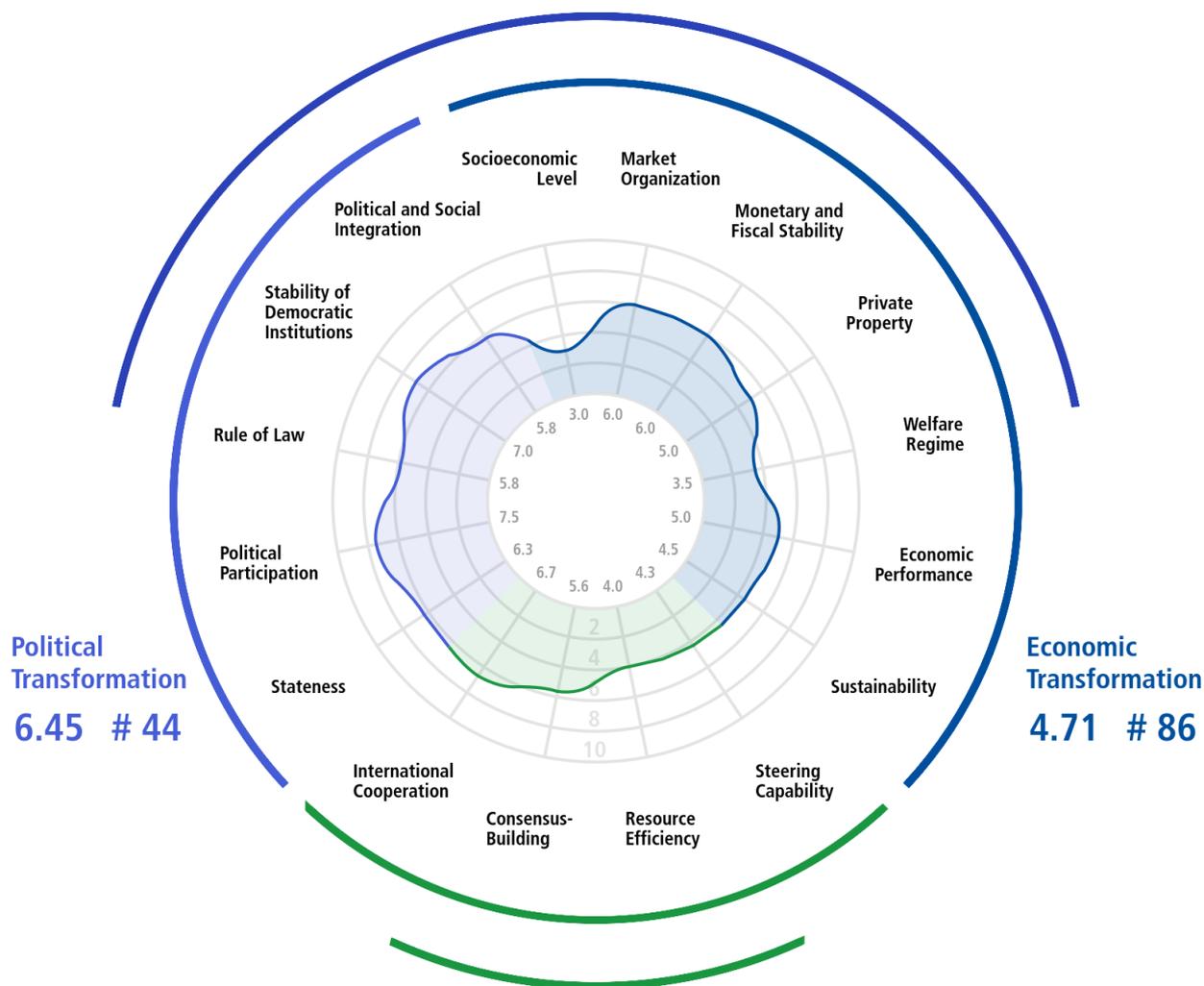


Nepal

Status Index

5.58 # 56

on 1-10 scale out of 137



Political Transformation
6.45 # 44

Economic Transformation
4.71 # 86

Governance Index

4.73 # 65

on 1-10 scale out of 137

This report is part of the **Bertelsmann Stiftung's Transformation Index (BTI) 2026**. It covers the period from February 1, 2023 to January 31, 2025. The BTI assesses the transformation toward democracy and a market economy as well as the quality of governance in 137 countries. More on the BTI at <https://www.bti-project.org>.

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Key Indicators

Population	M	29.7	HDI	0.622	GDP p.c., PPP \$	5737
Pop. growth ¹	% p.a.	-0.1	HDI rank of 193	145	Gini Index	30.0
Life expectancy	years	70.4	UN Education Index	0.532	Poverty ³	7.5
Urban population	%	22.4	Gender inequality ²	0.487	Aid per capita \$	39.5

Sources (as of December 2025): The World Bank, World Development Indicators | UNDP, Human Development Report 2025. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.65 a day at 2017 international prices.

Executive Summary

The past two years have been marked by relative stability in Nepal. Since the adoption of a new constitution in 2015, a politics oriented toward the Madhesi (Nepali citizens with an Indian cultural background) has paved the way for the implementation of federalism. All appeared to be on track until December 2020, when Prime Minister Khadga Prasad Sharma Oli (known as K.P. Oli), a member of the ruling Communist Party of Nepal (Unified Marxist-Leninist) (CPN-UML), dissolved parliament and announced snap elections in April 2021. This unexpected move triggered protests and a constitutional crisis that was eventually resolved effectively by Nepal's Supreme Court. Subsequent general elections in 2022 were widely deemed free and fair, and despite shifting pre- and post-electoral alliances and the rise of the National Independent Party (Rastriya Swatantra Party, RSP) as a new political player, a ruling coalition able to govern eventually formed. That ruling coalition included Maoist leader Pushpa Kamal Dahal (also known as Prachanda) as prime minister. In July 2024, the CPN-UML broke away from the ruling coalition, joining forces with the Nepali Congress party to create a new coalition government. This decision brought back Oli as prime minister. The changes marked the third government change in the two years since the 2022 parliamentary election. Viewed through the lens of democratization, the fact that a new coalition came together with little to no disruption of public life marked a political transition of great significance. However, as the review period closed, it was not clear how long that temporarily stable coalition would last, as considerable churn and public frustration in Nepali politics remained.

On the economic front, Nepal has moved past the COVID-19 pandemic but is now contending with global macroeconomic headwinds, particularly inflation and unemployment. On the positive side, in 2024, GDP growth rose to 3.9% (from 1.95% in 2023) and inflation eased to a rate of 4.1% (from 7.5%). This contrasted with a slight increase in the unemployment rate, and tax revenues as a share of GDP declined, signaling further economic challenges. Domestic energy production and

high remittance income from the Nepali diaspora provide a consistent stabilizing force for the national economy. Nepal continues to face institutional and funding challenges. Addressing them successfully could promote economic growth, particularly through a liberalization of trade, investment in education, the promotion of research and development, and the fostering of industrial and service-sector-based growth.

On the governance front, many challenges remain. Nepal is a landlocked country with few natural resources and mountainous terrain, which complicates governance and traditional industrialization paths. Poor governance has long contributed to the country's poverty and economic stagnation, but developments in the recent past have provided some hope for Nepal's future. Often at great personal or family expense, the country's young population is pursuing educational attainments that are on average beyond those of earlier generations, and is aiding the economy through remittances. This is a widely appreciated source of stability but also a source of regret for many Nepalis, who see the exodus of young people as a failure of the government. As a result, it is also a source of political contention, contributing to a sense of governance failure and precipitating political churn. Nepal's steering capability and resource efficiency remain poor, but it has made recent strides with regard to infrastructure. While some of these projects remain underutilized, most notably the Pokhara airport funded in large part through still-outstanding debt to China, increases in hydroelectric power generation capacity have generally proved productive. In addition, despite Nepal's efforts to maintain steady relations with both India and China, border issues with both countries continue to be a problem.

History and Characteristics of Transformation

Nepal's political history has been shaped by recurring episodes of mass mobilization and anti-regime contention. Until 1990, Nepal was an authoritarian monarchy rooted in an exclusive, oligarchic social order. A pro-democratic people's movement brought down the royalist Panchayat system and transformed Nepal into a constitutional Hindu monarchy and multiparty democracy. However, this transition did not establish a stable liberal democracy. Instead, a Maoist rebellion erupted and gained widespread support, especially among Nepal's impoverished and disadvantaged rural population, many of whom felt neglected by the state. This conflict contributed to democratic stagnation and numerous human rights issues. In 2001, King Birendra and nearly the entire royal family were murdered under mysterious circumstances. Birendra's brother, Gyanendra, was crowned king on June 4, 2001. After this event, support for the monarchy waned, even among royalists. Disappointed in the government's unsuccessful handling of the Maoist insurgency, Gyanendra staged a royal coup in February 2005, claiming full sovereignty and assuming executive authority. A broad opposition movement emerged, consisting of the Seven Party Alliance (SPA) and the Maoist insurgents. King Gyanendra was forced to reinstate the parliament in April 2006. The newly formed multiparty government concluded a comprehensive peace agreement that opened the way for the implementation of an interim constitution, effective in January 2007. A Constituent Assembly (CA) was elected in April 2008, with the Communist

Party of Nepal (CPN)-Maoists emerging as the strongest party with the most seats. In May 2008, at the CA's first meeting, the monarchy was abolished, and Nepal became a federal democratic republic based on an amended interim constitution.

The post-election years were marked by the reemergence of power struggles among long-standing political leaders, with no clear consensus on the shape of Nepal's future governing institutions. After four extensions of its initial two-year tenure, the CA was dissolved in May 2012 without promulgating a new constitution. Both the coalition government under then-Prime Minister Baburam Bhattarai of the Unified Communist Party of Nepal (Maoist) from August 2011 to March 2013 and the nonpartisan government led by Acting Prime Minister Khil Raj Regmi, chief justice of Nepal, from March 2013 to February 2014 proved unable to break the constitutional deadlock. In November 2013, a caretaker government succeeded in holding new CA elections, which resulted in an impressive comeback by the Nepali Congress – the main opposition party at the time, and the ruling party for much of the period from 1990 to 2006. After the CA assembled in January 2014, a multiparty coalition was formed under the leadership of Prime Minister Sushil Koirala (Nepali Congress) in February 2014. The new CA had made little further progress when, in April and May 2015, two devastating earthquakes hit Nepal, causing great loss of life and destruction. As awful as they were, the earthquakes served as catalysts for constitution-making. Nepal's political leaders fast-tracked the finalization of the draft constitution. Amid much controversy, violent protests in the Terai and an unofficial blockade by India, the new constitution was eventually promulgated on September 20, 2015. In October 2015, Communist Party of Nepal (Unified Marxist-Leninist) (CPN-UML) leader K.P. Oli became the new prime minister.

