
SUMMARY

1. Since the last Trade Policy Review of Nepal in 2012, economic growth has averaged 4.4% per year, despite GDP growth of only 0.4% in fiscal year (FY) 2015-16 when the country was hit by two earthquakes which caused considerable damage to infrastructure and production. Growth recovered in the following years, driven by good monsoons, post-earthquake reconstruction, and higher government spending. However, if Nepal is to achieve its objective of being a middle-income country by 2030, annual GDP growth of over 7% will be needed.

2. Although GDP per capita increased from US\$708 in FY 2012-13 to US\$1,004 in FY 2017-18, poverty alleviation continues to be a major challenge, with nearly six million Nepalese living in poverty. A large portion of the 45% of total population that are considered vulnerable may have also fallen back into poverty in the aftermath of the 2015 earthquakes. Estimates suggest that eight million people were affected by the earthquakes, with some US\$7 billion in damages and losses.

3. Nepal has achieved strong growth in government revenues in recent years through strengthening tax administration, including at customs. Government expenditure, however, has outpaced government revenues, due in part to housing grants to earthquake-affected households and to an increase in government wages and pensions. Following a review of the tax system, the Government is currently drafting a new single tax code to improve, consolidate and harmonize the main domestic taxes.

4. Nepal's current account surplus turned into a deficit in FY 2016-17 due primarily to increasing imports of goods and services, although the trade deficit was offset to some extent by strong remittances (about one quarter of GDP in FY 2017-18). The effects of the earthquakes, trade disruptions with India, and the appreciation of the real exchange rate affected the competitiveness of exports. Moreover, as a landlocked country, the transit of goods through India (mainly the port of Kolkata) to international markets imposes significant transport costs and delays on Nepalese exporters. Nepal has a narrow merchandise export basket concentrated in textiles, clothing, and agricultural products, while the structure of imports is considerably more diverse across commodity groups. Merchandise trade is mostly with India (65% of imports and 57% of exports in 2017).

5. The inward stock of foreign direct investment (FDI) represented 6.9% of GDP in 2017, still among the lowest in the region. Private investment, local and foreign, was inhibited by several factors, notably government instability, bureaucratic burden, inadequate infrastructure, and restrictive labour regulations. To tackle these problems, attract larger FDI inflows, and improve the business climate, several measures have been implemented, including improving customs procedures and the development of the Foreign Investment Policy 2014, as well as new legislation, such as the Industrial Enterprises Act, 2016, the Labour Act, 2017, and the Special Economic Zone (SEZ) Authority Act, 2016. There are no restrictions on foreign investment, apart from a negative list of 21 industries which include poultry, fisheries consultancy services, and rural tourism.

6. The political instability up to early-2018 meant that, in some areas, new laws which were in development six years ago at the time of the last TPR have yet to be presented to Parliament (including a bill on safeguards, anti-dumping and countervailing measures), and, in other cases, the laws may have been passed but the implementing regulations are still being drafted. Moreover, in some cases, where the laws and institutions are in place, there is little data on enforcement, such as the laws relating to intellectual property rights, government procurement, and competition policy.

7. A new Constitution in 2015 (which replaced the Interim Constitution of 2007) and a new Government with a large majority in 2018 should create political stability, although the shift to a federal system of government would require significant institutional changes and, at the federal level, the Government has also implemented changes to the number and authority of some ministries.

8. Despite the major transformations in institutional and regulatory arrangements, the key development objectives remain largely the same as in 2012. In the 14th National Development Plan, trade is recognized as an important factor towards achieving the objective of long-term inclusive and sustainable growth, which is also emphasized in the National Trade Integration Strategy (NTIS) 2016, which is an update to NTIS 2010. The objectives of the Trade Policy 2015 are to enhance

access of goods, services and intellectual property to regional and world markets. It also aims to complement other policies, including the NTIS, and to implement WTO decisions.

9. Nepal continues to participate in two overlapping regional agreements: the South Asia Free Trade Area (SAFTA); and the Framework Agreement on the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) FTA. In addition, Nepal has bilateral trade agreements with 17 countries, including the Treaty of Transit, the Treaty of Trade, Railways Services Agreement, and an Agreement of Cooperation to Control Unauthorized Trade with India. The Transit Treaty allows Nepal to trade with other countries through the Kolkata/Haldia ports and, since 2016, Vishakapatnam. In the WTO, Nepal has ratified the Trade Facilitation Agreement and the Protocol Amending the TRIPS Agreement. However, it is not a participant in the Information Technology Agreement, nor a party to the Government Procurement Agreement or its revision. Despite efforts to meet WTO notification requirements, many are still outstanding, including some relating to subsidies, domestic support for agriculture, services, customs valuation, and import licensing procedures.

