PERMANENT REPRESENTATIVE OF NEPAL
TO THE UNITED NATIONS
NEW YORK

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01 March 2018

Dear Mr. Mollerus,

I have the honour to refer to your letter of 8 February 2018 informing that according to Economic and Social Council (ECOSOC) resolution 2007/33, the Government of Nepal may, if it so wishes, also submit a written statement to the Committee for Development Policy (CDP) plenary further reinforcing its views and perceptions about the possibility of graduation from the least developed country category expressed by its delegation during the meeting with an expert group of the CDP in New York on 1-2 February 2018.

I have the further honour to submit herewith, on instruction, a written statement of the Government of Nepal in the form of its additional submission, for distribution to the CDP members ahead of its plenary meeting to be held in New York from 12 to 16 March 2018.

While conveying to you and, through you, to the expert group members of the CDP, our sincere thanks for seeking to understand the case of Nepal more fully, I also take this opportunity to express the confidence of the Government of Nepal that the esteemed members of the CDP will evaluate Nepal's unique case for graduation from the LDC status on the basis of its submission so as to ensure that the graduation is smooth and truly sustainable.

Should you need any further clarification or information from the CDP's side, please contact my colleague Mr. Lok Bahadur Chhetri (cell no.: 917 900 7880 and email: lokbpc@mofa.gov.np).

I thank you for your continued understanding and cooperation.

(Durga Prasad Bhattarai)
Ambassador

Mr. Roland Mollerus
Secretary
Committee for Development Policy
United Nations
New York

# Additional Submission of Government of Nepal to the ECOSOC Committee for Development Policy on LDC Graduation

## March 2018

1. The Government of Nepal recalls the interactive dialogue that its delegation had with the distinguished experts of the CDP on February 1, 2018. The views presented by the Nepali delegation during that meeting continues to be the official position of Nepal. Nepal wishes to thank the CDP and UNDESA for providing the opportunity to submit additional information and to reinforce its views expressed during the expert group meeting. For the reason that Nepali delegation outlined during the expert group meeting and for the following additional information, scenario of Nepal's graduation at this stage requires deferral.

2. Nepal has taken the process of potential graduation with utmost seriousness and had engaged in a broad analytical and consultative process for over seven years. The LDC graduation was paired with a more ambitious target of becoming a middle-income country by 2030 from the beginning of the current 14th (three-year) periodic plan. In March 2015, CDP review identified that Nepal had crossed two of the three thresholds for graduation, i.e. related to human assets and economic vulnerability indices. The performance was however inadequate in terms of GNI per capita that stood close to the half of the designated threshold. Even in the EVI and HAI, Nepal's progress was marginally above the border line of the threshold signifying potential relapse even by minor shocks. In the meantime, the catastrophic earthquakes of April 2015 and the natural calamities of various kinds, like flash floods and landslides occurred thereafter in many parts of the country and pushed the situation of economic vulnerability further down and risked human assets index to plummet. In particular, the devastating impact of the 2015 earthquakes and the 2017 floods need to be adequately taken into account in assessing the statistical criteria for 2018.

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3. While the calculation of Nepal's statistical criteria for 2018 may not differ from that of 2015, the country context has deteriorated significantly after the 2015 earthquakes. The derailment of the economy is not adequately captured as the statistical indicators average trends over a 20-year period. A major recovery effort is underway and will continue through 2020. Until the economy is repositioned on the underlying growth path, the statistical fit would diverge from the reality on the ground. The vulnerability assessment by UNCTAD states that: *"Nepal is economically much more vulnerable than it appears to be on the methodological and statistical grounds the United Nations presently leans on."* [1] It is important that the statistical criteria are appropriately assessed in light of the adverse effects of the 2015 earthquakes and border blockade, and the 2017 floods.

