JUSTICE IN TAX SYSTEM, PUBLIC SERVICES AND SOCIAL PROTECTION IN NEPAL:

AN ASSESSMENT AND WAY FORWARD

By

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FOREWORD

Sujeeta Mathema,
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It is my great privilege to present this report, **"Justice in Tax System, Public Services and Social Protection in Nepal: An Assessment and Way Forward**," at a critical juncture in Nepal's policy and governance landscape. As the country advances with commitments to transform the economy in a new way and vows to bring about substantive changes and reforms in fiscal policies, among others, this report based on intensive research offers timely evidence to inform equitable and forward-looking decisions.

Taxation, public services, and social protection are central to strengthening the social contract between the state and its citizens. Their design and implementation directly influence equity, public trust, and the credibility of democratic institutions. Ensuring that these systems are fair, transparent, and inclusive is therefore not only a policy imperative but also a prerequisite for sustainable development and social stability.

The analysis presented in this report underscores a clear policy challenge: while progress has been made in reducing poverty and expanding access, structural inequities persist. A disproportionate reliance on indirect taxation, gaps in the quality and reach of public services, and limited coverage of social protection continue to constrain inclusive outcomes. These trends call for deliberate, evidence-based reforms that place justice and equity at the centre of fiscal and development policy.

This report provides actionable insights for strengthening progressive taxation, improving the efficiency and accountability of public spending, and expanding inclusive, responsive social protection systems. Its recommendations aim to support policy coherence across sectors and enable better alignment between national priorities, parliamentary oversight, and citizens' expectations.

We hope this report will serve as a constructive resource for Parliament, government institutions, and national stakeholders in shaping policies that are more equitable, resilient, and responsive. Strengthening these systems requires sustained collaboration across all actors -including policymakers, civil society, and development partners.

We remain committed to working alongside all stakeholders to advance a just, inclusive, and accountable development pathway for Nepal.

ACKNOWLEDGEMENT

David Archer,
Head of Programmes,
ActionAid International.

This report is timely and addresses some of the most critical issues associated with justice in the tax system and access to public services and social protection in Nepal. Most importantly it connects the struggle for justice in public services with the struggle for tax justice. The central point it makes is that progressive taxation and equity-focussed investments in public services are now indispensable for Nepal to advance sustainable development and address persistently high levels of inequality.

The present tax system in Nepal Is shown to be unfair, with regressive, indirect taxes making up 70% of revenues. Tax policies are inconsistent and fragmented with insufficient attention paid to equity dimensions in the design of taxes. Meanwhile, present spending on health and education fails to deliver on the commitments made in the national constitution, with a continuing decline in the share of government spending allocated to these essential sectors. The result is that Nepal spends less per capita on health and education than countries with similar income levels.

The report notes that there has been an expansion in overall access to education within Nepal but documents persistent disparities, with many children dropping out or failing to complete primary or secondary education. Costs appear to be a major factor in forcing children to drop out of school with people living in poverty having to allocate a significant portion of their income to keep children in school – despite the avowed policy of free primary and secondary education. In practice, Nepalese households are expected to pay significant sums to ensure their children's success in school, with costs rising year on year as they move up through the grades – and this is the most unfair and unjust means to fund a public education system. A massive increase in funding for free public education is required, and this can only truly be achieved through ambitious and progressive tax reforms.

The alternative – of entrenched inter-generational inequality – should be unthinkable and unacceptable. At present those who can afford to pay for private education can benefit from high quality private provision, but the majority of Nepalese people are forced to pay for an underfunded public system that cannot deliver the same quality. Sadly, the same is increasingly true in health where access to healthcare is increasingly stratified by the ability to pay.

This report proposes some clear solutions, perhaps most importantly calling for an overhauling of the neoliberal orthodoxy in Nepal – so that the country can invest in transformative development for its people. There is a need for bold and progressive action to reform the entire budgetary system, including a revamping the tax system, moving from indirect to direct taxes with a specific attention to equity. This must be matched with a clampdown on tax evasion by the richest individuals and companies – with the removal of harmful tax incentives and the introduction of a wealth tax targeting the richest 0.5%.

And of course, this fairer tax system must be accompanied by a fairer allocation of tax revenues, with a focus on increasing equity in education and health. Systematic attention is needed to reduce the cost burdens placed on low income households who are simply seeking a better future for their children. Public education must be genuinely free and of good quality. Other countries around the world have shown that this can be achieved through building a progressive tax system and these are lessons that urgently need to be learnt in Nepal.

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LIST OF ABBREVIATIONS

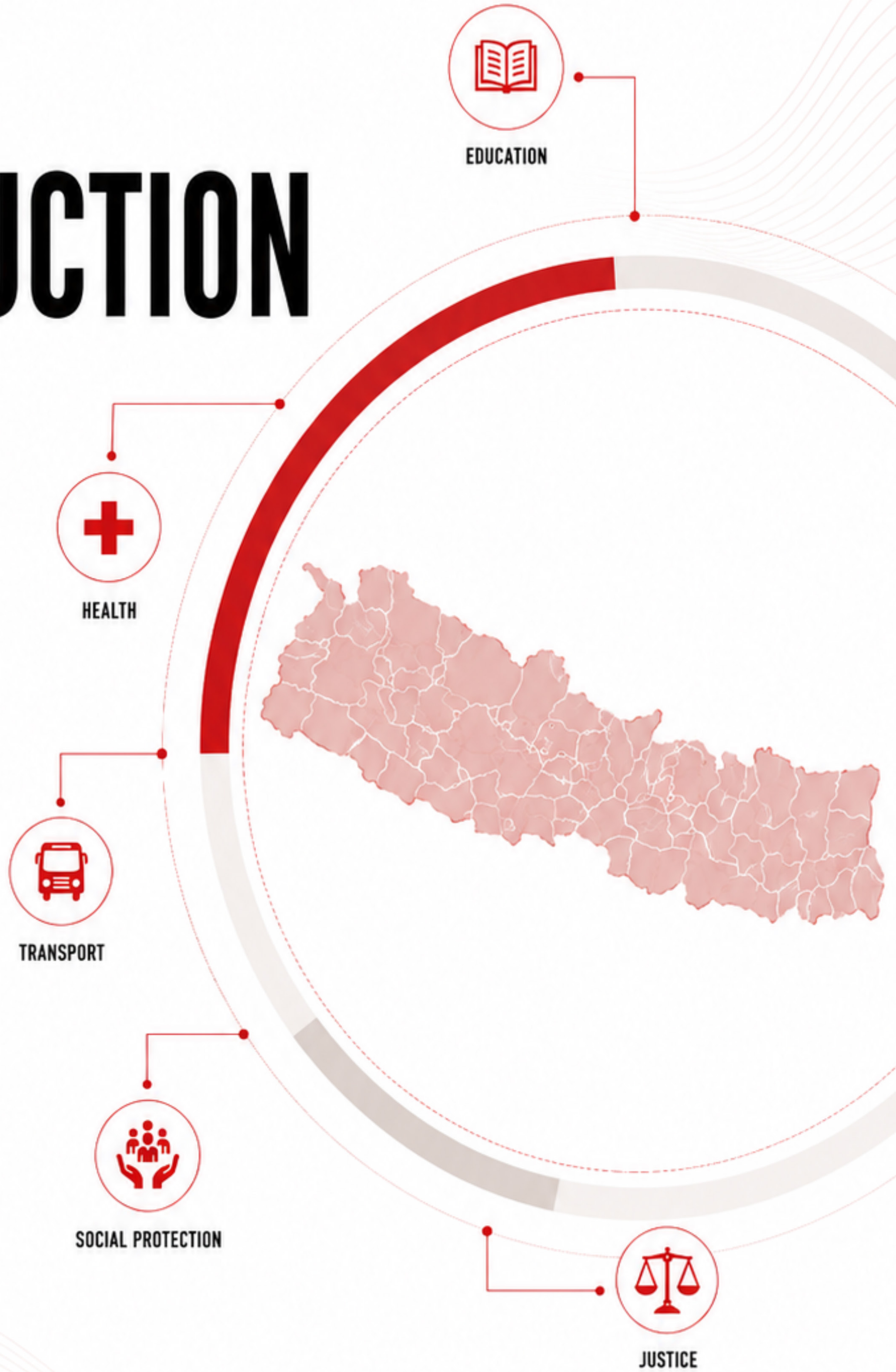
Acronym	Full form as mentioned
AGR	Auditor General's Report
B-PAN	Business Permanent Account Number
C-efficiency	Collection Efficiency
CBS	Central Bureau of Statistics
CFS	Consolidated Financial Statement
CIT	Corporate Income Tax
CNI	Confederation of Nepalese Industries
CPN(UML)	Communist Party of Nepal (Unified Marxist Leninist)
CSO	Civil Society Organization
CTEVT	Council for Technical Education and Vocational Training
DRI	The Department of Revenue Investigation,
DRM	Domestic Resource Mobilization
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
F/Y / FY	Fiscal Year
FCGO	Financial Controller, General Office
FDI	Foreign Direct Investment
FGD	Focus Group Discussion
FPFR	Financial Procedures and Fiscal Responsibility
FTM	Female to Male
G20	Group of 20
GATJ	Global Alliance for Tax Justice
GDP	Gross Domestic Product
GIL	Global Inequality Lab
GoN	Government of Nepal
GRID	Green Resilient and Inclusive Development
GST	Goods and Services Tax
HDI	Human Development Index
IANWGE	Inter-Agency Network on Women and Gender Equality
ICT	Information Communication Technology
IGD	Institute for Governance and Development
ILO	International Labor Organization
IMF	International Monetary Fund
IOSR	International Organization of Scientific Research
IPI	Interested Party Information
IPRAD	Institute for Policy Research and Development
IRD	Inland Revenue Department
IT	Information Technology
LDC	Least Developed Country
LPG	Liquefied Petroleum Gas
MBBS	Bachelor of Medicine and Bachelor of Surgery
MMR	Maternal mortality ratio
MNCs	Multinational Companies
MNE	Multi-National Enterprises
MoF	Ministry of Finance

MoHP	Ministry of Health and Population
MTBF	Medium Term Budgetary Framework
MTEF	Medium-Term Expenditure Framework
MTPMF	Medium Term Performance Monitoring Framework
MTRF	Medium Term Revenue Framework
NCE Nepal	National Campaign for Education Nepal
NHI	National Health Insurance
NLSS	Nepal Living Standards Survey
NPC	National Planning Commission
NRB	Nepal Rastra Bank
NRRFC	National Natural Resource and Fiscal Commission
NSO	National Statistical Office
OECD	Organization for Economic Co-operation and Development
P-PAN	Personal -Permanent Account Number
PAN	Permanent Account Number
PIT	The personal income tax
PPP	Purchasing Power Parity
PRI	Policy Research Institute
PRSP	Poverty Reduction Strategy Paper
SA	South Asia
SAAPE	South Asia Alliance for Poverty Eradication
SAARC	South Asian Association for Regional Cooperation
SAFER	Seismic Safety and Resilience of Schools in Nepal
SAFTA	South Asian Free Trade Association
SAP	Structural Adjustment Programme
SDGs	Sustainable Development Goals
SSF	Social Security Fund
TJNR	Tax Justice Network
U5MR	Under 5 mortality Rate
UN	United Nations
UNDP	United Nations Development Programme
US/ USA	United States of America
USAID	United States Agency for International Development
VAT	Value Added Tax
WB	World Bank
WHO	World Health Organization
WTO	World Trade Organization

CHAPTER 1

INTRODUCTION

> *Tax is a socio-political compact between a state and its people.*



A just and progressive tax system is essential for reducing inequality, financing public services, ensuring social protection and advancing towards inclusive and sustainable development.

PROGRESSIVE TAXATION | EQUITY | PUBLIC SERVICES | SOCIAL PROTECTION | ACCOUNTABILITY

CHAPTER 1

INTRODUCTION

1.1 GENERAL BACKGROUND

Tax, as a prime source of government revenue, is of paramount importance in countries like Nepal. Tax revenue is necessary for providing basic social services, reducing poverty, enhancing equity in society, building infrastructure, ensuring wellbeing of the people and advancing towards sustainable development. Persistent deprivation and vulnerability among large sections of the population, including women, further reinforce its critical role [1]. For such reasons taxes have long been advocated from the perspectives of economic justice and human rights, with government accountability to citizens considered an integral component of this framework[2]. Notably, tax is a socio-political compact between a state and its people.

In order to fulfil these multiple and important objectives, tax policies and their design play a vital role, as they shape tax structures and directions, wield decisive influence on the living conditions of the people and path of the economy[3]. Largely, tax policies have either progressive or regressive routes with divergent implications[4]. If a country relies heavily on direct taxes such as wealth, corporate and property taxes and collects no or minimum revenue from the poor or low-income people, such a tax system thwarts higher tax incidence among the poor and enhances progressivity. With progressive structures, it facilitates redistribution of resources from highly wealthier class to the poor and lower-income people and also ensures, among others, their access to public services through higher resources at the possession of the governments. On the other hand, if a tax system is intensely reliant on indirect taxes such as VAT and other consumption-based taxes unvaryingly, it embeds a regressive system in the tax structure and deprives people from, among others, getting public services through the governments[5]. Largely, the regressive tax system disproportionately benefits wealthier class and harms poor immensely. The policies that strengthen progressivity in the tax system enhance social justice and augment welfare system in societies simultaneously[6].

In recent years, prominence of progressive tax systems that ensure justice have increased along with colossal rise in income and wealth inequality globally amidst continued deprivation of large section of population from, among others, receiving basic social services[7]. Historically, taxation was largely regressive with high tax burdens directed disproportionately on the poor and working class. However, with progress in societies and the rise of more democratic governments in power, tax systems were gradually made progressive, aimed at redistributing wealth and income more equitably. In the aftermath of Second World War, various steps were taken to move towards more progressive taxation system, with higher tax rates on wealthy and large corporations. However, an era of regressive tax system began in the 1980s after the introduction of the Structural Adjustment Programme (SAP) and intensified during the 1990s with the adoption of Enhanced Structural Adjustment Facility (ESFAF) programme and Washington Consensus respectively, a decade often called a hallmark of neo-

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[1] The importance and role of taxes can be found in Thaci and Gerxhaliu 2018 and Amirthalingam 2020.
[2] For details, among others, see https://actionaid.org/sites/default/files/tax_justice_advocacy_toolkit.pdf.
[3] Nepal's tax structure and its main feature is discussed in Khanal et al 2018.
[4] Often neutrality is regarded to be added route. But in a highly unequal and discriminatory societies if neutrality is advocated without qualification it ultimately contributes to perpetuate the inequality and injustice.
[5] For detailed discussion see Meena 2024 and Kentikelenis and Stubbs 2025.
[6] Reports by Tax Justice Network evidently show that why the tax justice system is so vital today. They indicate that today's global tax system by facilitating tax evasion and illicit flows as well as providing special privilege benefit billionaires. For recent evidence based analysis see TJNR 2024 and 2025.
[7] This is evidently proven by the Oxfam annual reports on inequality (www.oxfam.org). The reports indicate that one of the reasons for the deepening global crisis is due to colossal rise in income and wealth inequality. The Global Inequality Lab which regularly monitors the trends in the global inequality and publishes inequality reports regularly also corroborate such finding.

liberalism. Though there were some jolts for such a super-rich biased tax system during the Great Financial Crisis of 2008/09 and COVID-19 pandemic, major directions have been even more regressive on the average in recent years as evidence proves. Since 2015, the 1 percent of the world's population including billionaires have gained USD 339 trillion in their wealth in real terms. Consequently, today the richest 1 percent top wealth holders own more than 43 percent of the total global assets. On the other hand, in terms of effective tax rates, the super-rich billionaires pay taxes equal to just 0.3 percent of their total wealth[8].

It is clear that when there is extreme inequality in society, the impact begins before a child starts school. This is evident through various indicators as a child from a poor family is often subjected to poor health care. Such a family is also faced with the inability to develop child's social skills. After starting school, disparities deepen with wealthier children benefitting from better cultural and social capital as well as privileged education and environment leading to consolidation of a social structure that perpetuates intergenerational inequality and deprivation. It is noticeable that when such a systemic phenomenon manifests without a hope for change, people left behind start revolting with the threat of disharmony and conflict in societies. This underscores that equality and public services are exceedingly intertwined[9].

Noticeably, Nepal embarked on the path to economic liberalization since the mid-1980s with the implementation of, at first, economic stabilization programme in 1985/86 followed by the SAP in 1986/87. Major liberalization policies were intensified in the 1990s with the implementation of ESAF in 1991/92. As a part of this, major overhauling of tax system was initiated with drastic reduction in the tax rates and their slabs. The VAT system was introduced in 1997 by replacing sales and other minor indirect taxes. Notably, economic stabilization[10] was in central to liberal policies and hence containing government expenditure was one of the policy priorities. Though after the introduction of PRSP in 2002 there was apparent focus on poverty reduction, social services development and governance related programme s amidst worldwide resentment against draconian neo-liberal policies, the conditions were embedded in such a way that such policies had to be intensified further[11].

However, with sweeping political change in 2006, both economic and social agenda changed drastically with apparent focus on inclusion, equity and prosperity which, in essence, demanded changing and restructuring of liberal economic policy discourse for making it to be consistent with such altered priorities. Such an agenda was institutionalized after long transition in 2015 through the Constitution. It has advanced transformative pathway for accelerating wellbeing of the people and prosperity of the nation. As per the constitution, various acts linked with economic and social rights of the people including rights to health and education have been enacted. Similarly, separate acts related to gender equality and right to deprived communities have also been introduced. As an offshoot, successive plans, budgets and other policy statements have repeatedly proclaimed that the development pathways and strategies pursued in the aftermath of constitution are in line with the constitutional commitments and commitments made in the SDGs. Despite predominance of indirect taxes, there are claims that progressivity is maintained through the direct taxes apart from excluding poor and low-income people from the tax net. It is also claimed that resources allocation principles and expenditure priorities are driven by the aim of ensuring, among others, better access of public services to the people in general and poor and low-income people including women in particular. The continued expansion of the budget to social protection is cited as one of the best examples[12].

A quick review of performance indicators show that some satisfactory progresses have been made in areas such as health and education. Similarly, as recent surveys show, a steady reduction in poverty and inequality

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[8] *For latest detailed analysis on inequality and information on taxes paid by billionaires see Oxfam 2025. Country by country inequality data can be found in Global Inequality Lab.*

[9] *For such evidence based arguments See Meena 2024 and Pickett 2025.*

[10] *While giving main focus on economic stabilization, it is noticeable that more shallow type approach was advanced and pushed undermining the institutional and structural factors constraining resource mobilization and use of government expenditure efficiently and effectively.*

[11] *Many critics have termed PRSP as augmented Washington Consensus. For details see Rodrik 2004. A detailed political economy discussion on how as a part of conditional loan program Nepal followed and intensified liberalization policy without internal homework immaturely can be found in Khanal et al 2005.*

[12] *For such claims see various periodic plans and budget statements. For claims on transformative and equity focus see NPC 2024. Commitments to accomplish the SGDs can be found in NPC 2017.*

has also taken place over the years[13]. Notwithstanding such progress at the aggregate level, they conceal or overlook many critical dimensions. For instance, in the areas of public services such as health and education, the progress from equity and quality dimensions are more important. But there are some indications that state of conditions on both fronts are highly miserable [14]. There are also question marks on the approach, reliability and robustness of poverty and inequality estimates following consumption-based approach [15]. Amidst growing debates and scepticism, the issues associated with taxes and government expenditure systems, especially from equity standpoint are highly pertinent from both policy and advocacy standpoint.

1.2 RATIONALE OF THE STUDY

Many theories and empirical studies point out that there is a close nexus between progressive taxes and income equality, better access to public services as well as sustainable development. The old Kuznets Curve hypothesizes that in the early stages of development inequality rises and declines only after society becomes wealthier and more industrialized is refuted by numerous histories of political economy and empirical studies carried out based on various countries' long experiences. Noticeably, under the influence of classical and neo-classical views that higher growth by automatically trickling down the benefits up to the poor and deprived led to bypass the inequality related issues in the policy making for long. Moreover, along with predominant policy focus on growth, popularization of notion that there is trade-off between growth and equality also by neglecting the distributional issues has led to ensure disproportionate benefit to those who have access to resources or are resourceful and privileged under the given power and social structure. Historically, there have been opposing perception or views on inequality issues among different schools of thoughts ranging from classical, structural, Marxist, Neo-Marxist, Keynesian and Neoliberals. Largely, except classical and neo-classical and to some extent Keynesians[16], other thoughts by terming inequality as the by-product of exploitation nationally and internationally have urged on the need of larger interventions to correct such unacceptable societal disease through evolutionary or revolutionary processes[17]. As is well known, the Marxian theory in which structural and Neo-Marxists tenets are rooted states that along with decline in the rate of profit amidst growing competition, the exploitation of labour by the capitalist class increases overtime in pursuit of higher profits leading to the rise in capital accumulation and thereby inequality in societies markedly. However, due to predominance of neoliberalism in the global economic system[18], hardly other alternative thoughts could prevail in the policy debate before the Great Financial Crisis of 2008/09. Such an abrupt and unanticipated catastrophic led to undertaking a series of studies during and in the aftermath of crisis to find out whether inequality was one of the principal sources of this. One of the first such studies after the havoc showed that inequality by intensifying the leverages and financial cycle injected the seeds of crisis in the economy[19]. Another study concluded that inequality could undermine progress in health and education, cause investment-reducing political and economic instability and diminish the pace and durability of growth[20]. More strikingly, Stiglitz in his book argued forcefully that the especial privilege provided to the rich under the neo-liberal premises allows financial excess to balloon before the crisis and, thus, it by heightening inequality leads to division in society, endangering nation and society's future[21]. Another study corroborating the earlier findings indicates that attention to inequality can bring significant longer-run benefits for growth and adds that over longer horizons, reduced inequality and sustained growth may thus be two sides of the same coin[22].

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[13] Reported progresses in such areas can be found in the Economic Survey of 2024/25 (MoF 2025). The government version of the progresses up to the 15th can be found in NPC 2024. Living standard survey 2022/23 shows a steady decile in both poverty and inequality (NSO 2024).

[14] A recent World Bank report (2025) reveals that share of human capital in total national wealth is the lowest in Nepal compared to similar other countries. It further indicates the possibility of very poor quality in both health and education services in Nepal. Added to these, some studies also point that, apart from efficiency problem in the government expenditure system, the resources allocated to the health and education have reduced drastically in recent years. For details see Khanal and Khanal 2024.

[15] Apart from raising the questions on the appropriateness of the methodological approach, structural and institutional constraints as well as pre-existing vulnerabilities compounded by low and poor quality growth, mounting unemployment problem, over concentration of bank lending in unproductive areas and that too in limited houses etc. are cited to refute such claims. A substantial increase in the poverty during the COVID-19 period as shown by then NPC study (2020) is also cited to counter such claims.

[16] Keynesians regard that given rich people's higher propensity to save, some income inequality is needed for higher saving and investment by them.

[17] A brief history on the political economy of different thoughts can be found in Khanal 2017 in which their relevance on Nepal's self-reliant development is discussed more elaborately.

[18] It is also noticeable that many left political parties and forces who used to claim the vanguards of the oppressed people or working class also hardly raised inequality agenda forcefully in various platforms. Such a lukewarm tendency is seen even today.

[19] Rajan 2010.

[20] See study by Berg and Ostry 2011 published in the IMF staff paper which by refuting IMF's popularized view argued that the sole focus on growth undermining inequality has been a mistake from the point of sustaining growth.

[21] See Stiglitz 2012.

[22] Obstry et al 2014.

A seminal contribution in the areas of inequality in the post crisis period has been made by Thomas Piketty. In his book on Capital in the Twenty-First Century[23], Piketty, based on the long term data on growth and inequality, shows empirically that there has been a policy induced tendency of rate of return on capital (r) exceeding the rate of economic growth (g) in the economy leading to the rapid rise in wealth inequality over time in societies and nations. By blaming policy fallacies for such a phenomenon advocate on the need to introduce progressive taxation on income and wealth to prevent overconcentration of wealth in the hands of a few. Another evidence-based study further reveals that higher inequality lowers growth in the economies considerably[24].

The COVID-19 pandemic with a heavy death toll amid weak or absent state and social resilience has further forced to think about inequality and inclusion issues more closely[25]. Studies devoted to examining the role of progressive taxation on bridging inequality and growth depict why income inequality is a defining issue in modern economies. Based on economic rationales, they argue that disparities by reducing aggregate demand in the economy and constraining social mobility opportunities intensify social conflict and obstruct economic advancements. On the same vein, the need to minimize income inequality through progressive taxation is advocated. It is added that imposition of higher tax rates on individuals with higher income enables them to distribute wealth and mobilize funds necessary for public goods like infrastructure, healthcare, and education. It is further supplemented that fair tax laws provide opportunities for marginalized populations through, among others, boosting labour force participation and fostering the development of human capital, essential factors for long-term progress in a country. Citing some developing country experiences, studies also caution that nominal progressive taxation through direct taxes such as income tax is not sufficient if reliance on highly regressive indirect taxes is predominant in parallel and thus, they highlight on the importance of complementary measures, such as strengthening tax enforcement and reducing reliance on consumption taxes, to maximize the redistributive potential of progressive taxation[26].

With inequality raising the threat of deepening crisis globally[27], mounting societal disenchantment and conflict, the urgency of addressing the inequality issue has featured more prominently in recent studies and global forums as well. A recent study with focus on Europe stresses that there is an urgency of fighting and tackling inequality through the implementation of progressive taxation along with expansion in social protections and promotion to healthy livelihoods. Importantly, it gives two fundamental solutions to curb inequality. Accordingly, it advocates on the need of implementing wealth tax[28] and universal basic income scheme simultaneously[29]. Similarly, the UN World Social Report 2025, by warning that economic insecurity and staggering levels of inequality leading to declining social trust and social fragmentation are destabilizing societies worldwide and hence demands immediate and decisive policy actions[30].

A recent Report prepared by the G20 Extra Ordinary Committee of Independent Experts and published by G20 South African Presidency 2025 also concludes that inequality by causing people's lives more fragile with perceptions of unfairness sparks frustration and resentment leading to undermining of social and political cohesion as well as erosion in citizens' trust in authorities and institutions. It shows that nationally 83 percent of countries have high income inequality (i.e., a Gini coefficient above 0.4[31]) with 90 percent of the world's population. Importantly, it besides underlining the major contributors to the rise in inequality globally, suggests

[23] *For details see Pikett 2014.*

[24] *For survey of the literature and intensive study on the impact of inequality on economic crisis see Magati ed. 2017.*

[25] *The GRID approach advanced by the World Bank in the aftermath of COVID-19 is outcome of this.*

[26] *For details in the context of developing countries see, among others, Meena 2024. In the context of Sub-Saharan countries more exclusively see Idrissa et al. 2025.*

[27] *It is worth noting that after the massive stimulus program launched in the aftermath of COVID-19 many countries were able to revive their economies in an albeit short period. However, it was a K shape type recovery with sole benefits to the haves and further marginalization of have nots leading to widening of inequality additionally.*

[28] *It is interesting to know that need of introducing wealth or similar progressive tax to impose tax on super rich has increased markedly recently in the political spectrum of Western Capitalist countries too. In UK and France, the pressure to introduce wealth tax has mounted. In the USA, the Governor of California despite strong resistance has proposed wealth tax subject to ratified after referendum on such a proposal. The Mayor of New York has declared to impose higher tax to the millionaires. In some European countries such as Norway, Spain and Switzerland, the Wealth Tax is under implementation since long. Now Brazil, Colombia and Tunisia have already initiated such a progressive tax system.*

[29] *Pickett 2025.*

[30] *For details see UN 2025.*

[31] *The World Bank recently defined high inequality as an income Gini greater than 0.4, moderate inequality as a Gini between 0.3 and 0.4, and low inequality as a Gini below 0.3. See Genoni and Lakner 2024.*

some policy options as well in a more precise manner. It states that distribution of asset ownership including skills and social networks (social capital), spreading of income among labor, capital, and rents (including market power and the laws and regulations affecting corporate power, the ability of firms to exploit workers, and corporate managers to extract rents from corporations again influenced by political and economic power) as well as public policies impacting redistribution of income through taxes, transfers and public services make decisive influence on the features and pattern of inequality in societies and nations. Accordingly, it stresses the need of progressive taxation as well as more pro-people public services and fiscal transfers policies and expenditure programmes in which reforms in rules and regulations are stated as preconditions. Importantly, it emphasizes the need of decisive steps at both international and national levels to address burgeoning inequality problem across the globe[32].

Despite momentum building up for the progressive taxation, however, not only are there serious problems on the extent of progressivity in the proposed taxation but also large complications to implement such taxes effectively. With the increased grip of plutocracy in the state and political system in many countries in the ages of financial capitalism heightened by increased monopoly power in the IT industry, the ability to bring larger progressivity in taxes has either limited in various countries or effectiveness in the implementation has emerged as a big problem through various rebates and other distortionary practices the net gains are reaped by the super-rich enormously[33]. In many instances, stress on inclusiveness and shared prosperity are found to be rhetorical not only in various policy statements of the governments but also in the actual policy advice of the multilateral agencies such as the IMF. A study analysing the IMF's tax policy recommendations to 125 countries between the period 2022 to 2024 provides a vivid example of this. While reviewing the policy advice, the study finds that publicly IMF endorses progressive taxation to reduce inequality and support fiscal sustainability. However, after reviewing the dataset of 1049 tax reform proposals, the study finds that low and middle-income countries are disproportionately advised not only to implement regressive taxes such as value-added and environmental taxes but also to increase their rates significantly. The study, thus, concludes that the IMF tax policy advice continues to reflect orthodox priorities, emphasizing revenue mobilization over equity, and thereby undermining the Fund's professed commitment to inclusive economic policies[34]. Such findings reinforce the widely held view that there is a need of restructuring and reforming the global financial architectures for ensuring fair and more equitable system of global governance. From the standpoint of bringing justice into the global tax system, there are continuous efforts globally to bring about broad consensuses on the agenda under the UN Framework Convention on International Tax Cooperation to be submitted to the UN General Assembly in September 2027 for its approval[35].

Though in Nepal rigorous studies on Nepal's tax system and access of people to the public services especially from justice standpoint are barely available, various studies and reports, however, have covered justice issues one way or the other to some extent. Some of the studies and reports show that multiple facilities provided through tax exemptions, rebates, and tax holidays by making huge revenue losses are affecting, among others, the access of people to the public services markedly. The Inland Revenue Department (IRD) of the GON has estimated that the revenue loss due to tax incentives could be as large as 5 percent of GDP[36]. The latest Tax Commission Report broadly corroborates this[37]. Similar conclusions are found in the Economic Reform Commission's report[38]. Strikingly, the Auditor General's Report of 2023/24 reveals that in the last five-year

[32] *For details See Stiglitz et al 2025. Indeed, after the report more than 500 eminent economists including many Nobel Literates have urged G-20 to form an International Panel on Inequality (IPI) for Inequality Eemergency. They have pleaded that for clear and proven steps to reduce inequality and build more equal societies and economies, the fundamental foundation stone of a successful future, such a panel is necessary.*

[33] *Such a problem is continuously raised by the Oxfam and Tax Justice Network study reports, among others. They evidently show that how through manipulations, evasions and other illegal means, super rich pay ether low taxes or do not pay taxes at all. The marked increase in illicit flows over the years is attributed to various forms of multiple malpractices. For latest data on the illicit flows and means adopted see TJNR 2024 and 2025.*

[34] *For details see Kentikelenis and Thomas 2025.*

[35] *Despite strong resistance from some developed countries, there have been continuous progress towards that end. For closer review on the progress and importance of justice on the global tax system see Stieglitz and Ghosh Feb 6 2026WWW. projectsyndicatewilldmocracygoverncapitalismorbeconsumedbyit.org. Because of increased big influence and manipulating capacity of super rich in developing country's decision making system as well, it is too early to hope for very bold decisions with desired outcomes. But it is certain that the UN resolution even if with certain give and takes could be a milestone towards continued push for a tax justice system.*

[36] *Such estimates are found in the IRD reports.*

[37] *See MoF 2024.*

[38] *See MoF 2025b*

period the revenue loss due to such facilities has been in the order of Rs. 300 billion[39]. On the other hand, studies show that the incentives provided through different means have not only distorted investment decisions and complicated tax administration but also have contributed very little in the growth of incentivized sectors[40]. Such findings are further corroborated by the deteriorated growth performance in the manufacturing sector as indicated by decelerated contribution of this sector in total value added in recent years[41]. An Action Aid study points out that there are problems in Nepal's tax system from both tax justice and neutrality standpoint[42]. In the same line, another study finds that Nepal's tax works very little for the poor and hence it suggests for progressive reforms in domestic revenue mobilization[43]. Similarly, a review paper on fiscal governance, debt crisis and tax justice in South Asia indicates that in South Asian countries both structures and patterns of taxes are deficient from the tax justice standpoint[44].

As already indicated, along with a tax system, government resource allocation patterns and their uses are equally critical and important from justice standpoint. In Nepal though access to public services such as health and education has gradually increased overtime as shown by the latest NLSS, these largely portray the supply side situation across provinces and municipalities[45]. At the same time, gender biases and discriminations are reported to be rampant and pervasive[46]. Hence, whether increased supply has ensured the use or ingestion of public services by the poor and deprived including women is a critical issue. But comprehensive studies in this area focusing on the demand side are hardly available. It is noticeable that despite commitments, a decelerating tendency of resource allocation in public services has taken place in recent years which indicates the possibility of worsening people's access to public services such as health and education. As a part of social spending, though the resources allocated to social protection have increased overtime, still 68 percent of the population is out of its coverage. More importantly, only negligible workers of the informal labour market are reported to be covered in the entire social protection scheme[47].

Thus, the scattered information and studies partially covering the tax justice issue signal on the need of a more comprehensive study in this area. As an offshoot, the huge revenue losses due to tax incentives or concession may have been compensated through taxing common people in the name of mobilizing larger resources with higher tax incidence to them. In Nepal, tax evasions and leakages are also said to be very high which is partly indicated in the Tax Commission report[48], having larger implications on revenue growth, economic development and income distribution. On the other hand, amidst a declining tendency in resource allocation in social sectors like health and education in recent years as well as low and exclusionary social protection coverage, whether such a deceleration has had adverse effect on access to social services with quality as well as social protection coverage is crucial from the justice standpoint which is associated with demand side as well. Altogether, how tax is mobilized, which sectors receive priority in resources allocation and in what way allocated resources is spent is vital in countries like Nepal for building inclusive, equitable and prosperous nation in a sustainable way. These are crucial for fulling the constitutional and SDGs commitments too which are reiterated further through plans, budgets and various policy statements. Paths to fulfilment of such commitments are exceedingly associated with effective institutional and responsive governance system as well. Such wider coverage and study focus is highly pertinent in the changed political milieu to a greater extent. As is clear, the popular Gen Z movement in Nepal was organized with the demands that all forms of worse governance practices are abolished and then corruption free, equitable, inclusive and effective governing state system is strengthened for fulfilling aspirations of people in general and youths in particular through a new development discourse in which no one is left behind. Outstandingly, people have given almost two thirds of

[39] *See AGR 2024.*
[40] *USAID 2018.*
[41] *It is noticeable that despite rapid expansion in the rebates and facilities in the name of incentives, the contribution of manufacturing sector in country's value added has decelerated in recent years. For details see MoF 2025.*
[42] *Action Aid 2022.*
[43] *Shrestha 2023.*
[44] *Khanal 2022.*
[45] *For details see Nepal Living Standard Survey 2022/23 (NSO 2024).*
[46] *Some references on these can be found in WB 2025.*
[47] *The state of conditions and targets are given in the current 16th plan. See NPC 2024.*
[48] *MoF 2024. Tax evasion and illicit flows in Nepal's context is regularly shown in tax justice network reports. For latest see TJ NR 2024 and 2025.*

the majority to the Rastriya Swatantra Party in recently held General Election for its commitments to overhaul the governance system and bring prosperity of the country and people more equitably in an accelerated way. Amidst such hopeful developments needing concrete actions, the study is expected to be valuable.

1.3 OBJECTIVES OF THE STUDY

The overall objectives of the study are to assess justice in the tax system and public services of Nepal and explore better alternatives for the future. The specific objectives are:

1. Undertake a brief review of the tax policies and their processes of the recent past determining the tax system in Nepal and make comparison with selected countries,
2. Examine the tax structure and its contributing factors taking tax rebates, evasion, compliance and various distortionary practices etc. into account with specific focus on justice dimension,
3. Assess the trends in access to public services and coverage to social protection taking government expenditure pattern in public services and social protection scheme into account with specific focus on justice aspects,
4. Provide alternative policy options as a way forward for ensuring that justice system is embedded in both taxation and public services system taking recent Gen Z movement into account,
5. Provide a strong evidence-based support for country-level advocacy, campaigns and policy influence, and
6. Contribute to the global level advocacy for bringing justice to taxation and public services system.

1.4 SCOPE OF THE STUDY

The scope of the study includes:

1. Tax policies, tax structure, distribution of tax burden and progressivity in tax system
2. Revenue sufficiency and tax leakages
3. Tax competition and corporate incentives
4. Effectiveness of the tax administration
5. Government spending on public services and social protection and their access as well as coverage specially from justice standpoint
6. Transparency and accountability in taxation, public services and social protection system

1.5 STUDY APPROACH, METHODOLOGY AND DATA SOURCES

The study follows mixed methodological approach in which both qualitative and quantitative techniques have been employed. Field visits and collection of feedback and suggestions through focus group discussions from the concerned stakeholders at the local level has been the added feature of the study.

Accordingly, at first, a closer quantitative assessment on the performance of the economy with focus on the nature of growth and investment, public services, poverty, inequality, social protection etc. is made taking likely implications of taxation, public services and social protection policies into account. Thereafter, in-depth critical review on the taxation, public services and social protection policies has been made in which equity in taxation, access to and quality of public services and effectiveness of social protection programme s have been especially looked into.

As validation and cross checks to the findings of critical review of the policies, focus group discussions were organized at the local level in the three provinces in which concerned stakeholders were invited to participate.

The published secondary data and information are the main sources of the study. The data published by international organizations have also been widely used either to fill the data gap or to make comparisons.

1.6 LIMITATIONS OF THE STUDY

The study has been unable to use advanced quantitative tools and models to ascertain the impact of policies on the economy in general and study areas in particular. Similarly, due to data gap problems and time constraints, the study is more macro focused and hence it could not go to the micro level to the desired extent.

1.7 STRUCTURE OF THE REPORT

After this introductory chapter, second chapter is devoted to examining the main features of the economy in which apart from assessing the overall performance of the economy, state of conditions in the areas such as poverty, inequality, access to public services and coverage of social protection is examined more closely. In the third chapter, a critical review on the tax justice system in Nepal is thoroughly assessed. The fourth chapter evaluates access to public services and social protection taking government spending pattern into especial account. The findings of the focus group discussions are presented in the fifth chapter. In the sixth chapter, the conclusions and way forward are presented.

CHAPTER 2

MAJOR FEATURES OF THE ECONOMY, POVERTY AND INEQUALITY IN NEPAL:

AN OVERVIEW OF RECENT TRENDS

This chapter examines the recent trends in Nepal's economic growth, structural changes, productivity, labor markets, poverty and inequality. It assesses key indicators to understand the quality and sustainability of growth and their implications for inclusive and equitable development.

