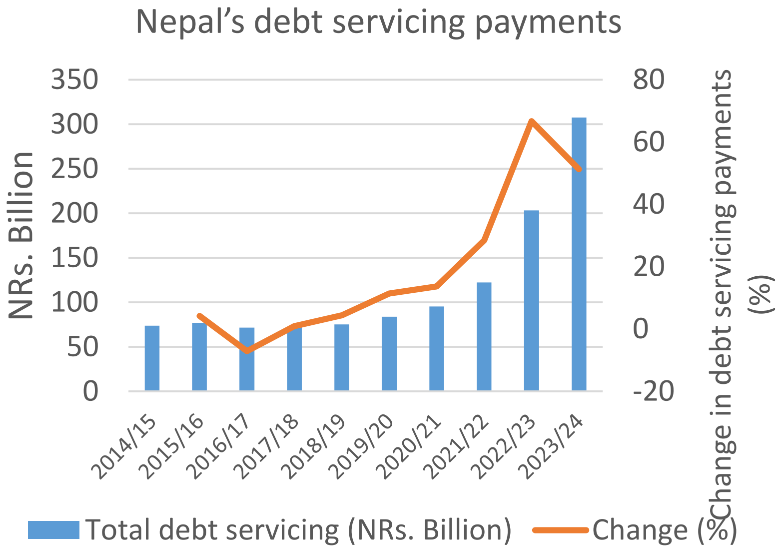
Data: PDM0



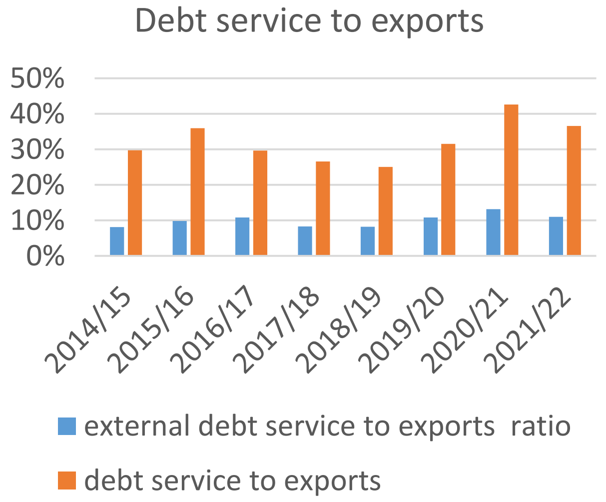




Data: IMF



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

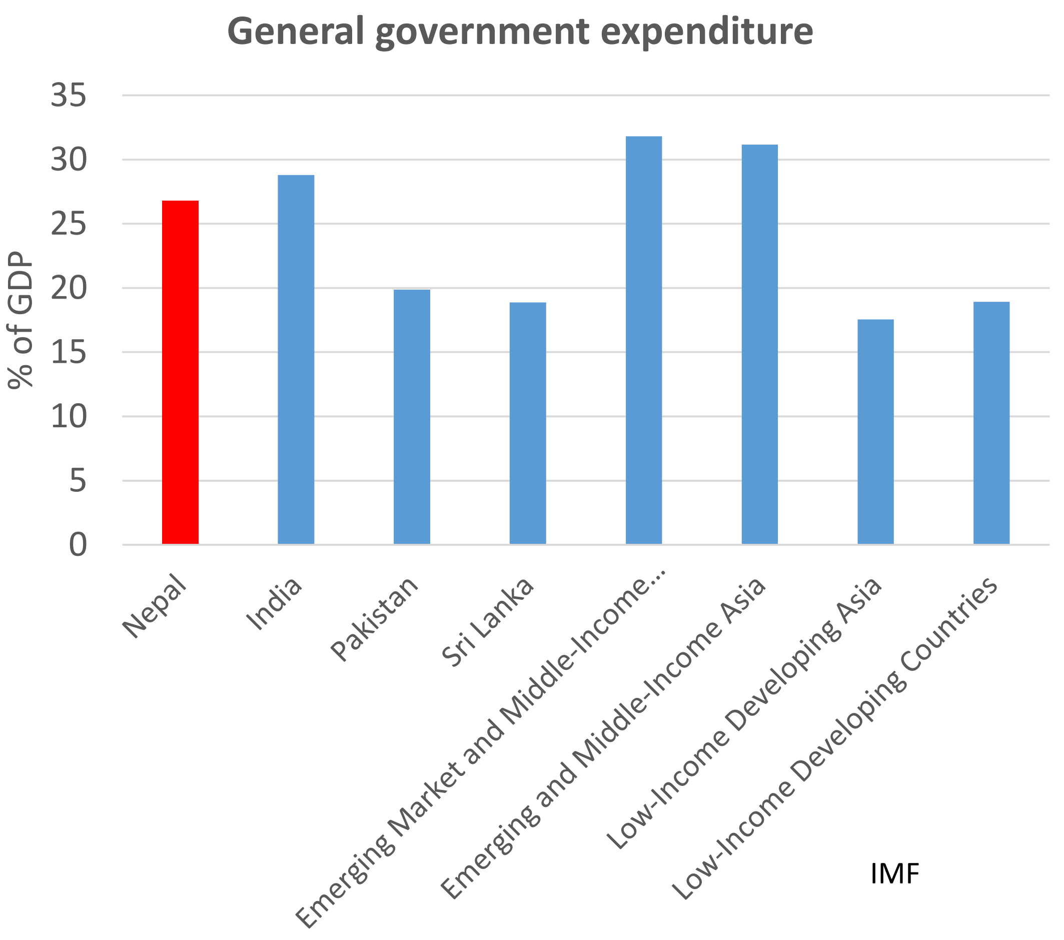
1. Over ambitious growth and development plans (without the necessary state capacity)

