CHAPTER I
INTRODUCTION

1.1 General Background

Nepal’s exports are heavily concentrated - both in terms of product and destination. Product wise, carpet, textiles and agricultural produce constitute more than 80 percent of Nepal’s total exports. In terms of destination, exports to India constitutes 67 percent of Nepal’s total exports. Top 10 export commodities to India (such as vegetable ghee, polyester yarn, jute goods, zinc sheets, textiles and threads) constitute more than 50 percent of Nepal's exports to India. Total exports to India would have been even more staggering, had informal trade across the porous India-Nepal border been documented.

Empirical evidence, particularly from developing and least developed countries, reveal that a narrow export base makes the economy susceptible to global economic volatility. Hence, diversification has been a goal of national development strategy of Nepal since the implementation of the Third Five Year Plan (1965-70). Besides this, various other government plans and policies (such as Agricultural Perspective Plan, Industrial and Trade Policies) have also recognized export diversification as a major strategy to achieve high economic growth. However, limited exportable items and trade dependency, particularly with India, continue to remain a major problem for the Nepali economy.

In the recent past, the Nepali government has made significant efforts to better integrate the economy with regional and global trading systems. Nepal joined the multilateral trading system – the World Trade Organization (WTO) – in 2004 and entered into two regional trade agreements – Agreement on South Asian Free Trade Area (SAFTA) and Bay of Bengal Initiative for Multispectral Technical and Economic Cooperation (BIMSTEC) Free Trade Agreement. While these global and regional trading systems offer Nepal an opportunity to diversify export products and markets, they are not without risks.

Challenges ranging from implementation of further liberalization commitments in different sectors of the economy to stiff competition from foreign goods and services are likely to make it difficult for Nepal to benefit from international trade. In this respect, export diversification – both vertical (from primary to manufacture) and horizontal (into completely new sectors) – is critical not only to lower the risk of trade dependency but also to benefit from regional and global trade.

Export diversification strategy for Nepal requires an integrated approach with three basic components: identification of products with comparative advantage, formulation and implementation of sector development strategy and development of a negotiation strategy for bilateral and multilateral trade forums. This Research Brief will attempt to address the first component by identifying products with Nepal's comparative advantage.

Trade and Export Promotion Centre (TEPC) has to identify the major 19 goods and services in 2008 which Nepal has comparative advantage. TEPC has to divided in major potential exportable 19 goods in three categories; Agro product, Craft and Industrial goods, and Services sector. The study selected only Agro product goods based on the following criteria:

- Review of past studies on export diversification potential of Nepal
- Revealed Comparative Advantage (RCA)
- Export performance

Trade is regarded as an 'engine of economic growth' as it has the potential to spur sustainable, long-term economic development. Considering this fact, many developing countries are adopting the liberal economic and trade policies under the auspices of multilateral, regional and bilateral free trade agreements. Nepal has also pursued the open economic policies since mid 1980s, which was accelerated in 1990s with the enactment of various pieces of legislations including Privatization Act, Industrial Enterprise Act, Foreign Investment and Technology Transfer Act, Industrial Policy and Trade Policy, among other. It has acceded to the World Trade Organization (WTO) and also become the member of two regional trading blocs in 2004. Substantial works were taken up in the area of trade facilitation as the development of Inland Clearances Depots (ICDs), simplification of documents and procedures including customs reform and modernization and streamlining of transit movement of Nepalese trade.

International trade (Foreign Trade) is defined as trade between two or more partners from different countries (an exporter and importer). It is the exchange of goods and services across international borders. It is also known as foreign trade. It has played an important role to boosts up the economy of any nation. No doubt, Nepal is a developing country and this country needs to operate development plan, import necessary goods and services for its people and the projects involve in the physical infrastructure development sectors. The cost of production has played an important role in the international trade. The price of goods and services is determined by the transaction and import and export of the countries. It is well known fact that the country is unable to produce all the goods because of its geographical limitations and even the high cost goods is not desirable to produce goods and services in the country. In the situation foreign trade is definitely helpful. It not only encourages the manufacturing industrial production but also helpful to create employment opportunities. It is also a source of foreign currency. It promotes the relationship among the countries due to the exchanges of goods and services. Foreign trade plays a vital role in the world's economy, as it is a sign of economic prosperity. The supply of good for development projects, raw material to the big industries and exchange of technology is only possible through liberalization of foreign trade. Both producer and production are benefited from the openness of foreign trade through the regional division of labor and specialization. Not only this, the consumer will have freedom to choose quality goods at a low price. It also makes possible to diversify the production that encourage creativity and the high volume of production. The flow of foreign trade is depends upon trade policy of a country (Regmi S. 2012).

The history of trade between Nepal and India is as old as the existence of these two countries. India is major trading partner Nepal. Owing to close proximity, similar socio-economic cultural and access to sea in only through India, India is the largest trade partner of Nepal. However, in the last four decades, government of Nepal has taken several measures to diversify her trade and this has led to decrease the heavy dependency on India and increased in the share of overseas. In this dynamic world every economy is tied to world market by financial and real flow. So in boundary of these transactions, there are receipts and payments by a nation to the rest of the world which creates the international account in a country that receipts by residents and the payments by residents to the rest of the world.

Nepal is a least developed country where inputs in an economic development are scarcely available; hence foreign trade becomes inevitable for Nepal. It provides indispensable raw materials for development. It also creates specialization and division of labor in production in market access to developing countries like Nepal.

No country in the world is the sufficient in all types of necessary goods and services. Nepal also imports goods and services of its needs and exports the surplus products, which are basically primary, because Nepal is a primary product producing country; its terms of trade remain unfavorable. Under these circumstances production, productivity and efficiency are two be generated which is possible by foreign trade. The deficit in total export, coupled with higher imports, resulted in a constant increase of current account deficit as the deficit was 12.2 percent of GDP in 1997/98, 8.1 percent in 1998/99, and 13.5 percent in 1999/2000 (Nepal Rastra Bank and Trade & Export Promotion Centre, 2012). However, it is found that the deficit in balance was Rs. 58,682.2 million in Fiscal Year 1999/2000, Rs. 60,033.1 million in Fiscal Year 2000/01 and Rs. 60444.2 million. in FY 2001/02. But after FY 2001/02, it is found to be increasing as the deficit in trade balance increased to Rs. 74,421.5 million in FY 2002/03 and further increased to Rs. 82,366.4 million in FY 2003/04. The trade deficit of FY 2004/05 was Rs. 90,768.5 million, which widened to Rs. 113,546.2 million in FY 2005/06. Over the years Nepal's foreign trade has operated at a deficit, as Nepal's imports have been outpacing its imports. And the deficit has been constantly going up creating a balance of payment problem. As a consequence the volume of trade deficit reached to maximum figure of Rs. 135,311.6 million in FY 2006/07, Rs. 162,671.2 million in FY 2007/08, Rs. 216,772.1 million in FY 2008/09, Rs. 313,511.2 million in FY 2009/10 . It continuously grew up to Rs. 331,837.0 million in FY 2010/11 and Rs. 387,406.7 million in FY 2011/12 and further increased to 479,823.2 million in FY 2012/2013. Although, it is seen that the exports have increased in a pace but imports have increased rapidly during those years. Nepal has been pursuing its trade and foreign exchange policies in tandem with the global liberalization process and striving its based to integrate it with the changing world economic order. In this light, on 7 December, 1995 Nepal entered into an agreement to enforce SAPTA and declared controversial custom duty on imports of fourteen items from SAARC countries. In the course of integrating Nepalese economy with global economy and thereby harnessing the potentialities of enhanced international market, Nepal has obtained the membership of World Trade Organization (WTO). Similarly, policy of economic diplomacy has been one of the major developments in the international relation aiming to promote economic situation of the country. In the light of increasing important of private foreign capital and technology particularly industrialization, Foreign Investment and Technology Transfer Act (FITTA), 1992 has been amended.

Trade in general, and export diversification and competitiveness in particular, is important for least-developed countries (LDCs) such as Nepal for a number of reasons. Firstly, it is basically the major principal mechanism for achieving the benefits of globalization. Secondly, the continuing reallocation of manufacturing activities from industrial to developing and LDCs such as Nepal provides many opportunities for expanding trade both in goods and services. Thirdly, the growth of trade is firmly supported by regional trading arrangements, such as the South Asia Free Trade Agreement (SAFTA) and the Bay of Bengal Initiative for Multispectral Technical and Economic Cooperation (BIMSTEC) and multilateral trading arrangement such as the World Trading Organization (WTO) in the Nepalese context.

1.2 Statements of the Problem

Nepal is an agriculture country and agricultural product exporting country and one third of GDP is contribution by agriculture. The industrial products are unable to meet the domestic demands and the industrialization is still in infant stage and the phase is creeping. The exported goods are unable to compete with international markets because of low quantity products. Therefore, Nepalese foreign trade is running in bad condition. There is a problem of trade diversification in terms of both commodity wise and destination wise. That is because mostly we are offering the same products to the same destination. But import is more diversified at comparison to export. When the import trade exceeds the export trade there is no question of surplus. The balance of trade position of Nepal has to face the problem of trade deficit. The government policy of trade diversification will be intended to import diversification. To promote export, there is a huge need of export credit. But Nepalese trade agencies and organization are not getting sufficient financial sector. However, opening of few commercial banks may provide financial support to promote export.

Nepalese foreign trade is increased considerably but the tendency of Nepalese trade balance is permanent deficit due to import exceeding exports. Nepal is fully dependent on foreign loans and aids which are further underutilized rather than increasing Nepalese economy. To make favorable balance of trade, export has to increase and it has to exceed import. But the land-locked country, vicious circle of poverty, stagnation, lack of export credit etc. are the main causes for stagnant export and increasing imports. Hence, there is poor economy and permanent increasing deficit in trade balance.

1.3 Objectives of the Study

The objectives of this study will be as follows:

1. To analyze composition and trade pattern of export diversification in Nepal.
2. To compare Nepalese exports diversification with India and overseas countries.

1.4 Significance of the Study

Foreign trade is a process of getting the goods produced in one country by the consumer in another country and machining the markets methods of the country to the commodities obtaining in the foreign country. Foreign trade can make an impressive contribution to a country’s development. It is considered to be not simply a device for achieving productive efficiency. It is also an engine of growth. International trade safeguards the economic interests of all the countries. It provides maximum scope for the optimum exploitation and allocation of world’s scarce resources. Foreign trade lowers the price of goods and services all over the world by extending the scope of the division of the labor. By ensuring free competition foreign trade reduces the danger of monopolistic exploitation of consumer because production of goods take place in the most efficient manner and the price is not higher than the average cost of production.

Foreign trade is important for national industrial development. Without foreign trade machineries and various inputs may not be available within the country. Hence, foreign trade seems to be essential, which utilizes the unemployed resources and generates employments. Imports and exports of goods and services are essential to fulfill the demand for necessities of life and for the development works. Hence, foreign trade plays a vital role in the economic development of a developing country, which is the condition of creeping like Nepal in order to sustainable long-term economic growth. To meet economic growth and development targets, export earnings must be expended thereby reducing imports. For that the quality of exported goods must be improved to compete in the international market, the natural domestic resources should also be properly used and productivity efficiency be improved rapidly.

Thus, the current trade is essential not only for Nepal but for all the countries of the world for economic prosperity and development. Nepal being a small country with smaller size of her domestic market, there are lesser possibilities of having diversified type of industries with large-scale operation. She has depended no trade in order to meet the domestic demand, at the same time she has to reap the economics of international division of labor by enhancing her product capabilities. Hence, the development of trade is much more important for Nepal.

1.5 Limitation of the Study

The major limitations of the study will be as follows.

1. This study will been covering the time span from 2001/02 to 2012/13.
2. This study will been based on secondary data provided by agencies and organization.
3. This study will been covering the Nepalese trade with India and overseas countries; it does not deal individual country data.
4. This study will been carried out systematic over the research period of 10 months with limited financial resources.

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

LITERATURE REVIEW

Trade is an indispensable factor of an economy. On the other hand it creates several ties with other countries while on the other side it makes a country's economic condition even stronger. The history of trade is as long as human civilization. In early period there existed Barter System while it is replaced by monetary system to a greater extent nowadays. Before the Rana's reign Nepal's only trade partners were India and China. The political upheaval in 1950 which made Rana's reign demise highlighted Nepal in the International scenario. Then Nepal could not remain isolated and established diplomatic and trade relations with numerous other countries.

Foreign Trade is fundamental part of economic and social development of the country. In the today’s world of economic liberalization and globalization trade is the most important engine of economic development. The main purpose of foreign trade towards the developing country is to uplift the sluggish economic condition up to self sustainable rate of economic growth. In the developing country like Nepal domestic resources are inadequate to meet the financial requirement for the economic development. The level of capital formation of these countries is very low because of the low income level. Public borrowing and taxation have got their own limitation. Deficit financing is also not effective due to inflationary pressure. Foreign trade, therefore, is advantageous towards the acceleration of economic growth of country.

There are still insufficient literatures regarding the Nepalese foreign trade. It could be the result of that still its significance has not been realized in Nepal yet. While reviewing these limited literatures, Nepal’s foreign trade is still found to be unfavorable. Nepal being an agricultural country always produces and exports primary products, while she imports processed and industrial goods. Thus Nepal’s trade has been observing the deficit situation and adverse balance of payment. No doubt all had emphasized and stressed the role of foreign trade in economic development of Nepal and presented the valuable suggestions to amend the situation of trade in Nepal. However, the researchers try to review some of the literature related to export diversification of Nepali foreign trade, which are found in the form of Books, Research papers, Articles and Thesis. This review will be divided into two parts. First part covers the conceptual review of export diversification where as second part covers empirical review.

2.1 Conceptual Review:

McCalla and Valde (1999) suggested that agricultural export diversification provides two advantages: First, it expands the production possibility set, thereby generating more opportunities for income generation and employment creation. Second, it lowers the risk of having all of one's eggs in a single basket containing a small number of commodities with potentially high covariance risk.

They also suggested that agricultural export diversification could be pursued with two broad objectives: First, to expand the production and distribution of commodities to satisfy a higher proportion of domestic food consumption. In this scenario, agricultural diversification is seen as a means of generating domestic food security, or as an import substitution policy. Second, to increase the mix of agricultural commodities targeted for the export market in order to stabilize foreign exchange earnings. In this context, agricultural diversification forms part of an export promotion strategy within the context of international trade. McCalla and Valde provided three justifications for agricultural export diversification (all of which applies to the Caribbean).

(i) some countries depend heavily on income from traditional agricultural exports, many of which suffer from falling world prices;

(ii) many countries are characterized by the existence of a relatively large non-tradable sector due to high transactions costs (transport and others), which would remain largely underdeveloped even if price distortions are eliminated; and

(iii) externalities and market failures, which give governments tremendous flexibility to influence the factor intensity of long run growth.

