



## Dispatches from the Hall of Ideas!

Year 03 | Issue 2 | February 2026

### Why Economic Reforms Stall: Ambition Vs Reality\*

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Nepal's economy today presents a peculiar contradiction that requires our urgent attention as practitioners and researchers. On paper, our situation appears stable; inflation, after rising in the post-pandemic period, has moderated, and our debt indicators remain manageable. Our revenue-to-GDP ratio, which hovers between 19 and 22 per cent, compares quite reasonably with our regional peers. Yet, as we can all observe, this macro-level stability has not translated into widespread public confidence. It has not generated sufficient employment, it has not stemmed the tide of migration, and it has not catalysed private investment at the scale required for a true structural transformation. The tension between macroeconomic stability and microeconomic frustration defines our current political economy; we are not a failed state, but we are not moving forward with sufficient force either.

Our growth trajectory averages around four per cent, and although we occasionally aspire to seven per cent, sustained acceleration has eluded us. More importantly, the composition of this growth raises significant concerns regarding its sustainability and its impact on the average citizen. Hydropower has emerged as a major contributor to GDP expansion, which is encouraging for infrastructure

development and our external balance, but we must acknowledge that hydropower is capital-intensive and generates limited employment relative to its contribution. The service sectors have also grown, yet the employment elasticity of this growth remains remarkably weak. We are, therefore, confronting a period of jobless growth. When growth fails to create domestic opportunity, migration becomes a structural necessity rather than an optional pursuit. Youth unemployment figures, when disaggregated, tell a far more troubling story than headline rates suggest. Economic growth that does not absorb labour cannot sustain social equilibrium, and frustration accumulates because opportunity stagnates even while macro variables remain stable.

Another structural vulnerability lies in our revenue composition. A substantial portion of our government revenue is tied directly to imports; when imports rise, our fiscal space expands, but when imports contract, our revenue declines. This dependence on imports reflects deeper weaknesses in our domestic production capacity. An economy that consumes what it does not produce remains externally fragile, and a fiscal system dependent on that structure compounds the risk. This vulnerability became painfully evident a few years ago when import compression directly translated into a revenue decline that was not easy to manage. The issue is not merely one of short-term volatility; it is a structural imbalance that we must address. Diversifying our revenue base requires us to first diversify our productive base.

\* The text is an abridged and translated version of the February 2026 edition of Sambaad @ Samriddhi. Sambaad @ Samriddhi is a monthly discussion on contemporary issues. In this edition of Sambaad@Samriddhi, Dr. Kalpana Khanal shares her insights on the Nepali Economy and reform process. This discussion was moderated by Arpita Nepal.

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In addressing these challenges, it is helpful to reflect on our history of reform. The reforms of the 1990s in Nepal were largely influenced by global waves of deregulation and liberalisation, led by Bretton Woods institutions. Those reforms focused on market opening, deregulation, and reducing the size of the government, but they were not necessarily homegrown. The outcomes were mixed, and today, we face the challenge of institutionalising reform rather than just drafting new documents. Reform in Nepal has often been personality-driven; when a capable individual leads a ministry or commission, progress occurs, but when that individual exits, the momentum often dissipates. Until reform becomes embedded in our systems rather than tied to individuals, our transformation will remain fragile.

The High-Level Economic Reform Commission, with which I have been involved, attempted to address this gap by producing a 400-page report based on evidence-based policymaking. Instead of centrally designed prescriptions, we conducted a root cause analysis that spanned provinces and local governments. We divided the geography of the country into five zones and consulted with local government representatives, civil society, bankers, and private equity players. We wanted to understand what worked and what did not work at the grassroots level, and this comprehensive document is the result of that consultation. We found that the central problem is that the confidence of the private sector is low, and we have tried to identify solutions involving policy, institutional, and operational changes.

One of the most critical areas for reform is our financial sector and the way we handle credit. A few years ago, Nepal's credit-to-GDP ratio approached 120 per cent, which was regionally quite high and a bit over-leveraged. Much of this expansion flowed into real estate speculation rather than productive sectors, a trajectory that was unsustainable and required correction. Today, that ratio has fallen closer to the mid-90 per cent range. However, we now face a different concern: liquidity exists and interest rates have softened, yet credit expansion remains subdued. Under classical economic theory, low interest rates and high liquidity should lead to increased borrowing and investment, but the theory is currently not working in Nepal. Private sector actors are hesitant to assume risk, and banks, having experienced recent volatility, are being cautious. The state must rethink its risk-sharing frameworks to encourage productive investment rather

than speculative accumulation. We need to strengthen project-based lending and evolve our collateral structures beyond traditional land-based security. If a young person wants to start a tea or coffee farm, the bank should look at the viability of that project rather than just asking for city land as collateral.

