

# NATIONAL SERVICES POLICY REVIEW



# NEPAL



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## FOREWORD

For many years, UNCTAD has been emphasising the importance of developing countries strengthening and diversifying their services sector. Since 1990 the share of services in GDP in developed countries grew from 64 percent to 72 percent. By contrast, in developing countries the share of services in GDP grew from 46 percent to 50 percent, with services accounting for only 35 percent of formal employment. These figures suggest a large un-tapped potential for developing countries to advance the development of their services sectors.

The Accra Accord states that “The services economy is the new frontier for the expansion of trade, productivity and competitiveness, and for the provision of essential services and universal access.” The Accord calls upon UNCTAD to assist developing countries and countries with economies in transition to establish regulatory and institutional frameworks and cooperative mechanisms to strengthen the capacity, efficiency and competitiveness of their services sector, and to increase their participation in global services production and trade, including by “providing support in national services assessment and policy reviews.” UNCTAD developed its tailor-made National Services Policy Reviews (NSPR) in response to the Accra Accord.

The services sector in Nepal is now the largest sector in the economy; its share of GDP has risen from 26 percent in 1980 to over 42 percent today. The Nepalese NSPR focused on two future growth areas within the services sector, namely tourism and IT services. In conducting the NSPR a national team of experts, with technical assistance from UNCTAD, engaged with a broad group of stakeholders from government, industry, academia and civil society to identify challenges and opportunities in tourism and IT services. The process included an analysis of the current policy framework for the tourism and IT services sector; regulatory and institutional challenges inhibiting sectoral development; national development objectives; prospective policy options to strengthen domestic supply capacity and SMEs competitiveness; and the potential impacts of services and services trade liberalization on sectoral FDI, SMEs, efficiency, employment, access to foreign markets and universal access to basic services.

The resulting recommendations from the NSPR are set out in detail in the body of this report and include proposed measures to enhance the tourism services sector and improve the IT services sector.

I hope that the contents of this publication will contribute to providing a strategic vision for the development of Nepal's services sector, and assist the country to continue to derive development benefits from trade in services.



Supachai Panitchpakdi  
Secretary-General of UNCTAD

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Part I contains a report prepared by UNCTAD to support Nepal’s NSPR entitled “Strategies for advancing development of the services sectors of Nepal”. The UNCTAD Report was prepared by a team led by Mina Mashayekhi, Head, Trade Negotiations and Commercial Diplomacy Branch. The contributors were Deepali Fernandes and Robert Hamwey. Comments were provided by Alberto Gabriele. The report draws on the ongoing substantive work of UNCTAD in the services sector.

Part II presents the NSPR Report of Nepal. It was prepared by a national team of experts with guidance and substantive support provided by UNCTAD. The national team included Ramesh Chitrakar, Anup Banskota and Manohar Bhattarai. Dr. Chirakar is Professor of Economics at Tribhuvan University and Executive Director, Centre for Economic Development and Administration; Mr. Banskota is Assistant Professor and Coordinator, Department of Computer Science and Engineering, Kathmandu University; and Mr. Bhattarai is Vice-Chairman, High-Level Commission for Information Technology, Government of Nepal. Inputs were also made by Purushottam Ojha, Permanent Secretary, Ministry of Commerce and Supplies, Government of Nepal; H.E. Mr. Dinesh Bhattarai, Ambassador, Permanent Representative and Mr. Ravi Bhattarai, Deputy Representative, Permanent Mission of the Federal Democratic Republic of Nepal to the United Nations Office in Geneva and Jibraj Koirala, Under-Secretary, Ministry of Commerce and Supplies, Government of Nepal, who served as the national focal point for the NSPR.

Part III provides a brief report of an UNCTAD meeting on National Services Policy Reviews convened in Geneva on 16 March 2010. This meeting provided an opportunity for national teams from Nepal, the Kyrgyz Republic and Uganda to present their NSPR reports to Geneva-based delegates and trade negotiators and the Department for International Development (DFID) of the United Kingdom of Great Britain and Northern Ireland and share experiences and lessons learnt.

The views expressed herein are those of the authors and do not necessarily represent those of the Government of Nepal or UNCTAD.

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# I

## **STRATEGIES FOR ADVANCING DEVELOPMENT OF THE SERVICES SECTORS OF NEPAL**

**A Report by UNCTAD**

## A. BACKGROUND

A vast body of analytical and empirical research undertaken by UNCTAD and others clearly demonstrates that a thriving services sector is vital for all countries [1]. High rates of investment and economic growth associated with services can contribute to poverty alleviation and human development when the right policies are in place to overcome supply constraints and ensure economy-wide development gains from services and services trade. New domestic services supply and services export opportunities for developing countries therefore need to be supported and facilitated by national policies and multilateral agreements relating to services trade, with an emphasis on creating an enabling environment for small and medium-sized enterprises (SMEs), which account for the bulk of developing country firms in the services sectors.

The recent expansion of global trade in services has provided broad economic gains to a relatively small set of developing countries that have developed modern, high value-added services-oriented economies over the past decade. By virtue of an early mover advantage, these countries are now well positioned to benefit from growth in the key services sectors they have developed, as distant service providers in global outsourcing markets, and as emerging services hubs in regional markets. Examples are the outward-oriented service economies of India, Hong Kong (China), Singapore and the United Arab Emirates. Other countries just steps behind these leaders include Mauritius, Jordan, Tunisia and Cost Rica. Among the key growth sectors are tourism, information technology-enabled services (ITES), business process outsourcing, transport and logistics services, financial services and multimedia services.

Evidence indicates that national governments, in consultation and coordination with the private sector and civil society, have played a formative role in the development of services economies in both developed and developing economies.[2] They have done so directly, through the development of human, capital and institutional infrastructure, and the design and implementation of supportive policy frameworks and financial incentives – and indirectly, by demonstrating the political will needed to drive the development of services sectors, a record of macroeconomic and political stability, good governance, transparency

and the rule of law. All these factors are essential in creating the environment needed to attract and sustain investment in the services sectors. However, while all are necessary for the development of a vibrant export-oriented services economy, they are certainly not sufficient; liberalized markets and high levels of foreign demand for services remain *prima facie* requirements.

Given the enabling and driving role that government plays in the development of services economies, it is useful for policy makers to devise national services export strategies. Moreover, to ensure buy-in and support, as well as to generate desirable spill-in and spillover effects among related economic sectors, strategy development should take place through participative consultations at the national level with all key actors, including parastatal institutions, potential foreign and domestic investors, the private sector, labour groups and academia. The inclusion of the latter two stakeholder groups is particularly relevant for the development of services strategies, given the need to ensure adequate labour transformations and enhanced levels of human capacity in order to support growth of the services workforce.

Nepal seeks to enhance national experience in developing national services export strategies through multi-stakeholder consultations, and in subsequently owning and driving these strategies with necessary government actions. The exercise at hand thus aims to survey some of the achievements Nepal has already made in developing the tourism services sectors; to examine what remains to be done to further enhance its development, including through regulatory, institutional and trade policy reform; and to identify what other services sectors may be the best candidates for future development, with particular attention given to the services related to information technology and communication (ICT) and to the education services sectors.

## B. ECONOMIC PANORAMA

Over the past 30 years, Nepal's economy has grown from an agricultural to an increasingly diversified economy. The contribution of agriculture, forestry and fishing to the gross domestic product (GDP) declined by nearly half from around 70 per cent in the mid-1970s to around 38 per cent today. The country's dependence on fluctuating prices in the world

agricultural commodities market, and its high degree of export concentration in a handful of commodities such as wheat, maize and cash crops, has motivated stakeholders to pursue opportunities to diversify the national economy, including within the agricultural sector by expanding the production and export of tea but also by building national supply capacity in industry and services.

Although Nepal is a landlocked least developed country (LDC) with a predominantly rural population of 30 million people, it has made considerable progress in diversifying its economy over the past decade.[3] Structural economic reform efforts began in 1992 to create a partially convertible current account, remove licence and quota requirements on imports, reduce tariffs, liberalize investment laws, restructure the tax system and privatize a number of state-owned enterprises. Progress in most areas has been slow owing to procedural problems that have impeded privatization. The Government began privatizing public enterprises in 1992 (Privatization Act of 1992) and had privatized or liquidated 26 public enterprises by mid-2006. This number should have been higher; however, privatization schedules were delayed because of political instability in the country from 2001 to 2006. In addition, although opposition to privatization of state-owned enterprises remains significant in some sectors, pronouncements by the Communist Party of Nepal, which now has more seats in Parliament than any other party (220 seats in the 601-member Assembly), have confirmed their support for investor- and market-oriented economic policies.

The recent period of instability resulted in the following impediments to Nepal's economic progress:

- Damage to infrastructure;
- Low private-sector investment;
- Slowed government spending on infrastructure;
- Closures of many firms;
- Disruption of development programme projects;
- Disruption of production, trade and transport;
- General insecurity in both rural and urban areas.

Despite these obstacles, the ongoing restructuring process continues to seek to reduce the country's reliance on agricultural output in favour of production in both industry and services. As a result, the share of the industrial and services sectors combined in real GDP increased from 55 per cent in 1992 to around 62 per cent in 2006. The services sector is now the largest

sector in the Nepalese economy, although it currently lacks dynamism. Its share of GDP has risen from 26 per cent in 1980 to over 42 per cent today. It has been buoyed by rapid growth in telecommunications, tourism and financial services. However, in recent years, tourism has declined in relative importance as a foreign-exchange earner because of growth in other sources of foreign exchange, such as remittances and foreign aid. Moreover, although restructuring has seen agriculture's share of GDP decline to around 26 per cent, farming still engages about 76 per cent of the country's workforce. As such, the improvement in workers' incomes has been largely limited to urban population groups engaged in the new economy.

Nepal has also liberalized its trade policy, including as part of its successful bid to join the World Trade Organization (WTO) in April 2004.[4] Reforms include: broad commitments in 11 services sectors, an average tariff binding of 42 per cent in agricultural products and around 24 per cent in industrial goods, and implementation of various WTO agreements such as the Agreement on Technical Barriers to Trade, the Agreement on the Application of Sanitary and Phytosanitary Measures, and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Results from privatization, investment and trade policy reforms have not yet translated themselves into strong GDP growth. In fact, Nepal's economic performance lags behind other South-Asian LDCs such as Laos and Cambodia. Since 2000, Nepal's, real per capita GDP has only increased from \$219 to \$290. [5] Nepal thus remains the poorest country in South Asia and ranks as the twelfth poorest country in the world. Nevertheless, government statistics indicate a steady decrease in the proportion of Nepalese living in absolute poverty – from over 42 per cent in 1996 to just over 31 per cent in 2004. However, the poorest region of the country most affected by the conflict – the Midwestern region – still has a poverty incidence almost 20 per cent higher than that of the Central region. Much more ambitious progress is now expected to reduce poverty levels in all regions of Nepal.

Trade remains to be ignited to expand the Nepalese economy. Exports of goods and services combined have shown no upward trend over the past decade (see figure I.3.) Although merchandise exports grew from \$346 m in 1995 to over \$760 million today, services decreased from \$679 million to \$386 million. A large part of Nepal's problem results from its

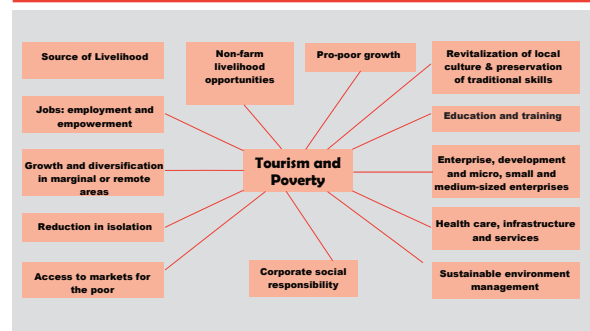
landlocked location between two giant economies: India and China. Trade with China to the north is held back by the physical presence of the Himalaya Mountains. Trade with India to the south is hampered by India's protective trade policies and the fact that competing firms in India have greater economies of scale and competitiveness. The transiting of goods through India to international markets also imposes significant shipping costs and delays on Nepalese exporters. In addition, other economies in South and Eastern Asia are more advanced, marked by the presence of very competitive firms that can produce higher quality goods and services than Nepal, making opportunities for Nepalese exporters difficult to identify and maintain.

As a result, Nepal continues to run a large trade deficit. Merchandise imports are typically valued at two to three times the value of merchandise exports. Nepal also runs a variable shortfall on its services account, which was valued at about \$100 million in 2006. Donor support and debt cover most of the current accounts deficit. Boosting national supply capacities to both reduce and finance import requirements is thus a national objective.

Certainly, political stability has been a much welcomed development for the economy, although other impediments to the realization of the country's full foreign trade potential remain. Insufficient physical infrastructure, limited electricity supply and high transit costs continue to impair the growth of its exports and overall economic progress. All impact negatively on producer costs, which remain high across all economic sectors. Domestic supply capacities for producer services also remain low, and the Government realizes that additional efforts are needed to stimulate entrepreneurship and domestic investment and to encourage foreign investment in the services sector.

The Nepalese economy has changed considerably since 1980. Agriculture has declined significantly as a component of GDP, while services output has expanded. Figure I.1. shows the evolution of the economy since 1980. While services accounted for only 26 per cent of total output in 1980, this figure has grown to almost 42 per cent today. Moreover, national statistics indicate that services accounted for over 75 per cent of GDP growth in 2006. Figure I.2 shows the relative contribution to GDP of the different economic sectors in Nepal. The dominance of services' contribution to GDP is clearly discernable.

**Figure I.1. Structure of the Nepalese economy in 1980 and 2005**



Source: UNCTAD Handbook of Statistics, 2007.

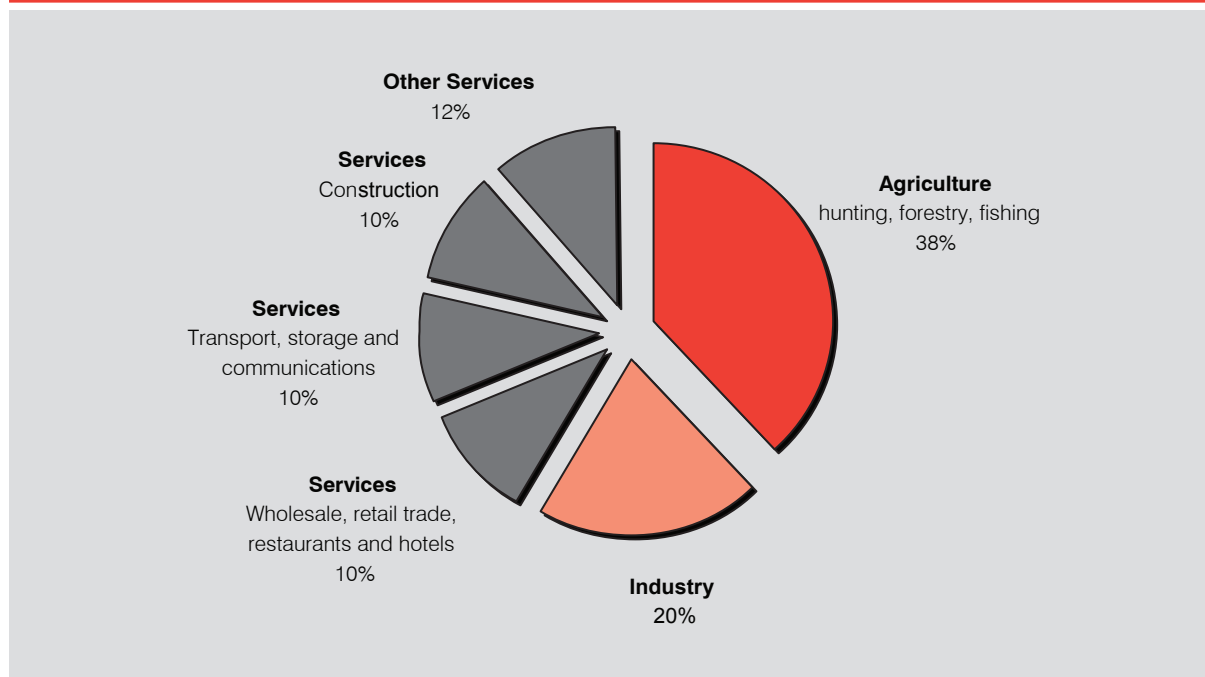
In 2005 over 21 per cent of the total employed workforce in Nepal was engaged in the services sector, and of these jobs, most (7 per cent) were in the wholesale and retail trade services sector. [5]

Regarding trade, figures I.3 and I.4 indicate that services exports have significantly underperformed merchandise exports. Average annual growth over the 1995–2006 period for merchandise exports was positive at 7.7 per cent, but negative at 7.2 per cent for services exports. The recent trend for negative services export growth showed signs of reversing itself in 2007 when services exports increased by 24 per cent. Initial data from 2008 are consistent with a continuation of strong services export growth.

No evaluation of Nepal's trade performance can be complete without recognizing that Nepal is a landlocked country, making market access a challenge. Surface transport into and out of Nepal is severely constrained and there is only one main road connecting India to Kathmandu. The only practical seaport for entry of goods bound for Nepal is Kolkata in India, about 1,000 kms from the Nepal-India border.

At 50 per cent of total commercial services exports, travel and tourism remain Nepal's dominant services exports. However, other export sectors remain to be more fully developed. Figure I.5 presents a breakdown of services exports by category.

Nepal's more active participation in numerous international organizations and agreements could help ensure its success in attracting foreign demand and investment to its services industries. For example, Nepal's participation in the World Tourism Organization and the International Air Transport Association can facilitate tourism. Its adherence to international

**Figure I.2. Sectoral composition of Nepal's GDP in 2006**

Source: National accounts data reported to the United Nations / UNCTAD.

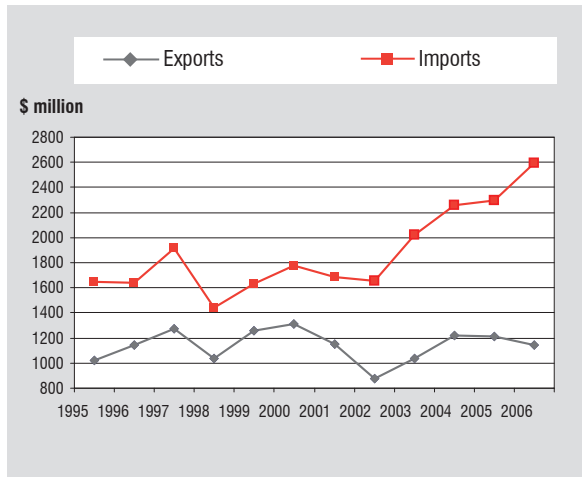
regulations and standards of the International Organization of Securities Commissions can build investor confidence in the financial services sector, and recent steps taken at the national level to improve compliance with provisions of the TRIPS Agreement encourage ITES and business process outsourcing engagements. Moreover, Nepal's membership of the WTO and of the South Asian Association for Regional Cooperation (SAARC) make Nepal an increasingly attractive site for investment in production facilities by multinational firms.

However, policy-related, infrastructural and market access constraints affect international trade in services. Many services sectors that have crucial bearing for Nepal's economy have been greatly affected by internal and external barriers. Nepal's export potential in services trade is adversely affected by some domestic constraints such as inadequate infrastructure, low quality and standards, and policy-related disincentives. External constraints that adversely affect international trade in services exist mainly in the form of immigration and labour market regulations, recognition and licensing provisions, limits on foreign equity participation and discriminatory treatment with respect to taxes, subsidies and other policies. [6]

As the structural transformation of the Nepalese economy from agriculture to manufacturing and new services sector industries has unfolded over the past decade, evidence from recent years suggests that it may not be transforming quickly enough. Growth of GDP has been uneven over the past decade, although consistently strong since 2002, as shown in figure I.6. The figure also reveals that Nepal's performance in boosting per capita GDP remains unsatisfactory. At only \$300 per year, Nepal's per capita GDP remains among the world's lowest, highlighting the need for improved policies to more broadly generate employment opportunities and distribute the benefits of an improved economy to the population

Although strategies to bring new sectors online, promote greater product diversification, increase value added through vertical integration in its traditional agricultural commodities sectors (coffee, tea and fish), enhance production efficiencies and diversify export markets have been able to sustain annual GDP growth rates above 4 per cent over the past decade, per capita GDP growth has been even slower, and in recent years has even declined (see figure I.7). The challenge to boost GDP growth to reduce poverty will continue to confront policy makers in the coming years.

**Figure 1.3. Performance of Nepal's combined services and merchandise trade over the past decade (1995 = 100)**



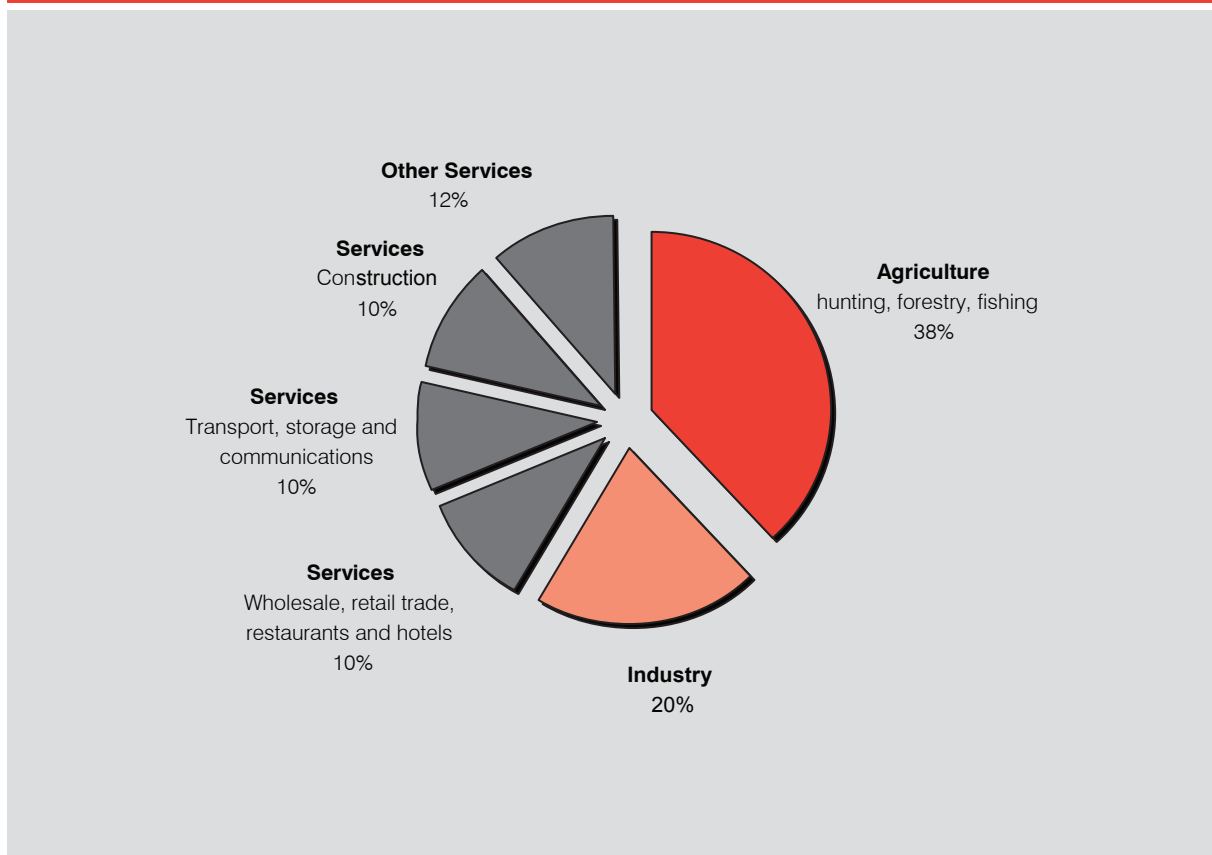
Source: UNCTAD Handbook of Statistics, 2007.

**Figure 1.4. Relative performance of Nepal's services and merchandise exports over the past decade (1995 = 100)**



Source: UNCTAD Handbook of Statistics, 2007.

**Figure 1.5. Breakdown of Nepal's commercial services exports in 2006**



SOURCE: UNCTAD HANDBOOK OF STATISTICS, 2007.

## Progress in meeting Millennium Development Goals

Nepal's Millennium Development Goals Report for 2005, prepared with the participation of a wide range of stakeholders, indicated that Nepal was likely or potentially able to meet most of the Goals except universal primary education and HIV/AIDS.[7] The next MDG Progress Report is planned for 2009. The assumption today is that Nepal still has the potential to reach almost all of the Goals if the Government and the development community make serious efforts to improve the implementation of programmes across the country. [8]

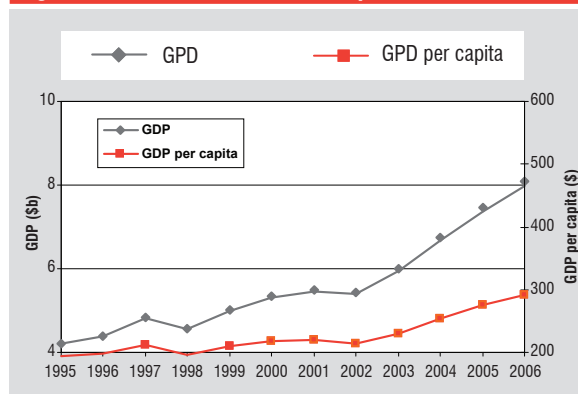
*An Assessment of the Implementation of the Tenth Plan: Poverty Reduction Strategy Review 2005/2006 and Millennium Development Goals: Needs Assessment for Nepal*, published in 2006, provide key inputs into the Government's Three Year Interim Plan (2007/08–2009/10).[9] Nepal is likely to meet Goal 1 of halving the proportion of people living below the national poverty line by 2015. It is also likely that Goal 4, reducing under-five mortality by two thirds by 2015 will be met. Similarly the target of halving the proportion of people who lack access to safe drinking water is likely to be met now that political stability has been restored.

With assistance from the Government and donor partners, other MDGs are also now expected to be achieved. These include promoting gender equality and empowering women (Goal 3), improving maternal health (Goal 5) and ensuring environmental sustainability (Goal 7). It is, however, feared that the goal of achieving universal primary education is unlikely to be met. Similarly, halting and reversing the spread of HIV/AIDS (Goal 6) by 2015 is also unlikely to be met. However the target of halting and reversing the spread of tuberculosis is likely to be met by 2015.

Improved capacity and efficiency in the services sector contribute considerably to meeting MDGs in developing countries, including Nepal, in key sectors such as health, education and environmental services. Moreover, the labour-intensive nature of the services sector more broadly ensures that growth of the sector generates higher levels, and an extended geographical distribution of employment needed to help reduce poverty. Exploring the potential of specific services sectors, and their linkages with other sectors, to generate employment, particularly among lower-income and skill-level workers is thus an important

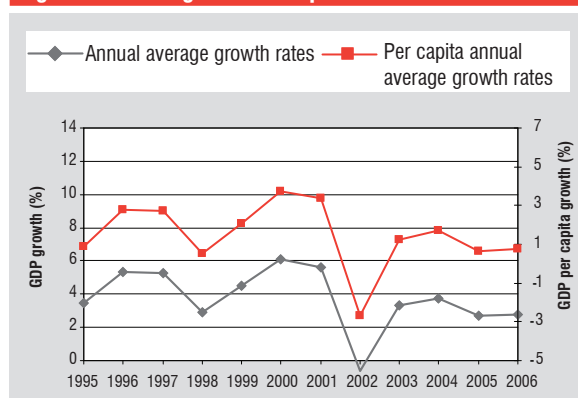
aspect of any assessment study of the services sector. Economic, regulatory, institutional and trade policy features of each sector also need to be examined to identify policy reforms with the potential to generate improved pro-poor outcomes.

Figure I.6. Evolution of GDP in Nepal in 2005



Source: UNCTAD Handbook of Statistics, 2007.

Figure I.7. GDP growth in Nepal



Source: UNCTAD Handbook of Statistics, 2007.



## C. ENHANCING GROWTH AND PERFORMANCE IN THE SERVICES SECTOR

A thriving services sector is vital for all countries. High rates of investment and economic growth associated with services can contribute to poverty alleviation and human development when the right policies are in place to overcome supply constraints and ensure economy-wide development gains from services and services trade.

Given the enabling and driving role that government plays in the development of services economies, it is useful for policy makers to devise national services development strategies. To ensure buy-in and support, as well as to generate desirable spill-in and spillover effects among related economic sectors, strategy development should take place through participative consultations at the national level with all key actors, including parastatal institutions, potential foreign and domestic investors, the private sector, labour groups and academia. Resulting from the national consultation process is a master plan that outlines not only national strategies, but also defines a process and series of practical steps through which strategic objectives can be pursued.

### 1. Building a master plan

A master plan to promote trade and investment in the services sectors is prepared through multi-stakeholder consultations at the national level. Far from being a static instrument, it is a dynamic tool whose purpose is to guide the long-range development of services sectors in the national economy. However, to get started, an initial draft master plan must be prepared for consideration by national stakeholders. National consultations will then refine and adjust the master plan according to shared perspectives and goals. Specifically, a master plan serves the functions outlined in table I.1.

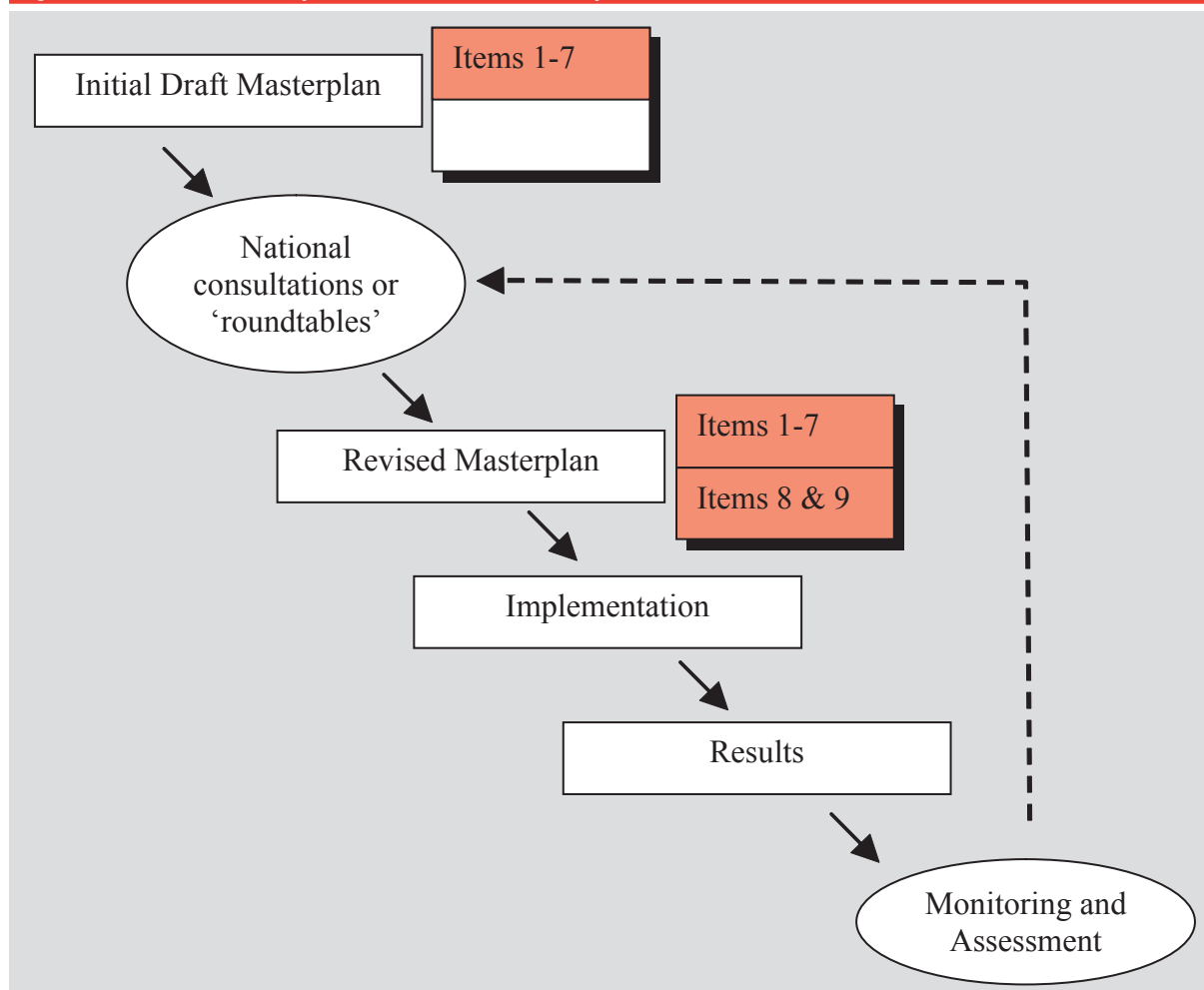
An initial draft master plan is prepared, addressing items 1–7 from table I.1. It is used to launch national consultations. Based on decisions taken in national consultations, a revised master plan includes revisions to items 1–7 as well as the elaboration of items 8 and 9. The revised master plan is subsequently implemented. As implementation of the revised master plan proceeds, results are monitored and assessed by stakeholders. They may decide to refine the master plan further to improve results. The entire process is shown schematically in figure I.8.

**Table I.1. Main functions served by the master plan**

Item	Functions
1	Defines a national vision for the long-range development of the services sectors and expectations for objectives that can be achieved.
2	Consolidates available economic data on national services sectors to identify trends, opportunities and constraints related to their future development.
3	Highlights the expected positive and negative economic and social impacts of privatization and trade liberalization of national services sectors.
4	Presents options for trade liberalization of services sectors – bilateral, regional, interregional and multilateral – and examines their respective economic and social implications.
5	Examines potential synergies, as well as potential threats, that arise, inter alia, as services sectors develop.
6	Projects how trade liberalization of services may stimulate and support merchandise trade.
7	Identifies areas where improved policies are needed to advance sectoral objectives, including in the areas of providing support to SMEs, streamlining national regulatory frameworks and enhancing trade and investment.
8	Defines policy reforms to be introduced and a timetable for their introduction.
9	Provides clear, practical steps that various stakeholder groups should take to advance agreed objectives for the future development of key services sectors.



Figure 1.8. Breakdown of Nepal's commercial services exports in 2006



## 2. Strengthening established services sectors

For a national services development strategy to be effective, it must not only look towards ways to support the development and/or expansion of new services sectors, but also examine those sectors which are already successful and identify ways to maintain and enhance their performance. Here, we review some of the constraints facing the two major export-oriented tourism services sector and explore ways in which its performance may be enhanced. Ideally, a master plan will be drafted by national actors to promote ways forward.

### The tourism sector: further diversification to sustain growth

The Himalayas, diverse landscapes, and rich cultural diversity provide Nepal with a natural advantage in the tourism industry. Tourism services can stimulate development through employment generation and foreign exchange earnings. In addition, the industry has a high multiplier effect and positive spillover effects. The industry also generates a high proportion of employment for women and youth. In Nepal's case, tourism also has the potential to aid rural development and contribute towards the preservation of historic, natural and cultural sites.

The Three Year Interim Plan (2007/08–2009/10) of the Government of Nepal formulates new plans

and policies for tourism infrastructure development; creates awareness about tourism, skills development and tourism activity expansion; improves standards of tourism services; and focuses on international promotion and marketing. Constraints hampering growth in this sector should be identified and eliminated, particularly those limiting product diversification and hindering the strengthening of linkages between the tourism industry and other economic sectors.