CHAPTER 2

MAJOR FEATURES OF THE ECONOMY, POVERTY AND INEQUALITY IN NEPAL:

AN OVERVIEW OF RECENT TRENDS

In this chapter, the main features of the Nepalese economy are discussed. In the beginning, an assessment of the growth performance is made. This is followed by a brief review on the changing pattern of the economy in which qualitative aspects of growth with focus on the form of structural changes and transformation are closely analysed. While doing so, indices associated with productive capacity of the economy and labour productivity growth are carefully examined. Similarly, in view of monetary policy being vital in promoting private sector investment and thereby raising the productive capacity of the economy widely and augmenting economic growth, among others, some monetary indices have also been analysed simultaneously. Such investigations are followed by some in-depth analysis on the labour market conditions as these are closely associated with, inter alia, quality and nature of the growth in different sectors of the economy. Thereafter, a concise review of the poverty trends has been made with some cross-checks on the recent estimates taking factors influencing poverty into account. A closer assessment of the phenomenon of inequality follows this. While gauging inequality, gender, labour and human capital-based inequality trends are also considered separately to apprehend likely intra equality gaps in them. Finally, some key proxy parameters have been analysed to verify the likelihood on the reliability and robustness of inequality estimates, having far reaching implications on the development trajectory and policy directions including public services policy directions.

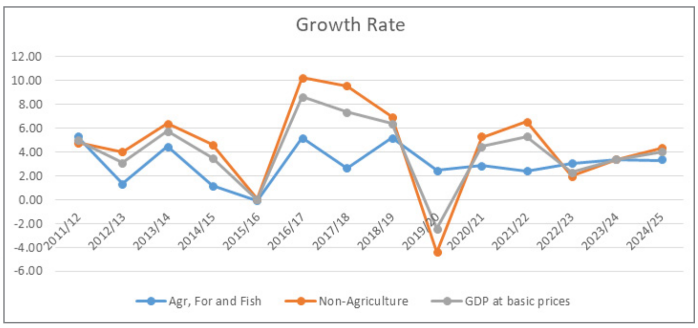
2.1 MAJOR FEATURES OF THE ECONOMY

Accelerating broad based high growth, enhancing equity, augmenting employment opportunities, reducing poverty and bringing prosperity rapidly in a sustainable way have been the priority agenda in Nepal in recent years[49]. How the economy has performed in such important critical fronts are discussed briefly below.

2.1.1 Growth Performance of the Economy

The overall growth performance of the period 2010/11 to 2024/25 shows that not only average growth rate has been low in many years, but also wider fluctuation has taken place simultaneously. Unlike the general expectation, the oscillation in growth rate has been sharper in the non-agriculture sector than monsoon dependent agricultural sector, indicating that Nepal faces bigger challenges of both higher growth and sustainability simultaneously (Graph 2.1).

Graph 2.1: Agri, Non-agri and Total GDP Growth at Factor Cost

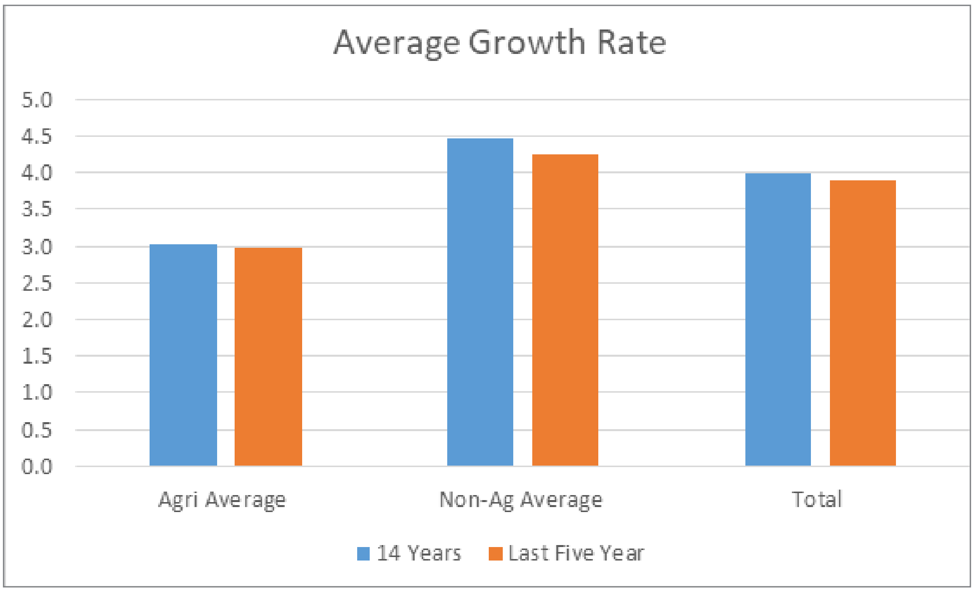


Source: National Statistical Office

[49] *Following many progressive clauses of the constitution and Nepal's commitments to the SDGs, such priority agenda are included in the last 15th and current 16th plan. For details see NPC 2019 and 2024. The budgets also try to follow these. See budgets of the recent years.*

The overall average growth rate of the last fourteen years (2010/11 to 2024/25) and latest five years' period (2019/20 to 2024/25) corroborates the above phenomenon further (Graph 2.2). As shown in graph 2.2, the overall average growth rate during the longer period has been merely 4 percent on average. The growth rate in the recent last five fiscal years has been less than 4 percent on average. Noticeably, the growth rate during the 15th plan period was one of the lowest in the planning history of Nepal at 2.6 percent on the average at the factor cost, contrary to very higher growth rate targeted for the plan period at 9.6 percent at the same cost[50]. Though larger dampening impact of COVID-19 was inevitable for some time, the resilience capacity of the economy and people have been very weak with no symptom of recovery and revival of the economy yet. This is further discerned by the growth rate of the first fiscal year of the current 16th plan period. The growth rate in the fiscal year 2024/25 hardly reached 4 percent on average at the factor cost[51]. At the same time, no improvement in the non-agricultural sector is taking place as graph 2.2 reveals. Consequently, the agricultural growth rate has outstripped the growth in the non-agricultural sector. In this respect, a strong view and larger consensus is that due to immature but isolated policies lacking comprehensiveness and coherency, the stagnation or slowdown in the economy has perpetuated and prolonged with larger economy-wide effect[52]. More recent worry is that huge property losses of the public and private sector [53]during the Gen Z movement in the last September 2025 accompanied by erosion in investors' confidence amidst concern about the safety of the property has dampened the prospect of the economy further.

Graph 2.2: Long Term Growth (2010/11-2024/25) and Growth in the Last Five Years Period (2019/20-2024/25)



Source: National Statistical Office

2.1.2 Assessing Structural Changes, Productive Capacity Enhancement, Labor Productivity Growth and Socio-Economic Transformation

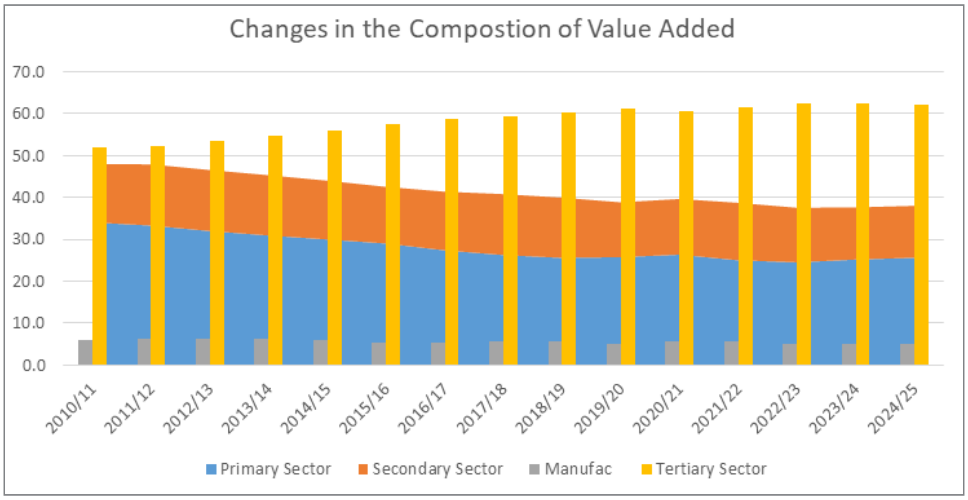
Notwithstanding the adverse impact of the shocks, the fragile nature of the economy can be better understood by examining the pattern in the structural changes, productive capacity and labour productivity enhancement which is a prerequisite for progressive transformation of an economy. It should be noted in the outset that though structural changes and transformation are highly correlated, they are not the same as they are quite often perceived synonymously. Broadly, structural change entails the sectoral changes in the value added as well as employment contribution to the economy in the development process. As such, a gradual shift from traditional agriculture to industry and from industry to modern services sectors is regarded as structural changes in the economy. Historically, such a change has occurred through a process of release of labour and capital from agriculture towards manufacturing industry and then towards modern services sectors.

[50] *For details See NSO 2025 and NPC 2024.*
[51] *NSO 2025.*
[52] *These aspects are partly discussed in Khanal 2023.*
[53] *Based on the NPC estimates It is reported that the total property loss has been in the order of Rs 84.5 billion, comprising Rs 44.94 and Rs 33.54 billon public and private sector and Rs 5.97 community and others.*

Economic transformation, on the other hand, requires that resources are shifted from low to high productivity activities and areas. Such a shift has to take place within and across sectors. Plausibly, it needs a strategic shift in two critical fronts simultaneously. First, it entails a priority shift towards the development of human capabilities (development of productive forces). Second, it, inter alia, requires that transformation of driving sectors of the economy takes place under which higher productivity of labour, among others, is ensured. Indeed, transformation is an accelerated process of socio-economic advancement under which profound changes in the production and distribution relations manifest which in turn enhance prosperity of a nation in a rapid way, at the same time ensuring equality and sustainability of development simultaneously[54]. For such advancements, apart from policy coherency, transformation of institutions and removal of structural barriers are prerequisites which are possible only if decisive decisions are made at the highest government level and hence regimes and government types are critical. Experiences show that amidst structural changes in the economy, hardly genuine transformation has taken place in many least developed countries leading to perpetuation in underdevelopment. The breakthrough could not take place largely due to inability to bring breakthroughs in overcoming constraints that were inhibiting progressive socio-economic transformation which required a process through which enhancing of productive capacity of the economy, raising labour productivity and augmenting development of highly competitive and potential sectors and areas could take place simultaneously. The regime or government types have been detrimental for continued underdevelopment to a larger extent[55]. While examining the character of the Nepali economy, above such dimensions have to be taken into account.

Apparently, large structural changes are observed in the Nepal's economy during the period 2010/11 to 2024/25 when alteration in the sectoral contribution of the value added is simply looked into (Graph 2.3). As shown in the graph, a steep rise in the contribution of tertiary sector has taken place in this period, from 52 percent in 2010/11 to 62 percent in 2024/25. Such a rise has been due to larger fall in the contribution of agriculture. During this period, the contribution of secondary sector has also reduced by 1.5 percent. Apparently, such a structural change resembles the historical phenomenon of the highly developed countries. Here the crux of the problem associated with structural changes comes to the fore instantaneously in the context of Nepal. Such a paradox can be understood by reviewing the underlying factors more closely.

Graph 2.3: Primary, Secondary and Tertiary Sector Contribution to Total GDP



Source: NSO.

More disaggregated sectoral growth contribution to GDP during the longer period (2010/11 to 2024/25) and the latest five-years period (2019/20 to 2024/25) shown in graph 2.4 gives a better picture of the accompanying structural changes in the economy. It is seen that compared to the longer period, apart from the agricultural sector, the contribution of critical sectors such as manufacturing, trade, IT and education has declined in the later period.

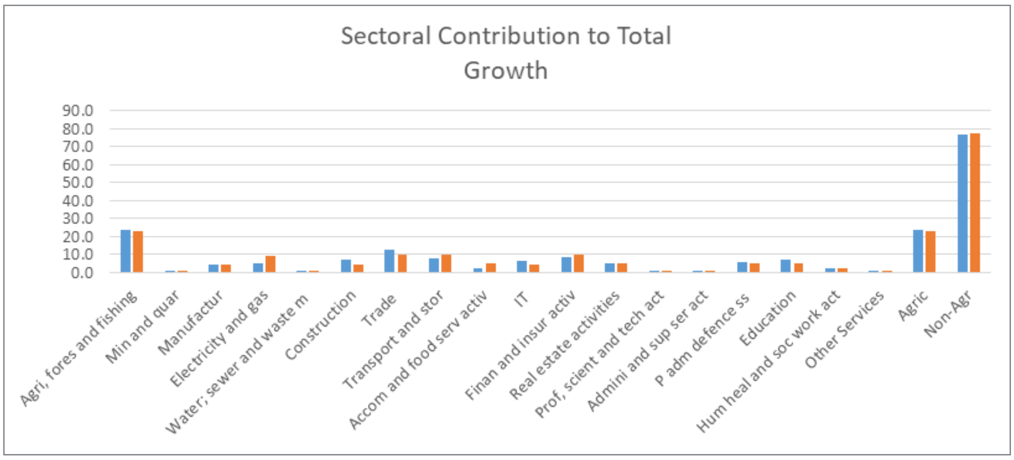
[54] *For such a line of reasoning and discussion along with review of both theories and country experiences see Khanal 2017 and 2018. It is noticeable that the LDC Program of Actions advanced since the early 1980s and implementation commitments made by the LDCs including Nepal largely recognize on the need of following such a development trajectory to overcome from the underdevelopment trap.*

[55] *Ibid. In these, how governments in East Asian and some others played a key role towards transformation of their economies compared to many poor countries which were early starter of planned development has been discussed.*

On the other hand, compared to others, added growth contribution has been made by sectors such as electricity, transport, tourism and financing and insurance in the recent five-year period. Though given the competitive edge of sectors such as electricity and tourism and needed increased role of the transport and financing sectors in the economy, their enlarged contribution can be regarded to be a positive development[56], sectors like energy and transport, however, are highly capital intensive and hence lack inclusiveness to a greater extent. At the same time, cost effectiveness has been a major problem for the debacle of the manufacturing sector[57].

More specifically, the drastic reduction in the contribution of the agricultural sector has not been due to higher productivity growth in that sector. The productivity in the major crops in Nepal is one of the lowest among South Asian countries. The phenomenal rise in imports of food items such as rice in recent years despite almost 60 percent of population still engaged in it further corroborates that slow pace of commercialization and low productivity are serious problems. More critically, the reduction in the secondary sector has been due to the deceleration in the contribution of manufacturing sector, which is considered to be as one of the major drivers of quality high growth and sustainable development. On the other hand, leaving a few sub-sectors aside, the expansion in the service sector has been accompanied by activities that have low value addition and productivity growth. This is one of the major reasons that why largely services led by non-agricultural sector's growth has been lower and more fluctuating in comparison to the agricultural sector growth as already pointed out above. To put it differently, added concern is that during this period, as noted above also, contribution of sectors having more inclusive, balanced and dynamic character has declined, impacting quality growth and positive transformation. In this respect, expansion in the growth contribution of education as well as health sector along with ensuring of quality services is regarded to be essential for enhancing productive capacity of the human resources. However, as evident from the graph below, in addition to almost stagnation in the growth of the health sector, the role and contribution of education sector have declined in recent years. Similarly, unlike the presumption that free trade plays an instrumental role in raising productivity and enhancing export competitiveness through technology adoption, managerial capacity enhancement and trade diversification could not materialize as sectoral contribution indicates[58]. Thus, by all accounts, structural changes have been asymmetrical without expected contribution to broad-based higher growth, equitable and sustainable development.

Graph 2.4: Sectoral Contribution to GDP (Long Term and More Recent Medium Term)



Source: National Statistical Office

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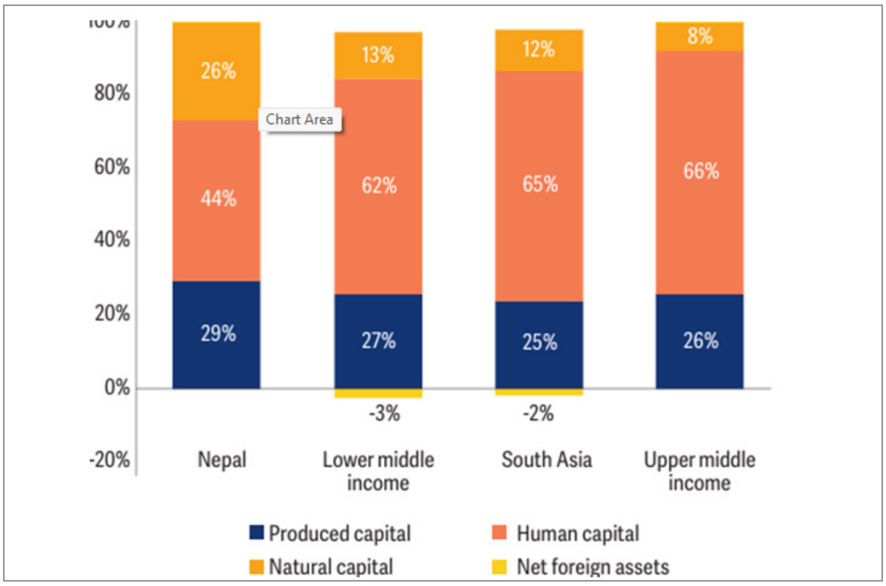
[56] If highly capital-intensive sectors have larger backward and forward spillovers, they may pull other sectors as well markedly. If there are poor linkages due to weaker demand in rest of the sectors, economy's overall drive cannot be ascertained. Nepal passes through such a phenomenon to a greater extent.

[57] Amidst very high production/ transaction cost compared to the neighbouring country having open border and strong economic linkages predominated by trade, share of logistic cost alone in total production cost is about 12.04 percent as recent estimates indicate (CNI 2025).

[58] It should be noted that, unlike the expectation, exports of goods as a share of GDP has stagnated or declined since last one and half decades amidst rise in imports leading to widening of trade deficit over the years. Thanks to the continued increased inflow of remittances, except in some exceptional years, Nepal has not faced foreign exchange constraint problems. However, the composition of trade and stagnating nature of exports corroborates that Nepal has additionally missed the opportunity of trade driven transformation of the economy. Consequently, Nepal continuously faces the problem of vulnerability in the external trade front.

A number of factors have played roles for largely a shallow type of structural change inhibiting progressive transformation of the economy. First, such a structural change has not taken place as a result of expected productive capacity enhancement in the economy. Though quantitatively, rapid progress in access to health and education has taken place in recent years, human capability has not enhanced accordingly. As shown in the graph 2.5, the share of human capital in total wealth is the lowest in Nepal compared to average low income as well as South Asian countries. More worry is that unlike many countries, experiencing faster rise in human capital in the process of development, share of human capital in recent years has decreased. Poor or worsening quality of health and education services has led to such a situation[59]. This along with constraining efforts to raise labor productivity is posing sustained economic growth and development more difficult and challenging.

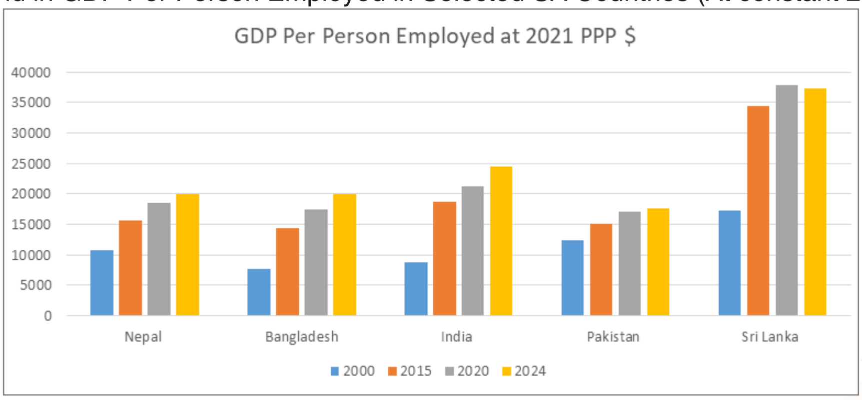
Graph 2.5: Share of type of human capital to total national wealth, 2018



Source: WB 2025a.

Though reliable data on labour productivity growth are not readily available, crude but proxy indicators in the form of GDP per person at PPP$ 2021prices shows that Nepal is behind the other South Asian countries expect Pakistan (Graph 2.6). Noticeably, GDP per person in countries like Bangladesh was behind Nepal in 2000. Bangladesh after catching up with Nepal is moving up since 2024. As revealed by the graph 2.5 additionally, India which was behind Nepal in 2000 has now gone up far ahead of Nepal. Thus, structural change has not been accompanied by expected labour productivity growth in the economy.

Graph 2.6: Trend in GDP Per Person Employed in Selected SA Countries (At constant 2021 PPP $)

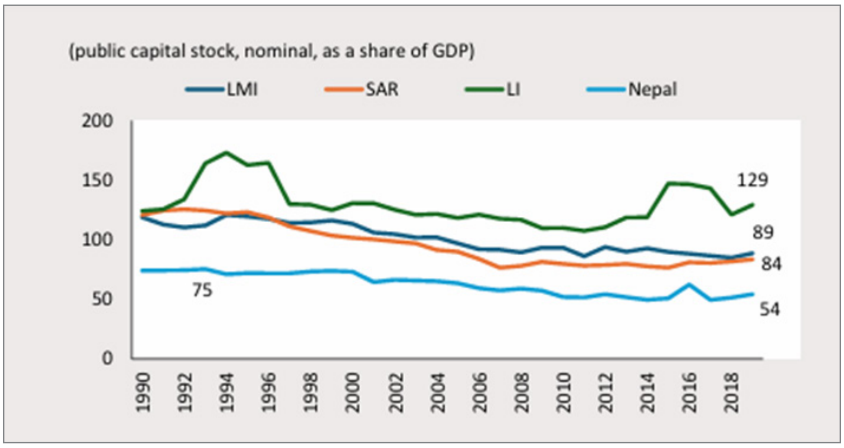


Source: World Development Indicators

[59] *For details see WB 2025a.*

As offshoots of above, in countries like Nepal it is necessary to ensure that the public sector by means of resource allocation and operational efficiencies backed by better and effective fiscal policy and budgetary management system enhances productive capacity of the economy at a faster pace. This is essential from both supply and demand side of the economy. Through both catalyst and complementary role, public sector is expected to contribute to enhance entrepreneurial ecosystems besides providing additional incentives and facilities to the private sector for larger investment in the productive areas. However, stagnation in the capital expenditure at the low level accompanied by dismal performance in the execution of projects with very low absorptive capacity on the one hand and escalation in wasteful and other unproductive expenses phenomenally overtime on the other has constrained such a role of the public sector immensely. More worry is that the performance has worsened further in recent years[60]. It is reported that Nepal's persistently low execution of infrastructure projects, among others, has significantly constrained the accumulation of public capital[61]. A separate study focused on capital expenditure bottlenecks finds a very dismal public investment management system in Nepal. It points out that with current levels of funding and project management system, it may take 41 years to complete 17 National Pride Projects. The estimates made during the analysis show that for infrastructure projects tree cutting approval processes takes 2 years, land acquisition process takes 2 to 3 years and procurement completion timeline for the World Bank funded projects takes 231 days on the average[62]. As an offshoot, the structural challenges in the allocation and uses of the capital budget in the line noted above have led to continuous decline in Nepal's public capital stock since the mid-1990s. The public capital stock which was around 75 percent of GDP in the mid-1990s reduced to nearly 54 percent in 2019[63]. Compared to the average low income and South Asian countries, the ratio is the lowest (Graph 2.7). This additionally substantiates that the ongoing level and structure of capital expenditure is highly detrimental to enhance productive capacity of the economy.

Graph 2.7: Trends in Total Public Capital Stock



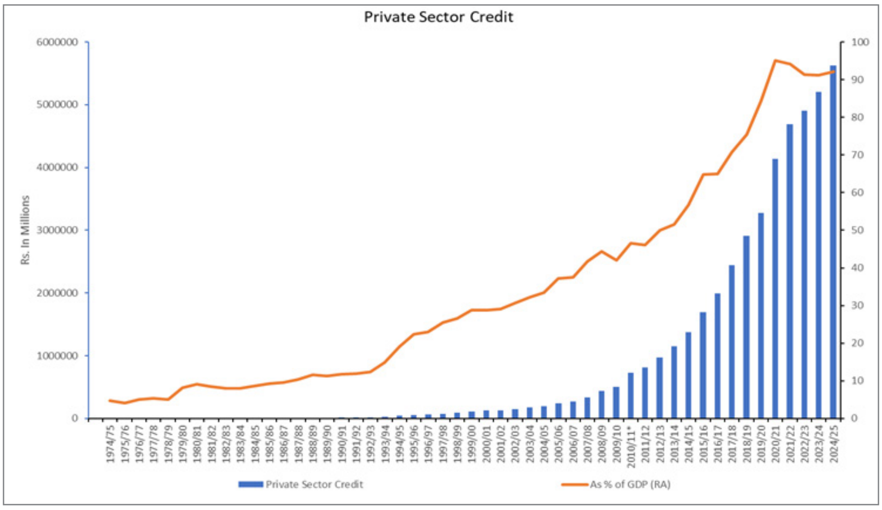
Source: WB 2025.

It should also be noted that if private sector investment, which is predominant in the total investment flows largely to the productive areas, there could be a wider spillover effect on the economy with intended net outcomes to a greater extent. For this to realize, however, it is necessary that economic policies and accompanying environments are prudent, cohesive and forward looking. In this context, as a part of larger economic policies, the monetary policy becomes highly crucial. In Nepal monetary policy has focused on liberalizing the financial sector after the mid-1980's though with many ups and downs. The positive aspect is that a marked rise in financial deepening has taken place overtime amidst continued larger inflows of remittances. Consequently, banking sector lending to the private sector has now exceeded 90 percent of GDP which is one of the highest in South Asia countries (Graph 2.8). In principle, such a financial deepening is expected to play a critical role in augmenting growth and development in a sustainable way. Evidence shown in the graphs above, however,

60 *More evidence based detailed discussion can be found in Khanal and Khanal 2024.*
61 *See WB 2025 for details.*
62 *See WB 2025 b for details.*
63 *The stagnating trend in capital expenditure at the low level together with widening gap between estimates and actual expenses added by deteriorating timely project implementation capacity in recent years indicates the possibilities of further worsening trend.*

contradict with such outcomes to a greater extent. This is taking place despite reintroduction of priority sector lending for almost two decades and continuity to target concessional loans with added focus in recent years.

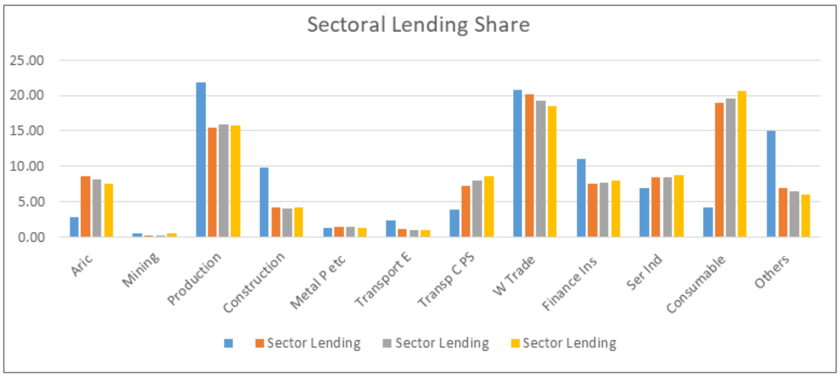
Graph 2.8: Private Sector Credit as a Share of GDP



Source: NRB and NSO.

The graph presented below (Graph 2.9) shows how the lending pattern of banking institutions has changed overtime especially from the standpoint of expansion in productive investment. It is seen from the graph that compared to 2020/21 expansion has taken place in limited productive sectors such as agriculture, transport (other than equipment) and services industry. On the other hand, in the productive sectors such as production and construction[64], the share of lending has decelerated considerably compared to 2010/11[65]. Conversely, larger expansion in the share of lending has taken place in sectors like consumables in recent years. Similarly, lending has been equally predominant in the trade sector though there has been some slowdown in the share of trade recently amidst slowdown in the economy. As an offshoot, most concerning feature is that there is over concentration of banking sector credit to the limited households and groups as well as locations. Thus, the changing pattern of lending accompanied by over concentration of lending additionally corroborates that it is largely inimical from the point of view of sustaining growth and development through enhancing productive capacity of the economy.

Graph 2.9: Long Term Trends in the Growth of Private Sector Credit



Source: NRB

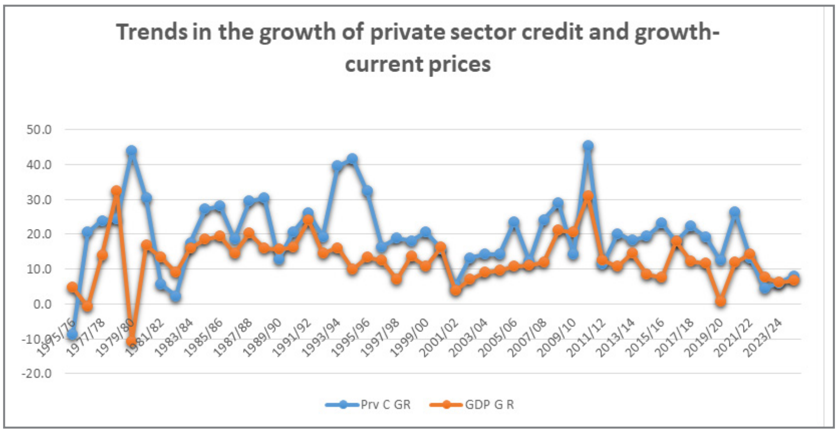
The cumulative impact can be seen when correlation between the rate of growth in the private sector lending and the economy is observed (Graph 2.10). As shown in graph 2.10, unlike the expected positive correlation, opposite relationships are observed in many years with some exceptions. It is interesting to know that in more recent years, a convergence between slowed growth and drastically reduced credit expansion has taken place. Such trends demonstrate a kind of low equilibrium trap situation. This raises questions about the rationality and soundness of the

[64] *The experience of East Asian countries including S Korea reveals that for rapid transformation and productivity growth construction sector has been one of the catalysts.*

[65] *A quick look at the share of concessional lending in total lending shows that it is just 1.7 percent in 2024/25. See NRB 2025.*

ongoing monetary policy which, in principle ignores, structural and many other real sector related supply side factors. The pervasiveness of such problems can be gauged by the recent phenomenon. Despite historically being one of lowest interest rates quite for some time, the demand for credit by the private sector has hardly increased, leading to mammoth rise in excess liquidity in the banking system. As is well known, if such a situation persists for lengthy period, the looming crisis in the banking system may blow up with a threat to larger economy-wide crisis.

Graph 2.10: Long Term Trend in the Private Sector Credit and Economic Growth



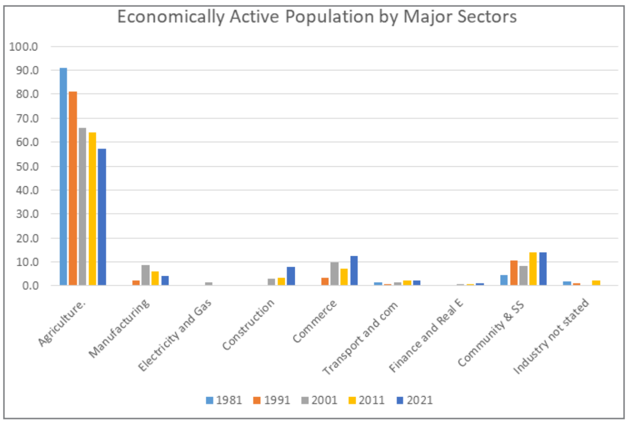
Source: NSO and NRB

Thus, the foregoing analysis associated with various aspects of growth and structural features of the economy provides bases under which the labour market is functioning.

2.2 LABOR MARKET AND EMPLOYMENT CONDITIONS

As expected, sectoral alterations in the engagement of economically active population have also taken place over time along with structural changes in the economy. As shown in graph 2.11, a steady fall in the active population engaged in agriculture occurred during the period 1981 to 2021, from above 90 percent in 1981 to less than 60 percent in 2021. Amidst such a fall, a gradual shift of economically active population to community and social services, commerce and construction sectors has taken place correspondingly though with large ups and downs except in construction sector. Noticeably, labour absorption in the construction sector has increased continuously despite decrease in the share of value-added contribution in recent years as already indicated above which means that this sector is more labour intensive. Though there is a gradual shift to sectors such as electricity, transport and finance, their absorption of economically active population is low compared to their contribution to the valued added. This is not surprising since sectors such as energy and transport are highly capital intensive. On the other hand, a sharp reduction in the absorption of economically active population has taken place in manufacturing sector after picking up in 1991. This is also expected trend amidst decline or stagnation in more labour absorbing manufacturing sector. So much so, the sectoral trends conceal many unique characteristics and conditions of the labour market in Nepal.

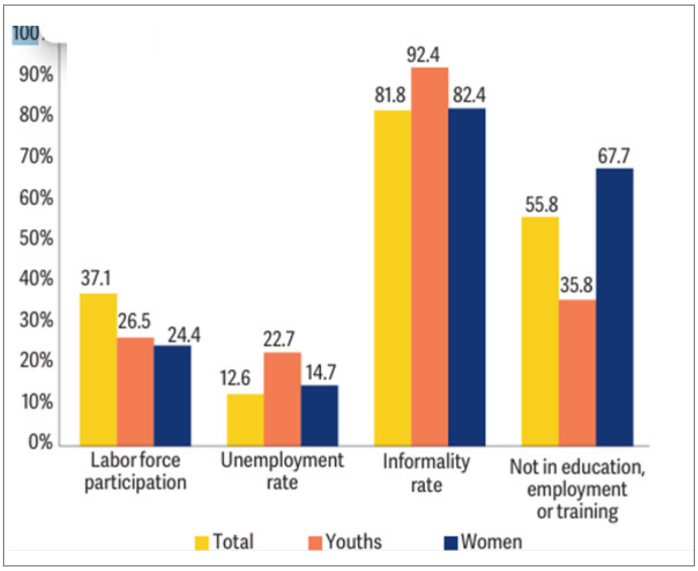
Graph 2.11 Economically Active Population by Major Sectors



Source: NSO (Census Results).

Nepal's labour market characteristics and conditions can be ascertained by closely looking into the graph 2.12 below. As shown in the graph, first and foremost is that total labour force participation rate in Nepal has declined over the years sharply and has now reduced to 37.1 percent. In that also, youths and women labour force participation rates are much lower at 26.5 and 24.4 percent respectively. Larger out-migration, higher level of unemployment added by skill mismatch, lack of training and education gap, bigger share of inactive population in unpaid subsistence work amidst very high rate of informality etc. have played a key role in that. Along with average total and women unemployment rate of 12.6 and 14.7 percent respectively, the youth unemployment rate is high at 22.7 percent. The high share of youth not in education, employment or training contributes to this to a greater extent. As shown in the graph 2.12, out of total 55.8 percent of labour force not in education, employment or training, 35.8 percent youth and as high as 67.7 percent women are deprived of such a facility[66]. Most worrisome phenomenon is that the percentage of informal labour market predominated by unskilled workers is still very high at 81.8 percent. Out of this, the informality rate of women is above the national average at 82.4 percent. Incredibly, informality among youth is extremely high at 92.4 percent. Added concern is that virtually most of the informal workers are out of social protection coverage. Nepal, thus, faces the extreme vulnerability in the labour market which further corroborates that growth, structural changes and targeted policies and programmes have dismally failed to improve labour market conditions in Nepal [67]. A review of the progress on the SDGs by the NPC also concedes that among all the 17 SDGs, the progress in the areas of employment and decent work has been the lowest with challenges to accomplish the SDGs 8 by 2030[68].

Graph 2.12: Selected Labor Market Indicators in Nepal, 2023-2024



Source: WB 2025a.

Added these, another serious problem is that utilization of adjusted human capital (UHCI) is the lowest in Nepal compared to South Asian and lower middle-income countries average. Estimates on such indices show that for Nepal UHCI is 0.18 compared to 0.25 for South Asia and 0.26 for lower middle-income countries (Graph 2.13). This means that Children born in Nepal today will only be able to utilize merely 18 percent of their potential productivity as an adult. Such calculations also show that if Nepal invests more effectively in its people and creates quality job opportunities, the GDP per capita could be five and a half times higher[69]. With more than 2200 youths leaving the country per day by air route alone in search of job abroad, the gravity of the problem in the labour market is yet to be taken more seriously at the higher political decision-making level.

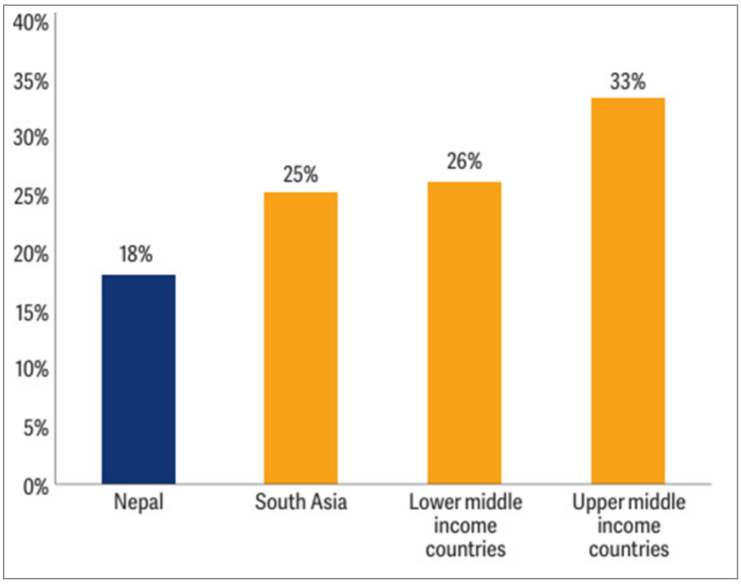
[66] *The percentage not in education, employment and training is high in Nepal compared to other South Asian countries except Afghanistan (WB 2025a).*

[67] *The extent of vulnerability can be understood by observing that every day more than 2000 youths leave the country by air route alone in search of the employment abroad. For such numbers see NRB 2025a.*

[68] *ibid*

[69] *For details see WB 2025a.*

Graph 2.13: Utilization-Adjusted Human Capital in Nepal, 2020

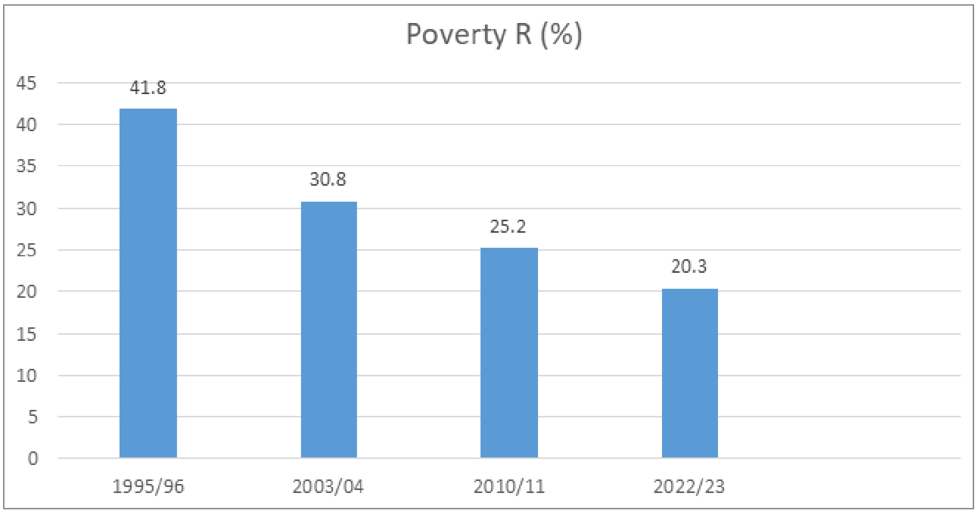


Source: WB 2025a

2.3 ASSESSING POVERTY TRENDS

Unlike the fear of pervasive adverse effects of economic fragility and highly vulnerable labour market conditions, a steady decline in the consumption poverty[70] has taken place over the years, from 41.8 percent in 1995/96 to 20.3 percent in 2022/23 (Graph 2.14). Thus, during the period of 1995/96 to 2022/23, more than half of the population below the poverty line has moved up from the poverty level. Notwithstanding such falls, still more than 6 million people are below the poverty line.

