STRUCTURE AND DETERMINANTS OF NEPALESE TRADE WITH INDIA

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Letter of Recommendation

This is to certify that the dissertation entitled "Structure and determinants of Nepalese Trade with India" is an independent work of Miss. Ashmita Acharya, completed under my supervision for the partial fulfillment of requirement for the Degree of Masters of Arts in Economics. This study carries useful information regarding foreign trade situation of Nepal. I forward this to the dissertation committee for evaluation and acceptance.

Prof. Dr. Ram Chandra Dhakal
Thesis Supervisor
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Date: 6th September, 2017

Letter of Approval

This Dissertation entitled “Structure and Determinants of Nepalese Trade with India” prepared by Ashmita Acharya has been accepted as a partial fulfillment of the requirements for the Degree of Masters of Arts in Economics.

Dissertation Committee

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Date: 6th September, 2017

Acknowledgement

This study on “Trend and Structure of Nepalese Foreign Trade with India” has been completed in partial fulfillment of the requirement for the Degree of Masters of arts in Economics.

It is my great privilege to complete this thesis under the continuous guidance and supervision of respected Professor Dr. Ram Chandra Dhakal from Central Department of Economics, T.U. Kritipur. The report in this form because of the inspiration, invaluable guidance and supervision from Prof. Dhakal. Without his guidance, suggestion and cooperation the thesis cannot be completed in this form. His patience, enthusiasm, co-operation, suggestions and keen interest in this study are memorable.

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Ashmita Acharya

Table of Contents

List of Tables

Abbreviations and Acronyms

ADB	:	Asian Development Bank
BIMESTIC	:	Bengal Initiatives Multi-Sectorial Technical Economic Condition
BOP	:	Balance of Payment
CBS	:	Central Bureau of Statistics
CEDA	:	Central for Economic Development and Administration
CEDCON	:	Central Department of Economic
DC	:	Department of Custom
DER	:	Dual Exchange Rate System
EEE	:	Exporters' Exchange Entitlement
EPZ	:	Export Promotion Zone
ESAF	:	Enhanced Structural Adjustment Facilities
FDI	:	Foreign Direct Investment
FNCCI	:	Federation of Nepal Chamber of Commerce and Industry
FOB	:	Fee on Board
FY	:	Fiscal Year
GDP	:	Gross Domestic Product
GON	:	Government of Nepal
ICT	:	Information and Communication Technology
IMF	:	International Monetary Fund
ISI	:	Import Substitution Industrialization
LDC	:	Least Development Country
MOF	:	Ministry of Finance
NPC	:	National Planning Commission
NRB	:	Nepal Rastra Bank
NRN	:	Non Residents Nepalese
OGL	:	Open General License
PRSP	:	Property Reduction Strategy Paper

SAARC	:	South Asian Association for Regional Co-operation
SAL	:	Structural Adjustment Loan
SAP	:	Structural Adjustment Program
SITC	:	Standard International Trade Classification
TEPC	:	Trade and Export Promotion Center
TU	:	Tribhuvan University
UNCTAD	:	United Nations Commission for Trade and Development
UNDP	:	United Nations Development Programme
WPI	:	Wholesale Price Index
WTO	:	World Trade Organization

CHAPTER I

Introduction

1.1 General Background

With globalization, the world has been transforming into a "global village" and is becoming more integrated. Globalization is a process of interaction and integration among the people, companies, and government of different nations, a process driven by international trade and investment and aided by information technology (Donald J. Boudreaux, 2014). This reward has been attractive to many nations which can be seen by ever increasing membership in the World Trade Organization. In this regard, on 23rd April 2004, Nepal has become the 147th member to this organization. In the less developed country (LDC) like Nepal, foreign trade plays a vital role in attaining sustainable economic growth. In the process of development, Nepal has adopted liberalization, globalization and open market mechanism. Nepal is dependent on foreign aid, foreign direct investment and foreign trade. Among them foreign trade is considered as a major source of foreign exchange. (Bista, 2008)

Foreign trade can be considered as exchange of goods and services between different countries. The basic principle of foreign trade is that goods and services must cross through the border. From the age of barter economy, foreign trade took place. Generally, a country imports the goods that cannot be produced cheaply at home country. All countries cannot provide various kinds of goods efficiently. Each country has to depend upon others for import and export of raw materials, manufactured goods, and technology and so on. Thus foreign exchange can only be earned from foreign trade which can be spent on the import of machinery and equipment. Foreign trade helps to accelerate the pace of economic growth. Hence, the economists have rightly referred to foreign trade as "engine of growth". (Jensen, 2000)

In the present emerging concept of globalization and open liberal market economy, international trade is the backbone of national economy. Increase in foreign trade can help to increase in the living standard of people which in turn help to increase the national income. No country can achieve rapid economic growth without mobilization foreign trade. However, Nepal has to largely depend on foreign aid even today. Industrial future of Nepal is heavily dependent upon the nature, structure and trends of foreign trade. This shows foreign trade plays a vital role for any country and is even more essential for developing countries like Nepal.

Since 1950s, many efforts were carried out to diversify Nepal's foreign trade. The main thrust of the policy was towards import substituting industrialization. During this period, Nepal's foreign trade regime was in contradiction in this sense that it was more or less free with India and controlled with the rest of the world. The main objective of the policy was to protect domestic industries from import of foreign goods. Similarly, the government has taken several measures such as export subsidy, dual exchange rate system and bonus voucher system in order to expand and diversify the export of Nepal. These measures helped Nepal to diversify foreign trade to some extent. But when Nepal faced balance of payment crisis in mid 1980s, it approached to IMF and World Bank for support to wake up BOP crisis. Along with financial assistance the Structural Adjustment Program (SAP) and Structural Adjustment Loan (SAL) Programs were introduced. These carried packages of conditionality of Nepal return for the financial assistance. These institution pressurized Nepal to accelerate the economic reforms. (Bista, 2010)

After the restoration of democracy in 1990, many processes of economic reforms were accelerated. In 1992, new trade policy came into existence which made trade more or less free, replacing earlier import substituting industrialization. But after these efforts also, Nepal was not able to diversify its trade as country wise and product wise.

Over the past years, Nepal had followed a liberal and open policy in all the sectors, all the trading partners were given equal chance to compete and sell their products in Nepalese market. No country is allowed to monopolize.

An assessment of trade policy of 1992 show that Nepal has not achieved much. Nepal has performed poorly in export sectors. Only few items such as carpets, garments and Pasminas play a dominant part in overseas export, while primary and agricultural products played dominant role in export to India. The history of foreign trade between Nepal and India is as old as the existence of these two countries. For a long time, India remained as a major trading partner of Nepal in term of present volume. The reason behind this fact is Nepal's open boarder with India, existence of traditional, historical, cultural and religious ties with India. Being as the larger country in the world, India can purchase goods produced in Nepal and also sell the goods needed by it. (Subedi, 2003)

Since the historical periods, Nepal-India trade and economic relations is the product of the old age culture, geographical situation and economic ties which maintain trade relation between the two countries. Nevertheless, the mutual understanding and proper communication have never been so easy between the two countries. The relation between the two countries from the past has often been uneasy because of constraint geographical position of Nepal.

However, Nepal is very hopeful with India. Nepal's main exports to India are agro products such as jute, rice, herbs, paddy, hand knitted woolen carpet, oil seeds, tea, tobacco, firewood, timber, readymade garments, animal ghee, spices, handicrafts products and many more. The prime imports from India to Nepal are petroleum products, textiles, cements, mineral oil tea, medicinal and pharmaceutical products, packed foods, beverage including tobacco, vehicles, machinery equipment, iron, steel, gems and jewelry chemicals, engineering goods and computer software. In addition to these, a large variety of manufactured products are also annually imported to the country. A large volume of luxurious and semi-luxurious are also imported to Nepal from India but these goods are extremely unnecessary sand avoidable. (Timilsina, 1991)

As even today Nepalese foreign trade is concentrated with India, so this study mainly concentrates to analyze export and import trades structure of Nepal and its trends, problems and prospects with India.

1.2 Statement of the Problem

High imports against little exports have widening the trade deficit between India and other countries each year. Nepal is suffering from huge trade deficit from long time. It affects all the economic variables negatively. The volume of trade comparing export, import goods and services are more qualitative as quantitative. So, Nepal is unable to manage balance of trade. Nepal can export low quality and agricultural raw based items only and import expensive and sophisticated items.

Nepal has pursuing open market and liberalized economy and entering into trade agreements such as SSAPTA and SAFTA including multinational trade agreement such as SWTO. But Nepal cannot take advantage from such agreements. Most of the policies are export oriented when import is treated as a source of revenue, even though Nepal cannot expand its export. Basically Nepal export agricultural products and it is the backbone of Nepalese economy. Due to the fact that 76 percent of economically active population is still dependent on agriculture according to economic survey 2010/2011. But agriculture products are basically primary products and they have a constant demand in the market of exporting partner of Nepal. On the other hand, industrial products occupy a small portion. Foreign trade sector of Nepal has not been able to play vital role and it has not been able to fulfill the nation's expectation.

Another bitter aspect is that Nepal is facing a transit problem because of land-locked geographical position in Asia continent. Though the transit facility is indispensable for such land-locked countries like Nepal, but Nepal is not getting such facility because of defective government policy and high interference of India. However, Nepal has conducted many trade and transits with India.

By all the means, the study of Nepal-India trade is very important focusing on its trade and composition during different periods. The study of Nepalese foreign trade shows that Nepalese foreign trade is considerably increasing but import dominating tendency over export is a major cause of being backward and having permanent deficit on foreign trade. Because of huge trade deficit, Nepal is quite near to fall in debt trap.

The main concentration of the study is to find out the how to minimize the trade deficit that Nepal is facing since longer period of time? The following are the main problem of this study

What is the structure and trend of Nepalese foreign trade with India?

What are the determinants of Nepal's export to India and import from India?

What should be the trade policies and reform measures to be undertaken?

Thus this study is concerned in the periphery of these questions.

1.3 Objectives of the study

The general objective of the study is to examine the Nepal's trade with India. The specific objectives are as follows:

- To analyze the structure and trend of Nepalese foreign trade with India
- To estimate the determinants of Nepal's export to India and import from India.
- To analyze Nepalese foreign trade policies and reform measures.

1.4 Hypothesis of the study

To test the reliability of the analysis of the trend values and relationships of dependent variable with independent variables, the following hypothesis have been developed:

Hypothesis to measure Total Export to India from Nepal

1. H0: Total export to India is not significantly different with time
   H1: Total export to India is significantly different with time
2. H0: Total export to India is not significantly different with total GDP of Nepal
   H1: Total export to India is significantly different with total GDP of Nepal
3. Ho: Total export to India is not significantly different with Relative price rate
   H1: Total export to India is significantly different with Relative price rate

Hypothesis to measure Total Import from India to Nepal

1. H0: Total Import from India is not significantly different with time
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2. H0: Total Import from India is not significantly different with total GDP of Nepal
   H1: Total Import from India is significantly different with total GDP of Nepal
3. Ho: Total Import from India is not significantly different with Relative price rate
   H1: Total Import from India is significantly different with Relative price rate

1.5 Significance of study

No country can achieve rapid economic growth without mobilizing foreign trade. It plays a vital role in economic development of any country. This study provides a brief knowledge about foreign trade, trade structure of Nepal, policies related to the foreign trade and problems facing by Nepal in foreign trade.

It also provides the brief knowledge about export/ import composition and investigates their effect on Nepalese economy. So this study will be more beneficial to the foreign traders, policy makers, industrialist including general public who wants to know Nepalese foreign trade.

1.6 Limitations of the Study

All research study is done to solve a particular research problem. So the study cannot give all the information about the subject matter. This study is no exception. This study is mainly based on secondary data. No attempt has been made to collect primary data and information by carrying out survey. So the limitation of secondary data may exist. It cannot cover all the data of trades and policies of foreign trade of Nepal. The study covers the time period from 1994/95 to 2014/15 only.

1.7 Organization of study

This study is divided into seven chapters. First chapter deals with the introduction of the study. It includes the general background of the study, statement of the problem, objectives of the study, rationale of the study, limitation of the study and organization of the study. Second chapter covers the review of literature which consists of international studied and national studies. Third chapter deals with the research methodology. It includes study area, nature and sources of data, data collection procedure, data processing and data analysis. In this chapter I have prepared equations for regression analysis and used export value as dependent variable and GDP, time series and relative price with India as an Independent Variable.