In August 2016, an unusual Nepali Congress-Maoist coalition took power. The coalition agreed to run the government and share the premiership as it oversaw local, provincial and national elections. Maoist leader Pushpa Kamal Dahal, known as Prachanda, took the helm first, overseeing the first phase of local elections. In June 2017, he handed power to Sher Bahadur Deuba of the Nepali Congress to oversee the latter two phases of local elections, as well as the provincial and national elections. These elections were all deemed free and fair, and representatives took their seats, marking a watershed moment in Nepal's political transformation. In 2022, a second round of free and fair national elections for all levels of government confirmed the conclusion of Nepal's protracted period of violent political contention. The national elections brought Communist Party of Nepal (Maoist Center) (CPN-MC) leader Prachanda to the prime minister's office, heading a coalition that included the CPN-UML and the new Rastriya Swatantra Party (RSP), among others.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

Although Nepal does not currently face an active armed insurgency like the Maoist insurgency of the past, organized crime, smuggling networks and local-level political-criminal nexuses still exist, especially in the southern plains and certain border districts, and can challenge the state's authority in practice. The security apparatus functions across the country and is under central control, but in some remote and mountainous areas, logistical and geographic constraints limit rapid state response, making full enforcement inconsistent.

During the review period, Nepal faced growing external pressures and territorial disputes that tested the strength and reach of the state's control, particularly along its international borders. Recently, there has been renewed contestation over the location of Nepal's western border after Indian security forces allegedly acted in what Nepal views as its territory. Along the northern border with China's Tibetan Autonomous Region, Chinese border troops have allegedly overstepped their jurisdiction by not only entering Nepali territory, but also taking land officially acknowledged as Nepali territory. Growing and ongoing concerns have also focused on China's influence in Nepal, especially after Nepal formally requested relief on a \$216 million loan used for the construction of the new Pokhara International Airport.

Nepal has a relatively strong sense of national identity, and the majority of the population accepts the legitimacy of the state. Although the Maoist insurgency contested control of the Nepali state and dramatically undermined the state's monopoly on violence, it did not question Nepal's existence as a sovereign entity. With the promulgation of the new constitution in 2015 and successful democratic elections in 2017 and 2022, stateness has strengthened overall. Since the end of the monarchy and the adoption of the federal democratic republic in 2008, the political system has been widely recognized and accepted by the public, and the 2015 constitution reaffirmed Nepal as a multiethnic, multilingual and multicultural nation. The constitution establishes "all the mother tongues spoken in Nepal" as national

Question
Score

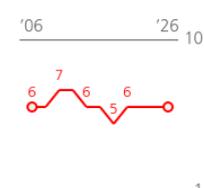
Monopoly on the
use of force

8



State identity

6



languages, with Nepali as the official language. Provinces are allowed to select one or more local languages for official business in addition to Nepali. In practice, however, Nepali has to date remained the dominant language of most official proceedings.

Despite broad acceptance of the nation-state, access to citizenship remains contentious, especially for Madhesi communities (Nepali citizens with an Indian cultural background), residents of the Terai region near the Indian border and individuals with foreign parentage. The citizenship law has been criticized for gender discrimination: Nepali women cannot independently pass citizenship to their children if the father's identity is unknown or foreign, whereas Nepali men can. Madhesi people, Janajati members of numerous Indigenous groups, women and Dalits, the so-called untouchable castes in Hinduism, continue to face substantial legal, economic and social discrimination from high-caste Hindus. The latter are often referred to as "hill elites" because of their residence in the central hill region and maintain dominance in the bureaucracy, politics and the national economy.

The state is not governed by religious law, and secular principles are enshrined in its legal and institutional framework. Some political and religious groups, including elements of the former monarchy's supporters, periodically demand that Nepal's status as a Hindu state be restored. Many public officials continue to assert that Nepali citizenship should be defined by proficiency in the Nepali language and adherence to Hinduism. Such ideals have been contested for decades by politically active members of minorities such as the Madhesi inhabitants of the Terai region, and by Adivasi Janajati movements representing Indigenous groups.

From Nepal's creation in the late 18th century through the Maoist conflict, the state was closely associated with the religion, language and culture of the so-called upper Tagadhari Hindu castes, especially the Brahmans – also known as Bahuns – who dominated politics, the judiciary, the media, the civil service and all other spheres of public life. This distribution of power changed little after the downfall of the Panchayat system in 1990. Since the beginning of democratization, however, power has been shifting geographically and away from those who traditionally wielded it.

As in most South Asian countries, various indicators, such as the state's ability to tax the economy, point to weak state and administrative capacity in Nepal. Many Nepalis seek to avoid paying taxes because of a deep-seated belief that their funds will be misused. The administrative structure of the state extends beyond maintaining law and order, yet the country's administration is weak and – despite recent improvements – largely unable to provide equitable access to administrative services for all citizens, particularly in rural areas. Citizens seeking basic state services such as birth and death registration, health care and education, let alone legal redress, face complex procedures subject to discretionary influence by individual political and administrative actors.

No interference of religious dogmas

6

'06 '26 10



1

Basic administration

5

'06 '26 10



1

As basic administration has spread throughout the country over time, it has been plagued by corruption. Nepal ranks 110th out of 180 countries on Transparency International's Corruption Perceptions Index. Corruption by officials has obstructed the delivery of foreign aid. It should be noted that the Commission for Investigation of Abuse of Authority (CIAA), Nepal's top anti-corruption agency, has been significantly more active in recent years.

According to the World Bank's World Development Indicators 2024, which includes data for 2022, 91.2% of the population had access to a water source, while only 16.1% had access to one that was safely managed. With regard to sanitation, 80.4% of the population had basic sanitation access, and 50.6% had access to safely managed sanitation. Finally, 91.3% of the population had access to electricity.

A general restructuring of the civil administration is underway with the aim of adapting Nepal's administration to the country's new federal structure. With the shift to a federal structure, decision-making has been decentralized to some degree.

2 | Political Participation

Since the promulgation of the new constitution in 2015, Nepal has held successful national elections in 2017, 2020 and 2022. Nepal uses universal suffrage with secret ballots, and offices are filled solely according to election results. To facilitate fair election campaigns, most parties and candidates have equal access to Nepal's vibrant media landscape in order to present their positions. Legal safeguards against the abuses of electoral law provisions are in place and have worked when invoked. In December 2020 and May 2021, for example, former Prime Minister Oli dissolved parliament and called for new elections, but in both instances, the Supreme Court restored freely elected representatives to office.

The Election Commission of Nepal is responsible for registering parties and candidates, polling and vote counting. Outside observers have found all recent elections to be free and fair. In the most recent elections in 2022, the voter turnout rate was 61%, down from 68% in 2017. Compared with the 2017 elections, positive changes were evident, as only sporadic pre-electoral violence occurred after security forces were deployed in order to ensure that elections were free and fair. The Madhesi parties that threatened a boycott in 2017 eventually confined their contestation to the electoral arena, and the issue of Madhesi secession appears to have lost political traction.

Free and fair elections

8



Since the 2013 elections to the second Constituent Assembly and the 2015 promulgation of the new constitution, democratically elected political representatives have effectively exercised their governing power. Nevertheless, their power remains somewhat constrained, particularly given that various groups threatened to exercise veto power throughout 2017. More recently, no such contestation has been evident in Nepal's political landscape.

At present, no political party can be characterized as a veto player. The Nepal Army (NA) no longer has a negative reputation for acting on its own. In the past, more than 1,400 former People's Liberation Army (PLA) combatants were integrated into the NA, making Nepal one of the few successful cases of post-conflict army integration worldwide. This has contributed to declining public concern over the prospect of a military coup. Other potential veto groups, such as large landowners and business elites, have sufficient access to political parties and can try to influence policymaking through institutionalized political channels. However, there are veto actors such as landowners and traditional elites at the local level, some of whom control the local means of violence and coercion.

Article 17 of the 2015 constitution guarantees the freedoms of association and assembly. Individuals in Nepal are free to join political and civic groups. Many people hold multiple affiliations. However, the constitution allows ordinary laws to impose "reasonable restrictions" on civil liberties in a wide range of circumstances. During protests against Prime Minister Oli's dissolution of parliament in 2021, security forces exercised restraint, and no substantial violence occurred. Although political violence has declined in recent years and the number of peaceful protests has risen, Nepal recently saw pro-monarchy assemblies turn violent after interventions by state authorities.

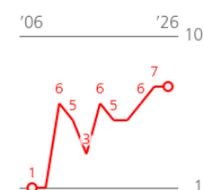
Although members of the Tibetan community lead well-equipped, unrestricted lives, they have sometimes been detained and arrested for staging protests and holding cultural festivals that invoke the Dalai Lama. This differential treatment largely correlates with Chinese pressure on Nepal.

As basic elements of a democratic polity, the freedoms of opinion and expression are guaranteed under Article 17 of the constitution. Still, the constitution does allow "reasonable restrictions" to be imposed by ordinary laws under a broad range of circumstances. With Nepal's political stabilization, protections for free speech – even on sensitive topics – have expanded. However, authorities occasionally crack down on individuals who criticize the government on social media or other platforms. For instance, after a ban in 2023, Prime Minister Oli restored access to TikTok only in August 2024.

The media landscape in Nepal is vibrant, with many newspapers available in Nepali, the national language; English; and several regional languages. Improved power grids, along with satellite and mobile technology, have given Nepalis access to social

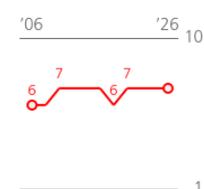
Effective power to govern

7



Association / assembly rights

7



Freedom of expression

8



media, where many voices are increasingly shared at the local, provincial and national levels. Altogether, these dynamics might help explain why Nepal rose 21 places to 74th in Reporters Without Borders' 2024 World Press Freedom Index.

3 | Rule of Law

Nepal's 2015 constitution expressly provides for separation of powers in Article 56. However, it slightly weakens the judiciary, especially compared with the interim constitutions that preceded it. The new constitution allows Supreme Court justices to be impeached. Even so, the institutional capital of Nepal's judiciary, especially vis-à-vis the legislature and the executive, has allowed it to withstand these relatively minor changes. The effective resolution of the constitutional crisis (2020 – 2021) – triggered by Prime Minister Oli, who twice dissolved Nepal's parliament in moves deemed unconstitutional – demonstrates the functionality of Nepal's separation of powers, and particularly the judiciary's ability to check executive overreach.

The institutional design of Nepal's judiciary is similar to that of other federal democracies, particularly that of India. The Supreme Court is the country's highest court and primarily hears appeals from the provincial High Courts, which in turn hear appeals from lower courts. The Judicial Council, which oversees key matters concerning the judiciary, provides an additional layer of protection for judicial independence.

The Supreme Court has not hesitated to assert its independence and authority. It has done so by impeaching political leaders on corruption charges and by making courageous decisions on issues such as transitional justice, citizenship and affirmative action. However, the court has faced the recurring issue of a lack of compliance with its judgments. The executive has at times ignored its judgments and at other times complied only reluctantly. In such cases, civil society has helped force the executive to comply. In 2021, the Supreme Court settled a constitutional crisis, after which it faced a crisis of its own when the Nepal Bar Association called for the resignation of Chief Justice Rana on grounds of corruption. He initially refused to step down, but after lawmakers initiated impeachment proceedings, he retired in December 2022.

