United Nations | Committee for Development Policy

CDP2023/PLEN/9.a

Committee for Development Policy
25th Plenary Session

United Nations
20-24 February 2023
UNHQ Headquarters, New York
Conference Room 8

Monitoring of countries graduating and graduated from the LDC category:

Nepal

SUSTAINABLE DEVELOPMENT GOALS

Contents

Summary

The CDP found that Nepal has achieved a quick recovery from the impacts of the COVID-19. The country is on a path to meeting all graduation criteria.

The Government of Nepal has taken steps to prepare the STS and submitted the annual report to CDP and participated in the consultation meeting. The country has sought technical assistance under the Sustainable Graduation Support Facility (iGRAD) in identifying and crafting the smooth transition measures to be prioritized in its STS and for more south-south-exchanges with other graduating and graduated LDCs on specific issues or topics of interest to Nepal. The Committee recommends Nepal to continue taking concrete measures to promote productive capacity, including promoting cottage industry and diversifying the economy.

Macroeconomic situation

Nepal's GDP growth rate averaged 7.8 per cent in 2017-2019 as the country rebuilt after the devastating Gorkha earthquake of 2015 which was magnitude 7.8 earthquake, impacting more than 31,000 people.[1] The COVID-19 pandemic severely impacted economic activity in 2020, causing an 2.4 per cent contraction in GDP (fiscal year).[2] The travel and transportation industries, as well as the industrial sector were particularly hit hard by the pandemic.[3] According to UN DESA, Nepal's real GDP is expected to rise by 5.8 per cent in 2022,[4] with support coming mostly from private consumption and remittance inflows. However, tourism in the Himalayas, which contributed 10 per cent of GDP in 2019, would not return to pre-pandemic levels by 2023. A rise in capital spending, particularly for public health and welfare in the face of the coronavirus, led to a budget deficit in Nepal of 5.3 per cent of GDP in 2020.

Table 1. Selected macroeconomic data for Nepal, 2016-2021

Indicator	2016	2017	2018	2019	2020	2021
GDP growth rate (per cent, constant price)	0.4	9.0	7.6	6.7	-2.4	4.3
Inflation rate (%)	8.8	3.6	4.1	5.6	5.1	6.2
Government revenue (billions of national currency)	525.0	644.5	766.0	862.6	865.0	1,012.8
Government expenditure (billions of national currency)	494.5	727.3	967.6	1055.0	1073.6	1186.0
Government balance (billions of national currency)	30.5	-82.7	-201.6	-192.4	-208.6	-173.2
Government balance (per cent of GDP)	1.2	-2.7	-5.8	-5.0	-5.4	-4.0
Net ODA received (millions of US dollars)	1,064.5	1,269.7	1,452.4	1,332.7	1,758.9	1,567.4
Balance of Payments (millions of US dollars)						
Current Account	-167.8	-1032.6	-2748.5	-1753.6	-84.1	-5363.0
Goods, Credit (Exports)	762.3	835.7	932.3	1110.9	890.1	1721.7

[1] World Vision, 2015 Nepal Earthquake. See: https://www.worldvision.org/disaster-relief-news-stories/2015-nepal-earthquake-facts

[2] UN DESA, World Economic Situation and Prospects, 2023.

[3] Nepal's statement on LDC Graduation for 2021 Triennial Review. See: https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/Nepal-2021-CDP-Plenary.pdf

[4] UN DESA, World Economic Situation and Prospects, 2023

Goods, Debit (Imports)	8,764.3	10,200.4	12,863.0	12,118.4	9,597.0	15,428.6
Balance on Goods	-8,002.0	-9,364.7	-11,930.7	-11,007.5	-8,706.9	-13,706.9
Services, Credit (Exports)	1,354.3	1,594.8	1,745.3	1,615.3	881.2	797.9
Services, Debit (Imports)	1,250.8	1,623.4	1,775.3	1,717.9	1,097.4	1,564.5
Balance on Services	103.5	-28.6	-29.9	-102.6	-216.2	-766.7
Balance on Goods and Services	-7,898.5	-9,393.3	-11,960.7	-11,110.1	-8,923.1	-14,473.6
Balance on Income	285.5	280.9	220.0	519.4	174.7	247.5
Balance on Current Transfers	7,445.1	8,079.8	8,992.1	8,837.0	8,664.3	8,863.1
Capital Account	164.6	149.1	133.9	142.1	115.4	118.0
Financial Account	553.2	-279.9	-1567.3	-653.4	270.8	-5036.9
Direct investment (net)	-106.0	-196.3	-68.3	-185.6	-126.6	-196.3
Portfolio investment (net)	...	0.0	0.0	0.0	0.0	0.0
Financial derivatives (other than reserves) and employee stock options	...	...	...	...	...	...
Other investment (net)	8.2	-455.7	-842.0	-806.2	-2,531.8	-2,466.3
Reserve assets	651.0	372.1	-657.1	338.4	2,929.2	-2,374.3
Reserves (months of imports)	10.3	9.4	6.6	7.5	12.5	6.8

Source: GDP growth is from UNSD, fiscal year. Inflation is from UN DESA, WESP 2023. Government balance is from IMF, World Economic Outlook Database. Net ODA is from OECD, OECD.Stat. All external sector indicators are from IMF, Balance of Payment Data Reports.

