

# Economic Freedom of the World Country Audit: Regulations

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### 1. Introduction

The Economic Freedom of the World Index, prepared and published by the Fraser Institute, measures the degree to which countries' policies and institutions support economic freedom<sup>1</sup>. The Institute does not gather data but relies on other indices to arrive at the final scores. The final score is an aggregation of scores received in five broader topics which include a) Size of Government, b) Legal System and Property Rights, c) Sound Money, d) Freedom to Trade Internationally and e) Regulations. Each of the five broader categories is disaggregated further to capture, in detail, a country's performance. To gather insights that complement the Economic Freedom Index scores, partner organisations of the Fraser Institute conduct a country audit.

The Economic Freedom Country Audit analyses the factors explaining a particular country's score. It relies on extensive stakeholder consultations to arrive at a set of conclusions which form the basis of actionable recommendations. In the Nepali context, an audit was undertaken in 2015<sup>2</sup>. This iteration of the audit and the analysis that follows thus, concerns itself with the sub-indicator "Regulations". The sub-indicator score relies on four measures, which include:

- a) Credit Market Regulations,
- b) Labour Market Regulations,
- c) Business Regulations, and
- d) Freedom to Compete

There are a few caveats worth noting related to data sources that the Economic Freedom Report relies on. All three elements heavily use the World Bank Ease of Doing Business Index, and the Global Competitiveness Report published by the World Economic Forum. The Ease of Doing Business report has been discontinued and its replacement the B-READY survey has so far not been incorporated in the report. Similarly, the Global Competitiveness Report remains to be updated since its latest iteration in 2019. Given the discontinuation and the lack of an updated version of the Global Competitiveness Report, the Economic freedom scores do not adequately represent the situation. For instance, since 2019 India has reduced over 39000 compliances and decriminalised 3400 legal provisions related to

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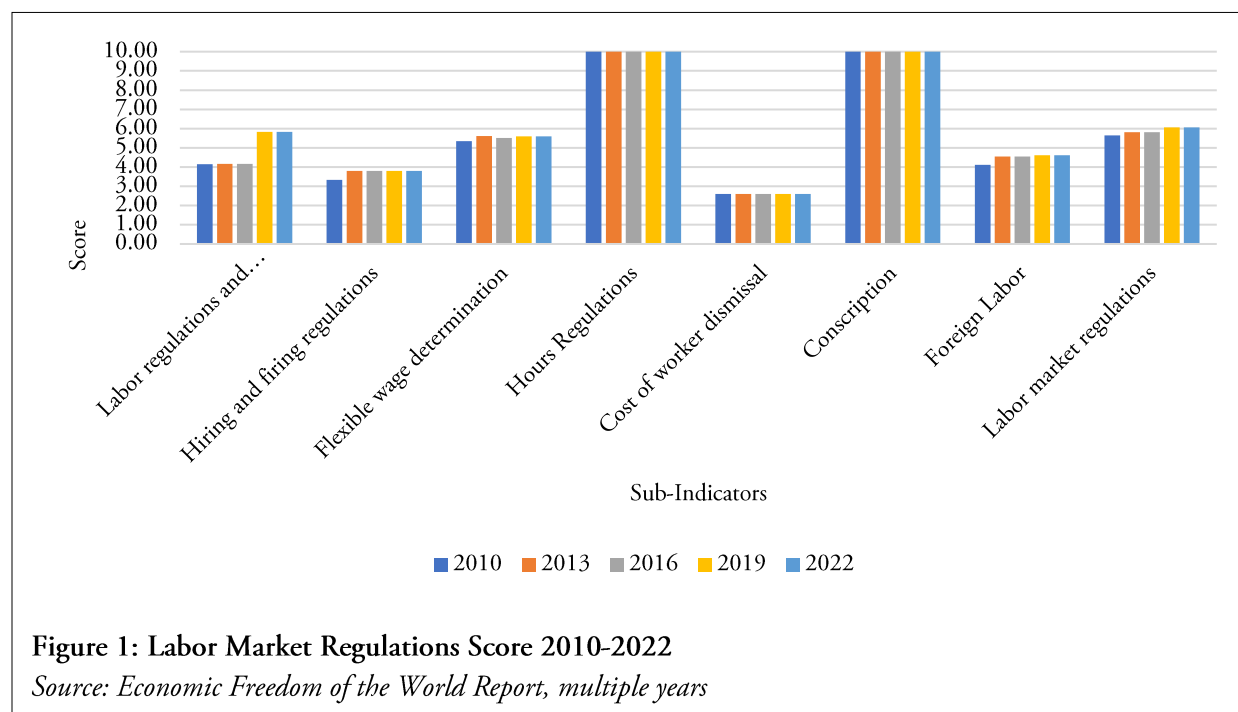
<sup>1</sup> James Gwartney, Robert Lawson, and Ryan Murphy, *Economic Freedom of the World: 2024 Annual Report*, (Vancouver: Fraser Institute, 2024), <https://www.fraserinstitute.org/sites/default/files/2024-10/economic-freedom-of-the-world-2024.pdf>

<sup>2</sup> Samriddhi Foundation, *Economic Freedom Country Audit Report Nepal* (Kathmandu: Nepal, 2015), <https://samriddhi.org/publications/economic-freedom-country-audit-report-nepal-2015/>

the business environment<sup>3</sup>, but its scores in the Economic Freedom Report specifically for sections detailed in this note have remained the same. Nevertheless, because Nepal has not undertaken any significant reform i.e. legislative amendment in the recent past, its scores present an adequate picture. However, its ranking relative to other countries would have changed significantly because of measures undertaken there.

## 2. Labour Market Regulations

**Labour market regulations capture the extent to which labour regulations pose an obstacle to the business environment.** Between 2010 and 2022, Nepal's overall score in labour market regulations improved marginally (See Figure-1). Specifically, Nepal's scores have improved in the labour regulations and minimum wages section, hiring and firing regulations, foreign labour section, and flexible wage determination section.



The improvements in score are driven by the enactment of a new labour law in 2017. The 2017 Labour Act relaxed some provisions related to the costs of employing workers and dismissal of employees. Most notably mandatory third-party approval for dismissal in case of retrenchment was removed<sup>4</sup>. Similarly, conditions for dismissal from service were broadened<sup>5</sup>, provisions for time-bound

<sup>3</sup> Archana Rao, *India's Reforms in Ease of Doing Business: From Compliance to Competitiveness*, India Briefing, December 24 2024, <https://www.india-briefing.com/news/indias-ease-of-doing-business-compliance-to-competitiveness-35544.html/>

<sup>4</sup> See Section 12 of the Labor Act, 2048 v.s. and section 145 of Labor Act, 2074 v.s. for a comparison of provisions relating to retrenchment.