Moreover, chapter four deals with trend and structure of Nepal-India foreign trade. It include historical trend, composition of Nepal-India Trade, and changing pattern of trade as well as comparative study of Indo-Nepal trade. Fifth chapter explains the major trade policies and inter regional trade. Chapter six includes the determinants of import and export. It provides the analysis of the hypothesis that were developed during this study. The final chapter contains the summary, conclusion and recommendations.

CHAPTER II

Literature review

This chapter consists of review of literature. In the part of literature review this study consist the theoretical review, international studies and national studies of relevant study.

2.1 Theoretical Review

This chapter consists of different studies conducted in the different part of the world in the relevant study. In this study, reviews present the effort of previous scholar to examine structure and trend of Nepalese foreign trade. There are many studies conducted to estimate the determinants of Nepal's export and import with the assistance of Nepal Rastra Bank. The relation between trade fluctuation and the socio-economic status and the relationship between trade deficit and fluctuation in economic activities has been examined in a number of studies.

The concept of foreign trade was started from beginning of human civilization. Economic history deals with ideas of foreign trade by different economists in different time period. The mercantilists writers emphasized on foreign trade as a means of accumulation of treasure which in turn was to increase the power of state. Foreign trade was quite flourished in this period. They advocated the principle of balance of trade which basically requires the creation of surplus of export over imports. (Lardy, 1999)

The classical economists were the supporter of laissez fair economy who believed in economic liberalization. This implies that classical economists highly believed on free trade. Adam Smith, the forerunner of classical school, developed his analysis of wealth and its growth in real terms and pointed out the benefit of the unrestricted trade. He pointed out that free trade guarantees extensive application of division of labor, which in turn increases labor productivity ultimately resulting in aggregate increase in wealth of country. (Berdell, 2002)

But after the world wide depression in 1930, a kind of intervention was felt in trade sector also. So, the world turned into protectionism. But after the end of Second World War, several factors influenced the development of world trade pattern. Firstly, countries were divided into communist and non-communist nations. But after the failure of communism in East Europe in 1990's, the world turned into economic liberalization and globalization, which upholds the free flow of goods and services from one country to other. Now, most of the countries of the world again turned into classical period. (Berdell, 2002)

Since 1950s, many efforts were carried out to diversify Nepal's foreign trade. The main thrust of the policy was towards import substituting industrialization. During this period, Nepal's foreign trade regime was in contradiction in this sense that it was more or less free with India and controlled with the rest of the world. The main objective of the policy was to protect domestic industries from import of foreign goods. Similarly, the government had taken several measures such as export subsidy, dual exchange rate system and bonus voucher system in order to expand and diversify the export of Nepal. These measures helped Nepal to diversify the foreign trade to some extent. But when Nepal faced the balance of crisis in mid 1980s, it approached to IMF and World Bank for support to wake up from BOP crisis. Along with financial assistance the Structural Adjustment Program (SAP) and Structural Adjustment Loan (SAL) programs were introduced. These carried packages of conditionality of Nepal return for the financial assistance. These institution pressurized Nepal to accelerate the economic reforms. (Dahal R. , 1992)

After the restoration of democracy in 1990, many processes of economic reforms were accelerated. In 1992, new trade policy came into existence which made trade more or less free, replacing earlier import substituting industrialization. But after these efforts also, Nepal cannot be able to diversify its trade as country wise and product wise. (Dahal R. , 1992)

2.2 Empirical Review

The empirical review consists of different empirical studies conducted in national and international level.

Timilsina (1991) in "Nepal's trade Scenario: its lapses and successes" has tried to analyze the situation of foreign trade in terms of composition, development and balance of payment with the help of secondary data. He has highlighted the tariff policy of Nepal in trade sector. He is of the view that quota and licensing are not providing worthy. The author has concluded that Nepal is facing various problems like high import payment, open border, etc. At last he suggest some alternatives like exporting national products, stocking in balance between export and import policy on the basis of what can work as engine of growth.

Rijal (1992) in his paper "Nepal's foreign trade and Economic development 1956/57 to 1979/80" compares the share of export, import and total trade with gross domestic product in the period between 1964-1978 whereas the share of export import and total trade has decreased. The analysis of import function, he tries to derive the relationship between import and GDP at current and market price. He found that because of low level of income and not improving the standard of living, imports are in increasing trends.

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

Poudal (1998) in this book "Foreign Trade, Aid and Development in Nepal" has overviewed the Nepalese economy as well as development plans up to 1982/83. He tries to analyze the behavior and determinant of macroeconomic variables such as investment, saving, export and import. Chapter four deals with the structure of foreign trade, direction of foreign trade, determinants of trade patterns, commodity and geographic concentration of exports and imports, instability in export earnings and terms of trade. Chapter five is devoted to analyze the achievements and shortcomings of export diversification schemes introduced in the 60's and 70's for the purpose of diversifying Nepal's trade in terms of goods and geographical patterns. This chapter also tries to deal with export promotion measures. Chapter six is about the determinants of exports destination. The import functions are discussed on chapter seven. In this chapter, he has reviewed Khan and Ross, Nasrtasimham, Chenery and Strout, Maizels and Agrawala, Murty and Sastry, Dutta, Marwah, Pani, Patel, Leamer and Stern and accordingly estimated linear, log linear, without lags, with lags, cyclical and secular income elastic of demand for imports, the partial adjustment scheme, the multiple lag scheme (5 lags) both at constant and current prices.

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

Sharma (2000) in his article, "Nepal's Foreign trade: Trends and Issue" attempts to assess the current trends and major issues facing the Nepalese foreign trade sector. The discussion on trade policy reforms with reference to export and trade with South Asian Association for Regional cooperation (SAARC) countries and also attempts to discuss issues relating to Nepal's entrance to the world trade organization (WTO).The author found that the trade deficit of Nepal has been increasing over the period of 1991/92- 1996/97 though export has increased at the average rate 11 percent per annum and import has increased at the average rate of 24.7 percent during the period. The ratio of trade deficit to GDP ratio increased from 12.6 percent in 1991/92 to 27.3 percent in 1996/7. 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 views 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 of 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 resign, 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.

Singh (2000) in their Article “Nepal’s Foreign Trade: the changing scenario of commodity consumption and Direction” starts with the role of foreign trade in the economic development of a developing country like Nepal, providing indispensable raw materials for development, technical knowledge, foreign capital and competition conductive to economic development.

He analyzes that Nepal is a primary product producing country. Under these circumstances, production, productivity and efficiency are to be generated which is possible by foreign trade in the short run. He further suggest that under economic is to be made compatible with these changes, hence cost of production is to be reduced, and efficiency and competitiveness are to be generated. He 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 study is the direction of Nepalese foreign trade, international relation 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 production, reducing cost of production, generating export surplus, encouraging research and development, while reducing import substitutes by adopting improved indigenous technology curbing non-essential and luxury imports, controlling growth of population and diversifying its exports and imports markets.

Dahal (2010) entitled a thesis named “ A Study on Nepalese Foreign Trade and its changing scenario” where he analyzed the current status of Nepal’s foreign trade. This study covers period from 1990 to 1998. This study mainly focuses on volume, composition and direction of Nepalese Foreign trade. This study also covers period from 1990 to 1998. The study mainly focuses on volume, composition and direction of Nepalese Foreign Trade. This study also examines the terms of trade i.e. the ratio of the index of export prices to the index of import prices. The study concludes that Nepal’s trade deficit is increasing with both India and overseas countries and it may have long term effects on country’s economy and such deficits are usually covered by the increased foreign loans and grants which may further deteriorate the economy.

Shah (2001) in her M.A. dissertation titled "The Study of Nepal's Foreign Trade 1974/75 - 1996/97" focuses on estimating the volume, composition and export and import instability .0vith the help of different statistical tools for export and import and their categories, primary, manufactured, investment and consumer goods are shown in the highest fluctuation. Commodity and geographic concentration ratios are taken as main causes of export instability. Similarly, income and foreign aid are taken as main determinants of Nepal's import trade. The results of multiple regression analysis show that imports are explained by income and foreign aid.

In her analysis she shows functional relation of manufactured goods and investment and log linear model is used for the import of primary goods and consumer's goods. Her study shows that the import does not depend upon previous income but only on current income.

The cyclical income elasticity of demand for total import, import-of primary, manufactured and consumer goods are shown significant at 1 percent level. The secular income elasticity for import of primary products, manufacturing products and consumer goods are significant at 10 percent, 15 percent and 1 percent respectively. In case of investment goods, secular income elasticity is greater than unity. Similarly, foreign aid elasticity for primary goods are not significant while for other categories significant at 1 percent.

Subedi (2003) in his unpublished M.A. dissertation "Nepal's Foreign Trade: The Changing Scenario of Size, Composition and Direction" intends to look over the composition of overseas trade. His study is limited to 10 years’ time span of 1991-

2001. He simply used secondary source of data and presented the data on tables and compare the data from different angle.

After presenting the plan-wise scenario of foreign trade, he found that performance in each and every plan has remained quite low and less effective in speeding up the total volume of trade. The percentage share of export decreased from fourth plan i.e 36.04% to sixth plan 22.48% and then slightly increased in seventh plan with 39.49% share on export. He also tries to show the composition of Nepalese import and export by standard international trade classification (S1TC) and direction of trade.

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

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

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

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

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

Niraula (2008) in his unpublished M.A. dissertation "Nepal's Trade with India" has shown the volume and composition of trade with India from the first plan period to the ninth plan period. He has examined the factors influencing export of Nepal to India and import from India. He has also made a review of trade transit treaties between the two countries. He also highlights the problems and prospects of Indo-Nepal trade. At last, he suggested that to promote export and to substitute import, new lines of export oriented industries using domestic raw material and labor must be initiated. Government should strictly stop trade leakage and export to China must also be encouraged.

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

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

Lama (1996) in his "The Economics of Indo-Nepal co-operation" tries to analyze the dynamics of Indo-Nepalese co-operation in terms of aid, trade and foreign investment. The study covers in the period 1956-1982. He reviews different trade treaties between Nepal and India and analyzes their possible impact on Indo-Nepal trade. Similarly, he examines the magnitude and composition of Indo-Nepalese trade between 1956 and 1982 and throws some light on major problems in the Indo-Nepal trade relations.

Above mentioned literatures have dealt with theory of foreign trade of Nepal with different countries. They studied about the concept, importance, size, composition, pattern, volume, direction, issues, etc. of foreign trade of Nepal with different countries. But there are very few literatures which studies about the foreign trade between Nepal and India. Therefore, I decided to study the foreign trade of Nepal with India. In this study, I have focused on trend and structure of Nepalese foreign trade with India.

CHAPTER III

Research Methodology

This study is entirely based on secondary source of data which are copied from published national and international organizations. This study only concerns with the mercantile trade data. This study aims at exploring the efforts made by foreign trade sector on national development. The study concentrates on Nepalese trade structure and trends, examination of the relations of trade with national income, policy judgments etc.