### Overview of the sector

Nepal is a multicultural, multilingual and multi-faith country. For a relatively small country, it has a diverse landscape, ranging from the humid Tarai plains in the south to the mountainous Himalayas in the north. It also has a rich cultural and religious history, making Nepal a major tourist destination. Nepal is also home to four World Heritage Sites: two cultural sites: Kathmandu Valley (1979) and Lumbini, the birthplace of the Lord Buddha (1997); and two natural sites, Royal Chitwan National Park (1984) and Sagarmatha National Park (1979). Tourists and outdoor enthusiasts are able to visit these natural environments through Nepal's well-established infrastructure of hotels, hostels and lodges strategically located near national parks. Budget hotels are popular among independent travellers and backpackers. But now a high-end market for nature and leisure tourism is emerging with four- and five-star hotels, heritage resorts and spa resorts primarily target adventure tourists. The other main product offering includes mid-range two- and three-star hotels that remain the preferred choice for the majority of Indian and Chinese tourists to Nepal.

Taken together, vacation tourism (52 per cent) and trekking tourism (28 per cent) accounted for over three-quarters of tourism visits in 2001 before political instability emerged. Business travel is also an important component of Nepal's tourism industry, particularly in Kathmandu, and accounts for over 10 per cent of total tourism receipts.

Over the past 10 years, Nepal's tourism sector has had discouraging results owing to political instability which dissuaded tourists from visiting the country. Tourist arrivals declined substantially from peak levels of one million recorded in 1999. With peace and stability now restored in the country, tourism is expected to regain its position as one of Nepal's fastest-growing industries and its principal source of foreign exchange. Nepal's tourism industry recorded a resurgence of growth in

2007, making it the most successful in seven years. Excluding overland arrivals from Tibet and India, the total number of tourists arriving in 2007 was 27.1 per cent higher than in 2006; 360,350 visitors arrived in Nepal through Kathmandu airport, the highest level since 2000. The major markets of Europe and North America recorded high growth in 2007: 46.8 per cent for North America and 38 per cent for Europe. Arrivals from Asian countries also recorded growth of 49.4 per cent; Chinese tourists led the way with a surge in tourist arrivals of 120.9 per cent. Nearly 14,500 Chinese tourists visited Nepal in 2007, up from 6,500 in 2006.

Figures for 2008 are somewhat less dramatic as the total number of visitors in 2008 reached 374,661, representing only a 4 per cent annual increase, compared with the 27 per cent rise registered for 2007. Nevertheless, against the backdrop of the global financial crisis, the 4 per cent increase in arrivals for 2008 remains encouraging.

Currently, in 2008, the tourism sector accounts for 3 per cent of GDP, directly, and 6.8 per cent of GDP if contributions from linked sectors – the wider tourism economy – is included. In terms of employment, the tourism sector accounts for 2.3 per cent of total employment (237,000 jobs) and the wider tourism economy accounts for 5.3 per cent of total employment (548,000 jobs) or 1 in every 18 jobs. Moreover, the tourism economy is estimated to account for 15 per cent of total goods and services exports. [10]

In 2003 it was estimated that 27 per cent of international tourists were from India, 3 per cent from China and up to 15 per cent from other developing countries, mostly in Asia. Over 50 per cent of arrivals are from developed countries. The latter are dominantly from Japan (8 per cent), the United States of America (6 per cent) and Europe (over 30 per cent).[11] Recently released data for 2008 show a relative increase in tourist arrivals from Asia (58 per cent) with a relative decline in arrivals from developed countries (40 per cent). These data thus suggest that as incomes of Asian tourists increase, they are becoming a dominant segment of Nepal's tourism market.

A development that has directly led to increasing tourist arrivals has been growth in the number of airlines and the number of cities their flights connect to Nepal as well as the higher frequency of their flights. There are now over 15 international carriers competing on routes between Kathmandu and major

Asian cities. These include not only national airlines, such as Indian, Royal Nepal Airlines, Qatar Airways and Pakistan International Airlines, but also a number of private and budget airlines, such as India's Jet Airways and Nepal's Cosmic Air, for connections with Indian cities. Internally, Royal Nepal Airlines and the seven small private airlines, which have emerged since the industry was opened up to competition, provide about 20,000 seats per week of capacity.

### Strategic direction

The Three Year Interim Plan (2007/08–2009/10) has set forth a long-term vision for the tourism sector: "By preserving and conserving the existing natural heritages, tangible and intangible intellectual and cultural heritages, and by developing accessible and safe air services, Nepal will be established as a major tourist destination in the international level, so as to enable the tourism sector to develop as an important segment of the national economy, which could contribute significantly in economic growth, employment generation and poverty alleviation". Strategic steps continue to be taken to realize this vision for the future.

Overall strategic management of tourism in Nepal is provided by the Nepal Tourism Board. Established in 1998 by an act of Parliament as a partnership between Government and the private-sector tourism industry of Nepal, the Board develops and markets Nepal as an international tourist destination by combining government commitment with the dynamism of private-sector tourism industries through a platform for dialogue and vision sharing among stakeholders. Through such dialogue, the Board guides and promotes the coordinated diversification and expansion of national tourism products.

Funding for the Board's activities derives exclusively from a tourist service fee paid by all departing foreign passengers at the Tribhuvan International Airport in Kathmandu. Chaired by a secretary at the Ministry of Culture, Tourism and Civil Aviation, the Board is composed of 11 members: 5 Government representatives, 5 private-sector representatives and 1 chief executive officer.

The Board is working toward repositioning the image of the country and in the near future it seeks to regulate the sector through product- and quality-development activities. It is primarily focusing on tourism products such as adventure tourism (which include mountain

treks and low-altitude treks), sightseeing trips (mainly to Pokhara and Kathmandu), religious tourism (at Buddhist and Hindu pilgrim centres) and cultural tourism (at historical sites). At the same time, the Board continues to promote Nepal as a leisure and shopping destination for Indian tourists, which account for 1 in 5 tourists arriving by air and a considerably larger number when land arrivals are included. Indian tourists, and an increasing number of Chinese tourists, dominate land arrivals in Nepal. In 2008, 32 per cent of all international tourist arrivals entered Nepal by land. India's proximity to Nepal, the absence of visa restrictions and the increasing disposable income of Indians are all factors contributing to the success of this major segment of Nepal's tourism market.

National tourism hubs have been designated by the Nepal Tourism Board to focus market promotion activities and quality improvement efforts. Efforts in these hubs have been successfully made to promote tourism activities having strong poverty alleviation and sustainable development impacts through the Tourism for Rural Poverty Alleviation Programme.

National tourism promotion activities have also been carried out focusing on large regional markets such as India and China, as well as in other countries in the region such as Japan, Singapore, Malaysia, Thailand, and Bangladesh. In both regional and global for a, the Nepal Tourism Board has convened international briefings and seminars to promote Nepal's tourism and cultural heritage assets and to raise awareness among tourism providers of opportunities to diversify the tourism industry. The task of branding, through the slogan *Naturally Nepal: once is not enough* continues to be successful in revealing the unique natural beauty of Nepal in the international market and establishing Nepal as a major tourism destination. Through increased destination awareness, the Board expects the performance of Nepal's tourism industry to show continuous improvement over the next several years. Moreover, as recent political developments in Nepal have led to a peaceful settlement of the decade-long conflict, the image of the country as a safe place to travel is improving at the global level and prospects for growth in the tourism sector continue to improve substantially.

Government involvement in the tourism sector also occurs through the activities of the Tourism Division of the Ministry of Culture, Tourism and Civil Aviation which has responsibilities for regulating the sector. The Civil Aviation Authority is responsible for

regulating Nepal's air transport industry and looks after the enforcement of over 30 bilateral air services agreements. Tourism services are regulated by the Tourism Act, 2035 (1978) amended under the Tourism Act, 2053 (1997), the Hotel, Lodges, Restaurants, Bar and Tourist Guide Rules, 2038 (1981), Travel and Trekking Agency Rules, 2037 (1980), Trekking and Rafting Rules, 2044 (1985), and Mountaineering Rules, 2036 (1979). Existing provisions of Nepal's Foreign Investment and Technology Transfer Act 1992 reserve certain component activities of tourism for domestic providers and do not allow the establishment of foreign companies or foreign investment in travel agencies, trekking agencies, water rafting and pony trekking activities or tourist lodges.

Nonetheless, Nepal opened up the travel agency and tour operator service for foreign investment up to 51 per cent of foreign equity capital when it became a WTO member. Foreign direct investment is permitted in the hotel and resort industry, for which government permission is required as provided by the Act. As per Nepal's WTO commitments, up to 80 per cent of foreign equity capital is allowed for hotel, lodging services and graded restaurants; however, domestic operators are well entrenched and organized to withstand foreign entry.

### Challenges and opportunities

Nepal's tourism sector's prospects continue to be negatively affected by many internal factors that include infrastructural inadequacies and shortcomings in quality and efficiency in other sectors. In addition, many external factors are also important for the growth of the tourism industry. Despite the fact that the tourism sector attracted more commitments by Members than any other services sector at WTO, significant restrictions still remain.

Raising the quality of national tourism remains an important challenge for the industry. Efforts to strengthen university courses and degree programmes in hotel, and travel and tourism, management have been successful and continue to be improved at the Nepal Academy of Tourism and Hotel Management and in private tourism management schools. There is also a need to review legal and trade provisions affecting the tourism industry in order to make them more investment friendly for both domestic and international investors. This applies not only to attracting investment in tourism restaurants and hotels, museums, cultural sites and natural attractions, but

also to securing finances needed to upgrade tourism infrastructure and facilities, including for roads, buses, airports, energy, water and communications.

Although efforts to raise awareness of tourism as a major national economic sector among local tourism providers and communities has been largely successful, more needs to be done to motivate and empower local actors to preserve tourism assets and build linkages between tourism activities and local economic activities.

In summary, key objectives for the sector include:

- Encouraging and identifying channels for financial support for the development of new tourism products and the improvement of existing products;
- Further improving national tourism marketing efforts;
- Developing public- or private-sector partnerships in the sector;
- Further improving human resource development programmes for tourism workers;
- Developing and supporting community-based tourism programmes;
- Improving transportation and energy infrastructure in the country.

### Diversifying product offerings in the tourism market

Although the main selling points of tourism in Nepal are focused on trekking and adventure tourism, including ecotourism, and cultural tourism, there is growing recognition within the sector of potential demand for new and additional tourism products. Many operators aim to market these new products to the current segment of tourists who visit Nepal, as well as to entirely new market segments of tourists originating in regional and more distant global markets. New tourism products being promoted or considered for promotion include: wellness tourism, educational tourism, community tourism, sporting vacations (golf, tennis), cultural and ethnic tourism, and business conferences. Initial progress has already been made in introducing some of these products. Expanding on them could provide significant opportunities for employment and enterprise development in the personal, cultural, recreational and education services sectors.

In response to tourist demand, cultural tourism is now being vigorously developed by Nepalese tourism operators. In addition to its main attraction of

national parks, Nepal also has numerous cultural and religious sites for tourists interested in cultural tours. Community tourism operators are now burgeoning in the locales of cultural tourism sites.

Diversification efforts are also focusing on expanding education and study tours. A number of international universities are sending their researchers and students on to Nepal as a part of study tours in the area biodiversity and anthropology. Many of these tours are conducted in collaboration with Tribhuvan University and relevant Government ministries. These tours last from several weeks to several months and provide employment and income opportunities to local communities, often in rural areas of the country.

### **Diversifying the tourist base (income class and geographical origin)**

Promotion of the regional middle-income tourist market segment could generate significant income and employment benefits. The segment could be promoted selectively during the up-market tourism off-season when hotel and airline occupancy rates are low. During the off-season, the growing offering of recreational activities that are currently focused on higher income tourists during the high-season – ecotourism, adventure tourism, cultural tourism – could benefit from increased marketing efforts through discount packages targeting middle-income tourists. The development and promotion of lower-cost vacation packages during the off-season could significantly reduce seasonal business fluctuations and give a boost to the tourism sector. Even during the high season, lower-cost vacation packages offered in the region could bring in additional tourists.

The pool of potential tourists could also be increased by attracting tourists from non-traditional markets. Regarding the geographical origin of tourists, data indicate that over 50 per cent of extraregional tourist arrivals are from Europe. Stronger efforts could be made to attract tourists from other developed countries as well as from developing countries in Africa and Latin America, particularly as new air airline links to these regions have recently been developed.

### **Possible next steps**

Increased coordination between hotels, airlines, tour operators and other tourism service suppliers to undertake marketing studies could be beneficial to all. Such studies could determine how to best design

and price vacation packages so that seasonal excess capacity is reduced and stronger linkages among suppliers in the tourism value chain are created. Studies could also help identify ways to further support diversification of product offerings in the sector.

At this relatively early stage of development of the sector, greater attention could be given to reducing the negative environmental impacts of tourism in Nepal to maintain long-term stability of biodiversity in the country upon which the success of the sector currently rests, and to ensuring that local populations continue to have access to high-quality residential, recreational and agricultural sites. Additionally, the need to continue improving transportation and energy infrastructure in the country cannot be over-emphasized. Visitors from the subregion are the most dependent on Nepalese and neighbouring road networks. Efforts to improve domestic road infrastructure will help, but cross-border improvements are required if full advantage is to be gained from domestic investments for international road-based tourism.

Trade policy should be re-examined with respect to enhancing foreign investment in the sector. Consideration could be given to increasing the coverage of commitments under the General Agreement on Trade in Services (GATS) in tourism services by scheduling new commitments for food and beverage services, tourist management services, education and health accommodation services and other non-conventional services.

In addition to the options above aimed at boosting tourism revenues, the industry could look towards ways to cut costs through e-tourism. Providing increased opportunities for tourists to book vacation packages online, in a one-stop shop regrouping a wide range of tourism service providers, could allow Nepal's tour operators to greatly reduce leakage (the share of tourist receipts paid to foreign agents), thus allowing them to offer lower-cost packages to consumers.

## **3. Maturing, new and emerging services sectors**

Nepal has made initial progress in developing other export-oriented services sectors, particularly the software and IT services sector. Other sectors for focused support and development include the

**Box I.1. Strengths, weaknesses, opportunities and threats: Nepal's tourism sector**

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Natural assets</li> <li>• Cultural diversity</li> <li>• Religious sites</li> <li>• Four World Heritage Sites</li> <li>• Acquired image as an adventure and cultural theme tourism destination</li> <li>• Good service, hospitable nature of the Nepalese people</li> <li>• Expanded air access to major markets</li> <li>• Government promotion of sustainable tourism</li> <li>• Wide array of ecotourism offerings</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• Lagging capacity expansion relative to targeted volume of tourists</li> <li>• Infrastructure limitations in rural regions: utilities, telecommunications, water treatment</li> <li>• Road network limitations/traffic congestion</li> <li>• Limited capacity of Kathmandu airport to accommodate growing traffic</li> <li>• Moderate levels of leakage</li> <li>• Foreign-based local businesses do not repatriate profits towards Nepal</li> <li>• Lower-quality service provided by small restaurants, guesthouses, taxis</li> <li>• Limited access to new investments and financing</li> <li>• Inadequate safety regulations</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Strengthen intersectoral linkages</li> <li>• Strengthen community-based tourism</li> <li>• Restored in-country stability, safety and security</li> <li>• Restored political stability</li> <li>• Improving tourism and transportation infrastructure and service</li> <li>• New tourism themes: health care and educational tourism, business and conference tourism</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Environmental degradation in high-traffic areas</li> <li>• Increasing incidence of theft and violence targeting tourists</li> <li>• Global economic crisis</li> <li>• Overdevelopment may damage the image of the destination</li> <li>• Competition for land between tourists and local needs</li> </ul>

Required spill-ins from other sectors: Improved supply of services from the transport, financial, ICT, recreation, health care, utilities and security services sectors

Anticipated spillovers into other sectors: Provide improved market for services from the transport, recreation and health care sectors; conservation and improved land-management-related environmental benefits; expanded offering of infrastructure in tourism zones; propagation of quality standards to other sectors

Key stakeholders: relevant government ministries and parastatals; tourism sector firms – hotels, restaurants; transport firms – airlines, taxis, car-rental; local communities; labour unions; recreation and sports firms and interest groups; advertising agents and e-tourism suppliers.

Source: SWPT diagram.

education, health care, and the financial services sectors (although not covered herein).

Trade in ICT-related services is a recent phenomena spurred by the latest innovations in communication technology. Computer, information, communications and other commercial services are emerging as dynamic sectors globally, particularly in South Asia. The availability of an educated urban class creates great possibilities for the development of ICT

services in Nepal. Several ICT services activities are already showing promising signs of growth, such as the establishment of outsourcing companies. In addition to its contribution towards exports earnings, ICT ventures can act as a training ground for entrepreneurs and become a medium for the transfer of technology. Such services increase efficiency of other sectors of the economy and make it possible for Nepalese entrepreneurs to compete internationally.



As the Nepalese economy modernizes, demand for home-grown software and hardware will increase. In this context it is essential to develop ICT services not only for foreign earnings and employment, but also to enhance efficiency of other sectors of the economy.

There are tremendous outsourcing opportunities in geographically isolated landlocked countries such as Nepal, especially when the majority of the educated people have a working knowledge of English. Moreover, many ICT services are highly labour intensive; Web design, data entry, coding and computer programming, therefore, can significantly contribute to the promotion of human development in labour-abundant countries. In addition, the proximity to two of the world's biggest and fastest-growing markets, India and China, will have a positive impact on Nepal's services sector.

### **Software and IT services: a rapidly rising sector**

#### **Overview of the sector**

Information technology services have been identified by the Government of Nepal as a rapidly growing area that is essential for economic and social development. [12] They facilitate progress at all levels in the economy, from poverty reduction in rural communities to the integration of national SMEs into the global economy. As such, the sector provides a platform for Nepal to accelerate its beneficial integration into the global economy as both an emerging producer and exporter of goods and services. E-commerce, e-government and other IT-based services have been earmarked as priority areas for domestic market development, while ITES, business process outsourcing and software development services have been targeted as key markets for export growth.

Recent advancements in ICT have offered Nepal new opportunities for economic development and for meeting imperatives to offer telecommunications and Internet access to its population. The High-Level Commission for Information Technology provides Nepal with strategic direction and helps formulate appropriate policy responses for the development of the ICT sector to meet key developmental challenges, including governance reform and catalysing economic growth for poverty reduction. Drafted by the Commission and adopted by Parliament, the National IT Policy of 2000 and the 2004 National Telecommunication Policy support the accelerated

development of this sector by liberalizing the sector and promoting private-sector participation and competition in all market segments, thereby broadening access to telecommunication facilities throughout the country. The ultimate goal is to build a knowledge-based society by 2015: "By the year 2015, Nepal will have transformed itself into a knowledge-based society by becoming fully capable of harnessing information and communication technologies and through this means, achieving the goals of good governance, poverty reduction and social and economic development".

There have been many positive developments in Nepal's ICT sector in recent years. Completion of the first phase of the East-West Highway Optical Fibre Project provides a modern optical-fibre backbone for telecommunication services in the country, greatly improving the reliability and quality of long-distance calls within Nepal and between Nepal and India. Upon completion of the project's second phase, Nepal will become fully connected to India through multiple fibre links. Outside of urban centres, in remote rural villages, the use of very small aperture terminal (VSAT) links for telephone and the Internet with the establishment of local telecentres that make these services available to the public is being pursued to provide rural areas with basic telecommunication facilities. Recent government allocation of frequency space for mobile Internet is also expected to facilitate the deployment of ICT in rural areas.

Another development of key importance has been the recent introduction of localized Nepali language versions of Windows and Linux operating systems for personal computers. This has resulted in the greatly increased use of IT by government and the private sector, and in particular, by the non-English speaking population. Regarding institutional infrastructure, there is now a rich set of effective government institutions and private associations that are involved in planning and coordinating activities in the sector. In addition to the High-Level Commission for Information Technology, these include the Nepal Telecommunications Authority the Federation of Nepalese Chambers of Commerce and Industry, the Computer Association of Nepal and a number of non-governmental organizations (NGOs) promoting the use of IT for development.

However, with many challenges facing the country, including difficult and remote terrain, the need to repair damaged infrastructure and limited possibilities for financing, access to ICT in Nepal remains low, particularly when compared with access levels in other

neighbouring Asian countries. Fixed-line penetration increased from 2 per cent in 2006 to just over 3 per cent in 2008, while mobile penetration rose more significantly, from 3 per cent to over 12 per cent during the same period, yielding a teledensity level of 15 per cent. Internet access remains very limited. The number of Internet users per 100 people in 2007 was only 1.4 in Nepal, compared with a regional average of nearly 15. Nevertheless, with liberalization of the ICT sector in 2004, the number of Internet service providers has risen sharply, climbing to over 30 in 2008, and annual user and subscriber growth rates are among the region's highest. The Three Year Interim Plan (2007/08–2009/10) has targeted increasing overall teledensity to 25 per cent by 2010, a target which may be exceeded given the currently high rate of growth in mobile subscriptions.

As with ICT infrastructure, there has been steady improvement in ICT human resources. Each year 3,000 students graduate from ICT programmes at four universities; the Tribhuvan, Kathmandu, Pokhara and Purbanchal Universities. Each offers a wide range of IT courses and specialized four-year ICT degrees. Another 1,000 students complete their ICT studies in neighbouring countries, such as India, Bangladesh and the Philippines, and then return to Nepal, resulting in a total of 4,000 ICT graduates being produced each year. Many – but not all – of these graduates secure employment in the sector in ITC-related engineering, hardware design and manufacturing, IT training centres, ITES, business process outsourcing and software development services.

Information technology hardware design and manufacturing activities in Nepal are performed by two modern, firms certified by the International Standards Organization (ISO), Mercantile and Beltronix. Additionally, there are numerous local companies assembling computers from imported parts. The software industry in Nepal is growing, focusing on human resources development. Companies in Nepal are focusing mainly on software development, software solutions and business process outsourcing. Revenues for Nepal's software companies surpassed \$40 million in 2007. In addition to more than 90 domestic companies, there are some 20 foreign companies from Japan, Germany, the United States and the Netherlands operating in the Nepal IT services market. Many foreign companies have established offices in Nepal to take advantage of a young, educated and English-speaking workforce

to lower their labour costs for producing software and IT-related services.

Boasting an improved business environment, a modern ICT infrastructure, a large labour pool with native English language skills and advanced education levels, and low labour costs compared with other developing countries, Nepal's IT services industry has already demonstrated substantial growth.

Information technology-enabled services are taking hold in Nepal and transforming the country into an emerging international outsourcing centre. New optical fibre links which first opened in late 2007 increase bandwidth capacity, enabling Nepal to compete competitively in international IT services markets and allowing Internet service providers to lower connection fees. Business process outsourcing contributes to the country's foreign currency earnings and provides a significant source of jobs to young people and women. Serving Minds and D2Hawkeye are examples of just two local business process outsourcing companies that have registered success in the international business process outsourcing market. Located in Kathmandu, Serving Minds is an international teleservices and telemarketing company operating out of Kathmandu that provides clients with a full range of inbound and outbound business process outsourcing services, and has become one of the largest employers of new Nepalese graduates. Its list of clients includes Motorola, Standard Chartered, Bank of America, Radisson Hotels, Verizon and ATT. D2Hawkeye is an international business process outsourcing firm with growing operations in Nepal. It is a medical data-mining company that provides decision support and builds fully integrated medical and financial databases for its clients. In five years, the company has grown to become one of the largest IT companies in Nepal. There are a number of other IT companies in Nepal offering IT and business process outsourcing services in the areas of medical transcription, digitization of maps and call centres to various international clients.

### Challenges and opportunities

Landlocked countries such as Nepal suffer from major handicaps, namely the lack of sea port access, high transportation costs in international transaction and limited access to global markets. In this context, the IT industry, where most business transactions do not necessarily need such facilities, can be another potential for Nepal. Therefore, an effective strategy



to develop this sector and to tap the benefits can be explored. Proper development of Internet, e-commerce (B2C, B2B) and software can be beneficial for Nepal. E-commerce especially holds potential benefits for Nepal: it not only boosts the economy, but helps create employment, develop other services sectors and spur trade in manufacture and industrial goods. Its geographical proximity and open border with India, which is emerging as a leader in IT industry, can also be instrumental in the development of Nepal's IT sector. Therefore, effective planning and coordination with India may help Nepal explore the potential of this industry.

Realizing the full potential for growth of Nepal's IT and software services sector requires overcoming a number of important challenges. The use of IT in Nepal's economy has already demonstrated the ability to generate cost savings and efficiency, productivity and economic opportunities through links to international partners, suppliers and consumers. Travel and tourism, banks and financial institutions, trading and export business, government administration, engineering, financial institutions, accounting services, the education institutions and hospitals are the major IT-enabled sectors in Nepal. Exporting IT services to global markets has also been a boon to the sector, while generating foreign exchange and employment. Major ITES and business process outsourcing export markets of significant potential for Nepal include call centres for marketing, customer support and accounts receivable; medical transcription; back-office operations; accounting, insurance claims processing; Web or digital content development, mapping and digitization.

Important advances made to facilitate the ICT sector include the establishment of a new legal infrastructure under the Electronic Transactions Act of 2005 to promote tele-medicine, distance learning, teleprocessing and e-commerce. Importantly, Nepal seeks not only to position itself in the IT services industry as a low-cost business process outsourcing provider, but also to develop high value-added IT services, including software development. New procedures have also been defined to facilitate the export of computer software through IT. Also important has been Nepal's strengthened commitment to protect IT-related intellectual property rights through the formulation of new laws.

However, realizing the full benefit of IT services and software products and services for the Nepalese

economy requires that remaining impediments to growth in the ICT sector be identified and effective policies to address them be developed. Some areas where improved policies and actions may be needed include government efforts to provide enhanced and more effective government support to the business process outsourcing and software industry through subsidies, export promotion and start-up financing. Establishing national research and development and marketing assistance centres, the promotion of software developed in country through government procurement, improved support for intellectual property protection and software certification programmes. Although Nepal already has laws related to intellectual property protection, enforcement remains inadequate. Without protection against piracy, Nepal's own software development firms are unable to build a national market for their products.

Moreover, immigration regulations may need to be reconsidered. Barriers related to visa and work permit procedures are one of the major restrictions under Mode 4. There are no distinctions between temporary and permanent movement of workers, and the process is complicated, non-transparent and costly. In addition to immigration policies, the lack of uniformity in workers' training and standards and a harmonized process for the evaluation of the quality and skills of workers in developing countries, further hampers the export of professional human resources.

As the sector matures, it is expected to make a major contribution to employment creation and export growth. Dynamic export growth has already been recorded in the sector. In just five years from 2001 to 2007, annual IT-services exports increased from less than 1 million dollars to over 30 million dollars. There is substantial national and international market demand for IT services to be captured in maturing the sector:

- Business process outsourcing, including electronic data entry and processing;
- ITES-based call centres;
- Software development;
- Data disaster recovery services and centres;
- Engineering design services;
- Online education and high-end ICT training;
- Technical documentation;
- Website development services.

However, sustained growth of the sector has encountered a range of problems, including regular and unpredictable electricity outages, the need for a fibre-optic connection to international networks – which has recently been resolved – high Internet connectivity costs, skill shortages for highly-specialized IT services, weak intellectual property right laws, few government initiatives to promote and support the sector and limited sources of investment.

### Strategic options for the sector

To sustain growth in the sector, efforts are needed to expand ICT use throughout the economy to further stimulate domestic demand for it. Export promotion efforts are equally needed to stimulate increased external demand for Nepalese IT services and software. Actions could thus be aimed at:

- Promulgating greater national use of the computers and the Internet;
- Broadening government incentives to attract investment in the sector;
- Providing Government support for vocational educational programmes to train business process outsourcing services workers;
- Liberalizing immigration policies and incentive plans for skilled foreign workers for highly specialized niche skills;
- Building stronger alliances with foreign ICT companies, particularly in India, through joint projects;
- Encouraging greater investment in the sector through mergers and acquisitions of successful start-up companies;
- Increasing broadband capacity and reducing Internet connectivity costs to increase domestic ICT consumption to middle and lower income households and smaller SMEs.

## 4. NATIONAL EFFORTS AND POLICIES TO SUPPORT SMALL AND MEDIUM-SIZED ENTERPRISES IN THE SERVICES SECTORS

Despite their small individual size, taken together, SMEs in Nepal's export-oriented services sectors provide a major engine of employment and growth.

Ensuring the success of SMEs is thus critical to sustained economic growth in Nepal.

Empirical evidence indicates that SME clusters are fundamental to the success of SMEs in most economic sectors in countries throughout the world.[13] A cluster is defined as a sectoral and geographical concentration of enterprises that benefit from common external economies[14] such as shared suppliers of technological inputs, shared pools of workers with sector-specific skills, and similar demands for tourism, and ITES and software services products designed to meet the needs of sectoral firms. Clusters not only allow for sharing of upstream inputs, but also of downstream buyers and agents who build and sell packages of goods and services to distant markets and who provide information on trends, clients and demand in foreign markets.

Although SME clusters are traditionally viewed as a mechanism benefiting industrial producers of goods, the potential of developing clusters to enhance the competitiveness and facilitate the growth of SME service providers warrants further exploration. These enterprises can capture a wide range of economic benefits by cooperating with other co-located SMEs active in the same and closely related sectors. Rather than viewing their peers as competitors, in clusters SMEs are encouraged to collaborate with their peers as partners in many shared business functions to jointly reduce costs, improve efficiency, attract investment and access new markets.[15]

There are many ways in which clusters can help member SMEs achieve these objectives, such as facilitating joint purchases of goods and technologies used in the sector's business, by sharing administrative and marketing operations and by forming consortia to attract both domestic and foreign investment. Clusters also allow SMEs to greatly enhance their export capacities by encouraging inter-firm collaboration in responding to large foreign orders that would otherwise exceed the capacity of any one member.

Inter-firm cooperation to facilitate technology transfer may be of particular interest to firms in Nepal's tourism, ITES and software services sectors. It can be focused not only on reducing costs for capital equipment that can be shared collectively among firms, but also on increasing the potential to attract financing needed for firm growth and acquisition. The combined assets, cash flow and liability of two or more firms greatly reduce the risk of defaults on borrowed capital and

**Box I.2. Strengths, weaknesses, opportunities and threats of the information technology, information technology-enabled services, and business process outsourcing sector in Nepal**

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Proven potential</li> <li>• High level of government commitment and support</li> <li>• Educated and trained workforce</li> <li>• English-speaking workforce</li> <li>• Low labour costs</li> <li>• Growing and modern ICT infrastructure</li> <li>• New optical-fibre connection to global networks</li> <li>• Diversified activities within sector</li> <li>• ISO certification of many firms</li> <li>• Strong and comprehensive institutional set-up in both public and private sectors</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• Inadequate enforcement of intellectual property protection</li> <li>• Limited availability of finance and investment</li> <li>• Human resources practices and organizational management to be improved</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Building stronger cooperation and investment links with India and China</li> <li>• Extend ICT access to rural population</li> <li>• More effective partnerships between firms and the universities, including through work-study internship programmes</li> <li>• Cooperation among SMEs in meeting foreign demand, international marketing and sharing human resources</li> <li>• Restored political stability</li> <li>• Return of diaspora to sectoral activities as sector prospects improve</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Growing levels of international competition</li> <li>• Global economic crisis</li> <li>• Brain drain to foreign markets of highly qualified professionals</li> </ul>

Required spill-ins from other sectors: Improve supply of skilled labour from the education sector.

Anticipated spillovers into other sectors: Provide local, low cost business process outsourcing services to Nepalese industry. Sectoral services improve efficiency and competitiveness of national firms.

Key stakeholders: Relevant government ministries and parastatals; sectoral firms, universities, labour groups, professional associations.

correspondingly enhance attractiveness for loans. In addition, closely cooperating competitive firms forming an export consortium often attract the interest of large international enterprises seeking to invest in new services industries in developing-country markets with high returns to investment, thus providing SMEs with the potential to attract foreign direct investment. It is extremely difficult for an individual SME to attract foreign direct investment, however, clusters of competitive SMEs often succeed in doing so.

Developing country SME clusters that have been successful in attracting foreign investment are those

in economies such as Nepal that benefit from a comprehensive programme of financial reforms, including the privatization of dynamic sectors, floating currencies, tax and duty-free industrial zones, sectoral trade liberalization and a substantial lowering of limitations to the free flow of cross-border capital. In Nepal, transparent regulations and policies, and accessible information on national institutions should attract the interest of prospective investors in the private sector. Taking into account limitations on foreign ownership set forth in Nepal's schedule of GATS commitments, foreign direct investment

can take place either through the direct entry of foreign firms through multinational joint ventures with domestic firms or simply foreign equity participation in existing domestic firms. In either case, the investing firm or consortium retains significant control of, and earns dividends on, its investments. Recipients benefit from foreign investment in sectoral infrastructure and facilities and from long-term technical cooperation.

Cooperation among Nepalese SMEs in services sector clusters can provide many of the above economic benefits. Inter-firm cooperation could also allow Nepalese firms to learn from each other through mutual exchanges of sector-specific information and trends relating to business techniques, financing and foreign markets, thus supporting collective learning curves that are significantly faster than those achievable by individual firms. However, although many of the benefits of clustering appear self-evident when viewed from outside, from the perspective of an SME considering its participation in a cluster, there is often considerable reluctance to actively engage in cooperative approaches to its business. Negative perceptions include the potential loss of trade secrets, resourceful employees and captive clients to other cluster members. Perception barriers may need to be overcome through national sectoral dialogue.

National dialogue should also examine what scope exists for the Nepalese Government to further advance an enabling environment for cluster development by promoting supportive policies and incentives, streamlining administrative regulations and serving as a cluster facilitator. For example, the Nepalese Government may seek to direct foreign direct investment to clustered SMEs in specific services sectors through a number of policy instruments, such as sector-specific investment guarantees, tax rebates, grants and subsidies.

National dialogue in Nepal should aim to increase awareness of private-sector decision makers and government policy makers of opportunities to enhance SME competitiveness by participating more fully in, and actively supporting cluster development, respectively. Participation in sectoral SME clusters should also be of interest to academic officials seeking to enhance coordination between the private sector and both technical schools and universities in order to enhance human capacity and technology transfer in national services industries. In their development of improved loan and credit instruments, financial institutions may also pay consideration to identifying difficulties faced

by SMEs in meeting capital requirements for start-up and technology acquisition, in order to develop tailored financial instruments to respond to market needs.

## **5. NATIONAL TRADE POLICIES FOR THE EXPANSION OF KEY SERVICES SECTORS**

### **5.1. Nepal's commitments to the General Agreement on Trade in Services**

Since in 1995, the entry into force of the Uruguay Round Agreements has facilitated an increase in trade and investment for the services sectors in many countries that undertook specific GATS commitments to open their services economies. These commitments were made as part of the first round of GATS negotiations – an integral part of the Uruguay Round – which commenced in 1986. Nepal assumed a large number of specific commitments under GATS in 2004 upon accession to WTO, including commitments to open its tourism and ITC services sectors.[16] The GATS agreements have stimulated considerable investment in the Nepalese economy, locked in key national policy reforms needed to ensure the competitiveness of the sectors and helped promote higher levels of export of these sectors. The liberalized tourism sector has witnessed substantial expansion in Nepal over the past four years. Recently, the tourism and ICT services sectors have demonstrated consistent year-on-year growth. [17]

Generally, Nepal has extended liberal market access for services imports through its horizontal commitments under GATS. Nepal has also pledged that the supply of services by an existing foreign supplier will not be made more restrictive than they were at the time of Nepal's accession to WTO. This commitment reflects that Nepal has agreed not to make the regime more restrictive than what exists at present. However, the movement of natural persons has been made unbound, or restrictive, except in the categories of services sales persons, persons responsible for setting up a commercial presence, and transferees within a corporation. Nepal has also committed to providing national treatment without any limitation. No limitation has been placed in respect to consumption abroad, though as specified earlier, the present limit of providing foreign exchange to

Nepalese citizens will continue.