<sup>5</sup> See section 51 of the Labor Act 2048 v.s. and section 131 of the Labour Act, 2074 v.s. for a comparison of offences classified as misconduct and the relevant punishment.

employment and work-based employment were added<sup>6</sup> and provisions related to retrenchment were amended. But despite these changes there are issues in the prevailing labour law. More specifically, these issues relate to small and medium enterprises in Nepal and the added cost of compliance created by the labour law.

**Small and Medium Enterprises find it hard to comply with labour laws in Nepal.** Before the new labour law was enacted, its previous iteration offered some recourse to small and medium enterprises. A headcount provision in the law ensured that small and medium enterprises were afforded some exceptions, specifically in relation to documentation requirements, minimum wages, and retrenchment<sup>7</sup>. However, the new law removes the headcount provisions and makes it mandatory for all enterprises, regardless of employee size, to comply with the provisions. The most pressing concern of Small and medium enterprises is their inability to pay minimum wages.

**The bulk of economic establishments in Nepal is comprised of small and medium enterprises, most notably enterprises that employ less than 10 people.** Per the most recent economic census, 95.3 per cent of all enterprises in Nepal employ less than 10 people. In addition, thirty eight percent of firms in Nepal are self-owned and operated, and 58 percent of firms employ between 5-9 employees<sup>8</sup>. Employment generation to that extent is driven by small and medium-sized enterprises characterised by informal operation, lack of access to finance resulting in lower chances of scaling-up, low productivity, and low profitability. Given this reality, the association of small and medium enterprises has consistently argued that minimum wages are too high in Nepal.

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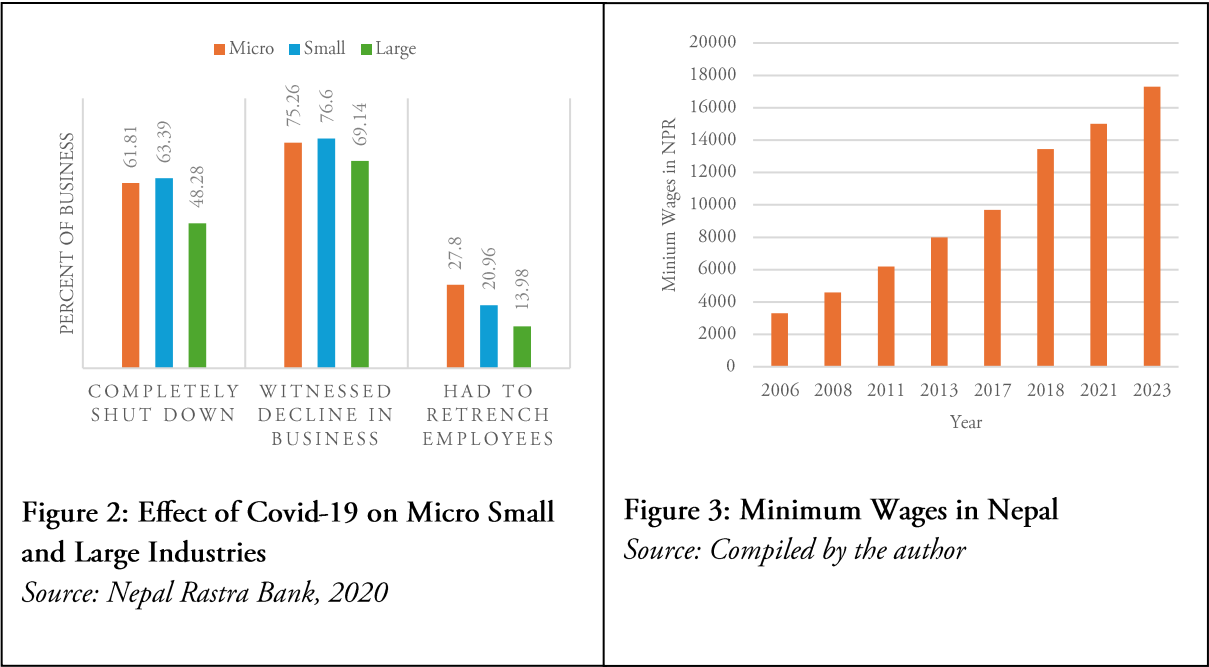
<sup>6</sup> See Section 140 of the Labour Act 2074 v.s.

<sup>7</sup> Labour Act, 2048 v.s. was applicable to any enterprise that employed more than 10 employees.

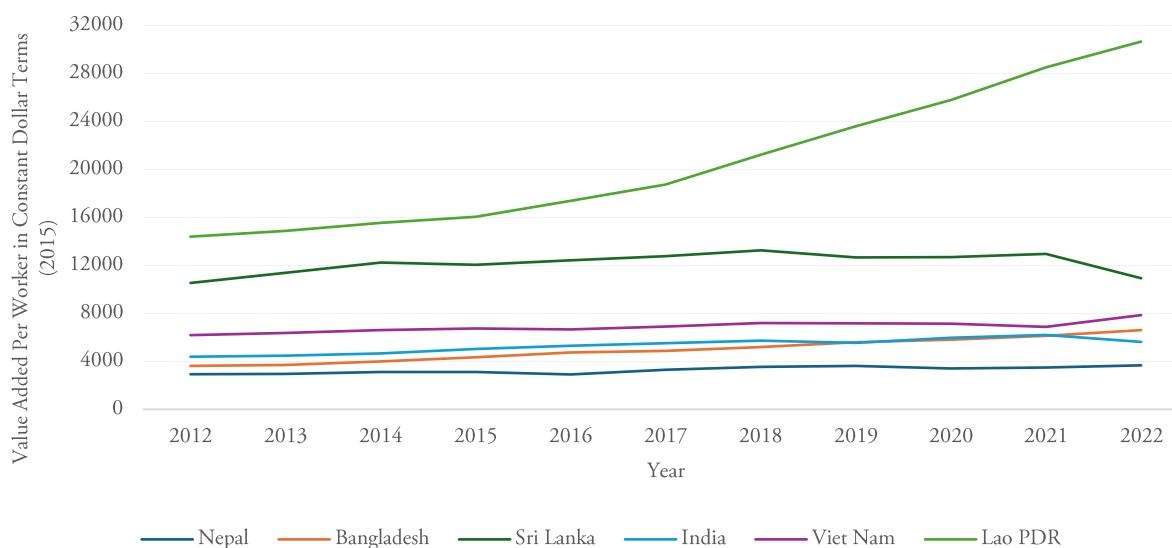
<sup>8</sup> Nepal Statistics Office, *National Economic Census: Main Results*. (Kathmandu: December 2019).

