

## Financial Liberalization and Access of Credit to Poor As Poverty Reduction Strategy

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### Abstract

*Financial liberalization in Nepal was initiated from mid-1980s. It is aimed at promoting growth of economy. As poverty reduction is one of the main objectives of development effort of the country, financial liberalization is therefore expected to alleviate poverty providing banking facility to poor. The aim of the paper is to examine the access of formal credit of commercial banks to poor after financial liberalization. Rationale of concentrating on commercial banks is that it accounts for 87 percent of total assets and 72 percent of loan and advances of depository institutions. Nepal Rastra Bank introduced "Intensive Banking Program", "Priority Sector Program", and "Deprived Sector Credits" to provide banking facility to poor through commercial banks. It is observed that commercial banks are contributing to alleviate poverty by providing credit to poor even after adaptation of financial liberalization policy. However, their credit facility to rural poor is declining in comparison to the urban counter parts. Nepal Rastra Bank is planning to phase out the Priority Sector Credit Program from FY 2007/08. It is highly recommended for commercial banks to continue lending requirement for deprived sector even after 2007/08. It would make commercial banks to participate in poverty reduction effort of the country.*

### Introduction

The national and international experiences demonstrate that economic development is possible only with the reduction of poverty. Despite the fact, the majority of the developing countries' socio-economic condition remained unsatisfactory. No doubt, national efforts and assistance from the donors have brought positive impact, but they are far from the expected level. In the mean time new challenges and opportunities for development emerged at global, regional and national levels.

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The collapse of state-dominated economic system led to the emergence of new thinking that intensified the process of globalization and liberalization across the countries. As a result, the private sectors were given leading role in the economy for managing and accelerating development process. During the decade of 1990s, most of the countries in the name of liberalization initiated several reforms and restructuring process. The development effort was not considered only the governments' duty but the role of the private sector was also considered equally important. The private sector was given more openness to participate in most of the economic sectors. Of course, such global movement has renewed the hope of the poor of the developing countries for their reduction of poverty.

Nepal could not remain isolated from the global movement of economic liberalization and globalization. Previously, most of the development activities were considered the responsibility of the government. No doubt, past development activities in Nepal did some significant positive results in socio-economic sector. However, Nepal's achievement in poverty reduction and socio-inclusion to the deprived population remained unsatisfactory. The issue of poverty reduction was for the first time spelt out in the Seventh Plan. The Tenth Plan proposes to continue emphasis on the reduction of poverty as an overriding objective of the Plan as in the Ninth Plan. The target has been to set to reduce the population below poverty level to 30 percent by the year 2007. To address the problem of poverty, His Majesty's Government of Nepal (HMG/N) promulgated policies aiming at limiting public intervention in direct economic activities and role of private sector is encouraged. Accordingly, the liberalization and privatization were expected to lead to the structural transformation of the economy, generating more employment to the poor and eventually reducing poverty level. HMG/N had pursued several liberal policies in different sector of the economy; the liberalization of financial sector is one of them. Financial liberalization policy is therefore, looked forward to help in poverty reduction strategy providing banking services to the poor and deprived people. Hence, it is the basic question whether the financial liberalization has made easy access of financial resources to the poor and deprived section of society that would help to achieve poverty reduction goal of the country.

The general objective of this paper is to review the financial liberalization policy relating to commercial banks and to examine the access of formal credit of commercial banks (CBs) to the poor after the financial liberalization. The issue raised in this paper is about the provision of formal credit to the poor by the CBs after the liberalization of financial sector in Nepal. The period under analysis extends from 1984 to 2002 incorporating the secondary data series such as Total Deposits, Deprived Sector Credit, Bank Branches, Employment Generation of Commercial Banks and Gross Domestic Product.

### **Financial Sector Development**

Financial sector operates as an intermediary between financial surplus sector and financial deficit sector. It boosts the economy by mobilizing and allocating the available financial resources most productively and efficiently, thereby increasing employment opportunities and production of the country. Thus, the financial sector facilitates to achieving development goal of the country and attaining overall macro-economic stability.

