

## The Role Of A Central Bank In LDCs: A Case Of Nepal

Gunanidhi Sharma\*

The main purpose of the study is to acquaint with the role of a Central Bank in a developing economy like that of Nepal rather than to deal with the central bank as a whole. In this connection I have tried my best to concentrate on the growing activities of Nepal Rastra Bank (NRB) in recent years, one of the important objectives of which is to assist in the process of economic growth of the nation. The need of building financial infrastructure for rapid economic development is not only unquestionable in the country like ours, but also we want a controlling mechanism in the financial system through which resources could be diverted to the concerned sector and channeled for capitalization. I believe on the efficiency of NRB and hope that the purpose can be fulfilled through it.

1. The concept of and the essence for a central bank in LDCs:-

The concept of central banking has been changing rapidly during recent years in terms of its role and policies, its relation with other central banks and government, its attitude towards economic development, etc. My attention in this study would be on its role, policies, and attitudes towards economic development.

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\* Mr. Sharma is a member of the Economics Instruction Committee, Tribhuvan University, Kirtipur, Kathmandu Nepal.

The traditional type of a central bank was mainly responsible for the internal and external stabilization of monetary unit whereas the modern CBs in LDCs deviate mostly from that line and they have been the potential developmental agency rather than being only the stabilization devices.<sup>1</sup>

As the basic problems of LDCs relate to the growth plus stability, the desire for economic growth deserves special attention.<sup>2</sup>

Raising percapita real consumption requires the rise in output rapidly and its equitable distribution gets special emphasis in modern times in many countries. The higher rate of saving becomes a crucial factor for capitalization without which the socio-economic infrastructure cannot be built up and a high level of output is unattainable. Apart from government savings from various sources such as fees, forests, public enterprises, taxation, etc, including aid from inside and outside, financial institutions can collect a huge amount of savings voluntarily by means of deposit acceptance and the sale of securities and the savings thereby could be channeled to productive sectors and that in turn helps in breaking a vicious circle of poverty—the burning problem of LDCs. This way of financing demands primarily the creation of financial infrastructure—Capital and money markets and their stock in trade.

If we divert our attention to our country, we find that she is endowed with several natural resources and energetic people, even then we have not been able to start the engine of self sustained growth and to determine the growth path along which development movement takes place. In the country where the dearth of capital becomes a crucial constraint, according to one estimate, gross capital formation is 5.2% of GDP

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1. For details See S. K. Basu, *A Review of current Banking theory and practice*, Macmillan, India, 1974, Chap. I, pp 1-24.
  2. The concept of economic growth these days is attached with the improvement in the quality of life of the countrymen in general.

and 2.3% of which comes from aid.<sup>3</sup> As the dependence on foreign aid is increasing during recent years,<sup>4</sup> that has to be complemented by a higher rate of domestic savings for financing the development activities. But since most of the population is below poverty line the burden of tax can be added only at the cost of subsistence. The present inflationary situation is no doubt, distributing income from the poor to the rich, villages to towns and so on<sup>5</sup> and one can argue that a high rate of capital formation is possible in this situation.<sup>6</sup> Albeit, it is heard that the higher and urban income community is being extravagant and conspicuous and that is leading to higher importation inviting again and again the serious balance of payment problem. Keeping this paradoxical situation aside, we are required to be very strict and clear with regard to policy affairs. Wastage of resources if unchecked future community will not only suffer but also the developmental problem will become more and more serious, creating self-generating problem for ever. Banking and financial institutions can at their best provide the opportunity for savings voluntarily and these can be used as a means of mobilization and channelisation. The financial institutions through their incentive rate, attract and bring borrowers and lenders together.<sup>7</sup> Central banks in LDCs, like ours, can design this institutional framework and create financial infrastructure, which is fundamental for generating growth in the country. Usually central banks in many LDCs are performing, as the developmental agency, the following functions.<sup>8</sup>

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3. Pashupati S. J. B. Rana, "The Nepalese Economy Problems and Prospects" in the *Weekly Mirror*, Vol 4, No 23, P 54.
  4. See Budget speech of the Fiscal year 1978-79, H.M.G., Ministry of Finance, Kath. P. 9.
  5. V. C. Nwaneri, *Income Distribution Criteria for the analysis of Development Projects*, in *Finance and Development*, IMF and IBRD, Vol 10, No 1, March 1973.
  6. Some writers, mostly neoclassical, favour the situation of income distribution towards potential savers group for high rate of capital formation (See Vicente Galbis "Structualism & Financial liberalism", in *finance & development*, IMF and IBRD, 1976, Vol 13.)
  7. Johan M. Culbertson, *Money & Banking*, TMH, New Delhi, 1972, P. 82.
  8. S. K. Basu, *Op*, int. pp 7-12.

