SUMMARY

1. Nepal started to liberalize its trade and investment regime, unilaterally, in 1992 and became the first least developed country (LDC) to join the WTO through the full accession process in April 2004. Since then, economic performance has not resulted in the strong development Nepal needs. Key factors impeding higher rates of GDP growth include political instability (due to the transition process embarked upon after the internal conflict of 1996-2006) and supply-side constraints, notably energy shortages, poor infrastructure, and labour strikes. Recognizing the effective role of trade to achieve sustainable and inclusive economic growth, and to establish the conditions to reduce poverty and improve the living standard of its people, Nepal is taking further steps to create a more friendly business environment and help its exporters to become more competitive.

(1) ECONOMIC ENVIRONMENT

2. Nepal's real GDP growth rate averaged 4.2% per year during 2004-11. It is still one of the poorest countries in South Asia with about 25% of the population living below the poverty line. Moreover, lack of diversity of its exports and heavy reliance on remittances from abroad (over 20% of GDP) make the economy very vulnerable to external economic shocks.

3. Nepal's annual average inflation rate reached double digits in 2009 mainly because of supply disruptions – general strikes, road closures, and cartelizing of essential goods and supplies, including food items – as well as swelling of domestic consumption (over 90% of GDP) due to increased remittances inflows. Prices in Nepal are also greatly influenced by inflation in India since the Nepali rupee is pegged to the Indian currency.

4. Nepal's fiscal management remains prudent, and recently implemented revenue administration reforms have resulted in strong customs and VAT collection. Consequently, the percentage of public debt to GDP declined from 59% in 2004 to an estimated 32% in 2011.

5. Nepal's trade deficit more than quadrupled during 2003-10 because of weak export performance and buoyant imports. However, high remittances from abroad led to current account surpluses during most of the period under review.

6. Trade accounts for about 40% of GDP. Nepal has a narrow export basket, and its export market is concentrated in a few countries, led by India. Between 2003 and 2010, the share of merchandise exports in GDP declined from 10% to 5%, while imports more than tripled, pushed by increased consumption due to higher remittances.

7. Nepal attracts very limited FDI inflows, largely due to the high cost of doing business and limited investment opportunities. In addition, certain economic activities are reserved for national investors (e.g. fisheries, cottage (traditional) industries, travel agencies and consultancy services). Thus, a major objective of Nepal's economic policy programme is to promote and encourage a transparent and fair business environment for both domestic and foreign investment, and to increase the role of the private sector in the development process.

(2) INSTITUTIONAL FRAMEWORK

8. Formulation and implementation of Nepal's trade policy is the responsibility of the Ministry of Commerce and Supplies (MoCS), in coordination with other ministries. The private sector provides inputs to trade policy formulation by communicating its views either directly to the MoCS or through the Federation of Nepalese Chambers of Commerce and Industry and the Nepal Chamber of Commerce.

9. Nepal became the 147th Member of the WTO on 23 April 2004. As part of its accession commitments, Nepal bound 99.4% of its tariff lines and made extensive commitments under the GATS. It has not been involved in any dispute under the WTO Dispute Settlement Mechanism, either directly or as a third party. Since acceding to the WTO, Nepal has made very few notifications; the authorities have requested help from the Secretariat in this regard. Nepal grants at least MFN treatment to all its trading partners.

10. Nepal participates in two overlapping regional agreements: the SAFTA (Afghanistan, Bangladesh, Bhutan, India, the Maldives, Pakistan, and Sri Lanka), and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC, with Bangladesh, Bhutan, India, Myanmar, Sri Lanka, and Thailand). In addition, Nepal has signed 17 bilateral trade agreements, notably with China and India.