LDC criteria and supplementary indicators

Nepal's latest three-year average (2019-2021) per capita GNI is $1,229, which is just above the graduation threshold of $1,222 which was established at 2021 triennial review. Meanwhile, the country's EVI score of 24.6, and the HAI score of 77.4, both meeting the graduation thresholds with comfortable margins.

Table 2. Indicators for LDC identification, Nepal, 2019-2023

Year	GNI per capita	EVI	HAI
2019	935.5	24.6	72.5
2020	1,031.2	24.3	74.0
2021	1,135.4	24.4	75.4
2022	1,195.2	24.2	77.2
2023	1,228.9	24.6	77.4

Source: CDP Secretariat Time series estimates (LDC criteria) dataset (2002-2023), available at https://bit.ly/LDC-data

Notes: a) Year refers to the year of a (actual or hypothetical) review. The timeliness of source data varies by indicator; generally, criteria capture data up to two years prior to a review. See the 'read me' in the source as well as the data sheet (Annex 1) for details on original data sources.

b) Data for 2021 might differ from official triennial review data and previous monitoring reports due to data revisions.

During the COVID-19 pandemic, remittances continued to arrive at recipient families, providing buffers against income losses (see table 3 for selected supplementary graduation indicators). ODA as the proportion of GNI has risen in 2020. Access to water and sanitation has improved over time, and HDI and women empowerment index have been maintained.

Table 3. Selected supplementary graduation indicators, Nepal, 2018-2021

Indicator	2018	2019	2020	2021
Remittances (% of GDP)	25.0	24.1	24.3	22.6
ODA received as a percentage of GNI	4.4	3.9	5.2	
Water Access	89.2	89.6	90.1	
Sanitation access	69.2	72.9	76.6	
Human development index	0.6	0.6	0.6	0.6
Women empowerment index	0.8	0.8	0.8	0.8

Source: CDP Secretariat, Supplementary graduation indicators

Data gap

In 2020, Nepal had an overall statistical capacity index of 72, slightly higher than the average of South Asian countries (69, 8), and higher than the average of lower-middle-income countries (66.4).[5] There is cause for concern about the methodology of the sources used, although the country does well in terms of frequency and accessibility.

Smooth transition, national plan and country specific factors

Nepal is scheduled to graduate on 24 November 2026, after a transitional period of five years. Nepal's departure from LDC status will be a turning point in its socioeconomic progress.

The participation rate of Nepal in monitoring is 100 per cent (four out of four occasions). It submitted annual reports in 2022 and 2023, and also attended consultation meetings both years.

Based on 2022-23 report by the Government, the impacts of COVID-19 pandemic were significant on the economic activities as well as living conditions and poverty, particularly on women. Public relief program included tax, lending, cash transfer and so on. Some impacts of LDC graduation are expected on carpet, Pashmina and garment industries. But the overall impact on growth would be minimal.

The National Planning Commission (NPC) is leading the graduation preparation. A consultative mechanism has been formed, and partnerships with other partners and UN entities are established. The government has been drafting the smooth transition strategy which would addresses six key issues: fiscal system; monetary policy; trades and industrial policy; financing; productive and decent employment; reducing vulnerabilities and enhancing resilience. The STS will be in line with 15th and 16th National Development Plans.

