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Nepal after LDC Graduation

New avenues for exports

Foreword

Created over 50 years ago, the least developed country (LDC) status was always meant to be a temporary phase in the national development. Belonging to the LDC category can boost development, particularly through duty-free, quota-free access granted by multiple markets. Graduating from this category is recognition of the development path travelled. At the same time, they must navigate new paths through trade.

Nepal became an LDC in 1971. After remarkable progress in recent decades, especially with respect to the

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Acronyms

Unless otherwise specified, all references to dollars (\$) are to United States dollars, and all references to tons are to metric tons.

EU	European Union
GDP	gross domestic product
GSP	Generalized Scheme of Preferences
ITC	International Trade Centre
LCD	least developed country
MFN	most favoured nation
NTIS	Nepal Trade Integration Strategy
SAFTA	South Asian Free Trade Area

Executive summary

Nepal will graduate from the least developed country (LDC) category in 2026. The period until then will be dedicated to preparing a smooth, sustainable transition out of LDC-specific support. This entails identifying the consequences of the loss of LDC support measures and devising strategies to offset them.

In line with that goal, this study projects export losses for Nepal connected to the removal of LDC preferential tariffs and identifies approaches to mitigate them.

Post-graduation tariff increases could reduce Nepalese exports by 4%

With graduation, Nepal will move from the unilateral tariff preferences for LDCs granted by 25 markets to the next best available regime. As a result, the average trade-weighted tariff will rise from 1% to 2%, but the increase will vary widely between sectors. The vegetable products sector and the cereals and cereal products sector will face the largest increases, with 27 percentage points and 25 percentage points in average applied tariffs, respectively.

Our study finds that tariff increases will reduce projected 2026 exports to \$1,313 million from \$1,372 million – a loss of \$59 million, equivalent to 4.3% of total projected exports.

A salient example of this is the case of exports of synthetic textile fabrics to Turkey, expected to fall by \$14 million, while the sector will have an untapped potential of \$8 million in Bangladesh and \$8 million in India. Actions targeted to overcome frictions that may hinder these exports to Bangladesh and India should be explored.

Improved market access

Improving market access conditions through new agreements or adherence to more preferential schemes may be the preferred option even if there is substantial untapped export potential. Obtaining GSP+ status to access the EU could reduce losses in export revenue by up to \$17 million. However, the challenges to qualify for GSP+ and to use its preferences once qualified are substantial.

Chapter 1

On the path to graduation

Nepal was recommended for graduation from the least developed country (LDC) category during the triennial review held by the United Nations Committee for Development Policy in February 2021.¹ In light of the COVID-19 pandemic, it was decided that the usual three-

How will tariffs change for Nepal ?

The first step in understanding how graduation can affect exports is to identify LDC-specific trade support benefiting Nepal. Trade support for LDCs takes several forms, among them institutional, analytical and productive capacity support, as provided, for example, through the Enhanced Integrated Framework.

This study focuses on the effect of graduation on exports through a specific aspect of trade support for LDCs: preferential tariffs. We therefore start by exploring what preferential tariffs Nepal receives based on its current LDC status, what tariffs will presumably be after graduation considering existing trade agreements and, to the extent possible, whether Nepal indeed uses its existing LDC tariff preferences.

Post-graduation tariff regimes

Nepalese exports face LDC-specific preferential tariffs in twenty-five markets.³ Once LDC support ends, the tariffs applied by those markets will revert to the next best scheme. Table 1 lists all markets that now grant LDC preferences to Nepal and groups them according to the type of regime they will apply after graduation: non-reciprocal preferential tariff schemes for developing countries, bilateral free trade agreements, preferential tariffs under the South Asian Free Trade Area (SAFTA) and most favoured nation (MFN) tariffs.

Table 1 Next best tariff schemes for Nepal in markets granting LDC preferences (2016-2017)

First, the non-reciprocal preferential tariff scheme for LDCs of the European Union (EU) – the Everything But Arms initiative – provides for a transition period of three years for graduating countries.⁶ During that time, Nepal will continue to benefit from duty-free, quota-free market access to the EU. After that transition period, Nepal will be eligible for the EU’s Generalized Scheme of Preferences (GSP) for developing countries.⁷ For comparability purposes, our analysis assumes that Nepal will move from Everything But Arms to GSP directly upon graduation.

