Reshaping Nepal-India Trade:
Prospective of Revision on Treaty of Trade

Submitted to the Ministry of Commerce, Government of Nepal

A Joint study commissioned by

FNCCI CNI NCC NICCI

Joint Working Group

Federation of Nepalese Chamber of Commerce and Industries (FNCCI), Confederation of Nepalese Industries (CNI), Nepal Chamber of Commerce (NCC) and Nepal-India Chamber of Commerce and Industries (NICCI)

July, 2016

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मितिः २०७३।४।

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विषयः
नेपाल भारत वाणिज्य सन्धी नविकरणका बेला सन्धीमा समय सापेक्ष सुधार गर्नु पर्ने समस्या तथा सुझावहरु प्रस्तुत गरेको सम्वन्धमा ।

महोदय,

नेपाल र भारत वीच सन १९९६ मा सम्पन्न भई सन २००९ मा नबिकरण भएको नेपाल-भारत बाणिज्य सन्धीको नबिकरण २७ अक्टोबर २०१६ मा पुनःनविकरण हुंदा अवको नविकरणमा उक्त संन्धीमा समय सापेक्ष संशोधनका लागि आवश्यक सुझावका लागि सरकार र नीजि क्षेत्रबीच अन्तरकृया गर्ने उद्देश्यले नेपाल सरकार, बाणिज्य मन्त्रालयको आयोजकत्व तथा नीजि क्षेत्रका संगठनहरु नेपाल उद्योग बाणिज्य महासंघ, नेपाल उद्योग परिसंघ, नेपाल चेम्वर अफ कमर्श तथा नेपाल-भारत उद्योग बाणिज्य संघको संयुक्त कार्यदलको सहकार्यमा मिति २०७३ साल जेष्ठ २४ गते सोमवार होटल अन्नपूर्ण काठमाडौंमा Nepal-India Trade बिषयक अन्तरकृया कार्यक्रम सम्पन्न भई त्यस कार्यक्रमवाट सुझाईएका समस्या तथा तिनका समाधानहरु यसै साथ प्रस्तुत गरेका छौं ।

यस सम्वन्धमा नेपाल उद्योग बाणिज्य महासंघ, नेपाल उद्योग परिसंघ, नेपाल चेम्वर अफ कमर्श तथा नेपाल-भारत उद्योग बाणिज्य संघको संयुक्त कार्यदलको साझा धारणा संलग्न सुझाव पुस्तिकाको भूमिका उल्लेख भएकै छ । तसर्थ, वाणिज्य सन्धी नविकरणका वखत ती समस्याहरु अधिकतम सम्वोधन हुने पहल नेपाल सरकार, वाणिज्य मन्त्रालयको तर्फ हुनका लागि समाधानका सुझावहरु सहित हार्दिक अनुरोध गर्दछौं ।

पशुपति मुरारका	हरिभक्त शर्मा	राजेश काजी श्रेष्ठ	सौर्य सम्शेर ज.ब. राणा
अध्यक्ष	अध्यक्ष	अध्यक्ष	अध्यक्ष
नेपाल उद्योग बाणिज्य महासंघ	नेपाल उद्योग परिसंघ	नेपाल चेम्वर अफ कमर्श	नेपाल-भारत उद्योग बाणिज्य संघ

आर. बि. रौनियार
संयोजक
संयुक्त कार्यदल

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Foreword

This year, Nepal-India Trade Treaty 2009 is due for automatic renewal on 27th October 2016 for the next seven year and has provision for amendment or modification by mutual consent.

The treaty initially signed in 1996 already had slight modifications in earlier renewals. However, since the basic provisions and spirits of the treaty conceptualized before two decades were wrinkled in the changed context of international business environment because of affiliation in regional and global trade regimes such as WTO and SAFTA in last two decades, business community in Nepal seeks review for contemporary update in it.

Similarly, Nepal-India Inter-governmental Committee (IGC) meeting was provisioned in the treaty itself to hold in every 6 months, alternately in Kathmandu and New Delhi, which was held last time in Kathmandu on Dec 21-22, 2013, and remained overdue for more than two years; and finally held on 28-29 June 2016 at New Delhi.

India being the single largest and nearest trading partner of Nepal, obviously there are several tariff, non-tariff, para-tariff, infrastructure and customs related issues, which need to be sorted out through bilateral mechanisms as provisioned in the treaty itself, but in practice, since the mechanism was not being able to meet timely, the issues have been stock piled.

Keeping in view the previous practice of suggesting the government from the private sector separately with different priorities, which mystified in identifying and further prioritizing the issues from the bundle, whether they are related to trade treaty or IGC; this time, FNCCI, CNI, NCC and NICCI came together with common views on the issues and it is our pleasure to bring out two separate documents for IGC meeting and for review of the trade treaty. The issues and suggestions related to IGC have been already submitted to the Ministry of Commerce four months before the last IGC meeting.

Regarding the issues which need to be addressed during the time of renewal of the trade treaty, Ministry of Commerce, GoN in association with the Joint Working Group of the private sector of Nepal had organized an interactive session on Nepal-India Trade on 6th June 2016 in Kathmandu, which was witnessed by the Honourable Commerce minister of Nepal, Secretary and Joint Secretary of Ministry of Commerce as well as high officials of the Government of Nepal, His Excellency Ambassador and high officials from the Embassy of India, Kathmandu and participated by district chambers of commerce of different parts of Nepal and the concerned commodity associations.

Following the conclusions drawn from the interactive session with the two presentations, one from Ministry of Commerce and the other from the Joint Working Group, as well as comments from the experts and business fraternity, we have prepared a joint document with pros and cons of the existing Nepal-India Trade Treaty, containing the background of the treaty, investment scenario, bilateral trade scenario, framework of the trade and investment, current issues, rational for revision in the treaty of trade, suggested revisions in the treaty and conclusion with the help of consultant Mr. Purushottam Ojha, former secretary, Ministry of Commerce and Supplies, Government of Nepal.

