GOVERNMENT SECURITIES AND INVESTMENT PRACTICES IN NEPAL

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RECOMMENDATION

This is to certify that the Thesis

Submitted by:

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GOVERNMENT SECURITIES AND INVESTMENT PRACTICES IN NEPAL

has been prepared as approved by this Department in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

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Article I.

Article II.

Article III.

Article IV.

Article V.

VIVA-VOCE SHEET

We have conducted the viva –voce of the thesis presented

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And found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for

Master Degree of Business Studies (M.B.S.)

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DECLARATION

I hereby declare that the work reported in this thesis entitled "**GOVERNMENT SECURITIES AND INVESTMENT PRACTICES IN NEPAL**" submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Master's Degree in Business Study (M.B.S.) under the supervision of **Meera Gautam** and **Rita Maskey** of Shanker Dev Campus.

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This research study “Government Securities and Investment Practicies in Nepal” is a partial fulfillment for the degree of Masters of Business studies (MBS) under the course designed by the Faculty of Management, T.U, is based on the prescribed research format involving the use of qualitative and quantitative model to explain the Government securities prevailed in the Nepalese Capital Market and their determining factors. Since, there was lack of such study relating to Government securities, it is hoped that this study will add one brick on the wall and will be beneficial for other researchers, students, teachers and other parties involved.

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Raj Kumar K.C.

Researcher

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ABBREVIATIONS

FM	=	Financial Minister
FY	=	Fiscal Year
GB	=	Government Bond
GDP	=	Gross Domestic Product
GON	=	Government of Nepal
IMF	=	International Monetary Fund
LDC	=	Least Developed Country
MOF	=	Ministry Of Finance
NC	=	Nepali Currency
NEPSE	=	Nepal Stock Exchange
NG	=	Nepal Government
NRB	=	Nepal Rastra Bank
PM	=	Prime Minister
REPO	=	Repurchase Agreement
T E	=	Total Earning
T R	=	Total Revenue
TB	=	Treasury Bill
US	=	United State
USA	=	United State of America

CHAPTER - I

INTRODUCTION

1.1 Background of the Study

Domestic debt is one of the components of public debt which consists of both domestic debt and external debt. We have the different definitions of domestic debt like “it is the debt denominated in local currency” or “it is the money borrowed by the government in local currency” etc. by these definitions, we can say that the domestic debt is the money borrowed by the government (the government may be of any form like state government, central government or it may be federal government) and that the borrowed money will be in local currencies. In domestic borrowing the debtor will be the individuals or the institutions. In public borrowing, the government provides some guarantee to the lenders by issuing the security papers in the form of certificates. It may be a bond certificates or a bill certificates.

For development activities, government has to invest huge amount of money as private sector is not well developed. In developing countries like Nepal, government has to engage itself for socio-economic infrastructure development like health, education, drinking water, transport, irrigation, communication and power, which need huge initial investment. Here, the government should also involve in other directly productive economic activities like establishing factories and running them. With the increasing role of government expenditure started to increase which were not possible to meet only through revenue collection. Increment of tax rate is also not possible in the context of Nepal. When the government expenditure exceeds revenue, most of the LDCs depend upon foreign aid, foreign loan and domestic borrowing.

The deficiency of capital in underdeveloped countries is a serious bottleneck for the development. The breaking of vicious circle of poverty created by capital deficiency and the requirement of heavy doze of development expenditure in developing countries can be meet by public borrowing. As Rostow has emphasized “underdeveloped countries are facing the deficiency of capital in relation to their population and natural resources. Most of the developing countries are characterized by deficiency of capital. To break the large amount of initial investment is necessary. Thus the underdeveloped countries should emphasize stimulate and accelerate capital formation” (Rostow, 1952:3).

The revenues of the most of countries have seldom covered expenses and the differences have been financed primarily by issuing debt instruments. Moreover, new debt must also be issued in order to get the necessary funds to pay off old debt that goes due.

Public debt is considered as subjugated issue of the government in terms of raising and disbursing the funds from borrowing both internally and externally. Within the ceiling of proclamation of relevant act, ordinance and budget, government can raise up to the limit either at once or at installments as per the necessity. The government receives the recommendations from Nepal Rastra Bank about the volume of debt, debt instrument, interest rate, maturity of debt, marketability of debt instrument etc. so as to bring the mutual co-ordination between fiscal and monetary policy. It is quite crucial for Nepal government and NRB because public debt simultaneously impacts fiscal and monetary policy in different manner at time but at same manner more frequently.

Similarly, the government announces its policy and programs annually through the budget. In the budget, the government also announces the projects to be implemented and the required expenditure for the implementation and completion of such projects. Since the targeted projects should be complete during the prescribed period by mobilizing required resources, the government fulfils its expenditure need through public borrowing.

Being an economic advisor of the government, Nepal Rastra Bank provides the deliberation on both presently hold external debt and same to be raised. But in case of government internal debt it is wholly responsible to maintain debt account and records, as the bank is sanctioned the entire responsibility in relation to the management of public debt. By act it is entrusted to the bank on such terms as may be agreed upon between Nepal Government and the bank. Not only maintaining the accounts and records of investment, NRB is equally responsible to handle and promote the government security market.

Government sells various securities in the market. They are Treasury Bill, Development Bonds, National Saving Bonds, Special Bonds and Citizen Saving Bonds. They are issued to raise capital in the market. These securities are known as government securities. Government issues securities internally and externally. The main source of internal debt is government bonds. It is one of the most important issuances of the government to maintain the deficit budgetary system of Nepal. It has been issuing a lot since the first budget in Nepal. The increasing trend of deficit has been balanced by borrowing from public.

However, “Developing countries mobilize part of their resources by borrowing form internal as well as external sources to finance their development activities; these sources gradually build up the debt stock of the country. Such debt stock demands regular debt servicing, that is, principal and interest payment, which consumes scarce resources that can be used for financing development. Therefore, excessive deficits and heavy borrowing to finance that deficit drain out the resources of the developing countries. Liquidity is also involved while borrowing and servicing. Thus, both of these transactions are conducted in such a way that the country concerned always finds itself in a comfortable position with regard to liquidity.

Every government falls short of funds to carry on the development works in developing 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 profit but for the welfare of the people. Therefore, it is believed by all that the government works in the country on the behalf of the people it has high responsibility to develop the country. The increase or decrease in the economic activity level depends upon the functions of the government. If the government begins works ideally in the country, it means the future economic situation of the country is going to be good.

It is very difficult to get uniform definition of the government securities. Some economists have emphasized on all kinds of financial obligations and others have focused on all kinds of financial liabilities that must be paid to debt holders or institutions after its maturity period from whom it has been raised. Government bond is regarded as the temporary source of financing for various government functions. For instance, hospitals, schools, bridge, roads, irrigation, projects, etc. These functions are required for the economic development of the country. Government needs funds to maintain peace in the country.

However, in the past, the government used to consider only protecting people from external aggression and internal disturbances. The ruling system of country was in the protection of the people in the state before a couple of century. The main duty was to protect people from external attacks and internal disturbances. So, they were free to determine their economy by themselves. Government collected revenues through tax in order to meet expenses like war, maintenance, of law, general administration, government expenditure, deficit budget, etc. Later on the concept gradually changed and the state realized that they should take part actively in economic development.

1.2 Development of Government Debt in Nepal

Nepal does not have very long history of domestic debt. The evolution of domestic debt in Nepal dates back to the great king Prithvi Narayan shah. He raised revenue even borrowing from the public for the purpose of unifying the kingdom of Nepal. However, the required amount of fund was not available. Thereafter in 1925 Rana Prime Minister Chandrashamsher borrowed money from Pashupatinath Temple for resettling the emancipated slaves.

Nepal came to the main stream of the world economy in 1951 with the end of 104 year long autocratic Rana Rule. The first annual budget was prepared and legislated in 1952 .The first 5 years plan was prepared and implemented in 1957. With the entry of plan era, Nepal required large chunk of resource in order to invest in various sector in the economy such as infrastructure development, establishment of public owned company, providing various types of social services to the people, establishing the hospitals and schools and so on. However, the economy was in primitive stage on the development and due to the efficiency and very poor infrastructure of tax administration, the potential of the taxation was very limited. The government started to achieve the foreign aid to fulfill the development budget. With the growing expectation of the people and expanding international relationship, the role of the government had expanded year by year. The government required huge amount of resources as development financing, but mobilization of resources couldn't expand in the same pace.

Nepal's experience in public domestic debt on modern documented basis dates back to 1962. Public debt act was enacted in 1960 and under the act Nepal raised public debt for the first time in 1962 to fulfill the development budget through issuance of Treasury Bill amounting to RS 7 million. Development bond, another instrument of domestic debt, was first issued in February 12, 1964, amounting to Rs. 13.1 million with a maturity period of 5 years. National saving certificates as an instrument has been issuing since January 1984 with an objective of mobilizing savings from the general public. The amount of first issuance of national savings certificates was Rs.250 million. Citizen Saving Certificate as a new instrument of domestic debt market in Nepal was introduced in 2001. The amount of first issuance of Citizen saving certificate was Rs 628.1 million. This certificate is similar to national saving certificate in nature only the difference between them is just after the restoration of democracy of 1990, Nepal Rastra Bank as a central bank of Nepal realized that there was excess liquidity in the market. With an objective of mopping of excessive liquidity, with reference to implementing monetary policy, NRB issued its one bond called Nepal Rastra Bank bond in January 1992. However, it was not available in the bond market since April 1996.

These are the bonds and bills of regular nature. Some of them have been used as the instrument of deficit financing and others are used for implementing monetary policy. Beside these, three percent interest bearing land compensation bonds with a maturity period of 10 years amounting to Rs 0.2 million was issued in 1965 for the acquisition of Birta land and forest compensation bond with a maturity period of 20 years and one percent interest issued in 1965 for the acquisition of private forest amounting Rs 5.5 million. The government issued non interest bearing prize bonds of Rs. 861 thousand to individuals in 1969. These are the special bond and among these prize bond did not become popular in the market. The year 1988 brought a revolutionary development in domestic debt management in Nepal. Treasury Bill had been started in the market to make transaction in competitive basis from 1988. Government short term liquidity position determines the Treasury Bill to be issued at the weekly auction. The interest rate of Treasury Bill are determined by the market forces. Since July 1994 onwards secondary market window of Treasury Bill has been setup in order to make the secondary transaction a primarily issued bills and fulfilling the short term fund shortage of commercial banks. Since April 1997, REPO facilities have also been issuing. Nepal Rastra Bank manages all the domestic public debt in Nepal on behalf of Nepal government. Treasury Bill of various maturity periods (28 days, 91 days, 182 days and 364 days) are available for the transaction in the secondary market.

1.3 Statement of the Problem

Due to political instability and the worse environment for the new investment in the development sector, overall growth of economy of our country has been far from satisfactory. Besides this destruction of the existing infrastructure and about nix development of infrastructure for this sector, Nepal has been becoming nearly a field state at the end of the decade of 1990's. The five decades of planned development of Nepal has yielded some positive gains, but overall growth rate of the economy has been far from satisfactory (Pant 2006:5).

Deficit budget is the sticky and ever occurring feature of Nepalese budgetary system. It is persistently becoming the great tension since the first budget in Nepal. The major proportion of the deficit incurred in the budget has been balanced by borrowing the public debt. Public debt contains two types of debt: internal debt and external debt.

The study of the budgetary trend of past 18 years disclosed that the budget deficit is widening each year since the growth rate of the government expenditure and revenue are not growing in the same rate. By this reason, Nepal has become an aid dependent country. The reliance on external assistance is increasing. More than 50% of development expenditure is financed through foreign assistance in most of the year between 1987/88 and 2004/05. External borrowing has been the major source of financing deficit in the government budget. The external borrowing accounts about 80% of budgetary deficits in most of the years between 1987/88 and 2004/05 (Economic surveys, various issues). Since the external debt accounts more than 85% of total debt, Nepal is heavily indebted from eternal debt (Chaudhary, 2008:3).

If the debt raising to balance the budget or for any purposes, is disbursed properly it may play the important role in the country for the economic and commercial development. Specially, if it had been used for acquiring income earning assets or project(s) of the government or on these heads, which add to productivity of the country's economy as a whole, it would have led the nation towards prosperity. Raising the debt for debt servicing and redemption would be a grim and wicked act to the nation. Moreover, it is ruinously harmful to borrow externally because it adversely impacts on the balance of payment of those countries that can export goods and services in a very small quantity like Nepal.

In each fiscal year, both internal and external debts have been increasing rapidly. The external debt is increasing more rapidly than internal debt. But debt servicing capacity of the country is not increasing with the same pace. So, our country, Nepal, is more heavily indebted from external debt than internal debt. The increasing dependency of the country upon the external borrowing is due to poor and inadequate internal resources mobilization to meet the growing need of the development expenditure. Ever increasing external debt and debt service obligations will create a serious problem in the economy. But internal borrowing doesn't create so serious problem in the economy as external. "To escape from external debt and debt servicing problem a policy can be adopted to make the economy less dependent on import, to promote export and improve the term of borrowing. In the case quite adverse and so, Nepal facing the problem ever increasing financial resources gap (Dhakal, 2006:4).

Most of the economists and many of the scholars who wrote a thesis on this context has strongly recommended that the public debt should be used on the productive schemes and programs and it must be noted at the outset that a modern government is not expected to borrow for the sake of it. Most of them have remarked the expensive debt should be discouraged at large extreme. They all have given figure heavily raised public debt may cause economic decrepitude of the nation. In spite of this obvious warning the Government of Nepal is borrowing large amount.

The government, on the one hand, has strongly restricted all procedure of appointing the all level of civil servants committing to reduce the public expenditure in the fiscal year, but on the other hand, thousands of persons are unnecessarily being recruiting to the police and army. It is generally understood that the service of Nepalese police and army is far mere unproductive in comparison with civil service. This is the clear-cut instance of government's negligence of economic discipline.

Nepal is facing problem of financial resources gap, on the one hand, and increasing inflation and population growth, on the other. The taxation is not sufficient enough to raise required funds for development. Even though, taxation is most important source for finance but it is impossible to raise adequate fund through taxation. It has own limitation beyond which it is bound to have an undesirable consequence.

The burden of the public debt has been one of the controversial issues in the economics of public finance. In Nepal, both internal and external debts have been increasing rapidly in each and every year. Increasing trend of the net public debt is likely to increase further. As a result, debt-servicing obligations are also increasing rapidly. Today debt servicing has become a major challenge to the nation. There is increasing reliance on the foreign assistance.

It has been proved that government debt has higher marketability that is, it does not have liquidity risk. The public borrowing is a device to utilize a substantial part of voluntary savings for financing the development plan of public sector. Public borrowing as a method of resource mobilization has certain advantages over taxation. When the government increases the taxes, the tax payers may not be ready to pay the tax. The government has to follow optimum tax policy. So the study of public borrowing is essential to find out investor's attitude towards government securities, its issuance policy, process and practice, etc which are mentioned below:

- What is the attitude of investors towards government security?
- How does the government issue the securities?
- Why does Government Issue securities?
- For what purpose does Government Issue the securities?
- What are the problems of issue of government securities and its practices?
- What is the relation of government security with deficit budget?

1.4 Objectives of the Study

The main objective of the study is to analyze government security issue practices of Nepal and investors preference towards them. In addition, the following are other specific objectives of the study:

- To analyze the trend and structure of the government bonds in Nepal.
- To examine the attitude of the investors towards the government securities.
- To overview Nepal Government's bonds issue system and practices.
- To analyze the burden of public debt.
- To suggest the policy and procedures to reform debt management of Nepal.

1.5 Significance of the Study

The study has been conducted to find out interest towards the securities on the basis of yields, face value, maturity period, cash receipt, etc. The country is liable to developing its economic and social condition by itself from the present level of domestic savings. In order to break the vicious circle of poverty and to improve the social condition of the people, there is a greater debt demand of the government borrowing. Government borrowing itself is not the medicine if it is not properly utilized. So government borrowing has been the necessary evil for developing country like Nepal. In this context a proper study on the subject matter is needed which is expected to fulfill by the present study.

This study is considered to be useful for those who want to get knowledge about government borrowing in Nepal. It is useful for the people and institutions that are purchasing government securities. It is hopefully written that it may be a little reference for the budgetary system, which is applying now. It determines the volume of borrowing debt from people by the government.

1.6 Limitation of the Study

Every work has its own limitation due to the lack of time, resources and knowledge. This work is completed within the periphery of its limitation. Due to various constraints all aspects of the public debt have not been discussed in this study.

This study will have the following limitations:

- This study has covered only 7 years time span (1999/00 to 2006/07).
- The study has not covered the effects of the public debt on some economic variables i.e. money supply, employment, price level, poverty, etc.
- This study does not address the impact of the public debt on socio-culture way of life.
- Basically this study is based on secondary data of seven years.