After the establishment of the NRB, the development of financial system gained momentum in Nepal. Within the decades, a number of financial institutions were established in public sector. These included Nepal Industrial Development Corporation (NIDC), Agricultural Development Bank (ADB/N), the Employees Provident Fund Corporation, Rastriya Banijya Bank, (RBB), the Credit Guarantees Corporation, Nepal Insurance Corporation and Securities Marketing Centre. Besides setting up new institutions, NRB encouraged branch expansion of the commercial banks between 1970 and 1989 with a view to provide modern banking facilities to the rural areas as well. With the branch expansion of the banks, banking habits of the Nepalese developed and banks were able to mobilize increased savings for investment. Both deposits with banking system and total credit expanded rapidly during the period of 1960 to 1985. The deposit increased from Rs.72 million in 1960 to Rs.8536 million in 1985. Similarly, credit increased from Rs.32 million to Rs.5489 million during the same period. (Acharya, 2003). The financial sector was under the control of NRB. It is observed that NRB had been constantly intervening in the financial sector to achieve economic development with stability. Despite constant effort of NRB the financial sector of the country remained small with limited penetration in the economy.

### **Financial Liberalization**

Nepal initiated financial liberalization since mid-1980s where as other South Asian Countries had already started in early 1980s. As soon as financial sector was made open, three joint venture banks were established in mid-1980s but most of the reform program was carried out only after 1987 following International Monetary Fund's (IMF) Structural Adjustment Program (SAP) and still been continuing.

After the introduction of the deregulation system, NRB fixed the maximum lending rates only to the priority sector credit. Moreover, NRB discontinued the provision of interest rates subsidy to the priority sector lending and the refinance facility was restricted to only few activities. The main objective of this policy was to lessen excessive dependence on NRB for resources and to encourage CBs to mobilize their resources through inter-bank borrowing. Before 29 May 1986 the maximum lending rate for priority sector was 11.0 percent, which was increased to 15.0 percent. The CBs had to invest at least 25.0 percent of their total loans and advances in productive sector including 8.0 percent in priority sector. This change in lending rate was to chanlize the resources of CBs to priority sector. The main objective of this policy is to provide loan to poorer section of the society and was considered positive from poverty reduction perspective. The interest rates of CBs and FIs were completely liberalized in July 1989.

The financial liberalization policy helped Nepal to receive Article VIII status of IMF on 30 May 1994. Under this status, Nepal is obliged to keep commitments towards the current convertibility. NRB further liberalized the restrictive measures providing more freedom to banks and non-banking financial institutions. On the other hand, CBs were required to increase capital adequacy ratio (CAR) to 3.5 percent at mid-July 1991 and 4.0 percent at mid-July 1992. In the mean time, the credit ceiling of financial institutions was removed in

1991 except on government and non-financial government enterprises under the indirect monetary control policy. Similarly NRB laid more emphasis on the open market operations as the main monetary policy instrument as Nepal entered into the Enhanced Structural Adjustment Facility (EAFS) in 1992 (Shrestha, 2004).

As the joint venture CBs established, they started competing to provide modern banking services to the customers. NBL and RBB faced hard time to compete with joint venture banks. Moreover, these two banks were already in ailing condition because of their own financial, managerial and organizational problems.

As per commitment of the government to reform NBL and RBB, the Nepal Banking Reform Project was started by HMG/N and NRB with funding assistance from World Bank (IDA) and DFID (UK). The KPMG Barents Group, the international expert team associated with the Banking Reform Project had started the project since 15 November 1999. The KPMG Barents Group recommended prompt action to be taken for NBL and RBB. It suggested to de-politicize and run both the banks an independent commercially run banking system and to follow comprehensive restructuring programs.

HMG/N has enacted various acts for financial reform such as NRB Act 2002, Debt Recovery Act 2002, and the Banking and Financial Institution Ordinance 2004. The Public Debt Act and the Foreign Exchange Regulation Act were amended in 2002. Similarly, the Credit Information Bureau would be established as a public limited company and the Debt Tribunal has already started its operation. The Asset Management Company is going to be established. Asian Development Bank (ADB) recommended for restructuring of ADB/N and NIDC. In the process of financial liberalization re-engineering NRB has started that would turn NRB into a competent modern central bank.

As a result of liberalization of financial sector, the number of CBs reached to 17 in mid-July 2004. There were 57 finance companies, 14 development banks, 11 micro-finance development banks, 34 savings and credit co-operative societies, 44 financial intermediary NGOs and 17 insurance companies. Development banks and especially the rural micro-finance development banks (RMFDBs) have tried to fill up the gaps created by the closures of CBs due to law and security problems.

### **Priority Sector Programs**

Various programs and projects had already been formulated and implemented to provide credit facilities to poor and to improve their living condition. HMG/N has given top priority to poverty alleviation in Ninth and Tenth Plan. The financial sector development would be helpful to reduce poverty through their access to financial services directly or indirectly. Financial sector development indirectly benefits the poorer section of society by increasing employment opportunities. The direct benefit to poor and deprived from financial sector development is the availability of credit facilities to them. In this context, 'Small Sector Program' had already been launched in early 1970s. Later, this program was known as 'Priority Program' to be financed by CBs and the Small Farmer Development Program

(SFDP) to be implemented by ADB/N to spread out and to provide banking services to rural and poor section of society. Thus it is observed that CBs were involved in providing loan to poor and rural population since early 1970s.