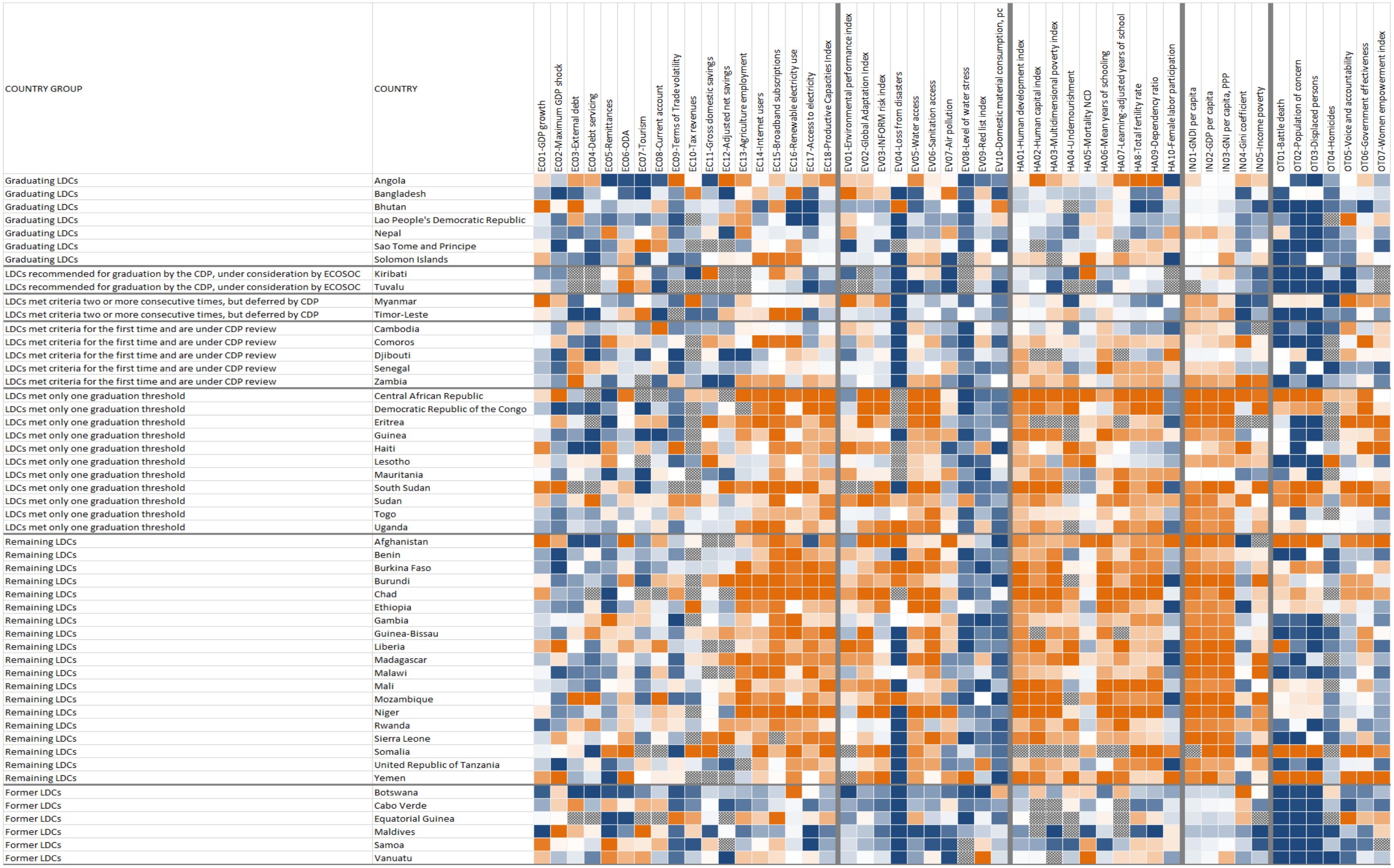
On 17 November 2022, the CDP conducted a virtual consultation with the Government of Nepal. The CDP suggested that Nepal should actively participate in the monitoring process, enhance its data capabilities, and include indicators about commerce. It also noted the continued reliance on remittances.

The Nepalese government highlighted that they benefitted from participating in the LDC graduation workshop which was organized by UN DESA, ESCAP, and Resident Coordinator's offices in Bangladesh, Lao PDR and Nepal, held in Bangkok in August 2022. They need experience sharing from other successful countries that have had a smooth graduation transition, strategy, and draft reports. Initial negotiations with the EU on general post-graduation support are still ongoing. In the last fiscal year, remittances increased by 4.8 per cent, equivalent to 20 per cent of GDP. The government representatives also

[5] World Bank, WDI. See:
https://databank.worldbank.org/reports.aspx?source=2&series=IQ.SCI.OVRL&country=NPL

mentioned that Nepal has made major policies such as incremental interest rates for people who deposit remittances at Nepalese banks, and the opening of dollar accounts.

Annex 1: Heatmap extract of the supplementary graduation indicators (SGIs) for LDCs and former LDCs (2023 or latest available year)



Legend: Indicator furthest below reference point, indicating most concern (5th percentile)

Indicator furthest above reference point, indicating least concern (95th percentile)

Reference point (e.g. 33th percentile)

No data available

Annex 2: Government report on Smooth Transition

Report on the Preparation of the LDC Graduation Transition Strategy of Nepal

(LDC Monitoring Report)

National Planning Commission

December 2022

Table of Contents

1. Introduction

A) Socio-economic Context of Nepal

Nepal, as an agriculture-dependent economy, faces structural problems on various socio-economic fronts. The share of agriculture in country's total GDP is about 24 per cent. About 60 per cent of population is engaged in this sector. Though the share of agriculture in GDP has declined overtime, 55 percent of the farmers still rely on subsistence farming. The year round irrigation facilities are limited to 33 percent of the total irrigable land. The land fragmentation and small holding is most common due to, among others, weaknesses in the implementation of land use policy effectively. In such a situation, rapid climate change and frequent natural disasters added by institutional and technical capacity deficit to cope with such unexpected shocks is still making the agriculture transformation a big challenge.

