
Nepal Competitiveness Index 2026

Supporting Nepal's Journey Towards Effective Planning

Foreword by
Lila Devi Gadtaula

Edited by

Jaya Jung Mahat

Juria Sato Bajracharya

A joint research initiative of

Nepal Competitiveness Index 2026

Supporting Nepal's Journey Towards Effective Planning

Advisor

Professor Paul Cheung, PhD
Director and Adjunct Professor
Asia Competitiveness Institute
Lee Kuan Yew School of Public Policy
National University of Singapore

Contributors

Jaya Jung Mahat, Lead Researcher and Project Lead
Yi Xin, PhD, ACI
Nischal Dhungel, NIPoRe
Juria Sato Bajracharya, NIPoRe
Pradhyumna Wagle, NIPoRe
Siddhartha Rayamajhi, NIPoRe
Anil Chaudhary, NIPoRe
Riddhimaa Gupta, ACI
Saurav Thapa Shrestha, NIPoRe

If you would like to request for an e-copy of the
whole book, please drop us an email at

aci@nus.edu.sg

Publishers' Note

Jointly Published by

Nepal Institute for Policy Research (NIPoRe),
Kathmandu, Nepal

AND

The Asia Competitiveness Institute (ACI),
Lee Kuan Yew School of Public Policy
(LKYSPP), National University of Singapore,
469C Bukit Timah Road, Wing A, Level 3,
Oei Tiong Ham Building, Singapore 259772

ISBN (hardcopy) 9789937-9839-4-5

ISBN (ebook) 9789937-9839-5-2

Citation

Mahat, J.J., and Bajracharya, J.S. (Ed.).
(2026). Nepal Competitiveness Index
2026: Supporting Nepal's Journey
Towards Effective Planning. Nepal Institute
for Policy Research (NIPoRe) and Asia
Competitiveness Institute (ACI).

For further information, please contact:

Jaya Jung Mahat

Yi Xin, PhD

Email: info@nipore.org

Price: NPR 500

Photos: Jaya Jung Mahat

Note

This publication may be reproduced in whole or in part and in any form for educational or nonprofit purposes with special permission from the copyright holders, provided the source is acknowledged. NIPoRe and ACI would appreciate receiving a copy of any publication that uses this publication as a source. No use of this publication may be made for resale or any other commercial purpose without the copyright holders' prior written permission. The contents of this publication do not necessarily reflect the views or policies of NIPoRe or ACI and do not imply the expression of any opinion concerning the legal status of any country, territory, city, or area of its authorities or concerning the delimitation of its frontiers.

This publication is available in electronic form at: www.nipore.org/nci

This work is licensed under a Creative Commons Attribution Non-Commercial, No Derivates 4.0 International License (<https://creativecommons.org/licenses/by-nc-nd/4.0/>)

About Publishers

Nepal Institute for Policy Research (NIPoRe)

Nepal Institute for Policy Research (NIPoRe) is an independent, nonpartisan research institute based in Kathmandu, Nepal. It generates evidence-based debates among citizens and critical stakeholders across the public and private sectors on contemporary policy issues in Nepal and Asia. The institution currently works on high-priority policy areas through four research centres: the Centre for New Economy and Inequality (CNEI), the Centre for Strategic Affairs (CSA), the Centre for Governance Studies (CGS), and the Centre for Human Development (CHD). NIPoRe's team members represent a diverse range of academic disciplines, professional backgrounds, and geographic locations. The institute adopts a multi-disciplinary approach in its analysis of policies and research, supported by researchers trained at universities and professional environments (from) across the globe.


 nipore.org

  [in niporeglobal](#)

 [@nipore.global](#)

Asia Competitiveness Institute (ACI)

The Asia Competitiveness Institute (ACI) was established in August 2006 as a research center at the Lee Kuan Yew School of Public Policy (LKYSPP), National University of Singapore (NUS). It aims to build intellectual leadership and a network to understand and develop competitiveness in Asia. ACI seeks to contribute to enhancing inclusive growth, living standards, and institutional governance through competitiveness research on sub-national economies in Asia.

 lkyspp.nus.edu.sg/aci

 [ACI.LKYSPP](#)

  [@aci_lkyspp](#)

 [in aci-lkyspp](#)

Preface

A decade into federalism, Nepal's public finance architecture has been markedly reconfigured, with federal transfers managed by subnational governments to meet local development needs. As Nepal approaches graduation from Least Developed Country (LDC) status, the effectiveness of this decentralised fiscal framework will become increasingly important in sustaining balanced growth across its seven provinces.

To enhance the understanding of this important transition, the Nepal Competitiveness Index (NCI) 2026 edition examines the performance of Nepal's fiscal federal system, assessing how intergovernmental transfers, provincial revenue mobilisation, and institutional capacity shape subnational outcomes. While Nepal has established a rules-based transfer system, the central question is how fiscal resources can be utilised efficiently and translated into tangible outcomes.

Since 2013, the Asia Competitiveness Institute (ACI) has conducted subnational economic analyses across ASEAN and other Asian economies. In 2022, Nepal Institute for Policy Research (NIPoRe) and ACI launched the first edition of the NCI, introducing a quantitative framework for assessing provincial competitiveness in Nepal. In 2023, the analysis expanded to include the digital economy. Last year, we incorporated the Provincial Competitiveness Perception Survey and examined the strategic distribution of Official Development Assistance (ODA) in the context of LDC graduation. These findings have been shared with federal and provincial stakeholders to inform economic development policy in Nepal.

Building on this foundation, the NCI 2026 focuses on the gap between fiscal allocation and utilisation, assessing which bottlenecks constrain the effective transmission of fiscal resources into subnational competitiveness. As Nepal advances beyond LDC status, these timely insights from the NCI 2026 will be particularly valuable. ACI will continue working with local partners to support Nepal's development priorities through rigorous, evidence-based analysis.

Professor Paul Cheung, PhD

Director, Asia Competitiveness Institute
Lee Kuan Yew School of Public Policy
National University of Singapore

Foreword

Nepal is at a crossroads. The journey toward federalism, constitutionally inaugurated in 2015, promised a new era of equitable governance, inclusive growth, and accountable public institutions, making it ambitious and transformative. Ten years later, the promise is clear, but the reality is mixed. Some provinces are emerging as engines of innovation and investment, while others continue to struggle with execution, transparency, and long-term planning. At this critical moment, the Nepal Competitiveness Index 2026 provides an invaluable compass, measuring not only resource allocation but, more importantly, how effectively provincial governments deliver tangible outcomes for their citizens.

This report arrives at a critical moment. The economy is recovering, provinces are finding their footing, and public expectations for transparency and accountability are at an all-time high, particularly in the wake of the 2025 youth-led protests. The Index offers an evidence-based, comprehensive analysis of provincial performance, highlighting both achievements and structural challenges in efficiency, fiscal management, and long-term planning.

The findings are compelling that while Bagmati continues to drive national growth, smaller provinces such as Gandaki and Karnali are emerging as engines of innovation and investment. Conversely, regions such as Madhesh face persistent hurdles. Beyond numbers, the report captures the lived realities of businesses, investors, and communities, revealing governance gaps, regulatory bottlenecks, and human capital constraints that must be addressed for federalism to be truly inclusive.

A major contribution of the NCI 2026 lies in its rigorous examination of Nepal's fiscal federalism. Despite constitutionally guaranteed revenue-sharing arrangements and the distributive role of the National Natural Resources and Fiscal Commission, provincial governments continue to face persistent challenges: low capital budget absorption, heavy dependence on federal transfers, and the volatility of conditional and special grants. These structural issues undermine long-term planning and dilute local accountability. The analysis presented in this volume moves beyond institutional design to interrogate how fiscal arrangements operate in practice and how they shape incentives for provincial governments.

Methodologically, this edition represents a significant advancement. The Index ranks Nepal's seven provinces using sixty-four indicators across four broad dimensions: macroeconomic stability; governance and institutional settings; financial, business, and manpower conditions; and quality of life and infrastructure development. In addition, NCI 2026 incorporates a Provincial Competitiveness Perception Survey, enabling a rare integration of quantitative indicators with firm-level and stakeholder perceptions. By combining hard data with local insights, this approach enables policymakers to ground decisions in on-the-ground realities rather than relying on formal metrics alone, thereby improving the relevance and precision of policy interventions.

Importantly, the Nepal Competitiveness Index 2026 does not confine itself to diagnosis. It offers a pragmatic and forward-looking policy roadmap centred on the principle of performance-based federalism. By advocating fiscal incentives linked to measurable service-delivery outcomes, strengthened audit and accountability mechanisms, and strategic investments in digital infrastructure, human capital, and small-business support, the Index presents a credible pathway to restoring public trust and enhancing provincial competitiveness. The underlying message is clear that federalism will succeed not through the distribution of resources alone, but through the consistent delivery of results.

This book will be of immense value to policymakers, public administrators, scholars, development partners, and citizens committed to Nepal's democratic and economic future. By grounding normative debates in rigorous analysis and actionable recommendations, the Nepal Competitiveness Index 2026 sets a new benchmark for evidence-informed policymaking in Nepal. I hope that this work will not only inform debate but also inspire the decisive reforms needed to ensure federalism becomes a vehicle for inclusive growth, accountability, and shared prosperity.

Lila Devi Gadtaula

Chairperson, Commission of Investigation on Enforced Disappeared Persons, Nepal
Former Chief Secretary, Government of Nepal

Table of Contents

| | |
|---|-------------|
| Preface | I |
| Foreword | III |
| Executive Summary | IX |
| Acknowledgement | XIII |
| List of Figures | XXIII |
| List of Tables | XXV |
| List of Abbreviations | XXVII |
| Chapter 1 Introduction | 1 |
| 1.1 Macroeconomic Snapshot | 1 |
| 1.1.1 GDP Growth and Economic Structure | |
| 1.1.2 Inflation, Prices, and Monetary Stability | |
| 1.1.3 External Sector and Trade Competitiveness | |
| 1.1.4 Remittance and the Diaspora Economy | |
| 1.1.5 Fiscal Position and Public Finance | |
| 1.1.6 Investment Climate and Financial Sector | |
| 1.1.7 Employment, Labour Market, and Productivity | |
| 1.1.8 Infrastructure and Connectivity | |
| 1.2 Competitiveness Performance by Provinces | 17 |
| 1.3 Fiscal Federalism as a Driver of Competitiveness | 20 |
| 1.4 Emerging Challenges and Opportunities for 2026 | 23 |
| 1.5 Conclusion | 24 |
| Chapter 2 Research Methodology | 29 |
| 2.1 Introduction | 29 |
| 2.2 Provincial Competitiveness Ranking Framework | 29 |
| 2.3 Nepal Competitiveness Index Study Framework | 30 |

| | |
|--|-----------|
| 2.3.1 Macroeconomic Stability | |
| 2.3.2 Government and Institutional Setting | |
| 2.3.3 Financial, Businesses and Manpower Conditions | |
| 2.3.4 Quality of Life and Infrastructure Development | |
| 2.4 NCI Provincial Perception Survey | 34 |
| 2.5 Computation of Competitiveness Ranking Using Equal Weights | 34 |
| 2.6 The Standardised Score | 25 |
| 2.7 What-if Competitiveness Simulation Analysis | 36 |
| 2.8 Conclusion | 37 |
| | |
| Chapter 3 Provincial Competitiveness Analysis | 41 |
| 3.1 Introduction | 41 |
| 3.2 Competitiveness Analysis Results for Seven Provinces of Nepal | 42 |
| 3.2.1 Overall Competitiveness Ranking of Provinces | |
| 3.2.2 Competitiveness Analysis Results for Koshi | |
| 3.2.3 Competitiveness Analysis Results for Madhesh | |
| 3.2.4 Competitiveness Analysis Results for Bagmati | |
| 3.2.5 Competitiveness Analysis Results for Gandaki | |
| 3.2.6 Competitiveness Analysis Results for Lumbini | |
| 3.2.7 Competitiveness Analysis Results for Karnali | |
| 3.2.8 Competitiveness Analysis Results for Sudurpaschim | |
| 3.3 Analysis of Two Best and Two Lagging Performing Provinces by Environments | 54 |
| 3.3.1 Macroeconomic Stability | |
| 3.3.2 Government and Institutional Setting | |
| 3.3.3 Financial, Businesses and Manpower Conditions | |
| 3.3.4 Quality of Life and Infrastructure Development | |
| 3.4 What-if Competitiveness Simulation Analysis on Overall Competitiveness | 68 |
| 3.5 What-if Competitiveness Simulation Analysis by Four Environments | 69 |
| 3.5.1 Macroeconomic Stability | |
| 3.5.2 Government and Institutional Setting | |
| 3.5.3 Financial, Businesses and Manpower Conditions | |
| 3.5.4 Quality of Life and Infrastructure Development | |
| 3.6 Conclusion | 76 |

| | |
|--|------------|
| Chapter 4 Lessons from Provincial Competitiveness Perception Survey | 81 |
| 4.1 Introduction | 81 |
| 4.2 Research Design | 81 |
| 4.2.1 Survey Design | |
| 4.2.2 Sampling Framework | |
| 4.2.3 Sample size and distribution | |
| 4.2.4 Data collection process | |
| 4.2.5 Data analysis | |
| 4.3 Key Provincial Competitiveness Perception Survey Findings | 86 |
| 4.3.1 National-level summary | |
| 4.3.2 Provincial Profiles | |
| 4.3.3 Cross-Cutting Insights from Perception Data | |
| 4.3.4 Perception Gaps Vs Reality | |
| 4.4 Key Takeaways from Provincial Competitiveness Perception Survey | 117 |
| 4.5 Conclusion | 118 |
| Chapter 5 Fiscal Federalism and Provincial Budget Performance | 123 |
| 5.1 Introduction | 123 |
| 5.2 Conceptual Framework | 125 |
| 5.3 Methodology | 127 |
| 5.4 Fiscal Allocation Patterns Across Provinces | 130 |
| 5.5 Fiscal Utilisation and Efficiency | 136 |
| 5.6 Fiscal Accountability and Transparency | 139 |
| 5.7 Policy Implications and Recommendations | 144 |
| 5.8 Conclusion | 146 |
| Chapter 6 Policy Recommendations | 151 |
| 6.1 Introduction | 151 |
| 6.2 Environment-Wise Policy Recommendations | 152 |
| 6.1.1 Macroeconomic Stability | |
| 6.1.2 Government and Institutional Setting | |
| 6.1.3 Financial, Businesses and Manpower Conditions | |
| 6.1.4 Quality of Life and Infrastructure Development | |
| 6.2 Way Forward | 184 |

