

A Study of India Nepal Trade Relations in the light of WTO Regime

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ABSTRACT

India has strong historical, cultural, socio and economic relations with Nepal. Both the countries are well integrated with each other through identical value system and geographical proximity. Nepal, being a landlocked country shares a long-standing border of 1600 km with India. In the recent years, Nepalese economy has undergone through phenomenal changes in terms of economic relations. The major economic change came in 2004 when Nepal gained the membership of WTO as earlier she had merely an observer's status. Nepal became a 147th member of WTO and first least developed country to join WTO. It is obvious that Nepal's accession to WTO was a major breakthrough to integrate its economy with the global economy. Nepal is the largest trading partner of India and under the new policy regime of WTO, the trade relations between India and Nepal has taken new dimension. The trade and investment pattern of both countries have changed. So, there is need to analyze trade and investment relations of these two countries after the Nepal's accession of WTO. The present study is divided into four parts. The first part of paper analyzes the impact of WTO membership on Nepal and its foreign trade direction and investment pattern pre and post WTO era. The second part of the paper analyzes the Indo- Nepal trade and investment pre and post WTO era. The third section of the paper identifies implication of WTO membership to Indo- Nepal trade relation. Finally, paper identifies the major areas for boosting the trade and investment between India and Nepal.

Keyword- WTO, Nepal, SAFTA, SARRC, MFN and Indo- Nepal Trade

Introduction

India has economic relationship with Nepal since 1950. India is the only nation that has significantly contributed to Nepal's economic development. Nepal is a landlocked country, and due to this position, Nepal has been keeping close economic relationship with India. Nepal had signed the treaty of Peace and Friendship with India in 1950 to strengthen the economic relationship. A reflection of this economic relationship is found in a number of areas and reflected in many writings and remarks. Some of these are referenced to ahead.

Bahaudhar Kalim & Lama Mahendra's (1995) remarks ; 'over the past three and half decades, India has been Nepal's biggest donor in building a variety of projects such as airports, irrigation, agriculture, supply of drinking water, roads, health industrial estate and education, etc

Similarly, in his study, Sharma (2003) reveals, most of the projects financed by India were undertaken between 1951 and 1954. It is noteworthy that Nepal started economic liberalization program in 1984. However, in the 1985 India - aided projects in Nepal declined gradually.

Adhikar M. Bharat (2007) reveals that there are 170 Indian joint ventures (JVs) in Nepal. India's direct investment in joint venture (JV) industry accounts almost thirty six percent of the total 'Foreign Direct Investment' (FDI) in Nepal. These joint ventures are in the areas of tourism, consumer goods like toothpaste, cosmetics, garments and mining industries

Another study conducted by RIS (2002) informs that, a high level task force (HLTF) has also been formed to oversee the progress of Indian-assisted projects in Nepal. A number of projects including improvement of physical facilities and infrastructure at important customs stations at border and check-posts, pilot-projects in rural and community development, small and medium hydro-power project, milk and dairy development, development of an information Technology Institute etc. are some of the other agreed projects

Foreign Trade Direction of Nepal Pre and post WTO Dimension

After the membership of WTO, Nepalese economy has seen a remarkable change in foreign trade

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direction. So it becomes imperative to see the changes that have taken place in pre and post WTO dimension. A cursory review of Nepal's export and import data reveals that the trade pattern has changed significantly. And markedly, these changes took place only within the span of the six year. Table 1 and Figure 1 clearly shows that Nepal exports have weakened after the membership of WTO. It is also clear from the data that the export is almost stagnant throughout the period, however; the sharp increase in import was recorded after attaining the membership of WTO. Similarly, the trade deficit of Nepal has widened after joining WTO and import export ratio has almost doubled (Nepal's import was 2.52 times the export in FY 2003-04, which increased to 4.24 times in FY 2008-09)