The court system in Nepal remains inaccessible to many Nepalis. While decentralization has improved geographic access, a lack of resources continues to hinder the system. Implementation of the Supreme Court's order to establish consumer courts at the local level has faced delays, and consumer courts are still not functional countrywide. Still, progress has been made, with the first such court opening in October 2024. In addition, the functional capacity of Nepali judges remains limited, citizens' awareness of the judicial process is persistently weak and system delays are common. This contributes to widespread frustration with the courts' inability to provide justice. While corruption remains a problem, the symbolic

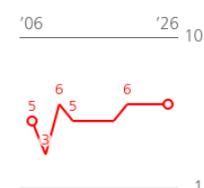
Separation of powers

7



Independent judiciary

6



significance of Chief Justice Rana’s retirement amid corruption allegations has modestly improved public perception of the courts. Still, the judiciary has considerable work left to do to build institutional capital.

Because of relatively weak judicial capacity, Nepal has long been characterized by a political culture of impunity. Public officeholders in Nepal are sometimes prosecuted and penalized, but prosecutions remain selective and uneven. Although legal mechanisms are active and occasionally yield penalties, political elites often evade meaningful consequences for their actions, making accountability partial and limited in reach.

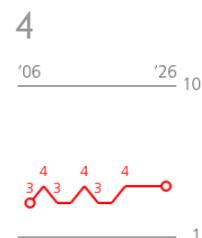
The 2015 constitution has exacerbated this problem by granting the president unrestricted authority to grant pardons. Nevertheless, safeguards for the rule of law and human rights are improving, largely owing to active journalists, civil society and an engaged citizenry. The political elite, who rarely faced consequences for misconduct in the past, are now occasionally held accountable for their actions.

In August 2024, Nepal finally passed its Transitional Justice Bill. While more than 60,000 individuals have contacted Nepal’s Truth and Reconciliation Commission and the Commission on Investigation of Disappeared Persons to report disappearances and crimes perpetrated by Maoists, security forces and the political leadership, few cases have been investigated, and none had been fully concluded as of the close of the review period.

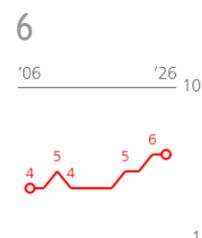
In addition to being strongly interwoven with politics, corruption has long been part of business operations in Nepal. However, there are signs of improvement. The Commission for the Investigation of Abuse of Authority (CIAA) has arrested and jailed high-level government officials and politicians on corruption charges. The institution appears to be gaining momentum by conducting numerous sting operations and taking on a wide variety of cases. This resonates with voters, particularly younger voters, who are impatient with the pace of reforms.

Nepal has made tangible progress in protecting civil rights, particularly since the adoption of the 2015 constitution, which enshrines a wide range of civil, political and socioeconomic rights. However, implementation remains uneven. For instance, women still face legal and administrative hurdles in passing citizenship to their children independently, and LGBTQ+ individuals continue to face social stigma despite formal recognition in law. Dalits and Indigenous groups often report unequal access to justice and public services, while religious minorities occasionally face discrimination with regard to political representation and in public life. Despite these challenges, Nepal’s civil society remains active and influential, advocating for accountability, inclusion and legal reform. The peaceful handling of the 2024 pro-monarchy protests, in which police avoided excessive force, signals a positive shift toward respect for the freedoms of assembly and expression. Overall, although significant work remains, there are clear signs of institutional maturity and a growing trend toward the resolution of rights-related grievances through legal and democratic means.

Prosecution of office abuse



Civil rights



4 | Stability of Democratic Institutions

Nepal has developed a comprehensive federal democratic framework with functioning institutions at the national, provincial and local levels. These institutions have gradually stabilized since the promulgation of the 2015 constitution and the successful conclusion of multiple elections, including the most recent in 2022. The judiciary has demonstrated its independence at critical moments – such as during the 2021 constitutional crisis – and local governments have played increasingly important roles in governance and service delivery.

However, institutional performance is often hindered by political instability, most notably by frequent changes in government driven by fragile and shifting coalition politics. Since 2013, Nepal has had numerous short-lived administrations, a circumstance that has undermined policy continuity, coherence and implementation. Intergovernmental coordination, especially between the federal and provincial levels, also remains weak due to ambiguities in the division of powers and insufficient administrative capacity. Vested interests among political parties continue to undermine democratic effectiveness. Patronage and clientelism remain common, subverting the equitable provision of public goods and fair appointments to office. The Bayesian Corruption Index (BCI), in which 100 indicates more corruption, gave Nepal a score of 51.9 in 2021, down from its 2017 score of 54.3. This figure can be compared to scores of 24.5 in the United States, 10.05 in the United Kingdom and 44.3 in India.

Despite these challenges, democratic procedures are generally followed, and decision-making is rooted in legitimate institutions. The core problem lies not in the absence of democracy but in institutional inefficiency, fragmentation and persistent political friction, which continue to limit the effectiveness of Nepal's democratic system.

Nepal's democratic institutions are generally accepted as legitimate by most political actors, as shown through regular elections, peaceful transfers of power and active political participation. In 2022, Nepal successfully conducted local, provincial and national elections that were widely viewed as free and fair and associated with relatively low levels of violence. While democratic institutions are mostly respected, their legitimacy can be challenged in political crises, such as Prime Minister Oli's attempted dissolutions of parliament, which tested institutional resilience. Some fringe groups, such as monarchists and Hindu nationalists, oppose the current secular republican model, indicating that a full consensus on the legitimacy of democratic institutions is not universal.

Generally, Nepalis see elections as the proper arena for political contestation, a view supported by the fact that disadvantaged segments of society have gained a voice in the process thanks to quotas in the proportional election system. Although the new

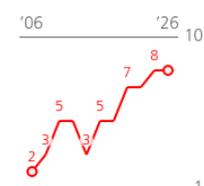
Performance of democratic institutions

6



Commitment to democratic institutions

8



constitution has reduced the scope of reserved seats for disadvantaged groups, these quotas still have an impact – particularly by helping members of marginalized groups gain positions of influence within major political parties. This dynamic may shift due to the rise of independent candidates and growing public disillusionment with traditional parties, which still lack strong internal democratic practices in many areas.

5 | Political and Social Integration

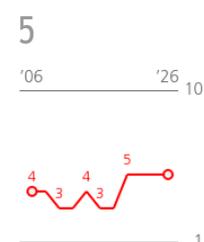
The political party system remains fractionalized, polarized and generally elite-dominated. Levels of popular support for and trust in the various parties have varied widely over time, as indicated by the Himalmedia Public Opinion Poll. Most political parties also lack adequate internal democratic and participatory mechanisms, remaining personality-oriented organizations with authoritarian power structures. Although power is typically concentrated in party headquarters in the Kathmandu Valley, decentralization and competition from independent candidates have led many established politicians to spend more time in their constituencies and shift their focus to local interests.

Because of proportional representation, disadvantaged groups have gained greater representation in the legislature. In recent years, several new parties and coalitions have emerged, largely organized around regional or ethnic affiliations but also, in part, around ideologies. For a long time, elites viewed regional and ethnic parties as potential threats to national unity, but that view has shifted as these parties have focused on peaceful participation in electoral contestation.

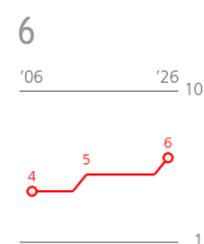
The rise of the National Independent Party, which won a substantial number of seats in the 2022 elections, represents a shift away from the establishment. Many ethnic and regional identity-based groups continue to perceive political parties as intent on keeping power in the hands of long-dominant upper-caste Hindus. The recent influx of independent candidates suggests turbulence for the party system, but the fact that this popularly supported trend is aimed at electoral victory – not violence – is promising.

Since Nepal's transition to democracy in the 1990s, civic organizations and interest groups have played a pivotal role in representing and mediating social interests. These entities include labor unions, community-based groups, local NGOs and women's rights organizations, for example. Organizations such as the Nepal Federation of Indigenous Nationalities, the Nepal Bar Association and the Federation of Nepali Journalists have exercised significant influence by fostering public debate and advocating on behalf of political positions. Some of these interest groups are funded by international development agencies, while others derive their support exclusively from local, national or regional actors. Some donors and NGOs act in a parastatal fashion, delivering services and exerting strong influence in policy arenas. In recent years, the range of interests represented by domestic associational groups has increased, and many of them cooperate with one another to achieve goals, whether those are legislative or oriented toward service delivery.

Party system



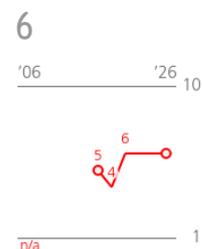
Interest groups



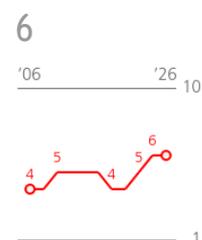
The Asia Foundation’s 2022 Survey of the Nepali People suggests increased levels of public trust in the federal government, federal parliament, provincial assemblies and local representatives, but declining trust in political parties. A 2024 nationwide public opinion poll published by the International Republican Institute’s Center for Insights in Survey Research (CISR) reported increased confidence in democracy, paralleled by continued frustration with political parties. The poll revealed that 59% of Nepali residents perceived democracy to be the best possible form of government. Moreover, 54% said they believed that political parties were doing enough to address the needs of voters, while 62% expressed a desire for new political parties. The Asia Foundation’s 2022 Survey of the Nepali People found that levels of trust in the media and in local-level organizations were relatively high, while trust in national-level institutions and political parties was growing. Overall, the data suggest that civil society may be effectively mediating between society and government, but that the traditional political parties are not particularly helpful in this regard. The rise of the National Independent Party (Rastriya Swatantra Party, RSP), a party of outsiders, lends credence to this idea. Democracy itself, however, is broadly supported, with few people believing that autocracy would be preferable. Even those desiring a return to monarchy, such as the National Democratic Party (Rastriya Prajatantra Party, RPP), pursue this goal through self-organization in a political party.

There are limited country-level studies of the level of interpersonal trust in Nepal, especially with regard to the strength and forms of social capital. Nepalis show mutual trust, and the social fabric is relatively strong. However, they remain partly stratified along ethnic, linguistic and caste cleavages. Associational activities have expanded over the past 30 years, with strong networks of cooperation along political, business, alumni, ethnic, caste and regional lines today evident. In many areas, such organizations have filled gaps left by decentralized state agencies. However, many associations primarily serve specific groups and may reinforce bonding social capital over bridging social capital, hindering broader civic self-organization.

Approval of democracy



Social capital



II. Economic Transformation

6 | Level of Socioeconomic Development

Large segments of the population are fundamentally excluded from society because of poverty and inequality. According to the UNDP's Nepal Human Development Report 2023, the country was ranked 146th out of 193 countries on the Human Development Index (HDI), with a relatively low score of 0.601 as of 2022. Nepal's current HDI ranking places it behind regional peers such as Sri Lanka (78), the Maldives (87), Bhutan (125), Bangladesh (129) and India (134). As of 2022, according to Nepal's National Planning Commission and based on a multidimensional poverty index, 20.1% of Nepal's population lived below the national poverty line, an improvement but still a comparatively high rate. World Bank data identify a relatively moderate Gini coefficient of 30.0 for Nepal, ranking it 108th globally, with a 2.8-point decrease from 2010 indicating reduced inequality. Nepal's score on the UNDP Gender Inequality Index is 0.495, ranking it 146th out of 193 countries in the 2022 edition. In addition, Nepal was ranked 117th among 146 countries on the Global Gender Gap Index 2024. This placed Nepal above Sri Lanka (122), Bhutan (124), India (129), the Maldives (132) and Pakistan (145).

