

# Policy Brief

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## Trade Policy Mainstreaming in Federal Nepal

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### Introduction

Nepal underwent a major change in its governance structure through the adoption of the new constitution in 2015—its unitary governance structure was transformed into a three-tier governance structure made up of the federal government, provincial governments, and local governments. Hence, many of the trade policies and strategies, which were formulated before this important transition, now require actions from subnational governments in order for them to be successfully implemented. Furthermore, while the most prominent instruments and activities under trade policy such as tariffs, customs clearance, and trade negotiations still fall under the purview of the federal government, the subnational governments, through their policies,

laws, and regulations, play an important role in shaping the environment that affects production as well as international trade.

Against this background, a SAWTEE study “Trade Policy Mainstreaming in Federal Nepal”<sup>1</sup> (the study henceforth) investigates the roles that the federal trade policies provide or envision for subnational governments, the current level of mainstreaming of trade in subnational governments’ plans, policies, and strategies, and coherence and complementarity in the trade-related policies and strategies of federal and subnational governments. This policy brief provides a concise synopsis of the discussions and findings of the study.

## Roles of subnational governments

Engagement of subnational units in trade-related areas, while showing significant variation, has been a widespread phenomenon in a number of developed countries. In the case of Nepal, the distribution of the state’s powers between the central unit of authority (the federal government) and subnational units is done in a way that each tier of the government has exclusive powers in some areas and concurrent powers (powers shared with the other tier of government) in other areas. In this distribution of the state’s powers, the Constitution of Nepal commissions international trade as an exclusive domain of the federal government. However, given that international trade is a sophisticated undertaking, all three levels of government interact at certain points in its administration. Consequently, it is through cooperation, coordination, and coherence in policymaking that trade’s role as an engine of growth and employment creation can be maximized. Furthermore, the Constitution defines Nepal’s federalism model—the interrelations between the different tiers of government—as based on the principles of “cooperation, coexistence, and coordination” (Article 232 of the Constitution), which provides further justification for cooperation and coordination in policymaking, including in the area of trade.

The Constitution does not list any exclusive or concurrent powers to subnational governments in the matter of international trade, although provinces do have exclusive powers in the area of intra-province trade. However, that should not stop provincial and local-level governments from implementing policies that aspire to manage trade or promote export, except for taxation on exports and imports, and direct participation in trade negotiations. Firstly, trade (import management and export promotion) is an important component of areas that are under the jurisdiction of subnational governments, such as production, industrialization, employment, and broad economic development of the province. Most often,

international trade could contribute to these areas that are under the jurisdictions of subnational governments or in some cases, such as industrialization, trade—the ability to source high-quality raw material at a cheaper price, and the ability to sell products to international markets—is an important component.

Furthermore, subnational policies to promote trade could be designed in a way that complements the efforts of the federal government rather than contradicting them—this could be done by simply steering away from direct roles in taxation and negotiations related to cross-border trade, and supplementing the federal government’s efforts through cooperation, coordination, and advice.

Engagement of provinces in trade, or more precisely in export promotion, could be in the form of interventions that directly target trade—programmes exclusively geared towards export promotion (e.g., providing trade information, providing training related to trade capacity, etc.); coordination and cooperation with the federal government to address trade bottlenecks; and lobby the federal government for a better trade policy. Or the interventions could indirectly impact trade—policies regarding increasing production, industrialization, production-linked subsidies and concessional loans, trade infrastructure (e.g., testing laboratories, warehouses, cold storage units, etc.). These are all under the powers or functions of provincial governments, while some large-scale projects may require cooperation from the federal government. Hence, the identification of priority products for exports and formulation of clear policies for interventions discussed here could constitute a trade policy for the provinces.

Thus, there are several areas where subnational governments, in their sole authority, or in coordination with each other and the federal government, have important roles to play. The roles could be in the form of their rights granted by the Constitution and relevant laws (autonomous roles) or consultative roles (support the federal government in policymaking through formal mechanisms) or pressuring roles (pressuring the federal government to support certain policies or to amend certain policies).

The proactive engagement of subnational governments in trade policymaking and export promotion activities, however, requires a clear vision, plans, institutional set-ups, and capacity. Hence, it is useful to assess what the federal government expects from the subnational governments in the area of trade, especially with regard to export promotion. There seems to be a lack of government document which clearly articulates what the federal government envisions are the roles and powers

of subnational governments in promoting exports and what kind of support the federal government can provide to subnational governments in that regard. This is particularly the case because the important trade policies and strategies are from the period before the implementation of federalism in Nepal. The current review of the 'Nepal Trade Integration Strategy' can be expected to fill the gap.