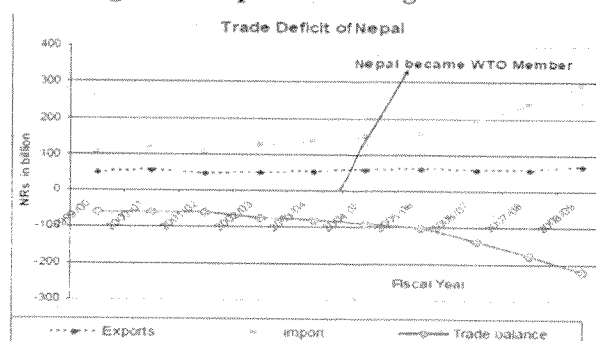
FY	Import	Export	Trade Deficit	Import/(-)Export Ratio
Pre-Accession Period				
1999/00	108.5	49.8	587	2.18
2000/01	115.7	55.7	60	2.08
2001/02	107.4	46.9	60.4	2.29
2002/03	124.4	49.9	74.5	2.49
2003/04	135.8	53.9	81.9	2.52
Composite Index	118.4	51.3	67.1	2.31
Post-Accession Period				
2004/05	148.3	58.4	89.9	2.54
2005/06	160.7	59.8	100.9	2.69
2006/07	195.8	58.9	136.9	3.32
2007/08	237	58.5	178.5	4.05
2008/09	291	68.6	222.4	4.24
Composite Index	206.6	60.8	145.2	3.4

Source: Ministry of Finance, Government of Nepal. Economic Survey of various years and Trade and Export Promotion Center (TEPC), Overseas Trade Statistics.

Indo Nepal Trade Relation

India is the founding member of WTO and Nepal got the membership of WTO in 2004. It is important to compare the trade data of India and Nepal under bilateral trade and trade data post Nepal's

Figure 1. Nepal's widening trade deficit



Source: Department of Industries, Ministry of Finance, Government of Nepal.

WTO membership. Since WTO aims at facilitating trade removing barriers to trade, provides the special support to the least developed and developing countries. It is very relevant to analyze the impact of WTO on Indo Nepal trade.

In Table 2 the analysis shows that an average share of India in Nepal's total export was around 51.8

Table 2. Composition of Export and Imports in Pre and Post-Accession Period

FY	Export (%)		Import (%)	
	India	Overseas	India	Overseas
Pre-Accession Period				
1999/00	42.6	57.4	36.6	63.4
2000/01	46.8	53.2	47.3	52.7
2001/02	59.6	40.4	52.7	47.3
2002/03	52.9	47.1	57	43
2003/04	57	43	58	42
Composite Index	51.8	48.2	50.3	49.7
Post-Accession Period				
2004/05	66.6	33.4	59.8	40.2
2005/06	68.1	31.9	66.7	33.3
2006/07	70.8	29.2	59.2	40.8
2007/08	65.9	34.1	60.1	39.9
2008/09	63.5	36.5	56.7	43.3
Composite Index	67	33	60.5	39.5

Source: Ministry of Finance, Government of Nepal, Economic Survey (various years) and Trade and Export Promotion Center (TEPC), Overseas Trade Statistics.

percent in 2003-04 (Composite Index), which increased to 67.0 percent in 2008-09, especially after joining WTO. Similarly, the import pattern has also changed. It was 49.7 percent and it decreased substantially to 39.5 percent in 2008-09. However, it would be a premature statement that WTO membership alone can not bring significant changes in Nepal's trade, therefore, the other factors need to be examined to make any comment on change of Nepal's trade pattern.

FDI in Nepal: Pre and Post WTO membership

FDI has not been an important source of aggregate investment finance and its impact on economic development has also been minimal. Nepal has some niche sectors such as tourism and herbal products, which has potential to attract more capital from overseas. Despite liberalized policies for these sectors in Nepal, the full potential has not been exploited. But it cannot be ignored that the increased FDI in the year 2008, is the result of few measures taken by Nepal with a motive to more liberalise its trade policies. Such as, the unweighted average rate of import tariff was reduced drastically. In addition to this, several other steps have been taken such as introduction of duty drawback and bonded warehouses. These steps induced foreign investor to invest in Nepalese market.

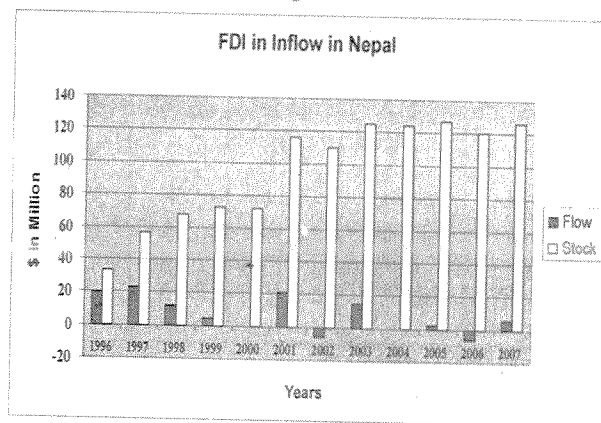
The flow of foreign capital has seen a dramatic change after the Nepal's accession to WTO. The flow of FDI before and after WTO accession is presented in Table 3 as giving below:

