CHAPTER I

INTRODUCTION

1.1 General Background

Situated in the lap of the Himalayas, Nepal is located between the latitude $26\ ^{0}22'$ to $30\ ^{0}27'$ North and longitude $80\ ^{0}4'$ E to $88\ ^{0}12'$ East, and elevation ranges from 90 to 8848 meters. The average length measures 885 km east to west and the average breadth is 193 km from north to south. The country borders between the two most populous countries in the world, India in the East, South, and West, and China in the North. Nepal is a land locked country and home place of natural beauty with traces of artifacts. The Northern range (Himalayas) is covered with snow over the year where the highest peak of the world, the Mount Everest, stands. Gorgeous mountains, high peaks, hills, valleys and lakes capture the middle range (Hill). Southern range (Terai) is the gigantic plain of alluvial soil and consists of dense forest area, national parks, wildlife reserves and conservation areas. The temperature and rainfall differ from place to place. In the geographic diversity and varied climatic conditions, 25.2 million people of more than 60 caste/ethnic groups are accommodated in the country.

Geographically, the country is divided in three regions; Mountain, Hill and Terai accommodating 7, 49 and 44 % of the population respectively. Based on area of districts these regions constitute 35, 42 and 23% of the total land area. There are 5 development regions and 75 administrative districts. Districts are further divided into smaller units, called Village Development committee (VDC) and Municipality. Currently, there are 3914 VDCs and 58 Municipalities in the country. There are number of peaks, rivers and lakes in the country. Nepal is the member of the United Nations and has established diplomatic relation with 119 countries of the world. Major export commodities are ready-made garments, Carpets (Hand knitted woolen), hides and skins, vegetable ghee, Zinc Sheet, jute goods, textiles, toothpaste, pasmina, juce, and handicrafts.

The Economic Survey 2006/07 indicates that in FY 2005/06 Nepal had Per capita income of 271 US dollars with lower economic growth rate 3.3%.Agriculture remains Nepal's principal economic activity, employing over 76% of the population and providing 39% of GDP. Only about 25% of the total area is cultivable; another 33% is forest area; most of the rest is mountainous. Rice and wheat are the main food crops. The lowland Terai region produces an agricultural surplus, part of which supplies the food-deficient hill areas. Because of Nepal's dependence on agriculture, the annual monsoon rain, or lack of it, strongly influences economic growth .With a population of about 25 million, the average population growth is about 2.24 % per annum. About 31 % of the Nepalese people survive below the poverty line. Human development indicators remain unsatisfactory. According to human development index 2006 published by UN, Nepal ranked 136 out of 177 countries on the human development index in 2007.

Nepal's exports increased by 9.32% in FY 2006/07 compared to an increase of 7.78% in FY 2006/07. Imports grew by 7.08% in FY 2006/07 compared with 5.94% in FY 2006/07. The increase in exports is marginal due to the fact that there has been a significant drop in Nepal's main export, ready-made garments. The trade deficit for FY 2005/06 was $1.0 billion, which widened to $1.18 billion in FY 2006/07. Real growth experienced a one-time jump in 2000, rising to 6%, before slipping back to below 5%. In 2003, the GDP recorded a negative growth rate of 0.33%, largely because of the Maoist insurgency. GDP grew by 3.1% in 2005 and 3.26% in 2005, and again slipped to 2.04% in 2007, according to Nepal Rastra Bank (Nepal's Central Bank).

Nepal embarked on development strategy from the year 1956. Eight five-year plans and one three year plan have been implemented till now. Vision -20 has also been formulated which was diagnosed by mid term evaluation of five year plan named Medium Term Expenditure Framework (MTEF). Now Nepalese economy is passing through its current Tenth five year plan. As in ninth plan poverty alleviation remains as the sole objective is exactly same of the tenth five-year plan. So far, the achievements are slow. Nevertheless some achievements have been made in the development of infrastructure.

The world has entered into the 21st century. With globalization, the world has been transforming into a "global village" and is becoming more integrated. Globalization gives nations the opportunity to increase their productive efficiency and attain their comparative advantage. This reward has been attractive to many nations which can be seen by the ever-increasing membership in the World Trading Organization, and advances in the technology and communication. In this regard, on 23 April 2005, Nepal became the 147th member with this organization. In less development country (LDC) like Nepal, Foreign Trade plays vital role in attaining sustainable economic growth. It is essential to address on tenth plan's major targets. In the process of development, liberalization, globalization and open market mechanism, Nepal is dependent on foreign aid, foreign direct investment (FDI) and foreign trade.

Foreign trade can be considered as exchange of goods between different countries. From the age of barter economy, foreign trade took apace. "Adam Smith" considered as the father of modern economics gave emphasis on free international trade and advocated the essence of foreign trade. He says" if a country can supply us the commodity cheaper than we ourselves can make it better by it of them with some parts of prudence of our own industry employed in a way in which we have some advantage".

Since the time of immemorial until the Mall period, Nepal's foreign trade was limited to only Tibet and India. This was based on barter exchange trade system. Now Nepal has trade relation with nearly 100 countries bilaterally and multilaterally. Trade policy as well as various bilateral and multilateral agreements guides Nepalese foreign trade strategy. For developed and underdeveloped country, foreign trade is considered as the engine of growth. In the present emerging concept of globalization and open liberal market economy, international trade is the backbone of national economy. Increase in foreign trade can help to increase in the living standard of people of that country which in turn helps to increase the national income. No country can achieve rapid economic growth without mobilizing foreign trade. However, Nepal has to largely depend on foreign aid even today. Nepal's industrial future heavily depends upon the nature, structure and trends of foreign trade. This shows foreign trade plays a vital role for any country and is even more essential for developing countries like Nepal.

This study concentrates on analyzing Nepal's export and import trade structure, its trends, problems and prospects. The aggregate foreign trade will be decomposed into trade with overseas and India. The study will cover the time frame 1993 - 2007.

1.2 Statement of the Problems

Trends of Nepalese foreign trade are not so satisfactory. The trade gap is becoming larger and larger. When import trade exceeds the export trade then trade deficit occurs. Nepalese external trade has been facing trade deficit and the size of deficit continues to grow .To cope with this, Nepal has to come with innovative ideas in the field of foreign trade. In the era of 19^{th} century, Nepal's foreign trade was limited to India and Tibet, which was extended to overseas in the 20^{th} century.

After 1990, with restoration of the democracy, Nepal has been pursuing open market and liberalized economy and entering into regional trade agreement such as SAPTA and SAFTA as well as multilateral trade agreement such as WTO. Most of the policies are export oriented when import is treated as source of revenue. Nepal is very much dependent on foreign aid and foreign investments. In the development process of a less developing country like Nepal, foreign trade plays a vital role in order to bring in sustainable long-term economic growth. In Nepal, agriculture is the backbone of the economy due to the fact that more than

76% of economically active populations are still dependent on agriculture. Agriculture product is basically primary product and they have a constant demand in the market of Nepal's exporting partners. On the other hand, industrial products occupy a small proportion. Nepal's foreign trade sector has not been able to diversify trade. So the behaviour, trends and structure of foreign trade should be analyzed. Trade policies based on liberal economy has been in implementation from 1992. Democracy was restored in 1990. Trade and transit treaties with India have been taking place with regular modification during this period. So we have especially taken up 1993 - 2007 due to the availability of data, limited resources and limited time frame.

1.3 Significance of the Study

Since the emergence of mercantilist school, the study of foreign trade has been prominence. Therefore, various researches, investigations and diagnosis has been done by various scholars in the field of foreign trade. Therefore, we can say it is not new one. However this study is little descriptive and mainly concentrates the study between 1993-2007. To analyze export and import composition and to investigate their effects on economy is the major concern of this study. Trends of foreign trade occur under the consideration of the study. These are the main importance of the study. To update the foreign trade data is another significance of this study.

Scene of transformation from command economy into liberalized economy, to overview Nepalese foreign trade volumes deserve importance. To cope with trade deficit, Nepal should correct balance of payment situation by promoting exports. This study has also emphasized on opportunities and challenges of foreign trade of Nepal.

1.4 Objectives of the Study

This study mainly concentrates on the trade relationship between Nepal and India. The major objectives of the study are:

1. To study structure of foreign trade between Nepal and India.
2. To analyze trend of Nepal's foreign trade.
3. To estimate the determinants of exports and imports.
4. To analyze Nepalese foreign trade policies and reform measures.
5. To recommend necessary measures for future improvement.

1.5 Limitations of the Study

This study has been carried out with an aim to explore trade relation between Nepal and rest of the India . In view of the time frame and emerging issues on trade, this study has focused the trade activities after the restoration of democracy in 1990.Simple Statistics have been used and analyzed accordingly. This study is based on the secondary data. No attempt has been made to collect primary data and information by carrying out survey. In course of this study, several visits to the concerned institutions and offices were made, viz. TPC, NRB 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 been carried 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 trade related issues. However, attempts have been made to incorporate the outputs of formal and informal discussions.

1.6 Organization of the study

This study is divided into 5 different chapters. There are,

i. Introduction

This chapter contains the brief introduction of the subject matter i.e. background of the study, statement of problem, significance of study, objective and limitation of the study.

ii. Review of Literature

This chapter is an explanatory section of the thesis. It reviews the literatures regarding the price and brief sketch of previous research work.

iii. Research Methodology

This chapter acknowledges the research methodology used in this study. It consists of research design, sources of data, data processing procedure, tools and techniques of analysis used.

iv. Data Presentation and Analysis

This chapter is truly an analytical section of the thesis. In this fourth chapter, data presentation and analysis with the help of selected tools and techniques have been included.

v. Summary, Conclusion and Recommendations

This is the final part of the study. This chapter consist summary of the overall study, conclusions from the analysis of data and put forward recommendations to improve the existing situation.

CHAPTER II

REVIEW OF LITERATURE

The history of foreign trade coincides with the beginning of human civilization. The literature concern on foreign trade can be found from the era of mercantilist school, which has been evolving till now. However, literature based on Nepalese foreign trade is not so abundant. Very few are found in the form of Books, Articles, Research Papers, Unpublished Dissertation and some web sites.

The mercantilist advocated the principle of balance on trade, which requires the creation of surplus of export over import. Classical economist assumed "laissez faire" doctrine who believed in economic liberalism or in free trade. Father of economics Adam Smith pointed out the benefit of unrestricted trade. According to him free trade guarantees division of labour which inturn increases labour productivity ultimately resulting in increased aggregate wealth of country.

After 1930's great depression, a kind of intervention was felt in trade sector too. However, after the Second World War several factors influenced the development of world trade patterns. Then some of the countries were in favour of restrictive trade and some were for liberal trade policy. The world has already entered into globalization and economic liberalization since 1990's that uphold the free flow of goods and services from one country to another. Now most of the countries have entered into World Trade Organization. No country can remain alone in this context of global economy. This study reviews different natures of foreign trade patterns, which is completely based upon the period 1990-2004.

2.1 Conceptual Review

2.1.1 History of Nepalese Foreign Trade

Historically, Nepal had pro-actively encouraged entrepot trade between Tibet and India and promoted self-reliant economy and political independence. According to Kautilya's Arthashastra during the rule of Kirats, people of Nepal used to sell wool, herbs and handicrafts to several Indian markets. This trade expanded during Malla period as they specialized in activities such as arts, painting, metal casting, gem cutting, wood and bronze carving, sculpture etc and exported to Tibet and India. Trade and other relationships were suspended between 618-907 A.D. and resumed from Yuan dynasty (1271-1368). Arniko helped to expand cultural developments across the East and Southeast Asia. King of Kathmandu Pratap Malla and the King of Gorkha Ram Shah, tried to spread their influence in Tibet. In 1625-30, Ram Shah twice tried to expand influence in Tibet. His second effort was successful and reached to Kukurghat. He controlled Kerung for a short time.

Pratap Malla around 1645-50 crossed over Kuti and reached to Xigatze in the leadership of Bhim Malla. A treaty between Tibet and Nepal was signed with provision of Tibet and Nepal establishing joint authority in boarder trade in Kuti and Kerung and Nepal had given comparatively more authority than Tibet. Later king Ranajit Malla supplied mixed silver coin throughout Tibet to gain considerable benefit. This created the possibility of friction between the two countries. Again in 1775 Nepal and Tibet made a treaty to close eastern route way and used Kuti and Kerung including a number of other small routes. War between Tibet and Nepal had occurred due to various causes but were amicably settled. The land-locked geography isolated Nepal from the center of world flows of goods, people and ideas and increased costs for trade and commerce. Before the unification of several principalities into a modern state, Nepal was geographically isolated from the international social, political and economic developments.

Prithivi Narayan Shah (1743-75) established the first modern state and began its internal consolidation. “The Alaichi Kothi in Patna, India, which was established during Mukhtiyar Bhim Sen Thapa’s premiership, was geared towards promoting Nepal’s trading interests” (Pandey, 2005: Preface, cit by Dahal). The Anglo-Gurkha war of 1814-16 removed Nepalese control over some areas of the Terai, marked the start of British efforts to liberalize trade and especially allowed the East-India Company easier access to the north-south trade from Tibet (Blaikie, Cameron and Seddon, 1982:30cit by Dahal).

The Rana regime imposed after the Kot Massacre of 1846 by Jung Bahadur Rana ended elite rivalry for power and established hereditary succession of Prime Minister’s position.“Prime Minister Jung Bahadur Rana was instrumental in getting a bilateral agreement popularly known as the Treaty of Thapathali signed between Nepal and Tibet in 1856. The agreement, envisaged the stationing of a Nepalese Bhardar or Vakil (envoy) in Lhasa while Nepalese trade agencies were established at Kuti (Nyalam), Kyerong, Shigatse and Gyanze” (Pandey, 2005, Preface cit by Dahal: 134). In the latter part, a trade treaty was signed with British India on December 1923 that allowed unrestricted import of British goods to Nepal. The Rana regime had established Development Board to promote economic activities. Trans-Himalayan trade routes continued for the people of northern border while Terai was modernizing itself due to the spillover effects of economic development taking place in India. The movement for the establishment of multi-party democracy in Nepal in the latter part of 1940s marked a break with the feudal past. In 1950, Nepal joined the democratic community of nations. But in the 1950s, political rivalry among various interest groups of society and chronic political instability remained strong. “The emergence of middle class, independent of Connections with either foreign nationalities or the Rana regime had not occurred” (Karan and Ishii, 1996:2, cit by Dahal) in Nepal to serve as a backbone of democracy and economic development. During 1960-1990 Nepal adopted state-led industrialization and import substitution oriented economic policies. Nepal had a small entrepreneurs, poor transportation and education, communication was undeveloped and traditional social structure of caste dominated attitude towards rational social change.