1.7 Organization of Study

This study is divided in five chapters. Prior to the body of the thesis several pages of preliminary material such as title page, approval sheet , viva sheet, acknowledgement, table of contents, list of figure, list of table, abbreviation used etc. have been used.

Chapter – I: Introduction

Chapter one is the introduction which contained the introductory part of the study where the general background of the study, the major issues to be investigated and the objective of the study are presented.

Chapter – II: Review of Literature

Chapter two is review of literature which consists of conceptual framework, major studies in general and reviews of major studies.

Chapter – III: Research Methodology

Chapter three describes the research methodology of the study. It includes the research design, nature and sources of data selection of enterprises, definition of the used terms and tools applied in the study.

Chapter – IV: Data Presentation and Analysis

Chapter four deal with the presentation and analysis of data. It consists of analyzing government debt practices in Nepal.

Chapter- V: Summary, Conclusion and Recommendations

Last chapter is the summary, conclusion and recommendations.

CHAPTER - II
REVIEW OF LITERATURE

2.1 Conceptual Framework

The government bond can be defined as the loan taken by the government through the issue of securities. The concept of government loan had come into practice after 19th century. In the modern era, the function of government has been increasing day by day. The present economic problems of the country including the election of the constituent assembly may be the main reason behind the raising government loan. Normally, the income or revenue generation is less than expenditure every year, so it is necessary to raise funds by issuing government securities.

The public debt is temporary source of income for government as it is to be returned back to the holders after its maturity period. Government issues securities for raising funds. Treasury Bill is the short-term loan and Development Bond and Saving Notes are the long term loans.

Government debt arises out of borrowing by the treasury from banks, business organization, and the 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. Government loan should be returned back to the holders after certain period. So it is not desirable to raise funds from public in every action taken by the government. Every year, the government has been issuing securities and collecting huge amount of money from public to uphold deficit budgetary system of the country.

The primary reason for issuing government securities arises due to deficit budget declaration in Nepal. It is obvious that the issuance of government bond is the sole cause of deficit budgetary system. Deficit in the budgetary system has been the normal feature since the first budget. The increasing trend of government budget has been balanced by borrowing from public. It is believed that government plans towards people's welfare including maintaining balance of peace in the country. It is the duty of the government to work for the economic development of the country. Therefore, the issuance of government securities to meet government expenditure is important to raise the living standard of the people. But the lack of proper utilization of the raised funds is said to have caused many problems.

Investors on the other hand have different thinking regarding their investment strategy that is some investors want to invest in short-term debt and some want to invest in long term debt. The term 'public debt' has not been defined uniformly. Several economists discussed it in 19^{th} century. It has also been discussing modern economists. Keynesians and their views towards public debt are centered on its size and use. Most of the students having the background of economics have discussed and analyzed public debt and some of these have focused on its structure and importance whereas others have focused on its burden and impact on inflation, employment, national solvency, etc. Similarly, the importance, role, need, and scope of public debt have also been discussed by thesis papers. Therefore, the present study has focused on the practice and systems of government bonds in the context of Nepal. This study is only related to internal issues (i.e. internal debt) of the government securities giving special reference to government loans.

In Nepal the public debt was first raised in 1961 with the issue of Treasury Bill. Thereafter the government has been issuing Development Bond, Special Debenture Bond, National Saving Certificate, Prize Bond and such other securities to raise the fund internally. Nepal Rastra Bank, the central bank of Nepal issues various securities on the behalf of the government. The bank issues various government securities after analyzing the liquidity position of the market, private investment opportunities, average interest rate in the market, inclination and attitude of people towards risk bearing capacity, etc.

The bank issues long-term securities and short-term securities at par value. The bank charges the government ¼ percent commission on transacted amount.

In April 2001, the bank floated the long term security named 'RBP 2062 Na' of Rs. 1000 million at 9% interest (taxable) for which buyers applied for more than issued amount within a few hours.

2.1.1 Views of the Economist

Most of the government in the world collects the money from two sources, namely, public revenue and public borrowing. These are the sources 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:

- Classical View
- Keynesian View
- Post-Keynesian View

2.1.2 Classical View

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

The classical authors were generally against public borrowing. They assumed that individual consumer and business firm employed 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 purposes.

2.1.3 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 bonds and will prove to be antiinflationary. 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.

2.1.4 Post-Keynesian View

During the World War II and in the post war years, the size of the public debt increased enormously. The post-Keynesian position accepts a large part of the modifications of the classical debt theory as brought about by Keynesian economist. 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, posses problems in the economy. It complicates monetary policy and creates difficulties of management. Both classical and Keynesian economists agree that a 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 expenditures by taxation but finds it inconvenient to do so. In the event of seasonal fluctuations of expenditure or revenue or error 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 increase in taxation.

A better argument in form of internal borrowing should be to avoid borrowing to pay for government consumption expenditure; 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 promotes growth.

2.1.5 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 a very good perspective in the country.

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

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

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 borrowing will be determined in such a way that, given the rate 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 to the government. Minimum level of debt can be expressed in terms of the following equation:

$$D \quad X \quad \frac{Y \quad _{T} \quad Z \quad O}{R}$$

Where,

D = Maximum sustainable national debt

O = Constant expenditure for ordinary government operation

T = Maximum ratio of tax receipts to national income (Y), and

R = Contractual interest rate of government debt

2.2 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 bond 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 mature after 28, 91, 182, or 364 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 the 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 the 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 risk.

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. The characteristics of the bond are mentioned as below:

- Bonds have their fixed interest.
- They are issued in a particular market.
- They are currently payable and in protective features.
- They have their legal status.

- They are issued by governments, corporations, special purpose trusts or even non-profit organizations.

2.3 Type of Debt in Nepal

The government debt is typically held by the central bank due to the conversion of overdraft to the Treasury Bills. Besides the commercial banks, financial institution, insurance companies, provident fund, corporate and individuals are holding government domestic debt. Nepalese government uses a number of instruments to raise funds domestically, which are described briefly as below:

1. Treasury Bill

The Treasury Bills are issued on the auction as specified in the issue calendar. The Treasury Bills are most of the time purchased by commercial banks as a competitive bidder and others rarely as non competitive bidders. Treasury Bills are issued on multiple price formats or pay your bid format. Thus, the Treasury Bills auction could be divided into competitive and non-competitive categories, allocating at least 15 percent of offer amount for the non competitive bidders.
While issuing Treasury Bills notice of auction would be published in the national daily newspaper mentioning the necessary terms like series number, offer amount, taxable nontaxable and maturity period, earnest money, issue date, bidding time, procedure and other conditions. This information would also be disseminated via website of NRB.

Treasury Bills are issued as promissory note so that the buyer of the TBs could purchase and sell these bills by endorsement as well as through the commercial banks. The face value will be repaid by the NRB, which are issued in discount at the maturity. The Nepal government has issued 28 days, 91 days, 182 days and 364 days bills under this category.

2. Bond

Long term securities are issued as per the issue calendar. The Nepal government issues long term securities such as Development Bond, National

Saving Certificate and Citizen Saving Certificate as stock or promissory note. For the issuance of these bonds, the notice would be published in the daily news paper by mentioning the special features like type of bonds, amount to be issued, interest rate, maturity period, time limit, procedure and required conditions. This information would also be availed from central bank's website. The types of bonds issued are briefly described below:

a. Development Bonds

The Development Bonds have been issued in face value at pre determined interest rate. A notice would be published in the newspaper by mentioning the special features like types of bonds, amount, interest rate, issue date, taxable/nontaxable, application time limit and others. This information would also be released in central bank's website. This instrument is generally issued for 3 years or more than 3 years maturity period for financing the development projects having long gestation period.

b. Special Bonds

These are conditional promises to pay a specific sum on specific dates. These instruments are specially issued in the case of short position in the government's cash flow. In these days, the special bonds are issued for the duty drawback settlement.

c. National Saving Certificate and Citizen Saving Certificates

Generally, these are non marketable and tax exempted debt instruments usually issued for the general public (household sector). However, National Saving Certificates and Citizen Saving Certificate in Nepal are marketable as well as taxable securities at determined interest rate for the issuance of the certificates. The notice would be published in the news paper focusing the necessary terms and conditions.

2.4 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 budgets were very small. The governments 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” (Lekhi, 1995).

The objectives of government securities are summarized below on the following headings:

i. 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.

ii. 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 can not flow the more cash in the market. Hence, the government can counteract the economy from the hyper-inflation and maintain the economic stability.

iii. 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.

iv. To Maintain Economic Growth

The state should conduct the general administrative functions and development programmed 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 can not use their natural resources due to the various constraints and on the other hand these can not 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 recourses in the nation.

v. To Meet 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 internal enemies or terrorism and foreign aggression and attack. These all cause the nation to be indebted.

vi. 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 one hand adopts the progressive tax system and on the other 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 finance public enterprises for public welfare to create the infrastructures, 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.

2.4.1 Impacts of Government Debt

The government debts as well as taxation transfer the purchasing power of people to the government. But in due course of time cash collected through the taxes and debts is transferred to the people when the state launches the development programmes in the society. In this way people's property reaches to the people in another form. However, the cyclical transfer leaves some impacts in macroeconomic situation for the nation and also common public behaviors, such as effects on consumption, investment, distribution of income, production, etc.

It will be appropriate to examine the impacts of public debt under the following two bases:

2.4.2 Advantageous Impacts of Government Debt

The classical economists were generally against the government debt. They advocated for the balanced budget so that the government would not unnecessarily bear the burden of deficit. Keynes was the first economist who took the position of deficit budget submitting the various theories for deficit budget and Keynesian theory on public finance brought the revolution in economic policy approaches. After the Keynesian theory was set up, most of the countries in the world have been adopting the deficit budget.

Most of the modern economists do not deny the need of government borrowing for following reasons, which can be dealt as the advantageous impacts of government borrowing.

i. Proper Use of Idle Capital

Government raises the loan from the people who save the money for no specific purpose. Most of the lenders are the permanent employees of an institution, civil servant and retired employees. Those sorts of people neither have the sufficient time to utilize the money properly not the inclination for the good entrepreneurship. In this condition government borrows the scattered money from them and use that accumulated fund on productive projects like irrigation, hydropower, railway, etc.

ii. Retraction of Over Floated Cash

The price of commodities and services are growing day by day. One of the factors of increasing the price is the overflow of cash in the market. It is therefore necessary to withdraw the cash from the market. Government borrowing retracts the overflowed money from the rich people in the country so that they can not spend more cash for their luxurious living. On the other hand, the government invests the borrowed fund in the fruit bearing programmes and hence most of the unemployed people get employment and improve their respective life standard.

iii. People's Pride In Their Contribution To National Welfare

It is perhaps the most important advantage of the public debt. It promotes patriotic feeling among citizens. The investors get satisfaction for their contribution to the nation. It makes the people feel that they are also involved in national development programmes. Plus, they get the interest income regularly for their property lent to the nation. Moreover, the interest rates in public debts (mostly in internal debt) would be and is slightly greater than in market and they are considered risk free.

iv. Encouragement in Saving

Government securities are purchased by both poor and rich people. Nepal's Government securities are bonds and promissory notes, which are available at minimum rate of Rs. 100 and divisible by Rs. 100 furthermore. It indicates the government's desire of borrowing the loan from each sector of society.

The government never adopts the policy of charging the tax on the amount purchase of securities. And it generally does not charge the tax upon the interest of government securities. It encourages each type of people to save the money even at small scale.

2.4.3 Disadvantageous / Impacts of Government Debt

i. Extraordinary Spending

There is no restriction for the government in internal borrowing. In case of external public debt most of the proposals from abroad are accepted and they are rarely refused. Due to the various internal factors, the government, for instance, had rejected the loan that was allocated for Arun Third, which was at very concessionary at interest rate. Anyway Nepal has been indebted both internally and externally. But in this thesis, only internal loan has been taken for the analysis.

There is unhealthy completion among the political parties in Nepal. The party (or parties) in power of governance does not hesitate to raise the debt huge internally and externally. Moreover the shameful thing is that the government prides itself for getting the external loan in large volume. The government spends unnecessarily even on unproductive schemes, which brings inflation in the country. Rich people get richer while the poor people are without resource during inflation

So the government should seriously consider upon such expense whether it is financed on fruit bearing projects or on salary, aid, donation and others.

ii. Probability of Falling into a Debt Trap

a. A debt trap simply means the inability to return the amount borrowed from home and abroad.

b. If the government raises enormous loans and finances funds on unproductive programmes, naturally the state would be badly indebted unless it considers for economic salvation by removing its considerably increased debt

In case of domestic loan it is not a serious matter. Firstly, the country issues the securities to collect the required fund from the people. If it forfeited the confidence of the people, secondly it may loose the trap either through levying the heavy taxes or through printing the money. But in case of external debt the situation is quite different than in internal loan. The external loan must be paid off either in US dollar or in respective currency of lender country or in Gold. The poor and heavily indebted country can not refund the in foreign currency amount in either form mentioned above. Consequence it falls into a debit trap. In this situation either it can request for postponement or repudiate the external loan. But these types of measures are the extreme measures, since through these, the country loses its credit worthiness and it becomes unable to borrow the foreign loan forever.

iii. Private Sector May be Discouraged

Exception the case of Nepal, public debit is mostly raised for generating the capital goods. It means that the accumulated fund, which is collected through the public debt, is the industry, trade and many of developmental infrastructures.

iv. Burden to Future Generation

Economists like HG Brown, Pigu, Learner, Samuelson and other have expressed the view that public debt carries the burden to the future generation. Modern economists deny this concept submitting the logics for public debt that is raised only for financing on return giving projects, which provides many economic and social benefits to people in the nation. According to them, the productive schemes do not bear the cost forever, rather than they start to draw the inflow of return after a certain period of time. In contrast, the traditional economists submit the logics that all of the public debt might not be disbursed only on productive projects. Thus when the state do not use the debt properly it becomes burden to future generation requiring to pay for the debt without any benefit.

In conclusion, government loan would be burdensome for future generation under the following conditions:

1. If the present government generates and disburses the great proportion of financial resources (it includes all kinds of revenue and debt) mainly to operate their regular administration.
2. If the government does not add to the capital stock and productive capacity of the country.

In case of Nepal, the above conditions are true ever since we started to borrow. We are, therefore, being squeezed by the public debt raised and consumed by previous generation and similarly coming generation will be squeezed by our irresponsible performance.

2.5 Bond Mechanism

If investors invest on Treasury Bills, they receive interest payments (a.k.a. coupon payments) every six months based on the coupon rate. The rate is expressed as annual rate, so if the rate is 6% you get $30 every six months for a total of $60/year. When the bond matures, you get back the original investment of $1000 called the principal.

This gives you a steady, predictable source of income from semi-annual coupon payments (hence the term “fixed income investment”) and your principal is guaranteed (the default risk of the US government is considered nil).

Treasury notes work just like bonds, with semi-annual coupon payments and a repayment of principal at maturity.

Treasury Bills work slightly differently. Since they mature so quickly, instead of using coupon payments to give a return on the investment, the bills are simply sold at a discount to their face value at maturity. The discount is determined by the interest rate. If it’s a 1-year bill with a 5% discount rate, the investor pays 95% of the face value or $9500, then receives $10000 back at the end of the year (this is a simplified example to give an idea of how bills work, the actual numbers are slightly different).

2.6 Effects of Government Bonds

Borrowing has a number of effects and these can be explained as below.

If a country borrows too much money, it has to pay a great deal of interest every year in order to serve that debt. This represents the money which could have been used to pay for program instead of spending. 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 market. 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 or 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 vicious circle of speculative attacks, followed by higher interest rates and higher interest payment 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 circle has been plaguing the economies of the economics 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.

"The growth of national debt may not only make some particular people richer and some people poorer, but may increase the inequality of distribution. This is because richer people can buy more government bonds and so get more of the interest payments without incurring a proportionately heavier burden of taxes" (Houghton, 1973: 75).

Most of the people would agree that it is bad for the country because it creates 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 payer to the bond holders. As regard payment of the principal sum, the future generation will bear the burden. In this case also, money remains within the country.

The burden of the government debt is not analogous to that of private debt. If the debt is internal to the country, interest payments and future retirement of the debt do not acquire 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 the government is reduction in output that its existence causes. To the extent that the taxes necessary to meet the interest payments have disincentive effect and causes 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 is 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, however, refers to the extent of adverse effect of increased taxation on the level of production.