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The most recent minimum wage increase represented a 15 per cent increase and came at a time when enterprises were recovering from the effects of Covid-19. The effects of Covid-19 have been more pronounced for small and medium enterprises (See Figure-2). Participants of the consultative meeting undertaken to inform this audit noted that since Covid-19, SMEs have not been able to fully recover. Absent an updated survey/national data on production and operation, anecdotal evidence suggests that Small and medium enterprises find it hard to pay minimum wages in Nepal.



While minimum wages have increased consistently, labour productivity has not caught up. Minimum wages are rarely set to match labour productivity but firm’s decision to employ labour given a particular cost is almost always a function of productivity. Amongst peers, Nepal has the lowest value added per worker (See Figure-4). Between 2012 and 2022, value added per worker grew by 33 per cent whereas minimum wages grew by 141 per cent. For comparison between the same period Lao PDR’s value added per worker grew by 112 per cent against a minimum wage growth rate of 80 per cent.



**Figure 4: Value Added Per Worker in Constant Dollar Terms (2015) between 2012-2022**

*Source: World Bank Development Indicators*

Because minimum wages are too high for Small and medium enterprises, firms have opted to employ labour temporarily. A recent World Bank survey noted “*There also appears to be a high degree of avoidance of labour law requirements by not offering people salaried jobs even when it is clear from the evidence that people are effectively working full time (one business for example told us that ‘temporary’ staff were needed every day of the year to look after poultry)*”<sup>9</sup>. In addition, 73.67 percent of employees of micro firms and 55.93 percent of Small firms who were furloughed were temporary workers compared to just 45 percent in large firms<sup>10</sup>. In reality, laws meant to protect workers have had the opposite effect; it has arguably created more informal jobs and pushed many outside of the ambit of the formal protection of the labour law.

The added non-wage costs of employment provide a strong disincentive for firms to employee labour permanently as opposed to on a piece-rate or temporary basis. preference for temporary or piece-rate workers over permanent employment. The Labour Act of 2017 significantly increased non-wage costs through its ambitious universal social security scheme. Under this scheme, an employee contributes 11 percent of their basic salary, and the employer contributes 20 percent. Given the absence of a headcount provision, the scheme is applicable to all enterprises regardless of size. In addition, the Labour Act also added other costs which include the mandatory provision for festival allowances i.e. amount equivalent to one month’s pay on top of a bonus sharing provision of 10 per

<sup>9</sup> World Bank, *Market study to understand job growth potential in SMEs in Nepal*, (World Bank Group: Washington DC, September, 2019) <https://documents1.worldbank.org/curated/en/308661592797260961/pdf/Market-Study-to-Understand-Job-Growth-Potential-in-SMEs-in-Nepal.pdf>

<sup>10</sup> Nepal Rastra Bank, *Survey Report on Effects of Covid-19 on the Economy* (Nepal Rastra Bank: Kathamndu, June 2020) <https://www.nrb.org.np/contents/uploads/2024/08/Survey-Report-onCOVID-Impact-Final-1.pdf>

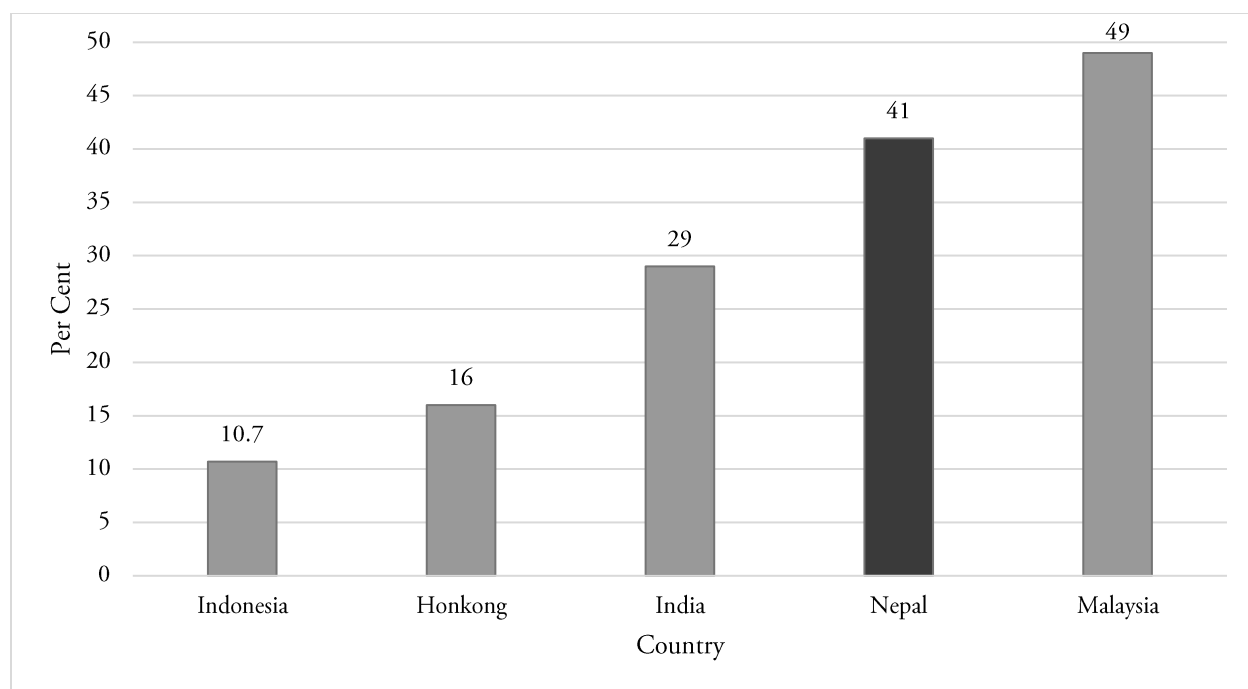
cent of net profits. Whereas under the previous regime, gratuity payments were only applicable after an employee had completed 3 years of service, the current law makes it mandatory for firms to allocate 8.33 per cent of an employee's basic salary from the day they join work. With these provisions in place, the non-wage costs of employing have increased in Nepal, the effect of which is more pronounced for small and medium enterprises.

