NEPAL
Creating a Competitive SEZ Regime
April 1, 2008

FIAS
Leaders in Investment Climate Solutions:
A multidonor service managed by the International Finance Corporation and The World Bank

IFC South Asia Enterprise Development Facility
A multi-donor facility managed by the International Finance Corporation of the World Bank Group
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Abbreviations

BEPZA  Bangladesh Export Processing Zones Authority
EPZ   export processing zone
EPZA  Export Processing Zones Authority (Pakistan)
FIAS  Foreign Investment Advisory Service (World Bank and IFC)
FITTA Industrial Enterprises Act or the Foreign Investment Act
FOB   free on board
FTZ   free trade zone
GON   Government of Nepal
ID    industrial district
IEA   Industrial Enterprises Act
IFC   International Finance Corporation
Nr(s) Nepalese rupee(s)
PEZA  Philippines Export Promotion Authority
SEDF  South Asia Enterprise Development Facility (IFC)
SEZ   special economic zone
SEZB  Special Economic Zone Board (Nepal)
VAT   value-added tax
Foreword

This report was prepared jointly by the World Bank Group’s Foreign Investment Advisory Service (FIAS) and South Asia Enterprise Development Facility of the International Finance Corporation (IFC-SEDF), as a follow up to the Nepal: Mini-Diagnostic of the Investment Climate (FIAS-SEDF 2007) and at the request of the Government of Nepal. The purpose of the report is to provide recommendations for development of a legal and regulatory framework, including tax incentives, for special economic zones (SEZs), a new model for Nepal’s economy.

The study was intended to provide brief market and policy analysis and recommend reforms to help Nepal’s economy grow through increase of private sector investment, both foreign and domestic, in the SEZs. Examples from many countries show that SEZs can offer a short- to medium-term solution in the context or regulatory constraints and can be catalytic in attracting investors, bringing new technologies, and linking the country to global markets. SEZs’ impact is ultimately measured by the number of new jobs created and investments brought to the country. These impacts largely depend on the legal and regulatory framework that influences potential investors’ decisions to locate in the zones; however, it is even more useful to view the SEZ investment framework as a pilot and a testing ground for broader economic reforms in the country.

The findings in this report incorporate interviews and surveys of Nepali and international companies conducted by the project team during their two-week mission in October 2007, as well as their discussions with Nepali business associations, government agencies, and other stakeholders. The report would not be possible without excellent support from Nepal’s Ministry of Industry, Commerce, and Supplies and the Special Economic Zone Project Office led by Mr. Jagadishwar Shrestha, as well as Ministry of Finance.

The principal authors of this report are Andrea Erdmann (Consultant), Marc Reichel (Consultant), and Sebastian James (FIAS) working under the expert guidance of Gokhan Akinci (FIAS). Paul Barbour and Martin Norman significantly contributed to the analysis and development of the recommendations. Irina Niederberger (IFC-SEDF) led the project. Critical inputs and guidance was received from Tom Davenport (FIAS). The report benefited from the IFC and the World Bank peer reviewers including Deepak Adhikary, Gabi Afram, Simon Bell, Matilde Bordon, Rajeev Gopal, Per Kjellerhaug, Syed Mahmood, Anil Sinha, Sevi Simavi, Rich Stern, and Robert Whyte. The World Bank’s Nepal country team, particularly Sabin Shrestha and Roshan Bajracharya, guided the team throughout the study preparation. Shakir Mustafizul helped with market research. Bharat Raj Upreti of Pioneer Law Associates (Kathmandu, Nepal) provided guidance on legal issues. Pamela Cubberly provided editing and formatting. Cecilia Najera, Loretta Matthews, and Rajshree Karki provided logistical support to the team.
Executive Summary

By request of the Government of Nepal (GON), the International Finance Corporation (IFC), through the joint project of Foreign Investment Advisory Service (FIAS) and SouthAsia Enterprise Development Facility (IFC-SEDF), agreed to examine Nepal’s proposed special economic zone (SEZ) regime and make recommendations for the incorporation of best practice principles into the SEZ bill. An IFC team* visited Nepal in October 2007 to meet with government and private sector stakeholders on a fact-finding mission for this analysis and report. Providing assistance to Nepal’s SEZ regime is part of a broader Investment Climate Reform Program of the IFC in Nepal.†

The primary objective of the IFC SEZ team’s work is ultimately to assist the GON in enacting a competitive SEZ bill that can lay the foundation for a business environment in zones that can attract investment and generate employment. This report will present the findings of the IFC team’s analysis and offer recommendations to the GON on SEZ best practices to enhance the design and competitiveness of the proposed SEZ regime.

An effective SEZ regime can potentially offer a conducive and cost-saving environment for both Nepalese and international investors. Appealing aspects of SEZs in general include: (a) access to serviced industrial infrastructure, (b) a more streamlined business operating environment, (c) lower working capital cost resulting from duty-free importation of raw materials and intermediate goods, and (d) improved security. When implemented effectively, these features of an SEZ lower the operating costs to firms located in the zones compared with those outside. In the long-term, SEZ regime is an affective way to introduce the improved policy and regulatory practices (with demonstrated impact in SEZs) into the overall economy.

The IFC team explored three main aspects of Nepal’s SEZ regime: (a) the draft SEZ bill and potential legislative changes required to bring Nepal’s SEZs in line with regional and international best practices, (b) the market demand for serviced industrial land, and cost competitiveness of Nepal in terms of other countries in the region, (c) tax incentives planned for Nepal’s SEZs, and their impacts on potential investments and government revenues.

After examining these aspects of Nepal’s proposed SEZ regime, the IFC team considers a number of actions to be vital for the success of SEZs in Nepal. Some of these actions need to be reflected in revisions to the SEZ bill, whereas others should be implemented through secondary legislation or SEZ regulations:

- **Expand the projected SEZ regimes from a purely export-oriented facility to a wide range of industries and services.** The current approach to SEZs includes only certain businesses producing and selling for markets outside Nepal. An integrated approach, however, would have fewer restrictions on allowed activities. Preferably, this integrated approach should be reflected in the draft SEZ law by changing its secs. 4 and 5; however, a second

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* The team comprises local and international consultants and staff from IFC-SEDF.
† This program focuses on the investment policy and legal framework with a focus on the special economic zones and tax incentives, assistance with establishment of a secured transaction registry, and reform coordination capacity.
best solution would be to leave the bill as it is and address the issues in secondary legislation.

- *Remove or significantly lower the export requirement to broaden the base of eligible enterprises.* The high threshold of 85 percent excludes many companies, including exporting companies, which are unsure about their export shares. Additional pressure is built up by high fines for companies not meeting the export threshold in one year. Removing or lowering the export requirement would open SEZs to considerably more companies. An amendment of the SEZ bill is necessary to implement this action.

- *Change from tax holidays to performance-based incentives.* Performance-based incentives, such as investment allowances, investment tax credits, and accelerated appreciation, are more cost effective in generating investment than general tax holidays. The SEZ bill would have to be changed to implement this action.

- *Authorize new SEZs for the most economically viable locations, based on demand by potential tenants.* Market studies, feasibility studies, and observation of the international markets are important to gauge the demand for land and infrastructure and select the best suitable location, layout, and standards for attracting investors. In this respect, the future SEZs in Nepal should be selected based solely on economic considerations, rather than politically motivated imperatives. Political interference often results in suboptimal locations and development plans. The SEZ bill does not need amendment to implement this action. The secondary legislation, tender, and selection rules should address the standards and selection criteria, and allow private developers to choose the most optimal locations.

- *Focus more on privately developed and operated SEZs.* To attract international investors, SEZs must be built and operated according to international standards. International private developers can bring their broad perspective and expertise to Nepal. If they take all or part of the commercial risk, then by using own capital in obtaining land and constructing zone infrastructure, they have an inherent motivation to choose locations best suited to the needs of potential tenants. Although the SEZ bill is low key on the use of private developers and operators and a change is welcomed to promote this option, the same can be achieved by including it in secondary legislation only.

- *Offer a wide range of public services on-site.* This is an instrument to address the problem of overregulation and corruption within the concept of SEZs. The establishment of a “one-stop shop” that allows companies to obtain registration, licenses, permits, and certificates in an efficient, fast, and inexpensive manner would be a major selling point for SEZs. In order to make this work, regulations and MoUs must be introduced as part of policy/legal/institutional framework. Among others, on-site services should include customs and tax administration, company registration, issuance and renewal of business licenses, environmental clearances, and labor inspections. The SEZ bill is silent on this issue, and it is preferable that this core service is named as a characteristic of SEZs in Nepal; however, the actual setup of governmental services can also be addressed in secondary legislation and through MoUs between the SEZs and government ministries and agencies.

- *Liberalize the labor regulations.* The requirements for hiring contractual workers and laying off workers should be liberalized within the SEZs, and the related costs, such as severance payments, lowered. The SEZ bill appears to give the SEZ Board the right to stipu-
late major employment regulations (health, security, working time, and welfare measures) for SEZs (sec. 36 [2]). Although ambiguously translated, the right appears to be exercised only by agreement with the workers and employees (sec. 37). It will be critical that the stipulations are clear and formal and based on international standards.

This report presents findings in two formats: part A develops three sets of actions and their likely effects on investment and employment generation. Table 1 summarizes the scenarios and assigns priorities to the various actions, and table 2 shows their impact on investment, employment, and zone revenues in the Bhairahawa SEZ. Part B delivers detailed and in-depth background information on each of the three topics. Parts A and B are summarized below:

**Part A: Three Scenarios and Effects on Investment and Employment Generation**

Part A provides the probable impact of three scenarios on investment and employment generation in Nepal:

1. **Scenario 1: “the conservative case.”** The first scenario reflects the status quo and assumes that the government will adopt and implement the existing SEZ bill without any changes. This results in a moderately positive impact on investment and employment, primarily a result of the fact that SEZs increase Nepal’s much-needed stock of serviced industrial land. Tax holidays offered by the existing SEZ law remain unchanged in the conservative case. Although some companies appreciate the application of such tax holidays, the IFC team anticipates that these tax holidays will only moderately impact investors’ decisions to locate in Nepal. The strongest adverse impact in the conservative case is the high exportation requirement (85 percent). This is a serious flaw in the current SEZ bill, particularly because it restricts purely domestic firms from accessing first-class industrial infrastructure and hampers the profitability of SEZs for private developers.

2. **Scenario 2: “the progressive case.”** The second scenario assumes that politically feasible, moderate improvements will be introduced in the SEZ bill and, at the same time, the implementing regulations will interpret the bill in terms of international best practices. The progressive case is associated with lower export requirements (50 percent) compared with the conservative case, as well as the introduction of performance-based incentives, market-based site selection, and on-site provision of public services. Liberalization of the entry regime of SEZs, in particular, would have a positive impact by increasing the customer base. Furthermore, introduction of non-tax incentives, such as streamlined registration and licensing procedures, coordinated efficient inspections of labor, and food and factory standards will make the SEZs in scenario 2 particularly attractive. Although few, but crucial, changes of the SEZ bill are necessary to implement this scenario, most of the recommended changes can be addressed in implementing regulations.

3. **Scenario 3: “the best case.”** This scenario assumes significant changes to the SEZ bill, creating a business-friendly environment in the SEZs. This scenario is based on the decisive features of some of the most successful SEZ regimes in the world. The best case scenario offers the maximum impacts in terms of investment and employment generation, and would bring Nepal’s SEZ regime on par with the best SEZs in South Asia and the world. This, however, can only be achieved by a complete overhaul of the currently envisioned SEZ policy and the draft legislation, as well as provision of first-class infrastructure. This is a model for the future and shall show the direction for further improvements.
Each of the above scenarios assumes that the government will not alter the current social and environmen- 
tal protection regimes and that existing social and environmental standards are also app- 
licable inside Nepal’s SEZs.
<table>
<thead>
<tr>
<th>Scenario/assumptions</th>
<th>Impact on investor decision to locate in SEZ</th>
<th>Comments</th>
<th>Priority/Legal instrument</th>
</tr>
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<tbody>
<tr>
<td><strong>Conservative case: SEZ bill without changes</strong></td>
<td></td>
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<tr>
<td>1. An 85% export requirement will be implemented.</td>
<td>Negative</td>
<td>The high export requirement and its enforcement rules exclude many potential SEZ candidates from locating in an SEZ.</td>
<td></td>
</tr>
<tr>
<td>2. The SEZs will be traditional export processing zones with tax holidays.</td>
<td>Neutral</td>
<td>Export-oriented companies will welcome the opportunity to obtain serviced land; however, it would not reach the potential of SEZs.</td>
<td></td>
</tr>
<tr>
<td>3. Tax incentives remain as written in the SEZ bill.</td>
<td>Neutral</td>
<td>Enterprises welcome tax incentives to increase competitiveness and compensate for a suboptimal investment climate in Nepal.</td>
<td></td>
</tr>
<tr>
<td>4. SEZs will be constructed in Bhairahawa and Birgunj and other locations, however without detailed demand forecasting.</td>
<td>Neutral</td>
<td>The offer of serviced land will render the designated locations attractive; however, proper planning, demand forecasting, and design would lead to more attractive locations and SEZs. In the absence of proper feasibility studies identification of locations has unclear basis.</td>
<td></td>
</tr>
<tr>
<td>5. The sites are owned, developed, and operated by the SEZ authority.</td>
<td>Negative</td>
<td>Although the SEZ bill allows private development and operation of SEZs, this is presented merely as an afterthought and yet has to be implemented. It is assumed that the SEZ authority remains the main factor in the development and operation of SEZs. Public authorities without experience in developing and operating SEZs are likely to make mistakes.</td>
<td></td>
</tr>
<tr>
<td>6. Customs officials will be on site, although no other services will be provided.</td>
<td>Positive</td>
<td>Export-oriented enterprises located in SEZs will welcome the possibility to use on-site customs services.</td>
<td></td>
</tr>
<tr>
<td>7. Labor regime will be changed/liberalized.</td>
<td>Positive</td>
<td>The SEZ bill allows for liberalization of labor rules regarding health, security, working time, and welfare measures. This should be welcomed by businesses and make SEZs more attractive; however, actual improvements must be negotiated with the unions and the outcome of such negotiations is unclear. The IFC team rated this proposed change as “positive,” assuming that the international labor obligations and standards are honored and the actually determined labor regime according to sec. 36 of the SEZ bill is accepted by the workers and their representatives.</td>
<td></td>
</tr>
<tr>
<td><strong>Progressive case: SEZ bill moderately changed</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. A range of various types of SEZs will be set up, including hybrids with export processing zone (EPZ) areas.</td>
<td>Strongly Positive</td>
<td>This would broaden the application of SEZs to various types of businesses and sectors, as well as allow linkages among businesses within SEZs and between businesses inside and outside SEZs.</td>
<td>High/Law and/or regulations</td>
</tr>
<tr>
<td>2. Export requirement will be considerably lowered (down to 50%).</td>
<td>Strongly Positive</td>
<td>Another vital measure to broaden the base of potential candidates in SEZs.</td>
<td>High/Law</td>
</tr>
<tr>
<td>3. Some incentives will be changed into performance-based incentives.</td>
<td>Positive</td>
<td>Performance-based or smart incentives would be more effective in achieving the goal of rewarding investment and employment generation.</td>
<td>Medium/Law</td>
</tr>
<tr>
<td>4. SEZs will be constructed economically in the most favorable locations demanded by firms, in suitable layouts, and according</td>
<td>Strongly Positive</td>
<td>SEZs tailored to demand in location, size, and service would increase their attractiveness to the private sector.</td>
<td>High/Regulations</td>
</tr>
</tbody>
</table>
5. The sites will mostly be developed and operated by the private sector, under supervision of the SEZ authority.

<table>
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<tr>
<td>5. The sites will mostly be developed and operated by the private sector, under supervision of the SEZ authority.</td>
<td>Strongly Positive</td>
<td>Experienced private developers and operators know the domestic and regional expectations regarding SEZs. They also have cost-efficient solutions to meet such expectations.</td>
<td>High/Law and/or regulations</td>
</tr>
</tbody>
</table>

6. A range of public services will be provided on site, including business registration, licensing, and other authorizations.

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<tr>
<td>6. A range of public services will be provided on site, including business registration, licensing, and other authorizations.</td>
<td>Strongly Positive</td>
<td>Nepal’s private sector suffers from an inefficient, time-consuming regulatory framework for doing business. The SEZs would be a good opportunity to provide a broad range of well-functioning public services on-site. This would be a strong incentive for enterprises to locate in an SEZ.</td>
<td>High/Regulations</td>
</tr>
</tbody>
</table>

7. Some cumbersome labor regulations will be improved, including procedures and related costs to hire and lay off workers.

<table>
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<tr>
<td>7. Some cumbersome labor regulations will be improved, including procedures and related costs to hire and lay off workers.</td>
<td>Positive</td>
<td>The draft bill includes provisions to establish a separate labor regime in SEZs in cooperation with the unions; however, the content of such a labor regime remains unclear. The SEZ bill also does not include reforms of the procedures and costs of hiring and laying off workers, a crucial point for businesses.</td>
<td>Medium/Regulations</td>
</tr>
</tbody>
</table>

**Best case: SEZ bill revised, and regulations include all elements of a modern SEZ regime**

1. A range of various types of SEZs will be set up, including hybrids with EPZ areas.

<table>
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<tbody>
<tr>
<td>1. A range of various types of SEZs will be set up, including hybrids with EPZ areas.</td>
<td>Strongly positive</td>
<td>This would broaden the application of SEZs to various types of businesses and sectors, as well as allow linkages among businesses within SEZs and between businesses inside and outside SEZs.</td>
<td>High/Law</td>
</tr>
</tbody>
</table>

2. The export requirement will be abolished.

<table>
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</thead>
<tbody>
<tr>
<td>2. The export requirement will be abolished.</td>
<td>Strongly positive</td>
<td>This would again broaden the base of eligible companies. Every company could gain from the favorable business conditions provided in SEZs.</td>
<td>High/Law</td>
</tr>
</tbody>
</table>

3. Smart incentives will be provided.

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>3. Smart incentives will be provided.</td>
<td>Positive</td>
<td>Performance-based or smart incentives would be more effective in achieving the goal of rewarding investment and employment generation.</td>
<td>Medium/Law</td>
</tr>
</tbody>
</table>

4. SEZs will be constructed in economically most favorable locations.

<table>
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<tr>
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<th>Comments</th>
<th>Priority/Legal instrument</th>
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<tbody>
<tr>
<td>4. SEZs will be constructed in economically most favorable locations.</td>
<td>Strongly positive</td>
<td>Tailoring SEZs to demand in location, size, and services would increase their attractiveness to the private sector.</td>
<td>High/Regulations</td>
</tr>
</tbody>
</table>

5. The sites will mostly be developed and operated by the private sector under supervision of the SEZ authority for each zone.

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>5. The sites will mostly be developed and operated by the private sector under supervision of the SEZ authority for each zone.</td>
<td>Strongly Positive</td>
<td>Experienced private developers and operators know the domestic and regional expectations regarding SEZs. They also have cost-efficient solutions to meet such expectations.</td>
<td>High/Law and regulations</td>
</tr>
</tbody>
</table>

6. A well-functioning, on-site one-stop shop will be established, providing all public services in the most efficient way.

<table>
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</thead>
<tbody>
<tr>
<td>6. A well-functioning, on-site one-stop shop will be established, providing all public services in the most efficient way.</td>
<td>Strongly positive</td>
<td>Nepal’s private sector suffers from an inefficient, time-consuming regulatory framework for doing business. The SEZs would be a good opportunity to provide a broad range of well-functioning public services on-site. This would be a strong incentive for enterprises to locate in an SEZ.</td>
<td>High/Law and regulations</td>
</tr>
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7. Labor regulations will be reformed to meet international standards.

<table>
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</thead>
<tbody>
<tr>
<td>7. Labor regulations will be reformed to meet international standards.</td>
<td>Strongly positive</td>
<td>The entire labor regime should be reformed on the legislative level, including a more business-friendly labor law.</td>
<td>High/Law</td>
</tr>
</tbody>
</table>

**Table 2: Impact of the Scenarios on the Planned SEZ in Bhairahawa**

<table>
<thead>
<tr>
<th></th>
<th>Conservative case</th>
<th>Progressive case</th>
<th>Best case</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment (millions of Nepalese rupees [Nrs])</td>
<td>427</td>
<td>625</td>
<td>884</td>
</tr>
<tr>
<td>Employment (no. of persons)</td>
<td>9,100</td>
<td>13,300</td>
<td>20,800</td>
</tr>
<tr>
<td>Annual zone revenues (millions of Nrs)</td>
<td>4.55</td>
<td>6.65</td>
<td>10.25</td>
</tr>
</tbody>
</table>
Considering the costs and benefits of the three scenarios, it can be concluded that the “progressive case” is most feasible and offers significant investment and employment generation benefits. As comparison of the impact on investment, employment, and zone revenues of the three scenarios (table 2) shows, scenario 2 yields an estimated 40–50 percent more investment, employment, and zone revenues than scenario 1. This is because the more liberal regime of scenario 2 caters to a broader base of investors. Alterations of the bill are limited; most changes are reflected in implementing regulations. The GON is therefore urged, at a minimum, to revise the current SEZ bill, and apply the main recommended changes included in scenario 2.

Part B: Market Analysis, the Effect of Tax Incentives, and an Assessment of the Legal Framework

Part B provides in-depth analysis of the potential demand for SEZs in Nepal, the impact of various tax incentives on the investment decisions, as well as an assessment of the legal framework to doing business in general and the SEZ bill specifically.

The market analysis identified the following main factors influencing the success of SEZs in Nepal:

- Nepal’s natural comparative advantages lie in (a) service-oriented sectors, (b) products produced for the local market, (c) high-value products exported by air, and (d) products with inputs sourced from a variety of global locations. These industries can potentially thrive in Nepal despite the country’s landlocked location.
- Production costs in Nepal are generally on a par with those in India or Dubai, but with some important differences. Labor and land are less costly in Nepal, but this is offset by higher prices of materials, transportation, and costs associated with bureaucratic hassles and corruption.
- The most important criteria for companies for selecting investment sites are security, access to markets, land infrastructure, power infrastructure, and water and sewer infrastructure.
- Up to 20 percent of companies are sensitive to tax and other incentives when making investment decisions, based on an IFC survey of companies in Nepal.
- Demand for serviced industrial land in Nepal is primarily from companies seeking to serve the local market. This is at a time when only three industrial districts have leasable plots remaining.
- The types of firms that have expressed an interest in locating in Nepal’s SEZs might not qualify based on the export requirement as currently drafted into the draft SEZ law.
- The Ministry of Industry, Commerce, and Supplies will require technical assistance for the creation, design, tender, development, regulation, and operation of future SEZs in Nepal if those zones are to perform measured against regional best practices.

The analysis of the tax incentive regime in the light of international experience concludes the following:

- Tax holidays to units within SEZs results in the risk of giving up tax revenue from investments that would have come in anyway.
- The use of tax holidays also has implications for overall compliance, because profits from businesses outside the SEZs could be diverted to those inside them, resulting in leakage of tax revenue.
- Overall, it is not obvious that Nepal’s policy of giving tax holidays to units within SEZs would benefit the SEZs, even when they attract some new investment.
- The added benefit of the tax holidays creates high demand for the limited space inside SEZs and resulting incentives for lobbying and rent seeking.
- All these risks can be minimized, but with great difficulty, through a set of policies that strengthen the tax administration—asking for greater amounts of information from tax returns and suitably modifying audit policies—both of which have been tried sporadically in India.
- Increasing the transparency of costs and benefits of tax incentives would in the long run help in framing future policy. The goal would be to provide to the entire country the level of benefits that SEZs provide to the limited number of units located within them. This would provide a level playing field for all businesses throughout the country.

The assessment of the legal framework concludes the following:

- The SEZ bill deviates in several areas from good practice.
- Yet, many of these suboptimal provisions, such as insufficient rules on use of private partners in the development and operation of SEZs, can be mitigated by secondary legislation after the bill has been adopted.
- Three areas are, however, important to the success of the SEZ regime, which can only be addressed in the bill: (a) opening the narrow export processing zone (EPZ) approach, (b) abolishing or lowering the high export requirement of 85 percent, and (c) using more performance-based incentives.
- The analysis of general business legislation shows that most of the business laws as such do not pose major problems for doing business. The Industrial Enterprises Act or the Foreign Investment Act can be improved, but both acts are not considered stumbling blocks for doing business.
- It appears that it is not the legislation, but its implementation that more often presents an impediment to investors.
- The obvious legislative issue is caused by the tedious and patronizing Labour Act; yet, the SEZ bill does address this problem by allowing a labor regime in SEZs that varies from the provisions of the Labour Act.

Within the framework of the Investment Climate and Reform Program, FIAS-SEDF can provide further assistance to the GON regarding the institutional, legislative, and administrative aspects of setting up successful SEZs in Nepal.
PART A: Three Scenarios to Set Up SEZs in Nepal

Context: Nepal is a fragile, post-conflict country, with gross national income per capita of only $290, the lowest in the region. Growth in Nepal in 2007 was 2.29 percent, the lowest in the past five years. Its foreign direct investment inflow is only $0.37 per capita (2004). It ranks 111 on the Doing Business 2008 report (World Bank 2008), with the worst indicator (rank 155) in labor, and other low ranks in trade (151) and licenses (125). More country data are available in World Development Indicators 2007 published by the World Bank.

The International Finance Corporation (IFC) recognizes that Nepal can choose to develop its future investment policy and special economic zone (SEZ) regimes based on a range of priorities and factors, each with its own corresponding risks and benefits. As such, the IFC team constructed three general scenarios to aid in the understanding of possible policy and investment outcomes. A matrix summarizing the assumptions and findings of three scenarios can be found in table 1 in the executive summary.

1. Scenario 1: “the conservative case.” The first scenario reflects the status quo and assumes that the existing SEZ bill will be adopted and implemented without any changes. Secondary regulations will be adopted based on the SEZ bill in a conservative manner, which means that the regulations will not include provisions that go against the general approach reflected in the bill.

2. Scenario 2: “the progressive case.” The second scenario assumes that politically feasible, moderate improvements will be introduced in the bill and, at the same time, the implementing regulations will interpret the bill in terms of international good practices.

3. Scenario 3: “the best case.” This scenario assumes radical changes of the SEZ bill, addressing all shortcomings in the general business climate and creating a business-friendly environment in the SEZs. This scenario is based on the decisive features of some of the most successful SEZ regimes in the world.

The impact of the three scenarios on the economy is estimated by their potential to generate in-

<table>
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<tr>
<th>Rating Scale for SEZ Investment Decisions</th>
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<tr>
<td>The following is a rating scale for assessing the impact of key factors on the decision to invest in SEZ:</td>
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<tr>
<td><strong>Negative:</strong> Businesses generally interested in locating in an SEZ will decide otherwise because of this factor.</td>
</tr>
<tr>
<td><strong>Neutral:</strong> This factor will have no significant effect on a business decision to locate in an SEZ.</td>
</tr>
<tr>
<td><strong>Positive:</strong> Businesses will take this into account as an argument for locating in an SEZ.</td>
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<tr>
<td><strong>Strongly positive:</strong> This factor is fundamental for a business to locate in an SEZ.</td>
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vestment and employment. Table 2 in the executive summary estimates these impacts for the Bhairahawa SEZ, which part B of this report describes in greater depth.

Each scenario is built on five factors: (a) the SEZ concept (type of SEZs, degree of openness to industries and activities, and private sector involvement as developer/operator), (b) use of tax incentives, (c) choice of physical setup: location and architecture, (d) type of services provided in the zone, and (e) legal framework.

The impacts of the three scenarios are measured by the two indicators set by the government as objectives for the new SEZ policy: investment (domestic and foreign) and employment generation. The key question is how these five factors will influence the decision of a business to locate in an SEZ. Due to lack of data, the impact can only be assessed in a descriptive way. Each of the key factors will be assessed separately and their impact will be reflected by four values: negative, neutral, positive, and strongly positive.

The assessment is complemented by describing the administrative and legislative implications for implementation of each factor.

It is understood that the Government of Nepal has more than three rigidly defined options for establishing an SEZ regime. The final SEZ regime will necessarily incorporate aspects of the three scenarios described here; however, the indicators and basic options should provide guidance for any changes undertaken to the status quo.

1. Scenario 1: “Conservative Case,” SEZ Bill Unchanged and Traditional Export Processing Zone

This scenario assumes a traditional approach to SEZs as reflected in the SEZ bill. The main characteristic of this case is its strong export orientation with a high export requirement for companies operating in the zone.

It is concluded that the main features of the traditional case will prevent the SEZs from developing their full potential in terms of investment and employment generation. Features in the conservative case, such as export requirements, have a negative impact on investment decisions of potential firms to locate in an SEZ, and features, such as tax holidays, have only a mildly positive impact on at most 20 percent of firms. One of the strengths of SEZs in Nepal, however, will be the provision of serviced land in an economy with a scarcity of industrial land. For this reason, any export-oriented company will perceive an SEZ as attractive. But again, it will be the industrial park, more than SEZ features, that attract investors. In terms of legal and administrative implications, this case assumes that the bill will not be changed and regulations will reflect the traditional export-oriented approach of the bill.

Decisive factors and their impacts on investors’ decisions to locate in the SEZ follow in boldface:

- The SEZs will be traditional export processing zones: negative impact.

The traditional approach of a fenced export processing zone will attract some export-oriented businesses if the location is well selected and good infrastructure is provided. Access to afford-

* The team comprised local and international consultants and staff from IFC.
able industrial land with infrastructure services is one of the most important investment considerations, according to an IFC survey of manufacturing and service companies in Nepal. Such land, however, is now in short supply. Only three industrial districts have leasable greenfield plots remaining. The Bhairahawa SEZ could provide much-needed industrial infrastructure to satisfy demand for serviced land in that region, although the export requirement would have to be relaxed to meet the need.

The export processing approach, however, will limit the impact of SEZs in Nepal and prevent the zones from reaching their full potential. Many exporting companies in need of serviced land and ready to invest also serve the domestic market. They are not allowed to locate in SEZs under the current proposed legislation. For example, after the FIAS team contacted companies interested in the Bhairahawa SEZ, two large companies (floriculture and motorbike assembly) indicated they would not be interested if the zone is an EPZ (table 4.6). At the same time, the enclave style of the EPZs provides for limited linkages to domestic businesses and services.

Legal and administrative implications: The SEZ bill would not change. Secs. 4 and 11 of the bill would continue to stipulate the export orientation of the law.

