

Policy Brief

NO. 45, 2022



Economic Diplomacy for Better Export Performance of Nepal

Swastik Aryal

Nepal's trade, specifically export trade, has consistently been not up to scratch. Despite numerous efforts to boost exports through trade facilitation, the actions have not been impactful to a large extent. In order to make a difference in the trade sector, the Government of Nepal (GoN) has turned towards economic diplomacy as a complementary tool. Although the concept of economic diplomacy is not new, it has undergone certain changes to meet the changes witnessed in the world. In the past, economic diplomacy affairs used to revolve around security, military power and colonization. Now, in the modern world, trade has become the subject of dispute as well as a show of power and presence. Thus, economic diplomacy has also shifted to focus more on increasing economic activities through trade. Economic diplomacy in Nepal was dormant in the past during the decade-long civil war. After the peace accord, the concept of economic diplomacy was reignited. The goal of economic diplomacy

is to tap Nepal's comparative advantages in the global economy and maximize the benefits from globalization, ensuring rapid economic development in Nepal.¹ Given that economic diplomacy has been identified as an important tool that has the potential to facilitate trade for better export performance of Nepal, it is prudent that its utilization is apt and to the fullest.

Nepal's export performance and trade facilitation

Growing imports and stagnant exports have widened Nepal's trade deficit (Figure 1). Data from the Trade and Export Promotion Centre (TEPC)'s Nepal Trade Information Portal (NTIP) shows a sudden drop in imports in 2020 due to the pandemic-induced lockdown. After the lockdown was lifted, imports shot up reaching an all-time high of NPR 1.87 trillion in 2021. Exports increased slightly from 2019 to 2021. However, there are concerns about the sustainability of the exports. Exports of refined palm oil and soybean oil are the major catalysts of the export growth. Nepali exporters are taking the advantage of duty differences between Nepal and India and provisions in the Agreement on the South Asian Free Trade Area (SAFTA), by importing crude palm and soybean oil from third countries and exporting the refined products to India, an unsustainable practice in the long run.

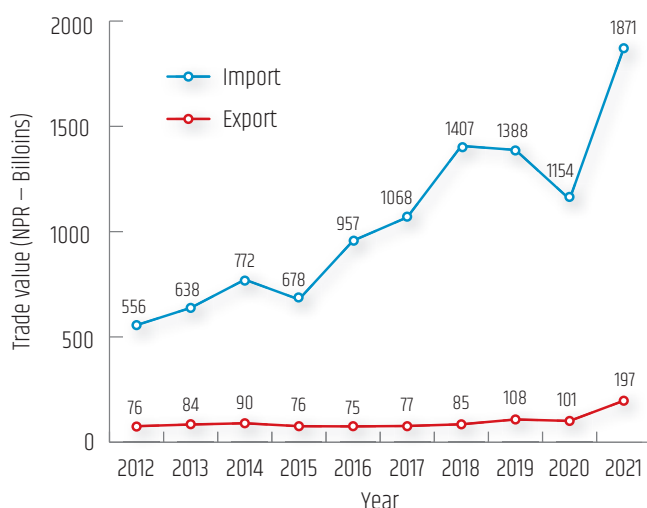
There are only a few indigenous high-value goods that Nepal is exporting in significant amounts. Large cardamom, tea and dog chew (*chhurpi*) are some of the high-value agricultural exports. In terms of manufacturing goods, carpet, yarn and felt are some of the high-value exports. Top imports, on the other

hand, consist of goods such as petroleum products, raw materials for manufacturing industries and steel production, and rice.

Nepal's largest trading partner remains India for both exports and imports. While Nepal exports goods to other destinations such as the United States of America (USA), China, Bangladesh and the United Kingdom (UK), among others, according to NTIP, 80 percent of the total exported value was to India in 2021. Additionally, Nepal has a trade deficit with all 30 countries in which it has diplomatic missions (Figure 2). Poor product and market diversification is a striking feature of Nepal's exports.

