State of Private Sector in Nepal

CONTRIBUTIONS AND CONSTRAINTS

May 2023

FNCCI

IFC International Finance Corporation
WORLD BANK GROUP
Creating Markets, Creating Opportunities

State of Private Sector in Nepal

CONTRIBUTIONS AND CONSTRAINTS

May 2023

FNCCI

International Finance Corporation
WORLD BANK GROUP
Creating Markets, Creating Opportunities

2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433
Internet: www.ifc.org

ABOUT FNCCI

The Federation of Nepalese Chambers of Commerce and Industry (FNCCI) is the nationally and internationally recognized umbrella organization of business in Nepal. Organized as a representative body of business organizations in the country, it represents the interests of the private sector and is involved in promotion of socio-economic development of Nepal through private sector led economic growth.

ABOUT IFC

IFC—a member of the World Bank Group—is the largest global development institution focused on the private sector in emerging markets. We work in more than 100 countries, using our capital, expertise, and influence to create markets and opportunities in developing countries. In fiscal year 2022, IFC committed a record $32.8 billion to private companies and financial institutions in developing countries, leveraging the power of the private sector to end extreme poverty and boost shared prosperity as economies grapple with the impacts of global compounding crises. For more information, visit www.ifc.org.

Acknowledgement

This Report was prepared under the guidance of FNCCI-IFC joint editorial board represented by Mr. Gokarna Awasthi, Director General from FNCCI and Mr. Ashim Nepal, Operations Officer, Mr. Ravikant Agrawal, Investment Officer, Mr. John Narayan Parajuli, Communications Officer and Mr. Diiwash Dhakal, Program Assistant from IFC. The team benefited from suggestions and comments from Mr. Peter Mousley, Mr. Sabin Raj Shrestha, Mr. Nayan Krishna Joshi, Mr. Prashant Raj Pandey and Mr. Harsh Jhanjaria from World Bank. The study was carried out by a team from FACTS Analytics and Research Nepal. The team would also like to express sincere thanks to Mr. Shishir Kumar Dhungana, Former Secretary of the Government of Nepal. This Report would not have been possible without encouragement advice and support from National Statistics Office. The team gratefully acknowledges the guidance of Babacar Sedikh Faye, Selma Rasavac-Avdagic and Santosh Pandey from IFC in preparing the report.

Foreword

PRESIDENT, FNCCI

I am thrilled to present the report on the State of Private Sector in Nepal: Contributions and Constraints. This report is the result of a joint effort by the Federation of Nepalese Chambers of Commerce and Industry (FNCCI) and the International Finance Corporation (IFC).

The report provides a comprehensive analysis of the private sector in Nepal, highlighting its contributions to the economy and the challenges it faces. It also offers specific policy recommendations that can help improve the business environment and encourage private investment.

This report is a valuable resource for policy makers and stakeholders as it helps them identify areas for improvement and gain a better understanding of the current state of the private sector. By implementing the policy interventions suggested in this report, Nepal can create a more favorable business environment that attracts investment and drives economic growth.

I am confident that this report will help foster greater collaboration between the public and private sectors in Nepal. The report is a testament to the hard work of the FNCCI and IFC, and I am proud of their efforts.

Chandra Prasad Dhakal
President, FNCCI

Foreword

IMMEDIATE PAST PRESIDENT, FNCCI

I am pleased to present this Report – State of Private Sector in Nepal: Contributions and Constraints – which was produced by the Federation of Nepalese Chambers of Commerce and Industry (FNCCI) in collaboration with the International Finance Corporation (IFC).

This study provides an in-depth analysis of the private sector's role in the Nepalese economy, including its contribution to development, current challenges and opportunities, and the impact of private sector investments on job creation and access to products and services. It also includes data and evidence on the private sector's contribution to Nepal's GDP, case studies on emerging and well or poorly performing sectors, and potential policy interventions to support private sector growth.

It was developed by conducting a comprehensive analysis of the private sector in Nepal, including a review of the National Accounts data, a literature review, key informant interviews, and a primary survey of over 500 firms.

We are grateful to IFC for providing the technical and financial resources required for the Report. Nepal is undergoing significant changes in its socio-economic landscape and is faced with the challenge of overcoming the disruptions caused by the COVID-19 pandemic. In order to advance its economy, consultation between stakeholders is essential. This report can serve as a useful tool for those who seek to maximize the private sector's contribution to Nepal and facilitate collaborative efforts between public and private sectors.

Shekhar Golchha
Immediate Past President, FNCCI

Foreword

COUNTRY REPRESENTATIVE, IFC

I am very pleased that our partnership with the Federation of Nepalese Chambers of Commerce and Industry (FNCCI) has enabled the production of this flagship report, which examines the state of the private sector in Nepal, highlighting contribution, recognizing its constraints, and proposing some ideas for the way forward.

It has become almost cliché to say that the private sector is the engine of economic growth. We also know that Nepal's private sector is particularly resilient and innovative. It has experienced remarkable growth since the country's policy shift in the 1990s and has become the central driver of capital formation and job creation.

Although the private sector's role in contributing to Nepal's socio-economic progress is widely acknowledged and appreciated, its true impact and magnitude have not been fully evaluated and consistently monitored. This joint FNCCI – IFC report is an attempt in that regard.

This report has other notable features, such as being a collaboration between the main association of businesses in Nepal and the world's largest development institution that focuses on the private sector in developing economies. Therefore, it does not represent the viewpoint of a single national or international organization regarding Nepal's private sector. Additionally, a local Nepali company produced the report and had remarkable access to an extensive array of reliable data sources.

Our intention for this report goes beyond simply acknowledging the private sector's significant role in Nepal's development. We hope that it will also provide valuable information and stimulate productive communication between the public and private sectors. This will enable the formulation of effective policies that can unlock the full potential of Nepal's innovative entrepreneurs. Ultimately, the people of Nepal require better job opportunities, goods, and services, which can only be achieved through a more robust and productive private sector.

This report is the first of its kind in Nepal, and we acknowledge that it may not be exhaustive. Therefore, we welcome constructive feedback from all stakeholders to enhance the discussions and improve future editions. In the upcoming reports, we plan to continue monitoring the private sector's growth, while also focusing on specific sectors or sub-sectors, geographic areas, or cross-cutting issues. By doing so, we aim to help identify the best policies that can increase domestic and foreign investment and improve competitiveness in Nepal.

Babacar S. Faye
IFC Country Representative

Table of Contents

List of Figures

List of Tables

Acronyms

ADB	Asian Development Bank
BFI	Bank and Financial Institutions
CNI	Confederation of Nepalese Industries
COFOG	Classification of functions of government
COVID-19	Coronavirus disease of 2019
DFQF	Duty-free and Quota-free
EBA	Everything but arms
EU	European Union
FCGO	Financial Comptroller General Office
FDI	Foreign direct investment
FNCCI	Federation of Nepalese Chambers of Commerce and Industries
FY	Fiscal year
GDP	Gross domestic product
GFCF	Gross fixed capital formation
GO	Gross output
GON	Government of Nepal
GSP	Generalized system of preference
GVA	Gross value addition
IC	Intermediate consumption
ICOR	Incremental capital output ratio
IFC	International Finance Corporation
IMF	International Monetary Fund
IRD	Inland Revenue Department
KUKL	Kathmandu Upatyaka Khanepani Limited
LDBDC	Least Developed Beneficiary Country Scheme
LDCs	Least developed countries
LPI	Logistics performance index
MoF	Ministry of Finance
MSMEs	Micro, small, and medium enterprises
NEA	Nepal Electricity Authority
NEPSE	Nepal Stock Exchange
NPC	Nepal Planning Commission
NPR	Nepali rupees
NRB	Nepal Rastra Bank (Central Bank of Nepal)

NSIC	National Standard Industry Classification
NSO	National Statistics Office
NTPA	Nepal Trade Preference Act
NWSC	Nepal Water Supply Corporation
OCR	Office of the Company Registrar
PE	Public Enterprises
SDGs	Sustainable Development Goals
SEBON	Securities Exchange Board of Nepal
SEOs	State-owned Enterprises
SIF	Specialized Investment Fund
SMEs	Small and Medium Enterprises
STCL	Salt Trading Corporation Limited
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USD and $	The United States Dollar
VC	Venture capital
WB	World Bank
WTO	World Trade Organization

Glossary

Consumption in the economy refers to the spending by households on goods and services for their own use or enjoyment during a specific period of time, usually a year. It includes spending on items such as food, housing, transportation, health care, education, and other goods and services.

Establishments: According to United Nations (UN) definition (ISIC revision 4), an establishment is defined as an economic unit that engages, under a single ownership or control—that is, under a single legal entity—in one, or predominantly one, kind of economic activity at a single physical location; for example, a mine, a shop, a factory, or workshop. An establishment is situated in a single location and in which only a single (non-ancillary) productive activity is operated or in which the principal productive activity accounts for most of the value added.[1]

Intermediate consumption (IC) refers to the value of goods and services that are used up or consumed as inputs in the production process of a particular industry or establishment during a given period of time. Intermediate consumption can include items such as raw materials, fuel, electricity, and other supplies that are used up during the production process. It does not include capital assets such as buildings and machinery, which are used in the production process but are not consumed or used up in the same way as intermediate inputs. Intermediate consumption is an important component of GVA calculation, as it represents the value of inputs used to produce goods and services.

GDP is defined as the total value of all final goods and services produced within the geographic boundaries of Nepal during a specific period, usually a year. GDP is calculated as the sum of GVA across all industries or sectors of the economy. GVA is calculated as the value of output minus the value of intermediate consumption, or the value added by an industry to its inputs. Therefore, GVA represents the contribution of an industry or sector to the overall economy, and the sum of all GVAs across all industries is equal to GDP.

[1] Nepal Economic Census, 2018, GoN

Gross domestic product (GDP) at basic price is a measure of the value of all the final goods and services produced within a country's borders during a given period of time, typically a year. However, GDP at basic price is calculated by subtracting the value of indirect taxes (such as sales tax and excise tax) from the total value of goods and services produced within the country's borders.

Gross value addition (GVA) is defined as the value of output minus the value of intermediate consumption incurred in the production process. In other words, it is the value added by a particular economic activity to the inputs used in the production process. Gross value added is a key measure of economic activity, as it helps to estimate the contributions of different industries or sectors to the overall economy.

Gross fixed capital formation (GFCF) is an economic concept that refers to the total amount of investment made by a country or an economy in the production and improvement of fixed assets, such as machinery, equipment, buildings, and infrastructure, during a specific period of time, usually a year.

Output in the economy refers to the total quantity of goods and services produced by all sectors of the economy during a specific period of time, typically a year. It is a physical measure of the economy's productivity.

Executive Summary

According to the Constitution and 15th Five-Year Plan, the private sector is considered a vital factor in Nepal's economic success. The Constitution's economic goal is to attain fair and sustainable growth with the participation of the public, private, and cooperative sectors. The Constitution prioritizes the role of the private sector in the economy to achieve economic prosperity by utilizing available resources and means to the maximum. The 15th Five-Year Plan acknowledges the private sector's significant role in driving economic growth and development, as it can contribute to creating employment opportunities, improving productivity, promoting innovation, and enhancing competitiveness to attain the country's development objectives.

Nepal's GDP largely constitutes three sectors—services, agriculture, and industry—with 61.76 percent, 23.95 percent, and 14.29 percent shares respectively. GDP growth averaged 4.9 percent from FY09 to FY19, with remittances playing a key role in poverty reduction. The COVID-19 pandemic induced the first contraction in 40 years, with the real GDP contracting by 1.9 percent in FY20 due to demand and supply-side shocks from restrictions and closures.

The private sector has been a major contributor to Gross Fixed Capital Formation (GFCF) and consumption in the economy. In FY 2020/21, government consumption expenditure increased by 4.4 percent, while private consumption expenditure grew by 5.5 percent. Public sector GFCF increased by 0.6 percent, while the private sector's GFCF grew by 6.1 percent. The private sector is Nepal's largest exporter; it contributes almost everything, except earnings from electricity export. The share of total consumption in GDP slightly decreased from 92.3 percent in FY 2020/21 to an estimated 90.7 percent in FY 2021/22. The private sector contributed around 87 percent of intermediate consumption in the economy between 2012/13 and 2021/22, and also 83 percent of national GDP at a constant price during the same period. However, the declining trend in private sector consumption over this period indicates potential hindrances to its growth.

The private sector is the largest employer in the country, providing employment to 85.6 percent[2] of the total labor force. The private sector's contribution to economic growth has increased steadily in recent years, with sectors such as tourism, agriculture, manufacturing, and services playing significant roles. According to the recent census, most of the Nepal's active work force is engaged in agriculture and the five most significant sectors ranked by percentage of people employed

[2] Nepal Census, 2021

are agriculture, forestry, and fisheries (57.3 percent), wholesale and retail trade including repair of motor vehicles and motorcycles (12.5 percent), construction (8.1 percent), other services (3.9 percent), and manufacturing (3.8 percent).

The private sector in Nepal is dominated by small enterprises, which make up 62.4 percent of the total, followed by medium-sized enterprises at 22.9 percent, and large enterprises at 14.7 percent.[3] The number of private sector establishments increased significantly over the past three decades, from 28,660 in 1983 to 923,356 in 2018. The service sector has the highest number of establishments, accounting for 85.5 percent of the total, followed by the secondary sector at 11.9 percent, and the primary sector at 2.7 percent. The number of private sector establishments has increased by 47.6 percent from the 2011 Economic Census, reaching 923,356 by 2018. Private sector establishments registered at the Office of Company Registrar (OCR) provided jobs to 4,938,566 persons. Of this, micro and small enterprises (MSMEs) accounted for 4,564,040 jobs,[4] small and medium enterprises (SMEs) accounted for 333,077, and large industries accounted for 41,449 jobs.

This Report calculates contribution of private sector to Nepal's economy through a GVA method. The National Statistical Office (NSO) has estimated the GVA of all sectors disaggregated into government and private sectors. Additionally, the output and intermediate consumption of agriculture, mining and quarrying, manufacturing, and construction sectors related to the government have been estimated based on expenditure data.

The private sector including households contributed 81.55 percent of total GDP in Nepal. This is computed on the basis of value addition of all the 18 sectors that contribute to the total GDP. The weighted average calculation of the GVAs is taken in account to derive the total contribution of private sector in GDP at basic price. As there is methodological difficulty on disaggregating household-level output and consumption, the study treats households as the private sector. The overall private sector contribution in 2012-13 was estimated at 86.67 percent, but has since declined to 81.55 percent in 2021-22.

This Report also involves a primary survey of 517 firms across Nepal to understand the impact of COVID-19 on businesses and their awareness of sustainability and climate change. The survey revealed that 50 percent of the firms were wholesale and retail traders, 13 percent were from the hotel and accommodation sector, and 12 percent were from the manufacturing sector. Additionally, 50 percent of firms surveyed had taken loans, within those firms 56 percent of them are taking loans from commercial banks. During the COVID-19 restrictions, 87 percent of the surveyed firms were affected, with 63 percent reporting full closure. Furthermore, 79 percent of enterprises incurred loss of revenue during the lockdown. However, once the lockdown was lifted, 50 percent of the firms reported that they were in profit. About 97 percent of the firms reported they were operating without any formal support from the government.

---

[3] National Economic Census, 2018
[4] National Economic Census, 2018

Nepal needs to continue strengthening of a competitive private sector to achieve its goal of becoming a middle-income country by 2030. To do so, the government needs to improve policy design and implementation, enhance governance, simplify bureaucratic processes, and promote transparency and accountability. There is a need for better coherence and harmonization in policies to facilitate investment in the productive sector. Intellectual property laws require reform, and ethical business practices need to be enforced uniformly without hindering entrepreneurship. Nepal should also address supply-side constraints to export by improving the reliability and cost of electricity and transportation services and reducing tariffs on crucial imported inputs.

This Report presents a comprehensive analysis of private sector, assessing its contribution to the economy, development, challenges, and opportunities. The study analyses the impact of private sector investments on job creation and access to products and services. The Report identifies the private sector's contribution to GDP and sectors with the highest potential economic impact, conducting case studies on emerging and well/poor performing sectors. Furthermore, the study aims to inform the government's economic analysis and policymaking by helping to understand the role of private sector in the country's economic development and providing valuable insights for potential policy interventions to support private sector growth.

SECTION I

Introduction

The global economy has continued to recover from the COVID-19 pandemic, but the pace of growth remains sluggish in some parts of the world. While advanced economies have seen some improvement, developing and least developed countries continue to face significant challenges, including weak economic growth and high inflation, resulting in unemployment, and rising levels of poverty and inequality. In addition, global trade tensions and geopolitical risks continue to pose challenges for businesses and investors. However, there are also reasons for cautious optimism.

The global economy is projected to grow by 4.4 percent in 2023, a significant improvement from the contraction of 3.3 percent in 2020, however this is less than the growth in the years 2021 and 2022, signalling towards a tough growth. Many countries have implemented measures to support recovery, including fiscal and monetary stimulus, infrastructure investments, and regulatory reforms. In addition, there is growing recognition of the need to address structural issues such as climate change, social inequality, and digital transformation, which can promote sustainable and inclusive economic growth.

As the world recovers, the private sector remains vital to drive economic growth and create new opportunities. In most countries, private enterprises are the major job providers. The sector accounts for 80 percent of jobs globally. In developing countries, over 90 percent of the jobs are created by the private sector. It contributes approximately 60 percent of the global GDP. Of the $1.5 trillion in global FDI flows, the private sector accounted for the majority of investment. The private sector is also an important contributor to achieve the Sustainable Development Goals (SDGs).

The private sector's contribution to job creation, enhanced productivity, and wealth creation has helped many developing and least developed countries improve their economies. Private sector participation in infrastructure projects in emerging and developing markets is projected to reach $3.7 trillion[9] by 2030. Developing countries like Bangladesh, Vietnam, and Cambodia are examples of how the private sector has helped countries to grow. In Bangladesh, the private sector accounts for 87 percent of GDP[10], and private sector investment

[5] World Bank. (2019). Maximizing Finance for Development: Leveraging the Private Sector for Growth and Sustainable Development. World Bank.
[6] https://www.ilo.org/pardev/public-private-partnerships/jobs-growth/lang--en/index.htm
[7] World Economic Forum. (2020).
[8] UNCTAD. (2021)
[9] IFC (2018)
[10] The World Bank. (2021). World Development Indicators. Retrieved from https://databank.worldbank.org/source/world-development-indicators#

in infrastructure totalled $48.7 billion until 2020,[11] resulting in an average growth of 5.88 percent over the past 20 years, reaching an all-time high of 8.15[12] in 2019. Vietnam's private sector has invested $116.2 billion over the past decade. Private businesses account for 84 percent of Cambodia's GDP and over 80[13] percent of the country's exports. These countries, which were once economically vulnerable, have now emerged among the world's most promising growth markets. The transformations were mainly driven by the private sector's contributions to their economies, demonstrating the potential for sustained and inclusive growth through private sector development.

The history of the private sector in Nepal dates back to ancient times, when the country was a transit point for trade from South India, East Asia, and Tibet. The major source of income then was customs revenue collected from traders and businessmen transiting through to the ancient silk route.[14] More recently, Biratnagar Jute Mill, Nepal's first industry, was established in 1936 as a joint stock company with public and the government participation. At that time, 14 joint stock companies were established; involved in hydroelectricity, cotton textiles, glass, and furniture. The government further established 35 joint stock companies, the majority concentrating on rice, pulses, and oil mills.

In 1956, the government launched the country's first five-year plan. Under it, public enterprises (PEs) were established to operate in infrastructure, industrial estates, banking, trading, and other commercial sectors, catering to both large and small manufacturing businesses. Till now, Nepal has had 66 PEs,[15] each having its own unique legal status, such as public corporations, companies, and banks. Realizing the importance of the businesses, trading, and savings, the government established Nepal Bank Limited in 1936 to help traders and factories operating in the country.

As the Nepali economy modernized and industrialized in the latter half of the 20th century, the private sector grew to include a broader range of industries, including manufacturing, construction, and services. The private sector continued to evolve and expand over the following decades, with many businesses venturing into new markets and industries. Today, the private sector is the largest employer in Nepal and an essential contributor to the economy, with many micro, small, and medium-sized enterprises operating in various sectors.

According to the recently-published 2021 census, 65.55 percent of the population are economically active. Of these, 50.1 percent were skilled workers in agriculture, forestry, and fisheries. The second largest group were elementary workers (23 percent), followed by service and sales workers (5.8 percent). Private households form the largest institutional sector in Nepal, according to the census.

