



COMMENTARY

NAVIGATING NEPAL'S LDC TRANSITION: COOPERATION OVER COMPETITION

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SOUTH ASIAN FUTURES FELLOWSHIP

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SAKSHEE SINGH IS AN EARLY-CAREER DEVELOPMENT PROFESSIONAL PASSIONATE ABOUT SUSTAINABILITY, EDUCATION, POLICY, AND ADVOCACY IN SOUTH ASIA, WITH EXPERTISE IN COMMUNICATION FOR DEVELOPMENT (C4D). IN NEPAL, SHE WORKED WITH THE WORLD BANK ON GRID DISCUSSIONS, PARTNERED WITH GIZ ON THE GRAPE PROGRAM FOR SMART AGRICULTURE, AND CONTRIBUTED TO THE INCLUSIVE GROWTH FRAMEWORK FOR THE NEPAL FINANCIAL INCLUSION REPORT 2023, SUPPORTED BY UNCDF AND IFC. AT THE NEPAL ECONOMIC FORUM, SAKSHEE GAINED VALUABLE INSIGHTS INTO THE COUNTRY'S DEVELOPMENT TRAJECTORY. PREVIOUSLY, SHE WAS PART OF THE INDIAN SCHOOL OF PUBLIC POLICY'S COMMUNICATIONS AND ACADEMIC TEAM, SUPPORTING ITS COMMUNICATION LAB AND ASSISTING IN LECTURES ON GENDER, URBANIZATION, AND DEVELOPMENT POLICY. SHE ALSO ACTIVELY VOLUNTEERS WITH CHARITIES EMPOWERING WOMEN AND GIRLS THROUGH EDUCATION IN INDIA AND THE UK.

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NAVIGATING NEPAL'S LDC TRANSITION: COOPERATION OVER COMPETITION

Background

The 40th plenary of the 76th Session of the United Nations General Assembly 2021 announced the decision for Nepal's graduation from its status as a Least Developed Country (LDC) to a Middle-Income Country (MIC). The graduation is set to come into place on November 24, 2024, with a five-year transitional period to prepare and build strategies in partnership with regional, multilateral, and bilateral allies [1]. While the country refused to move up the ladder in 2015 and 2018 due to the long-lasting impacts of the 2015 earthquake, it was in 2021 that Nepal finally decided to graduate by 2026. To graduate, an LDC is required to meet three specific criteria. However, Nepal is graduating despite only meeting two which include—the human asset index (HAI), and the economic and environmental vulnerability index (EVI)—leaving per capita income falling short at USD 1,027 when it should be USD 1,222 [2].

Nepal's impending graduation is a milestone in the country's development journey, symbolizing remarkable socio-economic progress achieved over the years. However, this transition comes with a bittersweet reality— it entails relinquishing Overseas Development Assistance (ODA). Nepal's preferential trade agreements grant duty-free access to various markets [3] significantly aiding its exports. With graduation, these privileges may diminish, creating a trade gap with potential repercussions [4].

In light of this change, this commentary will provide a brief overview of the decreasing support from multilateral organizations like the World Bank, Asian Development Bank (ADB), and United Nations (UN) agencies and assess alternative sources of development cooperation in the region that Nepal can cultivate, specifically looking at the South-South partnership between Nepal and countries like China and India. Graduating from LDC status presents three key challenges: the risk of preference erosion in international trade, potential disruptions in policy space affecting support for industries and exports, and disadvantageous impacts on development financing prospects, including a shift from grants to concessional loans and probable loss of access to specific funds dedicated to LDCs [6]. As Nepal prepares to graduate from being an LDC, the economy faces significant structural challenges with heavy reliance on remittances, constituting over 30% of its GDP, and the persistent "low-growth, high migration trap" [7] that pose obstacles to productivity growth.