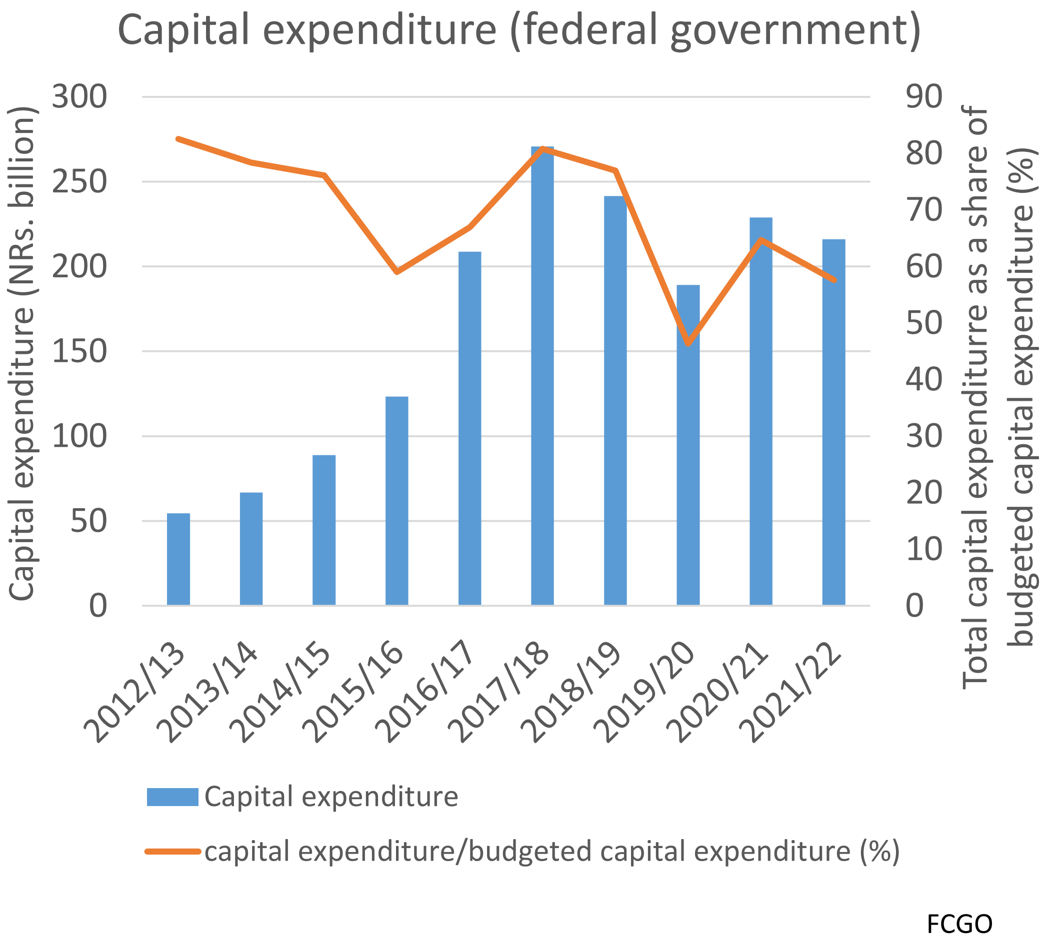
- Target growth rate: 10.1 percent per annum over the five-year period of the plan (FY 2019/20–2023/24); ambitious targets in other socio-economic areas as well