The manufacturing sector, which is key for structural transformation in the economy, is in its early stage of development. Its contribution to GDP was only 5.1 per cent in 2020/21. The continued policy reforms and strategies changes accompanied by various legal, regulatory and institutional reform initiatives have helped very little to promote and diversify manufacturing industries including exportable industries. Larger infrastructure gaps, limited skilled labour, poor capacity of institutions, problems in diversifying export markets and very low participation in Global Value Chain (GVC) are some of the impediments holding back manufacturing growth and productive capacity development. These are constraining enabling environment to the higher private investment including foreign direct investment in this sector.

There is a rapid expansion in the access to education services but the quality of education has not been improved as expected mostly in the public schools and colleges. There are also problems in strengthening equitable access to the education services. However, there have been seen improvements in school enrollment. In the health sector, despite notable progress in the health services as indicated by steady rise in average life expectancy, among others, the stunting rate, NMR and MMR remain still high compared to international benchmarks. There is also a large gap in access to health facilities. Despite high priority to the health sector in the aftermath of COVID -19 pandemic, the nutritional and malnourishment problems further add structural deficiencies.

The widening gap between imports and exports depicts an unsustainable phenomenon in the foreign trade. Though during the COVID-19 pandemic there was some downfall in the imports, the adverse effect was sharper in the export front. The problems in production sectors have constrained export trade creation which is partly due to low investment in productive sectors and poor linkages of limited investment with potential exportable industries. Most of the remittances inflows in the past coming through the banking and financial system were directed to lend to the imports and other quick yielding unproductive activities. Though in recent years there is more focus on productive sector lending, the excessive dependency on trade and finance based economic activities for quick high returns are still working as constraining factors for lending in prioritized productive sectors and activities. Amidst dwindling of good exports, the export market concentration is very high with share of India 71.8 percent, United States 9.7 percent, Germany 2.8 percent, Turkey 2.2 percent, United Kingdom 2.1 percent, China 1.2 percent and France 1.1 percent. In terms of relative share of value, Nepal exports a limited number of products. Nepal has also been able to use only 10 to 20 per cent of the total LDC-specific preferences.

One of the positive developments is that Nepal has been able to reduce poverty and prevent rise inequality to a greater extent added by more noticeable progresses in social front. However, internal drivers have played a limited role for such outcomes due to many pre-existing and ongoing structural impediments. Thus, Nepal still faces problems in enhancing productive capacity and transforming economy in a more positive way as a result of both supply and demand led factors at different levels.

B) Current Status on LDC Graduation

In 1971, for the first time, the United Nations General Assembly established the Least Developed Country (LDC) category. This category of LDCs was created to identify the poor developing countries that were facing severe structural impediments to economic growth and development. The low level of per capita income, structural impediments, higher vulnerabilities and poor human development are the most common features of these countries. At the beginning 25 countries were identified as LDCs, and Nepal was one of them.

However, due to continued development efforts in multiple fronts, Nepal was able to meet the two graduation criteria in the triennial review of 2015 and again in the triennial review of 2018. In both the triennial reviews, Nepal met the criteria of the graduation thresholds for Human Assets Index

(HAI) and Economic and Environmental Vulnerability Index (EVI). It has, however, not been able to meet the threshold for GNI per capita criteria. Since Nepal had met the graduation criteria for two consecutive triennial reviews, Nepal became eligible for LDC graduation for the first time in 2018. However, Nepal, being in the recovery phase after the devastating effect of earthquake in 2015, requested the Committee for Development Policy (CDP) to postpone the graduation process. Accordingly, the CDP recommended for deferring Nepal's graduation process. However, in the triennial review of 2021, the CDP recommended the graduation of Nepal from the LDC category as it once again met the graduation criteria by meeting the thresholds for HAI and EVI. The thresholds for LDC graduation were: $1222 GNI per capita, 66 or above HAI and 32 or below for EVI. The statuses of Nepal in these three criteria in 2021 triennial review were: EVI 24.7, HAI 74.9 and $1,027 GNI per capita. However, against the background of socio-economic devastations caused by COVID-19 pandemic and the future uncertainties, the CDP recommended an extended preparatory period of five years, two more years than the standard preparatory period of three years, to ensure smooth and sustainable transition.