Appendix **187**

Appendix I: List of Indicators for Provinces of Nepal

Appendix II: Definition of Indicators and Proxy Methods

Appendix III: Computation of Rankings Using Equal Weights – The Algorithm

Appendix IV: Types of Intergovernmental Fiscal Grants Under IGFA, 2074

Appendix V: Provincial Expenditure Details (NPR in 10 Millions)

Appendix VI: Alignment of Policy Recommendations with Nepal

Competitiveness Index (NCI) Scoring Logic and Empirical Fiscal Indicators

Appendix VII: About the Contributors

References **206**

Executive Summary

The Nepal Competitiveness Index (NCI) 2026 is the fourth edition of the book published by the Nepal Institute for Policy Research (NIPoRe) and the Asia Competitiveness Institute at the Lee Kuan Yew School of Public Policy, National University of Singapore. The NCI 2026 ranks Nepal's seven provinces based on 64 indicators spread across four environments, namely (i) Macroeconomic Stability, (ii) Government and Institutional Setting, (iii) Financial, Business, and Manpower Conditions, and (iv) Quality of Life and Infrastructure Development. In addition, the current edition of the index highlights key insights from the NIPoRe-administered provincial competitiveness perception survey, which interviewed 140 business executives across seven provinces. Finally, the book also includes a separate thematic chapter on "Fiscal Federalism and Provincial Performance in Nepal".

As Nepal navigates the pivotal transition to LDC graduation by the end of 2026, the functional maturity of our federal framework is being tested to the limit. After decades of observing the evolution of our economic setting, it has become clear that national growth is no longer determined solely in Kathmandu; it is now forged in the unique socio-economic characteristics of Nepal's seven provinces.

This executive summary serves as a strategic roadmap for provincial governments to redirect their focus from basic administrative establishment toward the pursuit of macroeconomic stability and institutional excellence. We must bridge the persistent gap between provincial planning and on-the-ground implementation by grounding our policy actions in rigorous analysis and the direct experiences of local business leaders and the youth. Across all regions, a vital common thread has emerged: the urgent need to restore the social contract by improving fiscal credibility and transparency. Provinces must move toward a delivery-first governance model that prioritises the institutionalisation of project banks, multi-year procurement frameworks, and digital accountability tools to ensure every rupee of public spending translates into actual service delivery and durable infrastructure.

In **Koshi**, the priority must be to aggressively **mobilise own-source revenue** to build a resilient fiscal base and reduce a precarious reliance on volatile federal transfers. This requires an overhaul of **capital expenditure efficiency** through rigorous project pipeline management, ensuring that infrastructure is climate-resilient and execution-ready from

day one. To bridge the trust gap with the private sector, Koshi must modernise investor-facing services and implement **predictable administrative processes** to address the severe dissatisfaction currently felt regarding export performance and foreign direct investment. Following recent socio-economic shifts and Gen-Z protests, it is critical to institutionalise financial accountability by mandating consistent reporting that explicitly links public spending to **tangible service delivery outcomes**. Furthermore, Koshi should focus on **industrial diversification** and firm-level productivity to address structural constraints in outward-oriented sectors. The province must adopt a **Disclosure by Default** mandate, requiring the online publication of draft budget ceilings and resource estimates to curb bureaucratic corruption and establish itself as a leader in subnational competitiveness.

Madhesh faces a significant technical capacity gap in project design and feasibility analysis, which has led to the loss of federal complementary and special grants due to **appraisal non-compliance**. To secure a stable macroeconomic environment, Madhesh must institutionalise a governance model that mandates coordination across provincial and local tiers to address public anxiety about **spending transparency**. Policy actions must prioritise **agricultural modernisation**, moving beyond basic farming to mechanisation and agro-processing, while rolling out targeted vocational training to address labour productivity mismatches. To convert its demographic potential into a growth engine, Madhesh needs to overhaul its investor-facing services and reduce the **100 percent dissatisfaction rate with foreign investment** through reliable administrative processes. This includes strengthening governance effectiveness and coordination to improve policy implementation and service delivery across all levels. To combat political volatility, Madhesh must institutionalise a **permanent administrative framework** and a Static Project Management Office staffed by merit-based experts to shield long-term projects from frequent political transitions.

Bagmati, as the leading economic engine, must now focus on diversifying into **high-value service exports and light manufacturing** to strengthen its external competitiveness. The provincial government should prioritise lowering logistics and regulatory costs through **modernised freight systems** and market infrastructure to position itself as a competitive regional trade hub. There is a critical need to bridge the fiscal credibility gap by institutionalising **independent verification of large-scale capital projects** and ensuring that budget performance data is published transparently and frequently. Bagmati should establish a **centralised investment facilitation mechanism** to provide predictable administrative processes and a clear project pipeline for investors. To overcome chronic capital underutilization, the province must synchronise its planning with federal funding windows and modernise **procurement management**. By adopting an Integrated Financial Management System and introducing **Value-for-Money audits**, Bagmati can maximise the quality of its spending and maintain its position as the primary driver of Nepal's post-graduation growth.

For **Gandaki**, long-term resilience depends on expanding **year-round tourism** and strengthening agricultural value chains to reduce income seasonality. The government must develop **multi-year investment planning frameworks** to shift from volatile, project-driven grants to more stable, conditionally funded federal programs. Restoring public

trust requires institutionalising stronger **project governance**, enforcing clear procurement timelines, and providing routine, transparent reporting on contract implementation. Gandaki needs to modernise road connectivity and logistics to ensure local production can access markets with minimal friction. Administrative reforms should specifically target the **near-100 percent dissatisfaction with foreign direct investment** by streamlining approvals and ensuring consistent service delivery. Additionally, Gandaki should launch **remittance-linked investment schemes** to redirect household capital into productive SMEs and agro-industries. To improve labour force participation, the province must institutionalise **women's economic inclusion** through childcare-linked training and safe commuting incentives.

Lumbini must strengthen its project preparation capacity and systematic appraisal processes to improve the **absorption of conditional and complementary grants**, thereby reducing volatility in development spending. A decisive overhaul of the investment climate is necessary, including establishing clear **land-use and zoning frameworks** to address gaps in foreign investment satisfaction. Tourism-led activity should transition toward more stable, investment-driven growth by modernising destination infrastructure and integrating local suppliers into the value chain. To ensure regional price stability, the government must prioritise investments in **agricultural logistics and storage**. Closer coordination between provincial line ministries and local governments is essential to eliminate procurement delays. Lumbini should also implement a **Digital Accountability Framework** to address systemic dissatisfaction with fiscal transparency and offer **Formalisation Incentives** for businesses in the tourism and agriculture sectors that transition to the formal economy.

In **Karnali**, the government must prioritise building foundational productive capacity by scaling up support for **agro-processing and organic farming**, alongside critical improvements in transport and energy access to reduce prohibitive transaction costs. It is imperative to restore the credibility of public spending through **rigorous project management and procurement oversight** to reverse the 100 percent dissatisfaction among local entrepreneurs regarding budget execution. Karnali must bridge its trade gap by **simplifying import-export processes** and reducing market-access barriers. To broaden its domestic investment base, the province needs to lower entry barriers for firms and improve access to finance. Given its heavy reliance on federal equalisation grants, Karnali must strengthen **inter-ministerial coordination and treasury systems** to transform these inflows into tangible health, education, and infrastructure services. Radical transparency is required through a public-facing e-governance portal that makes **every rupee of capital expenditure traceable**, ensuring last-mile service delivery reaches remote districts.

Sudurpaschim must broaden its productive base by supporting agro-processing and diversifying tourism beyond seasonal limits. Modernising logistics and cross-border trade facilitation, particularly through projects like the **Dodhara Chandani Dry Port**, is essential for exports to consistently contribute to growth. To address the 100 percent public concern about expenditure performance, the province must institutionalise **rigorous transparency and contract oversight**. Sudurpaschim should launch a **Fiscal Absorption**

Acceleration Program and establish strategic partnerships with federal agencies to build the internal procurement and engineering capacity needed for large-scale projects. Improved coordination with local governments is needed to reduce **project fragmentation** and ensure federal grants are utilised for high-impact outcomes. The province should also emphasise **digital finance** to reduce dependence on physical banking and build a targeted skills pipeline to reduce bottlenecks that hinder market access.

Ultimately, these policy pathways empower provincial stakeholders to convert federal transfers into sustainable, own-source wealth and competitive advantages. By enacting these evidence-based reforms, provincial governments can move beyond ad hoc political responses toward a stable, predictable, and integrative economic future that meets the rising aspirations of Nepal's public and its youth. National prosperity is now inextricably linked to deliberate, localised policy steps to strengthen growth momentum and improve economic resilience across all seven provinces.

Acknowledgement

The Nepal Competitiveness Index (NCI) 2026 is prepared by a team of researchers at the Nepal Institute for Policy Research (NIPoRe) and the Asia Competitiveness Institute (ACI) at the Lee Kuan Yew School of Public Policy, National University of Singapore. NIPoRe Director Jaya Jung Mahat led the study team of Nischal Dhungel, Siddhartha Rayamajhi, Juria Sato Bajracharya, Pradhyumna Wagle, Dr Yi Xin and Riddhimaa Gupta. The entire study was completed under the advice and guidance of ACI Director Professor Paul Cheung. Anil Chaudhary supported the cleaning and analysis of the provincial competitiveness perception survey data. Saurav Thapa Shrestha oversaw the document's overall design.

Additional support from the research and administrative teams at NIPoRe and ACI remained crucial to the study's successful completion. In particular, we would like to acknowledge the support of Mr Santosh Sharma Poudel (Co-Director, NIPoRe), Supun Dahal (Researcher, NIPoRe), Ms Tracy Cai Jiao (Senior Manager, ACI), Ms Lyne Po Lai Yin (Assistant Manager, ACI), Ms Nur Atiqah Binte Rhamat (Executive, ACI), and Dewi Jelina Ayu Binte Johari (Management Assistant Officer, ACI) in managing central logistics for the study. We also highly appreciate the contributions of NIPoRe Early Career Policy Research Fellows – Suvexa Pradhan Tuladhar and Mallika Ojha, in managing the event logistics.

In addition, we would also like to show our appreciation for the feedback and comments on the NCI 2026 working drafts from ACI researchers Dr Banh Thi Hang, Dr Bian Tingbin, Dr Liang Zixuan, Dr Nguyen Tran Bao Phuong, Dr Song Yunlong, Yan Bowen, Adam Bin Romzi, Chew Zhe Lin, Parag Dass, Gianina Amadira, Goh Yuh Xian, Huang Yijia, Mukund Kishore, Lian Huiyuan, Miranda Lu, Lu Weilin, Ma Qi Xiang, and Tran Thi Ngoc My.

We are equally grateful to Lila Devi Gadtula, former Chief Secretary, for writing the foreword to the fourth edition of the book.

Our sincere thanks also extend to key government ministries and department officials in Kathmandu and across the provinces for providing the essential data for our analyses and for their valuable input during both formal and informal preparatory meetings.

