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## **The Real Test of Nepal's LDC Graduation: Fiscal Discipline, Regional Integration, and Subnational Competitiveness**

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# The Real Test of Nepal's LDC Graduation: Fiscal Discipline, Regional Integration, and Subnational Competitiveness

Jaya Jung Mahat and Siddhartha Rayamajhi<sup>1</sup>

## Abstract

Nepal's graduation from the Least Developed Country (LDC) category in 2026 is more than a milestone: it is a stress test of whether the country can sustain growth without the cushion of preferential support. We show that Nepal's longstanding structural weaknesses, including remittance reliance, weak capital investment, and a narrow export base, are now entering a more exposed policy environment post-LDC. Critically, these vulnerabilities need to be addressed before they become permanent constraints. We argue that this will require fiscal discipline anchored to credible investment, digital transformation that enables regional integration, and subnational competitiveness beyond aid dependency. Looking ahead, Nepal's transition can draw on the experiences of its regional peers, while at the same time serving as a low-stakes stress test of how other South and Southeast Asian LDCs may manage their own graduation.

*Keywords: LDC Graduation, Fiscal Discipline, Regional Integration, Subnational Competitiveness, Economic Resilience, Structural Transformation*

*JEL Classification: F13, F35, O11, O19, O53*

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## 1. Introduction

Nepal is set to graduate from the Least Developed Country (LDC) category on 24 November 2026. While this marks a formal recognition of national progress, it is not a celebration without conditions. Graduation signals a shift in Nepal's international positioning: from a country eligible for special treatment to one expected to compete on more equal terms, economically, diplomatically, and institutionally.

Nepal's economy has long been characterised by fragile growth dynamics, rooted in a history of conflict, recurring natural disasters, and widening development gaps across its seven provinces. The country remains heavily reliant on remittances, with limited domestic productive capacity, weak capital investment, and a narrow export base. Graduation will not resolve these challenges. On the contrary, it marks a transition to a more exposed policy environment. One in which access to concessional finance, preferential trade arrangements, and special international support measures will progressively decline. This shift raises a fundamental question: Can Nepal build the institutional and fiscal capacity to manage its vulnerabilities before they harden into permanent structural constraints?

This paper argues that Nepal's post-graduation strategy must rest on three interlinked pillars: anchoring fiscal discipline to credible investment, leveraging digital transformation to support regional integration, and fostering subnational competitiveness that is no longer reliant on aid or migration.

First, fiscal discipline must be tied to productivity-enhancing investment in sectors with long-term returns, such as infrastructure, human capital, and clean energy. This includes tapping new sources of financing such as diaspora bonds and green finance, while resisting the temptation of populist spending.

Second, Nepal must leverage digital transformation not as a standalone sector, but as a cross-cutting enabler of trade and industrial competitiveness. Digital infrastructure, cross-border services, and data connectivity can help Nepal bypass geographic constraints and integrate more deeply into regional value chains, particularly in areas like digital services, tourism, and agro-processing.

Third, subnational competitiveness must be strengthened through more targeted provincial infrastructure, local industrial policy, and the productive reinvestment of remittances. This is essential for ensuring that growth is broad-based and no longer structurally dependent on external aid or outmigration.

Nepal's challenge is not unique. Other South and Southeast Asian countries, such as Bangladesh, Lao PDR, and Cambodia, stand at similar thresholds. All face the same questions of resilience, market access, and policy credibility as they prepare themselves for LDC graduation. While Nepal can draw valuable lessons from their early preparations, it also holds value in reverse: as a low-stakes stress test for the region, Nepal's graduation offers a live case on how preference erosion, institutional readiness, and development asymmetries interact in practice.

This paper is premised on the idea that LDC graduation should be a launchpad, not a cliff. If mishandled, graduation can erase past gains; if managed well, it can lay the groundwork for a more competitive and confident national strategy to navigate post-graduation challenges better. Nepal continues to face climate and disaster risks, limited productive capacity, over-dependence on external inflows, and underdeveloped subnational systems. Public-private cooperation remains underutilised, and infrastructure deficits continue to fragment domestic and regional integration.

Therefore, the transition presents an opportunity, but not a guarantee, to reframe Nepal's national development narrative. It creates space to rethink policy ambition, attract more strategic investment, and position the country as a credible regional partner. But it also demands clarity: Nepal must move from being a beneficiary of special support to becoming an actor accountable to global standards. This requires more than maintaining momentum. It calls for confronting domestic weaknesses, closing inter-provincial gaps, strengthening state capacity, and signalling credibility abroad.

Against this backdrop, the paper offers a policy-relevant analysis of Nepal's LDC transition. It examines the political economy of graduation, identifies structural risks, and highlights actionable entry points to convert this transition into a long-term opportunity. The analysis draws on academic and policy literature, national and international data, and credible official sources. Technical details of the graduation criteria and procedures are presented in the annex; the core text focuses on strategic and structural implications.

The remainder of the paper is organised as follows. Section 2 provides an overview of Nepal's LDC graduation journey. Section 3 outlines key economic factors relevant to the graduation plans. Section 4 briefly describes the data and methodology. Section 5 discusses the critical implications Nepal may face post-graduation. Section 6 examines the country's policy planning efforts. Section 7 draws lessons and opportunities for other Asian economies. Section 8 presents key takeaways for Nepal and other stakeholders in managing the graduation process. Section 9 concludes.

## **2. Nepal's Path to Graduation**

### **2.1. Historical Background**

The United Nations General Assembly (UNGA) established the LDC category on 18 November 1971 and listed Nepal, along with 24 other countries, in this category. [The UNGA uses three criteria to identify a country as an LDC](#) (LDC Watch, 2025)<sup>2</sup>: the low-income criterion, performance across the Human Assets Index (HAI), and the Economic Vulnerability Index (EVI). The low-income criterion takes into consideration a country's Gross National Income (GNI) per capita.

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<sup>2</sup> LDC Watch. 2025. Criteria for LDCs. <https://ldcwatch.org/criteria-ldcs/>

If the country has a GNI per capita of under USD 992, based on a three-year average estimate calculated using the World Bank Atlas method, it is categorised as an LDC country. If the GNI per capita of a country exceeds USD 1190, applied since the 2012 triennial review, the country is considered for graduation. Likewise, HAI assesses the country's performance across a range of development indicators, including nutrition, health, education, and adult literacy rate. Finally, the HAI measures the country's performance across a set of demographic and economic indicators, including population size, remoteness, merchandise export concentration, contribution of agriculture, forestry, and fisheries to gross domestic product (GDP), and instability of exports of goods and services, risks from natural disasters and climate change ([LDC Watch, 2025](#))<sup>3</sup>.

[According to Nepal's National Planning Commission \(NPC\)](#)'s LDC Graduation Smooth Transition Strategy document, by 2015, Nepal's performance in two of the three criteria, i.e., HAI and EVI, surpassed the LDC graduation threshold in three consecutive triennial reviews conducted by the Committee for Development Policy (CDP) at the United Nations in 2015, 2018, and 2021 (NPC, 2024)<sup>4</sup>. In 2018, Nepal became eligible for graduation; however, the Government of Nepal decided to defer the graduation process, citing low GNI and ongoing recovery efforts from the 2015 Nepal earthquake at the time.

In 2021, Nepal concluded most of its post-earthquake recovery efforts. It planned to cease operations of the National Reconstruction Authority (NRA), a government entity established in 2015 to manage the rapid reconstruction of the physical damage caused by the Nepal Earthquake in April and May 2015, by the end of December the same year. Similarly, by mid-2021, the country had also begun to recover from the COVID-19 pandemic lockdowns slowly.

[In November 2021](#) (UN, 2021)<sup>5</sup>, the 40th plenary meeting of the 76th Session of the UNGA unanimously adopted a resolution on Nepal's LDC graduation by December 2026, following the country's meeting of the CDP's graduation criteria. However, the UNGA provided Nepal with a five-year preparatory period to help the country recover from the socio-economic impacts of the COVID-19 pandemic.

## **2.2. LDC Graduation - Nepal's Performance Across Key Indicators**

The [CDP's 2025 Monitoring Report for Nepal](#) (UN CDP, 2025)<sup>6</sup> outlines the country's progress towards its graduation journey. The document highlights that Nepal, despite facing key challenges such as limited private sector capacity, climate change, and extreme natural disaster vulnerability, as well as trade and investment constraints arising from Nepal's landlocked geography, has met all LDC criteria and achieved socio-economic indicators, preparing itself for a smooth graduation.

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<sup>3</sup> Ibid.

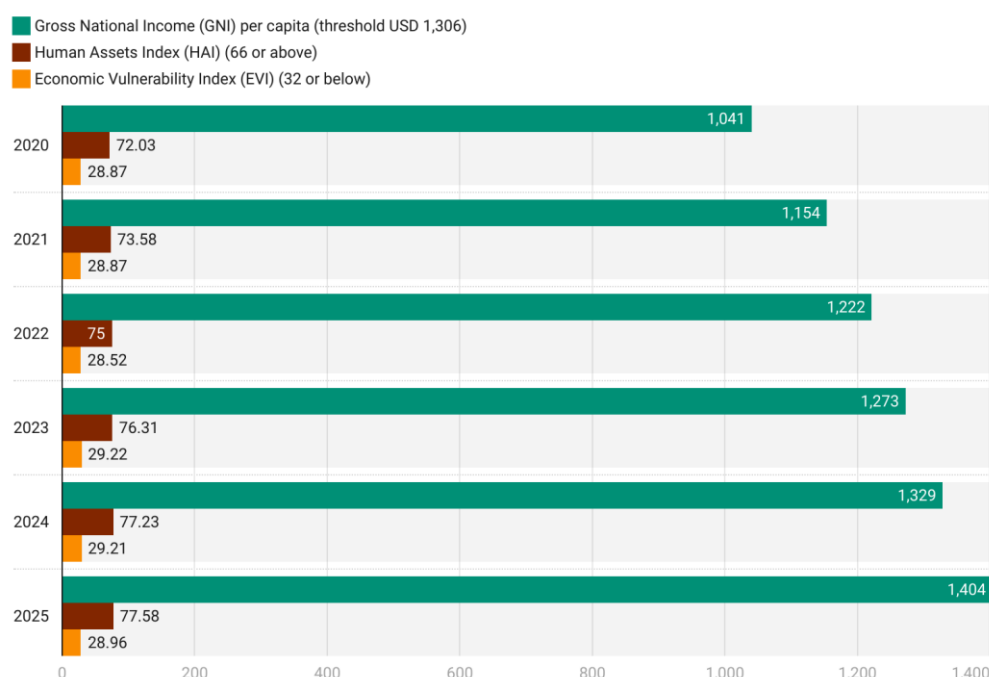
<sup>4</sup> NPC. 2024. LDC Graduation Smooth Transition Strategy. <https://www.un.org/ldcportal/content/nepal-ldc-graduation-smooth-transition-strategy>

<sup>5</sup> United Nations. November 2021. UNGA adopts resolution on Nepal's graduation from LDC category. [https://www.un.int/nepal/statements\\_speeches/unga-adopts-resolution-nepal%E2%80%99s-graduation-ldc-category](https://www.un.int/nepal/statements_speeches/unga-adopts-resolution-nepal%E2%80%99s-graduation-ldc-category)

<sup>6</sup> UN CDP. 2025. 2025 Monitoring Report for Nepal. <https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/CDP-PL-2025-NPL.pdf>

The figure below presents Nepal's performance across the three LDC category classifications. As presented in the table, Nepal has made significant progress across all three criteria used by CDP for graduation consideration.