Nonetheless, some documents provide some hints to the federal government's vision regarding the subnational government's space in the arena of international trade. For instance, 'National Action Plan on Trade Deficit Reduction, 2019'<sup>2</sup> lists mainstreaming of trade at all levels of government as one of the expected outcomes and mentions having directed all levels of government to prioritize the topics of export promotion, import management, production growth, and commercialization.

The government report 'Assessment of the state of Nepal's exports and future strategies'<sup>3</sup>, in its strategy for export promotion, mentions the need for the identification of export-oriented products in each province and the promotion of these products. While the report does not make it clear that the provincial governments should be in charge of product identification within the province and their promotion, one can assume that provinces will have important roles to play in this.

Hence, judging from the available documents, we assess that the government has envisioned important roles for subnational governments in the area of trade through anticipating their proactive participation

in export promotion, import management, support in increasing production, and commercialization of products. However, important trade policy documents, primarily Commerce Policy, 2015, and Nepal Trade Integration Strategy, 2016, which were formulated before federalism was implemented in Nepal, have to be updated or revised to reflect the roles of subnational governments in implementing trade policy and trade promotion activities. Likewise, the trade policy also needs revision "to reflect mechanisms/channels of translating national level export promotion plan into actions at sub-national levels"<sup>4</sup>.

## Mechanism for consultations and coordination

Nepal's Constitution envisages strong interlinkages and coordination among the different tiers of government. The lead role for ensuring effective coordination has been envisioned for the federal government—Article 235 (1) of the Constitution specifies that the federal parliament may make necessary laws to bring about effective coordination between the federation, provinces, and local levels. The Constitution also envisions a role for the provincial assembly in ensuring coordination between provinces and local governments—Article 235 (2) specifies that the provincial assembly may coordinate with municipalities, or settle political disputes, in coordination with the municipality and the District Coordination Committee. Furthermore, the Constitution (Article 234) has also created an institutional structure—the Inter-Province Council—for settling political differences between provinces and the



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Federal government or among provinces. While these structures are indispensable to the proper coordination and consultations among the three tiers of government, there are other structures, primarily created by the 'Federation, Province and Local Level (Coordination and Inter-relation) Act, 2020' (the Act henceforth), that could play important roles in managing 'inter-relations' in the area of international trade

The Act identifies several spheres for coordination and consultations. The areas for coordination and consultation indicate that coordination and consultation between the federal government and subnational governments are mandated in several areas including enactment of laws, formulation of plans and policies, implementation of development projects, infrastructure development, the conclusion of treaty or agreement by the federal government, and sharing of natural resources, among others. Hence, as per the Act, we can claim that coordination and consultation between the federal government and subnational governments would constitute an important aspect of the implementation of the federal government's trade policy as well as the formulation and implementation of subnational government's trade (promotion) policy (without encroaching upon the exclusive powers of the federal government). Furthermore, coordination and consultation could occur in any area of importance, especially if the federal government desires to do so—any matter deemed important for coordination and consultation by the federation is in the sphere of coordination and consultation.

The institutional structures created by the Act could play an important role in bringing about robust coordination among the different government levels, which is crucial for the effective implementation of trade policy. The primary among these institutional structures for coordination is the 'National Coordination Council', led by the Prime Minister and comprising major government stakeholders from subnational governments, which is entrusted with managing the coordination and inter-relations between the federal government, provinces, and local governments. The functions, duties, and powers of the National Coordination Council indicate that the Council could be the platform for the federal government to seek input from the subnational governments regarding trade policy as well as the platform for subnational governments to raise concerns and grievances about provisions in the trade policy.

The Act also creates a 'Thematic Committee' to establish a liaison among the concerned ministries of the Federation and Province and the Local Level. Hence, the 'Thematic Committee' could be an apt platform for coordination regarding themes, including policy formulation, that

are specific and neatly fall under the jurisdiction of a ministry, with the 'National Coordination Council' acting as a coordination platform for broad issues (such as the formulation and implementation of holistic trade policy and plans by provinces).

Likewise, the Act institutes a 'Provincial Coordination Council' in each Province, headed by the Chief Minister of the Province, to carry out coordination between Province and Local Level or between Local Levels within a Province. The Provincial Coordination Council, entrusted with managing "inter-relations between Province and Local Level or more than one Local Levels in development projects", has the power to form necessary committees, and is envisioned to coordinate with the National Coordination Committee. The Provincial Coordination Council could be an effective collaboration tool for seeking the inputs of Local Levels in the province's plans and policies, including in the area of trade. Likewise, it could also play a coordination role in the case of the Local Level's formulation and implementation of plans and policies.