3.1 Research Design

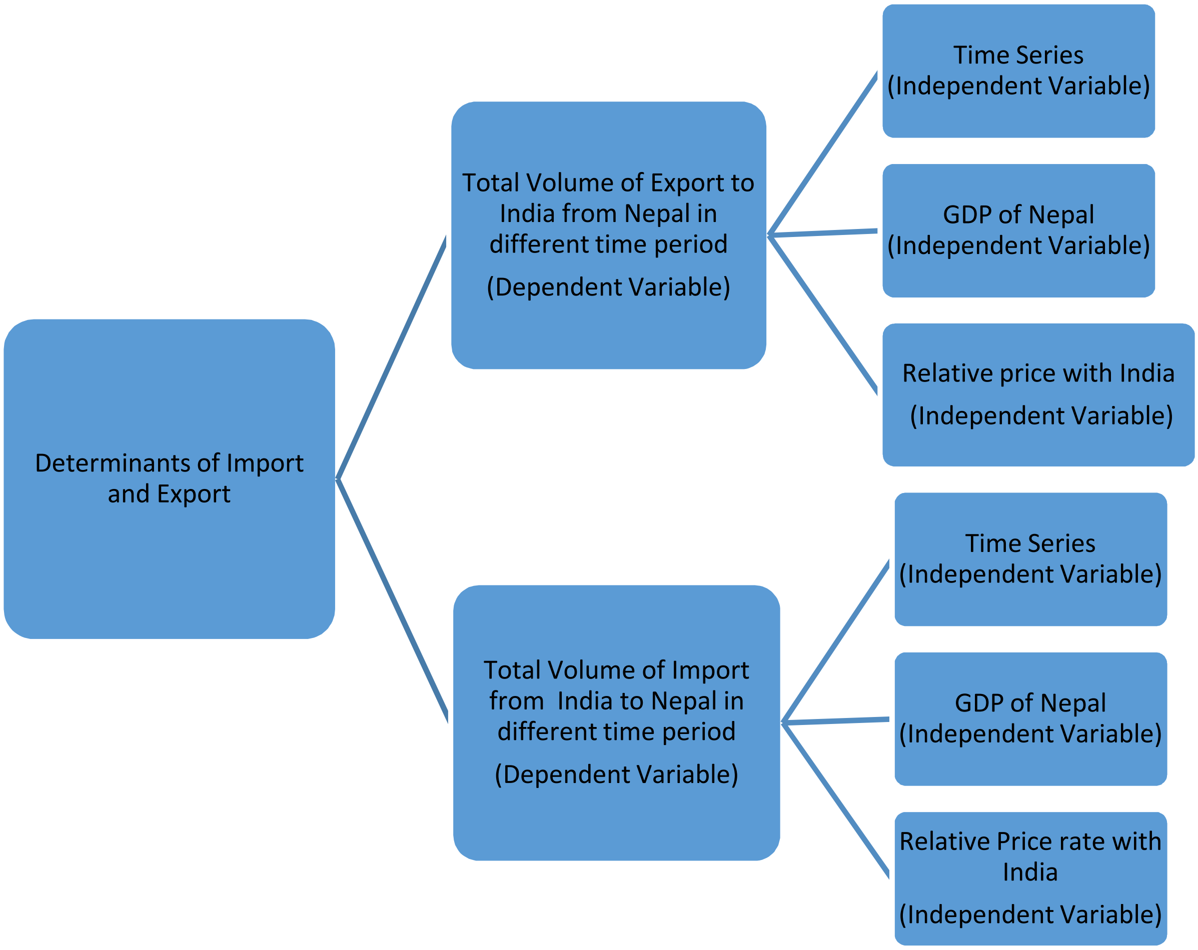
This study aims at exploring the effects made by foreign trade on national development. The study concerns on Nepalese trade structure and trends, examination of the relations of trade with national income, policy judgments etc., for which exploratory and analytical research design will be used.

3.2 Conceptual Framework

A conceptual framework is used in research to outline possible courses of action or to present a preferred approach to an idea or thought. A conceptual framework elaborates the research problem in relation to relevant literature. It consists of concepts that are placed within a logical and sequential design. It is based on specific concepts and proposition derived from the empirical observations. It clarifies concepts and proposes relationship among the concepts in the study. The framework may be summarized in diagram that presents the major variables and their hypothesized relationships.

Figure: 1

Factors affecting Total Export to India from Nepal and Total Import from India to Nepal



3.2 Nature and Sources of data

The secondary data of the study will be:

1. Nepal Rastra Bank (NRB) Annual report, Quarterly Bulletins.
2. FNCCI Economic Bulletins
3. The Government of Nepal (GON), Ministry of Finance (MOF), Economic Surveys.
4. Nepal Overseas Trade Statistics: Trade Promotion Centre.

3.3 Specification of the Variables:

a. Gross Domestic Product:

Gross Domestic Product refers to the market price of the total flow of goods and services produced by Nepal over a specified time period, normally a year. It is obtained by valuing outputs of goods and services at constant prices. It should be noted that all intermediate goods are excluded, and only goods used for final consumption or investment are included.

b. Relative Price with India:

Relative price is known as wholesale price index of India divided by wholesale price index of Nepal.

3.4 Data Processing and Analysis

The relative statistical information from the selected source was processed with the help of a computer especially by excel programmer. The study consists of describing the role and systematic of patterns as well as composition and trend of Nepalese foreign trade. The study arranged systematically, simple arithmetic analysis like ratio, percentage are computed in using methods of descriptive and empirical analysis.

3.5 Regression Models

The research used simple log-linear model and double log linear model because the slope coefficient of the equation measures the elasticity or the percentage change in dependent variable for a given small change in the independent variable.

3.5.1 Export to India

The following regression equations are calculated with time variable, GDP, relative price as the explanatory variables.

Equations used in Regression Analysis:

i. lnX1=A0+A1T+E

ii. lnX1=A0+A1ln$\frac{WPI(I)}{WPI(N)} + E$

iii. lnX1=A0+A1lnGDP+E

Where,

X1= Export to India

T=Time Variable

ln=Natural log

GDP= Gross domestic product of Nepal

E= Standard Error

WPI(I)= Wholesale Price Index of India

WPI(N)= Wholesale index price on Nepal

A0 and A1 are the parameters to be estimated

3.5.2 Import from India

The following regression equations are calculated with time variable, GDP, Relative price as the explanatory variables.

Equations used in Regression Analysis are:

i. lnM1=β0+β1T+E

ii. lnM1=β0+β1ln$\frac{WPI(I)}{WPI(N)} + E$

iii. lnM1=β0+β1lnGDP+E

Where,

M1= Import from India

T=Time Variable

ln=Natural log

GDP= Gross domestic product of Nepal

E= Standard Error

WPI(I)= Wholesale Price Index of India

WPI(N)= Wholesale index price on Nepal

β0 and β1 are the parameters to be estimated

3.6 Technique Used to test Regression Equations

To test the reliability of the analysis of the trend values and relationship among variables the following tests have been used.

a. Coefficient of determination (R^2)

The goodness of fitness of the regression line R^2 is the variation of dependent variable that is explained by explanatory variable.

$R^2 = \frac{Explained\ Vasriable}{Total\ Variable}$

$0<R^2<1$

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

b. Adjustment coefficient of multiple determinants ($\bar{R}^2$)

The use of additional explanatory variables in the function leads to the rise in the value of coefficient. To take account of this ($\bar{R}^2$) the adjustment coefficient of multiple determination is used.

The expression will be given by

$(\bar{R}^2) = 1 - \frac{ESS/\{n-(k-1)\}}{TSS/(n-1)}$

$= 1 - \frac{Error\ Sum\ Square}{Total\ Sum\ Square}$

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

Where,

$(\bar{R}^2)$= Adjusted R^2

n = number of observation

k = number of independent variables

c. T-test

The small sample test (n<30), t-test will be performed in order to identify the statistical significance of an observation sample regression coefficient and the formula for calculating the value is:

$t = \frac{\hat{a}_i}{SEa_i}$

Where,

$\hat{a}_i$ = estimated value of a_i

SEa_i = Standard error of $\hat{a}_i$ or $\sqrt{Var\ \hat{a}_i}$

d. F-test

F-test is used to measure the overall significance of the estimated regression, which is also a test of significance of R^2 because these two vary directly when $R^2 = 0$, F is 0 and $R^2 = 1$ is infinite. So that, larger the R^2 greater value of F. Thus, larger value of F-test implies that the overall significance of the estimated regression is good. The F value can be computed as:

$F = \frac{\frac{R^2}{(k-1)}}{(1-R^2)(n-k)}$

Where,

K = Total number of parameters to be estimated

n = Number of observation

R^2 = coefficient of determination

CHAPTER IV

Trend and Structure of Nepal-India Foreign Trade

4.1 Historical Trend of Nepalese Foreign Trade

Historically, Nepal had pro-actively encouraged enter-pot trade between Tibet and India and promoted self-reliant economy and political independence. According to Kautilya's Arthasthstra 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 reassumed from Yuan dynasty (1271-1368). Arniko helped to expand cultural developments across the East and Southeast Asia. King of Kathmandu Pratap Malla and the King of Gorkha Ram Shah, tried to spread their influence in Tibet. In 1625-30, Ram Shah twice tried to expand influence in Tibet. His second effort was successful and reached to Kukurghat. He controlled Kerung for a short time.

Pratap Malla around 1645-50 crossed over Kunti and reached to Xigatze in the leadership of BhimMalla. A treaty between Tibet and Nepal was signed with provision of Tibet and Nepal establishing joint authority in boarder trade in Kunti 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 as 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.

Prithvi 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: Predace, cit by Dahal). The Anglo Gurkha war of 1814-16 removed Nepalese control over some areas of the Terai, marked the start of British efforts to liberalize trade and especially allowed the East-India company easier access to the north-south trade from Tibet.

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 in Lhasa while Nepalese trade agencies were established in Kuti (Nyalam), Kyerong, Shigatse and Gyanze". 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 of the Rana regime had not occurred" 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 land lock condition and least developed status. The least developed status of Nepal is largely characterized by poverty, inequality, poor production of workforce and heavy dependence on few commodities in its structure of trade. Despite nearly sixty years of planned development, Nepal is predominantly an agriculture 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". This policy continued until recently. Landlocked situation, Peace and Friendly and Trade and Commerce Treaties with India opened door policy for Nepalese workers and vital trade links to the outside world through India strongly influenced Nepal's development policies and strategies. The new economic policy of finance and service had weakened the base of traditional manufacturing that was the base of its industrial development.

4.2 Trend of Trade

The study of trade is important because it indicates a country's international relation, facilities for trade and linking of nation. The direction of trade shows the share of export and import destination wise of both exportable and importable commodities. In context of Nepal. Direction of foreign trade is important to show whether the trade diversified to a few regions or countries. Nepal trade direction is basically with India and overseas countries but here, direction of Nepal's trade only with India is only presented.

Table 1: Direction of Nepal's foreign Trade

(Value in million Rs.)

Fiscal Year	Total Export	Export to India	Total Imports	Import from India	Total Trade	Total Trade with India
1994/95	7387.5	1552.2	23226.5	7323.1	30614.0	8875.3
1995/96	13706.5	1450.2	31240.0	11245.5	45646.5	12695.3
1996/97	17266.5	1621.7	38205.6	12542.1	16472.1	14163.8
1997/98	19293.4	2408.9	51570.8	17035.4	70864.2	19444.3
1998/99	17639.4	3124.3	63679.5	19615.9	81318.7	22740.2
1999/00	19881.1	3682.6	74454.5	24398.6	94335.6	28081.2
2000/01	22636.5	5226.2	93553.4	24853.3	116189.9	30079.5
2001/02	27513.5	8794.4	89002.0	27331.0	116515.5	36125.4
2002/03	35676.3	12530.7	87525.3	32449.7	123201.6	44650.4
2003/04	49822.7	21220.7	108504.9	39660.1	158327.6	60880.8
2004/05	55654.1	26030.2	115687.2	45211.0	171341.3	71241.2
2005/06	46944.8	27956.2	107389.0	56622.1	154333.8	84578.3
2006/07	49930.6	26430.0	124352.1	70924.2	174282.7	97354.2
2007/08	53910.7	30777.1	136277.1	78430.5	190187.8	109516.6
2008/09	58705.7	38916.9	149473.6	T88675.5	208179.3	127592.4
2009/10	60234.1	40714.7	173780.3	107143.1	234014.4	147857.8
2010/11	59266.5	38555.7	221937.7	142376.5	281204.2	180932.2
2011/12	59266.5	38555.7	221937.7	142376.5	281204.2	180932.2
2012/13	67697.5	41005.9	284469.6	162437.6	352167.1	203443.5
2013/14	60824.0	39993.7	374335.2	217114.3	435159.2	257108.0
2014/15	64338.5	43360.4	396175.5	261925.2	460514.0	305285.6

Source: Nepal and The World statistical Profile (FNCCI), Quarterly Economic Bulletin (NRB), 2015

Table 2: Direction of Nepal's Foreign Trade (in %)

Fiscal Year	Export to India as % of Total Export	Import from India as % of Total Imports
1994/95	21.01116751	31.5290724
1995/96	10.58038157	35.99711908
1996/97	9.3921756	32.82791004
1997/98	12.48561684	33.0330342
1998/99	17.7120537	30.80410493
1999/00	18.52311995	32.76981244
2000/01	23.08749144	26.56589712
2001/02	31.96394497	30.70829869
2002/03	35.12331716	37.07465156
2003/04	42.59243277	36.55143685
2004/05	46.7713969	39.08038227
2005/06	59.5512176	52.72616376
2006/07	52.93347166	57.03498373
2007/08	57.08903798	57.55222264
2008/09	66.29151854	59.32519187
2009/10	67.59410367	61.65434172
2010/11	65.05479487	64.15156145
2011/12	65.05479487	64.15156145
2012/13	60.57225156	57.1019188
2013/14	65.75315665	57.99996901
2014/15	67.39417301	66.113427

Source: Quarterly economic Bulletin (NRB), 2015

Table 1 shows that the direction of the foreign trade of Nepal from the fiscal year 1994/95-2014/15. It is clear from *table 1* that share of India in total exports to Nepal declined till fiscal year 1995/96. It was due to the demand of Nepalese goods in India and domestic availability. Another cause of fall in exports of Nepal to India may be large-scale smuggling across Nepal-India border. The export share with India was Rs. 1532.2 million in the fiscal year 1994/95 and it went up Rs. 43360.4 million in the fiscal year 2014/15. As table 3 shows that the percentage of export share of India in total export is increased, percentage of export with India is rapidly declining up to 1999/00 and rebound for the next year. Even though, it could not meet the same present before 1999/00. After the 1996 trade-treaty, Nepalese products could enter India free of custom duty and quantitative restriction so that there was a phenomenal increase in export to India. The export share to India in percentage in the year 1999/00 is 23.1. It mounted to 57.1 percentage in 2007/08 which reached 70.3 percentage in year 2010/11 which was the highest percentage share of export during the study period. In fiscal year 2014/15, export share to India is 67.4 percentage.