2.7 Pricing of Debt Securities

The values of bonds are determined by coupon rate and maturity period of debt securities. It is inversely related to the maturity period and the market rate of 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 (Samachar, NRB 2059 B.S.):

$$B_0 = C_1/(1 + K_1) + C_2/(1 + K_1)(1 + K_2) + C_3/(1 + K_1)(1 + K_2)(1 + K_3) + \ldots\ldots + C_N/(1 + K_1)(1 + K_2)(1 + K_3)(1 + K_N) + P/(1 + K_1)(1 + K_2)(1 + K_3)(1 + K_N)$$

Where, B_0 is the present value of the bond and P, the principle. 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 and investors receive capital gains.

Financial repression is a common phenomenon where economies 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, changed 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 cash 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 percent of the total internal debt; have the longest maturity period of about 20 to 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 Ltd. has currently started transacting government securities in the floor. Buying and selling orders can not be placed through electronic means and exchange of government securities.

2.8 Ownership and Marketability of Government Bonds

Ownership and marketability are important considerations in managing the government bond.

2.8.1 Ownership

The people and organization that lends money to the government by purchasing government bonds is the owner of the government bonds. The US government had divided its owners into three 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 based on ordinary financial management considerations). The second largest portion of the debt is held by government accounts, such as the social security and highway trust funds and the reserves of 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 US treasury government to cover a deficit 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 principal 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 voluntary transaction (Wayland, 1978).

Thus, bonds owned by the 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 seller.

2.8.2 Marketable

The government in a country issues bonds that are normally marketable which means that a person who owns such 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 the United States of America, some government bonds are marketable. Recently NRB has listed the government securities in NEPSE for the marketability for such government bonds.

2.9 Legal Provisions in Nepal

2.9.1 Prologue

Since four years after the establishment of Nepal Rastra Bank as the Central Bank of the country, the National Loan Law, 2017 was announced and in 2020 the Laws were finalized and implemented. In this law those rules and regulations were discussed which were supposed to help with regard to the national loan transactions.

This National Loan Law, 2017 was published in the Royal Gazette and was implemented from Poush 1st. In this Law there were altogether 17 sections (dafas) and many other sub-sections (upadafas). In the section 17 the procedures to simplify during the course of implementation of the National Law and to make it even more vivid the suggestions of the Nepal Rastra Bank were also included and implemented in this National Loan Law, 2020.

2.9.2 Definition

In the Prastavana of this law, it was explained that this law was created to encourage the savings and get national loan for the economic development and advancement of the country. The following Loan Papers (Rinpatras) could be published in any fiscal year to the limits of the rights allowed by Nepal Government:

a. Stock- to be registered in the accounts of Nepal Rastra Bank and transferring (Namsari) after the registration
b. Promissory Note and Treasury Bill- the loan that can be transferred by darapith,
c. Bearer Bond- the loan paper which is to be paid to the person with the Identity Certificate (pramanpatra)
d. Prize Bond – the loan paper in which the holder (owner wahak) can receive the amount in the interest or according to the lottery?
e. Any Loan Papers that are published by GON according to the law.

2.9.3 Procedures for Publishing of Loan Papers

After the decision of the Nepal Government to collect the loan by publishing the loan papers, the Department of National Loan will publish a notice in the periodicals mentioning total value, payment period, interest rate, interest payment duration and other essential conditions. After the issue of this notice and interested creditors (rindata) can buy the loan papers at mentioned branches of the bank or via licensed market makers While buying the form it has to be filled as required and it is compulsory to submit testimonials (praman?) about the identity of the interested buyer along with it.

2.9.4 Payment of Interest

With respect to Stock Loan Paper only the person whose name is registered, the loan and the interest will be paid to him or her. With respect to Promissory Notes and Treasury Bills, the owner or to the person that has been transferred (by darpith) by the owner, will be paid. The loan will be paid through the mentioned location when the duration is expired. In case of the Loan Paper for interest, it can be received through the mentioned location by Nepal Rastra Bank. If the interest is not collected within the allocated time, interest on interest will not be paid.

2.9.5 Procedures for Payment of Deposit (Savan)

After the expiration of the Promissory Notes and Stock, the owner has to sign at the back of the Loan Paper and when submitted to Nepal Rastra Bank the amount in the loan Paper will be paid. Any branches of the banks that do banking transactions if desired can pay the amount (Savan) of Loan Paper to the owner and demand for reimbursement from the National Loan Department. But there is no arrangement of any commission in this procedure.

2.9.6 Procedures for Payment of Interest

The interests on the Promissory Notes and Stock Loan Papers as mentioned in the payment Document (Bhuktani Purza) could be collected every 6 months through any branches that do banking transactions in the country. While demanding the interest in the branches of the banks, the owners must submit the Promissory Note with regard to Promissory Note and Interest Document (Purza) and with respect to Stock, the Interest Document. In case of Bearer Bond, the coupon which is issued along with the Bond should be submitted to collect the payment. In those Loan Papers in which tax is levied on the amount of interest, the bank will pay the interest after deducting the tax according to the rule. This amount of tax must be deposited (Dakhila) to the Department of Tax. After the payment of the interest by these bank braches, they should demand the reimbursement by submitting the red voucher of the bank form no 64 to the National Loan Department. After receiving the voucher the National Loan Department reimburses (Sodhbharna) the amount (Lekhankan).

2.9.7 Functions of the National Loan

While performing the tasks on the National Loan, Nepal Rastra Bank opens essential ledgers (accounts) and submits the report with suggestions regarding the financial status (Arthik Sthiti) of the National Loan on the allocated time and according to the accepted format of Nepal Government

2.9.8 Transference (Namsari) of Loan Paper

In case of Stock, only after the submission of the application by the owner in written and changing the name in the registration form of the bank the Transference would be valid. This Loan Paper can be transferred either wholly or partially. In case of Promissory Note, the person that is transferred by darapith by the owner will be declared the owner by Nepal Rastra Bank. This Loan paper cannot be transferred partially. In case of Bearer Bond and Prize Bond, the bearer of the Loan Paper will be considered the owner.

2.9.9 Procedure of Transference

The transference of the Promissory Notes can be done by ordinary darapith. But this loan paper cannot be transferred partially. While receiving the loan paper by Darapith, both the giver and receiver must write name, address and signature.

While transferring the Stock Loan Paper partially or wholly, the owner should register the name of the person to be transferred in the bank. Only then the transferred will be declared valid. In case of Bearer Bond and Prize Bond, the bearer of the bond will be considered the owner. The Loan Paper bought by Government Offices, Non-Government Organization, Organizations and Guthis.

By the invocation of ordinary or special permission of Nepal Government only the Government Offices can buy the Loan Papers. If bought accordingly, these Loan papers will be issued in the name of the respective Office. Any transactions regarding the Loan Paper could be dealt by only that person endowed with the right to do so.

2.9.9.1 In Case of the Death of Owner

In case of the death of the owner of the Loan Paper, the person mentioned in will paper (Ichchhapatra) by the owner will be declared the owner. In case of absence of the will Paper, the Hakwala of the demised will be declared the owner. If the loan was bought in the name of two or more than two persons and in case one or the entire owner dies, then in presence of the will paper the ownership will be transferred accordingly or if not the Hakwala will be declared the owner by law.

2.9.9.2 Procedure In Case of Suspicion With Regard To Owner or Refuses to Accept

If there arises any sort of suspicion or dispute with regard to the owner of the Loan Paper or if the amount (Savan) is not collected after 180 days of the expiration date of the Loan paper, then Nepal Rastra Bank will do essential enquiry and take the verdict of the related person and declare the rightful owner. For this Nepal Rastra Bank will issue an official and public notification

(Sarvajanik Suchana) and will also send the notice in written to the registered owner. It will be considered notified after 180 days of the latest issue of the notice. With regard to the declaration nomination (Manonit) of the owner and subsequent procedures Nepal Rastra Bank will have to obey any Aadesh issued by the court in such case of.

2.9.10 Issue of Duplicate of Loan Paper

In case the Loan Paper is lost, stolen, destroyed or became illegible the following particulars should be written by stamping Rs.1 stamp and should be submitted to the National Loan Department:

- Owner's Name, Address
- Serial Number
- Amount
- Police Report
- The older Remainder Part of the illegible loan paper

In case of Stock Loan Paper, the District Police Office must be notified of the lost and get the testimonial that the loan paper has not been transferred. These testimonials should be submitted along with the application.

When these application forms are received by the National Loan Department fulfilling the rules and regulations, except for Bearer Bond and Prize Bond, a public notice will be published in Gorkhapatra mentioning all the particulars to claim the ownership. If within 30 days of the issue of this notice, if anybody claims (ujuri) for the ownership, with regard to Promissory Notes within one year and with regard to Bearer Bond generally within two years, the renewed Loan Paper will be issued to the rightful owner with Identity Certificate.

In case of Stock Loan paper, the application that is received fulfilling the rules and regulations, the Department should consider valid (munasib) the duplicate of the Stock Loan Paper issued to the owner. No action will be taken in case of loss of Prize Bond.

There is an arrangement of issuing the duplicate of the Stock Loan Paper to the rightful owner while taking action on those above mentioned application form; they received fulfilling rules and regulations.

2.9.11 With Regard to Illiterate Loan Paper Owner

In case the owner is illiterate s/he should submit one copy of an application form and for identity Certificate Card (Prati Pramanpatra) one copy of photo should be submitted. The owner himself/herself must submit the application form and put finger print (Lahachhapa Signature) on it.

2.9.12 Nomination of Guardian

In case the owner of a child or mad person, the bank can nominate the guardian after essential enquiry (Jachbuch). The interest on the Loan Paper regarding the name of the Guardians could be paid in the amount as Nepal Rastra Bank thinks right. The full interest could be collected by the person only after the child reaches the required age, when the mad person becomes normal. But in case the child or the mad person dies before reaching the required age or normality, Rastra Bank will pay the amount and interest to the nominated guardian after proper inquiry.

2.9.13 Exemption of the Liability of Nepal Government or Nepal Rastra Bank

According to this law, after the nomination of the owner by Nepal Rastra Bank, no case could be filed in any court against GON and Rastra Bank. Similarly, no case could be filed regarding the payment of the Loan Paper either.

2.9.14 Punishments

In case any person claims the ownership by presenting the false documents in front of the officials of Nepal Rastra Bank, the respective may be fined by the equal amount of Savan and interest mentioned in the Loan Paper by the command decree (Aadesh) of the Court or may be imprisoned for 6 months or both.

2.9.15 Surveying of Documents

No one will be allowed to look at the accounts and documents of Nepal Rastra Bank and Government Offices with regard to Loan Papers apart from the allocated situations, condition or procedures.

2.9.16 Procedures and Conditions for Renewal of Promissory Notes

In case of lack of space in the ledgers of Promissory Notes, tearing or destroying or by any other reason found errors, if Darapith is unclear to the extent that the owners name is not readable, if the interest is not collected for 10 years or more, if the owner submits an application form complaining that the date of payment of interest every 6 months and the date allocated for the interest is mismatched, then the National Loan Department will issue the renewal. In such situation, interest etc. will not be paid until the Renewal of the Promissory Note.

2.9.17 In case of Changing the Type of Loan Paper

If the owner of the Promissory Notes wants to change it in the same series but to another Stock or Promissory Note or to unite the different loan papers into one of divide one loan paper into parts, required charge (Dastur) should be paid as mentioned by Rastra Bank to perform the above mentioned procedures. But to change any Loan Papers to Stock Loan Paper no charge is required.

2.9.18 Bidding of Government Bonds

When Nepal government decides to collect the loan by issuing Treasury Bill, Rastra Bank should be notified mentioning the required amount. After receiving this notice by Rastra Bank, it should publish Invitation for Bid for selling the Treasury Bills mentioning the payment periods and other essential conditions in periodicals. After the issue of the notice those who are interested in buying the Treasury Bills should clearly mention by agreeing the required amount and percent of interest s/he is interested offering. In case Rastra Bank itself buys all the Treasury Bills, by mutual understanding the interest could be determined. In case Rastra Bank buys partially, then it will receive the average percent of interest regarding the other interested parties (Bolwala). If the Rastra Bank issues the Treasury Bill after it has bought it then Rastra Bank will receive the average amount of interest with the other parties. In those Treasury Bills in which interest is mentioned, the interest will be paid along with the payment of amount (Savan) only.

2.9.18.1 Right to Accept or Refuse the Invitation Bid

Rastra Bank will have monopoly to decide how much to accept or refuse to those Treasury Bills that have been submitted by the bidders. To perform this procedure one Open Market Executive Committee has been formed. This Committee holds all the rights to accept or refuse any bids (Bolpatra).

2.9.18.2 Amount of Treasury Bill and Period of Payment

The amount of the Treasury bill should be minimum Rs.25, 000/- or maximum should not exceed as mentioned in the law and should the remainder amount divided by Rs. 1000. The payment time of the Treasury Bill should not be above one year after the issuing of the notice. Rastra bank must notify Nepal Government while paying the amount of the Treasury Bills.

2.9.18.3 Procedure for Transferring Treasury Bills

Those who want to transfer and have bought Treasure Bills without Identity Certificate should notify Rastra Bank in written and Rastra Bank will transfer after receiving it as accordingly. While transferring Treasury Bills both the giver and receiver must clearly write their respective names and addresses with signatures. In case of the lack of space in Darapit when this Treasury Bills are transferred, the second Loan Paper could be procured from Rastra Bank by paying Re. 1.

2.9.19 Theoretical Review of Government Securities Nepal

There is not a debate on the necessities 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 government. There are in contrast some theoretical aspects of raising the loan from the market on which the government should conceive thoroughly before floating its securities.

1. No one should be imposed on lending the loan to the government.
2. 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.
3. It should not impact adversely upon the target of sustainable economic development of the nation. The all practice regarding public borrowing should assist the state’s economic welfare as a whole.
4. The securities should not be floated at the time of deflation as well as increasing the interest rate in the market. And the state ought to be able to raise the loan at the period of decreasing the interest rate in the market.
5. The state should pay the proper attention towards the legal and ethical restriction on public borrowing.
6. However, the government may change the terms and conditions of payment of debt at any time it takes for public welfare, but it is expected everywhere that the government would abide by a self imposed and indulged limitation so that it does not loose the confidence of people in regard to refunding the loan in or on time set previously.

2.9.19.1 Borrowing System through the Treasury Bills

1. The Public Debt Department of NRB prepares the schedule of borrowing through the Treasury Bills for the fiscal year consisting the servicing amount of preciously raised debt and the additional amount accorded by Nepal government

2. The department calls for the sealed tender for offered amount mentioning the operation date, life of the bill and so on by issuing notice in any renowned national daily newspapers on every Thursday and Friday.
3. The Tender form can be obtained from any branches of NRB and it is to be submitted to the department in the valley and to the branch of NRB out of the valley within the Monday of next week, otherwise the application will be invalidated. The investor can apply for Rs. 25000.00 minimum.
4. The party (lender/investor) should enclose the original credit voucher as for 'earnest money' amounting 2.5 percent of required amount for an auction deposited in 'Sundry Creditors main account'. The deposits can be made at any (banking) branches of NRB.
5. The accepted competitive tenders, which are under the rule, are presented in the meeting of board of director on Monday afternoon. Board of Director accepts the selected tenders as per necessities and this notice will be published next morning. The selected party will be noticed to deposit the cash instantly while on the other hand rejected parties would get their respective earnest money which was deposited in the bank in course of applying.
6. 15 percent of offered amount is allocated for non-competitors. They should purchase the bill at average discount rate. It should be noted that the commercial banks are not allowed to take part as non-competitors.
7. Treasury Bills are issued at the discount rate declared by the auction system and redeemed at par (value) that it the offered amount would be paid off at the maturity of the bill.

The discount rate can be calculated as:

$$DR = \frac{100 - \text{Bid Price}}{\text{Bid Price}} \times \text{Maturity Period (in year)}$$

The 91days Treasury Bills are most popular in Nepal these days. However, 364 days Treasury Bills are also issued frequently. The government also floats 182 days Treasury Bills, but data on such bills are not available.

Note: For Treasury Bills calculations purpose it is assumed that there are 364 days in a year.

2.9.19.2 Borrowing System through the Long-Term Security

Every year the Finance Minister presents the budget in the parliament in which it is clearly mentioned that the amount to be borrowing from the banking and non-banking sector. Different instruments such as Treasury Bills and bonds are issued for such borrowing. As started earlier the Treasury Bills are used to borrow the loan for the period of less than one year. The funds borrowed through the Treasury Bills are financed on supporting the current expenditure of government and that sort of borrowing is made with only the banking sector. Long Term Securities, on the other hand, are floated for banking and non-banking sector and more significantly say, for the individuals in the country. However, NRB should purchase the remaining portion of stocks and bonds in case of under sales of stipulated quantity of bonds in the market.