**Table 1. Adverse Effects of Earthquake Relevant to Graduation Criteria**

| **Human assets (HVI)** | **Adverse effects** |
|---|---|
| Health index | Earthquake damage of water, health and sanitation infrastructure in April 2015. In November 2015, UNICEF warned that more than three million children under the age of five were at risk of death or disease due to the acute shortage of fuel, food, medicines and vaccines due to the blockade of the border with India. |
| Education index | Earthquake destruction of education infrastructure, including 19,000 classrooms. UNESCO data show a decline in the net secondary school enrolment ratio in 2016 to 54.4%, which is below the level reached in 2011 (54.7%). The gross ratio rose, reflecting students repeating levels due to missed classes.<br>See: http://uis.unesco.org/country/np. |
| **Economic vulnerability (EVI)** | **Adverse effects** |
| Natural shock index | A third of the population was victim of the 2015 earthquakes. In 2017, the damage from floods and landslides is estimated at 1.4% of GDP. |
| | Agricultural production in 2017 impacted by severe flooding damage to paddy plantation and other major crops. |
| Trade shock index | Tourism impacted by earthquake damage to monuments and infrastructure. |

Source: Graduation of Nepal from LDC Status, Strategic Options, NPC, 2017.

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1 UNCTAD (2017). "Vulnerability Profile of Nepal," United Nations Conference on Trade and Development, Geneva, DRAFT—22 November 2017.

4. Two additional caveats on the economic vulnerability criteria deserve mention in passing. First, remoteness is a difficulty for landlocked countries and particularly for Nepal, where transport links are few and involve delays and costs at border crossings. The criteria measure distance to world markets and adjust for transit difficulty. However, the distance measure should exclude regional markets, which are a default destination for unreachable world markets. As Nepal's major trade is in the sub-regional market, the remoteness calculation for its global trade is underestimated. Thus, under existing methods, Nepal is found to be physically less distant from world markets than, say, Bangladesh. Second, environment is a concern of low-lying coastal zones and also fragile mountain areas at risk to climate change. The severe flooding and landslides experienced in Nepal in 2017 are environmental events, which under existing methods would not show in the calculation of the environment sub index. Thus, a more judicious view of remoteness and environment is desirable in assessing the economic vulnerability indicator.

5. Though UNDESA ex ante assessment predicts that Nepal's gain and losses after graduation from LDC status 'are not likely to be seismic in scale'. However, given overall scenario of the economic and social performance as well as the unique sets of vulnerabilities that the country is exposed to preclude definitive conclusion. This judgment is based on Nepal's existing pattern of trade and aid flows. On trade, there will be loss of market when tariffs increase, for landlocked Nepal is not a competitive economy. A gradual loss of concessional market access it currently enjoys in the world's largest economies will aggravate the merchandise trade deficit whose size already exceeds one third of national output. The ratio of trade deficit to GDP was 35.28% in 2016/17. The export-import ratio remained at 13.04% with export to GDP ratio reduced to mere 2.81% whereas import to GDP ratio jumped to 38.09% in the same year. Export grew on average of only 4.79% in the last 10 years. However, import grew by an average of 32.47% in the same period, which for a country like Nepal is indicative of an unsustainable trend.

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6. At the WTO, LDCs enjoy special and differential treatment (SDT), which provides a degree of flexibility in conforming to the obligations under its trade regime. This includes transition periods, preferential rules of origin, exemptions on agricultural subsidies, and safeguards in dispute settlement. However, during the WTO accession negotiations, Nepal committed to full implementation of most of the WTO instruments (i.e., Trade-related Intellectual Property Measures, Sanitary and Phytosanitary Standards, Technical Barriers to Trade and Customs Valuation) and agreed to reduce agricultural and industrial tariffs; liberalize the services sector; and completely phase out other duties and charges. Nepal also pledged not to allow export subsidies on agriculture; not to introduce new trade-related investment measures and allow zero tariff on information technology products. This level of commitments demanded more dynamic and competitive export sector which Nepal basically failed to create even after it joined the WTO requiring continuity of LDC specific concessions and DFQF measures to support its limited export base.

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**Table 2: Trade Preferences for Nepal**