Nepal's economic stagnation is also reflected in its employment numbers. The Fourth Nepal Living Standard Survey reported an increase in the unemployment rate to 12.6% from 2022 to 2023, marking a 1.2 percentage point rise over the past five years. This shift has partly been due to demographic change, with a growing share of the young working-age population unable to find employment, prompting many to seek work abroad. Nepal's unfavorable investment climate, shaped by political and policy uncertainty, has stifled investment and job creation in the past. Further increases in the unemployment rate are likely because of the lingering effects of the COVID-19 pandemic and the impact of the economic recession in June 2024. Compounding the issue, many of the jobs being created are low quality, thereby increasing the country's reliance on remittance income.

Question
Score

Socioeconomic
barriers

3

'06 '26 10



Economic indicators		2021	2022	2023	2024
GDP	\$ M	36924.8	41182.9	41047.8	42914.3
GDP growth	%	4.8	5.6	2.0	3.7
Inflation (CPI)	%	4.1	7.7	7.1	-
Unemployment	%	12.2	10.8	10.6	10.7
Foreign direct investment	% of GDP	0.5	0.7	0.3	0.4
Export growth	%	-21.3	34.1	4.3	11.8
Import growth	%	18.8	16.4	-18.8	-2.5
Current account balance	\$ M	-5363.0	-9646.0	1053.9	4948.1
Public debt	% of GDP	43.3	42.7	47.0	48.3
External debt	\$ M	8820.9	9183.8	9968.5	-
Total debt service	\$ M	293.5	340.8	480.4	-
Net lending/borrowing	% of GDP	-4.0	-	-	-
Tax revenue	% of GDP	17.5	-	-	-
Government consumption	% of GDP	8.3	8.4	6.6	7.4
Public education spending	% of GDP	4.4	4.1	4.0	3.7
Public health spending	% of GDP	1.8	2.1	-	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	1.3	1.1	1.1	-

Sources (as of December 2025): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

Market-based competition in Nepal is constrained by a persistent structural trade deficit and a heavy dependence on India as its primary trading partner. With imports typically constituting about 90% of total trade, Nepal exhibits a strong degree of import dependence. Key imports include petroleum products, machinery and spare parts, transport equipment, pharmaceuticals, textiles, chemicals, electrical goods, vehicles and related components.

Nepal's investment climate holds potential but faces significant challenges. Political instability and widespread corruption remain deterrents, compounded by a lack of understanding of international business standards and practices among the political and bureaucratic class. The legal and regulatory framework often diverges from international practices, further complicating the investment landscape for foreign investors. The country also faces a pronounced talent drain. Nepal's mountainous, landlocked geography hampers access, especially given its deficient transportation infrastructure. Frequent, unpredictable general strikes and the inconsistent enforcement of laws and regulations add further uncertainty.

Bureaucracy in Nepal is notoriously cumbersome, with laws that restrict the operations of foreign banks, create challenges in repatriating profits, control currency exchange facilities and prohibit foreign direct investment (FDI) in certain sectors. Additionally, a minimum FDI threshold of NPR 20 million (approximately \$154,000) and the government's monopoly over key industries such as electricity transmission and petroleum distribution pose significant barriers.

Nepal has sought to create a more investment-friendly environment through reforms. However, recent political turbulence, including the government's collapse in 2023, has significantly hindered progress toward building investor confidence and improving the regulatory framework. Both foreign and domestic private sector representatives frequently express dissatisfaction, asserting that the government has not done enough to improve the business climate, even though several market-oriented initiatives have been undertaken to attract foreign investment. The Nepal Investment Summit 2024 – the third round of such gatherings – aimed to attract large foreign investors, particularly those involved in public infrastructure projects.

The government has made legislative and policy reforms to attract domestic and foreign investors in the hydropower sector and to further accelerate the sector's development. As the review period closed, Nepal was revising the Foreign Exchange Regulation Act. It was also expected to repeal the Act Restricting Investment Abroad (ARIA). The repeal of the ARIA, which prohibits outbound investment, would mark a pivotal step toward limited capital account convertibility. In October 2023, the government also streamlined the process for approving investments up to NPR 500 million (\$3.75 million), which now go through an automatic approval channel in key



sectors such as energy production, infrastructure, tourism and information technology. The Millennium Challenge Corporation (MCC) Compact, a \$500 million agreement ratified by parliament in February 2022, took effect on August 30, 2023. The program is expected to drive economic growth by promoting investment in critical energy infrastructure and sustainable road maintenance technologies, creating business and employment opportunities for the Nepali population, and enhancing the country's potential for cross-border trade within the region.

In April 2024, Nepal marked 20 years of membership in the World Trade Organization (WTO). While this milestone was significant, the country has struggled to benefit fully from its membership, largely because of its persistent trade deficit. Its heavy reliance on imports has been a major hurdle, limiting Nepal's ability to access the global market or compete in it. In addition, non-tariff measures (NTMs) have long created additional challenges, especially for agricultural exports, which face some of the strictest constraints. The NTMs embedded in Nepal's domestic systems are often more harmful to its trade than the external barriers imposed by trading partners. These internal obstacles have made it harder for the country to strengthen trade and diversify exports. To make matters worse, Nepal has yet to sign the WTO Investment Facilitation for Development Agreement, which could help attract investment and integrate the country more effectively within the global trading system. Looking ahead, Nepal's ability to thrive in the WTO will depend heavily on how it reforms trade policies and boosts efficiency.

Adding to these challenges, Nepal is set to graduate from the least developed countries (LDC) category in 2026. Although this transition will bring challenges, including the loss of preferential tariffs and special and differential treatment (SDT), it also presents significant opportunities. As such, the improved label might enhance Nepal's global standing, attract FDI and strengthen its negotiating power on international platforms, opening the door to new markets and trade agreements.

To comply with its WTO obligations, Nepal introduced the Competition Promotion and Market Protection Act, a law aimed at preventing unfair competition and curbing monopolies and cartels, in 2007. The country subsequently established the Competition Promotion and Market Protection Board, which is charged with overseeing competition. Despite this responsibility, cartels and syndicates remain deeply rooted in the country's economy, often operating under the banner of business associations. With cartels and syndicates dominating key sectors, it is difficult for new businesses to enter the market under conditions of fair competition.

During the review period, the government stepped up efforts to crack down on price gouging, targeting a range of businesses, including retailers, health care facilities and private schools. While these actions were meant to protect consumers, private sector representatives have accused the government of overstepping its boundaries. They claim enforcement efforts are often politically driven rather than serving to promote healthy competition, with businesses using their connections to arrange for their competitors to be targeted.

Competition policy

6

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The transportation sector illustrates these challenges. In 2018, the government moved to issue permits to new transportation companies, and the minister of physical infrastructure and transport strongly criticized the influence of cartels in the sector. Despite this bold stance, no meaningful action has followed to dismantle these entrenched networks, hindering competition and stalling economic progress.

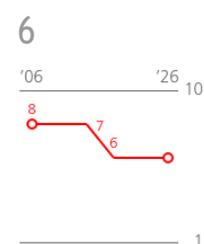
Since joining the WTO, Nepal's trade liberalization has proceeded slowly. As of 2023, the WTO reported that Nepal's average applied tariff rate was 12.7%. That same year, the government launched the Nepal Trade Integration Strategy (NTIS, 2023 – 2028), aiming to boost exports and increase the trade-to-GDP ratio. This strategy focuses on diversifying the economy and enhancing Nepal's global competitiveness. Nepal has also taken recent steps to relax import restrictions, mainly on luxury goods, signaling a shift toward a more open trade policy. Despite remaining restrictions, this move reflects an overall trend toward greater economic openness.

A key initiative in Nepal's trade landscape is the Nepal Trade Preference Program (NTPP), established by the United States in 2016 to aid Nepal's recovery after the 2015 earthquake. Set to conclude in 2025, the program offers duty-free access to the U.S. market for 77 types of Nepali products. In 2023, Nepal exported \$3.9 million worth of goods under the program, primarily container bags, handbags and hats. However, there is potential for growth, as an additional \$4.4 million in eligible products did not use NTPP benefits. Nepal has requested an extension of the NTPP beyond 2025 and the inclusion of more products, such as ready-made clothing and IT items.

To streamline trade processes, Nepal is working to create a paperless customs system. This initiative is particularly important as the country prepares to graduate from its status as a LDC in 2026, which will result in the loss of certain trade-related preferences. Anticipating this, the government is refining its Smooth Transition Strategy to align with the national development plan and to prepare for the loss of certain trade preferences. Despite these efforts, Nepal's export sector faced challenges in 2023, with exports declining by 21.4% to \$1.18 billion in FY 2022/23. As a result, the country continues to grapple with a significant trade deficit, and the government is providing financial incentives to exporters and encouraging growth in sectors such as manufacturing.

Nepal and the United States held their sixth Trade and Investment Framework Agreement (TIFA) Council meeting in Kathmandu in May 2023 and discussed various economic issues and ways to improve market access for certain agricultural products.

Liberalization of foreign trade



Nepal's financial system is composed of banks and financial institutions (BFIs), non-bank financial institutions (NBFIs), the capital market, the insurance sector, and cooperatives. It operates under the supervision of regulatory authorities and is supported by numerous financial service providers. Crucially, the Nepal Rastra Bank (NRB), the country's central bank, initiated the adoption of the Basel III accord in 2015. As of mid-July 2023, 112 BFIs had been licensed by the NRB, including 20 commercial banks, 17 development banks, 17 finance companies, 57 microfinance financial institutions and one infrastructure development bank. The ratio of bank capital to assets in the sector stood at 7.3% in 2022, and non-performing bank loans accounted for 2.4% of total loans, according to the World Bank. While the banking sector in Nepal is generally sound, it remains fragmented and regionally imbalanced. NRB supervision has gradually improved, but persistent concerns remain, with private sector representatives alleging that political interference undermines the central bank's effectiveness. To address this, the government has actively pushed for bank consolidation as a means of strengthening the sector's resilience, leading to a significant decrease in the number of commercial banks from 32 in 2012 to 27 in 2022.

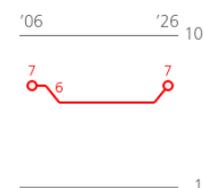
One of the major challenges Nepal's banking sector has faced in recent years, aside from underdeveloped infrastructure, is a persistent liquidity crunch. Shortages have consistently stifled business growth and discouraged entrepreneurs, harming the investment climate, boosting inflation and unemployment rates, and slowing the country's potential economic growth. Despite these difficulties, there have been recent signs of improvement. According to the central bank, the weighted-average interbank interest rate among commercial banks stood at 2.99% in mid-July 2024 and has been stable. The weighted-average interest rate on 91-day treasury bills was 3.0% in mid-July 2024, constituting a sharp decline from 6.35% in mid-July 2023.

