



**Policy Research Institute**  
**नीति अनुसन्धान प्रतिष्ठान**



**Preparing for  
Nepal's Graduation from the  
LDC Category**

**Research Report**

**Gyan Chandra Acharya  
Khaga Nath Adhikari, PhD**

**Kathmandu, Nepal**



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## LIST OF ACRONYMS AND ABBREVIATIONS

AAAA	Addis Ababa Action Agenda
ADB	Asian Development Bank
AGOA	Africa Growth and Opportunity Act
AI	Artificial Intelligence
AIB	Asian Infrastructure Investment Bank
AMIS	Aid Management Information System
ASEAN	Association of Southeast Asian Nations
BBIN	Bangladesh, Bhutan, India, Nepal
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
CDP	Committee for Development Policy
COVID	Coronavirus Disease
DAC	Development Assistant Committee
DFQF	Duty-Free and Quota-Free
DPR	Detailed Project Report
EBA	Everything But Arms
ECOSOC	Economic and Social Council
EIB	European Investment Bank
EIF	Enhanced Integrated Framework
EU	European Union
EVI	Economic Vulnerability Index
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATT	General Agreement on Tariff and Trade
GCF	Green Climate Fund
GDP	Gross Domestic Product
GEF	Global Environment Facility

GLOFs	Glacial Lake Outburst Floods
GNI	Gross National Income
GNP	Gross National Product
GSP	Generalized System of Preferences
HAI	Human Assets Index
HIPC	Heavily Indebted Poor Country
ICT	Information and Communication Technology
IDA	International Development Association
IMF	International Monetary Fund
INGO	International non-Governmental Organization
IPCC	Intergovernmental Panel on Climate Change
IPOA	Integrated Programme of Action
IT	Information Technology
ITC	International Trade Centre
KNOMAD	Global Knowledge Partnership on Migration and Development
LDC	Least Developed Country
LDCF	Least Developed Countries Fund
LLDCs	Land-locked Developing Countries
Macmap	Market Access Map
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
MFN	Most Favoured Nation
MOF	Ministry of Finance
NPC	National Planning Commission
NRB	Nepal Rastra Bank
NTIS	Nepal Trade Integration Strategy
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
OHRLLS	Office of the High Representative for the Least Developed, Land-locked Developing Countries and Small Island Developing States

PDR	People's Democratic Republic
PRI	Policy Research Institute
Rs/NPR	Nepali Rupees
RTA	Regional Trading Arrangements
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asian Free Trade Area
SDGs	Sustainable Development Goals
SIDS	Small Island Developing States
SPS	Sanitary and Phytosanitary
TBT	Technical Barriers to Trade
TRIPS	Trade-Related Aspects of Intellectual Property Rights
UK	United Kingdom
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNCDP	United Nations Committee for Development Policy
UNCTAD	United Nations Conference on Trade and Development
UNDESA	United Nations Department for Economic and Social Affairs
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFCCC	United Nations Framework Convention on Climate Change
UNICEF	United Nations Children's Fund
UNSG	United Nations Secretary-General
USA	United States of America
USD	The United States Dollar
WIPO	World Intellectual Property Organization
WIR	World Investment Report
WTO	World Trade Organization
WTOEIF	World Trade Organisation and Enhanced Integrated Framework

## FOREWORD

The UN Committee for Development Policy has recommended Nepal's graduation from the LDC category, which is expected to come into effect from the beginning of 2022. Nepal will get a five-year transition period to make preparations for facing the challenges resulting from the withdrawal of the LDC-specific support measures that Nepal is enjoying as an LDC. Based on the present scenario, Nepal is expected to continue to enjoy LDC-specific support measures from the international community until the end of 2026. And, from the beginning of 2027, we will have to manage the situation differently as a developing country.

Graduating from the LDC category presents both opportunities and challenges. The opportunities include national self-confidence, international recognition of socio-economic developments that we have achieved, and possibly an increase in foreign investment and technology transfer. And, the challenges range from the withdrawal of preferential treatments in trade to official development assistance (ODA) and other supports from Nepal's bilateral and multilateral partners. In the short run, the challenges seem more daunting than the opportunities. But, if we make good and effective preparations for graduation, it will be a unique opportunity for the country, and the graduation will be smooth, sustainable and irreversible.

Nepal first met two of the three criteria for graduation in 2015. In accordance with the prevailing rules, it could have graduated in 2018 itself. However, we preferred to defer Nepal's graduation to a later stage. We knew in 2015 itself that Nepal was graduating soon and had to start making preparations for it early on. But we have not meaningfully started preparations even today. Making preparations means an in-depth analysis of all the support measures that Nepal is enjoying as an LDC, making practical calculations of what we will lose after graduation, and making strategies to set off the negative impacts of the withdrawal of international support measures and maximize possible opportunities after graduation.

Realising this need, Policy Research Institute (PRI) commissioned a study on preparing for Nepal's graduation from the LDC category. Ambassador Gyan Chandra Acharya is one of the very few most suitable persons for this study because of his broad experiences as Nepal's Foreign Secretary and the Permanent Representative of Nepal to the UN (both in Geneva and in New York), and the UN Under-Secretary-General and High Representative for LDCs. On behalf of PRI, I thank Ambassador Acharya for accepting our request to take up this study. Another member of this research team, Ambassador Dr. Khaga Nath Adhikari, a career diplomat, who has served as Nepal's Ambassador to Thailand and PR to UNESCAP, and currently a Senior Research Fellow in PRI, also deserves special appreciation for his hard work to bring the publication in this form. Thanks are also due to the reviewers for their comments and suggestion, which have been useful to further refine the document.

The report analyses the international support measures that Nepal has been enjoying at present as an LDC. It has projected the impacts that Nepal will have to face after graduation and, based on the analysis and projection, made useful recommendations for the Government of Nepal on how to prepare for graduation from the LDC category.

I am confident that the study would be useful for every stakeholder in general, and the Government of Nepal, in particular. Constructive feedback and suggestions from readers are always welcome and appreciated.

Dr. Bishnu Raj Upreti  
Executive Chairperson  
June 2021

## ACKNOWLEDGEMENTS

We would like to express our appreciation to the Policy Research Institute (PRI) for taking the initiative to study and analyse the implications of Nepal's graduation from the LDC category. The issue is very important for Nepal, as it represents an important guidepost for Nepal's development progress and international engagements.

Graduation comes with both challenges and opportunities. With the right strategy and a holistic and forward-looking approach, Nepal should be able to manage the transition with confidence. However, it requires focused leadership and a coherent approach at home, and smart articulation and consistent advocacy at bilateral, regional and international levels.

In preparing this report, important suggestions and support were provided by the Institute. In particular, we would like to express our thanks to the Executive Chairperson of PRI for selecting the subject of the study and offering valuable suggestions along the way. Similarly, we would also like to express our gratitude to the officials and the staff who provided secretariat support as well as coordination and information on important issues relevant to the report.

While heartily appreciating the support and cooperation of all, we remain responsible for the analysis and recommendations contained in the report.

Gyan Chandra Acharya  
Khaga Nath Adhikari, PhD

## **EXECUTIVE SUMMARY**

Nepal has been endorsed by the United Nations (UN) for graduation from the Least Developed Country (LDC) status in the next five years on the recommendation of the Committee for Development Policy. Nepal has been a member of the LDC group since its establishment in 1971, one among 46 LDCs around the world representing about 13 per cent of the global population. Some countries in our neighbourhood such as Bhutan and Bangladesh have also been recommended for graduation.

Graduation of Nepal is based on Nepal having consistently met the two criteria – the Human Assets Index and the Economic Vulnerability Index – during the three triennial reviews. Graduation is an important development milestone as it reflects a significant change in the development situation of a country. It comes with both challenges and opportunities. If the transition is properly managed with strong national leadership and a proper strategy, complimented by robust international partnerships, it could be an important opportunity to transform the structure of the economy, promote sustained human development and ensure inclusive and sustainable prosperity. Conversely, if there is no preparation and no clear strategy, there will be adverse impacts in terms of some specific measures related to trade, flexibilities and other concessions.

In this study, an attempt has been made to analyze the evolution of the LDCs as a group at the international level, various facets of international support measures, Nepal's status of graduation in terms of the utilization of and getting due benefits from the support measures, current challenges and focus areas to ensure meaningful and sustainable graduation. Finally, some recommendations have been made for specific actions at the national and international levels.

The UN has, since its establishment, consistently called for the promotion of international peace and security, peaceful settlement of disputes, sovereign equality, international cooperation on economic development, social progress and human rights to establish a peaceful, inclusive and equitable international order. Being cognizant of the special problems of the LDCs among the developing countries, given their deep structural constraints and debilitating poverty, the international community agreed to constitute the group of LDCs with a call for special and preferential treatment and facilitatory international support measures. Over the period of time, it came up with institutional arrangements to support the LDCs, organized decennial UN conferences with a special focus on the LDCs' particular challenges and agreed on specific global support measures. These measures relate to the ODA, international trade, debt, investment, technology and capacity building together with some concessions and flexibilities.

Nepal has either benefited directly from many of these specific measures or has been able to project its LDC status to get support from the international community over the last five decades. Successive improvements in human development over the last two decades and moderate progress in economic development are some of its examples. However, economic development has not accelerated much when we look at it from the perspective of its inherent potential as well as in comparison to other countries in the region. A combination of factors such as internal conflicts and instability, the incidence of multidimensional poverty and inequality, mountainous terrain and landlocked status, lack of structural change in the economy, low productive and export capacity, growing vulnerability to disasters and external economic situations played an important role in this limited acceleration of economic growth and moderate impact on the lives of the people.

Despite the provisions of the duty-free and quota-free market access to LDCs and other trade-related support measures, Nepal's foreign trade has remained heavily import-dominated, less diversified in terms of products and markets and highly volatile. The utilization of preferences remains limited. While Nepal has been moderately successful in attracting the ODA, a rising gap between the commitments and disbursements, cost overruns of programmes, concessionality and convergence of priorities are some of its challenges. Similarly, the growing share of the loan component may impose certain restrictions in terms of utilization of the ODA in the coming years. Nepal has not been able to attract much FDI, despite various initiatives, and it remains very low even among the South Asian countries and other LDCs. Remittances have been the most important foreign exchange earning source and a big employment provider as well, for the burgeoning youth population of the country. Nepal needs to use this short-term window of opportunity and make a medium-term plan to employ most of the youth in the country and use remittances to promote entrepreneurial capacity and productive investment. Nepal has not benefited much from technological revolutions except in utilizing telecommunications and internet technology for communications, entertainment and the lower end of business services. Nepal has benefited from capacity building, technical cooperation and flexibilities and received concessions in the payment of contributions to global institutions and programmes.

There will be no direct impact of graduation on Nepal's access to the ODA and debt and hardly any impact on technology and investment. There could be even some positive impact on attracting investment. Market access to our products will be somewhat negatively impacted if we are not able to negotiate preferential trading agreements with our major trading partners. Capacity building related assistance from the UN agencies and our contributions to some of the UN-related bodies could marginally be affected. Remittances will not be affected at all. Therefore, Nepal should make maximum efforts to get an enhanced level of support from the international

community during the time of the transition period of five years and prepare better to ensure a smooth take-off after graduation.

Nepal should immediately prepare a comprehensive national transition strategy for sustainable and meaningful graduation. It should use the opportunity to fundamentally change the structure of its economy with a strong and coherent national leadership and expanded and comprehensive international cooperation. Therefore, priority should be given to bring a structural transformation of the economy with expansion of its productive capacity across sectors together with strategic development of efficient infrastructure, including the digital infrastructure. Similarly, effective and coherent programmes with investment plans should receive a high priority for the promotion of inclusive human development, building resilience and sustainability.

Strong policy coherence, institutional development and good governance play a very important role in making development inclusive, fair and sustainable. Similarly, effective national leadership with a multistakeholder approach is critical to take the country forward with confidence. Given the landlocked status, mountainous terrain, geostrategic location and the unprecedented economic progress of the neighbouring countries, India and China, a robust and multifaceted bilateral cooperation with the neighbours, accompanied by equally strong regional cooperation, would be critical to link up with regional and global value-chains and networks. An enhanced level of international support measures would be equally important across the board, from all the developed countries around the world, in order to diversify its political and economic relations and meet the growing development finance gap in the transition period and beyond.

Nepal should take it as a positive sign that it is graduating from the LDC status. It should use the opportunity to resolutely prepare itself for rapid and sustainable progress and inclusive prosperity. Nepal should promote the graduation of LDCs, poverty eradication and protection of natural resources as global public goods. While linking graduation from the LDC status with Sustainable Development Goals (SDGs) as well as with national development plan objectives, Nepal should establish a High-Level National Committee to prepare a comprehensive and coherent national transition strategy with a strong secretariat to bring coherence in all of its actions and review their implementation continuously in an effective manner. On the issues relating to international support measures, Nepal should intensify its advocacy at the international level while calling for an enhanced level of support to overcome Nepal's vulnerability to climate change, landlocked status and the incidence of multi-dimensional poverty. On international trade, there is a need for a comprehensive study of the implications of graduation on Nepal's major export products and partners in order to ensure trade concessions and preferences beyond graduation. A robust initiative should be put in place to attract FDI and new frontier technologies in the post-graduation phase.

Ardent advocacy of Nepal's case, close monitoring of global developments, networking with the graduating countries for ensuring a dedicated mechanism of enhanced cooperation, concessions and flexibilities in support of the graduated countries and close collaboration between key Government Ministries and the diplomatic missions abroad will be very important in the next few years to ensure a smooth, irreversible and meaningful graduation of Nepal from the LDCs status. This is both desirable and possible with a clarity of vision, strong determination and coherent and effective actions at the national and international levels.

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background

Nepal was among the 25 countries in 1971 to be categorized as an LDC. With the establishment of the LDC category, these countries advocated for special consideration and targeted support measures from the international community to overcome their persistent and widespread poverty and structural impediments. Like other members, Nepal also had an aspiration of alleviating poverty and achieving rapid and inclusive development. Meeting the three criteria for graduation, namely Gross National Income (GNI), Human Assets Index (HAI) and Economic Vulnerability Index (EVI), and finally graduating from the category would be an important milestone for any LDC. Nepal met two criteria ( HAI and EVI) for the first time in 2015, and again in 2018 during the triennial review by the UN Committee for Development Policy (UNCDP). However, in view of prevailing situations (the massive earthquake in 2015 and the border blockade by India), Nepal requested the UNCDP, in 2018, for deferring the graduation for a later stage. On 26 February 2021, the UNCDP recommended Nepal's graduation from the LDC country category. The ECOSOC and the UN General Assembly will respectively take note and approve the graduation recommendation by the end of 2021. Then, the process of graduation will commence with a five-year transition period for making preparations for facing the situation after the withdrawal of LDC-specific support measures.

The UN has consistently stressed that graduation should be smooth, sustainable and irreversible. Neither the graduated countries nor the international community would like to see them fall back into the category. Therefore, the international community has called for the formulation and adoption of a smooth transition strategy, with strong national ownership and a multistakeholder approach. It also calls for an equally robust international partnership to support graduating countries for their meaningful and sustainable transition.

The LDCs enjoy certain benefits from their development partners, the UN system and other international organisations under International Support Measures and other arrangements. Naturally, there is some level of anxiety in graduating LDCs to cope with a situation of withdrawal of the LDC-specific support measures after their graduation. But a forward-looking and thorough preparation followed by coordinated and coherent actions would contribute to systematically deal with the challenges and seize the opportunities of a new level of development. Therefore, the UN has put in

place a mechanism for providing some time to the graduating LDCs as a transitional period for making necessary preparations to better deal with the new situation after graduation. This time, the UNCDP has recommended providing a five-year transitional period for Nepal and other graduating countries. Under this arrangement, Nepal will continue to have access to all LDC-specific support measures until the end of 2026. After that, based on the current projection, Nepal will be graduated from the LDC category.

During these five years, Nepal will have to prepare itself for a smooth transition from an LDC to a middle-level developing country. It will have to enable itself to offset the losses resulting from the withdrawal of LDC-specific international support. The support measures include official development assistance, preferential treatment in international trade, flexibilities in and exemptions from obligations under WTO rules, and some other measures such as minimum membership contributions to the UN Agencies and support for participation in the UN conferences.

Nepal will have to make thorough preparations at the domestic level as well as at the international level. While structural transformation, productive capacity development, human development, building resilience and creating an enabling environment will, among others, have to be parts of the national agenda, there is also a need for stronger advocacy, smart articulation of our interests and vulnerabilities, and coalition building for garnering stronger international support for Nepal during the transition period and beyond. Nepal should take necessary steps at home and also articulate better at the international level to ensure ODC in the targeted areas, supportive international trading arrangements, robust enhancement of FDI, technology transfer and adaptation, technical cooperation and capacity-building support in the decades ahead. An in-depth study is necessary to analyse the situation that Nepal would be in after the transition period, and also to identify and recommend a strategy and the areas of focus from domestic as well as international perspectives in order to ensure a smooth transition from the LDC category.

## **1.2 Significance of the Study**

Nepal will hopefully start its transition towards graduation from the LDC category from the beginning of 2022. The transition period of 5 years will end at the end of 2026. During these five years, Nepal will have to make all the necessary preparations for dealing with the new situation following the withdrawal of the LDC-specific international support. Until now, the Government of Nepal has not taken any initiative towards preparing itself to face the new situation after graduation. And, without concrete and specific measures, it would be difficult for Nepal to tide over the possible adverse implications resulting from the withdrawal of those specific measures.

Therefore, an in-depth study is necessary to recommend well-thought-out measures to deal with the new situation effectively. This study attempts to fill this gap.

### **1.3 Objectives of the Study**

The Study has two-pronged objectives:

- i. To thoroughly examine all the preferential treatments and other support measures Nepal is entitled to as an LDC, including those granted by regions and countries.
- ii. To make specific recommendations on the course of actions that Nepal should take at the national and international levels to offset the challenges arising from the withdrawal of LDC-specific concessions and facilities.

### **1.4 Key Research Issues**

The Study has focused on the following issues:

- i. Identification and examination of all the LDC-specific preferential treatments/facilities,
- ii. Detailed analysis of the benefits Nepal has been enjoying as an LDC,
- iii. A thorough projection of the graduation's implications for Nepal, and
- iv. Specific recommendations for effectively dealing with the situation at home and abroad after the withdrawal of the LDC-specific international support.

### **1.5 Research Methodology**

The study has involved a qualitative research method. Data has been collected from a wide range of sources, including literature review, analysis of national policies, statistics, reports and their implementation status, in-depth overview of global developments, examination of global reports and their implications for Nepal and professional experiences at national and international levels.

Because of the limited time and availability of resources, as well as the unprecedented lockdowns in the country due to the Covid-19 pandemic, primary sources through interviews and discussions could not be organized. However, diverse secondary data and analyses were accessed from national as well as international sources to bring a comprehensive perspective on all the relevant issues dealt with in the report.

The study touches on various cross-cutting sectors with national and international implications. Therefore, efforts have been made to make it as focused, forward-looking and holistic as possible, based also on the personal experiences of the researchers.

The literature review included an analytical assessment of the theoretical underpinning of the development discourse and global support frameworks in favour of LDCs, successive developments at the UN to promote the cause of LDCs and global initiatives on various international support measures. Similarly, the global situation of LDCs in terms of specific support measures was examined based on various international reports.

National and international reports were also reviewed to evaluate the various facets of Nepal's national development trajectory and international solidarity and cooperation. National statistics, policy papers and progress reports of relevant agencies were also studied. And, sectoral analysis on the relevant areas of cooperation was used to assess how much Nepal has benefited based on the outcome as reflected in its current national status and data. Some comparative analyses were reviewed with comparator nations based on relevant international and regional studies.

## CHAPTER TWO

### OVERVIEW

#### 2.1 Historical Perspective

There are 46 LDCs around the world today. They are predominantly in Africa, but one-third of them is in the Asia-Pacific region. Together they represent about 13 per cent of the global population with almost 900 million people, but their share in global GDP is just about 2 per cent. In global trade in goods, they have merely around one per cent share (WTO, 2020, p 22). Whatever their location and natural endowments, they share certain common characteristics such as low economic growth, low human development, high level of poverty, low productive capacity and structural constraints, and a high degree of vulnerability to internal and external shocks, among others. In many cases, they have a small economy, most often an open economy, with a high level of dependence on external support to promote economic development and social progress.

During the time after the Second World War, there were global concerns about the high degree of underdevelopment in developing countries in general and divergence between them and developed countries in particular. Therefore, right at the time of the establishment, the UN, under article 1(3) of its Charter, made a clarion call for the “achievement of international cooperation in solving international problems of an economic, social, cultural or humanitarian character,” as one of its purposes. The UN was to work as the centre for harmonizing the actions of nations in the attainment of global cooperation on economic development and social progress, together with the promotion of collective security, sovereign equality and human rights around the world.

Subsequently, during the period of decolonization of many countries from 1945 to the 1960s, the need for a just global cooperation framework at the international level was articulated to ensure that these newly independent countries would have a fair opportunity to get due benefits and support from international economic and trading frameworks. A Generalized System of Trade Preferences, the concept of the ODA, global cooperation on the role of multinational corporations and investment, debt relief measures, access to technology, international development and monetary policies and commodities markets were discussed to reform the global structure to lend stronger and equitable support to the developing countries around the world. There was a strong feeling that the developing countries were at a disadvantage, because of the systemic frameworks that were established by the developed countries with natural advantage to them. The developing countries, therefore, called for a new international economic order.

Among the developing countries as well, some countries were in dire straits in terms of their economic situation. With an overwhelming majority of their population living in absolute poverty with deep structural impediments, they felt that the preferences, frameworks and support measures that were already in place and some others being conceived were not directly relevant to them because of their structural impediments at home. Therefore, while they supported the new international economic order being proposed at the global level, they called for focused measures specifically directed towards them. Therefore, the very first session of the UN Conference on Trade and Development (UNCTAD) in 1964 recognized the importance of paying special attention to the less developed among the developing countries. The second session of UNCTAD held in 1968 asked the UNCTAD Secretary-General to carry out a detailed examination of special problems of less developed countries and recommend special measures.

