

# CHAPTER ONE

## INTRODUCTION

### 1.1 Introduction

In Nepal, formal financial system began in 1937 with the establishment of the Nepal Bank Limited (NBL), which is the first commercial bank in the country. The economic development of the country depends upon the strategy implemented by the government and the participation of private sectors. In the recent years, people in Nepal have poured funds in newly established companies in the country encouragingly. However, there was no satisfactory growth of such business enterprises until 1990's.

Nepal Government (NG), under a program initiated to reform capital markets, converted Securities Exchange Center into Nepal Stock Exchange in 1993, which brought new atmosphere in the Nepalese Capital Market. Nepal Stock Exchange, in short NEPSE, is a non-profit organization, operating under Securities Exchange Act 1983. The basic objective of NEPSE is to impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through market intermediaries such as brokers. Even the rapid development and expansion of financial institutions, the country has not been able to achieve the desired income so far which is due to poor capital market condition in the country. Thus, the financial institutions play a major role in the economic development.

The development of systematic market of security is regarded as the securities issued by every government in the country. Due to lack of secondary market of government securities in Nepal, Nepal Rastra Bank (NRB) has been actively issuing various government securities in the country. It was established as Central Bank of Nepal

under the Nepal Rastra Bank Act, 1955 on April 26, 1956. During the time the Nepalese economy was traditional and characterized by dual currency system, low level of infrastructural development and virtual absence of the financial system. As the country's central bank, this bank has the sole right to issue currency notes and coins and is responsible to manage the country's foreign exchange reserves. The bank also renders advices to the government on financial and economic matters. The bank also manages public debt. In the late 1980s, liberalization of interest rates, creation of a regulatory framework that includes prudential regulations on capital adequacy, and the establishment of separate supervision department at the Nepal Rastra Bank, were also undertaken. Therefore, the bank issues various government securities to recoup deficit budgetary system of Nepal. The huge amount of government issuance has been subscribing immediately in Nepal, which may be due to no default risk of government securities.

Public debt in Nepal were found during the regime of Rana Bahadur Shah, who borrowed a large sum of money from the Indian merchants to meet its internal expenses levy was imposed on a country wide basis from 1804 to 1806 to finance the repayment of debts incurred by him. This initiation was interfered by the 104 years of rolling by Rana in Nepal. (Khanal: 2002, 25). Firstly government issued Treasury Bills in the year 1961 AD under the Public debt Act 1960. Government has been issuing Treasury Bills, Prize Bonds, Developing Bonds, National Saving Certificates, Special Bonds and Citizen Saving Certificates to collect small and scattered funds from public.

Internal borrowing program was carried out in fiscal year 1961/1962, when short term loan from Nepal Rastra bank as Treasury Bills amounting to Rs. 7.00 billion was carried out for the first time. Systematic internal debt service has been managed since the fiscal year 1964/65, in the budget of NG. (Paudel, 2002)

### **1.1.1 General Background of the Study**

Government issues the different types of government securities to cover the government's borrowing requirement. Government of Nepal issues five types of government securities which are Treasury Bills, Development Bonds, National Saving Bonds, Special Bonds, and Citizen Saving Bonds. Government issues securities internally and externally. The main source of internal debt is Government bonds. It is one of the most important issuance of the government to maintain the deficit budgetary system of Nepal. It has been suffering a lot since the first budget in Nepal. The increasing trend of deficit budget has been balanced by borrowing from public. Government bond is a part of public debt. Many economists have defined public debt as per their own views. According to HL Bhatiya, the Public debt includes five types of obligations that the government of a country usually incurs. He has focused the currency as the entire currency circulation in the market, which can be a part of public debt only if the Central bank is classified as a part of the government sector. But he has also added that in any case currency obligation normally remains dormant and inactive and the government does not pay them off.

Government has various economic functions that are protective or necessary and development or optional. Government has to make the provision of defense, justice and security, the framing of laws for liberty, property and contracts, the maintenance of the police force and the judiciary and the raising of the necessary revenue for the discharge of state functions. Some functions are compulsory for government. These relate to the provisions of currency, and weights and measures, sanitation, labor legislation, and interference with trade by tariffs or bounties, restraints on trusts and monopolies, control money lending, operation of industries and the setting up of social welfare services.

Every government falls short of funds to carry on development in the country. Due to this reason, government issues various securities in the country. The collected funds are spent on development functions for the welfare of people. Government commences various projects in the country. These are not for getting benefit but for the welfare of the people. Therefore, it is believed by all that the government works in the country on the behalf of people for it has high responsibility to develop country.

### **1.1.2 Types of Investor**

The immediate subscription of stocks depends upon various types of investors. They are classified into various groups on the basis of investment time horizon. Some are long-term investors, some are primary issue investors and some are speculative investors. They are listed below:

#### **– Long-term Investor**

The investor under this category has wide time horizon exceeding a period of 1 year and his primary motive is to get returns in excess of the prevailing bank interest rates. The period of such investment normally varies from one to three years and profits so accrued are termed as long-term capital gains. Conversely, a short-term investor look for short-term gains and his primary motive is capital appreciation. The time horizon in this case is normally three to six months.

#### **– Primary Issue Investor**

Such a category of investor associates themselves only with the initial public offerings by any company raising capital. Such types of investors normally liquidate their holdings as soon as the security is listed in the Stock Exchange to book their profit that may have accrued. In the Stock Exchange terminology, such an investor is called a Stag.

#### **– Speculator**

One who anticipates a rise in price in the near future is called a speculator. Speculators can be of two types: A Bull or a Bear. A Bull speculator is one who anticipates a rise in the price in the near future and thus buys shares so that he can sell them at a higher price in the future and make profit. The market is termed bullish. A Bear speculator is one who anticipates a fall in the price of stock in the immediate future. Speculators with bearish tendency sell securities so that they may purchase in future at lower price and earn profit. The market is then termed bearish. (<http://www.nrb.org.np>)

Thus the investors of different group have different thinking while making investment some investors invest into government securities and some invest into private organization's securities. However, it has been realized that government securities are highly marketable than private organization's securities.

## **1.2 Statement of Problems**

Government Securities are a secure type of investment securities; but individual investors have not given so much interest to invest. Most of the government securities are hold by institutional investors except few individual investors in long term securities. Today people are getting facilities of Internet, which is the most challenging communication media. People can access any information at any time from any part of the world. It is the age of information technology so any investor can use Internet access for the right selection of investment alternative. In Nepal, very few people have Internet connection. The communication media is also not so developed.

It is hard to obtain perfect information about the future risk and return on investment in Nepal. It is heard that even intellectuals, scholars, university graduates and postgraduates in business administration could not perfectly analyze good investment sector for future return. Similarly, there are no such organization that

gives investment information to accelerate investment and market efficiency. Till today, the government of Nepal has not launched any effective program to develop investors' knowledge.

This study relates on the following problems are:

1. What is the trend of Government securities ?
2. What does situation on the ownership pattern of Government securities in Nepal ?
3. What are the causes of funds investing in single security rather than portfolio by investors?
4. How do the Nepal Government bond issue processes and practices run?
5. How did the government securities determine the interest rate?
6. What are the investors' attitudes of government securities?
7. What are the views & opinion on the policy and procedures to reform debt management of Nepal.?
8. There is perfect information about the future risk and return on investment in Nepal?

### **1.3 Objectives of the Study**

This study is entirely related to internal debts. The overall objective of this study is to analyse the policy of NG security, issue process and practice of government securities and the investors' preference towards government bonds issued by NG depending upon yields, face value, maturity period, cash receipts, etc. However, the following objectives are focused for specific study:

1. To analyze ownership pattern of government securities in Nepal.
2. To analyze the structure of government securities in different period.
3. To examine the interest rate of government securities.

4. To examine the attitude of the different respondents towards the government securities.
5. To analyze the views & opinion on the policy and procedures to reform debt management of Nepal.

#### **1.4. Need of study**

This study has been conducted to find out the investors attitude towards government securities on the basis of yields, face value, maturity period, cash receipt, etc. Investors are pouring funds into government bonds as it has zero default risk. In the stock market, government bond has systematic market. Some investors are unknowing involved as per the advise of their relatives. In Nepal, there is lack of information agency to get immediate information on investment opportunities. So it is a serious problem to get the right investment information on time. Investors normally do not calculate intrinsic value bonds while making investment.

The deficit budgetary system has been creating serious problems since the first budget in Nepal. The large amount of deficit budget is fulfilled by borrowing through sales of government bonds. In this study, only internal debt is included as the study is limited to government bonds. Most of the economists have strongly recommended that public borrowing should be used on the productive schemes and programmes. Similarly, most economists remarked that expensive debt should be discouraged.

The internal borrowing does not create problems in the country. The raising of fund by issuing internal securities means to transfer funds from one person to another person. The internal borrowing refers to mobilize the idle cash in productive sectors.

## **1.5 Limitations of the Study**

The main problem of this study is related to deficit budgetary system of Nepal and the obvious problem found after the utilization of constraints resource. This study is strongly related to achieve the above mentioned objectives even though its broad study area. So, it is not a comprehensive study and limits to analyze the internal debts. The study is limited to find out on the following reasons:

- This study is based on the published secondary data provided by NRB and other related corporate bodies.
- It is based on limited area of government securities.
- The study is not related to macro economics like inflation, monetary policy, etc.
- This study does not cover to external public debt.

## **1.6 Chapter Plan**

The study organized into five chapters. Each of has some aspect of the study.

Chapter1: Introduction

Chapter2: Review of Literature

Chapter3: Research Methodology

Chapter4: Presentation and Analysis of Data

Chapter5: Summary Conclusions and Recommendation

Chapter one deals with the subject matter of the study consisting background of the study, statement of the problem, objective of the study, research questions, significance of the study, limitation of the study and scheme of the study.

Chapter two deal with review of literature. It includes conceptual review, review of articles and journal, review of past thesis, review of other research works relating with government securities, government debts are review of major empirical study.

Chapter three deals, research methodology. It includes research design, data collection, research tools and models explanation of the variables taken, samples selection and period of the study of the samples enterprise.

Chapter four deals with the presentation, analysis and interpretation of data by using statistical and financial models described in chapter three, findings of study.

Lastly, chapter five deals with summary, conclusion and recommendation of the study.

Bibliography and appendixes are included at last of the thesis report.

## **CHAPTER TWO**

### **REVIEW OF LITERATURE**

A literature review is an evaluative report of information found in the literature related to our selected area of study. It is a body of text that aims to review the critical points of current knowledge on a particular topic. Likewise, it is an integral and mandatory process in research works. The researcher has reviewed various books, journals, newspapers and thesis that were found while studying about the government security market in Nepal.

