Editor’s Note. The University of Kansas School of Law initiated the operations of the Center for International Trade and Agriculture (“CITA”) in early 2010 with an inaugural symposium held in Lawrence, Kansas. Shortly thereafter another element of the CITA’s expanding operations was put in place: the CITA Working Papers Series. The overall aim of the CITA Working Papers Series is to provide a forum in which interesting information and insights on a broad range of issues that lie at the intersection of three subjects – international trade, agriculture, and law – can be expressed and discussed in a manner that will benefit legal practitioners, policy-makers, academics, and those members of the general public who are interested in a thoughtful exchange of views on these issues.

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The first contribution to the CITA Working Papers Series – CITA Working Paper #1-2010 – was focused on international legal regimes to balance the protection of prairies and grasslands with their agricultural use. Now CITA is pleased to post CITA Working Paper #2-2011, providing a country study on Nepal in the context of international trade and agriculture. Written by Professor Surendra Bhandari, a national of Nepal who recently earned his S.J.D. degree at KU Law and has now begun a professorship at a Japanese university, this Working Paper #2-2011 examines the challenges facing Nepal’s agriculture sector in the face of recent developments. Comments on the paper are welcome, particularly in the form of either (i) direct communications with the author (bhandarisurendra@gmail.com) or (ii) submission of a contribution to the CITA Working Papers Series on this or a related topic.
A CONTEMPORARY ACCOUNT OF INTERNATIONAL TRADE AND AGRICULTURE IN NEPAL:
EFFECTS AND PROSPECTS

Surendra Bhandari *

Abstract

Nepal became the 147th member of the World Trade Organization (WTO) on 23 April 2004. It is the first least-developed country (LDC) to join the WTO through the full working party negotiations process. Nepal’s Membership to the WTO was inspired by its aspirations to change and diversify the pattern of trade from Indo-Nepal vicinity to the global scale.

This paper examines on the implications of the WTO Membership for Nepal’s trade aspirations in especial conjunction with Nepal’s trade relations with India. It focuses on the international trade pattern of Nepal in particular the agricultural trade. Since Nepal has negligible items of exportable merchandise, its international trade is substantially dependent on woolen carpets, ready-made garments, leather products, tea, cardamom, pulses, seeds, and other farm products.

Nepal’s bilateral and regional trade arrangements also play key role in its contemporary trade account. Nepal has bilateral trade relations with 17 countries and it is a Member of the South Asian Free Trade Agreement (SAFTA) and the Bay of Bengal Initiative for Multi-Sector Technical and Economic Cooperation (BIMSTEC). Thus, this paper also examines the effects and prospects of these bilateral and regional agreements on the international trade regime of Nepal.

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Abstract

1. Introductory: Agriculture and International Trade Regime in Nepal
   1.1. Agriculture and Trade
   1.2. Trend of Agricultural Trade and Neighboring Impact
   1.3. Nepal’s Membership to the WTO

2. Indo-Nepal Trade Regime and Agricultural Trade
   2.1. Before the Sugauli Treaty of 1816
   2.2. From the Sugauli Treaty of 1816 to the 1923 Treaty
   2.3. From the 1923 Treaty to the 2002 Treaty
   2.4. Post-2002 Indo-Nepal Trade
       2.4.1. Natural Death of the Indo-Nepal Trade Treaty
       2.4.2. Creation of More Opportunities for Indo-Nepal Trade
   2.5. The Indo-Nepal Trade and Investment Model
       2.5.1. Reciprocity
       2.5.2. Preferential Treatment
       2.5.3. Non-tariff barriers
       2.5.4. Unilateral Approach
       2.5.5. Quota System
       2.5.6. Avoidance of Double Taxation

3. Nepal’s Accession to the WTO and Agricultural Trade
   3.1. Nepal’s Commitment to the WTO
   3.2. Terms of Accession on Farm Products
   3.3. Nepal’s Legislative Commitment to the WTO
   3.4. Legal Policy Changes Following Nepal’s Accession to the WTO
   3.5. Implications of the WTO for Nepalese Trade Regime

4. Conclusion

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1. Introductory: Agriculture and International Trade Regime of Nepal

1.1 Agriculture and Trade
The Government of Nepal has acknowledged that Nepal is predominantly an agricultural country. The importance of this sector is understood for its role in generating employment and income sources, especially for the rural areas of Nepal. The
Government has given top priority to the agricultural sector for sustainable economic development through commercialization of farm products.¹

Agriculture plays a significant role in the Nepalese economy. Agriculture alone contributes about 35 percent to the gross domestic product (GDP) of Nepal. Its contribution to the GDP is gradually declining as service sector’s contribution to the GDP is gradually increasing.² During the financial year (FY) 1990-91, agriculture contributed 47.4 percent to the GDP that declined to 39.2 percent in the FY 2003-04 and to 35.5 percent in the FY 2008-09. It is estimated to decline further to 33.0 percent during the FY 2009-10.³ Nevertheless, agriculture is still a major source of livelihood for the majority of the population and one of the important components of Nepal’s foreign trade.

Nepalese foreign trade is highly concentrated to India. For example, during the FY 1974-75, India was the main destination of Nepalese export covering more than 84 percent of Nepal’s trade. Still, India is the main destination covering more than 65 percent of the Nepalese export in the FY 2007-08.⁴

Despite the government’s priority to promote international trade, the volume of trade deficit is widening due to heavy increase in imports and decline in export. As a result of the trade deficit, the balance of payment situation has eroded in the first eight months of the FY 2009-10.⁵ Obviously, political instability is the main reason for the trade imbalance in the country. In particular, obstacles in movements of goods, deterioration in industrial relations, and uncertainty in the energy supply⁶ are some other factors that have been unhelpful for export promotion.

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² See Nepal Rastra Bank (Central Bank of Nepal), Economic Report 2008-2009, 7 (Kathmandu, Nepal Rastra Bank, 2009). The sectoral composition of the GDP has been gradually changing over the few decades. The contribution of agriculture, industry and services sector in real GDP were 36.6 percent, 17.3 percent and 46.1 percent respectively in 2000/01. Such contribution stood at 35.9 percent, 16.2 percent and 47.9 percent in 2007/08 whereas, such shares were 35.5 percent, 15.5 percent and 49.0 percent in 2008/09 respectively. While the shares of both the agriculture and industrial sector in GDP have gradually been declining, the contribution of service sector has been increasing continually as a result of a gradual expansion of this sector.
³ See supra note 1.
⁵ See supra note 1, para. 18.
⁶ See http://www.ekantipur.com/2011/01/13/top-story/more-power-cut-on-cards/32797/ , since few years Nepal is facing power shortage. At one point, there was no electricity for 16 hours a day. At
1.2 Trend of Agricultural Trade and Neighboring Impact

Trade was one of the key sources of the Nepalese prosperity in its history. For a long time, Nepal remained a prosperous trade entrepot between China and India. Nepal’s trade niche in art, architecture, handicraft, and farm products was marked up with extensive market access in India and China. The political changes during 1940s in China and India affected the pattern of Nepalese trade. With mercantilist policy in India and closed door policy in China, the Nepalese trade niche decreased gradually to its nadir. Nevertheless, Nepal always tried to gain its trade niche by entering into bilateral trade arrangements with India and China.\(^7\)

Geographically, Nepal is a land-locked country. It is often depicted as India-locked country because it is surrounded by India in all sides except by China in the North. India presents as the only economically viable transit country for Nepal’s international trade. For its all commercial traffic flow with the third countries, Nepal is heavily dependent on the availability of transit facilities by India. The availability of transit facilities and the procedure to be followed for those available facilities in India also play a predominant role in the pattern of Nepalese trade beyond the territories of India.\(^8\)

This geographical situation of Nepal impacts her international trade regime in many respects and reminds one of the traps mentioned by Paul Collier in his book the *Bottom Billion* that “...the trap of being landlocked with bad neighbors.”\(^9\)

Some experts observe that India has a rather old-fashioned patronizing attitude towards Nepal, and the latter in turn suffers from the syndrome of a small country unable to move forward in her relations with India. This unfortunate state of affairs has hindered Nepal’s attempts at modernization and economic development and has also undermined India’s image as a large democratic nation capable of coming to terms with the reality of prudent conduct of relations with her smaller neighbor. Given her location in the southern flanks of the Himalaya, Nepal is virtually a country landlocked with

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\(^8\) Id.

