CHAPTER-I

INTRODUCTION

1.1 Background of the Study

Nepal is a land locked country located in South Asia. It is sandwiched between China and India. It has a size of 147,181 square kilometers and has most of the world's tallest mountains.It is a least developed country with a medium human development index (HDI) of0.574and ranks 149th in the world (United Nations Development Programme [UNDP] 2017).The total population of Nepal is 26.5 million (Central Bureau of Statistics [CBS] 2011). It is an agricultural country. Theshare of agriculture and non-agriculturesectorsto GDP is28.2 percent and 71.8 percent respectively in FY 2017/18. Its per capita incomeis just $1004(Ministry of Finance [MOF], 2018).

China is one of the two neighboring countries of Nepal, the other being India. It is the world's second largest economy. The trade relation between Nepal and China, especially between Nepal and Tibet Autonomous Region (TAR) of China dates back to centuries. Barter system was prevalent alongside trading in cash.Bilateral relation between Nepal and China dates back as early as 406 AD and commemorates the visit of a Chinese monk Fa Xian to Nepal and India. The cultural and social bonds are reflected in the marriage relations between the Tibetan monarch Srong-Chan Gam Po and the Nepalese princess Bhrikuti in the Seventh century. Similarly, the famous Nepalese architect Araniko constructed white pagoda temple in Beijing in the 14th century. The trade relations between Nepal and TAR flourished during the Malla rulers of Nepal and continued further during the latter part of 18thcentury. Nepal held the strategic position of facilitating transit trade between British India and TAR of China. Diplomatic relation with People's Republic of China was established in 1955.

Almost two-third of Nepal's trade takes place with India and trade between Nepal and China is significantly low compared to that between Nepal and India. Nepal has been facing a huge trade deficit with China since the volume of import has been much higher than that of exports. Nepal’s exports could meet only 15 percent and 2.5 percent of the imports from India and China respectively(Ministry of Foreign Affairs[MoFA], 2015).

The major export items of Nepal are readymade garments, woolen carpet, pulses, polyester yarn, textiles, jute goods, thread, juice and agricultural products. Similarly, the major imported items are petroleum products, gold, vehicles and spare parts, machinery, semi-finished iron products, Ms Billet, chemical fertilizer, electrical equipment, medicine, telecommunication equipments and parts, wires, rods, onion and garlic, and various types of household utensils and utility items. China's major overseas exports to Nepal are textiles, garments, light industrial products, petroleum products, food stuffs, cement, metal and steel products, lubricant oil, chemicals, raw wool, living sheep, salt, Yak, Yak tails and carpets, etc. Similarly, Nepal's main export to China are jute, sugar, timber, tanned sole leather, medicinal herbs, tea, food grains, wheat flour, sugar, jute bags and jute cloth, tobacco, dried chilies, candles, dyestuffs, soaps, timber, cross bred yak, etc (MOF, 1981).

China’s economy has been growing in an unprecedented way and it has pulled out millions of its citizens from extreme poverty. Despite being a neighbor of China, Nepal has not been able to benefit significantly from China's rapid economic expansion. In FY 2016/17, Nepal exported items worth Rs. 1,701,479,000 (Rs. 1.7 billion) to China while it imported items worth Rs. 129,878,417,000 (Rs. 129.9 billion) from China. This shows that Nepal's import from China is almost 76 times its export to China. There is a huge gap in trade balance. Inthe same fiscal year, China contributed to Nepal's 2.33 percent of exports while it occupied 13.19 percent share in Nepal's total imports (Department of Customs, 2017).

The trade imbalance with China is rising for years and the countermeasures haven't been successful to improve the balanceof payment situation. China has offered duty free entry facility tovariousexportable products fromleast developed countries (LDCs) including Nepal. Nepal can benefit from this provision. However, Nepal has been unable to export items from the zero-duty item list to China. China is the second largest trading partner of Nepal in terms of import and sixth largest partner in terms of export. It is Nepal’s biggest source of foreign direct investment. However, trade deficit of Nepal with China is increasing as the volume of the trade increases year by year. More than 80 percent of land trade with China is operated through Kodari-Nylam road (Tatopani entry point). Frontier trade is also allowed within the 30 km of border of each country (Adhikari, 2015).

Nepal's trade relation with China is guided by a number of bilateral agreements and understandings. These are: Trade and Payment Agreement-1981, Agreement on Road Transportation-1994, Agreement on Trade and other Related Matters-2002,memorandum of understanding (MOU) on establishment of Nepal-Tibet Trade Facilitation Committee-2009, Letter of Exchange for granting Special Preferential Tariff Treatment-2010, and Cooperation on Developing Border Infrastructures-2012,Transit and Transport Agreement-2016, etc. The pace of economic cooperation and trade between Nepal and China has been increasing over the decades. Chinese investment in Nepal is now moving towards hydropower and telecommunications from the tourism sector like hotel and restaurant and traditional medicines and heath care.

There has been a continuous increase in the import volume of Nepal. Nepal’s import crossed Rs. 1,245 billionand export reached Rs. 81 billion in the year 2017/18. Because of increasing imbalance between exports and Imports, trade deficit reached to a large volume of Rs. 1,164 billionin FY 2017/18 from Rs. 911 billion in 2016/17. Nepal’s major importing partner is India which held more than 65%share in FY 2017/18. China is the second biggest importing partner and held 12.80% of Nepal’s total imports in the same period with an increasing trend. France, Vietnam, Thailand, UAE andIndonesia are other major import partners (Department of Customs, 2018).

Nepal’s export toChina was almost stagnant during the last ten-fifteen years; it had even declined during the fiscal years2004/05 to 2006/07. On the other hand, imports from China are increasing continuously. As a result Nepal’s trade deficit has been rising year on year. Nepal’s export to mainland China and Hong Kong are insignificant and most of the exports are confined to Tibet Autonomous Region of China.China is the biggest investor in Nepal. Chinese investment in Nepal is growing although it ispresently lower than the need and potential. Chinese investment, particularly in the fields of hydro electricity, infrastructure development, mining and commercial agriculture would be extremely helpful. As of July 2012, 428 projects under Chinese investment came to operation in Nepal with investment of Rs 7,860 million which helped create 26,651 jobs (Kumar & Goyal, 2015).

1.2Statement of the Problem

Although foreign trade plays a vital role in economic growth of a nation, Nepal has not been able to substantially develop its foreign trade. The volume ofimport is many times its export and there is a huge discrepancy due to this trade deficit. Nepal has simply been unable to cut down the deficit and maintain a balance. The share of manufacturing goods is negligible compared to that of primary goods. Agricultural sector is very primitive and of subsistence type. It is almost completely dependent on the amount of rainfall as the irrigation facility is too poorly developed. Agricultural productivity is minute and mechanization of agriculture is too low. Human power and animal power occupies 36.3 and 40.5 percent of the total farm power available in the country respectively. The available mechanical power in the country is only 23 percent (Shrestha, 2012).

Nepal's trade deficit with China has been on continuous increase year on year. The major trade point betweenNepal and China from which the majority of bilateral trade takes place has been opened only recently, i.e. four years after the massive earthquakeof 2015. Serious efforts should be made to bring this vital trade point into full functional state as the volume of trade taking place via this route has not reached the pre-earthquake level. More border points should alsobe opened as soon as possible to facilitate the export and import of goods to and from China. This delay in opening other border points is deteriorating the trade deficitsituation.Despite being too close to the Chinese market, Nepal has been unable to promote export and reduce trade imbalancewith China let alone reverse the trend. Nepal has not been able to woo Chinesegovernment to facilitate trade, build major cross border road and rail network, gain proper market access and prioritize China's trade partnership with Nepal.In the light of the above mentioned situation, the problem that is examined in this research is “what is the current status of Nepal’s trade with China?” In addition to this, following questions will be answered through the study:

a) What are the trends of Nepal's bilateral trade with China?

b) What are the main reasons of growing Nepal’s trade deficit with China?

c) What sorts of policy measures could be taken to increase Nepal’s exports to China?

1.3Objectives of the Study

The research has general and specific objectives. The specific objective of the research is to analyze Nepal’s trade relationship with China.

The general objectives are as follows:

a) To analyze the nature, trend andcompositionof bilateral trade between Nepal and China.

b) To explore the contribution of bilateral trade between Nepal and China to the economic growth of Nepal.

1.4 Significance of the Study

The study will help to understand the importance of Nepal-China trade for Nepalese economy. It will extendexisting knowledge in the area under our investigation. The findings of this study will benefit policy makers to take appropriate steps to correct trade imbalance problems with China through the recommended approach derived from this study. It also gives the justification for the current study because of its potential contribution to understand the nature and structure of trade between the two nations.Apart from that, it will help the readers and students by bringing in additional understanding of the current status, trend and potentials of the Nepal-China trade. Administration and concerned government agencies will get insight regarding what should be emphasized to improve Nepal's trade performance with China. The study will also attempt to show that more deeper and better understanding is needed to find the solution to the problems of Nepal-China trade.

1.5 Limitations of the Study

The fundamental limitations of this study are as follows:

a) Data gaps and absence of reliable information are major problem in estimating the economic contributions of Nepal-China trade beyond what is available in official reports.

b) This study tries to explore only the current situation and trend of Nepal-China trade and focuses less on the obstacles and the measures to overcome them.

c) Only secondary data has been used and primary sources of data were not employed.

1.6 Organization of the Study

The study has been divided into five major chapters. Chapter One is related to Introduction. It contains a short background introduction to the Federal Democratic

Republic of Nepal, its economy and trade relations with China. A brief history of the evolution of trade up to its current situation has been presented. Similarly, this chapter sketches out the basic outline of the study, viz., statement of the problem, objectives of the study, significance of the study, limitations of the study, and organization of the study.

Chapter Two is related to Review of Literature. This chapter contains reviews of relevant literatures and articles related to trade between Nepal and China in the light of national and international trade. A brief theoretical background on the theory of international trade has also been given. An investigation of recent research, published information and available materials related to the topic is carried out under literature review.

Similarly, Chapter Three explains the Research Methodology used in this study which consists of a short introduction to research design, sources of data, sample period covered, tools and methods of collection of data as well as the methods of processing and analysis of data.

Chapter Four is related to Data Presentation and Analysis.This portion of the thesis presents the findings, analysis and interpretation of data. It is the main analytical section in which conclusion is derived about the current composition, trend and status of Nepal-China trade. The problems and prospects for the development of trade and improving bilateral trade relations between the two countries have also been discussed in this chapter.

Finally, Chapter Five is related to Summary of Findings and Recommendations. This chapter is the last part of the study. It consists of summary of findings and conclusion of the study along with some recommendations or suggestions to boost up Nepal-China trade and to improve thetrade imbalance that Nepal has been facing while trading with China.References and Appendix are presented at the end of the thesis.