| Importer | Trade regimes before graduation | Coverage | Effective dates of latest renewal | Trade regimes after graduation | Smooth transition |
|---|---|---|---|---|---|
| Bangladesh | SAFTA-LDC | All except 1,259 tariff lines | 1/1/2006- | SAFTA (all except 1,254 tariff lines) | Unclear. The former LDC Maldives still eligible for LDC treatment due to a special provision. |
| Canada | LDCT | 7,181 tariff lines (99%) | 26/6/2013-31/12/2024 | GPT (5,969 tariff lines) or MFN | No explicit smooth transition provision. Cabo Verde and Samoa LDCT as of 1/1/2017. Maldives LDCT until 2014, and MFN since 2015. |
| China | DFT-LDC | 8,047 tariff lines | 1/1/2015- | MFN | No explicit smooth transition provision. Maldives DFQF on Yemen 6 Scheme (2011-2012). Samoa DFT-LDC as of 2016 |
| EU | EBA | 6,964 tariff lines (99%) | 25/10/2012- | GSP (6,179 tariff lines), GSP+ (6,238 tariff lines), or MFN | At least 3 years for EBA. Cabo Verde EBA (2007-2012), and GSP+ (2012-). Maldives EBA (2011-2013), and GSP (2014). Samoa to be removed from EBA in 2019. |
| India | Indo-Nepal Treaty of Trade | All tariff lines | 10/2009- | Indo-Nepal Treaty of Trade | Not applicable |
| Japan | GSP-LDC | 9,068 tariff lines | 1/4/2011-31/3/2021 | GSP (3,559 tariff lines) or MFN | No smooth transition provision. Cabo Verde, Maldives and Samoa have access to GSP as of 4/2017. |
| Turkey | GSP-LDC | | 1/1/2012- | GSP or MFN | No explicit smooth transition provision. Maldives MFN. Cabo Verde and Samoa GSP as of 2017. |
| United States | GSP-LDC, TFN | 5,000 tariff lines | 29/1/2015-31/12/2017 | GSP (3,500 tariff lines), TFN (66 tariff lines), or MFN | No explicit smooth transition provision. |

Source: Ex-ante Impact Assessment of Likely Consequences of Graduation of Nepal from LDC Category, UNDESA, 2017.

7. The figures in the Table 2 show a high reduction of tariff lines for Nepal upon its graduation. In most cases smooth transition is elusive to the graduating country. In the EU, the reduction of the GSP tariff lines is provided with a 3 years of transition period for EBA, in case of Japan, however, GSP-LDC tariff lines go down from 9,068 to a mere 3,559 without a grace period for smooth transition. With Canada alone, 1212 tariff lines are lost upon the possible graduation of Nepal. Major export items of Nepal like woollen rugs/carpets and apparels go to the US, Germany and other EU market. Almost 87% of Nepal's export currently goes to the countries that provide duty free access. For an economy characterized by lack of innovation, low production, low productivity,



Government of Nepal National Planning Commission Secretariat Singh Durbar, Kathmandu limited application of technology, and lack of packaging and marketing, loss of duty free market will have a toll on limited exports that it currently enjoys.

8. In overall, Nepal is not ready to graduate meaningfully, smoothly, sustainably and irreversibly at this stage. It is on these substantive grounds, and not technical criteria per se, that Nepal lags behind to attempt for graduation at present.

9. The Economic Vulnerability Index (EVI) takes into account "population size, remoteness, merchandise export concentration, share of agriculture, forestry and fisheries in GDP, homelessness owing to natural disasters, instability of agricultural production, and instability of exports of goods and services, the share of population living in low elevated coastal zone". Not all of these criterion capture the atypical vulnerabilities of Nepal.

10. The share of agriculture stands at 33% of the GDP in 2016 that too is suffered from lack of innovation, low productivity, non-use of technology and limited to subsistence farming. The epic disasters that Nepal suffered between 2015- 2017 bring telling story of vulnerability of earthquakes, massive landslides and avalanches, and floods in Nepal. Total number of victims in the year 2015 owing to the earthquakes were 5,642,186 and 20,574 in 2016.

11. The progress was disrupted with the devastating earthquakes that struck Nepal in April-May 2015. A third of the population was impacted and 3 percent were pushed under the poverty line with the loss of 8,790 lives. Half a million homes and 19,000 classrooms were destroyed, and there was widespread disruption of water, sanitation and health facilities. A total loss of US$ 7,065 million was incurred by the earthquake. Tourism was impacted by earthquake damage to monuments and infrastructure. Overall, economic growth fell by half in 2015 and was 0.01 percent in 2016. Similarly, the southern part of the country was affected by flood in August 2017. A total damage of US$ 584.7 million was incurred by this calamity including severe impact on livestock, agricultural production and irrigation. Along with that, the crippling economic

disruptions as a result of a border blockade from September 2015 to February 2016, are also a reminder of the recurring nature of different forms of vulnerability of Nepal to external shocks which are not adequately captured by the Economic Vulnerability Index (EVI).