Particulars	Labour Act, 2047 <i>vs</i>	Labour Act 2074 <i>vs</i>
Provident fund	10 per cent contributed by an employee 10 per cent contributed by employer	10 per cent contributed by an employee 10 per cent contributed by employer
Gratuity	For the first 7 years of service: Half of monthly salary for each year of service. For 7-15 years of service: 2/3rd of the month's salary for each year of service. Eligible only after the completion of 3 years of service.	8.33 per cent of the basic salary Eligible from the first day of employment
Festival Allowances	No provisions	Equivalent to one month's remuneration once every year
Medical Insurance	No provisions	At least 1 Lakh per year for every worker/1.67 per cent of basic remuneration
Bonus	10 per cent of Net profit	10 per cent of Net profit

**Table 1: Comparison of non-wage costs between Labour Act 2047 and 2074**

*Source: Compiled by the Author*

**The added non-wage costs of employment have created a tax wedge high enough to disincentivise formal operation of business.** Taken together, bonus provisions, festival allowances, and social security payments, account for 28 per cent of the basic remuneration of employees. Firm costs for employing formally are in reality the cost of minimum wages plus twenty eight percent, excluding severance pay and medical insurance. Large tax wedges discourage formal employment, and compared to peers, Nepal has a higher tax wedge. Given the lack of any data about formal and non-formal employment in Nepal, an adequate picture of the dynamics of the labour market post the implementation of the labour act 2017 is not available. Anecdotal evidence, however, suggests that informal employment has risen with a preference for temporary and piece rate work.



**Figure 5: Tax Wedges in Nepal**

*Source: Compiled by the Author*

**Disincentive for engaging as a permanent staff member of any firm on part of the employee is an equally pressing concern<sup>11</sup>.** The government of Nepal's plans for contribution-based social security are ambitious, but it also effectively means that employees cannot access 28 percent of the amount of their remuneration until the age of retirement. The current scheme of contribution-based social security in Nepal is designed as a pension scheme. Contributions made by the employer are deposited in an employee-identifiable unique account and, subject to certain exceptions, are handed over to the employees after the retirement age of 60 in the form of monthly pensions. The entire apparatus is managed by the Social Security Fund, a government-owned and operated autonomous retirement fund. Aside from the Social Security Fund, the Government of Nepal also own and operates two other retirement funds—the Citizen Investment Trust and the Employee Provident fund. Both these funds offer far better services and have a much lower lock-in period for funds collected. For instance, the amounts deposited in the Citizen Investment Trust can be withdrawn in its entirety after deposits have been made for a period of 24 months. The same facility is not available under the mandatory Social Security Fund. While the Social Security Fund does provide facilities such as housing loan, medical insurance, and even dividends from investments made, its popularity nonetheless remains low given

<sup>11</sup> The effect is more pronounced in the IT sector. A news item notes that ever since the Government of Nepal announced a flat rate of taxation of 1 per cent for those working in the IT sector on a contractual basis, employees have opted become contractual staff rather than permanent employees. Abhaya Raj Joshi, *Tech founders say Nepal's new tax scheme is pushing workers to foreign firms*, Rest Of World (Kathmandu: 20 December, 2022). <https://restofworld.org/2022/nepals-new-tax-scheme/>

the lock-in period, its focus on pensions, and the inability of employees to withdraw the total amount deposited. In fact, there are other privately owned and operated retirement schemes that offer better services, especially by Banks and Financial Institutions for their staff. To that end, employees of banks and financial institutions have so far strongly opposed the Social Security Fund<sup>12</sup>.

**Aside from the added cost of employing, the current legal regime also places restrictions on termination of employment.** Unlike the previous law, the current law does not require mandatory third-party approval for dismissal of employees. Still it does, however, require that termination of permanent staff be made only when such certain conditions are fulfilled. Termination of employment in the legislation is framed as a last resort punishment that employers may take after warnings, suspensions, or retention of increment in remuneration as tools no longer work. Even in the case of termination of incompetence, an employer has to establish that an employee's work performance has deteriorated for three or more than three consecutive years as evidenced by work-performance evaluation. Worker protection from unfair termination is indeed an important safeguard that labour legislations should spell out, however, the current legislation places far too many restrictions and establishes multiple layers of criteria before the termination process can be established. The result of this system might very well be an incentive over casual-employment or time-bound contracts or piece-rate contracts, all of which offer flexibility to the employer but do not safeguard the interests and rights of the employee.

**The new regime has eased the requirement of seeking approval in the event of collective dismissal of employees, but it has increased the cost of dismissals.** The previous regime made it mandatory for firms to pay remuneration equivalent to 30 days of service for each year of employment in case of collective dismissal. This was, however, only applicable to permanent employees. The new law has, however, made it mandatory for firms to make arrangements for severance payments on a proportionate basis in case an employee has not completed a year of service.

## **Recommendations**

**The headcount provision should be reinstated in the labour law.** Making exceptions for small and medium enterprises isn't an entirely new concept. Several countries make specific exceptions for small and medium enterprises given the nature of operation and their inability to comply. Even the current labour law offers some exceptions, such as the need for an occupational and health safety committee is only applicable to enterprises with more than 20 employees.

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<sup>12</sup> In fact, 29 trade unions of Banks and Financial Institutions had jointly issued a statement stating their unwillingness to enroll in the Social Security Fund. The statement highlighted many key points of contentions amongst which was the high lock-in period and the inability to withdraw the funds in its entirety. Online Khabar, 29 *Vittiya Karmachar Sangathanle Bhane-Yathasthitima Saamjik Suraksha Koshma Jannau*, (Online Khabar: 26 September 2021). <https://www.onlinekhabar.com/2021/06/973940>



**Revisions to the Bonus Act, Labour Act, and the Contribution-based Social Security Act must be made to decrease the cost of employing.** At present, an employer allocates 10 per cent of the net profits and also a festival allowance in a sum equivalent to a month's remuneration. Together with mandatory contributions equal to 20 per cent of an employee's basic wage, the cost of employing is higher. The labour act should be amended to either provide for a festival allowance or a bonus, but not both. In fact, the previous regime did not make it mandatory for firms to pay festival allowance, firms allocated 10 per cent of their net profits during the peak festive season in Nepal, a practice which was later made mandatory by the new labour law.