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We are confident that the recommendations are in line with the requirements for promoting bilateral trade and investment, safeguarding and promoting the industries in Nepal, both large and small scale industries, regain the competitiveness in the nearest and neighbouring market which were eroded by multilateral commitments of India and Nepal and consequently superseded the unique provisions of the treaty conceptualized before two decades. Therefore, we hereby endorse the document on **"Reshaping Nepal-India Trade: Prospective of Revision on Treaty of Trade"** and submit to the Ministry of Commerce, Government of Nepal, and strongly recommend for consideration and needful action.

Considering the deepening economic relation with India, whereby India is also the largest source of foreign direct investment as well as that of tourists we, private sector feel that it is the high time that we renew our economic relation with India from new dimension as well. In this aspect, we also suggest the Government to mull over the comprehensive economic partnership with India.

We would like to extend our sincere thanks to Mr. Purushottam Ojha, former secretary, Ministry of Commerce and Supplies, Government of Nepal for his great contribution and gleaming suggestions in making our endeavour successful. We would also like to thank Dr. Posh Raj Pandey, Chairperson, SAWTEE for his luminous comments to the interactive session with his expertise on the international trade and trade/transit treaties.

Finally, we would also like to acknowledge the excellent coordination of the secretariats of the Joint Working Group of FNCCI/CNI/NCC and NICCI in making the joint efforts very successful.

Pashupati Murarka **President,** **FNCCI**	**Hari Bhakta Sharma** **President,** **CNI**	**Rajesh Kazi Shrestha** **President** **NCC**	Saurya Rana **Saurya SJB Rana** **President** **NICCI**

R B Rauniar
Coordinator
Joint Working Group
FNCCI/CNI/NCC/NICCI

Date: July, 2016

Acknowledgement

The first seven year cycle of the Nepal-India treaty of trade signed in 2009 is going to be completed in October 27, 2016. As, both governments are now prepared for taking up the treaty further, it is high time for Nepal to persuade improvement in the treaty provisions in view of reversing the lopsided growth of Nepalese trade over the past several years.

Trade is a dynamic sector and requires adjustment from time to time in the face of new developments taking place in the international economic landscape. Variables like demand and supply of goods and services, market access conditions, flow of foreign direct investment, innovation, technological development and adaptation, impact the performance of international trade. Thus trade rules should be continually updated with the objectives of removing barriers, serving the common interest of the trading partners and enhancing complementarity and overall welfare gains. In light of these perspectives, this study report provides some insights of adjustment and improvement warranted in the existing treaty between Nepal and India. Moreover, this could serve as inputs in taking up the bilateral trade negotiations on a mutually beneficial platform.

The consultant would like to appreciate and acknowledge the Nepal-India Chamber of Commerce and Industry (NICCI), Federation of Nepalese Chamber of Commerce and Industry (FNCCI), Confederation of Nepalese Industries (CNI) and the Nepal Chamber of Commerce (NCC) for entrusting this important task of identifying the areas of improvement in the treaty. This report takes a cue from the opinion expressed by various dignitaries and

Joint Secretary Ravi S. Sainju, Ministry of Commerce, President of CNI, Hari Bhakta Sharma, President of NCC Rajesh Kazi Shrestha, President of NICCI, Saurya Rana and Vice President of FNCCI, Dinesh Shrestha. Meanwhile, very useful suggestions were also received from Dr. Posh R Pandey, Chairman SAWTEE Nepal, Mr. R B Rauniar Secretary General of NICCI and representatives of various government and private sector organizations during the workshop. Their suggestions and opinion has been immensely useful in drafting this report and hence the author humbly recognizes and acknowledges their support.

(Purushottam Ojha)

Former Secretary, Government of Nepal

Consultant on Trade, Transit, Investment and Private sector Development

24th June 2016

List of Abbreviation

ADB: Asian Development Bank
ASYCUDA: Automated System of Customs Data
BIMSTEC: Bay of Bengal Initiatives for Multi-Sectoral Trade and Economic Cooperation
CO: Certificate of Origin
CNI: Confederation of Nepalese Industries
DFQF: Duty Free Quota Free regime
DRP: Duty Refund Procedures
DFTP: Duty Free Tariff Preferences schemes.
FNCCI: Federation of Nepalese Chamber of Commerce and Industry
ICD: Inland Clearance Depots (dryports)
ICP: Integrated Customs Check Post
LDC: Least Developed Countries
LOE: Letter of Exchange.
MFN: Most Favored Nations
MOC: Ministry of Commerce
MRA: Mutual Recognition Agreement
NCC: Nepal Chamber of Commerce
NICCI: Nepal-India Chamber of Commerce and Industries
NPR: Nepalese Rupees
NTWCL: Nepal Transit and Warehousing Company Limited
RTAs: Regional Trading Arrangements
SAFTA: South Asian Free Trade Area
SAWTEE: South Asian Watch on Trade Economics and Environment
TEPC: Trade and Export Promotion Center
WB: World Bank
WTO: World Trade Organization

Reshaping Nepal-India Trade: Prospective of Revision on Treaty of Trade

1. Background

Nepal and India inherits a long history of economic, social and cultural partnership from time immemorial as the later remained the single largest trading partner of Nepal almost at all times in the past. Traditionally, Nepal used to export agricultural products like ginger, cardamom, ghee (diary product), medicinal and aromatic plants, handicraft and jewelry items and imported salt, fabrics, utensils, kerosene, machinery, equipment and consumable items from India. Nepal's export trade was performing better than the import before 1950, incurring surplus trade balance. The scenario gradually turned around with the openness of economy on both countries, robust growth of manufacturing sector in India and loss of competitiveness of Nepalese goods.