### **Priority Sector Credit**

Commercial banks have been involved in rural lending since 1974. Initially, NRB directed two existing CBs to invest 5 percent of their total deposit in "Small Sector". This was the first initiative of involving CBs in rural lending directly in Nepal. Later, in 1976, the scope of small sector enlarged to cover agriculture, cottage industries and services and it was renamed as "Priority Sector". NRB had already established Credit Guarantee Corporation in 1974, later changed into Deposit Insurance and Credit Guarantee Corporation, encouraging CBs to invest in priority sector. The main objective of this corporation is to provide risk coverage for default to the extent of 75 percent of the outstanding loan. It was in fact the encouragement to CBs to disburse loan in priority sector.

### **Intensive Banking Program**

Priority Sector reformulated as Intensive Banking Program (IBP) in 1981. As already been mentioned CBs were required to invest 5 percent of their deposit resources in small sector. It was later increased to 7 percent in 1976. But due to lack of systemization of the program and traditional banking practices of CBs, the program did not make headway. This necessitated the formulation of IBP in 1981. The basic objectives of IBP were to (i) to provide credit and supporting services the residents of specified geographical area to increase production, employment and income, (ii) to motivate and assist the inhabitants of these areas for the full use of their productive assets, and (iii) to help develop institutions and institutional contacts which might help the poor to become free from local money lender. (NRB, 1994:212)

Under IBP, CBs were to invest at least 60 percent of priority sector loan to rural poor below poverty line as group based loan without any physical collateral. Focus on collateral free loan based on group guarantee opened an access of formal credit facilities to quite a good number of rural poor. The empirical question posed is whether credit facility provided by IBP went to poor section of the society so that CBs Practices were helpful for reduction of poverty in Nepal. The following table would be useful to examine the very question.

**Table No. 1**  
**IBP Loan Disbursement by Income Group**

Rs. in million

Year	High Income Families		Low Income Families		Total Rs.
	(Rs.)	Percent of total	(Rs.)	Percent of total	
1984	18.6	56.9	14.1	43.1	32.7
1985	37.3	52.8	33.4	47.2	70.7
1986	71.8	53.7	62.0	46.3	133.8
1987	89.3	52.6	80.6	47.4	169.9
1988	67.0	52.9	59.6	47.1	126.6
1989	104.8	50.1	104.3	49.9	209.1
1990	123.1	43.6	159.3	56.4	282.4
1991	118.9	45.5	142.4	54.5	261.3
Total	630.8	49.0	656.2	51.0	1286.5

Source: The World Bank (1993) "Sustainable Financial Services for the Poor" Washington D.C.

After the financial liberalization, the distribution of IBP loan by income group during 1984 to 1991, as shown in the Table No.1 indicates that on an average 51 percent IBP loan had gone to the low-income group and 49 percent to the high-income group. It is obvious that the percentage share of IBP loan to low income group is slightly increasing from 1984 to 1991. This ongoing analysis confirms that IBP loan was positive to provide credit to low income group or poor people of the society. Accordingly, "Priority Sector Credit Department" was established at central, regional and branch level thereby CBs were required to invest at least 12 percent of their loan portfolio in the priority sector. It is therefore, encouraging that CBs should divert their loan to poor people after financial liberalization.

### Deprived Sector Credit

NRB introduced "Deprived Sector Credit Scheme" in 1990. Under this scheme CBs were to invest a minimum of 2.75 percent to 3.0 percent of their total loan and advances of priority sector to the 'hard core poor' as "Deprived Sector Credit". But this rate was kept lower for joint venture banks at only 0.25 percent and later raised to 0.5 percent of their total loan. Failure to meet these targets would lead to a penalty on the shortfall equivalent to the highest interest rate the respective CBs charge its client. However, the CBs are open to choose any one or a combination of the following options to meet the deprived sector target:

- i. *Make direct lending to the people below poverty line.*
- ii. *Make wholesale loan to ADB, FI-NGOs/ Grameen Bikas Bank/Licensed SSC.*
- iii. *Make share participation in RMDC/Grameen Bikas Banks.*

With exception of a few, the CBs have been meeting their lending requirements in the priority sector and also in deprived sector for quite some time. (Sharma, 2003)

### Overall Outstanding Priority Sector Credit

Priority sector is related with the access of credit to the poor. So how much credit has gone to priority sector after 1984 is shown in Table NO.2.