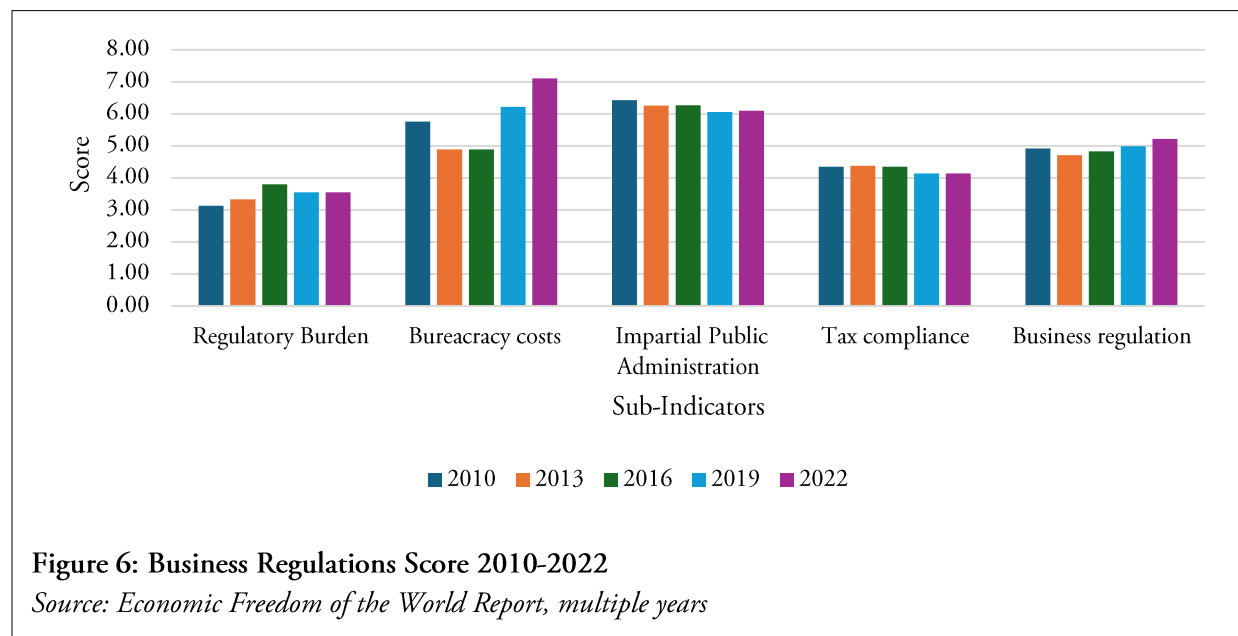
**Nepal's termination rules also require revisions to the extent that the law needs to be amended to provide flexibility to employers to terminate employment in case of incompetence.** Per the current provisions, an employment can be terminated on the grounds of incompetence if the employee's performance has been deemed weak for three or more than three consecutive years. Effectively, an employee will have to bear the cost of employment for three years before the termination process can be started. The need for protecting employee rights is an important aspect of labour law, but the law must also offer flexibility to the employer.

**Nepal's ambitious contribution-based social security scheme must be reviewed.** The present packages and services offered by the social security fund aren't lucrative, other retirement funds owned and operated by the government of Nepal offer better services and also don't have a long lock-in period for funds. The scheme hasn't been popular with both employees and employers, primarily because it does not provide employees the right to withdraw the entirety of the amount deposited in the fund. The scheme is also modeled as a pension scheme, rather than the mandatory application of a pension scheme, the Social Security Fund can be remodeled to allow employees to withdraw their amount in its entirety and also allow them to opt-out.

**Sectoral minimum wages can be more effective than the current system of universal minimum wages.** Sectoral minimum wages can be set through collective bargaining between trade unions and enterprises. In fact, the current labour law does allow for a collective bargaining scheme. There is also ample evidence to suggest that effective wages paid across several sectors are higher than the minimum wages set by the government of Nepal. The distortionary effect of the universal minimum wage is on the low end of the wage spectrum, potentially limiting the creation of formal jobs in the agriculture and hospitality sector.

### 3. Business Regulations and Freedom to Trade Internationally

As far as business regulations are concerned, Nepal has not made any significant improvements<sup>13</sup>. In 2022, Nepal scored 5.22 out of 10, highlighting a regime with excessive regulatory burden and complex taxation procedures. While Nepal has been able to reduce bureaucracy costs through digitisation of a few regulatory services, such as the company administration and tax administration, over the same period, the burden of regulations and the cost of tax compliance have also increased<sup>14</sup>.



Nepal has made significant improvements in the freedom to compete indicator<sup>15</sup>. Between 2010 and 2022, Nepal has made significant improvements highlighted by its score of 7.29 in 2022 as opposed to 6.17 in 2010. This increase was driven by a reduction in the time taken to receive permits related to electricity and construction. The time taken to obtain an electricity connection and water connection in Nepal is lower than the South Asian average and even the global average<sup>16</sup>. This together with the absence of any mechanisms for price control has meant that Nepal's overall scores are higher

