Nepal’s graduation from LDC status
Implications for international trade and development cooperation

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Background

• UN General Assembly, on 24 November 2021, adopted a resolution declaring that Nepal, along with Bangladesh and Lao PDR, would graduate from the LDC category with a five-year preparatory period.

• The three LDCs received an additional two years to the normal three-year preparatory period.

• Nepal is graduating by meeting the cut-offs pertaining to HAI and EVI, but without meeting the income cut-off.

• SAWTEE research
  • Kharel (2021)
  • Pandey et al. (2022): for GoN/Ministry of Finance, with support from FCDO, UK
  • Ongoing: SASGP/The Asia Foundation
Nepal’s comparative export performance

De-industrialization: manufacturing performance
Missing merchandise exports are 12 x actual exports

Source: World Bank (2021)
Nepal’s export destinations (% of total goods exports) (2016/17-2020/21 average)
3-year post-graduation extension to EU/UK’s LDC preferences. Tariff increase especially pronounced in EU and UK. However, entry into GSP+ or EF (from 2023: DCTS Enhanced Preferences) will result in insignificant or no change in tariffs overall.
Impact on goods exports

• Partial equilibrium models: -2.5% to -4%
• Notable losses in EU, Turkey, UK, China [varies across models]
• Losses concentrated in the textiles and clothing sector
• GSP+ could reverse most of the losses in the EU (and DCTS Enhanced Preferences could do the same in the UK)
• ROO to become stringent in alternative schemes: notably, double transformation requirement for apparel (GSP+). [UK’s Enhanced Framework had a provision for possibility of derogation]
• Conditions in alternative schemes
  • Economic vulnerability (EU GSP+/UK DCTS EP): Nepal meets it
  • Ratification and implementation of international conventions: precondition in GSP+; not in DCTS EP
    • Signed but not ratified the Cartagena Protocol on Biosafety to the Convention on Biological Diversity
    • Not signed and ratified the Freedom of Association and Protection of the Right to Organise Convention, 1948 (ILO Convention No. 87)
    • Not signed and ratified an additional convention that the EU proposes to include in new eligibility criteria: ILO Convention No. 81 on Labour Inspection (1947)
Impact on exports: Beyond modelling

- Two thirds of exports are to India; hence limited impact; but implications for export diversification
- Low preference utilization
- Huge untapped export potential; prospect of tapping partly predicated on tariff concessions; takes time to build productive capacity and alleviate supply-side constraints; foregone export potential due to tariffs possibly huge but not easily quantifiable
- SMEs likely to bear the brunt
- Stringency in ROO
- Double transformation requirement: Production/export capabilities exist in apparel, textiles and yarn, but how to harness them to meet ROO?
- Weak supply side: 2/3 of exports to US face zero MFN tariffs but total export value low; export performance of 77 additional products that get special zero duty access in US lacklustre; preference utilization rate of exports to China below 50%; Nepal’s untapped export potential is highest in China and India
- Services trade
  - Insignificant change in services trade because of the lack of effective and meaningful operationalization of WTO’s LDC services waiver
  - But Nepal will lose potential benefits if waiver is effectively and meaningfully operationalized post-graduation
Implications for policy space

- Loss of flexibilities enjoyed as an LDC in implementing policies related to trade, industrial development and health
- Greater scrutiny of Nepal’s policies
- Pressure to liberalize trade further at the WTO and regional forums >> less space to protect domestic industry; revenue loss
Implications of LDC graduation: aid

• Direct impact
  • Could lose preferential lending terms provided by Japan and South Korea
• World Bank: LDC status not a criterion; income graduation could impact concessionality (but blend credit is still highly concessional)
• ADB: LDC status is a criterion. If crossing of income threshold is sustained, losing LDC status will shift Nepal to blend assistance (also highly concessional)
• Debt distress and creditworthiness are also factors in ADB/WB aid
• UNDP and UNICEF are mandated to provide a certain portion of their core resources to LDCs
• Climate finance: Will not receive new funding support from LDCF but will be eligible to access other financing sources of UNFCCC
• Enhanced Integrated Framework (EIF): support provided for 5 more years
• Technology Bank: access for 5 more years; Nepal yet to collaborate/participate
• United Nations Capital Development Fund: 3 more years; possibility of access for 2 additional years at 50-50 cost sharing basis
Way forward - I

✓ GoN is preparing a transition strategy: expedite it;
✓ Use international/multilateral forums to pursue post-graduation interest (e.g., negotiate longer transition period for preferences; seek at least extensions a la EU/UK from other preference granting countries);
✓ Take initiatives to access alternative preferential schemes (e.g., GSP+/DCTS EP);
✓ Lobby for lenient rules of origin for newly graduated LDCs;
✓ Request SAARC members to accord same treatment as provided to previous graduated country/vulnerable country;
✓ Develop sector-specific strategy (e.g., textiles & clothing) [research needed];
✓ Develop backward integration strategy;
Way forward - II

✓ Strengthen productive capacity, improve competitiveness and generate exportable surplus;
✓ Reduce trade and logistics costs;
✓ Pursue trade agreements with adequate homework;
✓ Fully utilize the existing source of finances contingent upon LDC status;
✓ Improve aid absorptive capacity; seek more aid for trade to build productive capacity and enhance competitiveness;
✓ Cut wasteful expenditure; improve expenditure efficiency; plug revenue leakages; evaluate and streamline tax rebates and other subsidies;
✓ Develop a strategy on how to best utilize available policy space;
✓ Disseminate information at grassroots level on the implications of LDC graduation and availability of alternative preferential schemes
Thank you