Remittance has historically served as a vital poverty reduction mechanism in Nepal, financing basic needs, housing, and education. This was a necessary first phase, but we must now transition to a second phase. A remittance-based economy cannot indefinitely rely on consumption-driven welfare gains, especially when financial literacy remains insufficient amongst many migrant households. Remittance was not a designed policy instrument; it emerged from domestic employment scarcity, yet its macroeconomic importance is undeniable. This creates a paradox where the state benefits from these inflows without having fully institutionalised reintegration or long-term security mechanisms for the workers. We must implement contribution-based social security systems for migrant workers that function meaningfully, so that when they return after years of labour in harsh conditions, they have a pension or healthcare plan. We must also increase financial literacy so that savings can be converted into productive investments for the future.

The issue of state capacity is equally fundamental to our success. Nepal does not lack capable individuals; within our ministries, the central bank, and our academic institutions, one encounters high levels of professionalism and integrity. The problem is fragmentation. Competence exists in silos, and a whole-of-government approach to reform is largely absent. Institutional memory is frequently undermined by transfers that occur every six months or a year, preventing officials from building cumulative expertise in their sectors. Furthermore, we face a crisis of inaction. While we have laws to address active corruption, accountability for inaction remains limited. Delayed files and postponed decisions can damage institutions just as deeply as corruption, and without aligned incentives or clear rewards for performance, risk-taking amongst our bureaucracy will continue to decline. Our capital expenditure execution illustrates this perfectly; public investment should crowd in private investment, but when government execution falters, it erodes private sector confidence.

Regarding our industrial model, we must be realistic. Nepal cannot replicate the mass-manufacturing models of giants like Germany, India, or China. Our scale, geography, and

structural constraints suggest a different path, focusing on agriculture-based processing and niche products. We have products with high competitive potential, such as tea, cardamom, and ginger, but too often, raw materials are exported while the value addition occurs elsewhere. For instance, Nepalese tea is often bought in bulk and sold globally as Darjeeling tea because we lack our own processing and branding infrastructure. We should incentivise the private sector to scale these niche products and add value domestically. Small-scale processing, export-oriented niche specialisation, and targeted value chain integration are feasible pathways for us. Similarly, while hydropower is a major asset, we must use transmission line mechanisms to ensure it drives domestic employment rather than just being exported as a raw commodity. Diversification is essential; no economy should place all its bets on a single sector, whether that is remittance, hydropower, or digital services.

We must also recognise that democracy expands expectations. Citizens rightly demand better services, rights, and accountability, but when institutional capacity lags behind these aspirations, frustration intensifies. This is an argument for institutional strengthening, not a critique of democracy. Human capital investment in education, healthcare, and social security must remain central to our efforts, as public sector strength underpins democratic legitimacy. We must move beyond the culture of instant gratification fuelled by social media and understand that institutional reform is an iterative process that requires time, research, and consultation.

There has been some gradual improvement in evidence-based policymaking through the work of policy labs, stakeholder dialogues, and organisations like the Policy Research Institute (PRI). These efforts help generate the necessary data and evidence for the state, even if the impact is not immediate. However, structural barriers remain, such as inconsistent data access and the lack of a whole-of-government approach to research and implementation. We must avoid the habit of blindly replicating international models without grounding them in our domestic realities. Localisation does not mean rejecting global knowledge, but it does require disciplined adaptation to our specific context.

In conclusion, the central challenge facing Nepal today is one of confidence. Private sector confidence has weakened, citizens are questioning the effectiveness of the state, and bureaucrats often operate within systems that do not

reward initiative. Confidence cannot be legislated; it must be built through consistent execution, aligned policy signals, and credible institutions. This requires us to establish risk-sharing frameworks, diversify our economic activity, strengthen our implementation capacity, and improve fiscal-monetary coordination.



Reform is a long-horizon commitment. Our democratic transition is relatively recent, and institutional consolidation takes decades; thirty years is not sufficient to perfect these systems, particularly in the context of federal restructuring. We must accept that progress is often uneven and cumulative, but we cannot allow patience to become complacency. Stability without structural change will eventually exhaust itself, and our task is to convert our current macro resilience into micro-opportunity. Reform is not a promise delivered in a single speech; it is a disciplined, incremental process of aligning incentives, strengthening capacity, and building trust. The work is slow and often frustrating, but it remains necessary for the future of our country.

