

# **Nepal's Roadmap for Growth**

**By**  
**A.R. Bhattarai**  
**Kathmandu**  
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# Executive Summary

Nepal faces critical economic challenges, including rising living costs, slow growth, surplus foreign exchange with underutilized local reserves, low industrial productivity, increasing non-performing assets (NPAs), reduced consumer spending, and currency depreciation. To address these concerns, this strategic plan proposes five key strategies:

## 1. Regulatory and Governance Reforms

**Action Plan:** Streamline bureaucratic processes, implement a one-window clearance system, strengthen anti-corruption measures, and enhance public-private partnerships (PPP).

## 2. Export Diversification & Trade Promotion

**Action Plan:** Support high-potential export sectors, strengthen trade agreements, develop trade infrastructure, and launch international branding campaigns.

## 3. Digital Transformation & Innovation

**Action Plan:** Expand digital infrastructure, establish tech hubs, implement e-governance, enhance cybersecurity, and promote fintech development.

## 4. Sustainable Development & Green Economy

**Action Plan:** Accelerate hydropower expansion, invest in renewable energy, promote eco-tourism, support sustainable agriculture, and encourage green financing.

## 5. Fiscal & Monetary Policy for Economic Stability

**Action Plan:** Implement tax reforms, control inflation, attract foreign direct investment (FDI), manage debt effectively, and strengthen social security systems.

## 6. Legal and Policy Reforms

To achieve these strategic objectives, Nepal must undertake essential legal reforms, including:

1. **Foreign Direct Investment (FDI) Reforms:** Amend the FITTA 2019 to ease restrictions and introduce investor protection laws.

2. **Special Economic Zones (SEZs):** Enhance tax incentives and private sector participation in SEZ development.
3. **Labor & Employment Laws:** Allow flexible hiring policies and incentivize skill development.
4. **Land & Infrastructure Development:** Reform land acquisition laws and establish a Public-Private Partnership (PPP) legal framework.
5. **Tax & Trade Reforms:** Simplify the corporate tax structure and improve cross-border trade regulations.
6. **Financial & Digital Economy Laws:** Encourage digital payments, fintech startups, and enforce data protection laws.

## 7. Conclusion

By modernizing its regulatory framework and implementing targeted economic policies, Nepal can position itself as a competitive investment and manufacturing hub in South Asia. This strategic plan provides a structured approach to economic resilience, sustainable development, and long-term prosperity.

## A. Key Challenge

Nepal's economy faces significant challenges: rising living costs, slow growth, surplus foreign exchange alongside underutilized local reserves, low industrial productivity, increasing non-performing assets (NPAs), reduced consumer spending, and a weakening currency.

1. **Rising Living Costs:** Inflation has rendered essential goods and services increasingly unaffordable.
2. **Slow Economic Growth:** Structural inefficiencies hinder Nepal's economic potential.
3. **Underutilized Resources:** Surplus foreign exchange reserves coexist with unproductive local resources.
4. **Low Industrial Productivity:** Limited innovation and skill gaps impede industrial growth.
5. **Overleveraged Corporate Sector:** Rapid expansion, overreliance on borrowing from BFIs, and long cash conversion periods from corporate trading activities.
6. **Non-Performing Assets (NPAs):** Growing NPAs jeopardize the financial sector's stability.
7. **Reduced Consumer Spending:** Declining purchasing power has weakened demand and overall economic activity.
8. **Weakening Currency:** Depreciation of the Nepalese rupee raises import costs and strains the economy.

## B. Reform Actions Needed

1. **Targeted Stimulus:** Implement targeted stimulus measures to revive sectors hardest hit by the pandemic and policy changes. This includes providing financial support and incentives for industries such as tourism, hospitality, and small businesses.
2. **Infrastructure Investment:** Prioritize investments in infrastructure projects to stimulate economic activity and create employment opportunities. Infrastructure development not only boosts short-term growth but also lays the foundation for long-term prosperity.
3. **Diversification Strategies:** Encourage diversification strategies to reduce reliance on sectors susceptible to external shocks. Promoting innovation and supporting emerging industries can enhance economic resilience and mitigate vulnerabilities.
4. **Regulatory Clarity:** Provide clarity and consistency in regulatory frameworks to support lending activities and foster a conducive environment for credit growth.

Clear guidelines and streamlined processes can enhance the efficiency of credit allocation and promote investment.