\(^9\) See Paul Collier, *The Bottom Billion: Why the Poorest Countries are Falling and What can be Done about It?* 5 (USA, Oxford University Press, 2008).
India, and therefore there is a tendency in New Delhi to regard Nepal as its own
backyard. This has given Nepal sensitivity about her geographical handicap.\textsuperscript{10}

Nepal had positive balance of trade with India till the first quarter of the 20th century.
During 1880-1881, Nepal had exported goods of 16.2 million Nepalese Rupees (NRs.)
to India, whereas at the same time it had imported goods of 8.8 million NRs. from
India. Similarly, during 1899-1900 Nepal had exported goods of 25.0 million NRs to
India, whereas at the same time it had imported goods of 15.8 million NRs. from India.
During this period Nepal used to export chemicals, medicines, crystallized lime juice,
resin, food grains, ghee, raw jute, raw wool, tobacco and other goods. Until the Gantok
route was opened in 1904 between India and China, Nepal was an entrepot for Indo-
China trade.\textsuperscript{11}

This pattern of trade underwent a drastic change when Nepal signed a trade treaty with
British India in 1923. Since then, due to socio-cultural tie and geographical proximity,
Nepal’s international trade is virtually occupied by Indo-Nepal trade. Consequently,
Nepal’s trade balance deteriorated. Trade deficit with India continued even after Nepal
signed the first Treaty of Trade and Commerce with India in 1950.\textsuperscript{12} Till 1960, Nepal's
foreign trade underwent high dependency with India that posed adverse impact on the
economic development of Nepal. Thus, Nepal adopted a trade policy to diversify its
trade through its Fourth Five Year Plan 1970-1975. By the FY 1992/93 Nepalese
exports recorded to expand in 78 countries with 50 different exportable items.

The implementation of the trade diversification policy had some modest impacts on the
direction and composition of Nepal’s foreign trade but it could hardly change the Indo-
Nepal trade pattern. The following chart shows the direction of Nepal’s international
trade since 1970 to 2008.

\textsuperscript{10} See Surya P. Subedi, Dynamics of Foreign Policy and Law: A Study of Indo-Nepal Relations, xiv
(New Delhi, Oxford University Press, 2005).
\textsuperscript{11} See Surendra Bhandari, supra note 7.
\textsuperscript{12} See Treaty of Trade and Commerce between the Government of India and Nepal, done in
During the FYs 74/75 to 2008/09, agricultural export constituted the major portion of the Nepalese export. The following chart II & III show the direction of the agricultural export.

**Note:** The farm trade covers export of food and live animal, raw materials, and animal and vegetable oil. Data source: Nepal Rastra Bank, Quarterly Economic Bulletin Jan.-April 2010.

The above Charts I, II & III show that the trade gaps with India are gradually increasing after Nepal’s entry into the WTO. From the FYs 2004/05 to 2008/09 the pattern of Nepalese trade is changing in favor of India. Each year export to India is almost constant and import from India is increasing. On the whole, the trade deficit is widening. The following Chart IV shows the pattern of Indo-Nepal trade after Nepal’s entry into the WTO.

1.3 Nepal’s Membership to the WTO

Nepal’s Membership to the WTO was inspired by its aspirations to change the pattern of trade from Indo-Nepal vicinity to the global scale. Nepal joined the World Trade Organization (WTO) on 23 April 2004. It is the first least-developed country (LDC) to join the WTO through the full working party negotiation process.13 There are a number of reasons for Nepal’s joining to the WTO. Some of the main reasons of Nepal’s entry into the WTO can be summarized as follows:

i. One of the conspicuous reasons for Nepal’s entry into the WTO can be traced back to Indo-Nepal trade conflict during 1988-1990. Until Nepal experienced trade conflicts with India, Nepal did not seriously look at the General Agreement on Tariffs and Trade (GATT) as a forum for expanding its trade abroad. Nepal realized GATT’s importance when India unilaterally imposed trade embargo to Nepal. Nepal applied for the Membership of GATT on 16 May 1989. A Working Party was established on 21 June 1989. A Memorandum of Foreign Trade Regime (MFTR) was also submitted on 26 February 1990. But the negotiation did not take place. In April 1990, democracy was restored in Nepal. Following the restoration of democracy, the government of Nepal got a confidence to improve its trade relations with India and thus did not give priority to negotiate the GATT’s Membership. As a result, the GATT Membership was put on the back burner until the WTO was established.

ii. The Indo-Nepal trade regime is primarily governed by bilateral trade treaties offering trade concessions and facilities to each other on reciprocal basis. Those reciprocal concessions and facilities could be better preserved when both India and Nepal would be Members of the WTO and utilize the most-favored nation (MFN) exception framework under Article XXIV of the GATT. One of the major objectives of the WTO is to facilitate trade between the Member Countries removing trade barriers including the discriminatory trade practices. Whereas, the bilateral trade rules, by their very nature, are based on the philosophy of discrimination to the third parties, which the WTO does not allow except in the form of free trade area or regional trade arrangements under Article XXIV of the GATT. Nepal could better utilize Indo-Nepal trade concessions and facilities

governed by the bilateral treaty under the framework of GATT Article XXIV as a Member of the WTO.

iii. Nepal was facing serious macro economic instability such as a growing fiscal deficit and declining international reserves with negative trade balance. This situation compelled Nepal to implement the Stabilization Program in 1985/86 supported by the International Monetary Fund (IMF) and a Structural Adjustment Program (SAP) in 1987 and 1989 financed by the World Bank structural credits and IMF structural adjustment facility. With these major policy changes, Nepal entered into an era of a market oriented liberal economic system. At the same time, Nepal entered into an era of democracy in 1990 that further institutionalized the liberal economic policies of Nepal. Economic liberalization inherently strengthened trade diversification aspiration of Nepal for which WTO could be the best forum.

The following Chart shows the pattern of trade deficit of Nepal, which was unsustainable. Indeed, had there not been tourism and remittance, Nepal’s balance of payment situation would be unsustainable.
With the above mentioned reasons, His Majesty’s Government of Nepal (HMGN) brought the issue of WTO Membership from the back to the front burner. On 5 December 1995, HMGN expressed its interest to negotiate the WTO Membership. Following Nepal’s request, the Working Party established under the GATT restarted the negotiation process, which was successfully concluded on 15 August 2003. With the approval of the Working Party Report by the Cancun Ministerial Conference of the WTO in September 2003, Nepal was asked for ratification of the WTO Agreement. Following its ratification, Nepal became the 147th member of the WTO on 23 April 2004. It is the first least-developed country (LDC) to join the WTO through the full working party negotiations process.14

The six-year period of Nepal’s joining to the WTO is not a sufficient period to analyze WTO’s implications for Nepal in a definitive term. However, the above mentioned Charts and data show that Nepal’s aspiration to expand its trade from Indian vicinity to the global scale has not yet come true. The reasons might be many. One of the

14. See Id.
conspicuous reasons is political instability that has eroded confidence of investors and handicapped economic activities.\textsuperscript{15}

2. **Indo-Nepal Trade Regime and Agricultural Trade**

Indo-Nepal trade shows unprecedented dynamics. The dynamics can be generally examined in the four different periods that are shaped with different treaty models. They are respectively discussed below.