#### **2.1 Theoretical Reviews**

##### **2.1.1 Introduction of Government Securities**

Securities issued by a government to raise the funds necessary to pay for its expenses are called government securities. Government issues various types of securities both internally and externally. Treasury Bills, National Saving Bonds, Development Bonds, Citizen Saving Certificates, Special Bonds are the examples of government securities. Government issues the different types of government securities to meet the financial requirement in the country. In context of Nepal the primary reason for issuing government securities arises due to deficit budget declaration. Government Securities are less risky than other corporate securities. Therefore, risk averter investors are more attracting to hold the government securities.

The growth of the government securities helps the development of the money markets as well as capital markets. Large percentage of people in the country has

small income while some people in the country have higher income. Public debt encourages both lower and higher income people to invest in government bonds. There are commercial banks, financial institutions, other private companies and individual investors in the country invest their saving funds in different investment alternatives. Investors can also classify into two groups as short term investors and long term investors. Some investors want to invest in short term debt and some want to invest into long-term debt. (Gyawali, 2004, 215)

The issuance of government securities to meet government expenditures is important to raise the living standard of people. But the lack of proper utilization of the raised bonds is said to have caused many problems.

Government debt arises out of borrowing by the treasury from banks, business organizations, and individuals. The debt is in the form of promises by the treasury to pay the holders of these promises a principal sum and in most instance interest on that principal. He describes that government loan should be returned back to the investors after certain period. So it is not desirable to raise funds from public in every action taken by the government. An investor should familiar himself with the range and use of the various types of investment and aware of the current investment climate, so that he can evaluate and assess the advice he receives returns, investors on the other hand have different thinking regarding their investments strategy, investors of government securities can see the whole situation and interest rate on a purchase many only mean that the top price has been reached rather than that furthers appreciation is indicated. But the public debt has not been defined uniformly. It has been discussed by several economists in nineteenth century and after by modern economist.

The various types of government securities in term of maturity period & different nature are issued by the NRB. If the securities are not traded in the secondary market, they are called non-marketable securities. Special bonds issued by NRB are such type of debt securities. Non-marketable securities are also common in economically advanced countries. To develop the money and capital market, secondary market of government securities must be efficient.

### **2.1.2 Historical Background of Government Securities**

The idea of public debt was originated in the Great Britain in seventeenth century, where a group of city merchants provided grants and loans to the government. In return they received the privilege of a royal charter to fund the Bank of England, which becomes the country's Central Bank, Public debt has devoted simultaneously with the needs of the states development. Historically during the period of the world war, the governments borrowed larger amount of loans to meet in expenditure.

After the 1st & 2nd world war large amount were borrowed for the reconstruction and maintenance. In the previous time state only have to maintain the internal peace and prevent external disruption. But now every state should look after economic development and public welfare in addition to the previous work. Therefore the public debt becomes one of the most useful instruments for generating income to maintain the welfare state and economic development.

Developed countries were provided the loans from their people even in 18th century in a very systematic way. But incase of Nepal, people had no power and inclination to provide the money as a loan. They traditionally provided the human labor and good to their ruler. People had compulsory to contribute to overcome several emergency situations.

The article titled 'Public debt in Nepal' has written that the earlier king of Malla dynasty had borrowed the assets from renowned temple and social trust to hold the battle and overcome many emergency situations. The king Prithivi Narayan Shah was also indebted by the people in the expenditure of unification the nation (Acharya; 2003:20).

Some instance of government borrowing in Nepal can be hold during the time of Rana Bahadur Shah we borrowed a large sum of money (Rs.60,00,000) from Indian merchant to meet internal administrative needs. We had read that late Prime Minister Chandra Sumser Rana had also borrowed the loan from the trust of Pasupati temple to release the slavery in Nepal. But these all kinds of debt were not raised in a very systematic way. The government previous to the establishment of the democracy (1950) had no any legislation about the public finance and debt.

It has not been so larger of raising the public debt with in the legal from NRB Act (1955) was first act in which the procurement of raising the debt on behalf of the government was systematized well. After the establishment of Nepal Rastra Bank as the central bank of Nepal, another act named public debt act (1960) was also proceeded out. Under this act the government issued first time security (Treasury Bill) of Rs.70,00,000 in 1961. At the earlier time of insurance, the government raised the debt internally. The government raised Rs. 131 million in 1963 with the means of development bond from the people in Nepal. Plus, the government issued the public debt regulation in 1963. In the same period the government issued compensation.

Bond for land acquisition with the interest rate of 3% per annum and with the maturity period of 10 years amounting Rs 407 thousands and compensation bonds for same with one percent interest rate per annum with the maturity period of 20

years amounting Rs. 5.56 million and the other component of the borrowing was from Nepal Rastra Bank as guaranteed as loan and special bond. The government also started to borrow since 1984 by issuing National saving certificate, which amounted Rs 5,000 million that year. Similarly in 1991, the government started to borrow by Rs 8,478.1 million that year. (Rastra Reen Khabar Patra,)

### **2.1.3 Attitude towards Government Bond**

Most of the governments in the world collect money from two sources, namely, public revenue and public borrowing. These are the source to fulfill the budget expenditure in every country. The views of different economists at different time periods on matter of public borrowing are presented as under

#### **2.1.3.1 Classical View**

The classical view was practiced after the 19th century and followed by their neoclassical successors.

The classical authors were generally against public borrowing. They assumed that individual consumer and business firm employ resources more efficiently. Actually, most classical authors were not against public borrowing. They favored minimum public expenditure and favored taxation than borrowing. The reasons of their favor for taxation are as follows:

- Debt financing means an increase in public debt. Since it is an easy method of obtaining income, government is likely to be extravagant and irresponsible. Consequently, public debt will become a definite burden on the economy.
- Payment of interest on public debt and refund of the principal will require additional taxation.

- Deficit financing might produce currency deterioration and price inflation. It should, however, be kept in mind that classical economists were not against all types of public debt. They approved public debt for productive purpose.

*(Acharya, 2003, 14)*

### **2.1.3.2 Keynesian View**

It would not be correct to say that all classical authors stood against public debt. In 1967, Adam Smith in his 'Wealth of Nations' and James Stuart propounded the view that public debt should function as the balance wheel of the economy. Keynes effected a truly significant revision in the theory of public debt. He did not accept the classical notion of a free enterprise economy which is self equilibrating at full employment level. He advanced the concept of under employment equilibrium. Resources in the private sector might remain unemployed for relatively longer periods if corrective action is not taken by the government. In a situation when resources are unemployed on a large-scale government employment of these resources does not necessarily deprive the private sector of anything. Thus, public borrowing need not necessarily be unproductive, inflationary and burdensome.

Many Keynesians carried this analysis to the other extreme and held the view that, if debts are internally held, there is nothing to worry about their size. Such a debt involves merely a series of transfer payments and they cancel out for the economy as a whole. Hence the only concern should be about economic stability at high levels of income and employment.

A. P. Lerner maintains the theory that the government should borrow only when it wants to make people hold more bonds in place of money. This action will raise the rate of interest by lowering the value of bonds and will prove to be anti-inflationary. In the event of falling aggregate demand and shortage of funds for

productive investment, government should lend to the private sector or increase its own expenditure to arrest the fall in real income and employment. The government may also borrow from the central bank to retire the debt held by the public.

### **2.1.3.3 Post Keynesian View**

During World War II and in the post war years, the size of public debt increase enormously. The post-Keynesian position accepts a large part of the modifications of the classical debt theory as brought about by Keynesian economics. It emphasizes, however, the transfer and management aspects as well as the inter relationships between public debt and money supply.

Many economists argue that borrowing today constitutes burden for future. A large public debt, if internally held, poses many problems in the economy. It complicates monetary policy and creates difficulties of management. Both classical and Keynesian economists agree that distinction should be made between an internal and external debt. Internal borrowing is largely an act of expediency by a government when it prefers to finance its expenditure by taxation but finds it inconvenient to do so. In the event of seasonal fluctuations of spending or revenue or errors in budget estimates, a government may resort to temporary borrowings. In case of an emergency it is better to borrow than to go for sharp increases in taxation.

According to Richard Goode, a better argument in form of internal borrowing should be avoiding borrowing to pay for government consumption expenditures. Domestic borrowing is a use of national saving. "The inference is that future to restrict borrowing to the finance of investment will retard economic growth. A weakness of the argument is that not all outlays classified as investment actually

contribute to growth, while some expenditure usually classified as government consumption promote growth. (Goode, 1998: 214)

#### **2.1.4 Recent Thinking on Government Borrowing**

Many economists and analysts have keenly studied on government borrowing in the country. Some have criticized and some have taken it as very good prospective in the country.

All public debt is not burdensome in the country. Some economists suggested that it is essential to raise idle funds from public by issuing government bonds. Now days, public borrowing is considered necessary for the following purposes:

Public borrowing has a great role in emergency expenditures or war expenditures. It also plays an effective role in macroeconomic stabilization. A discretionary increase in public spending to cure unemployment was a Keynesian prescription. In the country, a part of recurrent outlays could be met out of public borrowing.

Chelliah observes that the ideal situation is one in which first, revenues will meet subsidies, other transfers, interest payments and the greater part of current expenditure, debt finance will be used for meeting the government's non-remunerative capital formation, a proportion of current expenditure designed to increase social capital and productivity and the requirements of financial investments; and second, the total of domestic saving, the non government sector will be able to obtain a due share of saving and that there will be no need to borrow from the central bank more the correct amount of seignior age.

The level of government borrowing is a function of the ability and willingness of persons and business to lend and the government's power and intention to tax. Minimum level of debt can be expressed in terms of following equation:

$$D = \frac{Yt - O}{R}$$

Where,

D = Maximum sustainable National Debt

O = Constant expenditure for ordinary government operation

T = Maximum ratio of tax receipts to National Income (Y)

R = Contractual interest rate of government debt

## 2.1.5 Government Security in Nepal

### 2.1.5.1 Pricing of Debt Securities

The values of bonds are determined by coupon rate and maturity period of debt securities. It is directly related to coupon rate whereas it is inversely related to the maturity period and the market rate or interest. The higher the coupon rates, the higher the value of the bond. The present value of the bond is calculated by summing all discounted coupons and principal payments with the discount rate being the market rate of interest of corresponding years as modeled below:

$$B_0 = \frac{C_1}{1+K_1} + \frac{C_2}{1+K_2} + \frac{C_3}{1+K_3} + \dots + \frac{C_n}{1+K_n}$$

Where,  $B_0$  is the present value of the bond. Similarly  $K_1, K_2, K_3, K_n$  and  $C_1, C_2, C_3, C_n$  are market interest rates or going interest rates or discounted rates and coupon rates respectively. When market rate of interest goes down, the price of previously issued bonds at higher coupon rate goes up investors receive capital gains.