Declining Privileges

The influx of multilateral aid as ODAs is a critical aspect that shapes Nepal's economic landscape. Over the years, the World Bank and the ADB have supplied over half of Nepal's ODA, further intensifying the significance of multilateral support in Nepal. The data from the Ministry of Finance (MoF) shows that Nepal has always been a recipient of a consistent inflow of ODA with around USD 1,282 million per year between 2013/14 and 2018/19 [8]. The incoming ODA surged by 25.5% to USD 2,002.8 million in FY2019/20 because of increased financial assistance to combat the impacts of the COVID-19 pandemic [8]. Despite these fluctuations, ODA disbursements as a percentage of GDP have remained relatively stable averaging above 5% during the period 2010/11-2020/21. After Nepal achieves its MIC status, the decrease in support from multilateral partners [5], coupled with the evolving debt landscape, necessitates a nuanced and strategic approach to navigate the intricate terrain of development financing and debt management, while exploring regional cooperation in a more concerted manner. Shifting gears towards south-south ties has the potential to smoothen the transitions for Nepal and create a regional cooperative network that supports developmental initiatives while navigating economic challenges effectively. However, the complexity of regional bilateral cooperation [7], influenced by strategic, geopolitical, and bilateral considerations, makes predicting the direction and composition of ODA post-graduation more complicated.

Strengthening South-South Cooperation

Nepal continues to exhibit a fiscal appetite for borrowing money to invest in development projects. However, the cost of borrowing [16] is increasing, which could make it difficult for Nepal to respond to economic downturns or make long-term investments. Simply put, Nepal's graduation from LDC status will mean less financial aid from international organizations. As Nepal plans for this transition, it needs to consider the rising cost of debt repayment. This could be an opportunity for South-South cooperation, with India and China potentially providing financial assistance. It's critical to note that the South-South relations [5] are likely to stay unchanged considering Nepal's bilateral FTA with India that grants duty-free access. Similarly, China's bilateral loans and the two countries' relations over the Belt and Road Initiative (BRI) will remain immune to LDC transitions.

Nepal's closest neighbors, India and China, are vital bilateral partners for its development. India is the fifth largest bilateral donor, followed by China in sixth place. Notably, India's development cooperation transcends Nepal's LDC status, focusing on recipient countries' priorities, while China,

with a focus on LDCs in Asia and Africa and BRI members, exhibits a distinct approach. Nepal's participation in the BRI and its proximity to China's land border suggest that its graduation from LDC status is unlikely to lead to significant changes in China's development cooperation with Nepal.

As Nepal approaches the transition and a widening gap owing to receding ODAs, bilateral aid to Nepal will become increasingly important. Nepal will need to engage closely with these partners in diplomacy, strategic planning, and geopolitical engagement to secure the support it needs for its development.

India-Nepal – A Long-Standing Partnership

The South Asian Free Trade Agreement (SAFTA), a preferential trade pact among eight SAARC member states, including Nepal, offers LDC-specific benefits but grapples with challenges arising from shallow tariff cuts and extensive sensitive lists. LDCs within SAFTA, Nepal included, enjoy special concessions in tariff preferences and rules of origin provisions [3]. Nepal's exports within SAFTA primarily flow to India, heavily reliant on the Nepal-India Trade Treaty rather than SAFTA, itself. However, the impact of LDC graduation on Nepal's exports to India is largely negligible, except for critical products like refined soybean oil and palm oil, where SAFTA's rules of origin play a decisive role. The post-graduation scenario could significantly impact these exports to India. While exports to Bangladesh and Sri Lanka may face limited tariff repercussions, other SAFTA countries are unlikely to experience substantial changes. Despite these trade complexities, India remains a cornerstone bilateral partner for Nepal, demonstrating a commitment that transcends the challenges posed by LDC status. India's collaborative spirit in supporting Nepal's development priorities highlights the enduring strength of their multifaceted relationship, extending beyond the formalities of LDC graduation. The Indo-Nepal partnership exemplifies resilience in bilateral ties, firmly rooted in historical, cultural, and economic connections, surpassing the formalities of LDC graduation.