- **An 85% export requirement is in effect: negative impact.**

The high export requirement guarantees the export orientation of the zones. The same arguments are valid for the choice of establishing traditional EPZs. The fact that the export requirement is very high and failure to meet the requirements has serious consequences, according to the SEZ bill (license withdrawal, high fines, and repayment of incentives), will keep any business that is uncertain about the export quota out of the EPZ.

In India, Bangladesh, and other countries, the export requirements associated with locating in EPZs or SEZs have had the effect of preventing access to serviced industrial infrastructure to companies who service only the domestic markets (annex 5). Concerned about this fact, the Government of Bangladesh, for one, is currently considering a policy paper recommending the phase-out or reduction of export requirements and associated tax holidays. Under this draft policy, new economic zones built in Bangladesh would likely be accessible to all tenants, regardless of export status, and feature incentives based on performance factors, such as exports.

Export requirements do limit the budgetary impacts of granting some forms of tax incentives, such as tax holidays—a very real concern for the government. That problem could be ameliorated through the establishment of more sophisticated incentive measures tied to actual export or capital investment performance.

Legal and administrative implications: The SEZ bill would not change. Sec. 11 (2) of the bill would continue to stipulate the export requirement of 85 percent.

- **Incentives remain as written in the SEZ bill: neutral impact.**

In general, incentives like the ones included in the SEZ bill have little or only a mildly positive effect on the decisions of businesses. Although companies in Nepal place greater importance on security; access to markets and supplies; land, power, water, and transportation infrastructure; and labor skills than they do on tax incentives, they often consider tax holidays as currently the only

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* See details under part B, sec. 4 (c).
† Details in part B, sec. 4 (c) and table 4.4.
avenue to compensate for the difficult business climate. Surveys conducted by the IFC team for this report pointed to the following attitudes regarding government-granted incentives:

Where tax incentives were deemed desirable, it was because (a) they put Nepal on a par with other countries in the region that have them and (b) they offset the additional costs of doing business associated with poor electricity, lack of security (law and order), high cost of transportation, and costs associated with extortion, bribery, and corruption.

A strong preference for tax holidays exists among some companies who think that the alternative—performance-based incentive schemes—would be complex to administer and would lead to additional opportunities for corruption and bribery by some Inland Revenue Department staff. Government tax incentives are only helpful if placed in the context of overall business climate and infrastructure reform, along with “trade and investment diplomacy,” that is, country leaders influencing other countries to allow greater exports or investment.

Based on results of the IFC survey (annex 2), up to 20 percent of industrial companies in Nepal are sensitive or extremely sensitive to the presence of tax incentives. Tax holidays and export performance–based incentives hold nearly equal appeal, provided granting of the tax scheme is not associated with additional opportunities for corruption.

Legal and administrative implications: The SEZ bill would not change. Chapter 6 of the bill would continue to stipulate the incentives, including 10 years of tax holidays (sec. 23).

- **SEZs will be completed as planned in the identified locations: neutral impact.**

The availability of affordable serviced industrial land infrastructure is the third largest aggregate driver of investment decisions of surveyed firms in Nepal. In general, any offer of serviced land will attract interested investors due to the scarcity of land available for businesses; however, the planned SEZs are not the best locations, because (a) no proper demand study has been undertaken and (b) the “as-planned“ designs will work, but are not ideal. The best place for a traditional EPZ is in Biratnagar, but none is planned for there.

Construction of SEZs in Bhairahawa and Birgunj represent positive steps toward creating additional serviced industrial land for foreign and local investors in Nepal. If export requirements are kept in place, however, demand for space in SEZs will fall, because many companies that have expressed interest will not qualify as tenants under proposed SEZ legislation. The risk exists that SEZ industrial infrastructure will sit idle while companies serving the local market are left without industrial infrastructure.

Legal and administrative implications: The SEZ bill does not include any provisions on the choice of location, size, or technical specifications. Regulations would have to address these issues in greater detail.

- **SEZs will be developed and operated by the SEZ authority: negative impact.**

The IFC team identified some design elements of the Nepali SEZ that are outside best practices now employed in new Philippine, Malaysian, United Arab Emirates, and other regional free zones, although these will not likely impact investor demand for land in the SEZ. These chal-

* Details in part B, secs. 4 (c–d).
Challenges are indicative of the relative inexperience of Nepal’s Ministry of Industry, Commerce, and Supplies in designing, tendering, and supervising construction of bonded SEZs.

The involvement of private companies with international experience in the development and operation of SEZs could bridge the GON’s lack of experience. It would bring international best practice in zone development, could provide private financing, and could introduce more efficiency in zone management. So far, the use of private companies beyond construction activities is limited.

Legal and administrative implications: The SEZ bill would not change, although the bill includes in sec. 6 the possibility of developing, managing, and operating SEZs. The bill does not have any preference for this option. It is assumed that the Build-Own-Transfer Act will be applied for private participation in SEZs. Sec. 6 (2) of the bill delegates details of public-private partnership arrangements to secondary regulations. Such secondary regulations should include bidding procedures, selection criteria, and the procedure for unsolicited offers in greater detail to ensure transparency and fair and equal treatment.

- Customs officials will be on-site (even though no other services will be provided): positive impact.

One of the main advantages of an EPZ is to cut down time and cost of importation and exportation procedures. The EPZ concept of the SEZ bill includes the classic feature of on-site customs officials. It is expected that on-site customs will positively affect processing time and cost. This will be a positive factor in the decision of investors to locate in an EPZ, particularly because the Doing Business 2008 report (World Bank 2008) ranks Nepal’s procedures for trade across borders at only 153rd of 179 countries and, next to Afghanistan, the worst in the region. Costs per container are comparatively very high—$1,600 (export) and $1,725 (import)—and processing time is extremely long—43 days (export) and 35 days (import).

Legal and administrative implications: According to sec. 15 (1) of the bill, the SEZ Board (SEZB) will provide an “industry certificate of export, import, approval, and certificate of origin as required.” The board must also establish bonded warehouses according to sec. 32 of the bill. It is assumed that the board will establish efficient services to issue the necessary certificates and permits in the most expedient way and at the lowest cost.

- Labor regime is changed: positive impact.

A company entering a new investment market will concern itself with the rigidity of employment—for instance, the ease of hiring and laying off workers—because it contributes to the overall cost of operations. In this regard, companies who locate in Nepal are faced with the most rigid labor regime in the region, based on indices created and measured by the World Bank (2008).

India, Sri Lanka, and Bangladesh have all at some point experienced significant union activities and worker strikes to varying degrees. Nepal is no different in this regard, and investors experienced with business conditions in South Asia factor these risks into their business models. All dollar amounts in this report are U.S. dollars, unless otherwise noted.

though labor strikes add to the cost of doing business, the greatest concern among investors surveyed for analysis was the loss of competitiveness stemming from a lack of security—road closures, no rule of law, political instability, and actions by political parties (often in the name of “labor rights”).

The SEZ bill calls for disconnection from the health, security, working hour, and welfare measures of the general regime. A special regime will be negotiated between employees and employers. Sec. 37 is vague, but appears to prohibit strikes. It is assumed that international labor obligations and standards will be honored. This will have a positive impact on the decision of labor-intensive exporters to invest in an SEZ.

Legal and administrative implications: The SEZ bill addresses labor issues sufficiently. Sec. 35 on obtaining a work permit from the SEZB will be applied. Sec. 36 will give the SEZB the power to determine health, security, working hours, and welfare measures.


This scenario assumes a progressive approach to SEZs. The SEZ bill will be moderately changed. The regulations will reflect most of the elements of the progressive case. The export requirement will be considerably lowered to 50 percent. Most zones will be developed, constructed, and operated by the private sector and regulated by the SEZ authority. Locations will be selected and designed based on results of independent feasibility studies that assess the economic viability and demand for land and infrastructure. On-site public services address most cumbersome administrative procedures. Some labor regulations will be lifted providing less bureaucratic and costly labor regimes.

Decisive factors and their impacts on investors’ decisions to locate in the SEZ follow in boldface:

- **The EPZ concept will be liberalized: positive impact.**

The range of companies interested in SEZs will increase significantly if the traditional EPZ concept as included in the SEZ bill is liberalized. Companies with a major share of exports, but desiring the opportunity to serve the local market, would gain from the advantages (serviced land, streamlined bureaucracy, and clusters) that an SEZ offers. The demand will increase as well as the diversity of SEZs. This would also give domestic companies a better opportunity to profit from linkages with foreign export companies.

**Legal and administrative implications.** The best option would be to change sec. 4 and stipulate an open SEZ concept in which all businesses and industries can locate. In addition, the positive list featured in sec. 5 would have to be abolished and replaced by a negative list. Several other places in the bill would have to acknowledge the more open approach and drop their export orientation.

There is a second best way, however, to open the current approach to a certain extent without changing the bill: secondary legislation could allow a more open use of the SEZ concept. This means, the regulations based on sec. 5 should include a wide list of industries, including basically

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* See details in part B, sec. 4 (c).
any kind of business. Also, the right to authorize applications on a case-by-case basis in sec. 7 (3) should be applied very flexibly by the SEZB.

- **The export requirement is significantly lowered (by 50%): positive impact.**

As mentioned above, the 85 percent export requirement and high fines keep away even exporting companies, because they are uncertain about meeting the high requirements, particularly in cases of fluctuating global demand. The high requirement is not in line with newer developments in the area of SEZs. Countries realize that pure EPZs are less successful than those with lower or no export requirements, as the example of Bangladesh shows.

In a next step, a combination of an EPZ with export requirements and an industrial park type of zone may be considered.

**Legal and administrative implications:** This is one of the two features of scenario 2 that can only be implemented by changing the bill. Sec. 11 (2) of the bill needs to be changed to replace the term “15 percent” by “50 percent.”

- **Mainly performance-based incentives offered: positive impact.**

Performance-based incentives are more effective than general tax holidays and give fewer opportunities for fraud. Tax holidays open up several opportunities for transfer of profits from already taxed entities to nontaxed entities based in the SEZs. Detailed methods on how profits may be diverted are explained in part B, sec. 5 of this report. These methods are very difficult to tackle and highly administratively intensive. Performance-based incentives, such as investment allowances, investment tax credits, and accelerated depreciation are all superior instruments or “smart” incentives. With each of these tools, the tax incentive is targeted specifically to the capital investment. As a result, the benefit-cost ratio (in terms of additional investment generated per unit of revenue lost) is high. In short, the government receives more for less; however, it should be noted that tax incentives have only a moderate impact on the investor’s decision to locate in an SEZ, no matter if tax holidays or performance-based incentives are offered.

It has been argued, with some justification, by the business community in Nepal that performance-based incentives involve greater interaction with the tax authorities and, hence, would be an administrative burden to investors. Interaction with the tax authorities, however, would not be less than in the case of tax holidays, as it would be important for Inland Revenue to require an annual tax return, even in the case of a tax holiday. Furthermore, the opportunities for fraud are far fewer in the case of performance-based incentives than tax holidays.

Keeping all else constant, based on what limited evidence exists, performance-based incentives have been shown to be more effective in attracting investment than tax holidays. In general, the evidence is that tax incentives alone do not encourage investment. Part B of this report mentions several instances. In light of this, performance-based tax incentives that result in less loss of revenue than tax holidays, but for the same benefit to investment, are recommended.

**Legal and administrative implications:** Incentives are the second feature that can only be implemented through a change of the bill. Chapter 6 of the bill, which refers to the facilities, would

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* See part B, secs. 5 (d–e).
† For example, in India this remains the most highly litigated tax provision (sec. 80HHC).
‡ See details in part B, sec. 5 (a), and table 5.1.
have to replace tax holidays with performance-oriented incentives, such as investment allowances, investment tax credits, accelerated depreciation, subsidized electricity, and upgrades to infrastructure, as suggested by Nepali businesses.

Preferably, the chapter on incentives could be moved from the bill to tax and customs legislation, omitting them entirely from the SEZ regime. The advantage of this practice is not only to keep the tax- and customs-related provisions in the laws where they belong and under which they are administered, it would also be a first step in consolidating tax incentives, if the Industrial Enterprises Act (IEA), 2049 (1992) follows this practice.

- **Best locations, layout, and international technical standards are applied: strongly positive impact.**

Locations should be carefully selected to mitigate transportation costs for both inputs and final products. An SEZ is most successful if it is close to the source of raw materials, intermediate or end-user markets, or means of transportation necessary to reach markets. This depends on the types of products produced in an SEZ and the destination markets. Market studies, feasibility studies, and observation of international markets are important to gauge the demand for land and infrastructure, and select the most suitable location, layout, and standards for attracting investors.

In this respect, the future zones should be selected based solely on economic considerations, rather than politically motivated imperatives. Political interference often results in suboptimal locations and development plans.

*Legal and administrative implications:* The procedure to select a site as stated in secs. 3 and 4 of the bill does not have to be changed. The issue can and must be addressed on the level of implementing regulations and administrative provisions. Here, secondary legislation should include the following, if not already covered under existing statutes or if the standards in those statutes are sub-par: (a) minimal coverage ratios, (b) standards for main and secondary roads, and (c) architectural guidelines and standards.

- **Private developer and operator are engaged: positive impact.**

To attract international investors, SEZs must be built and operated according to international standards. International private developers can bring their broad perspective and expertise to Nepal. If they take all or part of the commercial risk, then use own capital in obtaining land and constructing zone infrastructure, they have an inherent motivation to choose locations that are best suited to the needs of potential tenants. Even in cases in which the government funds SEZ land and infrastructure, the SEZ authority might gain considerably from the use of private developers and/or operators. In addition, private participation would allow the GON to share risk, rely on the private sector for financing, and efficiently develop zone infrastructure according to phased demand.

*Legal and administrative implications:* Sec. 6 of the bill allows private development and operation of SEZs; however, the option is presented in a rather defensive way. No priority is given to the involvement of private companies, and it is more a limiting clause. The best approach would be to change sec. 6, make the private development and operation a priority, and provide the key features of the procedure to outsource these services (procedure to address unsolicited offers, bidding process, selection criteria, features of agreement, etc.).

* See details on already chosen sites in part B, sec. 4 (d).
The change of sec. 6 of the bill, however, is not strictly necessary. A similar result can be achieved by addressing these issues in the regulations. Another question is whether the existing Build-Own-Transfer Act can and shall be used as a legal base for the private development and operation of an SEZ. If so, it must be clarified whether separate procedures and additional requirements are necessary in order to apply this act.

- **Wide range of public services provided on-site: positive impact.**

Administrative procedures are time consuming, cumbersome, and costly in Nepal. Nepal ranks 111th of 178 countries under the World Bank’s “ease of doing business” indicator. High costs and long delays negatively impact the competitiveness of goods and services from Nepal; therefore, simplified procedures offered in SEZs are a key argument for locating there.

The draft bill can do more concerning on-site public services than the envisaged customs clearance and issuance of work permits. A real one-stop shop, beyond a single window or mail box, in which officers from various ministries and the respective municipality issue licenses and permits and collect fees in simplified procedures, would lower the cost for businesses considerably.

This approach could also function as a catalyst for national investment reforms. Streamlined procedures can be tested on the small scale of SEZs, and successful improvements can be expanded to the whole country.

**Legal and administrative implications:** The one-stop shop exists as a concept in Nepal. The SEZ bill does not refer to it and has no provisions on how any public services will be offered in SEZs. It would have been helpful and reassuring for the bill to refer to public services. It might also be necessary to suspend the application of some specific laws in SEZs in order to offer streamlined procedures and divert companies from the regular administrative setup; this remains to be assessed. By and large, however, this issue can be addressed on a secondary legislative level. This means that the regulations shall have detailed provisions on which public services, authorizations, permits, and registrations will be offered on-site in each SEZ. It shall also identify the specific measures to reduce time and cost of the services, compared with the regular procedures. In addition, the intergovernmental chain of command and exchange of information should be addressed in the regulations to avoid turf battles and a smooth interface between the SEZ outfit and the line ministries/authorities.

On the administrative side, the actual one-stop shop needs to be established in each SEZ. This concerns the physical setup, the necessary human resources and skills, and the budget.

- **Some cumbersome labor regulations will be streamlined: positive impact.**

The rigidity of the labor indicator is based on the difficulty of hiring and firing, rigidity of hours and employment, as well as higher nonwage labor costs in Nepal than in neighboring countries and the region. Businesses perceive the cumbersome labor regulations as a major impediment to doing business in Nepal. Easing the procedures and cost of hiring and laying off workers, as well as the rigid rules concerning labor would improve the productivity and flexibility of companies.

**Legal and administrative implications:** The rules set up in the bill, namely, secs. 36 to 38, are a sufficient base for changing the labor regime specifically for SEZs as long as the unions agree. No additional legal changes are indicated.
3. Scenario 3: “Best Case,” Best Practice

This scenario assumes the application of best practices for SEZs. The SEZ bill will need to be fully revised to reflect experiences of the most successful SEZ regimes in the world. All types of SEZs will be allowed, and all sectors can settle down in an SEZ. The export requirement will be lifted. Smart incentives will be provided. Zones will be constructed and operated by the private sector and regulated by the SEZ authority. Technical requirements and construction standards will be at an international level. Locations will be selected on the results of feasibility studies according to economic viability only. Comprehensive public services will be provided on-site in each zone. Labor regulations will be liberalized.

Decisive factors and their impacts on investors’ decisions to locate in the SEZ follow in boldface:

- The hybrid concept is implemented: strongly positive impact.

The hybrid concept means an integrated approach with private service provision within zones and fewer restrictions on allowed activities (see box 3 for three best-practice models). Every company can settle in an SEZ, in which it has access to serviced land, export-oriented companies, duty-free importation of materials (until the time a product is sold into the domestic market), and streamlined public services under efficient zone management. This significantly broadens the base of potential customers and lowers the risk taken by the government when setting up an SEZ. Furthermore, hybrid zones are an excellent vehicle for promoting backward linkages between international companies and exporters with domestic suppliers. U.S. foreign trade zones are an example of such an integrated concept.

Legal and administrative implications: To implement a modern, best-practice SEZ concept that is open to all businesses and integrates a number of different activities—export and domestic market oriented—the legal framework would be much different from the traditional EPZ setup. Such an SEZ law also functions as a marketing tool to promote the open concept. The existing bill could not be amended to carry this new approach with confidence and conviction. A new law must be drafted. All references to export orientation would disappear, and the new integrated concept would be central in the new law, as would be openness and service orientation.

- No export requirements are applied within the SEZ, but EPZ is a fenced bonded area: strongly positive impact.

Good SEZs maintain close control of the movement of goods to and from the zone. For smaller zones this usually involves enclosing the entire zone with a fence. Nonexporters and exporters qualify to locate in the zone, and both types of businesses would have the same benefits of duty-free inputs. This model is applied, for example, in the U.S. foreign trade zones (box 5.1). Nonexporters would save in three ways: (a) duty-free importation of machinery, (b) cost savings associated with delaying tariff payments, while warehousing parts, and (c) tariff reassignment during manufacturing transformation.

Legal and administrative implications: The new law would not include any export requirement for the entire SEZ. Export requirements may be set to enjoy certain tax incentives or locate in an EPZ type of area within the SEZ. Yet, the export requirement would not serve as a general entry requirement for the SEZ.
• **Best locations, suitable layouts, and international technical standards are applied with high-quality infrastructure services: strongly positive impact.**

Key for the success of a hybrid zone is the concept, location, and offered facilities. The physical dimensions of the SEZ, size of plots, and specialty infrastructure must cater to the anticipated potential demand, which is known through in-depth feasibility analyses. In a country like Nepal, the facilities, such as utility services, must be decisively better than outside the zone. If multinational companies are to be attracted, the quality of roads, energy, water, effluent treatment, and telecommunications should be at international standards to attract companies that have many choices and the capacity of the infrastructure should be appropriate to the industries locating in the zone.

*Legal and administrative implications:* Access to serviced land is a crucial argument for companies to locate in industrial districts as well as in future SEZs. To attract international companies, it is important that the layout, facilities, and technical standards can compete with the best in the region. The law may include minimum requirements and standards. This shall be followed by detailed requirements in technical regulations.

• **Only smart incentives are provided: positive impact.**

The main attraction of these kinds of open SEZs is the services offered and not the tax incentives. In fact, the better an SEZ concept, the less important are incentives; however, in a world in which countries compete against each other through incentive packages, Nepal might decide to offer certain incentives. If so, performance-based tax incentives are more efficient and less costly than tax holidays.*

*Legal and administrative implications:* As mentioned above, performance-oriented incentives have a greater impact on driving additional investment and employment than tax holidays. If incentives are considered at all, the new law should include only performance-oriented incentives.

• **A one-stop shop provides all relevant public services on-site: strongly positive impact.**

A strong incentive for locating in an SEZ is the high quality of public services provided on-site. Other than a mailbox service, most of the general interactions would happen in an on-site public agency. Such a service is only economically justified if the SEZ is a certain size. But if this were the case, business registration and all kinds of licenses, building permits, clearances, and labor issues would be addressed and solved in this agency. The performance of the service would be closely monitored by the SEZ authority and the private sector association to ensure the best service. Such a service is particularly important in a country with poor administration and significant corruption.

*Legal and administrative implications:* The law would promise a full range of efficient public services relevant to doing business within the SEZ. A kind of parallel bureaucracy would be established in the SEZ in which ideal procedures—business-oriented, efficient, and/or inexpensive—will be offered to companies. Companies can register businesses, obtain licenses, pay taxes and fees, and obtain construction clearances, conformity certificates, customs clearance, etc. on-site. Such services could and should function as a spearhead for general regulatory reforms in the whole country.

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* See details in part B, sec. 5.
On the administrative side, administrative offices need to be established in each SEZ. This concerns the physical setup, connections to headquarters, necessary human resources and skills, and budget.

- Labor regulations are liberalized: strongly positive impact.

Liberalization of labor regulation would only be possible if the unions and the employers’ federation are on board. Both sides must cooperate in the liberalization process and ensure that it is a win-win situation. Workers would lose some of their legal protections, but gain from a vibrant SEZ through additional jobs and higher salaries. Employers would have to increase participation of the workers and their representatives in the economic success of zone companies. All rigidity of employment indicators would have to be improved to make not only layoffs, but hiring, easier; in the process, this would lower nonwage compensation, but in turn, increase salaries, and so on.

*Legal and administrative implications:* All rigidity indicators would be addressed and procedures for hiring and laying off employees reduced and nonwage costs lowered.
PART B: Background Information on the Market, Incentives, and Legal Framework

This part of the report provides background information in three sections on the three most relevant issues regarding establishing an SEZ regime in Nepal:

1. A market demand and benchmarking analysis, which delivers information necessary to design an SEZ policy, guide selection of appropriate types of zones and locations, and build the sites according to expected demand and international standards
2. Analysis of the various types of tax incentives and their effect on investments
3. Analysis of the SEZ bill and the legal framework for doing business, followed by examples of best practices.

The market analysis identified the following main factors influencing the success of SEZs in Nepal:

- Nepal’s natural comparative advantages lie in (a) service-oriented sectors, (b) products produced for the local market, (c) high-value products exported by air, and (d) products with inputs sourced from a variety of global locations. These industries can potentially thrive in Nepal despite the country’s landlocked location.
- Production costs in Nepal are generally on a par with those in India or Dubai, but with some important differences. Labor and land are less costly in Nepal, but this is offset by higher prices of materials, transportation, and costs associated with bureaucratic hassles and corruption.
- The most important criteria for companies for selecting investment sites are security, access to markets, land infrastructure, power infrastructure, and water and sewer infrastructure.
- Up to approximately 20 percent of companies* are sensitive to tax and other incentives when making investment decisions, based on an IFC survey of companies in Nepal (annex 2).
- Demand for serviced industrial land in Nepal is primarily from companies seeking to serve the local market. This is at a time when only three industrial districts have leasable plots remaining.
- The types of firms that have expressed an interest in locating in Nepal’s SEZs might not qualify based on the export requirement as currently drafted into the draft SEZ law.
- The Ministry of Industry, Commerce, and Supplies will require technical assistance for the creation, design, tender, development, regulation, and operation of future SEZs in Nepal if those zones are to perform as measured against regional best practices.

The analysis of the incentive regime in the light of international experience concludes the following:

- Tax holidays to units within SEZs risk the loss of tax revenue from investments that would have come in anyway.

* Based on IFC team surveys and anecdotal discussions with local and international investors—exporters and nonexporters—in Nepal.
The use of tax holidays also has implications for overall compliance, because profits from businesses outside the SEZs could be diverted to those inside them, resulting in leakage of tax revenue.

Overall, it is not obvious that Nepal’s policy of giving tax holidays to units within SEZs would benefit the SEZs, even when they attract some new investment.

The added benefit of the tax holidays creates high demand for the limited space inside SEZs and resulting incentives for lobbying and rent seeking.

All these risks can be minimized, but with great difficulty, through a set of policies that strengthen tax administration, asking for greater amounts of information from tax returns and suitably modifying audit policies, both of which have been tried sporadically in India.

Increasing the transparency of costs and benefits of tax incentives would in the long run help in framing future policy. The goal would be to provide to the entire country the level of benefits that SEZs provide to the limited number of units located within them. This would provide a level playing field for all businesses throughout the country.

The assessment of the legal framework concludes the following:

- The SEZ bill deviates in several areas from good practice.
- Yet, many of these suboptimal provisions, such as insufficient rules on use of private partners in the development and operation of SEZs, can be mitigated by secondary legislation after the bill has been adopted.
- Three areas important to the success of the SEZ regime, however, can only be addressed in the bill: (a) opening the narrow export processing zone approach, (b) abolishing or lowering the high export requirement of 85 percent, and (c) using more performance-based incentives.
- The analysis of general business legislation shows that most of the business laws do not pose major problems for doing business. The Industrial Enterprises Act or the Foreign Investment Act (FITTA) can be improved, but both laws as such are not considered stumbling blocks for doing business.
- It appears that it is not the legislation, but its implementation that more often presents an impediment to investors (this conforms with Nepal’s very low ranking in the Doing Business 2008 report (World Bank 2008).
- An obvious legislative issue is caused by the tedious and patronizing Labour Act; yet, the SEZ bill does address this problem by allowing a labor regime in SEZs, contrary to the provisions of the Labour Act.

4. Market Demand and Benchmarking Analysis

The IFC team examined the current investment and export climate in Nepal. The objectives of this investigation were to do the following:

- Highlight Nepal’s comparative strengths and weaknesses regarding other countries in the region
- Understand the primary investment and site selection motivations of companies
- Examine SEZ legal and infrastructure developments and their effects on investment in Nepal’s SEZs.
a. Analysis of Industry Sectors and Regional Competitors

Demand for space in Nepal’s EPZs will be driven by investments made by both local and international businesses in a variety of sectors. The IFC team examined industry trends and regional competitors to understand better how Nepal was positioned to attract businesses to its SEZs.

**Trade Trends**

The IFC team analyzed export growth and industry trends in Nepal to understand the types of companies that would likely locate in Nepal’s SEZs and determine the countries against which Nepal should be benchmarked. Table 4.1 lists industry sectors that have experienced increasing exports or sectors identified as having potential for growth in Nepal.

The primary investors in most of these sectors will be Nepalese entrepreneurs and businesspersons, and most enterprises are strongly inclined to serve primarily the Nepalese domestic market. Investment from other companies from other countries is also possible, especially where noted in table 4.1’s remarks section.

Nepal is undifferentiated in its top exports from other countries in the region, with the exception of China. IFC used the World Bank’s TradeCAN database and software to analyze trade competitiveness trends of Nepal and neighboring countries. Table 4.2 lists the top ten “Rising Star” sectors in each country, that is, those products in which exports as well as world demand for imports are increasing.

Garments and textiles are the predominant export leaders in most of the surrounding countries. Leather, instruments, and some pharmaceutical manufacturing are also strong exports from the region. IFC thus benchmarked the cost and quality conditions of the countries listed in table 4.2 to demonstrate Nepal’s strengths and weaknesses regarding other countries in the region.

**Industrial District Investment Trends**

IFC analyzed the types of companies that locate in Nepal’s industrial districts (IDs). The IDs operated by Industrial District Management Limited are Nepal’s only provider of serviced industrial infrastructure to firms. Although firms receive no special tax incentives for locating in the zones, the IDs are currently the closest entity in Nepal to “special economic zones.”

Nepal’s industrial districts are open to all firms: exporters, as well as firms that sell into the domestic market. In the past five years, the ten IDs have attracted an average of 25 new companies each year. This represents a total average annual investment of Nepalese rupees (Nrs) 236,972,519 ($3,599,984)—or an average of Nrs 9,403,641 ($142,856) per company. The majority of these firms—as illustrated in figure 4.1, are in the food processing, metalworking, and plastics industries.
Table 4.1: Analysis of Industry Sectors

<table>
<thead>
<tr>
<th>Sector</th>
<th>Increasing exports to India</th>
<th>Increasing to other countries</th>
<th>“Rising star”</th>
<th>Positive business trend</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Readymade garments</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td>Knitwear and pashminas are traditional strengths. Sector currently crippled by labor unrest and security problems. India has advantage, because it has supporting industries, such as design, maintenance, and textile supply sources. Nepal is competitive only when sourcing materials outside India. China, India, Bangladesh, Cambodia, and Vietnam are primary international competitors. India and China are possible international investors.</td>
</tr>
<tr>
<td>Textile fabric, thread, and sacks</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>China and India are primary international competitors. India and China are possible investors.</td>
</tr>
<tr>
<td>Fast-moving consumer goods: toiletries, etc.</td>
<td></td>
<td>X</td>
<td></td>
<td></td>
<td>Nepal has experienced disinvestment in this sector, and the trend is for large multinational firms to build regional, rather than national, production facilities. India and Bangladesh are primary international competitors.</td>
</tr>
<tr>
<td>Shoes</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>China is primary international competitor and possible investor.</td>
</tr>
<tr>
<td>Hides/skins, leather</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Herbs</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spices</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td>Exported spices include ginger, cardamom, and cinnamon.</td>
</tr>
<tr>
<td>Juice and beverages</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>Growing domestic market for processed foods and beverages.</td>
</tr>
<tr>
<td>Animal feed</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Processed foods</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>Growing domestic market for processed foods and beverages may be a trend for regional producers to locate in India, rather than Nepal.</td>
</tr>
<tr>
<td>Jewelry</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td>India is primary regional competitor, and potential investor.</td>
</tr>
<tr>
<td>Pharmaceuticals, including herbal</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>Inputs are more easily available in India than Nepal; it is difficult to export nonayurvedic medicines to neighboring countries due to policies protecting their own domestic pharmaceutical companies.</td>
</tr>
<tr>
<td>Packaging items, including containers</td>
<td></td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electronic parts</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td>China and Vietnam are strong international competitors. China is a potential international investor, because the cost of labor in coastal China has become expensive.</td>
</tr>
<tr>
<td>Handicrafts</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>Sector is currently hurting because of labor unrest and security problems.</td>
</tr>
<tr>
<td>Tea</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wire</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aluminum</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>Sector prospered under bilateral treaty with India, but may not be as competitive because India has liberalized its market.</td>
</tr>
<tr>
<td>Veneer sheet</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cement</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stone and sand</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plastics</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>India is a potential market; however, excess capacity currently exists in some plastics subsectors.</td>
</tr>
<tr>
<td>Vehicle parts</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>Chinese firm expressed interest in assembly motorcycles in SEZ.</td>
</tr>
<tr>
<td>Banking and financial services</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>Not affected currently by labor unrest; exports not allowed.</td>
</tr>
<tr>
<td>Insurance</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>Not affected currently by labor unrest; exports not allowed.</td>
</tr>
<tr>
<td>Educational consulting services</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Industry sectors that were not suitable for location in an SEZ were not included.