Finally, we thank all business executives from seven provinces for providing province-specific personal perceptions and experiences of key competitiveness factors during the provincial competitiveness perception survey.

List of Figures

- Figure 1.1** Nepal Annual GDP Growth Rate (In Percentage)
- Figure 1.2** Nepal Inflation Rate (In Percentage)
- Figure 1.3** Nepal's Balance of Trade (in NPR Millions)
- Figure 1.4** Remittance and the Diaspora Economy
- Figure 1.5a** Federal government budget size and Expenditure Pattern (NPR in Billion)
- Figure 1.5b** Trends of Allocation Vs Actual Spending (NPR in Billion)
- Figure 1.5c** Trend of Revenue Sources (NPR in Billion)
- Figure 1.5d** Trend of Public Debt (NPR in Billion)
- Figure 1.6** Trends of FDI (NPR in Billion)
- Figure 1.7** Employment, Labour Market, and Productivity
- Figure 2.1** Provincial Competitiveness Ranking Framework
- Figure 3.1** Two Best Performers in the Macroeconomic Stability Environment for 2024
- Figure 3.2** Two Lagging Performers in the Macroeconomic Stability Environment for 2024
- Figure 3.3** Two Best Performers in the Macroeconomic Stability Environment for 2025
- Figure 3.4** Two Lagging Performers in the Macroeconomic Stability Environment for 2025
- Figure 3.5** Two Best Performers in the Government and Institutional Setting Environment for 2024
- Figure 3.6** Two Lagging Performers in the Government and Institutional Setting Environment for 2024
- Figure 3.7** Two Best Performers in the Government and Institutional Setting Environment for 2025
- Figure 3.8** Two Lagging Performers in the Government and Institutional Setting Environment for 2025

Figure 3.9 Two Best Performers in the Financial, Business and Manpower Conditions Environment for 2024

Figure 3.10 Two Lagging Performers in the Financial, Business and Manpower Conditions Environment for 2024

Figure 3.11 Two Best Performers in the Financial, Business and Manpower Conditions Environment for 2025

Figure 3.12 Two Lagging Performers in the Financial, Business and Manpower Conditions Environment for 2025

Figure 3.13 Two Best Performers in the Quality of Life and Infrastructure Development Environment for 2024

Figure 3.14 Two Lagging Performers in the Quality of Life and Infrastructure Development Environment for 2024

Figure 3.15 Two Best Performers in the Quality of Life and Infrastructure Development Environment for 2025

Figure 3.16 Two Lagging Performers in the Quality of Life and Infrastructure Development Environment for 2025

Figure 4.1 Age of the Respondents

Figure 4.2 Institutional Roles and Responsibilities of the Respondents

Figure 4.3 Distribution of Respondents Across Key Economic Sectors

Figure 4.4 Company Size of the Respondents

Figure 4.5 Presence of Enterprises in Different Provinces (in percentage)

Figure 4.6 Satisfaction with Economic Growth Rate

Figure 4.7 Satisfaction with Economic Growth Rate by Age Group

Figure 4.8 Satisfaction with Province Contribution to GDP

Figure 4.9 Satisfaction with Province Contribution to GDP by Sector

Figure 4.10 Satisfaction with Public Spending Concern

Figure 4.11 Satisfaction with Public Spending Concern by Sector

Figure 4.12 Export of Goods and Services Satisfaction

Figure 4.13 Import of Goods and Services Satisfaction

Figure 4.14 FDI Stock Satisfaction Levels

Figure 4.15 Local Private Investment Satisfaction Levels

Figure 4.16 Map of Provincial Dissatisfaction with Transparency in Budget and Policy Formulation

Figure 4.17a Ease of Registering a Business Province-Wise

Figure 4.17b Ease of Registering a Business Sector-Wise

- Figure 4.18** Key Strengths of the Province
- Figure 4.19a** Provincial Distribution of Perception About Corruption
- Figure 4.19b** Age-wise Perception of Corruption
- Figure 4.20** Evaluation of the Availability of Financing Sources
- Figure 4.21** Ease of Obtaining Credit or Loans for Expanding Business Activities
- Figure 4.22** Availability of Skilled Labour
- Figure 4.23** Satisfaction With Women’s Participation in Local Industry and Businesses
- Figure 4.24** Satisfaction With the Results of the Company’s Investment in the Workforce
- Figure 4.25** Major Barriers to Business Ownership and Investment
- Figure 4.26** Perception of Availability of Health Services by Province
- Figure 4.27** Level of Satisfaction Regarding Road Infrastructure Across Sectors by Province
- Figure 4.28** Satisfaction Related to the Responsiveness of Provinces to Damages in Road Infrastructure
- Figure 4.29** Contribution of Major Provincial Infrastructure Projects for Livelihood Opportunities
- Figure 4.30** Satisfaction With the Availability of Educational Opportunities
- Figure 4.31** Market Accessibility by Province
- Figure 5.1** Total Expenditure of Highest- and Lowest-Spending Provinces in FY 2023/24

List of Tables

Table 1.1 Province Annual GDP (In NPR millions)

Table 1.2 Province Compound Annual Growth Rate (CAGR), 2018/19 – 2024/25

Table 1.3 Nepal's Top Five Exports and Imports (in NPR Millions)

Table 1.4 Banking Stability Indicator – Composite Index (A, B, and C class aggregate)

Table 3.1 Overall Competitiveness Ranking of Provinces with Score for 2024/25

Table 3.2 Competitiveness Analysis Results for Koshi for 2024 and 2025

Table 3.3 Competitiveness Analysis Results for Madhesh for 2024 and 2025

Table 3.4 Competitiveness Analysis Results for Bagmati for 2024 and 2025

Table 3.5 Competitiveness Analysis Results for Gandaki for 2024 and 2025

Table 3.6 Competitiveness Analysis Results for Lumbini for 2024 and 2025

Table 3.7 Competitiveness Analysis Results for Karnali for 2024 and 2025

Table 3.8 Competitiveness Analysis Results for Sudurpaschim for 2024 and 2025

Table 3.9 What-if Competitiveness Analysis Results for 2024 and 2025

Table 3.10 What-if Competitiveness Simulation for Macroeconomic Stability

Table 3.11 What-if Competitiveness Simulation for Government and Institutional Setting

Table 3.12 What-if Competitiveness Simulation for Financial, Business and Manpower Conditions

Table 3.13 What-if Competitiveness Simulation for Quality of Life and Infrastructure Development

Table 5.1 Total Transfers by Grant Type (All Provinces Combined) (NPR in lakh)

Table 5.2 Province-Wise Total Transfers by Year (2078/79–2082/83) (NPR in lakh)

Table 5.3 Province-Wise Equalisation Grants (2078/79–2082/83) (NPR in Lakh)

Table 5.4 Province-Wise Conditional Grants (2078/79–2082/83) (NPR in lakh)

Table 5.5 Province-Wise Special Grants (2078/79–2082/83) (NPR in lakh)

Table 5.6 Province-Wise Complementary Grants (2078/79–2082/83) (NPR in lakh)

Table 5.7 Annual Province Per Capita GDP (in NPR)

Table 5.8 Provincial Audit Irregularities, FY 2023/24 (NPR in billion)

List of Abbreviations

| | |
|-----------------|--|
| ACI | Asia Competitiveness Institute |
| ADB | Asian Development Bank |
| BFI | Banks and Financial Institutions |
| BSI | Banking Stability Index |
| CAGR | Compound Annual Growth Rate |
| CBOs | Community-Based Organisations |
| CEO | Chief Executive Officer |
| CNI | Confederation of Nepalese Industries |
| COO | Chief Operating Officer |
| COVID-19 | Coronavirus Disease 2019 |
| FATF | Financial Action Task Force |
| FBMC | Financial, Business and Manpower Conditions |
| FDI | Foreign Direct Investment |
| FNCCI | Federation of Nepalese Chambers of Commerce and Industry |
| FY | Fiscal Year |
| GDP | Gross Domestic Product |
| GIS | Government and Institutional Setting |
| GSDP | Gross State Domestic Product |
| ICT | Information and Communication Technology |
| IT | Information Technology |
| LDC | Least Developed Country |
| LG | Local Government |
| MIDEQ | Migration for Development and Equality |
| MoF | Ministry of Finance |
| MS | Macroeconomic Stability |
| NCC | Nepal Chamber of Commerce |
| NCI | Nepal Competitiveness Index |
| NCPI | National Consumer Price Index |
| NIPoRe | Nepal Institute for Policy Research |
| NNRFC | National Natural Resources and Fiscal Commission |
| NPR | Nepali Rupee |
| NRB | Nepal Rastra Bank |
| NSO | National Statistics Office |
| OAG | Office of the Auditor General |
| ODA | Official Development Assistance |
| PIM | Public Investment Management |
| QLID | Quality of Life and Infrastructure Development |
| USD | United States Dollar |





01

Introduction

Chapter 1 Introduction

1.1 Macroeconomic Snapshot

- 1.1.1 GDP Growth and Economic Structure
- 1.1.2 Inflation, Prices, and Monetary Stability
- 1.1.3 External Sector and Trade Competitiveness
- 1.1.4 Remittance and the Diaspora Economy
- 1.1.5 Fiscal Position and Public Finance
- 1.1.6 Investment Climate and Financial Sector
- 1.1.7 Employment, Labour Market, and Productivity
- 1.1.8 Infrastructure and Connectivity

1.2 Competitiveness Performance by Provinces

1.3 Fiscal Federalism as a Driver of Competitiveness

1.4 Emerging Challenges and Opportunities for 2026

1.5 Conclusion

Introduction

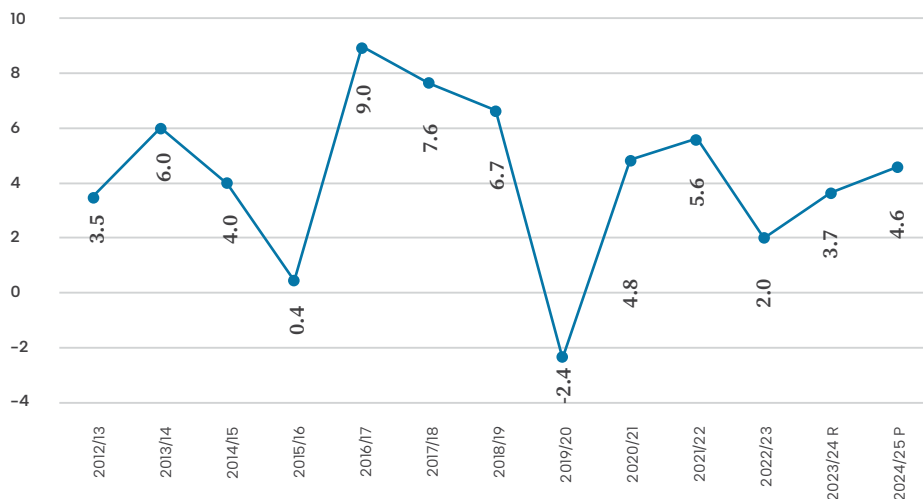
Chapter I provides an overview of Nepal's current economic landscape and competitiveness outlook. It begins with a macroeconomic snapshot that reflects recent trends in real and nominal Gross Domestic Product (GDP) and sectoral performance, including the gradual shift from an agriculture-based to a more services- and industry-focused economy. The section also links provincial GDP shares to differences in provincial competitiveness and highlights inflation and monetary stability, trade and remittance patterns, fiscal and financial developments, labour market conditions, and progress in infrastructure development. The summary findings of the National Competitiveness Index (NCI) 2025 report are also included in this chapter, demonstrating the linkages between provincial performance and key economic indicators. In addition, the chapter examines fiscal federalism as a crucial driver of competitiveness, focusing on revenue autonomy and intergovernmental transfers as key enablers. This section concludes with a forward-looking view of the challenges and opportunities Nepal faces in 2026, including significant external risks, fiscal reforms, and the potential for digital transformation and infrastructure-driven growth.

1.1 Macroeconomic Snapshot

1.1.1 GDP Growth and Economic Structure

Nepal's economic performance over the past five years has shown moderate growth and a resilient recovery. The country's real Gross Domestic Product (GDP) contracted by 2.4 percent in Fiscal Year (FY) 2020 before gradually regaining momentum, recording two percent in FY 2023 and 3.9 percent in FY 2024, as improvements were seen in agriculture, hydropower generation, and tourism. In nominal terms, GDP reached NPR 2,679 billion in FY 2023/24 and is projected to increase further to NPR 2,797 billion in FY 2024/25 (NSO, 2025). The World Bank has significantly lowered Nepal's economic growth projection for FY 2025/26 to 2.1 percent in light of recent political instability and social unrest (World Bank, 2025). Nominal GDP trends, which are more volatile due to inflation and trade shocks, are also expected to stabilise in the medium term as inflation moderates and external conditions improve (NSO, 2025).