Figure 2.1. Indicators for LDC Identification for Nepal (2020-2025)



Source: CDP 2025 Monitoring Report for Nepal (<https://bit.ly/LDC-data>)

## 2.3. Key Challenges of LDC Graduation

While Nepal's graduation from the LDC category is a positive development, the country's failure to effectively manage the transition, including addressing prevalent challenges and emerging risks, will limit its ability to fully benefit from its graduation.

For example, Nepal remains one of the world's most vulnerable countries to climate change and natural disasters. The [2025 Climate Risk Index \(CRI\)](#) ranks Nepal as the 68th most affected country globally (Germanwatch, 2025)<sup>7</sup>, out of 171, in terms of extreme weather events, including floods, landslides, droughts, extreme rainfall, and temperature fluctuations, over the past three decades (1993-2023). Moreover, it also states that Nepal loses an average of 249.7 people each year to these disasters, with more than 75,000 Nepalis directly affected by these calamities. In terms of economic losses, Nepal incurs an estimated annual loss of USD 221.3 million, equivalent to 0.258 percent of Nepal's GDP.

In terms of private sector capability and infrastructure readiness, Nepal has an uneven distribution of resources across provinces. Though one [past IFC and FNCCI study](#) (FNCCI and IFC, 2023)<sup>8</sup> found that Nepal's private sector employs about 85.6 percent of Nepal's formal

<sup>7</sup> Germanwatch. 2025. Climate Risk Index 2025. <https://www.germanwatch.org/sites/default/files/2025-02/Climate%20Risk%20Index%202025.pdf>

<sup>8</sup> FNCCI and IFC. May 2023. State of Private Sector in Nepal - Contributions and Constraints. [https://fncci.org/uploads/publication/file/Report\\_StatePSNepal\\_20230519064735.pdf](https://fncci.org/uploads/publication/file/Report_StatePSNepal_20230519064735.pdf)

sector workforce with five sectors namely (i) agriculture, forestry, and fisheries, (ii) wholesale and retail trade, (iii) construction, (iv) services, and (v) manufacturing being the dominant sectors employing the locals, the provincial distribution of these employment opportunities and infrastructure readiness vary across provinces. The annual [Nepal Competitiveness Index \(NCI\)](#) studies consistently found significant development gaps among Nepal's seven provinces across key competitiveness environments and indicators (NIPoRe, 2025)<sup>9</sup>. While Bagmati remains the best-performing province in all competitiveness rankings, i.e., overall competitiveness ranking, digital competitiveness ranking, and recipient of the highest official development assistance (ODA) and the foreign direct investment (FDI), other provinces, mainly three trailing provinces (Karnali, Sudurpaschim, and Madhesh), perform poorly in all NCI rankings since 2022.

Nepal's high vulnerability to deepening climate change-driven crises and unequal performance of the seven provinces across key areas that matter for the country's LDC graduation plans are likely to limit Nepal's ability to smooth the transition period, till graduation and beyond. The overall implications of the graduation in Nepal will be discussed in detail in Section 5.

### 3. Related Literature

The CDP plays a crucial role in reviewing and monitoring the status of LDCs (Alonso et al., 2014). LDCs are categorised based on three criteria: Gross National Income per capita, Human Asset Index, and Economic Vulnerability Index. The goal for LDCs is to overcome structural handicaps and graduate from the category with international support (Drabo & Guillaumont, 2018). The LDC graduation process should be viewed as part of a continuous development trajectory rather than an end goal (Bhattacharya & Khan, 2018).

LDC graduation presents both opportunities and challenges for graduating countries. Studies indicate that graduation may lead to significant export losses, particularly in the clothing sector, due to the loss of preferential market access (Bekkers & Cariola, 2025). For example, in Bangladesh, a potential LDC graduate, real GDP could drop by 0.38 percent, with exports falling by 6 percent and ready-made garment exports declining by 14 percent and urban households may experience income decreases and reduced consumption (Rahman & Strutt, 2022). To mitigate these impacts, countries can focus on increasing preference utilisation, which could boost LDC exports by nearly USD 7 billion. Additionally, attracting foreign direct investment (FDI) can support ongoing growth and economic development post-graduation. Other strategies include signing preferential trade agreements, enhancing domestic productivity, diversifying exports, and streamlining subsidy policies.

Bhutan's 2023 graduation, despite the impacts of COVID-19, is expected to have minimal economic effects due to its economic reliance on India (Adhikari, 2022). Laos, aiming for 2026 graduation, anticipates minor export impacts, except for the European Union market. Asian LDCs nearing graduation have expanded their share of world trade, with Bangladesh leading

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<sup>9</sup> NIPoRe. 2025. Nepal Competitiveness Index. <https://nipore.org/nci/>

in textile exports. However, these countries face vulnerability due to concentrated exports and limited trading partners (Navarro-Pabsdorf et al., 2023).

Nepal's case illustrates the complexities of LDC graduation, as it met two of the three criteria in 2015 but requested deferment. The UN CDP recommended that Nepal graduate by 2026, considering factors such as gross national income, human capital, and economic and environmental vulnerability (Adhikari et al., 2022). Environmental factors are particularly significant for Nepal's economy and development, highlighting the need for appropriate policies and programs to support successful graduation. Nepal has prepared a Smooth Transition Strategy that focuses on macroeconomic stability, economic transformation, and social inclusion (Shekh et al., 2024). While graduation offers opportunities such as increased foreign investment and an improved international reputation, it also means losing preferential trade benefits and concessional aid. Nepal's export success has been elusive despite trade preferences, and graduation could exacerbate this issue, potentially leading to higher export losses than current projections suggest. To mitigate these challenges, Nepal must focus on building productive capacity, addressing supply-side constraints, and enhancing non-price competitiveness (P. Kharel, 2022).

#### **4. Data and Methodology**

This paper draws primarily on time series data sourced from credible national institutions, including the National Statistics Office (NSO), the Ministry of Finance (MoF), and other relevant government departments and agencies. The dataset covers at least eight to ten years, ensuring that the analysis captures long-term structural trends, cyclical fluctuations, and any abrupt shifts that may have occurred due to significant policy interventions, socio-economic shocks, or external factors. Where appropriate, supplementary data from international organisations, such as the World Bank Group (WBG), have been utilised to triangulate and contextualise national estimates.

This paper takes a mainly descriptive approach. Rather than relying on heavy econometric models, the focus is on pulling together a wide range of subnational data. We combine information on macroeconomic trends, sector performance, and regional development to build a more complete picture of Nepal's conditions at the provincial level. By placing these different strands of data side by side, we can spot patterns at much more granular details, such as which provinces face the greatest structural risks, and which show emerging areas of strength. This broad, integrated view then provides the basis for the policy discussion in the later sections.

#### **5. Nepal's Economic Outlook, Challenges, and Opportunities**

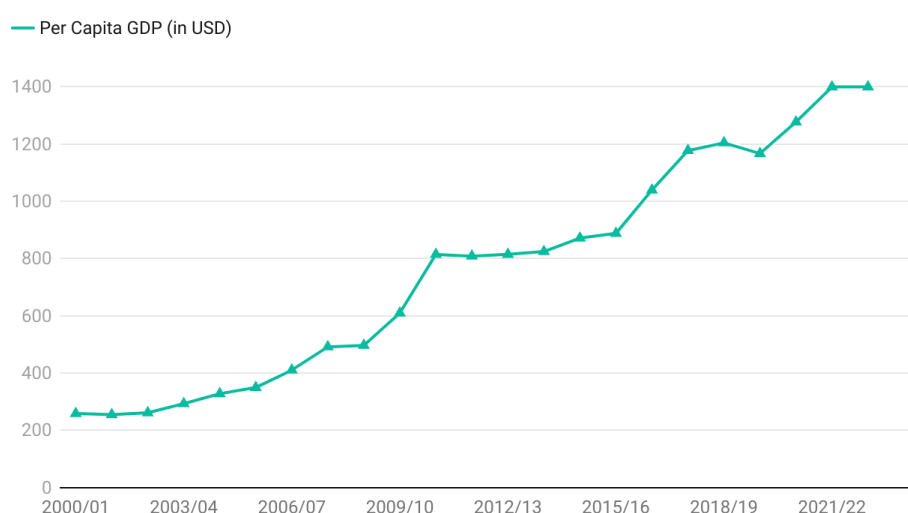
Nepal's anticipated graduation from the LDC category depends not solely on surpassing numerical thresholds but also on the country's ability to maintain macroeconomic stability and



continue progressing after the withdrawal of special international support measures—such as preferential trade access, concessional financing, and technical assistance—that it currently receives as an LDC. Between 1996 and 2023, real GDP grew at an impressive average annual rate of 4.2 percent, despite facing domestic conflicts and various external shocks (World Bank, 2025).

Likewise, Nepal's progress has been marked by notable gains in GDP per capita (see Figure 5.1). From a level of below USD 300 in the early 2000s, Nepal has steadily surpassed the USD 1,400 mark by the end of FY 2022/23. This sustained rise in per capita income reflects a gradual structural uplift and a growing domestic market base, as rising incomes increase household consumption, expand demand for goods and services, and incentivise private investment in local markets. Alongside this, Nepal has also achieved significant improvements in the Human Development Index (HDI), exhibiting a consistent upward trend since 1990, with a notable increase from 0.399 to 0.602 in 2022 (Dulal, 2023).

Figure 5.1. GDP Per Capita of Nepal



Source: NRB

However, beneath this aggregate growth story lies a more complex interplay of dependency, competitiveness constraints, and under-leveraged structural potential — evident in a remittance-driven economy, weak trade competitiveness, and an imbalanced sectoral composition. These structural features, while partially responsible for driving growth, also expose the economy to vulnerabilities that may intensify post-LDC graduation. In the following sections, we examine these underlying dimensions through key macroeconomic indicators, including labour migration patterns, remittance flow, trade performance, provincial competitiveness rankings, and the evolving contribution of agriculture, services, and tourism to GDP.

## 5.1. Consumption-Based Economy

Nepal has made substantial progress in reducing poverty, with extreme poverty declining from over 50 percent in 1996 to just 0.4 percent in 2023 (World Bank, 2025). This remarkable achievement has been primarily driven by remittance inflows from the country's growing number of migrant workers (see Table 5.1) — a phenomenon that reflects both an economic strength and a structural vulnerability.

Remittances have become a crucial factor in Nepal's economy, accounting for nearly one-third of Nepal's GDP. According to the Nepal Rastra Bank, remittances constituted over 22.7 percent of GDP as of 2021/22 (NRB, 2023). Paradoxically, while remittances have helped sustain household consumption and alleviate poverty, their transformative effect on the productive base has been limited. NSO (2022) reports that 72.4 percent of remittance-receiving households use the money for daily consumption needs. Redirecting even a fraction of these flows into agri-processing, services innovation, and tourism upgrading could yield significant productivity dividends. Practical mechanisms such as diaspora bonds, cooperative savings schemes, and incentives for formal remittance channels can help mobilise migrant savings towards sectors that directly strengthen Nepal's graduation readiness (NIPoRe, 2024).