- d. Identified by businesspersons surveyed as being a healthy and prospering sector in Nepal or a sector that has the potential to perform well.
Table 4.2. Top 10 “Rising Star” Exports from South Asian Countries

<table>
<thead>
<tr>
<th>Nepal</th>
<th>India</th>
<th>Pakistan</th>
<th>Bangladesh</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perfumery, cosmetics, and toiletries</td>
<td>Jewelry</td>
<td>Bed linen, table, and kitchen linens, curtains</td>
<td>Jerseys, pullovers, cardigans</td>
<td>Electronic parts</td>
</tr>
<tr>
<td>Other outer garments, women’s, girls’</td>
<td>Cotton undergarments</td>
<td>Jerseys, pullovers, cardigans</td>
<td>Cotton undergarments</td>
<td>Other electrical parts</td>
</tr>
<tr>
<td>Jerseys, pullovers, cardigans</td>
<td>Bed linen, table linen, toilet linen</td>
<td>Cotton undergarments</td>
<td>Other outer garments, women’s, girls’</td>
<td>Other sound recorders and reproducers</td>
</tr>
<tr>
<td>Under garments, knitted or crocheted, of cotton</td>
<td>Other outer garments, women’s, girls’</td>
<td>Other made-up textile articles</td>
<td>Leather of bovine cattle</td>
<td>Other furniture and parts</td>
</tr>
<tr>
<td>Spices</td>
<td>Special transactions and commodities</td>
<td>Other outer garments, women’s, girls’ and infants’</td>
<td>Bed linen, table, and kitchen linens, curtains</td>
<td>Lighting fixtures and fittings, lamps and lanterns, and parts thereof</td>
</tr>
<tr>
<td>Jewelry</td>
<td>Jerseys, pullovers, slipovers, and jackets</td>
<td>Leather of other bovine cattle</td>
<td>Skirts</td>
<td>Television, broadcasting, and radio equipment</td>
</tr>
<tr>
<td>Medications</td>
<td>Medications</td>
<td>Petroleum oils, crude, and crude oils obtained from bituminous</td>
<td>Corsets, brassieres, etc.</td>
<td>Electrothermal appliances,</td>
</tr>
<tr>
<td>Packaging items, including containers</td>
<td>Heterocyclic compounds; nucleic acids</td>
<td>Clothing accessories, knitted or crocheted, not elsewhere specified</td>
<td>Lenses, prisms, mirrors, and other optical elements</td>
<td>Other electrical machinery and equipment, not elsewhere specified</td>
</tr>
<tr>
<td>Miscellaneous electrical parts</td>
<td>Building and monumental stone, worked,</td>
<td>Medical instruments</td>
<td>Motor spirits (gasoline) and other light oils</td>
<td>Electrical appliances</td>
</tr>
<tr>
<td>Skirts</td>
<td>Motor spirit (gasoline) and other light oils</td>
<td>Furniture designed for medical, surgical, or dental use</td>
<td>Crustaceans and mollusks, prepared or preserved</td>
<td>Chairs and seats</td>
</tr>
</tbody>
</table>
During the same period, however, Nepal’s IDs experienced significant disinvestment. This is partially attributable to the worsening security situation, which added to the overall expense of doing business in Nepal for exporters and domestic market producers alike. Figure 4.2 shows the extent of disinvestment between 2002 and 2007.

Source: Industrial District Management Limited.
An average of 15 firms close every year in Nepal’s IDs, representing an average disinvestment of Nrs 187,879,912 ($2,854,017) a year. The hardest hit firms are in the metalworking, garment and textile, food processing, and “other” sectors, primarily handicrafts. Annex 1 figures A1(a) and A1(b) break down the investments and disinvestments in Nepal’s IDs between 2002 and 2007.

Industrial district investments, however, only represent a small fraction of enterprise creation in Nepal. Between 2000 and 2005, 25,386 new enterprises (in all industry sectors) were incorporated in Nepal. These new enterprises had an average initial authorized capital of Nrs 17,046,858 ($258,953) per company.*

b. Costs and Business Operating Conditions: Nepal Compared with Regional Competitors

IFC benchmarked some of the cost and quality conditions facing investors in Nepal and surrounding countries. Examination of individual cost variables, as well as the relative importance of each variable in an industry’s value chain points to areas in which Nepal offers a more—or less—attractive operating environment than other countries. The variables IFC benchmarked include labor, utilities, serviced industrial land, shipping, taxation, and incentives associated with investing in free zones or SEZs.

Benchmarking data were collected through official agencies, such as boards of investment, free zone authorities, published surveys, and IFC surveys conducted specifically for this exercise. Annexes 4 and 5 list the data.

Value Chain Analysis: Relative Importance of Benchmarked Costs and Quality Factors

Examination of the value chains of companies in various industry sectors is helpful in understanding the importance that firms place on various costs and factors of doing business. Several Nepalese enterprises provided IFC the cost breakdown in their production value chains (table 4.3).

Competitiveness of Labor

A company entering a new investment market will concern itself with the rigidity of employment—for instance, ease of hiring and laying off workers—because it contributes to the overall cost of operations. In this regard, companies who locate in Nepal are faced with the most rigid labor regime in the region, based on indices from the 2008 Doing Business Report (figure 4.3).

Labor has become a highly politicized factor of doing business in Nepal and elsewhere in the region. India, Sri Lanka, and Bangladesh have all experienced significant union activities and worker strikes to varying degrees at some point in time.† Nepal is no different in this regard, and investors experienced with business conditions in South Asia factor these risks into their business models. Although labor strikes add to the cost of doing business, the greatest concern among investors surveyed for analysis was the loss of competitiveness stemming from a lack of security—road closures, no rule of law, political instability, and activities by political parties (often in the name of “labor rights”). This, more than any other factor, has driven businesses from Nepal,

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* IFC calculation of data provided by the Office of Company Registrar of records of registered companies between 2000 and 2005.
† Worker discord exists in Pakistan and China as well, although labor organization and strikes are banned outright in those countries’ SEZs and EPZs.
Table 4.3: Breakdown of Typical Costs in Industry Value Chains

<table>
<thead>
<tr>
<th>Industry</th>
<th>Value chain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beverages</td>
<td></td>
</tr>
<tr>
<td>Raw materials:</td>
<td>50%–55% retail price</td>
</tr>
<tr>
<td>Freight/logistics:</td>
<td>5%</td>
</tr>
<tr>
<td>Labor:</td>
<td>7%–8%</td>
</tr>
<tr>
<td>Machinery:</td>
<td>5%</td>
</tr>
<tr>
<td>Utilities:</td>
<td>5%–6%</td>
</tr>
<tr>
<td>Inventory costs:</td>
<td>0.5%–1%</td>
</tr>
<tr>
<td>Excise tax:</td>
<td>5% (passed onto consumer)</td>
</tr>
<tr>
<td>VAT(^a):</td>
<td>7% (passed onto consumer)</td>
</tr>
<tr>
<td>Other:</td>
<td>15%</td>
</tr>
<tr>
<td>Fast-moving consumer goods:</td>
<td></td>
</tr>
<tr>
<td>detergents, shampoos, etc.</td>
<td></td>
</tr>
<tr>
<td>Cost of goods sold (advertising, retail costs, etc.):</td>
<td>40%–50% retail price</td>
</tr>
<tr>
<td>Labor:</td>
<td>20%</td>
</tr>
<tr>
<td>Raw materials:</td>
<td>30–40%</td>
</tr>
<tr>
<td>Other:</td>
<td>5%–10%</td>
</tr>
<tr>
<td>Textile yarn</td>
<td></td>
</tr>
<tr>
<td>Materials:</td>
<td>70% FOB(^b) price</td>
</tr>
<tr>
<td>Logistics:</td>
<td>8%–10%</td>
</tr>
<tr>
<td>Labor:</td>
<td>2%–4%</td>
</tr>
<tr>
<td>Utilities:</td>
<td>5%–7%</td>
</tr>
<tr>
<td>Cost of finance and depreciation:</td>
<td>8%–10%</td>
</tr>
<tr>
<td>Garments</td>
<td></td>
</tr>
<tr>
<td>Materials:</td>
<td>40%–50% FOB price</td>
</tr>
<tr>
<td>Labor:</td>
<td>30%</td>
</tr>
<tr>
<td>Utilities:</td>
<td>12%–15%</td>
</tr>
<tr>
<td>Overhead (incl. cost of finance):</td>
<td>15%</td>
</tr>
<tr>
<td>Logistics:</td>
<td>2%–3%</td>
</tr>
<tr>
<td>Carpets</td>
<td></td>
</tr>
<tr>
<td>Materials:</td>
<td>60% FOB price</td>
</tr>
<tr>
<td>Labor:</td>
<td>30%</td>
</tr>
<tr>
<td>Logistics:</td>
<td>10%</td>
</tr>
<tr>
<td>Bureaucracy:</td>
<td>Adds 15% in Nepal, 2% in India, and 0% in China</td>
</tr>
</tbody>
</table>


a. VAT = value-added tax.
b. FOB = free on board.

Wage rates are lower in Nepal than other benchmarked countries, except Bangladesh, in nearly all worker categories (figure 4.4). This is a fact substantiated by companies that IFC surveyed in Nepal. The downside of these lower wage rates is that skill levels of Nepalese workers are also lower. Nepal lacks the software engineering skills of India; the garment and textile design expertise of China, Bangladesh, and India; and other technical skills found in greater abundance in those countries. This can indeed raise the actual cost of employment when companies must employ Indians or other foreigners in technical capacities within their companies.

Utilities

Utilities—water, power, and gas—typically constitute between 5 and 15 percent of the free on board (FOB) cost of manufactured items, depending on the particular industry sector. Posted power tariffs in Bangladesh and Pakistan are lower than those in Nepal (annex 4) but the actual cost of power can only be known through a survey of generator usage, which is common in every country in the region. Companies located in Nepal’s industrial districts experience power-load shedding up to 12 hours per day in the winter. Electricity from generators costs two to four times...
the amount charged by the Nepal Electricity Authority. This situation will persist in Nepal’s SEZs unless they are provided with a dedicated uninterrupted supply of electricity.

Figure 4.3: Rigidity of Employment: Nepal and Other Countries in Region, 2007

![Figure 4.3: Rigidity of Employment: Nepal and Other Countries in Region, 2007](image)


Figure 4.4: Cost to Company of One Worker, Nepal and Other Countries in Region, 2007

![Figure 4.4: Cost to Company of One Worker, Nepal and Other Countries in Region, 2007](image)

Sources: For Nepal, India, and China, the IFC survey; for Bangladesh and Pakistan, the country’s board of investment.
The cost of water is competitively priced in Nepal, when benchmarked against other countries in the region. Piped water, however, is often not available in sufficient quantities in Nepal’s industrial districts. Even in IDs, companies must often dig their own bore wells to obtain water. Similar to the basic industrial estates in India and Bangladesh, Nepal’s IDs generally do not provide common wastewater treatment facilities, and effluent must be treated by companies themselves or is often not done at all. If Nepal’s Environment Act comes under stricter enforcement, many companies will face costly effluent treatment upgrades. Improved infrastructure, if offered in Nepal’s SEZs, will ameliorate these water supply and effluent treatment concerns and the associated costs for companies.

**Serviced Industrial Land**

The benchmarked costs of land listed in box 4.1 demonstrate that Nepal offers some of the least expensive industrial land in the region. Access to affordable industrial land with infrastructure services is one of the most important investment considerations, according to an IFC survey of manufacturing and service companies in Nepal. Such land, however, is now in short supply; only three industrial districts have leasable greenfield plots remaining:

- Hetauda ID: 17 hectares (ha) (336 ropani)
- Dharan ID: 2.4 ha (47 ropani)
- Nepaljung ID: 0.25 ha (5 ropani).

**Box 4.1: The True Cost of Land in Nepal**

Serviced industrial land is scarce in Nepal, particularly in the Kathmandu Valley. Industrial district annual rents of $0.13 per square meter are a bargain compared with EPZ rents in Bangladesh, India, and China. Hidden costs of obtaining land, however, negatively cloud the experience of doing business in Nepal.

A number of companies interviewed for this analysis discussed the money they had to pay *informally*—under the table—to industrial district managers or other “buying agents” to secure land within an industrial district. This was often in excess of several million rupees. One firm felt that ID managers have no incentives to provide support for existing companies in the zones, because they are in the personal business of “selling” defunct plots in IDs left by failed companies. This is undoubtedly a result of the under-development of serviced industrial land, but also a testament to poor management and oversight. It results in hidden prices, higher costs, and increasing distrust in the government. Care must be taken that management of SEZ resources is not similarly handled.

The Butwal ID receives four to five inquiries a month from interested entrepreneurs and investors. Construction of another industrial district in the area has been considered. The Bhairahawa SEZ *could* provide much-needed industrial infrastructure to satisfy demand for serviced land in that region, although the export requirement would have to be relaxed to meet the need.

Nepal’s IDs share some characteristics in common with the basic industrial estate facilities that the IFC team visited in India and Bangladesh. Basic infrastructure is provided at an attractive cost and meets the needs of most small and medium enterprises. Roads, buildings, and some utilities, however, are generally not well maintained. Few standards exist for development—mandatory

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*Industrial District Management Limited.*

† One hectare equals 19.7 ropani.

‡ Interview with Mr. Subash Sitoula, manager, Butwal Industrial District, October 11, 2007.
setbacks, coverage ratios, and architectural guidelines—and roads as narrow as five meters (m) are not designed or maintained for truck traffic and safe pedestrian worker access. The IDs, although quiet, are not very secure, and people with no business in the ID wander freely throughout the zone.

Cost of Transportation

Annex 4 lists the costs of transporting one container by sea or 1,000 kg of garments from Nepal and surrounding countries. Transportation is a factor where Nepal is at its greatest disadvantage. A container shipped to New York from Biratnagar through Haldia Port in Calcutta costs $5,850. The same container shipped from Dhaka would cost only $3,100. Similarly, garments shipped to New York by air from Kathmandu cost $3.95 per kilogram, compared with $3.35 from Dhaka. Although logistics make up just 2 to 3 percent of the FOB cost of a single garment, that can be the difference between a profitable and unprofitable enterprise in a sector known for low-cost pressure from international buyers and increasingly tight margins.

Nepal will be in a better position to achieve a comparative advantage in the export of services, tourism, high-value products shippable by air, and products destined for markets in northern India, rather than in other products requiring bulk shipping. Export-oriented services do now exist in Nepal, but are hindered by the current lack of competitive telecommunications services and an inadequate skilled workforce. These are factors that must be addressed independently of the SEZ regime.

Products for which transportation accounts for a negligible percent of their high-value FOB costs could be nurtured more aggressively in Nepal and even supported by an airport-based SEZ. Many such products, such as pharmaceuticals and electronic components, have not been export leaders to date in Nepal, because they rely on supplier networks outside Nepal or have not been aggressively promoted.

The cost of transportation associated with locating in Nepal is minimal for companies serving domestic and northern Indian markets. This is the group of investors for whom the greatest demand exists for SEZ space in the near to medium term. For exporters in this group, the biggest cost obstacle is not transportation, but duties imposed by India. Box 4.2 illustrates this in greater detail.

Value Chain Example

Companies make investment decisions based on the total cost of production. Their calculation involves multiple factors weighted for their importance in the operations’ value chains. Decisions are not made on the basis of single factors, such as labor costs or level of tax incentives. The IFC team investigated the costs of producing garments in India and Nepal. The example shown in box 4.2 is indicative of costs experienced by one company operating in both countries. Cost structures may be different for other firms.
Box 4.2: Cost of Production in the Garment Sector: India Compared with Nepal

These two tables benchmark India and Nepal in terms of the actual garment production value chain. The analysis assumes that fabric is imported from outside Nepal or India and final garments are sold in the Indian market.

**Overhead costs.** Overhead (production) costs are nearly identical in India and Nepal. Lower wage rates and power tariffs in Nepal are offset by higher costs associated with importing parts, materials, and technical management from India. Location in a Nepalese SEZ would save the company the cost of duties on imported inputs from India, thus bringing transformation costs in Nepal that are lower than in India.

<table>
<thead>
<tr>
<th>Overhead Cost Element</th>
<th>India</th>
<th>Nepal</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Worker salaries</td>
<td>40 45</td>
<td>33 37</td>
<td>Worker salaries are 18% lower in Nepal than in India.</td>
</tr>
<tr>
<td>Management salary</td>
<td>14 16</td>
<td>19 21</td>
<td>Nepalese management salaries are 33% higher due to relocation costs and compensation of technical workers hired from India.</td>
</tr>
<tr>
<td>Fuel &amp; electricity</td>
<td>8 9</td>
<td>7 7</td>
<td>Fuel and electricity costs are 19% lower in Nepal.</td>
</tr>
<tr>
<td>Insurance cost</td>
<td>8 9</td>
<td>10 11</td>
<td>Insurance premiums are 25% higher in India.</td>
</tr>
<tr>
<td>Repairs &amp; maintenance cost</td>
<td>4.6 5</td>
<td>5.3 6</td>
<td>Parts cost 20% more in Nepal due to higher logistics costs for import of spare parts.</td>
</tr>
<tr>
<td>Cutting &amp; sewing variables</td>
<td>4.6 5</td>
<td>5.8 7</td>
<td>Polywrap, brown paper, and plotter paper, which form 70% of costs, must be imported from India. The cost is 46.5% higher due to a 26.5% customs duty and 20% additional freight cost.</td>
</tr>
<tr>
<td>Misc. overheads</td>
<td>10 11</td>
<td>10 11</td>
<td></td>
</tr>
</tbody>
</table>

Total 89.2 100 90.1 100 The cost differential is 0.03%.

**Material, production, logistics, and duty costs.** Nepal is a more efficient country from which to source international fabrics than India. Higher freight charges and import duties applied by India result in 9 percent higher landed costs for a garment produced in Nepal. Tax incentives in Nepalese SEZs could offset duties imposed by India and bring total landed costs within a competitive range. Export performance–based incentives are recommended to achieve this.

<table>
<thead>
<tr>
<th>Material, production, logistics, and duty cost element (U.S. dollars)</th>
<th>India</th>
<th>Nepal</th>
<th>Diff.</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total fabric cost</td>
<td>4.81</td>
<td>4.43</td>
<td>(0.38)</td>
<td>Fabric costs are lower in Nepal due to sourcing efficiencies.</td>
</tr>
<tr>
<td>Other raw material cost</td>
<td>1.39</td>
<td>1.42</td>
<td>0.03</td>
<td>Costs are greater in Nepal due to higher logistic cost and incidence of additional customs duty on certain packaging material.</td>
</tr>
<tr>
<td>Clearing and inward freight charges</td>
<td>0</td>
<td>0.26</td>
<td>0.26</td>
<td>Additional inward and outward clearing charges apply, because Nepal is landlocked country.</td>
</tr>
<tr>
<td>Cut and sew</td>
<td>1.27</td>
<td>1.27</td>
<td>0.00</td>
<td>Costs are nearly identical (see table above).</td>
</tr>
<tr>
<td>Washing</td>
<td>0.18</td>
<td>0.18</td>
<td>0.00</td>
<td></td>
</tr>
<tr>
<td>Total material cost</td>
<td>7.65</td>
<td>7.56</td>
<td>(0.09)</td>
<td></td>
</tr>
<tr>
<td>Custom clearance</td>
<td>0</td>
<td>0.12</td>
<td>0.12</td>
<td></td>
</tr>
<tr>
<td>Total FOB</td>
<td>7.65</td>
<td>7.68</td>
<td>0.03</td>
<td></td>
</tr>
<tr>
<td>Freight and insurance to customs</td>
<td>0</td>
<td>0.03</td>
<td>0.03</td>
<td></td>
</tr>
<tr>
<td>Outward logistics</td>
<td>0.13</td>
<td>0.15</td>
<td>0.02</td>
<td></td>
</tr>
<tr>
<td>Countervailing and additional duties*</td>
<td>0</td>
<td>0.62</td>
<td>0.62</td>
<td></td>
</tr>
<tr>
<td>Total landed cost in India</td>
<td>7.78</td>
<td>8.48</td>
<td>0.70</td>
<td>The cost differential is 9%.</td>
</tr>
</tbody>
</table>

* Countervailing duty applied under sec. 3 of the Customs Act of India on imports at a rate equal to excise duties on Indian manufactured items. Additional countervailing duty of 4% on imports, applied under sec. 3 (5) of the act. Applied through the Indian budget of 2006 to offset local taxes paid by Indian manufacturers.
**Taxes and Incentives**

Corporate income tax and value-added tax (VAT) rates for Nepal and benchmarked countries are listed in annex 5. This annex also compares the incentives offered to exporters and/or tenants in the countries’ free zones and SEZs and the requirements for receiving them.

Tax holidays ranging from two to 10 years are the primary tax benefit of all benchmarked EPZ regimes, except Pakistan. Each of these regimes requires exportation of at least 50 percent of production, or—in the case of India—maintenance of net positive foreign exchange. Sri Lanka does not tie these benefits to location within an EPZ.

The tax benefits offered in benchmarked countries have undoubtedly spurred export-oriented investment throughout the region. This is particularly apparent in countries that have also actively promoted investment, lowered tariffs, built up industrial infrastructure, and focused on worker education and training.

In India, Bangladesh, and other countries, the export requirements associated with locating in EPZs or SEZs has had the effect of preventing access to serviced industrial infrastructure to companies who service only the domestic markets. Concerned about this fact, the Government of Bangladesh, for one, is currently drafting a policy paper recommending the phaseout or reduction of export requirements and associated tax holidays. As such, new economic zones built in Bangladesh would likely be accessible to all tenants, regardless of export status, and feature incentives based on performance factors, such as exports.

**Conclusions**

When benchmarked against other countries in the region, the business climate in Nepal confers both benefits and disadvantages. The SEZ regime can address some, but not all, of these factors (table 4.4).

c. **Investor Priorities and Decision-Making Triggers**

Nepal’s SEZ regime must be tailored to serve the clients that locate in the zones, in terms of export requirements and incentives, infrastructure design, services offered, and marketing methods. The IFC team analyzed the priorities of investors to understand better how to craft Nepal’s SEZ law and regulations in the best way.

**Investor Survey**

The IFC team surveyed approximately 25 local, foreign, and joint venture operational enterprises throughout Nepal. Respondents spanned a wide range of industry sectors from software design to wire rod manufacturing and represented both exporters and firms that solely serve Nepal’s domestic market. Interviewed firms maintain facilities both inside and outside Nepal’s industrial districts, with locations in Pokara, Butwal, Kathmandu Valley, Birgunj, and Biratnagar. Interviewees consisted of company owners, general managers, or company officials intimate with site selection and investment decisions of the companies.
**Summary**

IFC surveyed 25 companies in Nepal to gauge their investment priorities and the degree to which government incentives were important to their business operations or perception of the business climate.

Companies in Nepal place greater importance on (a) security, (b) access to markets and supplies, land, power, water, and transportation infrastructure, and (c) labor skills than they do on tax incentives. IFC team surveys point to the following attitudes on government-granted incentives:

- Where tax incentives were deemed desirable, it was because (a) they put Nepal on a par with other countries in the region that have them and (b) they offset the additional costs of doing business associated with poor electricity, lack of security (law and order), high cost of transportation, and costs associated with extortion, bribery, and corruption.
- A strong preference exists for tax holidays among companies that believe that complicated performance-based incentive schemes would be met with additional corruption and bribery hassles from the Inland Revenue Department.
- Government incentives are only helpful if placed in the context of overall business climate and infrastructure reform, along with “export diplomacy.”

Up to approximately 20 percent of industrial companies in Nepal are sensitive or extremely sensitive to the presence of tax incentives, based on results of the IFC survey. Tax holidays and export performance-based incentives hold nearly equal appeal, provided no extortion or corruption is associated with granting of the tax scheme.

**Table 4.4: Summary of Benchmarked Factors and Their Effects**

<table>
<thead>
<tr>
<th>Benchmarked factor</th>
<th>Negative</th>
<th>Positive</th>
<th>Effect of SEZ on factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor</td>
<td>Rigid employment laws and labor unrest</td>
<td>Very competitive wage rates</td>
<td>Separate labor regime in SEZ could address issues of frequent worker strikes. Concentration of labor in SEZs could raise local wage rates.</td>
</tr>
<tr>
<td>Utilities</td>
<td>Frequent power cuts; must dig own wells</td>
<td>Competitive utility tariffs</td>
<td>SEZs will provide water infrastructure. Dedicated power to SEZs would solve problem of power cuts.</td>
</tr>
<tr>
<td>Land</td>
<td>Poor administration of IDs, which are not well maintained</td>
<td>Least costly land of all benchmarked countries</td>
<td>Private operation of SEZs are urged to bring about efficient zone management. SEZs will likely be priced higher than current IDs.</td>
</tr>
<tr>
<td>Transportation</td>
<td>Most costly transportation of all benchmarked countries</td>
<td>Few, but costly transportation weakens import competition for local markets</td>
<td>SEZ located near airport could encourage development of high-value goods.</td>
</tr>
<tr>
<td>Duties</td>
<td>Duties imposed by India decrease cost competitiveness</td>
<td>Lower duty structure in Nepal makes worldwide sourcing more efficient</td>
<td>SEZs can create a more streamlined business environment with fewer bureaucratic costs. Export-based incentives could address countervailing duties.</td>
</tr>
</tbody>
</table>
Investment Priorities

The IFC team asked respondents to describe their investment site selection priorities, asking the following question (annex 2, question 13):

*If you were to consider a new investment location for this type of business, what would be your top five selection criteria, listed in terms of importance?*

Figure 4.5 displays the weighted aggregated results, and the top five investment priorities are discussed below.

**Figure 4.5: Investment Site Selection Priorities by Nepalese Enterprises Surveyed, 2007**

<table>
<thead>
<tr>
<th>Priority</th>
<th>Weighted Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Security</td>
<td></td>
</tr>
<tr>
<td>Access to markets</td>
<td></td>
</tr>
<tr>
<td>Land infrastructure</td>
<td></td>
</tr>
<tr>
<td>Power infrastructure</td>
<td></td>
</tr>
<tr>
<td>Water and sewer infrastructure</td>
<td></td>
</tr>
<tr>
<td>Access to supplies and raw materials</td>
<td></td>
</tr>
<tr>
<td>Transportation infrastructure</td>
<td></td>
</tr>
<tr>
<td>Labor skills</td>
<td></td>
</tr>
<tr>
<td>Tax incentives</td>
<td></td>
</tr>
<tr>
<td>Labor supply</td>
<td></td>
</tr>
<tr>
<td>Business investment and industrial legal climate</td>
<td></td>
</tr>
<tr>
<td>Cost of labor</td>
<td></td>
</tr>
<tr>
<td>Labor law</td>
<td></td>
</tr>
<tr>
<td>Cost of power</td>
<td></td>
</tr>
<tr>
<td>Access to finance</td>
<td></td>
</tr>
<tr>
<td>Cost of land</td>
<td></td>
</tr>
<tr>
<td>Cost of logistics</td>
<td></td>
</tr>
<tr>
<td>Cost of finance</td>
<td></td>
</tr>
<tr>
<td>Quality of life</td>
<td></td>
</tr>
<tr>
<td>Cost of water</td>
<td></td>
</tr>
<tr>
<td>IT infrastructure</td>
<td></td>
</tr>
</tbody>
</table>

a. Respondents’ first investment priority was multiplied by 5; second priority multiplied by 4; third priority multiplied by 3; fourth priority multiplied by 2, and fifth priority multiplied by 1.
Security. When considering a new location for investment, surveyed firms gave the greatest aggregate weight to security: the presence of law and order without disruption of company activities from crime, demonstrations, disturbances, road closures, or extortion. Where the rule of law and a peaceful industrial atmosphere exist, companies have a greater chance of receiving raw material shipments and fulfilling customer orders on time. Lack of security was the single greatest reason listed by carpet and garment companies as permanently or temporarily shutting down operations. Road closures and methods of extortion used by political parties slow factory production and do not allow products to reach markets on time. This ultimately results in unemployment of workers, as businesses lose international orders and sales.

Interviewed firms had mixed opinions regarding the security situation inside Nepal’s industrial districts. Some firms felt their operations were secure inside IDs, whereas others noted a lack of control on who enters an ID. Several firms specifically chose not to locate in an ID, expressly to avoid labor unrest from quickly spreading from one factory to another.

Access to markets. Most firms strategically chose their current location based on access to the markets they serve in order to reduce lead time and costs associated with logistics. Most nonexporting companies count the Kathmandu Valley as their primary market and consequently located either in the valley or in Birgunj. Proximity to Haldia Port in Kolkata or road connections to Mumbai, Delhi, or Karachi motivated the site selection of several exporting firms.

Land infrastructure. The availability of affordable serviced industrial land infrastructure is the third largest aggregate driver of investment decisions of surveyed firms. Companies tend to choose locations where they are assured that enough land is available to expand operations in the future. Nepal’s industrial districts generally have the type of infrastructure firms are looking for—level land, power, and road access—but land scarcity and high costs deter some entrepreneurs. Land must also be appropriately zoned and allocated, according to some respondents. Pharmaceutical firms, for instance, cannot locate next to polluting industries, such as brick or carpet manufacturers. Firms noted that India and Pakistan are better at properly designating land for light, heavy, polluting, or commercial uses and found this type of zoning largely absent in Nepal.

Power infrastructure. An uninterrupted power supply is equally important to exporters as it is to firms producing solely for Nepal’s domestic market. Many firms require locations where voltage fluctuations will not damage sensitive equipment or load shedding disrupts manufacturing operations or service delivery. Power reliability is particularly important to export-oriented business process outsourcing firms, which engage in real-time delivery of processed data and fast turnaround of projects for international clients. These businesses rely on constant uploading and downloading of data, and entire products can be lost during a power failure. In Nepal’s industrial districts, power shedding is announced ahead of time and normally cut during single blocks of time, rather than scattered periods throughout the day. This is helpful for businesses, allowing them to plan shutdowns in advance; however, it does not ameliorate the need for costly generators.