2.1 **Before the Sugauli Treaty of 1816**

Since centuries B. C. to the Treaty of \textit{Sugauli}, 1816 Nepal was a major exporter to India. Kautilya, the legendary political and economic scientist, who treats trade as the third pillar of economic activities, has also mentioned that Nepal was one of the principal exporters of woolen goods to India.\textsuperscript{16} All the \textit{Kirat, Lichhavi and Malla} dynasties had developed a close commercial contact to Indian rulers and traders. Truly, the Indo-Nepal trade was based on good faith, brotherhood, personal relations, and customary practices. It was neither guided by any specific trade rules or treaties nor by any tariff and non-tariff barriers. India and Nepal were almost like a free trade area where no custom barriers were applicable. Being a landlocked country, Nepal's trading partners were Tibet and India however most of Nepal's trade was with India.

2.2 **From the Sugauli Treaty of 1816 to the 1923 Treaty**

In 1791, the East India Company proposed 2.25 percent custom duty to export and imports of goods of both countries with a 7-clause treaty, which was concluded in March 1792. But it was not implemented. In 1793 Col. Kripthick visited Nepal to bring about the government of Nepal to act upon the Treaty but his attempt could not


succeed. Almost after two decades, Nepal was forced to sign a peace treaty called the Treaty of Sugauli, 1816. This Treaty had no specific provisions on trading rules but it had enabled the British merchants to have easy entry of Indian goods into the Nepalese market.

Before the 1923 Treaty was concluded,\(^{17}\) Nepal's trade balance with India was positive. In 1880-1881, Nepal had exported goods of 16.2 million NRs. to India, whereas at the same time it had imported goods of 8.8 million NRs. from India. Similarly, in 1899-1900 Nepal had exported goods of 25.0 million NRs to India, whereas at the same time it had imported goods of 15.8 million NRs. from India. During this period Nepal used to export chemicals, medicines, crystallized lime juice, resin, food grains, ghee, raw jute, raw wool, tobacco and other goods. Until the Gantok route was opened in 1904 between India and China, Nepal was an entrepot for Indo-China trade.

2.3 From the 1923 Treaty to the 2002 Treaty

This is a period in which Indo-Nepal trade was regulated by bilateral trade rules. During this period, India and Nepal had entered into at least eight trade agreements with a view to promote and protect trade interests of both countries.

Indo-Nepal trade was first time regulated by a bilateral trade agreement in 1923. Article VI of the 1923 Treaty had stipulated that "No customs duty shall be levied at British Indian ports on goods imported on behalf of the Nepal Government for immediate transport to that country . . . the British Government also agrees to grant the in respect of all trade goods, imported at British Indian ports for immediate transmission to Kathmandu without breaking bulk en route, of a rebate of the full duty paid. . . "Experts observe that due to red tape at the Indian borders Nepalese importers were discouraged to import from overseas that finally forced the Nepalese business personnel to import from India. As a result, this treaty opened the Nepalese market for Indian goods. As a result, Nepalese production capability decreased, export gradually declined, and trade deficit widen.

Further, India and Nepal entered into a new treaty called Treaty of Trade and Commerce in July 1950 that replaced the earlier treaty of 1923. The Treaty was concise having only ten provisions and Memorandum. It provided transit facility to Nepal through Indian territories and ports. It introduced some major changes to the Indo-Nepal trading regime.

Primarily, Article 5 of the Treaty required Nepal to levy customs duties to the goods imported from third countries not lower than those levied in India. However, it did not provide any provision about imposing import duty by Nepal to the Indian goods. It was said that the treaty aimed to restrict cheap re-export of goods to India. Perhaps the concern was genuine because of the open border between India and Nepal. But the concern was not based on market trend. Besides imposing import duty to third country goods, Nepal also had to levy export duty for both farm products and merchandise at rates sufficient to prevent sales of the Nepalese goods in Indian market by keeping the price of the Nepalese goods higher in the Indian market than the goods produced in India. The language “goods produced or manufactured in Nepal” was coined to sufficiently cover both farm products and merchandise. In particular, the 1950 treaty required Nepal to design the customs rules in line with Indian customs policy, open the Nepalese market for Indian goods, and restrict the export of the Nepalese goods, especially to the Indian market. With this treaty, Nepal paid a heavy price to India to get transit facilities. In short, Nepal got trapped by Indian trade policies that were unfair to Nepal.

The Memorandum of the Treaty required Nepalese exporter and importer to deposit an amount equal to the duty chargeable under the Indian Customs Tariff before the goods were moved from the Indian custom points. This provision along with bureaucratic hurdles of the time discouraged Nepalese business personnel to seek market access abroad. Thus, the 1950 Treaty formed a regime to confine Nepalese trade to India.

18. See Treaty of Trade and Commerce between the Government of India and Nepal 1950, available at http://www.nepaldemocracy.org/documents/treaties_agreements/indo-nepal_treaty_trade&commerce.htm. Article 5 of the 1950 Treaty provides that, “The Government of Nepal agree to levy at rates not lower than those leviable, for the time being, in India customs duties on imports from and exports to countries outside India. The Government of Nepal also agree to levy on goods produced or manufactured in Nepal, which are exported to India, export duty at rates sufficient to prevent their sale in India at prices more favorable than those of goods produced or manufactured in India which are subject to central excise duty.”
In short, the 1950 treaty introduced a system of Indo-Nepal trade regime from almost no customs barriers to full of custom barriers. This change in the trading regime was protectionist in nature designed to protect and promote the domestic industries of India. Nepalese rulers yielded to protectionist policies at the behest of India with a vested interest of surviving in power. The 1950 Treaty brought extensive changes to the Indo-Nepal trading dynamics.

The 1950 Treaty of Trade and Commerce was replaced by the 1960 Treaty of Trade and Transit. The 1960 Treaty was concluded with a view to develop it into a Common Market framework.\textsuperscript{19} It introduced a duty free entry of goods originating in either country and intended for consumption in the territory of the other.\textsuperscript{20} However, it maintained provisions to impose restrictions on export and import. For example, Article III of the 1960 Treaty provides some general exceptions similar in nature to Article XX of the GATT.

In 1971, a new Treaty of Trade and Transit concluded. It introduced provisions that imposed major limitations to the concept of duty free entry of goods between the two countries introduced by the 1960 Treaty. It set up a number of criteria. First, to have duty free access of the Nepalese merchandise to the Indian market, the merchandise had to meet the requirement of the rule of origin (ROO) with 90 percent local material content. If any exportable merchandise had not contained 90 percent material either from India or from Nepal the item could not be eligible for duty free access. Second, when such merchandise were manufactured in small units in Nepal, an additional duty equivalent to the rates of excise duty applicable under the Indian Customs and Central Excise Tariffs would be imposed on such merchandise produced in similar units in India. Third, for merchandise containing value of Nepalese material and labor at least

\textsuperscript{19} See Treaty of Trade and Transit between the Government of India and Nepal 1960, available at http://www.nepaldemocracy.org/documents/treaties_agreements/indo-nepal_treaty_trade&transit.htm . The Preamble states that, “Being animated by the desire to strengthen economic cooperation between the two countries, and convinced of the benefits likely to accrue from the development of their economies towards the goal of a Common Market . . .”