Table 5.1: Labour migration and workers' remittance

<i>Fiscal Year</i>	<i>Number of Workers having Foreign Employment Permit</i>	<i>Remittance as share of GDP (%)</i>
2015/16	403,174	26
2016/17	383,493	23
2017/18	354,082	22
2018/19	236,211	23
2019/20	190,453	23
2020/21	72,081	22
2021/22	348,867	20
2022/23p	494,224	23

*Source: Economic Survey of Nepal and NRB. P\* refers to projected for remittance.*

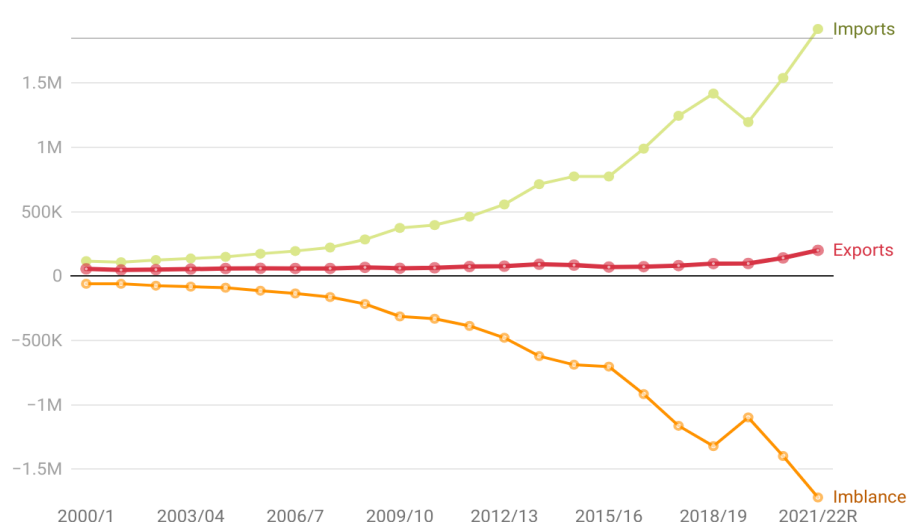
The dependence on overseas labour migration leaves Nepal's macroeconomy vulnerable to external shocks, including labour market fluctuations in destination countries and geopolitical tensions that can disrupt remittance flows. As Nepal prepares for its graduation from the LDC category, this consumption-based model poses a critical challenge. Without a transition toward production-oriented growth — underpinned by domestic job creation, private sector development, and export diversification — the sustainability of its development gains remains uncertain in the post-LDC era when preferential support measures begin to phase out.

## 5.2. Weak Trade Competitiveness

The growth of a country's exports of goods and services is a strong indicator of its economic competitiveness. In an increasingly interconnected global economy, countries that successfully integrate into global value chains tend to experience faster and more sustained growth.

In Nepal's case, however, trade performance has remained persistently weak, constrained by a narrow export base, low-value addition, and limited integration into global value chains. The trade deficit (see Figure 5.2) has widened consistently over the past two decades, reaching over NPR 1,720 billion in the FY 2021/22. This persistent trade imbalance exposes critical limitations, such as underdeveloped industrial development, a less industrialised job market, limited product diversification, and weak connectivity to regional and global markets.

Figure 5.2. Trend of trade deficit in Nepal (in NPR million)<sup>10</sup>



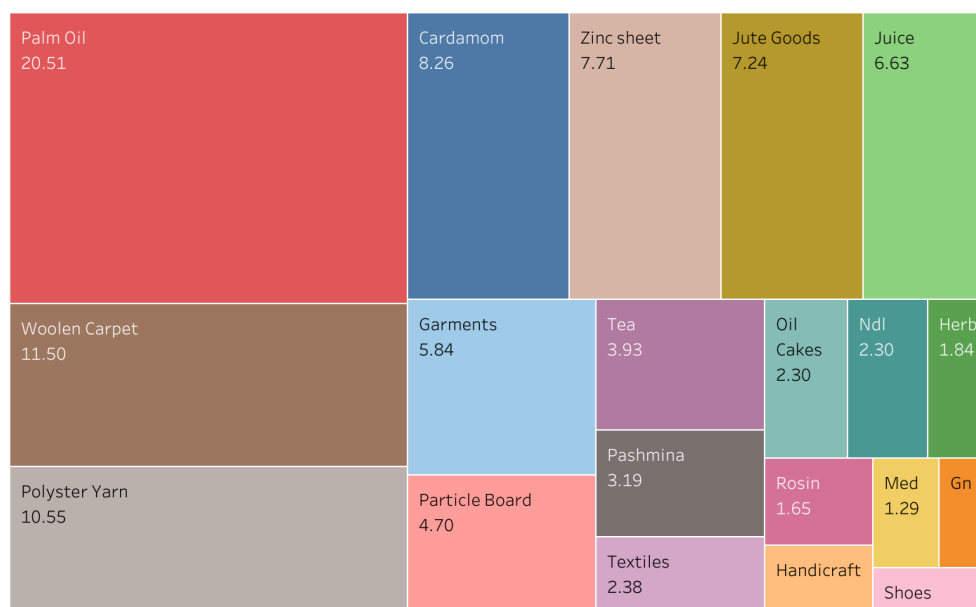
Source: NRB (R refers to Revised)

A visual examination of Nepal's export basket (see Figure 1.4) reveals a high concentration in labour-intensive products, such as carpets, pashmina, cardamom, tea, and palm oil. This indicates a lack of product diversification, suggesting that Nepal's exports are predominantly based on traditional, low-tech sectors with limited scope for value-added or innovative growth.

This is further supported by Nepal's position on the Economic Complexity (EC) ranking, where it ranks 73rd globally in 2023. While not at the very bottom, this ranking indicates a relatively low level of productive knowledge embedded within the economy, which constrains the country's ability to transition into more sophisticated, knowledge-intensive sectors.

<sup>10</sup>Note: The y-axis range in this chart is truncated. Values above 1.5M (imports) and below -1.5M (imbalance) are not labeled due to scale settings in Datawrapper. The final data points are 1,920,448.40 for imports and -1,720,417.40 for imbalance.

Figure 5.3: Nepal's Export of Goods as per FY 2022/23<sup>11</sup>



*Source: Current Macro-Economic and Financial Situation, NRB*

Nepal's weak trade competitiveness is particularly striking given its location between two of the world's largest and fastest-growing economies, India and China. Positioned at the heart of this emerging global growth axis, the country has yet to capitalise on its geographic advantage to achieve tangible gains in export-led development.

To capitalise on the benefits of this shifting economic landscape, Nepal must develop a robust trade policy framework that focuses on enhancing production and export competitiveness, anchored in improved infrastructure, logistics, and regional integration. Such a framework is not only vital for leveraging Nepal's geographic position but also essential for navigating the post-LDC transition, where stronger trade readiness will be critical to sustaining growth and minimising vulnerabilities. Without timely reforms, Nepal risks missing a historic opportunity to transform its economy, even as neighbouring countries accelerate ahead.

### 5.3. Under-Leveraged Sectoral Potential

Nepal's weak trade competitiveness is closely linked to its sluggish structural transformation. Despite policy aspirations such as ***“Long-term Vision 2100”*** with a mantra of ***“Prosperous Nepal, Happy Nepali,”*** Nepal's sectoral composition reveals that the industrial sector has contributed little to economic growth over the years. The limited contribution of the industrial sector undermines the foundations needed for sustained job creation, export diversification, and productivity growth. The economy remains dominated by the services sector, with only modest changes in the shares of agriculture and industry.

<sup>11</sup>Note: Shortened product names are: Herb = Herbs ,Ndl = Noodles ,Med = Medicine (Ayurvedic) ,Gn = Ginger, Handicrafts = Handicraft Goods and Other Handicrafts, Shoes = Shoes and Sandals. Amounts for Handicrafts, Shoes, and Ginger are 1.34, 1.02, and 1.07 million NPR respectively and may not be fully visible inside the tree map boxes due to size limitations. All values are expressed in Rs. million. The top 20 exports are selected from major commodities exported to India, China, and other countries.

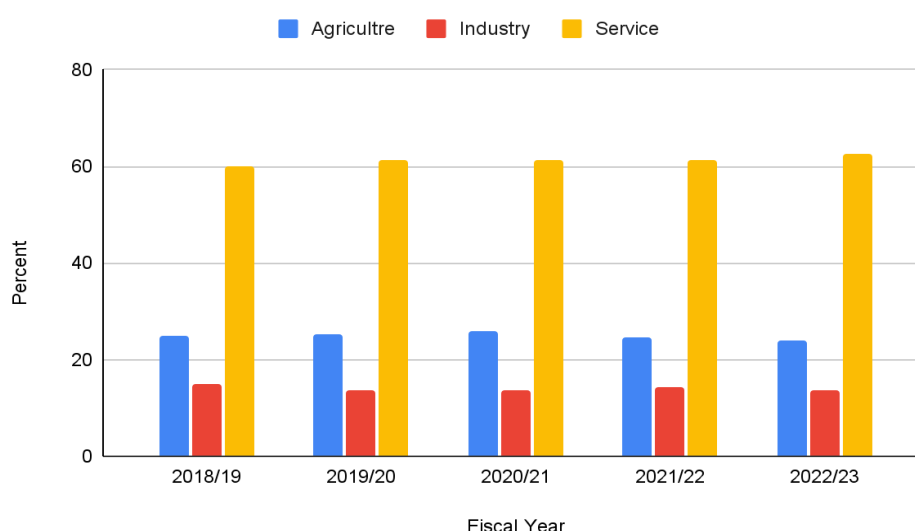
Over the five years, i.e., between FY 2018/19 and FY 2022/23, the share of industry in national GDP declined from 15.02 percent to 13.60 percent, underscoring the underperformance of Nepal’s manufacturing and industrial base. Meanwhile, the services sector has expanded steadily, accounting for over 62 percent of GDP. At the same time, agriculture continues to contribute around one-fourth (see Figure: 5.4). This pattern reflects a premature shift toward a service-based economy without a strong industrial foundation, commonly referred to as “services-led structural transformation.”

Such a transition is not inherently harmful, as a growing services sector can contribute to job creation, urbanisation, and increased productivity in specific areas such as ICT, finance, and tourism. In some countries, especially those with limited industrial capacity or those that are landlocked, the services sector can become a key driver of growth. However, in Nepal’s case, this shift has occurred without sufficient industrial development or agricultural modernisation, limiting the potential for high-value exports, structural resilience, and broad-based employment generation.

This under-leveraged structural potential has direct implications for Nepal’s future development, particularly as the country prepares for graduation from the LDC status. Graduation will lead to the phasing out of preferential market access, trade concessions, and development finance. Without a stronger industrial sector and a more diversified economic base, Nepal risks facing a “capability trap”—where the economy lacks the productive and institutional capacity to compete in global markets under standard trade rules.

To meet the challenges of the post-LDC era, Nepal must pivot toward a structurally balanced growth model, one that revitalises its industrial sector, modernises agriculture, and upgrades service delivery. Strengthening value chains, supporting SMEs, promoting export-oriented manufacturing, and incentivising private sector investment in high-productivity sectors will be critical to unlocking Nepal’s long-term growth potential.

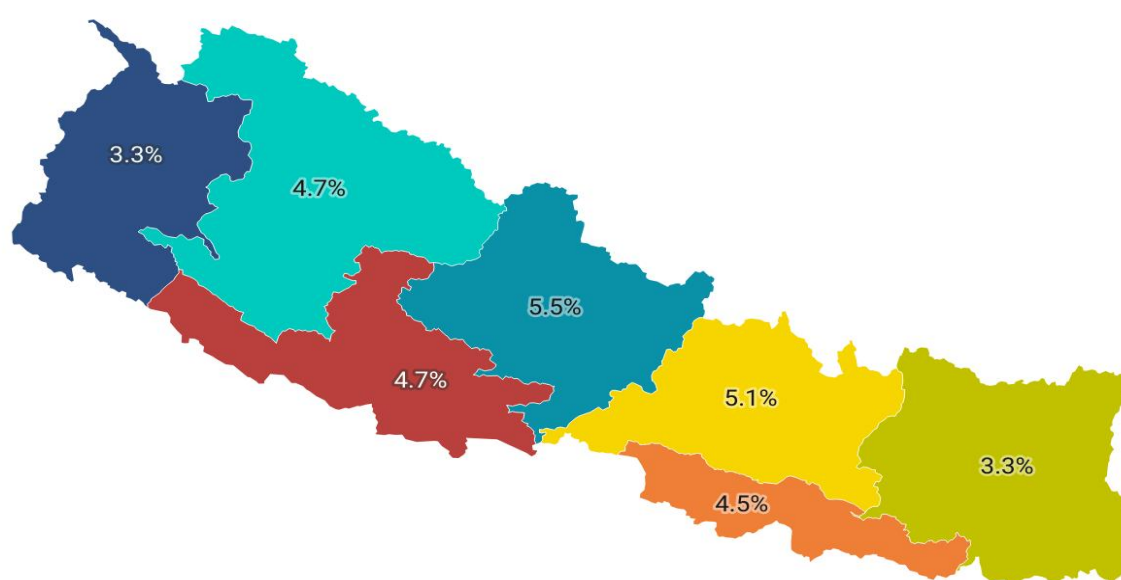
Figure 5.4. Real Sector Share of GDP (in Percentage)



## 5.4. Provincial Competitiveness: A Missing Link in Nepal's Growth Story

Nepal's federal structure presents a unique opportunity to unlock province-specific growth and foster inclusive national development. With the promulgation of the 2015 Constitution, Nepal embraced a federal governance model that devolved substantial fiscal and administrative powers to provincial and local governments. This transition was not merely institutional—it was envisioned as a pathway to correct entrenched provincial disparities, empower local actors, and catalyse context-specific development across the country.