Chuang (1998) argues, entering competitive international markets requires knowledge about foreign buyer's specifications, quality and delivery conditions. To satisfy these requirements, foreign purchasers help and teach local exporters to establish each stage of the production process and improve management and marketing practices. The development of efficient quality control procedures, management and marketing methods, product specifications and production guidelines is simultaneously fostered by the increased competitive pressure in world markets. If knowledge is generated through a systematic learning process initiated by exporting activities, developing countries will gain from orienting their sectors towards exporting. In this context, there are two well-known forms of export diversification that are common in the trade literature, namely, horizontal and vertical diversification. While horizontal diversification entails alteration of the primary export mix in order to neutralize the volatility of global commodity prices, vertical diversification involves contriving further uses for existing and new innovative commodities by means of value-added ventures such as processing and marketing. Hence, the authors conclude the horizontal export diversification will have a positive net effect on aggregate output .

Ghosh and Jonathan (1994) still that Export diversification is generally taken to be a positive trade objective in sustaining economic growth. Diversification makes countries less vulnerable to adverse terms of trade shocks by stabilizing export revenues, makes it simpler to channel positive terms of trade shocks into growth, and generates learning opportunities that lead to new forms of comparative advantage. However, the context of the most of the studies was different from Nepal. Those studies largely have been found to be based on the empirical studies owning availability of data, knowledge and resources. The studies carried out in the past at different length of time (particularly after 1990) definitely contributed to the policymaking and the theory building process.

The approach developed by Hausmann, Hwang and Rodrik (2007) identifies a relationship between the type of goods that an economy specializes in and its rate of economic growth. The main objective of this research paper is that the empirical analysis of income level of a country's exports by using revealed comparative advantage index. The researchers are concerned with the determination of the production structure of an economy in which the standard forces of comparative advantage play some role, but not the exclusive role. When local cost discovery generates knowledge spillovers, specialization patterns become partly indeterminate and the mix of goods that a country produces may have important implications for economic growth. The researches demonstrate this proposition formally and adduce some empirical sup-port for it. They construct an index of the "income level of a countries export," document its properties, and show that it predicts subsequent economic growth.

In this research paper, Hausmann et.al (2007) concludes that the type of goods in which a country specializes has direct implications for the economic performance of that country. Export of goods with higher productivity potentials bring about higher growth rates and this is achieved by transferring resources from low-productivity to the higher-productivity activities by the entrepreneurial cost-discovery process. In Hausmann et.al model, each firm has two options, either produce own products with productivity level θ_i or imitate what others discovered at a fraction of the productivity level of the inventor, $\alpha\theta_i^{max}$. Emulators operate at a fraction α of the incumbent's productivity, with $0 < \alpha < 1$. Each investor can run only one project, so having discovered the productivity of his own project, the investor has the choice of sticking with that project or emulating another investor's project. Firm will decide by comparing the respective productivity levels and stick to his own project if max $\theta_i > \alpha\theta_i^{max}$, and imitate if otherwise. The productivity level at which the firms operate will range then from $\alpha\theta_i^{max}$ to θ_i^{max}. θ_i^{max} shows the productivity level of the most productive goods that has been discovered. Their approach is, therefore, useful in understanding the role of export diversification in discovering the productive capacities in export markets.

Altogether, we know that exporting firms are more productive, but they do not know initially where their productive capacity lies; overall productivity level increases as firms discover their productive potentials; and economic growth entails concentration in relatively high productive activities, but initial discovery process may require diversification of production structure. Within this framework, what remains to be resolved is the appropriate level of specialization required in converging to the quality frontiers in those products and level of development at which countries should start diversifying or specializing to reach to the highest productivity level. Despite the fact that it is impossible to convey a precise pattern between level of specialization and productivity at every income level.

Bonaglia and Kiichiro (2003), analysis that Trade capacity is the aspect of non-price external competitiveness that is directly related to trade: it describes the availability of trade-oriented infrastructure, institutions, know-how, necessary to export competitively on foreign markets, and the ability to gain access to those markets through bilateral and multilateral negotiations and participation in multilateral trade organization. Paucity of trade capacity has been singled out by the international community as one of the major hurdles to development, as illustrated by the emphasis of the Doha ministerial declaration on the role of trade-related technical assistance and capacity building. The guidelines on trade capacity devised by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD) stress that efforts should be directed towards strengthening the capabilities of developing countries' policy making in three areas: a) formulation and implementation of a trade strategy, b) strengthening policies and institutions devoted to export performance, and c) effective participation in rule making shaping international trade.

Nelson and Rafael (2011) on their IMF working paper considers the role of export diversification in determining trade outcomes during the global financial crisis. The impact of export diversification (or concentration) is measured by assessing three different dimensions of specialization. First, concentration by geographic destination is considered; that is, whether the bulk of exports from a country go to many or few trading partners. Second, industry / sectoral concentration is considered; that is, whether a country's exports are scattered across many industries and sectors, or concentrated in just a few. Third, product concentration is considered; that is, whether countries produce many products within their export sectors or just a few. The workhorse gravity trade model is adapted with trade diversification as an additional trade cost, and the model solution is empirically tested on a dataset containing over 500 thousand observations for Latin America. Industry and product concentration are found to significantly affect the resilience of Latin American countries' trade during the global financial crisis – increasing the diversity of both export sectors and export products within sectors by one standard deviation reduces the quarterly decline in exports by approximately 4.7 percent. diversifying exports across many different trading partners is not

Bleaney and Greenaway (2001), Export instability is another reason for the benefits of export diversification, which is analogous to the portfolio effect in finance. Commodity products are often subject to very volatile market prices so that countries that are dependent on these commodities may suffer from export instability. This could discourage necessary investments in the economy by risk-averse firms, increase macroeconomic uncertainty, and be detrimental to longer-term economic growth. Export diversification could therefore help to stabilize export earnings in the longer run.

Hausmann and Rodrik (2003) highlight the importance of discoveries of new productive sectors against the existing comparative advantage. They emphasize the role of entrepreneur in discovering new products, called cost discovery, when there is uncertainty about what a country is good at producing. Three important arguments cited in Redding, Hausmann and Rodrik are the followings:

i. There is much randomness in the process of discovering what one can be good at. More likely, existing patterns of specialization are the consequence of historical accidents and serendipitous choices by entrepreneurs.

ii . For most economies, industrial success entails concentration in a relatively narrow range of high productivity activities. However, the specific product lines that eventually prove to be the most productive are typically highly uncertain and unpredictable.

iii. Enterprises may not be able to predict if, when, how, and at what cost they would learn enough to become fully competitive, even when the technology is well known and mature elsewhere.

Bagci (2010), Exporting firms are more productive, but they do not know initially where their productive capacity lies; overall productivity level increases as firms discover their productive potentials; and economic growth entails concentration in relatively high productive activities, but initial discovery process may require diversification of production structure. Given these evidences from empirical and theoretical analyses, we investigate the impact of export diversification on productivity by using four alternative measures of productivity and three measures of diversification and test whether diversification really helps discover productive capacities. We additionally introduce an index of within-diversification for empirical purposes. In general, we find no significant relationship between the structure of export and productivity. The results are robust to alternative measures of productivity, diversification, aggregation of the data, and estimation methods. Allowing for heterogeneity with respect to degree of development and sectoral classification, however, provides important insights. Low and lower middle income countries tend to suffer from within-diversification (or benefit from within-specialization) in manufacturing industries. Lower middle-income countries benefit from higher specialization in chemicals and related products, mineral products and in sector classified as other manufacturing articles. These findings confirm the previous findings on the impact of specialization on productivity for lower income countries.

2.2 Empirical Review in International Context :

Parteka and Tamberi (2008) has tried to study was to fill the gap existing in the empirical literature on diversification - development nexus. Their main purpose was to uncover what country specific factors determine the diversification process in the course of a country's economic development. Using a panel data set for 60 countries and twenty years (1985 -2004), they tries to analysis the role played by country specific factors as determinants of exports diversification process. When access to a big market (domestic and foreign) is possible, the diversification process is facilitated. They confirm that even after clearing out differences in income per capita, cross section variability in the degree of exports' diversification is significant. In general, apart from per capita income, variables influencing the size of accessible markets (domestic and foreign) are the most relevant and robust determinants of the export diversification process. Diversification opportunities grow if countries are large, not located far from economic core areas and when barriers to trade are restricted.

Francis, Iyare and Troy (2007) on their article uses co-integration and error-correction models to analyze the causal relationship between agricultural export diversification and economic growth in eight selected Caribbean countries using annual data from 1961 to 2000. The empirical results show that in the short run, agricultural export diversification Granger causes economic growth in Barbados and

Belize. Non-causality exists for the other countries. In the end, agricultural export diversification also Granger causes economic growth in the Dominican Republic. On the contrary, agricultural export diversification is the outcome of the economic growth process in Belize, Costa Rica, Haiti, and Jamaica, in the end. Non-causality exists in Trinidad and Tobago. There is no evidence of bi-directional causality in any of the countries in either the short or long run.

Paul, New farmer and Walkenhorst (2007) Three developments frame diversification opportunities in the new global economy: (a) the increasing spread and importance of global production chains; (b) rapid growth of new sources of demand in large emerging economies, such as Brazil, China and India; and (c) the growing importance of trade in services driven by rising incomes and the outsourcing of more and more services activities.

Wilhelmsson and Persson (2012) since at least the 1960s, the European Union (EU) – followed later by most industrialized economies – has offered various kinds of non-reciprocal trade preferences for developing countries. Originally, these trade preferences had two policy goals: (i) To increase export volumes for developing countries and thereby boost their export earnings, and (ii) to facilitate export diversification, so that developing countries could become less dependent on a small number of export products. Extensive research has been performed on assessing the first of these two goals, and studies typically suggest that there are positive volume effects from trade preferences. However, the second goal, i.e. to enhance export diversification, seems to have been largely forgotten by researchers as well as in policy circles, despite its clear policy relevance.

The aim of this paper is therefore to analyze the impact of the EU's non-reciprocal trade preferences for developing countries on export diversification. To fully capture the effect of all preference systems that have historically been in place, they use data for the period 1962-2007. Their baseline measure of export diversification is to count the bilateral number of SITC 4-digit product categories that is exported from a developing country to an individual EU-15 country. They also test the robustness of their results by employing two indices of export concentration that, in addition to the number of exported products, also takes into account how the value of exports is allocated between export products. An empirical model is then estimated with a Poisson fixed effects estimator. This allows us to control for unobserved heterogeneity and use the information contained in the observations of countries not exporting. In addition, the impact of preferences is allowed to vary over time periods to take into account how the preference systems have evolved over time. The general trend is that, on average, more products are exported to the EU countries over time.

However, their estimation results suggest that it is not necessarily the countries receiving the best preferential market access that have had the best results in terms of export diversification. For instance, while there was a positive effect from an early version of African, Caribbean and Pacific (ACP) countries preferences, this positive result turned insignificant and even significantly negative for later versions of ACP preferences. In other words, the ACP preferences of later years, including those offered in the current Cotonou Agreement, might lead beneficiary countries to specialize in fewer goods rather than to diversify into new export products. By contrast, the generally much criticized Generalized System of Preferences (GSP) regime exhibits positive results throughout the studied time. The authors conclude that it is at least not a general result for non-reciprocal trade preferences to have a positive effect on export diversification.

Amurgo-Pacheco and Pierola (2007) investigate pattern of export diversification in developing countries between 1990 and 2005. They study the effects of various explanatory variables such as GDP of trading partners, distance, FTA, and trade with developing countries on intensive and extensive margins. According to the classical definition "intensive margin refers to varying the amount of trade of a firm, industry, or country by varying the quantity that it trades of a given number of products, as opposed to the extensive margin at which it would vary the number of products". Since author studies product as well as geographic diversification, he adds geographic dimension and distinguishes extensive margin into product extensive ("export of new products to new destinations") and geographic extensive ("export of Old products to new destinations"). To estimate the gravity equation author uses the model, which takes into account zero-trade flows. Zero trade flows are observed for the non-productive firms, which do not export. To work with such kind of data the authors uses Tobit estimation technique, which considers zero-trade flows as censored data. To look at intensive and extensive margins separately author suggests using McDonald and Mofitt's (1980) decomposition. This method "disaggregates the total changes in the probability of being above the limit and changes in the value of the dependent variable if it is already above the limit.”

Jayaweera (2009) in his thesis paper entitled, "Foreign Direct Investment and Export Diversification in Low Income Nations" has seeks to understand whether increased foreign direct investment (FDI) can help low-income nations to diversify their export bases. Numerous governments in low-income nations have sought to attract FDI with an aim of diversifying their export bases while many large multilateral development organizations have also advocated such policies. The authors Using Melitz’s (2003) trade model to analyze the Foreign Direct Investment and Export Diversification in Low Income Nation, and identify a number of potential drivers of export diversification including firm productivity, the cost of trade, the fixed costs of export market entry and consumer preferences and incomes. According to him, many low-income nations have experienced large increase in FDI inflows and have engaged in competition with their neighbors to attract FDI, often by offering significant incentives. In the literature on FDI, a number of theoretical and empirical studies link FDI to these drivers of export diversification. These linkages are primarily based on FDI leading to improved productivity in the host nation, together with a number of spillover benefits, which help local firms to become export competitive leading to an increase in export diversification. He has construct a rich panel dataset of 29 low-income nations from 1990 to 2006 and employ an instrumented variables estimation technique using differenced data to test the link between FDI and export diversification. The results of his study paper outlined the theoretical case for an association between increased FDI and export diversification. FDI may result in a direct positive effect on diversification through the establishment of export platforms while also resulting in indirect inter and intra-industry spillovers to host nation firms which improve their productivity and reduce the fixed costs associated with exporting, thereby increasing the number of firms which are export competitive. The results also find that this effect is reversed for nations which export a high proportion of oil and mineral resources. Furthermore, the value in signing free trade agreements with import partner nations is reinforced as these are found to be associated with improved export diversification.

Dennis and Shepherd (2007) in their article, "Trade Costs, Barriers to Entry, and Export Diversification in Developing Countries" have show that lower export cost, international transport costs and domestic market entry cost all robustly associated with export diversification in sample of 118 developing countries and this articles is to expand the range of factors believed to influence export growth at the extensive margin or export diversification to include a range of policy variables related to the cost of trading and domestic market entry. Then they used Non-parametric model to drive some stylized facts that motivate their subsequent work. This paper founds that a 1 percent reduction in the cost of exporting or the cost of international transport is associated with an export diversification gain of 0.3 percent or 0.4 percent respectively. Lower domestic market entry costs can also promote diversification, but the elasticity is weaker (-0.1). To obtain these results, the authors construct new measures of export diversification for 118 developing countries using highly detailed 8- digit mirror data from the European Union. The analysis also incorporates new export cost data from the World Bank's Doing Business database, covering document preparation, inland transport, administrative fees, and port/customs charges. Findings are highly robust, including to the use of geography and colonial history as instruments for trade and entry costs. Both the signs and relative magnitudes of these effects are consistent with predictions from a heterogeneous firm's model of trade with asymmetric costs.

