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Integrating Trade in Nepal's Development Strategies

Abstract

An isolated country for much of its history, Nepal underwent tremendous political and economic changes in the past decade. Acknowledging the role of trade in development, Nepal entered a truly multilateral framework with its accession into the World Trade Organization in 2004. Since then, the country has signed several bilateral and regional trade agreements in order to integrate its trade sector into the global mainstream. Strengthening its commitments towards liberalized economy, several policies have also been reformed. In 2010, the Government of Nepal approved a new strategic document, the Nepal Trade Integration Strategy (NTIS). The purpose of the document is to identify sectors with potential comparative advantage so as to revitalize its dwindling exports. However, fact remains that Nepal is still an impoverished nation with an ever-widening trade deficit. Several internal limitations and bottlenecks that are holding the country back from taking advantage of the multilateral framework and other agreements still remain. The present challenge for Nepal, thus, is to address these issues and effectively implement the NTIS by developing effective collaborative mechanism involving the government, the private sector and international partners.

Background

Nepal, a landlocked South Asian country perched between China and India, has historically been isolated from the global economy. This isolation can be attributed to various factors including geographical dependency with its neighbors, centralized economic policies of the past regimes, rough terrain, poor infrastructure and lack of adequate resources, both natural and human.

A largely traditional, agrarian society, Nepal took first steps towards economic reform measures in mid-eighties in cooperation with the International Monetary Fund (IMF) and the World Bank. However, it was only after the advent of democracy following 1990's democratic movement that Nepal opened up to the world of free trade and commerce. In 1992, the newly elected representative government introduced a liberalized economic policy that ushered in a new era; establishing several reformative regulations, privatizing several public enterprises and recognizing the private sector as the engine of national development.

The move had started to show instant results as the economic growth rate jumped to as high as 8.22% in 1994¹. Unfortunately, this optimism was short lived as the country soon plunged into a bloody decade long civil war; the aftermath of which is still being felt in the country. This

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¹ (MoF, 2013)

period proved to be disastrous for the economy as the growth rate nosedived, reaching as low as 0.12% in 2002.

Despite the political and economic turmoil, however, Nepal continued to make progress in its attempts towards mainstreaming the country's trade into global trading system. The most important milestone in this process came when Nepal obtained the membership of the World Trade Organization (WTO) in 2004. Membership of the WTO was an important step in Nepal's commitment towards building a truly multilateral economic framework.

Today, Nepal is at another threshold of political transition, with second constituent assembly election held on 19th November 2013. Despite the collapse of the previous constituent assembly, there is newfound optimism that this new election will complete the long political transition since the end of the civil war, and will help institutionalize major issues such as democracy, secularism, federalism, ethnic and gender representation as well as an open market economy.

Present Scenario

After the end of the conflict, despite the political impasse, Nepal has made some positive economic progress. In the past decade, Nepal has undertaken initiatives in establishing several bilateral, regional and multilateral trade agreements. Apart from being a member of WTO's multilateral framework, Nepal is a member of two regional trade agreements: the South Asian Free Trade Area (SAFTA)² and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)³. Bilaterally, Nepal has trade agreement with its major trading partner, India as well as seventeen other countries.

To accommodate these changes, new policies in the area of trade, industries as well as service have been formulated and there are some growing trends, especially in service sectors. Considering that Nepal has largely been an agrarian society throughout history, it is remarkable how the country's service sector has grown in the past decade, when it overtook agriculture to be the highest contributing sector to the national Gross Domestic Product (GDP).

This growth in service sector can be attributed to growth in tourism as well as due to considerable inflow of remittance money from workers employed in foreign countries. Despite the growth in service, agriculture remains vital for Nepal as more than 73% of the population is employed by this sector. Development of agriculture is thus crucial to

Sector	GDP Composition
Agriculture	35.3%
Industry	14.4%
Service	50.3%

Source: Economic Survey, MOF, GON

Nepal's poverty alleviation and UN's MDGs efforts as much of the rural livelihood depends on it. However, agriculture sector of Nepal still suffers from perennial problems of low productivity, small and subsistence farming, land use of primitive technology, low investment, lack of R&D, and poor input-output market structure. The industrial sector has shown

² The other members of SAFTA are Bangladesh, Bhutan, India, Maldives, Pakistan and Sri Lanka.

³ The other members of BIMSTEC are Bangladesh, India, Myanmar, Sri Lanka, Thailand and Bhutan.

unsatisfactory growth as well. Political instability, lack of infrastructure, weak law and politicized labor unions have all contributed to this sluggish nature of industrial growth.