A financial repression is a common phenomenon where economics are not liberalized. The government directed system in such repressed market fails to competitively determine interest rate on deposit and lending. While government borrows at rate lower than market rate of interest, the government coupon rates sometimes provide real return on government debt security in negative at a time

when the coupon rate is lower than inflation rate. Risk associated with bond investment reduces the value of the bond. The longer the period of maturity, the higher would be the default risk. Though, the default risk of government bonds is assumed zero, changes in inflation rate, tax rate, market rate of interest and depreciation of domestic currency affect the value of government bond. Thus, pricing of bonds is determined by the relevant macroeconomic variables as well.

Treasury Bills, National Saving Certificates, Development Bonds and Special Bonds are the government debt securities; they are issued to recover the deficit budget. Treasury Bills are short-term money market instruments having low return and low risk. Commercial Banks mainly hold Treasury Bills to manage their balances. National Saving Certificates and Development Bonds are two long-term marketable securities, both are contributing one third of total internal debt. Special Bonds are specially sold to NRB and Commercial Banks. Coupon payments fixed on Special Bonds are below the market rate. Special Bonds constitute 40% of the total internal debt; have the longest maturity period of about 20-25 years and highest risks associated with uncertainty of the longer term.

National Saving Certificates and Development Bonds are the long-term marketable securities available in the exchange market. Market makers facilitate the secondary market transactions of marketable government securities. Settlements of payments are made through NRB. Nepal Stock Exchange Limited has not yet started transacting government securities in the floor. Buying and selling orders cannot be placed through electronic means and exchange of government securities.

Government loan has the all-financial obligations of the nation including its currency or as government borrowing. In many cases, the currency is not included in government debt. Moreover, some of them do not include even the overdraft amount from NRB, which must be refunded by the government to the bank within a time limitation.

Government Securities are classified as two types in terms of internal public debt. They are explained below:

#### ❖ **Short- term Government Debt**

Short- term loan is collected by issuing the short- term government securities such as Treasury Bills. They mature in less than one year. In Nepal, Treasury Bills are sold at discount and pay no interest with the appreciation in value to maturity, which represent investors' return. The NRB (on behalf of government) offers various parties for the sale of Government Securities, for example Commercial Banks, Development Banks, Government and non-government financial institutions, group of investors, etc. Treasury Bills normally matures after 91 days. Sometimes they are issued with the maturity period of 182 and 364 days. Such Government Securities are issued through the auction system. The party who submits the higher amount of cash can purchase the Treasury Bills floated by the NRB.

#### ❖ **Long- term Government Debt**

Long term Debt issued to provide the funds for sustainable development of the nations, to make the people contemplative to the pride of participation in nation's development and welfare, to draw the liquidity from the market for a long-run. Government issues Development Bonds and National Saving Bonds with a long-term maturity period. These bonds are issued for a long- period. The government also issues Special Bonds, which are in practice today.

#### **2.1.5.2 Objectives of Government Debt**

There are various objectives in issuing Government Securities. "In the past, the way of living was very simple and the borrowing was not very significant. The government's budgets were very small. The government also followed the policy of non-intervention in economic system. But in modern times, especially after the

world depression of 1930's, the public authorities have started to take keen interest in the economic development of their respective countries”.

**The objectives of Government Securities are Summarized Below;**

➤ **To Recover the Deficit Budget**

The most important aim of public borrowing is to fill the gap between the revenue received by the government and proposed expenditure during the year. Modern governments do not have piles of cash or treasure to meet any budget deficit. Normally, the annual expenditure proposed by the government for the running year should be and is met by the annual revenue. But because of many unexpected and unplanned circumstances, the yield from the taxation and other sources may not be equal to actual expenditure. This is why the government raises funds through the issue of securities.

➤ **To Restrain Inflation**

It is a condition that we are suffering from the pain of the gradually increasing prices in the market. In other words, we are surrounded by the phenomenon where too much money chases too few goods. In these conditions the government can withdraw a large volume of money from the public to check prices from increasing. Thus the best way to curb private spending is to borrow from the people, so that they cannot flow the more cash in the market. Hence, the government can counteract the economy from the hyper-inflation and maintain the economic stability.

➤ **To Know Unpopularity of Taxation**

Most of the people are not interested to pay the taxes to the government. The tax will be resented by the people whether it may be old or new. People always opposed the enhancement of old rate of tax and the announcement of the new ones. The government through this device can protect itself from the criticism of people in regard of levying the tax but it may lead the nation to grim predicament in long run.

➤ **To Maintain Economic Growth**

The state should conduct the general administrative functions and development programs simultaneously. The government should implement the construction of public works like roads, railway lines, irrigations, powerhouses, etc. for accelerating its economic and social progress. Underdeveloped countries on one hand cannot use their natural resources due to the various constraints and on the other hand these cannot levy heavy taxation upon their people due to the low rate of real saving of their people. In this situation, borrowing from the people and abroad would be the main and only device of getting financial resources to the nation.

➤ **To Meet the Unexpected Expenses**

Sometimes the government borrows from the people to meet the unexpected expenses due to floods, famines, earthquakes, major accidents, epidemics, etc. Such terrible incidents lead the nation to a sudden spurt of the government expenses.

On the other hand, there are a great tussles and enmities among the powerful countries for their economic and political supremacy and many other interests. And relatively powerless countries are also bearing the incessant tensions among their neighbors for their respective interests. In this very tense situation, war is the most probable at any time. Now a day, war is becoming very expensive. Of course, a country needs a large amount to maintain its defense service and up to date equipment if it wants to protect itself from its natural enemies or terrorism and foreign aggression and attack. These all cause the nation to be indebted.

➤ **To Allocate Resources Properly**

Specially, the country having the capitalism economic system is not directly liable for its resources allocation. In this and similar other conditions, the country on the one hand adopts the progressive tax system and on the other hand borrows huge amount of money from the capitalists so that the borrowed amount could be

redistributed towards the poor people in the country. So the borrowing is justifiable in terms of better allocation of resources.

Apart from these all-public loans in modern times are necessary to remedy the business depression, to check the cyclical fluctuations to, to finance public enterprises for public welfare to create the infrastructure, for establishment of socialistic state and even for meeting the current and regular expenses. It should be noted that different types of loans would be raised for different types of objectives.

### **2.1.5.3 System of Government Debt**

With the inclination and intention of mobilizing the available capital resources the government has maintained some sort of approach in relation to public debt initially by promulgating Financial Act and Nepal Rastra Bank Act 1955. The act at section 20.2 sanctioning the responsibility and authority of raising the internal debt to NRB further clears that "the entire responsibility in relation to the management of public debt shall be entrusted to the bank (NRB) on such terms as may be agreed upon between GON and the bank". After 5 years the government issued the Public Debt Act 1960 with the main objective to encourage the saving for economic development of the nation.

Similarly Public Debt Regulation 1963 has been formulated by GON, which sets the details of systematic process and procedure for borrowing, servicing and redemption of public debt. A part from this; the regulation includes the system for transference or ownership of bonds, conversion of type and form of securities, provision of losing the bills and certificates and so on.

In Nepal, the task of co-ordination in all this aspects is achieved through NRB and or the agencies of NRB. NRB advises the agencies as per necessities, regarding the timing, terms and the amount of loan that can be raised in market without undue difficulties.

#### **2.1.5.4 Theoretical Aspects of Issuing the Government Securities**

There is not a debate on the necessity of public debt for sound economic development and stabilization. No one violates the power and authority of government for borrowing for public purpose. But it is not expected to borrow for indulging in ‘wasteful’ expenditure of any kind of or to suit the personal whims of individuals (particularly of PM and FM) running the loan from the market on which the government should conceive thoroughly before floating its securities.

- No one should be imposed for lending the loan to the government.
- The management should keep its interest cost to the minimum possible. The government, therefore, should issue the securities with minimum interest rate as far as possible and practicable.
- It should not impact adversely upon the target of sustainable economic development of the nation. Rather the all practice regarding to public borrowing should assist the state’s economic welfare as a whole.
- The securities should not be floated at the time of deflation as well as increasing the rate in the market. And the state ought to be able to raise the loan at the period of decreasing or stagnating the interest rate in the market.
- The state should pay the proper attention towards the legal and ethical restrictions on public borrowing.

However the government may change the terms and conditions of payment of debt at any time it likes for public welfare, but it is expected everywhere that the government would abide by a self imposed and indulged limitations so that it does not lose the confidence of people in regarding to refunding the loan in or on time set previously.

### **2.1.6 Effects of Government Bonds**

Borrowing has a number of effects and these can be taken from the following paragraph:

If a country borrows too much money, it has to pay great deal of interest every year in order to service that debt. This represents money that could have been used to pay for program spending instead. By borrowing money, the government has placed a greater emphasis on spending in the present than in the future. It has discounted the value of future expenditure.

Depending on how much money the citizens of that country or that province save out of their own incomes, the borrowing government must sell its obligations to foreigners. By doing so, the government makes itself vulnerable to the shifting and often volatile sentiment of the international capital markets. If they have a sufficiently large external debt in relation to their GDP (as an indicator of their current and future capacity to repay), speculators might attack their currency of their countries bond markets forcing interest rates higher and causing the value of their economy to degrade in international terms.

Indeed, an excessive debt policy can lead to a vicious cycle of speculative attacks, followed by higher interest rates and higher interest payments that can cause an economic slowdown. Just when a stimulate policy is required to help the economy struggle back to its normal growth trajectory, the government finds itself crippled by high interest rates and poor liquidity. Nobody else will lend the government money with which it can stimulate the economy under anything but the most onerous terms.

The vicious cycle is one that has plagued economies of the third world, and particularly Brazil, for years. On the other hand, it may be prudent to borrow during economic downturns in order to stimulate the economy with the intention of repaying those funds (and thereby dampening the economy) in times of economic growth.

Most people would agree that it is bad for the country because it creates a burden for paying regular interest and at the end of the time, it should be back for the investors. Similarly, it has been argued by many authors that there is no direct money burden of internal debt as money is only transferred from one group to another. When interest on debt is paid by levying taxes, money is transferred from the tax payers to the bond holders. As regard to payment of the principal sum, the future generation will bear the burden. In this case also, money remains in the country.