Figure 5.5. Provincial GDP Growth Rates of Nepal (Based on the Preliminary Data)

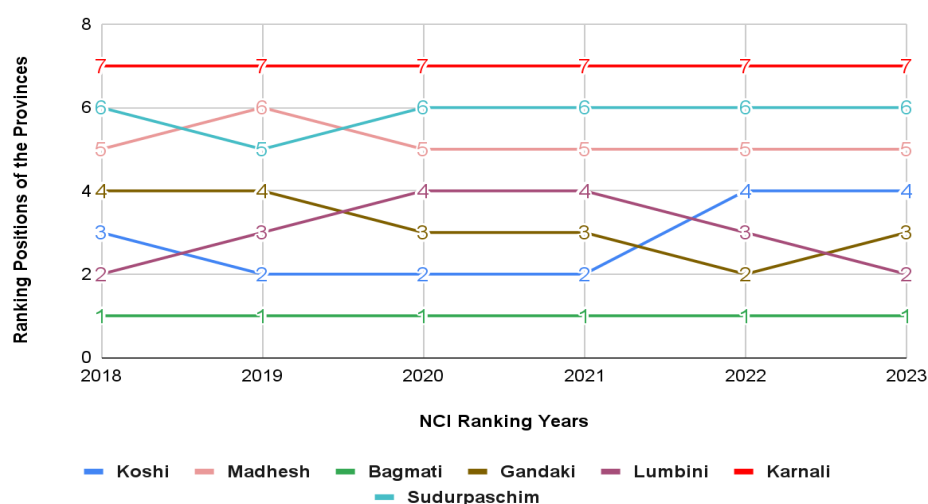


*Source: Press Note on Provincial Gross Domestic Product Estimates for FY 2024/25, NSO*

However, the Provincial GDP growth is uneven. In FY 2024/25, Gandaki recorded the highest growth rate (5.5 percent), followed by Bagmati (5.1 percent), while Koshi and Sudurpashchim both remains at 3.3 percent growth. A closer look, however, reveals that Sudurpashchim (3.32 percent) is marginally lower than Koshi (3.34 percent), making it the weakest performer, which highlights persistent inter-provincial disparities.

This evidence is further supported by the Nepal Competitiveness Index (NCI) findings, which include provincial competitiveness rankings from 2018 to 2023. Figure 5.6 highlights persistent gaps in competitiveness across provinces. Provinces endowed with relatively better transport connectivity, thriving industrial clusters, and urban centres—such as Bagmati and Gandaki—continue to outperform more than less competitive provinces like Karnali and Sudurpashchim across key pillars, including logistics, infrastructure readiness, business environment, and human capital development (NCI, 2025). These disparities underscore the fact that while decentralisation has shifted responsibilities downward, it has not yet ensured equitable capacity or outcomes across provinces.

Figure 5.6. Overall provincial competitiveness ranking



Source: NCI 2025

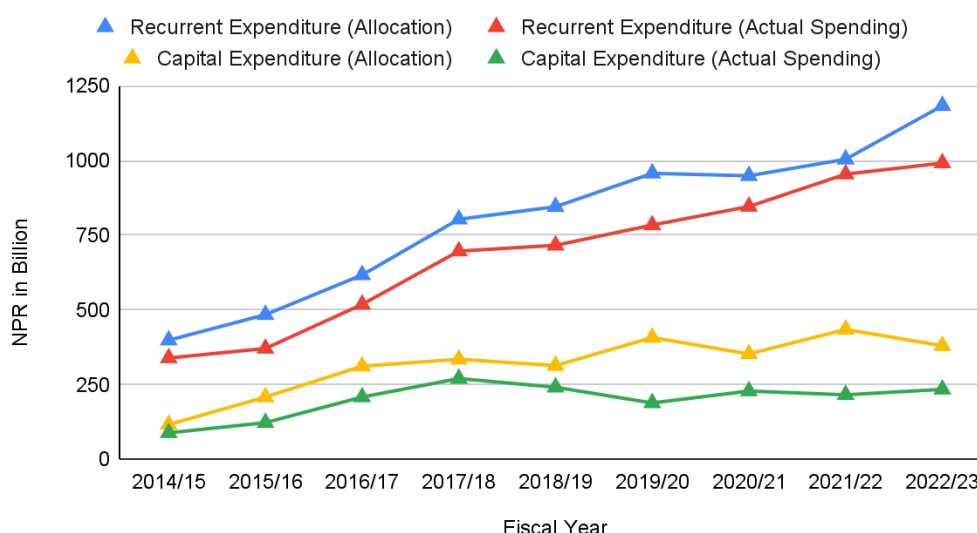
If left unaddressed, these intra-country gaps in competitiveness may reinforce existing structural bottlenecks, limit productivity spillovers, discourage private investment, and impede Nepal's broader development ambitions. In the context of Nepal's planned graduation from LDC status, persistent provincial inequality could weaken national resilience to external shocks, reduce fiscal space for redistributive policies, and deepen socio-economic fragmentation.

Yet, these disparities also present a window of opportunity. Lagging provinces, if supported through targeted investments in physical infrastructure, digital connectivity, sector-specific value chains, and institutional capacity-building, can emerge as new engines of growth. A differentiated policy approach—one that recognises the unique comparative advantages and constraints of each province—can help build a more integrated and competitive national economy. Strengthening subnational competitiveness is thus not just about closing regional gaps; it is about ensuring that the benefits of growth are broad-based and that federalism delivers on its promise of inclusive prosperity.

### 5.5. Debt, Spending, and Development Trade-offs

As Nepal advances toward LDC graduation, government spending patterns remain anaemic, particularly in capital expenditure. While overall public spending has increased steadily over the past decade, capital expenditure continues to underperform—both in absolute terms and as a share of total spending—reflecting persistent structural weaknesses in the state's implementation and absorptive capacity.

Figure 5.7. Government Allocation Vs Spending Trend



*Source: Office of The Auditor General*

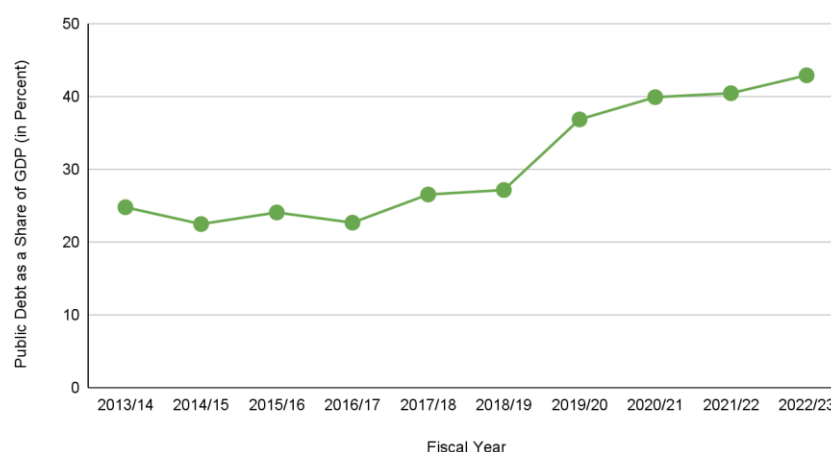
Between FY 2014/15 and FY 2022/23, Nepal's recurrent expenditure (mainly consisting of salaries, administrative costs, and subsidies) accounted for an increasing share of the national budget. While actual spending on recurrent heads consistently hovered close to allocations—with an average shortfall of just 14.76 percent—capital expenditure consistently underperformed, with an average shortfall of 35.3 percent over the same period (see Figure 5.7).

This imbalance in fiscal priorities—favouring day-to-day expenses over long-term investments—has negative implications for structural transformation. Weak capital execution undermines economic diversification, productivity-enhancing infrastructure, and job creation—all of which are central to Nepal's post-LDC development narrative. Without targeted remedies in planning, procurement, and inter-agency coordination, the country risks squandering its limited fiscal space on consumption-heavy spending rather than transformational investments.

The rising public debt burden further complicates these challenges. Nepal's total public debt as a percentage of GDP increased from 24.07 percent in FY 2015/16 to 42.92 percent in FY 2022/23, with the sharpest increase occurring during the pandemic years (see Figure 5.8). This growing debt burden raises macroeconomic concerns, particularly in light of evidence suggesting a negative correlation between public debt and economic growth in developing countries (Panizza & Presbitero, 2014). Moreover, high external debt has a non-linear negative impact on economic growth, reducing investment efficiency rather than volume (Pattillo et al., 2002).



Figure 5.8. Trend of Total Public Debt as a Share of GDP



*Source: Macroeconomic Dashboard, MOF*

Moreover, as countries graduate from LDC status, they often face tighter financing conditions and reduced concessional lending. Nepal is no exception. Graduation implies reduced access to soft loans and grants, resulting in increased reliance on more expensive debt. Without significant improvements in capital budget utilisation, there is a risk of entering a post-graduation debt trap. In this scenario, higher-cost borrowing fails to generate adequate returns on growth. As UNCTAD (2022) notes, many LDCs that graduate without strengthening their public investment systems or export bases often become vulnerable to unsustainable debt cycles.

Going forward, Nepal must enhance its capacity to absorb development finance. This includes reforming project pipeline readiness, improving bureaucratic coordination, and strengthening fiscal discipline at all three tiers of government. Investing in capital efficiency today is not just about building roads and bridges; it's about laying the foundation for resilient, inclusive, and self-sustained growth in a post-preferential LDC graduation.

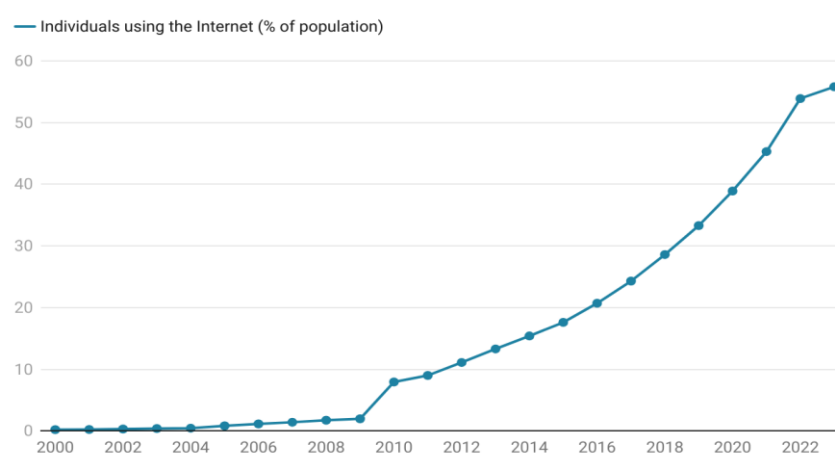
## 5.6. Unlocking Digital Dividend

Nepal's geography has long posed barriers to trade and connectivity, particularly as a landlocked country with rugged terrain and limited regional integration. Yet, in the digital era, this geographic constraint can be transformed into an opportunity. Unlike physical infrastructure, digital connectivity bypasses borders, enabling even remote or landlocked nations to integrate into global value chains through digital means.