Before 1950, bilateral trade between Nepal and India were governed by the treaty of peace and friendship concluded between the government of Nepal and the British-India government. The first treaty exclusively related to trade and transit were concluded in July 31, 1950 in the name of treaty of trade and commerce that formally ended all the former agreement concluded by the British government on behalf of India. This agreement basically propounded the notion of customs union as there were provisions of harmonizing the external tariff by the two countries. Nepal was allowed to use any ports of India for her trade with the overseas countries. This agreement was substantially modified in 1960 and passed through the stages of renewal with time to time modifications until three separate agreements on trade, transit and control of unauthorized trade concluded in 1978. The bilateral trade and transit provisions are governed by these agreements which have gone through substantial amendment and changes from time to time.

Economic engagement between the two countries is enormous and spreads over a large number of sub-sectors. India occupies two-third of the international trade of Nepal and remains the single largest source of foreign direct investment. Service trade is significant as the people on both countries travel to each other's country for tourism, health, education and for employment. The open and porous border along with the legal provision of allowing movement of people without passport or visa is the reason behind the inseparable economic relations and development of trade in goods and services between the two countries. Politicians of both countries prefer to label the bilateral relations as the Bread and Bride Relations (*Roti-Beti ko Sambandha*). Growing cooperation in cross-border transportation, tourism, health and education services are the bedrock of increasing economic engagement between the people and government of the two countries.

2. Investment Scenario

Department of Industry data (2013-14) shows that altogether 3330 projects were approved for foreign direct investment with a total project cost of 340,154 million rupee (of this amount NRs 182,502 million as the foreign investment) that provides employment to 206,116 people. Majority of these industries are in services sector (1081) followed by tourism (934), manufacturing (930), agriculture and forestry based (204), energy (72), minerals (65) and construction (44).

Of these, the Indian investment comprises of 613 industries (18 percent) with a total investment of 78,760 million rupee (43 percent) and employment to 64452 people (31 percent of total FDI projects).The second largest investment is from Hong Kong, China with a total projects/industries of 28 (0.8 percent), with a total 4346 people (2 percent) and investment of NRs.25, 000 million (13.7 percent). The third largest investment is from Mainland China with a total number of project 849 (25 percent) with total capital investment of 22,340 million rupee (12 percent), providing employment to 42150 people (20 percent).

Out of the total foreign investment projects 256 are large industries, 361 medium and remaining 2713 are the small industries according to the classification of Nepalese industries (DOI-2015).

The above statistics shows that India is the largest FDI source country for Nepal in terms of the size of investment capital and employment despite that this size in absolute terms is less in comparison to its true potentials. The Nepal-India joint venture (JV) industries like Arti Strips, Dabur Nepal, Surya Nepal and Unilever generate the substantial volume of exports from Nepal.

3. Bilateral trade

The bilateral trade between Nepal and India has increased to 449.8 billion NPR in 2012-13 from 109.5 billion NPR in 2003-04. Nepalese export during this ten year period increased from 30.8 billion NPR to 51.8 billion NPR (68 percent) while import from India increased from 78.7 billion NPR to 398 billion NPR (406 percent). Thus the average annual increment of export remained 6.8 percent while the import increment has been 40.6 percent annually. The share of India in overall trade basket of Nepal is increasing over the years occupying 66 percent of total export and import in 2012-13. This trend is still continuing as the trade data 2014-15 shows that export to

India was NRs 55.8 billion (64%) out of total export of NRs 86.6 billion, while the imports from India was NRs 500 billion (63.7%) out of total import of NRs. 784.6 billion (TEPC-2015).

The major import items from India comprises of; petroleum products, iron and steel, vehicles and machinery, chemicals, cement clinkers, pharmaceutical products, cereals, fruit and vegetables, electronic and electrical articles among others. Similarly, the main export items of Nepal to India comprises of; product of iron and steel, non-alloy steel, large cardamom, tea, ginger, medicinal herbs, jute bags and hessians, juices, dentifrices, readymade garments and hide and animal skins. Thus composition of Nepalese export is mainly the primary goods and agricultural products while the import mostly consisted of industrial raw materials as well as manufactured articles. In recent years, the import of cereals and food grains is also increasing at a substantial volume from India.

UP and Bihar are the two bordering states of India providing around 90 percent of the trade and transit passage for Nepalese trade. Five major border posts of Nepal; Birgunj, Biratnagar, Bhairahawa, Krishnanagar and Nepalgunj link with these bordering states of India.

Border markets provide unique opportunities of trading and exchange of goods and services, particularly to the people and residents of the bordering districts. This has also enhanced the cultural and social proximity between the people on both sides, made the life easier due to easy access at each other's market but at the same time porous border has also been the reason for informal trade and smuggling. There are positive as well as negative social impacts due to the existence of open border between Nepal and India.

4. Framework of trade and investment

The latest **Treaty of Trade** was signed on 27 October 2009 that provides a new framework for enhancing cooperation in the areas of trade and investment. The treaty provides some unique features over the existing provisions. These mainly covers; a) commitment for simplification, standardization and harmonization of customs, transport and other trade related procedures and development of border infrastructures for facilitation of bilateral trade, b) both sides to undertake measures in eliminating non-tariff, para-tariff and other barriers; c) undertake the measures to mutually recognize the test and certification provided by the competent authority of a contracting Party, subject to meeting the mandatory requirement of the importing country; d) India to support Nepal for trade capacity strengthening and improvement in technical standards, quarantine and testing facilities and HR capacity development. The treaty further defines the e) rules of origin criteria with the narrative of the wholly produced according to the regional trade agreement and consistent with the WTO agreement; f) allows export of scrap and marine products under the wholly produced items. The new provisions also allows the temporary importation of the used machinery and equipment into India for the purpose of repair and maintenance.