Water and sewer infrastructure. Water and sewer infrastructure are important priorities for many industrial firms. Access to land with good drainage and the ability to tap into an existing piped water network are factors that save companies the expense of digging their own bore wells. Pharmaceutical firms and textile firms that employ wet processing techniques often place a priority on locations that offer common effluent treatment facilities.
Relative Importance of Tax Incentives

Of the 21 factors listed by company owners or managers as priorities, “tax incentives” rank ninth in terms of weighted aggregate score and incentives are valued slightly more by exporters than nonexporters; however, only three firms (two of which were exporters) listed “tax incentives” as one of their top five investment site selection criteria. The rest of the approximately 25 firms surveyed did not mention incentives as an investment priority, when not specifically asked about them.

d. Current SEZ Development and Construction in Nepal

Despite not having passed an SEZ law or regulations, Nepal has embarked on the construction of SEZs in Bhairahawa and Birgunj. Development of the zones has proceeded slowly, and some elements of their construction indicate a lack of understanding of SEZ design and operation.

Examination of Physical Infrastructure at the Bhairahawa SEZ

On October 11, the IFC team visited the Bhairahawa SEZ construction site, accompanied by Engineer Thata of the Special Economic Zone Project in the Ministry of Industry, Commerce, and Supplies. The purpose of the visit was to examine the zone layout, gauge the progress of zone construction, and visit companies in nearby Butwal Industrial District. The visit began with an examination of the Bhairahawa SEZ master plan (annex 3) and followed by a drive around the site.

The perimeter fence was at that time completed, but internal roads were not yet paved and land had not been raised to accommodate the planned sidewalks. Power, water, and sewer infrastructure had been laid in the southern portion of the SEZ, and infrastructure for the northern half of the zone is currently in a tender process.

The SEZ has been under construction for three years and is being developed in one master plan phase. Anticipated investment of Nrs 950 million ($14,431,110), of which land is Nrs 400 million ($6,076,257), current construction is Nrs 100 million ($1,519,064), future construction is Nrs 250 million ($3,797,661), and waste treatment is Nrs 200 million ($3,038,129).

Summary

An IFC consultant investigated the Bhairahawa Special Economic Zone under construction, and found the following:

- The zone will provide good to excellent land, water, and waste treatment infrastructure for tenants, but the reliability of power will be subject to Nepal Electricity Authority load shedding, as in the rest of Nepal.
- The zone has some master planning design challenges. These will not hinder the attractiveness of the zone, but neither will they make Nepal stand out as an SEZ best practice leader.
- Many investors who have expressed interest in locating in the Bhairahawa SEZ would not qualify as tenants under proposed Nepalese legislation.
- The Ministry of Industry, Commerce, and Supplies would benefit from IFC-supported technical assistance in designing and tendering the master plan, construction, and operation of future SEZs.

* Construction of the SEZ has been tendered in two phases, although the zone will open to tenants with all planned infrastructure in place throughout the entire zone. Feasibility studies for the zone did not include phasing based on forecast of tenant demand.
Box 4.3: Bhairahawa Special Economic Zone: Facts at a Glance

Gross size: 30 ha
Net leasable land: 20 ha
Minimum plot size: 1,000 m²
Maximum plot size: 2,000 m²; plots can be combined
Periphery fence: Concrete; 3 m high; surrounds entire SEZ
Prefabricated factory/warehouse shells: Not planned
Water: 15-cm buried water pipes supply each plot; currently installed in southern section of SEZ
Sewerage: 40-cm sewage outflow pipes buried to supply each plot; currently installed in southern section of SEZ
Sewage treatment facility: Planned, but not yet tendered; will provide secondary liquid waste treatment and cover 16,000 m²; will be suitable for common biological wastes, but not for toxic chemical waste from leather, pharmaceuticals, or other caustic waste–producing industries; will discharge treated grey water to nearby natural stream
Solid waste disposal: Nothing yet planned within zone for disposal of solid wastes, including tenant garbage and sludge by-products of waste treatment
Power: Electricity supplied to zone by the Nepal Electricity Authority; 11-kilovolt transformer within SEZ; power lines within zone run above ground; SEZ tenants will purchase power directly from SEZ, perhaps at a 10 to 15 percent discount rate over the authority’s tariffs; tenants will be subject to the authority’s load shedding schedule, currently two days a week during evening hours
Telecommunications: Telephone landlines not constructed to periphery of SEZ; 1.2-km extension of lines required from Siddharta Highway to SEZ; no mobile telephone network signal currently available at SEZ site
Planned facilities: Administration building, childcare center, and medical clinic; none yet constructed
SEZ road design standard: 10.2 metric tons per axle (unless weight limits are enforced, overloaded trucks carrying up to 16 tonnes per axle [typical in Nepal] will likely ply SEZ roads, causing premature deterioration)
Internal SEZ roads: Perimeter roads are two-lane, 7 m wide. Other internal roads are two lanes, 9 m wide; some are divided by a median; not yet paved; tarmac is planned
SEZ connection road: Links SEZ to Siddharta Highway; paved with gravel; 1.2 kilometer (km) long and 9 m wide; tarmac surface planned for 2008, pending available budget
Distance to Kathmandu: 300 km
Distance to Indian border: 3 km
Distance to Bhairahawa Airport: 8 km; connected to SEZ by 7-m wide, two-lane Lumpini-Bhairahawa and Siddharta Highways in fair to good condition
Airport runway length: 1 km long; not suitable for wide-body cargo flights
Surrounding population: About 200,000 persons

Source: Data courtesy of Engineer Thata, engineering and construction supervisor, Bhairahawa Special Economic Zone, Special Economic Zone Project, Nepal Ministry of Commerce and Supplies (interview, October 11, 2007).
The IFC team benchmarked Bhairahawa SEZ’s construction and design to SEZs, free zones, and industrial estates in India, Bangladesh, Malaysia, and elsewhere in the region. This was deemed important because company owners had described “land infrastructure” as their third most important investment site selection criterion (figure 4.5).

Effects of Physical Design and Location on Tenant Demand

Physical size. The infrastructure as designed and constructed in the 30 ha SEZ will be attractive to small and medium enterprises requiring up to 1 or 2 ha (20 to 39 ropani) of land. This is the profile of most local—and some international—companies currently operating in Nepal. IFC’s survey companies operating in Nepal noted that industrial firms typically demand from 1,000 sq m (approximately 2 ropani) to 2 ha (about 39 ropani) of land. Plots of 1,000 and 2,000 sq m (1 to 2 ropani) can be combined, according to SEZ Project Office officials.*

Nepal’s largest multinational investors, however, sit on campuses ranging in size from 2.8 ha (55 ropani) to 28 ha (551 ropani). Limitations of physical space would preclude large exporting firms of this size from locating in the Bhairahawa SEZ. The 500-ha (9,850 ropani) SEZ planned for Birgunj, however, would likely be able to accommodate larger firms demanding land in excess of 3 ha (59 ropani). Plots can be combined, but the positioning of roads will limit access to large land users (greater than 3 ha), especially as the zone starts to fill up.

Standard factory buildings and office space. No plans exist at the moment to build prefabricated standard factory buildings† or office buildings within the Bhairahawa SEZ. The latter are not expected to impact the SEZ negatively, because the types of firms that lease office space—software, business process outsourcing, and insurance—are not likely to locate in the Bhairahawa area, given its remote location away from major urban areas; however, firms that seek rapid “turn-key” start-up often lease standard factory buildings to reduce significantly the time between site selection and commencement of manufacturing activities. Cut-and-sew garment manufacturers are a prime example. The lack of standard factory buildings in the Bhairahawa SEZ does decrease the attractiveness of the zone for such potential tenants and could cause some companies to choose locations elsewhere.

Effluent treatment. The SEZ will have common wastewater treatment facilities, which is an improvement over the infrastructure currently available in most Nepalese IDs. The design and construction of wastewater treatment facilities had not yet been tendered as of October 2007, but will likely treat only common biological waste effluent. No chemical effluent treatment facilities are planned, and factories must still install their own facilities to pretreat any waste. This is common among older free zones and industrial estates in the South Asian region, although India’s new SEZs are trending toward offering tenants specialty waste treatment facilities. These SEZs charge tenants to treat their garment, leather, pharmaceutical, and other effluents at one common treatment facility within the zone. It is an attractive cost-saving feature for firms, which otherwise would have had to invest in their own costly facilities.

The lack of specialty effluent treatment options in the Bhairahawa SEZ will not likely decrease demand among companies that have already decided to locate within Nepal, because serviced industrial land is in short supply; however, the wastewater treatment facilities as currently

† Also known as standard design factories within Indian SEZs.
planned in the zone will also not make the SEZ stand out among free zone and SEZ options in the region. The IFC team, however, has recommended to the SEZ Project Office that the Birgunj SEZ should include some sort of specialty effluent treatment facilities. This would increase the zone’s marketability to pharmaceutical, leather, garment wet processing, and other firms with caustic effluent.

**Transportation.** The SEZ is conveniently located within 3 km of the Indian border, making it an ideal location for companies wanting to serve the northern Indian market, particularly those that source raw materials or intermediate goods from northern India or Nepal. This includes cement, garments, metal products, food processing, and other consumer goods. The zone is **not**, however, ideally located for companies that source raw materials and intermediate goods from multiple worldwide locations or that serve markets outside India, because transportation and logistics become prohibitively expensive.

Companies normally use the Port of Haldia in Kolkata to import materials and export manufactured goods to and from markets outside the region. Bhairahawa will not be as attractive a location for firms whose business models rely on such logistics. Similarly, firms manufacturing high-value goods, such as electronic components or pharmaceuticals, rely on access to international air cargo facilities. This is not an option in Bhairahawa, which has only basic airport facilities and a 1-km long runway that is currently incapable of handling cargo flights.

**SEZ Design Challenges**

The Bhairahawa SEZ will provide good facilities in a region that currently lacks any serviced industrial infrastructure. IFC identified some design elements of the SEZ that are outside the best practices now employed in new Indian, Malaysian, United Arab Emirates, and other regional free zones—although these will not likely impact investor demand for land in the SEZ. These challenges are indicative of the relative inexperience of the Ministry of Industry, Commerce, and Supplies in designing, tendering, and supervising construction of bonded SEZs—areas in which IFC may be able to offer future technical assistance to the Special Economic Zone Project Office or designated SEZ authority.

The SEZ master plan† is shown in annex 3, which highlights specific design elements.

*Vehicular traffic circulation and road design.* The SEZ’s status as a bonded customs area will impact the vehicular flow of traffic in and out of the zone. Customs inspection and truck parking areas will be situated to the left and right of the SEZ gate for inbound and outbound inspection of cargo. This is represented by areas A and B on the master plan drawing (annex 3).

The positioning of the customs inspection points necessitates inbound and outbound traffic circulation along the periphery road—shown in green in areas C and D on the master plan. This circulation pattern was not likely to have been envisioned by zone designers, because the periphery road is constructed at a narrower (7 m) width than the wider (9 m) “main” internal roads (area E) that run through the zone. This will have little negative impact on the attractiveness of the zone to potential tenants; however, the design overlooked the effect of customs inspection on traffic circulation and departs from best practice designs now seen in new SEZs in India and elsewhere in the world.

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* Discussion with Ms. Andrea Erdmann, Mr. Jagadiswar Shrestha, and Engineer Thata in the SEZ Project Office, October 16, 2007.
† Master plan obtained and used with permission of Mr. Jagadiswar Shrestha, project chief, Special Economic Zone Project, Nepal Ministry of Industry, Commerce and Supplies.
Pedestrian traffic circulation. Figure 4.6 illustrates the design of the vehicle (left) and passenger (right) gates leading into the Bhairahawa SEZ. The vehicle gate is under construction (see photograph in figure 4.6. A two-story guardhouse separates the two gates, and additional land must be acquired before construction of the pedestrian gate begins.

**Figure 4.6. Design of the SEZ Gate and SEZ Gate under Construction**

Pedestrian gate (at right, in the drawing) has no planned facilities for inspection of inbound and outbound pedestrians.

The bonded nature of an SEZ necessitates the inspection of all outbound vehicles and pedestrians for smuggled materials and products. This is standard procedure in many free zones throughout the world, and free zone designs typically incorporate infrastructure to facilitate this. In the case of the Bhairahawa SEZ, there are no guard facilities inside the SEZ gate to aid the inspection of outgoing workers. The current design of the guard post is sufficient as a security “watch tower,” but not appropriate for inspection of contraband items carried on persons or in trunks of passenger cars exiting the zone.

The SEZ will not provide intrazone worker transportation, a benefit that more and more large free zones in the region are offering. The Bhairahawa SEZ is small enough that workers can walk or ride bicycles to their work sites, but this passenger traffic will impede truck and automobile traffic in many cases. For much larger SEZs—such as that planned in Birgunj—the SEZ Project Office should consider designing worker transportation hubs and shuttle operations into the master plan design.

Inbound and outbound pedestrian worker traffic must necessarily cross all outbound truck traffic in the SEZ. This potential choke point is labeled as area F in the master plan drawing (annex 3) and is shown in figure 4.7). This does not allow for smooth outbound truck traffic circulation and is unsafe for the thousands of workers employed in the zone. Future SEZ designs should take such traffic flow considerations into account.
Pedestrian, bicycle, lorry, and automobile congestion is possible in the area in the lower right portion of the photograph.

*Passenger transportation staging area.* The SEZ currently has right of way access to 9 m of land on either side of the SEZ access road, shown in figure 4.8. Plans exist, however, to acquire an additional 4 m right of way to widen the road and create a passenger vehicle staging area outside the SEZ gate.

Land must be acquired to widen road and accommodate passenger drop-off and vehicular traffic outside the SEZ gate, which connects the SEZ to Siddharta Highway.
The problem with the current design is that buses, taxis, rickshaws, and other vehicles dropping off passengers will be required to do three-point turns in the middle of the road to turn around. (See area G on the master plan in annex 3.) This creates a dangerous situation for all vehicles and passengers and will most certainly impede the flow of traffic into and out of the SEZ. The IFC team thus recommends altering the design to create a passenger vehicle staging area with a traffic circle approximately 500 to 1,000 meters in front of the SEZ gate, with proper sidewalks on the south side of the road for workers to reach the pedestrian gate safely.

All facilities inside bonded area. An SEZ differs from a normal industrial estate in that the premises must be maintained as a secured duty-free bonded area. On a practical level, this means that all vehicles and persons must be inspected before leaving the zone. This is normally done at the zone gate by guards who examine the contents of both the bags and purses of persons and of trunks in all exiting automobiles. Sometimes inbound traffic is searched as well. Newer approaches to SEZ design are thus placing many administrative services outside the fenced bonded area of the zone. This cuts down on the number of visitors and their vehicles that must be searched on entry or exit. The Bhairahawa SEZ has not been designed in this manner, and the administration building and “service center” will be constructed entirely within the perimeter of the zone (area H in master plan shown in annex 3). Current best practices would suggest that future SEZs in Nepal be designed differently to inspect traffic more efficiently and cut down on potential smuggling of goods out of the SEZ.

Demand for Land in the Bhairahawa SEZ

The SEZ Project Office gave IFC a list of businesses that have expressed interest in locating in the Bhairahawa SEZ. The SEZ office considers these companies to be applicants and permitted the IFC team to contact the firms to understand more about their motivations for establishing operations in the SEZ. IFC contacted five of these firms (table 4.5).*

If investor interest is a gauge, the Bhairahawa SEZ will likely attract small and medium Nepalese firms interested in exporting textiles, plastics, and food to northern India. Nearly two years have passed, however, since some companies on the list expressed interest in the zone; many of these firms may have cancelled their investment plans (company no. 4 in table 4.6) or located elsewhere.

If Nepal’s SEZ bill is passed with a mandatory export requirement, some of the companies interested in the SEZ would not be able to locate there because their business models are set to produce predominantly for the Nepalese market. This was the case for companies nos. 2 and 14 (table 4.5). This highlights the serious need for development of serviced industrial land accessible to both local and foreign firms, regardless of export volume.

Construction of the Birgunj SEZ

IFC briefly examined the “conceptual plan” for the planned 500 gross ha† SEZ in Birgunj.‡ Plans lay the zone out in three noncontiguous areas on land owned by the Government of Nepal. One hundred gross hectares are planned as a garment processing zone, a decision made at the behest of the Nepal Garment Association, which has long supported creation of SEZs in Nepal.

* Names of companies have not been published to maintain the privacy of the businesses. The numbers, however, correspond to those in the “applicant” list furnished to IFC.
† The total land on the site, as opposed to “net” hectares, which is the amount of leasable space.
‡ Discussion with Engineer Thata and Mr. Jagadiswar Shrestha at SEZ Project Office, October 15, 2007.
### Table 4.5: Motivations of Firms that Have Expressed Interest in Bhairahawa SEZ

<table>
<thead>
<tr>
<th>No.</th>
<th>Industry sector</th>
<th>Country</th>
<th>Intended exports</th>
<th>Interest in the SEZ</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Motorbikes, toys</td>
<td>China</td>
<td>Did not reply to IFC</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Motorbikes⁴</td>
<td>Nepal-China joint venture</td>
<td>• Want to produce solely for the Nepalese market&lt;br&gt;• Would consider exporting to Indian market, but problems exist on entering that market&lt;br&gt;• 85% export requirement in SEZ would not suit their business model</td>
<td>• Want to import kits from China to assemble in Nepal&lt;br&gt;• Want to establish themselves in Nepalese market, as the Indians have&lt;br&gt;• Chinese partners recommended the SEZ, but Kathmandu Valley or location near Kasa border crossing more ideal than Bhairahawa; will not invest if poor security situation continues in Nepal.</td>
</tr>
<tr>
<td>3</td>
<td>Textiles: silk</td>
<td>Nepal</td>
<td>Did not reply to IFC</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Textiles: knitted fabric⁵</td>
<td>Nepal</td>
<td>100% exports</td>
<td>• Interested in SEZ, because no bank guarantees are required and electricity and water are provided&lt;br&gt;• Bhairahawa is convenient for exporting to India.&lt;br&gt;• Has cancelled investment plans, because SEZ is not yet constructed and no law has been passed</td>
</tr>
<tr>
<td>5</td>
<td>Crafts, carpets</td>
<td>Nepal</td>
<td>Did not reply to IFC</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Tea</td>
<td>Nepal</td>
<td>Did not reply to IFC</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Plastics</td>
<td>Nepal</td>
<td>Did not reply to IFC</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Plastic packaging material⁶</td>
<td>India</td>
<td>Nearly 100% exports, primarily to India</td>
<td>Interested in SEZ because:&lt;br&gt;• SEZ has access to Uttar Pradesh, Bihar, West Bengal, and Jharkhand with population of around 300 million.&lt;br&gt;• Low-cost electricity available&lt;br&gt;• Nearby availability of raw material from GAIL, Haldia, and Reliance.&lt;br&gt;• Free import of plastic waste from Europe and United States is not currently allowed in India, reducing cost of raw materials (which constitute 80% of total cost) by around 10%</td>
</tr>
<tr>
<td>9</td>
<td>Textiles: polyester thread</td>
<td>Nepal</td>
<td>Did not reply to IFC</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Textiles: polyester bags and materials</td>
<td>Nepal</td>
<td>Did not reply to IFC</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Food: ghee</td>
<td>Nepal</td>
<td>Did not reply to IFC</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Textiles: silk</td>
<td>Nepal</td>
<td>Did not reply to IFC</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Plastics⁷</td>
<td>Nepal</td>
<td>Export 100% goods to India</td>
<td>Interested in zone because of ease of exporting</td>
</tr>
<tr>
<td>14</td>
<td>Floriculture⁸</td>
<td>Nepal</td>
<td>• Primary market will be Nepal.&lt;br&gt;• Export 35 to 40% of production</td>
<td>Interested in SEZ because of sufficient labor, irrigation facilities, climate, and safety&lt;br&gt;• There is good demand in local area—and the rest of Nepal—for large-scale production of flowers and plants</td>
</tr>
</tbody>
</table>

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* a. IFC interview in person, October 16, 2007.<br> b. IFC interview by telephone, October 15, 2007.<br> c. E-mail reply to IFC request for information, October 22, 2007.<br> d. E-mail reply, October 16, 2007.<br> e. E-mail reply, October 17, 2007.
A prefeasibility study has been conducted for the SEZ, although no demand forecast, master plan, or phased development plan yet exists for the site. Nevertheless, the SEZ road and periphery fence are currently under construction at the site, and estimated development costs are Nrs 6 billion ($91,143,855). Discussions are under way with the Government of India to provide financing assistance for development of the SEZ, and the Government of India has recommended the Indian firm Infrastructure Leasing and Financial Services as a designer and zone developer.

Conclusions

Construction of special economic zones in Bhairahawa and Birgunj represent positive steps toward creating additional serviced industrial land for foreign and local investors in Nepal. If export requirements are kept in place, however, demand for space in SEZs will fall, because many companies that have expressed interest will not qualify as tenants under proposed SEZ legislation. The risk exists that SEZ industrial infrastructure will sit idle, while companies serving the local market are left without industrial infrastructure. This stymies both enterprise development and the creation of jobs.

IFC recognizes the relative inexperience of the Ministry of Industry, Commerce, and Supplies in SEZ design and development. The SEZ Project Office has thus far based its SEZ designs on models from India and Bangladesh, some of which depart from current best practices. Although IFC found some design challenges in the Bhairahawa SEZ, the zone’s relatively small size makes any resulting problems manageable. This might, however, not be the case for very large SEZs, such as the one planned in Birgunj. This is an area where IFC can provide much needed implementation assistance to the SEZ Project Office—or designated SEZ authority—in the following areas.

- Concept of phased design and development, based on market demand for industrial infrastructure, including design of specialty infrastructure, such as common chemical effluent treatment to attract niche industry sectors to a zone
- Conducting feasibility studies that incorporate analysis of market demand
- Conducting financial and economic analyses on potential SEZ projects to gauge internal and external rates of return and make informed decisions on whether to develop such projects
- Best practice in SEZ design and master planning
- Drafting tenders for SEZ development, and supervising international and local consultants and construction engineers
- Methods for marketing SEZs
- Training SEZ authority staff
- Best practice methods for operating SEZs
- Regulating private developers and operators of SEZs.

e. Demand for Special Economic Zone Land under the Three Scenarios

In July 2004 Cemeca Consultant Pvt. Ltd. conducted feasibility studies for the development of special economic zones in Birgunj, Bhairahawa, and other locations in Nepal for the Ministry of Industry, Commerce, and Supplies. The analyses delivered to the ministry, however, did not contain demand forecasts, normally considered a crucial element of SEZ feasibility studies.
Although detailed demand forecasts for Nepal’s special economic zones lie outside the scope of this report, the IFC team wanted to highlight the effects of the three scenarios presented in part 1 of this report. Policy decisions taken by the Government of Nepal and reflected in the draft SEZ law and regulations will have an impact on the types and numbers of firms that locate in Nepal’s SEZs. This has ramifications for the levels of domestic and foreign direct investment in Nepal, as well as employment generation. Because the government will operate the proposed SEZs in Bhairahawa and Birgunj, the number of potential tenants will also impact revenues to the government zone operator.

Scenarios

Part A of this report introduced three scenarios for crafting Nepal’s SEZ regime. Those scenarios differed in four major ways:

1. *The degree to which the private sector is allowed to develop and operate SEZs.* Private SEZs are developed with a greater understanding of the infrastructure needs of potential tenants and are more efficiently operated than government-run SEZs. All else being equal, a private SEZ can potentially attract more tenants.

2. *Tenant limitations based on exports.* SEZs that require firms to export any or all of their manufactures will attract fewer tenants than SEZs that do not place such restrictions on tenants. Zone operators will benefit from zones that are open to both exporters and non-exporters, because it will result in greater revenues to the government or private zone operator. Firms that sell domestically will benefit from first-class serviced industrial infrastructure, which is now currently lacking in Nepal.

3. *Types of incentives.* Tax incentives are important to investors, as explained in the next section of this report. The most important investment criteria, however, are security, access to markets, and land infrastructure. Tax incentives play the biggest role when they lower a company’s operating costs enough to tip the balance of investment in favor of one location over another. This might be salient for a firm that is choosing between locating in northern India or southern Nepal, for instance. The IFC team estimates that SEZs with tax incentives will be a factor in the investment decisions of 12 to 20 percent of potential export-oriented SEZ tenants.

4. *Zone services.* When bureaucratic services are streamlined and offered through a one-stop office within the zone, it lessens the cost of doing business for firms and heightens the attractiveness of the zone to potential tenants.

Demand under Three Scenarios

A special economic zone in Bhairahawa is under construction and potentially capable of opening by 2009, provided that the draft SEZ bill and regulations are passed. The IFC team created a forecast to demonstrate the potential demand for land inside the Bhairahawa SEZ under three scenar-
ios. These are estimations based on the trade and investment trends, benchmarking analysis, company interviews, and potential investor inquiries analyzed and presented in this report. These forecasts are illustrated in figure 4.9, which shows the estimated cumulative number of tenants in the Bhairahawa SEZ during 10 years. Estimates for planned SEZs in Birgunj and other sites would differ based on the attractiveness of their locations and other factors; however, the rough spread among demand in various scenarios would be similar.

**Figure 4.9: Cumulative Tenant Demand Estimates under Three Scenarios during 10 Years, Bhairahawa SEZ**

In the *conservative scenario*, the SEZ is only available to exporters and the ease of investing in Nepal remains largely unchanged from the present. Tax holidays are offered, as per the current draft law. The *progressive scenario* allows tenants to sell 50 percent of their goods in the local market, offers some incentives based on investment performance that are more or less as attractive as tax holidays, and offers a slightly better business environment. In the *base case scenario*, firms are allowed to sell 100 percent of their goods into the domestic market, and all bureaucratic services are offered through one-stop shops within the SEZ.

In figure 4.9 the differences between demand in the progressive and best case scenarios is largely explained by the presence of nonexporting companies located in the SEZ. The nearby Butwal ID receives approximately four inquiries a month from interested investors, despite the fact that the ID has reached its capacity. Serviced industrial infrastructure across southern Nepal is in short supply, and Bhairahawa and other SEZs could provide this much-needed catalyst for both domestic and export-oriented businesses.

What is uncertain is how much of the investment illustrated in figure 4.9 would have located in Nepal in the absence of the SEZ regime. The IFC team estimates that two-thirds of the exporting firms would not have located in Nepal were it not for the SEZ. This is likely the case for about half of the domestic-oriented firms as well. This estimate is justified by the fact that firms that have inquired into the availability of space in the Butwal ID and Bhairahawa SEZ have not found suitable locations elsewhere.
Investment, Employment, and Revenue under Three Scenarios

The three scenarios presented for Nepal’s SEZ legal regime have various ramifications on investment, employment, and annual revenues to the government or private sector zone operator. The IFC team estimated each in table 4.6.

Table 4.6: Investment, Employment, and Revenue of Bhairahawa SEZ: Three Scenarios

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Investment after 10 Years (Nrs)</th>
<th>Employment in year 10 (persons)</th>
<th>Annual revenue to zone operator in year 10 (Nrs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conservative case</td>
<td>427,869,000</td>
<td>9,100</td>
<td>4,550,000</td>
</tr>
<tr>
<td>Progressive case</td>
<td>625,347,000</td>
<td>13,300</td>
<td>6,650,000</td>
</tr>
<tr>
<td>Best case</td>
<td>883,947,897</td>
<td>20,500</td>
<td>10,250,000</td>
</tr>
</tbody>
</table>

Estimates in table 4.6 are based on the following assumptions by the IFC team:

- **Investment.** Nonexporting firms would invest an average of Nrs 9,403,641 ($142,856). This is based on the current average investment of firms in Nepal’s IDs. Exporting firms would invest an average of Nrs 32,913,000 ($500,000) each, based on typical investment patterns in Nepal and the region.

- **Employment.** Exporting firms would employ an average of 700 workers. Nonexporting firms would employ 300 workers. This is based on current employment patterns in Nepal based on IFC team interviews inside and outside of IDs.

- **Revenues to zone operators.** These are based on the assumption that exporters would demand an average of 7,000 sq m of land and nonexporters would demand 3,000 sq m of land in the SEZ. In addition, SEZ land lease tariffs would be set at Nrs 50 per square meter per year. This is significantly higher than current ID land tariffs, but still, appreciably lower than SEZ land rates in India and Bangladesh.

In the best case scenario, investment, employment generation, and revenues to the SEZ operator are more than twice those in the conservative scenario. A well-operated SEZ regime that provides access to serviced industrial infrastructure for the largest number of firms is the superior choice.

5. SEZ and the Role of Tax Incentives in Nepal

The IFC team mission of April 2007 highlighted that, in the area of taxation, issues of concern to the private sector include tax policy, tax administration, dispute resolution, subnational taxation, and tax incentives in special economic zones. The present mission was limited to the role of tax incentives to attract investment.

The Government of Nepal has already gone ahead with providing tax incentives in the draft SEZ law, which has gone through the GON Cabinet and was in the process of being tabled in the Parliament at the end of October 2007.

The draft SEZ law provides for a tax holiday of 100 percent for the first five years and 50 percent for another five years. Units located within SEZs do not have to pay a VAT, and there is a full customs duty exemption on raw materials and plant and machinery. These units are also exempt from local taxes. All benefits are withdrawn in case the unit does not export all its production.
Based on international best practices, the IFC team discourages the use of tax holidays as a means of attracting investment; however, several countries resort to using them to maintain tax rates on a par with neighboring countries. This section of the report will (a) examine the view of investors in Nepal on tax incentives, (b) reiterate the argument against tax incentives, (c) suggest ways the Government of Nepal may reduce the administrative and evasion implications that usually accompany tax holidays, and (d) suggest increasing transparency on the costs and benefits of tax incentives so that the effectiveness of this policy may be reviewed from time to time.

### a. Nepal’s Investors on Tax Incentives

To learn more about companies’ views on incentives, the IFC team conducted a mini-survey of 25 domestic and foreign businesses and joint ventures. Firms were asked to highlight their investment priorities when undertaking a site selection calculus for a new business or business expansion (see part B, sec. 4 [c]). Company owners and general managers were then asked the following question (annex 2, question 16):

*What importance do tax incentives play for your business?*

The question undoubtedly led many respondents to consider a factor they had not previously ranked as a priority. The question was asked in order to gauge the general outlook on tax incentives in the Nepalese business community and not to convince or dissuade respondents’ initial priority rankings.