In 1971, the UN endorsed the list of 25 LDCs, based on the recommendations of the Committee for Development Policy under ECOSOC, on the methodology of identifying LDCs. Nepal was among the 25 original LDCs. A decade after that resolution, the first UN-led LDC conference was held in Paris in 1981, which came out with the Paris Declaration. Since then, the LDC conferences have taken place every ten years. Over the period of time, many initiatives regarding the ODA, trade preferences, debt relief and many other supportive measures were successively introduced and reinforced. The UNCTAD was at the forefront for so many decades. Later on, as decided during the Brussels Programmes of Action for LDCs, a separate high-level office was established under the UN Secretary-General as High Representative for LDCs, LLDCs (Land-locked Developing Countries) and SIDS (Small Island Developing States) at the UN headquarters to promote research and analysis of the LDC situation, advocate their cause, sensitize the international community to enhance the level of international support to these vulnerable countries and coordinate UN system-wide support. On many occasions, the UN system also strongly advocated against the orthodox and neoliberal approach to development and called for targeted measures in favour of them, while taking into account their impact upon poverty and human development, promoted policy space for the developing countries and called for a fair balance between the role of the developmental state and market considerations given the initial stage of development in these countries and their structural barriers. At the turn of the century, the Millennium Development Goals (MDGs) galvanized the international community for more coherent actions on specified human development areas by all. As we approached 2015, the international community, including global institutions, both developmental as well as financial, collectively agreed on the Sustainable Development Goals (SDGs). Such a coherent approach with a consensus on these global goals and targets, applicable to all countries, developed and developing, is indeed propitious for effective global actions. However, how and what transition paths will be followed and how all the players in the development field - especially from

developed countries, emerging countries, other developing countries including the LDCs and their institutions - will implement them will have to be carefully reviewed. Because SDGs are ambitious, achieving them would require an integrated and coherent approach towards economic, social and environmental issues. It also calls for transformative actions with significant trade-offs in development practices from all stakeholders: government, the private sector, civil society and individuals. Considering the capacity constraints and structural barriers, the UN system and its bodies, multilateral institutions and development partners, including the countries in the South, were encouraged to support those LDCs. It is the reason why many LDC-specific provisions and targets have been incorporated in SDGs as part of the global goals and targets.

Nepal has regularly been participating with a high-level delegation in all these conferences and has highlighted its challenges while calling for robust international partnerships to overcome them and realize its full potential. The Fourth UN LDC Conference was held in Istanbul, Turkey in 2011, which approved a holistic Istanbul Programmes of Action with a set of objectives, principles and priorities. It laid a strong emphasis on comprehensive global partnerships to promote the welfare of the people in the LDCs together with some dedicated support measures on the widest possible areas of activities. The forthcoming Fifth LDC conference is to be held in Doha, Qatar in January 2022.

## **2.2 Graduation of LDCs and the Criteria**

Graduation from the LDC status could be considered as a natural aspiration of all LDCs, as it is clear that everyone would like to move on to the next phase of its economic development and social progress. Yet in the decades from the 1970s to 1990s, many countries joined the rank of LDCs. It was only in 1994 that Botswana became the first country to graduate from the LDC category. Until 2012, when South Sudan joined the group, more countries were joining in than graduating from the LDC category. Since then, no new country has joined the group. But 4 LDCs have graduated in the last decade and over a dozen are in the process of graduation in the coming decade.

The UN has developed criteria for inclusion as well as for graduation from the LDCs status. There is a higher benchmark for graduation than inclusion, precisely because graduation should be a one-way street and that the graduated countries should not fall back into the LDC category. The LDC criteria have evolved, reflecting the changing conditions of LDCs and the global understanding of constraints and factors of economic development and social progress. Even then the criteria do not capture many specific challenges of all LDCs, because of the vast diversity among LDCs and the need to make the criteria manageable.

There are three main headings of the criteria. GNP Per Capita, Human Assets Index (HAI) and Economic Vulnerability Index (EVI) (UNCDP, 2018, p.8).

The Committee for Development Policy (CDP) under the Economic and Social Council of the UN, which is responsible for reviewing the criteria and recommending LDCs for graduation following the analysis of their situation based on the criteria, has stressed that in reviewing the criteria, the underlying principle of identifying LDCs as “low-income countries that face structural handicaps to growth” has essentially been maintained. The Committee has furthermore stressed, “the importance of maintaining stability in the criteria and in the application of the established procedures so as to ensure the credibility of the process” (Kim, 2018, p.2). Similarly, asymmetry in inclusion and graduation, equal treatment of all countries, some flexibility in borderline cases and the availability of reliable data have been emphasized. The following is the diagrammatic representation of the criteria and their weightage, as approved by the Committee most recently in 2021.

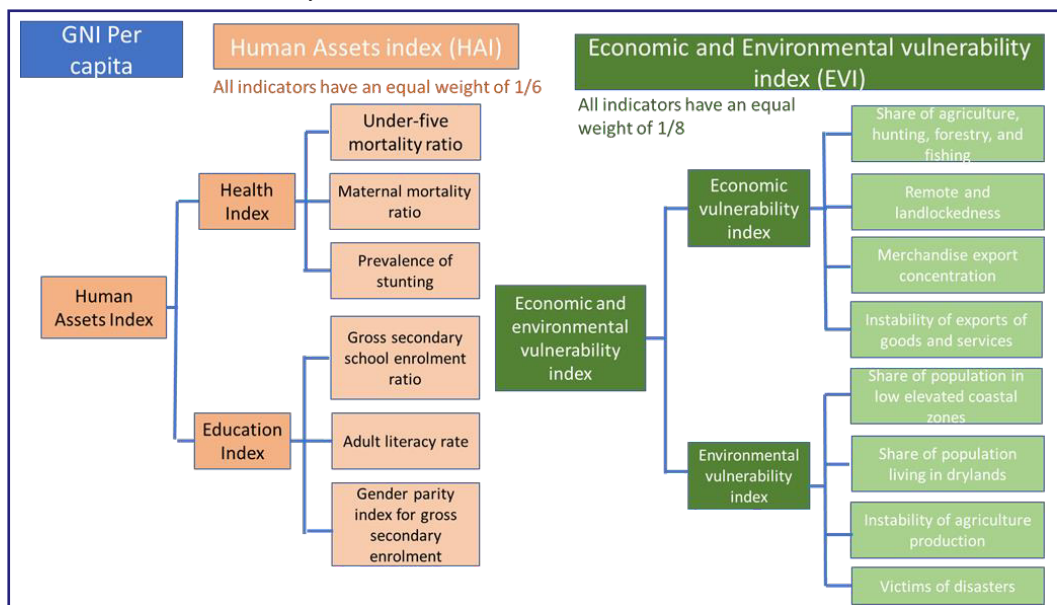


Figure 1: Diagrammatic Representation of LDC Graduation Criteria

Source: UNCDP March 2021 Presentation Briefing

Similarly, the triennial review by CDP in 2021 has agreed on the following for inclusion and graduation criteria. It clearly shows that there is a higher benchmark for graduation than inclusion.

An LDC will graduate if it meets two of the three criteria or if it has an income level, which is double the GNP per capita for graduation. Transition to graduation can start if an LDC meets these criteria for two consecutive reviews done every three years (UNDESA, 2021, p.6).

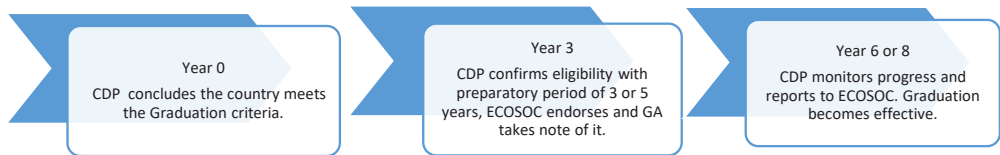


Figure 2: Transition to Graduation

### 2.3 IPOA and Graduation

The last UN LDC conference that was held in Istanbul, Turkey in 2011 came out with more international measures in favour of LDCs. But it was also for the first time that a UN conference came out with the explicit inclusion of the graduation aspirations of the international community. There were several reasons for such inclusion.

Table 1: LDC Indicators for Inclusion and Graduation

Indicators	2021 Triennial Review	
	Inclusion	Graduation
Per capita GNP (USD)	1,018	1,222
Human Assets Index (HAI)	<60	>66
Economic Vulnerability Index (EVI)	>36	<32

Source: UNCDP

that the situation of LDCs should improve quickly with poverty reduction, rapid economic growth and reduction in vulnerability. Moreover, there was a global campaign slowly building up with a strong focus on reducing inequality, making use of revolutions in science and technology for the eradication of poverty and promoting more convergence as a common goal for the entire humanity. Secondly, LDCs themselves were saying that they aspire to get out of it, as it was both desirable and possible, considering the breathtaking development that transformed economies in one generation in some of the developing countries in Asia. Thirdly, globalization and

First, it was felt that since 1971 the number of LDCs increased substantially, reaching 48 countries in 2011. Furthermore, only two countries – Botswana and Cabo Verde – had graduated. It was therefore a negative reflection on both the LDCs themselves and the partner countries that, despite four decades of international efforts and support, so few countries were rapidly moving upward. Therefore, there was a genuine desire to see

revolutions in science and technology provided opportunities for many countries to make the most of the globalization of markets, with the right policies together with committed leadership and growing competitiveness in some specific sectors. Fourthly, there was also a growing realization in this interdependent and globalized world that islands of prosperity in a sea of poverty is not sustainable and would give rise to conflicts, migration and humanitarian disasters, which can have spill-over effects around the world.

It is for these reasons that the Istanbul Programme of Action (IPOA) stated that “the overarching goal of the Programme of Action for the decade 2011-2020 is to overcome the structural challenges faced by the least developed countries to eradicate poverty, achieve internationally agreed development goals and enable graduation from the least developed country category” (UNOHRLLS, 2012). This clearly showed the interlinkages among structural challenges, eradication of poverty, meeting of internationally agreed development goals and graduation.

For the first time, it had also a separate chapter on graduation and smooth transition, where the vital role of smooth transition without disruption to their development prospects was stressed. It also asked LDCs to develop a smooth transition strategy with the support of development-and-trade partners and UN institutions and called for phasing out of measures and benefits consistent with their specific development situations.

Based on this commitment, a UN Ad Hoc Working Group was established in 2012, which presented its report after extensive consultations. It reinforced all these provisions with the need for the preparation and implementation of a robust and comprehensive strategy, longer-term transitional periods considering specific challenges and constraints of LDCs and an enhanced level of support for those graduating countries to make their transition smooth and sustainable. It also highlighted the risk of perverse incentives, as the binary nature of the LDC status could penalize the progress made by graduating countries leading to abrupt changes and therefore causing concern. It also called for predictability, specificity, certainty and transformation-oriented transition measures for the graduating countries including support modalities beyond transition.

Since the IPOA of 2011, Samoa, Equatorial Guinea and Vanuatu have graduated. Angola, Bhutan and Sao Tome and Principe are going to graduate in the next three years. Besides Nepal, Bangladesh and Laos have been recommended for graduation by 2026. Recommendations of Myanmar and Timor Leste have been postponed for review in 2024. Tuvalu and Kiribati have been recommended to the ECOSOC several times, yet due to their extreme vulnerability, the ECOSOC has not yet taken up their

cases. And, Cambodia, Comoros, Djibouti, Senegal and Zambia have met the criteria for the first time in 2021. By the next decade, there will likely be hardly any LDC left in our extended neighbourhood, and there may be no or only a couple of LDCs in the Asia Pacific region as a whole.

This clearly shows that a good number of LDCs are on the way towards graduation, even though as envisaged in the IPOA, one half of the LDCs would not meet the criteria for graduation. A growing trend of graduating countries shows that many countries are reaching this important milestone in the development process, even though all of them may not have witnessed a fundamental change in their structure. Therefore, the challenge is to make sure that the transition is smooth, meaningful, transformative and sustainable. The LDCs and the international community have a collective responsibility to make that happen.

## CHAPTER THREE

# NEPAL'S INCLUSION IN THE GRADUATION LIST

### 3.1 Nepal and the Graduation Criteria

Nepal was included in the LDC graduation list for the first time in 2015 when it crossed the two thresholds: Human Assets Index (HAI) and Economic Vulnerability Index (EVI). It again crossed them in the 2018 triennial review. In both the review times, Nepal's per capita GNI at USD 1027 was much lower than USD 1,222, the LDC threshold for graduation. This clearly indicated that investment in human resources was showing results, thanks to the global campaign for MDGs and the national and international efforts over the period of time. Such improvements, however, were not visible in the economic growth or income-generating activities of the people. Similarly, EVI showed improvements due to various factors like diversification of our exports, the share of the primary sector in GDP, etc., even though it did not capture other vulnerabilities fully, like our over-dependence on imports and remittances.

Normally, a country would have been recommended by the Committee for Development Policy for graduation with two successive periods of crossing thresholds. However, because of our submission on the devastating impacts of massive earthquakes in Nepal and the border blockade in 2015, the graduation recommendation was deferred to the following triennial review for 2021. Even in 2021, Nepal's GNI per capita remained almost 200 US dollars less than the threshold for graduation. If we look at both HAI and EVI, Nepal's index is better than not only that of the average LDCs but also that of the average developing countries (figure 3).

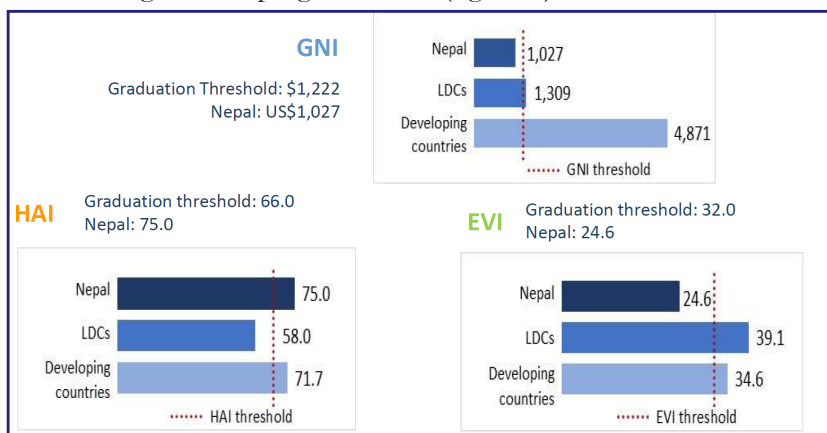


Figure 3: Nepal and Graduation Criteria 2021 Triennial Review by CDP

Source: United Nations

As stated earlier, Nepal's GNI per capita has reached 1,027 US dollars, which is well short of the threshold by about 200 US dollars. There is room for argument about the scope of HAI, as Nepal has a long way to go in terms of the multidimensional index of poverty and level of inequality in income and opportunities. Similarly, EVI of LDCs does not fully capture all our vulnerabilities and risks such as the slow onset of climate change impacts and low level of export to GDP ratio and a low equilibrium trap.

### 3.2 Assessment of Nepal's Status in the Criteria

The evolution of Nepal's status over two decades can be seen in the following graphs.

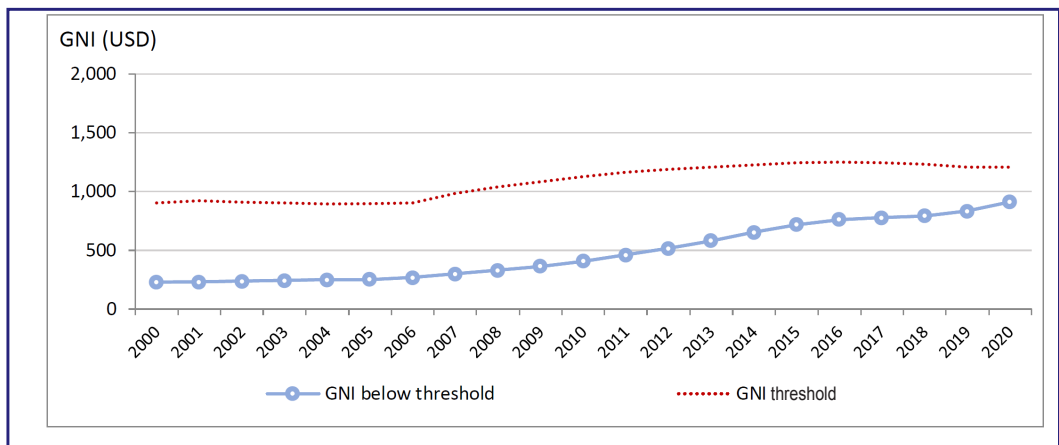


Figure 4: Nepal's Per Capita GNI (2000-2020)

Source: UNCDP

Nepal's GNI per capita remained almost standstill from 2000 to 2006 (figure 4). Even when it started its upward trajectory in 2007 following the resolution of the internal conflict in Nepal, it started increasing only slowly even from that period onwards. This again proves that Nepal was moving with a sluggish economic growth rate, about 4.4 per cent, over the last decade. We need to look at the structure of the economy, overall productive capacity and enabling environment to fully appreciate this pattern of a lower rate of economic growth.

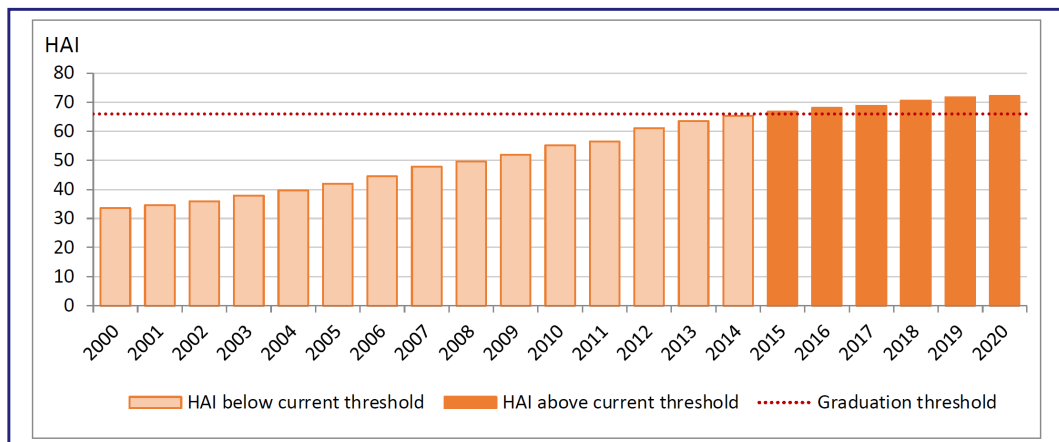


Figure 5: Nepal's HAI (new composition), 2000-2020

Source: UNCDP

In looking at the HAI index of Nepal (figure 5), it shows that Nepal has consistently made progress since it met the HAI threshold in 2015. The fact that the gap between the threshold and our achievement is slowly but consistently growing over the period of time suggests that our progress in human development, analyzed against the HAI criteria of the LDCs, is clearly visible. This is also corroborated by the fact that Nepal has been making steady progress since 2001 and its human development score has improved from 0.45 to 0.64 in the Global Human Development Index prepared by UNDP. However, we should continue to make progress to reduce the incidence of poverty and inequity by improving the conditions of the bottom quintile of the population, as shown by our other indicators like Multidimensional Poverty Index (MPI) and Inequality-adjusted Human Development Index (IHDI).

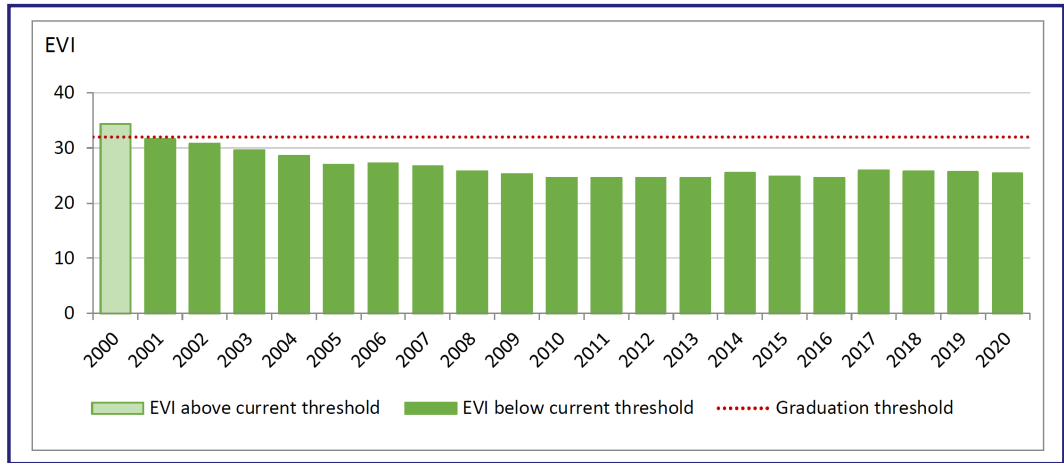


Figure 6: Nepal's Economic Vulnerability Index (new composition), 2000-2020

Source: UNCDP

The Economic Vulnerability Index of Nepal as defined for LDC graduation in (figure 6) shows that Nepal met this criterion long ago in 2001. Since then, the vulnerability of Nepal has gone down and has remained stable for the last two decades. However, there is some caution required in this analysis. The LDC EVI index does not fully capture all the vulnerabilities such as the share of manufacturing in GDP and employment, the share of exports in GDP or dependence on the remittances and other structural volatility. However, it indicates that based on the four economic and four environmental vulnerability indices, defined by CDP for LDCs, Nepal is doing better.

## CHAPTER FOUR

# LDC-SPECIFIC INTERNATIONAL SUPPORT MEASURES

International support measures related to the LDCs cover many important dimensions of international cooperation and are diverse in nature. Some of the measures are specific to LDCs and have stronger commitments such as those related to international trade, some climate-related funds and dedicated activities of UNCDF and EIF. Others are of facilitatory and of recommendatory nature such as those related to the ODA, investment and technology. A few of the provisions are general and apply to all, but they have larger implications for LDCs. The four specific areas of support measures have been analyzed in detail.

