Evaluating Contribution of Industrial Policy in Nepal's Development

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Abstract

Nepal's industrial sector has undergone significant transformation evolving from protectionist policies in the 1930s and state-led planning in the 1950s to liberalization and market-oriented reforms in the 1990s. These shifts aimed to attract investment, modernize production, and enhance competitiveness. Yet, despite repeated reforms, the sector's contribution to GDP has steadily declined, with manufacturing falling from nearly 9% in 1999/2000 to just 4.87% in 2023/24.

This policy brief reviews the evolution of Nepal's industrial policy, highlighting its achievements, limitations, and lessons for the future. Liberalization delivered short-term gains, expanding exports and investment but failed to trigger lasting structural change. Persistent constraints such as weak infrastructure, unreliable energy, policy instability, and limited markets continue to stifle growth.

The brief recommends adopting a coordinated, innovation-driven, and inclusive industrial strategy that ensures policy stability, invests in infrastructure and technology, supports MSMEs, and strengthens regional and global integration. Drawing on lessons from South Asia, it argues that linking industrial policy with national development goals is essential for inclusive and sustainable growth.

Introduction

Industrial policy is a cornerstone of economic transformation, enabling countries to diversify production, create employment, and strengthen competitiveness. In Nepal, where agriculture still dominates, industrialization is seen as a key pathway to reduce import dependency, expand exports, and achieve sustainable growth.

However, Nepal's industrial experience illustrates the difficulties of sustaining progress amid structural and institutional weaknesses. This policy brief assesses how industrial policy has shaped Nepal's development trajectory, identifies its achievements and failures, and outlines priorities for revitalizing the sector.

Historical Evolution of Industrial Policy

Early Beginnings (1930s–1950s)

Industrial development in Nepal began modestly in the 1930s, when small-scale industries emerged within a feudal, agrarian economy (Adhikari, 1986). Activity was largely confined to traditional crafts and cottage production.

The 1950s marked the beginning of state-led industrialization. Following the end of Rana rule, Nepal introduced five-year plans inspired by socialist planning models, emphasizing public enterprises and industrial estates as tools of modernization.

Protectionist Era (1960s–1985s)

Between the 1960s and mid-1980s, Nepal pursued import-substitution industrialization (ISI) to reduce reliance on foreign goods. The state promoted domestic industries through tariffs, quotas, and import restrictions, while expanding public enterprises in textiles, cement, and basic manufacturing.

These measures created initial industrial capacity but also fostered inefficiency, limited innovation, and imposed heavy fiscal burdens. Private investment remained weak, and foreign participation was tightly controlled.

Shift to Liberalization (Mid-1980s–1990s)

By the mid-1980s, inefficiency and fiscal strain made protectionism unsustainable. Under World Bank and IMF guidance, Nepal adopted structural adjustment reforms that introduced liberalization, privatization, and deregulation.

The Industrial Policy of 1992 signaled a new direction — encouraging private investment, opening markets to foreign competition, and promoting export-oriented growth (Kharel, 2014). This marked Nepal's entry into a more globally integrated industrial environment.

Industrial Policy 2010 and Beyond

The Industrial Policy of 2010 sought to deepen earlier reforms by improving competitiveness, streamlining regulations, and fostering public–private partnerships. It aimed to attract investment through a more predictable business environment.

However, despite these goals, industrial growth stagnated. Manufacturing's share of GDP fell sharply, highlighting a key paradox: liberalization expanded opportunities but failed to generate durable structural transformation.

The Current Policy Landscape

Today, Nepal's industrial policy represents a hybrid approach maintaining liberal market principles while emphasizing inclusion, sustainability, and social justice. Frameworks like People's Multiparty Democracy (PMPD), inspired by Madan Bhandari, advocate a balance between market efficiency and equitable development.

Yet policy inconsistency, weak coordination, and fragile institutions continue to undermine effectiveness. Nepal's challenge lies less in the absence of policy frameworks and more in their fragmented and short-term implementation.

Impacts of Liberalization

Positive Outcomes

Liberalization in the 1980s and 1990s produced measurable benefits. Export-oriented industries, especially textiles, garments, and hand-knotted carpets expanded rapidly, generating employment and foreign exchange (SAWTEE, 2007).

Reforms also eased restrictions on foreign investment, introduced tax incentives, and encouraged entrepreneurship (Kharel et al., 2024). Privatization increased private sector participation, aligning Nepal with global market trends. In the short term, these shifts supported output and job growth, particularly in urban industrial clusters.

Limitations and Negative Impacts

However, liberalization did not yield sustained industrial transformation. Manufacturing's GDP share declined from nearly 9% in 1999/2000 to 4.87% in 2023/24 (Paudel, 2025), signaling premature deindustrialization (Rodrik, 2016). Export-oriented industries remained weakly linked to domestic supply chains, relying heavily on imported inputs.

The post-2005 collapse of garment exports following the end of the Multi-Fiber Arrangement exposed Nepal's vulnerability to external shocks. Meanwhile, chronic bottlenecks in infrastructure, energy, and governance constrained productivity, preventing deeper industrial development.

Structural Constraints

Nepal's industrial underperformance reflects a set of interlinked structural challenges:

- Policy volatility and frequent political changes discourage long-term investment.
- Inadequate infrastructure (poor transport, logistics), and digital connectivity raises production costs.
- Energy insecurity and high costs undermine competitiveness.
- Weak governance and overlapping institutions slow implementation and reduce accountability.
- Limited domestic demand and narrow export bases increase exposure to global fluctuations.
- Skills shortages and labor migration create a mismatch between workforce capacity and industrial needs.

These systemic weaknesses perpetuate low productivity and deter innovation.

Current Status

Nepal's industrial sector remains fragile and underdeveloped. The service sector now dominates GDP growth, but it has not generated sufficient employment. Industrial production remains concentrated in low-value, labor-intensive activities.

Nonetheless, Nepal possesses strong potential abundant natural resources, a youthful workforce, and a strategic location between India and China. Unlocking this potential requires sustained policy stability, effective infrastructure investment, and better alignment between industrialization and broader development goals such as poverty reduction, inclusion, and sustainability.

Policy Priorities and the Way Forward

a. Ensure Policy Stability and Coordination: Embed industrial goals within national development frameworks and legal mandates to guarantee continuity beyond political cycles.

b. Modernize Infrastructure and Energy Systems: Prioritize investment in transport, logistics, and reliable renewable energy leveraging public–private partnerships to reduce costs and enhance competitiveness.

c. Foster Innovation and Technology Upgrading: Promote R&D, digital adoption, and collaboration between industry and academia to strengthen productivity and innovation capacity.

d. Empower MSMEs and Local Enterprises: Support micro, small, and medium enterprises with access to finance, training, and market opportunities, fostering inclusive and regionally balanced growth.

e. Build a Skilled Workforce: Expand vocational and technical education aligned with industrial needs to reduce skills shortages and encourage youth participation in domestic industries.

f. Deepen Regional and Global Integration: Diversify exports, participate in regional value chains, and position Nepal as a bridge economy between India and China to expand market access and attract investment.

Conclusion

Nepal's industrial policy has evolved through experimentation from state-led protectionism to liberalization, yet it has struggled to achieve sustainable transformation. The core obstacles are not policy absence but weak implementation, institutional fragility, and lack of strategic continuity.

A future-ready industrial policy must therefore be coherent, innovation-led, and inclusive, underpinned by reliable infrastructure, human capital, and good governance. With consistent commitment from government, private sector, and communities, Nepal can transform its industrial sector into a driver of jobs, exports, and long-term prosperity.

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