Nepal after LDC Graduation

New avenues for exports

International Trade Centre

The International Trade Centre (ITC) is the joint agency of the World Trade Organization and the United Nations.

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About the paper

Nepal could lose 4.3% of exports because of tariff changes when it graduates from least developed country status in 2026. 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.

This report suggests strategies such as targeted trade promotion and market diversification to materialize remaining export potential and counterbalance the expected impact of graduation on exports.

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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 human assets and economic vulnerability criteria, it was agreed in 2021 that Nepal would graduate from the LDC category by the end of 2026.

Today's challenges associated with graduation are compounded by climate change concerns and the consequences of the COVID-19 pandemic. What's more, Nepal faces unique challenges as a landlocked least developed country. It is therefore crucial that Nepal make the most of the five-year preparatory period and put in motion strategies that secure a sustainable transition out of the LDC category.

The International Trade Centre and the United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States stand ready to support Nepal's efforts towards a successful graduation process. That is why we joined forces to produce this study, which uncovers the effect of graduation-related tariff changes on Nepalese exports and identifies targeted strategies to counterbalance them.

We hope this study will be a useful input to ensure Nepal's sustainable and inclusive development post-graduation.

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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.

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%. Losses will likely concentrate in exports to the European Union (EU) (-$18 million), Turkey (-$14 million), China (-$11 million), the United Kingdom (-$7 million) and Canada (-$3 million).

The projected losses will be concentrated in apparel (-$21 million), synthetic textile fabrics (-$14 million), carpets (-$6 million), metal products (-$3 million) and miscellaneous manufactured products (-$2 million). While the loss represents a relatively small share of exports forecast for 2026, for some sectors the loss is sizable, notably for processed cereals (69%) and home textiles (25%).

Counterbalancing export losses – policy options

Targeted responses can counterbalance trade losses. They include using trade promotion to tackle hurdles that prevent the realization of export potential, facilitating market diversification and pursuing better market access conditions.

This study contrasts the post-graduation untapped export potential estimated for 2026 with the projected export losses at the sector and market levels to identify which mitigation strategies best suit each case.

Targeted trade promotion

In some cases, the untapped export potential in a given market and sector after graduation exceeds the expected graduation-related export losses. After graduation, unlocking the full export potential of apparel to Japan, beauty products and perfumes to China, and carpets to Canada could offset the losses expected for those markets and sectors. Targeted trade promotion that enables companies to overcome current frictions – such as non-tariff measures, rules of origin or specific consumer preferences in the target market – can help realize the export potential of these sectors and markets.

Market diversification

Several sector-market combinations will face a drop in exports without having enough space to counter this decline through trade promotion. However, alternative markets are available with sufficient untapped export potential, turning market diversification into a promising strategy to balance out graduation-induced trade losses.

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-year preparatory period would be extended to five years.

This means that Nepal will continue to receive LDC-specific support until 2026. The time until then is to be dedicated to preparing a smooth, sustainable transition out of the LDC category. 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 aims to estimate graduation-related trade losses for Nepal and to identify approaches to compensate them.

The analysis uses a partial equilibrium model to calculate the impact of tariff changes on potential trade outcomes. This approach differs from others used in the literature in that we project current trade to its expected level in 2026, using forecasts of the gross domestic product (GDP) and population of all countries.

Using projected rather than current exports is important as we expect Nepalese exports to shift towards fast-growing markets that do not have special LDC schemes. If that is the case, traditional approaches based on current trade values tend to overestimate the impact of LDC graduation. Likewise, we consider future changes in Nepal's tariff advantages over competitors by including the 2026 tariff rates available from the tariff reduction schedules of trade agreements that are in force.

The analysis identifies, at a detailed product and market level, for all potential partners, where losses are expected to be significant. The findings are contrasted with the untapped trade potential estimated for 2026 – a figure calculated by tailoring the International Trade Centre (ITC) export potential methodology to the LDC graduation context.[2]

Whenever the trade loss identified exceeds the untapped trade potential, Nepal may seek to prioritize strategies to improve market access, such as bilateral or plurilateral agreements, or to pursue market diversification opportunities. Conversely, whenever the untapped trade potential exceeds the trade loss, Nepal may seek to prioritize strategies that help companies overcome the frictions that prevent them from unleashing market opportunities, e.g. investment in trade promotion and advisory.

This approach thus provides estimates of expected trade changes after graduation and concrete recommendations on actions to buffer the effects. Chapter 1 describes tariff changes to be expected upon graduation. Chapter 2 examines the estimated effects of these changes on exports. Chapter 3 summarizes export growth opportunities and the impact of compensatory approaches such as market access, trade promotion and market diversification. Chapter 4 offers policy options.

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[1] The United Nations Committee for Development Policy recommends graduation from the LDC category based on certain criteria scores that are evaluated every three years. The criteria considered are gross national income per capita, the Human Assets Index and the Economic and Environmental Vulnerability Index. Countries that meet thresholds on any two of these indicators for two consecutive reviews, or alternatively more than double the gross national income threshold at two consecutive reviews, are recommended for graduation. Complementary country-specific information and the views of the government are also considered. Nepal first met graduation criteria by surpassing the thresholds of the two indexes in 2015 and 2018. However, graduation differed then in consideration of the economic turmoil generated by the 2015 earthquake and concerns over the sustainability of graduation at that time.

[2] For a technical document on the ITC export potential methodology, see Decreux and Spies (2016). Results of this methodology are disseminated through a free online tool, the ITC Export Potential Map (https://exportpotential.intracen.org). The specific tailoring of the methodology to the context of LDC graduation is explained in Appendix A.1.