Second, Nepal could also

In the coming years, we expect Nepal’s exports to shift towards fast-growing markets that do not have special LDC schemes. Therefore, the increase in average trade-weighted tariffs faced will only affect 22% of the exports projected for 2026 (34% of current exports).

Under the scenarios outlined in Table 1, the average trade-weighted tariff will rise from 1% to 2%. The increase will vary widely between sectors, as shown in Figure 1. While many sectors will only experience increases smaller than one percentage point, others will see steep rises in the tariffs they face. That is, for example, the case of the vegetable products sector, and the cereals and cereal products sector, with increases of 27 percentage points and 25 percentage points in average applied tariffs, respectively.

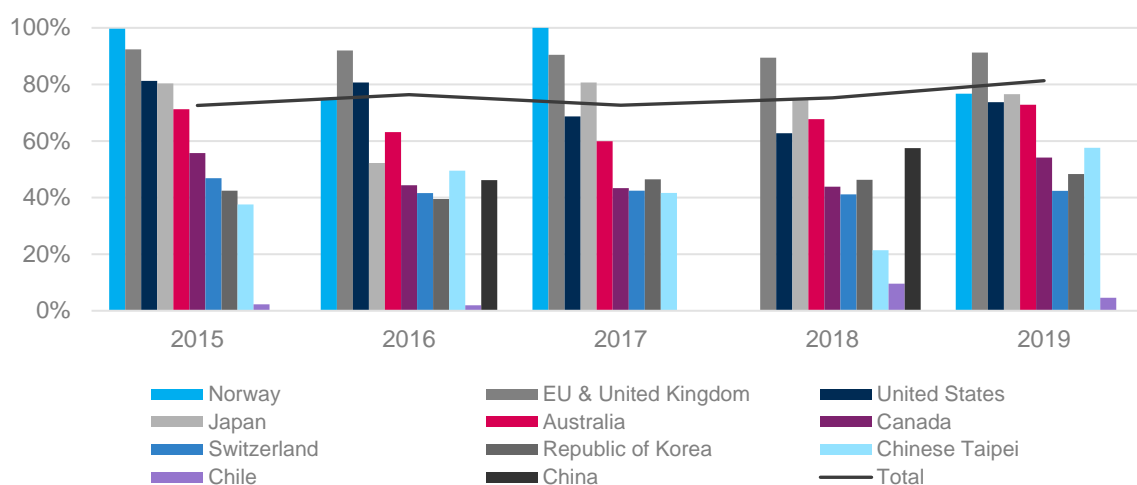
Utilization rate of preferences

The loss of LDC status and subsequent tariff increases can only have a negative impact on Nepal’s exports if tariff preferences are currently being used. Recent evidence presented from the World Trade Organization suggests there is a high rate of underuse of preferences for LDCs across all sectors, especially for landlocked LDCs.

It is difficult to verify if this is the case for Nepal, due to the lack of detailed data available on the use of LDC preferences from some of the country’s main partners. Some information is available through the World Trade Organization’s Integrated Database, according to which the total utilization rate of preferences ranged from 72% to 81% in 2015–2019.

Data by country show a wide range of utilization rates, from exports to the European Union and the United Kingdom staying close to 90% throughout the period, to Republic of Korea or Switzerland closer to 40%–50%, and to Chile under 10% for all years.¹¹ Note in particular that information from LDC preference-granting SAFTA partners (Bangladesh, India and Sri Lanka) are not available.¹²

Figure 2 Nepal regularly uses EU and British LDC preferences



Note: Data for China are only available in 2016 and 2018.

Source: ITC staff calculations based on data from World Trade Organization’s Integrated Database.

While preference use varies significantly between partners, it is high for some of Nepal’s main export destinations, namely the European Union and the United States. This suggests that the loss of LDC status in 2026 and subsequent tariff increases will indeed have a negative impact on Nepalese exports.

¹¹ While most LDC preference schemes shown in Figure 2 have been in place for a long time, Chile’s was only implemented in 2014.

¹² Preference utilization data are also not available for Armenia, Belarus, Iceland, Kazakhstan, Kyrgyzstan, Montenegro, New Zealand, Russian Federation, Tajikistan and Turkey.

Chapter 2

The effect of tariff changes on trade

We use a partial equilibrium model to estimate the size of the effect by partner and product, considering all possible partners and all products exported consistently. In the model, trade and tariff values are projected to 2026. Trade projections are based on trade between 2015 and 2019, the expected growth rates of GDP and population of all countries, and the responsiveness of import demand to GDP per capita and population growth.