The country’s diplomatic opening towards the outside world started very lately. One can find a connection between Nepal’s landlockedness and least developed status. The least developed status of Nepal is largely characterized by poverty, inequality, poor productivity of workforce and heavy dependence on few commodities in its structure of trade. Despite nearly sixty years of planned development, Nepal is predominantly an agricultural country and agriculture sustains the livelihoods of majority of population. Industrialization is at incipient stage and bulk of the income comes from the export of commodities. Effective co-operation of Nepal with neighboring countries and international community is, therefore, important to overcome its development problems and expand access to regional and international markets. The “Treaty of 1923 between Nepal and British- India led Nepal’s trade to be India-oriented” (NPC, 1983, 29 cit by Dahal).This policy continued until recently. Landlocked situation, Peace and Friendship and Trade and Commerce Treaties with India (1950), open door policy for Nepalese workers and vital trade links to the outside world through India strongly influence Nepal’s development policies and strategies. The new economic policy of finance and service has weakened the base of traditional manufacturing that was the base of its industrial development.

Before 1951, the foreign trade of Nepal was limited namely USA, France, and US. Before the Second World War Nepal used to import from the countries, such as England, Japan, Singapore and export her agricultural products like jute. After 1960 Nepalese overseas trade become possible, since the foreign currencies were needed for development. Nepal's export had to be promoted by diversifying her trade.

2.1.2 Trade Diversification Policies of Nepal

Nepal has been trading with India and Tibet, the autonomous region of China, since the time immemorial. Nepal started to diversify its trade since 1960's and adopted Import Substituting Industrialization (ISI) policy. During this period, trade was more or less free with India and controlled with the rest of the world. Imports particularly from overseas countries were restricted through tariff walls, quantitative restricted through tariff walls and quantitative restriction. The main objective of ISI policy was to protect domestic industries from imports facilitate import of raw materials and intermediate goods required for domestic production by local, export oriented industries, converse adequate level of convertible currency reserves, and discourage the deflection of goods to India.

In 1985, Nepal entered into an 18-month standby arrangement with International Monetary Fund (IMF). The government launched an economic stabilization program. The Nepali currency was devalued by 14.7 percent against US dollar in November 30, 1985. An import licence auction system replaced the system of administrative quotas for imports in July 1986. Initially auctioning for import licenses took place for 88 groups of commodities. Following the successful conclusion of the stand- by arrangements, structural Adjustment program (SAP) with the financial support of the IMF and Structural Adjustment Loan (SAL) with the World Bank, were implemented in 1987. Under the both programs, more commodities were put under the open general license (OGL). Following the introduction of the structural adjustment and stabilization programmes in mid 1980s, trade reforms aimed at shifting the development strategy from an inward looking import -substitution to export promotion. A number of trade facilitation measures and incentives were introduced, such as introduction of duty drawback and bonded warehouse systems, restructuring and reduction of import duties, abolition of quantitative restrictions and import licensing systems for almost all products and rendering full convertibility of current account transactions. In the process of economic liberalization, started with SAF, Enhanced Structural Adjustment Facility (ESAF) was initiated on October 1992 for three year. This programme was launched with the financial assistance of IMF to further reform of Nepalese economy. With effect from July 1993, except for few contraband items, merchandise imports were put under the Open General License (OGL) system. Elimination of quantitative restriction has been one of the major reforms. The structure of tariffs was rationalized by a general reduction of rates and a reduction in the number of rate Slabs. Quantities restrictions on imports were completely eliminated in number of steps implemented between February 1992 and July 1993. The number of rate slabs was reduced from more than 100 in the eighties to five in 1997-1998 with the majority of imports being subject to customs tariff rate ranging between 10 percent and 20 percent.Inorder to reduce to the poverty GON has developed a Poverty Reduction Strategy Paper(PRSP; which is also the country's tenth plan (2002-2007). This programme is supported by Poverty Reduction Growth Facility (PRGF) and Poverty Reduction Support Credit (PRSC) which are funded by IMF and World Bank.

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.

2.1.3 Exporters' Exchange Entitlement (EEE) Scheme

In 1961, Nepal Government introduced the EEE scheme (bonus voucher) to promote and diversify export from India to the overseas countries. Under this scheme, overseas exporters were provided a bonus in the form of convertible foreign exchange, which could be used to import wide range of semi-luxury and luxury goods from overseas countries except some restricted items. The main aim was to compensate possible loss that exporters may suffer while diverting export from India to overseas countries. This scheme was very lucrative for export to overseas due to the incentive provided under the scheme. Due to the provision of bonus system under the EEE scheme, there was significant increment in the export from India to overseas countries. EEE scheme was in operation for seventeen years. During this period, Nepalese trade grew substantially in terms of volume and directions. As a result, India's share in the total trade started to decline. Though the EEE scheme was successful in diversifying Nepal's foreign trade from India to overseas countries and augmenting foreign exchange albeit not successful in creating strong trade sector capable of supporting the economy on sustainable basis. In fact, whatever being exported to India got diverted to the overseas countries because of the attractive incentive provided by the government for overseas exporter. During this period, country could not expand the export base.

This scheme gave birth to a number of anomalies and distortions in the economy.

- Over invoicing of exports and under invoicing of imports.
- Influx of non-essential and luxury goods.
- Lack of product diversification.
- Distortion in the resource allocation.
- Gradual emergence of unscrupulous trade practices.
- Shortage of India currency
- Dependence on India was reduced.

Due to abuse of the facilities provided by the government to overseas export, exporters indulged in fraudulent trade practices in Nepal. The EEE scheme neither helped in expanding the export base nor contributed to reduce the dependency on India. Consequently, in 1977 Dual Exchange Rate System replaced the EEE scheme.

2.1.4 Dual Exchange Rate System (DER)

In March 1977, Nepal Government introduced Dual Exchange Rate System. The main purpose of DER system was to diversify trade to overseas countries, to control the import of luxurious goods and to improve deteriorating terms of trade. Two exchange rates were fixed, rate was specified as one for buying and one for selling of foreign currencies. One of the official rate and other as the depreciated rate. The basic (official) rate of exchange was fixed at US $ 1 = RS 12 and the depreciated second rate was fixed at US $ 1 = RS. 16. The basic (official) rate was applicable for importation of certain development goods and essential commodities with view to increase the production of exportable items.

The depreciated second rate was only applied for importation of luxurious commodities. All the earning from overseas exports was converted at the second rate to encourage the exports. Under this scheme, incentives were granted to encourage export to the overseas countries and to expand the production base. The purpose of the DER system was the same as EEE system only difference is that DER system was implemented to control importation of luxurious goods. DER system was successful in the delinking of import from export. Under DER system, unnecessary and unavoidable imports were discouraged. Due to attractive incentive provided by government to overseas exports under DER system, market diversification only changed the direction of export from India to overseas without expanding the production base. Despite several advantage of this scheme, the DER system also carried of the similar defects of the EEE scheme. This system also raised a number of anomalies and trade destructive practice such as :

- Over invoicing of exports and under invoicing of imports.
- Emergence of unscrupulous trade practices.
- Shortage of Indian currency.
- Dependency on India did not decrease.

Various measures adopted by the Nepal Government in different time period not contribute to positive impact in the trade sector and in the economy as a whole. Only providing lucrative incentive to the exporter was not sufficient to correct problems that existed in the trade sector. To alleviate the serious problem and to foster a sustainable development of the trade sector GON adopted new trade policy in 1992.

2.1.5 Trade Policy 1992

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. The new trade policy was introduced in 1992. In order to materialize following basic policies have been formulated:

- The role of public sector will be minimized and used as a catalyst to expand the role of private sector in trade.
- 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.
- Production of quality goods and services for internal consumption as well as for exports through effective and appropriate utilization of economic resources.
- 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.
- Public sector trading corporations will gradually be privatized taking into considerations the development and efficiency of the private sector.
- Institutional development and information network as well as on monitoring system and quality improvement for the promotion of foreign trade.

Export Policy

The export policy underlines the following fundamental provisions:

- Production and quality of exportable products to make them competitive in the international market

- Increase and diversify exports of goods and services with objective of increasing foreign exchange earnings.
- More emphasis on the export of profitable but processed and finished products. For the export promotion of these products, new markets will be identified.
- Increase service-oriented activities to promote foreign exchange earnings.
- Export of hydro-electricity on a profitable basis.
- Export promotion will be provided on an institutionalized basis

Export Strategy

The export strategy includes:

- 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
- Transparent, smooth and efficient administrative procedures
- Exports will be free from all charges except the service charge other than specified conditions
- 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.
- Gearing up towards export promotion activities, and trade missions will be opened and institutionalized on the basis of feasibility.
- Export promotion on the basis of an institutionalized basis.

Import Strategies

- Linking import with export
- Reducing transit cost

- Procedural simplification
- De-licensing of imports except for banned or under qualitative restriction items or in the auction system

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. In order to make policy consistent with overall economic reforms, the new trade policy has made trade more of less free. The hydropower sector was opened to private sector and in 1992 trade policy envisages export of hydroelectricity to neighboring countries. The foreign investment and technology transfer Act (1992) opens up foreign investment in all areas except for some industries such as defiance, cigarettes, bidis and alcohol. Foreign investment was also permitted up to 100 percent in large and medium scale industries. GON has made major policy commitments for economic liberalization with a view to adopting with global trends. Full convertibility, privatization- deregulation, de-licensing, export-import liberalization are some of the measure taken into this direction.

2.1.6 Indo- Nepal Treaty of Trade and Transit

Indo-Nepal Treaty of Trade

In order to expand trade between Nepal and India and to encourage collaboration in economic development, Treaty of Trade, 1991 was signed on 6 December 1991, which was followed and refined on December 3, 1996.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 provisions can be viewed as follows:

- 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.
- 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.

- Export of Nepalese consignments with the certificate of origin would not be delayed at the Indian customs border/check-post.
- Indian investment in Nepal in Indian Rupees for up to 25 crores would get fast track clearance.
- The governments of the two countries agreed to have open sky policy.
- The government of India opened the transit route to Bangladesh through Phulbari.
- Nepal Government amended its foreign investment policy, company law and transfer of technology act.
- Nepal decided to open Nepali Stock Exchange to overseas investors.
- India and Nepal signed the power trade agreement and allowed private investment in hydropower project.

Again, the treaty was revised in 2002 with the modification of some provisions. 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.
- Safeguard clause introduced with provision for the affected country to take appropriate remedial measures only if joint consultations on surge do not yield results.

Treaty of Transit

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. In addition, 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. 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.

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. The transit facilities provided by India to Nepal under the Treaty of Trade and Treaty of Transit include the following:

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

2.1.7 Impact of Trade and Transit Treaties on Indo- Nepal Trade

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. Following the table 5.1 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 approached to 73.8 percent in 2001/02 then again declines. The share of India in the total import of Nepal was 26.6 per cent in 1996/97, which gradually increased and approached 72.6 percent in 2001/02 then again declines. Treaty of Trade 1996 has indeed played a crucial role in the foreign trade structure of Nepal. 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.

2.1.8 Trade policy in the Tenth Plan

Objectives

(1) Import will be integrated to industrial development and export will be promoted to increase the overall contribution of the trade sector to the GDP.

(II) People will be enabled at all levels to utilize the gains of domestic and foreign trade through maximum participation of the private sector under the liberal, competitive and market - oriented economic environment.

In pursuance of the above objectives, the following policies and strategies will be under taken.

- Continuation of policy level change
- Making arrangements to obtain WTO membership
- Integration of import trade with industrial base.
- Emphasis on export promotion
- Emphasis on promotional progress and institutional capacity enhancement

2.2 Review of Unpublished Thesis

There are many dissertations written by various researchers in past years. Among them some dissertation are reviewed here for analysis of literature.

Supriya Shah (1999) "*The Study of Nepal's Foreign Trade: 1965-97*" M. B.S. unpublished dissertation seems quite different study in the field of foreign trade. She took three objectives that are to study Nepal's foreign trade, to analyze exports and to examine imports. There are five chapters in her dissertation. The information of foreign trade is taken by SITC. She used mathematical tools, foreign trade multiplier, linear equation and regression analysis.

She concluded that Nepal's foreign trade is non-uniform with trade in GDP. Her export multiplier and import multiplier finding are 10.72 and 2.19 respectively also marginal propensity to import and saving on average are 0.3143 and 0.1413 respectively. She estimated annual exponential growth rate of the specified macroeconomic variables that are vary from 10 percent to 21 percent. Growth rate of GDP at constant price (1974/75 = 100) is only 3 %.

She raised recommendation that the detection of non-stationary time series data, and accordingly choosing the functional form, and specification of the variables to analyze the structural changes caused by various economic measures can be done with the help of dummy variable analysis.

She concludes that the estimates should be used with precaution because of quality of data and presence of auto correlation.

Ganesh Prasad Subedi (2003) in his unpublished M.A. dissertation "*Nepal's Foreign Trade: The Changing Scenario of Size, Composition and Direction*" intends to look over the composition of overseas trade. His study is limited to 10 years time span of 1991-2001. He simply used secondary source of data and presented the data on tables and compare the data from different angle.

After presenting the plan-wise scenario of foreign trade, he found that performance in each and every plan has remained quite low and less effective in speeding up the total volume of trade. The percentage share of export decreased from fourth plan i.e 36.04% to sixth plan 22.48% and then slightly increased in seventh plan with 39.49% share on export. He also tries to show the composition of Nepalese import and export by standard international trade classification (SITC) and direction of trade.

He reviewed the implementation of different trade policies implemented by GON and point out the significance of reforms measures taken by the government. He touches in brief on different policies of the Government such as Structural Adjustment Programme, Trade policy 1992, Industrial Enterprises Act 1992, Exporters' Exchange Entitlement Scheme (EEE), Dual Exchange Rate System, Exchange Convertibility System and so on. However, according to his findings, dual exchange system could not serve the basic objective of the country because exporters did not pay any attention to the question of creating basic and favorable infrastructure for the expansion of the country's export trade.

He recommended making appropriate export plan, expanding the domestic markets, initiatives to private sectors, diversification of trade, improvement of trade and transit treaties and searching the alternative routes of trade and progressive tax system should be of immediate concern for nation's prosperity.

2.3 Review of Books, Journals and Reports

P.N. Roy (1977) in his article "*A Note on Nepal's foreign Trade*" pointed out that the increasing trade deficit is a serious concern for Nepal. Hence, it appears that nibbling with exchange rate alone to take care of the payment position is hardly adequate since by all indications trade deficit is tending to become woven inextricably into the very fabric of the Nepalese economy. Nepal has abolished the incentive bonus scheme and introduced a dual exchange rate system for all convertible foreign currencies. He argues that the incentive bonus scheme allowed for many exchange rates depending upon the commodity exported overseas. The writer argues about the often alleged over invoicing of export that is associated with the incentive bonus scheme.