2. Impact of COVID-19 Pandemic and Government Initiations

The overall socio-economic impact of COVID-19 pandemic has been severe and wide ranging. In March 2020, the first case of Coronavirus was confirmed and local transmission was reported in April 2020. The pandemic, however, spread rapidly in the country as a result of rapid inflows of Nepalese workers from the neighboring country, where the COVID-19 was rampant. In this situation, to control the spread of Coronavirus, the government imposed lockdown from March, 2020 which continued for four months and introduces a policy of social distancing as well. After four months, the lockdown was removed which eased supply disruption. However, the second wave which picked up in March 2021 created further risk and uncertainties in the economy. In terms of transmission of the virus and death toll, second wave was more damaging which also adversely affected various ongoing initiatives. After some gaps, Omicron Variant of Coronavirus was first recorded in November 2021. Thus, the repeated waves of virus have posed continuous challenges in socio-economic front. The pre-existing vulnerabilities in different sectors have also hindered to augment that process.

The socio-economic impact of COVID-19 pandemic was very severe and pervasive. In 2019/20 the major sufferer was the tourism sector. The value added in this sector decelerated by as much as 37 percent compared to 2018/19. Similarly, the transport sector registered around 13.4 percent negative growth rate. Trade sector recorded a negative value added growth of around 10.7 percent. The manufacturing and the construction sectors experienced a negative growth rate of 8.6 percent and about 5 percent, respectively. However, moderate growth in agriculture and other few sectors and relatively high growth rate in electricity sector as a result of large energy supply in the economy, the deceleration in growth rate was only about 2.1 percent on an average in 2019/20.

Along with such a negative growth resulting from heavy decline in output in critical sectors, employment, livelihood and poverty effect was very damaging, more so during the lockdown period. Studies reported that 28 percent of men and 41 percent of women lost their jobs during the lockdown. There was an overall wage cut of 18.2 percent with sharper cuts in hotels and restaurants, transport and education sectors by at 36.4, 31.2 and 21.1 percent, respectively.

It was estimated that about 5.8 percent of internally employed (or 0.924 million workforce) and 20 per cent of externally employed (or 0.64 million) workers were compelled to leave the job in 2019/20 due to spread of pandemic and adoption of lockdown measure.

The spread in pandemic and lockdown measure had very adverse effect on the health and education services as well. Amidst continued human losses, COVID-19 pandemic amplified the health inequalities by destroying many of the gains made in child survival, health and nutrition over the last several decades. Similarly, the nationwide school closures in response to the pandemic disrupted the education of millions of students which undermined the learning potential in the short run and foreshadowed major human capital losses in the long run. The COVID-19 pandemic has also raised great inequalities in access to the technologies required for remote learning and digital education, disproportionately affecting poorer communities. More broadly, the notable progresses made in the areas of health and education was also threatened by the COVID-19 pandemic. In sum, the COVID-19 has made socio-economic impacts. Health and wellbeing of a large section of population have been severely affected. Livelihood of the daily laborers, small vendors and daily wage workers was severely challenged.

To control the spread of Coronavirus, initially, the government adopted a policy of social distancing. Moreover, the government took a number of monetary and fiscal measures and other initiatives. The prompt actions in number of areas helped to avert much more devastating socio-economic impact. To deal with the problems of people's livelihood emanating from lockdown and movement restrictions, government introduced relief packages targeting daily wage earners, poor and other vulnerable people mostly through the local bodies. The relief package covered food items and other some daily necessities. In addition, most sufferers were made eligible of the Prime Minister’s Employment Programme.

The Government of Nepal introduced relief packages for certain period of time to marginalized population and to the patients affected by COVID-19. Due to closed down of schools, children not only had lost their learning hours but also had to face less nutritional intake by those who were receiving mid-day meal from the schools. Schools in urban areas and private schools had to run online classes. However, it created digital divide with more privileged receiving online education and others not. These adverse impacts raised the likelihood of a rise in poverty and inequality simultaneously.

To address the mounting economic crisis, tax rebates and facilities of delayed payment of taxes were provided to the business and industrial community. The concessional loan facilities were provided to the severely affected sectors. In parallel, the central bank launched liquidity support programme to the banking system for facilitating the credit to the private sector. Among the key measures included a relaxation of regulatory requirements for banks and financial institutions and a reduction of targeted interest rates as a part of the country’s interest rate corridor. It also provided a facility of delayed loan and interest payment. The refinancing facility was focused on small businesses and industries.

After such immediate relief and support measures, number of programs focusing on strengthening health system, containing virus, providing relief to the poor and highly vulnerable people, generating employment and supporting most affected industries and businesses were declared through the budget of FY 2020/21. There was a big surge in the heath budget. The relief package in the form of food and other few essential items were further extended. Through the budget, various tax rebates and other facilities were provided to the highly affected manufacturing and services industries. In that the focus was on cottage and small scale enterprises. For providing relief and support to the affected sectors, a fund of NRs 50 billion was provisioned in the budget for transferring it to the central bank for its use under refinancing facility. As a part of relief to the wage earners and other people who were forced to be jobless, a scheme of direct employment to more than 700 thousand people was also announced by the budget. In the budget, agriculture, manufacturing, energy and infrastructure sectors were conceived as major vehicles of reviving the economy, generating employment to the neediest and enhancing resilience of the economy.