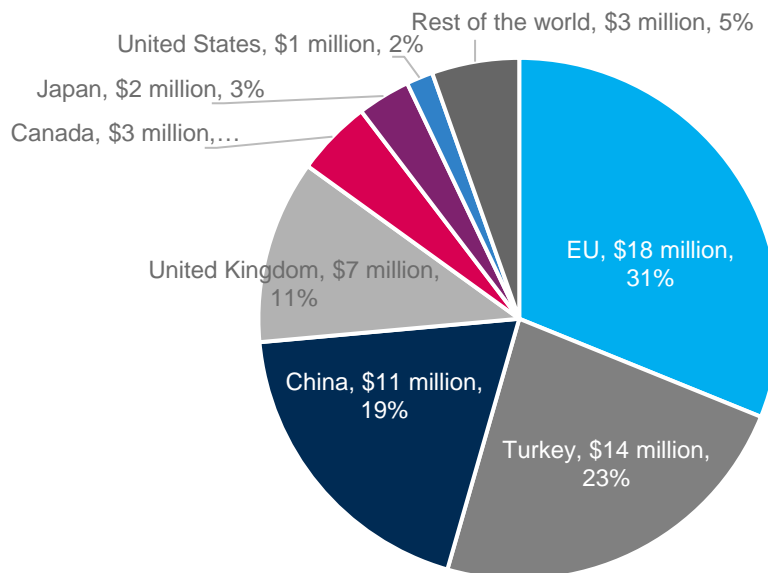
Tariff projections assume that, upon graduation, Nepalese exports that had LDC preferences will receive the next best alternative tariff available. For all other countries, we reflect the tariff situation in 2026 by integrating information from tariff reduction schedules of agreements that are now in force.

To compute the model, we use trade and tariff data coming from the ITC Trade Map and Market Access Map databases, respectively, as well as GDP forecasts from the International Monetary Fund's April 2021 World Economic Outlook, population projections from the World Bank's World Development Indicators database and other sources. Details on the methodology and data used can be found in Appendix A.1.

Results show that Nepal would export \$1,372 million in 2026 if it retained LDC status, but only \$1,313 million if the country moved to the next-best alternative tariff regime shown in Table 1 – a loss of \$59 million.¹⁴ The estimated loss represents 4.3% of total projected exports, yet specific individual product-market combinations can be severely affected.

Losses are expected to concentrate in exports to the EU (\$18 million), Turkey (\$14 million), China (\$11 million), the United Kingdom (\$7 million) and Canada (\$3 million). Among Nepal's main export destinations, projected exports to India and the United States are likely to remain largely unaffected, while projected exports to other top trade partners will suffer losses between 17% and 33%.

Figure 3 Losses to E U, Turkey and China will be highest

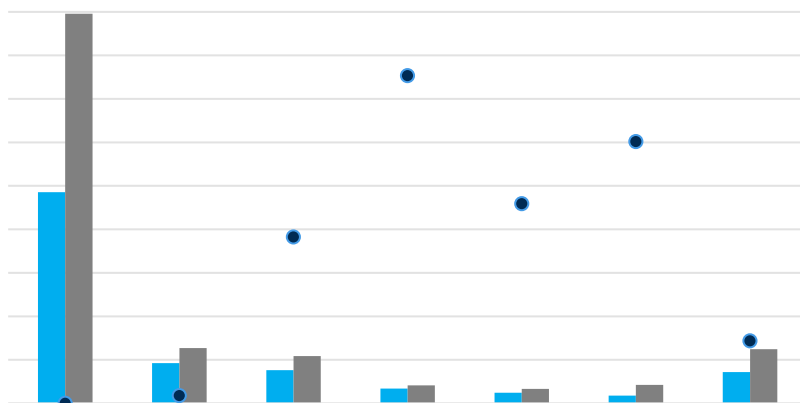


Note: The figure shows the markets with the largest losses, up to 90% of total losses.

Source: ITC staff calculations based on data from the ITC Market Analysis Tools (2021).

¹⁴ Annual exports were \$802 million on average over 2015–2019.

Figure 4 Exports to largest partners are minimally affected



Note: The figure shows the main export partners, up to 90% of total exports.

Source: ITC staff calculations based on data from the ITC Market Analysis Tools (2021).