Over the past few years, Nepal has experienced a significant increase in digital connectivity. As of October 2022, mobile broadband penetration reached 95.79 percent, while fixed broadband coverage stood at 35.48 percent (NCI, 2025; NTA, 2023). These numbers reflect not only improved access but also increasing digital adoption, particularly among young people and urban consumers. Recognising this momentum, the Government of Nepal launched the Digital Nepal Framework (DNF), a national strategy aimed at digitally empowering citizens and the economy. This rise in digital connectivity is mirrored by a sharp increase in internet

adoption in Nepal. Internet usage (percentage of population) remained below two percent until 2009 but saw a significant rise from 7.93 percent in 2010, coinciding with government IT policies and telecom reforms aimed at expanding digital infrastructure (see Figure 5.9). This upward trend continued steadily, reaching over 55 percent by 2023, underscoring the significant impact of strategic interventions and technological advancements on internet adoption rates.

Figure 5.9. Individuals Using the Internet in Nepal



*Source: World Bank Development Indicators*

The potential of the digital sector is already visible in the rise of Nepal’s Information Technology Enabled Services (ITeS) industry. IIDS (2023) estimates that the ITeS sector is valued at approximately USD 515 million, contributing about 1.4 percent to Nepal’s GDP and 5.5 percent of the total foreign exchange reserves. With a young, tech-savvy population, competitive wage levels, and a growing startup culture, Nepal is becoming an increasingly attractive digital outsourcing hub for software development, animation, fintech, and business process outsourcing.

Moving forward, Nepal must now shift from isolated digital progress to a more integrated and strategic digital transformation. This involves strengthening digital infrastructure beyond urban centres to ensure last-mile connectivity, investing in digital literacy and upskilling programs to prepare the workforce for future-ready jobs, and improving the regulatory environment to attract international tech investment. Policies must also promote digital entrepreneurship, facilitate e-commerce, and ensure data security and compliance with cross-border digital trade regulations. Furthermore, embedding digital tools across key sectors—such as education, health, agriculture, and public services—can enhance inclusion and resilience.

As Nepal prepares for its post-LDC transition, a strong and inclusive digital economy can become a vital pillar for sustaining competitiveness, diversifying exports, and cushioning the loss of preferential trade treatments. By riding on the growth of the digital economy, Nepal can mitigate some post-LDC vulnerabilities and tap into new channels of regional integration and service exports.

## **6. Nepal's LDC Graduation Plans**

Nepal is on track to graduate from the Least Developed Country (LDC) category by 2026, having met the eligibility criteria for graduation twice—first in 2015 and again in 2021—based on a review by the United Nations Committee for Development Policy (CDP). While graduation marks a milestone in Nepal's development journey, it also presents risks, particularly in terms of reduced access to concessional finance, preferential trade schemes, and technical assistance. Recognising these challenges, the Government of Nepal (GoN), under the leadership of the National Planning Commission (NPC), has initiated several policy and strategic measures to ensure a smooth and sustainable transition.

### **6.1. Policy Framework for LDC Graduation and Smooth Transition**

The cornerstone of Nepal's graduation preparedness lies in its Smooth Transition Strategy (STS), which is prepared with technical support from UNDP. The NPC has drafted a transition roadmap that emphasises sustaining development gains, protecting trade competitiveness, and diversifying the economy. According to the STS, the key focuses of the document are on six pillars: (i) Macro-economic stability and fiscal sustainability, (ii) Trade and investment, (iii) Economic transformation, (iv) Building productive capacity, (v) Climate change and disaster risk management, (vi) Social inclusion and integration. The Sixteenth plan has been a guiding document for the STS.

### **6.2. Plans to Offset Declining ODA Post-Graduation**

As graduation may lead to a decline in concessional Official Development Assistance (ODA), Nepal has started exploring alternative development financing mechanisms. The Ministry of Finance (MoF) has emphasised blended finance, public-private partnerships (PPPs), and foreign direct investment (FDI) as priority areas to compensate for ODA losses. The Development Cooperation Report 2022 highlights Nepal's commitment to transitioning from donor-driven development to co-financing and results-based investment models.

Moreover, the Development Finance Assessment (DFA) conducted by UNCDF in 2021 recommends building a stronger domestic resource mobilisation (DRM) base, enhancing tax administration, and leveraging diaspora bonds. The GoN is also exploring climate finance mechanisms such as the Green Climate Fund (GCF) and carbon markets, especially given Nepal's climate vulnerability and strong credentials in conservation.

### **6.3. Strengthening Industrial and Trade Capacity**

Nepal has initiated several steps to enhance its industrial base and trade competitiveness in anticipation of its graduation from the LDC status. The Nepal Trade Integration Strategy (NTIS) 2016, though in need of updating, remains a key instrument for promoting priority export sectors such as tourism, IT services, agro-processing, and handmade goods. The GoN, with the support of the EIF (Enhanced Integrated Framework), has also prioritised capacity-building programs for small exporters and producers.

Under the Nepal Industrial Policy 2011, efforts are underway to establish industrial zones and Special Economic Zones (SEZs) in strategic locations. The Gorahi-Dang, Simara-Bara, and Dhankuta SEZs are being developed to promote manufacturing and cross-border trade. The Nepal Investment Board has also accelerated large-scale infrastructure projects aimed at improving transport connectivity with India and China, which are key to reducing trade costs following Nepal's graduation from LDC status.

#### **6.4. Domestic Job Creation Initiatives**

Recognising the need to reduce reliance on foreign employment, Nepal's recent policy focus has shifted toward domestic job creation. The Youth Employment Transformation Initiative (YETI), supported by the World Bank, has played a crucial role in creating short-term employment opportunities for youth, particularly in rural municipalities. The Prime Minister Employment Program (PMEP) has also been scaled up to provide wage subsidies and link job seekers with local governments.

Simultaneously, sectoral initiatives in agriculture, tourism, and renewable energy are designed to absorb semi-skilled labour. The Startup Enterprise Loan Scheme, launched in 2022, seeks to encourage youth-led startups, particularly in underserved regions, with subsidised credit and business development services.

#### **6.5. Readiness of Digital Economy and Infrastructure**

Digital transformation is increasingly central to Nepal's post-LDC development strategy. The Digital Nepal Framework (DNF) outlines eight priority sectors, including agriculture, health, education, energy, and finance. Its goal is to create a digitally connected and innovation-driven economy by leveraging broadband connectivity, e-governance, and digital finance.

While mobile broadband penetration has reached nearly 96 percent, fixed broadband penetration remains limited to 35 percent as of 2022 (NTA, 2023). The challenge now lies in improving rural digital access, ensuring cybersecurity, and equipping citizens with digital skills. The newly established ICT Council of Nepal and the Digital Economy Development Committee under MoCIT are tasked with coordinating these efforts. Investments in data infrastructure, including the National Data Centre and digital ID systems, are crucial steps toward building a resilient digital economy capable of withstanding external shocks post-graduation.

To sum up, Nepal is preparing to graduate from the Least Developed Country (LDC) category by 2026, guided by a Smooth Transition Strategy (STS), which focuses on macroeconomic stability, trade and investment, economic transformation, productive capacity, climate resilience, and social inclusion. To address expected declines in concessional aid, the government is pursuing blended finance, public-private partnerships, foreign direct investment, stronger domestic resource mobilisation, diaspora bonds, and climate finance. Efforts to boost industrial and trade competitiveness include updating the Nepal Trade Integration Strategy, developing Special Economic Zones, and advancing connectivity projects. Domestic job creation is being promoted through initiatives such as the Youth Employment Transformation

Initiative, the Prime Minister Employment Program, and sectoral investments in agriculture, tourism, renewable energy, and startups. The Digital Nepal Framework aims to drive innovation and economic diversification by enhancing broadband access, digital infrastructure, and skills, with a focus on expanding rural connectivity and strengthening cybersecurity.

## **7. Policy Implications**

Nepal's graduation from the LDC is a recognition of its achievements in human development and macroeconomic stability. The graduation changes preferences in trade, access to concessional finance, and the modality of development cooperation; thus, it is essential that the country's readiness be thoroughly examined.

This section analyses five interconnected aspects of the post-graduation landscape. It begins with macroeconomic changes, examining how shifts in trade trends, aid flows, and fiscal pressures can impact growth prospects at the federal, provincial, and local levels. Second, it examines trade reconfiguration, describing how LDC-specific market access is eroded, changes in relationships with India, China, and other partners occur, and efforts are made to diversify exports. The discussion then shifts to development financing transition, describing the shift away from concessionary aid toward market-based finance and surveying innovative instruments such as green and diaspora bonds. Foreign direct investment options are then evaluated, considering both the image boost that graduation would create and the structural reforms needed to attract and keep investors. Lastly, the section examines the future of remittances, including potential shifts in migration patterns and strategic ways to channel these flows into productive, growth-promoting uses. Together, these ideas provide a pragmatic outlook on the risks, opportunities, and policy options that will determine whether Nepal's graduation from LDC serves as a launchpad for shared prosperity or a test of its resilience.

### **7.1. Macroeconomic Conditions Post-Graduation**

Nepal's graduation from LDC status is likely to usher in notable changes to the country's macroeconomic situation, which is characterised by structural weaknesses, including a persistent trade deficit, low productivity, reliance on remittances and grants, and inadequate domestic resource mobilisation. The adjustment would accentuate these weaknesses unless institutional strengthening and macroeconomic policy coordination are stringently strengthened.

One of the most explicit consequences relates to the possible loss of preferential market access that Nepal currently enjoys under various LDC-specific schemes, such as the EU's Everything But Arms (EBA) and the United States' Generalised System of Preferences (GSP). A reduction or loss of these gains might slow export competitiveness, particularly in the manufacturing sector, which has been slowly recovering in recent years following the disruptions caused by the 2015 earthquake and the COVID-19 pandemic. Total exports of Nepal comprised only slightly more than 12 percent of its GDP, highlighting the narrow base of the country's exports (MOF, 2025).

The trade deficit—presently over 25 percent of GDP as of FY 2022/23—can be further increased if growth in exports is slowed after graduation. Hence, pressure on the foreign exchange reserves and the current account is expected to increase, particularly if the flow of remittances becomes volatile due to geopolitical or labour market developments in large destination countries. [Nepal Rastra Bank's Macroeconomic Update](#) recommends that, despite reserves remaining in a comfortable seven months of import cover range, maintaining such a level once it graduates would require structural changes in order to increase export-led growth and reduce import dependence (NRB, 2025).

From a fiscal policy standpoint, graduation would lead to the gradual decline of grant-based ODA, currently contributing two to three percent to GDP annually. The decline would limit fiscal space, with the government being forced to rely more on domestic borrowing and domestic revenues, with implications on debt sustainability and potential inflationary pressure. Subnational and provincial government stand to lose disproportionately under such a change, with intergovernmental transfers not rising proportionally to limit their ability to fund development schemes and the provision of essential services. This is in addition to relatively weak revenue-raising powers at the subnational level, with most provinces collecting less than 10 per cent of their total spending from own-source revenues (FCGO, 2023).