CHAPTER-II

REVIEW OF LITERATURE

There are various books, articles and dissertations covering the subject. Literature review will be carried out in international context and national context. The theories on international trade have also been discussed.

2.1Introduction

Trade between nations has been taking place from the very beginning of the human civilization itself. Ancient philosophers and economists have expressed the importance of foreign trade to the national economy. Long distance trade was prevalent even five thousand years ago. Trade theories and practices have evolved significantly over this time period along with the evolution of human society.

2.2 Theoretical Perspectives

Mercantilism was the dominant economic doctrine of trade before the advent of Adam Smith, the father of Economics. Mercantilist favored export and discouraged imports of goods and services. They encouraged the accumulation of gold and silver.

Smith (1776) was of the view that absolute advantage in production of particular goods by a country is the main reason for trade to take place and criticized protectionism. According to Smith, a country has an absolute advantage over others when it is more productive in producing a particular product. He argued that a county should specialize in production and export of goods for which it has an absolute advantage while import other necessary products.

Ricardo (1817) shifted the focus from absolute advantage to comparative advantage theory of trade to explain why countries engage in international trade. In Ricardo's opinion, absolute advantage is only a special case of comparative advantage and that a country should specialize in the production of those goods in which it is relatively or comparatively more productive even if it has an absolute advantage in all goods it produces.Ricardo advocated free trade or laissez-faire.The theory of international trade has gone through great changes and developments since the advent of laissez-faire and several new theories have been developed to describe the international flow of goods and services.

Heckscher(1919) and Ohlin(1933) theorized that the differences in factor endowments and not the differences in productivity determine the patterns of trade. Absolute amount of factor endowments is what matters and their theory is also known as factor proportion theory. According to Heckscher-Ohlin theory, comparative advantage arises from differences in national factor endowments. The more abundant a factor, the lower its cost. They predicted that countries will export goods that make intensive use of locally abundant factors and import goods that make intensive use of factors that are locally scarce. But this theory is heavily criticized due to the Leontief Paradox.

Leontief (1954) found an inconsistency or paradox in Heckscher-Ohlin trade theory. According to the Heckscher-Ohlin theory, since the US was relatively abundant in capital compared to other nations, the U.S. would be an exporter of capital intensive goods and an importer of labor-intensive goods. However, Leontief found that US exports were less capital intensive than US imports.

Isard (1954)introduced the gravity model of international trade. It predicts bilateral flow of trade based on the sizes of the economies and distance between two units. The relative size is determined by GDP, and economic proximity is determined by trade costs- the more economically distant, the greater the trade costs.

Kravis (1956) opined that domestic availability or non-availability of goods govern the pattern of trade. While, he was attempting to test the generalizations of Hecksher-Ohlin theory that the abundant countries export labour-intensive goods, he found that the exporting industries invariably had been paying relatively high wage rates even in those countries. Kravis, therefore asserted that the nations would export those products which were readily available in the home country. On the contrary, they would tend to import such products the domestic such of which had been short of their demand. According to him, the essential basis of international trade has been the ‘non-availability of goods at home’. The non-availability of goods in the home country may either be in the absolute or in the relative sense.

Linder (1961) developed the country similarity theory as he tried to explain intraindustry trade. His theory proposed that consumers in countries that are in same or similar stage of development would have similar preferences. Companies first produce for domestic consumptionand when they explore exporting, they often find that markets that look similar to their domestic one, in terms of customer preferences, offer the most potential for success. So, most trade in manufactured goods will be between countries with similar per capita incomes, and intraindustry trade will be common.

Posner (1961) forwarded the imitation gap or technological gap theory by analyzing the theory put forward by Kravis. He argues that the process of technological change leads to the imitation gap which influences the patterns of international trade. His model stressed the time lag in the imitation process. As foreign producers acquire the new technology, they are eventually able to conquer foreign markets. They can also conquer the domestic market for the product because of their lower labor costs. Domestic producers may also introduce still newer products and production processes and may be able to export these products based on the new technological gaps. However, this theory does not explain the size of technological gaps and the reasons that these gaps arise mays to eliminate the gap. It contends that the technologically-abundant countries would possess relative advantages in new products over less technologically developed nations.

Kenen (1965) stressed the role of human capital in determining the comparative advantage of nations. He criticized Leontief for not including the value of human capital by considering only physical capital. In his study, he found that the Leontief Paradox was reversed when human capital was added to Leontief's physical capital. He argued that capital should not be treated as a separate specific factor endowment, but as an agent that is applied to resource stocks to bring forth their flow of useful services. Adding the additional human capital to the existing estimates of physical capital, he concluded that exports were indeed slightly more capital intensive, on the whole, than import-competing production.

Keesing(1966) put forwardhis human skills theory. It emphasized differences in endowments and intensities of skilled and unskilled workers. This theory explains the Leontief paradox. Since the U.S. has highly trained, educated workers relative to other countries, U.S. exports tend to be skilled-labor intensive.

Vernon and Wells (1966)put forward the product life-cycle theory of trade. It explains that as products mature, both the location of sales and the optimal production location will change affecting the flow and direction of trade. However, globalization and integration of the world economy has made this theory less valid today. One the one hand, this theory is ethnocentric and on the other, production today is dispersed globally and products today are introduced in multiple markets simultaneously.

Krugman(1979) put forward a new trade theory known as the new trade theory. It suggests that the ability of firms to gain economies of scale (unit cost reductions associated with a large scale of output) can have important implications for international trade. Countries may specialize in the production and export of particular products because in certain industries, the world market can only support a limited number of firms. According to the new trade theory, nations may benefit from trade even when they do not differ in resource endowments or technology. A country may dominate in the export of a good simply because it was lucky enough to have one or more firms among the first to produce that good. Governments should consider strategic trade policies that nurture and protect firms and industries where first mover advantages and economies of scale are important.

Lancaster (1980) and Krugman (1981) developed a theory of international trade known as the global strategic rivalry theory. It focused on MNCs and their efforts to gain a competitive advantage against other global firms in their industry. Firms will encounter global competition and in order to prosper, they must develop competitive advantages by overcoming the barriers to entry. These obstacles or barriers to entry that corporations may seek to optimize include research and development, the ownership of intellectual property rights, economies of scale, unique business processes or methods as well as extensive experience in the industry, and the control of resources or favorable access to raw materials.

Porter (1985) put forward his competitive advantage theory of trade. Competitive advantage occurs when an organization acquires or develops an attribute or combination of attributes that allows it to outperform its competitors. The theory suggests that states and businesses should pursue policies that create high-quality goods to sell at high prices in the market. Porter emphasizes productivity growth as the focus of national strategies.

In today's globalized world, international trade is regulated by the World Trade Organization (WTO) which was created in 1995. It was preceded by General Agreement on Tariffs and Trade (GATT), created in 1948 after the end of the Second World War.

2.3International Context

There is no dearth of literature regarding international trade. Various writers have expressed their opinions on foreign trade.

Tyler (1981) analyzed the empirical relationship between economic growth and export expansion in developing countries as observed through an inter-country cross-section. Using data from 55 middle income developing countries for the period 1960–1977, the researcher revealed significant positive associations between growth and various other economic variables including the growth of manufacturing output, investment, total exports, and manufacturing exports. The results indicated that export performance was important, along with capital formation, in explaining the inter-country variance in *GDP* growth rates during the 1960–1977 period.

Gershon (1983) provided the formal model to show significant relationship between export and growth of the economy. The writer provided a mathematical model representing GDP as dependent variable with independent variables of export and non-exports. Gershon further classified non-export variables into labor and capital. Through analysis of the marginal productivity of labor and capital and the growth rate of export, he found that there is a positive association between export and growth.

Bergstrand (1985) applied the gravity model to the study of international trade. He stated that the gravity equation is empirically successful for the explanation of trade flows but maintained that the theoretical foundation was weak in respect of projecting thepotentiality of the model. Bergstrand (1989) studied the consistency of the gravity equationwith contemporary theories of inter-industry and intra-industry trade. This paper was an extension of the microeconomic foundations spelt out in his earlier paper of 1985 in that the gravity equation incorporated factor endowment differences and non-homothetic preferences.

Montenegro and Soto (1997) also used simulation techniques from their estimated results based on the gravity model to study the distortions in Cuban trade. They discussed the Cuban trade structure and identified the effects of liberalization on the development of trade. The deviation they found between the predicted and actual values from simulation was a consequence of non-economic factors. Import quotas caused significantly lower actual import volumes in Cuba from USA than predicted one.

Francis (2003) used a two-country, two-sector new geography model where workers are imperfectly monitored, to examine the relationship between fallingtrade costs and unemployment. The writer has shown that as trade costs fall over time, the world naturally falls into an industrialized core and an agricultural periphery. Globalization has a positive effect on employment in the core in both the short and long term. The periphery suffers employment losses in the short term but can gain in the long term.

Sohn (2005) examined the extent to which the gravity model can be employed to study South Korea's bilateral trade flows and thereby applied in the formulation of trade policy. He found that the gravity model is the best tool for the explanation of South Korea's bilateral trade flows as a single country case. The coefficient on the trade variable showed that Korea's trade flows depend on comparative advantage, income differences, and stages of development rather than on economies of scale, as proposed in Heckscher-Ohlinmodel on the study of international trade pattern. South Korea has large unrealized trade potentials with Japan and China, suggesting that they are desirable partners for an FTA. North- South Korean trade will expand markedly if bilateral relation normalizes and North Korea participates in APEC.

Maina (2008) found that exports led to economic growth in Kenya. There was a strong positive or direct relationship between exports and economic growth. However, the correlation coefficient between exports and economic growth compared to the correlation between imports and economic growth was slightly small. For this case, it would mean that imports had a greater impact than exports on economic development in Kenya. Also, the findings indicated that there was a strong positive or direct relationship between imports and economic growth in the country.

Schuett (2010)analyzes that well established economic links exist between Germany and China despite political differences on various international issues. Schuett also argues that the noneconomic relations are dominated by the human rights topic, which apparently has no influence on the booming economic ties. At the end,the writer has concluded that economic relations dominate the bilateral relations as both partners expect a lot from the economic collaboration.

Sun and Heshmati (2010) demonstrated that increasing participation in the global trade helps China reap the static and dynamic benefits, stimulating rapid national economic growth. Both international trade volume and trade structure towards hightech exports result in positive effects on China’s regional productivity. The eastern region of China has been developing most rapidly while the central and western provinces have been lagging behind in terms of both economic growth and participation in international trade.