Nepal's bilateral trade agreement with India offers duty-free access for most Nepalese exports. For other products, non-LDC SAFTA preferences are generally as favourable as LDC SAFTA preferences. However, the bilateral agreement contains quotas on three categories of goods relevant to Nepal's exports: acrylic yarn, copper products and vegetable fats. We analyse these cases in detail in Box 1.¹⁵

In the case of the United States, Nepal does not export significant quantities of the products that hold preferences under the US LDC preferences scheme. This explains the limited expected impact of graduation observed in Figure 4.

Figure 5 Top projected EU export losses will be in Germany and France

Note: The figure shows the markets with the largest losses, up to 90% of total losses.

Source: ITC staff calculations based on data from the ITC Market Analysis Tools (2021).

¹⁵ In the case of Bangladesh, a significant export partner not featured in Figure 4, trade after graduation will also continue to enjoy preferential access under SAFTA. As a result, projected exports are largely unaffected.

Export losses in the EU range from \$446,000 to \$7 million, with the largest absolute losses concentrated in Germany, France, and Italy. Losses for all main destinations in the EU range from 8% to 24% of projected exports for 2026. Figure 5 illustrates

Box 1 Quotas under the India –Nepal free trade agreement

The bilateral trade agreement between India and Nepal ensures that most trade flows will continue to be duty free after LDC graduation. However, the agreement establishes quotas for acrylic yarn, copper products and vegetable fats, which are an important part of Nepalese exports. Each case is considered in detail below.

Acrylic yarn :

The quota of acrylic yarn is 10,000 tons, above which a 5% duty will apply. Projected exports for 2026 are 9,000 tons, meaning that they will remain duty free and graduation should not have an impact on exports. If acrylic yarn exports to India exceed the quota, those beyond the quota will be reduced by 11%–12%.

Copper products

The quota of copper products is set at 10,000 tons, with a 5% MFN tariff applied on out-of-quota exports. According to projections, exports will reach 3,300 tons by 2026. As the quota will not be binding, graduation is not expected to have an effect on exports of copper products.

Vegetable fats

N10.916 (eg)1.2 ra (b)1.2 (l)y84rdog6 0 Td8T9uTd8T9uTdp05e (e)0.6 (EMC /P <</MCID 2y(oj)7.4 (ec)-1.9 (t)3.5 (i)1.

Chapter 3

Compensation strategies

Expected export losses after Nepal is no longer an LDC could be offset

Apparel exports to Japan are expected to decline by \$928,000 but have \$2.2 million untapped export potential. Losses are spread among different products,¹⁸ but \$1.9 million of the untapped potential concentrates in Scarves, veils & similar of wool/fine animal hair (product code 621420).

Exports of beauty products and perfumes to China are likely to drop by \$661,000, across many products.¹⁹

s

Metal products – China

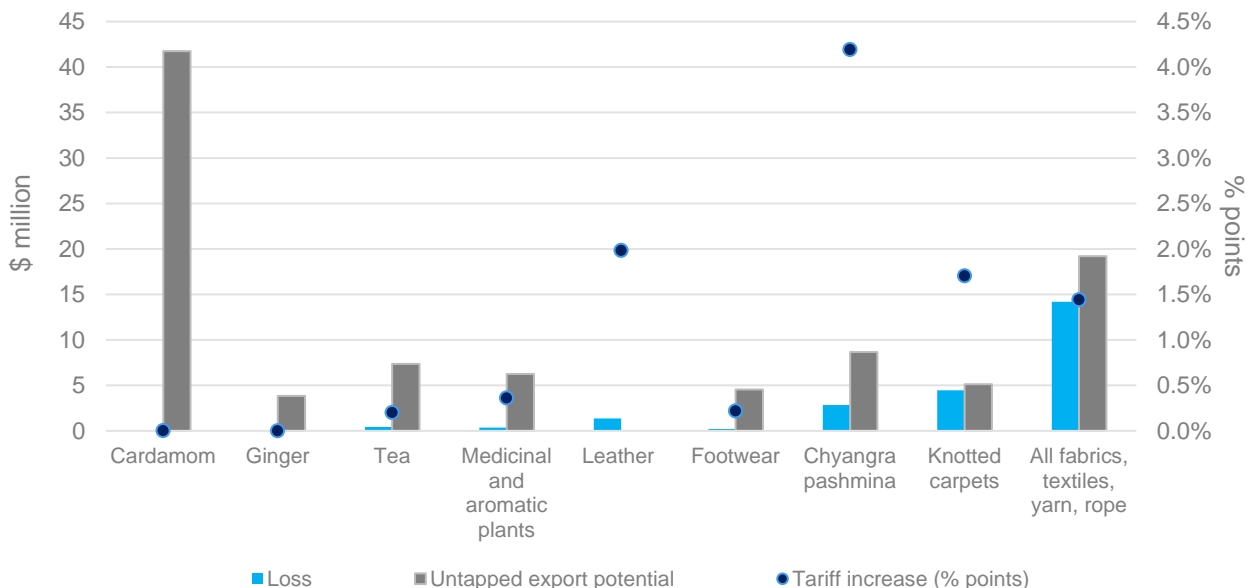
The projected loss in exports of metal products to China is \$2.5 million, with no remaining untapped potential in that market. The biggest loss (\$1.9 million) will be in Statuettes and other ornaments (codes 830621 and 830629). Alternative markets for this product are the United States, the EU and India, which have large untapped export potential for statuettes and other ornaments: \$1.9 million in the United States, \$1 million in the EU and \$291,000 in India.