On the other hand, India's share in total export shows the fluctuating tendency. Total import in fiscal year 1994/95 is Rs. 23226.5 million in which India's share is Rs 7323.1 million. In this figure an amount is increasing in each year but as percentage it increase and decreased. As import share is small i.e. 26.6 percentage in fiscal year 2000/01 and high i.e. 66.1 percentage in fiscal year 2014/2015. This increasing trend shows that large chunk of import demand is mostly met through imports from India because import from India are cheaper for Nepal then from the countries other than India because of close proximity and open borders.

During the year 1994/95 to 2014/15 it is founded that export and import of Nepal is not limited with her neighboring country India only. After the year 2004/05, maximum share had been covered by India.

4.3 Composition of Nepal-India Trade

Composition of trade indicates the pattern of goods that are being exported and imported. It also shows the level of development of a country. In the early stage of development primary goods dominated the import and export composition. Nepalese export commodity composition has little diversified than import commodity composition. The composition of Nepal India trade is analyzed here on the basis of SITC. The primary products are summed of (0+1+2+4) and manufacturing goods are summed of (3+5+6+8+9). Similarly, SITC 7 is given separately.

Major Commodity Groups According to SITC Code

- 0 = Food and Live Animal
- 1 = Tobacco and Beverages
- 3=Crude Materials, inedible except fuels
- 4=Mineral, Fuels and Lubricants

- 4=Animal and vegetable oil and fats
- 5=Chemical and Drugs
- 6=Manufactured Goods classified mainly by material
- 7=Machinery and Transport Equipment
- 8=Miscellaneous Manufactured Articles
- 9=Commodity and transaction not classified according to kind

4.3.1 Composition of Nepal's Export to India

In these days structure of trade between Nepal and India have been changed Agro-based and forest based primary commodities constructor principle export of India in the past, at present manufactured products have replaced them. The composition of Nepal's export to India has been shown in appendix 1.

As the appendix 1 shows the Nepal's Export to India according to India according to SITC categories the major exported commodities were food and live animals, crude materials and inedible except fuels, animal and vegetable oils and manufacturing goods classified by materials i.e. SITC 0, 2, 4 and 6 till 1997/98. From fiscal year 1997/98, mineral fuels and lubricants (SITC 3) also became major export commodity and miscellaneous manufactured articles (SITC 8) from 2001/02.

Appendix 1, shows food and live animals cover large share of Nepal's export to India. In the year 1994/95, exported amounted amount was Rs. 789.1 million. In the remaining two years, it declined and later then started to increased. Significant increase can be realized after the fiscal year 2003/04. The share has become highest Rs. 10151.1 million in the fiscal year 2012/13. Again declined in the fiscal year 2013/14 and in the fiscal year 2014/15, it reached to Rs. 10104.5 million. Tobacco and beverages shows the fluctuating nature in prevailing its highest contribution of such groups was in the year 2012/13, at that time, it was Rs. 329.6 million which has become Rs. 0.0 million in the fiscal year 2014/15.

Similarly, export of crude materials, inedible except fuels classified on group 2, shows increasing tendency up to the fiscal year 1995/96 and then after there is ups and down. In the fiscal year 2013/14 it became highest Rs 2103.3 and in the fiscal year 2014/15 it is declined to Rs.1509.0 million which was Rs.212.1 million in the year 1994/95. The situation of export of the mineral fuels and lubricants is vulnerable except in the fiscal year 2001/02 with the amount Rs.20.6 million of our analysis and has come to zero in fiscal year 2014/15. The share of Animals and Vegetable Oil and fats seems quite low up to 2000/01. As shown by the table, Indo-Nepal Trade and Transit Treaty was the door to enter on export for group 4 and 5. Share of both items Rs.4337.2 million and Rs.3977.4 million respectively in fiscal year 2010/11. But after fiscal year 2010/11, share of both items declined and fluctuate. Share of both items, in the year 2014/15reach Rs.310.4 million and Rs.2673.7 million respectively.

Manufactured goods mainly by materials under group 6 show the steady growth. The share in the fiscal year 1994/95 was Rs.339.1 million and it has come to 29396 in fiscal year 2014/15. There is drastic change in between the time period after and before 2000/01. Export under group seven has increased only after 1996/97, before it was high. The share is very high in fiscal year 2011/12, which comes to be Rs.359.4 million against Rs.490.6 million in the year of 2014/15. The export share of miscellaneous manufactured articles was increasing up to the year 2003/04 and become high at that period reaching Rs.4323.5 million from Rs.15.9 million in the fiscal year 1994/95. The share was, started to declining after the same year of 2003/04 up to 2004/05. The share in fiscal year 2009/10 was Rs.3477.7 million and then after again started to decline, the share is more fluctuating from the fiscal year 2009/10-2014/15.

Export of commodity and transactions not classified according to the kind is negligible especially in all years. It is Rs.9.1 million in 2004/05 and 0.2 million in 2014/15.

Table 3: Exports to India by Commodities According to SITC Categories

(In Percentage)

Fiscal Year	SITC Code										Total
	0	1	2	3	4	5	6	7	8	9	
1994/95	50.84	0.17	13.66	0.00	11.98	0.48	21.28	0.00	1.02	0.00	100.00
1995/96	52.52	0.12	19.83	0.00	7.90	0.67	17.02	0.00	1.94	0.00	100.00
1996/97	46.54	0.34	20.16	0.00	10.46	0.95	19.56	0.06	1.86	0.09	100.00
1997/98	38.44	0.17	12.16	0.00	5.54	8.40	33.95	0.00	1.38	0.01	100.00
1998/99	42.10	0.09	12.44	0.00	6.75	8.19	28.96	0.08	1.40	0.00	100.00
1999/00	34.94	0.05	9.95	0.04	3.74	16.78	33.57	0.72	1.54	0.00	100.00
2000/01	33.50	0.03	7.29	0.03	2.94	25.51	29.11	0.21	1.37	0.01	100.00
2001/02	19.38	0.22	3.75	0.23	22.51	22.18	28.99	0.05	2.69	0.00	100.00
2002/03	16.28	0.35	2.82	0.00	26.92	22.19	25.92	0.19	5.32	0.00	100.00
2003/04	17.56	0.49	2.35	0.01	13.81	18.29	26.28	0.83	20.37	0.00	100.00
2004/05	15.34	0.26	2.73	0.00	15.10	15.35	34.22	0.76	16.24	0.00	100.00
2005/06	16.24	0.51	2.00	0.00	25.80	11.57	35.67	1.13	7.08	0.00	100.00
2006/07	17.68	0.40	2.58	0.02	15.34	12.01	43.09	0.45	8.42	0.02	100.00
2007/08	14.93	0.14	1.87	0.05	10.42	11.78	52.73	0.71	7.35	0.02	100.00
2008/09	13.85	0.07	1.89	0.01	12.49	9.19	54.87	0.22	7.39	0.02	100.00
2009/10	15.49	0.04	2.86	0.00	10.18	8.76	53.86	0.27	8.54	0.01	100.00
2010/11	14.25	0.03	3.10	0.00	10.39	9.53	56.95	0.45	5.31	0.00	100.00
2011/12	19.76	0.03	3.06	0.00	5.25	6.99	59.50	0.78	4.63	0.00	100.00
2012/13	24.76	0.80	3.64	0.10	0.78	7.29	51.15	1.20	10.27	0.00	10.00
2013/14	21.48	0.00	2.26	0.00	0,51	4.12	63.62	1.32	3.68	0.00	100.00
2014/15	23.3	0.00	3.48	0.00	0.72	6.17	60.88s	0.83	4.63	0.00	100.00

Source: Table on Appendix 1

The above table clearly shows the share of exportable commodities as per SITC. This clearly portrays a clear picture of changing composition of Nepal's export trade with India over seventeen years. Group 0 shows, share of food and live animals has been decreasing after fiscal year 1995/96 and it comes to be only 13.85 percent in fiscal year 2008/09. After 2008/09, share of food and live animals slightly increased and went on increasing from fiscal year 2011/12. Trend of Tobacco and Beverage shows the percentage share is not explanatory whereas exports of crude materials inedible except fuels had taken a main portion in the early year of 1994/95-1998/99 but in the year of 2014/15, it is limited to keep its share only on 3.48 percentages. Export share of minerals fuels and lubricants is a very little share on over all percentage shares of manufactured goods. Percentage share of animals and vegetable oils and fats fluctuate more during the study period as shown by table above. Its highest share was 26.92 percent during 2002/03 and become 0.72 percent in 2014/15. Mainly chemical and drugs contributes a major share only after 1997/98. It went on increasing till 2000/01 and the percentage share was 25.51 which was highest share during the study period. Then from 2001/02, it started to decline and become 6.17 percent in 2014/15. As shown by the table above manufacture goods classified by materials cover major share. Share of it was 22.28 percent in 1994/95 and reach 60.88 percent in 2014/15. Similarly share of miscellaneous manufactured articles was very low up to the fiscal year 2002/03 (5.32 and below that) but after that increased on slow rate and has come to be 8.54 percent in the 2009/10. It again decreased and increased and reached 4.63 percent in fiscal year 2014/15. Export share of machinery and transport equipment and commodity and transaction not classified according to kind are very little share.

4.3.2 Composition of Nepal's Import from India

The composition of Nepal's import from India explicitly shows an increasing tendency during the fiscal year 1994/95-2014/15. In 1994/95 the import share of food and live animals was Rs.1496.8 million, it went on increasing up to the fiscal year 1997/98 and there was fluctuating tendency up to 2002/03. In 2003/04 the import share was Rs.6975.8 million. After that till 2010/11 it shows fluctuating tendency. But after 2010/11, share of import increased steadily and reached Rs.22175.0 million in 2014/15. From the fiscal year 1994/95- 2012/013, the import of Tobacco and Beverage show almost same trend. In the fiscal year 2013/14 import of tobacco and Beverage increased drastically. Share of it in fiscal year 2014/15 is Rs. 2135.6 million.

