

**Nepal-India Bilateral Trade Relations**  
*Problems and Prospects*

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## *Preface*

The Visiting Research Fellowship in International Economic Issues and Development Policy is a programme conducted by the RIS under the Indian Technical and Economic Cooperation (ITEC) Programme of the Government of India with the objective of providing to the officials and scholars from other developing countries an opportunity of receiving training in India in specific areas of common interest. Under the Visiting Research Fellowship programme of the RIS, the selected Fellows spend about four months with RIS during which they attend specialized courses on select themes in the fields of economic development and international economic relations and also work on a select theme of research under the guidance of the RIS faculty. The Visiting Fellows are also given an opportunity to interact with experts in different fields.

Dr. Gyanu Raja Shrestha, Tax Officer, Ministry of Finance, Nepal, conducted his research at RIS during February-May, 2003 as a Visiting Research Fellow under the programme. He also interacted with officials in the ministries, government organizations, industry and scholars in the academic world.

This paper resulted from Dr. Raja's work on "Nepal-India Bilateral Trade Relations: Problems and Prospects" during his stay at RIS, under the guidance of Dr. Ram Upendra Das, Fellow, RIS.

An earlier version of the paper was presented at the Seminar on "Development Cooperation Prospects between India and Other Developing Countries" held at RIS on May 28, 2003. The Seminar had representation of ministries and government organizations, embassies, industry and academics, and the paper benefited from the feedback.

We are happy to release the research paper of Dr. Raja as RIS Discussion Paper for contributing to wider awareness about the potentials of cooperation between India and Nepal. We do hope that the ideas and suggestions contained in this paper would be found useful both in India and Nepal.

(Nagesh Kumar)  
Director General

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# Chapter I

## Introduction

### 1.1. Economic Relationship between Nepal and India

Economic relationship between Nepal and India is unique. There are historical, geographical, cultural, linguistic, ethnic, social and family links between people living in India and Nepal. Institutions relating to government and the economic activities are also more or less similar. Therefore, the trade and other related relationship between Nepal and India has its own significance. Trade relationship between these two countries often goes beyond the economic reason significantly influenced by the social-ethical norms and values. Research and studies reveal that both the countries have comparative cost advantages in trading amongst themselves for several reasons. Historic trade relation, geographical proximity, identical culture, similar agriculture productions are cited few examples quite repeatedly. Economical transport cost is seen as another important factor determining the volume of trade between these countries. In view of the rising energy costs, it often considered that the transport costs are likely to rise so that the transport cost advantage to both these countries trading with each other is likely to increase in future. This would further increase the potential for trade between these countries.<sup>1</sup> Timilsina (2000), on the other hand, notes that the economic cooperation between Nepal and India is based on the movements of goods and services across Nepal-India border of about 1,600 km. The movement is free and spontaneous. This movement further accelerated by the movement of people for economic pursuits, social and marriage relations. The cultural ties and non-existence of visa system have created better environment for the conduction of free trade between the two countries.<sup>2</sup>

Indo-Nepal trade has its own importance for the economic development of both these countries. Trade relation with India is rather crucial to Nepal particularly due to her land-locked geographic characteristics. Trade statistics show an increasing trend of trade in both the exports and imports. However, it is noteworthy that the trade balance is not in favour of Nepal. As such, it does not present a convincing picture in the macro-economic performance of Nepal. Both the countries have realized the significance of bilateral trade. Trade with India is likely to play further a key role in trade and industrial fronts in the future as well. Trade and transit treaties held between the two countries are continuously reflecting the fact. And, these treaties have increasingly guided the trade direction, more specifically in the case of Nepal. Taking into account these factors, this study has made an attempt to analyze some of the key issues related with Indo-Nepal trade relation and scope for improving trade relationship between these countries in the future.

### 1.2. Trade and Trade Liberalization

The conventional economic wisdom holds that trade is beneficial to growth of a country. Although one country may have a higher productivity in the production of all goods compared to another country, the relative productivities in producing different goods will differ. Trade is based on the relative comparative advantage and increases welfare in both countries. It has been increasingly stressed in recent years that welfare would only come from increased exports. Trade liberalization, in this direction, paints a picture suitable for export promotion. On the other hand, it is also argued that the participating countries should share the benefits of free trade. Trade liberalization as a policy focus predominantly on diminishing restrictions to the free international movement of goods and services. More, in particular, it includes the diminishing of import quota and the lowering of export taxes. These policies will result in a decrease of the price of importable, and in an increase in the price of exportable. If

markets work as they are expected to work, these measures lead to increases in imports and exports. And, a balance trade scenario is obtained. Trade liberalization, more often, forms a part of structural adjustment program of a country.<sup>3</sup> Economic reforms programs in many countries can be seen as a consequence of this program.

### **1.3. Economic Reform Initiatives**

It is noteworthy to note that the South Asian economies (SAEs) launched comprehensive reform programs at the beginning of the 1990s. However, some attempts were made towards the opening up of trade and investment regimes in the 1980s. The reform initiatives included, among other things, reducing the level and dispersion of tariffs and quantitative restrictions and improving regulations on domestic and improving regulations on domestic and foreign investments.<sup>4</sup> Nepal and India also stepped towards economic reform process during this period.

The new economic thinking involving speedy economic liberalization oriented toward free and competitive market in Nepal and India has, by and large, contributed in changing the scenario of Indo-Nepal trade relation. Steady move towards economic liberalization undertaken by the both countries brought fundamental changes in the pattern and direction of economic exchanges between them.<sup>5</sup> As such; the traditional age-old relationships between these two neighboring countries assumed new dimensions with economic and trade liberalization regimes.

#### **1.3.1 Economic Liberalization in India**

India started to deregulate her economy in the mid-1980s when the import restrictions on a number of goods were relaxed by expanding the positive OGL list, tariff rates on capital goods were brought down, and FDI policy was liberalized. In July 1991, the government initiated a comprehensive package of reforms covering trade, industrial and exchange rate policy regimes. The import licensing system has been dismantled. As non-tariff barriers (NTBs) were phased out from all tradeables except consumer goods in early years of 1990s. the quantitative restrictions (QRs) on the remaining items have been phased out by March 2001, two years ahead of the original schedule. The QRs on imports of around 2300 items from SAARC countries had been removed unilaterally in 1998. The peak tariff rates have been brought down to a maximum of 50 per cent from up to 355 per cent and average weighted tariff rates have come down from 87 per cent to just 20 per cent by 1999. Tariff rates on most of the commodities had been brought well below the bound rates by 1998/99 except for 40 commodities.

The New Industrial Policy (NIP) of 24 July 1991 and subsequent amendments brought far-reaching changes in the policy regime governing the industrial investments. The industrial licensing (or approval) system that regulated the industrial investments in the country has been dismantled by abolishing the requirement of obtaining an industrial license from the government in all except 14 specified industries that need to be regulated because of environmental or security considerations. Many industries, earlier reserved for public sector, have been opened to private including foreign investments such as telecommunication, roads, ports, power generation, petroleum refining. NIP accords a much more liberal attitude to foreign direct investments (FDI) than ever in the post-Independence India. For speedy clearance of FDI proposals the policy allows an automatic approval system subject to the fulfilling of specified equity norms. A Foreign Investment Promotion Board (FIPB) has been set up to consider all other proposals that do not qualify for automatic clearance. FIPB is empowered to approve up to 100 per cent foreign ownership. The restrictions on investments



by large industrial houses and foreign controlled companies under the MRTP Act were also abolished. A phased program of disinvestments of public ownership in public sector corporations has been launched. The outward investments by Indian enterprises were also liberalized and proposals fulfilling certain norms could now be granted automatic approval.

The partial convertibility of rupee on the trade account was announced in the 1992-93 budget that was subsequently broadened to full convertibility on current account by August 1994. The Capital Issues Control Act was repealed and the Securities and Exchange Board of India (SEBI) was set up as a watchdog for regulating the functioning of the capital market. SEBI has focused on the regulatory reform of the capital market as well as on market modernization. Online trading and dematerialized trading have been introduced. Companies have been allowed to buy back their own shares subject to the regulations laid down by SEBI. In September 1992, the government announced guidelines for investments by foreign institutional investors (FIIs) in the Indian capital market. FIIs are now welcome to invest in all types of securities traded on the primary and secondary market with full repatriation benefits and without restrictions on either volume of trading or lock-in-period. In January 1993, a package of financial sector reform was announced that included permission to new private sector banks including foreign joint ventures. The government has also established a policy regime for the functioning of private non-banking finance companies (NBFCs) and agencies for rating their credit worthiness.<sup>6</sup>

### **1.3.2 Economic Liberalization in Nepal**

Nepal opened up its economy in the early 1990s with the adoption of economic reform package. The reform measures have since covered almost all sectors of the economy including trade and investment, fiscal and monetary policies, financial and capital markets and other economic and social sectors. The import licensing system and quantitative restrictions were eliminated and tariff rates and structure were reduced and rationalized to make the trade sector competitive. The trade weighted nominal rate of protection declined from about 80 per cent in the early 1980s to about 31 per cent in 1994. Similarly, the average rate of protection has declined from about 111 per cent in 1989 to 16 per cent in 1992. In a similar manner, the number of slabs subject to protection fell from more than 100 in the 1980s to 5 in 1996. Additional measures initiated to promote international trade include the introduction of a bonded warehouse, duty-drawback scheme, initiation of the multi-modal facility (dry port) and an export-processing zone.

A new bilateral trade treaty signed with India in 1996 supported the trade reform program of Nepal. The treaty allows Nepal to export manufactured products to India free of customs duty and quantitative restrictions. Similarly, in order to improve the environment for investment, the Industrial Enterprise Act, 1992 and the Foreign Investment and Technology Transfer Act (1992) were enacted in line with the open, liberal and market-oriented policy. These Acts have further improved investment incentives. No license is required for the establishment, expansion and modernization of industries except for a few related with defense, public health and environment. In short, the environment was made more conducive to larger inflows of foreign direct investment (FDI).

Financial sector reforms have also been carried out to support the trade and industrial reforms. Interest rates were deregulated and joint-venture banks were allowed to open up. Nepal also included full convertibility of the Nepalese rupees on the current account. The overvalued Nepalese currency was also corrected to improve export competitiveness of the

trade and industrial sectors. HMG/N has been committed towards trade liberalization through simplification of trade and tax procedures, and also through revising custom tariffs to encourage exports and ultimately attract more foreign investments.<sup>7</sup>

Furthermore, various sectoral strategies have been introduced to attract investment. The Hydropower Policy 1992 has opened up new avenues to develop the hydropower of the country by motivating national and foreign private investors in this sector. The liberalized aviation policy has contributed tourism industry significantly. Road, airport construction and telecommunication services have also been opened to the private sector in order to attract more domestic as well as foreign investments and to improve service delivery.

#### ***1.3.2.1. Financial Sector Reform***

The Nepalese financial system is in the midst of great changes along with Nepal's preparation for entry into World Trade Organization (WTO). Nepal Rastra Bank (the central bank) has given priority to the financial sector reform by developing and updating necessary policies and guidelines for further consolidation of the financial system. Nepal Rastra Bank Act 2002, formulation Financial Institutions Act, Financial Intermediary Act, Debt Recovery Act, management transfer of the two largest banks, i.e. Nepal Bank Ltd. And Rastriya Banijya Bank, proposals for restructuring of the Agricultural Development Bank and Nepal Industrial Development Cooperation (NIDC) can be seen as the major initiatives undertaken in respect to the financial sector reform process.

#### ***1.3.2.2. Nepal's Accession to World Trade Organization (WTO)***

With the growing global integration, there are benefits and advantages to the domestic economy reflected in greater competition with the lower cost and higher quality goods as well as the opportunity for reaching the potential inherent in the country's comparative advantage. To capture those benefits and advantages of global trade, Nepal has commenced the accession process for membership in the World Trade Organization (WTO).

Nepal had formally applied for GATT membership on May 1989. Nepal became an observer to the WTO in December 1995. It is to be noted that WTO provides for observer status for governments to allow them to familiarize themselves with the organization and to prepare for accession negotiations. Nepal converted the application for membership in GATT to membership in WTO in 1997. The Working Party established for Nepal's accession to GATT was also transformed into a Working Party on accession to WTO. In accordance with WTO procedures for accession, Nepal had submitted to the Working Party a Memorandum of Foreign Trade Regime in July 1998. The WTO Secretariat circulated Nepal's Memorandum on Foreign Trade Regime to WTO member countries in August 1998 and invited any queries and comments from members. The WTO Secretariat compiled all the queries and comments on the Memorandum of Foreign Trade Regime, which were forwarded to the member countries, and passed them to HMG/N in January 1999. There were altogether 364 questions; based on the Nepalese laws; 24 questions on economy, economic policies and foreign trade, 178 on the framework for making and enforcing policies affecting foreign trade in goods and services, 114 on trade related intellectual property rights regime and 48 on trade related service regime. Nepal responded to the queries and questions raised on the Memorandum by WTO members in 1999 and 2000. In this process, the project for "Nepal's Accession to the World Trade Organization (WTO)" was formed on July 1999.<sup>8</sup>

The first meeting of the Working Party was held on 22 May 2000. After the meeting, the WTO Secretariat transmitted additional questions, which had been raised during the first

Working Party Meeting. Nepal submitted a schedule of tariff concessions and schedule of initial commitment on service sector in July 2000. Again, additional questions were raised from the Working Party and the country duly answered. In the second round of meeting, 94 questions have been raised and were supposed to be answered by the first week of March 2003. The questions were, as reported, related with tariff rates, provision for foreign investment in additional service sector, information technology and legal reforms in accordance with the WTO policy regime.<sup>9</sup>

It is to be noted that Nepal has been undertaking steps gradually as per the accession process. Amendment of Custom Act 1962 in 1997, amendment of Foreign Investment and Technology Transfer Act 1992 in 1996, amendment of the Copy Right Act 1964 in 1997, application of new Company Act 1997 can be seen as some of the reform initiatives that have been under taken in the legal aspects besides the reform initiatives in other sectors.<sup>10</sup> And, the country is in a firm believe that it would obtain all the facilities that are supposed to be granted to a land-locked country in respect to trade related affairs.

#### ***1.3.2.3. Comprehensive Economic Reform Program, 2002***

A comprehensive Economic Reform Program 2002 has been implemented recently. The reform program has focused on the important areas such as planning and public expenditure management, financial transparency and management, public enterprises management, private sector development, decentralization and good governance with the objectives of maintaining macroeconomic stability and bringing economy into right track to ensure healthy and sustainable development of the economy. The implementation of the program was observed satisfactory in course of reviewing the program. It was further noted that due to the satisfactory progress achieved in the economic reform programs, the World Bank upgraded its level of assistance to Nepal from a Low Case to Base Case scenario. As a consequence of which, Nepal will now be eligible for up to \$ 350 million assistance for three years while the country was eligible for a maximum of \$50 million assistance annually during the last three years.<sup>11</sup>

Furthermore, several arrangements have been made to facilitate export and industrial sectors, which include:

- a. In addition to cash deposit required against excise duty for exportable goods, an alternative arrangement has been made to accept bank guarantee as well.
- b. Bonded warehouse facility would be provided for exports of ready-made garments to India.
- c. In an effort to improve the situation of industries and hotels including tourism sector, necessary facilities will be provided effectively to the sick industries. For this purpose, existing committee on sick industries will be made effective to provide quick relief to the sick industries.
- d. Customs Post Clearance Audit based on real transactions value, will be implemented effectively.
- e. Electronic media will be utilized and further cooperation will also be sought from private sector such as Federation of Nepalese Chambers of Commerce and Industries (FNCCI), Nepal Chamber of Commerce (NCC) and the Confederation of Nepalese Industries (CNI) to prepare database.

#### **1.4. Macroeconomic Performance of India**

Gross Domestic Product (GDP) at factor cost at constant 1993/94 prices grew at 5.6 per cent in 2001/02, as against 5.4 per cent projected in February 2002. In 2000/01, GDP at factor cost at constant price 1993/94 prices grew at 4.4 per cent, as against the previous estimate of 4.0 per cent. The pick-up in growth of the Indian economy observed in 2001/02 was stronger than what had been initially anticipated. The growth recovery was accompanied by continued macro economic stability in terms of low inflation, orderly market condition and comfortable reserves. However, the overall GDP growth in the current year 2002/03 is likely to be only 4.4 per cent.

Agricultural and allied sector growth is likely to register a decline of 3.1 per cent in the current year. In 2001/02, the growth of this sector was 5.7 per cent. India witnessed a weak industrial growth of 2.7 per cent during 2001/02 as measured by the Index of Industrial Production (IIP). The slow down was broad-based and took place across most industrial groups, with particularly weak growth of only 1.2 per cent in mining and quarrying. Notwithstanding lower industrial growth during 2001/02, the index of industrial production has displayed definite signs of pick-up in the first eight months of the current financial year showing an overall growth of 5.3 per cent over the same period of 2001/02. The 52-week average based inflation rate based on Wholesale Price Index (WPI) has remained below 3 per cent much of the year. The annual point-to-point inflation rate for the week ended January 18, 2003 has touched 4.4 per cent and may creep up further if global oil prices continue to rise. Consumer Price Index (CPI) for industrial workers registered 5.2 per cent in 2001/02 but expected to remain at 3.2 per cent in 2002/03.

Balance of Payments (BOP) in 2001/02 exhibited mixed developments. Exports remained stagnant, in BOP basis, at previous year's level. Imports declined by 2.8 per cent resulting in a decline in merchandise trends deficit, as of GDP, from 3.1 per cent in 2000/01 to 2.6 per cent in 2001/02. The current account turned into a surplus in 2001/02, after a gap of 24 years. The net capital flows also improved during the year, thus resulting in a largest reserves build-up in a single year. The net accretion to foreign exchange reserves in 2001/02 was all-time high in the past decade. Stagnation in export growth in 2001/02 as compared with an increase of 19.6 per cent in 2000/01 was partly due to weak external demand. It has affected India's export performance. The decline in imports, on BOP basis, was mainly due to lower POL imports. Exports (in dollar value) declined by 1.6 per cent in 2001/02; as against a growth of 21.0 per cent in 2000/01 and an average rise of 8.6 per cent in the 1990s. Growth in volume of exports decelerated sharply from 23.9 per cent in 2000/01 to 3.8 per cent in 2001/02. Imports growth (in dollar value) was stagnant in 2001/02, as in the previous year, at 1.7 per cent despite an increase of 5.1 per cent in volume terms.

The consequential trade deficit came down from US\$ 14.37 billion in 2000/01 to US\$ 12.70 billion in 2001/02, representing 2.6 per cent of GDP. The net foreign investment inflows in 2001/02 at US\$ 5.29 billions was the highest inflows during the past four years, indicating the rising confidence of international investment in Indian economy.<sup>12</sup>

#### **1.5. Macroeconomic Performance of Nepal**

GDP growth of Nepal slowed to 4.8 per cent in 2001 from 6.2 in 2000. It was mainly because of slightly weaker performance of agriculture, a sharp deceleration in manufacturing and continued weakness in tourism after an exceptional year in 2000. Agricultural output slowed to 4.3 per cent growth in 2001 from 4.9 per cent in 2000, while industrial sector growth fell to 2.0 per cent from over 7.1 per cent during the same period.<sup>13</sup> Tourism-related services were

also hit by the prevailing unnatural incidents in the country. These factors contributed to a 21 per cent drop in tourist arrivals by air during the year. The budget deficit widened to 4.2 per cent of GDP in 2001 from 3.3 per cent in 2000.<sup>14</sup>

Growth in merchandise exports fell sharply to 3.7 per cent in 2001 from the substantial rate of 42 per cent in 2000. Most of the decline was due to the sharp drop in the growth rate of exports of ready-made garments and woolen carpets. Meanwhile, imports declined by nearly 1 per cent, following expansion of 20 per cent in 2000. The poor import performance reflected a deceleration of growth in manufactured imports. The current account deficit remained at 4.4 per cent of GDP in 2001.<sup>15</sup> GDP was preliminary estimated to increase by 0.8 per cent with the agriculture and non-agriculture sector registering of 1.7 per cent and 0.2 per cent growth rates respectively in 2002.<sup>16</sup> However, the revised estimates of GDP growth is reported to decline further in 2002.

## **1.6. Trade Policy**

Trade activities are much more directed by the trade and industrial policy of a country. The trend of foreign trade, in particular, moves in accordance with the trade policy adopted by the country. Therefore, the import and export trade largely depend upon the trade policy.

### **1.6.1. Trade Policy of Nepal**

The trade policy of Nepal envisaged enhancing the contributions of trade sector to national economy by promoting internal and international trade with the increased participation of private sector through the creation of an open and liberal atmosphere. It further states to diversify trade by identifying, developing and producing new exportable products through the promotion of backward linkages for making export trade competitive and sustainable. In order to materialize following basic policies have been formulated:<sup>17</sup>

- i. The role of public sector will be minimized and used as a catalyst to expand the role of private sector in trade.
- ii. Improve balance of payments position by promoting exports to increase foreign exchange earnings as well as by fulfilling internal demand of economic and quality products.
- iii. Production of quality goods and services for internal consumption as well as for exports through effective and appropriate utilization of economic resources.
- iv. Modernizing management and technology, on promoting market and on attracting direct foreign investment in order to identify and develop new products as well as raise the production and quality of the traditional products.
- v. Public sector trading corporations will gradually be privatized taking into considerations the development and efficiency of the private sector.
- vi. Institutional development and information network as well as on monitoring system and quality improvement for the promotion of foreign trade.