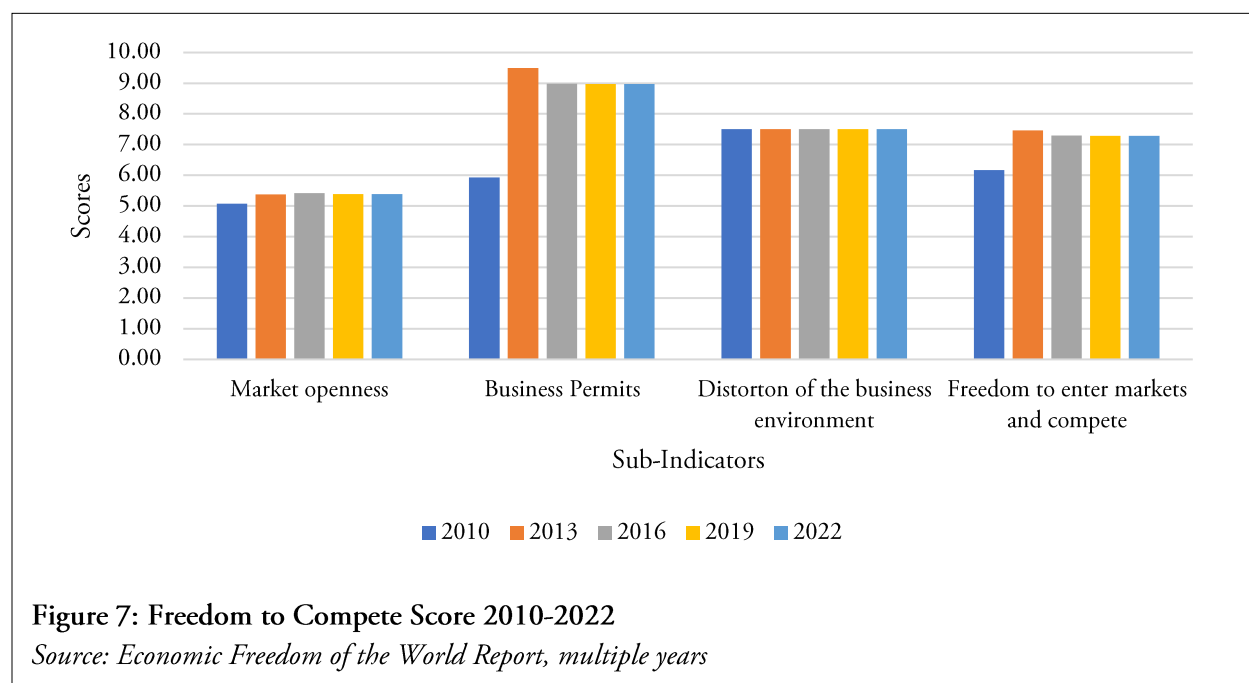
<sup>13</sup> Business Regulations measure the extent to which an economy is free as evidenced from costs of complying with regulations and the quality of the regulatory body i.e. impartiality. The underlying assumption is that lower regulatory costs, impartial public administration, and lower costs of complying with business regulations signal an economically free country.

<sup>14</sup> Company administration, Tax administration, and Industry registration function are now completely digitised.

<sup>15</sup> Freedom to compete measures the extent to which market entry is restricted. The assumption is that restrictions on entry through increased cost of starting a business, complex licensing mechanisms and price controls create a distortionary effect that limits competition.

<sup>16</sup> World Bank, *Enterprise Survey* (Washington DC: World Bank, 2023), <https://www.enterprisesurveys.org/en/data/exploreconomies/2023/nepal>

than other countries in South Asia—India (6.77), Bangladesh (5.29), Pakistan (6.06), Sri Lanka (6.89)—and even comparator countries like Lao PDR (5.43), Vietnam(5.76) and Malaysia (7.03).



**Regulatory burden disproportionately affects small and medium enterprises in Nepal.** The latest Enterprise survey noted that the senior management of Small and Medium enterprises spent 6.7 and 9.4 per cent of their time, respectively, dealing with government regulation against 4.9 per cent of the time spent by senior management of large enterprises<sup>17</sup>. The findings are consistent with the Enabling Environment for Sustainable Enterprises Survey, 2018 conducted by the ILO<sup>18</sup>. The survey reports that a higher share of small enterprises find the regulatory environment to be more problematic than large enterprises. The low uptake of digital services provided by the government of Nepal amongst small and medium enterprises is likely a reason for small and medium enterprises finding the regulatory environment burdensome, for instance, only 35.3 per cent of small firms file taxes electronically compared to 71.6 per cent of large firms<sup>19</sup>.

**Even large firms face significant regulatory costs.** Except for a brief period in the 1990s, rationalising legal provisions related to the business environment has never been the top priority. Consequently, several redundant and often conflicting provisions exist. A prime example is the Black Marketing and Other Social Offences Act. Nearly all provisions of the law have been covered by the Consumer

<sup>17</sup> World Bank, *Enterprise Survey* (Washington DC: World Bank, 2023), <https://www.enterprisesurveys.org/en/data/exploreeconomics/2023/nepal>

<sup>18</sup> International Labour Organisation, *Enabling Environment for Sustainable Enterprises* (Geneva: Switzerland, 2018), p.33. [https://www.ilo.org/sites/default/files/wcmsp5/groups/public/%40asia/%40ro-bangkok/%40ilo-kathmandu/documents/publication/wcms\\_655934.pdf](https://www.ilo.org/sites/default/files/wcmsp5/groups/public/%40asia/%40ro-bangkok/%40ilo-kathmandu/documents/publication/wcms_655934.pdf)

<sup>19</sup> World Bank, *Enterprise Survey* (Washington DC: World Bank, 2023), <https://www.enterprisesurveys.org/en/data/exploreeconomics/2023/nepal>

Protection Act, yet the former is still in effect. Large firms also have to comply with multiple regulatory requirements implemented by multiple government agencies. For instance, a hydropower business is regulated by a total of 26 government agencies under seven different ministries, the cement industry is regulated by 27 different governments. Some efforts have been made to rationalise the legal regime. The most notable being a wholesale revision of a bundle of legislation. While a step in the right direction, government efforts should be concentrated on reducing the number of government agencies involved in regulating a particular business.

**Firms regardless of their size find tax provisions hard to comply with.** Against the South Asian average, Nepali firms spend an additional 22 hours complying with taxes<sup>20</sup>. In addition, 20.2 per cent of large firms noted that they were expected to give gifts in meetings with tax officials<sup>21</sup>. Numerous commissions formed since 2065 *v.s.* to suggest taxation reforms have noted the complexity of the taxation regime<sup>22</sup>. The issue is further compounded by the outlook of tax offices i.e. losses are a deliberate attempt made by firms to evade taxes, and inconsistent judgments rendered by the Supreme Court of Nepal<sup>23</sup>.

**The complexity of the tax regime isn't a result of the current tax codes, but rather because of weak implementation capacity.** In consultative meetings undertaking to inform this audit, participants noted that the tax laws in and of themselves weren't the problem. They were in fact, save for a few provisions, in line with global standards. The problem is that the interpretation of the laws is not consistent. Although the Inland Revenue Department has issued explanatory notes for all provisions, businesses often have to navigate the challenges brought forth by inconsistent interpretation by tax officers. To make matters worse, even the court has not offered a consistent interpretation of the provisions in its judgments.