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

Generalized System of Preferences	Bilateral free trade agreement
Armenia	India
Australia	**SAFTA**
Belarus	Bangladesh
Canada	India[4]
Japan	Sri Lanka
Kazakhstan	**MFN**
Kyrgyzstan	Chile
New Zealand	China
Norway	Iceland
Russian Federation	Montenegro
Switzerland	Republic of Korea
Turkey	Taipei, Chinese
United Kingdom	Tajikistan
United States[5]	
European Union	

Source: ITC staff illustration based on data from the ITC Market Access Map (2021).

Fifteen of the 25 markets granting LDC preferences to Nepal also have a non-reciprocal preferential tariff scheme that offers some tariff reductions to developing countries. Bangladesh, India and Sri Lanka are the only members of the South Asian Association for Regional Cooperation that grant additional preferences to Nepal due to its LDC status; they will move to the standard SAFTA preferences after graduation. Nepal also benefits from a bilateral trade agreement with India.

The remaining seven markets have no alternative preferential scheme in place for which Nepal could qualify. Therefore, Nepalese exports to these markets will be subject to MFN tariffs following graduation.

Some comments are in order regarding how these schemes are used in the analysis that follows.

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[3] The European Union (EU) is considered as one market.

[4] For most products, the India–Nepal bilateral trade agreement will apply. Elsewhere, the non-LDC SAFTA preferences will apply.

[5] There is also a specific Nepal–United States preference programme. This agreement is set to expire in December 2025, independently of the LDC status of Nepal. In the calculations that follow, this programme is assumed to be expired both pre- and post-graduation.

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 eventually qualify for the EU's extended, more generous GSP system, GSP+. To do so, Nepal would have to fulfil the vulnerability criteria, reflecting a non-diversified economy and low import shares into the EU, and implement 27 international conventions on labour rights, human rights, environment protection and good governance.[8,9] The analysis that follows considers both scenarios, GSP and GSP+.

Third, whenever more than one preference scheme is applicable, our analysis assumes that Nepalese exporters make use of the most favourable one, regardless of differences in the rules of origin.

Lastly, the analysis considers the tariff levels that will be available in 2026. This is done using all tariff schedules already negotiated. Likewise, we project exports to 2026.[10]

Figure 1   Vegetable products and cereals to face steep tariff increase
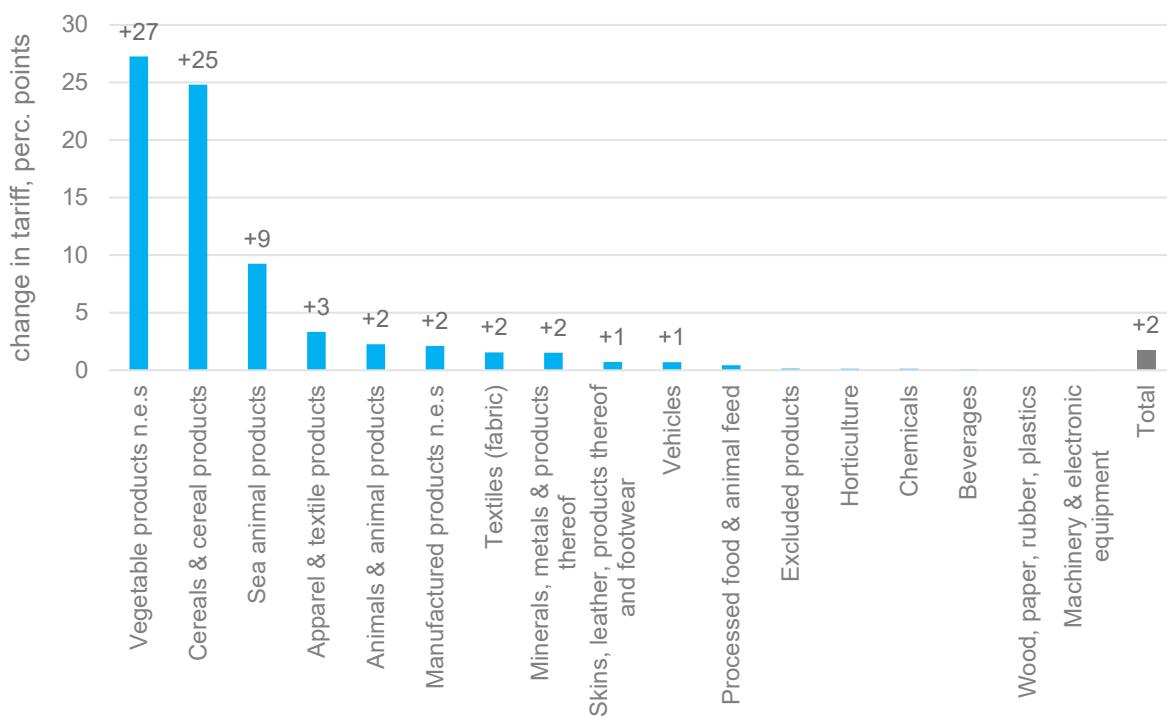
Note: Averages by sector weighted by pre-graduation 2026 exports. The acronym n.e.s. stands for not elsewhere specified.
Source: ITC staff calculations based on data from the ITC Market Access Map (2021).

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[6] As part of the ongoing GSP review, the extension of the smooth transition out of Everything But Arms to five years is being considered.

[7] To be granted EU GSP preferences, a country needs to be classified below the 'upper middle income' category of the World Bank, and not benefit from other preferential market access schemes to the EU.

[8] Razzaque (2020) reports that Nepal meets the vulnerability criteria.

[9] Upon exiting the European Union, the United Kingdom implemented its own GSP system, similar to the one of the EU with three categories: LDC countries, general framework and enhanced framework. The eligibility criteria for each category are also similar. See https://www.gov.uk/guidance/trading-with-developing-nations-during-and-after-the-transition-period.