With respect to commercial presence, no limitation on national treatment has been placed on foreign investments and reinvestments, save two conditions: that both of these requires approval from the Department of Industry, and incentives and subsidies, if any, will be available to wholly owned Nepalese enterprises only. With regard to the presence of natural persons, it has been unbound or restrictive except specified in the natural person category for market access. The schedule also places restrictions on foreigners who wish to buy and sell real estate in Nepal. The Civil Code prohibits selling, mortgaging, gifting or endowing real estate to foreigners. Additionally, Nepal has committed to providing decisions within 30 days of the date of application for investments, except when environmental impact assessments are needed. Nepal has made it clear that such investments will not be withheld normally unless environmental standards are not met. This is a wide-ranging commitment and indicates that Nepal has opened foreign investments with full commitment. The following facilities for the repatriation of investment in foreign currency have been agreed:

- The amount received by the sale, in whole or part, of the investors' share of equity;
- The amount received as profit or dividend as a result of an equity investment;
- The amount received as the payment of the principal of and interest on any foreign loan;
- The amount received under an agreement to transfer technology approved by the Department of Industry or Department of Cottage and Small Industries.

Nepal has also made specific commitments in various services sectors, the major features being as follows:

- No restrictions generally have been put in cross-border supply and consumption abroad, although for the latter the foreign exchange limitation has been continued;
- Natural persons will not be allowed to operate except as specified, for example, as sales persons for a limited time, those coming for feasibility studies and as managers and specialists whose number have been limited to 15 per cent of local employees;
- Nepal will provide market access through a commercial presence. This would require all entities to create a commercial presence before entering into the Nepalese market;
- Foreign equity participation is allowed:

- Up to 51 per cent in accounting, auditing and book keeping services; veterinary services; research and development services; rental or leasing services without operators (to be increased to 80 per cent 5 years after Nepal's accession to WTO); market research and public opinion polling services; management consulting services; technical testing and analysis services; services incidental to mining; related scientific and technical consulting services; packaging services; printing and publishing; convention services; general construction work for civil engineering (to be increased to 80 per cent 5 years from the date of accession); distribution services (to be increased to 80 per cent 5 years from the date of accession); franchising; higher, adult and other education services (which will be increased to 80 per cent 5 years from the date of accession); sewage, refuse disposal and similar services (which will be increased to 80 per cent 5 years from the date of accession); hospital services; tourism (travel agency and tour operators); cinema theatre services, including cinema projection services, with a minimum foreign investment of \$1 million required and foreign equity participation will be increased to 80 per cent 5 years from the date of accession); maintenance and repair of aircraft (to be increased to 80 per cent after 5 years from the date of accession); computer reservation services (will be increased to 80 per cent 5 years from the date of accession); transportation of fuels and other goods; and storage and warehouse services (to be increased to 80 per cent 5 years from the date of accession);
- Up to 67 per cent in architectural services; engineering services; integrated engineering services; urban planning and landscaping; advertising services; and financial services;
- Up to 80 per cent in computer and related services; courier services; basic telecommunications; mobile telecommunication services; value-added telecommunications; wholesale trade services of radio and television equipment, musical instruments, and records, music scores and tapes; hotel and lodging (star hotels only) and graded restaurants.



## 5.2. Liberalization of trade in services within the Regional Forum of the South Asian Association for Regional Cooperation

Services and services infrastructure are very important for the development of a developing country such as Nepal. The global welfare effect of services liberalization is deemed to be roughly of the same order of magnitude as that associated with full liberalization of barriers to trade in merchandise (Organisation for Economic Co-operation and Development: 2002). Moreover, it was found that developing countries stand to gain relatively more than industrial countries for liberalizing their services trade (Chadha: 1999). Similarly, it is argued that Mode 4 liberalization could generate global gains ranging from \$150 million to over \$300 million per year (OECD: 2003).

These clearly indicate that the SAARC agreement on services can have major benefits for LDCs such as Nepal. Moreover, in LDCs where the provision of both essential and commercial services is at times inadequate, imports of services can add to the overall availability of services and to the variety and quality from which individual and corporate consumers can choose.

However, the claimed benefits of services liberalization are disputed. Critics cite instances where services liberalization, especially when coupled with privatization, has in fact led to job losses, higher prices and discontinued service provision to the poor where suppliers choose to focus on more profitable segments of society. This can be especially contentious where public services such as water, electricity and health care are involved. Similarly, it is claimed that foreign direct investment in services and technology and skills transfer or spillovers should allow foreign suppliers to contribute to technological advancement in certain sectors, enabling LDCs to improve their local capacity to world-class standards. However, this is true only in high-tech and information-intensive services such as communications, finance, and in public services such as health and environmental services. A frequent lament from developing countries is that the promised technology transfer often does not take place for intellectual property protection and other reasons. The growth of services firms can create employment opportunities for skilled university graduates and school leavers, helping to stem the brain drain that affects many LDCs. Communication technologies can enable services firms to operate with a scattered telecommuting workforce – creating

jobs in remote areas, thereby reducing pressure on urban areas.

It is also argued that specific commitments in a country's GATS schedule constitute a minimum standard allowing foreign firms to enter a country's market. The extent to which this stability and certainty attracts foreign direct investment is debatable because there are many other factors that influence the decision to invest. Indeed, there is no empirical evidence to link any significant flows of foreign direct investment to developing countries and LDCs with the conclusion of GATS. Finally, as with goods, there are also negative consequences that can arise from poorly planned liberalization. Indeed, there is still no consensus as to whether certain critical services such as health and education should be subject to liberalization at all. Hence, in undertaking liberalization, LDCs need to pay close attention to sequencing, pacing and ensuring that the appropriate regulatory frameworks are in place. UNCTAD's Note on Services provides further discussion of key requirements for regulatory and institutional frameworks (UNCTAD: 2009).

## 5.3. General discussion of policy options for Nepal

Recognizing the stance taken by the Government and major parastatal and private stakeholders in key services sectors to increase private participation in, and in some cases to liberalize, key services sectors, all must now agree on the best way forward to advance the liberalization process, subregionally through SAARC and multilaterally through GATS and transcontinental economic partnership agreements. Whether, how and with whom Nepal should pursue services liberalization remain crucial decisions that need to be taken carefully and on the basis of national economic, social and developmental objectives and circumstances. The challenge for Nepal will be to ensure coherence between its national development policies on the one hand, and regional, interregional and multilateral trade negotiations on the other.

Trade liberalization options are varied yet clear: multilateral, interregional, regional, bilateral or autonomous. National stakeholders must examine which options, or combinations thereof, have the greatest potential to meet agreed objectives. Each option has its advantages and disadvantages, some of which are briefly outlined below:

- Opening services sectors to a global market

under multilateral liberalization under GATS may provide the greatest opportunities for investment and employment, but will limit opportunities for ownership and control, and potentially introduce significant competitive shocks, which, if they occur too abruptly and/or in the absence of adequate flanking policies, may negatively impact national SMEs and consumers. Moreover, GATS liberalization will expose Nepalese firms to considerable foreign competition, particularly from developed country firms, and it is legally binding and very difficult to reverse. Pursuit of multilateral liberalization should thus include carefully designed restrictions on market access and national treatment that include performance requirements and economic needs tests where necessary to ensure development gains;

- Interregional and bilateral options may be difficult to manage administratively and may not provide sufficient levels of competition among foreign entrants;
- In the absence of a complementary multilateral agreement, bilateral, regional and interregional agreements may reduce the number and diversity of potential market entrants;
- Regional liberalization has the advantage of being among more similar economies; however, opportunities for foreign investment from regional markets would be more limited than under multilateral liberalization. At the same time, options for Nepal within the agreements to which it is currently a party – SAARC – do not currently have integral services trade agreements, and advancing these existing agreements, or developing entirely new agreements with other parties, will take time to initiate, negotiate and conclude;
- Hybrid solutions should be considered. Regional liberalization, for example, in the context of SAARC, could complement liberalization at the multilateral level and provide a number of export opportunities. Liberalization at the regional level could also serve as a stepping stone towards liberalization at the multilateral level, whereby, after generating regional supply capacity and trade in certain services sectors, particularly sensitive sectors, Nepalese service suppliers would possess a strengthened ability to venture into global markets;
- Autonomous liberalization could be effected quickly through national reforms and laws, but national stakeholders may resist such moves, and autonomous reversible reforms would not send

a strong signal to foreign investors that Nepal's liberalization commitments are firm, and for all practical purposes, irreversible and permanent. Without sufficient confidence, foreign investors may be less willing to make investments in liberalized sectors.

Which liberalization options are best for Nepal? Does the best way forward depend on the sector in question? What practical considerations must be assessed: timing, sequencing and administrative burden? Any assessment of how to best liberalize a services sector must be considered against the aims of the liberalization process.[18] [19] For each sector in which liberalization is being considered, several important questions need to be answered:

- Is Nepal seeking to enhance export opportunities or improve prospects for inward investment?
- On the domestic front, is Nepal seeking to simply replace current public-sector providers or rather to encourage growth in the sector by providing incentives for new private services providers to enter targeted sectors of the market alongside the public-sector players in public-private partnerships?
- Is Nepal seeking to attract investment from regional players from other developing countries, international players from developed countries, or both?
- Is Nepal seeking to encourage players from select countries (i.e., from country X, Y or Z) to enter its market as investors, or rather a much larger varied mixture of players that would enter the market under more competitive conditions?
- How important is it for Nepal to demonstrate that it will not backtrack on its market-opening commitments?
- What sequencing of market opening is desirable based on future expectations for the sector, both in Nepal and in South Asia?

Consideration of these questions should be made against the set of shared aims defining the country's stance in developing the tourism, and the software and IT services sectors:

- To encourage growth in the sector by providing incentives for new service providers to enter targeted sectors of the market alongside public-sector players in public-private partnerships;
- To attract investment from top international players from both developing and developed countries;
- To encourage the most competitive players from a large varied mixture of players to enter the market;

- To demonstrate that market-opening commitments are firm and permanent in order to encourage investment;
- To open national markets first to encourage inflows of investment and subsequently expand services activities, including through outward investments in regional markets, as a regional services hub.

There is a need to move quickly in order to (a) ensure these sectors open fast enough to generate national employment opportunities lost in declining sectors (i.e., agriculture, textiles and clothing); and (b) secure an early mover advantage in these sectors (relative to other countries in the region) in order to establish Nepal as a regional hub for each of these emerging sectors.

UNCTAD works with Nepal through a project entitled, Assistance to Developing Countries on Services, Development and Trade Negotiations to assess approaches and options for regional and multilateral services trade liberalization, including through a comprehensive questionnaire-based study. Such assessments can assist countries determine which approaches to liberalization are best suited to meeting national development objectives and generating gains from trade in each of the sectors selected for liberalization and in the wider national and regional economies.

#### **5.4. Planning and the wider policy framework for services development**

The growth story of the ICT and tourism services sectors in Nepal, and more broadly, recent growth of the economy as a whole, is consistent with results from a recent multi-country study of trade liberalization in these sectors providing econometric evidence that openness in services influences countries' long run growth rates by improving efficiency in national economies.[20] Specifically, the study shows that countries with fully open services sectors grow up to 1.5 percentage points faster than other countries.

However, not all countries liberalizing these sectors experienced increased growth. In this context, UNCTAD's work to assess the impacts of trade liberalization in developing countries finds that not only the quantity of opening, but also the quality thereof is important – that is, how various elements of complementary national policy measures influence entrepreneurship, ease of entry, labour recruitment and investment in liberalized sectors. Specifically,

UNCTAD finds that “The issues of the pace and sequencing of reforms and the impact of regulatory frameworks on the final outcome of trade liberalization have received increased attention as they seem crucial for assuring development gains from services trade liberalization. There is also a need to identify flanking policies to strengthen domestic capacities in services. Trade liberalization alone does not guarantee that services needed for growth and development will automatically emerge in developing countries”.[21]

In this context, UNCTAD further emphasizes: “While analysis of such experiences is increasing, to date there is still a lack of understanding about the functioning of the various policies, and there is even less understanding about the ways in which these options may play out in different economic and social scenarios. In order for privatization and liberalization to deliver their expected benefits, there is a need for more analytical work on types of flanking policies (which are in themselves not cost-free), their pros and cons, the range of situations in which they produce desirable results and their potential for failure (their costs and who pays the costs). Finally, relying on flanking policies to make privatization and liberalization work may – in certain cases – foreclose the more fundamental question about whether or not private-sector and foreign operators' involvement is the most suitable option in the first place. Even in developed countries there are sensitivities, particularly in respect of health, education and water services. All these complex issues need to be taken into consideration prior to deciding on whether or not privatization is the best option”.[22]

The current round of market access negotiations launched in 2000 under GATS Article XIX, aims to achieve progressively higher levels of liberalization of trade in services through the reduction or elimination of the adverse effects on trade in services of measures in order to provide effective market access. These negotiations provide developing countries with an opportunity to achieve commercially meaningful market access commitments in sectors and modes of interest to them and a progressive opening to market access consistent with their development situation. This includes the flexibility to open fewer sectors and liberalize fewer types of transactions (i.e., Modes 1–4). Key objectives for developing countries, including Nepal, should be not only to maximize flows of services exports, but to ensure developmental gains from increased services trade to contribute to building



a competitive services sector and maximization of overall level of development at the national level. [23][24] Accordingly, of the sectors where further liberalization is currently possible under GATS, those selected for further liberalization should contribute to the following goals: [25]

- Strengthening of the sector by introducing competition, efficiency and transfer of technology;
- Strengthening other goods and services sectors (producer services);
- Expansion of exports of goods and services;
- Infrastructure building (telecommunications, transport and financial services);
- Attracting foreign direct investment where no or only limited service capacity presently exists (foreign direct investment, by opening a commercial presence with appropriate limitations and performance requirements, could contribute to domestic capacity-building);
- Developing sectors in which the country has achieved considerable capacity and competitiveness;
- Locking in the process of domestic reform.

Each liberalized sector in Nepal should be screened against the above benchmarks by stakeholders. This process also needs to be accompanied with the identification of potential regulatory barriers in major trading partners which may prevent greater outsourcing or delocalization of services of export interest to developing countries. Moreover, supportive SME policies that provide financial incentives, including government-sponsored mechanisms offering start-up financing on attractive and easily accessible terms to firms in the sector, could be designed and put in place to facilitate SME entry into the new candidate sectors.

## D. RECOMMENDATIONS FOR NATIONAL CONSULTATIONS

National dialogue and consultation on how to proceed in developing the new candidate services sectors discussed above have been undertaken in

Nepal. However, additional talks are now needed to set objectives and strategies for the current round of GATS negotiations. All relevant stakeholders from government, parastatals, the private sector, labour groups, civil society and academia should work together to draw up a national master plan to develop the services sector (for details see Section III.A), seeking to answer the following questions:

- Is there too much, or not enough, opening in the tourism and ICT services, as well as other liberalized sectors? Does Nepal's new or current offer reflect these prospects?
- Were regulatory frameworks for the telecommunication and tourism services markets sufficiently robust before these sectors were opened up by GATS?
- To what extent was additional regulation needed and how quickly was it developed and implemented?
- Should additional openings be made in other sectors such as the financial, insurance, environmental, education and health-care services sectors in order to build synergies with export development efforts in the tourism and ICT services sectors?
- What are the development advantages and disadvantages of liberalizing the environmental, education and health-care sectors for tourism and IT services?
- What are the outstanding development concerns associated with liberalizing the environmental, education and health-care sectors?
- What positive linkages with merchandise trade are anticipated with ICT-sector development?
- What limitations on market access and national treatment, horizontally and by sector and subsector, can be devised to maximize development gains from the services sectors?
- What positive and negative interactions exist between the liberalized services sectors?
- What concessions do stakeholders desire from Nepal's trading partners? What sectoral liberalization requests should Nepal make, and to which countries?

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# III

## **NATIONAL SERVICES POLICY REVIEW OF NEPAL: TOURISM AND INFORMATION TECHNOLOGY SERVICES**

## A. OVERVIEW OF NEPAL'S SERVICES SECTOR

### 1. Introduction

A thriving services sector is vital for all countries. Studies have shown that countries with fully open services sectors, compared with those whose sectors are not, grew up to 1.5 percentage points faster. The high rate of investment and economic growth associated with services can contribute to poverty alleviation and human development if the right policies are in place. Service and service trade will also allow the right environment to overcome supply constraints and ensure economy-wide development gains. This development however, requires devising an enabling national service policy and development strategies.

The service industry has emerged as one of the major contributors to world GDP, providing more than 70 per cent in developed countries and around 50 per cent in developing countries. Like many other countries, the Government of Nepal is also increasing its emphasis on the services sector, considering its importance to the Nepalese economy in terms of its contribution to GDP, employment, international trade and balance of payments. This study aims to survey some of the achievements Nepal has already made in developing tourism services and ITC-related services and to examine what remains to be done for further development in these sectors, including through regulatory, institutional and trade policy reforms. The present National Services Policies Review is being carried out with UNCTAD's financial support and technical inputs.

### 2. Economic performance

The Central Bureau of Statistics of Nepal has introduced a new series of National Accounts Statistics since 2006/07 taking 2000/01 as the base year, following the 1993 United Nations System of National Accounts adopted by a number of countries around the world. A new series was necessary to reorient the national accounts preparation method, introduce new concepts and definitions, and respond to the need for new classification. Prior to this, Nepal's national income statistics was based on the 1968 system of national accounts.

Adoption of the 1993 system of national accounts is, in fact, considered to be a step forward in defining and conceptualizing key macroeconomic variables such as production, consumption and investment. The economic activities under this system have been classified into 15 sectors, compared with 9 in the 1968 system of national accounts. The new system also provides an estimation of value addition, production and intermediate consumption. The International Standard Industrial Classification of All Economic Activities, Revision 3, has, in fact, classified the entire economy into 17 sectors. In the case of Nepal, however, the contribution to GDP of workers in private households and the activities of foreign missions and international NGOs is negligible; therefore, the data pertaining to these two sectors have been included in the Other Community, Social and Individual Services category, bringing the total to 15 sectors only.

The new series includes many service activities not included in the previous series – microbus and cable car services, public call offices, mobile telephones, Internet, cable television, rental service, services of employment agencies, cooperatives, consultancies, computer and photography, private postal services, private-sector education services, community forestry and others. Thirty new surveys and studies were conducted to strengthen national income statistics. Improvements were also made in the national accounts survey frame and estimation methods.

#### 2.1. Contribution to gross domestic product

According to the new classification, the contribution of service and non-services sectors to GDP for the year 2007/08 is shown in figure II.1.

The above-mentioned 15 sectors have also been broken down into three broad sectors: the primary, secondary and tertiary sectors. The primary sector includes agriculture and forestry, fisheries, and mining and quarrying; the secondary sector covers manufacturing, electricity, gas, water and construction; and the tertiary sector includes the entire services sector, except for water, gas and construction. The growth and contribution of these sectors to GDP over the past 8 years is shown in table II.1.

The table shows that the share of these sectors for the fiscal year 2007/08 was 33.09 per cent, 15.70 per cent and 51.21 per cent, respectively. The contribution of the services sector has been increasing gradually over the years. The growth rate of the tertiary sector is

Figure 1. Sector wise contribution to GDP

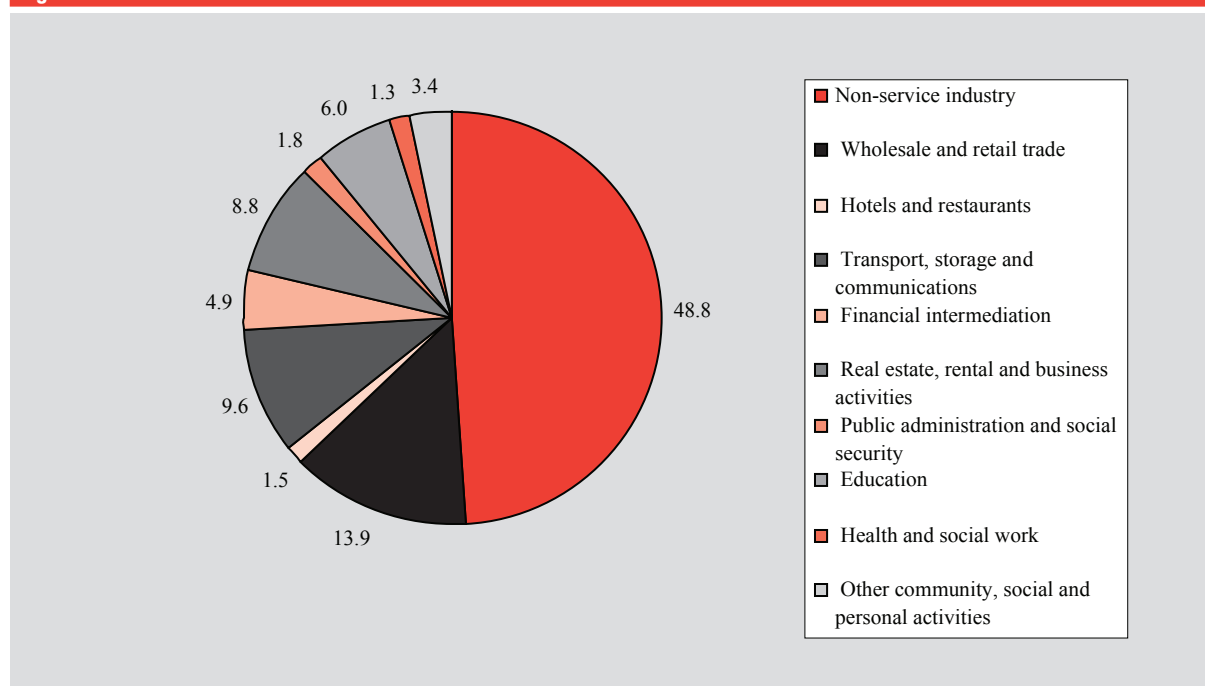


Table II.1. Sectoral contribution to GDP and GDP growth rate

Description	2000/0	2001/0	2002/0	2003/0	2004/0	2005/0	2006/0	2007/08
Annual GDP (constant price) growth rate	---	0.16	3.77	4.41	3.23	3.73	2.74	5.26
Primary sector	---	3.15	3.33	4.75	3.54	1.86	0.98	4.68
Secondary sector	---	0.66	3.09	1.48	2.91	4.37	4.02	1.82
Tertiary sector	---	-1.78	3.68	6.82	3.33	5.63	4.49	7.00
Composition of GDP (in percentage)	---	---	---	---	---	---	---	---
Primary sector	37.01	37.89	36.98	36.42	35.67	34.08	33.00	33.09
Secondary Sector	16.86	17.05	17.15	16.78	16.65	16.18	16.07	15.70
Tertiary Sector	46.13	45.06	45.87	46.81	47.68	49.74	50.93	51.21

Source: Government of Nepal/MOF, Economic Survey, Fiscal Year 2008/09  
R: Revised.

also the highest (7 per cent), compared with the two other sectors.

Table II.2 provides a further breakdown of three broad services sectors into 15 sectors.

Table II.2 shows that the percentage share of the service industry in Nepal rose from 46 per cent in 2001/02 to over 51 per cent in 2007/08. Among these services, the share of wholesale and retail trade sector is the largest, followed by real estate,

rental and business activities; transport, storage and communications; education and so on. Financial intermediation, followed by the education sector, has shown remarkable growth. The share of financial intermediation increased from 2.69 per cent in 2000/01 to 4.86 per cent in 2007/08. Similarly the share of education jumped from 4.08 per cent in 2000/01 to 6.00 per cent in 2007/08. Hotels and restaurants under the tourism sector contribute about 1.5 per cent. The *Economic Survey of Nepal* does not include

**Table II.2. Sector-wise GDP composition (percentage), 2000/01–2007/08**

Sector	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Agriculture and forestry	36.15	36.92	36.03	35.45	34.71	33.09	32.04	32.11
Fishery	0.43	0.49	0.46	0.48	0.47	0.49	0.47	0.49
Mining and quarrying	0.43	0.48	0.49	0.48	0.49	0.50	0.49	0.49
Manufacturing	9.03	8.50	8.20	8.05	7.92	7.59	7.48	7.16
Electricity, gas and water	1.82	2.06	2.42	2.31	2.26	2.09	2.13	2.01
Construction	6.01	6.49	6.54	6.42	6.47	6.50	6.46	6.53
Wholesale and retail trade	16.44	14.59	14.51	15.29	14.09	14.31	13.43	13.94
Hotels and restaurants	1.99	1.61	1.59	1.73	1.57	1.49	1.44	1.49
Transport, storage and communications	7.39	7.87	8.31	8.94	9.06	9.72	9.91	9.58
Financial intermediation	2.69	2.75	2.72	2.65	3.06	3.49	4.08	4.86
Real estate, rental and business activities	8.29	8.23	8.08	7.72	8.69	9.53	10.15	8.77
Public administration and social security	1.24	1.63	1.70	1.55	1.69	1.74	1.75	1.83
Education	4.08	4.69	5.19	5.08	5.59	5.55	5.81	6.00
Health and social work	0.98	1.04	1.14	1.12	1.24	1.24	1.26	1.29
Other community, social and personal activities	3.03	2.66	2.63	2.73	2.69	2.67	3.12	3.44
Subtotal (non-service industry)	53.87	54.94	54.14	53.19	52.32	50.26	49.07	48.79
Subtotal (Service industry)	46.13	45.07	45.87	46.81	47.68	49.74	50.95	51.20

Source: Government of Nepal/MOF, *Economic Survey, Fiscal Year 2008/09*.

the entire tourism sector. This will be accomplished by using satellite accounting methodology, developed by the World Travel and Tourism Council, in the following section. Unlike WTO, where construction is classified as a services sector, the *Economic Survey of Nepal* does not include construction under the services sectors. If included, the contribution of the services sector becomes even higher. The contribution of the construction sector<sup>1</sup> to GDP in Nepal was 6.53 per cent in the 2007/08 fiscal year.

## 2.2. Contribution to trade

With a trade-to-GDP ratio of more than 50 per cent, an average tariff rate of about 14 per cent and virtually no quantitative restrictions, Nepal is one of South Asia's most open and trade-dependent economies (Ministry of Industry, Commerce and Supply: 2004). Nepal has adopted a more open trade policy in recent years, as shown by its WTO membership and related commitments. Nonetheless, its total exports have always remained below imports, resulting in trade deficits, and therefore, a balance-of-payments deficits

even with the current transfer. This indicates that there are either other factors that affect the import–export ratio, for example, the availability of limited export items, or that other countries are more open to trade than Nepal.

**Table II.3. Nepal's exports and imports of services (in millions of dollars)**

Year	Exports	Imports	Net exports
2000	506	200	306
2001	413	215	198
2002	305	237	68
2003	372	266	106
2004	461	385	76
2005	380	435	-55
2006	386	493	-107
2007	477	657	-180

Source: UNCTAD *Handbook of Statistics, 2008*.  
([www.stats.unctad.org/Handbook/TableViewer/tableView.aspx](http://www.stats.unctad.org/Handbook/TableViewer/tableView.aspx))



**Table II.4. Trade in services in Nepal by major sectors (in millions of dollars)**

Year	Export / Import	Sectors			
		Total services	Transport	Travel	Other Services
2000	Export	505.9	61.4	157.8	286.8
	Import	199.9	64.8	73.3	61.9
	<b>Net export</b>	<b>306.0</b>	<b>-3.4</b>	<b>84.5</b>	<b>224.9</b>
2001	Export	413.3	47.3	143.8	222.2
	Import	214.7	71.6	79.7	63.3
	<b>Net export</b>	<b>198.6</b>	<b>-24.3</b>	<b>64.1</b>	<b>158.9</b>
2001	Export	305.2	36.2	103.5	165.5
	Import	236.8	110.9	69.2	56.7
	<b>Net export</b>	<b>68.4</b>	<b>-74.7</b>	<b>34.3</b>	<b>108.8</b>
2003	Export	372.1	35.9	199.5	136.7
	Import	266.2	115.0	81.2	70.0
	<b>Net export</b>	<b>105.9</b>	<b>-79.1</b>	<b>118.3</b>	<b>66.7</b>
2004	Export	460.9	32.5	230.3	198.2
	Import	385.0	141.5	153.8	89.8
	<b>Net export</b>	<b>75.9</b>	<b>-109</b>	<b>76.5</b>	<b>108.4</b>
2005	Export	380.4	32.6	131.3	216.4
	Import	434.7	160.8	163.2	110.7
	<b>Net export</b>	<b>-54.3</b>	<b>-128.2</b>	<b>-31.9</b>	<b>105.7</b>
2006	Export	385.7	35.1	127.8	222.7
	Import	492.8	186.3	185.3	121.2
	<b>Net export</b>	<b>-107.1</b>	<b>-151.2</b>	<b>-57.5</b>	<b>101.5</b>

Source: UNCTAD Handbook of Statistics, 2008.

**Table II.5. Nepal's service trade, including Mode 2 trade (in millions of Nepalese rupees)**

Supply of services	Fiscal year							
	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Net	9302.3	3938.4	7049.7	9074.9	-2034.2	-6818.3	-8377.3	-11393.4
Credit	29821.7	23508.2	26518.9	34315.9	26001.9	26469.7	32078.9	42236.1
Debit	-20519.4	-19569.8	-19469.2	-25241.0	-28036.1	-33288.0	-40456.2	-53629.5
Credit: travel	11717.0	8654.3	11747.7	18147.4	10463.8	9555.8	10125.3	18653.1
Government services	7614.2	8894.5	6624.0	7143.9	6804.9	7441.5	12336.4	13301.8
Other Services	10490.5	5959.4	8147.2	9024.6	8733.2	9472.4	9617.2	10281.2
Debit: transportation	-9308.7	-8854.4	-8618.4	-9382.1	-10602.2	-12592.3	-14557.4	-22969.2
Travel	-5520.4	-5731.1	-6171.5	-10021.5	-9691.9	-11960.8	-15785.0	-20862.0
Other Services	-5690.3	-4984.3	-4679.3	-5837.4	-7742.0	-8734.9	-10113.8	-9798.3

Source: Quarterly Economic Bulletin (various issues), Nepal Rastra Bank.

Looking at the services sector trade from a global perspective, the imports and exports of services in the world economy are at about the same levels. The exports of services of developed countries are higher than the imports, whereas the imports of services of developing countries in general are higher than the exports. In the case of Nepal, the exports remained higher than imports until 2004, though showing a downward trend. However, imports exceeded exports from 2005 onwards, indicating the need to determine its causes and take necessary action. Table II.3 presents Nepal's exports and imports of services.

Table II.3 clearly reveals the decreasing net exports of Nepal from \$306 million in 2000 to \$76 million in 2004. There was a deficit of \$55 million in 2005, rising to \$180 million in 2007. Sectorwise, Nepal has had a deficit in transport services from the very beginning, but travel and other sectors have had a surplus, as shown in table II.4. However, since 2005, even the

travel services have started to show deficits, implying the need to pay attention to this sector as well.

The situation did not improve even after 2006, which is clear from the data provided by Nepal Rastra Bank, the central bank of Nepal. This is presented in table II.5.

Table II.5 shows a positive trade balance of services trade until 2003/04 and a positive balance of travel services until 2004/05 (credit, Nr 10.5 billion and debit, Nr 9.7 billion), which turned into a negative balance from then onwards.

### 2.3. Contribution to foreign investment

The contribution of the services sector in Nepal's total foreign investment is also substantial (table II.6) and its share in the recent inflows of foreign investment has also increased (table II.7).

**Table II.6: Industries permitted for foreign investment by mid-March 2009**

Industry type	Number of industries	Total project cost (in millions of Nr)	Total fixed capital (in millions of Nr)	Foreign investment (in millions of Nr.)	Number of people employed
Industrial Products	634	447,260	318,520	172,250	72,941
Service industry	482	250,330	205,860	114,970	25,285
Tourism industry	479	183,720	173,070	68,500	22,099
Construction	40	34,350	25,480	25,950	2,890
Energy	37	43,720	38,220	26,510	2,848
Agro-based	21	54,000	40,940	28,810	4,219
Mining	50	298,590	275,260	84,440	9,310
<b>Total</b>	<b>1743</b>	<b>1,306,980</b>	<b>1,082,350</b>	<b>521,430</b>	<b>139,592</b>

Source: Department of Industries, Tripureshwore

**Table II.7. Industries approved for foreign investments in the 2007/08 fiscal year**

Industry type	Number of industries	Total project cost (in millions of Nr)	Total fixed capital (in millions of Nr)	Foreign investment (in millions of Nr.)	Number of people employed
Industrial Products	51	3,028	1,920	1,244	3,775
Service industry	55	3,370	2,454	813	1,513
Tourism industry	67	783	697	745	2,180
Construction	13	2,119	1,585	1,804	1,143
Energy	8	7,346	7,288	2,868	967
Agro-based	11	127	100	107	377
Mining	7	3,630	2,853	2,230	722
<b>Total</b>	<b>212</b>	<b>20,403</b>	<b>16,897</b>	<b>9,811</b>	<b>10,677</b>

Source: Department of Industries, Tripureshwore

**Table II.8. Employment in various services sectors, 2007**

Sector	Employed population			Percentage of total (males)	Percentage of total (females)	Percentage of total
	Males	Females	Total			
Construction	229,464	48,321	277,785	4.4	1.3	3.1
Wholesale and retail trade	441,811	182,154	623,965	8.5	4.9	7.0
Hotels and restaurants	77,991	40,565	118,556	1.5	1.1	1.3
Transport, storage and communications	153,997	5,689	159,686	3.0	0.2	1.8
Financial intermediation	39,645	6,769	46,414	0.8	0.2	0.5
Real estate, rental and business activities	25,398	3,433	28,831	0.5	0.1	0.3
Public administration and social security	262,499	34,651	297,150	5.0	0.9	3.3
Education	166,814	58,151	224,965	3.2	1.6	2.5
Health and social work	43,172	17,936	61,108	0.8	0.5	0.7
Other community, social and personal activities	60,379	9,947	70,326	1.2	0.3	0.8
<b>Subtotal (service industry)</b>	<b>1,501,170</b>	<b>407,616</b>	<b>1,908,786</b>	<b>28.8</b>	<b>11.0</b>	<b>21.4</b>
<b>Total (all industry)</b>	<b>5,212,329</b>	<b>3,689,065</b>	<b>8,901,394</b>	<b>---</b>	<b>---</b>	<b>---</b>

Source: Government of Nepal/Central Bureau of Statistics, *Statistical Year Book of Nepal, 2007*.

Of 1,743 industries permitted for foreign investment by mid-March 2009 (see table II.6), the number of service industries, including tourism services, is 941 (54 per cent). Total foreign investment in the services industries amounts to Nr 181,470 million, which is 35 per cent of the total. Recent foreign investments in the services sector is 122 out of 212 in the fiscal year 2007/08, i.e. 57.5 per cent. However, the percentage of foreign investment is only 16 per cent of the total investment for that particular year. The percentage of employment generated is 21.4 per cent, implying that the services sector generates more employment opportunities than other sectors (see table II.8).

### 3. Social performance

The services sector in Nepal has contributed not only to GDP and GDP growth, trade and foreign

investment but also to social contribution. Social contribution includes poverty reduction, employment, rural development, and development of transport and communications, education, health and culture. The employment contribution of the services sector is presented in table II.8 and the contribution to other social factors is analysed in table II.9 under contribution to achieving the MDGs.

According to table II.8, the services sector, including construction, contributed over 21.4 per cent of the total employed workforce. Of the various services sectors, the highest percentage, i.e. 7 per cent, is contributed by wholesale and retail trade services. Other major services sectors that provide employment opportunities to the people in Nepal are public administration and social security, construction, education, transport, storage and communications, and hotels and restaurants. In terms of gender, 29 per

cent of male employment and 11 per cent of female employment are provided by the services sector. Females are mostly employed in the wholesale and retail sectors and the education sector (table II.8).

The above includes direct employment only. If indirect employment is included, the number of jobs in services becomes much higher. The figure does not include the contribution made by various services sectors in terms of training and capacity-building programmes.

The services sector contributes 17.5 per cent of rural employment and 49.3 per cent of urban employment, indicating a higher percentage of people employed in the services sector in urban areas. Table II.9 shows

the breakdown of rural employment and table II.10, the breakdown of urban employment into various services sectors.