- ▶ International Trade
- ▶ Development Finance
- ▶ Investment, Remittances and Technology
- ▶ Other Support Measures

Given the inherent structural challenges and a high level of dependence on the global support for poverty eradication and economic progress in LDCs, international support measures play a critical role. There was also some recognition over the period of time that such support measures should be comprehensive, robust and deliverable to LDCs. Therefore, many international commitments, norms and provisions were made in the successive decades ranging from collective commitment to provide targeted official development assistance, facilitation in international trade, debt, investment and reduction in the cost of the transaction of remittances and transfer of technology. Similarly, UN agencies and other international organizations were encouraged to provide priority to the LDCs in terms of their programmatic support and technical cooperation, while taking due account of their capacity in determining membership contributions from the LDCs to these organizations.

### 4.1 International Trade

LDC-specific International Trade measures are as follows:

1. Duty-free and quota-free market access for goods from LDCs in many developed country markets and some major developing country markets, with preferential rules of origin,
2. Offer of waiver from 23 countries in services negotiations in WTO indicating

- preferential treatment on certain sectors and mode of supplies (to be negotiated),
3. Flexibilities in agriculture and some other export subsidies, trade facilitation agreement and trade policy review mechanism,
  4. Exemption from applying TRIPS related standards till 2021 (being negotiated for further extension) and from pharmaceutical products till 2033,
  5. Technical assistance in Sanitary and Phytosanitary measures and Trade facilitation measures,
  6. Due priority in Aid-for-Trade support and dedicated technical support for LDCs from the Enhanced Integrated Framework (EIF)

International trade has been an important economic activity for all countries around the world. But, particularly for the developing countries, this has helped accelerate their development progress, reduce poverty and change the structure of their economies. However, fair and inclusive trade and their positive contributions to development is not automatic, especially when a country has to compete with the countries with a historically strong economic base. Therefore, making international trade just, fair and rules-based that takes into account different starting points and capabilities is critical. If properly managed, it could be an important engine of growth, poverty eradication and rapid and transformative development. East Asia, South East Asia and China are its glaring examples. They have completely transformed their economies within a single generation. General improvement in the lives of the people and poverty reduction has also been observed in almost all the countries around the world including the LDCs.

In order to facilitate exports of the developing countries to the major markets of the advanced countries, the UN, and in particular, UNCTAD, contributed to establishing the non-reciprocal Generalised Systems of Preferences (GSP) as a special and differential treatment, since the early 1970s. They are still being implemented by many developed countries like the USA, EU, Japan, Norway and Switzerland. Because it was applied to all the developing countries in general, the large developing countries took full advantage of that because of their stronger economic base from early on. Many low-income and LDCs were unable to compete with them in the advanced country markets with similar market access and equal tariff concessions to all developing countries.

Because of the low productive capacity, limited export capacity, dependence on a few primary commodities, structural constraints, incidence of poverty and high cost of doing trade, the LDCs could not gain their due market share without some deeper and wider special and differential treatment and some preferential arrangements. This has been recognized since the creation of the category of LDCs. Therefore, a number of

preferential rules were developed over a period of time, even though there was a growing erosion of margin of preferences as a result of the Most Favoured Nation tariff reductions under the General Agreements on Tariffs and Trade (GATT) and its successor, the World Trade Organisation (WTO). For the LDCs, it was critical, as the products of their interest were still carrying high tariffs in the developed countries. Even today, agriculture products, textiles and garments carry substantial tariffs in many countries around the world. Regional trading agreements among the developed and major developing countries further created tariff differences between those signatories to the agreements and those outside of it. Most of the LDCs were not part of such free trade agreements. Even though there were some unilateral or bilateral preferential arrangements and some regional cooperation agreements in Africa and Asia, which included LDCs in some markets for a long time, it was the Singapore Ministerial Declaration of WTO in 1996 that called for providing effective unilateral preferential measures to LDCs like duty-free quota-free provisions on an autonomous basis. Finally, it was following the meticulous and lengthy negotiations and strong advocacy by the LDCs that in the Hong Kong Ministerial Declaration of WTO in 2005, the duty-free and quota-free facility for all products from all LDCs were included to be provided on a lasting basis by the developed countries and the developing countries in a position to do so.

Since then, with concerted efforts of the LDCs and the positive response from the development partners, more systematic efforts started taking shape and preference regimes were implemented, like Everything But Arms (EBA) by the European Union, Africa Growth and Opportunity Act (AGOA) and targeted GSP provisions by the US. And, similar LDC-focused duty-free provisions under GSP were provided by Japan, Canada, Switzerland, Australia and Norway, among others. Some of the major developing countries like China, India and Turkey also started providing preferential arrangements to LDC products.

Table 2: Impacts of Graduation on Market Access Preferences

Source of Preferential Treatment	Example	Depth of Preferential Erosion	Graduating LDCs to be Mostly Affected
Non-reciprocal market access	Everything But Arms (EBA) initiative of the EU which benefits all graduating LDCs	Significant for items for which MFN and standard GSP tariffs are high (e.g, T-shirts: 12.0% vs 9.6%; carpets: 11.2% vs 8.0%) Some agriproducts (e.g, frozen fish: 12.0% vs 4.2%)	Bangladesh, Nepal and Myanmar will experience significant preference erosion

Regional trading arrangements (RTAs)	SAFTA where Bangladesh, Nepal and Bhutan are beneficiaries. Asian-FTA were Lao PDR and Myanmar are beneficiaries	Significant, when preferential treatment is contingent on LDC status, as in SAFTA. Not significant when all members are accorded the same treatment (ASEAN-FTA) or member countries have bilateral FTAs (as some LDCs in SAFTA)	Bangladesh will suffer from preference erosion. Nepal and Bhutan will not be affected as they have bilateral FTAs with India. Lao PDR and Myanmar will not be adversely affected in terms of preference erosion as tariff rates for all members have been brought down to zero
Bilateral non-reciprocal Initiative	Unilateral GSP schemes such as those run by China, India, Japan and others	Significant, when export from beneficiaries are high and MFN tariffs are also high. For example, Angola because of export of frozen fish to China (MFN tariff: 7.6% and GSP tariff: 7.0%)	Angola, Myanmar, Vanuatu and Tuvalu will experience preference erosion

Source: Rahman (2020) based on ITC Macmap

Despite these provisions, some of the stark realities are in front of us. While LDCs' exports have increased gradually over the years with these provisions, their relative share in the global trade and exports have marginally improved. Even today, with almost 13 per cent of the global population, the LDCs share of international trade in goods is around 1 per cent with ever-growing trade deficits every year.

The WTO Annual Report of 2020 states that "LDCs' share of world exports increased slightly from 0.92 per cent in 2017 to 0.94 per cent in 2018. As this is still lower than in 2011, the LDCs are unlikely to achieve the 2011 Istanbul Programme of Action target to double their export share by 2020. The LDCs' trade deficit remained substantial at USD 98 billion in 2018, more than twice the 2011 level. The LDCs called on WTO members to continue to make progress in the implementation of ministerial decisions on duty-free and quota-free (DFQF) market access, preferential rules of origin, and the LDC services waiver to further facilitate LDCs' market access" (WTO, 2020, p. 22).

Besides tariff-related issues, the reasons for a low trade share of LDCs can be looked at from three perspectives, behind the border, at the border and beyond the border issues.

Behind the border issues include a lack of coherent and effective economic and trade policies, limited export capacity with low productive capacity and other structural constraints, lack of competitiveness and diversification of products, low technological inputs and high logistics costs due to infrastructure and institutional bottlenecks, among others. Strong and coherent national commitment and integrated trade and development policies will also play an important role.

At the border issues include a lack of simple, consistent, efficient and facilitatory cross border mechanisms with modern facilities to reduce the time and cost for the LDC products to cross the border on the way to their final destination. Market confidence will decrease and cost would escalate if the transit time of the goods is longer and not reliable.

Beyond the border issues for the LDCs include complex requirements of preference utilization mechanisms, lack of simple, transparent and predictable rules of origin, non-tariff barriers and trade-distorting measures, and lack of full knowledge of changing market dynamics. Also, part of the reason has been the lack of sufficient regional economic integration and infrastructure network and low participation in regional or global value chains.

It is for these reasons that the LDCs have consistently been making calls for strong, targeted and supportive measures in an integrated manner. They have asked for an enhanced level of global cooperation for enhancing productivity and export capacity in LDCs including thorough more investment in infrastructure and productive sectors, implementing measures to mitigate external trade shocks, technical cooperation with more resources, effective implementation of all special and differential provisions on goods and services as well as that of the Trade-Related Aspects of Intellectual Property Rights (TRIPS) provisions, waivers, flexibilities and a longer duration of transition with stronger technical and financial support for the implementation of other burdensome international trade-related rules and provisions. With a combination of these measures, some of the LDCs have become successful in enhancing their export capacity, reducing poverty and promoting overall economic development. But, a large majority of them has not been able to fully benefit from these arrangements. While some of these measures are ongoing, the fact that the share of the LDCs in international trade has only marginally improved over the years and remains far below its potential means that such support measures need to be enhanced and made more effective.

The following table provides the current status of the duty-free quota-free provisions provided to LDCs together with major exclusions in key developed countries and some emerging developing countries.

Table 3: Duty-free and Quota-free Provisions for LDCs

Market	Duty-free Tariff Line Coverage and Major Exclusions
Australia	100 per cent duty-free, quota-free entry (DFQF)
Canada	98.6 per cent DFQF (Exclusion: dairy and other animal products, meat, meat preparation, cereal products)

Chile	99.5 per cent DFQF (Exclusion: cereals, sugar, milling products)
China	96.6 per cent DFQF (Exclusion: chemicals, transport vehicles, machinery and mechanical appliances, electrical machinery, paper)
European Union	99.8 per cent DFQF (Exclusion: arms and ammunition)
Iceland	91.8 per cent DFQF (Exclusion: meat, food preparation, vegetables, dairy and other animal products, plants and trees)
India	95.1 per cent DFQF (Exclusion: plastics, coffee and tea, alcoholic beverages, tobacco, food residues)
Japan	97.9 per cent DFQF (Exclusion: fish and crustaceans, footwear, milling products, cereal products, sugar)
Republic of Korea	89.9 per cent DFQF (Exclusion: fish and crustaceans, mineral fuels, oil seeds and oleaginous fruits, wood products, vegetables)
New Zealand	100 per cent DFQF
Norway	100 per cent DFQF
Russian Federation	37.1 per cent DFQF (Exclusion: machinery and mechanical appliances, chemicals, electrical machinery, iron and steel products, transport vehicles)
Switzerland	100 per cent DFQF
Chinese Taipei	30.8 per cent DFQF (Exclusion: machinery and mechanical appliances, chemicals, electrical machinery, fish and crustaceans, plastics)
Thailand	70.4 per cent DFQF
Turkey	80.5 per cent DFQF (iron and steel products, fish and crustaceans, food preparation, meat, oil and seeds and oleaginous fruits)
United States	82.2 per cent DFQF (apparel and clothing, cotton fibres, footwear, dairy and other animal products)

Source: WTOEIF, 2020

## 4.2 Development Cooperation

The following are the major issues related to the ODA to the LDCs that were agreed in the international forums.

- i. Ensuring that the ODA is disbursed in such a way that the LDCs collectively receive 0.15 to 0.20 per cent of GNI of the developed countries, as per the global commitment,
- ii. Also ensuring that if not full, a larger proportion of aid is untied,
- iii. The ODA to be fully used through the national budgetary system,
- iv. Dedicated funding and support to the LDCs to prepare and implement adaptation plan under climate change negotiations,
- v. Balanced disbursement of the ODA in the social, economic and infrastructure sectors to strengthen productive capacity development as per the priorities of the LDCs,
- vi. Exploration of new innovative finance mechanisms, including blended finance and strengthening and scaling up of the existing ones by targeted de-risking mechanisms.

A systematic global campaign was initiated at the UN to promote an equitable global economic order and also lift the status of the developing countries from deprivation and the lack of means for development. In the 1970s, the developed countries endorsed a target of 0.7% of GNI as a goal for ODC. This was also further reinforced in successive international development and financing related conferences. The Millennium Development Goals also reiterated it. This was further committed in the 2015 Addis Ababa Action Agenda (AAAA) and agreed upon within the Sustainable Development Goals (SDGs) and targets. However, the ODA going to all developing countries has consistently remained well below these commitments. Only a few of the developed countries and some emerging developing countries have reached or surpassed this target.

Similarly, to prioritize the proper share of allocation of the ODA going to the LDCs, the Istanbul Programme of Action for LDCs (IPOA-2011), Sustainable Development Goals (SDGs 2015-30) and the Addis Ababa Action Agenda for Financing for Development (AAAA-2015) have all committed to providing 0.15 to 0.20 per cent of GNI of the developed countries to the LDCs, as part of the 0.7 per cent of GNI to the developing countries. The average contributions of about 29 DAC countries going to all developing countries have remained less than 0.3 per cent of GNI and those going to the LDCs have been only around 0.09 per cent of GNI.

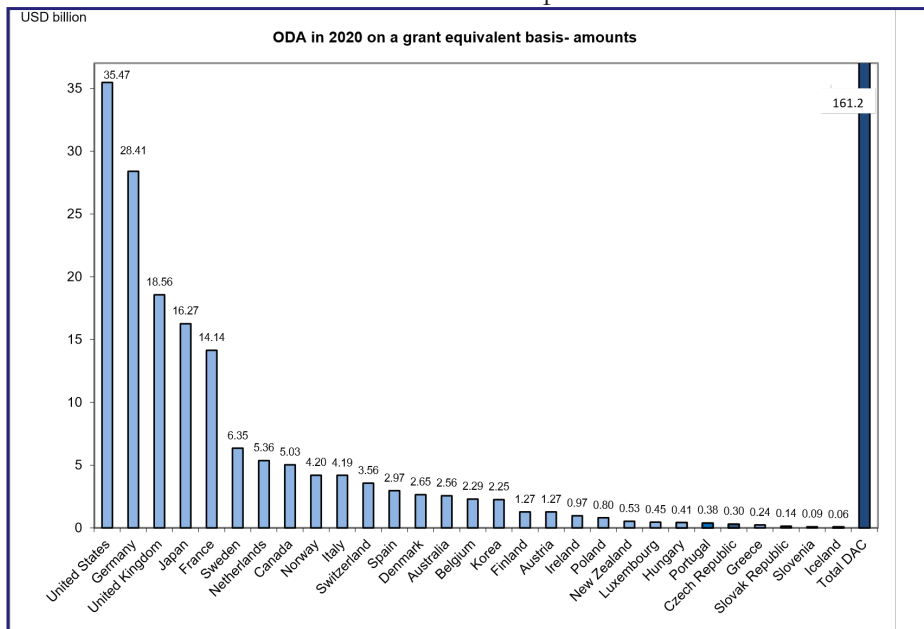
The dependence of the LDCs on the ODA is highest among all the developing countries. The ODA constitutes the largest external development assistance for financing development related works in these countries. An OECD report has stated that “while the growth in private finance has reduced the relative importance of aid in

many countries, the capacity of LDCs to attract flows beyond aid remains limited. For these countries, concessional finance continues to represent the bulk of external financial resources, accounting for 62% of total external finance supplied by OECD economies in 2014. By contrast, in other countries, concessional finance represents only 11% of total external finance” (OECD, 2016, p.2).

The need for further enhancement and consolidation of the ODA based on the Development Effectiveness of the Busan Declaration is critical to increasing its impact on the ground. Consistent advocacy, political will and support, civil society mobilization, promotion of global public goods, humanitarian cause, possible spillover effects across the regions of abject poverty and deprivation, global calls for ambitious and visionary actions to meet the internationally agreed development goals and solidarity and mutual interest in collective development and progress have played a very important role in continuing the ODA over the years.

In recent years, the economic capabilities of the major developing countries have also enhanced tremendously. As a result, they have also been increasing their development assistance programmes as part of the South-South cooperation, particularly in the LDCs. They do not like to call it the ODA; they have designated it as a solidarity-based partnership of south-south cooperation.

The current status of the ODA from the developed countries is as follows.



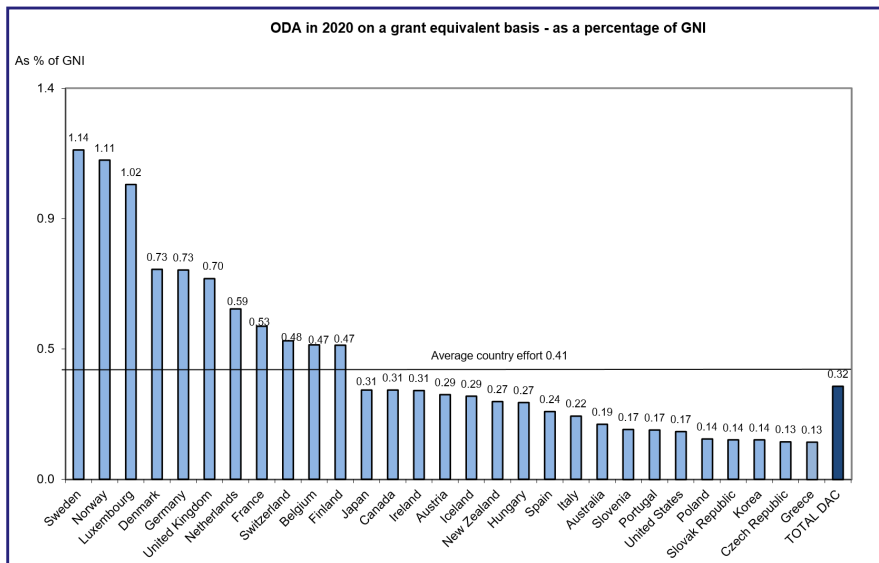


Figure 7: Current ODA Status from Developed Countries (in amounts and percentage)

Source: OECDstats

It is clear from the graph above that only 6 countries namely Luxembourg, Norway, Sweden, Denmark, Germany and the UK have fulfilled their commitments to meet 0.7 per cent of GNI as the ODA to the developing countries in 2019. Other countries are far from meeting the goals as the average ODA share is 0.32 per cent of GNI in 2020, which was 0.30 in 2019. This trend of a vast majority of the developed countries not meeting the criteria has been going on for several decades, even when these countries had booming economies.

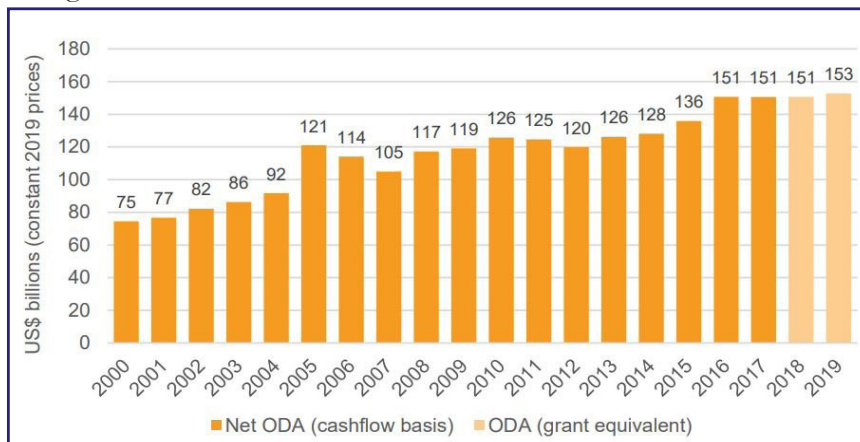


Figure 8: Flow of ODA from OECD Countries to Developing Countries (2000-2019)

Source: OECDstats

The graph above shows the amount of the ODA provided by the developed countries, which had remained almost constant in the last four years, with only a marginal improvement in 2019. However, showing strong resilience in a time of the global pandemic like Covid-19, and because of the increase in health and humanitarian related support programmes, there has been an increase by 7 per cent in 2020, reaching USD 161.2 billion. Several analyses have indicated that the size of the ODA is not necessarily always dependent upon the rate of economic growth of the developed countries. Rather, it has been guided more by political will and global solidarity. We have to see whether this increase in 2020 will be maintained or improved even better in the next few years. Many developed countries have announced that they would protect the ODA budgets in 2020 and maintain or increase them in 2021. This year's increase is notable given the slump in international trade, investment and other flows to the developing countries. If vaccinations against Covid-19 continue apace and there are no lockdowns, the world GDP growth is projected to be about 6 per cent in 2021 and 4.4 per cent in 2022.

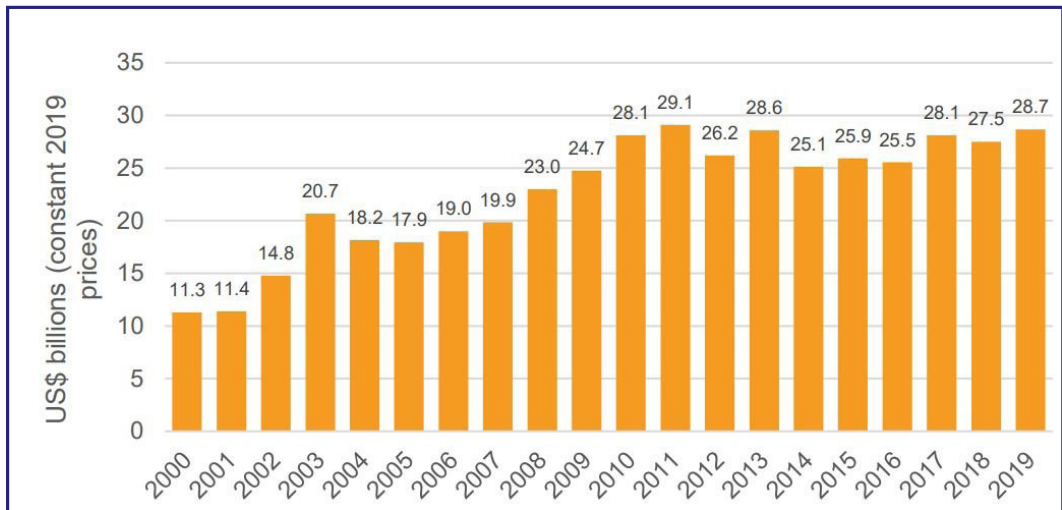


Figure 9: Flow of ODA from OECD Countries to the Least Developed Countries (2000-2019)

Source: OECDstats

Several observations could be pertinent to this graph. The ODA going to the LDCs had slightly increased in 2019 and also increased by 1.8 per cent reaching USD 34 billion in 2020, because of the considerable increase in the pandemic-related funding. This means the ODA to the LDCs did not increase in the last 8 years and marginally increased this year due to the covid pandemic, whereas the net ODA to non-LDC middle-income countries increased by 7.6 per cent in the same period.