- A significant role of public investment envisioned

- Inflated budget

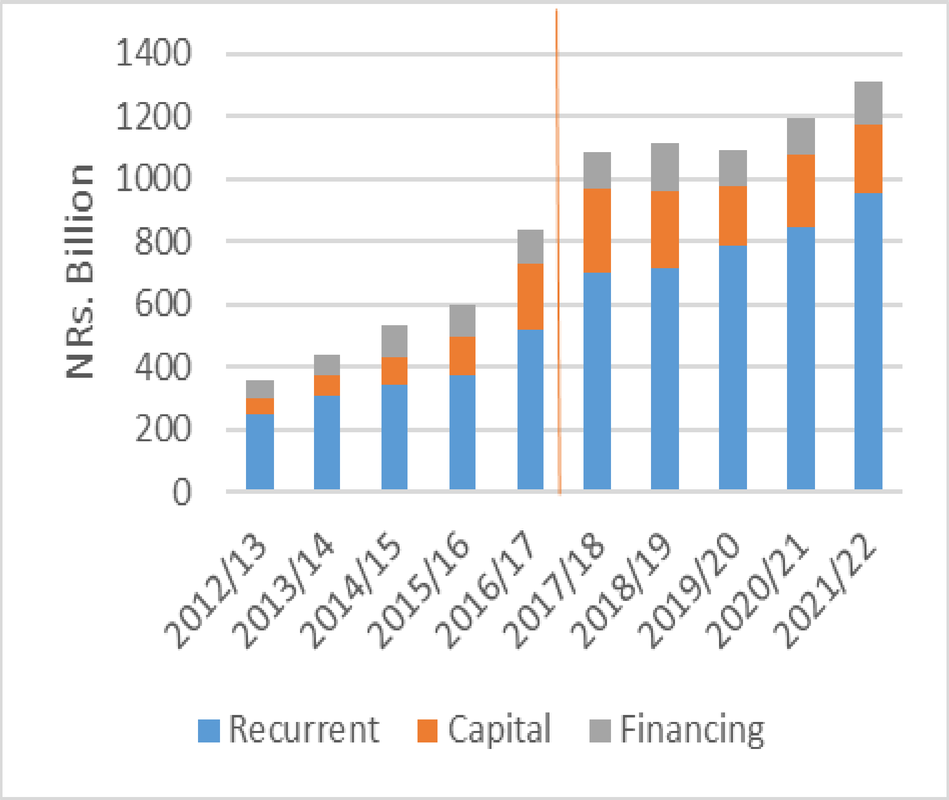
- Limited state capacity—weak project selection and execution, poor state of capital expenditure, ineffective implementation of plans and policies, slow pace of reforms


General government expenditure
35
30
25
20
15
10
5
0
% of GDP
Nepal
India
Pakistan
Sri Lanka
Emerging Market and Middle-Income...
Emerging and Middle-Income Asia
Low-Income Developing Asia
Low-Income Developing Countries
IMF

