

SECTOR ASSESSMENT (SUMMARY): INDUSTRY AND TRADE¹

A. Sector Performance, Problems, and Opportunities

1. Nepal's gross domestic product (GDP) growth averaged 3.8% per year in FY2002–FY2016, much lower than the average rate of 6.6% in other South Asia Subregional Economic Cooperation (SASEC) countries over the same period. Its manufacturing sector has a smaller share of GDP than would be expected for a country at Nepal's stage of development, and its ratio of goods exports to GDP has been declining. A small and declining contribution of manufacturing to GDP at a low level of per capita income, as in Nepal, is unusual. A diversified economic base with an increasing share of manufacturing in the economy will be crucial for Nepal to attain middle-income status by 2030.² To achieve this, Nepal will need to raise investment levels, both domestic and foreign. Diagnostic studies for Nepal identify weak governance and policy uncertainty, inadequate infrastructure (transport and energy), poor industrial relations, and inability to address market failures as critical constraints.³ Inability to address market failures leads to lack of public inputs, such as soft and hard infrastructure, to facilitate movement of goods across borders.

2. Nepal continues to score poorly and lags on indicators of trade facilitation performance, although it has improved marginally.⁴ The Organisation for Economic Co-operation and Development (OECD) trade facilitation indicators rank Nepal lowest among the SASEC countries.⁵ Further, Nepal is ranked 124th out of 160 countries on the overall Logistics Performance Index (LPI), worse than 105th out of 160 in 2014.⁶ Similarly, on efficiency of customs clearance, Nepal's score deteriorated to 1.93 in 2016 from 2.31 in 2014, although it improved from the 2007 score of 1.83. On the other hand, Nepal's score on the World Bank's ease of trading across borders indicator improved dramatically in 2015 to rank 69th out of 190, up from 171th out of 189 in 2014.⁷ However, if the cost to export and import is adjusted to consider the level of development, Nepal does not perform well and its adjusted ranking is lower.⁸ Nepal also scores poorly and ranks in the bottom half on time taken to export and import.

¹ This summary is based on Nepal's Development Context and the Role of Trade Facilitation; and Nepal's Compliance with the World Trade Organization's Trade Facilitation Agreement (accessible from the list of linked documents in Appendix 2).

² The vision to attain middle-income status by 2030 is described in Government of Nepal, National Planning Commission; and Asian Development Bank (ADB). 2016. *Envisioning Nepal 2030: Proceedings of the International Seminar*. Kathmandu.

³ ADB. 2009. *Nepal: Critical Development Constraints*. Manila; Millennium Challenge Corporation. 2014. *Nepal Growth Diagnostic*. Washington, DC; and Overseas Development Institute. 2014. *Structural Economic Transformation in Nepal*. London.

⁴ Comparisons are in Nepal's Development Context and the Role of Trade Facilitation (accessible from the list of linked documents in Appendix 2).

⁵ The OECD trade facilitation indicators and Nepal's performance are detailed in Nepal's Compliance with the World Trade Organization's Trade Facilitation Agreement (accessible from the list of linked documents in Appendix 2).

⁶ The overall LPI is constructed from an analysis of six core components: (i) efficiency of customs and border clearance, (ii) quality of infrastructure, (iii) ease of arranging international shipments, (iv) quality of logistics services, (v) ability to track and trace consignments, and (vi) timeliness of shipments. While the overall LPI score improved from 2.14 in 2007 to 2.59 in 2014, it declined to 2.38 in 2016.

⁷ The change in Nepal's ranking is due partly to a change in the survey methodology and partly to successful reforms such as the implementation launch of the Automated System for Customs Data (ASYCUDA) World. World Bank. 2017. *Doing Business 2017: Equal Opportunity for All—Economy Profile 2017: Nepal*. Washington, DC. p.73.

⁸ The adjusted score and ranking are described in Nepal's Development Context and the Role of Trade Facilitation (accessible from the list of linked documents in Appendix 2).