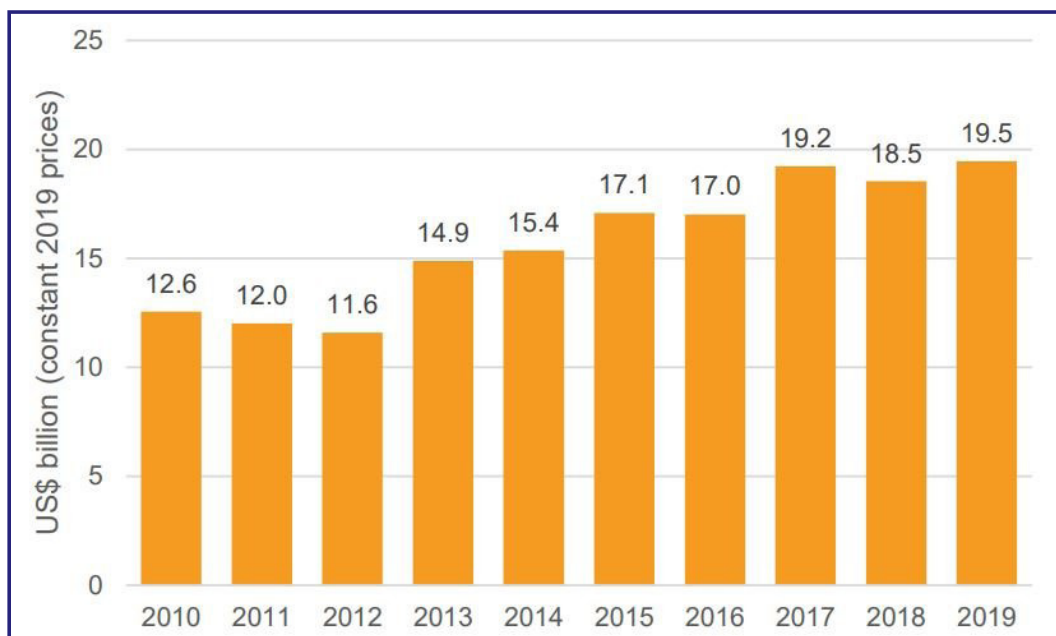


Figure 10: ODA Going as Loan from DAC Countries

Source: OECDstats

There is a growing sign of the loan component of the ODA by DAC countries in recent years, especially from Japan, France and Germany. Overall, bilateral ODA loans grew by almost 50 per cent between 2012 and 2018 and the ODA loans going to the LDCs have also increased by almost 400 per cent in the same period.

### Climate Change and the LDCs

The LDC Group has been negotiating collectively, articulating their vulnerabilities, defending their collective needs and taking positions at the negotiations under the UNFCCC process. Article 4, para 9 of the UNFCCC has asked “the parties to take full account of the specific needs and special situations of the LDCs in their actions about funding and transfer of technology” which resulted in the establishment of the LDC work programme in 2001. The Group has called for flexibility in obligations, special consideration in accessing funds and technical support to implement climate change-related programmes in LDCs.

### Least Developed Countries Fund

The LDCF was established in 2001 to help the LDCs prepare and implement National

Adaptation Plans of Action, NAPS process and LDC work Programme. As of October 2019, 51 LDCs and former LDCs had access of US \$1.4 billion, with each LDC not exceeding USD 50 million cumulatively from the LDCF.<sup>1</sup>

Similarly, the LDC Experts Group has been established since then to provide technical guidance and support to the LDCs, organize training workshops and help prepare programmes to access LDCF and also GCF.

## **Global Climate Fund**

This fund was established to provide financial support to all the developing countries. The total pledged amount for the Fund in 2020 July was USD 8.3 billion.<sup>2</sup> The fund is to be divided equally between mitigation and adaptation, that is 50 per cent each. There is also a decision that provides for at least a half of adaptation-related resources to be invested in the most vulnerable countries like LDCs, SIDS and the African States.

## **Blended Finance**

Given the huge requirement of finance for development among the LDCs and the need for enhancing the market mechanism and the role of the private sector, there have been some efforts to mobilize private finance with development finance interventions. Although it is slowly growing, only 6 per cent of private finance was mobilized in the LDCs by development finance interventions between 2012 and 2018. However, in 2018, it reached USD 3.8 billion reaching 7.5% of the total with multilateral institutions taking the lead in their mobilization. Guarantees were followed by direct investment in companies, and special purpose vehicles. However, between 2012-18, Angola, Bangladesh, Myanmar and Senegal were on the top list of LDCs attracting about 1 billion dollars each, while 12 countries received less than USD 10 million, and the remaining 30 countries received USD 270 million in total (OECD/UNCDF Report, 2020, p 20-23).

Two of the important benefits of the growing support for such blended finance have been its support for the financial ecosystem together with market development and the possibility of scaling it up with more transformational and systemic approaches even in the LDCs. But making it inclusive and reaching those farthest behind remains a challenge.

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1 See, <https://unfccc.int/process-and-meetings/bodies/constituted-bodies/least-developed-countries-expert-group-leg/least-developed-countries-portal>

2 See, [https://www.greenclimate.fund/sites/default/files/document/status-pledges-irm-gcf1\\_5.pdf](https://www.greenclimate.fund/sites/default/files/document/status-pledges-irm-gcf1_5.pdf).

## International Debts

A growing burden of international debt has been a major concern for the LDCs. Fluctuations in the international price of their exports, volatility in international markets, limited access to external finance and tough competition for market access at the global level have reduced their capacity to increase the sources of international finance to support their national development efforts. The rising cost of building infrastructure, high level of poverty and low level of economic development, vulnerability to natural and man-made disasters have also reduced their capacity to mobilize enough domestic resources to meet the growing demand for public expenditure. Therefore, the LDCs have called for debt forgiveness and debt restructuring so that their development efforts are not undermined and their resource mobilization capacity is not hampered.

The International Support for the Heavily Indebted Poor Country (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) have contributed to reducing the LDCs' debt levels considerably till now. These initiatives, however, are not specific to LDCs and apply to all the eligible countries as defined. Though many LDCs, especially in Africa, have received support from these initiatives, no Asian LDC has received such support so far. With almost 9 per cent of LDC export earnings being used for debt service on average, some additional countries have been classified as 'at a high risk of debt distress.'

With sweeping and disastrous impacts of COVID-19 on the LDCs and the growing share of private and non-traditional creditors with shorter maturities and less concessional financing, there is a danger of increasing challenges to service debt by the LDCs in the coming years.

In conclusion, the ODA to the LDCs has remained around 0.09 per cent of GNI of the developed countries despite the commitments made at the global level to reach 0.15 to 0.20 per cent. The allocation among the LDCs is also not uniform. There is also a trend of increasing the loan component of the ODA to the LDCs as well as some support for blended finance. There has been some improvement in untying aid over the years and in making use of national systems and procedures in disbursing the majority of the ODA going to the LDCs. Tied aid is normally calculated to escalate cost by about 30 per cent. National ownership and leadership on external development finance have improved. Even then, effective utilization of the ODA and the timely and full delivery of the commitment remains a major challenge to the LDCs and their development partners.

### 4.3 Investment, Remittances and Technology

While there was a specific target of increasing the investment to GDP ratio to 25 per

cent in the LDCs in the Brussels Programme of Action in 2001, and there were calls thereafter during the 2011 Istanbul conference to take initiatives to promote FDI in the LDCs, there was no dedicated programme established to encourage FDI to the LDCs.

The gap in the development finance in LDCs is very high. Domestic resources and the ODA would not be enough, given the huge gap in savings and investment and the high cost of building social and physical infrastructures. Therefore, domestic private sector investment and FDI play a very important role. The small size of the market, institutional bottlenecks such as unstable regulatory, legal and economic frameworks, paucity of the bankable projects and quality DPRs, lack of coherent FDI governance, facilitatory mechanisms and basic infrastructure have been identified as some of the key challenges of the LDCs in attracting FDI. There is a strong conviction that in the globalized world of today, FDI would not only fill up the resource gap but will also contribute to promoting production capacity and diversification of products, linkages with developed country markets, to facilitate the transfer of technology, innovation, skills and to support employment opportunities and poverty alleviation efforts.

There was also a growing recognition around 2011 during the preparation of the 4<sup>th</sup> UN LDC conference that, together with stronger host country measures in the LDCs, some home country promotional measures by the investing countries could go a long way in highlighting the market potentials as well as mitigating the initial risks in entering the markets of the LDCs. Following up on the IPOA, the UN Secretary-General in 2013 proposed the establishment of an international investment support centre dedicated to the LDCs. Such a centre would be a common information depository containing all relevant information on regulatory, promotion and protection-related policies, provide support for contract preparation and negotiations, in the form of rapid response, lend advisory support in dispute settlement, and facilitate risk insurance and guarantees for investment in the LDCs. However, such a centre has not yet been established.

Even then, there are a number of investments guarantees and financial and fiscal support provided by home countries as an individual initiative. In the last ten years, the UNCTAD (2020) has reported that at least 42 new investment promotion and facilitation measures were introduced by the LDCs. Similarly, there are 220 bilateral investment treaties between LDCs and developed economies and 86 of them are new generation treaties. These measures mainly include investment facilitation, investment incentives and special economic zones.

Out of the USD 740 billion FDI going to developing and transition economies in 2018, FDI flows to the LDCs increased from USD 20 billion in 2011 to USD 24 billion in 2018. This was decreased by 5.7 per cent in 2019 reaching only USD 21.1 billion. This

is only about 1.4 per cent of the global FDI inflows. Even though FDI going to the LDCs is concentrated heavily in extractive industries, the share in the manufacturing and services sector is gradually growing. China and India have also increased their investment in the LDCs in the last ten years. The Chinese investment in the LDCs nearly doubled in the last decade. The top 10 investors in the LDCs are now equally divided between the developed and the emerging developing countries (UNCTAD, 2020, pp. 68-70).

### **4.3.1 Remittances**

There are no remittance-related measures specific to the LDCs at the international level. However, because of the growing size of the remittances, the international community has prioritized the following issues at the global level, which could positively affect the LDCs in improving the inflow of resources as well as the overall situation of the migrant workers.

- i. Remittances should not be a substitute for the ODA or FDI or debt relief measures.
- ii. The transaction cost of remittances should be reduced to 3 per cent of the total transaction.
- iii. Migration procedures should be simplified and the cost for migrants should be reduced.
- iv. The rights of migrant workers and their families should be protected and fair working and other social conditions should be provided for migrants.

Remittances have occupied an important place in generating foreign exchange for the LDCs, providing employment outside the country for the burgeoning youth population, contributing to reduce poverty by enhancing nutrition, better healthcare, education, social safety nets and promoting transfer of certain skills and exposure to the outside world. This has also created a human resource gap, cultural challenges while increasing conspicuous consumption and the Dutch disease to some extent in the LDCs. Because of the inflow of foreign exchange and the growing purchasing power of the people, trade deficits have been further intensified. A serious discourse is ongoing about the targeted policy measures in order to help better channel remittances towards enhancing productive capacity in these countries.

Remittances are an indispensable source of income for many LDCs, and they are the most important source of external financing, which have remained substantially higher than FDI in 2018 (USD 40 billion compared with USD 24 billion) (UNCTAD, 2020 & World Bank, 2020). The flow reached \$ 52.1 billion in 2019 with the Asia- Pacific LDCs receiving almost 70 per cent of the total remittances to LDCs. Some of the countries including Nepal, Comoros and Haiti receive remittances constituting more than 25 per cent of GDP. The average cost of remittance transaction is still around 6.8

per cent, which is more than twice the international commitment. In some of the corridors, the cost of transaction is much higher than even the average cost.

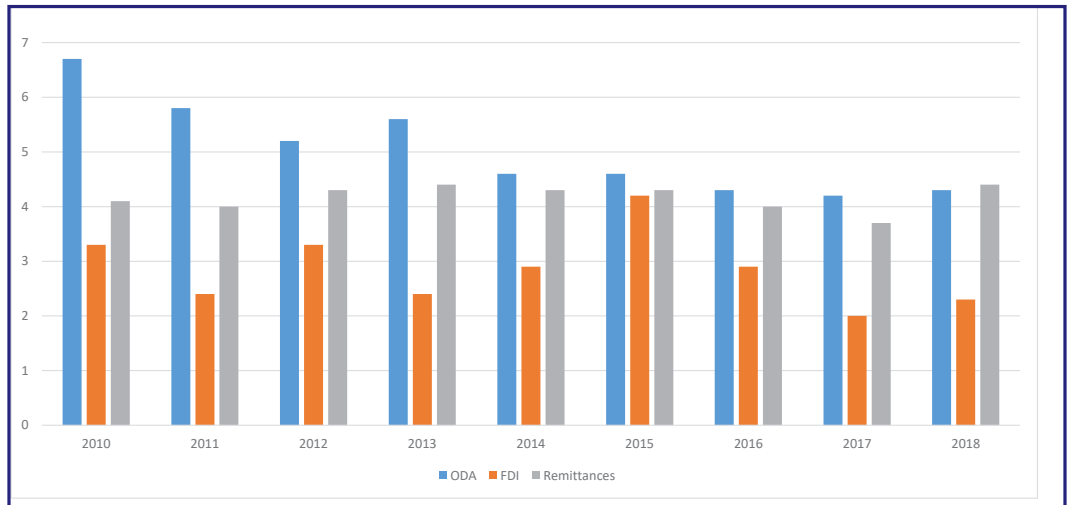


Figure 11: External Financing in LDCs

Source: UNCTAD/OECD Data

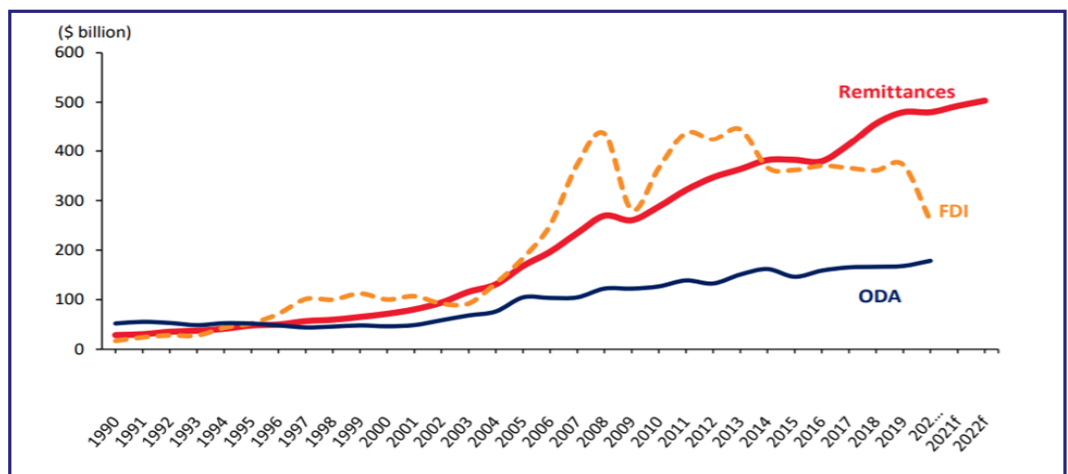


Figure 12: Remittances, Foreign Direct Investment, and Official Development Assistance Flows to Low- and Middle-Income Countries, Excluding China, 1990–2022<sup>3</sup>

Source: World Bank Stats

<sup>3</sup> Available at <https://reliefweb.int/sites/reliefweb.int/files/resources/Migration%20and%20Development%20Brief%2034.pdf> accessed on June 28, 2021

Statistics from 2010 to 2018 clearly show that the ODA has systematically decreased in proportion to the GNI of the LDCs. Similarly, there is some degree of volatility in FDI inflow in the LDCs, but it is also decreasing, though a bit slowly. However, the share of remittances has remained stable, despite the changing global economic situation and it is showing some signs of resilience and growth as well.

The attention of the international community has been drawn to the issue of migration in recent years. The Istanbul Programme of Action (IPOA) for the LDCs had a specific reference to remittances under the means of implementation as they became as big as or sometimes even bigger than ODA and FDI. There were calls for better protecting the rights of migrants and their safety issues. Similarly, a reduction in the transaction cost of the income of migrants was also discussed. The Global Compact for Safe, Orderly and Regular Migration has been agreed at the UN, highlighting the importance of migration and mobility of people, benefits of migration to both the sending and the receiving countries, while committing to make them safe and orderly at both ends and develop collaborative mechanisms to ensure fairness and protect their rights. The contribution of migration to development was also emphasized.

It is because of the growing importance of migration as well as the challenges faced by the migrants that the Sustainable Development Goals include migration and jobs related issues under Goal 8: Economic Growth and Jobs, and Goal 10: Inequality. In particular, under Goal 8.8, it calls for protecting a safe and secure working environment for all migrant workers in particular women migrant workers and those in precarious employment. Similarly, under 10.7, the international community urges all to facilitate orderly, safe, regular and responsible migration through planned and well-managed migration policies. Under 10.C, it has set a target to reduce to less than 3 per cent the transaction cost of migrant remittances and eliminate the remittance corridor by more than 5 per cent.

There is a general call on all countries to resist unfair and discriminatory treatment of migrant workers and the imposition of unreasonable restrictions on labour migration and to reduce the cost of remittances as well as create a system of short-term migration, including workers from the LDCs. However, there is no specific or targeted programme related to remittances to, or migrants from, the LDCs.

### **4.3.2 Technology**

Science, technology and innovation have always been recognized as major drivers of economic growth and development. With revolutions in science and technology and globalization in recent decades, they play an even larger role in improving lives, promoting economic growth and speeding up overall progress around the world.

LDCs are far behind others in building domestic institutions, promoting the indigenous capacity and acquiring new technologies and adapting them to the production, distribution or consumption activities on a sustainable basis. Therefore, despite various efforts, there exists a huge digital divide and technological gap between the LDCs and the developed countries or even LDCs and other developing countries. The share of Low-Income Countries in new patent filing and intellectual property registration in 2019 was around 2000, which is less than 0.1 per cent of the total (WIPO, 2020).

Therefore, in view of the growing importance of ubiquitous technology and the prospect of LDCs to leapfrog some stages of development with the adoption of and adaptation to new technology, the LDCs are being encouraged to build strategic partnerships with all stakeholders, academia, private sector and research institutions, set up and strengthen institutions and expand the knowledge base to support local, national and regional research and development, science and technology; and allocate more resources for research and development.

Development partners have been also encouraged to support science cooperation and technology transfer to LDCs and prioritize scientific collaboration in their development cooperation strategies and programmes. Even then, no targeted action of substantial nature has been initiated under any specific international programme for technology transfer to the LDCs, except for the pharmaceutical products under the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement under WTO. This has enabled the LDCs to buy and produce generic medicines, which are less expensive than the branded ones.

Because of the importance of science and technology for all, but particularly to encourage collaboration with LDCs, the UN has recently established an LDC Technology Bank in Gebze, Turkey. As it was established only in 2018, it has just started some programmes on a limited scale, focusing on STI review and needs assessments, promoting access to research and technical knowledge and strengthening the capacity of Academies of Science in the LDCs.<sup>4</sup>

#### **4.4 Other Support Measures**

Besides those specific measures in favour of the LDCs, there are other support measures of various kinds that have been provided to the LDCs by the UN. Therefore, in various programmes of technical cooperation and capacity building related assistance, LDCs are given high priority due to their low technical capacity and other structural constraints. Priority has been given to the LDCs by allocating at least 50 per cent of the core budget and programmes by many UN bodies.

<sup>4</sup> See, <https://www.un.org/technologybank/content/current-activities>

Similarly, to ensure equitable participation of all countries of the world and also to ensure that there is a fair contribution of all based on their capacity, it has been agreed that LDCs could make minimum financial contributions to the international institutions.

- i. Dedicated support to the LDCs is being provided by UN Capital Development Fund (UNCDF), and Enhanced Integrated Framework (EIF).
- ii. Support for participation is provided to LDC representatives to take part in the UN General Assembly every year and other UN-organized conferences and meetings. The UN provides travel and participation cost for representatives from LDCs when resources are made available to the UN.
- iii. In membership dues and contributions to the UN Secretariat and various UN bodies, including UN Peacekeeping Operations, some concessions have been provided to LDCs. There are various indicators for determining contributions, and one of them, in some cases, is the status of being a least developed country. This would ensure that they only provide a minimum or nominal contribution to these bodies or programmes.

## CHAPTER FIVE

# NEPAL AND ITS CURRENT STATUS

As Nepal prepares to graduate, it will be important to look at how it has been able to make use of the international support measures as an LDC. The broad general impacts on the LDCs, in general, have been assessed in the preceding chapter. Now, it would be worthwhile to look into the specific impacts on Nepal and the possible implications of the graduation on various facets of international support measures.

- ▶ Terms of Trade and Direction, Preferences and Flexibilities
- ▶ ODA and Debt (Bilateral and Multilateral)
- ▶ FDI, Remittances and Technology
- ▶ Capacity Building, Participation and Contributions

With the graduation of Nepal from the LDC status, there will be some direct and immediate impact on its trade-related preferences, flexibilities and exemptions. There could be some indirect and medium-term implications on the ODA from certain countries and certain institutions, but more particularly on the terms of payment and other concessionality. There will be no negative effect on FDI, remittances and technology access. A higher-income status could even create a positive outlook for attracting FDI, with better credit rating and ever-growing disposable income of the people. Some reduction in the size and the nature of technical assistance by UN-related institutions are likely. And, contributions to some of the UN-related organizations could slightly increase together with the reduction in assistance to support the participation of Nepal in some UN-related international meetings and conferences.

### 5.1 Terms of Trade and Direction, Preferences and Flexibilities

#### 5.1.1 Terms of International Trade and its Direction

Let us consider Nepal's composition of trade and its basic features.

The first feature is that Nepal's foreign trade has been around 40 per cent of its GDP in the last several years. It shows that Nepal has a relatively smaller but open economy. However, its economy is heavily import-dependent, as the export-import ratio has been unusually high and growing over the years.