10. Since its last TPR, customs procedures have continued to improve. Nepal is currently implementing the fifth in a series of Customs Reform and Modernization Strategies and Action Plans (CRMSAPs), and an E-customs Master Plan which is intended to create a web-based paperless system of customs clearance using ASYCUDA World and a Single Administrative Document in the Nepal Customs Automation System (NECAS). At end-August 2018, the NECAS had been implemented in 12 customs offices, covering 95% of Nepal's trade.

11. Tariffs are one of the main trade policy instruments, and customs duties collected are an important source of government revenue. Nearly all tariffs are applied on an *ad valorem* basis, with 51 tariff lines subject to specific rates. The simple average applied MFN tariff in FY 2018-19 was 12%, a slight decrease from 12.2% in FY 2011-12. Average tariffs on agricultural products (12.6%) are higher than those on non-agricultural products (11.9%). The highest *ad valorem* rate of 80% applies to one tariff line related to tobacco, plus some motor vehicles, and arms and ammunition products. Specific duties are applied to some alcohol, tobacco, cement, and petroleum tariff lines. In general, tariff protection is particularly high for arms and ammunition and, to a much lesser extent, prepared foods and transport equipment. About 1.5% of agricultural products and 4% of non-agricultural tariff lines are duty free.

12. In acceding to the WTO, Nepal bound all but 54 tariff lines at the HS eight-digit level and, in general, applied tariffs are much lower than bound rates, with a 14.6 percentage point difference between the average MFN applied rate and the average bound rate. However, in FY 2018-19, out of a total of 5,572 tariff lines, the applied rates exceed the bound rates for 38 tariff lines. In addition, in a small number of cases, a bound tariff line was subsequently separated into a number of separate tariff lines, and some of these new tariff lines (eight in total) bear applied tariffs in excess of the binding. There are also 12 tariff lines subject to specific duties, where it is possible that they could exceed the bound *ad valorem* rates.

13. Import prohibitions or restrictions may be applied to some goods on the grounds of, *inter alia*, national security, protection of life or health, and protection of national treasures. Import licences or permits are required for some other goods, such as narcotics, arms and ammunition, and some communications equipment. Nepal also prohibits the export of certain goods for various policy objectives, and about 100 products are subject to export duties on grounds of environmental protection, food security, and to discourage trade diversion.

14. Import duties and other taxes collected at the border are important sources of revenue, with import duties, VAT on imports, and excise duties on imports providing 18%, 19%, and 7% of total tax revenue, respectively. Exports are zero-rated for VAT and are exempt from excise duties. The corporation tax system is quite complex, with different rates depending on the type of activity and a variety of rebates, reductions and exemptions for different industries, locations, and/or social goals, including under the SEZ Authority Act, 2016. The excise duty system is also complicated, with duties applied to about 600 products, including alcohol and tobacco products and motor vehicles. It appears that, in two cases (cider and wine), the excise duty on domestic products is lower than on imported products.

15. The Nepal Council for Standards and the Nepal Bureau of Standards and Metrology are the main agencies responsible for developing and approving standards and technical regulations. Out of about 900 national standards (51 of which were developed since 2012), 11 are mandatory, i.e. technical regulations (4 of which were made mandatory since 2012 and were notified to the WTO). Nepal is also a member of the South Asian Regional Standards Organization (SARSO), which develops standards for the South Asian Association for Regional Cooperation (SAARC). According to the authorities, most standards are based on those developed by international organizations or well-known national standards bodies.

16. Several government agencies are responsible for SPS measures under a variety of laws, rules, and regulations, including the National Standards for Phytosanitary Measures Law, which was introduced in 2013 and sets out a framework for pest risk analysis. However, some legislation is quite dated, and, under the Agriculture Development Strategy (ADS), the authorities intend to prepare new legislation relating to food, establish an independent food authority, and enhance capacity in other agencies. A total of 13 SPS notifications have been made to the WTO, including the Framework for Pest Risk Analysis, and a quarantine list of pests for apples, citrus, potatoes, ginger, garlic, bananas, and coffee.

17. The Competition Promotion and Market Protection Act of 2007 and its Implementing Regulation of 2010 prohibit anti-competitive agreements, abuse of dominant position, mergers and amalgamations with the intent of restricting trade, bid-rigging, and other anti-competitive activities. Any person or business may provide information to designated market protection officers or the Competition Promotion and Market Protection Board relating to anti-competitive practices. However, although the legal and institutional framework is in place, the Act has never been used to prosecute a case, although other laws have been used in about 30 other competition-related cases.

18. There are about 40 state-owned enterprises. There has been no action under the privatization programme since 2008. During the review period, SOEs as a group have become profitable, primarily because of reforms affecting two of the largest, the Nepal Oil Company (NOC) and the Nepal Electricity Authority. In the case of the NOC, which has the sole rights to import, transport, store and distribute petroleum products, the introduction of the Automatic Petroleum Pricing Mechanism allows it to adjust prices.