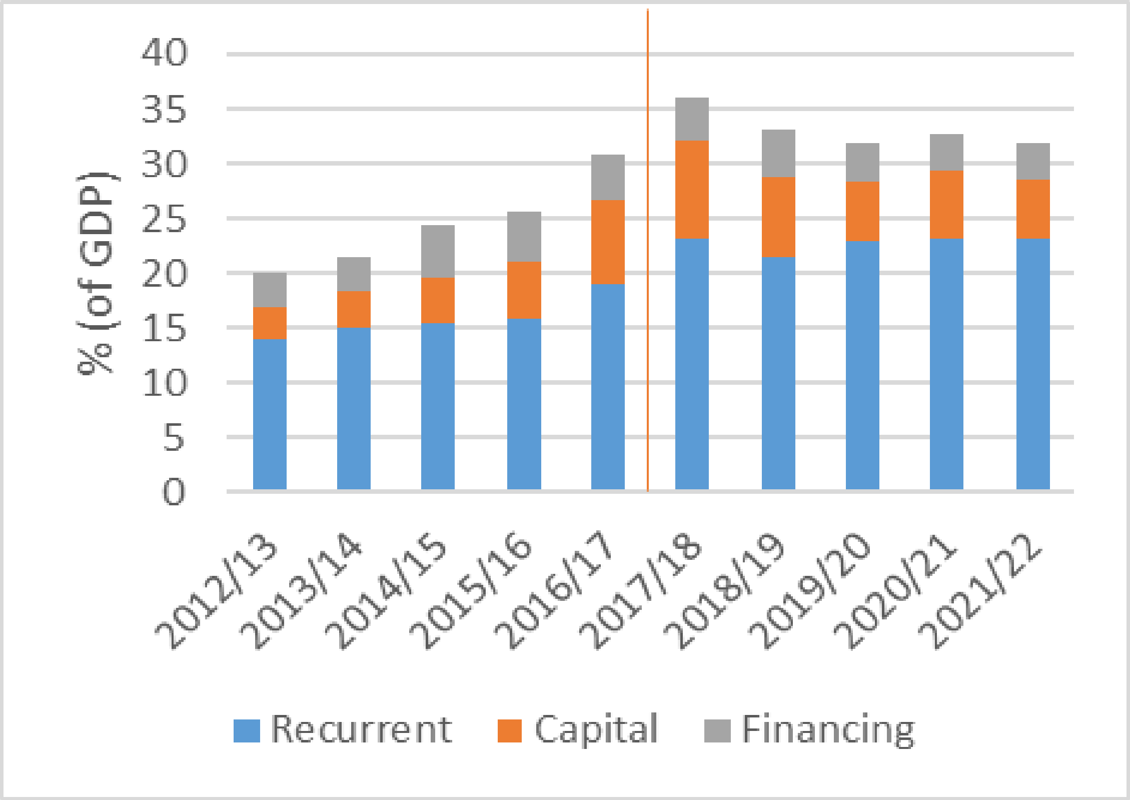

Capital expenditure (federal government)
300
250
200
150
100
50
0
Capital expenditure (NRs. billion)
90
80
70
60
50
40
30
20
10
0
Total capital expenditurre as a share of budgeted capital expenditure (%)
2012/13
2013/14
2014/15
2015/16
2016/17
2017/18
2018/19
2019/20
2020/21
2021/22
Capital expenditure
capital expenditure/budgeted capital expenditure (%)
FCGO