The trade treaty in 2009 not only elaborated rules of origin criteria but also bought changes in the methods of calculating the value addition of the products from Ex-factory to FOB basis. In addition to preferential Certificate of Origin (CO), another CO for MFN import into India was assigned in the treaty. Provisions were made on waiver of the additional duty of customs by the government of India upon request by the government of Nepal. The treaty further ended the discrimination on treatment of exports from India on the basis of the currency of payment which of course effectively eliminated the duty refund system (DRP) allowing the government of Nepal to impose full duty on import of manufactured goods from India.

Application of safeguard measures were aligned with the provisions made in WTO agreement.

The treaty of trade has provided for a three tier consultation mechanisms at the level of Commerce Secretary, Joint Secretary and the Chief of Border Customs, increased the overland trade routes to 26 from existing 22 routes, and added air route in the list, connecting Kathmandu to New Delhi, Mumbai, Kolkata and Chennai in India.

The tariff rate quota on four products, namely vegetable fats, acrylic yarns, copper products and zinc oxide imposed since 2002 still remains a part of the treaty.

Treaty of Transit signed on 1991 has been gradually evolving with periodic revisions for adaptation to the changing need of time. The provision made for movement of containerized cargo on the basis of one-time-lock (OTL) in 1996 was a milestone towards simplification of the transit procedures with the secured movement of transit cargo. The rail link to Birgunj ICD and its operation since July 2004 further simplified and facilitated the movement of transit traffic on container, covered wagon and open wagons.

Nepal and India signed a memorandum in 1997 that provided additional transit routes to and from Bangladesh through Kakarbhitta-Panitanki-Phulabari-Banglabandha road corridor and this has served as the lifeline of trade between Nepal and Bangladesh.The process in movement of transit traffic through this corridor had some conditions requiring; formation of convoy of 20-25 trucks, escorting by the Indian security forces, movement allowed only on day time and week days, and undertaking required by Nepal Transit and Warehousing Company Limited (NTWCL). Over and above, movement of Nepalese trucks were allowed only up to the India-Bangladesh Border called the zero point.

The process of transit movement were simplified to some extent in the past; first by allowing the movement of Nepalese trucks up to the Banglabandha land port in 2011 under the Car Pass system. Secondly, the need of escorting and making convoy of the transport vehicles and undertaking by NTWCL has been dispensed with the signing of Letter of Exchange (LOE) between the government of India and the government of Nepal in February 2016.

Government of Nepal and government of India also agreed on February 2016 through separate letter of exchangesallowing the movement of Nepalese transit traffic through the Visakhapatnam port and Singhabad-Rohanpur railway link in order to facilitate the third country trade of Nepal.

The **Rail Service Agreement (RSA)** signed in May 2004 provides legal framework to move bilateral trade traffic between Nepal and India and the transit traffic of Nepal between the port of Kolkata/Haldia and Birgunj ICD in Nepal. The agreement was modified in December 2008 to allow oil/liquid traffic in tank wagons and bilateral break-bulk cargo in flat wagons.

The revised Agreement of Cooperation to Control Unauthorized Trade, signed on 27 October 2009 has added the provision of allowing export of the imported goods from another contracting party to the third countries without involving any manufacturing activity.

The other agreements that are aimed at facilitating bilateral trade and investment are; Bilateral Investment Protection and Promotion Agreement (BIPPA), signed on 21st October 2011, Double Taxation Avoidance Agreement (DTAA), signed on 27th November 2011 Motor Vehicle Agreement (MVA)-2014 for movement of passenger vehicles between major cities in Nepal and India. Besides, revisedAir Services Agreement was signed on 16 February 2010 that provides more liberal regime for operating air services between the two countries.

5. Current issues

India has emerged as the fast growing economy of Asia over the last decade and treading along the economic growth of China. But, Nepal as a country wedged between these two big neighbors is not yet able to harness any substantial benefits from these two fast growing economies. Nepal basically faces structural and strategic problems in establishing meaningful partnership with the neighboring countries. Nepal is losing its market share in export to both neighboring countries. Duty free market access lies in the heart of Nepal-India bilateral trade treaty. But, there are structural problems in utilizing the market access opportunities available in India since over the past two decades. Major identified issues are discussed below.

5.1 Preference available to Nepalese products got eroded due to tariff reduction:

Nepalese export to India grew substantially between 1996 and 2002 as a result of unique preferences available to Nepalese products on the basis of certification provided by the designated authority of government of Nepal. Under the arrangement made in the revision in the treaty in 1996, the designated authority of GON were allowed to determine the origin criteria by themselves. Taking advantage of this provision, export to India jumped to NRs 28 billion in 2001-02 from around NRs 4 billion in 1995-96[1]. Another revision in the treaty done in 2002 set the rules of origin criteria in three parameters (namely changes in customs tariff heading, value addition and insufficient working or operations), imposed tariff rate quota in four products and canalization in import of vegetable fats.

[1] Trade Statistics; Trade and Export Promotion Center-2016.

Following the revision in the treaty in 2002, the export to India recorded a tepid growth reaching NRs 41.7 billion in 2006-07[2]; growth by simple average of around 9.8 percent each year. Sluggish growth of export in the ensuing years is the outcome of trade liberalization on both sides of the borders. The reduction in Most Favored Nations Tariff in India increased competition for the exporters in the Indian markets and Nepalese exporters were gradually displaced by the more competitive export from other countries. The tariff preferences given to South Asian LDCs under SAFTA and the Duty Free Tariff Preferences (DFTP) scheme of India for providing tariff preferences to all LDCs around the world, resulted in erosion of preferences available to Nepal.

5.2 Trade liberalization brought about double whammy effect on Nepalese trade:

Trade liberalization initiatives on both sides not only resulted in loss of market share for the Nepalese export products but also impacted adversely on overall trade performances of Nepal with rapid increase in import resulting to heavy trade deficit. Volume of Nepalese import from India during 2001-02 was NRs 56.6 billion which rose to NRs 321.4 billion in 2011-12; six fold increase over a period of ten years. The latest figure available for the year 2014-15 shows that Nepal's export to India (around NRs 55 billion) constitutes only ten percent of the import (NRs. 500 billion) from that country.