Graph 2.14 Percentage of Population Below Poverty Line (1995/96 to 2022/23)

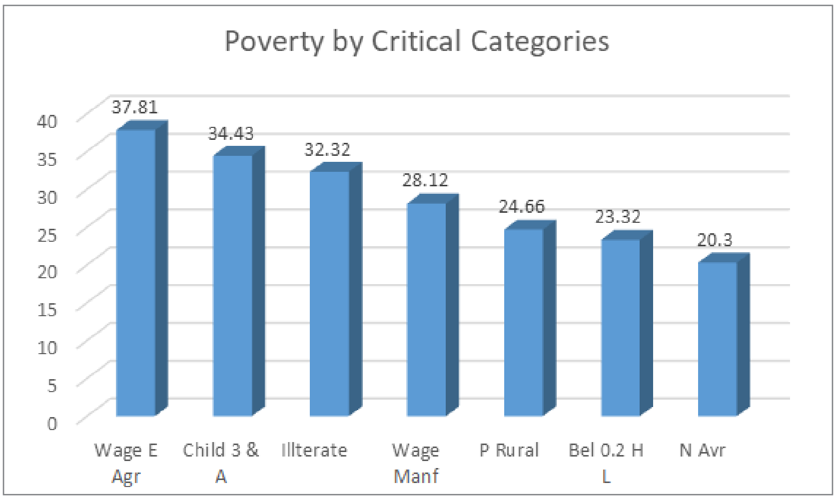


Source: CBS for 1995/96 to 2010/11 and NSO for 2022/23

Among the total population confronting poverty, certain occupational and other socio-economic groups, however, face more hardship and misery than others. As shown in the graph 2.15, the poverty among wage earners in the agriculture sector is more prevalent. Their share among the population below poverty line is higher at 37.81 percent. Similarly, households having 3 and above children struggle with high poverty which is estimated to be around 34.43 percent. Other categories which confront with rampant poverty include illiterate, wage earners in manufacturing, rural population and farmers holding less than 0.2 hectare of land.

[70] *The poverty estimates are based on the consumption approach.*

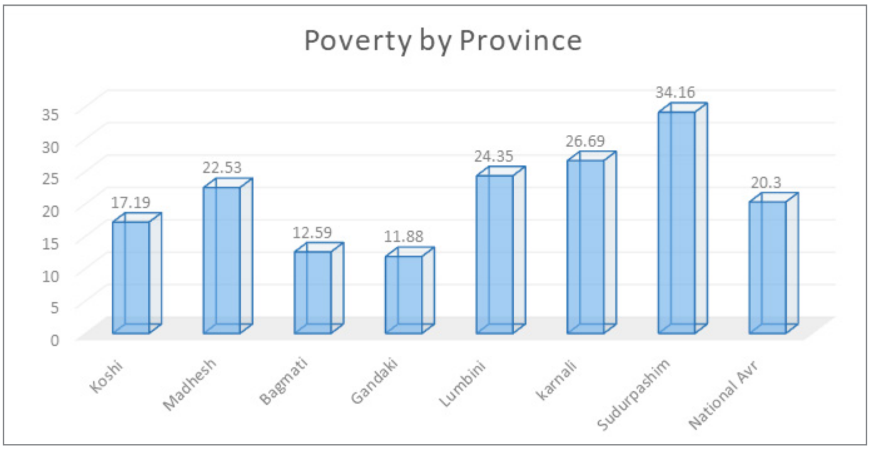
Graph 2.15: Poverty by Critical Categories 2022/23



Source: NSO 2024

Another phenomenon is that the poverty gap among the seven provinces is quite large with less developed provinces facing upper level of poverty than others. As shown in the graph 2.16, poverty in Sudurpashchim province is high at 34.16 percent followed by 26.29 percent in Karnali and 24.35 percent in Lumbini respectively. The lowest poverty is in Gandaki at 11.88 percent. This means that the poverty gap between the provinces with lower and provinces with higher level of poverty is quite large.

Graph 2.16: Poverty by Province 2022-23

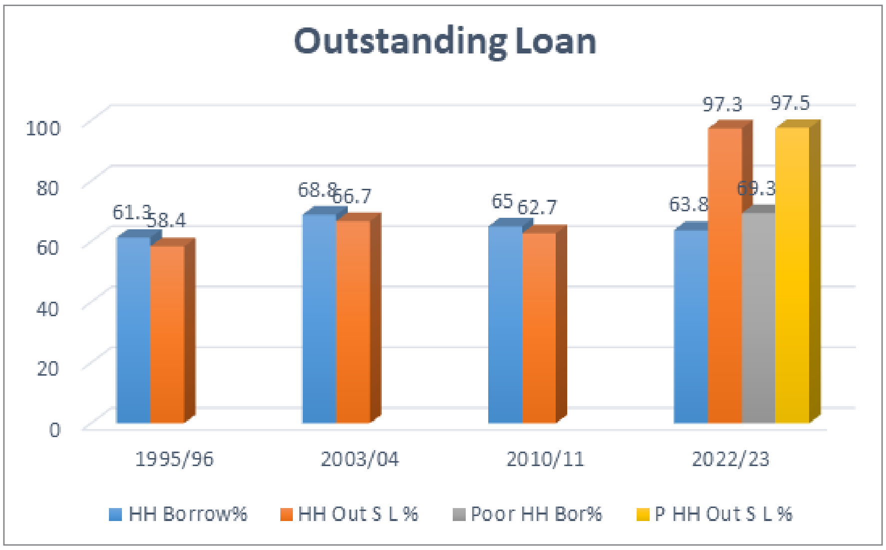


Source: NSO 2024

It should, however, be noted that such larger poverty gaps are there despite, as noted above, poverty estimates made following consumption approach. It should be noted that generally there is a practice of over-reporting of consumption leading to underestimation of poverty conditions. Moreover, for maintaining the minimum consumption level, poor have to take loans from different sources including money lenders besides selling their property if any. In this respect, it is notable that in Nepal total debt outstanding of a household has jumped phenomenally in recent years (Graph 2.17). During the period 2010/11 to 2022/23, the share of households having debt outstanding has risen from 67.7 percent to 97.3 percent. Such a ratio is even higher among the poor. This means that unless households in general and poor households in particular get opportunity of earnings sufficiently to fund their consumption baskets, both level and intensity of poverty may upswing again with the upsurge in debt burden of households amidst weakening of their debt servicing capacity. Another notable aspect is that the reduction in consumption poverty has taken place predominantly as a result of continuous increase in the inflow of remittances which is contributing to raise household's level of disposable income. This is corroborated by the NLSS findings[71]. Thus, it is clear that the policies and programmes pursued internally have played a minor role in such reductions which reinforce the major findings derived above.

[71] *For details see CBS 2011 and NSO 2024.*

Graph 2.17 Household Borrowing and Total Debt Outstanding



Source: NSO 2024

Notably, due to the reasons underlined above, consumption approach may not be appropriate to gauge the intensity of poverty and ascertain the sustainability of poverty reduction. However, the problem is that the income-based poverty estimates are not readily available. But a proxy estimate made based on the distribution of income by each decile group reported in the NLSS of 2010/11 taking computed poverty income threshold into account shows that income poverty was above 42 percent in that fiscal year. This means that in 2010/11 the income poverty compared to consumption poverty was higher by about 17 percent[72]. Though similar quick proxy calculations are difficult to estimate based on the NLSS 2022/23 for the reasons discussed in the next section, there is likelihood of such a gap continuing or manifesting further. As country experiences show, higher poverty, in turn, makes more pervasive adverse impact on both equality and employment.

2.4 DIAGNOSING OVERALL AND VARIOUS DIMENSIONS OF INEQUALITY

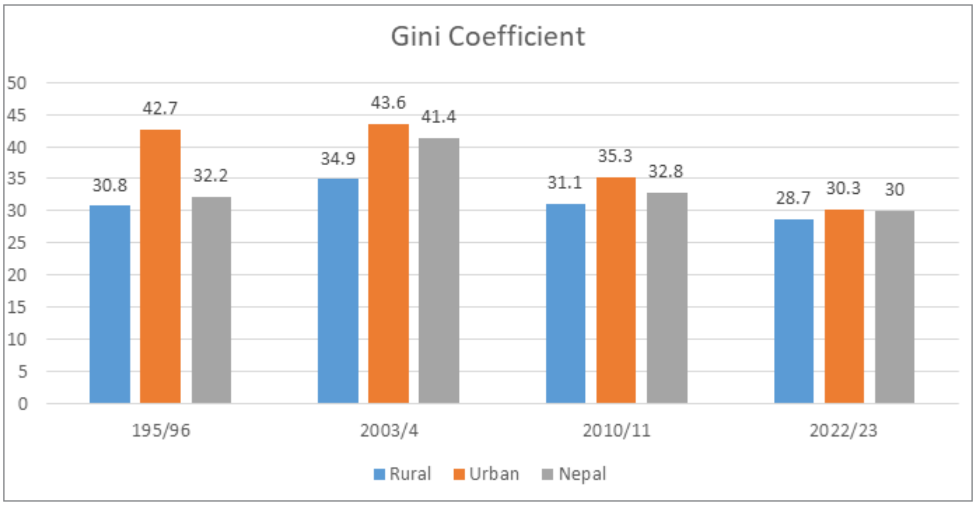
In Nepal inequality is also commonly estimated following consumption approach. As shown in the graph 2.18, consumption-based inequality has also steadily declined overtime in Nepal though with some fluctuations (Graph 2.18). In 1995/96, the inequality measured through Gini coefficient was 0.322 with urban inequality at 0.427 and rural inequality at 0.308 respectively. There was a peak thereafter which reached 0.414 in 2003/04 with a sharp increase in urban inequality at 0.436. After 2023/04, a steady decline took place in inequality and reduced to 0.30 in 2022/23 with urban and rural inequality at 0. 303 and 0.287 respectively.

Although this declining trend is a positive development, it, however, hardly represents true situation in inequality in societies. Such a deficiency is corrected by income inequality to some extent. In recent years, parallel estimation of wealth inequality has also been equally popular as it additionally helps to gauge how unevenly money, property, investments, and other valuable assets are distributed across population of a country. Such popularity has arisen partly because of wealth apart from reflecting people's economic security reveals that overconcentration of wealth could be a threat to peaceful transformation of society towards prosperity of a nation. As various country estimates show, the gap between income, wealth and consumption inequality is more striking [73] and hence from justice standpoint, examination of income and wealth inequality is very important.

[72] *For both estimates and inferences see Khanal 2018.*

[73] *Global inequality lab provides comparable numbers in many country contexts. For instance, in its recent estimates it shows that in India income inequality measured through Gini coefficient for 2023 is one of the highest in the world at 0.61. Same estimate shows that it was 0.47 in 2000. The consumption Gini estimated by the same for 2023 has been derived to be 0.255. This indicates a huge gap between the two and hence it depicts that consumption Gini cannot be as a true basis of measuring inequality in societies. It shows that wealth Gini higher than income Gini. South Africa is ranked the top unequal country in the world on both counts. How income and wealth accumulation has increasingly concentrated on limited individuals leading to escalation in income and wealth Gini can be gauged from the recent Oxfam and Global Inequality Lab Reports (Oxfam 2026 and GIL 2026).*

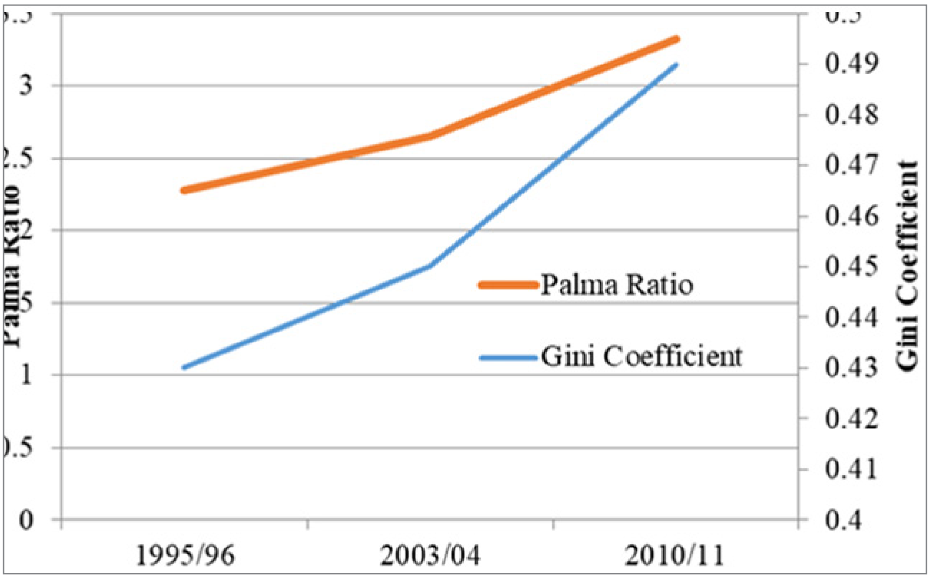
Graph 2.18: Consumption based Inequality (Gini) during 1995/96 to 2022/23



Source: CBS for 1995/96 to 2010/11 and NSO for 2022/23

In Nepal's context, an in-depth study on both income and wealth inequality was carried out some years back in Nepal based on the household data of NLSS 2010/11 and Health and Demographic Survey 2016[74]. It shows that both income and wealth inequality are high in Nepal, more so with respect to the latter. The income Gini reported in the study is in the neighbourhood of 0.494[75] which may be considered to be one of the highest in the world. Computed Palma ratio which measures the ratio between the income share of the top 10 percent and the bottom 40 percent proved this further (Graph 2.19). By comparing the results of the three NLSSs it shows that the share of the 10 percent rich reached 3.32 times higher than the poor in 201011 from 2.28 and 2.65 times in 1995/96 and 2003/04 respectively. Conversely as the report indicates the income share of the poorest 40 percent declined from 15.3 percent in 1995/96 to 11.9 percent in 2010/11.

Graph 2.19: Palma Ratio and Gini Coefficient

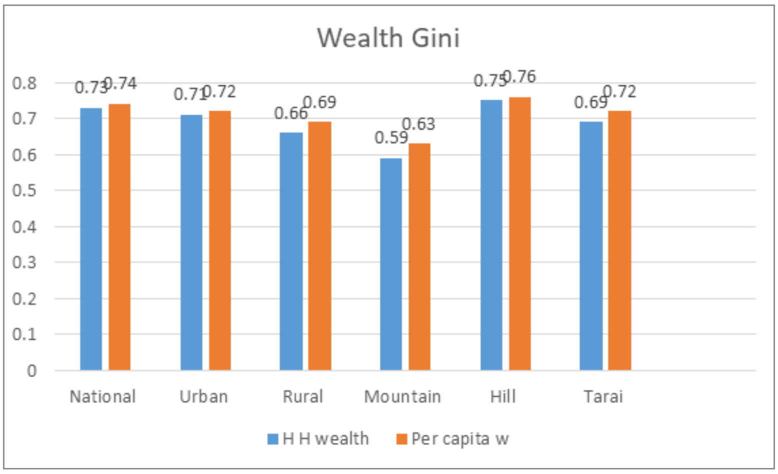


Source: Oxfam et al 2019

In the report wealth Gini [76] is also presented. It shows that the wealth Gini is very high at about 0.72 in Nepal (Graph 2.20). As shown in the graph 2.20, the wealth Gini is reported to be comparatively high in the urban areas compared to the rural areas. The wealth inequality is estimated to be higher in Hills than in Mountain and Tarai.

[74] *For details see Oxfam, HAMI and SAAPE 2019.*
[75] *It additionally proves that the consumption Gini highly underestimates the inequality in societies.*
[76] *Though there is now a practice of computing and including wealth Gini in the plan documents, there are doubts on their robustness. The estimated Gini shown in the 16th plan for the year 2022/23 is 0.24 which is only slightly higher than consumption Gini.*

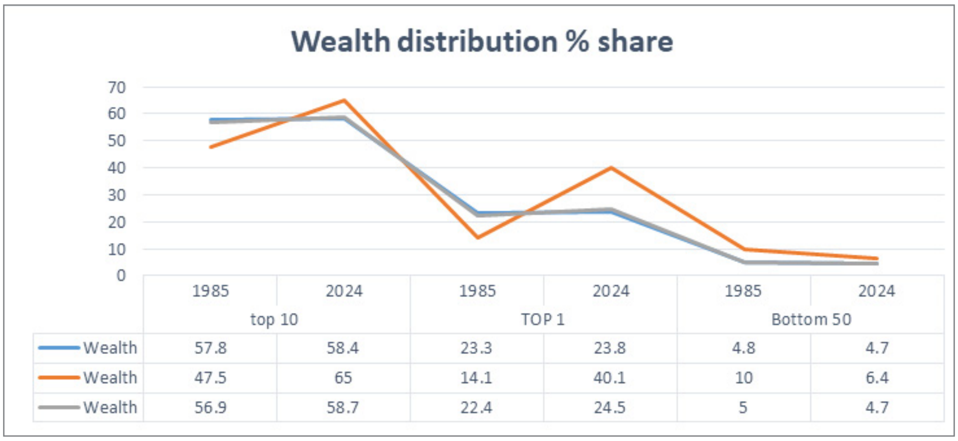
Graph 2.20: Wealth Gini by Rural, Urban and Ecological Regions



Source: Source: Oxfam et al 2019

Moreover, recent estimates by the Global Inequality Lab estimates confirm that is very high and rising in Nepal. As shown in the graph 21 below, wealth shares of top 10 percent were 56.9 percent in 1985 in Nepal. The share of the top wealthy increased overtime and reached 58.7 percent in 2024. During the same period, the share of top 1 percent reached 24.5 percent from 22.4 percent whereas the share of bottom 50 percent reduced to 4.7 percent from 5 percent. Such recent estimates largely support the above findings.

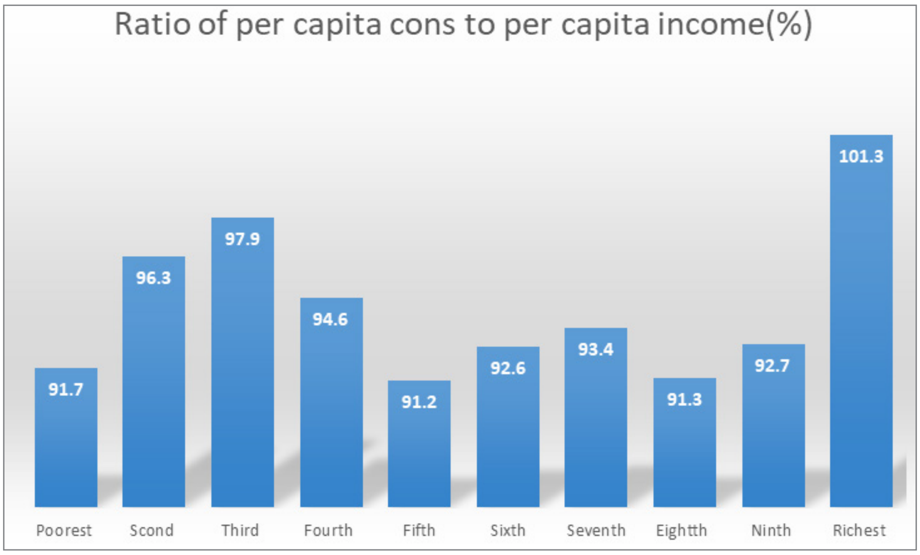
Graph 2. 21: Wealth Distribution between Rich and Poor



Source: Global Inequality Lab 2026.

The above estimates support the argument that consumption Gini is not the better measurement of estimating inequality. This is further corroborated if income and consumption data by decile groups reported in the latest NLSS 2022/23 are closely analysed. Estimation of saving rate among decile groups by simply subtracting consumption from income reveal that there are doubts on the robustness of data used for consumption-based inequality approximations. As depicted by the graph 2.22 below, the saving rate of the lowest decile group derived accordingly shows that this group has higher saving rate at 8.3 percent as against negative saving rate of 1.3 percent of the highest decile group. It, thus, demonstrates that the income of the higher income group is highly underestimated and those of the poorest decile group is highly overestimated compared to the consumptions. If such estimates are compared with the overall domestic and national saving rate, more questions than answers come to the fore. Interestingly, the above saving rate of the lowest decile group is higher than the average domestic saving rate of the country which is 7.22 percent for that fiscal year. More fundamentally, the national saving rate is always substantially higher than domestic saving rate. In 2022/23 it was 33.91 percent which is higher by 9.2 percent compared to gross fixed investment. There is a likelihood that such a higher saving rate is closely associated with the higher income groups. Notably, it is clear that there is a close link between rapid growth in the accumulation of foreign exchange reserve and national saving as foreign exchange reserves represents retained net earnings acquired from abroad to a greater extent. Amidst low investment rate, very high saving rate also portrays the likelihood of very higher savings among certain group of people. Thus, unlike the inequality figures reported and used for different official purposes, there is a strong possibility that country is moving towards very high inequality trajectory[77].

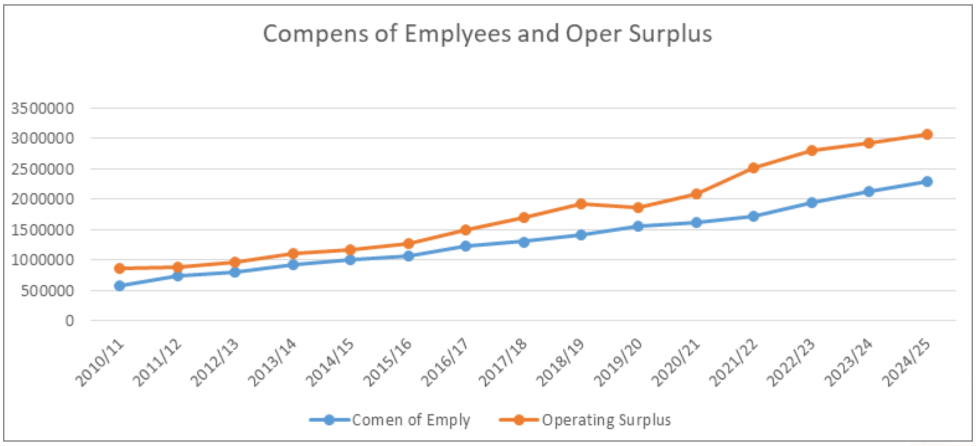
Graph 2.22 Comparison of Consumption and Income by Decile Group



Source: NSO (NLSS 2022/23).

One of the broad indicators to verify the altering pattern in inequality is the changing phenomenon overtime in the share of compensation of employees and operating surplus of the proprietors in total factor distribution. Acknowledging limitations of such separate calculations during the course of national accounts estimates their trends provide some idea on the likely impact on income distribution. From the graph 2.23 below, it is clear that in addition to share of compensation to the employees being persistently lower overtime, a fast rise in the share of operating surplus has taken place in the post Covid-19 period leading to widening of gap between the two. Persistence of larger wage gap between the male and female workers may be playing a key role in such a widening gap. The NLSS of 2022/23 sows that amidst low wages, the wages of the short-term women workers are below by as much as 67 percent to those of male workers. In the long-term wage employment also, wages of the women workers are reported to be below 56 percent compared to the male. Such a tendency additionally depicts the possibility of more pervasive nature of inequality. As an offshoot, there is an increased practice of providing very higher salary to the senior management team members compared to the lower staff in the private run banks and other selected companies with a possibility of fuelling inequality further[78].

Graph 2.23 Compensation of Employees and Operating Surplus

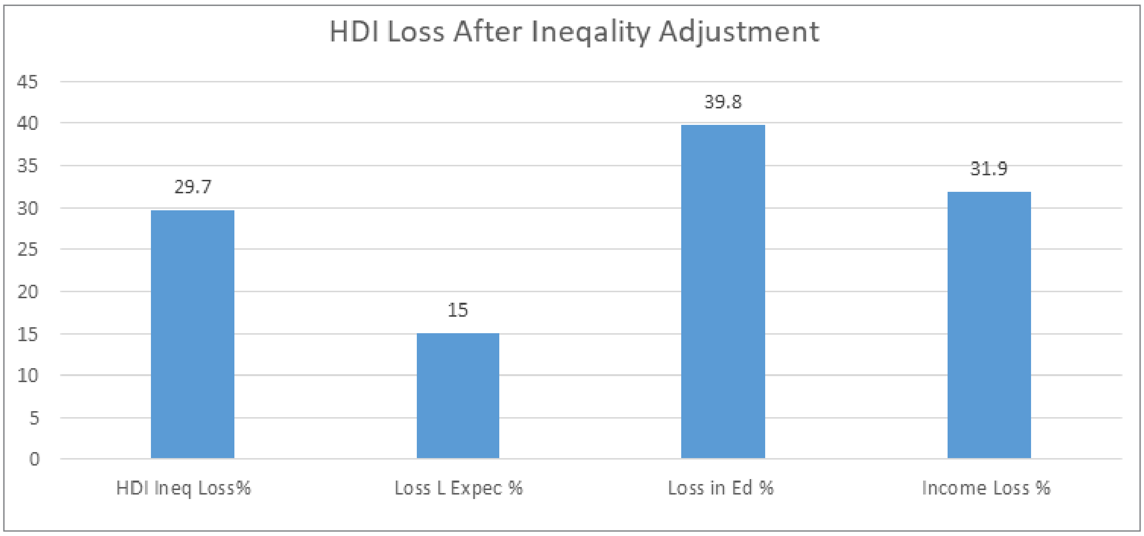


Source: NSO (2025)

[77] *Inequality from such an angle is yet to be further substantiated which will need compilation of more disaggregated data and in-depth analysis.*
[78] *Oxfam, HAMI and SAAPE report (2019) corroborates this.*

The estimated losses in overall human development and its major components also additionally provide broad ideas on the likelihood of inequality in societies. The latest Global Human Development report depicts that the overall loss in human development resulting from inequality adjustment is in the neighbourhood of 30 percent in Nepal (Graph 2.24)[79]. Only in the health services index represented by life expectancy at birth, does the loss seem to be albeit low at 15 percent. On the other hand, the loss in education index due to inequality adjustment is estimated to be high at about 40 percent. Similarly, the loss in income index equality is stated to be 32 percent, which is also high. Additionally, the gender inequality index consisting of reproductive health, empowerment (represented by women in parliament) and labour market conditions (represented by labour force participation rate) shows that gender inequality is high in Nepal at 0.487 as against South Asian average at 0.458[80].

Graph 2.24 : Loss in HDI and Its Main Components after Inequality Adjustment



Source: UNDP 2025.

Thus, contrary to consumption-based Gini, income and wealth Gini added by other related indices show that inequality is emerging a major challenge for Nepal. From the same token, the tax policies as well as spending on public service and social protection programme s are contributing to escalating or reduce inequality becomes critically important from justice standpoint.

[79] *Almost similar loss is reported in the Nepal Human Development Report (NPC/UNDP 2020).*
[80] *See UNDP 2025.*

CHAPTER 3

TAX JUSTICE SYSTEM IN NEPAL:

A CRITICAL REVIEW AND ASSESSMENT

This chapter critically examines the current tax justice system in Nepal. It reviews global tax justice debates, assesses institutional roles and structures, evaluates tax policies and their equity implications, and identifies challenges such as base erosion, exemptions and weak enforcement. The chapter provides an evidence-based assessment with policy recommendations for a fairer, more progressive and accountable tax system.

TAXATION

JUSTICE

INEQUALITY

CUSTOMS AND TRADE

CORPORATE ACCOUNTABILITY

WEALTH AND CONCENTRATION

PUBLIC REVENUE MOBILISATION

FAIR AND EQUITABLE TAXATION

REDUCTION OF INEQUALITIES

ACCOUNTABILITY AND TRANSPARENCY

STRONG INSTITUTIONS AND EFFECTIVE GOVERNANCE

SUSTAINABLE REVENUE AND DEVELOPMENT

CHAPTER 3

TAX JUSTICE SYSTEM IN NEPAL:
A CRITICAL REVIEW AND ASSESSMENT

3.1 GLOBAL TAX SYSTEM AND JUSTICE: A REVIEW

As briefly pointed out in Chapter 1, the high income and wealth inequalities will have pervasive social economic consequences with very adverse effect on the well-being of people including health outcomes[81]. Lower effective tax rate not only promotes inequalities and injustices in societies but also affects tax morals adversely[82]. However, with the increased financial power and influence of the multinational companies in the decision makings, a global tendency of pressuring for very low taxes, exploiting loopholes and avoiding tax rules has increased. A massive rise in intangible assets amidst phenomenal rise in digitalization has led to tax avoidances or evasions further particularly through the means of tax havens, among others. The corporate tax loss is estimated to be 10 percent of global tax revenue[83]. On the other hand, the major problem of the countries in the global south is that they are hardly able to collect adequate revenue from the MNCs operating within their territories. Generally, bilateral treaties prevent developing countries from imposing taxes on them, constraining their ability to impose source-based taxes. Often bilateral tax treaties provide limited withholding rights for cross-border dividends, interest, and royalties. As a consequence, about one percent of GDP flows from poor countries to richer countries annually as a net foreign income transfer[84].

Though agreement by the developed countries to impose a global minimum tax rate of 15 percent on the big multinational companies have seen positive development, low rates, tax avoidance and evasions as well as continued pressures to reduce statutory CIT rates are still the major problems faced by the developing countries[85]. More worrying is that now the USA has backtracked from such commitment as the recent agreement between the USA and EU under its pressures reveals.

Estimates show that the annual global requirement of about $ 4 trillion to support public services, among others, can be mobilized by revamping existing global tax and budgetary systems. For realizing this, a corporate tax rate of 25 percent and a wealth tax rate of 2 percent on billionaires is suggested86. In this context, initiatives through the UN Framework Convention on International Tax Cooperation for promoting global tax justice including climate and gender justice is a move towards right direction. The Framework focuses on the need of fairness in taxing rights besides emphasizing on exceeding the arm's-length principle and moving beyond bilateral tax treaties87. As is well known, the arm's-length framework promotes true market prices in intra-group transactions and helps to shift profit to low or no-tax jurisdictions. This is a favoured taxing principle in a situation where economic activities take place through global supply chain and digital platforms and also local labour, infrastructure, and markets contribute substantially to acquire corporate profits88. Hence, if such a principle is agreed, it would help in promoting a fairer, transparent, and beneficial system globally leading to a reasonable share of global revenues to the developing countries. Similarly, the UN framework proposes a coherent, transparent, and universal framework for fairer allocation of taxing rights across jurisdictions and emphasizes the need of democratic and transparent international tax architecture for tackling tax avoidance, tax evasion, tax abuses, illicit financial flows and secrecy

[81] *See Pickett and Wilkinson 2015.*
[82] *Dom et al., 2022*
[83] *EU 2024.*
[84] *World Inequality Report 2026.*
[85] *See Hugger et al, 2024*
[86] *Ibid*
[87] *Details on these are given in GATJ 2025.*
[88] *Ibid*

jurisdictions. Despite so many hurdles limiting the possibility of breakthroughs, the forthcoming UN Convention on Tax Cooperation is expected to contribute to moving towards a fairer global tax system. Noticeably, unless there is a parallel drive domestically, the larger aim of enhancing the tax justice system will be defeated with weak grounds to advocate for the same at the global level. From that standpoint, how Nepal's system has been evolved and implemented becomes highly crucial and important.

3.2 ROLE OF INSTITUTIONS IN DETERMINING TAX SYSTEM IN NEPAL

The constitution of Nepal assigns exclusive and concurrent rights and responsibilities to the federal, provincial and local governments. As per the constitution, the federal government has the major expenditure responsibilities and revenue rights[89]. More particularly, it has the absolute right to determine the bases and the rates of the corporate income tax, personal income tax, remuneration tax, value-added tax, excise and customs duty. It has also the right to impose additional taxes and fees through the finance bill. Concurrently, foreign employment service fees, education service fees, infrastructure fees, green tax, road construction fees, road maintenance and improvement fees, pollution control fees, cinema development fees, telephone ownership fees, telecom service fees, digital service tax and casino royalty are being implemented by the federal government. Similarly, provincial governments have the right to impose land and building registration tax, vehicle tax, entertainment tax, advertisement tax and tax on agriculture income. They can also introduce service fees, tourism fees, fines and penalties which fall under non-tax category. Similarly, local governments have the authority of implementing taxes ranging from property, house rent, land and building registration, vehicle, land, entertainment, advertisement to business tax. Under the non-taxes, local governments have the authority to impose service fees and tourism fees besides the right to charge fines and enforce penalties. Importantly, federal, provincial and local governments have the right to formulate and change taxation policies as and when required. As an offshoot, they have the authority to bring about reforms and changes in tax laws as a part of budget formulation and implementation processes.

In the entire process of budget preparation and execution, the role of the National Planning Commission (NPC) is also vital. Besides preparing a periodic plan, the NPC is responsible for preparing a medium-term expenditure framework each year with three-year projections on a rolling basis to guide and facilitate budget preparation processes in advance. In such projections, total size of the budget with detailed breakdown on the three major expenditure heads viz, current expenditure, capital expenditure and financing as well as major sources of funding are included. Such a role is undertaken through the resource committee which is chaired by the Vice Chairman of the NPC. The resource transfer to the sub-national governments is also proposed by this committee based on the recommendations of the National Natural Resource and Fiscal Commission (NRRFC) which is constitutionally mandated to it. Apart from this, the NPC is responsible for coordinating, supporting, and facilitating the provincial and local governments in the formulation and implementation of periodic plans, MTEF and annual programmes. As in such entire exercises the revenue projections in general and tax revenue projections in particular are grounded on potential tax policy changes, their recommendations, thus, play some roles in the ultimate design or reforms in the tax system to be proposed in the federal and sub-national government's budget for submitting to the parliament and assemblies for discussion and approval.

The roles of the NPC and NRRFC, being fully responsible to formulate federal budget covering transfers to the sub national governments as well, the MoF acts as the ultimate authority to design and reform or restructure the tax system. It should be added that as the formalization of tax design and policy changes take place only after the approval of the budget by the parliament, the involvement of parliament and parliamentary committees is quite natural. But the irony is that there is a custom of approving the proposed budget in its entirety by the parliament. Hence, the role of the parliamentary institutions is limited to the feedback and suggestions in the pre-budgetary consultation processes to a greater extent. On the other hand, it is an open secret that the role of the multilateral institutions has been decisive in fixing or changing the tax regime in Nepal since the introduction of conditional SAP in the mid-1980s followed by implementation of similar conditional loan programmes in different time periods. The frequent policy prescriptions of such institutions directly or through different windows has also played a role in determining or changing the tax system in Nepal [90] .

[89] *Section 58 Constitution of Nepal, Government of Nepal*

[90] *For details on the extent of conditional aid programs and other policy means influencing Nepal's tax system see Khanal et al 2005 and Khanal 2023.*

Under the MoF, there are two major institutional arms which are primarily responsible for the collection or mobilization of the tax revenue and implementation of the tax policies at large despite other related organizations also playing such roles to some extent. The Inland Revenue Department (IRD) is particularly responsible for the implementation of the procedures and programmes that are associated with strengthening the compliance system in income tax, VAT and excise duties. It concentrates on collecting internal revenue as per the targets set and also provides services to the taxpayers besides issuing permanent account numbers to the taxpayers. Throughout the country, there are a few large and medium level taxpayer offices besides 43 inland revenue services and 39 taxpayer's service offices.

The Department of Customs (DRI) is entrusted with the task of promoting fair trade and collecting revenue at the border entry points. Trade facilitation and revenue collection as per the set tax or tariff rules are its main responsibilities. Typically, in Nepal besides tariff, VAT, excise duty, pollution control fee, and several other border-based taxes are also imposed at the custom point and hence collection of revenue from these sources is also the responsibility of the DRI. For such purposes, more than 40 main customs offices and 133 small customs offices are operating across the border of the country which undertake the responsibility of customs administration besides contributing to border regulation. Checking illegal trade and earnings, controlling revenue leakages, investigating economic crime, and preventing illegal transfer and transactions of foreign currency come within their jurisdictions. Investigation of money laundering and terrorism financing also comes within the domain of the DRI.

3.3 TAXATION POLICIES: A BRIEF REVIEW

The taxation policies have undergone substantial changes over the years, more so after the introduction of the SAP in the mid-1980s followed by restoration of democracy in 1990 which also marked the beginning of a liberalized economic regime in the country. As an offshoot, the conditional ESAF programme of the IMF was implemented by the then government in the early 1990s which required a fast move from protectionist economic regime to the liberalized one. During the ESAF period, large restructuring of the domestic taxes as well as tariffs with focus on minimum slabs and rates were carried out apart from expediting internal liberalization through deregulation and privatization. Priority was given on widening tax bases and raising revenue productivity as a part of liberalizing the tax policy. The Washington Consensus introduced in 1995 also had a greater impact towards further opening of the economy. Aimed at making the tax system more liberalization friendly, reducing revenue dependency on international trade or enhancing internal revenue mobilization capacity and minimizing cascading effect, the VAT was introduced in 1997 by replacing the sales and other few taxes. For simplifying the tax system and improving the tax compliance also, the VAT was argued to be highly important. The WTO membership in 2004 contributed markedly to advancing towards further liberalization of international trade through large restructuring in the tariff system. It is also obligated to deregulate and liberalize the domestic economy more. With the WTO membership, there were hopes that it would contribute to enhancing the competitive strength of international trade leading to boosts in exports through, among others, inducement to industrialization.

Though in the aftermath of the big political change in 2006 neo-liberal economic discourse has principally been followed with often more stress on liberal trade and tax policies, however, changes in the tax policies in general and rates in particular have been regular through every 's annual budget. More particularly, the Finance Act is used as a major instrument for determining the tax bases, tax rates, tax reliefs or incentives, tax rebates, and other procedural and administrative changes across three tiers of the government. There is a customary of using it to propose changes to the Income Tax Act, the VAT Act, the Excise Act, the Customs Act, and other tax-related acts. Lately, the tax policy rules are guided by the fiscal rules laid down in the Financial Procedure and Fiscal Responsibility Act of 2019 to some extent.