On the monetary policy side, Nepal's peg to the Indian Rupee has been a pillar of exchange rate stability. However, post-graduation, inflationary pressures can rise due to imported inflation on account of loss of duty-free access to inputs and capital goods. Besides, with the decline in concessional external borrowing, external finance will be more expensive, which can have implications for public sector investing as well as crowd out private credit. This can reduce economic growth, which the National Planning Commission (NPC) projects to be on average six to seven percent per annum in the post-graduation decade, conditional on significant structural reforms (NPC, 2023).

Nepal's graduation also has macro-fiscal policy credibility implications. On a positive side, LDC graduation could contribute to perceptions and political stability and governance, thereby enhancing sovereign credit ratings and investor confidence. Such favourable reputations could lower the risk premium on domestic debt and foreign portfolio investment could be induced. In order to achieve these gains, however, the government must demonstrate macroeconomic discipline, fiscal transparency, and sound public financial management.

Another crucial factor of macroeconomic implication is the need for enhanced statistical capacity and data-driven planning. The shift to new modes of finance, reduced aid dependence, and competitive trade regimes calls for high-quality, timely, and disaggregated macroeconomic data. Strengthening of national statistical institutions, including the National Statistics Office and provincial statistical offices, will be central to ensuring evidence-based policy decision-making at all levels of government.

Lastly, macroeconomic transition impacts will not be homogenous across the nation. NIPoRe (2025) finds that higher macroeconomic stable provinces such as Bagmati, Madhesh, and Lumbini could be more prone to manage the new landscape. On the contrary, less competitive

provinces such as Karnali and Sudurpaschim needs targeted fiscal equalisation and development support in order to avoid elongating provincial disparities. The post-graduation period thus demands more attention towards fiscal federalism, horizontal equity, and strategic use of capital investment, particularly in infrastructure, health, and education, to secure macroeconomic stability and inclusive growth.

## 7.2. Nepal's Trade with Global Partners

Nepal's graduation from the LDC status will have significant implications on its international trade relations with its international partners, requiring a diligent overhaul of its trade policy and diplomatic efforts. As a landlocked, least developing country profoundly depend on import and remittance dependence, and fragile export diversification, Nepal's trade environment is vulnerable to shocks stemming from the loss or reorientation of preferential trade arrangements that have long facilitated its integration with the global market.

Nepal's trade regime is currently characterised by an unyielding trade deficit since imports surpassing the exports. The Ministry of Finance's FY 2024/25 Economic Survey states that Nepal's trade deficit accounted for approximately 25 percent of its GDP, indicative of the structural deficits in export competitiveness and diversification (MoF, 2025). The country's major export products such as textiles, carpets, pashmina, tea, handicrafts, and agricultural products—have duty-free and quota-free access to crucial markets, primarily under schemes such as the European Union's EBA, United States GSP, and other such preferential trade facilities with countries such as the United Kingdom, Japan, Australia, and some ASEAN members.

The impending graduation will most likely trigger the withdrawal or deceleration of such trade preferences. The notifications and assessment by the World Trade Organisation (WTO) indicate that LDC graduates tend to go through a phase of transition wherein preferences are gradually eliminated over years, often taking several years to allow adjustment ([WTO, 2022](#)). The elimination of preferences will therefore affect Nepal's export sectors in two significant ways:

1. **Reduced price competitiveness:** Without duty exemptions, Nepali exports would become relatively more expensive than competitors from least developed countries that still enjoy preferential access and may lose market share in traditional export destinations.
2. **Increased non-tariff barriers:** Graduation may result in Nepal losing certain flexibilities in complying with sanitary and phytosanitary (SPS) standards, technical barriers to trade (TBT), and rules of origin requirements, which are critical for market access, especially in Europe and North America.

In light of these risks, Nepal's trade relationship with its two largest neighbours—India and China—will help minimise the adverse effects of graduation. India commands over 60 percent of Nepal's trade turnover, with China at approximately 15 percent ([NRB, 2024](#)). The bilateral trade agreements with these countries recently provide some protection in the guise of tariff

preferences and transit facilitation. These arrangements are not altogether comprehensive or problem-free in procedure, though. Exporters, for example, face non-tariff barriers in the form of complex customs procedures, delays at borders, and certification that hamper the competitiveness of Nepali products ([MoICS, 2025](#)).

Furthermore, Nepal's trade deficit with India and China remains sizeable, reflecting the over-reliance of the country on imports of petroleum products, machinery, vehicles, and consumer goods. The imbalance points to the structural challenges of inadequate local production capacity and the necessity of export diversification. Post-graduation, Nepal will need to exert more efforts to deepen regional value chains, particularly in sectors like hydropower equipment manufacturing, agro-processing, and textiles, to take advantage of both preferential and non-preferential trade arrangements.

Nepal's ties with other key global partners, such as the United States, the European Union, Japan, South Korea, Australia, ASEAN nations, and Middle Eastern countries, are also poised for transformation. While some of these partners have indicated providing "graduation-sensitive" trade preferences or extending special trade arrangements beyond graduation, such concessions are not guaranteed and often require bilateral negotiations, as well as compliance with stringent regulatory and environmental standards.

For instance, the EU has signalled its willingness to provide some form of "differential treatment" to LDC graduates, albeit with a smaller scale than the EBA advantage. America has also hinted at continued maintenance of some trade preferences under its GSP program, pending Nepal's qualification based on meeting certain eligibility factors, e.g., labour rights and intellectual property standards ([U.S. Trade Representative, 2023](#)). These changes imply that Nepal needs to improve its institutional strength to achieve international standards and norms to ensure market access after graduation.

Trade diplomacy, therefore, will become a cornerstone of Nepal's post-graduation strategy. The Ministry of Foreign Affairs (MoFA), in coordination with the Ministry of Industry, Commerce and Supplies (MoICS) and the Ministry of Finance (MoF), is tasked with spearheading negotiations to safeguard preferential terms where possible and explore new trade agreements, including Free Trade Agreements (FTAs) with key partners. The Nepal-China Transit and Trade Agreement and the Nepal-India Trade Treaty will require updates and stronger implementation mechanisms to facilitate smoother cross-border trade and reduce transaction costs ([MoFA, 2024](#)).

At the subnational level, provinces with export-oriented industrial clusters—such as those in Bagmati, Koshi, Madhesh, and Lumbini ([NIPoRe, 2022 - 2025](#))—may face immediate challenges as preferential tariffs phase out. These provinces will require targeted policy to upgrade infrastructure, improve compliance capacity for international standards, and develop local value chains that enhance product quality and competitiveness. Provincial and local governments must be integrated into national export promotion strategies to ensure inclusive and regionally balanced growth.



Finally, the decline in trade preferences will encourage Nepal to pursue a more export-oriented trade policy with diversification of markets and products. Supply-side constraints, including ensuring customs efficiency, decongesting logistical bottlenecks, upgrading quality assurance systems, and supporting export-oriented investments, will be essential to maintain and grow Nepal's international trade footprint in the post-LDC era.

### **7.3. Development Financing Landscape**

Graduation for Nepal will also fundamentally alter its development funding environment, from concessionary aid dependence to more commercial and market-based funding modalities. It necessitates an in-depth comprehension of the developing environment and its bearing on sustainable development funding across all levels of government

Official development assistance (ODA) in the way of grants and heavily concessionary loans by multilateral development institutions such as the International Development Association (IDA) of the World Bank and the Asian Development Fund (ADF) of the Asian Development Bank (ADB) form an important component of Nepal's social sector funding and public investment. As Per the Ministry of Finance's Economic Survey 2024/25, concessional ODA represents a share of about 2.5 percent of Nepal's GDP every year, supporting infrastructure development, health, education, and governance reforms ([MoF, 2025](#)).

Upon graduation, Nepal will face a phasing out of eligibility under these concessional windows progressively. For instance, IDA financing terms will change from grants and soft loans to even tougher loans at market rates, which could add significantly to the government's debt servicing. The OECD Development Assistance Committee notes that countries graduating from LDC status typically experience a cut of up to 30 percent of concessional assistance over a five- to seven-year average transition period ([OECD DAC, 2022](#)).

This reduction in concessional aid poses a dual challenge: first, fiscal space will tighten as grant financing shrinks, and second, debt sustainability risks will heighten if commercial borrowing replaces concessional funds without robust debt management frameworks. The NRB reports that Nepal's public debt stood at 40 percent of GDP in FY 2023/24, with external debt accounting for approximately 20 percent ([PDMO, 2025](#)). Maintaining debt at sustainable levels will require prudent borrowing strategies and increased emphasis on domestic resource mobilisation (DRM). DRM efforts are crucial to offset the decline in external concessional finance. Recent reforms aimed at expanding the tax base, improving compliance, and enhancing revenue administration have yielded modest increases in tax-to-GDP ratios, currently at approximately 13 percent ([MoF, 2025](#)). However, these gains remain insufficient to fully substitute for ODA reductions. Provincial and local governments, under Nepal's federal structure, contribute less than 15 percent of total tax revenues and face considerable challenges in expanding their own-source revenues (FCGO, 2023). Addressing this gap is crucial for sustaining service delivery and capital investments at the subnational level.

This reduction in concessional support poses a dual challenge: first, fiscal space will be limited as grant finance shrinks, and second, debt sustainability risks will rise if commercial borrowing

replaces concessional funds in the absence of effective debt management institutions. The NRB reports that Nepal's public debt stood at 40 percent of GDP in FY 2023/24, with external debt at approximately 20 percent ([PDMO, 2025](#)). Maintaining debt at sustainable levels will require cautious borrowing policy and increased emphasis on domestic resource mobilisation (DRM). DRM efforts are needed to offset the decline in external concessional finance. Recent fiscal efforts to expand the tax base, enhance compliance, and refine revenue administration have yielded modest increases in tax-to-GDP ratios, which are currently at about 13 percent ([MoF, 2025](#)). These increases, however, are not yet sufficient to fully offset ODA decreases. Provincial governments and local governments, according to Nepal's federal system, collect less than 15 percent of total tax revenues and face sizable challenges in raising their own-source revenues (FCGO, 2023). Reducing this gap is crucial to ensure service delivery and capital expenditure at the subnational level.

The changing development finance architecture also opens up room for new financing instruments. Graduation can also render Nepal more creditworthy to access new sources such as green bonds, diaspora bonds, social impact bonds, and public-private partnerships (PPPs). For example, the government's recent launch of its first-ever sovereign green bond in 2023 demonstrated investor appetite for sustainable financing, raising NPR 10 billion for renewable energy and climate resilience projects ([MoF, 2025](#)).

However, leveraging these instruments requires strengthened institutional frameworks, robust regulatory environments, and enhanced capacity in project preparation and financial management across all tiers of government. Provincial governments, which have expanded roles in infrastructure development, require support to develop credible investment pipelines and comply with fiduciary standards, thereby attracting private capital and blended finance.

Multilateral and bilateral development partners are likely to recalibrate their support from direct financing towards technical assistance, capacity building, and policy dialogue, with a focus on facilitating Nepal's integration into global financial markets and enhancing domestic governance. Effective coordination among development partners, federal, provincial, and local governments will be imperative to align resources effectively and avoid duplication.

Ultimately, the shift in development financing will necessitate enhanced debt transparency and reforms in public financial management to mitigate fiscal risks. The Ministry of Finance's recent initiatives on debt recording, risk analysis, and medium-term debt strategies represent steps in the right direction but require scaling and institutionalisation.

#### **7.4. Prospects for Foreign Direct Investment**

The graduation will also reshape Nepal's foreign direct investment (FDI) landscape, offering new opportunities while presenting significant challenges. Graduation is expected to enhance Nepal's economic profile and global standing, which can improve investor confidence and attract higher volumes of FDI. However, it simultaneously demands notable improvements in the investment climate and regulatory environment to realise Nepal's potential as a top destination for foreign investors. According to the Ministry of Finance's Economic Survey

(2025), Nepal's FDI inflows remain modest relative to its economic size, amounting to approximately 1.2 percent of GDP in fiscal year 2024/25. The principal sectors attracting FDI include hydropower, telecommunications, manufacturing, and tourism. However, challenges such as cumbersome bureaucratic procedures, land acquisition hurdles, inadequate infrastructure, and regulatory uncertainties have constrained the scale and diversification of FDI ([World Bank, 2020](#)).