Wang, Wei, and Liu (2010) studied the causes of trade flows between 19 OECD countries from 1980 to 1998 by using the augmented gravity equation. They aimed to identify the main causes of bilateral trade flows in OECD countries. The specific features of the study included the explicit introduction of R&D and FDI as the two important explanatory variables, conduct of unit root tests in the panel data framework and careful consideration of endogeneity. Their results demonstrated that geographical distance, domestic technology (R&D) stock, inward FDI and total inward FDI stock, level of GDP and factor endowment are the major factors affecting trade flows. Similarly, they found that the levels and similarities of market size, domestic R&D stock and inward FDI stock are positively related to bilateral trade, while the distance, measured by both geographical distance and relative factor endowment, between trade partner countries has a negative impact. These findings lend support to new trade, FDI and new growth theories.

Kahya (2011) analyzed the relationship between foreign trade and economic growth in Turkey during the period 1980-2009. He found that the export growth was significantly affected by the GDP growth which indicates growth-led export pattern in Turkey during these periods.

Oh and Tumurbaatar (2011) studied the international trade patterns of Mongolia. They state that the log-linear structure of regression equation based on the gravity model produces not only a comparison of traded goods and trading partners but also the determinants of trade. They also examine the influence of Mongolia’s geographical location on the country’s trading patterns. The results show that Mongolia’s exports are distorted by its geographical location. However, its imports and overall trading patterns have not been distorted. The writers analyzed the influence of Mongolia's landlocked location between Russia and China on the country's international trade patterns through the use of an augmented gravity model. The results are basically consistent with the prediction of the gravity model with some unexpected results on per capita GDP and the WTO dummy.

Antunes (2012) studied the impact international trade had on the economic growth of Portugal and the Netherlands in the period 1970-2010. Although both economies are small open economies, the result registered is distinct. For Portugal both exports and imports play a significant role, as for the Netherlands, only exports show a positive effect on GDP.

Jimenez and Razmi (2013) found that the proportion of a country's manufactured exports that is destined for industrialized countries is robustly associated with growth. Their findings show that prospects for continued growth, now centered on domestic tradable consumption or on developing countries as markets, may be limited. South–south trade may not be a good substitute for south–north trade.

Vijayasri (2013) focuses on the relationship between economic development and international trade, as well as on the disadvantages of international trade. And has concluded the role of foreign trade in achieving a quicker pace of economic development is well recognized and that the planning of foreign trade cannot be divorced from the strategy of overall development. The disadvantage of international trade is that the welfare of the people in nations that produce goods and services is sometimes ignored for the sake of profits. Vijayasrihas said that the international trade leads to economic growth provided the policy measures and economic infrastructures are accommodative enough to cope with the changes in social and financial scenario that result from it.

Abdullahi, Safiyanu and Soja(2016) analyzed the relationship between international trade and economic growth in West Africa from 1991- 2011. Based on the panel data of 16 out of 17 countries in the region, the study found that a one percent rise in export variable will lead to growth of GDP by 5.11 percent. Import on the other hand had positive but insignificant impact on GDP growth. Foreign exchange had negative impact on GDP growth. Therefore, the study concluded that exports impact positively on economic growth of the region and recommended that West African countries should encourage indigenous enterprise for export promotion and import substitution.

Bakari (2017) investigated the impact of exports on economic growth in Gabon using annual time series data for the period 1980-2015 by implementing co-integration analysis and error correction model. The empirical results showed that in the long run, investment and exports affect negatively on economic growth. However, in the short run, investment and export cause economic growth. These results provided evidence that investment and exports are necessary in Gabon's economy and are presented as an engine of growth since they cause economic growth in the short term.

Hasnain (2018) analyzed the achievements of the economy in terms of important variables as export and import which together forms international trade and economic growth was determined by GDP. This study used Pearson Correlation and Multiple regression model for empirical findings. The study found that international trade (export and import) has a significant positive impact on economic growth (GDP) in Bangladesh and international trade is strongly positively correlated with economic growth (GDP) in Bangladesh.

2.4 Nepalese Studies

There are several studies that had been carried out discussing the foreign trade of Nepal. Some of the most valuable studies are discussed in this section.

Timilsina (1985) has tried to investigate the then trade situation, commodity composition, development and BOP with the help of secondary data. The tariff policies adopted in different time periods by the policy makers and the use of tariff instruments to promote foreign trade and protect vulnerable industries. Timilsina found that the non-tariffs instruments are not working and concluded that Nepal's foreign trade is not working as a vehicle to drive economic growth and is facing various problems like high imports and import of non- essential goods. Similarly, the researcher has analyzed the issues of informal trade, long and porous open border, smuggling and import payment etc.

Jha (1987) has analyzed Nepal’s trade situation for the period 1956/57 to 1985/86. Jha has analyzed the overall foreign trade scenario and the strategies adopted by the then HMG of Nepal towards diversifying the country's trade with other countries. The study also covers tariff and transit problems and joint ventures in Nepal as well as the composition of export and import trade, direction, structure and tariff rate. It also highlights the various aspects of Indo-Nepal trade.

Chakrabarti (1990) has carried out a thorough analysis of trans-Himalayan trade that used to take place before the Chinese invasion of Tibet in 1950. The writer has mentioned various aspects of Nepal-China trade including Gorkha invasion of Tibet in 1792 in which the Chinese had helped Tibet.

Dahal (1992) tries to analyze the contribution of foreign trade to the total revenue of the government of Nepal. Dahal has studied foreign trade's contribution and its relation with the GDP of Nepal. The researcher found that in the case of underdeveloped countries, there was little investment and industrial backwardness and thus to meet their needs such underdeveloped countries had to import goods and services from other countries.

Singh and Singh (1999)have argued that since Nepal is a primary product producing country, the terms of trade are unfavorable for Nepal. They are of the view that internationally, all nations are undergoing economic reforms such as liberalization, privatization and globalization. So the Nepalese economy also has to be made compatible with these global changes to reap the benefits. They found thatthe import commodity composition of Nepal is more diversified than the export commodity composition. Also they have examined Nepalese trade direction in terms of destination wise exports and imports. Finally, they have suggested measures to increase export and decrease import.

Sharma and Bhandari (2005) have expressed the view that foreign trade has been rendered due weight in all the periodic plans because of the adverse balance of paymentposition. Realizing that the composition of exports be changed by identifying new exportable items, the Ninth Periodic Plan (1997/98-2001/02) too discouraged the import of luxury goods and called for an adequate supply of necessities at reasonable prices. Huge stress has been placed on industrialization through export promotion and import substitution. The same study has concluded that exports growth leads to economic growth. Private spending is the most import-increasing factor than government spending. The remarkable conclusion that may be drawn is that the substitution between the Indian goods and Nepalese goods through price effect is highly considerable.

The writers have suggested that foreign trade has tremendously been suffering from successive deficit which can have negative effect on foreign currency reserve of the country and thereby invite macro economic instability. Inefficient management of the growing population may invite disaster to the economic growth of country in long run. The import substitution policy demands an overall evaluation so that industries only competitive in the international markets are selected for promotion. Therefore, government should encourage the policy of adequate investment in export oriented industries that embodies a ‘proper mix’ of export promotion and import substitutions.

Subedi (2012) holds the view that eight years after Nepal's accession to the World Trade organization (WTO), the country's trade deficit has increased four folds and the share of export in GDP decreased to 5 percent from 10 percent.

Acharya (2013) analyzed the determinants of foreign trade of Nepal using gravity model approach and has concluded that the distance to trade partner county of Nepal is highly significant implying that higher the distance lower the trade.

Sapkota (2014)has viewed that Nepal's regular trade with mainland China is a post 1956 development. But Nepal's ancient trade history with Tibet started using barter system at the time of beginning of Malla and Lichchhavi regime. Trade relation between Nepal and Tibet had grown with the commercial policy of Malla rulers, who played a significant role in boosting up trade. Nepal-Tibet trade used to be carried out through many passes or frontiers by the people of both sides. Nepal's trade with China is the composition of trade with three parts of China i.e. Tibet, mainland China and Hong Kong. But there is no separate trade relation with TAR since 2007/08 because of the combined trade transaction of both Tibet and China. Nepal's trade with China is also characterized by dominance of imports over exports. Among the three parts of China, Nepal's export is highly concentrated to Tibet but regarding import, Nepal has been importing from all the three parts approximately in equal amounts from 2000/01. But, till 1999/00, the largest proposition of import was from Hong Kong. The commodity composition of trade both in terms of export and import is different with respect to the three parts of China.

Magar (2016) has concluded that Nepalese foreign trade trends and structure is not so satisfactory.Gradual increment of trade deficit problem shows the fact that Nepalese trade is dominated by imports. It alsoindicates that there are various barriers on Nepalese trade. Although Nepalese government has introduced different policies and measures with regular modifications, Nepalese trade cannot take positive direction towards benefit of the nation. However, there is future potential to expand export trade. Therefore, government should take immediate action.

Kafle (2017) examined the trends in Nepalese foreign trade and the major reasons for trade deficit with India. He argued that Nepal’s foreign trade is rapidly increasing but the rate of increase in import is higher than that of export, which is regarded as a major problem of Nepal’s foreign trade.

2.5 Research Gap

From the review of literature, it is noticed that though several writings have been published, relevant, adequate and recent publications are still not available in the field of Nepalese foreign trade with China. Most of the literatures are related to Nepal's overall trade with the world. There are only a handful of studies concerned with Nepal's trade with China and they have used old statistical data. For example, the study carried out by the Federation of Nepalese Chambers of Commerce and IndustryFNCCI study is already more than a decade old and outdated given the evolution of trade and items traded with China. Hence, the research gap is significant. Because of the above mentioned reasons, this thesis is quite new and it carries out recent data from FY 2007/08-2017/18 related to Nepal’s foreign trade with China.

CHAPTER-III

RESEARCH METHODOLOGY

Research methodology plays an important role in achieving the research goal. In this section research design, sources and nature of data, data collection, data processing and analysis have been discussed by the researcher for the convenience of research work.

3.1Introduction

A descriptive research design is used because of the nature of my study. Research design is the blueprint for the collection of data, its measurement and analysis. It is a work plan owing to the objective of the research. The study is designed in accordance with the given objective of the study. Tables are incorporated whenever necessary to show the volume, composition and trend of trade.

3.2Sources of Data

Data is a piece of fact, the wholesome aggregate of which gives the information. This information in fact contributes to the inquiry of truth and approaches towards the reality. The nature of the data that will be used as per research questions are secondary data. Secondary data are those data which have already been collected for any other purpose or investigation. Since, this research is mounted on the base of description and analysis, secondary data is used.. Therefore, secondary data plays the role of cornerstone for this research. Both published and unpublished sources were used. The data is taken from Economic Survey published by MOF, documents published by the Central bank of Nepal- NRB, Central Bureau of Statistics (CBS), books and economic journals.