2. Federalism as a driver of expenditure/deficits

Total federal government expenditure

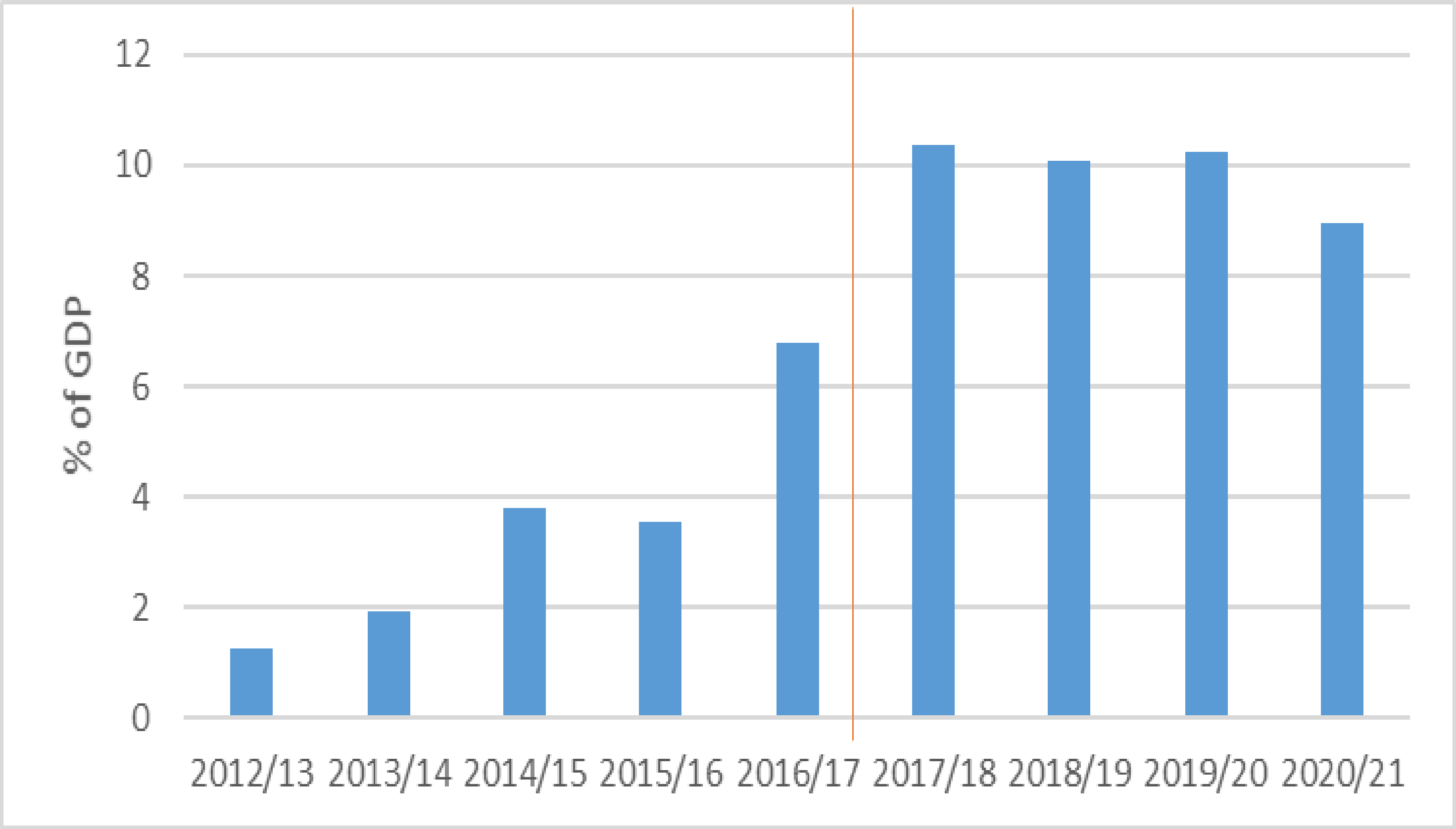


Federal government expenditure (% of GDP)



Data: MoF

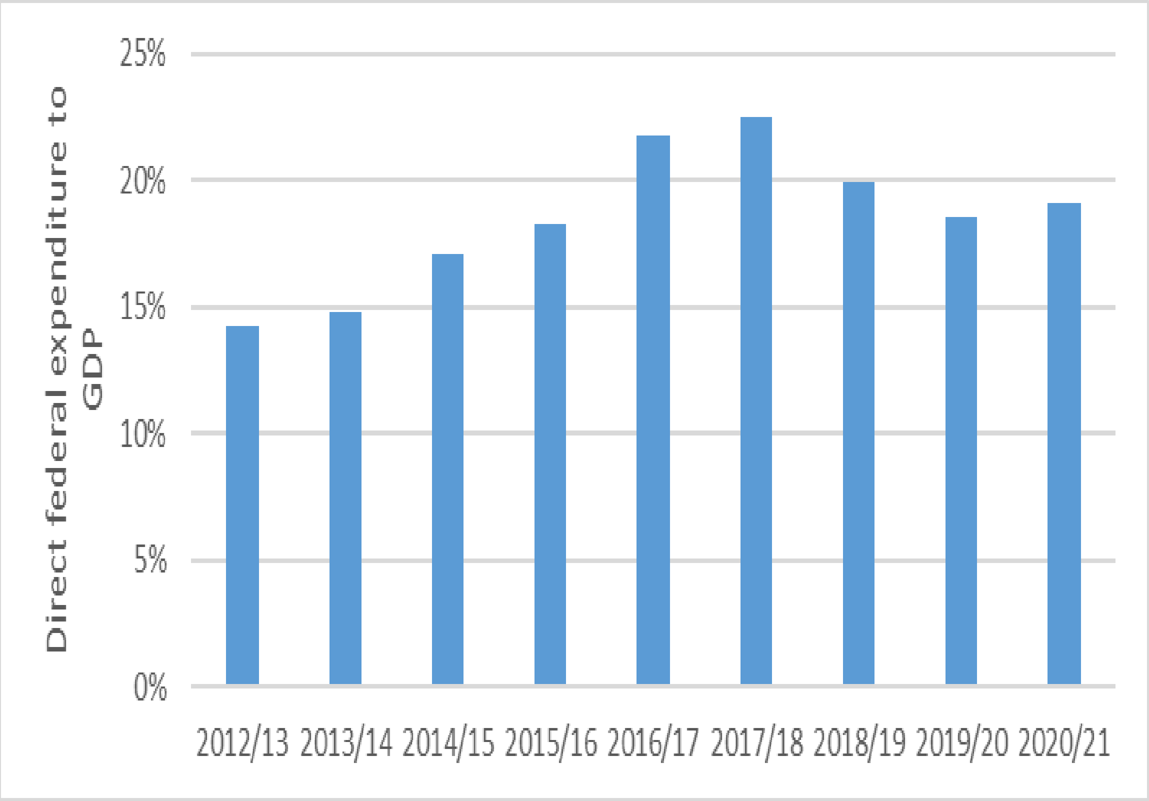
Structural change in fiscal deficit after federalism