[10] As Nepal will graduate at the end of 2026, any effects on tariffs – and subsequently on exports – will materialize in 2027 at the earliest. In spite of this, we estimate the effects of graduation on 2026 trade because the GDP forecasts we use, which play an essential role in our trade projections, are only available up to 2026. See additional details on methodology and data in Appendices A.1. and A.2.

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
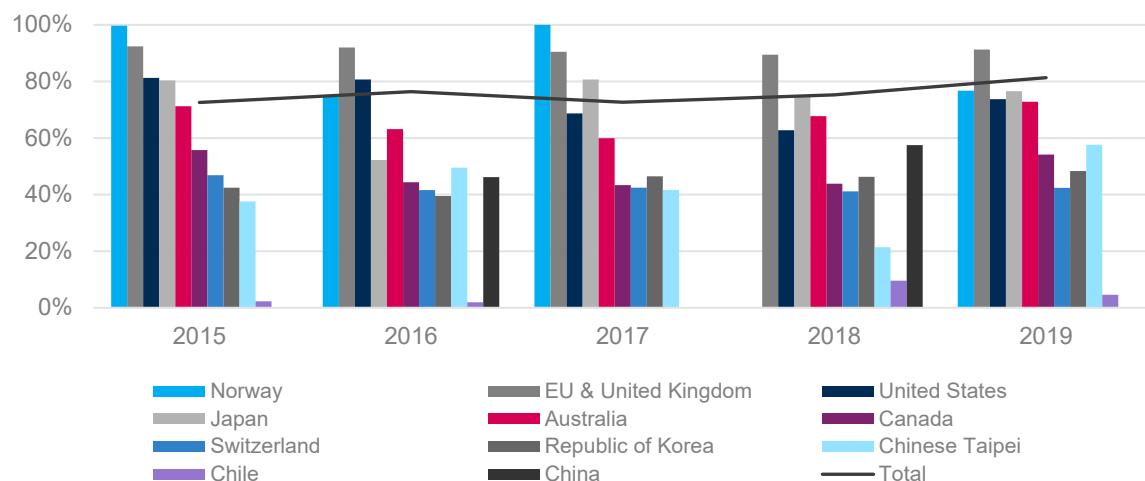
Note: Data for China are only available in 2016 and 2018.
Source: ITC staff calculations based on data from World Trade Organization's Integrated Database.

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.

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[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.

Rules of origin

Graduation from LDC status implies a change in tariffs and in the rules of origin with which graduating countries must comply to be eligible for preferential treatment. More stringent rules of origin often lead to lower utilization rates of preferences.

The next best regimes listed in Table 1 are associated with both higher tariffs and often stricter rules of origin. For example, non-LDC preferential access to SAFTA countries requires 40% local value addition, instead of the 30% required under LDC status. Similarly, the 30% local value-addition requirement under the Everything But Arms initiative becomes a 50% requirement under GSP and GSP+.

In many cases, the apparel sector must meet additional transformation conditions to qualify for preferences. Razzaque (2020) conducts a thorough review of the changes in rules of origin that Nepal can expect upon graduation.[13]

The tougher rules of origin post-graduation requirements can be expected to reinforce the negative impact of tariff increases on Nepal's exports. As rules of origin changes are not considered in our analysis, the calculated trade losses associated with tariff changes can be considered as lower-bound estimates.

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[13] Additional details can be obtained in the ITC Rules of Origin Facilitator, a web-based application for country- and product-level information on rules of origin for 347 trade agreements (www.findrulesoforigin.org).

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 EU, Turkey and China will be highest
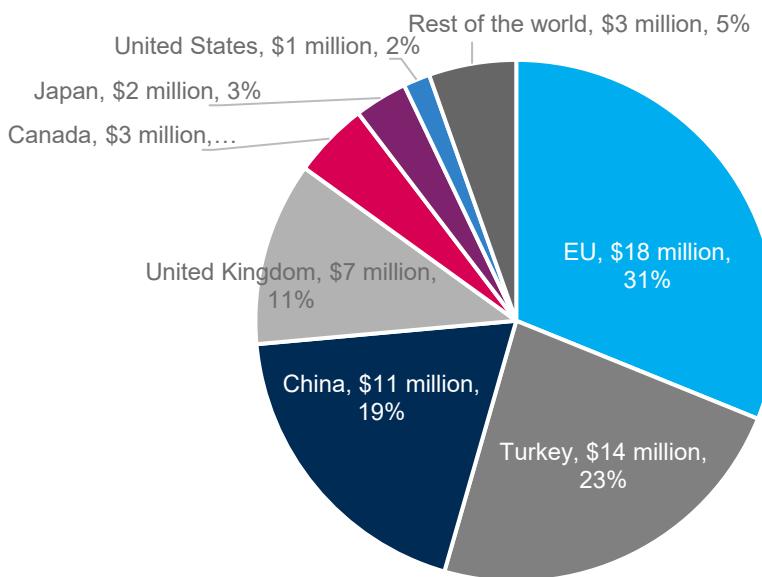
Note: The figure shows the markets with the largest losses, up to 90% of total losses.
Source: ITC staff calculations based on data from the ITC Market Analysis Tools (2021).