1. They are assisting in the creation of specialized financial institutions by subscribing to their equity capital and thereby are raising the credit supplying strength of concerned institutions.
2. They are lending and advancing to the financial agency and are accomodating the needs of the economy.
3. They are guaranteeing the bonds issued by development banks to enable them to attract capital from inside and outside of the country.
4. They are formulating such type of monetary policy which diverts bank credits to prefered such productive areas as trade, industry, agriculture etc.
5. They are helping in the creation of financial infrastructure by laying the foundation of security markets so as to buildup socio-economic framework conductive to economic development.
6. They are keeping their fingers on economic pulse of the defferent sectors of the economy.

2. Central banking in Nepal:- The Nepal Rastra Bank, as the central bank of the country, was established in 1956 and it was endowed with the powers of a bankers bank after 1966. As the country is developing, the role of that bank in Nepal is different from that of traditional type. The preamble of NRB act lays down the purposes of the bank as: regulating the issue of paper money, securing country wide circulation of Nepalese currency, achieving stability in exchange rate, mobilization of capital for economic growth, developing banking system in the country, etc.

The NRB issued and managed Nepalese currency since the time of its establishment but it became a bankers bank only after 1966 after the ammendment of the Act in 1962 and 1966. During the period in between NRB was mainly concerned with countrywide circulation of Nepalese currency. In reference to that, it tried to control over the supply of Indian currency and maintained its convertibility in the initial years-during early sixties, and as NRB became the member of IMF and IBRD in 1961, it fixed the rate of foreign exchange, managed and regulated it, and was

concentrated in advising govt. in those matters.<sup>9</sup> Today NRB executes its following policies.

1. To increase the growth rate by providing institutionalized credit on easy terms to priority sectors such as agriculture, industry, trade, etc.
2. To extend the banking facilities throughout the country so as to monetize the economy by helping the establishment of the branches of commercial bank.
3. To coordinate the policies and functions of banking and nonbanking institutions with that of NRB for the smooth functioning of the economy.
4. To regulate the money and credit supply so as to have stable growth of the economy.

These policies basically reflect the objectives that are wider than those of developed countries including the regulation of money and capital market, promotion of economic life, maintenance of high level of employment, stabilization of monetary unit, etc. But since the success of the monetary policy depends upon the use and exercise of Fiscal policy, both the policies should be treated not as the substitute for each other but as the complement to each other. In this respect His Majesty's Government (HMG) and NRB should work in harmony. HMG should not misuse its power of influencing NRB activities and should not try to impart undue influence over it. That means to say NRB's suggestions in monetary affairs must be influential and should get due weight.

The NRB, in Nepal, apart from the traditional functions of stabilization, performs the following developmental functions.

#### 2.1 Promotion and development of capital, money and credit markets:-

Unless the country develops its capital and money market, the economic and financial development is impossible. The institutions dealing in capital funds and credit supply such as commercial banks and development banks are the pre-requisite for

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9. Y. P. Pant, Banking and Development, Nepal Rastra Bank, 1971, Chap. 7, pp 49-51.

stimulating the development process. These institutions meet the financial needs in the country by mobilizing the resources scattered throughout the country. The NRB since the very inception has helped and supported these institutions in financial matters.

The institutions, whose concern is to arrange medium and long term credit facilities for agricultural and industrial sectors as Nepal Industrial Development Corporation (NIDC) and Agricultural Development Bank (ADB) have been established in the country. The NRB is providing financial facilities and has undertaken in an equity participation. Not only has it promoting these institutions and through them mobilized savings but also it has given the direction as to where these savings are to be channeled. By giving refinance facilities to these institutions NRB has strengthened their financial position and has supplied credit to the priority sectors. Again, the NRB has given refinance facilities to Rice exporting Co., National Trading Ltd., Oil Corporation, Jute Corporation and Food Corporation.

Apart from these, there are other institutions the promotion of which would help the mobilization of savings. The NIDC in the country was established in 1968 and this not only mobilizes savings through the means of premium, but also it provides security to industry, commerce and other activities so as to develop an economic environment conducive for the growth of financial activities. Besides that, the Sansthan subscribes to the share capital of other development institutions and the savings thereby are channeled to the different sectors of the economy.