Figure 1.1 Nepal Annual GDP Growth Rate (In Percentage)



Source: Nepal Statistics Office

Nepal's economic growth is primarily driven by the service sector, followed by agriculture and industry. Agriculture, which accounted for NPR 705 billion in output in FY 2023/24, grew by 3 percent but is projected to slow slightly to 2.8 percent in FY 2024/25. The industrial sector, with NPR 1,261 billion in output in FY 2023/24, remained weak, growing by only 1.3 percent amid contractions in construction and manufacturing. However, it is forecasted to rebound to 3.9 percent in FY 2024/25, supported by hydropower expansion and improved credit conditions (MoF, 2025). Services continue to be the most significant contributor, generating NPR 1,940 billion in FY 2023/24, with 4.5 percent growth, and are projected to expand further by 4.8 percent in FY 2024/25. The sector's momentum is underpinned by a revival in tourism, strengthening trade, and rapid growth in information and communication technology (ICT) exports (ADB, 2025).

Nepal's structural transformation is gaining momentum, shifting toward higher-value-added activities. The agriculture sector's share of GDP has steadily increased, contributing 25.2 percent in FY 2024/25, compared to 24.7 percent in FY 2023/24 (MoF, 2024/25). The industrial sector contributes approximately 15 percent, while services dominate, accounting for over 60 percent of GDP (NSO, 2025). Agriculture remains critical for rural employment and food security, but its declining contribution provides an opportunity for diversification. The industrial sector is gradually improving, particularly through hydropower and construction, although manufacturing continues to face demand-side pressures. Services now define Nepal's growth trajectory, absorbing labour, fuelling urban demand, and expanding foreign-exchange earnings through tourism and ICT. This structural change, from an agriculture-based economy to one led by services, with industry as a supporting pillar, can emerge as a new engine of growth. Nepal's growth pattern is slow but steady, reflecting its ongoing transition toward higher-value-added goods and services (ADB, 2025).

Table 1.1 Province Annual GDP (In NPR millions)

| P/Y | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25* | Share in National GDP |
|-----|----------|----------|----------|----------|----------|----------|----------|-----------------------|
| K | 3,41,851 | 3,36,608 | 3,52,330 | 3,70,889 | 3,80,005 | 3,91,422 | 4,02,103 | 0.16 |
| M | 2,90,813 | 2,79,806 | 2,91,409 | 3,05,283 | 3,09,276 | 3,19,907 | 3,32,328 | 0.13 |
| B | 7,65,013 | 7,36,158 | 7,70,043 | 8,15,401 | 8,33,538 | 8,61,829 | 9,01,114 | 0.36 |
| G | 1,86,661 | 1,84,375 | 1,91,924 | 2,02,566 | 2,10,803 | 2,18,777 | 2,29,464 | 0.09 |
| L | 3,00,487 | 2,94,940 | 3,08,421 | 3,22,995 | 3,30,280 | 3,42,265 | 3,56,240 | 0.14 |
| K | 80,503 | 81,232 | 84,961 | 88,824 | 90,994 | 93,682 | 97,541 | 0.04 |
| S | 1,43,935 | 1,45,031 | 1,51,410 | 1,58,022 | 1,60,820 | 1,65,597 | 1,70,086 | 0.07 |

Source: Nepal Statistics Office (NSO)
*Projected

Note: P/Y: Province/Year, K: Koshi, M: Madhesh, B: Bagmati,
G: Gandaki, L: Lumbini, K: Koshi, S: Sudurpashchim

Nepal's Gross State Domestic Product (GSDP) varies considerably across provinces in terms of size and competitiveness. Bagmati stands out as the country's largest economy, with a real GDP of NPR 1,083.6 billion (approximately 36 percent of the national GDP), driven by its strengths in services, industry, and public administration (NSO, 2025). Koshi recorded NPR 457.2 billion, accounting for nearly 16 percent of the national GDP. In comparison, Lumbini, at NPR 408.7 billion, and Madhesh, at NPR 377.2 billion, contributed roughly 14 percent and 13 percent, respectively, each supported by agriculture, manufacturing, and proximity to the Indian border. Gandaki reached NPR 263.5 billion, representing nearly nine percent of the national GDP, driven by its comparative advantages in tourism and hydropower. By contrast, Sudurpashchim, at NPR 196.9 billion, and Karnali, at NPR 115.9 billion, remain the smallest provincial economies, together contributing just over 10 percent of total output. Both continue to face structural challenges related to remoteness, weak infrastructure, and limited industrial activity (NSO, 2025).

An analysis of the Compound Annual Growth Rate (CAGR) over the six years from FY 2018/19 to FY 2024/25 shows that Gandaki (3.5 percent CAGR) and Karnali (3.2 percent CAGR) recorded the fastest growth, while Madhesh (2.3 percent CAGR) experienced the slowest expansion. Although Bagmati remains the largest economy, the momentum of annual growth has increasingly shifted toward smaller provinces by economic size. Gandaki and Karnali achieved the most substantial annual expansions, driven by tourism recovery, energy development, and infrastructure investment. Lumbini (2.8 percent CAGR) and Sudurpashchim (2.8 percent CAGR) also demonstrated solid performance. In contrast, Bagmati (2.7 percent CAGR) and Koshi (2.7 percent CAGR) expanded steadily but at more moderate rates. Madhesh, despite its strategic importance in agriculture and cross-border trade, registered the weakest growth over the review period (NSO, 2025).

Table 1.2 Province Compound Annual Growth Rate (CAGR), 2018/19 – 2024/25

| Province | 2018/19 (NPR millions) | 2024/25* (NPR millions) | Compound Annual Growth Rate (CAGR) in Percent |
|---------------|---------------------------|----------------------------|--|
| Koshi | 3,41,851 | 4,02,103 | 2.7 |
| Madhesh | 2,90,813 | 3,33,228 | 2.3 |
| Bagmati | 7,65,013 | 9,01,114 | 2.7 |
| Gandaki | 1,86,661 | 2,29,464 | 3.5 |
| Lumbini | 3,00,487 | 3,56,240 | 2.8 |
| Karnali | 80,503 | 97,541 | 3.2 |
| Sudurpashchim | 80,503 | 97,541 | 2.8 |
| Nepal | 21,09,263 | 24,89,776 | 2.9 |

Source: Author (Nischal) calculation based on NSO 2024/25 Province GDP data

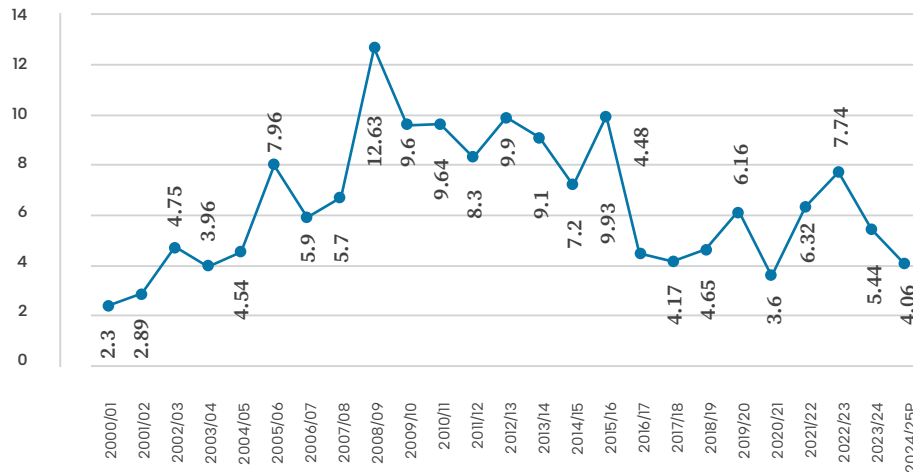
*Projected

1.1.2 Inflation, Prices, and Monetary Stability

Inflation in Nepal has eased compared to previous years, but it continues to weigh on households and remains a challenge for policymakers. The National Consumer Price Index (NCPI) shows that average inflation slowed from 5.4 percent in FY 2023/24 to a projected 4.06 percent in FY 2024/25, while core inflation, particularly in non-food and services, softened to 3.71 percent from 4.64 percent (NRB, 2025). Food remains the primary source of price pressure, with fruits, ghee, oil, and pulses recording sharp annual increases of 10.47 percent, 8.72 percent, 7 percent, and 7 percent, respectively. By contrast, the prices of meat, fish, and spices stabilised, bringing partial relief to consumers. Non-food costs also added upward pressure, especially in education, restaurants, accommodation, housing, and utilities. These trends, driven by domestic supply disruptions, weather-induced fluctuations in agricultural production, and imported inflation from global commodity markets, continue to leave Nepal vulnerable to recurring shocks (ADB, 2025).

The Economic Survey 2024/25 highlighted that price pressures vary significantly across the geographical areas and products (MoF, 2025). As of February 2025, inflation stood at 3.25 percent in Kathmandu Valley, 3.77 percent in the hills, 3.71 percent in the Terai, and 4.77 percent in the mountain region. Rural areas experienced inflation of 3.18 percent, slightly lower than the 3.60 percent observed in urban areas, where exposure to rising service costs is higher. On the product side, petroleum products, fruits, and various goods and services saw the sharpest increases, while prices of spices, vegetables, and some meats declined. Wholesale price inflation remained moderate at 3.43 percent, compared with 3.66 percent the previous year, with primary goods recording higher price growth than manufactured products (MoF, 2024/25).

Figure 1.2 Nepal Inflation Rate (In Percentage)



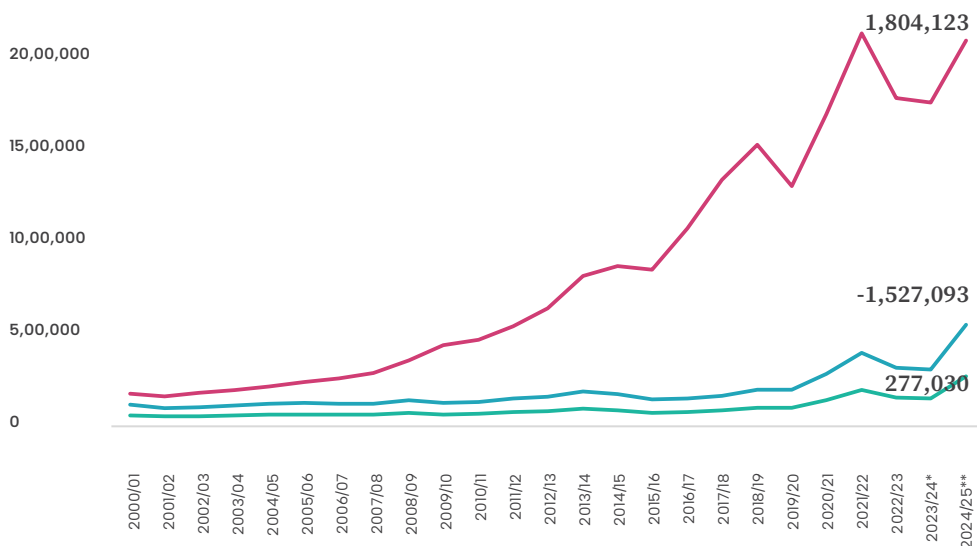
Source: Nepal Rastra Bank, National Consumer Price Index as of August 2025

Nepal Rastra Bank (NRB) unveiled its Monetary Policy in July 2025 and adopted a flexible, accommodative monetary stance for FY 2025/26 to revive growth while maintaining stability (NRB, 2025). The central bank’s focus is on supporting a sluggish economy where non-performing loans had climbed to 5.05 percent by April 2025, and the post-pandemic recovery has remained uneven. The policy aims for 12 percent private sector credit growth to complement the government’s 6 percent GDP target, channelling funds toward housing, agriculture, and small enterprises. It also eases rules on working capital loans, extends grace periods until 2027, and raises limits on margin lending, while strengthening anti-money laundering measures to address concerns from the Financial Action Task Force (FATF). Interest rates remain steady, with the policy rate at 5 percent, the deposit rate at 3 percent, and the bank rate at 6.5 percent, helping to lower borrowing costs. Commercial banks have followed suit, reducing deposit rates to around 6.5–7.5 percent and base lending rates to 9–11 percent. While this pro-business shift signals intent to boost credit flow and investment, risks remain from growing loan defaults and heavy reliance on remittances.

1.1.3 External Sector and Trade Competitiveness

Nepal’s external sector remains dominated by a large trade deficit, despite some encouraging growth in exports. In FY 2023/24, exports totalled NPR 152.4 billion, while imports reached NPR 1,593 billion, resulting in a deficit of NPR 1,440.6 billion. For FY 2024/25, exports are projected to increase to NPR 180.4 billion, while imports are expected to reach NPR 2,770.3 billion, resulting in a further widening of the deficit to NPR 1,590.9 billion (NRB, 2025). Hence, the pace of import growth far outstrips the gains in exports, making the external sector one of the most fragile parts of Nepal’s economy.