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

Figure 4   Exports to largest partners are minimally affected
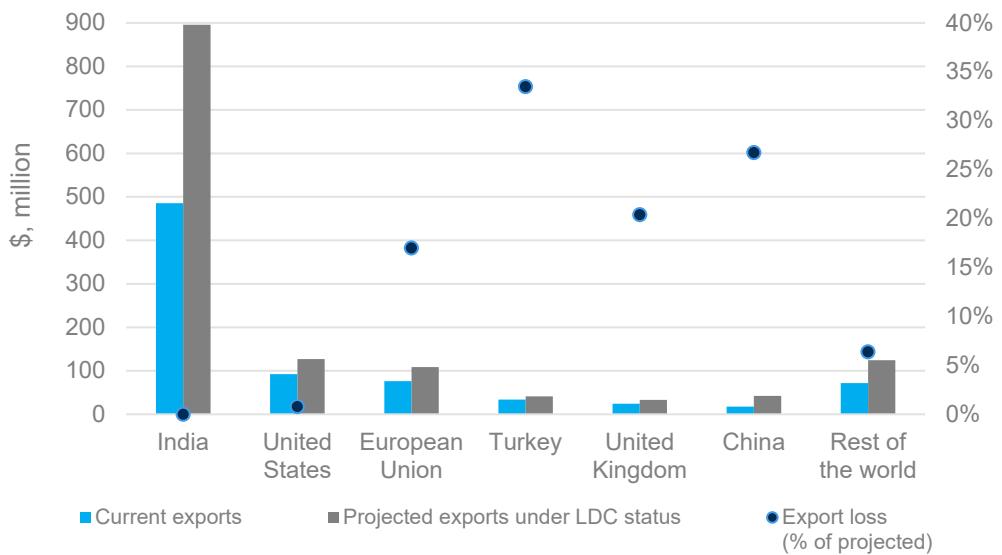
Note: The figure shows the main export partners, up to 90% of total exports.
Source: ITC staff calculations based on data from the ITC Market Analysis Tools (2021).

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
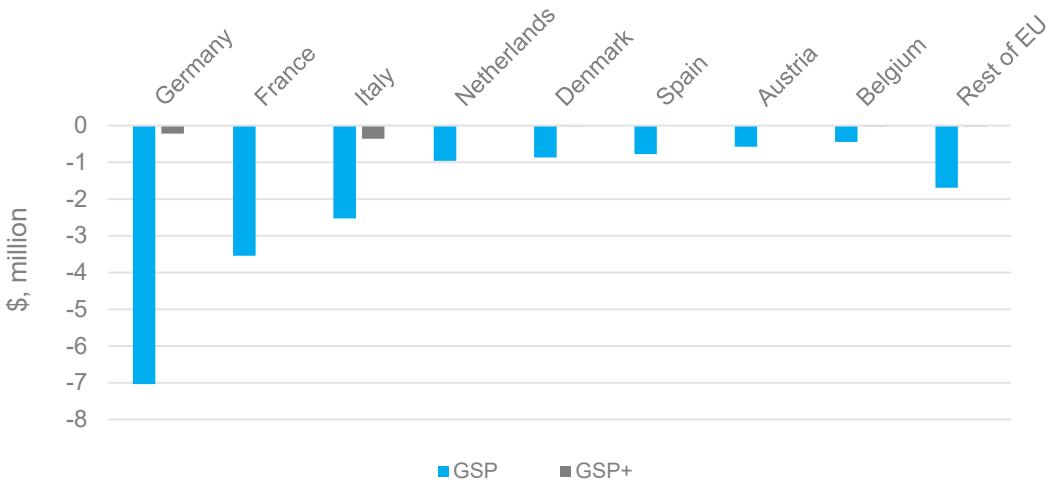
**Note:** The figure shows the markets with the largest losses, up to 90% of total losses.
Source: ITC staff calculations based on data from the ITC Market Analysis Tools (2021).

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[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 how losses would be drastically reduced under the GSP+ scheme. Losses in exports to the European Union would drop from $18 million to less than $1 million if GSP+ preferences applied to trade with the EU instead of GSP preferences.

While total export losses upon LDC graduation were estimated at $59 million, or 4.3% of projected exports for 2026, the impact would decline to $40 million (3% of projected exports) if GSP+ applied to EU countries after graduation.

The projected losses will likely be concentrated in the following sectors: apparel ($21 million), synthetic textile fabrics ($14 million), carpets ($6 million), metal products ($3 million) and miscellaneous manufactured products ($2 million). Sectors with losses under $2 million are shown on the right-side panel of Figure 6, which also reflects the differences of the effect across sectors. While the loss represents a relatively small share of exports forecast for 2026 for some sectors – textile products, for example (2%) – the loss is sizable for others, notably processed cereals (69%) and home textiles (25%).

Figure 6 also highlights the potential of GSP+ preferences to curtail graduation-related trade losses in specific sectors. GSP+ grants duty-free status to several industries in the textile and apparel sectors. This would benefit some of the products most affected by LDC graduation – in the apparel, carpet, home textile, textile fabric and textile product sectors.[16] Other sectors, such as some manufactured goods and some processed food products, would not benefit, or would only marginally benefit.