5. **Policy Coordination:** Enhance coordination between fiscal and monetary authorities to ensure a cohesive approach to inflation management. Coordinated policies, including targeted fiscal measures and appropriate monetary interventions, can effectively address inflationary pressures.
6. **Forward Guidance:** Provide clear and transparent forward guidance on monetary policy to guide market expectations and promote stability. Clear communication from central banks can help manage interest rate expectations and minimize market volatility.
7. **Policy Flexibility:** Maintain policy flexibility to respond to evolving economic conditions. Central banks should stand ready to adjust interest rates in line with changing economic indicators, ensuring an appropriate balance between growth and inflation objectives.

## C. The 6 Strategies

Nepal can implement the following strategies and action plans to strengthen its economic resilience, enhance competitiveness, and achieve sustainable growth.

### 1. Regulatory and Governance Reforms

#### a) Strategy:

Nepal must streamline bureaucratic processes, modernize regulations, and improve governance to create a more business-friendly environment and attract investment.

#### b) Action Plan:

- a) **Regulatory Overhaul:** Conduct a comprehensive review of existing economic policies and eliminate outdated and redundant regulations.
- b) **Ease of Doing Business:** Establish a **one-window clearance system** to simplify business registration, licensing, and compliance.
- c) **Public-Private Partnerships (PPP):** Foster PPP models to develop key economic sectors such as infrastructure, energy, and manufacturing.
- d) **Anti-Corruption & Transparency Measures:** Strengthen institutions like the National Vigilance Centre and implement digital governance to reduce corruption.
- e) **Decentralization & Local Empowerment:** Empower provincial and local governments with financial and policy-making autonomy for faster economic decision-making.
- f) Ensure **sector-specific incentives** are integrated into **financial laws** for effective implementation.

- g) Amend the **Finance Bill** to align with the **Industrial Enterprises Act** to guarantee industry-related benefits.
- h) Implement **Second Generation Economic Reforms** by amending at unfair **laws, including black-market regulations**.
- i) Revise the **SAFTA Sensitive List** to promote exports.
- j) Establish a **stable industrial policy** for at least **10 years** to encourage long-term investments.
- k) Introduce **Anticipatory Bail provisions** and reform laws that intimidate industrialists, ensuring **fair hearings**.
- l) Modify the **Public Procurement Act** to award contracts based on **quality, past performance, and maintenance commitments**, rather than just the lowest bid.
- m) Promote **venture capital and private equity investments in startups and distressed industries** by amending **Section 57 of the Income Tax Act**.
- n) Revise the **contract manufacturing system** to align with the **Industrial Enterprises Act, 2016**.
- o) Allow private sector participation in **electricity transmission, distribution, and trade** through necessary legislative changes.
- p) Allow the **private sector to develop and operate industrial zones**, with the government providing **essential infrastructure (roads, electricity, water, and drainage)**.
- q) Prioritize **cement-concrete roads** for new constructions due to **lower lifecycle costs**.
- r) Amend laws to allow industries to use **excess land as collateral** and sell it when needed.
- s) Develop a **long-term plan for domestic fertilizer production**, improving the **existing DPR** and inviting private sector participation.
- t) Permit **private-sector fertilizer imports** to ensure **competitive pricing**.
- u) Implement **mandatory quality and SPS (Sanitary and Phytosanitary) testing** on **all imported agricultural products**.
- v) Identify and promote industries where Nepal is or can be **self-sufficient**, including **cement, paint, footwear, pharmaceuticals, textiles, garments, biscuits, noodles, poultry, woolen carpets, pashmina, carbon dioxide, oxygen gas, spirits, iron, and agro-processing**.

## 2. Export Diversification & Trade Promotion

### a) Strategy:

Enhance Nepal's export potential by identifying new markets, improving trade policies, and increasing the production of value-added goods.

### b) Action Plan:

- a) **Sector-Specific Support:** Provide financial incentives and policy support for high-potential exports, including textiles, handicrafts, tea, herbs, and IT services.
- b) **Bilateral & Regional Trade Agreements:** Strengthen trade ties with India, China, and SAARC nations by negotiating favorable trade agreements.