The Systems of issuing long-term Securities are listed below:

Public Debt Regulation of 1963, Section 4 consists of the process and procedure of borrowing the loan through the long-term securities. The system of borrowing through the bonds is given below:

1. Firstly the Finance Minister presents the budget in the parliament including the proposal of borrowing from banking sector and non-banking sector in the country. After getting the consent from the legislative bodies (parliament) the government schedules for borrowing from banking and non banking sector through the long-term securities. It forwards the programme to NRB for further functioning. The interest rate for the bonds is determined by Nepal government in general, but it may be fixed to some extent on the recommendation of NRB.
2. Public debt department of NRB publishes the notice in any reputed national dailies containing the principal features, terms and conditions

related to the bonds to be floated generally providing 15 days time duration for the submission of application. If whole of the bonds are sold before the due date, the sales would be stopped.

3. If it could not be sold during the stipulated period of time. NRB will purchase the whole or remaining portion. The issuance of security thereby stopped exactly at previously scheduled date.
4. In case of both National Saving Certificate and Development Bonds, the holders are provided the securities in the form of either the promissory notes or the stocks as per the request by the holder, whereas the Special Bonds are issued in the form of stock only.
5. People may apply for the bonds at any branches and agencies of NRB. Similarly the certificates would be dispatched through the same body involved having the application for bonds.
6. Only the individuals may apply for the bonds at its initial flotation but in case of bonds owned by NRB, that is, under the provision mentioned at no.3, might be sold both to individuals and institutions.
7. The ownership of bonds may be registered into the account of minors with the reference of their guardians.
8. The bonds are issued in the amount of Rs.1000 at minimum and divisible by Rs.1000 thereafter.

The salient feature of government bond is that no one can claim upon the bond unless the holder endorses him/her. This kind of protective provision is set for either alive or dead holders. Commercial bank and financial institutions should invest at least Rs. 25000 but rest can invest in the multiple of Rs. 100. The bond may be sold in premium, discount or in par value.

2.9.20 Debt Servicing System in Nepal

The term ‘servicing’ in economics simply means the payment in interest of periodic basis to the investors for their investment. As, the private firm pays the interest to their lender either at a single installment or at multiple installments as per compromise, the government in the same way, makes the payment of interest mostly on periodic basis on its borrowing so that the compromise between the lender and itself would be renewed timely and it does not involve the tremendous burden of interest, occurring in case if it is to be paid in as single installment. The periodical payment of interest is quite beneficial than the single payment.

The term ‘servicing’ refers the regular payment of interest on borrowing. The economic survey which is the catalytic tool of dissemination of Nepalese economic information, data and indices, has included both periodic interest payment on internal and external borrowing and partial payment of principal of that borrowing .

The procedures of borrowing are listed below:

1. Firstly, the government, in its annual budget that is presented in the parliament, allocates the certain amount of principal and interest of borrowing under the distribution of regular expenditure.
2. In case of internal debt servicing NRB is responsible to maintain the entire process and procedure as accorded in NRB act 1955, at Section 20 and in Public Debt act 1960.

   Treasury Bill was also issued at par value and carried a determined percentage of interest before the fiscal year 1987/88. During this year the ‘open market system’ came into use and NRB started to float the Treasury Bill at discount rate basis and redeemed at par value.
3. The state can make people to purchase the government securities with no interest at all, by enacting the rules. But to date Nepal Government has never borrowed from the people without paying interest, though once it had issued the Prize Bond with no interest in 1966/67. Even in this case there was no compulsion to purchase the bond. Moreover, it has provided attractive prize to some randomly selected luckier holders. Thus, it has been providing the interest on borrowings ranging from 1% - 15%. In this

system, the holders are paid the interest twice a year from any branches of NRB and commercial banks they want. To receive the interest payments, the holders have to submit the interest payment slip along with the certificate.

4. As previously mentioned all government security holders are provided the facility to collect their interest amount from any branches of NRB and Commercial Banks they want NRB and Commercial Banks charge commission at prescribed rate for operating the transaction concerned with the public debt. NRB receives interest and commission from Nepal Government, Financial Controller General Office makes the realization for formerly paid cash. It credits its account when with realizing the cheque from Nepal Government and makes the deposits upon their respective account, on transaction connected to the public debt and advises them immediately.
5. NRB obtains 0.2% of total transacted amount while other commercial banks get 0.25% of total transaction related to public borrowing and redemption. They further get the sales commission at prescribed rate for the transaction they made in relation to selling the government securities.
6. In case of external loan, the maturity period is generally longer than one year. Furthermore the buyers are being provided the grace period for maturity and interest rebate. In spite of all these incentives, due to improper financing and use of foreign debt and gradual depreciation of NC with the convertible currencies over the past years, the servicing burden has increased significantly every year.

The interest rate servicing system and timing is fixed by mutual consent or as per the negotiation made between Nepal Government and lender country or agency. The servicing amount and partial and periodic payment of principal of foreign debt should be justified and approved by the parliament.

2.9.21 Debt Redemption System

Debt once borrowed has to be redeemed within stipulated maturity period of the debt. The government mostly pays the interest rate at periodic (semi-annually and annually) basis and redeems the principal either on partial payment basis or payment at maturity or at its' will on a single installment. Nepal Government has been redeeming the loans at maturity in case of internal debt. It has already been explained that Treasury Bills implies the funds rose at discounted rate and redeemed at face value. And in case of Treasury bill, the transaction of servicing and redemption would be made at once by a single transaction.

On the other hand, the government may implement the various methods like serial bond redemption, conversion of loan, sinking fund, buying up and buying off loans, capital levy upon borrowed amount and finally it may simply employ the repudiation method for redemption of long term debt. Nepal Government has been redeeming its debt by applying the serial bond redemption method mostly and conversion of loan method alternatively. The Nepalese government has never repudiated its debt till now.

2.9.21.1 Short term Debt Redemption System

Short- term loan, in Nepal, represents only the Treasury Bill (however, overdrafts from NRB should also be taken as the short term loan). None of the securities from NRB were issued under one year of maturity except the Treasury Bills. So it is also stated that the Treasury bill and the short-term loan are considered as the same in this study.

The processes of repayment of the bill are discussed below:

1. Being a bank of the government, NRB is fully empowered to handle the system and practice of redemption of debt. Accordingly it receives the par amount of Treasury bill from Nepal government at just the maturity of the Bill.

2. NRB redeems the debt by crediting the concerned account for those who get the par value prescribed in the bill and bank with it (NRB). The investors who do not buy with NRB get the amount in cash.
3. The amount prescribed in the Treasury Bill would be cashed at any branches of NRB after the maturity of the bill. But no commercial banks and other financial bodies are consented to transact about the redemption of Treasury Bill.

The investor should pay the income tax at stipulated rate according to his income received from the Treasury Bills.

2.9.21.2 Long Term Debt Redemption System

Long-term security has the life of more than one year. In Nepal, generally it represents the Special Bonds, Development Bonds, Compensation Bonds, Prize Bonds, National Saving Certificates, etc. Most of them are repayable in a long period, say after 10 years or more. These bear higher rate of interest in comparison with the short term debt.

The redemption processes of long-term debt as practiced in Nepal are given below:

1. The government allocates the amount in its annual budget for redemption of a small portion of total debt every year. The flotation of long-term securities is arranged so systematically that, loans to be paid every year are staggered well.
2. NRB receives the amount from Nepal government financial comptroller general office and provides the principal and also the outstanding interest (if any) after verifying the signature of security holder.
3. There can be claim for principal and also the accumulated interest, till the five years maturity. The amount would be transferred to government's revenue account. If the investor claims his principal later than that, it will be paid as per the decision made by the government.

4. The stockholders are provided the facility to collect their interest and principal from any branch of NRB and commercial banks. NRB and its agencies get the commission at prescribed rate for the transaction works done.

Another method of redemption of public debt is known as ‘conversion of loan’ that is conversion into a new loan. When it has not sufficient funds for redemption and the current (interest) rate in the market is lower than the rate at which the government is paying for existing debt, the government employs the ironical method to reduce its interest payment. The conversion of loan is a bit different from the actual redemption in a way that –in case of conversion of loan the holders are required either to receive money in cash even before the maturity or to convert their old bonds into a new one which lessens their interest from the security. The simultaneous redemption and issuance of old and new Treasury Bill brings the assemblance of conversion of loan but these are not actually converted.

The government has been floating the new securities for the target of redemption of old debts but current investors are not required to have the new securities with low rate of interest instead of existing securities.

2.10 Review of Related Studies

2.10.1 Review of Books

Every government needs funds from different sources to carry out its functions. Therefore every government considers the different sources of revenue e.g. by levying different taxes, duties, fees and fines on the people residing or coming within the power of its jurisdiction of its power. The revenue raised by issuing its taxation power depends upon function 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 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 regime (1100 BC to 300 AD). However there must have been some method of revenue collection. Taking into account the Mithila kingdom during the Ramayan period, king Birat's kingdom during the Mahabharat period and Gautam Buddha's father's kingdom Kapilvastu, it is definite that these kingdoms must have generated revenues through taxes and levies on the simple logic that there were many state functions and development functions carried out such as construction 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 undertaken in small amounts and that too after great difficulty. Most of the borrowing was undertaken by the rulers for financing wars. Such borrowing was not approved by the society. It was considered 'dead weight' debt.

In the 20th century, almost all democratic government borrowed on large scale such borrowings have been made easy because of the development of capital market, increased confidence in the stability and integrity of the government and social sanction for welfare expenditure.

Deficit budgetary system in Nepal is the cause for the issue of the government securities. The government prepared a national budget for the first time in 1951 and enforced it and has been suffering deficit since the first budget. The increasing trend of deficit budget has been met by borrowing from the public.
"Public finance can be, at one extreme, be taken to cover the general subject of the central government economic planning- a discussion of the merits and demerits of having a plan of the Indian model, for instance, or the most appropriate way of constructing such a policy framework" (Prest,1975).

Borrowing is the major source of government financing. People have options either to invest in government securities or private securities. Government issues risk free securities so almost all of the risk averter investors invest in the government securities rather than private securities. “The government can borrow more cheaply than individuals because of lesser risk” (John et al., 1981).

“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 has to play in the initial stages of development. In the first place, it has always been the task of the 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 justify their ownership and management by the government itself in the interests of community at large” (Shrestha, 1981).

In the words of Ministry of finance “Government has the virtual monopoly over the security market.” (Mahat, 1981)

The following arguments have been advanced in the justification of government borrowing:

- Capital projects like steel mills, fertilizer factories, heavy machinery manufacturers, roads, railways, power, irrigation, etc. require large sums of money initially. They have long gestation periods; initially they run into losses. The rate of return on such projects is low and less attractive to private investors and entrepreneurs. Government has to undertake such projects. As these projects provide services over a long period, the taxpayers would like to pay for them as they use them. Thus, the tax payers will have the option of pay as you use, an option similar to the option enjoyed by the consumers in purchasing consumer durable like car or refrigerator on a hire-purchase basis.

- Not only the present generation but the future generation will also be benefited from such projects through public debt, newcomers pay for the cost of the projects from which they receive benefits.
- Loan finance is therefore an alternative to tax finance. It is based on the principles of 'pay-as-you-use' and equity between present and future generation.
- Loan finance enables the government to secure money from even the low income groups from whom, on equity ground, it may not be justifiable to collect tax revenues. Taxation may be administratively difficult and affects incentive to work.
- Borrowing is better than currency inflation, which affects all sections of people, and particularly poor people who have to tighten their belts. Forced saving is resented while loan finance is voluntary.
- Borrowing provides an opportunity to those who have idle savings. Generally the household sector has surplus saving, which is tapped by the government. Investor's preferences for different types of loans can be easily satisfied with the government.
- External debt permits import of real resources. It provides additional facilities and goods- capital equipment, know-how, raw materials and intermediate goods- without an immediate reduction in internal assumption or capital formation. (C.S. Seth,1982)

Public borrowing is treated as a source of revenue like raising funds from tax but the collected fund should be returned back to the holders within the maturity period. Borrowing may be from the banks, from public or from abroad. Likewise it is important to note public expenditure. "In the context of Nepal major public expenditure categories come under economic services, social services, defense, administrative and miscellaneous services"(Khanal, 1988). Thus public expenditure can be classified into two main categories, viz.

regular and development. This is budgetary classification. For instance, in regular expenditure there are four sub categories, viz. economic services, social services, defense and administration and miscellaneous services. Similarly, the development expenditure consists of three sub groups, viz. economic services, social services and miscellaneous services.

“Public sector debt is interrelated with the basic governmental fiscal flows of taxation and spending. If the volume of governmental expenditure exceeds the volume of tax and other (no-tax) revenues, a deficit budget exists. Such a deficit budget provides the fundamental precondition for the debt creation. Debt is merely a means of meeting a particular budgetary situation namely, a deficit budget caused by the excess of government spending over receipts” (Herbier and Richard, 1998).

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’ (Buchanan, 1999).

The resort to security market by the government has been only in the form of borrowing mainly through the issuance of the Development Bonds to meet the budgetary expenses. The first series of Development Bonds were floated on February 12, 1964 (NRB quarterly Economic Bulletin, 1971). It carried 6% rate of interest and had the maturity period of five years. Since then, the government has been floating the Development Bonds each year. Till 1981, it had floated fourteen issues of such bonds carrying the interest rate ranging from 5 to 10% and within the maturity period varying from five to ten years. The magnitude of funds raised through this method also has been rising each year. The total bonds issued during the fiscal year 1965/66 amounted to Rs. 705 million. In 1970/71, it was equivalent to Rs. 30 million and it reached Rs. 300 million in 1976/77. The growth has been in absolute as well as relative term.

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

Government borrowing is classified into two types. Purely internal debt exists within a nation. The internal debt refers to the situation whereby the borrowing unit acquires the money from itself (lends to itself). External debt is a condition whereby the borrowing unit acquires money from some other lending unit or units. The borrowing unit may be a unit of government, or a consumer. Size of political jurisdiction essentially determines the internal borrowing limit of government debt.

Internal debt refers to amount raised from Treasury Bills, Development Bonds, National Saving Bonds, Special Bonds, International Monetary Fund (IMF), and Promissory Notes. Among these different government securities and IMF, Promissory Notes, Treasury Bills are 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/July 1962. The government floated 6 percent interest bearing Development Bond of Rs. 13.1 million with a maturity period of 5 years for the first time on Feb. 12, 1964. In 1965, 3% Compensation Bond with a maturity period of 10 years were issued for the acquisition of Birta Land and 1% Compensation Bond with maturity period of 20 years issued for the acquisition of private forests. Non-interest bearing Prize Bonds amounting Rs. 861 thousands was also issued to individuals in 1969.

2.10.2 Review of Dissertations

Thesis, dissertations and other relevant study reports related to the present study were also reviewed. Besides various articles and papers, published as well as unpublished were also taken into consideration. Some related findings on this subject matter are presented below.

The clear vision of the government bond comes from the concept of public debt, so it is necessary to know that government bond is a source of public debt. Sometimes government debt and public debt are used interchangeably. “Public debt is popular because of the payment of debt on maturity that can be adjusted through the issue of fresh public debt. Due to popularity of purchasing bonds through people, there is no difficult for the subscription of public debt” (Acharya, 1968). Investors have full trust on government and subscription of government bond is high than the bonds issued by other non-government institutions.

The internal borrowing mobilization for the development purpose has also been fluctuating and the banking sector has dominated the total internal borrowing. Government should have to initiate policies to attract maximum borrowing from non-banking sector. It is the most non-inflationary source of internal borrowing since it is simply transfer of idle saving from people to government for development purpose.

“Ad-hoc Treasury Bill versus ways and means advanced debate on their implication for monetary policy. Government borrowing from the central bank is not considered good because it collects funds regarding for money print” (Mirmire, 2063).

“The public debt as a monetary measure and it is a weapon in hands of the central bank to regulate the economy so that the inflation generated in the process of economic growth may not be followed by hyper inflation. The least developed and underdeveloped countries should form quite effective and strong fiscal policy so that domestic savings would be maximized and it can be used for capital formation and on nation’s well being in turn. The fund may be gained either from effective and progressive taxation or from the borrowing" (Khanal, 1991).

"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. In order to ensure private initiative government should not have interference on the liquidity position existing in the market. The government should not borrow the capital from the public so that private investors will not lack from capital" (Pant, 1997).

"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. The interest rate and its development are the major benefit from the public debt. But if there is saving small ownership of debt is defused and the problem of inequality in the distribution of wealth and income is minimized" (Sharma, 1998).

In 1974/75, the internal debt of the government was amounting Rs. 412 million. The internal debt in 1984/85 has increased to Rs. 7706 million. The growth of public debt and the burden of debt servicing liability, it imposes a matter of serious concern. This is so special because the public sectors "need" for large net borrowing is likely to continue, given the overall trends in the public sector's financial operations. The total debt in 1974/75 (Internal and External debt) was Rs. 758 million which reached Rs. 16909 million in 1984/85. Therefore, the debt has been increasing from its beginning till now due to recoup deficit budget in Nepal (Nepal Rastra Bank Quarterly Bulletin, 2000).