Brenton and Hoppe (2007) analyze the clothing sector still provides an opportunities for export diversification and the expansion of manufactured export for low wage countries. The clothing sector was at the forefront of export diversification for many low-income developing countries that have now achieved middle or high-income status . This is so even though China and India have been unfettered from quotas in the main consuming markets in the world economy. There are substantial export possibilities for countries that can effectively exploit their labor cost advantages and which can fill emerging niches. This policy research working paper assesses this issue taking into account key changes to the market for clothing: the emergence of India and especially China as exporting countries; the rise of global production chains; the removal of quotas from the global trading regime but the continued presence of high tariffs and substantial trade preferences; the increasing importance of large buyers in developed countries and their concerns regarding risk and reputation; and the increasing importance of time in defining sourcing decisions. To assess the importance of the factors shaping the global clothing market, the authors estimate a gravity model to explain jointly the propensity to export clothing and the magnitude of exports from developing countries to the EU and US markets. This analysis identifies the quality of governance as an important determinant of sourcing decisions and that there appears to be a strong bias against sourcing clothing products from Africa, beyond that which can be explained by governance and country characteristics such as income, size and distance from the market.

Bebczuk and Berrenttoni (2006) in their project paper, "Explaining Export Diversification: An Empirical Analysis", have analyzed a panel of 56 developing latin American countries over the period 1962- 2002. In this paper their main aim to investigate that employing econometric technique on a cross-country database and analyzing as a case study firm level export diversification in Argentina. The cross-country exercise revolves around a Herfindahl index using export data disaggregate at 2- digit SITC into 69 sectors. The Herfindahl index equates the sum of the squared proportional exposures to each sector and hence has to a maximum of 1 when the country is completely focused on one sector, so lower value of the index indicate more diversification.

Bebczuk and Berrenttoni has also analyze about the export concentration approaching the recent Argentine experience. Given the Sharpe devaluation of early 2002, the value of the American dollar increased by 266% and their effect show the change in the real exchange rate and export concentration in Argentina after the crisis and export diversification at the firm level. There was a big change in relative prices that stimulated a shift in resources to tradable production. That change has the main driver of a rapid increase in exports between 2001 and 2004, the value of the goods sold abroad increased by 30% from US $ 26,000 million to US $ 34,550 million. This observation has probably to do with a massive switch of many firms toward new some profitable exportable products, which by itself increased the number of exporters (across-firm diversification) and the number of exported goods (within-firm diversification). If the export diversification occurs across- firm, it is necessary new firms to enter the export business, conversely if export diversification is a within-firm phenomenon, eventual supporting policies should be targeted towards existing exporting firms.

2.3 Empirical Review in Export Diversification of Nepal:

Pant and Panta (2010) describe that Nepal's policy regime has not been very instrumental in improving trade competitiveness. Although policy measures have been announced from time to time to identify new exportable products and encourage diversification of export markets, these have hardly been executed. The challenge for Nepal is complicated by the legacy of the past. Against this perspective, this paper a) examines the export scenario of Nepal and reviews the past studies on the country's export potential; b) illustrates Nepal's competitiveness of the export sector; and c) suggests measures for promoting export diversification and competitiveness. Based on the estimation of the real effective exchange rate (REER), this paper shows that the country is gradually losing its competitiveness.

The author also explains that export diversification and competitiveness is important for least development countries (LDCs) such as a Nepal for a following reasons.

I. It is the major principle mechanism for achieving the benefit of globalization.

II. The continuing reallocation of manufacturing activities from industrial to developing and LDCs such as Nepal provides many opportunities for expanding trade both in goods and in services.

III. The growth of trade is firmly supported by regional trading arrangement, such as the South Asia Free Trade Agreement (SAFTA) and The Bay of Bengal Initiative for Multisectoral Technical and Economic Co-operation (BIMSTEC) and Multilateral Trading Arrangement such as the World Trading Organization (WTO) in the Nepalese context.

Although various studies have demonstrated that Nepal possesses competitive advantage in herbal products, woollen carpets, tea, garments and pashmina, among others, a comprehensive case-by-case analysis of home and host countries trading environment, supply and demand conditions, cost of production, capacity to innovate, as well as its forward and backward linkages should be conducted to translate the export potential to the actual trading opportunities.

Singh, M.P. and V.S. (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 knowhow, 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 destination wise 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.

Thapa (1986) has analyzes the transit problems limited resources hindering the development of Nepalese foreign trade. His study deals with the trade routes, trade arrangement, incentives of trade diversification and other institutional in the development of foreign trade and gives the glimpse of Nepalese foreign trade prior to 1961/62 by using secondary source of data information. He analyzes the composition and direction of Nepalese foreign trade, as the primary goods exported in 1961/62 was 86.17 percent and dropped to 63.63 percent in 1982/83. On the other hand, the growth of manufactured exports to overseas countries increased from 28.6 percent to 61.9 percent in the respective. Thapa highlights on trade instability, concentration, and diversification. In his study, he observes the high export instability in SITC in primary commodities, along with manufactured commodities. The concentration of Nepalese exports to third countries in lower on a region on and country-wise.

Piya and Yagi (2010) are tries to observed and analyzed the behavior of Nepalese agricultural export using vector error correction model (VECM). The first part of the analysis focused on the dynamic relationship among agricultural export, geographic concentration, and total agricultural production. Results of the study revealed that Nepalese agricultural export was very much dependent on the Indian markets and had positive relation with the geographic concentration index in the end. The significant and higher error correction term indicated that the short-run fluctuations in geographic concentration and agricultural production were promptly adjusted to its long-run trend. The long-run effect of agricultural production increment on export was positive. The second part of the analysis focused on the export of niche products. The analysis in vector auto regression (VAR) form indicated that the relationship between export of niche products and geographic concentration was insignificant. Granger causality test revealed that the production granger causes export and export granger causes geographic concentration.

Shakya (2001) has cited four major bottlenecks to export in Nepal viz:

a. Supply side constraints: The narrow export base, non-competitive technology, high production-cost, characterizes supply sources 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.

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 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.

All above literature are related in our study because they suggest that foreign trade can play a vital role to promote economic development. The under developed countries are characterized by the existence of vicious circle of poverty. It Implies, low income, deficiency of demand and lack of demand accounts for low supply which in turn accounts for low income. However, international trade enables underdeveloped countries to produce more of those goods in which they enjoy greater comparative advantage. Consequently, production, income and employment in these countries increases leading to increases in demand. This increased demand is partially met by domestic production and partially by foreign imports. In this way, exports and imports of various products help in breaking the vicious circle of poverty. Thus, it accelerates the rate of economic development automatically in the economy.

I study on export diversification of Nepalese economy within the period (2001/2-2012/13). I have pointed out the three objectives that are to examine the Nepalese foreign trade and to analyze the export between Nepal with India and overseas countries. And analyze the composition, direction and term of export between Nepal with India and overseas countries and found out the condition, differences and gap of foreign trade in Nepalese economy since started period to ending period.

2.4 Research Gaps

A number of studies in and outside the country were conducted on export diversification and export dimensions in the world. While carrying out this study, a number of literatures relating to the export diversification have been consulted in libraries and website. Issues relating to export diversification in various regional groupings such as NAFTA, EU, AFTA, and SAARC have been taken into account.

However, the context of the most of the studies was different from Nepal. Those studies largely have been found to be based on the empirical studies owning availability of data, knowledge and resources. Research works of Feenstra and Kee (2005), Brenton and Hoppe (2007), Dennis and Shepherd (2007), Amurgo-Pacheco and Pierola (2007), Paul, Newfarmer, and Walkenhorst(2007), Francis, Iyare , and Troy (2007), Parteka and Tamberi (2008), Jayaweera (2009), and Wilhelmsson and Persson (2012) provide an insight into the country trade.

The research articles on the impact of Export Fluctuation on income - A Cross Country Analysis by Brenton and Hoppe, Amurgo-Pacheco, and Pierola, Paul, Newfarmer, and Walkenhorst, Francis, Iyare , and Troy, Parteka, and Tamberi also depicted cross- country relations of export between the countries of various regional grouping. Nevertheless, these studies in the Nepalese context seemed to be complex. However, they could be helpful in introducing new models and framework in thrashing out new solutions to the new challenges that are likely to emerge after Nepal's entry into WTO, SAFTA, and BIMSTEC.

Nepalese Context

Undoubtedly, lost of studies were carried out on dimensions of Nepalese foreign trade in the past. The studies or research works conducted on foreign trade (export diversification) in Nepal lacked comparison to other countries in the region.

However, the studies in this area distinctly impeded by the paucity of data and proper research methodologies. Moreover, the studies carried out in the past propagated the need for a thorough review of all studies. The studies carried out in the past at different length of time (particularly after 1990) definitely contributed to the policymaking and the theory building process.

The studies carried out in the past showed their own significance because of time and the existing scenario of trade. Among the studies that were carried out in the past, the study of Pant and Panta (2010), Singh and Singh, (1999) Thapa (1986), Piya and Yagi (2010), and the study of Sharma (1999) were the prominent from point of view of policy issues that were in existence during that time.

Most of those studies except that of Singh and Singh (1999), Thapa (1986), Piya, and Yagi (2010), and Shakya (2001) lacked empirical test. Some of the studies were conducted only to test the short-term and long-term elasticity.

Similarly, the study undertaken by Thapa (1886) confied to Nepalese export structure and trade expansion in South Asia, but the study also gave the overall export trend of overseas trade from1961/62 to 1982/83. This study, on the one hand, is not quite recent, it dates back to 1983, and on the other hand, it lacks empirical tests. And this study does not mention the reasons for a noticeable decline in export trade.

The study carried out by pant and panta (2010) was focused on the analysis of Nepal's export trade with the India and overseas countries. The study was confided to limited goods under SITC group (which now has been categorized under HS code). Similarly, the authors identified the major commodities for a export. he conducted studies on some key exportable items such as herbal products, woolen carpets, tea, garments and pashmina, among others. The TEPC added other products such as large cardamom, ginger, tea, noodles, honey, Essential oils, Medical herbs, Nepali hand made paper, woolen products, lentils, iron and steels products and articles of silver jewelry as the most potential products. On top of that pant and panta's research work did not base on any specific empirical tools as they were used in that of Singh and Singh (1999).

The Nepal Rastra Bank has conducted research on various issues relating to trade, but the studies did not focus on country-wise and commodity-wise diversification of trade. Lost of changes have taken place in the country after these studies were carried out. Since trade is one of the vital components of the economy, study on trade in the new context is quite essential. Bearing this in mind, this study attempts to employ both quantitative and qualitative tools to discuss the vital issue of export diversification.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Research Design

The study starts with a description of the development of foreign trade in the historical perspective. It is a description chapter based on secondary sources. Description of such a historical scenario helps to understand the past performances and make a comparison with the present for future policy prescriptions.

The trade is dynamics that the study basically concentrates are the exposures, some analysis comparisons and calculation of some new dimensions. The study which incorporates flow of goods into different destinations, volume, composition, analysis of terms of trade distortions, examination of the relations of trade with national income, policy judgments etc. are the enclaves of the whole scenario of Nepalese export trade for which exploratory and analytical research design has been follow up.

3.2 Data Collection Technique and Sources of Data

The collection of data is the important part of research study. There are always two types of data- primary and secondary. But, this study is conducted with the help of secondary data only. There are different national and international agencies that provide the data for trade.

The national sources are:

- Nepal Rastra Bank (NRB), Annual Reports, Quarterly Bulletin
- Nepal Overseas Trade Statistics: Trade Promotion Center,
- Ministry of Finance (MOF); Economic Survey
- National Planning Commission Secretariat; Central Bureau of Statistics
- Statistical Year Book of Nepal, Central Bureau of Statistics
- Ministry of Industry, Suppliers and Commerce

The international sources are:

- International Monetary Fund (IMF), International Statistical Financial Year Book
- Reserve Book of India; Bulletin

- United nations Commission for Trade and Development
- United Nations (UN) Statistical Papers; Commodity Trade Statistics etc

The relevant statistical information's are collected from Quarterly Economic Bulletin of Nepal Rastra Bank, Economic survey, Central Bureau of Statistics.

3.2.1 Quality of Data

The quality of data could be the question of the study. Still it is felt quite difficult to measure the quality and relevance of data. So that data from only renowned and authorized agencies are collected. There are different national and international sources of data, which are mentioned already. These data from different sources are found to be identical and some variations. So still it creates difficulties to pick up the correct information. However, the data of Quarterly Economic Bulletin Nepal Rastra Bank have been found to be best standard and qualitative. Students, researchers, and scholars have been found to be using this bulletin for a long time. To solve confusions, necessary corrections are applied from the scholars of research division of Nepal Rastra Bank.

The statistics of foreign trade has a no long history in Nepal. Only after the adoption of development plan, statistics of foreign trade are published by various institutions and started to keep systematically. The Central Bureau of Statistics (CBS) started to publish data on foreign trade by commodity classification from 1955/56 to 1962/63. Nevertheless, publishing data on trade was stopped by CBS after 1970/71. Quarterly Economic Bulletin of Nepal Rastra Bank also stopped compiling data and publishing from 1971 to 1974 and restarted publishing it from 1974/75 and has continued to data. Total exports and imports of Nepal including export to and import from overseas countries are included in the data provided by NRB. But there is no similarity between the data of NRB and the data published by TEPC from 1973/74 and Department of Custom (DC) from 1980/81, although the source of data mentioned by these institutions are the same. The published data of the Department of Custom (DC) after 1980/81 also do not match with those of NRB and TEPC. The variation in data is one of the difficulties in using and providing correct information, but this study has mainly used data published by NRB, CBS and TEPC.

There is no complete record of values and quantities on a country wise basis in the foreign trade statistics of CBS. The data from the customs offices prepared mostly for the assessment of tariff duties. Export and import carried on along the 500 miles of Nepal. India open boarder had the less chance of being recorded also. In developing countries illegal international transaction are encouraged by foreign trade taxes, exchange rate over valuation or quantitative restrictions on international trade and the existence of illegal trade mislead policy makers.

3.2.2 Tools and Technique for the Analysis of Data

For the analysis of data revealed comparative advantages methods are used. To fulfill the specific objectives processed data are tabulated and descriptive statistical tools are applied such as rate, ratio, and percentage etc. Most of analyses are done with the help of SPSS/Start graphic software.

3.3 Data Analysis and Presentation of Data

In this study, export trade considered as the main sources of growth and economic development. After collecting data from different sources, data are arranged in systematic way and tabulated in accordance with the need for the study. The first part of the study consists of describing the history and major trade policies of Nepalese foreign trade. Hence, this part of this study constitutes estimation of the role of foreign trade of Nepalese economic development. Another part of the study consists of systematic presentation of volume, composition and direction of Nepalese export trade. Facts are arranged systematically as obtained through secondary sources with the help of ratios, percentage, and graphs to make them comparable and explanatory. The analysis is based on time series data of 12 years covering the period 2001/02 to 2012/13. The compiled data have been processed with the help of computer for analysis. Nepal's trade with India and other countries are presented in chronological order. Data were presented in simple and complex tables in attaining general and special objectives of this study.

The role of foreign trade in economic development is considerable. It has worked as an engine of growth as has been witnessed by Great Britain in 19th century and Japan in 20th century. Therefore, one of the major objectives of this study is to measure the contribution of export trade on Nepalese economy. In this respect, it is more suitable to study the impact of export trade on Nepalese economic development.