19. Although Nepal is neither an observer nor a party to the Government Procurement Agreement, it has a procurement system regulated by the Public Procurement Act and overseen by the Public Procurement Monitoring Office. The procurement method depends on thresholds. The authorities stated that the system is now more transparent since e-bidding was introduced, starting in 2007, which applies to goods' contracts of more than NR 5 million and works' contracts of more than NR 10 million.

20. Although there were no changes to the legislation on intellectual property rights during the review period, the new Constitution now explicitly includes intellectual property in the definition of property. Enforcement at the border is the responsibility of Customs but they may act only following a complaint by the holder of the IPR. Although data on enforcement at the border were not available, there was a total of 679 cases relating to infringements of trademarks under consideration in the Department of Industry, of which 209 were under appeal in the courts.

21. Agriculture represents over one quarter of GDP and two thirds of employment. Nepal's diverse topography creates the potential to produce a wide variety of products but it faces many challenges as a landlocked LDC with poor infrastructure, small scale farming, low productivity, and a high risk of natural disasters (the 2015 earthquakes were estimated to have caused NR 28.3 billion in damages and losses to agriculture). Current policy for agriculture is set out in the ADS 2015-2035 and several product-specific policy documents. The ADS includes a number of programmes aimed at improving efficiency, sustainability, and resilience to climate change and disasters. The largest programme is for irrigation (NR 95 billion over 10 years), and the total 10-year cost of all programmes is about NR 502 billion, about 11% of which is to come from donors. The ADS also sets out targets, with an emphasis on developing a trade surplus for agricultural goods, improving sustainability and competitiveness, and reducing poverty. The most recent notification to the WTO on domestic support is for calendar years 2010 and 2011; it showed that all support was in the Green Box, and amounted to less than 1% of the value of production. Data on government spending during the review period shows that government programmes are focused on input and infrastructure support, research, and interest rate subsidies. Exports of some agricultural products

qualify for export support under the Cash Incentive for Exports (CISE) 2070, with a budget allocation of US\$5.4 million for FY 2018-19.

22. The mining and quarrying sector (0.6% of GDP in 2017-18) is gradually being developed. Under the National Mineral Resources Policy 2017, Nepal's main policy objectives include making the sector more competitive, sustainable and environmentally friendly by using new and innovative technology; and attracting larger private sector investment by providing incentives and facilities.

23. The period 2016-26 has been declared National Energy Crisis Reduction and Electricity Development Decade (Energy Emergency Decade). Nepal recognizes that it must accelerate the development of its abundant hydropower potential as an important step to reduce poverty and stimulate economic growth. Hydropower development would provide clean energy to enhance economic and social development in rural and urban areas, and enable Nepal to generate revenue from the export of excess energy to neighbouring countries. Nepal aims to achieve zero power outages and ensure energy security by 2019.

24. The contribution of manufacturing to GDP has steadily declined during the last decades, to 5.4% in 2017-18. Reasons behind this overall downward trend include low labour productivity, high transport costs, production stoppages due to electricity cuts, and poor labour-employer relations leading to strikes. With the aim of promoting industrial activity and increasing its contribution to GDP, the SEZ Authority Act 2016 and the Industrial Enterprises Act 2016 were enacted (the implementing regulations are still being drafted). Various incentives for manufacturing and export-oriented industries are provided under both Acts.

25. The services sector is, increasingly, the largest contributor to GDP, with nearly a 60% share in 2017-18. Based on tourism-related receipts, Nepal became a net exporter of services during the review period. The tourism sector is central to Nepal's social and economic development, and the Government's objective is to double tourist visitors by 2020, make it the number one employment generator by adding one million jobs to the sector by 2020, and to almost quadruple the contribution of tourism to GDP by 2025.

26. Nepal is developing its largely untapped financial services market. Access to financial services and financial deepening have been growing over the last few years, and financial soundness indicators have improved. Despite recent changes made to the regulatory framework of financial institutions, accelerating financial sector reforms is needed. Nepal's telecom sector has been further liberalized during the review period through the adoption of various policy papers and regulations, including the National Broadband Policy 2015, the National Information and Communications Technology Policy 2015, the Spectrum Policy 2016, and the Telecom Infrastructure Service Regulation 2017.

27. Under its National Transport Policy, Nepal is to invest over US\$8 billion in road infrastructure, rail connectivity and transport sector management in the next five years. The Government aims to connect all of Nepal's regions, develop a reliable, cost effective, safe, facility-oriented and sustainable transport system. Road transport is the predominant mode of transport in Nepal, accounting for 90% of the movement of passengers and goods.

28. During the review period, Nepal has taken several steps to improve the trading and business environment, including ongoing programmes on import procedures, and the electronic government procurement system. Political stability should also give the Government the opportunity to enact new and/or updated legislation. However, some aspects of doing business in Nepal are still complicated, expensive and time-consuming, such as paying taxes and starting a business, and simplifying them may help improve the investment, trading, and business environment.