The government of Nepal recognizes the private sector as contributor (an essential component) of the country's economic prosperity. The Constitution of Nepal states that the economic objective is to achieve equitable and sustainable growth with the participation of public, private, and cooperative sectors. The 15th Five-Year Plan (2019-2024) recognizes the role of the private sector as an important driver of economic growth and development. The Plan states that the private sector can contribute to achieving the country's development objectives by creating employment opportunities, increasing productivity, promoting innovation, and enhancing competitiveness.

---

11 Asian Development Bank. (2021). Development Indicators. Retrieved from https://www.adb.org/countries/Bangladesh/data
12 Data.worldbank.com
13 International Finance Corporation. (2019). Cambodia - Infrastructure Finance: A Pathway to Growth. Retrieved from https://www.ifc.org/wps/wcm/connect/publications_ext_content/ifc_external_publication_site/publications_listing_page/cambodia-infrastructure-finance-pathway-to-growth
14 History of Nepal Customs (2019) https://customs.gov.np/storage/History%20of%20Nepal%20Customs%20English%20Final%20printed_2020-03-11-20-40-18.pdf
15 Impact of Economic Liberalization in Nepal, Institute for Integrated Development Studies.

To help Nepal graduate from among the least developed countries (LDCs) by 2026 and to achieve the Sustainable Development Goals (SDGs), the government has emphasized the importance of the private sector and the role of public-private partnerships (PPPs). The government is committed to facilitating PPPs by creating an enabling environment for private investment, promoting entrepreneurship, and providing the necessary infrastructure.

The private sector has been a catalyst in the overall economic growth and development of Nepal. It contributes significantly to the country's GDP and employment. As per the Economic Survey 2020-21 published by the Ministry of Finance (MoF), the private sector is the largest employer in the country, providing employment to around 80 percent of the total labor force. In 2018, the private sector employed approximately 5.5 million people, while the public sector employed less than half a million people.[16] The contribution of the private sector to Nepal's economic growth has increased steadily in recent years. According to the same economic survey, the private sector grew at an annual rate of 6.6 percent in 2018-19, while the public sector grew at 4.8 percent. Some of the major sectors contributing to the growth of the private sector include tourism, agriculture, manufacturing, and services.

The private sector also plays a critical role in infrastructure development, transportation, and energy. According to the Ministry of Finance over the last decade, the average share of public and private sectors in total consumption was 9.1 percent and 89.2 percent respectively. The private sector is also growing in terms of volume, investment, and contribution to GDP.

In fiscal year 2021-22, gross fixed investment is estimated to have increased by 7.3 percent to NPR1250.98 billion compared to the previous fiscal year, of which private sector gross fixed investment increased by 9.6 percent while public sector investment decreased by 2.8 percent. Private sector investment accounts for more than two-thirds of the total fixed investment. Private sector fixed investment has averaged 71.4 percent of the total fixed investment in the last ten fiscal years, indicating the continued dominance of the private sector in driving economic growth and development.[17]

Nepal's private sector is also the backbone of the country's financial system. In FY2019-20, the ratio of broad money supply (amount of money circulated in the economy) to GDP was 108.1 percent, the ratio of debt flow to private sector to GDP was 83.7 percent and total deposit to GDP ratio was 98.1 percent.[18] Over the years, there has been an increase in credit to the private sector. Total credit to the private sector increased by 17.5 percent in 2020-21, whereas it increased by 13.9 percent till Mid-March 2021/22. The private sector contributes to all the major areas of the economy and has invested NPR19.5 billion in industrial estates, and generated 742.45 megawatt of electricity. Credit expansion to the private sector has helped these sectors grow and increase competitiveness and confidence. However, there are still bottlenecks and constraints, including insufficient access to finance and exposure to technology, which have resulted in the private sector not being as efficient and successful in terms of creating more new jobs and realizing its potential for exports.

The private sector has played a crucial role in expanding access to services and creating jobs. However, productivity levels remain low. There are several factors that possibly impact the productivity of the private sector, including the available infrastructure, access to capital, regulatory regime, and overall business environment. Productivity is a

[16] International Labour Organization. (2019). Nepal Labour Market Update. Retrieved from https://www.ilo.org/wcmsp5/groups/public/---Asia/---ro-bangkok/documents/publication/wcms_721127.pdf
[17] MoF, 2021
[18] Economic survey 2020/21 Ministry of Finance,

complex issue that will likely require a combination of efforts from the government, private sector, and other stakeholders to be addressed effectively. The government has implemented initiatives to improve the ease of doing business and encourage investment, but challenges persist, such as difficulty in starting a business, paying taxes, getting permission from utility service providers, and limited access to markets and finance.

To shed light on these issues, the Federation of Nepalese Chamber of Commerce and Industries (FNCCI), in collaboration with the International Finance Corporation (IFC), have jointly brought out this Report on the state of the private sector and its importance to the economy, explore reform agendas, create the basis for stronger policy dialogue, and maximize the sector's potential. This Report notably aims to develop awareness about the areas requiring improvement to establish a more favourable environment for businesses, inform discussions between the public and private sector stakeholders, and emphasize the important role of the private sector in Nepal's economy.

What is the Private Sector?

The Constitution of Nepal recognizes the private sector as one of the economic pillars of the country. It is a group of individuals desirous of undertaking any enterprise with a profit motive. They may incorporate a company, either singly or jointly with others, for the attainment of one or more objectives set forth in the memorandum of association. However, the scope of the private sector is much wider in any context. The private sector can collaborate with the government in public-private partnerships to jointly deliver services or ventures to communities. Private sector companies may emerge through the privatization of a public organization or through the establishment of new private enterprises. By creating fair market conditions, businesses in the private sector contribute to price stabilization, promoting economic growth, and development.

The private sector in Nepal consists of establishments that are owned and managed by individuals, groups, or corporations, rather than by the government. This sector includes various types of enterprises, such as cottage industries, SMEs, including retail businesses, large businesses, and multinational corporations operating in Nepal.

Private households, which are an important part of consumption and production, are also considered by this Report as part of the private sector and contributors to the GDP.

SECTION II

Report Methodology

To understand the private sector's contribution and the present context in Nepal, this study has taken four approaches: (i) a thorough analysis of secondary data of National Accounts collected by the National Statistics Office (NSO) and various line ministries, (ii) a secondary level desk review of available literatures and policy notes, (iii) key informant interviews, (iv) a primary firm-level survey conducted on 517 firms across Nepal.

Baseline from Secondary Research

For this Report, disaggregation of private sector (including household) contribution to gross value addition (GVA) by Nepal Standard of Industrial Classification (NSIC) has been done by subtracting public sector output and intermediate consumption from overall sectoral output and intermediate consumption. Public sector output and intermediate consumption have been computed based on, where applicable, the Profit and Loss account to ascertain annual expenditures and revenues as reported by public sector entities to the Classification of Function of Government (COFOG). For private sector contributions, estimates of public sector contributions were subtracted from the overall sectoral contribution to GDP as reported in the National Accounts by the NSO.

Using disaggregated data of private and public sector entities, the total private and public output, rate of intermediate consumption, and sector-wise classification of private sector contribution to the overall value added in the economy were calculated from the national accounts data. The identification, calculation, and disaggregation of data related to the private and public sectors were done from the system of national accounts with the set of data published by the National Statistics Office.

Secondary data were collected from various sectoral ministries, and departments and NSO.

Desk Review

A desk study was conducted to identify relevant literature at national and provincial levels, which include guidelines, strategies, policies, previous studies, project documents, and intervention activities. Reports published by Office of the Company Register (OCR), Nepal Rastra Bank (NRB), provincial governmental entities, provincial non-government agencies (for example, FNCCI, businesses/employer organizations/associations, etc.) were also reviewed during the process. Similarly, the policy environment that surrounds private enterprises in Nepal was comprehensively captured by referring to different legislations.

Key Informant Interviews

Ten one-on-one interviews were conducted with key experts, public officials, business leaders and chambers were conducted to obtain in-depth information and insights about specific aspects of the policy and regulatory environment related to private sector in Nepal.

Primary Survey

The firm-level survey with a representative sample collected detailed, cross-sectional, and descriptive statistics of enterprise characteristics and inferential insights to answer the following research question:

How have firms adjusted to the shock from the COVID-19 pandemic?

The survey sample estimation is based on a stratified proportional sampling approach using Arkin and Colton, 1963. A total of 517 samples were computed for this purpose.

SECTION III

The Economy of Nepal

Nepal achieved a GDP growth averaging 4.9 percent from FY09 to FY19, where remittances played a decisive role as a key driver of poverty reduction. Since 2005, Nepal has earned more foreign exchange from remittance inflows than exports and FDI combined. Prior to the 2015 earthquake, Nepal's economy had grown by an estimated 5.2 percent in the fiscal year 2014 - the highest since the global recession of 2008. As a result of the devastating earthquake, especially the service sector was severely disrupted. Travel and tourism too were badly hit and a drastic drop in the quarrying, manufacturing, and construction sector was observed.

The COVID-19 pandemic dealt a huge shock to Nepal's economy, inducing the first-of-its-kind contraction in 40 years, with growth declining to -2.4 percent in FY20. Demand and supply-side shocks arising from the restriction of movement and almost complete closure of sectors such as tourism severely affected growth.

The pandemic had a severe impact on the service sector, resulting in a 3.6 percent contraction in output. The tourism industry came to a standstill, causing a ripple effect on tourism-linked activities, while transport, wholesale, and retail trades were also severely affected. The industrial sector suffered, with output contracting by 4.2 percent due to shortages of inputs, restricted labour mobility, and limited market access, affecting manufacturing and construction. Despite shortages in fertilizer supply and production disruptions due to climate-related shocks and low productivity, agriculture remained the sole driver of growth, expanding by 2.3 percent.[19] The central bank responded to the COVID-19 crisis by reducing the interest rates and introducing additional measures to support credit to the private sector, including refinancing programs for COVID-19-affected firms. In addition the GoN announced relief measures such as deadline extension for tax payment, waiver of customs duty for import of medical equipment, NPR 2.5 million free insurance for medical personnel, discounts on renewal and utility bills, employers asked to pay salaries to their employees, etc. The process was simplified by ensuring support through the local bodies. Despite these measures, due to insufficient awareness among the individuals and small businesses, many could not benefit from the government support.

The Monetary Policy for FY22 predicted a slow recovery in several productive sectors of the economy. The aim was to provide support to the economy while ensuring economic and financial stability. The policy included maintaining a growth rate of 18 and 12 percent for broad money and credit to the private sector, respectively. The inflation

[19] World Bank, Nepal Development Update, October 2022

ceiling was set at 6.5 percent,[20] and the policy floor of foreign exchange reserves covering seven months of imports was maintained. An accommodative monetary policy stance led to a surge in credit and import growth. The credit surge resulted in imports reaching their peak in the first half of FY22 and led to a decline in foreign exchange reserves. In the last one year alone, private sector credit to GDP ratio jumped to 109 percent and the money supply to GDP ratio exceeded 120 percent.

The central bank responded by tightening the monetary policy in February 2022 and again in August 2022, with a total increase of 350 basis points in the policy repo rate. The central bank also required banks and financial institutions to limit their credit-to-deposit ratio to less than 90 percent by mid-July 2022. The impact of monetary policy tightening on credit demand has been limited so far, as the interbank rate has followed the upper bounds of the interest rate corridor since July 2021 and the volume of liquidity demand has grown substantially. The central bank provided required liquidity to the financial sector during FY22, which was higher, than in previous years, and various measures to protect foreign exchange reserves.

In December 2021, import control measures were introduced, including increase in the cash margin to obtain letters of credit (LCs) for importers of 47 product groups; it now required a deposit of 50 to 100 percent of import values in bank accounts to obtain LCs. In April 2022, an outright ban on the import of 10 product groups was also imposed. These measures resulted in a decline of import duties by about 0.1 percent of GDP. The base of other sources of revenue also shrank. However, the government has fully relaxed the control measures as of April 2023, and import activity has resumed as normal.

According to the National Statistics Office (NSO), Nepal's economy is predicted to grow by 2.16% in fiscal year 2022/23. However, the economy has been struggling due to various factors such as a lack of lonable fund, high interest rates, inflation, and weak market demand. The NSO reported

FIGURE 1: Nepal vs. comparator's real GDP growth rate (in percentage)

Source: NSO, 2022 for Nepal; World Development Indicators, 2023 for comparators

[21] NRB, 2021

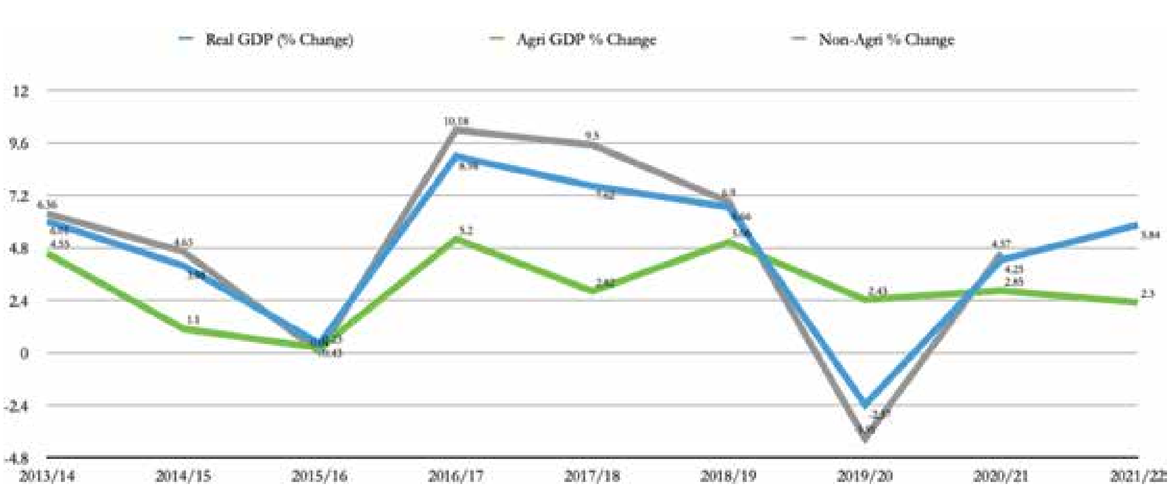
that the GDP growth was only 1.7 percent in the first quarter of the fiscal year, and they project negative growth of 1.1 percent for the second quarter. Additionally, Nepal's GDP is expected to reach NPR 5,381bn in fiscal year 2022/23. The major composition are tertiary, primary and secondary sectors, with sectoral shares of 62.4, 24.6, and 12.9 percent respectively. It is also important to note that on March 4, 2021, the government re-based the national accounts statistics of FY10-11 from the previous base of FY00-01. This re-basing induced a revision of several key macroeconomic indicators. For instance, the size of the economy, per the latest re-basing, was estimated at $34 billion in FY20 compared to $32.4 billion as per the old base. Similarly, the new base yielded a 5 percent higher gross value addition (GVA) than under the old base.

GDP Growth by Sector

Over the past decade, Nepal's GDP growth has been driven largely by the services sector. Figure 2 shows that the services sector accounted for the highest percentage of Nepal's GDP growth during this period followed by the industry and agriculture sectors. The agriculture sector's growth remained relatively stable over the decade, with an average growth rate of around 2.5 percent. The industry sector experienced some fluctuations, with a peak growth rate of 7 percent in 2019 and negative growth in 2020 due to the impact of COVID-19. On the other hand, the services sector consistently grew faster than the other sectors, with an average growth rate of around 5.5 percent over the past 10 years. However, the sector also experienced negative growth in 2020 due to the pandemic.

The reason behind the services sector's strong performance Is likely due to the growth of tourism and remittances which also reflects low risk compared to the manufacturing sector. The country also has a large population of Nepali migrant workers overseas who send remittances back home. In contrast, the agriculture and industry sectors face several challenges, including a lack of infrastructure and limited access to finance. Agriculture is largely rain-fed and vulnerable to natural disasters, such as floods and landslides. The industry sector also faces challenges, such as an unreliable electricity supply and limited transportation infrastructure.

FIGURE 2: GDP growth rate by sectors (in percentage)

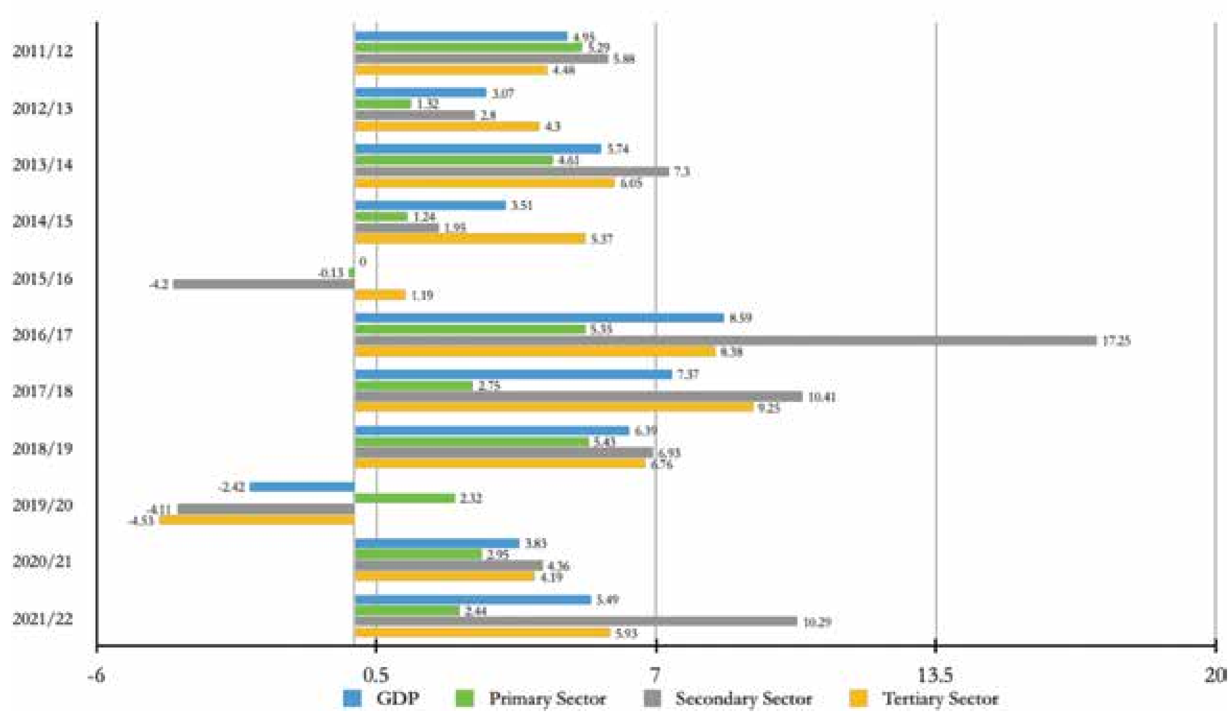


Source: NSO, 2022

GDP Growth by Broad Sector

The economy is dominated by the tertiary sector, which has grown steadily over the last five years, rising from 50.3 percent in 2012 to 56.7 percent in 2021. The tourism industry has been a significant contributor to Nepal's GDP, which includes hotels and accommodations, transportation and other related activities accounting for about 8 percent of the country's tertiary sector. Over the past ten years, this sector has grown by an average of 7 percent annually. However, the COVID-19 pandemic has severely impacted the tourism industry. In contrast, the primary sector, which includes agriculture, forestry, and fisheries, has been relatively stable, contributing between 26.4 percent in 2017 to 28.7 percent in 2012 to GDP. Similarly, the secondary sector's contribution to GDP has remained steady over the past decade, ranging from 13.5 percent to 16.1 percent. According to the World Bank's 2020 report, the secondary sector accounted for 15.8 percent of GDP, with manufacturing being the most significant contributor, accounting for around 10 percent and growing at an average of 5 percent per year over the past decade. Figure 3 provides an illustration of broad sector GDP composition and trends. Over the past decade, the contribution of the secondary sector to GDP has remained stable, ranging from 13.5 percent to 16.1 percent. In 2020, the World Bank reported the sector's contribution to be 15.8 percent, with manufacturing being the largest contributor, accounting for around 10 percent of GDP, and growing at an average of 5 percent per year over the past decade. Figure 3 explains the composition and trend of broad sector GDP.

