

# Financial Development and Economic Growth in Nepal

ビン, プラサード, ブサール

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氏 名 : Bhim Prasad BHUSAL (ビンプラサードブサル)

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## 論 文 内 容 の 要 旨

This thesis focuses on assessing impacts of financial development on economic growth in Nepal by utilizing descriptive and econometric analysis framework. The main purpose is to assess the long-run relationship between financial development and economic growth in Nepal. Particular attention is paid to observing the influence of various financial factors and their economic performances on different industries of the Nepalese economy.

Chapter 1 briefly reviews past studies relating to financial development and the economic growth process. It deals with reviewing the finance-growth nexus under the basis of both theoretical and empirical analysis. The review found financial development and liberalization have more or less impacted in many different economies. Similarly, financial development is also contributing to economic growth through various channels. However, there are few empirical studies which attempted to investigate the extent of liberalization or attempted to find the causality between financial development and economic growth in Nepal for a short period of time. This motivates to examine the impact of financial development on economic growth of Nepal.

Chapter 2 analyzes the historical development of financial system in Nepal with a focus on its performance in three different phases; primitive phase, controlled and regulatory phase and the modern liberalized phase. This chapter examines the current state of the financial system of Nepal by using the monetary and credit indicators, and macroeconomic indicators. Financial indicators rapidly increased in the liberalization period in comparison to the pre-liberalized period. Similarly, the present financial system of Nepal is an underdeveloped bank-based system. Therefore, this chapter guides the investigation in two ways. First, it is essential to examine how the bank-based system is contributing to the economy, and secondly, an empirical analysis is essential to investigate whether liberalization brought any other changes to Nepal's financial system.

Chapter 3 provides evidence of financial system development through the development of commercial banking in Nepal. To fulfill an objective of the thesis, author attempts to investigate a few factors which are responsible for the development of commercial banks in Nepal. Banks mainly focus on their activities of deposit collection and loan extension. The Majority of loan supplied by domestic private and joint venture banks are extended to the service and industrial sectors whereas loans supplied by public banks are largely to the agricultural sector. However, despite some problems (such as problem of non-performing loans and low level of credit supply) commercial banks are supplying loans to the agriculture and service sectors

under the government and the central bank's policies from a long time, i.e., from the mid-1970s. Therefore, this chapter further guides the investigation to examine the long-run linkage between agriculture and service sectors and financial development.

Since the implementation of liberalization policies from the mid-1980s has changed the financial system significantly, investigation of the impact of policy reforms on the financial sector and on macro economy is an important issue. In this regard, Chapter 4 attempts to investigate the impact of financial policy reforms on financial development and macroeconomic indicators in Nepal. The study applies a descriptive methodology to analyze the performance in some monetary and bank-based financial indicators in various phases of policy implementation. Liberalization policies were implemented from the mid-1980s; however, effects those policies had on the system were mostly observed from the 1990s. Due to high competition, resulting from entry of new intermediaries from the private sector, easing legal barriers, and deregulation of interest rates, the level of financial development sped up in comparison to the pre-liberalized period. But this situation could not be sustained for a long time and spreads increased in the beginning of 2000s. The liquidity situation of the banking system and easing of some monetary policy instruments caused a reduction in deposit rates that raised the margin between lending and deposit rates.

Chapter 5 investigates a long-run relationship between financial development and economic growth in Nepal by employing Johansen's cointegration technique. It generally assumes that if financial sector development has an impact on economic growth, there should exist a long-term relationship between the two. This chapter not only looks into the impact of financial sector on overall economy but also tries to find a particular sector of the economy where the financial sector has the most influence. The estimation shows first, a long-run relationship is observed between the financial development variables, e.g. broad money and other credit indicators, and real GDP. These financial proxies also show a long-run linkage with value added of agricultural and service sectors rather than that of the industrial sector. The government and the central bank are imposing some policies on commercial banks to supply loans to priority and deprived sectors from the mid-1970s. Mainly agriculture and service sectors were selected as priority or deprived sectors. Therefore, financial development has an impact on the growth of agriculture and service sectors.

The thesis concludes that financial development has had more impact on the agricultural and service sectors than on the industrial sector. Scarce evidence of a cointegration relationship between financial development and industrial sector also suggests that the implementation of policies to promote the influence of financial sector development over industrial sector is necessary.