Realizing the fact that export performance has been poor and is in desperate need of facilitation, the GoN has attempted to facilitate trade through efforts such as easing customs procedures, infrastructure development, and periodic policy and strategy formulation, among others. The United Nations Conference on Trade and Development (UNCTAD)'s Automated System for Customs Data (ASYCUDA) has been adapted and implemented to ease customs procedures. To strengthen infrastructure at the border, integrated check posts (ICPs) and/or inland container depots (ICDs) have been constructed on the northern and southern borders, which have contributed towards trade facilitation. Policies and strategies such as the Commerce Policy of 2015 and the Nepal Trade Integration Strategy of 2016 have been formulated to boost exports and economic growth. However, despite such efforts, trade or specifically export performance has not improved. Economic diplomacy can be one effective tool to diversify products and better grasp the opportunities available in destination countries, which can contribute towards better export performance of Nepal.

Figure 1 Nepal's trade gap



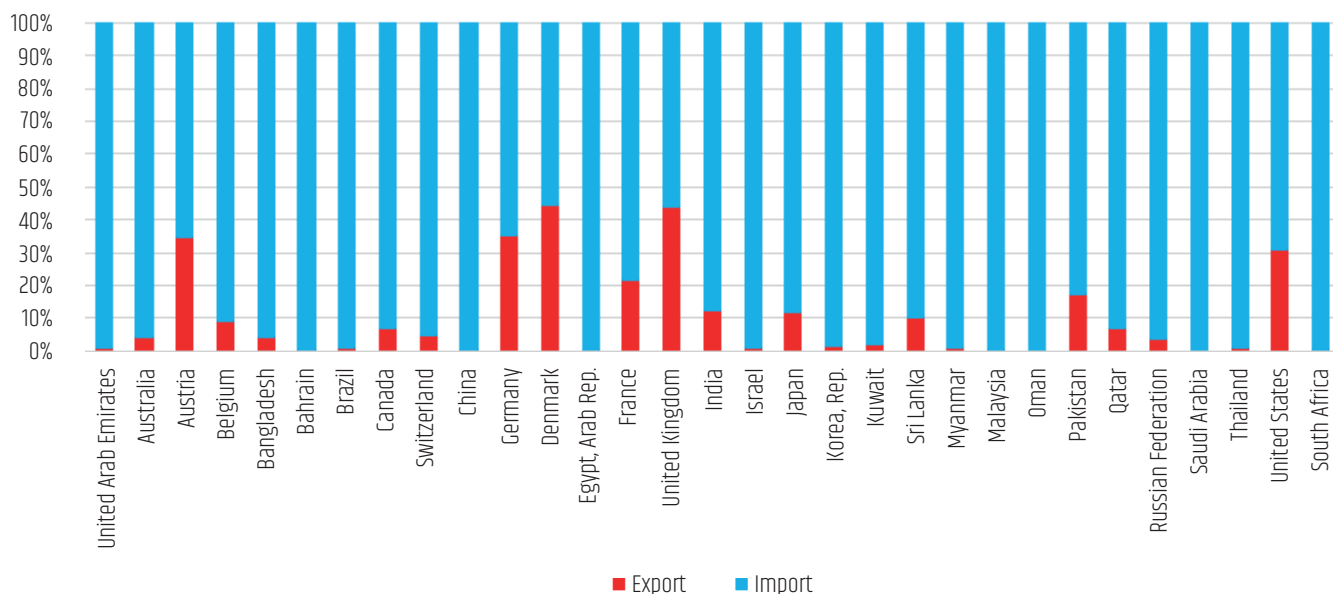
Source: Author's illustration based on data from NTIP, TEPC.

Trade and economic diplomacy

In the past, during the era of colonization and frequent wars, diplomacy used to revolve around allies and military power. While economic diplomacy was a component of diplomacy back then, it had been dormant. Now, in a world integrated by trade, economic diplomacy has gained prominence. The race towards power has changed from military to trade; thus, the use of diplomacy has been geared towards economic benefit and growth.