If policies pertaining to individual tax are reviewed closely, mixtures and contradictions are found. In the case of capital income, a flat rate is applied to the individuals. Some different rate structures aimed at bringing some progressiveness are found in the personal income tax. In such tax labour and self-employed people are covered. The individuals are provided with exemption thresholds with revision in certain time intervals. Similarly, agriculture, real estate, financial services, electricity, transport and necessities are excluded from VAT. There is a minimum threshold for registering to the VAT compulsorily. Simplified tax recording and return have been introduced for the small enterprises. The presumptive and turnover tax under the income tax fall into this category. Necessities are exempted from indirect taxes such as customs duty and VAT. The property tax is a major source of revenue from local government but policies pertaining to base determination and effective implementation are yet to be clearly spelt out and institutionalized.

Though at the broad policy level more focus has been on raising tax compliance, strengthening risk-based management capability and improving equity and efficiency through digitalization and improved administrative mechanism[91], the tax policies encompass many serious deficiencies and gaps. First, in every budget high priority is given on changing the tax policy in general and tax rates in particular aimed at mobilizing higher revenue leading to policy uncertainties. Importantly, this is partly due to inability to mobilize revenue in a spontaneous way, unlike the presumption that policy focus on low rates leading to base expansion will help to mobilize higher revenue. Second, as an offshoot of above, it is well established that tax policies are hardly linked to higher production and productivity[92]. Third, every year billions of rupees are provided to the enterprises through tax concessions, tax holidays and rebates without rationalizing in a transparent way leading to perpetuation in many forms of distortions and anomalies. Fourth, in Nepal leaving the enacted tax rules aside, as indicated above, every year tax rates are changed and manipulated overnight before presenting to the parliament which undermine required systemic improvements in the tax system. Fifth, despite claims, the equity aspect is poorly embedded in the tax system. Finally, the tax governance policy is not only very weak but also highly deficient as predominance of informality, revenue dependency on a small section of population and continued tendency of under-voicing as well as over-voicing amidst fortified parallel economies indicate. As such, apart from under reporting of transitions, exclusion of potential taxpayers, larger share of economic activities including emerging IT based businesses are hardly taxed. Poor taxpayer friendly policies coupled with discretionary rules are also partly encouraging economic activities and transactions informally[93].

3.4 STRUCTURE OF THE TAX SYSTEM

One of the characteristics of the tax system is that a steady expansion in the tax base has taken place in Nepal, more so in recent years. Today, approximately 25 percent of the population is now under the tax net of which 76 percent are personal taxpayers. The number of registrations recorded reached 17 percent of the population under the personal income tax (P-PAN) and 7 percent under the business tax (B-PAN). Approximately 17 percent of business taxpayers are covered under the VAT. Under the excise duty 6 percent are covered. However, a unique phenomenon is that almost 41 percent of the internal revenue is collected from 1000 large taxpayers followed by 3 percent from 500 medium level taxpayers and the rest 56 percent from the small taxpayers. Another unique phenomenon is that 63 percent of the internal revenue is collected from the capital city Kathmandu. At the same time, the dispute settlement process is highly cumbersome and complicated in Nepal. Approximately 50 percent of internal revenue which is equivalent to 5 percent of GDP is under three layers of judicial processes.

3.4.1 Tax to GDP Ratio, Contribution Trend and Elasticity of Major Taxes

A distinct aspect of the tax system in Nepal is that, except Maldives, the tax to GDP ratio is the highest among the South Asian countries. Though in recent years' tax to GDP ratio has declined sharply from 23 percent in 2020/21 to 17.19 percent in 2024/25, still this ratio is high. In terms of total revenue, tax revenue accounts for 90 percent. Another feature is that in the total tax revenue the share of indirect tax accounts for more than 70 percent. This means that despite some satisfactory progress on tax revenue mobilization compared to many other South Asian countries, the indirect taxes are still dominant. In direct tax, income tax is the major source. Out of the total tax revenue, 28 percent is collected from this source. The rest mainly comes from indirect taxes.

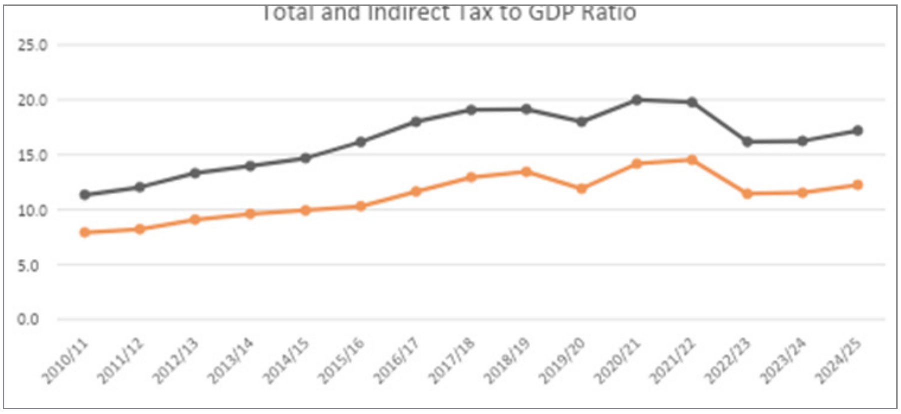
91 For such claims see MoF 2024.

92 This is the major shortcoming pointed out by the tax reform report (MoF 2023).

93 Chamber of Commerce estimates indicate that the unrecorded trade is in the neighborhood of Rs 500 billion in a year which still may have been underestimated.

In the indirect taxes, the contribution of VAT, customs and the excise duty account for 33, 22 and 17 percent respectively. Similarly, another unique phenomenon is that out of the total tax revenue 50 percent comes from the international trade-based revenue as VAT and excise duty are also imposed at the custom point[94]. Additional unique phenomenon is that federal government mobilizes almost 90 percent of the total tax revenue leading to continued very high dependency of sub-national governments on the federal government for their required resources[95]. This additionally pressurizes the federal government to frequent changes in the tax policy amidst predominance of the informal economy in the line noted above. All these indicate that despite some satisfactory performances, the overall structure of the tax system encompasses through many paradoxes, inconsistencies and challenges, especially from the standpoint of ensuring sustained growth in revenue, among others. Trend in contribution as share of GDP and buoyancy of major taxes provide more insights on this.

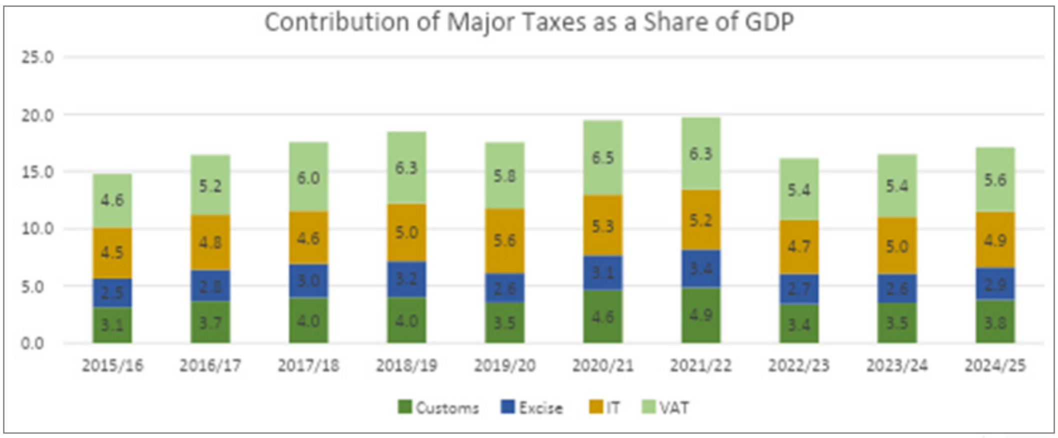
Graph 3.1: Total and indirect taxes as a share of GDP (%)



Source: MOF 2024/25.

The contribution of major taxes as a share of GDP shows a declining or less encouraging trend in recent years. The contribution of VAT, which is a larger contributor, was reduced as a share of GDP in recent years, from 6.5 percent in 2020/21 to 5.6 percent in F/Y 2024/25. Similarly, the income tax to GDP ratio declined to 4.9 percent from 5.6 percent during the same period. During the same period, the excise to GDP ratio reduced to 2.9 percent from 3.4 percent. Likewise, contribution of custom as a share of GDP reduced to 3.4 percent in F/Y 2024/25 from 4.9 percent in 2021/22. The frequent changes in the tax rates through various manipulation practices added by expansion in exempted items in VAT, increase in thresholds and proliferation in the informal economy, among others, contributed to such a worsening performance. This reveals that the productivity of the taxes has declined in recent years, which is a major concern [96].

Graph- 3.2: Contribution of major taxes (As a share of GDP)



Source: IRD 2024/25.

94 IRD 2024/24

95 FCGO 2024. .

96 MOF 2024 .

Major features of the tax structure can also be gauged by examining the buoyancy and elasticity of major taxes. In table 1 below, both buoyancy and elasticity of major taxes are presented. The elasticity of total tax revenue is estimated at 0.619 and 0.601 respectively, which are far below their buoyancy value at 1.292 and 1.202 respectively. Though the elasticity value of income tax is relatively high at 0.713 compared to other taxes, the large gap between the buoyancy and elasticity in major taxes indicates the need for frequent discretionary measures for mobilization of more revenue. These corroborate that tax system encompasses many structural and other problems which in many respects are rooted in policy weaknesses and gaps in other critical areas.

Table 3.1 : Tax buoyancy and elasticity

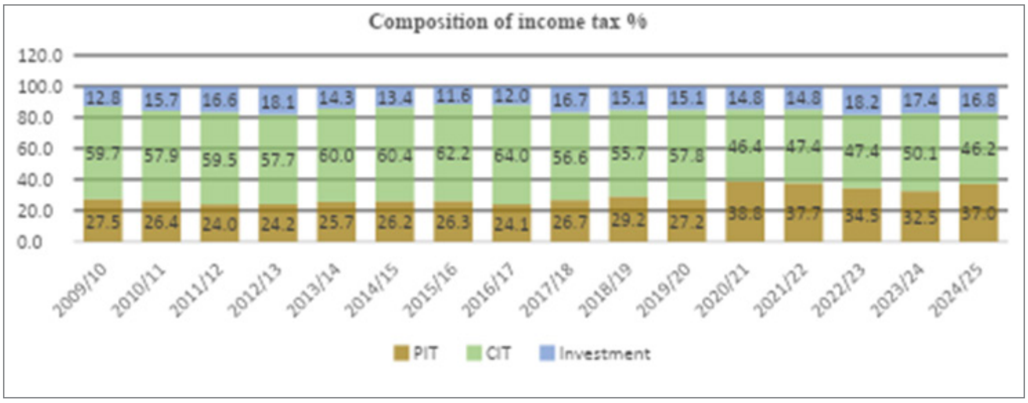
	Buoyancy	Elasticity
Total Revenue	1.292	0.619
Tax revenue	1.202	0.601
VAT	1.198	0.581
Custom	0.914	0.566
Income tax	1.463	0.713
Excise	1.184	0.509

Source: MOF 2024. 3.4.2 Individual Taxes in the Over Tax Structure

3.4.2 Income Tax

Income tax is the major source of direct tax in Nepal. The effective corporate tax rate and personal income tax rate is 40 and 10 percent respectively [97]. The share of corporate, personal, and the investment sector accounted for 46, 37, and 17 percent respectively in the overall income tax composition (Graph 3.3). The personal income tax (PIT) share is low compared to similar other countries as well as the global average [98] though there are some improvements in recent years. Low effective tax rate, massive deductions and exemptions, low per capita income, widely applicable flat rate, and high rate of informality are major contributing factors for the low contribution of income tax in Nepal. The improvement can be seen in the share of personal income tax from the last couple of years.

Graph 3.3: Composition of Income Tax



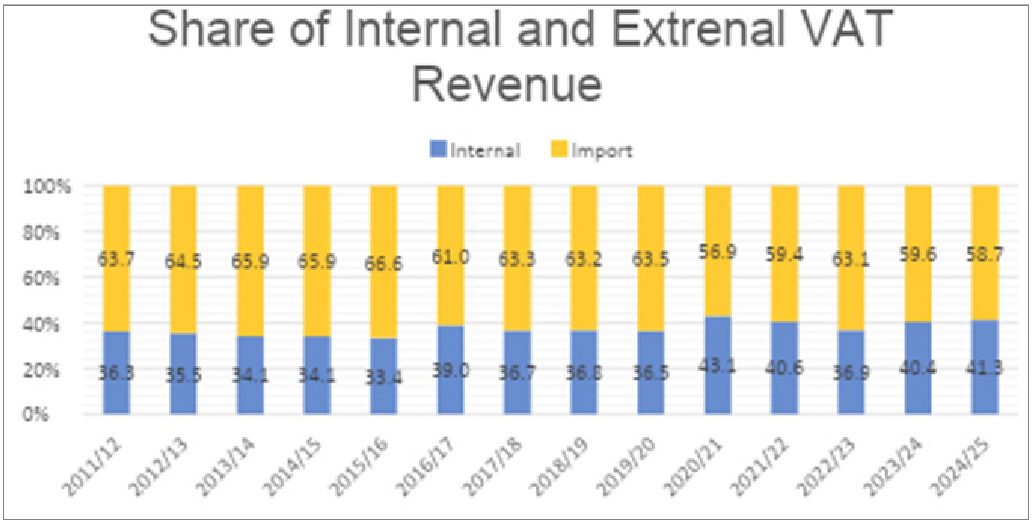
Source: IRD 2024/25.

3.4.3 Value Added Tax (VAT)

Unlike the expectation that VAT will be a major source of internal revenue mobilization in due course of time, import is still a major source of VAT in Nepal. Out of the total VAT revenue, still nearer to 60 percent is contributed by imports though some marginal increment in the internal share has occurred in recent years (Graph 4.4). Due to the exemption of a substantial portion of the economy from the tax net, there is a high burden on internal VAT despite low internal share. Sectors such as manufacturing and construction contribute 28 and 21 percent respectively in the total internal VAT revenue. On the other hand, an inverse relationship is found in the service sector. Its share of total internal VAT is only 21 percent despite its more than 62 percent contribution to the overall GDP.

[97] *World Bank 2025d.*
[98] *World Bak 2025e.)*

Graph 3.4 : Share of VAT: Internal and External VAT Revenue

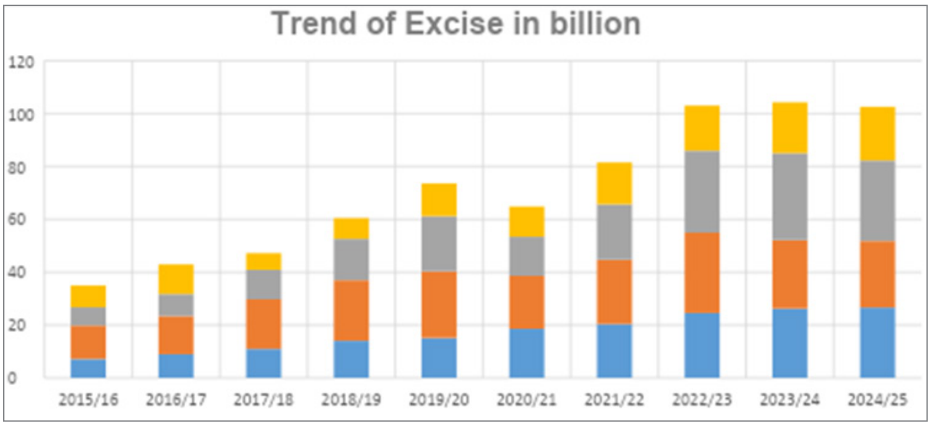


Source: IRD 2024/25.

3.4.4 Excise Duty

Excise is one of the major revenue sources of the federal government. The tobacco, alcohol and beer industry contribute as much as 80 percent of the total excise revenue at 23.26 and 31 respectively. The remaining 20 percent is contributed by the rest of the industries (Graph 3.5). Altogether, alcohol contributes 57 percent of the total excise revenue. This, apart from indicating that excise duty is over dependent on few products, additionally it reveals that industrial diversifications and expansions have been sluggish and miserable.

Graph 3.5: Trend of excise revenue (in billion)



Source: IRD 2024/25.

3.4.5 Green Taxation

Nepal implements both carbon and fuel related multiple taxes for the overall effectiveness to contain and compensate for environmental losses. Noticeably, the constitution of Nepal by stating the right to a clean environment makes an exclusive provision for compensating the environmental losses. Being a member of the Paris Convention, Nepal is also obligated to make different provisions that are associated with carbon taxation and environmental-related issues.[99] It is well established that a carbon tax may lead to create an environment that provides economic double dividend[100] in a cost-effective manner. Apart from contributing to reducing carbon emissions and asset exposure to climate, transitional risk often helps to produce development co-benefits. In view of fifty-one percent of the households still using firewood as the main source of fuel followed by LPG gas use by 44 percent and cow dung use by 2.9 percent, carbon related taxes have greater significance[101]. Today, the cost of poor air quality is reported to be more than 6 percent of GDP in Nepal.

[99] *See Bhattarai 2026.*
[100] *World Bank 2021.*
[101] *CBS (2021)*

Accordingly, it is estimated that this may lead to reduce life expectancy by 3.4 years on average beside causing 26000 premature deaths annually[102].

Today Nepal has introduced more than half a dozen environmental taxes on fuel and fuel-related imported vehicles. The taxes include green tax, infrastructure development tax, road construction, road maintenance and improvement tax, pollution control tax and fuel excise. Reduced customs duties are offered to the electric vehicles.

3.4.6 Wealth Taxation

Though Nepal abolished the wealth tax in the mid-1990s which was formally introduced in 1990, there are various forms of taxes which are associated with wealth in one way or another. As is well-known, taxes such as transfer, capital gain, capital income, and recurrent are inter-liked to capital assets. Among them, capital income tax and recurrent tax are associated with retaining of capital assets. The transfer and capital gain taxes are applicable at the time of capital asset disposal. At present, the capital gain and capital income tax are under the jurisdiction of the federal government. The transfer tax is under the jurisdiction of the provinces whereas recurrent tax, such as property tax, is under the domain of the local government. Tax on capital income is under the authority of the federal government in which dividends, interest, retirement income, insurance income and rental income are its main sources. The individual rental income, on the other hand, is under the jurisdiction of the local government. The features of such taxes are briefly discussed below.

Wealth Transfer Tax

Transfer tax is basically applied to the sale and transfer of property, such as house and land property, by means of sale, transfer, bequest, and inheritance. The provincial government is responsible for the determination of the tax base, rate, and collection of the transfer tax.

Table 3.2: Composition of transfer tax

Description of income	Tax base	Jurisdiction	Tax rate
Transfer taxation	Market value of Land and Building	Provincial government	Gift tax[103]- 0.5 to15.3 % Inheritance tax[104] 0.2 to 0.75 % Transfer tax- 1 to 5.3 %[105]
Capital Income	Gross income of Interest, dividends, and rental income	Federal Government:	Interest Income[106]: 6 percent, Dividend: 5 percent Rental income: net income
	Rental income of an individual from a house and land	Local government:	0 to 10 percent[107]
Capital gain tax	Gain from the sale of the house and land, financial assets share, debenture, and bond	Federal government	0-10 percent flat rate

Source: Compiled from the provincial fiscal act (2025)

[102] World Bank 2025c.

[103] Gift tax is imposed from 10- 15.30 percent in case of the third person and 0.5- 2.8 percent in case of family members. The rate of gift tax is based on the geographical location, highest in the metropolis and lowest in rural municipalities.

[104] The highest tax rate is applied at 0.75 percent in Sudurpaschim and the lowest tax rate is applied in Koshi province.

[105] Transfer tax is based on the location, highest rate is in metropolises such as Bagmati and lowest rate is sub-metros.

[106] Individual interest income from the bank and financial institution as well as debenture and bonds are taxed at a flat rate at 6 percent. Interest received from the other sources taxed progressively

[107] Local governments tax individual rental income from house and land. The tax rate varies across local governments with up to 10 percent in the metropolis.

The provincial governments have introduced gift, inheritance and transfer taxes. The tax rate is low in remote municipalities, and it is high in the metropolis of Kathmandu valley. The transfer tax rate is up to 15 percent. The minimum rate is applied to family members. The applied gift tax rate varies from 0.5 to 15 percent. The applied inheritance tax rate is found to be minimum 0.2 to maximum 0.75 percent. In case of transfer tax, the applied rate is 5.3 percent, in which the burden is imposed on the buyers.

Capital Gain Tax

Individual capital gains are categorized as short-term or long-term. Ownership of financial assets with a holding period of less than or equal to 365 days, and houses and land with a holding period of less than or equal to five years, are defined as short-term capital gains, subject to a tax rate of 7.5 percent above the exemption threshold. Long-term capital gain is defined as financial assets held for more than 365 days, and ownership of a house and land for more than 5 years and is taxed at 5 percent on the long-term capital gain. Capital gain tax does not apply to land and building ownership for more than 10 years. For non-listed securities, an individual must pay a 10 percent tax on their net capital gain.

Capital income derived from the inheritance and bequest is exempted from the capital gain tax. Income derived from ownership transfer within the three generations, proceeds of house and land less than or equal to 1 million, and ownership of more than 10 years are tax-exempt income. Gains from the precious stones and other capital gains are exempted in Nepal. A concessional flat tax rate applies to individual capital gains and income from the listed financial assets, house, and land. A more favourable rate is offered in assets that have a longer period of ownership. The higher rate is proposed in the income from the unlisted financial asset.

The concessional capital gain tax encourages the conversion of normal gain into capital gain. The company can prefer to repurchase shares to fund growth. Taxing capital income favourably is not an equitable treatment because entrepreneurial income largely depends on ideas, development of product, entrepreneur capability, technological breakthrough and smartness of the leadership. In such a situation, taxing differently in different sources of income distorts substance and exacerbates horizontal inequality. For example, entire interest income is not the cost of capital; it includes labour efforts such as compensation for the fund manager, services coordination, partnership, finding a structure for the investment, and advising the portfolio[108]. The cost of capital includes a high labour portion associated with the labour efforts. If capital gain is taxed at lower rates than wages, it may strongly encourage managers to shift income to converse labour income into capital gain. Therefore, differentiating capital income may destroy horizontal equity. Nepal's capital gain tax has hardly taken above factors including equity related factors into account.

Tax on Capital Income

Flat rates are applied to the individuals on interest, dividend, and house rent income. On the other hand, a phenomenon of under taxation is observed on the gains accrued from investment insurance, retirement income, interest income received from the bank and financial institution by individuals, debenture, bond, and government treasury.

Dividend and Interest Income

Dividends are either least taxed or not taxed in Nepal. The general dividend is taxed at a minimum flat rate of 5 percent. Even for corporations, a similar rate is applied. On the other hand, income of non-savings and credit cooperatives and rural-based cooperatives as well as income of a company converted to public from a private company and capitalization of profit for further expansion by special industry is exempted. Similarly, the information technology industry and tourism industry are exempted. Such exemptions narrow down the scope of raising revenue from dividend tax.

There is a dual provision in case of interest income in Nepal. Interest in income of a corporation and individual income from interest other than Bank, financial institution, cooperative bond, and debenture is taxed at the

[108] *OECD 2025.*

normal rate and different rates on personal income. Interest income of individuals from banks, financial institutions, cooperatives, bonds, and debenture is taxed at a flat rate of 6 percent. Therefore, a flat rate of tax at an unlimited level of income Favors high-income earners with inducement to both horizontal and vertical inequality in both individual as well as corporate income.

Additionally, dividend and interest income earners don't have to pay social security and sub-national taxes amidst lack of progressive taxation on dividend income. This leads to benefitting the high-income earners as they earn a larger share of their income from capital sources[109]. This perpetuates inequality, both vertically and horizontally. This besides making loss of revenue to the government creates income-shifting opportunities, reduces tax minimization opportunities, and ultimately creates distortions in the economy.

Rental Income

As noted above, local governments are authorized to collect revenue from individual rental income whereas corporate rental income tax comes within the domain of the federal government. The corporate rental tax is normally levied after deducting depreciation, maintenance costs, interest, and taxes. Individual rental tax is levied on gross rental income. The tax rate varies among several local authorities and municipalities, even in similar types and levels of municipalities. For example, Kathmandu, Lalitpur, and Biratnagar metropolises tax individual house rent at 10 percent, while Chitwan and Pokhara metropolises tax 1 and 7 percent respectively[110]. Rate variation in the same income leads to inducing of horizontal and vertical inequity at a higher rate in comparison to other sources of income.

3.5 REBATES, CONCESSIONS, DISTORTIONS AND REVENUE IMPLICATIONS

The government provides several concessions, rebates, and incentives to the individuals, industries and corporate houses. Such various forms of incentives and concessions are provided to the manufacturing industries, public limited companies, IT parks, infrastructure, export goods and IT-based corporations besides added facilities to the industries based in remote areas. In such facilities employment promotion is also covered on a case-by-case basis. Largely, they are aimed at promoting industries, augmenting industrialization and sustaining overall development in the country. The facilities provided through taxes and their corresponding implications are briefly assessed below.

3.5.1 Personal Taxation

Individual taxes are diverse in nature in Nepal. Besides different rate structures, flat, presumptive and turnover taxes are applicable simultaneously in Nepal. Different rates are applied in payrolls, businesses and investment income. As noted above also, a flat rate is applied to capital income and capital gain. As a simplified tax, presumptive and turnover tax system is applied up to 3 million annual turnovers. Businesses operated under the proprietorship business with 10 million turnovers also come under such a tax system. Such an arrangement is made aimed at reducing the compliance cost of medium and small taxpayers.

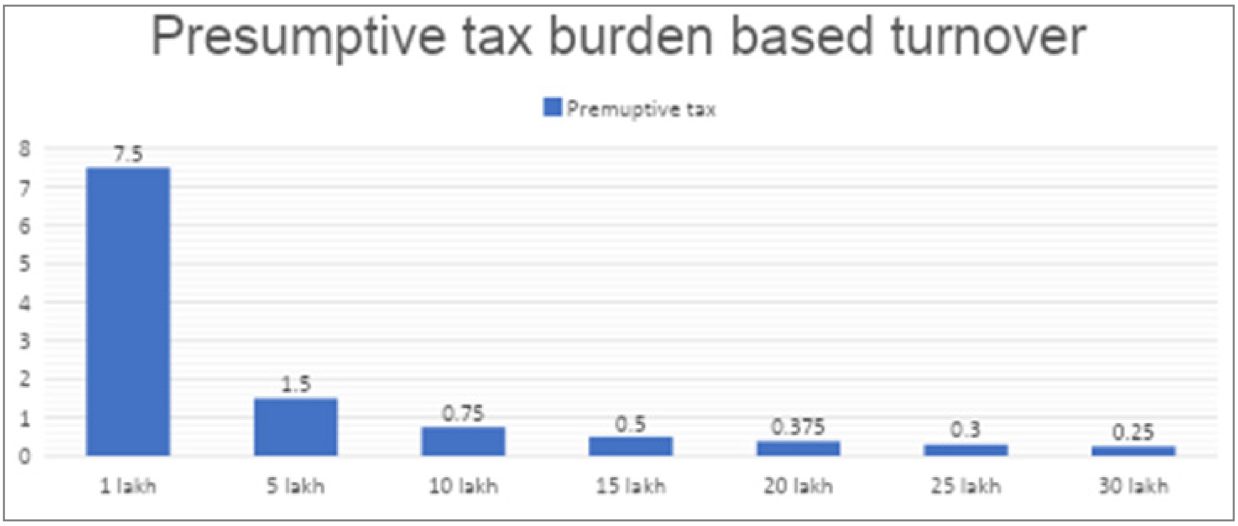
3.5.1.1 Medium and Small Taxpayers' Taxation

As a special tax policy, presumptive and turnover tax system has been introduced targeting small and medium-sized individual taxpayers. The presumptive tax is allowed for those taxpayers who have a turnover of Rs 3 million and a profit of Rs 0.3 million. The turnover tax scheme allows turnover between Rs 3 million and 10 million and profit up to Rs 1 million. The presumptive tax rate varies depending upon location, Rs 2500 in rural municipalities and Rs 7500 in metro and sub metro polls with equal turnover and income level. The differential tax rate is levied under the turnover tax system based on the nature of the business and level of turnover. The applied rate is 0.25 to 2 percent. The minimum rate of 0.25 percent applies for cigarette and gas business, and highest rate is applied in the service business

[109] Hourani, et al 2023.
[110] See Finance act of Kathmandu, Lalitpur, Pokhara and Chitwan metropolis, 2025 (2082)

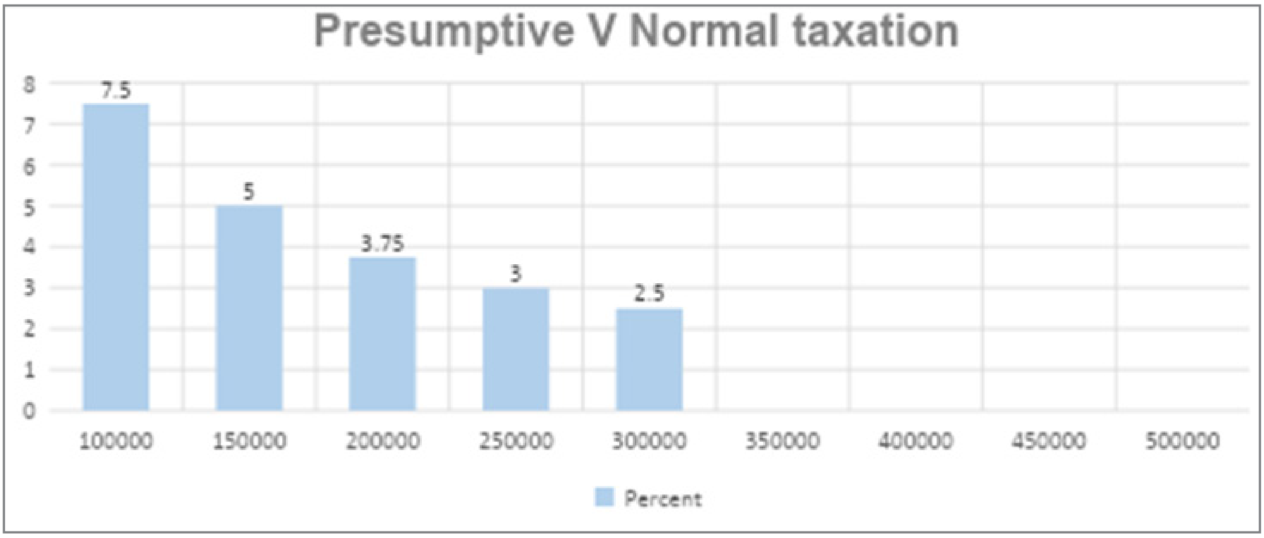
As evidently clear from the graph below, horizontal inequity is quite visible in the presumptive tax system as differential rates are applied for the same income in different locations. High tax burden is to the small taxpayers when their turnover is near zero. On the other hand, tax papers having turnover of about Rs. 3 million are benefitted.

Graph 3.6 : Tax burden of presumptive tax



The effective tax rate applied to the businesses in metro/ sub metro at various turnover levels is presented in the figure below. In this also, high tax burden is on the small taxpayers compared to the bigger one which is another example of undermining of equity dimensions in fixing the rates.

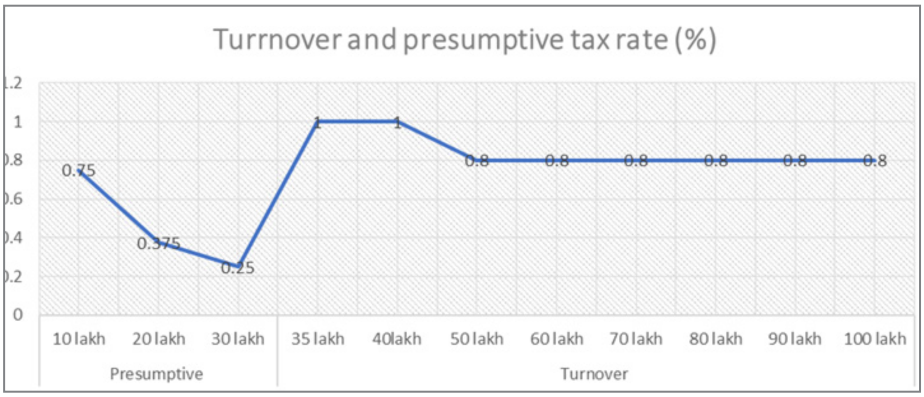
Graph 3.7 : Comparison of tax burden presumptive and normal tax system



Source: MOF 2002.

Taxpayers who are eligible for the turnover will benefit if they choose to file a normal tax return as tax liability is zero up to income of Rs. 0.6 million for such taxpayers. They can also make zero up to additional Rs. 0.6 million income level by utilizing the deduction facilities. However, discrimination is found in the turnover tax rate structure. The small taxpayers whose turnover is below 4 million have to pay 1 percent as against 0.8 percent tax rate applicable on turnover above Rs 4 million. This is also another example of inequity in the tax system.

Graph 3.8 : Comparison of tax burden (Presumptive & turnover tax system)



Source: MOF 2002.

As shown in the graph above, the burden of the presumptive tax is higher among the small taxpayers whose turnover is up to Rs 1 million. Similarly, higher tax burden is faced by the tax papers under the turnover tax. Compared to the income level, more taxes have to be paid by the tax papers whose return is up to Rs 4 million. This shows that there is vertical inequity among the small and medium taxpayers.

3.5.1.2 Personal Income Taxation

Individuals are allowed to submit tax returns individually and spouses may also file jointly if they wish. The system tries to maintain progressivity and equity to some extent. Taxpayers who do not want to choose the presumptive and turnover tax scheme (voluntarily) and have an annual turnover of 10 million and income earners from employment are obligated to pay tax under this scheme. The employees who have a single employment and do not have other sources of income do not need to submit the annual tax return.

Taxpayers are allowed to deduct 1.35 million (0.75 million deductions and 0.6 million exemption limit). If compared, the allowed deduction comes out to be more than 10 times higher than per capita income[111]. Full facilities can be used by those taxpayers who have more than 1 million incomes during the year. Moreover, the high tax wedge facilities that are based on personal savings favour the high-income earners. The low-income earners can neither contribute nor can utilize all these facilities due to their limited income.

A closer analysis shows that the deduction facilities that are available under the income tax of Nepal are found to be hardly guided by equitable principles. There is a provision of a pension exemption limit of up to 25 percent to those who retire in Nepal. On the other hand, full exemption of pension income from the foreign governments causes discriminations and reduces a tax base in Nepal, which is available for those involved in economic activities. In addition, gender biases also can be observed as compared to 3.7 percent males, only 1.2 percent females receive a pension in Nepal [112]. Health insurance premiums and medical expenses are available to a person. These provisions distort both horizontal and vertical equity. The remote area allowance is in between Rs 10000 to Rs. 50000, depending on the remoteness of the areas. Organizations generally provide additional allowances to those who work in the remote areas where per capita expenditure is lower than in urban areas[113]. The provision, thus, provides higher tax benefits to those in the remote areas besides deduction limits profiting the rich.

Nepalese diplomats enjoy the flat rate of tax-free income up to 75 percent of their foreign allowances and hence such a flat rate ignores the living standard of the respective countries. Generally, diplomats receive refunds of direct and indirect taxes in the country where they reside from the respective countries. Such types of multiple facilities create inequality in societies. They erode tax bases and distort the tax system. The facilities provided by the organizations to the employees include vehicle facilities for personal use (0.5 percent of the salary) and

[111] *The deduction limit are contribution to retirement or social security fund (Rs 500 thousand), donations to tax-exempt organizations (100 thousand), life insurance premiums (annual up to Rs 40000), health insurance and home insurance premiums (Rs 30000), remote area allowances (up to Rs 50000), and pension income exemption (Rs 150 thousands) and foreign allowance deduction up to 75 percent of the foreign allowances. All these provisions favor the high-income earner rather than the low-income earner.*

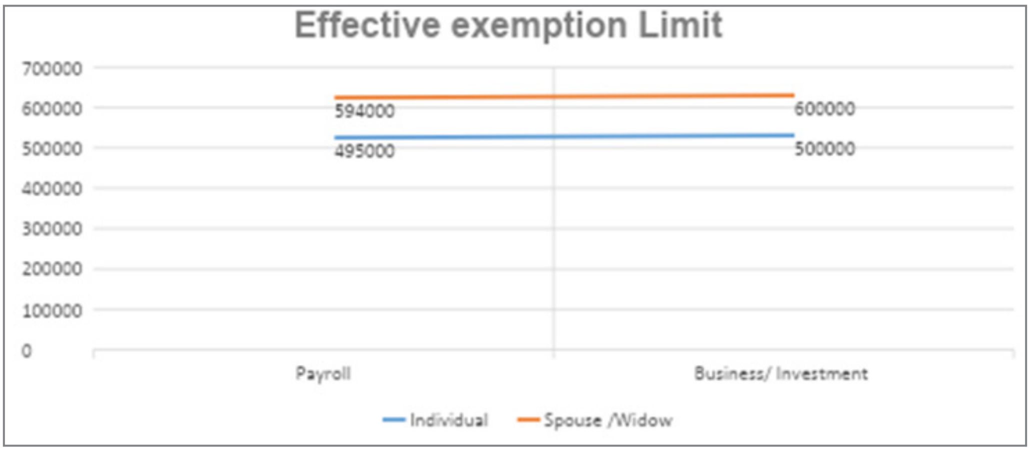
[112] *NSO 2025.*

[113] *CBS 2022/23.*

2 percent for the accommodation facilities. All these distort horizontal and vertical equity. This is done without quantifying the market rate,

Such reductions or extra facilities have to be considered in the light of a system of threshold as well. The tax law recognizes individuals, spouses, and widows. Accordingly, the exemption threshold is Rs 0.5 million for individuals. At the same time, an additional 20 percent or up to Rs 0.6 million threshold is provided to spouses and widows. No additional deductions are allowed, even for secondary taxpayers in joint filing. Therefore, it can be said to be a kind of marriage penalty[114]. It stretches into those families who have a limited number of earners in the family and provide higher benefits to the families in which a higher number of family members are income earners. Thus, such a provision discriminates against the vulnerable families having a higher number of children, a low number of workers, and many older members. In this context, the justice issue becomes more pertinent as the level of consumption poverty is reported to be very high among families with large numbers of children[115]. In addition, big inconsistencies are found in the government policies with respect to other facilities provisioned to all family members. Such facilities cover health insurance, hospitals, property tax, pension income and other financial liabilities.

Graph 3.9 : Implication of a 1 percent income tax on the exemption limit



Source: MOF 2002.

Rationalization of the tax slab is important from both revenue mobilization and equity standpoint. In Nepal there is a 1 percent tax on up to Rs. 500 thousand, 10 percent tax on the next Rs. 200 thousand and 20 percent tax on the next Rs. 300 thousand. Thereafter, it jumped with the interval of Rs. 1000 thousand and then jumped with the interval of Rs 3000 amounts. Thus, both rate and slap increment are not properly rationalized though the upper rate is relatively compared to many South Asian countries.

Generally, there is a practice of cutting taxes to reduce the income tax liabilities for the low-income earners besides increasing the tax-exempt income bracket. In such cases, it will not be rewarding to those taxpayers who have lower taxable income. As such, it will benefit those who are closer to the threshold limit and those who cross the exempted threshold. Deductions or exclusions from income can be justified as a proper measurement from the standpoint of ability to pay tax principles and it also helps to measure the income accurately[116]. The tax incentives for savings such as tax exemption for individual retirement accounts and pensions as well as preferential tax rates for capital gains are considered to be the tax expenditures.