When it comes to trade, the performance in the last decade has been dismal. Trade deficit has been ever widening and the country has been able to maintain its positive balance of payment only due to the influx of remittance money. This year alone exports grew minimally by 4.2% while imports have continued to increase by double figures, 20.7%⁴. Trade deficit grew by 23.5% this year and now occupies a negative of 24.9% of the total GDP. Import occupies 29% of the total GDP while export occupies a mere 4% of the total GDP. The import of petroleum products has alone overshadowed the entire export figure of Nepal.

All these data point out that Nepal hasn't been able to take full advantage of the opportunities available due to its bilateral, regional and multilateral trade membership, agreements as well as economic grants. Several internal bottlenecks, structural limitations and supply side constraints remain which have made satisfactory growth difficult to achieve.

Integrating Trade in National Development Strategies

Trade is linked to all the dimensions that contribute to the social and economic development of a country, and to poverty reduction. Trade can become 'an engine of development', however, its positive effect is maximized when certain pre-conditions are respected.

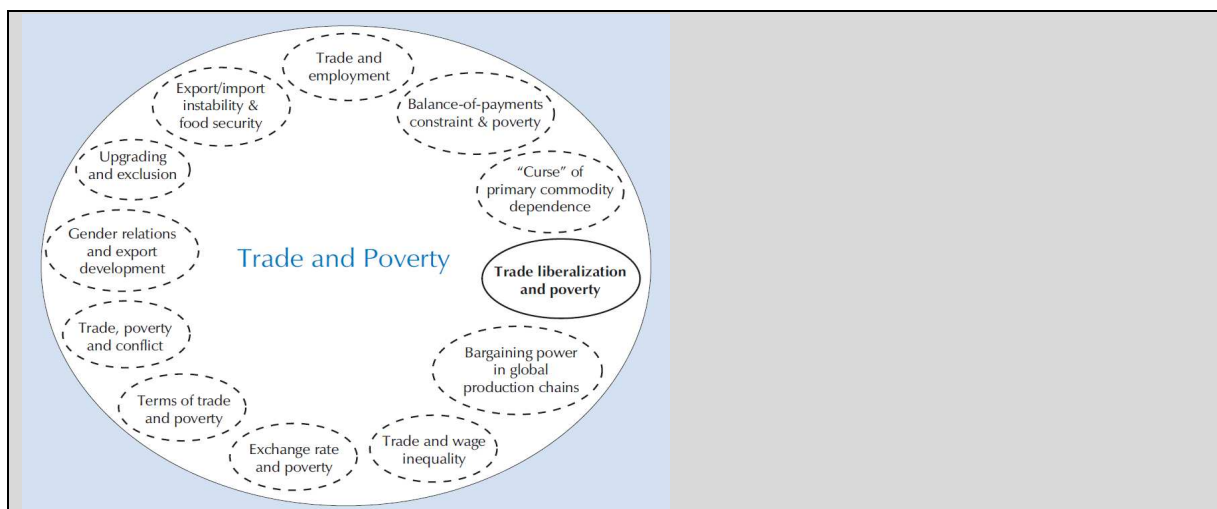
Trade is linked to many development dimensions

The understanding of the powerful role trade can play in a development process is nothing new. But the societies of the 21st century have become even more dependent on international trade. All nations of the world participate in the international trading system. International trade is indispensable to developing countries and LDCs because it can provide the sustained growth they need in order to develop. In addition to their direct income effects, international trade and production also have strong indirect effects.

International trade is related to cross-cutting development dimensions:

Trade affects poverty directly and indirectly through multiple channels; The linkages between trade and employment are complex; International trade can contribute to women's equality and empowerment; International trade cannot work without investment, in particular FDI, and *vice versa*; A key to achieving sustained development and poverty reduction in the LDCs is to put the development of productive capacities at the heart of development policies.

⁴ (TEPC, 2013)



But trade is also linked to sectoral dimensions of development present in MDGs:

Trade influences agriculture, food security and environment through various channels; The services economy and trade in services have become important engines for growth and development in developing countries; Trade is a major channel for technological progress and innovation which are themselves crucial drivers of productivity gains, and therefore growth and development; Trade facilitation has a strong development dimension.