FIGURE 3: Nepal's GDP Growth Rate by Broad Sector (in percentage)



Source: NSO, 2022

[21] South Asia Economic Focus 2020, World Bank
[22] ILO, 2021

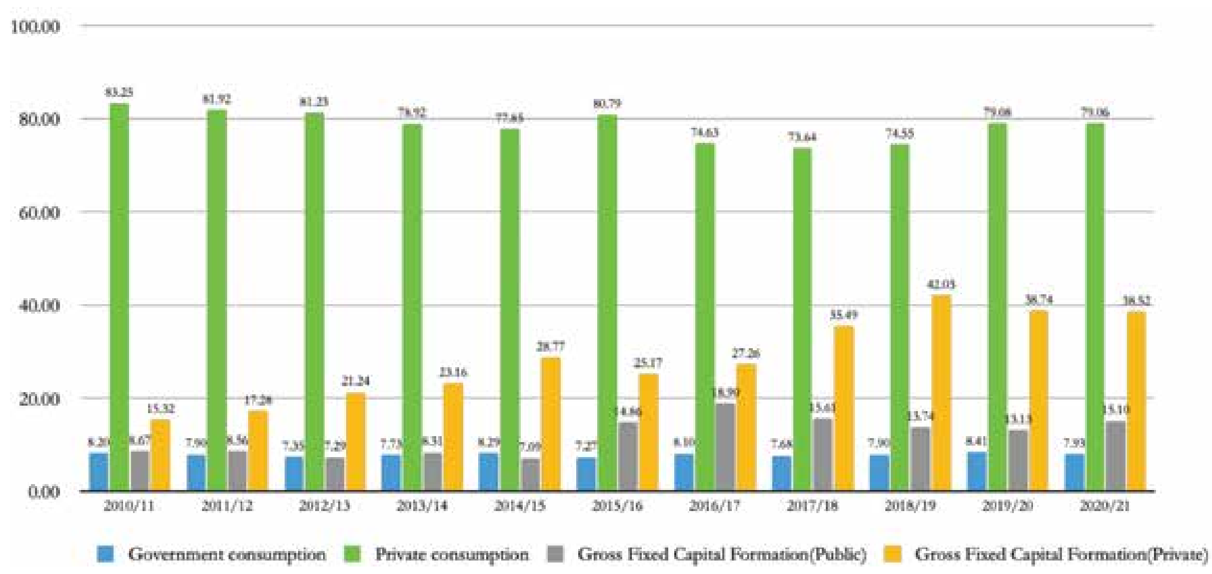
Consumption Trend in Nepal's GDP

The private sector over the years, has been a major contributor to Gross Fixed Capital Formation (GFCF) and consumption in Nepal's economy. The government consumption expenditure increased by 4.4 percent in FY20-21, compared to a growth rate of 5.5 percent the previous fiscal year. Private consumption expenditure grew by 5.5 percent in FY20-21, compared to 7.9 percent the previous fiscal year. Public sector GFCF increased by 0.6 percent in FY20-21, compared to a growth rate of 9.2 percent the previous fiscal year. The private sector's GFCF grew by 6.1 percent in FY20-21, compared to growth of 11.7 percent the previous fiscal year. The slowdown in growth of government consumption expenditure can be linked to the impact of COVID-19. The government had to redirect resources towards managing the pandemic, which affected its expenditure in other areas. The slowdown in the growth of private consumption expenditure could also be attributed to the pandemic's impact on people's income and employment opportunities. Figure 4 explains the trend of GFCF and consumption in the economy.

Import and export

The economy heavily depends on imports, which accounts for 36 percent of GDP. Imports increased by 13.5 percent in 2020-21, reaching NPR1,636.2 billion, compared to NPR1,439.6 billion the previous fiscal year.[23] In contrast, exports increased by only 6.5 percent, reaching NPR111.3 billion, in 2020-21, compared to NPR104.4 billion the previous fiscal year.[24] Nepal imports majority of its products for domestic consumption while it also imports intermediate and capital goods. The trade deficit has been growing over the years, indicating an increasing dependence on imports, which can be attributed to several factors. One reason is limited production capacity, largely limited to agriculture and traditional

FIGURE 4: Demand Side Contributors to GDP

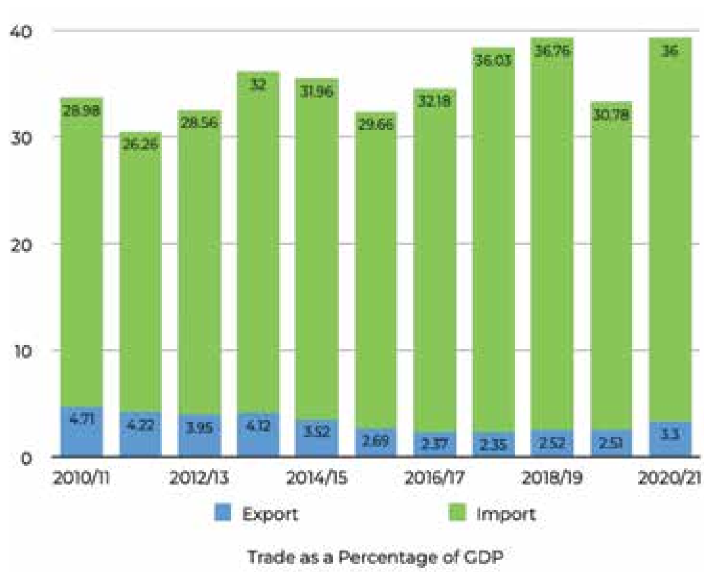


Source: NSO, 2022

[23] NRB Annual Report, 2021
[24] NRB Annual Report, 2021

handicrafts, which are not enough to meet growing demand for goods and services. In addition, infrastructure and energy supply are inadequate, which hampers production capacity. Figure 5 shows the composition of trade as a percentage of GDP.

FIGURE 5: Import/export (As a percentage of the GDP)



Source: NSO, 2022

Nepal's LDC graduation and impact on the Private Sector

Nepal aims to move up one level in its economic development status. On November 24, 2021, the United Nations General Assembly approved a proposal to upgrade Nepal from an underdeveloped country to a middle-income developing country by 2026. With this, Nepal may face economic costs resulting from the loss of access to international support measures (ISMs) available to LDCs. Currently, Nepal has access to various preferential market-access schemes offered by the Generalized System of Preference (GSP), including full duty-free and quota-free (DFQF) programs for its majority of exports and few examples of such export items include knotted carpet, garments, handicrafts, tea and coffee. The erosion of these preferential treatments may have an impact on exports and tariff concessions. Moving up from an underdeveloped country to a middle-income country is generally seen as a positive step towards economic development.

The European Union (EU) is the second most important export destination for Nepal's carpet, handicrafts, and garments and has contributed an average of 10 to 14 percent to the country's exports in recent years. The loss of preference from EU could result in an average tariff rate increase of 8.1 percent.[25]

Nepal has benefited from preferential trade schemes offered by the U.S., which is the third most important export destination for Nepal with an estimated growth rate of 70.08 percent between 2011-2021. These schemes include the Least Developed Beneficiary Country scheme (LDBDC) and the Nepal Trade Preference Act (NTPA), which provide preferential tariffs and duty-free market access for certain products, respectively. After its graduation, Nepal will lose the benefits of both schemes.

Nepal is expected to lose a significant portion of its exports after its graduation, with the loss of export to the EU & the US estimated to be more than 50 percent of the total loss of exports under preference. The hardest-hit areas will be apparel, carpets, and pashmina, which are subject to relatively large tariff increases in all major preference-giving countries. The loss of export of these product categories is expected to reduce the size and number of small and medium enterprises (SMEs), which are a major source of manufacturing and export of almost all

[25] WTO (2020), Trade impact of LDC graduation, World Trade Organization, Geneva

major products from the country.

Nepal faces the risk of losing preferential treatment for export. The loss of policy space in the area of intellectual property rights, covered by the World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), is of significant concern for Nepal and other LDCs. While Nepal agreed to implement TRIPS provisions in its accession negotiations, LDCs have been granted special flexibility in its implementation. Nepal and other LDCs have been given a transition period until January 1, 2033, or until they cease to be LDCs, whichever is earlier, to implement TRIPS provisions for pharmaceutical products. This transition period provided LDCs with some benefits, but there are concerns about the impact of losing this flexibility once they graduate out of LDC status.[26] This is likely to have significant negative effects on its exports and employment, which would primarily impact female workers. The loss of preference margins in key export sectors may lead to a decline in the size and number of SMEs, affecting the overall competitiveness of the economy.

Export Potential Arising from LDC Graduation

Despite the potential challenges to the national economy because of LDC graduation, Nepal will also have opportunities. These include non-reciprocal market access, opportunities to access regional trading arrangements, and entertain bilateral and non-reciprocal regimes in different aspects of economic activities. Other benefits include improved national self-confidence, international recognition of socio-economic development, opportunities to enhance competitiveness through introduction of modern technology, and the possibility to attract more foreign investment and technology transfer. Concessional private investment for project financing will be mobilized due to creditworthiness of the Nepali private sector.

Agricultural Sector Export

Nepal has the potential to increase its agricultural and forest product exports through various measures. First, the government could introduce non-fiscal export incentives such as reducing the cost of doing business, streamlining export processes, and improving market access. Second, to incentivize businesses to focus on export, the government can explore other measures such as providing technical assistance, market information, and other non-fiscal support services. Third, concessional financing can be made available to agriculture businesses through crops insurance, fixation of minimum support price of the agriculture products, credit guarantee schemes, investment funds, and other financial instruments that can help them operate and expand. In addition, involving young entrepreneurs in agriculture businesses, with special concessions for small-scale entrepreneurs, could help to rejuvenate the industry. Moreover, investment in agriculture infrastructure is critical to support the growth and development of this sector, and the government can explore public-private partnership models to improve infrastructure. Finally, branding agro-products for the international market could help to increase their visibility and competitiveness in the global market. By implementing these measures, Nepal can become a more attractive destination for businesses in the agricultural and forest product sectors.

Mining and Manufacturing Sectors

Nepal has several advantages when it comes to exporting its products. It has the opportunity to use preferential trading arrangements through bilateral and multilateral agreements, which could increase market access for products. Similarly, increased infrastructure for connectivity enables easier and faster transportation of goods, making it easier to export products.

[26] As per the Doha Ministerial Declaration on the TRIPS Agreement and Public Health, adopted in November 2001, LDCs were exempted from protecting patents and undisclosed information for pharmaceutical products until 2016.

Government has to support value addition of the products, encouraging businesses to improve product quality. Nepal has a relatively cheap labor force, making it cost-effective to produce goods for export. Likewise, tax incentives can be provided for exports, making it more financially attractive for businesses to engage in export.

Nepal has a supportive logistics system in place, making it easier to move goods to market. Procedural simplification for exports can help reduce the time and costs associated with exporting products. Easy financing for export-based industries can support their growth. Nepal's geographical location is advantageous, as it is situated within a catchment of five to six hours by air from around 40 percent of the world's population, making it more advantageous for exporting goods.

Electricity Sector

Nepal has emerged as a potential exporter of electricity, which presents significant opportunities for economic growth. In addition, Nepal has established bilateral and multilateral power trade agreements that facilitate cross-border power transmission. The construction and expansion of cross-border transmission lines, such as Dhalkebar-Muzaffarpur, Lamki-Bareli, Duhabi-Purniya, New Butwal-Gorakhpur, and Ratmate-Rasuwagadhi-Kerung, further enhance Nepal's ability to export power. The global consensus on reducing carbon emissions through the massive use of renewable energy has created an attractive environment for the private sector to invest in hydro projects. Moreover, India's commitment to making zero carbon emissions by 2070 has further incentivized growth of renewable energy in the region. The enactment of hedging provisions for mega hydro projects aims to promote power export, adding to the potential contributions of this sector to Nepal's economic growth.

SECTION IV

Private Sector in Nepal: Contribution to Investment, Job Creation, and Revenue

The Constitution of Nepal 2015 aims to strengthen the country's economy by supporting the development of the private sector and making the best use of available resources. It also emphasizes the need to attract foreign investment and technology for infrastructure development.

To achieve its goal of becoming a middle-income country by 2030, the 15th Periodic Plan (FY19-20 to FY23-24), which lays out a roadmap that requires an investment of over USD $79 billion (NPR 92.29 billion)[27] over the plan period. The private sector is expected to contribute 55.6 percent of this investment, including through foreign investment. To achieve the SDGs by 2030, Nepal will need to invest approximately $17.45 billion (NPR. 20.25 billion) per year for the next ten years.

In terms of private sector-run industries, small enterprises make up 62.4 percent of the total, followed by medium-sized enterprises at 22.9 percent, and large enterprises at 14.7 percent. Prior to 1983, the number of establishments was 28,660, which has since increased to 923,356. The service sector has the highest number of establishments at 85.5 percent, followed by the secondary sector—industries, construction, and energy—at 11.9 percent, and the primary sector—agriculture, forestry, and fisheries—at 2.7 percent.

The privatization of state-owned enterprises (SOEs) in the 1990s led to a decrease in their numbers from 67 to 44 by 2020-21. Of the 44 enterprises, 21 are fully owned by the government, which also owns over 50 percent of the remaining 23 enterprises, resulting in the private sector becoming larger than the state-owned sector. According to the State-Owned Enterprise Report 2021 from the Government of Nepal, the transaction value of these enterprises is 10.17 percent of the GDP, this was 13.60[28] percentage the previous fiscal year. In addition to this, state-owned enterprises contributed 6.23 percent of the government revenue in the earlier fiscal year, this was 8.82 percent in the last financial year and 9.02 in FY19-20. In all, 28,002 people are employed in these enterprises. This shows that the contribution of the state-owned enterprises is declining in the economy.

[27] 15th Fiver-Year Plan, NPC
[28] GoN (2020). SoE Report.

TABLE 1: Status of State-owned Enterprises in Nepal

Sector	No. establishment	Transaction value to GDP (%)
Industrial	10	0.15
Public service	5	5.63
Business	4	0.34
Financial	9	0.07
Social	5	2.51
Service	11	1.48
Total		10.17

Source: SOE Report, MoF, 2022

Table 1 shows that the private sector dominates the manufacturing and service industries with 99.5 percent of Nepal's formal companies being privately owned.[29] Private entities also play a significant role in social sectors such as health and education, including both non-profit and for-profit organizations. For example, private providers attract 15 percent of primary school enrolment and 26 percent of secondary school enrolment.[30] Private investment has been steadily increasing with the ratio of private investment to GDP rising from 10 percent in 1990 to 23.5 percent in 2017[31] (ADB, 2019). However, productivity is low, with the lowest value-added per worker in the manufacturing sector among comparator countries in South and East Asia. For example, Nepal's value-added per worker is only one-third that of India. The low productivity in manufacturing is believed to be a contributing factor, as seen in countries with better data availability such as India.

Private Sector in Nepal

There was a total of 923,356 private sector establishments operating in Nepal in 2018.[32] This represented an increase of 47.6 percent from the 2011 Economic Census, which recorded 610,364 private sector establishments. Of these, MSMEs accounted for 95.3 percent, SMEs for 4.5 percent, and large industries for only 0.2 percent. The breakdown of MSMEs is as follows: micro enterprises accounted for 88.4 percent, small enterprises for 6.3 percent, and medium-sized enterprises for 0.6 percent.

According to data from the Office of Company Registrar (OCR), there are 326,220 private sector companies registered. The number of registered companies varies by sector, with some sectors having a higher concentration of companies than others. Analyzing the number of registered companies by sector can provide insights into the state of the economy and the sectors that are driving growth.

[29] IFC, 2018
[30] NSO, 2018
[31] ADB, 2019
[32] National Economic Census, 2018

TABLE 2: Public and Private Establishment in Nepal

Sectors	Private Establishments	Public Establishments
Agriculture and Forestry	23810	125
Fishing	5004	18
Electricity, Gas and Water	4812	301
Mining and Quarrying	3312	13
Manufacturing and Recycling	46603	231
Wholesale and Retail Trade	34452	90
Construction	29948	39
Education	26278	61
Transport, Storage and Communication	23460	90
Hotels and Restaurants	16256	44
Health and Social Work	11854	44
Financial Intermediation	8420	551
Public Administration and Social Security	8899	40
Real state, Renting and Business Activities	65173	271
Other Community, Social and Personal Service Activities	17350	32
Private Household and Employed Person	384	-
Extra territorial Organization Body	205	-
Total	326220	1950

Source: OCR, 2022

The total investment in both public and private was estimated to increase by 18.1 percent to NPR 1312.71 billion in 2020-21 after experiencing a contraction of 30.4 percent[33] in the previous year due to reduced public and private sector expenditure and measures to control the pandemic. It was anticipated that economic activities would return to normal by the second quarter of the current fiscal year, leading to an increase in investment. However, a rapid increase in COVID-19 cases poses a risk of a decline in total investment for the remaining period of the FY 20/21.

In the fiscal year 2019/20, total investment decreased by 25.9 percent, but it has been increasing over the last two years. It rose by 29.3 percent in the fiscal year 2020/21 and is projected to increase by 18.1 percent to reach Rs.1807.29 billion in 2021/22. Despite the anticipated increase in public and private sector spending due to the easing of Covid-19 restrictions, the overall growth in investment is expected to be modest due to the liquidity issues in the banking and financial sectors and low capital expenditures in the current

[33] Economic survey MoF (2021)

TABLE 3: Industries in Nepal

Fiscal year	No. Of industry	Total capital (rs. In million)	Fixed capital (rs. In million)	Working capital (rs. In million)	No. Of employment
2015/16	408	120,377.78	103,960.39	16,417.39	18737
2016/17	508	162,952.01	144,907.26	18,044.75	26478
2017/18	498	349,851.23	328,544.61	21,306.63	27544
2018/19	439	283,352.61	264,169.53	19,183.08	23043
2019/20	277	152,625.28	140,392.03	12,233.26	17388
2020/21	176	143,473.97	131,493.61	11,980.35	10,369
TOTAL	2306	1,212,632.88	1,113,476.43	99,165.46	123, 559.00

Source: SOE Report, MoF, 2022

fiscal year. The private sector's share of gross fixed investment is estimated to be 74.3 percent in the 2021/22, where the share of public sector and public-owned enterprises are 18.1 percent and 7.6 percent respectively. Resulting from this investment, the private sector's share on total fixed capital formation increased by 16.0 percent in the current fiscal year. As of March 2022, the Government of Nepal has allocated approximately NPR2.759 billion towards the development of ten industrial sectors, while the private sector has invested a total of NPR57.23 billion. The cumulative investment in these sectors amounts to NPR59.989 billion.

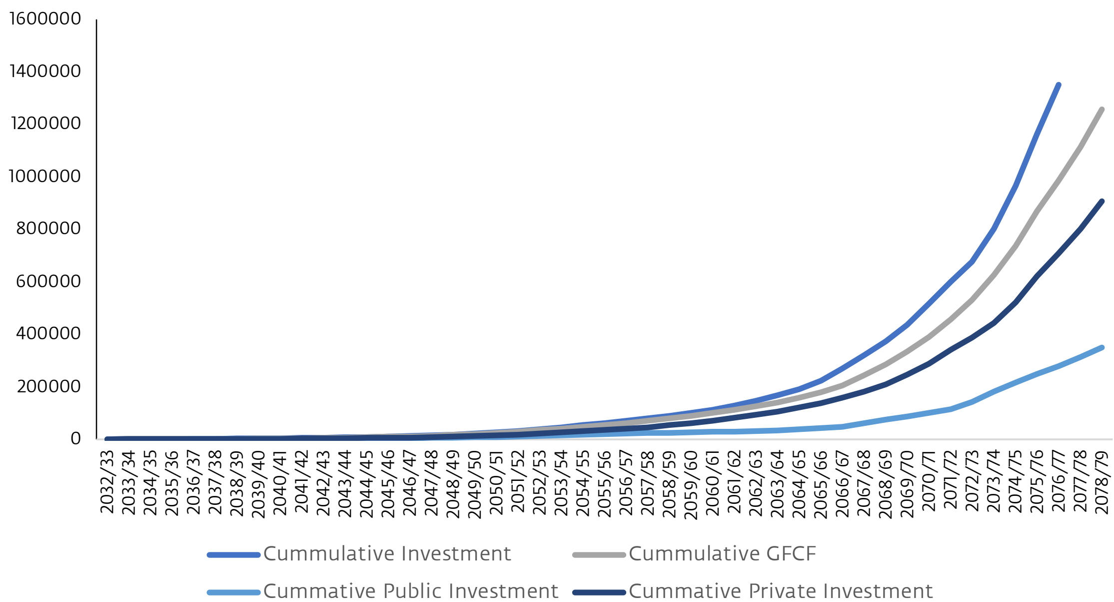
Private investment is a crucial component of capital formation, as it provides the necessary funds to create new capital goods. The private sector plays a significant role in capital formation in the economy. According to the Economic Survey 2020-21, the private sector contributed 76.9 percent of the total investment in the country, while the public sector contributed the rest.[34] The private sector's contribution to capital formation has been increasing over the years, reflecting the growing role of the private sector in the country's economy.