Figure 5.1 illustrates the importance of incentives in investment decisions and company operations. IFC classified firms’ open-ended responses into the following five categories:

- **Crucial.** Tax incentives are the sole reason the company located in Nepal, and the company could not operate without them. This response, by one firm, was provided before the IFC team inquired about the firm’s investment site selection priorities.

- **Important.** Tax incentives were listed as one of the firms’ top five investment site selection priorities (annex 2, question 13).

- **Helpful.** When specifically asked about the role tax incentives play in their business (figure 5.1), respondents described the helpful effects they have on company operations. This includes offsetting the costly burdens of doing business, making it easier to deal with tax authorities, and putting Nepal on a par with incentive schemes granted by other South Asian countries.

- **Indicates strong government signal.** Some respondents indicated that incentives were not particularly helpful to their business operations, but rather, were an important signal that the government sends to potential investors. Tax incentives are a “sign” that the government values investment and is “open for business” in the eyes of these respondents.

- **Not helpful/not important.** When specifically asked about the role of incentives, firms stated that (a) incentives played no importance in their investment decisions or operations, (b) incentives were not helpful in ameliorating operational difficulties, or (c) reform, infrastructure development, and training—rather than incentives—should be the focus of the government. One fear about tax incentives is that uncompetitive companies with bad management could derive short-term benefits from tax breaks, but ultimately
fail in their business ventures. It would be better, some respondents said, to reform the overall business environment and provide a level playing field.

Figure 5.1: Importance of Tax Incentives for Business Operations of Nepalese Companies Surveyed, 2007

Most Desirable Incentives

Following up on the question on importance of tax incentives, the IFC team asked company respondents the following question:

What would be the most desirable type of government incentive for your business, if such were to exist?

Figure 5.2 presents company responses to this question, which are also discussed below.

Tax holidays. Eight respondents stated that corporate income tax holidays were the most desirable type of government incentive. Opinions on the usefulness of tax holidays differed from firm to firm, as did the rationale for preferring this type of incentive over others.

Those who advocate for tax holidays stated the following:

- Many firms doubt the government’s ability to reform the duty drawback and income tax collection systems and see tax holidays as more reliable and easier to administer.
- Tax holidays help new companies take risks and offset the cost of expensive capital equipment, which is necessary to being competitive in export markets.
Nepal requires tax holidays to offer a business environment and incentive package on a par with those of Bangladesh, Sri Lanka, China, and India—particularly India’s “Seven Sisters” Northeast region.

Several firms urged caution on tax holidays for the following reasons:

- There is general mistrust that the Government of Nepal would maintain a tax holiday scheme for long. When the government cancelled such incentives in the past, many companies who had constructed their business models around the tax holiday experienced significant disruptions in their operations.
- Tax holidays are an important, but not sufficient, condition for creation of a competitive business environment in Nepal and elsewhere. Tax holidays must be combined with a total government commitment to the health of industry, including real reforms in the areas of income tax collection, development of more land infrastructure, resumption of law and order, privatization of telecommunications, construction of additional power plants, and other important developments.
- A few firms thought that tax holidays help ameliorate the financial losses to businesses caused by corruption and extortion; therefore, in this case, the ultimate beneficiaries may not be the firms themselves.
- Businesses do play games with tax holidays, cautioned some firms. When the holiday expires, footloose industries shut down their business and move elsewhere under a separate corporate identity.
Export performance–based incentives. Tax holidays in SEZs that have an export requirement act as de facto export incentives themselves. The performance-based incentives described here, however, (a) are not tied to location in an SEZ or (b) are offered in SEZs without minimal export requirements. Seven interviewed firms stated that export performance–based incentives would be the most attractive for their businesses. Firms stated that they would be attracted to environments with the following:

- Subsidies on export revenue
- No tax or low tax, on revenues from exports
- Tax incentives linked to export performance, in combination with greater “export diplomacy” and promotion by the government.

Some firms, however, urged caution for the following reasons:

- Export performance–based incentives would not be attractive if administered by the Inland Revenue Department. The documentation and anticipated bribery required to receive such incentives would be costly, according to respondents. One business leader starkly stated, “People don’t want their taxes in corrupt hands!” If Inland Revenue were to administer such incentives, some firms would prefer straight tax holidays with minimal or no Inland Revenue interaction.
- Incentives based on profits from exports assume that a firm is making a profit, cautioned some companies. Many firms are not profitable, and, therefore, would not benefit from such schemes.

Alternatives to tax incentives. When questioned about the most desirable types of incentives, some respondents listed alternatives to standard income tax holidays or export-based incentives. Some companies suggested the following as attractive alternatives:

- Accelerated capital depreciation on equipment (especially beneficial to more established companies)
- No import tax on imported capital equipment
- Subsidized electricity
- Upgrades to infrastructure.

Conclusions

Tax incentives were not primary motivators for investment among most firms surveyed by the IFC team. They can be helpful tools, however, for offsetting costs associated with difficult investment climates, such as Nepal. Their perceived effectiveness, however, is directly linked to government reforms in areas such as taxation, land infrastructure, power supply, trade relations, and export promotion.

A number of survey respondents invested in Nepal when tax holidays were offered. One of those companies would not have invested in Nepal under current “no incentives” conditions. Lack of incentives may or may not have spurred two other firms to locate elsewhere, depending on the firms’ overall cost calculus at the time of investment.

Although unscientific, it could be assumed that about 12 to 20 percent of firms are sensitive or extremely sensitive to tax incentives, based on IFC Team surveys and anecdotal evidence sup-
plied by interviewed firms. Most in this category would not locate in Nepal under current conditions, a calculus based both on the lack of incentives and current investment climate. For companies in this group, tax holidays and export performance–based incentives have nearly equal hypothetical appeal—provided incentives are administered without the extortion and bribery.

**IFC Team Comments on the Observations Made by the Exporters**

- *The business community sees tax holidays as a means of compensating them for a poor business environment.*

  *IFC team:* From a public policy perspective, tax holidays are a very poor means of making up for an inadequate business environment. In general, in poor countries it worsens the problem, because the government loses revenue both through the businesses benefitting from the incentives and also through reduced compliance by existing taxpayers. These revenues could be used to invest in infrastructure in the first place. The argument that tax holidays could make some unviable projects become viable by compensating the business for other costs of operating in the country, while true, is a weak argument at best. The danger of such a strategy is that a business with low returns and one that is viable only because of the tax benefits could quickly become unviable with even cyclical economic downturns. It is not in the interest of public policy to support such precarious investments.

- *Tax holidays are easier to administer than performance-based incentives.*

  *IFC team:* The reality is that tax holidays are as administratively intensive as any other tax instrument. In fact, in the case of India, this is the most litigated section of the tax code. Businesses taking the benefit of tax holidays are required to continue to file tax returns, and these are subject to scrutiny just like any other taxpayer’s return. Issues regarding transfer pricing imply that businesses would continue to face intrusive tax inspections.

- *Nepal requires tax holidays because neighbors, such as India and Bangladesh, give them.*

  *IFC team:* This argument is quite strong, but needs to be nuanced. It is true that businesses who export would be outcompeted in the international market by those who operate in cheaper jurisdictions. To remain competitive, businesses would have to suffer lower margins if they choose to remain in a tax-disadvantaged area; however, this argument is valid only when everything else is the same. Taxes are only one of several factors that affect the returns of businesses, such as labor, cost of raw materials, infrastructure, etc. If everything else remains the same, a tax holiday might tip the balance in attracting the kind of investment that is highly price sensitive, such as exporters. As a tax holiday has a limited period of applicability, such an investment should also be mobile, that is, to be able to relocate to another low-taxed jurisdiction and survive. A good example of such a mobile and marginal investor is a textile exporter. It is mainly for a marginal investor that the tax incentive tips the balance in the decision of an investor from investing in that jurisdiction or not. The difficulty is that such marginal investments are relatively few, and in many cases, the investment would have come in anyway, even without the tax incentives. In any case, it has been argued that tax incentives exist that are better than tax holidays and would attract investment with less revenue cost, such as investment-linked incentives (performance-based incentives).
• After the duration of the tax holiday, “footloose” industries would close shop and either relocate or reorganize and try to claim the tax benefits again.

IFC team: This is indeed a problem with tax holidays, and revenue is lost in the process of attracting footloose investment that may not be the kind of investment that is the best for the country.

b. Review of the Evidence on Incentives

The IFC team in Nepal has made several observations based on evidence and experience of tax incentives around the world.*

• Experience and analysis show that tax incentives play a very small part in determining the investment decisions of either domestic or foreign investors. This fact was further substantiated by the survey IFC conducted of companies in Nepal specifically for this analysis. Investors do seek certainty on tax and other matters. In the case of Nepal, political stability, rule of law, and security play greater roles in determining investment decisions than the tax incentive regime.
• Because tax incentives create advantages for some firms, by definition they must also create disadvantages for others. The uneven playing field results in increasing demands for incentives in all sectors and for new incentives to replace old ones. The result is most commonly a web of incentives that are complex to understand for the investor and complex to administer by the government, and provide little real benefit.

Nonetheless, where a clear market failure (such as positive externalities or the provision of public goods) exists, tax incentives can prove a useful policy tool. Examples of positive externalities are investments in R&D, infrastructure, education, health, and so on, which generate social returns much greater than financial returns, because they benefit those far removed from the direct users. Because financial returns are low, these sectors are likely to experience underinvestment, even while society as a whole benefits from such investments. Similarly, investments that generate a lot of employment in a situation of high unemployment generate social returns that are much greater than financial returns. To be effective, however, the tax incentives must be carefully designed, well implemented, and robustly evaluated. The same applies to investments in public goods by the private sector; for example, a business that takes up maintenance of a public road to improve access to its own business benefits society much more greatly than the business benefits financially. The following highlights important considerations that government should make when evaluating implementation of various forms of tax incentives.

Tax holidays. Tax holidays are an especially ineffective form of tax incentive, because:

• They do not explicitly target capital investment; tax holidays are a blanket benefit given to investors and are not related to the amount of capital invested or even the growth in investment during the period of the tax holiday. These could be linked together, for example, through minimum capital investment requirements to get the benefit of the tax holiday.
• Firms have an incentive to close down and sell their businesses at the end of the tax holiday, only then to re-open as a “new” investment, thus gaining an indefinite tax holiday.

* This section draws heavily on Zee, Stotsky, and Ley (2002), Bolnick (2004), and Shah (1995).
With foreign direct investment operating under double taxation agreements, in the absence of tax sparing, tax holidays simply lead to a transfer of tax revenue from Nepal to the home country. (Note: tax sparing is apparently part of the bilateral tax agreement with South Korea and under discussion with India).

If tax holidays attract any investments, they tend to be “footloose” investments that move away as soon as the tax holiday ends.

Tax holidays threaten the existing tax base by allowing firms to funnel profits, via transfer pricing, from an existing profitable company through the “tax holiday” company and, therefore, avoid paying tax on either. Such a practice is likely to be especially prevalent in Nepal where many group companies have multiple operations.

**Performance-based incentives.** Investment allowances, investment tax credits, and accelerated depreciation, are all performance based and, therefore, superior instruments or “smart” incentives. Each of these tools targets the incentive specifically to the capital investment. As a result, the cost-benefit ratio (in terms of additional investment generated per unit of revenue lost) is high. Table 5.1 shows that the investment tax credit is the most cost-effective incentive to drive investment and long tax holidays are the least effective. In the case of Nepal, one of the most effective (and simple) changes would be to extend the loss carryforward provisions. This would allow firms to “use” the depreciation allowance from their capital investments more effectively.

**Table 5.1: Cost-Effectiveness of Tax Incentives under Four Scenarios**

<table>
<thead>
<tr>
<th>Scenarios</th>
<th>1 0% debt/ greenfield project</th>
<th>2 50% debt/ greenfield project</th>
<th>3 0% debt/ 100% plant &amp; equipment</th>
<th>4 0% debt/ 100% plant &amp; equipment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marginal effective tax rate for benchmark tax regime (percent)</td>
<td>57.0</td>
<td>52.6</td>
<td>59.0</td>
<td>56.0</td>
</tr>
<tr>
<td>1 Benchmark + tax rate = 30%</td>
<td>1.01</td>
<td>1.00</td>
<td>1.02</td>
<td>0.98</td>
</tr>
<tr>
<td>2 Benchmark + tax rate = 15%</td>
<td>0.99</td>
<td>0.92</td>
<td>0.98</td>
<td>0.90</td>
</tr>
<tr>
<td>3 Benchmark + tax holiday of 5 years</td>
<td>1.07</td>
<td>1.12</td>
<td>1.05</td>
<td>1.07</td>
</tr>
<tr>
<td>4 Benchmark + tax holiday of 10 years</td>
<td>0.96</td>
<td>0.88</td>
<td>0.95</td>
<td>0.85</td>
</tr>
<tr>
<td>5 Benchmark + double declining balance</td>
<td>1.03</td>
<td>1.30</td>
<td>1.03</td>
<td>1.21</td>
</tr>
<tr>
<td>6 Benchmark + 20% ITC (no adjustment to basis)</td>
<td>1.43</td>
<td>1.72</td>
<td>1.51</td>
<td>1.81</td>
</tr>
<tr>
<td>7 Benchmark + 50% IA (adjustment to basis)</td>
<td>1.06</td>
<td>1.30</td>
<td>1.04</td>
<td>1.21</td>
</tr>
<tr>
<td>8 Benchmark + 50% IA (no adjustment to basis)</td>
<td>1.05</td>
<td>1.07</td>
<td>1.03</td>
<td>0.96</td>
</tr>
<tr>
<td>9 Benchmark + dividend tax = 0%</td>
<td>1.02</td>
<td>1.07</td>
<td>1.02</td>
<td>1.05</td>
</tr>
<tr>
<td>10 Benchmark + capital gains tax = 0%</td>
<td>1.00</td>
<td>0.81</td>
<td>1.01</td>
<td>0.84</td>
</tr>
<tr>
<td>11 Benchmark + import duty on capital goods = 0%</td>
<td>1.03</td>
<td>1.22</td>
<td>1.03</td>
<td>1.21</td>
</tr>
</tbody>
</table>


- Relative cost-effectiveness (RCE) = percentage decline in marginal effective tax rate/percentage decline in present value tax. When RCE > 1, the incentive effect (percent reduction in marginal effective tax rate) exceeds the direct revenue effect (percent revenue foregone in present value terms).
- Greenfield project = 10% land, 40% building, 40% plant and equipment, and 10% vehicles.
- Benchmark case: 35% company tax and capital gains tax; declining balance depreciation at rates of 5%, 15%, and 25% for buildings, plant and equipment, and vehicles, respectively; 15% dividend withholding tax; unlimited loss carryforward, but no loss offset; 10% inflation; 25% nominal interest rate (to accentuate debt effect) without indexing; 10% duty on imported capital goods; and sale of company after 10 years.
- Capital gains rate also adjusted to equal the tax rate.
- ITC = investment tax credit
- IA = initial allowance.
Export-based incentives are targeted to those who primarily export their production. As discussed above, an exporter is especially price sensitive and, hence, any reduction in cost of business, including taxes, could be passed on in the form of lower prices to remain competitive in the international market. Taxes, however, are only one of several “costs” for the business, and it is not clear in all cases that the cost in terms of lost revenue is made up by benefits that the investment brings with it.

Regional policy. Tax incentives to promote investment in specific geographic areas can also be problematic. Nepal’s Income Tax Act, 2057 (2000) lowers the income tax rate in certain disadvantaged geographic areas. Investing firms are very astute at taking advantage of such schemes by, for example, registering the company in a disadvantaged area (to take advantage of tax incentives), only to undertake the majority of operations in a high-income area; care must be taken to guard against this. Promoting regional development can often be better undertaken by addressing the investment climate constraints in the region itself (for example, by improving infrastructure and tackling administrative barriers, subnational taxation, and regulation faced by investors). No evidence exists in India that tax holidays for industrially backward areas, such as the North East, have resulted in additional investments into that region. It has been found, however, that tax holidays for investment in industrially backward states, such as Himachal Pradesh, have only resulted in shifting of investments meant for the neighboring state of Punjab. Furthermore, the investments into Himachal Pradesh have not been made in the industrially backward hilly regions of the state, but on the plains, areas that did not face any disadvantage for investments in the first place.

c. Managing the Negative Fallout of Having Tax Holidays in SEZs

As mentioned above, tax holidays create an uneven playing field and as a result give opportunities for rent seeking. Instances of corruption in allocating limited space in industrial estates to business are due to the limited availability of infrastructure that is common in Nepal. With tax benefits thrown in, as is the case with SEZs, this problem will likely be exacerbated.

Where tax holidays do exist, the IFC team recommends several policies to mitigate the problems associated with tax holidays. These are discussed below.

Policy that Tackles Transfer of Profits from Taxed to Untaxed Entities

The benefit of such a policy is to minimize the risk of diversion of profits from taxed units to untaxed units. This is a serious problem in many countries, and the IFC team has documented instances where this has happened within the exporting community in India (James 2007).

Transfer pricing methods. Such diversion of profit could occur in several ways:

- By borrowing at higher-than-market rates from related entities.

In this method, a unit outside the SEZ borrows money at market rates for business purposes and lends to a unit inside the SEZ at lower-than-market rates, hence, incurring a loss on that account. This loss reduces its taxable profit. The unit within the SEZ, however, gets finance at lower-than-market rates and, hence, increases its profits, which are not taxed anyway because they are generated within the SEZ. In this manner, profit escapes taxation and the loss for the unit is only notional, because its related firm within the SEZ has higher profits and overall the profit remains the same, even while the firm incurs less tax.
• **By sourcing inputs from related parties at higher-than-market rates.**

In the same manner, units outside the SEZ could source inputs, such as raw material to the units within the SEZ, at lower-than-market rates. This reduces profits of the unit outside the SEZ and consequently the taxes owed. The profits are transferred to the SEZ unit, which is not taxed at all.

• **Through sales at higher-than-market rates between a unit inside the SEZ to one outside it.**

Production by a unit inside an SEZ could be sold to a unit outside an SEZ at higher-than-market prices. This has the effect of raising profits of units inside SEZs at the expense of those outside the SEZ. This is not an issue if all sales are export sales, as the tax benefit is to a unit outside the country; however, even if some of the sales can be local sales, this is a potential issue in undermining the tax base.

• **Through billing sales for the unit with the tax holiday, while billing inputs to the unit outside the tax holiday.**

A business that has units within the SEZ and another outside the SEZ could bill sales of the unit outside the SEZ illegally to the unit within the SEZ, lowering the profit of the former, which is taxable.

• **By diverting profit from unrelated parties for a fee.**

All the methods described above are illegal and generally easy to carry out between related parties; however, these could also be carried out between parties unrelated to each other as long the spoils of the evasion are shared. Such cases are very difficult to detect as the tax administration must look at all transactions with entities with business connections, which includes borrowers, lenders, suppliers, and buyers. Furthermore, the tax administration needs to have market information to be able to make a prima facie case of transfer pricing.

• **By creating a legal entity outside the SEZ, which contracts out its sales to a unit within the SEZ tax holiday for a fee.**

This reduces potential tax revenue by diverting economic activity to the tax-free area. As long as the unit within the SEZ has spare capacity, this would create a potential loss of tax revenue without new economic activity.

**Helping the tax administration tackle transfer pricing.** As described above, tackling this issue is extremely difficult for any tax administration. The following methods provide the tax administration with additional information on tackling such cases better when they arise.

• All SEZ tenants must file income tax returns. If the SEZ tenant is part of another taxed entity, it must file separate financial statements of its activities along with the tax return.
• All SEZ tenants must reveal in their tax return the units and/or firms that are owned by related individuals or related businesses.
• Transfer pricing compliance requirements for international firms must be imposed for such related businesses.
• Audit strategy identifies cases that report “higher than usual” profits for units within SEZs and “lower than usual” profits for related units outside SEZs. It is also possible that profit diversion is sold for a fee to unrelated parties, but this should be reflected as “higher than usual” profits for units within the SEZs. There is no foolproof method to identify all cases, but such unusual profit figures could act as audit triggers.

**Policy that Tackles the Duration of the Tax Holidays**

Tax holidays create a community of businesses that depend on them and lobby for their continuance, even after using up the benefits for the initial period they were granted. It has been the experience in many countries that tax holidays tend to remain in the statute books well after the period for which they were originally intended and well after the benefit from such a policy no longer exists. Furthermore, it has been the case that businesses that have claimed the tax holiday for the eligible number of years reorganize themselves and resurface with another name in another place and continue to avail of benefits. In the light of this, tax holidays create many opportunities for leakage.

It is recommended that the current draft SEZ law provide a date after which no industry would be eligible for any tax holiday benefits. This ensures that the risks of misuse of tax holiday provisions are minimized.

**Controlling the Reorganization of Industries to Claim Benefits of Tax Holidays**

As mentioned above, firms are strongly motivated to reorganize themselves to extend their claim of tax benefits. This, however, presents another potentially severe problem for the Inland Revenue Department in the case of firms who participate initially in the SEZ scheme. The goal of the SEZ policy is to attract new investment; however, existing investment outside the SEZs could relocate into the SEZ, controverting the intended goal and adding the risk of reducing the existing tax base. It is necessary to mitigate such a risk; benefits of both will attract only genuine and new investment and preserve the existing tax base.

It is recommended that the process of clearing initial investment into the SEZ be tightly controlled and strict information requirements be imposed on firms moving into the SEZ with their existing and related businesses. Such information requirements include complete financial statements of related businesses. This ensures that audits can track activities that deplete investment in one unit with corresponding increases in another; unusual depletion of capital stock would then trigger an audit. This, however, does not solve the problem of units outside the SEZ licensing their production out to firms inside SEZs, which is legal. Such possibilities are reduced when adequate demand exists for the good produced so that businesses do not find it beneficial to produce below capacity.

**d. Increasing Transparency on the Costs and Benefits of Tax Incentives**

The current draft SEZ law includes tax incentives with costs that can be measured relatively easily and benefits that are uncertain (box 5.1). It would greatly benefit policy makers to inform the public and legislatures of these costs and benefits so that these incentives may be re-evaluated from time to time. Tax expenditure statements are international best practice, greatly increase transparency, and raise the level of debate on the relevance of these incentives.
Box 5.1: The Effectiveness of Tax Incentives in Attracting Investment

Several countries have used tax incentives in the hope of attracting investment. The results have shown that, even when they appear to have worked, they do so only when accompanied by other factors, such as a stable macro economy, tight fiscal and monetary policy, and proactive government that went out of its way to woo investors.

In fact, several countries have stopped giving tax holidays and replaced them with a uniform regime with low tax rates and highly selective and limited tax incentives:

- South Africa replaced its tax holidays with duty-free imports, higher capital allowances, zero rating of VAT for exports, etc.
- In 1997 Uganda replaced its tax holidays with a lower uniform corporate tax rate and still attracted large increases in foreign investment.
- In 1984 Indonesia lowered the corporate tax rate from 45 to 35 percent and removed all selective tax incentives, such as tax holidays, preferential tax rates, and accelerated depreciation; despite this, foreign direct investment went up many times in the next decade.
- In 2005, Egypt replaced all its tax incentives and lowered the tax on profit to a uniform rate of 20 percent; despite this change, tax revenues actually increased from 4 to 7 percent of gross domestic product in one year.

Tax incentives have worked, but only when the broad macro economy provided a catalyst. Ireland has provided tax incentives since 1959, which has included tax holidays and entirely tax-free export profits. This did not do much for investment growth, so in 1981 the tax holiday was replaced by a uniform but very low tax rate of 10 percent and was combined with major reforms, such as a tight monetary and fiscal policy. In the case of Costa Rica, export promotion programs, which included EPZs and investment incentives, failed to benefit the country until the mid-1980s. At that time, exports rose rapidly and the country’s economy was stabilized. When the government devalued the currency, the highly bureaucratic EPZ laws were relaxed.

Furthermore, even if tax incentives may have been successful in attracting foreign investment, it has not been without costs that might actually have been more than the benefits. Malaysia, which used tax holidays and EPZs with zero import duties and subsidized infrastructure since 1958, did attract large amounts of investment; however, according to the World Investment Report 2002: Transnational Corporations and Export Competitiveness (UNCTAD 2002), the foregone revenue was as high as 1.7 percent of gross domestic product and some of the incentives were overly generous.

Source: Bolnick (2004)

The current draft law may include a provision placing the benefits and costs of the tax incentives before the legislature on a yearly basis. This would best be possible with a yearly tax expenditure statement that includes the incentives accorded under the draft SEZ law and those offered in other tax laws.

e. Conclusion

Nepal’s policy of giving tax holidays to units within SEZs results in risks that may have implications for the investment climate and overall compliance. The policy also creates incentives for lobbying and rent seeking.Fixing the problems associated with tax holidays is very difficult and can only be tackled through a strong tax administration. Given that firms in Nepal highly distrust the tax authorities, plugging the potential leakage of tax revenue using a set of policies that are administration intensive is not likely to be popular. Increasing transparency of the costs and benefits of tax incentives would help in the long run in framing future policy. The goal would be to
provide to the entire country the same level of benefits that SEZs provide to the limited number of units located within them. This would create a level playing field to all businesses throughout the country.

6. Assessment of Legal Framework to Attract Investment to SEZs in Nepal and Characteristics of Good SEZ Legislation

As is clear in preceding sections, a special economic zone is a designated area in which legislation is applied that differs in some respect from laws and regulations applied outside the zone. Although the legislation specifically adopted for SEZs diverts from and replaces general business legislation in some respects, the general business legislation is still available to apply in areas in which the special SEZ regime is silent.

This section reviews the legal framework for doing business in special economic zones in Nepal. This includes the rules specifically applied in SEZs only, as well as the relevant rules of the general business legislation that remain applicable in SEZs. This report focuses on only the most relevant legislation and should not be construed as an in-depth legal review of all applicable legislation.

The review of the latest draft SEZ law* is based on earlier reviews undertaken by FIAS and the Nepal: Mini-Diagnostic of the Investment Climate, 2007 (FIAS-SEDF 2007), the limited comments of September 26, 2006, and an FIAS-SEDF review in 2006. This assessment is followed by a review of the most relevant general business legislation that remains applicable in special economic zones. Furthermore, this section provides the principles of good SEZ legislation with best practice examples from the region.

a. The SEZ Bill

The bill for the Special Economic Zone Act reviewed by the IFC team is the version submitted by the GON to the World Bank Office in Kathmandu in November 2007. The exact date and version of the bill could not be verified. The English translation of the bill is in some parts ambiguous and may have caused misinterpretation.

The following boldfaced statements comprise the main points that resulted from the IFC team review of the bill:

- The bill contains improvements in scope and concept, but is still generally export-focused without reflecting new developments in the area of SEZs.

* The draft SEZ law was titled “Special Economic Act, 2064 (2006).”
According to the bill, a special regime shall be applicable in areas designated by the government on recommendation from the board of the authority in charge of special economic zones in this case the SEZ Board.

A positive list of industries in an SEZ shall be prepared and regularly reviewed by the SEZ Board. The bill mentions a number of industries and types of businesses that must be on the list: manufacturing, tourism and entertainment, information technology, agriculture, mines and forest products, and export-oriented businesses; however, businesses not on the list can be licensed if they are environmentally and economically appropriate as well as export oriented.

The bill is open to any kind of business being established in an SEZ as long as it is prescribed by the GON; however, it describes three basic types of activities within an SEZ: EPZs targeting export-oriented industries; special business zones targeting storage; classification, packaging, and assembling activities of imported or domestic goods with the intention to export value added products; and tourism or entertainment zones developed for the establishment of tourism and entertainment-related industries.

Assessment of these provisions. The scope and concept of the SEZ regime propagated by the SEZ bill is too narrow:

First, it is a rather restrictive approach to creating a positive list of industries whose establishment is allowed in an SEZ. A better practice would be to have a narrow negative list with the few industries or activities whose establishment is prohibited in an SEZ, so that any activity not on the list can be executed in an SEZ. In the current form, however, the positive list of the SEZ bill covers most activities and can be managed in an efficient and flexible manner. The GON can add activities to the positive list in the rules or issue licenses for activities not on the list as suits it, without changing the law.

Second, the wording as well as the spirit of the law emphasizes the export orientation of the SEZs. The export orientation is present throughout the SEZ bill: each of the three types of SEZs and any activity added at a later stage has an export requirement. The licensing decision includes the export requirement as well as the information requirements toward the SEZ Board. In addition, the fines are designed to ensure fulfillment of the export requirement.

- High export requirements do not reflect good international practice.

According to the bill, at least 85 percent of all services and goods produced by a license holder must be exported, except for tourism and entertainment businesses. Tourism and entertainment businesses will have different export requirements provided in secondary regulation. The export orientation is emphasized throughout the SEZ bill, including regular reporting requirements, heavy “appropriate” fines, and withdrawal of the license in case of failure to export less than the 85 percent threshold. In addition, any granted tax incentives must be paid back if the export requirements are not met in the respective year. Information on products and services provided for the domestic market must be submitted to the SEZ Board.

Assessment of these provisions. It is understood that the government reduced the export requirement from 95 percent in the first draft laws to 85 percent in the SEZ bill. This is an improvement; however, it is still very high and does not reflect good international practice or the overall trend in countries, such as India and Bangladesh, to reduce export requirements further in SEZs. The placement of export requirements in the law is largely driven by a desire to limit government spending on tax incentives to exporters, while not disadvantaging those who sell solely into the
domestic market. With the current shortage of serviced industrial land in Nepal, however, export requirements in SEZs deny companies access to needed infrastructure—one of the primary motivators for investment. Details on the practice can be found in part B, sec. 4 (c), including figure 4.5.

- **Private sector involvement in all stages of an SEZ is allowed; details must be addressed in secondary legislation.**

According to the bill, private businesses can develop SEZs as per provisions of the existing law. This includes development of infrastructure as well as management and operation of SEZs.13 The Private Investment in the Development and Operation of the Public Infrastructure Act, 2063 (2006) provides for participation of the private sector in development of such business-related infrastructure under a different model of public-private partnership. Private enterprises are excluded from providing original public services, such as registration, revenue collections, etc. Maximum validity of the license is 30 years with the possibility of extensions for five years.14 The bill is not clear on whether only a one-time or several consecutive extensions are possible.

*Assessment of these provisions.* Private businesses can develop, construct, manage, and operate SEZs according to the SEZ bill and the Private Investment in the Development and Operation of Public Infrastructure Act.15 Private contractors are only prohibited from providing public services. It is a vital provision, allowing not only the GON, but also private developers and management companies, to develop and operate SEZs. In this way, the best services can be contracted and market forces used for successful implementation of the draft SEZ law.