Another notable phenomenon is that differential treatment is made between the retirement income of the government employees and private sector employees while imposing the rate. A flat rate of five percent is applied to the retirement income received from the government fund, and fifteen percent is applied to the retirement income received from the private organization and semi-governmental organization. This

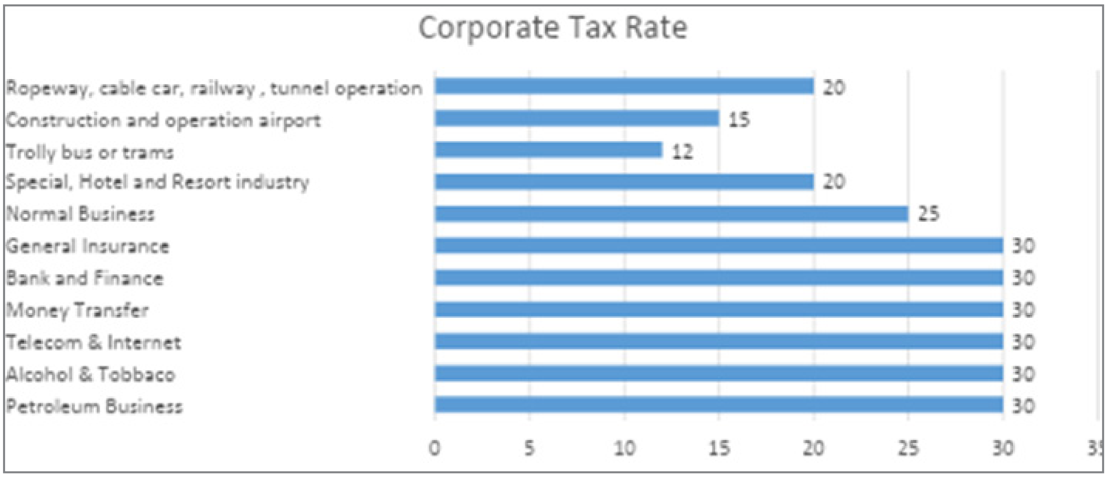
[114] *Barnett & Grown 2004.*
[115] *See NSO 2024.*
[116] *OECD 2010.*

provision destroys both horizontal and vertical equity as fixing a lower flat-rate tax to the payroll and business income reveals.

3.5.2 Corporate Tax System

The statutory corporate tax rate varies across the sectors in Nepal. The effective tax rate is minimum 12 percent to maximum 30 percent. The 12 percent rate is applied to the income of the infrastructure-based industries. The 30 percent rate is applied to the petroleum businesses, alcohol, bank and financial institutions, telecom and IT-related industries. The different rates applied in the various shows that the negative and positive externalities having diverse implications are hardly considered. The corporate tax rate applied in the different sectors is presented in the figure below.

Graph 3.10 : Corporate tax rate in Nepal (%)



Source: MOF 2002.

Despite such rates, several extra incentives are provided to the specific sectors and areas. Apart from exportable industries, sectors such as mining and mineral, hydropower and agriculture receive such tax incentives. Similarly, areas of larger investment and employment generation provide similar incentives. Incentives are provided to the remote areas and locations more exclusively [117]. The total amount of forgone tax revenue is estimated to be around 3.1 percent of GDP[118]. As such, 75 percent tax rebates are provided to the IT industries. Similarly, 10 to 25 percent rebate is offered to the employment-based manufacturing industries. Moreover, 15 year's tax holiday is given to the manufacturing industries of Karnali and Sudurpashchim provinces. Likewise, 7 to 15 year's tax holiday and concessions are delivered to the mining and hydropower industries. In addition to these, 80 to 90 percent tax rebates are specified to the industries that are established in highly remote, remote, and less remote areas. Investment-based incentives are provided to the tourism industry. Accordingly, five to fifteen years' tax holidays are offed apart from a 50 percent rebate after the expiry of the tax holiday. Thus, there are several sector and industry-specific tax incentives that are in practice under the corporate tax system in Nepal.

The evidence, however, proves that such incentives have hardly been effective in fulfilling the aim of generating employment, expanding production, augmenting exports and increasing investment. In Nepal, most of the incentives are profit-based whereas in the developed countries incentives are largely expenditure based. The experience shows that the expenditure-based incentives are better targeted and have been proven to be more effective in stimulating investment[119]. Incentives like reduced tax rates and R and D tax incentives have been used by only a few countries in South Asia [120] .

Based on the quick review it is seen that several incentives are provided for an unlimited period of time in which almost all incentives are profit-based and only some are tax and expenditure-based incentives. The major

[117] MOF 2002.
[118] World Bank 2021. k
[119] World Bank 2024.
[120] James 2010.

problem is that the benefits are hardly linked with the industry's performance and that maximum benefits are enjoyed by the existing industrialists. Based on some yardsticks associated with the impact, except hydropower, it is difficult to establish the justification of the tax incentives on local as well as foreign investment, employment and export promotion. For instance, the contribution of manufacturing sectors has been declining for the last many years. The contribution of this sector in Nepal is now the lowest in the SAARC countries. The foreign investment is lowest compared to other South Asian countries. The Income Tax Act offers a 15 percent tax rebate for the listed public limited companies, including energy-based industries and manufacturing industries for an unlimited period. Such facilities have been utilized mainly by some multinational companies as their large turnover and high profit indicates.

3.5.3 Withholding Payment

Any withholding payment made to non-resident persons and several payments made to the resident person such as interest, dividend, rental, retirement income, several service charges including meeting allowances are treated as final withholding payment, which means a flat rate of tax is levied rather than the progressive taxation. The tax rate for the non-resident is applied from 1.5 to 10 percent, while the higher effective rate is applied for residential people in the same case. The provision distorted source-based taxation, while higher tax rates should be applied as a source of income. The final withholding provision made even for the residential person distorted the horizontal equity due to the flat rate of taxation in even higher-level income. The final withholding rate is applied for residential people between 5-15 percent while normal person tax rate is up to 39 percent. The final withholding tax rate applied almost on capital gain which favours higher income earners rather than low-income earners.

3.5.4 Value Added Tax (VAT)

Introduced in 1997 with the aim of expediting revenue generation, widening tax bases, reducing tax evasion, and avoiding the cascading effect, the Value-added tax (VAT) is the main source of tax revenue in Nepal as briefly indicated above also. Initially a single rate of 10 percent was introduced and in July 2025 it was raised to 13 percent. The common principles of VAT have been applied in Nepal also with a threshold is Rs 5 million which is mandatory for registration. The Zero-rate is applicable in exports, agricultural goods and services, medical goods, financial services, education, health, electricity, and real estate. Hence, these are exempted from the VAT. Consequently, the C-efficiency of the VAT is estimated to be only 54 percent leading to the VAT gap of 6 percent of GDP. As an offshoot, it is also reported that there is 5 percent compliance and 1 percent policy gap in the VAT[121] .

The single rate is applied despite the demand of the business community for multiple rates. Such rates are in practice in other South Asian countries such as India, Bangladesh, and Pakistan. Country experiences show that the single rate is less distortionary, less inequality enhancing and cost-effective from the point of view of tax administration and political economy point of view. Therefore, many countries are also gradually shifting to a single rate VAT or GST. India is the latest example of this. Recently India has reduced the higher GST rate of 28 percent to 18 percent apart from converting 4 rates into two rates. Several studies have recommended Bangladesh and Pakistan to go for a single rate of VAT. The best single rate practices can be found in the East Asian countries where VAT rate is limited to 10 percent in which the base is quite wider. Considering the regressive nature of the VAT and its negligence to the ability principles leading to very adverse income distribution implications, some low and middle-income countries are applying reduced rates apart from larger exemptions in the tax bases. Recent studies also corroborate that if reduced rate with exemptions on basic necessities is applied, this may help to prevent pervasive adverse effect on equity to some extent[122]. It is now well established that rate differentiation is not an effective instrument to address VAT driven inequity as it often benefits the rich more than the poor.

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[121] *MOF 2024.*
[122] *OECD 2020. D*

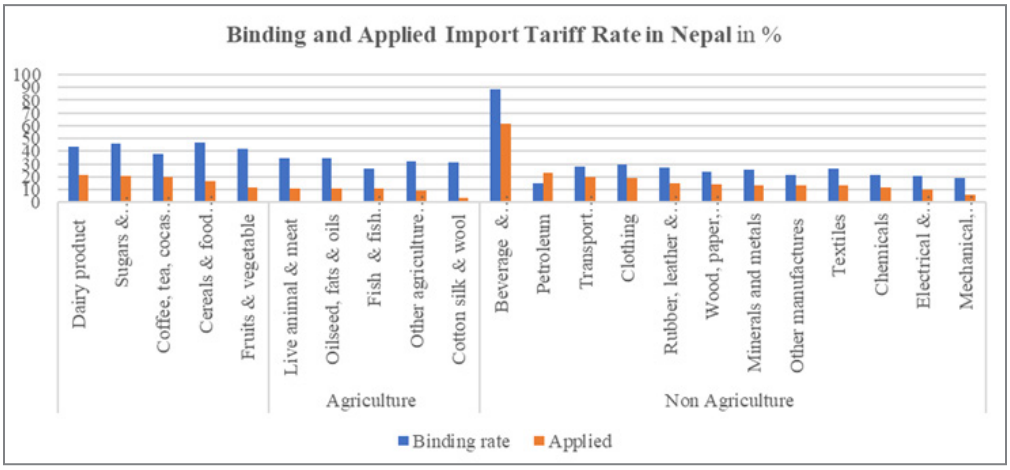
3.5.5 Taxation on Imports

As already indicated, tariff is one of the major sources of revenue in Nepal. If VAT and excise revenue collected at the custom point is taken into account, imports are the major sources of government revenue in Nepal. Therefore, from an equity standpoint also, apart from tariff structure, the bases and revenue collection from these taxes at the custom point becomes equally important.

If tariffs are imposed at a high rate on the imported consumable goods to be used by low-income households, this may be termed as a regressive tariff system. In other words, if poor are forced to pay a higher share of their income on tariffs than higher-income households, such a tariff system becomes more regressive[123]. It has been found that a 10 percent tariff rate could bring roughly a 1.1 percentage point loss in a country's GDP The tariffs are found to be distortionary with adverse impact on either growth or revenue through circumvention of the tariffs if they are not properly rationalized[124].

Apparently, based on the overall average rate, Nepal can be said to be one of the protected countries. The average rate is in the neighbourhood of 15.8 percent on average. But when distribution is taken into account, a different picture emerges. The weighted average tariff rate in agricultural and non-agricultural products is below average at 14 and 13.1 percent respectively[125]. These rates are substantially lower than the binding tariff rates as such rates for the agricultural and non-agriculture sector are 41.3 and 23.5 percent respectively. It is, however, noticeable that there are some products in which the tariff rate is relatively high. Such high tariff products include beverages and tobacco (61.8 percent), petroleum products (22.8 percent) and sugar and confectionery (20.6 percent), respectively. Understandably, these rates are contributing to making the average rate relatively high. The sectoral binding and applied import tariffs are presented below in the graph.

Graph 3.11 : Binding and applied tariff rate in Nepal



Source: WTO, 2025.

As offshoots of the above, there are multiple issues associated with customs. The major problem is that the rebates, concessions and intended protections are provided on an ad hoc basis. Largely, industries are provided with incentives without social cost-benefit analysis and periodic review of the progress on the intended outcomes. At the same time, another major problem in the past has been such that the tariffs have largely been imposed uniformly by fixing the same rate to the consumption goods, capital goods and raw materials. Consequently, there has been negative protections to the domestic industries with very adverse effects on both industrial development and employment generation[126]. After too much dampening effect coupled with continued pressures from the entrepreneurial community, though some initiatives to reduce tariff rates on the raw materials on a case-by-case basis have been made recently, these are not enough.

[123] *Shambaugh 2025.*
[124] *Shambaugh 2025.*
[125] *Tax foundation 2024.*
[126] *Studies since long have concluded that such a tariff system is very detrimental to promote industries and augment employment in the country. For such conclusions see Khanal et al 2005 and Khanal and Kanel 2005. But the irony is that with the influence of neo-liberal orthodoxy, such a policy has continuously been continued though only recently some limited policy shifts are being initiated.*

In the table below, rebates provided under different categories and accompanying revenue loss in each are presented. As the table shows, the total revenue loss has been almost Rs 100 billion in 2023/24 which is equivalent to 26 percent of total revenue collected at customs points in that fiscal year. The revenue loss as a result of rebates provided through fiscal act has been very high. Similarly, the revenue loss due to rebates on custom tariffs has been equally high. Such huge losses in both categories are mainly due to the high rate of rebates. As already indicated, adhoc practices followed without assessing likely economic and other social benefits in a priory has contributed to such losses without any net gains[127].

Table 3.3: Status of Tax expenditure: Import tariff

Description	Loss In billion Rs	Percent of Rebate
Due to fiscal act	35.92	36.14
Due to VAT Act	38.14	38.37
Under the SAFTA	9.21	9.27
Under the Fiscal Act, section 18 Non-profit Organizations	5.43	5.57
Under the Fiscal Act 18(3)	4.42	4.47
Imports from India	3.66	3.69
Diplomatic facilities	2.11	2.13

Source: MOF 2024.

Generally, if high tariffs are imposed almost uniformly, they increase input prices and thereby encourage firms to use less productive inputs. In such a system, encouragement to cascading structure becomes a common phenomenon. It hurts consumers due to the higher prices which in turn raises cost of living[128]. In contrast, targeted low tariffs benefit poor consumers, including women, and households[129]. Largely, protection policies perused irrationally with ulterior motives raise domestic prices of imports relative to exports and discourage exports as a result of rise in intermediate input costs[130] . Therefore, how judiciously the tariff policies are pursued becomes highly important in countries like Nepal.

3.5. 6 Excise Duty-Taxing for Bad

The government of Nepal levies excise duty on alcohol, tobacco, several industrial products including vehicles and junk food. The excisable items are briefly discussed below.

3.5.6.1 Alcohol Taxation

In Nepal one fourth of the population, 36.2 percent males and 18.7 percent females, are alcohol users. About 16.3 percent of road traffic deaths are attributed to alcohol. The economic burden of the alcohol is estimated to be around 5.44 percent of GDP in Nepal [131] . Alcohol has a heavy burden on the economy and society. It contributes to worsening health and social conditions among genders, social classes and communities. Criminality creates heavy burden on the economy and society[132]. The addictive nature of alcohol use leads to crowd out productive spending.

Generally, excise is conceived as taxing bad for doing good and hence levying goods such as tobacco and alcohol could be considered from such a standpoint[133] . Therefore, it is one of the most important instruments to improve the health of the people and control the excessive use of unhealthy products. Accordingly, excise taxes are levied heavily on alcohol and sugar-sweetened beverages worldwide. With low price elasticity of

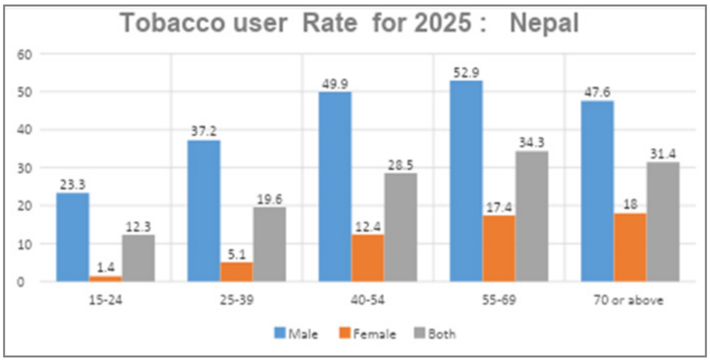
[127] MOF 2024.
[128] World Bank 2021. k
[129] Gender Equality and Trade Policy (2011) Women Watch, United Nation Inter Agency Network On Women and Gender Equity
[130] World Bank 2021.k
[131] Mevendi (2019)
[132] Mevendi (2019)
[133] Bird et al 2015.

demand, alcohol is highly revenue-yielding products[134]. At the same time, high tax helps to reduce negative externalities[135]. Taking all these into account, revisit the existing quantity-based alcohol excise into an Alvalorem system based on alcohol content in Nepal.

3.5.6.2 Tobacco Taxation

In Nepal still 5.4 million are tobacco users. In that one fourth are females. Nepal is in the 31st position among the tobacco user countries in the world [136]. Nepalese people spend 8 percent of their daily income on tobacco with the economic cost of around Rs. 47.2 billion annually which comes out to be 1.8 percent of GDP. Evidence shows that tobacco is the third highest risk factor for most deaths and disability.

Graph 3.12 : Status of tobacco users in Nepal



Source: WHO Database

As studies indicate[137]tobacco addiction among lower income people has increasingly become a big concern worldwide as the poor spend a larger portion of their income on tobacco products. Hence, poor people suffer the most from smoking-related illnesses. As such, medical expenses and loss of earnings associated with these illnesses are pushing the poor households into financial crises and deeper poverty every year. Therefore, high duty tobacco is prescribed by international organizations. For instance, the WHO has recommended imposing taxes at a rate of minimum 75 percent on the retail prices. Coming to Nepal, however, the effective excise duty rate is about 32 percent, below the half of the WHO recommended rate. It is noticeable, in countries like India it is 57 percent and in Bangladesh it is 59 percent [138]. As a result of the low rate, the poor smoke more than the rich. The smoking rate of the bottom quintile in Nepal is 74 percent higher than the top quintile. As an offshoot, the death rate accounts for 22 percent among the bottom quintile compared to 10.2 percent among the top quintiles.

As is clear, higher tobacco taxation providing multiple benefits in countries like Nepal [139] . Evidence reveals that user rate drops by around 30 percent if tax rate is increased by 33 percent over time leading to earnings gains including income gains to females as result of income transfer from male smokers. Thus, an increase in the cigarette prices through hiking taxes raises progressivity in taxation and disproportionately benefits the poor[140]. Considering from different angles, the policy of imposing low excise duty on tobacco needs complete review.

3.6 ASSESSING EQUITY DIMENSION IN THE NEPALESE TAXATION SYSTEM

As thorough review of literature including country experiences made in the introductory chapter have indicated, the state of conditions and trends in inequality in societies and nations are closely linked with the taxation and transfer systems that countries adopt and pursue. As pointed out there, progressivity on the tax system and more targeted transfer programmes not only lead to reduced income concentration at the top but also help to overcome the problems of exclusions at the bottom. The taxation system can be used to reduce tax liabilities

[134] *Bird et al 2015.*
[135]*Grown & Mascagni 2024. ,*
[136] *Global Action 2024.*
[137]*World Bank 2017.*
[138] *NDRI 2019.*
[139] *Uji 2023.*
[140] *WHO 2023. /*

of low-wage earners besides excluding them from the tax net through a tax exemption policy. As noted above also, deductions or exclusions from taxable income are justified on the ability to pay tax principle[141]. Increasing minimum wages, bringing price stability and creating decent jobs are considered to be contributing positively to addressing inequality problems. Below the equity dimension of various taxes is briefly analysed.

3.6.1 Personal Taxation

Nepal has adopted a dual tax system where income on payroll or personal income is taxed at different rates and capital gain is taxed at a flat rate[142]. The resident individual has to accumulate all taxable income, including domestic as well as international sources for determining the tax liability. For spouse and widow, there is an additional threshold limit. Now the exemption threshold is 0.5 million for the resident individual and 0.6 million for the spouse or widow. The additional amount of the exemption threshold is 20 percent above the individual exemption limit. Non-resident individuals, on the other hand, have to pay the normal rate of 25 percent on their gross income derived in Nepal. Employees are subject to pay one percent income tax on the exemption threshold of the individual or spouse, or the widow. One percent income tax is not applicable to the threshold limit of the self-employed or individuals who earn income from sources other than employment. Individual capital gain is not taxed up to the exemption threshold and applied flat tax rate throughout the income level in addition to the exemption limit. The flat rate of tax is applied to the capital income. The rate varies depending on the source and holding period. In addition to that, an individual tax system is also in place.

In Nepal there is no family financial support scheme based on their income, exemption limit, and dependent family members that need care. The tax wedge rate is the same throughout the income level. The tax wedges are high, from at least 31 percent to 35 percent in Nepal. Such a policy reduces the realized income of households. At the same time, Nepal has not adopted the need-based exemption policy like many OECD and East Asian countries including the USA have. In these countries child tax allowance and child tax credit systems added by differential tax wedge for individual taxpayers, dual earners, and multiple earners are provided. There is also a high rate of tax wedge for those single earners who do not need to care about other family members [143]. Besides, the OECD countries have introduced social security contributions, income tax liability, and a cash transfer programme for the low-income earners. As such, higher income earners with low family responsibilities are required to take a higher tax burden whereas low earners are entitled to receive cash transfers from the single window system. Singapore is another example which provides reliefs to the working parents, such as child reliefs for both parents, working mother-child reliefs, parenthood tax rebate, and grandparent caregiver reliefs. The higher proportion of relief is provided to families with higher numbers of children[144]. Such a policy encourages parents to work or be involved in economic activities.

Such country experiences with need-based approaches could be effective for minimizing gender inequity in Nepal as the share of the bottom female population is large. It reduces the marginal tax rate for married women or their families. A flat tax child credit for women can lead to increase the supply of female labour in the market also[145]. Introducing Household taxation could be more appropriate for a couple to address inequity for the low-income earner and high dependency ratio. As already indicated, if the government raises the threshold, there could be a marriage penalty[146]. To avoid such weaknesses, some countries combine the common approach of individual or household taxation by providing spouse and child allowances. Therefore, from an equity standpoint Nepal's personal taxation system encompasses many deficiencies.

3.6.2 Taxation on Capital Income

As indicated above also, capital income is taxed on economic rent, either from the endowment and previously untaxed income or on higher average wealth as well as financial income[147]. The income is concentrated if high income earners are subject to low taxes. Low taxation on capital compared to normal income or labour income

[141] OECD 2010.
[142] Hourani,et al (2023)
[143] OECD 2025 . D
[144] Tax relief SIngapore, 2026.
[145] Coeho et. al 2022.
[146] Coeho et. al 2022.
[147] IMF 2022.

discourages participation in the labour market, which can create distortions and raise inefficiency in the tax system [148]. Low effective statutory taxes facilitate raising capital gains significantly leading to accumulation of income and wealth in limited hands[149]. The wealthiest are more responsible for human-induced carbon emissions due to their high consumption and investment habits. Wealth inequity fosters gender and other forms of inequity in society. Women and marginalized individuals with limited wealth or low-income are those who fall under low pay or underpaid category[150]. On the other hand, wealthy people are those who can save more, invest more, and reap high returns from the high investment. They are additionally advantaged of higher level of education, expertise, and access to professional investment advice and hence they can invest in risky assets [151]. When taxing capital income these factors have to be taken into account.

In Nepal there was no capital gain tax before the new Income Tax Act 2002 and hence the number of assets were tax free leading to very low direct taxation. As such, there was no taxation on precious stones, gold, and valuable metals. Besides, agricultural income was tax-free. Today also there is exemption of capital gains on unlimited residential building benefitting the wealthiest households with further distortion in the allocation of savings in favour of owner-occupied housing[152]. Needless to add, taxing wealth is beneficial for tax administration as well. Importantly, evaluation of assets can help to check sources including income sources. The wealth tax is considered as a sustainable and fair source of expenditure needs of a government. As such, taxing at the top of the wealth distribution from high-net-worth and ultra-high-net-worth individuals at a moderate is justified from equity, social and ethical perspective[153]. In these backgrounds, a very low rate of 0.5 percent wealth tax on highly rich people is suggested by the Tax Justice Network. Its proposals are given below on the table. Some countries' experiences show that such a low rate also helps to generate a large amount of revenue as a result of consolidation in all wealth related data and information.

Table 3. 4: Recurrent wealth tax: Threshold and tax rate

Wealth level	Associated threshold US$	Tax rate
Wealth above the top 0.5 %	89859	1.5
Wealth above the top 0.1	201721	2.1
Wealth above the top 0.05 %	336211	3.5

Adopted from Palansky, M., and Schultz, A. (2025) Taxing Extreme Wealth: What countries around the world could gain from progressive wealth taxes

Though Wealth Tax Act and Regulation were formulated in 1960 in Nepal, such a tax, however, was never implemented. After restoration of democracy in 1990, the wealth tax was formally announced through the budget. But due to difficulties in the implementation amidst strong opposition from the private sector it was abolished during the mid-1990s. However, capital income is taxed in various forms as already pointed out above. But, as already highlighted above, various forms of capital income tax introduced and operationalized are regressive and hardly consider the equity dimension. At the same time, the sources are covered poorly and undertaxed. Taking all these together, from the standpoint of both scope of larger revenue mobilization and at the same time ensuring equity in the taxation, the time has come to consider reintroducing the wealth tax system in Nepal. From the standpoint of smooth and fair development of business and industry also reconsideration could be appropriate and timely.

3.6.3 Tax Expenditure

Generally, tax expenditure is found to be increasing inequity, distorting the fairness of outcomes between taxpayers and violating the principle of horizontal equity[154]. This happens if deductions and exemptions

[148] OECD 2023.
[149] Advani and Summers 2020 .
[150] TJN 2024.
[151] OECD 2018.
[152] OECD 2022 .
[153] TJN 2024 ,
[154] IMF 2025. F

exclusively benefit people with higher incomes, added by large reductions in tax payments. More particularly, the tax expenditure increases inequality when the size of deductions in items such as mortgage interest and pension contributions is made larger for the higher-income households[155]. Indeed, tax expenditure is one form of transfer of resources from government to taxpayers which leads to reducing tax liability of the taxpayer besides decelerating revenue to the government. It is equivalent to the direct government spending on, for instance, subsidy or grant[156] This is considered to be an inferior policy instrument with adverse effects on efficiency and effectiveness, fairness, and simplicity of the tax system and more generally on government operations.

Despite such deficiencies, profit-based and expenditure-based incentives such as tax holidays, reduced tax rates, accelerated depreciation, environmental allowance or accelerated depreciation for green technology and exemption of income from taxes are quite common in Nepal as partly indicated above also. Importantly, the foregone revenue has to be compensated through either higher taxes on other areas or through deficit financing of restraining expenditure in critical areas. The revenue foregone due to tax expenditure for the fiscal year 2022/23 and 2023/24 is presented in the table below.

Table 3.5: Tax foregone (Rs)

Particular	2023/2024 Amount (billion Rs)	% of Total Revenue	% of GDP	2022/2023 Amount (billion Rs)	% of Total Revenue	% of GDP
Total	309.25	31.46	5.42	306.57	33.11	5.73
VAT	179.65	58.09	3.15	170.21	55.52	3.18
Income Tax	56.96	18.42	1.0	53.60	17.48	1.0
Excise	39.83	12.88	0.7	37.80	12.33	0 .71
Custom	32.82	10.61	0.58	44.96	14.67	0.84

Sources:MOF 2024b.

As the table above shows, approximately one third of existing revenue collection was forgone due to incentives etc. which is equivalent to 5.42 percent of GDP in 2023/2024 and 5.74 percent of GDP in 2022/ 2023 [157]. The share of VAT is estimated to 58 percent in total tax expenditure which is 3.15 percent of GDP. This is followed by income tax at 18.4, excise at 12.9 and customs at 10.6 percent of GDP. Thus, such numbers corroborate that such a tax system contributes to destroying efficiency and effectiveness, fairness, and simplicity in the tax system with a high risk on fiscal sufficiency. It is also less transparent and constraints regular review for remedial action[158]. Most often, it is advantageous for income from capital and self-employment rather than labour. Under tax incentives, upper-income taxpayers take advantage of retirement savings and housing benefits as studies point out. Such a policy is often called an upside-down subsidy. All these indicate that there is a need to review the system of tax expenditure.

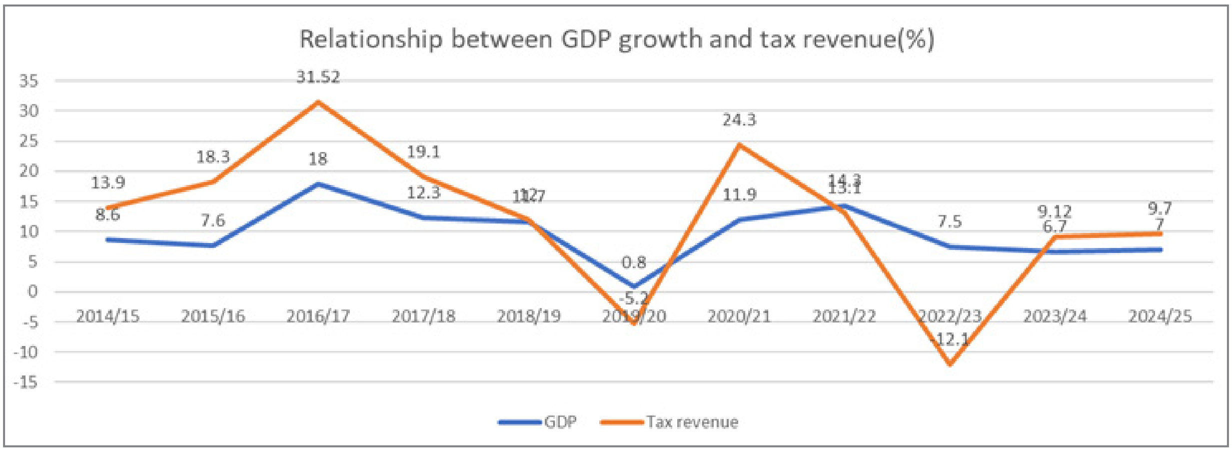
3.7 LINKING REVENUE AND KEY MACROECONOMIC PARAMETERS: A QUICK ASSESSMENT

Below a quick assessment of the growth of the revenue, its contribution to the total and major component of federal government expenditure as well as its linkages with the key macroeconomic parameters of the economy are presented below. These provide broad ideas on whether there is a conversing or diverging trend between the revenue and the key macro parameters of the economy. Examination of linkages is important not only from the point of tax policies as such but also from the standpoint of justifying the high priority on revenue mobilization. Ideally, revenue to growth and vice versa is expected through two-way causation if structural dimensions of tax as well as economy are examined simultaneously.

[155] ADB 2023.
[156] IMF 2025.
[157] MOF 2025.
[158] OECD 2010.

Nepal can be considered to be one of the best performers in South Asia if revenue performance is measured in terms of its share in the country's GDP. Nepal comes to the second position after Maldives among the South Asian countries in such a comparison. 90 percent of revenue comes from taxes, the share of consumption taxes which gives more burden to the common people comes out to be 70 percent in Nepal. As already indicated, the tariff rate is the highest in South Asian countries. Nepal lags far behind other South Asian countries in changing the tax structure when contribution of income tax as a share of GDP is looked into. The share of corporate and personal income taxes is only 2.6 and 1.6 percent of GDP respectively. On the other hand, such a share of consumption and trade tax is 9.9 and 3.6 percent of GDP. Moreover, the predominant contribution from international trade to the total tax revenue further indicates that the revenue growth has not been as a result of rapid expansion in the domestic economy which led to resource mobilization in a big way. Though predominance of informal economy, tax policy loopholes, poor tax administration etc.[159]have played a role for the low revenue contribution internally preceded by very poor performance of the income tax, largely structural deficiencies are apparent which portray that despite a higher share of revenue in GDP compared to many other South Asia countries, sustainability of revenue mobilizations speedily remains a major challenge. Such a possibility, at the same time, poses the risk of undermining tax justice and improved access to qualitative public services, among others.

Graph 3.13 : Relationship of Economic Growth and Revenue

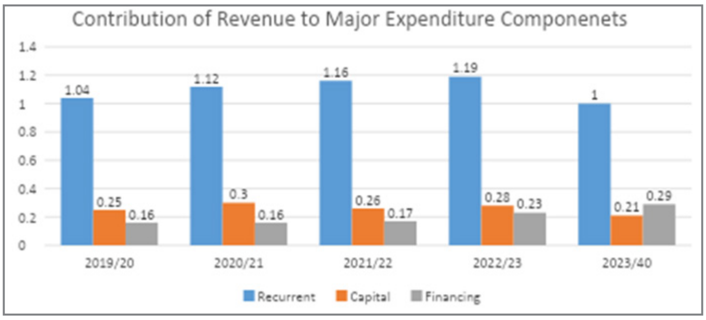


Source: MOF 2024/25. .

When the role of revenue in funding the total government expenditure in general and major components in particular is examined by taking the likely two- way causation as well as subsequent spillover effect into account, some of the key underlying reasons for too much dependency on international trade-based revenue can be found. The most miserable part is that as a share of GDP the share of capital expenditure has not only remained very low but also has declined in recent years. Capital expenditure as a share of GDP was just 3.4 percent of GDP in 2023/24. Such a ratio was 7.8 percent in 2017/18. In 2023/24, the share of current expenditure and financing in GDP have been in the neighbourhood of 16.3 and 4.8 percent respectively. Consequently, a major part of the mobilized revenue had to be diverted to fund the current expenditure resulting in the suppression of capital expenditure. More worrying is that now with the financing component surpassing the size of the capital expenditure, revenue saving to fund capital expenditure is becoming more and more difficult. This means, for a low level of capital expenditure also, dependency on external and internal borrowing may rise further for its funding. Comparative figures presented below on revenue vis-à-vis capital expenditure provide more insights on to what extent revenue has played a role in funding capital expenditure. More precisely, such a phenomenon is highly detrimental for a highly aspirant developmental state like Nepal.

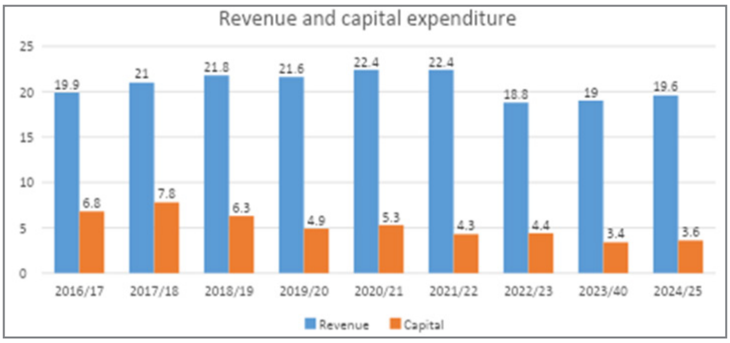
[159] *World Bank 2025.*

Graph 3.14 : Trend of revenue and effect on expenditure



Source:MOF 2024/25.

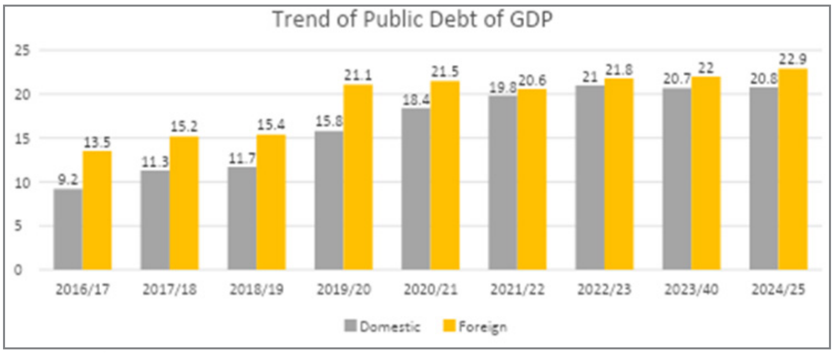
Graph 3.15 : Relationship between the Revenue and Capital expenditure



Source: NRB 2026.

As an offshoot, along with shrinking revenue mobilization in recent years coupled with continued rise in current and financing expenditure, Nepal's dependency on borrowing has increased at a faster rate in recent years. The tremendous increase in debt serving has been compelled to fund such services through internal borrowing leading to rapid expansion in internal debt outstanding simultaneously. The domestic public debt which was 9.2 percent of GDP in 2016/17 has reached 21 percent in 2024/25. Similarly, foreign debt rose to 22.9 percent of GDP from 13.5 percent of GDP during the same period. Such a tendency apart from narrowing the share of capital expenditure may be very adverse in continuously suffering sectors such as health and education, critical for enhancing justice through better access to such services. As is well known, public debt propels a shift of wealth from the public to the private sector through taxation and other means leading to exacerbation in inequality.

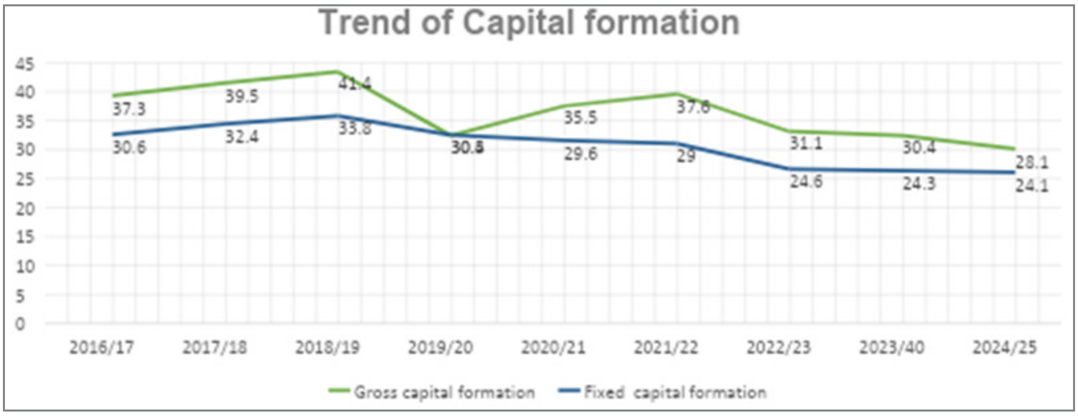
Graph 3.16: Trend of public debt



Source: NRB , 2026.

One of the objectives of the tax policy was to promote investment. But the sharp decline in gross capital formation in recent years proves that the taxation policies have failed to boost investment in the economy. This raises questions about the role and effectiveness of large numbers of incentives provided aimed at enhancing private investment.

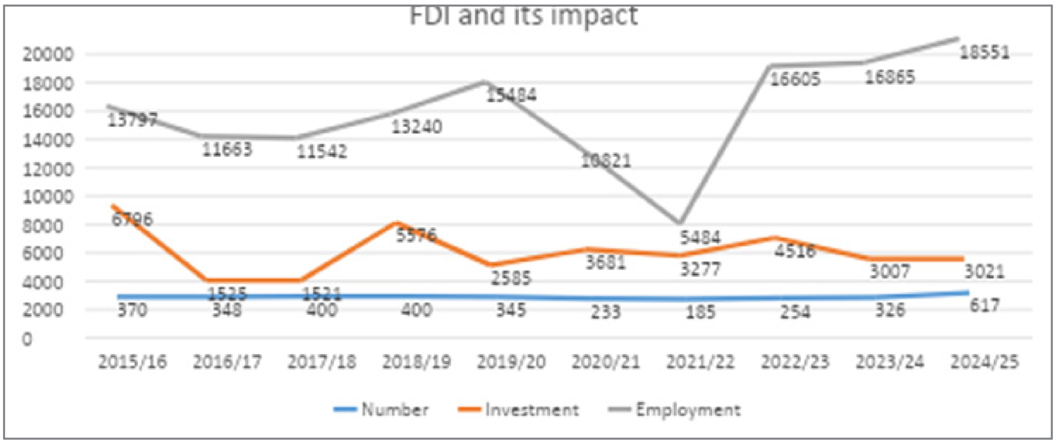
Graph 3.17 : Trend of capital formation



Source: MOF 2024/25.