In February 2024, Nepal's parliament passed an anti-money-laundering law to address the most persistent deficiencies and avoid being put on the Financial Action Task Force's (FATF) gray list, which could compromise Nepal's correspondent banking relationships and general economic prospects.

Nepal's digital payment landscape has undergone significant transformation in recent years, with adoption and use surging in 2024, in part due to government initiatives led by the NRB. Despite an overwhelming reliance on cash transactions, the COVID-19 pandemic has encouraged a shift toward digital payments, with many consumers and businesses embracing cashless payment options. NRB data highlights this trend, showing a sharp rise in mobile banking, e-wallet and QR-code-based transactions. However, this progress remains heavily concentrated among middle- and upper-class populations in urban areas, largely due to the high cost of data. Future efforts must focus on the 46% of Nepalis who are unbanked, many of whom are women.

Banking system

7



8 | Monetary and fiscal stability

Nepal has long struggled with monetary policy and central bank independence but has been relatively consistent lately, despite the restricted independence of the NRB. In January 2025, the Nepalese rupee (NPR) reached a historic low against the U.S. dollar, with \$1 trading for NPR 138.4, bearing serious implications for Nepal’s largely import-driven economy. According to the World Bank, Nepal’s consumer price inflation rate was 7.1% in 2023, but the figure has been volatile and subject to conditions in India, the region’s main exporting state. Around the third quarter of 2022, Nepal experienced its first economic recession in six decades, with the inflation rate reaching a high of 8.6% some months later. Since then, the economy has recovered somewhat and inflation has eased, driven by a sharp drop in non-food and services inflation. During FY 2023/24, the inflation rate remained below the monetary policy target of 6.5%, averaging 5.62% and falling to 4.17% by mid-June 2024. Expectations of only modest inflation of 5.5% in FY 2024/25 were overturned by the severe flooding that hit in late September 2024. Although the full extent of the disaster’s impact was still becoming clear as of the close of the review period, the economic strain was already evident. By mid-December 2024, consumer price inflation had risen to a rate of 6.05%, while only non-food and service prices stayed relatively stable at 3.92%. However, food was hit hard, with prices jumping by 9.99% and the vegetable price index soaring by a striking 43%.

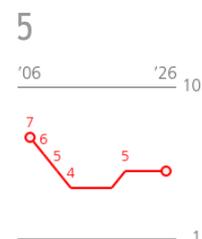
In a general environment of sound fiscal policy, the public debt-to-GDP ratio has risen, but in a sustainable manner. However, given Nepal’s continued reliance on remittances, debt dynamics remain susceptible to volatility in remittance flows, as seen during the pandemic. Nepal’s current debt-to-GDP ratio indicates that public debt rose over the last decade to 47.1% of GDP as of 2023, while net government lending/borrowing stood at -4.0% of GDP in 2021. While this suggests that Nepal’s government is spending more than it raises in taxes, it does not indicate extreme fiscal irresponsibility.

9 | Private Property

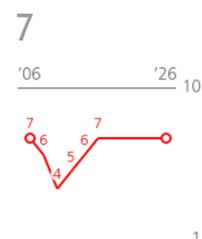
Although property rights and the regulation of property are defined by the 2015 constitution, they are regularly violated. Some property – mostly land – confiscated during the civil war has yet to be returned. As part of the peace process that began in 2006, the Maoists agreed in principle to return all of it and have done so in most cases. Some land remains to be restored, even if there is no official data on contested titles.

Insecure property rights pose a particular problem for the poor, who often lack proper documentation for land titles and are ill-equipped to maneuver through local courts and administrative bureaucracies. These challenges were more severe during Nepal’s

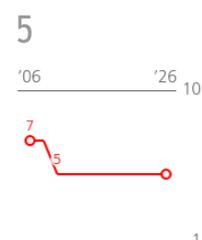
Monetary stability



Fiscal stability



Property rights



switch from unitary to federal administration, but land title offices are now often easier to access under the federal system. However, the poor and uneducated still face barriers to finding the locations of new offices. Among the poor, women are at a particular disadvantage.

In addition, many who have built additional structures on their land without proper documentation – a typical practice, as land is conventionally split among male heirs and individual dwellings are built for nuclear families – are now unable to sell their land legally. There are numerous cases of developers who have taken deposits for plots of land but are then unable to deliver the plots due to oversubscription.

Private companies are permitted and protected by the constitution. Bureaucratic and legal hurdles to incorporating and registering a new firm are among the lowest in South Asia. The main obstacle to setting up a private commercial or industrial enterprise is not registration, but rather political and bureaucratic interference in day-to-day operations. A joint study by the Federation of Nepalese Chambers of Commerce and Industry (FNCCI) and the International Finance Corporation (IFC) found that the private sector in Nepal accounted for 81.55% of Nepal’s GDP between 2011 and 2021.

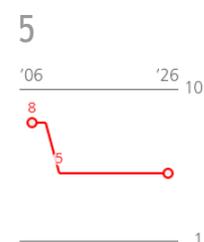
More than 80 public enterprises across diverse sectors were privatized in the 1990s. The process drew criticism as many newly privatized companies soon found themselves struggling. There were allegations that the privatization process lacked transparency and that state assets had been widely undervalued. The privatization of state-owned enterprises has been on hold since 2008. As of May 2024, Nepal had 44 public enterprises, with few being profitable. Many have incurred large cumulative losses and unfunded liabilities for years because of operational inefficiencies and other problems. Because of their poor performance, public enterprises continue to be a burden on taxpayers and consumers. However, further privatizations appear unlikely in the near future.

10 | Welfare Regime

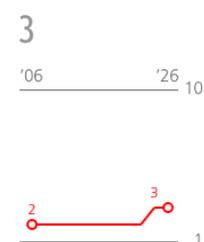
Nepal’s welfare regime remains largely limited to social networks based on familial structures. NGOs attempt to fill this gap but provide only specific, piecemeal services on a local basis. In some cases, they undercut the state’s efforts to build capacity and deliver services. As a result, social welfare options vary greatly depending on the area of residence, access to international donors and personal networks.

Remittances have long been and remain a significant part of Nepal’s revenue. Estimated at 24.25% of GDP in 2020, they provide a substantial source of social safety for many families. Nepal’s remittance income has rebounded since 2022, and remittances accounted for an estimated 26.2% of GDP in 2023, reflecting year-over-year growth of about 3.4%. Unfortunately, remittances also tend to promote

Private enterprise



Social safety nets



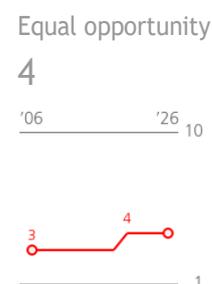
inequality and are highly vulnerable to external shocks. In addition, the country's strong family support structures have been weakened by widespread, long-term out-migration for work. Although domestic transfers of wealth from the capital region to rural areas and financial remittances from workers abroad compensate for social risks, the physical absence of family members strains the social fabric.

Nepal's public spending on health, at 1.8% of GDP in 2021, is relatively high by South Asian standards – higher than in India but lower than in Sri Lanka and many Southeast Asian countries – yet remains insufficient. Inefficient use of funds remains a significant problem. Private initiatives to improve social services are limited, and public social services are underdeveloped and insufficient to meet demand. That said, access to health care in particular has improved dramatically in recent years, with the health care system today including public hospitals that provide free or affordable care as well as private hospitals that are unaffordable by many. In addition, there are some health clinics run by NGOs and private organizations that expand access to affordable care in Nepal. Access to health care is better in urban than rural areas, but is overall considerably better than in the past. Only limited government provision for old-age care in the form of monthly allowances, pensions and free health care exists, as such matters are generally regarded as the responsibility of the family.

Legally sanctioned social inequality based on ethnicity, language, caste and gender was a defining feature of the Nepali state until very recently. Although caste-based discrimination was outlawed in principle in the 1960s, it remains a defining feature of life for many Nepali citizens in practice. Gender-discriminatory laws have only recently been struck down. In practical terms, it remains very difficult for women to obtain their legal inheritances. The equality of access to education remains highly dependent on caste and class, as well as on whether a child lives in a rural or urban setting (with better opportunities in urban areas).

The 2015 constitution requires political parties to field a certain percentage of female candidates both in first-past-the-post and closed-list proportional races. Since the 2022 local elections, women have held 41.21% of elected positions in local councils and ward committees, with many being political newcomers and a substantial number being of Dalit background. In the federal parliament, women make up 33.1% of all elected deputies. Furthermore, Sunil Babu Pant, the country's first openly gay legislator, served in the Constituent Assembly, which created the 2015 constitution during the 2008 – 2012 period.

Since the end of the conflict in 2006, a range of measures has aimed to lessen social inequality, but their implementation and impact remain limited. A 2007 amendment to the Civil Service Act established affirmative action provisions for the civil service, including the police. The new constitution guarantees 40% of parliamentary seats to minority groups under a proportional representation system. However, it also establishes the controversial category of Khas-Arya – that is, high-caste Pahadi Hindus, Bahun and Chhetri – for affirmative action purposes. Male members of the



Nepali-speaking, hill-dwelling Brahmin caste (Bahun), who make up only 11.29% of the country's population (as of 2021), continue to secure a disproportionate share of new civil service posts, though the overall percentage of positions they hold has decreased slightly. In a recent report, 19.57% of civil service applicants recommended for recruitment were Brahmin. Brahmins from the Terai, Kayasthas and Rajputs are also overrepresented, though they constitute much smaller shares of the overall Nepali population. Members of these same groups dominate staffing in the judiciary, the education system, the media, labor unions and even NGOs.

Nepal's labor market offers highly unequal opportunities. The ILO estimates that about 70% of Nepal's workforce remains employed in the informal sector, facing multiple challenges and constraints and lacking basic social safety nets. Workers are subject to exploitation and deprived of many fundamental rights at work. The government has largely turned a blind eye to such abuses, though the recent implementation of a labor law is slowly shifting the labor market landscape.

11 | Economic Performance

As of 2024, Nepal remained on the United Nations' list of least developed countries, with persistently high levels of socioeconomic exclusion. Nepal's main sources of national income are tourism, agriculture and remittances. The World Bank estimates that per capita GDP growth in Nepal was 2% in 2023, while per capita gross national income (adjusted for purchasing-power parity) was approximately \$4,280 and per capita gross domestic product (PPP) was \$4,917.20.

For the first time in eight years, Nepal's current account balance improved significantly in FY 2023/24, reaching a surplus of 3.9% of GDP due to reduced imports and strong remittance inflows. Remittance levels reached a nine-year high thanks to record outward migration in 2023, boosting foreign exchange reserves.

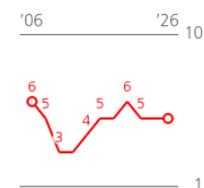
The World Bank's October 2024 Development Update noted that real GDP growth had accelerated to 3.9% in FY 2024, largely driven by the services sector, which benefited from a substantial 30.7% increase in tourist arrivals. This influx revitalized key service industries such as transportation, accommodation and gastronomy. Additionally, the expansion of hydropower production by more than 450 MW boosted the energy sector, supporting industrial and economic activity.

