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# Nepal's graduation from the least developed country group: Potential implications and issues for consideration

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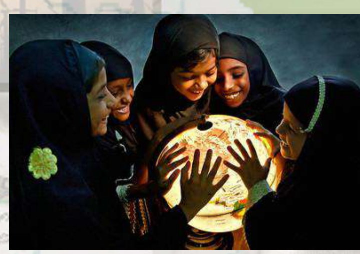



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# Contents

# Nepal's graduation from the least developed country group: Potential implications and issues for consideration[+]

by

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March 2020

Abstract

Nepal has achieved significant socio-economic progress despite being confronted by unfavourable conditions such as its being landlocked and susceptible to natural disasters. It has demonstrated a paradoxical development pattern in which a relatively low long-term average economic growth has been accompanied by brisk poverty reduction. The country met criteria for graduation from the group of least developed countries (LDCs) in two consecutive United Nations triennial reviews in 2015 and 2018. With a per capita income of just 60 per cent of the graduation threshold level of per capita income, it was quite extraordinary for Nepal to meet the other two graduation criteria, the Human Asset Index and the Economic Vulnerability Index. It provides a classic case in which a country's achieving LDC graduation thresholds do not adequately reflect its challenges of achieving sustainable development through building productive capacities as envisaged in the Istanbul Programme of Actions (IPoA) for LDCs. Most concrete LDC-specific international support measures (ISMs) are related to international trade from which Nepal has not been able to benefit much. While the IPoA and 2030 Sustainable Development Agenda anticipated LDC trade share to double by 2020, in reality, it has declined with Nepal's merchandise exports falling in both absolute and relative terms. The 2018 United Nations Committee for Development Policy (CDP) decision to defer the recommendation of graduation until the next review was a judicious one and further deferments could also be considered as part of ISMs in helping Nepal consolidate its socio-economic achievements and securing Sustainable Development Goals. For Nepal, dealing with general development challenges, promoting external competitiveness, trade capacity building, and exploring enhanced trading opportunities in neighbouring and regional partner countries, amongst others, should remain important policy priorities.

***JEL classification numbers**:* O14, O23, O56, P41, P45.

***Keywords**:* least developed countries, LDC graduation, smooth transition, Nepal.

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# I. Introduction

Nepal is a South Asian least developed country that has made significant socio-economic progress in recent times despite being confronted by unfavourable conditions, adversely affecting its development prospects. Being a landlocked country means trade-led growth is not an easy option and its mountainous terrain poses a natural barrier for internal integration. Furthermore, susceptibility to natural disasters such as earthquakes has frequently caused Nepal to suffer from severe economic and human losses. Political instability arising from a prolonged transition – from a monarchy to multiparty democracy – associated with armed conflict and changes in government in quick succession has also taken its toll on the economy. Yet, Nepal has demonstrated a paradoxical development pattern in which a relatively low long-term average economic growth has been accompanied by brisk poverty reduction. Nepal also met most of Millennium Development Goal targets, demonstrating a more inclusive development paradigm in comparison with many countries at a similar level of development. Indeed, it met two of the three criteria for graduation from the group of least developed countries (LDCs) for the second consecutive time in the latest triennial review, held in 2018, by the United Nations Committee for Development Policy (CDP)[1]. However, the Committee deferred its decision to recommend the graduation of Nepal until the 2021 triennial review because of the concerns about the sustainability of development progress.

Since the initiation of the LDC category in 1971, the United Nations organized four global conferences (once in every decade) with the objective of supporting LDCs in dealing with their inherent challenges. The latest or the fourth conference, held in Istanbul, Turkey, in 2011, adopted an ambitious agenda known as the Istanbul Programme of Action (IPoA), articulating a vision and strategy for the sustainable development of LDCs with a strong focus on developing their productive capacities. It also targeted halving the number of LDCs to 24 even though over the past decades only a few countries have been able to graduate out of the group.[2] The IPoA ambition was to be fulfilled through favourable international support measures (ISMs) for these countries in various areas, including international trade, development financing and technical assistance, productive capacity building, etc. While it is widely viewed that much of the IPoA support measures has not been materialized, it is also true that some LDCs did make progress towards their economic development.[3] In this respect, Nepal provides a classic case study in which a country's

[1] Graduation from LDC status requires a country to meet development thresholds under at least two of the three pre-defined criteria (of per capita income, human asset and economic vulnerability) in two consecutive triennial reviews. Nepal first met the human asset and economic vulnerability criteria in 2015 triennial review. It is to be noted that there is also a provision for the 'income-only' graduation rule under which, if the 3-year average per-capita gross national income of an LDC has risen to a level at least double the graduation threshold, the country could be eligible for graduation regardless of its situation under the other two criteria. Once a country fulfills the graduation criteria in two consecutive triennial reviews, it is recommended to graduate from the group in three years' time.

[2] A/CONF.219/3/Rev.1, titled Programme of Action for the Least Developed Countries for the Decade 2011-2020. Only three countries graduated by the time IPoA was adopted in 2011. Since the creation of the LDC group five countries could graduate of which two did after the IPoA's coming into force.

[3] The graduated counties are Botswana (1994), Cape Verde (2007), Maldives (2011), Samoa (2014) and Equatorial Guinea (2017).

achieving LDC graduation thresholds as measured by various criteria do not adequately reflect its challenges of achieving sustainable development through building productive capacities as envisaged in the IPoA.

Many pledges for supporting LDCs have not been binding in nature and thus their implementation has not been effective. Furthermore, not many LDCs have been able to make use of the available ISMs for them often because of their inherent capacity constraints. The most important ISMs enjoyed by LDCs are preferential market access and special and differential treatment (S&DT) including favourable conditions and flexibilities granted under various World Trade Organisation (WTO) agreements. Besides, development partners are perceived to have provided special attention to supporting LDCs with financial and technical assistance.[4] Therefore, the implications arising from graduation will depend on any benefits that a graduating LDC has made use of and will have to be forgone because of its transition from the group of LDCs. Against this backdrop, this paper highlights the challenges and opportunities associated with Nepal's impending graduation and discusses the way forward.

The paper is organized as follows: after this introduction, Section II provides a snapshot of socio-economic progress and Nepal's somewhat unusual path to LDC graduation; Section III discusses the likely implications of its graduation from LDC status; Section IV provides some discussion on the way forward suggesting relevant policy options in dealing with any potential consequences and carving a smooth graduation strategy; finally, Section V concludes the paper.

# II. A snapshot of socio-economic progress and Nepal's path to LDC graduation

## 2.1 Socio-economic progress

Over the past three decades, the Nepalese economy grew from $3.6 billion in 1990 to $24.5 billion in 2017 (Table 1) with an annual average growth of 3 per cent per annum. Compared to its South Asian neighbours, Nepal's long-term economic growth has been sluggish.[5] However, very recently economic activities picked up registering a growth of 7.1 per cent in FY2019 while the projected medium-term growth outlook is expected to be around 6.5 per cent (World Bank, 2019). The devastating earthquake of 2015 caused economic growth to plummet to just about 0.6 per cent (Figure 1) and such natural disasters will remain a major factor in shaping the country's future development. Reflecting the weaker rate of expansion in economic activities, the per capita GDP

[4] Although it is very difficult to assess if the provided assistance was due to LDC status alone.
[5] According to the National Planning Commission of Nepal, the factors that have contributed to slow growth include armed conflict (1996–2006), protracted democratic transition (2006–2017), border blockage in the Southern border (September 2015–February 2016), catastrophic earthquake in 2015, and floods in 2017.

grew only at a modest pace during the almost thirty-year period since 1990 from about $200 to $835 after.

**Table 1. A Snapshot of major socio-economic indicators of Nepal**

| Particulars | 1990 | 2000 | 2010 | 2017 |
|---|---|---|---|---|
| GDP (current $, billions) | 3.6 | 5.5 | 16.0 | 24.9 |
| Per capita GDP (current $) | 193 | 231 | 592 | 835 |
| GDP per capita, PPP (current international $) | 774 | 1220 | 1946 | 2682 |
| Merchandise exports (current $ million) | 204 | 804 | 856 | 741 |
| Merchandise imports (current $ million) | 672 | 1573 | 5133 | 10345 |
| Merchandise exports as % of GDP | 5.62 | 14.63 | 5.35 | 2.98 |
| Merchandise trade as % of GDP | 24.15 | 43.26 | 37.43 | 44.56 |
| Services exports (BOP, current $ million) | 204 | 506 | 671 | 1595 |
| Services exports (% of GDP) | 5.63 | 9.21 | 4.19 | 6.41 |
| Exports of goods and services as % of GDP | 10.53 | 23.28 | 9.58 | 9.1 |
| Total trade (% of GDP) | 32.19 | 55.71 | 45.98 | 51.98 |
| Personal remittances received (current $ billion) | 0.05 | 0.11 | 3.46 | 6.93 |
| Remittance (% of GDP) | 1.50 (1993) | 2.03 | 21.65 | 28.31 |
| Exchange rate (local currencies per dollar, period average) | 29.37 | 71.09 | 73.26 | 104.51 |
| External debt stock (% of GNI) | 44.69 | 52.19 | 23.50 | 20.07 |
| FDI net inflows (% of GDP) | 0.16 | -0.01 | 0.55 | 0.80 |
| Net ODA received (% of GDP) | 11.66 | 7.03 | 5.09 | 5.06 |
| Inflation CPI (annual %) | 8.24 | 2.48 | 9.32 | 3.23 |
| Population (million) | 18.7 | 23.7 | 27.0 | 29.3 |
| Poverty headcount ratio at $1.90 a day (2011 PPP) (% of population) | 61.9 (1995) | 46.1 (2003) | 15 | - |
| Average life expectancy at birth (total years) | 54.26 | 62.39 | 67.91 | 70.25 |
| Gross secondary school enrollment (%) | 33.27 | 36.06 | 58.83 | 71.21 |
| Access to electricity (% of population) | 0.01 | 27.54 | 67.00 | 90.7 (2016) |
| Mobile cellular subscriptions (per 100 people) | - | 0.043 | 34.028 | 123.174 |
| % of the population with access to the Internet | - | 0.20 | 7.93 | 19.69 (2016) |

*Source:* World Development Indicators, World Bank, https://datacatalog.worldbank.org/dataset/world-development-indicators and International Trade Centre (ITC).

Currently, 57 per cent of economic activities are concentrated in the services sector, followed by 28 per cent in agriculture.[6] While the share of industry has hovered around 15 per cent (Figure 2),

[6] The remaining 15 per cent is industry, which includes manufacturing and utilities.

Nepal has seen a significant decline in the manufacturing activities in GDP falling from an already low level of 8.8 per cent in 2000 to just above 5 per cent in 2017. All other Asian LDCs have a higher share of manufacturing in their respective economies (Figure 3).

**Figure 1. Nepal: GDP growth rate (%)**

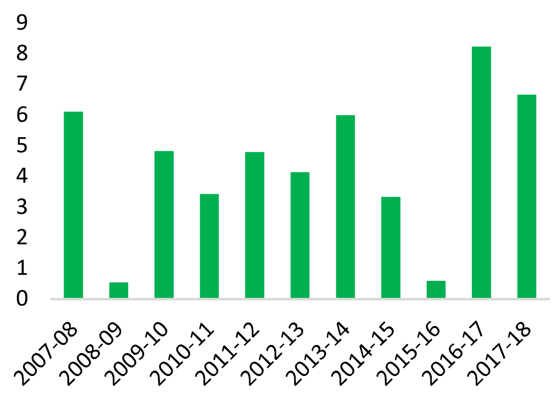
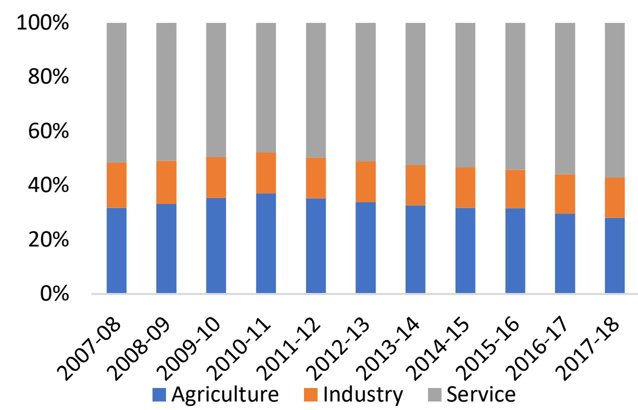
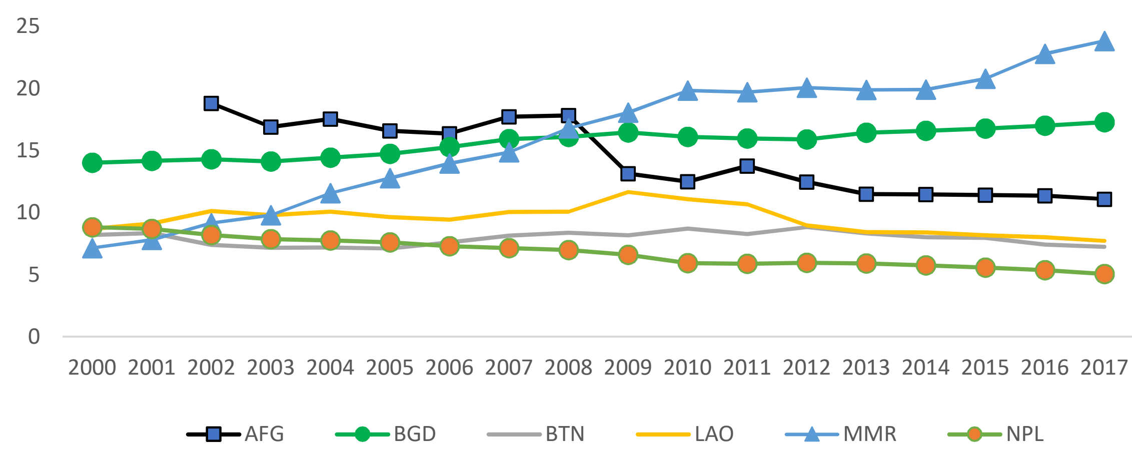



**Figure 2. Composition of GDP by major sector**




*Source:* Central Bureau of Statistics, Nepal.

**Figure 3. Manufacturing value added (% of GDP)**




*Source:* Central Bureau of Statistics, Nepal and WDI.

In terms of social development, Nepal has shown remarkable progress. Since 1990, the average life expectancy at birth increased by more than 16 years to reach 70 years – thanks to significant reductions in child mortality rates. Although poverty estimates are not up to date, the proportion of the population living below the poverty line is reported to have declined considerably to reach 21 per cent in 2018.[7] According to World Bank (2017), the headcount poverty rate declined by an average annual rate of 2.2 per centage points per year between FY1996 and FY2011. This is

[7] This can be found here www.nepalisansar.com/news/21-per cent-of-nepal-population-under-poverty-line/ accessed on 20 August 2019.

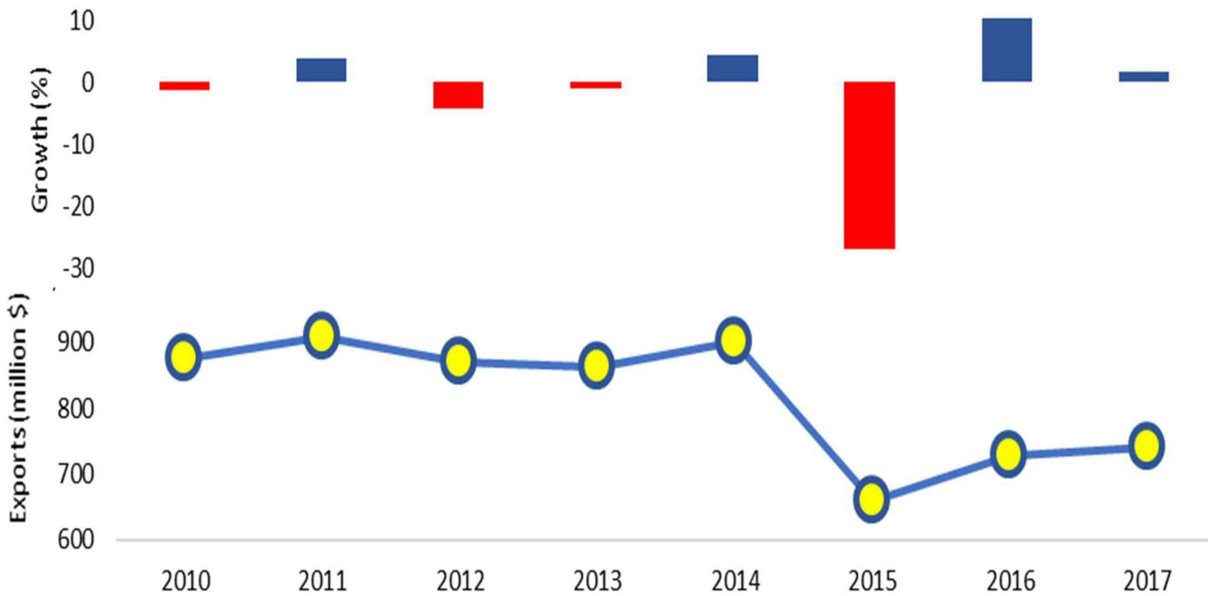
very impressive given the relatively low overall economic growth rates observed during the period. It has been shown that Nepal's economy grew slowest amongst the South Asian countries but recorded the second-fastest (after Sri Lanka) poverty reduction rate. This inclusive development paradigm is also reflected in amongst others, the progress made in the gross secondary school enrollment rate and access to electricity, where Nepal's success is truly remarkable. About 91 per cent of people have access to electricity as in 2016, rising from less than 30 per cent in 2000s. Mobile cellular and internet subscriptions have also improved quite significantly. With the growing size of the economy, the significance of the net official development assistance (ODA) has declined from about 12 per cent of GDP in 1990 to just above 5 per cent in 2017 (Table 1).[8] However, despite huge potential Nepal has not been able to attract much foreign direct investment (FDI).