The monetary policy of FY 2020/21 also announced a very comprehensive policy package focusing on reliefs to the most suffering industries and businesses and reviving the economy. The loan and interest payment schedule of businesses and industries were extended from 6 months to one year. Refinancing facility to the banks and financial institutions at very low interest rate was declared. Bank and financial institutions were directed to divert such facilities to the most affected export oriented as well as micro, cottage and small industries. For revival and further boost to the promising sectors, banks were instructed to lend 40 percent of their total lending in three priority areas viz, agriculture, energy and micro, small and medium industries. For ensuring enough liquidity and maintaining financial stability, the upper bound of the IRC (Interest Rate Corridor) was maintained at 5 percent. Repo rate was reduced to 3 percent. The deposit collection rate as a lower bound was fixed at 1 percent.

The budget of this FY 2021/22 has given added thrust not only on improving the health system, providing cash support to the most vulnerable people and reviving the most affected sectors but also on the projects and programmes that could give high returns more quickly and contribute to bring back the economy to a path to higher growth and rapid development. Similarly, the Monetary Policy of FY 2021/22 apart from continuing the relief and priority sector lending programs has given priority on strengthening financial stability in the banking and financial system. However, as a result of repeated waves added by adverse geo-political external environment, the revival of the economy has been slow and less encouraging.

3. Impact of LDC Graduation

LDC graduation brings both opportunities and challenges in the development process. LDC graduation represents important development milestone and it indicates country progressing on its overall economic aspects. This also creates more confidence on foreign investors in bringing foreign direct investment (FDI) into the country. Since the LDC graduation likely improves country's creditworthiness ensuring less risk premiums, *ceteris paribus,* the country may be able to attract more investments from both domestic as well as foreign investors. The Nepali private sector can also have a better access to external investment loans at a concessional interest rate.

On the other hand, with LDC graduation, the several international support measures such as preferential market access and other general support that the country enjoys at the moment in the areas of foreign trade will be phased out.

Nepal could also lose 4.3 percent of exports because of tariff changes. The removal of preferential tariffs will especially affect the apparel, synthetic textile fabric and carpet sectors. Losses will mostly occur in exports to China, the European Union, and Turkey.

However, no large scale adverse growth effect is expected due to graduation. An overview of probable impact of international support measures on exports as well as development cooperation indicates that there could be some dampening effect on growth through different channels and transmission mechanisms. The report of Federation of Nepal Chamber of Commerce and Industries (FNCCI) states that three major industries will be significantly impacted by the preferential loss after LDC graduation i.e., carpet industry, Pashmina and garment industry. It shows some broad idea on the likely poverty and inequality implications due to preference erosion and thereby on export loss.

Trade preferences are considered as one of the most significant and accessible international support measures (ISMs) provided to LDCs. Trade-related support measures for LDCs encompass the following major areas: support towards WTO accession, preferential market access for goods (greater preferences than provided to other developing countries), preferential treatment for services, other special and differential treatments (SDTs) regarding obligations and flexibilities towards WTO provisions, and technical support to promote trade and trade capacity (UNCTAD, 2016; CDP and UN-DESA, 2018). While graduation will not have any impact on concessions gained during WTO accession, trade-related impact of LDC graduation will arise from the loss of other preferences and support. Among these, the primary trade related loss will result from the loss of preferential market access for goods and reduced flexibilities in implementing WTO provisions.

The impact on development cooperation in the form of Official Development Assistance (ODA) coming from the bilateral development partners and multilateral institutions through grants, concessional loans and humanitarian support would be minimal. These supports play an important role in closing Nepal’s fiscal, savings, foreign exchange, technical knowledge and technology gaps and meeting humanitarian needs.

The impact of LDC graduation will be the loss of LDC-specific special and differential treatment (S&D) provisions in WTO. Loss of these S&D provisions, resulting in reduced flexibilities in implementing WTO provisions, can result in a reduced policy space.

4. Government Initiatives on Preparation for Graduation

A) Institutional Setup:

As a focal agency in preparation of the LDC graduation strategy, National Planning Commission (NPC) has been in consultation within Commission and with other relevant stakeholders for preparing and finalizing the LDC graduation strategy.

Steering Committee

A High-level Steering Committee has been formed under the chairmanship of Honorable Vice-Chair of the National Planning Commission (NPC). The members of the Committee constitute of Honorable Member of NPC looking after the economic affairs, Member - Secretary of NPC, Secretary of Ministry of Finance, Secretary of Ministry of Foreign Affairs, Secretary of Ministry of Industry, Commerce and Supplies, President of Federation of Nepalese Chambers of Commerce and Industries (FNCCI), President of Nepal Chamber of Commerce (NCC), and the President of Confederation of Nepalese Industries (CNI). Similarly, the Joint-Secretary of the Sustainable Development and International Relations Division of NPC functions as the Member-Secretary of the Committee. Thematic committees are yet to be formed in the changing political context.