## **1.7. Export Policy**

The export policy underlines the following fundamental provisions:

- i. Production and quality of exportable products to make them competitive in the international market
- ii. Increase and diversify exports of goods and services with objective of increasing foreign exchange earnings.
- iii. More emphasis on the export of profitable but processed and finished products. For the export promotion of these products, new markets will be identified.
- iv. Increase service-oriented activities to promote foreign exchange earnings.

- v. Export of hydro-electricity on a profitable basis.
- vi. Export promotion will be provided on an institutionalized basis

### **1.7.1. Export Strategy**

The export strategy includes:

- i. not required licenses for the export of products other than banned or quantitatively restricted items. In the case of quantitatively restricted products, arrangement for issuance of export license will be made in consultations with the private sector. Quantitative restrictions in the export of such products will gradually be removed through appropriate taxation measures
- ii. Transparent, smooth and efficient administrative procedures
- iii. Exports will be free from all charges except the service charge other than specified conditions
- iv. Export Promotion Zone (EPZ) will be established. No duty will be levied on the raw materials and auxiliary imports used by industries established in such EPZ. Industries exporting more than 90 percent of their production will be granted similar facilities as given to the industries established in EPZ.
- v. Gearing up towards export promotion activities, and trade missions will be opened and institutionalized on the basis of feasibility.
- vi. Export promotion on the basis of an institutionalized basis.

The trade policy states that imports of all items other than banned or quantitatively restricted are allowed. In this way, the import and export policy have made significant contribution in the trade diversification and modifications.

### **1.8. Trade Policy of India**

Trade policy has been directed towards a paradigm shift over the years in India. The policy has undergone fundamental shifts to correct the earlier anti-export bias through the withdrawal of quantitative restrictions (QRs), reduction and rationalization of tariffs, liberalization in the trade and payments regime and improved access to export incentives besides a realistic and market based exchange rate. The focus of these reforms has been on liberalization; openness, transparency and globalization with a basic trust on outward orientation focusing on export promotion activity and improving competitiveness of Indian industry to meet global market requirements. In early 2002, the Government presented a Medium Term Export Strategy (MTES) for 2002-07 providing a vision for creating a stable policy environment with indicative sector-wise targets, with a mission to achieve one per cent of global trade by 2007. The new Export and Import (EXIM) Policy framed for the period 2002-07 and unveiled on 31 March, 2002 also seeks to usher in an environment free of restrictions and controls. Synergy between these policies and strategies is expected to realize India's strong export potential and enhance the overall competitiveness of its exports.

Policy measures announced in the Union Budget 2002-03 included a comprehensive package for development of Special Economic Zones (SEZ) including entitlement by these Zones to procure duty free equipment, raw materials, components, etc. whether imported or purchased locally, further decontrol and deregulation of agriculture sector to encourage higher exports of farm products (with measures like decimalization of export of agricultural commodities, phasing out of remaining export controls, setting up of more Agri-Export Zones in various states and enhanced incentives of export of food grains), de-reservation from small scale industry (SSI) provisions for over 50 items (of knitwear, selected agricultural implements, chemical and drugs and others ) to facilitate higher investment, technology up gradation and

exports from these sectors and fiscal measures for strengthening certain key industries (including textiles, steel, non ferrous metals and IT industry) for improving their competitiveness and exports. The Budget announced a reduction in peak customs duty from 35 per cent to 30 per cent and also provided an indication of further reductions/rationalization in these duties into only two slabs of 10 per cent (for raw material, intermediate and components) and 20 per cent (for final products) by 2004-05. Further reforms are expected to undergo in areas related to customs tariffs, rationalization of export promotion schemes, trade facilitation and other changes in tax administration.<sup>18</sup>

Undoubtedly, the reform initiatives undertaken in Nepal and India have provided new impetus to trade activities of both the countries. More significantly the treaties of Trade and Transit as well as the agreement to control unauthorized trade have changed the trade composition, in particular of the Nepalese trade. The changing trade scenario of Nepal as an impact of the trade treaties has been the main thrust of this study.

## **2. Objectives of the Study**

This study mainly concentrates on the trade relationship between Nepal and India. Therefore, the study has been carried out keeping in view the following general and specific objectives:

- i. General Objectives:
  - a. review of Indo-Nepal trade relation in brief,
  - b. an overview of trade treaties held between Nepal and India,
  - c. analyze foreign trade direction of Nepal
- ii. Specific Objective:
  - a. analyze the impact of Indo-Nepal Trade Treaty 1996, in particular, in improving trade relation between the two countries, and
  - b. identify the scope and areas of improvement in Indo-Nepal trade relations.

## **3. Scope of the Study**

The importance of economic and trade relation with India is to remain as same as it was in the past from the Nepalese perspective. Its significance may further be high in years to come. Trade relationship between Nepal and India, by and large, is being considered to be smooth. In the realm of global trade integration the trade relation between these two countries needs to improve further. On the other hand, in the present era of trade specialization both the countries need to develop their own specific trade activities based on the scale of economies, value addition and competition. This study aims to explore the scope for trade improvement between Nepal and India. Thus, the study pertains an immense scope in this direction.

## **4. Research Methodology**

A combination of descriptive and explorative research design has been employed in course of this study. Based on the secondary data, the study has made an attempt to derive a firm view with regard to the established objectives of this study. Data and information with regard to trade and treaties between Nepal and India have been used from the published and unpublished research papers, books, periodicals, journals, Internet websites and official sources.

## **5. Limitations of the Study**

This study has been carried out with an aim to explore trade relation between Nepal and India. In view of the time frame and emerging issues on Indo-Nepal trade, this study has focused the trade activities after the execution of the Treaty of Trade, 1996. Therefore, trade

statistics have been used and analyzed accordingly. In course of this study, several visits to the concerned institutions and offices were made, viz. CII, FICCI and the Ministry of External Affairs. However, the nature of this study has been primarily a desktop study. As it has already been stated that this study has to carry out within a specified limited time period, it could not incorporate the views and opinions of the business communities and civil society on the sphere of Indo-Nepal trade related issues. However, attempts have been made to incorporate the outputs of formal and informal discussions.

## **6. Organization of the Study**

This study has been divided into six chapters. A brief note on the economic relationship between Nepal and India accompanied by an overview of economic reforms and macroeconomic performance of the both countries is presented in the first chapter. This chapter further chalks out the basic framework of this study consisting of objectives, limitations and scope of the study. The second chapter deals with various aspects on Indo-Nepal trade relation. By and large, it includes the trade structure, trend and balance of payments situation between the two countries. Attempts have been made to analyze the provisions made in the bilateral trade and transit treaties in view of the economic cooperation in the third chapter. It has also been made an effort to analyze the impact of the bilateral treaties with the focus on treaties of 1990s onward. Realizing the significant role to be played by the trade-points in the future towards the development of bilateral and multilateral trade, chapter four deals in these aspects of the both countries. Chapter five has made an attempt to draw the problems that are being realized in the contemporary situation. Moreover, the challenges and prospects for the development of trade and improving bilateral trade relation between the two countries are discussed in this chapter. Both the countries are facing the similar problems of imbalance trade i.e. the problem of increasing trend of trade deficit. Unfavorable balance of payments, indeed, could react in the national economy in many respects. Therefore, chapter six of this study identifies the scope and some areas to improve the bilateral trade. Finally, the chapter seven provides the summary and conclusion of the study followed by the policy recommendations towards improving the trade structure as well as the trade relation between Nepal and India.



## **Chapter II**

### **Nepal-India Trade Relations**

#### **2.1. Indo-Nepal Economic Relations**

India is extending economic and technical support to Nepal for almost for decades since 1951. India was the most important donor to Nepal in the early decades after the independence of India. The signing of the India-Nepal Treaty of Peace and Friendship in 1950 established the framework for the unique ties between the two countries. Since the early fifties, India has contributed significantly to the economic development of Nepal. Beginning with major irrigation projects such as the Koshi and Gandak barrages, Indian assistance has significantly contributed to the development of the economic structure in Nepal. Areas of economic relation were mainly confined to the basic infrastructure which cover; airports, irrigation, agriculture, supply of drinking water, roads, bridges, power projects, health, industrial estates, communication, surveys, education, forestry, building construction, ex-servicemen welfare etc. Many of the projects were associated with the areas of infrastructure building. Sharma (1995) remarks that most of the projects financed by India were undertaken between 1951 and 1984. It is noteworthy that Nepal stepped into an economic liberalization in 1984. The number of aided projects gradually declined after 1985. However, the economic cooperation continues to exist. Mohana Bridge (1990), Western Sector 203 km. Mahendra Rajmarga (1992), supply of equipments and its further expansion (1990), Telephone Exchange of Rangeli (1993) are some of the projects undertaken after 1985. Assistance in the areas of water supply, medicine packets, financial assistance to cooperatives, scholarships and educational assistance being the other economic cooperation.<sup>1</sup>

Indian assistance to Nepal has increased over the years. From the assistance of an average of IRs. 150 million in the mid-1980s, it has reached to IRs. 750 million in 1999/2000. So far over 120 agreements and letters of exchange have been concluded for Indian aided projects in Nepal totaling over IRs. 4000 million. These figures do not include the supply of subsidized commodities such as rice, sugar, cement, fertilizers, petrochemical etc., refund of excise duty levied on items exported from India, IRs 500 million stand-by credit facility etc. During the year 2000-2001, the utilization was approximately NRs. 450 million. A High Level Task Force (HLTF) has also been formed to oversee progress in Indian-assisted Projects to Nepal. A number of projects including improving physical facilities and infrastructure at important border customs stations and check-posts, pilot projects in rural and community development, small -medium hydro-power project, milk and dairy development, development of an Information Technology Institute etc. are some of the agreed projects. B. P Koirala Institute for Health Sciences at Dharan and 22 Bridges on the Mahakali-Kohalpur sector of the East-West Highway are two projects recently completed. During the SAARC summit held on January 3-6, 2002 a grant of NRs. 800 million was announced by the Prime Minister of India for developmental projects in the social sectors including health, education and rural development of Nepal.<sup>2</sup> India's other major commitments in Nepal are the setting up of an Emergency and Trauma Centre at the Bir Hospital and the Mahendranagar-Tanakpur Link Road Project. The Raxaul-Birgunj Broad Gauge Rail Link Project (5.3 kms.) is another Project in this category. Therefore there is a clear indication that Nepal and India are having cordial economic relationship from quite a long time back.

#### **2.2 Indo-Nepal Trade Relations**

Studies undertaken in the field of Indo-Nepal trade relation have revealed that both the countries have a historical trade relationship and are continuing quite smoothly. An attempt

has been made in this study to analyze the trade structure and trade trends between the two countries in the following sections.

### **2.2.1. Historical Perspective**

Indo-Nepalese trade relations can be traced back to ancient times. Kautilya (400 B.C.), great economist of that time, mentions Nepal as the principal exporter of woolen goods. Increased trade activities were seen between northern India and Nepal during the golden age of Guptas (beginning in 320 A.D.). During the Nepal-Tibet war of 1791, the East India Company proposed a 7-clause treaty under which imports and exports of goods between India and British India would be subject to 2.25 per cent customs duty. A peace treaty of Sugauli in 1816 enabled the British to enter the Nepalese markets.<sup>3</sup>

In the early days, foreign trade of Nepal was limited mainly with India and Tibet. The only trade route in between India and Tibet was through Nepal. It had helped very much in developing trade of Nepal. However, major proportion of the Nepalese trade was with India. Trade with Tibet was focused for meeting the basic requirements in the Himalayan and hilly region, whereas trade with India consisted of export and import of several agricultural, mineral and forest products. Before the nineteenth century, imports from India consisted of a few items of which scrap metals, precious stones, spices, tobacco etc. were among them. Whereas Nepal exported most of her primary products like timber, rice, ghee etc. Nepal's trade with India continued till 1923 without having a trade agreement with British India. Prior to the signing of this trade agreement, British East India Company was interested to have trade relations with Nepal, for expansion of its own exports. The opening of direct India-Tibet route via Gyantse routes further promoted Nepal to develop trade with India. Moreover, the development of good transportation system and the creation of many trade centers in the northern India further helped to enhance the trade turnover between Nepal and India.

The Article VI of the first Trade Treaty between Nepal and India signed in 1923 provided that "No customs duty shall be levied at British Indian Ports as goods imported on behalf of the Nepal government for immediate transport to that country." Provision of this Article in Trade Treaty 1923 led to the development of Nepal-British trade freely through the port of British India for Nepal could not import goods from other overseas countries. Nepal was compelled to purchase goods manufactured in Britain.<sup>4</sup> Nepal was very much isolated from other countries, especially from the developed Western countries prior to the political change of 1951. Before 1950, Nepal had an open interaction with Tibet where Nepalese currency was on circulation. Trading arrangements between Nepal and Tibet too was unrestricted. As a result there was an easy movement of man and materials. There appeared a break in all these, however, after 1951 when Nepal tilted more towards the southern India.<sup>5</sup>

The pattern of Nepal's trade with India remained more or less the same during the 19<sup>th</sup> century and first half of the 20<sup>th</sup> century. Exports to India mainly consisted of food grains, raw jute, wool, cotton, hides and skins, musk, medicinal herbs, cardamom, metal goods, ghee, tobacco etc. Imports from India used to consist of mainly the agricultural products such as wheat, rice, gram and pulses, iron, brass, copper, cotton goods, salt and live animals besides others. India has, thus, been a major trade partner of Nepal since a long time back. Popular and cultural ties of India with Nepal have consistently been close and have reflected in trade terms continuously.

### **2.2.2. Foreign Trade Structure: Till Early 1990s**

Nepal's exports to India comprised of 98.7 per cent of the total exports since 1956/57 to 1970/71. The same pattern was reflected in Nepal's import as well. From the year 1970/71, however, Nepal's exports to as well as imports from India started declining significantly. This was the result of trade diversification policy of Nepal, which decided to remove the over-dependence on India by increasing Nepal's trade with overseas countries. The export share of Nepal's exports to India came down to 75.4 per cent in 1975/76, 40 per cent in 1985/86, and 21 per cent in 1990/91. It further came down to a mere 9.6 per cent in 1992/93. Likewise, share of imports from India out of the total imports came down to 61.9 per cent in 1975/76. It declined to 42.5 per cent in 1985/86 and it further declined in 1995/96. The trade balance with India has also been negative and has been quite substantial.<sup>6</sup> Katti (2001) remarked that Nepal's exports to India as a percentage of total trade with India have been less than its imports from India. The percentage of exports to India in total trade with India has been declining over the years. It came down from 36.1 per cent in 1956/57 to 31.3 per cent in 1980/81. It further came down to 17.5 per cent in 1990/91 and declined still further to 11.6 per cent in 1992/93. It has experienced the reversal in the trend since 1993/94 and has gone up marginally in 1995/96. Imports from India as a percentage of total trade with India was 63.9 per cent in 1956/57 and went up to 68.7 per cent in 1980/81. There was a tendency of raising the import trend showing 82.5 per cent in 1990/91 and 88.6 per cent in 1992/93. Since then, however, there is a slight deceleration on the share of India in Nepal's total imports and it has come down to 86.5 per cent. Although it is seen a little bit ups and downs in the import trend. Nepal's import has mostly been dominated by India's export.

### **2.2.3. Foreign Trade Direction of Nepal: Onward 1990s**

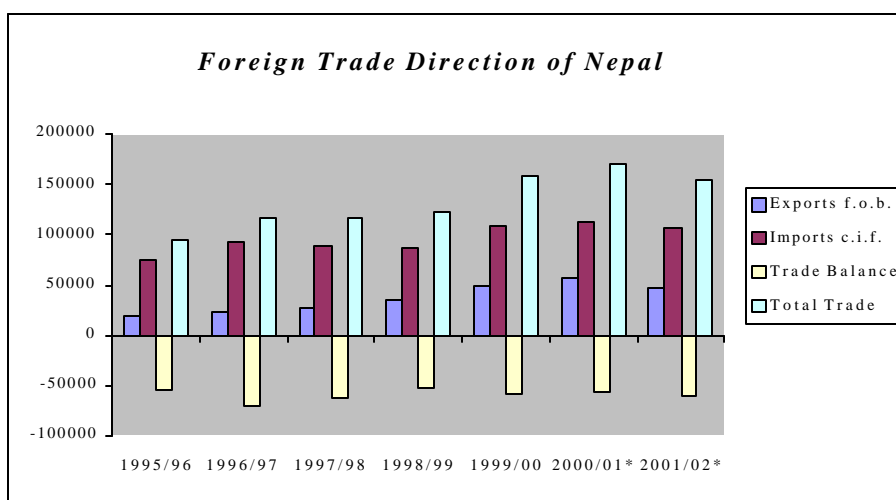
There is an indication that the total foreign trade of Nepal is continuously increasing except to the year 2001/02. However, the increasing foreign trade pattern has been at the fluctuating ratio, which can be observed in Table 1. Total foreign trade increased by 23.2 per cent in 1996/97 but it increased marginally by 0.3 per cent in 1997/98. The volume of trade went on increasing till 2000/01 but it decreased by 9.6 per cent in 2001/02. The share of India in the total foreign trade was 29.8 per cent in 1995/96 and it declined to 25.9 per cent in 1996/97. Since that year, India's share in total foreign trade has gradually been increased showing the share holdings of 43.3 per cent in 2000/01 and 48.1 per cent in 2001/02.

**Table: 1**  
**Foreign Trade Direction of Nepal**

Description	NRs. in million						
	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01*	2001/02*
<b>Exports f.o.b.</b>	<b>19881.1</b>	<b>22636.5</b>	<b>27513.5</b>	<b>35676.3</b>	<b>49822.7</b>	<b>57244.7</b>	<b>47540.4</b>
<i>Change percentage</i>	<i>12.7</i>	<i>13.9</i>	<i>21.5</i>	<i>29.7</i>	<i>39.7</i>	<i>14.9</i>	<i>-17.0</i>
India	3682.6	5226.2	8794.4	12530.7	21220.7	27304.1	28865.2
	<i>18.5</i>	<i>23.1</i>	<i>32.0</i>	<i>35.1</i>	<i>42.6</i>	<i>47.7</i>	<i>60.7</i>
Other Countries	16198.5	17410.3	18719.1	23145.6	28602.0	29940.6	18675.2
	<i>81.5</i>	<i>76.9</i>	<i>68.0</i>	<i>64.9</i>	<i>57.4</i>	<i>52.3</i>	<i>39.3</i>
<b>Imports c.i.f.</b>	<b>74454.5</b>	<b>93553.4</b>	<b>89002.0</b>	<b>87525.3</b>	<b>108504.9</b>	<b>113386.3</b>	<b>106731.3</b>
<i>Change percentage</i>	<i>16.9</i>	<i>25.7</i>	<i>-4.9</i>	<i>-1.7</i>	<i>24.0</i>	<i>4.5</i>	<i>-5.9</i>
India	24398.6	24853.3	27331.0	32119.7	39660.1	46662.3	45364.3
	<i>32.8</i>	<i>26.6</i>	<i>30.7</i>	<i>36.7</i>	<i>36.6</i>	<i>41.2</i>	<i>42.5</i>
Other Countries	50055.9	68700.1	61671.0	55405.6	68844.8	66724.0	61367.0
	<i>67.2</i>	<i>73.4</i>	<i>69.3</i>	<i>63.3</i>	<i>63.4</i>	<i>58.8</i>	<i>57.5</i>
<b>Trade Balance</b>	<b>-54573.4</b>	<b>-70916.9</b>	<b>-61488.5</b>	<b>-51849.0</b>	<b>-58682.2</b>	<b>-56141.6</b>	<b>-59190.9</b>
India	-20716.0	-19627.1	-18536.6	-19589.0	-18439.4	-19358.2	-16499.1
	<i>38.0</i>	<i>27.7</i>	<i>30.1</i>	<i>37.8</i>	<i>31.4</i>	<i>34.5</i>	<i>27.9</i>
Other Countries	-33857.4	-51289.8	-42951.9	-32260.0	-40242.8	-36783.4	-42691.8
	<i>62.0</i>	<i>72.3</i>	<i>69.9</i>	<i>62.2</i>	<i>68.6</i>	<i>65.5</i>	<i>72.1</i>
<b>Total Trade</b>	<b>94335.6</b>	<b>116189.9</b>	<b>116515.5</b>	<b>123201.6</b>	<b>158327.6</b>	<b>170631.0</b>	<b>154271.7</b>
<i>Change percentage</i>	<i>16.0</i>	<i>23.2</i>	<i>0.3</i>	<i>5.7</i>	<i>28.5</i>	<i>7.8</i>	<i>-9.6</i>
India	28081.2	30079.5	36125.4	44650.4	60880.8	73966.4	74229.5
	<i>29.8</i>	<i>25.9</i>	<i>31.0</i>	<i>36.2</i>	<i>38.5</i>	<i>43.3</i>	<i>48.1</i>
Other Countries	66254.4	86110.4	80390.1	78551.2	97446.8	96664.6	80042.2
	<i>70.2</i>	<i>74.1</i>	<i>69.0</i>	<i>63.8</i>	<i>61.5</i>	<i>56.7</i>	<i>51.9</i>

Note: \* Provisional  
 Figures in italic indicate the percentage of the total.  
 Source: FNCCI and Nepal Rastra Bank

The trend of Nepal's export trade shows an increasing trend of exports. Total export in 1995/96 was in value NRs. 19881.1 million which reached to NRs 57244.7 million in 2000/01 indicating an increase by 2.9 times in the export trade. However, the total export trade decreased in 2001/02 and stands at NRs 47540.4 million. The ratio of exports to India from Nepal shows a gradual increasing trend. It was 18.5 per cent of the total export being exported to India in 1995/96. The ratio stood at 47.7 per cent in 2000/01. It further increased in 2001/02 and the proportion of export to India reached 60.7 per cent.