As shown by the appendix 2, the import of crude materials, inedible except fuels up to 2000/01 is comparatively low in the year 1994/95, it was Rs.178.4 million and Rs.701.4 million in the 2000/01. After that it has become significant stride and come to reach Rs.15772.4 million in fiscal year 2014/15. Import share of mineral fuel and lubricants in the fiscal year 1994/95 from Rs.778.5 million in the fiscal year

1994/95was Rs.210.1 million. After 2003/04, import share of it increase significantly. It has shown increasing trend up to six year later and decreased for one year and again started to increase in the remaining year. In the fiscal year 2003/04 it was Rs.778.5 million, and it was Rs.10, 854.4 million in the year 2004/05. In the current year of 2014/15 share of the group 3 was Rs.78986.6 million. The import of group 4 has increased continuously up to 2000/01 and since then it has shown sharp fluctuation. The highest share was Rs.418.2 million in the fiscal year 2004/05. Imports of chemicals and drugs increased continuously up to the 2004/05, reaching Rs.6628.0 million in the fiscal year 1994/95. It decreased in the 2005/06, and again increased up to 2011/12, decreased one year and again increase and reached Rs.25706.1 million in fiscal year 2014/15. The import of commodities under group 6 (manufactured goods classified mainly by materials) fell down from Rs.9472.6 million in 1999/00 to Rs.8,962.2 million in 2000/01, but after that there has been growing trend up to the 2014/15. In the same way imports of machinery and transport equipment increased constantly till 2004/05 decline in 2005/06 and again increase till 2013/14. It again decreased in the year 2014/15 from Rs.43791.2 million in 2013/14 to Rs.42808.5 million. Imports of miscellaneous manufactured articles show the constant growth up to 2004/05 and decreased in 2005/06, again increased from 2006/07. There is extreme increase from the year 2010/11 to 2014/15, reaching Rs.3708.0 million to Rs.15948.0 million. The import of commodities under group 9 from India shows a fluctuation during the study years. The lowest share was Rs. 0.1 million and highest share was Rs.342.4 million in the fiscal year 2007/08.

Table 4: Imports from India by Commodities According to SITC

(In Percentage)

Fiscal Year	SITC Code										Total
	0	1	2	3	4	5	6	7	8	9	
1994/95	20.4	3.5	2.4	9.2	0.02	17.6	26.6	22.3	4.4	0.02	100.00
1995/96	21.6	2.6	2.3	2.9	0.008	16.8	29.3	20.0	4.6	0.1	100.00
1996/97	20.2	3.5	3.1	2.8	0.03	15.2	31.6	18.2	3.1	0.004	100.00
1997/98	17.9	2.0	2.3	2.6	0.1	14.5	34.8	21.1	4.7	0.1	100.00
1998/99	14.4	2.4	3.3	1.9	0.1	14.7	37.6	21.6	4.0	0.009	100.00
1999/00	13.4	1.8	3.6	1.8	0.2	14.5	38.8	21.7	4.1	0.02	100.00
2000/01	14.7	2.2	2.8	2.0	0.4	16.4	36.1	20.3	5.1	0.004	100.00
2001/02	12.3	2.5	3.7	1.8	0.04	19.3	36.3	18.9	5.0	0.01	100.00
2002/03	17.2	2.0	4.3	1.6	0.1	17.1	32.6	20.7	4.3	0.2	100.00
2003/04	17.6	1.6	3.9	2.0	0.2	15.9	35.5	17.7	5.8	0.01	100.00
2004/05	8.1	1.2	4.3	19.8	0.8	12.1	33.1	15.9	4.8	0.00	100.00
2005/06	8.8	1.1	5.3	26.8	0.4	9.1	33.1	13.3	3.1	0.01	100.00
2006/07	9.3	0.8	6.0	27.6	0.07	9.6	31.7	11.9	2.9	0.01	100.00
2007/08	8.0	0.9	5.9	27.4	0.1	10.3	29.0	15.1	2.7	0.4	100.00
2008/09	7.6	0.7	5.3	33.3	0.07	11.8	25.5	12.5	3.0	0.03	100.00
2009/10	9.3	0.6	5.1	33.2	0.1	12.6	23.8	11.2	3.8	0.0	100.00
2010/11	7.1	0.6	4.1	30.7	0.1	12.6	25.6	16.0	3.2	0.0	100.00
2011/12	6.1	0.6	3.3	30.3	0.2	10.8	28.8	16.2	3.0	0.1	100.00
2012/13	7.6	0.8	5.2	27.1	0.0	9.2	24.6	20.5	5.0	0.1	100.00
2013/14	7.3	1.1	6.6	25.1	0.1	10.2	24.2	20.2	5.3	0.0	100.00
2014/15	8.5	0.8	0.1	30.2	0.1	9.8	22.3	16.3	6.1	0.0	100.00

Source: Appendix table 2

The table 4 provides the clear picture of changing composition of Nepal's imports trade with India. The imports of food and live animals show fluctuating and decreasing trend. In the fiscal year 1994/95, it was 20.4 percent but coming up to the fiscal year 2014/15 it is limited to 8.5 percent only. As the table shows, major imported group from India is manufactured goods classified chiefly by materials that 30.9 percent on average each year. Similarly, another major important group from India is machinery and transport equipment, which includes more than 19 percent on average. Both of these items have fluctuating trend decreased in the last ear of our comparison with the starting year.

Imports of animals and vegetable oils and fats and commodity translation not classified according to kind contribute negligible share. The percentage share of animals and vegetable oils and fats in the fiscal year 1994/95 was 0.02 percent, and come to be 0.1 percent in the fiscal year 2014/15. Similarly, percentage share of group 9 was very low. The percentage share of Tobacco and Beverage was 3.5 percent in the fiscal year 1994/95. It was regularly decreasing after 1998/99. It is only 0.8 percent in the last year of our study. The import share of mineral fuels and lubricants was dismal in the early year but after 2005/06, it has intensively increased covering 30.2 percent in the fiscal year 2014/15. In the initial period of our study, percentage share of chemicals and drugs shows that it was contribution highest in 2001/02 i.e. 19.3 percentage, till then it was decreasing and again increased after the fiscal year 2007/07 and reached 12.5 percent in the fiscal year 2010/11. Again decreased and reached 9.8 percent in fiscal year 2014/15.

4.4 Changing Pattern of Indo-Nepal Trade

Table 5: Changing Pattern of Indo-Nepal Trade

Nepal Export to India				Nepal Import from India		
Fiscal Year	Primary Products	Manufactured products	Total	Primary Products	Manufactured Products	Total
1994/95	76.7	23.3	100	26.3	73.7	100
1995/96	80.4	19.6	100	26.4	73.6	100
1996/97	77.5	22.5	100	26.8	73.2	100
1997/98	56.3	43.7	100	22.3	77.7	100
1998/99	61.4	38.6	100	20.2	79.8	100
1999/00	48.7	51.3	100	19.0	81.0	100
2000/01	43.8	56.2	100	20.2	79.8	100
2001/02	45.9	54.1	100	18.5	81.5	100
2002/03	46.4	53.6	100	23.6	76.4	100
2003/04	34.2	65.8	100	23.3	76.7	100
2004/05	33.4	66.6	100	14.4	85.6	100
2005/06	44.6	55.4	100	15.2	84.8	100
2006/07	36.0	64.0	100	16.3	83.7	100
2007/08	27.4	72.6	100	15.0	85.0	100
2008/09	28.3	71.7	100	13.8	86.2	100
2009/10	28.6	71.4	100	15.1	84.9	100
2010/11	27.8	72.2	100	11.9	88.1	100
2011/12	28.1	71.9	100	10.2	89.8	100
2012/13	30.0	70.0	100	13.6	86.4	100
2013/14	27.3	72.7	100	15.1	84.9	100
2014/15	27.5	72.5	100	9.4	90.6	100

Source: Appendix table 1 and 2

Changing pattern of Nepal's trade with India shows the exports of primary product has been decreasing as compare to the initial fiscal year of 1995/96, whereas export of manufactured products has been increasing. Export of primary product in the fiscal year 1994/95 is 76.6 percent of total export to India. In the corresponding second fiscal year it increased reaching 80.4 percent. After 2003/04 export share of primary product declined more and in fiscal year 2014/15 it has become only 27.5 percent.

Opposite case is true in the Case of manufacture product. It was confined to 23.3 percent in the fiscal year 1990/91 has become 72.5 percent in fiscal year 2014/15 as a consequence of Trade Treaty.

There is another situation in case of Nepal's import from India. The changing pattern clearly reveals that share of primary product is almost same in three consecutive year of initial period around 26.3 percent. It has come down to 20.2 percent in the 1998/99. And it started to decline till 2001/02 and increased in 2002/03 reaching 23.4 percent. Again it decreased and reached 9.4 percent lowest in the fiscal year 2014/15. On other hand, share of import of manufactured product showed increasing trend during the study period. The share percentage was 73.7 in fiscal year 1994/95and reached 90.6 percent in 2014/15.

4.5 Trade Balance of Nepal with India

Balance of Trade is simply the difference between the value of commodity exported and imported. If this difference (X-M) is positive, there is surplus in trade balance, if it is negative there is deficit in trade balance. If it is positive there is surplus in the balance of trade, the prospects of economic development of that country will certainly be higher. But such prospect will be gloomy if there is deficit balance of trade. Thus trade deficit adversely affects the economic development of a nation. Though export to India is increasing significantly in recent years, a huge trade deficit still plagues the Nepalese economy. Nepal's deficit trade balance with India has a direct impact up on the Nations balance of payment situation.

Table 6: Trade Balance of Nepal with India

Fiscal Year	Total Trade Balance (Rs. In Million)	Trade balance with India (Rs. In Million)	Percentage change to previous year	Trade Deficit with India as % of Trade Deficit.
1994/95	15389.0	-5770.9	-	36.4
1995/96	18233.5	-9755.5	69.7	53.7
1996/97	21939.1	-10920.4	11.4	49.8
1997/98	32277.4	-14626.5	33.9	45.3
1998/99	46040.3	-16491.6	12.8	35.8
1999/00	54573.4	-20716.0	25.6	38.0
2000/01	70916.9	-19627.1	-5.3	27.7
2001/02	61488.5	-18536.6	-5.6	30.1
2002/03	51849.0	-19589.0	5.7	37.8
2003/04	58682.2	-18439.4	-5.9	31.4
2004/05	60033.1	-19180.4	4	32.4
2005/06	60444.2	-28665.9	49.5	47.4
2006/07	74421.5	-44494.2	55.2	58.2
2007/08	82366.4	-47962.4	7.8	58.2
2008/09	90767.9	-49758.6	3.8	54.8
2009/10	113546.2	-66428.4	33.5	58.5
2010/11	135311.5	-74143.5	11.6	54.8
2011/12	162671.2	-103820.8	40.0	63.8
2012/13	216772.2	-121431.7	17.0	56
2013/14	313511.2	-177120.6	45.9	56.5
2014/15	331837.0	-218564.8	23	65.9

Source: NRB Quarterly Economic Bulletin Mid-April, 2015

The trade balance of Nepal has remained always unfavorable and has been quite stagnant during the study period (FY 1994/95 to FY 2014/15). An immediate case for the deficit trade balance is higher import against the smaller export the trade balance of Nepal with India as shown in the table 4.6 above. Trade deficit with India has increased significantly from 1994/95 to 1999/00. It has shrunk a major amount in 2000/01, 2001/02 and 2003/04 as compared to previous fiscal year. This is a welcome future. The trade balance With India which was in deficit of Rs.5770.9 million in

1994/95 reached the negative of Rs.218564.8 million in 2014/15. If the deficit in foreign trade goes on same trend in future the trade sector will face more acute shortages of foreign exchanges. Thus the only way to overcome this problem is through enhancing exports rapidly and by controlling the flow of luxury and semi-luxury items. To overcome such deficit a massive amount of foreign trade debts and assistance have been received by the country. Such types of remedy in the balance of payments difficulties are only a short-term remedy and if they continue the debt service ratio may climb rapidly in the future hampering the economy ultimately. On top of that the burden of foreign exchange to the nation becomes more serve in case of such practices (Maskya, 1991)

The neighboring country, India is the main trading partner and hence larger proportion of Nepal's trade deficit is with India. In 1995/96, total trade deficit was Rs.18233.5 million of this deficit accounted for 53.7 percent with India while third countries accounted for only 46.3 percent. India accounted for more than 50 percent of Nepal's total trade deficit in that year. Afterwards India's share has remained at less than 50 percent, till 2004/05. From 1995/96 to 2000/01 a gradual declining tendency was witnessed in Indian's share in the total trade deficit of Nepal. But the trade deficit is more than 50 percent since 2006/07 the highest trade deficits 65.9 percent in 2014/15 which is more than sixty percent.