Figure 6   Apparel and synthetic textile exports to decline the most
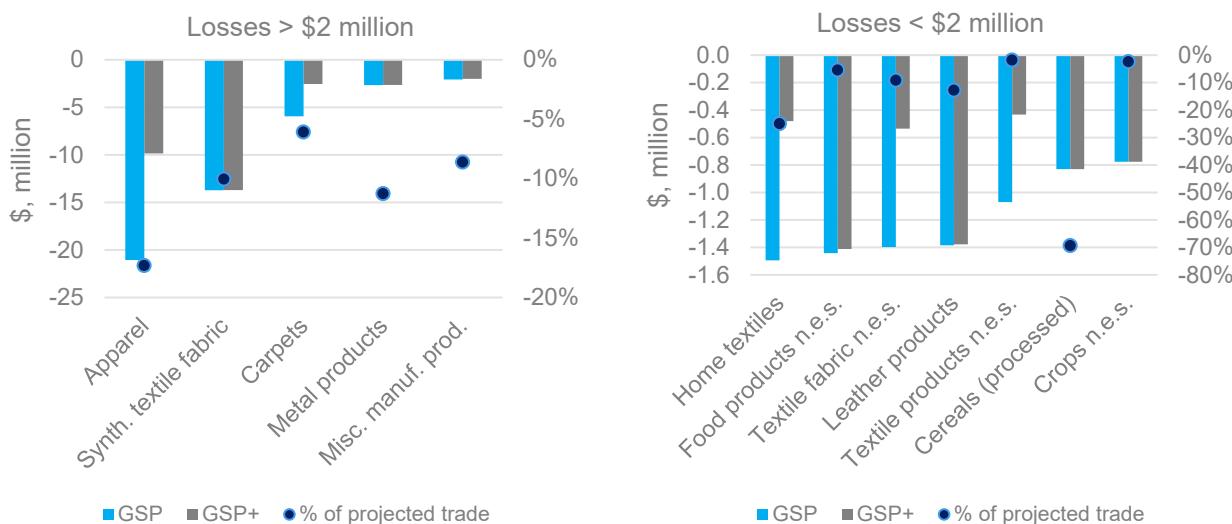
Note: The figure shows the sectors with the largest losses, up to 90% of total losses. The acronym n.e.s. stands for not elsewhere specified.
Source: ITC staff calculations based on data from the ITC Market Analysis Tools (2021).

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[16] As pointed out in Razzaque (2020), access to GSP and GSP+ preferences for textiles and clothing requires the fulfilment of stringent rules of origin. In particular, double transformation processes are needed, instead of the single transformation processes that suffice to qualify for Everything But Arms preferences.

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

Nepal has exported large quantities of vegetable fats to India in recent years, especially processed palm oil and soybean oil. Sustaining these exports has become a top priority for Nepal.

Nepalese exports of palm oil and soybean oil are refined from crude imports that enter the country under a low import duty and move on to India duty free after processing. The same crude oil imports would face high tariffs if they entered India directly.

After LDC graduation, the bilateral trade agreement between India and Nepal will apply to these exports. The quota for vegetable fats under the agreement is 100,000 tons. The applicable above-quota tariffs for the main vegetable fats that Nepal exports to India range from 25% to 54%.

The quota will be easily surpassed if the high volumes of exports in these categories continue, implying a major increase in tariffs upon graduation. The out-of-quota tariff for palm oil exceeds that for soybean oil, as does its price, so we assume that the quota will be used for palm oil after graduation.

Under this assumption and considering an expected palm oil price of $1 per kilogram in 2026, estimated export losses amount to $21 million for palm oil and $21 million for soybean oil. In this scenario, total graduation-related export losses reach $101 million, or 13% of total projected exports for 2026.

Chapter 3
Compensation strategies

Expected export losses after Nepal is no longer an LDC could be offset through several mitigation or adaptation strategies. These include pursuing better market access conditions, using trade promotion to tackle hurdles that prevent the realization of export potential, or facilitating market diversification.

Table 2 identifies the sectors and markets likely to face the largest losses, as well as possible corresponding mitigation strategies. The Export Potential Indicator allows us to evaluate whether trade promotion efforts in these markets and sectors can compensate for graduation losses.

ITC developed this methodology to identify growth opportunities for exports. The Export Potential Indicator is based on three pillars: (i) the current and projected *supply* capacity of Nepal for any given product, (ii) the current and projected *demand* for that product in a given target market, as well as the market access conditions for Nepal in terms of future relative tariffs and transportation costs, and (iii) the overall *ease* of trade between Nepal and each target market.

For each regularly exported product, we used the Export Potential Indicator to calculate potential export values for 2026, in dollar terms, to any given market, for the post-graduation scenario considered in Table 1. We compared the post-graduation export potential to the post-graduation projected exports to identify untapped export potential after graduation.[17]

The market-sector combinations listed in Table 2 accumulate an untapped export potential of $18 million, i.e., just over 30% of projected trade losses. The sectors also have untapped export potential in other destinations.

Untapped export potential may be realized through targeted trade promotion – for example, by helping firms overcome non-tariff measures, comply with rules of origin, or meet consumer preferences in the target market. To determine whether such efforts could compensate for the losses, and whether they should focus on the affected market or alternative ones, we contrast the expected losses for each sector-market to their untapped potential, and that of alternative markets.

Market access

Improving market access conditions through new agreements or adherence to more preferential schemes may be the preferred option even if there is a substantial untapped export potential. In particular, in the case of the most affected sectors of exports to the EU, pursuing GSP+ status would almost completely counterbalance graduation losses. Total expected losses of $18 million would fall to $644,000. A similar case can be made with respect to the Enhanced Framework of the United Kingdom, with requirements that closely resemble those of the GSP+.

Trade promotion

In some of cases, the untapped export potential in a given market and sector exceeds the expected graduation-related export losses. This is the case for exports of apparel to Japan, beauty products and perfumes to China, and carpets to Canada. In all three cases, targeted trade promotion of the products with the most export growth potential to the affected market could help unlock enough exports to offset the expected losses.

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[17] See additional details on the methodology in Appendix A.1 and in Decreux and Spies (2016).

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] However, the sector has untapped export potential of $1.6 million – most of it in Dentifrices (product code 330610, $1.5 million).

The losses for carpets exported to Canada are projected at $563,000, with more than 90% of this decline originating in three types of knotted and tufted floor coverings.[20] By contrast, the untapped potential of the sector to export to Canada is $611,000, with $559,000 in Floor coverings of wool/fine animal hair, knotted (570110).