Import trade of Nepal is growing over the past few years with a varying scale. Total imports raised by 25.7 per cent in 1996/97 whereas it marginally increased by 1.7 per cent in 1998/99. Again it increased by 24 per cent in 1999/2000 and slightly increased by 4.5 per cent in 2000/01. But it dropped by 5.9 per cent in 2001/02. The share of imports from India out of the total import was 32.8 per cent in 1995/96 but the share stands at 26.6 per cent in 1996/97. Since that year the share of import from India have been gradually increased. It has been 42.5 per cent in 2001/02. Trade balance with India has continuously been negative. Of the total trade balance, India claims 34.5 per cent in 2000/01 and 27.9 per cent in 2001/02.

**Table 1.1**  
**Direction of Foreign Trade**  
**(Comparison of First Six Months for Three Years)**

NRs. in million

Export/Import	First Six Months						Percent	
	2000/01*	Percent	2001/02^	Percent	2002/03^	Percent	2001/02	2002/03
<b>Total Export</b>	<b>28063.3</b>	<b>100.00</b>	<b>26362.3</b>	<b>100.00</b>	<b>23519.8</b>	<b>100.00</b>	<b>-6.1</b>	<b>-10.8</b>
India	12403.3	44.2	16506.2	62.6	12959.4	55.1	33.1	-21.5
Other Countries	15660.0	55.8	9856.1	37.4	10560.4	44.9	-37.1	7.1
<b>Total Import</b>	<b>56984.9</b>	<b>100.00</b>	<b>52426.2</b>	<b>100.00</b>	<b>57702.3</b>	<b>100.00</b>	<b>-8.0</b>	<b>10.1</b>
India	21885.8	38.4	21786.0	41.6	25188.5	43.7	-0.5	15.6
Other Countries	35099.1	61.6	30640.2	58.4	32513.8	56.3	-12.7	6.1
<b>Total Trade Balance</b>	<b>-28921.6</b>	<b>100.00</b>	<b>-26063.9</b>	<b>100.00</b>	<b>-34182.5</b>	<b>100.00</b>	<b>-9.9</b>	<b>31.1</b>
India	-9482.5	32.8	-5279.8	20.3	-12229.1	35.8	-44.3	131.6
Other Countries	-19439.1	67.2	-20784.1	79.7	-21953.4	64.2	6.9	5.6
<b>Total Foreign Trade</b>	<b>85048.2</b>	<b>100.00</b>	<b>78788.5</b>	<b>100.00</b>	<b>81222.1</b>	<b>100.00</b>	<b>-7.4</b>	<b>3.1</b>
India	34289.1	40.3	38292.2	48.6	38147.9	47.0	11.7	-0.4
Other Countries	50759.1	59.7	40496.3	51.4	43074.2	53.0	-20.2	6.4

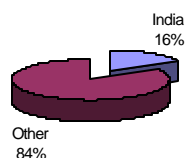
Note: \* Revised

^ Provisional

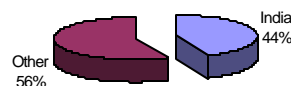
Source: Nepal Rastra Bank, Nepal's Foreign Trade Statistics, FY 2002/03, Research Department, BOP Division, Kathmandu, Nepal.

Comparison of total exports for the first six months of 2001/02 and 2002/03 (Table 1.1) shows a decline by 6.1 per cent and 10.8 per cent respectively in these years. However, the proportionate share of export to India has increased and stood at 55.1 per cent during the period in 2002/03. Similarly, proportionate share of import from India has also increased showing 43.7 per cent of the total imports.

**Proportionate Share of Export Trade:**  
**1991/92-1996/97**

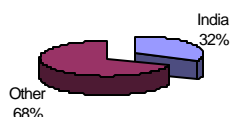


**Proportionate Share of Export Trade:**  
**1997/98-2001/02**

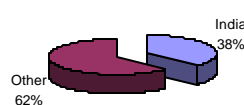


Analysis of exports and import trade of Nepal based on the averages of five years present a different picture. The proportionate share of the Nepalese export to India was 16.3 per cent for the period of 1991/92 to 1996/97. The share of export to India significantly increased and reached 43.6 per cent in the period of 1997/98 to 2001/02 out of the total export of Nepal during this period.

**Proportionate Share of Import Trade:  
1991/92-1996/97**



**Proportionate Share of Import Trade: 1997/98-  
2001/02**



Similarly, the import from India to Nepal also grew in this period but not with the same tune as that of export. The average annual import from India was 31.8 per cent in the total import of Nepal for the period from 1991/92 to 1996/97. This share percentage increased to 37.5 per cent for the period from 1997/98 to 2001/02. Significant increase in the export from Nepal to India can be seen as the consequence of favorable provisions resulted from the Treaty of Trade 1996.

#### **2.2.4. Nepal's Export Trade: Partners and Commodities**

The leading export partners of Nepal have been India, USA, Germany, United Kingdom, Belgium, France, Japan, Bangladesh, Peoples' Republic of China, Hong Kong, Switzerland, Spain, Italy and Canada over the last few years. Germany was the major country to import goods and commodities from Nepal for 1995/96 and 1996/97. (Table 2) But India has been the major country to import from Nepal since 1997/98. USA stands to be the second country in Nepal's export followed by Germany and other countries for the last couple of years. The major commodities exported by Nepal to the countries other than India include; cotton, readymade garments, woolen carpets, hide and skins, gold and silver ornaments, pulses, handicrafts, tea, cardamom, herbs, niger seeds and perfume oil. ( 1)

**Table: 2  
Major Export Trade Partners of Nepal**

		NRs. in million				
Country		1995/96	1996/97	1997/98	1998/99	1999/2000
1.	India	3682.6	5226.2	8794.4	12530.7	21220.7
2.	USA	5672.8	5930.2	7106.4	9520.3	13677.7
3.	Germany	6751.3	7651.7	6813.5	7820.7	7510.6
4.	United Kingdom	289.4	297.7	318.2	521.8	1192.4
5.	Belgium	309.9	231.2	152.7	283.3	812.1
6.	France	175.6	241.9	486.6	479.2	735.5
7.	Japan	79.0	100.3	178.5	230.8	705.0
8.	Bangladesh	385.5	497.9	595.0	1296.3	561.1
9.	China P.R. *	549.3	625.1	621.1	558.7	514.3
10.	Hong Kong	28.6	21.1	17.8	31.0	504.3
11.	Switzerland	445.2	346.5	234.9	281.5	418.5
12.	Spain	182.9	156.6	194.8	180.5	301.3
13.	Italy	356.6	348.3	461.8	385.0	300.0
14.	Canada	112.0	164.7	97.0	156.1	285.0
15.	Netherlands	127.6	174.2	129.8	159.1	193.3
16.	Austria	196.4	309.2	329.4	330.9	187.5
17.	Singapore	40.9	22.8	28.7	17.6	174.8
18.	Australia	40.4	58.5	81.7	101.6	109.9
19.	Sweden	71.8	170.9	151.5	78.8	95.7
20.	Korea R.	28.1	33.8	17.3	6.4	61.5

Note: Ranking is applicable for the year 1999/2000 only.

\*China P.R. includes Tibet

Source: FNCCI, Nepal Rastra Bank and Trade Promotion Centre

The share of Nepal's export to SAARC member countries was 25.4 per cent of the total export trade in 1996/97. The share gradually increased over the last few years and stood at 43 per cent in 1999/2000. (Table 3) Among the SAARC member countries, India has been the major country to import by virtue of importing more than 90 per cent of the total export of Nepal. Major commodities exported to India include; vanaspati ghee, polyester yarn, pulses, twines, snacks, cardamom, noodles, vegetables, live animals, hide and skins, ginger, catechu, oil cakes, tooth paste, toilet soap, herbs, rosin, rice bran oil and cattle feed. ( 2) Bangladesh has been the second after India to import from Nepal in this region. Pakistan, Sri Lanka and Bhutan are also importing from Nepal but at a very low scale. In recent years, Maldives has also started to import goods and commodities from Nepal.

**Table: 3**  
**Nepal's Export to SAARC Member Countries**

NRs. in thousands

Country	1995/96		1996/97		1997/98		1998/99		1999/2000	
	Value	Percent	Value	Percent	Value	Percent	Value	Percent	Value	Percent
Bangladesh	385535	9.43	497948	8.66	594981	6.10	1296282	9.34	127554	0.60
Bhutan	47	-	566	0.01	6364	0.07	24349	0.18	41807	0.19
India	3682600	90.08	5226200	90.88	8794400	90.22	12530700	90.30	21220700	99.18
Maldives	-	-	1	-	3	-	-	-	225	-
Pakistan	3032	0.07	19898	0.34	51505	0.53	21933	0.16	5857	0.03
Sri Lanka	17117	0.42	6243	0.11	300626	3.08	3186	0.02	306	-
Total to SAARC	4088331	100.00	5750856	100.00	9747879	100.00	13876450	100.00	21396449	100.00
Total Export	19881100		22636500		27513500		35676300		49822700	
Total Export to SAARC in percent	20.56		25.41		35.43		38.90		42.95	

Source: FNCCI, Nepal Rastra Bank and Trade Promotion Centre

Nepal's export products include various products. However, the major export products have been readymade garments, woolen carpets, woolen and pashmina goods, vegetable ghee, toothpaste, jute and jute goods, pulses, polyester yarns, hide skins and handicrafts. Among many export products, woolen carpets used to be the prime export product of Nepal. The share of woolen carpets in the total export of Nepal comprises 40.4 per cent in 1995/96 and 1996/97. Since 1997/98, the share of woolen carpets in Nepal's total export trade is declining. The share of this product in the total export trade was 27.8 per cent and 20.9 per cent in the year 1998/99 and 1999/2000 respectively.

**Table: 4**  
**Share of Selected Commodities in Total Export**

NRs. in million

S.N.	Description	1995/96		1996/97		1997/98		1998/99		1999/00	
		Value	%	Value	%	Value	%	Value	%	Value	%
1.	Readymade Garments**	5417	27.2	5620	24.8	6800	24.7	8195	22.6	11128	22.3
2.	Woolen Carpets*	8032	40.4	9145	40.4	8516	31.0	9927	27.8	10405	20.9
3.	Woolen & Pashmina Goods**	n.a.	n.a.	n.a.	n.a.	208	0.8	730	2.0	7079	14.2
4.	Vegetable Ghee***	n.a.	n.a.	n.a.	n.a.	1580	5.7	2898	8.0	2743	5.5
5.	Tooth Paste***	309	1.6	384	1.7	823	3.0	1291	3.6	2263	4.5
6.	Jute & Jute Goods***	489	2.5	572	2.5	725	2.6	872	2.4	1104	2.2
7.	Toilet Soap***	n.a.	n.a.	n.a.	n.a.	569	2.1	725	2.0	1084	2.2
8.	Pulses**	692	3.5	1008	4.5	1068	3.9	1189	3.3	1047	2.1
9.	Polyester Yarn***	238	1.2	326	1.4	549	2.0	371	1.0	630	1.3
10.	Hides/Skins**	593	3.0	481	2.1	612	2.2	413	1.1	352	0.7
11.	Handicrafts**	177	0.9	237	1.0	275	1.0	343	0.9	344	0.7
	Percentage Share in Total Export		80.3		78.4		79.0		74.7		76.6

Notes: 1. \*Exclude India \*\*Include India \*\*\* India Only

2. n.a. Implies not available

3. Handicrafts do not include paper & Products, wooden products, silverware and jewellery

Source: FNCCI, Nepal Rastra Bank and Trade Promotion Centre

Readymade garments have been another major export product of Nepal. The share of readymade garments in the total export has been almost at the same scale with a little variance as it was 22.6 per cent in 1998/99 and 22.3 per cent in 1999/2000.

Exports of Nepal mainly comprise of manufactured goods and articles by SITC (Standard Industry Trade Classification) group. The share of products included in this group claimed 60.8 per cent of the total in 2001/02. Export of products in this group further increased in 2002/03 and reached 68.9 per cent. Food and live animals, chemicals and drugs, animals and vegetables oils and fats, and crude materials are some other products exported under the SITC group.

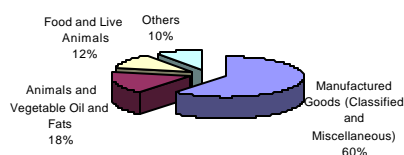
**Table: 5**  
**Nepal's Export Trade by SITC Group**

SN	SITC Group	NRs. in million				% Change
		2001/02*		2002/03*		
		Value	%	Value	%	
1.	Food and live animals	3051.8	11.6	3096.4	13.2	1.46
2.	Tobacco and beverages	65.4	0.2	60.4	0.3	-7.65
3.	Crude materials, inedible except fuels	502.7	1.9	360.0	1.5	-28.39
4.	Mineral, fuel and lubricants	0.3	0	6.1	0	1933.33
5.	Animals and vegetable oil and fats	4769.4	18.1	2150.2	9.1	-54.92
6.	Chemicals and drugs	1742.5	6.6	1478.6	6.3	-15.14
7.	Manufactured goods classified chiefly by materials	9529.7	36.2	8020.9	34.1	-15.83
8.	Machinery and transport equipment	217.5	0.8	124.0	0.5	-42.99
9.	Miscellaneous manufactured articles	6483.0	24.6	8182.7	34.8	26.22
10.	Commodity and transactions not classified according to kind	0.0	0	40.5	0.2	100.00
	Total	26362.3	100.00	23519.8	100.00	-10.8

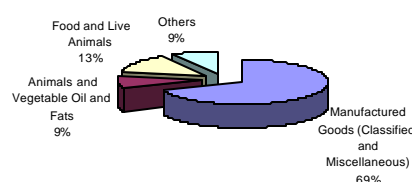
\* Provisional for the first six months

Source: Nepal Rastra Bank, Nepal's Foreign Trade Statistics, FY 2002/03, Research Department, BOP Division, Kathmandu.

**Share of Selected Commodity Group in Export Trade: 2001/02**



**Share of Selected Commodity Group in Export Trade: 2002/03**



### 2.2.5. Nepal Import Trade: Partners and Commodities

Nepal imports her commodity requirements from different countries. India, Peoples' Republic of China, Switzerland, Singapore, Hong Kong, Japan, Korea Republic, Thailand, Malaysia, Indonesia and Kuwait have been the major import trade partners of Nepal. However, it is noteworthy that India has been the country from where imports are made comparatively to a large extent.



**Table: 6**  
**Major Import Partners of Nepal**

NRs. in million

Country	1995/96	1996/97	1997/98	1998/99	1999/2000
1. India	24398.6	24853.3	32119.7	32119.7	39660.1
2. China P.R. *	4067.4	4334.5	5268.4	5252.1	12530.1
3. Switzerland	119.5	2321.2	1885.5	7545.2	10193.4
4. Singapore	10563.3	9943.4	12640.4	9679.0	8013.4
5. Hong Kong	11706.1	20242.5	9283.7	4947.1	6801.3
6. Kuwait	1222.0	87.2	1602.5	1342.1	2974.9
7. Japan	4551.2	3955.3	2751.6	2251.5	2891.9
8. Korea R.	1099.6	993.9	1862.0	1956.2	2794.8
9. Indonesia	563.3	865.0	1351.4	1157.7	2242.9
10. Thailand	1030.3	1632.3	1735.8	1565.9	2211.0
11. Malaysia	607.1	818.5	1163.3	1779.8	2203.9
12. UAE	923.1	5572.4	4322.2	2763.3	1991.3
13. Saudi Arabia	1042.0	1691.8	1901.6	1431.0	1979.5
14. France	513.7	317.6	463.4	1043.3	1920.3
15. USA	765.6	862.3	1357.7	1317.9	1713.0
16. Germany	2455.0	1148.6	1498.6	1463.4	1499.7
17. New Zealand	2357.2	2203.2	1515.3	1785.3	1470.2
18. United Kingdom	1024.3	3147.0	1312.6	1639.5	1462.5
19. Italy	186.2	346.8	1367.6	603.7	909.7
20. Argentina	367.1	190.1	92.1	1106.0	934.8

Note: Ranking is applicable for the year 1999/2000 only.

\*China P.R. includes Tibet

Source: FNCCI, Nepal Rastra Bank and Trade Promotion Centre

Nepal imports more than 30 per cent of her requirements from SAARC region. But the major country to import has been India from where more than 95 per cent of her requirements are fulfilled. Apart from India, commodities are imported from Bangladesh and Pakistan too but the percentage of imports from these countries is very low.

**Table: 7**  
**Nepal's Import from SAARC Member Countries**

NRs. in thousands

Country	1995/96		1996/97		1997/98		1998/99		1999/2000	
	Value	%	Value	%	Value	%	Value	%	Value	%
Bangladesh	679647	2.69	439918	1.72	365606	1.29	614215	1.84	561130	1.38
Bhutan	29936	0.12	28040	0.11	21857	0.08	54959	0.17	39991	0.10
India	24398600	96.55	24853300	97.00	27331000	96.79	32119700	96.11	39660100	97.80
Maldives	-	-	-	-	2	-	57	-	69	-
Pakistan	135091	0.53	208025	0.81	381726	1.35	577910	1.73	240926	0.59
Sri Lanka	26934	0.11	92920	0.36	137682	0.49	50967	0.15	52173	0.13
Total Import from SAARC	25270208	100.00	25622203	100.00	28237873	100.00	33417808	100.00	40554389	100.00
Total Import	74454500		93553400		89002000		87525300		108504900	
Total Import from SAARC in percent	33.94		27.39		31.73		38.18		37.38	

Source: FNCCI, Nepal Rastra Bank and Trade Promotion Centre

Due to the production of limited domestic products on the one hand, and the increasing requirements of commodities and products, the country needs to import from different countries. Nepal imports crude palm oil, kerosene, diesel, petrol, chemical fertilizers, copper wire rod, scraps and sheets, machineries and parts, polythene granules, computer and parts, transport vehicles and parts, electrical equipments and goods, telecommunication equipments

and parts, raw wool, television, deck and parts among many from the countries other than India. ( 3) Similarly, the country imports transport vehicles and spare parts, medicine, cotton textiles, cement, mechanical equipments and spare parts, petroleum products, chemicals, electrical equipments and goods, coal, vegetables, pulses, paper, tobacco, salt and milk products from India besides many other products. ( 4) Looking at the products and items being imported from India, it is seen that Nepal imports raw products, semi-finished and finished products to fulfill the demands of the people and also to fulfilling development needs.

From the aspect of SITC group, Nepal's major import has been manufactured goods, which constitute 31.2 per cent and 30.1 per cent for the year 2001/02 and 2002/03 respectively. Machinery and transport equipment stands as the second largest group to import, which constitutes 17.5 per cent and 16.2 per cent in 2001/02 and 2002/03 respectively. Similarly, minerals, fuel and lubricants, food and live animals, chemical and drugs, animals and vegetable oil and fats have been the major products and items being imported by Nepal.

**Table: 8**  
**Nepal's Import Trade by SITC Group**

NRs. in million

S. N.	SITC Group	2001/02*		2002/03*		% Change
		Value	%	Value	%	
1.	Food and live animals	3564.0	11.6	4593.7	13.2	28.89
2.	Tobacco and beverages	421.7	0.2	430.4	0.3	2.06
3.	Crude materials, inedible except fuels	3428.9	1.9	3059.1	1.5	-10.78
4.	Mineral, fuel and lubricants	6496.1	0	9197.3	0	41.58
5.	Animals and vegetable oil and fats	4113.1	18.1	3410.1	9.1	-17.09
6.	Chemicals and drugs	6469.3	6.6	6835.8	6.3	5.67
7.	Manufactured goods classified chiefly by materials	16377.1	36.2	17338.1	34.1	5.87
8.	Machinery and transport equipment	9167.0	0.8	9362.8	0.5	2.14
9.	Miscellaneous manufactured articles	2377.2	24.6	2946.8	34.8	23.96
10.	Commodity and transactions not classified according to kind	11.8	0	528.2	0.2	4376.27
	Total	52426.2	100.00	57702.3	100.00	10.1

\* Provisional for the first six months

Source: Nepal Rastra Bank, Nepal's Foreign Trade Statistics, FY 2002/03, Research Department, BOP Division, Kathmandu.

### 2.2.6. Shares in Total Trade and Trade Deficit

Bilateral trade with India is indispensable to Nepal. As such, the volume of trade with India used to be in a large volume. As a result, the share of India in the total volume of the Nepalese trade used to be comparatively in large proportion. But the share of India declined particularly in the year 1996 and remained below 39 per cent up to 1999/2000. Alternatively, it suggests that trade with other countries was extended. Therefore, the share of other countries in the total volume of the Nepalese trade remained above 52 per cent in the review period. The largest proportionate trade share of these countries were in between the year 1995/96 to 1997/98 registering around 70 per cent of the total trade.