Source: LDC Report 2004; Linking International Trade with Poverty Reduction, UNCTAD

Realizing the importance of trade in development, the Government of Nepal (GoN) in recent years has developed several strategies specifically intended towards growth of the trade sector. In terms of institutional changes, the Government has created various institutional setups and mechanisms. To facilitate inflow of foreign investment, Nepal Investment Board was established. In order to carry out trade related promotional efforts, Trade and Export Promotion Center (TEPC) was put in place. Similarly, Board of Trade (BOT) and Industrial Promotion Board (IPB) were established to promote trade and industry respectively. Establishment of Inland Clearance Depots (dry-ports) in four major customs points of the country has been carried out. Also initiatives have been put forth with an intention of efficient import and export through integrated checkpoints in major customs.

The past few years also saw a major shift in government policies regarding trade. In 2009, the Government developed a new trade policy, highly focused on export sector. The policy, consistent with WTO principles of liberal, open and transparent economic system, emphasizes on export focused private sector development. The objective of this new policy is to integrate and increase contribution of trade to the national economy in order to accelerate growth, provide domestic employment and reduce poverty. The policy also recognized trade in services as well as intellectual property as potential trade sectors of Nepal.

The next major milestone in this effort to integrate trade in the national economy came when the Government, led by Ministry of Commerce and Supplies (MoCS), launched a strategic document called Nepal Trade Integration strategy in 2010 (NTIS 2010). Developed with the

financial and technical assistance from several donor organizations⁵, the NTIS 2010 is the main trade strategy of the Government of Nepal. Within the NTIS, the Government established a National Implementation Arrangement (NIA) for the purpose of implementing the Enhanced Integrated Framework (EIF) and related activities at the national level in order to take full benefits of Trade-Related Technical Assistance (TRTA) and Aid for Trade (Aft).

The NTIS 2010 broadly lays out the following four objectives⁶:

1. Enhance market access by strengthening trade negotiations
2. Enhance overall supply capacity by strengthening the technical capacity of domestic Non-Tariff Barrier (NTB) and other business environment supportive institutions
3. Enhance supply capacity of priority export sectors by strengthening capacity of 'inclusive' export potential goods and services
4. Efficiently and effectively mobilize resources by and strengthening GoN's capacity to coordinate and manage TRTA and Aft

In order to fulfill these objectives, the NTIS 2010 identified nineteen high potential goods and services that Nepal has comparative advantage on and could gain competitive edge to excel in the export market. Out of the nineteen priority sectors, seven are agro-based products, five are craft and industry based goods while seven are services. In addition, five more sectors have been identified as 'high potential sectors'⁷.

Implementing the NTIS

The implementation phase of the NTIS began with full force right after the strategic document was released. In order to effectively execute the EIF and to fully realize the capacity building opportunities provided by the framework, the government has established a strong institutional structure, integrating EIF focal points with government institutions and ministries. Not only this, adhering to NTIS guiding principle of involving all stakeholders in its implementation, strong public-private partnership and effective donors collaboration has also been recognized and put in place.

In order to align the country's national trade strategy with the EIF multi-structural format and implement the NTIS, the MoCS started Nepal Enhanced Capacities for Trade and Development (NECTRADE) project. The NECTRADE project has been in operation since 2010 as a Tier 1 project of EIF Nepal under the MoCS. The objective of the project is to facilitate trade mainstreaming, trade promotion, TRTA management and awareness-raising on trade issues, coordinate Aft and enhance supply-side capacity through the EIF National Implementation Arrangement (NIA). The project is further designed to strengthen the NIA to enhance Nepal's ownership of TRTA and maximize the benefits that the country can derive from participation in international trading system. As we head into the end of 2013, the

⁵ NTIS 2010 supporting organizations: United Nations Development Programme (UNDP), Government of Finland, United Kingdom's Department for International Development (DFID), the International Finance Corporation (IFC), and International Trade Centre (ITC).

⁶ (MoCS, 2010)

⁷ (See: Annex 2)

NECTRADE project is also moving into its second phase where finalization and validation of Nepal's second Diagnostic Trade Integration Study (DTIS) update will take place.

The Government of Nepal, to effectively address trade related issues and to facilitate growth especially of the priority sectors, has put in place several initiatives in close coordination with private sector and donor agencies. Following success of collective trademark registration of Chyangra Pashmina, similar initiatives for tea and coffee have been carried out to help these sectors gain competitive advantage through brand value. The government has also taken initiatives to facilitate nursery development and have been providing high yielding seeds to enhance the Large Cardamom sector. Cold warehouse in Tribhuvan International Airport has been established. Several export focused trade fairs have been organized, and various trainings and capacity building workshops targeting the beneficiaries have been carried out.