5.3 Presence of non-tariff barriers is impinging on the export trade of Nepal:

[2] Ibid.

The growing trade deficit for Nepal is also associated with the presence of numerous trade barriers which are mostly associated with the sanitary and phytosanitary measures and the technical barriers. Nepalese export items mostly comprises of agricultural and processed food products that are subjected to checks on account of quarantine, food test (FSSAI) certification, labelling and packaging requirements. Besides, there are other barriers like transit fee on export of medicinal and aromatic plants, additional duty of customs in textile and garment items, non-automatic licensing in import of vegetables and fruits. The trade treaty has created some other barriers in terms of tariff rate quote, canalization and the stringent rules of origin criteria. Customs procedures and documentations also often poses problem in cross-border movement of goods and services.

5.4 **Transport and border infrastructures are inadequate and inefficient:** Most of the border posts on both sides are badly designed, congested, narrow and inefficient from the perspective of fast clearances of cargo, vehicles and passengers. Border posts development program has started in some major border crossings since late 1990s with the development of Inland Clearances Depots (ICDs) in Birgunj, Biratnagar and Bhairahawa. Another ICD in Kakarbhitta was developed and bought to operation in 2010. Similarly, Integrated Check Posts (ICPs) are being developed at four locations (Biratnagar-Jogbani, Birgunj-Raxoul, Bhairahawa-Sunouli and Nepalgunj-Rupaidia), in Nepal and India as the mirroring facilities. But the development process is too slow. The physical facilities in the border posts are in shambled state and the customs and border agencies functions still to be effectively coordinated among those regulatory agencies. The road leading to the border posts are not upto the international standards, parking of the vehicle and warehousing of the goods is still a problem in many border posts.

5.5 Customs procedures, and documentation are burdensome and lack harmonization between the cross-country customs:

Altogether 10 various type of documents in imports and 11 documents in export are required for clearances of cargo at the Nepalese border posts. The documentary requirement for the port clearances and land customs station are also heavy and there is no harmonization of documents and working hour. This has increased the cost of transaction. Nepalese and Indian customs do not follow the same IT system and there is no EDI connectivity between customs to facilitate the clearances of goods.

5.6 Lack of effective institutional mechanisms to address the imminent issues:

The government to government mechanism is built up at three levels; Inter-Governmental Committee (IGC), Inter-Governmental Sub-Committee (IGSC) and the Border Custom's level. IGC and IGSC mechanism has become more formal than the business like and the field level committee has not been found effective to deal with the problems at the borders.

5.7 There is no compliance between the trade data reported by the agencies on two sides:

The method of capturing data by the Nepalese and Indian authorities is different and follow their own parameters. Generally, Nepalese customs data includes all type of import; import through letter of credit, in-bond, and local import but the Indian authorities do not give much importance on local export as the revenue implications of such export is nil. Thus the export from one country cannot mirror the import of another country due to discrepancies in data collection. Thus it has been observed that export volume recorded by the Indian agencies are always less than the import volume recorded by the Nepalese authorities.

Weak supply side capacity of Nepal and less integrated value chain are the major reasons behind burgeoning trade deficit: The production and the productive capacity of the Nepalese agriculture and manufacturing sector has not increased over the last decade. Rather the share of manufacturing in the GDP is sharply declining, now hitting to around 6 percent. Agriculture sector produces mostly for domestic consumption rather than for export. This shows the weak supply-side capacity of goods for export. Most of the services sector except tourism, education, IT/BPO and hydropower are non-exportable. There is no vertical linkages in production of manufacturing and agricultural goods between Nepal and India.

6. Rational for revision in the treaty of trade

Basics of bilateral trade treaty has not gone any substantial changes over the last two decades except the reversal of more preferential provisions back in 2002. From the Nepalese viewpoint, the revision introduced thereby was not helpful in building complementarity on trade. Some improvements introduced in the treaty in 2009 largely remain weak in implementation. The treaty need to get a facelift in the wake of increasing challenges for increasing trade and investment relations between the two close neighbors. The following provides some insight into the need of revisiting the major contents of the treaty.

6.1 Regional preferences available under SAFTA supersedes the provisions of bilateral treaty:

Government of India has announced unilateral preferences to South Asian least developed countries under SAFTA for all manufacturing, agricultural and primary products with a very short sensitive list (only two products alcohol and tobacco); there is no tariff rate quota and canalization; the regional trade agreement has provided a number of facilitation measures to enhance the intra-regional trade. These constitutes; works on customs cooperation, establishment of South Asian Regional Standard Organization (SARSO), works on creating regional standard and harmonization, and avoidance of double taxation, among others. Nepal-India treaty of trade lacks many trade enabling instruments that are available under the regional trading arrangements.

6.2Reciprocity in tariff preferences for the agricultural goods has put the Nepalese farmers in vulnerable position:

Nepalese agricultural products, particularly the production of cereal crops, are getting affected due to cheap imports from India. Government of Nepal cannot match the subsidy given to the farmers in India and the farm's sizes and economies of scale is much higher in India in comparison to Nepal. Consequently, production cost of these crops is higher in Nepal than in India and are displaced by the cheap imports. This has raised the concern on food security, vulnerabilityof farmers and loss of employment in the agricultural sector.

6.3 Some of the provisions of the trade treaty are not consistent with WTO principles:

The Tenth Ministerial conference of WTO has decided to introduce the preferential rules of origin criteria in order to provide a respite to the least developed countries for enhancing their access in the developed and developing country markets. The new rules requires only 25 percent domestic value addition (a maximum of 75 percent of the part and produce of non-originating parts or produce), provide for cumulating with other least developed countries and making optional provisions between the value addition criteria and the changes in the customs tariff heading[3]. The imperative lies in making the rules of origin criteria in line with the Nairobi Package of World Trade Organization.