- c) **Trade Infrastructure Development:** Modernize border points, dry ports, and customs procedures to facilitate smoother trade.
- d) **Export Credit & Insurance:** Establish an export credit facility to provide low-interest financing and risk coverage for exporters.
- e) **Brand Nepal Campaign:** Launch international marketing campaigns to position Nepalese products in global markets.
- f) Enforce **higher customs duties on finished goods than on raw materials**, with at least a **two-tiered system**.
- g) Eliminate the **Customs Valuation Tariff Schedule** and integrate Nepal's **customs department with India's GST portal** for better transparency.
- h) Accept importers' **declared values**, with a **government purchase option at 5% premium** if value is suspected. Distribute these goods via **state-run enterprises and cooperatives**.
- i) Strengthen **customs valuation** to curb smuggling, particularly in sectors like **footwear**.
- j) **Encourage domestic production** by discouraging imports of products that can be made locally (e.g., energy drinks, snacks, electrical cables, animal feed, tiles, pharmaceuticals, agricultural tools).
- k) Expand **cash incentives for all exports** that bring in foreign exchange, based on value addition, volume growth, and forex inflows.
- l) Identify **non-subsidized export goods** if full-scale subsidies are not feasible.
- m) Simplify **foreign currency payment processes** for IT-related hardware and software imports.
- n) Maintain a **1% income tax rate on IT service exports** for at least **10 years** to boost digital trade.

### 3. Digital Transformation & Innovation

#### a) Strategy:

Accelerate digitalization across industries to boost productivity, improve governance, and attract investment in the technology sector.

#### b) Action Plan:

- a) **5G & Digital Infrastructure:** Expand high-speed internet access, especially in rural areas, to enable a digital economy.
- b) **Tech Hubs & Startup Ecosystem:** Establish special economic zones (SEZs) focused on IT, AI, and software development.
- c) **E-Governance:** Implement paperless government services, e-taxation, and blockchain-based land registration.
- d) **Cybersecurity & Digital Literacy:** Develop cybersecurity laws and conduct nationwide digital literacy programs.
- e) **Fintech & Digital Banking:** Promote mobile banking, e-commerce, and financial technology startups.

## 4. Sustainable Development & Green Economy

### a) Strategy:

Promote environmentally friendly economic growth by leveraging Nepal's natural resources sustainably.

### b) Action Plan:

- a) **Hydropower Expansion:** Accelerate the development of hydroelectric projects and establish cross-border electricity trade with India and China.
- b) **Renewable Energy Investments:** Provide incentives for solar, wind, and biomass energy solutions.
- c) **Eco-Tourism Development:** Promote responsible tourism that balances conservation and economic growth.
- d) **Sustainable Agriculture:** Support organic farming, introduce climate-resilient crops, and reduce chemical dependency.
- e) **Green Financing:** Encourage banks and financial institutions to provide green bonds and low-interest loans for sustainable projects.

## 5. Fiscal & Monetary Policy for Economic Stability

### a) Strategy:

Implement sound macroeconomic policies to ensure financial stability, control inflation, and support growth.

### b) Action Plan:

- a) **Tax Reforms:** Reduce tax complexities, expand the tax base, and provide incentives for high-growth industries. Reduce personal and corporate income tax rates to increase savings and investments.
- b) **Amend Section 113:** Government will promptly pay tax refunds as soon as appropriate officials have confirmed that the taxpayer is entitled to a refund.
- c) **Amend section 132:** Tax auditors will be incentivized assessing and collecting the correct amount of tax under Income Tax Act.
- d) **Inflation Control Measures:** Strengthen monetary policies by managing interest rates and ensuring currency stability.
- e) **Investment-Friendly Laws:** Update investment policies to attract foreign direct investment (FDI) in priority sectors.
- f) **Debt Management Framework:** Develop a strategy to manage external and internal debts effectively.
- g) **Social Security & Welfare Expansion:** Strengthen safety nets for vulnerable populations to reduce poverty and inequality.
- h) **Enable foreign nationals to purchase apartments to boost real estate investment.**

## 6. Amend the Financial Act to Incorporate Industrial Incentives

To ensure the effective implementation of the **Industrial Enterprises Act**, all **benefits, incentives, and concessions** provided under this Act should be explicitly **incorporated into the Financial Act**. Without this inclusion, industrial incentives face challenges in enforcement due to inconsistencies with broader economic and tax laws.

