

Taneja, Nisha; Prakash, Shravani; Bimal, Samridhi; Garg, Sakshi; Roy, Riya

Working Paper

Strengthening India-Nepal economic relations

Working Paper, No. 381

Provided in Cooperation with:

Indian Council for Research on International Economic Relations (ICRIER)

Suggested Citation: Taneja, Nisha; Prakash, Shravani; Bimal, Samridhi; Garg, Sakshi; Roy, Riya (2019) : Strengthening India-Nepal economic relations, Working Paper, No. 381, Indian Council for Research on International Economic Relations (ICRIER), New Delhi

This Version is available at:

<https://hdl.handle.net/10419/203715>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Working Paper 381

**Strengthening India-Nepal Economic
Relations**

**Nisha Taneja
Shravani Prakash
Samridhi Bimal
Sakshi Garg
Riya Roy**

July 2019



Table of Contents

Acknowledgements	ii
Abstract.....	iii
1. Trade Patterns and Potential	3
2. Issues Facing India’s Exports to Nepal	6
3. Issues Facing India’s Imports from Nepal	11
(i) <i>Import Potential from Nepal</i>	11
(ii) <i>Underutilisation of the Tariff Rate Quota</i>	11
(iii) <i>High ROO Criteria under Trade Treaty</i>	12
(iv) <i>Non-Tariff Measures Facing Nepal’s Exports to India</i>	13
4. Physical Barriers to Cross-Border Movement of Goods	14
5. India’s FDI in Nepal.....	15
6. Policy Recommendations	18
References.....	22
Appendices.....	24

List of Tables

Table 1: India’s Trade with Nepal (US\$ Million).....	3
Table 2: India’s Top 10 Exports to Nepal.....	4
Table 3: Top Items Imported into India from Nepal (Values in US\$ Million).....	4
Table 4: Total Additional Trade Potential between India and Nepal (US\$ Million).....	6
Table 5: India’s Additional Export Potential to Nepal	6
Table 6: Items with Highest Export Potential from India to Nepal (Values in US\$ Million) ..	7
Table 7: Comparison of Applicable Rate of Duty under SAFTA and Indo-Nepal Bilateral Agreement.....	9
Table 8: Nepal’s Top Import Partners.....	10
Table 9: Top Items with Import Potential from Nepal (US\$ million)	11
Table 10: India’s Imports of TRQ Products from Nepal (Metric Tonnes) and Quota Utilisation (%).....	12
Table 11: India’s Cumulative FDI in Nepal (Values in USD million).....	15
Table 12: Stock of FDI by Countries and Sectors in Mid-July 2016.....	16
Table 13: India’s Sector-wise FDI in Nepal (Values in USD million).....	17

Acknowledgements

We gratefully acknowledge the support provided by the Ministry of Commerce, Government of India for this study. The interactions held with several stakeholders during consultations in New Delhi and Kathmandu provided in-depth understanding of issues related to the subject. We would especially like to thank South Asia Watch on Trade, Economics and Environment (SAWTEE), Nepal for their constant support and valuable inputs at different points in time.

Abstract

India and Nepal have traditionally shared a unique relationship of friendship and economic cooperation. The relationship is characterized by an open and people-friendly border and is built on shared historical, cultural, linguistic, ethnic links between people residing in India and Nepal.

With Nepal being a priority under India 'Neighborhood First' policy, strengthening the economic relationship holds immense significance and potential for both the countries. India is Nepal's largest export market, the biggest source of its imports and the top investor of foreign capital stock. India also provides Nepal transit facility through its territory to access sea ports for trading with rest of the world.

Given this, the main objective of this paper is to suggest policy measures which can increase bilateral trade and investment between India and Nepal. We analyse the bilateral trade patterns and estimate the maximum additional trade potential. We discuss a wide range of issues of importance pertaining to bilateral trade, including tariffs, levy of an agricultural reform fee, under-utilization of the tariff rate quota, non-tariff measures, issues related to ROO and physical barriers to cross-border movement of goods. We also analyse the trend and changing sectoral composition of India's investment in Nepal. We discuss barriers and opportunities for Indian investment in Nepal. The paper concludes by charting a way forward for bolstering economic cooperation between the two countries by listing down recommendations for enhancing trade, addressing non-tariff barriers, upgrading infrastructure to improve connectivity and enhancing Indian FDI in Nepal.