3.3Sample Period Covered

Due to gaps in data and reliable statistics, the data used in this analysis begins from FY 2007/08 to 2017/18. Data available for the last 10 to 11 years has been incorporated while conducting this research. Data was gathered from various sources and checked for its validity and only the most reliable once published mainly from government sources were used along with data from non-government sources.

3.4Tools and Methods of Collection of Data

Secondary data and information have been employed to achieve the objectives taken by this study. Due to the use of secondary data and limited time schedule, case studies, checklists, interviews, observations and surveys or questionnaires were not used. Both quantitative and qualitative data have been used. Various internal and external sources have been used for acquiring data. Secondary data has been obtained from relevant literatures about Nepal-Chinatrade, books, scholarly journals, research reports, journals, newspapers, documents, theses and the Internet.

3.5Methods of Processing and Analysis of Data

After collecting data from different sources, it has been arranged in systematic way and tabulated. Preliminary analysis shows that Nepal- China trade faces many obstacles such as lack of transportation, lack of quarantine zone, limited customs capacity, lack of credit facility, absence of dry port, language barriers, lack of electricity, etc. Furthermore, the transportation and transit cost should be minimized. The trend and structure of trade with China is not satisfactory. Both tariff and non-tariff barriers should be minimized to benefit from trade with China. The share of trade on Nepal's GDP should also be increased to reduce poverty and achieve economic growth. All stakeholders should be consulted and appropriate policy measures should be taken by the government to tap the full potential of bilateral trade between the two countries.

CHAPTER -IV

DATA PRESENTATION AND ANALYSIS

After the collection of relevant data related to the study, it has been shown with the help of various tables and analyzed thoroughly. This chapter presents the data gathered from various sources, the results of the analysis and the interpretation of data.

4.1 Introduction

The trend of the Nepalese economy can be analyzed using data released by The Ministry of Finance.Nepal has remained an agricultural country and the process of industrialization is very slow. Data show that the economy is growing at a stable rate in the recent years despite of limited resources to finance the prerequisites of development and public service delivery. To increase investment and maintain high growth rate, greater involvement of private sector as well as foreign direct investment (FDI) is necessary. Table 4.1 shows the major macroeconomic indicators of the Nepalese economy. This macroeconomic data is prepared based on the past eleven years report published by the Ministry of Finance. Economic activities in Nepal have picked up in recent years due to greater political stability and completion of the peace process that ended the civil war. The key macro-economic indicators and variables are presented in Table 4.1 and explained further.

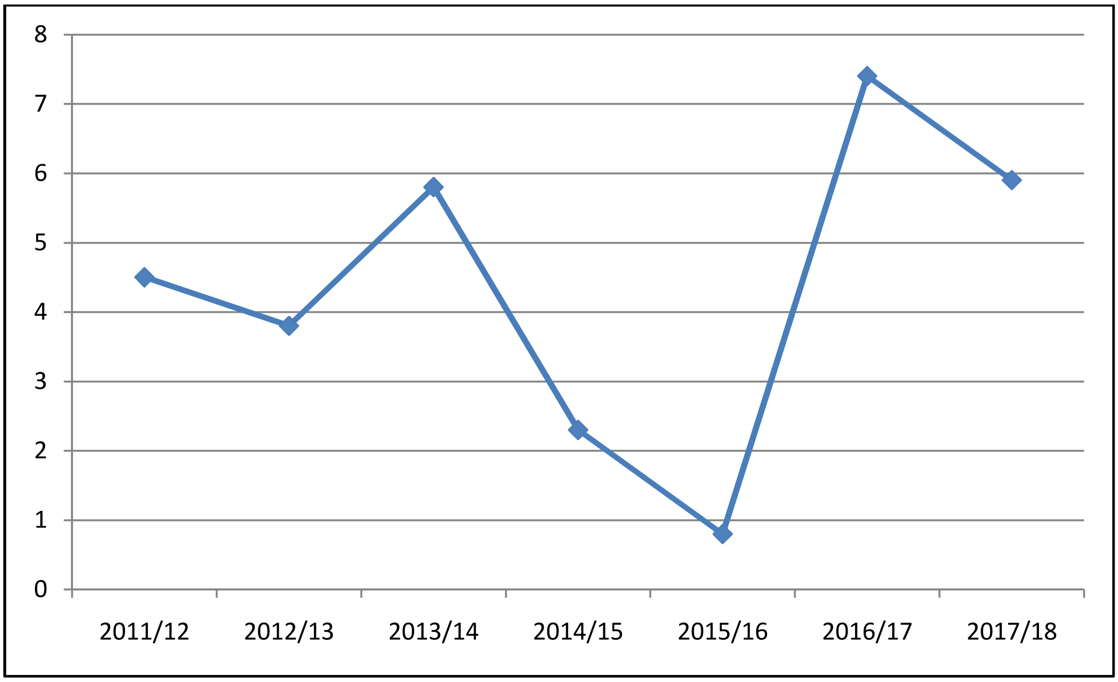
Table 4.1: Major Macroeconomic Indicators

	Units	Fiscal Year										
		2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Real GDP /At Basic Prices)	*Annual % change*	5.8	3.9	4.3	3.8	4.6	3.8	5.7	3.0	0.2	7.4	5.9
GDP (At Current Price)	*Annual % change*	12.1	21.2	20.7	14.6	11.7	11.0	15.9	8.4	5.8	17.3	13.8
Per Capita GNI	*US Dollar*	496	502	614	718	708	714	737	778	759	877	1012
Total Outstanding Debt/GDP	*In %*	46.1	40.3	33.5	32.1	33.9	31.9	27.9	25.4	27.6	26.4	28.0
Export (Goods)	*Annual % change*	-0.2	14.2	-10.2	5.8	15.4	3.6	19.6	-7.3	-17.8	4.2	13.0
Import (Goods)	*Annual % change*	14	28.2	31.6	5.8	16.5	20.6	28.3	8.4	-0.1	28.0	20.6
Export/Import Ratio	*In %*	26.7	23.8	16.2	16.2	16.1	13.8	12.9	11.0	9.1	7.4	6.9
Trade Deficit	*Annual % change*	20.2	33.3	44.6	5.8	16.7	23.9	29.7	10.8	2.0	30.4	21.2
Current Account Balance	*Rs. in Billion*	23.7	41.4	-28.1	-12.9	76.0	57.1	89.7	108.3	140.4	-10.1	-198.3
Trade Deficit/GDP	*In %*	-19.9	-21.9	-26.3	-24.3	-25.4	-28.3	-31.7	-32.4	-32.4	-34.7	-37.0
Balance of Payments	*Rs. in Billion*	29.7	44.8	-3.3	4.1	131.6	68.94	127.1	145.0	189.0	82.2	-8.0

*Source:*Economic Survey,2017 and 2018, MoF.

As shown in Table 4.1, Nepal's real GDP growth was 7.4 percent in FY 2016/17 and 5.9 in FY 2017/18. The GDP growth rate was almost zero in the previous FY 2015/16 due to the adverse impact of devastating earthquake and the subsequent disruption of flow of goods due to border disruption. Per capita GNI is too low which is typical of underdeveloped country. The table also shows that the country is heavily indebted. Export and Import growth situation has regained strength in comparison to past year's performance. Export/ Import ratio is on continuous decline and it shows the volume of export is lower than that of import. Annual percentage change of trade deficit was 30.4 in FY 2016/17 and it declined to 21.2 percent in FY 2017/18. The decrease in current account balance was by Rs. 10.1 billion in FY 2016/17 however, this negative balance rose toRs. 198.3 billion in FY 2017/8 . Lastly, the balance of payment was Rs. 82.2 billion in FY 2016/17 and Rs. -8.0 billion in FY 2017/18.

Figure 4.1:GDP Growth Rate(at Basic Prices)



*Source:*Nepal Rastra Bank, 2016, 2017 and Economic Survey, MoF 2018.

Nepal’s GDP inFY2015/16 grew by only 0.8 percent at basic prices as the graph shows. In FY2014/15, such growth was 2.3 percent. The growth fell down as insufficient rainfall resulted in contraction in output of major agricultural crops. Also, the disruption of border points together with closures and strikes for a considerable period of time impacted unfavorably the overall sectors of the economy inFY2015/16. The GDP growth rate jumped to 7.4 percent in FY 2016/17 and 5.9 percent in FY 2017/18.

Table 4.2: Sectoral Production Growth Rate of GDP (%)

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Agriculture	5.82	2.99	2.01	4.48	4.63	1.11	4.64	1.12	-0.01	5.30	2.8
Industry	1.64	-0.63	4.05	4.4	2.95	2.69	6.92	1.42	-6.45	12.4	8.8
Service	7.35	6.0	5.83	3.42	5.01	5.73	6.22	4.63	2.06	7.5	6.6
Export/GDP	7.3	6.9	5.1	4.7	4.9	4.5	4.7	4.0	4.0	2.8	2.7
Import/GDP	27.2	28.8	31.4	29.0	30.2	32.8	36.4	36.4	36.4	37.5	39.7

*Source:*Economic Survey,2017 and 2018, MoF.

Table 4.2 shows the sectoral production growth rate of GDP in percentage. As the table indicates, the contribution of agriculture as percentage of GDP has been decreasing whereas the contribution of services in GDP has been increasing in a slow pace. Contribution of industry dropped in the year 2014/15. Agricultural and industrial sector registered negative growth in FY 2015/16 due disruption at border entry points with India however sharply recovered in 2016/17. Among the non-agriculture sector, industry and services sectors grew by 12.4 percent and 7.5 percent respectively in FY 2016/17 which shows robust recovery. The primary sector or agriculture sector registered a positive growth rate of 5.3 percent. Recently, in the FY 2017/18 these growth rates were 2.8 percent for agriculture, 8.8 percent for Industry sector and 6.6 percent for the service sector. Double digit growth took place only in the industrial sector in FY 2016/17. The completion of political transition is expected to positively affect sectoral growth in the upcoming years.

Likewise, export to GDP ratio is on a continuous decline and import to GDP ratio is on continuous rise. This shows there is huge trade imbalance and that the foreign trade is heading towards wrong direction which is very much alarming. The export/GDP ratio was 2.8 in FY 2016/17 and it declined to 2.7 percent in FY 2017/18. On the other hand, the import/GDP ratio was 37.5 in FY 2016/17 and it rose to 39.7 in FY 2017/18.

4.2 Overview of Foreign Trade

The overview of foreign trade is presented in the subsequent sections.

4.2.1 Composition of Foreign Trade

Table 4.3 shows the major commodity composition of Nepal’s foreign trade with China in the recent years.