"It itself is neither the worse nor it impairs the economy. Public borrowing in the country is taken for budgetary aspects for maintaining smooth and sound economy. It is quite beneficial for the nation as it outstrips the national economy as a whole. The bad aspects of borrowing in the country, which are presented below (Sharma, 2001).

- Government borrows the loan according to its whim and indulgence, and
- It pours the whole amount of borrowing on non-productive sector.

The borrowing from people can be considered important if generated funds are honestly used in education, health and other development functions.

Every year, Government has been borrowing a huge amount of money from public by issuing government bonds to finance deficit budgetary system of Nepal. The external debt threats for the economy but internal debt is considered good because it transfers money from one person to another person within the country itself. Therefore, the internal debt is somewhat better than external debt.

2.10.3 Review of Others Studies

In this study attention has been paid to collect materials from other sources as well. In the process of collecting materials, the recent technology, ‘computer’ has been used. The internet has been used to collect relevant information required for study. The study of bank of Thailand is somewhat relevant and the purpose of issuance of the government securities has been explained in this study. So these have been considered for the preparation of this report. The bank of Thailand took over the following four bonds after its establishment in 1942. The ministry of finance entrusted the Thai National Banking Bureau to manage the bond sales as follows:

- Loan bond for the cooperatives B.E. 2483 (1940), a bearer bond issued in the act of 20 million Bhatt with 30 years maturity at 4.5 percent interest per annum. The purpose was to raise capital for cooperatives to lend to their members.

- Loan bond for municipality B.E. 2483 (1940), a bearer bond issued in the amount of 20 million Bhatt with 30 years maturity at 3.5% per annum. The purpose was to raise fund for the municipality development.
- Loan bond for industrialization B.E. 2483 (1940), a bearer bond issued in the amount of 20 million Bhatt with 30 year maturity at 4.5% per annum. The purpose was to raise fund for lending to the public organizations or entrepreneurs.
- National loan bond B.E. 2483 (1940) and National note, issued in the amount of 8 million Bhatt with 7 year maturity at 2% per annum, and 2 million Bhatt with 10 years maturity, respectively. The national note was a bearer note sold for 5 Bhatt per unit, redeemable for 6 Bhatt per unit. The purpose of the two borrowings was to compensate the treasury reserve spent on the Indo-China war.

Thus the government of every country has different purposes for issuing different types of bonds. In 1945, the Thai government implemented short-term borrowing for the first time by holding auction of the Treasury Bill with maturity period of less than 12 months, in accordance with the Treasury Bill act B.E. 2487 (1944). In terms of long term borrowing, issuance of the government bonds was used as a tool. Issuance of both Treasury Bill and government bonds was backed by loan acts issued for the specific purposes. It was until 1960 that the government issued the “Budgetary Appropriations Act (No. 2) B.E. 2503 (1960)”, as amended from the Budgetary Appropriations Act B.E. 2502 (1959) in some major sections concerning borrowing. When budgetary expenditures or additional budgetary expenditures previously promulgated exceeded budgetary revenues, the ministry of finance was empowered to borrow for expenditures as needed. However, such borrowing must not exceed 20% of the budgetary expenditures plus additional budgetary expenditures. Alternatively, the ministry of finance could draw an overdraft facility at the bank of Thailand. As the first national economic and social development plan (1961-1966) was launched, the government, in each year, had to increasingly secure fund to compensate the budget through domestic borrowing. Treasury Bonds are the government's way of borrowing money, so lower deficits mean a smaller supply of T-Bonds and higher prices. With bonds, higher prices are equated with lower yields. (www.bot.or.th)

The government has to borrow money at lower interest rates. The impact ripples across all other interest rate bearing securities and creates lower interest rates for stocks, which is bullish. The higher the budget deficit, the more Treasury Notes and bonds must sell to finance its operation.

The government of Canada has been issuing various types of government bonds. They have been issued by different governmental bodies. They issue different types of government bonds. In Canada, investors have different attitudes while they are making investment towards government securities due to various government bodies in the country. They have the authority to issue securities (http://www.finpipe.com)

Treasury Securities, Treasuries, US Government Bonds, T-Bonds, T-Notes, T-Bills, and Govies all refer to the same type of security, and are debt obligations of the United States. Investor lends money to the federal government, which repays investor with interest.

Maturity refers to the length of your loan to the government. Treasury Bonds have maturities longer than 10 years (usually sold as 30 year bonds). Treasury Notes have maturities of 2 to 10 years (usually 2, 3, 5 and 10 year notes). T-Bills have maturities typically from 3 months to 1 year (usually 3month, 6 month and 1 year bills).

In the past, the minimum purchase amount varied by maturity. In august 1998, the Treasury ruled that all securities it issues now have minimum denominations of $1000.

2.10.3.1 Review of Thesis

Many related thesis has been studied from different sources to add more value to the study. Material has been collected from different campuses' library done by different students in different period of time. Some of the campuses where the materials have been collected are Tribhuvan University, Management dept., Nepal Commerce Campus, Public Youth campus etc. Some of the studies that are indifferent between other and are vital for the studies are presented below:

The government of Nepal is successful to manage the debt raising and repayment smoothly. But debt management tools are not emphasized rather than raising the funds and repayment the same figures. Some debt management tools like information management, strategic management are still not been prioritized by the concern agencies. The debt management objectives are cleared and the debt management institutional framework has been formed. Marketing Management is sound and successful in terms of raising the required funds. Following the presentation and analysis chapter, the time series analysis predicts the internal borrowing is in fluctuating with comparison to the estimated line. Likewise the ratio of public debt to GDP has reached nearly 67.41% that is becoming the real challenge for the nation's annual income. But the correlation factor between the government deficit and the total borrowing is positive i.e. 0.83 that means the upcoming budget size will increase and the contribution of national debt will be further dominating the Government budget to bridge the deficit gap. Finally, debt management is sound and systematic in Nepal but it should be revolutionized including information and strategic management tools on the days ahead (Pant, 2006:88).

The average annual growth rate of fiscal deficit in terms of GDP shows decreasing tendency which might have been due to the increasing trend of foreign grants and revenue from remittances. The share of external loan in total is increasing which might be due to excess reliance on external loan for financing fiscal deficit. The major sources of internal loan in banking which is nearly three fourth to total loan. Banking sources from internal loan is supposed to cause inflation in the economy. The share of multilateral loan in total loan is increasing. Similarly, the indebtedness of internal and external debt in absolute terms and with respect to GDP is increasing. The internal debt service ration has increased rapidly. This may compel government to cut development expenditure or take fresh loan for financing old loan. The ratio of external debt service to export does not appear to have been reduced due to the low export capacity and increasing debt service obligation of the government. The position of net transfer suggests the increasing trend of imports and debt servicing. The primary surplus less than debt serving suggests the incapability of government to finance additional debt burden in the recent years (Chaudhary, 2008:74).

Internal public debt has played significant role in the financial resources for development expenditure as well as in the growth of money and capital marked and it facilities the effective implementation of monitory policy. Internal debt is one of the best way of financing which helps to control inflation and to mobilize the internal financial resources in the productive sector of the country's economy. If exceeds the maximum legal limit of internal borrowing increases the state has to face inflation problem. So internal borrowing should be used as per the need of the economy. Public internal debt is not utilizing effectively in Nepal. Because it is not contributing to increase productivity in the economy. The increasing rate of national income and G.D.P. is lower than the rate of increase in internal debt. Internal borrowing and debt servicing obligation are increasing trend but debt servicing capacity of the country has not been increase with the same pace. During the review period, average annual growth rate of revenue is low as compared with debt and debt servicing obligation. This shows our debt servicing capacity is very poor to sustain increasing debt servicing obligation (Dhakal, 2006:56).

The basic objectives of the study were to examine the practices of government securities in Nepal and the attitude of investors towards it.

By analyzing the findings of present study it can be conclude that the government is borrowing the internal in increasing trend, the composition of the internal debt is built by several government securities and the major portion of internal debt is covered by the short term debt like treasury bills, overdraft etc.

Similarly, this study concludes that government is borrowing the internal debt on the basis of needs and all the classes of individual people, banks, financial institution, government owned organization, private sector investors are the main investors of government securities types of government securities.

Regarding the attitude and preference of the investors towards the government securities, general investors are found tremendously positive toward the government securities. The general investors prefer to invest on government securities because of the risk on this investment and unavailability of other investment opportunities.

Because of insufficient revenue resources to meet the deficit budget, lack of regular commitment of foreign and donor agencies on development of the country, it can be assumed that the growth of internal debt in Nepal in coming years will be increased in same pace (Pokhrel, 2007).

The findings led the study to conclude that the market of government securities are in increasing trend but secondary market is not developed smoothly as primary market & major portion of G.B. are held by individual in recent year. Trend amount of marketable securities are in growing trend while non-marketable securities (i.e. special bonds) are decreasing. Similarly interesting conclusion id that the market interest rate is decreasing while the coupon rate of government securities are not decreasing as decreased of market interest rate. Another conclusion is that secondary market of treasury bills held by NRB are more efficient then bond market which are in increasing trend. Lastly from the field research it is concluded that secondary market of government securities are not developed efficiently and many problems are existed ion government securities market (Panday, 2007).

2.11 Research Gap

Many researchers were done on the government securities & its practices in Nepal. Most of researchers were base on past secondary data. Major thesis were focused on the trend analysis of government securities. Some researcher had attempted to analyze the primary data classifying them into category of institutional and individual group, but has not tried to analyze the primary data based on their income brackets, profession who he or she belonged to. Further no ones research work were studied the ownership pattern at the government securities, which is a crucial matter of public debt. It shows the interest of various investors on specific types of government securities. Besides most of the analyzed the trend and issue system of government securities on lump sum, but because of specific nature of particular securities, it has to be analyzed separately.

Hence, review the related literature in this regard and considering the several gaps, this thesis has been presented at its best to fulfill those insufficient and vital matters. Thesis has covered the short term & long term securities growth and problems and its practices in Nepal. It has presented different data and its analysis that are sufficient to overview the clear image of government securities and its practices in Nepal.

CHAPTER - III

RESEARCH METHODOLOGY

3.4 Introduction

Research methodology is a systematic way to solve the research problem. In other words, research methodology describes the methods and process applied in the entire aspect of the study. Research methodology refers to the various sequential steps (along with a rational of each step) to be adopted by a researcher in studying a problem with certain objectives in view. Thus, the overall approach to the research is presented in this chapter. This chapter consists of research design, sample size and selection process, data collection procedure and data processing techniques and tools.

3.5 Research Design

A research design is the specification of methods and procedures for acquiring the information needed. It is the overall operational pattern of framework for the project that stipulates what information is to be collected from which sources and by what procedures. The research design followed for this study is historical, analytical and descriptive. To determine the Government security and deficit budgeting relation, historical data are analyzed and the research design followed is also analytical. For some qualitative factors, the research design is descriptive as per the objectives of the study.

3.6 Population and Sample

Various types of bonds both in government and private sector are there in the market but this study only considers about the government bond which are purchased by different institution such as Nepal Rastra Bank, commercial banks, financial institutions, provident fund, govt. business enterprises, private business enterprises, national insurance company, individuals, non-profit organizations etc.

3.4 Sources and Nature of Data

This study requires both primary and secondary data. The sources of secondary data are collected from published annual reports of NRB, quartilely bulletins, NRB Samarachar, Rastra Rinpatra, various thesis, books, various papers, journals, magazines and websites. The source of primary data is 60 correspondents who are concerned with various professions of different institutions who helped research by filling 16 questions from questionnaire supplied to them. Some part of primary data consists of direct interview with managers of concerning institutions.

3.5 Method of Data Analysis

Data collected for the study are presented in various forms. Most of the secondary data are presented in tabular form and some graphical presentation is also used. Since the primary data collected are more subjective and they are presented in tables and graphs and conclusions have been drawn. So far as the computation is concerned; it has been done with the help of scientific calculator and computer software programmed.

As per the requirement of the study and its objectives available data are analyzed using following statistical tools.

Arithmetic Mean: It is the sum of all the observations divided by the number of observations. In such a case all the items are equally important. Simple arithmetic mean is used in this study as per the necessity in analysis.

$$\text{Mean}\left(\bar{X}\right) = \frac{\sum X}{N}$$

Where, $\sum X$= sum of all values of the variable 'X'

N = number of observations

X= variables involved

Growth Rate (Change)

It is the mathematical tool for data analysis. It is the change in amount of this year as compared to previous year amount divided by previous year amount.

$$\text{Growth Rate X}\frac{\text{Change in Amount}}{\text{Previous year Amount}}\,|\,100$$

Graphs

The line graph is used for the study of trend of issue of government security in Nepal. Multiple bar diagram is also used for presentation of issued amount in a single figure.

3.6 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. In Nepal, the coupon is usually paid on annual or semi annual basis.
- Par value: It is apparent worth i.e. the normal value of the bond, which appears on the face of the debt instrument. 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 purchasing 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.

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

This chapter deals with the main body of the study i.e. the presentation and analysis of the performance of the loans raised by government. This chapter includes two sections; they are (a) Trend and structure of government debt in Nepal (b) Investors attitudes towards government securities

4.1 Secondary Data Analysis

4.1.1 Present Position of Government Securities in Nepal

The government of Nepal has been issuing four types of securities. Therefore, the government issues various bonds to recover the deficit budget of Nepal. Every year, the government has adopted a deficit budgetary system in the name of development functions. They are Treasury Bills, Development Bonds, National Saving bonds, Special Bonds, Citizen Saving Bonds and overdraft. They are debt-borrowing instrument in Nepal. The types and amount of government securities under the review period 1999-2007 is tabulated below:

1. Treasury Bills

The Treasury Bills is a short term loan which is familiar in the market. Most of the commercial banks use such bond. The reasons for buying this bond may be more liquid nature. Banks can use this bond for REPO agreement also. The investors of such bond are NRB, commercial banks and others. The trend of the TB is described by the following table 4.1:

Table 4.1

Treasury Bills

(Rs. in million)

Years	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Amount	2510	1781.4	1500	1768.5	2460	5471.2	10834.2	12051.5
Change(%)	-	(29.03)	(15.8)	17.9	39.1	122.37	98.02	11.24

Sources: Monetary Policy 2007/08

Figure 4.1

Treasury Bills

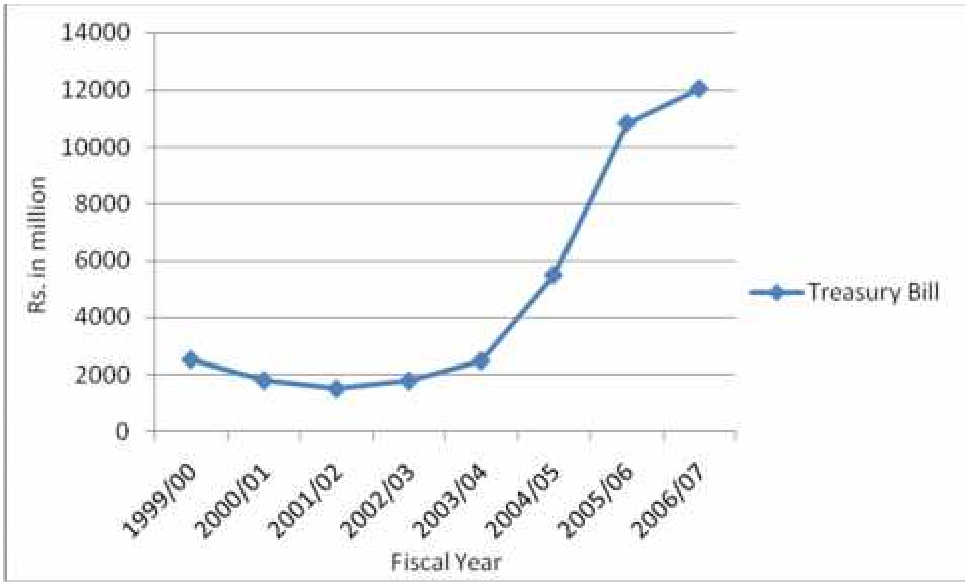


Table 4.1 shows that in the initial period of the study the trend of the issuing TB was slightly decreasing. But from FY 2002/03 the issue amount were increasing. The rate of increase is upto122.37% in FY2004/05, 98.02% in FY 2005/06 and 11.24% in FY 2006/07. The trend clears that popularity of such bond is going on increasing.