**Table: 9**  
**Nepal's Trade Share and Trade Deficit**

Fiscal Year	Trade with India In %	Trade with Other Countries In per cent	Total Trade Deficit to Total Trade in NRs. in million	Change In %	Trade Deficit With India NRs. in Million	Change In %	Trade Deficit With Other Countries NRs. in Million	Change In %
1995/96	29.8	70.2	-54573.4	12.0	-20716.0	25.6	-33857.4	14.6
1996/97	25.9	74.1	-70916.9	30.0	-19627.1	-5.3	-51289.8	51.5
1997/98	31.0	69.0	-61488.5	-13.3	-18536.6	-5.6	-42951.9	-16.3
1998/99	36.2	63.8	-51849.0	-15.7	-19589.0	5.7	-32260.0	-24.9
1999/00	38.5	61.5	-58682.2	13.2	-18439.4	-5.9	-40242.8	24.7
2000/01	43.3	56.7	-56141.6	-4.3	-19358.2	5.0	-36783.4	-8.6
2001/02	48.1	51.9	-59190.9	5.4	-16499.1	-14.8	-42691.8	16.1

Based on Table 8

The trend of total trade deficit indicates of not being increased extensively since 1996/97. In that year the deficit was increased by 30 per cent to that of previous year. Trade deficit of Nepal with India is constantly lowering since the year 1996/97 whereas this trend is at the varying scale in the case of other countries. Among the many reasons, it has been identified that a move towards freer trade or favorable environment for the Nepalese export to Indian market could be some of them for the decreasing scale of trade balance with India.

### 2.2.7. Trade Deficit with India

Nepal imports goods and articles from India in high volume in comparison to the volume of exports. Therefore, India enjoys a substantial balance of trade with Nepal. However, the balance of trade trend presents a varying picture for some years. Trend analysis of the trade balance indicates that the ratio of deficit was at the increasing trend till early 1990s. But the ratio declined substantially onward mid-1990s.

**Table: 10**  
**Nepal's Trade Deficit with India**

Year	Export (f.o.b.) to India	Import (c.i.f.) from India	NRs. in million	
			Trade Deficit with India	Percentage Change
1991/92	1450.0	11245.5	-9795.5	69.7
1992/93	1621.7	12542.1	-10920.4	11.5
1993/94	2408.9	17035.4	-14626.5	33.9
1994/95	3124.3	19615.9	-16491.6	12.8
1995/96	3682.6	24398.6	-20716.0	25.6
1996/97	5226.2	24853.3	-19627.1	-5.3
1997/98	8794.4	27331.0	-18536.6	-5.6
1998/99	12530.7	32119.7	-19589.0	5.7
1999/00	21220.7	39660.1	-18439.4	-5.9
2000/01*	27304.1	46662.3	-19358.2	-5.0
2001/02*	28865.2	45364.3	-16499.1	-14.8

\* Provisional

Source: Economic Survey 2001/02, MOF, FNCCI and Nepal Rastra Bank

It is noticeable from the Table 10 that the trade balance ratio went on increasing till the fiscal year 1995/96 significantly in favour of India on the basis of year-to-year comparison. In the fiscal year 1995/96, trade deficit ratio was 25.6 per cent. But the ratio of trade deficit fell

immediately in the next fiscal year, i.e. 1996/97. Onward to this fiscal year, it can be seen that the ratio came down in the subsequent fiscal years except the year 1998/99. It is estimated that the ratio of trade deficit decreased by 14.8 per cent. It may be seen, of course, as the positive effects of the Indo-Nepal Treaty of Trade, 1996.

### 2.3. Foreign Trade of Nepal and India: Growth and Trends

Nepal and India shares some common characteristics. Both the countries are developing and are members of SAARC. Both of them have adopted economic liberalization policy for achieving economic development at a desired level. Moreover, both the countries are committed towards diversifying trade related activities through trade liberalization policy. India has already become the member of World Trade Organization (WTO) to seek advantages of trade specialization and competitive international trade. Nepal, on the other hand, has already applied for the membership of WTO and is expected to become a member in the near future. Nepal and India, being neighboring countries and situated in the South Asian region (SAR), are facing identical problems in many respects and also the problem of achieving an accelerated economic growth. Furthermore, both the countries are facing the problem of negative trade balance. As such, they often struggle with the management of foreign currency, which depends much upon their respective foreign trade structure i.e. the quantum of export and import and their growth. And it is noteworthy that trade relation depends much more on the structure and growth of a country's trade.

#### 2.3.1. Growth Pattern of Trade

Growth rates of merchandise trade of the South Asian region (SAR) has been at a varying scale for different years in 1990s (Table 9). Nepal and India cannot be aloof from that trade pattern. In the case of Nepal, export trade was at its highest level in 1992 registering a growth by 56.1 per cent and came down gradually in the mid-1990s. Export trade again improved towards the end of 1990s. To the reversal, the import trade was slowed in the early 1990s. It peaked up in the mid-1990s and declined in the late 1990s. However, a positive growth by 20.1 per cent was recorded in 2000. The major exports of Nepal include the agricultural, forestry and related products; finished products, by-products and miscellaneous ( 5) whereas the imports include food and spices; industrial raw materials; construction materials; petroleum products; transport, vehicles and communication equipments; agricultural machinery, tools and fertilizer; medicine, medical equipment and tools; textile and apparels and miscellaneous.

**Table: 11**  
**Growth Rates of Merchandise Trade of Nepal and India**

(in per cent)

Year	South Asia		Nepal		India	
	Export	Import	Export	Import	Export	Import
1991	5.2	-11.8	12.8	-0.2	-1.1	-24.5
1992	8.0	9.2	56.1	15.8	3.3	10.3
1993	15.3	14.3	18.0	14.9	20.2	15.1
1994	21.3	38.7	3.6	21.9	18.4	34.3
1995	20.2	21.6	-9.7	21.7	20.3	21.6
1996	6.5	12.5	1.9	5.8	5.6	12.1
1997	4.8	2.3	10.2	21.6	4.5	4.6
1998	-0.1	-5.7	11.9	-12.4	-3.9	-7.1
1999	5.8	10.5	18.2	-10.3	11.6	16.5
2000	15.5	11.4	42.3	20.1	17.0	13.0

Source: RIS (2002), South Asia Development & Cooperation Report 2001/02, p. 83

In the case of India, the export growth grew at a slow pace in the early 1990s. It gradually peaked up in the mid-1990s. Again the export trade declined in the late 1990s. But the trade peaked up towards the end of 1990s. Import trade moderately increased in the early 1990s. It was at the highest in the mid-1990s. The growth of trade came down in the late 1990s. But it gained its pace again towards the end of 1990s. Principal exports of India include the agricultural and allied products, ores and minerals, manufactured goods, mineral fuels and lubricants and others. ( 6) The major imports of India include food and live animals; cereals and cereal preparations; raw materials and intermediate manufactures; petroleum products; animal and vegetable oils and fats; fertilizers and chemicals; pulp and paper; iron and steel; electrical machinery, apparatus and appliances; transport equipment and others.

**Table: 12**  
**Growth and Instability in Trade Flows**

	Export Growth (in per cent)				Import Growth (in per cent)			
	1991-2000	1991-92	1993-95	1996-2000	1991-2000	1991-92	1993-95	1996-2000
South Asia	10.3 (0.7)	6.6 (0.3)	18.9 (0.2)	6.5 (0.9)	10.2 (1.4)	-1.0 (11.4)	24.9 (0.5)	6.2 (1.3)
Nepal	16.5 (1.2)	34.5 (0.9)	4.0 (3.5)	16.9 (0.9)	9.9 (1.4)	7.8 (1.5)	19.5 (0.2)	5.0 (3.3)
India	9.6 (0.9)	1.1 (2.8)	19.6 (0.1)	7.0 (1.1)	9.6 (1.7)	-7.1 (3.5)	23.7 (0.4)	7.8 (1.2)

Note: Coefficients of variation are given in parentheses.

Source: RIS (2002), South Asia Development & Cooperation Report 2001/02, p. 84

Growth rates of trade for the both countries present ups and downs. (Table 12) For Nepal, 1992-93 was the peak period during which exports grew at a robust rate of 34.5 per cent followed by a phase of low growth of 4 per cent during mid-1990s and a quick recovery during the late 1990s with an average rate of nearly 17 per cent. Whereas, India witnessed an increase of 19.6 per cent in export growth rate in the mid-1990s followed by a decline in the late 1990s.<sup>7</sup> The growth rate of import trade, however, portrays the similar trend as of the export trade.

### **2.3.2. Regional Foreign Trade of Nepal and India: A Comparison**

The regional foreign trade of the both countries, Nepal and India, is changing its structure. Specifically the regional export and import trade of Nepal has been drastically changed. (Table 13) Out of the total export of Nepal, 88.3 per cent was exported in the industrial countries whereas 11.7 per cent was exported to the developing countries in 1991. But the export to the developing countries significantly increased in 1999 and reached to 38.7 per cent. Exports to industrial countries came down to 59.8 per cent in the same year. This trend is also seen in Nepal's import. In 1991, imports from the industrial countries comprised of 44 per cent and 56 per cent from the developing countries. By the end of 1999, imports from industrial countries dropped and stands at 10.6 per cent whereas imports from the developing countries rose significantly and reached 87.9 per cent. Most of the import and export trade of Nepal have been with USA, EU and Japan among the industrial countries whereas South Asia, East Asia and China among the developing countries.

**Table: 13**  
**Regional Foreign Trade of Nepal and India**

(In per cent)

	Industrial Countries	Of which			Developing Countries	Of which							Others
		USA	EU	Japan		Africa	Asia	South Asia	East Asia & China	East Europe	Middle East	Latin America	
<b>Exports of Nepal</b>													
1991	88.3	23.7	58.0	0.8	11.7	0.0	11.7	8.2	2.7	0.9	3.3	0.0	0.0
1995	88.9	30.6	49.9	0.6	10.8	0.0	10.2	9.3	0.0	0.0	1.3	0.3	0.3
1999	59.8	30.8	24.6	0.9	38.7	0.0	31.6	29.5	1.9	0.4	0.0	6.7	1.7
<b>Exports of India</b>													
1991	57.7	16.3	28.3	9.3	39.7	2.6	15.4	3.5	11.7	11.3	9.7	0.4	3.1
1995	54.7	17.4	27.0	7.0	41.2	4.4	21.9	5.1	16.4	4.9	8.9	0.8	5.0
1999	56.6	22.2	25.1	5.2	40.5	4.6	20.6	5.1	14.1	3.8	9.0	1.4	9.2
<b>Imports of Nepal</b>													
1991	44.0	1.4	12.2	21.6	56.0	0.0	53.0	19.8	33.2	0.4	2.4	0.0	0.2
1995	27.4	1.5	9.7	8.9	72.6	0.0	69.9	17.5	52.5	0.8	1.5	0.5	0.0
1999	10.6	1.6	5.1	1.9	87.9	0.0	65.5	31.7	32.4	0.4	8.7	13.1	3.1
<b>Imports of India</b>													
1991	52.1	9.7	29.9	7.0	37.1	4.7	9.2	0.5	8.1	4.3	17.2	1.6	11.6
1995	48.4	9.7	25.9	6.5	45.6	4.6	13.9	0.6	12.7	4.3	21.4	1.3	6.8
1999	45.8	9.0	26.6	5.9	53.3	6.5	26.0	0.9	23.3	4.4	14.7	2.3	2.2

Source: RIS, South Asia Development & Cooperation Report 2001/02, p. 99

The structure of export and import trade of India is found not much fluctuating during 1991-99. Exports to industrial countries in 1991 were 57.7 per cent, which declined marginally in 1999 and comprised of 56.6 per cent. Exports to developing countries were 39.7 per cent and 40.5 per cent respectively for the corresponding years. Imports from the industrial countries are seen gradually decreased. It was 52.1 per cent in 1999 whereas it came down to 45.8 per cent in 1999. On the other hand, imports from developing countries are increasing. It was 37.1 per cent in 1991, which reached to 53.3 per cent in 1999. India imports from Africa, South Asia, East Asia and China, East Europe, Middle East, Latin America and other countries. But Nepal, notably, imports a great deal from Asia as compared to East Europe and Latin America. Nepal's foreign trade with Asia is at an increasing trend, particularly with India. The share in export trade with India is increasing rather at a slow pace.

**Table: 14**  
**Nepal's Export & Import Trade:**  
**Their Share with India and Other Countries**

In percentage

Description	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
Export as percentage of Total Trade	21.1	19.5	23.6	29.0	31.5	33.5
Import as percentage of Total Trade	78.9	80.5	76.4	71.0	68.5	66.5
Export to India as percentage of Total Trade with India	13.1	17.4	24.3	28.1	34.9	36.9
Import from India as percentage of Total Trade with India	86.9	82.6	75.7	71.9	65.1	63.1
Export to Other Countries as percentage of Total Trade with Other Countries	24.4	20.2	23.3	29.5	29.4	31.0
Import from Other Countries as percentage of Total Trade with Other Countries	75.6	79.8	76.7	70.5	70.6	69.0

Note: Figures for the year 2000/01 are provisional

Source: FNCCI and Nepal Rastra Bank

In 1996/97, the share of export as a percentage of total trade was 19.5 per cent. It has reached to 33.5 per cent in 2000/01. In the same year export to India as a percentage of total trade with India registered 36.9 per cent. As compared to export, the share of import with India has

been significant. Import from India as the percentage of total trade was 80.5 per cent in 1996/97. But the share in total import is declining marginally every year. However, imports from India as a percentage of total trade stands still at 66.5 per cent. Likewise, imports from India as a percentage of total trade with India still remains at 63.1 per cent. It suggests the significant role of India in the overall foreign trade of Nepal.

The volume of foreign trade of both the countries are at the increasing trend with an exception to certain year. The import trade is exceeding as compared to the export trade in both the countries. As such they are facing the similar problem of negative trade balance. In comparison to Nepal, India is improving in its foreign trade structure. Therefore, the trade balance of India is gradually tends to be improving than the picture of Nepalese trade balance.

**Table: 15**  
**Export, Import & Trade Balance: Compare of Nepal and India**

in 10 million

Fiscal Year	Export		Import		Trade Balance	
	Nepal <sup>a</sup>	India <sup>b</sup>	Nepal <sup>c</sup>	India	Nepal	India
1995/96	1988.1	106353	7445.5	122678	-5457.4	-16325
1996/97	2263.7	118817	9355.3	138920	-7091.6	-20103
1997/98	2751.4	130100	8900.2	154178	-6148.8	-24076
1998/99	3567.6	139752	8752.5	178332	-5184.9	-38580
1999/00	4982.3	159561	10850.5	215236	-5868.2	-55675
2000/01	5724.5	203571	11338.6	230873	-5614.1	-27302
2001/02	4754.0 <sup>d</sup>	209018	10673.1 <sup>d</sup>	245199	5919.1 <sup>d</sup>	-36181

Note: Values of Nepal and India represent NRs. and IRs. respectively.

<sup>a</sup> value in f.o.b.

<sup>b</sup> includes re-export

<sup>c</sup> value in c.i.f.

<sup>d</sup> provisional

Source: FNCCI, Economic Survey (2001/02), Ministry of Finance, Nepal and DGCI&S, India

The trend of export trade of Nepal continued to rise from 1995/96 to 1999/2000. Export trade in 1995/96 was increased by 12.7 per cent. Showing a tendency of increased trade, it revealed an increase of 39.7 per cent in 1999/2000. On the other hand, the import trade of Nepal increased consecutively for 1995/96 and 1996/97. Onward of these years, the import trade trend declined for succeeding years. Again, it rose in the year 1999/2000. However, it is showing a downward trend onward to this year.

**Table: 16**  
**Changes in Export & Import Trade of Nepal and India**

In percentage

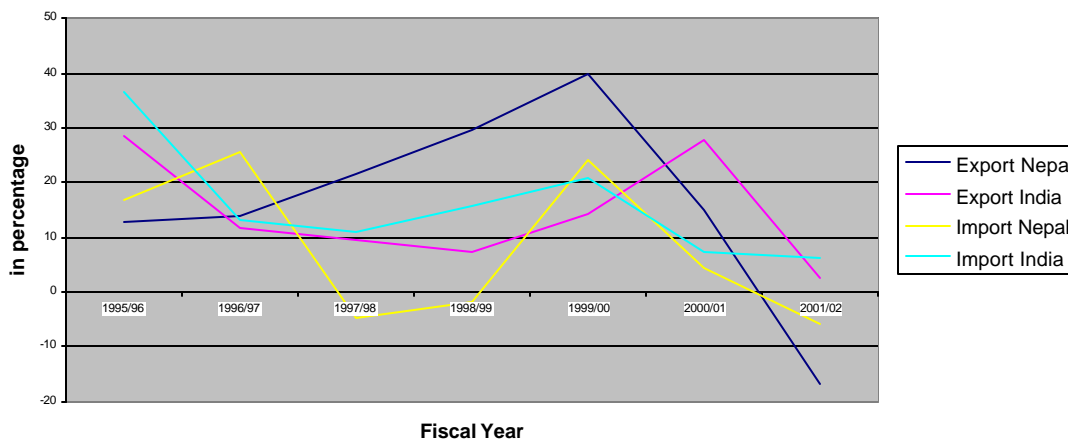
Fiscal Year	Export		Import	
	Nepal	India	Nepal	India
1995/96	12.7	28.6	16.9	36.4
1996/97	13.9	11.7	25.7	13.2
1997/98	21.5	9.5	-4.9	11.0
1998/99	29.7	7.4	-1.7	15.7
1999/00	39.7	14.2	24.0	20.7
2000/01	14.9	27.6	4.5	7.3
2001/02	-17.0	2.7	-5.9	6.2

Based on the figures of FNCCI, Economic Survey (2001/02), Ministry of Finance, Nepal and DGCI&S, India

In the case of India, both the trade i.e. export and import, were at the increasing trend in 1995/96 showing an increment of 28.6 per cent and 36.4 per cent respectively. Foreign trade

declined at a slow pace till 1997/98. Export trade picked up its tempo as such an increase of 14.2 per cent and 27.6 per cent was recorded for the year 1999/2000 and 2000/01 respectively. It dropped significantly in 2001/02 revealing a marginal increment of 2.7 per cent. On the other hand, the import trade picked up in 1999/2000 registering an increment of 20.7 per cent. Import trade is at the declining trend since that year.

**Changes in Export & Import Trade of Nepal and India**



It thus suggests that trade relation between Nepal and India is continuously moving on smoothly. Significant proportion of export trade of Nepal is held with India. However, the share proportion in the export and import trade has been varying from time to time. The volume and direction of foreign trade largely rely on the provisions made in the trade and transit treaties. Furthermore, the bilateral trade depends much more upon the mutual share and cooperation in the information management. In this arena, trade points are emerging as effective tools towards dissemination of trade information and also sharing information for the sake of trade development. Therefore in the next chapters efforts have been made to analyze on the various aspects of trade and transit treaties held between Nepal and India on the one hand, and the development of trade points in India and Nepal on the other.



## **Chapter III**

### **Nepal-India Trade Treaties**

#### **3.1. Bilateral Trade Treaties between Nepal and India**

Bilateral treaty, by and large, reflects a symbol of the very special relationship that prevails between two countries. Bilateral trade and trade related activities between Nepal and India are generally governed by the treaties of trade, transit and other agreements for cooperation to control unauthorized trade. Nepal is a land-locked country surrounded by India in the east, south and west. Due to its geo-situational characteristics, bilateral trade and treaties with India play a significant role in the economic development process of Nepal. They determine, to a large extent, the trade pattern and prospects of the country.

Nepal and India have historical relationships. The history of Nepalese trade reveals that India has been the old trade partner since a quite long time ago. Prior to 1950s, India and Tibet were the major trade partners of Nepal. Virtually, the country had a closed economy. The signing of Treaty of Peace and Friendship, and Treaty of Trade and Commerce between Nepal and an independent India in July 1950 can be seen as the landmark towards the external trade of Nepal. Treaty of Peace and Friendship 1950 formalized close relations between the two countries. This Treaty can be seen as a non-reciprocal treaty. The Treaty symbolizes a balanced document and served for more than five decades to keep harness between the two countries. Apparently, it can therefore be seen that the pace of organized and diversified trade, in true terms, began after the signing of the Treaty of Trade in July 1950. Article 1 of this Treaty made the provision of full and unrestricted right of commercial transit of all goods and manufactures through the territory and ports of India. ( 7) Formal trade relation between the two countries was established in 1950 with the signing of the Treaty of Trade. This Treaty was modified and renewed in 1961 and 1971, and incorporated provisions regarding transit facilities extended by India for Nepal's trade with a third country, as well as on cooperation to control unauthorized trade. Duty free access to Nepalese imports on a non-reciprocal basis was first given in 1971 but with a Nepalese/Indian material content requirement of 90 per cent. This was gradually reduced when the Trade Treaty was periodically renewed and in 1993, it was brought down to 50 per cent of Nepalese/Indian material content and Nepalese labor content. In 1978, instead of a single Treaty, three different agreements were signed. These treaties were modified significantly in 1991, after the advent of democratic government in Nepal. India signed two treaties on trade and transit with Nepal in 1991. Indo-Nepal Treaty of Trade 1991 made the provisions of extending substantial concessions. The Treaty of Trade, valid for five years, was revised and renewed through an exchange of letter on 3<sup>rd</sup> December 1996. The Treaty was renewed in December 1996 for a further period of five years with the provisions for further periods of five years, at a time, by mutual consent subject to such modifications as may be agreed upon. The Protocol to the India-Nepal Treaty of Trade was renewed with some modifications in February 2002.