The burden of Government debt is not analogous to that of a private debt. If the debt is internal to the country, interest payments and future retirement of the debt do not require that resources be transferred outside the country. Thus, except for some side effects, the total goods and services available to the economy remain unchanged.

One clear burden of a government bond is reduction in output that its existence causes. To the extent that the taxes necessary to meet the interest payments have disincentive effects and cause a misallocation of resources, the debt does reduce output. If the debt also reduces investment, the future inherits a smaller capital stock and hence less potential output. A growth of debt can also add to inflation. Economists have explained different types of burden of government bond as direct, indirect, monetary and real and it may tend to fall either on the present or

sometimes on the future generation. Direct money burden is measured by the extent of money payment involved and the rise in taxation needed. Direct real burden is equal to the loss of economic welfare on account of the direct money burden of increased taxation. Indirect burden of debt refers to the extent of adverse effect of increased taxation on the level of production.

#### **2.1.6.1 Effectiveness of Public Debt in Nepal:**

Let us recall the twin objectives of public debt management in Nepal as (a) Fiscal Policy implementation through deficit financing and, (b) Monetary Policy implementation through liquidity management.

How effective is the public debt in the policy perspectives and in fulfilling the objectives can be substantiated only if we quantify its effect on macroeconomic variables (GDP, price, capital formation etc) through empirical verification. However, in a general perspective, Public Debt has been a prominent variable in meeting the government's deficit financing targets as there are no such incidents that government has never been able to mobilize the targeted amount of public debt. There is a very positive response from the general public and other sectors including the banking system towards the public debt. It has been a market interest rate activating and adjusting driver as well many a times especially to the fixed income investors. Especially the 91 Days T-Bills's rate has been a reference rate in the money market.

In the part of liquidity management, public debt has been instrumental as it is the sole equipment available that NRB is using for liquidity management (mopping up or injection). This statement can be supported by the fact that out of the total public debt holding, T-Bills's holding percentage is about 72 percent, which is purely used for the money market transaction. NRB does not have its own separate liquidity management instruments till date and it is deploying the public debt instrument (T-Bills) for the effective liquidity management.

### **2.1.7 The status of Primary and Secondary Market of Government Securities:**

Public debt plays an important role in the development of the capital market.

#### **2.1.7.1 Primary Market**

Primary market includes the transactions through which securities are issued, redeemed and interest is paid. This means that every market transaction with a security should necessarily involve the issuer of that security and/or its agent. The primary issue of government securities is managed by NRB and its sales are done through market makers in the Kathmandu valley and through NBR branch offices and commercial banks out of the valley.

Primary market is basically used for the financing of the issuer, although, it can be used for monetary policy also. In this case, due to lack of flexibility it should only be used for longer term monetary targeting. An important role played by this market is to establish interest rate parameters through auctions.

#### **2.1.7.2 Secondary Market**

The concept of secondary market includes all other transactions with the securities that are carried out between their issuing and redemption. These transactions do not usually involve the issuer be in the markets trading with self issued securities for monetary policy reasons.

Operation of secondary market makes the security market active and attractive. Nepal Rastra Banks started to operate secondary market for treasury bills and NRB bonds since the FY 1995/96. All commercial banks and one development banks have been actively participating in the secondary market. Daily auction is held in such a market. The operation of secondary market has not only helped optimum

liquidity management of financial institutions but also created room for more active open market operations of the NRB.

As there are no standardized maturities, securities can be traded in this market until their redemption is due. This feature grants the market participants a great deal of flexibility for their active participation in these markets to improve their short term liquidity management.

### **2.1.8 Ownership, Marketability and Term Structure of Government Bonds**

Ownership, marketability and term structure are important considerations in managing the Government bond.

#### **❖ Ownership**

The people and organizations that lend money to the government by purchasing government bonds are the owners of the government bonds. The U.S. government has divided its owners into 3 categories, according to debt held report from 1951 to 1976, the largest portions of the government debt is owned by private investors, including banks, insurance companies, corporations, private individuals, and state and local governments (which are classed as private investors because their decision to buy bonds is voluntary and based on ordinary financial management considerations). The second largest portion of the debt is held by government accounts, such as the social and highway trust funds and the reserves or retirement programs for federal government employees. The smallest portion of debt is held by the Federal Reserve Banks. These banks acquire government bonds in the process of money creation. They may purchase bonds to help the U.S. treasury government to cover a deficit in the budget.

The debt owned by private investors represents genuine borrowing by the Federal government. This borrowing involves a transaction between the government and an

investor who agrees to transfer funds to the government in exchange for the receipt of periodic interest payments and eventual repayment of the sum loaned. Interest payments are necessary to persuade investors to purchase these bonds, and the maturity debt, which is part of the conventional bond agreement, obligates the government to repay the principle at some specified date. Genuine borrowing withdraws funds from the private sector of the economy and therefore has effects on the equilibrium level of national income similar in many respects to those of taxation. Taxation, however, is compulsory, genuine borrowing is a voluntary transaction (Gardner, 1978:161).

Thus, bonds owned by government accounts are not money creation indebtedness because the money used to purchase them has come from taxes collected from the public. But these bonds do not reflect genuine borrowing in the sense of voluntary transaction between the buyer and the seller.

#### ❖ **Marketability**

The government in a country issues bonds that are normally marketable which means that a person who owns a bond may sell on mutual agreement. Therefore, the market value of these bonds can fluctuate depending upon the interaction of demand and supply, In U.S. some U.S. government bonds are marketable.

#### ❖ **Term Structure**

The term of a debt instrument is the length of time that must elapse before the obligation matures and the principal sum of the loan must be repaid. The treasury issues a variety of different debt instruments, some with short term maturities of a few months and some with long term maturities of twenty or thirty years. At the short end of the term structure are Treasury Bills, which matures after 91 or 365 days from the date of issue. Treasury Bills are sold on a discount on the basis of competitive bidding which means that the rate of interest actually paid on each issue is determined only after the issue has been sold. Because time period is short, the

risk incurred by buyers is low; interest rates on Treasury Bills therefore are typically the lowest in the family of government debt instruments. Treasury Notes are intermediate term instruments and have maturities from one to five years. Interest rates on Treasury Notes ordinarily will be somewhat higher than those on Treasury Bills. because the longer maturity time exposes the buyer to greater risk.

Long-term Government bond are normally matures in five years or more, It has fixed & high interest rate, Interest paid on semiannual .

Bonds have many characteristics such as the way they pay their interest, the market they are issued in, and the currency they are payable in, protective features and their legal status.

- Bonds have their fixed interest.
- They have particular market they are issued in.
- They are currently payable in and protective features.
- They have their legal status.
- They are issued by governments, corporations, special purpose trusts or even non-profit organizations.

#### ❖ **Terms used in Bonds**

- **Coupon**

The fixed interest paid on a debt instrument expressed as a percentage of the face value for its whole life is called coupon. The coupon is paid on quarterly, semi-annual or annual basis.

- **Par Value**

It is the apparent worth i.e. the nominal value of bond, which appears on the face of the debt instruments. The amount of par value is repaid at maturity. It is also known as face value.

- **Price**

It is the price which is set for repurchasing or selling the securities in the market. It is expressed in rupee amount.

- **Yield**

It is the income from an investment in debt instruments expressed as a percentage of the purchase price or current market price.

### **2.1.9 Public Debt and the Nepalese Context:**

All of the aforesaid discussions regarding public debt hold true to the Nepalese context to a greater extent. Basic stance of the public debt management in Nepal is to achieve “twin objectives” as:

1. Resource mobilization to the Nepal government for deficit financing for the conduct of fiscal policy; and
2. Liquidity management through the Treasury Bills auction for the conduct of monetary policy.

### **2.1.10 Public Debt in Legal Perspective in Nepal**

In Nepal, there exists the legal provision to mobilize the public debt. As such public debt is mobilized as per the budgetary provision after the approval of the Parliament. The following acts, rules and regulations are the guiding documents for the mobilization of public debt by NRB.

1. Nepal Rastra Bank Act 2058
2. Rastra Rin Uthaune Ain 2059
3. Rastra Rin Niyamawali 2059
4. Primary & Secondary Market Niyamawali 2061
5. Rastra Rin Margadarshan 2060
6. Otherrules/regulation.

## **2.2 Review of Related Studies**

### **2.2.1 Review of Journals & Books**

According to James Stuart, "Public borrowing must be adjusted to conditions of trade at the particular time. It would only raise the rate of interest and have undesirable consequences for commerce. On the other hand, when circulation is stagnating in one part of the economy and there is unemployment and a slackening of trade industry. The state should absorb this excess and through its expenditures throw it into new channels of circulation. Thus the use of public credit is convinced as the balance wheel in the economy. It keeps resources full employed and prevents stagnation in any part of the economy from having an adverse effect elsewhere. In addition public credit is a necessary instrument of war finance." (James Stuart, 1950:116)

Bhargava Viewed that government borrowing is also useful to combat against inflation because in this situation effective demand is more than the available supply of goods and services and here the government transfer the extra purchasing power from the hands of the people. Thus, a sensible debt policy can be used to check a depression or a boom. (Bhargava, 1956:191)

Similarly K. Barman says that Public debt is denoted as a kind of tax through which public enjoys the advantage of public expenditure since it becomes grater than current revenue collection, it refers to these obligations of state promises to pay the amount borrowed by the lender with the interest after a given period of time" (Braman, 1986)

Public debt is the legal obligation on the part of government to make interest of amortization of payment to holder of designated claims in accordance with a defined temporal schedule. It is created through the government borrowing from

individual, co-operations, institutions and other government. It refers to raise by government within the country or outside the country. Every government like individual has to borrow when its expenditure exceeds its revenue. The receipts from the sale of financial instruments by the government to individual or firm, in the private sector to induce the private sector to release manpower and real resources and to finance the purpose of these resources or to make welfare payment or subsidies. (The new Palgrave, A dictionary of Economics, 1988)

Mrs. Rameshwori Pant has clearly emphasized about internal debt and economic stability. In her article title "Management of Internal Debt and Economic Stability", she has concluded the private industrialists and traders would be hesitant and discouraged if the state is also to conduct simultaneously the business and industries. This may create the unhealthy competition between the government and private sector. She also explains that in order to ensure private imitative government should not interfere the liquidity position existing in the market. In conclusion, she recommends the government not to borrow the capital from the public so that private investors will not lack the capital. (Samachar, 1997, The Annual Economic Publication of Nepal Rastra Bank).