Secondary legislation must add the regulatory framework for private participation in development and operation of SEZs.

- **The institutional setup includes the basic rules, but details must be addressed in secondary regulation.**

According to the bill, an autonomous regulatory authority for special economic zones is the SEZB. It is located in Kathmandu and can establish branches.16 The SEZB is in charge of constructing SEZs, monitors and regulates the license holders, and provides services. It has the autonomy to sign contracts under its own name.17

The bill provides a long list of rights and obligations for the SEZB.18 The main items on the list are formulating technical standards for establishment of SEZs; setting rents and fees; managing services, such as banks, post offices, and health and entertainment places; and providing certificates of export, import, approvals, and certificates of origin. The SEZB is also in charge of issuing work permits to foreign workers.19 The SEZB has the right and duty to inspect and monitor the license holders.20

The Board of Directors of the SEZB has five members: two representatives from the Ministry of Industry, Commerce, and Supply, the president of the Chamber of Commerce and Industry; and two additional members appointed by the GON, of which one is appointed as chairperson.21 Employees of the SEZB appear to be public officials, and salaries are determined by the Board of Directors.22

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* Nepal follows a lunar calendar. In this report, the lunar year will be followed by the Gregorian calendar year in parentheses.
Assessment of these provisions. The SEZB’s autonomy and ability to sign contracts in its own name are welcomed and according to best practice. The broad scope of its responsibilities, functions, and powers provides the prerequisites for making the SEZB an efficient regulatory and managing authority of SEZs. This includes the important function of setting up and acting as a one-stop shop for import government services.

Many of the issues addressed in the SEZ bill would need to be specified and fleshed out in secondary legislation. These issues include, for example, actual functioning as a one-stop shop, interaction between the SEZB and line ministries and authorities in charge of issuing certificates and clearances to be included in the one-stop shop, standards to set rents and fees, budgetary rules for the revenues generated by the services, standards and rules for developing an SEZ, etc.

Even if secondary legislation will add specifics and details to the general provisions of the SEZ bill, however, the draft law has one shortcoming that should be addressed: the Board of Directors of the SEZB does not have sufficient private sector participation. All but one of the members are public officials and appointed by the GON, and the one private sector representative is from the semi-official Chamber of Commerce and Industry. The Board of Directors should include the same number of members from the public and private sectors, plus a chairperson from the public sector.

- The SEZ bill includes basic rules on licensing of businesses to be established in an SEZ and a one-stop shop for administrative services.

According to the bill, investors need a license to operate in a designated SEZ. The board of the SEZ authority issues the license within 30 days for a fee. If more than one application for establishing a particular type of industry in the SEZ is submitted and if there are constraints on space, the decision criteria are higher investment, higher exports, employment generation, and use of raw materials of Nepalese origin.

The license must be followed by an agreement between the license holder and the board, including the main obligations of the business: land allocated, lease or rent to be paid, establishment and operation date, quantity of exports and overall production, and any other issue.

The board can cancel a license for reasons prescribed in the bill and includes a failure to fulfill the export requirements. An appeal to the Appellate Court is possible against the decision to withdraw a license.

License holders are required to submit annual reports to the SEZB, including export data, income, and expenditures.

Assessment of these provisions. It is common practice to require a license for operating in an SEZ. A few details are included in the bill; however, the bill does not set requirements, decision criteria, or procedural rules for licensing. It is regular practice that SEZ entrants must conclude an agreement with the operator on basic rights and obligations to create a legal basis for the relationship between the regulator and the business.

The one-stop shop concept is mentioned in the SEZ bill, although it remains vague and does not provide any specifics on how this concept shall work in practice. It is preferable to have more concrete description in the draft law of this crucial idea; however, it is also workable to leave the entire implementation of the concept to secondary legislation. The GON should be aware of the risk that the necessary cooperation with other line ministries and authorities will be more difficult.
if the draft law does not provide any guidance on its implementation, the rights and obligations of involved authorities, and the budgetary implications.

- **The bill contains many tax incentives and exemptions, whose effect on additional investment and employment is questionable.**

According to the bill, several tax incentives are provided for businesses operating in an SEZ. For details and an assessment, please see part B, sec. 5.

- **Investors’ guarantees are provided, but important guarantees are missing.**

The bill provides guarantees of no expropriation, the right to repatriate profits for foreign investors, the right to open foreign exchange accounts, the right to obtain six-month visas for potential foreign investors and a residence permit for an investor and dependents if more than $10 million is invested. The granted tax incentives are legally guaranteed. Foreign workers are allowed to repatriate up to 60 percent of their income.

Assessment of these provisions. The bill contains important guarantees for investors; however, it lacks an equal treatment clause and a nondiscrimination guarantee. Also, a repatriation guarantee for 100 percent of profits and salaries of foreign investors and foreign employees is standard. The current limitation on the amount invested and 60 percent of the salary is not very attractive to foreign investors and highly skilled foreign employees.

- **Preferential labor regulations are welcomed; however, the ability to implement them remains to be seen.**

According to the bill, work permits for foreign workers with a duration of up to five (for regular workers) to seven (for special skilled technical workers) years can be obtained from the SEZB, if the business can prove that no suitable domestic worker is available. Exceptions to the time limits are possible for workers at the management level and for those with skills in modern technologies.

Minimum wage and labor conditions of workers in the SEZ shall be set by the SEZB. According to the bill, minimum wage and labor conditions cannot be lower than the wage determined by the GON on the recommendation of the Minimum Wage Determination Committee under the Labour Act, 1993. In addition, the freedom of employment contracts is established, allowing employers and employees the ability to set up their relationships under contracts, subject to compliance with the minimum requirement prescribed by the SEZB; however, in reading secs. 36 and 37, the team understands that sec. 37 does not mean complete freedom of contract. Rather, it is limited by the standard fixed by the board (but not by provisions of other general labor legislation, such as the Labour Act); therefore, no employment contract can be made in contravention with the minimum standard fixed by the SEZB.

A vague formulation appears to prohibit strikes in SEZs.

Assessment of these provisions. The possibility of obtaining work permits for foreign workers in SEZs is welcomed and should have a positive impact, as long as the procedure is transparent, streamlined, and efficient.

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* This should also be understood in light of sec. 35 (5) of the bill, which requires the license holder to substitute the foreign worker or employee by a Nepalese one.
Setting labor conditions and minimum wages for SEZs is also welcomed and can lead to more flexible labor regulations. The same is true for the possibility of minimum wage setting in SEZs.

Nepal ratified the International Labor Organization Convention No. 98 (Right to Organize and Collective Bargaining Convention, 1949) in 1996; hence, a prohibition of strikes may violate the International Labor Organization Convention No. 98.

- **Secondary legislation will play an important role in implementation of the bill.**

According to the bill, the GON will adopt necessary rules for implementing the bill⁴¹ and the SEZB has the power to adopt implementing directives.⁴²

Assessing the provisions. The regulations to the SEZ Act will be a vital instrument for providing an SEZ regime that attracts investment and generates employment. The bill includes many open provisions, which can be interpreted and filled by regulations in different ways. The regulations can make the SEZ regime more rigid or open. It is important that the regulations are perceived as an instrument for interpreting the provisions of the bill in the most open and liberal manner to improve the attractiveness of SEZs in Nepal.

### b. The General Business Legislation

The SEZ bill will provide a special legal framework for companies operating in and out of an SEZ; however, it is important to understand that this special legal framework does not establish comprehensive business legislation for SEZs. Rather, it addresses some specific points of the business climate, while general business legislation is applicable in areas not covered by the SEZ bill. It is important, therefore, to obtain an overview of the general business legislation relevant for companies that remains applicable in SEZ despite the new SEZ bill. The following section describes and assesses the relevant general business legislation of Nepal.

**Constitution.** The Interim Constitution of Nepal (2063) was adopted in 2007 replacing the Constitution (2047) of 1990. The Interim Constitution contains certain basic guarantees and rights for businesses that are also relevant to the economy, but it also includes broad rights of the state to interfere in businesses and allows discrimination against foreign businesses.

Fundamental economic objectives of the state include “giving preferential treatment and encouragement to national enterprises, both private and public.”⁴³ At the same time, it is the State’s objective “to pursue a policy of taking measures necessary for the attraction of foreign capital and technology.”⁴⁴

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**Summary**

The analysis of general business legislation shows that most of the business laws do not by themselves pose major problems. The Industrial Enterprises Act or the Foreign Investment Act can be improved, but both acts are not considered stumbling blocks. At the same time, the World Bank’s *Doing Business 2008* report ranked Nepal performance very low (111 of 175); many indicators were the lowest in the region (annex 6). It appears that implementation, not the legislation itself, more often causes an impediment to investors.

The only obvious legislative issue is the tedious and patronizing Labour Act. Yet, the SEZ bill does address this problem by allowing a labor regime in SEZs to deviate from the provisions of the Labour Act.
The Interim Constitution guarantees every individual freedom to practice any profession or to carry out any occupation, industry, or trade under certain conditions. The state may restrict this freedom by imposing rules to prevent acts contrary to public health or morality; confer on the state the exclusive right to undertake specified industries, businesses, or services; or impose any condition or qualification for carrying on any industry, trade, profession, or occupation.

All citizens have the right to property, including the right to acquire, own, sell, and otherwise dispose of property; however, this is a right of citizens and does not include foreigners or foreign-owned companies. The Lands Acquisition Act, 2034 (1978) deals with compensation matters arising from acquisition of private land for any public cause.

Every citizen has the right to establish and join unions and associations. Every citizen has the right to employment, social security, and a proper work practice.

Companies Act, 2063 (2006). Company legislation was overhauled in 2006 and is a sufficient tool for doing business. Every company, including foreign companies, must be registered with the Office of Company Registrar before operation. This office should register domestic companies within 15 days from the date of application and foreign companies within 30 days. In fact, it takes fewer than the stated days to register a company (about four days for a nonforeign company). This is more or less the average in the South Asia region. The act includes appropriate rules on company registration, company documents, shareholder protection, corporate governance, record keeping, and audits.

Licensing. Existing Nepalese laws do not require a general license, only sector-specific licenses, such as licenses, approvals, and/or permits for undertaking banking transactions, insurance businesses, tourism, securities transactions, etc.

Similarly, the municipal authorities (local bodies) do not issue licenses for any business under the Local Self-Governance Act, 2055 (1998). They only impose taxes on business entities as specified in the act; however, business entities are required to register with the concerned local body for the purpose of paying tax.

Likewise, the approval from the concerned village development committee is required for the construction work; however, such a license is not required for undertaking construction work that is approved by the Government of Nepal or district development committee.

Foreign investment law. Nepal’s foreign direct investment law is the Foreign Investment and Technology Transfer Act of 1992, amended in 1996, 2000, and 2005. The scope of the law is limited to foreign investors and investments, and the law includes provisions on foreign investor entry and guarantees. On the positive side, the law provides certain protections for foreign investors against undue state interference. On the negative side, it establishes a very bureaucratic and discretionary entry procedure for foreign investors.

FITTA prohibits foreign investment in a list of certain industries. Foreigners are allowed to invest in all legal activities not mentioned on the list. Part A of the list (e.g., national security, cottage industries, and real estate businesses) is issued by parliamentary decision (i.e., can be altered by parliamentary enactment only), and part B of the list (e.g., retail business, small tourist-related activities, and consultancy services) is issued by the GON through gazette notification. An amendment made in 2005 allowed foreign investment even in retail businesses that have a chain of businesses in more than two countries.
Foreign investments and agreements on technology transfers from abroad must be approved by the GON (Department of Industries).\textsuperscript{56} If the proposed amount of investment is more than Nrs 100 million, the Industrial Promotion Board decides on the approval. The Department of Industries is also in charge of facilitating foreign investment. Obtaining applications for work permits, visas, and investment-related foreign exchange control approvals from the concerned regulator under the specific act is required.

A wide range of documents must be submitted to obtain an investment approval. The criteria for the decision are not stipulated, and the decision is issued without explanation or reasons within 30 days, according to the law.\textsuperscript{57}

FITTA guarantees repatriation of equity investment, profits, and dividends made by the foreign investment, as well as principal and interest paid on a foreign loan.\textsuperscript{58}

Several essential state guarantees usually found in investment laws are missing in FITTA. For example, the law does not guarantee the principle of equal treatment of foreign and domestic investors, and in some instances, domestic investors enjoy preferential treatment over foreign investors (e.g., duration of build-operate-transfer schemes for electricity projects and higher fees for trademark registration). Although FITTA does not include provisions on protection against expropriation, such a guarantee can be found in the Industrial Enterprise Act.\textsuperscript{59}

Foreign investors can obtain a nontourist visa to explore an investment opportunity (six months). The foreign investor or his family or his authorized representative or his family can obtain business visas during the investment or even a residential visa (for an investment above $100,000).\textsuperscript{60}

According to rules of the United Nations Commission on International Trade Law, dispute settlement is allowed, but only after consultations in the presence of the Department of Industries in Kathmandu.\textsuperscript{61}

FITTA does not contain any tax incentives for foreign investors. The general tax incentives are provided by the Industrial Enterprise Act.\textsuperscript{\textit{Industrial Enterprises Act.} The main law on business entities is the Industrial Enterprises Act of 1992. The law established a fairly liberal business environment and includes targeted tax incentives (table 6.1). The tax incentives contained in the act are applied in practice; however, the one-stop shop concept has not effectively materialized. In general, enterprises need not obtain permission from the Government, apart from industries listed in annex 2 of the law.\textsuperscript{62} Annex 2 of the law includes a positive list of activities, which require government permission, because they may have a materially adverse effect on security, public health, and the environment.\textsuperscript{63}

The act provides tax incentives for certain industries and products, and/or in certain regions; for example, cottage industries are fully exempted from sales taxes, excise duties, and income taxes (table 6.1). Additional tax incentives can be granted by the GON to industries mentioned in the law, including the export promotion industry, industries established in export promotion zones, and industrial estates.\textsuperscript{64}

The tax incentives provided by the Industrial Enterprises Act are applied in practice. The incentives under the act, however, are changed by the Finance Act from time to time; frequent changes have resulted in uncertainty. The Supreme Court decides many cases in favor of enterprises, confirming their right to enjoy financial incentives provided by the act.
Table 6.1: Tax Incentives Granted under the Industrial Enterprises Act

<table>
<thead>
<tr>
<th>Addressee</th>
<th>Legal base</th>
<th>Requirements</th>
<th>Incentive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cottage industries</td>
<td>Secs. 4 and 15 (a) of the Industrial Enterprises Act (IEA), annex 1</td>
<td>Annex 1 contains a list of industries considered cottage industries; use of machines with less than 5 kilowatt energy consumption</td>
<td>No sales taxes, excise duties, and income taxes</td>
</tr>
<tr>
<td>Any industry other than cigarettes, bidi, cigars, chewing tobacco, khaini, alcohol, and beer</td>
<td>Sec. 15 (f) of the IEA, annex 2</td>
<td>Located in remote, undeveloped and underdeveloped areas</td>
<td>Rebate of excise duty (35%, 25%, and 15%) for 10 years</td>
</tr>
<tr>
<td>Fruit processing, cider, and wine producing</td>
<td>Sec. 15 (g) of the IEA</td>
<td>Fixed assets less than Nrs 2.5 million; in certain areas</td>
<td>Exemption of excise duties and sales taxes for 10 years (with extension of 3 years possible)</td>
</tr>
<tr>
<td>Any industry</td>
<td>Sec. 15 (h) of the IEA</td>
<td>No special requirements</td>
<td>33% accelerated depreciation under existing income tax laws</td>
</tr>
<tr>
<td>Machinery to reduce pollution</td>
<td>Sec. 15 (k) of the IEA</td>
<td>Permission from the GON</td>
<td>Up to 50% from taxable income</td>
</tr>
<tr>
<td>Expenses related to technology, product development, and efficiency improvement</td>
<td>Sec. 15 (n) of the IEA</td>
<td>No special requirements</td>
<td>Allowance of 10% of gross profit as deduction against taxable income</td>
</tr>
<tr>
<td>Raw and auxiliary materials</td>
<td>Sec. 15 (u) of the IEA</td>
<td>Inputs used for exports</td>
<td>Customs duty, sales tax, and excise duty</td>
</tr>
<tr>
<td>Export promotion industry</td>
<td>Sec. 15 (y) of the IEA</td>
<td>Export industry</td>
<td>No taxes, fees or charges on machines, tools, equipment, machinery, and raw materials</td>
</tr>
<tr>
<td>“Sick” industries</td>
<td>Sec. 25 (a) of the IEA</td>
<td>Five consecutive years of loss making and actual production 20% under production capacity; industry declared as “sick” by Government</td>
<td>No duties, fees, or other levies on machinery imported</td>
</tr>
</tbody>
</table>


The law also established a one-stop shop for industries. The respective committee includes officials from the Department of Industry, Tax and Customs Department, Department of Commerce, Central Bank, Labour Union Federation, and Federation of Nepal Chambers of Commerce and Industries.  

Private participation in infrastructure. The Private Investment in the Development and Operation of Public Infrastructure Act, 2063 (2006) covers utilities and allows privately constructed and operated infrastructure. The rules under the act are in place and come into force as of 2060-10-19 (February 2, 2004). The rules have been framed under the ordinance.

The government can outsource the management and operation of infrastructure constructed or developed by the government or by the private sector (such as under the model of lease-operate-transfer or lease-construct-operate-transfer). The act includes different models of private public partnership, such as build-transfer, build-operate-transfer, build-operate-own-transfer, lease-operate-transfer, etc. This could include the construction and/or operation of an SEZ.
The concerned line ministry implements the act; however, other implementing mechanisms were devised under the act. The Project Coordination Committee acts as an advisory body to the Government. It helps identify the viable infrastructure project, coordinate the implementation of the project, and determine the priority of infrastructure development. The committee consists of nine members, including representatives from the National Planning Commission; Ministry of Law, Justice, and Parliamentary Affairs; Ministry of Physical Planning and Construction; and the concerned ministry having the development and operation of particular infrastructure under its scope.

The GON is required to consult with the committee before entering into a project agreement with the successful bidder. The concerned ministry should form an expert committee (technical committee) consisting of five members with the secretary of the concerned ministry as chairperson. A separate body determines the tariff on utilities to be paid by the consumer.

In general, public-private partnership agreements are awarded through public bidding. If the project costs more than Nrs 2 billion ($30,381,285), the public-private partnership agreement can also be entered through private negotiation. The GON may also be an equity partner in any public-private partnership work, but its stake cannot exceed 25 percent. The term of the project agreement is 30 years plus five years under certain circumstances.

Labor legislation. Labor regulations are perceived as an important barrier to investment and employment creation. The Doing Business 2008 report (World Bank 2008) assesses Nepal’s labor regulation as one of the worst in the world. Although the indicator for “ease of doing business” ranks Nepal at 111th of 178 countries, the indicator for “employing workers” positions Nepal only at 155th. The latter indicator takes into account the area of employment (hiring and firing) and social security; industrial relations and occupational health and safety laws were not assessed. The survey states that labor regulations have not been reformed in past years. An attempt to reform the labor legislation with a Labour (Second Amendment) Bill, 2058 (2001), failed; the bill was not submitted to Parliament. Although countries in the region have rather rigid labor regulations in place, they do much better than Nepal: India (rank 85), Sri Lanka (111), Bangladesh (129), and Pakistan (132).

Major applicable law is the Labour Act (2048) of 1992 amended in 1998, and a number of rules. The Labour Act is very restrictive, and state interference is present in almost all aspects of the employer-employee relationship. The act allows the state to interfere in the following instances:

- State applies mandatory job classification; every employer must classify its employees and submit the information to the Labour Office.
- Every new labor contract must be submitted to the Labour Office.
- No adverse change of labor conditions is permissible in the case of a company takeover (i.e., change in ownership of the enterprise).
- The Labour Department must authorize layoff of workers in the case of downsizing or closure. Laid-off workers and employees should be given priority in the case of the need for an additional employee.
- Compulsory retirement is set at 55 years.
- Minimum pay and benefits are set for all workers by the GON on the recommendation of the Minimum Remuneration Fixation Committee. The committee consists of an equal number of representatives from labor, management, and employees.
- A minimum annual pay raise equal to half a day’s salary is fixed in the act.
- No internal appeal mechanism exists for review of decisions made by the Labour Office.
- Social contributions are high.
In addition to the interventional labor regulations, the strong position of the labor unions is perceived as a major impediment to doing business in Nepal. Chapter 10 of the Labour Act deals with labor disputes, and the Trade Union (First Amendment) Act, 2055 (1998) sets rights and obligation of trade unions. Trade unions and federations are autonomous bodies with the right to represent workers, negotiate on their behalf, and participate in collective bargaining procedures on behalf of workers and employees. Unions and federations must register with the state to be recognized. Strikes and lockouts are acknowledged instruments in labor disputes, but they must follow certain rules. Strikes and lockouts are prohibited during the procedures of collective bargaining and the validity of a collective agreement. A law can prohibit workers and employees from going on strike. The Essential Service Operation Act, 2014 (1957) prohibits strikes by workers and employees serving in enterprises rendering essential services by gazette notification. For example, by gazette notification in 2062-11-5 (February 17, 2006), the GON prohibited strikes in communication, airlines, health, banking, and insurance services, among others.

Child labor for children under 16 years is prohibited by the Child Labour (Prohibition and Regulation) Act of 2057 (2000).

Foreign investors are particularly sensitive to work and residence permit procedures, because they usually tend to employ more foreigners than domestic investors. The work permit procedure is set in sec. 4A of the Labour Act and special provisions for foreign investors can be found in FITTA and the Industrial Enterprise Act. Permanent residence and the right to work are offered for those foreign investors investing more than $100,000. The legislation does not include decision criteria, apart from the need to show that no national employee is available for the relevant position. Foreign employees are allowed to repatriate 75 percent of their income. The legislation to obtain work and residence permits can be improved, for example, by offering fast-track procedures for highly skilled employees, combining the work and residence permit procedures, and providing clear and transparent decision criteria.

Land laws. The main legislation on land are the Land Act, 2021 (1964) and Land (Measurement) Act, 2019 (1962). Land titles can be obtained according to the Land (Measurement) Act. Titled land can be used to obtain mortgages. The Land Act sets a maximum size of land that can be owned privately. The ceiling on the area of land is set differently for Terai, Kathmandu Valley, and the Hilly Region. It is 10 bigha (0.6773 ha), 25 ropani (1.27 ha), and 70 ropani (3.55 ha), respectively. In addition to this, the permissible quantity of land can be owned for residential purposes; however, the GON can authorize ownership of the area of land above the ceiling for a specific purpose; for example, land exceeding the ceiling can be owned for industrial purposes as authorized by the GON. Nepal does not have any separate law on industrial estates.

The chapter on miscellaneous of the Country Code, 2020 (1963) prohibits foreigners or foreign entities from owning or holding land without the prior approval of the GON; however, a subsidiary company incorporated under the Companies Act having foreign investment is not a foreign entity; hence, such a subsidiary company need not obtain government approval to own land.

The Land Acquisition Act, 2034 (1978) provides that the GON can acquire private land for any project. Different sectoral laws and specific laws (discussed below) contain a provision on land acquisition by the GON for industrial purposes. For example, under the Private Sector Investment in the Construction and Operation of Infrastructure Act, 2006, the GON can acquire land on behalf of a licensee. A similar provision is contained in the Electricity Act, 2049 (1993). The compensation matter is dealt with by the Land Acquisition Act.
Nepal does not have any separate industrial law governing the establishment and management of industrial estates. Eleven industrial zones exist in Nepal. The first industrial district was established in Balazu, Kathmandu in 1960. These industrial zones are managed by Industrial District Management Limited, a fully government-owned undertaking registered under the Companies Act. The Industrial Policy, 2049 (1993) provided for the establishment of this entity.

**Tax legislation.** Central legislation on taxation is the Income Tax Act, 2057 (2000) and the Value-Added Tax Act of 1995. These two acts are frequently changed by the Finance Act passed every fiscal year. The tax rates, deductions, reporting requirements, auditing rules, and procedures set in the Income Tax Act are in accord with good international practice. The general corporate tax rate is 25 percent. Cigarette, tobacco, or alcohol businesses and banks, financial institutions, and insurance and petroleum businesses pay 30 percent income tax. A lower income tax rate of 20 percent applies to exporters, operators of infrastructure (roads, bridges, tunnels, etc.), build-operate-transfer concessionaires, and transportation companies. Cross-border transfers of companies established in Nepal, but owned by a nonresident, are taxed at 5 percent.

The withholding tax rate on investment returns for resident persons is 15 percent and 5 percent on dividends paid to nonresident persons.

The GON has also imposed various security surcharges to meet increased security expenditures. Special fees of 3 percent have been added to the taxable income of individuals, couples, companies, partnerships, and nonresident taxpayers. Surcharges of 1 to 3 percent have been applied to imports, plus a Nrs 1 (about $0.015) per liter tax has been added to petroleum products.

The tax legislation itself does not grant tax incentives to entities. A few concessions are granted only to employees in certain industries (of more than 600 Nepali employees or operating in remote, undeveloped, or underdeveloped areas) and cooperative societies and to persons earning personal income from agriculture.

In 1997 Nepal replaced the sales tax with a value-added tax regime. General VAT rate is set in the Financial Act for each year and is currently at 13 percent. Schedule 1 of the VAT Act contains a list of goods and services exempt from the VAT, which includes goods for basic needs, basic agricultural products and agricultural inputs, medicines, medical and similar health services, books, education, among others. Every business except small vendors with an annual turnover of less than Nrs 2 million must register with the VAT Department (Inland Revenue Department) and submit monthly VAT returns. Taxes are paid monthly according to a self-assessment by the taxpayer. Actual tax due is calculated upon submission of receipts and balanced with the self-assessed taxes to be paid the next month.

International accounting standards are not applied in Nepal. Double accounting causes additional costs to international companies applying international accounting standards, such as generally accepted accounting principles or international financial reporting standards.

**Customs code.** Customs duty is covered under the Custom Act, 2019 (1962) and Customs Rules, 2026 (1969). The Department of Customs is the competent authority under the act responsible for the administration and implementation of the act. Any person willing to act as a customs agent is required to obtain a license from the Department of Customs or a customs officer. Generally, customs duties are applicable to the import and export of all types of goods; however, the Government may give full or partial concession on the applicable customs duty on certain goods by gazette notification. The rate of customs duty is determined on the basis of the transaction cost of the goods and is fixed by the Finance Act in each financial year. Under the act and rules, the cus-
c. General Characteristics of Good SEZ Legislation with Examples

Countries differ in economic conditions, legal traditions, resources, and capacity; therefore, the reasons for establishing an SEZ with better investment conditions than in the rest of the country differ from country to country. Despite these differences, SEZ legislation governing successful SEZs share certain general characteristics. Success in this context means the attraction of additional investment and creation of employment.

This subsection identifies and describes the fundamental features of modern and successful SEZ legislation. The information provided could contribute to refinement of Nepal’s draft SEZ law and further drafting of implementing regulations. The examples below illustrate countries and legal texts incorporating best practice as well as international standards and limitations set by international organizations, such as the International Labour Organization, World Trade Organization, and World Bank. Philippines, Thailand, and India are examples of countries with successful SEZs based on good legislation. In addition, examples of competitor countries are provided to show the regional context of the draft Nepalese SEZ law. Bangladesh, Pakistan, and also India are the competing economies in the region. Table 6.2 includes information on the countries compared.

It is important to note that the legal framework is only one element of an SEZ regime. Although poorly drafted SEZ legislation will make it more difficult to convince investors to come and invest in the country; good laws and regulations alone are not enough. A well-drafted SEZ act and implementing regulations will only have the intended effect if other essential factors, such as a suitable institutional setup, effective administrative zone, good infrastructure, targeted marketing, and so on are also in place.

<table>
<thead>
<tr>
<th>Summary</th>
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<tbody>
<tr>
<td>The main principles of good SEZ legislation are:</td>
</tr>
<tr>
<td><strong>Principle 1:</strong> A broad scope: openness to industries</td>
</tr>
<tr>
<td><strong>Principle 2:</strong> Privately developed and operated SEZs should be allowed and supported.</td>
</tr>
<tr>
<td><strong>Principle 3:</strong> Provision of infrastructure is a key obligation.</td>
</tr>
<tr>
<td><strong>Principle 4:</strong> SEZs should be designed to alleviate regulatory shortcomings and simplify administration.</td>
</tr>
<tr>
<td><strong>Principle 5:</strong> Legislation should include detailed provisions on zone authority and administration.</td>
</tr>
<tr>
<td><strong>Principle 6:</strong> Tax, customs, or SEZ legislation should incorporate the use of targeted tax incentives.</td>
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</tbody>
</table>
Table 6.2: SEZ Data on the Countries Compared

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Successful SEZ Regimes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>• Special Economic Zone Act of 1995 • Regulations</td>
<td>4 public, 41 private SEZs, 31 info tech parks and buildings</td>
<td>32,030</td>
<td>1,270</td>
<td>1,128,197</td>
</tr>
<tr>
<td>Thailand</td>
<td>• Chapter 10 bis (Free Zone) of the Customs Act • Notification of the Customs Department No. 87/2546.</td>
<td>10 EPZs, 22 general industrial zones</td>
<td>8,242</td>
<td>1,442</td>
<td>451,599</td>
</tr>
<tr>
<td>SEZ Regimes in the Region</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>• The Bangladesh Export Processing Zones Authority Act, 1980, modified 1994 • Principles and Procedures Governing Setting Up of Industries in EPZs of 1981</td>
<td>8 EPZs; 5,341 BGMEA &amp; BKMEA*</td>
<td>11,716.98</td>
<td>1,035</td>
<td>188,394 BGMEA and 3,250,000 BKMEA*</td>
</tr>
<tr>
<td>India</td>
<td>• The Special Economic Zones Act, 2005 • Special Economic Zones Rules, 2006</td>
<td>8 SEZs</td>
<td>4,900</td>
<td>7,960</td>
<td>100,650</td>
</tr>
<tr>
<td>Pakistan</td>
<td>• Export Processing Zones Authority Ordinance, 1980 • Export Processing Zones Authority Rules, 1981 • Customs Export Processing Zones Rules, 1982 • Notifications under the Foreign Exchange Act, 1947; State Bank of Pakistan Act, 1956; Banking Companies Ordinance Act, 1962; Import and Export regulation</td>
<td>22 EPZs</td>
<td>8,073.1</td>
<td>3,872.5</td>
<td>888,312</td>
</tr>
</tbody>
</table>

Source: ILO Database on Export Processing Zones (Revised). (Boyenge 2007).

a. BGMEA = Bangladesh Garment Manufacturers and Exporters Association; BKMEA = Bangladesh Knitwear Manufacturers and Exporters Association.