Key words: *India-Nepal, Bilateral Trade, Bilateral Investment, Trade in Services, Non-Tariff Barriers*

JEL classification: *F10, F13, F15, F50, F53, P45*

Author's email: *ntaneja@icrier.res.in; sbimal@icrier.res.in; sgarg@icrier.res.in*

Disclaimer: *Opinions and recommendations in the report are exclusively of the author(s) and not of any other individual or institution including ICRIER. This report has been prepared in good faith on the basis of information available at the date of publication. All interactions and transactions with industry sponsors and their representatives have been transparent and conducted in an open, honest and independent manner as enshrined in ICRIER Memorandum of Association. ICRIER does not accept any corporate funding that comes with a mandated research area which is not in line with ICRIER's research agenda. The corporate funding of an ICRIER activity does not, in any way, imply ICRIER's endorsement of the views of the sponsoring organization or its products or policies. ICRIER does not conduct research that is focused on any specific product or service provided by the corporate sponsor.*

Strengthening India-Nepal Economic Relations

Nisha Taneja, Shravani Prakash, Samridhi Bimal, Sakshi Garg and Riya Roy

India and Nepal have historically shared strong trade and commercial relations as neighbours in the South Asia region. Even during the three decades when Nepal faced continuous political uncertainty that created several barriers to trade and investment, India remained the country's closest commercial partner. India is Nepal's largest export market, the biggest source of its imports, the top investor of foreign capital stock and the largest donor of foreign aid. India also provides Nepal transit facility through its territory to access sea ports for trading with rest of the world, since Nepal is a landlocked country bordered by India on three sides.

The cross-border flow of goods between India and Nepal is governed by three legal instruments:

Bilateral Trade Treaties

Trade between the two countries is governed by the Bilateral Trade Treaty signed in 1971 (and revised in 1991, 1993, 1996, 2002 and 2009), under which India and Nepal offer tariff and other duty concessions on primary and manufactured products imported from each other's territory. The key features of these treaties are as follows:

- (i) For primary products, both countries provided duty-free access on imports of 14 primary products on a reciprocal basis from each other in 1991, and expanded the list to 16 products under the 2009 treaty. However, for import of certain agriculture goods, Nepal levies an Agriculture Reform Fee. This fee is levied at the rate of 5 percent for 384 items and 8 percent for 9 items.
- (ii) In the case of manufactured products, Nepal provides India a rebate in the chargeable customs duty based on ad valorem. This rebate is 5 percent of the applicable tariff rate of up to 30 percent and 3 percent of applicable tariff rate of more than 30 percent. India receives the rebate on the Nepal's MFN rates for imports and henceforth, it will be referred as the bilateral rate of duty. However, such rebate is not applicable to the goods attracting specific duty.

India's duty concessions to Nepal, on manufactured goods have varied over time. The rules of origin criteria have played an important role in determining the extent of concessions offered by India to Nepal. Under the 1971 treaty, India allowed duty-free access to items manufactured in Nepal with 90 per cent Nepalese/Indian material content for import to India (subsequently reduced to 80 per cent in 1991 and then further to 50 per cent in 1993). In 1996, India provided duty-free access to all products manufactured in Nepal¹ on the basis of a Certificate of Origin and no value-added criteria. The 2002 revision of the treaty re-introduced two conditions for duty free access of Nepalese products into India – (1) a value addition norm of 30 per cent, and

¹ Except three items that were on the sensitive list-namely alcoholic liqueurs, perfumes and cigarettes and tobacco

(2) requirement that the manufacturing process should lead to a change in classification at the four-digit level of the Harmonised Commodities Description and Coding System. In addition, a tariff rate quota was imposed on four items (vegetable ghee, acrylic yarn, copper products and zinc oxide) under which duty-free access was allowed only up to a specified limit beyond which MFN tariff was applicable. In the 2009 treaty, the tariff rate quota for copper products was increased by 2,500 metric tons.