**Table No.2**  
**Priority Sector Credit of Commercial Banks**

Millions of Rs.

Year	PSC <sup>1</sup>	TD <sup>2</sup>	GDP <sup>3</sup>	TC <sup>4</sup>	PSC/TD*	PSC/GDP**	PSC/TC***
1984	289	7091.2	39390	5004.9	4.075474	0.733689	5.774341
1985	432.8	8560.1	46587	6464.4	5.056016	0.929015	6.695130
1986	558	10315.4	55734	7942.4	5.409388	1.001184	7.025584
1987	549.8	11900.5	63864	9410.2	4.619974	0.860892	5.842596
1988	647	14996.2	76906	11439.4	4.314426	0.841287	5.655891
1989	902.7	19008.6	89270	14219.8	4.748903	1.011202	6.348191
1990	1312.3	21942.5	103416	16009.4	5.980631	1.268953	8.197059
1991	1256.9	26804.2	120370	21932.3	4.68919	1.044197	5.730817
1992	1608.8	33686.1	149487	17168.2	4.775857	1.076214	9.370813
1993	1763	43777.9	171492	19241.8	4.027146	1.028036	9.162344
1994	2129.7	52304.8	199272	27347.2	4.07171	1.06874	7.787635
1995	2797.1	61164.1	219175	38779.1	4.573107	1.276195	7.212906
1996	3683.2	71346.2	248913	50891	5.162433	1.479714	7.237429
1997	4676	81660.6	280513	58378.3	5.72614	1.666946	8.009826
1998	5893.1	102543.6	300845	68618	5.746921	1.958849	8.588271
1999	7183.1	127062.9	342036	81758.7	5.653184	2.100101	8.785732
2000	9520.7	154940.8	379488	96324.8	6.144734	2.508828	9.883955
2001	11177.5	181674.9	410287	109121	6.152473	2.724312	10.2432
2002		184331.1	421334	113174.6			
2003		203296.9	446476	124522.4			

Source: 1. Commercial Banking Statistics and Banking and Financial Statistics

2. Quarterly Economic Bulletin

3. Economic Survey

4. Commercial Banking Statistics and Banking and Financial Statistics

\* PSC Percent of TD

\*\* PSC Percent of GDP

\*\*\* PSC Percent of TC

Note: PSC = Priority sector credit

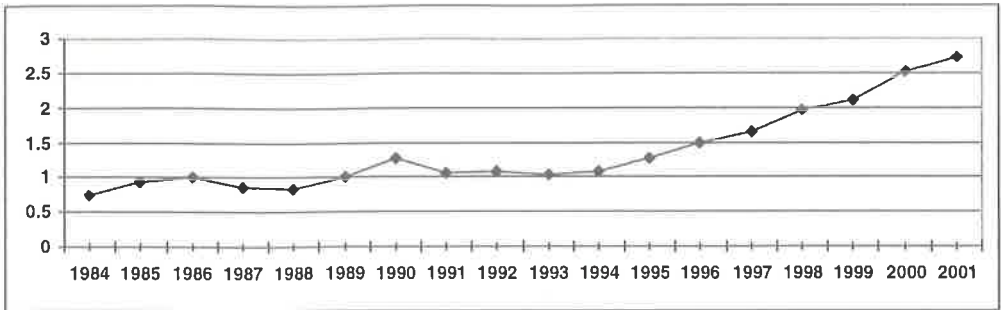
TD = Time Deposit

GDP = Gross Domestic Product

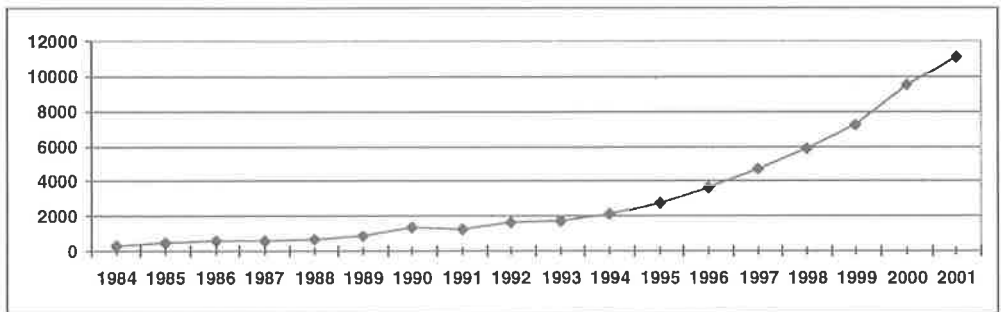
TC = Total Credit

Table No.2 indicates that absolute amount of priority sector credit is increasing from 1894 to 2001, but access of credit to the poor should be examined in relative term. Therefore, the percentage share of priority sector credit in Total Deposit (TD), Gross Domestic Product (GDP) and Total Credit (TC) is shown. The percentage share of Priority Sector Credit (PSC) in total deposit is varying between 4 to 6 percent. However, systematic trend is not observed.