Figure 1.3 Nepal’s Balance of Trade (in NPR Millions)



Source: Nepal Rastra Bank

* Revised
** Projected

Nepal’s trade structure remains highly concentrated, with a narrow export basket dominated by soybean oil and a heavy reliance on petroleum and other essential imports. Soybean oil alone accounts for nearly 38.5 percent of total exports, followed by polyester yarn and thread, woollen carpets, zinc sheets, and jute goods. Traditional exports, such as tea, cardamom, and pashmina, remain essential but relatively small in value. Electricity exports, however, have been steadily rising and now represent a promising area of diversification. Imports, on the other hand, remain concentrated on petroleum products, which account for 16 percent of the total, along with large volumes of crude soybean oil, transport equipment, machinery, and chemical fertilisers (MoF, 2025). This dependence on fuel, machinery, and other essentials means Nepal’s trade balance is highly sensitive to global price changes and supply disruptions.

Nepal’s foreign trade remains heavily import-driven, with only marginal improvement in the export-to-import ratio and a widening deficit despite overall trade growth. Nepal’s export-to-import ratio is improving slightly to 15.4 percent in FY 2024/25, up from below 10 percent over the past two years (NRB, 2025). India remains the dominant partner, accounting for more than 80 percent of Nepal’s exports and nearly 60 percent of its imports. Trade with China, although growing, still accounts for less than 1 percent of exports, while accounting for 18 percent of imports. Meanwhile, other countries account for around 18 percent of exports and 22 percent of imports, offering limited diversification. While total foreign trade expanded by 19.2 percent in FY 2024/25, the persistent and widening trade deficit of over NPR 15 trillion reflects Nepal’s continued reliance on imported fuel, machinery, and consumer goods, despite a narrow and undiversified export base.

Table 1.3 Nepal's Top Five Exports and Imports (in NPR Millions)

| Rank | Imports | Amount (2024/25)* | Exports | Amount (2024/25)* |
|------|--------------------------------|-------------------|-------------------------|-------------------|
| 1 | Petroleum Products | 287,788.2 | Soybean Oil | 106,790.8 |
| 2 | Crude Soyabean Oil | 108,002.3 | Polyester Yarn & Thread | 13,580 |
| 3 | Transport Equip. & Spare Parts | 96,223.6 | Woolen Carpet | 10,773.4 |
| 4 | Other Machinery | 82,283.8 | Zinc Sheet | 10,108.5 |
| 5 | Ferrous Products | 48,766 | Jute Goods | 8,222.9 |

Source: Nepal Rastra Bank

*Projected

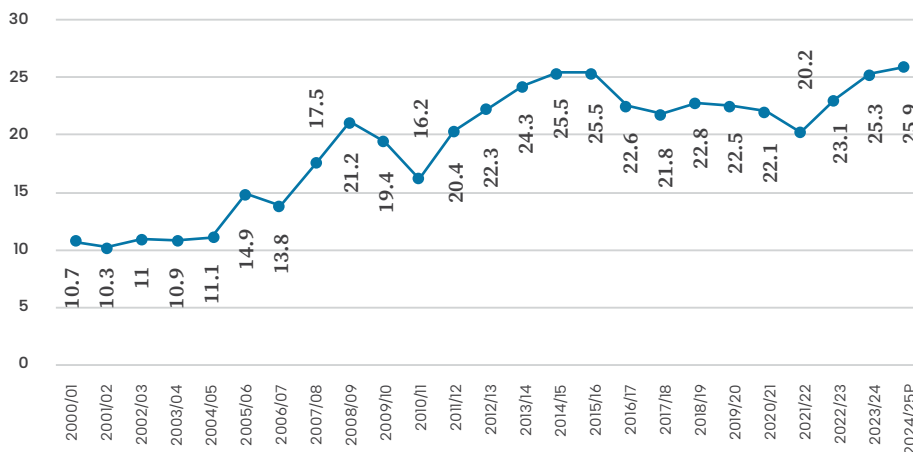
Nepal's external sector has remained resilient, supported by stable reserves and rising remittances, though risks persist from a large trade deficit and import dependence. Nepal's currency remained broadly stable, despite some depreciation, with the rupee weakening by 2.66 percent against the US dollar in mid-July 2025 compared to the same period a year earlier. The external balance temporarily improved in FY 2024, as the current account recorded a surplus of 3.9 percent of GDP (NRB, 2025). At the same time, gross foreign exchange reserves climbed to USD 19.50 billion (NPR 2,677.68 billion), providing sufficient cover for 18.2 months of merchandise imports or 15.4 months of goods and services imports, which provides a comfortable external buffer. With rising remittances (25 percent of GDP) playing a stabilising role in Nepal's balance of payments and helping finance the persistent trade deficit, sustaining this inflow while ensuring the welfare of migrant workers remains a critical challenge for policymakers. However, the current account surplus may not last long unless Nepal reduces its trade deficit in FY 2026, as rising imports, especially of capital goods and services, outpace export growth (ADB, 2025). There is a pressing need to improve competitiveness in goods and services, expand electricity and Information Technology exports, add more value to traditional goods, and reduce dependence on imported energy and capital goods, all of which are essential to improving the current account surplus (MoF, 2025).

1.1.4 Remittance and the Diaspora Economy

Migrant remittances continue to contribute significantly to Nepal's total GDP. Remittance inflows reached their highest level in FY 2024/25 at 25.9 percent, a 19.2 percent increase from FY 2023/24 (NRB, 2025). Since 2011, remittances have consistently made up at least 20 percent of the GDP and have been on an upward trend since the pandemic. Nepal is one of the most remittance-dependent economies in South Asia (World Bank, 2025), receiving inflows more than eight times the South Asian average.

As a result of strong remittances, foreign currency reserves surged to a record high in FY

Figure 1.4 Remittance and the Diaspora Economy



Source: Nepal Rastra Bank (2025)

2024/25, providing a financial cushion to external shocks and stabilising the economy. The continuous flow of remittances has been a lifeline for many households in Nepal over the past decade, helping meet household expenses, invest in education and healthcare, and improve the standard of living. Overall, remittances have also contributed to reducing poverty by nearly 32 percent between 2011 and 2023 (NIPoRE, 2024). Despite receiving substantial remittance inflows over the past decades, it is increasingly evident that these funds in Nepal have been predominantly used for daily consumption. In 2021/22, approximately 73 percent of remittances were spent on household consumption (NIPoRE, 2024). The share allocated to productive sectors – such as business investment or capital formation – remains relatively low, highlighting a persistent lack of domestic investment driven by remittance income.

Nepal is increasingly evolving into a diaspora-shaped economy, with large-scale migration of the working-age population continuing at a significant rate. About 3.5 million people are working abroad, representing a notable 14 percent of the total population in Nepal (MIDEQ, 2025). In 2024/2025, the number of Nepali workers receiving first-time approval for foreign employment increased by 9.9 percent, from 505,957 to 460,102 in the previous year. Likewise, Nepali migrant workers seeking approval to renew their labour permits increased by approximately 18 percent, from 281,195 to 333,309 in 2024/25 (NRB, 2025). Current levels of remittance dependency make Nepal's economy particularly vulnerable to external shocks and to any crisis in the destination countries of migrants. In the medium term, steady levels of remittance inflows can present a valuable opportunity to channel capital into key sectors of the economy, creating livelihoods within Nepal and fostering long-term economic growth and development (NIPoRE, 2024).

1.1.5 Fiscal Position and Public Finance

Banking sector stability

NRB (2025) defines the Banking Stability Index (BSI) as a composite indicator that combines multiple financial ratios to gauge the overall soundness of the banking system. It includes the measures of asset quality (such as non-performing loans), capital strength (capital adequacy ratio), liquidity position (net liquid assets ratio), operational efficiency, and profitability.

Table 1.4: Banking Stability Indicator – Composite Index (A, B, and C class aggregate)

| Period | Soundness | Profitability | Liquidity | Sensitivity | Efficiency | Asset Quality | Composite Index |
|---------------|-----------|---------------|-----------|-------------|------------|---------------|-----------------|
| Mid-July 2021 | 0.06 | 0.09 | 0.27 | 0 | 0.63 | 0.32 | 0.23 |
| Mid-July 2022 | 0.16 | 0 | 0.66 | 0.35 | 0.87 | 0.25 | 0.38 |
| Mid-July 2023 | 0.49 | 0.27 | 0.42 | 0.44 | 0.58 | 0.82 | 0.5 |
| Mid-July 2024 | 0.8 | 0.5 | 0.22 | 0.76 | 0.73 | 0.88 | 0.65 |

Source: Financial Stability Report, FY 2023/24, NRB

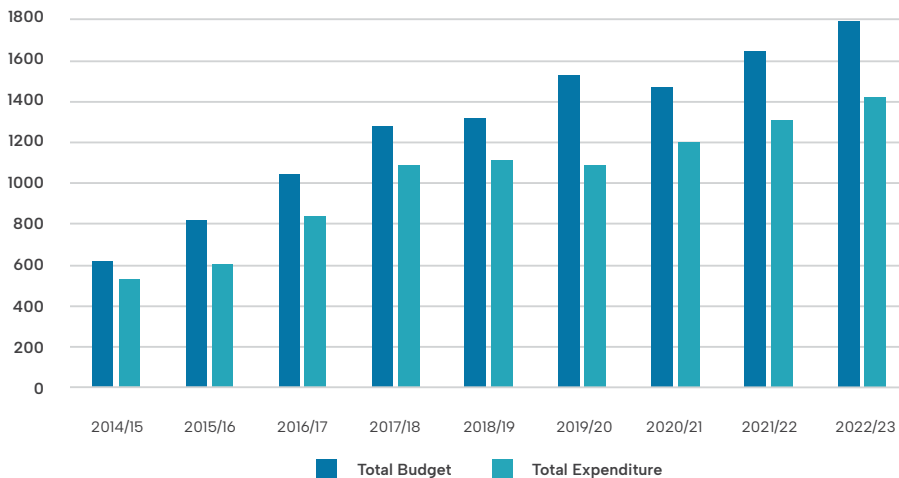
The composite index of the Banking Stability Indicator (A, B, and C class aggregate) has increased from 0.23 in mid-July 2021 to 0.65 in mid-July 2024. The rise in the composite index highlights the increased level of overall risk in banking stability. Liquidity has been on the comfortable side and visibly shows no risk at the end of the period under study. The Indicator shows an improvement over the period. However, risk in the soundness has surged significantly and stands at a score of 0.80. Similarly, the asset quality, profitability, and sensitivity have been sticky on a higher side as of mid-July 2024, indicating the concentration of risks in these indicators.

Central Government Budget Size and Expenditure Priorities

While Nepal's budget has grown in ambition year after year, persistent deficits and under-expenditure reveal deep inefficiencies in public spending. Figure 1.5a clearly illustrates a significant disparity between the total budget and total expenditure. The total budget of Nepal has grown steadily over the past decade. In FY 2014/15, the total budget was NPR 618 billion, which steadily rose to NPR 1,794 billion in FY 2022/23. However, this upward trend tells only half the story. The total expenditure has consistently fallen short of the planned budget. Each government has consistently failed to utilise the allocated budget fully. Over the years, the total spending has fallen short with an annual average of 20.04 percent. The gap ranged from 14 percent in FY 2014/15 to a peak of 28.8 percent in FY 2019/20, a year marked by significant budget execution challenges associated with the onset of the COVID-19 pandemic.

The breakdown between recurrent and capital expenditures reveals even deeper

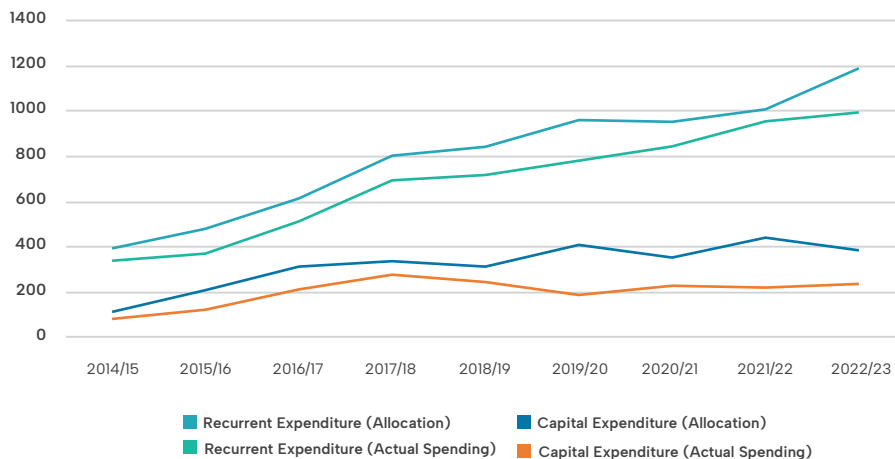
Figure 1.5a: Trends of Allocation Vs Actual Spending (NPR in Billion)



Source: Financial Comptroller General Office (FCGO)

mismanagement (see Figure 1.5b), with a persistent gap between allocated and actual spending on recurrent and capital expenditures. Recurrent expenditure refers to the government spending on ongoing costs to maintain public services and administration, such as interest, pensions, salaries, social security, and subsidies. On the other hand, capital expenditure includes investing in long-term assets, such as development programs, equipment, and infrastructure projects, to expand the economy’s productive capacity.