Added worry is that despite the number of facilities and concessions declared time and again to attract foreign direct investment, no rise in FDI is taking place in Nepal. As shown in the graph, it is highly insignificant and stagnating. With Nepal in the process of graduation, Nepal's inability to attract FDI in Key strategic sectors and areas will be highly detrimental for ensuring sustainable graduation as potential export, employment and revenue loss, erosion of competitiveness in trade and industry and above all threat of deindustrialization entail.

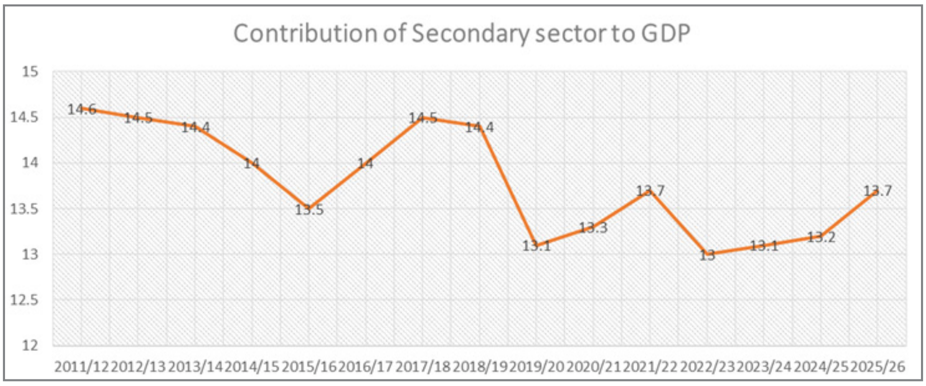
Graph 3.18: FDI and Its Impact



Source: . MOF 2024/25

In the overall tax policy, promotion to the manufacturing industries has been the key trust and priority. As indicated above, several concessions and rebates have been provided to the manufacturing industry. Concessionary or soft loans, export subsidies, duty drawback schemes and incentives for import substitutions etc. have been integral parts of various rebates and facilities. However, as shown in the graph below, a steady decline in the contribution of manufacturing industries has taken place, which is a major area of concern. In countries like Nepal industrialization is central to positive transformation of the economy which is again prerequisite to higher quality growth and sustainable development. Though forward and backward linkages driven by the spillover effect it ensures more balanced inter-industry development. The worsening performance in the manufacturing sector demands a total review of concessions, rebate and exemption embedded in the existing tax policy regime. Such a necessity is much more pronounced at a time when Nepal is in the process of graduation with high risk and threat to the manufacturing sector.

Graph 3.19 : Contribution of secondary sector



Source: National account Data, CSO, 2026

3.8 TAXATION AND INFORMALIZATION

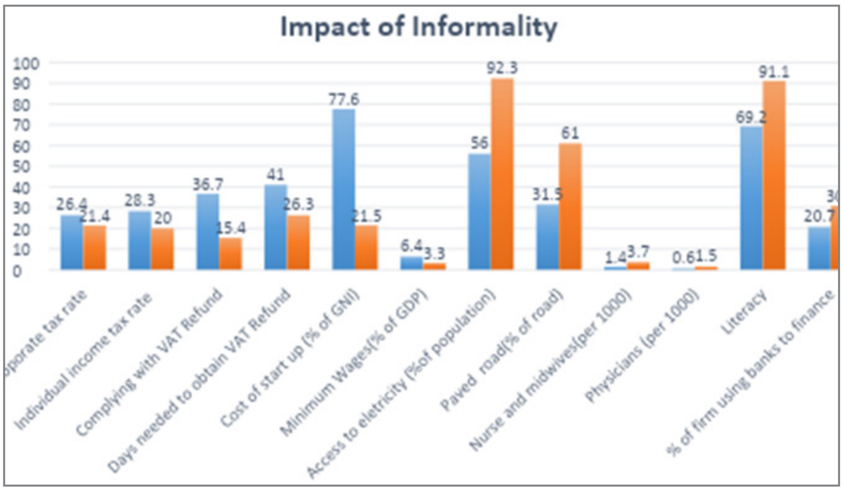
In Nepal one of the serious problems from the larger development perspectives in general and taxation perspectives in particular is that the size of the informal economy is very large. Though the estimates made by different organizations vary, all of them have shown that the informality is very high in Nepal. The first Economic Census of 2018 has shown that almost 50 percent of the businesses operate informally in Nepal[160]. A study carried out during the same period reveals that the size of the informal trade between Nepal and India is larger than the formal trade[161]. Subsequent study exclusively focusing on estimating the size of the informal economy in Nepal finds that the size of the informal economy is in the neighbourhood of 44.66 percent[162]. It estimates sector specific informal situations also and thus provides more insights into the reasons for this. Based on such sectoral estimates, the highest share of informal economy is in the real estate sector (99.97 percent) followed by agriculture, forestry and fisheries (96.48 percent), accommodation and food services (50.42 percent), transportation-related to entertainment, and recreation (33.69 percent), manufacturing (16.36 percent), infrastructure and construction (16.26 percent) electricity, gas, steam, and air condition (14.99 percent) and administrative and support services (8. 66 percent). More recent estimates further corroborate that the share of the informal economy is very high at 51percent in Nepal. In the global ranking, Nepal is reported to be in third place after Sierra Leone (64.5 percent) and Niger (56.3 percent). Nepal, thus, ranks top among South Asian countries. The size of the informal economy in Pakistan is estimated to be 35 percent followed by Bangladesh at 29 percent, India at 26 percent and Sri Lanka 20 percent[163]. As an offshoot of such a pattern, a very high share of informality is in the labour market of Nepal at 84.6 percent. In this, the share of women is 90.5 percent, and the youth (15-24 age) is 95 percent [164]. It is also additionally reported that out of the total labour force, 61 percent work in the informal sectors, 22 percent work informally in formal sectors, and 2 percent work in the household sector informally. The service sector is estimated to be major source of informality in Nepal[165].

As studies diagnose, for, among others, monetary, regulatory and institutional reasons people hide economic activities from the official authorities. Avoiding tax payments, escaping from social security contributions and evading government bureaucratic hassles are generally regarded to be the main reasons for the perpetuation or thriving of the informal economy. Very weak rules of law lacking transparent and accountable system, fragile state institutions with poor capacity to enforce laws added by multiple loopholes in them, rampant corruption and rent seeking practices and incentives for appropriation of profit quickly through whatever means are often cited as key reasons [166]. Attempts to avoid compliance with legal labour market standards, such as minimum wages, maximum working hours and safety standards etc. also perpetuate informality in the economy to a greater extent.

[160] *CBS 2019.*
[161] *World Bank 2018. k*
[162] *NRB and CDECON 2024.*
[163] *IMF 2025.*
[164] *ILO 2022.*
[165] *World Bank 2018.*
[166] *IMF 2021.*

The most distressing part is that informality limiting the scope of mobilization resources speedily, constraining investment through formal channels, halting development of business and industry fairly and smoothly as well as obstructing the development of productive forces, barricades growth and development and thereby perpetuates inequality and poverty in societies. More particularly, a more burdensome tax system accompanied by regulatory regime with excessive control and highhandedness as well as weak and non-responsive governance system induce informality in a big way leading to poor fiscal performance and developmental outcomes including outcomes on health, education, clean water and so forth[167]. It is well established that informality makes very pervasive adverse on direct taxes as well as indirect taxes such as VAT[168]. The table below showing the impact of high and low informality reveals how informality impacts the different sectors of the economy. As shown in the table, along with taxes, the strap up businesses, health, education, infrastructure etc. are highly impacted by the informality and hence they additionally prove that informality is a major barrier to the mobilization of revenue and augmentation of socio-economic development.

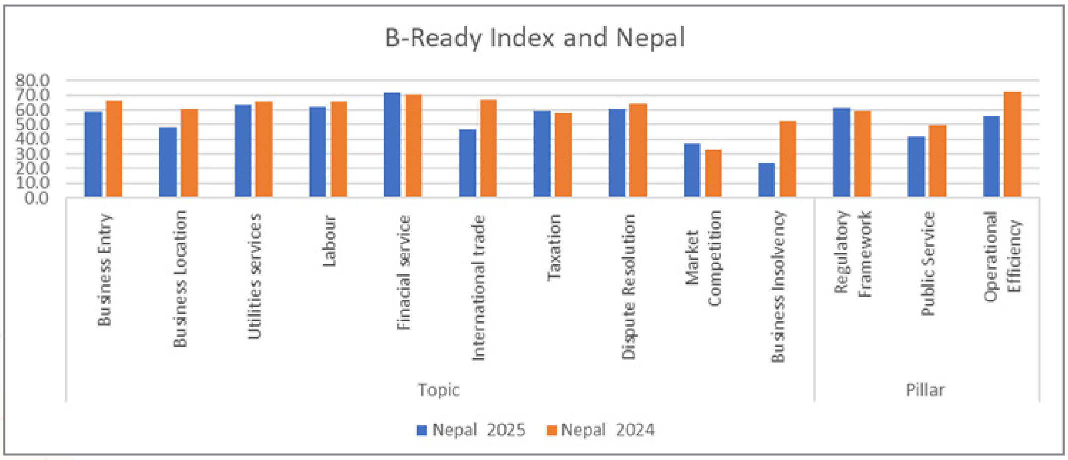
Graph 3.20: Impact of informality



Source: World Bank 2019.

The B-Ready (Doing business) index computed for different countries shows the importance of business and regulatory environments along with taxation systems for reducing informality in the economies. The B-Ready indices prepared for Nepal for 2024 and 2025 also verify their importance. It is interesting to note that in a number of areas such as business entry, business location, utilities services, labour, international trade, business insolvency and market competition Nepal slipped in 2025 compared to 2024.

Graph 3.21 : Cost of doing business



Source: World Bank 2024-25.

[167] *Ohnsorge et al 2021.*
[168] *Lampo 2024.*

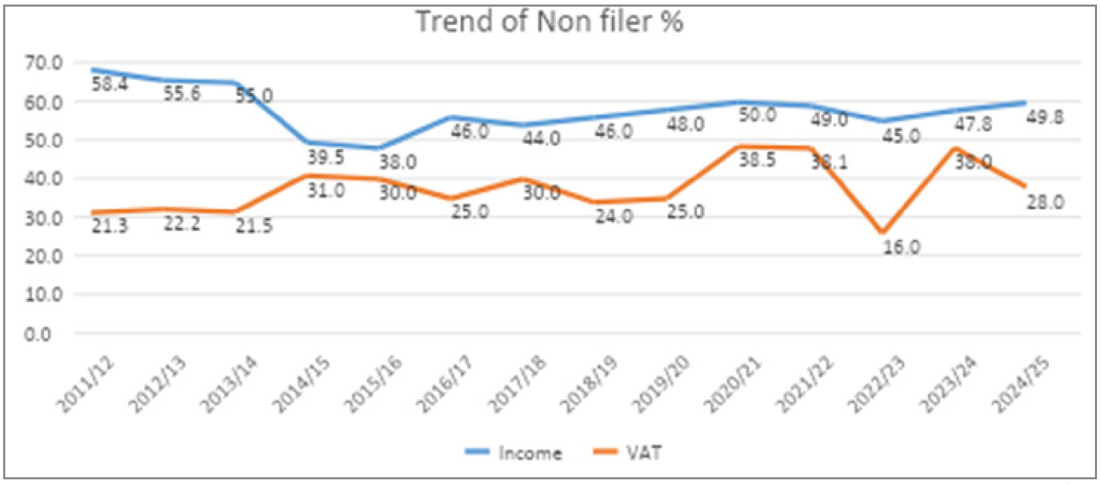
B-Ready indices for Nepal, thus, show the need of formalization of the economy speedily with focus on areas where informality is high and is dampening the economy in multiple ways. Study findings portray that along with rationalization in the tax system, flexibility in the labour market, wider coverage of social protection, higher productivity of labour and efficiency in regulatory as well as justice system are key for reducing the informality in an economy [169]. The empirical studies show that a 1 percent reduction in informality may lead to decrease extreme poverty by 0.6 percent. Formalization is reported to be positively correlated with the perception on corruption and building up trust on state institutions[170]. On the taxation front, presumptive tax system, among others, is found to be problematic as it raises both tax burden and compliance costs[171]. It is also noticeable that formalizations of small-scale business instantly may adversely affect self-employed people, particularly women, vendors, farmers and people engaged in multiple personal services. These instances indicate that along with expediting the formalization process by making tax system formalization friendly and initiating concrete sector and area specific steps to reverse an ongoing phenomenon, a more cautious approach will be needed to insulate the likely adverse effect on the most vulnerable informal businesses and occupations.

3.9 COMPLIANCE IN THE TAX SYSTEM AND ITS IMPLICATIONS ON THE REVENUE

By the end of the mid of Jan 2026, approximately 24 percent of the total population has received a Permanent Account Number (PAN). Out of this, 70.6 percent are personal taxpayers, 28.9 percent are business taxpayers and 0.5 percent are registered for withholding purposes[172] as indicated above also. Despite this, compounded by informality, the tax compliance is dismally poor in Nepal. For instance, the compliance gap is derived from being around 5 percent of GDP in VAT only[173] .

As shown in the table below, the non-filer ratio is extremely high in both income tax and VAT at 49.8 and 28 percent, respectively. The high non-compliance ratio can be considered to be more serious as it is like government agents collecting taxes from the general people. Though there was some improvement in 2022/23 at 16 percent, such a ratio in VAT reached around 38 percent in the subsequent years. Added worry is that despite VAT being the main source of revenue, the compliance pattern is highly poor. Out of only 17 percent of debit filers (deposit VAT government treasury), 62 percent asked for refund from the government[174] . Another 20.5 percent submitted a zero return. Such a phenomenon is continuing despite the fact that about 50 percent of the businesses are operating without registering businesses with the concerned government institutions.

Graph 3.22 : Trend of tax non-compliance



Source: IRD 2024/25

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[169] Loyza 2018.
[170] OECD 2023. D
[171] Komastu 2024.
[172] Total 7.29 million taxpayers registered at the tax office at the end of the poush, 2082 and out of them 363 thousand taxpayers registered for the VAT and 129 thousand taxpayers registered for excise tax in Nepal. Nepal Economic Bulletin, MOF (2086),
[173] Silvani 1992.
[174] IRD 2024/25

Recent literature has recommended that in such a situation tax administration has to pursue a behavioural approach rather than an enforcing approach for ensuring higher tax compliance. Recently developed approaches[175] are focusing on a kind of hybrid approach combining traditional and modern that is based on fairness, equity, reciprocity, and accountability. More specifically, such a behavioural innovative model combines three pillars viz, facilitation, reciprocity and accountability. The approach focuses on trust and accountability. More precisely, effective tax administration is regarded to be the key for reducing the shortfall between the potential and registered taxpayers, between the registered taxpayers and the tax file returns, between the registered taxpayers and the tax reports and finally between the tax reporting amount and the potential tax as per the law [176]. Since non-filer is a serious issue in Nepal, without a big reform in tax admiration together with adoption of a modern behaviour approach, more resource mobilization and equity in the tax system will be a mirage rather than reality.

3.10 WAYS AND SCOPE OF ENHANCING EQUITY IN THE TAX SYSTEM

In Nepal today, undermining the ability to pay tax principle and uneven distribution of tax burden are the key concerns. Amidst widening wealth and income inequality, regressive taxation, informal and large sections of population remaining outside the orbit of the taxation, higher level of tax evasion or avoidance are the major concerns from the standpoint of enhancing equity in Nepal's tax system. Such problems, at the same time if addressed properly, heighten the scope of augmenting resource mobilization and enhancing equity in tandem. From the analysis made above it is clear that there is a big scope of shifting the tax base from indirect taxation to direct taxation, especially personal taxation. Broadening of tax base, rationalization of tax incentives and implementation of progressive taxation system augments such possibilities significantly.

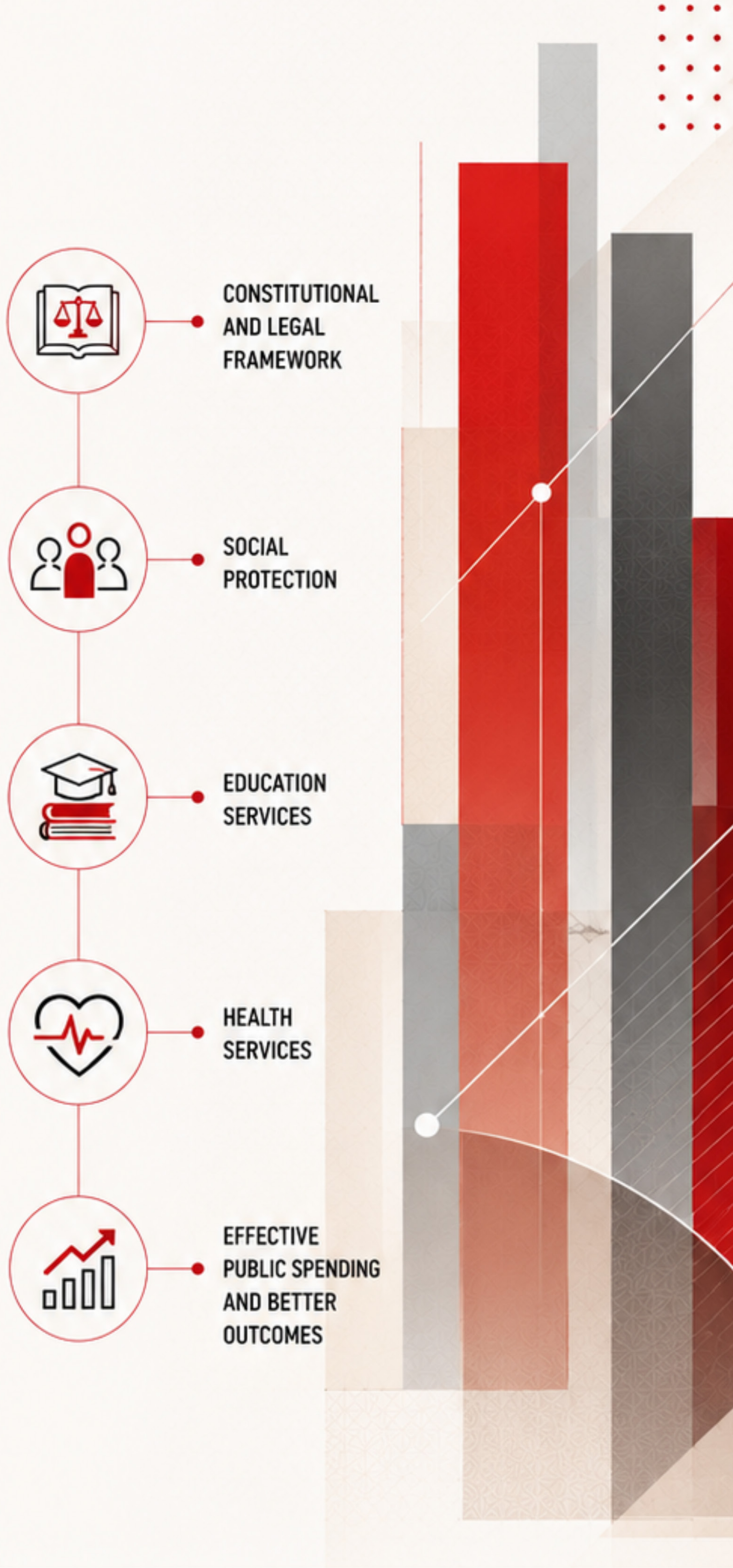
As noted above, there is a big scope of strengthening both horizontal and vertical equity in Nepal's tax system. The closer review of tax bases, concessions, incentives, deduction schemes, rate structures and rampant tax evasion or avoidances indicates that there is as strong possibility of ensuring both equities simultaneously provided a transformative approach in the overall governance system in general and tax system in particular is introduced and strengthened with high priority.

[175] *Dom et al 2022*
[176] *Silvani 1992*

CHAPTER 4

GOVERNMENT SPENDING PATTERN AND ACCESS TO PUBLIC SERVICES AND SOCIAL PROTECTION:

A REVIEW OF OUTCOMES AND EFFECTIVENESS



This chapter reviews constitutional and legal arrangements for public services and social protection in Nepal. It examines government spending patterns in education, health and social protection programs, and assesses their outcomes and effectiveness.
The analysis highlights gaps between commitments and actual spending, and identifies key challenges in ensuring equitable access to quality services and social protection for all.

CHAPTER 4

GOVERNMENT SPENDING PATTERN AND ACCESS TO PUBLIC SERVICES AND SOCIAL PROTECTION: A REVIEW OF OUTCOMES AND EFFECTIVENESS

For translating the principle of 'leaving no one behind', minimizing and preventing present as well as intergenerational inequality, empowering people in general and deprived in particular and bringing prosperity in a sustainable way, public services are the key in countries like Nepal. The speed of advancement leaping through innovation compounded by IT revolution further entails that how critical have been the public services to those who cannot afford these on their own[177]. As an offshoot, persistence or perpetuation of various forms of vulnerabilities in societies including child as well as labour market vulnerabilities aggravated by frequent unexpected shocks underscore that social protection is immensely important. Indeed, the public services and social protection are intertwined[178]. Prospects of social protection employing as a vehicle of better access to and demand for public services and diversifying it for other productive uses enhances its catalyst as well as complementary role further for making both mutually inclusive. Hence, the central issue in countries like Nepal is how scare resources are allocated and used efficiently and productively for ensuring better access to and quality of public services and guarantying social protection of people who are living in a very distressed or vulnerable conditions. In this chapter below, first constitutional and legal arrangements made in these areas are briefly reviewed. This is followed by an examination of federal government resources spending pattern in both public services and social protection programmes. The outcomes and effectiveness are assessed in the last section.

4.1 CONSTITUTIONAL AND LEGAL ARRANGEMENTS

One of the main features of Nepal's Constitution is that it guarantees the fundamental socio-economic rights to all citizens[179]. Free education and healthcare that are directly associated with public services are guaranteed by the Constitution. Special rights to the marginalized and vulnerable citizens is another distinct feature of the Constitution. Such citizens covered include the indigent, incapacitated, single women, children, Dalit, people with disabilities, and endangered ethnic groups. They are entitled to get social security benefits. The special political, social, and economic rights is provisioned to the Dalit community in which rights to educational scholarships, health and social security benefits, and land and housing are covered in it. Similarly, right to food security and sovereignty, right to appropriate housing and right to employment are included in the Constitution. Right to social justice to women, Dalit and indigenous communities are also incorporated in it. Strikingly, in most such critical areas, separate acts have been introduced.

As a part of such rights, the Constitution guarantees social security to every citizen which includes social protection right to the workers. Accordingly, two acts, viz., Social Protection Act 2018 and the Contribution-Based Social Protection Act 2018 are under implementation. The former is associated with universal social protection which was started back in the early 1950s[180], after the restoration of democracy in 1990. This has been expanded continuously after the democratic movement of 2005/06 which led to the establishment

[177] A rrecent study focused on IT induced inequality indicates that AI and robots will have destructive effects on jobs especially in the poor countries leading to stagnation in wages, immature deindustrialization and flow of workers to service sector with added adverse effect on poverty reduction including poverty reducing growth, inequality and existing social contract. Based on such conclusions, it highlights on the need and importance of public policies to protect the poor in less developed countries. For details see Kiely and Summer edit., 2020.

[178] A recent report says that the social determinants of pandemics are critical, such as education, income, housing, environmental and social conditions. It also adds that access to financing and the cutting-edge health technologies are critical. Accordingly, it indicates on the need of exploring means that help to build strong health systems and social responses. On the same ground it stresses that those who are concerned with pandemics and their impact must be concerned with inequality as well. For details see GCIAP 2025.

[179] GoN 2015

[180] Such a scheme focused on elderly, widow and disabled was first introduced in 1994/95 by then CPN(UML) minority government of Nepal.

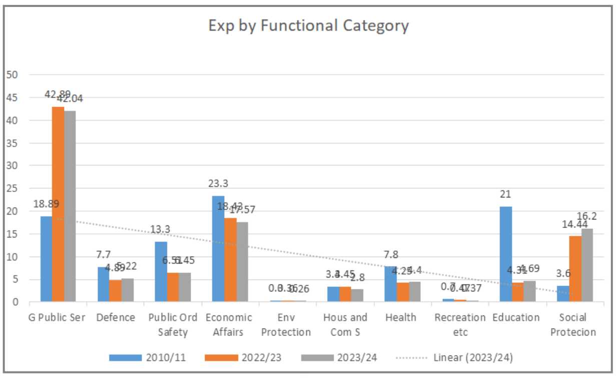
of federal democratic republic in the country[181]. Under such a scheme formalized through the above act, social assistance allowances is provided to the elderly (70 years and above) , all Dalit and residents of the erstwhile Karnali Zone above 60, single (unmarried or divorced) women above 60 years, holders of red or blue disability identification cards, widows, citizens from endangered ethnic groups, all children below five years in the erstwhile Karnali Zone and other districts that have low human development index (HDI) scores and Dalit children across the country. The Contribution-Based Social Protection Act 2018 introduces a social insurance scheme for all workers. Workers in the formal and informal sectors, as well as self-employed are eligible to enlist in contribution-based schemes for medical, accident, disability, and unemployment insurance, as well as maternity leave and retirement pensions. The schemes are directed to provide benefits to the workers and their dependent family members. From this fiscal year 2025/26, all civil servants receiving pensions are also included in the contribution based social protection scheme.

Thus, social and economic rights included in the Constitution followed by enactment of various related laws underscore on the need of following right and equity-based approach of development for ensuring that no one is discriminated against, left behind and deprived of opportunities and dignified life.

4.2 PUBLIC SERVICES AND SOCIAL PROTECTION SPENDING PATTERN: A REVIEW

The government expenditure trend of last more than one decade is any guide that clearly indicates that there is hardly any coherency between the commitments made in the Constitution as well as enacted acts and actual priority attached to the public services like education and health by the successive governments. As shown in graph 4.1, the actual expenditure made on the health and education services has declined sharply in recent years. For instance, the actual expenditure in education sector was about 21 percent of total spending in 2011/12. Such a ratio reduced to just 11.27 percent in 2023/24 in which spending by the federal government was 4.69 percent as shown in the graph 3.1 and the rest was done by the sub-national governments[182]. Similarly, the share of health sector expenses has decelerated to 4.2 percent in 2022/23 from 7.8 percent in 2023/24. More strikingly, during the same period the share of general public services in which administrative type services constitute the major components has jumped to about 42.9 percent in 2022/23 with minor reduction at 42.04 percent in 2023/24 from 18.9 percent in 2011/12. Increase in such a ratio in the post federal period is quite opposite to the general principles of federalism. As an offshoot of above unexpected phenomenon, the share of economic affairs has also reduced to 18.4 percent from 23.3 percent during the period 2011/12 to 2023/24 despite capital expenditure constituting the larger share under its different sub-categories compared to other categories. For instance, the share of capital expenditure under economic affairs has been in the neighbourhood of 67.13 percent for 2023/24[183]. This simply means from larger macroeconomic perspectives that the government spending pattern is hardly conducive to enhance productive capacity of the economy and augment transformation for sustaining growth which further corroborates the conclusion derived in Chapter two.

Graph 4.1: Trend in the Government Expenditure as Per Functional Category



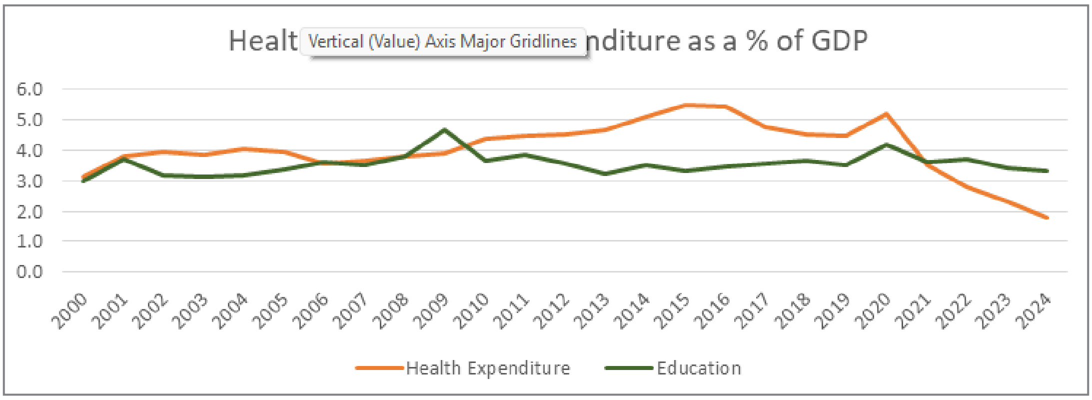
Source: MoF 2025 (Economic Survey).

[181] *How Nepal despite some reservations in some quarters was able to push it through own resources has been closely reviewed and discussed lately in Greenslade 2026.*
[182] *In the graph, expenses by the federal government in education is shown for 2022/23 and 2023/24,*
[183] *For details on the breakdowns within the current and capital expenditure see FCGO 2025.*

In addition to administrative services, the other category that has shown a phenomenal rise continuously is universal social protection category. Its share in total government expenditure has risen to 16.2 percent in 2023/24 from just 3.4 percent in 2010/11. Such a rise could have been justified to some extent had it covered the most vulnerable section of the population leading to enlargement of purchasing capacity of populous with direct as well as indirect boosts to development. As will be discussed later, unlike in many countries, this has not been the case in Nepal. With rapid politicization accompanied by misuse of resources and poor coordination, sustainability has emerged a big problem amidst emerging resource crunch snags to the government, more so in recent years. It is also noticeable that due to continuous expansion in contributory based social security scheme, accumulation in the Social Security Fund (SSF) has increased rapidly. By the third week of Feb 2026, the accumulated fund has reached Rs. 102.54 billion with participation of more than 2.8 million employees and workers of which 2.2 million are migrant workers. Noticeably, the participation of most deserved informal workers has remained meagre. So far only 854 informal workers have been covered under this contributory scheme[184]. As will be discussed below the outcome in terms of targeted beneficiaries has been highly disappointing.

A quick review of the trends in education and health expenditure as a share of GDP further indicates that their share has stagnated over the years at a low level with some minor fluctuations. More typical phenomenon is that when there were upswings in both revenue and total expenditure as a share of GDP[185] no noticeable growth in these services took place. With deceleration in both revenue and total expenditure in recent years, more sufferers have been these services. Though recent decile in the share of these services at the federal government level is partly due to the shift of resources from the center to the sub-national governments as per the responsibilities laid down in the Constitution, the decile at the center has not been compensated enough to prevent the total decline in the share of both health and education[186]. Their share in GDP, thus, shows that the benchmarks committed at the international level have been grossly undermined.

Graph 4.2: Trends in Health and Education Expenditure by the Federal Government



Source: Economic Surveys of Various Years, MoF.

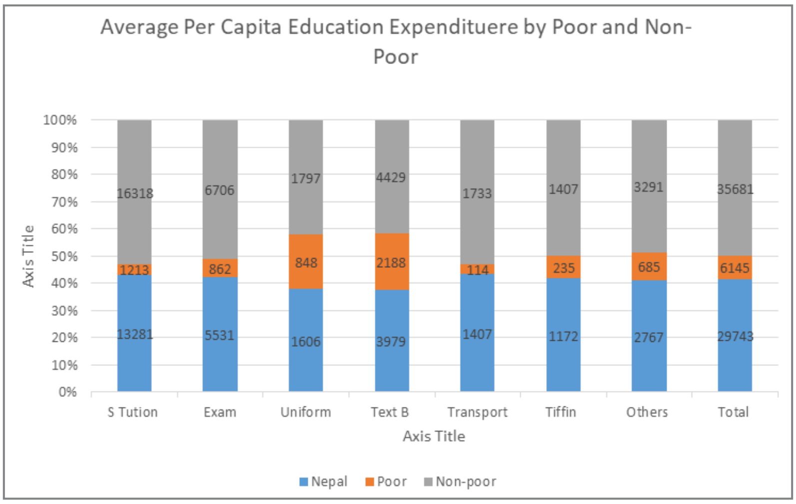
Amidst such tendencies, still the poor are compelled to bear large chunk of expenses for education to their children. As shown in graph 4.3 below, the per capita education expenses of the poor are reported to be Rs. 6145 for 2022/23. Out of this, major expenses are reported to be for the textbooks and tuition fees. Though without detailed scrutiny of individual household data it is difficult to trace out that out of such expenses how much was spent in government funded primary and secondary education which are free, compulsion to make expenses in different essential heads indicates that the cost for the poor is high, revealing that for the poor affordability is a big problem.

[184] *For details see SSF 2026.*

[185] *Data show that revenue as share of GDP reached up to 22.4 percent in 2020/21 from 11.9 percent in 2004/05. Likewise, total expenditure as a share of GDP reached 31.5 percent of GDP in 2016/17 from 22.2 percent in 2008/09.*

[186] *See WB 2021 and 2024.*

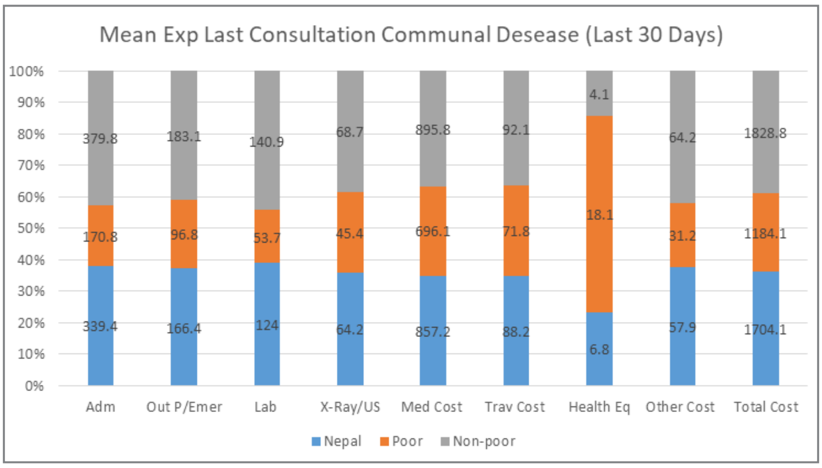
Graph 4.3: Average Per Capita Education Expenditure by Poor and Non-Poor



Source: NSO 2024.

Likewise, mean expenses of the poor patients associated with consultation and treatment for a month are reported to be high at Rs 1184.1 which is not significantly lower than spent by the non-poor patient for the same purpose (Graph 4.4). As shown in graph 4.4 below, out of the eight categories associated with consultation and treatment, large amounts are spent on medical equipment. This is followed by expenses on medicine. Similarly, admission, emergencies, various tests and travel also form the major parts of the expenses. Amidst a policy of free primary health services, why the poor have to bear such expenses is a matter of serious concern and hence needs further investigation and cross checks.

Graph 4.4: Mean Expenditure for Last Consultation to Communal Disease (Last 30 Days)



Source: NSO 2024.

Understandably, if efficiency and effectiveness is ensured through improved institutional, technical and management performances, better results can be ensured with decreased resources also. On the other hand, if there is misuse of resources or resource drain, expansion in expenses also cannot ensure better outcomes and delivery. Hence, the performance in terms of outcome, impact and effectiveness in these crucial areas becomes highly important.

The poor quality of health and education services in Nepal is partly a result of insufficient and ineffectiveness in public spending in both education and health. Compared to countries with similar income levels, Nepal invests significantly less per capita in education and health[187] (Graphs 4.3 and 4.4).

[187] *WB 2025a.*

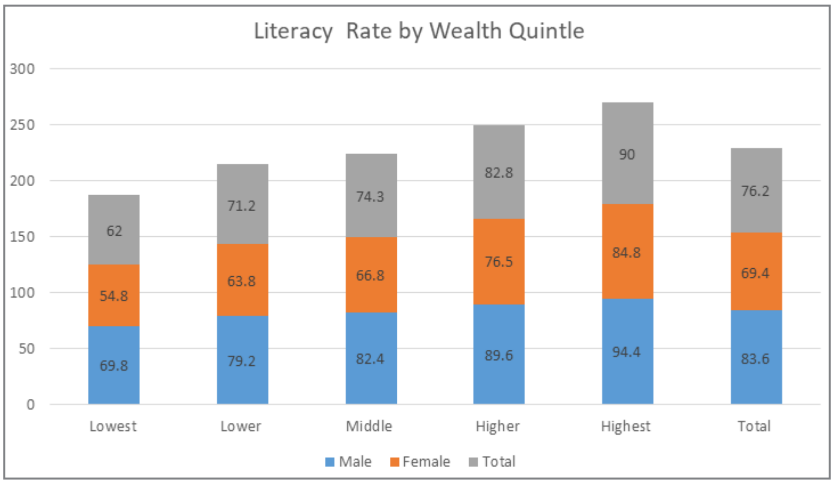
4.2.2 OUTCOME AND EFFECTIVENESS OF PUBLIC SERVICES

4.2.2.1 Education

A rapid expansion in the access to education has taken place in Nepal over the years, more so in recent years. Inclusion of education as a fundamental right in the Constitution as indicated above followed by introduction of the Free and Compulsory Education Act (2018) have played a considerable role in it. The School Education Sector Plan (2021–2030) has also helped on the development of the school education further. Nationwide midday meal and scholarship programmes mainly targeted at disadvantaged groups, among others, have facilitated to improve access to the education to a greater extent. The literacy rate among 5 years old and above has reached 76.2 percent in which male literary is 83.6 percent and female literacy is 69.4 percent. This indicates that there has been substantial increase in literary over the years. In recent years, progress in female literary rate has been faster. For instance, during the period 2011 to 2021 adult female literacy rate has increased by 16 percent compared to 10 percent increase in the adult male literary rate on the average. One of the notable developments is that enrolment has reached almost universal levels at the primary and lower secondary levels. Similarly, 89 percent of children are enrolled in upper secondary school[188].

Notwithstanding this progress, there are, however, many lapses and gaps compounded by severe systemic problems. First of all, the progress is highly skewed. Similarly, the inefficiency is continuously perpetuating with mounting cost and effectiveness problems. As the Population Census data indicate, the completion rate declines sharply as the children move from lower to higher grade. The completion rate at the primary, lower secondary and upper secondary level is 82, 77 and 35 percent respectively. Moreover, despite higher share of students completing primary school, only 61 and 80 percent are reported to be achieving minimum proficiency in mathematics and reading. Importantly, a larger disparity across provinces persists. Within provinces also, a larger variation in attendance at the local level remains with some municipalities reporting the rates below 80 percent[189]. More worry is the perpetuation in gender gap in a systemic way in some critical areas such as adult literacy rate. As shown in the graph 4.5 below, the literary gap with male is about 14.2 percent. Noticeably, the male and female literacy gap persists across all wealth quintile groups though with some narrowed gap at the highest wealth quintile.