Furthermore, in order to promote and enhance capacity of the priority sectors, Expression of Interest (EOI) was published in August 2011 for NTIS implementation at local level. Some of the projects, led by private institutions and supported by MoCS, have been effectively practiced. Since August 2012, first EIF Tier 2 project supporting the ginger value chain has also been put in place. This EIF funded project is supported by Standards and Trade Development Facility (STDF) and implemented by Food and Agriculture Organization (FAO). Similarly, another EIF Tier 2 project supporting Pashmina sector enhancement was developed with the assistance of International Trade Centre (ITC) and ready for implementation. Yet, another project supporting exports of medicinal herbs and silver jewelry has been developed jointly by the German Development Co-operation (GIZ) and MoCS. All these sectors have been identified as high-potential sector for export, value-addition, employment and income-generation in the NTIS 2010. With effective recipient-donor collaboration, many such project supporting other sectors under Nepal's trade baskets are to be carried out in order to fully realize the potential identified in the NTIS 2010.

One current undertaking on recipient-donor collaboration aimed at linking trade with other development dimensions and NTIS implementation is reflected in proposed United Nations Development Assistance Framework (UNDAF) 2013-17. As an LDC, Nepal's matrix is closely related to the technical assistance priorities identified by the Enhanced Integrated Framework.

Multidimensional approach on trade and development in proposed UNDAF 2013-17

In the matrix Nepal is currently preparing, one outcome of the Component III (*Creating an enabling environment for enhanced international cooperation*) deals more specifically with trade-related development issues. It is Outcome 8: which aims to see Nepal's institutions and economy 'more effectively integrated into inter-governmental economic and normative dialogues, and policy and legal regimes'.

This outcome is itself divided into four outputs, two of which are of interest for our analysis:

With output 8.1 entitled '*the Government of Nepal and other institutions are better able to strategize international policy regulatory issues and comply with international trade, industrial and environmental agendas*', UNCTAD and UNCITRAL will assist national authorities to

improve their capacities to strategize international development issues and regulatory frameworks with implications on international trade. The emphasis is put on regional and multilateral negotiations (with a particular focus on WTO post-accession), as well as South-South cooperation.

UNEP, for its part, will implement actions to improve Nepal's capacity to comply with the international agenda on trade and environment (in particular the Convention on biodiversity and the Montreal Protocol).

Output 8.2 deals with the enhanced capacity of Nepalese institutions to 'comply with international policy regulatory framework, recommendations and standards'. In this context, UNIDO, FAO and ITC will in particular:

- Assist to comply with SPS requirements for the export of commodities (mainly ginger). Among the actions envisaged, we should note the training and equipment of laboratories,
- Establish a ginger processing plant complying with international standards.

The general objective here is to promote industrial development, develop an agriculture respecting international standards and assist governmental institutions and private sector to promote specific exports.

Source: Trade Dimension in United Nations Development Assistance Frameworks, UNCTAD

Constraints

In recent years, the Government of Nepal has acknowledged trade as an essential foundation for the national economy. In order to stay true to the liberal economic principles of the WTO, Nepal has introduced various reform programs. However, being a Least Developed Country (LDC), complete implementation of NTIS 2010 is not possible with the Government's effort alone, due to limitation regarding resources and technical expertise. Furthermore, several constraints historically limiting Nepal's progress are still in existence. Some of these constraints include ongoing political transition, difficult terrain, landlocked geography, limited export basket, weak management-labor equilibrium, inadequate infrastructure, insufficient skilled human resources, inadequate/inaccurate market information and inadequate trade related assistance⁸. All these factors have severely hampered Nepal's trade capacity building efforts.

⁸ (TPR, 2012)

The Way Forward

In order for Nepali products to be competitive in the international market, it has to strengthen its capacity in terms of quality, quantity as well as price. Because of insufficient skilled human resource as well as inadequate R&D, Nepali products haven't been able to gain competitive edge. Many of the products do not match international standards. One of the reasons for these constraints is Nepal's substandard testing laboratories, conformity assessment bodies and accreditation institutions. Hence it is essential that a focused collaboration between public and private sectors facilitated by donor agencies be established through proper bilateral or multilateral platforms. Lack of accurate market information and know-hows is another factors hampering Nepal's trade growth. It is important to establish an international market information center with proper public-private partnership as well as through coordination with international partners. Furthermore, collaboration of these institutions with local experts and academics, media and non-government organizations cannot be negated.