The transition from LDC status is expected to enhance Nepal's creditworthiness and risk profile, factors that are crucial in attracting long-term, high-quality FDI. International investors typically view graduation as a signal of improved macroeconomic stability, higher governance standards, and more effective regulatory reforms, which can reduce perceived investment risks and the cost of capital ([ADB, 2023](#)). Nepal's recent upgrades in sovereign credit ratings further underscore this trend. However, the loss of preferential trade agreements and concessional financing associated with LDC status means that Nepal must strengthen its comparative advantages to attract FDI on a sustainable basis. This involves reforms in the ease of doing business, intellectual property protections, labour market flexibility, and enforcement of contracts. The World Bank's Doing Business 2020 report ranks Nepal 94th out of 190 countries, highlighting areas such as construction permits, electricity supply, and cross-border trade where Nepal lags behind its regional peers ([World Bank, 2020](#)).

At the policy level, the Government of Nepal has initiated reforms aimed at improving the investment climate, including the simplification of registration procedures through the Office of the Company Registrar, the introduction of one-stop service centres, and the digitisation of government services. However, effective implementation and institutional coordination remain significant challenges.

From a sectoral perspective, hydropower continues to offer significant FDI potential due to Nepal's vast untapped water resources. The government's "Hydropower Development Vision Paper - *Urja Bikas Margachitra 2081*" emphasises attracting private and foreign investors through public-private partnerships (PPPs), risk-sharing mechanisms, and tariff rationalisation (MoEWRI, 2023). Similarly, the tourism sector, which benefits from Nepal's unique natural and cultural assets, is poised for growth with targeted investments in infrastructure and marketing.

Provincial governments have a growing role in promoting local investment opportunities and facilitating land acquisition and licensing processes. Their engagement is crucial in leveraging regional comparative advantages and enhancing provincial governance, which can positively impact investor perceptions. For example, Lumbini's efforts to plan joint initiatives with Karnali and Gandaki are likely to boost inter-provincial industrial and tourism initiatives further, providing potential hubs for future FDI attraction ([NIPoRe, 2025](#)).

Additionally, Nepal's strategic location between India and China presents unique opportunities for integration into regional value chains. Participation in initiatives such as the Belt and Road Initiative (BRI) and the South Asian Free Trade Area (SAFTA) could enhance connectivity

and market access, making Nepal more attractive to investors focused on regional supply chains.

The development of Special Economic Zones (SEZs) and export processing zones with improved infrastructure and regulatory regimes is another avenue to boost FDI. Lessons from other regional economies suggest that successful SEZs require efficient governance, transparent policies, and strong linkages with domestic enterprises.

Furthermore, Nepal's graduation status could incentivise greater engagement from institutional investors such as pension funds and sovereign wealth funds, provided that the capital markets and regulatory frameworks develop sufficiently to accommodate such players.

Nevertheless, challenges persist. Infrastructure deficits, political volatility, land acquisition difficulties, and bureaucratic inefficiencies continue to be key deterrents to investors. Addressing these constraints requires a sustained political commitment, improved intergovernmental coordination, and robust public sector reforms.

## **7.5. Future Remittance Flows and Their Use in Nepal**

Remittances represent a strong pillar of Nepal's economy, accounting for approximately 24 percent of the country's GDP as of the fiscal year 2024/25 ([NRB, 2025](#)). The substantial remittance inflow has been instrumental in supporting household consumption, alleviating poverty, and bolstering foreign exchange reserves. The steady flow of remittances, primarily from Nepali workers employed in countries such as India, the Gulf Cooperation Council (GCC) states, Malaysia, South Korea, and increasingly in Western countries, has underpinned macroeconomic stability and mitigated current account pressures. However, Nepal's impending graduation from LDC status is poised to influence both the volume and patterns of utilisation of remittance flows. Although graduation itself does not directly restrict remittance inflows, it may affect migration dynamics and labour mobility. Key destination countries may revise their migration policies in response to Nepal's altered economic status, potentially imposing stricter visa requirements, higher recruitment costs, or adjusted quotas for Nepali workers. For instance, host countries could reevaluate bilateral labour agreements or tighten eligibility criteria, influencing remittance volumes indirectly ([IOM, 2024](#)).

Moreover, the structural transformation accompanying graduation may gradually shift the composition of labour migration from low-skilled to higher-skilled segments, which tend to remit differently in terms of volume and frequency. The National Planning Commission's projections suggest a gradual rise in skilled labour migration over the next decade, necessitating policy adjustments to facilitate skills recognition and labour market matching abroad ([NPC, 2023](#)).

Beyond volume considerations, the productive use of remittances constitutes a crucial area for policy focus post-graduation. In recent year, the remittances have been channelled towards consumption and basic household needs, contributing to poverty reduction but less so to long-term capital formation or productive uses. The opportunity cost of this pattern is high, as

remittance inflows could be leveraged to catalyse investments in micro, small, and medium enterprises (MSMEs), agricultural modernisation, infrastructure development, and human capital enhancement. Empirical studies have shown that formal financial inclusion and accessible credit markets significantly enhance the propensity of migrant households to channel remittances into productive investments ([ADB, 2023](#)). Despite improvements, financial intermediation in Nepal remains constrained by factors such as high collateral requirements, limited banking penetration in rural and provincial areas, and regulatory bottlenecks. These challenges are even more acute at the local government level, where institutional capacity to mobilise and manage remittance-backed projects is limited.

Provincial governments, with greater fiscal autonomy and mandates under Nepal's federal structure, are uniquely positioned to foster an enabling environment for remittance investment. This could involve facilitating diaspora bonds, creating local investment funds, and partnering with commercial banks and microfinance institutions to extend credit lines to remittance recipients for productive activities. For example, Bagmati Province, with its concentration of urban and peri-urban populations, has piloted remittance-linked cooperative financing models aimed at microenterprise development (Bagmati Provincial Government Report, 2023). At the federal level, the Government of Nepal has initiated frameworks to engage the diaspora through incentives, including tax holidays, repatriation facilities, and streamlined investment procedures. However, the scale and scope of these initiatives need to be expanded and adapted to the post-LDC context to maximise their impact. Strengthening remittance data tracking systems, enhancing transparency, and integrating remittance management within broader development finance strategies will be critical.

Finally, while remittance flows are likely to remain a backbone of Nepal's external financing landscape post-graduation, their role must evolve from consumption smoothing towards fostering economic resilience and structural transformation. Achieving this requires multi-level government coordination, financial sector reforms, and innovative policy instruments that bridge the gap between migrant households and productive investment opportunities.

## 7.6. Summary of Policy Suggestions

Nepal's LDC graduation represents both a significant achievement and a critical resilience test for the economy. Drawing on international experiences and Nepal's own structural realities, the following insights outline possible pathways for policymakers, development partners, and the private sector to explore. These approaches are framed as potential directions for further discussion and assessment, focusing on measurable outcomes and long-term sustainability.

### 1. Macroeconomic Conditions Post-Graduation

- a. Evidence suggests scope for **expanding provincial own-source revenues**, possibly through broader property tax coverage, tourism-based levies, and streamlined local business licensing—helping narrow the current gap of under 10 percent.

- b. Opportunities may exist to **narrow the trade deficit-to-GDP ratio** by replacing part of petroleum imports with domestically generated hydropower, complemented by electric mobility initiatives.
- c. Maintaining **foreign exchange reserves near eight months of import cover** could be supported by mechanisms such as remittance reserve retention, where banks hold a proportion of annual inflows in reserve accounts.
- d. For regions such as Karnali and Sudurpaschim, **fiscal equalisation grants linked to high-return infrastructure**—roads, irrigation systems, and agro-processing facilities—may yield measurable benefits, with projections indicating potential annual GDP growth gains of around 1.5 percent.

## 2. Nepal's Trade with Global Partners

- a. Stakeholders could explore the scope for **retaining EU GSP+ access** post-EBA to sustain annual exports in garments, pashmina, and tea currently valued at over USD 150 million.
- b. Regional value addition might be supported by establishing **agro-processing export hubs** in Madhesh, Lumbini, and Koshi, complete with cold chain systems and certification labs, which modelling suggests could generate an additional USD 200 million annually within seven years.
- c. Efforts to **reduce customs clearance times** at key border points (Birgunj, Biratnagar, Bhairahawa) from three days to 24 hours through full digitalisation of processes could lower logistics costs by 12–15 percent.
- d. Membership in **Regional Comprehensive Economic Partnership (RCEP)** might open access to new markets with regional trade flows exceeding USD 500 billion, potentially diversifying Nepal's export base.

## 3. Development Financing Landscape

- a. Issuing **sovereign green bonds** could be a potential instrument for financing hydropower and climate-resilient infrastructure, with estimates suggesting GDP growth gains and creation of new jobs in construction.
- b. A **Nepal Diaspora Growth Fund** —co-financed by the NRB and multilateral partners—could focus on tourism, IT parks, and high-end agriculture as priority sectors.
- c. Increasing the **tax-to-GDP ratio** might be supported by measures such as a high-net-worth individual asset registry and wider use of digital invoicing for VAT compliance.
- d. Pilot projects in **subnational PPP financing** in provinces like Bagmati and Lumbini could mobilise a reasonable amount of financial resources in private investment for industrial and logistics hubs within five years.

## 4. Prospects for Foreign Direct Investment (FDI)

- a. Fully operationalising **five Special Economic Zones (SEZs)** in Birgunj, Bhairahawa, Simara, Damak, and Nepalgunj could attract a considerable amount of FDI in manufacturing sector.

- b. Accelerating priority **hydropower projects** under PPP models may help generate additional annual export revenues.
- c. Long-term incentives, such as **10-year corporate tax holidays for tourism investments above USD 50 million** in destinations like Lumbini, Pokhara, and Khaptad, could stimulate job creation and making key urban areas economically more vibrant.
- d. Greater integration into **India–Bangladesh–Bhutan power trading corridors** may allow Nepal to tap into an energy market in key South Asian economies.

## 5. Future Remittance Flows and Their Productive Use

- a. Evidence points to opportunities in **channeling around 10 percent of annual remittance inflows** into investment funds for tourism, IT, and high-end agriculture—potentially supporting higher GDP growth and creation of new employment opportunities.
- b. A **“Remittance-to-Enterprise” initiative** with partial loan guarantees for MSMEs financed through migrant earnings could support thousands of enterprises to scale up their businesses.
- c. **Provincial Diaspora Investment Platforms** in Bagmati, Koshi, and Lumbini could pool migrant capital for targeted ventures, such as apple processing in Karnali and trout farming in Gandaki.
- d. Creating a **remittance-backed municipal bond market** could enable cities to fund urban infrastructure using predictable diaspora-linked revenue streams.

If Nepal executes these targeted policies, graduation will not be a loss of privileges but a leap into competitiveness. More importantly, the policy playbook Nepal develops can guide other South and Southeast Asian nations facing similar transitions—showing how small economies can pivot from preference-dependent growth to self-sustaining resilience. The following section examines how Nepal’s experience can inform its regional peers, paving the way for a broader conversation on shared opportunities and risks.

## 8. Implications for Countries in South and Southeast Asia<sup>12</sup>

Nepal's upcoming graduation from LDC status is more than a domestic milestone. It is a regional case study in navigating structural transformation under tightening global conditions. Countries like Bangladesh, Lao PDR, and Cambodia face similar transitions in the coming years. Their experiences underscore a shared challenge: how to shift from dependence on trade preferences, concessional finance, and policy flexibilities toward long-term competitiveness built on domestic capabilities.