South Asian Preferential Trade Agreement (SAPTA)

The South Asian Preferential Trading Agreement (SAPTA) was an initiative taken by the South Asian Association for Regional Cooperation (SAARC) to augment trade between the Asian countries through preferential treatment. The agreement came into effect in December 1995 after the conclusion of its first round of negotiations. Overall, it had four rounds of negotiations based on the 'request and offer' approach. Under this approach, the exporting countries presented a country-specific list of items (currently being traded as well as potential) on which the party seeks preferential treatment. The importing countries would make an offer on the items from the request list and indicate the extent of concessions. The tariff concessions were guided by the Margin of Preference (MoP). With the help of this approach, each consequent round aimed at increasing the number of products covered and at deepening tariff concessions. At the end of the fourth round of the negotiations, tariff concessions were exchanged for around 5000 commodities.

In January 2006, SAPTA was superseded by the South Asian Free Trade Agreement (SAFTA). According to Article 22 (Para 1 and 2) of the Agreement on South Asian Free Trade, the concessions granted under SAPTA were to be available to the countries until the Trade Liberalisation Programme under SAFTA was completed. Nepal is yet to undertake complete tariff liberalisation under SAFTA due to which the concessions given under SAPTA are not discontinued. Thus, it leaves the status of SAPTA ambiguous.

South Asian Free Trade Agreement (SAFTA)

India and Nepal also offer concessions to each other under the South Asian Free Trade Agreement (SAFTA). Under the SAFTA agreement, Nepal is expected to offer zero duty to all products except on 1062 items (HS 6-digit level) on the sensitive list. However, Nepal is yet to complete its tariff liberalisation and currently offers zero duty on only a limited number of items. Thus, India is yet to receive zero duty access into Nepal on all items but on the sensitive list items.

The main objective of this paper is to suggest policy measures which will increase bilateral trade and investment between India and Nepal. The key questions posed are as follows:

- What additional trade potential is available for the two countries to tap into for enhancing bilateral trade and in what commodities?
- What further tariff concessions can India demand from Nepal for its exports, especially in terms of reducing the number of items on Nepal's SAFTA sensitive list applicable to India?

- What are the anomalies under the bilateral agreement and SAFTA? How can these be corrected?
- How can the bilateral treaty of trade be modified to make it more relevant to current trends? Is the Tariff Rate Quota still relevant?
- What other steps can India take to improve Nepal’s market access into India in terms of addressing the non-tariff barriers facing Nepalese exports to India?
- What steps can India take to improve its market access to Nepal in terms of addressing non-tariff barriers faced by Indian exporters?
- What measures can help enhance India’s investment flows into Nepal?

The study makes use of “mixed methods”, based on secondary sources and primary information collected through stakeholder’s consultations. Secondary sources include published papers, reports, books, customs tariff manuals, government policies, agreements, regulations and protocols. Secondary data on India’s trade with Nepal has been collected from the Directorate General of Foreign Trade (DGFT), Ministry of Commerce and World Integrated Trade Systems (WITS) Database published by the World Bank. Stakeholder consultations were conducted with importers, exporters, freight forwarders, clearing agents, government officials and academics on various issues at different points in time during 2017-18, both in India and Nepal.

The paper is organized as follows. Section 1 of the paper analyses the bilateral trade patterns of India and Nepal along with their maximum additional potential. Section 2 examines the issues faced by India’s export to Nepal and section 3 examines the issues facing India’s imports from Nepal. Section 4 analyses the physical barriers to cross-border movement of goods between India and Nepal. It is followed by section 5 which focuses on India’s FDI in Nepal. Finally, section 6 provides the concluding observations and the way forward.

1. Trade Patterns and Potential

India has had a trade surplus with Nepal since 2002-03 which has been growing over the years. The average trade balance ratio increased from 40% in the period 2002-03 to 2009-10 to 75% in the period 2010-11 to 2017-18, reflecting India’s expanding trade surplus (Table 1). The growing trade deficit has been a major cause of concern for Nepal. A point worth noting is that there is has been a sharp drop in number of items exported from Nepal to India.