**The issue of inconsistent interpretation is further compounded by the refusal of the tax office to issue advance rulings.** Section 76 of the Income Tax Act provides for advance rulings—explanations regarding the interpretation of provisions of the Income Tax Act should any person request the Inland Revenue department for removal of confusion regarding said provision. The act however, does not make it mandatory for the Inland Revenue Department to issue advance rulings; it rather provides the Inland Revenue Department power to provide rulings. As participants of the consultative meeting noted, the department, in a majority of

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<sup>20</sup> Small firms spend 90 hours, medium-sized firms spend 122 hours, and large firms spend 130 hours yearly complying with tax provisions.

<sup>21</sup> World Bank, *Enterprise Survey* (Washington DC: World Bank, 2023), <https://www.enterprisesurveys.org/en/data/exploreeconomies/2023/nepal>

<sup>22</sup> Ministry of Finance, *Rajaswa Pramasha Samitika Sujhav tatha Sifarishharuko Sanghalo (2066-2078)*, (Singha Durbar: Nepal, 2078).

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<sup>23</sup> Shailendra Uprety, *Taxation of Material Losses: Thousand possibilities and One Truth*, Journal of the Institute of Chartered Accountants of Nepal, Vol. 24, No. 2, December, 2021, 37-42, [https://en.ican.org.np/browsable/file/journals/Journal\\_Issue\\_December\\_2021.pdf](https://en.ican.org.np/browsable/file/journals/Journal_Issue_December_2021.pdf)

instances, does not provide an advance ruling. Businesses, as a consequence, have no other option but to bear the costs of inconsistent interpretation of laws in Nepal.

**Inconsistent interpretation also highlights the nature of public administration in Nepal.** Public administration in Nepal is not entirely impartial. While Nepal's scores on the impartial public administration section have increased, data from the latest round of the Enterprise survey especially with regards the number of firms expected to give gifts for getting an electricity connection, construction permit, and import licenses indicates otherwise. Admittedly, Nepal has reduced this incidence amongst small and medium enterprises but substituted it with expectations from large enterprises (See Figures 8 and 9). Between 2013 and 2023, the number of large enterprises reporting the expectation of a gift for an import license, construction permit and electrical connection has increased, whereas the figures for small and medium enterprises have decreased.



Several barriers to entry have likely fostered a rent-seeking culture. Nepal still has in place a multitude of pre-operational licenses that are required before anyone can commercially operate a business. In fact, it has been noted that the license raj, which existed before the 1990s, has silently crept into the current bureaucratic apparatus<sup>24</sup>. In recent years, there have also been several high-profile corruption scandals relating to the use of the law to grant licenses for the operation of businesses to

<sup>24</sup> Ram Krishna Paudel, *Khula Arthatantra Bhitra ko License Raaj* (Bikash News: 16 January, 2019), <https://www.bikashnews.com/story/131204/>

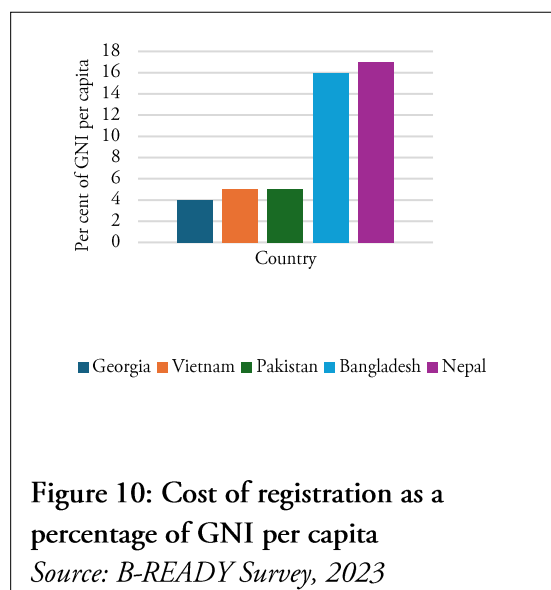
those close to the political elites<sup>25</sup>. Even when the primary legislation makes arrangements for the registration of companies, rules and regulations framed there under impose several restrictions. A prime example is the case of Micro Breweries in Nepal. The Industrial Enterprise Act, 2020 officially recognised Micro Breweries as a business establishment, it provided the Industrial and Investment Facilitation Board with the power to frame working procedures for the registration of microbreweries. The board took four years to issue regulations, and its regulations favoured large businesses over small breweries evidenced by the criteria requiring a seating capacity of more than 200 for any establishment to operate a microbrewery<sup>26</sup>.

**The time and cost of starting a business are high.** In 2023, it took 14 days to register a company, and it cost 17 per cent of the total GNI per capita<sup>27</sup>. In comparison to other countries, the time taken to register a company is lower in Nepal, but this figure does not account for the time taken to receive pre-approval licenses. Similarly, the lack of nodal agencies of the company registrar's office across Nepal has significantly increased the cost of company registration in the absence of substantial uptake of the online registration facility<sup>28</sup>.

Compared to Bangladesh, Viet Nam, Georgia and Pakistan, Nepal's cost of registration is higher given paid-up capital requirements for public limited

companies and registration fees (See Figure 10). In addition, the cost of lawyers also adds to the cost of registration. While the primary legislation, i.e. the company act does not specify that consultation with a legal service provider is mandatory, the companies' directives require the signature of a legal service provider in the Memorandum of Association and Articles of Association, along with all other documents.

Simplification of the process and cost of registration, although talked about, have nonetheless suffered from a lack of legislative changes. A telling example is the state of the one-stop centre. One-



<sup>25</sup> Ramesh Kumar, *Panchayt Samjhaune License Raaj: Yasari Posidai Cha Aaasepase* (Himal Khabar: 19 June, 2021), <https://www.himalkhabar.com/news/124497>

<sup>26</sup> Ramesh Kumar, *Kina Khuldainain Micro Brewery Sanchalan Garne Dhoka* (Himal Khabar: 27 October, 2020), <https://www.himalkhabar.com/news/124497>

<sup>27</sup> World Bank, *B-READY Nepal Country Profile* (Washington DC: World Bank, 2023), <https://www.worldbank.org/en/businessready>

<sup>28</sup> Laxmi Prasad Paudyal, *The Need for Decentralisation of Company Administration Services in Nepal: A Study Report from Karnali Province* (Surkhet: Hriti Foundation, 2024). <https://hriti.org/the-need-for-decentralization-of-company-administration-services-in-nepal/>

stop centres were envisioned in 2016, but their operationalisation remains a challenge in the absence of necessary amendments to prevailing legislation. A Department of Industries research notes that the operationalisation of a one-stop centre requires amendments to 10 legislations<sup>29</sup>. Efforts to amend these legislations have so far not been undertaken. Even the bundle of legislation amended before the latest iteration of the investment summit to facilitate the investment regime seemingly left them out<sup>30</sup>.