12. The Human Assets Index (HAI), reflects "first generation" achievements in enrolment, literacy, undernourishment and mortality, and does not reflect the crisis of quality in public services in Nepal. Both the human assets and economic vulnerability indices, therefore, provide an imperfect fit to the country situation of Nepal.

13. There are a lot of challenges in the EVI criterion. Agriculture sector, which contributes about one third in GDP, is not commercialized and is still based on subsistence farming. Investment in infrastructure has been consistently inadequate. The landlockedness of Nepal has underplayed EVI components. In addition to this, loss of foreign grants, development aid and concessions in trade will increase the economic vulnerability. As current EVI are pre-disaster estimates, due considerations should be given to account the damages and losses incurred and huge finance required for reconstruction and rehabilitation from natural disasters.

14. The UNCTAD's report on Vulnerability Profile of Nepal poignantly captures the economic vulnerability of Nepal. It states, *"the intrinsic economic vulnerability of Nepal is significantly underplayed because of the inadequacy to the case of Nepal of half of the components of the Economic Vulnerability Index. Nepal is economically much more vulnerable than it appears to be on the methodological and statistical grounds the United Nations presently leans on."* In addition, this report shows the imbalance in Nepal's achievements across the three indices.

First, while eight of the 14 indicators appear to be satisfactory, five of them constitute the Human Assets Index (HAI).

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Second, the gross national income (GNI) per capita is not only low, but it also does not reflect a worrying process of *atypical* structural transformation ongoing in Nepal, where people are moving out of agriculture, but are not being absorbed into higher productivity industrial and service activities.

Third, the EVI appears to be truly deficient in accounting for Nepal's difficulties, with four of the eight components underplaying the structural disadvantage of landlockedness. Indeed, in its future work, we request CDP to revise the EVI to make it more representative of the kind of structural vulnerabilities that countries like Nepal endure.

15. More worrying is Nepal's drawn-out economic stagnation, going back decades. It is only beginning to come out of a twenty-year period marked by the armed conflict (1996-2006) followed by a protracted transition (2006-2017). Nepal remains one of the poorest countries in the world, with a per capita income well below the average income of LDC peers. The dependence on remittances, relative to the size of the economy, is the highest in the world for a populous country. In this respect, we note the observation cited in the DESA report that: "Nepal is unlikely to be on a sustained growth path and able to generate enough resources for development immediately after graduation". If Nepal cannot continue to be in a sustained growth path, the impending risk of sliding back appears imminent for a country that is being considered for graduation with bare minimal achievement in HAI and EVI and close to two third performance in income criteria. None of the country has been considered for graduation under such a weaker performance in all three indicators.

16. Nepal at present encounters several challenges to meet the most important criteria of graduation i.e. income. GDP growth remained about 4.18% in the last decade ranging from 0.01% (2015/16) to 6.94% (2016/17). The ratio of Gross Domestic Saving to GDP was 10.3% whereas Gross National Saving to GDP was 43.8% in 2016/17. Income level cannot be raised significantly with the prevailing pace of investment and productivity growth. It demands of stimulating higher domestic savings, mobilizing foreign sources of financing and enhancing investment in productive sector.