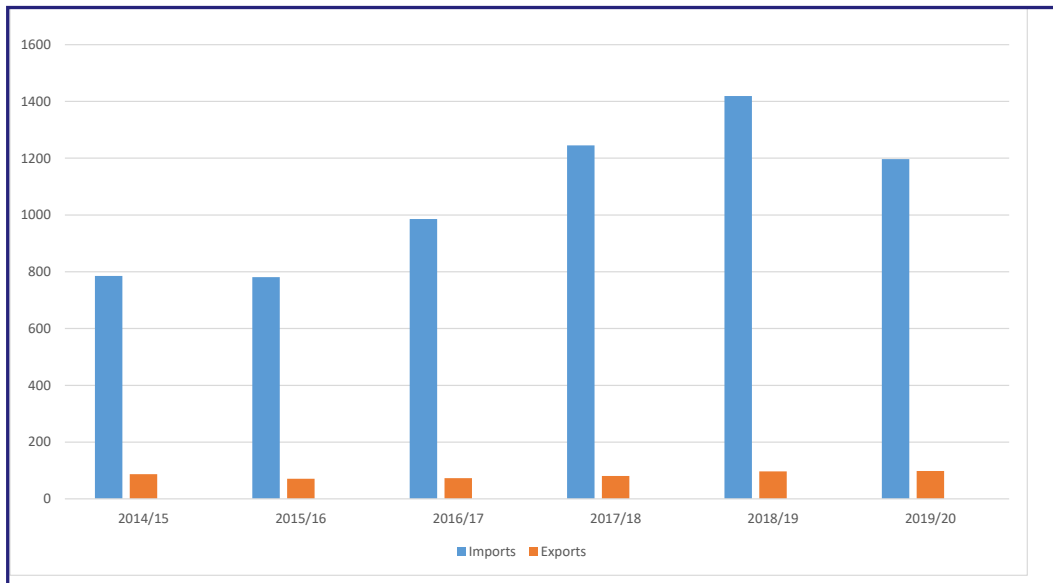


Figure 13: Imports and Exports by Fiscal Years (Rs. in billions)

Source: Annual Trade Statistics, 2015-20, Nepal Trade and Export Promotion Centre

The second feature is that the overall trade deficit has been very high with the Export-Import ratio growing every year. It was 1:9.1 in 2014/15 but reached 1:15.3 in 2017/18 and has remained at 1:12.2 in 2019/20. It was only because of the COVID-19 impacts resulting in a big drop in imports that the ratio has shown some improvement in 2019/20. But, the overall trend in normal years has seen a successive deterioration of the terms of trade for Nepal. The trade deficit stands at 38 per cent of GDP, which is very high and unsustainable. For the country with the size of Nepal, exports of less than US \$ one billion is very low even by the LDC standards.

The third feature is the market concentration of its international trade. In 2019/20 data of the Nepal Trade and Export Promotion Centre show that India (71.8%), United States (9.7%), Germany (2.8%), Turkey (2.2%), United Kingdom (2.1%), China (1.2 %) and France (1.1%) together constitute about 90 per cent of the export market for Nepali products. This level of concentration, with India alone getting a share of 71 per cent of the total exports, shows a very high level of dependence on a few markets for our products. Similarly, the import market is also concentrated but not as much as export markets. India (61.4%), China (15.2%), Indonesia (2.6%), US (2.0%), UAE (1.5%) and Canada (1.4%) and Argentina (1.3%) constitute about 85 per cent of total imports (TEPC, 2020).

The fourth feature is the concentration of export products, as well as the short duration of their growth and the limited increase in the value of exportable products. Nepal exports a limited number of products in terms of their relative share of value, even though there are a large number of items it exports in smaller quantities to many countries around the world. For example, the products exported in terms of value in 2019/20 were palm oil, soybean oil, polyester, cotton and other yarns, woolen carpets, jute and jute products, readymade garments, cardamom, juices, iron and steels, textile and tea, felt, woolen pashmina etc. While the first three highest shares of products are employing a limited number of people with limited value addition, the rest of the products employ a larger number of people while adding substantial value to it. However, the first three occupy almost one-third to 40 per cent of the value of exports.

### **5.1.2 Preferences**

The preferential market access could be of various in nature. It could be a zero-tariff provision or the tariff reduction applicable only to the LDCs. Or, it could be GSP-related preferences, which apply to many other developing countries, including the LDCs. There are also regional or bilateral agreements, providing preferences to countries that are party to them.

While Nepal has been making good utilization of some of the LDC-specific or other general preferences in the USA, EU, India, Switzerland, Norway and Australia, it has not been able to utilize it better in China, Japan and Korea. Overall, Nepal has used only between 10 to 20 per cent of the total LDC-specific preferences, whereas countries like Bangladesh have been able to use 71 per cent of such preferences (WTO, 2020).

The second type of preferential treatment relates to product coverage and the rules of origin, certification process and direct consignment. In the case of the LDCs, coverage of a larger number of products, and less stringent and flexible rules of origin and their application process are critical. With export growth at 4 per cent on average since the turn of the century, Nepal features among the 20 countries in the world with the slowest export growth in the past two decades (World Bank, 2021).

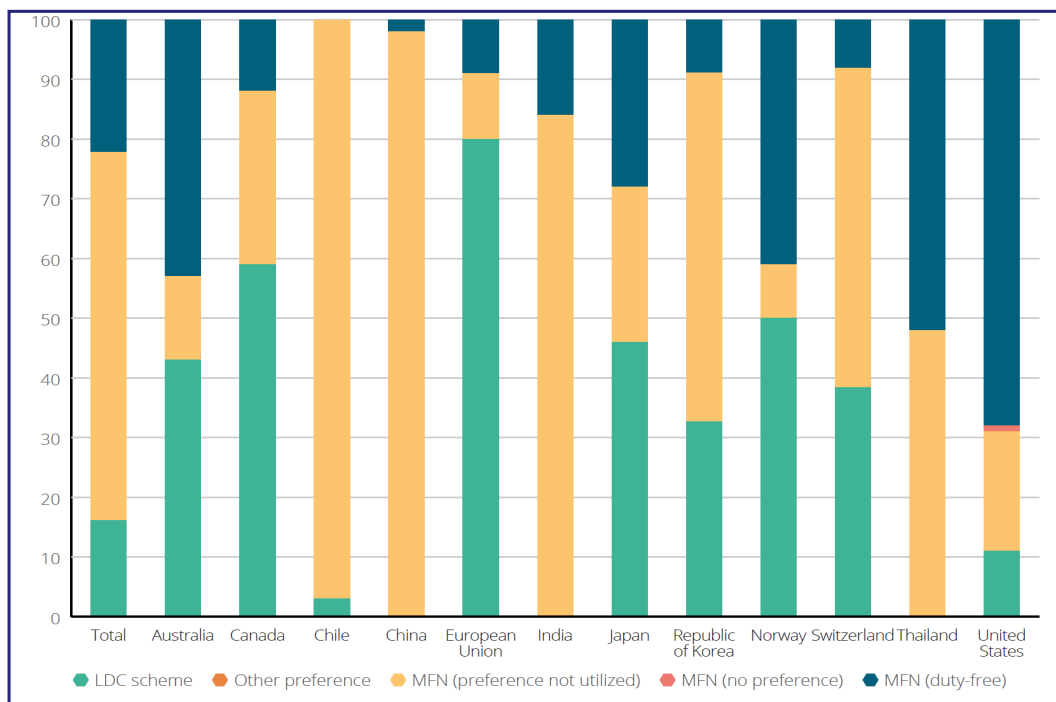


Figure 14: Utilisation of Various Preferences by Nepal in its International Trade

Source: WTO IDB

This graph clearly shows that even with LDC preferences, Nepal is one of the LDCs with only limited export market performance. Our productive capacity and export capacity need to be enhanced both in the transition time in the next five years and in the post-graduation phase of a more competitive international market.

Based on the current composition of trade and market performance of Nepal, the WTO has estimated a possible loss of export value of Nepal at 7 per cent in EU markets following the withdrawal of the LDC-related preferences. In particular, it will negatively affect carpets and garments in a substantial manner, which attract a higher percentage of tariff, around 8 to 12 per cent in various developed country markets. The other losses could be in Switzerland, Norway, Canada and Australia and even Japan, because of the current use of preferences in these countries. The US market will not be affected provided the bilateral agreement of 2015 with preferential access provided for 77 products of Nepal is at least maintained beyond the current time period or expanded to include more products. Similarly, the market in India will not be affected, because of the bilateral trade agreement.

Nepal has huge untapped export potential, which is much larger than the current annual merchandise exports. A recent study by the World Bank estimates that it could

grow 12 times more than its actual current export to reach around USD 9.2 billion (World Bank, 2021, p.viii).

### **5.1.3 Flexibilities**

On flexibilities regarding the various rules and provisions and technical support, some of the flexibilities specific to the LDCs would not be available after graduation. However, flexibilities and provisions related to other developing countries could be continuously enjoyed by Nepal after graduation.

With regards to many of the LDC-specific WTO provisions on tariffs, rules and other systemic issues, Nepal, along with Cambodia and Laos, has, at the time of accession to WTO, made more commitments than other LDCs, together with shorter transition arrangements on IPR provisions. Most of them are related to legal and institutional measures. A detailed study will be required to look at various flexibilities, such as those under services sector waiver which is under negotiation, under Agreement on Agriculture, Trade-related Aspects of Intellectual Property Rights (TRIPS) and in particular about exemption on pharmaceutical products, trade facilitation agreement, Agreement on Sanitary and Phytosanitary measures (SPS), Agreement on Technical Barriers to Trade (TBT), customs valuation and import licensing related provisions, among others.

Exemptions from the export subsidy are yet another form of preferences, which could be affected, and the trade policy review will have to be done more frequently in WTO. The support from the Enhanced Integrated Framework (EIF) will end after a 5-year transition period beyond graduation.

## **5.2 ODA and Debt**

### **5.2.1 ODA**

The ODA has been an indispensable part of Nepal's development efforts. A high level of poverty, a low level of human development, an early stage of economic growth with limited domestic financial resources, and huge physical and social infrastructure gaps have made it imperative to seek and receive ODC from bilateral partners and international institutions. Nepal has also made some progress in mobilizing domestic resources in the last few decades. Similarly, various other financing mechanisms, public and private, have also filled in the gap to meet the resources requirements for economic development in the country.

Efforts have also been made to develop and implement development cooperation policy over the years. Such policies were prepared in 2002, 2014 and the latest one was announced in 2019. The recent policy has come out with aid mobilization modalities

for grants and loans, utilization modality in the context of the federal structure of the country and the introduction of the Aid Management Information System (AMIS).

*(i) The Size of ODA and Utilization*

From the First Five-year plan in 1956 to the Fifteenth Five-year plan now, the share of the ODA has successively come down from a high of 71 per cent to about 17 per cent (expected) of the total outlay of the fifteenth plan period (NPC, 2020a).

In the last few years, the ODA has been gradually increasing. The annual ODA disbursement was around USD 1 billion from 2011 to 2016 and USD 1.5 billion from 2016 to 2019, with a substantial increase in its volume during the time of the humanitarian crisis (MOF, 2021). It is also important to highlight here that the share of the ODA to GDP has remained constant in the last ten years at around 5 to 6 per cent. This shows that Nepal's domestic resource mobilization has also continued apace with the increase in the size of GDP. But the share of the ODA to Nepal's national budget is still around 23 per cent and it covers almost 60 per cent of our total development expenditure.

It is also important to highlight that in the last ten years, average aid expenditure has been just about 45 per cent of the aid allocation made by the development partners, with the variation ranging from 66 per cent to 31 per cent (MOF, 2021). The aid utilization ratio is therefore still very low.

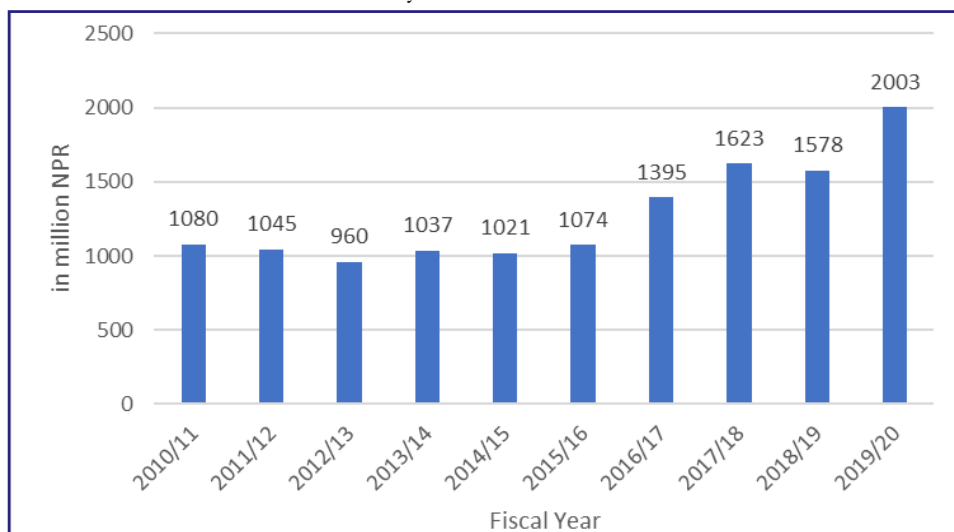


Figure 15: Average Aid Expenditure by Fiscal Years

Source: MoF, 2021<sup>5</sup>

<sup>5</sup> Available at [https://mof.gov.np/uploads/document/file/DCR%202019-20\\_20210507041616\\_2\\_20210531082627\\_20210617072124.pdf](https://mof.gov.np/uploads/document/file/DCR%202019-20_20210507041616_2_20210531082627_20210617072124.pdf) Accessed on June 28, 2021

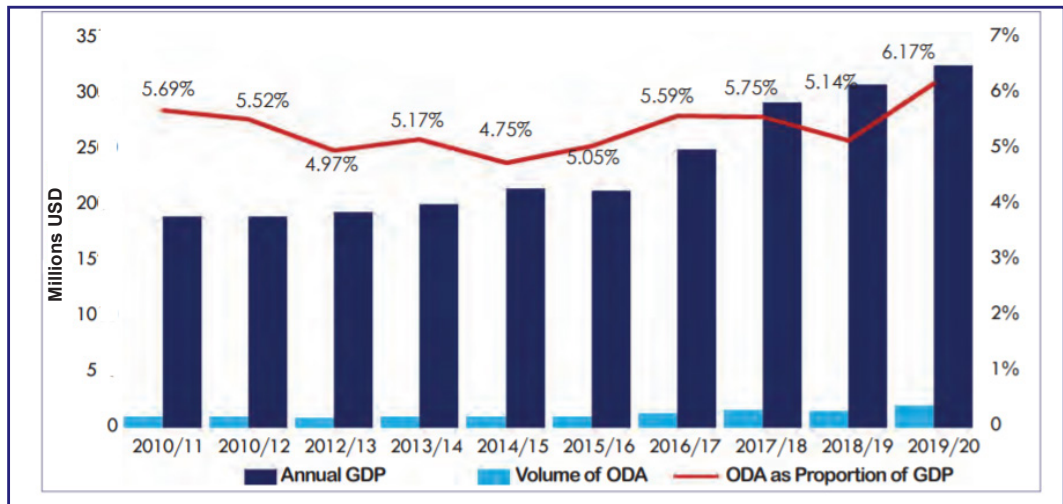


Figure 16: ODA as Proportion to GDP by Fiscal Years<sup>6</sup>

Source: MoF, 2021

### (ii) ODA Partners

The biggest development partners in Nepal are multilateral organisations. The World Bank, the Asian Development Bank, and this year the International Monetary Fund, the European Union and the UN are major partners. Their contributions are growing and now have reached 71 per cent of the total ODA in 2019/20 (MOF, 2021).

The major bilateral development partners are the USA, the United Kingdom, India, China, Japan and Switzerland. Together, bilateral contributions constitute about 29 per cent of the total ODA in 2019/20.

Based on the self-reporting, INGOs' contributions are said to be ranging from 150 million to 200 million a year in the last five years.

### (iii) Composition of ODA

As multilateral assistance is growing relative to bilateral assistance in the last ten years, the composition of the ODA has also undergone some changes with a consistent rise in the loan component. Now the loan component of the ODA is 70 per cent of the total in 2019/20 and the grant and technical assistance components are 19 and 11 per cent respectively. The loan was 60 per cent in the 2018/19 period.

6 Available at [https://mof.gov.np/uploads/document/file/DCR%202019-20\\_20210507041616\\_2\\_20210531082627\\_20210617072124.pdf](https://mof.gov.np/uploads/document/file/DCR%202019-20_20210507041616_2_20210531082627_20210617072124.pdf) Accessed on June 28, 2021

#### (iv) Humanitarian Assistance

The international community has disbursed only USD 1.4 billion by 2019/20 period, out of the pledged USD 4 billion for the post-earthquake reconstruction. This is about 36 per cent of the commitments so far. The earthquake reconstruction disbursements were multi-year disbursements. The Covid-19 disbursements were about USD 500 million in 2019/20, which is about 25 per cent of the total ODA disbursements. Ninety-five per cent of it came from the multilateral partners, mostly as loans.

Nepal has been receiving substantial ODA over the last several decades. Though most of it was in grants in the early period, with the increase in multilateral assistance, the loan component has been increasing over the decades. Therefore, debt stock and debt service ratio are becoming important, even though multilateral assistance has a very favourable term of concessions with a grace period, low-interest rate and long-term payment plan. There is also a growing amount of loan coming from some of the bilateral partners like India, China, Japan and South Korea.

It is against this background that the following issues should be considered.

First, the ODA is provided by the development partners as part of their national policies and international commitment and is granted more based on historical connections, socio-economic and political conditions and geostrategic considerations. They are also influenced by the advocacy of the international community and the national public opinion. For all these reasons, Nepal is being viewed positively, and as such has been receiving good support in terms of getting ODC in general from various partners. There will be no discernible negative impact on the bilateral ODA because of the LDC graduation.

Second, as the growing share of the ODA coming to Nepal is from multilateral agencies and as they do not disburse financial assistance based on the LDC criteria, graduation does not necessarily affect such allocation. They have low income and other vulnerability criteria for access to IDA, and the related concessions.

Third, there is a huge gap between disbursement and commitment and the sector-wise distribution of the ODA shows that external assistance touches almost all sectors.

Fourth, the loan service ratio is going to increase over the years, as our loan component grows together with the reduction in concessionality by multilateral as well as some bilateral partners. Therefore, programmes and projects should be appraised with due diligence and detailed analysis of the maximum impact on the ground. They should be completed with effectiveness, result-orientation and efficiency.

And finally, over the decades, domestic resource mobilization has grown substantially in Nepal. In fact, among the LDCs, Nepal is doing better as its internal revenue constitutes about 24 per cent of its GDP.

### **5.2.2 Public Debt**

Public debt has been an important means of resource mobilization for governments around the world. Government borrowing, if effectively used, can be a good stimulator for economic growth, can fill the resource gap and direct some of the resources to the important sectors with good impacts. But if it is not raised at a prudent level and is not used efficiently and effectively, it could be a burden on the economy and even impede economic growth and undermine macroeconomic stability. Therefore, many believe that there is a concave or U-shaped relationship between economic growth rates and public debt to GDP ratio in many developing countries, including the LDCs. However, the right proportion depends upon the quality of governance and the rate of trade deficit and other sources of stable finance that can help countries withstand a bit higher proportion in general.

Nepal had almost 60 per cent of debt to GDP ratio from 1990 to 2004, with a successively increased proportion of external debt. Since then, it started coming down to around 40 per cent from 2004 to 2009. Nepal's ratio has been hovering around 30 per cent since 2010 and this year it has reached 37.7 per cent, with the proportion of foreign debt at around 57 per cent of the total debt. Although there is no strict rule about the exact percentage of debt to GDP ratio, because of the weaker country performance and institutional bottlenecks, around 40 per cent of public debt is being considered as a prudent threshold for vulnerable countries with low income and limited capacity.

While there are no LDC-specific public debt-related international support measures, debt relief measures, in general, have been requested by heavily indebted countries including LDCs in the international forums. As a result, development partners have responded to their call with several measures in the past. Multilateral institutions and the bilateral partners have taken specific measures such as the Heavily Indebted Poor Country (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), which have contributed to substantially reduce the debt burden of many heavily- indebted LDCs and other income groups. Therefore, graduation from the LDC status will have no direct impact on accessing debt relief measures, should that be the case in future. However, we should ensure that we would never reach that stage, as it would have a huge and cascading negative impacts on the overall economic activities of the country and the general welfare of the people.

## 5.3 FDI, Remittances and Technology

### 5.3.1 FDI

FDI in Nepal has been rather stagnant, and relatively small compared to the size of its GDP, investment potentials as well as relative to the countries in a similar situation in the region.

Although Nepal received some FDI, especially from the Indian investors, from early on, some small scale FDI started to come into the country after it hosted the Nepal Investment Forum in 1992. From 1996 to 1998, FDI inflow on average was just about Rs. 1 billion a year. There were some net outflows in the years of conflict in Nepal. While after the end of the internal conflict, FDI started coming in slowly. Based on the report of the Nepal Rastra Bank, the status of FDI in Nepal in the last several years is as follows (NRB, 2019).