Apparel – Canada

Apparel exports to Canada are expected to drop by \$1.8 million, dispersed over multiple products, with little remaining export potential to the Canadian market (\$256,000)

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Figure 7 Some NTIS priorities face higher tariffs and export losses



Note: Product/sector definitions follow NTIS 2016. Tariffs changes shown are a weighted average using projected 2026 exports. Source: ITC staff calculations based on data from the ITC Market Analysis Tools (2021).

Box 2 Nepal Trade Integration Strategy priority products after graduation

Nepal launched the latest Nepal Trade Integration Strategy (NTIS) in 2016, charting a course to develop exports in the following five years. NTIS 2016 set out several objectives, among them strengthening an export-enabling environment, enhancing trade-related infrastructure and reinforcing institutional capacity. NTIS 2016 also listed priority products and services for exports based on world market conditions, export performance, domestic supply conditions and socioeconomic impact. The sectors identified were:

Agriculture (2.6%), Handicrafts (2.6%), Leather goods (2.6%), Medicinal and aromatic plants (2.6%), Textiles (2.6%), Footwear (2.6%), Knotted carpets (2.6%), Chyangra pashmina (2.6%), and All fabrics, textiles, yarn, rope (2.6%).

Chapter 4

Policy options

The partial equilibrium analysis used in this report shows that Nepal can expect to lose \$59 million in export revenues in 2026 due to LDC graduation tariff changes. This represents 4.3% of projected exports for that year – and losses in specific markets and sectors will probably be considerable. Targeted responses are the best way forward to counterbalance these losses:

x Improve market access:

Obtaining GSP+ status to access the European Union could reduce total expected losses up to 30%,

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Appendices

Appendix 1 Methodology

Effect of graduation

We have customized and applied a partial equilibrium model to assess the trade impact of tariff changes to Nepal, based on the following assumptions:

- 1) The elasticity of supply is infinite and returns to scale are constant: every country can supply an unlimited amount of the products it now exports, at current prices.²⁴
- 2) The global elasticity of import demand for a product is equal to one.
- 3) Products from different foreign suppliers are substitutable with a constant elasticity of substitution (Armington assumption).
- 4) Preferential tariffs are fully used.²⁵

The trade and tariff values in the model are projected to 2026. We project trade by (i) forecasting country share in market for a given product $G_{ij,k}$ (ProjMS_{ijk}) – Ω_{ja} 7.6 Ω_{b11} Ω_{aB} prQ7 5 & "11 pfH\$QeiBRR4#

where \bar{t}_{ij} is the average tariff applied by a market to all suppliers weighted by their market shares.²⁷ This simple procedure leads to the same result as analytically solving the partial equilibrium model described above.

Calculation of untapped trade potential

ITC has established a methodology to calculate potential trade values based on a country's potential share in a given market and the market's projected demand,

$$EPI_{ij} = MS_{ij}^{\text{pot}} \times ProjM_{ij}$$

with

$$MS_{ij}^{\text{pot}} = ProjMS_{ij} \times \left(\frac{E_{ij}}{E_{ij}^*} \right) \times \left(\frac{MA_{ij}}{MA_{ij}^*} \right)$$

The potential market share of country i in product j and market F combines information of i 's world market share of G , the ease of trade between E and F and market access. $ProjMS_{ij}$ is projected based on the growth rate of E relative to its competitors. $ProjM_{ij}$ is projected based on the elasticity of import demand for G to F 's expected growth rate and expected tariff changes.