However, strong domestic consumption remains reliant on remittances. These rose from just under 11.21% of GDP in 2002 to a high of 31.43% in 2015 and, as of 2023, stood at 26.2% of GDP. With remittances increasing since 2022, Nepal has experienced a gradual economic recovery from the pandemic.

Nepal continues to face a high trade deficit, particularly in its trade with India. Presumably due to lower demand, exports to India fell by 5.3%, to China by 24.8% and to other countries by 6.6% (FY 2023/24). Imports from India declined by 3.9%,

Output strength

5



from China by 1.5% and from other countries by 7.9% in the same period. Nepal's total trade deficit decreased 4.0% to NPR 352.37 billion in the first three months of the 2024/25 fiscal year. Officially, Nepal aims to maintain a trade deficit of 20% of GDP, but estimates for 2022 indicated a deficit of about 35.9% of GDP. As of FY 2022/23, India commanded the largest share of Nepal's foreign trade at approximately 64.1% in 2023, while China accounted for 13.1%.

According to World Bank data based on modeled ILO estimates, Nepal's overall labor force participation rate was 42.7% in 2022. Women's participation is relatively low at a rate of only 28.7% compared with 53.9% for men. These data do not account for the significant informal household and farm labor provided by women. The official unemployment rate was 10.7% in 2023, according to the World Bank.

The economic environment described above shifted dramatically in late 2024 and early 2025 due to severe weather events. In September, Nepal experienced its heaviest monsoon rainfall recorded in 50 years, resulting in floods and landslides that inflicted an estimated loss of NPR 17 billion. The actual economic impact was still being assessed as the review period closed, but initial estimates suggested that losses could exceed NPR 57 billion, potentially reducing GDP by 1%. The agricultural sector sustained the hardest blow from the flooding, with losses estimated at NPR 6 billion, leading to higher food prices and reduced incomes, while increased food imports are expected going forward. Other sectors likewise faced substantial losses, including NPR 4 billion in the energy sector, NPR 3.55 billion in water supply, NPR 2.52 billion in roads and NPR 1 billion in irrigation. Infrastructure damage was extensive, with damage affecting 37 highways, 312 telecom sites, five major transmission lines and 16 hydropower projects with a combined capacity of 664 MW. As a result, the need for reconstruction is urgent, though relatively low government revenues and significant public debt constrain options.

12 | Sustainability

In September 2024, Nepal was hit by the heaviest monsoon rainfall recorded in 50 years. Climate experts attribute the intensity of this monsoon event to climate change. This was supported by a study from World Weather Attribution scientists, who found that climate change amplified rainfall by about 10%. Nepal's vulnerability to such disasters is underscored by its ranking 124th out of 187 countries in the 2022 Notre Dame Global Adaptation Index (ND-GAIN) measuring climate change vulnerability. Crucially, the catastrophic outcome of the floods highlighted Nepal's long-standing weaknesses with regard to disaster preparedness and response. Experts criticized the government's response as reactive, with policymakers taking action only after the disaster had struck. Indeed, even after meteorologists had warned of upcoming rain, no action was taken. Rapid urbanization and poor urban planning, along with haphazard construction on floodplains and riverbanks, inadequate drainage systems, and encroachment on waterways, have increased vulnerability to flooding and contributed significantly to the disaster's severity.

Environmental
policy

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The significant reduction in forested area over the years due to land-cover conversion, coupled with frequent forest fires, has increased the risk of landslides. While the country has increased its forest cover over the years, concerning trends in deforestation and forest degradation were documented in 2023 and 2024, especially in the Terai region. Indeed, Global Forest Watch data show that Nepal lost 48,600 hectares of tree cover from 2001 to 2023, with 7,050 hectares lost to fires. With more than 5,500 reported forest fire incidents, 2023 was particularly devastating.

Several factors continue to threaten Nepal's forests, including illegal logging, fuelwood extraction, cattle ranching, agricultural expansion and infrastructure development. Recent policy changes have further exacerbated these concerns. In 2024, the government introduced measures allowing for large-scale infrastructure projects in previously protected areas, alarming conservationists and Indigenous communities alike. Moreover, Nepal's Community Forestry Program – which is the cornerstone of Nepal's sustainable forest management, enabled by the Forest Act of 1993 and the Forest Regulation of 1995 – has faced significant challenges and developments since 2021. Financial constraints have become a major issue, with more than 13,000 community forests unable to renew operational plans due to insufficient funding. This has been compounded by demographic shifts, particularly outward migration from mid-hill and mountainous areas, leading to a loss of financial support for community forest groups. Taxation issues also play a role, with community forest groups facing a 25% tax on their annual income.

Despite such deficiencies, Nepal is engaged in carbon-trading programs. Recently, the World Bank announced it would pay up to \$45 million for the protection of Nepal's forests through the Forest Carbon Partnership Facility (FCPF). Crucially, however, communities may fail to benefit from this program due to bureaucratic complexity. The program also faces challenges with regard to biodiversity conservation. Many newly forested areas are pine monocultures, which are economically viable but inadequate as wildlife habitats.

By international standards, Nepal's energy is relatively clean, driven primarily by the remarkable hydroelectric potential of its many rivers. Abundant renewable power has fueled the rapid expansion of charging networks, with electric vehicle import volumes having doubled for two years running. As a result, Nepal has significantly reduced its oil imports by about \$22 million a year while simultaneously improving air quality. Still, Nepal's intense hydropower expansion in 2023 and 2024 has brought significant environmental challenges. Rivers and aquatic ecosystems have been disrupted, resulting in dried riverbeds and disrupted fish migrations. Furthermore, the vulnerability of this energy source to climate change has increased, with recent floods and landslides causing extensive damage.

Under its 2019 National Climate Change Policy, Nepal is attempting to transition away from carbon, but its emissions rose 41.5% between 2010 and 2021 to 50 million metric tons of carbon dioxide equivalent, despite its aim to reach net-zero emissions

by 2045. In April 2024, Kathmandu’s air quality worsened to unhealthy levels, and the city was ranked the sixth-most-polluted municipality globally. The primary sources of pollution and activities in Nepal include vehicle emissions, road dust, construction activities and agricultural waste burning. The problem is exacerbated by Nepal’s topography, particularly in the Kathmandu Valley, where pollution tends not to disperse beyond the surrounding mountains.

At the time of the last census in 2021, the literacy rate among men was 83.1%, compared to 69.4% among women. The overall adult literacy rate was 76.2%. According to World Bank data, Nepal’s public expenditure on education amounted to 3.7% of GDP in 2023, and Nepal’s primary school completion rate has recently increased significantly to 115%, implying that overage children are now enrolled in school.

Nepal has also completed its transition from a school-leaving certificate examination (SLC), which acted as an “iron gate” for many students who attended government schools in rural areas, to a secondary education examination (SEE). Although initial pass rates in 2022 were much higher, the 2024 pass rate was 47.87%, meaning less than half of examined students were able to progress to 11th grade. This was very similar to pass rates under the SLC system, suggesting persistent problems in education delivery, exacerbated by underfunding. In 2023, 15% of overall public spending was allocated to education, falling short of the government’s goal of allocating at least 20% of its budget to education.

Pursuing tertiary education has become more common among the youngest generation, yet many college students seek to leave Nepal for their education. Despite this negative trend, Kathmandu now hosts a number of public and private universities. Kathmandu performs reasonably well in professional-level medical training. Overall, however, national spending on research and development remains almost nonexistent, and it will be some time before Nepal develops a thriving R&D sector.

Education policy /
R&D

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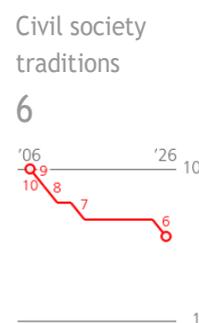
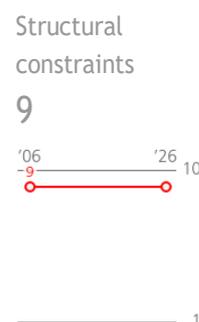


Governance

I. Level of Difficulty

Political leaders in Nepal continue to face significant structural constraints in achieving good governance goals. Highly unfavorable conditions for economic and political transformation include a low level of economic and social development; a population with relatively low, though improving, average educational attainment; the geographic disadvantages of a landlocked and relatively resource-poor state; and a strengthening but still fairly weak state. Nepal’s environment is prone to natural disasters, as seen in the devastating 2015 earthquakes. Furthermore, the state has not adequately addressed climate change-related problems, as evidenced during the 2024 floods. The country’s terrain is challenging to navigate, but with the federal system and the rise of independent politicians, policymakers are increasingly assessing citizens’ aspirations and needs closer to the ground and beginning to meet them. Still, poverty remains problematic and educational resources are scarce in many parts of the country. Rapid urbanization and an ongoing brain drain also present unique policy challenges, though the COVID-19 pandemic brought many expatriate Nepalis home. The political leadership is at fault for Nepal’s governance problems, but a nascent trend toward electing political outsiders may breathe life and accountability into the system. Infrastructure remains a problem, but investments in this sector are beginning to pay dividends.

Nepal has a vibrant civil society, which has long been a major recipient of official development assistance. Governance has been supported by a host of international and national NGOs – sometimes to the long-term detriment of state capacity, as private initiatives have reduced the need for stronger government assistance. Against this background, Nepal has a high level of social trust, and spaces for civic participation are relatively open. This environment has contributed to the emergence of various indigenous civil society movements. Many forms of engagement revolve around highly specific local affiliations and identities as opposed to national ones, enabling a wide range of civil society organizations to operate even in the most remote and impoverished areas of the country.



Political elites have used polarizing tactics to create cleavages along ethnic and regional lines. However, recent voting patterns suggest a shift away from identity politics. The National Independent Party (Rastriya Swatantra Party, RSP), which unites political independents, won an unexpectedly high number of seats in the 2022 elections. Still, many minority ethnolinguistic groups remain dissatisfied with their representation in the system. Fortunately, outright violence is rare. Most actors turn to electoral politics or the courts to resolve disputes and grievances. Nepal's new institutional framework – federalism in particular – is addressing these concerns more effectively than its old institutions.

II. Governance Performance

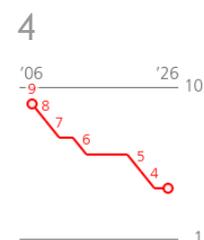
14 | Steering Capability

Nepal faces significant structural challenges in governance, but much of the difficulty in advancing its development agenda stems from weak political leadership and limited strategic direction. The heterogeneous character of multiparty coalition governments before 2004, in the period from 2006 to 2012, and again since January 2014 has made it extremely difficult, even for determined policymakers, to set strategic, long-term priorities. This is compounded by the segmentation of the cabinet along party lines, which causes coordination problems among ministries. Important policy decisions are frequently subject to fierce distributional battles among ministries. This tendency is now being replicated at the provincial and local levels with the step-by-step introduction of federalism and decentralization.