Table 4.3: Exports of Commodities to China

(Rs. InMillion)

SN.		2012/13	2013/14	2014/15	2015/16	2016/17
	A. Major Commodities	**1,110.5**	**947.5**	**916.9**	**1,002.7**	**956.3**
1	Incense Sticks	31.0	43.4	14.0	5.6	9.5
2	Aluminium, Copper and Brass Utensils	128.3	0.0	0.0	0.0	0.0
3	Handicraft (Metal and Woolen)	131.1	260.9	202.0	429.3	373.0
4	Herbs	0.0	0.0	0.0	0.0	0.0
5	Human Hair	0.6	10.8	17.2	13.3	0.0
6	Musical Instruments, Parts and Accessories	0.4	0.0	0.1	0.0	0.0
7	Nepalese Paper & Paper Products	0.1	0.0	0.0	0.0	0.0
8	Noodles	55.4	49.1	47.3	12.9	27.7
9	Other handicraft goods	26.8	20.1	57.4	52.0	85.6
10	Pashmina	29.8	39.8	28.1	50.3	25.5
11	Readymade Garments	88.8	28.1	43.9	15.4	58.7
12	Readymade Leather Goods	0.8	2.1	0.4	0.2	0.0
13	Rudrakshya Beads	9.6	0.0	10.1	0.0	0.0
14	Silverware and Jewelleries	0.7	7.1	4.3	1.0	3.2
15	Tanned Skin	407.5	247.9	306.9	171.4	138.2
16	Tea	5.1	8.3	13.4	11.9	8.7
17	Vegetables	1.7	0.0	0.0	0.0	0.0
18	Wheat Flour	107.4	110.1	22.3	5.7	6.0
19	Woollen Carpet	85.2	119.7	149.3	232.1	219.0
B. Other		**975.3**	**1,893.2**	**1,313.1**	**678.9**	**745.3**
Total (A+B)		**2,085.8**	**2,840.7**	**2,229.9**	**1,681.5**	**1,701.6**

*Source:*Economic Survey, MoF (2018).

As shown in Table 4.3, the main exports consist of agro-based products, handicrafts, tanned skin and woolen carpet, etc. Other important items are tea, noodles, human hair and garments, etc. The contribution of Nepal's export items such as vegetables, readymade leather products, musical instruments and utensils is almost nil. In the year of 2016/17, Nepal mainly exported metal and woolenhandicrafts (Rs. 373 million), woolen carpet (Rs. 219 million), tanned skin (Rs. 138.2 million), other handicraft goods (Rs. 85.6 million), readymade garments (Rs. 58.7 million) and other items. Nepal has been unable to promote and diversify its export basket. The export of Aluminium, Copper and Brass utensils was Rs. 128.3 million in FY 2012/13 but is nil in all the last four fiscal years.

Similarly, Nepal has been unable to export an amount of herbs although the country is very herbs in herbal and aromatic plants of various medicinal uses. The export of human hair, musical instruments, Nepalese paper, readymade leather goods, Rudrakshya beads and vegetables, etc. was non-existent FY 2016/17. Nepal has to find more exportable items as well as protect the vulnerable industries before they become extinct. The contribution of these products in income generation by exporting to China cannot be neglected. Similarly, the composition of imported items from China is depicted by Table: 4.4.

Table 4.4: Imports of Commodities from China

(Rs. in Ten Million)

SN.		2012/13	2013/14	2014/15	2015/16	2016/17
	A. Major Commodities	**4392.9**	**5398.4**	**6470.6**	**7610.7**	**8268.7**
1	Aluminium Scrap, Flake, Foil, Bars, &Rods	78.2	107.6	143.8	170.5	145.1
2	Chemical	94.6	100.8	118.7	136.7	119.1
3	Chemical Fertilizer	234.6	470.0	762.0	1,612.0	874.6
4	Electrical Equipments	544.4	654.8	909.1	896.1	893.0
5	Medical Equipment & Tools	57.6	79.5	159.8	128.2	102.8
6	Medicine	46.7	41.1	47.6	56.2	56.7
7	Metal & Wooden furniture	51.3	65.1	70.4	83.5	126.0
8	Office Equipment & Stationary	56.7	64.4	75.1	64.8	86.8
9	Other Machinery and Parts	470.6	504.0	832.3	791.8	1,047.6
10	Pipe and Pipe Fittings	268.9	15.4	49.3	27.0	66.6
11	Plywood & Particle board	20.3	24.9	35.5	29.6	38.1
12	Plastic Utensils	1.8	13.5	5.0	0.0	0.0
13	Raw Silk	42.1	148.6	153.8	133.8	75.5
14	Raw Wool	44.0	54.4	51.8	75.1	72.0
15	Readymade Garments	478.1	608.8	408.0	561.8	556.0
16	Powder for Noodles	3.3	5.8	5.1	4.9	7.1
17	Shoes and Sandals	194.2	222.0	168.6	240.9	217.6
18	Smart Cards	17.1	24.5	22.5	20.2	14.8
19	Solar Panel	32.4	82.6	70.9	82.0	83.2
20	Steel Rod & Sheet	3.6	3.5	54.8	17.3	63.3
21	Storage Battery	52.8	56.6	104.7	45.9	83.8
22	Telecommunication Equipments and Parts	1,189.6	1,120.5	1,539.7	1,799.0	2,423.1
23	Polyester-Yarn	10.2	28.3	34.9	31.4	33.2
24	Toys	36.6	43.8	51.1	61.7	73.5
25	Transport Equipment & Parts	79.6	119.4	132.2	158.3	278.7
26	Tyre, Tubes and Flapes	293.3	16.7	19.8	13.6	15.9
27	Video Television & Parts	254.4	327.0	444.1	368.5	714.7
B. Other Commodities		**1,852.2**	**1,933.5**	**3,546.0**	**3,958.7**	**4,455.8**
Total (A + B)		**6,245.1**	**7,331.9**	**10,016.6**	**11,569.4**	**12,724.5**

*Source:*Economic Survey (2018), MoF.

Table 4.4 shows 27 major commodities imported by Nepal from China. The top imports for the year 2016/17 were telecommunication equipments and parts (Rs. 24,231 million), other machinery and parts (Rs. 10,476million), electrical equipments (Rs. 8,930 million), chemical fertilizer (Rs.8,746 million),video television & parts (Rs. 7,147 million), readymade garments (Rs.5,560 million), etc. In the year of 2015/16, the major import commodities from China were telecommunication equipments and parts,chemical fertilizer, electrical equipments, other machinery and parts,readymade garments, video television & parts, etc. The rise in import from China from the year of 2014/15 is mainly attributed to border blockadewith India. Table 4.4 gives clear picture of the import commodities of Nepal over the last few years. However, trade with China is quite lower than that with India, the biggest import partner. There is also a significant difference in terms of commodity composition of import in comparison with India. For example, import of petroleum products, agricultural equipment and parts, coal, fruits, salt, etc from China is almost nil when compared to imports of these products from India.

Table 4.3 andTable 4.4 show the composition of export-import commodities of Nepal with China during the last few years. The export basket of Nepal is dominated by primary and agricultural products, handmade products and some manufactured products. While Nepal imports different kinds of electronic and telecommunication equipments, vehicular and machinery parts, readymade garments, onion, garlic, and a wide variety of household utensils and utility items from China. Nepal’s exported items mostly go to mainland China and also to Hong Kong and Tibet Autonomous Region.

4.2.2 Volume and Direction of Nepal’s Foreign Trade

The import-export volume as registered by Nepal’s custom offices is shown in Table 4.5

Table 4.5: Imports and Exports by Customs Offices : 2017/18
(FY 2074/75)

(In ‘000 Rs.)

S.N.	Customs Offices	Imports	Imports Share %	Exports	Exports Share %
1	Birgunj	421,939,564	33.89	14,063,766	17.29
2	Bhairahawa	224,037,171	17.99	3,510,935	4.32
3	Biratnagar	152,944,627	12.28	24,558,279	30.18
4	TI Airport	149,160,142	11.98	22,723,049	27.93
5	Dryport	130,639,040	10.49	4,835,817	5.94
6	Nepalgunj	45,083,797	3.62	2,255,549	2.77
7	Mechi	37,580,934	3.02	6,730,357	8.27
8	Krishnanagar	26,869,478	2.16	450,193	0.55
9	Rasuwa	22,648,766	1.82	1,166,232	1.43
10	Kailali	17,580,716	1.41	742,672	0.91
11	Jaleshwor	8,392,131	0.67	-	0.00
12	Sunsari	3,506,584	0.28	170,167	0.21
13	Janakpur	1,383,677	0.11	-	0.00
14	Sarlahi	1,312,218	0.11	2,517	0.00
15	Kanchanpur	1,147,227	0.09	34,170	0.04
16	Gaur	413,319	0.03	62,851	0.08
17	Siraha	175,026	0.01	-	0.00
18	Others	288,806	0.02	53,243	0.07
	Total	1,245,103,223	100.00	81,359,796	100.00

*Source:*Department of Customs, Nepal Foreign Trade Statistics (2018).

Table 4.5 shows the import-export volume as registered by various Nepal's custom offices in FY 2017/18 in both value and percentage. The total import worth Rs1,245,103,223,000 and total export worth Rs 73,036,244,000. The highest portion of export (30.18%) was carried out through Biratnagar and the second highest portion (27.93%) took place through the one and only international airport. Similarly, the maximum value of import was Rs. 421,939,564 (33.89%) through Birgunj custom office. 14 out of 22 custom offices registered less than one percent export share each. Similarly, 12 out of 22 custom offices registered less than one percent import share each in FY 2017/18. The government should not only upgrade these alternative custom offices but also check illegal trade that can take place through these low profile border entry points. Similarly, computerized custom clearance system should be installed at all remaining custom offices.

As we know, foreign trade has two components: export trade and import trade. Nepal's export is of low volume low value agricultural products, raw materials and simple manufactured products, whereas its import is high both in volume and value items like machinery, electronic equipments and capital intensive commodities. Nepalese foreign trade performance has been so far so poor. Therefore, Nepal's balance of trade is unfavorable for overall growth. Nepal's volume of export has not been increasing in the same rate as the increase in volume of import. A study of direction of trade is significant to know the diversification of trade with other countries and mainly the dependence on the two large neighbors India and China for import and export both. The direction of foreign trade shows the share of export and import trade in terms of destination. The volume and direction of Nepal's foreign trade from 2010/11 to 2016/17 has been explained in brief with the help of Table 4.6.