Table 1: India’s Trade with Nepal (US\$ Million)

Year	Export to Nepal	Import from Nepal	Total trade	Trade Balance	Trade Balance Ratio (%)
2002-03	350	282	632	69	11%
2003-04	669	286	955	383	40%
2004-05	743	346	1,089	397	36%
2005-06	860	380	1,240	480	39%
2006-07	927	306	1,233	621	50%
2007-08	1,507	629	2,136	879	41%
2008-09	1,570	496	2,066	1,074	52%
2009-10	1,533	453	1,986	1,081	54%

Year	Export to Nepal	Import from Nepal	Total trade	Trade Balance	Trade Balance Ratio (%)
2010-11	2,168	513	2,682	1,655	62%
2011-12	2,722	550	3,272	2,172	66%
2012-13	3,089	543	3,632	2,546	70%
2013-14	3,592	530	4,122	3,062	74%
2014-15	4,559	640	5,199	3,919	75%
2015-16	3,930	471	4,401	3,460	79%
2016-17	5,454	445	5,899	5,009	85%
2017-18	5,518	414	5,932	5,104	86%

Source: Directorate General of Foreign Trade, Ministry of Commerce

In 2017-18, India's top exports to Nepal at the HS-6 classification of items included petroleum oil and oils from bituminous minerals, semi-finished products of iron or non-alloy steel, wholly milled rice, light oils and cement clinkers (Table 2).

Table 2: India's Top 10 Exports to Nepal

Hs Code	Commodity	Values in US\$ Million
271019	Other petroleum oils and oils obtained from bituminous minerals etc.	870
720719	Other products containing by wt<0.25% of carbon	396
100630	Semi/wholly milled rice w/n polished/glazed	199
271012	Light oils and preparations:	197
252310	Cement clinkers	182
871120	Motor cycle etc with reciprocating internal combustion piston engine of cylinder capacity>50 cc to 250 cc	176
271119	Other in gaseous state :	172
842952	Machinery with a 360 degree. Revolving super-structure	137
271600	Electrical energy	128
300490	Other medicine put up for retail sale	114

Source: Directorate General of Foreign Trade, Ministry of Commerce and Industry

In 2017-18, India's top imports from Nepal at the HS-6 classification of items included flavoured water, cardamoms, articles of plastic, tea, fabrics, etc (Table 3).

Table 3: Top Items Imported into India from Nepal (Values in US\$ Million)

HS Code	Commodity	2017-2018
220299	Other sweetened flavoured waters	59
090831	Cardamoms: neither crushed nor ground:	47
392690	Other articles of plastics	31
090240	Other black tea (and other partly fermented tea :	26
531010	Unbleached woven fabrics of jute/other textile bast fibres	18
721720	Wire of iron/non-alloy steel,plated/coated with zinc	17
630510	Sacks and bags for packing,made of jute or of heading no.5303	17

HS Code	Commodity	2017-2018
380610	Resin and resin acids:	17
230690	Oil-cake and other residues resulting from extraction of other oil-seed and oleaginous fruits	14
721041	Corrugated products, otherwise plated or coated with zinc	13

Source: Directorate General of Foreign Trade, Ministry of Commerce and Industry

We have also attempted to estimate the maximum additional trade potential that exists between India and Nepal. Trade potential is defined as the trade that could be achieved at an “optimum trade frontier” in the case of open and frictionless trade possible given current trade, transport and institutional technologies or practices (Drysdale et al., 2000; Kalirajan, 2000; Armstrong, 2007). There exists a gap between potential and actual trade, which is associated with various socio-political and institutional factors that may be hindering the actual trade to grow to the upper limit of the production frontier. It is of significant importance to know the trade potential that exists between two countries so that they can engage in negotiation processes or undertake reforms to minimize or partially mitigate the effect of existing restrictive measures to trade growth.

Following the methodology followed in Taneja et al (2013), we estimate additional trade potential using the “trade possibilities approach”. Trade possibilities are determined by the exporting country’s supply capabilities and importing countries demand capabilities. We define trade possibilities to exist in items that the two countries can import from each other instead of from elsewhere in the world. In order to identify items having trade potential and assess the magnitude of trade possibilities (referred to as trade potential) between the two countries, products having trade potential are identified as those with (a) adequate demand in the receiving country and (b) adequate supply capabilities in the source country.

Potential trade for any commodity is given by Min (SE, MI) - ET where SE, MI and ET are supplier’s global exports, receiver’s global imports and existing trade between the supplier and the receiver. The exercise is conducted by first posing India as a supplier and then by posing Nepal as the supplier country.²

The results of the exercise show the existence of an estimated additional trade potential of around US\$4 billion if the two countries were to import from each other what they import from the rest of the world (Table 4). Of this total trade potential, India’s export potential to Nepal accounted for US\$ 3.71 billion and its import potential from Nepal accounted for US\$ 0.17 billion (Table 4).