Principle 1: A Broad Scope: Openness to Industries

SEZs come in more than one outfit. The first SEZs were historically traditional export processing zones. With time, various other types of SEZs were created, including industrial estates, free trade zones, or hybrid SEZs. Most have three basic characteristics in common: (a) provision of serviced industrial infrastructure in a defined geographical area, (b) multiple companies functioning with a single zone administration providing services, and (c) conditions—such as laws and regulations—that differ from those in the rest of the country. Considerable differences may exist concerning
the economic regime (taxes, tariffs, social contributions, etc.), administrative requirements (tax reporting, customs administration, registrations, licensing requirements, inspections, etc.), social obligations (labor conditions), or infrastructure provision.

The most successful approach is the hybrid economic zone, which combines several approaches in one location. The state usually provides first-class infrastructure, such as roads, electricity, telecommunications connections, water, sewerage, etc. A hybrid EPZ includes export-oriented businesses, often operating under special export incentives, as well as nonexporting companies that do not avail of such incentives. Regardless of their export status, however, all firms in such zones benefit from quality infrastructure, efficient bureaucracy, and the ability to import and warehouse inputs duty free (until such time as a final product is sold into the domestic customs territory). Box 6.1 provides examples of such zones.

Most successful SEZ regimes allow in their legislation a wide range of sectors and activities:

**Philippines.** The Philippine SEZ Act refers to ecozones containing a broad range of special economic zones, including industrial estates, export processing zones, free trade zones, and tourist/recreational centers (box 6.2). Each ecozone shall be developed, as much as possible, into a decentralized, self-reliant, and self-sustaining industrial, commercial/trading, agroindustrial, tourist, banking, financial, and investment center with minimum government intervention.

**Singapore.** Any trade or industry is allowed in designated free trade zones. Retail and consumption of dutiable goods are not allowed in a free zone, unless specifically allowed by written permission of the free trade zone authority or customs department.

**Thailand.** The Customs Act and Regulations define a free zone as a designated area for industrial or commercial operation. No sector restrictions or export thresholds apply in free zones. Private developers or companies can apply to the Customs Department, Ministry of Industry, Industrial Estate Authority, or Board of Investment to be authorized as a free zone. Various types of free zones exist: industrial free zones, commercial free zones, single-company free zones, or any other operation involving economic growth and development. Only residential areas are prohibited in free zones.

**India.** The SEZ Act provides for the establishment of special economic zones. No export requirement exists for setting up a business in an SEZ, and no negative or positive lists are applied (box 6.3). The zones allow a wide range of activities, including special sector zones exclusively for biotechnology, unconventional energy, electronics hardware, and software businesses. Details for each of the various components or types of SEZs are set in the rules. It should be noted that India sets minimum sizes for each of the types of SEZs to ensure an economy of scale. Export-oriented units are defined under the Foreign Trade Policy and can operate in an SEZ.
Box 6.1: Free Zones: Three Best Practice Models

The defining features of free zones are the provision of serviced industrial infrastructure and the ability to import raw materials and intermediate goods duty free, foregoing normal customs procedures. These are benefits that many countries extend to both export- and non-export-oriented firms alike. The following three case studies highlight best practices in this inclusive approach.

**Aqaba Special Economic Zone, Jordan: Large Semi-Autonomous Bonded Region**

In 2001 the Government of Jordan turned the port city of Aqaba and surrounding 375 sq km into a special economic zone. All businesses within the zone—retail merchants, restaurants, manufacturers, and hotels—enjoy the same benefits, regardless of whether they export or sell merchandise into the domestic customs territory. Benefits include a low 5 percent tax on corporate net profits, exemptions from social services and property taxes, the ability to repatriate profits, 100 percent foreign ownership, and streamlined investment procedures. The zone attracts investors in tourism, retail, manufacturing, and other services. It is operated by the government, although individuals may own land and also reside within the zone.

The zone is operated by the Aqaba Special Economic Zone Authority, a government body with ministry-level jurisdiction over operation of all activities in the zone. In this respect, the authority—not the central government—is responsible for collection of income taxes, sales taxes, zone customs, environmental controls, company registration, permitting, public safety, and other regulatory and operational functions of the zone. This was made possible through a national special economic zone law establishing the semi-autonomous area, by implementing regulations, and through memoranda of understanding with national government ministries that allow for ceding of responsibilities to the authority.

**El Salvador Free Zones: Classic Free Trade Zones, Inclusive Approach**

El Salvador has 17 free zones—small and medium serviced industrial areas ranging in size from 1.4 to 100 ha. Explosive growth occurred after private free zones were allowed to form (from 1 in 1992 to 16 in 2002). The success is attributed to light-handed regulation with many of the regulatory functions delegated to the individual economic zones. Benefits include 100 percent exemption on corporate income and municipal taxes, duty-free importation of machinery and fuel, and 100 percent foreign ownership. Sales of goods produced within free zones are allowed to the domestic customs territory, provided all taxes and duties are paid. Assembly, manufacturing, and services linked to international trade—packaging, distribution, and cargo consolidation—are allowed in free zones. Many zone tenants operate in the readymade garment and textile sectors. The government allows for private development and operation of free zones under the Industrial and Commercial Free Zone Law. Free zone status and benefits are also extended to 200 individual stand-alone factories that are not located within a physical zone.

**U.S. Foreign Trade Zones: No Special Regime or Benefits**

The United States has 250 foreign trade zones (FTZs) throughout the country. There are 450 additional subzones, that is, stand-alone companies that are granted FTZ status. FTZs are specially licensed industrial areas that allow tenants to avail of special customs procedures and duty-free treatment for re-exported items. Companies who choose to sell products within the United States have the option to pay either the finished product duty rate or the component rate, whichever is lower. Manufacturing, warehousing, assembling, and packaging activities are allowed in FTZs, although retail activities are not. The largest user of FTZs is the petroleum refining industry, followed by automotive, electronics, and pharmaceutical sectors.

Foreign trade zones are independently owned, developed, and operated, but must be licensed by the U.S. Foreign Trade Zone Board under the jurisdiction of the Department (Ministry) of Commerce. FTZ licensees must be public or public-type corporations, such as port authorities, cities, or economic development organizations and must be located within 60 statute miles of a customs port of entry. U.S. FTZs differ from those in many other countries in remaining under the legal jurisdiction of local, state, and national laws and agencies. There are no special “FTZ incentives,” other than duty-free imports. If the local state or municipality offers special incentives, however, those are normally extended to an FTZ in that jurisdiction.
The SEZ regime in Bangladesh is considering updating its policies:

**Box 6.2: Example of Broad Scope in SEZ Legislation: Philippine SEZ Act of 1995**

SECTION 4. **Definition of Terms.** For purposes of this Act, the following definitions shall apply to the following terms:

(a) “Special economic zones (SEZ),” hereinafter referred to as the Ecozones, are selected areas with highly developed or which have the potential to be developed into agro-industrial, industrial tourist/recreational, commercial, banking, investment, and financial centers. An Ecozone may contain any or all of the following: industrial estates (IEs), export processing zones (EPZs), free trade zones, and tourist/recreational centers.

(b) “Industrial estate (IE)” refers to a tract of land subdivided and developed according to a comprehensive plan under a unified continuous management and with provisions for basic infrastructure and utilities, with or without pre-built standard factory buildings and community facilities for the use of the community of industries.

(c) “Export processing zone (EPZ)”: a specialized industrial estate located physically and/or administratively outside customs territory, predominantly oriented to export production. Enterprises located in export processing zones are allowed to import capital equipment and raw materials free from duties, taxes, and other import restrictions.

(d) “Free trade zone”: an isolated policed area adjacent to a port of entry (as a seaport) and/or airport where imported goods may be unloaded for immediate transshipment or stored, repacked, sorted, mixed, or otherwise manipulated without being subject to import duties. However, movement of these imported goods from the free-trade area to a non-free-trade area in the country shall be subject to import duties. Enterprises within the zone are granted preferential tax treatment and immigration laws are more lenient.

**Box 6.3: Example of an Open SEZ Regime: India, SEZ Act, 2005**

Sec. 5. (1) The Central Government, while notifying any area as a Special Economic Zone or an additional area to be included in the Special Economic Zone and discharging its functions under this Act, shall be guided by the following, namely:

(a) Generation of additional economic activity
(b) Promotion of exports of goods and services
(c) Promotion of investment from domestic and foreign sources
(d) Creation of employment opportunities
(e) Development of infrastructure facilities
(f) Maintenance of sovereignty and integrity of India, the security of the State, and friendly relations with foreign States.

Sec. 6. The areas falling within the Special Economic Zones may be demarcated by the Central Government or any authority specified by it as:

(a) The processing area for setting up units for activities, being the manufacture of goods, or rendering services, or
(b) The area exclusively for trading or warehousing purposes, or
(c) The nonprocessing areas for activities other than those specified under clause (a) or clause (b).

The SEZ regime in Bangladesh is considering updating its policies:

**Bangladesh.** The law targets export-oriented businesses. This translates into a 100 percent export requirement, which is confirmed in the Principles and Procedures Governing Setting Up of Industries in EPZs Act of 1981. The law does not include a positive or negative list of industries per-
mitted or prohibited in a zone; however, the act empowers the Bangladesh Export Processing Zones Authority (BEPZA) to determine the types of businesses to be set up in a zone.\textsuperscript{101} Like Nepal, Bangladesh also has a local industrial estate regime. Any business, regardless of exporting status, can locate in a Bangladesh Small and Cottage Industries Corporation industrial estate, although without the same incentives as in an EPZ. A policy paper has been developed, however, that advocates gradually scaling back export requirements in Bangladeshi EPZs, and looks to create a new SEZ regime open to both exporting and nonexporting firms.

**Pakistan.** SEZs in Pakistan are pure export processing zones with an export requirement of 100 percent, unless the Export Processing Zones Authority (EPZA) specifies a different threshold on a case-by-case basis with approval of the government.\textsuperscript{102} Businesses must be incorporated in Pakistan to set up shop in an EPZ. All investment must be in foreign convertible currency.\textsuperscript{103} Preferred are businesses that are export oriented and require sophisticated technology and advanced marketing arrangements, and use local materials and labor.\textsuperscript{104} Industries are not allowed if they compete with similar export industries in the tariff area. Postal, fire services, first aid stations, and medical centers are provided in a zone as well as banking and insurance services.\textsuperscript{105}

**Principle 2: Privately Developed and Operated SEZ Should Be Allowed and Supported**

State-regulated private development and operation of SEZs has proved very successful. It is more efficient in terms of costs and use of human resources, and results in better service. By now, highly skilled and experienced companies specialize in developing and operating SEZs all around the world. They use cutting-edge technology and knowledge to do the job in a highly efficient manner. Many governments in the world understand that they cannot provide the same quality of service and so contract out development and operation of SEZs to the private sector; however, it is vital to establish a well-developed regulatory framework to select, monitor, and evaluate this private partner.

**Philippines.** The Philippines are ambiguous in this respect. The Philippines Export Promotion Authority (PEZA), the SEZ authority, is in charge of developing, operating, and managing SEZs\textsuperscript{106}; however, outsourcing appears to be allowed and practiced.

**Thailand.** State enterprises and private developers are eligible to develop and operate a free zone (box 6.4). A private company must have a minimum capital of 20 million baht for a free zone located in the Bangkok area and 10 million baht in the countryside.\textsuperscript{107} The government can authorize the private development of free zones. A developer of a free zone must submit an application and supporting documents to the Customs Department.

**Bangladesh.** The law does not allow private development or operation of EPZs. The BEPZA is the only authority in charge of EPZs.

**India.** Any private person or entity can establish an SEZ after submitting a proposal to the Indian Government and receiving approval from the board of the SEZ authority.\textsuperscript{108} The procedure to obtain approval is described in detail in the SEZ Act. The board of the authority is the regulator and supervisor of the private developer.\textsuperscript{109}

**Pakistan.** The legislation does not allow private development or operation of an EPZ. The EPZA is the only body in charge of developing and managing an EPZ.
Box 6.4: Approval Application for a Private Free Zone Developer/Operator in Thailand

[Notification No. 87/2546]

3. Procedures of free zone establishment application.
Those desiring to apply for free zone establishments are to fill in the form attached herein and submit it to the Customs Privileges Regulation Division, Tax and Duty Privileges Bureau, Customs Department with the following details and documents:

3.1 Two copies for details on the free zone establishment project.
   3.1.1 Project, objectives, type of business or industry to be operated within the free zone.
   3.1.2 Plans, administrative plan, time required for the construction of buildings, facilities and other items on convenience and project development period from the beginning to the completion.
   3.1.3 Financial plan, source of capital, and size of investment.
   3.1.4 Sale, rent, hire-purchase, immovable property and movable property possession plans for the exercise of tax and duty privileges.
   3.1.5 Facilities and public services maintenance plan or proposal for the establishment of a fund for the maintenance, repair, and improvement of facilities and items of convenience.
   3.1.6 Future expansion plan (if any).

3.2 Two copies of each of the following documents with the exception of three copies for item (3.2.6).
   3.2.1 Copies of juristic person registration certificate.
   3.2.2 Copies of letter of certification and shareholders list issued no longer than six months prior to the date of application.
   3.2.3 Copies of the value-added tax registration (VAT. 20).
   3.2.4 Financial statements as certified by a licensed auditor for the past three years.
   3.2.5 Copies of title deeds or letter confirming the rights to the land or permission to manage the land or area where establishment is requested.
   3.2.6 Brief maps. Establishment area and constructions layout. Minimum size of 40 x 60 cm.
   3.2.7 Letter of construction certification, procurement of necessary equipment, tools, office appliances, items of convenience, and facilities in accordance with the criteria and conditions detailing the stages and operation stages from the beginning to the operable stage.

3.2.8 Establishers of free zone for the industry are required to submit the following documents:
   • A copy of letter of permission for the industrial zones or industrial communities (independent factory buildings) from the Ministry of Industry, or
   • A copy of letter of permission for the general industrial zones from the Industrial Estate Authority of Thailand, or
   • A copy of letter of investment promotion for industrial zones, software industrial zones, or jewelry and ornament industrial zones from the Office of Board of Investment, or
   • A copy of letter of permission or letter of certification for any other industry beneficial to the economy from a relevant agency.
   • In the case where there exist in the area of establishment operators of industry, commerce, or any other businesses beneficial to the economy of the country, a letter of permission or a letter of certification for the business from a relevant agency is required.

Principle 3: Provision of Infrastructure Is Key Obligation

Physical features of successful SEZs are provision of land and functioning, maintained infrastructure, such as roads, electricity, sewerage, information technology systems and networks, etc. The more developed the provided infrastructure, the more advanced will be the attracted industry.

Philippines. Private participation in provision of infrastructure in ecozones is supported (box 6.5). Most public-private partnerships are done under a build-operate-transfer scheme. Box 6.5 shows the legal formulation of this policy.
Thailand. The licensee of a free zone (operator) shall provide utilities, necessary facilities, and services, including appropriate offices, equipment, and residences for customs officers.\textsuperscript{110}

Bangladesh. It is the function of the BEPZA to provide infrastructure in the zone.\textsuperscript{111} The law does not provide any specifics.

India. It is the task of the SEZ authority to develop the infrastructure in an SEZ.\textsuperscript{112} Infrastructure of SEZs is broadly defined in the rules and includes all kinds of services (box 6.6).

Pakistan. The EPZA has the task of providing infrastructure, such as electricity, water, gas, telephone, and telex, which are considered necessary for efficient industrial operators in a zone. The costs must be borne by the industries set up in a zone.\textsuperscript{113}

**Principle 4: Simplified Administration: Designed to Alleviate Regulatory Shortcomings**

The incentive and justification of an SEZ is to provide a better investment climate. This means having better administrative services, including streamlined administrative procedures, no waiting times, fewer documentation requirements, accessible authorities, business-friendly officials, etc. In short, successful SEZs offer less bureaucracy.

Philippines. PEZA establishes one-stop shop centers for businesses in each ecozone facilitating registration, licensing, and issuance of permits. Box 6.7 provides the respective provision of the SEZ Act. PEZA also issues working visas to foreign investors and their dependents, if the investment is in an SEZ and not less than $150,000. The authority also issues working visas for foreign executives and highly skilled experts in a fast-track procedure.\textsuperscript{114}
Box 6.7: Example of Provision in Philippine SEZ Act on One-Stop Shop Center in SEZs

SECTION 36. One Stop Shop Center. The PEZA shall establish a one-stop shop center for the purpose of facilitating the registration of new enterprises in the Ecozone. Thus, all appropriate government agencies that are involved in registering, licensing, or issuing permits to investors shall assign their representatives to the Ecozone to attend to investor's requirements.

Thailand. The Thai Customs Department is in charge of all customs procedures in a free zone. Simplified procedures are applicable in the areas of conditions for granting tax and duty privileges, laws and regulations on import/export licensing, standard and quality control procedures, and clearance for hazardous goods.

Bangladesh. A business needs permission from BEPZA before setting up in a zone. This permission has indefinite validity. The BEPZA Act gives the Bangladeshi Government the power to exempt zones from the operation of certain laws. In fact, the BEPZA act lists 16 acts, including the Companies Act, Foreign Exchange Regulation Act, Factories Act, and Municipality Taxation Act, from which zones can be exempted. The authority has the power to issue work permits to foreign workers employed in a zone.

India. The central government can empower the development commissioner or the approval committee in charge of an SEZ to exercise any administrative task on site. Box 6.8 shows the respective provision in the SEZ Act.

Box 6.8: Empowering the Government to Authorize Regulatory Bodies to Exercise Administrative Tasks: the Indian SEZ Act

Sec. 19. Notwithstanding anything contained in any other law for the time being in force, the Central Government may, if required:

(a) Prescribe a single application form for obtaining any licence, permission, or registration or approval by a Developer or an entrepreneur under one or more Central Acts

(b) Authorise the board, the Development Commissioner or Approval Committee, to exercise the powers of the Central Government on matters relating to the development of a Special Economic Zone, or setting up and operation of units

(c) Prescribe a single form for furnishing returns or information by a Developer or an entrepreneur under one or more Central Acts.

Pakistan. The EPZA authorizes and registers businesses in an EPZ on a discretionary basis. The authorization can be withdrawn at any time on a discretionary basis. Apart from on-site customs offices, no streamlined administrative services are offered in a zone. The EPZA is also in charge of issuing work permits with a maximum validity of three years to foreign workers. The legislation leaves the procedure and decision criteria to the EPZ authority.

Principle 5: Legislation Should Include Detailed Provisions on Zone Authority and Administration

The role of the zone authority should be carefully defined. A zone authority should not add yet another layer of bureaucracy, nor should it become a politicized body to serve narrowly defined government interests. Zone authorities are more of a hybrid between the public and private sector.
A zone authority has the regulatory role of the government, ensuring the rule of law and application of the SEZ legislation, but the authority is also a service and a partner to the private sector. It should assist the businesses in the SEZ and provide services that make doing business in the SEZ attractive. This role must be carefully developed in primary and secondary legislation to ensure a clear understanding of the focus, power, function, and tasks of the zone authority.

**Philippines.** PEZA reviews proposals for SEZs; undertakes establishment, operation, and maintenance of utilities, other services, and infrastructure; and implements the SEZ Act. It is a corporate body, governed by a board, in which the private sector has one representative. Each ecozone has a decentralized administration and an advisory body, including the president of the association of investors in the zone, governor of the respective province, mayor(s) of one or more municipalities, presidents of unions, representative of the business sector in the periphery of the zone, and representative of PEZA.

In the context of Nepal’s labor issues, the way the Philippines fosters cooperation with unions in SEZs is interesting. Box 6.9 contains the respective provisions.

**Box 6.9: How Philippines Addresses Cooperation with Unions in Ecozones**

**CHAPTER IV: INDUSTRIAL HARMONY IN THE ECOZONES**

**SECTION 37. Labor and Management Relations.** Except as otherwise provided in this Act, labor and management relations in the Ecozone shall be governed by the existing Labor Code of the Philippines. Employees and personnel in the Ecozone enterprises shall receive salaries and benefits and shall enjoy working conditions not less than those provided under the Philippine Labor Code and other relevant laws, issuances, rules, and regulations of the Philippine government and the Department of Labor and Employment.

**SECTION 38. Promotion of Industrial Peace.** In the pursuit of industrial harmony in the Ecozone, a tripartite body composed of one (1) representative each from the Department of Labor and Employment, labor sector, and business and industry sectors shall be created in order to formulate a mechanism under a social pact for the enhancement and preservation of industrial peace in the Ecozone within thirty (30) days after the effectivity of this Act.

**SECTION 39. Master Employment Contracts.** The PEZA, in coordination with the Department of Labor and Employment, shall prescribe a master employment contract for all Ecozone enterprise staff members and workers, the terms of which provide salaries and benefits not less than those provided under this Act, the Philippine Labor Code, as amended, and other relevant issuances of the national government.

**SECTION 40. Percentage of Foreign Nationals.** Employment of foreign nationals hired by Ecozone enterprises in a supervisory, technical, or advisory capacity shall not exceed five percent (5%) of its workforce without the express authorization of the Secretary of Labor and Employment.

**SECTION 41. Migrant Worker.** The PEZA, in coordination with the Department of Labor and Employment, shall promulgate appropriate measures and programs leading to the expansion of the services of the Ecozone to help the local governments of nearby areas meet the needs of the migrant workers.

**SECTION 42. Incentive Scheme.** An additional deduction equivalent to one-half (1/2) of the value of training expenses incurred in developing skilled or unskilled labor or for managerial or other management development programs incurred by enterprises in the Ecozone can be deducted from the national government’s share of three percent (3%) as provided in sec. 24.

The PEZA, the Department of Labor and Employment, and the Department of Finance shall jointly make a review of the incentive scheme provided in this section every two (2) years or when circumstances so warrant.

**Thailand.** There is no free zone authority in place. The licensed developer (private or public) is in charge of operating and managing the free zone. The Thai Customs Department is in charge of ensuring compliance with the Customs Act.
**Bangladesh.** The BEPZA Act basically concerns the status, power, functions, and tasks of the zone authority. The involvement of high-level representatives of the private sector in a consultative committee, which advises the board of the authority, is interesting. The authority has the right to buy land for the development of a zone. Officers are not civil servants.

**India.** The administration of SEZs is decentralized in India. A special economic zone authority is established for one or more zones. A development commissioner is the chairperson of the SEZ authority. The authority is in charge of developing and promoting one or more SEZs. The development officer supervises private SEZ developers and also approves businesses to operate in an SEZ. The central government must appoint for every SEZ an approval committee as the regulatory authority in charge of a specific SEZ. The approval committee can exercise duties entrusted by the central government, including any administrative task.

**Pakistan.** A separate act established the EPZA. The EPZA is in charge of implementing the EPZA Ordinance. It develops and operates EPZs and has the right to acquire land for this purpose. The EPZA is an autonomous body and officials are public servants. The EPZA is financed by a special fund consisting of government grants, government loans, grants of local bodies, private loans, sale proceeds, foreign aid, and taxes and fees.

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**Principle 6: Use of Targeted Tax Incentives Incorporated in the Tax, Customs, or SEZ Legislation**

Please refer to the description of tax incentives in part B, sec. 5. Tax incentives are usually set out in law. Many countries insert the incentives or concessions in free zone legislation; however, some countries see the tax incentives as part of tax or customs legislation. Thailand, for example addresses all free zone–related customs issues in a special chapter of its Customs Act. This is preferable so that all tax-related legislation is in one location (for simplicity) and the Ministry of Finance has primacy on taxation issues.

**Principle 7: Smart Use of Primary and Secondary Legislation**

The legal framework for SEZs usually consists of two layers. The law provides the major principles governing SEZs; this is often a separate law on SEZs, containing 30 to 50 provisions. In some cases, the provisions are inserted in customs legislation. The law empowers the government and/or the SEZ authority to adopt detailed regulations and rules. This secondary legislation contains the nuts and bolts of procedures on development and operation of SEZs.
Thailand. Thailand has no special economic zone legislation in place. All rules on free zones are integrated into its Customs Act. The following are applicable: a regulation on the application for free zone establishment criteria, procedures, conditions, and approval; application for business operation within free zones; and exemption of import duties for goods imported.

Bangladesh. A detailed act on the authority leaves the authority sufficient leeway for day-to-day operation. There are no regulations, but principles and procedures for setting up an EPZ provide guidance for decisions.

India. The SEZ Act provides a detailed account of the issues on which the SEZ authority is empowered to issue rules (box 6.10). Ninety-four pages of detailed rules were enacted in 2006 and 2007 based on this empowerment.

Pakistan. An act on the authority is followed by detailed procedural rules.

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India. The SEZ Act provides a detailed account of the issues on which the SEZ authority is empowered to issue rules (box 6.10). Ninety-four pages of detailed rules were enacted in 2006 and 2007 based on this empowerment.

Pakistan. An act on the authority is followed by detailed procedural rules.
55. (1) The Central Government may, by notification, make rules for carrying out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:

(a) The infrastructure facilities necessary for the development of the Special Economic Zones under clause (p) and services in the Special Economic Zones under clause (z) of section 2

(b) The period within which the person concerned shall obtain the concurrence of the State government under subsection (3) of section 3

(c) The form and the manner in which a proposal may be made and the particulars to be contained therein under subsection (5) of section 3

(d) The period within which the State Government may forward the proposal together with its recommendation under subsection (6) of section 3

(e) The requirements subject to which the board may approve, modify, or reject the proposal under subsection (8) of section 3

(f) The period within which the grant of letter of approval shall be communicated to the State Government or Developer or entrepreneur under subsection (10) of section 3

(g) The other requirements for notifying the specifically identified area in a State as a Special Economic Zone under subsection (1) of section 4

(h) The terms, conditions, and limitations subject to which the goods or services exported out of, or imported into, or procured from the Domestic Tariff Area to, a Special Economic Zone, be exempt from payment of taxes, duties, or cess under section 7

(i) The procedure for transfer of letter of approval in case of suspension of letter of approval of a Developer under clause (a) of subsection (9) of section 10

(j) The form and the manner in which a proposal may be submitted and the particulars to be contained therein under subsection (1) of section 15

(k) The time within which a person aggrieved by the order of the Approval Committee may prefer an appeal under subsection (4) of section 15

(l) The form in which the appeal shall be made and the fees for making such appeal under subsection (6) of section 15

(m) The procedure for disposing of an appeal under subsection (7) of section 15

(n) The requirements (including the period for which a unit may be set up) subject to which the proposal may be approved, modified, or rejected under clause (a) of subsection (8) of section 15

(o) The terms and conditions, for the Unit subject to which it shall undertake authorised operations under clause (b) of subsection (8) of section 15 and the obligations and entitlements of the Unit

(p) The time within which a person aggrieved by the order of the Approval Committee may prefer an appeal under subsection (4) of section 16

(q) The form in which the appeal shall be made and the fees for making such appeal under subsection (6) of section 16

(r) The procedure for disposing of an appeal under subsection (7) of section 16

(continued)
(Box 6.10 continued)

(s) The form and the manner in which an application may be made for setting up of an Offshore Banking Unit in a Special Economic Zone under subsection (1) of section 17, and
(t) The requirements for setting up and operation of an International Financial Services Centre in a Special Economic Zone under subsection (1) of section 18
(u) The requirements and terms and conditions subject to which a Unit in the International Financial Services Centre may be set up and operated in Special Economic Zone under subsection (2) of section 18
(v) The form of single application for obtaining any licence, permission, or registration or approval under clause (a) of section 19
(w) The form of single return or information to be furnished by an entrepreneur or Developer under clause (c) of section 19
(x) The manner in which and the terms and the conditions subject to which the exemptions concessions, drawback, or other benefits shall be granted to every Developer and entrepreneur under subsection (2) of section 26
(y) The period during which any goods brought into, or services provided in, any Special Economic Zone shall remain or continue to be provided in such Unit or Special Economic Zone under section 28
(z) The terms and conditions subject to which transfer in ownership of any goods brought into, or produced or manufactured in, any Unit or Special Economic Zone, or removal thereof from such Unit or the Zone, shall be allowed under section 29
(za) The conditions subject to which the Units shall be entitled to sell the goods manufactured in a Special Economic Zone to the Domestic Tariff Area under section 30
(zb) The term of office of the Members, other than ex officio Members, of every Authority and the manner of filling of vacancies under subsection (6) of section 31
(zc) The manner in which and the conditions subject to which and the purposes for which any person may be associated under subsection (7) of section 31
(zd) The times and the places of meetings and the procedure to be followed in the transaction of business meeting under subsection (10) of section 31
(ze) The powers and the functions of every Development Commissioner under subsection (1) of section 32
(zf) The method of appointment of officers and other employees of every Authority, conditions of their service and the scale of pay and allowances under subsection (3) of section 32
(zg) The other functions to be performed by the Authority under clause (e) of subsection (2) of section 34
(zh) The form in which the accounts and other relevant records of every Authority shall be maintained and annual statement of accounts shall be prepared under subsection (1) of section 37
(zi) The form and the manner in which and the time at which every Authority shall furnish returns and statements and other particulars to the Central Government under subsection (1) of section 39
(zj) The form in which and the date before which every Authority shall furnish to the Central Government the report of its activities, policy and programmes under subsection (2) of section 39
(zk) The form in which and the particulars to be contained in the identity cards under section 46
(zl) Any other matter which is to be, or may be, prescribed.
Annex 1. New and Closed Companies in Nepal’s Industrial Districts

Figure A1(a). New Companies in Nepal’s Industrial Districts (April 2002–April 2007)