Gyawali and Bajracharya (2004) on their article "Public Debt Management in Nepal" explains that the government borrows for financing the budgetary deficit. Deficit budget is estimated as a gap between expected revenue plus foreign grant minus expected government expenditure. Thus,  $\text{Deficit} = \text{Expenditure} - (\text{Revenue} + \text{Foreign Grant})$ . He further explains that public borrowing is increasing in an alarming scale. It is high time that some more concerned efforts are taken and institutions be developed for managing the debt which can now extend to private sector borrowing from abroad.

Shiva Raj Shrestha (2061) on his article “Effective Domestic Debt Management in Nepal” stated that the government domestic debt is the debt that a government incurs through borrowing in its own currency from the residents of its country. The internal borrowing does not increase the real resources of the country. It is simply a transfer of purchasing power within the country over the same stock of real resources. An excessive government borrowing could have a number of bad effects.

- Excess borrowings can also increase interest.
- Excess borrowing from central bank to finance the deficit, stokes-up inflation.
- Excessive debt entails higher servicing costs on future generations who suffer higher taxation.
- Excessive debt can affect credit ratings, which increase the cost of its future borrowing etc.

He also explained that the domestic debt management in Nepal involves interrelated functions; planning of financing requirement; policy formulation and preparation of issue calendar, issue management, managing secondary market delivery and reduction management, administration and accounting payment and settlement system & publicity. The debt manager should have an interest in developing market for government debt securities. The issuance of scrip less securities, inflation of auctioning of long term government debt securities, implementation of market based pricing mechanism and issuance of varied securities like insurance bonds, pension bonds, provident fund bonds, municipalities bonds and other special bonds would be the major achievements for strengthening the debt market in Nepal.

Nara Bahadur Thapa in his article ‘Some Issues in Domestic Debt Management in Nepal’ has stated that level and rate of growth in domestic debt is important

especially in developing country like Nepal. The reason is that governments in developing countries tend to spend more than their revenue. They find less resistance in bridging the gap between their total spending and revenue through domestic borrowing regardless of productive or unproductive use of public debt. (Rastra Reen Khabar Patra, 2007, April)

Shree Prasad Poudel in his article, "Government Securities Markets: Rational and Development in Nepal" has stated that, security markets are centre of the financial system. Private corporations and government can issue debt securities. If securities can not be traded in secondary market, those are call non marketable securities. Special bonds issued by NRB are such types of securities. Holders of debt securities receive interest payment at predetermined dates and principal payment at the maturity of the debt instruments. Periodic interest payments and capital gains are the incentives in bond investments. Debt securities market in Nepal is highly dominated by government debt securities. Corporate debt securities in Nepal are extremely limited. Government in less developed country usually borrow at lower rate than the market rate of interest on the one hand while on the other hand securities are exchanged in the face value even if their value is appreciated in the market. More over, international loans substitute bonds in emerging markets. In Nepal, international loan use to substitute the domestic debt securities market of government. Bonds price should be determined competitively in market, which is lacking for the government debt so there may be problem of corporate and soveiring bond market development. The market paved the way for debt security market development. When market interest rates goes down price of previously issued bonds at higher coupon rate goes up and investors receive capital gains. While government borrows at rate lower than market rate of interest, the government interest rates some times provide real return on government debt security in negative at a time when the coupon rate is lower than inflation rate. Risk associated with bond investment

reduces the value of bond. Issuing and exchange of corporate bonds is virtually absent in Nepal. Market makers facilitate the secondary market transaction of marketable securities. Settlement of payments is made through NRB. NEPSE has not started transacting government securities in its floor. Buy and sell can not be placed through electronics means and exchange of government securities is hindered by the fixed price of the securing. Securitized government debt, as percentage of GDP is low. Marketable government securities are lower than non marketable securities. All these factors are the impediments of developing cheap and vibrant debt securities market in Nepal. Further he has given that NRB and commercial banks are main holders of government bonds. Higher proportion of ownership of government security needs to be transferred to the households sector for secondary market development.

Every government needs funds from different sources to carry out its function .Therefore every government considers different sources of revenue e.g. different taxes,duties,fees & fines on the people residing on coming within the jurisdiction of its power .The revenue raised by issuing its taxation power depends upon functions it needs to perform and this in turn depends upon the ideology it is pursuing.If a government wants to regulate the activities of the people more ,it needs more revenue and consequently it squeezes the people more .Normally when tax collection alone is not sufficient the government issues various types of securities for raising the essential funds.Government bond is one of the important sources of public debt.

There was no knowledge of government bond at the time of Kirat period (1100BC-300AD).However there must have been some method of revenue collection .Talking into account the Mithila kingdom during the Ramayan period,king Birat's kingdom during the Mahabharat period and Gautam Buddha's father kingdom Kapilvastu,it is definite that these kingdom taxes and levies on the

simple logic that there were many state functions and development function carried out such as constuction of roads,maintenance of religious places running of state administration and recruiting soldiers.Thereafter in the middle ages borrowing was a rare event and it was under taken by the rulers for financing war.such borrowing was not approved by the society.It was considered ‘dead –weight’ debt.

Consequently in the past public finance was taken as a dull unimaginative extremely limited and almost irrelevant discipline but today it is considered as ‘one of the most exciting areas in political economy’.(jame buchana,237)

A public sector debt is the attempt to solve the optimal inter sector resource allocation issue by means of a debt oriented analogy.Government debt whether large or small nonexistent has no direct implication on the proper size of the private sector.

Government borrowing are classified into two types purely internal debt exists within a nation.The internal debt refers to situation where by the borrowing unit acquires the money from itself.External debt is a condition where by the borrowing unit acquires money from some lending unit .The borrowing unit may be a unit of government ,a business or a consumer size of political jurisdiction.Essentially determines the internal borrowing limit of government debt.Internal debt to amount raised from Treasury bills,Development bond,National saving bond,International Monetary Fund(IMF),promissory Notes,Treasury bills is the short term securities.

Nepal remained almost a debt free country till 1961/62.The accumulation of debt began since 1962/63,91 days Treasury bills of RS.7 million were issued for the first time during june/july1962.The government floated 6% interest bearing Development bond of RS.13.1million with a maturity period of 5 years for the first time on Feb.12.1964.In 1965, 3% compensation bonds with a maturity period of 10

years were issued for the acquisition of Birta land and 1% compensation bonds with a maturity of 20 years issued for the acquisition of private forests. Non interest bearing prize bonds amounting RS.861 thousand was also issued to individuals in 1969.(NRB ,bulletin)

B.P.shrestha has focused on the importance of government financing for under developed countries according to him The importance of government finance in under developed countries like, Nepal may be appreciated in terms of the strategic role which the government of such countries have to play in initial stages of development. In the first place it has always been the task of government to create some minimum preconditions of development such as building up of social and economic overheads, which do not generally attract private investments for one obvious reason that such investment works usually require huge resources but do not promise immediate returns. Even if private individuals are interested in such investment works, divergence between private and social gains from the overhead facilities justifies their ownership and management by the government itself in the interests of community at large.(B.P.shrestha,210)

### **2.2.2 Review of Previous Thesis**

**Virju Prasad Sharma (1998)** in his dissertation paper titled 'Public Debt in Nepal' in 1998 has dealt on the positive role of public borrowing for the sound economic growth and prosperity. He also suggested that the state should not disburse the debt unproductively. The rich people can get more benefit from public debt due to increasing trend in the issue of public debt. He clearly says the interest rate its development are the major benefit from the public debt. But if there increase in small saving, ownership of debt is defused and the problem of inequality in the distribution of wealth and income minimized.

**Mr. Daya Ram Sharma (2001)** in his thesis “Public Debt System and Practice in Nepal” studies the specific objectives are:

- i) To overview the system and practice of public debt in Nepal
- ii) To analyze the trend and structure of public debt in Nepal
- iii) To understand the attitude of the investors towards the government securities
- iv) To examine impacts of the public debt
- v) To suggest the measures for reform in the debt financing economy of Nepal.

The study finds that the interest of investors on government securities and their educational background is completely independent each other. Both educated and uneducated people are equally interested on government securities. The study also concluded that both poor and rich people are interested to government securities. These mean that government is efficacious to draw the attention of rich and poor, educated and uneducated people when the government sells its securities which are means of borrowing the loan internally. The study verifies the general statement that the people in urban area are more aware to the government securities.

**Mr. Ram Prasad Paudel (2002)** in his thesis “A study on government security practice in Nepal” studies the specific objectives are: (i) to analyze the trend and structure of government bond in Nepal (ii) to examine the attitude of the investors towards the government securities (iii) To overview NG bonds issue system and practices (iv) To suggest the policy and procedures to reform debt management of Nepal. He concluded that Nepalese investors are attracted towards government securities in comparison to other investment sectors. Most of the investors of Nepal are risk averter and they seek less risky investment. Different people are participating in government securities such as rich, poor, educated, uneducated etc.

**Mr. Indra Tribicram Pahari (2003)** in his study finds that Market interest rate is significantly influenced by coupon rate of national saving certificate and development bond & market interest rate is adversely influenced by rate of treasury bill, there is positive relationship between inflation rate and government borrowing, there is positive relationship between government securities market and GDP, there is positive relationship between nominal interest with inflation rate, and with risk premium. Lastly he stated that government securities are unable to create as corporate debt securities.

**Mr. Sandip Mohan Bhattarai (2003)** in his study explains that Nepalese Debt Securities market is still at under-developed stage. Government debt securities' market is slightly at maturing stage as compared with corporate debt securities' market. Lack of public awareness, limited supply of quality bonds, investors increasing attraction towards common stock and also towards the banking sector's securities, difficult process of issuing debenture, insufficiency of legal provision and the infra-structure of capital market, dominant by credit oriented transactions, feeling of non-existence of debt market, lack of large business organization and a narrow area of government securities market are the specific problems. He further explains the prospectus of debt market are as investor's attraction towards liquid assets like debt securities, desire to invest on debenture of an potential issuance, attraction towards convertible debenture, declining interest rate on deposit of commercial banks, increasing trend of amount of government securities and the increasing trend of issuance of corporate debenture.

**Mr. Narayan Prasad Panthi (2004)** in his study suggested that to reduce the dedicatory budget the government should have a control on inflation, finance development expenditure and mobilize the internal resources in productive sector, public debt plays very significant role. There was also substantial increase in the

internal debt over the years, which led to increase heavy dependency on internal loan. The total debt and debt serving obligation are increasing rapidly in each years but debt servicing capacity and revenue is not increasing in the required rate.