In addition to these institutional structures, the Act institutes a 'District Coordination Committee' in each district, which acts as the coordinating institution among different levels of government for development works and any other businesses of the different levels of government in the district.

While robust coordination among the different levels of government in wide areas is envisioned, with different institutional structures constituted to achieve the coordination, the results so far, in terms of the effectiveness of the coordinating institutions and the achievement of robust inter-relations, are disappointing. This will be a significant barrier to subnational units' engagement in trade policymaking as well as in the implementation of the national trade policy formulated by the federation.

## **Mainstreaming international trade at the subnational level**

The study assesses the mainstreaming of trade in subnational governments in Province 1, primarily the provincial government, by examining the extent of integration of trade into provincial policies and budgets, along with how the policies envision dealing with coordination issues and using trade as an engine for growth, enhancing productivity, and economic transformation. The findings of the assessment are as follows:

The Province does not have an integrated trade (promotion) policy or export promotion strategy/policy

that articulates its vision, plans, and strategies for trade and exports. The province does not currently have programmes in place that exclusively seek to promote trade/export.

Trade does not occupy an important role in the Province's periodic plan. While the Province's first periodic plan (FY 2019/20–2023/24) includes many strategies and action plans, including at the sectoral level, that impact trade such as increasing production and productivity, enhancing private sector capacity, branding and commercialization, logistics development, etc., a separate plan for promoting international trade is absent and trade gets only a passing reference in the overall economic strategy as well as the sectoral strategy. The strategies and action plans are mostly oriented toward domestic trade and do not specifically mention exports or imports.

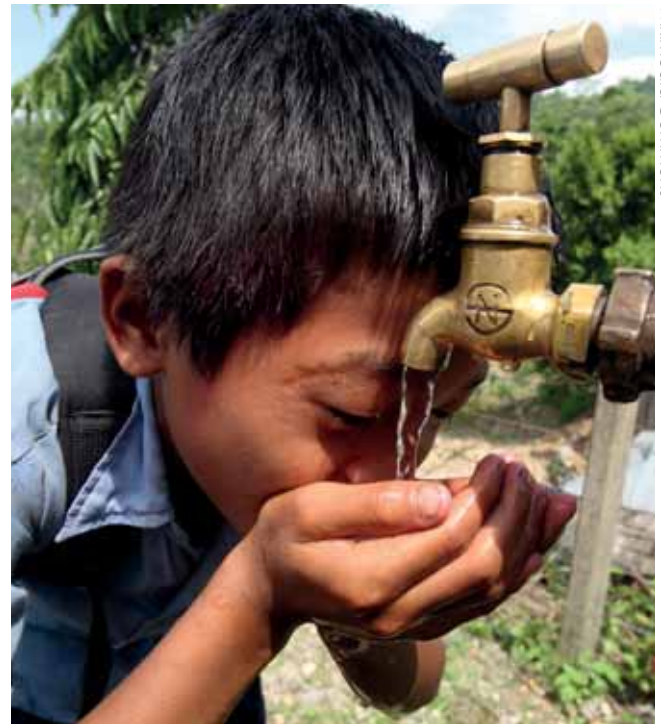
An assessment of the Province's 'policy and programmes' and fiscal policies (budget speeches) indicates an inadequate mainstreaming of trade. While the agriculture sector is accorded the highest priority in the province's 'policy and programme 2022/2023', it is silent on the trade aspects of agriculture, primarily the export of agricultural produce. Similarly, the focus of the budget seems to be on import-substituting industrialization but not on export-led industrialization. For example, high-value crops with export importance such as ginger, large cardamom (alaichi), and tea get budget allocation for value addition and market promotion, but there has not been budget allocation for export promotion.

Weak coordination and cooperation between the Province and the Federation impede mainstreaming of trade. The institutional platforms for coordination and cooperation between the two levels of government are not functioning well and the level of mutual cooperation and coordination remains weak.

The Province does not have a separate ministry, or, according to the available information, a department within the Ministry, or any agency, that looks into the issues of cross-border trade. In the absence of a policymaking entity that overlooks trade, it will be hard to mainstream trade in provincial policies.

The level of trust and dialogue between the private sector and the provincial government is inadequate to contribute to mainstreaming of trade. There is no robust platform for private-public dialogue at the provincial level, which does not bode well for the mainstreaming of trade.