In rural areas, the highest employment lies in the wholesale and retail trade sector, followed by construction, public administration and education (table II.9). In urban areas as well, the highest employment is in the wholesale and retail trade, followed by public administration and social security, construction, education, and transport, storage and communication; however, education, and transport, storage and communication play a more important role in urban areas (table II.10).

**Table II.9. Rural employment in various services sectors, 2007**

Sector	Employed population			Percentage of total (males)	Percentage of total (females)	Percentage of total
	Males	Females	Total			
Construction	184,216	39,949	224,165	4.1	1.2	2.9
Wholesale and retail trade	305,996	138,231	444,227	6.9	4.1	5.7
Hotels and restaurants	50,189	28,206	78,395	1.1	0.8	1.0
Transport, storage and communications	104,520	3,182	107,702	2.4	0.1	1.4
Financial intermediation	24,209	3,278	27,487	0.5	0.1	0.4
Real estate, rental and business activities	15,653	1,871	17,524	0.4	0.1	0.2
Public administration and social security	177,170	20,057	197,227	4.0	0.6	2.5
Education	132,734	37,425	170,159	3.0	1.1	2.2
Health and social work	30,634	11,334	41,968	0.7	0.3	0.5
Other community, social and personal activities	43,823	6,538	50,361	1.0	0.2	0.6
<b>Subtotal (service industry)</b>	<b>1,069,144</b>	<b>290,071</b>	<b>1,359,215</b>	<b>24.1</b>	<b>8.7</b>	<b>17.5</b>
<b>Total (all industry)</b>	<b>4,443,476</b>	<b>3,343,113</b>	<b>7,786,589</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Government of Nepal/ Central Bureau of Statistics, Statistical Year Book of Nepal, 2007.

**Table II.10. Urban employment in various services sectors, 2007**

Sector	Employed population			Percentage of total (males)	Percentage of total (females)	Percentage of total
	Males	Females	Total			
Construction	45,248	8,372	53,620	5.9	2.4	4.8
Wholesale and retail trade	135,815	43,923	179,738	17.7	12.7	16.1
Hotels and restaurants	27,802	12,359	40,161	3.6	3.6	3.6
Transport, storage and communications	49,477	2,507	51,984	6.4	0.7	4.7
Financial intermediation	15,436	3,491	18,927	2.0	1.0	1.7
Real estate, rental and business activities	9,745	1,562	11,307	1.3	0.5	1.0
Public administration and social security	85,329	14,594	99,923	11.1	4.2	9.0
Education	34,080	20,726	54,806	4.4	6.0	4.9
Health and social work	12,538	6,602	19,140	1.6	1.9	1.7
Other community, social and personal activities	16,556	3,409	19,965	2.2	1.0	1.8
<b>Subtotal (service industry)</b>	<b>432,026</b>	<b>117,545</b>	<b>549,571</b>	<b>56.2</b>	<b>34.0</b>	<b>49.3</b>
<b>Total (all industry)</b>	<b>768,853</b>	<b>345,952</b>	<b>1,114,805</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Government of Nepal/ Central Bureau of Statistics, Statistical Year Book of Nepal, 2007.

#### 4. Institutional overview

Various institutions deal with the services sector in Nepal. Where wholesale and retail trade are concerned, for example, the agencies involved include the Ministry of Commerce and Supplies, Trade and Export Promotion Centre, Handicraft Association and several wholesale and retail traders. Similarly, the agencies dealing with tourism include the Ministry of Tourism and Civil Aviation, the Nepal Tourism Board, the Hotel Association of Nepal, the Trekking Association of Nepal and King Mahendra Trust for Nature Conservation. The details of the institutions involved in various services sectors in Nepal are presented in table II.11.

Table II.11. Institutional overview of services sector in Nepal (cont)

Sector	Institution	Main responsibilities
Construction	Ministry of Physical Planning and Works, line agencies	Policy, planning and regulation
	Nepal Housing Finance Company	Provide detailed company information on Nepal housing development
	Department of Urban Development and Building Construction	Protect and promote tourist and historical places and to modernize infrastructures
Wholesale and retail trade	Ministry of Commerce and Supplies	Policy, planning and regulation
	Handicraft Association of Nepal	Focus on the promotion and popularization of handicrafts locally and abroad
	Export and Trade Promotion Centre	Advise the Government of Nepal in formulating policies for the development and expansion of trade and export
	Ministry of Tourism and Civil Aviation, line agencies	Policy, planning and regulation
	Nepal Tourism Board	Promote Nepal as a quality tourism destination in the international arena with specific brand image, offer information on tourism attraction and products
Hotels and restaurants	Hotel Association of Nepal	Promote hotel industry in Nepal
	King Mahendra Trust for Nature Conservation	Preserve natural heritage, animal and plant species
	Department of Wildlife and National Parks	Conserve and manage the rich and diverse biological diversity of Nepal with emphasis on wildlife and protected areas
	Nepal Academy of Tourism and Hotel Management	Produce skilled manpower to develop hospitality and tourism industry
	Nepal Mountaineering Association	Promote mountaineering activities in the Himalayan region: promote mountain tourism, climbing sports, protect mountain environments and preserve and promote cultural heritage of mountain people
	Nepal Association of Rafting Agents	Help the government and private sector enhance Nepal's river tourism industry
	Nepal Association of Tour and Travel Agents	Conduct activities to promote Nepal's tourism
	Trekking Agents Association of Nepal	Assist the government by providing suggestions to make trekking an income-generating business and to provide employment opportunity to local people
	Airlines Operators Association of Nepal	Represent interests of airline operators
Association of Helicopter Operators Nepal	Promote easy access to remote areas of national heritage	

Table II.11. Institutional overview of services sector in Nepal (cont)		
	Restaurant and Bar Association of Nepal	Promote tradition of providing broad array of food for tourists
	Tourist Guide Association of Nepal	Help the government promote tourism industry
	Freight Forwarders Association of Nepal	Facilitate export and import trade in Nepal and elsewhere; provide information and consultation, produce reports through work shops, seminars, interaction, training
	Nepal Association of Tour Operators	Ensure that major tour operators such as hotels, airlines, golf courses or cable cars promote tourism industry
	Nepal Entrepreneurs Association of Tourism	Promote entrepreneurship in tourism industry
	Non-Star Hotel Association of Nepal	Help the government promote tourism industry
Transport, storage and communications	Ministry of Information and communication and line agencies	Policy, planning and regulation
	Ministry of Labour and Transport Management	Policy, planning and regulation
	Nepal Telecommunication Corporation	Provide communication services for the promotion of services sector
	Radio Nepal, NTV	Provide comprehensive information about Nepal to promote the services sector
Financial intermediation	Ministry of Finance	Policy, planning and regulation
	Nepal Rastra Bank	Central banking responsibilities, including guiding the development of the embryonic domestic financial sector
	Commercial banks	Provide various banking services such as accepting deposits and granting loans
	Financial institutions	Provide financial services, including microfinance
	Cooperatives	Provide microfinance
	Insurance companies	Provide various types insurance facilities
	Security Board	Apex regulator of securities markets in Nepal to offer advice to the government on matters connected with development of the capital market
	Nepal Stock Exchange	Impart free marketability and liquidity to the government and corporate securities by facilitating transactions in its trading floor through members and market intermediaries, such as brokers and market makers
	Citizen Investment Fund	Operate retirement and unit trust schemes, provide capital market services



**Table II.11. Institutional overview of services sector in Nepal (cont)**

	Employee Provident Fund	Manage government provident fund of public- and private-sector employees and help them financially on retirement or separation from their jobs
Real estate, rental and business activities	Federation of Nepalese Chambers of Commerce and Industry	Umbrella organization of the Nepalese private sector; aims to spur socio-economic development by promoting business and industry and protecting the rights and interests of business and industrial communities
	Nepal Chamber of Commerce	Assist in the development of national economy through the promotion and protection of commerce and industries, both in the private and public sectors
	Nepal Housing Finance Company	Provide detailed company information on Nepal housing development
Public administration and social security	Ministry of General Administration, line agencies	Policy, planning and regulation
Education	Ministry of Education	Policy, planning and regulation
	University Grants Commission	Advise the government, formulate policies, provide coordination among universities, allocate and disburse government grants to universities and higher educational institutions and take appropriate steps for the promotion and maintenance of standards of higher education
	Universities	Produce skilled manpower essential for Nepal's overall development
	Higher Secondary Education Board	Produce middle-level manpower and impart necessary knowledge and skills to students pursuing higher education
	Council for Technical Education and Vocational Training	National autonomous body for the development of human resources concerned with basic and middle-level technical education and vocational training
	Intergovernmental organizations, NGOs	Help government organizations implement education programmes
Health and social work	Ministry of Health and Population, line agencies	Policy, planning and regulation
	Hospitals and nursing homes	Provide medical, nursing and surgical treatments

**Table II.11. Institutional overview of services sector in Nepal (cont)**

	Health institutions	Provide medical academic training programmes and provide medical care and services
	Intergovernmental organizations, NGOs	Help government organizations implement programmes
	Ministry of Physical Planning and Works, line agencies	Policy, planning and regulation
	Ministry of Local Development, line agencies	Policy, planning and regulation
	Ministry of Women, Children and Social Welfare	Policy, planning and regulation
	Social Welfare Council	Promote, facilitate, coordinate, monitor and evaluate NGO activities in Nepal
Other community, social and personal activities	Central Children Welfare Committee	Help the government build capacity in child rights and protection
	Association of International NGOs in Nepal	Promote mutual understanding, exchange information and share experiences and learning of work among international NGOs in Nepal for more effective collaboration
	Association of NGOs	Promote mutual understanding, exchange information and share experiences and learning among NGOs in Nepal

## B. TOURISM SERVICES SECTOR

### 1. Role and performance of the tourism services sector

As previously explained, Nepal is located between the world's two fastest growing countries: India and China. It is uniquely endowed with rich and diverse natural resources and cultural attractions. The Himalayan country has an incomparable cultural heritage as well as a rich environmental spectrum from the highest mountains to the Terai plains. Tourism is, therefore, a sector of comparative advantage which can be instrumental in spreading the benefits and providing alternative economic opportunities to the people of Nepal.

This chapter focuses on the economic aspects of tourism and underscores the impact of tourism from a macroeconomic level. Trends are assessed by using the approach used by the Government of Nepal and also on tourism satellite account methodology as

developed by the World Travel and Tourism Council. Tourism is considered according to its contribution in the form of receipts; share of GDP and exports; and growth rate patterns for the tourism industry, tourism economy, government expenditures and capital investment. The economic impact of the tourism industry can be assessed and measured at the macroeconomic level in several different ways. The most common method of measurement focuses on tourism receipts and the contribution of tourism to a country's GDP. The subsequent sections deal with market trends and its contribution to the Nepalese economy, including meeting the national MDGs and drawing policy recommendations to increase its developmental and social contributions.

#### 1.1. Effect of the tourism services sector on the national economy

Tourism services in Nepal can stimulate development through employment generation and foreign exchange earnings. The industry has a high multiplier effect and positive spillover effects, generating a high proportion

of employment for women and youth. Furthermore, it has the potential to aid rural development and contribute to the preservation of historic, natural and cultural sites.

According to Tourism Vision 2020 of Nepal of May, 2009, tourism is valued as the major contributor to a sustainable Nepalese economy, having been developed as an attractive, safe, exciting and unique destination through conservation and promotion, leading to equitable distribution of tourism benefits and greater harmony in society. After a peace accord between the Communist Party of Nepal (Maoist) and the then Government of Nepal, tourist arrivals numbered 526,705 in 2007. Looking at the encouraging trend in 2008 and 2009 and to sustain the growth and spread the benefits across the nation, the one millionth annual arrival is targeted by Vision 2020, declaring Nepal Tourism Year 2011 a national campaign. Tourism Vision 2020 envisages two goals, namely:

- To increase annual international tourist arrivals in Nepal to two million by 2020;
- To enhance economic opportunities and employment in the tourism sector to one million jobs.

Though Tourism Vision 2020 does not mention the present level of employment, it identifies six objectives and strategies and develops immediate and long-term actions to implement them.

## 1.2. Market trends

The real opening of Nepal for foreigners may be dated as early as the year 1949 when Arnold Heim made an aerial flight over Dhaulagiri. S. Dillon Ripley searched for mountain quail in Rekcha (Surkhet) and Chainpur (Sankhuwasabha), H.W. Tilman's party explored and climbed Lamtang and Ganesh Himal, and Sutter-Lohner's expedition made a 99-day alpine trek around Kanchanjungha (Gurung, 1989). The number of tourists has been growing ever since, as indicated in table II.12. However, due to a decade

**Table II.12. Number of tourists by purpose of visit**

Year (December)	Pleasure	Trekking and mountaineering	Business	Officials	Pilgrimage	Meetings and seminars	Other	Total
2000	255,889	118780	29454	20832	15801	5599	17291	463646
Percentage of total	55.2	25.6	6.4	4.5	3.4	1.2	3.7	100
2001	187,022	100828	18528	18727	13816	-	22316	161237
Percentage of total	51.8	27.9	5.1	5.2	3.8	-	6.2	100
2002	110143	59279	16690	17783.00	12366	-	58907	275468
Percentage of total	40	21.5	6.2	6.50	4.5	0	21.3	100
2003	97904	65721	19387	21967	21395	-	111758	338132
Percentage of total	29	19.4	5.7	6.50	6.3	0	33.1	100
2004	167262	69442	13948	17088	45664	-	71893	385297
Percentage of total	43.4	18	3.6	4.40	11.9	0	18.7	100
2005	160259	61488	21992	16859	47621	-	67179	375398
Percentage of total	42.7	16.4	5.90	4.50	12.7	0	17.8	100
2006	145802	66931	21066	18063	59298	-	72766	383926
Percentage of total	38.0	17.4	5.5	4.7	15.4	-	19.0	100
2007	217815	101320	24487	21670	52594	8019	100800	526705
Percentage of total	41.4	19.2	4.6	4.1	10.0	1.5	19.2	100
2008a	152950	100055	23039	45091	43044	6938	129160	500277
Percentage of total	30.6	20.0	4.6	9.0	8.6	1.4	25.8	100

Source: Ministry of Culture, Tourism and Civil Aviation  
<sup>a</sup> Estimates

of Maoist movement in the country, the number of tourist arrivals in Nepal declined and the tourism industry was adversely affected. It was only in 2007 that the country started attracting more tourists anew, reaching more than 500,000 for the first time – a jump of more than 100,000, compared with 2006. However, this does not appear to be an enduring trend, as the estimate for 2008 points to a decline of about 27,000 tourist arrivals.

Based on 2008 figures, table II.12 shows that most tourists come to Nepal for pleasure (31 per cent), followed by trekking and mountaineering (20 per cent) and pilgrimage (9 per cent). It is also interesting to note that there has been some increase in the number of tourists visiting for official purposes, meetings and seminars, indicating foreigners' preference to hold seminars and meetings in Nepal.

Table II.13 presents the growth rate of tourist arrivals by major regions of the world.

According to table II.13, the growth rate of tourist arrivals in Nepal in recent years has not been encouraging. The average annual growth rate was in the vicinity of 3 per cent during the period 2001–2008. It was highly negative in 2001 and 2002 when the country was in the grips of internal conflict. The eight-year trend analysis shows a negative growth rate for four years and a very low one for 2006. The growth rate improved in 2007 (33.5 per cent), but could not be sustained in 2008, due in part to the financial recession in the western world and to political conflict

within the country in spite of the peace accord. As the Nepal Tourism Board Annual Operational Plan (2008/09) has rightly pointed out, "Although tourist numbers have gradually begun to increase, tourism receipts have yet to rise, and any renewed worsening in the political situation could again send tourist arrivals into decline".

In terms of the country of origin, the growth rate reflected in table II.13 shows there has been negative growth of tourism from North America, but positive growth from Europe, Asia and Australia. In Asia, there has been a minimum increase of tourists coming from India. Though Nepalese tourism statistics do not provide time-series data for inflows of Chinese tourists, the information available from the Nepal Tourism Board has shown that the Chinese visitors by air in 2007 increased by almost 63 per cent over 2006 and 7 per cent in the first half of 2008 compared to the same period in 2007, indicating the importance of Chinese tourists in the days to come.

The United Nations Statistics Division and the World Tourism Organization developed the tourism satellite account in 2001 as one of the most systematic measurements of the economic impact and contribution of tourism at the national level. According to the World Travel and Tourism Council, the tourism satellite account is based on a demand-side concept of economic activity. The tourism industry does not produce or supply a homogeneous product or service like many traditional industries. Instead, the travel and

**Table II.13. Growth rate of tourist arrivals by major regions (percentage)**

Year	North America	Central and South America	Western Europe	Eastern Europe	Africa	Asia		Total	Australia and Pacific	Other	Total
						India	Other				
2001	-20.2	-23.7	-17.4	-11.3	-21.8	-32.9	-21.7	-26.5	-16.5	0.0	-22.1
2002	-45.6	-39.8	-33.2	-14.9	-29.1	3.8	-18.7	-9.9	-35.4	0.0	-23.7
2003	8.1	-19.0	8.2	22.3	42.4	29.3	38.8	34.6	14.1	0.0	22.7
2004	10.9	93.3	22.4	18.8	-28.0	4.5	12.7	9.2	13.9	0.0	13.9
2005	-10.4	-18.6	-15.8	7.9	12.1	6.9	4.4	5.4	-24.0	266.2	-2.6
2006	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9
2007	29.4	252.1	31.4	197.2	54.0	-4.9	32.9	17.1	86.8	568.1	33.5
2008	2.8	16.3	-2.2	-23.0	0.1	-5.0	-9.6	-8.2	11.6	25.8	-5.0
2001-2008	0.6	9.8	0.7	10.6	-2.2	0.8	7.5	4.6	3.7	47.3	2.8

Source: Calculations based on data from the Ministry of Culture, Tourism and Civil Aviation.

tourism industry is defined by a diverse collection of products (durables and non-durables) and services (transportation, accommodation, food and beverage, entertainment and government services) that are delivered to visitors. It is important for policy makers at the national and local levels to see that this diversity has many complex links to all parts of the economy. This is what makes the economic impact of tourism so significant for development (United Nations: 2007).

According to statistics provided by the World Travel and Tourism Council, exports make up a very important share of travel and tourism's contribution to GDP in Nepal. Of Nepal's total exports, travel and tourism is expected to generate 14.8 per cent (Nr 16.6 billion or \$257.3 million) in 2008, increasing to Nr 52.1 billion or \$552.1 million (14.8 per cent of total) in 2018. According to the literature, the contribution of the travel and tourism economy to employment was estimated at 548,000 jobs in 2008, amounting to 5.3 per cent of total employment, or 1 in every 18.8 jobs. Estimates for 2018 are put at 824,000 jobs, representing 6.2 per cent of total employment, or 1 in every 16 jobs. The projection seems to match with the aim of Vision 2020 to create 1 million jobs. The World Travel and Tourism Council reported that in 2007, travel and tourism direct industry jobs accounted for 2.3 per cent of total employment, or 237,000 jobs; by 2018, the figure is expected to reach 369,000 jobs, or 2.8 per cent of the total.

### 1.3. Contribution to national development objectives and economic diversification

Poverty reduction is the main national objective in Nepal. In this context, it can be argued that tourism can be more effectively harnessed to address poverty reduction in ways that are more direct. According to the World Tourism Organization, tourism can contribute to development and poverty reduction in a number of ways, though the focus is normally on economic benefits. Tourism can have social, environmental and cultural benefits.

Tourism can reduce poverty when it provides employment and diversified livelihood opportunities, as it provides additional income. It can also contribute to reducing vulnerability by increasing the range of economic opportunities available to individuals and households living in poverty. Further, tourism can contribute through direct taxation and by generating taxable economic growth since taxes can then be used to alleviate poverty through education, health and infrastructure development. These are tourism's contributions at the macroeconomic level. Tourism's contribution at the microeconomic level is explained through its contribution to MDGs in the following section.

Tourism makes a direct contribution to the Nepalese economy through foreign exchange earnings, which,

**Table II.14. Foreign exchange earnings from tourism**

Year	Total foreign exchange earnings from tourism (in thousands of Nr) 11,717	Percentage of total value of merchandise exports	Percentage of total value of exports of goods and non-factor services	Percentage of total foreign exchange earnings	Percentage of total foreign exchange earnings	Percentage of GDP	Growth rate (percentage)
2000/01a	11,717	21	12	7.4	2.7	-	-22.1
2001/02	8,654.3	14.9	10.6	6.1	1.9	-26.1	-23.7
2002/03	11,747.7	23.1	15.2	8.20	2.4	35.7	22.7
2003/04	18,147.4	32.9	20.3	11.40	3.4	54.5	13.9
2004/05	10,464	17.5	12.2	6.10	1.8	-42.3	-2.6
2005/06	9,556	15.5	10.90	4.60	1.5	-8.7	4.9
2006/07	10,125	16.1	10.70	4.50	1.4	6.0	33.5
2007/08b	10,891	26.7	16.6	6.6	1.3	7.6	-5.0
<b>Average Growth Rate</b>							<b>3.8</b>

Source: Economic Survey 2007/08.

a Data based on new format since 2000/01 fiscal year

b First eight months

however, have been fluctuating over the years. Earnings increased up to the 2003/04 fiscal year, then started to decline until 2005/06 to pick up again from then onwards. The contribution was highest in 2003/04, when foreign exchange earnings from tourism accounted for 33 per cent of the total value of merchandise exports, and 20.3 per cent of the total value of exports of goods and non-factor services. In 2003/04, the percentage of total foreign exchange earnings generated by tourism stood at 11.4 per cent, the contribution to GDP, at 3.4 per cent and the growth rate, at 54.5 per cent (table II.14).

The data presented in table II.14 also shows that there have been no remarkable increases in foreign exchange earnings from the tourism industry. Foreign exchange earnings from tourism as a percentage of GDP decreased from 3.4 per cent in 2003/04 to 1.3 per cent in 2007/08. The average growth rate of foreign exchange earnings for the period under analysis stood at a mere 3.8 per cent. As a result of inflation and a surge in imports, earnings from tourism are not substantial and do not have a significant impact on the serious trade deficit situation.

As explained previously, trekking and mountaineering are key objectives for tourists visiting Nepal. The following table shows the details of the mountaineering expedition teams, the royalty they paid the Ministry of Tourism and Civil Aviation to obtain a climbing permit and team expenditures.

According to table II.15, the number of mountaineers and jobs hit rock bottom in 2005, which however increased gradually as of 2006 and peaked in 2008. There was not, however, much difference in royalty

income until 2007, which may be due to increased royalty rates. Nevertheless, royalty income also rose in 2008 to reach Nr 239 million. The expenditure incurred by the team also increased drastically in 2007 (Nr 967 million), part of which may be due to inflation. The royalty income is the direct contribution to the government treasury, and the expenditure incurred has a spillover effect on the Nepalese economy. Royalties are paid by the mountaineering teams to Nepal's Ministry of Tourism and Civil Aviation to obtain permission to go mountaineering.

The World Travel and Tourism Council (2008) gives a comprehensive picture of the economic impact of tourism on Nepal. According to a 2008 update, the travel and tourism industry in Nepal was expected to contribute 3 per cent directly to GDP in 2008 (Nr 20.5 billion or \$318.9 million), rising in nominal terms to Nr 50.8 billion or \$538.1 million (3.6 per cent of total) by 2018. The contribution of travel and tourism to the economy (per cent of total) should rise from 6.8 per cent (Nr 46.1 billion or \$716.5 million) to 7.9 per cent (Nr 110.7 billion or \$1,172.9 million) during the same period. The report also expects the travel and tourism economy to grow by 4.9 per cent per annum in real terms between 2009 and 2018. The contribution of the travel and tourism economy to employment was estimated at 548,000 jobs in 2008, 5.3 per cent of total employment, or 1 in every 18.8 jobs. By 2018, this should amount to 824,000 jobs – 6.2 per cent of total employment or 1 in every 16 jobs. The 237,000 travel and tourism direct industry jobs represented 2.3 per cent of total employment in 2007 and are expected to rise to 369,000 jobs, or 2.8 per cent of the total by 2018.

**Table II.15. Mountaineering expedition teams**

Year	Number of teams	Number of mountaineers	Number of jobs	Royalty (in thousands of Nr)	Team expenditure (in thousands of Nr)
2000	132	773	11,587	119,893	498,513
2001	112	836	6,203	127,394	552,033
2002	134	913	9,928	128,185	600,000
2003	152	1080	14,838	181360	630,000
2004	140	1042	9362	127,072	494,494
2005	128	940	636	156,240	400,137
2006	133	986	4,344	145,612	423,985
2007	162	1128	4,843	169,829	966,637
2008	202	---	8,080	239,426	---

Source: Ministry of Culture, Tourism and Civil Aviation

Similarly, capital investment in travel and tourism in Nepal was estimated at Nr 14.0 billion, \$218.2 million or 11 per cent of total investment in 2008. By 2018, this is estimated to reach Nr 31.7 billion, \$335.7 million or 11.7 per cent of the total. Government travel and tourism operating expenditures are expected to reach Nr 3.6 billion (\$55.6 million), or 5.1 per cent of total government spending, which is forecasted to total Nr 7.9 billion (\$83.6 million), or 5.3 per cent, in 2018.

#### 1.4. Contribution to National Millennium Development Goals

By definition, MDGs are an agreed set of goals to be achieved by 2015 based on all stakeholders working together at global, regional and national levels. The Goals represent a global partnership aimed at responding to the world's main development challenges, including mitigating poverty, opening up opportunities for education, achieving better maternal health, promoting gender equality, reducing child mortality and combating AIDS and other diseases. International tourism contributes to MGDs by generating benefits to poor people and communities in the context of sustainable tourism development, usually without specifically targeting the poor.

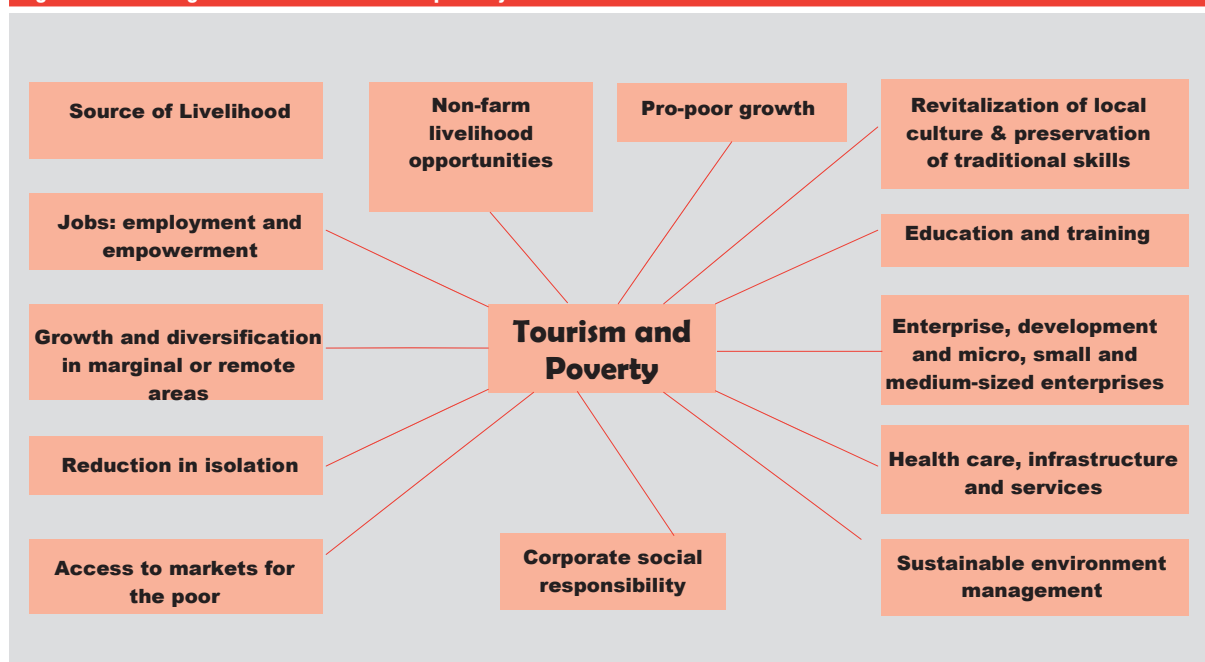
Targeted actions to achieve specific MDGs should include measures that contribute to poverty alleviation

at the local and community levels through tourism. In addition, the linkages between tourism and poverty must be identified for such action to be effective. Figure II.2 illustrates many of these linkages.

Table II.16 illustrates the potential contributions that appropriate interventions can make in the tourism sector to achieve each of the MDGs. The creation of income and employment in the tourism industry and the tourism economy would contribute to reducing the proportion of people living on less than a dollar a day (target for Goal 1). The provision of infrastructure facilities and services for tourists (roads, communications, and health and sanitation services) can be designed to benefit local communities at the same time. Such facilities can contribute to the achievement of Goals 4, 5, 6 and 7. In terms of gender equality and the empowerment of women (Goal 3), tourism is recognized as a sector that employs a high proportion of women. As shown in table II.10, the proportion of males and females employed in hotels and restaurants in Nepal is roughly the same, i.e. 3.6 per cent, in contrast with other services sectors.

The MDG agenda and the role of tourism in poverty alleviation converge with the concept of pro-poor tourism, an approach that results in increased net benefits for poor people by enhancing linkages between them and tourism businesses. Its strategies

**Figure II.2: Linkage between tourism and poverty**





**Table II.16. Contribution of tourism to achieving the Millennium Development Goals**

Goal	Contribution of tourism
1. Eradicate extreme poverty and hunger	<p>(a) Tourism stimulates economic growth at the national and local levels and promotes the growth of the agricultural, industrial and services sectors;</p> <p>(b) Tourism provides a wide range of employment opportunities easily accessible by the poor. Tourism businesses and tourists purchase goods and services directly from the poor or enterprises employing the poor. This creates opportunities for micro-, small and medium-sized enterprises in which the poor can participate;</p> <p>(c) International and domestic tourism spreads development to poor regions and remote rural areas of a country that may not have benefited from other types of economic development;</p> <p>(d) The development of tourism infrastructure can benefit the livelihood of the poor through improvement in tourism-linked services sectors, including transport and communications, water supply, energy and health services.</p>
2. Achieve universal primary education	<p>(a) The construction of roads and tracks to remote areas for tourists also improves access for school-age children and teachers;</p> <p>(b) Tourism can help local resource mobilization, part of which can be spent on improvement of educational facilities.</p>
3. Promote gender equality and empower women	<p>(a) The tourism industry employs a high proportion of women and creates microenterprise opportunities for them. It promotes women's mobility and provides opportunities for social networking.</p>
4. Reduce child mortality 5. Improve maternal health 6. Combat HIV/AIDS, malaria and other diseases	<p>(a) The construction of roads and tracks to remote areas for tourists also improves access to health services;</p> <p>(b) Revenues accruing to national and local governments through taxes on the tourism industry can be used to improve health services and nutrition for young children and their mothers;</p> <p>(c) Tourism raises awareness about HIV/AIDS issues and supports HIV/AIDS-prevention campaigns;</p> <p>(d) Tourism aggravates the spread of HIV/AIDS (negative effect).</p>
7. Ensure environmental sustainability	<p>(a) Tourism can generate financial resources for the conservation of the natural environment;</p> <p>(b) Tourism raises awareness about environmental conservation and promotes waste management, recycling and biodiversity conservation;</p> <p>(c) Uncontrolled tourism may generate negative externalities as a result of pollution, congestion and depletion of natural resources (negative effect).</p>
8. Develop a global partnership for development	<p>(a) Tourism contributes to the socio-economic development of least developed countries, landlocked countries and island developing countries through foreign exchange earnings and the creation of job opportunities;</p> <p>(b) Tourism stimulates the development of the transport infrastructure, which facilitates access to and from the least developed countries, landlocked countries and island developing countries;</p> <p>(c) Tourism stimulates internal and external trade and strengthens supply chains;</p> <p>(d) Tourism promotes the integration of isolated economies with regional and global flows of trade and investment;</p> <p>(e) Tourism reduces the burden on government budgets through implementation of public-private initiatives;</p> <p>(f) Tourism creates decent and productive work for youth;</p> <p>(g) Tourism provides opportunities for bilateral, multilateral and subregional cooperation among countries;</p> <p>(h) Information technologies play an important role in integrating tourism enterprises into global tourism markets.</p>

Source: United Nations ESCAP, Transport and Tourism Division, Transport Policy and Tourism Section, adapted from United Nations (2007), *Study on the Role of Tourism in Socio-Economic Development*.

focus on the local or community level and aim at increasing tourism's contribution to poverty reduction and enabling poor people to participate more effectively in tourism development. Village tourism, introduced in Tourism Policy 1995 and emphasized in the Tenth Plan (2002–07), was the focus of a project aimed at developing village tourism and reducing poverty in Nepal in the frame of the Tourism for Rural Poverty Alleviation Programme. Village tourism is also associated with health tourism, and establishing tourism villages, particularly at high altitudes, is considered to be suitable for attracting visitors who seek longevity.

## 2. Regulations, institutions and policy measures

### 2.1. Assessment of the existing regulations, institutions and policy measures

Present tourism development in Nepal is governed by Tourism Policy 2008 (2065 BS). In addition to employment generation, the policy expects that tourism will contribute to productivity, improved standards of living, economic growth and government revenue. The policy has provisioned two organizations in the government, first the National Tourism Council, chaired by the Prime Minister of the country and second, the Tourism Development Coordination Committee, chaired by the Minister of Tourism and Civil Aviation. The Secretary to the Ministry of Tourism and Civil Aviation acts as the Secretary to the Council and the Joint Secretary looking after policy, planning and infrastructure in the Ministry of Tourism and Civil Aviation acts as the Secretary to the Ministry's Coordination Committee.

The government's involvement in the tourism sector also occurs through the activities of the Tourism Division of the Ministry of Culture, Tourism and Civil Aviation which has responsibilities for regulating the sector. The Civil Aviation Authority is responsible for regulating air transport and looking after the enforcement of over 35 bilateral air services agreements. Tourism services are regulated by the Tourism Act 2035 (1978) amended in the Tourism Act 2053 (1997), the Hotel, Lodges, Restaurants, Bar and Tourist Guide Rules 2038 (1981), Travel and Trekking Agency Rules 2037 (1980), Trekking and Rafting Rules 2044 (1985), and Mountaineering Rules 2036 (1979).

The Foreign Investment and Technology Transfer

Act – 1992 of Nepal reserve certain activities of tourism only for the domestic providers. Accordingly, no permission was granted for the establishment of foreign companies, or foreign investment in the travel agencies, trekking agencies, water rafting, pony trekking, horse riding, and tourist lodging. Foreign investment is therefore restricted to hotel accommodations and resort operations; however, domestic operators are well entrenched and organized to withstand foreign entry. Nepal has opened up the travel agency and tour operator service for foreign investment up to 51 per cent of foreign equity capital since it became a WTO member in April 2004. As per Nepal's commitments in the WTO, up to 80 per cent of foreign equity capital is allowed for hotel, lodging services and graded restaurants.

The Government of Nepal adopted the following policies for the development of tourism for the 2008/09 fiscal year:

- Grant tourism recognition as a prioritized industry;
- Build infrastructures: construction and enhancement of roads and other infrastructure to link tourism product areas and provide necessary facilities;
- Construct international airport, enhance conditions of domestic airports;
- Open country to foreign investment;
- Focus on public–private partnership approach;
- Encourage private entrepreneurship;
- Encourage non-resident Nepalese to invest in infrastructure development, industry and other economic activities;
- Recognize and promote domestic tourism;
- Focus on sustainable tourism, eco-tourism, rural tourism, pro-poor tourism, educational tourism, health tourism and cultural tourism;
- Focus on product diversification and decentralization;
- Adopt open-sky policies.