3. Modern customs and efficient trade facilitation are important export enablers. Procedural costs affect manufacturers' competitiveness and limit their access to foreign markets.⁹ The role of customs has expanded from revenue collection and enforcing security controls to acting as facilitators of government policies, aimed at increasing foreign direct investment and export potential. Recognizing the importance of customs in achieving diverse economic gains,¹⁰ the World Trade Organization (WTO) negotiated the Trade Facilitation Agreement (TFA), which entered into force in February 2017.¹¹ The WTO defines trade facilitation as the simplification, modernization, and harmonization of export and import processes, particularly customs processes, to reduce trade costs.¹² Nepal's Parliament approved accession to the WTO TFA in January 2017. Earlier in September 2016, the Parliament also ratified the revised Kyoto Convention (RKC) on the simplification and harmonization of customs procedures.¹³

4. Nepal's customs is oriented toward revenue collection and at-the-border control, and is yet to transform into a modern agency that provides an enabling trading and business environment. A gap analysis assessed Nepal's current alignment with the WTO TFA and identified gaps and measures to comply with the TFA provisions.¹⁴ Implementation of these measures will help the Department of Customs (DOC) become a modern, paperless, and risk-based customs agency, equipped with facilities and mechanisms to improve its performance of behind-the-border functions: (i) post-clearance audit, (ii) advance rulings, (iii) pre-arrival clearance, (iv) expedited shipment, (v) risk management, and (vi) trusted traders program.¹⁵ Implementation of these reforms is hampered by (i) an inadequate legal framework, policies, and agreements to facilitate trade; (ii) unpredictable and inconsistent clearance procedures at different border points, unsupported by modern automation tools; (iii) dated institutional structures that are incompatible with the modern role of customs; and (iv) a shortage of human resources capacity. Other development partners are addressing bottlenecks under these broad sector challenges, notably in supporting interventions in laboratory accreditation, the national single window, transit agreements, and coordination challenges.¹⁶

5. Findings of Time Release Studies (TRSs)¹⁷ point to the need for stronger behind-the-border customs clearance mechanisms. The DOC conducted TRSs at two major border points, Biratnagar and Mechi customs, in 2016.¹⁸ A key finding is that a trader carrying a consignment spends a long time at the customs yard before submitting the declaration documents to customs. The average time needed for this pre-submission step is significantly longer than the

⁹ International Trade Centre. 2016. *SME Competitiveness Outlook: Meeting the Standard for Trade*. Geneva.

¹⁰ The gains from implementing the WTO TFA for Nepal are discussed in Economic Analysis (accessible from the list of linked documents in Appendix 2).

¹¹ The requirements of the WTO TFA are in Nepal's Compliance with the World Trade Organization Trade Facilitation Agreement (accessible from the list of linked documents in Appendix 2).

¹² WTO. 2015. *World Trade Report 2015—Speeding up trade: benefits and challenges of implementing the WTO Trade Facilitation Agreement*. Geneva. Trade costs are all costs, apart from the cost of production, incurred in getting a good from the producer to the final consumer.

¹³ Nepal submitted the RKC instrument of accession to the World Customs Organization (WCO) in February 2017.

¹⁴ World Bank Group. 2015. *WTO Trade Facilitation Agreement—Nepal Gap Assessment and Implementation Action Plan (Final Report)*. Washington, DC (restricted distribution).

¹⁵ Nepal's Compliance with the World Trade Organization Trade Facilitation Agreement (footnote 11) discusses these six WTO TFA provisions and how the program outputs support them. Nepal will also improve compliance with related international standards set by the WCO, including the RKC.

¹⁶ Development Coordination (accessible from the list of linked documents in Appendix 2).

¹⁷ The WCO developed the TRS as a methodology to determine the average time taken to clear consignments, from entry to exit in the customs area, and to prescribe corrective measures to allow prompt clearance of cargoes.