Graph 4.5: Literacy Rate among Male and Female by Wealth Quintile



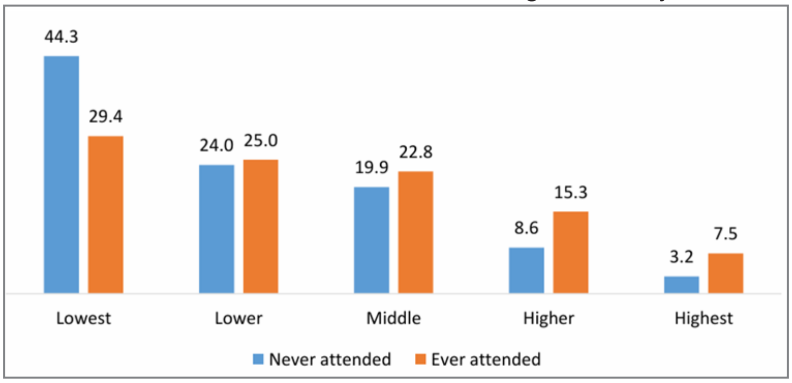
Source: NSO 2025a.

Another phenomenon is that a larger proportion of school age population is still out of the school in Nepal. As the census data reveals, altogether 0.769 million children in the age group of 5 to 17 were out of school as per the reporting made during the time of enumeration. Out of this number, 0.389 million and 0.380 million children were reported to be ever attended and never attended respectively. Such data by wealth quintile portray more dismal picture (Graph 4.6). The percentage of both never and ever attended children is very high among the

[188] *For details see NSO 2025a.*
[189] *Ibid*

lowest wealth quintile group with predominant share of never attended group at 44.3 percent. But beyond lowest quintile group, the share of discounted children overtakes the never attended ratio. This simply means that the retention rate of children sharply drops among the better off households as well. This corroborates that both efficiency and effectiveness still remain a big problem in the education system.

Graph 4.6: Distribution of Out of School Children aged 5–17 by Wealth Quintiles

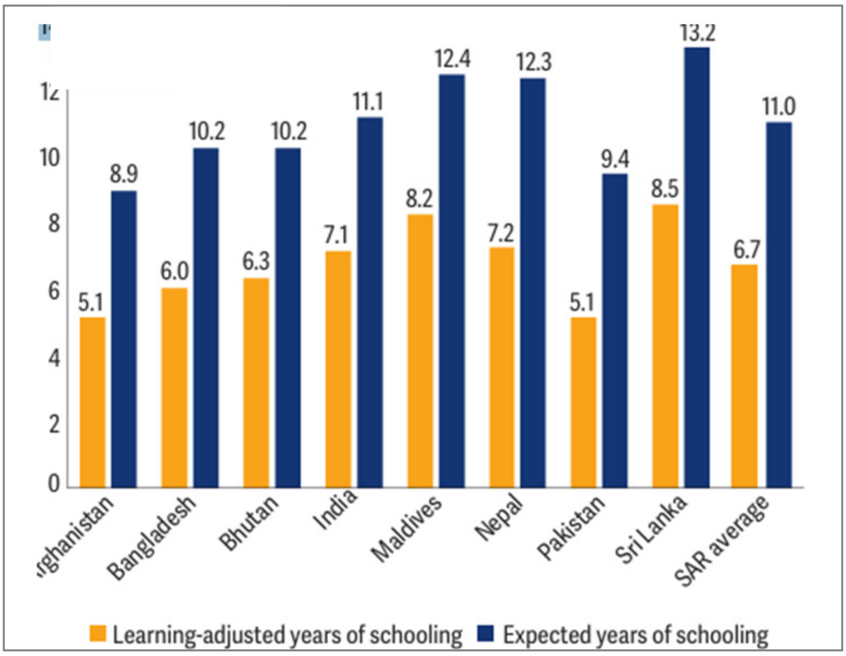


Source: NSO 2025a.

Added phenomenon which is closely associated with quality education is that despite notable expansion in the access to education, students in Nepal, contrary to established norms, learn very little while at the school. As a consequence, learning outcomes in Nepal are reported to be lower than in countries with similar income levels. On the assumption of a student's 12.3 years of schooling on the average in Nepal, effective schooling is estimated to be 7.2 years after adjustment to the learning levels (Graph 4.7) amidst large learning disparities based on gender, province, education levels and income quintile[190].

Graph 4.7 Learning-Adjusted Years of Schooling and Expected Years of Schooling in South Asia, 2021

Source: WB a 2025.



Based on various yardsticks, quality of school education can be regarded to be major stumbling blocks for expediting more equitable, competitive and qualitative sustainable development amidst rapid changes and advancements globally in this area. The UN education quality index 2025 constructed covering universal access to education, robust teachers training and equitable policies etc. comes out to be 0.50 for Nepal which is less than the index computed for Bangladesh and India. Sri Lanka is far ahead than other South Asian countries in the quality of education. Lack of poor infrastructure including modern infrastructure, scarcity

[190] See WB 2025a and NSO 2025a.

of resources added by distribution thinly, less qualified teachers, outdated or poor learning methods, gender disparities, poor governance including resource misuse amidst highly politicized management and above all lack of transformative strategic and policy direction are regarded to be major hindering factors for higher quality education at the school level[191]. The policies promoting commodification in education system with negligence to public/community schools have additionally augmented education quality divide between public and private schools leading to children of poor and disadvantaged families depriving of quality education at the school level with a danger of perpetuation in inter-generational inequality.

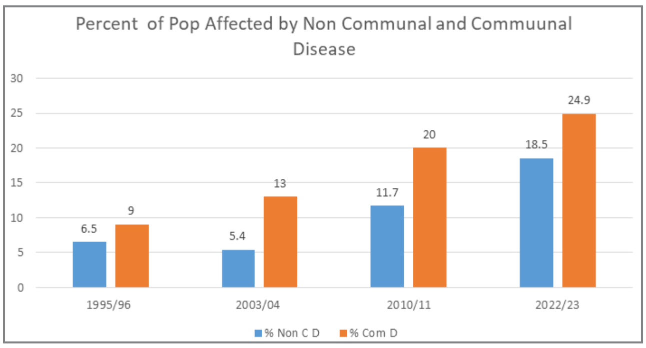
The higher education system also faces multiple challenges in Nepal amidst rapid expansion in university numbers and other institutions designated for higher education. The major problem in higher education is largely similar to the problems in the lower-level education system. The major problem is that the rapid expansions have not commensurate with enhancing quality education, ensuring alignment of education system with changing labour market demand and retaining youths that are about to join university and colleges. Production of low-quality graduates in dominant non-technical educational institutions is preventing them from competing with the changing global and domestic labour markets. Outdated academic programmes and curricula, poor infrastructure, low priority to research and innovation, under funding as well as poor governance and management system have hindered quality education at the higher educational level markedly[192].

4.2.2.2 Health

A rapid expansion in access to health services along with steady development in the health sector has also taken place in Nepal over the years. Life expectancy at birth reached 71.97 years in 2021, which is relatively satisfactory compared to the countries with similar level of development. A continuous reduction in maternal mortality ratio (MMR) has taken place in recent years, from 539 per 100,000 live births in 1996 to 151 per 100, 000 live births in 2021. Similarly, under-5 mortality rate (U5MR) has fallen to 33 per 1,000 live births in 2022 with neonatal mortality at 21. Stunting among children under 5 now stands at 24.8 percent on average. Total fertility rate has stabilized at 2.1 per woman[193]. All these progresses are the outcomes of improved access to health services.

Despite these, worrying phenomenon is that both non-communicable and communicable diseases are on the rise. As shown in the graph 4.8, the population affected by non-communicable was 6.5 percent in 1995/96. Such a percentage after some slowdown in 2003/04 continuously increased and reached 18.5 percent in 2022/23. Likewise, the population affected by communicable disease reached 24 percent in 2022/23 from 9 percent in 1995/96. One-fourth of children under five are still stunted. Stunting rates are particularly high among Nepal's poorest (37 percent), least educated (36 percent), and rural (31 percent) populations as well as in the provinces of Karnali (36 percent) and Gandaki (31 percent). Noticeably, stunting rate under 5 children is high in Nepal. In that also the gap between rural and urban areas as well as across wealthy quintiles and provinces is very high.

Graph 4.8: Population Affected by Non-communicable and Communicable Disease

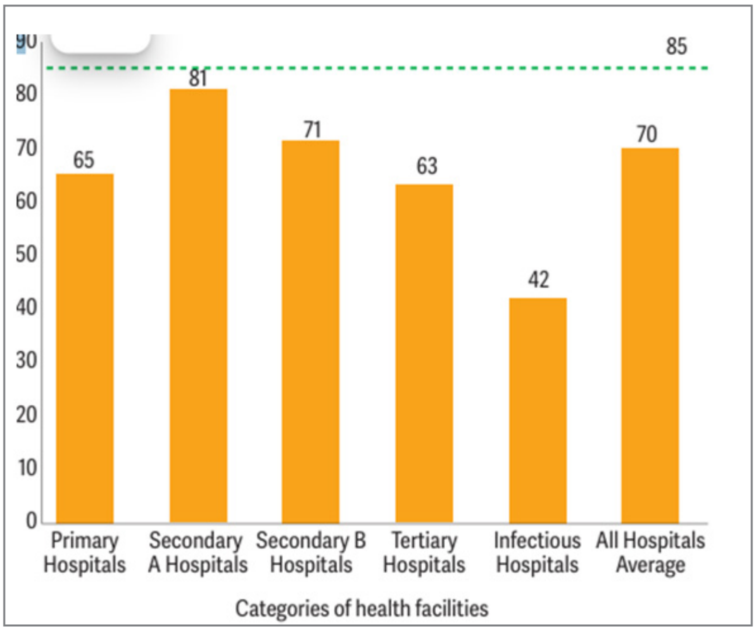


Source: NSO 2024.

[191] *Action Aid advocacy reports and UNCEF studies and fact sheets, among others, resource corroborate these. A review on quality school education can also be found in NCE Nepal 2020.*
[192] *For details see Gnawali 2025.*
[193] *Such progresses are reported in the Nepal Heath Fact Sheets 2025. See MoHP 2025.*

Amidst such a rising tendency of both communicable and non-communicable disease, one of the closely associated problems is the delivery of poor-quality health services. The health facility tiers compounded by inadequate health service coverage do not meet the government's minimum health service delivery scores. This is evident from Graph 4.8 below. As shown below, the facility in the infectious hospitals is highly poor. This is followed by tertiary and primary health facility related hospitals.

Graph 4.9: Health Service Delivery Score 2022



Source: WB 2025a

In addition to this, countries with levels of per capita health spending similar to Nepal are reported to be achieving better outcomes, even after controlling for cost-of-living differences. The studies indicate that due to slow progress in the implementation of the National Health Insurance (NHI) programme, improvement in access to healthcare and financial protection has remained a big problem. Consequently, as studies portray, households persistently face difficult choices between spending on medical care and essential needs amidst low health emergency preparedness and response capacities at the time of natural disasters epidemics and other abrupt health crises. As an offshoot, Nepal's capacity to implement international health regulations has remained low compared other South Asian countries[194].

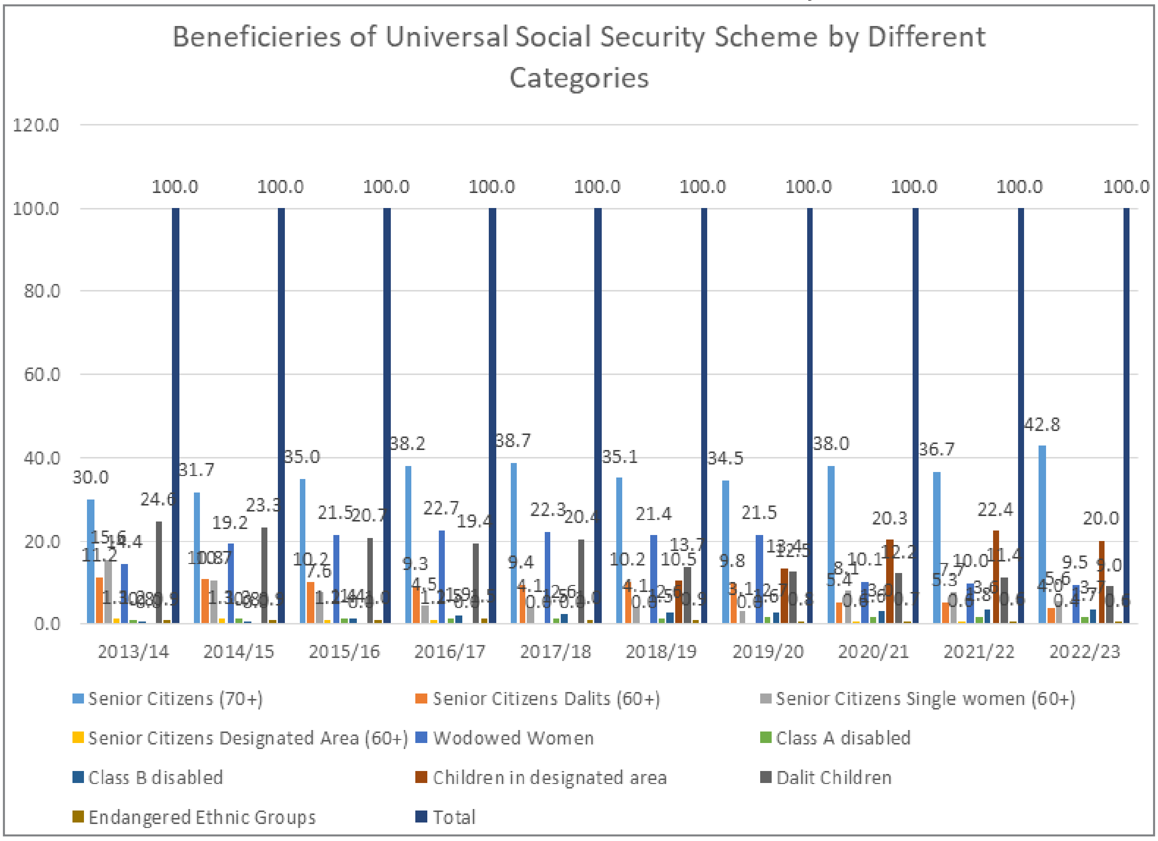
All these indicate that not only is progress on the expansion in access to health services slow but also a large gap between the wealthy and poor population in its access is continuing. Added problem is that the quality of health services across various categories of hospitals is low with Nepal remaining at the bottom on the average among South Asian countries.

4.2.3 Social Protection: Coverage and Effectiveness

A slow progress in the expansion of social protection coverage is taking place in Nepal despite rapid expansion in the government spending in such programmes. In the 15th Plan (2019/20-2023/24) a target of covering 60 percent of population was set. At the end of the 15th Plan, the progress compared to the target was very low at 32 percent. Out of the coverage among 10 categories, the major beneficiaries have been senior citizens above 70 years. In others, share of beneficiaries during the period 2013/14 to 2022/23 has changed to a greater extent. Amidst decline in the share of senior citizen Dalits, senior citizen women and widow, the share of children in designated area has gone up at a faster rate (Graph 4.10).

[194] *For details see WB 2025a.*

Graph 4.10: Share of Beneficiaries in Social Security Distribution



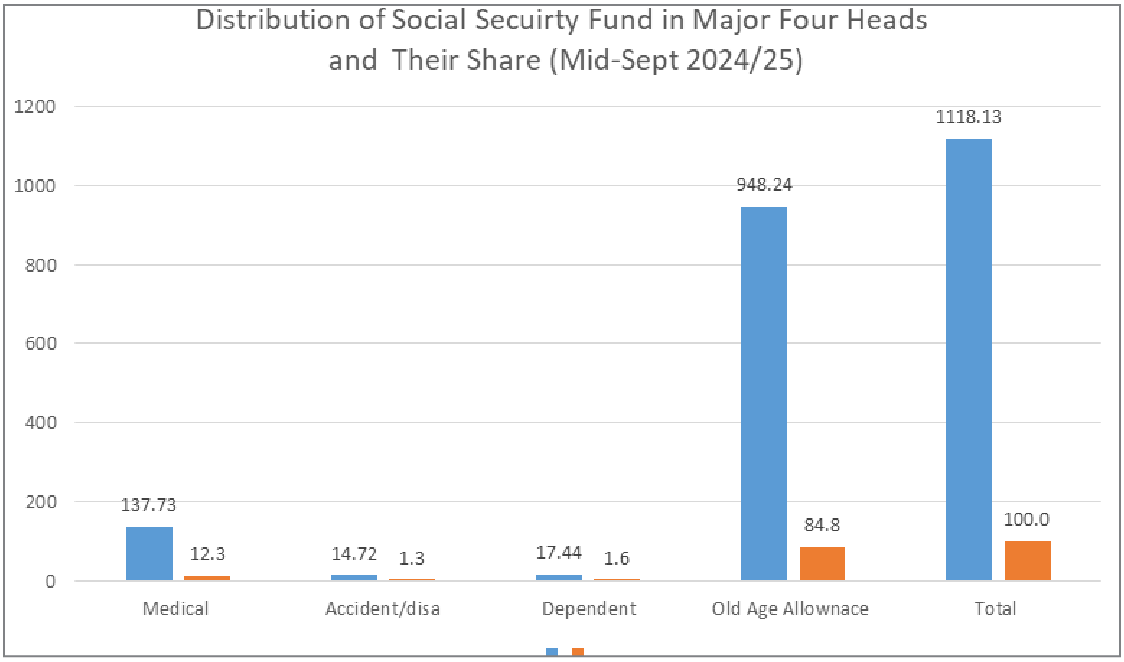
Source: MoF 2025.

An assessment on the SDG indicator 1.3.1 provides more insights into the progresses in the expansion of social protection coverage. It indicates that effective coverage of the income support scheme reached 18.9 percent only in 2023/24 at the aggregate level. As it reveals, despite a steady expansion in the protection of employment injury, sickness, mother with newborns, children and vulnerable people in the aftermath of contributory scheme, a slight decile in the share of age-old pension has taken place under such a cash support scheme amidst some rise in the share of kinds. Strikingly, coverage of cash support scheme remains far below the regional and global levels. Such an average coverage level is estimated to be 35.4 percent for South Asia and 53.6 percent for Asia and the Pacific with global average at 52.4 percent[195].

Under the contributory scheme, a big asymmetrical tendency is found. Despite accumulation of huge amounts as already indicated, actual distribution per year is very low and meagre. As shown in graph 4.11, by Mid-Sept 2024/25, only Rs 11.18 billion was distributed among the four major categories. This is just 16.8 percent of the accumulated fund of that time. In such a distribution, the major beneficiaries have been the old age security workers. Their share in total distribution comes out to be 84.8 percent. About 12.3 percent was distributed to healthcare workers and their families. Out of the total, only 1.6 percent dependent families and 1.3 percent workers suffering from accidents and disability were able to receive the funds. As already indicated, in such benefits also, the share of informal workers was quite negligible due to virtually no progress on covering the informal workers despite proclaimed priority for many years. It is illuminating that the share of informal workers in Nepal is overwhelming at 81.8 percent which is far higher than regional and global averages. In that total, the share of informal employment among youth is as high as 92.4 percent. Likewise, informal employment among women workers is 82.4 percent[196]. It is also noticeable that despite frequent but abrupt shocks due to, among others, natural calamities, disasters and pandemic, no social protection coverage is in place to those severely affected by such shocks.

[195] *See Karki 2026.*
[196] *For details see WB 2025a.*

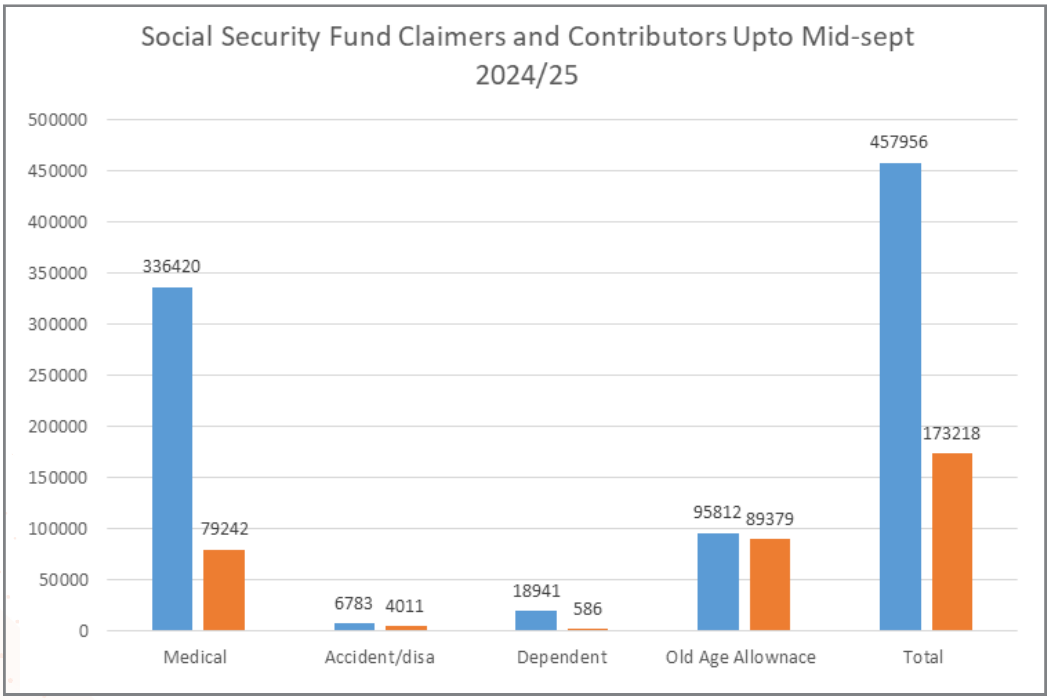
Graph 4.11 Distribution of Social Security Fund by Mid—Sept 2024/25 (Rs. in Crore)



Source: Social Security Fund, GoN

Another unique phenomenon is that there is a huge gap between the fund claimers and contributors to the Social Security Fund amidst wider variations across four categories (Graph 4.12). As of Mid-Sept 2024/25, the larger gap is found under the dependent family category. In this, the gap between the claimers and contributors is 32.3 times. This is followed by medical and accident category at 4.2 and 1.7 times respectively. The least gap is found in age old allowance category at 1.1 times. The huge gaps in the two categories additionally substantiate that apart from immaturity in the design and implementation of the entire scheme, there are least efforts to widen the coverage of contributors taking rising demand for support into account.

Graph 4.12: Social Security Fund Claimers and Contributors up to Mid-sept 2024/25



Source: Social Security Fund, GoN

It should be added that with wider criticism on poor coverage, overlaps, misuses, inefficiencies and ineffectiveness of social protection schemes amidst rapid expansion in spending, some attempts to streamline them have been initiated from this fiscal year's budget. The commitment to follow an integrated approach covering both universal and contributory scheme is outcome of this. Though this is a positive step, effectiveness in its implementation is awaited. Similarly, from this fiscal year, the contributory scheme in the civil service has been enforced by replacing the pension system which is also a positive step to contain the unsustainable financial liability of the government. Notwithstanding these initiatives, the larger problems of coverage and effectiveness are yet to be addressed. Amidst growing sustainability problems compounded by mounting resource constraints, questions arise why allowances are being provided to those who are rich and do not need such support.

CHAPTER 5

MAIN FINDINGS AND MESSAGES OF FOCUS GROUP DISCUSSIONS

VOICES FROM COMMUNITIES, INSIGHTS FOR ACTION

This chapter presents the key findings from focus group discussions held in selected districts across Karnali, Bagmati and Madhesh provinces. It captures the experiences and perspectives of teachers, health workers, parents, local representatives, business leaders and consumer groups on access to and quality of education and health services, and on the tax system from a justice perspective. The findings highlight community priorities, challenges and aspirations to inform evidence-based policy recommendations for a fairer and more inclusive society.

CHAPTER 5

MAIN FINDINGS AND MESSAGES OF FOCUS GROUP DISCUSSIONS

This chapter presents the findings of the focus group discussion carried out in selected districts. The objective was twofold. First was to get feedback from the stakeholders on their experience with education and health system in their vicinity, especially from the point of view of access to and quality of both services. Second was to get opinions from the business groups, entrepreneurial community and consumers' representatives about their practical experience with the tax system in promoting businesses and industries as well as protecting consumer's interest especially from the tax justice standpoint. The major findings of such discussion with the stakeholders are presented below.

5.1 METHODOLOGY AND GROUP DISCUSSION AREA

A total of six FGDs were conducted in three districts of Karnali, Bagmati and Madhesh provinces. Surkhet district was selected from the Karnali province. Dhading was chosen from the Bagmati province and Parsha district was picked up from the Madhesh province. Accordingly, the focus group discussions were organized in Bheriganga and Surkhet municipality of Karnali province for

the discussion on health and education services and tax related issues respectively. Likewise, Thakre Rural municipality and Nilkantha municipality of Bagmati Province were chosen for discussion on health and education and taxation related issues respectively. From Madhesh province, Paterwassugali Rural municipality and Birgung Metropolis were selected for the discussion on health and education and tax related issues respectively. The businessmen, entrepreneurs, consumer forum representatives were invited for the FGD to discuss on the taxation issues. Similarly, schoolteachers, health workers, parents, representatives from local NGOs as well as local governments were invited to discuss on the issues associated with health, education and taxation at the local level. In the FGD discussions, following major issues were covered:

- Access to and quality of education and effectiveness public education system
- Access to and quality of health services and its effectiveness
- Taxation system and its effectiveness in promoting business and industries and state of conditions in tax system from justice perspectives

5.2 ACCESS TO AND QUALITY OF EDUCATION SERVICES

In most of the schools, quality of education services are serious problems though access to schools is also found to be problems resulting from parents' poverty conditions. The inadequate infrastructure compounded by scarcity of funds and lack of teachers as per the quota added by absence of trained or qualified teachers on more technical subjects are the big problems faced by the schools. The skill deficiency of teachers to impart required knowledge including computer knowledge has made students learning below standards. Poor school environment and motivations added by lack of strong accountability of schoolteachers also have played a key role in perpetuating ineffectiveness in the school system. FGD-based details presented below provide more sights on specific issues and problems.

5.2.1 High Absenteeism and Children Drop Out

Parents of the public school are either illiterate or low educated. Many of them are either in foreign employment or are engaged in earnings for daily livelihood activities such as working outside the home besides being busy with agriculture-related work, particularly in peak seasons. Public schools are largely attended by students from such poor families and therefore many of the parents cannot manage basic education materials such as dress, bag, and stationery to the children, not to mention arrangement of tuition at home. As a result, apart from poor performance, the drop out ratio of the poor students becomes quite large. Lack of awareness of parents on the importance of education is also fuelling dropouts and absenteeism. An increased tendency of children's involvement in wrong activities is also contributing to high drops outs.

A poor parent participant of the Thakre Rural Municipality told that Rs 400 scholarship is highly insufficient for continuing children to the school. It was told that poor parents have no money to buy a dress, a bag, and stationery and to support for the lunch in schools leading to dropping of children from the school. It was told that dropping is a major problem.

5.2.2 Poor Quality Teaching and Motivation

As per the complaints of the participants, the teachers in the government schools are less accountable with limited care to the students and often deliver traditional pedagogy. Because of no fulfilment of vacancies for decades, in some schools lower-level teachers are compelled to teach at the higher classes. Hardly training is carried out by the government. In some schools, training is often taken by NGOs with some positive impact on education quality. In the absence of permanent teachers, schools often appoint teachers on a short-term basis with financial support from the local government. Such teachers, however, are generally underpaid, and hence their motivation and performance are low.

Teacher shortage is most common and acute in Madhesh's public schools. Often classes have combined due to the shortage of teachers in the school. Parents generally send their daughters to the public schools and boys to private schools (Participants from Paterwassugali Rural Municipality).

5.2.3 Poor Infrastructure and Resources

Based on the FGD in all covered areas, almost all schools lack the required level of physical infrastructure, ICT infrastructure, proper classrooms, skilled manpower to teach technical subjects like computer, smart board, and skills about in internet services. Similarly, extra-curricular activities are limited; some schools offer none.

5.2.4 Lacking Accountability

Most of the teachers in government schools are qualified to a greater extent. But accountability is a major problem as poor care by them to the students as complained by the parents indicates. At the same time, another problem is that there is a limited interaction between teachers with the parents regarding the performance of students. More strikingly, there is hardly any supervision and monitoring by the local governments despite public school funding by them. In most cases, the management committee is highly politicized leading to further weakening of accountability. Motivation programmes, either from the teachers and local authorities, or from parents and administration are absent or rare. Interestingly, most of the teachers from the government school enrol their children in private school. Accountability has further weakened due to waning confidence in public schools.

There is no budget for extracurricular activities in the school, and teachers do not care for the hygiene of students, which is also part of learning (Participants of the Bheriganaga Municipality).

5.2.5 Gender Discrimination

More striking aspect pointed out by the participants was that there is still a growing tendency of enrolling female students in the public schools and boy students in the private schools. This means, gender discrimination is still dominant.

5.3 EFFECTIVENESS OF HEALTH SERVICE

In the areas of health, not only has access of common people to the minimum primary health services been rare and unreliable but also affordability of services has remained a big problem. Amidst such a perennial problem, insurance scheme is not existent in all areas covered for the FGDs. Some details on these and other related areas based on the FGDs is presented below:

5.3.1 Accessibility and Affordability to Health Care Services

From the FGD it became clear that the government health services are primarily used by the poor and low-income population. People who can afford or can obtain loans from different sources, go to the private hospitals because of low trust on the public health services. The public health service centres face number of problems which include lack of building or poor infrastructure, absence of test equipment or existence of outdated equipment, limited or no skilled manpower. In some overcrowded health centres, the selected medicines become available only for three months. Amidst such a situation, people are deprived of free medical check-ups and tests in the government hospitals and health centres, Therefore, from a health services standpoint, poor and low-income people are most sufferers.

Test Charges but Designated Medicine only for Three Months at Government Heath Centres/ Hospitals
Laxmi Chepang is from the Tharke Rural municipality, Dhading, surviving by working daily as a construction labourer at the local level. She had to go to the government health centre for a health check-up supposing that it will be a free. The hospital, however, charged big amount for her check-up and a basic test. The doctors, then, prescribed a list of medicine and suggested her to buy them from the private pharmacy saying that heath centre has no medicine. But due to part of her daily earnings to be saved after house expenses to meet children's public-school cost, she has been compelled to stop her treatment. During the FGDs, it was told that such a charge is quite common. A senior lady teacher also shared her experience by saying that a big amount had to be paid by her some months ago for some tests in the same health centre.

5.3.2 Coverage and Effectiveness of Health Insurance Programme

Amidst both affordability and accessibility big problems, insurance programme was largely absent in the observed area. Hence, patients are compelled to pay for their full hospital as well as medicine bills. In some municipalities like Paterwassugali Rural municipality, basic medicines are made available by the municipality through its budget to the health centres to provide medicine freely to the people to the extent possible.

5.3.3 Quality of Health Services

It was known that generally no permanent doctor is available from the government to the local health centres with problems in health quality. Because of severity of health snags of people added by affordability problems, municipalities like Thakre and Paterwassugali Rural municipalities are supporting health centres to hire MBBS doctors. Generally, neither buildings nor modern labs are available for even basic tests in health. Apart from absence of proper medicine for particular disease for even limited periods, largely people are compelled to purchase from private pharmacies at high prices.

5.4. TAXATION, BUSINESS/ENTREPRENEURIAL ENVIRONMENT AND EQUITY

As indicated briefly above also, focused group discussions (FGD) were organized with the representatives from businessmen community, enterprises and consumers' forums. Largely, the focus of discussion was on the business and entrepreneurial environment, domestic market conditions, exports prospects, consumer's hardships etc. particularly taking the implication of various taxes such as corporate personal income tax, capital gain tax, wealth tax, excise duty, VAT as well as local taxes such land and property tax into account. The major findings of the FGDs are presented below:

5.4.1 Inconsistent and Fragmented Tax Policies and Inequity

One of the major problems pointed out by the participants has been such that there is a big overlap in the taxation policy among the federal, provincial and local governments. The businesses and enterprises are compelled to pay taxes at local, provincial and federal levels simultaneously for the similar nature of taxes. Under the business tax category, taxes have to be paid to the local levels. Similarly, under the entertainment and advertisement taxes category, taxes have to be paid to the provincial governments. Paying VAT, excise and customs to the federal level is binding. More concerning part has been such that the taxpayers are compelled to pay tax multiple times while transporting goods from one place to another. Often tax rates are determined unilaterally by the tax officials without consultation with the stakeholders concerned. Largely, the ability to pay principle is ignored while determining the tax rates and tax bases. Added to this, the coordination among the agencies, including vertical layers of organizations, is reported to be almost absent. Ultimately, such a practice apart from negatively impacting the small businesses and enterprises, more pervasive adverse impact is felt by the consumers. As an offshoot, the tax policy often ignoring the likely implications on micro and small enterprises as well as consumers leads to increase the tax incidence on them enormously undermining the justices in the tax system.

5.4.2 Lack of Trust between Taxpayers and Tax Administration

Big complaint among the business community and entrepreneurs is that tax administration always follows negative approach to the taxpayers. The strictness or highhanded tactics pursued by tax officials while monitoring the transitions or reviewing the auditing tax statements is perceived as punitive rather than supportive or facilitating role by the business community and entrepreneurs. Indeed, such tactics are continuously distorting the environment for voluntary tax compliance and narrowing down the trust deficit between the taxpayers and tax administration. Non-acceptance of financial statements of the taxpayers in which tax deductions, loss statements, or loss carry forward etc. are included creates a kind of fear among the taxpayers. In the absence of tax awareness programs for the small and medium taxpayers, fear or trust deficit perpetuates.

Non supportive behaviour from the local government

As well-known, several tax and non-tax incentives for the micro industries are there by the federal, provincial and local governments. The aim has been to promote entrepreneurship in the country. The government provides a 7-10-year income tax holiday for micro enterprises, seven years for male-owned micro enterprises, and 10 years for a women-owned micro enterprises through the Federal Industrial Enterprises Act. However, at the practical level, the story is quite different.

Sarita Rawal, who is operating a micro enterprise in Surkhet District shared her experience during the discussion. She said that micro enterprises are now facing survival problems because of recent actions of the local tax authorities. According to her, local governments are trying to forcefully collect taxes of the last 18 to 20 years from micro enterprises despite the fact that local governments were established in 2017 after the promulgation of New Constitution 2015. Several other participants said that such problems are faced by almost all such enterprises operating in different parts of the Karnali province. This entails that such attempts are not only big hurdles to promote micro enterprises but also are highly objectionable from the tax justice point of view.

5.4.3 Higher Level of Informality, Illegal Trade and Tax Evasion

Amidst serious problems due to tax policies as well as tax official's behaviour, illegal trade or informal sector trade has been the biggest problem in general and especially shown in the border areas in particular. Such a problem came up more prominently in all FGDs. The multiple layers of compliance requirements and obligations have been major obstacles for the formalization of trade and businesses. Likewise, under-billing and non-billing practices have been most common across the entire value chains. Consequently, not only have there been huge tax losses emanating from tax evasions but also the domestic businesses and enterprises have suffered enormously due to unhealthy competition, non-transparency and unfair or illegal business practices.

Illegal/informal trade and suffering of textile industry –a classic example

Birgunj is the major import point from India as well as third countries. The business in Indian side of the border generally is established targeting Nepalese customers. Nepalese people, even from the Narayangadh visit the Indian border to buy the daily necessities in India. On Saturday, a large crowd of Nepalese customers can be found in the India border. People visit Indian borders even for the maintenance of motorcycles and cars.

Textile is one of the highly potential industries in Nepal. It is a strategic industry from the point of view of promoting employment, substituting imports and creating economy-wide spill overs through backward and forward linkages effect. The industry now is highly suffering from the informal and illegal trade. According to one textile industrialist who has long experience in such an industry, about 7500 million metre is required for the domestic consumption in Nepal. He told that only 50 percent is fulfilled from the domestic production as well as formal imports. Rest is imported from the informal channels. Consequently, a substantial amount of tax revenue and thousands of jobs is lost in addition to continued injuries to the domestic textile industries. This is an example of how informal and illegal trade is affecting domestic industries.

5.4.4 Complex Administration and High Cost of Compliance

During the discussions participants said that excessive paperwork, need of frequent reporting and registration of businesses and industries every year with multiple agencies is enormously raising the cost of compliance and doing business in Nepal. Amidst these, a high number of taxes and their complex procedures are posing bigger challenges to the business and industrial organizations. Even the micro industries are now facing several regulations from three layers of the government. High customs duty applied at the border point creates cascading effect leading to a practice of under-billing with distortionary effect on creating industrial environment. Behaviour of the tax officials and complicated compliance procedures are contributing to induce informalization to a greater extent in Nepal. Ultimately, such practices are backfiring the aim of extending tax bases augmenting revenue mobilization along with promoting businesses and industries among others.

CHAPTER 6

CONCLUSIONS AND WAY FORWARD

TRANSFORMING SYSTEMS FOR EQUITY AND INCLUSION

This chapter draws the key conclusions from the findings of the study and highlights the critical lessons for advancing social justice in Nepal. It outlines the systemic reforms required in taxation, public spending, public services, and social protection to address inequality and build a more inclusive and resilient economy.

The way forward emphasizes integrated policy action, accountable institutions, and people-centered governance to ensure that no one is left behind and development is sustainable, equitable and just.

CHAPTER 6

CONCLUSIONS AND WAY FORWARD

6.1 CONCLUSIONS

The social justice issue has received prominence globally especially after the broad consensus that the colossal rise in income and wealth inequality leads to generate or mount bigger crisis in the economies and aggravates conflict and instability in societies. The great financial crisis of 2008/09 and subsequent developments across countries are proving this. From the same token, the Kuznets hypothesis of a phenomenon of inverse U shape in equalities in early to advanced stages of development has now become evidently obsolete. Similarly, unlike the customary view justifying inequality to boost growth via higher saving and investment, it is increasingly being verified empirically that higher inequality retards sustainable growth and development. Amidst SDG's major thrust on no one is left behind added by intensifying worldwide Champaign, advocacy and pressures, there is a growing realization on the urgency of addressing swelling inequality problems more vigorously and effectively as recent G20 resolutions and UN initiatives on tax convention, among others, indicate.

Amidst such initiatives, evidence-based studies as well as country experiences indicate, that apart from a more inclusive and broader sustainable growth, highly progressive taxation as well as pro-people and more equity embedded public services and social protection policies are indispensable for addressing amplified inequality in societies. With a parallel threat of plutocracy dictating or influencing the policies across countries, it is also evidently clear that instead of isolated and piecemeal tactics, a comprehensive systemic reform approach with focus on overcoming institutional and structural obstacles, among others, will be essential to fight against inequality effectively. Distinctively, the present study has been guided by such premises and orientations.

The overall and sectoral growth pattern of the last one and half decade of Nepal examined in the beginning, added by cross checks on its inclusive character, reveals that the growth performance has been highly dismal while the quality has also been a big problem. It is apparent that such a growth pattern is regarded to be hardly ineffective from the standpoint of reducing poverty and inequality. Strikingly, the fluctuation in the non-agricultural growth rate has been wider than agricultural sector growth over the years revealing the surficial nature of structural changes and transformation of the economy.