Figure 1.5b: Trends of Allocation vs Actual Spending (NPR in Billion)



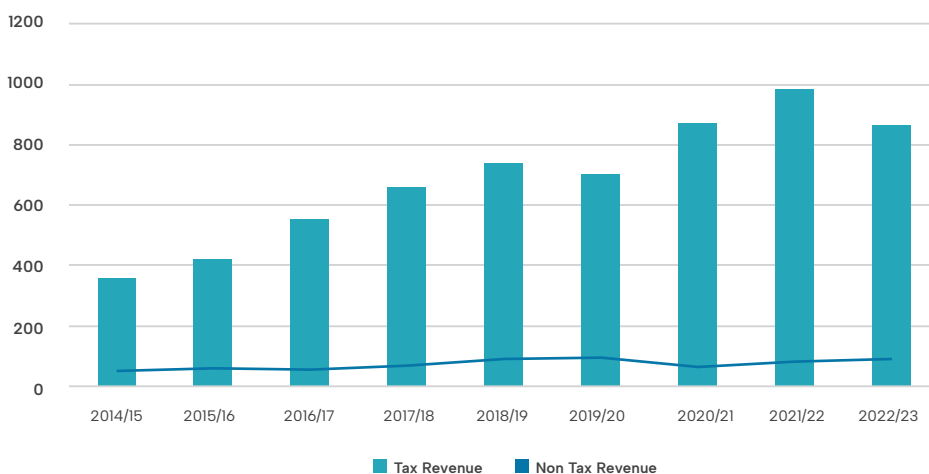
Source: Office of The Auditor General

The recurrent expenditure is high compared to capital expenditure in Nepal. Rimal (2023) finds that spending on recurrent expenditure tends to have a stronger and more immediate effect on the GDP. In FY 2022/23, NPR 1,183 billion was allocated for recurrent spending, while NPR 380 billion was earmarked for capital expenditure. However, actual spending fell short of allocations in both expenditures, with recurrent expenditure underspending by an annual average of 14.7 percent and capital expenditure by a much larger average of 35.30 percent over the nine years.

Revenue Sources

Nepal’s revenue collection over the past decade has reflected a strong dependence on tax revenues as the primary source of government income. Nepal’s experience reveals a notable difference between the impacts of tax and non-tax revenue. Non-tax revenue consistently shows positive and significant relationships with economic growth, whereas tax revenue demonstrates positive but insignificant effects (Shrestha & Kautish, 2020; Thapa, 2023).

Figure 1.5c Trend of Revenue Sources (NPR in Billion)



Source: Economic Survey of Nepal 2023/24

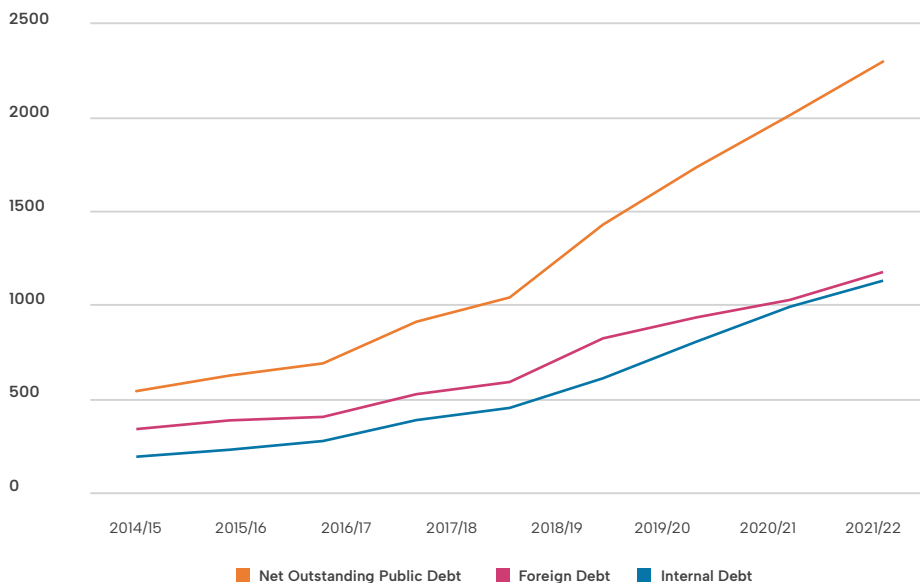
Between fiscal years 2014/15 and 2022/23, tax revenue consistently accounted for the majority of total government earnings, rising from NPR 355.96 billion in FY 2014/15 to a peak of NPR 984.33 billion in FY 2021/22, before slightly declining in FY 2022/23. Similarly, the tax-to-GDP ratio in Nepal has increased sharply from 1990 to 2021. In 2021, the rate was noted at 17.5 percent. In contrast, non-tax revenue remained comparatively modest and fluctuating, ranging from NPR 49.91 billion to NPR 93.69 billion during the same period. The steady growth in tax collections highlights improvements in revenue administration and economic activity, while the relatively stagnant non-tax revenue highlights Nepal’s limited diversification of income sources beyond taxation.

Public debt levels

The rising public debt over the past decade reflects the country’s growing fiscal dependence on borrowing to sustain development and welfare spending. The impact of public debt on economic growth has long been a subject of debate in the macroeconomic literature. Panizza and Presbitero (2014) find that, while debt and growth are negatively correlated, this relationship disappears once endogeneity is addressed, providing no evidence of a causal effect of public debt on economic growth. Studies on public debt and economic growth in South Asian countries reveal predominantly negative relationships between the two. Akram (2014) examined Bangladesh, India, Pakistan, and Sri Lanka from 1975–2011, finding that both external debt and debt servicing negatively affect economic growth and investment through “debt overhang” and “crowding out” effects.

Between fiscal years 2014/15 and 2022/23, (see figure 1.5d) the net outstanding public debt surged from NPR 544.92 billion to NPR 2,295.44 billion, marking a more than fourfold increase. This expansion was driven by simultaneous growth in both foreign and domestic debt. Foreign debt rose steadily from NPR 343.26 billion in FY 2014/15 to NPR 1,170.25 billion in FY 2022/23, while internal debt expanded from NPR 201.66 billion to NPR 1,125.19 billion during the same period. The upward trajectory highlights Nepal’s increasing reliance on domestic and external borrowing to finance fiscal deficits, particularly during the post-2015 earthquake reconstruction phase and the COVID-19 recovery years. While this borrowing has supported development expenditure, the rapid

Figure 1.5d: Trend of Public Debt (NPR in Billion)



Source: Economic Survey of Nepal 2023/24

accumulation of debt underscores the need for prudent debt management and stronger domestic revenue mobilisation to ensure long-term fiscal sustainability.

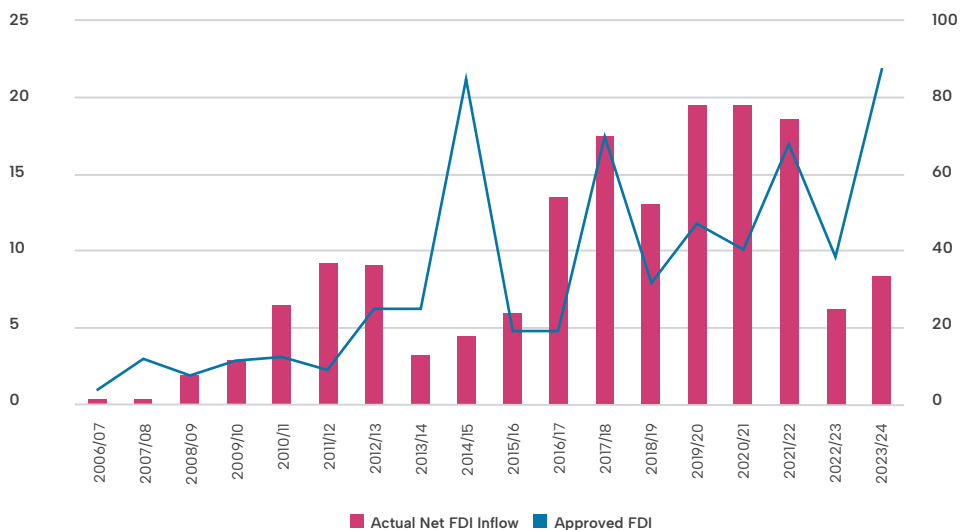
1.1.6 Investment Climate and Financial Sector

Foreign Direct Investment (FDI) trends over the past two decades reveal a persistent gap between approved FDI commitments and actual net inflows, underscoring structural and policy challenges in translating investment commitments into actual capital inflows.

The top ten sectors attracting FDI in Nepal include Agriculture, Energy, Tourism, Transportation, Manufacturing, ICT, Health, Mines, and Minerals, Education, Banking, and Finance (Investment Board of Nepal, 2025).

Figure 1.6 shows that, in the fiscal years 2006/07 and 2023/24, approved FDI fluctuated sharply – from as low as NPR 3 billion in 2006/07 to a peak of NPR 69.83 billion in 2023/24 – indicating periodic surges in investor interest. However, actual net FDI inflows remained considerably lower, rising modestly from NPR 0.36 billion in 2006/07 to NPR 8.40 billion in 2023/24, with notable peaks in 2011/12 (NPR 9.20 billion) and 2019/20 (NPR 19.48 billion). This widening gap highlights Nepal’s long-standing challenges in converting investment approvals into tangible inflows, often due to bureaucratic hurdles, regulatory uncertainties, and inadequate infrastructure. Most importantly, studies show that the number of key factors plays a significant role in attracting FDI, such as market size, economic growth, infrastructure, trade openness, human capital, and political stability.

Figure 1.6: Trends of FDI (NPR in Billion)



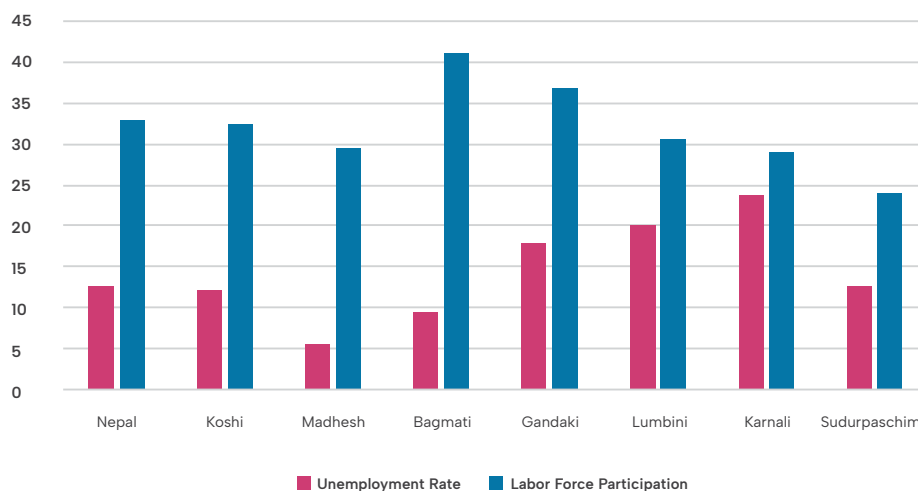
Source: Survey Report on Foreign Direct Investment in Nepal (2023/24), NRB

Note: Actual Net FDI on (Left) and Approved FDI on(Right)

1.1.7 Employment, Labour Market, and Productivity

Persistent structural challenges persist in Nepal's labour market. In FY 2022/23, Nepal recorded a national unemployment rate of 12.6 percent and a labour force participation rate of just 32.9 percent among individuals aged 15 and above (NSO, 2023). Among provinces, Madhesh has the lowest unemployment rate at 5.5 percent, while Karnali has the highest at 23.8 percent. Labour force participation, which measures the proportion of a country's working-age population actively engaged in work or seeking a job, remains low at the national level. It is lowest in Madhesh at 29.4 percent and highest in Bagmati at 41.2 percent, reflecting not only the limited availability of resources and opportunities within these provinces but also significant disparities between them.

Figure 1.7: State of Employment by Province (%)



Source: Nepal Living Standard Survey (2022/23)

Among the many challenges in Nepal's labour market is the high unemployment rate among women and their significantly lower labour force participation. Disaggregated by gender at the national level, unemployment rates among men stand at 11.3 percent compared to 14.7 percent among women. Labour force participation reveals an even wider gender disparity, where 52.7 percent of men are active in the labour market, compared to only 24.2 percent among women (NSO, 2023).