The cumulative private investment amounted to NPR3,191.57 billion, as of mid-July 2022. This is an increase of 10.7 percent over the previous year. Nepal Rastra Bank data shows that private investment has been increasing at an average annual rate of 11.7 percent over the past five years. Figure 6 shows public and private GCEF trend in over the last four decades.

In addition to the gross domestic investment from the local private sector, Nepal needs foreign direct investment (FDI). The private sector plays catalytical role in attracting FDI into the country. The ratio of FDI to GDP has been nominal which was 0.46 percent in 2021.Gross FDI inflows has increased by 1.2 percent in the year 2020-21, with net FDI increment of 0.2 percent in the same year. Table 4 below explains the FDI inflow in over the period of last seven year, the FDI stock as percentage of GDP has remained around 5 percent of the GDP.

[34] Nepal Economic Census, 2018

FIGURE 6: Status of Investment and Capital Formation



Source: Economic Survey Ministry of Finance, 2022

TABLE 4: Status of FDI

FY (mid-July)	FDI inflow	FDI stock	GDP	FDI inflow/GDP(%)	FDI stock/GDP(%)
2015	4.4	106.2	2,423	0.18	4.38
2016	5.9	137.5	2,608	0.23	5.28
2017	13.5	168.6	3,077	0.44	5.48
2018	17.5	200.5	3,455	0.51	5.80
2019	16.5	182.9	3,858	0.43	4.74
2020	19.5	198.5	3,914	0.50	5.07
2021	19.5	218.0	4,266	0.46	5.11

Source: NRB (2021)[35]

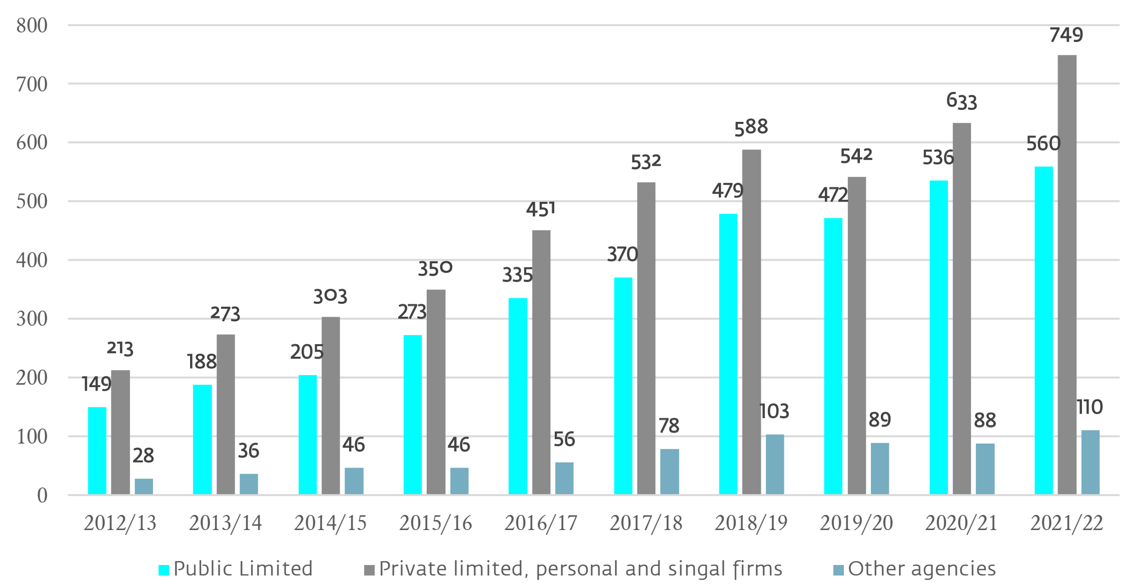
[35] Survey Report on FDI in Nepal, 2020, NRB

The private sector in Nepal continues to be the largest provider of employment, creating a significant portion of both formal and informal jobs. In 2018, the private sector provided jobs to 4,938,566 persons. Of this, MSMEs accounted for 4,564,040 jobs, SMEs for 333,077 jobs, and large industries for 41,449 jobs[36]. Till March 2022, 555,776 micro and small industries were registered and they created 3,008,369 jobs[37]. The formal private sector comprises over 99 percent small and medium-sized enterprises, with only 18 percent of these firms employing more than 20 individuals.[38]

Private Sector Contributions to Income Tax

The private sector plays a significant role in contributing to the country's tax revenue. According to the Inland Revenue Department (IRD) of Nepal, the sector accounted for 80 percent of the total income tax revenue in the fiscal year 2019-20. Revenue collection is highly reliant on import tax, value added tax and excise duty collected by the customs office. Figure 7 shows the contribution of private enterprises to income tax collection. Private enterprises' share in revenue collection has been growing over the past decade. In 2021-22 private enterprises contributed NPR749 million in income tax revenues.

FIGURE 7: Income Tax Contribution by Private Sector



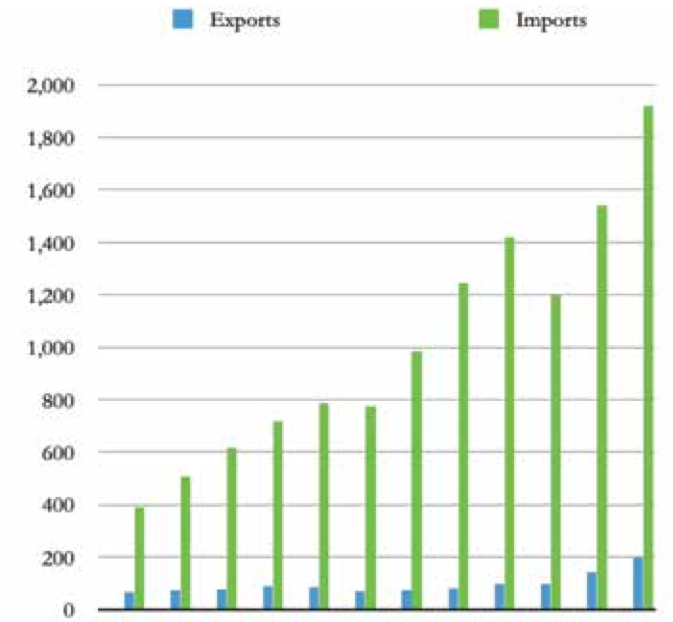
Source:

[36] Nepal Economic Census, 2018
[37] Economic Survey 2021-22, MoF
[38] Nepal Jobs Diagnostics, World Bank, 2018

After a decade of stagnation, Nepal's merchandise export has proliferated over the last two fiscal years. Nepal has had an average export growth rate of 4 percent since 2000, placing it in a group of 20 countries with the lowest export growth in the past 20 years.

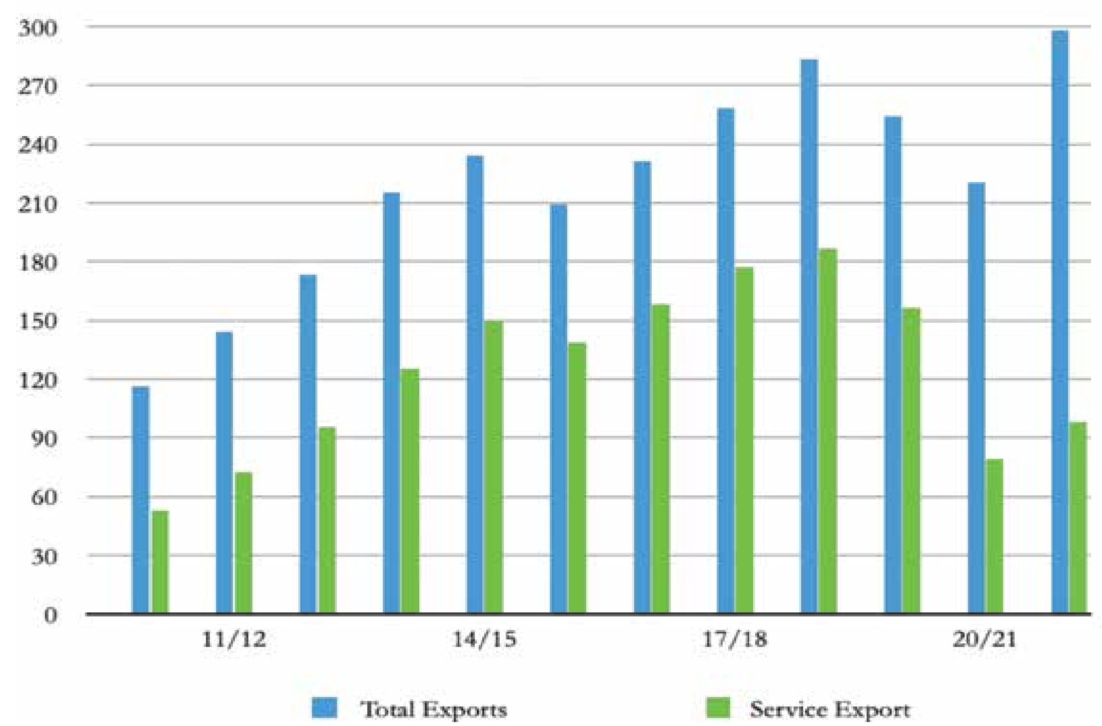
The private sector will have a critical role to play in diversifying merchandise export basket. The lack of significant changes in export basket over time indicates a lack of progress in developing innovative capabilities, as shown in figures 8 and 9. Even within broader sectors, there has been little innovation in terms of introducing new products. In 2009, Nepal exported 1,167 different types of products, while in 2017, this number had decreased to 1,093, putting Nepal at the 125 spot out of 154 countries in

FIGURE 8: Nepal's Merchandise Trade Comparison (In NPR Billion)



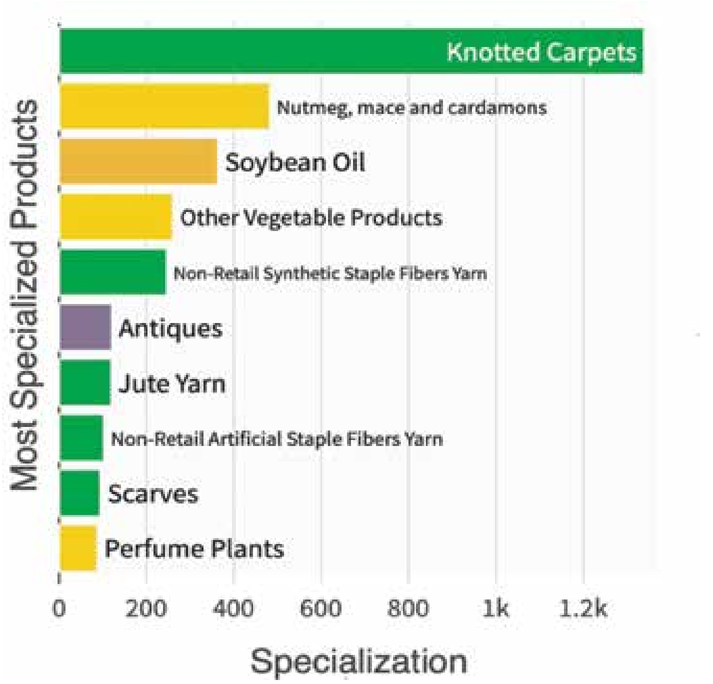
Source: NSO, 2022

FIGURE 9: Nepal's Service Export (in NPR Billion)



Source: Economic Survey Ministry of Finance, 2022

FIGURE 10: Export potential by RCA index



Source: NSO, 2022

terms of the number of product varieties exported. While diversifying destinations is important to reduce risks and build resilience, Nepal's progress in this area has been limited. In 2009, Nepal exported to 146 different countries, but by 2017, this number had fallen to 124, ranking Nepal 101 of 154 countries in terms of this metric.[39]

Service sector exports are substantial contributors to Nepal's overall export bill. Travel-related service remains the top service sector export, driven by a tourism sector that has substantial private sector contribution. Computer and information services comes in second, followed by transportation-related services.

Private Sector and Nepal's Export Performance

Nepal stands to gain as much as $9.2 billion if it could tap into its export potential. A World Bank study relying on a gravity model took into account Nepal's characteristics, including size, geographic location and land-locked features, level of development, and factor endowments such as land labor and capital, found that Nepal's untapped export potential (or "missing exports") are equivalent to 12 times its actual annual merchandise exports. Nepal ranked first in the index of missing exports across a sample of 104 countries.[40]

Nepal has a greater degree of specialization in the agricultural processing handicraft, and textile manufacturing sectors. Revealed Comparative Advantage (RCA)[41] indexing of merchandise export shows a high level of specialization in knotted carpets, nutmeg, mace and cardamom, soybean oil, other vegetable products, and non-retail synthetic staple-fiber yarn.

Nepal Trade Integration Strategy (NTIS), 2016 identifies 12 product segments across three sectors (i) agro-based products, (ii) craft and manufacturing products, and (iii) services. NTIS employs a weighted score model for the following criteria: export size and growth, export potential, and potential value and destination diversification.

[36] National Economic Census, 2018
[37] Economic Survey 2021-22, MoF
[38] Nepal Jobs Diagnostics, World Bank, 2018
[39] Ibid
[40] Based on Mulabdic and Yasar, World Bank, 2021. Nepal Development Update
[41] When a country has a revealed comparative advantage for a given product (RCA >1), it is considered a competitive producer and exporter of that product relative to a country producing and exporting that product at or below the world average. A country with a revealed comparative advantage in a product is considered to have an export strength in that product. The higher the value of a country's RCA for a product, the higher its export strength in that product.

Sectors with High Export Potential

In the medium term, Nepal has the ability to tap into its potential for exporting and creating numerous new job opportunities. If Nepal's exports had increased at the same rate as the South Asia region average since 1999, i.e., 10.6 percent,[42] the gap between actual and potential exports would be significantly smaller by 73 percent compared to the current situation. By tapping into its export potential, Nepal can increase the ratio of exports to GDP from the current 9.5 percent (average 2015-19) to 46 percent, which would move Nepal from the sixth least-export-oriented economy in the world to 64 of 188 countries.

1. Agro-Based Processing

NTIS recognizes cardamom, ginger, tea, and medicinal and aromatic plants as key products with high export potential. Cardamom and tea are among the top ten export commodities for Nepal. In 2020-21, Nepal exported NPR7.02 billion worth of cardamom and NPR3.79 billion of tea.[43] Likewise, all four product segments rank highly in NTIS's export potential index. NTIS also recognizes the following factors as key driving forces behind the export potential of these product segments:

- Possibility of production area expansion and productivity enhancement
- Rising global demand
- Possibility for value addition via processing
- Scope for product diversification and brand value in niche markets along with the potential to capture a greater share of value in the overall global value chain through improved collection, storage, and processing facilities.

2. Craft and Manufactured Products

Under this, NTIS lists all fabrics, textiles, yarn and rope, leather, footwear, pashmina, and carpets as high export-potential segments. Export growth for all of these segments, except for footwear, has been tepid in the past. However, NTIS outlines prospects for value addition and potential for growth and diversification opportunities arising from external factors—-such as, high demand for wet blue leather in international markets due to export bans by neighboring countries— that could allow Nepal to position itself better via backward value chain integration in leather tanning. In 2020-21, NPR28.48 billion worth of craft and manufactured products was exported.[44]

3. Services

NTIS also lists skilled and semi-skilled professionals in various categories (remittance-generating services), tourism (including leisure, business, education, and medical), IT and BPO, and IT engineering as priority sectors with high export-potential segments. Service exports represented almost one-third of Nepal's total export basket, averaging 64.63 percent between 2013 and 2014 and 2019 and 2020.[45]

In the wake of the COVID-19 pandemic, the uptake of remote suppliers for various services such as telemarketing, IT support, accounting, and other professional services improved. Taking advantage of these opportunities could benefit Nepal by helping it cope with the negative impact of reduced tourism and retain skilled workers in the country.[46] However, there are several obstacles that the sector must overcome, including inadequate digital infrastructure, such as insufficient broadband access across the country, slow implementation of an e-payment gateway that forces e-commerce users to rely on costly banking services or informal payment methods, the absence of an e-commerce framework that could encourage digital trade, lack of skilled workers, and difficulties obtaining work visas for foreign talent.[47]

---

[42] World Bank Group, April, 2021
[43] Department of Customs, 2022
[44] Department of Customs, 2022
[45] Calculation from NSO's National Accounts database, 2022
[46] Ezemenari, Kenechukwu Maria; Joshi,Nayan Krishna; Blum, Florian Michael; Varela,Gonzalo J.; Ganz Carulla, Federico. Nepal [36] Development Update: Harnessing Export Potential for a Green, Inclusive, and Resilient Recovery (English). World Bank Group, Washington, D.C.
[47] Joshi, P., and A. Antoni, 2019. "Mid-term evaluation of Nepal Trade Integration Strategy 2016." Manuscript, Kathmandu, GFA Consulting Group.

Policy and Regulatory Environment for Private Sector in Nepal

The legal frameworks listed here are relevant for businesses operating in Nepal. Additionally, a comprehensive assessment of various legal and regulatory frameworks will have to be carried out to identify all constraints to enabling a conducive business environment for the private sector.

The Companies Act 2006 oversees the registration of companies, with provisions including compulsory electronic filing, time-bound approval, and protection of business names and trademarks. The Private Firm Registration Act 1958 governs the registration of sole traders and partnerships, with registration being carried out at either local or provincial offices depending on the proposed capital of the firm and the type of business. However, there is a lack of clarity on the roles of provincial governments in the federal structure, with some actively formulating policies and others lagging behind. Bagmati Province recently endorsed a separate Trade and Business Act to govern incorporation of unlimited liability vehicles, while provinces that have not yet endorsed such an act will have to follow the federal act.

The Industrial Enterprise Act, 2020, is an important law that aims to promote economic development by creating a favourable environment for both domestic and foreign investment and job creation, while responsibly using resources. The law offers incentives such as tax exemptions, expense deductions, and registration fee waivers for industries engaged in manufacturing, micro and small-scale enterprises, export-oriented businesses, those that employ Nepali citizens, marginalized individuals or women, and those operating in underdeveloped areas. The law also provides for the regulation of industries by sub-national governments, an improvement from the Department of Industry's previous role in Nepal. However, Nepal still lags behind its South Asian neighbours in terms of tax compliance, with medium-sized businesses making 46 payments for taxes or mandatory contributions and paying 41.8 percent of their profits. In the federal system, the companies are required to pay taxes to each level of government, with the federal government responsible for VAT, income tax, duties, and customs.

According to the Value Added Tax (VAT) Act of 1996, all businesses are required to obtain a tax registration certificate under either the PAN or VAT category issued by the IRD. The VAT Act of 1996 mandates that a business with an annual transaction exceeding NPR 5 million must register for VAT, although the prerequisites for registration can be complicated.

Under the Income Tax Act (ITA) of 2002, resident businesses are taxed on their global income. Additionally, a foreign permanent establishment owned by a non-resident person within Nepal is regarded as a resident business for tax purposes under the ITA of 2002. The ITA of 2002 imposes a standard rate of 25 percent corporate income tax on the income generated by incorporated businesses, although certain sectors such as manufacturing, hydropower are taxed at a concessional rate of 20 percent, while corporate income tax for sectors like banking is set at 30 percent of taxable income.

Finance and Investment-Related Legislations

The Foreign Investment and Technology Transfer Act (FITTA), 2019, offers two paths for foreign investment approval: the Department of Industry handles investments below NPR6 billion, while the Investment Board of Nepal handles investments above NPR6 billion. Additionally, FITTA mandates a minimum foreign investment of NPR20 million. FITTA 2019 also follows a negative list approach for investment regulation and requires sector-specific approval from relevant authorities. However, stakeholders have pointed out that compliance with FITTA can be cumbersome and may hinder the efficient flow of offshore investments into Nepal.

To promote alternative investment assets such as Venture Capital (VC), Private Equity (PE) and Hedge Funds, the government introduced the Specialized Investment Fund (SIF) Regulations 2019, setting a minimum fund size of NPR15 million for equity funds, VC, or hedge funds. The regulation also requires a minimum stake threshold of 2 percent for fund managers with a paid-up capital of NPR20 million. The SIF regulation permits institutional investments, including BFIs, pension funds, and insurance companies (both foreign and domestic), to participate in local PE/VC funds. Although the regulation provides a base for alternative investment, individual foreign investors are restricted from participating in local PE/VC funds due to cumbersome FDI approval processes.