Market diversification

In other cases, the post-graduation export potential in the affected market will already be largely realized, or it will not be big enough to offset the expected losses. In such cases, trade promotion in the affected market is not the best strategy to prepare for graduation. Rather, market diversification – that is, increasing exports to other markets – should be considered instead.

Table 2 lists the top alternative markets for the most affected market-sector combinations that will lack sufficient export potential to offset losses. These markets have the largest post-graduation untapped export potential for the sector in question. Selected cases for which market diversification should be considered are briefly analysed below. Additional details on the remaining market diversification cases listed in Table 2 can be found in Table A.3.1 of the appendix.

Synthetic textile fabrics – Turkey

Exports in the synthetic textile fabric sector to Turkey are expected to face a $14 million graduation-related loss, the largest projected market-sector impact. The post-graduation export potential of synthetic textile fabrics to Turkey is rather low, at $359,000, meaning that the promotion of synthetic textile fabrics exports to Turkey would not compensate for the expected losses. However, the sector has a projected untapped export potential of over $16 million to India and Bangladesh.

More specifically, export losses to Turkey are expected to concentrate in products 550921 ($9.1 million) and 550951 ($3.9 million).[21] For those same products, India has an untapped export potential of $5.2 million and $2.8 million respectively, while products 550932 and 551012, which are different types of cabled yarn, have $5 million and $1.1 million in untapped export potential to Bangladesh.[22]

Export promotion that aims to facilitate Nepalese exports of these products to India, Bangladesh and other markets may offset the losses expected for this sector in Turkey upon graduation.

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[18] Losses occur for more than 130 products, but Jerseys, pullovers & similar, of wool, knit/crochet (611011), Women's jackets of cotton (620432), Jerseys, pullovers & similar, of cashmere, knit/crochet (611012) and Women's trousers & shorts of cotton (620462) represent more than 60% of losses in apparel exports to Japan.

[19] Among them, hair lacquers, dentifrices and beauty, make-up and skincare preparations account for almost 60% of the expected market-sector losses.

[20] Product codes 570110, 570190 and 570310. The corresponding product descriptions are: Carpets and other textile floor coverings, of wool or fine animal hair, knotted, whether or not made up; Carpets and other textile floor coverings, of textile materials, knotted, whether or not made up (excluding those of wool or fine animal hair); and Carpets and other floor coverings, of wool or fine animal hair, tufted 'needle punched', whether or not made up.

[21] The corresponding product descriptions are: Yarn, <85% polyester staples, with artificial staples and Single yarn, >=85% polyester staples.

[22] The precise product descriptions are Multiple 'folded' or cabled yarn containing >= 85% acrylic or modacrylic staple fibres by weight (excluding sewing thread and yarn put up for retail sale) (550932) and Multiple 'folded' or cabled yarn containing >= 85% artificial staple fibres by weight (excluding sewing thread and yarn put up for retail sale) (551012).

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). However, the untapped potential for apparel exports to the United States and China is projected at $3.6 million and $3.4 million, respectively.

While the untapped export potential is also spread across many products in the sector, a few have more potential for export growth. For instance, certain jerseys have $891,000 and $422,000 in untapped export potential in the United States and China, respectively, while some scarves have $621,000 and $777,000 in untapped export potential in each market.[23]

Carpets – China

Exports of Nepalese carpets to China can be expected to lose $1.5 million upon graduation, with almost no remaining potential for the sector in that market. Most of the loss ($1.3 million) is concentrated in Floor coverings of wool or fine animal hair, tufted or knotted (codes 570310 and 570110). This product, specifically code 570110, has $4.9 million, $2.5 million and $2.4 million in untapped export potential in the United States, Switzerland and Japan, respectively.

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[23] The product descriptions and codes are: Jerseys, pullovers & similar, of cashmere, knit/crochet (611012) and Scarves, veils & similar of wool/fine animal hair (621420).

Table 2   Adaptation strategies to counter significant export losses ($,000)

Subsector	Country	Export losses	Untapped export potential	Untapped export potential in other markets	Strategy
Apparel	European Union	11,208	3,522	United States (3,576), China (3,368), India (1,881)	Market access (GSP+)
	United Kingdom	5,661	141		Market access
	Canada	1,784	256		Market diversification
	Japan	928	2,155		Trade promotion
Beauty products & perfumes	China	661	1,633		Trade promotion
Carpets	European Union	3,403	4,420	United States (5,084), Switzerland (2,543), Japan (2,487)	Market access (GSP+)
	China	1,514	10		Market diversification
	Canada	563	611		Trade promotion
Crops n.e.s.	China	742	526	European Union (3,991), United States (2,598), United Kingdom (753)	Market diversification
Food products n.e.s. (processed)	China	753	356	European Union (757), Canada (403), United Kingdom (268)	Market diversification
Glass articles	United States	713	113	India (2,344), China (202), European Union (154)	Market diversification
Home textiles	European Union	1,014	44		Market access (GSP+)
Metal products	China	2,549	0	United States (2,096), European Union (1,511), India (578)	Market diversification
Misc. manufactured products	China	1,361	258	European Union (1,072), United States (992), United Kingdom (893)	Market diversification
Skins, leather & products thereof	China	992	574	India (2,986), European Union (666), Turkey (180)	Market diversification
Synthetic textile fabric	Turkey	13,685	359	Bangladesh (8,161), India (7,987), European Union (2,729)	Market diversification
Textile fabric n.e.s.	European Union	863	208		Market access (GSP+)
Textile products n.e.s.	European Union	637	2,375		Market access (GSP+)

Note: The table shows the market-sector combinations that are expected to face losses exceeding $500,000. They represent 83% of total projected losses. The acronym n.e.s. stands for not elsewhere specified.