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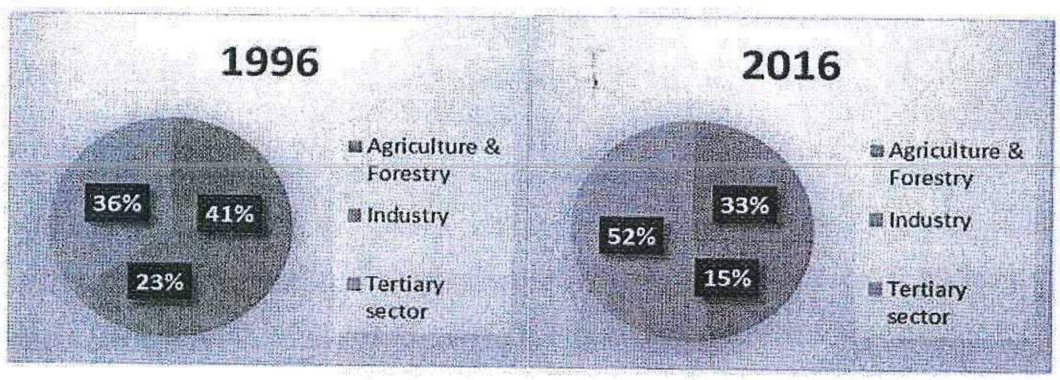
17. Nepal's current GNI is largely contributed by remittances—the ratio of remittances to GDP was 29.6% in 2015/16 and 26.8% in 2016/17, a trend of net decline. It is vulnerable to external shocks beyond Nepal's control and its fluctuations cannot be predicted. As some of the major labour destination in the GCC countries are reaching saturation, and experiencing economic slowdown due to constant decrease in oil price and lack of investment capital, the imminent fallout will be on the labour market. Similarly, Nepal mostly sends unskilled workers, the labour demand and migration as well as labour policy of country of destination plays a crucial role on which Nepal has little control. This can be observed in the economy in the declining growth of remittance in recent years. The remittance grew on average by 20.6% per annum in last 10 years while only by 7.7% in 2015/16 and 4.6% in 2016/17. This represents a worrisome trend.

18. A glance to Nepal's economic structure over the years reflects a typical scenario with low contribution of manufacturing sector in GDP. In the year 1996, agriculture and forestry contributed 41%, industry contributed 23%, and the service sector contributed 36% in the GDP. After 20 years, the structure of GDP has substantially changed and contribution of service sector surged to 52% whereas industry sector declined to mere 15% and agriculture and forestry to 33% in 2016.

**Graph 1: Composition of GDP by economic sectors, 1996 and 2016**




Source: Vulnerability Profile of Nepal, UNCTAD, 2017.

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19. It is noteworthy that the countries that went through the graduation process had all met the income criteria. Nepal would be the first country being considered for graduation from much below the income threshold. Two other criterion that Nepal is considered to have met too stand close to the borderline signifying likely reversal even by a small shock. It is also striking that the countries currently eligible for graduation are already middle-income and have met the income threshold substantially higher than the threshold level.

20. As LDC status confers benefits, giving these up necessarily entails costs. LDCs enjoy more than 136 international support measures, and additional commitments of partnership with foundations and private sector, mainly in trade and development assistance. Nepal draws benefits from these measures, and also from others that are available to developing countries generally. It is therefore important to fully avail of the LDC-specific measures and to line up replacements in the transition period to graduation. The benefits would be short-lived if the country's risk profile, borrowing record and business environment does not measure up to expectations.

21. In development aid, Nepal's concessional lending from multilateral agencies is presumed not to suffer much. However, linkages of impact of other major sources of international development cooperation, such as the Kuwait Fund, KFW, Saudi Fund and so forth are yet to be established. The United Nations and bilateral development partners' role in the development process of Nepal is critical. Impact on their cooperation is yet to be properly assessed. Nepal would be deprived of LDC-targeted funds in the area of climate change in the future.

22. Restrictions on the availability of other forms of development assistance, such as travel aid, sponsorships, and LDC specific assistance will seriously constrain opportunities for official representation at crucial international forums, and learning and capacity building of national institutions as well as young citizens and civil society. Nepal will feel the brunt of giving up several LDC-specific concessions, and will likely

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be under stress to manage the economic transition well at a time when there exist competing political priorities, such as the implementation of a new federal constitution.

23. In Nepal, the share of official development assistance (ODA) in gross national income (GNI) declined by half between 1994 and 2004, and further declined to 4.4% of GNI in 2014. Nevertheless, Nepal received as much resources from external aid ($880 million in 2014) as it earned from merchandise exports ($901 million). During the last 10 years, the average revenue to GDP ratio was 17.27% and expenditure to GDP ratio was 23.43%. The foreign aid was 3.61% of GDP in 2016/17. In recent years, the public expenditure on development has increased significantly, among others, due to reconstruction after the disasters, implementation of federal structure, and targeted commitment to the sustainable development goals (SDGs). As such Nepal will need more focused assistance in effecting a smooth and sustainable transition. Graduation will have an impact on the amount Nepal receives as external aid.