Although none have graduated yet, all three economies are already grappling with the risks ahead. Bangladesh's concentrated gains in garments, Lao PDR's reliance on resource exports, and Cambodia's fragile industrial linkages point to common vulnerabilities: narrow export bases, weak local supply chains, and rising exposure to compliance costs in labour and sustainability standards. They also highlight the need to prepare for higher borrowing costs, develop credible investment pipelines, and address subnational disparities in industrial benefits. Nepal can pre-emptively draw from these insights by strengthening fiscal and institutional capacity, improving trade logistics, and investing in skills and supplier networks, before the loss of international support measures hits.

At the same time, Nepal's own transition offers value back to the region. Nepal's success or struggle will serve as a low-stakes stress test for South and Southeast Asian LDCs on how to manage preference erosion, mobilise domestic value chains, and adapt to global expectations on sustainability and market access. Its policy responses, institutional preparedness, and ability to withstand financial tightening will send early signals about what is politically and economically viable in similar contexts.

For all these countries, graduation does not mark the end of development; it shifts the terrain. The central lessons are clear: diversify exports and destination markets, deepen backward linkages, build blended-finance readiness, and align domestic reforms with environmental and labour compliance regimes. Regional partners like ASEAN, BIMSTEC, China, India, SAARC, and Singapore can amplify these efforts by offering not just infrastructure, technology, and financial services, but also targeted capacity-building where such support aligns with their strategic or commercial interests. But ultimately, the burden of transformation rests at home, and Nepal's experience may help define the margin of error for others.

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<sup>12</sup> The appendix offers a deeper examination of these implications across South and Southeast Asia.



## 9. Conclusion

Nepal's graduation from the Least Developed Country (LDC) category in 2026 is a moment of recognition, but also a test of readiness. Graduation removes the cushion of trade preferences and concessional finance, placing Nepal's economy on exposed ground where resilience must come from within. The country's reliance on remittances, its narrow export base, and its widening provincial disparities are not new problems, but after 2026 they will no longer be offset by special treatment. The real test is whether Nepal can convert this milestone into a platform for fiscal credibility, productive investment, and inclusive growth.

Meeting that test requires strategic discipline across three core priorities:

- (i) Fiscal policy must shift toward disciplined, productivity-enhancing investment, backed by innovative financial tools such as diaspora and green bonds. Without such discipline, post-graduation vulnerabilities may turn into a debt trap.
- (ii) Trade and industrial policies should strengthen Nepal's competitiveness in hydropower, agro-processing, digital services, and tourism. The digital economy, in particular, offers an opportunity to bypass geographic constraints and deepen regional integration.
- (iii) Federalism must deliver by closing provincial competitiveness gaps. Targeted infrastructure investments and the productive use of remittances at the subnational level can anchor a more inclusive growth path.

If pursued with coherence and resolve, LDC graduation need not be a cliff, but a launchpad for Nepal's transformation. Done right, it can reposition Nepal as a builder of regional resilience, rather than a recipient of foreign aid. It offers a rare opportunity to convert past fragilities into policy credibility, and to shift from special treatment to earned influence. In doing so, Nepal could stand not just as a graduate, but as a live case for other Asian economies on how to climb the development ladder: with discipline, balance, and national purpose.

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## **Appendix: Dissecting the Implications for Countries in South and Southeast Asia**

Nepal's upcoming graduation from the LDC status is more than a domestic milestone—it is a regional case study in managing the trade-offs of structural transformation. In South and Southeast Asia, countries such as Bangladesh, Lao PDR, and Cambodia stand at similar thresholds, each facing the same core challenge: turning the loss of preferential trade, concessional finance, and policy flexibilities into a springboard for sustainable competitiveness.

Nepal's trajectory offers a live test of strategies that can help these economies safeguard market access, build domestic value chains, mobilise investment, and meet the rising bar of environmental and labour standards. In a global landscape of tariff tensions, fragmented supply chains, and climate-related trade conditions, the stakes are high—and so are the opportunities for regional cooperation, market diversification, and green growth.

### **A1. Bangladesh: scale, exposure and the imperative to upgrade**

Bangladesh's growth story shows how focusing on exports and improving industries can drive fast development, with the ready-made garment sector boosting jobs and earning tens of billions of US dollars by the early 2020s, alongside many years of strong GDP growth ([UNCTAD, 2024](#)). Graduation, however, brings the risk of losing key trade benefits in major markets like the EU's Everything But Arms and other Generalised System of Preferences schemes, which could hurt competitiveness in garments—especially when production relies heavily on imported materials ([IGC, 2024](#); [WTO, 2020](#)). To adapt, Bangladesh needs to move from relying on trade preferences to building lasting strengths through higher productivity, adding more value, using local materials, improving product quality and design, and adopting technology. For areas that depend on textile jobs, this shift will be crucial to protect employment and local revenues while meeting stricter global standards. Graduation will also mean less access to cheap development loans, so borrowing costs may rise, making it important to prepare projects that are attractive to lenders. The broader lesson is that success in one sector can be powerful but risky if too concentrated, and the way forward is to strengthen domestic capabilities, link better with regional partners, and branch into higher-value manufacturing and services like ICT that are less affected by tariff changes ([UNCTAD, 2024](#); [IGC, 2024](#)).

### **A2. Lao PDR: small, landlocked and the challenge of diversification**

Lao PDR's graduation experience shows the challenges small, landlocked countries face when relying on a narrow range of exports, mainly resource commodities and limited manufacturing. The loss of trade preferences after graduation could slightly reduce overall exports but hit vulnerable sectors like apparel hard, where low profit margins and strict rules of origin matter most ([UNDP/ITC modelling referenced by UNDP/UNESCAP, 2023](#)). With manufacturing still dependent on imported inputs, much of the value from exports leaves the country. The task ahead is twofold: maintain external stability while building stronger domestic capabilities. Although graduation may reduce some concessional aid, it can also enhance investor confidence and widen financing options. For remote provinces, better trade logistics and facilitation are crucial, as livelihoods in farming and informal work could suffer if manufacturing benefits are not spread more evenly. The way forward lies in selective diversification—higher-value agribusiness, power-linked manufacturing from hydropower, and improved transport links to major markets in Vietnam, China, and Thailand. The key lesson is to prioritise public investments that cut trade costs, modernise customs, strengthen skills, and enable local firms to join regional supply chains, while balancing the push for private investment in energy and infrastructure with careful debt management (UNDP, 2023; ITC Intracen country note on Lao PDR).

### **A3. Cambodia: growth anchored in openness, exposed in linkages**

Cambodia's growth over the past two decades, driven by garments, tourism, and construction, shows how fast expansion can boost incomes but also create reliance on a few sectors. Exports surged after trade liberalisation and WTO accession, with special economic zones bringing in investment and jobs ([UNDP, 2024](#)). Graduation will mean losing preferential market access while the industrial base still depends heavily on imported inputs and has weak local supplier networks. The key challenge is to strengthen domestic linkages so that export earnings generate more local jobs, skills, and tax revenues, as countries graduating without this risk losing much of the gains through import costs and profit outflows (UNCTAD, 2023). For provinces hosting factories and SEZs, the benefits will hinge on whether local firms can join supply chains and whether workforce skills match business needs. Cambodia's opportunity lies in using its openness to attract higher-value manufacturing, digital services, and green investments, while diversifying tourism toward higher-yield markets. Achieving this will require better skills training, improved logistics, and stronger support for domestic SMEs as suppliers to export-oriented firms (UNDP, 2024; UNCTAD, 2024).

### **A4. Cross-cutting lessons for graduating economies**

Across Bangladesh, Lao PDR and Cambodia, common themes emerge. First, the withdrawal of International Support Measures—such as preferential tariffs, special WTO flexibilities, and concessional windows—does not automatically trigger catastrophic trade losses. Still, it does expose sectors where margins are thin and value addition is low. Second, subnational impacts matter: provinces and municipalities with concentrated export activity will feel the effects first and most strongly. Third, the transition from grants and highly concessional loans to blended and commercial finance elevates the importance of credible project pipelines, fiscal

management, and public financial institutions. Fourth, environmental and labour compliance are no longer ancillary but central to maintaining market access, especially given growing climate-related standards and corporate sustainability demands.

An overarching lesson is that graduation provides a window of opportunity to transition from external dependence to internal capability. That shift implies greater emphasis on value chain development, skills, logistics, green transition investments and diversification of markets beyond traditional partners.

## **A5. Opportunities for major regional partners**

The graduation of Bangladesh, Lao PDR, and Cambodia also creates specific economic opportunities for major regional economies, such as China, India, and Singapore.

China has an interest in deeper connectivity and supply-chain integration. For landlocked Lao PDR, Chinese investment in infrastructure—such as rail, roads, and energy—can enhance trade competitiveness while linking local manufacturers to Chinese supply networks. For Cambodia and Bangladesh, the relocation of Chinese manufacturing or its complementarity can lead to industrial clustering and technology transfer, provided local firms can participate as suppliers.

India's economic opportunities are manifested in market linkages and investment complementarities. Bangladesh's expanding middle class and improving infrastructure create opportunities for Indian firms in pharmaceuticals, engineering goods and services exports. India's Act East and neighbourhood initiatives can be leveraged to boost regional trade facilitation and integrate the graduating economies into broader South Asian markets. Indian investors may also find cost-competitive manufacturing prospects in Bangladesh and Cambodia as firms seek diversification from China.

Singapore plays a different, more service-oriented role. As a financial hub and a centre for logistics, maritime services and technology, Singapore can offer capital, managerial expertise, and digital services that help graduating economies professionalise financial markets and upgrade trade facilitation systems. Singaporean firms are natural partners for services offshoring, fintech solutions for remittance intermediation, and sustainable-finance instruments to underwrite green projects.

Collectively, these partner opportunities underscore the regional potential of graduation as a prompt for deeper economic integration. They also create room for non-traditional cooperation such as supply-chain re-routing, joint investments in renewable energy and regional logistics corridors.

## **A6. Global context: trade wars, tariffs and environmental constraints**

Graduation must be interpreted against a global backdrop of intensifying trade tensions, intermittent tariff wars and rising environmental standards. Tariff retaliation and non-tariff measures in advanced economies add uncertainty to export forecasts; therefore, LDCs, including graduating countries, that remain overly reliant on a small set of markets or products

are especially exposed. Equally, environmental concerns and low-carbon transition dynamics shape buyer preferences and investor due diligence. For example, apparel buyers are increasingly requiring lower carbon footprints and transparency in supply chains; exporters that fail to comply risk market exclusion, even where tariffs remain unchanged.

Therefore, post-graduation strategies in South and Southeast Asia need to be resilient to these global shifts. Diversifying product baskets and destination markets reduces the risk of tariff concentration. Investing in energy efficiency, sustainable inputs, and climate-resilient infrastructure responds to both buyer demands and physical risks. Moreover, strengthened compliance with labour and environmental standards preserves market access and attracts sustainability-seeking investors.

In summary, the graduation pathway for Bangladesh, Lao PDR and Cambodia combines macroeconomic opportunity with structural adjustments. Economies that built export capacity under preferential regimes now face the test of converting market access gains into durable, value-adding competitiveness. The principal economic implications are clear: preference erosion will accentuate the need for diversification, stronger backwards linkages, skills development, and institutional readiness to manage blended finance. For provinces and localities, the transition highlights the importance of distributing industrial benefits and preparing local economies for structural shifts.

Regional partners, including China, India, and Singapore, stand to gain by deepening trade, investment, and service linkages with emerging economies. Yet the success of these opportunities depends on graduates responding to global trade regimes and environmental expectations. Diversification, higher domestic value capture, and green, resilient investments will be the currency of sustainable post-graduation growth.