¹⁸ Biratnagar is the third highest revenue-yielding customs office and Mechi is the seventh highest. Government of Nepal, Ministry of Finance, DOC. 2017. *Time Release Study Report: Mechi & Biratnagar Customs 2017*. Kathmandu. The TRS was supported by ADB technical assistance (para. 9). ADB. 2013. *Technical Assistance to Nepal for Supporting Participation in the South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila.

next step, customs inspection and clearance. The finding highlights excessively complex at-the-border procedures and document requirements for traders, as they prepare to submit their declaration to customs.¹⁹ The TRSs also observed that the average clearance time for goods using the red lane (a clearance channel to conduct physical inspection of high-risk cargoes) was implausibly low, given customs staffing levels and the estimated time required per truck for full physical inspection.²⁰ This finding, related to the absence of effective risk management, raises concerns about the thoroughness of inspections, which could create revenue leakage, as well as social, environmental and cultural safety, and security risks.²¹ The TRSs also identified key factors extending the cargo release time, including (i) limited use of automation, (ii) non-application of a robust risk-based approach to customs clearance, (iii) lack of nonintrusive inspection equipment to support physical verification, and (iv) lack of coordination among government agencies to implement a one-stop clearance facility.

B. Government's Sector Strategy

6. The government has recognized the role of exports as a key driver of economic growth and inclusive development. The Nepal Trade Integration Strategy, 2016 seeks to address the outstanding trade and competitiveness challenges confronted by the country's export sector, and cites lower customs clearance costs to improve export competitiveness.²² The strategy's implementation framework identifies the need to increase Nepal's export competitiveness through improved trade and transport facilitation, and its short-term action points contain several DOC actions to meet the WTO TFA obligations.

7. Progress has been made under Nepal's Customs Reform and Modernization Strategy and Action Plan (CRMSAP) since 2003.²³ Implementation of successive CRMSAP phases has brought Nepal's customs procedures closer to international standards. In 2017, the DOC prepared the fifth phase CRMSAP, 2017–2021 with the objective of aligning its strategic priorities and action plans with (i) the WTO TFA and other key international standards, in content and in the implementation schedules; and (ii) the national development agenda of export promotion through implementing custom procedures with economic impact. The guiding principles of the fifth phase also highlight the centrality of risk management in all aspects of customs operation. The DOC will formulate field-level CRMSAP implementation action plans to equip the major customs offices with a customized work plan and an implementation monitoring tool for each office.

C. ADB Sector Experience and Assistance Program

8. Asian Development Bank (ADB) engagement in Nepal's trade facilitation dates to 1996. The introduction of the first generation Automated System for Customs Data (ASYCUDA) was among the early projects.²⁴ Support to customs automation continues, rolling out ASYCUDA

¹⁹ Statistics on the average time taken at different stages of the cargo clearance at Biratnagar and Mechi, disaggregated by export and import, are in Government of Nepal, Ministry of Finance, DOC. 2017. *Time Release Study Report: Mechi & Biratnagar Customs 2017*. Kathmandu.

²⁰ Green and yellow lanes are released without physical verification, with yellow lane cargo going through a document verification process.

²¹ According to the DOC's ASYCUDA statistics, 74.15% of declarations were selected to pass through the red lane in Biratnagar customs and 42.70% in Mechi customs.

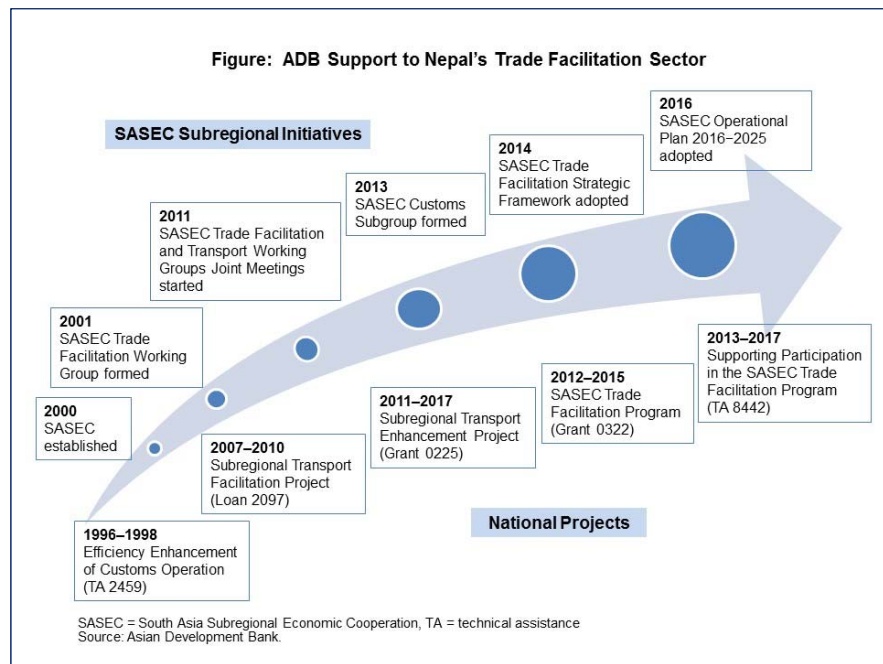
²² Government of Nepal, Ministry of Commerce. 2016. *Nepal Trade Integration Strategy 2016: Executive Summary and Action*. Kathmandu.