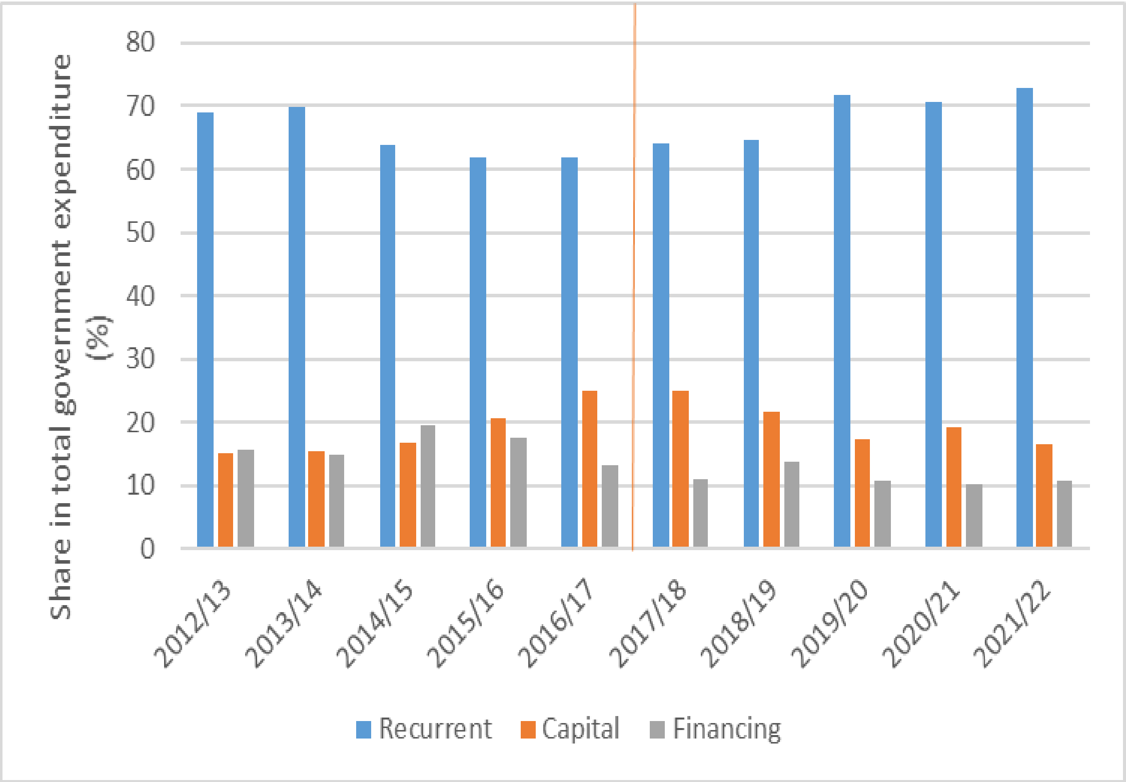
MoF

Issues in the implementation of federalism

Direct federal expenditure (excluding intergovernmental transfers)



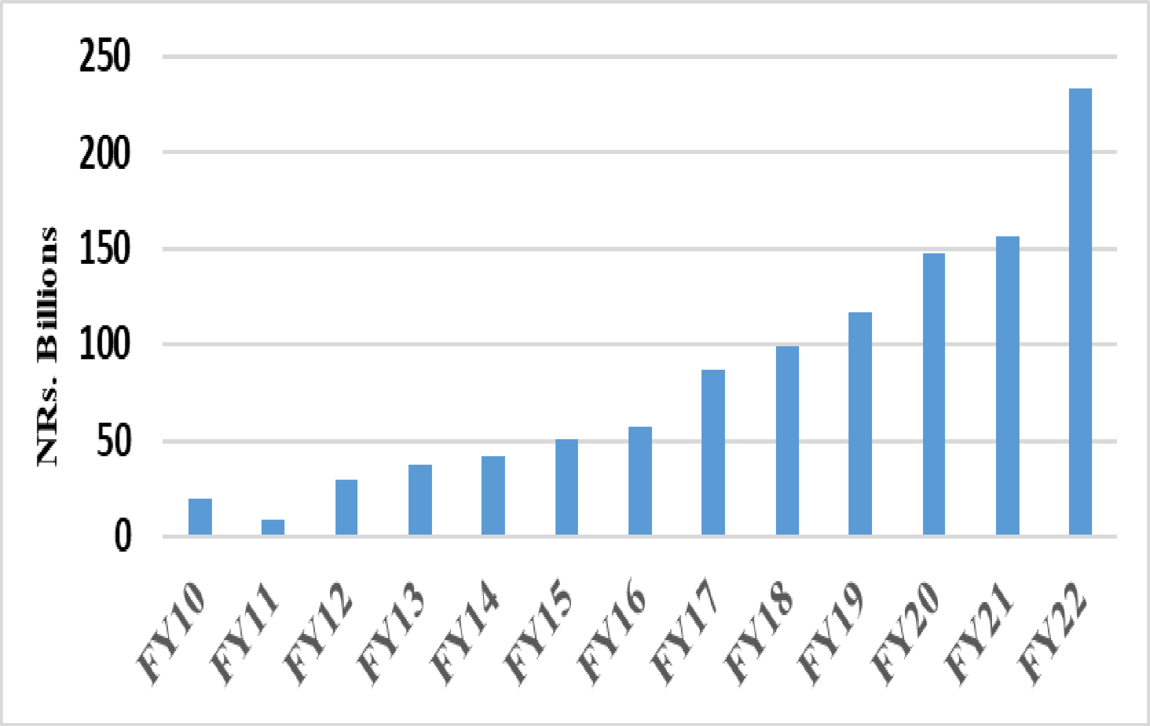
Trends in different categories of federal expenditure