The other provisions laid in the WTO agreements is related with the avoidance of tariff rate quota and canalization to the possible extent as these are non-tariff barriers and lack transparency in implementation. Tariff rate quota imposed on imports of four products into India under the treaty has lost the relevancy as these products are not actively traded between the two countries. The utilization rate of export quota for Nepal of the vegetable fats has gone to zero since 2007-08, for zinc oxide, export was completely stopped since 2003-04. For copper products, the latest utilization rate is 22 percent and for acrylic yarn, it is only 49 percent. The utilization rate of these products is given in Annex-1

Prompt redress mechanisms of the complaint and dispute should be a part of the trade treaty as it increases transparency and provides predictability for the investors and exporters.

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[3] Refer; https://www.wto.org/english/thewto_e/minist_e/mc10_e/nairobipackage_e.htmr

Trade Related Technical Assistance (TRTA) for the least developed countries has been a part of the trade rules in the regional and multi-lateral agreements. SAFTA is one step ahead even proposing for revenue compensation to the least developed countries for the revenue foregone on account of trade liberalization.

6.4Treaty largely does not embrace the elements of trade facilitation:

Reducing trade cost is crucial in view of facilitating trade and realizing the benefits of liberal tariff regimes. Consequently various trade agreements has built-in the trade facilitation arrangement as part of implementation of the agreement. Article-8 of SAFTA has defined various facilitation measures including customs harmonization and simplification, enhancing connectivity, facilitating transit, harmonization of test and certification standards, and harmonization national customs classification, among others. These elements are equally applicable in the bilateral treaty provisions but a missed part of the treaty.

The Protocol to the Treaty of Trade-2009 mentioned about increasing cooperation and collaboration in the areas of improving technical standards, quarantine and testing facilities and building HR capacity, combined with the provision of MRA of the test and certifications. This provision has not been explored and utilized from both sides in absence of appropriate implementation plan and program.

6.5Current coordination mechanism is not sufficient to address the trade related issues:

Quarantine, food test and certification, transit transportation and trade facilitation are the crucial issues impinging on the performance of Nepalese export. The institutional mechanism of IGSC is overstretched in terms of technical capability to carry out the technical discussions on these issues. There is no joint mechanism to adequately discuss the technical issues that are critically important for trade development.

6.6Some important provisions in the treaty are still waiting for implementation:

The treaty provides for "refund of the additional duties" up to 25 percent of the collected amount to the medium and large industries, in proven case of Nepalese products having higher cost of production in comparison to similar Indian products (Protocol V). This provision has never been implemented. Similarly, the arrangement related with extension of relief on products of small scale unit of Nepal on levy of additional duty of customs at par with the product of similar unit of India is also confined on the paper and not enforced in practice.

7 Suggested revisions in the treaty

Nepal-India treaty of trade is evolving over the years but efforts of enhancing complementarity through promotion of export has become an uphill task for Nepal due to liberalization of trade, particularly after 2000. The treaty provides duty free tariff preferences to all Nepalese goods except three items (alcohol, perfume and tobacco) in the MFN list. Nepal also provides duty free market access to the agricultural and primary products from India except the application of agriculture reform fee on agricultural imports from India. In fact, the agricultural reform fee is also in the way of phase-out due to the commitment made in WTO. It is obvious that tariff is no longer a trade barrier but the incidence of non-tariff barriers remains a vexing problems in export of goods to India and elsewhere. It is very much important to focus and work collectively to address the non-tariff barriers so that current level of trade gap is mitigated and trade transaction is sustained for a longer term. There are other relevant issues that are impeding the sustainable growth of Nepalese trade.

In fact, trade treaty is only a part of overall economic engagement between the nations. Designing a trade treaty, thus, requires a holistic framework that decides the level and kind of engagement for serving the economic interests of the partnering countries. In the above backdrop, review and revision in the treaty of trade should be looked from two perspectives. First, both governments may consider for a deeper economic engagement that will elevate the treaty to a new height covering broad areas of economic cooperation namely, trade in services, investment, transport and communication, health, education and hydropower. This sort of comprehensive economic partnership agreement is now being pursued and negotiated between various countries like India-Sri Lanka, and India-Thailand. However, the impact of this sort of agreement should be assessed beforehand and scoping should be done to preempt any negative outcome. Moving toward a greater partnership approach requires high level discussion with adequate technical feedback. Such a move would require a broader vision to align Nepal-India economic relations in the new path with a view to enhance complementarity in trade and investment and harness benefit from the growing economic clout of India.

The second way would be a gradual or incremental approach of reforming and updating the provisions of the existing treaty to adapt to the provisions laid in the regional and multilateral trade agreements. The rationales for such improvements have been mentioned in the foregone section. Nepalese private sectors and business entities have also provided specific suggestions for improving the specific provisions of the treaty. The issues that may be considered for the revision in the treaty can be summed up as follows;

7.1Reiterate the commitment of technical support toward enhancing the supply side capacity of Nepal:

The treaty has mentioned some provisions that are non-committal and in the form of best endeavor. But, this may require clear commitment of government of India to support the initiatives of enhancing production and productivity of agriculture and manufacturing, strengthening capacity for meeting the requirement of sanitary and phyto-sanitary and standard related measures, direct trade measures and linkages of cross border value chain.

7.2Delineate the extent of cooperation and related actions on proposed areas of cooperation:

This would require extensive inputs from the concerned line agencies (LAs), and private sector organizations, particularly in the areas of SPS and TBT, trade facilitation, customs cooperation, border infrastructure, use of EDI and customs connectivity, intellectual property rights, dispute settlement, rules of origin criteria, trade related technical assistance, direct trade measures, trade remedy measures, and value chain linkages in specific products like garments, agricultural products etc. Identification of the extent and level of support would be necessary before making them as part of the trade treaty.