B) Consultative Mechanism

In preparation of the LDC graduation strategy, National Planning Commission is in consultation within the Commission, and with other representing relevant line ministries including Ministry of Finance (MoF), Ministry of Foreign Affairs (MoFA), Ministry of Federal Affairs and General Administration (MOFAGA), Ministry of Industry, Commerce and Supplies (MOICS), Ministry of Education, Science and Technology (MoEST), and other stakeholders including representatives from private sector organizations.

During the preparation of the smooth transition strategy, NPC has conducted consultation with provincial government representatives, development partners, private sector associations representing major impacting sectors and major associations. Nepal has also been in a regular communication with CDP as a part of preparation for the LDC graduation. Nepal has been rigorously in consultation with its co-graduating countries (i.e., Bangladesh and Lao PDR) to learn from each other. Nepal has been in close coordination with the UN country team while preparing the United Nations Sustainable Development Cooperation Framework (UNSDCF).

C) Collaboration with Development Partners

In the process of preparing a smooth transition strategy (STS) for the LDC graduation, Nepal has received support from the United Nations Development System (UNDS). One of such supports was the opportunity for Nepal to participate in the 'South-South Exchange on Preparing Smooth Transition Strategies (STS): Graduating Cohort of 2021' and exchange ideas with its peer. The South-South Exchange was organized jointly by the UN Department of Economic and Social Affairs (UN DESA) as the Secretariat for the Committee for Development Policy (CDP) of the United Nations and the United Nations Resident Coordination Offices (RCOs) in Bangladesh, Lao Peoples' Democratic Republic (Lao PDR) and Nepal and in collaboration with the United Nations Office for the High Level Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States (UN-OHRLLS) and the United Nations Economic and Social Affairs for Asia and the Pacific (UNESCAP).

At the South-South Exchange Programme, government officials, private sector, academia, research institutes, think tanks and civil society from Nepal, Bangladesh, and Lao PDR attended the event alongside representatives from RCOs, UN DESA, ESCAP, OHRLLS, UNDP, UNCDF, ILO, the Enhanced Integrated Framework (EIF), International Trade Center (ITC), other relevant UN agencies, the European Union, and the Republic of Korea and Viet Nam. The delegates and the UN representatives came together to discuss, exchange views, and advise on opportunities, and areas of common concern for the preparation and implementation of the STS in the three countries. This South-South Exchange offered an opportunity to discuss *how* to develop and *what* actions to be taken to promote in the STS to manage the next steps in the development pathways of the three countries. The South-South Exchange involved a discussion on a wide range of issues including international trade, development finance, climate change, and governance as well as human rights.

The exchange programme re-energized the Nepal's STS preparation process, allowing it to learn from industry/sector experts and share ideas as well as benefit from each other's experience.

This broad and inclusive participation not only showcased good practice and possible pathways ahead, but also highlighted the many trade-offs that must be addressed to ensure a sustainable, irreversible, and quality LDC graduation. This underlined the necessity to approach the LDC graduation from, not only a *whole of government*, but *a whole of society* point of view. The government of Nepal has used the ideas and learning from the exchange programme in the formulation of the STS.

5. Smooth Transition Strategy

Nepal has prepared draft Smooth Transition Strategy with detailed policy action matrix. Strategies are focused on addressing the major structural constraints of the economy and development challenges.

Structural Transformation and Major Constraints

The structural problems in both supply and demand side of the economy including weak market linkages are still constraining the prospects of enhancing productive capacity, augmenting productivity in most promising sectors and raising consumption, investment and export demand in a way that could contribute to augment more inclusive growth and development through strong positive implications, among others, on productive employment and income distribution.

Though a rapid change in the production structure has taken place in Nepal with sharp rise in the share of services sector in GDP in recent years, such a structural shift has contributed very little to raise the productive capacity and productivity of the economy. Some underlying reasons for the structural pattern of the economy are:

a) the share of agriculture sector in GDP has sharply declined overtime but without commensurate reduction in the share of population depending on the agriculture. Today, the share of agriculture value added is almost one fourth in total GDP whereas the share of economically active population engaged in agriculture is almost two third of the total population. This indicates that despite priority to the agriculture sector accompanied by concerted efforts at its commercialization and modernization, the progresses have been slow.

b) the industrial sector that is highly critical for higher production, transformational changes and productivity enhancement of the economy through both backward and forward linkages and spillover effects is also confronting with many structural problems. Within the secondary sector, share of electricity in total value added has remained almost constant in last one decade despite huge potentials of harnessing abundant water resources. More strikingly, the share of manufacturing sector has declined during the same period, from 6.1 percent in 2010/11 to 5.1 per cent in 2020/21 indicating a tendency of deindustrialization. The outcome of continued policy reforms and changes in strategies overtime accompanied by legal, regulatory and institutional initiatives to promote and diversify manufacturing industries including exportable industries have, thus, been less encouraging.

c) Within the tertiary sector, there is a steady rise in the value added contribution of education sector which is a positive structural change and is largely due to rapid expansion in the access to education services. Worryingly, however, there has been steady decline in the share of education budget of the federal government in recent years which is hampering the infrastructure development and other education quality enhancing activities. In the health sector, though in the aftermath of COVID -19pandemic more priority to the health sector has been given, low priority to the health sector in the past has exposed poor infrastructural, institutional and technical capacity problems. The rising infrastructure gap is a major area of concern for tapping the contribution of construction and transport sectors.