4.6 Comparative Study of Indo-Nepal Trade

Since our study is concerned with the trade relation between Nepal and India it is most essential to do a comparative study of these two countries. Only then we can ascertain a clear picture of the relation between two countries in the field of trade. For this purpose, Nepal's trade dealing is needed not only to be with India but also with the countries other than India. This will clarify the percentage share of the Nepalese trade held by India and other countries of the world.

Table 7: Export to India and Overseas Countries

(In Rs. Million)

Fiscal Year	Total Export	To India	% Total Export	Overseas countries	% of total export
1994/95	7387.5	1552.2	21.0	5835.3	79.0
1995/96	13706.5	1450.0	10.6	12256.3	89.4
1996/97	17266.5	1621.7	9.4	15644.8	90.6
1997/98	19293.4	2408.9	12.5	16884.5	87.5
1998/99	17639.2	3124.3	17.7	14514.9	82.3
1999/00	19881.1	3682.6	28.5	16198.5	81.5
2000/01	22636.5	5226.2	32.1	17410.3	76.9
2001/02	27513.5	8794.4	32.0	18719.1	68.0
2002/03	35676.3	12530.7	35.1	23145.6	64.9
2003/04	49322.7	21220.7	42.6	28602.0	57.4
2004/05	55654.1	26030.2	46.8	29623.9	53.2
2005/06	46944.8	27956.2	59.6	18988.6	40.4
2006/07	49930.6	26430.0	52.9	23500.6	47.1
2007/08	53910.7	30777.1	57.1	23133.6	42.9
2008/09	58705.7	38916.9	66.3	19788.8	33.7
2009/10	60234.1	40714.7	67.6	19519.4	32.4
2010/11	59383.1	41874.8	70.5	17654.3	29.5
2011/12	59266.5	38555.7	65.1	20710.8	34.9
2012/13	67697.5	41005.9	60.6	26691.6	39.4
2013/14	60824.0	39993.7	65.8	20830.3	34.2
2014/15	64338.5	43360.4	67.4	20978.1	32.6

Source: NRB Economic Bulletin (various issues), Nepal and World Statistical profiles 2015 (FNCCI)

In the fiscal year 1994/95, export to India includes only 21 percent of total export, this figure is 67.4 in the current year of 2014/15.

Table 8: Import from India and Overseas Countries

(In Rs. Million)

Fiscal Year	Total Imports	From India	% Total Imports	From overseas countries	% of total Imports
1994/95	23226.5	7323.1	31.5	15903.4	68.5
1995/96	31940.0	11245.5	35.2	20694.5	64.8
1996/97	39205.6	12542.1	32.0	26663.5	68.0
1997/98	51570.8	17035.4	33.0	34535.4	67.0
1998/99	63679.5	19615.9	30.8	44063.6	69.2
1999/00	74454.5	24398.6	32.8	50055.9	67.2
2000/01	93553.4	24853.3	26.6	68700.1	73.4
2001/02	89002.0	27331.0	30.7	61671.0	69.3
2002/03	87525.3	32119.7	36.7	55405.6	63.3
2003/04	108504.9	39660.1	39.1	68844.8	63.4
2004/05	115687.2	54700.9	47.3	70476.2	60.9
2005/06	107389.0	56622.1	52.7	50766.9	47.3
2006/07	124352.1	70924.2	57.0	53427.9	43.0
2007/08	136277.1	78739.5	57.8	57537.6	42.2
2008/09	149473.6	88675.5	59.3	60798.1	40.7
2009/10	173780.3	107143.1	61.5	66637.2	38.5
2010/11	194694.6	115872.3	59.5	78822.3	40.5
2011/12	221937.7	142376.5	64.2	79561.2	35.8
2012/13	284469.6	162437.6	57.1	122032.0	42.9
2013/14	374335.2	217114.3	58.0	157220.9	42.0
2014/15	396175.5	261925.2	66.1	134250.3	33.9

Source: NRB Economic Bulletin (various issues), Nepal and World A Statistical profiles 2015 (FNCCI)

The exports and imports table shows that India has become the major trade partner of Nepal since our study begins. So far the exports to India are concerned India has been a dominating importers of Nepalese products the percentage of exports to India has been more than 50 percent after the fiscal year 2004/05 to the current time period.

On other hand, more than 50 percent of the goods imported to Nepal are from India. In the current fiscal year of 1994/95, the percentage share of Nepal's import was 31.5. In the succeeding period it was fluctuating tendency but after 2004/05, share of goods imported from India went on increasing rapidly. In the fiscal year 2014/15 it reached to 66.1 percent of the total import. This is also clearly depicted in the table 8 above.

CHAPTER V

Major Trade Policies and Inter Regional Trade

5.1 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 and 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 programs 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 program 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 program 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.

5.1.1 Exporters' Exchange Entitlement (EEE) Scheme

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

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

- Over invoicing of exports and under invoicing of imports.
- Influx of non-essential and luxury goods.
- Lack of product diversification.
- Distortion in the resource allocation.
- Gradual emergence of unscrupulous trade practices.
- Shortage of India currency
- Dependence on India was not reduced.

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

5.1.2 Dual Exchange Rate System (DER)

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

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

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

Various measures adopted by the Nepal Government in different time period not contribute to positive impact in the trade sector and in the economy as a whole. Only providing lucrative incentive to the exporter was not sufficient to correct problems that existed in the trade sector. To alleviate the serious problem and to foster a sustainable development of the trade sector GON adopted new trade policy in 1992. As this study concentrates the study of foreign trade with India only after the restoration of democracy in 1990, this study will review the trade policies after 1990 only.

5.1.3 Trade Policy 1992

The trade policy of Nepal envisaged enhancing the contributions of trade sector to national economy by promoting internal and international trade with the increased participation of private sector through the creation of an open and liberal atmosphere. It further states to diversify trade by identifying, developing and producing new exportable products through the promotion of backward linkages for making export trade competitive and sustainable. The new trade policy was introduced in 1992. In order to materialize following basic policies have been formulated:

- The role of public sector will be minimized and used as a catalyst to expand the role of private sector in trade.

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

Export Policy

The export policy underlines the following fundamental provisions:

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

Export Strategy

The export strategy includes:

- Not required licenses for the export of products other than banned or quantitatively restricted items. In the case of quantitatively restricted products, arrangement for issuance of export license will be made in consultations with the private sector. Quantitative restrictions in the export of such products will gradually be removed through appropriate taxation measures.

- Transparent, smooth and efficient administrative procedures
- Exports will be free from all charges except the service charge other than specified conditions
- Export Promotion Zone (EPZ) will be established. No duty will be levied on the raw materials and auxiliary imports used by industries established in such EPZ. Industries exporting more than 90 percent of their production will be granted similar facilities as given to the industries established in EPZ.
- Gearing up towards export promotion activities, and trade missions will be opened and institutionalized on the basis of feasibility.
- Export promotion on the basis of an institutionalized basis.

Import Strategies

- Linking import with export
- Reducing transit cost
- Procedural simplification
- De-licensing of imports except for banned or under qualitative restriction items or in the auction system

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

5.1.4 Indo- Nepal Treaty of Trade and Transit

Indo-Nepal Treaty of Trade

In order to expand trade between Nepal and India and to encourage collaboration in economic development, Treaty of Trade, 1991 was signed on 6 December 1991, which was followed and refined on December 3, 1996.This Treaty is seen more often as the turning point in the history of Nepal- India trade relations leading to several policy changes. Some of the provisions can be viewed as follows:

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

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.

Again, the treaty was revised on 2007 and again in 2009 Nepal- India signed the revised India-Nepal Treaty of Trade and Agreement of cooperation. This new treaty revises the 1996 Trade Treaty between the two countries. The main features of this new revised treaty are:

- The validity oldie treaty has been increased from five to seven years, along with the provision of automatic extension for further periods of seven years at a time.
- Four additional land customs stations (LCSs) will be established to facilitate bilateral trade, bringing the total number of stations to 26.
- Criterion for calculating value addition for gaining preferential access to India has been changed from ex-factor basis to FOB basis.
- The Indian side agreed to review and simplify the existing administrative arrangements for operationalization of fixed quota for acrylic yarn, copper products and zinc oxide.
- India has agreed to consider several additional products as wholly produced or manufactured in Nepal for the purpose of gaining preferential access to the Indian market. It includes articles collected in Nepal fit only for recovery of raw materials and waste and scrap resulting from manufacturing operations in Nepal.
- No discrimination will be made in respect of tax including central excise, rebate and other benefits to exports merely on the basis of payment modality and currency off payment of trade. This will bring the bilateral trade conducted in Indian Rupees at par with trade in convertible currency and will end the existing mechanism of Duty Refund Procedure (DRP) which has procedurally cumbersome. It will provide Nepal a direct control on the customs duty revenues on manufactured goods from India. Making these products more competitive for further sale or value addition in Nepal.

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. 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 operationalized 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.

5.1.5 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 2000/01 onward. Of course, it may be due to the outcome of favorable provisions in the Indo-Nepal Trade Treaty of 2000. Following the table 4.2 the share of India in the total export of Nepal was 23.1 per cent in 2000/01. The trend escalated gradually in the successive years approached to 70.3 percent in 2010/11 then again declines. The share of India in the total import of Nepal was 26.6 per cent in 2000/01, which gradually increased and approached 61.6 percent in 2009/10 then again declines and increase and reach 66.1 percent in 2014/15. Treaty of Trade 2000 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.

CHAPTER VI

Determinants of Import and Export

Export and Import of the developing countries are affected by forces of demand and supply factors such as domestic price, the growth of gross domestic products, taxes, tariff, subsides, price in competitor countries etc.

Expansion of Nepalese export trade volume can definitely encourage GDP. So we have taken GDP and relative price with India as major determinants of export to India and import from India. Now we have estimated the log linear equations to determine the contribution of exports considering total volume of export in different time periods as dependent variable and gross domestic product, time period and relative price with India is considered as independent one. The regression is carried out with 21 years of data from 1994/95 to 2014/15. The fitted equations of the regression model are as following that the estimates are based on constant data. No attempt has been made to correct the problem of serial correlation. In all statistical analysis, figures in parentheses below the coefficients for independent variables indicate respective t-values. All the statistical values are computed from computer via SPSS programmers. All of Variable name, label and formation of regression can be seen by appendix 3.

6.1 Exports to India

The following regression equation is calculated with exports to India as dependent variable and other variable such as time variable, GDP of Nepal and Relative price.

1. Relation between Total Export to India and Time series: The estimating equation and result are:

   Equation, lnX1=A0+A1T+E

   Growth rate of total export to India = {antilogA1-1}*100 percentage

   The estimated results are:

lnX1=-165.925+0.085T	
(14.316) (0.007)	
T=-11.590, 11.877	R Squared: 0.881
P=0.000, 0.000	Adj. R Squared: 0.875
Growth rate of X1=22%	F: 141.059

One year change in the time period causes 0.085 percentage change in total export to India. Value of t-stat justifies the significance of parameters. The values in parenthesis are standard errors of respective parameters. The value of R square show that 88 percent variation in total export to India is explained by time period. The value of t-stat is the statistical significance level of 1 percent of parameters. Similarly the value of F also justifies at 1 percent level of significance of regression line. The average annual growth rate of total export to India during the review period remained 22%.

2. Relation between Total Export to India and Total GDP of Nepal: The estimating equation and result are:

   Equation, lnX1 = A0+A1lnGDP+e

   The estimated results are:

LnX1=-6.073+1.82InGDP	
(0.830) (0.148)	R Squared: 0.888
t=-7.314, 12.267	Adj. R Squared: 0.882
p=0.000, 0.000	F: 150.525

In this double log linear regression equation, the result states that one percent increase in GDP causes 1.82 percent increase in total export to India. This implies higher elasticity of total export to India to GDP. The value in parenthesis is standard errors of respective parameters. The value of R Square shows that 88 percent variation in total export is explained by GDP in this regression equation. This means higher goodness of fit of the estimated regression line. Values of t-stat are just enough to signify the statistical significance of parameters at 1 percent level of significance. And value of F also justifies at 1 percent level of significance of the regression line.