Table 4.6: Nepal's Foreign Trade Performance

(Rs. in Million)

	Direction	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17 R	2017/18 P
Exports	India	43,360.4	49,616.3	50,999.8	59,613.7	55,864.6	39,493.7	41,449.2	46,604.8
	China	-	-	2,085.8	2,840.7	2,229.9	1,681.5	1,701.5	2,437.8
	Others	20,978.1	24,644.7	23,831.6	29,537.0	27,224.6	28,941.9	29,898.4	32,149.0
	Total	64,338.5	74,261.0	76,917.2	91,991.4	85,319.1	70,117.1	73,049.1	81,191.6
Imports	India	261,925.2	2,99,389.6	367,031.2	477,947.0	491,655.9	477,212.6	633,669.6	809,814.2
	China	-	-	62,451.2	73,318.6	100,166.4	115,694.3	127,245.0	159,636.3
	Others	34,250.3	162,278.1	127,257.7	163,100.2	182,861.9	180,692.4	229,198.6	273,376.2
	Total	396,175.5	461,667.7	556,740.1	714,365.9	774,684.2	773,599.3	990,113.2	1,242,826.8
Trade Deficit	India	218,564.8	249,773.3	316,031.4	418,333.3	435,791.3	437,718.9	592,220.4	763,209.4
	China	-	-	65,978.0	70,477.9	97,936.5	114,012.8	125,542.5	157,198.5
	Others	113,272.2	137,633.4	103,426.1	133,563.2	155,637.3	151,750.5	199,300.2	241,227.2
	Total	332,973.6	424,072.0	523,856.8	622,374.5	689,365.1	703,482.0	917,064.1	1,161,635.2
Total Foreign Trade	India	305,285.6	349,005.9	418,031.0	537,560.7	547,520.5	516,706.3	675,118.8	856,419.0
	China	-	-	64,537.0	76,159.3	102,396.3	117,375.8	128,946.5	162,074.1
	Others	155,228.4	186,922.8	151,089.3	192,637.2	210,086.5	209,634.3	259,097.0	305,525.2
	Total	460,514.0	535,928.7	633,657.3	806,357.3	860,003.3	843,716.4	1,063,162.3	1,324,018.4

Source: Nepal Rastra Bank (2018).

Table 4.6 shows the volume and direction of Nepal’s foreign trade from FY 2010/11 to 2017/18. It shows the increment in both export trade value and import trade value during each period. The import value against export is higher which gives negative trade balance for Nepal. India and China have remained the major trade partners. As the table shows, Nepal-China trade is far imbalanced than Indo-Nepal trade. Nepal is facing a huge discrepancy in its trade with China. In the year of 2012/13, China occupied only 2.7 percent share in Nepal’s total global exports, while it constituted 11.2 percent share in Nepal’s total imports. Similarly, the trade data for FY 2017/18 shows that China occupied threepercent of all exports and 12.85 percent share in Nepal’s total import. In the context of India in the year of 2017/18, it occupied 57.4 percent share of Nepal’s export and constituted 65.16 percent share in Nepal’s total import.

In terms of trade deficit, in FY 2012/13 trade deficit with China was Rs.65,978.0million. This trade deficit grew steadily every year and was Rs. 70,477.9 million in 2013/14, Rs. 97,936.5 million in 2014/15, Rs. 114,012.8 in 2015/16, Rs. 125,542.5 million in 2016/17and finally Rs. 157,198.5 million in 2017/18. Since Nepal’s trade imbalance with China has increased tremendously, it has necessitated the search for a win-win outcome for both the trading parties in which Nepal can narrow down the deficit by promoting export. The table also highlights the overall foreign trade value. In the year 2012/13, Nepal’s total foreign trade with India amounted to Rs 41,8031.0million and that with China amounted to Rs. 64,537.0 million only. Figures for both the countries has risen to Rs. 856,419.0 million for India and Rs. 162,074.1 million for China in FY 2017/18. The table shows that the aggregate value of total foreign trade with all the countries including China and India both was Rs. 1,324,018.4 million in FY 2017/18which shows slow and gradual increase in international trade.

Before 1950, Nepal's international trade was almost limited to its two neighbors India and China. However, the traditional trade has gone through a huge transformation due to the development of transportation and communication and other developments. Now,Nepal imports and exports goods to and from hundreds of nations. The export and import of goods to the world is discussed with the help of Table 4.7 and Table4.8.

Table 4.7: Nepal's Export, Import and Trade Balance

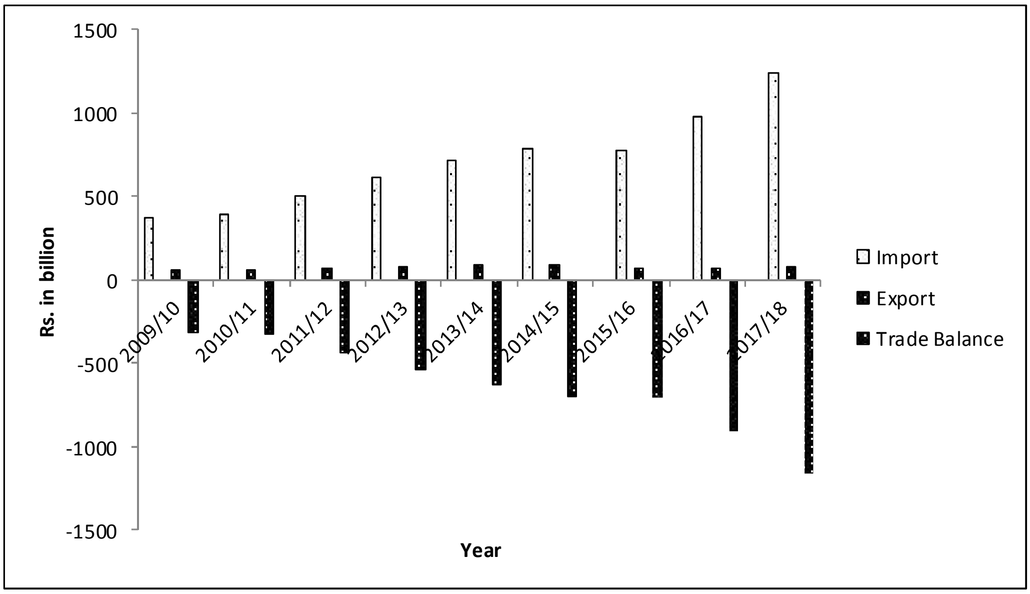
(Trade in billion Rs.)

F/Y	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Import	374.3	390.3	506.7	613.6	716.1	786.2	774.7	984.3	1,245.1
Export	60.8	62.7	72.1	77.4	89.6	85.2	70.2	73.0	81.4
Trade Balance	-313.5	-327.6	-434.6	-536.2	-626.5	-701	-704.5	-911.3	-1,163.7

Source: Department of Customs, Nepal Foreign Trade Statistics (2018), NRB (2016).

Table 4.7 shows that Nepal's total export, import and also the trade balance. It shows there is a huge trade imbalance and it can be detrimental to the economic growth and stability. Nepal's import in FY 2017/18 was more than three times that of 2009/10. Import has been increasing year on year and reached Rs. 1,245.1 billion in the year 2017/18, up from Rs. 984.3 billion recorded in FY 2016/17.By contrast, the export volume has not even doubled in between these years. It was Rs. 60.8 billion in 2008/09 and merely reached Rs. 81.4in FY 2017/18. Owning to this, trade deficit has skyrocketed from Rs. 313.5 billion in 2008/09 to Rs. 1,163.7 billion in 2017/18. Table 4.7 is shown with the help of a bar diagram in Figure:4.2.

Figure 4.2: Nepal's Export, Import and Trade Balance



Source: Department of Customs, Nepal Foreign Trade Statistics (2018), NRB (2016).

As Figure 4.2 shows, in FY 2017/18, export growth is almost at the same level as in FY 2008/09, however, imports from China have increased more than three folds. This has lead to the condition of negative trade balance with China.

Table 4.8:Growth of External Sector (Change in Percentage)

FY	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Export	14.2	-10.2	5.8	15.4	3.6	19.6	-7.3	-17.8	4.2	13.0
Import	28.2	31.6	5.8	16.5	20.6	28.3	8.4	-0.1	28.0	20.6
Trade Balance	33.3	44.6	5.8	16.7	23.9	29.7	10.8	2.0	30.4	21.2

*Source:*Economic Survey, MoF (2018).

Table 4.8 shows the percentage growth rate of the external sector. The export was severely affected in FY 2014/15 and FY 2016/17. The growth rates were -7.3 percent and -17.8 percent respectively. These rates were 4.2 percent in FY 2016/17 and 13.0 percent in FY 2017/18. In terms of import, it showed negative change of -0.1 percent in FY 2015/16 butsharply recovered in the following years with growth rate of 28.0 percent and 20.6 percent in the fiscal years 2016/17 and 2017/18 respectively. In these last two fiscal years, the percentage change in trade balance was 30.4 and 21.2 respectively.

Nepal's major export destinations and the volume of export have been shown in Table 4.9. Nepal exports goods to over 100 countries. Figures from the top 15 countries are presented in Table 4.9.

Table 4.9: Nepal's 15 Major Export Destinations and Export Volume

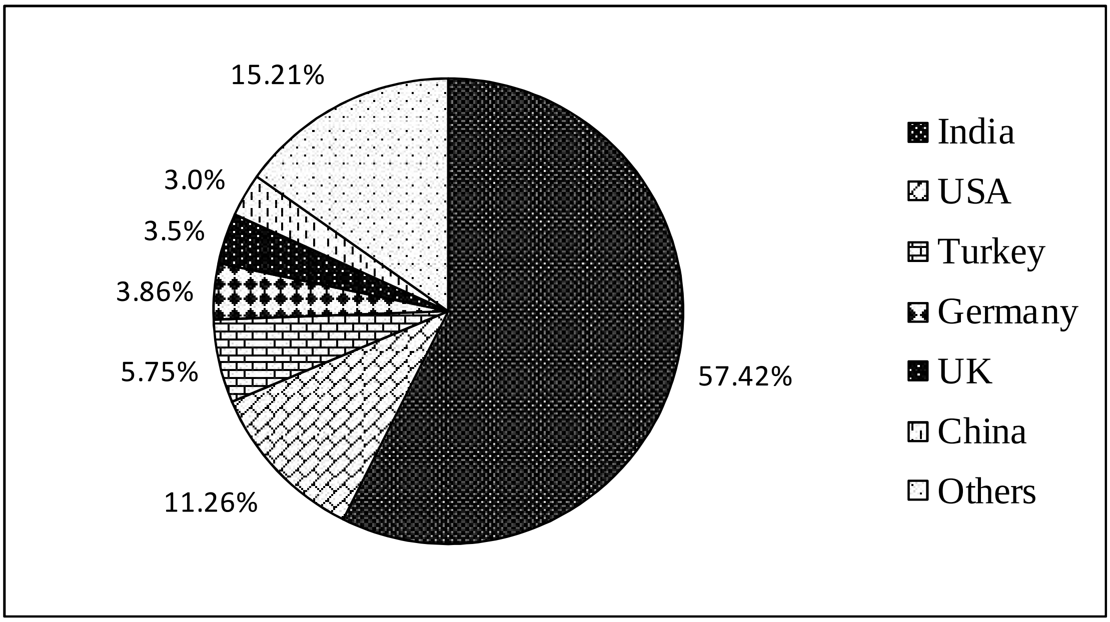
(Rs. in Million)