**Figure 1.**  
**Priority Sector Credit by Year**



**Figure 2**  
**The share of PSC in GDP (in percent)**



The percentage share of PSC in TC is varying between 5 to 10 percent, but no systematic pattern is observed from 1984 to 1996. Its share is increasing after 1998 onwards. A clear picture is appearing in percentage share of PSC in GDP. Its value is stagnating around 1 percent and it approached more than 2 percent from 1999 onwards. The conclusion is that the relative percentage share of PSC in relation to other variables is either stagnating or increasing over the time, though it is not decreasing. It indicates the positive trend of access of credit to poor after financial liberalization.



**Table No. 3**  
**Priority and Deprived Sector Credit of Commercial Banks (July 2003)**

S.N.	Banks	Total loan	Priority sector Credit (PSC)	Deprived Sector Credit (DSC)	DSC as a percent of TC
1	NBL	19266.1	1061.9	316.1	1.64
2	RBB	28258.9	NA	NA	NA
3	NABIL	8267.5	895.8	286.2	3.46
4	NINV	5949.2	493.9	148.3	2.49
5	SCBL	6080.7	722.4	216.4	3.55
6	HBL	11488.6	665.4	284.1	2.47
7	NSBIB	4795.7	797.1	172.1	3.58
8	NBBL	8491.9	702.4	280.8	3.31
9	EBL	5049.6	550.6	131.0	2.59
10	BOK	4956.2	315.4	203.7	4.11
11	NCCB	3322.3	322.6	76.4	2.29
12	MBIBL	2632.0	260.6	50.9	1.93
13	NICB	2567.3	317.2	69.1	2.69
14	MPBL	1496.0	140.7	6.4	0.44
15	KMBL	2146.4	181.1	62.2	2.89
16	LAXMI	776.2	72.8	1.5	0.19
17	SDBL	629.3	129.2	0	0.00
<b>TOTAL</b>		<b>87912*</b>	<b>7629.1</b>	<b>2305.3</b>	<b>37.63</b>

Source: Banking and Financial Statistics, Vol. 41.

\* Excludes RBB.

Note:

BOK	:	Bank of Kathmandu
EBL	:	Everest Bank Ltd
HBL	:	Himalayan Bank Ltd
KMBL	:	Kumari Bank Ltd.
LAXMI	:	Laxmi Bank Ltd
LMBIBL	:	Lumbinin Bank Ltd.
MPBL	:	Machhapuchare Bank Ltd
NABIL	:	Nabil Bank Ltd.
NBL	:	Nepal Bank Limited
NCCB	:	Nepal Credit and Commercial Bank Ltd.
NICB	:	Nepal Industrial and Commercial Bank Ltd.
NINV	:	Nepal Investment Bank
NBBL	:	Nepal Bangladesh Bank Ltd.
NSBIB	:	Nepal SBI Bank
RBB	:	Rastriya Banijya Bank
SCBL	:	Standard Chartered Bank
SDBL	:	Siddhartha Bank Ltd.

Table No.3 shows the distribution of total loan (TL), priority sector credit (PSC), and deprived sector credit (DSC) by all CBs of Nepal except RBB. It is observed that all CBs are not advancing loans to the deprived sector uniformly. Out of total loan, only the five banks namely NABIL, SCBL, NSBIB, NBBL and BOK are providing loan to the deprived sector more or equal to the amount of minimum requirement i.e. 3 percent of total loan advancement. Other eleven banks are making under investment, less than minimum requirement to the deprived sector.

The highest figure of priority sector credit in absolute term is of NBL. The second, third, fourth, and fifth highest figures of priority sector credit are of NEBIL, NSBIB, SCBL and NBBL respectively. Similarly, in absolute term, highest figure of investment in deprived sector is from NBL, NABIL, HBL and NBBL respectively. Thus, there is no uniformity in the investment in deprived sector by CBs. Some of them are maintaining the minimum requirement while others are not. Those banks that do not maintain minimum requirement they are subject to pay the penalty as per rules of NRB.