On the other hand, the dual exchange rate system is expected to provide some relief to export. They will be paid for the amounts they are entitled to receive in convertible foreign currencies in accordance with the second rate of exchange of the U.S. dollar, fixed at 16 Nepalese rupees to a dollar. The second rate of exchange will be applicable to all imports except “development goods and materials”. The basic exchange of all convertible foreign currencies will be based on the official exchange rate of U.S. dollar of twelve Nepalese rupees to a dollar. It will be valid for overseas payments, for invisible exports, services, capital transfers and for foreign exchange to provide for services and travel. It will also be valid for development goods like petroleum, fertilizer, certain raw material and machinery.

Lastly, he suggested that the dual exchange rate system must be under careful vigilance since there is a dangerous possibility that Indian currency may be purchased and taken to India for buying dollar, which in turn can be transferred elsewhere or registered in Nepal as export earnings, which results in loss for Nepalese economy. He also says that it is also likely that the long predominance of illegal trade along the border will be successfully countered resulting in trade gain for both the countries.

P.P Timilsena (1981) in his study " *Nepal's Trade Scenario: It's lapse and success for economic Development*" tries to diagnose Nepalese trade's composition, development, direction, balance of payment (BOP) and trade policies with the help of secondary data. His study starts with the trade before unification of Nepal till the present period based on treaties made with different countries. The tariff policy adopted in different period shows that the policy makers are conscious about the use of tariff instruments to promote export trade, to provide essential goods, to protect domestic industries. He pointed out that non-tariff barrier, as quota and licensing too are not providing worthy. The author highlights on some challenges like import, payments, growing development expenditure ,development of foreign raw material based industries , open boarder etc. He has given very much attention on monitoring side of trade policies. He emphasizes that comprehensive planning of trade is essential factor for Nepalese economy.

N.P. Baskota (1981) in his book," *Indo-Nepal Trade and Economic Relation* "highlights on the treaties of Nepal with India and the historical relations, which includes transit trade route of Kathmandu in Trans-Himalayan Trade, Indo-Nepalese Trade in pre-British period.

The author says that the treaty of 1923 put a death-knell to the Nepalese trade. Whereas the treaty of 1950s debarred Nepal in activing independent economic policy which was viewed as a symbol of India's economic domination over Nepal. The treaty of 1960 also stood against Nepal's favour. He also included detailed description on the treaty of trade and transit of 1971.

He describes about the composition and the direction of Nepalese foreign trade with India in terms of commoditywise, itemwise, SITC, and sub-aggregation of SITC (primary and manufactured). He studied that in between 1956/57 to 1969/79 import exceeds export leading to adverse trade balance. He also included the construction of concentration ratio of export and import. The (recent) trend in Indo-Nepal trade with special reference to pricing and settlement, and makes explicit examination over the Indo-Nepal transaction and measures gross and net barter terms of trade.

Lastly, the author pointed out the bottlenecks and suggestions for the relevant problems. It deals with the problems associated with transit, diversification, trade deficit, trade surpluses, rigidity in composition of trade items, excise refunds, production bottlenecks, tariff preferences, lack of finance etc

P.R. Reejal (1982) in his paper "*Nepal's Foreign Trade and Economic Development 1956/57 to 1979/80*" compares the share of export, import and total trade with gross domestic product in the period between 1964 - 1978 where as the share of export import and total trade has decreased. In the analysis of import function, he tries to derive the relationship between imports and GDP at current and market price. He found that because of low level of income and not improving the standard of living, imports are in increasing trends.

Finally, the principle of export and import items and computation of effective rate of protection of manufacturing is established. He has used two variables regression analysis by the least square method.

S.R. Poudyal (1988) in his book "*Foreign Trade, Aid and Development in Nepal*" has overviewed the Nepalese economy as well as development plans upto 1982/83. He tries to analyze the behaviour and determinant of macro- economic variables such as investment, saving, export and import. Chapter four deals with the structure of foreign trade, direction of foreign trade, determinants of trade patterns, commodity and geographic concentration of exports and imports, instability in export earnings and terms of trade. Chapter five is devoted to analyse the achievements and shortcomings of export diversification schemes introduced in the 60's and 70's for the purpose of diversifying Nepal's trade in terms of goods and geographical patterns. This chapter also tries to deal with export promotion measures. Chapter six is about the determinants of exports destination. The import functions are discussed on chapter seven. In this chapter he has reviewed Khan and Ross, Narasimham, Chenery and Strout, Maizels and Agrawala, Murty and Sastry, Dutta, Marwah, Pani, Patel, Leamer and Stern and accordingly estimated linear, log linear, without lags and with lags, cyclical and secular income elasticity of demand for imports, the partial adjustment scheme, the multiple lag scheme (5 lags) both at constant and current prices.

His analysis deals with aggregation and has used proxy variable for unit import and export price of India. His analysis of Nepal's export to India and overseas shows that domestic supply factor is the most crucial variable in determining export of these countries, while export to India appears to be highly elastic with respect to Nepal's agricultural GDP and relative price between the Indian and Nepal's market. Empirically he shows that income and foreign aid are the major determinants of imports. He also examined that export diversification policies are not so well designed and implementation side is poor. He suggested that government should take care the programmed oriented import substitution strategy and strategy of diversification of export.

Shyam K. Shrestha (1994) A research report on "*Direction of Nepal's Foreign Trade*" concentrates on the patterns of Nepalese trade, balance of payment situation. This study emphasizes Nepal's terms of trade and gain from trade. He tries to identify the major challenges faced by the country and suggest the most viable solutions to the problems of Nepal's foreign trade.

He overviewed the trends of Nepal's foreign trade in between 1982- 1992 ie in ten years of time span he found that export value increased by 12 fold , while during the same time period import value increased by 5 fold. Also trade deficit accounted to 19011.9 million rupees which is about the 1.4 times the export value at that time period.

He tries to separate study of geographical pattern of trade viewing the trade with India, Tibet, overseas and SAARC member countries and found that the trade deficit is becoming more widened with India due to the policy and behaviour of GoN is India - oriented. Similarly, imports from overseas may continue to increase by big percentage in the years to come. He found that Tibet has successfully enjoyed the benefits from the trade arrangements while Nepal remained the sufferer.

He gives very much attention on balance of payment situation and Nepal's terms of trade and gains from trade. He calculated the terms of trade in period between 1982 - 1992 assuming the base year 1973/74 =100 and observed that the movement of our export has taken a right direction since 1990/91 only. However, the term of trade was below 100 during the whole period. It clearly shows that

Nepal is still far away from the gains of international trade, though the terms of trade shows a satisfactory trend in the economy.

He summarizes that GoN must immediately take certain concrete steps to expand its export trade and improve the country's foreign trade situation in the years to come. He focused that the major bottlenecks of our country is geography and other is continuous trade deficit as well as the government policy and policy makers too.

He raised some future potential that government should focus on appropriate protection of domestic industries, empowerment and environment friendly policies for private sector, developing joint venture business, implementation of clear cut policies and so on. Similarly, he says that Nepal should learn a lesson to march forward for self -sufficiency at a faster pace.

M.P. Singh and V.S. Singh (1999) in their Article "*Nepal's Foreign Trade: the changing scenario of commodity composition and Direction*" starts with the role of foreign trade in the economic development of a developing country like Nepal, which provides indispensable raw materials for development, technical know how, foreign capital and competition conductive to economic development.

They analyzes that Nepal is a primary product producing country; her terms of trade remain unfavorable. Under these circumstances, production, productivity and efficiency are to be generated which is possible by foreign trade in the short run. They further suggest that under economic reforms at global level i.e. liberalization and globalization, Nepalese economy is to be made compatible with these changes, hence cost of production is to be reduced, efficiency and competitiveness are to be generated.

They focused on important issue facing Nepalese foreign trade, which is the pattern of commodity composition, classified as import commodity composition and export composition where import commodity composition of Nepal is more diversified than the export commodity composition.

Another area of their study is the direction of Nepalese foreign trade, international relations and facilities for trade of Nepal. They examined Nepalese trade direction in terms of destinationwise exports and imports. Finally, they suggested that to improve BOP, Nepal should increase export and decrease import. Export can be encouraged by improving the quality of products, reducing cost of production, generating export surpluses, encouraging research and development, while to reduce import substitutes should be encouraged by adopting improved indigenous technology curbing non-essential and Luxury imports, controlling growth of population and diversifying its exports and imports markets.

Sharad Sharma (1999) in his article, "*Nepal's Foreign trade: Trends and Issue*" attempts to assess the current trends and major issues facing the Nepalese foreign trade sector. The discussion on trade policy reforms with reference to export and trade with South Asian Association for Regional cooperation (SAARC) countries and also attempts to discuss issues relating to Nepal's entrance to the world trade organization (WTO).

The author found that the trade deficit of Nepal has been increasing over the period of 1991/92 – 1996/97 though export has increased at the average rate 11 percent per annum and import has increased at the average rate of 24.7 percent during the period. The ratio of trade deficit to GDP ratio increased from 12.6 percent in 1991/92 to 27.3 percent in 1996/97. He also found export – GDP ratio during the period was 9 percent in average while the import GDP average ratio was more than 29 percent, which is not a favorable indication for the Nepalese economy.

The author also found that Nepal has been actively participating in many multilateral economic cooperation programs. The government holds the view that these multilateral cooperation arrangements cannot be fully exploited without joining the WTO. Nepal intends to integrate into the multilateral trading system to increase the supply of tradable items, both goods and services, to attract foreign investment and to gain better market. Nepal has recently submitted a memorandum on foreign trade regime to the WTO office. However, one vital missing factor in the domestic front for Nepal is to benefit maximally from the WTO is a consistent set of strategies and policy instruments to boost-up quality production in sufficient amount for low bulk high value selective commodities.

One of the major challenges for Nepal to achieve higher economic growth is systematically unfavorable foreign trade balance characterized by low level of export trade and increasing volume of imports of both consumption goods and investment items.

Lastly, he highlights on some recommendations, which are: Adjustments in exchange rate regime, to curtail domestic consumption in order to reduce import from India, the study focuses to expand export through supply management of selective items. Moreover, the study also focused on the necessity of reasonable tariff protection.

M.B. Garanja (2000) in his article "*A Note on Prospect of Balance of Trade of Nepal*" attempts to project the future trend in foreign trade of Nepal. For this purpose, export, import and trade balance have been computed by applying statistical tools and time series equation. He says that it is not possible to measure accurately the future behaviour of foreign trade of Nepal. He assumed that no radical changes would take place in the area of foreign trade. Further, at the national level, the foreign trade policies would also not be changed drastically. The bahaviour of foreign market would also not take any rapid change. In brief, it is hoped that the situations of export and import trade would be changed in the earlier pattern.

He pointed that the trade balance of Nepal has remained unfavourable during study period 1974-1996. He also estimates the future value of exports and imports. He pointed out that main cause of trade deficit is higher imports against exports, narrow production and exportable base, infant industrial shape, low level of quality of agro and forest based exportable goods, high transit and transportation cost, land-locked situation, mountainous and rugged geographical structure of the country, lack of sound and effective strategic policies for foreign trade.

Bijendra Man Shakya (2001) has cited four major bottlenecks to export viz:

a. Supply side constraints: supply sources are characterized by the narrow export base, non-competitive technology, high production-cost and inadequate quality and packing for export.

b. lack of trade support services: i.e. inadequate logistic and transport services, international price and market information, export marketing services and export financing support.

c. demand constraints: quality, non competitive prices, design and unreliable delivery, not easy acceptance of Nepalese products

d. policies constraints : Excessive administrative procedures, imposition of tariffs and ineffective incentives are some of the government policy flaws that cause difficulty to exporters.

Gyanu Raja Shrestha (2003) in his paper "*Nepal- India Bilateral Trade Relations Problems and Prospects*" is entirely concerned about analyzing the Indo- Nepal trade treaty of 1996 and try to find out the scope and areas of improvements in indo Nepal trade relation. He observed that the major problems of Indo Nepal trade are trade deficit, which recorded 18 billion to 20 billion rupees from 1996-2001, Inadequate market, frequent revision of duties and rules, administrative and procedural complication and delays, Export and Import (EXIM) facility, understanding and good faith and unauthorized trade.

He observed that some of the prospects too which is completely based upon the cooperation between India and Nepal. He pointed out some of the key areas are potentialities of hydroelectric power, tourism industry, education and training, mineral exploration and exploitations, information and communication technology etc. Finally, he gives some policy prescription that strengthening cooperation between the chamber of commerce and industry, investments by business sector in trade points, increasing the scope of joint ventures ect task should be done.

Sivendra Thapa (2005) in an article entitled "*Make Trade Fair*" states that today; two opposing schools of thought exist in the debate about world trade. The 'Globaphiles' insist that globalization is working for the poor and their view inherently suggests that opening up markets is a panacea for the reduction and eventual elimination of world poverty. On the flip side, 'Globaphobes' argue that trade is bad for the poor. One perspective represents chronic pessimism whiles the other, fundamentalist optimism. They do not represent a balanced view of trade. Such imbalanced views do not provide solutions. Rather, they become a means to inflame further disagreements and division within the global community. A balanced, middle way approach to the issues of trade and its economic implications is a more pragmatic step towards a representative outcome. In the Nepalese context, we cannot afford to align our trade policies to such extreme diatribe. In a globalize world, trade is inevitable and irreversible but responsible communities and institutions must oversee that the trade is also fair.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Introduction

Research Methodology can be understood as a science of studying how research has been done. This chapter looks into the research design, nature and sources of data, data collection procedure and tools & technique of analysis. For the purpose of achieving the objectives of the study, the applied methodologies will be used. The research methodology to be used in the present study is briefly mentioned below.

3.2 Research Design

A research design is the arrangement of conditions for collection and analysis of data that aims to combine relevance to the research purpose with economy in procedure. According to wolf and pant, "Research design is the plan, structure and strategy of investigations conceived so as to obtain answer to research questions and to control variations."

3.3 Source of Data and Data Collection Procedure

The following are the sources of statistical data under the study.

National sources are:

1. Nepal Rastra Bank (NRB) Annual Reports, Quarterly Bulletins
2. Nepal overseas trade statistics: Trade Promotion Center.
3. The Government Nepal (GON), Ministry of Finance (MOF); Economic Surveys
4. National Planning Commission (NPC) secretariat; Central Bureau of Statistics.