7.3Review the list of 16 agricultural and primary products (Article-IV) and align in the HS classifications:

In case of maintaining the primary and agricultural products under reciprocal tariff preferences, there should be review and revision in the list taking consideration of the need of protecting agriculture, and food security need of the country. The number of products in the list should be reviewed and reduced. Maintaining some products in the list are irrelevant (e.g. yaks tail). The product to be included in the list under the Protocol to Article-IV should be identified under customs HS classification in order to avoid confusion and ambiguity.

7.4Consider revising the free riding provisions in the treaty:

The reciprocal provisions for extending unconditionally no less favorable treatment than any third country with respect to customs duties and charges and import regulation (Article-III), has given free riding authority to each other contracting Party on concessions extended under any other agreements. Despite that this seems an equal treatment on both sides, Nepal as the weak and small economy is, particularly, facing problems in entering into bilateral free trade agreement with other neighboring countries. Hence, this provision needs to be reframed with the provisions of non-applicability of other agreements concluded by the contracting parties with any other countries or organizations.

7.5Define the work processes and terms of references for the Inter-Governmental Committee, Sub-Committee and Border Level Committee:

It is important to make these institutional mechanisms effective in order for maintaining close coordination between the governmental agencies and address the issues related with trade, transit and investment. The treaty or its protocol/ memorandum should provide a clear cut working guidelines and terms of reference for these committees and the meetings should be held at regular intervals as assigned in the treaty.

7.6 Explore forming a cross-border trade facilitation committee:

Current provisions on the bilateral consultation mechanism is limited at the government level. Works on trade, transit and investment facilitation demands the active support and harmonious work relations with the private sector, business entities who are the key players and service providers in international supply chain. Hence, both governments may consider in forming a cross-border trade facilitation committee with the representation of government, and private sector business entities which will have the primary role of advising both governments on matters of policy and operational issues on trade and transit facilitation and investment promotion. Such a body should be made effective and efficient by assigning the detailed terms of reference and standard operating procedures.

7.7 Consider adopting product specific rules for handicraft and small scale industry items:

The general rule as defined in the rules of origin criteria is more appropriate for the manufactured articles produced in the medium and large scale industries. The small scale industries products like handicraft items and cottage industry products cannot complete the rigorous process of value added calculations and changes in the customs tariff heading. Hence, consideration should be given in devising the simple and implementable product specific rules targeting such products.

7.8 Introduce the system of promoting cross-border value chain:

Vertical integration of industries and intra-industry trade has become an important part of globalization and economic integration process around the world. Industries generally outsource the parts and produce from other countries in order to reduce the cost of production. Nepal and India may consider exploring the measures for enhancing intra-industry trade through long and medium term contracts, buy back arrangement and preferences in the public procurement that will help linking the Nepalese product in the value chain of Indian manufacturing. The treaty may develop the framework of such intra-industry linkages. Some of such potential products may be: textile and garments, jute products, energy intensive manufacturing, gems and jewelries etc.

7.9 Introduce trade related technical assistance as measures for enhancing economic cooperation and integration:

Around two-third export trade of Nepal is taking place with India and there are imminent potentialities of increasing export to this country in future. Many Nepalese products are facing difficulties on account of SPS and TBT measures. Hence, technical assistance from the government of India would be critically important for trade capacity building and facilitating the export trade of Nepal. Such a program should focus on strengthening the test and certification capacity of Nepalese SPS labs, developing standards and their harmonization in order to address the key concerns related with SPS and TBT measures.

7.10 Consider the provision of organizing border markets (*haat bazaar*) to discourage the informal trade along the porous border:

It is said that the volume of informal trade between Nepal and India is as higher as the formal trade. Every day, a large number of small traders on both sides enter into the other territory with the goods for sale and purchase, as also facilitated by the porous border. Many agricultural products are also traded unofficially due to the stringent requirement of quarantine and food test certification. Such informal trade could be formalized by organizing regulated border markets where the local people and farmers within certain range of distance from the border can trade their products in the market without incurring much hassles. The treaty may include the provisions of formally organizing border markets (*haat bazaar*) under least regulated conditions that will help to minimize the incidence of informal trade.

7.11 Organize regular trade and investment fair alternatively in Nepal and India:

Trade fairs comprises one of the effective means of promoting product and services of participating countries and enhance buyer-seller contact for businesses and deal making for investment and trade. The trade treaty may outline the provision and facilitation by governments in organizing such events regularly and alternatively in the big cities of Nepal and India. National and local chamber of commerce and industries should be encouraged to take the lead for trade and investment fair and government should come up with support program to facilitate such events.

7.12 Establish effective mechanisms to control unauthorized trade: One of the irritants in the conduct of the bilateral trade is the high prevalence of informal trade, often the traders circumventing the legal provisions. Informal trade has been a two way features (both from Nepal and India), mostly triggered by the high transaction cost of formal trade, excessive duty differences, poor border control and inadequate coordination mechanisms between the border control agencies. The volume of informal trade is as much higher as the formal trade between Nepal and India as a study done in 2002 by the South Asia Network of Economic Research Institutes indicates that in the Indian territory, informal exports from India are 128% of formal exports, while the corresponding figure for the Nepalese territory is 34%. In the Indian territory informal imports are 89% of formal imports. The corresponding figure for the Nepalese territory is 44%[4]

The agreement of cooperation to control unauthorized trade is another treaty that goes along the treaty of trade. This agreement may need review along with the trade treaty in order to regulate the trade and check unauthorized trade effectively. Surveillance along the border may be increased by forging collaboration between the security agencies of the two countries. New provisions should be added in order to allow the import of specified third country goods from India.