**Mr. Debendra Rana (2005)** in his thesis “A study on government securities and its secondary market” studies the specific objectives are: (i) to determine the nature and size of government securities over the study period (ii) to analyze the ownership pattern of government securities (iii) to examine the interest rate of government securities (iv) to overview the trading system of secondary market of government securities (v) to find out problem of secondary market for government securities. In his study, he concluded that the market of government securities are in increasing trend but secondary market is not developed smoothly as primary market and major portion of G.B. are held by individual in recent year. Trend amount of marketable securities (i.e. special bonds) are decreasing. Similarly market interest rate is decreasing while the coupon rate of government securities are not decreasing as decreased of market interest rate.

Rajendra pandit(1998) in his thesises ‘A study on ownership pattern of government securities and effectiveness of open market’has concluded the efficient functioning of securities market the time has come to study whether the government securities and NRB’s bond have to be listed in the stock exchange centre as are done by other institutions but prior to this it is important to study in detail to final out the better solution besides government has to link seriously to introduced more additional securities to tap the market behaviour and to lessen the burden to central bank because if a central bank has to hold a large amount of government securities.It has to issue from stock or print out new money which bears a multiplier effect in the money supply.This is why the central bank holding of government securities has been handed over to the commercial bank to minimize the multiplier effect in other

developing countries like Nepal. Last but not least it is the government who should have a commitment to reduce the budgetary deficit and helps the banking sector to loan. The overall economic policies are interrelated and should move in a coordinated approach to achieve the targeted goal. Therefore open market operation could not be imagined to develop in isolation.

### **2.3 Research Gap**

The review of above relevant literature has contributed to enhance the fundamental understanding and knowledge, which is required to make study meaningful and purposive. There have been lots of articles published related to internal borrowing of government. Most of the researches focused only on trend analysis and remaining others conducted only on secondary market of government securities but it has been found that no such research has been made in the practices & ownership pattern of government securities and its term structure of interest rate. Without analyzing ownership pattern and term structure of interest rate, trend analysis and analysis of secondary market can't provide the real practices of government securities. So this study had attempted to fill this research gap by analyzing practices & ownership pattern of different types of government securities and their trend analysis.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

The main purpose of this chapter is to focus on different research methods which are used while conducting this study. Every study needs a systematic methodology to show the better result of the research. The government securities of Nepal has been analyzed based on the secondary data published by the Nepal Rastra Bank, Research Department ,the Ministry of Finance, Books, journals, previous thesis and website etc. The study specially has focused the term structure and ownership pattern of government securities in Nepal.

#### **3.1 Research Design**

This study based on secondary data and descriptive, analytical as well as quantitative approaches are deployed to examine the issues. The study is an examination and evaluation of the deficit budgetary policies as incorporated in the budget documents. The government has been borrowing huge money to recover deficit budgetary system of Nepal. Therefore, the study is also related with the various budget speeches. The data, information and policies extracted from the budget documents and economic bulletin from NRB have been presented in meaningful order.

#### **3.2 Source & Method of Data Collection**

This study is based on secondary data. Secondary data are used to examine the trend, ownership pattern and determine the interest rate of government securities. So the main sources of this study are secondary data which are collected from different sources as follows:

- Nepal Rastra Bank (Various issued of Quarterly Economic Bulletin)
- Government Finance Statistics and other publications
- Various issued of Economic Surveys of NRB
- Different year's Budget Speeches
- National Planning Commission (Various issued of plans)
- Central Bureau of Statistics (Various issues of Statistical Yearbook, Statistical pocket book and other publications)
- Center for Economic Development and Administration (CEDA)
- Other government and non government publication, journals, previous research studies, dissertations, websites and articles

### **3.3 Presentation and Analysis of Data**

The secondary sources of data are first coded, tabulated and presented in a meaningful manner. For the sake of effectiveness, the data collected from various sources have been presented in the form of table and chart as per the need of the study. The result obtained from the analysis has been clearly interpreted so as to depict the exact findings of the study.

### **3.4 Method of Analysis**

Statistical tools are the key for the analysis of numerical data in most of the researches in the study, only analytical tool has been used i.e. statistical tool.

#### **❖ Mean**

Mean is the simple arithmetic average .It is relatively easy to calculate and is widely used in statistical research. it is the sum of all

observation divided by the total number of observation. It is denoted by  $\bar{X}$ , for variable X.

$$\bar{X} = \frac{\text{Sum of all observations}}{\text{Total number of observation}}$$

### ➤ **Standard Deviation**

Standard deviation is the most widely used measure of dispersion. It is an improvement over the mean deviation is free from the defects of other measure of dispersion. It is a statistical measure of the variability of the observations. The symbol is  $\sigma$ , pronounced 'sigma'. The standard deviation is quantitative measure of an asset's total risk. Higher the standard deviation higher the total risks.

$$\text{Standard deviation } (\sigma) = \sqrt{\frac{\sum x^2}{n}}$$

Where,  $x = X - \bar{X}$

n= Number of periods

### ➤ **Coefficient of Variation(CV)**

The standard deviation divided by expected return which is called coefficient of variation .It measure a risk and shows the risk per unit of return and provides a meaningful basis for comparison when the expected return on two alternatives are not the same because the coefficient of variation captures the effects of both risk and return, it is a better measure for evaluating risk in situations where investment

differ with respect to both their amounts of total risk and their expected return. A project with a low CV has less risk per rupee than a project with a high CV.

$$\text{Coefficient of variation} = \frac{\text{Standard deviation}}{\text{Expected return}}$$

- Some relevant statistical, accounting, mathematical and financial tools as per requirement have been applied in analysis and interpretation. Presentations have been made in the form of tables, graphs, charts and figures etc.

## **CHAPTER FOUR**

### **PRESENTATION AND ANALYSIS OF DATA**

The main aim of this chapter is presenting and analyzing data according to research methodology to attain the objectives of this study. In this chapter, presentation and analysis are shown as: Analysis of secondary data .

#### **4.1 Presentation and Analysis of Secondary Data**

##### **4.1.1 Ownership Pattern of Government Securities**

The ownership pattern of bond & treasury bills deals with the proportion of total government bonds and treasury bills purchase by different financial institutions and individuals. In Nepal, the main owner of the permanent markets of government securities is the banks and financial institutions. A substantial amount of government securities are held by them. At the initial age of government borrowing, a large amount of debt was provided by Nepal Rastra Bank. It means to say that the main holder of the government securities is NRB. Now the situation has been improved many organizations including individuals have been attracted towards government securities.

### 4.1.1.1 Ownership Pattern of Treasury Bills.

**Table No. 4.1**

**Ownership Pattern of Treasury Bills (Rs. in Millions)**

Year	NRB		Commercial Banks		Financial Institution		Others		Total
	Amount	%	Amount	%	Amount	%	Amount	%	
<b>2002</b>	15,263.90	37.1	23,029.90	56	0.00	0.00	2,812.80	6.84	<b>41,106.60</b>
<b>2003</b>	16,550.50	35.3	27,835.20	59.4	0.00	0.00	2,459.20	5.25	<b>46,844.90</b>
<b>2004</b>	9,804.40	19.8	36,154.30	73.1	0.00	0.00	3,470.90	7.02	<b>49,429.60</b>
<b>2005</b>	10,923.80	21.3	39,501.60	76.9	0.00	0.00	957.70	1.86	<b>51,383.10</b>
<b>2006</b>	9,209.30	14.6	51,645.80	82	0.00	0.00	2,115.20	3.36	<b>62,970.30</b>
<b>2007</b>	13,768.80	18.5	58,611.50	78.7	0.00	0.00	2,065.00	2.77	<b>74,445.30</b>
<b>2008</b>	17,579.00	20.7	64,966.30	76.4	0.00	0.00	2,487.70	2.93	<b>85,033.00</b>
<b>2009</b>	22,548.60	26.1	61,054.80	70.6	0.00	0.00	2,911.70	3.37	<b>86,515.00</b>
<b>2010</b>	26,400.58	32.1	51,980.80	66.4	1294	1.57	2,698.50	3.28	<b>82,373.88</b>
<b>2011</b>	27,678.59	28.2	66,091.60	67.3	2753.1	2.8	1,745.00	1.78	<b>98,268.29</b>
<b>2012</b>	25,072.93	19.1	102,188.20	77.6	4,320.48	3.28	42.5	0.03	<b>131,624.11</b>

*Source: NRB, Quarterly Economic Bulletin, 2012.*

In the above table, ownership pattern of treasury bills are presented in Rupees and proportion of treasury bills in percentage. In average around 55% ownership of treasury bills is held by commercial bank over 11yrs In the year 2006, the proportion of commercial banks is 82%. Among the total treasury bills, share of commercial banks is higher than NRB and others. It shows that Marketability of Commercial banks is also higher than others. In the year 2002 and 2003 the portion of treasury bills purchased by commercial banks decrease to 56.02 and 59.42 but there after its portion is more than 70%. This table clearly reflects that the major portion of treasury bills is purchased by commercial banks and they purchase those treasury bills to get benefit from the short term public deposits. Development Bank and Finance company (Financial Institution) have started purchase Treasury Bills in year 2010 .In this year portion of Financial Institution is RS. 1294.00(in million),1.57% thereafter increasing pattern of 2011and 2012 then 2010.

Concludes in this table is now a day's ownership pattern of government securities is goes NRB to Commercial Banks and other sectors.