Table No.3 shows that at aggregate level, priority sector credit is 8.7 percent of total credit. Deprived sector credit is 2.6 percent of total credit and 30.2 percent of priority sector credit. Minimum requirement of priority sector is 7 percent of total credit for year 2003. Table No. 4 present requirements to invest in priority sector in the years to come. It is observed that credit flow to priority sector by CBs is not made compulsory in FY 2007/08. But it would have been better if CBs are made compulsory to invest in priority and deprived sector so that it would help to achieve poverty reduction goal of Tenth Plan to some extent.

**Table No. 4**  
**Credit Flow to Priority Sector**

Year	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Percent of Total credit	7	6	4	2	2	Not compulsory

Source: Economic Survey, (2003)

### **Composition of Priority and Deprived Sector Credit**

Realizing that the priority sector credit cannot reach the hard core poor deprived sector credit scheme made credit available to population below poverty line through group guarantee scheme to those who cannot meet collateral requirements for loan This very appreciable policy after financial liberalization to reach banking service to deprived section of society. The loan statement of CBs in priority and deprived sector in mid-July 2003 is presented in Table No. 5.

**Table No. 5**  
**Composition of Priority and Deprived Sector Credit of Commercial Banks**  
**(Mid-July 2003)**

(Rs. In Million)	
1. Priority Sector	7629.1
(A) Direct Investment	6282.3
Agriculture	830.2
Domestic Industry	1731.4
Service	3169.0
Power	522.2
Import (Machine & Raw Material)	29.5
(B) Indirect Investment	1346.8
2. Deprived Sector	2305.6
(A) Direct Investment	571.1
Agriculture	245.4
Domestic Industries	13.9
Service	311.7
(B) Indirect Investment	1734.4

Source: Banking and Financial Statistics, No. 41, NRB

The total loan in priority sector was Rs.7629.12 million and in deprived sector Rs.2305.6 million, direct investment is more than the indirect investment in priority sector. On the other hand, indirect loan is more than direct loan in case of deprived sector loan. The reason is that banks seek physical collateral for priority sector loan but in case of deprived sector loan against physical collateral is quite low. Thus, indirect investment for deprived sector is more than direct investment. Again if we observe at sector wise investment, deprived sector credit to domestic industries is low (only Rs.13.9 million) indicating inadequacy of resources that encourages entrepreneurship among the poor. The practice of collateral based credit of CBs limits the access of poor, small farmers, marginal and landless households to CBs' credit structure. Nevertheless, CBs started practice of indirect lending to deprived sector through FIs, especially in rural areas. It should be taken as positive step of CBs to reach the poor.

**Table No. 6**  
**Sector Wise Loan Disbursement of Commercial Banks**

(Rs. Million)

Year (Mid- July)	(i) Agriculture	(ii) Industry	(iii) Commerce	(iv) General Use & Social Purpose	(v) Others	Total
1984	119.8 (3.4)	475.1 (13.5)	1652.4 (46.9)	1223.6 (34.7)	55.1 (1.5)	3526.0 (100)
1985	145.6 (3.2)	851.1 (18.8)	1997.8 (44.1)	1361.2 (30.0)	176.4 (3.9)	4532.1 (100)
1986	148.9 (2.5)	1736.8 (29.1)	2334.8 (39.1)	1517.3 (25.4)	236.4 (4.0)	5974.2 (100)
1987	153.2 (2.2)	2042.0 (29.4)	2476.8 (35.7)	1698.5 (24.5)	571.0 (8.2)	6941.5 (100)
1988	553.2 (6.8)	2575.2 (31.5)	2512.0 (30.8)	2190.1 (26.8)	333.8 (4.1)	8164.3 (100)
1989	1157.8 (11.2)	3134.7 (30.3)	2829.8 (27.3)	2733.2 (26.4)	501.2 (4.8)	10356.7 (100)
1990	1531.6 (13.0)	3817.6 (32.4)	3371.7 (28.5)	2785.3 (23.6)	292.5 (2.5)	11798.7 (100)
1991	1850.3 (13.2)	4545.6 (32.4)	4150.0 (29.6)	3132.7 (22.4)	330.4 (2.4)	14009.0 (100)
1992	2432.1 (13.0)	5389.3 (28.7)	6801.8 (36.2)	3629.3 (19.3)	545.1 (2.8)	18797.6 (100)
1993	3144.2 (14.6)	6621.1 (30.8)	7235.2 (33.8)	3741.0 (17.4)	735.5 (3.4)	21477.0 (100)
1994	3395.6 (11.6)	11046.9 (37.7)	9508.1 (32.4)	4116.7 (14.0)	1271.8 (4.3)	29339.1 (100)
1995	4923.8 (12.1)	15877.6 (39.1)	13305.7 (32.8)	4785.5 (11.8)	1697.7 (4.2)	40590.3 (100)
1996	3972.8 (7.0)	24212.6 (46.0)	17010.3 (32.3)	4749.7 (9.0)	2674.4 (5.7)	52619.8 (100)
1997	5102.9 (8.5)	26393.8 (43.6)	20401.3 (33.8)	5651.9 (9.3)	2927.0 (4.8)	60476.6 (100)
1998	6095.9 (8.6)	31775.2 (44.6)	23963.9 (33.6)	5970.1 (8.4)	3439.1 (4.8)	71244.2 (100)
1999	7868.5 (9.4)	38062.1 (45.3)	27654.9 (32.9)	6256.1 (7.4)	4240.9 (5.0)	84082.5 (100)
2000	8683.7 (8.7)	44885.3 (45.1)	32753.3 (32.9)	7237.9 (7.3)	5713.6 (5.7)	99453.8 (100)
2001	9999.4 (8.9)	51008.9 (45.2)	36200.2 (32.1)	8048.9 (7.1)	7603.2 (6.7)	112860.6 (100)
2002*	10156.0 (8.6)	53595.3 (45.4)	36928.60 (31.3)	8238.2 (7.0)	9110.3 (7.7)	118028.4 (100)