<table>
<thead>
<tr>
<th>Industrial Sector</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>Total</th>
<th>Total Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>New</td>
<td>Size of</td>
<td>New</td>
<td>Size of</td>
<td>New</td>
<td>Size of</td>
<td></td>
</tr>
<tr>
<td></td>
<td>companies</td>
<td>investments (Nrs)</td>
<td>companies</td>
<td>investments (Nrs)</td>
<td>companies</td>
<td>investments (Nrs)</td>
<td></td>
</tr>
<tr>
<td>Food processing</td>
<td>4</td>
<td>46,685,270</td>
<td>4</td>
<td>50,794,000</td>
<td>4</td>
<td>48,811,883</td>
<td>4</td>
</tr>
<tr>
<td>Metal products</td>
<td>2</td>
<td>52,563,418</td>
<td>4</td>
<td>41,318,000</td>
<td>6</td>
<td>27,583,950</td>
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</tr>
<tr>
<td>Plastic products</td>
<td>5</td>
<td>56,619,866</td>
<td>4</td>
<td>24,551,111</td>
<td>4</td>
<td>26,871,000</td>
<td>4</td>
</tr>
<tr>
<td>Other</td>
<td>3</td>
<td>1,687,500</td>
<td>5</td>
<td>44,950,574</td>
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<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Garment/textile</td>
<td>0</td>
<td>0</td>
<td>5</td>
<td>86,476,218</td>
<td>3</td>
<td>17,350,000</td>
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<tr>
<td>Furniture</td>
<td>3</td>
<td>5,361,000</td>
<td>2</td>
<td>2,739,375</td>
<td>1</td>
<td>214,500</td>
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<tr>
<td>Electronics</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Printing/packaging</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>2</td>
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<tr>
<td>Chemicals</td>
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<tr>
<td>Pharmaceuticals</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>Machinery</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>80,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>Paper</td>
<td>2</td>
<td>341,000</td>
<td>0</td>
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<td>1</td>
<td>100,000</td>
<td>0</td>
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<tr>
<td>Rubber products</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>15,054,000</td>
<td>0</td>
</tr>
<tr>
<td>Wood products</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>500,000</td>
</tr>
<tr>
<td>Footwear</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Table: Companies that Closed Down in Nepal's Industrial Districts (April 2002–April 2007)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Metal products</td>
<td>2 56,750,000</td>
<td>3 1,262,117</td>
<td>1 1,000,000</td>
<td>0 0</td>
<td>0 5</td>
<td>11 88,339,841</td>
<td></td>
</tr>
<tr>
<td>Garment/textiles</td>
<td>3 6,770,000</td>
<td>4 22,655,175</td>
<td>1 31,894,000</td>
<td>1 50,000,000</td>
<td>1 18,404,000</td>
<td>10 129,723,175</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>1 623,000</td>
<td>1 500,000</td>
<td>4 29,982,050</td>
<td>0 400,000</td>
<td>3 1,955,097</td>
<td>9 33,460,147</td>
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</tr>
<tr>
<td>Food processing</td>
<td>1 60,000,000</td>
<td>1 240,000</td>
<td>4 1,265,801</td>
<td>1 27,900,000</td>
<td>2 395,504</td>
<td>9 89,801,305</td>
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<tr>
<td>Plastic products</td>
<td>1 800,000</td>
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<td>0 0</td>
<td>2 8,884,116</td>
<td>4 35,939,935</td>
<td>7 45,624,051</td>
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<tr>
<td>Furniture</td>
<td>1 299,274</td>
<td>0 0</td>
<td>1 452,946</td>
<td>2 4,990,000</td>
<td>2 939,375</td>
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<tr>
<td>Wood products</td>
<td>0 0</td>
<td>2 494,260</td>
<td>0 0</td>
<td>2 1,491,655</td>
<td>1 2,000,000</td>
<td>5 3,985,915</td>
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</tr>
<tr>
<td>Electronics</td>
<td>0 0</td>
<td>0 0</td>
<td>2 75,802,000</td>
<td>1 16,000,000</td>
<td>0 0</td>
<td>3 91,802,000</td>
<td></td>
</tr>
<tr>
<td>Machinery</td>
<td>0 0</td>
<td>1 683,577</td>
<td>1 650,000</td>
<td>1 400,000</td>
<td>0 0</td>
<td>3 1,733,577</td>
<td></td>
</tr>
<tr>
<td>Rubber products</td>
<td>1 4,000,000</td>
<td>0 0</td>
<td>0 0</td>
<td>0 0</td>
<td>1 4,900,000</td>
<td>2 8,900,000</td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td>1 332,800,000</td>
<td>1 6,599,000</td>
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<td>0 0</td>
<td>2 339,399,000</td>
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<td>Paper</td>
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<td>0 0</td>
<td>0 1</td>
<td>0 1</td>
<td>0 978,025</td>
<td>2 978,025</td>
</tr>
<tr>
<td>Warehousing</td>
<td>1 3,050,000</td>
<td>0 0</td>
<td>0 0</td>
<td>0 0</td>
<td>0 0</td>
<td>1 3,050,000</td>
<td>2 978,025</td>
</tr>
<tr>
<td>Footwear</td>
<td>0 0</td>
<td>0 0</td>
<td>1 0</td>
<td>0 0</td>
<td>0 0</td>
<td>0 1 0</td>
<td></td>
</tr>
<tr>
<td>Printing/packaging</td>
<td>0 0</td>
<td>0 0</td>
<td>1 94,996,000</td>
<td>0 0</td>
<td>0 0</td>
<td>1 94,996,000</td>
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<td>Optics</td>
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<td>1 10,000</td>
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<tr>
<td>Pharmaceuticals</td>
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<td>0 0</td>
<td>0 0</td>
<td>1 914,930</td>
<td>0 0</td>
<td>1 914,930</td>
<td></td>
</tr>
</tbody>
</table>

Figure A1(b). Companies that Closed Down in Nepal's Industrial Districts (April 2002–April 2007)
Annex 2. Nepal Survey Questionnaire

1. Date and Time:

2. Company/Agency Information and Contacts:

<table>
<thead>
<tr>
<th>Company/Agency name:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Parent company:</td>
<td></td>
</tr>
<tr>
<td>Country of origin:</td>
<td></td>
</tr>
<tr>
<td>Year of establishment in Nepal:</td>
<td></td>
</tr>
<tr>
<td>Year of expansion/reinvestment:</td>
<td></td>
</tr>
<tr>
<td>Respondent’s name:</td>
<td></td>
</tr>
<tr>
<td>Position:</td>
<td></td>
</tr>
<tr>
<td>Telephone number:</td>
<td></td>
</tr>
<tr>
<td>Fax number:</td>
<td></td>
</tr>
<tr>
<td>Company address:</td>
<td></td>
</tr>
<tr>
<td>E-mail address:</td>
<td></td>
</tr>
<tr>
<td>Web site address:</td>
<td></td>
</tr>
</tbody>
</table>

3. In what sectors do you operate?

4. Ownership structure of company (local, foreign, joint venture) and percentages.

5. Land and facility sizes:
6. Number employees:

7. Primary markets served:

8. Where source inputs:

9. Discuss quality of infrastructure:

10. Wage rates:

11. Why are you located in Nepal?

12. Why are you located at this specific site?

13. If you were to consider a new investment location for this type of business, what would be your top five selection criteria, listed in terms of importance?
14. What about Nepal’s investment climate is appealing?

15. What about Nepal’s investment climate is not appealing?

16. What importance do tax incentives play for your business? What role did incentives play in your decision to locate where you did?

17. How would you benefit from changes in Nepal’s legal regime?

18. What do you know about Nepal’s proposed SEZ regime? What about it is appealing or not appealing?
Annex 3. Master Plan Diagram

Note: Master plan obtained and used with permission of Mr. Jagadiswar Shrestha, project chief, Special Economic Zone Project, Nepal Ministry of Industry, Commerce and Supplies.
Annex 4. Costs and Quality Conditions in Nepal and Other Countries

<table>
<thead>
<tr>
<th>Cost of labor</th>
<th>Nepal</th>
<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>China (Guangzhou)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly salary: mid-level manager</td>
<td>$333$</td>
<td>$1,639$</td>
<td>$400$</td>
<td>$575–$1,725</td>
<td>$160–$300</td>
<td>$520$</td>
</tr>
<tr>
<td>Monthly salary: skilled/technical worker</td>
<td>$225$</td>
<td>$354$</td>
<td>$100$</td>
<td>$115–$287</td>
<td>$64–$300</td>
<td>$250$</td>
</tr>
<tr>
<td>Monthly salary: unskilled worker</td>
<td>$71$</td>
<td>$102$</td>
<td>$50$</td>
<td>$77–$105</td>
<td>$45$</td>
<td>$135$</td>
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</tbody>
</table>

Rigidity of employment

<table>
<thead>
<tr>
<th>Rigidity of employment (composite index)</th>
<th>Nepal</th>
<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>China (Guangzhou)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>52</td>
<td>30</td>
<td>35</td>
<td>43</td>
<td>27</td>
<td>24</td>
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</table>

Difficulty hiring index

<table>
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<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>China (Guangzhou)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>67</td>
<td>0</td>
<td>44</td>
<td>78</td>
<td>0</td>
<td>11</td>
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Rigidity of working hours index

<table>
<thead>
<tr>
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<th>Nepal</th>
<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>China (Guangzhou)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>70</td>
<td>70</td>
<td>40</td>
<td>60</td>
<td>60</td>
<td>40</td>
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</tbody>
</table>

Difficulty firing index

<table>
<thead>
<tr>
<th>Difficulty firing index</th>
<th>Nepal</th>
<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>China (Guangzhou)</th>
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<tr>
<td></td>
<td>70</td>
<td>70</td>
<td>40</td>
<td>60</td>
<td>60</td>
<td>40</td>
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</table>

Firing costs (weeks of wages)

<table>
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<th>Firing costs (weeks of wages)</th>
<th>Nepal</th>
<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>China (Guangzhou)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>90</td>
<td>55.9</td>
<td>104.3</td>
<td>169</td>
<td>169</td>
<td>91</td>
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</table>

Non-wage labor cost (% salary)

<table>
<thead>
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<th>Non-wage labor cost (% salary)</th>
<th>Nepal</th>
<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>China (Guangzhou)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>10</td>
<td>17</td>
<td>0</td>
<td>15</td>
<td>15</td>
<td>44</td>
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</table>

Cost of utilities

<table>
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<tr>
<th>Cost of electricity usage (per kilowatt hour)</th>
<th>Nepal</th>
<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>China (Guangzhou)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$0.0898$</td>
<td>$0.076$</td>
<td>$0.0597$</td>
<td>Industrial Off-Peak: $0.058$</td>
<td>Off-Peak: $0.059$</td>
<td>Off-Peak: $0.039$</td>
</tr>
<tr>
<td>Cost of electricity capacity demand (per kilovolt ampere [KVA]/month)</td>
<td>$2.892$</td>
<td>$4.24–$6.52</td>
<td>None</td>
<td>None</td>
<td>$3.440 for bulk customers demanding $42 KVA$</td>
<td>Volume of transformer: $2.43$</td>
</tr>
<tr>
<td>Cost of piped water (per m$^3$)</td>
<td>$0.20$ (Hetauda ID)</td>
<td>$0.076$ (Kathmandu Valley for customers using &gt;10 m$^3$/month)</td>
<td>$0.52$</td>
<td>$0.253$ (Dhaka EPZ)</td>
<td>$0.261$ Sewerage: $0.065$</td>
<td>$0.471$</td>
</tr>
<tr>
<td>Natural gas (per m$^3$)</td>
<td>$0.102$</td>
<td>$0.07$</td>
<td>$0.072/MMTU$</td>
<td>$0.154$</td>
<td>$0.126$</td>
<td></td>
</tr>
</tbody>
</table>

Cost of serviced industrial land and buildings

<table>
<thead>
<tr>
<th>Cost of serviced land inside free zone or industrial estate (per m$^2$/year)</th>
<th>Nepal</th>
<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>China (Guangzhou)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$0.13$ (Balaju, Patan, and Bhaktapur IDs)</td>
<td>$0.98$</td>
<td>$1.25–$2.2</td>
<td>Industrial plots: Downpaymt of $5/m$² &amp; $2.50/m$² annual ground rent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of prefabricated factory shell (per m$^2$/year)</td>
<td>$5.76$ (Balaju ID)</td>
<td>$15.43–$16.30</td>
<td>$18–$33</td>
<td>Standard factory buildings not available; short-term warehouses available for $2.43/m$²/month</td>
<td></td>
<td></td>
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</table>

Ranges between $6.46 and $243$
### Cost of Shipping

<table>
<thead>
<tr>
<th>Cost of shipping*</th>
<th>Nepal</th>
<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>China (Guangzhou)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of ocean freight (of 40’ container to Long Beach)</td>
<td>$5,800 from Kathmandu</td>
<td>$5,500 from New Delhi</td>
<td>$3,800 from Dhaka</td>
<td>$3,100 from Karachi</td>
<td>$3,500 from Colombo</td>
<td>$3,939 from Guangzhou (Maersk)</td>
</tr>
<tr>
<td>Cost of ocean freight (of 40’ container to New York)</td>
<td>$6,200 from Kathmandu</td>
<td>$4,400 from New Delhi</td>
<td>$3,100 from Dhaka</td>
<td>$2,925 from Karachi</td>
<td>$4,100 from Colombo</td>
<td>NA</td>
</tr>
<tr>
<td>Cost of ocean freight (of 40’ container to Rotterdam)</td>
<td>$6,100 from Kathmandu</td>
<td>$5,000 from New Delhi</td>
<td>$3,500 from Dhaka</td>
<td>$3,370 from Karachi</td>
<td>$2,850 from Colombo</td>
<td>$3,918 from Guangzhou</td>
</tr>
<tr>
<td>Cost of ocean freight (of 40’ container to Yokohama)</td>
<td>$4,200 from Kathmandu</td>
<td>$3,000 from New Delhi</td>
<td>$1,050 from Dhaka</td>
<td>$1,050 from Karachi</td>
<td>$1,150 from Colombo</td>
<td>$1,248 from Guangzhou</td>
</tr>
<tr>
<td>Air freight rates for 1,000 kg garments (per kg) to New York</td>
<td>$3.95 from Kathmandu</td>
<td>$4.30 from Biratnagar</td>
<td>$3.35 from Dhaka</td>
<td>$3.30 from Karachi</td>
<td>$3.75 from Colombo</td>
<td>NA</td>
</tr>
<tr>
<td>Air freight rates for 1,000 kg garments (per kg) to Los Angeles</td>
<td>$4.20 from Kathmandu</td>
<td>$3.60 from New Delhi</td>
<td>$3.80 from Dhaka</td>
<td>$5.28 from Karachi</td>
<td>$3.80 from Colombo</td>
<td>NA</td>
</tr>
<tr>
<td>Air freight rates for 1,000 kg garments (per kg) to Amsterdam</td>
<td>$2.77 from Kathmandu</td>
<td>$2.90 from New Delhi</td>
<td>$3.10 from Dhaka</td>
<td>$2.70 from Karachi</td>
<td>$2.90 from Colombo</td>
<td>NA</td>
</tr>
<tr>
<td>Air freight rates for 1,000 kg garments (per kg) to Tokyo</td>
<td>$3.95 from Kathmandu</td>
<td>$4.35 from Biratnagar</td>
<td>$2.75 from Dhaka</td>
<td>$2.60 from Sri Lanka</td>
<td>NA</td>
<td></td>
</tr>
</tbody>
</table>

### Taxation

<table>
<thead>
<tr>
<th>Statutory corporate income tax rate</th>
<th>20%</th>
<th>33.7%</th>
<th>40% (30% for publicly traded companies, per Nat’l Board of Revenue)</th>
<th>35%</th>
<th>35%</th>
<th>33%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total corporate income tax rate II</td>
<td>18.6%</td>
<td>17.2%</td>
<td>27.3%</td>
<td>25.8%</td>
<td>26.3%</td>
<td>19.4%</td>
</tr>
<tr>
<td>VATa</td>
<td>13%</td>
<td>4% (central sales tax)</td>
<td>12.5% (state VAT)</td>
<td>15%</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>Administrative burden spent paying taxes (hours per year)</td>
<td>408</td>
<td>271</td>
<td>400</td>
<td>560</td>
<td>256</td>
<td>872</td>
</tr>
</tbody>
</table>

---

a. Data from IFC survey.
b. Data from that country’s board of investment.
c. Data from World Bank (2008).
d. Data from Industrial Districts Management Limited. ID = industrial district.
e. Data from Visakhapatnam Special Economic Zone and Madras Export Processing Zone.
f. Data from Bangladesh Export Processing Zone Authority (BEPZA).
g. Data from Guangzhou Economic and Technological Development District.
h. MMTU = millions of (British) Thermal Units.
i. Data from Pakistan Export Processing Zone Authority.
k. Data on freight rates are from port to port and do not include any FOB charges and pickup. Does not include insurance. Air freight rates include security and fuel surcharges. Rates are from airport to airport and do not include FOB charges.
l. Tax on profits for a typical medium enterprise (World Bank 2008).
m. Tax calculated after allowing for typical deductions and exemptions of a medium-sized company (World Bank 2008).
### Annex 5. Comparison of Corporate Tax Rates and Incentives Associated with SEZs

<table>
<thead>
<tr>
<th>Country</th>
<th>Statutory corporate income tax (estimated actual)</th>
<th>Tax holidays associated with free zones or exports</th>
<th>Other incentives (fiscal and nonfiscal)</th>
<th>Eligibility for incentives</th>
</tr>
</thead>
</table>
| Nepal   | 20% (18.6%)                                   | An income tax holiday is granted for the first five years from the start of commercial operation. Additional five years of income tax holidays are applied in SEZs in mountainous and hilly districts. A rebate from income tax of 50% is granted after expiration of the tax holidays (proposed) | Fiscal incentives:  
- Dividends are exempted from withholding tax for five years and reduced to 50% for three years thereafter.  
- Foreign investors enjoy 50% discount from income taxes for fees and royalties earned for foreign technology and management services.  
- VAT is fully exempted for importing capital goods, including raw materials. The same exemption is applicable when goods and services are exchanged between companies within the SEZ.  
- Excise taxes are not levied for goods produced in the SEZ.  
- Customs duty exemptions are applied to the importation of capital goods and input material as long as the goods remain in the SEZ or are exported. Customs duty must be paid if the goods are sold in the domestic market.  
- Local taxes will not be levied.  
- Accelerated depreciation.  
Nonfiscal incentives:  
- Rent for land or buildings reduced by 50% in the first, 40% in the second, and 25% in the third year. | • Locate in an SEZ  
• Export 85% production |
| India   | 33.7% (17.2%)                                 | On proceeds from sale of exports  
0% (five years)  
20% (years 6–10)  
40% (thereafter)  
On proceeds from sales to domestic territory: 40% | Fiscal incentives:  
- Exemption from national duties on imports and exports  
- Exemption from service tax  
- Exemption from national sales tax on all goods, except newspapers  
- Exemption from stamp duties  
- Eligible for reserve investment account during years 11 to 15 to put up to 50% of profits toward future capital investments  
- Losses carry forward to next fiscal year  
- Exemption from all state and local taxes, levies, and duties  
- Exemption from electricity duties and taxes  
Nonfiscal incentives:  
- Free remittance of profits after a delay of one year | • Locate in an SEZ  
• Positive foreign exchange earnings within five years |
| Bangladesh | 40% (27.3%)  
0% (first 10 years)  
20% (years 10–15) | Tax on corporate profits  
0% (first 10 years)  
20% (years 10–15) | Fiscal incentives:  
- Duty-free imports and exports  
- Relief from double taxation  
- Exemption from dividend tax  
- Duty-free importation of three vehicles  
- Expatriates exempt from personal income tax for three years  
- Accelerate depreciation on machinery and plant  
Nonfiscal incentives:  
- 100% foreign ownership allowed  
- Generalized system of preferences (GSP) facility available | • Locate in an EPZ  
• Export 70–100% production, depending on industry, unless supplying an exporting firm, whether inside or outside an EPZ |
<table>
<thead>
<tr>
<th>Country</th>
<th>Statutory corporate income tax (estimated actual)</th>
<th>Tax holidays associated with free zones or exports</th>
<th>Other incentives (fiscal and nonfiscal)</th>
<th>Eligibility for incentives</th>
</tr>
</thead>
</table>
| Pakistan         | 35% (25.8%)                                     | None. General income tax rates apply               | • Remittance of royalties and technical and consulting fees  
 • Repatriation of capital and dividends                                                                  | • Locate in an EPZ  
 • Export 100% production, except in cases of defective goods or case by case permission to sell to domestic market  
 • All investment must be made in convertible foreign currency |
| Sri Lanka        | 35% (26.3%)                                     | Tax on corporate profits:*  
 0% (three to seven years, depending on industry sector)  
 10% (years 5–7 or 5–9)  
 15–20% (thereafter, depending on sector)                | Fiscal incentives:  
 • Exemption from import duties on capital goods and raw materials  
 Nonfiscal incentives:  
 • Exemption from exchange controls                        | • Export 70% (services) or 80% (manufacturing)         |
| China (Guangzhou)| 33% (19.4%)                                     | Tax on corporate profits:*  
 0% (two years, commencing year company earns a profit)  
 7.5% (years 3–5)  
 15% (thereafter)                                           | • Exemption from taxes on remittances  
 • Reimbursement of corporate taxes if reinvested within China  
 • Exemption from import tariffs                             | • Locate in an SEZ  
 • Manufacturing or high-tech firm  
 • Export 50.1% of production                                 |

Annex 6. Comparison of South Asian Countries on Ten Core “Doing Business” Indicators

(175 countries were rated, 1 = best, 175 = worst)

<table>
<thead>
<tr>
<th>Country Rank: Ease of doing business</th>
<th>Starting a business</th>
<th>Dealing with licenses</th>
<th>Employing workers</th>
<th>Registering property</th>
<th>Getting credit</th>
<th>Protecting investors</th>
<th>Paying taxes</th>
<th>Trading across borders</th>
<th>Enforcing contracts</th>
<th>Closing a business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maldives (60)</td>
<td>34</td>
<td>8</td>
<td>7</td>
<td>178</td>
<td>135</td>
<td>64</td>
<td>1</td>
<td>110</td>
<td>94</td>
<td>120</td>
</tr>
<tr>
<td>Pakistan (76)</td>
<td>59</td>
<td>93</td>
<td>132</td>
<td>88</td>
<td>68</td>
<td>19</td>
<td>146</td>
<td>94</td>
<td>154</td>
<td>51</td>
</tr>
<tr>
<td>Sri Lanka (101)</td>
<td>29</td>
<td>160</td>
<td>111</td>
<td>134</td>
<td>97</td>
<td>64</td>
<td>158</td>
<td>60</td>
<td>133</td>
<td>39</td>
</tr>
<tr>
<td>Bangladesh (107)</td>
<td>92</td>
<td>116</td>
<td>129</td>
<td>171</td>
<td>48</td>
<td>15</td>
<td>81</td>
<td>112</td>
<td>175</td>
<td>102</td>
</tr>
<tr>
<td>Nepal (111)</td>
<td>60</td>
<td>125</td>
<td>155</td>
<td>25</td>
<td>97</td>
<td>64</td>
<td>92</td>
<td>151</td>
<td>123</td>
<td>95</td>
</tr>
<tr>
<td>Bhutan (119)</td>
<td>52</td>
<td>119</td>
<td>14</td>
<td>33</td>
<td>158</td>
<td>122</td>
<td>68</td>
<td>149</td>
<td>38</td>
<td>178</td>
</tr>
<tr>
<td>India (120)</td>
<td>111</td>
<td>134</td>
<td>85</td>
<td>112</td>
<td>36</td>
<td>33</td>
<td>165</td>
<td>79</td>
<td>177</td>
<td>137</td>
</tr>
<tr>
<td>Afghanistan (159)</td>
<td>24</td>
<td>141</td>
<td>24</td>
<td>169</td>
<td>177</td>
<td>178</td>
<td>38</td>
<td>174</td>
<td>160</td>
<td>178</td>
</tr>
</tbody>
</table>

Annex 7. Country Comparison of Foreign Direct Investment and Trade

Figure A7 Nepal Trade Trends (millions of U.S. dollars)

References


World Bank. 2007. World Development Indicators. Washington, D.C.


Endnotes

1 Art. 5 (2) of the SEZ bill.
2 Art. 7 (3) of the SEZ bill.
3 Art. 4 (2) of the SEZ bill.
4 Art. 5 (2) of the SEZ bill.
5 Art. 4 (2) of the SEZ bill.
6 Art. 7 (3) of the SEZ bill.
7 Art. 11 (2) and (4) of the SEZ bill.
8 Arts. 34 (4) and 47 of the SEZ bill.
9 Art. 39 (1) of the SEZ bill.
10 Art. 12 (2) of the SEZ bill.
11 Art. 34 of the SEZ bill.
12 Art. 34 (4) of the SEZ bill.
13 Art. 6 (1) and (2) of the SEZ bill.
14 Art. 9 (1) and (2) of the SEZ bill.
15 Art. 6 (1) and (2) of the SEZ bill.
16 Art. 13 (2) of the SEZ bill.
17 Art. 14 of the SEZ bill.
18 Art. 15 of the SEZ bill.
19 Art. 35 of the SEZ bill.
20 Art. 46 of the SEZ bill.
21 Art. 16 of the SEZ bill.
22 Art. 19 of the SEZ bill. As the SEZ bill provides that salaries of SEZ employees shall be as prescribed, the said section should be read in conjunction with sec. 2 (k) of the SEZ bill. Sec. 2 (k) of the bill says that “as prescribed” means as prescribed in the rules framed by the GON; therefore, it appears that SEZ employees are appointed by the GON, which also fixes their salaries and benefits. In this sense, they will not be different from other public servants.
23 Art. 13 of the SEZ bill.
24 Art. 14 of the SEZ bill.
25 Art. 15 of the SEZ bill.
26 Art. 35 of the SEZ bill.
27 Art. 16 of the SEZ bill.
28 Art. 7 (5) of the SEZ bill.
29 Art. 12 (2) of the SEZ bill.
30 Art. 47 of the SEZ bill.
31 Arts. 22 to 32 of the SEZ bill.
32 Art. 29 of the SEZ bill.
33 Art. 30 of the SEZ bill.
34 Art. 31 of the SEZ bill.
35 Art. 33 of the SEZ bill.
36 Art. 36 (3) of the SEZ bill.
37 Art. 35 (3) and (4) of the SEZ bill.
38 Art. 36 (1) and (2) of the SEZ bill.
39 Art. 37 of the SEZ bill.
40 Art. 38 of the SEZ bill.
41 Art. 53 of the SEZ bill.
42 Art. 52 of the SEZ bill.
43 Art. 34 (4) of the Constitution.
44 Art. 35 (12) of the Constitution.
45 Art. 12 (2) (f) of the Constitution.
Proviso (5) of Art. 12 (2) (f) of the Constitution.
Art. 19 of the Constitution.
Arts. 12 (2) (d) and 30 (2) of the Constitution.
Art. 18 (1) of the Constitution.
Art. 18 (2) of the Constitution.
Art. 30 (1) of the Constitution.
Secs. 5 (5) and 154 (1) of the Companies Act.
Secs. 5 (1) and 154 (4) of the Companies Act.
Sec. 3 (4) of FITTA and annex.
Annex B (as amended).
Sec. 3 (2) of FITTA.
Sec. 3 (3) of FITTA.
Sec. 5 (2) of FITTA.
Sec. 21 of the Industrial Enterprises Act (IEA).
Sec. 6 of FITTA.
Sec. 7 of FITTA.
Sec. 9 (1) of the IEA.
Sec. 9 (1) of the IEA.
Sec. 16 of the IEA.
Secs. 17 to 19 of the IEA.
See list of rules based on power given to the Government in sec. 86 of the Labour Act.
Sec. 3 of the Labour Act.
Sec. 4 of the Labour Act.
Sec. 12 of the Labour Act.
Sec. 12 (4) of the Labour Act.
Sec. 15 of the Labour Act.
Secs. 21 to 24 of the Labour Act.
Sec. 21A of the Labour Act.
Secs. 72 to 83 of the Labour Act.
Secs. 74 and 78 of the Labour Act.
Sec. 78 of the Labour Act.
Sec. 3 of the Child Labour Act. This is not in compliance with the age threshold of 14 years in sec. 5 of the Labour Act, and it is assumed that the Child Labour Act overrules the Labour Act.
Sec. 22 of the IEA.
Sec. 4A of the Labour Act.
Sec. 22 (3) of the IEA.
Sec. 7 of the Land Act.
Sec. 12 of the Land Act.
No. 2 of the chapter on miscellaneous of the Country Code.
Sec. 3 of the Land Acquisition Act.
Sec. 33 of the Electricity Act.
Sec. 2 of the Schedule 1 of the Income Tax Act.
Amended by the Finance Act, 2007.
Amended by the Finance Act, 2007.
Secs. 10 to 12 of the VAT Act.
Sec. 7 of the VAT Act.
Sec. 9 of the VAT Act.
Sec. 10 of the VAT Act.
Sec. 18 of the VAT Act.
Sec. 8 of the VAT Act.
Secs. 17 (1) and 24 of the VAT Act.
Sec. 4 of the SEZ Act.
Sec. 7 of the SEZ Act.
Sec. 7 of the Free Zones Act.
100 Sec. 3 (1) of the SEZ Act.
101 Sec. 16 of the BEPZA Act.
102 Sec. 11 (3) of the EPZA Ordinance.
103 Sec. 4 of the EPZ Rules.
104 Sec. 5 of the EPZ Rules.
105 Sec. 15 of the EPZ Rules.
106 Sec. 8 of the SEZ Act.
107 Sec. 1 (1) of the Notification No. 87/2546.
108 Sec. 3 (2) and (3) of the SEZ Act.
109 Sec. 10 of the SEZ Act.
110 Secs. 2.4 and 2.5 of the Notification 87/2546.
111 Sec. 7 of the BEPZA Act.
112 Sec. 34 of the SEZ Act.
113 Sec. 15 of the EPZ Rules.
114 Sec. 10 of the SEZ Act.
115 Sec. 12 of the BEPZA Act.
116 Sec. 11A of the BEPZA Act.
117 Sec. 7 of the BEPZA Act.
118 Sec. 7 of the EPZ Rules.
119 Customs Export Processing Zones Rules, 1981.
120 Sec. 22 of the EPZ Rules.
121 Secs. 12 and 13 of the SEZ Act.
122 Sec. 11 of the SEZ Act.
123 Sec. 15 of the SEZ Act.
124 Sec. 97ter of the Customs Act.
125 Sec. 6A of the BEPZA Act.
126 Sec. 11 of the BEPZA Act.
127 Sec. 20 of the EPZA Act.
128 Sec. 31 of the SEZ Act.
129 Sec. 12 of the SEZ Act.
130 Sec. 13 of the SEZ Act.
131 Sec. 14 of the SEZ Act.
132 Sec. 14 of the EPZA Ordinance.
133 Secs. 15 and 16 of the EPZA Ordinance.
134 Sec. 19 of the EPZA Ordinance.
135 Sec. 31 of the SEZ Act.
136 Sec. 12 of the SEZ Act.
137 Sec. 13 of the SEZ Act.
138 Sec. 14 of the SEZ Act.
139 Sec. 14 of the EPZA Ordinance.
140 Secs. 15 and 16 of the EPZA Ordinance.
141 Sec. 19 of the EPZA Ordinance.
142 Chapter 10bis (Free Zone) of the Customs Act.
143 Notification of the Customs Department No. 87/2546.
144 Chapter 10bis (Free Zone) of the Customs Act.
145 Notification of the Customs Department No. 87/2546.