5. Statistical Pocket Book, Nepal; Central Bureau of Statistics.
6. Statistical Year Book of Nepal; Central Bureau of Statistics.
7. Department of Customs; Foreign Trade Statistics
8. Related internet web-sites

International sources are:

1. International Monetary Fund (IMF): International Financial Statistical Year Book
2. United National Commission for Trade and Development (UNCTAD)

The Quarterly Bulletin published by NRB and data published by trade promotion center are considered as the major sources under the study. So far as possible, efforts have also been made contact with expertise, policy makers to collect their views, comments and suggestions.

3.4 Data Analysis Tools and Variables

3.4.1 Variables

(i) Price index: in order to calculate price index the following stastical formula has been used.

$$I = \frac{p_i}{p_o} \times 100$$

Where, I = Price Index

P_i = Export Price or Import price of the current year.

P_o = Export Price of Import price of the base year

(ii) Net barter terms of trade (ToT):

In order to calculate net barter terms of trade the following formula has been used:

$$N = \frac{p_x}{p_m} \times 100$$

N = Net barter terms of trade

P_x = price index of exports

P_m = price index of imports

Analysis of terms of trade:

If N < 100, export performance is weak compared to import

If N > 100, export performance is better than import

If N = 100, both exports and imports are taking the same direction

(iii) Real Exchange Rate: Real Exchange Rate is the relative price variable in a single supply and demand analysis in which the quantity of real dollar demanded or supplied is expressed as a function of it's real price. In other words, RER reflects the price of a real dollor (representative foreign currency) measured in Nepalese Rupees.

$$RER \qquad \text{X} \quad \frac{E_n}{p_d} \mid \quad p_w$$

Where,

P_w = deflator of the US dollor

P_d = domestic price deflator

E_n = nominal exchange rate

(iv) GDP: Refers to the market price of the total flow of goods and services produced by Nepal over a specified time period, nominally a year. It is obtained by valuing outputs of goods and services at constant prices. It should be noted that all intermediate goods are excluded, and only goods used for final consumption or investment are included.

3.4.2 Data Analysis Tools

(i) Simple Linear Regression Model

The simple linear regression analysis includes the regression equation with only one independent variable. If two variables say x and y are linearly related and y is a linear function of x, then the regression of y on x be formulated as:

$Y = a_o + a_1X$

Y= dependent variable

X = independent variable

a_o, a_1 = regression parameter

(ii) Multiple Regression Analysis

The regression equation with more than one independent variable is called multiple regressions. Therefore general form of multiple regression equation is

$Y = f(x_1, x_2, \ldots..x_n)$

Or $Y= a_o + a_1x_1 + a_2x_2+ a_3x_3 + \ldots\ldots a_nx_n$.

It should be noted that the relation between the dependent variable and independent variables is a linear one.

(iii) Coefficient of Determination R^2

It shows the percentage of the total variation of the regressed variable that can be explained by the regressor variable.

$$R^2 \; \mathrm{X} \frac{Explained \;\; Variation}{Total \;\; Variation}$$

$o < R^2 < 1$

The higher the value of R^2 the better the fit.

(iv) Adjusted Coefficient of Multiple Determination $(\overline{R^2})$

The use of additional explanatory variables in the function leads to the rise in the value of coefficient. To take account of this $(\overline{R^2})$ the adjusted coefficient of multiple determinations is used. The expression will be given as:

$$(\overline{R^2}) = 1 - \frac{ESS \;/\{n \,\mathrm{Z}\, (k \,\mathrm{Z}\, 1)\}}{(TSS \;/(n \,\mathrm{Z}\, 1)}$$

$$\mathrm{X} 1 - \frac{Error \; Sum \; Square}{Total \; Sum \; Square}$$

$$= 1 - (1 - R^2) \frac{(n \,\mathrm{Z}\, 1)}{(n \,\mathrm{Z}\, k \,\mathrm{Z}\, 1)}$$

Here, $(\overline{R^2})$ means the adjusted R^2.

Where, n = number of observations

K = the number of independent variables

(v) T - Test

The t- ratio is the significant test of the regression coefficients. It indicates whether, the hypothesis should be accepted or rejected. The t-test is used when the number of parameters is less than 30 (n<30). It is computed as

$$t = \frac{Estimated\ \ Regression\ \ Coefficient}{Respective\ \ Standard\ \ Error}$$

$$= \frac{a_i}{\sqrt{var\ a_i}}$$

If t lies in the critical region (i.e. t > t ~) for the chosen level of significance for (n - k - 1) degree of freedom, we accept the alternative hypothesis. This concludes b_i is stastically significant.

(vi) F- Test

To test the significance of the regression equation, F- test is done. It is calculated by

$$F = \frac{Variance\ Explained\ by\ Regression}{Unexplained\ Variance}$$

If F is greater than the tabulated value of F at ~ level of significance with K, (n-k-1) degree of freedom, we reject the null hypothesis and it is concluded that the regression equation is significant at ~ level of significance.

(vii) Durbin waston (D-W) statics

The Durbin waston statics measures the serial correlation in the residuals. The D-W statics is computed as:

$$DW = \frac{\sum_{i=1}^{T} (e_i - e_{i-1})^2}{\sum_{i=1}^{T} (e_i)^2}$$

In the time series regression the D-W static is highly relevant .It measures the association between adjacent residuals. In regression, there is no particular reason to suspect that one residual will be correlated with its successor in alphabetical order. So it is not a problem. However, with time series regression, positive correlation of residuals, which are adjacent in time, is frequently a problem. Serial correlation of residuals as it is called endemic in time series work. D.W. static is formal test for serial correlation. The analysis of D-W is based upon the following:

Analysis of D-W test

Null hypothesis	decision	condition
No positive auto correlation:	reject	$0 < d < d_L$
No positive auto correlation	no decision	$d_L \leq d \leq d_U$
No negative auto correlation	reject	$4\text{-}d_L < d < 4$
No auto correlation	accept	$d_U < d < 4 - d_U$

CHAPTER III

DATA PRESENTATION AND ANALYSIS

Data presentation and analysis is the important part of the research work. It can be considered as the heart of research. In this chapter, the researcher presents and analyzes the collected data. According to research methodology mentioned in previous chapter, only collected data are nothing if they are presented and analyzed properly.

1.4 Trends of Foreign Trade

In 1956/57, the rupee value of Nepal's exports was 95.47 million rupees. It increased to 53910.7 Million rupees in 2006/07, i.e. within a period of half century its total export increased by about 564 fold. Within the same period the value of imports increased from 169.89 million rupees to 136277.1 million rupees i.e. within the same period imports increased by about 802 Folds.

The study of 14 year period from 1993- 2007 in table 4.1 shows that our export value increased by 7 times, while import value increased by 5 Times only. However, imports value is 1.4 times the export value. The total trade deficit of Nepal in 1993 was 15839 Million rupees. During 14 years period our trade deficit increased to 73950.6 Million rupees, which is about 1.4 times the export value. Although the trend of Nepal's foreign trade during the past few years is encouraging, the value of our trade deficit is yet discouraging

The main reason for the increasing Nepalese trade deficit is higher imports against small exports. The factors, which cause deficit trade balance, are: narrow base of exportable production, infant industrial shape, low level of quality, agro and forest based exportable goods, high transit and transportation cost, land-locked situation, mountainous and rugged geographical structure of the country, unfavorable environment for industrial development, lack of sound and effective strategies policies for foreign trade etc.

Table 4.1

Foreign trade of Nepal

(In million rupees)

Fiscal year	Total export	Total import	Trade balance
1993/94	7,387.5 (24.13)	23,226.5 (75.87)	-15839.0
1994/95	13,706.5 (30.03)	31,940.0 (69.97)	-18233.5
1995/96	17,266.5 (30.58)	39,205.6 (69.42)	-32277.4
1996/97	19,293.4 (27.23)	51,570.8 (72.77)	-46040.3
1997/98	17,639.2 (21.69)	63,679.5 (78.31)	-54573.4
1998/99	19,881.1 (21.08)	74,454.5 (78.92)	-70916.9
1999/00	22,636.5 (19.48)	93,553.4 (80.52)	-61488.5
2000/01	27,513.5 (23.61)	89,002.0 (76.39)	-51849
2001/02	35,676.3 (28.96)	87,525.3 (71.04)	-58682.2
2002/03	49,822.7 (31.47)	108,504.9 (68.53)	-60033.1
2003/04	55,654.1 (32.48)	115,687.2 (67.52)	-60444.1
2004/05	46,944.8 (28.64)	107338.9 (67.50)	-60394.1
2005/06	49930.6 (28.64)	124,352.1 (71.36)	-82366.4
2006/07	53910.7 (28.34)	136,277.1 (71.66)	-73950.6

Note: figures in parenthesis are percent share in total volume of trade.

Source: Nepal Rastra Bank, Quarterly Economic Bulletin, Mid-July 2007.

4.2 Trade with India

Till 1970, 99 % of Nepal's total export and 88 % of total import trade of Nepal was confined to India alone. Table 4.2 shows that though the value of export is in increasing trend, the trade deficit with India is quite discouraging which was

5770.9 million rupees in 1993 increased to 47962.4 million rupees in 2006/07 that is about 8.31 times increment during the study period. There is tremendous increment on value of import too. During the 14 year study period; there is 20-fold increment on total value of trade with India. The share of export to total trade with India seems decreasing from the starting of study period ie in 1993/94 to 1998/99. However, the share of export took positive direction from 1999/00 and continuous increment till 2003/04. In 2004/2005, the India's share in export on total trade hyper jumped approached to 73.8 % share on total trade. Which again declined on succeeding period but still more than 50% share has been occupying on total trade by India.

At the same time period, the total value of import with India increased about 11-fold. The share of import with India seems not much fluctuating from the study period 1993/94 till 2003/04 on and average of 33%. However, in 2004/05, the % share of import has tremendously increased approached to 72%. Then started to decline but not less than 50% share with succeeding periods.

Table 4.2

Nepal's Trade with India

FY	Export (Rs in million)	Import (Rs in million)	Trade balance (Rs in million)	% share in total export	% share in total import	Export as a %of import
1993/94	1,552.2	7,323.1	-5770.9	21.0	31.5	21.2
1994/95	1,450.0	11,245.5	-9795.5	10.6	35.2	12.9
1995/96	1,621.7	12,542.1	-10920.4	9.4	32.0	12.9
1996/97	2,408.9	17,035.4	-14626.5	12.5	33.0	14.1
1997/98	3,124.3	19,,615.9	-16491.6	17.7	30.8	15.9
1998/99	3,682.6	24,398.6	-20716.0	18.5	32.8	15.0
1999/00	5,226.2	24,853.3	-19627.1	23.1	26.6	21.0
2000/01	8,794.4	27,331.0	-18536.6	32.0	30.7	32.2
2001/02	12,530.7	32,119.7	-19589.0	35.1	36.7	39.0
2002/03	21,220.7	39,660.1	-18439.4	42.6	36.5	53.5
2003/04	26,030.2	45,211.0	-19180.8	46.8	39.1	57.6
2004/05	27,956.2	56,622.1	-28665.9	73.8	72.0	49.4
2005/06	26,430.0	70,924.2	-44494.2	52.9	57.0	37.3
2006/07	30,777.1	78,739.5	-47962.4	57.1	57.8	39.1

Note: % share in total export and % share in total import are calculated value from table 4.1

Source: Nepal Rastra bank, Quarterly economic Bulletin, Mid- July 2007/ economic survey 2006/07

4.3 Trade With Overseas

After 1971, Nepal diversified its trade with many overseas countries of the world. Nepal's major overseas suppliers are Japan, Germany, Singapore, Honkong, Saudi Arabia, United Kingdom, Italy, USSR, U.S.A, South Korea, New Zealand, France, China, Tibet and SAARC member countries. On the export side, the major export markets for Nepalese products are Germany, United Kingdom, Italy, Japan, and Belgium. While on the regional basis, the major export market is Asia. European Community is the largest partner of Nepal.

Table 4.3 shows that during the study period 1993-2007, there are 3.96 times increased in total value of export which was 5835.3 million rupees in 1993/94 increased to 23133.6 million rupees in 2006/07. On the import side 3.61 times increased the total volume which was 15903.4 million rupees in 1993/94 increased to 57537.6 million rupees in 2006/07. So there is nearly balanced increment on both export and import value of overseas trade. Trade deficit in 2007 has increased about 3- times more than the starting period of study i. e. 1993. In addition, trade deficit with overseas countries had been increasing trend from 1995/96 approached to climax on 1999/00. Then it started to decline for succeeding periods till 2005/06, and then it slightly increased from the last 2006/07.

The percentage share of overseas trade to total export is accounted highest 90.6% in 1995/96 and the lowest contribution is recorded 26.2% in 2004/05. Which has been occurring very much fluctuate tendencies. From 1995/96 till 2004/05, the % share of export continuously decreased from 90.6 % down to 26.2 %. Though the last two years share is quite increasing, it could not exceed about 50% share on total export. This indicates that the Nepalese trade diversification policies are not in favor of overseas countries.

On the import side there is not much fluctuation since 1993/94 till 2003/04, there average on last 11 years was around 65% contribution of overseas import to total trade. But there is drastic decline of its share in 2004/05, which is accounted 28%. Then again took positive direction in the succeeding two fiscal years.

Table 4.3

Nepal's Trade with Overseas Countries

FY	Export (Rs in million)	Import (Rs in million)	Trade balance (Rs in million)	% share on total export	% share on total import	Export as a %of import
1993/94	5,835.3	15,903.4	-10068.1	79.0	68.5	36.7
1994/95	12,256.5	20,694.5	-8438.0	89.4	64.8	59.2
1995/96	15,644.8	26,663.5	-11018.7	90.6	68.0	58.7
1996/97	16,884.5	34,535.4	-17650.9	87.5	67.0	48.9
1997/98	14,514.9	44,063.6	-29548.7	82.3	69.2	32.9
1998/99	16,198.5	50,055.9	-33857.4	81.5	67.2	32.4
1999/00	17,410.3	68,700.1	-51289.8	76.9	73.4	25.3
2000/01	18,719.1	61,671.0	-42951.9	68.0	69.3	30.3
2001/02	23,145.6	55,405.6	-32260.0	64.9	63.3	41.8
2002/03	28,602.0	68,844.8	-40242.8	57.4	63.5	41.5
2003/04	29,623.9	70,476.2	-40852.3	53.2	60.9	42.0
2004/05	18,988.6	50,766.9	-31778.3	26.2	28.0	37.4
2005/06	23,500.6	53,427.9	-29927.3	47.1	43.0	44.0
2006/07	23,133.6	57,537.6	-34404.0	42.9	42.2	40.2

Note: % share in total export and % share in total import are calculated value from table – 4.1

Source: Nepal Rastra bank, Quarterly economic Bulletin, Mid- July 2007/ economic survey 2006/07.