SECTION V

Sectoral Contribution of the Private Sector in Nepal

This chapter attempts to outline the contribution of the private sector to the overall economy. Using disaggregated data of private and public sector entities, this chapter sheds light on the total private and public output, rate of intermediate consumption, and sector-wise classification of private sector contributions to overall value addition in the economy.

The chapter leverages findings based on data related to government expenditure by the Financial Comptroller General Office (FCGO) and various ministries. Financial statements of entities such as the Nepal Electricity Authority (NEA), Kathmandu Upatyaka Khanepani Limited (KUKL), Nepal Water Supply Corporation (NWSC), Salt Trading Corporation Limited (STC) and Food Management and Trading Company Limited have been used to elucidate the contribution of the private sector to the Nepali economy. Annual Reports from various regulators in the financial sector have also been used. Other studies, annual Reports from line agencies, and surveys have been used where applicable.

The gross value added (GVA) of all sectors by NSIC classification has been estimated by NSO; disaggregated into government and private sectors. The gross output (GO) and intermediate consumption (IC) of the agriculture, mining and quarry, manufacturing, and construction sectors associated with the government have been estimated based on detailed expenditure data by COFOG data. The output of the government for this sector is the cost of agricultural production (compensation of employees plus intermediate consumption).

PRIVATE SECTOR CONTRIBUTION

National Economy

NSO has projected that the country's economic growth rate for the current fiscal year 2022/23, will be limited to 2.16 percent, which is almost four times lower than the government's target of 8 percent. The World Bank and Asian Development Bank, had projected an average growth rate of 4.1 percent. The NSO estimates that Nepal's economy will reach NPR 5.38 trillion in the current fiscal year. The primary sector is expected to contribute 24.6 percent to the GDP, with the gross value-added growth rate increasing by 2.69 percent at constant prices. Meanwhile, the secondary sector, which includes industry, electricity, gas, steam, air conditioning supply services, water supply, sewage waste management and recycling activities, and the construction sector, is estimated to contribute 12.9 percent to the GDP, with the gross value-added growth rate increasing by 0.56 percent at constant prices. The service sector is expected to contribute 62.4 percent to the GDP, with the gross value-added growth rate increasing by 2.33 percent at constant prices. The agricultural sector is expected to contribute 24.12 percent to the GDP, while the non-agricultural sector will contribute 75.88 percent. The NSO has also projected that the per capita income will remain the same for a year. The economy was expected to expand by 5.84 percent in FY21-22 after the expansion rate capped at 4.25 percent in FY20-21, contingent on the lifting of COVID-19 restrictions and an encouraging expansion of the energy sector. National output expanded from NPR 6446.14 billion in 2020-21 to NPR 7356.71.61 billion, heavily driven by contributions from the private sector. Between 2012-13 and 2021-22, the private sector, on average, annually contributed 85 percent to the national output.

FIGURE 11: Private sector contribution to total domestic output (in percentage)

FIGURE 12: Private sector contribution to total domestic consumption (in percentage)

Likewise, the share of total consumption in GDP was 92.3 percent in FY20-21, while the share is estimated at 90.7 percent in FY21-22, indicating a marginal decline compared to the previous fiscal. The average share of public and private sector consumption to total consumption in the last decade was 9.14 and 89.14 percent respectively.

In FY21-22, the total value added in the agriculture and non-agriculture sector is estimated to increase by 2.3 and 6.88 percent respectively. In the previous fiscal year, the total value added by the agriculture sector increased by 2.85 percent and of the non-agricultural sector by 4.25 percent.

Agriculture, Forestry, and Fisheries

The contribution of the agriculture sector (agriculture, forestry, and fisheries) in total value added to the overall economy was 24.9 percent in FY20-21, and its share of GDP is estimated at 23.9 percent in FY21-22. According to the recent census data, 57.3 percent of the total population is engaged in this sector.

The agriculture, forestry, and fisheries industry are solely driven by the private sector with a median contribution of 97.62 percent to sectoral GVA between FY12-13 and 21-22. The share of the private sector has been consistently above 95 percent of total sectoral output and corresponds to the expansion of total sectoral output.

FIGURE 13: Private sector contribution to GDP (in percentage)

TABLE 5: Private sector contribution to total sectoral GVA of agriculture, forestry, and fisheries (in percentage)

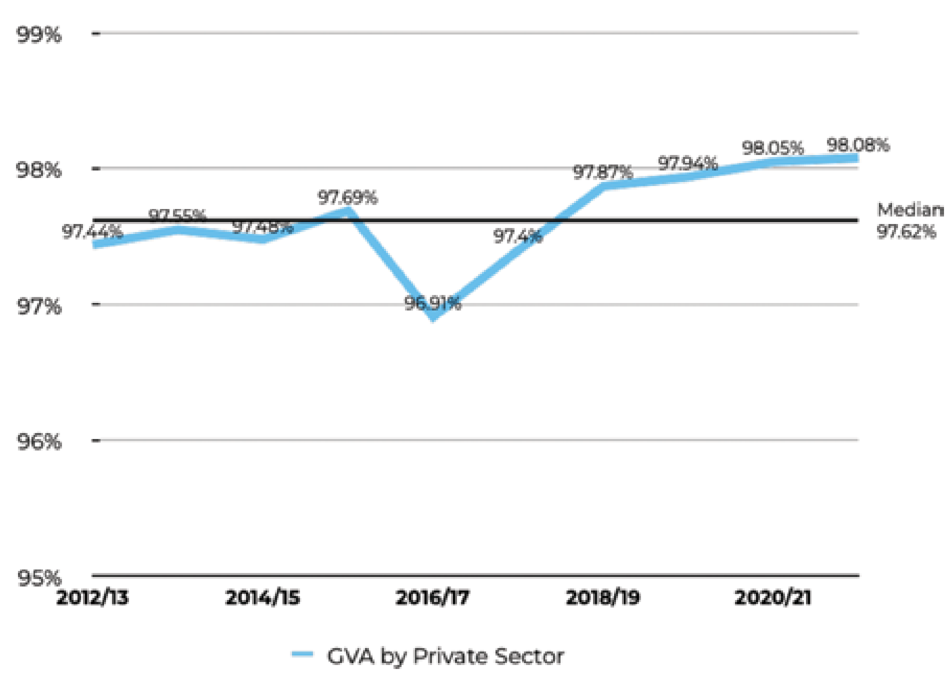
Fiscal Year	Sectoral Sharein GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	31.39	97.44	2.56
2013/14	30.31	97.55	2.45
2014/15	29.39	97.48	2.52
2015/16	28.43	97.69	2.31
2016/17	26.81	96.91	3.09
2017/18	25.63	97.40	2.60
2018/19	24.92	97.87	2.13
2019/20	25.16	97.94	2.06
2020/21	24.90	98.05%	1.95
2021/22	23.95	98.08	1.92

Calculated using Reports of Ministry of Agriculture and Livestock Development (MoALD), Government Expenditure by COFOG Classification, Financial Comptroller General Office (FCGO)

The gross output (GO) and IC of this economic activity in the government sector have been estimated based on detailed expenditure data from COFOG data. The output of the government for this sector is the cost required for agricultural production (compensation of employees plus intermediate consumption). According to the recent census data, 57.3 percent of the total population are engaged in this sector. The difference between GO and IC is the GVA of the government sector.

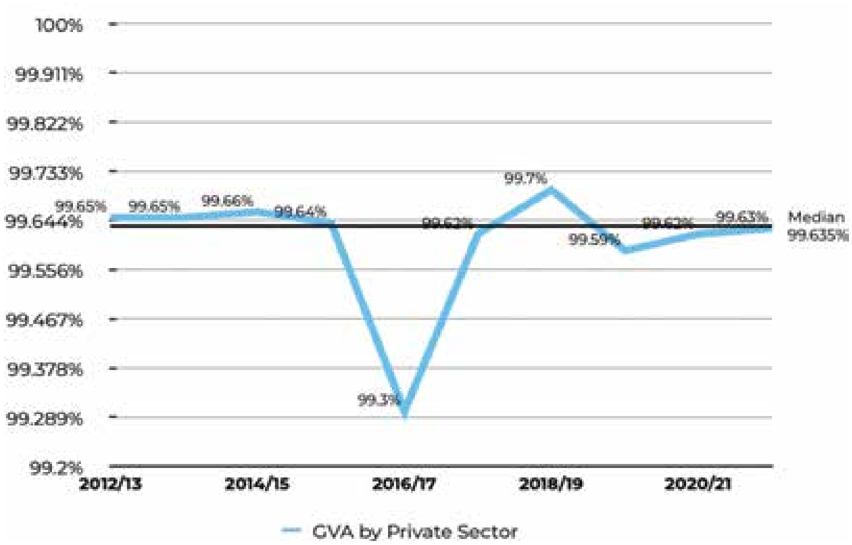
The private sector and households continue to contribute to a big chunk of value added by the sector. The sector has performed poorly in terms of overall value added to GDP due to a sustained shortage of fertilizers, lack of investment in technology upgradation, and weak access to agricultural inputs. Further, inadequate infrastructure systems—warehouses, cold storage, agricultural markets, irrigation facilities, and road networks—have prevented commercial agriculture by the private sector. To this end, appropriate land-use planning also remains a challenge as implementation of the revised Land Use Act, 2019 is inadequate. Likewise, coverage of minimum support price (MSP) schemes for agricultural products should be widened.

FIGURE 14: Trend of Private GVA contribution to total GVA of Agriculture, Forestry, and Fisheries



Calculated by using reports by the Ministry of Agriculture and Livestock Development (MoALD), government expenditure by COFOG Classification, Financial Comptroller General Office (FCGO)

FIGURE 15: Private sector contribution to total sectoral GVA of mining and quarrying



Source: NSO, 2022

Mining and Quarrying

The value added in the mining and quarrying sector in FY20-21 was 7.5 percent and the sector is estimated to grow at 8.15 percent in FY21-22. Almost all activities in this industry classification are undertaken by the private sector, which produces close to 99 percent of total sectoral output. A median of 99.63 percent of this sector's total value addition between 2012-13 and 2020-21 was from the private sector.

TABLE 6: Private sector contribution to total sectoral GVA of mining and quarrying (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	0.59	99.65	0.35
2013/14	0.60	99.65	0.35
2014/15	0.58	99.66	0.34
2015/16	0.58	99.64	0.36
2016/17	0.58	99.30	0.70
2017/18	0.61	99.62	0.38
2018/19	0.66	99.70	0.30
2019/20	0.60	99.59	0.41
2020/21	0.59	99.62	0.38
2021/22	0.58	99.63	0.37

Calculated by using: Reports of Ministry of Industry, Commerce and Supply (MoICS) government expenditure by COFOG Classification, Financial Comptroller General Office (FCGO)

Manufacturing

The industrial sector maintained a value-added growth rate of 3.3 percent per annum over the past decade. Despite a decline in gross value addition in 2019-20 owing to the COVID-19 pandemic, the manufacturing sector is expected to recover in the coming years. According to the Census 2021, 3.8 percent of the labor force is employed in this sector.

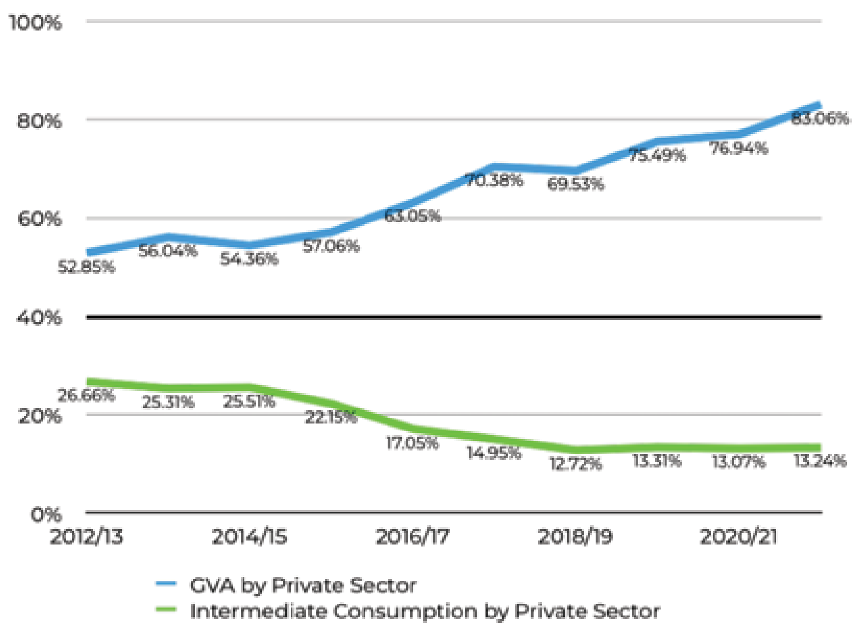
In FY20-21, the manufacturing industry contributed 5.45 percent to total value addition while for 2021-22, it is forecasted to increase marginally to 5.65 percent. Almost all activity in this sector is led by the private sector, which produces most of the total sectoral output as well as contributes to above 99 percent of GVA of the entire industry.

TABLE 7: Private sector contribution to total sectoral GVA in manufacturing (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	6.31	99.98	0.02
2013/14	6.20	99.99	0.01
2014/15	5.94	99.99	0.01
2015/16	5.45	99.99	0.01
2016/17	5.49	99.99	0.01
2017/18	5.63	99.99	0.01
2018/19	5.75	99.99	0.01
2019/20	5.08	99.99	0.01
2020/21	5.45	99.99	0.01
2021/22	5.65	99.99	0.01

Calculated by using Reports from the Ministry of Industry, Commerce and Supply (MoICS) Financial General Comptroller Office (FCGO)

FIGURE 16: GVA Vs IC of private sector in electricity, gas and air conditioning supplies



Calculated using financial statement of Nepal Electricity Authority; financial statements of various private electricity producing companies

Electricity, Gas and Air Conditioning Supplies

The contribution of this sector to the GDP was 1.14 percent in FY20-21, an increase of 2.57 percent of the total value added. Despite being comparatively small in terms of contribution to GDP, the sector has seen a surge in private sector-led activity, producing approximately one-third of sectoral output between 2012-13 and 2021-22, with a slightly decreasing trend over these years.

TABLE 8: Private sector contribution to Total GVA of electricity, gas and air conditioning supplies (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	1.13	52.85	47.15
2013/14	1.02	56.04	43.96
2014/15	0.97	54.36	45.64
2015/16	0.81	57.06	42.94
2016/17	1.07	63.05	36.95
2017/18	1.03	70.38	29.62
2018/19	1.01	69.53	30.47
2019/20	1.18	75.49	24.51
2020/21	1.14	76.94	23.06
2021/22	1.37	83.06	16.94

Note: Total output, IC and value added of NEA is estimated for the government, the difference from total GVA estimates for this sector is then the GVA for the private sector.

However, the private sector has consistently accrued a larger share of total sectoral GVA; from 52.86 percent in 2012-13 to 83.06 percent in 2021-22.

Although the private sector accounts for only one-third of total sectoral output, it has been able to add more value compared to the public sector. This suggests that the private sector has been able to reduce its intermediate consumption and operate more efficiently than the government. Higher productivity in the private sector implies that it can produce the same output with fewer intermediate inputs.

Water supply, Sewerage, Waste Management, and Remediation Activities

To derive private sector contribution to sectoral output and GVA, the total value added by government sector agencies Kathmandu Upatyaka Khanepani Limited (KUKL) and Nepal Water Supply Corporation (NWSC) was accounted for and the residual value of the difference between government GVA and total GVA was assigned to the private sector. The table 9 depicts that government agencies occupy a small fraction of total sectoral output. The contribution of this sector in total value addition is estimated to be 0.51 percent in FY21-22. This was 0.56 percent in the previous fiscal year.

TABLE 9: Private sector contribution to total GVA of water supply; sewerage, waste management, and remediation activities (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	0.62	98.20	1.80
2013/14	0.77	96.40	3.60
2014/15	0.78	96.42	3.58
2015/16	0.78	96.79	3.21%
2016/17	0.69	96.99	3.01
2017/18	0.65	97.24	2.76
2018/19	0.59	96.70	3.30
2019/20	0.59	96.78	3.22
2020/21	0.56	95.69	4.31
2021/22	0.51	95.86	4.14

Calculated by using financial statements of Kathmandu Upatyaka Khanepani Limited (KUKL) and Nepal Water Supply Corporation (NWSC)

Construction

The construction sector in FY21-22 contributed an estimated 6.17 percent to GDP. In the previous fiscal year, it contributed 5.19 percent to GDP. The construction sector expanded by 5.19 percent in FY20-21 and is projected to expand by 9.51 percent in FY21-22. The GVA estimate for the government is based on data provided by COFOG; the rest is assigned to the private sector. This sector employs 8.1 percent of the total labor force, according to census 2021.

TABLE 10: Private sector contribution to total sectoral GVA in construction (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	6.48	91.71	8.29
2013/14	6.39	90.85	9.15
2014/15	6.32	89.24	10.76
2015/16	6.48	87.45	12.55
2016/17	6.73	79.56	20.44
2017/18	7.23	77.92	22.08
2018/19	7.01	81.44	18.56
2019/20	6.23	87.98	12.02
2020/21	5.95	76.69	23.31
2021/22	6.17	81.97	18.03

Calculated through data from FCGO

Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles

This sector is the second highest contributor to employment, after the agriculture sector, at 12.8 percent, as per the census 2021. The contribution of the wholesale and retail trade and vehicle and motorcycle repair services sector to the total value addition in FY20-21 was 15.96 percent and is estimated to be 16.4 percent in FY21-22. To assess the contribution of the private sector to this sector, government estimates based on the P/L accounts of Salt Trading Corporation Limited (STC) and Food Management and Trading Company Limited were subtracted from the total sectoral GVA, with the balance GVA assigned to the private sector.

Activities in this sector are predominantly led by the private sector, which has consistently produced above 90 percent (approximately) of total sectoral output.

TABLE 11: Private sector contribution to Total sectoral GVA of wholesale and retail trade; repair of motor vehicles and motorcycles (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	15.43	93.22	6.78
2013/14	15.49	93.17	6.83
2014/15	15.59	93.55	6.45
2015/16	14.98	93.76	6.24
2016/17	14.76	93.37	6.63
2017/18	15.73	92.52	7.48
2018/19	16.25	92.31	7.69
2019/20	15.02	93.50	6.50
2020/21	15.96	93.20	6.80
2021/22	16.40	93.28	6.72

Calculated using financial statements of the Salt Trading Corporation Limited (STC) and Food Management and Trading Company Limited, Agriculture production, MoALD and manufacturing production, NSO, Import data, Nepal Rastra Bank (NRB), P/L account of Nepal Oil Corporation

Transport and Storage

With the lifting of COVID-19 restrictions, the transport and storage sector is expected to improve as compared to last year. The contribution of this sector to the total value addition in FY20-21 was 5.36 percent while it is estimated at 5.98 percent for the current fiscal year. The sector's average contribution to GDP over the past decade is 6.09 percent with an average rate of value addition of 4.28 percent. Activities in this sector are largely driven by the private sector.

The government GVA estimate for this sector was done by adding GVAs of government and public companies associated with this sector. The government's annual expenditure in the transportation sector is based on COFOG data, while the GVA of the public sector (that is, government-owned or public transportation and storage services such as Sajha Yatayat, Nepal Transit and Warehousing Co. Ltd.) was estimated on the basis of their P/L accounts. Then, the difference between total GVA and government GVA was considered as GVA of the private sector.

TABLE 12: Private sector contribution to total sectoral GVA of transport and storage (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	5.96	97.11	2.89
2013/14	5.84	97.93	2.07
2014/15	5.86	96.42	3.58
2015/16	6.86	95.49	4.51
2016/17	6.77	96.72	3.28
2017/18	6.57	97.56	2.44
2018/19	6.46	97.78	2.22
2019/20	5.26	97.39	2.61
2020/21	5.36	97.21	2.79
2021/22	5.98	98.19	1.81

Calculated using government expenditure by COFOG Classification, FCGO. Vehicle registration data from DoTM; P/L account of transport- related establishments. (airlines companies, transport companies, etc.)