The Treaty of Transit, 1991 came up for renewal in December 1998 and following bilateral talks, a renewed Transit Treaty was signed on January 5, 1999. The renewed Treaty contains liberalized procedures of the transit of the Nepalese goods. The Government of India accepted Nepalese request for "automatic renewal" of the Treaty for further seven-year periods. However, the Protocol and Memorandum to the Treaty, containing modalities and other would be subject to review and modification every seven years or earlier if warranted. The Nepalese request for an additional transit route to Bangladesh via Phulbari was accepted

in June 1997. Operating modalities for the transit were accordingly worked out. And, the route was operationalised from 1 September 1997. A review of the working of the route was held in March 1998 at Commerce Secretary-level talks in Delhi when several relaxations of the operating modalities requested by the Nepalese were agreed to. These included Nepalese request to keep the route open on all days of the week.

Trade and Transit Treaties, held between Nepal and India, can be seen as the outcomes of progress and understanding towards improving trade relationship between the two countries. On the other hand, it can also be seen as the reform initiatives of the both countries as per demand of the socio-economic and geo-political framework. These treaties have been quite comprehensive concentrating on the issues of hazardous cargo, insurance, quantum of primary commodities and rules of origin. The rules of origin norms enabling preferential treatment of the Nepalese manufactured goods for entry into the Indian market has gradually been relaxed to improve coverage of eligible products. As a result of the good understanding reflected in the bilateral trade and transit treaties, the number of primary commodities eligible to enter into both the countries free of restrictions has been increased. Similarly, the number of transit points to facilitate Nepal's trade with India and, also Nepal's trade with third countries through Indian territory has been expanded.<sup>1</sup> Realizing the significance of the bilateral treaty and its impact on the foreign trade, it has been remarked that the Indo-Nepal bilateral economic cooperation treaties have led to significant policy inferences for future economic cooperation in the South Asian Region (SAR). It is due to the fact that India has emerged as a major trade partner of Nepal as both exports and imports in value terms have been quite high in comparison with Nepal's major trade partners. The possible reason for this tendency could be the freer trade regime that has existed between India and Nepal.<sup>2</sup> Since 1991, trade relation between Nepal and India has been intensified and also entering into a new arena. Taking into account the fact, this study has made an attempt to analyze the provisions made in the trade and transit treaties and the major impact of these on the structure and trend of Indo-Nepal trade.

### **3.2 Indo-Nepal Treaty of Trade, 1991**

In order to expand trade between Nepal and India and also to encourage collaboration in economic development, Treaty of Trade, 1991 was signed on 6 December 1991. It was explicitly expressed in the Treaty to promote mutual trade between the two countries for the benefits of mutual sharing of scientific and technical knowledge and experience.

Article II of the Treaty provisioned of endeavoring to grant maximum facilities and to undertake all necessary measures for the free and unhampered flow of goods needed by one country from the other to and from their respective territories. With a view to promote trade, Article IV of the Treaty stated that the contracting parties agree, on the reciprocal basis, to exempt from basic customs duty as well as from quantitative restrictions on the import of such primary products as may be mutually agreed upon from each other. Furthermore, the Government of India agreed to promote the industrial development of Nepal through the grant on the basis of non-reciprocity of especially favorable treatment to import into India of industrial products manufactured in Nepal in respect of customs duty and quantitative restrictions normally applicable to them. As such, a scope for exception was made in the Article V of the Treaty to the Nepalese manufactured products. On the basis of reciprocity and with a view to facilitating greater interchange of goods between the two countries, it was expressed in the Article VI of the Treaty that His Majesty's Government of Nepal shall endeavor to exempt, wholly or partially, imports from India from customs duty and

quantitative restrictions to the maximum extent compatible with their development needs and protection of their industries.

This Treaty also made the provision of all goods of Indian or Nepalese origin shall be allowed to move unhampered to Nepal or India respectively without being subjected to any quantitative restrictions, licensing or permit system with the exception of restricted or prohibited goods and articles. Furthermore, the Government of India agreed to allow to His Majesty's Government of Nepal the payment of excise and other duties collected by the Government of India on goods produced in India and exported to Nepal provided that:

- i. such payment shall not exceed the import duties and like charges levied by His Majesty's Government of Nepal on similar goods imported from any other country, and
- ii. His Majesty's Government of Nepal shall not collect from the importer of the said Indian goods as much of the import duty and like charges as is equal to the payment allowed by the Government of India.

In respect to the access, duty and quantity of the goods and articles, the Treaty provisioned of providing access to the Indian market free of basic and auxiliary customs duty and quantitative restrictions, generally, for all manufactured articles, which contain not less than eighty per cent of the Nepalese materials, or Nepalese and Indian materials. Furthermore, the Government of India would provide access to the Indian market, on case-to-case basis, free of basic and auxiliary customs duty and quantitative restrictions for manufactured articles that contain not less than fifty five per cent of the Nepalese materials or Nepalese and Indian materials. In addition, with a view to extend benefits to small manufacturers, the Treaty made a provision of levying 'additional' duty on the 'small' units manufactured in Nepal equivalent to the rate of excise duty applicable under the Indian Customs and Central Excise Tariff to articles produced in similar units in India.

With regard to 'additional' duty collected by the Government of India in respect of manufactured articles other than those manufactured in 'small' units, certain provisions were made as whenever it is established that the cost of production of an article is higher in Nepal than the cost of production in a corresponding unit in India, a sum representing such difference in the cost of production, but not exceeding 25 per cent of the 'additional' duty collected by the Government of India, will be paid to His Majesty's Government of Nepal provided that:

- i. such manufactured articles contain not less than eighty per cent of Nepalese and Indian materials, and
- ii. His Majesty's Government of Nepal has given assistance to the same extent to the (manufacturer) exporter.

In the case of other manufactured articles in which the value of the Nepalese and Indian materials including labor added in Nepal is at least forty per cent of the ex-factory price, the Government of India will allow the articles on case-by-case basis following preferential treatment keeping in mind the need for expeditious clearance in the Indian market. On the other hand, in the case of other manufactured articles in which the value of the Nepalese and Indian materials and labor added in Nepal is less than forty per cent of the ex-factory price, the Government of India will provide normal access to the Indian market consistent with its import regime and most favored nation (MFN) treatment. This Treaty, by and large, concentrated on the material content requirements while importing goods and articles in

India. However, the Treaty recognized the immense importance of export trade for the economic development of Nepal and as such made necessary provisions in the Treaty.

### **3.3. Treaty of Transit, 1991**

Recognizing the fact that Nepal is a land-locked country and its need to have access to and from the sea to promote its international trade, the Treaty made the provision in its Article I that the contracting parties shall accord to 'traffic in transit' freedom of transit across their respective territories through routes mutually agreed upon. No distinction shall be made which is based on flag of vessels, the places of origin, departure, entry, exist, destination, ownership of goods or vessels. Further, exemption from customs duties and from all transit duties or other charges were made except reasonable charges for transportation and such other charges as needed to commensurate with the costs of services. In addition, for the convenience of traffic in transit the contracting parties agreed to provide point or points of entry or exist warehouses or shed and open space for the storage of traffic in transit awaiting customs clearance before onward transmissions. As such the requirements in course of import and export of goods and articles from Nepal was well established in this Treaty.

### **3.4. Agreement of Cooperation to Control Unauthorized Trade. 1991**

An Agreement of Cooperation to Control Unauthorized Trade was signed between the Government of India and His Majesty's Government of Nepal (HMG/N) on 6 December 1991. Article I of the Agreement well recognized that there is a long and open border between the two countries and there is free movement of persons and goods across the border. It further notes that they have the right to pursue independent foreign trade policies. In order to protect the interest of both the countries the Article made the provision of taking all such measures that are necessary to ensure that the economic interests of the other party are not adversely affected through unauthorized trade between the two countries. As per the Article II of the Agreement, both the countries agreed to cooperate effectively with each other to prevent infringement and circumvention of the laws, rules and regulations of either country in regard to matters relating to customs, narcotics and psychotropic substances, foreign exchange and foreign trade.

Article III of the Agreement further made the provision of prohibiting and cooperating each other to prevent:

- a. re-exports from its territory to third countries of goods imported from the other Contracting Party and products which contain materials imported from the other Contracting Party exceeding 50 per cent of the ex-factory value of such products;
- b. re-exports to the territory of the other Contracting Party of goods imported from third countries and of products which contain imports from third countries exceeding 50 per cent of the ex-factory value of such goods.

According to this Agreement, both the governments agreed to exchange with each other regularly the lists of goods the import and export of which are prohibited, or restricted or subject to control according to their respective laws and regulations. In this way commitment was made to cooperate with each other in the prevention of unauthorized trade.

### **3.5. Revision in Indo-Nepal Trade Treaty, 1991 and Treaty of Transit, 1991**

At the end of the official visit of Prime Minister of India, Mr. P.V. Narasimha Rao on October 21, 1992, a joint communiqué was issued in Kathmandu, which considerably enhanced India's bilateral trade preferences to Nepal and further improvement in its transit

facility. In accordance with the communiqué, India and Nepal signed three letters of exchange on 16 February 1993.

One of the letters related to trade while the other two related to transit. The letter relating to trade replaced Part V of the Protocol of the Treaty of Trade 1991. One notable feature of the amendment was the eligibility of the Nepalese labor content along with Indian and Nepalese materials qualifying as inputs while estimating their content in the ex-factory value of Nepalese manufactured output. Henceforth the Government of India provide access to the Indian market free of basic and auxiliary customs duty and quantitative restrictions for all articles manufactured in Nepal which contain not less than 50 per cent of the Nepalese labor content, Nepalese material content and the Indian labor content. Thus the requirement of Nepalese raw material content for duty free access to the Indian market was reduced from 55 per cent to 50 per cent. Such rules of origin permitting the inclusion of labor in a preferential trading arrangement are unique in Indo-Nepalese relations. Another important feature of the amendment was that the proforma clearance system for the preferential export of Nepalese manufactured items to India was abolished. By this provision it was expected to abolish the procedural delays faced by the Nepalese exporters.

Another letter of exchange was concerned with the replacement of the letter exchanged at the time of signing of the Treaty of Transit on December 6, 1991. Under the agreement, movement of the Nepalese private commercial vehicles from the Nepalese border to Calcutta/Haldia and back was allowed on such vehicles being duly authorized by His Majesty's Government of Nepal or the Nepal Transit and Warehousing Company Ltd. or the Nepal Transport Corporation, and the necessary undertaking being given by them to the Indian customs authorities. As such the signed three letters of exchange between Nepal and India were related with:

- i. provisions relating to improvements and simplification of the regime for the export of Nepalese manufactured items to India on a preferential basis,
- ii. movement of the Nepalese private commercial vehicles between Nepalese border and Calcutta/Haldia, and
- iii. easier Nepal to Nepal movement of Nepalese vehicles and goods through India.<sup>6</sup>

### **3.6. Indo-Nepal Trade Treaty, 1996**

This Treaty, signed on December 3, 1996 at Kathmandu, sets a landmark in bilateral trade relation between Nepal and India. It gave a new direction in the trade related areas as well as a scope for the trade improvement especially to Nepal. Some of the provisions made in the earlier treaties were replaced and modified. It made the procedures simple and straight so as to remove the procedural delays. Moreover, the Treaty committed the cooperation in more specific and extended manner. Some of the provisions of the Treaty are stated below:

- i. access to the Indian market free of customs duties and the quantitative restrictions for all articles manufactured in Nepal.
- ii. import of articles in accordance with (i) above shall be allowed by the Indian customs authorities on the basis of a Certificate of Origin (CoO) to be issued by the agency designated by His Majesty's Government of Nepal in the format prescribed at ' B' for each consignment of articles exported from Nepal to India. But this facility is not provided to the negative list of articles mentioned in "C".

- iii. on the basis of a certificate issued by His Majesty's Government of Nepal, for each consignment of products manufactured in the small scale units in Nepal, that the relevant conditions applicable to the products manufactured in similar Small Scale Industrial Units (SSIU) in India for relief in the levy of applicable excise duty rates are fulfilled for such a parity, Government of India will extend parity in the levy of additional duty on such Nepalese products equal to the treatment provided in the levy of effective excise duty on similar Indian products under the Indian Customs and Central Excise Tariff.

However, The "Additional Duty" rates equal to the effective Indian excise duty rates applicable to similar Indian products under the Indian Customs & Central Excise Tariff will continue to be levied on the imports into India of products manufactured in the medium and large-scale units in Nepal.

- iv. In regard to Indian additional duty collected by the Government of India in respect of manufactured articles other than those manufactured in "small" units: whenever it is established that the cost of production of an article is higher in Nepal than the cost of production in a corresponding unit in India, a sum representing such difference in the cost of production, but not exceeding 25 per cent of the "additional duty" collected by the Government of India, will be paid to His Majesty's Government of Nepal provided His Majesty's Government has given assistance to the same extent to the (manufacturers) exporters.
- v. Export of consignments from Nepal accompanied by the Certificate of Origin (CoO) will normally not be subjected to any detention or delays at the Indian customs border check posts and other places en route. In case any need for clarification arises, this will be obtained expeditiously by the Indian Border Customs authorities from the Indian and Nepalese authorities, as the case may be.

Negative list of articles that are not allowed preferential entry from Nepal to India on the basis of Certificate of Origin (CoO) include:

- i. Alcoholic Liquors/ Beverages and their concentrates except industrial spirits,
- ii. Perfumes and Cosmetics with non-Nepalese/ non-Indian Brand names, and
- iii. Cigarettes and Tobacco.

However, a provision was made that Nepalese beers can be imported into India on payment of the applicable liquor excise duty equal to the effective excise duty as levied in India on Indian beers under the relevant rules and regulations of India. Furthermore, it was also stated that the Government of India might modify the negative list in consultation with His Majesty's Government of Nepal. Furthermore, provisions were made in the Treaty to adopt appropriate measures in the event of facility leading to a surge in the import. In this regard governments of the both countries may consult with each other with a view to take appropriate measures.

With regard to the validity of the Treaty, it was mentioned that it would remain in force up to December 5, 2001. In accordance with the provision made in the Treaty ( 8) it would be automatically extended for further period of five years at a time on the condition that unless either of the parties gives to the other a written notice of its intention to terminate the Treaty. But the notice should be given three months in advance. Furthermore, the scope for

amendment and modification of the Treaty was provisioned upon the mutual consent of both the countries.

This Treaty facilitated to a greater extent in favor of Nepal. By virtue of this Treaty Nepal can export to India without any quantitative restrictions on the one hand and, free of custom duties on the other. These provisions were definitely the positive aspects and also creating an appropriate environment for boosting up the Nepalese export trade.

### **3.7. Agreement of Cooperation to Control Unauthorized Trade, 1996**

An Agreement of Cooperation (AoC) between His Majesty's Government of Nepal and the Government of India was also signed to control unauthorized trade. Article III of the Agreement made the provisions of:

- i. each contracting party will prohibit and cooperate with each other to prevent re-exports from its territory to the third countries of goods imported from the other contracting party without manufacturing activity, and
- ii. re-exports to the territory of the other contracting party of goods imported from third countries without manufacturing activity. However, it was stated that the provision of (i) stated above would not be applicable in the case of the export of the Nepalese goods into India under the procedure set out in Protocol V to the Treaty of Trade between His Majesty's Government of Nepal and the Government of India.

This Agreement also expressed its commitment to cooperate and control unauthorized trade in accordance with the provisions of the Agreement of Cooperation to Control Unauthorized Trade, 1991.

### **3.8. Treaty of Transit: Modifications in 1996**

In order to facilitate the provisions made in the renewed Treaty of Trade 1996, it was felt some modifications in the Treaty of Transit too. As such some Articles and clauses were modified as well as revised in the Treaty of Transit, 1991. The major changes made in this Treaty can be observed as follows:

- i. The Indian customs authorities posted at Seaports/Border Land Customs Stations shall merely check the "one time lock" of the container put on by the shipping agent or the carrier authorized by the shipping agent or the carrier authorized by the shipping company. If it is found intact, it will be allowed for transportation of the containerized cargoes without examination unless there are valid reasons to do otherwise.
- ii. In case where the "one time lock" on the container arriving at Seaports/Border Land Customs Stations in India are found broken or defective, the Indian customs authorities shall make due verification of the goods to check whether the goods are in accordance with the Customs Transit Declaration and shall put fresh "one time lock" and allow the containers to move to the destination. The serial number of the new "one time lock" shall be endorsed in the Customs Transit Declaration.
- iii. The procedures stated above are applicable to the Nepalese containerized export and import cargoes moving to and from Seaports and Border Land Customs Stations in India.

Indo-Nepal Trade Treaty, 1996 indeed provided liberal framework in the arena of trade relationship between these two countries. Katti (2001:55) remarks, of course quite rightly with regard to the revised treaty stating that bilateral trade agreements is indeed a bold step in an effort to further boost bilateral trade and joint investment with Nepal. These new era earmarking a movement in the direction of making SAPTA successful and the consequent Free Trade Area among the member nations of the region a reality at the earliest. One of the significant promising characteristics of this Treaty can be identified as to waive off the condition of material content in the Nepalese goods while exporting to India. The provision of non-reciprocal basis duty free and without quantitative restrictions access to the Nepalese manufactured articles in India was available to Nepal as per the Treaty of Trade, 1991. But the content of raw material in the exportable articles was being the central issue from the side of the Nepalese businessmen. This issue was resolved by the provision in this Treaty.

### **3.9. Treaty of Trade, 1996: Major Policy Changes**

This Treaty is seen more often as the turning point in the history of Nepal- India trade relations leading to several policy changes. Some of the changes can be viewed as follows:

- a. Government of India provided access to the Indian market free of customs duties and quantitative restrictions for all products manufactured in Nepal on the basis of the certificate of origin.
- b. The negative list of product imported to India were shortened from seven to three items which are alcoholic liquors/beverages and their contents except industrial spirits, perfumes and cosmetics, cigarettes and tobacco.
- c. Export of Nepalese consignments with the certificate of origin would not be delayed at the Indian customs border/check-post.
- d. Indian investment in Nepal in Indian Rupees for up to 25 crores would get fast track clearance.
- e. It was decided to increase the air seat capacity from 4000 to 6000 per week. Also two more points in India would be opened for Nepalese airlines. The governments of the two countries also agreed to have open sky policy.
- f. The government of India opened the transit route to Bangladesh through Phulbari.
- g. HMG/N amended its foreign investment policy, company law and transfer of technology act.
- h. Nepal decided to open Nepali Stock Exchange to overseas investors.
- i. India and Nepal signed the power trade agreement and allowed private investment in hydropower project.

### **3.10. Treaty of Transit, 1999**

This Treaty was signed on 5 January 1999 between the Government of India and His Majesty's Government of Nepal with a desire to maintain, develop and strengthen the existing friendly relations and cooperation between the two countries recognizing the need to facilitate the traffic-in-transit through their territories. It was stated in the Treaty that it will remain in force up to the 5<sup>th</sup> January 2006 and will, thereafter, be automatically extended for a further period of seven years at a time unless either of the parties gives to the other a written notice, six months in advance.

In the Article 1 of the Treaty provision was made that the Contracting Parties shall accord to "traffic-in-transit" freedom of transit across their respective territories through routes mutually agreed upon. No distinction shall be made which is based on flag of vessels, the places of origin, departure, entry, exit, destination, ownership of goods or vessels. Article II stated that each Contracting Party shall have the right to take all indispensable measures to



ensure that such freedom, accorded by it on its territory, does not in any way infringe its legitimate interests of any kind.

The provision of exemption from customs duties and from all transit duties or other charges was also made for the traffic-in-transit, except reasonable charges for transportation and the costs of services rendered in respect of such transit. Moreover, with a view to offer convenience of traffic-in-transit the Contracting Parties agreed to provide, at point or points of entry or exit, warehouse or sheds for the storage of traffic-in-transit awaiting customs clearance before onward transmission. In order to extend the enjoy of freedom of the high seas, merchant ships sailing under the flag of Nepal, the Treaty made the provision of providing treatment no less favorable than that accorded to ships of any other foreign country in respect of matters relating to navigation, entry into and departure from the ports, use of ports and harbor facilities, as well as loading and unloading dues, taxes and other levies. In fact, this Treaty continued many of the provisions made by the earlier treaties to provide transit facilities as needed by Nepal.

Treaty of Transit is very vital to a land-locked country like Nepal. It was well reckoned in this Treaty. Fulfillments of social, economic and developmental needs largely depend upon the export and import trade. And, trade depends much upon the transit procedures and facilities. As one of the characteristics this Treaty made a provision of renewing automatically for a period of further seven years. It can be viewed as one of the beautiful aspect of the Treaty. It minimizes the administrative procedures that were seen in the past. This Indo-Nepal Treaty of Transit provided, as the earlier transit treaties had made, port facilities to Nepal at Calcutta and specified 15 transit routes between Calcutta and the India-Nepal border. In addition 22 entry/exit points along with India-Nepal border for mutual trade and Nepal-Nepal transit have also been provided.

### **3.11. Indo-Nepal Treaty of Trade, 2002**

This treaty is a continuation of the Treaty of Trade, 1996 rather in a revised form with the inclusion and exclusion of some of the provisions in the Articles. After a series of meetings in Delhi from 27<sup>th</sup> February to 2<sup>nd</sup> March 2002, an agreement was reached to extend the validity of all the twelve Articles of the India-Nepal Treaty of Trade, and Protocols to Articles I, II, III, IV and VI in their present form for a period of five years with effect from 6<sup>th</sup> March 2002. And, it was also agreed that the revised Protocol to Article V and the new Protocol to Article IX of the Treaty would also be valid for the same period. Some of the major provisions made in the Treaty can be identified as follows:

1. preferential access to the Indian market free of customs duties normally applicable and quantitative restrictions for all articles manufactured in Nepal, except the mentioned articles, provided they fulfill the qualifying criteria.