² Estimation has been done for the year 2016.

Table 4: Total Additional Trade Potential between India and Nepal (US\$ Million)

	India's Export to Nepal	India's Import from Nepal	Total Trade
Current Trade	4,518	385	4,903
Maximum Additional Total Trade Potential	3,715	170	3,963

Source: Author's calculations based on UNCTAD-WITS data

Note: All above figures based on 2016 data

The trade potential exercise reflects that Nepal has limited scope for reducing its trade deficit as there is inadequate potential to further expand its exports to India. On the other hand, India's untapped potential to export to Nepal is significantly higher.

On further analysing India's export potential to Nepal, it was found that 31% of the total additional export potential can be attributed to the items on Nepal's sensitive list with a value of US\$ 1,147 million. The remaining 69% can be attributed to the items that are not on the sensitive list with a value of US\$ 2,568 million (Table 5)

Table 5: India's Additional Export Potential to Nepal

Export Potential	Values (USD million)	Share (%)
Max. Additional Export Potential for Sensitive List Items	1,147	31%
Max. Additional Export Potential for Non-Sensitive List Items	2,568	69%
Max. Additional Total Export Potential	3,715	100%

Source: Author's calculations based on WITS database

2. Issues Facing India's Exports to Nepal

(i) India's Export Potential and Tariffs under Bilateral Treaty and SAFTA

The top 10 products (at HS-6 level) with the largest export potential from India to Nepal are semi-finished products of iron or non-alloy steel, cellular phones, petroleum oils and oils obtained from bituminous minerals, homeopathic medicines, cement clinkers, mechanical shovels, vehicles, polyethylene and semi-milled or wholly milled rice aircrafts (Table 6).

Out of these 10 highest-potential items, 3 items are on Nepal's sensitive list i.e. they do not receive a preferential rate of duty under SAFTA but receive bilateral rebates given to India on Nepal's MFN rates. Of the remaining 7 non-sensitive items, 4 are subjected to a higher rate of duty under the bilateral agreement between India and Nepal than that offered under the SAFTA agreement (Table 6). The bilateral rate of duty for India is determined by applying the bilateral rebate on Nepal's MFN tariffs. This rebate is 5 percent of the applicable tariff rate of up to 30 percent and 3 percent of applicable tariff rate of more than 30 percent.

Table 6: Items with Highest Export Potential from India to Nepal (Values in US\$ Million)

HS Code (at 6 digit)	HS Code (at 8 digit)	Product Description	Export Potential (in USD million) in 2016	Included in Sensitive List1	SAFTA Rates	MFN	Bilateral Rate of Duty for India (MFN Rate minus Rebate)
720719	72071900	Containing by weight less than 0.25 % of carbon	217.43	No	5	5	4.75
851712	85171200	Telephone sets, including telephones for cellular	192.21	No	Free	Free	-
271019	27101910	Petroleum oils and oils obtained from bituminous (kerosene)	131.44	Yes	Per KL Rs. 2000	Per KL Rs. 2000	-
	27101920	Aviation Turbine Fuel			Per KL Rs. 2100	Per KL Rs. 2100	-
	27101930	High Speed Diesel			Per KL Rs. 2000	Per KL Rs. 2000	-
	27101940	Light Diesel Oil			Per KL Rs. 440	Per KL Rs. 440	-
	27101950	Fuel oil (Furnace oil)			5	5	4.75
	27101960	Base Oil (to be used in the manufacturing of lubricants)			30	30	28.50 ²
	27101970	Jute batching Oil and textile oil			15	15	14.25
	27101980	Lubricating Oil			30	30	28.50
	27101991	Spindle Oil			15	15	14.25
	27101992	Transformer Oil			15	15	14.25
	27101993	Mineral Turpentine Oil			15	15	14.25
	27101994	Rubber Processing Oil			20	20	19.00
	27101995	White Oil			15	15	14.25
	27101999	Other			30	30	28.50
300390	30039010	Other; Homeopathic Medicaments (Pure Ayurvedic and Yunani)	101.80	No	9	10	9.50 ³
	30039040	Battisa, Drakshasab, Trifala...			9	10	9.50
	30039090	Other			14	15	14.25 ³
252310	25231000	Cement clinkers	63.93	Yes	Per MT Rs. 2400	Per MT Rs. 2400	-