4.4 Composition of Nepalese Foreign Trade

Composition of trade vindicates the patterns of goods that are being exported and imported .Based on agricultural economy, Nepal has been taking with pace of industrialization indolent. The composition of foreign trade also shows the level of the development of the country. Nepalese export commodity composition has little diversified than import commodity composition. Here goes the composition of Nepalese foreign trade analysis on the basis of standard international trade classification (SITC) as well as brief account of dominant commodities on particular.

4.4.1 Composition of Nepalese Export

According to S.R. Poudyal's SITC classification, the following Table 4.4 and 4.5 shows the composition of Nepalese export accordingly manufacture goods and primary commodities. Though there is SITC 7, we are neglecting here to analyze the export trade composition due to this item is consider separate one.

Major SITC Commodity Groups

0	=	*Food and Live Animal*
1	=	*Tobacco and Beverages*
2	=	*Crude Materials, inedibles except fuels*
3	=	*Mineral, Fuels and Lubricants*
4	=	*Animal and vegetable oil and fats*
5	=	*Chemical and Drugs*
6	=	*Manufactured Goods classified mainly by materials*
7	=	*Machinery and Transport Equipment*
8	=	*Miscellaneous Manufactured Articles*
9	=	*Commodity and Transaction not classified according to kind.*

Table 4.4 shows that during the study period 1993- 2007, manufactured goods (SITC 3, 5, 6, 8, 9) ie five items has been playing dominant role in Nepalese export which has been constant tendency during the study period on an average at around more than 81% share in total export. . The share of manufactured goods classified mainly by materials (SITC 6) has relatively greater magnitude and it has been increasing. SITC 8 also another leading item. In1996/97 the share of manufacture products covered highest more than 90% share on export.

Table 4.4

Composition of Nepal's Export classified by Major SITC Manufacture Goods Groups

(Rs in million)

FY	Export SITC Manufacture Goods Group						
	3	5	6	8	9	Total	% share in total export
1993/94	0.0	17.7	4312.3	1545.7	0.0	5875.7	79.5
1994/95	0.0	19.6	7557.2	3576.4	0.0	11153.2	81.4
1995/96	0.3	28.7	10298.0	4352.3	1.4	14680.7	85.0
1996/97	0.0	212.1	10913.0	6415.1	0.2	17540.4	90.9
1997/98	0.0	302.3	9260.3	5765.8	0.1	15328.5	86.9
1998/99	1.3	640.4	10456.0	5772.2	0.0	16869.9	84.8
1999/00	1.4	1353.4	11029.0	6540.3	0.5	18924.6	83.6
2000/01	20.9	1968.5	11637.0	8059.6	0.0	21686.0	78.8
2001/02	0.5	2804.0	13540.0	11392.8	0.0	27737.3	77.4
2002/03	2.2	3933.2	15839.0	21509.2	0.0	41283.6	82.9
2003/04	1.3	4041.7	18909.0	22650.9	0.0	45602.9	81.9
2004/05	1.6	3308.3	17395.0	12589.3	0.0	33294.2	70.9
2005/06	5.5	3279.0	17795.0	17281.5	43.3	38404.3	76.9
2006/07	14.5	3865.9	23602.0	15380.1	6.9	42869.4	79.5
Average							81.5

Source: Nepal Rastra bank, Quarterly Economic Bulletin, Mid-July 2007

On the primary goods side, table 4.5 shows that during the same time frame on an average at around 18% share has occupied by primary goods export. Food and crude materials (SITC – 0 and 4) appeared to be the main commodity group and it showed a continuous increasing tendency in the preceding years. (SITC 1) have lowest contribution not more than 1 % on export .The share of primary goods (SITC 0,1,2 , 4) was Rs. 1510.9 million (20.45 percent) in 1993/94 and it reached to Rs. 10422.1 million (19.3 percent) in 2006/07 .

Table – 4.5

Composition of Nepal's Export classified by Major SITC Primary Commodity Groups

(Rs in million)

FY	Export SITC primary Commodity Group					
	O	1	2	4	total	% share on total export
1993/94	986.5	11.2	312.1	201.1	1510.9	20.5
1994/95	1941.6	13.7	437.4	160.3	2553.0	18.6
1995/96	1862.9	13.2	531.8	176.4	2584.3	15.0
1996/97	1163.4	12.8	432.4	138.4	1747.0	9.0
1997/98	1562.7	11.3	485.5	214.1	2273.6	12.9
1998/99	1946.6	9.7	768.7	251.3	2976.3	15.0
1999/00	2661.7	14.9	663.5	312.6	3652.7	16.1
2000/01	3123.2	22.8	487.1	2136.3	5769.4	21.0
2001/02	3724.5	50.0	469.9	3597.2	7841.6	22.0
2002/03	4240.4	117.2	561.3	3229.7	8148.6	16.4
2003/04	4776.6	75.6	751.1	4104.0	9707.3	17.4
2004/05	5094.2	145.7	624.5	7421.4	13285.8	28.3
2005/06	6100.9	138.7	800.1	4278.7	11318.4	22.7
2006/07	6276.9	55.2	714.3	3375.7	10422.1	19.3
Average						18.2

Source: as per as table 4.4

On the export composition of Nepalese foreign trade, the share of primary goods, according to table, in nominal value, is increasing continuously but its share in total export has noticed almost unchanged during the study period. The share of manufactured goods in total export increased significantly but the worth considering fact is that Nepalese exports are limited to few items.

4.4.2 Composition of Nepalese Import

The pattern of commodities composition considers an important issue of Nepalese trade structure. The following table 4.6 and 4.7 shows the contribution of manufacturing goods and primary goods according to SITC classification.

During the 14-year study period, Table 4.6 shows that on an average more than 61% share has occupied by manufactured goods (SITC 3, 5, 6, 8, 9). Though SITC 9 have lowest contribution on import, SITC (5 6 and 8) seems dominant goods than the other items. However, since the last three years of study period, SITC (3 and 6) has been playing dominant one. Import of minerals, fuel and lubricants (SITC 3) has been continuously increasing items on all the succeeding periods. The volume of Manufacture goods classified by materials (SITC 6) approached to peak on 1999/00 with 44741.9 million rupees. However, its share started to decline with ups and down on succeeding years.

Table 4.6

Composition of Nepalese Import Classified by Major SITC Manufacture Goods Groups

(Rs in million)

FY	Import SITC Manufacture Goods Group						
	3	5	6	8	9	Total	% share on total Import
1993/94	2278.3	3051.1	5950.8	1120.7	2.2	12403.1	53.4
1994/95	3644.7	4615.3	8599.9	1547.6	186.7	18594.2	58.2
1995/96	3834.1	5265.0	11633.1	2185.9	29.7	22947.8	58.5
1996/97	4837.0	5541.4	19147.5	2884.5	91.2	32501.6	63.0
1997/98	4717.1	7193.0	25300.6	3057.2	15.0	40282.9	63.2
1998/99	5549.3	8686.8	28129.7	3794.6	1.8	46162.2	62.0
1999/00	7160.3	8504.2	44741.9	4016.4	1529.8	65952.6	70.5
2000/01	9537.3	11077.3	32601.6	3974.0	346.6	57536.8	61.6
2001/02	8737.5	12476.4	25638.0	4302.4	266.0	51420.3	58.7
2002/03	9097.9	14474.2	34420.0	6682.8	78.2	64753.1	59.7
2003/04	11269.2	12941.9	41188.0	7210.2	0.8	72610.1	62.8
2004/05	15200.8	12380.9	32889.1	5670.3	62.1	66203.2	61.6
2005/06	19944.1	14319.5	34888.2	6582.7	1523.0	77257.5	62.1
2006/07	21904.1	16544.9	36510.5	5103.8	1753.8	81817.1	60.0
Average							61.1

Source: As per as table 4.4

On the primary goods side, table 4.7 shows that during the 14-year study period, on an average the share of primary products (SITC 0, 1, 2, 4) occupies at around lowest contribution that 19%. This was 4832.6 million rupees in 1990/91 and approached to 28765.8 million rupees in 2006/07. SITC (0 and 2) have greater magnitude than the remaining two items where the harmful item tobacco and beverage SITC 1 have lowest share on primary goods import side. Food and live animal SITC (0) in 2002/03 climbed at peak with maximum volume 10839 million rupees. Animal and vegetable oil and facts SITC (4) have an increasing tendency on succeeding years except in 1999/00.

Table 4.7

Composition of Nepalese Import Classified by Major SITC Primary Commodity Groups

(Rs in million)

FY	Import SITC primary Commodity Group					
	O	1	2	4	total	% share on total import
1993/94	1820.5	257.0	2013.4	741.7	4832.6	20.8
1994/95	2947.5	288.3	3415.7	801.8	7453.3	23.3
1995/96	3024.7	469.3	3977.0	1085.1	8556.1	21.8
1996/97	4084.8	367.6	3122.3	1457.2	9031.9	17.5
1997/98	4464.0	500.9	3347.9	2056.0	10368.8	16.3
1998/99	4785.8	508.6	4865.9	2830.9	12991.2	17.4
1999/00	5400.5	590.7	5487.1	2327.6	13805.9	14.8
2000/01	4929.0	799.5	6976.2	2025.8	14730.5	16.8
2001/02	7619.5	846.1	6246.7	3329.0	18041.3	20.6
2002/03	10839.0	906.5	7012.4	4446.0	23203.9	21.4
2003/04	5994.4	906.1	7559.6	5589.2	20049.3	17.3
2004/05	6333.2	717.1	6734.1	7887.5	21671.9	20.2
2005/06	9370.5	792.2	8479.3	7750.5	26392.5	21.2
2006/07	8554.0	1026.8	10550.6	8634.4	28765.8	21.1
Average						19.3

Source: As per as table 4.4

4.4.3 Export of Major Commodities to India.

In 1993 onward Nepalese major export commodities to India were jute goods, live animals, rice brain oil, pulses, herbs, ghee etc having few million rupees. Those item were limited only till 1997/98. However, table 4.8shows that since 1997- 2007, the major commodities export to India were toothpaste, textiles, Zinc sheet, veg ghee, jute goods. Pasmina occupied highest share in 1999/00with the volume of 3544.2 million rupees. Then the declination happened on succeeding years which is accounted only 373.1 million rupees in 2006/07 (Economic Survey, 2006/07). Copper wire rod, thread, plastic utensils also have few contribution on export.

The table 4.8 shows the export of major - commodities with India. On an average, the following 5- items covered around one third of total export with India during last 10 years. This approached about 43 % share on 2001/02. Export of vegetable ghee is an increasing trend and top most position starting with 1580 million rupees approached to 2959 million rupees on 2006/07. Volume of zinc sheet is also taking triple jump and textiles took double than the previous year 2005/06.

Table 4.8

Export of Major Commodities to India

(Rs in million)

FY	Veg ghee	Zinc sheet	Jute goods	Textiles	Tooth paste	Total	E_{mci} / T_{ei}
1997/98	0.0	0.0	231.1	0.0	179.9	411.0	26.5
1998/99	0.0	0.0	453.2	0.0	309.2	762.4	20.7
1999/00	0.0	0.0	565.1	0.0	384.5	949.6	18.2
2000/01	1580.0	0.0	720.2	0.0	823.5	3123.7	35.5
2001/02	3146.4	0.2	871.7	115.9	1291.4	5425.6	43.3
2002/03	2743.0	58.0	1103.9	138.0	2262.9	6305.8	29.7
2003/04	3560.3	72.0	1294.2	449.3	2033.4	7409.2	28.5
2004/05	7081.4	13.3	1630.1	562.5	1606.7	9394.0	33.6
2005/06	3812.3	970.6	1899.0	878.2	1002.8	8562.3	32.4
2006/07	2959.0	2785.3	1882.6	1780.5	1478.8	10886.2	35.4
Average							30.4

Source: economic survey 2006/07

Note: E_{mci} = Export of major five commodities to India

T_{ei} = Total export to India

4.4.4 Export of Major Commodities to Overseas

There are not more commodities on export to overseas countries. However, carpets, hides & skins, pasmina, ready-made garments, products are leading commodities export to overseas. Table 4.9 shows that these five commodities are covering more than 83% on an average during 10 year. Form appendix - 2, the other commodities like Pulses, cardamom, woolen goods, catechu ect and other have less than 17% share on export to overseas. When pasmina products introduced in 2002/03, their share jumped to 93.9%. i.e. almost most of the overseas trade has covered by these five commodities. However, the situation could not remain till longer. Disappointing scene can be seen easily since 2004/05 of pasmina products, which decline more than 300% on succeeding years that is hampering the share of export to overseas trade to total overseas trade too. All of those five items are declining trend in 2007 according to previous year.

Table 4.9

Export of Major Commodities to Overseas

(Rs in million)

FY	Carpets	Hides & skin	Pasmina	Readymade garments	Products	Total	E_{mco} /T_{eo}
1997/98	513.3	7718.1	-	145.4	416.5	8793.3	60.6
1998/99	5374.8	8163.9	-	81.8	387.6	14008.1	86.5
1999/00	5955.0	8880.0	-	142.1	288.5	15265.6	87.7
2000/01	7015.4	8485.3	-	135.0	417.3	16053.0	85.8
2001/02	9701.9	9802.0	-	173.5	270.5	19947.9	86.2
2002/03	13942.4	9842.1	2665.0	218.1	181.9	26849.5	93.9
2003/04	13124.7	8592.3	4121.2	233.9	658.4	26730.5	90.2
2004/05	7833.0	6212.5	1245.0	233.8	464.7	15989.0	84.2
2005/06	11890.1	5320.0	1157.6	352.1	227.3	18947.1	80.6
2006/07	9550.0	5675.5	1064.1	626.4	309.0	17225.0	74.5
average							83

Source: economic survey 2006/07

Note: E_{mco} = Export of major five commodities to overseas

T_{eo} = Total export to overseas

4.5 Movements of Terms of Trade in Nepal

Terms of trade is the ratio of the index of export prices to the index of import prices. The general concepts is that an improvement in the terms of trade when there is a relative increase in export price or a relative fall in import prices and an adverse situation takes place when there is a relative rise in import price or a fall in export prices.

The general principal for terms of trade (ToT) is:

ToT > 100 implies that the performance of the nations export is favorable compared to its import

ToT < 100 implies that the performance of the nation’s export is unfavorable compared to its import.

ToT = 100 implies that both export and import are moving in the same direction.