In addition, there have been few internal regulatory impact assessments carried out and no strategic planning units in place, which has made it challenging for any government to strategize and organize its policy measures. However, NGOs regularly provide guidance to fill this void. On the positive side, with the political struggle over the character of the Nepali state settled at least in the medium term, there is no longer a political excuse for failing to pay attention to administrative reforms and long-deferred governance tasks such as infrastructure development, poverty alleviation, and climate adaptation and mitigation.

Even when there is consensus around a particular policy, the crucial bottleneck in Nepal lies less in drafting good policies than in implementing them. Successive governments have instituted numerous industrial growth, investment and trade promotion policies, often with substantial and systematic donor input. However, implementation has often been limited. This is not entirely an effect of poor governance at the top, as it also involves a pervasive lack of expertise and capacity throughout the bureaucracy. One example of this inefficiency was the delayed implementation of the National Reconstruction Authority and the continued struggle

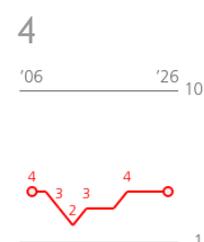
Conflict intensity



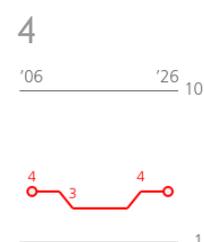
Question

Score

Prioritization



Implementation



to deliver relief to millions of earthquake victims across the country. Nepal's government showed moderate improvement in its crisis response with a more structured COVID-19 strategy and its relatively swift reaction to the 2024 floods, including by declaring disaster zones and deploying rescue teams. However, both responses revealed ongoing weaknesses in the areas of coordination, infrastructure and preparedness. It should not come as a surprise that a government which struggles to implement disaster relief would have limited steering capacity on other issues.

The multiple governments in power during the review period have not been particularly effective at implementation. A constitutional crisis had distracting effects for some time, but federalism has become increasingly institutionally anchored, and its implementation has forced parties and the bureaucracy to learn and innovate beyond the electoral arena. With resources now distributed closer to the ground, both governing parties and candidates for power have learned to tailor policy to local needs. In the past, many of these policies were colored by ethnic politics, but recent electoral results suggest a move away from identity and establishment parties and toward political newcomers. The most concrete success in the field of policy learning is Nepal's National Monitoring and Evaluation System, which has been in place since the mid-1970s and has only recently become more effective. However, it is limited to certain sectors in which the Asian Development Bank is active, such as the energy sector.

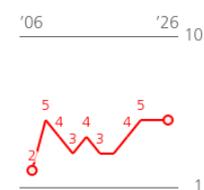
15 | Resource Efficiency

Many recent governments in Nepal have struggled to use available economic and human resources efficiently for policy implementation. During the COVID-19 pandemic, the government marshaled its resources effectively, acquired additional resources, hired staff and provided a reasonably effective pandemic response. In terms of broader project execution and fiscal management, however, Nepal continues to face challenges. A host of infrastructure projects – particularly roads and tunnels aimed at cutting travel and transport times – appear to be moving forward, though many projects have stalled or failed to progress as anticipated. These inefficiencies persisted into 2024 and 2025, reflecting deeper issues in project implementation and capital expenditure, though it is unclear whether this is a personnel problem or something else entirely.

Development aid from India, China and the West plays an important role in Nepal's budget. Monitoring of these funds and their implementation remains problematic but has improved, with civil society acting as a watchdog. Nepal's administrative and civil services remain underfunded and understaffed, and their decision-making processes continue to be fragmented. Problems with timely spending also contribute to serious delays and the waste of resources on infrastructure projects and beyond. Such funding has also become politicized, with Millennium Grant protests forcing Nepali authorities to publicly deny that Chinese infrastructure funding in Nepal is part of the Belt and Road Initiative (BRI).

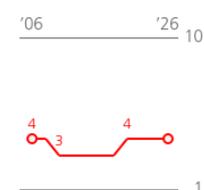
Policy learning

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Efficient use of assets

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However, some improvements have occurred. The near-elimination of electricity cuts, which were initiated under a Maoist-Congress coalition government, is one example. A decade ago, Nepal often faced 16-hour-per-day cuts; since then, overall electricity consumption has risen by 21.18%, and an impressive 98% of the population now enjoys access to electricity without significant staffing or budget increases having been carried out. Water resource management has also improved. In March 2024, the government introduced a Response Strategy for Water Resources Management, incorporating an Action Plan and a Finance Plan aimed at addressing the impacts of climate change and enhancing resource management efficiency. The effectiveness of these efforts will be addressed in future BTI review periods.

Youth unemployment and a domestic job shortage are among Nepal’s most pressing problems. Young Nepalis are migrating abroad for work in record numbers. The government conducts decent job monitoring and supports individuals seeking work abroad, yet it has struggled to administer programs to create jobs at home.

Over the past 30 years, as politicians and bureaucrats have focused on pressing issues such as civil war or drafting a new constitution, policy coordination in Nepal has suffered. Nepal has often formed commissions or committees to address policy incoherence and improve horizontal coordination, but these recommendations have rarely resulted in policy action.

Political churn may be to blame for this problem. The coalition government in power as the review period closed was the 12th to be formed over the last decade. Because Nepal has many political parties, they have had to become increasingly flexible to win elections. Overall, few parties have had time to implement their policy agendas before losing office, which fundamentally hampers the efficient use of resources and effective policy coordination.

Persistent corruption undercuts government efficiency in Nepal. Corruption hampers the effective use of public funds, misdirects aid money and undermines the execution of development projects. Acknowledging the problem, the government is taking steps to tackle corruption. The CIAA significantly increased its efforts in FY 2023/24, filing 201 corruption cases involving 1,545 individuals, twice the comparable figure from the previous year. Fiscal measures, including cuts in recurrent spending and austerity policies, helped narrow the fiscal deficit to 2.6% of GDP in FY 2024. In terms of public procurement, Nepal’s implementation of the e-Government Procurement (e-GP) system has led to significant transparency gains. Nepal has institutionalized the Office of the Auditor-General responsible for overseeing public spending, but the office has not been particularly powerful or well staffed. In addition, party funding and campaign financing remain opaquely regulated, so parties regularly exceed legal spending limits and often do not disclose their funding sources.



16 | Consensus-Building

Nepal's considerable ethnic and linguistic diversity makes it challenging to achieve political consensus. Fortunately, political parties have a long history of supporting democracy even prior to the democratization process initiated in the 1990s. When it committed to peace, the CPN-M agreed to conduct politics within constitutional-democratic boundaries and has largely done so to date.

The 2022 elections brought Prime Minister Pushpa Kamal Dahal, leader of the Communist Party of Nepal (Maoist Center) (CPN-MC) to power at the head of a coalition government that included the Communist Party of Nepal (Unified Marxist-Leninist) (CPN-UML) and the new National Independent Party (RSP), among others. However, when the CPN-UML withdrew, the coalition quickly shifted, and a “national consensus government” was formed under Prime Minister K.P. Oli. In March 2023, Ramchandra Paudel was elected president with the support of eight political parties. Dahal's backing of Paudel, the Nepali Congress party candidate, over the CPN-UML candidate contributed to CPN-UML's withdrawal from the coalition. Such frequent shifts in alliances highlight the weak nature of consensus-building in Nepal, where coalitions remain unstable.

Nepal has many communist-leaning parties. Despite their orientation, they advocate land redistribution and a more inclusive welfare state without truly challenging Nepal's market economy.

Despite Nepal's history of protest-based movements and civil conflict, there is now a pro-democratic consensus among all major political actors. This is because after years of conflict and upheaval, a democratic framework has proved to be the most effective means of achieving stability, power-sharing and legitimacy. The 2006 peace agreement, the 2015 constitution and regular elections have brought former rebels and traditional elites into a common system, reducing incentives for extralegal or violent political action. Moreover, federalism has reduced the ability of individual actors to concentrate power. Even those aspects of the state not subject to democratic processes, such as the Nepal Armed Forces, do not pose a major threat to the pro-democratic consensus.

Other potential sources of dissent from the pro-democratic consensus do not appear to pose an imminent threat to it. For its part, the former royal family has not attempted to return to power, even though the royalist Rastriya Prajatantra Party enjoyed renewed support in the 2022 elections. Conservative parties running on platforms that stress a return to Hindu values and culturally homogeneous nationalism do not appear poised to make gains (unlike parties in neighboring India). Although Nepal has a long history of politics playing out in the streets rather than through institutional mechanisms, the frequency and tenor of protests – apart from the recent pro-monarchy protests – have moderated dramatically over the past few years.

Consensus on goals

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Anti-democratic actors

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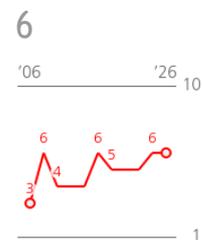
The most significant problem Nepal faces with regard to consensus-building is the tendency of the political elite to use identity politics to create cleavages for political gain. This has been particularly evident in recent years. Once ignored during the monarchy because of presumed cultural homogeneity and the political, social and economic domination of the high-caste Hindu elite – which benefited from maintaining the status quo – identity politics have become an effective means for improving the rights of marginalized groups. Combined with federalism, they have also contributed to establishing a more inclusive state than before. However, identity-based political mobilization threatens to fragment the political spectrum and limit political parties to little more than identity-based distribution of state resources, an issue neighboring India has struggled with for decades. The rise of the National Independent Party (RSP) portends a shift away from identity politics toward political outsiders. The RSP’s ability to moderate cleavage-based conflict has been tested, if only briefly. Another party, the RPP, aims to unite across cleavages in support of a return to the monarchy, but in practice those who endorse this party tend to be upper-caste, relatively well-off and from Kathmandu or the hills.

The political leadership has become less repressive and more consultative over the years. As a result, there has recently been increased activity among non-governmental organizations and civil society groups. Advocacy on behalf of women’s and minority rights has increased. However, this identity-based activism has led many citizens to view civil society as dominated by the same identity cleavages they see in the political arena. This is partly because organizations often attract members along party lines. In addition, many civil society organizations are highly dependent on donor funding. While this funding is vital, it also skews agendas toward donors’ funding priorities. It should not be surprising, then, that the legitimacy of social movements, civic associations and non-governmental organizations is sometimes politically determined. Few organizations are accepted as legitimate across the political spectrum. Moreover, a persistent problem is that ethnic and regional identity-based groups perceive mainstream political parties as representing the long-dominant upper-caste Hindus, though decentralization and federalism have dampened these concerns.

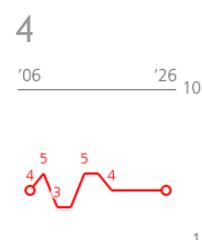
Class-based tensions previously drove rural support for the Maoists. While some grievances that led to the civil war have been addressed, others raised during the armed conflict have not. Although parliament passed the long-awaited Transitional Justice Law in August 2024, human rights organizations say it still contains provisions that are likely to undermine the prospect of a successful outcome. Perpetrators of abuse during the conflict remain at large, and victims’ concerns remain unaddressed.