- (a) the articles are manufactured in Nepal wholly from Nepalese materials or Indian materials or Nepalese and Indian materials ;or
- (b) (i) the articles involve a manufacturing process in Nepal that brings about a change in classification, at four digit level, of the Harmonized Commodities Description and Coding System, different from those, in which all the third country origin materials used in its manufacture are classified; and the manufacturing process is not limited to insufficient working or processing as indicated in “B”, and

- (b) (ii) From 6th March 2002 to 5th March 2003 , the total value of materials, parts or produce originating from non-Contracting Parties or of undetermined origin used does not exceed 75 per cent of the ex-factory price of the articles produced, and the final process of manufacturing is performed within the territory of Nepal. From 6th March 2003 onwards, the total value of materials, parts or produce originating from non-Contracting Parties or of undetermined origin used does not exceed 70 per cent of the ex-factory price of the articles produced, and the final process of manufacturing is performed within the territory of Nepal.
  - (c) preferential access to the Nepalese articles not fulfilling the conditions of 1 (b) (i) but fulfilling the condition 1 (b) (ii) on a case by case basis.
  - (d) normal access to other articles manufactured in Nepal which do not fulfill the qualifying criteria specified with MFN treatment.
- 2. Import of articles in accordance with (1) above shall be allowed by the Indian customs authorities on the basis of a Certificate of Origin to be issued by the agency designated for this purpose by His Majesty's Government of Nepal in the format prescribed at -"D" for each consignment of articles exported from Nepal to India.
- 3. for each consignment of articles manufactured in the small-scale units in Nepal, on the basis of a Certificate issued by His Majesty's Government of Nepal, that the relevant conditions applicable to the articles manufactured in similar Small Scale Industrial Units in India for relief in the levy of applicable Excise Duty rates are fulfilled for such a parity, Government of India will extend parity in the levy of Additional Duty on such Nepalese articles equal to the treatment provided in the levy of effective Excise Duty on similar Indian articles under the Indian Customs and Central Excise Tariff.
- 4. "Additional Duty" rates equal to the effective Indian excise duty rates applicable to similar Indian products under the Indian Customs & Central Excise Tariff will continue to be levied on the imports into India of products manufactured in the medium and large-scale units in Nepal.
- 5. In regard to additional duty collected by the Government of India in respect of manufactured articles other than those manufactured in "small" units; wherever it is established that the cost of production of an article is higher in Nepal than the cost of production in a corresponding unit in India, a sum representing such difference in the cost of production, but not exceeding 25 per cent of the "additional duty" collected by the Government of India, will be paid to His Majesty's Government of Nepal provided His Majesty's Government of Nepal has given assistance to the same extent to the (manufacturers) exporters.
- 6. Export of consignments from Nepal accompanied by the Certificate of Origin will normally not be subjected to any detention or delays at the Indian customs border check posts and other places en route. However, in case of reasonable doubt about the authenticity of Certificate of Origin, the Indian Customs Authority may seek a clarification from the certifying agency.

7. The importing country may request for consultations in the Joint Committee to take appropriate measures in the event of imports in such a manner or in such quantities so as to cause or threaten to cause injury to the domestic industry or a significant segment of it relating to the article.
8. Provisions made for some of the articles allowed to entry into India with free of customs duties on fixed quota basis are as follows:

S.No	Nepalese article	Quantity in MT per year
1.	Vegetable fats (Vanaspati)	100,000 ( One hundred thousand)
2.	Acrylic Yarn	10,000 (Ten thousand)
3.	Copper products under Chapters 74 & Heading 85.44 of the H.S.Code	7,500 (Seven thousand five hundred)
4.	Zinc Oxide	2,500 (Two thousand five hundred)

However, it is stated in the Treaty that imports of the above four commodities into India in excess of the fixed quota will be permitted under normal MFN rates of duty. ( 9) And, they will be permitted through the land Customs Stations (LCS) at Kakarbhitta/Naxalbari, Biratnagar/Jogbani, Birganj/Raxaul, Bhairahawa/Nautanwa, Nepalgunj/Nepalgunj Road and Mahendranagar/ Banbasa .

Furthermore, the following articles are not be allowed under preferential entry from Nepal to India on the basis of Certificate of Origin:

1. Alcoholic Liquors/ Beverages and their concentrates except industrial spirits,
2. Perfumes and Cosmetics with non-Nepalese / non-Indian Brand names,
3. Cigarettes and Tobacco

With regard to the articles that are not to allow under preferential treatment a provision has been made stating the Government of India, in consultation with His Majesty's Government of Nepal, may modify the list of articles. However, Nepalese beers can be imported into India on payment of the applicable liquor excise duty equal to the effective excise duty as levied in India on Indian beers under the relevant rules and regulations of India. This Treaty made an amendment in some Articles of the earlier treaty. Noticeably, the Treaty introduced the value addition norms while exporting to India and also adopted quantitative restrictions on some commodities or articles such as vegetable ghee, acrylic yarn, copper products and zinc oxide.

The salient features of this Treaty can be viewed as:

- detailed Rules of Origin incorporated to encourage genuine industrialization in Nepal and to provide greater clarity and transparency
- value addition norm - a very low value addition percentage has been agreed to by India of a maximum ceiling for third country inputs fixed at 75 per cent for one year from 6th March, 2002 and 70 per cent thereafter, (i.e. a domestic value addition requirement of only 25 per cent for the first year and 30 per cent thereafter)
- Certain sensitive items will be allowed continued entry into India free of customs duty on the basis of a special and liberal quota. No ceiling prescribed for imports of these items into India on MFN basis.

- Safeguard clause introduced with provision for the affected country to take appropriate remedial measures only if joint consultations on surge do not yield results.

### **3.12. Transit Provisions**

There are 22 land border points specified as agreed routes for mutual trade between India and Nepal under the terms of the Indo-Nepal Treaty of Trade. Under the Treaty of Transit and the Protocol to the Treaty of Transit, the Calcutta-Haldia port complex has been specified as port of entry for Nepal's third-country trade by sea. However, 15 land-border points have been specified for the passage of Nepal's third-country trade. The transit facilities<sup>7</sup> provided by India to Nepal under the Treaty of Trade and Treaty of Transit include the following:

- i. India allows freedom of transit for Nepalese third-country trade across its territories through routes mutually agreed upon,
- ii. Permission for the movement of Nepalese trucks to and from the nearest railway stations to pick up the export and transit cargo to Nepal,
- iii. Traffic in transit is exempted from customs duty and from all transit duties or other charges, except charges for transportation and service charges,
- iv. Facilities are provided for warehousing and for storage of goods in transit awaiting customs clearances before inward transportation to Nepal, through Indian territory.

### **3.13. Agreement of Cooperation to Control Unauthorized Trade**

Along with the Treaty of Trade, an agreement of cooperation to control unauthorized trade between Nepal and India was signed in March 2002. In the agreement it was mutually agreed to extend the validity of all the eight Articles of the Agreement of Cooperation between the Government of India and His Majesty's Government of Nepal to control unauthorized trade in their present form for a period of five years with effect from 6<sup>th</sup> March 2002. Thus, the agreement did not modified or included any Articles but agree to continue under the existing provisions .

### **3.14. Impact of Trade and Transit Treaties on Bilateral Trade**

Trade and Transit Treaties with India carry significant meaning particularly to Nepal. The Treaties provide guidelines and also scope for furthering bilateral trade. A general overview on the impact of Indo-Nepal bilateral trade and transit treaties specifically on the trade structure and the trend of trade of Nepal is discussed in the following sections.

#### **3.14.1. Impact on Structure and Trend of Nepal's Trade**

The provisions on the Treaty of Trade and Transit between Nepal and India considerably determine the direction of Nepalese international trade. There have been ups and downs in the structure and trend of Nepalese export, in particular, since the first formal Treaty of Trade and Commerce, 1950 with India. Impact of the subsequent Trade and Transit Treaties provides varying scenarios in the export and import trade of Nepal.

##### ***3.14.1.1. Period between 1950 and 1970***

The share of India was more than 95 per cent in the total trade transactions of Nepal during the period of 1956/57 to 1959/60. Evidently, the total trade transactions with other countries were less than 5 per cent. Imports from India were 98.5 per cent of the total import in the year 1964/65 whereas the percentage went on decreasing in the subsequent years. In 1965/66 it was 97.6 per cent, in 1966/67 it was 96.8 per cent, in 1967/68 it was 92.3 per cent, in 1968/69 it was 93.2 per cent and in the year 1969/70 it was 91.5 per cent of the total imports. Nepal's export to India was 98.3 per cent of the total exports of Nepal in 1964/65. It went on decreasing in the subsequent years with a lower scale.

#### ***3.14.1.2. Period between 1971 and 1980***

The share of India in total import of Nepal was 88.2 per cent in 1970/71. It declined over the period and reached finally to 51.3 per cent in 1979/80. On the other hand, the share of third countries in total import of Nepal was only 11.8 per cent in 1970/71. It climbed steadily over the period and reached to 48.7 per cent in 1979/80. Likewise, the share of India in total export of Nepal was 81.9 per cent in 1970/71. It steadily decreased during the period and reached to 45.3 per cent in 1979/80. On the other hand, the share of other countries gradually picked up during the same period. The share in the total export was 18.1 per cent in 1970/71, which increased to 54.7 per cent in 1979/80. As a result, the share of India in Nepal's total trade decreased from 85.9 per cent (1970/71) to 49.8 per cent (1979/80) and that of the other countries, it increased from 14.1 per cent (1970/71) to 50.2 per cent (1979/80).<sup>8</sup>

#### ***3.14.1.3. Period between 1981 and 1990***

The share of India in the total export of Nepal was 61.7 per cent in 1980/81. The share declined further in 1985/86 and reached to 40.3 per cent. However, the share of India in Nepal's total export increased a little bit in 1986/87 and registered 43.5 per cent. The trend went on declining from that year. As such, it was 24.7 per cent in 1988/89. It further declined in 1989/90 and revealed just 11.7 per cent. On the total import of Nepal, the share of India was 49.2 per cent in 1980/81, which went on at a decreasing rate. The share of India in the total import of Nepal was, thus, 42.5 per cent in 1985/86, 39.1 per cent in 1986/87, 33.1 per cent in 1987/88 and 26.1 per cent in 1988/89. The share came down still a little bit in 1989/90 and stood at 25.5 per cent.

#### ***3.14.1.4. Period between 1991 and 1995***

In the year 1990/91, the share of India in the total export of Nepal was 21 per cent. It decreased in the successive years and, thus, revealed 10.6 per cent and 9.6 per cent for the year 1991/92 and 1992/93. Situation in such a share improved marginally in 1993/94 revealing 12.5 per cent. The share percentage was 17.7 per cent and 18.5 per cent for 1994/95 and 1995/96. On the other hand, the share of India in the total import of Nepal remained in between 30 per cent to 35 per cent during that period. Such a share was 31.5 per cent in 1990/91, which increased in 1991/92 showing 35.2 per cent. In 1992/93 it was 33.3 per cent, in 1993/94 it was 35.4 per cent, in 1994/95 it was 30.8 per cent and it was 32.8 per cent in 1995/96.

#### ***3.14.1.5. Period between 1995 and 2001***

It is interesting to note that the trend of the total trade, i.e. export and import, between Nepal and India has increased from the year 1996/97 onward. Of course, it may be due to the outcome of favorable provisions in the Indo-Nepal Trade Treaty of 1996. The share of India in the total export of Nepal was 23.1 per cent in 1996/97. The trend escalated gradually in the successive years. It was 32 per cent in 1997/98 while it was 35.1 per cent, 42.6 per cent and 47.7 per cent in the year 1998/99, 1999/2000 and 2000/01 respectively. The share of India in the total import of Nepal was 26.6 per cent in 1996/97, which gradually increased revealing 30.7 per cent, 36.7 per cent, 36.6 per cent and 41.2 per cent in 1997/98, 1998/99, 1999/2000 and 2000/01 respectively. In the year 2001/02, such a share is estimated to be 42.5 per cent.

Treaty of Trade 1996 has indeed played a crucial role in the foreign trade structure of Nepal. The average exports per annum from Nepal to India during the period of 1991/92 to 1996/97 show 16.3 per cent out of the total export Nepalese trade. But the average exports from Nepal to India jumped to 43.6 per cent during the period of 1997/98 to 2001/02. It can, thus, be noted as the phenomenal impact of the Treaty on the trade structure of Nepal. Similarly, the

import structure also presented a different scenario but at a lower scale. The average imports from India were 31.8 per cent during the period of 1991/92 to 1996/97. The ratio increased to 37.5 per cent during the period of 1997/98 to 2001/02.

The trend analysis of Indo-Nepal bilateral trade evidently indicates that the trade and transit treaties held between these countries determine the volume of trade on the one hand, and the direction of trade on the other. It can be seen, particularly, the level of exports from Nepal to India fluctuating as the provisions in the treaties changes such as; the Articles relating to material content, value addition norms, restrictions of the specific goods and articles and the quantity restrictions of certain items.

Among the positive implications of the Indo-Nepal Trade Treaties, one of the most important has been to widen the basket of Nepalese export commodities to India. Besides the traditional Nepalese exports like jute goods, pulses, ginger, oil cakes, cardamom, rosin, skin and hide and skin, a number of new commodities have been added to the Nepalese export basket including vanaspati, toothpaste, acrylic and polyester yarn, Ayurvedic medicine, soap, turpentine, brooms and handicrafts, copper wire and other copper products, paper and wax products. A total of 184 odd Nepalese products are being exported to India at present.

Trade structure analyses in the above sections indicate that there has been a significant correlation between the Indo-Nepal Trade and Transit Treaties on the Nepalese trade. Specifically, the liberal provisions in the treaties have contributed significantly in the expansion of trade between Nepal and India. Export trade of Nepal, as compared to the import trade, can be seen fluctuating very speedily. It is to be noted that export trade has a significant impact on the balance of payments.

### **3.14.2. Policy Implications**

The Trade and Transit Treaties between Nepal and India not only make a firm basis for the foreign trade of Nepal but also reflect on the macroeconomic policy framework of Nepal in many instances. It is not unnatural that the export to and import from India vary in accordance with the inclusion, exclusion or modifications of certain provisions in the Protocol of the Treaty in the case of Nepal. Because a large proportion of Nepal's foreign trade is shared with India. But the national policy framework and priorities are also seen being affected by the Treaties.

As Pant (2002:33) notes, Nepal did not take initiative to become the member of then global trading regime, GATT, a predecessor of WTO, until 1989 following a trade dispute with India. However, the dispute lasted for 15 months, and new treaties were signed in 1991. Hence, the urgency for Nepal to become a WTO member so as to be protected under GATT Article V on transit rights, weakened. It chose for the observer status, and did not convert that into an application to join the WTO until 1997. Since, then, the country has been undertaking steps gradually as per the accession process.<sup>9</sup> It provides a fine example of the role of Trade and Transit Treaties and their impact on the policy framework of Nepal. After the signing of the Treaty of Trade and Treaty of Transit in 1991 one can observe the introduction as well as amendment of several policies for instance, economic and trade liberalization, foreign direct investment etc. Similarly various Acts were revised and amended in 1992. These reform initiatives cannot be viewed as the consequences of the bilateral treaties as the sole reason. However, improved bilateral trade relations between the two countries did influence adoption of such measures.

## **Chapter: IV**

### **Trade Points in Nepal and India**

#### **4.1. Trade Points in Nepal**

The Trade Point Program was launched in 1992 by United Nations Conference on Trade and Development (UNCTAD) as a part of larger initiative to improve trade efficiency and designed to establish, operate and interconnect trade points across the globe for providing trade information, trade facilitation and trade transaction services. Currently 154 trade points are operating globally in 127 countries.

Trade points are designed to have the unique combination of national and international support system and trade implementation tools including the service users mainly SMEs, local enterprises, government agencies and the strong physical and on line network of trade points and their associate enterprises worldwide. The existing network of trade points makes the Trade Point Program distinct from other institutions. The existence of the network ensures the reduction in transaction cost and international trade facilitation for the national local enterprises and government agencies.

#### **4.2. Functions**

Trade point generally makes an attempt to achieve its objective performing following broad functions.

##### **a. Source of trade -related information**

Trade point provides actual and potential traders with data about business and market opportunities, potential clients and suppliers, trade regulations and requirements.

##### **b. Trade facilitation Centre**

The participants in foreign trade transactions; for example customs, banks, chambers of commerce, freight forwarders, transport and insurance companies; are grouped together under a single physical roof or linked virtually to the Trade Point so as to provide all the required services for trade transactions

##### **c. Gateway to Global Electronic Networks**

All Trade Points are interconnected in a worldwide electronic network i.e. the Global Trade Network (GTPNet), which has now been transformed in to WTPF (World Trade Point Network). The network is equipped with efficient telecommunication tools to link up with other global networks in order to increase the participation of traders, in particular SMEs, in the emerging electronic commerce economy.

##### **d. Electronic Trade Opportunities**

Trade Point facilitates to develop a personalized trade leads service that allows to post, subscribe, upload and download the trade offers. And the demands of products and services are categorized in accordance with HSCODE; international classification standards from WTPF and other trade sources.

#### **4.3. Trade Point Program and UNCTAD**

Trade Points decided to set up World Trade Point Federation during 6<sup>th</sup> World Trade Point meeting in November 2000 at Geneva and committed themselves to taking over the Trade

Point Program by the end of 3 year implementation period of the 'Exit Strategy'. The second General Assembly of the Federation in November 2001 adopted an institutional, strategic and operational framework of the Federation namely statutes 'Strategic Business Development Plan', general principles of cooperation within the Trade Point Community and the operational plan for the year 2002. As a first step in line with the externalization of Trade Point Program; UNCTAD transferred the Electronic Trading Opportunities System to the Federation in May 2001 and finally transferred the ownership and the name, trademark, logo and the Trade Point Program to the Federation. The final official agreement of transfer of the program to the Federation was signed on November 4, 2002 in Beirut, Lebanon during 3<sup>rd</sup> General Assembly of World Trade Point Federation. The management of the Federation is looked after by the Steering Committee consisting of 15 representatives from different parts of the world including a representative from UNCTAD and the Bureau of the Federation. However member states have extended the mandate and decided to continue the support of UNCTAD for strengthening the Federation for a period of another two years by providing Secretariat and the support in the capacity building of the Federation and Trade Points.

The Federation during last two years has made suitable progress in the self-enhancement of self-management capacity of the Trade Points community and in approaching public and private partners. The enhanced ETO system, the new Website and Global Trade Directory Service has been launched. The efforts are also being made to strengthen relationship with international agencies such as the World Bank, International Trade Centre, data providers, certification and credit rating companies etc.

The Trade Points, in the new scenario, are expected to be proactive and reinforce their management, financial and marketing capabilities so as to develop new products and services and effective utilization of available communication and information network with a view to serving the trading community more effectively and ensuring success in international business.

#### **4.4. Establishment of Trade Points in Nepal**

The establishment and operationalisation of Trade Points in Nepal is the initiative to create an institutional mechanism to support the business community particularly from the small and medium enterprises (SMEs) in international trade by providing them an access to advanced technologies and information networks.

##### **4.4.1. Need for Export Support Services**

During recent years, the Export Promotion Program in Nepal has been accorded an important status in the economic growth process of the country. A range of institutional changes has been taking place at international, national, regional, and city level with a view to improving and accelerating support to existing and potential exporters within the kingdom of Nepal. There are approximately 8000 formal companies (+/-500 manufacturing companies), of which it is estimated that 1000 to 1500 companies are active in export business. However, the previous economic isolation, scarcity of resources, various tariff and non tariff barriers, and the global integration of world economies and above all the digital divide has constrained the capabilities of large number of potential exporting companies. It is, therefore, essential that an institutional mechanism is created to tap the full trade potential of the country where the proposed trade point can play the key role.



#### **4.4.2. Setting Up Trade Points**

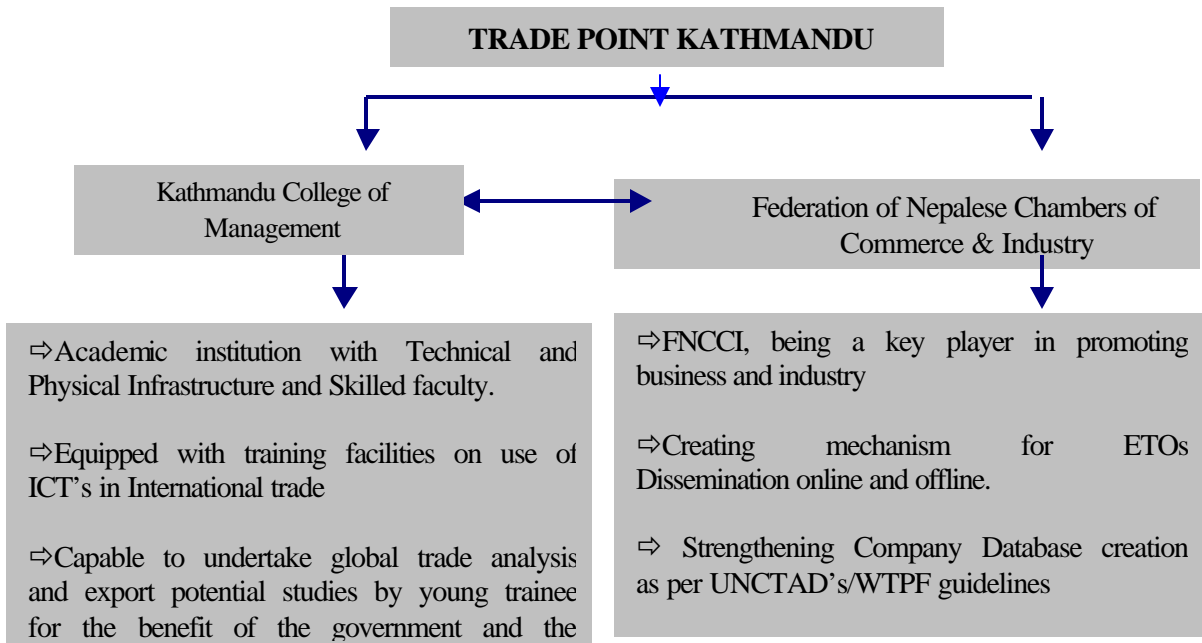
An UNCTAD Mission had a wide range of discussions with the identified institutions to explore the possibility of setting up Trade Point in the suitable institution in consultation with His Majesty's Government of Nepal. Keeping in view the diverse requirements of user community, the strengths and weaknesses of the prospective institutions and specific requirements of the country being an LDC in the foothills of Himalayas, the Mission had considered an Alliance Approach to be ideal for setting up Trade Point and recommended to set up two trade points, viz. Himalayan Trade Point and Trade Point Kathmandu.