It is true that the term of trade does throw little light on the change in a nation’s economic position. It might serve as an indicator of a change in a country's real income in the international sector. The effect of changes in the terms of trade should be appraised in the light of other relevant effects like changes in productivity, demand, total exports and imports, employment etc. The terms of trade has been calculated for the 1993-2007 taking 1974/75 as a base year i.e. assuming that the total export and import value of 1974/75 is 100. Here the question may arise as to why has 1974/75 been selected as a base year Assuming Rs. 889.9 million that of 1974/75 price equals to 100. The basic ground for selecting FY 1974/75 as the base year is that the actual effort for Nepalese trade diversification was made since 1971 and its effect in Nepal was seen after FY 1974/75 and data are available since FY 1974/75 only.

Table 4.10

Nepal's Terms of Trade

(Base year: 1974/75 = 100)

Fiscal year	Price index of export (p_x)	Price index of import (p_m)	Terms of trade (ToT)
1993/94	830.4	1279.9	64.9
1994/95	1540.7	1760.2	87.5
1995/96	1940.9	2160.6	89.8
1996/97	2168.8	2841.9	76.3
1997/98	1982.8	3509.3	56.5
1998/99	2234.8	4103.1	54.5
1999/00	2544.6	5155.6	49.3
2000/01	3092.8	4906.8	63.1
2001/02	4010.4	4823.4	83.1
2002/03	5600.6	5979.5	93.7
2003/04	6256.1	6375.4	98.1
2004/05	5277.0	5918.0	89.1
2005/06	5612.7	6852.8	81.9
2006/07	6060.1	7510.0	80.6
average			76.3

Source: Nepal Rastra Bank, Quarterly Economic Bulletin, Mid July2007

The Table 4.10 shows that the terms of trade of Nepal are not favorable. During the study period 1990- 2004, the terms of trade of Nepal are found on an average 76.3 i.e below 100. Starting two periods shows that improvement in the terms of trade. While during 1993/94 to 1996/97 the terms of trade was in negative direction. Within these years, there was a fluctuation in terms of trade. This is because a smooth growth of import price than export price. After that period, the terms of trade shows improvement during 1997/98 to 1999/00. In 2000/01, ToT has seen much interesting near to 100 i.e 98.1 but it could not touch 100.

This tendency of terms of trade indicates that the Nepalese export performance is weak compared to import. So, Nepal is still far away from the gain of international trade, though the terms of trade show satisfactory trend in the economy.

4.5. 1 Nepal's Terms of Trade with India

The Table 4.11 shows during the 14-year study period, Nepal’s terms of trade with India on an average is found 59.5 moved discouragingly from 1993- 2007. This is because the import price increased more rapidly than export price. Then after two succeeding period, ToT crossed 100 in 2005/06 i.e. approached to 105.7. The positive direction remained in 2006/07 too with ToT 113.8 Then after ToT came back below 100. This situation clearly indicates that Nepal’s export performance with India is weak than the import. Nepal has been losing its economy perspective from foreign trade with India. These unfavorable happenings suggest that immediate action should be taken by government with strategically to expand export base. Import should be controlled in terms of both commodity and value.

Table 4.11

Terms of Trade with India

(Base year: 1974/75 = 100)

Fiscal year	Price index of export (p_x)	Price index of import(p_m)	Terms of trade
1993/94	207.9	496.2	41.9
1994/95	194.2	762.0	25.5
1995/96	217.2	849.9	25.6
1996/97	322.6	1154.4	27.9
1997/98	418.4	1329.3	31.5
1998/99	493.2	1653.4	29.8
1999/00	699.9	1684.2	41.6
2000/01	1177.8	1852.0	63.6
2001/02	1678.1	2176.6	77.1
2002/03	2841.9	2687.5	105.7
2003/04	3486.0	3063.7	113.8
2004/05	3743.9	3837.0	97.6
2005/06	3539.6	4806.1	73.6
2006/07	4121.7	5335.7	77.2
Average			59.5

Source: Nepal Rastra Bank, Quarterly Economic Bulletin, Mid-July 2007

4. 5. 2 Nepal's Terms of Trade with Overseas Countries

The Table 4.12 shows that the terms of trade with overseas countries has a fluctuation movement, some ups and downs within the study period 1993- 2007. However, on an average To T seems satisfactory which is near to 100 i.e.96.7. In 1993/94, the terms of trade with overseas countries were below 100. But three succeeding years till 1996/97, To T with overseas countries was more than 100. It clearly throws the light that export to overseas countries is increasing more rapidly than import. In other words Nepalese export performance is better than import and gained something from overseas countries.

From 1997- 2000, ToT with overseas countries was quite discouraging having the value below 100 owing to import from overseas countries increased more than the export. While during the 2001- 2003 it improved as compared to pervious years but could not exceed 100. Once again, In 2005/06 To T crossed the value of 100 i.e. approached to 104.3. Again started to decline in succeeding year having below 100. This situation suggests that Nepal has to diversify its exports to overseas countries in terms of both commodity and value.

Table 4.12

Terms of Trade with Overseas Countries

(Base year: 1974/75 = 100)

Fiscal year	Price index of export	Price index of import	Terms of trade
1993/94	4083.5	4692.6	87.0
1994/95	8576.9	6106.4	140.4
1995/96	10948.1	7867.7	139.1
1996/97	11815.6	10190.4	115.9
1997/98	10157.4	13001.9	78.1
1998/99	11335.5	14770.1	76.7
1999/00	12183.6	20271.5	60.1
2000/01	13099.4	18197.4	71.9
2001/02	16197.1	16348.6	99.0
2002/03	20015.4	20314.2	98.5
2003/04	20730.5	20795.6	99.7
2004/05	13288.0	14979.9	88.7
2005/06	16445.5	15765.1	104.3
2006/07	16188.7	16977.8	95.4
Average			96.7

Source: Nepal Rastra Bank, Quarterly Economic Bulletin, Mid-July 2007

4.6 Exports Trade Contribution to GDP

GDP accounts the overall output of the nation throughout the year. It indicates the nation's capability as well. Export trade is considered an important aspect to raise GDP. In developing economics like Nepal, export trade no doubt plays vital role. Export enhances capability to develop an industrial base and it is one of the major sources of generating foreign exchange required to import goods, raw materials and technology. However, Nepal have minimum share of world's export, Table

4.13 shows that the share of export to GDP ratio on an average during the 14 year study period at around 10 percent.

Table 4.13 shows that Export to GDP ratio is fluctuating ups and down with minimum about 6 to maximum about 14 percent. Export - GDP ratio with India on an average is 3.4 %, which was lowest share on 1993-2001. However, after onwards till 2004, the share of export to India improved and remained around 6 %. On the other side export to GDP with overseas countries seems more, which is on an average during the study period, is observed 6.8%. it occupies Double the share of export- GDP with India. However, in the previous period of study, there was high share of Export - GDP with overseas than the India. Nevertheless, in the last 3 years, overseas export contribution on GDP is slowing down which is less than the India's share on export- GDP.

Table 4.13

Share of Export on Gross Domestic Product

(In Million rupees)

FY	GDP	Export	Export/GDP	E_i /GDP	E_0 /GDP
1993/94	116127	7387.5	6.36	1.3	5.0
1994/95	144933	13706.5	9.46	1.0	8.5
1995/96	165350	17266.5	10.44	0.9	9.5
1996/97	191595	19293.4	10.00	1.3	8.8
1997/98	209974	17639.2	8.40	1.5	6.9
1998/99	239388	19881.1	8.30	1.5	6.8
1999/00	269570	22636.5	9.39	1.9	6.5
2000/01	289798	27513.5	9.49	3.0	6.5
2001/02	330018	35676.3	10.81	3.8	7.0
2002/03	366284	49822.7	13.60	5.8	7.8
2003/04	393473	55654.1	14.14	6.6	7.5
2004/05	406138	37862.8	9.31	6.9	4.7
2005/06	437546	49930.6	11.41	6.0	5.4
2006/07	474129	53910.7	11.37	6.5	4.9
Average			10.17	3.4	6.8

Source: Nepal Rastra Bank, Quarterly Economic Bulletin, Mid-July 2007

Note: Export/ GDP is calculated value from table 4.1 .E_i /GDP and E_o /GDP are the calculated value from table 4.2 and 4.3 respectively.

E_i /GDP = Export to India/ GDP ratio.

E_o /GDP= Export to overseas / GDP ratio

4.7 Determinants of Nepalese Trade

Nepalese foreign trade is very much affected by so many factors. Expansion of Nepalese export trade volume can definitely encourage GDP. An attempt is made in this section to analyze the main determinants of export of Nepal. Now we have estimated the linear equations to determine the contribution of exports considering total volume of export in different time periods as dependent variable and gross domestic product, agriculture GDP and Non-agriculture GDP, one period lag export is considered as independent one. The regression is carried out with 14 years of data from 1993/94 to 2006/07. The fitted equations of the regression model are as following that the estimates are based on constant data. No attempt has been made to correct the problem of serial correlation. In all statistical analysis, figures in parentheses below the coefficients for independent variables indicate respective t-values. All the statistical values are computed from computer via SPSS programmers. All of Variable name, label and formation of regression can be seen by appendix 1 and appendix 2. The following are the regression equation in matrix form.

Simple linear models for exports

Eq^n	Dep. var.	Cons	Independent variables				R^2	$Ad.R^2$	F	D-W
			GDP	GDPAG	GDPNAG	Xt-1				
1	Xt	- 9257.415	0.963 (12.372)				0.927	0.921	153.189	0.896
2	Xt	-8898.397		0.298 (0.250)	0.665 (0.557)		0.927	0.914	70.224	0.884
3	Xt	-8144.673	0.615 (2.293)			0.362 (1.350)	0.932	0.918	68.614	1.256

First equation shows that there is significant positive relationship between total foreign export (Xt) and GDP. The fitted equation is a good fit with R^2 = 0.92 which indicates that 92% of variation in foreign export (x) are explained by independent variable GDP. The F value is also significant at the level of 5 percent and indicating that there is strong association of variables in question. On an average Nepalese economy one million of export is capable of generating additional income worth Rs. 0.963 million.

Equation 2 shows that there exist positive relationship between volume of export with agricultural GDP and non- agricultural GDP. The coefficient of independent variables is not significant at 5% level of significance, as indicated by its lower t-value ie. Less than $t_{0.05}$ = 2.145. However the equation itself is a best fit with adj R^2 = 91.4 percent of the variation in dependent variables being explained by the independent variable respectively. However, larger F- value is indicating that there is strong association of variable in question.

In equation 3 there is again direct relationship between export with GDP and one period lag export volume. Although it is the best fit wit adj $R^2 = 0.918$ i.e. 91.8 percent of the total variation is explained by independent variable, the independent variable one period lag export having its lower t-values indicating that there is no significant relationship between dependent and independent variable. The greater F- value is depicting that there is strong association between variable in question.

The D-W table value with 5% level of significance, n = 14 observations and $K^{'} = 1$, $K^{'} = 2$, $K^{'} = 3$ and $K^{'} = 4$ independent variable

Eqn 1: $0 < 0.896 < 1.045$ implies that $0 <$ d cal value $< d_L$ which means that there is positive autocorrelation between export and GDP.

Eqn 2: $0 < 0.884 < 0.905$ implies that $0 <$ d cal value $< d_L$ which means that there is positive autocorrelation between export with agricultural GDP and non-agricultural GDP.

Eqn 3: $0.81 < 1.256 < 1.562$ implies that $d_L <$ d cal value $< d_U$ which means that statically it have no decision.

Now we have log linear regression combinations as well which gives the elasticity of the concerned variable.

Log linear regression models for determinants of exports:

Eq^n	Dep.var.	Cons	Independent variables				R^2	$Ad.R^2$	F	D-W
			GDP	GDPAG	GDPNAG	Xt-1				
4	Xt	-6.705	0.972 (14.424)				0.945	0.941	208.061	0.984
5	Xt	-5.310		0.215 (0.328)	0.758 (1.153)		0.946	0.936	96.533	0.944
6	Xt	-5.621	0.692 (2.758)			0.290 (1.156)	0.948	0.937	90.763	1.143

The elasticity coefficient of the entire concern explanatory variable is less than one telling that total volume of export is quite low responsive to agricultural GDP incomparision to GDP and non-agricultural GDP and one period lag export value too. For equation 4 to 6 the adj R^2 are 94.1, 93.6 and 93.7 Percent total variation is explained by independent variables respectively which can be considered is the best-fitted regression model. The log linear equation indicates again there is positive relation export with GDP and their by agricultural GDP and non-agricultural GDP as well as direct relationship occurs in between export to one period lag export. We observe that some independent variables are significant with larger t- value. However, some variables are not significant. Comparing with its tabulated value with n= 14, t = 2.145 at 5% level of significance, we can see t-values of GDP is significant with greater than $t_{0.05} = 2.145$. Similarly, in equation 5, the explanatory variables agricultural GDP and non- agricultural GDP are not significant due to the lower value of t. in equation 6, the explanatory variable of one period lag export is insignificant. Similarly, for equation 4 - 6, the greater value of F - test is highly significant indicating that there is strong association of variable in question.

The D-W table value with 5% level of significance, n = 14 observations and $K' = 1$, $K' = 2$, $K' = 3$ and $K' = 4$ independent variable.

In Eqn 4: $0 < 0.984 < 1.045$ implies that $0 < d$ cal value $< d_L$ which means that there is positive autocorrelation between export with GDP.

In Eqn 5: $0.905 < 0.944 < 1.551$ implies that $d_L <$ d cal value $< d_U$ which means that statically it have no decision.

In Eqn 6: $0.81 < 1.143 < 1.562$ implies that $d_L <$ d cal value $< d_U$ which means that statically it have no decision.

Within the same time frame and following same procedures as above the regression equations of the determinants of Nepalese import trade are illustrated. Import is considered as a dependent variable. In addition, the explanatory variables are gross domestic products, GDP- Population ratio of Nepal, wholesale price index of India and real exchange rate. The following table shows the linear regression models for imports.

Simple Regression models for determinants of imports:

Eq^n	Dep. var.	Cons	Independent variables					R^2	$Ad.R^2$	F	D-W
			GDP	GDPNAG	GDP/POPN	RER	WPI				
7	Mt	-5218.069	0.978 (16.222)					0.956	0.953	263.155	1.064
8	Mt	-26887.3			1.032 (8.450)	-0.053 (-0.434)		0.970	0.964	176.695	1.643
9	Mt_I	22200.961	2.159 (4.939)				-1.218 (-2.786)	0.950	0.940	103.709	0.851
10	Mt_O	-14636.1		0.254 (0.692)		0.585 (1.597)		0.668	0.608	11.082	0.979

In equation 7, we can see that there is positive relation between import and GDP. According to adj R^2 , 95.3 % of the total variation of import is explained by GDP. There is significant relationship between GDP and import which is indicating by respective t- values with 16.222 > $t_{0.05}$ = 2.145. The greater F- values is depicting that there is strong association of variable in question.