### a) Key Justifications for Amendment:

- i. **Legal Certainty & Implementation:**
  1. Currently, industrial incentives remain unenforceable if they are not reflected in financial and tax-related laws.
  2. By incorporating them into the **Financial Act**, industries can claim the benefits without ambiguity or administrative hurdles.
- ii. **Tax & Customs Alignment:**
  1. Industrial incentives (such as tax holidays, duty exemptions, and rebates) must align with tax and customs laws to avoid conflicts in application.
  2. Harmonizing these provisions within the Financial Act ensures that tax authorities recognize and implement them uniformly.
- iii. **Investment Promotion & Stability:**
  1. A clear legal framework ensures that industries receive promised incentives, boosting investor confidence.
  2. Stability in financial policies will attract long-term industrial investments and prevent abrupt policy reversals.
- iv. **Compliance & Transparency:**
  1. Integrating industrial incentives into the Financial Act ensures their implementation is legally binding and not subject to discretionary approvals.
  2. This reduces bureaucratic delays and enhances transparency in granting industrial benefits.

### b) Key Areas for Inclusion in the Financial Act:

- i. **Tax Holidays & Exemptions:** Ensure all income tax, VAT, and excise exemptions provided under the **Industrial Enterprises Act** are listed in the **Financial Act**.
- ii. **Customs Duty Concessions:** Codify lower duties on industrial raw materials and machinery imports.
- iii. **Subsidies & Incentives:** Specify export incentives, cash subsidies, and financing support for industries.
- iv. **Industrial Land & Infrastructure Benefits:** Include land acquisition benefits, industrial zone privileges, and government-supported infrastructure provision.

# Reform Matrix

To achieve the proposed **industrial growth strategy**, Nepal needs **legal reforms** that facilitate investment, improve ease of doing business, and create a competitive industrial environment. Here are the **key legal reforms Nepal should initiate**:

## 1. Industrial and FDI Reforms

### a. Investment-Friendly FDI Laws

Amend the **Foreign Investment and Technology Transfer Act (FITTA) 2019** to:

- i. **Ease restrictions on foreign investment** in high-potential sectors like **manufacturing, energy, and technology**.
- ii. **Allow automatic route for FDI** in key sectors, reducing bureaucratic delays.
- iii. **Introduce investor protection laws** ensuring non-discriminatory treatment of foreign investors.
- iv. **Provide tax incentives and land lease policies** similar to India's SEZ framework.

### b. Special Economic Zones (SEZ) Act Reform

Amend the **SEZ Act 2016** to:

- i. **Allow private sector participation in SEZ development**.
- ii. **Provide 10+ years of tax holidays for industries setting up in SEZs**.
- iii. **Introduce fast-track clearance for SEZ-based businesses**.

## 2. Labor & Employment Reforms

### a. Flexible Labor Laws for Manufacturing & IT Sector

Amend the **Labor Act 2017** to:

- i. **Allow flexible hiring & firing policies** in manufacturing and IT industries.
- ii. **Introduce fixed-term employment contracts** for large-scale industrial projects.
- iii. **Streamline work visa approvals** for foreign professionals.

### b. Incentivizing Skill Development

Create a **National Employment Promotion Law** to:

- i. **Mandate industries to invest in vocational training**.
- ii. **Provide tax incentives for companies hiring locally trained workers**.

### **3. Land & Infrastructure Development Laws**

#### **a. Land Acquisition & Industrial Use Reform**

Amend the **Land Acquisition Act 1977** to:

- i. Allow land leasing for long-term industrial projects (30+ years).
- ii. Simplify the land conversion process for industrial use.
- iii. Remove land ceiling restrictions to facilitate large-scale industrial expansion.

#### **b. Public-Private Partnership (PPP) Law**

Enact a **PPP Act** to:

- i. Provide a legal framework for private investment in infrastructure.
- ii. Reduce government monopoly in major projects.
- iii. Ensure transparent bidding & dispute resolution mechanisms.