For a landlocked economy, transport costs to international markets other than the adjacent countries with common land borders are usually much higher than a country with direct sea access. As a result, the share of trade in economic activities tends to be low. Given that Nepal is richly endowed with natural beauty, it is popular amongst international tourists. Services exports (due mainly to the tourism sector) were recorded at about $1.6 billion in 2017 (i.e. 6.5 per cent of GDP). Another important aspect of the services economy is the contribution made by the migrant workers by sending remittances back home.[9] Nepal has recorded growth in remittances received at an unprecedented pace. Since 2000, the share of remittances in GDP rose from 2 per cent to a staggering 30 per cent in 2015. In the 1990s, while a quarter of the households in the country received some remittances, by 2010s this rose to a half. While the inflow of remittances has contributed to rising consumption expenditures and well-being of many households, such a large labour migration, 4 million out of a total workforce of 14 million, is considered to be associated with certain structural factors, inhibiting productivity growth and putting Nepal in a 'low-growth, high migration trap' (World Bank, 2017).

Nepal seriously lacks in merchandise export performance, which is severely affected by being a landlocked country. In 2017, its exports of goods stood at $741 million – down from its highest-ever receipts of $900 million in 2011 (Figure 4). It suffered from a massive 27 per cent decline in exports in the aftermath of the 2015 devastating earthquake. Coffee, tea, mate and spices (HS 09) account for more than 10 per cent of export earnings, closely followed by carpets (9.8%), man-made staple fibres (HS 55, 8.6%), woven garments (8.0%), vegetables and fruits (5.9%) and textile articles (4.6%) etc. Several other small items together comprise about 37 per cent of the total export receipts (Figure 5).[10] The ratio of total merchandise exports to GDP is around 3 per cent.

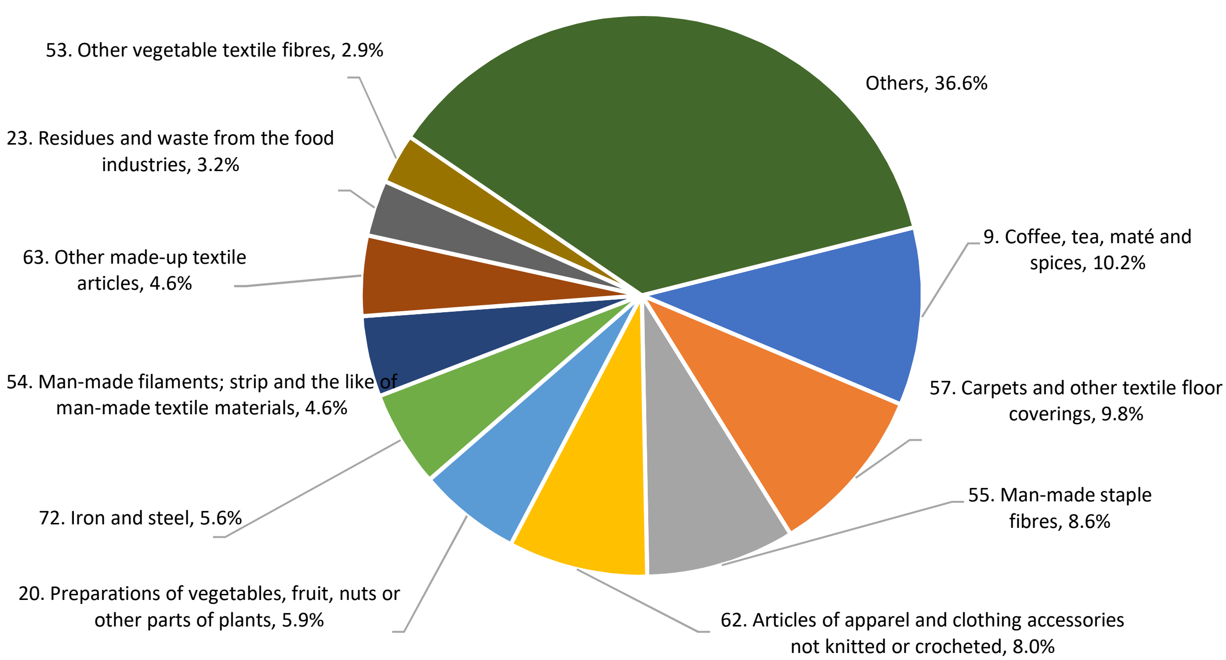
[8] Nonetheless, in absolute terms, ODA followed an upward trend immediately after the devastating earthquake in 2015 and floods in 2017, mostly due to major reconstruction work.
[9] Remittances are not usually accounted for within the balance-of-payments items related to services transactions. They are shown separately as "personal remittances" as shown in Table 1 above.
[10] At a disaggregated HS 6-digit level, it has been estimated that the topmost 20 items together account for 60 per cent of all exports.

**Figure 4. Nepal's merchandise exports and its growth**




*Source:* Author's analysis using the data from the International Trade Centre (ITC).

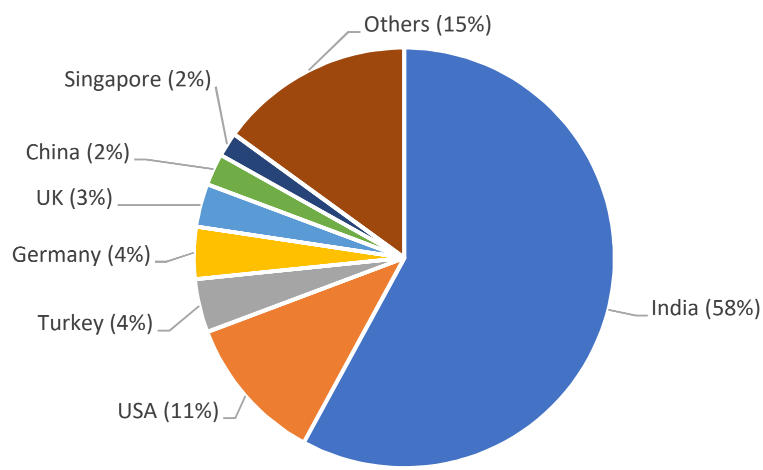
**Figure 5. Export composition of Nepal**




*Source:* Author's presentation using the data from the International Trade Centre (ITC).
*Note:* Three-year average data are considered.

Landlocked countries are mostly dependent on trading with their adjacent countries. As such, India is the single largest export destination of Nepal, accounting for 58 per cent of its total exports (Figure 6).[11] This is followed by the United States of America (11%), Turkey (4%), Germany (4%), United Kingdom (3%), China (2%) and Singapore (2%). It is rather striking that despite sharing a common border and being one of the major global economic powerhouses, China's significance in Nepal's exports is so low. A high export market concentration poses a serious risk due to any unfavourable developments in the main market(s). Nepal's export market concentration is estimated to be higher than Afghanistan and Lao PDR, two landlocked LDCs in Asia (Figure 7).[12] On the other hand, Nepal's export market penetration rate is just 2.4 per cent (Figure 8), which is lower than that of Asian LDCs of Afghanistan, Bangladesh, Maldives and Myanmar.[13]

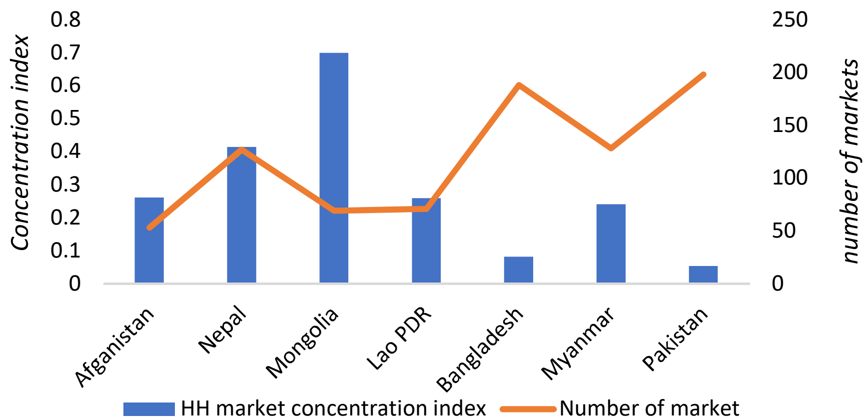
**Figure 6. Nepal's major exported destinations**




*Source:* Authors' presentation using data from International Trade Centre (ITC).
*Note:* Top export destinations (Taking 3-year average 2015-2017)

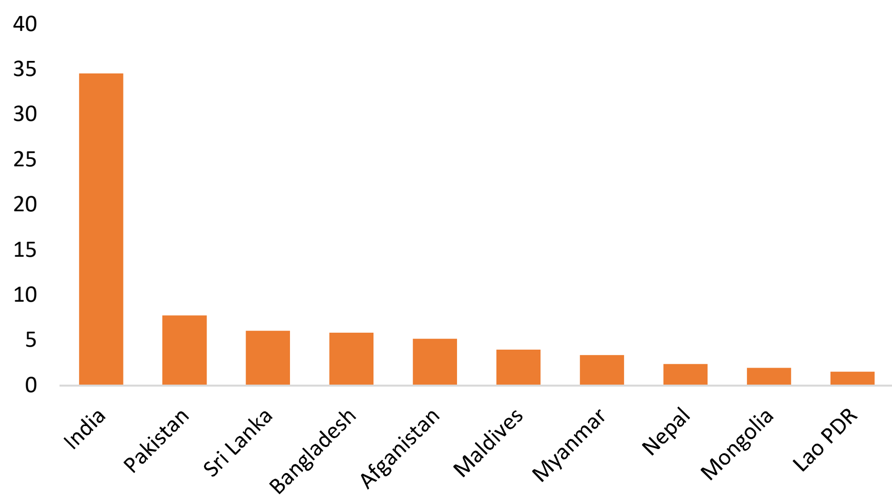
[11] Export share is based on the average share from 2015 to 2017.
[12] The market concentration of an exporting country can be better explained by the Herfindahl-Hirschman Market Concentration Index. The index values vary between 0 and 1. A higher index value closer to 1 indicates that exports are concentrated in fewer markets, whereas a country with diversified partners will have an index closer to 0.
[13] The export market penetration rate is measured by the Index of Export Market Penetration (IEMP). It firstly considers the total number of all possible market reaches based on the country's all individual export items. Then, it computes the actual number of market connections that a country has been able to establish as a share of all possible market reaches estimated in the first step.

**Figure 7. Export market concentration: Nepal and others**




*Source:* Author's calculation using data from the World Integrated Trade Solution (WITS).

**Figure 8. Index of export market penetration (%)**




*Source:* Author's presentation using data from the World Integrated Trade Solution (WITS).

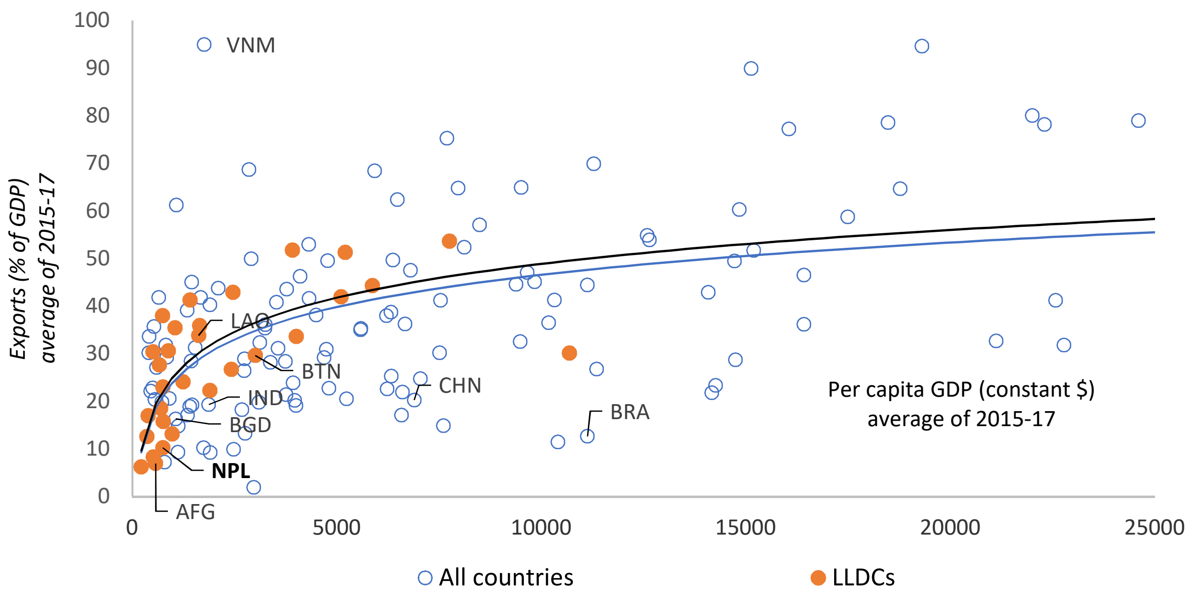
While landlocked countries are more disadvantaged to trade than countries having easier sea access (Figure 9), Nepal's export-orientation, measured by exports of goods and services as a proportion of GDP, is much lower than that of the average of landlocked developing countries (LLDCs): 9.6 per cent vis-à-vis 28.6 per cent.[14] Given that Nepal has relatively large remittances to finance its imports, its overall trade-GDP ratio improves substantially to 51 per cent.[15] Nevertheless, it remains lower than the level of trade-orientation that can be predicted for Nepal using the cross-

[14] If only exports of merchandise goods considered, Nepal would perform even worse as its goods' export-GDP ratio is around 3 per cent.

[15] This can be compared against the average trade-GDP ratio of 71.2 per cent for landlocked developing countries.

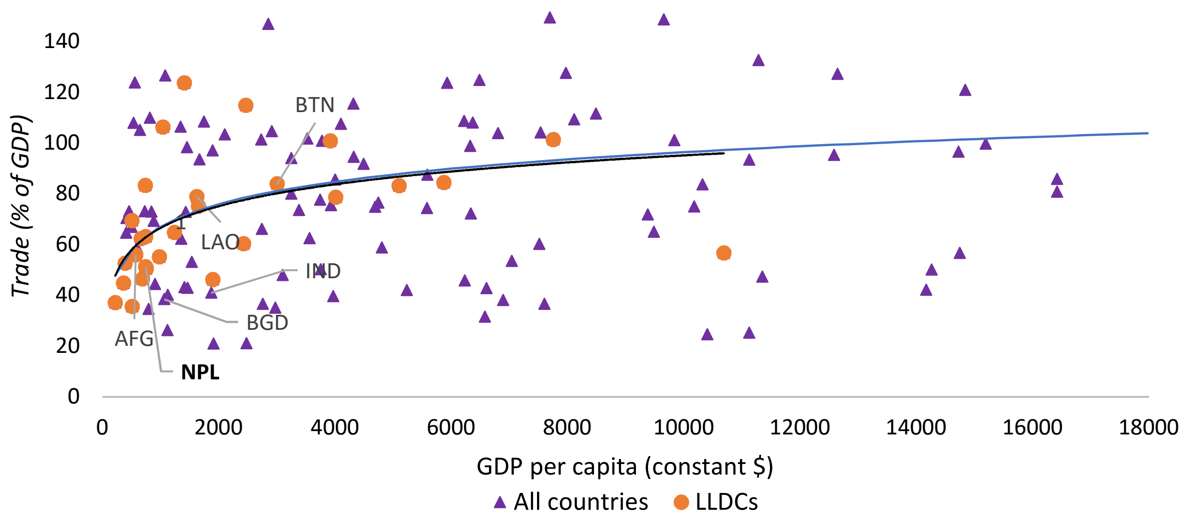
country relationship between trade-GDP ratios and per capita GDP amongst the set of developing countries (Figure 10).

**Figure 9. Export-GDP ratio and per capita GDP in developing countries**




*Note:* The figure shows compared to other developing countries, landlocked countries have lower export-GDP ratios, controlling for per capita GDP.

**Figure 10. Trade-GDP ratio vs GDP per capita**

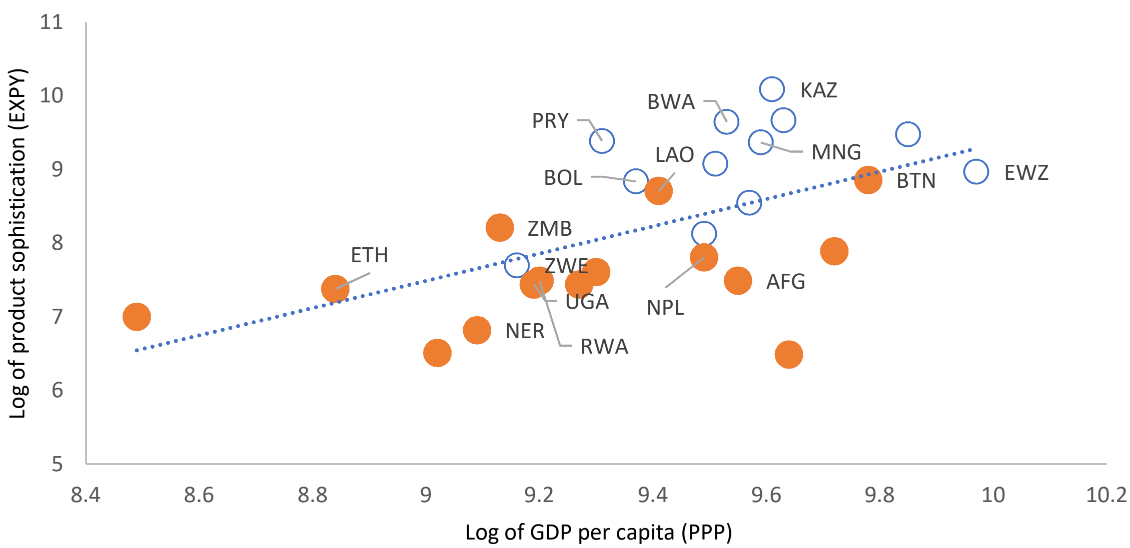



*Source:* Author's presentation using data from the World Development Indicators (WDI).

*Notes:* AFG – Afghanistan, BGD – Bangladesh, BRA – Brazil, BTN – Bhutan, CHN – China, IND – India, LAO – Lao PDR, NPL – Nepal. The blue line indicates the predicted relationship between exports (% of GDP) and per capita GDP whereas the black line reflects the same for landlocked developing countries.