This shows that the mainstreaming of trade in Province 1 is only happening at a superficial level without any



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specific policies/strategies, and with poor coordination to support trade-related activities.

### Coherence between subnational and federal policies

Policy coherence is a crucial element of effective trade policy framework. In the case of Nepal, some legislative provisions and prevalent practices promote coherence between the federal policies and the subnational policies. The legislative framework that defines inter-relationships between the federation, province, and the local level—the Federation, Province and Local Level (Coordination and Inter-relation) Act, 2020—has a chapter on formulation of law, policy and plans (Chapter 3), which has provisions to ensure coherence in laws, policies, and plans of the federation, province, and local level.

First, the Act (Section 4) directs the federation, province, and local level not to encroach upon the exclusive powers of entities other than itself. Provinces should frame their laws and policies in a way that they are not inconsistent with the federal law and are consistent with the national policies and priorities. Local levels should frame their laws and policies through avoiding inconsistencies with federal and provincial laws.

Regarding the execution of exclusive powers, the Act (Section 5) directs the provinces and local levels to enact laws and implement them in a manner that they are not contrary to the federal law (and the provincial law as well in the case of local levels). In the case of the

execution of concurrent powers, the Act (Section 6 and Section 7) specifies areas where federal laws have to be in accordance with the provincial law or the local laws, and matters that are to be governed by federal laws. Furthermore, the Act (Section 11) requires the province to coordinate and consult with the thematic ministry or body of the federal government, and the local level with the thematic ministry or federal government body and the provincial government during the enactment of laws and formulation of policies on matters that fall under the concurrent powers of the federation and province.

In addition, the National Planning Commission (NPC)—the apex policymaking authority of the country—has prepared a guideline that aspires to ensure coherence in development planning of the different government tiers. Accordingly, provinces' periodic plans, along with the medium-term expenditure frameworks (MTEFs) prepared by province planning commissions, which mostly guide the plans, policies and strategies of provincial governments, have to take into account the visions, goals, targets, and strategies of the national periodic plan, along with the medium-term expenditure framework (MTEF) prepared by the NPC; the local governments have to do the same by taking into account the national and provincial development frameworks. It is perhaps for this reason that the study did not observe any major incoherence between the national periodic plan and Province 1's periodic plan, although it is the study's assessment that more could have been done to promote trade as an engine of growth and employment creation by mainstreaming trade in Province 1's plan.

## Recommendations

Against the identification of the roles that subnational governments could play in enhancing trade (particularly in export promotion), the assessment of the mechanisms for coordination and consultations among the different government tiers, and an assessment of the current level of mainstreaming of trade at the provincial level (Province 1), the study proposes the following broad measures.

- Given that international trade falls under the exclusive jurisdiction of the federal government, it has to play the lead role in effecting a meaningful role of subnational governments in trade policymaking, trade promotion, and implementation of federal trade policies and programmes.
- The coordination and consultations among the different tiers of government need to be enhanced. This could be achieved, for instance, through a more robust inter-province council that meets regularly to discuss major disputes, and through the strengthening of other institutions set up for coordination such

as the National Coordination Council and Thematic Committee.

- Provinces could prepare a trade/export policy (or export promotion policy), which identifies priority export products in the province, and action plans for their promotion.
- The Board of Trade, an instrumental body for the implementation of the federal trade policy, can form sub-committees to oversee the implementation of trade policies in subnational governments.
- There is an urgent need to revise the trade policy and National Trade Integration Strategy (NTIS) to reflect the roles of subnational governments in the implementation of trade policy, including in export promotion.
- Through the clear articulation of the roles that the federal government envisions for the subnational governments regarding trade policy formulation and implementation and through necessary capacity building, the subnational governments must be encouraged to mainstream trade in their plans and policies.

## Notes

- <sup>1</sup> Dahal, Kshitiz. 2022. "Trade Policy Mainstreaming in Federal Nepal". Kathmandu: SAWTEE.
- <sup>2</sup> MoICS. 2019. *Byapar ghata nyunikaran sambhandhi rastriya karyaajana, 2075* [National Action Plan on Trade Deficit Reduction, 2019]. Ministry of Industry, Commerce and Supplies, Government of Nepal.
- <sup>3</sup> MoICS. 2020. *Nepal ko niryat abastha ko bisleshan ra bhavi radaniti* [Report on assessment of the state of Nepal's exports and future strategies]. Unpublished.
- <sup>4</sup> ADB. 2021. *Nepal: Macroeconomic Update (Volume 9, No. 2, September 2021)*. Kathmandu: Asian Development Bank, Nepal Resident Mission.



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