\* Provisional

Figures in parenthesis denote percentage of total.

Source: Economic Survey, Various Issues, MOF

Table No.6 presents the overall loan structure of CBs. There has been persistent rise in the total loan disbursement of CBs during the period of 1984 to 2002. In 1984, largest share of loan was disbursed to commercial sector (46.9 percent) followed by general uses and social purposes (34.7 percent). Gradually, the flow of credit for commercial purposes declined and was only 31.3 percent in 2002. On the other hand, the share of industrial loan increased persistently from 13.5 percent in 1984 to 45.5 percent in 2002. It may be due to the increase in the number of industries especially after liberalization policy adopted by HMG/N thereby increasing industrial employment opportunities to poor.

The CBs loan to agriculture sector increased marginally from 3.4 percent in 1984 to 8.6 percent in 2002. The share of agriculture in the total loan of CBs remained high during 1989 to 1995, the highest being in 1993 with 14.6 percent. The reason for this rise in agricultural loan may be due to that CBs were required to invest 12 percent of their loan in the priority sector. This may be considered as a positive step of NRB towards poverty reduction strategy by making compulsion for CBs to invest in poorer section of society. From 1996 onwards, CBs share in agriculture has declined. The reason may be the implementation of various micro credit institutions to cater small loan in rural areas.

### Commercial Bank Branches, Rural Banking and Employment Generation

Poverty in Nepal is wide spread. To examine the access of credit to poor it is imperative to look at the bank branches in Hill, Terai and Kathmandu Valley. Distribution of CBs branches especially after liberalization is shown in Table No.7.

Table No. 7

#### Commercial Bank Branches by Area

Year	1984	1990	1995	2000	2003
Area					
Kathmandu	49	65	65	75	87
Hill	151	192	190	164	131
Terai	15	184	189	200	181
Total	357	441	444	439	399

Source: Quarterly Economic Bulletin, 2003.

Expanding bank branches in Kathmandu indirectly indicates that credit facility is increasing and more people are benefited in the valley. The constraint in the expansion of CB branches in Hill areas has made it quite discouraging to achieve the national objective of poverty alleviation. Bank branches in Hill increased from 1984 to 1990. After those branches have declined hence, access of credit to the Hill area is decreasing. Reason for the decline may be due to (i) the problem of security in Hill area because of Maoist insurgency and (ii) economic liberalization policy which is injecting incentives of profitability for CBs. In

Terai bank branches are increasing from 1984 to 2000 and then started to decline up to 2003. At national level, the total number of branches increased from 1984 to 1995 then declined up to 2003.

As majority of poor reside in rural area the facility of credit to the rural area may be taken as an indicator of financial sector's role in poverty alleviation. It is therefore imperative to examine CBs branches in rural and urban area. Table No.8 presents the CBs branches in rural and urban area.

**Table No. 8**  
**Rural and Urban Distribution of Commercial Bank Branches\***

Year	Rural	Urban	Total	Rural as Percentage of total
1985	267	116	383	69.7
1990	300	160	460	65.2
1995	310	134	444	69.8
2000	285	193	478	59.6

\* Includes ADB/N Commercial Bank Branch

Source: Acharya, Meena (2003).

Rural branches as a percentage of total branches are declining with passage of time. Conclusion is that, credit facility of commercial bank to rural poor is gradually declining after the financial liberalization in comparison to the its urban counterparts. The formal financial system of Nepal is becoming urban based and liberalization has helped to intensify this bias. Therefore, it is advisable not to close bank branches in rural areas.