The level of technological sophistication embodied in a country's export portfolio is also an indicator of a country's economic progress, as Hausmann, Hwang and Rodrik (2006) show that countries with high export sophistication tend to have higher growth rates in the future. Within the set of landlocked developing countries, Nepal is found to have lower export sophistication than what is expected given its per capita income (Figure 11).[16] This implies that developing new products for exports is much more important for Nepal.

**Figure 11. Export sophistication and per capita GDP of landlocked developing countries**



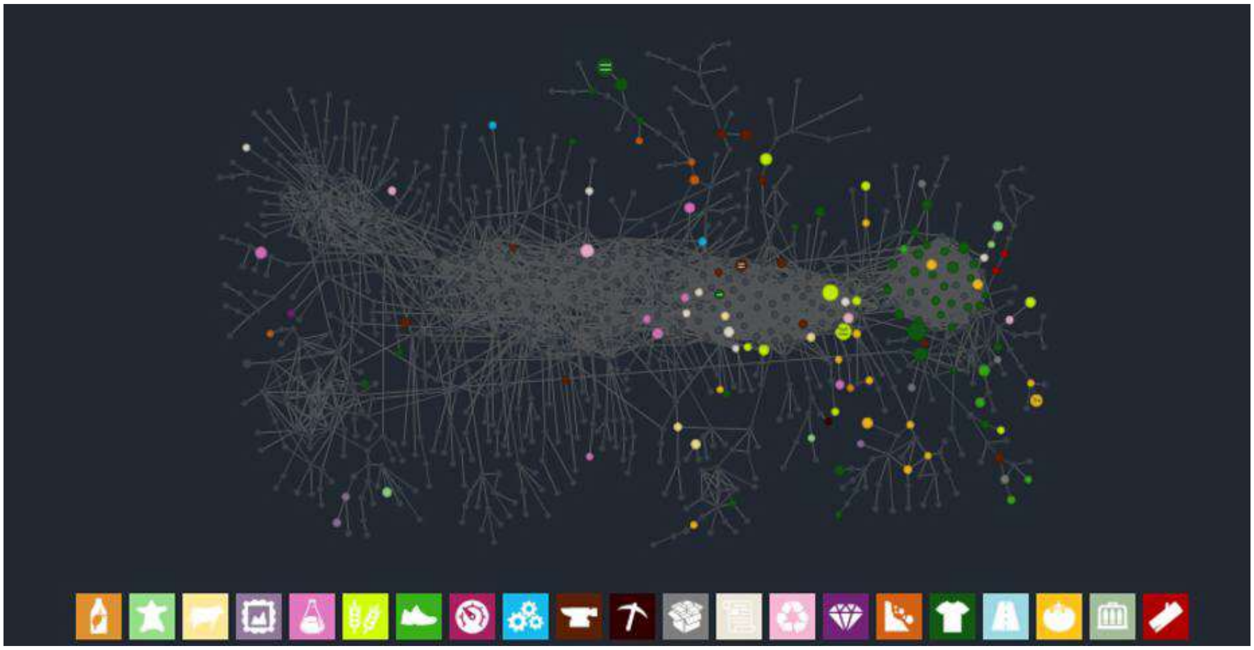

*Source:* Author's analysis using data from the World Integrated Trade Solution (WITS).
*Note:* Shaded circles are landlocked LDCs while others and landlocked developing countries. AFG – Afghanistan, BTN – Bhutan, BOL – Bolivia, BWA – Botswana, ETH – Ethiopia, KAZ – Kazakhstan, LAO – Lao PDR, MNG – Mongolia, NPL – Nepal, NER – Niger, PRY – Paraguay, RWA – Rwanda, EWZ – Swaziland, UGA – Uganda, ZMB – Zambia and ZWE – Zimbabwe.

Notwithstanding the above, Nepal has significant prospects for export development and diversification. This is reflected in the location of the country's exports products in connection to all possible export products (supplied by all global economies). Nepal's product space analysis reflects significant exporting activities in the textile and clothing cluster that provides linkages amongst many potential export items (Figure 12). Its several other products are also suitably located within the economic complexity atlas that can generate export expansion from the related sectors.[17]

[16] This measure of export sophistication first sorts all products into one of five mutually exclusive technological groupings: high tech, medium tech, low tech, primary products, and resource-based products. Then, it uses the methodology introduced by Hausman, Hwang and Rodrik (2006) to estimate the level of technological sophistication embodied in a country's export portfolio.

[17] The product space analysis assesses the prospects for export expansion and diversification. In simple terms, the product space depicts a map of all export items (also known as the economic complexity atlas) to indicate how individual products are linked to one another. Towards the centre of the space, product linkages are dense. This implies

**Figure 12. Nepal's product space**



*Source:* http://atlas.media.mit.edu/07hi03

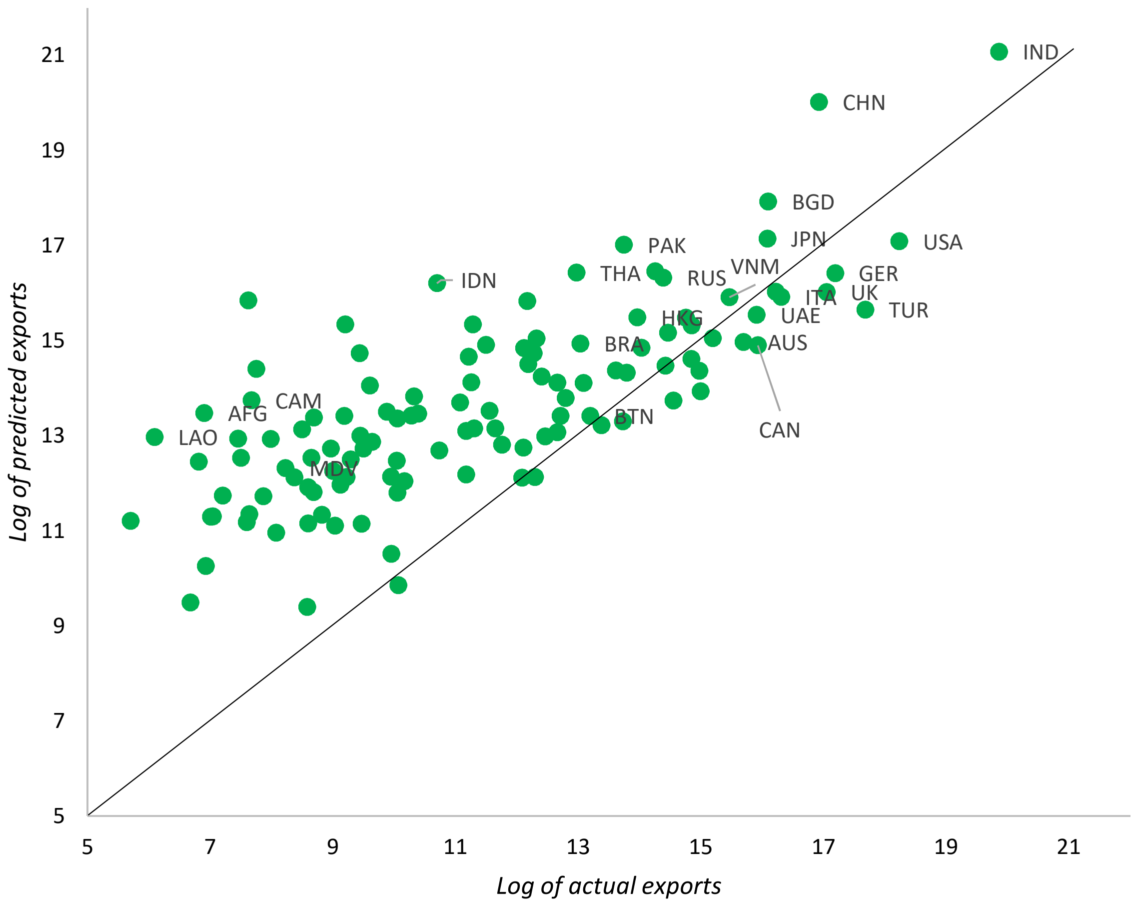
Indeed, the untapped exporting opportunities for Nepal, derived from an econometrically estimated gravity model of international trade appears to be very high. The gravity model, which is regarded as the most successful analytical tool in explaining trade flows between countries, can be utilized to identify the partners where a country in question is exporting less than what is predicted based on cross-country experiences and the opposite. Partners that receive exports-less-than-predicted could be considered as markets with potential for export expansion while those that receive exports-more-than-predicted would indicate niche markets.[18] The model estimated for this paper suggests that the realized exports of Nepal, $741 million in 2017, is less than one-third of the potential of $2.31 billion. The largest difference between actual and predicted exports is with India (Figure 13). That is, Nepal can potentially earn an additional $ 1 billion from India. Again, what Nepal exports to China is almost half a billion dollars less than what is predicted. Amongst others, Nepal is under-exporting by about $50 million to Bangladesh, $24 million to Pakistan and $18

that if a country's products lie at or close to the centre, it is easier to expand exports through the related products. When products are at peripheries of product space, counties exporting these items find it very difficult to move into other sectors. Many agricultural exports and mining activities are located in the periphery. Therefore, location of a country's products can depict the nature of its diversification prospects.

[18] The gravity model takes into consideration numerous factors in explaining bilateral trade flow such as, countries' incomes; geographic distance between trade partners; countries' having common borders, language, and currencies, past colonial linkages; other country specific characteristics such as if a country is landlocked or an island economy; etc. Amongst others, the results from estimated gravity models show that while bilateral trade flows are positively influenced by country sizes (measured by GDPs) but are negatively affected by geographical distances. Amongst others, having common land borders, common language, and past colonial linkages, tend to augment trade flows between two countries.

million to Japan. In countries such as Australia, Canada, Germany, Italy, Turkey, the United Kingdom, and the United States, Nepal's export volumes are higher than what can be predicted from the global countries' experience. These are the countries where Nepal also gets preferential market access as an LDC.

**Figure 13. Actual and predicted exports of Nepal to all partners: Gravity model results**



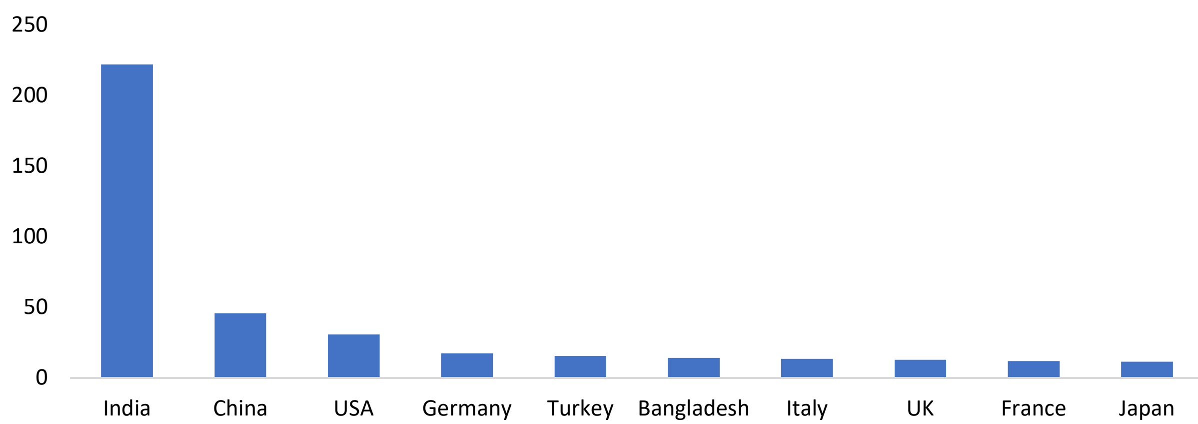

*Source:* Author's estimation and presentation.

*Note:* The actual and predicted exports of Nepal from the estimated global gravity model is summarised in the figure for 2017. The partner countries that lie above the 45-degree line (the diagonal line from the origin) are those where Nepal exports more than what could be predicted from the model. AFG – Afghanistan, AUS – Australia, BGD – Bangladesh, BRA – Brazil, BTN – Bhutan, CAM – Cambodia, CAN – Canada, CHN – China, GER – Germany, HKG – Hong Kong, China, IDN – Indonesia, IND – India, ITA – Italy, JPN – Japan, LAO – Lao PDR, MDV – Maldives, PAK – Pakistan, RUS – Russian Federation, THA – Thailand, TUR – Turkey, UAE – United Arab Emirate, UK – United Kingdom, USA – United States of America and VNM - Vietnam.

The untapped export potential in different destination markets can also be analysed by making use of another methodology developed by the International Trade Centre (Decreux and Spies, 2016). The ITC Export Potential Indicator (EPI) identifies products in which an exporting country has already proven to be internationally competitive and which is likely to have good prospects of export success. The potential export value in a target market is approximated based on exporters' supply capacity, demand condition in the market of interest, and market access conditions.[19] Potential export values are compared with actual export earnings to reveal untapped opportunities. While the gravity model uses the experience of global economies in predicting trade potential of a country, the ITC methodology is more detailed considering the supply-side capacity and sectors where a country has established its export competitiveness through actual export response.[20]

The estimated results show that Nepal has an unutilised export potential worth of almost half a billion dollars (i.e. almost two-thirds of its current export volume) in different destination countries. In the EU, the existing level of exports is short of more than $100 million potential. With the highest absolute difference between potential and actual exports, India leaves the RoOm for additional export earnings of $222 million (Figure 14). That is, more than 50 per cent of the potential is unexploited in the largest destination market of Nepal. In China – the other neighbouring country – Nepal is currently exploiting only 17 per cent of its potential. Amongst others, Nepal is utilising only 6 per cent potential in Bangladesh, 52 per cent in Germany, 57 per cent in Turkey, 35 per cent in Italy and 62 per cent in the United States.

**Figure 14. Countries with highest untapped export potential for Nepal (million dollars)**




*Source:* Author's extraction of data from ITC Export Potential Map.

[19] The EPI has three components: exporters' supply capacity of a product, demand conditions and bilateral 'easiness' to trade. An exporter's supply capacity is estimated as a dynamic version of market share where expected economic growth is considered to augment the exporter's capacity; and product-specific trade balance measured by the export-import ratio and global margin of preference, which encompasses information on tariff preference. Demand conditions are captured through partners' projected imports, which are determined by projected GDP and population growth; margin of preference in the target market; and distance advantage, which compares suppliers' geographical distances with the target market. The easiness-to-trade between two countries is computed based on the actual trade relative to hypothetical trade estimated by supply and demand conditions. If easiness to trade between countries is greater than 1, countries find it easier to trade between themselves relative to world markets. The export potential is then multiplication of estimated supply capacity, demand conditions and bilateral easiness to trade. Potential exports are estimated for disaggregated products at HS 6-digit level. The aggregate export potential of a country in a target market is the sum of product-level export potentials.

[20] Therefore, the ITC methodology would provide more conservative estimates than the gravity model based results.

## 2.2 Nepal's way to LDC graduation

Nepal was included in the Least Developed Country (LDC) list in 1971. Over the past decades, it managed to make remarkable progress under two of the three criteria used in assessing graduation qualification. These are the Human Asset Index (HAI) and the Economic Vulnerability Index (EVI). Based on the improvements in these two areas, Nepal became eligible for graduation in the 2015 triennial review by the United Nations Committee on Development Policy (CDP).[21] Nepal could also maintain its eligibility in the 2018 review in the same way (Table 2). However, the CDP deferred its decision to recommend the graduation of Nepal until the next review because of the concerns about the sustainability of development progress. It is rather quite extraordinary that with a per capita income (of $745 in 2018) as low as just 60 per cent of the graduation threshold level of per capita income (of 1,230), Nepal could meet the other two criteria. Nepal is the only country amongst all the graduated countries as well as countries with graduation eligibility (which are likely to graduate by 2021), secured graduation requirements without fulfilling the per capita GNI threshold criterion (Figure 15 and 16).

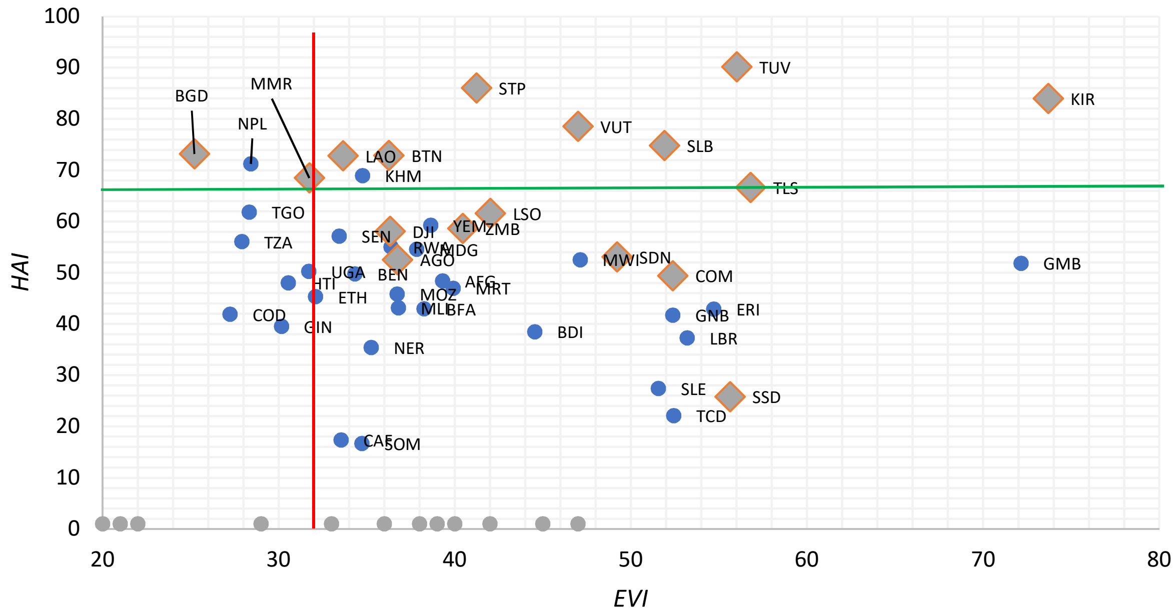
**Table 2. Nepal's way to LDC graduation**

| Criteria | Thresholds | 2006 | 2009 | 2012 | 2015 | 2018 |
|---|---|---|---|---|---|---|
| Per capita GNI ($) | Inclusion thresholds | 749 | 905 | 992 | 1,035 | 1,025 |
| | Graduation threshold (country to have higher GNI per capita for graduation) | 900 | 1,086 | 1,190 | 1,242 | 1,230 |
| | Nepal's situation | 690 | 1,486 | 1,700 | 659 | 745 |
| HAI | Inclusion thresholds | 58 | 60 | 60 | 60 | 60 |
| | Graduation thresholds (countries to have higher than the threshold values for qualification) | 64 | 66 | 66 | 66 | 66 |
| | Nepal's situation | 56.0 | 58.3 | 59.8 | 68.1 | 71.2 |
| EVI | Inclusion thresholds | 42 | 42 | 36 | 36 | 36 |
| | Graduation thresholds (countries to have lower than the threshold value for graduation) | 38 | 38 | 32 | 32 | 32 |
| | Nepal's situation | 37.4 | 33.6 | 27.8 | 26.8 | 28.4 |

*Source:* Rai (2018) and CDP (2018).