As GNP growth rate and GNP per capita income are also important indicators of economic development, this study has tried to measure the contribution of Nepalese export trade on economic development through the measurement of the contribution of export trade on GNP. Thus, this study will used the following method to fulfill the objective of measuring contribution of export trade on Nepalese economy.

Revealed Comparative Advantages (RCA) : The terms comparative advantage is often meant to describe resource use by different entities such as the firm, industry or a country. Comparative advantage contains two general categories of use: a production context and a trade context. With respect to international trade, comparative advantage denotes a comparative cost advantage in producing commodities and describes observed trade patterns based on country differences in resource endowments, investment patterns, technology, human capital and managerial expertise, infrastructure and government policies. From an *ex post* sense, comparative advantage denotes country specialization in the production and sale of commodities over time and across countries/regions.

Balassa was the first to build a measure of RCA. His analysis demonstrated that observed trade patterns produce estimates of RCA. Balassa's index of RCA can be written as follows (Esterhuizen, 2006; Karmarcharya, 2000):

$$\mathbf{RCA} = \frac{X_k^i / X_k^w}{X_t^i / X_t^w} \ldots\ldots\ldots\ldots\ldots\ \mathbf{(1)}$$

Where,

X_k^i = Country i's export of good K;

X_k^w = World exports of good K;

X_i^t = Country i's export's of all good (and t denotes total exports); and

X_w^t = World export's of all good

Equation I can be rearranged as follows:

$$\textbf{RCA} = \frac{X_k^i / X_t^i}{X_k^w / X_t^w} \text{ ....(2)}$$

CHAPTER IV
TREND AND NEPALESE EXPORT TRADE

4.1 History of Nepalese Foreign Trade

Historically, Nepal had pro-actively encouraged entrecote 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). Araniko 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, cite 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, 1982:30 cite 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 cite 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, cite 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.

4.2 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 license 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. 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.

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.

4.3 Trade Policy, 2009

With the changed context, the Government has introduced a new Trade Policy in April, 2009 replacing the Trade Policy, 1992. It is a comprehensive and updated policy which was framed and brought into implementation after Nepal became a member of the WTO. It is consistent with the principles of WTO and adheres to the principles of liberal, open and transparent economic system. It emphasizes on private sector-led competitive economy. The main objective of this policy is to increase contribution of trade sector in national economy and thereby reduce poverty and accelerate economic growth. The new Trade Policy, besides emphasizing trade in goods, has also duly recognized trade in services and intellectual property equally as potential trade sectors for Nepal. This policy includes an exhaustive list covering from institutional strengthening to legal and procedural reforms in order to create conducive environment for trade in the country. These measures and provisions are supposed to enhance country's trade both internally and externally. The policy has broadly classified potential Nepalese exports into two categories: Special Focus Area and Thrust Area Development. Four products are included under special focus area, most of which have already been established in the export market. Newly emerging fifteen products have been listed under the second category. Currently, the Government is preparing a detailed action plan to expedite the implementation of this policy.

The new trade policy was introduced in 2009. In order to materialize following basic objectives have been formulated:

Objectives:

1. To enhance 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.
2. To diversify trade by identifying, developing and producing new exportable products through the promotion of backward linkages for making export trade competitive and sustainable.
3. To expand trade on a sustained basis through gradual reduction in trade imbalances.
4. To co-ordinate trade with other sectors by expanding employment-oriented trade.

Export policy:

1. The production and quality of exportable products will be raised to make them competitive in the international market.
2. Necessary efforts will be made to increase and diversify exports of goods and services with the objective of increasing foreign exchange earnings.
3. Exports will be promoted by raising the production and quality of traditional as well as new products. Similarly, more emphasis will be placed on the export of profitable but processed and finished products. For the export promotion of these products, new market will be identified.
4. Foreign exchange earnings will be increased and opportunities for gainful employment will be created by identifying and increasing the production of new products.
5. Service-oriented activities will be promoted to increase foreign exchange earnings.
6. Encouragement will be given to the export of hydro-electricity on a profitable basis.
7. For the effective utilization of manpower, stress will be given to the development of appropriate and potential skills to promote service sector as well as export of skilled manpower in an organized way.
8. Appropriate monetary, foreign exchange and fiscal policies will be formulated and necessary changes will be made in the administrative procedures to make them liberal, simple and dynamic in order to implement above policies on an efficient, smooth and transparent basis.

Export Strategy :

1. License will not be required for the export of products other than banned or quantitatively restricted items as listed in Annexure No. 1. In the case of quantitatively restricted products arrangement for issuance of export license will be made in consultation with the private sector. Quantitative restrictions in the export of such products will gradually be removed through appropriate taxation measures.
2. For export promotion, improvements will be made in the existing transit transport network and its infrastructure. Administrative procedures will also be made transparent, smooth and efficient.
3. For the promotion of exports, container service will be introduced and the existing bonded warehousing system will be further expanded and improved.
4. The duty drawback scheme for the refund of import duty paid on the importation of raw materials and intermediate goods required for the production of exportable products will be effectively implemented. In this context, duty on import of raw materials will be fully exempted taking into consideration the needs, or the bonded warehousing system will be introduced for the storage of such materials.
5. Exports will be free from all charges except the service charge. However, the specific provisions will be applicable in respect of the export of essential products.
6. For the promotion of exports, 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.
7. As a preparatory step towards full convertibility of the Nepalese currency in trade and services, exporters will have to sell in the stipulated percentage the amount of foreign exchange earned through exports of goods and services to commercial banks at a rate fixed by the market mechanism and the remaining balance to Nepal Rastra Bank at an exchange rate fixed by the Government. No license will be required and no quantitative restriction will be imposed on the imports of raw materials (except stipulated) required for the export-oriented and import-substituting industries. But for the import of such materials, foreign exchange will be made available by the commercial banks at the rate fixed by market mechanism. Exporters will be allowed to open a foreign exchange

account in the banks for the purpose of spending certain percentage of one's foreign exchange earnings in trade promotion activities.

8. Export Valuation System will gradually be abolished after the full convertibility of the Nepalese currency.
9. Quality will be tested from time to time in order to improve the standard of exportable products and necessary information will be made available for this purpose.
10. Simple and convenient procedures relating to pre-and post-shipment credits will be adopted on a priority basis.
11. Income tax on income from exports will be fully exempted, and income earned from exports to India on the basis of letter of credit or agreed banking document will also be free from income tax.
12. Emphasis will be given in the development of packaging technology to maintain the quality standard of export products.
13. Nepalese missions abroad will be geared up towards export promotion activities, and trade missions will be opened and institutionalized on the basis of feasibility.
14. No quantitative restrictions will be imposed on the exportable products carried by tourists while returning from Nepal.
15. Export procedures and documentation, thus formulated, will be short and simple.
16. An annual indicative export plan and program on the basis of feasibility will be formulated with the co-operation of private sector to promote exports.
17. Necessary information and training relating to technology, marketing and export procedures required for export promotion will be provided on an institutionalized basis and arrangements will also be made for the participation in national and international trade fairs for market promotion.
18. Regular monitoring will be made to avoid distortions in exports and imports. Strong actions will be taken in case of misuse of facilities.
19. Export promotion, research and development and training schemes will be developed on institutional basis for developing new exportable products and for raising the quality and production of the traditional exportable products.

4.4 Nepal Trade Integration Strategy (NTIS) 2010

Nepal launched a detail study of its trade sector which was called the Diagnostic Trade Integration Study (DTIS) with the technical and financial assistance of Integrated Framework (IF) in 2003. This was a very useful comprehensive study. But due to several reasons, especially the lack of technical and financial support by the DPs and political turmoil in the country, this study could not be implemented properly.

The IF, after its reincarnation as EIF, again started the same program as major component of its technical support to LDCs. Nepal undertook the task of updating DTIS, which it renamed as Nepal Trade Integration Study (NTIS), in 2010. This is a very pragmatic, comprehensive and in-depth study which elaborates the current status, the constraints and future prospects of trade and also suggests the necessary future actions to be undertaken to promote trade. It complements Trade Policy 2009. The NTIS has identified four major challenges in enhancing its export trade, which include ensuring proper market access, building domestic support institutions, strengthening the supply capacities and mobilizing overseas development assistance. In order to face these challenges, the strategy has set four major objectives: strengthen trade negotiations (especially bilateral); strengthen the technical capacity of domestic non-tariff barriers (NTB) and other business environment supporting institutions; strengthen the export capacity of 'inclusive' export potential goods and services, and strengthen the Government's capacity to coordinate and manage Trade-Related Technical Assistance (TRTA) and Aid for Trade (AFT) and to implement the NTIS. It has also recommended 258 action plans as necessary for the promotion of trade and to improve its contribution to GDP. It has identified 19 products comprising 12 commodities and 7 services as major export potential items that can contribute significantly in the promotion of export. It has also identified 10 major potential markets for Nepalese export. Now the challenge is to fully implement the recommendations of NTIS. The Government, with firm determination to implement the study in a holistic manner, has formally adopted NTIS as its mid-term national trade development strategy. MOCS has started its implementation process. However, thorough implementation of all NTIS' recommendations is not possible from the Government's own limited resources and technical capacity. Therefore, the DPs have been requested to support its implementation. In this process, the Government would like to see the individual donors committing to implement some part of the implementation matrix in such a way that all recommendations of the NTIS are implemented within the timeframe of five years as stipulated in NTIS in a coordinated and coherent manner.

4.5 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 cores 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.

4.6 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. The share of India in the total export of Nepal was 23.1 percent 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.

4.7 Trade Liberalization and Nepal’s Export Potential

After the introduction of the structural adjustment and stabilization programmes in mid-1980s, trade reforms in Nepal focused on shifting the development strategy from an inward looking import -substitution to export promotion. A host 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.

Moreover, the Trade Policy of 1992 and the Foreign Investment Policy of 1992 put greater emphasis on deregulation, competition and increased reliance on market forces. Moving along the long-term vision of developing trade as one of the pillars of the economy, the Tenth Plan's Poverty Reduction Strategy Paper (PRSP) (2002-2007) aimed for Nepal's integration in globalization process and increased participation of the private sector in open competitive and market-oriented trade regime. The new Trade Policy 2009, besides emphasizing trade in goods, has also duly recognized trade in services and intellectual property equally as potential trade sectors for Nepal. The main objective of this policy is to increase contribution of trade sector in national economy and thereby reduce poverty and accelerate economic growth. This policy includes an exhaustive list covering from institutional strengthening to legal and procedural reforms in order to create conducive environment for trade in the country. These measures and provisions are supposed to enhance country's trade both internally and externally. The policy has broadly classified potential Nepalese exports into two categories: Special Focus Area and Thrust Area Development. Four products are included under special focus area, most of which have already been established in the export market. Newly emerging fifteen products have been listed under the second category. Currently, the Government is preparing a detailed action plan to expedite the implementation of this policy. Subsequently, a number of policy initiatives were planned, such as establishing linkages of imports to industrial development for transformation of domestic trade into market based system, promotion of export through identification of products of competitive and comparative advantages, diversification of export, and improvement in the quality of exportable goods. Further, facilitation of trade by developing and improving required infrastructure, institutional capacity and business services was part of the reform process. These policy initiatives and reforms were all the more demanding in the light of Nepal becoming a member of WTO and two regional trading arrangements—SAFTA and BIMSTEC.

After the implementation of some of these policies, the export sector in Nepal initially grew quite rapidly. However, in recent years the rate of export growth has slowed somewhat or even declined slightly due to an array of factors. Trade remains highly concentrated and Nepal’s share of exports in world markets is still very low. Manufactured goods account for close to 80 percent of total merchandize exports. Nonetheless, Nepal remains dependent on a few exports and markets, making it vulnerable to external demand and policy shocks. Three exports—garments, pashmina, and carpets—account for 48 percent of exports outside India in FY 2007/08. Reliance on a few markets has been growing with the United States, Indian, and German markets Comprising 75 percent of its exports in FY 2007/08. Moreover, despite doubling over the 1990s, Nepal’s share of world exports is less than 0.01 percent.

The geographical and commodity concentrations of exports are quite high. The country has not been successful to create backward and forward linkages of international trade that is necessary for self-sustained economic growth. While attempts have been made to address legal/policy discrepancies *vis-à-vis* WTO commitments, structural weaknesses and inadequate levels of resources—financial, human and technological— have undermined Nepal's productive capacities and competitiveness for effective integration into the global trading regimes. Hence, Nepal's economy still remains the least competitive of all the major South Asian economies (Adams and Adhikari, 2005).

4.8 Trends of Foreign Trade:

In 2001/02 the rupees value of Nepal's export was 46,944.8 million. It was increased to Rs. 74,261.0 million in F.Y. 2011/12 consequently it increased Rs. 76,917.1 million in F.Y. 2012/13. Its total export increase by about 1.64 folds.. Within the same period the value of imports increased from Rs. 107,389.0 million to Rs. 556,740.3 million. i.e., within the same period imports increased by about 5.18folds. The Study of 12 years, the trend of Nepalese foreign trade from 2001/02 to 2012/13 has presented in below table.

At table 4.1, the total trade deficit of Nepal in FY 2001/02 was Rs. 60,394.2 million. But after FY 2001/02, it is found to be increasing as the deficit in trade balance increased to Rs. 74,421.5 million in FY 2002/03 and further increased to Rs. 82,366.4 million in FY 2003/04. The trade deficit for FY 2004/05 was Rs. 90,768.5 million, which widened to Rs. 113,546.2 million in FY 2005/06. Over the years Nepal's foreign trade has operated at a deficit, as Nepal's imports have been outpacing its imports. And the deficit has been constantly going up creating a balance of payment problem. As a consequence the volume of trade deficit reached to maximum figure of Rs. 135,311.6 million in FY 2006/07, Rs. 162,671.2 million in FY 2007/08, Rs. 216,772.1 million in FY 2008/09, Rs. 313,511.2 million in FY 2009/10 . It continuously grew up to Rs. 331,837.0 million in FY 2010/11 and Rs. 387,406.7 million in FY 2011/12 and further increased to 479,823.2 million in FY 2012/2013. Although, it is seen that the exports have increased in a pace but imports have increased rapidly during those years. Nepal has been pursuing its trade and foreign exchange policies in tandem with the global liberalization process and striving its based to integrate it with the changing world economic order.

The main reason of the increasing Nepalese trade deficit is higher imports against small exports. The factors, responsible for deficit trade balance are narrow base of exportable production, infant industrial shape, high transit and transportation cost, land-locked situation, unfavorable environment for industrial development, low quality of produced goods, instable of political condition, insecurity of investors and lack of sound, effective strategically policies for foreign trade, changing pattern of consumption of consumers and increase in production cost of Nepalese goods than as foreign goods etc.