HS Code (at 6 digit)	HS Code (at 8 digit)	Product Description	Export Potential (in USD million) in 2016	Included in Sensitive List ¹	SAFTA Rates	MFN	Bilateral Rate of Duty for India (MFN Rate minus Rebate)
842959	84295900	Mechanical shovels, excavators and shovel loaders ...	60.36	No	5	5	4.75
870323	87032300	Other vehicles, with spark-ignition internal combustion	50.27	Yes	80	80	77.60
390120	39012000	Polyethylene having a specific gravity of 0.94	45.62	No	6	10	9.50
100630	10063000	Semi-milled or wholly milled rice, whether or not	42.63	No	9	10	9.50 ⁴
880230	88023000	Aeroplanes and other aircraft, of an unladen weigh	41.51	No	6	10	9.50 ⁵

Source: Author's calculations based on Nepal's Customs Tariff Manual

Note:

¹- Nepal's sensitive list as given by SAARC Secretariat.

²- Under partial exemption of customs duty, only 15% customs duty is charged on import of base oil of sub-heading HS Code 27101960 when imported by the registered industry with the purpose of producing grease and lubricating oil

³- Under partial exemption of customs duty, only 5% customs duty is charged on medicines falling under chapter 30 (HS Code 3009010 and HS Code 3009090)

⁴- Full consumption in the customs duty is granted for the good (HS Code 100630) when imported from India. However, an Agriculture Reform Fee (@8%) is charged for this good

⁵- Aircraft of subheading HS Code 88023000 imported by the airline service operator or the company licensed by the Civil Aviation Authority.

The exercise of identifying items with the highest potential was extended to include top 50 items at the HS-6 level of classification. These items when expanded at the 8-digit level covered 83 items (Appendix A). An examination of the tariff rates applicable to these 83 items with export potential items from India to Nepal indicates that there is an “anomaly” in the imposition of tariff rates under SAFTA and the Indo-Nepal bilateral trade treaty. For 17 items, the duty applicable under the bilateral trade treaty is higher than the SAFTA rate (Table 7). This anomaly needs to be addressed so that India gets the benefits of SAFTA under its bilateral trade agreement.

Table 7: Comparison of Applicable Rate of Duty under SAFTA and Indo-Nepal Bilateral Agreement

Tariff Rates	Number of Items
Zero Duty	9
Specific Duty	10
SAFTA Duty is more than Bilateral Rate of Duty	47
Bilateral Rate of Duty is more than SAFTA Duty	17
Total	83

Source: Author's calculations based on Nepal's Customs Tariff Manual

Note: The top 50 items at the HS-6 digit level have been further disaggregated at the HS-8 digit level which resulted into a total of 83 tariff lines.

(ii) Levy of the Agricultural Reform Fee

While the Bilateral Trade Treaty provides duty free access to each other's primary products as the agreed list, Government of Nepal levies Agriculture Reform Fee at the rate of 5% on import of primary products from India. When Nepal became a member of the World Trade Organisation (WTO) in 2004, it had made a commitment to eliminate the duty in 10 years. However, this fee continues to be levied. Since 2014, the Government of India has been raising the issue of eliminating 'Other Duties and Charges' (ODCs) during the Intergovernmental Committee Meeting (IGC). But Nepal had sought an extension to eliminate tax citing the adverse impact of a devastating 2015 earthquake on the economy (The Himalayan Times, 2018).

India could negotiate the removal of this duty in future, at least on the agricultural items on which customs duty has been exempted under the bilateral trade treaty.

(iii) Competition from Chinese Exports

There is a general perception that India faces a looming threat from the growing dominance of China in Nepal's domestic markets. However, data shows that even though China's share in Nepal's imports increased from 11% in 2010 to 14% in 2016, India's share also increased from 64% to 66% during the same period. Therefore, India continues to be the largest exporter of goods to Nepal (Table 8). It can be seen that both India and China competed to take away market share from other exporters like UAE, Indonesia and Thailand who saw a drop in their share of Nepal's imports (Table 8).