\textsuperscript{20} Id. Article II. It provides that, “Subject to such exceptions as may be mutually agreed upon, goods originating in either country and intended for consumption in the territory of the other shall be exempt from customs duties and other equivalent charges as well as from quantitative restrictions.”
50 percent of the ex-factory price, the Government of India would decide on case by case basis for preferential entry into the Indian market.\textsuperscript{21}

The 1960 Treaty had permitted duty free entry for both farm products and merchandise but the 1971 Treaty excluded the farm products from the duty free entry. Also, for the merchandise it imposed three major limitations to the duty free entry among others. As a result, the agriculture trade of Nepal declined from about 45% in the FY 1974/75 to almost 15% in the FY 94/95 of its share to the total trade. The following Chart shows the share of farm exports to the total exports of Nepal.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{chart_vii.png}
\caption{Chart VII: Export of Farm Products in percentile of the total export}
\end{figure}

In 1978, instead of a single treaty on trade and transit, Nepal sought two different agreements on trade and transit. India agreed to the Nepalese request and proposed to have a treaty on control of unauthorized trade as well. Hence, three separate treaties on trade, transit, \& control of unauthorized trade were concluded. In 1988, when the two treaties (trade and transit treaties) were up for renewal, Nepal's refusal to accommodate India's position on the transit treaty caused India to call for a single trade and transit treaty. In response, Nepal took a hard-line position that led to a serious political crisis in Indo-Nepal relations. After extensions twice, the two treaties expired on 23 March 1989, resulting in a virtual economic blockade to Nepal that lasted

until late April 1990. Although, economic issues were major factors in the confrontation, India's dissatisfaction with Nepal's 1988 acquisition of Chinese weaponry caused a flame of fire in the confrontation. New Delhi perceived the arms purchase as an indication of Kathmandu's intent to build a military relationship with Beijing, in the violation of the 1950 Peace and Friendship Treaty, and letters exchanged in 1959 and 1965. India linked security with economic relations and insisted on reviewing India-Nepal relations as a whole. Nepal had to back down after worsening economic conditions at home that led to a major change in Nepal's political system, in which the King was forced to institute a multiparty democracy with a constitutional monarchy a substitute for an absolute monarchy.

The new government sought quick restoration of amicable relations with India. The meeting of the Nepalese Prime Minister Krishna Prasad Bhattarai and the Indian Prime Minister V. P. Singh in June 1990 in New Delhi resulted in strengthening friendly relationship between India and Nepal. During a visit to India in December 1991 by the Nepalese Prime Minister Girija Prasad Koirala, the two countries signed two separate trade and transit treaties. The 1991 Trade Treaty provided substantial unilateral concessions, especially to Nepal.

Indo-Nepal relations resurfaced reassessment when the Nepalese Prime Minister Manmohan Adhikari visited New Delhi in April 1995. He insisted on a major review of the 1950 Peace and Friendship Treaty. In the face of benign statements by his Indian host relating to the treaty, Adhikari sought a greater economic space for Nepal.

In December 1996, the Treaty was renewed without any modification, whereas in 2002 the Protocol added some modifications, among them the rules of origin was the major one. Under the Treaty of Trade, 1991 India provided, on a non-reciprocal basis, duty free access, without quantitative restrictions, to the Indian market for all Nepalese-manufactured articles but the 2002 modification added quantitative restrictions for vegetable fats (vanaspati ghee), acrylic yarn, copper products under chapters 74 & heading 85.44 of HS Code and zinc oxide. The Treaty placed alcoholic liquors and their concentrates except industrial spirits, perfumes and cosmetics with non-Nepalese / non-Indian brand names and cigarettes and tobacco to MFN treatment. However, Nepalese beer could be exported to India on payment of the applicable liquor excise duty equal to the effective excise duty as levied in India on Indian beer. Such exports
from Nepal need a Certificate of Origin issued by the Federation of Nepalese Chambers of Commerce and Industry.

During this period, trade statistics show both exports and imports between India and Nepal were growing. However, it is noteworthy that the trade balance was not in favor of Nepal. As such, it did not present a convincing picture in the macro-economic performance of Nepal, yet both the countries realized the significance of bilateral trade. Trade with India is likely to play a key role in the future as well. In this context, especially the need of protection of investment through an investment agreement, application of enabling clause under the WTO for the continuation of preferential trade between India and Nepal, continuation of preferential trade in the context of BIMSTEC and SAFTA, equivalence of standards and others are some of the important issues associated with future dynamics of Indo-Nepal trade.

2.4. Post-WTO Indo-Nepal Trade

The Indo-Nepal trade historically regulated under bilateral treaties has now been opened for the multilateral rules of the World Trade Organization (WTO) and regional rules of the Bay of Bengal Initiative for Multisectoral Technical and Economic Cooperation (BIMSTEC) & South Asian Free Trade Area (SAFTA). India and Nepal both are Members of the WTO, which is a body of multilateral trade rules. They are also Parties to the two regional trade agreements namely the BIMSTEC and SAFTA. In this background, it seems natural to raise different questions on the dynamics of the Indo-Nepal trade, especially of the future of the bilateral trade regime.

Broadly speaking, two schools of thoughts have seen on the issue of post-WTO Indo-Nepal trade. They are:

I. Natural death of the Indo-Nepal trade treaty, and

II. Creation of more opportunities through an FTA model of the Indo-Nepal trade treaty.

Both of these perspectives are gradually developing with their own reasoning. Each has its own strengths as well as weaknesses. These perspectives might have potential implications for future dynamics of the Indo-Nepal trade. Therefore, the arguments of both of these perspectives are briefly summarized as follows:
2.4.1 *Natural Death of the Indo-Nepal Trade Treaty*

Some argue that the multilateral and regional trade rules diminish the importance of bilateral trade rules. It is because the rules of the WTO are binding and demand the bilateral trade rules to be compatible with the WTO rules. One of the major objectives of the WTO is to facilitate trade between the Member Countries removing trade barriers including the discriminatory trade practices. Whereas, the bilateral trade rules, by their very nature, are based on the philosophy of discrimination to the third parties, which the WTO does not allow except in the form of free trade area (FTA) or regional trade arrangement (RTA) under Article XXIV of the GATT.

The FTAs or RTAs by their very nature offer more advantages, concessions, and facilities to the Contracting Parties and disallow similar advantages, concessions, and facilities to the third parties. In other words, FTAs/RTAs maintain discrimination, which is legitimate under the WTO subject to compatibility with WTO rules. On this background, it is argued that when both the tariff and non-tariff barriers are substantially reduced under the BIMSTEC and SAFTA, within a reasonable period of time they will substitute the Indo-Nepal trade treaty.

Further it is also argued that the WTO and RTAs have opened markets both for India and Nepal to other countries in terms more or less at parity to the terms of Indo-Nepal trade rules by reducing the margin of preferences both for India and Nepal under the bilateral treaty. Also, the traditional concept of protected market has also diffused to a larger extent in relation to Indo-Nepal trade as both India and Nepal have reduced their tariff rates on an MFN basis applicable to all Members of the WTO. Importantly, in the 14th SAARC summit in 2007, India has declared to bring zero customs rate to provide entry into its market to the four LDCs of SAARC including Nepal. If this is implemented without any quantitative restrictions, it might impact the dynamics of Indo-Nepal bilateral trade regime.

On these grounds, some argue that Indo-Nepal trade under the bilateral trade agreements will have a natural death in the future. However, the trade data show that after Nepal’s entry into the WTO regime, the Indo-Nepal trade is increasing each year with further negative trade balances for Nepal.

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2.4.2 **Creation of More Opportunities for Indo-Nepal Trade**

On the other hand, it is also equally argued that the WTO offers more opportunities both for India and Nepal for opening their markets legitimizing the bilateral trade treaty as an FTA on the following grounds:

- WTO opens markets in the developed and developing countries on more favourable terms for the LDCs. For example the EU has opened its market to the LDCs at zero tariff rates on everything but arms (EBA) policy.\(^{23}\) Nepal can seize these opportunities producing quality goods in scale. Perhaps it requires foreign investment and necessary preconditions in hand for foreign investment. Out of total foreign investment in Nepal, India has more than forty percent share. On this backdrop, protection of Indo-Nepal trade and investment through bilateral rules is still likely and practically viable.