24. The United Nations Development Assistance Framework (UNDAF) was budgeted at $685 million for the five-year period of 2013-2017, of which less than half was delivered by the UN Country Team due to a shortfall in funding and by the necessary shift of attention by UN agencies to earthquake response. The United Nations gives priority to countries with special challenges, including LDCs, landlocked developing countries, and countries adversely affected by disasters. Similarly, the United Nations Development Assistance Framework (UNDAF) for the next five-year period of 2018-2022 has been budgeted at $643 million.

25. Nepal also benefits from the United Nations Capital Development Fund (UNCDF). Projects involve district-level support (capital and technical assistance) to financial services providers serving agriculture, energy enterprises, and local governments rebuilding after natural disasters. The projects promote financial inclusion. Nepal receives negligible foreign direct investment (less than 1 Percent of GDP) and could benefit from the newly launched Investment Support Programme for LDCs.

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26. The preconditions for sound graduation are eligibility and timing. Statistical thresholds confer eligibility but timing is set by the country situation. It is encouraging that Nepal has met the criteria for pre-eligibility. It would be only prudent that the transition to graduation is timed to commence after the efforts underway to recover from the 2015 earthquakes are completed in 2020. It would conform to past graduation practices.

27. A more positive development in Nepal is the imminent conclusion of the long democratic transition. In September 2015, we adopted a new constitution that establishes a federal structure to uphold inclusive and participatory decision-making at federal, provincial and local levels. Through 2017, Nepal conducted, over five phases, a series of elections for local, provincial and federal parliaments and governments. Ensuring the successful completion of the democratic transition and the establishment of a functioning federal system of governance is the overriding concern of the Government. Political stability might finally pave the way for economic momentum and provide impetus to augmented growth in average per capita incomes. However, restructuring a 250-year old unitary state into a federal union poses a daunting combination of fiscal, administrative and legal challenges. This is an unexplored territory for Nepal, which will consume full political capital of the state in the immediate future.

28. It would be prudent for the transition to graduation to commence once the economic recovery and political revival are well underway. A more gradual withdrawal of international support measures would facilitate the shift to a sustained growth path that could generate adequate alternative resources for development subsequent to the loss of LDC status.

29. In view of the historical processes and events described above, Nepal has requested CDP to defer up until 2021 of its consideration of Nepal's graduation. Even then, given the present level of economic performance and achievements made so far call for an amplified transition trajectory. While the stipulated transition interval is three years, we



Government of Nepal National Planning Commission Secretariat understand that grace periods, in practice, have varied according to specific country contexts.

30. The purpose of a transition strategy is to operationalize that goal by engaging stakeholders, development partners and international organizations in collective actions to achieve an effective graduation. The strategy should ensure that Nepal makes full use of its LDC status before giving it up. It should provide strategic direction, and strengthen policy implementation, supported by development partners and underpinned by industry and civil society.

31. Moreover, the technical eligibility of Nepal also warrants close scrutiny. As stated at the outset, the mood in the country is for a meaningful graduation that is irreversible. Our ambition for graduation is keen and alive. A principal concern, however, is that Nepal is the first and only LDC to be considered for graduation without fulfilling the income criterion. The Committee sets the income graduation threshold at 20 percent above the inclusion threshold for entry into the LDC category. Nepal is well below both the graduation and the inclusion thresholds. For it to feel comfortable to embark on a graduation path that is smooth and sustainable, the achievement on the income criterion, in particular, should not be below the inclusion threshold or 20 percent of the requisite threshold.

32. Nepal recognizes that a robust preparatory effort will be needed to catch up after years of political strife and tepid development efforts. It is opportune now to exercise the peace dividend of the democratic transition. There is a need for a concerted effort to clear the backlog of pending legislation, and to accelerate the pace of public and private investment. The Government of Nepal, development partners, business and civil society need to mobilize together for a broadly-owned graduation process.

33. Graduation from LDC status is an integral part of Nepal's long-term development strategy to become a vibrant middle-income country by 2030. The Government of Nepal does not see this as an isolated international milestone. Graduation entails up-front costs and back-end benefits. The costs can be minimized and the benefits maximized with an



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operative transition strategy and consultative process in a climate of greater political stability and faster economic pace.

34. Against this background,, Nepal reiterates its request to the Committee for Development Policy to defer a possible recommendation for Nepal's graduation in the triennial review of 2021.

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