The promotional aspect of tourism development in Nepal is handled by the Nepal Tourism Board. The Nepal Tourism Board Act was passed by both the houses of Parliament in 1996 and obtained the government seal in 1997. The Board, formed as a partnership between the government and the private-sector tourism industry in Nepal, replaced the then Department of Tourism. The Board was empowered to work as a national tourism organization since 31 December 1998 to address the pressing need of the Nepalese tourism industry by designing a specific

brand image for Nepal as a travel destination and to support the same by self-sustained promotional campaigns.

The Board comprises 11 members, including the Secretary of the Ministry of Tourism and Civil Aviation as ex-officio chairperson. Out of the ten members, five come from the public sector and five, from the private sector and are nominated by the Government of Nepal to serve for a period of three years. The Chief Executive Officer acts as the member secretary of the Board. The Board can have observers on the Executive Committee. Five departments are represented on the Board.

It is a statutory institution and thus has statutory duties assigned to it. It has a well-defined funding mechanism to finance the promotional efforts of the Board. The Board's statutory responsibilities are as follows:

- Develop and introduce Nepal as an attractive tourist destination in the international market place;
- Promote the tourism industry in the country while working for the conservation of natural, environmental and cultural resources;
- Work towards increasing GDP and foreign exchange income by means of promoting the tourism industry;
- Work towards increasing employment opportunities in the same industry;
- Develop Nepal as a secure, dependable and attractive travel destination by establishing a respectable travel trade community;
- Work towards providing quality service to the tourists visiting Nepal;
- Study the bottlenecks against the same by conducting research and adopting effective measures to address the problems;
- Promote and develop an institution for the promotion of the tourism industry.

The Nepal Tourism Board Act also defines the Board's ancillary responsibilities, which include a wide range of developmental functions within Nepal and marketing activities both in Nepal and overseas. These responsibilities also stress the Board's consultative and advisory functions.

## 2.2 Need for regulatory and institutional reform

The Tourism Industry Division under the Ministry of Tourism and Civil Aviation is the tourism regulator in Nepal, with responsibilities for registering, licensing

and categorizing star hotels, providing facilities, incentives, monitoring and evaluation. The monitoring and evaluation system, however, has been described as inadequate. This has created problems not only in the overall development of the sector, but also in the protection of tourist rights. For example, it is not sufficient to categorize the hotels into different stars alone, but also to ascertain whether the tourists are enjoying the benefits they are supposed to receive under the classification.

Likewise, the Civil Aviation Authority of Nepal, which came into existence in December 1998, under the Civil Aviation Act 1996, has three activities relating to aviation: regulation, growth and monitoring. Prior to liberalization in 1993, the Civil Aviation Department used to perform such activities. Under regulation, it provides air operator certificates and enters into air service agreements with other airlines. Out of 35 air service agreements, only 17 have scheduled flights at present. One of the problems of having more flights is the closing of airport after 12.30 (midnight) and the lack of confidence to fly at night. This has also resulted in a lack of parking bays at the international airport. These indicate the need to open the airport round the clock as in other countries. Moreover, the uncoordinated activities of different agencies operating in the airport such as immigration, customs and other services (trolley/taxi) have created inconvenience for the passengers, implying a need for inter-agency coordination to achieve working effectiveness. One way to do this is to bring all the agencies under the umbrella of the Tribhuvan International Airlines Office, which seems unlikely.

Under Mode 3 trade, foreign companies can obtain a licence only under a joint venture of up to 51 per cent, unlike other tourism activities. India allows only those airlines with a majority of Nepalese shares to fly from Nepal.

Lack of domestic regulation to abide by the WTO commitments is a regulatory problem in Nepal. As per its WTO commitments, the country has opened up travel agency and tour operator services for foreign investment up to 51 per cent of foreign equity capital since it became a WTO member in April 2004. However, this has not happened so far because the domestic law and regulations are not yet formulated for this. This implies the need to formulate domestic regulation in conformity with WTO commitments. The Government of Nepal has also established a WTO Reference Centre under the Commerce Department

of the Ministry of Commerce and Supplies to provide WTO-related services. However, the Centre needs to be strengthened to make it more effective.

China has provided Nepal with approved tourist destination status since 2001, implying a potential for huge inflows of Chinese tourists. As per the World Tourism Organization, China ranks fifth out of the top ten tourism spenders in the world<sup>2</sup>. However, Chinese arrivals in Nepal have not exceeded the 4 per cent overall tourist arrival figure in Nepal. Only three agencies in China can provide approval for Chinese citizens to travel to Nepal, hindering the free flow of Chinese tourists. This is, however, a problem on the part of China. Nevertheless, Nepal needs to negotiate with the Chinese Government on necessary regulatory matters to allow additional inflows of Chinese tourists.

People with international linkages are needed to promote tourism abroad. Developing linkages, however, requires capital investment. This is not possible at present because Nepal has not allowed capital account convertibility. The maximum limit a visitor can take abroad is \$2,000.

Last, but not the least, the Government needs to strengthen the service enquiry point established under the WTO division of the Ministry of Commerce. At present, there is a coordinating body, which is represented by 17 Ministries/agencies. However, it does not function effectively for lack of necessary manpower, equipment and activities. This implies the need to take account of these factors when considering the role it is going to play in the overall development of the Nepalese services sector.

### 2.3. Potential for medical tourism

Medical tourism can be defined broadly as the provision of cost-effective private medical care in collaboration with the tourism industry for patients needing surgical and other forms of specialized treatment (Chaudhary: 2009). Medical tourism, therefore, refers to travelling to other countries to obtain medical, dental, and surgical treatment and at the same time, tour and experience the attractions of the countries they visit. This is being facilitated by the corporate sector involved in medical care and the tourism industry, both public and private. Key factors leading to the rise of medical tourism include the exorbitant cost of health care in industrialized countries, the ease and affordability of international travel, favourable exchange rates, rapidly improving

technology and standards of care in many countries and most importantly, the proven safety of health care in some countries. Medical services include elective procedures as well as complex specialized surgeries such as joint replacement, and cardiac, dental and cosmetic surgery.

Medical tourists come from all points of the globe, including Europe, the United States, the United Kingdom, Japan, Canada and the Middle East. These areas are characterized by large populations, high wealth, high health-care costs or lack of local care options and increasingly high expectations with respect to health care. Major requirements for medical travel are convenience and speed of services. It takes considerable time to obtain non-urgent medical care in the countries with public health-care systems such as the United Kingdom and Canada. For example, a hip replacement in those countries may take a year or more, whereas a patient could feasibly have an operation the day after his or her arrival in the countries such as Thailand, Singapore, Hong Kong (China) and even India. Even where an insurance system is in place, patients are finding that either it does not cover orthopaedic surgery (knee/hip replacement) or it imposes unreasonable restrictions on the choice of the facility, surgeon, or prosthetics to be used.

Medical tourism for knee or hip replacements has emerged as one of the widely accepted procedures because of the lower cost and minimal difficulties associated with travelling to and from different countries for surgery. As far as cost is concerned, Colombia provides knee replacement for about \$5,000, including all associated fees such as prosthetics approved by the U.S. Food and Drug Administration and hospital stays over expenses. Medical tourists also seek essential health care services such as cancer treatment and brain and transplant surgery as well as complementary or elective services such as cosmetic surgery. According to data provided by a well-known university, "the cost of surgery in Bolivia, Argentina, Cuba, India, Thailand, Colombia, Philippines or South Africa can be one tenth of what it is in the United States or Western Europe, and sometimes even less. A heart-valve replacement that would cost \$200,000 or more in the United States, for example goes for \$10,000 in Philippines and India – that includes round-trip airfare and a brief vacation package. Similarly, a metal-free dental bridge worth \$5,500 in the United States costs \$500 in India or Bolivia and only \$200 in the Philippines, a knee replacement in Thailand with six days of physi-

cal therapy costs about one-fifth of what it would in the States, and Laic eye surgery worth \$3,700 in the United States is available in many countries for only \$730" (Chaudhary: 2009).

However, medical tourism is not always viewed as positive. For example, in places such as the United States where most people have health insurance and access to quality health care, medical tourism is viewed as risky. In some parts of the world, wider political issues can also influence medical tourists negatively. This factor will have to be taken into consideration if Nepal is also to make efforts towards medical tourism. Similarly, while medical tourism may be a big draw for South-East Asian countries, some countries focus on simple procedures, whereas others may position themselves as a primary medical destination for the most complex medical procedures in the world, for example India. Similarly, Singapore positions itself as a medical hub where health-care services, medicines, biomedical research and pharmaceutical manufacturing converge. In South America, countries such as Argentina, Bolivia, Brazil and Colombia lead in plastic surgery medical skills. Nepal should consider how it to position itself as a medical tourism provider in the global market.

The New Tourism Policy 2008 of the Government of Nepal has identified health tourism a potential tourism product. As Nepal is famous for its natural treatment methods, the Policy stresses that Nepal should be developed as a place that offers traditional Ayurvedic and naturopathic methods to treat diseases with greater participation of the private sector. Naturopathy includes exercise, yoga, reiki, meditation, physiotherapy and other methods and activities. It aims to adopt and publicize low-cost treatment methods. As Nepal is equipped with valuable natural, historical and cultural heritage, the Policy also highlights the importance of post-treatment rest around natural heritage sites in Nepal. For this purpose, it attaches importance to infrastructure development with the participation of the private sector. High-altitude sports such as cricket may also be included in Nepal's health tourism portfolio.

Qualified doctors who have completed post-graduate degrees in developed countries with several years working experiences are also available in Nepal. People can come from developed countries such as the United States, the United Kingdom and Japan to Nepal for treatment in order to save cost. Medical check-ups, diagnoses, lab facilities, indoor service,

surgery and follow-up care is available in Nepal at a very low cost compared with developed countries.

## 2.4. Effect of trade liberalization on tourism

### The General Agreement on Trade in Services and the World Trade Organization

Reforms to achieve higher demands for services began in Nepal in 1992 in efforts to remove licensing and quota requirements in imports, reduce tariffs, liberalize investment laws, restructure the tax system and privatize a number of state-owned enterprises. Although the process remains slow due to political instability, and opposition to privatization, Nepal has slowly yet steadily moved towards integration with the global economy. A salient reflection of this can be seen in the country's active participation in numerous international organizations and trade agreements. A milestone in this process is Nepal's membership in WTO. Upon accession to WTO in 2004, Nepal assumed a large number of general and specific commitments. The following is a schedule of Nepal's tourism services sector commitments made during the WTO accession process under GATS. These commitments were made to liberalize markets and achieve a high level of foreign demand for services, which are *prima facie* requirements for the development of tourism services in Nepal.

Nepal's commitments under each mode of supply for the delivery of services are listed in table II.17 by number: (1) cross-border supply, (2) consumption abroad, (3) commercial presence and (4) presence of a natural person.

Among the many commitments under GATS, liberalization of tourism trade is an important one. Since Nepal became a member of the WTO, it has opened up the travel agency and tour operation services for foreign investment up to 51 per cent of foreign equity capital. Foreign direct investment is permitted in the hospitality industry, for which Government permission is required as provided by the Foreign Investment and Technology Transfer Act 1992. As per Nepal's WTO commitments, up to 80 per cent of foreign equity capital is allowed for hotels, lodging services and graded restaurants.

What is the origin of foreign direct investment in Nepal, how much has it increased since Nepal became a member of WTO and which subsectors – hotels, tourism companies and the like – have benefited from it?



**Table II.17. Nepal's Tourism Commitments within the World Trade Organization**

Sector or subsector	Limitation on market access	Limitation on national treatment
Tourism and travel-related services		
A. Tourism and restaurants Hotel, lodging services (CPC 6411) (star hotels only); graded restaurants (CPC 6421–6423)**	(1) None (2) None (3) None, except only through incorporation in Nepal and with maximum foreign equity capital of 51 per cent for travel agency and tour operator (CPC 7471) and 80 per cent for hotel, lodging services (CPC 6411) (star hotels only), and graded restaurants (CPC 6421- 6423) **	(1) None (2) None (3) None (4) Unbound, except as indicated in horizontal section
B. Travel agency and tour operator (CPC 7471)	4) Unbound, except as indicated in horizontal section.	

Source: World Trade Organization, WT/ACC/NPL/16/Add.2, 28 August 2003.

The liberalization of tourism services has stimulated investments in the Nepalese economy, and locked in key national policy reforms. This is reflected in the substantial growth of the tourism sector in the past four years. The South Asia Watch on Trade, Economics and Environment published a report on “Nepal’s Export Potential in Services” suggesting that services trade is growing through commercial presence in the form of foreign direct investment. The inflow of foreign direct investment in Nepal, caused by the additional commercial presence in the tourism sector, provides externalities beyond capital infusion. The additional foreign direct investment provides excellent opportunities to achieve the following objectives:

- Upgrade the infrastructure and facilities related to tourism such as roads, transportation, water, energy and communication;
- Raise the quality of national tourism;
- Increase marketing efforts in order to raise awareness of tourism as a major economic sector among local tourism providers;
- Increase coordination between hotels, airlines and tour operators;
- Diversify product offerings in the tourism market by introducing new products such as wellness tourism, community tourism, sporting vacations, cultural and ethnic tourism, and the like;
- Promote e-tourism.

Tourism remains Nepal’s dominant service export. It

is important to examine this already successful sector and to identify ways of maintaining and enhancing its performance. The membership in the WTO has helped integrate Nepal’s tourism services into the global economy, stimulating development through employment creation, and foreign exchange earnings. The positive spill over effect of this will aid rural development by: reducing dependency on agriculture as a source of income, distributing the benefits of an improved economy to the population, and boosting GDP growth to reduce poverty.

### Constraints and limitations

Many developing countries initially opposed the initiation of GATS because the vast; difference in service capacity between the developed countries and developing countries created an imbalance in the agreement. Developing countries and their local companies would stand to lose from this agreement. Thus during the Uruguay Round negotiation, several safeguards and flexibilities were created to protect developing countries, such as:

- A “positive-list” approach as opposed to a negative-list approach;
- Allowing a developing country to choose the sectors it wants to include in the schedule and place exceptions and exclusions;
- Negotiations based on the bilateral request-offer modality;
- Additional special and differential treatment clauses

allowing developing countries to liberalize less than developed countries and to choose their own pace of liberalization.

Nonetheless, an inherent imbalance in the agreement remains and GATS faces many problems that have not been resolved. Although it is widely accepted that countries that chose deeper involvement in the multilateral trading system through liberalization benefit economically, it is important to keep in mind that countries such as Japan, Korea, Singapore, Taiwan Province of China, and Australia, became industrialized through protectionist economic regimes. These countries started liberalizing only after they became strong enough to penetrate foreign markets and compete effectively against new foreign entrants in the domestic market.

### South Asian Free Trade Area

What is the trade potential of the tourism sector with regard to the South Asian Free Trade Area (SAFTA)? How much can Nepal gain, and in what subsectors? What marketing or institutional arrangements can be made in the SAFTA context to raise the profile of Nepal as a regional tourism hub?

SAFTA creates a framework for a free trading zone between the SAARC countries. Recently SAARC has commenced negotiations on incorporating trade in services in the agreement. The Draft SAARC Framework Agreement on Trade in Services prepared by an expert group on states that the objectives of the service trade agreement are to help Contracting States achieve their developmental objectives by expanding trade in services through regional cooperation, to adopt approaches that are GATS-consistent and GATS-plus in commitments (Article 2).

For Nepal, the incorporation of trade in service into the SAFTA agreement will have similar benefits to those of liberalizing service trade under GATS. Incorporating trade in services into SAFTA would facilitate the trade in goods, integrate trade services among SAARC nations, enhance the regulatory framework and increase foreign direct investment. An added benefit is that fewer parties are involved and results are more likely to be seen early.

The increased cooperation created by this agreement would make South Asia more attractive as a destination for investment. Foreign direct investment would increase in sectors such as travel and tourism, telecommunications, banking, and education. The

agreement will create low tariff rates for investors, allowing expansion into other SAARC countries, boosting interregional trade and allaying security fears. It would also increase the import-export flow between the South Asian countries, preserving capital within the Contracting States.

During the fifteenth SAARC summit the Head of State underscored the vital contribution that tourism could make to the economic development of the SAARC region. Agreements were made to facilitate the movement of people through improved travel infrastructure, collaboration in human resource development and the promotion of SAARC as a common destination through public or private partnership and joint campaigns.

The harmonization of customs procedures and improvement of transit facilities and communication systems are key elements that facilitate a suitable environment for tourism growth. In view of this, Nepal has proposed the establishment of a SAARC tourism board, a SAARC visa allowing easy movement of nationals of SAARC countries within the Contracting States and discount on travel fares for SAARC nations.

India is one of the largest sources of tourism for Nepal. The highest number of tourist arrivals of tourists in 2007 – 96,010 – was from India, representing 18.2 per cent of the total (see table II.18). The Nepal Tourism Board would like to attract more tourists from India and the South Asia, and the SAFTA agreement on services trade will provide an abundance of opportunities.

Available data show Nepal's trade potential in travel and tourism services. The country holds a comparative

**Table II.18. International tourists visiting Nepal in 2007**

Country	Number	Percentage of total
India	96,010*	18.2
United Kingdom	32,367	6.1
United States	29,783	5.7
China	27,339	5.2
Germany	27,058	5.1
Japan	21,323	4.0
France	20,250	3.8

Source: Government of Nepal, Ministry of Tourism and Civil Aviation.

\* Indian tourists arriving in Nepal by air only.



**Table II.19. Revealed comparative advantage by sector**

Region/economy	Transport		Travel		Insurance and financial		Computer information and other communication services	
	1990	2003	1990	2003	1990	2003	1990	2003
Bangladesh	0.5	0.8	0.2	0.4	0.01	0.9	2.5	1.5
India	0.7	0.4	1.0	0.4	0.4	0.1	1.3	1.9
Nepal	---	0.5	1.8	2.1	---	0.02	0.9	0.5
Pakistan	2.1	2.5	0.4	0.2	0.2	0.2	0.8	0.8
Sri Lanka	1.4	1.8	0.9	1.0	0.6	0.4	0.8	0.6
South Asia	1.0	1.2	0.9	0.4	0.3	0.1	1.2	1.7
Low and middle-income countries	1.0	1.0	1.2	1.5	0.4	0.2	0.8	0.6
High-income countries	1.0	0.9	1.0	0.8	1.07	1.1	1.0	1.0

advantage in the travel and tourism sector as it accounted for 65.9 per cent of Nepal's total service exports in 2003. Its percentage of service trade in 2007/08 was 44.2 per cent. Its relative comparative advantage in this sector also increased from 1.8 in year 1990 to 2.1 in the year 2003 (table II.19).

However, rising imports of travel services of SAARC countries are squeezing the trade balance. Nepal had a the negative balance of 2.6 per cent in 1995–2005. Though South Asia's share of exports exceeded that

of imports in 1995, it was smaller than that of imports in 2005 (table II.20).

Regarding tourist arrivals in Nepal from SAARC countries, more than 91,000, 58 per cent, were from India, followed by Sri Lanka and Bangladesh. Tourists visiting Nepal from other SAARC countries are limited to 2 per cent, implying that there is an opportunity to increase the number of tourist arrivals from other countries if specially targeted tourism products are developed.

**Table II.20. Trade in travel services**

Countries/Region	Exports 1995	Exports 2005	Imports 1995	Imports 2005	Average annual growth rate (percentage)	
					Exports	Imports
(in millions of dollars)					1995-2005	
Bangladesh	25.06	69.70	233.50	131.65	17.81	-4.36
India	2581.54	7653.00	996.18	6464.00	20.42	54.89
Maldives	210.73	286.49	31.40	69.94	3.60	12.27
Nepal	177.40	131.31	136.34	163.20	-2.60	1.97
Pakistan	109.64	181.00	446.26	1275.00	6.51	18.57
Sri Lanka	225.85	429.06	186.38	314.46	9.00	6.87
South Asia	3330.22	8950.56	2030.06	8418.25	16.88	31.47
Asia	53308.50	101111.00	47699.00	9320.00	8.97	9.61
World	392530.00	679860.00	379434.00	633784.00	7.32	6.70
South Asia's Share in Asia	6.25	8.85	4.26	9.00	---	---
South Asia's Share in World	0.85	1.32	0.54	1.33	---	---

Source: Research and Information System for Developing Countries based on IMF BOP CD-ROM 2008.

Table II.21 indicates the need to boost tourism from within SAARC countries as well as from the SAARC region as a whole. The latter could be facilitated by the establishment of a SAARC tourism board as suggested by Nepal at the fifteenth SAARC Summit.

### Constraints to Inter-SAARC trade in services

The progressive liberalization of other services sectors is essential for the sustainability of tourism. The lack of progress in the implementation of SAFTA poses a threat to the growth of many industries, including tourism. Below are some causes for the slowdown of Inter-SAARC trade:

- Although the economies of the South Asia region are reinforced by the services sector contribution of about 55–60 per cent of the region's GDP, service trade among the SAARC countries only constitutes a fraction of the total. India's trade with SAARC countries amounted to 2.8 per cent of its total trade in 2006, while its trade with East Asia amounted to 24.9 per cent. Pakistan, Bangladesh, the Maldives and Sri Lanka had more trade with the East Asian region than with SAARC nations;
- Political issues take precedence over economic matters. The political tension between India and Pakistan may cause major setbacks to inter-SAARC trade growth;
- Asymmetry between India and other SAARC members in terms of geographical and economic size;
- SAFTA's failure to address issues related to a sensitive list of items such as para-tariff measures and non-trade barriers.

**Table II.21. Tourist arrivals from countries of the South Asian Association for Regional Cooperation, 2008**

Countries	Number	Percentage
Afghanistan	1,371	0.9
Bangladesh	20,067	12.8
Bhutan	2,662	1.7
India	91,177	58.1
Maldives	491	0.3
Pakistan	3,248	2.1
Sri Lanka	37,817	24.1
<b>Total</b>	<b>156,833</b>	<b>100.0</b>

Source: Research and Information System for Developing Countries based on IMF BOP CD-ROM 2008.

### Constraints to Inter-SAARC tourism

There are many internal and external barriers that prevent the growth of Inter-SAARC tourism and transportation

- Internal factors include inadequate infrastructure, insufficient funding of tourism promotion, shortcomings in quality and efficiency in other sectors such as educations, and health. (CEDA: 2007; World Bank: 2004);
- External factors include among others; immigration laws, documentation requirements, restriction on currency movements, lack of transparency, and policies that work as a disincentive for specific destinations (CEDA: 2007).

### Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation

Nepal is a party to two regional trade agreements: the Agreement on the South Asian Free Trade Area, which came into force on 1 January 2006, and the Framework Agreement on the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Free Trade Area, established in 2004 to promote free trade in goods, services and investments. This includes economic cooperation in mutual recognition agreements, customs cooperation, trade finance, e-commerce, and business and personal visa facilitation. The first summit level meeting held in July 2004 identified and covered six broad sectors for cooperation: trade and investment, technology, tourism, transport and communication, energy, and fisheries. Nepal should strive to increase the number of tourist arrivals from BIMSTEC countries as well as those from SAARC countries.

### Bilateral agreements

Nepal has entered into bilateral trade treaty agreements with a number of countries. Though separate tourism agreements have not been established, these trade treaties include some tourism-related provisions. One such treaty is the Trade and Payments Agreement concluded between the People's Republic of China and the Government of Nepal were in Kathmandu on 22 November 1981. The Agreement on Trade and Other Related Matters, aimed at supporting the movement of persons between Nepal and Tibet, was signed in Beijing on 10 July 2002 with a view to enhancing the traditional friendly relations between the two countries, particularly the autonomous region

of Tibet. The agreement provides the provision of travel to the border districts for the border inhabitants of either country for the purpose of pilgrimage, small fairs or border trade in small volumes, visiting relatives or friends with exit-entry passes of the border districts through the existing routes and entry points until such routes and entry points are mentioned specifically.

### **Contribution of liberalization in achieving Millennium Development Goals**

Table 2.5 clearly shows that tourism helps achieve the Goals of universal primary education, gender equality, child mortality reduction, maternal health improvement, disease control, environmental sustainability and global partnership development. Since tourism has a close linkage with many important goals of the nation as mentioned above, the liberalization of tourism trade presents the nation with an opportunity to achieve its MGDs.

### **2.5. Analysis of strengths, weaknesses, opportunities and threats**

Tourism is one of the strongest sectors of Nepal and there enormous opportunities for further development. Nevertheless, there are certain weaknesses and threats that need to be tackled. The present chapter is devoted to examining Nepal's tourism strengths and weakness, opportunities and threats. The chapter will review two analyses of strengths, weaknesses, opportunities and threats, one prepared by the Nepal Tourism Board and the other by UNCTAD and then present an action plan.

Box II.1 presents an analysis of strengths, weaknesses, opportunities and threats relating to the Nepal's tourism sector prepared by the Ministry of Tourism and Civil Aviation of Nepal and box II.2, by the Division on International Trade in Goods and Services, and Commodities (DITC) of UNCTAD.

As presented in the two boxes, Nepal is rich in natural resources, cultural diversity and religious sites. It has four world heritage sites, two cultural and two natural. The cultural sites include Kathmandu Valley (1979) and Lumbini- Birth place of Lord Buddha (1997) and, natural sites include Royal Chitwan National Park (1984) and Sagarmatha National Park (1979). And, Nepal is also recognized as a famous spot for adventure tourism. However, Nepal has been criticized for not having a clear tourism vision, though the government has recently come up with

its new Tourism Vision 2020 (2009) campaign – a campaign promoting tourism for peace, people and prosperity. Nepal's tourism sector is also criticized for the lack of competent delivery system. Although some peace and stability has been restored in the country, there still exists political instability and the status quo bureaucratic structure. The need to obtain approval from the ministry and other bureaucratic procedures causes a major slowdown in proposal rectification- It still takes months to have a proposal rectified. Not only this, even the services provided by small restaurants, guest houses and taxis as mentioned in UNCTAD analysis, is very poor.

Regarding access to air services, Nepal has air service agreements with more than 35 countries. Tribhuvan International Airport saw 87 per cent of total flight operated with 1,064 cancellations. Likewise, there were 212 charters flight during the year 2008. Those flying at present include not only national airlines such as Nepal Airlines, Qatar Airways, Pakistan International and Indian Airlines, but also private and budget airlines such as India's Jet Airways. Nepal's budget airways Cosmic Air could not survive the market forces. Since there are very few direct international flights connecting to Kathmandu and since there is a lack of direct connections to Europe, the air service of Nepal is a threat to the Nepal's tourism sector. Nepal Airlines Corporation is pitted against its inefficiency and criticized for the decrease in tourist arrivals since 2000. Political interference and mismanagement in Nepalese airlines is still considered to be one of the biggest threats to Nepalese tourism. Though the Nepal Tourism Board considers competitive ground-handling costs to be an opportunity (see analysis of strengths, weaknesses, opportunities and threats), the landing and parking fee is said to be the highest in South Asia. In the past, Nepal has also had also to face growing threat of international terrorism and insurgency within the country.

At present, the Nepal Tourism Board provides the overall strategic management of tourism in Nepal by integrating government commitments with private-sector dynamism. Although branding Nepalese tourism with the slogan *Naturally Nepal: once is not enough* has been successful in revealing the unique natural beauty of Nepal in international markets, Nepalese tourism still has several weaknesses, as extensively portrayed in the previous two boxes. Infrastructure problems, such as limited road networks and traffic congestion, and few new investments are

**Box II.1. Analysis of strengths, weaknesses, opportunities and threats prepared by the Government of Nepal and the Ministry of Tourism and Civil Aviation: Nepal's tourism sector**

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Unmatched natural products: Mt. Everest, Himalayan range and 8 of the worlds 14 8,000-m peaks, diverse landscape, sublime natural scenery, protected areas with diverse flora and fauna, fast-flowing rivers, year-round pleasant weather.</li> <li>• Ultimate adventure destination: number-one destination for mountaineers and trekkers, white-water rafting, largest assortment of aerial, terrestrial and aquatic sports.</li> <li>• Rich culture: multicultural, multi-ethnic; multilingual yet harmonious society; unique Newari architecture of Kathmandu valley, Limbini and other UNESCO world heritage sites; Kumari-the Living Goddess; more festival than days in a year; tourist-friendly, hospitable people, diverse cultures in Terai region</li> <li>• Other: a model of successful peace process, able private-sector, awareness of community level, public-private-people partnership approach, gateway to the Himalayas.</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• Insufficient infrastructures</li> <li>• Inadequate investment in tourism sector</li> <li>• Limited air connectivity and weak national carrier</li> <li>• Poor coordination among different agencies</li> <li>• Weak public–private partnerships</li> <li>• Scarcity of resources for massive publicity and consumer promotion</li> <li>• Tourism patterns limited to a few geographical areas</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Government has placed high priority on tourism</li> <li>• Growing tourism out of bounds of immediate neighbours</li> <li>• Competitive ground-handling costs</li> <li>• Spillover effects from neighbouring destinations of India and China</li> <li>• Growing demand for adventure travel</li> <li>• Sustainability of natural and cultural heritage through tourism and economic development</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Political environment in transitional phase</li> <li>• Global terrorism</li> <li>• Cross-border disease</li> <li>• Unfavourable travel advisories</li> <li>• Global economic downturn</li> <li>• Climate change</li> </ul>

Source: Government of Nepal/Ministry of Tourism and Civil Aviation (2009), *Tourism Vision 2020: Tourism for Peace, People and Prosperity*.

critical. To this end, improvements in the domestic road infrastructure will be helpful, but cross-border improvements are also required if full advantage is to be gained from domestic investment in road-based tourism. The 18-hour load shadings in the recent past have had a negative effect on tourism; improving energy infrastructure is therefore also a major priority. Poor networking between the Nepal Tourism Board and other related tourism associations and a centralized decision making system are other weaknesses to be noted.

In regional tourism, the Board has been criticized for failing to come up with attractive and incentive

packages for travellers coming from India and China compared with those provided by other destinations such as Hong Kong (China), Dubai, Singapore and Malaysia. For example, the countries such as Thailand, Dubai and Mauritius are said to have provided three to four days' vacation, including airfare for the same price as Nepal, implying the need to observe and study pricing policies of competing destinations.

Tourism data also show that an increasing number of tourists in Nepal enter by land (26.1 per cent in 2006). The majority of those entering by land include tourists from India and China. India's proximity to Nepal, the absence of visa restrictions and increasing disposable

**Box II.2. Analysis of strengths, weaknesses, opportunities and threats prepared by UNCTAD-DITC: Nepal's tourism sector**

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Natural assets</li> <li>• Cultural diversity</li> <li>• Religious sites</li> <li>• Four World Heritage Sites</li> <li>• Acquired image as an adventure and cultural theme tourism destination</li> <li>• Good service, hospitable nature of Nepalese people</li> <li>• Expanded air access to major markets</li> <li>• Government promotion of sustainable tourism</li> <li>• Wide array of ecotourism offerings</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• Lagging capacity expansion relative to targeted volume of tourists</li> <li>• Infrastructure limitations in rural regions: utilities, telecommunications, water treatment</li> <li>• Road network limitations and traffic congestion</li> <li>• Limited capacity of Kathmandu Airport to accommodate growing traffic</li> <li>• Moderate leakage levels</li> <li>• Foreign-based local businesses do not repatriate profits towards Nepal</li> <li>• Lower quality service provided by small restaurants, guest houses, taxis</li> <li>• Limited access to new investments and financing</li> <li>• Inadequate safety regulations</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Reinforced intersectoral linkages</li> <li>• Strengthened community-based tourism</li> <li>• Restored in-country stability, safety and security</li> <li>• Restored political stability</li> <li>• Improving tourism and transportation infrastructure and service</li> <li>• New tourism themes: health care and educational tourism, business and conference tourism</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Environmental degradation in high-traffic areas</li> <li>• Increasing incidence of theft and violence targeting tourists</li> <li>• Global economic crisis</li> <li>• Overdevelopment may damage the image of the destination</li> <li>• Competition for land between tourists and local needs</li> </ul>

Required spillovers from other sectors need improved supply of services from the transport, financial, ICT, recreation, health care, utilities and security services sectors.

Anticipated spillover into other sectors provides improved market for services from the transport, recreation and health-care sectors; conservation and environmental benefits derived from improved land management; expanded offering of infrastructure in tourism zones; spreading of quality standards to other sectors.

Key stakeholders: relevant government ministries and parastatals; tourism sector firms – hotels, restaurants; transport firms – airlines, taxis, car-rental companies; local communities; labour unions; recreation and sports firms and interest groups; advertising agents and e-tourism suppliers.

*Source: UNCTAD-Division on International Trade in Goods and Services, and Commodities-Trade Negotiations and Commercial Diplomacy Branch, Strategies for advancing development of the services sector of Nepal, draft version, February 2009.*

income of Indians are factors contributing to inflows of Indian tourists. The percentage of tourists coming from India was 24.4 per cent of that in 2006. China has declared Nepal an approved tourism destination. Thus, there is a huge opportunity for increasing tourists from both of these neighbouring countries. As new tourist destinations on both sides of the border have been opened and developed – especially Tibet, Himachal

Pradesh, Uttar Pradesh and Bihar – it is very likely that the number of tourists visiting Nepal by land will grow in years to come. However, the regular bandas, road blockades, highway obstructions and landslides have dissuaded overland tourists, especially those travelling from India and China. Similarly, there is a potential for tourists coming from non-traditional markets such as Africa and Latin America.

Though Nepal is currently focusing on adventure tourism, including eco-tourism and pleasure tourism, there are opportunities for new tourism products such as health and wellness tourism, educational tourism, community tourism, sporting vacations, ethnic tourism and business conferences. This also shows the need to reclassify tourist arrivals under new categories. Although the Ministry of Tourism has provided the data for conventions and conferences since 2001, there are no figures. Further, Nepal is currently focusing on the promotion of recreational activities for higher-income tourists during the peak season. However, during the off season, promotion and marketing are minimal, implying its earning potential during the off season by increasing marketing efforts through discount packages targeting the middle-income tourist market.

In addition to adopting plans and strategies to increase tourism revenues, Nepal should also explore ways to cut costs through e-tourism. Providing increased opportunities for tourists to book vacations online could allow Nepal's tour operators to greatly reduce leakage (tourist receipts paid to foreign agents), thus boosting the possibility to offer lower-cost packages to consumers.

As environmental degradation is a threat to tourism in Nepal, the country should re-emphasize the need to reduce negative environmental impacts to ensure long-term stability of biodiversity in the country and continued access by the local population to high-quality residential, recreational and agricultural sites.

### Strengths:

- Rich in natural resources, cultural diversity and religious sites;
- Number one destination for mountaineers and trekkers, and other adventure tourism (rafting, aerial, terrestrial and aquatic sports);
- Tourism: Nepal's leading service export.

### Weaknesses:

- Poor services provided by small restaurants, guest houses and taxis;
- No direct air connection to Europe and very few international flights with connections to Kathmandu;
- Weak domestic airline;
- Unable to reap benefits from intraregional tourism;
- Failure to provide attractive incentive packages to travellers from India and China, compared with competing destinations.

### Opportunities:

- Adding new tourism products such as health and wellness tourism, educational tourism, community tourism, sporting vacations, ethnic tourism;
- Attracting middle income tourists during off season and from non-traditional markets;
- Decreasing costs through e-tourism;
- Good prospects for attracting surface travellers in future, both from India and China, with the opening and development of new tourism destinations on both sides of border;
- Prospect of opening new border points, such as Rasuwa for Chinese tourists;
- Reducing negative environmental impacts to ensure long-term stability of biodiversity;
- Membership of WTO has helped integrate Nepal's tourism services into the global economy, stimulating development through job creation and foreign exchange earnings. The positive spillover effect of this will aid rural development by reducing dependency on agriculture as a source of income, distributing the benefits of an improved economy to the population and boosting GDP growth to reduce poverty.

### Threats:

- Lack of political stability and status quo bureaucratic structure;
- Political interference and mismanagement of Nepalese airlines;
- Threat of international terrorism and insurgency within the country in the past;
- Regular bandas, road blockades, highway obstruction and landslides.