##### ***4.4.2.1. Trade Point, Kathmandu***

Kathmandu College of Management (KCM) and Federation of Nepalese Chamber of Commerce and Industry (FNCCI) are jointly hosting the Trade Point, Kathmandu; with a view to follow the synergetic approach for utilizing management capability of the KCM and database and wider user community of FNCCI. The Trade Point, Kathmandu would also be able to introduce the trade point program to the emerging and young entrepreneurs and providing training for effective utilization of the Program. As per the agreed arrangement the trade point would be physically set up and managed by KCM whereas FNCCI would provide support in database creation and would have unrestricted and full access to the trade point facilities in both i.e. offline and online. As trade point is a one-stop source of trade related information, which provides present and potential traders or entrepreneurs with data about business and market opportunities, potential clients and suppliers, trade regulations and requirements, KCM has been identified as an ideal location for hosting the trade point.

On the other hand, the Federation of Nepalese Chambers of Commerce and Industry (FNCCI) is an umbrella organization of the Nepalese private sector and has been playing the key role in promoting business and industry in the country. It provides, inter alia, information, advisory, consultative, promotional and representative services to the business community and government as and when required in formulation and execution of business and industrial related policies and programs. It represents almost all national councils, boards, associations, committees, policy advisory bodies as well as the district and municipality level chambers of commerce and industry and national chambers of commerce and industry. It is providing "One Stop" service to its members by providing business information, guidelines for promoting exports and investments along with promoting entrepreneurship. FNCCI has, therefore, been selected as an ideal partner for KCM for hosting trade point by virtue of which existing information and communication technologies (ICT's) and the management skills can be clubbed with strong databases, an essential requirement for the trade point operation. The available company databases can be made more users friendly as per the international format and requirements. The products and services by TPK would need to be devised keeping in view the requirement of existing users of FNCCI's services and the emerging young entrepreneurs and management graduates. The synergy between the two trade points hosting institutions would strengthen the dissemination mechanism so as to expose trading community to international business and thus reduce transaction cost. The organization of the Trade Point, Kathmandu and the background of the hosting institutions have been depicted in the following diagram:

Diagram: 1



KCM can play an important role in promotion of exports from Nepal. It can use its faculty and infrastructure for creating awareness on the use of ICT's for international trade. This can be a very good value addition to their services. Entrepreneurs getting trained at KCM can also undertake global trade analysis and research on various commodities having potential for exports for policy formulations by government. These researches will also help new entrepreneurs in their endeavor to serve the nation.

On the other hand Federation of Nepalese Chambers of Commerce and Industry (FNCCI) which is already playing a key role in promoting business and industry in the country can enrich its services by providing trade leads through their regular publication besides providing the same on-line. They are already publishing statistics, annual reports and directory of their members. As one of the hosting institutions of Trade Point Kathmandu, they can add value to these databases by conforming to the International Standards as per UNCTAD's/WTPF guidelines. Further, as partner organizations of Trade Point Kathmandu, KCM and FNCCI can complement each other's services.

**4.4.2.1.1. Scope for Value Addition**

The partner organizations of Trade Point Kathmandu have great scope for value addition in their services under the Trade Point Program. Besides management education, Kathmandu Collage of Management can play an important role in promotion of Exports from Nepal. KCM can use its faculty and infrastructure for creating awareness on the use of ICT's for international trade. This can be a very good value addition to their services. Entrepreneurs getting trained at KCM can also undertake global trade analysis and research on various commodities having potential for exports for policy formulations by government. These researches will also help new entrepreneurs in their endeavor to serve the nation.

On the other hand, Federation of Nepalese Chambers of Commerce and Industry (FNCCI) which is already playing a key role in promoting business and industry in the country can enrich its services by providing trade leads through their regular publication besides

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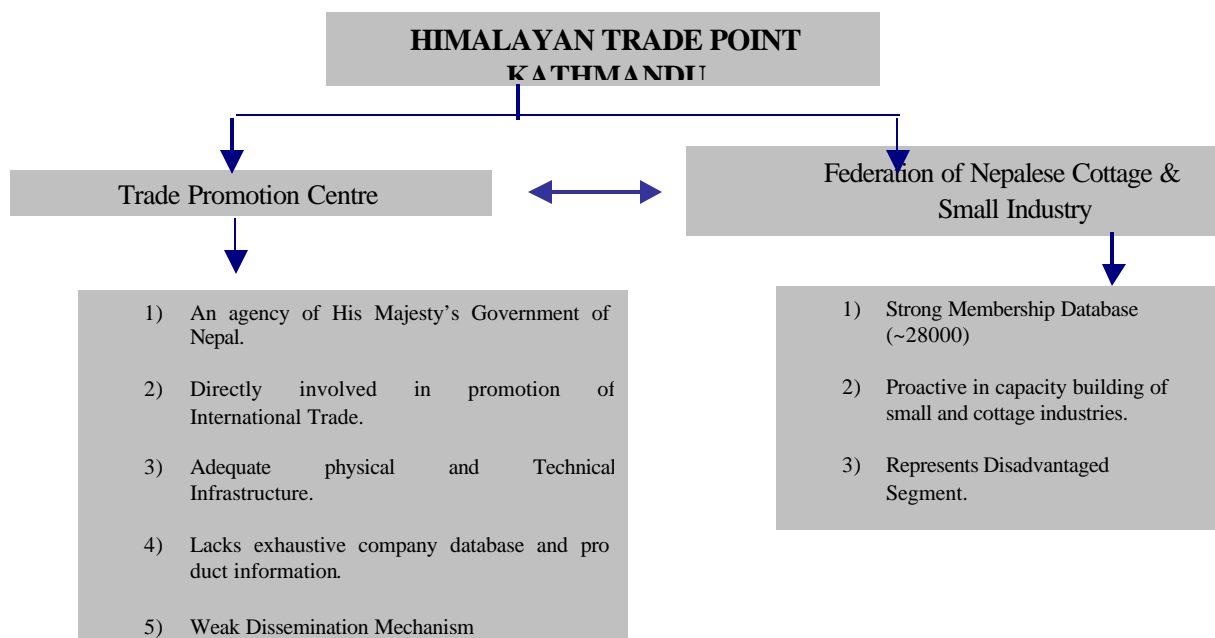
#### **4.4.2.2. Himalayan Trade Point, Kathmandu**

Trade Promotion Centre (TPC) and Federation of Nepalese Cottage and Small Scale Industries (FNCSI) are jointly hosting the Himalayan Trade Point, Kathmandu with a view to follow the synergetic approach for utilizing the strengths of TPC, which is an institution having an enormous amount of experience in international trade promotion activities and strong database. Trade Promotion Centre was established to promote, expand and diversify the export capacity as well as to explore export potentiality of the country. It is a non-profit making and focal trade promotion organization in the government sector for the promotion of foreign trade in general and exports trade in particular. The development and strengthening of the foreign trade of the country by means of export promotional program has been its main activities. The primal functions of TPC are to boost trade, assist the government in formulation and implementation of national trade policy and export promotion strategies, maintain liaison with trade related international organization, develop export awareness and entrepreneurship among the business communities.

As trade point is a one-stop source of trade related information that provides present and potential traders or entrepreneurs with data about business and market opportunities, potential clients and suppliers, trade regulations, policies and requirements, TPC has been identified as an ideal institution for hosting the Trade Point from where the exporters would gather trade-related activities within the Kingdom of Nepal and thereafter of the global trade.

On the other hand, FNCSI is a non-governmental and non-profit making organization established as a movement of the cottage and small entrepreneurs. FNCSI is an autonomous, single and leading organization of the cottage and small industries in Nepal. Established with an objective to serve the cottage and small entrepreneurs by uniting cottage and small entrepreneurs into an organizational framework and to protect the cottage and small industries through assisting the government in policy formulation. It has strong membership databases of 28000 general members in 68 districts out of 75 districts of Nepal. Moreover, it has formed a separate women entrepreneurs' sub-committee on central level as well as districts level in 42 districts of the country, 14 institutional members (Registered Commodity Association) and 8 autonomous district associations (Registered District Associations) all of which are allied under its' umbrella. FNCSI is promoting Cottage and Small entrepreneurs by providing wide range of services, business information, recommendations for promoting exports and investments along with promoting entrepreneurship. Therefore, TPC is considered to be an ideal partner for hosting trade point by virtue of which information and communication technologies (ICT's) and the government support mechanism can be clubbed with strong databases, an essential requirement for the trade point operation. The formers responsibility would primarily be to create databases as per the format and the latter's responsibility would be to develop products and services and dissemination mechanism so as to expose trading community to international business and reduce transaction cost. The synergy between the two institutions has been depicted in the following diagram.

**Diagram: 2**



The Himalayan Trade Point would also be able to introduce the trade point program to the emerging cottage, small and micro enterprises and providing training to them for effective utilization of the Trade Point Program. As per the agreed arrangement the Trade Point would be physically set up and managed by TPC whereas FNCSI would provide support in database creation and would have unrestricted and full access to the trade point facilities in both i.e. offline and online.

#### **4.4.2.2.1. Scope for Value Addition**

The partner organizations of Himalayan Trade Point, Kathmandu have great scope for value addition in their services under the Trade Point Program. TPC being the government-supported institution, it is directly involved in the promotion of international trade. The institution has adequate physical and technical infrastructure but lacks in exhaustive company database and product information and therefore unable to disseminate useful trade information effectively. On the other hand, FNCSI, which has around 28000 members (together of small, cottage and women entrepreneurs) rich company and product database can supplement the deficiencies of TPC. FNCSI is already playing a key role in developing small and cottage industries in the country, can enrich its services by providing exposure to these industries to the global market through trade leads through their regular publication much more effectively. As one of the partner hosting institutions of the Himalayan Trade Point, Kathmandu, they can add value to their databases by conforming to the International Standards as per UNCTAD/WTPF guidelines. Further, TPC and FNCSI can complement each other's services through various trade point services.

### **4.5. Institutionalization and Operationalization**

In the process of establishing trade points in Kathmandu, a consultancy project was awarded to the National Centre for Trade Information (NCTI), New Delhi for setting up and operationalisation of Trade Points in Kathmandu, Nepal by UNCTAD, Geneva. NCTI as a consultant prepared the business plan for both the Trade Points, keeping in view the essentials of the Trade Point Program, the requirements of the local trade and industry

particularly SMEs, the assessment of the capabilities and requirements of the hosting institutions and divided the business plan into the following segments: -

- Product and services
- Dissemination mechanism of proposed products and services
- Marketing and promotion
- Financial plan and revenue models
- Technical infrastructure and up-gradation
- Manpower planning and training
- Management and operationalization of Trade Points

## **4.6. Trade Points in India**

### **4.6.1. National Centre for Trade Information (NCTI)**

The Trade Point Program of the UNCTAD has certified National Centre for Trade Information (NCTI) as an Operational Trade Point in New Delhi. It is also recognized focal point of Trade Analysis and Information System (TRAINS) of UNCTAD. NCTI was set up in 1995 under the Ministry of Commerce & Industry with a view to creating an institutional mechanism for collection and dissemination of trade data and improving information services to the business community especially small and medium enterprises. The Government of India recognized Trade Point-India under the Trade Efficiency Program of United Nations Conference on Trade & Development (UNCTAD). Besides using technology for trade for collection, collation and dissemination of trade information, NCTI is involved in establishing linkages in India and abroad, facilitating training in the areas of trade, commerce and informatics besides continuously augmenting its information base and providing inputs to the Government in strategic trade promotion.

#### **4.6.1.1. Objectives**

The main objectives of NCTI include collecting, collating, storing, processing, analyzing and disseminating information on trade and commerce utilizing the tools and methods of information. As such it involved in:

- i. Creating databases and disseminating information from databases on trade and commerce at national and international level for export promotion and import facilitation
- ii. Collecting and disseminating information on countries of interest and to organise profiles of the countries and clients of interest
- iii. Establishing linkages with export promotional bodies/export support bodies/regulatory bodies for collection and dissemination of information on trade and commerce and related matters
- iv. Organising training in the field of trade and commerce informatics
- v. Maintaining and analysing the database on trade policies, trade regulations and trade agreements with various countries and its impact on country's International trade;
- vi. Building a modern public library complex for trade and commerce related books, periodicals and brochures and to publish papers, periodicals, reports, articles and other literature having a bearing on trade and industry
- vii. Initiate understanding, exchange of data and mutual cooperation with Foreign Trade Development Boards, Trade Councils, Chambers, Confederations, Trade Institutes, Trade Center for the benefit of Indian exporters and business entrepreneurs

- viii. Keep abreast of emerging information technologies and standardize formats for collection and dissemination of trade information in user-friendly formats.
- ix. Act as Trade Point as recognized by the Ministry of Commerce & Industry under the trade efficiency program of UNCTAD and take suitable measures for taking fuller advantage of the program for promoting country's trade

#### 4.6.1.2. Functional Areas

NCTI working as a Trade Point-India comprises of the following functional areas:

- i. Indian Statistics, Company Profiles, Product Profiles, Trade & Economic Policies, Export / Import Procedures, Regulations, Trade Fairs & Other Trade Promotional Activities
- ii. Uploading of Trade Leads on the Global Trade Point Network (GTPNet) as per UN/ EDIFACT standard.
- iii. Process ETOs received through GTPNet and disseminate after value addition and HS Code classification to the trade community.
- iv. Information on demand relating to Trade Leads received from Indian Missions abroad & Foreign Missions

#### 4.6.2. Memorandum of Understanding

Since inception in 1995, NCTI has entered into Memorandum of Understanding (MoU) with organizations in 14 countries. The objective of these MoU is to increase level of communication between the two countries for the benefit of the trade and industry on both sides by providing non-sensitive trade and commercial information on a reciprocal basis. Value added information could also be provided on a charged basis.

#### List of Memorandum of Understanding (MoUs)

	Name of the Organisation	Signing Date
1	Croatia Chamber of Commerce (CCE), Croatia	23.10.1996
2	Slovak Ministry of Economy (SME), Slovakia	13.12.1996
3	Mongolian Trade and Industry Promotion Organisation (MOTRA), Mongolia	Nov., 1996
4	Chamber of Economy of Slovenia (CES), Slovenia	04.02.1997
5	Centre for Foreign Economic Research (CFER), Czech Republic	06.02.1997
6	Romanian Foreign Trade Centre (RFTC), Republic of Romania	11.02.1997
7	Hungarian Investment and Trade Development Agency (ITDH), Republic of Hungary	11.11.1997
8	Egyptian International Trade Point (EITP), Ministry of Economy and Foreign Trade, Egypt	12.11.1997
9	Moscow Scientific and Research Centre (MSRC), State Committee for Communication and Informatisation of the Russian Federation (GOSCOMS VYAZ) (iii) Chamber of Commerce & Industry of the Russian Federation (CCIRF), Moscow (iv) Russian Information Network for Business Co-operation (RBCNet Corpn) , Moscow	04.02.1998
10	The Ceylon Chamber of Commerce (TCCC), Sri Lanka	12.05.1998
11	Cyprus Chamber of Commerce & Industry, Cyprus	10.09.1998
12	The Export Promotion Centre (IGEME) Under secretariat of Foreign Trade, Republic of Turkey	17.09.1998
13	The Bulgarian Export Promotion Centre, Ministry of Trade & Tourism, Bulgaria	26.10.1998
14	National Centre for Marketing & Price Study, Ministry of Foreign Affairs of the Republic of Belarus	22.02.2001

The growth in international trade need to be seen in relation to the contribution of trade points within the country and in other countries.

## **Chapter: V**

### **Problems and Prospects**

#### **5.1. Problems**

Nepal and India are two traditional trade partners. Bilateral trade between the two countries has been quite smooth. However, there persist ups and downs in trade flow and structure as the literatures often present. In the recent past quantitative restrictions, content of domestic materials etc. were seen major problems by the both countries in their own perspectives. With the signing of Trade Treaty in 1996, much of the problems seemed to have been resolved. Furthermore, the agreement on the control of unauthorized trade has contributed in controlling informal trade. As a consequence of the positive impact of the Trade Treaty and agreement the volume of exports from Nepal to India increased considerably. Specifically, it has been remarked that few articles were being imported in India in bulk quantity. The need for value addition norms was realized again to protect the domestic industries and producers in India. As such, the rules of origin procedures have been introduced in the renewed Treaty of Trade in 2002. There were six rounds of talks in reaching mutual consent. It denoted that there exist certain problems and issues, which could not be easily resolved. Nepal-India trade matters have not been isolated from the social, political, ideological and economic factors.

It is important to note that both the countries are heading towards to deal trade affairs under the WTO regime. In this direction, they have adopted trade liberalization approach followed by macro-economic reforms. Moreover, a series of reform processes are under way. Even though, there is an indication that trade activities are not going in a desired direction. Against this background, the following problems are identified which could be considered to review for further sound bilateral trade.

##### **5.1.1. Trade Imbalance**

It has been frequently recognized that Nepal possesses limited exportable articles when compared with India. On the other hand, Nepal being predominantly a land-locked and agrarian country, the country requires many articles and items in bulk for heading towards an industrial era. Various industrial raw materials, semi-finished as well as finished products are required in huge quantities for developmental works besides the requirements for fulfilling the peoples' increasing needs. India exports the manufactured goods and articles in higher proportion to total export. Due to the persistence of unequal balance between demand and supply of goods and articles, the question of balance of trade and balance of payments have been in central when considered Indo-Nepal trade relation. Trade balance in total with India in value has not been reduced significantly. The total has remained in between NRs. 18 billion to NRs 20 billion since 1996/97 to 2001/01. The share in total trade deficit reveals an average of 32.3 per cent. For a healthy trade relation it cannot be seen as a good sign. On the other hand, it creates in the management of foreign exchange currencies.

##### **5.1.2. Adequate Market**

The major problem for the unfavorable balance of trade on the part of Nepal can be noted as not finding proper market for the Nepalese manufactured goods in the Indian market. There could be many reasons in this respect. The prominent factors may include, in the business term, inability to compete in the Indian market on the grounds of quality, price, supply capability etc. In trade terms, it could be quantitative restriction, product disqualification etc. It is understandable that unless a sizable export of manufactured products do not find market, the proportionate to the trade balance cannot be reduced. Therefore, finding a proper segment

in the Indian market for the Nepalese manufactured goods can be seen as one of the major problem.

### **5.1.3. Frequent Revisions in Duties and Rules**

It takes relatively a fair amount of time to find a place in the market for the goods and articles. On the other hand, market structure development process depends upon many factors. Rules and regulations relating to exports and imports, and the import and export duties of the exporting and importing country play dominant role in the foreign trade. It has been frequently noted that the rules, procedures and duties are revised through the government budget on the one hand, and the provisions of the trade and transit treaties. Such types of changes and modifications create confusions among the business communities, which ultimately affects the trade in a great deal.

### **5.1.4. Administrative and Procedural Complications and Delays**

Trade is governed, to a large extent, by the trade regulations and related administrative procedures. More often the entry and exit from the market as well as the volume of trade rely on the transparent and simplicity of trade and administrative procedures. In a study recently carried out by the South Asia Network of Economic Institute (SANEI) to identify the extent of informal trade between Nepal, Bangladesh, Sri Lanka and India, it has been stated that submission of unnecessary documents, administrative hassles at custom offices, additional detention charges and untimely delivery of goods increase the cost of transaction in formal trade.<sup>1</sup> Such types of activities and procedures enormously affect the trade affairs. Alternatively, it discourages the businessmen in carrying out their businesses freely and fairly.

### **5.1.5. EXIM Facility**

Export trade facilitates in maintaining favorable trade balance. It is well understood. It is also a means to keep balance in the foreign exchange transactions. As compared to the importers, the exporters look for facilities from the respective country. At present situation, 0.5 per cent is charged as the export service charge in the export business in Nepal. Earlier, there were no service charges to be levied on the export business. Exemption in the income tax, foreign exchange facilities etc. are seen as the effective tools to encourage export business. Similarly, the rates of custom duties and other rates and taxes determine the trend of import business. Changing situations in the EXIM i.e. export and import facilities could have well determined in the trade structure in the both countries. However, it demands a detailed in-depth study.