[21] An LDC will be eligible for graduation if it meets two of the three graduation criteria (per capita GNI, Human Asset Index-HAI and Economic Vulnerability Index-EVI) in two consecutive CDP's triennial reviews. There is also the income-only criterion under which if a country's per capita GNI is at least twice the threshold level (i.e. at least $ 2,460 as per CDP Triennial Review, 2018), it will graduate irrespective of its situations under the two other criteria.

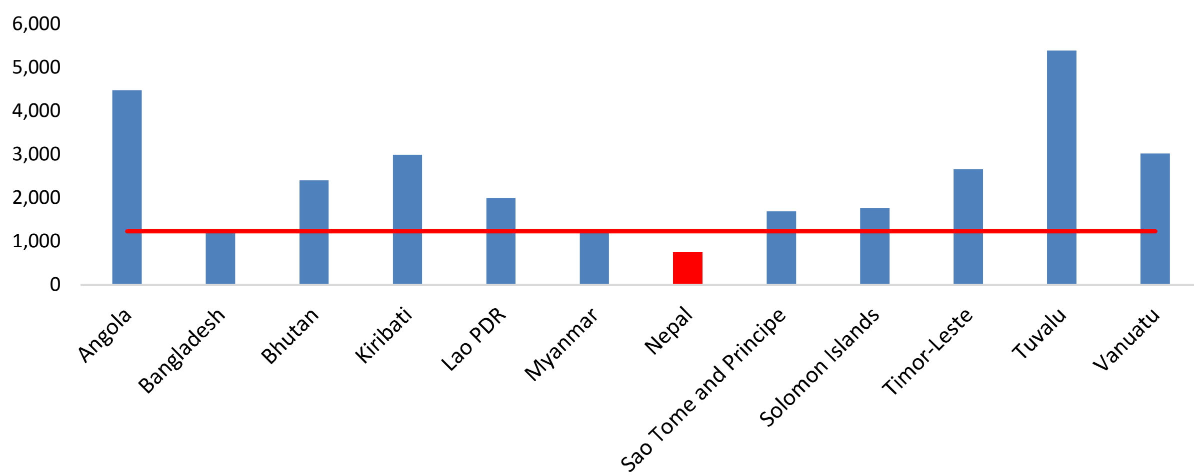
### Figure 15. EVI and HAI scores of LDCs




*Source:* CDP Triennial Review Dataset (2018).

*Note:* The shaded diamonds represent LDCs with per capita GNI higher than the threshold level of per capita GNI while blue dots indicate the opposite. The red vertical line indicates the EVI threshold (32 or less) while the green horizontal line represents the HAI threshold level (66 or more). The threshold levels for EVI and HAI correspond to the CDP's 2018 Triennial Review. Countries denoted as AGO – Angola, BGD – Bangladesh, BTN – Bhutan, COM – Comoros, DJI – Djibouti, KIR – Kiribati, LAO – Lao People's Democratic Republic, LSO – Lesotho, MMR – Myanmar, STP – Sao Tome and Principe, SLB – Solomon Islands, SSD – South Sudan, SDN – Sudan, TLS – Timor-Leste, TUV – Tuvalu, VUT – Vanuatu and ZMB – Zambia.

### Figure 16. Per capita GNI of graduating LDCs




*Source:* CDP Triennial Review Dataset (2018).

*Note:* The red line represents the per capita GNI threshold level ($ 1,230) according to CDP Triennial Review (2018).

# III. Potential implications of graduation

Being an LDC, Nepal enjoys certain privileges and special and differential treatments (S&DT) including development partners' various concessions, special attention and commitments to support with development finance, trade preferences and technical assistance. After graduation, Nepal would not be eligible for the LDC-specific benefits. Consequently, the implications could broadly arise from (i) preference erosion in international trade potentially affecting export competitiveness, (ii) reduced policy space, tightening the scope of supporting exporters and domestic market-oriented industries; and (iii) unfavourable impact on the prospects for development financing. At the outset, it must be pointed out that when preferences and privileges remain unutilized due to various factors including supply-side constraints, LDC graduation could only imply forgone opportunities in the future without causing any actual consequences.

## 3.1 Preference erosion in international trade

Under the WTO's "Enabling Clause" adopted in 1979, most developed country members grant concessional and/or complete duty-free, quota-free market access conditions and less stringent preferential rules of origin for goods originated in LDCs under the Generalized System of Preference (GSP) schemes. After graduation, benefits for LDCs under GSP will either cease to exist or get less generous to be at par with other developing countries that can also access GSP benefits. In some cases, LDCs also have preferential access to developing countries and after graduation the terms of market access can change unless there are other bilateral or regional trading agreements are in place. [22] In terms of preferential rules of origin, graduating countries must fulfil the standard rules of origin applicable for non-LDCs in order to obtain any favourable market access conditions.

Impact of graduation will mostly depend on the exporting products of LDCs and the associated provisions for market access in destination countries. It will have no implication if the export items of interest to a particular LDC are not covered by the LDC-specific treatment and if the importing countries do not allow any preferential access in the first instance. The utilisation of preferences is another important factor in post-graduation impact assessment. If the initial supply response from an LDC under a GSP scheme is either low or non-existent, graduation will not have much impact.

### 3.1.1 Preferential market access in the European Union

The EU is the second-largest destination of Nepal's exports accounting for 13.5 per cent of total earnings. Apparel items comprise almost half of the total exports (woven garments (HS 62) 35.3% and knitwear (HS 61) 11.8%) to the EU. Other major products are carpets and other textile floor

[22] For regional trading arrangements, graduation would have implications on exports if the provisions are LDC-specific.

coverings (HS 57), Wadding, felt and nonwovens; special yarns (HS 56), home textiles (HS 63), leather and leather products (HS 41 and 42) etc. The European Union grants non-reciprocal and unilateral trade preferences to developing nations to support their development process. The current EU-GSP regime offers three different preferential treatments: (i) a general arrangement (Standard GSP); (ii) a Special Incentive Arrangement for Sustainable Development and Good Governance (GSP Plus); and (iii) an Everything But Arms (EBA) arrangement for the group of LDCs. Provisions under these GSP arrangements are summarised in Table 3.

**Table 3. EU GSP arrangements and their provisions**

| | Standard GSP | GSP+ | EBA |
|---|---|---|---|
| **Indicators** | Low- or lower-middle-income countries | Vulnerable (in terms of export diversification, export and import volumes) Standard GSP beneficiaries that have ratified the 27 GSP Plus-relevant international conventions | LDCs |
| **Number of beneficiaries** | 18 | 9 | 49 |
| **Non-sensitive goods** | Duty reduction for around 66% of all EU tariff lines | Duty suspension for around 66% of all EU tariff lines | Duty suspension for all goods with the exception of arms and ammunition |
| **Sensitive goods:**<br>**- specific duty**<br>**- ad valorem duty** | Duty reduction:<br>- 30%<br>- up to 3.5 per centage points | Duty suspension | Duty suspension |
| **Rules of origin (important provisions only)** | Double transformation for textile and clothing items. For all other products, a minimum local value-added of 50% | Double transformation for textile and clothing items. For all other products, a minimum local value-added of 50% | Single transformation for textile and clothing items. For all other products, a minimum local value-added of 30% |

*Source:* Razzaque and Rahman (2018) using the documents available in the European Commission website.

Nepal gets duty free market access under the EBA. After graduation, as under the current EU provision for LDCs, Nepal will continue to enjoy the same access for a three-year transition period. Then, it can be entitled to either Standard GSP or GSP Plus, the latter being more generous as shown in Table 3. The standard GSP provides some duty reduction only for various pre-defined sensitive products (e.g. textile and clothing items) within the 66 per cent of EU tariff lines while the GSP Plus allows duty-free access in these products. The rules of origin provisions, however, are almost similar for both Standard GSP and GSP+. After graduation, Nepal can apply for the GSP Plus scheme. To be eligible for it, the country must fulfil the Standard GSP conditions[23] and two additional criteria.[24] First, the vulnerability criteria comprises (i) the import share criterion – requiring that the country's share of GSP-covered import must remain below 6.5 per cent of GSP-covered imports of all GSP countries; and b) the diversification criterion, stipulating that the seven largest sections of GSP-covered imports must constitute 75 per cent of imports from the beneficiary country over a period of three years. Second, the sustainable development criterion which requires the applicant country to have ratified and effectively implemented 27 international conventions on labour rights, human rights, environmental protection and good governance. Nepal clearly satisfies the first criteria (including the vulnerability and diversification provisions) while a further assessment is needed for its meeting sustainable development criterion.

If qualified for GSP Plus, Nepal's major exporting products should continue to benefit from duty-free access, provided that the forthcoming EU GSP regime in 2023 does not make changes to the existing coverage of products and eligibility criteria.[25] However, one major supply-side constraint could arise due to more stringent rules of origin provisions. Under Standard GSP and GSP Plus, the minimum local value-added content for exports to benefit from preferential treatment would increase from 30 per cent to 50 per cent. For apparels, the most important exporting products of Nepal to the EU, exports will require going through a double transformation process while LDCs under the EBA scheme can benefit from duty-free market access with a single transformation. [26]

[23] Any developing country will benefit from Standard GSP unless: a) it has another type of special trade access to the EU granting the same tariff preferences as the scheme, or better, for substantially all trade, b) it has achieved a high- or upper-middle income economy status during three consecutive years according to the World Bank classification.
[24] Information obtained from European Commission website. URL: https://trade.ec.europa.eu/tradehelp/gsp
[25] Depending on the date of Nepal's graduation, the market access conditions to the EU could differ. The current Generalised System of Preferences (GSP) regulation will expire at the end of 2023.
[26] Double transformation implies that preference-seeking countries will have to prove that they can produce fabrics and the domestically produced fabrics are used in making garments.

## Table 4. Market access conditions for major exporting items in the EU

| HS code | Product description | Share in exports to the EU in 2017 (%) | MFN rate | GSP + | Standard GSP |
|---|---|---|---|---|---|
| **62** | Articles of apparel and clothing accessories, not knitted or crocheted | 35.3 | 6.5-12% 12% mostly; average rate 11.6% | duty suspension | 5%–9.6% 9.6% for most products and avg tariff rate 9.25% |
| **57** | Carpets and other textile floor coverings | 23.4 | 3.5%-8% 8% for most products; average rate is 7.6 % | duty suspension | 2.8%-6.4% duty reduction by 20% |
| **61** | Articles of apparel and clothing accessories, knitted or crocheted | 11.8 | 8-12% 12% mostly; average rate 11.6% | duty suspension | 6.4%-9.6% 9.6% for most products and avg tariff rate 9.3% |
| **56** | Wadding, felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles thereof | 6.0 | 3.2%-12% 6.5% and 8% for most products; average rate 6.1% | duty suspension | 2.5%-9.6% tariff rates above 20 per cent reduction for all tariff line under this category |
| **63** | Other made-up textile articles; sets; worn clothing and worn textile articles; rags | 3.4 | 0%-12% 12% for most products; average rate 10% | duty suspension | 0%-9.6% 9.6% for most products and avg tariff rate 8.25% |
| **41** | Raw hides and skins (other than furskins) and leather | 3.4 | 0%-6.5% 6.5% for most products; average rate is 3.1% | tariff suspension for more than 85% of tariff line under this category | 0%-6.5% tariff reduction and suspension for 85% of tariff line |
| **48** | Paper and paperboard; articles of paper pulp, of paper or of paperboard | 2.8 | MFN 0 for all products | | |

| HS code | Product description | Share in exports to the EU in 2017 (%) | MFN rate | GSP + | Standard GSP |
|---|---|---|---|---|---|
| **65** | Headgear and parts thereof | 2.2 | 0%-5.7% 2.7% for most products; average rate 2.8% | duty suspension | duty suspension |
| **97** | Works of art, collectors' pieces and antiques | 2.1 | MFN 0 for all products | | |
| **9** | Coffee, tea, maté and spices | 1.9 | 0%-12.5% 0% for most of the products; average rate 2.7% | Duty suspension | 0%- 8% concessional rate for the products whose MFN rate is non-zero |

*Source:* Author's analysis based on data obtained from the International Trade Centre (ITC) and the World Integrated Trade Solution (WITS).
*Note:* Average tariff rates are calculated as a simple average.

On the other hand, if not qualified for GSP+, the application of EU Standard GSP could imply that more than 80 per cent of Nepal's exports to the EU, including all major items such as apparel products, carpets, etc) would be subject to some tariff (Table 4). In this case, an analysis of EU tariff structure seems to suggest that about 40 per cent of Nepal's exports will fall under the average tariff rate of 5–7.9 per cent while another 35 per cent of exports will have to subject to 8–9.9 per cent on average (Table 5). A very insignificant proportion of export could see tariff rate facing above 10 per cent. For comparison purposes, Table 5 also incorporates Nepal's exports against MFN tariff structure.

### Table 5. Nepal's exports in the EU under MFN and Standard GSP tariff rate

| | Nepal's current exports against EU MFN rates | | Nepal's current exports against EU Standard GSP rates | |
|---|---|---|---|---|
| | Exports in 2018 ($) | Share in 2018 | Exports in 2018 ($) | Share in 2018 |
| **0%** | 8.83 | 8.70 | 21.37 | 21.05 |
| **0%-4.9%** | 15.82 | 15.59 | 4.70 | 4.63 |
| **5%-7.9%** | 6.81 | 6.71 | 38.97 | 38.39 |
| **8%-9.9%** | 33.01 | 32.52 | 35.74 | 35.21 |
| **10%-11.9%** | 0.62 | 0.61 | 0.72 | 0.71 |
| **12%-15%** | 35.17 | 34.65 | 0.02 | 0.02 |
| **15.1%-20%** | 0.73 | 0.72 | 0.001 | 0.001 |
| **Above 20%** | 0.52 | 0.51 | - | - |
| | 101.51 | 100.00 | 101.51 | 100.00 |

*Source:* Author's analysis using data from EU Comext and WITS.
*Note:* Some products with MFN tariffs are also subject to specific duties. In this exercise, these products are placed under the relevant ad valorem tariff slabs only.

### 3.1.2 Market access conditions in India

India is by far the largest market for Nepal. LDC graduation will unlikely to have any impact given that the bilateral trade between the two countries is governed by the Indo-Nepal Treaty of Trade. This treaty enabled duty-free access of Nepalese origin products into the Indian market.[27] In terms of rules of origin, Nepalese manufactured products enlisted for duty-free access in the Indian market must fulfil certain criteria: (i) 30 per cent domestic value addition (of ex-factory price of the products)[28] (ii) requiring sufficient information on manufacturing process, especially when using third country origin inputs so that it can be confirmed that inputs are adequately transformed.[29] However, some products will be subject to MFN tariffs in excess of their quota amount. Products that are without any preferential treatment are alcoholic liquors/beverages and

[27] An exclusion to duty-free access occurs under three criteria: "(i) Goods restricted for export into third countries, (ii) Goods subject to control on prices for distribution or movement within the domestic market and (iii) Goods prohibited for export to each other's territories to prevent deflection to third countries".
[28] This provision is applied since March 2003 to onwards.
[29] Sufficient information on Harmonised System of Product Description and Coding System (at four-digit level) are required.

their concentrates except industrial spirits[30]; perfumes and cosmetics with non-Nepalese/non-Indian brand names; cigarettes and tobacco (Ministry of Commerce and Industry, 2009).

### 3.1.3 Market access conditions in the United States

The United States GSP provides preferential duty-free entry for more than 5,100 products, out of around 12,000 tariff lines at the HTS (Harmonized Tariff Schedule) 8-digit level of trade classification. There are 131 designated beneficiary countries and territories, including 44 least-developed beneficiary developing countries (LDBDCs) (USTR, 2016). Nepal benefits from the LDBDCs scheme under the USA's "Nepal Trade Preferences Act", enacted after the 2015 devastating earthquake. Under this Act, the United States allows duty-free preferential treatment of 66 products (at the HTS 8-digit level until December 2025). The rules of origin applicable is that the local content of the products produced in the beneficiary country must equal at least 35 per cent of the appraised value of the article at the time of entry into the United States.

Should Nepal graduate from the group of LDCs, it will no longer benefit from the GSP designed for LDBDCs. However, as a developing country, it can enjoy preferential treatment under the GSP for BDCs. Graduation will have no implications on the rules of origin provisions as they are similar for BDCs and LDBDCs. In 2017, Nepal exported about $ 90 million worth of goods to the United States of which only 0.5 per cent were exported under GSP for LDBDCs while another 8 per cent were exported under GSP for BDCs. About 2.4 per cent were exported under the special treatment under Nepal Trade Preferences Act.[31]

In 2017, Nepal exported close to 600 items (at the HTS 8-digit level) to the United States. Of these, Nepal enjoyed preferences for only a handful of items. In only 18 products, it got duty suspension under GSP for LDBDCs and in 46 products it benefitted from the Nepal Trade Preferences Act.[32] After graduation, those 18 items under LDBDC scheme will be subject to MFN duty. Given the low volume of these items, the resultant implications are unlikely to be significant. Table 6 summarises the changes in post-graduation tariff treatment in the United States.