- Under the WTO Enabling Clause the Members of the WTO are permitted to provide special and differential treatment to the LDCs. This provision can be applied both at general level and at specific level. The specific measures allow scope for bilateral agreements for providing specific concessions and facilities to

the LDCs. In this context, the possibility of the advancement of bilateral trade agreement between India and Nepal cannot be denied.

- The 1999 waiver decision\(^ {24} \) of the WTO allows preferential access to the LDCs also in the market of developing countries. This further expands the scope of bilateral agreements between the Member Countries of the WTO, which justifies a need for Indo-Nepal trade regime under bilateral rules.

- Article XXIV and Part IV of the GATT also provide scope for bilateral agreements subject to be more liberal than the WTO rules. On MFN basis Nepal's bound average tariff rate is 24 percent on merchandise goods and 41 percent on farm products and the average applied tariff on merchandise is 11 percent and 14 percent on farm products. The average MFN tariff of India is about 30 percent, which is higher than of Nepal. The bilateral tariff rate is almost zero for Nepal subject to rules of origin and other criteria. In this context, the Indo-Nepal Trade Treaty is more liberal than the WTO rules and therefore its role in the future is undeniable.

- Equally, both the SAFTA and BIMSTEC do not affect or nullify the rights and obligations of the Parties under bilateral agreements. However, the negative list and sensitive list under the SAFTA and BIMSTEC are quite extensive than under the bilateral trade treaty between India and Nepal. On the whole, in terms of market access, the Indo-Nepal Trade Treaty is more liberal than the SAFTA and BIMSTEC.

The 1991 Indo-Nepal Trade Treaty has been substituted by a 2009 Indo-Nepal Trade Treaty signed in Kathmandu on 27\(^ {th} \) October 2009. Both the 1991 and 2009 treaties consist of twelve articles. Out of twelve articles, from Article I to Article XI, they maintain no changes. Article XII has incorporated some changes. First, the 1991 treaty was concluded for five years and that could be renewed by mutual consent for further five years at a time. Thus, it was renewed in 2002. But, it could not be renewed automatically. The 2009 treaty has incorporated a provision for automatic renewal. As a result, now onwards, unless either of the parties gives to the other a written notice three months in advance of its intention to terminate the treaty, it will be extended for

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another seven years at a time. Second, under the 1991 treaty, the sunset period of the
treaty was for five years. Under the 2009 treaty, the sunset period is for seven years.
Like the 1991 treaty, the 2009 treaty under Article V & VI institutionalizes the grounds
for more facilitative treatment to each other in terms of market access and promotion
of mutual trade interest, which justify the need of the bilateral trade treaty in the form
of an FTA. On the whole, it can be stated that the future dynamics of Indo-Nepal trade
seems more jubilant and concentrated even in the post-WTO era.

2.5 The Indo-Nepal trade and investment model

2.5.1 Reciprocity

In the realm of Indo-Nepal trade, the principle of reciprocity is in vogue since it was
first introduced by the Peace and Friendship Treaty of 1950. It can also be termed as
"beggar-my-neighbour" policy, by which governments extend to each other similar
concessions or restrictions in trade. Reciprocity is the fundamental rule by which parties
maintain the balance of treatment by means of granting the same or equivalent rights,
benefits and obligations to each other. A reciprocal relationship can be explained as a
balanced condition in which one side gives the other certain treatments while the other
returns the equivalent treatments. The reciprocity method is also extended to custom
duty and quantitative restrictions based on mutually agreed terms from time to time
under the Indo-Nepal Treaty of Trade.

2.5.2 Preferential Treatment

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25 See Arts. 6 & 7 of the Treaty of Peace and Friendship Between the Government of
undertakes, in token of the neighbourly friendship between India and Nepal, to give to the
nationals of the other, in its territory, national treatment with regard to participation in industrial
and economic development of such territory and to the grant of concessions and contracts relating
to such development." Art. 7 provides, "The Government of India and Nepal agree to grant, on a
reciprocal basis, to the nationals of one country in the territories of the other the same privileges
in the matter or residence, ownership of property, participation in trade and commerce, movement
and privileges of a similar nature."

26 See Akiko Yanani, Reciprocity in Trade Liberalisation, Working Paper 00/01-02, APEC
(2001). See also, Surendra Bhandari, World Trade Organisation and Developing Countries, at 66

27 Art. IV of the Treaty of Trade between His Majesty's Government of Nepal and the
reciprocal basis, to exempt from basic customs duty as well as from quantitative restrictions the
import of such primary products as may be mutually agreed upon, from each other."
Preferential treatment is another important feature of Indo-Nepal trade and investment. One country provides special or preferential facilities and concessions that do not require reciprocity. The Indo-Nepal Trade Treaty has incorporated the principle of preferential treatment. The Government of India (GoI) has committed to promote industrial development on the basis of non-reciprocity, especially of favourable treatment to the Nepalese products for exporting to India in terms of custom duty and quantitative restrictions.28 Similarly, Government of Nepal (GoN) has also made commitments to provide preferential treatment to the importable goods from India.29 The Contracting Parties have also agreed for some exceptions to their commitments, rights, and obligations. Among such exceptions, one important is related to safeguarding national treasure.30

2.5.3 Non-tariff Barriers

The Indo-Nepal trade regime has also incorporated mechanism on elimination of quantitative restrictions, licensing or permit system with some exceptions.31 However, in many occasions non-tariff barriers are imposed unilaterally. Due to this unilateral approach, often the Nepalese goods exported to India have been victim of non-tariff barrier measures, such as quarantine, surge, and permit in advance.32

28 Id. Art. V. The Art. 5 provides, "Notwithstanding the provisions of Article III and subject to such exceptions as may be made after consultation with His Majesty's Government of Nepal, the Government of India agree to promote the industrial development of Nepal through the grant on the basis of non-reciprocity of specially favourable treatment to imports into India of industrial products manufactured in Nepal in respect of customs duty and quantitative restrictions normally applicable to them."

29 Id. Art. VI. The Art. VI provides, "With a view to facilitating greater interchange of goods between the two countries, His Majesty's Government shall endeavour to exempt, wholly or partially, imports from India from customs duty and quantitative restrictions to the maximum extent compatible with their development needs and protection of their industries."

30 Id. Art. IX. The Art. IX provides, "Notwithstanding the foregoing provisions, either Contracting Party may maintain or introduce such restrictions as are necessary for the purpose of: (d) safeguarding national treasures, . . . "

31 Art. II of the Protocol to the Treaty of Trade. The Art. II.1 provides, "It is understood that all goods of Indian or Nepalese origin shall be allowed to move unhampered to Nepal or India respectively without being subjected to any quantitative restrictions, licensing or permit system with the following exceptions:

(a) goods restricted for export to third countries;
(b) goods subject to control on price for distribution or movement within the domestic market, and
(c) goods prohibited for export to each other's territories to prevent deflection to third countries.

2.5.4 **Unilateral Approach**

The unilateral approach enables each Contracting Party to act on its own judgment. The Protocol of the Indo-Nepal Trade Treaty has also adopted negative list approach that allows the Contracting Parties to apply the negative list as an exception to the treaty obligations. Article II.2 of the Protocol grants unilateral authority to the Contracting Parties to prepare and communicate the list of goods that are restricted or prohibited on exports.\textsuperscript{33}

2.5.5 **Quota System**

The Indo-Nepal Trade Treaty has also adopted quota system to be applicable to restricted or prohibited goods under negative list. Each Contracting Party may request for export permission and the other may unilaterally consider allowing import of such goods under quota system.\textsuperscript{34}

2.5.6 **Avoidance of Double Taxation**

Nepal has entered into avoidance of double taxation with nine different countries.\textsuperscript{35} The Indo-Nepal Double Tax Avoidance Agreement was concluded in January 1987 that continues for indefinite time unless one of the Contracting Parties notifies another through diplomatic channel for the termination of the Agreement.\textsuperscript{36}

\textsuperscript{33} Supra note 27 Art. II.2. The Art. II.2 follows, "In order to facilitate the smooth flow of goods across the border, the list of commodities subject to restriction/prohibitions on exp[orts to each other's territories shall be immediately communicated through diplomatic channels as and when such restrictions are imposed or relaxed."