2. Development Bonds

The Development Bond is a long term bond which matures in more than one year. The investors of such bond are NRB, commercial banks, financial institutions, provident fund, government business enterprise, private business enterprise, individuals and non-profitable organizations. It is issued for fulfilling deficit amount of fund for development work. The trend of the Development Bond is described by the following table 4.2:

Table 4.2

Development Bonds

(Rs. in million)

Years	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Amount	790	1700	5372.1	6408.5	2000	3000	750	5500
Change(%)	-	115.19	216.01	19.29	-68.79	50	-78.33	633.33

Sources: Monetary Policy 2007/08

Figure 4.2

Development Bond

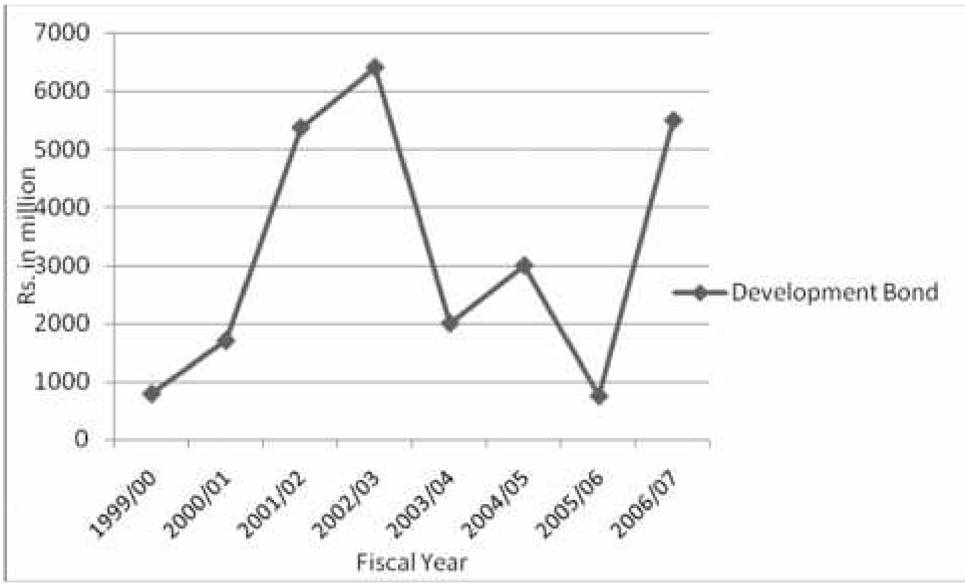


Table 4.2 and graph 4.2 shows that the trend of issue amount of Development Bond was increasing till FY 2002/03 up to growth rate 216.01% but on the remaining review period the rate is more fluctuating. The issue amount reach up to Rs.6408.5 million from Rs.790 million and finally it slide down up to Rs.750 million in FY 2005/06. The reason may be not suitable environment for the development work in the country. But in 2006/07, the growth rate has increased to 633.33% which shows enthusiastic increment.

3. National Saving Certificates

National Saving Certificate is also a long term bond which matures in more than one year. But in the recent year it is not issued. The investors of National

Saving Certificates are NRB, commercial banks, financial institutions, national insurance company, provident fund, government business enterprise, private business enterprise, individuals and non-profitable organizations. The trend of the National Saving Certificates is described by the following table 4.3:

Table 4.3

National Saving Certificates

(Rs. in million)

Years	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Amount	2200	2100	499.8	400	900	216.9	0	0
Change(%)	-	4.55	(76.2)	19.97	125	(75.9)	-100	0

Sources: Monetary Policy 2007/08

Figure 4.3

National Saving Certificates

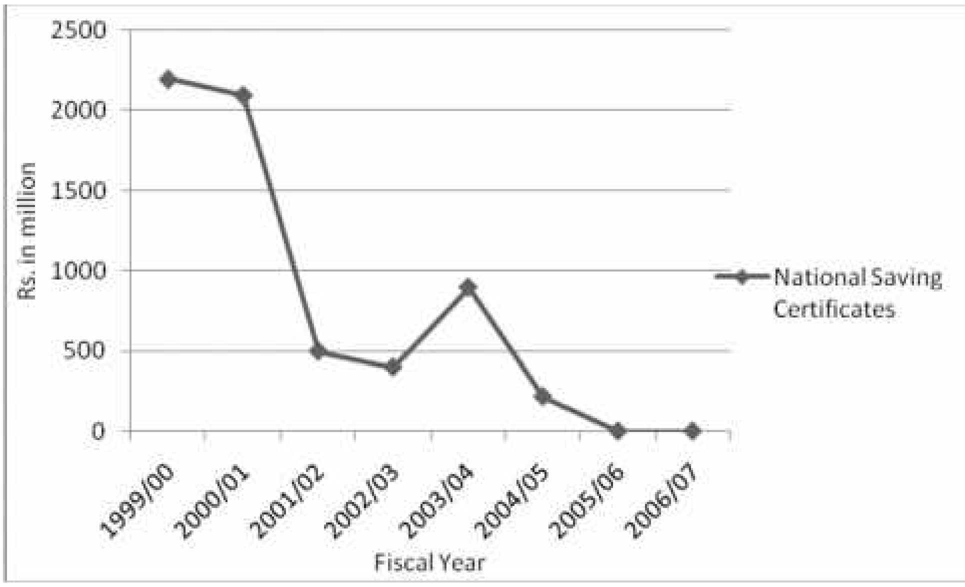


Table 4.3 and figure 4.3 shows the trend of issuing National Saving Certificates. This is in decreasing order except FY 2003/04 in the review period. In the FY 2005/06 and 2006/07 the bond is not issuing due to the policy of government not to issue such bond.

4. Citizen Saving Certificates

This is non marketable and tax exempted debt instruments usually issued for the retail public (household sector). Currently it is not popular for the investors because of the establishment of more insurance company which is also non taxable instrument. The trend of the Citizen Saving Certificates is described by the following table:

Table 4.4

Citizen Saving Certificates

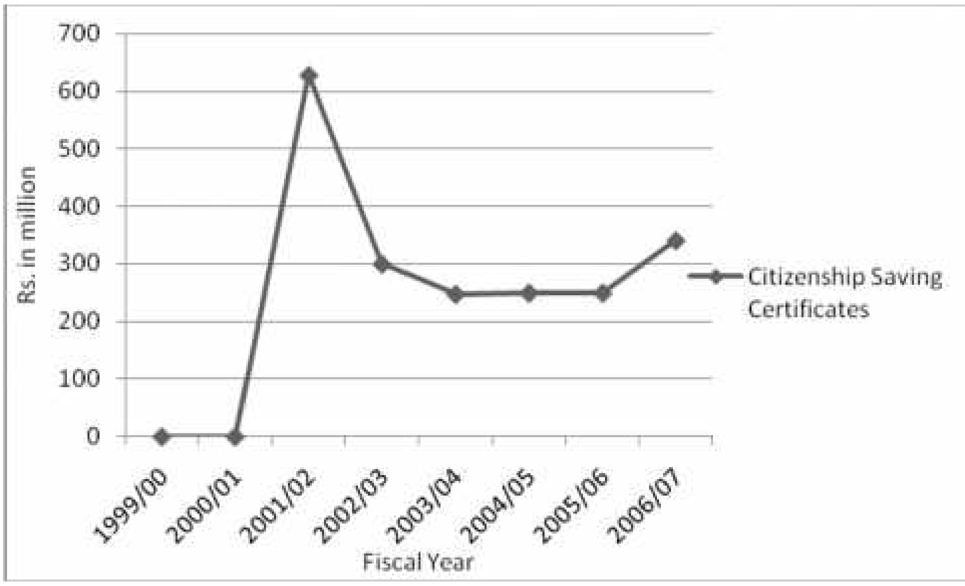
(Rs. in million)

Years	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Amount	0	0	628.1	303	247.8	250	250	340.8
Change(%)	-	-	-	(51.76)	(18.22)	0.009	0	36.32

Sources: Monetary Policy 2007/08

Figure 4.4

Citizenship Saving Certificates



From table 4.4 and figure 4.4 describe the trend of issuing Citizen Saving Certificates. This Certificate was not issuing up to FY 2000/01and it is same amount in the FY 2004/05 and FY 2006/07 of review period. The trend of issuing amount is more fluctuating. In 2006/07 the growth rate has slightly increased to 36.32%.

5. Overdrafts

Government may not have sufficient fund in any time due to unduly collected revenue. It is the facility given by the NRB to the government. But government can't Overdraft more than 10% of last year's revenue. The trend of the Overdrafts is described by the following table 4.5 and figure 4.5:

Table 4.5

Overdrafts of Nepal Government

(Rs. in million)

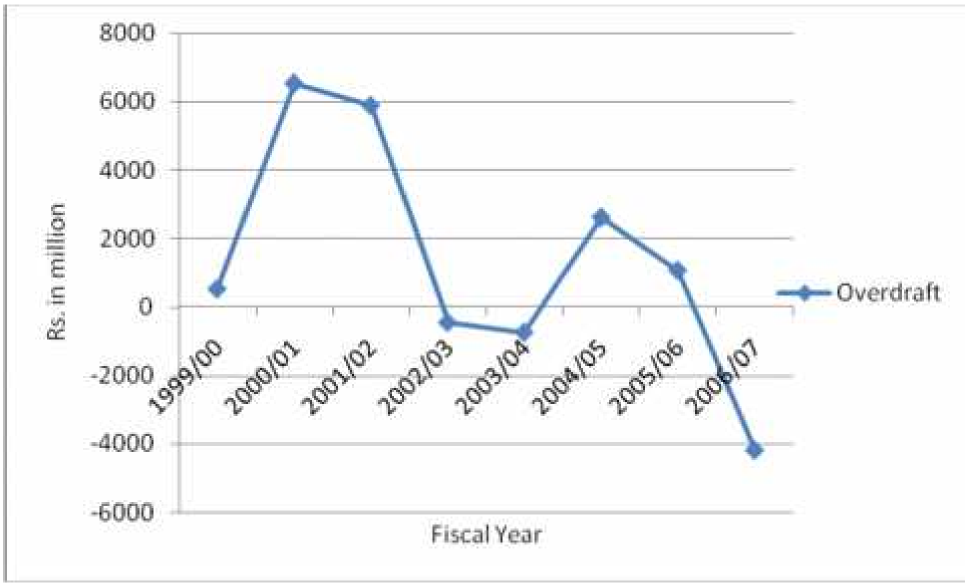
Years	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Amount	522.7	6546.7	5898.3	(461.4)	(753)	2623	1071	(4201)

Bracket indicates surplus

Sources: Monetary Policy 2007/08

Figure 4.5

Overdrafts



The Overdraft amount is taken by the government to fulfill current financial problem which is not meet by the revenue collection at that time. In the

FY2002/03 and 2004/05 the amount is being surplus. But in 2006/07, the amount is being deficit.

4.1.2 Summary of Internal Loan

Government collects Internal Loan by issuing different types of instruments like Treasury Bills, Development Bond, National Saving Certificates, Citizen Saving Certificates and Special Bond. Different bonds and their respective issued amount are shown by following table 4.6 and figure 4.6:

Table 4.6

Internal Loan of Nepal Government

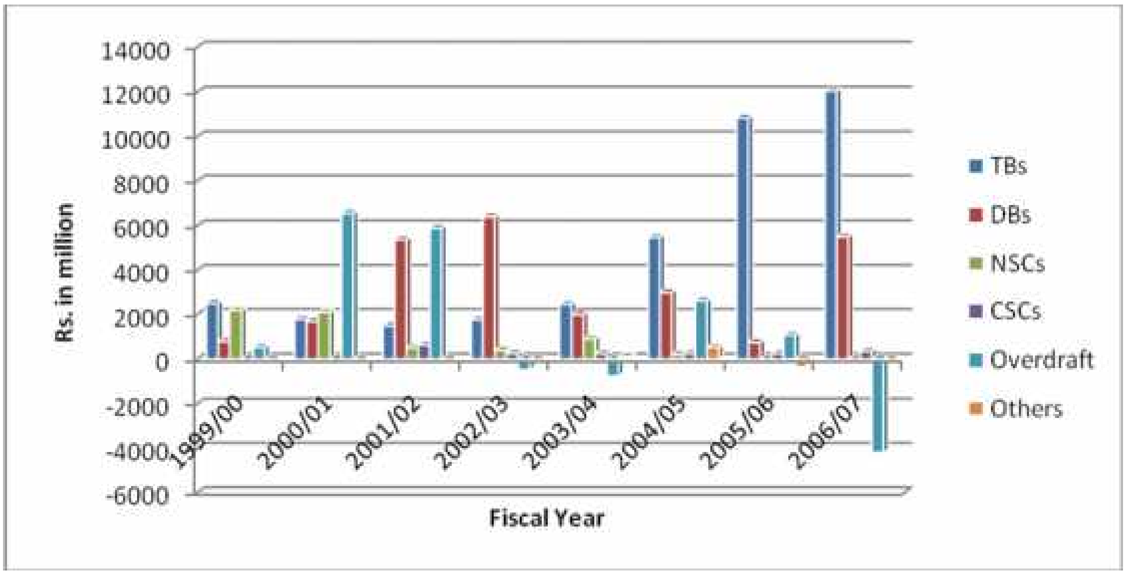
(Rs. In million)

Years	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Heads	Amount	Amount	Amount	Amount	Amount	Amount	Amount	Amount
Treasury Bills	2510	1781.4	1500	1768.5	2460	5471.2	10834.2	12051.5
Development Bonds	790	1700	5372.1	6408.5	2000	3000	750	5500
National Saving Bonds	2200	2100	499.8	400	900	216.9	0	0
Citizen Saving Bonds	0	0	628.1	303	247.8	250	250	340.8
Overdrafts	522.7	6546.7	5898.3	(461.4)	(753)	2623.0	1071	(4201)
Others	0	0	(29.2)	(143.7)	116.2	524.6	(323.2)	(105.5)
Total	6022.7	12128.1	13869.1	8274.6	4971	12085.7	12582	13585.8

Sources: Monetary Policy 2007/08

Figure 4.6

Internal Loan



As compared to different years' issue amount of government bond, the volume of TB is larger than other bonds. It is more popular in the recent years to the financial institutional. In the last review period the National Saving Certificates is not issuing. The issued amount of Treasury Bills is in rapid growth. The trend of other bond is more fluctuating by which it can not be forecasted.

4.1.3 Total Internal Loan

Total combined amount of internal loan is the total internal loan. This amount depends upon the deficit budget, foreign loan and foreign grant. So the trend of this amount is more fluctuating. The following table and graph explain the amount and trend of total internal loan

Table 4.7

Total Internal Loan

(Rs. in million)

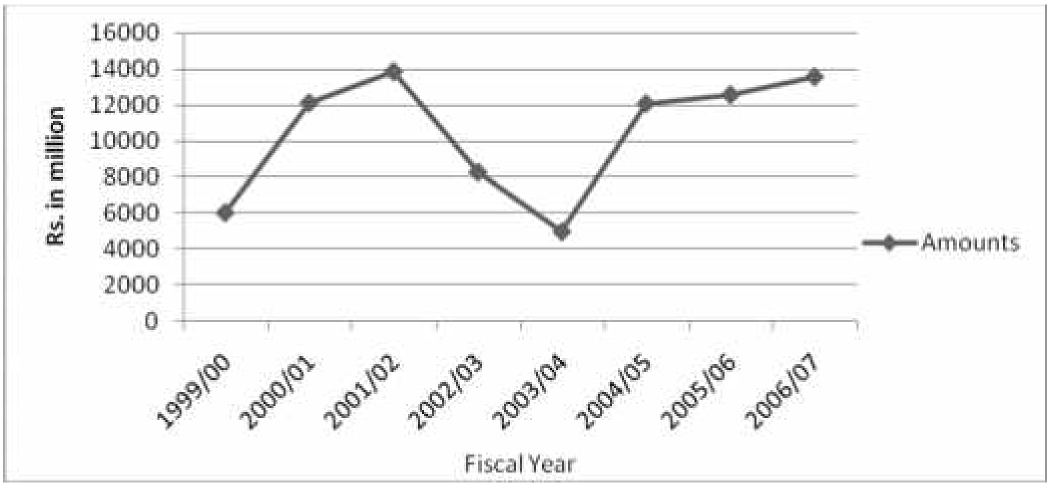
Years	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Amounts	6022.7	12128.1	13869.1	8274.6	4971	12085.7	12582	13585.8
Change(%)	-	101.37	14.36	-40.33	-39.99	140.55	4.1	8

Sources: Monetary Policy 2007/08

The internal debt was decreasing in the FY 2002/03 and FY2003/04 but in other review period it is increasing. The issue amount is 2.62 times greater in the last fiscal year as compare to the first fiscal year.