Table: 4.1

Trend of Nepalese Foreign Trade (2001/02-2012/13)

(In million rupees)

Fiscal Year	Total Export	Total Import	Total Trade	Trade Balance
2001/02	46,944.8 (30.41)	107,389.0 (69.59)	154,333.8	-60,394.2
2002/03	49,930.6 (28.64)	124,352.1 (71.36)	174,282.7	-74,421.5
2003/04	53,910.7 (28.34)	136,277.1 (71.66)	190,187.8	-82,366.4
2004/05	58,705.1 (28.19)	149,473.6 (71.81)	208,178.7	-90,768.5
2005/06	60,234.1 (25.73)	173,780.3 (74.27)	234,014.4	-113,546.2
2006/07	59,383.1 (23.37)	194,694.6 (76.63)	254,077.7	-135,311.6
2007/08	59,266.5 (21.07)	221,937.7 (78.93)	281,204.2	-162,671.2
2008/09	67,697.5 (19.22)	284,469.6 (80.77)	352,167.1	-216,772.1
2009/10	60,824.0 (13.97)	374,335.2 (86.03)	435,159.2	-313,511.2
2010/11	64,338.5 (13.97)	396,175.5 (86.03)	460,514.0	-331,837.0
2011/12	74,261.0 (13.86)	461,667.7 (86.14)	535,928.7	-387,406.7
2012/13	76,917.1 (12.13)	556,740.3 (87.87)	633,657.4	-479,823.2

Note: Figures in parenthesis are present share in total volume of trade

Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid- July 2013.

4.9 Trends of Export Trade:

Since a long time Nepal's foreign trade has largely been confined to India primarily owing to close proximity, similar socio-economic condition and availability of transport facilities. The volume of Nepal's foreign trade with India in terms of both exports and imports has been rising due to the increasing demand of different types of industrial raw materials, machinery and petroleum products in order to undertake various types of developmental works and consumer goods to meet the requirements of the growing population. Economic development of Nepal is also somehow struggling to achieve the development path. Nepalese Export items are primarily dominated by agricultural product which has low value by nature and less competitiveness in the world market. Nepalese all export concentration to the India. So the main targets of many fiscal policies were to diversify the Nepalese export from both commodities as well as destination point of view. Nepal follows are the almost same economic policy and program that were follow by giant neighboring economy India. The coverage of study period is from FY 2001/02 to FY 2012/13. The total exports trade with India increased from 27,956.2 million rupees in FY 2001/02 to 50,999.8 million rupees in FY 2012/13, i.e. within a period of 12 years its export trade with India increased by 84.42 percents. Similarly, within the same period the value of export trade with other countries (overseas) increased from 18,988.6 million rupees to 25,917.3 million rupees, which is almost 36.48 percents increased in the same period of time.

Nepal's trade policies are inextricably related with those of India. This is observed not only from the huge amount of trade with India, but also from the quantity of Nepali goods exported through the Port of Kolkata. This dependence is considerably greater than that associated with other landlocked countries as the majority of landlocked countries rely on more than one transit country to seek access to port facilities. In Nepal's case, alternative routes to the sea through Bangladesh or Tibet Autonomous Region of the People's Republic of China do not seem viable for large freight movement, though they may be feasible for smaller quantities of specialized freight. The Study of 12 years, the trend of export trade of Nepal from FY 2001/02 to FY 2012/13 has presented in below table.

Table: 4.2

Export Trade of Nepal (2001/02-2012/13)

(In million rupees)

Fiscal Year	Total Export	Total Trade	Total Export in India	Total Export in Overseas Countries
2001/02	46,944.8	154,333.8	27,956.2	18,988.6
2002/03	49,930.6	174,282.7	26,430.0	23,500.6
2003/04	53,910.7	190,187.8	30,777.1	23,133.6
2004/05	58,705.1	208,178.7	38,916.9	19,788.8
2005/06	60,234.1	234,014.4	40,714.7	19,519.4
2006/07	59,383.1	254,077.7	41,728.8	17,654.3
2007/08	59,266.5	281,204.2	38,555.7	20,710.8
2008/09	67,697.5	352,167.1	41,005.9	26,691.6
2009/10	60,824.0	435,159.2	39,993.7	20,830.3
2010/11	64,338.5	460,514.0	43,360.4	20,978.1
2011/12	74,261.0	535,928.7	49,616.3	24,644.7
2012/13	76,917.1	633,657.4	50,999.8	25,917.3

Note: Figures in parenthesis are present share in total volume of trade

Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-July 2013.

Table: 5.7

Major Export Trade Partners of Nepal

(In million rupees)

Countries	Fiscal Year												
	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2011/12	Percentage change	
													2011/12	2011/12
India	27,956.2	26,430.0	30,777.1	38,916.9	40,714.7	41,728.8	38,555.7	43,574.5	39,902.8	42,868.1	50,933.2	51,788.4	18.8	1.67
U.S.A	9,377.8	12,686.5	9,695.9	7,570.7	6,993.4	5,571.2	4,598.9	4,878.5	3,867.2	4,392.6	5,551.9	5,750.1	26.39	3.56
Bangladesh	237.1	411.3	421.3	290.8	234.3	521.4	4,664.3	4,710.4	3,373.7	3,471.9	2,578.0	2,730.2	-25.74	5.90
Germany	4,043.2	3,555.3	3,567.0	3,121.7	2,843.7	2,573.7	2,332.0	2,785.0	2,391.0	2,768.9	2,965.8	2,761.2	7.11	-6.89
Bhutan	27.0	52.312	77.7	149.5	238.2	310.9	142.6	194.80	1,554.8	425.4	543.8	333.8	27.83	-38.62
U.K	808.	1,070.7	1,677.0	1,050.0	1,184.0	998.6	1,066.3	1,429.6	1,228.1	1,389.5	1,461.9	1,584.1	5.21	8.36
France	473.4	453.9	581.7	617.8	1,297.4	903.	1,001.1	1,144.6	1,152.9	1,206.1	1,062.8	1,053.1	-11.88	-0.91
China P.R	1,040.1	1,631.0	2,348.1	1,888.5	892.5	377.9	736.4	1,847.9	1,008.6	746.0	985.6	2,176.7	32.11	120.85
Canada	305.9	383.6	546.4	528.7	644.6	593.7	713.7	795.3	768.0	820.3	782.0	643.9	-4.67	-17.65
Italy	566.5	530.8	589.3	582.8	712.3	684.3	583.7	851.5	716.1	758.2	792.2	785.2	4.48	-0.88
Japan	492.8	474.2	525.6	534.9	572.0	559.4	488.0	572.6	554.1	652.3	767.2	962.2	17.61	25.42
Switzerland	382.8	262.9	306.2	316.0	317.6	316.8	391.2	251.9	370.9	215.2	219.9	201.1	2.18	-8.55
Hongkong SAR	61.3	86.6	77.0	129.3	111.7	824.7	208.0	303.4	369.4	179.4	255.4	356.9	42.36	39.74
Australia	60.1	82.2	96.6	101.3	154.0	209.0	175.8	432.7	333.1	304.8	354.2	414.7	16.20	17.08
Turkey	12.3	89.1	264.6	232.8	278.0	174.8	107.7	472.4	276.9	865.6	548.7	1,053.1	-36.61	91.92

Belgium	295.1	230.4	260.9	318.9	308.8	191.0	249.6	313.3	265.8	244.6	247.2	199.7	1.06	-19.21

Cont ……………………

Continued Major Export Trade Partners of Nepal

Denmark	24.5	26.6	128.5	88.0	81.4	94.1	110.8	215.2	175.9	192.8	199.8	206.6	3.63	3.40
Netherlands	182.7	239.5	286.1	241.6	228.9	246.4	288.2	249.2	258.1	300.9	411.4	368.9	36.72	-10.33
U.A.E	126.9	57.6	81.2	153.9	164.7	147.2	176.4	575.7	255.0	326.3	440.7	297.2	35.06	-32.56
Spain	154.3	200.1	206.0	223.0	282.6	382.5	357.6	214.1	181.0	279.5	273.5	232.2	-2.15	-15.10
Malaysia	4.0	8.3	8.3	12.4	35.5	47.7	78.8	81.3	110.3	76.4	113.5	135.2	48.56	19.12
Austria	122.3	60.1	89.3	101.8	100.0	162.1	88.0	78.3	100.9	163.0	176.0	183.9	7.97	4.48
Pakistan	61.5	73.9	277.8	229.3	186.2	126.9	80.6	86.0	78.9	142.3	225.9	139.8	58.75	-38.11
Taiwan	44.3	46.1	50.9	66.8	70.3	56.9	70.4	55.07	71.1	80.9	73.7	98.7	-8.89	33.92
Sub Total	46,862.1	49,143.6	42,941.8	57,431.9	58,828.4	57805.3	57,240.0	66,113.8	59,366.1	62,872.3	71,891.8	74,456.9	14.34	3.56
Other Countries	524.6	867.5	1,007.6	1,001.9	948.4	1,121.7	1,234.4	2,483.0	1,583.5	1,690.1	2,197.2	2,893.8	30.00	31.70
Grand Total	**47,386.7**	**50,011.1**	**53,949.4**	**58,443.8**	**59,776.8**	**58,927.0**	**58,474.3**	**68,596.8**	**60,949.6**	**64,562.4**	**74,089.0**	**77,350.7**	**14.75**	**4.40**

1. Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-July 2013, Economic Survey 2012/13.

A glimpse of Nepal's total exports from 2001/02 to 2012/13 reveals a mixed picture. Exports have been steadily growing except for 2012/13 when exports increase by only 4.40 percent in comparison to the previous year. In terms of country-wise diversification of exports, it is only in the case of India where exports have been consistently growing, except for in 2012/13 when exports increase by 1.67 percent in comparison to the previous year excluding India, exports to other countries (on an individual country basis) have shown a fluctuating trend. The rise in exports to India in the previous years could be ascribed to the long open border, the preferential trade treaty and special payments regime between the two countries and slowdown in exports to other key destinations, among others.

As a whole, Nepalese export trade situation suggests that Nepal government must immediately take certain concrete steps and strategies, policy and instability political condition to expand its export trade improve the country's foreign trade situation in the years to come. The delay in decision making in this regard may well prove to be quite costly to the nation.

5.7 Analysis of Export Diversification

A number of studies have analyzed Nepal's comparative advantage horizons based on various indicators. In the first place, Karmacharya (2000) estimated the revealed comparative advantage (RCA) indices for various products based on aggregated SITC 6 digit levels. The top products arranged in ascending order of their RCA values were: hand-knotted woolen carpets, large cardamom, lentils, bran of rice, men's or boy's cotton shirts (knitted or crocheted), niger seeds, women's or girls' blouses, cotton and men's or boys' cotton shirts (not knitted).

The Nepal Trade and Competitiveness Study pinpointed the following as the "areas of opportunity": (a) lentils; (b) spices (cardamom and ginger; (c) leather and leather products (hides, skins, blue chromes); (d) hand-knotted wool carpets; (e) polyester yarns; (f) garments and pashmina; (g) niger seeds; (h) stone-carved Buddhas; (i) specialty teas; and (j) fragrant grasses and oils (Ministry of Industry, Commerce and Supplies, 2004).

Another report prepared by UNIDO (2002) accorded more priority to industry rather than export advantages, although the two are interlinked. According to this report, Nepal has revealed comparative advantage in the following areas: (a) lentils, spices, seeds; (b) leather and leather products; (c) fibers, yarn and textiles; (d) apparel and clothing; (e) cardamom and ginger; (f) niger seeds, (g) hides, skins and wet blue chromes, (h) carpets; and (i) pashmina. Adams (2005) examined export screens that demonstrated, in different time periods, which of Nepal's exports were talking an upward trend and which were faltering. The export screens identified seven high productivity export categories based on export promotion industries: (a) garments and textiles; (b) carpets; (c) wood and paper products; (d) value-added agriculture; (e) handicrafts and leather products; (f) technology-based products and service exports; and (g) other emerging exports.

Another research suggested five sectors for export diversification based on the criteria of RCA (SAWTEE, 2007). These include tea, herbs, leather, tourism and information and communication technology (ICT). A study undertaken by the IMF concluded that Nepal's comparative advantage rested on labor and resource intensive industries such as hydropower, tourism, carpets, some yarns and textiles, paper products, and agro-processing (vegetables, spices and herbs, tea, honey, flower and leather products) (IMF, 2006). Opportunities also existed in educational and health services, information technology, and financial services such as those being outsourced to India.

Finally, a recent study assessed the potential for future export growth of nineteen goods and services sectors were identified based on an initial assessment of export performance and some extensive discussion with Nepalese business community and government official, including from the MoCS (ITC/TEPC, 2010). TEPC has to divided in major potential exportable 19 goods in three categories; Agro product, Craft and Industrial goods, and Services sector. Among the 19 sectors considered, the export potential was highest for tea, medical herbs/essential oils, wool products, tourism, and labor services, followed by cardamom, ginger, honey, lentils, silver jewelry, iron and steel products, pasmina products, IT and BPO services, and hydro-electricity. Instant noodles, health services, education services, and engineering services possessed the lowest export potential. Here, this research paper study based on the only 7 agriculture products. These are all depicted in Table 5.8.

Table: 5.8

Export of Major Potentials Agriculture Goods(Classified by TEPC)

(In millions Rupees)

Products	Years					Percentage Changes	
	2008/09	2009/10	2010/11	2011/12	2012/13	2011/12	2012/13
Cardamom	1,343, 571	1,171,597	2,043,716	3,496,733	3,849,995	71.1	10.1
Lentils	5,660,786	3,744,922	3,349,101	2,677,970	2,677,319	-20.0	0.0
Tea	1,240,864	1,195,318	1,549,891	1,573,651	2,043,220	1.5	29.8
Medical herbs/essential oils	758,307	477,398	792,625	882,222	1,359,984	11.30	54.15
Ginger	403,468	456,014	281,949	507,590	1,332,453	80.0	162.5
Noodles	835,314	675,005	702,567	603,021	601,396	-14.2	-0.3
Natural Honey	N.A.	230	7,667	1,898	21	-75.2	-98.9

Sources: Nepal Foreign Trade Statistics 2012/13, Trade and Export Promotion Center.

N.A. = Not available

Table 5.8 shows changes that have occurred in the basket of agricultural export goods. Ginger, which in 2011/12 still represented 80.0 percent increase in the world, and then it continuously increased 162.5 percent in 2012/13. Similarly, the export of tea and medical herbs/essential oils are increase in at 29.8 and 54.15 percent in 2012/13 respectively and 10.1 percent increase export of cardamom with decreasing trend. But the export of noodles and natural honey products are decrease by 0.3 and 98.9 percent respectively. These items have survived or even prospered in that sector in view of sharp changes in market access conditions.

Nepalese foreign trade is affected by so many factors. Expansion of Nepalese export trade volume can definitely encouraged GDP. An attempt is made in this section to analyze the main determinations of export diversification of Nepal. In Nepal's case, various studies have identified the export potential/competitive products based on the high RCA and other indicators as discussed at length in the above in this section. Now, This paper has computed the RCA indices for some major exports of top exporting items in Nepal for 2012 using the data from the Trade Map. The results are depicted in Table 5.9.