3. Relationship between Export to India and GDP of Nepal and Relative price with India: The estimating equation and result are

Equation, $\ln X1 = A0 + A1 \ln GDP + A2 \frac{WPI(I)}{WPI(N)} + e$

The estimated results are:

$LnX1 = -9.230 + 2.341 \ln GDP + 1.640 In \frac{WPI(I)}{WPI(N)}$	
(1.538) (0.259) (0.698)	R Squared: 0.914
T= -6.003, 9.044, 2.349	Adj. Squared: 0.905
P=0.000, 0.000, 0.030	F: 95.913

Nepal and relative price with India is presented. In this equation X1 denotes the export to India is the dependent variable GDP and relative price are the independent variable. This estimate states that one present change in GDP change 2.34 percent in to export India in same direction as relative price place constant. And 1 percent increase in relative price leads to increase 1.64percent increase in total export to India as GDP placed constant. The values in parenthesis are standard errors of respective parameters. The value of R squared 0.914. This indicates that 91percent variations to total export to India explain by GDP and relative price. This shows higher goodness of fitness of the regression line. The value t-stat of the coefficient of GDP is significant at 1 percent level. While the coefficient of relative price is significant at 5 percent level. Similarly the value of F justifies the 5 percent level of significance of the regression line.

6.2 Imports from India

The following regression equation is calculated to determine the Import from India. Import as the dependent variable and other variable such as time GDP of Nepal and relative price are the independent variables.

1. Relation between Total Import from India and Time Series. The estimating equation and result are:

Equation, $InM1 = B0 + B1t + e$

Growth rate of total import from India = {(anti logB1)-1}*100 percent

The estimated results are:

lnM1= 8.9687 + 0.1632t	
(0.0464) (0.0045)	
Growth rate: 46%	R Squared: 0.98
t= 193.16, 36.04	Adj. R Squared: 0.97
p= 0.000, 0.000	F: 1298.66

One year change in time period causes 0.16 percent increase in total import from India value of t-stat justifies the significance of parameter. The value in parenthesis is standard errors of respective parameters. The value of R Squared shows that 98 percent variant in total import from India is explained by time period. The value of T-stat and F-stat are significance at 1 percent significance level. The average growth rate of total import from India during the review period remained 46%.

2. Relation between Total Import from India and Relative price $\frac{WPI(I)}{WPI(N)}$the estimating equation and result are

   Equation, lnM1=B0+B1ln$\frac{WPI(I)}{WPI(N)}$+ e

   The estimated results are:

lnM1=5.211 + (-3.573)ln$\frac{\mathrm{WPI(I)}}{\mathrm{WPI(N)}}$	
(0.088) (0.485)	R Squared: 0.741
t= -259.153, - 7.365	Adj. R Squared: 0.727
p= 0.000, 0.000	F: 54.246

In the double log linear regression equation one percent change in relative price with India total import results to decrease in 3.57 percent vice versa. This implies that high elasticity of total import from India to the relative price with India. The value in parenthesis is standard errors of respective parameters. The value of R Squared shows that only 74 percent variant in total import from India is explained by the relative price with India. Thus, it shows the lower goodness of fitness of the regression model.

3. Relation between Total Import from India and GDP of Nepal. The estimating equations and result are:

   Equation, lnM1=B0+B1lnGDP+E

   The estimated results are:

lnM1 = -3.904 +1.535ln GDP	
(0.136) (0.024)	R Squared: 0.995
t= -28.646, 63.059	Adj. R Squired: 0.995
p=0.000, 0.000	F: 3.976

In this double log linear regression equation, the result states that one percent change in GDP results to1.535 percent change in import from India in same direction i.e. 1 percent increase in GDP of Nepal 1.535 percent increase in total import from India. The values in parenthesis are standard errors of respective parameters. The value of R Square show that 99 percent variation in total import from India is explained by GDP in this regression equation. This means that higher goodness of fitness of the estimated regression model. Value of t-shit is just enough to signify the statistical significance of parameters at 1 percent significance. And value of F is justifying the 1 percent level of significance of the regression model.

4. Relationship between Import from India and GDP of Nepal and Relative price with India.

Equation, lnM1=B0+B1lnGDP+B2ln $\frac{WPI(I)}{WPI(N)}$+e

The estimated results are:

$$\ln M1 = 3.739 + 1.508 \text{In} GDP - 0.086 \text{In} \frac{WPI(I)}{WPI(N)}$$

(0.285) (0.048) (0.129)	R Squared: 0.995
t=-13.118, 31.429,-0.662	Adj. R Squared: 0.995
P= 0.000, 0.000, 0.516	F: 1.930

In the estimated regression line, the relationship between import from India and GDP of Nepal and relative price with India is presented. In this equation MI denotes the Import from India is the dependent variable, GDP and relative price are the explanatory variable. This estimated line states that one percent increase in GDP of Nepal leads to increase 1.5 percent total import from India as relative price placed constant. And also that one percent change in relative price leads to change 0.08 percent import from India in negative direction as GDP placed constant. The value in parenthesis is standard errors of respective parameters. The value of R Squared shows that 99 percent variation in import from India is explained by GDP and Relative price with India. Thus, it shows that higher goodness of fitness of the regression line. The value of F and t-stat of the coefficient GDP is significant at 1 percent. On the other, F and t-stat of the coefficient Relative price is insignificant i.e. the variation on import from India is not explained by relative price variable.

CHAPTER VII

Summary, Conclusion and Recommendation

7.1 Summary

The study of foreign trade trend and structure with India shows that the foreign trade is still unfavorable to Nepalese economy. In other words, high imports against little exports have widening the trade deficit between India and other countries each year. This study provides a clear view regarding the history, trend of trade between Nepal and India, policy review and review of reform programs as well as trade composition and determinant of export and import. The following information summarizes the picture of Indo-Nepal trade situation in brief.

Export and import, between Nepal and India has increased from the year 2000/01 on ward of course, it may be due to the outcome of favorable provision in the Indo-Nepal trade treaty of 1996. The share of India in the total export of Nepal was 23.1 percent in 2000/01. The trend escalated gradually in the successive years and approached to 46.8 percent in 2004/05, which hyper jumped up to 59.6 percent in 2005/06. The share of India in total import of Nepal was 26.6 percent in 2000/01, which gradually increased revealing 52.7 percent in 2005/06. Treaty of trade has indeed played a crucial role in foreign trade structure of Nepal.

Composition of trade indicates the pattern of export and import in the initial stage of development, where as in the advanced stage the majority of produced goods can be found in the composition of trade so the composition of foreign trade also determines the level of the development of a country. In this study composition of Nepal-India analyzed on the basis of SITC.

Composition of Nepal export to India has been changed. In the past primary commodities constituted that principle export to India, but at percent manufactured products have replaced them. Exports of primary products such as Food and Live animals, tobacco and Beverage etc., show the decreasing trend towards India. The share of food and animals in total exports to India constituted 50 percent in fiscal year 1994/95 but it confined only to 23.30 percent in the fiscal year 2014/15 observation made on the manufactured items exported to India shows manufactured goods classified mainly by materials (group 6) occupy the major portion of imported commodities from India (Table No. 3, 4, 5 and 6).

Changing pattern of Nepal-India trade shows that exports of primary product is decreasing from the 76.6 percent in the fiscal year 1994/95 to 27.5percent in the fiscal year 2014/15. After 1999/01, total export and import of manufactured product is increasing. In the fiscal year 1994/95 share of manufactured products imported from India was 73.7 percent, till then it showed fluctuating tendency and reached only 90.6 percent in the fiscal year 2014/15. Similarly, imports of primary were 26.3% in fiscal year 1994/95 and it is 9.4 percent in the fiscal year 2014/15 (Table No. 7).

The trade balance of Nepal remains unfavorable with increasing deficit with India during the study period. The trade balance with India was Rs. 5770.9 million in fiscal year 1994/95, and it reached Rs. 218564.8 million in the fiscal year 2014/15. The main reason for the growing trade deficit is the prevalence of import over export. To solve the overriding problems, Nepal needs to have adequate market penetration and import substitution policies (Table No. 8).

Comparative study of Nepal India-trade clarifies the percentage share of the Nepalese trade held by India and countries other than India. In the fiscal year 1994/95 the share of total export was 21.0 percent and 79.0 percent to India and overseas countries. This came to be 67.4 percent for India and 32.6 percent for overseas countries. This indicates India is the key partner from Nepal's perspective in trading relationship (Table No. 9 &10).

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

GON adopted Exporters' Entitlement Scheme (EEE) in 1961, to promote and diversify export from India to the overseas countries. The EEE scheme neither helped in expanding the export base nor contributed to reduce the dependency on India.

Consequently, in 1977 Dual Exchange Rate System replaced the EEE scheme. A number of trade facilitation measures and incentives were introduced, such as duty drawback and bonded warehouse systems. Enhanced Structural adjustment facility (ESAF) was initiated on October 1992 for three year. The new trade policy has been implementing since 1992 with the basic objective to enhance trade diversification, to promote private sector participation, production of qualitative and competitive good, and establishment of EPZ. Ln order to reduce to the poverty GUN has developed a Poverty Reduction Strategy Paper (PRSP; which is also the country's tenth plan (2002-2007). This program is supported by Poverty Reduction Growth Facility (PRGF) and Poverty Reduction Support Credit (PRSC) which are funded by IMF and World Bank.

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

The Indo Nepal treaty was revised in 2009 with the modification of some provisions of treaty signed on 1961. This Treaty is seen more often as the turning point in the history of Nepal- India trade relations leading to several policy changes. The Treaty of Transit, 1991 came up for renewal in December 1998 and following bilateral talks, a renewed Transit Treaty was signed on January 5, 1999. The renewed Treaty contains liberalized procedures of the transit of the Nepalese goods, The empirical study of determinants of exports and imports helped to reach the conclusion that the GDP, time period and relative price are the main determinants of total export and import. GDP plays the dominant role in total export and import from India. The result states that one percent increase in GDP causes 1.82 percent increase in total export to India on other hand one percent increase in GDP causes 1.53 percent increases in total import from India. It shows that both export and import have positive relationship with GDP. This study conclude that relative price have less significance role as compare to GDP and time variable. The average annual growth rate of total export to India during the review period remained 22 percent whereas average annual growth rate of import from India is 46 percent during the study period which is 24 percent higher the export.

7.2 Conclusion

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

Strength of Nepalese trade:

- Nepal is very much rich on natural resources such as hydropower, mines etc. and there is high potentialities of agro based industries too.
- Being a member of WTO, SAPTA and SAFTA , Nepal can achieve so many benefit and have chance to expand export , to improve trade deficit and to correct BOP situation.
- Development of information technology and introducing of new technology on some industries are encouraging factor to assure quality and competitive products.
- Adequate work force with Low labor 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 strengthen export trade oriented industries.
- The political condition of the country is in the stage of transformation. Since, civil war has been ceased; there is high potential for the tourism based industry as it had been serving a Nepalese economy for a long period. The positive direction for fostering tourism industry has been opened with the peace process.

- Nation is going towards political settlement with cease-fire. Democratic system has reestablished and decade long moist insurgency is finally over.
- Political parties are trying to make consensus for the formation of new government and political stability. No doubt, political consistency is essential factor to do something on the area of export promotion.

Weakness of Nepalese Foreign Trade:

- Land-locked situation, mountainous and rugged geographical structure of the country is one of the biggest bottlenecks in Nepalese foreign trade expansion.
- One of the main reasons for losing foreign market for Nepal's product is the child labor issue and poor quality of the product itself the government should facilitate the domestic industry and provide proper subsidy to promote foreign trade and regulate the serious human exploitation issue in grass root level.
- Open border and free flow of goods between Nepal and India also are serious problems for Nepalese products because Indian products are available cheaply in Nepalese market. Owing to smuggling practices, the illegal traders are getting advantage of imports and exports.
- Infant industrial shape with narrow base of exportable production having low quality products has been challenging scene of Nepalese trade, though it has already entered into global trade i.e. WTO and bilateral trade arrangements like SAPTA and SAFTA.
- Though the agricultural is the fundamental aspect of the Nepalese economy, it has been extremely disappointing. Transit and transportation cost is too high and there is no effective rural- urban linkages practices too.
- Unfavorable environment for industrial development, lack of sound and effective strategic policies, inconsistency of government policies , political instability and a decade more long moist problem are hampering facts for the Nepalese trade expansion. No doubt delay in decision-making and lack of political-will cannot possess a country's progress.
- Due to the adoption of liberal economic policy, government levied international trade tax to generate revenue but it neglected the aspect of import substitution. So, the trade deficit of Nepal becomes more acute.
- Nepal uses only one transit to (trade route) trade with overseas countries other than India and China. Although Nepal can use other trade routes such as

Fulbari Banglaband through Bangladesh but not action is forwarded regarding this.