Any gap between potential and actual trade indicates room for export growth.²⁸ In the case of Nepal, the gap we considered is between potential exports after graduation and projected exports after graduation. We call this gap post-graduation untapped export potential.

Contrasting the post-graduation untapped export potential with the projected export losses at the sector and market level helps Nepal set priorities – either on the negotiation of better tariff regimes or on trade promotion, in affected markets or in alternative ones.

²⁷ The indices LDC and grad refer to the specific situation of Nepal in 2026.

²⁸

Appendix 2 Data

The model uses trade and tariff data from the ITC Trade Map and Market Access Map databases, respectively. For trade projections, we use an arithmetic average of direct and mirror flows when both countries are estimated to be reliable reporters of their trade statistics (or when neither is reliable, but both report a trade flow for the same given product).²⁹ When only one of the trade partners is reliable, this country's reported trade flow is retained. For the calculation of export potential, we use a geometric average of reliable direct and mirror flows.

To reduce the impact of outliers, a weighted average of 2015–2019 data is calculated with a higher weight given to years that are more recent. Import demand and Nepal's exports in current United States dollars are projected to 2026 using the International Monetary Fund's April 2021 GDP forecasts and an estimation of import demand elasticities.

Two sets of tariffs feed into the calculations: the first corresponds to tariffs during the observation period (2015–2019), while the second corresponds to tariffs during the projection period (2026). Elasticities of substitution are taken from the Global Trade Analysis Project (GTAP) database and from the Centre d'études prospectives et d'informations internationales.

²⁹ An earlier version of the reliability assessment is described in Decreux and Spies (2016).

Appendix 3 Additional tables

	Affected market Loss	Alternative markets Untapped export potential		
Glass articles	United States 713	India 2,344	China 202	European Union 154
	711 Table/kitchen glassware, of glass ceramics (701310)	2,344 Glass beads (701810)	103 Glass beads (701810) 99 Cullet & other glass waste (700100)	100 Cullet & other glass waste (700100) 53 Glass beads (701810)
Metal products	China 2,549	United States 2,096	European Union 1,511	India 578
	1,631 Statuettes & other ornaments (830629) 622 Copper articles, nes (74XXXX) 224 Statuettes & other ornaments (830621)	1,890 Statuettes & other ornaments (830629)	1,033 Statuettes & other ornaments (830629) 196 Copper articles, nes (74XXXX)	291 Statuettes & other ornaments (830629) 241 Statuettes & other ornaments (830621)
Misc. manufactured products	1,361	European Union	United States	United Kingdom

	Affected market	Alternative markets		
	Loss	Untapped export potential		
Skins, leather & products thereof	China	India	European Union	Turkey
	992	2,986	666	180
	515 Grains of hides & skins of bovine or equine animals (410411)	2,918 Hides & skins of goats or kids, in the wet state (410621)	386 Hides and skins of bovine or equine animals, nes (410419)	180 Hides & skins of goats or kids, in the wet state (410621)
	306 Hides and skins of bovine or equine animals, nes (410419)		279 Grains of hides & skins of bovine or equine animals (410411)	
	165 Hides & skins of goats or kids, in the wet state (410621)			
Synthetic textile fabric	Turkey	Bangladesh	India	European Union
	13,685	8,161	7,987	2,729
	9,130 Yarn, <85% polyester staples, with artificial staples (550951)	4,672 Cabled yarn, >=85% (mod-) acrylic staples (550932)	5,260 Yarn, <85% polyester staples, with artificial staples (550951)	943 Single yarn, >=85% polyester staples (550921)
	3,902 Single yarn, >=85% polyester staples (550921)	1,095 Cabled yarn, >=85% artificial staples (551012)	2,757 Single yarn, >=85% polyester staples (550921)	808 Yarn, <85% polyester staples, with artificial staples (550951)
		778 Single yarn, >=85% polyester staples (550921)		480 Cabled yarn, >=85% (mod-) acrylic staples (550932)

Note: The table displays the most affected market-sector combinations that do not have enough untapped export potential to counterbalance the effect of graduation. It also lists the top three

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