Table 3. FDI in Pre and Post Accession Period

Fiscal Year	No. of Industries Registered	FDI (INR in million)	Employment
<i>Pre-Accession Period</i>			
1999/00	71	1417.61	4703
2000/01	96	3102.56	6880
2001/02	77	1209.65	3731
2002/03	74	1793.77	3572
2003/04	78	2764.8	2144
Composite Index	79.2	2057.68	4206
<i>Post-Accession Period</i>			
2004/05	63	1635.77	5559
2005/06	116	2606.31	7358
2006/07	188	3226.79	7386
2007/08	212	9811	10677
2008/09	150	5355.54	8305
Composite Index	145.8	4527.08	7857

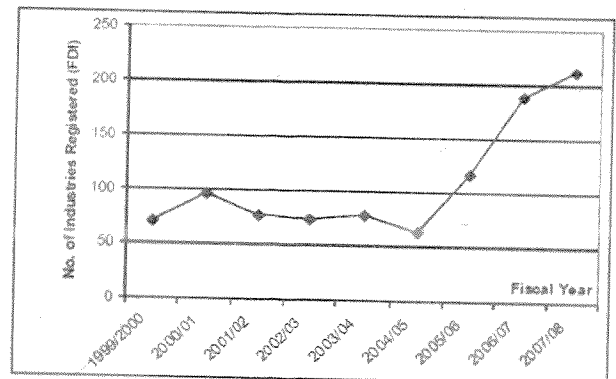
Source: Department of Industries, Ministry of Finance, Government of Nepal

Figure 2



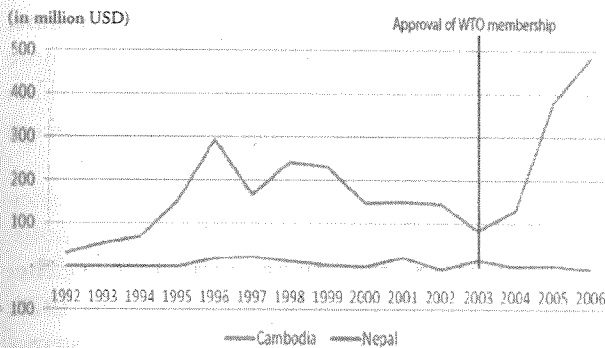
Source: UNCTAD

Figure 3.(a) Flow of FDI in Nepal



Source: Department of Industries, Ministry of Finance, Government of Nepal.

Figure 3(b).



Source: Baumuller et al (2008).

Table 3 and Figure 3 clearly reveals that the capital inflow has increased in Nepal very rapidly after joining the WTO. The number of companies registered, FDI amount and number of employment opportunities created in such companies also increased significantly after joining the WTO. On average, the number of FDI companies registered annually in Nepal was 79 in pre accession period which increased to 146 in post accession period. Similarly, on an average the FDI amount was doubled in post accession period (average annual FDI amount was Rs.2057.68 million in pre accession period, which was increased to Rs. 4527.08 million in post accession period). The number of employment opportunities created as a result of FDI also almost doubled in the post accession period.

India's Investment in Nepal

India's investment in Nepal is primarily in the form of joint venture. India's investment mainly concentrated in wood products, non metallic, mineral products, hydropower, other manufacturing products, transport ,communication and service industries . However, investments in sectors like paper and paper products, construction and housing and

agriculture is low. Table 4 analyzes the Indian investment in Nepal after the WTO membership. It shows that Indian investment in Nepal was 7862.13 million in 2002-03 and number of industries covered was 280. However there is significant changes India's investment in Nepal afterwards. In 2007-08, Indian total investment was 18,888.23 million and number of industries covered in this investment was 401. It is obvious that the quantum of India's investment in Nepal has changed significantly after the WTO membership

Problem in Enhancing the Trade between two Countries

Ever Widening Trade Gap

The volume of Nepal foreign trade has increased significantly in the past one decade, and the demand for imports has increased very rapidly and exceeded the capacity to generate sufficient revenue from the exports. It has been recognized that Nepal possesses limited exportable articles when compared with India. On the other hand, Nepal being predominantly a land-locked and agrarian country, the country requires many articles and items in bulk for heading towards an industrial era. Various industrial raw materials, semi-finished as well as finished products are required in huge quantities for industrial development, besides the requirements for fulfilling the peoples' increasing needs for consumer goods. India exports the manufactured goods and articles in higher proportion to total export. Due to the persistence of unequal balance between export and import of goods , the questions of balance of trade and balance of payments has always been raised in case of Indo-Nepal trade relation. The widening of trade deficit of Nepal has

Table 4. Indian Investments in Nepal

(Million INR)

	Cumulative upto 2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	Cumulative upto 2007-08
Indian Investment	7862.13	1,696.48	1,167.10	1,563.36	2,045.94	4,553.21	18,888.23
Growth in %	7.6	236	-31.2	34	30.8	122.5	31.7
No. of Industries	280	10	15	31	28	37	401

Source - Department of Industries, Ministry of Finance, Government of Nepal

become a common characteristic and a chronic problem of Nepalese economy.