Another significant factor is the mismatch between the skills sought by the private sector and the available labour in the domestic market (The Kathmandu Post, 2023). Nepal's demographic dividend can be a crucial driver for its growth; however, many working-age population are seeking opportunities abroad due to an educational and vocational training ecosystem that has struggled to produce a highly skilled workforce.

Compounding these challenges is the large presence of the informal sector in Nepal, which is estimated to employ 82 percent of the workforce and account for approximately

38.6 percent of the economy (The Kathmandu Post, 2025). Women make up a substantial share of informal sector employment, according to the latest census data, which indicates that 87.4 percent of the female population is economically inactive and engaged in household work, and that 77.4 percent of women are involved in family care. While the informal sector plays a vital role in job creation, it operates largely outside the formal economy. Since it is neither taxed nor regulated, the informal sector tends to be small and unproductive for revenue generation. As a result of these factors, Nepal's economy has not fully realised its potential. Furthermore, in the absence of formal oversight, labourers in this sector are often exposed to poor working conditions and lack access to social security, including access to health and education services. These factors can further deepen existing labour-market disparities, particularly for women.

1.1.8 Infrastructure and Connectivity

(i) Energy generation capacity, transmission, and provincial access

Hydropower dominates Nepal's electricity production, accounting for more than 95 percent of total electricity (Shrestha et al., 2023; Mainali & Silveira, 2015). In 2023, Nepal's total electricity generation capacity was around 2875 MW. Few large projects have been established, such as the Upper Tamakoshi Hydropower Project, which is the largest, single-handedly producing 456 MW (Shrestha et al., 2023). Large-scale hydropower projects have often been slowed by governance issues and a lack of transparency, which have ultimately delayed project completion and have frequently discouraged foreign investment. The dominance of hydropower reflects Nepal's reliance on its abundant river system, but

importantly, it also exposes the country's vulnerability. Systemic challenges in planning, financing and implementation mean that high-potential hydropower projects often fail to deliver, limiting the sector's ability to grow. This makes the economy's reliance on hydropower a structural risk rather than a strength.

Electricity access across the provinces is relatively high, with approximately 95 percent of Nepal's population having access; however, there is significant variation between provinces. The variation ranges from 98 percent in Lumbini to 67 percent in Karnali (Mainali & Silveira, 2015; Karki et al., 2020). Main challenges to electricity access are power outages in relatively remote, geographically challenging terrain, where extending national grids is technically demanding and expensive. Encouraging decentralised renewable energy in such regions could significantly improve equity and resilience of Nepal's energy infrastructure. Alternatives such as solar and micro hydro have been discussed but not implemented to the level needed (Karki et al., 2020; Sovacool

Large-scale hydropower projects have often been slowed by governance issues and a lack of transparency, which have ultimately delayed project completion and have frequently discouraged foreign investment.

et al., 2011). While Nepal has ambitious plans to expand clean and renewable energy with ambitious goals, including reaching 15000 MW of renewable energy by 2030, it needs to focus on increasing the electricity penetration in provinces like Karnali through alternative electricity generation (Shrestha et al., 2023; Mainali & Silveira, 2015). This energy expansion must be complemented with stronger governance mechanisms, transparent procurement, and diversified investments across other renewable energy sources to reduce risk and improve long-term sustainability.

(ii) Transport infrastructure (roads, airports, trade corridors)

Despite the gradual expansion of road networks, Nepal faces recurring cycles of infrastructure reconstruction rather than building strong, resilient transport infrastructure.

Nepal's road network spans approximately 80,000 kilometres, encompassing national, provincial and rural highways (ADB, 2020; Tiwari & Chhetri, 2021). Of this, the combined length of national highways is around 11,000 km, with just over half being paved. However, around one-third of these highways remain unpaved or gravel-surfaced. This is primarily due to the poor condition of many rural highways, which are not built to standard and often deteriorate during the rainy season (Tiwari & Chhetri, 2021; Shrestha et al., 2014). Despite the gradual expansion of the road network, challenges such as weak enforcement of construction standards, insufficient maintenance funding, and the prevalence of corruption in contract awards continue to undermine the quality and durability of Nepal's roads. As a result, the country faces recurring cycles of reconstruction, rather than achieving long-term, sustainable infrastructure.

Nepal has a total of 53 airports, among which only 34 are operational. While international airports are either overused or underused, domestic airports are critical for connecting remote regions to urban areas.

To increase connectivity, Nepal is building north-south corridors like the Koshi, Gandaki, and Karnali economic corridors. This would link roads between India and China, directly enabling direct flow of people and goods (Thapa & Paudel, 2022). These projects have the potential to reduce transport costs and increase economic activity along the corridors. Progress has been slow due to limited financing, bureaucratic delays, and political instability, which have constrained Nepal's ability to leverage its strategic geographic position between two major trade economies. There are also studies on Nepal-China railway connectivity, which could have a positive impact on Nepal's trade with China (Gurung, 2021; Sharma & Pant, 2020). Yet, given the high costs and technical challenges posed by rugged terrain and geopolitics, such projects require feasibility evaluations and transparent foreign investment to avoid long-term risks.

Nepal has a total of 53 airports, among which only 34 are operational. While international airports are either overused or underused, domestic airports are critical for connecting remote regions to urban areas. However, most are small and operate only under favourable weather, which limits expansion (Upadhaya et al., 2021; Sharma et al., 2019).

Improving runway standards, navigation systems, and flight frequency could enhance regional accessibility and support tourism-driven economic growth.

(iii) Digital connectivity and broadband penetration

Mobile access has expanded massively, but broadband coverage remains limited due to challenges in terrain. As of 2024, about 49.6% of Nepal’s population has internet access (Khanal, 2024). Mobile broadband penetration is much higher, ranging from 90 to 95 percent, as mobile broadband costs in Nepal are relatively affordable compared to those in other developed countries (Budhathoki & Poudel, 2022; Dahal & Timilsina, 2020). By contrast, only a third of the population uses fixed broadband, which reflects the rural-urban disparity (Budhathoki & Poudel, 2022). In addition, private sector incentives to serve sparsely populated areas are limited. The speed of broadband, especially cellular internet, is relatively high in urban areas, but rural and mountainous regions still face limitations (Shrestha et al., 2021). All these lead to an imbalance in connectivity, which perpetuates unequal access to other infrastructures like education, telemedicine, and e-governance, thereby constraining inclusivity in connectivity and digital transformation.

To address these challenges, the Government of Nepal, with the help of the International Finance Corporation (IFC) and other international partners, is planning to expand data centres and optical-fibre networks (World Bank, 2021)—the Digital Nepal Acceleration project, financed by the World Bank at around USD 140 million, is also underway. In addition, the Digital Nepal Framework 2.0 outlines several policies to promote universal access and improve infrastructure (World Bank, 2021; Adhikari, 2022). However, the implementation of these policies has been slow, primarily due to fragmented institutional coordination. Nepal’s heavy reliance on imported technology and limited local technological capacity further exacerbates the challenges. Consequently, fostering domestic innovation and ensuring equitable access are critical to achieving Nepal’s digital transformation goals.

1.2 Competitiveness Performance by Provinces

This section summarises provincial scores from prior years’ NCI versions across the 4 environments.

(i) Macroeconomic Stability

Under Macroeconomic Stability, Bagmati has been the top-performing province since 2018 across all NCI studies. As the home of the capital city, Kathmandu, Bagmati performs well in indicators such as Gross State Domestic Product (GSDP) and foreign direct investment (FDI), positioning itself as the nation’s hub for industrial and commercial activities. Lumbini and Madhesh have followed Bagmati in the Macroeconomic Stability indicator in NCI 2022 and NCI 2024. However, Gandaki surpassed both provinces in NCI 2025 due to significant growth in its economic output, particularly through focused development of the energy sector, including hydropower. Lumbini and Madhesh have demonstrated stability across all NCI studies, with robust trade ties with India through the southern border. On the other hand, Sudurpaschim and Karnali remain at the bottom of the rankings, primarily due to geographical challenges and limited investment.

(ii) Government & Institutional Setting

Bagmati has consistently ranked as the top-performing province under the Government & Institutional Setting since the first edition of the NCI report. Nepal's historically centralised governance system has allowed Bagmati to benefit significantly from the existing governmental structure. The province performs exceptionally well in areas such as the presence of foreign companies, government revenue, and the number of registered public and private limited companies. Lumbini, Gandaki, and Koshi follow Bagmati in this same category, frequently interchanging ranks across the various editions of the NCI reports. Lumbini has shown strong performance in reducing corruption cases and improving the efficacy of its provincial government. Gandaki has improved its budget balance but has seen declines in tax revenue and government expenditure, as observed in the 2025 edition of the NCI report. Koshi, home to Nepal's oldest industrial establishments and key manufacturing industries, has maintained a strong governmental influence. Most recently, the province added to its political prominence with the swearing-in of a sixth Prime Minister originating from the province. In contrast, Sudurpaschim, Madhesh, and Karnali continue to rank lowest under this indicator, with political instability as a recurring challenge across all three provinces.

(iii) Financial, Business & Manpower Conditions

Bagmati performs better than all other provinces under Financial, Business & Manpower Conditions. Bagmati has always been the most developed province in terms of financial services and internal migration, with it being the top choice for migrants within the country. That has helped Bagmati create a favourable and ever-growing business climate, boosting economic competitiveness. Koshi has always been second under this indicator, supported by its strong commercial sector. Gandaki and Lumbini follow the top two, maintaining their strong positions in this indicator, but need greater focus and investment in industrial training, wages and salaries. Madhesh Pradesh and Karnali remain the bottom two states across all NCI studies, performing poorly for agricultural wages, labour productivity, and inequity within business resources.

(iv) Quality of Life & Infrastructure Development

Bagmati has historically ranked high in Quality of Life & Infrastructure Development, with strong performance in the standard of living and social stability. Gandaki ranks as the second-best performer through sustained investment in health and education. Notably, NCI 2025 finds that Gandaki now surpasses Bagmati in both standard of living and social stability, though it still scores relatively low on the broader environment. Madhesh has shown high volatility in this indicator, ranking as high as second in 2018 but falling to the bottom in 2019 and 2023. This inconsistency is attributed mainly to low literacy rates and limited mobile phone penetration. Lumbini has demonstrated steady progress over the years. On the other hand, Koshi continues to lag in this category, particularly in road infrastructure, health, and education. Karnali and Sudurpaschm rank low due to persistent underperformance in the same areas.

NCI 2025 finds that Gandaki now surpasses Bagmati in both standard of living and social stability, though it still scores relatively low on the broader environment.

Strengths & Weaknesses: Key areas where provinces excel or lag

Bagmati consistently performs the best in all environments, benefiting from robust infrastructure and strong business and manpower conditions. Kathmandu, located in this province, contributes to a strong institutional setting and other factors, such as higher GDP per capita, easier access to credit, and a strong flow of development assistance. These elements position Bagmati as a key economic hub in

Nepal. However, despite its strong performance, Bagmati faces challenges, including government consumption expenditure, which is primarily directed toward administration rather than productive investment.

Lumbini performs well under the Governance and Institutional setting, where it has made substantial investments in key infrastructure. The construction of a new airport, despite some controversy, is a prime example of Lumbini's focus on boosting tourism, an area in which it has also invested heavily. In terms of quality of life and public infrastructure, Lumbini has performed decently, with notable improvements in the health and education sectors. However, Lumbini has struggled to attract foreign investment due to persistent regulatory and bureaucratic hurdles. The province also faces a shortage of skilled manpower, which, coupled with delays in infrastructure projects, has led to dissatisfaction among stakeholders and hindered its economic potential.

Gandaki has long been a strong performer in tourism, with the newly constructed international airport in Pokhara enhancing connectivity and boosting the province's tourism infrastructure. As a result, Gandaki has seen positive growth in tourism-related activities and has also recorded improved business and manpower conditions. Despite these strengths, Gandaki faces several challenges. It struggles with low tax revenue and is heavily reliant on governmental transfers, limiting its financial autonomy. Moreover, there is a need to formalise local businesses to ensure long-term sustainability and foster economic resilience.

Koshi performs well in institutional and governmental performance, with notable potential in agriculture and export, particularly through the construction of cross-border trade hubs. The province is rich in natural resources, further bolstering its economic prospects. There is a significant opportunity to improve infrastructure and public services, particularly in areas that directly benefit citizens. However, Koshi faces considerable challenges, including poor road and transport links and underinvestment in health infrastructure. To realise its potential, Koshi must prioritise the development of human capital and focus on improving the overall quality of life for its citizens.