## 2.6. Policy recommendations

Since Nepal is uniquely endowed with rich and diverse natural resources and cultural attractions, tourism is a sector of comparative advantage for Nepal. This is one of the most important services sector of the country, which has contributed to GDP, employment, rural development and poverty reduction. Tourism can reduce poverty when it provides employment and diversified livelihood opportunities because it provides additional income. There is also high potential for tourism contributing to the achievement of each of the MDGs, and such contributions could increase if appropriate steps are taken.



Tourism makes a direct contribution to the Nepalese economy through its foreign exchange earnings. Data analysis (see table II.14) has shown however, that there have been no remarkable increases in foreign exchange earnings from tourism. Foreign exchange earnings from tourism as a percentage of GDP decreased from 3.4 per cent in the 2003/04 fiscal year to 1.3 per cent in the 2007/08 fiscal year. The average growth rate of foreign exchange earning for the period also stood at a mere 3.8 per cent, implying that earnings from tourism are not significant as per inflation and surge in imports, and therefore does not affect the present serious trade deficit situation.

The above situation indicates the need for remedial action to improve the contribution of the tourism sector. This has been explained under three headings: Socio-economic and political aspects, Regulatory and institutional aspects and General Agreement on Trade in Services.

### **Socio-economic and political aspects**

- The number of tourist arrivals in Nepal has dropped and the tourism industry has been adversely affected in recent years by political instability and a decade-long Maoist movement prevailing in the country. The country only started to re-attract tourists in 2007, reaching more than 500,000 for the first time. To maintain this momentum, tourism should be made free from politics and conflict. Any renewed worsening of the political situation could again send tourist arrivals into decline;
- The linkages between tourism and poverty are identified in figure II.2. The development of such linkages will help increase tourism's contribution to the Nepalese economy. In order to increase linkages for global partnership, emphasis should also be given to information technologies, as they play an important role in integrating tourism enterprises into global tourism markets;
- Tourism should focus on the local or community level and aim at increasing tourism's contribution to poverty reduction. Efforts should also be made to enable poor people to participate more effectively in tourism development; hence the need to pay attention to village tourism, a concept that was introduced in the Tourism Policy (1995), emphasized in the Tenth Plan (2002–07) and exemplified by the implementation of the Tourism for Rural Poverty Alleviation Programme. Village tourism is also associated with health tourism, particularly tourism

villages to be set up in cold regions;

- Trekking and mountaineering are main objectives of tourists visiting Nepal. This segment of tourism makes royalty income the direct contribution to the government treasury. The expenditure incurred in this segment also has a spillover effect in the Nepalese economy;
- As Nepal offers rich religious and cultural attractions, emphasis should also be given to religious and cultural tourism;
- Infrastructure facilities and tourist services should be set up (roads, communications, and health and sanitation services). These can also be designed to benefit local communities at the same time, so that they will help achieve Millennium Development Goals 4, 5, 6 and 7;
- Though tourist arrivals in Nepal rose 3.8 per cent in 2001–2007, there has been negative growth of tourism from North America. Similarly, from Asia, there has been a minimum growth of tourists coming from India (1.7 per cent), suggesting the need to implement specific programmes to increase inflows of tourists coming from these countries;
- Tourism and travel play an important role in Nepal's exports. However, the travel industry had a surplus only up to 2004. Since 2005, travel services have suffered deficits, indicating that this sector requires attention as well;
- To have tourism data that is comparable with other countries, Nepal needs to have a tourism satellite account developed by the World Travel and Tourism Council. Similarly, Nepal's services sector classification should be compatible with the 1993 System of National Accounts and WTO classifications.

### **Regulatory and institutional aspects**

- The Ministry of Tourism and Civil Aviation in Nepal needs to improve its monitoring and evaluation system that will help tourists visiting Nepal enjoy facilities provided by Nepalese policy and acts;
- The opening of Tribhuvan International Airport only until 12.30 midnight has not only created a problem of landing and take off during the day time (peak time 11 a.m. –4 p.m.), but has also resulted in the lack of parking bays at the airport. It should, therefore, be open round the clock as in other countries. Moreover, there is a need for inter-agency coordination to achieve working effectiveness;



- The Government of Nepal needs to formulate domestic regulations that will enable the country to abide by its WTO commitments. This will help improve Nepal's credibility in the world. There is also a need to strengthen the WTO Reference Centre established under the Commerce Department of the Ministry of Commerce and Supplies;
- The service enquiry point established under the WTO division of the Ministry of Commerce needs to be strengthened with the necessary manpower, equipment and activities so that it can function properly, in view of the role it is going to play in the overall development of the services sector in Nepal;
- Since Nepal's New Tourism Policy 2008 has identified medical tourism a potential tourism product, the country needs to do further work in implementing and introducing it. The potential lies in low-cost medical services, especially compared with those offered by developed countries, such as check ups, diagnosis, laboratory facilities, indoor services, surgery and follow-up. Nepal should market this product by promoting these advantages, focusing on natural treatment methods and convalescence near natural heritage sites.

### General Agreement on Trade in Services

- Nepal has made commitments under GATS in 12 sectors, including tourism. Thus there is a need for a comprehensive service plan in the tourism sector to:
  - Access Nepal's capabilities and resources to compete in the global tourism industry;
  - Find the optimum balance between local and foreign participation in the industry;
  - Access the capability and resources to fight barriers to market access created by other countries through technical standards, subsidies, discriminatory access to information and distribution channels;
  - Identify supply constraints created by the lack of human resources, technology, and quality standards;
  - Develop plans and policies to overcome supply constraints and barriers to market access;
- As the tourism industry is expected to have the largest monetary turnover in the world by the year 2020 (*Frontline Magazine*), trade liberalization constraints in tourism must be acknowledged and differences between the SAARC nations must be rectified in order to reap the highest benefit of this growing industry;
- Trade policies should be re-examined to enhance foreign direct investment in the tourism sector.

In this regard, consideration should be given to increasing the coverage of GATS commitments in tourism services by scheduling new commitments for food and beverage services, tourist management services, education and health accommodation services and other non-conventional services.

### Action plan

1. Develop a services sector database in Nepal compatible with WTO classifications and the 1993 System of National Accounts. The Organization has classified the services sector into 12 services, including construction services. The Nepalese service classification has chosen construction as a service. In addition, the government has classified 15 economic activities, which have been grouped into three broad sectors: primary, secondary and tertiary. Only the tertiary sector is considered a services sector; construction is included in the secondary sector.
2. Introduce the tourism satellite account with classifications comparable with international practice. The tourism satellite account follows the standardized United Nations' methodology to measure travel and tourism's economic impact on personal consumption, business spending, capital investment, government expenditures, and exports and imports, culminating in the quantification of the contribution to GDP and employment. Several OECD countries, such as Australia, Canada, France, Mexico, New Zealand, Norway, Sweden and the United States have successfully implemented the system. Other countries – for example, Poland, Spain and Switzerland – are beginning to work on its implementation. Considering the role tourism plays in the economy, Nepal needs to implement the system, as the current data include only the contribution of hotels and restaurants to GDP. Current data do not show the total contribution of tourism and travel-related services, hence it is underestimated.
3. Boost investment in tourism to create tourism attractions and facilities. At present, Nepalese tourism is basically confined to five traditional attractions, namely Kathmandu, Pokhara, Chitwan, Everest and Annapurna. A breakthrough is necessary to include new tourism attractions. Policies and regulations should also attract foreign and domestic investment.

4. The tourism policy prepared by the Government needs to be evaluated by an independent party. A common complaint is that the Government of Nepal's new tourism policies contain changes in dates rather than substance.
5. Since tourism plays a major role in poverty reduction, tourism activities should be extended to rural and remote areas. Further initiatives such as the Tourism for Rural Poverty Alleviation Programme are also necessary to alleviate poverty. These initiatives contribute both at the macro and micro levels.
6. The Nepal Tourism Board should develop attractive incentive packages for travellers coming from India and China that are cheaper or at least comparable with those provided by countries such as Thailand, Dubai and Mauritius. A new, improved overland transport network would also be desirable.
7. Pass necessary acts and regulations prohibiting strikes, bandas, road blockades and highway obstruction, which have a negative effect on Nepalese tourism.
8. The garbage problem also affects Nepalese tourism adversely, implying the need for proper garbage management in Kathmandu Valley.
9. Although Nepal has bilateral air-service agreements with some 35 countries, only 22 airlines have been operating until now. It is necessary to increase airline connectivity and attract more budget carriers to Nepal.
10. Improve and strengthen Nepal Airlines Corporation by enhancing its capacity and reliability; repair aircraft and implement long-term fleet plans and link route plan with fleet plan.
11. Make necessary improvements in Tribhuvan International Airport, which includes equipping it with basic facilities, expanding the international parking bay, dispersion of flights from peak hours by introducing night flights and the concept of aerobridges, making fees and charges competitive with other SAARC countries, rationalizing the price of aviation turbine fuel and running the airport round the clock.
12. Construction of a second international airport at Nijgada. Similarly, upgrading and/or construction of existing airports at Bahirahawa and Janakpur as regional airports to increase religious tourism and Pokhara airport, natural tourism.
13. Capacity-building of service providers for quality service. This could be done through training sessions and other capacity-building programmes. At present, the lack of human resources has become a serious problem, owing to the movement of skilled human resources abroad, forcing many hotels in Nepal to manage their businesses through interns.
14. Add and introduce new tourism products such as health and wellness tourism. There is a large potential for this new product, in view of Nepal's climate and biodiversity.
15. Introduce e-tourism tools, such as the computer reservation system and the global distribution system.
16. Reduce environmental impacts to ensure long-term stability of biodiversity.

An action plan matrix is presented in table II.22.



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## C. INFORMATION TECHNOLOGY AND SOFTWARE SERVICES SECTOR

### 1. Role and performance of the information technology and computer services sector in the national economy

#### 1.1. Introduction

Countries around the globe have become more information- and knowledge-intensive, giving rise to the phenomenon of the knowledge-based economy. The increasing importance of knowledge to economies is a truly international trend affecting all levels of development.<sup>1</sup> Sharing its borders with two ICT giants; Nepal has also reckoned the importance of a knowledge-based economy, which has been clearly reflected in IT Policy 2000.

Immediately after the restoration of democracy in 1990, Nepal witnessed the influx of joint-venture software companies such as Pilgrim Software and Communication. These initiatives helped establish Nepal as a possible outsource destination for the IT and ITES sectors. Unfortunately, no significant measures were taken by the government on this front until 1997. With constant lobbying from the private sector, it was only after 1997 that the government took initiatives to facilitate the sector by enacting necessary legislation. After the promulgation of the Telecommunication Act - 1997 (the Nepal Telecommunication Authority was constituted in 1998), IT Policy 2000 (revised in 2004) and the Electronic Transaction Act (2006), IT/ITES industries started growing in number and volume. The establishment of the High-Level Commission for Information Technology and liberalization in telecommunication further boosted the growth of this sector.

Trade in the IT/ITES services sector has started growing, albeit not at the desired pace. The opportunity of outsourcing is tremendous for landlocked countries such as Nepal. Technology transfer, innovation/incubation, offshore destination centres and business process outsourcing are among the few avenues for which Nepal can prove its competence. A desk study (UNCTAD, 2009) has also identified the IT sector as one of the most promising services sectors in Nepal.

### 2. Overview of the information and communication technology and computer services sectors

#### 2.1. Telecommunications

Since the establishment in 1998 of the Nepal Telecommunications Authority (regulatory body for the telecommunication sector) and enactment of the Telecommunication Policy 1999, progress in telecommunication access has been remarkable. With further liberalization measures taken by the Nepal Telecommunications Authority, there are already six fixed-line and mobile phone service providers operating in various parts of the country and a few are in the offing. The *Management Information Systems* report produced by the Authority in June 2009 shows that more than 5,182,304 mobile phones are in service and 812,623 fixed lines have been rolled out, which results in a tele-density of 22.07 per cent of the total population.

Similarly, ahead of Internet services, the Nepal Telecommunications Authority has granted 8 licences to network service providers, 94 licences to VSAT users and 38 licences to Internet and e-mail providers. The total number of Internet subscribers is 176,024, resulting in an Internet density of 0.64 per cent of the total population (Central Bureau of Statistics). From the 2009/10 fiscal year, the government removed the licence fee for VSAT users, which is expected to enhance rural telephony and Internet facilities. Similarly the Nepal Telecommunications Authority has permitted the Voice over Internet Protocol service to international long distance gateways, which means that – except for local or national calls – call forwarding can be done using Voice over Internet Protocol service through the national telecommunication operators.

This sector is considered a major employer of IT professionals. Nepal Telecom Authority alone boasts having over 6000 employees, and Spice Nepal and United Telecom Limited are also rapidly expanding its human resources. The contribution of telecommunication companies to the national economy is significant. Spice Nepal, the second largest private telecommunication company, ranked second on the list of highest taxpayer industries in Nepal in 2008.

#### 2.2. Connectivity

With the aim of enhancing capacity as well as the quality of telecommunication services, an optical fibre backbone has been laid across the East-West



highway of Nepal. Nepal is now connected to India through fibre links via different connecting points and the country has an optical fibre backbone the entire length. Nepal is also now connected with China through a 110-km-long optical fibre backbone, which means Nepal can now leverage this connectivity to establish a transit communication route between China and India. This is ultimately going to reduce the voice and data transmission rate dramatically. Further, Nepal can charge rental fees for allowing India and China to use this route. The data and voice routed from and through China and terminating in India and vice versa can be routed through this transit. Leasing the service to the private sector seems to be a more effective way to proceed, considering its strength in telecommunication sector.

The Nepal Telecommunications Authority aims to expand the optical fibre network to all the 75 districts within the next five years with a view to developing the country's information and communication technology sector. The feasibility study has been carried out and the project is expected to be completed by 2014.

With regard to Wi-Fi connectivity, two frequency bands (2.4GHz and 5.8 GHz) have been opened for public use and permission or licence fees are not required, offering an incentive to the private sector to establish network services in Nepal's difficult terrains.

Despite these positive developments, Nepal is still struggling to secure a higher rank in networked readiness index. In 2008–2009, the World Economic Forum placed Nepal in 127<sup>th</sup> position in the networked readiness index among 134 nations of the world.

### 2.3. Software development

Software development is defined as a priority area for export-oriented services by the Government of Nepal. Though the current export volume is not that significant (about \$10 million in 2008), this field has been identified as one of the most promising services sectors.

The software industries of Nepal can be grouped into three categories:

Local-level solution providers;

- Export oriented;
- Hybrid industries.

The primary consumers of local-level solution providers are local NGOs, government, academic institutions and local-level small- and medium-scale

industries, for example, travel agencies, food and beverage industries and pharmaceutical companies. Major services from this category include Web-enabled application development, management information systems and process automation of industries, academics and NGOs. However, owing to the lack of required infrastructure, corporate practice and quality control measures, this category is having a hard time surviving in the competitive market. Lack of exposure, scale of transaction and international standards and certifications such as ISO 9001 and capability maturity model integration (CMMI) limit their participation in bigger opportunities. Nevertheless, the contribution of this category cannot be overlooked, as it consists of the highest number of registered software companies and provides employment to most of the IT professionals.

In the past few years, a significant number of export-oriented software industries have come to the fore. Such companies can be grouped into two types, i.e. the home-grown variety and foreign subsidiaries incorporated in Nepal. A few examples of home-grown companies are Data Analysis & Software Solutions (DASS), NepaSoft, Hi-Tech valley iNet and Yomari.com. Many of these have tie-ups with reputed international companies and they work either as independent solution providers or as offshore destination centres for their clients. However, onshore service exports have not yet been recorded in this category. Foreign subsidiary models have become popular and many foreign establishments have set up branches. Few of them have their own liaison centres in developed countries, which act as an onshore contact point. For example, DASS has established branches in the United States and the United Kingdom in an effort to gain the confidence of onshore clients and meet country-specific data security requirements.

D2HawkEye Services, IT@Himalaya, HWB and JavaSoft are a few examples of foreign investment or subsidiaries. They offer lucrative remuneration across all categories and boast the highest number of employees. D2HawkEye Services currently employs more than 300 professionals and other companies are on their heels.

### 2.4. Information technology-enabled services industries

In 2007, the total market potential for ITES industries was \$475 billion, of which 14 per cent of transactions took place in the offshore market (McKinsey, 2007). The



outsourcing trend is expected to grow at a faster clip in the coming years. The projected transaction in 2010 approaches \$130 billion and in 2015, it may rise to \$250 billion. Among all these transactions, India is the highest beneficiary. Aside from the infrastructure and suitable government intervention, other requirements are not beyond the reach of countries such as Nepal.

Though ITES were delivered by fringe companies in the early 1990s in the form of data entry, large-scale ITES-based industries started growing in map digitization and medical transcription. In 1998, Himalayan InfoTech Private, Ltd. employed 600 medical transcription graduates for (some contractual problems led to the closure of this company). Since then, many companies in the areas of ITES, business process outsourcing and knowledge process outsourcing have been established and are a major source of income generation and employment in this sector.

Companies such as D2HawkEye, Serving Minds, Incessant Rain, LinkTree and National Information Technology Institute are among the few examples of successful ITES companies, and the staff employed is also in the hundreds. The total number of human resources in this category currently exceeds 4,000. The domain of work involves data processing, call centres, medical transcription, map digitization and animation. Unlike other categories, the availability of qualified graduates with English proficiency within Kathmandu Valley has helped the ITES sector grow much faster.

However, the distribution of such industries across the country is not that encouraging. Almost all are located within the capital city and only one company has been recorded as operating at Biratnagar, the second largest city of Nepal. This can be attributed to the lack of graduate education in English and supporting infrastructure. There is a tendency to send children to the capital city for their studies where there is an uninterrupted supply of electricity.

## 2.5. Human resources

Altogether, four universities in Nepal offer IT education. Kathmandu University (non-government) is the pioneer university, offering IT-based courses. More than 200 graduates per year are produced in the fields of engineering and IT management. This university offers undergraduate, graduate and post-graduate degrees in various IT-related streams.

The courses are offered in consultation with local industry, and the university has signed memoranda of understanding with many national and international industries. Before graduating, students must fulfil the requirement of internship. This is a good example of industry institutes interfacing and helps students to acquire hands-on knowledge of industry before graduating. In exchange, industry enjoys enough lead time to assess and train prospective employees. The absorption rate of Kathmandu University graduates immediately after graduation is 90 per cent.

Tribhuvan University also offers all ranges of IT education, producing nearly 800 graduates every year. Purwanchal and Pokhara Universities offer IT education through their central campuses and affiliated colleges. Approximately 1500 students graduate in engineering, management and computer applications.

Apart from national universities, India, Singapore, Bangladesh, Thailand and the Philippines are among those countries contributing to the production of approximately 1,000 Nepalese IT graduates per annum. The trend shows that after graduation most of them return to Nepal to start their career. However, students opting for developed countries such the United States, the United Kingdom and Australia have not been found to contribute to local human resources.

In almost all Nepalese universities, the medium of communication is English, which has become a major strength of IT graduates. Unlike India, the accent does not vary much across the country. However, higher education in IT is concentrated mostly in the capital city and there is not much coherence between the standards of education offered by different universities. An academic career is not among the priorities of IT graduates, causing a dearth in quality faculty members. Faculty development in the IT sector has been seen as a coordinated effort. Though the University Grant Commission and universities are striving to develop higher-level graduates, they have not succeeded in retaining them as faculty members.

Research and development is still in its infancy, and national industries are yet not in a position to offer assistance for research and development at universities. Very few faculty members and graduate students are involved in research activities and the field of research does not correspond adequately to the needs of local industries. Until now, universities

have not spun off companies to promote innovation. Similarly, business incubation centres are also very important for innovation and many successful ideas have been incubated and further converted into SMEs in the periphery of universities. However, no such efforts have been made in the Nepalese context.

Unlike India, there is not a single human resources company in Nepal that deals with producing industry-ready human resources. Most IT/ITES companies are not in a position to provide training for their prospective employees. The industry expects fresh graduates to be ready for their assignments, whereas they do not receive sufficient exposure to industry culture and practices during their studies. This gap can be shortened by offering industry-readiness training or boot-camp training to aspiring professionals. (This differs from training programmes conducted by private training centres, which focus more on training in specific technology).

Nepal offers very low labour costs, which are further lowered by the continuing depreciation of the Nepalese currency. In software development, the average charge for a skilled resource (in the offshore destination centre model) is approximately \$1,200, significantly lower than its neighbouring countries. A software professional with three to five years of experience earns in the range of \$6,000 to \$8,000 per year, which is almost ten times less than in the United States. This is equally applicable to ITES professionals as well. On average, ITES professionals earn around \$2,000 per year, almost half the salary of their Indian counterparts. A general study shows that approximately 2,500 professionals are working on software development and more than 4,000 are in ITES industries.

The attrition rate in software industries is high and the trend shows that after two years of hands-on experience, IT professionals leave the country to pursue further studies. The number of professionals who come back from abroad is insignificant and this process does not contribute to the uplifting of local industries. It is not that the local industries are not in a position to use those talents. There has always been shortage of talent pools in the industry and this has become a major setback when seeking to scale up the organization. As a result, some software industries have started providing university scholarships on the condition that the successful candidate works for several years in the company after graduation. IT@himalaya private limited and Websearch private limited

have established strategic tie-ups with Kathmandu University, and others are in the offing.

The ITES sector is a knowledge-based industry; hence it has seen very little unrest due to employee-related problems. Unlike other industries, none of the software development industries have employee unions. However, one of the largest ITES companies, Himalayan InfoTech Private, Limited, was forced to shut down in 2000 because of employee agitation.

### 3. Investment trends

The expansion of communication facilities, English-speaking graduates and lower labour costs have attracted many local and foreign investments in the software sector and ITES industry. The Government of Nepal has also shown commitment to the growth of this sector by liberalizing policies and enforcing appropriate laws and policies. The Controller's Office for Digital Certification has started preparations to ensure the legal framework for digital transactions. Similarly, the government has also an identified IT park for Nepal at Banepa, Kavre as a special economic zone for the promotion of IT and ITES-related activities.

The automation process in various government or semi-government organizations has also encouraged local entrepreneurs to establish such outfits. Implementation of enterprise resource planning, management information systems, industry process automation systems and Web-based service delivery has started taking place in many the large-scale organizations. The telecommunication sectors (public and private), land revenue department, department of water supply, financial institutions (bank, insurance, cooperatives, remittance) are among those investing heavily in automation. This has helped local companies work as technology partners and service providers.

Traditionally, North America has been the primary market for outsourcing-based Nepalese companies but recently, many European companies have established subsidiaries in Nepal. More than 10 Dutch companies have up-and-running local setups in Nepal followed by the companies based in Sweden, Denmark, Austria and Norway. IT@himalaya, HWB, Websearch Pro, JavraSoft and ByProxy are a few examples. However, many foreign subsidiaries and home-grown companies have yet not registered with the relevant government authorities. The very nature of this industry has helped these outfits work clandestinely. The intent behind such a practice is to

evade taxes and hide from political or non-political outfits that used to extort money for different pretexts. This stems from the unavailability of reliable IT-related export data.

Most IT/ITES industries are located in the capital city and very few have invested in their own infrastructure. Apart from technology, most of the fixed assets are rented by the companies. Very few companies (e.g. JavraSoft, NepaSoft, D2HawkEye, DASS) have invested in ergonomics and or maintained the corporate culture exemplified by formal reception desks, defined processes or security and backup services. Similarly, the cost of providing full-fledged electricity backup service is very high (particularly when there is 16 hours of load-shedding in a day) and very few companies can afford to have their own alternative source of electricity. Except for a handful of reputed outfits, software piracy is rampant in all sorts of IT/ITES industries. Companies working as foreign subsidiaries and some with international certification of standards implement the licensed software at their workplaces.

Also, following the lack of defined procedures or processes, the companies adhere to the build-and-fix approach, which further increases the cost of managing the quality of deliverables. In the case of software development, the standard tools and techniques such as requirement management, security management, configuration or issue management and quality management are followed by very few companies. Standard processes such as agile processes and rational unified process are found to be implemented scantily.

A missing attribute in the IT/ITES sector is the investment in process definition and quality assurance. International standards and appraisals are needed to maintain quality at par and gain an edge among the global competitors. ISO 9001:2008, CMMI and other data security-related certifications are among such requirements. CMMI has been a long-standing de-facto standard for assessing the strength of a software company. India alone has half of the entire CMMI level-5 (highest level of maturity) appraised companies in the world and thus has stood at the top worldwide. Ironically, D2HawkEye is the only company in Nepal appraised as a CMMI ML-3 Company. Only six software development companies have acquired ISO 9001 certification. In the context of LDCs such as Nepal, it is relatively expensive for companies to apply for CMMI appraisal where a software company may have to spend \$25,000 for a level-2 appraisal.

The presence of multinational corporations in this sector could have played an anchor role for SMEs. Recently IBM signed a memorandum of understanding with the Government of Nepal with the vision of expanding their presence in the services sector and expanding its expertise in capacity-building, particularly in innovation or business incubation, research and development and training. Multinational corporations such as Infosys, Wipro and TCS are establishing their presence through local representatives, but those are limited to promoting their products in case of possible business opportunities.

## 4. National supply capacity

Nepal is still struggling to position itself in the ranks of tier-3 countries (taxonomy of software-exporting nations, Carmel, 2003). There is no lack of demand, but concerted efforts among stakeholders and proper government intervention regarding policies and laws have hindered growth in this sector. Other issues relating to national supply capacity are discussed below.

### 4.1. Lack of international promotion and country branding

Bodies such as NASSCOM are seriously needed to advocate at the international level and to promote activities. Nepal is still perceived as a not-so-open country for foreign investment. The 10 year-long insurgency had also added fuel to this notion. Nepalese companies have so far not been able to market their software products or ITES capability in the international arena.

### 4.2. Know-how in project management

Regardless of human resources capabilities, project management has always been a difficult issue. Tailoring the process across the organization and ensuring the proper implementation of such a process is a common problem across IT companies. The consequences of this scenario are inconsistency in service delivery, customer satisfaction and continual improvement.

### 4.3. Lack of IT managers, including middle and higher levels

Because of the tendency of IT professionals to go abroad after two to three years of work, grooming them to be managers has always been a problem

in this sector. Again, the trend shows that very few professionals return to their home countries.

#### **4.4. Collaboration between companies: resources and opportunity**

Collaboration among industries is very rare in Nepal. This hampers the delivery capacity of industry when the volume of work outplays available resources. Similarly resource sharing is not a regular practice in this sector. This could happen provided the industries are in close proximity of each other (for example, in an IT park). Mergers and acquisitions between successful IT/ITES companies are not common in the Nepalese context either and there is a prevailing indifference of banks or venture capitalists towards funding IT projects. Further, the sector is generally considered to be risk prone, which is a disadvantage when the industry needs to increase its supply capacity.

#### **4.5. Lack of corporate practices**

Proper training, space allocation, productivity-based perks, defined processes such as standard operating procedures, project management tools and techniques, security measures and ergonomics are the among the few attributes that favour quality and efficiency. Save a few successful companies, seriousness about acquiring these attributes is somewhat lacking in this sector. When scale-up is required in terms of volume, the quality of delivery has to be compromised in many cases.

#### **4.6. Difficulty in acquiring international standards**

International standards benchmark an organization's quality and delivery capacity. CMMI appraisal is still out of reach for many IT/ITES companies. To attract important clients with a significant volume of assignments, CMMI is considered a de-facto standard. The different levels of CMMI assess and benchmark the capabilities of quality management and delivery. Only one Nepalese company to date has been appraised for CMMI.

#### **4.7. Space and infrastructure constraint when scale-up is required**

Let alone the second-tier cities, there is scarcely space even in the capital city. The only IT park of Nepal, located on the outskirts of Kathmandu, has a capacity of 300 persons, which is insufficient.

#### **4.8. Higher bandwidth cost and irregular electricity supply**

Despite the growing optical fibre and broadband connectivity network, bandwidth costs five times more than in India. The hegemony of Nepal Telecom in the utilization of its optical fibre network prevents other private-sector service providers from using them to the desired extent. The fragmented effort of acquiring bandwidth from an international network service provider has also led to increased bandwidth cost.

At times, industry has witnessed 16 hours of load-shedding every day. In the ITES sector the turnaround time is generally not more than 12 hours. For example, in medical transcription, uninterrupted electricity is the prime criteria for smooth operation. An immediate solution is to acquire one's own backup service, but this ultimately detracts from the basic value proposition, cost-effectiveness.

### **5. Status of achieving national Millennium Development Goals**

National MDGs have identified communication and information technology as a key part of the development indicator. It equally stresses private-sector participation to enhance the quality of life by making the benefits of new technologies available. In this context, Nepal has been able to meet Target 8f.

Nepal has made remarkable progress in telecommunications. In 2005/06, fixed-line telephone density was 2.29 per 100 people, and this has risen to 2.954. Similarly in 2005/06, the penetration of cellular mobile phone per 100 people was 2.9, and this has grown significantly to 18.84. In all, the total teledensity has reached 22.07 per 100 people.

Government had committed to completely liberalizing the telecommunication sector by January 2009. Six major telecommunication service providers already provide various kinds of services. Code division multiple-access service – both voice and data – is provided in almost all Nepalese districts. By 2014, the Government of Nepal plans to connect all the districts with an optical-fibre backbone, which will remove the bottleneck of existing services. This programme is expected to bolster rural telephony by providing high-speed connectivity among the entire district and gradually removing the exiting ad-hoc telephony system.

More than 0.64 per cent of the population currently has a subscription to Internet services, compared with 0.43 per cent in 2006. These data do not include the number of Internet users in cyber cafes, which is much higher than that of fixed Internet subscribers.

The private sector has invested heavily in telecommunications. Spice Nepal Private Limited, the second largest telecommunication provider in the country, consists of 80 per cent foreign investment (Telia-Sonera Group). STM Sanchar is also a subsidiary of STM USA, which provides rural telephony service. Similarly, the software and ITES industries have witnessed significant foreign direct investment and are major technology transfer contributors and exporters of IT services. However, restrictions in the mobility of natural persons have not favoured foreign direct investment in IT and ITES.

## 6. Policy recommendations and elements of national strategy

### ***Provide incentives to industry for shared use of resources***

– Industries that share resources should be provided financial incentives such as tariff reductions in shared captive resources, supply of uninterrupted power through dedicated feeders or smooth dedicated water supply.

### ***Conduct IT management training to produce middle- and high-level IT managers***

– Training should be tailored to prepare middle- and high-level IT managers. Industry should be encouraged to have prospective managers participate in such training programmes. Training costs should be reduced by bringing many industry employees under a single umbrella.

### ***Create a revolving fund for CMMI appraisals for aspiring industries***

– Government should provide seed money to help companies seeking CMMI appraisal. Aspiring companies should contribute fair amounts to a revolving fund at defined time intervals, thus alleviating the burden at the time of appraisal.

### ***Invest in training to prepare a resources pool***

– ITES industries need many employees; when it needs to increase delivery volume, it faces an acute shortage of qualified human resources. To mitigate the problem, provision for a resources pool is necessary. This can be achieved by conducting training sessions by means of public-private partnership.

### ***Support universities to produce ready-to-be-absorbed graduates***

– Universities should be assisted in

improving the skills of industry-ready graduates by providing extra hands-on training required for the industry.

### ***Create a climate of trust with venture capitalists and financial institutions to encourage them to invest in the IT/ITES sector***

– Government should provide a mechanism to ensure investment security for financial institutions and venture capitalists. Promising IT/ITES business plans should receive government or other third-party guarantees. Due diligence should be strictly followed while assessing such business plans.

### ***Provide a mechanism to ensure uninterrupted electricity supply***

– Dedicated feeders should be made available to clusters of IT/ITES companies located in close proximity to one other. Fuel subsidies for power can be provided when alternative energy sources are used.

### ***Establish incubation or innovation centres in cooperation with universities to commercialize research activities***

– University resources, both infrastructure and human resources, can be utilized to establish incubation or innovation centres. The first few years should be funded and after a certain period of time, such centres should be made self-sustainable by transferring knowledge into the industries.

### ***Provide investment securities to multinational corporations and foreign direct investment (securities can be facilitated in terms of productivity).***

### ***Reinforce standards for intellectual property rights and data security***

– Regulations should be stringently enforced by means of appropriate laws. Disaster recovery centres should be established in different parts of the country in line with international standards.

## 7. Regulations, institutions and policy measures

### 7.1. Regulators and institutions

#### **Nepal Telecommunications Authority (regulatory body)**

Using a liberalization policy and striving to involve the private sector in a competitive environment for the development and expansion of telecommunication sector in Nepal, the Government of Nepal passed the Telecommunications Act (1997). The Act established the Nepal Telecommunications Authority, transferring to it the role of government with respect to licensing, monitoring, facilitating the operators for network



interconnection, protecting consumer interest, issuing guidelines, formulating necessary by-laws, settling disputes between licencees and between licensees and customers. The following table shows the number of licences issued by the Nepal Telecommunications Authority under various headings.

Recently, the Nepal Telecommunications Authority cancelled the provision of VSAT licence fees. Also, there is no need for licence fees or permission to use Wi-Fi based services (for two frequency bands, i.e. 2.4 GHz and 5.8 GHz). These provisions clearly encourage Internet services providers to set up their installations in rural areas.

The standardization of a frequency-allocation mechanism is already in place. The revenue and volume-based differential spectrum allocation helps new telecommunication operators secure a frequency and creates competition among the telecommunication operators; performers obtain larger parts of the spectrum while non-performers perish. Similarly, the issues of interconnection between different telecommunication vendors have been resolved, resulting in cheaper communication rates, for both landlines and mobile telephones.

### High-Level Commission for Information Technology (policy maker)

The High-Level Commission for Information Technology is an apex body formed that aims to provide crucial strategic direction and help formulate appropriate policy responses for the development of the ICT sector in the country, as well to harness these technologies to meet key developmental challenges, including governance reform and catalysing economic growth for poverty reduction.

The Commission's role has been crucial in formulating IT-related policies and acts. It oversees the implementation of national IT policies and strategies and provides strategic policy direction to the Government of Nepal. The Commission's main responsibilities are as follows:

- Act as promoter, facilitator and regulator to develop the IT sector and create an environment conducive to the increased participation of the private sector.
- Provide policy feedback and support to the Government of Nepal by maintaining a close relationship between industry, academia and the donor community
- Promote innovation and research and development to

standardize IT-related resources, training and activities

- Liaise between local and international IT industries
- Facilitate IT activities by establishing physical or virtual IT parks
- Help promote services provided by Nepalese industry in the international market
- Help mobilize foreign direct investment and technology transfer arrangements for the development of the IT sector in the country by cultivating networking arrangements and relationships with governments, companies, entrepreneurs and international development agencies
- Help prepare requisite legal, regulatory and operational instruments in the form of acts, regulations and guidelines within the larger purview of development and growth of ICT sector in the country.

The Commission is mandated to implement e-government enterprise architecture. This is the hub for all e-government applications to be implemented across the government bodies. The deadline for the implementation of enterprise architecture is 2011 and required tender documents have already been floated. Implementation is expected to help the national IT industries to obtain exposure in high-end technology by establishing tie-ups with international vendors. Technology transfer is another key benefit. The Asian Development Bank has granted \$25 million for the implementation of an e-government master plan, which was also initiated by the Commission. The government portal is another application it is planning to implement. The implementation of an e-government master plan will be a major opportunity for Nepalese IT firms. They can forge partnerships with global solution providers if they cannot deliver complete solutions to tailor and support implementation. This will help local firms acquire the benefits of knowledge transfer. Partnering with global players also helps bring local firms up to date with cutting-edge technology and processes.

The establishment of IT parks is also within the purview of the Commission. Currently, the only IT park of Nepal, at Banepa, on the outskirts of Kathmandu, is in a ready-to-use-state, but the frequent strikes (banda) and road and traffic blockades have hindered full occupancy. Recently, the Commission signed a memorandum of understanding with IBM, which has already established a research wing and open-standard research centre at the IT park.