7.13 Bring new dimension in the treaty by adding some new provisions and introducing reforms in the existing provisions:

The participants of a consultation workshop organized in Kathmandu in June 2016 have raised various other pertinent issues that could be useful for consideration in treaty negotiations. Those participants mostly represented the private sector and business entities who have export interest to India. The issues raised were:

a) Remove TRQ in four products in export to India; alternatively Nepal may also ask provisions for applying the same principle of TRQ to agricultural and primary products.
b) Nepal should create export-import bank in order to provide soft loan to the manufacturing industries.
c) Revisit the provision of cash incentive scheme; extend export to India equal treatment at par with the third country export in providing cash incentives.

[4] Taneja, Karmacharya. et.al. Refer: www.saneinetwork.net/Files/02_07.pdf

d) Extend the scope of treaty to other sectors such as trade in services; tourism, education, IT and BPO and hydropower.

e) Extend the scope of mutual recognition agreement (MRA) to forest products; do not limit this to only agricultural products.

f) Revise the rules of origin criteria in accordance with the WTO decisions.

g) Consider creating a higher level consultation mechanism at the level of Commerce Minister that will provide overall guidance and political direction to the IGC mechanism.

h) Devise simple and separate rules for facilitation of the export of handicraft items and SSI products.

i) Develop Special Economic Zones near to the major border posts in order to give a boost to Nepalese exports.

j) Enhance road and rail connectivity and devise simplified procedures for allowing the Nepalese transport vehicle to run between destinations in Nepal and India.

7.14 Review the product under the most favored nations (MFN) category: There are three products listed in Annex-E of the treaty that can be exported to India by paying full duty. Out of three, perfumes may be stroked off from the list to make the sensitive list at par with the SAFTA concessions.

8 Conclusion

Nepal and India are natural partners in milieu of trade, economy and socio-cultural exchanges. However, the potential of trade and investment has not yet been realized to its potential. Nepal is facing a large trade imbalance in its trade with the neighbors both India and China and lately with Bangladesh as well. Tariff barriers are going down but the non-tariff barriers on account of the SPS and TBT regulations have remained unresolved issues between Nepal and India.

The issues of food safety and quarantine certification have been discussed quite for a long time in the past without any substantial result. Both countries should consider prioritizing the actions on non-tariff issues and work together to remove those barriers. This would help in building capacity and confidence among the test and certification agencies on both countries and also help to build up export potential of Nepal to Indian markets.

The reasons behind the low performance of the Nepalese is the lack of supply-side capacity of the economy which requires a comprehensive approach in arresting the situation and require measures for enhancing the total factor productivity, creating business enabling environment and resolving the market entry barriers. Focus should be on streamlining the trade procedures and transport facilitation. Creating a seamless transport network should be on high agenda that not only facilitate the transit movement of Nepalese goods through India but also help build connectivity within the sub-region of South Asia.

The institutional measures for enhancing cooperation in cross-border movement of goods, vehicle and services demands effective coordination between the land port authorities, trade facilitation bodies including customs, border agencies, chambers and business organizations. Both countries should not lose sight of constituting such mechanism in order to promote bilateral economic engagement.

Both Nepal and India are the member of multilateral trading system of world trade organization (WTO) and two regional trading arrangements of SAFTA and BIMSTEC free trade agreement. Besides, India has trade and economic partnership agreement with many countries and group of countries around the world and also provides duty free tariff preferences to all LDCs under the DFQF scheme of WTO. South Asian least developed countries get more favorable treatment in export of products to India except very few items retained as the sensitive items.

In the above context, the revision in the bilateral treaty of trade can take a cue from and benchmark the provisions of the regional and multilateral trade agreements. Both governments may also explore the best practices followed in other trade agreements concluded between the LDC and developing or developed countries and use these as feedback for improving the provisions of bilateral trade rules.

The foregone section provides some narratives where the two countries could work together to reverse the existing lopsided growth of Nepalese trade. But, further study and research may be needed to assess the actual cost and benefits of the proposed reform on the contracting Parties.

Further, actions may be required in scoping the areas to be covered by the trade agreements and then formation of sub--groups led by senior officer of the specific sector who will be responsible for developing negotiating strategies and preparing draft text of agreement. Such sub-committees may require the feedback from academia, businesses and industries as input while going ahead with their tasks.

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Annex-1

Utilization Rate of Quota from 2002/03 to 2015/16

FY	Vegetable Fat		Copper Products		Acrylic Yarn		Zinc Oxide	
	Export Quantity	Export % of Quota Limit	Export Quantity	Export % of Quota Limit	Export Quantity	Export % of Quota Limit	Export Quantity	Export % of Quota Limit
2002/03	96,811	**97%**	6,801	68%	1,360	**14%**	366	**15%**
2003/04	78,870	79%	7,440	74%	2,204	22%	145	**6%**
2004/05	70,795	71%	8,603	**86%**	2,771	28%	-	0%
2005/06	90,251	90%	5,873	59%	2,396	24%	-	0%
2006/07	95,019	95%	3,284	33%	1,463	15%	-	0%
2007/08	47,509	**48%**	3,000	30%	1,865	19%	-	0%
2008/09	-	0%	3,558	36%	5,168	52%	-	0%
2009/10	-	0%	4,009	40%	5,200	52%	-	0%
2010/11	-	0%	3,243	32%	3,952	40%	-	0%
2011/12	-	0%	2,851	29%	5,105	51%	-	0%
2012/13	-	0%	2,805	28%	4,308	43%	-	0%
2013/14	-	0%	2,399	24%	4,798	48%	-	0%
2014/15	-	0%	2,453	25%	5,598	**56%**	-	0%
2015/16	-	0%	2,169	**22%**	4,937	49%	-	0%

Source: *NICCI Secretariat, the monitoring agency of quota administration, data based on annual export report from concerned customs point.*
Quota year: starts at 6th March and ends on 5th March of next year.
Highlighted percentage in bold are maximum and minimum quota utilization during the review period.

Annual quota allocated are as follows:

Vegetable Fat	100,000	MT
Copper Products	10,000	MT
Acrylic Yarn	10,000	MT
Zinc Oxide	2,500	MT