In equation 8, there is direction relationship of import with the ratio of GDP and population but there is negative relation with real exchange rate. It also shows that there is no significancant relationship between real exchange rate and import according to lower t- value of it. However, there is positive and significant association between imports with GDP- Population ratio as indicated by respective greater t-values. The regression equation is the best fitted we can say due to the fact that about 94.6 percent of the total variation is explained by independent variable. By the greater F- values also shows that there is strong association of variables in questions.

Again, equation 9 is indicating that relationship of import of India with GDP and wholesale price index is indicating that there is positive and significant relation with GDP but negative with wholesale price index according to its parameters value and respective t- values. The greater F- value shows that there is strong association of variable in question. The regression model can be said the best fitted model due to its greater adj R^2 value. This implies that 94 percent of the total variation is explained by regression plane.

In equation 10, we have taken the total volume of import from overseas in different time periods as dependent variable whereas non- agricultural gross domestic product and real exchange rate is considered as the explanatory variable. There is direct relationship between overseas import with non- agricultural GDP as well as Real exchange rate. The regression equation is fitted so as to 60.8 percent of the variation is explained by independent variable. However, the lower respective t- values is indicating that there is not significant relationship between concerned variable. However, the greater value of F is implying that there is strong association between variable in question.

To check in D-W table value with 5% level of significance, n = 14 observations and $K' = 1$, $K' = 2$, $K' = 3$ and $K' = 4$ independent variable. We have the following.

In Eqn 7: 1.045 < 1.064 < 1.35 implies that d_L < d cal value < d_U which indicates that the test is inconclusive. In eqn 8, the calculated value of D-W is greater than its upper limit ie. 1.551< 1.643< 4-1.551=2.449 ie the value falls in $d_U < d < 4\text{-}d_U$ which means that there is no auto correlation. In Eqn 9 the calculated value is less than its lower limit. Therefore, we can say that there is positive autocorrelation between concern variable. However, in eqn 10 the calculated value of D-W test is falling in between lower and upper limit that indicates that the test is inconclusive.

Once the entire above regression model for import is presented with their log linear forms that are illustrated on the following table.

Log linear regression models for determinants of imports:

Eq^n	Dep.var.	Cons	Independent variables					R^2	$Ad.R^2$	F	D-W
			GDP	GDPNAG	GDP/POPN	RER	WPI				
11	Mt	-3.857	0.977 (15.965)					0.955	0.951	254.874	0.604
12	Mt	-3.403			0.942 (7.671)	0.046 (0.372)		0.967	0.961	162.463	0.837
13	Mt_I	-14.180	1.584 (3.170)				-0.599 (-1.198)	0.978	0.974	246.574	0.797
14	Mt_O	1.128		0.631 (2.097)		0.283 (0.942)		0.797	0.760	21.560	0.646

The log linear regression model for import is indicating near about same result as its simple regression equation. The elasticity coefficient concern independent variable is depicting that total value of import is quite low responsive to the ratio of GDP and population in comparison to GDP and real exchange rate too. Similarly, import with India is highly responsive with regard to country's GDP. But, negatively elastic with wholesale price index of India. On the other side, the elasticity of import with overseas have quite low responsive with real exchange rate than GDPAG. We can claim the fitted regression models are best one according to their respective Adj R^2. In similar fasion, the linear regression models are indicating the direct relationship of import to GDP and also positive relationship between import with non- agricultural GDP as well as real exchange rate that seems quite different in logarithm form compared to simple form. However, the lower t- value of explanatory variables ie RER and WPI except GDP and GDPNAG is implying that there is no significance relationship with dependent variable and independent variable. However, the F- value is highly significant depicting that there is strong relation between all variables in question.

To check in D-W table value with 5% level of significance, n = 14 observations and $K' = 1$, $K' = 2$, $K' = 3$ and $K' = 4$ independent variable. We have the following.

In eqn 11: 0 < 0.604 < 1.045 implies that 0 < d cal value < d_L which means that there is positive autocorrelation between import and GDP. The result happens exactly same in eqn 12, 13 and 14 too. That is there is positive autocorrelation between all concern variables.

4.8 Major Findings of the Study

The Major finding of the study can be presented as below:

1. The share of trade on GDP is about 10%, export trade has been deteriorating, however being a member of WTO SAFTA, SAPTA, Nepal can achieve benefits to expand export and improve trade deficit and correct the balance of payment situation
2. To enhance the trade sector potentiality, international agencies like NRN investment can be encouraged
3. Trade oriented industries can be strengthen as there is hig potentiality of bringing FDI in Nepal.
4. The Land-locked situation, mountainous and rugged geographical structure of the country is one of the biggest bottlenecks in Nepalese foreign trade expansion.
5. The Open border and free flow of goods between Nepal and India also are serious problems for Nepalese products because Indian products are available cheaply in Nepalese market. Owing to smuggling practices, the illegal traders are getting advantage of imports and exports.
6. The Infant industrial shape with narrow base of exportable production having low quality products has been challenging scene of Nepalese trade, though it has already entered into global trade ie. WTO and bilateral trade arrangements like SAPTA and SAFTA
7. The Unfavorable environment for industrial development, lack of sound and effective strategical policies, policies adhocism, inconsistency of government policies , political instability and a decade more long moist

problem are hampering facts for the Nepalese trade expansion. No doubt delay in decision-making and lack of political-will cannot possess a country's progress.

8. Nepal has been facing fundamental trade deficit and no favorable position of terms of trade with both destination India and overseas that may have long-term effect on the Nepalese economy. The main cause behind trade deficit is high import against small export.
9. The adoption of liberal economic policy, government levied international trade tax to generate revenue but it has neglected the aspect of import substitution increasing the trade deficit of nepal.
10. Nepal uses only one transit to (trade route) trade with overseas countries other than India and China. Nepal must use other trade routes such as Fulbari Banglaband through Bangladesh
11. There is Lack of diplomatic efforts, India oriented policies, condition imposed by donor agencies, donor driven strategies, poor implementation , not effective monitoring and evaluation mechanism, no price and reward system, red tapism on bureaucracy which should be controlled to enhance the foreign trade situation of Nepal.
12. Government should invest some money on R & D, as well as human resource development. Similarly proper utilization IT, introduced of changing technology on new established industries are essential.
13. Implementation of policies should take care in an effective manner as well as monitoring and evaluation of policies is essential.
14. Provision of Surveillance at borders where goods are smuggled can be control smuggling practices across the borders, especially with India. In this regard, public cooperation should also be sought.
15. Export should be increased by improving the quality of product, introducing new commodities, reducing cost of production, generating export surpluses, encouraging research and development.

16. Imports substitutes should be encouraged by adopting improved indigenous technology curving non-essential and luxury imports and controlling population growth. It should also diversify its imports and exports markets and products via trade agreements and developing friendly relations.

17. Open market policy will be beneficial for the country only when Nepalese products should be able to provide opportunities not to taste international products in the country but also to give the taste to others in the same proportion.

18. Nepal should give higher priority to remove the nation's deficit problem by adopting long-term measures like penetration to export market and effective application and execution of import substitution regime.

19. Nation is going towards political settlement with cease-fire. Democratic system has reestablished and decade long moist insurgency is on the process of negotiation. No doubt, political consistency has supported the growth of industries.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The study of Nepalese foreign trade trend and structure has shown that till now our trade is still missing its right track. The study provides a clear view regarding the history, plan wise trends, policy review, and review of reform programmes, trade with India and overseas, trade composition and terms of trade of Nepalese foreign trade. The following information summarizes the picture of Nepalese trade situation and export diversification of Nepalese government in brief.

The total export has increased over the various plans ranging from Rs. 628.1 million in first plan to Rs. 206529.4 million in ninth plans which are about 328 times more than that of first plan. Total import has steady growth in the subsequent plan till ninth plan. The total value of trade in seventh plan was 49464.4 million rupees which increased to 419180.5 million rupees in eighth plan the total trade variation in eight plans over seventh plan was 847 percent.

Between 1993-2007 total volume of export value is increased by 7 times which was 7387.5 million rupees in 1993/94 increased to 53910.7 million rupees in 2006/07. Total volume of import was 23226.5 million rupees in 1993/94 increased to 136277.1 million rupees in 2006/07. There was 5 times increment during study period. So yet imports value is 1.4 Times the export value. The total trade deficit of Nepal in 1993 was 15839 Million rupees. During 14 years period our trade deficit increased to 73950.6 Million rupees, which is about 1.4 times the export value. Although the trend of Nepal's foreign trade during the past few years is encouraging, the volume of trade deficit is yet discouraging.

Nepal started to diversify its trade since 1960's and adopted import substituting Industrialization (ISI) policy with the objective to protect domestic industries and in 1985, Nepal entered into an 18-month standby arrangement with international monetary fund (IMF). The government launched an economic stabilization program. The Nepali currency was devalued by 14.7 percent against US dollar in November 30, 1985. Structural Adjustment Program (SAP) with the financial support of the IMF and structural Adjustment loan (SAL) with the World Bank, were implemented in 1987.

GON adopted Exporters' Entitlement Scheme (EEE) in 1961, to promote and diversify export from India to the overseas countries. The EEE scheme neither helped in expanding the export base nor contributed to reduce the dependency on India. Consequently, in 1977 Dual Exchange Rate System replaced the EEE scheme. A number of trade facilitation measures and incentives were introduced, such as introduction of duty drawback and bonded warehouse systems. Enhanced Structural Adjustment Facility (ESAF) was initiated on October 1992 for three year. The new trade policy has been implementing since 1992 with the basic objective to enhance trade diversification, to promote private sector participation, production of qualitative and competitive good, and establishment of EPZ. In order to reduce to the poverty GON has developed a Poverty Reduction Strategy Paper (PRSP; which is also the country's tenth plan (2002-2007). This programme is supported by Poverty Reduction Growth Facility (PRGF) and Poverty Reduction Support Credit (PRSC) which are funded by IMF and World Bank.

In this way, various measures adopted by the Nepal Government in different time period not contribute to positive impact in the trade sector and in the economy as a whole. However, trade deficit has been quite discouraging. The implementation side is being poor. Frequently changed Government, insurgency, not appropriate environment on FDI, lack of long-term vision of policy makers are some of the worst realities on Nepalese foreign trade policies.

The Indo Nepal treaty was revised in 2002 with the modification of some provisions of treaty signed on 1961. This Treaty is seen more often as the turning point in the history of Nepal- India trade relations leading to several policy changes. 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.

Export and import, between Nepal and India has increased from the year 1999/00 onward. Of course, it may be due to the outcome of favorable provisions in the Indo-Nepal Trade Treaty of 1999. The share of India in the total export of Nepal was 23.1 per cent in 1999/00. The trend increased gradually in the successive years and approached to 47.7 per cent in 2003/04 which hyper jumped upto 73.8 % in 2004/05.The share of India in the total import of Nepal was 26.6 per cent in 1996/97, which gradually increased revealing 41.2 per cent in 2003/04. Treaty of Trade 1999 has indeed played a crucial role in the foreign trade structure of Nepal.

During the 14 year study period; there is 20-fold increment on total value of export trade whereas the total value of import with India increased about 11-fold. The share of export to total trade with India seems decreasing trends form the starting of study period ie in 1993/94 to 1998/99. However, the share of export took positive direction from 1999/00 and continuous increment till 2003/04. In 2004/2005, the India's share of export in total trade jumped to 73.8 % share on total trade. The share of import with India seems not much fluctuating from the study period 1993/94 till 2003/04 on and average of 33%. But in 2004/05, the % share of import has tremendously increased approached to 72%. Then started to decline but not less than 50% share with succeeding periods.

On the basis of standard international trade classification (SITC), Nepalese export commodity composition is less diversified than the import commodity composition. The export composition of Nepal's foreign trade shows that, the primary products (SITC 0, 1, 2 4), poudel's classification have increased in nominal value but their share in total export has noticed almost unchanged during the study period. On an average during 1993-2007, under manufactured groups, manufactured goods classified mainly by materials (SITC 6) and miscellaneous manufactured articles (SITC 8) have a greater magnitude in total export. Both categories SITC 6-8 together constitute two third of the total export. The share of manufactured goods increased significantly in Nepalese export but the worth considering fact is that Nepalese exports are limited to few items. In import side, primary goods has maintained its growing tendency in nominal value and share as well. The high share of manufactured items compared to primary goods imports endorses the poor development of the economy. Therefore, it is necessary to build import substitution industries.

The share structure of exports and imports of India and overseas countries shows that there is a domination of overseas trade, in the total import and total export trade of Nepal. In the early stages, there was the deep domination of trade with India. Now, Nepalese trade direction is diversified from India to overseas countries.

The terms of trade of Nepal are unfavorable during the study period 1993-2007 i.e. less than 100. The main reason for terms of trade always unfavorable is rapidly increased import price than export price. Destination wise terms of trade with India was less than overseas countries during 1993 - 2001 .The terms of trade with overseas countries much more improved and favorable during 1994 - 1995. During 2002 - 2004, terms of trade with India more than overseas countries i.e. more favorable.

During the study period, the share of export in GDP is found on an average about 10 percent. However, there is domination of share of overseas trade on GDP. The fitted regression equations prove that there is direct relationship between export and GDP as well as there exist positive association of export with agricultural GDP and non- agricultural GDP and one period lag export so far. On the import side, import also has significant and positive association with gross domestic product as well as positively associated with the ratio of GDP and population of Nepal. However, there exist negative relation occurs with import and real exchange rate.

5.2 Conclusion

Nepal has been suffering vicious circle of poverty and economic backwardness. No doubt, Nepalese foreign trade plays vital role to make economic strength and prosperity of the nation. To give proper direction to our export trade, the government has introduced several policies and efforts have done. Nevertheless, the outcome has not achieved properly. The share of trade on GDP is about 10% but especially export trade has been deteriorating rather than improving. However, Nepalese trade has some strength too.

Strength of Nepalese trade:

- Nepal is very much rich on natural resources such as hydropower, mines etc. and there is high potentialities of agro based industries too.
- Being a member of WTO, SAPTA and SAFTA , Nepal can achieve so many benefit and have chance to expand export , to improve trade deficit and to correct BOP situation.
- Development of information technology and introducing of new technology on some industries are encouraging factor to assure quality and competitive products.
- Adequate work force with Low labour cost can easily available through out the country.
- Various national and international agencies like NRN are seeking to invest in Nepal, which will enhance trade sector too.