²³ Government of Nepal, Ministry of Finance, DOC. 2016. *Customs Reform and Modernization Strategy and Action Plan (CRMSAP) 2013–2017: Midterm Review Report*. Unpublished.

²⁴ ADB. 1995. *Technical Assistance to Nepal for Efficiency Enhancement of Customs Operation*. Manila.

World.²⁵ ADB's support began expanding in 2012 to broader areas of customs modernization—combining the lending modalities of investment, policy-based lending,²⁶ and technical assistance—grounded in a collaborative and harmonized approach being promoted as part of the SASEC trade facilitation strategic framework (Figure).²⁷

9. Recent ADB support has increasingly emphasized advisory services and training, aimed at improving Nepal's compliance with international trade facilitation standards. Achievements include the formulation of the e-Customs Master Plan,²⁸ preparation for accession to the RKC, conduct of the TRSs, and establishment of the client services desks—all critical to improving Nepal's compliance with the WTO TFA.²⁹ In 2015–2016, ADB engaged in the formulation and assessment of the DOC's CRMSAP, including a midterm review of the ongoing fourth phase CRMSAP, 2013–2017 and drafting of the fifth phase for 2017–2021. Further, in response to the April 2015 earthquake, ADB was the first development partner to recommend the DOC to form a task force on relief consignment clearance, and to join the task force, which drafted new legislation and procedures to expedite the duty-exempt clearance of relief materials.



10. Since 2001, the ADB-supported SASEC program has provided a platform for member countries, including Nepal, to address trade facilitation sector issues of subregional concern collectively.³⁰ SASEC's Trade Facilitation Strategic Framework focuses on the four pillars of (i) customs reform and modernization (the Customs Subgroup was launched in 2013), (ii) standards and conformity, (iii) border facilities, and (iv) transport facilitation.³¹ While continuing to build on two decades of support to the DOC, ADB is well equipped to mobilize the SASEC platform to continue support to Nepal's trade facilitation.

²⁵ ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Grant to Nepal for Subregional Transport Enhancement Project*. Manila; and ADB. 2012. *Validation Report: Subregional Transport Facilitation Project in Nepal*. Manila. ASYCUDA World is the latest web-based version of the software.

²⁶ ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loans and Grants for the South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila.

²⁷ ADB. 2013. *Technical Assistance to Nepal for Supporting Participation in the South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila.

²⁸ Government of Nepal, Ministry of Finance, DOC. 2013. *E-Customs Master Plan*. Unpublished.

²⁹ ADB's support and Nepal's compliance with the TFA measures are in Nepal's Compliance with the World Trade Organization Trade Facilitation Agreement (accessible from the list of linked documents in Appendix 2).

³⁰ Regional Cooperation and Integration (accessible from the list of linked documents in Appendix 2).

³¹ ADB. 2014. *South Asia Subregional Economic Cooperation: Trade Facilitation Strategic Framework, 2014–2018*. Manila.

Problem Tree for Industry and Trade: Trade and Services Subsector (Trade Facilitation)