**Aside from the licensing regime and the time and cost of starting a business, regulations in Nepal impose criminal sanctions on economic offenses.** There are a total of 40 provisions in 12 primary laws relating to the business environment that impose a punishment ranging from six months to five years. Overt criminalisation of offenses discourages investment. In addition, both fines and imprisonment can be imposed. Given that Nepal does not have a completely impartial public administration system, the risk of criminal sanctions being used for rent seeking is always a possibility. Furthermore, laws framed in recent years have also added provisions for criminal sanctions. The only saving grace is perhaps the fact that the implementation capacity of regulatory agencies in Nepal remains weak.

## Recommendations

**Regulatory burden can be reduced by rationalising the number of departments and agencies that currently regulate businesses.** In fact, certain steps have already been taken. The High-Level Reform Commission, constituted by the Government of Nepal, suggested the repeal of several redundant laws and even went on to recommend the dismantling of a few government agencies.

**As an alternative to shutting down government agencies, decentralisation is an option that can be pursued.** Nepal is a federal country, but its business regulations remain centralised. Several licenses that are currently administered by the federal government can be decentralised. While removal of licenses is the optimal solution, a politically viable alternative is to grant jurisdiction over regulation to provinces, bringing down compliance costs significantly.

**The issuance of advance rulings should be mandatory.** Many of the problems in the administration of tax legislation stem from inconsistent interpretation. The issuance of explanatory notes has so far not been successful; to that extent, advance rulings should be mandatory. The cost of tax compliance can be brought down significantly if businesses can adequately foresee how provisions will be implemented, should there be any confusion regarding it.

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<sup>29</sup> Department of Industries, *Ekal Vindu Sewa Kendra: Ek Adhyayan* (Tripureshwor: Department of Industries, 2077 v.s.). <https://doind.gov.np/detail/69>

<sup>30</sup> PKF TR Upadhyaya & Co., *Flash Alert: Ordinance Amending 8 Nepal Acts related to Investment Facilitation 2081* (Kathmandu: PKF TR Upadhyaya & Co, April 2024). [https://pkf.trunco.com.np/files/publications/1714479862\\_06%20Flash%20Alerts\\_%20Ordinance%20amending%208%20laws%20to%20attract%20investment.pdf](https://pkf.trunco.com.np/files/publications/1714479862_06%20Flash%20Alerts_%20Ordinance%20amending%208%20laws%20to%20attract%20investment.pdf)

**Decriminalisation of offenses should be the next big agenda.** A country's business environment cannot be deemed friendly if there exist overt criminal sanctions. While the rationale is to deter non-compliance, the same can be achieved through fines. The Indian example is a case in point and model that Nepal can also replicate in decriminalising offenses.



### Proposed Legal Amendments based on the Audit

Name Of Law	Amendments Required	Reasons for Amendment
<b>Labour Act</b>	Amend Section 3 of the labour act to read “This Act shall remain as minimum standards for labours and on matters relating to labours for any enterprise employing more than 10 people.”	Headcount provision can decrease the cost of Compliance for small enterprises.
<b>Labour Act</b>	Remove Section 37 of the labour Act, which reads “ Each labour shall be entitled to an amount equal to the basic remuneration of one month as the festival expense each year for the festival to be celebrated according to his or her religion, culture and tradition.”	Provisions for sharing profits have already been made under then Bonus Act. To that extent the provision for festival expenses can be removed in its entirety. Alternatively the provision for sharing bonuses can also be removed instead of removing festival expenses provision.
<b>Labour Act</b>	Amend section 106 of the Labour Act to read “The Ministry shall, on recommendation of the Minimum Remuneration Fixation Committee referred to in Section 107, fix the minimum remuneration of labours in every two years. Provided that in case a collective agreement in relation to remuneration has been reached through collective bargaining by an between the employer and the Collective bargaining committee in accordance with Section 116 the minimum wage shall not be applicable.	Minimum wages can have distortionary effect if applied universally, instead provisions for collective bargaining have been known to be more efficient.
<b>Labour Act</b>	Amend section 142 of the Labour Act to read “If, while evaluating the work performance of any labour pursuant to the provisions set forth in this Act or the rules and bye-law framed under this Act, the work performance of such a labour is found unsatisfactory or poor during performance review undertaken by the	The current provision requiring poor performance for three consecutive years is too onerous and places an unnecessary burden on the employer.

	employer, the employer may terminate the employment of such a labour.	
<b>Income Tax Act</b>	Amend Section 76 to read “ If any person makes an application in writing to the Department for the removal of any confusion as to the application of this Act to any arrangement proposed or accepted by such person, the Department shall issue its version by an advance ruling as prescribed, by notifying the person in writing.”	Mandatory provision for advance ruling can offer some form of consistency in interpretation of tax laws.
<b>Income Tax Act</b>	Amend Section 81(2) of the Income Tax Act to read “Except as otherwise specified by the Department by issuing a notice in writing, the documents referred to in this Section have to be safely retained for three years from the date of expiration of the concerned income year.	The current provision for maintaining all documents for five years places an unreasonable burden on businesses, the term can be reduced to three years to reduce compliance costs.
<b>Companies Act</b>	Amend Section 160 and remove all provisions of the imprisonment term of two years	Decriminalisation of offenses is required to reduce both rent seeking and establish a business-friendly environment
<b>E-Commerce Act</b>	Amend Section 23 of the E-commerce Act and remove the provision of imprisonment of up to three years	
<b>Wholesale amendment for decentralisation of services</b>	Amend Companies Act, Animal Slaughter and Meat Inspection Act, Animal Health and Livestock Services Act, Feed Act, Feed Regulation, Education Act, CTEVT Regulation, Tourism Act, Casio Regulation, Tourism Industry Service Delivery Regulation, Rafting Regulation, Homestay Operation Directive, Advertisement Act, Cinema Act, Printing Press Act, Water Supply and Sanitation Act, and Directives Related to Management of Social Medial Services to decentralise licensing provisions	Compliance costs can be decreased by decentralising licensing regulation. Provincial governments can implement the current apparatus of licenses, and given their proximity to the service seekers, they can be administered efficiently.