Key Issues Addressed by the Strategy

Drafted smooth transition strategy addresses six key issues related to fiscal system, monetary policy, trades and industrial policy, diplomatic capital, productive and decent employment, and reducing vulnerabilities and enhancing resilience.

The primary objective of the preparation and implementation of smooth transition strategy- a time bound and short-term post-graduation measures- is to use the transition period to help overcome the challenges to be faced due to loss of LDC-specific support measures on the development trajectory and to set the conditions for more resilient future as well as to identify and pursue areas for augmented international support to achieve long term development goals. It is about ensuring that the phasing out of support measures for LDCs does not disrupt a country’s development process. It focuses on the measures that could contribute more effectively to building, accumulating, and upgrading productive capacities in a way to ensure structural transformation more positively leading to meaningful, sustainable and irreversible graduation.

During transition period and post-graduation, Nepal will focus on expanding productive capacity through focus on building human capital with investment on education, health and utilizing demographic dividend. Productive capacity encompasses a set of productive resources such as human, physical, financial and natural capital, entrepreneurial as well as institutional capabilities and production linkages across sectors. Linking of production externally through trade is equally important. Investing in people and building human capital are critical to close the existing human capital gaps.

Human development and economic progress mutually reinforce each other. The concept of human development has further evolved, which includes choices, capabilities and participation in an overall institutional and social milieu. Hence, now the pro-active role of the regulatory system will also be vital. Nepal will revamp education system to make it compatible with the ongoing fourth industrial revolution with focus on more technical and vocational education with equal focus on equity dimension. Technical and vocational education is most crucial for overcoming the growing mismatches between the demand and supply of human resources. Ensuring applied research in higher education, establishing quality institutions and engaging in innovative research is also important. Similarly, necessary reform will be made in public schools for minimizing the quality gap between the private and public schools (performance indicators kept as a part of such a program). Education reform will be made while giving more thrust on equity dimension especially taking inter-provincial gaps into account in which gender and various socio-economic groups based gap is high. Effective regulatory system will be put in place for maintaining the quality of education at all levels.

Health is another important factor of Human Development and for fostering productive capacity. After the impact of COVID-19, an integrated approach to universal health coverage and equitable access to affordable and quality health service is emphasized. An umbrella law and policy for the overall management of health services will be introduced for integrated health service delivery system in a coordinated way more effectively. Ensuring social health protection with more enlarged and effective role of the provincial and local governments is equally important. Efforts will be made for the reorientation of agriculture and food policy to strike balance between staple crops and highly nutritious, climate resilient but neglected and underutilized secondary crops like finger millet, buckwheat, millet, legumes etc by providing proper incentives. Harnessing Democratic Dividend is utilizing the opportunity we have. As predictions indicate, Nepal is going to the transition very rapidly from being an ageing society in 2028to an 'aged society' by 2054. Nepal will make every possible effort to translate demographic bulge into a demographic dividend when a qualitative productive workforce is developed and harnessed for larger socio-economic transformation.

Other aspects Nepal considers important post-graduation are: meeting infrastructural gap and accelerating productive capacity, making structural transformation of the economy affirmatively, reorienting macroeconomic policies for inclusive, broad based and sustainable growth, addressing vulnerabilities and strengthening resilience, bringing wide-ranging institutional and governance reforms for better outcomes and efficient delivery of government services for sustainable graduation.

We are preparing transition strategy aligning with 15th Development Plan, Sustainable Development Goals (SDGs), industrial policy, trade policy and other sectoral policies as well as Green, Resilient and Inclusive Development (GRID) approach introduced in the aftermath of COVID-19 pandemic. We have started a process of preparing 16th plan which will be aligned with the transition strategy.

7. Conclusion

Nepal is committed to making its LDC graduation smooth and irreversible. The LDC graduation smooth transition strategy is being prepared by identifying the challenges of the process and formulating pathways to address them. As a part of it, institutional setups and monitoring mechanisms such as steering committees and thematic committees are being formed. Nepal has also identified major sectors to focus on for achieving smooth, irreversible and sustainable graduation. In the process of graduation, Nepal will be seeking augmented support and commitments from all development partners.