[30] Nepalese beer can be exported into India "on payment of the applicable liquor excise duty equal to the effective excise duty as levied in India on Indian beers under the relevant rules and regulations of India."
[31] The information is obtained from the US ITC and analysed by the author.
[32] The information is obtained from the US ITC.

**Table 6. Market access conditions for major exporting items in the United States**

| HS code | Product description | Share in exports to the USA in 2017 (%) | MFN tariff | Current rate (GSP for LDBDCs) | Post-graduation tariff (GSP for BDCs) |
|---|---|---|---|---|---|
| **57** | Carpets and other textile floor coverings | 41.7 | 0%-8%<br>6 per cent for most items<br>Average rate 2.7% | No LDBDC benefits. Tariff suspension for few products under GSP for BDCs. Nepal also enjoys 0 tariff for a number of items under Nepal Trade Preferences Act | Tariff suspension for few products |
| **62** | Articles of apparel and clothing accessories, not knitted or crocheted | 13.7 | 0%-27%<br>Average rate 10.3% | These products are not covered in GSP for LDCs. GSP for BDCs is applicable. Nepal gets benefits for 7 products under Nepal Trade Preferences Act | 9 out of 383 HTS 8-digit products are included in GSP for BDCs |
| **23** | Residues and waste from the food industries; prepared animal fodder | 7.5 | 0%-7%<br>Average rate 1.5% | Duty suspension | Duty suspension for few items |
| **56** | Wadding, felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles thereof | 6.5 | 0%-19%<br>Average rate 4.7% | These products are not covered in GSP for LDCs. GSP for BDCs is applicable | Duty suspension for few items. |
| **70** | Glass and glassware | 6.4 | 0%-38%<br>Average rate 6% | Duty suspension except for few items | Duty suspension for few items<br>Average rate 4.2% |
| **63** | Other made-up textile articles; sets; worn clothing and worn textile articles; rags | 3.1 | 0%-20%<br>Average rate 6.6% | These products are not covered in GSP for LDCs. GSP for BDCs is applicable | 7 of 94 HTS 8-digit products are included in GSP for BDCs |

| HS code | Product description | Share in exports to the USA in 2017 (%) | MFN tariff | Current rate (GSP for LDBDCs) | Post-graduation tariff (GSP for BDCs) |
|---|---|---|---|---|---|
| **61** | Articles of apparel and clothing accessories, knitted or crocheted | 2.8 | | | |
| **65** | Headgear and parts thereof | 2.7 | 0%-11% Average rate 5% | These products are not covered in GSP for LDCs. GSP for BDCs is applicable. Besides Nepal gets benefits for 13 items under Nepal Trade Preferences Act | 6 of 25 HTS 8-digit products are included in GSP for BDCs |
| **48** | Paper and paperboard; articles of paper pulp, of paper or of paperboard | 2.4 | MFN rate 0% | | |
| **71** | Natural or cultured pearls, precious or semi-precious stones, precious metals, metals | 1.7 | 0%-11% MFN 0 % for a number of products Average rate 2.8% | Duty suspension | Duty suspension except few items |

*Source:* Author's analysis using data from ITC Trademap and US ITC.
*Note:* Average rates are calculated as simple average.

### 3.1.4 Market access in Canada and China

In Canada, Nepal has duty-free market access under the least developed country tariff (LDCT) scheme (UNCTAD, 2013 and Canada Border Services Agency, 2019).[33] The LDCT is the designation for LDC tariff rates under the Canadian GSP scheme. Canada grants tariff preferences for selected agricultural and industrial products of export interest to developing countries. Some products, such as certain textiles and apparel items, footwear, and chemical products are excluded from the generalised preferential tariff (GPT) – a preferential treatment designed for developing countries. With the exception of dairy, poultry and egg products, Canada provides LDCT to all imports from LDCs.

[33] Information available in Canada Border Services Agency website. URL: https://www.cbsa-asfc.gc.ca/trade-commerce/tariff-tarif/ldct-tpmd-eng.html

After graduation, Nepal will no longer benefit from LDCT and will be entitled to preferential treatment under GPT with implications for tariff hike and changes in rules of origin provisions. The GPT rates range from duty-free to reductions in the MFN rate but are generally far less generous than LDCT rates. The rules of origin to be entitled to LDCT is that the local value-added content should be no less than 40 per cent of the ex-factory price of the goods as packed for shipment to Canada. For apparels and made-up articles, the LDCT rules of origin provisions are quite different. For apparel items, the fabric or parts of knit should be produced in a) an LDC or Canada from yarns spun or extruded in an LDC, a country set out in Schedule 2 of the Regulations[34], or in Canada; b) a country set out in Schedule 2 of the Regulations from yarns spun or extruded in an LDC, a country set out in Schedule 2 of the Regulations, or in Canada and the value of any materials, including packing, that is used in the manufacture of the goods and that originate outside the LDCs in which the goods are assembled in no more than 75 per cent of the ex-factory price of the goods as packed for shipment to Canada. The GTP rules of origin are that the local value-added content should be no less than 60 per cent of the ex-factory price of the goods as packed for shipment to Canada.

An analysis of market access conditions for Nepal in major 10 items exported to Canada is shown in Table 7. In carpets and floor coverings – the most important exporting item to Canada – Nepal, after graduation, will have to pay on average 6 per cent tariff vis-à-vis duty-free access under LDCT. The largest impact will be on knitwear and woven garments and on made textiles: Nepal will have to pay on average 16 per cent, 14.7 per cent and 14 per cent, respectively.

**Table 7. Market access conditions for major exporting items in Canada**

| HS code | Product description | Share in exports to Canada in 2017 (%) | MFN rate | Current rate (LDCT) | Post-graduation tariff (GPT) |
|---|---|---|---|---|---|
| **57** | Carpets and other textile floor coverings | 28.48 | 0%-14%<br>12.5 % for most products<br>Average rate 11.1% | Duty suspension | Partial reduction<br>0%-10% applicable<br>8% for most products<br>Average rate 5.9% |
| **62** | Articles of apparel and clothing | 19.95 | 0%-18%<br>18% for most products | Duty suspension | Duty reduction for only a few products<br>0%-18% applicable |

[34] See the regulation here: https://laws-lois.justice.gc.ca/eng/regulations/SOR-2013-165/ and https://www.cbsa-asfc.gc.ca/trade-commerce/tariff-tarif/ldct-tpmd-eng.html

| HS code | Product description | Share in exports to Canada in 2017 (%) | MFN rate | Current rate (LDCT) | Post-graduation tariff (GPT) |
|---|---|---|---|---|---|
| | accessories, not knitted or crocheted | | Average rate 15.2% | | 18% for most products<br>Average rate 14.7% |
| **61** | Articles of apparel and clothing accessories, knitted or crocheted | 11.20 | 0%-18%<br>18 per cent for most products<br>Average rate 16.8% | Duty suspension | Duty reduction for only a few products<br>0%-18% applicable<br>18 % for most products<br>Average rate 16.5% |
| **56** | Wadding, felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles thereof | 7.81 | 0%-16%<br>0% for most of the products<br>Average rate 3.1% | Duty suspension | No preference under GPT |
| **65** | Headgear and parts thereof | 4.53 | 0%-15.5%<br>Average rate 6.6% | Duty suspension | Duty reduction for few selected items<br>Average rate 5.4% |
| **95** | Toys, games and sports requisites; parts and accessories thereof | 4.21 | 0%-8%<br>0% for most items<br>Average rate 0.9% | Duty suspension | Duty reduction |
| **23** | Residues and waste from the food industries; prepared animal fodder | 4.15 | 0%-10.5%<br>0% for most items<br>205.5% for 230990 | Duty suspension except 230990 | Partial reduction |
| **84** | Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof | 4.15 | 0%-8%<br>O% for most items<br>Average rate 0.35% | Duty suspension | Duty reduction |
| **33** | Essential oils and resinoids; perfumery, cosmetic or toilet preparations | 3.14 | 0%-8%<br>6.5% for most products<br>Average rate 4% | Duty suspension | Duty reduction<br>0%-5%<br>0% and 3% for most products<br>Average rate 1.6% |
| **97** | Works of art, collectors' pieces and antiques | 2.39 | 0%-7%<br>0% for most items<br>Average rate 1.4% | Duty suspension | Duty suspension |
| **63** | Other made-up textile articles; sets; | 2.25 | 0%-18% | Duty suspension | Duty reduction only for few items |

| HS code | Product description | Share in exports to Canada in 2017 (%) | MFN rate | Current rate (LDCT) | Post-graduation tariff (GPT) |
|---|---|---|---|---|---|
| | worn clothing and worn textile articles; rags | | 17% and 18% for most items<br>Average rate 15.3% | | 17% and 18% for most items<br>Average rate 14% |

*Source:* Author's analysis using data from ITC Trademap, World Integrated Trade Solution (WITS) and the Canada Border Services Agency.
*Note:* average rates are calculated as simple average.

### Table 8. Market access conditions for major exporting items in China

| HS code | Product description | Share in exports to China in 2017 (%) | Current rate (Chinese preferential tariff for LDCs) | Post-graduation tariffs (Under MFN) |
|---|---|---|---|---|
| **33** | Essential oils and retinoids; perfumery, cosmetic or toilet preparations | 17.62 | Duty suspension | 6.5% – 20%<br>For most products either 10% or 20%<br>Average rate 14.6% |
| **83** | Miscellaneous articles of base metal | 14.08 | Duty suspension | 8% – 18%<br>Average rate 11% |
| **57** | Carpets and other textile floor coverings | 10.21 | Duty suspension | 10% – 16%<br>Average rate 13.3% |
| **17** | Sugar | 9.69 | Duty suspension | 8% – 50%<br>30% and 50% for most products<br>Average rate 30.9% |
| **41** | Raw hides and skins (other than furskins) and leather | 5.30 | 0%-14%<br>0% for most products | 5% – 14%<br>Average rate 9.3% |
| **62** | Articles of apparel and clothing accessories not knitted or crocheted | 4.85 | Duty suspension | 14% – 20%<br>14% and 16% for most products<br>Average rate 16.9% |
| **97** | Works of art, collectors' pieces and antiques | 4.72 | Duty suspension | 8% – 14% |

| HS code | Product description | Share in exports to China in 2017 (%) | Current rate (Chinese preferential tariff for LDCs) | Post-graduation tariffs (Under MFN) |
|---|---|---|---|---|
| | | | | For products under 9705 and 9706 tariffs 0%<br>Average rate 9.8% |
| **74** | Copper | 4.28 | Duty suspension | 1% – 20%<br>For most products either 2% or 4% or 7%<br>Average rate 6.9% |
| **19** | Preparations of cereals, flour, starch or milk; pastrycooks' products | 3.76 | Duty suspension | 10% – 30%<br>For most products 15%<br>Average rate 18.9% |
| **14** | Vegetables plaiting materials | 3.55 | Duty suspension | 4% – 15%<br>Average rate 9.4%<br>For most products 10% |

*Source:* Handbook on the Special and Preferential Tariff Scheme of China for Least Developed Countries (UNCTAD, 2016) and the International Trade Centre (ITC).
*Note:* average rates are calculated as simple average.

### 3.1.5 Market access conditions in other countries

Australia's preferential scheme for developing countries is known as the Australian System of Tariff Preferences. It encompasses five preference categories: least developed countries, Forum Island Countries, developing countries, developing country status and developing country category T (UNCTAD, 2018). Nepal gets duty-free quota-free treatment to 100 per cent of products exported to Australia as an LDC (under Part 2 of Schedule 1 of the Australian System of Tariff Preferences (ASTP). Graduation would imply Nepal to be subject to GSP for developing country status – designed for developing countries (part 4 of Schedule 1 of the regulation) which allows duty-free treatment to almost 50.6 per cent of tariff lines. 39.1 per cent of Australian tariff lines have a duty rate of 5 per cent and the remaining 9.7 per cent products have a 4 per cent rate. Textile and apparels are not included in the GSP for developing country status. Therefore, graduation will have some implication on Nepalese export in the Australian market. There is no transition period for Australian GSP. One possible option for Nepal would be an extended period of continuation of current provisions, as Australia extends DFQF access for graduating LDCs including Maldives, Samoa and Equatorial Guinea, which graduated respectively in 2011, 2014 and 2017.[35]

[35] www.un.org/ldcportal/preferential-market-access-australia-gsp/

Bangladesh is one of the major destinations of Nepalese exports. Nepal enjoys preferential treatment in Bangladesh under SFATA. The SAFTA preference margin remains low mostly due to a large number of products being in the sensitive list. LDC graduation will have no major implications for market access conditions in Bangladesh. However, under the rules of origin provisions, the local value-added content will increase from 30 per cent (for LDCs) to 40 per cent (for non-LDCs).

Japan grants preferential tariff treatment to 138 developing countries and five territories including 47 LDCs (UNCTAD, 2017a). Nepal is a designated beneficiary of the duty-free and quota-free special preferential treatments offered to least developed countries for 9,068 items. Graduating Nepal will be eligible for the GSP scheme designed for developing countries, which is much less generous. Under the developing country scheme, various tariff reductions (of up to 20, 40, 60 or 80 and 100 per cent of MFN rates) are available. It is worth noting that only a few of textile and clothing items get benefits from this GSP scheme. As such, Nepal will have some tariff implications.

Being an associate member of the European Commission, Turkey's GSP is fully aligned with the European Union (UNCTAD, 2017b). Being a member of the group of LDCs, Nepal enjoys duty-free quota-free market access under the EBA scheme. Graduation would imply Nepal to access any benefits either under general GSP (Standard GSP) or GSP plus scheme.

Other countries where Nepal gets preferential access includes New Zealand, Norway, Republic of Korea, Russia, Switzerland, and Thailand, etc. Export competitiveness in these countries as well can come under some pressure because of either loss of or reduction in tariff preferences along with more stringent rules of origin. However, as the export presence in these markets is currently low, any adverse implications due to graduation are likely to be less pronounced.

### 3.1.6 Tariff implications for export earnings

The likely implications of tariff changes on exports can be analysed using different methods. One popular approach is to consider a partial equilibrium model. Being a partial equilibrium model means it uses only one sector while disregarding its interactions with others – a feature that general equilibrium models (GEMs) deal with. However, in contrast to GEMs, partial equilibrium approaches can make use of highly disaggregated trade and tariff data. The partial approach is also preferred due to its simplicity as the data requirements are minimum, and the simulations performed are simple and do not require very involved and too many assumptions about the underlying model structures and in making them operational. Utilising a partial equilibrium model as in Razzaque and Rahman (2018), the resultant implications for exports arising from the erosion of tariff preferences are summarised in Table 9. The impact estimation for Nepal's exports to the EU is based on almost 1,200 individual products (at CN 8-digit level) imported by the EU in 2018.

For Canada and China, estimations are based on respectively 125 and 302 HS 6-digit individual items exported by Nepal in 2017. To assess the likely impact in the United States, tariff and product data for 576 items at HTS 8-digit level have been gathered from US ITC.

**Table 9. Estimated impact of graduation**

| Partner country | Current exports (million $) | changes in exports due to loss of tariff preferences (million $) | Per cent of fall in exports (%) |
|---|---|---|---|
| Canada (if Nepal gets GPT) | 8.25 | -0.6 | -7.25 |
| China (if Nepal pays MFN tariff) | 22.33 | -2.56 | -11.45 |
| EU (if Nepal secures GSP Plus) | 101.51 | -0.06 | -0.06 |
| EU (if Nepal gets Standard GSP) | 101.51 | -6.05 | -5.96 |
| USA (if Nepal gets GSP applicable for BDCs) | 91.85 | -0.32 | -0.34 |
| USA (if Nepal pays MFN tariff) | 91.85 | -1.06 | -1.16 |

*Source:* Author's estimation.

The estimated results suggest that the highest absolute fall in export, equivalent to almost $6 million or about 6 per cent of current exports, will be due to the European Union under a circumstance when Nepal can only secure Standard GSP after its graduation. On the other hand, if Nepal qualifies for GSP Plus, the resultant impact would be negligible. In terms of proportion changes, Nepal's export to China could fall by 11.5 per cent in China followed by a 7.25 per cent decline in Canada due to changes in post-graduation GSP regime changes. As discussed above, the likely impact in the United States will be negligible even if Nepal is subject to MFN duties in that market.

It is worth pointing out that the above impact assessment does not take into consideration the likely consequences arising from changes in the rules of origin provisions. In some cases, more stringent ROO can seriously inhibit exporters' capacity in accessing any tariff preferences. LDCs in almost every case will have to give up the most relaxed ROO provisions as they graduate.

### 3.2 Loss of policy space

LDC graduation could potentially mean a significant loss of policy space in supporting various domestic sectors. Having recognized their supply-side constraints and weak economic capacities, LDCs are often exempt from making commitments and implementing stringent provisions of agreements. WTO members are also generally reluctant about raising concerns and/or initiating dispute settlement procedures about individual least developed countries' policy support measures targeting certain sectors that otherwise will be deemed inconsistent or non-compliant with international trade rules and regulations. LDC graduation will require the graduating countries to make the necessary adjustments for conformity with WTO agreements. In this regard, potential loss of policy in supporting agricultural exports, non-agricultural exports and pharmaceutical sector have direct consequences arising from LDC graduation.