S.N.	Countries	2017/18	2016/17	2015/16	2014/15	2013/14
1.	India	46,604.8	41,449. 2	39,493.7	55,864.6	59,613.7
2.	U.S.A.	9,162.5	9,129.3	9,267.6	7,468.3	7,610.5
3.	Turkey	4,676.5	4,199.6	2,204.4	1,597.4	1,263.2
4.	Germany	3,139.9	3,046.4	3,144.6	3,091.0	3,413.7
5.	U.K.	2,847.2	2,521.7	2,799.2	2,025.8	2,082.0
6.	China	2,437.7	1,701.5	1,973.1	2,229.9	2,840.7
7.	Italy	1,279.7	1,184.0	1,135.7	1,198.1	1,002.1
8.	France	1,225.5	1,193.6	1,272.3	1,175.8	1,333.2
9.	Bangladesh	1,083.0	1,046.6	737.1	1,084.4	2,140.5
10.	Japan	1,037.4	1,023.4	1,116.9	1,170.4	1,050.2
11.	UAE	1,007.2	100.4	76.5	300.8	419.8
12.	Canada	858.2	885.7	917.6	871.8	832.5
13.	Australia	643.2	648.7	600.6	588.8	566.5
14.	Vietnam	615.1	410.0	408.0	585.9	299.7
15.	Denmark	374.0	352.9	288.5	211.9	245.2
Sub Total		76,991.9	68,863.0	65,435.8	79,644.9	84,713.5
Other Countries		4,198.2	4,186.1	4,681.3	5,674.2	7,277.8
Grand Total		81,190.1	73,049.1	70,117.1	85,319.1	91,991.3

*Source:*Macroeconomic Indicators of Nepal, NRB (2018),(2017), (2016), (2015).

Table 4.9 shows the destination of exported items over the last five years. Most of the countries show ups and downs trend. Nepal's exports have been limited to fewer countries compared to importing countries. India, USA, Turkey, Germany, UK, China and Italy are the major export destinations. China occupied 6th position in FY 2017/18, FY 2016/17 and FY 2015/16. India contributed 57.42 % of all exports while China contributed merely three percent of the exports. This indicates that exports toChina is insignificant despite being Nepal's northern neighbor. The table shows that Nepal's export to China is even lesser than that to USA, Turkey Germany and the UK although these countries are located very far away from Nepal in comparison to China. This shows that Nepal has not been able to promote exports to China. Therefore, special attention should be paid in this regard. Nepal should make efforts to benefit from the huge Chinese market which is located too close to Nepal.

Figure4.3: Composition of Export Counterparts



*Source:*NRB (2018).

The major export destinations have been shown with the help of a pie chart in figure 4.3. As the chart shows, the share of China in total exports is only three while that of India is 57.42%. USA, which is on the second place after India and very far away from Nepal occupies 11.26%. China, although being too close to Nepal, ranks 6th in terms of export destination. Turkey, Germany, U.K. and others occupy 5.75%, 3.86%, 3.5% and 15.21% share in export respectively.

Nepal imports goods from several countries from around the world.The volume of imports is continuously rising. As shown in the Table 4.10shows, India and China are the two major importing countries. The top 15 countries from which Nepal imports goods have been shown in Table 4.10.

Table 4.10: Nepal’s 15 Major Import Partners and Import Volume

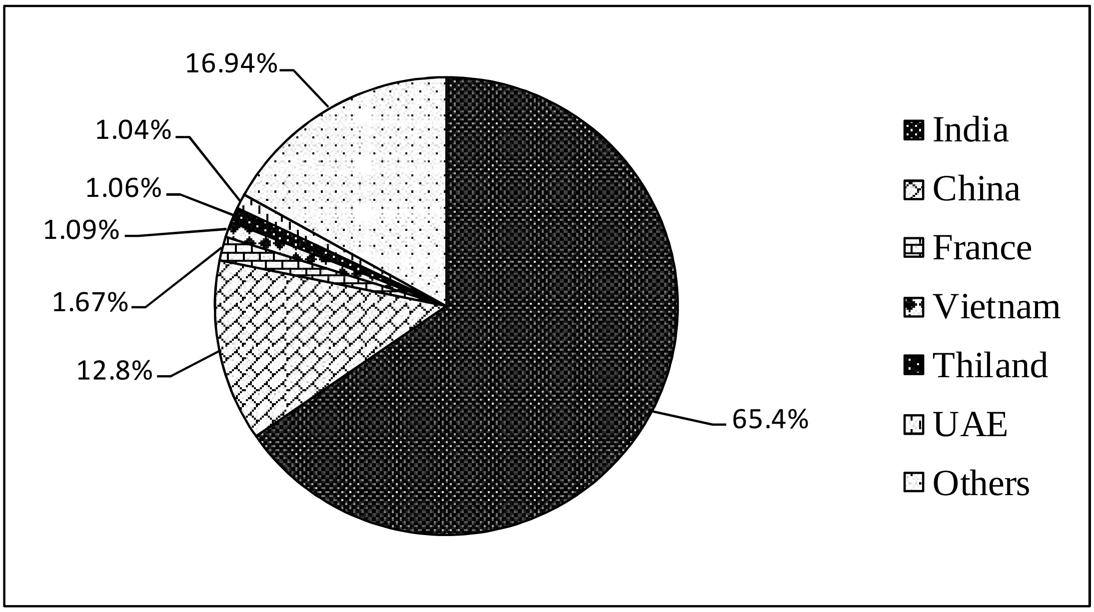
(Rs. in million)

S.N.	Countries	2017/18	2016/17	2015/16	2014/15	2013/14
1.	India	814,101.6	633,669.6	477,212.6	491,655.9	477,947.0
2.	China	159,987.1	129,743.1	120,318.4	100,166.4	73,318.6
3.	France	20,836.4	13,100.7	7,061.7	6,930.8	1,414.9
4.	Vietnam	13,529.5	8,658.8	6,030.2	4,484.6	3,970.3
5.	Thailand	13,135.0	11,537.3	9,851.1	9,947.4	9,380.9
6.	UAE	12,919.4	41,515.2	23,056.3	34,558.4	40,555.0
7.	Indonesia	12,470.2	11,494.4	11,224.8	16,552.5	15,476.8
8.	Argentina	10,226.7	11,404.9	8,187.1	9,765.1	7,597.0
9.	South Korea	10,164.7	9,399.2	4,896.1	3,884.1	3,761.9
10.	Malaysia	10,028.4	8,811.0	6,666.0	7,807.5	6,539.8
11.	USA	9,894.1	9,941.4	9,676.9	7,468.3	6,288.9
12.	Saudi Arabia	9,006.0	6,837.4	5,801.9	4,701.6	5,584.8
13.	Canada	8,011.9	9,378.4	5,635.1	3,585.2	2,977.3
14.	Germany	7,872.9	4,234.5	4,338.7	9,373.2	6,159.5
15.	Japan	7,750.4	6,718.8	7,473.1	5,958.4	4,538.5
Sub Total		1,119,934.3	916,444.7	707,430.0	716,839.4	665,511.2
Other Countries		125168.9	73668.5	66169.1	31,290.1	55,144.8
Grand Total		1245103.2	990113.2	773599.1	714,365.9	708,761.8

*Source:*Macroeconomic Indicators of Nepal, NRB (2018),(2017), (2016) and (2015).

Table 4.10 shows the status of Nepal's imports from 15 nations over the last five years. Nepal's imports have been increasing year on year. It was Rs. 773,599.1 million in FY 2016/17 and rose to Rs. 1,245,103.2million in FY 2017/18. India, China,France,Vietnam and Thailand have been the top nations from which majority of Nepalese imports take place. China occupied 12.80 % of all imports in FY 2017/18. Imports from China is on a continuous increase over the last many years. The major countries from where Nepal imports most of its goods have been shown with the help of a pie-chart.

Figure 4.4: Composition of Import Counterparts



*Source:*NRB (2018).

Figure 4.4 shows the share of import by major import counterparts. India occupies 65% of all imports and is the largest import partner followed by China in the second place which occupies 12.80% in Nepal’s total foreign imports. In contrast to China’s share in import i.e., three percent, its share in export is almost four times i.e., 12.80% which indicates trade deficit. France and UAE each occupy less than two percent share in Nepal’s import and the remaining 19.46% is covered by other countries like Vietnam, Thailand, Turkey, Switzerland, Canada, etc.

4.3Trend and Composition of Foreign Trade Between Nepal andChina

Nepal has been facing trade deficit with China year after year. Nepal and China have been trading goods and services since ancient times. Lately, Nepal has been making efforts towards increasing trade and connectivity with China. There are several problems and challenges that Nepal has to overcome to improve bilateral trade. In order to curb too much dependence on the imported Chinese goods, the government of Nepal should begin the process of rapid industrialization by creating a favorable investment climate and giving subsidy to vulnerable industries. Nepal's trade balance situation with its northern neighbor China has been shown in Table 4.11.

Table 4.11: Nepal's Exports, Imports and Trade Balance with China

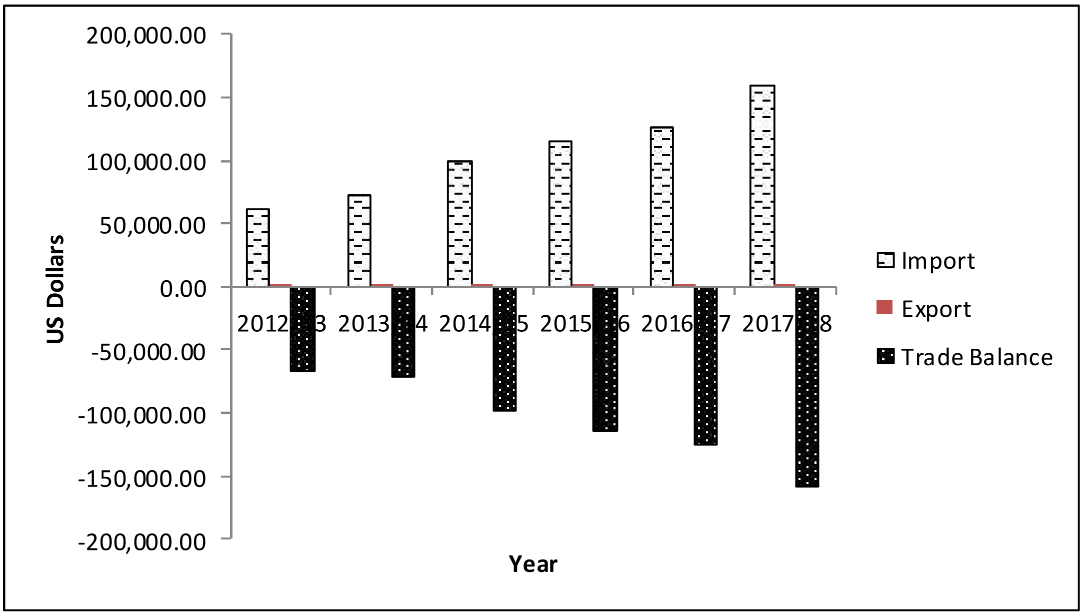
(In '000 Rs.)