Accommodation and Food Services

The contribution of the accommodation and food services sector in total value added is estimated at 1.65 percent in FY21-22, up from 1.6 percent in FY20-21. The sector's average contribution over the last ten years was 1.93 percent with a growth rate of 2.67 percent, solely driven by the private sector. Based on COFOG data, the government is not directly involved in this service and has no contribution to GVA for this sector. Thus, all GVA is generated by the private sector. Here, GVA is calculated by using the financial statements of privately owned hotels and restaurants.

Information and Communication

The contribution of this sector to total value addition in FY20-21 was 2.22 percent, and is expected to contribute 2.09 percent in FY21-22. The sector consists of both government and private operators and service providers. Estimates were calculated by adding the government's annual expenditures in the information and communication sector using COFOG data and gross value added (GVA) by government-owned or public information and communication companies such as Nepal Telecommunication, Nepal Television, etc.

The private sector in this industry has consistently grown over the years, reaching 77.43 percent of sectoral output share. Similarly, the value added by the private sector in this industry has improved. In 2012-13, the private sector contributed 57.18 percent of total sectoral GVA. Save for a minor decline in FY16-17, the private sector continued to increase its share in sectoral GVA to 68.62 percent in 2021-22.

TABLE 13: Private sector contribution to total sectoral GVA of accommodation and food services. (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	1.96	100	0
2013/14	1.94	100	0
2014/15	2.10	100	0
2015/16	1.98	100	0
2016/17	2.06	100	0
2017/18	2.24	100	0
2018/19	2.26	100	0
2019/20	1.47	100	0
2020/21	1.60	100	0
2021/22	1.65	100	0

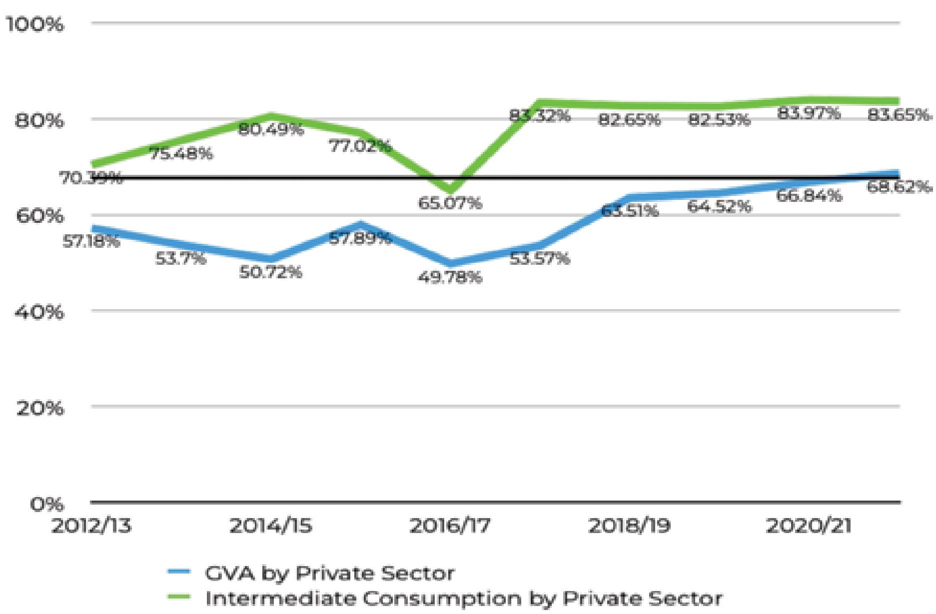
Calculated from P/L accounts of sector-related establishments (like hotels, etc.).

TABLE 14: Private sector contribution to total sectoral GVA of information and communication industry (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	2.27	70.39	29.61
2013/14	2.52	75.48	24.52
2014/15	2.58	80.49	19.51
2015/16	2.58	77.02	22.98
2016/17	2.52	65.07	34.93
2017/18	2.33	83.32	16.68
2018/19	2.22	82.65	17.35
2019/20	2.24	82.53	17.47
2020/21	2.22	83.97	16.03
2021/22	2.09	83.65	16.35

Computed on the basis of government expenditure by COFOG Classification, FCGO; financial statements of ISP establishments; telecommunication service providers; financial statement of Nepal Telecommunications Authority (NTA)

FIGURE 17: Proportion of GVA vs. IC of information and communication



The government contribution in this sector is calculated by adding the government's annual expenditures in information and communication sectors using the COFOG data and the gross value added (GVA) by government-owned or public information and communication companies such as Nepal Telecommunication, Nepal Television, etc. Then, the difference between total GVA and Government GVA is the GVA of the private sector.

Financial and Insurance Activities

In FY 2020/21, the growth rate of total value added in this sector stood at 4.05 percent. The sector is expected to grow at the rate of 6.06 percent in FY 2021/22. Similarly, the contribution of this sector to total value addition was 7.01 percent in FY 2021/22. Over the last ten years, the sector has accounted for an average contribution of 5.86 percent to the national economy and witnessed a growth rate of 5.96 percent to the national economy.

For the banking sub-sector under this industry classification; total annual stocks of deposits and loans of all financial institutions have been collected from the annual reports of Nepal Rastra Bank, and Annual stock of deposits and loans of government banks (Nepal Bank Limited, Rastriya Banijya Bank Limited, and Agricultural Development Bank Limited). Based on this information, indicators including ratio of stocks of deposits and loans, the share of private and government value added have been estimated. The value addition from Nepal Rastra Bank, Employees Provident Fund, Citizen Investment Trust, Nepal Insurance Authority (formerly the Beema Samiti, Nepal Stock Exchange (NEPSE), Securities Board of Nepal (SEBON), and Social Security Fund activities, etc. are categorized as the Government sector and, (iii) the value addition from other sub-sectors: Life and non-life insurances, Reinsurance, capital markets, money exchange markets, mutual funds, cooperatives and share brokerage activities (saving and credit) are categorized within private sectors. The GVAs of the government and private sectors are estimated on their gross outputs and intermediate consumptions.

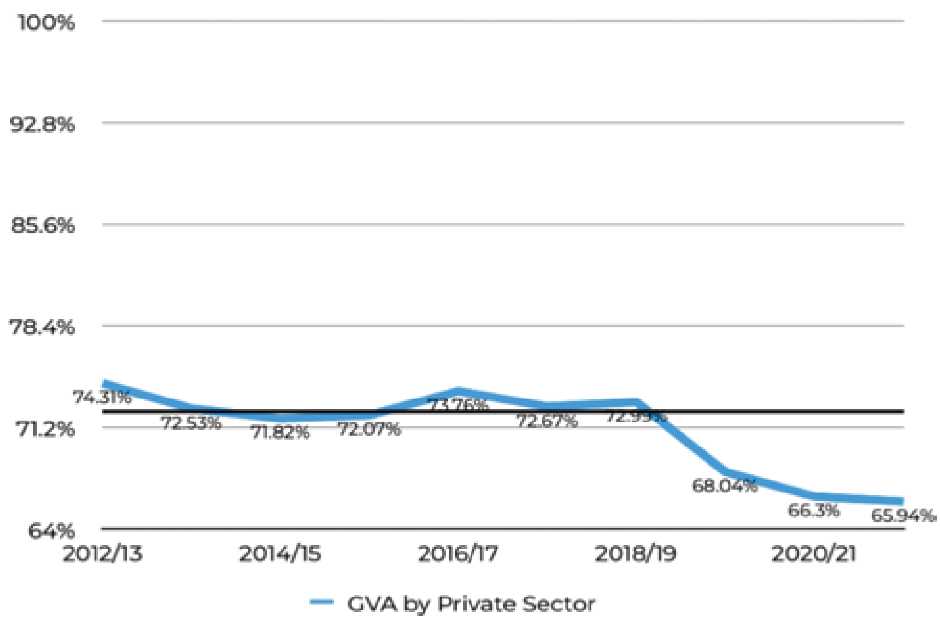
The share of the private sector in the total output of this sub-sector is approximately two-third of the entire sectoral output. However, private sector contribution to both (i) sectoral output and (ii) GVA is declining. In 2012-13, private companies sector contributed 74.31 percent to the overall output of this sector. However in 2021-22, this share was estimated at 65.94 percent. Likewise, the share of privately contributed GVA is on a downward trend.

TABLE 15: Private sector contribution to total sectoral GVA of financial and insurance activities (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	4.57	74.31	25.69
2013/14	4.59	72.53	27.47
2014/15	4.90	71.82	28.18
2015/16	5.44	72.07	27.93
2016/17	5.82	73.76	26.24
2017/18	6.20	72.67	27.33
2018/19	6.20	72.99	27.01
2019/20	7.06	68.04	31.96
2020/21	7.01	66.30	33.70
2021/22	6.86	65.94	34.06

Computed using financial statements of Nepal Rastra Bank (NRB); annual reports of NBL, RBBL, ADBL; annual reports of Beema Samiti, Life and Non-life karobar from Insurance Board and Reinsurance data; annual reports of SEBON, NEPSE, EPF, and CIT; money exchange activities, COFOG data for social security fund.

FIGURE 18: Private sector GVA trend for financial and insurance activities (In percent)



Computed using: Financial statements of Nepal Rastra Bank(NRB); annual reports of NBL, RBBL, ADBL; annual reports of Beema Samiti, life and non life karobar from Insurance Board and Reinsurance data; annual reports of SEBON, NEPSE, EPF and CIT; money exchange activities, COFOG data for Social Security Fund

Real Estate

The real estate industry, in the last decade, has contributed 9.09 percent to the overall GDP with a growth rate of 2.29 percent. Its growth rate for FY20-21 stood at 2.25 percent with an estimated growth rate of 3.82 percent in FY21-22. Total GO and IC were disaggregated into government and private sector by using the ratio of institutional (government) and individual households for the respective years. The entire industry has no contribution from the government or the public sector.

Professional, Scientific, and Technical Activities

The professional scientific and technical sector, on average, contributed 0.98 percent to the GDP over the past decade with a growth rate of 4.78 percent. The contribution of this sector to the total value addition in FY20-21 was 1.01 percent and its contribution in the current fiscal year is estimated at 0.99 percent. The total value added increased by 2.37 percent in FY20-21 and is estimated at 3.78 percent for the current fiscal year.

The contribution of the private sector here, while approximately one-third of total sectoral output, fluctuates greatly.

TABLE 16: Private sector contribution to total sectoral GVA of the real estate sector (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	9.82	99.93	0.07
2013/14	9.21	99.93	0.07
2014/15	8.76	99.93	0.07
2015/16	9.27	99.93	0.07
2016/17	8.97	99.93	0.07
2017/18	8.78	99.93	0.07
2018/19	8.85	99.93	0.07
2019/20	9.42	99.93	0.07
2020/21	9.09	99.93	0.07
2021/22	8.79	99.93	0.07

Calculated using benchmark survey/census 2013 and 2019; Report of the Real Estate Service Providers, 2018; NRB Nepal Living Standard Survey III (NLSS 2010).

TABLE 17: Private sector contribution to total sectoral GVA of professional, scientific, and technical activities (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	0.91	65.97	34.03
2013/14	0.92	60.81	39.19
2014/15	0.96	59.42	40.58
2015/16	0.99	63.17	36.83
2016/17	0.99	51.64	48.36
2017/18	0.99	55.46	44.54
2018/19	0.98	74.42	25.58
2019/20	1.03	72.51	27.49
2020/21	1.01	74.58	25.42
2021/22	0.99	66.67	33.33

Calculated using government expenditure by COFOG Classification, FCGO

Administrative and support service activities

The administrative and support services industry's contribution over the past decade was 0.66 percent with an average growth rate of 10.38 percent. Total value added in FY20-21 increased by 2.3 percent, and the industry is estimated to grow by 4.4 percent in the current fiscal year. Based on FCOG data, there is no involvement of the government and no public organization is engaged in this sector.

Public administration and defense; compulsory social security

The contribution of the public administration, defense, and compulsory social security sector to value addition in FY20-21 was 7.85 percent and is estimated to be 7.73 percent in the current fiscal year. The sector's average contribution over the past decade was 6.57 percent and it has an average growth rate of 5.17 percent. The total value added of public administration, defense, and compulsory social security sector is estimated at 4.05 percent in FY21-22.

Because this industry is associated with administration and regulatory activities of the government, there is no private sector contribution. COFOG data was used to estimate output and IC using the cost of production approach.

TABLE 18: Private sector contribution to total sectoral GVA of administrative and support services (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	0.47	100	0
2013/14	0.51	100	0
2014/15	0.56	100	0
2015/16	0.64	100	0
2016/17	0.62	100	0
2017/18	0.65	100	0
2018/19	0.76	100	0
2019/20	0.81	100	0
2020/21	0.80	100	0
2021/22	0.78	100	0

Calculated by using the Report of Financial Comptroller General Office (FCGO),

TABLE 19: Private sector contribution to total sectoral GVA of public administration and defence (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	4.65	0	100
2013/14	5.61	0	100
2014/15	6.18	0	100
2015/16	5.89	0	100
2016/17	6.80	0	100
2017/18	6.43	0	100
2018/19	6.54	0	100
2019/20	8.07	0	100
2020/21	7.85	0	100
2021/22	7.73	0	100

Calculated by using the Report of Financial Comptroller General Office (FCGO),

Education

The education sector, over the last decade, has contributed 7.21 percent to the overall value added with an average growth of 5.36 percent. In FY21-22, the industry contributed 8.1 percent to the overall value addition.

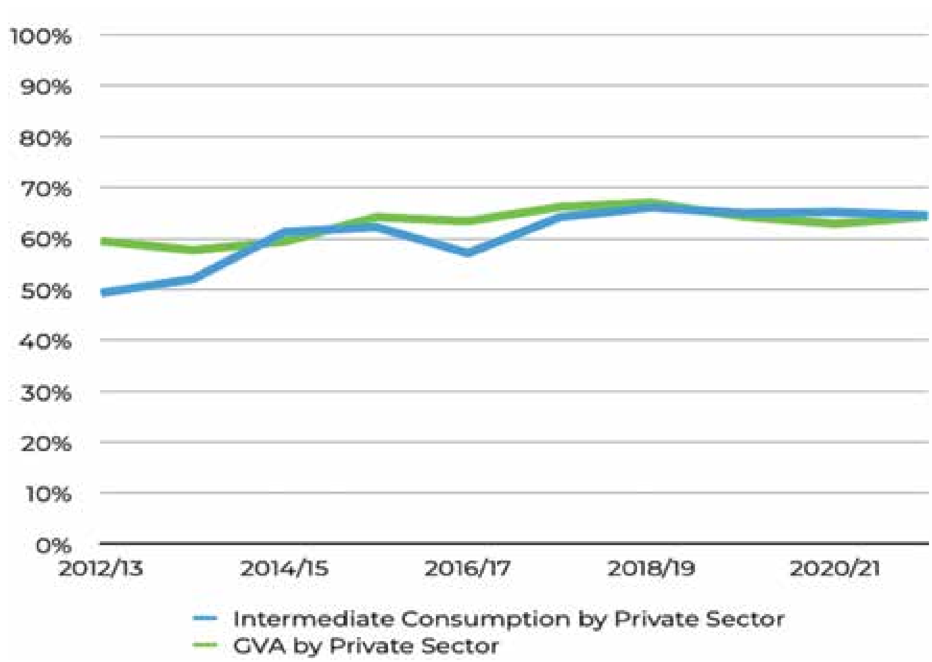
For government education, government's output is measured as a cost of production. For private education, output and IC for 2012-13 (at current price) were compiled from Private Education Survey 2013-14 and for the other years, volume extrapolation was done using the number of students at each level.

The private sector has captured approximately one-third of the entire sectoral output with a growing trend between 2012-13 to 2017-18. However, since then, the private sector's share in overall output has declined slightly, owing to restrictions due to the COVID-19 pandemic.

TABLE 20: Private sector contribution to total sectoral GVA of education (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	5.75	59.52	40.48
2013/14	6.26	57.73	42.27
2014/15	6.54	59.40	40.60
2015/16	6.89	64.22	35.78
2016/17	7.27	63.43	36.57
2017/18	7.29	66.21	33.79
2018/19	7.53	66.99	33.01
2019/20	8.41	64.27	35.73
2020/21	8.10	62.94	37.06
2021/22	8.10	64.33	35.67

FIGURE 19: Private sector GVA vs. IC in Education Sector (In Percent)



Calculated by using the monthly data of Classification of the function of government (COFOG) data: private educational institution survey 2013-14; flash Report from the Department of Education; Study on Tuition, Coaching, and educational consultancies.

Human Health, Social Work, and Other Service Activities

This sector's average contribution to GDP over the past decade was 1.52 percent, and with an average growth rate of 5.92 percent. The sector has seen proliferation due to increased public health spending in response to the pandemic. In FY21-22, the growth rate of total value addition of the human health and social work sector was estimated at 6.91 percent.

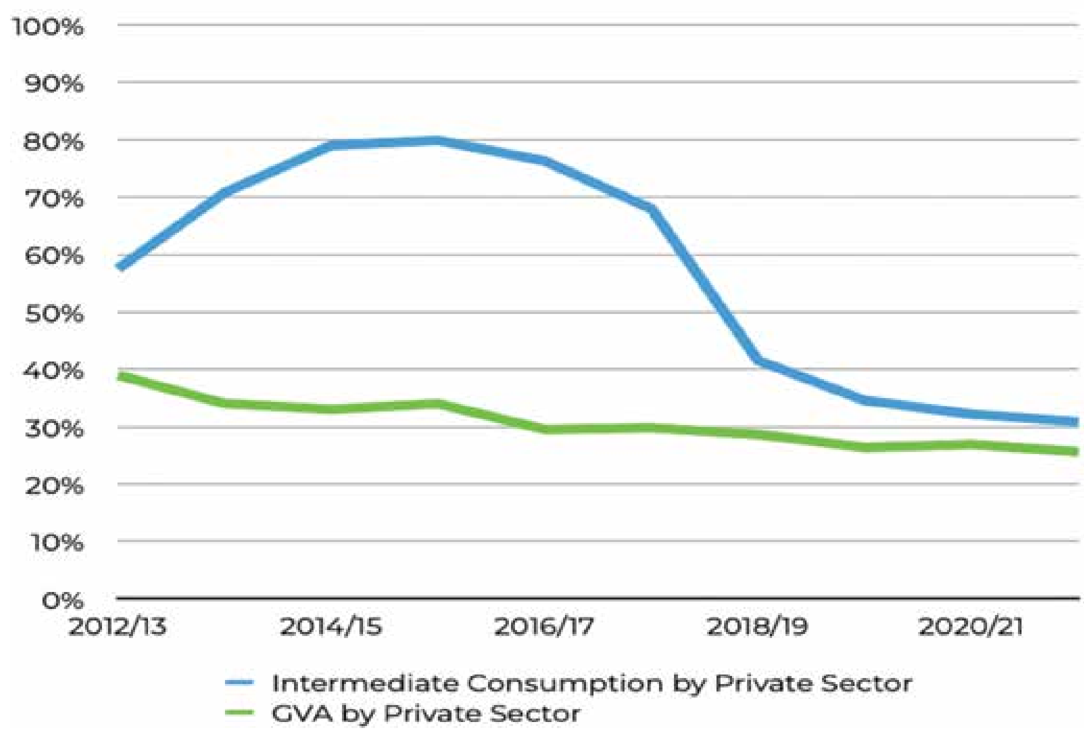
The sector grew at the rate of 6.60 percent in FY20-21. While the contribution of this sector to the total value addition in FY20-21 was 1.78 percent, it is estimated it will be 1.79 percent in the current fiscal year.

Private sector share in the overall industrial output has been on a decreasing trend. From contributing 44.14 percent to the entire industry's output in 2012-12, its share has declined to 27.71 percent in 2021-22.

TABLE 21: Private sector contribution to human health, social work, and other service activities (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	1.20	38.95	61.05
2013/14	1.32	34.00	66.00
2014/15	1.46	33.01	66.99
2015/16	1.42	33.97	66.03
2016/17	1.52	29.48	70.52
2017/18	1.46	29.76	70.24
2018/19	1.49	28.63	71.37
2019/20	1.76	26.39	73.61
2020/21	1.78	26.92	73.08
2021/22	1.79	25.59	74.41

FIGURE 20: Private sector GVA vs IC of in human health, social work, and other service activities. (In Percent)



Calculated using monthly data of Classification of the function of government (COFOG); data from financial comptroller general office for each year; private hospital census 2012-13; Health Management Information System (HMIS), Ministry of Health Study on Radiology, Pathology, and Care activities.