**Table II.23. Number of licences issued by the Nepal Telecommunications Authority**

	Type of industry	Total licensees
1	Network service providers	8
2	GMPCS service providers	3
3	Video conferencing service provider	1
4	Limited mobility service based on wireless telecommunication to be operated in specified area of providers	2
5	Cellular mobile service providers	3
6	Internet service providers	38
7	Basic telephone service providers	3
8	Rural telecommunication service providers	2

Source: Nepal Telecommunications Authority -MIS-2009 ([www.nta.gov.np/articleimages/file/NTA\\_MIS\\_29.pdf](http://www.nta.gov.np/articleimages/file/NTA_MIS_29.pdf))

### **National Information Technology Centre (implementing organization)**

Established under the Ministry of Science and Technology, this government unit is responsible for implementing government IT initiatives and works as the secretariat for the National Information Technology Development Committee. Recently, it has been mandated to provide technical assistance in implementing e-government solutions across various government organizations. It also maintains the Government-Integrated Data Centre, whose purpose is to maintain government data in a centralized repository and to serve as a disaster recovery centre. Training and awareness programmes are also organized by the Committee on behalf of government.

### **Controller of Certification Authority**

The primary task of this government body is to establish, monitor and regulate the digital certification process. It acts as an apex body to oversee secured electronic transactions. Data security, disaster recovery and the issuing of digital certificates are among the key responsibilities of this body. Security enforcement is necessary to effectively implement services such as e-commerce and payment gateways. Very soon, the Office of Controller of Certification is planning to implement public key infrastructure to initiate the distribution and practice of digital certificates.

### **Trade associations**

#### **Computer Association of Nepal**

Trade associations in the IT/ITES sector have always been a driving force for growth and development. The Computer Association of Nepal is the largest body to represent IT professionals and industries. Apart from conducting business fairs, seminar and workshops, it also represents IT initiatives of government. This body has been instrumental in providing policy ingredients to the government. Its representation in the High-Level Commission for Information Technology, the National Information Technology Centre, and the Federation of Nepalese Chambers of Commerce and Industry has created a major impact in every IT-related decision-making process. It also helps national industries obtain exposure to the international IT arena by conducting business meetings and interaction between them.

#### **Federation of Nepalese Chambers of Commerce and Industry**

The Federation of Nepalese Chambers of Commerce and Industry is an umbrella organization of the Nepalese private sector. It plays a key role in promoting business and industry in the country. It provides, inter alia, information, advisory, consultative, promotional and representative services to business and government and organizes training sessions, workshops and seminars on a regular basis.



Recently, the Federation has identified the IT/ITES sector as a promising export avenue and has formed a separate committee for ICT development.

### **Internet Service Providers' Association of Nepal**

The Internet Service Providers' Association of Nepal (ISPAN) is another active trade association working for the common interest of Internet service providers in the private sector. It advocates and provides support for healthy Internet access across the country by establishing liaisons between regulatory bodies, service providers and end-users. It has been instrumental in initiating the Nepal Internet exchange, which keeps the local traffic local and saves the international bandwidth.

### **IT Professional Forum**

The IT Professional Forum focuses on advocacy and strengthening of IT and ITES. The group consists of IT professionals and has been involved in business incubation research and consultancy; however, the limited number of members (by invitation only) has not helped it become a common forum for IT professionals.

## **7.2. Policy frameworks**

### **Telecommunication policy**

The following recommendations are made in the 2004 Telecommunication Policy:

- Liberalize the telecommunication sector fully to open the sector to new service providers without restriction, except where spectrum is a constraint;
- Introduce multiple service and operator environments so that any operator can offer any service, which can be obtained from a number of operators;
- Introduce an open-licence regime, so that new licensing methods can be applied to open the sector to new operators in a transparent manner that creates a level playing field;
- Commercialize and privatize the incumbent;
- Promote private-sector participation in the operation of telecommunications;
- Introduce new mobile operators through tenders;
- The government should purchase services from several operators based on price and quality assessments to demonstrate its commitment to market liberalization, rather than obtain services

from the incumbent.

By its very nature, a regulatory authority exercises its right as a quasi-judicial body. In this regard, it has the right to punish financially, issue directives to improve services provided by the operator and suspend and cancel licences. The Nepal Telecommunications Authority has been given the power to settle disputes relating to telecommunication services between the licensees or between the licensees and the customers. It also has the right to formulate necessary by-laws to perform its duty and issue other relevant guidelines to regulate the telecommunication sector under the Act.

Though the monopolistic market of Nepal Telecom was terminated by providing additional licences to private sectors, it has not been able to create a competitive market in the true sense of the word. This is due to legal ambiguity, court cases and frequent changes of government, as well as a lack of expertise in regulatory mechanisms. Nepal had pledged to liberalize fully the telecommunication sector by January 2009, but that was not achieved, owing to parliamentary obstruction. The political agenda and drafting of the Constitution is a lengthy process, with legislation a lower priority.

### **Information technology policy**

The IT policy was established in 2000 with the vision of placing Nepal on the global IT map. The following strategies were adopted to realize its objectives:

- Develop competent manpower;
- Establish IT as an e-governance tool;
- Promote e-commerce;
- Create an environment conducive to attracting domestic and foreign investment;
- Promote e-commerce;
- Extend the IT network to rural areas;
- Develop a computer education curriculum starting from school level;
- Export IT services worth Nr 10 billion within the next five years.

To follow the above-mentioned strategy, the following action plans were decided:

- Declare IT a priority sector
- Adopt the one-window system
- Prioritize research and development
- Install computer systems in all government units
- Develop virtual or physical IT parks
- Establish venture capital funds
- Enact necessary legislation.

Most of the strategy and action plans are yet to be implemented and the IT policy has not been revised, although it has been recommended that it should be revised every five years. The set goals are not realistic and the necessary infrastructures such as payment gateway and digital certificates are not yet in place for secure e-commerce implementation. Except for facilitating some research and development on the localization of popular software, no significant research has been initiated. The only IT park of Nepal does not have any tenants yet. Although a venture capital fund (fortune cookie venture) was set up by a consortium of national companies, there has been no realization of concept in terms of output and government efforts on this front have been minimal or none at all.

Another pertinent issue is the conflict of scope between different implementing agencies. In many cases, the Ministry of Information and Communication and the High-Level Commission for Information Technology/Ministry of Science and Technology do not have clear boundary of executing authority. Similarly, in the prevailing scenario, an aspiring investor has to knock on the doors of various government bodies to establish an IT/ITES company. This unnecessary encumbrance dampens the enthusiasm of entrepreneurs and foreign investors.

However, the Nepalese Government has deemed IT a priority sector and declared the IT park a special economic zone. It is expected that the facilities provided by the special economic zone such as bonded warehouses, building facilities, leasing facilities and tax holidays will attract national and international investors. The Commission is working on the revised draft policy, which is near completion. Recently, it signed a memorandum of understanding with international giants such as IBM and Microsoft for cooperation to implement the strategy.

### Electronic Transaction Act 2005

This Act, followed by the Electronic Transaction Act of 2007 primarily deals with the implementation of digital signatures in governmental and non-governmental document transaction. Implementation of an asymmetric cryptosystem in electronic transactions is ensured by the establishment of the Office of Controller of Certification. The active enforcement of this law is necessary for all types of secured electronic transactions. E-commerce, m-commerce, e-procurement and data centres are among the few requiring digital security, for example, origin of

document. This Act has also made a provision for security enforcement through legal settlements. For every ICT-related offence, legal solutions in terms of imprisonment and compensation have been defined. Under the Act, there is a provision for a fast-track tribunal to review cyber crimes. Intellectual property right issues also fall within the scope of this Act.

Although the Office of Controller of Certification was established in 2007, the public key infrastructure has not yet been implemented. A few e-commerce-related service industries such as Munchahouse.com and financial sectors such as commercial banks providing mobile transactions are operating at their own risk. The establishment of payment gateways is also hindered in the absence of security measures. Similarly, owing to the lack of stringent measures, protection of customer data – both in the software and ITES industries – has not been fully ensured. Nepal has not been able to attract the data conversion and medical transcription markets, particularly in European countries with stringent data-protection laws.

An IT tribunal has yet not materialized and cyber crime and intellectual property right-related issues are being handled as forgery cases.

### Proposed regulatory and institutional reform

High-Level Commission for Information Technology

- Policies should be updated in accordance with changing paradigms or technologies;
- Since 2000, the IT policy has not been amended to reflect changing requirements and technology. Missing or new policies should be amended promptly, and strategies and corresponding policies should be practical and based on empirical data. Policies relating to software export and ITES should be further developed;
- Redundant, ambiguous duties and responsibilities should be reviewed and addressed;
- The Commission's role is ambiguous in that many of the responsibilities are duplicated or overlap with those of the Ministry of Information and Communication, the Nepal Telecommunications Authority and the National Information Technology Centre;
- The Commission should operate more like a regulatory body and policy maker;
- Although its organizational structure appears to be very strong given that the body is chaired by the Prime Minister, the authorities are subject to

many constraints and therefore cannot perform as envisaged. The Nepal Telecommunications Authority seems to be far more powerful in implementing policy and functions as a regulatory body;

- A software/ITES export committee should be formed and an action plan should be drawn up to achieve a realistic target;
- An IT park management committee should be set up to expedite the proper utilization of the existing IT park and to plan for further new parks;
- Strong regulations and action plans should be in place to monitor and regulate the implementing agencies;
- A data management committee should be established to maintain the empirical data and findings, fact sheets, White Papers and publications for a national IT database. Although a national fact sheet has been published, it has not been updated. The anachronistic data may mislead potential investors and planners;
- The need for special economic zones, duty exemptions and tax holidays should be promoted.

National Information Technology Centre

- The Board of the National Information Technology Centre should bring in more representatives from the private and academic sectors;
- The Centre should focus more on implementation;
- A government-integrated data-centre policy should be in place, which may help the IT/ITES industry to store and maintain data in a secure manner.

Nepal Telecommunications Authority

- Voice over Internet Protocol service for IT/ITES industries should be made available;
- A dedicated optical fibre network should be installed in major cities to make it available to the ITES industries.

## Trade organizations

Computer Association of Nepal:

- Transform it from a hardware-centric organization to one that is focused on IT/ITES;
- Restructure its organization and functionality to resemble that of NASSCOM.

Federation of Nepalese Chambers of Commerce and Industry:

- Encourage IT/ITES industries to become a member;
- Maintain IT import and export status database.

IT Professional Forum:

- Open its door to aspiring IT professionals (membership is more by invitation);
- Orient it towards research on national IT scenarios and help the High-Level Commission for Information Technology propose new policies and strategies.

## Proposed policies and strategies

**One-window policy for the establishment and operation of the IT/ITES industry** – This can be achieved by setting up a body with a special mandate to facilitate an IT/ITES industry and that can resolve day-to-day issues of this sector. A single government entity will handle all issues that have to be dealt with by industry. This measure is intended to help win the confidence of prospective investors and significantly reduces the time incurred in normal bureaucratic processes.

**Establishment of an IT/ITES promotion centre** – Similar to the Nepal Tourism Board, an IT/ITES promotion board is needed to strengthen the sector on a national scale. This includes disseminating information, preparing exhibitions and hosting prospective clients in the country.

**Demarcation of responsibilities among regulating and implementing agencies** – Redundant responsibilities should be identified and resolved promptly. Implementers and regulators should be assigned clear roles and responsibilities.

**“Brand Nepal” initiative** – This should be achieved by developing international linkage and cooperation with international giants and trade organizations. Other measures include establishing liaison offices in Europe and North America, inviting prominent persons or organizations to give them first-hand experience of the Nepalese market and organizing international workshops, symposiums and conferences. In addition, liberalization measures, reforms and other important propositions should be publicized properly by assigning high-ranked government spokesmen exclusively for this sector. Websites are the first point of contact for offshore businesses. Training for industry should be conducted to help them design business-savvy Websites.

**Implementation of a provision for investment guarantees to attract investment** – Given the lack of a “brand Nepal” and the prevailing geo-political scenario, candidate investors (venture capitalists) are reluctant to invest in this sector, as they consider it a high-risk portfolio. To mitigate this, the government should create an environment for investment insurance. Exim Bank and

OPEC, for example, provide insurance against socio-political unrest, law-and-order situations or any other unanticipated reasons.

**National database for empirical data pertinent to IT/ITES industries** – Extensive research on the status of the IT/ITES industry should be conducted and the outcome should be placed in the public domain. This should be done in alliance with universities or research centres with IT capabilities.

**Immediate action on the formation of tribunals for fast-track litigation** – Many cases of cyber crime have already been reported, but because the Electronic Transaction Act is not strictly enforced, culprits often escape legal action. To address these problems and create a climate of trust with investors, a fast-track tribunal, as specified in the Electronic Transaction Act (2007), must be set up. Since the IT/ITES industry is dynamic, conventional litigation mechanisms do not work in this sector.

**Expedite the implementation of public key infrastructure:** To ensure secured electronic transactions, document transfer and the proliferation of e-commerce-based set-ups, public key infrastructure should be implemented at the earliest convenience. This is even more important in IT/ITES where service providers are expected to ensure the security of client-related data.

**Plan for further physical and virtual IT parks** – Presently there is an availability of space for small-scale IT/ITES industries. However, if an industry has to be scaled up to a class A set-up, a visible dearth of space becomes apparent. Plans should be in place to accommodate larger set-ups in terms of physical and virtual IT parks. Parks should be planned near the international airport or within the vicinity of Kathmandu. An IT park should be able to accommodate more than 800 employees (a decent-sized business process outsourcing company). Build-operate-transfer models are more suitable because they engage the private sector in building and managing IT parks with suitable financial security-related incentives. The sharing of captive resources should be promoted by providing extra incentives.

**Prepare data centre policy and invite the private sector to make use of the Government Integrated Data Centre for data security** – Unless concrete policy measures are in place, data is something no organization should lose from their perceived control. At the same time, ensuring a foolproof mechanism to protect and store data is a very expensive investment. In the scenario of avail-

ability of government-owned data centres, the proper dissemination of data storage and its underlying security measures should be provided for the industries. Data centre policy should be made public and strictly followed. This is particularly necessary when companies need to produce adequate security measures to convince security-sensitive clients.

## 8. Trade liberalization

### 8.1. Overview

Trade in Nepal was liberalized in 1985, but measures started taking effect in the 1990s. These measures were expected to modernize and accelerate structural changes by creating a conducive environment for the participation of the private sector. Gradually, the government withdrew its direct participation in industry and deregulated various sectors to promote private-sector and foreign investment. In 1992, a liberal industrial policy was introduced to privatize state-owned industries. A major breakthrough in this policy is the provision that encourages service-sector industries by identifying foreign investment as a key strategy. The Industrial Enterprise Act, the Foreign Investment and Technology Transfer Act and one-window policies are the main elements of liberalization initiatives that can establish the dominant role of private-sector participation.

In 1992, a trade policy was introduced to support the economic liberalization programme. Promotion of national and international trade, expansion of employment-oriented trade, reduction of the trade imbalance, promotion of backward linkage and increased private-sector participation are the key objectives of this policy. The export policy has incorporated strategies for the removal of licences, exemption of income taxes on export-based income and a provision for bonded warehouses. The export policy aims to enhance the production and quality of export-oriented products and to identify new markets with a focus on global competition.

The Telecommunication Policy 2004 has incorporated further liberalization measures in the telecommunication sector. This includes complete liberalization in terms of restrictions placed on new operators, the introduction of an open-licence regime and the government purchase of services from private operators.

The IT Policy 2000 and the Electronic Transaction Act (2006) contain provisions to attract private-sector and

foreign investors by providing incentives in various areas. Tax exemptions, special economic zones, technology transfer and intellectual property right protection are the major commitments.

Under the GATS negotiations, most countries have made liberal commitments in IT- and ITES- related services. Joint research conducted by SAWTEE and ActionAid Nepal has identified ICT-related services as a major sector with export potential.

Nepal has entered into various multilateral agreements, including GATS, BIMSTEC and SAFTA; however, no specific negotiations have been made regarding the IT/ITES sector. Nepal has also signed a series of bilateral treaties with India, but again, not much substance is included in these treaties.

## 8.2. Trade liberalization measures in information and communication technology

With Nepal's accession to WTO in 2004, the liberalization process in trade and services was reinforced. Nepal has shown commitment in the telecommunication sector and by January 2009, Nepal had decided not to impose limitations on the number of basic-telecommunication, mobile-telecommunication and value-added telecommunication service providers.

It is noteworthy that computer and IT services are not included in the restricted list under the Foreign Investment and Technology Transfer Act. There are very few horizontal commitments produced by Nepal that may affect this sector. However, commitments in the ICT sectors are largely concentrated on Modes 1 and 3. Mode 4 is one of the most restricted categories within the services sector, leading to visa and work permit restrictions. Another problem in the services sector is the lack of a clear definition of temporary and permanent movement. Ambiguity between the movement of workers and the process associated therewith is very complicated and costly.

Nepal has restricted foreign equity capital up to 80 per cent for companies incorporated in Nepal to provide these services in compliance with its WTO commitments.

## 8.3. Assessment of effectiveness of liberalization

### Investment

Liberalization has had a visible impact on the telecommunication sector. After the privatization of Nepal Tele-

com, five more companies were registered to operate basic telephony, mobile telephony and other value-added services. The penetration rate of mobile, land-line and other telecommunication services is 19.73 per cent, 2.93 per cent and 0.28 per cent respectively. Currently there are six telecommunication companies, namely Nepal Telecom, Spice Nepal, United Telecom Limited, STM Telecom, Nepal Satellite and Smart Telecom that have received licences from the Nepal Telecommunications Authority to operate telecommunication services in the country. Except for Nepal Telecom, most of the other companies were established as joint ventures with major equity as foreign investment. Similarly, the recent exemption on VSAT licence fees has also encouraged service providers to embark on new ventures.

A significant number of foreign companies has invested in the computer-related services sector. Export-oriented software companies and ITES are the sectors that attract maximum foreign investment. This has resulted in substantial job creation.

Although the movement of natural persons as business representatives or promoters to another country is not restricted, save a few exceptions, the dollar-exchange policy remains a constraint. The exchange limit of \$2,000 does not suffice for purposes of business promotion. Similarly, in principle, Nepalese companies can open subsidiaries on foreign soil, but again there is no provision for foreign currency exchange facilities to do so.

### Human capital

Unlike other sectors, IT/ITES is in a relatively better position in terms of human resources required for the industry, and supply-side constraints are not very severe. Four universities and over 30 institutions offer graduate and post-graduate-level courses in information technology. However, an uneven quality of knowledge and delivery has been reported. Organizations such as the Nepal Engineering Council, the University Grant Commission and the High-Level Commission for Information Technology are mandated to supervise the quality of institutions and their product, but in practice it has not been done as rigorously as needed. In the GATS negotiations, Nepal promised to open up the higher-education sector from 2009, which is expected to increase the participation of international institutions to produce better qualified human resources.



As the IT/ITES industry needs to compete globally, foreign employees are a need rather than a choice. To facilitate the transfer of knowledge, Nepal should invite subsidiaries of multinational companies and foster technical collaboration between national and international players. However, due to the restriction in the Mode 4 category, mobility is very complicated. The IT/ITES sector does not need a protectionist policy, as an expansion of industry will produce an acute shortage of human resources. Knowledge and technology are necessary to create middle- and high-level managers.

### Regulations

Although the commitment is expressed in the WTO negotiations, effective implementation is a concern. Legislation is not expedited swiftly to implement policies. For example, the Nepal Telecommunications Authority has not fully opened the licensing mechanism in the absence of legislation. Similarly, there is a provision for an IT tribunal to settle disputes and crime, but no such body yet has been formed. The Office of Controller has been established but it is taking too long to implement the public key infrastructure. This is jeopardizing investment in one of the major domains of IT, e-commerce. Without data security and specialized courts, it is very difficult to attract investors in electronic transaction-based IT/ITES industries. Similarly, payment gateways and bank transactions are also affected for this very reason.

The Copyright Act (2002) has been enacted, but effective implementation is another matter. Amendments are needed to create a climate of trust with investors. Again, patent, design and trademark acts are not very effective in handling the inherent issues of the IT services sector. This also jeopardizes investment in e-commerce. To complement the negotiations, flanking policies and legislation need to be in place. The Consumer Protection Act, Public Nuisance Act (deterrence and punishment) for Web-based nuisance and digital contract act are among the few laws that require formulation or updating. Nepal needs to develop an intellectual property right regime that balances the need to protect intellectual property with the rapid adoption of foreign technology (SAWTEE: 2008).

Commitments have been made at the policy level but special economic zones, tax holidays, bonded warehouses and other IT-specific privileges have not yet been implemented.

### Tax and other duties

The import tax for hardware imports has been brought down to 1 per cent. Similarly, software exports are considered to be another form of export and a 20 per cent export tax is imposed. To date no tax measures have been reported on software imports. In cases of warranty-related transactions, theoretically a one-time import tax is applied, but in practice there is no clearly defined process, and industries are forced to pay multiple import taxes for the same item. Again, there is no clear differentiation between paid and non-paid imports. If a company imports hardware without a sales record, which acts as a base for software development, (for example, a test bed), a 150 per cent import tax is imposed even if the hardware is returned to the source after the consumption of its service.

Foreign nationals working in Nepalese industry are liable to pay income tax if they remain in the country more than 184 days.

### Repatriation of investment

Liberalization measures provide for the repatriation of dividends, sale of shares, principal and interest on foreign loans, royalties and fees for technical collaboration and remuneration for foreign investment projects. (Department of Industry: 2005). Under the Foreign Investment and Technology Transfer Act (1992), a foreign investor making investments in foreign currency shall be entitled to repatriate the following outside Nepal:

- The amount received by the sale of a share of foreign investment as a whole or any part thereof;
- The amount received as profit or a dividend of foreign investment;
- The amount received as the payment of principal and interest on any foreign loan;
- Foreign investors or foreign technology suppliers are also entitled to repatriate amounts received under technology transfer agreements.

This Act has maintained the interest of investors concerning investment security.

### 8.4. Liberalization and the Millennium Development Goals

The penetration rate of mobile, landline and other telecommunication services is 19.73 per cent, 2.93 per cent and 0.28 per cent respectively, clearly demonstrating the leap-frog development of the

telecommunication sector. In 2004, before the privatization of Nepal Telecom, the state-owned telecommunication service provider, the penetration rate was a mere 11 per cent and the market was devoid of private-sector firms. Within five years, five private companies had started their telecommunication services. Apart from value-added services, cutting-edge technologies such as 3G mobile service had also been added. The Nepal Telecommunications Authority has recently developed a scientific frequency management mechanism aimed at promoting progressive service providers with transparent frequency allotments.

With the advent of cutting-edge technologies such as the asymmetric digital subscriber line (ADSL), Internet subscriptions have grown sharply. Nepal Telecom has extended its ADSL services outside the capital city as well. Apart from Internet subscriptions, the many cyber cafes in Nepal's major cities have contributed to the rising number of Internet users. The government has also formulated a strategy called "a mobile in every hand and Internet in every household".

### 8.5. Intellectual property right issues

In reviewing software development and the ITES sector in a number of countries, intellectual property right regimes have been identified as a barrier to software companies from developing countries expanding overseas (Correa: 1996). On the opposite side of the debate, there are those who consider intellectual property rights a "critical determinant for client companies contemplating offshore software development" (Bhatnagar and Madon: 1997).

The role of intellectual property rights has become more and more important in the case of software development companies of developing countries such as Nepal. Technology transfer becomes more difficult in situations where intellectual property rights are not implemented stringently. At the same time, knowledge dissemination becomes difficult, particularly in the case of ever-changing technologies and paradigms, if intellectual property rights are enforced strictly.

Intellectual property rights and piracy are found to be considerably less important in the when the sector is in a fledgling state. Over time, this laxness starts affecting the national and international packaged software vendor. Nepal has yet to begin exporting packaged software but at the same time it needs to

invite multinational companies to establish a presence in the local market. Anything catering towards one extreme may hamper the growth of the sector. Nepal has already agreed on TRIPS negotiations, with the provision of gradually implementing a strong intellectual property rights regime. At the moment, Nepal needs to develop an intellectual property rights regime that balances the need to protect intellectual property with the need to adopt foreign technology without barriers.

### 8.6. Export opportunities and potential

#### Software export

Owing to the liberalization measures adopted by the Government of Nepal, software exports have become a very promising export avenue. At present, companies such as Data Analysis and Software Solutions (DASS), D2HawkEye Services, NepaSoft, IT@himalaya and Hi-Tech valley iNet are among the few prominent software exporting companies. Thanks to the availability of English-speaking IT graduates, these companies are able to bag significant opportunities from reputed overseas-based clients. The domain of expertise of these export-oriented companies includes Web-enabled application development, enterprise solutions (management information systems), financial packages, commodity management software, process automation and customer relationship management and embedded systems. For example, DASS works for reputed companies such as Panasonic and Ti-Tech Japan and also for CRM-based companies of the United States such as Salesforce.com and CarThink.com.

North America has always been a most favoured destination for software exports. Recently European and the Asia Pacific countries have become new export destinations. Because of cultural and other affinities, Nepalese companies have been successful in wooing Japanese clients. The time difference is also an advantage for the export of IT services. Export-oriented companies provide round-the-clock facilities and a virtual presence for their clients.

Nepal has better prospects in exporting software development services compared with off-the-shelf packaged software. In the service model, Nepalese companies provide the overseas client's virtual presence. The software development process and standards are maintained in accordance with primary



companies. Clients have the impression of having an extension of their companies at offshore locations. This model ensures that offshore centres will receive assignments on a regular basis and at the same time, that they can anticipate growth and maintain the resource pool in line with that anticipation.

There is great potential in the export of services in the form of remote assistance in system management. Backup management, optimization and other clean-up work should be done during off-hours and owing to the time difference, Nepalese companies can exploit this edge to seize such opportunities. Currently few companies in Nepal are engaged in server management – database tuning, optimization and backup – of the banking and insurance sector of the United States. With advancements in connectivity, such as bandwidth availability, this can become a new promising avenue for export of IT services.

Despite Nepal's proximity to India, there are no records of software exports to India. India is no longer an inexpensive offshore destination. By forging strategic tie-ups with Indian multinational corporations, Nepalese IT industry can serve them as a subcontracting source or offshore destination centre. This is more important in the sense that Nepal shares an open border with India and the issue of mobility of natural persons is insignificant. Further, India permits Nepalese citizens to work in all kind of business enterprises without a work permit. Similarly Nepal's citizens and industry can invest in India without any restriction.

The acquisition of standards such as CMMI is needed to attract bigger clients. It has become a de-facto standard in software development and overseas clients trust companies that are benchmarked for CMMI appraisals. Having more CMMI-appraised companies ensures manifold software export opportunities. In many cases, it is mandatory for clients to acquire services and products from CMMI-appraised companies. Providing such an environment to help Nepalese industry adopt CMMI standards may create an immense opportunity for Nepal as a major outsourcing destination.

A recent World Bank draft report shows that even with the present scenario, Nepal has a strong export potential in software and IT services. Infrastructures and human resources need to be expanded, as endorsed by the stakeholders' meeting on 24 September 2009. Universities have increased their capabilities and production strength, given the technical and other required assistance.

### **ITES export**

Transactions relating to ITES have surpassed \$700 billion globally and more than 14 per cent took place offshore. India has become one of the most successful nations to exploit the opportunity provided by the ITES industry. Given the similarity in cultural and social dynamics as well as the education system, Nepal can learn and implement the success stories of India's ITES industries. The basic requirement of the ITES sector is proficiency in English and specialized training. The language is not a difficult issue, as English is introduced at every level of education and is the medium of communication in most of the institutes located in urban areas. Many training institutes offer short-term training courses in ITES-related technologies, which is an advantage. Below are several ITES avenues where Nepal can offer proven competence.

### **Call centres**

Call centres have become one of the most important entity for large services and manufacturing organizations to provide customer information and services. They are used for responding to customer queries, telemarketing and conducting customer surveys. At present, companies such as Serving Minds and LinkTree are proving the potential and prospects of ITES export possibilities. English proficiency and short training courses on handling audio-visual applications are the basic requirement for ITES employees. The United States and Europe are the major export destination for call centres.

### **Digital content development**

This field requires skills in graphics-related applications and basic programming language. Advertising companies and Web-hosting companies are the major clients for this domain. CD/DVD authoring, which is mostly used to create digital profiles, is also a field with immense opportunities.

### **Medical transcription**

Medical transcription is a successful category in the ITES sector of Nepal. The National Information Technology Institute and PentaSoft are examples of successful medical transcription service providers. The United States is the major destination for exports of medical transcription services and this category is one of the largest employment creators in the ITES

sector with more than 2,000 job opportunities. English language proficiency and short training courses in medical terminology are sufficient qualifications for such work. Turnaround time for service delivery, usually 12 hours, is very critical in this category, leading to round-the-clock operations.

### **Back-office processing**

Conversion of paper-based data into digital data is a popular back-office-based opportunity. Similarly, data analysis, data mining and trend analysis also fall within the ambit of this category. The digital conversion of legal and account-related data can be a promising ITES export prospect.

### **Computer-aided design**

Computer-aided design is another ITES prospect where Nepal can gain a competitive advantage. Conversion of paper-based design into digital design has attracted many opportunities from countries such as Japan and the United States. Tribhuvan University and the Council for Technical Education and Vocational Training offer a large number of skills-oriented diploma courses in design. This pool of graduates can be utilized in industries based on computer-aided-design.

### **Geographic information system services**

Geo-Spatial and the National Information Technology Institute are examples of companies providing geographic information system-based services. Japan, Europe and the United States have been identified as client bases for this industry. Digitization of maps and other cartography-based services requires minimal computer skills with a working knowledge in cartography.

## **8.7. Prospect of trade agreements and cooperation**

Since trade is a global business and most countries have agreed to maintain the maximum level of liberalization in WTO negotiations, no IT/ITES-related bilateral or multilateral agreements are being sought in the near future. Nevertheless, market access appears to be restricted because of supply constraints, quality measures and branding. Ironically, Nepal cannot promote itself as an independent country with full of IT/ITES export opportunities. “Brand Nepal” is an essential campaign that needs to be launched urgently. Trade-related bodies such as the Federation

of Nepalese Chambers of Commerce and Industry and the Computer Association of Nepal and other can play a vital role in such a campaign. Recently, the Federation organized an international meeting of ITES-related industries to promote Nepal as a promising ITES destination. Similar activities should be conducted by inviting prospective clients and giving them first-hand experience in the Nepalese scenario. Regional workshops, retreats, meetings and exhibitions in the presence of leading international corporations can enhance business prospects.

Nepal needs to relax Mode 4-related constraints to invite foreign expertise to initiate the knowledge transfer. Unlike other protected sectors, IT/ITES requires more interaction and knowledge transfer to improve its delivery quality. Similarly, foreign currency exchange constraints to establishing promotion centres or subsidiaries hinder efforts to promote export possibilities. Also the individual currency exchange facility of \$2,000 is not sufficient to send sales and marketing personnel to developed countries. These issues should be addressed as soon as possible by establishing a dedicated centre within organizations such as the Nepal Rastra Bank, the country’s central bank.

“Brand Nepal” can further be promoted by inviting multinational companies that can play a pivotal role as anchors to invite others. Such a presence also creates a sense of confidence for those that do not want to bear the risk of being first movers. Recently IBM and Microsoft signed memoranda of understanding with the Government of Nepal, and IBM has already started their research wings in the IT park of Nepal. Such collaborations are needed to create an opportunity for them to establish their centres. Special packages and incentives such as tax holidays, exemptions for import-related duties and captive resources should be provided for first movers.

## **8.8. South–South Cooperation**

Technical and economic cooperation between countries sharing similar interests and contexts is crucial in order to boost each other’s knowledge economy. As Nepal is rich in communication and human resources, special bilateral or multilateral cooperation agreements can be concluded with countries weak in those areas but strong in technology and economy of scale. One example could be country-level collaboration between Nepal and the Republic of Korea for economic and technical collaboration in

the field of IT/ITES establishments. Giants such as LG and Samsung have started turning towards Nepalese IT markets; this kind of activity can be stepped up by facilitating proper national agreements. The Government of Nepal has already concluded an agreement with the Republic of Korea to send skilled workers there. Similar bilateral agreements can be drawn up to invite Korean IT/ITES industries to establish branches in Nepal and exchange skilled IT professionals.

### 8.9. Policy recommendations and strategies

- Expedite the enactment and amendment of necessary legislation to fulfil export potential. Legislation relating to copyrights, consumer protection and public nuisance needs to be amended to build investor confidence. Similarly, the Telecommunication Act should be revised to accommodate the necessary provision for a fully open and transparent licensing process. Legislation on a special economic zone act should be passed to facilitate the entry of multinational corporations;
- Set up an intellectual property rights regime to enable the establishment of a balanced strategy that protects intellectual property and adopts state-of-the-art technology;
- Revise the Nepal Rastra Bank's policy pertaining to foreign currency exchange and investment in foreign countries. A separate branch should deal with the investment initiatives on foreign soil intended for market expansion and promotion;
- Expedite the formation of IT-tribunals to deal with the cyber offences or crime;
- Implement a one-window policy for the establishment of companies so as to obviate the need to go through multiple government units;
- Start public key infrastructure services promptly to advance initiatives related to secure document transactions and secure e-commerce. This is very important, particularly when e-government operations will be up and running within a couple of years time;
- Relax constraints in all modes of service categories – especially Mode 4 – to increase the participation of foreign expertise in local industry;
- Set up facilities devoted to IT policy by communicating with relevant government stakeholders. Special economic zones, tax holidays and incentives for captive resources should be dealt with as soon as possible;
- Attract anchor companies by offering special incentives. The presence of multinational corporations helps to anchor and attract other companies;
- Leverage the platforms of the Federation of Nepalese Chambers of Commerce and Industry, the Computer Association of Nepal and others to attract investors by organizing international promotion activities, exhibitions, workshops and visits;
- Bring export-related transactions under the purview of the Nepal Rastra Bank. This can be done by simplifying the procedure and providing incentives to companies that make transactions through the Bank. This helps identify the exact contribution of this sector to GDP and at the same time discourage foreign exchange-related malpractice;
- Update customs rules and procedures and apply them stringently. Implement the simplified procedures of sending and receiving of products within the warranty period for the purpose of repairs; include the special provision of importing test beds and returning to the source country with a minimal import tax;
- Expand broadband services to major cities in Nepal as soon as possible for the even distribution of IT and ITES companies across the country;
- Monitor the quality of IT education rigorously by setting up a coordination committee within the framework of the High-Level Commission for Information Technology. Standards and guidelines should be developed to assess the uniformity of quality across the board. The coordination committee should include the representatives of supervisory bodies such as the Engineering Council, the Board of the Council for Technical Education and Vocational Training, the University Grants Commission and other stakeholders and should monitor IT academic institutes by using standards and guidelines;
- Declare IT/ITES an essential service. The sector needs to be in operation round the clock. Labour laws should be amended to reflect that need;
- Revise the diploma-level curriculum to tailor it to ITES sector requirements.

## 9. Analysis of strengths, weaknesses, opportunities and threats: IT sector

Opportunities	Threats
<ul style="list-style-type: none"> <li>• Growing interest of multinational corporations such as IBM and Microsoft in the Nepalese market</li> <li>• Active participation of international agencies (World Bank, Asian Development Bank) in activities relating to ICT</li> <li>• Diversification of ITES sector to second-tier cities in Nepal</li> <li>• Government a major consumer of domestic software and services sector</li> <li>• Access to higher bandwidth and thus reduction in the prevailing cost of subscription in the near future</li> <li>• Capability of existing universities and institutes to raise the number of IT graduates</li> <li>• Growing cost of services in Indian industry may cause the re-routing of opportunities towards Nepal. India can be a major market for Nepalese industry</li> <li>• Virgin market for e-commerce-based application development</li> <li>• Establishment of disaster recovery centre for the industries of neighbouring countries</li> <li>• Growing free and open-source software movement in Nepal</li> <li>• Industry institute interfacing by setting up internship programme</li> <li>• Extension of ICT to rural population through telecasters and mobile devices</li> </ul>	<ul style="list-style-type: none"> <li>• Political environment in transitional phase</li> <li>• Global terrorism</li> <li>• Cross-border disease</li> <li>• Unfavourable travel advisories</li> <li>• Global economic downturn</li> <li>• Climate change</li> </ul>

## 10. Proposed action

*(a) Amend the IT policy urgently.*

A policy amendment committee (comprising national experts) should suggest the necessary amendments. A national workshop should be conducted with the participation of various stakeholders and a draft should be revised after the incorporation of feedback.