Economic diplomacy is no brand-new contemporary phenomenon. Since the early days, securing economic interests has always been one of the twin core tasks of diplomacy, alongside military or security diplomacy. Economic and military diplomacy can be viewed as two linked DNA-chains, alternately gaining prominence to the apparent detriment of the other, with the latter evidently not disappearing but temporarily taking

Figure 2 Nepal's trade with countries with Nepali diplomatic missions



Source: Author's illustration based on data from World Integrated Trade Solution (WITS).

a back seat.² While economic diplomacy has been around for a long time, due to the changing nature of the world, the definition of the term has also varied. Some scholars have described diplomacy as the main instrument of foreign policy enabling the management of external relations of a state through communication with foreign authorities and publics, as well as through the process of negotiations and networking.³ Most diplomacy textbooks define economic diplomacy as the use of traditional diplomatic tools such as intelligence gathering, lobbying, representation, negotiation and advocacy to further the foreign economic policies of the state.⁴ Although there are some differences in the views on economic diplomacy in the literature, all agree that economic diplomacy is important and can drive economic development of a country.

Although economic or development diplomacy in Nepal has been around for more than six decades, its utilization remained dormant when the country was in the grip of a civil war from 1996 to 2006. After the peace accord, economic diplomacy was reignited. However, export performance remains poor. Trade has been considered to be important for the economic development of Nepal. Similarly, economic diplomacy has been identified as a tool with the potential to drive and boost trade. Now that the country has adopted a federal structure with three tiers of governments, and in view of the implications for trade and development cooperation of Nepal's expected graduation from the least developed country (LDC)

category in 2026, effective economic diplomacy has become even more important.

Institutional arrangement

The focal point or the lead agency to drive economic diplomacy is usually the foreign or external ministry of a country. Economic diplomacy is an important component of Nepal's foreign policy. While the Ministry of Foreign Affairs (MoFA) is the focal point, coordination with other ministries, including the Ministry of Industry, Commerce and Supplies (MoICS), the Ministry of Finance (MoF) and the Office of the Prime Minister and Council of Ministers (OPMCM), among others, is a must. Specifically, for trade facilitation through economic diplomacy, coordination between line ministries and agencies needs to be strengthened. Considering the fact that international trade and economic diplomacy are both foreign matters, some countries such as Australia and New Zealand have merged the two agencies into one to ensure better streamlining of policies. While that is not necessary for the case of Nepal, the institutional mechanism to utilize the entirety of economic diplomacy for trade enhancement should be strengthened. The unit within MoFA that focuses on international trade, development cooperation, investment, technology transfer, tourism, foreign employment and climate change is the Policy Planning, Development Diplomacy and Overseas Nepali Affairs Division. Moreover, all diplomatic missions of Nepal have economic diplomacy and trade as a key

agenda and the budget earmarked for activities related to economic diplomacy cannot be transferred to any other headings. High-level task forces have also been formed to further the economic diplomacy agenda.

The government has institutional arrangements in place to utilize economic diplomacy for trade facilitation, from policy focus to a dedicated division to diplomatic missions to high-level task forces. A big gap in the institutional arrangement for economic diplomacy still remains coordination between agencies. A close coordination mechanism between the TEPC (under the MoICS) and the Policy Planning, Development Diplomacy and Overseas Nepali Affairs Division (under the MoFA) should be established, maintained and strengthened. Similarly, the Institute of Foreign affairs (IFA), a government think tank under the MoFA, was established specifically to utilize and enhance economic diplomacy. Coordination between the IFA and other relevant ministries for trade facilitation should also be strengthened. Furthermore, after the transition into federalism, coordination with the provincial and local governments has also become important. While institutions have been established for both economic diplomacy and trade facilitation, the strength of the institutions remains fickle as they are still largely working in silos.