Arts, Entertainment and Recreation; Other Service Activities; and Activities of Households as Employers; Undifferentiated Goods and Services-Producing Activities of Households for Own Use

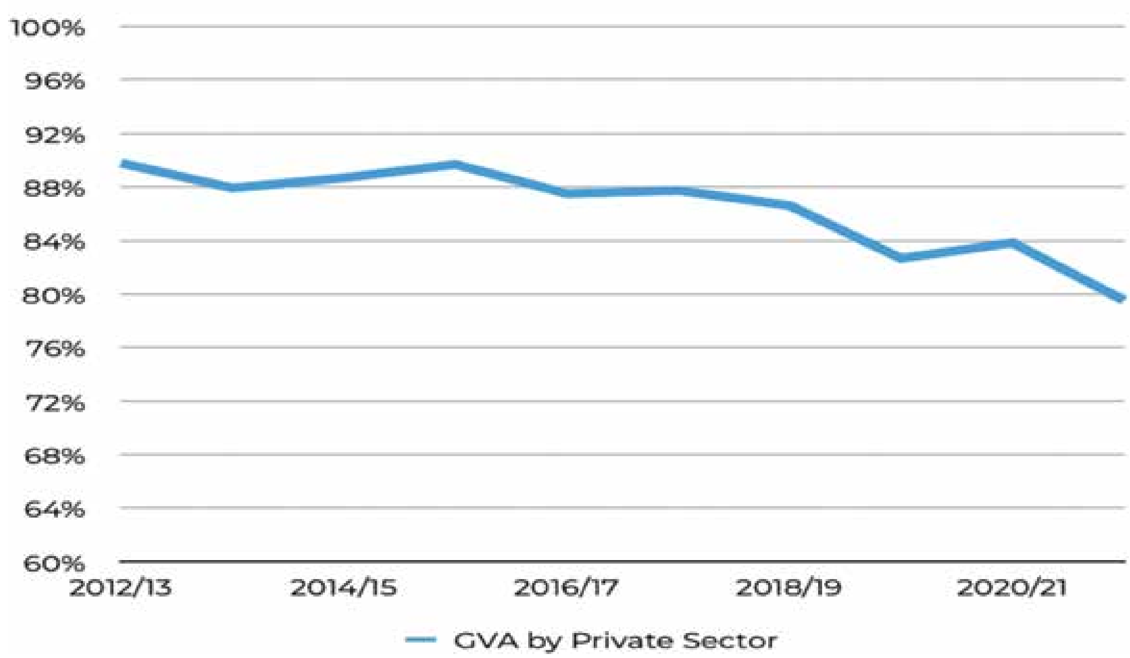
The other service sectors (arts, entertainment, other employer household activities, and household goods and service production activities for their own use) average contribution over the past decade was 0.55 percent with an average growth rate of 4.46 percent.

Output, IC and GVA of government for these industries are estimated from COFOG data and then subtracted from the total. The difference is the contribution of the private sector.

TABLE 22: Private sector contribution to total GVA in service sector (in percentage)

Fiscal Year	Sectoral Share in GVA(%)	Private Sector(%)	Public Sector(%)
2012/13	0.49	89.79	10.21
2013/14	0.49	87.92	12.08
2014/15	0.53	88.68	11.32
2015/16	0.55	89.69	10.31
2016/17	0.54	87.51	12.49
2017/18	0.53	87.75	12.25
2018/19	0.54	86.61	13.39
2019/20	0.62	82.67	17.33
2020/21	0.63	83.83	16.17
2021/22	0.61	79.53	20.47

FIGURE 21: Trend of private sector GVA to other service activities (In Percent)



Calculated by using Government Expenditure by COFOG Classification, FCGO

SECTION VI

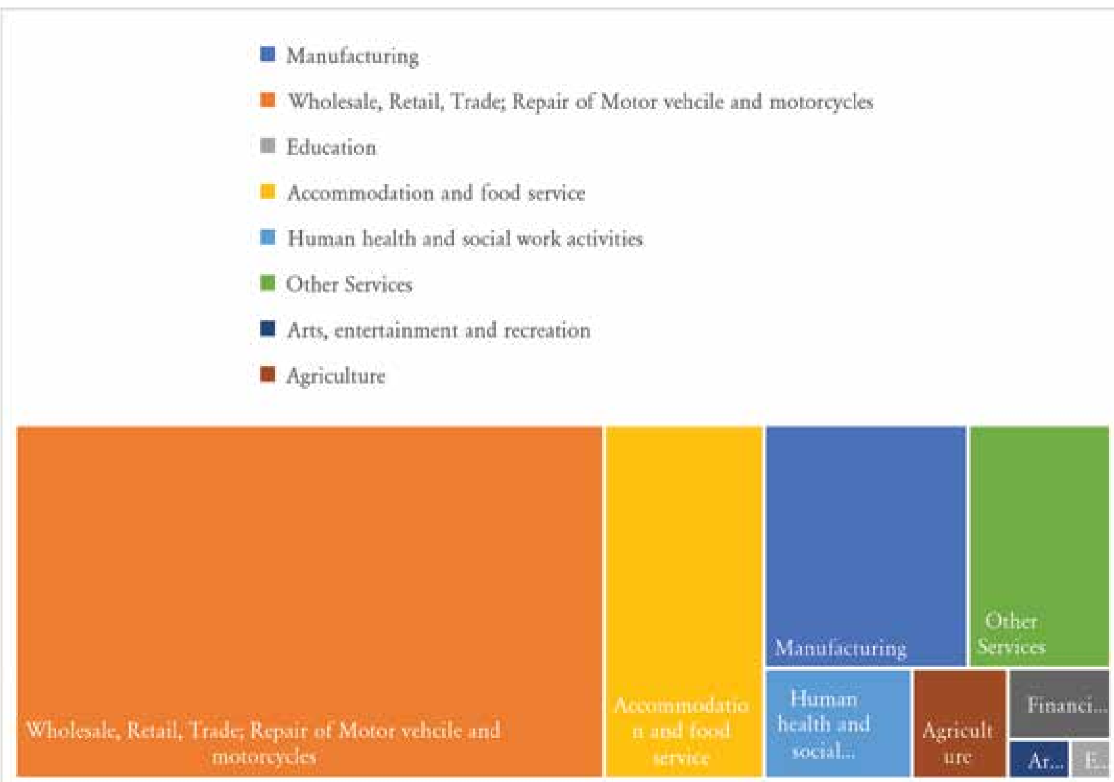
Impact of COVID-19 on the Private Sector in Nepal

This section of the Report compiled by analyzing primary data collected from a firm-level survey carried out specifically for this report. The primary data collection process involved designing a survey questionnaire that was tailored to the specific research questions related to the impact of COVID-19 in businesses across Nepal.

The questionnaire included closed-ended questions to gather quantitative data. The survey was administered through various means such as in-person interviews, phone interviews, and online survey across 517 firms throughout the country. Overall, the primary data collection aimed to provide a more comprehensive understanding of the impact of COVID-19 on firms in Nepal and their awareness towards sustainability and climate change.

Of the sample size, 50 percent of firms participated in the survey were wholesale and retail traders, 13 percent of respondents were from the hotel and accommodation sector, and 12 percent were from the manufacturing sector. Figure 19 below breaks down the nature of firms that participated in the survey.

FIGURE 22: Composition of enterprises that participated in the survey



Among participating firms, 71 percent of owners were male, 21 percent were female, and 5 percent were jointly owned. Figure 23 shows ownership structure of the businesses.

50 percent of the firms participating in the survey have taken loans from through formal or informal measures. Of the firms that had taken loans, 56 percent took loans from commercial banks, 25.2 percent from cooperatives, and 19.6 percent reinvested profits. The figure 24 below shows the sources of financing of the businesses.

FIGURE 23: Business ownership

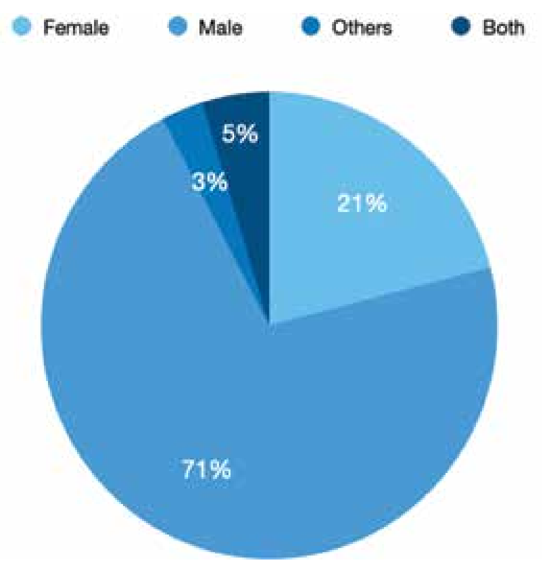
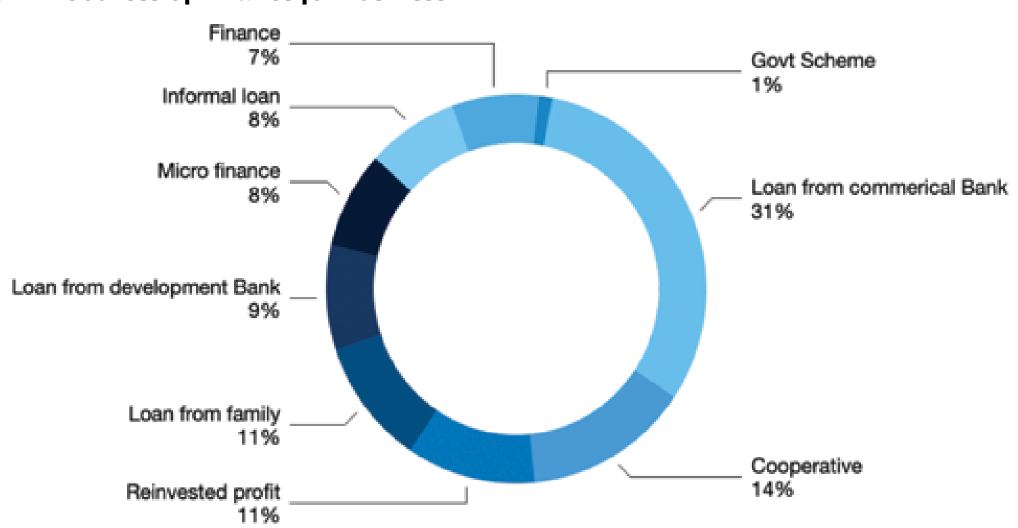


FIGURE 24: Sources of Finance for Business



The COVID-19 Pandemic and Businesses in Nepal

The COVID-19 pandemic had significant impact on Nepal's business. About 87 percent of surveyed enterprises were affected during the restrictions; this result agrees with the earlier enterprise-level survey conducted by NRB in 2021, where 87 percent of business reported that they shut down.

Out of the total businesses affected by pandemic, 63 percent of firms reported they were fully closed during the lockdown, 31 percent reported were partially closed, 6 percent were closed intermittently, and 13 percent were not affected. During the lockdown, the majority of 85 percent were closed for up to 30 days and 14 percent for more than 60 days.

FIGURE 25: Businesses during COVID-19

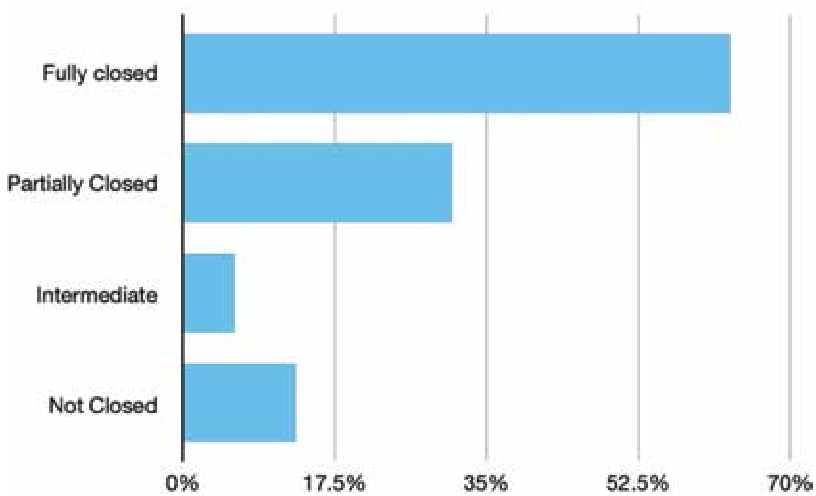
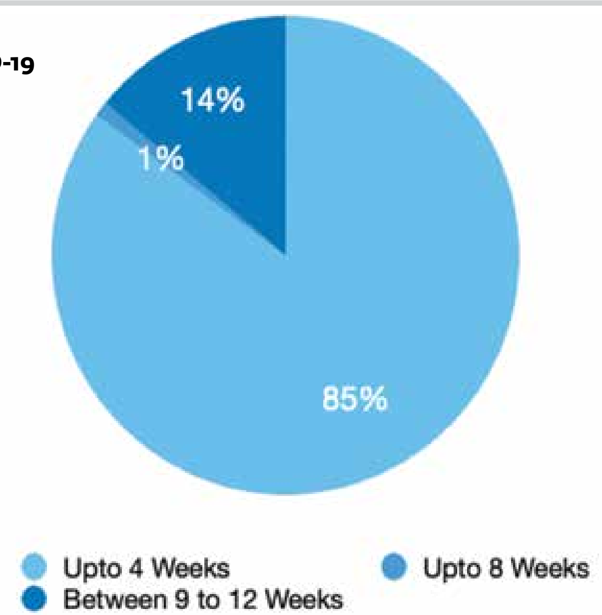


FIGURE 26: Business closure during COVID-19



While reporting profitability of the businesses, 79 percent reported they were in loss during the lockdown, 14 percent reported they were breaking even, and 7 percent reported that they were in profit. 50 percent of firms reported that they were in profit once the lockdowns were lifted, 34 percent reported they were breaking even, and 16 percent reported losses. 97 percent of the firms were operating without any formal support from the government.

When asked about measures that were taken during the shock, the majority of the businesses reported they reduced working hours, around 39 percent of businesses reduced employee strength, and 34 percent discontinued production.

FIGURE 27: Business status during COVID-19

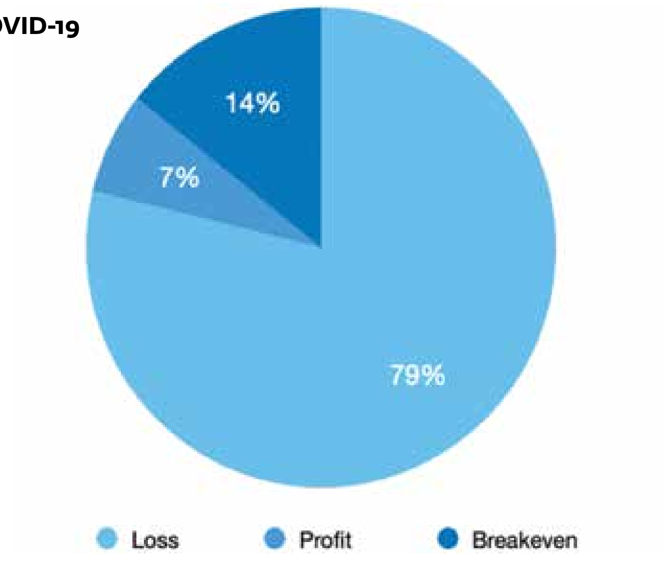


FIGURE 28: post-COVID-19 businesses' status

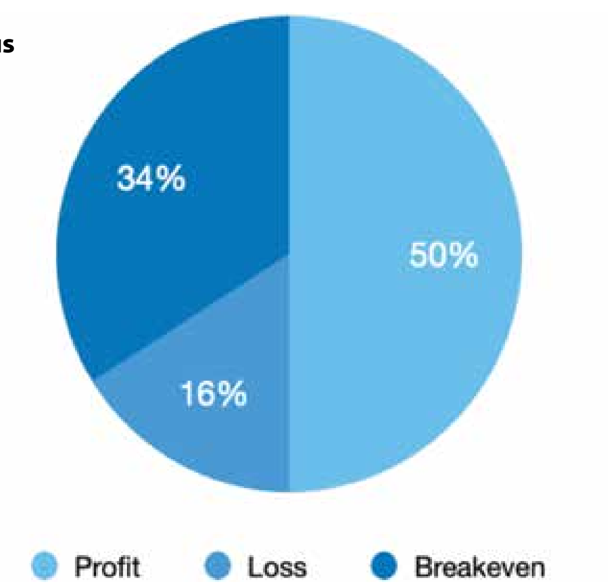
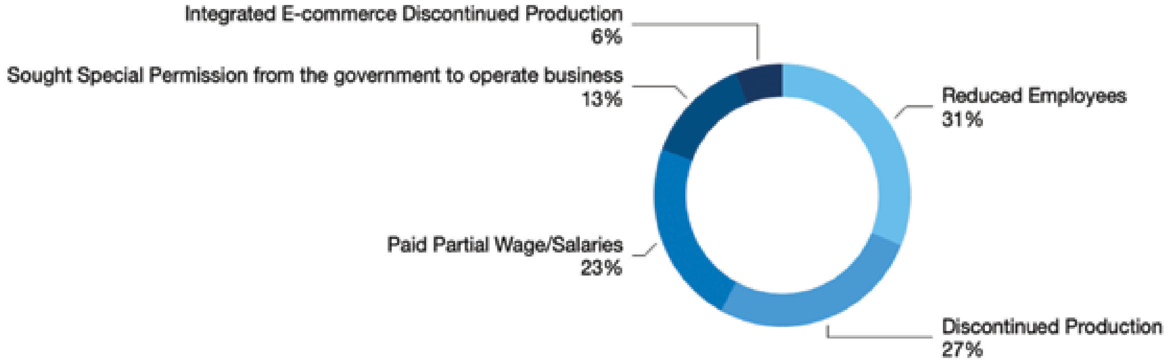


FIGURE 29: Adaptive measures taken during COVID-19



SECTION VII

Way Forward

Nepal's constitution has formally acknowledged the importance of the private sector as the key driver of the economy, as reflected in the country's periodic plans and annual budgets. Private sector involvement in national development has been a longstanding tradition since the inception of the state, gaining momentum with the government's liberalization, privatization, and globalization policies following the restoration of democracy in the 1990s.

Consequently, there have been notable positive changes in various sectors, such as the financial sector, hospitality, tourism, education, and health. Furthermore, the private sector's share of the GDP has steadily increased over the years. To unleash the potential for sustainable industrial development in the country, attracting private sector investment in areas of competitive and comparative advantages is vital.

The government has implemented various policies to support and encourage private sector investment, including easing regulatory provisions, introducing liberalized policies to promote entrepreneurship, and establishing public-private partnerships for infrastructure projects. However, there are significant challenges facing the private sector, including legal barriers, complicated registration and permission processes, inadequate financial resources, and difficulties in accessing preferential facilities and services. These challenges hinder the private sector's ability to invest and perform optimally, ultimately impacting the country's economic growth and development.

The private sector is facing challenges competing in the global economy due to its limited size and insufficient innovation. Most companies are small and operate in the informal market, lacking economies of scale and profitability. However, the scenario is changing as the market is becoming more liberalized, allowing foreign investment, and leading to growth in capacity through exposure to such investments.

Goals are not aligned between government and private sector partners. Steps need to be taken to create the necessary enabling environment through way of legal reforms in acts such as the Industrial Enterprise Act, Company Act, Forest Act, Land Administration Act, Insolvency Act, Foreign Investment and Technology Transfer Act, etc., evaluating program beneficiaries and tailoring interventions, piloting programs at a smaller scale, mobilizing and supporting local government bodies, and using team members with understanding of the private sector to address the needs and motivations of the sector.

Nepal should adopt a new growth strategy that prioritizes a competitive private sector. As there has been a growing concern regarding sustainability of remittances and migration and its long-term impacts on economy, a different approach is needed to reach its goal of becoming a middle-income country by 2030. Current growth projections suggest that maintaining recent averages for investment-to-GDP ratio, human capital growth, and productivity growth will not be enough. The new strategy should focus on increasing investment and productivity, and expanding access to global markets. As a small economy, outward orientation is crucial for firms to reach markets and become more competitive. This requires policies that enhance the productivity of key industries (such as transportation, energy, and IT), reduce business costs, and improve global value chain integration. Additionally, new sources of growth and revitalization of existing industries with high potential should be pursued, while investing in human capital and putting more people to productive use.