#### **4.1.1.2 Ownership Pattern of Government Bonds**

##### **Table No. 4.2**

**Table No. 4.2**  
**Ownership pattern of Government Bonds (Rs in Millions)**

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	S.D.	Mean	C.V
Nepal Rastra Bank	10240.30	10275.30	9334.30	6533.60	1839.90	1860.80	1338.90	1534.20	294.41	349.24	4234.09	4360.95	0.97
	31.37%	29.84%	24.94%	18.02%	6.59%	7.0%	4.94%	4.54%	7.21%	5.90%			
Commercial Bank	6331.40	8048.20	7642	9049.10	7215.60	7224.90	7174.30	10894.3	1488.63	1947.98	2914.67	6701.64	0.44
	19.40%	23.37%	20.42%	24.96%	25.83%	27.18%	26.46%	31.7%	36.47%	33%			
Govt. Business Enterprise	725.90	705.90	380.80	300.30	230	0.00	0.00	0.00	0.00	0.00	291.43	234.29	1.24
	2.22%	2.05%	1.02%	0.83%	0.82%	0.00%	0.00%	0.00%	0.00%	0.00%			
Financial Institutions	2012.80	2324.40	4115.40	4565.70	4339.30	4636.50	6608.10	7842.40	1086.62	1416.3	2216.83	3894.75	0.57
	6.17%	6.75%	11%	12.59	15.54%	17.44%	24.37%	23.23%	26.6%	24%			
Pvt. Business Enterprises	353.20	319.40	444.10	358.40	418.50	342.50	0.00	0.00	0.00	0.00	195.75	223.61	0.88
	1.08%	0.935%	1.19%	0.99%	1.50%	1.29%	0.00%	0.00%	0.00%	0.00%			
Non-Profit Orgs.	1262.60	1213	1198.40	487.10	1153.30	1735.90	2189.80	2602.80	254.96	262.16	1391.78	2328	0.6
	3.87%	3.52%	3.20%	1.34%	4.13%	6.53%	8.08%	7.71%	6.25%	4.4%			
Provident Funds	2743.90	2481.30	3386.50	4035.80	3075.80	4056.40	4965.40	6365.20	653.91	653.91	5610.73	3307.20	1.7
	8.41%	7.21%	9.05%	11.13%	11.01%	15.26%	18.32%	18.85%	16%	11%			
Individuals	6865.40	6749.60	7768.40	8320.40	6173.80	3153.60	1228.60	703.10	52.68	117.42	3394.95	4113.30	0.83
	21.03%	19.60%	20.76%	22.95%	22.10%	11.86%	4.53%	2.08%	1.3%	2%			
Others	2106.80	2314.20	3166.30	2602.10	3483.70	3571.40	3605.80	3823.20	250.39	1151.76	1177.78	2606.57	0.45
	6.45%	6.72%	8.43%	7.18%	12.47%	13.44%	13.30%	11.32%	6.13%	19.5%			
Total Gov. Bonds	32642.30	34431.30	37426.20	36252.50	27929.90	26582	27110.90	33765.20	4081.60	5898.77	12005.5	26612.0	0.45

*Source: NRB, Quarterly Economic Bulletin, 2012*

Ownership pattern of government bonds are presented in Rupees (i.e. in million) as well as proportion in percentage. Investors are classified into nine categories. From the table, we can analysis that first 3 years i.e. 2002, 2003 & 2004 the proportion of ownership is more than 20% with Nepal Rastra Bank. But later, the ratio of ownership with NRB is continuously in decreasing. In the year 2002, the ownership of government bonds with NRB is 31.37% (in Rs. 10240.30 million) but in the year 2011 it is 5.9% (in amount Rs.3492.4 million). This means the marketability of government bonds is being broad now a day. Except NRB others institutions and individuals are purchasing governments bonds in large scale.

The portion of commercial banks to purchase the government bonds is in large scale except NRB. Ownership portion of commercial banks is in increasing trend. In the year 2002, the portion of commercial banks is Rs.6331.40million (i.e. 19.40% of total issued) and in the year 2009, it is Rs.10894.30 million (32.26%).In the year 2010 and 2011 portion of commercial bank isRS. 14886.3million(36.47%) and RS.19479.8million (33%of total issued) .It shows that interest of commercial banks to invest in government bonds is too high. Like this financial institutions & Provident fund investment in government bonds is also in increasing trend. But private business organizations & government business enterprise not contribution to purchase government bonds in year 2007 to 2011 . In the year 2004 the portion of private business organizations is Rs.444.10 million i.e. 1.19% of total issued which is reached to Rs.319.40 million i.e. 0.93% of total issue and in 2005years 2008 and 2011 there is no any investment on government from private business enterprises side.

Government business enterprises has no contribution in the last year 2011 which portion is zero i.e. 0%. But the trend of purchasing government bonds by individuals is fruitful. In average more than 15% of total government bonds are purchasing by individuals but its trend is decreasing . Purchasing of governments bond is also 2% i.e.RS.117.42million in 2011. Recent years, others purchasing of government bond is trend of increasing 2011is RS.1151.76 (19.5%).

From the above table shows the highest CV 1.7 hold by provident fund and lowest CV hold by commercial bank .i.e.0.44.Where as average mean of study period is 26612.7 million.

#### **4.1.2 Pattern and Amount of Government Securities Issued in Nepal**

The government of Nepal has been issuing five types of securities as short term

and long term securities. Therefore, the government issued various bonds to recover the deficit budget of Nepal. Every year, the government has adopted a deficit budgetary system in the name of development function. They are Treasury Bills, Development Bonds, National Saving Bonds, Public Saving Card, Special bonds and Overdraft. They are debt-borrowing instruments in Nepal. Types and amount of government securities under the review period 2002 to 2012 in tabulated in the given table below:

#### 4.1.2.1 Pattern of Short term government securities issued in Nepal

**Table No 4.3**

**Pattern of Short term government securities issued in Nepal (Rs in Millions)**

<b>Treasury Bills</b>			
<b>FY</b>	<b>Amount</b>	<b>Percentage</b>	<b>Growth Rate</b>
2002	41107	5.08	
2003	46845	5.78	13.96
2004	49430	6.1	5.52
2005	51383	6.34	3.95
2006	62970	7.8	22.55
2007	74445	9.2	18.22
2008	85033	10.5	14.22
2009	86515	10.7	1.74
2010	82374	10.17	(4.79)
2011	98268	12.13	19.29
2012	131624	16.25	33.94
Total	809994	100	

Source: NRB Quarterly Economic Bulletin 2012

Government issues Treasury Bills to collect the scattered fund for short period. From the above table, we can analyze the trend of T-Bills during the past 11 yrs. In this period, growth rate is in increasing and decreasing trend. In the year 2004, the growth rate is decreasing 5.52% as comparative to previous year 2003 which is 13.96%. The maximum growth rate is 33.94% in year 2012; it has been increasing trend till now. In the year 2004, 2005 & 2009, growth rate of T-Bills shows comparatively less than other remaining years and year 2010 growth rate is negative growth rate i.e. (4.79).

Average growth rate = 11.69%

Standard Deviation = 35476.60

Coefficient Variation (C.V) = 0.482

Mean = 73635.82

By the observation of growth rate, the average growth rate is 11.69% where as highest growth in year 2012 and deficit rate in year 2010. There is low risk for investors because coefficient variation is less than one.

#### **4.1.2.2 Pattern of Long Term Government Securities Issued in Nepal**

##### **Table no 4.4**

**Pattern of Long Term Government Securities Issued in Nepal (Rs In Millions)**

**Table No. 4.4****Pattern of Long Term Government Securities Issued in Nepal (Rs. in Millions)**

FY	Development Bond			National Saving Bond			Citizen Saving Bond			Special Saving Bond		
	Amount	Percentage	Growth	Amount	Percentage	Growth	Amount	Percentage	Growth	Amount	Percentage	Growth
2002	11,091	4.03		11,536	17.97		628	2.17		9,259	21.4	
2003	13,091	4.8	18.03	10,660	16.6	-7.6	931	3.21	48.24	9,622	22.22	3.91
2004	17,549	6.38	34.06	9,030	14.06	-15.29	1,179	4.1	26.61	8,946	20.7	-7.02
2005	19,999	7.27	13.96	6,577	10.24	-27.17	1,429	5	21.21	8,176	18.9	-8.61
2006	17,959	6.53	-10.2	3,877	6.4	-41.05	1,679	5.8	17.5	3,470	8	-57.56
2007	17,177	6.24	-4.35	1,517	2.36	-60.87	1,391	4.8	-17.15	2,774	6.4	-20.07
2008	21,735	7.9	26.54	1,117	1.74	-26.37	3,014	10.41	116.7	339	0.78	-87.76
2009	29,479	10.72	35.62	217	0.34	-80.58	4,434	15.31	47.08	230	0.53	-32.35
2010	30,979	11.26	5.1	-		-100	5,034	17.4	13.53	172	0.4	-25
2011	38,519	14	24.34	4,000	6.23	-	5,123	17.7	1.77	162	0.37	-5.84
2012	57,519	20.91	49.33	15,680	24.42	292	4,123	14.23	-19.52	158	0.36	-2.82
<b>Total</b>	<b>275,097</b>	<b>100</b>	<b>278.44</b>	<b>64,210</b>	<b>100</b>	<b>-66.93</b>	<b>28,965</b>	<b>100</b>	<b>256</b>	<b>43,308</b>	<b>100</b>	<b>-243.12</b>

Source: Quarterly Economic Bulletin, Nepal Rastra Bank

### **Pattern Analysis of Development Bonds:**

Over the period of 11 yrs., the value of development bond has been increasing. Above table shows that growth rate of years 2002 is RS.11090.7 millions. Then, the amount of development bond issued has been increasing and reaches to Rs.13090.7, Rs.17549.2 & Rs.19999.2 million in the year 2003 to 2005 respectively. After the period of 2005, amount of development bond has been decreasing 2006 and in the year 2007. Then after the remaining year growth rate is increasing trend. The maximum increased in growth rate by 49.33% in 2012 as compared with all years.

### **Pattern Analysis of National Saving Bonds:**

From the table, it shows that beginning of 9 yrs value of National Saving bonds is decreasing trend. In growth rate, we can see fluctuating trend. Last nine years, trend of growth rate in National Saving Bonds is decreasing because it is somewhat issuing of public saving cards. year 2010 maximum negative growth rate of 100% is seen. It is also clearly seen in the above National Saving Bond's trend line. But after the year 2011, it is maximum increase the growth rate 292%(RS.15680 million)in year 2012.

### **Pattern Analysis of Citizen Saving Card:**

The government initiated it from the second quarter of 2002. The main investors of its, is individual. The initiation of Citizen saving card has initiated the new step in the growth of government bond which is also helped to grow the ownership proportion of individual in total issued government bond. From the year 2003 to 2006, amount of Public Saving card is in increasing trend where as the last year in 2007 growth rate if Citizen Saving Card is in negative. In the Citizen Saving Card trend line graph, we can show that it is in increasing trend except than year 2007.

### **Pattern Analysis of Special Bonds**

The year 2003, special bonds is in higher trend. Then there after decreased till now. Last two year growth rate is decreased by 5.84% and 2.82%. It shows that being the non marketable securities is the cause of declining trend of special bonds.