F/Y	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Import	62,451.2	73,318.6	100,166.4	115,694.3	12,7245	159,636.3
Export	2,085.8	2,840.7	2,229.9	1,681.5	1,701.5	2,437.8
Trade Balance	- 65,978.0	-70,477.9	-97,936.5	-114,012.8	-125,542.5	-157,198.5

Source: Nepal Rastra Bank (2018).

Table 4.11 shows Nepal's foreign trade from FY 2012/13 to 2017/18. It shows steady increment of both export trade value and import trade value each period. However, the value of imports against exports is quite high which gives negative trade balance for Nepal. China has been a major trade partner for a long period of time. In the period of 2012/13, the value of export to China was Rs. 2,085.8 million. This figure reached Rs. 2,437.8 in the period 2017/18. The FY 2013/14 has recorded the highest export till date. Then it has not crossed that mark yet and is slowly recovering. Devastating earthquake and disruption of goods flow to and from India has fuelled the existing problem. This statistical data indicates in what way export growth has diminished against imports. In terms of import, the value of import from China in the period 2012/13 was Rs. 6,2451.2 million. There was a tremendous increase in imports over the years from China. It reached Rs. 159,636.3million in FY 2017/18. One of the main reasons for such a remarkable growth was high dependency on cheap imports from China. This heavy share of imports on the total volume of trade with China has been found discouraging for trade balance. Table 4.11is also shown with the help of a bar diagram in Figure 4.5.

Figure 4.5: Nepal's Export, Import and Trade Balance with China



Source: Nepal Rastra Bank (2018).

4.4 Contribution of Foreign Trade in Economic Growth of Nepal

Foreign trade has enlarged the market for Nepal's output and lead to increase in national output. It has helped Nepal to import capital goods required for its development. The import of machinery, transport equipment, vehicles, generators, construction machinery, chemicals and other goods with high growth potential has provided huge benefits to a developing country like Nepal where capital intensive industries are very few and they are unable to meet the growing demands of the population. Flow of technology into the country has helped to increase productivity. International trade has increased the accumulation of human capital and contributed to Nepal's economic growth. Expanding exports has provided greater employment opportunities. Rise in employment levels has lead to a growth in the gross domestic product.Foreign trade has helped to earn foreign currency that can be used to remove the poverty and for other productive purposes.

Foreign trade is a remarkable factor in expanding the market and encouraging the producers. In countries where home market is limited it is necessary to sell product in other countries. Foreign trade also provides healthy competition and keeps in check inefficeient monopolies. The more competitive an economy is, the more efficient it will be. Foreign trade provides incentives for the foreign investors, besides local investment, to invest in those countries where there is a shortage of investment. It encourages businessmen to increase the investment to produce more goods. So the rate of investment increases.The significance of international trade on economic, political, and social conditions has been long well illustrated and emphasized by many economists. It is essential for the growth of globalization.Development of trade allows use of latest and improved techniques of production in agriculture as well as in industry sector. It helps in the commercialization of agriculture sector and creates environment for the establishment of new export oriented industries. Competition helps in the development of the export sector and in checking inefficient exploitative monopolies that enjoy state subsidy.

Nepal's trade relation with China will help to overcome problems of Nepal's huge dependence on India for transit facilities, import of essential goods and export promotion. In difficult situations like border disruption with India, the economy of Nepal would not be paralyzed. Nepal-China trade will also support Nepal's wish to maintain a geo-political balance with both nations. However, due to extreme terrain along the Nepal-China border, trade cannot be easily facilitated and advantage is always with India due to geographical proximity and abundance of transport facility.

Growth of volume of trade between China and Nepal is also expected to bring in more Chinese investments in much needed projects in which India is reluctant to invest.Finally, it is expected that the implications and results of this research will aid future researchers to uncover critical areas in their study of Nepal's trade with China.

Foreign trade also makes companies more efficient. Exporters become more productive than companies that focus on domestic trade. Domestic companies get more experience in producing for foreign markets. Bilateral trade has been strongly associated with reduction in poverty in most developing countries. Growth in exports causes real GDP growth. International trade plays an important role in increasing the production of any country and helps in market expansion. Trade has enhanced growth and enabled people to obtain goods and services from a variety of sources. Foreign competition has helped to reduce prices for consumers. Therefore, trade expansion policies should be adopted as a means of accelerating economic growth in Nepal.

CHAPTER –V

SUMMARY OF FINDINGS AND RECOMMENDATIONS

5.1Summary of Findings

Nepalese economy suffers from various problems. International trade can help Nepal to overcome the problems of capital accumulation and achieve economic growth. Enhancing bilateral trade with China is important because of its various advantages to the Nepalese economy. Several trade agreements have been concluded between the two nations. However, trade deficit with China has been rising continuously. Although the volume of trade between the two countries has increased manifold after the establishment of diplomatic relations in 1956, exports are several times less than the imports. The government of Nepal should address this problem as soon as possible. Export expansion should be prioritized.

Nepal has not been able to exploit its main competency areas such as tourism, hydropower, medicinal herbs and minerals.Although labor cost is too low in Nepal, flow of FDI is minimum. Despite being a member of WTO, Nepal has not been able to promote export significantly to other countries. Especially export trade has been deteriorating instead of improving. Nepal is trapped in vicious circle of poverty and underdevelopment. Import prices are rising in comparison to export prices. The investment climate which had declined due to the decade long civil war,has only recently improved. Government should settle political issues and maintain long lasting political stability to achieve economic growth and overall economic development.

The following information summarizes the picture of Nepalese trade situation in brief.

Nepal's total import in FY 2016/17 was Rs. 984.3 billion and total export was Rs. 73 billion. In FY 2017/18, total import was Rs. 1,245.1 billion and total export was Rs. 81.4 billion. Trade deficit jumped from Rs. 313.5 billion in 2009/10 to Rs. 1163.7 billion in 2017/18. In the period of 2016/17, the total value of export to China was Rs. 73.0 billion. This number reached Rs. 81.4 billionin the period 2017/18. In terms of import, the value of import from China in the period 2009/10 was Rs. 374.3 billion. There was a tremendous increase in imports over the years from China. It has reached Rs.1,245.1 billion in the period of 2017/18. One of the main reasons for such an increase was high dependency on cheap imports from China. Nepal's main exports consist of agro-based products, handicrafts, tanned skin and woolen carpet, etc. Other important items are tea, noodles, human hair and garments, etc. The contribution of Nepal's export items such as vegetables, readymade Leather products, musical instruments and utensils is almost nil. In the year of 2016/17, Nepal mainly exported metal and woolen handicrafts,woolen carpet, tanned skin and other handicraft goods to China. India has been the major foreign trade destination of Nepal, while other countries share a very low amount in trade.

Nepal imported telecommunication equipments and parts worth Rs. 24,231 million, other machinery and parts worth Rs. 10,476million, electrical equipments worth Rs. 8,930 million, chemical fertilizer worth Rs.8,746 million, video television & parts worth Rs. 7,147million and readymade garments worth Rs.5,560 millionin FY 2016/17. In the year of 2015/16 the six major import commodities were telecommunication equipments and parts, chemical fertilizer, electrical equipments, other machinery and parts, readymade garments, video television & parts, etc. However, trade with China is quite lower than that with India, the biggest import partner. There is also a significant difference in terms of commodity composition of import in comparison with India. Large portion of Nepalese exports is occupied by primary and agricultural products, handmade products and some manufactured products. Similarly, significant portion of Nepal's imports is dominated by electronic and telecommunication equipments, vehicles and machinery parts, readymade garments, onion, garlic, and a wide variety of household utensils and utility items from China.

5.2Conclusions

The major conclusion and findings of the study can be presented as follows:

(i) Export commodity composition of Nepal is less diversified than import commodity composition.

(ii) Nepal is facing trade deficit with both of its neighbors, India and China

(iii) Diversification of Nepal's imports and exports markets and products through trade agreements and developing friendly relations is very essential.

(iv) Joint venture in establishing industries together with other countries is very less in Nepal.

(v) Unfavorable trade and transit treaties with India is hampering Nepal's export capability.

(vi) Nepalese domestic industries have not been able to produce even the basic goods for Nepalese growing population.

(vii) Quality of manufactured goods in Nepal is not high enough to attract more demand in international market.

5.3Recommendations

There are plenty of measures to be taken to address the situation of trade deficit and achieve balance of trade. Serious attention should be paid as soon as possible to make export an engine of economic growth. The recommendations are as follows:

i. Request the government of China to offer better preferential treatment of Nepal's export items.

ii. Discuss with the Chinese side to lower tariff rates on Nepal's export items.

iii. Road transport should be facilitated by upgrading existing trade routes.

iv. Open up more trade and transit points in the Himalayas and upgrade existing check points.

v. Establish and upgrade quarantine facilities to meet the quarantine requirements imposed by the Chinese.

vi. Since huge volume of petroleum products and automobiles are imported annually, the government should create suitable environment to develop these industries within Nepal itself to curb import.

vii. Population growth should be controlled in order to reduce increasing demand for imported goods.

viii. Identify potential exportable items and ways to enhance their promotion.

ix. Maintain political stability and enhance business-doing environment in the country.

x. Boost-up industrialization process in the country to decrease excessive reliance on imports.

xi. Special economic zones (SEZs) should be established to expand bilateral trade with China.

xii. Nepal should take part in trade exhibitions and fairs in China to boost up demand for Nepalese products.

xiii. Areas of Nepal-China joint venture should be figured out and promoted.

xiv. Request the Chinese government for the earliest completion of projects related to One Belt One Road (OBOR).

xv. Difficulties and hassles that Nepalese traders and drivers are facing at border check points should be removed.

xvi. Request both India and China to use Nepal as transit point for trade between the two nations.

xvii. Dry ports should be constructed near transit points to facilitate cross border trade.

xviii. Surveillance should be increased at border points to minimize smuggling of goods.

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