The following are the broad reforms carried out by the Government of Nepal to facilitate private sector:

- Public-private partnership: The government has established policies to on-board private sector involvement in economic, social, and infrastructure development projects.
- Liberalized policy: The government has introduced liberalized policies to promote private entrepreneurship and investment in developing industrial infrastructure.
- Bilateral and multilateral agreements: The government has established bilateral and multilateral agreements to expand private investment in the country.
- Legal and procedural reform: The government has been continuously reforming legal and procedural frameworks to protect and promote the private sector, ensuring trust between private sector entities and state operators.

Constraints for Private Sector and Potential Ways Forward

Productive sector: Nepal aims to achieve sustained and high economic growth by channelling financial resources into prioritized productive sectors. However, there are concerns about registration and operation of businesses, land availability, inadequate industrial infrastructure, complex processes for environmental impact assessment, challenges with forest land use, unreliable power supply, transportation costs, lack of financing, unclear policies, and issues related to intellectual property protection.

To address these challenges, initiatives such as establishing a one-stop-shop for industry management, public-private dialogue, adequate industrial infrastructure, promoting ancillary industries, uninterrupted power supply, promoting private sector development of industrial parks and exhibition centres, simplifying environmental impact assessment processes, amending forest laws, increasing road capacity, introducing quick response teams for industrial security, increasing investment in the productive sector, restructuring customs tariffs, promoting domestic industries, and introducing subsidies for export-based industries are recommended.

Agriculture sector: The agricultural sector is a potential area for private investment and commercialization. Despite progress made through plans and budgets, there are still several hindrances such as lack of land-use planning, limited access to quality inputs, insufficient infrastructure, ineffective regulations, and inadequate investment in research and technology.

To address these challenges, there is a need to encourage private sector investment in commercial farming, support technology-based agriculture, establish land-use planning, determine minimum support prices for major crops, facilitate the development of storage and infrastructure, introduce subsidies for agricultural infrastructure and equipment, ensure quality of inputs, promote indigenous seeds, implement holistic insurance systems, establish contract farming systems, improve irrigation facilities, establish fertilizer plants, introduce output-based subsidies, establish bulk agricultural markets, increase investment in research and technology, and provide tax incentives for corporate investment in agriculture.

Mining: Nepal has abundant mineral resources required for industry and construction, including limestone, coal, talc, red clay, granite, marble, gold, and precious and semi-precious stones. The country also possesses construction minerals such as construction aggregates, sand, gravel, dimension stone, decorative stones, paving stones, and roofing slates. Although international companies are attracted to mining business in Nepal, the sector faces various challenges including complex licensing processes, difficulties in obtaining environmental clearances, lack of infrastructure, local obstacles, interrupted power supply, duplication of taxes, lack of consensus to mobilize foreign investment, delayed approval processes for foreign investment, lack of technical expertise, and insufficient investment in processing plants.

To realize the potential of the mining industry in Nepal, important measures include simplifying licensing and environmental clearance processes, harmonizing taxation across government levels, resettling communities near mining areas, developing mining infrastructure through public-private partnerships, ensuring transparent licensing processes, incentivizing value-added exports, improving the country's human resources, and simplifying procedures to attract foreign investment.

Hydropower: Nepal has significant potential for hydropower generation, with a current installed capacity of 2205 MW out of 83,000 MW of total potential. Private investment in the sector has increased since the 1990s, but there are various challenges, such as difficulties in obtaining land for power plants, non-compliance with government commitments, and obstacles to obtaining commercial loans due to the absence of a sovereign credit rating.

To address these challenges, the government and stakeholders need to attract private sector investment by ensuring policy stability, facilitating investment in storage projects, simplifying land and environmental regulations, exploring export markets, completing cross-border transmission lines, and developing effective hedging policies for infrastructure projects. Additionally, exploring regional markets through government-to-government and business-to-business mechanisms would further support development of the sector.

Tourism: The tourism sector in Nepal is a significant source of foreign exchange earnings, but its contribution to the GDP is limited. The sector faces various challenges such as difficulties in acquiring public land for tourism infrastructure, limited access to credit, absence of a concrete plan to revive tourism after the COVID-19 pandemic, and excessive regulation involving multiple agencies. To overcome these challenges, long-term tourism policies and programs should be designed and implemented, and the process to acquire land for tourism should be simplified. In addition to this, there should be a provision for easy access to finance for the sector.

The private sector should be supported to develop quality and diversified tourism products, and traditional and new networks should be mobilized to promote tourism. Additionally, more air service agreements should be explored with potential tourism hub countries, adventure tourism should be promoted with new destinations, and incentives should be provided to tourism entrepreneurs.

Micro, Small, and Medium Enterprises have the potential to contribute to sustained and high economic growth in the country. However, despite measures and policy changes made in this area, the development of SMEs has not met expectations. To attract private investment in the sector, there are various constraints such as difficulty in registering businesses due to multiple government tiers, inadequate and unaffordable infrastructure for micro, small, and medium enterprises (MSMEs), lack of ownership towards the operation of the industrial village, limited access to financial resources from bank and financial institutions (BFIs), weak infrastructure for promoting markets, insufficient project-based lending, and lack of forward and value-chain linkages with larger industries.

To promote robust private sector investment in SMEs as a main driver of sustained and high economic growth, several steps need to be taken. These include establishing one-stop services for the registration, renewal, and regulation of MSMEs, developing digital platforms to deliver effective services, ensuring financing facilities to MSMEs, promote asset-backed lending for MSMEs, developing value chain linkages between MSMEs and larger industries, promoting and protecting MSMEs through taxation systems, and promoting start-up businesses through challenge funds and start-up funds.

Cross-Cutting Constraints and Recommendation for Private Sector Development in Nepal

Institutional Capacity for Implementing Policies

Due to frequent government changes, institutions face difficulties in separating policymaking from politics, resulting in high levels of political uncertainty that hinder private investment. Nepal needs to improve its policy design and implementation to enhance the ease of doing business and foster productive partnerships between the government and the private sector.

Complexity Posed by of Taxation Laws

Tax revenue collection has been consistently increasing over time, and this trend is expected to continue due to ongoing efforts to formalize and digitize the tax system. However, the government should remain vigilant about the challenges it faces in its tax system and address them promptly to incentivize the private sector. The tax system in Nepal is hindered by significant institutional constraints, including administrative and bureaucratic difficulties within the current Income Tax Act, which is complex and lacks accountability. Other challenges include high tax rates, tax collection leakages, complex income tax regulations, inefficient tax administration, lack of consolidated property records with the Inland Revenue Department, low taxation elasticity, limited potential for direct taxes, and negative land tax responsiveness with high administrative costs. To support rapid economic development and create a favorable business environment, Nepal must take initiatives to strengthen institutions, increase transparency and accountability, and simplify bureaucratic processes.

Policy Coherence

Likewise, the Patent Design and Trademark Act, 2022 (1965 A.D) governs patents, designs, and trademarks for the convenience and economic benefit of the general public, and the Copyright Act, 2059 (2002) intends to provide a legal framework related to copyrights are rather simplistic and may not respond well considering the pace and dynamics of globalized competition.

Fair Market Practices

Nepal has several laws aimed at preventing unethical business practices, including the Black Market and Some Other Social Crimes and Punishments Act, 2032 (1975 A.D), the National Offence (Code) Act, 2074 (2017), and the Consumer Protection Act, 2075 (2018 A.D). These laws cover various aspects of fair market practices and hold parties such as producers, importers, carriers, hoarders, sellers, and service providers liable for consumer services related to goods and services. While consumer protection is important, the government should also ensure that such laws do not hinder entrepreneurship and the growth of the industrial sector, which drives the economy. It is important for law enforcement authorities to implement these laws uniformly and with wisdom to achieve the desired outcomes.

Supply-Side Constrains to Exports

Nepal's exporters have faced challenges in taking advantage of trade agreements and preferential access due to limitations on the supply side. These exporters are mostly small and encounter difficulties in expanding their shipments once they enter new markets, which may be due to costly and unreliable electricity and limited transportation services. Moreover, high tariffs on crucial imported inputs have put Nepali exporters at a disadvantage. Compared to countries like Vietnam and Malaysia, Nepal has consistently imposed higher tariffs on the import of intermediate and capital goods.[48] However, the primary barriers for Nepalese exporters are internal, stemming from various business climate issues such as electricity supply and bureaucratic procedures. Textiles, which have been Nepal's primary export driver, are facing increasing competition from countries like Bangladesh and India. Evidence suggests that Nepal has primarily benefited from trade agreements as an importer rather than as an exporter, and firms have struggled to make full use of trade preferences provided by high-income countries under the Generalized System of Preferences (GSP).[49]

Investment Promotion

Nepal's public investment rate is low, but private investment has grown and contributes significantly to capital formation. However, obstacles to foreign investment and foreign exchange transactions limit the potential for private sector growth. For a country like Nepal, connecting with global markets could be a significant catalyst for economic expansion. Complex procedures, overly restrictive policies—including sector caps in the form of a long "negative list" of sectors barred from FDI—and restrictions on non-equity modes of investment that are often implemented in an inconsistent manner hinder FDI.[50] Such policies include limits on investment in certain sectors and restrictions on non-equity modes of investment, which are inconsistently implemented. Additionally, foreign trade and FDI are impeded by limitations on foreign-exchange transactions, such as complicated procedures for opening U.S. dollar-denominated bank accounts.

Nepal faces various challenges in its financial infrastructure that hinder its ability to provide credit to companies. The majority of businesses in Nepal are SMEs and many of them have movable assets as their primary assets. Nevertheless, the legal, regulatory, and institutional framework for financing movable assets needs to be improved to facilitate financing for these SMEs.

Quality of Basic and Connective Infrastructure

In the 2016 Global Competitiveness Index of infrastructure, Nepal's ranking was 130 out of 138 countries.[51] Similarly, Nepal secured the 124th position out of 160 countries in the 2016 Logistics Performance Index (LPI) and has lower road density compared to other countries. This is significant because industries such as agro-processing heavily rely on transportation as a crucial part of their input bundle.[52]

Nepal's private sector is facing significant challenges due to the current state of infrastructure, which is crucial for potential growth drivers such as tourism and agro-processing. The high cost of domestic transportation is a major issue due to poor infrastructure and logistics. These challenges are even more significant for foreign trade as it requires complex border procedures. According to international benchmarks, Nepal's tourism sector is not competitive due to the quality of air, ground, and tourist service infrastructure. For example, the inadequate road network makes it difficult to access many areas with nature-based tourism potential.

Nepal has limited land located close to roads due to its low road density. The dispersed locations of production and low quality of roads result in high costs for accessing markets and increased post-harvest losses. This poor transport infrastructure also increases transaction costs among regional, central, and border markets, which leads to the fragmentation of Nepal's agricultural markets.[53]

---

[48] Creating Markets in Nepal (2018) Country Private Sector Diagnostic. World Bank Group, IFC
[49] World Bank 2016b
[50] Creating Markets in Nepal (2018) Country Private Sector Diagnostic. World Bank Group, IFC
[51] World Economic Forum. 2016.
[52] Hollweg, Claire H. "From Evidence to Policy Supporting Nepal's Trade Integration Strategy: Diversifying Nepal's Economy through a Dynamic Services Sector." World Bank, Washington, D.C., 2016. https://openknowledge.worldbank.org/ handle/10986/24932 License: CC BY 3.0 IGO.
[53] Shively Gerald and Ganesh Thapa. 2017. Markets, Transportation Infrastructure, and Food Prices in Nepal, American Journal of Agricultural Economics, Volume 99, Issue 3, 1 April 2017, Pages 660–682, https://doi.org/10.1093/ajae/aaw086.

The aforementioned reform interventions require strong institutional and financial capacity as well as human capital development. The recommendations to develop the private sector have been developed while taking into account the capacity constraints of both the government and the private sector. The government faces major constraints such as a growing fiscal gap, limited investment in infrastructure, weak implementation capacity, and weak adaptation capacity of the reform initiatives. To address these constraints, it is necessary to develop strategies that can effectively implement these recommendations and enhance the role of the private sector in the economy.

On the other hand, the private sector is also beset with various constraints. Low levels of investment, high cost of finance, weak business networks, weak entrepreneurship capacity, and increased production costs are the major factors affecting the expansion of the private sector. In order to address these issues, collaboration between the government and the private sector is necessary to effectively implement reform agendas, taking into account the constraints faced by both actors in the economy.

Moving up the ladder from an underdeveloped country to a lower middle-income country is a significant achievement in terms of economic development. Nepal's progress in this regard has the potential to attract more foreign investment, which can provide a boost to the country's economy and enhance the competitiveness of the private sector. This can also create more job opportunities for Nepali citizens, which can help to alleviate poverty and improve living standards. Additionally, as Nepal continues to develop and improve its economic status, it can become more attractive to local and international private sector and investors, which can further enhance its growth potential.


HYUNDAI

Bibliography

1. GoN (2019), National Economic Census 2018: national report, Kathmandu: National Statistics Office
2. GoN (2012) Nepal Population Census 2021: national report, Kathmandu: National Statistics Office
3. GoN (2019), National Economic Census 2018: national report, Kathmandu: National Statistics Office
4. GoN (2019), National Economic Census 2018: national report, Kathmandu: National Statistics Office
5. International Monetary Fund. 2020. World Economic Outlook: A Long and Difficult Ascent. Washington, DC, October.
6. Attinasi, M. G., Balatti, M., Mancini, M., & Metelli, L. (2022)
7. International Monetary Fund. 2018. World Economic Outlook: Growth Slowdown, Precarious Recovery. Washington DC, April.
8. International Monetary Fund. 2020. World Economic Outlook: A Long and Difficult Ascent. Washington DC, October.
9. United Nations. 2021. The state of the least developed countries.
10. World Bank. (2019). Maximizing Finance for Development: Leveraging the Private Sector for Growth and Sustainable Development. World Bank.
11. ILO. the private sector, and employment promotion (PARDEV).https://www.ilo.org/pardev/public-private-partnerships/jobs-growth/lang--en/index.htm
12. World Economic Forum. (2020). Annual Report
13. United Nations Conference on Trade and Development. (2021). Investing in Sustainable Recovery.
14. International Finance Corporation (2018)
15. The World Bank. (2021). World Development Indicators. Retrieved from https://databank.worldbank.org/source/world-development-indicators#
16. Asian Development Bank. (2021). Development Indicators. Retrieved from https://www.adb.org/countries/Bangladesh/data
17. Bangladesh - Private Sector Infrastructure Development Project (English). Washington, D.C. : World Bank Group.http://documents.worldbank.org/curated/en/545421468741860256/Bangladesh-Private-Sector-Infrastructure-Development-Project
18. International Finance Corporation. (2019). Cambodia - Infrastructure Finance: A Pathway to Growth. Retrieved fromhttps://www.ifc.org/wps/wcm/connect/publications_ext_content/ifc_external_publication_site/publications_listing_page/cambodia-infrastructure-finance-pathway-to-growth
19. GoN. (2019) History of Nepal Customs. Department of Customs https://customs.gov.np/storage/History%20of%20Nepal%20Customs%20English%20Final%20printed_2020-03-11-20-40-18.pdf
20. Impact of Economic Libaralization in Nepal, Institute for Integrated Development Studies.

21. International Labour Organization. (2019). Nepal Labour Market Update. Retrieved from https://www.ilo.org/wcmsp5/groups/public/---Asia/---ro-bangkok/documents/publication/wcms_721127.pdf
22. GoN. (2021). Nepal Economic survey 2020/21, Kathmandu. Ministry of Finance
23. GoN. (2021). Nepal Economic survey 2020/21, Kathmandu: Ministry of Finance
24. Ezemenari,Kenechukwu Maria; Joshi,Nayan Krishna; Blum,Florian Michael; Varela,Gonzalo J.; Ganz Carulla,Federico.Nepal Development Update : Harnessing Export Potential for a Green, Inclusive, and Resilient Recovery (English). Washington, D.C. : World Bank Group. http://documents.worldbank.org/curated/en/332751617996242148/Nepal-Development-Update- Harnessing-Export-Potential-for-a-Green-Inclusive-and-Resilient-Recovery
25. NRB (2022), Monteary Policy 2022-23, Kathmandu. Nepal Rastra Bank.
26. Ezemenari,Kenechukwu Maria; Joshi,Nayan Krishna; Blum,Florian Michael; Varela,Gonzalo J.; Ganz Carulla,Federico.Nepal Development Update : Harnessing Export Potential for a Green, Inclusive, and Resilient Recovery (English). Washington, D.C. : World Bank Group. http://documents.worldbank.org/curated/en/332751617996242148/Nepal-Development-Update- Harnessing-Export-Potential-for-a-Green-Inclusive-and-Resilient-Recovery
27. GoN. (2021). Nepal Economic survey 2020/21, Kathmandu: Ministry of Finance
28. International Labor Organization (2021)
29. NRB (2021) Annual Report; Nepal Rastra Bank Kathmandu
30. Ibid
31. WTO (2020), Trade impact of LDC graduation, World Trade Organization, Geneva
32. As per the Doha Ministerial Declaration on the TRIPS Agreement and Public Health, adopted in November 2001, it originally exempted LDCs from protecting patents and undisclosed information for pharmaceutical products until 2016
33. GoN(2020). The Fifteenth Plan, Kathmandu: Nepal Planning Commission
34. GoN(2020): A report on State Owned Enterprieses in Nepal
35. International Finance Corporation (2018)
36. NSO 2018
37. Asian Development Bank. (2019): Macroeconomic Update
38. GoN (2019), National Economic Census 2018: national report, Kathmandu: National Statistics Office
39. GoN. (2021). Nepal Economic survey 2020/21, Kathmandu: Ministry of Finance
40. GoN (2019), National Economic Census 2018: national report, Kathmandu: National Statistics Office
41. NRB (2020); Survey report on FDI in Nepal
42. GoN (2019), National Economic Census 2018: national report, Kathmandu: National Statistics Office
43. GoN. (2021). Nepal Economic survey 2020/21, Kathmandu: Ministry of Finance
44. Nepal - Jobs Diagnostic (English). Issue No. 22,Jobs Series Washington, D.C. : World Bank-Group.http://documents.worldbank.org/curated/en/501501592797725280/Nepal-Jobs-Diagnostic
45. Ibid
46. Based on Mulabdic and Yasar (2021) in World Bank. 2021. Nepal Development Update
47. When a country has a revealed comparative advantage for a given product (RCA >1), it is inferred to be a competitive producer and exporter of that product relative to a country producing and exporting that good at or below the world average. A country with a revealed comparative advantage in a product is considered to have an export strength in that product. The higher the value of a country's RCA for a product , the higher its export strength in that product .
48. Ezemenari,Kenechukwu Maria; Joshi,Nayan Krishna; Blum,Florian Michael; Varela,Gonzalo J.; Ganz Carulla,Federico.Nepal Development Update : Harnessing Export Potential for a Green, Inclusive, and resilient Recovery (English). Washington, D.C. : World Bank Group

49. GoN (2022), Nepal Foreign Trade Statistics (2021/22): Department of Customs
50. GoN (2022), Nepal Foreign Trade Statistics (2021/22): Department of Customs
51. Calculation from NSO's National Accounts database, 2022
52. Ezemenari,Kenechukwu Maria; Joshi,Nayan Krishna; Blum,Florian Michael; Varela,Gonzalo J.; Ganz Carulla,Federico.Nepal Development Update : Harnessing Export Potential for a Green, Inclusive, and Resilient Recovery (English). Washington, D.C. : World Bank Group.
53. Joshi, P., and A. Antoni. 2019. "Mid-term evaluation of Nepal Trade Integration Strategy 2016." Manuscript, Kathmandu, GFA Consulting Group.
54. Creating Markets in Nepal (2018) Country Private Sector Diagnostic. World Bank Group, IFC
55. World Bank Group (2016b)
56. Creating Markets in Nepal (2018) Country Private Sector Diagnostic. World Bank Group, IFC
57. International Monetary Fund; 2016: World Economic Outlook Database
58. Hollweg, Claire H. "From Evidence to Policy Supporting Nepal's Trade Integration Strategy: Diversifying Nepal's Economy through a Dynamic Services Sector." Washington, DC: World Bank, 2016. https://openknowledge.worldbank.org/ handle/10986/24932 License: CC BY 3.0 IGO.
59. Gerald S and Thapa G. 2017. Markets, Transportation Infrastructure, and Food Prices in Nepal, American Journal of Agricultural Economics, Volume 99, Issue 3, 1 April 2017, Pages 660–682, https://doi.org/10.1093/ajae/aaw086.

FNCCI

IFC International Finance Corporation
WORLD BANK GROUP

Creating Markets, Creating Opportunities