\textsuperscript{34} Id. Art. II.4. The Art. II.4 provides, "In respect of goods falling under prohibited or restricted categories as mentioned in para I above and where needed by one Contracting party, the other shall authorize exports of such goods subject to specific annual quota allocations. Specific request list of such goods shall be furnished to each other by the end of November and specific quota allocations for the following calendar year shall be made by the end of December with due regard to the supply availability and the overall need of the other Contracting Party. The quota list may be jointly reviewed as and when necessary."

\textsuperscript{35} Austria, China, India, Korea, Mauritius, Norway, Pakistan, Sri Lanka and Thailand are the nine countries whom with Nepal has entered into Double Tax Avoidance Agreements.

\textsuperscript{36} See Art. 28 of the Agreement Between HMG Nepal and GoI for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Tax on Income, (January 1987). The Art. 28 provides, "This Agreement shall remain in force indefinitely but either of the Contracting States may, on or before the thirtieth day of June in any calendar year beginning after the expiration of a period of five years from the date of its entry into force, five the other Contracting State through diplomatic channels, written notice of termination and in such event, the agreement shall cease to have effect."
Under the Agreement, income derived by a resident of a Contracting State (e. g. India) from immovable property\textsuperscript{37} including income from agriculture or forestry situated in the other Contracting State (e. g. Nepal) may be taxed in that other State (Nepal).\textsuperscript{38} The profits of an enterprise of a Contracting State (e. g. India) shall be taxable only in that State (e. g. India) unless the enterprise carries on business in the other Contracting State (e. g. Nepal) through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State (e. g. Nepal) but only so much of them as attributable to that permanent establishment.\textsuperscript{39}

Dividends paid by a company, which is a resident of a Contracting State (e. g. India) to a resident of the other Contracting State (e. g. Nepal) may be taxed in the other state (e. g. Nepal). However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed ten percent of the gross amount of the dividends, if the beneficial owner is a company which owns at least ten per cent of the shares of the company paying the dividends and fifteen percent of the gross amount of the dividends in all other cases. But this does not affect the taxation of the company in respect of the profits out of which the dividends are paid.\textsuperscript{40}

Interest arising in a Contracting State (e. g. India) and paid to a resident of the other Contracting State (e. g. Nepal) may be taxed in that other State (e. g. Nepal). However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed fifteen percent of the gross amount of the interest.\textsuperscript{41}

\textsuperscript{37} The term "immovable property" is defined as ". . . shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general laws respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources, ships and aircraft shall not be regarded as immovable property."

\textsuperscript{38} See supra note 36, Art. 6.

\textsuperscript{39} See id. Art. 7.

\textsuperscript{40} See id. Art. 10.

\textsuperscript{41} See id. Art. 11.
Royalties arising in a Contracting State (e.g. Nepal) and beneficially owned by a resident of the other Contracting State (e.g. India) shall be taxable in that other State (e.g. India). However, such royalties, may also be taxed in the Contracting State (Nepal) in which they arise and according to the laws of the State (Nepal), if the recipient is the beneficial owner of the royalties, the tax so charged shall not exceed fifteen percent of the gross amount of the royalties. 42

3. Nepal’s Accession to the WTO and Agricultural Trade

3.1 Nepal’s Commitment to the WTO

The Working Party Report on the Accession of Nepal to the WTO43 comprises 152 paragraphs. Out of them, 25 paragraphs are commitments paragraphs. Broadly, the commitments are related to systemic commitments and market access commitments.44

- Paragraphs 10-21 present a broad picture of economic policies of Nepal including monetary and fiscal policies, foreign exchange and payment, investment regime, state ownership and privatization, pricing policy, and competition policy.
- Paragraphs 22-31 provide for a framework for making and enforcing policies.
- Paragraphs 32-117 provide for policies affecting trade in goods.
- Paragraphs 118-136 provide for trade related aspects of intellectual property rights.
- Paragraphs 137-141 provide for policies affecting trade in services.

42 See id. Art. 12.
43 WTO, Report of the Working Party on the Accession of the Kingdom of Nepal to the World Trade Organization, WT/ACC/NPL/16 (18 August 2003). However, the new document WT/ACC/NPL/16 (28 August 2003) comprises 155 paragraphs. However, the new three paragraphs consist of now new contents but three references to the goods, services and specific commitments are given separate three paragraphs.
• Paragraphs 142-149 present miscellaneous commitments including publication and information on trade, notification, information about bilateral trade agreements, and technical assistance, and
• Paragraphs 150-152 are concluding paragraphs.

There are two schedules attached to the Accession Protocol. One of them provides for tariffs commitments on both merchandise and farm products. The second schedule provides specific commitments related to the service sector. Briefly, these schedules are as follows:

First, schedule of tariffs commitments on goods comprises Nepal's commitment not to raise tariff on certain commodities in future above the agreed ceiling line. About eighty percent of people of Nepal depend on agriculture therefore, considering the importance of agriculture in Nepal, an average tariff rate is bound at 51 percent on the date of accession subject to bringing down to 42 percent in three years time at equal annual basis against the 10 percent applied tariffs in farm products. Flexibilities have been maintained on merchandise products by committing 39 percent average bound tariff rate at the date of accession subject to lower down to 24 percent in three years time at equal annual basis. The higher level of bound tariffs rates provide room for policy flexibilities to increase tariffs rates up to the bound level, if needed.

Second, schedule of specific commitments in service sectors has agreed conditionally to open eleven service sectors that cover about seventy-five sub-sectors. The eleven service sectors are as following:

• business services,
• communication services,
• construction and related engineering services,
• distribution services,
• educational services,
• environmental services,
• financial services,
• health related social services,
• tourism and travel related services,
• recreational, cultural and sporting services, and
• transport services.

3.2 Terms of Accession on Farm Products

Nepal’s commitments to the WTO allow Nepal to undertake necessary steps to promote export of farm products such as lentils, Niger seeds, tea and coffee, ginger, cardamom, vegetable seeds, flower, silk and silk products, medicinal herbs, and fruits. The commitments also allow Nepal to exempt sales tax, excise duty and income tax to small industries that are called cottage industries. The details of the Nepal’s commitment to the WTO on farm products are presented in the following table.