- There is high potential to bring FDI to strengenthen export trade oriented industries.
- Nation is going towards political settlement with cease-fire. Democratic system has reestablished and decade long moist insurgency is on the process of negotiation. No doubt, political consistency is essential factor to do something on the area of export promotion.

Weakness of Nepalese Foreign Trade:

- Land-locked situation, mountainous and rugged geographical structure of the country is one of the biggest bottlenecks in Nepalese foreign trade expansion.
- Open border and free flow of goods between Nepal and India also are serious problems for Nepalese products because Indian products are available cheaply in Nepalese market. Owing to smuggling practices, the illegal traders are getting advantage of imports and exports.
- Infant industrial shape with narrow base of exportable production having low quality products has been challenging scene of Nepalese trade, though it has already entered into global trade ie. WTO and bilateral trade arrangements like SAPTA and SAFTA
- Though the agricultural is the mainstay of the Nepalese economy, it has been extremely disappointing. Transit and transportation cost is too high and there is no effective rural- urban linkages practices too.
- Unfavorable environment for industrial development, lack of sound and effective strategical policies, policies adhocism, inconsistency of government policies , political instability and a decade more long moist problem are hampering facts for the Nepalese trade expansion. No doubt delay in decision-making and lack of political-will cannot possess a country's progress.

- Nepal has been facing fundamental trade deficit and no favorable position of terms of trade with both destination India and overseas that may have long-term effect on the Nepalese economy. The main cause behind trade deficit is high import against small export.
- Due to the adoption of liberal economic policy, government levied international trade tax to generate revenue but it neglected the aspect of import substitution. So, the trade deficit of Nepal becomes more acute.
- Nepal uses only one transit to (trade route) trade with overseas countries other than India and China. Although Nepal can use other trade routes such as Fulbari Banglaband through Bangladesh but not action is forwarded regarding this.
- Nepalese domestic industries cannot produce enough goods for Nepalese growing population.
- Nepalese export commodity composition is less diversified than import commodity composition. It is also less diversified country wise or destination wise.
- Export procedure documentation, Quality industrialization and quality mix, Lack of human resources and R & D, Insecure of FDI, Lack of dry port facilities, High transport cost and problems in the seaport are also consider the barrier to expand Nepalese export trade.
- Lack of diplomatic efforts, India oriented policies, condition imposed by donor agencies, donor driven strategies, poor implementation , not effective monitoring and evaluation mechanism, no price and reward system, red tapism on bureaucracy can also be consider the challenging scenarios .

5.3 Recommendations

In globalize economy, Nepal cannot remain on isolation. Now Nepal has trade relation with more than 100 countries. Nepalese foreign trade trends and structure seems not so satisfactory. Gradually increment of trade deficit problem shows the fact that Nepalese trade is dominated by imports. It also indicates that there are various barriers on Nepalese trade. Although Nepalese government has introduced different policies and measures with regular modification, Nepalese trade cannot take positive direction towards the nation. However, there is future potential to expand export trade. Therefore, government should take immediate action. This study has some suggestions for the promotion and expansion of Nepal's foreign trade especially exports trade and consequent economic growth of the country. The following measures should be considered.

- As soon as possible political settlement must be assured with the coordination of all the stakeholder of the nation. Without Political stability and consistency, nothing can be achieved.
- Re inventing of government is essential with cutting Red-Tapism and putting customer first strategies should be taken by government.
- In favour of country's interest, effective diplomatic efforts with strong political -will and commitment should be taken by the government.
- It is necessary to make export plan having the framework of enhancing strategies of export and discouraging the volume of import that can reduce trade deficit problems. To reduce imports, domestic industries should be encouraged to produce consumer goods, which can be done by increasing tax on imported items.
- Government should have the strategies to protect domestic industries that can be exercised by imposing quantitative restriction on imported items, developing of infant industries and expanding domestic markets.
- Government role should be defined as catalytic in practice not only on paper. Government should empower and attract the private sector involvement by making environment friendly policies.
- Foreign trade should be directed towards export promotion, import substitution and export diversification. Policies must not be influenced by foreigners.

- Diplomatic efforts should be started and search appropriate trade and transit route with overseas trade. Immediate action should take towards rethinking about the trade and transit treaties with India.
- Government should invest some money on R & D, as well as human resource development. Similarly proper utilization IT, introduced of changing technology on new established industries are essential.
- Implementation of policies should take care in an effective manner as well as monitoring and evaluation of policies is essential.
- There are possibilities of trading activities with SAARC countries. It does not only reduce trade concentration with India, but also work as a milestone towards mutual co-operation. It increases the possibility of joint venture in establishing industries.
- Provision of Surveillance at borders where goods are smuggled can be control smuggling practices across the borders, especially with India. In this regard, public cooperation should also be sought.
- Export should be increased by improving the quality of product, introducing new commodities, reducing cost of production, generating export surpluses, encouraging research and development.
- Imports substitutes should be encouraged by adopting improved indigenous technology curving non-essential and luxury imports and controlling population growth. It should also diversify its imports and exports markets and products via trade agreements and developing friendly relations.
- Open market policy will be beneficial for the country only when Nepalese products should be able to provide opportunities not to taste international products in the country but also to give the taste to others in the same proportion.
- To expand trade regular meetings, seminars, workshop with the participation of the all stakeholder should be conducted.

- Nepal should give higher priority to remove the nation's deficit problem by adopting long-term measures like penetration to export market and effective application and execution of import substitution regime.

Overall, Nepalese foreign trade situation suggests that though Nepalese trade has been facing too barriers, it have some potential too. To reduce gradual trade deficit government must immediately take action towards the direction of expanding export.

APPENDIX:

Appendix 1

Variable Name & Variable Label

Variable	Level
FY	Fiscal Year
T	Time
GDP	Nominal Gross Domestic Product
GDPAG	Nominal Agriculture Gross Domestic Product
GDPNAG	Nominal Non Agriculture Gross Domestic Product
Xt	Total Value of Exports
Mt	Total Value of Imports
Mt_I	Total value of Import with India
Mt_O	Total value of Import with Overseas
Xp	Exports of primary product
Xm	Exports of manufacturing goods
Xt-1	One Period Lag Exports
ln	Natural log
POPN	Population of Nepal
Mt-1	One Period Lag Imports
Eqn	Equation
Dep	Dependent Variable
WPI	Wholesale Price Index of India
RER	Real Exchange Rate
GDP/POPN	Ratio of Gross Domestic Product and Population of Nepal
Cont...	Continued

Appendix 2

Regression Equations

Simple Regression Model for Exports

Eqn 1 : Xt = ao + a1GDP

Eqn 2 : Xt = ao + a1GDPAG + a2GDPNAG

Eqn 3: Xt = ao + a1GDP + a2Xt-1

Log linear models for Exports

Eqn 4 : lnXt = ao + a1lnGDP

Eqn 5 : lnXt = ao + a1lnGDPAG + a2lnGDPNAG

Eqn 6 : lnXt = ao + a1lnGDP + a2lnXt-1

Simple regression Model for Imports

Eqn 7 : Mt = ao + a1GDP

Eqn 8: Mt = ao + a1GDP/ POPN + a2RER

Eqn 9: Mt_I = ao + a1GDP + a2WPI

Eqn 10 : Mt_O = ao + a1GDPNAG + a2RER

Log linear Models for Imports

Eqn 11: lnMt = ao + a1lnGDP

Eqn 12: lnMt = ao + a1lnGDP/ POPN + a2lnRER

Eqn 13: $lnMt_I$ = a0 + a1lnGDP + a2lnWPI

Eqn 14 : $lnMt_O$ = ao + a1lnGDPNAG + a2lnRER

Appendix 2

Basic Data

FY	Xt	Mt	Xp	Xm	GDPAG	GDPNAG	GDP
1993/94	7387.5	23226.5	1510.9	5875.7	55368	60759	116127
1994/95	13706.5	31940	2553	11153.2	65156	79777	144933
1995/96	17266.5	39205.6	2584.3	14680.7	70090	95260	165350
1996/97	19293.4	51570.8	1747	17540.4	80589	111007	191595
1997/98	17639.2	63679.5	2273.6	15328.5	85569	124407	209974
1998/99	19881.1	74454.5	2976.3	16869.9	96896	142492	239388
1999/00	22636.5	93553.4	3652.7	18924.6	108785	160785	269570
2000/01	27513.5	89002	5769.4	21686	112495	177303	289798
2001/02	35676.3	87525.3	7841.6	27737.3	132373	197645	330018
2002/03	49822.7	108504.9	8148.6	41283.6	145131	221120	366284
2003/04	55654.1	115687.2	9707.3	45602.9	151059	242993	393473
2004/05	46944.8	107389	13285.8	33294.2	160144	245994	406138
2005/06	49930.6	124352.1	11318.4	38404.3	171104	266442	437546
2006/07	53910.7	136277.1	10422.1	42869.4	183357	290772	474129

Cont...

Continued Basic Data

FY	POP	RER	GDP/POP	Mt_I	Mt_O	WPI
1993/94	18.11	29.78	6412.31	7323.1	15903.4	60.6
1994/95	18.49	52.93	7838.45	11245.5	20694.5	68.8
1995/96	18.94	48.42	8730.2	12542.1	26663.5	77
1996/97	19.39	58.77	9881.18	17035.4	34535.4	82.7
1997/98	19.86	54.84	10572.81	19615.9	44063.6	91.5
1998/99	20.34	53.53	11769.32	24398.6	50055.9	100
1999/00	20.83	59.42	12941.43	24853.3	68700.1	105.9
2000/01	21.33	64.67	13586.4	27331	61671	111.4
2001/02	21.84	67.82	15110.71	32119.7	55405.6	119.1
2002/03	22.37	73.75	16372.42	39660.1	68844.8	123.3
2003/04	22.98	71.33	16753.91	45211	70476.2	127.5
2004/05	23.52	69.67	17267.77	56622.1	50766.9	133.6
2005/06	24.06	70.45	18185.62	70924.2	53427.9	137
2006/07	24.61	71.38	19265.71	78739.5	57537.6	141.5

Sources: Compiled by the author From NRB, Economic Survey, Statistical Year Books (1993-2007)

Appendix 3

Composition of Nepal's Export classified by Major SITC Commodity Groups

(In million Rupees)

Fiscal year	Export SITC Commodity Group									
	0	1	2	3	4	5	6	7	8	9
1993/94	986.5	11.2	312.1	0.0	201.1	17.7	4312.3	0.1	1545.7	0.0
1994/95	1941.9	13.7	437.4	0.0	160.3	19.6	7557.5	0.3	3576.4	0.0
1995/96	1862.9	13.2	531.8	0.3	176.4	28.7	10298.3	1.2	4352.3	1.4
1996/97	1163.4	12.8	432.4	0.0	138.4	212.1	10912.6	6.4	6415.1	0.2
1997/98	1562.7	11.3	485.5	0.0	214.1	302.3	9260.3	37.1	5765.8	0.1
1998/99	1946.6	9.7	768.7	1.3	251.3	640.4	10455.7	35.2	5772.2	0.0
1999/00	2661.7	14.9	663.5	1.4	312.6	1353.4	11028.6	59.6	6540.3	0.5
2000/01	3123.2	22.8	487.1	20.9	2136.3	1968.5	11637.1	58.0	8059.6	0.0
2001/02	3724.5	50.0	469.9	0.5	3597.2	2804.0	13539.6	97.8	11392.8	0.0
2002/03	4240.4	117.2	561.3	2.2	3229.7	3933.2	15838.7	390.8	21509.2	0.0
2003/04	4776.6	75.6	751.1	1.3	4104.0	4041.7	18909.3	343.6	22650.9	0.0
2004/05	5094.2	145.7	624.5	1.6	7421.4	3308.3	17394.9	364.9	12589.3	0.0
2005/06	6100.9	138.7	800.1	5.5	4278.7	3279.0	17794.7	208.2	17281.5	43.3
2006/07	6276.9	55.2	714.3	14.5	3375.7	3865.9	23601.7	619.5	15380.1	6.9

Source: NRB: Quarterly economic Bulletin Mid-July 2007

Major SITC Commodity Groups where

0 = Food and Live Animal
1 = Tobacco and Beverages
2 = Crude Materials, inedibles except fuels
3 = Mineral, Fuels and Lubricants
4 = Animal and vegetable oil and fats
5 = Chemical and Drugs
6 = Manufactured Goods classified mainly by materials
7 = Machinery and Transport Equipment
8 = Miscellaneous Manufactured Articles
9 = Commodity and Transaction not classified according to kind.

Appendix 4

Composition of Nepalese Import Classified by Major SITC Commodity Groups

(In million Rupees)

Fiscal year	Import Classified by Major SITC Commodity Groups									
	0	1	2	3	4	5	6	7	8	9
1993/94	1820.5	257.0	2013.4	2278.3	741.7	3051.1	5950.8	5990.8	1120.7	2.2
1994/95	2947.5	288.3	3415.7	36.44.7	801.8	4615.3	8599.9	5892.5	1547.6	186.7
1995/96	3024.7	469.3	3977.0	3834.1	1085.1	5265.0	11633.1	7701.7	2185.9	29.7
1996/97	4084.8	367.6	3122.3	4837.0	1457.2	5541.4	19147.5	10037.5	2884.5	91.2
1997/98	4464.0	500.9	3347.9	4717.1	2056.0	7193.0	25300.6	13027.6	3057.2	15.0
1998/99	4785.8	508.6	4865.9	5549.3	2830.9	8686.8	28129.7	15301.1	3794.6	1.8
1999/00	5400.5	590.7	5487.1	7160.3	2327.6	8504.2	44741.9	13794.9	4016.4	1529.8
2000/01	4929.0	799.5	6976.2	9537.3	2025.8	11077.3	32601.6	16734.7	3974.0	346.6
2001/02	7619.5	846.1	6346.7	8737.5	3329.0	12476.4	25638.0	18063.7	4302.4	266.0
2002/03	10839.0	906.5	7012.4	9097.9	4446.0	14474.2	34420.0	20547.9	6682.8	78.2
2003/04	5994.4	906.1	7559.6	11269.2	5589.2	12941.9	41188.0	23027.8	7210.2	0.8
2004/05	6333.2	717.1	6734.1	15200.8	7887.5	12380.9	32889.1	19513.8	5670.3	62.1
2005/06	9370.5	792.2	8479.3	19944.1	7750.5	14319.5	34888.2	20702.1	6582.7	1523
2006/07	8554	1026.8	10550.6	21904.1	8634.4	16544.9	36510.5	25694.2	5103.8	1753.8

Source: as per as appendix 4 & major SITC commodity groups as above.

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