Further, the NRB has helped, by means of equity participation, in the establishment of security market (032-33) under NIDC which aims at the provisions such as<sup>10</sup> to develop stock-exchange market, to induce capitalization of investable fund, to underwrite the share and debentures of the company and corporations, to buy and sell the securities of company and corporations, to buy and sell the securities issued by govt., semi-govt., and other bodies.

This will definitely fill the voids of capital market in the country.

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10. Annual Report of NRB, 2032-33.

Besides these, the NRB aims at providing banking facilities in different parts of the country. Today the two commercial banks - one in the public sector and one in the private sector, as semi-govt. body, are opening their branches all over the country. The NRB has not only directed these banks to open up branches but it has also regulated their credit operations. The long-run objective of the NRB had been to provide at least one commercial bank branch in each district. The NRB has constituted a "Banking Development Fund" and the fund will be used to compensate the losses arising from opening new branches, to the extent of 100%, 75% and 50% in the first, second, and third year respectively, at places directed by NRB.

The commercial banks working through the branch banking system are required not only to collect and channel savings but they also have to extend credits to the rural and small sectors to the extent of 7% of their deposit liabilities.<sup>11</sup> If commercial banks incur losses from lending to agriculture, cottage industry, village industry and other employment oriented industries this shall be compensated to the extent of 80% by recently established "Kajra Surakshan Nigam".<sup>12</sup> With a view to protecting commercial banks from the loss Agricultural Project Services Centre (APROSC) has been established to conduct studies and surveys of the rural projects and the NRB has subscribed to its share capital. There were some 173 branches of commercial banks at the end of Ashadh 033 and the NRB time after time is giving directions to commercial banks to establish branches to the remote rural areas, with a view to mobilizing more savings the NRB by using its statutory power fixes and revises the deposits and lending rates from time to time. Recently it revised the old rates of interest. Because of the higher deposit rates savings in the accounts of commercial banks have swollen.<sup>13</sup> The channelization side of the savings must not be taken very lightly for that affects the general economic condition of the country.

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11. Ibid.

12. Kulshekhar Sharma, "Nepal Rastra Bank and the process of economic development", in *The Rising Nepal: coronation special 1975*, pp 101-104.

13. See *Economic Survey, 1977-78*, HMG, 1978.

2.2 Monetary Management: The NRB is using its means of monetary management - quantitative and selective for the achievement of broad economic goals of the country. But the scope still is very narrow because of: small size of the money market, low degree of control over the money and capital market, uncontrollable influence of foreign trade on the national economic activities, low stage of the development of organized money and capital market, inelastic structure of the economy i. e. weak influence of interest rates on investment decisions for raising the level of output, employment, etc.

Therefore Dr. Pant concludes, "It is not through various conventional weapons which were originally initiated in the developed countries of the west the central banks should try to use in a country like Nepal and other developing countries but it is more through moral suasion and similar other methods that the central bank can efficiently exercise in properly guiding the monetary policy in relation to growth and development"<sup>14</sup>.

We should be more aware of the country's economic situation and search for more appropriate and direct methods of monetary management.

2.3 Other activities:- As the NRB constitutes the apex of the financial structure in the country, it acts as the bank of issue, as the bankers bank, as the government banker, agent and advisor, as the guardian of the money and capital markets. Apart from these functions it keeps its fingers on the economic pulse of the country. The NRB has conducted various surveys relating to agriculture, Jute, Price, balance of payment, family budget, etc. These surveys are very crucial from the economic point of view. The conduction of such surveys enables us to know the country's financial and economic situation and thereby will give us some guide line for the policy formulation and implementation.

Since the agril. development has been our basic aim for years "Agricultural credit survey" is the most important one conducted during 1969-71 from the view-point of agril. development. It has given us the information about the magnitude, direction,

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14. Y. P. Pant, OP. cit. P. 70



and need of credits and the institutions dealing with such credits. The survey shows that about 21% of the total credit is supplied through organized institutions and the rest through traditional sources.

The survey has suggested that agriculture, still is mostly depending on traditional source of credit supply. The increase of institutional credit supply has been the call of the day. Similar suggestion are available from other surveys which direct us in our financial activities.

Further, the NRB has kept its hands on educational development. It has provided financial help to the Institute of Humanities and Social Sciences for producing research scholars in economics, conduction of seminars, and other things. The NRB has been supplying its services to the government in matters of foreign exchange, national & international transactions and monetary affairs.

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