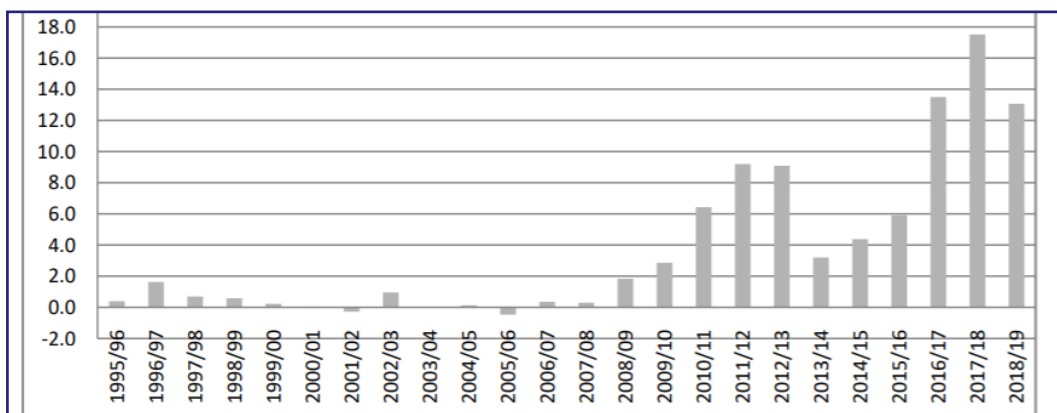


Figure 17: Status of FDI in Nepal-Net FDI Inflows<sup>7</sup>

Source: Nepal Rastra Bank

<sup>7</sup> Available at <https://www.nrb.org.np/contents/uploads/2020/08/FDI-Report-December-2019.pdf>  
Accessed on June 28, 2021

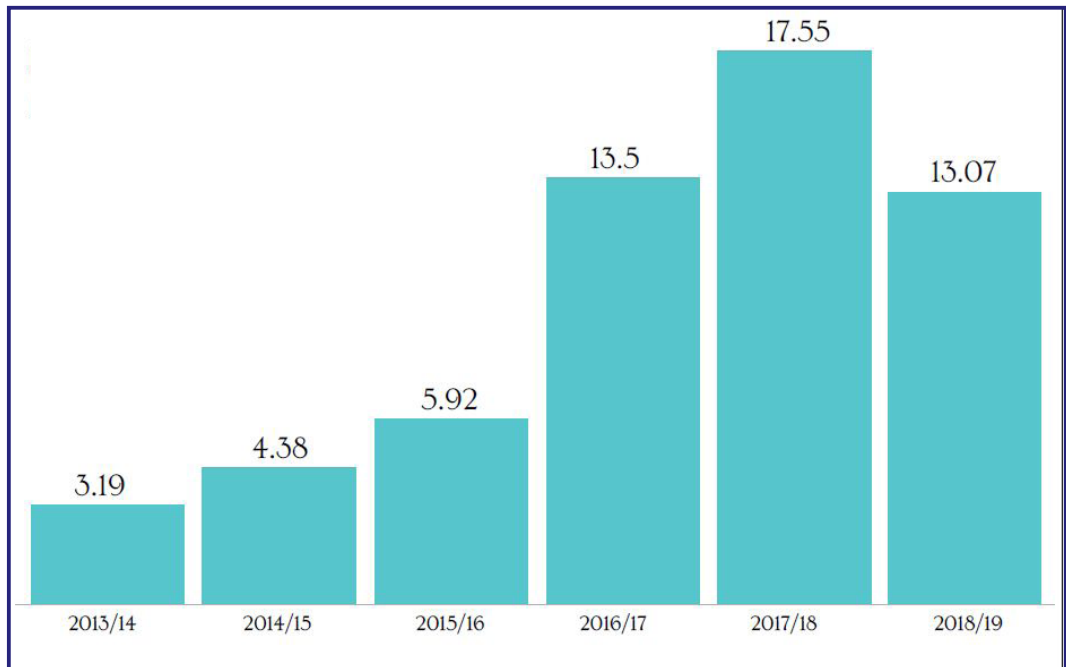


Figure 18: FDI Received by Fiscal Years (in billion, NPR)

Source: Nepal Rastra Bank

The total FDI stock in 2012/13 was 52 billion, which reached Rs. 200.55 billion at the end of FY 2017/18. This is merely 6.6 per cent of the GDP of Nepal. In terms of its sectoral distribution, the Service sector accounted for 63.27 per cent, whereas the industrial sector accounted for Rs 73.54 billion. The details of the sectoral breakdown of FDI stock in Nepal are presented below.

Table 4: Sectoral Breakdown of FDI Stock in Nepal

S. N.	Sectors	Paid-up	Reserves	Loans	FDI Stock
1.	Agriculture	124.2	-6.0	-	118.2
2.	Manufacturing	37,931.2	25,685.5	9,919.3	73,536.0
3.	Service	38,794.9	81,712.5	6,385.8	126,893.2
	<b>Total</b>	<b>76,850.3</b>	<b>107,392.0</b>	<b>16,305.1</b>	<b>200,547.4</b>

Source: Nepal Rastra Bank

(i) Sources of FDI

As regards the sources of FDI, it has been found that the neighbouring countries, a few developed countries and some other countries in Asia have been the source countries of FDI in Nepal. We have to enhance the level of investment from these countries and also make an effort to further diversify our sources by reaching out to other countries in Asia, Europe and North America. The following table highlights the major sources of FDI in Nepal.

Table 5: Major Sources of FDI in Nepal

S. N.	Country	Paid-up	Reserves	Loans	FDI Stock	Share in Total (%)
1	West Indies	80.0	62,471.4	-	62,551.4	31.19
2	India	16,008.5	24,918.6	810.2	41,737.3	20.81
3	China	22,007.6	-5,093.8	9,899.0	26,812.8	13.37
4	Ireland	4,024.9	6,271.6	-	10,296.5	5.13
5	Singapore	3,916.4	3,541.8	222.4	7,680.6	3.83
6	Australia	4,260.8	2,883.7	-	7,144.5	3.56
7	Hong Kong-China	5,562.5	1,039.3	456.1	7,057.9	3.52
8	UAE	233.5	5,706.4	-	5,939.9	2.96
9	Bangladesh	3,328.6	1,500.9	-	4,829.5	2.41
10	USA	1,596.6	2,073.6	593.6	4,263.8	2.13
11	Others	15,830.9	2,078.5	4,323.8	22,233.2	11.09
	<b>Total</b>	<b>76,850.3</b>	<b>107,392.0</b>	<b>16,305.1</b>	<b>200,547.4</b>	<b>100.00</b>

Source: Nepal Rastra Bank, 2019

This clearly shows that FDI remains at one of the lowest levels in Nepal. While some measures have been taken, including the recent promulgation of the Foreign Investment and Technology Transfer Act 2019, to improve the one-window system, with some incentives, including 100 per cent equity investment in many areas except a few, repatriation guarantees, among others, FDI has remained at a very low level. Some of the reasons have been identified as the rising wage cost, low productivity, the small size of the market, high infrastructure cost, delay in providing effective and coordinated support for the early operationalization of FDI, including energy and access roads, environmental assessments, and other related permits and institutional challenges related to the effective implementation of the one window system.

While we have foreign investment coming into Nepal in tens of millions of US dollars a year, countries in a similar situation in our region have been attracting FDI in billions of dollars for the last several years or decades. Therefore, we have to dispassionately

and comprehensively review the whole ecosystem of FDI from legal, institutional, infrastructural perspectives, and consider enabling environment, incentives and regulatory mechanisms in a more holistic manner. Nepal hosted the most recent Nepal investment Forum in 2017 where a commitment was made to invest about USD 13.74 billion in 10 sectors from 26 companies from 8 countries. However, the actual FDI inflow in the last two years has been USD 67 million (Rs. 7.4 billion) in 2018 and USD 185 million (Rs. 20 Billion) in 2019. This is a big mismatch between the announcement of FDI and its actual realization. As a comparison to the status of FDI in comparators in the region, out of the 5 top FDI destinations among the LDCs, three were from the Asia Pacific region. Cambodia, Myanmar and Bangladesh had an FDI inflow of USD 3.7 billion, 2.8 billion and 1.6 billion respectively in 2019 alone (UNCTAD, 2020).

Since no specific measures are in place for promoting FDI to the LDCs, graduating from the LDC status will have no negative effect on FDI. On the contrary, getting out of the LDC status could be interpreted as the country having made good progress in the economic, social and other vulnerability related indicators. It could even prompt investors to look at those countries in a more positive light. If we take targeted and holistic national initiative and implement them effectively, FDI in Nepal should improve substantially in the years ahead.

### **5.3.2 Remittances**

Remittances have become a great source of foreign exchange to the government with almost two-thirds of the total foreign exchange earnings, and one of the most important private sources of income for the migrants and their dependents in the last two decades. The total number of labour migrants is estimated to be over 4.7 million, about 25 per cent of the working-age population. The work permits issued for labour migrants reached a peak of 516, 983 in 2013/14. In recent years, it has been about 300,000 per year. If we include unofficial channels, it would be somewhat larger than that. Over 50 per cent go for low skilled jobs, 35 per cent for semi-skilled jobs, 14 per cent for mid-level skilled jobs and only about 1 per cent get high-skilled jobs (MOL, 2020).

While the young unemployed Nepalese have been migrating to India, the Middle East, South East Asia and East Asia in large numbers to get employment, it has also triggered labour shortage in rural and urban areas and has also created unintended social consequences. Remittances going directly to the people have contributed to the reduction of poverty and human development, created opportunities for micro and small-scale income-generating activities, enhanced consumption expenditure, promoted some savings and investment and increased government revenue due to a high level of imports triggered by remittances income. Several studies have also shown that remittances tend to contribute to the appreciation of a real exchange rate and an increase in the trade deficit. It could also negatively impact export competitiveness and

increase imports and thus undermine firm productivity.

There has to be a medium to a long-term plan to make the best use of the youth talent and energy within the country. In the short to medium terms, we have to make use of the international migration and remittances to enhance longer-term change in the structure of the economy by fully utilizing the knowledge, skills and earnings of the returned migrants in the productive sector. Better protection, safety and orderly migration should be promoted with legal, institutional and diplomatic means to ensure their welfare in the destination countries.

A quick analysis of the migration data over the last two decades shows that contributions of remittances to GDP was about 2% in 2000, which accelerated to 11 per cent in 2002 and reached 21 per cent in 2008. And, in the last five years, their contributions have been at least 25 per cent to a maximum of 30 per cent of GDP.

As the returning migrants brought their savings and increased the utilization of formal channels for transfer, the inflow of remittances slightly increased in 2020/21 even after Covid-19. However, the fact that there has been a steep reduction by almost 70 per cent in getting the approval by the migrant workers from the Ministry of Labour in 2020/21 indicates that there could very well be a delayed but substantial impact on the inflow of remittances in the country in the coming years.

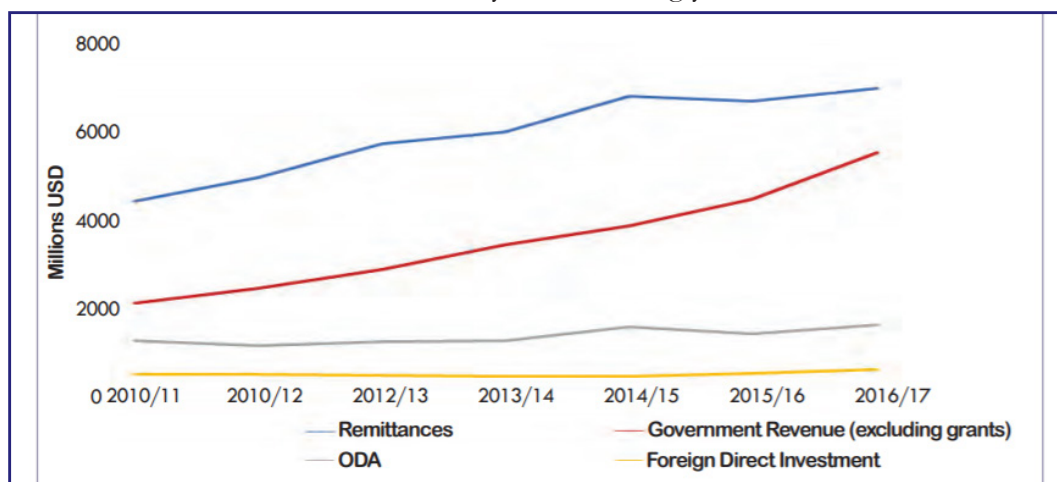


Figure 19: A Comparative Figure for Growth of External Finance (ODA, FDI and remittances)<sup>8</sup>

Source: MOF, 2021

Nepal ranks among the top five countries in terms of the highest remittance to GDP

<sup>8</sup> Available at [https://mof.gov.np/uploads/document/file/DCR%202019-20\\_20210507041616\\_2\\_20210531082627\\_20210617072124.pdf](https://mof.gov.np/uploads/document/file/DCR%202019-20_20210507041616_2_20210531082627_20210617072124.pdf) Accessed on June 18, 2021

ratio. The other countries around the world are Tonga, Kyrgyzstan, Tajikistan and Haiti.

The most recent statistics on the impact of Covid-19 should also open up our eyes to the possible vulnerabilities of our huge dependence on remittances, as the global economic crisis, pandemics and volatility in commodity prices could affect our main foreign exchange earning source.

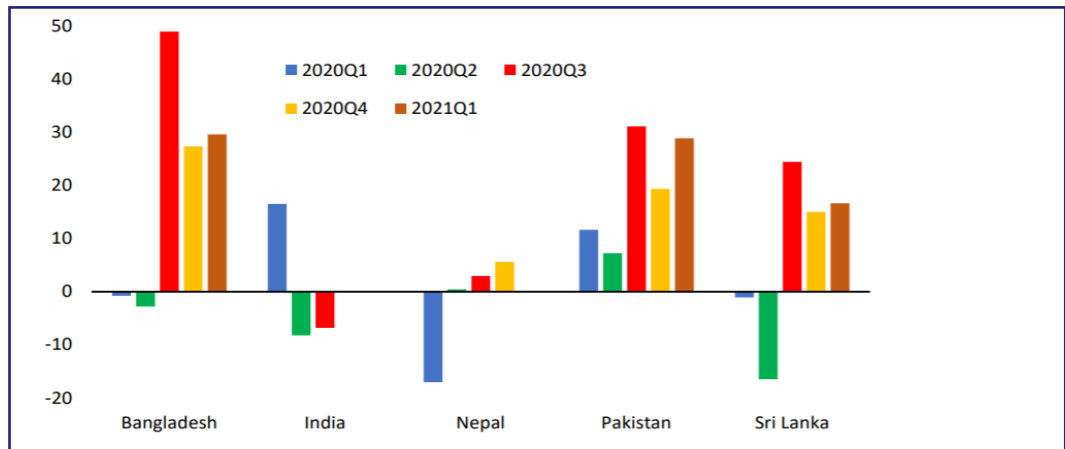


Figure 20: Quarterly Change in Percentage of Inflow of Remittances <sup>9</sup>

Source: Haver Analytics and World Bank-KNOMAD staff

It is also important to highlight here that if we look at the proportion of the remittances in South Asia, India, Bhutan and Afghanistan have the share of remittances to GDP between 3 to 4 per cent, Bangladesh, Sri Lanka and Pakistan have between 7 to 10 per cent and only Nepal has a very high share at 24 per cent.

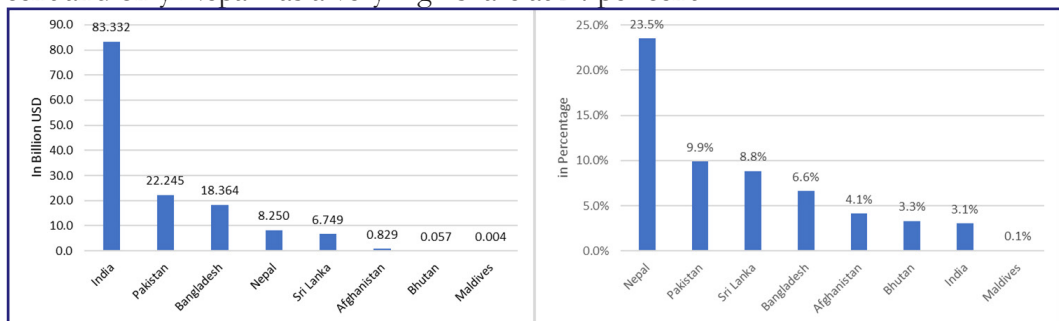


Figure 21: Annual Inflow of Remittances in US Dollars in South Asia and the Ratio of Remittances to GDP in South Asia<sup>10</sup>

<sup>9</sup> Available at <https://reliefweb.int/sites/reliefweb.int/files/resources/Migration%20and%20Development%20Brief%2034.pdf> Accessed on June 28, 2021

<sup>10</sup> Available at <https://reliefweb.int/sites/reliefweb.int/files/resources/Migration%20and%20Development%20Brief%2034.pdf> accessed on June 28, 2021

By endorsing both SDGs and the Global Compact for Migration, Nepal has also committed to promoting international cooperation to implement them. Similarly, Nepal has chaired the Colombo Process until recently and has been regularly taking part in the Abu Dhabi Dialogue as a regional consultative process.

Concerning the cost of migration, the World Bank has reported that the average cost of sending remittances of USD 200 to the low and lower-middle-income countries is still 6.8 % in 2020 against the UN target of 3%. While it is 9% to the Sub-Saharan Africans, to the South Asian migrants, it is 4.9%. And, the India-Nepal corridor has been considered as having one of the lowest rates in South Asia (World Bank/KNOMAD, 2021).

As there is no specific or targeted programme related to remittances to or migrants from the LDCs and there are general provisions applicable to all, there will be no impact on either remittances or migration-related issues because of graduation from the LDC status. However, with targeted programmes in the short to medium term, Nepal should be able to use migration and remittances to bring about the structural transformation of the economy for sustainable graduation.

### **5.3.3 Technology**

Technological inputs in the productive sectors and innovation remain at a very low level. That is one of the reasons that we have not seen the structural transformation in the country. And, even though Nepal has improved its Doing Business Index coming down to 94 in 2019, Nepal has remained around 108<sup>th</sup> position in the global competitiveness index of the World Economic Forum.

Though Nepal has made substantial improvement in connectivity, moving up from 126<sup>th</sup> to 118<sup>th</sup> position in the Network Readiness Index of the World Economic Forum in the last five years, and has doubled the number of tech hubs to 12 in the last three years, it has a long way to go to fully reap the benefits from the new digital technology. The mobile subscription penetration has improved tremendously reaching 127 per cent of the total population. And, about 75 per cent of the population has access to broadband internet with a large majority through mobile subscriptions (NTA, 2076/77 BS).

However, the IT sector has remained much underutilized in Nepal, except for the consumption of entertainment and communication contents and for providing the lower end of the business services. Its coordinated, strategic, comprehensive and productivity-enhancing use in all aspects of our development process offers a possible way out of many structural constraints and geographical disadvantages. The new digital technology and its ubiquitous application hold a great promise for bringing

structural transformation to the country. Further expansion and effective implementation of the Nepal Digital Framework 2019, bringing FDI in the technology sector and linking better with the rest of the world by developing more digital contents and benefitting from the new path-breaking areas such as quantum computing, AI, 5G, automation and other new frontiers should be high on the agenda of Nepal.

As there are no LDC-specific technology-related mechanisms, besides a general call for supporting technology adoption in these countries and the just established LDC Technology Bank limited to information gathering work, there will be no impact on technology access and adoption or innovation after graduation of Nepal.

## **5.4 Capacity Building, Participation and Contributions**

Nepal has been receiving technical assistance in various important sectors to fill up the knowledge as well as the technical skills gap. Such assistance has been received from bilateral development partners, multilateral financial institutions and multilateral organizations. Those received from bilateral partners and multilateral financial institutions will not be affected after graduation because those are related to or tied with specific programmes and projects and not contingent on Nepal being the least developed country.

Multilateral Organizations like the UN and related organizations will not cut off their technical assistance to the graduated countries. However, they tend to give priority to the LDCs and thereafter other vulnerable countries such as small island countries, landlocked countries and other developing countries with limited capacity. For example, UNDP and UNICEF have allocated about 60 per cent of their budget to LDCs as a group. But the regular or core sources of funding have come down to only 13 per cent of their total budget. That means a large part of resources is earmarked for specific purposes or country programmes. Therefore, the modality of cooperation, the scale and focus will change substantially over the period of time. There would be some impacts on the nature and scope of cooperation programmes with these organizations.

GEF related LDC funds were only 0.6 per cent of the total multilateral aid in 2006-2015, though they have increased over the last five years. The projects approved and funded will continue until their completion, regardless of the country's LDC status. After graduation, Nepal will not have access to new funds from LDCF, but Nepal will remain eligible to access funds available at other financing sources of UNFCCC, such as the GEF Trust Fund, the Special Climate Change Fund, the Adaptation Fund, and the Green Climate Fund (GCF).

With regards to the support for participation in the UN and other international

meetings, the most obvious impact of graduation will be probably the forfeiture of the travel cost of 5 delegates to participate in the UN General Assembly meeting every year. It was around USD 28,000 in 2016 (UNCDP, 2018 p 28). Even this limited travel support has been extended to the LDCs until three years after graduation. For participation in other UN and related meetings, the UN normally creates a voluntary fund for all developing countries in general and gives priority to LDCs followed by other vulnerable countries and those with limited capacity. Sometimes, it also depends upon the level of relevance of the issues to the particular developing countries.

On contributions to the UN and other International Organizations, there are different provisions agreed by each of the multilateral organizations. LDC status, GNI per capita and other factors are considered in assessing the contribution rate in many of the UN organizations. Nepal's contribution rate is not likely to increase much after graduation because it will still be a low-income country. There would be some increment in the UN Peace Keeping contributions from the current level of about USD 40,000 and some minor enhancement in other organizations (UNCDP, 2018).

A few of the scholarships or fellowships by some international organizations like UNESCO and IPCC are provided to the LDCs without cost. Nepal may lose them after graduation. However, most of the international organizations and bilateral partners do not have such dedicated LDC focused programmes of scholarship or fellowship. Therefore, the impact on Nepal after graduation would be minimal.

## CHAPTER SIX

# STRATEGY FOR SUSTAINABLE AND MEANINGFUL GRADUATION

To make our graduation both meaningful and sustainable, we need to prepare a comprehensive and well-thought-out strategy. In view of our vulnerability to internal and external shocks and a high degree of volatility with a weaker economic base, graduation presents us with an opportunity to reorient our economy and make it more resilient with inclusive and transformative growth and progress.