Madhesh holds a strong position in agriculture and cross-border trade, with vast areas of both cultivated and uncultivated land that offer immense potential for increasing

agricultural production. This agricultural base, combined with proximity to neighbouring countries, provides significant opportunities for economic growth. Despite these advantages, Madhesh faces a weak financial environment, marked by limited access to financial services and barriers to small business development. The province also performs poorly in quality of life and infrastructure, and the intergovernmental coordination is also weak, hindering effective policy implementation and provincial development.

Correlation with Economic Indicators: How NCI scores align with GDP growth, employment rates, and investment levels

Foreign direct investment (FDI) is overwhelmingly concentrated in provinces with higher overall rankings.. Bagmati, which ranks highly across all NCI versions, accounts for more than 50 percent of FDI (Nepal Rastra Bank, 2023; Paudel, 2023). Gandaki and Koshi have mid-level NCI rankings and mirror their FDI performance, each accounting for about 17 percent of the country's FDI (Nepal Rastra Bank, 2023). Karnali and Sudurpaschim, which account for less than one percent of total FDI, perform poorly in NCI rankings (Nepal Rastra Bank, 2023). NCI ranking and investment concentration do seem to be correlated (World Bank, 2021).

For per capita GDP, Bagmati, the highest-ranked province, holds the largest GDP share of 37 percent of the national total(Koirala, 2022; Ministry of Finance, 2023). Gandaki follows Bagmati in both NCI rankings and GDP share, while Karnali and Madhesh Pradesh sit at the bottom in both NCI rankings and per capita GDP share. While long-term GDP is generally correlated with NCI rankings, growth indicators can fluctuate year by year, meaning short-term GDP per capita does not always align with the NCI rankings. The NCI serves more as a structural capability indicator rather than a predictor of short-term GDP growth, which can be influenced by external factors such as weather conditions, tourism shocks, and one-off projects.

The provinces that perform weakest under the Financial, Business & Manpower Conditions environment – Karnali and Madhesh – face significant challenges in their employment and ecosystems. These provinces have very few firms, limited access to finance, and a mismatch between available skills and market demand. Karnali has the lowest number of firms in the country, with fewer than 45,000 establishments, compared to over 280,000 in Bagmati (CBS, 2019). Both provinces also face credit constraints and limited financial access, as highlighted by the World Bank (2021). These financial challenges can be compounded by a persistent skills mismatch and labour market inefficiencies across the country (ILO, 2020), affecting both job seekers and employers.

1.3 Fiscal Federalism as a Driver of Competitiveness

(i) Federal Structure Overview

With the promulgation of the Constitution of Nepal in 2015, the country formally adopted

a federal democratic republic model, organised into three tiers of government: the federal (central) government, seven provincial governments, and 753 local governments.

Nepal's 2015 constitutional framework provides a promising architecture for fiscal federalism—an architecture that, if fully and effectively utilised, can unlock provincial competitiveness by aligning local revenue sources, spending autonomy, and transfers. However, the realisation of this promise has been uneven across provinces. For provinces to truly drive competitiveness, they need more robust own-source revenue mobilisation, gaining greater discretion over expenditure, and receiving transfers that are designed and executed in ways that reinforce, rather than constrain, strategic local choices. Over time, as institutional capacities strengthen and formulas evolve to reward performance and regional potential more than mere need, fiscal federalism can become a genuine driver of competitiveness rather than simply a mechanism for equalising across regions.

Critically for fiscal federalism, the Constitution in Part 5 (Restructuring of the State and the Distribution of State Power) spells out the intention to distribute power — including fiscal power — across tiers. For example, Article 60 provides that “the federation, province and the local level entity shall impose tax on subjects within their fiscal jurisdiction and collect revenue from such sources”.

Further, Article 60 states that the Government of Nepal shall “make necessary arrangements to equitably distribute the revenue generated by it from its sources, between the federation, province and the local level entities” and that the amount of fiscal transfer to provinces and local levels shall be as recommended by the National Natural Resources and Fiscal Commission (NNRFC). Schedules five to nine of the Constitution list exclusive, concurrent and residual powers among the three tiers, including finance, resources and functions.

In short, Nepal's federal structure establishes a clear constitutional framework for devolving fiscal authority and sharing resources, enabling provinces to compete, innovate, and leverage their own strengths. But that potential depends critically on how the arrangements play out in practice.

(ii) Revenue and Expenditure Autonomy

From the perspective of provincial competitiveness, two dimensions are key: the revenue-raising power provinces have (and therefore their fiscal space), and the discretion they enjoy over what they spend (and thus how they can shape development agendas).

Revenue autonomy: The Constitution authorises provinces to impose taxes on subjects within their fiscal jurisdiction. In practice, however, provinces in Nepal face significant constraints in mobilising own-source revenue (OSR). Several studies show that OSR

The Nepal's 2015 constitutional framework provides a promising architecture for fiscal federalism—an architecture that, if fully and effectively utilised, can unlock provincial competitiveness by aligning local revenue sources, spending autonomy, and transfers.

accounts for a small share of provincial budgets – for example, one review found that average OSR in provincial budgets from FY 2019/20 to FY 2021/22 hovered around 11–14 percent. The Asia Foundation notes that in some provinces, OSR accounts for as little as 1.6 percent of the budget. The dominance of the federal government over primary revenue sources – particularly customs, VAT, and excise – contributes to this imbalance.

Expenditure autonomy: On the expenditure side, the constitutional Schedules allocate to provinces various exclusive and concurrent responsibilities. For instance, as per a detailed review, provinces have exclusive functions such as provincial police, provincial highways, vehicle management, trade and industry, and the operation of banking or financial institutions. Concurrent functions across tiers include health, agriculture, irrigation, forest, environment, and hydropower, among others. Thus, provinces have room to shape sectoral priorities within their assigned domains. Nevertheless, absolute autonomy is tempered by the fact that many provincial expenditures rely heavily on federal transfers (i.e., grants) that come with conditions or earmarking. For example, one report notes that provinces still rely heavily on transfers and conditional grants, which limit their discretionary spending. A study of implementation highlights that, although the constitutional framework exists, actual functional autonomy remains weak.

From a competitiveness lens, this means that while provinces have the constitutional mandate to develop their own strategic agenda (for example, focusing on tourism, hydropower, agro-processing, regional trade), their real capacity to mobilise revenue and direct expenditure is constrained. The provinces that succeed in building stronger OSR bases, manage public expenditure well, and deploy capital spending strategically will be better positioned to harness competitiveness advantages.

(iii) Intergovernmental Fiscal Transfers

The third pillar of fiscal federalism concerns the design of intergovernmental fiscal transfers (IGFT) and their implications for competitive performance across provinces.

Design of transfers: The Constitution (Article 60) and associated laws (such as the Inter-governmental Fiscal Arrangements Act, 2017) provide for revenue sharing, fiscal equalisation grants, conditional grants, complementary and special grants. The NNRFC is constitutionally mandated to recommend the formula for revenue sharing and grants based on expenditure needs and revenue capacity. Recent budget numbers illustrate these in practice: for FY 2025/26, the federal government allocated approximately NPR 582.8 billion to provinces and local levels via revenue sharing and various grants.

Impact on competitiveness gaps: On the positive side, the equalisation grants are intended to reduce disparities between richer and poorer provinces by accounting for their differing revenue-raising capacity and development needs. This provides a fiscal mechanism to level the playing field and give weaker provinces resources to invest in infrastructure, human capital, or enterprise development.

However, in practice, several issues inhibit the competitiveness dividend:

- a. Vertical imbalance remains stark (Neupane and Aryal, 2025) – the federal level retains

- many major revenue streams, while sub-national levels remain heavily dependent on transfers, reducing autonomy and potentially dampening incentives.
- b. A high share of transfers is conditional or earmarked (for specific projects or sectors), which limits provinces' discretion to direct spending where their comparative advantages lie. A past report (2023) notes that the "largest and proportionally growing fund transfers have been through conditional grants. Since conditional grants are heavily earmarked, they limit provincial and local governments' spending autonomy".
 - c. The calibration of formulas and actual disbursements sometimes does not reflect the true revenue-raising capacity gap or the development potential of provinces. As per one study (2021), some provinces with weaker domestic bases remain stuck in a 'dependency trap', unable to invest in competitiveness-enhancing sectors such as value-added agriculture or hydropower. Among provinces, internal revenue mobilization is highly uneven: e.g., Bagmati may have OSR around 41percent, but others like Karnali struggle at 1.6 percent.
 - d. Governance, institutional capacity and planning constraints at the provincial level further limit how well transfers translate into improved competitiveness (such as productivity growth, infrastructure linkage, enterprise support). Research (Shah, 2019) suggests that despite constitutional changes, the legacy of centralised structures and weak sub-national capacity means that the full potential of fiscal federalism has yet to be realised.

What this means for competitiveness is that provinces that can combine transfers with proactive revenue mobilisation, smart expenditure prioritisation (especially in growth-oriented sectors), and efficient execution will grow faster and better address regional disparities. Meanwhile, provinces that remain heavily dependent on conditional grants without strong internal revenue bases or institutional readiness risk falling further behind. Thus, the design and implementation of IGFTs directly shape the competitive dynamics across Nepal's provincial economies.

The Constitution (Article 60) and associated laws (such as the Inter-governmental Fiscal Arrangements Act, 2017) provide for revenue sharing, fiscal equalisation grants, conditional grants, complementary and special grants. The NNRFC is constitutionally mandated to recommend the formula for revenue sharing and grants based on expenditure needs and revenue capacity.

1.4 Emerging Challenges and Opportunities for 2026

Nepal has been suffering from decades of rampant corruption, poor governance mechanisms, less accountable political leadership, and elite impunity. The frustration

among the young generation of Nepalis, i.e. Gen Z, led to massive protests against the government on 8 September 2025 (Sen and Tuladhar, 2025). Within 48 hours, the Gen Z protests, the accompanying vandalism of public and private property, and attacks on businesses nationwide forced the then Prime Minister to resign and pave the way for a new interim government led by former Chief Justice of Nepal, Sushila Karki. So far, PM Karki has expanded her ministerial cabinet three times, appointing ministers representing diverse sections of the Nepali society (OPMCM, 2025). The Karki-led government has announced a new election on 5 March 2026. Post-election, the winning political parties will form a new government and work on much-needed constitutional

The Karki-led government has announced a new election on 5 March 2026. Post-election, the winning political parties will form a new government and work on much-needed constitutional reforms to stabilise the Nepali economy.

reforms to stabilise the Nepali economy. However, with less than 5 months left until the election, the Karki-led government has yet to form a complete cabinet, and the key ministries, including the Ministry of Foreign Affairs, the Ministry of Labour, Employment and Social Security, and the Ministry of Defence, remain vacant. This has led to public speculation on the uncertainty of the upcoming election and the subsequent polycrisis in Nepal.

On one hand, the private sector still remains suspicious of the level of security for businesses and investments across the country since the September Gen Z protests (MyRepublica, 2025). The unprecedented damage to private firms during the protests has raised serious concerns among key private-sector stakeholders in Nepal about the future of FDI and private investment in the country.

On the other hand, Nepal continues to remain in the Financial Action Task Force (FATF)'s grey list (FATF, 2025). This damages Nepal's global investment outlook and thus limits future FDI flows into Nepal. Similarly, due to worsening political and economic conditions in the aftermath of the September Gen Z protests, experts have suggested that (Prasain, 2025) Nepal delay its planned LDC graduation, originally scheduled for November 2026.

Overall, the political and business environments in Nepal remain very fluid, surrounded by new uncertainties. This will, without any doubt, affect the provincial governments and their overall competitiveness moving forward.

1.5 Conclusion

Nepal's economic and institutional journey, as outlined in this chapter, reflects a nation in transition—moving gradually from agriculture to services, from centralised governance to federal pluralism, and from dependence on remittances to a search for productive competitiveness.

While provinces such as Bagmati, Gandaki, and Lumbini have made visible strides in infrastructure, investment, and fiscal management, others like Karnali and Sudurpaschim continue to face deep structural challenges. The country’s macroeconomic stability is anchored by remittance inflows and service-sector growth, yet constrained by limited export diversification, weak fiscal execution, and rising debt dependency.

The provincial competitiveness landscape reveals both promise and paradox: Nepal’s federal framework provides a constitutional foundation for balanced growth, but actual fiscal autonomy and institutional capability vary widely across provinces. As the nation prepares for a new political and economic chapter, marked by electoral uncertainty and calls for reform, sustaining competitiveness will depend on how effectively provinces can mobilise resources, improve governance, and attract investment amidst shifting national priorities.

The next chapter—Research Methodology—outlines how these patterns are measured, compared, and interpreted across provinces. It introduces the analytical tools and indicators that underpin the Nepal Competitiveness Index 2026, setting the stage for a rigorous, data-driven exploration of how Nepal’s provinces compete, cooperate, and chart their distinct development trajectories.