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

Figure 7   Some NTIS priorities face higher tariffs and export losses
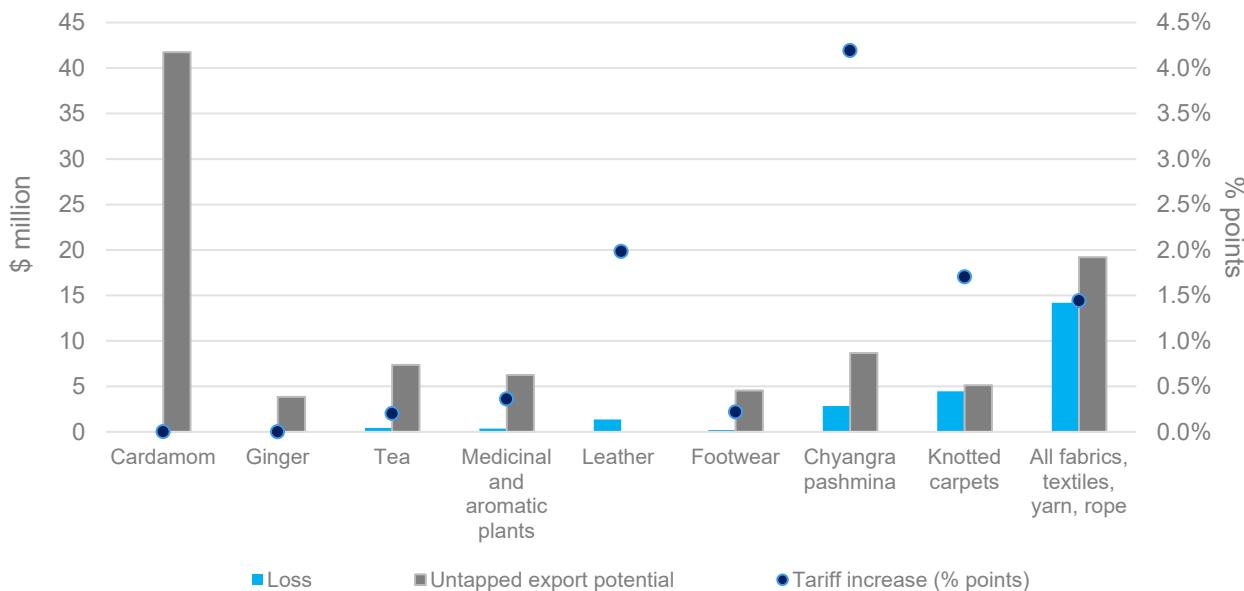
Note: Product/sector definitions follow NTIS 2016. Tariffs changes shown are a weighted average using projected 2026 exports.
Source: ITC staff calculations based on data from the ITC Market Analysis Tools (2021).

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 and forest products Cardamom, ginger, tea and medicinal and aromatic plants.

Craft and manufacturing products: Leather, footwear, chyangra pashmina, knotted carpets and all fabrics, textiles, yarn and rope.

Services: Skilled and semi-skilled professionals in various categories, information technology and business process outsourcing, and tourism (leisure, business, education and medical).

Tariff changes on certain NTIS 2016 priority products, such as cardamom and ginger, will be negligible (weighted) after graduation. Other goods will face significant tariff increases: up to 1.5 percentage points (knotted carpets, fabrics, textiles, yarn and rope), 2 percentage points (leather) and more than 4 percentage points (chyangra pashmina). Some NTIS priority products are expected to experience the largest export losses upon graduation, between $1 million and $14 million.

It is interesting to note that after LDC graduation, the untapped export potential of all NTIS products except leather will exceed the losses they are expected to encounter. This points out to the potential for continued trade promotion efforts for these goods, despite the higher tariffs associated with graduation.

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:

- *Improve market access*:

Obtaining GSP+ status to access the European Union could reduce total expected losses up to 30%, especially in the apparel and textile products subsectors, which would avoid losing up to $17 million in export revenue. Qualifying for GSP+ status requires meeting economic criteria (vulnerability, non-diversification, and low shares of imports in the EU), ratifying 27 international conventions and passing the monitoring of their implementation.

Several issues should be examined when considering this approach to counterbalance graduation losses, including:

- For how long will Nepal meet the economic criteria?
- What would be the process to ratify pending conventions?
- How can the monitoring process be facilitated?
- How might the GSP+ scheme change when it is revised 2024?

Moreover, as most benefits would concentrate in apparel and textile products, it is important to know what additional support measures might be necessary to comply with the stricter rules of origin of the GSP+ scheme. Similar considerations should be explored regarding the United Kingdom's Enhanced Framework.

- *Targeted trade promotion:*

After graduation, unlocking the full export potential of apparel to Japan, beauty products and perfumes to China, and carpets to Canada could offset the losses expected for those markets and sectors. Targeted trade promotion that enables companies to overcome current frictions – such as non-tariff measures, rules of origin or specific consumer preferences in the target market – can help realize the export potential of these sectors and markets.

- *Market diversification:*

Several other sector-market combinations will see a drop in exports without having enough space to counter this decline through trade promotion. However, alternative markets are available with sufficient untapped export potential, turning market diversification into a promising strategy to balance out graduation-induced trade losses.

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.

References

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World Trade Organization (2021). 'Utilization of Trade Preferences by Least Developed Countries: 2015-2019 patterns and trends.' Note by the Secretariat, 7 May 2021 (G/RO/W/204).