### **5.1.6. Understanding and Good Faith**

Trade is an activity carried between two parties. It requires a certain degree of good faith and understanding. On the other hand, it demands mutual cooperation. In the case of Bilateral trade between Nepal and India depends much on the bilateral treaties on trade and transit. It is noticeable that a series of bilateral talks are held during the period of renewing the treaty, as may be recalled of a series of talks at various levels during the renewal of Trade Treaty in 2002. Further, various provisions govern the access to the market of particular products as per the specified provisions and quantities. Such types of situations create uncomfortable to the business communities. As a consequence, it affects in the entire trade activities.

### **5.1.7. Unauthorized Trade**

Nepal and India share an open border of more than 1600 km. Import and export trade is operated through 22 transit points as per the Treaty of Transit. Due to the open border it is frequently reported that goods and articles are imported and exported through unofficial



transit points too. Studies and researches in this regard indicate that though there are no precise estimates in connection with unauthorized trade but it constitutes a large volume. It is further noted that the growth has been facilitated by the complete freedom of currency movement between the two countries and availability of increasing number of transit outlets for Nepal through the Indian territory.<sup>2</sup> Both the sides are concerned about it. Undoubtedly, the unofficial trade affects the government revenue of both countries. It is furthermore recognized that riverside routes are also used in course of unauthorized trade. It has been, indeed, very difficult for the both sides even if they are adhered to the agreement on the cooperation to control unauthorized trade and committed as per the agreement.

## 5.2. Prospects

Nepal and India shares common features in many respect, particularly in the social and economic aspects. However, India has been more advanced than Nepal in some of the specific sectors, such as the commercial and industrial, information and communication, health and education sectors. India being a large country, on the basis of physical structure, population and resources, possesses comparative advantage. On the other hand, Nepal stands as a unique country of its own. Natural scenarios have made the country a beautiful. Studies reveal that the country possesses several mines and minerals along with huge water resources. Labor force is at the increasing rate. Comparatively, labor is cheap. The country is heading towards the industrialization regime. Preparation of basic infrastructure at the required level for this purpose is underway. Available resources and facilities can be used for the economic growth and development. But the country is still facing the problems of adequate capital to invest for seeking beneficial outcomes on the one hand, and the desired level of entrepreneurship and skills on the other hand. Against this background, India can cooperate in many respects to Nepal. Both the countries can share mutual benefits by doing so. Some of the key areas where Nepal and India can cooperate each other are identified below.

### 5.2.1. Hydroelectric Power

Nepal is well endowed with enormous hydropower resources. The country has a total hydropower potentiality of 83 thousand MW of which 50 per cent could be economically harnessed. Out of the potential only 373.6 MW has been exploited by the end of 2000/01, i.e. 0.5 percent of total capacity. The completion of Kaligandaki hydropower plant (144 MW), and Indrawati III hydropower plant (7.5 MW) at the private sector's ownership has added 151.5 MW. The total installed capacity has reached to 585.6 MW (0.67 percent of total capacity), including private and others, by the end of FY 2001/02. Out of total, 113.6 MW i.e. 19.4 percent of the total power production has been generated by the private sector.

**Table:  
Existing Power Generation By Type**

S/N	Types of power generation	Power (MW)	Percentage
1	Major Hydropower Projects	396.150	67.7
2	Small Hydropower Projects	18.968	3.2
3	Hydropower developed by IPPs	113.583	19.4
4	Diesel Power Plants	56.756	9.7
5	Solar Power Plants	0.100	0.0
	Total	585.557	100.0

Source: Nepal Electricity Authority

The trend of energy consumption pattern indicates that the commercial energy is replacing the traditional energy. The use of electricity is increasing to 1.4 percent in 2001/02 from the 0.7 percent in 1987/88. Out of the total population, 18 per cent has used electricity in 2000/01, which is expected to reach 20 per cent in 2001/02.<sup>3</sup> The Tenth Plan has a target to supply electricity to additional 10 per cent of the population.<sup>4</sup> It is enunciated that the power demand will grow to 0.61 million kilowatts by the year 2005 and to 1.64 million kilowatts by the year 2015. Evidently, the demand for electric power is growing rapidly within the country.

Hydropower generation can be seen as one of the most significant potential area to cooperate and also to invest in case of Nepal for not only meeting domestic needs but also generating the power for export. Hydropower Development Policy 2001 has encouraged the private sector to be involvement in the hydropower development. Furthermore, the policy has identified hydro electricity as export commodity. It has further encouraged operating on the basis of BOOT (Build-Operate-Own-Transfer) or BOT (Build-Operate-Transfer) model to attract local and foreign investors. In addition, it underlines the need for bilateral and multilateral assistance to export electricity besides electricity generation. In this respect a Power Trade Agreement was signed on 5 June 1997 between Nepal and India, which opened up the possibilities of private sector participation in power generation, and export of power between the two countries. The agreement has made some of the specific provision which include:

- i. Any party (government, semi-government or private) in any country may enter into power trade agreement.
- ii. Parties themselves determine the agreement parameters (including quantum and tariff)
- iii. Parties will be afforded all assistance to implement agreements in accordance with existing laws and regulations
- iv. Parties will be granted all incentives and concessions of their respective countries.

Keeping in view the growing internal demand, and also to exploit the tremendous potential for export of hydropower, the HMG/N has adopted several drastic measures to strengthen the institutional and legal framework, to attract direct and indirect foreign investment in Nepal in the power sector. The major relevant legislations concerning hydropower development are:

- i. Hydro Power Development Policy, 1992
- ii. Industrial Policy, 1992
- iii. Foreign Investment and One-Window Policy, 1992
- iv. National Environment Impact Assessment Guidelines, 1993
- v. Electricity Act, 1992
- vi. Electricity Regulation, 1993
- vii. Industrial Enterprises Act, 1992
- viii. Foreign Investment and Technology Transfer Act, 1992

The key features of the policies and enactments include:

- i. The period of the license for generation, transmission or distribution of electricity may be granted up to 50 years.
- ii. The license for power projects is to issue within 120 days of the application. Survey license is to be issued within 30 days. Survey license period can be for a period up to 5 years.

- iii. Power projects established by the private investors will not be nationalized.
- iv. Foreign exchange facilities at market rate for repatriation of investment, repayment of principal or interest on loans made in foreign currency and repatriation of profits or dividends earned thereof shall be made available.
- v. One per cent customs duty shall be levied on the import of construction equipment, machinery, tools and their spare parts not manufactured in Nepal.
- vi. The Ministry of Water Resources has established the Electricity Development Centre (EDC) as “one window” for issuance of survey and project licenses, provision of tax concessions and incentives, assistance in importing goods, assistance in obtaining land, assistance in obtaining necessary permits, approvals etc, and regulation and monitoring of projects.

Obviously, hydropower generation has been seen as one of the prominent areas for the potential export trade. A number of projects have been initiated with the private sector participation since the promulgation of the Electricity Act, 1992. Some of the medium size hydropower projects are already in advanced stage, which include Khimti-I (60 MW), Upper Bhoite Koshi (36 MW), Upper Marsyandi (43 MW), Chilime (20 MW), Indrawati (5MW).

Other major projects on which preliminary studies have been undertaken include Chisapani (10800 MW), Upper Arun (335 MW), Pancheshwor (6480 MW), Lower Arun (308 MW), and Upper Kamali (300 MW) hydroelectric projects. Another major project West Seti Hydel project (750 MW) is being taken up by a private sector. There are still a number of feasible projects in the hydroelectric power sector. Some of the feasible identified projects in this sector include; Arun III, Kali Gandaki II, Burhi Gandaki, Burhi Ganga, Likhu Khola, Dudh Koshi, Tamur Mewa, Kabeli and Rahughat.

The Tenth Plan (2002-2007) has envisaged developing the electricity as export goods and has set a target to generate 842 MW. The Plan states that the water resource development and management will be based on river basin approach. Electricity development will be based upon the comparative national benefits and will be developed under public, private or their joint investments. The Plan has encouraged private sector participation in both i.e. power development for domestic consumption and export.

### **5.2.2. Tourism Industry**

Tourism stands out most important sector in which Nepal has a comparative advantage and vast potential due to its rich cultural heritage, and unrivaled natural scenic beauty. Tourism has emerged as one of the most dynamic and promising sectors in the country providing employment opportunities, and income generation for small and large entrepreneurs.

This sector provides a room for economic cooperation in a number of areas like tourism infrastructure, hotels and resorts, games and amusement centers etc. Tourism products like holiday homes, mountain sports, adventure travel and amusement parks are some other potential areas. The construction and operation of hotels and resorts offer very promising prospects for profitable investment. Similarly, investment in popular tourist activities and recreations are perceived to be successful undertakings. Foreign direct investment has been encouraged in capital-intensive tourism industries such as hotels, resorts and in the areas, which transfer modern technology and skills. Being a neighbor country, India could also gain the benefits from the tourism development in Nepal. There is tremendous potential for co-operation between the two countries in the field of water resources. Treaty concerning the Integrated Development of the Mahakali River, including Sarada Barrage, Tanakpur Barrage

and Pancheshwar Project was signed in February 1996. The two sides have also agreed to implement the Pancheshwar Multi- purpose Project as an integrated project.

### **5.2.3. Education and Training**

The mode and model of trade is changing rapidly in recent years. Trade also demands a fair amount of education and training in the respective field and areas. India is extending cooperation in the education and training since long back. In accordance with the changing scenario, both the countries can promote mutual understanding and cooperation through a process of wide sharing of knowledge and professional talents in both academic pursuits and technical specializations.

### **5.2.4. Mineral Exploration and Exploitations**

Mineral resources, which can be commercially exploited, are identified as limestone, magnesite, dolomite, silica, clay, construction stone, iron ore, lead and zinc etc. Several major limestone deposits have been identified in Nepal and exploitation of some of these deposits for the manufacture of cement and agricultural and industrial lime is already underway. Major limestone deposits are found in Okhare, Udaypur and Surkhet. A large deposit of magnesite has been identified and exploited for the production of dead burnt magnesite. Talc deposits have been identified and one deposit is being exploited. Two large silica sand deposits are found in Nepal and these could be exploited for the production of sodium silicate. An important marble deposit is being exploited for the production of slabs. A commercial deposit of lead and zinc has been identified and initial steps have been taken to exploit it. Mineral exploration and exploitation in some of the areas identified offer promising prospects for cooperation and investment.

### **5.2.5. Information and Communication Technology**

Developments in the areas of information and communication technology (ICT) are growing rapidly. India has already moved in the advance stage in the ICT components, particularly in the software development. The demand for ICT is likely to increase in the future as well. This has been one of the prominent service trades having potential of high value addition. Nepal has well-educated and trained manpower in this sector. An Information Technology Park has also been established to facilitate and promote such activities. A couple of joint venture in this sector has already been emerged. In view of the comparative cheap labour and the growing demand for information technology, the private sector also obtains a good opportunity to invest in this service trade. This sector offers a wide scope to go hand in hand to serve common interests

## **5.3. Foreign Direct Investment in Nepal**

Nepal has opened the doors to foreign investment. The Foreign Investment and Technology Transfer Act 1992 lays down the law governing foreign investment and the applicable rules and regulations. The Act has undergone its first amendment in 1996 aiming at making the environment of industrial investment more congenial straightforward encouraging and transparent. The Industrial Policy of 1992 identifies foreign investment promotion as an important strategy in achieving the objectives of increasing industrial production to meet the basic needs of the people, create maximum employment opportunities and pave the way for the improvement in the balance of payments. Foreign investment is expected to supplement domestic private investment through foreign capital flows, transfer of technology, improvement in management skills and productivity and providing access to international markets. HMG/N is encouraging foreign direct investment in Nepal by providing attractive incentives and facilities within a liberal and open policy. Foreign investment is allowed in

Nepal in every sector of economic activities with the exception of certain business and industry ( 10,11,12) such as; cottage industries, personal service business, arms and ammunition industries, explosives, gunpowder, security printing, currencies and coinage etc.

Establishment of one-window system for giving single point service to the investors and opening up of different economic sector to private investment are other major initiatives taken by the government to encourage private investment. The forward-looking liberal trade policy has encouraged trade promotion in the country simplified administrative procedures, adoption of realistic exchange rates and instituting support mechanisms have led the growth of trade in recent years. Likewise, changes in the monetary policy providing easier entry in banking and other financial sector, and open-sky policy contributed the private sector to participate in aviation business. The government has recently opened up VSAT, Internet, pager, video conferencing and several other information and technology related business to the private sector. As a consequence, private sector is operating in all spheres of economic activities ranging from financial to aviation, to manufacturing, to trade, to tourism and other service sectors including information and technology development. There are a number of projects suitable of joint venture and foreign direct investment in Nepal. ( 14) As an indication the number of industries registered in the Office of Company Registrar (CRO) is continuously increasing. The number of industries registered in the CRO reached 16,859 in the fiscal year 2001-02. Among them, 18,067 were private limited companies and 792 public limited companies.

It is well recognized that foreign investment not only facilitates inflow of capital and modern technology but also infuses competitive corporate culture, technical skill and access to the international market, which are equally important factors for the industrial development. It is reported that at the beginning period of 2003, the number of projects registered involving foreign investment has reached 792 with the total project cost of NRs.81.30 billion. The total foreign investment in these projects amounts NRs. 22 billion. These foreign investment projects are engaged mainly in hydropower, mineral exploitation, chemicals, hotel and resort, transport and communication, housing and apartments, construction, agriculture and forestry, food and beverage, textile and garments and, specialized service sector industries. These investments have mainly come from India, Japan, U.S.A., China, South Korea, United Kingdom, Germany, France, Switzerland, Italy, Bangladesh, Australia, Austria, Canada, Hong Kong, Netherlands, New Zealand, Norway, Pakistan, Singapore, Taiwan, Thailand, Bermuda besides other countries. In 2000/01, 96 enterprises with the project cost amounting to NRs. 7901.2 million were given permission. Out of them 54 projects were related with production of goods, 19 with hotel and resort, 13 with service industries, 4 with electricity, drinking water, and cooking gas and 6 were related with transport and communication, housing and construction and agro forestry. The country wise involvement revealed that Indian investment turned out to be in 37, Chinese investment in 15, Japan in 8, United Kingdom, United States of America each in 7, South Korea in 5, Austria, Finland, Spain and Switzerland each in 2 and Brazil, British Virginia Island, Canada, Federal Republic of Germany, Hong Kong, Netherlands, New Zealand, Singapore and Sri Lanka each in one enterprise.<sup>5</sup>

### **5.3.1. Nepal-India Joint Venture**

The number of joint ventures is increasing in Nepal as a consequence of the policy change in the pattern of investment and ownership of the project. In this respect, it has been remarkably noted that one of the important incentives for foreign direct investment is free access to the large Indian market. By virtue of its proximity an the Trade Treaty with India, close

economic linkages between the two countries have manifested themselves, inter-alia, through Indian investment and joint ventures in Nepal. It is also noted that there are over 265 approved Indian joint ventures in Nepal of which over 100 are operational, with a cumulative total Indian investment lying in between 36 per cent to 40 per cent of the total foreign direct investment in Nepal. The total project cost of these 265 projects is around IRs. 28.5 billion, with fixed investment amounting to IRs. 21.9 billion and the foreign investment component amounting to IRs. 7427 billion. These joint ventures are associated with different sectors that include tourism, infrastructure, consumer durables and non-durables and export-oriented industries like garments and carpets. A number of Indian companies, including Dabur, Hindustan Lever, Colgate, etc. have established their manufacturing base in Nepal with the objective to export their finished products to India. It has also been stated that the Government of India has established a special “Nepal Window” to facilitate approvals for Indian investment in Nepal, as there is no outflow of foreign exchange. The limit for ‘fast track’ approval by the Reserve Bank of India for investments in Nepal has been raised in July 2000 to IRs. 3500 million. Furthermore, there is also a proposal to conclude a Bilateral Investment Promotion and Protection Agreement between both the countries.<sup>6</sup>

### 5.3.2. Industrial Support Services

The Economic Services Centre (ESEC) provides a package of non-banking services and helps interested parties to invest in industrial ventures in the country. The centre provides assistance in carrying out techno-economic feasibility studies. It also conducts management-training programs. The Nepal Industrial Development Corporation (NIDC) extends loans to industry; guarantees loans raised by industrial enterprises through commercial banks and also participate as an equity investor in technically feasible and economically sound projects. The Securities Exchange Centre (SEC) established under the Securities Exchange Act of 1984, promotes the economic welfare of the public through protection of the interests of investors and encourages wider participation of the public in the ownership of business enterprises. It provides a useful mechanism for the mobilization of domestic capital through the issues of shares in public companies and thereby creates opportunities for broad base of the ownership of companies. The Trade Promotion Centre (TPC) acts as a catalyst to create, develop and promote the export of the Nepalese products in international markets. It offers a range of services to exporters including product studies and market surveys, develops systems which will facilitate smooth flow of goods and services and facilitates the participation of Nepalese businessmen in international trade fairs to promote export development

### 5.3.3. Industrial Zones and Location

The Government has specified four zones for the purpose of granting permission or registration of new industries in an out of the municipalities including Kathmandu valley. It is expected that the zoning of industrial location will facilitate planned, systematic and healthy industrial development by reducing industrial pollution, and over utilization of infrastructure facilities. The specified four zones of industrial locations are as follows:

Zone 1:	Municipalities areas of Kathmandu valley
Zone 2:	Outside the municipality areas of Kathmandu valley
Zone 3:	Municipality areas of Biratnagar, Dharan, Pokhara, Birgunj, Janakpur, Siddhatha Nagar, Butwal and Nepalgunj.
Zone 4:	Municipality areas other than those mentioned in zone 3

Each zone has been clearly specified as to what type of industries is allowed to establish and operate. This policy has been adopted to ease and facilitate new investors so that they are encouraged to start their undertakings without any difficulties. There are currently 11 industrial districts in various regions of the country with a view to boost industrialization by setting up various physical infrastructures and facilities necessary for the establishment of industrial enterprises.

#### **5.3.4. Financial Support Services**

The financial institutions consist of Nepal Rastra Bank (the central bank), commercial banks and development banks. There are 403 branches of commercial banks spread throughout the kingdom. Moreover, there are 5 rural development banks, 54 finance companies, and 54 cooperative societies with the limited banking operation, and 37 non-cooperative societies providing micro-credit. Nepal Stock Exchange Ltd. (NEPSE) promotes the economic welfare of the public through protection of the interests of investors and encourages wider participation of the public in the ownership of business enterprises. Securities Board (SEBO), on the other hand concentrates its efforts to improve the legal and statutory frameworks, which are the bases for the healthy development of the capital market. The board is particularly concerned with promoting and protecting the interest of the investors, monitoring and supervising the activities of the stock exchange market, and development of capital market by making securities transactions fair, healthy, efficient and responsible. It also regulates public issues of securities including the mutual and trust funds. The NIDC Capital Market provides merchant banking services including issue management, fund management, mutual fund, venture capital fund, security exchange and other financial management. It also provides consultancy services for the development of capital market as well as new forms of corporate activities. The Federation of Nepalese Chambers of Commerce and Industry (FNCCI) and Nepal Chamber of commerce (NCC) are there to support industrial and commercial ventures in providing information and support services.

#### **5.4. Privatization of State-owned Enterprises (SOEs) in Nepal**

Privatization program in Nepal initiated in the 1990s. It forms a key part of efforts to enhance private sector participation in the economy. This program extends an opportunity to participate the private sector as well as the joint ventures in the national commercial domain of the country. Many large industrial, business and service-oriented enterprises are operated in the public sector. So far a total of 18 state-owned enterprises (SOEs) have been privatized. ( 13) Butwal Power Company is the latest enterprise being privatized. Few other enterprises are in the pipeline for privatization proceeds.

#### **5.5. Investment Environment in India**

The reform process has deregulated the economy and stimulated domestic and foreign investments, taking India firmly into the forefront of investment destinations. The Government, keen to promote investment in the country has radically simplified and rationalized policies, procedures and regulatory aspects, Foreign investment is welcome in almost all sectors, except those of strategic concern, for instance, defense and atomic energy).

A series of incentives has been announced to promote investment in India. These include import of capital goods at concessional customs duty (subject to fulfillment of certain export obligations), liberalization of external commercial borrowing norms, tax holiday, and concessional tax treatment for certain sector. In addition, several State Government offer incentives, such as subsidy on fixed capital, loans at concessional rates of interest, and attractive power rates, While several incentives are project specific, a number of firms have

been successful in negotiating favorable investment terms with the State Government concerned.

Since the initiation of the economic liberalization process in 1991, sectors such as automobiles, chemicals, food processing, oil & natural gas, petrochemicals, power, services, and telecommunications have attracted considerable investments. Today, in the changes investment climate, India offers exciting business opportunities in virtually every sector of the economy. Currently, the area of trade and business viable for the foreign direct investment (FDI) include; energy, non-conventional energy sources, oil and gas, coal, telecommunications, information technology, e-commerce, chemicals and biotechnology, infrastructure sector such as road, ports and civil aviation.<sup>7</sup>



## **Chapter: VI**

### **Major Policy Prescriptions**

- Setting up of a Research and Policy Group to improve Trade Composition and Trade Imbalance between India and Nepal.
- Strengthening Cooperation between the Chambers of Commerce and Industry Associations.
- Investments by Business Sector in Trade Points.
- Collaborative Research Study on Learning the Lessons from India on WTO Negotiations and Implementation of WTO Agreements.
- Increasing the scope of Joint Ventures.
- Setting up of R & D Facilities in Nepal with Indian Assistance specifically for Quality Improvement, Designing, Innovation and Product Development.
- Constitution of a Joint Task Force for Simplification of Administrative Procedures.

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