#### 4.1.2.3 Pattern of total internal Debt Issued in Nepal

**Table no. 4.5**

**Pattern of total internal Debt Issued in Nepal (Rs Millions)**

FY	Short Term Debt		Long Term Debt		Total Internal Debt	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
2002	41107	55.84	32514	44.16	73621	100
2003	46845	57.73	34304	42.27	81149	100
2004	49430	57.39	36704	42.61	86134	100
2005	51338	58.68	36181	41.32	87564	100
2006	62970	70	26985	30	89955	100
2007	74445	76.51	22859	23.49	97304	100
2008	85033	76.44	26205	23.56	111238	100
2009	86515	71.57	34360	28.43	120875	100
2010	82374	69.48	36185	30.52	118559	100
2011	98268	67.27	47804	32.73	146072	100
2012	131624	62.95	77480	37.05	209104	100

*Source: Economic Report, Nepal Rastra Bank.*

In the above table, shows the structure of total internal debt, it consist the total amount of short term debt and total amount of long term debt . Increasing trend of

total debt and short term debt but long term debt trend of decreasing. In year 2002 short term debt is Rs 41107 millions, 55.84% of total debt. Maximum highest amount of issue of short term debt is Rs131624 million in year 2012, but highest percentage of 76.51% in year 2007. Here long term debt portion of percentage is decreasing trend and amount is increasing because now a day's issued of total debt amount is high.

#### **4.1.3 Analysis of Term Structure of Interest Rate and Yield**

The structure of yields that is observed for bonds with different terms to maturity is called the term structure of interest rates. This study analyzed yield of treasury bills, Development Bonds, National Saving Certificates and two years and above time deposit interest rate of the commercial banks. All of this interest rate is taken as the midpoint of the range given by Nepal Rastra Bank Quarterly Economic Bulletin.

**Table No. 4.6****Term Structure of Interest Rate and Yield (In Percentage)**

<b>Year</b>	<b>Time Deposit</b>	<b>Annualized T.B. Rate (91 days)</b>	<b>NSCr</b>	<b>DBs</b>
2001/02	8.75	2.33	10.87	7.5
2002/03	7.12	4.66	10.87	6.75
2003/04	6.37	4.96	10.57	6.75
2004/05	5.66	4.71	10.63	5.5
2005/06	5.37	3.48	10	5.5
2006/07	5.37	2.98	10	5.5
2007/08	4.50	1.47	9.75	5.5
2008/09	4.28	3.94	9.75	5.5
2009/10	4.45	3.25	9.75	4.88
2010/11	4.00	2.77	9.75	4.88

*Source: Quarterly Economic Bulletin, NRB, 2012*

In the above table shows that the market interest rate (time deposit rate) represents 8.75% in 2001/02 and 4.00 percentages in 2010/11. It means market interest is in decreasing trend. Likewise, initial year of study, rate of National Saving Cards is 10.87% and 9.75% in the year 2001/02 and 2010/11. Rate of Development bonds is 7.50 and 4.88 in the year 2001/02 and 2010/11 respectively. Trend of National Saving Card's return is not more fluctuate. But Development Bonds return is continuously in decreasing rate. The difference between market interest rate and return of National Saving Cards and Development Bonds was 2.12% and 1.25% respectively at the beginning of the fiscal year 2001/02. However, at the end of year (2010/11) these differences were 5.75% and 0.88%. This study shows that government securities coupon rates are unable to match with market interest rate. If

this interest determinant system is not change such misfortune may recur in the future also. Nevertheless government debt securities in its present form are definitely more attractive than corporate debt securities both in term of default and price risk. Such situations discourage the issuance of securities from corporate sectors.

## **4.2 Major Findings**

### **Findings from Ownership Pattern of Government Securities**

- Analysis of 11 years period of treasury bills from 2002 to 2012, it is found that the major holder of T-bills is commercial banks which are 72 % in average.
- The proportion of ownership of treasury bills by NRB is in fluctuating trend; this may be the reason of increment in number of commercial banks and other financial institutions.
- Ownership of others in purchasing the Treasury bills is still nominal. In the year 2002 to 2009 portion of treasury bills by others is 4.16% in average but last years its average is only 1.7%.
- After the analysis of ownership pattern of governments bond, it is found that the major holder of government bonds in first 3 years i.e. 2002, 2003 & 2004 is Nepal Rastra Bank (more than 30%). But thereafter the proportion of NRB is continuously in decreasing trend. It may be the reason of issuing public saving cards and individuals are the main investors of Citizen saving card. Similarly increment of commercial banks, financial institutions and others institutions may also the reason of decreasing NRB's ownership in Government bonds.

### **Findings from the Trend Analysis of Government Securities**

- History of government securities is started with the issuance of treasury bills in 1961. Since than volume and kind securities have been growing over the period.

But now a days government issues five type of securities these are treasury bills, development bonds, national saving certificates, Citizen saving cards and special bonds.

- The trend of Treasury bills as a whole is seems to be fluctuating trend. Its trend in previous year was slightly decreased. In the year between 2006-2008, it increased rapidly but after 2003 its growth is in decreasing trend.
- The trend of developing bonds was in decreasing trend in beginning period of this study, increased in the beging period. Again after year 2006, is in decreasing trend. To collect the long term fund, developing bonds are the main tools of government securities.
- The government of Nepal has started to collect fund thorough Citizen saving cards from the year 2002. It helps to grow the ownership proportion of individual in total issued of government bond. First four years, the trend of Citizen saving cards is increasing but at last year 2012, it is decreased by 19.52%.
- The trend of special bonds were decreased trend in previous year . But recent years; trend of declining is too high. Being non marketable securities may be the reason of declining of its trend.
- As a whole, by observing the trend of government securities, the amount government securities are increased every year. By using curvilinear model, the forecasted amount in the coming years also show the increasing trend of amount which is the positive sign of development of securities market as well as financial market.

## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Summary

Securities which are issued by the government assures to pay a certain percentage of interest with principal at a certain period are government securities. Government issues different types of securities to collect reserve fund from financial institutions, non-financial institutions, industries and individual etc. under the NRB act 2058 and public debt act 2058 through NRB and its market maker. Government issues two types of securities. As a short-term securities; T-Bills are issued and as the long term securities; developing bond, national saving certificates, public saving card & special bond are issued. The history of government securities is started after issuing of T-Bill in 1961 under the public debt act 1960.

The Domestic resources are not sufficient to promote the rapid development of the Nepalese economy. For this, the internal debt has played a significant role in the financial resources for development expenditures as well as in the growth of capital market. In contrast to this beneficial measure the obvious practice of borrowing even to conduct the general administration is being build up gradually. The government has been borrowing overdraw from NRB as well. The government must pay the amount of overdraft with its interest within the stipulated period. This way it is also considered as a kind of internal debt.

This research mainly aims to study on ownership pattern of government securities in Nepal. Its specific objectives are (i) To analyze ownership pattern of

government securities in Nepal. (ii) To analyze the structure of government securities in different period. (iii) To examine the interest rate of government securities. (iv) To examine the attitude of the different respondents towards the government securities. (iv) To analyze the views & opinion on the policy and procedures to reform debt management of Nepal. The study is based on secondary as well as primary sources of information. The study on ownership pattern of government securities is accomplished on Treasury Bills and Bond separately by using secondary data for the period of 2002 to 2012. Similarly, trend of issuing government securities are analyzed on the bases of secondary data for the period of 2002 to 2012. The study also analyzed the interest rate and yield of government securities on the basis of last 10 years data.

The debt raised by Government has been in increasing trend in last few years. Government issues various types of securities both internally and externally to fulfill the deficit budget. Many economists suggest that borrowing from internally is better than externally. The internal investors of the government are the people of the country. Amount of large public debt may create problems in the economy of the country in future.

## **5.2 Conclusions**

From the above findings, this study concludes that Nepalese investors are attracted to government securities in comparison to other investment sectors. Most of investors in Nepal are risk averter and they search less risky investment. Residence and awareness of investors are affecting to participate in government securities. To access the countryside people on government securities, the government should conduct the awareness programs in rural areas and have to be used collected finance in productive sectors.

Likewise another conclusion is that the market interest rate is decreasing while the coupon rate of government securities are not decreasing as decreased of market interest rate. Trend amount of marketable securities are in growing trend while non marketable securities i.e. special bonds are decreasing.

One of the reasons of borrowing the loan internally is also to make the people participate in development programs launched by the nation. The study clears that rich, poor, educated and uneducated investors are equally interested to government securities and who have not the sufficient time and are unskilled to run the private enterprise competitively are more interested to government security.

### **5.3 Recommendations**

For the further improvement and development of government securities, following recommendations are proposed.

- **Develop a well functioning financing strategy:**

A well-defined strategy for issuing domestic debt needs to be developed to provide a stable and sustainable source of domestic financing of Government requirements and minimize interest costs and risks associated with public domestic debt. The strategy should also support the development of a well functioning market for Government securities.

- **Minimize the unproductive expenditure**

The government should attempt to reduce the unproductive expenditure which helps to control immensely increment of budgetary expenses. It presses on mobilizing internal revenue in order to reduce dependency on loans for financing development expenditure.

-**Encouragement of financial institution, business enterprises and individuals**

The major ownership of treasury bills is held by commercial banks. So government should encourage financial institution, business enterprises and individual investors to invest on Treasury bills. Government should introduce zero coupon bonds as alternative of T-bills.

- **Conduct awareness program in rural area:**

Government should try to inform about the government securities in rural area and the subject about the government securities so that people of rural area or other academic background will be equally aware to the government securities.

- **Help to NRB to tackle the fiscal and monetary problem:**

The government should help to NRB to tackle the fiscal and monetary problem in the nation rather than unnecessarily interfere on it.

- **Well direction to commercial banks:**

NRB should strongly direct all the commercial banks that they must pay the interest of government bond of their respective customers timely and thereby claim the amount with NRB.

-**Specified particular locality to use special bonds:**

It is essential that some special bonds might be issued for development work for a particular locality to attract people towards government securities. When such development work as bridge, road, communication and irrigation etc would be built with the funds from the special bonds at a place, people of other locality might be encouraged to purchase such bonds.

- **Management of securities issue of time:**

The amount and date of issue of government securities has to be published at the beginning of the fiscal year. Such arrangement helps investors to manage their investment portfolio appropriately.

- **Utilization of borrowing on productive programmes:**

Government should finance the public borrowing on productive programmes, which can provide the return most efficiently at short. If this can be done the national revenue will increase faster and inevitably that debt-servicing ability will also increase in the same pace.

- **Initiation of policies to attract non banking sector:**

Excessive dependency upon foreign assistance for development expenditure is due to poor mobilization of internal resources both revenue and borrowing. Government should initiate policies to attract maximum borrowing from non banking sector. It is most non-inflationary source of internal borrowing since it is simple transfer of idle saving from people to the government for development purpose.

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