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 i's share in market j for a given product k (ProjMS$_{ijk}$) using country i's GDP growth rate relative to the GDP growth rate of its competitors and (ii) evaluating how import demand of product k in market j (ProjM$_{jk}$) will develop based on its elasticity to market j's expected growth rates of GDP and population, and expected tariff changes.[26] We define

$$\mathrm{X}_{ijk} = \mathrm{ProjMS}_{ijk} \times \mathrm{ProjM}_{jk}$$

where

- X_{ijk}: projected exports of k from i to j;
- ProjMS$_{ijk}$: projected market share of i in j's imports of k;
- ProjM$_{jk}$: projected demand of j for k.

Tariff projections assume that Nepal will move to the next best alternative tariff that is available following graduation (Table 1). For all other countries, we reflect the tariff situation in 2026 by integrating information from tariff reduction schedules of agreements that are currently in force.

First, tariff changes reduce Nepal's market share by

$$\left(\frac{1 + t_{LDC}}{1 + t_{\mathrm{grad}}}\right)^{\sigma}$$

Then, the sum of market shares in a given market is normalized to one. This ensures that the first order conditions of the demand by origin optimization are met.

Based on old and new market shares, average tariffs with and without graduation are computed. Overall import demand is reduced by:

$$\frac{1 + \bar{t}_{LDC}}{1 + \bar{t}_{\mathrm{grad}}}$$

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[24] Nepal's exporters will not reduce their prices in response to lower demand for their products.

[25] Note that stricter rules of origin may apply under the alternative tariff regimes, which could prevent Nepalese exporters from accessing preferential tariffs.

[26] The elasticity of import demand to population is assumed to be equal to 1. The elasticity of import demand to GDP per capita is estimated, see Decreux and Spies (2016). We increase the import demand by the factor $\frac{1 + \bar{t}_{\mathrm{current}}}{1 + \bar{t}_{\mathrm{projected}}}$, where $\bar{t}$ is the average tariff applied by a market to all suppliers weighted by their market shares, to account for future tariff reductions under trade agreements that are currently being implemented.

where $\bar{t}$ 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,

$$\text{EPI}_{ijk} = \text{MS}_{ijk}^{EPI} \times \text{ProjM}_{jk}$$

with

$$\text{MS}_{ijk}^{EPI} = \text{ProjMS}_{ik} \times \text{Ease}_{ij} \times \text{MAccess}_{ijk}$$

The potential market share of country i in product k and market j combines information of i's world market share of k, the ease of trade between i and j, and market access. ProjMS_{ik} is projected based on the growth rate of i relative to its competitors. ProjM_{jk} is projected based on the elasticity of import demand for k to j'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.

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

[28] Please refer to Decreux and Spies (2016) for a detailed description of the method.

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 internationals.

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

Appendix 3   Additional tables

Table A3.1 Detail of market diversification options for markets and sectors with significant export losses and limited untapped potential (US$ thousands)

	Affected market Loss	Alternative markets Untapped export potential		
Apparel	Canada 1,784	United States 3,576	China 3,368	India 1,881
	229 Hats & other headgear, knitted/crocheted etc. (650500) 142 Gloves of wool/fine animal hair, knit/crochet (611691) 105 Jerseys, pullovers & similar, of wool, knit/crochet (611211) 102 Men's shirts of cotton (620520)	891 Jerseys, pullovers & similar, of cashmere, knit/crochet (611012) 621 Scarves, veils & similar of wool/fine animal hair (621420) 592 Women's trousers & shorts of cotton (620462)	777 Scarves, veils & similar of wool/fine animal hair (621420) 527 Women's jackets of cotton (620432) 422 Jerseys, pullovers & similar, of cashmere, knit/crochet (611012)	349 Hats & other headgear, knitted/crocheted etc. (650500) 261 Men's shirts of cotton (620520) 238 Women's trousers & shorts of cotton (620462)
Carpets	China 1,514	United States 5,084	Switzerland 2,543	Japan 2,487
	744 Floor coverings of wool/fine animal hair, tufted (570310) 520 Floor coverings of wool/fine animal hair, knotted (570110)	4,884 Floor coverings of wool/fine animal hair, knotted (570110)	2,487 Floor coverings of wool/fine animal hair, knotted (570110)	2,427 Floor coverings of wool/fine animal hair, knotted (570110)
Crops n.e.s.	China 742	European Union 3,991	United States 2,598	United Kingdom 753
	340 Medicinal plants, herbs, etc., nes (1211XX) 283 Vegetable products nes (140490) 118 Bamboos (140110)	2,547 Medicinal plants, herbs, etc., nes (1211XX) 1,444 Vegetable products nes (140490)	1,715 Medicinal plants, herbs, etc., nes (1211XX) 883 Vegetable products nes (140490)	378 Medicinal plants, herbs, etc., nes (1211XX) 376 Vegetable products nes (140490)
Food products n.e.s. (processed)	China 753	European Union 757	Canada 403	United Kingdom 268
	354 Uncooked pasta (190219) 125 Sweet biscuits (190531)	575 Pasta (190230) 108 Uncooked pasta (190219)	219 Pasta (190230) 171 Uncooked pasta (190219)	253 Pasta (190230)

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 alternative destinations according to their untapped export potential. Below each country-sector, the products with the largest shares of losses or export potential are listed.

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

	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	China 1,361	European Union 1,072	United States 992	United Kingdom 893
	542 Mattresses nes (940429) 427 Paintings (970110)	259 Bags, cases, holsters & similar containers, plastics/textiles outer surface (420292) 228 Christmas articles, nes (950510) 229 Original sculptures & statuary (970300)	479 Original sculptures & statuary (970300) 341 False beards, eyebrows & -lashes, of human hair (670420) 142 Collages & similar decorative plaques (970190)	305 Original sculptures & statuary (970300) 251 Paintings (970110)

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 alternative destinations according to their untapped export potential. Below each country-sector, the products with the largest shares of losses or export potential are listed.

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

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

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