A closer analysis shows that the fast rise in the share of tertiary sector value added over the years has taken place as a result of the fast decline in the contribution of subsistence farming dominating agricultural sector while deteriorating the share of productive and growth enhancing manufacturing sector. Notably, the expansion in the service sector has largely been accompanied by activities that have small value addition and low productivity growth. Added to such a trend, the contribution of health and education sector has also either stagnated or declined steadily overtime. Thus, from the standpoint of both the productive capacity enhancement and transformation, the growth phenomenon has resulted to be highly problematic. In this respect, there is more worry in the fact that the share of human capital in total wealth, in Nepal is among the lowest in that of the South Asian countries. Such a state of affairs is the outcome of poor or worsening quality of health and education services which, in turn, is making detrimental impact on labour productivity.

A more fundamental problem is that both budgetary and monetary systems have contributed very little to enhance productive capacity of the economy. Stagnation in the capital expenditure at low levels see dismal performance in the execution of projects and programmes, added to by very low absorptive capacity and escalation in wasteful and unproductive expenses. This has aggravated by budgetary problems in a systemic way which in turn has led to the continuous decline in Nepal's public capital stock since the mid-1990s. Likewise, private sector credit reaching the level of GDP, which is one of highest in South Asia, has played no discernible role to augment growth with quality commensurately. Importantly, there has been over concentration of rapidly expanded banking sector credit in limited households, groups and locations. Furthermore, the irony at the moment is that despite historically low levels of interest rate, the deposits in the banking system have piled up due to no or depressed credit demands from the private sector resulting in rising vulnerabilities in the economy. All these phenomena reconfirm that due to poor role of both fiscal and monetary policies, as the most important components of macroeconomic policies towards augmenting productive investment and expediting positive transformation of the economy, Nepal is confronted with low- and poor-quality growth trap.

As offshoots of the above features, labour market vulnerability is one of the biggest issues in Nepal. Very low levels of labour force participation rate, higher dependency on agriculture for livelihood, very high rates of unemployment in general and youth unemployment in particular, low wages and very high proportion of informal labour market predominated by unskilled labour force coupled with worse labour market conditions of women are its principal features. As such, the progress on SDGs 8 associated employment and decent work has been the lowest. Added to these, the utilization of adjusted human capital (UHCI) is the lowest in Nepal, in comparison to the South Asian countries' average. Some assessments show that a child born in Nepal today will only be able to utilize a mere 18 percent of their potential productivity as an adult. As the study findings reveal, if Nepal invests more effectively in its people and creates quality job opportunities, the GDP per capita could be five and a half times higher. With more than 2200 youths leaving the country by air route per day in search of job abroad, the gravity of the problem in the labour market is yet to be taken more seriously. Thus, both labour market conditions and utilization of human capital rates portray the likelihood of their limited role towards reducing poverty and inequality.

Notably, in contrast of the fear of a pervasive and adverse effects of poor-quality growth, economic fragility and, a highly vulnerable labour market conditions in the least, the consumption-based poverty and inequality estimates show that both have, on average, reduced considerably overtime. However, such estimates also show that certain occupational and other socio-economic groups such as wage earners in agriculture, households having more children, illiterates and farmers holding very limited farming land have higher poverty incidence than the national average. This is apart from larger poverty in some provinces such as Sudurpashchim, Karnali and Lumbini respectively. It should be noted that generally consumption poverty rates are associated with the over reporting of consumption. At the same time, for survival, poor households rely heavily on borrowings amidst no alternative earning opportunities. Interestingly, the average borrowing of poor households in Nepal has increased phenomenally over the years. For such a reduction, remittances, rather than internally driven development efforts, have played a key role. Early estimates based on NLSS of 2010/11 show that income poverty compared to consumption poverty remained higher by 17 percent. Though similar income-based poverty estimates based on the NLSS 2022/23 are not available, various features of the economy including numerous adverse factors noted above indicate the little possibility of reduction in income poverty after 2011 like the reduction shown by the consumption poverty estimates. As is well known, during this period, people had to suffer enormously due to devastating the Nepal earthquake and the global COVID-19 pandemic.

Similar problems are encountered when inequality trends are observed, as for such estimates a consumption approach is followed. With some fluctuations, consumption-based estimates show a continuous decline, which indicates that inequality in Nepal is moderate and is not a big problem. However, a more exhaustive early income and wealth-based estimates on inequality made by the global inequality lab on wealth, demonstrate that both are very high in Nepal in comparison to global estimates. The global inequality lab's latest estimates show that 10 percent of wealthiest people in Nepal capture around 58.7%percent of the country's total wealth. This evidently proves that inequality has already emerged as one of the biggest problems in Nepal.

Some cross checks of the recent estimates and proxy indices analysed indicate that income as well as wealth inequality might have remained persistently high. First, the saving rate estimated based on the income and consumption data by decile group of NLSS 2022/23 shows that such a rate is negative among the highest decile group as opposed to positive and relatively higher saving rate among the lowest decile group. This simply means that the income of the higher income group is highly underestimated and that of the poorest decile group which is highly overestimated in turn leading to the underestimation of income inequality to a greater extent. Second, though deeper investigation will be needed, the accumulation of the foreign exchange reserve and its contributing factors together with higher national saving rate added to by higher retained earnings, enjoyed by limited households or groups, indicates the possibility of higher saving induced inequality. Third, the national accounts estimate show that there is continuous decline in the share of compensation of employees compared to the operating surplus of the proprietors in recent years, which is a strong indicator of rising inequality. Fourth, the estimated loss in overall human development index due to inequality adjustment also additionally indicates the likelihood of perpetuating higher inequality in societies amidst women population surpassing male population. Thus, various related indicators also portray the possibility of higher income inequality in Nepal. In this context, how taxation policies as well as government spending on public services and social protection programmes have been pursued and advanced becomes highly important.

When overall tax structure, features of the individual taxes and tax governance system in the light of tax policies, is closely reviewed and analysed; large deficiencies and gaps are found in the Nepalese tax system, more so from equity perspectives. Out of the 90 percent of the total revenue contributed to by the taxes, the share of the indirect tax is still 70 percent. In that the contribution of VAT is predominant, which is a highly regressive tax. Added to this, there is a concentration of tax over base because of larger areas of the economy being exempted from the indirect tax net. More worry is that compliance gap of the VAT is almost 50 percent. Likewise, almost 10 percent of imports is totally exempted. Because of large rebates and concessions on imports, the effective average import tariff of Nepal is one of the highest. At the same time, at least one-third of current revenue is lost due to tax incentives provided in an adhoc manner. The predominant share of the informal economy together with a common practice of under-billing and non-billing added by very large size of illegal or unrecorded trade raises larger questions regarding in the effectiveness of the entire tax system. Along with these, poor coordination and unfriendly attitudes of the tax officials is compounding a very negative business and entrepreneurial environment in the country. Imposition of taxes in multiple places while transporting goods as well as tax overlaps among the three tiers of government added by a tendency of imposing multiple taxes increasingly in an adhoc manner especially by the local levels have compounded tax governance and equity problems simultaneously. So much so, a larger chunk of tax revenue is sacrificed in the name of a flat tax rate on capital income, capital gains, personal tax exemption and final withholding tax. The equity aspect is largely absent in such direct taxes, amidst the highly regressive nature of the indirect taxes. Thus, in addition to huge revenue loses or revenue foregone, tax incidence is very high among both poor and low-income people, as well as small industries and businesses in Nepal, with larger implications on both income and wealth inequality.

The overall findings of the focus group discussions provide more insights on the major features of the tax system. In the focus group discussions major deficiencies highlighted, among others, include inconsistent and fragmented tax policies, no attention on equity dimensions, large trust deficits between the taxpayers and tax officials, higher level of illegal trade and tax evasions, a thriving informal economy, a complex and non-transparent tax administration, as well as very high cost of compliance. These further corroborate that the Nepalese tax system encompasses serious systemic problems on multiple fronts.

The government expenditure trend of the last decade shows that there is hardly any coherency between the commitments made in the Constitution and the enacted acts and actual priority attached to the public services like education and health. Indeed, in recent years, there is a continual decline of government spending share in both education and health services, as opposed to phenomenal rise in the expenses on administrative services and social protection. One typical phenomenon is that when there were upswings in both revenue and total expenditure as a share of GDP there were no noticeable growths in these services but when deceleration in both revenue and total expenditure occurred, these services suffered the most. Consequently, compared to countries with similar income levels, Nepal invests significantly less per capita in education and health, as a share of GDP.

Truly, a rapid expansion in terms of access to education, has taken place in Nepal over the years. As offshoots, there has been a fast rise in the women literacy rate along with a rapid increase in the enrolment of girls in schools over the years. However, the progress is still highly skewed added by many structural problems. Firstly, the gap in the adult literacy rate between male and female is still very high. Secondly, the completion rate of students drops in terms of the lower to higher level significantly. Thirdly, a larger disparity across provinces persists. Fourthly, a larger proportion of children who fall in the school age population are still out of the school. The data by wealth quintile further shows that the percentage of never attended school children is very high among the lowest wealth quintile group. Fifthly, quality of education in Nepal is very poor as children learn very little while in the school. On the assumption of a student's 12.3 years of schooling, on average in Nepal, effective schooling is estimated to be 7.2 years after adjustment to the learning levels. The UN education quality index for 2025 has been derived to be 0.50 which is less than the index computed for Bangladesh and India. Importantly, large learning disparities are also noticed when gender, provinces, education levels and income quintiles are taken into account.

Amidst these tendencies, latest NLSS survey results show that large amounts are spent by the poor people in the children's school education, despite the declared policy of free education up to the secondary level. This is indeed a major area of concern.

The focus group discussions carried out reveal the severity of problems in the education system at the local level. As pointed out during the discussions, not only are the problems of quality pervasive, but also both access and affordability in education present themselves as equally large problems for the poor and low-income families. It was pointed out that in different pretexts parents are compelled to pay larger amounts to the schools each year. The other major problems highlighted during the discussions include lack of or poor infrastructure, including modern infrastructure such as ICT infrastructure, shortage of teachers more so of technical teachers, scarcity of resources added by distribution thinly, less qualified teachers, outdated or poor learning methods, higher dropouts, gender disparities and poor governance including resource misuse amidst highly politicized management. It was also pointed out that quality divide between public and private schools poses a threat of perpetuating inter-generational inequality as children of the poor family cannot afford to enrol their children in the private schools. Based on the discussions it became clear that, amidst low priority, lack of transformative strategies and policies have been major hindering factors towards better access to and quality of education at the school level. It is also noticeable that quality problem is equally serious at the higher educational level.

Noticeably, a rapid expansion in the access to the health services has also taken place in Nepal leading to, among others, a continuous rise in life expectancy at birth and a steady decline in the maternal mortality as well as under-5 mortality rates. However, the recent trend shows that there is continued increase in both non-communicable and communicable diseases, apart from the persistence of larger quality health services problems. The health facility tiers compounded by inadequate health service coverage do not meet the government's minimum health service delivery scores. As a result, quality of health services across various categories of hospitals is low with Nepal remaining at the bottom of the average among South Asian countries. Similarly, due to the slow progress in the implementation of the National Health Insurance (NHI) programme, improvement in the access to healthcare and financial protection still remains a big problem. As an offshoot, Nepal's capacity to implement international health regulations remains low compared to other major South Asian countries. Moreover, a large gap between the wealthy and the poor population in terms of access to health services continues.

A better picture of the status of health services emerged during the focus group discussions. The major issues raised during the discussion include budget shortages, scarcity of skilled manpower, lack of owned building, poor infrastructures, very limited supply of medicines and lack of or outdated test labs and instruments, among others. The absence of health insurance services in health centres and hospitals due to scarcity of funds was also pointed out to be a major problem for improved access of poor people to the health services. It was also reported that only for three months the medicine is made available in the health centres and hospitals for the distribution to the needy patients. Some participants sharing their experience also told that apart from buying medicine from the private pharmacy they have to pay a large amount for tests in government health centres and hospitals. Thus, despite the declared policy of free access to primary health services added by macro picture showing progresses, people in general and poor people in particular at the grass roots, are still deprived of health services to a greater extent which is a serious problem.

Despite of a phenomenal rise in social protection related spending, progress on the coverage has been slow and unsatisfactory. So far, effective coverage of income support scheme has remained below 19 percent. Accordingly, the coverage of cash support scheme remains far below the regional and global levels. Also, under the contributory scheme, the progress remains highly disappointing. Apart from very low distribution compared to accumulated Social Security Fund over the years, coverage of informal workers is highly negligible amidst predominance of the informal labour market. On the other hand, no social protection coverage is in place to those who are affected by abrupt shocks emanating from natural calamities, disasters and pandemic, among others. Though as a result of wider criticism on poor coverage, overlaps, misuses, inefficiencies and ineffectiveness of social protection schemes; long commitments to pursue an integrated approach has been made. There is still little clarity on its modality and ways to enhance the effectiveness of its implementation. Amidst mounting resource constrains and deepening sustainability problems, continuity to such a scheme following universal approach has become highly questionable.

6.2 WAY FORWARD

6.2.1 Beginning a System of Measuring Income and Wealth Inequality Robustly

Taking into view the higher inequality instigating a threat of deepening economic as well as social crisis, there is a need of measuring income and wealth inequality periodically in a more robust way as consumption-based estimates do not represent true inequality situation in the country. The periodic NLSSs can be used to extend the data coverage for such purposes.

Along with institutionalization of such measurements, the justice agenda has to be embedded in the policy making and execution processes more sincerely and effectively. This has to be guided by the aim of replacing customary or tokenism type practices often employed to address most unrelenting inequality issue.

6.2.2 Navigating Transformative Pathways to Development and Prosperity

Transformative pathways require multipronged strategies to get rid of pre-existing or contemporary structural and institutional bottlenecks together with the revamping of fragile, non-responsive and non-functional governance structures that hinder inclusive, equitable, resilient and sustainable development in an accelerated way. This means, a fundamental shift in the development strategy has to take place to be consistent with transformative development pathways. Such a strategic shift has to be comprehended in a way that it simultaneously helps in unlocking both the supply and demand side constraints of the economy. Understandably, such a path will facilitate in unleashing the forces and resources of development, essential for bringing breakthroughs towards rapid advancement.

On the supply side, strategies for bringing transformative changes and reforms in a number of areas will be needed. First, strategies to ensure improved access to and quality of health and education with a focus on bringing gender parity up to higher education. This includes providing, at least, free primary health services across all areas of the country Second, massive development of semi and skilled manpower linking with market demands which will be essential to overcome the skill mismatches and, in enhance the employable and entrepreneur capability of the workforce. The formalization of labour should be an integral part of it. Third, development of entrepreneurial capacity with a priority on small scale industries as well as emerging industries in areas such as IT and minerals. Further inducement towards innovation and strengthening of institutions for smooth functioning of the market largely following entrepreneurial eco-systems, will be vital. The focus should be on bringing breakthroughs in a way that help remove institutional, structural and policy hurdles leading to rapid industrialization from the grassroots. Largely, lowering operational costs and boosting competitiveness will be key towards that end. Fourth, overcoming the infrastructural gaps by assuring that quality needs are highly prioritized for which deep-rooted structural reforms are given priority towards expediting project implementation preceded by preparedness robustly. Fifth, strategic focus has to be on integrating domestic market, as well as intensifying linkages with international markets through regional and global supply chains. Sixth, maximizing the advantages of the demographic dividend has to be one of the central parts of the strategies. Finally, inclusion and equity dimensions should be an integral part of the overall strategy. All these should be strategized in a way that it helps to expedite the productive capacity of human resources and the economy.

On the demand side, strategies have to be evolved and concretized in ways that sectors already having competitive advantages along with sectors emerging which have high potentials, are transformed rapidly to ensure that they become the major catalysts or drivers of the economy. As well established, sectors such as agriculture, manufacturing, energy and tourism are competitive and promising. Similarly, IT; some mining-based industries; and specialized health and education services have great potential. The focus ultimately should be on technology-driven industries. However, unlike in the past, it is necessary that both intra and inter-sectoral transformative strategies are pursued more vigorously by embedding inclusion and equity aspects in ensuring that production and productivity enhancement in each area takes place in an equitable and sustainable manner. The formalization of the economy should be a part and parcel of such transformation driven strategies. Strategically, consumption, investment and export demands should be designed and reoriented in such a way that they take distributional dimensions into the especial account which, in turn, along with facilitating market expansion, could ensure a sustainable development discourse more effectively.

6.2.3 Aligning Macroeconomic Policies with Transformational Development Discourse

The foremost necessity is that the macroeconomic policy route grounded on the neo-liberal orthodoxy is overhauled to fully align with the transformative development discourse outlined above. Needless to add, the central focus of such an orthodoxy has been on economic stabilization for which pro-cyclical macroeconomic policy route is advocated in a mechanistic way by undermining deep rooted structural and institutional problems. The fragile nature of the economy and the continued looming crisis in the economy can be linked with such a deficient policy approach, to a great extent. For alignment, it is necessary that the macroeconomic policies in which fiscal and monetary policies are the principal components contribute to raise productive capacity and transform the economy simultaneously which, in turn, through demand and supply side effect could help bringing macroeconomic stability in a more balanced and sustainable way.

Following the above route, first of all it is necessary that the externally imposed superficial fiscal balance rule is replaced by a new fiscal policy rule, under which it is conditioned that fiscal balance is determined endogenously. Accordingly, factors driving the expenditure growth and its pattern, as well as revenue structure and its performance is examined extensively in the beginning, by taking institutional and structural factors, among others, into account to ensure that in addition to maintaining stability, the development agenda is not compromised as in the past. At the same time, fiscal policy should directly support or incentivize private sector investment in the productive areas besides ensuring allocative and operational efficiency of the government resources.

More specifically, it is utmost necessary that the highest priority is given on revamping the budgetary system. In that direction, a move to overhaul the MTEF is a prerequisite as the budgets are predominantly influenced by it. As such, input, output, outcome and impact criteria have to be embedded in its framework to ensure efficiency and other set criteria in resource allocations at projects/programmes and fixing sectoral priorities, accordingly. It is also necessary that both equity and employment dimensions are embedded in as a part of such criteria. Though there are certain positive moves through project banks, neither is there a full compliance nor has it been able to address the perpetuated problems inherent in the framework, which has now become ritualistic. The above criteria if followed strictly will facilitate to bring a qualitative dimension, while fixing fiscal balance targets derived through endogenous processes. This will enable to institutionalize performance based budgetary as well as monitoring and evaluation systems simultaneously which in turn could become a catalyst to overcome the deep-rooted problems in the budgetary system. More broadly, the MTEF needs introduction of a robust framework to make the three-year projections more realistic and predictable as it makes considerable immediate impact on budgetary, public expenditure and financial management.

In parallel, it is also necessary that a Medium-Term Budgetary Framework (MTBF) is developed and institutionalized at the ministries level which can facilitate to make the MTEF more robust by taking, among others, sectoral perspectives into account more closely.

Similarly, a system of formulating a Medium-Term Revenue Framework (MTRF) has to be institutionalized at the NPC for replacing the adhoc practices used in resources and expenditure projections by the Resource Committee at the NPC for the budget and MTEF. This will enable making projections more realistic while at the same time aid in identifying the major reasons behind the wider gaps between the projections and realization on both the resources and expenditure fronts. Such a framework will also enable us to assess more closely why unproductive expenses have increased phenomenally over time at the cost of capital expenditure. It will also help to gauge the role of the tax policy on determining tax structures besides, facilitating the identification for the reasons of the poor alignment of foreign aid with set priorities. It will further delineate factors contributing to the worsening absorptive capacity of foreign aid. As is well known, only institutionalization of such a framework can enable the circumstances to embark on a path to systemic reforms in a continuous manner.

Along with such initiatives, systemic reforms, as indicated above, through introduction of performance budgetary system will be necessary simultaneously to replace ongoing expenditure centric approaches and practices which violate many mandatory provisions laid down in the FPFR Act 2019, among others. As a part of revamping, the first and foremost priority has to be given to drastic cuts in wasteful expenses together with institutions and structures that are instrumental for the resource drain. As offshoots, the practice of allocating billions of rupees to government bodies, committees and boards etc. as well as unproductive activities has to be stopped for larger savings of resources required for a stagnated capital budget as well as for the neediest areas such as health and education. Importantly, it is utmost of utmost necessity that a strong criterion is developed and implemented to make a systemic breakthrough towards reversing a phenomenon of raising the level of current expenses, markedly every year without justification. At the same time, it is highly essential that restructuring and reprioritizing of the capital budget is carried out massively by terminating unviable and resource draining projects along with ensuring timely completion of strategically important projects in an effective and efficient way. This will give enough space to introduce many strategically new projects in the budget at the beginning. More broadly, allocative efficiency criterion has to be forcefully implemented as a part of institutionalizing performance budgetary system.

For enhancing operational efficiency and timely implementation of the budgets, the gap between capital budget estimates and actual expenses must be bridged while bringing about effectiveness in the public expenditure management system, besides following set rules. The loopholes must be checked through revisions in the rules and regulations through a system of punishing rule violators. All cumbersome procedures, including long delays in timely procurements, have to be addressed firmly. In these respects, it is necessary that along with the streamlining of the institutions, responsive and accountable system have to be institutionalized and strictly followed across all entities that are associated with budget formulation and through implementation processes. In parallel, the role of the oversight institutions has to be strengthened distinctly.

Highly importantly, there is an urgency of introducing Medium Term Performance Monitoring Framework (MTPMF) as a part of performance budgetary system to make the institutions and assigned personnel at different levels to be responsive and accountable. This will help to enhance efficiency and effectiveness in the system of implementation in the budgets.

As a part of macroeconomic policy, monetary policy is crucial. As bank credit to the private sector has approached the size of GDP, monetary policy has become increasingly influential on the economy. However, the direction and efficacy show that a big shift in the monetary policy for its role and effectiveness is necessary. In this respect, the foremost need is the explicit recognition that in countries like Nepal monetary policy has to play a decisive role in boosting growth and employment which in turn could additionally contribute to the stabilization of prices and maintain a balance of payments more sustainably. Accordingly, the policy focus has to be on expanding the banking sector lending towards productive areas more aggressively with added focus on diversifying the loan portfolio. The structural problems constraining credit demand has to be addressed with priority by discarding the classical view that supply creates its own demand. The deprived sector lending as well as concessional or subsidized loan facilities to the female entrepreneurs have to be expanded and made result oriented. Steps to divert more financial resources into the backward areas have to be taken to avail along with credit facilities to the needy. As an offshoot, expanding financial inclusion covering ownership of payment, savings and credit etc. will be crucial for socioeconomic transformation from the grassroots. Such a policy has to be augmented simultaneously and rapidly by expanding access to digital technologies. Country experiences show that financial inclusion contributes to fostering economic growth and development, including employment by strengthening financial resilience among households and businesspeople.

The pegged exchange rate system has to be reviewed with priority which has already been too late. These corrections are required as it will be directed towards enhancing export competitiveness, minimizing vulnerability in the external trade and payments front and augmenting industrialization, In this respect, a policy of gradual adjustments can be pursued to correct misalignment in the exchange rate so that likely adverse near-term effect emanating from abrupt shock could be minimized.

6.2.4 Augmenting Revenue Mobilization and Enhancing Justices in the Tax System

The major policy focus should be on revamping the tax system in which the highest priority has to be given to changing the tax structure from indirect to direct taxes, in which equity dimension has to be taken into especial account. This demands rapid expansion in the tax bases as well. This will help in increasing the elasticity of the tax system markedly, creating a necessary condition to enhance sustained growth in revenue mobilization in a more automated way. As an offshoot, the large tax evasion practices have to be controlled effectively which will help to collect extra trillions of Rupees. For the protection of the industries from negative consequences, the cascading tariff and revenue structure has to be thoroughly reviewed and changed. A policy discourse of homogeneous tariff structure discouraging high value added, employment generation or import substituting industries have to be revamped. More progressivity in the income tax system will be needed. In the process, expediting the formalization of the economy is a must to check unauthorized trade which will help to mobilize additional billions of Rupees. In this context, digitalization of tax systems and use of data analytics to combat evasion will be needed. The tax system must be taxpayer friendly and has to create and boost business and entrepreneurial environment with an adequate level of playing field given to the micro and small enterprises located across the country. This was the message obtained from stakeholders during the focus group discussions. More broadly, the tax system has to be comprehensive, efficient, business and enterprises friendly, as well as more equitable. Largely, the ability to pay principle has to be the main bases of taxation policies.

More particularly, tax rebates and tax incentives provided under the indirect taxes needs complete review and rationalization to ensure that the tax incentives best serve the rapid industrialization of the country while contributing to the transformation of the strategic sectors, instead of being the means of resource drains and misuses. As an offshoot, the tax compliance gap has to be reduced to zero. Similarly, a rapid expansion in the VAT bases will be needed along with review on the threshold. Excise duty especially on alcoholic, tobacco, sugar-sweetened products and carbon-generating goods and services should be restructured, taking externalities into account. At the same time, it will be appropriate to levy a single excise by abolishing several taxes. Now the time has come to consider reintroducing the wealth tax system by ensuring its progressivity. In the beginning, it can be introduced among top 0.5 percent wealthiest group. Equally importantly, the capital income, capital gain, and other income-based taxes should be restructured made progressive for ensuring justices in the tax system, among others.

As a specific part of tax incentives to the industries, the time has come to review and restructure for ensuring that such incentives contribute genuinely to promote industries and enhance their competitiveness. A better monitoring system has also to be an integral part of it. The experience shows that the other facilities including enabling environment are important to enhance competitiveness and secure markets. For instance, reduction in the logistic costs could raise competitiveness on industries and businesses in a big way. Given the predominance of micro and small enterprises in the total industries, as indicated above also, policies creating level playing fields to them will be highly important for augmenting industrialization in the country and generating employment in a large scale.

As a part of formalization, revenue base expansion and rationalization of tax system, low compliance requirements, automatic registration, expansion of social protection, low customs duty in general and raw materials in particular, open border control, better enforcement and compliance on the part of the tax officials will be essential which will also help to contain illegal trade and businesses markedly.

Based on the closer analysis, it is clear that there is a big scope of strengthening both horizontal and vertical equity in Nepal. For this apart from revamping the tax system which considers tax justice to be an integral part it, a transformative approach in the overall governance system in general and tax system in particular has to be introduced and strengthened with high priority.

Based on the proposed overhauling in the tax system, there is strong possibility of mobilizing additional revenue in the tune of Rs 500 billion in a year, while at the same time ensuing justice in the taxation system.

6.2.5 Ensuring Access to and Quality of Public services

Along with maximum priority on enlarging investment in education and health as per commitments, added on by priority on lagging provinces, various bold measures with focus on addressing pre-existing and contemporary impediments will be needed in multiple fronts and should include:

Education

The foremost priority has to be given on enhancing quality education in schools. The teachers need to sincerely ensure that students learn the subject matter perfectly and gain intended textbook knowledge. Besides institutionalization of a system improving curriculum in certain time intervals, wider reforms in scholarships as well as free textbooks and uniform distribution programme will be needed to enhance their effectiveness. Importantly, a system of effective regular evaluation system will be essential to get feedback on students' learnings, to check whether or not free education is ensured and to identify gaps and weaknesses as a guide for future reforms to ensure better delivery, among others. Such reform measures will help to considerably reduce dropout rate. These are some of the major messages from the focus group discussions.

There is a need of bringing effectiveness in gender responsive policies in which girl-friendly facilities such as safe toilets and menstrual health resources are given priority. Similarly, apart from enlarging community awareness campaigns for discouraging early marriage, there is need of widening the gender responsive budgetary system with a focus on its effectiveness. Similarly, conditional cash transfers as well as girl-focused scholarships programmes should be launched, especially in areas where girl's enrolment in schools is very low.

Similarly, targeted additional support programme should be launched among marginal caste and poor households to check dropout rates of their children and ensure their continuity up to the, at least, secondary level education.

In parallel, high priority has to be given to develop infrastructure in schools where such facilities are lacking. As a part of this, sufficient learning materials have to be provided to the teachers. The internet and other IT related facilities have to be provided to all schools with special focus on remote and lagging areas.

One of the areas needing high priority is the fulfilment of teacher's quota in every school with added attention in subjects such as English, Math and Science. In parallel, there is a need of merging schools aggressively throughout the country which will help to reduce overall cost significantly besides fulfilling the quota in schools to a greater extent. In addition, school networks for better alignment with current and projected enrolment patterns be strengthened which could facilitate to augment school mergers in a more scientific way.

Equal priority has to be given to provide trainings to the teachers regularly with focus on ensuring their professional development. Training also should be provided to the teachers to enable them to deliver remote and blended learning to the students to minimize education losses emanating from closer of schools due to disasters or other abrupt shocks. Importantly, a system of incentives through promotion and expansion in faculties has to be institutionalized. Added by depoliticised management, school leadership should have greater decision-making power.

Priority also to be given to developing a more resilient education system by strengthening the education system's ability to withstand and recover from natural disasters and other disruptions. In this respect, school infrastructure facilities need expansion to make them disaster resilient. Similarly, a system of mobilizing funds has to be established to create temporary learning centres during emergencies. Due attention also has to be given to develop and promote e-learning modules, digital plat forms, and offline educational materials for continuity to the education during sudden school closures caused by pandemics and natural disasters.

There is also need of more clarity on the role of the local level, provinces and central government as per the responsibilities bestowed by the constitution to each level.

To enhance the quality of higher education and discouraging outflow of students abroad, a number of reform measures have to be expedited in higher educational institutions. Towards that end, curriculum updating periodically on par with the best universities abroad, developing faculties substantially, institutionalizing research and enhancing quality as well as improving governance system markedly should receive priority.

Health

The foremost priority has to be given on improving the access to and quality of health services to the people of remote and backward areas as they are still deprived of such facilities despite declared policy of providing, at least, free primary health services to all. In this context, equity should be a priority in distributing resources on health in order to ensure that high priority is given to increase healthcare providers to population ratios in the areas where both communicable and non-communicable diseases are on the rise.

Likewise, it is highly necessary that everyone gets free check-ups, supply of medicines and full treatment throughout the year in areas where heath centres and hospitals are already there. Equally importantly, regular monitoring and review on the effectiveness of health services programme will be extremely important to ensure that people are not deprived of health services facilities, without compromise on the quality. Besides quality assurance, it is also necessary to monitor that the treatment of a patient is made up to the full recovery period without any charge in different pretext.

A high priority has to be given on expanding the health insurance programme to cover the entire population within the shortest period with equal focus on raising its effectiveness markedly. Under this, a free insurance scheme has to be ensured to those who cannot afford to pay the insurance premium. Momentarily, the practice of avoiding treatment to those who have not come within the health insurance programme must be strictly checked.

There is also need for more clarity on the role of the local level, provinces and central government as per the responsibilities bestowed by the constitution on health services to each level. This will also be essential for improving delivery and accountability at each level.

Launching of special programmes to reduce stunting rate will be needed with exclusive focus on the areas where stunting rates are disproportionately high, having severe adverse impact on the poorest population.

Strengthening the maternal-child health services accompanied by targeted nutrition programme to the children will be required in an effective way by focusing on poor and vulnerable population.

Priority should be given on reducing increased non-communicable diseases which will help to lessen the financial burden to the family while it also raises productivity of the workforce. Focus has to be on preventive care system, early diagnosis and timely management. In parallel, awareness campaigns have to be carried out more aggressively at the local level with focus on the importance of healthy lifestyles. In that the role of balanced nutrition, regular exercise, and non-use of tobacco and alcohol can be highlighted. Innovation in disease management as well as expansion on the outreach through digital health solutions through telemedicine and mobile health apps will need due attention.

Strengthening the resilience capacity of the health system is essential to prevent, detect, and respond to disease outbreaks and other emergencies. As an offshoot, expansion and strengthening of disease surveillance networks including sentinel sites will be required to improve early detection. Upgrading of laboratory networks to enable timely and accurate diagnoses with focus on enhancing capacity of local governments for emergency preparedness will be needed. In parallel, maintaining of stockpiles of essential vaccines and medicines to ensure their availability during the emergencies will be equally essential. Likewise, provision of retrofit health facilities for resisting natural disasters such as floods, landslides, and earthquakes will also be required besides providing training to the healthcare staffs.

6.2.6 Introducing Comprehensive Labor Market Policy and Augmenting Productive Employment

Along with a rapid generation of employment through positive transformation in the economy in the line noted above, a comprehensive labour market policy contributing to added massive productive employment will be needed, in which coordination with the private sector as its catalyst role will be vital. To overcome the deepening labour market vulnerability and enhancing equity, apart from direct employment through qualitative higher, targeted and more effective employment programmes correcting the past deficiencies will be equally necessary.

As is well known, labour market policies are the key for improving the functioning of the labour market in countries like Nepal where structural deficiencies and pre-existing vulnerabilities including high level of informal labour market persist. Therefore, a comprehensive labour market policy should be evolved with clear cut policies that could contribute more effectively to raise labour force participation rate, protect workers' rights, enhance workforce capability to employment, formalize the labour market, augment decent employment, support most vulnerable work force seeking employment and strengthen governance system including regulatory system.

As an offshoot of above, formalization of the labour market and raising of the labour force participation rate with a gender focus has to receive high priority. An automatic system of online registration of enterprises and firms may enhance formalization processes greatly. Similarly, certain incentives through training and skill development programmes as well as extra facilities through financial inclusion and access to credit programmes may help to enhance formalization of the labour market considerably. Incentives through tax rebates and other concessions may encourage firms and businesses to enter into the formalization processes. Prompt tax paying or clearing processes through digitalized systems more effectively aid to prevent hassles or cumbersome procedures and curbing malpractices may help to augment formalization process further. Rapid expansion of social protection coverage may help to expedite formalization process noticeably which may also help to raise the labour force participation rate simultaneously.

Highly importantly, a comprehensive but robust roadmap aiming at least 4 lakh employment generation in a year is needed in which after assessing the growth induced employment, targeted self and wage employment is ascertained more genuinely. For instance, if qualitative growth of 6.5 percent in a year is assured through progressive transformation, this may enable to generate around 2.5 lakh employment in a year. This means, generating of 1.5 lakh self and wage employment per year has to be generated through special programme. Capability enhancement of the work force has to form an integral part of entire employment generating programme.

As an important part of special targeted programme, there is a need for the revival of 100 days' employment programme by restructuring it to overcome the past lacuna and deficiencies. This should be launched in a coordinated way by all three tiers in cooperation with the private sector. The focus should be on generating demand for employment, which has received less attention in the past experiments. The inclusion of employment dimension in the appraisal and selection of projects and programmes with focus on labour use and its intensity may enhance the scope of generating additional employment at all three tiers. A system also has to be strengthened to ensure that required semi and skilled manpower are supplied by CTVT and other various training centres at par with rising demand. The startup and other more specialized youth entrepreneurship development and employment generating programmes could also be part of this targeted programme.

Along with reimplementation of 100 days' employment programmes, all the small employment programmes spread across different ministries or entities should be completely transferred to the local levels. While doing so, the capacity enhancement of local levels has also to be increased markedly.

The vocational and other short training programmes carried out by different ministries should be implemented through one window system massively linking with the market for standardizing and avoiding duplication. Most of such programmes should be shifted to the local levels. As a part of such programmes, unskilled youth, particularly those not in employment, education and training should receive priority in which focus should be on gender dimension. In this respect, collaboration with private sector stakeholders to ensure demand-driven training programmes will be important. In these programmes, the priority should be on addressing the skill mismatch problem in the market in which training programmes should focus on supplying specific low or semi-skilled manpower in specific industries and businesses that predominantly employ workers from abroad.

For enhancing employable capacity and generating employment from the grassroots, institutionalization and strengthening of employment service centres at the local level will be essential. These centres can play a decisive role for the school students for facilitating them to move to the labour market, which could be very helpful to jobseekers including youth and returning migrants. Similarly, these centres could be mobilized to promote micro-enterprises development and self-employment generating programmes. In addition, the centres could be entrusted with the responsibility of providing short-term employment driven programme for local unemployed people to be engaged in local infrastructure and other development programmes.

6.2.7 Targeted Social Protection and Full Coverage of Vulnerable Population

First of all, it is necessary that as already committed, an integrated framework has to be evolved to prevent misuse and enhance effectiveness of the programme. Toward that end, it is essential to clarify that how the integrated policy will be implemented in a unified way as the institutional arrangement and mechanism of distribution of cash transfers and social security fund is entirely different. With clarity, an institution can be authorized and made accountable to oversee policies, programmes, and systems for better coordination, efficiency, and effectiveness.

In case of cash transfer programme, full authority has to be given to the local levels to check misuse and bring effectiveness in the programme. At the local level, very prompt delivery system has to be strengthened through digital payment or digital cash management system. A policy of productive use of cash transfers can also be introduced through offering certain incentives as has been the case in many countries.

A high priority has to be given for expanding social insurance schemes rapidly to fully cover both formal and informal workers within a specific time period. Given very insignificant progress, certain conditions may be imposed under which employers are compelled to enlist their companies or firms in the Social Security Fund. At the same time, a special support programme has to be worked out and implemented in which informal workers who are unable to contribute are not left out from this scheme.

It is also necessary to introduce more systematic policy of cash transfer to cover those who are badly affected by the abrupt shocks like disasters and pandemic.

Importantly, the time has come to introduce targeted cash transfer scheme with rising threat of unsustainability due to mammoth rise in claims for this amidst mounting resource crunch problem. Apart from rising demand for other pressing areas, the swelling debt servicing depicts the looming crisis in the fiscal front. Therefore, the universal scheme should be replaced by a targeted scheme in which only vulnerable population is covered in it.

6.2.8 Transforming Governance System, a Must

For making institutions and different entities efficient, responsive and effective, transformation of governance system is a must. Towards that end, foremost necessity is revamping government institutions through drastic cuts in overburdened bureaucratic size and abolishing unnecessary and duplicative structures or tiers. The entire focus should be on enhancing the quality of institutions markedly in which capacity building has also to be part of the transformation. Strengthening of a true performance-based system has to be an integral part of this. These, inter alia, will need bold steps to smash state captured practices that have been perpetuated as a result of too much politicization of constitutional bodies and bureaucratic apparatus over the years. As an offshoot, a very effective mechanism to ensure both horizontal and vertical coordination will be needed. Forceful reward and punishment system should be part and parcel of such bold steps.

As an integral part of above, the regulatory system has to be revamped and strengthened to ensure the prompt quality services, control institutionalized rent seeking practices and exploitation of consumers and service receivers, among others. For a breakthrough, digitalized system has to be institutionalized which may contribute immensely to make the governance and delivery system efficient and effective. Institutionalization of a strong and effective regular reporting and progress monitoring system will facilitate those processes further.

Governance system has to ensure through bold systemic reforms including legal reforms that the misuse of authority, policy and day today corruption and rampant rent seeking practices are fully controlled. In this respect, a transparent and accountable governance system is a must.

There is a need of introducing strong measures to control market captured practices which have flourished over the years. Cultures such as cartel, syndicate and other forms of such malpractices rampant in product, factor and financial market has to be fully controlled through creation and strengthening of, among others, market institutions for promoting fair competition and smooth functioning of the market. Above all, there is a need of controlling bourgeoning parallel economy perpetuated through hundi and other illegal means over the years.

There is also a need of enforcement of a digitalized system in which the wealth and property of the people in the power, leadership in the political parties and civil services is recorded and updated annually and then disseminated which would be highly effective towards transforming governance system.

In parallel, role and effectiveness of oversight institutions including civil society institutions has to be enhanced markedly. In this respect, a system has to be strengthened in such a way that the strong measures proposed or recommended by the oversight institutions are taken as benchmarks for prompt actions.

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