Table: 5.9

RCA Index of Major Export of Argo Products in 2012

(In thousand dollar)

S.N.	HS-code	Products	Nepal's Export	World's Export	RCA
1	090830	Cardamom	43591.428	785329	12.06
2	071340	Lentils	30313.847	630591	10.45
3	0902	Tea	23134.284	793208	6.34
4	121190	Medical herbs/Essential oils	15398.369	431980	5.72
5	091010	Ginger	15086.650	573026	15.43
6	1902	Noodles	6809.284	35902	3.77
7	0409	Natural Honey*	0.238	137	7.75

Source: Trade and Promotion Centre of Nepal, International Trade Statistics books and www.trademap.org,

* based on data of 2010

Table 5.9 exhibits that HS 091010 (Ginger) possesses the highest RCA index. Similarly, other major exports with greater than unity RCA values imply that Nepal has comparative advantage in these commodities. This is in confirmation with earlier studies. Although the results suggest that Nepal has comparative advantage in a number of products, the actual data shows a real decline in the exports of these commodities over the years. It should be emphasized that these indices are only relative measures and that the measurement of these concepts need to be treated with caution. Their limitations, that they only serve as *ex-post* measures and are static in nature, should be understood. Moreover, diversification is a dynamic concept and the values of RCA may change over time.

5.8 Constraints of Export diversification

There are certain constraints that have inhibited the country from promoting export diversification. Some of them are presented below.

1. The gains from trade and global integration of a country are based basically on the competitiveness of the country's economy, that is, how efficiently it can produce goods and services. While Nepal's lower wage costs are an important competitive advantage, this is offset by the country's lower labor productivity.
2. Limitations in infrastructure impede both the production and the distribution of goods and services. Weaknesses in the basic national infrastructure

(transport, utilities, and telecommunications) are major constraints on investment and operations.

3. Nepal faces high transport costs. Lack of investment and inadequate maintenance of facilities, as well as poor administration, characterize the transport system in Nepal. Transit times at Indian ports are also long. High costs and the unreliability of electricity provision are also endemic. Again, administrative procedures are typically very complex and cumbersome, providing opportunities for rent-seeking but discouraging investment.
4. Developing productive capacities is the key to export diversification and sustained economic growth. However, building productive capacities poses enormous challenges to Nepal, primarily owing to lack of adequate development finance, low savings, and investment rates, low levels of technological development, insufficient managerial skills and lack of skilled work force, the confluence of which undermines their international competitiveness.
5. With a narrow range of goods and destinations to export, Nepal encounters a serious threat of vulnerability in the international market. For instance, the abolishment of textiles quota after the WTO's Agreement on Textiles and Clothing (ATC) expired in December 2004 has not only negatively impacted the garment exports but also the people employed in this sector.
6. Acquiring new technology is important to make export qualitative and competitive. Technology transfer mechanisms are weak among the Nepalese exporting firms. Insufficient access to the latest technology in the export promotion activities, costs involved in access to licensing agreements and lack of in-house training program are the broad reasons for weaker technology.
7. Although the three-year customs modernization plan effected some improvements in the adoption of transactions values and computerization of some functions, problems remain. These include poor infrastructure and facilities, complicated procedures and excessive documentation that are poorly harmonized with neighboring economies, and weak governance and human resource management. The capacity of the Customs Department is still weak and informal payments are still widespread.

5.9 Problems of Nepalese Export Trade

Nepal is a landlocked nation, surrounded by India on three sides and by Tibet in the north. Historically, international trade before the 1950s was with these countries. Exports have consisted of primary agricultural produce, while everything not produced locally has been imported. Throughout the years of development, these imports have included industrial inputs, fertilizers, and petroleum. Since the 1970s, the balance of trade has been increasingly negative. During the same period, however, exports of garments and carpets have grown; reaching sales close to US $300 million, and trade with other countries has increased to the detriment of the trade with India.

Nepal's basic trade problems arise from a huge commodity concentration and a high geographic centralization in its export trade, coupled with an increasing trade deficit. Nepal is excessively dependent on India as the only market for its entire foreign trade, placing it in a unique and problematic situation. Nepal is forced to this 1 market because of its claustrophobic topography and also because India is a transit country providing Nepal with an access to the sea. Because of developmental efforts, however, Nepal's total imports are likely to grow whereas its major exports are subject to uncertainties. Transfer of unrequited capital has met deficits in the trade; this situation is likely to get worse without substantial improvement in Nepal's exports. In addition, since the 1950's Nepal has had several trade treaties with India to accommodate her disadvantaged position in trade. The latest threat in 1971 imposed a condition that Nepal's exports to India should contain at least 90% Nepalese materials. This was aimed at generating greater income, output, and employment opportunities for Nepalese while maintaining a balanced trade exchange. Indo-trade relations have been marked by free trade between countries; however, the proportion of Nepal's trade with the rest of the world is very small.

Geographic constrain is no doubt the major constraint for the development of trade in Nepal. But still several reasons exist behind it. The domestic environment, regulations and infrastructural bottlenecks, fluctuating exchange rate, political instability all act on it. Agricultural, technological, and economical backwardness, all are hampering the trade in Nepal. The productions are found to be of low quality and have no demand in the international market. Agriculture is the mainstay of the national economy which contributes to around 40 % of GDP. But development of agriculture is very miserable. Whatever produced are of low quality and without market.

Further, economic reforms such as globalization and liberalization have been initiated worldwide. That’s why international trade has become more challenging and competitive. In this situation due to the technological backwardness, the country is not able to compete in the global market. That is why Nepal’s enter in to WTO could not have become too much fruitful. As foresaid geographic landlockness is the major problem of Nepalese foreign trade. Then other problems are agricultural dominance, technological and industrial backwardness, agricultural dominance, low productivity, and high costs etc. Similarly, small size market, lack of market strategy, lack of concrete and long term trade policies, limited export base, limited manpower are the major constrain of the Nepalese foreign trade.

CHAPTER-V

Volume, Composition and Direction of Nepalese Export Trade

5.1 Volume of Export Trade of Nepal

Nepal's exports are heavily concentrated in a few markets and products. This has made the country vulnerable to external shocks arising from shifting demand and policy in destination markets. For example, in FY 2012/13, 66.30 percent of Nepal's exports went to India. The figure would be even more staggering if informal trade across the porous Nepal-India border were documented. Besides India, the US and Germany are two other major export destinations, occupying more than two-thirds of total overseas exports. Similarly, According to *Overseas Trade Statistics* of Trade Promotion Centre, overseas exports (other than India) are heavily concentrated in a few products: RMG (30 percent), carpets (29 percent) and pashmina (8 percent) constituted two-thirds of Nepal's overseas exports in FY 2005/06. A few commodities, namely vegetable ghee, jute goods, pulses, zinc sheets, textiles and threads, dominate exports to India.

The phasing out of T&C quotas under ATC has created various challenges for Nepal, ranging from trade and macroeconomic imbalances to unemployment. In the post-ATC period, competitive countries such as China and India have gained whereas Nepal has witnessed a sharp decline in its exports. Such outcomes demonstrate that countries such as Nepal, which rely heavily on a few exports and a few markets, suffer the most. In order to mitigate such risks, it is desirable for Nepal to devise negotiation strategies to regain its market share in international T&C markets. At the same time, it is equally important to identify the products and the markets with export potential in other sectors so that it could achieve high and sustained economic growth, and reduce its economic vulnerability. In the case of Nepal, tea, herbs, leather, tourism and ICT are considered to have a significant potential for export diversification. This chapter presents an analysis of the constraints on the expansion of these sectors and the strategies that the country needs to devise and implement for effective export diversification.

5.2 Total Volume of Export Trade with India

In this section the total volume of export trade with India during the period of 2001/02 to 2012/13 is studied. The total volume of export trade with India are tabulated in the Table 5.1. In this study period, there is fluctuated condition has been seen in the total volume of export trade with India. During the 12 years study period, there was 63.78 percents increments on total volume of export trade in the world, where as 84.42 percentages increments on total volume of export trade with India. The share of export to total trade with India seems decreasing trends from the starting of the study period in 2001/02 to 2003/04 till. But after FY 2003/04, the trends of Nepalese export trade with India seems fluctuating condition from in FY 2004/05 to 2012/13. In FY 2004/05, the India's share of export on total export trade jumped approached to 66.28 percent share on total export. Then, fluctuated conditions have seen on succeeding period till the final year. It is presented below in table 5.1.

Table: 5.1

Export Trade of Nepal with India (2001/02-2012/13)

(In million rupees)

Fiscal Year	Total Export	Total Trade	Total Export in India	% Share in Total Export in Total Trade	% Share in Total Export in India
2001/02	46,944.8	154,333.8	27,956.2	30.41	59.54
2002/03	49,930.6	174,282.7	26,430.0	28.64	52.93
2003/04	53,910.7	190,187.8	30,777.1	28.34	57.07
2004/05	58,705.1	208,178.7	38,916.9	28.19	66.28
2005/06	60,234.1	234,014.4	40,714.7	25.73	67.59
2006/07	59,383.1	254,077.7	41,728.8	23.37	70.25
2007/08	59,266.5	281,204.2	38,555.7	21.07	65.05
2008/09	67,697.5	352,167.1	41,005.9	19.22	60.57
2009/10	60,824.0	435,159.2	39,993.7	13.97	65.75
2010/11	64,338.5	460,514.0	43,360.4	13.97	67.39
2011/12	74,261.0	535,928.7	49,616.3	13.85	66.81
2012/13	76,917.1	633,657.4	50,999.8	12.14	66.30

Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-July 2013, Economic Survey 2012/13.

5.3 Total Volume of Export Trade with Overseas Countries

After 1971, Nepal diversified its trade with Many overseas countries like Japan, Germany, Singapore, Honkong, Saudi Arabia, United Kingdom, Italy, USSR, U.S.A., South Korea, New Zealand, France, China, 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. The export trade with overseas countries during the period FY 2001/02 to FY 2012/13 is show the below table 5.2. There was 36.48 percentage increased in total value of export which was 18,988.6 million rupees in FY 2001/02 increased to 25,917.3 million rupees in FY 2012/13. The percentage share of other countries export to total export to accounted highest 47.07% in FY 2002/03 and the lowest contribution is recorded 29.75% in 2006/07. Which has been occurring very much fluctuate tendencies. From FY 2001/02 till FY 2012/13, the percentage share of export continuously decreased from 40.46 % down to 33.69 %. This indicated that the Nepalese Export diversification policies are not in favor of overseas countries. It is presented below in table 5.2.

Table: 5.2

Export Trade of Nepal with Overseas Countries (2001/02-2012/13)

(In million rupees)

Fiscal Year	Total Export	Total Trade	Total Export in Others Countries	% Share in Total Export in Total Trade	% Share in Total Export in Others Countries
2001/02	46,944.8	154,333.8	18,988.6	30.41	40.46
2002/03	49,930.6	174,282.7	23,500.6	28.64	47.07
2003/04	53,910.7	190,187.8	23,133.6	28.34	42.93
2004/05	58,705.1	208,178.7	19,788.8	28.19	33.72
2005/06	60,234.1	234,014.4	19,519.4	25.73	32.41
2006/07	59,383.1	254,077.7	17,654.3	23.37	29.75
2007/08	59,266.5	281,204.2	20,710.8	21.07	34.95
2008/09	67,697.5	352,167.1	26,691.6	19.22	39.43
2009/10	60,824.0	435,159.2	20,830.3	13.97	34.25
2010/11	64,338.5	460,514.0	20,978.1	13.97	32.60
2011/12	74,261.0	535,928.7	24,644.7	13.85	33.18
2012/13	76,917.1	633,657.4	25,917.3	12.13	33.69

Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-July 2013, Economic Survey 2012/13.

2. 5.4 Composition of Nepalese Export Trade

3. Economic development of Nepal is also somehow struggling to achieve the development path. Nepalese export items are primarily dominated by agriculture product which has low value by nature and less competitiveness in the world market.

4. Nepal has been adopting a single digit classification of goods for its records of trade flow. 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.

5. According to S.R. Poudyal's SITC classification, the following Table 5.3 and 5.4 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.

6. **Major SITC Commodity Groups**

7. 0 = Food and Live Animal
1 = Tobacco and Beverages
2 = Crude Materials, inedible 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.

8. Table 5.3 shows that during the study period FY 2001/02-2012/13, manufactured goods (SITC 3, 5, 6, 8, 9) i.e. 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 73 % 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. In FY 2003/04 the share of manufacture products covered highest more than 79.51% share on export.

9.

10.
11.
12.
13. Table: 5.3
Composition of Nepal's Export Classified by Major SITC Manufacture Goods Groups

(In million rupees)

FY	Export SITC Manufacture Goods Group						
	3	5	6	8	9	Total	% share in total export
14. 2001/ 02	1.6	3,308. 3	17,394. 9	15. 12,58 9.3	16. 0. 0	33,294. 1	70.92
17. 2002/ 03	5.5	3,279. 0	17,794. 7	18. 17,28 1.5	19. 43 .3	38404. 0	76.91
20. 2003/ 04	14. 5	3,865. 9	23,601. 7	21. 15,38 0.1	22. 6. 9	42869. 1	79.51

23. 2004/05	4.2	3,677.6	28,590.6	24. 13,239.6	25. 9.1	45521.1	77.54
26. 2005/06	3.2	3,686.9	28,533.0	27. 14,081.6	28. 2.5	46307.2	76.87
29. 2006/07	0.0	4,091.6	30,412.2	10,736.5	0.0	45240.3	76.18
30. 2007/08	0.0	2,823.5	29,643.3	9,281.7	3.2	41751.7	70.44
31. 2008/09	41.7	3,087.3	28,241.6	13,859.7	6.4	45201.2	66.76
32. 2009/10	0.0	1,676.9	33,395.2	9,116.5	0.0	44188.6	72.64
33. 2010/11	0.0	2,679.5	33,496.5	19,911.1	5.9	47092.3	73.19
34. 2011/12	0.0	2737..3	39,008.9	13,284.0	2.5	55032.7	74.10
35. 2012/13	7.9	3852.2	39857.6	10938.2	3.5	54659.4	71.06
36. Average							73.84

37. *Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-July 2013, Economic Survey 2012/13.*

38. On the primary goods side, table 5.4 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 2) 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. 13,285.8 million (29.08 percent) in FY 2001/02 and it reached to Rs. 21,738.5 million (28.26 percent) in FY 2012/13.

Table: 5.4

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

(In million rupees)

FY	Export SITC primary Commodity Group					
	O	1	2	4	Total	% share on total export
39. 2001/02	40. 5,094.2	41. 145.7	42. 624.5	43. 7,421.4	13,285.8	29.08
44. 2002/03	6,100.9	138.7	800.1	45. 4,278.7	11,318.4	23.09
46. 2003/04	6,276.9	55.2	714.3	47. 3,375.7	10,422.1	20.49
48. 2004/05	6,993.5	31.6	881.6	49. 5,070.3	12,977.0	22.46
50. 2005/06	51. 7,192.0	52. 25.0	53. 1,223.4	54. 4,284.6	12,725.0	23.13
55. 2006/07	56. 7,055.8	57. 23.2	58. 1,368.0	59. 4,454.9	12,901.9	23.82
60. 2007/08	61. 13,164.9	62. 24.3	63. 1,350.7	64. 2,062.0	16,601.9	29.56
65. 2008/09	66. 19,145.3	67. 345.2	68. 1,973.1	69. 362.9	21,826.5	33.24
70. 2009/10	71. 13,155.2	72. 18.4	73. 2,469.6	74. 267.2	15,910.4	27.36
75. 2010/11	76. 14,531.8	77. 1.7	78. 1,923.3	79. 409.0	16,865.8	26.81
80. 2011/12	81. 15,930.3	82. 101.8	83. 2,587.0	84. 331.7	18,950.8	25.90
85. 2012/13	86. 18,089.1	87. 214.3	88. 3,278.7	89. 156.4	21,738.5	28.26
90. Average	91.	92.	93.	94.		18.2

95. Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-July 2013, Economic Survey 2012/13.