Data: MoF

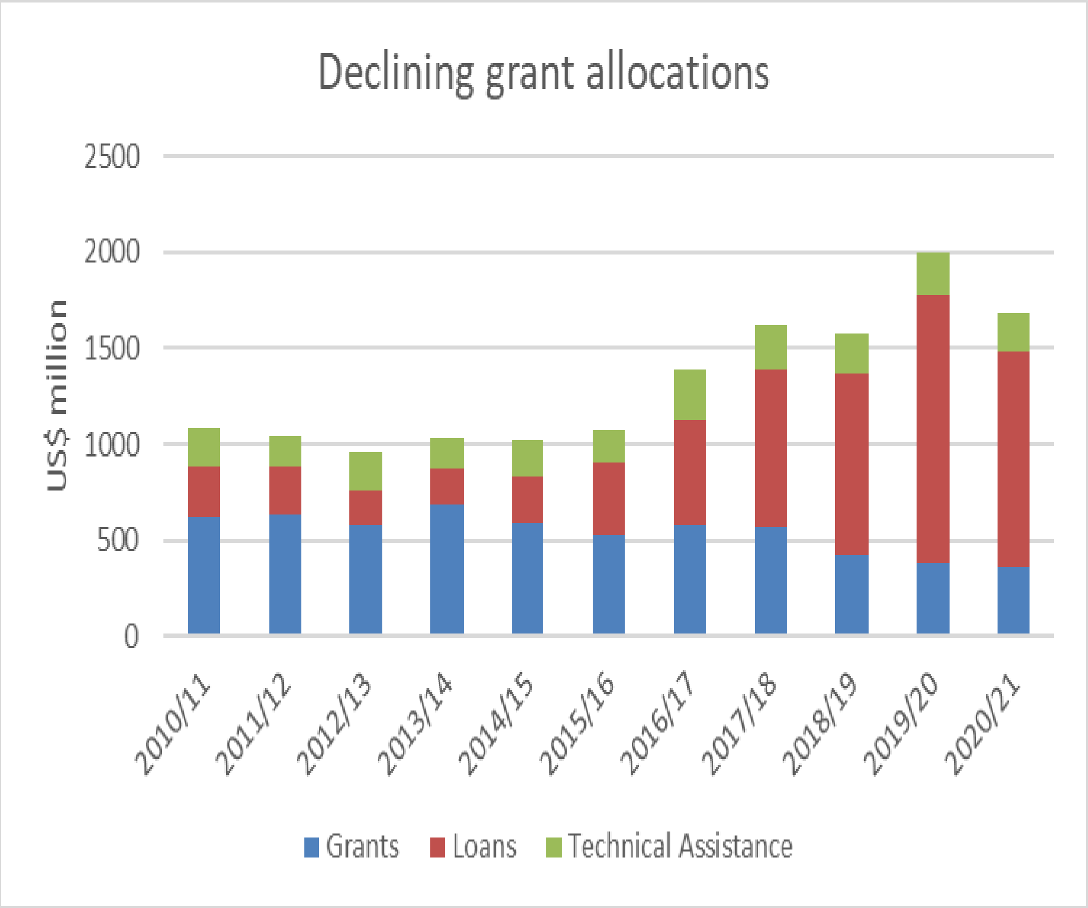
3. Rise in social security expenditure

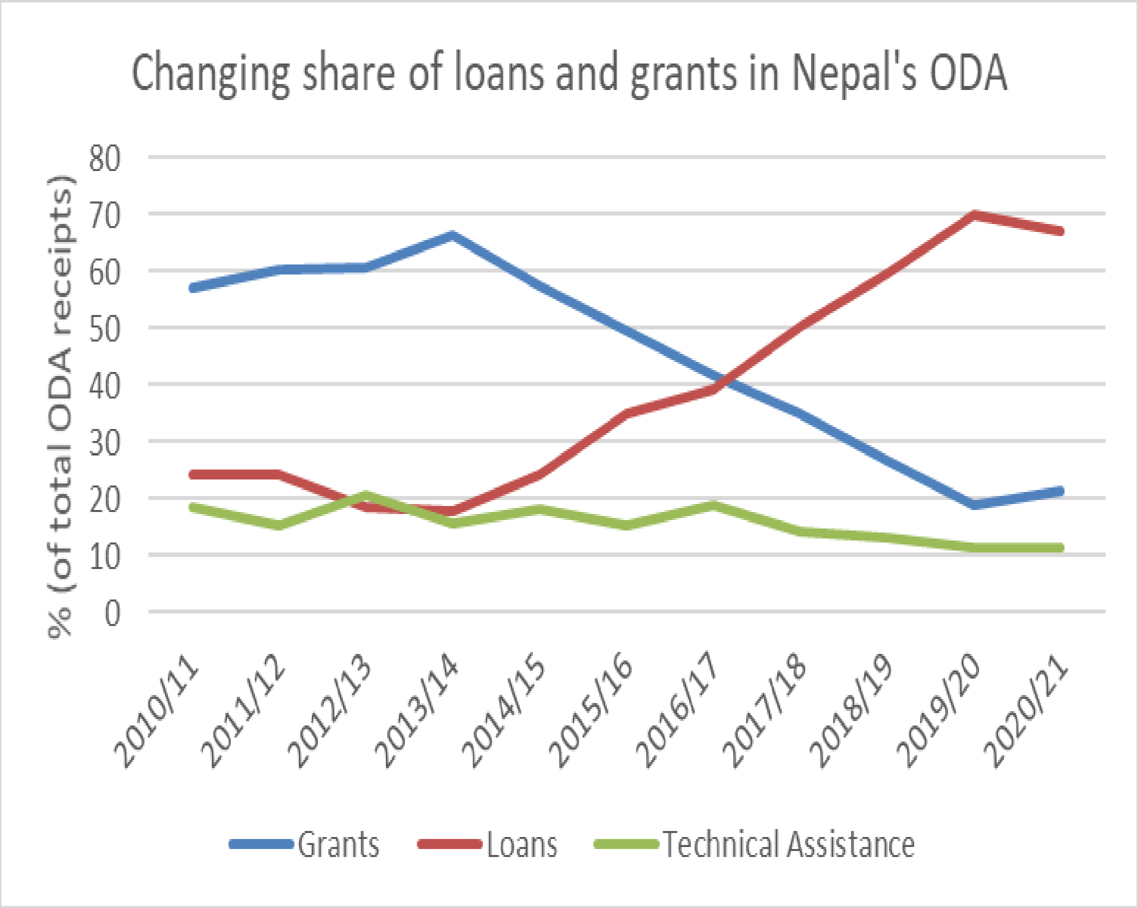
Trends in social security expenditure



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

Bank's fiscal year	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**
Data for calendar year	**2017**	**2018**	**2019**	**2020**	**2021**
Operational cutoff (GNI per capita, US$)	1,145	1,175	1,185	1,205	1,255
GNI per capita for Nepal (US$)	970	1,110	1,220	1,180	1,220

Terms and conditions of IDA loans

Terms and Conditions	**Regular Terms**	**Blend Terms**
Interest charge (SDR)	No interest charge	1.25% (in addition to the service and commitment charges)
Amortization period	38 years	30 years
Grace Period	6 years	5 years
Service charge (SDR)	0.75%	0.75%
Commitment Charges	0%-0.50% per annum	0%-0.50% per annum

Source: World Bank/IDA

ADB's decision matrix of classification

Creditworthiness	Per Capita GNI Cutoff		
	Below Per Capita GNI Cutoff	Above Per Capita GNI Cutoff	
		LDC	Other
Lack of	Concessional assistance-only (Group A)	Concessional assistance-only (Group A)	OCR Blend (Group B)
Limited	OCR Blend (Group B)	OCR Blend (Group B)	OCR Blend (Group B)
Adequate	OCR Blend (Group B)	OCR Blend (Group B)	Regular OCR-only (Group C)

ADB's terms and conditions of concessional loans

Terms and Conditions	Group A (Concessional assistance-only)		Group B (OCR blend)
	Project Loans	Policy-based loans	
Interest	1% during the grace period; 1.5% during the amortization period	1% during the grace period; 1.5% during the amortization period	2% interest per year
Maturity	32 years	24 years	25 years
Grace Period	8 years	8 years	5 years
Other Features	Equal amortization; No commitment fee	Equal amortization; No commitment fee	Equal amortization; No commitment fee

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