It is also imperative that Government further develop its legal infrastructure so as to be on par with the pace of rapidly changing international trade regime. Several initiations have been taken, but bureaucratic hurdles still remain. Crippling energy crisis has made Nepal even less attractive market for investment. Sincere efforts to curb these problems need to be undertaken. Several Nepali products, despite huge potential, haven't been able to get proper market access because of infrastructural limitation. Major investments dedicated towards development of trade infrastructure are needed, for which, collaboration at a larger scale between the government, public-private sectors as well as international agencies is necessary.

Nepal also needs to enhance its capabilities at economic diplomacy to fully utilize the benefits offered by the international trade system, more importantly the GSP. It is essential for Nepal to strengthen its trade negotiations for the purpose of greater market access and exemptions. Nepal also needs to conduct stronger engagements with other LDCs to make their issues heard in the international forums. It is crucial for Nepal to develop highly qualified diplomatic missions that can properly take a stance while negotiating with its bilateral and multilateral counterparts. Importantly, there is a need to strengthen country's ownership by following demand driven process. Considering the enormous challenges faced by Nepal's economy, assistance from donor agencies can still not be deemed enough. Hence, it is necessary to enhance direct budgetary support through Aid for Trade channel or through similar other processes. However, it is essential that the processes be conducted ensuring full transparency and accountability of recipients.

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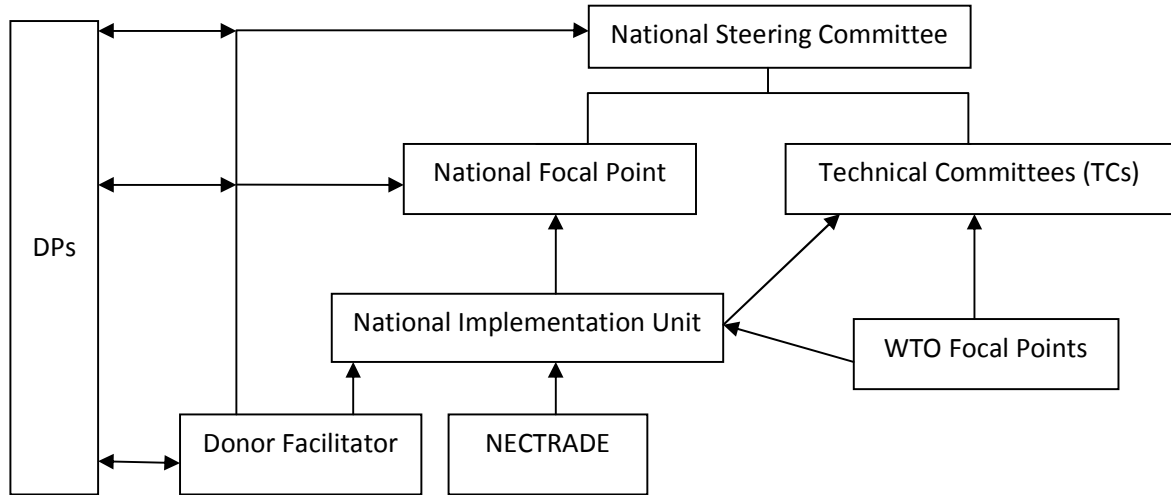
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Annex 1: EIF/NTIS Implementation Arrangement



Technical Committee 1 (TC 1)	Aid for Trade and Service Trade, Lead by PITCD, Ministry Commerce and Supplies
Technical Committee 2 (TC 2)	Trade Negotiation Capacity Development and Trade Support Institutions, Lead by EPTT Division, MOCS
Technical Committee 3 (TC 3)	Agriculture and SPS, Lead by Ministry of Agriculture and Cooperatives
Technical Committee 4 (TC 4)	Manufacturing, TBT, Investment and IPR, Lead by Ministry of Industry
Technical Committee 5 (TC 5)	Customs, and Trade Facilitation, Lead by Ministry of Finance
Technical Committee 6 (TC 6)	Legal Reform, Lead by Office of the Prime Minister and Council of Ministers

Annex 2: Priority Sectors Identified by NTIS 2010

Agro-Food	Craft and Industrial Goods	Services	Other Potential Export Sectors
1) Cardamom 2) Ginger 3) Honey 4) Lentils 5) Tea 6) Noodles 7) Medicinal Herbs/Essential oils	8) Handmade Paper 9) Silver Jewelry 10) Iron and Steel 11) Pashmina 12) Wool Products	13) Tourism 14) Labour Services 15) IT and BPO Services 16) Health Services 17) Education 18) Engineering 19) Hydro-electricity	20) Transit Trade Services 21) Sugar 22) Cement 23) Dairy Products 24) Transformers