**Table No.9**  
**Direct Employment in Major Commercial Banks (2000)**

S.No.	Banks	Officers	Non-offers	Total
1	Nepal Bank Limited	1024	5225	6249
2	Rastriya Banijya Bank	636	5208	5844
3	Nepal Arab Bank	120	263	383
4	Himalayan Bank Limited	79	246	325
5	Nepal Bangladesh Bank	61	212	313
6	Everest Bank Limited	44	220	264
7	Nepal Grindlays Bank	29	138	167
8	Nepal SBI Bank	43	88	131
9	Nepal Indo-suez Bank	41	58	99
10	Bank of Kathmandu	27	71	98
11	Total	2104	11769	13873

Source: Acharya (2003).

CBs affect the poverty by generating employment. Table No. 9 shows the employment generation in the few selected CBs. The ten CBs all together were employing 13,873 people in the year 2000. Out of them, 2104 (15.16 percent) were officer level and the rest 11,769 (84.84 percent) were non-officers. This figure indicates that employment generated in CBs that helped to reduce income and human poverty for the employed and their dependents. But it is to be noted here that those employed in banks are literate and educated but masses of population of the country are illiterate, inefficient and below poverty line may not be addressed by this figure. Moreover employment in CBs has probably increased only in margin because of the restructuring exercise currently underway in the bigger and older two banks namely, NBL and RBB.

### **Financial Sector Reform and Access of Credit to Poor**

Financial sector reform has extensively expanded financial services in Nepal. But these services are urban based because most of the financial activities took place in urban and sub-urban areas of the country. On the other hand, poor and hard-core poor reside in remote and rural areas where financial services could not be reached to them. As analyzed above figures of loan to Priority and Deprived Sector seem to be quite encouraging but it is very difficult to find out whether these loans have actually reached to the targeted sector or not.

After liberalization in financial sector, NBL and RBB had to curtailed their branches in rural areas due to competitive market and cost effectiveness. The present security problem has also restricted CBs to expand their branches in rural areas that have adversely affected poor people's reach to credit of CBs. The directives of NRB required to two branches in rural areas for one in every one in urban area, recently it has reduced to one. This change has further impeded the CBs branches in rural areas depriving poor from service of CBs.

NRB's recent policy reform to phase out the Priority Sector Program would deprive CBs service to poor. "Priority Sector Credit Program required all CBs to target a specified percent of loan to priority sector such as agriculture and rural industry. Although the deprived sector lending requirement at 3 percent of the outstanding loan of CBs is not phased out. The phasing out of priority sector component is also likely to deprive rural development banks and micro finance institutions of captive source of fund coming from commercial banks in the form of meeting priority sector lending requirement". (Khatiwada, 2003). The recent reform also look forward not to provide subsidies to micro financial services providing credit to the rural poor depriving institutional credit facilities to rural poor.

Financial liberalization has definitely increased various financial services to urban population but it has not ensured the rural people's access to institutionalized financial services. If the ongoing reform of financial sector is implemented it may not fulfill national goal of poverty reduction.

## Conclusion

Most of the South Asian Countries initiated economic liberalization during 1980s. Financial liberalization policy in Nepal was initiated from 1984 and still continuing. Poverty reduction has always been considered the cornerstone of development effort of the country, the financial liberalization policy therefore, expected to alleviate poverty providing banking services to poor. As the present study has concentrated CBs credit to poor after liberalization, IBP was implemented in Nepal through commercial banking system and was positively contributing to the upliftment of the condition of the poor.

As the total amount of priority sector credit did not go to the "hard core poor", the "Deprived Sector Credit Scheme" was introduced in 1990. The CBs extended credit facility to deprived sector, which represented 2.6 percent of the total credit at macro level. It gives the evidence of the involvement of CBs in the access of credit to poor even after adaptation financial liberalization policy.

The CBs are confining priority sector credit even after financial liberalization and its share in GDP is stagnating around one percent from 1984 to 1993, and increased from 1994 and reaching to 2.7 percent in 2001. It indicated the increasing importance of priority sector credit to national economy.

The CBs are contributing credit facility to poor for productive and employment generating economic activities. However, their credit facility to rural poor is gradually declining after the financial liberalization in comparison to the urban counter parts. The commercial banking system of Nepal has evidenced urban bias and liberalization has helped to intensify this bias. NRB is planning to gradually phase out the priority sector program from 2007/08. It is highly recommended for CBs to continue providing credit to poor and deprived section of society. It would make CBs to participate in poverty alleviation effort of the country.

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