### 3.2.1 Support for agriculture

Nepal was an acceding member of the WTO. Countries that accede to the WTO face very tough accession negotiations and end up undertaking many more commitments than the original or founding WTO members. Nepal ended up binding 100 per cent of its tariff lines on agriculture products and 99.3 per cent of its tariff lines on non-agriculture products. In agriculture goods, Nepal's bound average tariff is 41.5 per cent; a bound tariff above 25 per cent for more than 90 per cent of the tariff lines (Pandey, Adhikari and Wagle, 2014). Nepal bound its industrial tariff at an average of 23.7 per cent. Beyond these average bound rates, there are very high tariff peaks in certain specific sectors (e.g. tobacco in agriculture and automobiles in industrial goods). While it is true that compared to many other WTO members at a similar level of development Nepal had to accept much lower bound rates, applied tariffs in Nepal are still significantly lower. Therefore, tariff commitments are unlikely to be a major problem after graduation. Unlike founding WTO members, acceding members were required to binding 'other duties and charges' (ODCs) and make commitments for bringing them to zero. Nepal made a commitment to phase out all ODCs within 10 years from the entry into the WTO. Therefore, in this instance, policy space was lost much before the LDC graduation.

As part of its accession negotiation, Nepal undertook not to use export subsidies for agricultural goods. However, as it stands, under government's Cash Incentive Scheme for Exports (CISE), 26 exportable items (industrial and agricultural) receive some incentives (3–5 per cent of export value), given that domestic value addition is at least 30–50 per cent. As shown in Table 10, such agricultural products as turmeric, vegetables, flowers, cardamom, ginger are eligible for receiving subsidies if they are exported to non-Indian destinations. LDC graduation could trigger more scrutiny by WTO members in challenging the non-compliant export support. There are suggestions that e.g. WTO Trade Review (2018) and Defever *et al.* (2017) impact of these subsidies remain insignificant. Therefore, while the removal of these subsidies may not cause any major adverse impact, it highlights the problem of reduced policy space in supporting export and export market diversification in post-graduation era.

**Table 10. Exports items eligible for CISE**

| Eligible for up to 5 per cent subsidy | Eligible for subsidy only if exported in non-Indian destinations | Eligible for 3 per cent subsidy |
|---|---|---|
| Processed tea and coffee; handicrafts and wooden crafts; leather goods; handmade papers and related products; processed herbs; oil products; precious stones and jewellery; finished products made of allo; mineral water | Turmeric; Vegetables; Flowers; Processed honey; Cardamom; Ginger and related products. | Textiles; Readymade garments; carpets and wooden products; Pashmina; gold and silver jewelry; Semi processed leather; drugs and pharmaceutical items; Felt items; Copper utensils; Yarn made out in polyester, viscose, acrylic and cotton. |

*Source:* Based on information from (Defever, Reyes, Riaño, & Varela, 2017); (WTO, 2018); (Ministry of Finance, 2018) and (Kathmandupost, 2018).

### 3.2.2 Supporting non-agricultural exports

Nepal's accession treaty allows it to maintain its right to administer certain subsidy programmes in conformity with the WTO Agreement on Subsidies and Countervailing Measures (SCM). However, LDC graduation has certain implications in this respect. According to the SCM, prohibitive subsidies are those that are linked to export performance (export subsidies) and are based upon the use of domestic material against imported goods (domestic content subsidies). It defines actionable subsidies to include injury to the domestic industry of another member country; nullification or impairment of benefits accruing directly or indirectly; and serious prejudice to the interests of another WTO member. However, Article 27 of the agreements allows LDCs and 21 developing countries (known as article VII (b) countries) with GNP per capita lower than $1,000 at 1990 prices to be eligible for the Special and Differential Treatment (S&DT).[36] These countries can use prohibitive subsidies unless they have more than 3.25 per cent share in global exports. But it does not exempt them from countervailing measures by other members in case of using actionable subsidies. In FY 2018–19, Nepal had a total budget allocation of $5.4 million for export subsidies (Ministry of Finance, 2018). While this might not mean very high export subsidies but the implications of LDC graduation should be understood carefully. Nepal is likely to remain a country with a per capita GDP of $ 1,000 for several years after graduation. However, there is no clarity about Nepal's being included in Article VII (b) countries following its graduation. Countries in Article VII(b) appear to be somewhat pre-specified. This is one issue where Nepal should approach the WTO for seeking clarification and making a case that graduating LDCs be

[36] Along with the LDCs, these countries are known as article VII (b) countries. Their economic performance is annually evaluated by the WTO. If a member exceeds GNP per capita of $1,000 at 1990 prices based on latest World Bank data for three consecutive years, it will have binding to follow SCM Agreement.

considered automatically included in Article VII (b) list provided that they qualify given the per capita GDP.

### 3.2.3 Trade-related aspects of Intellectual Property Rights and support for the pharmaceutical industry

The WTO's Trade-related Intellectual Property Rights (TRIPS) Agreement covers such areas are copyright, trademarks, geographical indications, industrial designs, etc. LDCs have not been required to implement the Agreement, apart from a few areas, until 1 July 2021. For pharmaceuticals, the transition period for LDCs is until 1 January 2033 or the date of graduation, whichever comes first. As part of its WTO accession negotiations, Nepal waived its right to the general transition period and was committed to implementing the agreement by no later than 1 January 2007. Nepal, however, declared that it would be entitled to the flexibilities contained in the Doha Declaration on the TRIPS Agreement and Public Health, including the pharmaceutical-specific transition period. Therefore, although graduation would not have much impact on its general obligations under the TRIPS agreement, it could lead to more scrutiny of its intellectual property rights (IPR) regime. Consequently, if the TRIPS implementation process has been slow, LDC graduation could result in implementation costs. An in-depth assessment will perhaps be needed in understanding the nature of TRIPS implementation in Nepal.

The size of Nepal's domestic pharmaceutical market is estimated at about $400 million, 45 per cent of which is catered by domestic producers. According to the Department of Drug Administration of Nepal, currently, there are 57 allopathic and 42 ayurvedic drug producers in the country. Most of these productions are not covered by patents and are generic pharmaceutical items in nature. Data from ITC Trade Map suggests that Nepal exported about $9 million worth of pharmaceutical products in 2017, mostly to neighbouring countries – India, China and Pakistan.

The assessment by CDP suggests that after graduation Nepal would lose access to the specific transition period for pharmaceuticals, which may negatively affect Nepal's ability to produce and import generic versions of patented medicines. There is the suggestion that graduating LDCs would not be able to receive technology transfer under Article 66.2 of the TRIPS agreement. However, it is not clear if any LDC has benefited from the provision at all.

### 3.2.3 Services trade and the LDC services waiver

The role of the services is extremely important for Nepal given its tourism activities are important sources of foreign exchange earnings. Tourism exports as shown above in the paper are more than double the receipts from merchandise export. Overall, the services sector is also the largest contributor to the domestic economy (i.e. 57 per cent of GDP). Yet, it accounts for only just over 6 per cent of GDP. There is thus the huge potential for the services sector to grow and in this respect, one issue is any likely impact of LDC graduation.

For Nepal, an important element of services exports is the export of migrant labour services, which falls under the so-called Mode 4 (presence of natural persons) according to the definition of various types of services trade by the General Agreement on Trade in Services (GATS). Nepal is critically dependent on remittances as discussed earlier. The migrant workers are sent under bilateral initiatives and the relevant services trade is not open to multilateral liberalization. Despite many studies' showing substantial gains from the movement of natural persons, labour market liberalization remains a highly sensitive matter in international trade negotiations.

Although the WTO's General Agreement on Trade in Services (GATS) provides a framework for liberalization, it did not adequately spell out options for preferential treatment for LDCs and other developing countries like the case in trade in goods. In 2011, WTO members reached an agreement to allow LDC-specific preferential treatment for services and service suppliers as the "Enabling Clause for services", which is popularly known as the Services waiver and is granted for until 2030. In 2014, the LDCs submitted a collective request for ensuring preferential commitments from members in service modalities. Despite the confusion over how it can be implemented, more than 25 developed and developing countries in 2015 indicated sectors and modes of supply where they intend to provide preferential treatment to LDC services and service suppliers. While most of these waivers include wide varieties of services, the main challenge has been to work out the modalities so that the preferences can be implemented in a commercially meaningful manner for LDCs. This has now been a longstanding issue and no major breakthroughs could be achieved in operationalizing the services waiver. With the current stalemate in the WTO, the prospect of any imminent progress in this regard is extremely limited.

Since the services waiver is still at a very preliminary stage of implementation, and all major services exports of Nepal (mainly travel and tourism and migrant workers' services) currently take place without any recourse to the services waiver, LDC graduation should not result in any loss of export opportunities. However, Nepal might face a disadvantaged situation if the waiver comes into operation in the future, and developed countries offer labour market openings to LDC workers and service providers. As Nepal will likely to graduate out before the effective implementation of the provisions, the LDC waiver may be a missed opportunity for local services exporters.

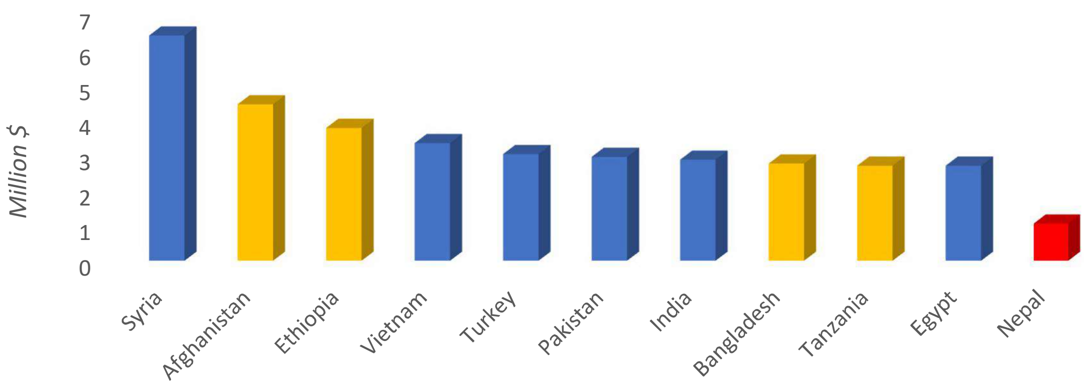
### 3.3 Implications for Development Financing

Despite falling significance in the national economy, Nepal continues to receive sizeable foreign assistance. Both traditional bilateral donors such as OECD countries and multilateral agencies play a significant role in Nepal's economic development. India and China have also important sources of financial assistance. The way foreign assistance is allocated to recipient countries, it is unlikely that LDC graduation will have any significant concern for LDCs.

Developed economies made commitments to provide the equivalent of 0.15 to 0.20 per cent of their GNI in the form of ODA to LDCs as part of the commitment of providing the equivalent of

0.7 per cent of GNI in ODA to developing countries. However, this has not been materialised as only five countries have so far been able to meet the overall target of 0.7 per cent. Therefore, it is not that graduation means reduced access to a secured pot of funding designated for LDCs. Furthermore, while LDCs are recognised as countries with severe development challenges, LDC status itself hardly features prominently in allocating aid to developing countries. The patterns and trends in aid allocation suggest that recipient countries' historical and bilateral relationships with donors, and country-specific situations such as civil wars and unrests, natural disasters, refugee crisis, etc. are important determinants of aid inflows. Indeed, during 2013-2017, of the top ten ODA recipient countries, only four belonged to the group of LDCs (Figure 17). Nepal is around 30th largest ODA recipient. Less than 30 per cent of ODA goes to LDCs.[37]

**Figure 17. Top ODA recipients and Nepal (average 2013-2017)**

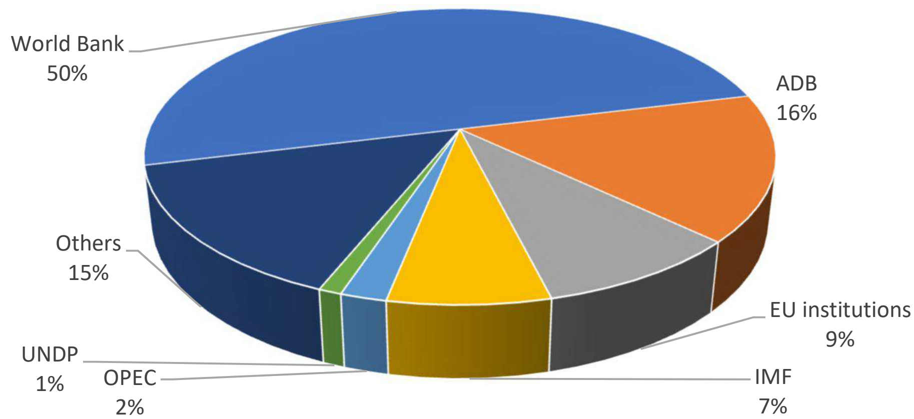



*Source:* Based on OECD Stats. LDCs apart from Nepal are marked yellow.

Key multilateral development partners of Nepal are the World Bank, Asian Development Bank (ADB), International Monetary Foundation (IMF), the European Union institutions, United Nations, etc. The World Bank's concessional loan support through IDA soft credit accounted for almost half of all multilateral development financing ($546.1 million) to Nepal in 2017 (Figure 18).

[37] During 2013–2017, Nepal received just above $1 billion per annum with the per capita net ODA inflow in 2017 being $46. The inflow increased in recent years due to post-earthquake assistance programmes.

**Figure 18. Share of multilateral support in 2017**



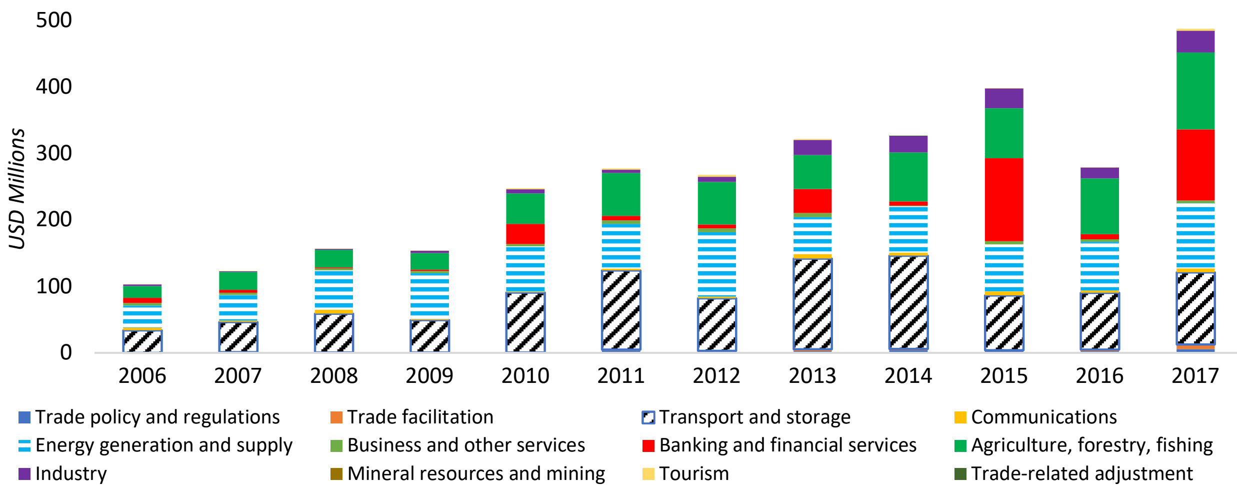

*Source:* Based on World Bank data.

Most of the multilateral support received by Nepal is not dependent on the LDC status of the country. Almost all concessional loan providers follow World Bank's income-based definitions such as low-income countries (LICs), lower-middle-income countries (LMICs), etc. as eligibility criteria for soft loans. As Nepal's per capita GNI rises with time, in the future it will be considered for credit support with less concessional rates and repayment conditions. A few UN organisations like UNDP and UNICEF have budgetary obligations to keep 60 per cent of their total support focused on LDCs. The consequent impact is going to be rather small. Donor responses (from both multilateral as well as bilateral) reported in the 2018 UINCDP report on Nepal show that LDC graduation will unlikely to make any significant changes to aid allocation to the country.

Aid for Trade (AfT) has emerged as an important source of trade-related supply-side capacity-building assistance. Nepal has been a consistent LDC-recipient of AfT over the years (Figure 19). The inflow slowed down somewhat in 2016 as an impact of post-earthquake aid diversion in sectors that required immediate attention. In 2017, AfT bounded back to $488 million. Between 2013–2018, the largest AfT recipient sector has been transport and storage (on average more than 30 per cent) followed by agriculture (22 per cent), energy generation and supply (20 per cent), banking and financial services (15 per cent). LDC graduation should not hamper the prospect of future support under AfT, as it remains part of the ODA allocation. However, as graduation could lead to various adjustment support, e.g. making the trade regime more consistent with the WTO regime, Nepal could ask for more trade-related adjustment support as part of the AfT budget.

Graduation would affect only the financing sources that are exclusively available for LDCs. Nepal receives some technical and trade diagnostic assessment support from the Enhanced Integrated Framework (EIF), which is only available to LDCs. Any graduating LDCs will continue to remain eligible for EIF support for a period of up to five years after graduation.

**Figure 19. Aid for Trade disbursements composition in Nepal (2006-2017)**




*Source:* Based on OECD database.

Another LDC-specific support is due to climate change-related assistance and is known as the Least Developed Countries Fund (LDCF) managed by the United Nations Framework Convention on Climate Change (UNFCCC). Nepal approved National Adaptation Programme of Action (NAPA) back in 2010 to access LDCF funds. It is being currently implemented along with five more programmes under LDCF funding (GEF, 2019). These programmes will be funded until completion regardless of the changes in LDC status. Graduation would, however, mark an end to receiving support from the LDCF. Nonetheless, Nepal also receives support from climate change funds like Global Environment Facility (GEF), Green Climate Fund (GCF). Under GEF, Nepal is currently implementing 20 programmes at the national level and 11 more at the regional level. Till 2018, Nepal received around $430 million from different climate change and adaptation funds. Most of these funds will be available after graduation, but due to changed circumstances Nepal will have to compete with other developing countries for allocation as some funds have more priorities for LDCs, small island developing states, and African countries.

## IV. Recommendations and way forward

The above analysis seems to suggest that Nepal's graduation from the group of LDCs is likely to have a diverse impact. The resultant implications might not seem to be profound partly because of the fact that Nepal has not been able to make use of trade preferences that are most prominently linked to LDC status. Nevertheless, the transition is to be recognized as a lost opportunity for fostering the development of a country that is clearly marked by severe development challenges. Graduation could also imply development efforts being even more challenging as, amongst others, the forgone trade benefits would mount pressure on the country's external competitiveness.