Diplomatic missions

Although the world moved towards digitization even for meetings, seminars and workshops, especially during and after the COVID-19 pandemic, people-to-people contact is still extremely important and highly effective. Nepal has established residential missions in various countries to enhance economic diplomacy (Table).

Exporting from a developing country can be more difficult due to various factors. These include limited

information on the environment of foreign states, limited knowledge of the non-tariff barriers (NTBs) in place and a lack of credibility with potential foreign buyers.⁵ Gathering information on the foreign states and their NTBs, and acting as a bridge between home traders and foreign buyers is a crucial role to be played by diplomatic missions. Market analysis is one of the most crucial roles missions can play to facilitate trade. Identifying the needs, tastes and demands of potential markets and sharing the information to Kathmandu can help policy makers and private sector to introduce and increase exports of specific products. After the identification of suitable products for the market, connecting local traders in destination markets with Nepali exporters is a key role of diplomatic missions. Another key activity of missions is to provide consular services. While this may seem to be of limited importance to trade facilitation, this is far from the case in reality. Consular services can play an important part in facilitating trade as consular services also provide business opportunities.⁶ By simply providing consular services, diplomatic missions indirectly contribute towards business-to-business linkages. Further strengthening of the linkages can be done by acting as a bridge between Nepali exports and foreign buyers.

LDC graduation

Nepal is set to graduate from the LDC category to a developing country in 2026. Nepal stands to lose LDC-specific trade preferences such as duty-free and quota-free (DFQF) market access after graduation. A major hit might be experienced by readymade garment exports to the European Union (EU) as trade preferences provided under the Everything but Arms (EBA) initiative will be lost after graduation. A key utilization of economic diplomacy could be to strategically negotiate for the next best trade benefit scheme. The EU offers Generalized System of

Table Diplomatic missions of and to Nepal

Region	Nepali residential and permanent missions	Consulate generals of Nepal	Foreign residential missions	Honorary consulate of Nepal	Honorary consulate for Nepal
Oceania	1		1	5	2
North and South America	3+1	1	2	12	4
Europe	7+2		7	17	30
South Asia	4	1	4	1	1
Southeast Asia	6	4	6	11	3
Middle East	7	1	4	4	1
Central Asia					2
Africa	2		1	3	8
Total	30+3	7	25	53	51

Source: Author's presentation based on data from MoFA.



Preferences (GSP) and GSP + to non-LDC trading partners in the developing world under certain conditions. Negotiating for the GSP + scheme could be one of the major agendas of economic diplomacy to better prepare for the trade changes that will be brought by graduation.

The EU has declared an extension of trade preferences under the EBA to graduated LDCs for an additional three years. Some of the tasks cut out for Nepal's economic diplomacy apparatus are: lobbying for the extension of these and similar trade preferences by all countries for a certain number of years, lobbying for the extension of various LDC-specific special and differential treatment provisions under the World Trade Organization for a defined period, requesting for lenient rules of origins (ROOs) for a sufficient period for the private sector to adjust to the new ROOs that will kick in upon graduation, and requesting for flexibilities for graduated/graduating LDCs in existing and possible regional trade agreements under the South Asian Association for Regional Cooperation (SAARC) and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), among others.⁷

Way forward

Foreign policy is to a large extent dictated by trade. Trade and security are interlocking components of the overriding objectives of peace and development. The fight for peace and development has to be on both

security and socio-economic fronts. Successes on both the fronts can assure the world of enduring peace. Economic diplomacy should be, first and foremost, for long-term, sustainable, and inclusive development as an end.

Trade matters considerably in speeding up the development process. The rapid expansion of foreign trade has been transformative and remains a defining characteristic of the world economy. In order for economic diplomacy for trade facilitation to effectively take off, some policy reforms are needed. The following recommendations can also address the gaps that are acting as bottlenecks to economic diplomacy and trade facilitation.

