OVERVIEW OF NEPAL'S PUBLIC DEBT MANAGEMENT

1. Nepal lacks a coherent and centralized institutional body that is fully responsible for relevant policy and operational matters relating public debt management. While the Ministry of Finance (MOF), as the frontline office, is legally the government's key executive institution for the country's overall public debt management, the National Debt Act 2059 (2002) delegates domestic debt management to Nepal Rastra Bank (NRB), as the middle line office. Accordingly, MOF has been focusing on policy guidelines and external debt (although NRB plays an advisory role) and NRB, through its Open Market Operation Committee and Public Debt Department (PDD), on issuing and registering government debt securities, which include treasury bills and longer term bonds.[1] Within this framework, as the backline office, the Financial Comptroller General's Office under MOF (FCGO), mainly responsible for treasury operations and government accounting and internal auditing, registers and repays external debt. Although FCGO functions as a treasurer, repayment of domestic debt is done by NRB.

2. Despite this institutional arrangement, there is a lack of a coherent cash management strategy to guide decisions on the volume and maturity of each issuance of government securities mainly due to the lack of a well-coordinated revenue and expenditure projection system and an amortization schedule. While the OMOC develops the issuance calendar for the debt securities at the beginning of each fiscal year based on the MOF's annual budget projections, decisions on actual issuance, volume, and maturity are ad hoc and discretionary, and made throughout the year subject to the government's financing needs during the course of the year. For treasury bills PDD often decides on issuance on the basis of NRB's monthly forecasts of liquidity in the market and requests from commercial bankers. For long-term instruments, the volume of the issue is determined on the basis of MOF's projected fiscal deficit for the year and divided into four quarters. Given the weak institutional capacity and the lack of a coherent debt management system, there is also an absence of a well established and rational pricing system for the government securities.

3. A key requirement for more efficient public debt management in Nepal is to enable better control over government financial resources, better cash management, and reduction of idle balances by bringing all government accounts under the control of the Treasury and consolidation in a Single Treasury Account (TSA).[2] Currently, treasury disbursement and revenue remittance operations have been assigned to the FCGO and its district level branches District Treasury Comptrollers Officer. The FCGO appoints accountants to administer government disbursements in approximately 3,500 paying offices. There is a complete separation of budget execution and treasury management between the MOF and/or FCGO. Although the decentralization of authority to execute the government budget is common and generally desirable, government treasury (i.e. cash management) functions are almost exclusively delivered by the MOF and/or Treasury in the advanced economies.

[1] The treasury bills (maturity periods of up to one year) and most development bonds (maturity periods of 7–10 years) are sold through auction mostly to institutional investors such as banks, insurance companies, and provident fund, with a certain percentage of the treasury bills reserved for non-competitive buyers. The Citizens Savings Certificates (maturity period of about 7 years) are targeted towards individual investors and are sold at discounted face value and a coupon rate. While there are some 69 NRB-licensed primary dealers for these securities, most are not active and the primary dealership system is not well established.

[2] The Government of Nepal has already taken a decision to establish a TSA regime, under Phase I of the broader public financial management reform program. The piloting of a Treasury System has begun in two districts, Lalitpur and Bhaktapur. The program is being supported by the World Bank and DFID. IMF is providing technical assistance directly to the FCGO.

4. A large number[3] of government accounts are maintained at NRB headquarters, some of which are essentially government budget monitoring accounts, and form the basis of NRB periodic statements to the MOF on the implementation of government budget. The main accounts at NRB reflecting cash inflows and outflows are (i) revenue account; (ii) expenditure account; and (iii) local administration account. Each paying office maintains four (in some cases more than four) bank accounts—(i) expenditure (operational); (ii) capital expenditure; (iii) non-budget deposits; and (iv) nontax revenues. The Director General of Inland Revenue and Director General of Customs maintain sets of bank accounts for each major tax source. The IMF estimates that approximately 14,000 bank accounts are operated by 3,500 paying offices in Nepal. The 22 regional inland revenue offices and 30 regional custom offices contribute additional estimated 450–700 accounts. A fundamental flaw in Nepal's public debt management system is the dual and conflicting functions of NRB with respect to monetary operations—its primary function as the country's central bank—and domestic debt management, which blurs its role in performing these important functions independently. For example, decisions on monetary operations such as ceilings for repos and reverse repos in the open market can distort decisions on issuance of the government debt securities. The fragmented system of public debt management without a strategic direction of operation also means inefficiency, higher cost, and other risks of domestic debt to the government. Further, the fragmentation and proliferation of primary issues of treasury bills, Development Bonds, Special Bonds, and savings certificates with a range of maturity periods not only pushes up the issuance costs but also leads to illiquidity and hinders the development of the secondary market, which is critical to the development of the corporate bond market. Therefore, the consolidation of various government debt instruments into a single series of long-term government bonds is important for building an efficient bond market in the country.

5. Weak capacity—understaffing, lack of trained specialized staff, and lack of automation of procedures and transactions—of key institutions (MOF, NRB, and FCGO, in particular) is also a key constraint to effective public debt management and development of a well functioning market for government debt securities. While attempts have been made to automate the systems in these offices and train staff, these efforts have not been sustained due to lack of resources and broader institutional and legal reforms. As a result, while basic debt data recording is computerized, all other office procedures and transactions are virtually manual and paper-based without any information and technology networking between the key institutions and resulting in time lags and discrepancies between, for example, PDD and the banking department of NRB on matters relating debt repayment. There is, therefore, an urgent need for modernization and automation of the debt record keeping system, projection of key variables such as government revenue and expenditure and liquidity, payment settlement system, and debt sustainability analysis. Also, while there is a need to establish a dedicated public debt management office, as currently being contemplated by the government, to assume full responsibility of all policy and operational aspects of public debt management, this would be a medium to long-term proposition given. However, in the meantime, there is an urgent need to establish proper policy and operational coordination and IT linkage between the key institutions in public debt management.

[3] The IMF reports that there are 2,697 government bank accounts at NRB headquarters. Of these 22 accounts belong to "A" group—central accounts. The remaining accounts in "B" and "C" groups service retail banking operations of central and local administration accounts respectively.