11. Recognizing the effective role of trade in transforming a traditional agrarian economy into a modern economy, Nepal adopted its 2009 Trade Policy. It is being implemented through Nepal's Trade Integration Strategy (NTIS) 2010, which, *inter alia*, aims to strengthen Nepal's capacity to benefit from trade-related technical assistance and aid for trade, and promote 19 priority export potential activities: cardamom; ginger; honey; lentils; tea; noodles; medicinal herbs/essential oils; handmade paper; silver jewellery; iron and steel; pashmina; wool products; tourism; labour services; information technology and business process outsourcing services; health services; education; engineering; and hydro-electricity. Other potential exports are: sugar, coffee, dairy products, cement, and transformers.

12. The NTIS also identifies needs for donor support to address current constraints to trade and to help potential exports to flourish. Support to the trade agenda is being provided by bilateral and multilateral partners. Recently, the Government, led by the MoCS, has started to improve donor coordination in Nepal's aid-for-trade agenda. Nepal's efforts to mainstream trade into its national process, improve donor coordination, and implement the NTIS priorities are supported by the Enhanced Integrated Framework, in particular through a multi-year project for enhancing institutional capacity.

(3) TRADE POLICY INSTRUMENTS

13. Being a landlocked country, trading costs are particularly high in Nepal. The transit of goods through India (mainly the port of Kolkata) to international markets imposes significant shipping costs and delays on Nepalese exporters. On the other hand, the Customs Act and Regulation of 2007 simplified customs procedures in Nepal. Progress made in trade facilitation has also improved customs clearance.

14. Nepal's tariff is relatively simple, as 99.3% of total lines are *ad valorem*. Its average applied MFN tariff decreased from 13.8% in 2002/03 to 12.2% in 2011/12, while the average final bound tariff is 26.3%. Nepal applies no tariff rate quotas. Upon its accession to the WTO, Nepal bound all but 54 tariff lines at the HS 8-digit level. The authorities note that Nepal excluded these lines for revenue collection and environment protection reasons.

15. Nepal's tax revenue relies heavily on taxes collected at the border by Customs because of its administrative convenience compared with other sources of revenue collection. Nepal has eliminated a number of other duties and charges (ODCs) on imports, and the only remaining ODC – the agriculture reform fee – is levied on imports from India and the Tibet Autonomous Region of China, from where agricultural imports are exempted from tariffs.

16. Nepal does not have legislation on contingency trade remedies; nonetheless, draft legislation on anti-dumping and countervailing measures is under preparation. Nepal has not applied any anti-dumping, countervailing, or safeguard measures.

17. Import and export prohibitions and restrictions are maintained on a number of products, to protect national security, maintain public morals, and conserve exhaustible natural resources. Some restrictions are applied to ensure the availability of domestic raw materials, which are essential for domestic processing industries. Other than for goods restricted from importation, there is no need for an import licence in Nepal.

18. Nepal applies export taxes on some products; according to the authorities, these are applied to protect the environment, ensure food security, and discourage trade diversion to India. These export restraints may not be the best way to achieve some of the Government's objectives. For example, levying export tax on wood tends to discourage the export of wood. When demand for wood from other countries increases, the export tax on wood tends to encourage illegal wood exports.

19. The Government promotes exports through various channels (e.g. profits earned through exports are subject to an income tax rate at 15%, instead of the 25% general corporate income tax rate), and legislation to establish special economic zones and export processing zones is in the pipeline.

20. Nepal has a complicated income tax system; in particular, corporate income tax rates vary depending on the lines of business. Foreigners' income and income from export-related activities also have different tax rates. A standard 13% VAT is applied to most goods and services. Some goods and services are exempted from VAT, while some are zero rated. For the most part, the same VAT rate is applied to domestically produced and imported goods and services.

21. The authorities noted that privatization of public enterprises has been on hold since 2008. The Government acknowledges that public enterprises, in general, have performed poorly, and increasing the participation of the private sector could increase productivity, by improving efficiency and reducing the fiscal burden on the Government. However, there has been no regular monitoring of the privatized enterprises. Some enterprises have been closed after privatization, and others are operating with no increase in investment, production, and productivity. Petroleum and petroleum products, and iodine salt are the only products under state trading, managed by the Nepal Oil Corporation and the Salt Trading Corporation, respectively.