- ▶ Structural Transformation and Infrastructure
- ▶ Inclusive Human Development, Building Resilience and Sustainability
- ▶ Policy Coherence, Institutions and Good Governance
- ▶ Strong National Leadership and Committed Action with a Multistakeholder Approach
- ▶ Bilateral and Regional Cooperation
- ▶ Robust International Support Measures

Recently, there have been some policy-related discussions on the need for changing the structure of the economy, including in the Fourteenth and the Fifteenth Plan documents, there is a discernible lack of progress in effectively reorienting the economy. Therefore, besides such broad policy orientations, we need an effective strategy and clear pathways, intersectoral coordination and above all outcome and impact-oriented implementation. As graduation of Nepal from the LDC status will have some direct impact on Nepal's export market and medium-term impact on other sectors, the best way to cushion the negative impacts and overcome these challenges is to bring about the structural transformation of our economic activities with a long-term vision and committed action across the sectors. There is a need for a paradigm shift in our national economic activities accompanied by strong national leadership with a multistakeholder approach. Equally important would be to take a proactive role at the international level to ensure that comprehensive and dedicated support and cooperation is accorded to Nepal during the transition period and beyond graduation. It is only with a strong national and international interface that Nepal can smoothly get out of the LDC status. This is also in line with the spirit of mutual accountability, which is embedded in the concept of international cooperation and solidarity and the Istanbul Programme of Action for the LDCs.

Therefore, a six-way approach to sustainable graduation has been proposed for making it smooth, meaningful and transformative.



Figure 22: Six-way Approach to Sustainable Graduation

## 6.1 Structural Transformation and Infrastructure

### 6.1.1 Structural Transformation

One of the fundamental challenges of Nepal has been the lack of structural transformation of its economy over the decades. Even though gradual progress has been observed in expanding the size of the economy and trade, in financial deepening and improvement in the standard of living of the people, it remains way below its potential as its economic structure as such has not transformed fundamentally. Therefore, the prospect of graduation provides an important opportunity for Nepal to make its economy fundamentally more resilient, inclusive and sustainable.

The share of agriculture in national GDP is successively decreasing, but the dependence of the people on agriculture has not diminished that much. The share of manufacturing has also successively declined which is at the lowest level now to almost at about 5 per cent of GDP. The service sector has expanded tremendously over the decade in terms of its contributions to GDP, but again they are predominantly at the lower end of the less competitive and highly untradable sectors with very limited multiplier effects. Normally, the history of economic activities the world over has been slowly but successively moving away from the agrarian economy to industrialization and then on to the service economy. In Nepal's case, we have moved from an agriculture-dependent

economy to a service dominated economy with a high degree of unemployment or underemployment. Nepal has also become an example of what the renowned economist Dani Rodrik called 'premature deindustrialization' (Rodrik, 2016). The long-term study of the productivity of the agriculture sector has shown that it has remained either stagnant or marginally improved in the last two decades. Our agricultural productivity has been almost at the bottom even when compared with other countries in our region. Though productivity in the manufacturing sector is slightly better than the agriculture sector, it is again nowhere near the average South Asian regional level. A recent World Bank report has stated, "In the past two decades, total factor productivity contributed only 0.8 percentage points to overall annual growth, substantially below the 2.3 and 3.2 percentage point contributions, respectively, observed in structural or aspirational comparators like Laos, and Cambodia" (World Bank, 2021, p.24).

The long-term data panel of the structural pattern of Nepal and other countries in the region collected by the Groningen University also proves a very slow change in the structure of the economy. Our tertiary sector is also dominated by low productive and non-tradeable subsectors, except tourism, IT and financial services, which are doing better than other subsectors.

Moving away from lower productivity to higher productivity, specialization and diversification of products, upgrading from lower technological inputs to products with higher technological inputs, higher efficiency in producing competitive products in large quantities and reducing the cost of transportation and participation in regional and global value chains have to be a central economic theme and preoccupation for Nepal's rapid, inclusive and sustainable development efforts. It is true that geographical disadvantages, such as the mountainous terrain with high logistics cost and cumbersome transit procedures, have also undermined Nepal's competitiveness as a landlocked country. A long term, comprehensive and coherent policy with an action plan and its effective implementation is urgently required for Nepal's structural transformation. Right incentive mechanisms and ensuring an enabling environment for the promotion of the private sector and the cooperative sector would be equally critical.

As graduation entails both challenges and opportunities, we should make full and effective use of the transition time of graduation to initiate transformative change in Nepal's economic structure. The current model of a consumption-led, remittance-oriented and import-driven economy is not only unsustainable but also highly volatile. We have to move away from the short-term comfort of a remittance economy to the long-term sustainability of our economic activities. A better alignment of our short-term outlook with the long-term sustainable progress is also indispensable, given our political economy and geostrategic imperatives. A country located strategically between the two emerging powers with natural beauties and resources and a medium-size

population enjoying youth dividend should not remain trapped in a low-level equilibrium growth. Nepal has also a good standing at the international level in terms of garnering support from its development partners, which will help Nepal substantially transition away from the current economic volatility to a more resilient, inclusive and sustainable economy.

The literature on the study of many LDCs has also shown a similar lack of structural transformation in other parts of the world. It has been suggested that the type of structural transformation that gives rapid, inclusive and sustained growth depends upon (i) high productivity, (ii) dynamic productivity growth via relocation in a sector with high national and international convergence, (iii) expansion of the sector in its use of inputs (iv) comparative advantage and (v) exportability of the products (Enache, Ghani & O'Connell, 2016).

The UNCTAD has called for graduation with momentum by promoting productivity and structural transformation, enhancing employment opportunities and reducing vulnerability. The UN LDC conference in Istanbul in 2011, therefore, called for the transformation of LDC economies with productive capacity development with infrastructure building, while according it the very first place among its 7 priorities. Productive capacity development has been defined as enhancement of productivity across the sectors, technological capabilities, human development and efficient production processes. We have to promote them holistically to ensure transformative and sustainable change in the country.

### **6.1.2 Infrastructure Development**

A strategic approach to infrastructure development could also play a very important role in Nepal for structural transformation. Physical infrastructure, in particular roads, electricity and ICT, has to receive a high priority. It reduces the cost of doing trade, promotes productive capacity and helps better integrate with the rest of the world. There is a direct co-relationship between the reach of infrastructure and human and economic development, reduction of inequality and poverty and increase in income. It is clear how infrastructure changes the lives of the people by making it easier to access health and education facilities, creating jobs and spurring new economic activities, connecting with local or national markets for its products, getting goods and modern services from outside and enhancing efficiency across the board. But building efficient infrastructure in an environmentally sustainable way with due recognition of the physical and natural settings, maintaining them regularly, and linking them with income-generating activities for all but especially those at the lower end of the development scale and making them accessible to all has been a particular challenge in Nepal. Similarly, an efficient cross border movement of goods and transit facilities with effective

implementation of trade facilitation measures will have a salutary impact on making trade more competitive for a landlocked country like Nepal. Situated between the two emerging global powers, Nepal should also look at the long-term economic benefits of being a land-linked country, utilizing the possibility of enhancing export capacity, competitiveness and participation in the regional and global value chains.

### **6.1.3 Technology**

New production, consumption and distribution patterns with the application of digital technology across the board, development of digital contents, digital innovation, and investment in digital infrastructure should be considered as part of our core national policy for structural transformation.

They are all interlinked and mutually supportive. Therefore, a coherent approach within the nation among all the relevant sectors and similar coherence between the national actions and international support measures would be critical going forward.

In sum, in the interdependent and highly globalized world of today, many of the national policy space that the early movers enjoyed may not be there. Therefore, making full use of the available flexibilities while fighting for more to deal with specific vulnerabilities and structural barriers would be critical. Similarly, finding coherence between the national economic measures and the global trading regime, global investment patterns, official development assistance, even the remittances in a more holistic manner with a focus on the long-term transformative change would go a long way towards achieving a higher level of productivity across the sectors, resilience and shared progress in the country.

## **6.2 Inclusive Human Development, Building Resilience and Sustainability**

Nepal has a sizable population of about 30 million with a predominance of the youth population and has also made good progress in human development over the years. The National Planning Commission has estimated that the demographic window of opportunity for Nepal will last for 55 years in total. As it started around 1992, we are around the middle of it now, which will begin to close around 2047 (NPC, 2017, p.v) In the global human development index, we have moved from 0.45 to 0.64 in the last twenty years (NPC, 2020b, p.17).

Since human development is both an end by itself and the means to transform the economy and society as a whole, we should accord the highest priority to develop it to ensure Nepal's inclusive progress and shared prosperity.

While Nepal has made good progress in basic human development indicators in the last few decades, it faces several challenges on the human development front. The level of multidimensional poverty has remained still high at 36% of the population, despite consistent progress over the years. Poverty, deprivation, unemployment, equality of opportunity, regional imbalance and continued marginalization of some sections of the population are major challenges in the country. Leaving no one behind and including the bottom quintile in the transformation would be critical for fairness, justice and sustainability of the progress. Therefore, providing fair and equitable opportunities for all to enhance their capabilities and fully use their potential should be one of the high priorities for all sectors going forward.

A high drop-out ratio, especially among women as they go towards a higher level of education, quality of education, fair opportunities for higher education, professional technical skills and employability of the educated people, and the underemployment and lack of employment opportunities are other major concerns. Matching of the skill sets of people with what is required by the economy and society has never been well coordinated. Furthermore, in recent years, the migration of a large number of youths for work abroad has also created a labour shortage of semi-skilled or skilled workers in the country, both in the agriculture sector and the industrial sector.

Therefore, the graduation and transformation of our economy should closely look at human development in a coordinated manner. To promote the welfare of the people, enhance our productivity, compete at the international level and sustain our progress, we need to make inclusive human development a high priority as part of our graduation strategy. In a globalized and integrated world, the fourth industrial revolution, quantum computing, automation and AI-driven economic activities will have lasting impacts on all economies irrespective of their location and status. As we missed earlier revolutions, we should not be left out of the fourth industrial revolution, which can help us overcome or circumvent many of our structural barriers as well. With a right and visionary outlook, we should be able to make the best use of the new revolution. But it demands a strong digital infrastructure, digital literacy, high scientific and technical capability for innovation and application, robust institutional and policy frameworks including for effective collaboration with the private sector and support mechanisms across the sectors. To compete in the new economy of the twenty-first century, we must now lay a strong foundation of a knowledge economy with conviction and a firm commitment to action.

### **6.2.1 Building Resilience**

The other important issue for Nepal is the high degree of vulnerability to internal shocks from natural and man-made disasters and exogenous economic, pandemic and other shocks.

Nepal will have to ensure that it has a strong disaster prevention and disaster risk reduction plan and the necessary preparedness with effective and inclusive mechanisms to mobilize all resources and stakeholders. Nepal ranks 4<sup>th</sup> and 11<sup>th</sup> in terms of relative vulnerability to climate change and earthquakes. Regular frequency of fire, landslides and hydrological disasters and occasional mega-disasters like the massive Earthquake of 2015, and now the Covid-19 pandemic have adversely affected its economy and the livelihood of the people and has tested our resilience. While the earthquake pushed down the economy to a low level of growth at 2 per cent in 2015 with a loss of one-third of GDP and loss of lives of about 8,800 people, the Covid-19 pushed down the economic growth to negative territory with -1.99 per cent growth rate, a first in the last forty years. Similarly, it has devastated our tourism and hospitality sectors, like no other disaster. With its widespread impacts on the economy, government revenue, income level of the people, public and private investment all have suffered. It has also exacerbated inequality, poverty and deprivation. With the ongoing second wave of the pandemic, our health system, which was in a precarious situation even in the best of times, has now completely unravelled. The slowly recovering economy is now being hit hard and will have longer and deeper implications to the economy, livelihood and welfare of the people.

Therefore, comprehensive support from the international community, especially to prevent and cope with natural disasters and the pandemic, and to build stronger resilience with a stronger healthcare system and infrastructure, will have to be an essential part of our sustainable graduation strategy. Similarly, national efforts will have to be enhanced to establish robust preventive mechanisms as well as building back better programmes and strengthening resilience with strong safety nets and social mobilization.

### **6.2.2 Sustainability**

Another equally important part of building resilience is ensuring the sustainability of all our activities. As a country with a fragile mountain ecosystem, Nepal has to ensure a delicate balance between development and environmental conservation. Nepal has made good progress in increasing the forested area with the commitment to maintain at least 40 per cent of the total land area under the forest cover. It has also achieved 80% electrification through renewable energy resources. Nepal has a huge hydropower development capacity, which can provide clean and renewable electricity to the region as a whole.

Even though Nepal emits only 0.027 per cent of the global emission of carbons, it is facing cascading adverse impacts of rising temperature and black carbons, triggering a rapid reduction in the density and coverage of snow and ice in the Himalayan region,

as well as the likely increase in the Glacial Lakes Outburst Floods (GLOFs). The Himalayan range including that of Nepal provides water, energy, food and ecosystem services not only to Nepal but to the vast plains of South Asia. Therefore, preserving the Himalayan ecosystem is a regional and global public good.

Environmental sustainability should guide all our activities. We should commit to an effective plan of action to reduce air pollution, manage waste, change unsustainable patterns of production and consumption, prevent soil erosion and landslides, avoid depletion of sources of water and unsustainable extraction of natural resources. Our unsustainable behaviours and disproportionate impacts of climate change on these natural resources have further aggravated the prospect of the sustainable livelihood of the people in Nepal. With the right trade-off, innovative incentive mechanisms and technologies, and supportive and coherent transitional arrangements, Nepal should intensify its mitigation and adaptation measures, protect the ecosystem and promote a green economy with stronger national leadership. Nepal should also lobby for more meaningful regional cooperation and stronger global support and solidarity. Sustainable and transformative graduation has to take these environmental considerations and sustainability issues into account.

### **6.3 Policy Coherence, Institutions and Good Governance**

Policy coherence, institutions and good governance play a significant role in ensuring sustainable graduation and structural transformation of the country.

One of the fundamental challenges in Nepal has been uncoordinated and incoherent sectoral policies without any consideration to the multiple layers of their impacts on other policies. As Nepal faces multiple vulnerabilities like mountainous terrain, low economic growth, high level of multidimensional poverty, together with tough geopolitical realities, and the situation of being land-locked, the structural transformation of its economy calls for coherent national policies for maximum positive impact and effective collective outcome. A high degree of coherence is required among macroeconomic policies and all other related economic policies. As we depend a lot on our imports, a fair balance between import policy, customs policy and industrial and export promotion policy would be required. Internal revenue policy should not undermine the productive capacity-building policy across the sectors and a long-term export promotion policy of the country. Our bilateral trade agreements and FDI policy have to be synchronized with our structural transformation objectives. Monetary and fiscal policies, exchange rate policies and sectoral policies have to be well-coordinated with each other and with the larger objective of structural transformation of the economy. This level of overall policy coherence and coordinated approach among all sectors relevant to structural transformation alone will ensure Nepal's sustainable graduation.

The second important issue is the institutional frameworks and limited capacity to effectively implement adopted policies and deliver results on the ground. There is a huge development literature, especially produced by new institutional economists, highlighting extensively the role and impacts of institutions on the development trajectory of a country. Looking at the institutional frameworks, we have to consider both the formal legal rules and informal social norms. We all know that it is their collective impact that often determines individual behaviour and social interactions. While one may debate about the scale of impact of institutions on economic development, no one can deny that they substantially affect all economies. Institutional bottlenecks including those related to accountability and effective and efficient implementation of programmes with strong monitoring of results and impacts would have to be looked at dispassionately and on a priority basis to accelerate our development process and ensure sustainable graduation. Therefore, consolidating favourable institutional frameworks will be important to promote economic growth, reduce poverty and ensure the sustainability of the progress in Nepal.

There is no need to stress here how important a role good governance plays in the effective delivery of services as well as the development outcome. Transparency, strong regulatory mechanisms, anti-corruption measures, accountability, efficient use of resources, a quick decision-making process, proper delegation of authority, non-politicization and professionalism of bureaucracy and clean political leadership are essential prerequisites to accelerating rapid progress and sustainable development in the country. While Nepal has moved up in the corruption perceptions index by 6 points in the last 8 years, it stands way below the overall index at 33. To what extent we effectively deal with these issues from the federal to the province and the local levels and from the political leadership to the bureaucratic level would determine the pace and scale of transformation in the years ahead.

## **6.4 Strong National Leadership and Multistakeholder Approach**

The graduation of Nepal from the status of LDCs is an important milestone in Nepal's development process. But this needs to be carried forward with a clarity of vision and commitment. That alone would help make our national economic structure transformative and sustainable. This calls for a united vision among the political leadership of the country, to begin with. We should agree on some core issues and policies to ensure smooth structural transformation in the country. Commitment to implement policies and programmes for structural transformation and productive capacity building, promote export capacity, ensure inclusive human development while building resilience and environmental sustainability and strengthen good governance, institution building and coherence among all relevant policies with strong national leadership would be all critical going forward confidently.

Similarly, strong ownership of the important objective of sustainable graduation and the pathways by the administrative leadership, the private sector and civil society will be equally crucial to ensure that all stakeholders will contribute to the larger objective of sustainable graduation. The private sector in particular and civil society has to be convinced that the long-term national transformation needs their enthusiastic support and contributions. After all, it is the private sector, which will have to be at the forefront of all economic activities and investments to ensure economic transformation in the country.

## **6.5 Bilateral/Regional Cooperation**

As stated in the earlier chapter, strengthening bilateral trade agreements, economic cooperation with cross border infrastructure facilities would be critical for Nepal's sustainable graduation. Furthermore, looking at Nepal's unrealized potential and further prospects of enhancing bilateral cooperation, our relationship with the two great emerging powers in the neighbourhood should be comprehensively reviewed, expanded and deepened in all the prospective areas in the context of our graduation as well as structural transformation. The new areas of cooperation from the energy and productive and export potential sectors to the participation in regional value chains with enhanced FDI and preferential market access in both the countries should be maintained or expanded to get due benefit from their ever-growing economic capacity and the global reach of their products and services.

Likewise, with all development partners, especially those which are currently our biggest partners like US, UK, Germany, EU, Japan, Switzerland, Norway and Finland and other prospective partners, we should start having detailed discussions on our transition strategy and the need for their comprehensive support. Such support should include official development assistance, FDI, preferential trade agreements, technology adaptation and overall political support during our negotiations at the international institutions such as the UN, World Bank, ADB, EIB, AIIB and other international forums.

Similarly, at the regional level, promotion of regional infrastructure networks and trade facilitation, participation in regional value chains and trading arrangements with preferences during the transition period and beyond graduation will have a huge impact on making our transition smooth and graduation meaningful and sustainable. Nepal's trade profile, FDI situation, the ODA, and the rising South-South cooperation in various social, productive and infrastructure projects and programmes call for such cooperation to be taken to the next level. Nepal, as a founding member of SAARC and member of other regional bodies such as BBIN and BIMSTEC, should work hard to make these bodies meaningful, beneficial and relevant to the country in the new context

of Nepal's graduation. These regional cooperation frameworks should be fully utilized to get due support from them in making our transition smooth, and graduation sustainable and transformative.

## 6.6 International Support Measures

All aspects of international support measures will have to be carefully assessed by Nepal in the coming years. Nepal should have a two-pronged international strategy to support its graduation strategy. **One is for the transition period and the other is for the post-graduation strategy.** During the transition period of five years, all the current international support measures being provided to the LDCs such as the ODA, Trade, FDI promotion, blended finance, technology, and technical cooperation should be fully utilized. This would help ensure that we will have a robust take-off and meaningful transition.

Nepal should call for an enhanced level of cooperation from its development partners to **recognize the special situation of Nepal** being graduated based only on HAI and EVI without meeting the income criterion. This is the first time that an LDC is graduating without meeting the income criteria. That means we have to go a long way towards enhancing our economic growth, national income and inclusive prosperity.

To ensure a smooth transition and a confident and sustainable take-off, Nepal should convince the development partners that they should provide an **enhanced level of support for Nepal in the allocation of the ODA** in the social sector as well as productive sectors and infrastructure during the transition period and beyond graduation. We should also engage with the multilateral financial institutions to call for more allocation of resources going to the just-graduated countries and also call for greater concessionality going forward. As the share of multilateral assistance is growing very fast and the loan component is therefore concurrently growing with the rising need for external resources to ensure a rapid, inclusive and sustainable economic growth, we should develop a good strategy to promote both access and concessionality at the global level. In a similar vein, as our bilateral loan component, especially with India, China, Japan and Korea is increasing, we should make sure that these investments go into the productive sector together with open and competitive project financing and construction arrangements. Efficient and timely completion of such projects should be ensured with strong national commitment and equally strong monitoring and implementation mechanisms with the partners.

Similarly, **to increase the share of export** in its international trade and to prepare better for a more competitive market in the international arena in the post-graduation period, more targeted support should be explored. Such support should contribute to

enhance export capacity within the country, promote Nepal's products in the developed country markets including through technical and other assistance for matchmaking with buyers from the developed country markets, enhance quality and other standards, and reduce burdensome provisions about the market access.

**For the International trade-related rules and flexibilities,** a detailed Nepal-specific study should be done on all agreements based on our accession commitments and other LDC-specific flexibilities. Similarly, working together with other graduating countries, LDCs and partners, we should start well-coordinated and deeper engagements for meaningful negotiations in the WTO. That should include rules, TRIPS, services negotiations, AOA, trade facilitation, Aid for Trade among others.

We should concentrate our efforts both on the facilities being provided during the transition period and beyond graduation.

For the post-graduation period, we should have an in-depth study of our possible challenges in each product. Similarly, negotiations on new trade agreements should start early on in order to protect and promote Nepal's trade prospects in the new situation. As these bilateral and regional trade negotiations take a long time to conclude, there is a need for initiating actions for preparation right now. Especially market access agreements with the EU for GSP++ agreement, with the US for more coverage of products and extension of the provision, with Japan for supportive provisions after graduation, with Switzerland, Norway, Canada and Australia for agreements similar to GSP++ provisions would be critical. Similarly, we should negotiate with India to facilitate the reduction of our huge trade deficit and promotion of export of our goods and energy to India, and further expansion of trade with Bangladesh via India. Similarly, investment promotion measures should be upgraded with India in the energy, infrastructure and productive sectors. A new generation of agreements should be also concluded with China to ensure better market access for our products, and for more investment in the productive sector and infrastructure with the possibility of creating a value chain. Similarly, BRI projects should be fully aligned with our long-term interest in structural transformation and sustainable development of our economy.