96. 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.

5.4.1 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 FY 1997/98. However, Appendix 1 shows that since FY 2001/02-2012/13, Nepal's exportable products to India include were cardamom, catechue, cattle feed, copper wire rode, ghee(vegetable), ghee(clarified), ginger, herbs, juice, jute goods, medicine(ayurbedic), noodles, oil cakes, paper, particle board, pasmina, plastic utensils, polyester yarn, pulses, readymade garment, rice bran oil, rosin, shoes and sandals, tooth paste, wire, Zink sheet, textiles, thread, skin, soap, stone and sand, aluminum section, G.I. pipe, M.S. pipe, chemicals and carpets. Ghee(Vegetable) occupied highest share in FY 2001/02 with the volume of 7081.4 million rupees. Then the declination happened on succeeding years which is accounted only 28.0 million rupees in FY 2012/13 (Economic Survey, 2012/13).

The Appendix 1 shows the export of major - commodities with India. On an average, the following 35- items covered around more than two third of total export with India during last 12 years. This approached about 50.22 % share of total export with the world on FY 2001/02. Export of Cardamom, Catechue, G.I. pipe, Ginger, Juice, Jute Goods, Polyester Yarn, Rosin, Skin, Thread, Wire, Textiles, Thread and Zink Sheet are an increasing trend and export of Zink sheet is top most position starting with 13.3 million rupees approached to 4,948.4 million rupees on FY 2012/13. Volume of Rosin, Skin, Ginger are also taking triple jump and G.I. pipe double increasing than the previous year FY 2011/12.

5.4.2 Export of Major Commodities to Overseas Countries

There are not more commodities on export to overseas countries. However, carpets, hides & skins, pasmina, ready-made garments, Tanned Skin, Pulses products are leading commodities export to overseas. Appendix 2 shows that the export of major these six commodities are covering more than 80 % on an average during 12 year. Form the Appendix 2, the other commodities like Handicraft (Metal and wooden), Herbs, Nepalese Paper and Paper Products, Nigerseed, Readymade Leathers Goods, Silverware and Jewelleries, Tea etc. and other have less than 20% share on export to overseas. When pasmina products introduced in FY 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 FY 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.

Nepal's exportable products to India include zinc sheet, threat, polyester yarn, jute goods, vegetable ghee and textiles, among others (In the Appendix 1). Manufactured exports are concentrated in garments, carpets, and *pashmina* that have constituted the bulk of exports to other countries (In the Appendix 2). The other major commodities exported overseas include pulses, Nepalese paper & paper products and silverware & jewelleries.

97. 5.5 Export Trade Contribution to GDP

98. 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 5.5 shows that the share of export to GDP ratio on an average during the 12 year study period at around 7 percent.

99.

100. Table 5.5 shows that Export to GDP ratio is fluctuating ups and down with minimum about 4.52 to maximum about 10.14 percent. Export - GDP ratio with India on an average is 4.69 %, which was lowest share on 2008/09 -2012/13. However, after onwards till 2008/09, the share of export to India unfavorable and remained around 3 %. On the other side export to GDP with overseas countries seems

more, which is on an average during the study period, is observed 2.74%. It occupies near to equal the share of export- GDP with India. However, in the during the period of study, there was high share of Export - GDP with India than the overseas countries.

Table: 5.5

Share of Export on Gross Domestic Product (GDP)

(In million rupees)

FY	GDP	Export	Export/GDP	E_i/GDP	E_0/GDP
101. 2001/02	549447	46,944.8	8.54	5.08	3.46
102. 2002/03	492235	49,930.6	10.14	5.37	4.77
103. 2003/04	536751	53,910.7	10.04	5.73	4.30
104. 2004/05	589412	58,705.1	9.96	6.60	3.36
105. 2005/06	654084	60,234.1	9.12	6.22	2.98
106. 2006/07	727827	59,383.1	8.15	5.73	2.42
107. 2007/08	815658	59,266.5	7.27	4.73	2.54
108. 2008/09	988272	67,697.5	6.85	4.15	2.70
109. 2009/10	1192774	60,824.0	5.09	3.35	1.75
110. 2010/11	1374953	64,338.5	4.68	3.15	1.53
111. 2011/12	1536000	74,261.0	4.83	3.23	1.60
112. 2012/13	1701194	76,917.1	4.52	2.99	1.52
Average			7.43	4.69	2.74

113. Source: Nepal Rastra Bank, Quarterly Economic Bulletin, Mid-July 2013 and Economy Survey 2012/13.

Note: E_i /GDP and E_o /GDP are the calculated value from table 5.1 and 5.2 respectively.

114. 5.6 Direction of Export Trade of Nepalese Foreign Trade

115. A study of direction of export trade is important because it indicates a country's international relation, facilities for trade and linking of nation. In the context of Nepal a study of direction of export trade is important to show whether trade is diversify or limited to a few regions or countries. The direction of export trade shows the share of exports destination-wise of exportable commodities. A change in the direction with the strategy of trade diversification helps to narrow down the trade deficit and build a sound footing for the economic development of a country. Region wise exports indicate that Nepal's trade is confined to limited markets such as, north and Central America and Western Europe while exports are limited to SAARC countries and other regions. However, analysis of Nepal's trade with different countries and regions is made less than two destinations, India and overseas countries. The direction of export trade is presented in table 5.6.

116.

117. Table: 5.6

118. Nepal Export Trade Direction (2001/02-2012/13)

119. **(In millions rupees)**

120. Fiscal	121. Export	122. Percentage	123. Export to Overseas	124. Percentage Export to	125. Tot

Year		to India		Export to India		Countries		Overseas Countries		Export	
126.	2001/02	127.	27,956.2	128.	59.55	129.	18,988.6	130.	40.45	131.	46,94
132.	2002/03	133.	26,430.0	134.	52.93	135.	23,500.6	136.	47.03	137.	49,93
138.	2003/04	139.	30,777.1	140.	57.08	141.	23,133.6	142.	42.92	143.	53,91
144.	2004/05	145.	38,916.9	146.	66.29	147.	19,788.8	148.	33.71	149.	58,70
150.	2005/06	151.	40,714.7	152.	67.59	153.	19,519.4	154.	32.41	155.	60,23
156.	2006/07	157.	41,728.8	158.	70.27	159.	17,654.3	160.	29.73	161.	59,38
162.	2007/08	163.	38,555.7	164.	65.05	165.	20,710.8	166.	34.95	167.	59,26
168.	2008/09	169.	41,005.9	170.	60.57	171.	26,691.6	172.	39.42	173.	67,69
174.	2009/10	175.	39,993.7	176.	65.75	177.	20,830.3	178.	34.25	179.	60,82
180.	2010/11	181.	43,360.4	182.	67.39	183.	20,978.1	184.	32.61	185.	64,33
186.	2011/12	187.	49,616.3	188.	66.81	189.	24,644.7	190.	33.19	191.	74,26
192.	2012/13	193.	50,999.8	194.	66.30	195.	25,917.3	196.	33.70	197.	76,91

198. *Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-April 2013, Economic Survey 2012/13.*

199. The coverage of study period FY 2001/02 to 2012/13. The export is increased from 46,944.8 million of Rs. in FY 2001/02 to 76,917.1 millions of Rs. in FY 2012/13. In the early years, Nepal's foreign trade was concentrated with India. So the main targets of many fiscal policies were to diversify the Nepalese export from both commodities as well as destination point of view. Nepal follow the almost same economic policy and program that were follow by giant neighboring economy India. At very first Nepal did not have strategic trade policy after Second World War. But In FY 1956/57, the rupee value of Nepal's exports was 95.47 million rupees. This value is amounted to Rs. 46,944.8 Million rupees in FY 2001/02, i.e. within a period of nearly half century its total export increased by about 491 fold. More that 80 percent of total export trade was limited to India only. But in the 80s and 90s the scenario has been drastically changed. Diversion of Nepalese trade from India to other countries has taken place. In the early 90s the share of export to India was within the range of 10 to 20 percent but recently it has increased. The share of export to India was 59.55 percent in FY 2001/02. After that, the share of India showed an increasing trend till FY 2006/07 that reached 70.27 percent but reduced the share of India was 65.05 percent in FY 2007/08 than preceding year. Then, fluctuated conditions have seen on succeeding period till the final year. It is presented above in table 5.6.

On the other hand, export to other overseas countries showed a fluctuation trend. It was 40.45 percent of export to other countries in FY 2001/02 and 47.03 percent in FY 2002/03 that is highest percent during the study period. Then, it started to reduce the export trend recording the minimum share of 29.73 percent in FY 2006/07. Except the starting period then the trend of export with other countries showed a fluctuation trend till an end of the period. Export of Nepal is exceeded with India more than overseas countries due to being a neighbor country with many boarders of trade centre and closed down the factories and industries which supplied the goods to the overseas countries due to domestic environment, regulations and infrastructural bottlenecks, fluctuating exchange rate and political instability.

5.6 Major Export Trade Partners of Nepal

The leading export partners of Nepal have been India, USA, Germany, People's Republic of China, United Kingdom, France, Italy, Canada, Japan and Bangladesh. This is illustrated in Table 5.7 which depicts that India, the US and Germany constituted about three-fourths of Nepal’s total exports in 2012/13.

CHAPTER- VI

SUMMARY, CONCLUSION and RECOMMENDATIOS

6.1 Summary

The Study of Nepalese export trade trend and structure has shown that our trade is still missing its right track till now. The Study provides a clear view regarding the history, policy review, and review of reform programs, export trade with India and other countries, export trade composition and diversification of Nepalese export trade. The following information summarizes the picture of Nepalese export situation and export diversification of Nepalese government in brief.

Despite economic liberalization and growth of trade in the 1990s, the competitiveness of Nepal's economy is rather low and labor productivity is one of the lowest among its neighboring and competitor countries. There are three factors that are largely responsible for the low price competitiveness and productivity in the economy: a) insufficient mechanisms and incentives for firms to procure new and modern technology, b) poor infrastructure, and c) an unfriendly investment climate. Weak infrastructure, transport and transactions delays, and an unpredictable regulatory framework further weaken price competitiveness. Again, the physical handicap (landlockedness) and the high transit transport cost associated with it have further compounded the ability of Nepal to produce and trade on the regional and international markets, thus undermining its international competitiveness.

While export diversification broadens the scope for employment creation and poverty reduction, it also increases a country's economic resilience to external shocks, subsequently making income more stable and predictable. It can also promote technological advance and efficiency, and boost labor productivity and incomes. Moreover, successful export diversification is both indicative of and conducive to technological upgrading and knowledge acquisition.

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 IME and Structural Adjustment Loan (SAL) with the World Bank, were implemented in 1987.

Government of Nepal adopted Exporters' Entitlement Scheme (EEE) in 1961, to promote and diversify export from India to the others 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 system. Enhanced Structure Adjustment Facility (ESAP) 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, and production of qualitative and competitive goods. In order to reduce to the poverty, government of Nepal 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.

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 transit of the Nepalese goods.

The Trade Policy 2009 and NTIS 2010 are important instruments which have precisely identified the requirements for the promotion of trade and prescribed the list of actions needed to be undertaken in this regard. The Government and the developments partners need to come together and jointly act in close coordination to implement all the suggestions made by these two policy documents. The Government has officially adopted NTIS as the midterm national trade strategy and has started implementing it. However, the Government does not have sufficient resources to implement all of them on its own. So, the Developments partners are expected to extend their support in a coordinated and coherent manner to fully implement the identified program. Some Developments partners have shown their interest and have started implementing some projects from NTIS.

It is still premature to assess the market access gain Nepal has been able to achieve from its accession to the WTO which took place in 2004. However, it is clear that Nepal needs to have a coherent trade negotiation strategy in order to benefit from the current round of trade negotiations. The country mainly needs to focus on issues such as agriculture, services and trade facilitation. Industrial tariff is also an issue for Nepal but the gains from a predictable and meaningful Duty-Free and Quota-Free (DFQF) market access, which cuts across the agricultural as well as industrial sector, are likely to be significant. Nepal also needs to actively participate in the negotiations on aid for trade, which can help the country in addressing its major supply-side constraints, including those relating to trade facilitation.

Benefits from the regional trade agreement such as SAFTA and BIMSTEC, FTA are likely to be limited for Nepal, unless major countries in the region take initiatives to unilaterally remove the products of export interests to the LDCs in general from their sensitive lists. In order to exploit the potential of a broader cooperation, which is the need of the hour, these countries need to actively start discussions and negotiations, as the case may be, on other areas of economic cooperation, including trade in services, energy, investment, trade facilitation and infrastructure development.

The balance of trade between Nepal and India is heavily tilted in favor of the latter, despite the non-reciprocal nature of the trade agreement. Since India will continue to remain an important trading partner for Nepal in the foreseeable future, other areas of economic cooperation such as energy, services and investment can contribute to more balanced economic relations between these two countries. It is also necessary to create an environment for formalizing informal trade. Though India has proposed to sign a Comprehensive Economic Partnership Agreement (CEPA) with Nepal, the latter has not done adequate homework, including consultation with concerned stakeholders, on this issue. Hence, there is a need to do such domestic preparations urgently with a view to safeguarding developmental interests at the time of actual negotiation.

Nepal is an agricultural country. Technological and industrial backwardness, excessive dependence on agriculture, poor economic growth, and low per capita income are the main features of Nepalese economy. Being an agricultural country, Nepal produces and exports only primary goods and raw materials. From the case study it has been found that, Nepal mainly exports cereal crops, cash crops, pulse crops, pashmina, medicinal herbs etc.

In this research Nepal's foreign trade within the latest 12 years of time period from 2001/02 to 2012/13 has been intensively studied and analyzed. India is the Nepal's major trade partner. For both export and import Nepal mainly depends on India. After India, U.S.A, Germany, U.K., France, China P.R, Canada, Italy, Japan, Switzerland, Hongkong SAR, Australia, Turkey, Belgium, Netherlands, U.A.E., Spain, Denmark, Malaysia, Austria, Taiwan, are Nepal's major trade partners. Inside SAARC, Bangladesh, Bhutan, Pakistan, are major trade partners. Analyzing twenty four trade of Nepal, Nepal's foreign trade is not found to be favorable. The export is found to be very low and import is always dominating. As a result foreign trade is always suffering the adverse trade balance for a long time. With time period trade with India has concentrated more. Terms of Nepalese foreign trade also explains the poor performance of trade.

Export trade 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 export to total trade with India seems decreasing trends from the starting of the study period in 2001/02 to 2003/04 till. But after FY 2003/04, the trends of Nepalese export trade with India seems fluctuating condition from in FY 2004/05 to 2012/13. In FY 2006/07, the India's share of export on total export trade hyper jumped approached to 66.28 percent share on total export. Treaty of Trade 1999 has indeed played a crucial role in the foreign trade structure of Nepal.