22. Nepalese exporters find it difficult to compete in global markets due to weak standardization and conformity assessment infrastructure. Nepal lacks an accreditation system and sufficient testing facilities. Its traditional agriculture exports (such as honey) have been subject to restrictions in the international market.

23. Nepal's law on government procurement, adopted in 2007, also covers procurement by public enterprises; it gives a price preference of 10% to Nepalese products. However, public procurement is inadequately monitored due to lack of trained staff and underfunded resources. Among other major problems, procurement methods have not been defined, no procurement reporting system has been established, e-procurement system does not exist, and IT application has not been introduced. Thus, compliance with the procurement legislation has been limited, and there has been unfair competition.

24. Nepal adopted a competition law in 2007, which established the Competition Promotion and Market Protection Board. However, the law does not apply, for example, to export business, and business relating to cottage and small industries.

25. As an LDC, Nepal is not required to apply the provisions of the TRIPS Agreement until 1 July 2013. It is preparing legislation on industrial property protection. So far, there have been no cases of customs action in IPR enforcement at the border.

(4) Sectoral Policies

26. Agriculture accounts for 36% of real GDP and employs around two thirds of the labour force, mostly in subsistence farming. With most of the country facing food deficit, Nepal's key objective for the sector is food security. Government assistance is provided mainly through loans and structural policies (e.g. credit and support for general research and extension services). Nepal's simple average applied MFN rate on agriculture, hunting and fishing is 9.7% and the final bound rate is 33.9%, leaving ample margin for increasing applied tariffs. Nepal does not have tariff-rate quotas on agricultural products, nor a system of guaranteed prices.

27. Under the Agriculture Perspective Plan 1995-2015, the Government aims, *inter alia*, to: increase factor productivity; alleviate poverty, and significantly improve living standards through accelerated growth and employment; and transform subsistence agriculture into commercial agriculture.

28. Manufacturing contributes only 6.1% to real GDP, reflecting Nepal's early stage of industrial development. Under its Industrial Policy 2010, Nepal aims, *inter alia*, to promote value-added industries, and increase production and productivity. Nepal does not provide direct payments to any manufacturing industry. Nonetheless, there are certain incentives, such as income tax, VAT, excise duty, and customs duties exemptions or deductions for certain industries. According to the authorities, the purpose of these incentives is to ensure balanced industrial development both regionally and sector-wise.

29. The simple average applied MFN tariff on manufacturing is 12.3%, while the final bound rate is 26% leaving ample scope for increasing applied MFN tariffs. Some of Nepal's unbound tariff lines are on manufacturing products (e.g. cement). The positive tariff escalation in some industries (e.g. food, beverages and tobacco, and textile and leather) provides higher levels of effective protection to those industries than that reflected by the nominal rates.

30. Despite having abundant hydropower resources, Nepal has not been able to generate enough electricity to match its demand. Addressing its energy shortages, therefore, is crucial for Nepal to achieve rapid and sustained economic growth.

31. Services is, increasingly, a key sector of Nepal's economy in terms of contribution to real GDP (about 50%). Nepal is a net importer of services. Under the GATS, it undertook extensive market-access commitments, and included 77 subsectors in its schedule. Nepal also signed the Reference Paper on basic telecommunications.

32. Since its WTO accession, Nepal has taken steps to address some of the structural problems in certain services activities, notably in banking where total foreign shareholding increased from 67% to 80%, while foreign banks/financial institutions may open branches for wholesale banking since 2010. Nepal is renowned worldwide as a tourist destination thanks to its ethnic/lingual/social diversity and natural beauty. Nevertheless, it faces key problems, notably poor infrastructure, limited air connectivity, and shortage of good quality accommodation and skilled manpower. Some of these shortcomings are being addressed. Further liberalization of services should improve the efficiency of the economy as a whole and the competitiveness of Nepalese exports, especially by reducing costs related to telecoms and transport.