**FDI remains** at the lowest level in Nepal. Now that we are preparing for graduation, in the transition period, as called for by the international community, more targeted and supportive measures should be requested from the partners to encourage their investors to come to Nepal and also mitigate their initial risks by either providing guarantees or taking up their initial cost of DPR studies. Such promotional measures coupled with our own national FDI policy reforms, better incentives and efficient facilitation mechanisms could go a long way towards better preparation for graduation. Increasing our domestic investment capacity and promoting FDI in the productive sector needs to be considered as part of our long-term strategy as well

**Financing for development through debt** has also been going through a gradual change in Nepal. While the domestic resources have increased over the years including through domestic revenue reforms as well as remittances-driven economic activities, Government expenditure has also substantially increased, especially the recurrent expenditure. Development related work is still overwhelmingly dependent upon external finance and internal borrowing. While they remain relatively at a low level from the general standards for the developing countries, the debt to GDP ratio has been growing over the years. Therefore, Nepal should continue to ensure that the debt situation remains under control by enhancing its capability to invest more in productive sectors, finish projects in time with the least cost overruns, and negotiate better terms with the lenders. Therefore, clear advocacy for concessional loans should be promoted at bilateral, regional and global levels to keep the country away from the possible debt distress.

**Technology has always played** a very important role in modernization. Now with the revolutions in science and technology in the last decades, together with the development of ubiquitous technology, the fourth industrial revolution, AI and quantum technology, and rapid digitalization of the global economy further accelerated by the COVID-19 pandemic, Nepal should effectively implement the “Digital Nepal Framework 2019” with strong interlinkages with the productive sectors. Investment in digital infrastructure, digitalization of services and other productive sectors, development of highly skilled technology professionals and digital contents should receive a high priority. This will help speed up Nepal’s structural transformation and also lessen the adverse impact of it being landlocked. Therefore, more support and investment from the international community to fill up the digital gap and stronger international support to help Nepal get access to new technology should receive our priority attention.

For the period beyond graduation, **we should articulate better** from now on that Nepal’s vulnerability has not gone away after graduation, despite some progress in human development and reduction of absolute poverty. Nepal should therefore clearly articulate and stress at the global level that its geographic disadvantage of being a landlocked country with a high degree of multi-dimensional poverty and high and multiple vulnerabilities to climate change impacts and disasters risks and a volatile and vulnerable economic base should be taken into account while extending the ODA and providing concessions to Nepal.

The disproportionate **impacts of climate change** on the mountain people, melting of glaciers and the cascading impact on the lives and livelihood of the people downstream, the least contribution of Nepal to the carbon omission combined with the least capacity to adapt to the new environmental challenges should be well articulated at the global level for due recognition of Nepal’s challenges and the need

for a higher level of assistance and cooperation. Similarly, more support for the protection of the Himalayas should be promoted as a regional and global public good, as it provides direct benefits of water, energy, food and ecosystem services to over 500 million people downstream. As a custodian of these natural resources, Nepal should call for more international action on mitigation of carbon emission and also more support for adaptation to build resilience and protect its people from climate-change-induced disasters.

Similarly, Nepal should articulate at the global level that after a protracted internal conflict and equally long transitional period, the country has now come out of transition with a national consensus **on a new constitution that has a forward-looking approach** to the political, economic and social issues. Creating a just, fair and inclusive society with rapid and sustainable change in the lives of the people with equally inclusive and non-discriminatory society under a federal structure with a clear division of power have the great potential to support such a transformative change in the country. This post-conflict transition and a forward-looking approach of Nepal should be also highlighted for an enhanced level of support from the international community.

Finally, working together with **a coalition of graduating countries and also with development partners** across the whole spectrum of issues, and consistent advocacy at the regional and global levels would be very important for Nepal going forward. Nepal is one of the first LDCs to graduate without meeting the income criteria, and as such its development challenges are many. All our relevant Ministries and the diplomatic missions abroad should be provided with clear instructions to look for opportunities to engage the partners for an enhanced level of support for Nepal's graduation from the LDC status, with special emphasis on the countries which are or could be important development, trade and technology partners. Furthermore, the UN, WTO, International and Regional Financial Institutions such as the World Bank, IMF, ADB, AIIB, European Investment Bank and other bilateral development/financial institutions should be fully engaged to promote Nepal's graduation strategy with a special focus on structural transformation and the need for global support.

## CHAPTER SEVEN

### THE ROAD AHEAD AND RECOMMENDATIONS

Nepal should take it as a positive sign that it is scheduled to graduate from the LDC status after a five-year transition period. Graduation of Nepal from the LDC status comes with both challenges and opportunities.

Graduation is an important milestone; however, it is not a reflection of a fundamental change in the economic character of a country. It presents an evolution of the situation towards a more promising future. But graduation could be used to promote rapid, inclusive and sustainable development with a resilient economic base. Some graduated countries have utilized graduation to enhance their economic performance and increased Foreign Direct Investment together with a better credit rating and projection of a confident and rising economy.

With the development of the right transition strategy based on in-depth studies, effective and coherent implementation, strong national leadership with a multistakeholder approach, and robust international partnership, Nepal should be able to overcome its challenges and benefit from the opportunities. The transitional period of five years should be fully utilized to bring about a transformative change in the country with strong national leadership and robust support of the international community. The period should also help the country to move towards sustainable and meaningful graduation with structural transformation. A smooth transition is not automatic. It calls for a united, multisectoral, confident and forward-looking commitment while striking a fair balance between the short-term needs and the long-term transformation objectives.

In the globalized world of today, graduation of LDCs and poverty eradication, like protection of natural resources, are global public goods. They have a long-term positive impact on all. And, conversely, their continued marginalization and their divergence from the global trajectory of growth and prosperity will have adverse regional and global implications with the possibility of a rise in conflict, instability, volatility and migration. This also goes against the very foundation of the commitment of the international community to create a just, inclusive, peaceful, stable and prosperous global order. Reducing global poverty and inequality, promoting stable and fair international order, and meeting the internationally agreed development goals, including SDGs, have been agreed as our common global aspirations. As such, it calls for an enhanced level of comprehensive global solidarity and cooperation. And, the developed countries and countries in the South have also made commitments to extend support and cooperation to the LDCs in a spirit of mutual accountability. As LDCs

express their commitment to achieving those goals including graduation, Nepal should resolutely call for a robust and enhanced level of international partnership and a favourable international environment for its smooth and sustainable graduation.

Considering the political economy of Nepal and our geostrategic location, targeted diversification of our multifaceted relationships with all our partners in the neighbourhood and beyond should be considered across the board. This requires a forward-looking and prudent analysis of the current global and regional order to enhance Nepal's larger national interests. Therefore, graduation should also be taken as an opportunity to consolidate our national strength to be more resilient in the face of the changing power dynamics and deepen and diversify multidimensional relations with all our partners. It is only with strong national leadership and ownership at home and an enhanced level of partnership and solidarity at the regional and the global levels that Nepal can ensure a sustainable and transformative change in the country after graduation.

Nepal should consider taking the following steps at the national and international levels in a coordinated manner, as part of our preparation for meaningful and sustainable graduation.

## **7.1 National Level Actions**

Nepal should immediately **establish a High-level National Committee** involving the National Planning Commission, Office of the Prime Minister, and Ministries of Foreign Affairs, Finance, Industry, Commerce and Supplies, Labour, Employment and Social Security, and Agriculture and Livestock Development, Physical Infrastructure and Transportation, Energy, Water Resources and Irrigation, Communications and Information Technology, Education, Science and Technology, Forests and Environment and Federal Affairs and General Administration. This High-level Committee should also have a good representation of the private sector and experts from outside to ensure a multistakeholder representation and the broader national ownership. It should have a permanent unit, which will prepare a transition strategy, oversee its implementation, monitor and review periodically. The committee would develop a comprehensive national transition strategy. Even though no two countries or economies are similar, yet there are always lessons that can be learned with appropriate modifications. Therefore, in preparing such a national strategy, some of the key features of the changing patterns and structure of economic activities, and challenges and opportunities, especially of LDCs such as Cambodia, Laos, Bangladesh and Myanmar in particular, and also of some other developing countries like Malaysia, Thailand, Vietnam, etc. could be studied.

Graduation should help build a foundation for rapid, inclusive, resilient and sustainable development. That is possible only with the structural transformation of the Nepalese economy. To promote such structural transformation, the following should be studied and analyzed.

- a. **A coherent and comprehensive policy on structural transformation** with the productive capacity building would be prepared, which will look at the national endowments, sectoral analyses, comparative advantage, the current status of development in the context of the regional and global dynamics and prospective development. In particular, dynamic interrelationships with other sectoral policies should be examined. Key drivers of structural transformation will be identified in line with the graduation objective, the national plan, as well as SDGs.
- b. **Infrastructure development policies** and the current infrastructure status especially in the areas of road and air transport but also energy and ICT infrastructure should be reviewed in terms of its overall impact on the transformation of the economy. More specifically investment requirements, modality of investment, sustainability, equitable access to infrastructure and its linkages with other economic sectors as well as in the context of enhancing regional infrastructure networks with the neighbouring countries should be analyzed in detail to promote it in a coordinated manner.
- c. For **promoting inclusive human development**, education at all levels, technical skills, professional development, employability, entrepreneurship and absorption by the productive sectors and the participation of the bottom quintile and marginalized in jobs, should be analysed to promote human development inclusively and holistically. Labour migration patterns and their challenges and opportunities should be considered including the protection of the rights of migrants, development of entrepreneurship of the returnees and investment in the productive sector. A medium-term plan to fully utilize the labour force within the country also needs to be prepared. To reduce vulnerability to man-made and natural disasters, a comprehensive plan should be prepared and synchronized with the structural transformation of the economy, while giving due emphasis to building better resilience and sustainable livelihood of the people.
- d. **To promote policy coherence**, there should be a study of the current policies related to export, import, fiscal, monetary, exchange rate, industrial, agriculture, ICT, infrastructure and education sectors and their interrelationships to ensure that they support each other and contribute to transforming the structure of the economy after graduation.
- e. Similarly, **institutional and good governance-related issues** should be analyzed to further strengthen them to ensure effective delivery of services by the Government and implementation of the policies, programmes and projects. The

Governments in LDCs are not only providing security, delivering public services, and making fair rules and regulations to allow economic activities to thrive. They are also big investors in infrastructure and other areas, and propel economic activities through incentive mechanisms and also play a leading role in promoting inclusive and sustainable development. Therefore, institutions and governance including those related to the implementation of priority projects have a big role to play in the transformation of the economy and society as a whole to make graduation meaningful.

- f. The devastating **impacts of COVID-19** have not only triggered a health crisis in Nepal, it has also caused unprecedented economic, social and equity-related challenges here. As we pass through the ravaging second wave of the pandemic, there is a clear need for a detailed and multi-sectoral analysis of the impacts of the pandemic on the livelihood of the people, equity and the national economy. This should include a comprehensive study of the possible further waves and their far-reaching impacts. Furthermore, COVID-19 is likely to have a medium-term impact at the regional and global levels, including implications on supply of and access to vaccines, medicines and medical equipment, supply chain disruptions, the rise of protectionist policies and challenges of enhancing global solidarity and cooperation. We should study how that would impact Nepal's overall progress towards graduation and how an enhanced regional and international cooperation could be ensured in support of Nepal's national efforts to overcome these pandemic-related challenges affecting health, livelihoods and multiple sectors.

## 7.2 International Support Measures

On the issues related to strengthening international support measures during the transition period and beyond graduation, the following should be studied in detail.

### 7.2.1 ODA

- a. A detailed analysis of Nepal's development cooperation partnership would be useful. The breakdown of the level of involvement of the key bilateral development partners in the last few years, their approach towards development cooperation, level of commitment, sectoral priorities, alignment with the national priorities, their projection for the next few years, their focus countries and their priority areas need to be fully studied. This will help us articulate our advocacy efforts better with the bilateral development partners. The changing status of Nepal may not immediately affect bilateral development cooperation, but a higher level of allocation and better alignment with our priority sectors would be critical going forward.
- b. Similarly, regarding the multilateral partnership, the evolving nature of their

engagements, rising proportion of loan and the nature of concessionality, because of our lower-middle-income status, and their projections for the next few years should be closely examined. Furthermore, our environmentally fragile situation, the land-locked status and incidence of multi-dimensional poverty should be articulated to get due priority in receiving greater support and better concessionality in the days ahead.

- c. We should also carry out a full analysis of our bilateral loans and possible access to such loans with greater concessionality in the coming years so that we can fully mobilize them to the productive or infrastructure sectors without making them too burdensome. The growing size of debt should be kept in mind, as we look at the debt servicing and total stock of debt for the coming decade.
- d. For programmes or projects being operated with the support of the development partners as well as those with the government expenditure, we should reevaluate the entirety of the projects and programmes based on their merits, benefits and priorities and complete them in time with the stipulated budget. Cost overruns and delay in the completion of projects have not only increased our expenses or the burden, but they are also likely to have negative impacts on our access to funding from abroad for national development projects and programmes. It will have a bad reflection on us, which might negatively affect our preferential access to external finance in future. Timely completion and effective management of projects and programmes on the other hand would enhance our capacity to get more resource from these institutions.

### **7.2.2 International Trade**

- a. In order to better prepare ourselves to negotiate a favourable deal for Nepal on market access with preferences at the bilateral and regional levels, we should have a thorough study on our overall trade performance, current market status of the existing export products, development of new products and the likely impact on their exports in various markets in the post-graduation period. It is only with this type of full information and the analysis of the future prospects that we can ask for a favourable trade deal with the trading partners. This will be crucial.
- b. A separate and detailed analysis should be done for the current and prospective key trading partners, together with their preferential arrangements for promoting and diversifying our export markets.
- c. We should also prepare a new NTIS study to replace the current NTIS of 2016 to better reflect the changing trends, preferences and capacity of the country and market access possibilities in the post-graduation period, in order to enhance our export performance of the key products.
- d. A systematic study should be carried out on the impacts of graduation on the enjoyment of flexibilities and exemptions by Nepal within the WTO framework.

### 7.2.3 FDI, Technology and Remittances

- a. Nepal has been receiving very little FDI, despite some FDI related policy and institutional reforms. We should review the full dimension of FDI in Nepal from legal, institutional, financial, infrastructural, coordination related and implementational aspects critically and dispassionately. Compared to even other LDCs like Cambodia, Bangladesh and Myanmar, FDI in Nepal is minuscule, hovering around tens of millions of dollars per year. Getting a credit rating and the growing size of GDP and disposable income may attract more FDI, but the national policy and overall enabling environment would be critical.
- b. Similarly, a special focus on bringing new technology through FDI or other partnerships should remain a priority. Therefore, we should study how best and in what areas, transformative technologies could be specifically encouraged. Priority should be given to the adoption of new technology and innovation to get due benefit from the global markets. Creating a necessary environment in the legal, technical, human and institutional areas and collaboration with the private sector and academia should be comprehensively analyzed.
- c. Similarly, remittances remain the most important source of foreign exchange, employment and the national economy at the time. A comprehensive plan should be prepared to enhance the productive use of remittances as well as a medium-term plan to ensure employment to most of the youth within the country.

### 7.3 Advocacy at the International Level

- a. Close **monitoring of global developments and coalition-building** with the graduating LDCs, where appropriate, would be critical to developing a position on major issues of importance to us, in particular, for the development of favourable international norms as well as for ODA related issues. Similarly, close monitoring, lobbying and coalition building should be promoted to strongly advocate for the trade interests, flexibilities and exemptions of the graduating countries at the WTO processes including the Ministerial meetings. This requires a constant engagement of our mission to the WTO and follow up from the capital.
- b. Similarly, **developments in major trading partner countries** on issues related to trade preferences and concessions should be monitored to ensure a better deal for Nepal.
- c. Likewise, on **FDI and technological issues as well**, we should look at the possible global norms or facilitation, which could help us do better in attracting them in Nepal.
- d. There should be **regular and consistent dialogue with all our bilateral and multilateral partners** at all levels so that they remain fully aware of our articulation

and also extend the necessary support for our efforts for smooth graduation from the LDC status and beyond.

- e. The Foreign Ministry and its diplomatic missions abroad and the Finance Ministry should have a **regular mechanism of close communication** with the proposed High-Level Committee to effectively oversee the transition to graduation.
- f. Some of the **key development partners and the neighbouring countries** should be particularly lobbied in favour of our positions and expectations. Their continuous and consistent support bilaterally and also at the international level would be crucial to create favourable norms and possible concessions after graduation.
- g. The **UN LDC V conference is taking place in Doha, Qatar** in January 2022. Preparatory processes have begun in New York. Various events are being organized in different capitals by different multilateral organizations. **Nepal should actively take part and voice its position strongly on both fronts; (1) to ensure better transitional arrangements, and (2) to call for specific supportive post-graduation measures with a dedicated mechanism or facility.** On trade, investment, technology and IP related issues and WTO related rules and flexibilities, our diplomatic mission in Geneva and for overall political negotiations on targeted global support and norms, our diplomatic mission in New York have to play a proactive role in the next few years. Therefore, strong backup support with clear and coordinated analysis should be provided to them, and intensive two-way communications should be maintained with them to ensure that our issues get properly reflected in the global platforms. Similarly, we should also effectively and constantly engage our embassies in key capitals to advocate for positive support from these countries in bilateral as well as multilateral negotiations.
- h. **With the Multilateral and regional financial institutions**, we should have specific and targeted discussions on how best they can help support a smooth transition and sustainable graduation. Even though they do not officially recognize the category of LDC as such, they should be made fully cognizant of the implications of our graduation from the LDC status. Therefore, they should be kept on board with intensive discussions on and articulation of our positions and expectations.
- i. Finally, **regular dialogue should be held with the local development partners including the UN institutions** in the country to interact with them on the status of our preparation and expectation of their strong support for a smooth transition and specific support beyond graduation. The nature of UN involvement in Nepal after graduation, their funding modality as well as focus areas are most likely to change. Therefore, preparation in advance for the evolution of their role in Nepal's development efforts in the post-graduation phase will be very important.

## **7.4 Recommendations for the PRI**

Graduation from the LDC status is going to be an important milestone for Nepal. We should use this as an opportunity to bring about a transformative change in Nepal and also take our international engagements to a new height. Conversely, if graduation is not prepared well in a coherent manner, it could also have some repercussions resulting in adverse impacts on our overall development aspirations. Therefore, this deserves a high priority at the national level.

As PRI is a think tank of the Government of Nepal for policy research, it could conduct researches and comprehensive studies on the issues related to graduation from the LDC category. In particular, there should be a holistic and strategic analysis of the current status of the economic situation with a special focus on structural transformation across sectors like agriculture, industry and services, human development, resilience and sustainability. Furthermore, a cross-cutting analysis of all relevant sectoral policies and macroeconomic policies would be very useful to suggest informed and pragmatic policy options to the Government.

Such comprehensive studies should also scan the horizon of the international landscape in the context of Nepal's graduation and suggest an international strategy to promote Nepal's larger national interests in the context of graduation while giving due emphasis to articulation, advocacy and coalition building at the bilateral, regional and global levels.

Since the biggest impact would be on trade-related issues, a comprehensive study should dispassionately analyse the possible implications of graduation on our international trade and suggest a pathway for maximizing Nepal's trade prospects in the international market with a specific focus on exportable products and services as well as markets. Similarly, it should also make a forward-looking assessment of the external sources of development finance and international cooperation and consider a possible strategy to maximise concessionality, ensure greater access to and diversification of foreign assistance and enhance the inflow of Foreign Direct Investment in the next few years. PRI can coordinate such studies.

In order to ensure pragmatism and prepare a workable yet visionary strategy, the PRI serving as an interface of knowledge and public policy formulation should organize brainstorming sessions among the political leadership, policymakers, private sector, experts, and the academia to enhance better understanding of the interrelated issues and ensure a multistakeholder approach. The Institute could provide an important forum to bring all the diverse views and also to ensure dispassionate and critical analysis of the current situation to find integrated and coordinated perspectives on the way

forward. It can better synthesize the academic and practical viewpoints in its conclusions.

Such a report prepared holistically with multistakeholder participation could provide a strong input for the Government to prepare its strategy. After the finalization of the transition and graduation strategy by the Government, the Institute can also help develop benchmarks for effective monitoring and help organize discussions and review sessions, as appropriate. This will be an important contribution to the Government agencies to critically assess the implementation with open and comprehensive deliberations.

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## Mr. Gyan Chandra Acharya

Mr. Gyan Chandra Acharya, who joined Nepal's foreign service in 1983, has three decades of experience in the diplomatic service of Nepal. During his long career, he was involved in the articulation and promotion of bilateral, regional and global issues. He has served as Nepal's Foreign Secretary (2007-2009), as Ambassador and Permanent Representative to the United Nations and the World Trade Organization in Geneva (2003-2007), as Spokesman of the Foreign Ministry (1999-2002) and as Joint Secretary (Director-General) responsible for South Asia, Europe and the Americas and Regional Organizations, Economic Relations and Coordination Divisions (1998-2003).



As Permanent Representative of Nepal to the United Nations in New York between 2009 and 2012, Mr. Acharya chaired the LDC Global Coordination Bureau for over two years and was a member of the LLDC Global Bureau.

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PRI is a think tank of the Government of Nepal established on 14 November 2018 in accordance with the Policy Research Institute Board (Formation) Ordinance with a vision to contribute to effective and responsive public policy for national prosperity. PRI's mission is to establish itself as a credible institution that offers informed public policy and its goal is to generate reliable, evidence-based and transformative knowledge for public policy. Its seven core values – quality, objectivity, integrity, diversity, transparency, accountability and engagement – define its workings.

PRI carries out policy research on all issues and sectors of public policy concerns – through five thematic clusters and 16 subclusters – and recommends to the Government of Nepal what reforms it has to undertake in each of these policy areas. All researches are conducted in accordance with PRI's public policy research process and standard, which form part of a broad policy cycle.

Knowledge management is an important component of PRI. It operates a public policy dialogue forum as a regular mechanism for learning, sharing and debating policy issues. In PRI's belief, public policy formation requires the combination of three types of knowledge: (a) scientific knowledge generated through research and analysis, (b) administrative knowledge gathered through bureaucratic experiences and (c) societal knowledge developed through social and political processes, such as political debates, media advocacy as well as people's experiences.