- Nepalese domestic industries cannot produce enough goods for Nepalese growing population.
- Export procedure documentation, Quality industrialization and quality mix, Lack of human resources and R & D, Insecure of FDI, Lack of dry port facilities, High transport cost and problems in the seaport are also consider the barrier to expand Nepalese export trade.
- Lack of diplomatic efforts, India oriented policies, condition imposed by donor agencies, donor driven strategies, poor implementation , not effective monitoring and evaluation mechanism, no price and reward system, red tapes on bureaucracy can also be consider the challenging scenarios .

7.3 Recommendations

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

- As soon as possible political settlement must be assured with the coordination of all the stakeholder of the nation. Without Political stability and consistency, nothing can be achieved.
- Re-inventing of government is essential with cutting Red-Tapism and putting customer first strategies should be taken by government.
- In favour of country's interest, effective diplomatic efforts with strong political -will and commitment should be taken by the government.

- It is necessary to make export plan having the framework of enhancing strategies of export and discouraging the volume of import that can reduce trade deficit problems. To reduce imports, domestic industries should be encouraged to produce consumer goods, which can be done by increasing tax on imported items.
- Government should have the strategies to protect domestic industries that can be exercised by imposing quantitative restriction on imported items, developing of infant industries and expanding domestic markets.
- Government role should be defined as catalytic in practice not only on paper. Government should empower and attract the private sector involvement by making environment friendly policies which is lacking now.
- Foreign trade should be directed towards export promotion, import substitution and export diversification. Policies must not be influenced by foreigners.
- Diplomatic efforts should be started and search appropriate trade and transit route with overseas trade. Immediate action should take towards rethinking about the trade and transit treaties with India.
- Government should invest some money on research and development, as well as human resource development. Similarly proper utilization IT, introduced of changing technology on new established industries are essential.
- Implementation of policies should take care in an effective manner as well as monitoring and evaluation of policies is essential.
- There are possibilities of trading activities with SAARC countries. It does not only reduce trade concentration with India, but also work as a milestone towards mutual co-operation. It increases the possibility of joint venture in establishing industries.
- Provision of Surveillance at borders where goods are smuggled can be control smuggling practices across the borders, especially with India. In this regard, public cooperation should also be sought.
- Export should be increased by improving the quality of product, introducing new commodities, reducing cost of production, generating export surpluses, encouraging research and development.

- Imports substitutes should be encouraged by adopting improved indigenous technology curving non-essential and luxury imports and controlling population growth. It should also diversify its imports and exports markets and products via trade agreements and developing friendly relations.
- Open market policy will be beneficial for the country only when Nepalese products should be able to provide opportunities not to taste international products in the country but also to give the taste to others in the same proportion.
- To expand trade regular meetings, seminars, workshop with the participation of the all stakeholder should be conducted.
- Nepal should give higher priority to remove the nation's deficit problem by adopting long-term measures like penetration to export market and effective application and execution of import substitution regime.
- Trade oriented industries can be strengthen as there is high potentiality of bringing FDI in sectors as hydro-power, eco-tourism etc. in Nepal.

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

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Appendix 1

Exports to India Commodities According to SITC Categories.

(Value in million Rs.)

Fiscal Year	SITC Code										Total
	0	1	2	3	4	5	6	7	8	9	
1994/95	789.1	2.6	212.1	0.0	185.9	7.5	339.1	0.0	15.9	0.0	1552.2
1995/96	761.6	1.8	287.5	0.0	114.5	9.7	246.8	0.0	28.1	0.0	1450.0
1996/97	754.7	5.5	326.9	0.0	169.6	15.4	317.2	0.9	30.1	1.4	1621.7
1997/98	925.9	4.1	291.6	0.0	133.5	202.4	817.9	0.1	33.2	0.2	2408.9
1998/99	1315.2	2.8	388.7	0.0	210.6	256.0	904.9	2.5	43.6	0.0	3124.3
1999/00	1267.8	1.9	336.5	1.3	137.9	628.1	1236.1	26.4	56.6	0.0	3682.6
2000/01	1750.8	1.7	381.1	1.4	153.4	1333.0	1521.5	11.2	71.6	0.5	5226.2
2001/02	1704.2	19.7	329.2	20.6	1979.4	1950.6	2596.4	4.4	236.9	0.0	8794.4
2002/03	2040.5	43.7	353.9	0.5	3373.0	2780.3	3248.0	23.6	667.2	0.0	12530.7
2003/04	3726.2	103.2	498.4	2.2	2931.4	3882.0	5577.7	176.1	4323.5	0.0	21220.7
2004/05	3992.4	66.7	705.6	1.2	3931.4	3995.1	8907.3	197.8	4228.6	0.0	26030.1
2005/06	4542.4	141.4	560.2	5.2	7211.7	3234.2	9971.1	314.6	197.5	0.0	27956.2
2006/07	4672.3	106.6	682.2	14.5	4053.2	3174.1	11387.7	111.8	2225.7	0.0	26430.0
2007/08	4595.5	42.3	576.2	14.5	3206.4	3624.5	16228.9	219.1	2262.5	4.5	30777.1
2008/09	5389.3	26.5	736.6	3.9	4858.8	3577.7	21353.1	85.7	2876.2	6.9	38916.9
2009/10	6306.7	14.3	1163.3	0.5	4145.7	3564.7	21928.3	111.0	3477.7	9.1	40714.7
2010/11	5944.3	12.0	1291.6	0.0	4337.2	3977.4	23763.4	185.7	2217.2	2.5	41728.8
2011/12	7617.4	10.7	1181.4	0.0	2023.6	2696.3	22942.2	300.4	1783.7	0.0	38555.7
2012/13	10151.1	329.5	1494.6	40.6	319.6	2990.8	20976.0	490.6	4213.1	0.0	41005.9
2013/14	8591.6	0.0	2103.3	0.0	205.6	1648.5	25445.6	528.1	1471.1	0.0	39993.7
2014/15	10104.5	0.0	1509.0	0.0	310.4	2673.7	26396.9	359.4	2006.3	0.2	43360.4
Average	4140.3	44.6	734.0	4.4	2047.3	2200.6	10764.7	150.3	1630.9	1.2	21765.8

Source: Quarterly Economic Bulletin Volume Mid-April, 2015

Appendix 2

Imports from Indian by Commodities According to the SITC

(In Rs. Million)

Fiscal Year	SITC Code										Total
	0	1	2	3	4	5	6	7	8	9	
1994/95	1496.8	254.4	178.4	210.1	1.6	128.0	1948.9	1629.5	922.1	1.3	7323.1
1995/96	2429.9	287.3	255.1	321.3	0.9	1891.5	3298.3	2251.1	518.6	0.5	11245.5
1996/97	2537.6	443.6	393.0	356.6	3.6	1912.6	3966.5	2284.1	637.6	7.2	12542.1
1997/98	3044.9	340.5	395.7	435.0	9.2	2476.9	5228.5	3598.0	805.1	1.6	17035.4
1998/99	2834.0	468.8	638.5	379.9	11.4	2874.4	7374.4	4240.1	791.1	3.3	19615.9
1999/00	3265.7	437.7	889.5	436.7	51.4	3540.6	9472.6	5301.6	1001.8	1.0	24853.3
2000/01	8658.1	536.8	701.1	499.1	91.5	4077.0	8962.2	5053.7	1271.2	2.6	24853.3
2001/02	3364.8	667.2	1020.7	479.6	12.0	5279.5	9919.6	5154.2	1369.0	54.4	27331.0
2002/03	5501.0	658.0	1369.9	513.1	40.0	5502.0	10482.1	6663.5	1380.0	0.4	32119.5
2003/04	6975.8	642.5	1535.9	778.5	84.0	6287.7	14032.4	7006.1	2317.1	0.1	39660.1
2004/05	4412.3	630.1	2375.5	10854.4	418.2	6628.0	18099.8	8686.5	2605.3	0.8	54700.9
2005/06	4989.1	619.1	3010.6	14761.9	23.0	5129.0	18746.4	7527.4	1768.2	1.0	70924.2
2006/07	6598.1	600.1	4297.5	19609.7	55.4	678.9	22499.6	8444.8	2035.1	1.0	124203.1
2007/08	6357.9	737.9	4628.4	21593.6	107.9	8083.8	22807.5	11923.8	2714.8	32.4	82753.7
2008/09	6750.1	687.5	4670.4	29551.3	64.4	10479.4	22532.0	10073.8	2714.8	31.8	88675.5
2009/10	10108.8	724.5	5437.6	35665.3	152.6	13520.8	25487.4	11974.0	4072.1	0.0	107143.1
2010/11	8220.4	712.6	4764.6	35612.6	65.6	14647.7	29627.5	18513.3	3708.0	0.0	115872.3
2011/12	9757.0	877.1	4700.4	43146.4	229.7	15356.4	40950.9	23064.8	4219.7	74.1	142376.5
2012/13	12335.3	1324.3	8469.9	43957.2	35.7	14877.7	40018.1	33255.5	8068.6	107.3	162437.6
2013/14	15850.9	2370.3	1427.8	54391.1	301.1	22167.4	52454.9	43791.6	11477.2	38.0	217114.3
2014/15	22175.0	2135.6	15772.4	78986.6	0.0	25706.1	58278.5	42808.6	15948.0	114.4	261925.2
Average	8336.1	770.7	3798.9	18692.2	83.8	8500.3	20333.2	12583.2	3294.6	39.5	74888.4

Source: Quarterly Economic Bulletin Volume Mid-April, 2015

Major Commodity Groups According to SITC Code

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 material

7=Machinery and Transport Equipment

8=Miscellaneous Manufactured Articles

9=Commodity and transaction not classified according to kind

Appendix 3

Basic Data

Period	Total Export	Total Export to India	Total Import	Total Import from India	GDP of Nepal	WPI of Nepal	WPI of India	$\frac{WPI(I)}{WPI(N)}$
1994	7387.5	1552.2	23226.5	7323.1	116127	34.3	60.6	1.77
1995	13706.5	1450.0	31940.0	11245.5	144933	41.5	68.8	1.66
1996	17266.5	1621.7	39205.6	12542.1	165350	45.1	77	1.71
1997	19293.4	2408.9	51570.8	17035.4	191596	49.2	82.7	1.68
1998	17639.2	3124.3	63679.5	19615.9	209974	52.9	91.5	1.73
1999	19881.1	3682.6	74454.5	24398.6	239388	57.3	100	1.75
2000	22636.5	5226.2	93553.4	24853.3	269570	61.9	105.9	1.71
2001	27513.5	8794.4	89002.0	27331.0	289798	67.0	111.4	1.66
2002	35676.3	12530.7	87525.3	32119.7	330018	74.7	119.1	1.59
2003	49322.7	21220.7	108504.9	39660.1	366251	77.2	123.3	1.60
2004	55654.1	26030.2	115687.2	54700.9	425454	79.1	127.5	1.61
2005	46944.8	27956.2	107389.0	56622.1	444052	81.4	133.6	1.64
2006	49930.6	26430.0	124352.1	70924.2	473546	85.2	137	1.61
2007	53910.7	30777.1	136277.1	78739.5	517993	88.6	141.5	1.60
2008	58705.7	38916.9	149473.6	88675.5	566579	92.6	100	1.08
2009	60234.1	40714.7	173780.3	107143.1	630301	100.0	104.4	1.04
2010	59383.1	41874.8	194694.6	115872.3	696989	105.9	111.3	1.05
2011	59266.5	38555.7	221937.7	142376.5	755257	113.0	116.6	1.03
2012	67697.5	41005.9	284469.6	162437.6	909309	127.2	126	0.99
2013	60824.0	39993.7	374335.2	217114.3	1060881	139.4	130.8	0.94
2014	64338.5	43360.4	396175.5	261925.2	1168949	152.7	143.2	0.94

Source: Compiled by the author from NRB, Economic Survey, Statistical year Books (1994-2014)