### **4. Tax & Trade Policy Reforms**

#### **a. Simplify Corporate Tax Structure**

- i. Reduce corporate tax rates for priority sectors (e.g., manufacturing, IT, energy).
- ii. Provide tax holidays for FDI-backed firms in key industries.
- iii. Introduce a GST/VAT reform to simplify indirect taxes and boost trade.
- iv. Amend tax law and Supreme Court law to allow arbitration for tax cases instead of criminalization through the Department of Revenue Investigation.
- v. Amend Section 57 of Income Tax Act to align with international practice – collect tax from owners who sell their company at the time of sale
- vi. Amend tax law to eliminate retrospective taxation, create clear laws for foreign investors, and reconcile conflicting tax laws. (i.e., Industrial Enterprise Act allows tax deductions for corporate social responsibility donations, but Taxation Act does not allow deductions.)
- vii. Progress Double Taxation Avoidance Agreements (DTAAs) and Bilateral Investment Treaties with priority governments.
- viii. Tax Reforms: Reduce tax complexities, expand the tax base, and provide incentives for high-growth industries. Reduce personal and corporate income tax rates to increase savings and investments.
- ix. Amend Section 113: Government will promptly pay tax refunds as soon as appropriate officials have confirmed that the taxpayer is entitled to a refund.
- x. Amend section 132: Tax auditors will be incentivized assessing and collecting the correct amount of tax under Income Tax Act.
- xi. Ensure tax policy stability to maintain investor confidence (e.g., reversing IT sector tax benefits discouraged investment).

### **b. Improve Cross-Border Trade Regulations**

Amend the **Customs Act 2007** to:

- i. **Digitize customs clearance to reduce delays.**
- ii. **Reduce export-import restrictions on manufacturing inputs.**
- iii. **Implement India-Nepal trade facilitation policies to leverage the Make in India supply chain.**
- iv. **Develop country-specific export promotion strategies.**

## **5. Financial & Digital Economy Laws**

### **a. Fintech & Digital Banking Regulation**

Amend the **Nepal Rastra Bank Act** to:

- i. **Allow foreign banks & fintech firms to operate in Nepal.**
- ii. **Encourage digital payments & blockchain adoption.**
- iii. **Create a regulatory sandbox for fintech startups.**

### **b. Data Protection & E-Commerce Laws**

Enact a **Comprehensive Data Protection Law** to:

- i. **Attract global IT firms & data centers (similar to India's Data Center Policy).**
- ii. **Provide clear regulations for e-commerce & digital trade.**

## **6. Ease of Doing Business**

- i. **Develop of a new unified insolvency law: dealing with the financial distress of consumers, MSMEs, and corporates that will have a modern and comprehensive restructuring regime as well as a more efficient liquidation regime.**
- ii. **Amendment to the civil procedure rules: relating to the handling and disposal of commercial matters with a view to making certain provisions more efficient, such as the handling of injunctions and fast-tracking smaller cases.**
- iii. **Assessment of the use of alternative dispute resolution mechanisms: namely commercial mediation and arbitration in Nepal to strengthen tools and procedures that facilitate dispute resolution outside of the formal courts.**
- iv. **Amendment to Companies Act: to address: (a) standardization and consolidation of Articles of Association and Memorandum of Association; (b) submission of the document related to registration of company through online portal, (c) reduce the need for a professional to verify and certify registration documents, and (d) extend company registrar services across provinces.**

## 7. Strengthening Anti-Money Laundering (AML) Regulations

To enhance financial transparency and prevent illicit activities, Nepal should **centralize the AML reporting system** under a single regulatory authority. This will streamline reporting, reduce redundancy, and ensure **consistent enforcement of AML regulations** across financial institutions and businesses.:

- i. **Strict Implementation of AML Regulations:** Strengthen oversight to prevent financial crimes while maintaining a balanced approach that does not overburden legitimate businesses.
- ii. **Encouraging Voluntary Reporting of Suspicious Transactions:** Businesses should be incentivized to report suspicious activities proactively. A safe harbor provision can be introduced to protect businesses that voluntarily disclose transactions in good faith.
- iii. **Reducing Compliance Costs:** Current AML compliance requirements create a heavy financial and administrative burden on businesses. Simplifying reporting procedures, digitalizing compliance processes, and providing clear guidelines will reduce costs and ensure smoother operations.
- iv. **Enhanced Coordination Among Agencies:** Establish a centralized digital platform for AML reporting, allowing banks, financial institutions, and businesses to submit reports efficiently without duplication.
- v. **Capacity Building and Awareness Programs:** Train businesses and financial institutions on AML best practices, ensuring they understand regulatory expectations and compliance requirements.
- vi. **By adopting these measures, Nepal can strengthen its AML framework while maintaining a business-friendly environment,** ensuring that financial integrity and economic growth go hand in hand.

## 8. Conclusion: Nepal's Legal Roadmap for Growth

By modernizing its legal framework, Nepal can attract foreign investments, promote industrialization, and integrate into regional supply chains. A combination of FDI-friendly laws, labor reforms, SEZ expansion, tax incentives, and digital economy regulations will position Nepal as a competitive manufacturing & financial hub in South Asia.