Figure 4.7

Total Internal Loan



4.1.4 Different Scenarios of Resource Gap

Government prepares budget annually to meet national policy. Most of developing countries prepare deficit budget due to more expenditure than revenue collected. Government fulfills deficit financing by collecting from foreign grant, foreign loan and internal loan. The following table shows the different year's expenditure and resource gap:

Table 4.8

Different Scenarios of Resource Gap

Rs. In million

Fiscal year	Total Revenue	Annual growth Rate of TR (%)	Total Expenditure	Growth Rate of TE (%)	Deficit	Growth Rate of Deficit (%)	Foreign Grant	Growth Rate of Grant (%)	External loan	Growth Rate of External Loan (%)	Internal loan	Growth Rate of TR (%)	Cash balance
1999/00	42893.6	-	66272.5	-	23378.8	-	5711.7	-	11812.2	-	6022.7	-	354.8
2000/01	48893.6	13.99	79835.1	20.46	30941.2	32.35	6753.4	18.23	12044	1.96	12128.1	101.37	5144.1
2001/02	50445.5	3.17	80072.3	0.3	29626.8	-4.25	6686.1	-1	7698.7	-36.08	13869.1	14.36	7241.9
2002/03	56229.8	11.47	84006.1	4.91	27776.3	-6.25	11339.1	6.96	4546.4	-40.95	8284.4	-40.27	3010.8
2003/04	62331	10.85	89442.6	6.47	27111.6	-2.39	11283.4	-0.49	7629	67.8	4971	-40	2591.4
2004/05	70122.7	12.5	102560.5	14.67	32437.8	19.65	14391.1	27.54	9266.1	21.46	11957.6	140.55	157.7
2005/06	72282.1	3.08	110889.2	8.12	24799.6	37.42	13827.5	3.91	8214.3	11.35	11834.2	32.4	4731.1
2006/07	87712.1	2.13	133604.6	20.48	30091.7	21.13	15800.8	14.27	10053.5	22.39	17892.3	51.19	2145.9
Average Growth Rate (%)	-	8.17	-	10.77	-	13.98		9.92	-	3.6	-	21.1	

Source: Economic Survey MOF/NG 2006/2007

The table 4.8 reveals the resource gap which is the difference between revenue and expenditure of the government. The resource gap is increased from Rs. 23378.8 million in Fiscal Year 1999/2000 to Rs.30091.70 million in Fiscal Year 2006/2007, which is 1.28 times more than of starting year of review periods. In average annual basis it was remained 13.98 percent. However, the revenue of Nepal government increased Rs. 42893.6 million in Fiscal Year 1999/2000 to Rs. 87712.1 million in 2006/2007. In average annual growth rate was 8.17 percent, which is 2.04 times more than of starting year of review period. On the other hand the government expenditure met 2.02 times more than of starting year of review period 1999/2000-2006/2007.

Thus, it shows some what improvement in rapid growing tendency of budget deficit in comparison with the increasing tendency of Nepal government expenditure. But in relative term, the table shows the horrible increment of budget deficit that increased from Rs. 23378.8 million to Rs. 30091.7million.

The deficit is fulfilled by three elements, grants in the most potential source of foreign currency, which is the best instrument for the government to import the capital goods and to pay the interest and principle of external debt. Moreover, it can be used on capitalization itself. It does not give burden to the economy. But the table 4.8 shows the up-swing and down-swing tendency of grant component. However, the table shows the increasing tendency of grants Rs. 5711.7 million in Fiscal Year 1999/2000 and reached Rs. 15800.8 million in Fiscal Year 2006/2007, in average it was 9.92 percent, annual.

During the review period, amount of bilateral and multilateral grants has not been increased sufficiently, which has created a sort of constraints in the scenario of state’s economy as a whole. Hence, Nepal Government has been committed to reduce the unproductive expenses, though considering the achievement we can not get the satisfactory impacts on aggregate economy of the nation.

The second element of resources, the external loan was Rs. 11812.2 million in 1999/2000 but it reached Rs. 10053.5 million in 2006/2007, which is 0.85 fold of starting year of review period. On the other hand, the internal debt amounted to Rs. 17892.3 million in 2006/2007 from Rs. 6022.7 million in 1999/2000. Growth of internal loan is not constant. In average it is 21.10% and it is 2.97 fold more than that of starting year of review period.

The cash balance shows the difference between already determined deficit to sum of its every recovery [deficit – (grants + internal debt + external debt)]. The amounts more than necessity are understood as surplus which is called the domestic resource gap and these are to be financed through government's cash balance.

And finally the fiscal deficit shows the amount of [TE- (TR + Foreign grants)]. This increased from Rs. 23378.8 million in starting year of review period 1999/2000 to Rs. 32437.8 million in last year of review period 2006/2007.

4.1.5 Public Debt and GDP

"GDP measures the total output of goods and services for final use produced by residents and non-residents, regardless of the allocation of domestic and foreign claims" The function of public borrowing is also guided by the indices of GDP. Government should borrow the internal debt in limit of 1-2 percent of GDP for economic betterment. But there is no any boundary in case of foreign borrowing; however it must keep within certain limit of GDP. Internal borrowing direct interference the private investment in the nation in the two ways: firstly, it transfers resources from private to government sector and secondly, it has adverse effect on the capacity and willingness to save. The following table clearly shows the percentage of internal and external debt to GDP. (world Bank, 1995).

Table 4.9

Public Debt as Percentage of GDP

(Rs. in million)

Fiscal Year	GDP at Producers price	Growth Rate of GDP(%)	Total Debt	External loan	Internal loan	Total % of Debt to GDP	% of Internal Debt to GDP	% of External Debt to GDP
2000/01	441519	4.06	19044	12044	7000	4.31	1.59	2.73
2001/02	459443	7.14	15698.7	7698.7	8000	3.42	1.74	1.68
2002/03	492231	7.14	13426.4	4546.4	8880	2.73	1.80	0.92
2003/04	536749	9.04	13236.8	7629	5607.8	2.47	1.05	1.42
2004/05	589412	9.81	18204.2	9266.1	8938.1	3.09	1.52	1.57
2005/06	654055	10.96	20048.5	8214.3	11834.2	3.07	1.81	1.26
2006/07	727089	11.16	27945.8	10053.5	17892.3	3.84	2.46	1.38
Average Annual	-	8.47	-	-	-	3.28	1.71	1.57

Source: Economic Survey 2006/2007, MOE/Nepal Government of Nepal.

In table 4.9 we can see the gradual increment of GDP and debt in 2001/2001 to 2006/2007. The GDP increased up to Rs.727089 million in 2006/2007 from Rs. 366251 million in 1999/2000. The average annual rate of increase of GDP was 8.47 percent. The percentage of total debt to GDP in starting years of review period (2000/2001) was 3.84 percent and it placed only 4.17 percent in the final year of review period (2006/2007), which indicates our satisfactory progress of GDP compared with the indebtedness of country.

In case of internal debt, the table 4.9 reflects decreasing tendency in comparison with the growth rate of GDP. The percentage of internal debt to GDP in the beginning year of review period (2000/2001) was 1.59 and the final year of review period (2006/2007) it had increased to 1.59 percent of GDP. In the year 2000/2001, the internal debt was less than the specified limit of 2 percent of GDP but in other period it is more than that limit. In an average internal debt rate is 1.71% of GDP which was not satisfactory level. The percentage of external debt to GDP has generally existed within the range of 0.5-3 percent. It is not so remarkable condition but we should grimly consider the heavy increase in foreign debt and its some burden servicing.

4.1.6 Outstanding Government Domestic Debt Securities issued by NRB

Government loan has all the 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. Loan outstanding with the different buyers is mentioned as below:

Table 4.10

Outstanding Government Domestic Debt

(Rs in million)

Investors	2001	2002	2003	2004	2005	2006	2007
NRB	17399.7	24122.3	23685.7	19138.8	17445.8	15805.0	20101.8
Com. Bank	25392.9	29361.2	39469.3	43796.3	48550.7	58861.4	65836.4
Others	17251.1	201372.2	21490.3	23198.6	25567.7	20044.4	17837.9
Total	60043.7	7362O.7	84645.3	86133.7	87564.2	94710.8	103776.1

Sources: Rastra Rin Khabarpatra, NRB 2007

NRB and Commercial banks are the main holders of government bonds. The share of NRB and others decreased from 28.98 percent and 28.73 to 19.37 percent and 17.19percent from 2000 to 2007 respectively. Shares of Commercial banks were 42.29 percent in 2001 and increased by 63.44 percent in 2007. It shows that it is more popular to the commercial banks rather than others. The reason may be more liquidity with commercial bank due to lack of investment opportunity in the market.

4.2 Primary Data Analysis

4.2.1 Introduction

The analyst may judge the simple approximation instead of the result of test of goodness of fit, test of independence, and test of homogeneity but unless and until it is proved statistically. It can not be certified as an authentic accreditation. This study has attempted the sample survey among the security holders and awareness on government securities. 60 sample sizes were taken which were scattered at most, among the various categories of people in regards to their income, residence, profession, awareness, etc. There were 14 questionnaires, requested to fill up to test the investors' attitude towards government securities.

The public debt departments of NRB, civil servants of Ministry of Finance have put their view in favor of public borrowing as the most popular investment. On the other hand, the private stockholders who were dealing highly marketable stocks at Nepal stock exchange argued the government securities are created for those who are attracted to invest in the government securities. As the issue is closely related to economics and due to the fact that government security is beyond the reach of the common people naturally they did not want to go into the depth and refused to answer in detail. On the matter of government security they were indifferent.

This study has considered various income groups, various professions of investors, various geographical areas and so on. The test has tried to find out whether the awareness of investors on government securities is dependent upon their respective profession, income or not.

Some investors invest on government securities as they consider it more beneficial and secured. They have expressed their satisfaction on such investments. They do not sell the bonds until they need cash for some sorts of urgent need. In brief they are entirely satisfied as investors on government security. They have no particular grievances against the procedure of debt financing management. Similarly, some investors invest on government securities as they can not find other sound investment opportunity. Besides they understand that the government securities are more secured than others. In fact, the attitude towards the government bonds is not so satisfactory. They sell government bond if they find the good investment opportunity in the market.

Some investors invest on government security because of its financial return, marketability etc. They are very watchful about whether the amount they have lent to the government is utilized properly or not. It is natural because they lend the money at low rate of interest so that they may also contribute to the nation according to ability and status. They sell the government security when they require fund or when they are psychologically dissatisfied with the government security. Likewise they sell the bonds if more beneficial opportunity appears in the market**.**

4.2.2 Investors Attitude towards Government Securities

A questionnaire was prepared to evaluate the attitude of investors on government securities in Nepal. There were 14 questions (see Appendix - I) and 60 respondents included in analysis. The respondents were service holders, university students, business man, and others. The attitudes of investors are explained below in the basis of collected sample.

1. Investors' Classification

Investors investing in government securities are classified into two types: institutional investors and individual investors. Out of the total 60 respondents, 66.67% belonged to individual investors' group and 33.33% were institutional investors. Following table describe the above mention information:

Table 4.11

Investors' Classification

Options	No. of Correspondents	Percentage
Institutional	20	33.33
Individual	40	66.67
Total	60	100

Source: Field Survey, 2009

Individual investors are more interested in government securities as compared to institutional investors. It shows individual investors are highly scattered. Institutional investors are invisibly in fewer amounts due to the less number of investing institution established in the nation. It concludes that the majority of government securities investors are individual.

2. Source to know about Government Securities

In response to the question of time since they have known about Government securities, majority 58.33% respondents felt that they have known about the Government securities by being as staffs of company, 33.33% respondents come to know from papers/government securities, rest 16.67% have come to know from relatives/friends.

Table 4.12

Source to know about Government Securities

Options	No. of Correspondents	Percentage
Relatives/Friends	10	16.67
Papers	20	33.33
Staff of company	35	58.33
Total	60	100

Source: Field Survey, 2009

Most of the investors grab the information about the government securities as being staff of the different companies. Since the last decade, the investors are more conscious about the investment opportunity available in the market. As the staff of the company they are directly and indirectly related with the financial and economy of the country. Others get the information about government with the help of newspapers and relatives and friends.

3. Reason for Investment in Government Securities

In response to the question of the reason for the investment in government securities, 41.67% respondents responded that investment in government securities was risk less investment, 33.33% respondents invest due to no investment opportunity and rest 25% respondents invest due to lack of corporate securities.

Table 4.13

Reason for Investment

Options	No. of Correspondents	Percentage (%)
Risk less	25	41.67
Zero liquidity risk	0	0
Lack of corporate securities	15	25
No investment opportunity	20	33.33
Total	60	100

Source: Field Survey, 2009

Since the government securities have no risk on investment. Most of the investors are attracted towards it. Government securities are risk less due to its high liquidity, easy on transfer of ownership, provision of collateral and government liabilities on investment etc. There are less investment opportunities in the country due to the political instability, proper infrastructures. So, other investors invest due to the less investment opportunity available in the country. Due to the lack, proper economic environment business organizations are on high risk. Investors are highly conscious on investment on corporate securities.

4. Buyers Income Level

Most of the buyers who buy the securities are of high income level people. 58.33% of respondents, who buy the securities, have income level above Rs. 300000 per annum. 33.33% people whose income is between Rs 100,000 to Rs 200,000, rest 8.33% people their income level is Rs. 200,000 to Rs. 300,000.

Table 4.14

Buyers Income Level

Options	No. of Correspondents	Percentage (%)
BelowRs100000	0	0
Between 100000-200000	20	33.33
Between 200000-300000	5	8.33
Above 300000	35	58.33
Total	60	100

Source: Field Survey, 2009

The survey has proved that high level income people are more conscious on investment on government securities. As they have high liquidity level, the investors on government securities. Government securities are popular towards the investors due to its rate investment.

5. Difficulty while Collecting the Interest and Principal

Out of total correspondents 91.67% investors they do not feel any difficulties while collecting the interest and principle but only few 8.33% investors they feel difficulties. Those who feel difficulties they face the problem by the long process. It shows collecting the interest and principle is quiet satisfactory.

Table 4.15

Difficulty while Collecting the Interest and Principal

Options	No. of Correspondents	Percentage (%)
Yes	5	8.33
No	55	91.67
Total	60	100

Source: Field Survey, 2009

The procedure of collecting principles and interest are easy and simple. It has added plus to the investors to invest on government securities. Only few people feel difficult on collecting principles and interest. It may be lack of information on procedure.

6. Reasons for Selling the Securities

Majority i.e. 66.67% investors they sell the securities when they get good investment opportunities in the market, 25% investors they sell to meet their household requirements, and rest 8.33% sell their securities to get benefit from investment in real state.

Table 4.16

Reasons for Selling

Options	No. of Correspondents	Percentage (%)
To alternative opportunities	40	66.67
To meet household requirement	15	25
To benefit from investment in real estate	5	8.33
Total	60	100

Source: Field Survey, 2009

Most of the investors sell government securities when they find better investment opportunity in the market. There is no doubt that investors always expect of high return. Other investors sell the securities to fulfill the household requirement. Such as marriage, education, health etc. Only few investors are attracted in real state business. This is due to high fluctuation of price on real state business.

7. Major Buyers of Government Securities

The investors respond 75% of total buyers are Financial Institutions, 16.67% are retired people, and rest 8.33% is government employees. Therefore the major buyers of Government securities are Financial Institutions. The main reason may be no other investment alternatives in the market.

Table 4.17

Major Buyers

Options	No. of Correspondents	Percentage (%)
Employee	5	8.33
Business firm	0	0
Financial institution	45	75
Retired people	10	16.67
Total	60	100

Source: Field Survey, 2009

Although there is few numbers of financial institutions, they invest huge amount on government securities. Financial institutions have high liquidity level, the feel free to invest on government securities due to its safe investment. Some retired people invest their life time savings on government securities. Government employees are less conscious on investment. So only few employees invest on government securities.

8. Income Source to Purchase the Securities

58.33% investors they invest from saving money but 41.67% they invest from idle cash. More correspondents save their income to such securities.

Table 4.18

Income Source

Options	No. of Correspondents	Percentage (%)
Saving money	35	58.33
Idle cash	25	41.67
Sale of fixed assets	0	0
Total	60	100

Source: Field Survey, 2009

Saving money is the main source of investors to invest on government securities. Investors feel useless to deposit saving on financial institution since it has less return. So, the investors are more conscious on high return investment opportunity. Only few people respond that their investment source is idle cash. They invest idle cash in government securities as it is good investment opportunity.

9. Reasons for Full Subscription of Securities

58.33% of investors they respond the cause of full subscription is risk-free instrument, 25% investors viewed that its reason is huge amount of idle cash in the market, and rest 16.67% thought its reasons is no investment opportunity in the market.

Table 4.19

Reasons for Full Subscription

Options	No. of Correspondents	Percentage
Good marketing policy of NRB	0	0
Risk free instrument	35	58.33
Huge amount of idle cash	15	25
No investment opportunity	10	16.67
Total	60	100

Source: Field Survey, 2009

Most respondent are in favor of government securities that it is risk less. Most investors invest the government securities as it is safe investment opportunity. Some investors invest their idle cash in government securities. Few investors presented the reason of full subscription on government securities that there are less investment opportunity in the country.