Within the scope of this paper, the following provides several broad areas of way forward for Nepal.

### 4.1 Consideration of an extended period of deferment for graduation and transition period

The 2018 United Nations Committee for Development Policy (CDP) decision to defer the recommendation of graduation until the next review was a judicious one. Nepal shows a development pattern, the sustainability of which could be considered risky. This is quite clearly reflected in the fact that its per capita income ($745) remained much lower than the threshold level of per capita income (of $1,230). There is no other country within the set of graduated countries as well as the countries that have achieved graduation eligibility to achieve graduation requirements through fulfilling the Human Asset and Economic Vulnerability indices while failing to achieve per capita income threshold.

Nepal represents a case showing that assessing economic vulnerability cannot fully capture the vulnerability associated with natural disasters. The devastating earthquake of 2015 is a reminder of how its growth and economic development prospects remain exposed to natural calamities. According to the Global Climate Risk Index, it is a country that has been assessed as the 11$^{th}$ most climate risk affected-country over the past two decades or so since 1998. The same Climate Risk Index also found Nepal as the 4$^{th}$ most affected country in 2017, the latest year for which the assessment is available (Eckstein et al. 2019). Along with earthquakes, Nepal remains vulnerable to damages caused by massive rainfalls-related damages particularly during the monsoon. The analysis presented in the Global Climate Index exercise highlights Nepal's being subject to flash floods and landslides causing severe economic damages and loss of lives. In addition, climate change is also affecting Nepal in unprecedented manners. For example, the country's first tornado in March 2019 hit two Terai districts (Bara and Parsa) with the resulting economic costs associated with loss of crops and livestock estimated at $4.6 million (World Bank, 2019). Given all this, Nepal has to invest a lot in disaster response, risk management and rehabilitation programmes.

There has been some concern that the Economic Vulnerability Index (EVI) as used in assessing countries' eligibility for LDC graduation often cannot fully capture the vulnerability due to natural disasters. It is also inadequate in reflecting the risk of emerging climate change-related issues triggered by global warming. It is widely recognized that climate change is taking place faster than anticipated and as such the risk affected countries might see sudden changes in their economic prospects. For Nepal, these issues require careful consideration.

It is true that despite natural calamities, Nepal has made solid economic progress. However, in assessing graduation prospects, it is also important to measure countries' socio-economic improvements against the envisaged development objectives. One important benchmark for comparison in this respect is the objectives set in the Istanbul Programme of Action (IPoA) for

LDCs. An important IPoA goal was to "[A]chieve sustained, equitable and inclusive economic growth in least developed countries, to at least the level of 7 per cent per annum, by strengthening their productive capacity in all sectors through structural transformation and overcoming their marginalization through their effective integration into the global economy, including through regional integration" (IPoA paragraph 28 (a)). Unfortunately, during the IPoA period, LDC average growth has been much lower than 7 per cent. While Nepal has been amongst the top LDC growth performer since the initiation of IPoA, it has even failed to achieve the stipulated growth target. As mentioned above, the growth trend was affected by the 2015 earthquake when growth fell to just 0.6 per cent. Economic activities subsequently picked up above 7 per cent in 2017 and 2019, but the medium-term projections suggest growth hovering around 6.5 per cent.

The main driver of economic activities has stemmed from a huge outflow of migrant workers and the resultant remittances that have flown back into the economy causing consumption expenditure to rise and poverty incidence to fall. The remittance-dependent growth and development pattern is vulnerable to exogenous shocks. The outflow of migrant workers is determined by economic conditions in migrant-receiving countries. Sustained lower prices of oil could put downward pressure on the demand for migrant workers and thus reduced remittance inflows. Thus, more concrete development progress should be reflected in a country's building productive capacities through structural transformation, which the IPoA also put a lot of emphasis on.

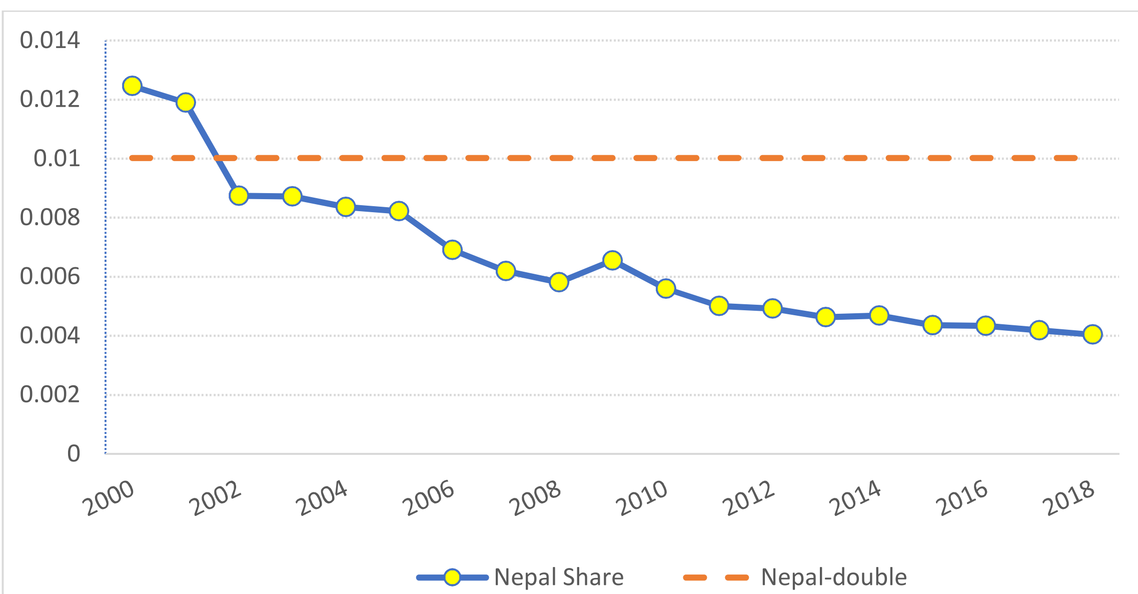
A general trend in the structural transformation that marked the early development process in many developed and relatively advanced developing countries is the rising share of manufacturing in the national economy. This has not happened in the case of Nepal as it has witnessed a falling relative significance of manufacturing activities as shown above in this paper. Furthermore, the IPoA emphasised on several other goals and targets in developing productive capacities in LDCs as a means for their promoting economic progress. Amongst others, it set a goal of diversifying local productive and export capability with a focus on dynamic value-added sectors in agriculture, manufacturing and services. Along with assessing the three graduation indicator thresholds, it is also important to analyse the development outcomes as against the objectives and targets of IPoA. Only then it is possible to determine the sustainability of the development process as revealed through the graduation indicators.

In the Istanbul Programme of Action (IPoA) for LDCs and in the global Sustainable Development Agenda, a major thrust was given on countries' taking advantage of international trade for promoting growth and development. The United Nations-led global development initiative *Transforming Our World: The 2030 Agenda for Sustainable Development* recognises international trade as a means for achieving various Sustainable Development Goals (SDGs). Indeed, unlike the MDGs, the 2030 Agenda for Sustainable Development provides an elaborate role – both direct as well as cross-cutting – for international trade in achieving many specific sustainable development goals and targets. The Millennium Development Goals explicitly mentioned 'trade' only under

MDG 8 relating to global partnerships, while in the SDGs trade appears directly under seven goals concerning hunger, health and wellbeing, employment, infrastructure, inequality, conservative use of oceans, and strengthening partnerships.

In the above backdrop, however, the global trade situations in recent times have been very disappointing. Between 2002 and 2011, global merchandise exports grew from \$6.5 trillion to \$18.3 trillion, while in 2018 such exports were valued at just \$19.3 trillion. Indeed, since the adoption of IPoA and SDGs, global trade has seen an unprecedented slowdown (Razzaque and Ehsan, 2019). Along with this, faltering LDC participation in global trade is to deal an early blow to one SDG target. Having adapted from the IPoA, SDG target 17.11 stipulates a doubling of LDC share of global exports by 2020. At the start of IPoA implementation in 2011, the corresponding LDC share was 1.05 per cent, which declined to 0.99 per cent in 2018. It was shown above that during the same time Nepal's exports has fallen in absolute terms, reducing its already paltry global share from 0.005 per cent to 0.0047 per cent (Figure 20). Given the trend over the past decade or so, it can now be concluded Nepal is going to miss the IPoA and SDG target of doubling its export share by 2020 by a big margin. It is rather an irony that when IPoA and SDGs emphasised so much on LDCs' improved participation in global trade, for many of them and Nepal in particular, the period since 2011, which coincides with IPoA implementation, can be regarded as a lost decade of gains from trade.

**Figure 20. Nepal's share in global merchandise exports (%)**




*Source:* Author's estimate based on UNCTADstat data.

Along with weaker participation in world trade, the unfolding global trading environment threatening to derail the rules-based multilateral trading system is another serious concern for graduating LDCs. Trade multilateralism is in grave crisis with WTO members failing to reach consensus and conclude the longest-running Doha Round of trade negotiations. Recent trends seem to suggest that trade policy regimes in major economies are going through fundamental changes, giving rise to profound implications for the world's poorest, smallest and most vulnerable economies. Triggered initially by the global financial crisis of 2008, this dismal state of affairs is intensified as the benefits of globalization and free trade are called into question, causing political upheavals in Europe and the USA. In particular, the trade policy reversals of the United States have caused a massive turmoil in the international trading environment with heightened policy uncertainty. Furthermore, the ensuing USA–China trade war is likely to have widespread global ramifications weakening the global trading system, limiting the impact of trade in international development and hindering the prospect of improved participation of LDCs in global trade. When IPoA and SGDs were initiated, these unfavourable developments could not be foreseen.

It should also be borne in mind that in addition to the above concerns and the typical structural problems associated with LDCs, landlocked LDCs face further challenges in promoting their trade-led developments. An excessively high cost of trading seriously undermines their export competitiveness. Landlocked countries like Nepal have to depend on the economic, political and environmental situations of neighbouring countries, particularly transit countries for their foreign trade (UNCTAD, 2016). Given all this, withdrawal of LDC-specific trade privileges will stifle any remaining opportunities of trade-led development in a country like Nepal.

One important way forward for Nepal thus will be to engage with the United Nations, development partners and international civil society organizations in realistically assessing any concrete gains materialized due to international support measures committed from IPoA or SDG initiatives. Nepal should argue that certain LDCs including itself have made some progress despite extremely unfavourable global trade situations. Many fundamental development objectives – such as productive capacity development and structural transformation – that were to achieve through international support mechanisms have remained elusive. Moreover, most LDC privileges are associated with trade preferences from which a country like Nepal has hardly been benefited. It also needs to be highlighted that the special challenges of landlocked LDCs, climate vulnerability and proneness to natural disasters should be given a much greater weight when assessing the economic vulnerability of LDCs for their graduation.

Nepal could propose deferment of the graduation process until the declaration and implementation of the next UN Conference on LDCs and improvement in the global trading environment. Of course, countries that would like to leave the group voluntarily, they can always do so. But, for other LDCs, the graduation process should be linked to their benefiting from the ISMs and achieving visible structural transformation and productive capacity development. Nepal should work with all other LDCs and particularly with landlocked LDCs in taking this idea forward.

### 4.2 Proactive engagement with trading partners on post-graduation preferential trade regimes

More than half of Nepal's exports are to India and is governed under a bilateral trade treaty. Beyond it, trade preferences received in other countries are important. Amongst this, the graduation process and the availability of various EU trade policy regimes for different groups of countries mean there is scope for being strategic. The political processes within UN systems and development partners generally emphasise smooth graduation and transition processes, although there is not much clarity regarding how other international support measures, such as bilateral and multilateral aid and technical assistance, can be of help and will actually be made available. However, in the case of preferential market access, once Nepal graduates, e.g. in 2024, it will remain eligible for all EBA-related benefits in the EU for another 3 years. Nepal should assess if it can then qualify for GSP Plus and try to undertake any measures needed for meeting the requirements. Under GSP Plus, most Nepalese exports to the EU will continue to receive duty-free access. However, the rules of origin requirements for GSP Plus are quite stringent and as such, it is important for Nepal to look for an alternative EU trade policy regime that is more generous. The European Commission's current GSP regime will apply until 2023 and is to be replaced by a new regime. Therefore, proactive engagement with the European Commission and other stakeholders could be undertaken to influence any future changes in the EU GSP regime that would benefit Nepal. One proposition could be that GSP Plus beneficiary countries should be subject to same ROO provisions as EBA. In the light of the fact that several other LDCs are in the process of graduation, coordinated efforts could enhance the chance of graduating LDCs having an extended transition period from EBA and/or more liberal GSP Plus provisions including the continuation of the EBA ROO for graduating LDCs.

Apart from the EU, other important preference granting countries such as Australia, Canada, China, Japan and Republic of Korea also provide important market access for LDCs, although much of which has remained unutilized for Nepal. It is important to keep the preferences in these markets as long as possible. Unlike the EU, these countries, however, do not grant an additional three years' transition period. Nepal with support from other LDCs should engage with these countries to extend the transition period at least by the same extent as the EU. This will require a prompt move by Nepal and LDCs as changes in the GSP regime of in the respective donor countries might require a lengthy procedure.

### 4.3 Making an all-out effort to explore exporting opportunities in neighbouring and regional partner countries and improving connectivity

It is widely known that landlocked countries need to do more trade with their neighbouring countries. Nepal is sharing borders with two large Asian economies – China and India. Currently, China is the second-largest economy in the world in terms of GDP measured in US dollars, but it is the largest when measured in terms of PPP (purchasing power parity) dollars.[38] On the other hand, India is now the world's sixth-largest economy. Given the size and growth of these two giant economies, Nepal should be able to export more to these countries. Despite India being a major market, it has been shown above that in both India and China Nepal's actual exports are much less than the potential. The rise of China and India should be seen as new growth poles, integration with which should generate massive trading opportunities. There is empirical evidence that suggests that new markets and growth centres are closely related to growth in neighbouring countries (see, for example, Redding and Venables 2004, Moore 2015).

Trade with fast-growing developing countries offers new opportunities for specialisation, efficiency gains, investment and export market diversification. China and India, now provide improved market access to LDCs. They have also become important sources of technical and financial assistance. The growing significance of developing countries within global trading flows offers new opportunities for forming regional supply chains. It is widely recognised that most production networks and supply chains are regional in nature. Nepal should aim for integrating into regional supply chains.

Nepal's exports to China is unusually low.[39] This is often attributed to the presence of various forms of non-tariff measures such as stringent provisions on quarantine and safety regulations and rules of origin requirements.[40] Inadequacy of infrastructure especially insufficient road and rail linkages of landlocked countries is regarded as one of the major hindrances to facilitate trade with neighbouring countries. Nepal should prioritize its increased trade integration with China and India through all possible ways including asking for technical assistance in dealing with compliance and standards related requirements and building bilateral and regional infrastructures to facilitate trade. Nepal and China have agreed to finalise an FTA between them. Nepal should proactively pursue this with the objective of promoting its export to China and attracting investment.

It is worth pointing out that, amongst others in South Asia, Bangladesh, which is separated by a narrow strip of Indian land, is also becoming an increasingly sizeable economy and thus a potential

[38] See https://www.worldbank.org/en/country/china/overview for details.
[39] As mentioned earlier, Nepal exports only 2 per cent of its total exports in the Chinese market. According to the Nepal Chamber of Commerce (2017), products with higher export potential in Chinese markets are apparels and textiles, citrus orange, carpet, processed food, etc.
[40] Sometimes inadequacy of infrastructure especially insufficient road and rail linkages of landlocked countries is regarded as one of major hindrances to facilitate trade with neighbouring countries.

market for Nepalese goods.[41] Nepal is a member of a number of regional and sub-regional trading agreements including the South Asian Free Trade Agreement (SAFTA), the SAARC Agreement on Trade in Services (SATIS) and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Free Trade Area (Table 11). Currently, under a sub-regional initiative Bangladesh, Bhutan, India and Nepal (BBIN) are trying to promote regional connectivity amongst them through land transportation. Nepal should work with others to make the BBIN scheme successful and thus explore the market in Bangladesh. Nepal can also partner with Bangladesh in making progress on the BIMSTEC FTA.

**Table 11. Nepal's preferential trading arrangements**

| Name of the arrangements | Number of partners | Countries involved | Remarks |
|---|---|---|---|
| **SAFTA (South Asian Free Trade Agreement)** | 8 members | Afghanistan, Bangladesh, Bhutan, India, Nepal, the Maldives, Pakistan and Sri Lanka | Signed in 2004<br>Came into effect in 2006.<br>An active FTA. |
| **SATIS (SAARC Agreement on Trade in Services)** | 8 members | Afghanistan, Bangladesh, Bhutan, India, Nepal, the Maldives, Pakistan and Sri Lanka | Entered into force on 29 November 2012.[42]<br>Implementation progress has been slow. |
| **BIMSTEC (Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation) Free Trade Area** | 7 members | Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand | Proposed. Fourteen priority sectors of cooperation have been identified and several BIMSTEC centres have been established to focus on those sectors. An FTA is under discussion and progress has been slow. |

[41] Bangladesh is currently a $300 billion economy, which is expected to grow further to $500 billion by 2025. As per projections of the PriceWaterhouseCoopers (PWC), it is projected to be the 28th largest economy of the world by 2030 in terms GDP measured in purchasing power parity terms.
[42] As noted by the Eleventh Meeting of the Expert Group, held in Islamabad on 5 July 2015, Nepal was in a position to provide the final offer list and the authorities stated that Nepal had submitted its final offer to the SAARC Secretariat.

| | | | |
|---|---|---|---|
| **Bangladesh, Bhutan, India and Nepal (BBIN)** | 4 members | Bangladesh, Bhutan, India and Nepal | Active. An active Motor Vehicle Agreement is currently under implementation (Bhutan is yet to ratify). |
| **Bilateral FTAs** | | | |
| **Indo-Nepal Treaty of Trade** | India and Nepal | | Active |
| **China-Nepal Free Trade Agreement** | China and Nepal | | Proposed |
| **Nepal-Pakistan Free Trade Agreement** | Nepal and Pakistan | | Proposed |

*Source:* Author's compilation from various sources.