*(b) Carry out activities to implement the financial benefits as stated in the IT policy.*

The High-Level Commission for Information Technology should liaise with the Ministry of Finance to implement a tax holiday for the next 7–10 years. The fiscal budget should include a provision for defining current and future IT parks as special economic zones with facilities such as bonded warehouses, tax-free captive resources and concessions for other financial transactions.

*(c) Avoid conflicting roles and responsibilities among government bodies.*

The roles and responsibilities of the Ministry of Infor-

mation and Communications, the High-Level Commission for Information Technology and the National Information Technology Centre should be non-redundant. The Commission should work as a regulator, implementer and facilitator for the IT/ITES sector, whereas the National Information Technology Centre should be brought under the Commission's purview as an implementing agency. The Ministry should focus only on the infrastructure front.

*(d) Set up a special tribunal to deal with the offences relating to IT and computer services.*

Laws are already in place to establish a tribunal composed of five judges to deal with computer-related disputes and crime. The line ministry should call for interest in the positions defined in electronic transaction law.

*(e) Devise a one-window policy to provide end-to-end solutions for the IT/ITES industry.*

The High-Level Commission for Information Technology should implement a mechanism to deal with the entire life cycle of the industry, starting from

company registration to company closure and should create an interface to deal with the bureaucratic process that the industry faces.

*(f) Establish a special branch within the Nepal Rastra Bank to deal with IT/ITES service-related issues.*

A dedicated unit would ensure that export-oriented companies use the proper channels and that policies related to investments in foreign markets are reformed.

*(g) Relax national policies relating to the mobility of foreign employees.*

Immigration policies and visa procedures should be simple and favourable to the IT/ITES industry. The constraints on Mode 4 categories should be relaxed by amending relevant policies.

*(h) Plan more IT parks to accommodate the anticipated growth of the IT/ITES sector.*

An IT park management committee should be formed under the auspices of the High-Level Commission for Information Technology for effective planning of existing and future physical and virtual parks.

*(i) Encourage the private sector to adopt industry-readiness programmes and human resource pool management methods.*

Boot camp training sessions and other finishing school programmes should be conducted in collaboration with the private sector to prepare industry-ready human resources. Partnerships between industry and institutes in the form of internships should be encouraged by restructuring university curricula.

*(j) Provide training for middle- and upper-level IT managers by funding intensive training programmes.*

In collaboration with the Federation of Nepalese Chambers of Commerce and Industry, the Computer Association of Nepal and other similar institutions, high-end training programmes should be conducted by human resources personnel and hands-on experience should be provided.

*(k) Set up a venture capital fund to support innovation and incubation activities.*

To initiate the transfer of knowledge and technology in the form of innovation centres and business incubation centres, the government should establish a venture capital fund as a joint-investment project with the private sector. The government also needs to encourage banks to provide loans to the IT sector.

*(l) Create an IT/ITES sector to plan activities that promote exports.*

In collaboration with trade-related institutions such as the Federation of Nepalese Chambers of Commerce and Industry and the Computer Association of Nepal, the government should set up a software and service exports board that would be responsible for recommending IT/ITES export policies as needed. It should be mandated to organize export promotion activities in the form of seminars, exhibitions and visits aimed at creating an image of Nepal, or “brand Nepal”, as a popular offshore centre worldwide.

*(m) Publish updated White Papers and fact sheets about IT/ITES activities.*

To encourage investors to establish an IT/ITES industry, the High-Level Commission for Information Technology should publish up-to-date data about IT/ITES sector activities by revitalizing the research committee. These empirical data should enable investors to make decisions on their investments.

*(n) Encourage the IT/ITES industry to work in a clustered environment.*

The High-Level Commission for Information Technology should guarantee financial incentives for using shared captive resources among IT/ITES companies. Companies within a clustered environment should be offered basic amenities, including dedicated feeders for electricity.

*(o) Promote the free and open-source software (FOSS) movement.*

In collaboration with FOSS community-Nepal and other NGOs working to heighten awareness of free and open-source software, the Commission should promote the movement by incorporating FOSS in the curricula of different levels of education and providing training for government employees.

*(p) Prepare a government data-centre policy.*

In collaboration with the Office of Controller of Certification, the National Information Technology Centre should formulate a policy of the Government Integrated Data Centre to offer a secured data repository to the public and private sectors. Plans should be made to extend the Centre to a remote location that should serve as a disaster recovery centre in case of natural or other disasters.

*(q) Establish a revolving fund to help national companies acquire international certification of standards.*



Provision should be made to set up a revolving fund with seed money from the government. Candidate companies should a nominal amount to the fund.

*(r) Tailor vocational education to meet industry needs.*

The High-Level Commission for Information Technology should collaborate with the Council for Technical Education and Vocational Training and industry to design and implement a curriculum of vocational education in IT. Special focus should be given to imparting hands-on skills in cutting-edge technology and soft skills such as business communications. Elective courses should be offered to hone skills in ranges of domains.

*(s) Formulate IT policy guidelines related to technology transfer.*

A technology transfer policy related to IT needs to be established. Apart from the Foreign Investment and Technology Transfer Act (1992), there are no specific legal frameworks that address IT-related technology transfer issues. A new science, technology and innovation policy should be formulated to meet the needs of the IT sector.

*(t) Encourage the merger and acquisition of successful SMEs in the IT/ITES sector.*

Incentives should be in place for successful companies opting for mergers and acquisitions.

*(u) Internet penetration should be increased.*

This includes the need to expand ADSL technology in the tier-two cities of Nepal.

## 11. Conclusion

Despite its many challenges and problems, Nepal has plenty opportunities for local and export-oriented IT and computer service industries. By taking on WTO commitments, Nepal has opened up the market for the education and telecommunication sectors. As a result, Indian education giants have already started investing in higher education. The competition in the education sector clearly leads to the production of more competent graduates. Similarly, an effective vocational degree programme will help create skilled manpower for ITES industries.

Liberalization in telecommunications has created a level playing field among service providers and competition has helped consumers enjoy technology at a cheaper price. The introduction of wireless Internet services by Nepal Telecom and United

Telecom Limited has further boosted the penetration of Internet. In addition, the introduction of WiMax technology will help expand Internet use, despite the difficult terrain.

The industries of European countries such as the Netherlands, Denmark, Norway and Sweden have shown significant interest in establishing subsidiaries in Nepal and have played a pivotal role in promoting “brand Nepal”. Finland, Switzerland and Belgium are other possible candidates who can invite their industries to set up subsidiaries as well. The implementation of effective marketing strategies backed by locked-in commitments will surely help Nepal expand the avenues for IT exports.

The effective and immediate implementation of an electronic transaction law will help win the confidence of foreign investors. Security of transactions, data and effective cyber legislation are the prime requirements for establishing e-commerce- and m-commerce-related industry. Other flanking policies are also needed.

There are few decision makers at the policy level who are well versed in the knowledge-economy. This situation can be improved by introducing relatively younger IT professionals to the ranks of decision makers.

Soft skills are equally important in the IT/ITES sector. Business marketing managers, offshore programmers and people working in medical transcription need to possess soft skills.

Nepal has to work very hard to maintain effective coordination among the various government entities to facilitate prospective investors. Many successful neighbouring countries have realized this and the appropriate mechanisms, such as a single-window policy, have been initiated to facilitate their software industries.

To decrease dependency on proprietary software and tackle intellectual property rights issues, the promotion of FOSS applications not only helps foster user creativity – particularly among students – but also helps customize applications that meet user requirements.

Concerted, coordinated efforts of and partnerships between the public and private sectors can increase export opportunities significantly. Market access is presently not much of an issue.



## Annex 1. Summary tables of estimates and forecasts

Nepal	2008			2018		
	Billions Nr	Percentage of total	Growth <sup>a</sup>	Billions Nr	Percentage of total	Growth <sup>b</sup>
Personal travel and tourism	30.7	5.7	2.8	68.9	6.2	4.2
Business travel	13.4	2.0	2.8	27.6	2.0	3.3
Government expenditures	3.6	5.1	4.1	7.9	5.3	4.0
Capital investment	14.0	11.0	3.0	31.7	11.7	4.2
Visitor exports	15.2	11.3	7.4	48.4	11.4	7.9
Other exports	1.3	1.0	0.7	3.7	0.9	6.6
Travel and tourism demand	78.3	8.6	3.7	188.2	9.3	4.9
Direct industry GDP	20.5	3.0	4.8	50.8	3.6	5.2
Travel and tourism economy GDP	46.1	6.8	4.3	110.7	7.9	4.9
Direct industry employment	237.3	2.3	4.7	368.6	2.8	4.5
Travel and tourism economy employment	547.9	5.3	4.1	824.1	6.2	4.2

<sup>a</sup> 2008 real growth adjusted for inflation (percentage)

<sup>b</sup> 2009–2018 annualized real growth adjusted for inflation (percentage)

South Asia	2008			2018		
	Million dollars	Percentage of total	Growth <sup>a</sup>	Millions dollars	Percentage of total	Growth <sup>b</sup>
Personal travel and tourism	52,000.1	5.4	6.3	148,574.0	9.4	9.5
Business travel	12,487.5	0.8	6.5	29,420.0	1.4	7.2
Government expenditures	2,086.6	1.2	8.9	4,280.6	4.0	5.8
Capital investment	35,379.2	7.1	8.2	85,654.9	9.8	7.7
Visitor exports	17,005.2	5.2	5.2	39,067.5	3.0	7.1
Other exports	5,589.4	1.7	4.7	22,318.2	1.7	13.0
Travel and tourism demand	124,548.0	6.5	6.7	329,316.0	10.3	8.6
Direct industry GDP	34,841.1	2.3	6.6	74,489.3	3.2	6.3
Travel and tourism economy GDP	90,828.3	6.1	7.2	207,664.0	10.5	7.0
Direct industry employment <sup>c</sup>	15,448.2	2.5	2.9	19,506.6	3.1	2.4
Travel and tourism economy employment <sup>c</sup>	36,543.9	5.9	4.1	47,638.4	9.2	2.7

Worldwide	2008			2018		
	Million dollars	Percentage of total	Growth <sup>a</sup>	Millions dollars	Percentage of total	Growth <sup>b</sup>
Personal travel and tourism	3,211,550	9.2	3.0	5,459,650	9.4	3.5
Business travel	843,190	1.4	3.0	1,443,210	1.4	3.5
Government expenditures	380,817	3.8	2.2	616,307	4.0	3.0
Capital investment	1,353,510	9.4	3.7	3,145,530	9.8	5.6
Visitor exports	1,118,220	5.8	3.1	2,189,140	5.4	5.3
Other exports	984,727	5.1	5.1	1,984,470	4.9	6.0
Travel and tourism demand	7,892,010	10.1	3.3	14,838,300	10.3	4.4
Direct industry GDP	2,007,630	3.4	2.7	3,362,390	3.2	3.3
Travel and tourism economy GDP	5,889,770	9.9	3.0	10,855,200	10.5	4.0
Direct industry employment	80,749	2.8	2.0	97,983	3.1	2.0
Travel and tourism economy employment	238,277	8.4	2.4	296,252	9.2	2.2

<sup>a</sup> 2008 real growth adjusted for inflation (percentage)

<sup>b</sup> 2009–2018 annualized real growth adjusted for inflation (percentage)

Source: World Travel and Tourism Council (2008).

## APPENDIX

### Questionnaire

This questionnaire focuses on three types of stakeholders – industry, policy makers and institutions and academic institutions. Each has a different set of questions for (not necessarily exclusive).

#### Industry

1. How do present policies or regulations affect IT/ITES businesses in Nepal?
  - (a) What laws, regulations or policies need to be established urgently?
  - (b) Does the present organizational structure of IT bodies require changes?
2. Are NGOs necessary for the smooth operation of the IT/ITES sector?
3. Explain your domain of expertise, nature of work, human resource strength, infrastructure and volume of transaction.
4. What are the major obstacles to further investment in this sector?
5. What are key points require immediate attention to improve this sector?
6. With regard to your company:
  - (a) Does it follow any software processes?
  - (b) Has it acquired any international standards?
  - (c) Does it face severe attrition problems?
  - (d) Does it have a human resource management system in place?
  - (e) Does it have bandwidth, connectivity or infrastructure issues?
  - (f) Has it concluded memoranda of understanding or strategic tie-ups with academic institutions?
7. In your view, what are the strengths, weaknesses, opportunities, and threats of this sector at present?
8. How do bilateral or multilateral treaties affect this sector?
9. Why did your company not choose the IT-park for your operations?
10. Do you think that private-sector forums such as the Computer Association of Nepal are capable of representing the private sector effectively? What changes, if any, do you suggest?

#### Policymakers and institutions

11. What are the roles and responsibilities of your organization in this sector?
12. Who are the active collaborators and donor agencies at present?
13. Which government agencies deal with IT/ITES related activities?
14. What are the current activities carried out by the government in the IT/ITES sector?
15. Are there any policies or laws in the offing that may affect this sector?
16. What are your thoughts regarding the revision or adoption of treaties relating to the IT/ITES sector?
17. How is the government initiating public-private partnership programmes in this sector?
18. What is the modus operandi of coordination between government and the private sector?
19. Are there any coordination problems between government agencies to effectively implement policies or programmes?
20. What initiatives is the government taking to reach the Millennium Development Goals in information and communication technology?

#### Academic institutions

21. How does liberalization affect academic institutions?
  22. Explain your strengths and weaknesses in terms of infrastructure and human resources.
  23. What is the annual intake of your university or institution in the information technology sector?
  24. What major problems do you encounter in increasing intake?
  25. How do you collaborate with the private sector?
  26. What are the consumption patterns of your product in the local industries?
  27. How can you make your product more industry ready?
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# III

## **PRESENTATION OF THE NATIONAL SERVICES POLICY REVIEW OF NEPAL**

## PRESENTATION OF THE NATIONAL SERVICES POLICY REVIEW OF NEPAL

**Geneva, 16 March 2010**

UNCTAD convened this meeting to provide an opportunity for national teams from the Kyrgyz Republic, Nepal and Uganda to present their National Services Policy Reviews to each other, to UNCTAD, Geneva-based United Nations delegates, trade negotiators and the Department for International Development (DFID). Meeting discussions allowed for a rich exchange of national experiences and lessons learned. At the meeting UNCTAD also made presentations based on the UNCTAD reports that were prepared for each country.

### A. INTRODUCTION

Nepal's National Services Policy Review was presented by a delegation comprised of Mr Purushottam Ojha, Permanent Secretary, Ministry of Commerce and Supplies; Mr Ravi Bhattarai, Deputy Permanent Representative, Permanent Mission of Nepal to the United Nations and other International Organizations, Geneva; Mr Ramesh Chitrakar, National Expert and Professor at Tribhuvan University; and by Mr Manohar Bhattarai, National Expert and Vice-Chairman, High-level Commission for Information Technology.

The growing importance of the services sector to the Nepalese economy and the valuable technical assistance provided by UNCTAD was acknowledged in the area of services, and in many other areas, including trade facilitation, customs reform and modernization, transport and logistics, investment promotion and improving the overall business environment. Nepal's openness to the services trade was highlighted and it was noted that Nepal had made commitments to open 67 subsectors (CPC classification) under WTO GATS. It was also emphasized that the landlocked nature of the country inclined the national economy towards services sector development in comparison with goods.

In an effort to advance Nepal's trade development agenda, a National Services Policy Review was requested by Nepal during the visit of a high-level delegation with UNCTAD's Secretary General in 2008.

With support from DFID, the Review was carried out under the aegis of UNCTAD in cooperation with the Ministry of Commerce and Supplies. The first National Stakeholder Workshop was convened in 2009 with tourism and information technology (IT) services selected for detailed study within the Review. Other key sectors which could benefit from a National Services Policy Review in the future include health, education, communication, banking, financial, transport and retail services. Subsequently, in consultation with national stakeholders, national experts drafted Nepal's National Services Policy Review. The report was presented at the Second National Stakeholder Workshop in October 2009, wherein findings and recommendations were discussed, refined and adopted by participants.

It was noted that Nepal's National Services Policy Review process has helped greatly in clarifying stakeholders' views and aspirations for the services sector, permitting a holistic approach to overcoming constraints and seizing new opportunities in the tourism and IT services sectors.

### B. RECOMMENDATIONS

Recommendations for tourism and IT/ITES services were presented at the meeting. These recommendations are those adopted by the stakeholders at the Second National Stakeholder Workshop.

### C. RECOMMENDATIONS FOR THE TOURISM SERVICES SECTOR

Stakeholders recognized the immediate need of the Government of Nepal to draw up a comprehensive service plan in the tourism sector to access Nepal's capabilities and resources to compete in the global tourism industry. The plan should be based on results of the National Services Policy Review and other inputs provided by national stakeholders. Key objectives of the plan should include the following: increase revenue and employment generation in the sector; optimize the balance between local and foreign participation in this industry; identify and address supply constraints created by the lack of human resources, technology, and sectoral quality standards; and reduce leakage from the sector, primarily by lowering barriers to

market access created by other countries through technical standards, subsidies and discriminatory access to information and distribution channels.

To enhance the expansion of tourism-related revenue generation in Nepal, the linkages between tourism and poverty should be identified and strengthened. Given the country's rural nature and the need to increase tourism's contribution to poverty reduction, particular focus should be placed on tourism at the local and community level. Revenue for rural communities can be raised by enhancing royalty income from trekking and mountaineering tourism through higher fees; these fees have not been revised for many years and are currently low by international standards.

A key element of strengthening linkages involves diversifying Nepal's tourism product. Nepal's cultural endowment provides an immediate opportunity to do this. To this end, the Government and tourism service providers should more actively promote religious and cultural tourism. Further emphasis should also be placed on implementing and introducing health and wellness tourism. Beyond diversifying tourism products, there is also a need to diversify Nepal's source markets for tourists through specific programmes targeted at increasing inflows of tourists from North America and India. Moreover, ways to further enhance tourist arrivals from China, which have increased markedly in recent years, should be explored, including through inter-governmental cooperation.

Efforts to diversify the tourism product and tourist source markets require improving and extending physical infrastructure. The government should therefore make necessary provisions for infrastructure facilities and services (roads, communications, and health and sanitation services) which also benefit local communities and contribute to the achievement of Millennium Development Goals 4, 5, 6 and 7. Air transport infrastructure must also be modernized and enhanced to allow night flights at Kathmandu's Tribhuvan Airport. This would greatly broaden opportunities for new agreements with major international carriers to extend regular services to Nepal.

A re-examination of trade policies in the sector is due in order to assess their effectiveness since Nepal acceded to WTO in 2004. Consideration should be given to increasing the coverage of GATS commitments in tourism services by scheduling

new commitments for food and beverage services, tourist management services, education and health accommodation services, and other non-conventional services. Enhancing Nepal's openness to international trade in tourism and related sectors can stimulate new foreign investment in the tourism sector. It is also important to formulate domestic regulations that are more compatible with supporting Nepal's WTO commitments and to strengthen Nepal's WTO Reference Centre, which was established under the Ministry of Commerce and Supplies.

The proper design and implementation of improved policies for the tourism sector require accurate real-time information to guide and inform the policymaking process. For this reason it is recommended that Nepal introduce tourism satellite accounting into national statistics compiling, make national services sector classification compatible with up-to-date versions of international classification systems and improve the Ministry of Tourism and Civil Aviation's monitoring and evaluation system for the sector.

## **D. RECOMMENDATIONS FOR THE INFORMATION TECHNOLOGY SERVICES SECTOR**

Stakeholders recommended that a focused policy thrust be applied to capture the stock of opportunities and potential identified in the National Services Policy Review. Investment, infrastructure, capacity-building and better regulation were identified by stakeholders as the main missing ingredients needed to advance development of the sector, as requirements for many other ingredients, including basic human capital, have already been met.

Designing appropriate policies requires a coordinated and responsive approach by the government to a rapidly changing environment in a very dynamic sector. At the same time, better coordination of the private sector is also needed, and platforms such as the Federation of Nepalese Chambers of Commerce and Industry and the Computer Association of Nepal should be better utilized to attract investors to the sector by organizing exhibitions, workshops and visits of potential investors.

A more coordinated national response to emerging market opportunities in the IT services sector could help Nepalese firms capture new business opportunities.



Well-targeted policy incentive measures, such as the offering of tax holidays through 2015 to IT services firms and the establishment of a national venture capital fund for IT firms, are recommended. Full implementation of the 2008 Electronic Transaction Act legalizing electronic transactions and digital signatures must also occur to increase market confidence and build market depth.

Regarding trade policy, a review of the import-export regime for IT equipment and services was recommended to make it more IT/ITES-friendly. Furthermore, a foreign exchange regulatory regime targeting the IT/ITES sector is still needed to stimulate development of the sector. It is recommended that an IT/ITES caucus be formed to develop informed positions on issues and provide guidance to Nepal's negotiators in future trade negotiations.

Although Nepal has a strong base of IT professionals, with over 3,000 university-trained IT graduates entering the workforce every year, business and management training programmes are needed for middle and higher-level managers working in the sector. Human resource management courses would be an important element of these programmes aimed at enhancing productivity.

Finally, the business environment in the IT services sector should be improved to better attract foreign investors. Recommendations include establishing IT-specific export processing zones backed by targeted policy instruments to promote shared resource and coordinated development efforts and improving the implementation of regulations designed to protect intellectual property rights and ensure data security.

## E. ACTION PLAN

Recommendations will be incorporated into national development planning for the country's services sector, but there is a need to create ownership for specific actions and arrange for the effective implementation of each recommendation. The published National Services Policy Review will be used expressly to disseminate the results of Nepal's National Services Policy Review. In parallel the Ministry of Commerce and Supplies will conduct consultations with the relevant Ministries and NGOs to define concrete

action plans and timetables for their implementation.

## F. QUESTIONS AND ANSWERS

While clarification was provided on the scope and nature of several National Services Policy Review recommendations, questions focused on the need for their effective implementation. The Government of Nepal stressed that recommendations only have value when they are implemented, and that their implementation is needed to make a difference in terms of expanding human capacity, income, living standards and employment possibilities for Nepalese citizens. While it was acknowledged that the Government of Nepal plays a central and driving role in implementing National Services Policy Review recommendations, a guiding role for UNCTAD and DFID, as well as other interested donors, was emphasized.

## G. IMPLEMENTATION ROLES FOR THE GOVERNMENT OF NEPAL, UNCTAD AND DONORS

The Government of Nepal indicated that the Ministry of Commerce and Supplies would engage stakeholders to advance implementation of National Services Policy Review recommendations. At the same time it was recognized that implementation of some recommendations would require substantial financial resources and that financial assistance from the donor community would be needed to ensure their effective implementation. Technical assistance will also play a central role in supporting the effective implementation of recommendations to build productive capacity and enhance quality, including through new training and technology transfer initiatives.

UNCTAD was requested to continue providing Nepal with advisory services. In this respect, UNCTAD will maintain regular two-way contacts with project experts, national ministries and Nepal's Geneva mission to assist with national efforts to achieve benchmarks for reforms that will be adopted based on National Services Policy Review recommendations.

**Annex 1. Agenda: Nepal First National Stakeholder Workshop on Services Kathmandu, Nepal, 19-20 February 2008**

Day 1	
Time	Session
10.00 – 11.00	<p><b>Session I: Opening and introduction</b></p> <ul style="list-style-type: none"> <li>• Mr. Purushottam Ojha, Secretary, Ministry of Commerce and Supplies, Government of Nepal (subject to availability)</li> <li>• Robert Hamwey, UNCTAD</li> </ul> <p>UNCTAD will introduce its National Services Policy Reviews (NSPR) Country Projects. Nepal's NSPR Project will produce a Country Report including an overall assessment of Nepal's services sector with specific focus on the tourism, education and IT related services.</p> <p>The Ministry of Commerce and Supplies will discuss the relevance of the project within the context of national development objectives and ongoing regional and multilateral trade negotiations. An overview of previous studies and other ongoing work will be provided.</p> <p>The opening will set out the project's scope, purpose and intended outcome, and open the floor for discussion/suggestions on approach and methodology to be followed.</p>
11.00 – 13.00	<p><b>Session II : Nepal's services economy: prospects and challenges</b></p> <p>Based on economic and market analysis, and taking into account national development objectives, this session will present its preliminary appreciation of issues and options for Nepal's services sector based on a draft UNCTAD study distributed to participants in advance of the meeting. (20 minutes)</p> <p>Chair: Dr. Badri Pokharel, Joint Secretary Ministry of Commerce and Supplies</p> <ul style="list-style-type: none"> <li>• Robert Hamwey, UNCTAD</li> <li>• Mr Ravi Bhattarai, Deputy Permanent Representative, Permanent Mission of Nepal to the United Nations and other International Organizations, Geneva, Switzerland</li> <li>• Federation of Nepalese Chambers of Commerce and Industry</li> <li>• Dr. Posh Raj Pandey (Former member of National Planning Commission)</li> <li>• Comments: Mr. Ramesh Chandra Chitrakar Executive director, Centre for Economic Development and Administration, CEDA</li> </ul> <p>The aim of discussions is to:</p> <ol style="list-style-type: none"> <li>Identify overall challenges and opportunities for Nepal's services sector;</li> <li>Make related suggestions for Nepal's NSPR Project.</li> </ol> <p>Interactive discussion encouraging comments and views of stakeholders</p>
13.00 – 15.00	<p><b>Break for lunch</b></p>
15.00 – 17.00	<p><b>Session III : Cross border trade in services: software and IT related services</b></p> <p>UNCTAD will provide an overview of the economic, development and regulatory issues for the software and IT related services sector, including how progress can be made to build supply capacity. (20 minutes)</p> <p>Chair: TBD, (Representative of Ministry of Information and Communication/ Nepal Telecommunication Authority)</p> <ul style="list-style-type: none"> <li>• Deepali Fernandes, UNCTAD on Cross border trade in services</li> <li>• Mr. Manohar Bhattarai, Member, high level commission on ICT</li> <li>• Mr. Biplav Man Singh, Computer Association of Nepal, on "prospects and interlinkages"</li> </ul> <p>The aim of discussions is to:</p> <ol style="list-style-type: none"> <li>Identify specific challenges and opportunities for the software and IT related services sector;</li> <li>Make related suggestions for Nepal's NSPR Project.</li> </ol> <p>Interactive discussion encouraging comments and views of stakeholders</p>

Day 2	
Time	Session
10.00 – 11.00	<p><b>Session IV: Issues relating to Mode 4 services trade for Nepal</b></p> <ul style="list-style-type: none"> <li>• Deepali Fernandes, UNCTAD</li> <li>• Mr Ravi Bhattarai, Deputy Permanent Representative, Permanent Mission of Nepal to the United Nations and other International Organizations, Geneva, Switzerland</li> <li>• Mr. Hari Dutt Pandey, Joint Secretary, Ministry of Labour and Transport, Government of Nepal</li> </ul> <p>Interactive discussions, comments and views of stakeholders</p>
11.30–13.30	<p><b>Session V: Tourism services</b></p> <p>UNCTAD will provide an overview of the economic, development and regulatory issues for the Tourism services sector, including how progress can be made to build supply capacity. This will include consideration as to how medical tourism can be built up as an area of possible exports. (20 minutes)</p> <ul style="list-style-type: none"> <li>• Mr. Prachanda Man Shrestha CEO of Nepal Tourism Board</li> <li>• Robert Hamwey, UNCTAD</li> </ul> <p>Nepal hotel and tourism operators association Ministry of Environment Ministry of Health service on “leveraging the potential of health related tourism” The aim of discussions is to: (a) Identify specific challenges and opportunities for tourism services sector; (b) Make related suggestions for Nepal’s NSPR.</p> <p>Interactive discussion encouraging comments and views of stakeholders</p>
13.30 – 14.30	<b>Break for lunch</b>
14.30 – 16.00	<p><b>Session VI: Regulations and institutions</b></p> <p>This session will provide an overview of the findings of UNCTAD expert meetings on regulatory and institutional issues for the services sector, including in terms of best practices, lessons and sector specific issues. The Ministry of Commerce and Supplies to make presentation on issues of concern and areas of possible inter-institutional cooperation, especially in the context of achieving coherence in policy, regulation, trade negotiations and enhancing intersectoral linkages.</p> <ul style="list-style-type: none"> <li>• Deepali Fernandes, UNCTAD</li> <li>• Dr. Posh Raj Pandey, Former Member National Planning Commission/Nepal</li> </ul> <p>Comments: Ramesh Chandra Chitrakar, Executive director, Centre for Economic Development and Administration, CEDA</p> <p>Interactive discussions, comments and views of stakeholders</p>
16.00– 17.30	<p><b>Session VII: Considerations in WTO, bilateral and regional trade agreements: Nepal’s experience</b></p> <p>This session will provide an overview of the development of service trade in the world and its growing importance in Bilateral and Multilateral field. This will be followed by a presentation made by the Government of Nepal on trade negotiations from a national perspective.</p> <p>Chair: Chair; Dr. Posh Raj Pandey, Former Member National Planning Commission/Nepal</p> <ul style="list-style-type: none"> <li>• Mr Ravi Bhattarai, Deputy Permanent Representative, Permanent Mission of Nepal to the United Nations and other International Organizations, Geneva, Switzerland</li> <li>• Ramesh Chandra Chitrakar, Executive director, Centre for Economic Development and Administration, CEDA on the SAARC and SAFTA context</li> </ul> <p>Comments: UNCTAD</p> <p>Interactive discussions, comments and views of stakeholders</p>
17.30 – 18.00	<p><b>Session VIII: Next steps for Nepal’s NSPR project</b></p> <ul style="list-style-type: none"> <li>• Mr. Jib Raj Koirala, Under-Secretary, Ministry of Commerce and Supplies, and Focal Point, Government of Nepal</li> <li>• Robert Hamwey, Deepali Fernandes, UNCTAD</li> </ul> <p>Interactive discussions, comments and views of stakeholders</p>
18.00	<p><b>Workshop adjournment</b></p> <p>Closing remarks</p>

**Annex 2. List of Participants: First Nepal National Stakeholder Workshop on Services, Kathmandu, Nepal, 19-20 February 2008**

	Participating organization	Number of participants
1	Ministry of Tourism and Civil Aviation	5
2	MOHP	2
3	MOE	2
4	Tribhuvan University	1
5	KU	1
6	MOLT	1
7	MOPPC	1
8	Ministry of Information and Communications	1
9	Nepal Telecommunication Authority	1
10	Central Bank of Nepal	1
11	Nepal Insurance Committee	1
12	Nepal Bar association	1
13	Nepal Medical Council	1
14	Nepal Engineer Association	1
15	Nepal Tourism Board	1
16	MOLJ	1
17	PABSON	1
18	MOFA	1
19	MOF	1
20	TEPC	1
21	Ministry of Environment	1
22	Federation of Nepalese Chambers of Commerce and Industry	1
23	CNI	1
24	NCC	1
25	Ministry of Industry, Commerce and Supply	10
26	SAWTEE	1
27	SAARC Secretariat	1
28	Charter Accountants Association of Nepal	1
	<b>Total</b>	<b>43</b>

**Annex 3. Second National Stakeholder Workshop on Services, Co-organized by UNCTAD and the Ministry of Commerce and Supplies, Kathmandu, Nepal, 27–28 October 2009**

27 October, day 1	
Time	Session
09:30	Registration
	<b>Session I: Opening statements</b>
10:00	Opening statement of Mr. Purushottam Ojha, Permanent Secretary, Ministry of Commerce and Supplies, Government of Nepal Opening statement of UNCTAD Opening statement of DFID representative Moderator and commentator: Mr. Badri Pokhrel, Joint Secretary, Ministry of Commerce and Supplies
10:30	The role of Services Sector in the economy of Nepal Dr. Ramesh Chitrakar, National Expert and Prof. of Economics at Tribhuvan University
10:45	Impact of the economic crisis, specific focus on tourism, IT sectors and migration: Ms. Deepali Fernandes, UNCTAD
11:00	Coffee break
	<b>Session II: National experts' presentations on the NSPR study</b>
11:15	Introduction by Mr. Ravi Bhattarai, Ministry of Commerce and Supplies
11:30	Current state of tourism services sector in Nepal and ways forward Dr. Ramesh Chitrakar, National Expert and Prof. of Economics at Tribhuvan Univ
12:15	The role and effectiveness of IT and software services sector in the national economy and ways forward Mr. Manohar Bhattarai, Vice-Chairman, High Level Commission for Information Technology
13:00	Lunch
(parallel sessions)	<b>Session III: Working Group discussions with the participants</b>
14:30 – 17:00	Group 1. (Led by Dr. Ramesh Chitrakar) Tourism sector of Nepal
14:30 – 17:00	Group 2. (Led by Mr. Manohar Bhattarai) IT and software services sector of Nepal
28 October, day 2	
	<b>Session IV : Presentation of Working Groups' resolutions</b>
09:30	Presentations by Working Group Chairs
10:30	Perspectives of UNCTAD representatives
11:00	Coffee break
11:30	Perspectives of Ministry of Commerce and Supplies representatives
12:00 – 13:00	General discussion of ways forward, elaboration of action plan
13:00 – 15:00	Lunch break followed by individual meetings

**Annex 4. List of Participants: Second National Stakeholder Workshop on Services, Co-organized by UNCTAD and the Ministry of Commerce and Supplies, Kathmandu, Nepal, 27–28 October 2009**

	Participating organization	Number of participants
1	Ministry of Tourism and Civil Aviation	1
2	Civil Aviation Authority of Nepal	1
3	Nepal Travel and Tour Operator Association	1
4	Hotel Association of Nepal	1
5	Nepal Academy for Tourism and Hotel Management	1
6	Nepal Tourism Board	1
7	Trekking Agents Association of Nepal	1
8	Ministry of Education	1
9	Tribhuvan University	1
10	Private and Boarding Schools Organization of Nepal	1
11	Kathmandu University	1
12	Ministry of Transport and Labour	1
13	Ministry of Information and Communication	1
14	Nepal Telecommunication Authority	1
15	Ministry of Science and Technology	1
16	National Information Technology Commission	1
17	Computer Association Nepal	1
18	Central Bank of Nepal	1
19	Insurance Committee	1
20	Nepal Bar Association	1
21	Nepal Medical Council	1
22	Nepal Engineer's Association	1
23	Ministry of Health and Population	1
24	Ministry of Law and Justice	1
25	Ministry of Foreign Affairs	1
26	Ministry of Finance	1
27	Trade and Export Promotion Nepal	1
28	Federation of Nepalese Chambers of Commerce	1
29	Confederation of Nepalese Industries	1
30	Nepal Chamber of Commerce	1
31	Ministry of Commerce and Supplies	8
32	Department of Commerce	1
33	SAWTEE	1
34	The Institute of Chartered Accountants Of Nepal	1
35	Nepal Bankers Association	1
36	Ministry of Industry	1
37	Department of Industry	1
	<b>Total</b>	<b>44</b>



## NOTES

1. According to the Central Bureau of Statistics , division 45 of the construction sector includes site preparation (4510), the building of complete constructions or parts thereof, civil engineering (4520), building installations (4530), building completion (4540) and rental of construction or demolition equipment with operator (4550).
  2. Other spenders include Germany, the United States, the United Kingdom, France, Italy, Japan, Canada, the Democratic People's Republic of Korea and the Russian Federation, respectively.
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