200. 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 2001/02-2012/13, 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.

The share structure of exports trade of India and overseas countries shows that there is a domination of overseas trade, in the 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. Similarly, Export is found to be very important part of the economic development. The export has contributed of about 7.43% of GDP in the average 12 years of time period.

201. The fitted RCA index shows the major agriculture goods exports with greater than unity RCA values imply that Nepal has comparative advantage in these commodities. This is in confirmation with earlier studies. Although the results suggest that Nepal has comparative advantage in a number of products, the actual data shows a real decline in the exports of these commodities over the years. It should be emphasized that these indices are only relative measures and that the measurement of these concepts need to be treated with caution.

202. Weakness of Nepalese Export 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. Owing to smuggling practices, the illegal traders are getting advantage of exports.
- Unfavourable environment for industrial development, lack of sound and effective strategically policies, policies adhocism, inconsistency of government policies , political instability and a decade more long moist

problem are hampering facts for the Nepalese export 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 favourable 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.
- 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 export commodity composition is less diversified than import commodity composition. It is also less diversified country wise or destination wise.

6.2 Conclusion

203. Nepal’s export trade has several problems. Because of these problems export trade is not able to flourish in Nepal. These problems are land-lockedness, technological backwardness, lack of effective trade policy etc. 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. If Nepal could clear up these problems, certainly Nepal would have good prospects of foreign trade. Nevertheless, especially export trade has been deteriorating rather than improving. However, Nepalese export trade has some strength too.

204. Strength of Nepalese Export 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.
- Adequate work force with low labour cost can easily available throughout 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.

6.3 Recommendations

205. 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 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. A few suggestions are provided below for incorporation in the export diversification strategy of Nepal together with some measures for boosting export competitiveness.

- Nepal needs to use WTO membership to lock in past trade reforms, improve the domestic trade policymaking process, help exporters contest foreign trade barriers, and supplement the preferential market access it enjoys in key foreign markets. These benefits will help the country better integrate itself into the world economy.
- Export growth, including diversification of markets and higher-valued products, should be a major thrust of trade policy. Trade and industrial policies need to be aimed at promoting structural reforms to improve Nepal’s efficiency and international competitiveness and reduce its vulnerability to external shocks that may arise from globalization.
- In order to expand and diversify the Nepalese foreign trade, it is inevitable to have control over smuggling practices across the borders, especially with India. It can be done besides surveillance at border regions.

- Nepal should think of benefiting by means of comparative advantage. Tea and jute farming should be encouraged in Nepal by giving financial and technical support to the farmers.
- Nepal should build road networks in every parts of the country. This helps to transport the goods from different parts of the country.
- The improvement in Nepal's trade competitiveness calls for faster, more efficient movement of goods into, out of, and throughout the country. Streamlined cargo customs procedures, including transit, are important in reducing transaction costs for traders.
- Since Nepal is primarily a rural-oriented economy, a separate Agricultural Export Diversification Program should be formulated whose aim should be to augment the country's export growth rate and reduce its volatility. The program could consist of the following: a) promotion of private sector entrepreneurship in agribusiness; b) improving agribusiness export and facilitation services; c) strengthening agricultural health and food safety services; and d) rehabilitation of drainage and irrigation systems.
- Landlockness is the major problem of Nepalese trade. But it is a natural problem. In order to facilitate the trade in Nepal, this problem must be dissolved. This could be only done by means of political and diplomatic efforts.
- India is Nepal's major trade partner. It is the nearest neighbor of Nepal too. So that sound relation and efficient trade policies and treaties should be maintained with India by means of commitment of government. Indian dominance would always undermine the Nepalese trade. Conflicting treaties should be dissolved. The government must make strong commitment for it.
- Private sector should be given reasonable facilities and incentives to play the dominant role in country's export trade. By means of public private partnership, the foreign trade could be developed.

Finally, export diversification has long been a stated policy goal for Nepal. However, no considerable shift has been witnessed in patterns of exports in recent years which implies policy failures in directing new product categories in the export markets. Product diversification efforts must go hand in hand with efforts to secure markets for new products for long-term sustainable economic development.

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Appendix 1

Export of Major Commodities to India

(In million rupees)

Commodities	Fiscal Year								
	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
A. Major Items	**23,576.2**	**20,355.6**	**25,439.7**	**31,082.5**	**30,558.7**	**33,726.0**	**32,024.3**	**29,334.8**	**28,38**
Aluminum Section	219.8	255.1	381.1	879.2	893.7	831.5	894.5	482.9	346.6
Cardamom	359.9	469.6	451.0	607.0	608.1	848.1	1034.8	1,216.0	1,316
Catechue	180.4	145.4	162.5	438.7	382.4	542.8	543.7	1,217.1	1,682
Cattlefeed	215.0	405.9	550.9	547.4	454.6	80.9	176.9	350.5	144.1
Chemicals	87.3	148.5	610.0	1,407.5	1,057.5	950.2	275.7	290.1	151.8
Copper Wire Rode	2620.5	356.6	200.8	530.1	305.8	206.0	617.4	571.8	643.6
G.I. pipe	165.9	357.2	556.3	424.0	519.3	127.8	242.7	1,098.4	567.9
Ghee (Vegetable)	7,081.4	3,812.3	2,959.0	4,635.9	3,861.7	4,136.5	2,132.3	9.1	4.6
Ghee (Clarified)	60.0	54.6	76.5	83.1	103.0	110.9	101.7	106.5	126.8
Ginger	207.9	315.4	287.1	161.0	275.2	541.3	543.2	335.1	353.9
Herbs	84.1	111.9	91.5	132.4	133.5	105.6	148.6	206.6	239.0
Juice	452.9	600.1	786.8	1,091.3	1,139.6	1,591.3	1,836.4	1,952.2	1,740

Cont……………………

Continued Export of Major Commodities to India

Commodities	Fiscal Year								
	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Jute Goods	1,630.1	1,899.0	1,882.6	2,693.5	2,636.8	2,756.8	2,582.5	1,282.5	2,896
Medicine (Ayurbedic)	583.4	743.1	289.9	205.6	301.1	156.3	132.1	163.4	138.8
M.S. Pipe	410.4	548.2	851.8	316.6	105.7	761.9	979.5	571.2	695.1
Noodles	227.0	309.7	259.7	369.3	414.7	237.4	532.9	803.2	576.4
Oil Cakes	302.6	311.1	324.1	317.1	291.6	318.1	405.0	532.7	497.5
Paper	251.5	363.6	266.3	169.7	95.5	131.6	120.2	93.1	42.8
Particle Board	243.1	243.8	283.5	335.3	227.5	206.8	157.6	145.7	103.3
Pasmina	673.3	475.6	427.7	341.5	210.7	48.3	44.0	65.9	60.7
Plastic Utensils	770.9	807.7	1,192.4	1,361.6	808.3	415.1	302.6	513.4	181.7

Polyster Yarn	1,070.4	656.9	1,114.5	1,896.3	3,476.3	2,241.0	2,618.0	1,499.8	3,397
Pulses	1,005.7	880.4	579.1	667.1	643.2	306.9	314.8	381.6	27.6
Readymade Garment	213.5	399.2	626.7	365.9	1,137.3	765.0	478.1	1,715.1	333.9
Rice bran Oil	90.6	210.0	194.7	199.0	112.6	178.3	196.5	143.3	111.9
Rosin	233.7	221.6	173.6	256.6	346.5	577.4	355.6	346.6	358.8
Shoes and Sandles	98.0	108.2	107.7	235.9	237.8	244.4	384.6	750.1	568.0

Cont……………………

Continued Export of Major Commodities to India

Commodities	Fiscal Year								
	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Skin	157.8	248.5	332.3	338.6	334.8	363.1	346.6	167.5	288.8
Soap	528.9	469.2	539.6	368.0	363.6	502.7	424.2	591.0	404.1
Stone and Sand	104.6	189.5	209.1	249.1	321.3	425.6	395.4	415.6	478.8
Textiles	562.5	878.2	1,780.5	2,996.6	2,154.6	3,056.9	2,114.8	3,193.5	3,361
Thread	846.9	1,235.2	1,637.4	2,213.7	1,898.3	4,055.9	4,134.8	2,525.4	2,771
Tooth Paste	1,606.7	1,002.8	1,478.8	1,283.0	730.8	663.4	475.6	813.2	673.2
Wire	252.2	150.9	710.9	1,221.4	1,504.1	1,610.7	1,546.7	895.0	1,200
Zink Sheet	13.3	970.6	2,785.3	1,663.2	2,409.0	3,579.9	4,416.9	2,821.7	1,794
B. Others	**4,380.0**	**6,074.4**	**5,337.4**	**7,834.4**	**10,156.0**	**8,002.8**	**6,531.4**	**11,671.1**	**11,61**
Total (A+B)	**27,956.2**	**26,430.0**	**30,777.1**	**38,916.9**	**40,714.7**	**41,728.8**	**38,555.7**	**41,005.9**	**39,99**

206. Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-April 2013, Economic Survey 2012/13, and Trade & Export Promotion Centre 2012/13, Ministry of Finance, Nepal Government.

Appendix 2

Export of Major Commodities to Overseas

(In million rupees)

Commodities	Fiscal Year

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
A. Major Items	**16,800.2**	**19,893.2**	**18,357.2**	**1,390.5**	**15,241.0**	**13,563.8**	**13,144.0**	**20,956.1**	**15,648.**
Handicraft (Metal and wooden)	233.8	352.1	626.4	37.9	430.9	250.2	194.0	1,077.8	1,082.8
Herbs	25.4	33.3	48.3	4.3	19.0	43.5	97.9	412.0	239.4
Nepalese Paper and Paper Products	200.5	262.0	279.6	15.7	257.0	190.6	347.1	361.2	553.3
Nigerseed	12.9	10.6	8.5	0.0	7.0	8.8	1.2	1.0	0.0
Pashmina	1,245.0	1,157.6	1,064.2	93.3	1,577.8	931.0	643.4	1,526.9	1,267.6
Pulses	216.0	214.9	280.7	31.7	191.7	488.5	1,458.4	6,247.1	3,952.0
Readymade Garments	7,833.0	11,890.1	9,550.0	528.2	6,204.1	5,212.9	4,755.8	4,904.7	3,890.7
Readymade Leathers Goods	56.4	33.1	30.6	3.1	14.4	111.1	22.9	58.2	59.6

Cont……………………

Countinued Export of Major Commodities to Overseas

Commodities	Fiscal Year								
	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Silverware and Jewelleries	274.1	347.7	368.7	32.1	282.4	325.4	269.4	262.4	126.6
Tanned Skin	464.7	227.3	309.0	11.0	310.4	279.1	248.7	305.4	307.0
Tea	25.9	44.5	113.7	2.4	107.6	122.5	57.0	63.9	91.2
Woolen Carpet	6,212.5	5,320.0	5,677.5	630.8	5,838.7	5,600.2	5,048.2	5,735.5	4,078.
B. Others	**2,188.4**	**3,607.4**	**4,776.4**	**18,398.3**	**4,278.4**	**4,090.5**	**7,566.8**	**5,735.5**	**5,181.**
Total(A+B)	**18,988.6**	**23,500.6**	**23,133.6**	**19,788.8**	**19,519.4**	**17,654.3**	**20,710.8**	**26,691.6**	**20,830**

207. Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-April 2013, Economic Survey 2012/13, and Trade & Export Promotion Centre 2012/13, Ministry of Finance, Nepal Government.

Appendix 3

Export to India Classified by Major SITC Primary Commodity Groups

(In million rupees)

F.Y.	Export SITC Commodity Group					
	0	1	2	3	4	5	6
208. 2001/02	209. 4,542.4	210. 141.4	211. 560.2	212. 1.2	7,211.7	3,234.2	9,971
213. 2002/03	4,672.3	106.6	682.2	214. 5.2	4,053.2	3,174.1	11,38
215. 2003/04	4,595.5	42.3	576.5	216. 14.5	3,206.4	3,624.5	16,22
217. 2004/05	5,389.3	26.5	7,36.6	218. 3.9	4,858.8	3,577.7	21,35
2005/06	6,306.7	14.3	1,163.3	0.5	4,145.7	3,564.7	21,92
219. 2006/07	220. 5,944.3	221. 12.0	222. 1,291.6	223. 0.0	4,337.2	3,977.4	23,76
224. 2007/08	225. 7,617.4	226. 10.7	227. 1,181.4	228. 0.0	2,023.6	2,696.3	22,94
229. 2008/09	230. 10,151.1	231. 329.5	232. 1,494.6	233. 40.6	319.6	2,990.8	20,97
234. 2009/10	235. 8,591.6	236. 0.0	237. 2,103.3	238. 0.0	205.5	1,648.5	25,44
239. 2010/11	240. 10,104.5	241. 0.0	242. 1,509.0	243. 0.0	310.4	2,673.7	26,39
244. 2011/12	12,002.7	25.6	1,858.0	0.0	247.2	2,725.8	29,69
245. 2012/13	12,901.7	0.0	2,030.9	0.0	134.0	3,598.9	28,85
246. Average	247.	248.	249.	250.			

251. *Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-April 2013, Economic Survey 2012/13, Ministry of Finance, Nepal Government.*

Appendix 4

Export to Other Countries Classified by Major SITC Primary Commodity Groups

(In million rupees)

F.Y.	Export SITC Commodity Group						
	0	1	2	3	4	5	6

252. 2001/02	253. 551.8	254. 4.3	255. 64.3	256. 0.4	257. 209.7	74.1	7,423.9
258. 2002/03	1,428.6	32.1	117.9	0.3	259. 225.5	104.9	6,407.0
260. 2003/04	1,681.4	12.9	137.8	0.0	261. 169.3	241.4	7,372.8
262. 2004/05	1,604.2	5.1	145.0	0.3	263. 211.5	99.9	7,237.5
264. 2005/06	265. 885.3	266. 10.7	267. 60.1	268. 2.7	269. 138.9	122.2	6,604.7
270. 2006/07	271. 1,111.5	272. 11.2	273. 76.4	274. 0.0	275. 117.7	114.2	6,648.8
276. 2007/08	277. 5,547.5	278. 13.6	279. 169.3	280. 0.0	281. 38.4	127.2	6,701.1
282. 2008/09	283. 8,994.2	284. 24.7	285. 478.5	286. 1.1	287. 43.3	96.5	7,265.6
288. 2009/10	289. 4,563.6	290. 18.4	291. 366.3	292. 0.0	293. 61.7	28.4	7,949.6
294. 2010/11	295. 4,427.3	296. 1.7	297. 414.3	298. 0.0	299. 98.6	5.8	7,099.6
300. 2011/12	301. 3,927.6	302. 76.2	303. 729.0	304. 0.0	305. 84.5	11.5	9,315.5
306. 2012/13	5,187.4	214.3	1,247.8	7.9	22.4	253.3	10,999.
307. Average	308.	309.	310.	311.	312.		

313. *Source: Nepal Rastra Bank, Quarterly Economic Bulletin Mid-April 2013, Economic Survey 2012/13, and Ministry of Finance, Nepal Government.*