Still, changes are occurring, and reconciliation is slowly accelerating as a result of decentralization and federalism. Like many countries, Nepal has experienced a growing rural-urban divide over the last 20 to 30 years, with urbanization and

Cleavage / conflict management



Public consultation



Reconciliation



outward migration leaving few working-age men in rural areas. For many years, rural areas remained poor and were largely supported by subsistence agriculture and remittances. Because of improvements in communications, the rural poor became progressively more aware of their relative deprivation, particularly compared with their urban counterparts. Their concerns were prominent in Nepali politics for years. However, federalism and infrastructure improvements are once again changing this. There remains a sense that both physical and social mobility are possible.

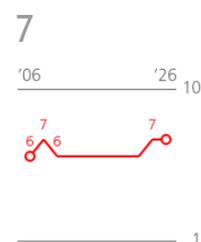
17 | International Cooperation

Nepal has historically cooperated effectively to achieve its development goals, both with its neighbors and with the international community. Yet in FY 2023/24, the country experienced a significant shortfall in foreign aid as international donors increasingly favored loans over grants. Initially, Nepal anticipated receiving NPR 49.94 billion in grants, but ultimately secured only NPR 11.22 billion. This decline is tied to Nepal’s ongoing graduation from least developed country status, which has led donors to view Nepal as financially capable of repaying loans rather than relying on grants. Because 26% of Nepal’s national budget depends on foreign aid, this transition poses a substantial challenge. The country will be required to allocate a larger share of its resources to debt repayment in the future, further straining its financial stability.

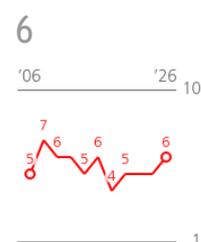
Although Nepali governments have historically cooperated relatively well with international donors and agencies, and continue to do so, this cooperation has not come solely with benefits. Donors and international financial institutions – and, implicitly, the financiers behind them – have long exerted significant policy influence in Nepal, while the government has almost never been in a position to turn down assistance. As a result, despite a relatively clear economic and political development strategy, the government has often had to deviate from its own road map to take advantage of donor or lender assistance that entailed different priorities. In addition, short-term expediencies and rent-seeking sometimes influence the actual integration of international assistance into cooperative projects.

Nepal generally acts as a credible and reliable partner in its interactions with the international community, as illustrated by the amount of aid it continues to garner. To support Nepal’s efforts to strengthen democracy, federalism and sustainable development, the European Union allocated €209 million for the country for the period from 2021 to 2024. Additionally, Germany pledged €56 million for 2022/23, while Australia contributed an estimated \$27.2 million in official development assistance for 2023/24. Among the various multilateral financial institutions (MFIs), the World Bank plays a prominent role in the country, having also entered into two concessional financing agreements with Nepal. One of the agreements includes \$275 million for Nepal’s Accelerating Regional Transport and Trade Connectivity (ACCESS) Project, primarily targeting the country’s connection to India’s western

Effective use of support



Credibility



seaports. A second agreement allocates \$140 million to the Digital Nepal Acceleration (DNA) Project, which aims to expand affordable broadband access in rural areas to enhance the delivery of digital government services. Importantly, this initiative is shaped by a high degree of inclusivity, as it seeks to make digital services more accessible to women, ethnic and social minorities, and persons with disabilities.

Nepal has also cooperated with the international community to bolster its education and health systems. The Nepal-World Health Organization Country Cooperation Strategy, for instance, aims to strengthen and develop Nepal's national health care system. In 2023, the World Bank committed \$100 million to the Nepal Quality Health Systems Program, which is considered a critical step toward achieving the objectives of Nepal's Health Sector Strategic Plan for 2022 – 2030. These efforts were further supported by a \$3.84 million grant from the Health Emergency Preparedness and Response Trust Fund and additional bilateral agreements, such as an agreement with Japan to improve a trauma and emergency center. An example of support in the education sector is financing by the Asian Development Bank (ADB) and the World Bank totaling more than \$300 million to implement Nepal's School Sector Transformation Program (2023 – 2027).

Infrastructure goals have also guided much of the significant cooperation between Nepal and the international community. In 2023 and 2024, Nepal signed agreements with the ADB focused on urban resilience, infrastructure and energy development, including a \$166 million financing package for the Urban Resilience and Livability Improvement Project. Moreover, the ADB approved a \$300 million loan to upgrade a 95-kilometer stretch of the Kakarbhitta-Laukahi road, which is part of the East-West Highway and is also relevant for international trade via the South Asia Subregional Economic Cooperation corridor, which serves as a vital trade route connecting Nepal with India and Bangladesh. In the electricity sector, the ADB approved a \$311 million loan for a project to finance 290 kilometers of power transmission lines, and a \$30 million grant to support training and capacity-building activities in this sector.

In key areas such as sustainable economic development, climate change and environmental sustainability, Nepal has continued to expand its international partnerships. One notable event was the EU-Nepal Business Forum held in May 2024, which aimed to strengthen trade and investment ties between European and Nepali businesses. In addition, the European Union has provided significant funding for Nepal's Local Adaptation to Climate Change project, a 2024 to 2028 collaboration between Nepal and Finland intended to enhance climate resilience and promote sustainable natural resource management.

Nepal is a signatory to a wide range of international agreements, including the Paris Climate Agreement, the International Covenant on Civil and Political Rights, and the Convention Against Torture. Nepal became a member of the WTO on April 23, 2004, after holding observer status under the General Agreement on Tariffs and Trade (GATT). It was also the first least developed country to join the WTO through full

accession negotiations. Nepal has made sincere efforts to implement these agreements domestically, but struggles with enforcement due to limited state capacity.

Nepal is a member of regional agreements that affect trade and markets, including the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Free Trade Area, the South Asian Free Trade Area (SAFTA), and the South Asian Association for Regional Cooperation (SAARC). Despite commitments to cut formal tariff rates to zero by 2016, hundreds of “sensitive” goods produced by various SAARC member countries remain subject to tariff barriers, excluding them from duty-free status.

The relationship between Nepal and India saw significant advancements during the review period, particularly in the sectors of energy, connectivity, trade and infrastructure. Amid this intensified exchange, India increased its development assistance to Nepal, allocating INR 7 billion under its “Neighborhood First” policy. With regard to energy, a long-term power trade agreement was signed, enabling Nepal to export 10,000 MW of electricity to India over the next decade. The two nations also made progress on various hydropower projects and transmission lines. Connectivity improvements included the revision of the Nepal-India Trade and Transit Treaty, granting Nepal access to India’s inland waterways, and progress in the development of four integrated check posts. In October 2023, the duty-free Trade Treaty was automatically renewed, maintaining Nepal’s access to the Indian market. The transportation sector also saw notable progress with the Kurtha-Bijalpura railway section and the inaugural run of an Indian cargo train from Bathnaha to Nepal Customs Yard. Digital connectivity between the countries improved with the introduction of Unified Payments Interface (UPI) payments for Indian nationals in Nepal in February 2024. In October 2024, a B2B Framework Agreement was signed to develop petroleum infrastructure in Nepal, including plans for a 50-kilometer pipeline from Siliguri to Charali and the construction of a Smart Greenfield Terminal at Charali. Financially, India increased its annual grant to Nepal for FY 2024/25 to INR 11.2 billion, up from INR 8.8 billion the previous year, and extended lines of credit worth \$1.65 billion for various infrastructure projects.

Cooperation with China, the country’s second significant neighboring state, advanced in 2023 and 2024. To boost trade, China announced zero-tariff treatment for 100% of taxable Nepali exports. On December 4, 2024, Nepal and China signed the Framework for Belt and Road Cooperation, a significant milestone toward Nepal’s participation. Under this agreement, the two countries identified 10 projects to be executed within the Belt and Road Initiative (BRI) framework. Relatedly, Nepal has reiterated its commitment to the “One China” policy, assuring China that no anti-China activities would be permitted on Nepali soil. Despite these advancements, challenges remain. Nepal initially advocated for grants, while China preferred alternative financing models. As of the close of the review period, Nepal was still awaiting the release of \$740 million in development grants pledged by China.

Regional cooperation

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Strategic Outlook

During the review period, Nepal proved to be more stable than in most periods in recent memory. National-level coalitions formed after the canceled elections in 2022, re-formed and fell apart again without any external influence or violence, confirming that Nepal has shifted away from its previous anti-democratic and conflict-prone trajectory. However, this does not mean that the country's politics have been straightforward or more stable. Given the massive influx of political newcomers during the 2022 election cycle and the flexibility that Nepali political parties have shown in alliance-building, it is hardly surprising that pre-electoral alliances are different from post-electoral coalitions, and that these coalitions have not lasted particularly long. The important point to note here is that, despite considerable political churn, the prospect of renewed conflict – or, in fact, anything other than electoral democracy – is far from most Nepalis' minds. Even the pro-monarchy protests that occurred in 2024 and the unresolved desire among many Nepali youth to emulate Bangladesh's regime-toppling protests have not changed that fact. Furthermore, security forces are improving their self-restraint in response to street protests, crucially enabling the open, peaceful protest that is the hallmark of a consolidated democracy. It will be advisable for Nepal to stay the course and take pride in the fact that in a world shaped by democratic backsliding, its own democratic transition continues to deepen.

Economically, Nepal has largely recovered from the COVID-19 pandemic, but still faces the effects of heightened inflation that continue to plague much of the world. Remittance flows have increased again, though this is viewed with growing ambivalence domestically. On the one hand, they are a much-needed lifeline that spurs domestic consumption; on the other hand, there is regret that Nepal's remittance-based economy entails a brain drain and social costs. Nepal has been trying to foster exports, aided by a weak national currency, yet more is needed for sustainable change. Particularly in light of Nepal's expected graduation from LDC status, which will affect trade, reforms should be prioritized over exchange rate fluctuations. In addition, incremental efforts to liberalize trade and move toward digitalization in the banking sector are important and should be deepened. Nepal has also made sustainability gains and must continue to build on them. Finally, Nepal should continue pushing back on China's investments. Infrastructure is vital, and Nepal requires significant upgrades, but it should carefully consider deeper cooperation with China under the BRI framework.

Governance in Nepal has long been challenging. Despite this, governance is improving – in part due to better infrastructure and communications, and also to federalism and the greater resulting responsiveness of local politics. Combating corruption has been a higher priority in the past two years than previously. The Commission for the Investigation of the Abuse of Authority (CIAA) has used the additional resources it has received to pursue investigations of higher-level figures, and is beginning to build a reputation. Nepal has also progressed in terms of pluralism, civil society consultation and post-conflict reconciliation.

Positive developments should by no means overshadow the challenges ahead. Going forward, Nepal must find a way to support domestic job creation. The resources that families and the state invest in young citizens – only for them to contribute to economic development abroad – are staggering. Nepal must also determine how to respond to climate change-related risks and, inevitably, disasters. The floods of 2024 demonstrated how much action is needed. As with the COVID-19 pandemic, tackling these challenges will help develop state capacity. Nepal can even use this opportunity to improve policy coordination, implementation and resource use by finally completing much-needed administrative reforms. Failing to do so will carry significant costs in the long run.