10. Use of Government Borrowing

Majority of the investors respond that government is not using productively such borrowing which represents 58.33%, 25% investors view was used productively, and rest 16.67% investors could not say any i.e. they do not have any idea.

Table 4.20

Use of Borrowing

Options	No. of Correspondents	Percentage
Productively used	35	58.33
Unproductive use	15	25
None	10	16.67
Total	60	100

Source: Field Survey, 2009

The borrowing used by the government is not properly invested on productive area. The outcome of such investment has not satisfied to the investors. Some investors only feel that the government used the borrowing in the productive area. It may be due to the gap of flow of information about productivity of such investments.

11. Amount of Investment in Government Securities

All investors invest less then 25% of their income in government securities. It shows saving or residual income only invested on such security**.**

Table 4.21

Amount of Investment

Options	No. of Correspondents	Percentage
Less then 25%	60	100
Between 25 to 50%	0	0
Total	60	100

Source: Field Survey, 2009

Most of the investors invest only less than 25% of their income. Investors are using their saving for investment. They invest less due to the lack of investment opportunity.

12. Expectation from Government Securities

66.67% of the investors invest in government securities to get regular income and rest 33.33% of them invest to get other benefit.

Table 4.22

Expectation from Securities

Options	No. of Correspondents	Percentage
Regular income	40	66.67
Capital gain	0	0
Others	20	33.33
Total	60	100

Source: Field Survey, 2009

Due to the expectations of regular source of income, most investors are investing on government securities. Investors feel the security of investment and satisfied returns from the government securities. Only few investors invest on government securities to get other benefits like grab of investment opportunity, security of investment etc.

13. Opinion about Present Investment Procedure

41.67% of correspondent view that present procedure is satisfactory but rest 58.33% of the investors could not say anything about it. They are neither satisfactory nor unsatisfactory.

Table 4.23

Opinion about Present Investment Procedure

Options	No. of Correspondents	Percentage

Satisfactory	25	41.67
Neither satisfactory nor unsatisfactory	35	58.33
Unsatisfactory	0	0
Total	60	100

Source: Field Survey, 2009

The procedure of investment on government securities seem to be neither satisfactory nor unsatisfactory. Most respondent are equally satisfied and unsatisfied with the procedure. Investors have different opinion on same point. Only few investors are fully satisfied with the procedure on investors.

14. Preference Given to the Securities

While asking the question which securities do you prefer?, 33.33% investors prefer National Saving Certificates, 25% investors equally prefer Treasury Bills and Citizen Saving Certificates, and only few 16.67% investors prefer Development Bond.

Table 4.24

Preference given to the Securities

Options	No. of Correspondents	Percentage
Treasury bills	15	25
Development bond	10	16.67
Citizen investment bond	15	25
National saving certificates	20	33.33
Special bond	0	0
Total	60	100

Source: Field Survey, 2009

Citizen investment bond is the most popular among the investors. Treasury bills and citizen investment bond is equally preferable to the investors. Only few investors are interested on investment on development bond.

4.3 Major Findings of the Study

- The government has adopted a deficit budgetary system in the name of development functions. Treasury Bills, Development Bonds, National Saving Bonds and Special Bonds are debt borrowing instruments in Nepal. Government has been taking overdraft every year. It has also been collecting a huge amount by issuing these securities. From past few years, it has been issuing Citizen Saving Certificates to collect the funds from people. Treasury Bills are normally floated for the period of 28 days, 91 days, 182 days and 364 days. In the year 2004/05, the Development Bonds were Rs 3000 million. Various securities are issued for the purpose of fulfilling varieties of the country.
- Internal borrowing has been fluctuating in different period of time. It is depending upon the deficit financing and collection of revenue. The government borrows largest funds by issuing Treasury Bills. It shows that TB is issued not only to meet deficits financing, it is also issued to control the inflation rate.
- Long term loan has been issued by auction since 2003 and it also sold on premium. Till then secondary market was performed by NEPSE.
- Nepal has been suffering from capital shortage since the first budgets speech of Nepal. So it has been going through a critical phase of inadequate financial resources, while its duties and responsibilities are widening day by day. But the public funds available for the administration and development are limited. The government, therefore, adopts the policy of borrowing internally and externally. This study is limited only to the internal borrowing policy of Nepal.
- The government has been adopting liberal policy in the matter of collecting funds. The main objective of internal borrowing is to collect idle funds from the people to use it in productive sectors. But this unlimited and unsystematic borrowing may cause negative impact on the economy in the future. It has led the country to be considered as a levered country. Borrowing is good if borrowed fund is used in productive sectors. But the government of Nepal has not been able to

use the collected funds in productive sectors (From Questionnaire Survey).

- The enormously increasing magnitude of public debt is becoming a great challenge of the nation. The government had borrowed a total amount of Rs.6022.7 million in 1999 and the amount borrowed reached Rs 17892.3 million in 2007. The government in 2007 had raised 2.97 times more debt than in 1999.
- Between the periods 1999 to 2007, the average annual growth rate of total outstanding public debt (i.e. only internal debt) was 21.1%.
- People in Nepal are striding towards the indebtedness by borrowing more, but not redeeming the debt in time.
- The interest rate on public debt is naturally higher than in the market so that we should allocate more amounts for interest servicing motive.

4.4 Finding from Survey

- The highest number of investors belongs to individual investors and least of them belong to institutional investors.
- The Treasury Bills are highly subscribed in the market in comparison to five government securities.
- 58.33% investors knew about the securities being the employee of company. It shows that publicity of securities is not satisfactory.
- About 41% investors investing in government securities due to risk free security. It shows in the market that there is high risk to invest in other alternative.
- It may be due to Maoist problem in the past but if the peace is stabilized investors' interest towards government securities will decrease so that government may fail from its' target.
- Nearly 100% investors felt no difficulty while collecting interest and principle. It shows that the staff of NRB and other distribution center are quiet appreciable.

- The majority investors 66.67% sell government security to grab the investment alternative in the market and remainder of them sell to meet their household requirement and a caused of investment in real state.
- The majority of buyers are service holders and remainders of them are retired people and institutions. But institutional buyers borrowed in huge quantity even if they are few.
- Large investors invest saving money in government securities. Institutional investors invest from their idle cash and they are investing in huge scale, it shows that there is lack of investment alternatives in the market.
- Large number of investors feels that government is using collected fund on unproductive sector. Investors want to see their fund used in productive sector.
- The majority of respondents felt that risk-free instrument is the main reason for full subscription of government securities.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The government statement of income and expenditure was not in fixed schedule up to 1950's. The budget preparation was only for allocation of funds in different sector of the country. The budget was used to facilitate the requirement of such investment only. After the restoration of democracy in 1951, the process of maintaining income end expenditure was set as per the house of democratic government. Thus, they were aimed at maintaining the statement of lives of the people rather than specific class. Accordingly, the government was compelled to present a deficit budget. Till 1960s, the deficit was met by bilateral grants and internal loan.

Nepal started to raise the internal loans in fiscal year 1961/62 by issuing the Treasury Bills. People started to purchase government securities, as it constituted the risk less investment.

The government debt is neither worse nor it impairs the economy. The government has been borrowing funds from people to maintain smooth and sound economic condition of the country. Government debt is issued to meet short-term and long-term financial requirement. The government expenditure through public debt is quite beneficial for the nation if it is used productively. Thus, the government has been collecting huge amount of fund through sale of securities every year to fulfill the deficit budgetary system of Nepal.

The Nepal Government has been borrowing overdraft from NRB as well. The government must have to pay the amount of overdraft with its interest to NRB within the stipulated period. This is why it is also considered as a kind of internal debt.

The debt financing of Nepal has also bad side as government has been borrowing according to its whim and it has been pouring the borrowed fund into unproductive sectors. However, expenditure made on sectors like health, education, road, bridge, irrigation, drinking water, etc have benefited Nepalese people. The nation as a whole gets positive return through such kinds of projects in the long run. The necessity to invest on such projects has been the main cause for deficit and hence public debt.

In fiscal year 2007, the total internal debt was Rs 13,585.8 million. The same debt was Rs 6022.7 million in 1999. The debt raised by government has been increasing from the year 1999 to 2007. This may generate serious problems for future generations. The innocent children have to bear loan taken before their birth. Therefore, the increasing trend should be managed soon. The country must have far bureaucracy sustainable economic growth, investment in productive sector, etc.

Government sells various securities to collect funds from people, such as Treasury Bills, Development Bonds, National Saving Bonds, Special Bonds and Citizen Saving Certificates. Treasury Bills are issued every week. In 2007, the government borrowed huge amount by issuing Treasury Bills. It is a short term government securities, generally issued for 91 days maturity period. Others are long term securities; they are issued to collect long term capital. But in case of Special Bonds, it has special provisions while issuing securities. Thus, government issues various types of securities, both internally and externally. Many economists believe that borrowing internally is better than borrowing externally. The internal investors of the government are the people of the country.

It is obvious that the issuance of government bond is the sole cause of deficit budgetary system. Every year the Finance Minister presents the budget in the parliament in which it is clearly mentioned the amount to be borrowed from various sectors. The Nepal Rastra Bank the Central Bank of Nepal issue various securities on behalf of the Nepal Government. The bank charges to the government 0.25% commission in the transacted amount.

Borrowing provides an opportunity to get interest earning to those who have idle savings. Most economists agree that 'borrowing is better than currency inflation'. On the other hand, most economists argue that borrowing of today constitutes burden for future. A large public debt may create problems in the economy in future.

5.2 Conclusions

The internal borrowing is the process of involving domestic people in the development programme launched by the nation. This study shows 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. Different people are participating in government securities such as rich, poor, educated, etc. This study has supported general assumption that only retired persons, civil servants are interested in government securities.

In response to collecting sample, some investors responded some sorts of complaints and grievances against the marketability of security. Government can raise fund internally and externally. The analysts have focused on internal funds from one person to another person within country.

The domestic debt market in Nepal is underdeveloped. There are insufficient of debt instruments, which makes market primitive. The prevailing mechanisms for trading government debt securities are inefficient and unreliable as the authorities regulate the prices. These weaknesses enormously hamper not only the debt management practices but also monetary management process in Nepal. The debt manager should therefore have an interest in developing market for government debt securities. The issuance of scripless securities, initiation of auctioning of long term government debt securities, implementation of market based pricing mechanism and issue 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 of Nepal. Launching of awareness program on market mechanism, pricing method, types of instruments issued and timing of issue could also help the deepening of domestic government debt securities market in Nepal.

The supply of government securities can be more efficient by developing a primary market, projection of government treasury position, and safe and efficient channel for distribution of securities. Brokers are also not efficient in market making because of huge amount holding by single institution.

5.3 Recommendations

Public debt assists the government in solving the economic, monetary and budgetary problems, which are to be addressed by the state as per the situation. In addition people pride themselves of their financial contribution to the nation through the public debt. But in other sense, if it is used improperly, it hurts the people. The government in Nepal has been collecting funds by selling various government securities. The main reason is to recover deficit budgetary system. The trend of loan outstanding is increasing every year.

The following are recommendations, which are required to be solved the problem of capital market in Nepal.

- The government should maintain the fiscal balance and strong fiscal and monetary discipline by controlling the unproductive expenditure so that annual budgetary expenses would not increase immensely than the annual revenue income. Government’s effort should be directed towards mobilizing internal revenue in order to reduce dependency on loans for financing development expenditure.

- Since Nepal is still backward in terms of development infrastructure, there is no alternative except from external source to industrialize the nation. Besides, the capital is needed to promote our export trade and reform our tourism industry as well. It is necessary to formulate the long term plan for export promotion and coordinating the various export related activities such as product development market promotion all over the world, export stabilization, quality improvement, etc. The internal capital is needed for the various functions in the country. Therefore, the government should develop various methods to influence the business and private individuals to buy more and more government securities and these should be more liquid which can do listing in NEPSE.
- The government should maintain the strong fiscal discipline in all sectors of the economy which government itself must follow initially. The government must set and implement the effective legal system to control the ever-increasing corruption, unnecessary expenses, improper allocation of resources and like as. Likewise, the suggestions by auditor general office must be adopted instantly. Thus, maximum effort should be exercised to maintain the fiscal discipline so that budgetary deficit would be minimized without impairing existing development programmes.
- The most common problem of underdeveloped countries like Nepal is the loose monitoring and inspection of the progress of newly launched projects. Regular reviewing must be made on the return of the projects so that they help improve the rate of future projects.
- The government should not unnecessarily interfere to the NRB. If so, the bank, being an advisor of the government can be recommended the significant measures independently which help the government to tackle the fiscal and monetary problem in the nation. The government may borrow the overdraft from NRB with the stipulated limitation but the

bank should not be compelled to provide the overdraft as per the government's ad-hoc decision.

- To attract people towards government security it is essential that some Special Bonds might be issued for development work for a particular locality. When such development works as bridge, road, irrigation, communication, etc. would be built with the funds from the Development Bond at a place, people of the other localities might be encouraged to purchase such bonds. On the other hand, NRB should strongly direct all the commercial banks that they must pay the interest of the government's bond of their respective customers timely and claim the amount with NRB afterwards. It is because of a few government security holders in course of sample survey, had grieved for no interest payment at some of commercial banks in Nepal, though investors are provided the facility, that they can collect their interest from any commercial banks in Nepal.
- The debt management to control and regulate the economic activity is an instrument in the hands of the monetary authorities like Ministry of Finance and Nepal Rastra Bank in the nation. All the decisions regarding the public debt from borrowing to redemption of loan influence the general economic phenomena in country. All possible efforts therefore, are needed to be made by the monetary authorities to direct economy in the desired way through the technique of debt management.
- The entire government bonds should be listed in the NEPSE so that secondary market of such bond will attract to the investors. Endowment system is not satisfactory. All the system should be done by computerized.
- Listing and fixing to the market maker to the Development Bond is quiet satisfactory but it is not performing what the investors were expecting. Further step towards implementation is necessary.

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APPENDIX

Questionnaire

GOVERNMENT SECURITIES AND INVESTMENT PRACTICIES IN NEPAL

A Survey Questionnaire

Full Name: ……………………………………………

Occupation: ………………………………………….

Age: …………………..   Sex:

Educational Qualification: ……………………………………

1. Please indicate, the category of investor that you belongs to?

☐Institutional investor

☐Individual investor

☐ Other

2. How did you come to know about government securities?

☐Relatives/friends

☐Papers/government securities

☐Staff of company

☐Brokers

☐Others

3. What is the main reason for making investment in government securities?

☐Risk less investment

☐Zero liquidity risk

☐Lack of corporate securities (declining interest rate in investment sector i.e. interest rate on saving account)

☐No investment opportunity

☐Legal provision

☐Speculative motive

☐Others

4. In which of the following income group you belong?

☐BelowRs100000

☐Between 100000-200000

☐Between 200000-300000

☐Above 300000

5a. Did you feel any difficulty in collecting interest and principle of your investment?

☐Yes

☐No

5b. If yes, what types of difficulties you found?

☐Long process

☐Brokerage

☐Behavior of officials

☐Others

6. Which of the following make you sell the government securities? (Rank1 for important 2and so on)

☐To alternative investment opportunities

☐To meet household requirement

☐To benefit from investment in real estate

☐When, the stock is overpriced.

☐Others

7. Who are the major buyers of government securities? (Please tick one for major buyers, 2 for less and so on)

☐Employee

☐Business form

☐Financial institution

☐Retired people

8. Out of your total income which income source you use to purchase government securities? (Please tick any one)

☐Saving money

☐Profit from business

☐Loan

☐Idle cash

☐Sale of fixed assets

9. Please rank, what is the reason of full subscription of government securities in market?

☐Good marketing policy of NRB

☐Risk free instrument

☐ Huge amount of idle cash

☐Good investment sector from risk and return perspective

☐Lack of information of other investment sector

☐No investment opportunity

10. The government of Nepal has been colleting huge amount of money from people .What is your opinion about the productive used of the collected amount?

☐Productively used

☐Unproductive use

☐None

11. What is the percentage of total earning you use in purchasing securities?

☐Less then 25%

☐Between 25 to 50%

☐Above 50%

12. What do output from investment in government securities?

☐Regular income

☐Capital gain

☐Others

13. Give your opinion about the present investment procedure of govt. bond?

☐Satisfactory

☐Neither satisfactory nor unsatisfactory

☐ Unsatisfactory

14. What type of securities do you prefer to purchase?(Please rank 1 for most purchase, 2 prefer and so on)

☐Treasury bills

☐Development bond

☐Citizen investment bond

☐National saving certificates

☐Special bond

15. Please give any of your opinion about government securities.

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Thank You!