Weak Export Base

Nepal has very weak export industry, which mainly confines to primary products and a very few manufactured products. On the other hand, the few manufacturing units operating in the country are very much volatile, swayed more often than not by short term profit. These industries, in the mean time are prone to external shocks such as change in attitude of consumer. Lack of product specialization is also the major problem prevalent in the manufacturing industry. Low volume of export trade has further weakened the Nepalese economy. The position of Nepal in the international market is very weak. The delivery system in external trade is weak. The support of export sector is trifling which never brought benefits for export industry. Despite the economic liberalization, Nepal could not make sound and stable export policy, and further unstable political environment, is the biggest reason behind the poor performance of the export sector of Nepal.

Lack of Diversification

Nepal's foreign trade is mainly confined to specific regions. The overall structure of Nepal's foreign trade has not been diversified both commodity and region wise. Moreover export is confined to some specific countries. This may be revealing the fact that product diversification in general and industrialization of economy in particular has not taken place. This indicates that there is problem in product identification and market research. Woolen carpet and readymade garments are the only items that account major portion of Nepalese exports. Moreover the export of these products is tied to some particular countries only. This type of dependency on a couple of products is very risky. Thus there is urgent need to diversify Nepalese export markets, region wise and commodity wise.

Increasing Import Demand

The basic problem of Nepalese foreign trade sector is to pay large amounts for the imports. On the other hand, a development project in the country has also increased the demand for capital-intensive

products in Nepal. So the sudden leap has been witnessed in importing items. In the mean time, developed countries are also in race of securing more natural resources all around the world, which exerted a great pressure on the demand for foreign exchange.

Lack of Commitment

Several measures, such as the Bonus Voucher Scheme 1962; Dual Exchange Rate System 1978; Single Exchange Rate 1981; The Basket System - 1986; the New Trade Policy -1982; the Nine Point Programme- 1983; the Devaluation of 1985 and 1981; Export Processing Zone- 1990; Industrial Policy of 1992 etc , were initiated to promote the exports in Nepal. The benefits of these policies have been experienced in terms of foreign exchange earning and reducing the concentration of trade from Indian market. However, policies brought by the government from time to time have not been able to cope up with the prevailing problems, not because of the policies pronounced were irrelevant and inappropriate, but mainly due to its ineffective implementation of policies by the pronouncing authority.

Unauthorized Trade

Nepal and India share an open border of more than 1600 km. Because of the long open border between India and Nepal, and various forms of malpractices take place at the boundaries of two countries. The direct impact of these malpractices can be seen on the Nepal's foreign trade sector of the national economy. Both India and Nepal exporter and importer are engaged in the informal trading, through smuggling of goods. Studies and researches in this regard indicate that though there are no precise estimates in connection with unauthorized trade but it constitutes a large volume. It is further noted that the growth has been facilitated by the complete freedom of currency movement between the two countries and availability of increasing number of transit outlets for Nepal through the Indian Territory. Undoubtedly, the unofficial trade affects the government revenue of both countries. It is furthermore recognized that riverside routes are also used in course of unauthorized trade. It has been, indeed, very difficult for both sides,

even when they adhere to the agreement on the cooperation, to control unauthorized trade.

Administrative and Procedural Complications and Delays

It is well known that trade is governed, to large extent by the trade regulation and related administrative bodies. Moreover, the volume of trade is largely depending on transparent and simplicity of trade and administrative procedures. In a study, recently carried out by the South Asia Network of Economic Institute (SANEI) to identify the extent of informal trade between Nepal, Bangladesh, Sri Lanka and India, it has been stated that submission of unnecessary documents, administrative hassles at custom offices, additional detention charges and untimely delivery of goods increase the cost of transaction in formal trade. Such types of activities and procedures enormously affect the trade affairs.