<table>
<thead>
<tr>
<th>SN</th>
<th>Heading</th>
<th>Commitments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Agriculture Development Fee (para. 40)</td>
<td>Nepal is permitted to levy 2.5 - 14.5 per cent agriculture development fee as ODC over a period of ten years with a commitment for elimination between two to ten years period.</td>
</tr>
<tr>
<td>2</td>
<td>Export promotion (para. 84)</td>
<td>Nepal has expressed that it would undertake necessary steps to promote export on agricultural commodities such as lentils, Niger seeds, tea and coffee, ginger, cardamom, vegetable seeds, flower, silk and silk products, medicinal herbs, fruits etc.</td>
</tr>
</tbody>
</table>
| 3  | Some major tax facilities (para. 85)              | • Nepal continues to exempt sales tax, excise duty and income tax to Cottage Industries.  
• Nepal continues to provide 50 per cent rebate for seven years to agro based industries and storage of fruits and vegetables.  
• Fruit-based fruit processing industries of fixed assets up to NRs. 2.5 million established in particular areas are exempted from excise duty and sales tax for a period of ten years. |
<p>| 4  | Plant and animal importation (para. 92)           | Nepal has confirmed that importation of plant, plant products, animals and animal products are required meeting the plant quarantine standards laid down by the standards laid down by Department of Agriculture. |</p>
<table>
<thead>
<tr>
<th></th>
<th>Export and import of food products (para. 98)</th>
<th>Nepal has confirmed that both processed, semi-processed or unprocessed food products are required meeting the food standards set by DFTQC for export and import.</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>Import and export restrictions</td>
<td>Nepal has informed that few agricultural products are restricted for import and export for preventing diseases and protect health and environment and religious reasons.</td>
</tr>
</tbody>
</table>
| 7 | Pesticide regulation                        | - Nepal has confirmed that export and import of pesticide is regulated with a view to protect the environment and ensure sanitary measures.  
- Nepal has also confirmed that it can ban or restrict any PIC pesticides that are potentially hazardous to health. |
| 8 | Agricultural policy (para. 114)             | - Nepal has informed that it is a net food-importing country.  
- Nepal has also informed that there is no specific incentive for the export of agricultural commodities.  
- Nepal has informed that it provides assistance to agricultural producers by government programs in areas such as support for general research relating to different products, extension services, marketing and promotion activities including agricultural market information, natural disaster relief through crop subsidies, loans and grants for cultivation, natural disaster relief through crop subsidies and other infrastructure support for small farmers, urea transport subsidies for remote areas, subsidies for tea promotion and dairy development grants.  
- The base total aggregate measures of supports (AMS) are below the de minimis 10 percentages. |
| 9 | Agricultural subsidy (para. 114)            | Nepal has informed that it does not have agricultural export subsidies.                                                            |

### 3.3 Nepal’s Legislative Commitment to the WTO

Nepal has made a commitment to enact different 41 pieces of laws to comply with the WTO requirements. These laws range from custom duty to intellectual property rights and judicial reform. The following table presents the details of the commitments.
<table>
<thead>
<tr>
<th>SN</th>
<th>Heading</th>
<th>Commitments</th>
<th>Time line</th>
</tr>
</thead>
</table>
| 1  | Enactment of Laws (para. 28)                                           | • Nepal has undertaken a commitment to enact different 41 pieces of legislation.  
• Nepal has undertaken a commitment that any changes in laws, regulations and practices during the transitional arrangements would not result in a lesser degree of consistency with the provisions of the relevant WTO Agreements than existed on the date of accession.  
• The scope of application of existing inconsistencies with WTO provisions in these areas would not be allowed to increase. | 2003-2006                      |
| 2  | Review of administrative decision making system (para 30 & 31)          | Nepal has expressed that it would review the legislation on appeal against the decisions made by administrative agencies to ensure that there would be an appropriate system either through enactment or amendment of appropriate legislation.                           | Upon the date of accession     |
| 3  | Competition (para. 21)                                                 | To frame a Competition Law consistent with WTO Agreements                                                                                                                                                   | • Prepare Bill by Nov. 2003  
• Enactment by July 2004       |
<p>| 4  | Import Licensing (para. 48)                                            | Nepal has expressed that it would enact legal instruments codifying the substances of WTO Agreement on Import Licensing Procedures                                                                          | by December 2003               |
| 5  | Custom valuation (para. 50)                                            | Nepal has expressed that it would examine the modifications that would have to be introduced in current legislation and practices to fully implement the WTO Custom Valuation Agreement                                         | by 1 January 2004              |
| 6  | Rules of origin                                                        | Introduce a WTO consistent legal regime on rules of origin                                                                                                                                                 | by December 2003               |</p>
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<tbody>
<tr>
<td>7</td>
<td>Anti-dumping and countervailing measures</td>
<td>Nepal shall enact a law on anti-dumping and countervailing measures</td>
</tr>
<tr>
<td>8</td>
<td>Subsidies and Countervailing Measures</td>
<td>To develop a legal regime on Subsidies and Countervailing Measures</td>
</tr>
<tr>
<td>9</td>
<td>TBT</td>
<td>To amend existing laws to bring them into full compliance with the WTO Agreement on Technical Barriers to Trade</td>
</tr>
<tr>
<td>10</td>
<td>SPS Measures</td>
<td>Make existing laws compatible with SPS Agreement</td>
</tr>
<tr>
<td>11</td>
<td>TRIMs</td>
<td>Nepal would develop legal regulatory mechanism compatible with WTO Agreement on Trade Related Investment Measures</td>
</tr>
</tbody>
</table>
| 12 | TRIPS | • Nepal has committed to prepare Industrial Property Act covering all categories of industrial property rights under Section 2 through 7 of Part II of the TRIPS.  
• Nepal has committed to amend the Copyright Act 2002 as necessary | by December 2005 |
| 13 | Plant Variety | Nepal has committed to prepare Plant Variety Protection Act | by December 2005 |
| 14 | GATS | Nepal has committed to amend and enact different laws | by Feb 2004 |

3.4 Legal Policy Changes Following Nepal’s Accession to the WTO

After joining the WTO, Nepal took some important steps to reform its legal regulatory mechanism. It started a three-year customs reform program since the FY 2003/04 that completed in the FY 2006/07. Also a trade facilitation committee at the central level was established in 2004 in order to harmonize customs work for trade facilitation. Trade and Export Promotion Committee (TCPC) has been established in October 2006.45 It

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has integrated the three institutions (Trade Promotion Center, Export Promotion Committee and Carpet, and Wool Development Committee). TCPC is authorized to help export promotion.

Immediately after joining the WTO, a major policy change was introduced to promote export. With the policy change, exporters are facilitated with the authorization to the commercial banks to extend Cash Against Document (CAD) certificates against exports for up to three years. In the past, such payments certificates could be extended up to six months only with the permission of Nepal Rastra Bank (Central Bank of Nepal). Facility being offered to exporters under the CAD system has been further extended with the reduction of bank guarantee level to 5 percent from the earlier 10 percent and also the value under such export facility has been raised to US $ 100,000.00 from the earlier limit US $ 50,000.00.  

Also, the system of requiring a permission from Nepal Rastra Bank to issue bank guarantees (bid bonds, performance bonds), against payments to be made to a foreign supplier in convertible currency for import of goods by an entity in Nepal has been simplified. Under the new system, effective from the 2004/05 fiscal year, commercial banks themselves can issue such bank guarantees. There was no separate exchange facility available for transportation for imports from abroad (except India), such imports had to be made on the cost-insurance-freight (CIF) basis. Taking into consideration the operation of the dry port in Birjung from the FY 2004/05 the government introduced a separate exchange facility for imports on freight-on-board (FOB) basis. From the FY 2006/07 the commercial banks of Nepal are authorized to open more than one year letter of credit (LC) under deferred payment and suppliers’ credit against the prevailing provision of requiring the permission of Nepal Rastra Bank for more than one year from the countries other than India.

Also the Government of Nepal has started to work out on developing Nepal as a transit point between India and China. It will be helpful to Nepal to find out and explore its own export possibility in the context of increasing trade and high economic growth rate of these two large neighboring countries.

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46 See Ministry of Finance, Economic Survey FY 2004/05, Box 6.2 (Kathmandu, His Majesty’s Government Ministry of Finance, 2005)
47 Id., Box 6.2.
48 Supra note 45 Box 6.A.
The Government of Nepal has developed a National Agricultural Policy along with joining the WTO. The policy aims to develop large production pockets to produce farm products to the demand of market. The policy also aims to introduce business oriented programs in the agricultural sector focusing on the production and use of organic farming, hybrid seed, and hybrid species of livestock.\(^{49}\)

The Government of Nepal also developed a policy to increase farm production and promote farm export through “one-village one-product” program in the FY 2005/06. The program aims to specialize in production to promote farm export.

