PREFACE

A well functioning financial system plays a crucial role in the process of economic development by efficiently mobilizing resources and allocating capital for productive investment projects. After the introduction of financial sector reforms, the number of banks and other financial institutions with variegated types of financial instruments has emerged up.

As a first step of initiation to liberalize the financial sector since mid-1980s, entry barriers were removed. Three joint venture banks were established in the three subsequent years from 1985. Following it, interest rates were liberalized gradually. Then, especially after the restoration of democracy in 1990, popularly elected government gave its major thrust on economic and financial liberalization in Nepal. The institutional network and volume of operations of the financial system has expanded and diversified, with the number of commercial banks going up from five in 1990 to 17 in 2003. The number of other financial institutions has likewise seen quantum jump.

Realizing the significance of the financial system in the economic development, the government formulated and implemented various policies and processes during the past one and a half decade. They are permission to establishment of the joint venture banks, autonomy in the determination of the interest rate, scrapping of statutory liquidity ratio, implementation of the prudential guidelines, removal of credit ceilings, and introduction of open market operations and other indirect instruments of the monetary policy. This has resulted significant improvements in quantitative as well as qualitative dimensions of Nepalese financial system.

Over the past decade, Nepal has made serious efforts to transform into a market-based economic system and adopted the policy of financial sector reforms. The financial sector reform aimed at enhancing savings mobilization and credit allocation to the private sector. However, growth experience is less than expectation, which also affected the performance of its financial sector. Nepal formulated a comprehensive financial sector reform to deregulate the financial markets from decades of government intervention, mainly, by late 1980s and 1990s. Despite of the efforts on financial sector reform, critics argue that the reform has had little impact on mobilization of financial savings. Instead, the reform led to high nominal interest rates on lending (rather than deposit) and continuous devaluation of its currency.

Improvement so far achieved after the introduction of reforms, mainly in the financial sector, improvements are not satisfactory. Mainly the performances of public sector banks and financial institutions have been observed poor. So, Nepalese financial sector is in the process broad and comprehensive reform program. Still there are some lacuna and loopholes making reform efforts less effective. It is, therefore, critical to assess the effectiveness of financial sector reforms in Nepal.

Nepal has embarked on economic reforms since mid 1980s with far reaching impacts on trade, industry and financial sector. A comprehensive economic and structural reform has achieved a relatively significant success in stabilizing its economy. As a result, inflation has reduced successfully and economic activities have expanded gradually. Most of the non-tariff barriers have been eliminated and tariff structure streamlined. Foreign investment policy has been liberalized and exchange rate policy changes have eliminated the discriminatory official exchange rates and parallel market rates are discouraged completely. However, political instability, particularly, since mid-1990s has hindered its growth potential and Nepal is not yet able to reap the benefits of economic stability, which is beyond the coverage of present study.

Present study is unique in the sense that no comprehensive study has been made in the evaluation of policy reforms in the financial sector of Nepal. There have been wide cross-country studies in this topic in other countries which also cover Nepal but it is felt needed that whether these findings can be generalized in the case of Nepal. So, present study aims to find out the facts in this case.

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Khem Raj Bhetuwal