- Strength abroad comes from strength within or at home. Thus, strengthening the existing institutional mechanism, close coordination between agencies should be ensured and maintained for effective economic diplomacy.
- Prepare properly and adequately to advance trade interests and attract foreign investment geared to productive sectors in the economy.
- Timely meetings of bilateral mechanisms should be held at a regular interval to resolve any transit, trade and transport issues.
- Diplomatic missions should be instructed with all necessary details to encourage the establishment of bilateral chambers of commerce and industries



and to make the chambers active wherever they already exist, and where possible cultivate people's representatives in host countries dealing with finance, trade, commerce, technology, and industrial matters.

- Diplomatic missions abroad should reach out to a cross-section of stakeholders in the host countries, establishing formal and informal communication links with them. Such links should include politicians, the private sector and opinion makers both at the centre and the periphery of the host countries.
- Strategize to secure preferential market access for the nation's products with export potential and encourage the private sector to take advantage of the trade preferences.
- Establish and strengthen the post of economic counsellor (trade) at diplomatic missions to be jointly funded by the government and the private sector where there are prospects for trade, aid and investment.
- Adequate resources, technical capacity, and staff should be provided and simultaneously enhanced to strengthen institutions.
- Strong partnerships are needed among relevant ministries and departments in the conduct of economic diplomacy to develop a road map for investing in trade diplomacy, and building capacities and skills that survive and thrive for generations.
- Diplomatic missions abroad, in coordination with relevant agencies back in Nepal, should regularly gather market intelligence.
- Where bilateral initiatives do not work or get enough attention, use all possible channels, including multilateral and regional forums, to advance trade interests. ■

Notes

- ¹ Dahal, Madan K, Mohan M Sainju, Mohan P Lohani, Shanker P Sharma, and Umakant Parajuli. 2008. "A Generic Guideline for Development through Economic Diplomacy." *Institute of Foreign Affairs*.
- ² Coolsaet, Rik. 2004. "Trade and Diplomacy: The Belgian Case." *International Studies Perspectives*, Vol 5(1): .61-65.
- ³ Kostecki, Michel, and Oliver Naray. 2007. "Commercial Diplomacy and International Business." *Netherlands Institute of International Relations*. Discussion Papers in Diplomacy.
- ⁴ As discussed in Lee, Donna and Brian Hocking. 2018. "Economic Diplomacy." *Oxford Research Encyclopedia of International Studies*. Vol II: 1216-1227.
- ⁵ Rana, Kishan S and Bipul Chatterjee. 2011. *Economic Diplomacy: India's Experience*. Jaipur: CUTS International.
- ⁶ *ibid*.
- ⁷ Pandey, Posh R, Paras Kharel, Kshitiz Dahal, Dikshya Singh, and Swastik Aryal. 2022. *Nepal's graduation from the LDC category: Implications for international trade and development cooperation*. Kathmandu: SAWTEE.



This policy brief is prepared by Mr. Swastik Aryal, Research Officer, SAWTEE, based on a study on "Effective Economic Diplomacy for Trade Facilitation and Better Export Performance of Federal Nepal", supported by The Asia Foundation (the Foundation). Views expressed are those of the author and do not necessarily reflect the position of SAWTEE and its member institutions or the Foundation.

South Asia Watch on Trade, Economics and Environment (SAWTEE) is a regional network that operates through its secretariat in Kathmandu and 11 member institutions from five South Asian countries, namely Bangladesh, India, Nepal, Pakistan and Sri Lanka. The overall objective of SAWTEE is to build the capacity of concerned stakeholders in South Asia in the context of liberalization and globalization.

P.O. Box: 19366
Tukucha Marg, Baluwatar, Kathmandu, Nepal
Tel: +977-1-4424360/4444438, Fax: +977-1-4444570
E-mail: sawtee@sawtee.org

Design: Bipendra Ghimire