3.5 Implications of the WTO for Nepalese Trade Regime

It was a coincidence that following Nepal’s joining to the WTO the Agreement on Textiles and Clothing (T&C) expired on 31 December 2004 that phased out the quota system in the textiles and clothing sector. Garment export was one of the key activities of Nepalese foreign trade that underwent a serious problem after the expiration of the quota system. Ministry of Finance observed that, “Garment industries are facing serious problem . . . these industries have come across a situation of facing the challenge of open competition in the international market . . . the overall export suffered with recording a marginal growth as a consequence of the sharp fall in the export of readymade garments.”\(^{50}\) The Ministry of Finance also assessed that it would be very difficult in the coming days for the garment industry of Nepal, which was solely dependent on quota, to increase its share in international market in a competitive way.\(^{51}\)

The overseas export of primary goods including the farm products decreased in the FY 2004/05, which was the year of Nepal’s entry to the WTO. Also, the overall overseas exports of Nepal fell by 22.4 percent in the FY 2004/2005. It was due to the substantial decrease in the export of garments. Despite the overall decline of export, the export of some of the farm products such as cardamom and herbs was increased.\(^{52}\) Also during

\(^{49}\) *Supra* note 46 Box 8.1.

\(^{50}\) *Id.* para. 6.1.

\(^{51}\) *Id.*

\(^{52}\) *Id.* para.6.7.
the same period, imports of farm products such as unprocessed soya bean, unprocessed palm oil, and unprocessed wool had decreased.\textsuperscript{53}

The government of Nepal assessed positive implications for the tourism industry of Nepal after its entry into the WTO, especially due to high economic growth rate in China and India. The growing and economically bettered-off middle class in China and India are expected to be the cultural and religious visitors to Nepal.\textsuperscript{54}

One of the challenges to Nepal after its entry into the WTO was to meet the technical standard of the Agreement on Sanitary and Phytosanitary Measures (SPS) and the Agreement on Technical Barriers to Trade (TBT). Many of the Nepalese products both farm products and merchandise had to undergo a quality improvement process to get market access, especially in the EU, Japan, and USA.\textsuperscript{55}

During the 14\textsuperscript{th} SAARC Summit in New Delhi in 2007, India has declared to provide duty free export to its market from the four LDCs of SAARC including Nepal. Also, India has declared to minimize the list of sensitive products to enter India from these countries. Theoretically, this liberal policy of India would help promote export of Nepalese farm products and merchandise in the Indian market. Practically, the Government of Nepal comprehended that this move may create additional difficulties for the Nepalese products, which were being exported with customs exemption facilities, to uphold the larger share of Indian market. As a result of the policy changes, the Nepalese products will have to face a sharp competition with the products of Bangladesh, Bhutan, and Maldives since the products of these countries will also have the same customs exemption facilities. It is expected that the Nepalese export to India of vegetable ghee, jute products, polyester yarn and readymade garments will suffer most.\textsuperscript{56}

4. \textbf{Conclusion}

Nepal is considered one of the most open trade regimes in South Asia with lowest tariff rate, no explicit export subsidies, and no quantitative restrictions. The overall

\begin{footnotesize}
\textsuperscript{53} Id. para.6.10. \\
\textsuperscript{54} Id. para.6.17. \\
\textsuperscript{55} Id. para.6.21. \\
\textsuperscript{56} Supra note 46 Box 6.B.
\end{footnotesize}
agricultural tariff structure is well below the WTO’s bound rate under agreement on agriculture.

However, there is a lack of study that would help measure how much Nepal has gained or lost joining the WTO. A few studies have been carried out assessing the impact on garment sector of the phasing out of the Multi-fiber Agreement.

Based on the above-mentioned data, it can be discerned that Nepal has not made any tangible progress in terms of growth, employment, poverty reduction, production, and export after joining the WTO. In fact, exports have declined, imports have increased and the manufacturing sectors, especially the ones that weighted high in the exports basket have experienced a downturn.

Trade as a percentage of GDP has marginally declined since Nepal’s joining to the WTO. During 1995-2003, on average, trade had contributed 52 percent of the GDP, whereas in the post-WTO period, on average, trade has contributed 46 percent of the GDP. Investment is not growing, rather declining. There has been no change in production structure. Trade deficit is increasing continuously. Economic growth rate is not satisfactory. Employment generation activities are also not satisfactory. Can we blame all these to the WTO?

The answer is no. The lack of competitiveness and quality production are mired with endogenous factors such as political instability, poor infrastructure, high transportation cost, industrial strikes by highly motivated political trade unions, lack of corporate culture, pervasive corruption, lack of institutional fairness, poor research and development activities, unpredictable judiciary, and overall trade unfriendly domestic environment. The educational sector is also responsible for these syndromes. Mostly, the public educational institutions are apt to produce political cadres than competent human resources.

Government often makes commitment but fails to implement it. For example, the plan for establishing special economic zones (SEZ), which comprise of export processing zones, special trading zones, tourism/recreation and simplified banking facilities, have still not materialized due to political instability and also a lack of effective lobby from the industrial sector. Typically, the firms based in SEZs are expected to produce quality goods for exporting over 70 percent of their total production.
On the whole, the six-year period of Nepal’s joining to the WTO is not a sufficient time to analyze WTO’s implications for Nepal in a definitive term. Though, the above mentioned data show that Nepal’s aspiration to expand its trade beyond Indian vicinity to the global scale has not yet come true. Nepal’s international trade regime still carries the India dependency syndrome.

The 1950 Treaty introduced a system of Indo-Nepal trade regime from no customs barriers to full of custom barriers that had significantly drawn Nepal to India dependency syndrome. The regime was mainly protectionist in nature as it had aimed to protect and promote the domestic industries of India. Nepalese rulers had yielded to protectionist policies at the behest of India with a vested interest of surviving in power. The regime of 1950’s treaty was finally changed by the 1991 treaty.

Like the 1991 treaty, the 2009 treaty under Article V & VI institutionalizes the grounds for more facilitative treatment to each other in terms of market access and promotion of mutual trade interest, which justify the need of the bilateral trade treaty in the form of an FTA. On the whole, it can be stated that the future dynamics of Indo-Nepal trade seems jubilant and concentrated even in the post-WTO era.

On the one hand the phase out of quota system in the garment sector has negatively impacted Nepal’s market access to the international market and on the other hand Nepal’s aspiration to expand its trade beyond Indian vicinity has not yet come true. Along with these limitations, the red tape at Indian customs point and the unpredictable Indian quarantine mechanism in place have especially discouraged the Nepalese farm trade even in the post-WTO era.

After trade liberalization under the WTO and other regional agreements in South Asia, the impact on agricultural trade has received increasing attention. Agricultural trade would have greater role to play in the future in food security particularly in a situation of food production not keeping pace to high population growth i.e. 2.25%, low productivity, and increased threat of climate change.

Despite all these endogenous limitations, market access provides as one of the attractive factors of the multilateral trading system. However, developed member countries are finding excuses to provide market access under the veil of protecting the domestic interest, thereby raising the trade barriers on account of the product quality standards, environment, and labor issues. This is also largely being used to discourage
the exports from the developing world as those countries are unable to meet the mandatory standards of the developed countries. The case in point for Nepal is honey, coffee, and other high value agricultural products, which were prevented from entering into the European markets on account of pesticides residue.\textsuperscript{57}

In short, to benefit from the WTO regime and have better access to the international market Nepal needs to be focused on developing corporate culture, exploiting its comparative advantages, encourage scale production, and ensuring quality production to meet the requirement of the international markets, especially the sanitary and phytosanitary standards.

Optimistically, there are tangible benefits to Nepal from the WTO. Among others they include; ensured transit right under Article V of the GATT, opportunity to voice the concern of country’s interest in the international forum, benefits of special and differential treatment, benefits of GATT Article XXIV, increased market access to all countries around the world and the opportunity to harness trade related assistance and development assistance for capacity enhancement of the country. The effective participation in the international trade negotiations will also help Nepal to reap the benefits arising from the WTO.