China-Nepal – A Strategic Partnership

For Nepal, China emerges as a key player with a strategic partnership extending beyond LDC status, notably through initiatives like BRI. LDC graduation appears to have marginal significance in shaping this partnership, given China's overarching focus on collaborating with BRI participant countries. Nepal's role in the BRI reinforces China's enduring importance as a development ally, ensuring that graduation doesn't mark a departure in China's approach [3]. Beyond BRI, the partnership also

promised to focus on infrastructural development, energy cooperation, and tourism. It can be concluded that the Sino-Nepal development partnership underscores collaboration beyond BRI scope as Nepal embarks on a new phase post-graduation.

Strategic Advantage in Regional Cooperation

Nepal can work on enhancing its appeal to foreign direct investment (FDI) by focusing on domestic improvements such as simplifying tax procedures, reforming labor laws, and implementing better regulatory frameworks. While this path towards enhanced FDI [9] may seem straightforward, it is plagued with multiple ever-changing factors. Additionally, the country can, and must, explore financial assistance beyond India and China by initiating ties with economies like Turkey, Brazil, and South Africa [10] through the Global South framework.

However, owing to its geographical location, Nepal's existing relations with India and China also place the country in a strategic position to leverage the relationship and the proximity to its advantage. Recognizing the friction between its neighbors and their vested interests in Nepal, the country can focus on prioritizing its own national interests. By maintaining neutrality while benefiting from both countries' initiatives, Nepal could use its geopolitical importance in the region to negotiate preferential trade agreements [iii] with both countries. Similar to Botswana, which achieved its graduation by focusing on its development policies, Nepal could not only invest in its infrastructural development but also create a situation where the two neighbors could compete to secure favorable terms for infrastructural projects to gain favors [11]. Another way Nepal could leverage its strategic position is by attracting both tech-focused nations to invest in knowledge-intensive sectors in Nepal, utilizing the space for innovation and technological advancements that would benefit the bilateral relationship.

Prioritizing National Interest – Cooperation Over Competition in Post-LDC Nepal

LDC graduation presents Nepal with a unique set of opportunities and challenges, particularly in the realm of trade and development cooperation. To ensure a seamless and sustainable transition, Nepal must proactively formulate a comprehensive strategy [12] that addresses the loss of LDC-specific support measures, capitalizes on emerging opportunities, and tackles structural challenges and vulnerabilities. Seeking preferential market access conditions under SAFTA [3], exploring innovative financial models like blended finance and public-private partnerships, and

collaborating with development partners for dedicated funds, disaster insurance, and technology transfer mechanisms are crucial steps in this direction. Nepal must also carefully re-engineer its development aid ties, leveraging its geographical position between India and China to maximize its bargaining potential.

While Nepal sometimes finds itself in a geopolitical bind between its two powerful neighbors, it is essential to prioritize cooperation over competition to achieve its national interests. Strengthening bilateral partnerships with India and China [3], while exploring South-South cooperation opportunities, will be critical for maintaining trade balance, competitiveness, and market access.

LDC graduation is not an endpoint but rather a stepping stone on Nepal's development journey [13]. While the reduction in multilateral ODAs is a concern, bilateral aid is likely to remain relatively stable [14], driven by strategic and geopolitical factors. To navigate this complex transition effectively, Nepal must adopt a comprehensive strategy that emphasizes cooperation over competition and prioritizes national interests. By adopting a cooperative approach and prioritizing its national interests [15], Nepal can successfully navigate the challenges of LDC graduation and propel itself toward sustainable economic growth and the attainment of its Sustainable Development Goals (SDGs).

Endnotes

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- [16] The "cost of borrowing" refers to the interest rate that Nepal must pay on the loans it takes out to fund development projects. When the cost of borrowing increases, Nepal will have to pay a higher interest rate on its loans, making it challenging to manage its finances.

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