Existence of Close Substitutes

Nepal is South East Asian country where all the other countries in the region trade in the same commodity as Nepal does. Nepal is less advantageous as compared to other countries as regard the quality production. Apart from this, Nepal's geographical positions also make her uncompetitive in overseas market. In the mean time, Nepal products are costlier as compared to other countries in this region. As a result Nepalese goods fail to compete with goods from other countries in the region, in international markets.

Lack of Effective Regional Co-operation

Lack of effective regional co-operation is also the major concern in South Asia. The past performances of SAFTA have shown the political ambition of the leaders but at the market level it is not implemented effectively. It is obvious that for a small country like Nepal it has become difficult to achieve the true benefits from the regional co operation because Nepal has low economies of scale which is considered to be a major obstacle. Furthermore, Nepal's approach towards setting up of big industry for the export for Indian markets is passive.

Less Effective Institutional Mechanism for Nepal India Trade

Up to some extent the monitoring of the trading activities between the two countries are being carried by the Trade and Commerce Ministries of the concerned governments and by the Federation of Chamber of Commerce of both countries. This arrangement of monitoring trade activities is inadequate and feeble. The trading activities are carried by the individual trading house without any backup.

Frequent Revisions in Duties and Rules

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

Suggestions for strengthening trade between two Countries

India as an Opportunity

In the present world, efforts have been made to form regional economic co-operation, where the countries have shown the interest in common currency, free movement of goods and services, and free movement of people from one region to other. For the economic and trade development, India and Nepal need to cooperate on these elements. It is evident from economic relationship between India and Nepal. But the true benefits of economic and trade relationship has not been utilized by the policymaker. The landlocked needs should be turned into opportunities from the constraints.

Nepal must forget the threat of being a landlocked economy and its dependence on India. On the other hand Indian practitioners need to change their attitude. This socio psychological elements can be changed with the joint efforts of both the countries at the government and non government levels. The

civil societies of both the countries can act as instrument to change the social psychology of the people of the both countries.

Promoting Indo Nepal Joint Ventures

Economic liberalization in Nepal has played important role in attracting private investment in wide range of industries. India has been at the forefront of such ventures. In fact, the history of Indian investment in Nepal dates back to pre independence years when industrial houses such as the Birlas and Golchas were among the early Indian capitalist to set up ventures in Nepal. At present, there are number areas where India has made investment through joint ventures. Nepal has wide range of joint ventures in diverse areas like hotels, minerals exploitation, mining, textiles, dry battery, brewery, banking, electronics, transport and tourism among others. The establishment of the joint ventures and the promotion of private investment by the India investors in Nepal have provided ample of scope for the development of Nepal India trade. With the establishment of such activities there will be the possibilities for the formation of institutional mechanism to aid the development of trade between the two countries. There is great possibility of the expansion of export of commodities like toothpaste, soap, ayurvedic medicine etc. as the industries, established through joint ventures are mainly focusing on Indian market. It is anticipated that more industries with Indian joint ventures will be put into operation in Nepal in the near future.

Mineral Exploration and Exploitations

Mineral resources, such as limestone, magnesite, dolomite, silica, clay, construction stone, iron ore, lead and zinc etc are identified which can be commercially exploited. Several major limestone deposits have been identified in Nepal and exploitation of some of these deposits for the manufacture of cement and agricultural and industrial lime is already underway. Major limestone deposits are found in Okhare, Udaypur and Surkhet. A large deposit of magnesite has been identified and exploited for the production of dead burnt magnesite. Talc deposits have been identified

and one deposit is being exploited. Two large silica sand deposits are found in Nepal and these could be exploited for the production of sodium silicate. An important marble deposit is being exploited for the production of slabs. A commercial deposit of lead and zinc has been identified and initial steps have been taken to exploit it. Mineral exploration and exploitation in some of the identified areas may offer promising prospects for cooperation and investment

Common Pricing of Products

The open border, free trade and fixed exchange ratio between Nepalese and Indian rupess have created a market, where any variation in pricing of a product will ultimately lead to level of price with small difference due to transport cost and tariff. This has created a congenial climate for investors

Products Matching the Needs of the Citizen of the Two Countries

Products produced in India are suitable to the needs and buying capacity of large numbers of Nepali consumers and in the same way the products produced in Nepal are demanded by Indian consumers. These characteristics of the products of the two countries have created ample of opportunities for the promotion of trade between the two countries.

Despite various loopholes in the policies dominating trade between the two countries, the socio-cultural similarities, the urge for growth, availability of profitable avenues, potential markets, liberalised policies etc., will further help in strengthening the economic ties between India and Nepal.

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