LDC graduation can have some implications for future regional trading arrangements. Graduated Nepal will lose the LDC-specific preferential access and will be subject to tariff rates applied for Non-LDC members. The critical factor behind the low rate of success of SAFTA is the high number of products in the sensitive list. Bangladesh, India, Nepal and Sri Lanka have included a large number of products in their respective sensitive lists. After graduation, Nepal will face non-LDC sensitive lists in accessing markets in Bangladesh and Sri Lanka.[43] Graduation will also have implications for preferential rules of origin (RoO). The minimum value addition requirement for a single country is changes in tariff headings plus 30 per cent value addition (CTH+30 per cent) for LDCs, CTH+40 per cent for non-LDCs; and in the case of SAARC cumulation, along with CTH regional content requirement of 40 per cent for LDCs, 50 per cent for non-LDCs – that is, a 20-per cent additional value addition is required from the exporting country. It indeed makes the market access conditions much more stringent. However, as Nepal's dependence on Bangladesh and Sri Lanka for exports is limited, LDC graduation should not cause any major disruptions. The SAARC Agreement on Trade in Services (SATIS) has been in force since 2012, but the implementation progress has been very slow. As proposed and provisioned in the agreement, LDC members will have more favourbale terms than those that are non-LDCs. However, since no major gains have been materialized from the SATIS, actual consequences due to post-graduation will be non-existent. Similarly, BIMSTEC has not yet been a formal trade agreement with very little progress made so far in translating it into a full-fledged FTA. Therefore, consideration of any potential foregone gains due to graduation is rather hypothetical. While it is true that in future Nepal may have to accept non-LDC terms under SATIS or BIMSTEC, what is most obvious is that there exist opportunities for Nepal to proactively engage in the negotiation process aiming to influence the outcomes that would benefit it most. Nepal can build a coalition with other graduating LDCs such as Bangladesh in exploring mutual benefits.

[43] Nepal already has a bilateral agreement with India. So, as discussed above, LDC graduation will not have any implication in Indian market.

A comprehensive effort to expand regional trading opportunities will also require improved connectivity. This is particularly so for a landlocked country. Nepal has several connectivity options, but inefficiencies in the existing corridors do not help reduce costs. In some cases, customs and transport procedural reforms are important, while in other instances investments will be needed in physical infrastructures. Between India and China, Nepal's connectivity with India is much better. With China, it currently lacks viable connectivity largely because of the difficult Himalayan terrain. Transport constraints inhibit Nepal's more effective trade ties with China. Therefore, an important consideration will be to look for opportunities in making substantial improvements in direct connectivity with China.

Nepal's major share of third-country trade is conducted through Indian ports. With the construction of Inland Clearance Depot (ICD) in 2004, Nepal is now better connected with Indian railway to transport its cargo to Kolkata and Haldia port. Since 2016, the connectivity with the Visakhapatnam port has also improved (Nepal Chamber of Commerce, 2017). Most shipping lines related to Nepalese trade operate their functions entirely from Kolkata and Haldia ports. However, liability management mechanism of shipping lines, the limited turnaround time for containers, demurrage and detention fees associated with the turnaround time etc. sometimes work as impeding factors in affecting trade expansion.[44]

Nepal also sought for third-country trade through China. It signed the protocol on implementing 'The Transit and Transport Agreement' with China in early 2019 that would provide access to the landlocked nations to use Chinese ports for foreign trade.[45] During the visit of Chinese President Xi Jinping in October 2019, both countries signed an agreement to develop a multidimensional trans-Himalayan connectivity network that will help Nepal transform itself from a landlocked country to land-linked country. Implementation of these projects should be given due priority. Besides using Chinese ports, Nepal can explore the opportunities to utilise the Mongla and Chittagong ports of Bangladesh. Therefore, there are scopes for improving connectivity for which Nepal will have to work closely with various partners either bilaterally or through regional/sub-regional initiatives.

### 4.4 Promoting external competitiveness and trade capacity Building

Nepal being a landlocked country has a natural comparative disadvantage in international trade which in turn undermines external competitiveness lowering the country's trade-orientation.[46]

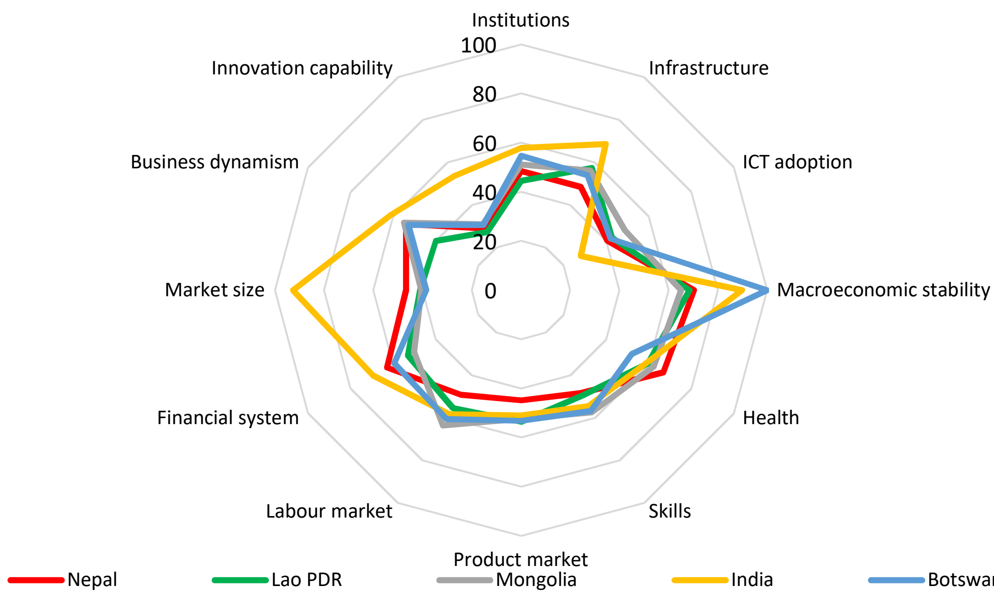
[44] In case of exports, shipping lines take up the responsibility from Kolkata port to destination port while it does so to Kolkata port for Nepalese imports.

[45] See details at https://kathmandupost.com/national/2019/04/30/nepal-signs-deal-with-china-to-access-seven-chinese-sea-and-land-ports

[46] According to World Trade Organisation Staff (2015), between years 2005–2014, landlocked LDCs experienced an increase of 46% in terms of both costs to exports and costs to imports. While their counterparts – countries with coastal ports, experienced about 7% and 12% increment in costs to exports and costs to imports respectively during the same time period.

Poor and inadequate infrastructure along with the insufficient and inefficient port facilities exacerbates the problem. Dependence and usage of second country ports, inept trade logistics support, and time-consuming clearance systems in the economic transit corridors lead to both high lead and lag time (WTO 2015).[47] Trading cost is further compounded by the relatively weak state of various indicators as captured by World Bank's Ease of Doing Business Report (2019). Nepal ranks 110th and ahead of a number of landlocked Asian economies excluding Mongolia (e.g. Afghanistan ranks 167th, Lao PDR ranks 154th and Mongolia ranks 74th). Still, Nepal is plagued by serious constraints regarding getting electricity connections, registering property etc. Similarly, in the World Economic Forum's Global Competitiveness Index Nepal demonstrates a weaker performance in such indicators as infrastructure, product market, ICT adoption, labour market, skills etc. in comparison with some selected landlocked countries namely Botswana, Lao PDR and Mongolia (Figure 21). These factors serious constrain the development of productive capacities and lack of economic diversification.

**Figure 21. Performance of selected countries in Global Competitiveness Index**




*Source:* Author's presentation using data from the Global Competitiveness Report (2018).

A landlocked country with natural comparative disadvantage in the tradable sector will require improved efficiencies in other sectors to generate external competitiveness. Building new infrastructures, amongst others, can help alleviate some of the problems (Ezemenari and Joshi, 2019), but it is also important to address the policy constraints that undermine the competitiveness of the export sector. Nepal, having experienced huge inflow remittances, is likely to be subject to the so-called Dutch disease phenomenon that tends to further weaken external competitiveness

[47] Since more than 90 per cent of Nepalese exporters are dependent on imported raw materials, they incur two-way shipping cost – (i) importing raw materials from port to factory (ii) exporting finished products from factory to ports (Narian and Varela, 2017).

(World Bank, 2017). Again, the tariff policy that aims to protect domestic sectors and government revenue will likely to generate anti-export bias, making exporting activities relatively unattractive. Therefore, prudent macroeconomic and trade policies should have an important role in promoting trading capacities and export supply response.

### 4.5 Attracting FDI for export success

Attracting FDI can be an effective means for investment stimulation and ensuring export success. The role of FDI in expanding exports and promoting export diversification is so prominent from the experience of many Asian developing countries including, Cambodia, China, Malaysia, and Vietnam. Skill upgrading, improving productivity, positive spillover effects arising from knowledge and technology transfers and better management practices are some of the direct impacts of FDI. The spillover effects can also benefit local firms, facilitating their industrial upgrading and enhanced participation in GVCs.

FDI inflow into Nepal is around 1 per cent of GDP, which is lower than that of such landlocked comparators as Bhutan and Lao PDR. Nepal's poor performance in attracting FDI inflows has been attributed to *inter alia*, uncertain policies, stringent procedural requirements, uncongenial investment climate, burdensome processes for fund repatriation, and cumbersome and time-consuming process to employ overseas labours (World Bank, 2017). Nonetheless, in recent times, Nepal has provided significant policy attention to foreign direct investments. According to the Foreign Investment Policy (2015) and Nepal Rastra Bank (2018), Nepal's potential sectors with huge potential to attract FDIs are hydroelectricity generation and distribution; tourism development, railway, metro rail, flyover and international airport under transportation sector, agribusiness and herb processing sector, etc. It is however also important to identify some niche merchandise export sectors where FDI can generate initial break-throughs to be replicated in other sectors.

### 4.6 Dealing with development challenges in achieving SDGs

It is important to recognize that LDC graduation is not any winning post, rather the first milestone in the marathon of development (UNCTAD 2016). Graduating LDCs will continue to confront with many development challenges.

One key priority for Nepal will be to build momentum and sustain economic growth. Despite being landlocked, Nepal has unique natural resources to foster economic activities. For example, given the much-unexploited potential across the country, Nepal's tourism sector could be an important source of growth and job creation. The natural endowment of fertile land and abundant water resources provide tremendous opportunities for agribusiness development (IFC, 2018). The country has huge potential for hydropower, and it is estimated that less than 2 per cent of this economically viable potential is being exploited (World Bank, 2017). Dynamism in these areas should result in robust economic growth. As Nepal has made impressive socio-economic progress even with low per capita income, growth dynamism can be beneficial in promoting human capital further and helping it meet many of the SDGs.

It is worth pointing out that the key challenges to growth and development such as grossly inadequate and inefficient infrastructure, lack of private investment in the productive sectors, weak implementation of development projects, etc. are now duly recognized, attracting policy attention. Improvements in these areas will be preconditions for smooth graduation in putting Nepal on a solid track to its transition to a middle-income economy.

### 4.7 Establishment of a national committee

Preparing for smooth graduation with proper and timely planning and strategies is important. This can make a country focused on exploiting the existing LDC specific international support measures (including duty-free market access in the major export destinations), negotiating better with major trading partners to extend transition period and/or provide alternative support measures in the post-graduation era, and preparing medium to long-term strategies (CDP, 2019). The resultant benefits can only be capitalized through the government's proactive policy stances. In this regard, governments of different graduated and graduating countries formed national committees to prepare smooth graduation strategies commensurate with the respective countries' long-term development plans (Table 12). One recent example of such a government-led initiative is from Vanuatu, which initiated the *'Vanuatu 2030: The People's Plan'* that aims to align the objectives of sustainable development goals (SDGs) with a set of priorities (such as enhancing productivity, expanding exports, reducing heavy reliance on imports, generating employment opportunities, etc.). This Plan also worked as a basis for smooth LDC graduation (Brien, 2019). Bangladesh, which is expected to be graduated in 2024) has also set up a National Task Force to assess the likely impact of graduation and formulate policy options to mitigate any consequences while achieving SDGs. Nepal could consider establishing such a national committee to achieve policy coherence and ensure a smooth transition.

**Table 12. National committees on LDC graduation in different countries**

| Country | Committee name | Description |
|---|---|---|
| Bangladesh | National Task Force & LDC Core Group | • comprised of various government entities to work as a focal point<br>• assessment of likely impacts of LDC graduation in different sectors<br>• formulation of post-graduation policies aligning with development planning as well as SDG implementation strategy |
| Maldives | Working Group on Smooth Transition from LDC Status | • comprised of members from different ministry<br>• formulation of a framework to ensure smooth graduation |

| | | |
|---|---|---|
| | | • seeking help from UNESCAP and UNCTAD to prepare a graduation strategy |
| Vanuatu | National Coordination Committee | • monitoring the transition<br>• raising awareness among the relevant stakeholder about the likely impacts of graduation<br>• collecting valuable inputs from different bodies of government<br>• aligning graduation strategies with the national development policy |
| Cape Verde | Donor support group (Grupo de Apoio à Transição - GAT) & Budget Support Group | • preparing a transition strategy integrating with gradually decaying international support measures<br>• adopting an agenda for socio-economic transformation<br>• safeguarding donor support (combining government, bilateral and multilateral donors) to eradicate poverty and ensure growth |

*Source:* Author's compilation from various sources.

## V. Conclusion

Nepal's development transition deserves serious attention by its policymakers as well as global stakeholders including development partners. While it's true that the country has met two of the three criteria for graduation, its low-income, susceptibility to natural disasters, and constrained trade-led development prospects due to being a landlocked country raise concerns about the sustainability of development progress.

Despite emphasis given in such global initiatives as the Istanbul Programme of Action for LDCs and Sustainable Development Agenda 2030 on developing productive capacities and structural transformation of the economy, Nepal has not managed to make noticeable progress in these areas. For an economy to be so heavily dependent on remittances and Large-scale migration is being seen as not a sign of strength but of deep structural problems (World Bank, 2017). Nepal, therefore, presents a dilemma about the assessments made for LDC graduation and the ground realities associated with persistent development challenges.

Most of the LDC related international support measures related to international trade from which Nepal has not been able to benefit much. That would also imply that LDC graduation itself should not be a cause for concern as the benefits were never materialized in the first place. However, IPoA and SDGs highlighted the role of trade, anticipating that the participation of LDCs, as measured by their share in world exports, would double. In reality, that share has declined and Nepal's merchandise exports have fallen in both absolute and relative terms. The global trading environment has been marked by policy uncertainty with escalating trade tensions between the world's two largest economies having widespread ramifications. Rules-based multilateralism was considered as an important precondition for effective participation of the poorest, weakest, and most vulnerable countries in world trade. The stalled progress of WTO-led multilateral trade talks, heightened trade policy uncertainty, and trade slowdown has generated a decade of lost gains from international trade for many individual LDCs including Nepal.

Although Nepal did not manage to take advantage of trade preferences, graduation would imply foregone opportunities. Particularly for landlocked LDCs, any trade preferences could be extremely helpful in overcoming its inherent comparative disadvantage in trade.

Under the above circumstances, further deferment of LDC graduation recommendation for a country like Nepal would perhaps be the most appropriate global response. An alternative approach could be to link the graduation of landlocked countries and all other LDCs to their performance in achieving SDGs by 2030.

Should graduation go ahead, Nepal should aim to seek for a longer transition period for trade preferences. Currently, only the EU provides an additional three years' transition period after graduation. Other donor countries such as Australia, Canada, China, Japan, Republic of Korea, etc. should be approached to consider the EU example of granting a longer transition period.

Nepal should assess if it can qualify for the EU GSP Plus preferential scheme after its LDC graduation. If this is possible, tariff implications on Nepalese products in the EU would be minimal. However, GSP Plus is associated with more stringent rules of origin requirements. The current GSP regime will be replaced by a new one in 2024 and proactive engagements with the European Commission can be undertaken with the possibility of the EU's granting GSP Plus beneficiary countries the same ROO provisions as in the EBA.

Graduation might not have much implication for development financing as development partners do not use LDC status as an important factor in deciding about aid allocation. However, accessing certain LDC-related funds such as LDC climate change fund (LDCF) and Enhanced Integrated Framework (EIF) will have to be discontinued after the relevant transition periods.

LDCs are often exempt from making commitments and implementing stringent provisions of agreements. LDC graduation could potentially mean a significant loss of policy space in supporting such sector as agricultural and non-agricultural export and pharmaceutical sectors. Providing subsidies and other direct financial assistance to any exports could be particularly problematic. WTO members have been quite reluctant in questioning LDCs policy space and domestic support, but graduation could trigger closer scrutiny to ensure conformity with the rules and regulations.

Exploring new trading opportunities and enhancing export completeness should constitute two priority areas for Nepal. As a landlocked country, it should trade more with its neighbouring countries, China and India, that are also amongst the world's largest economies. There remains immense potential of increasing trade with both these countries and integrating into the regional supply chains led by them. Nepal's current international standing in cost of doing business and global competitiveness rankings shows ample Room for improvements. Along with this, appropriate macroeconomic and trade policies can provide competitiveness boost improving export supply response. Nepal has not been successful in attracting FDI, which is often a principal driver of export growth and diversification in many developing countries.

Finally, it must be pointed out that like other graduating LDCs, Nepal will continue to confront development challenges. Therefore, it is important to attach policy priority to sectors that can build growth momentum and sustain it. Tourism, agribusiness, and hydropower are areas where Nepal has a natural comparative advantage and much-unexploited potential in generating growth and creating employment opportunities. Key impediments to unleash dynamism in these sectors – such as lack of investment, large infrastructure deficit, and weak implementation of development projects – must be tackled effectively for smooth graduation and Nepal's transition to a middle-income country and beyond.

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