Table 8: Nepal’s Top Import Partners

Year	2010		2016	
	Value (US\$ mn)	% of Total Imports	Value (US\$ mn)	% of Total Imports
India	3,253	64%	5,816	66%
China	561	11%	1,247	14%
UAE	194	4%	210	2%
Indonesia	107	2%	111	1%
Thailand	102	2%	110	1%

Source: UNCTAD-WITS Database

(iv) Non-Tariff Measures Faced by India’s Exports to Nepal

According to UNCTAD (2010), Non-tariff measures (NTMs) are defined as “policy measures, other than ordinary customs tariffs, that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both”. NTMs cover a diverse set of measures in terms of purpose, legal form and economic effect. When these measures are imposed in a restrictive manner, they are often referred to as “barriers” to trade.

Indian exporters have often complained about facing non-tariff barriers while accessing the Nepal market. The objective of this section is to identify non-tariff barriers faced by Indian exporters to Nepal. Based on the survey of existing literature, we identify two products for our analysis-pharmaceutical products and cement.

In the case of export of pharmaceutical products, a study by Taneja (2018) reports that Indian exporters find it difficult to meet the Technical Requirements (TR) because of the complex regulations related to authorization requirements and regulations on production processes. The process for obtaining authorization and product registration is time-consuming and there are substantial delays. For authorization to export to Nepal, the Indian exporter must pay NPR 50,000 and register the company with the Drug Development Administration (DDA), Nepal. A majority of Indian pharmaceutical exporters felt that the requirements were too detailed and there were substantial delays in obtaining authorization from the DDA. The Good Manufacturing Practice (GMP) of the World Health Organization must be followed by manufacturers exporting pharmaceutical products to Nepal. In order to ensure compliance, DDA inspectors visit the site factory in India and for each visit Indian exporters have to pay US\$1,500.

The Nepalese authorities recognize pharmaceutical products produced in countries that are members of the Pharmaceutical Inspection Convention (PIC) and the Pharmaceutical Inspection Co-operation Scheme (PIC Scheme), which, together, are known as the PIC/S.³ The Nepalese authorities do not conduct any tests of manufacturing facilities or processes

³ The PIC/S is an instrument agreed among countries and pharmaceutical inspection authorities to promote GMP. The aim of the PIC/S is global harmonization of health and regulatory inspection procedures through the establishment of common GMP standards and the provision of training opportunities for inspectors.

associated with products from PIC/S member countries. Because India is not a member of the PIC/S, the authorities in Nepal conduct inspections of manufacturing facilities.

In the case of export of cement, it was reported that Nepal has instituted a complete ban on the import of Portland Pozzolana Cement (PPC) grade cement manufactured by ACC Ltd. The ban was imposed on the basis of the ‘fly ash’ component of the cement. The PPC cement by ACC Ltd had ‘fly ash’ component equivalent to 30.1% which is more than the limit of 15 to 25% as stipulated by the Nepal Bureau of Standards (NBS). However, ACC Ltd’s cement is in accordance to the BIS standards which allows the ‘fly ash’ content to vary between 15 to 35% (IGC, 2016).

3. Issues Facing India’s Imports from Nepal

(i) *Import Potential from Nepal*

Calculating the value of additional import potential for India to import from Nepal at the HS 6-digit disaggregated level shows that there is only a small US\$ 170 million worth of additional goods that Nepal can potentially export to India (Table 10), which is less than half of the current imports amounting to US\$385 million. This gives an indication that products that Nepal is exporting to other countries do not have a demand in India (as they are not being imported into India from other countries as well).

Table 9: Top Items with Import Potential from Nepal (US\$ million)

Hs code	Product description	Nepal’s exports to India	India’s import potential	Included in India’s sensitive list ¹
490700	Unused postage/ revenue stamps	0	35	No
71340	Lentils	0.7	13	No
650500	Hats and other headgear	0	5	No
550921	Yarn other than sewing thread	9	5	No
620462	Trousers/ breeches	0	4	No
230910	Dog/cat food	0	4	No
970110	Paintings, drawings and pastels	0	4	No
410621	Hides and skins of goats or kids	0.1	4	No
701310	Glassware of glass-ceramics	0	3	No
620442	Dresses of cotton	0	3	No
Total (top 10)		10	79	
Total		385	170	

Source: Author’s calculations using UN ITC-WITS database

Note: India’s sensitive list as given by SAARC Secretariat

(ii) *Underutilisation of the Tariff Rate Quota*

The 2002 revision of the Bilateral Trade Treaty imposed a tariff rate quota on four items - vegetable ghee, copper products, acrylic yarn and zinc oxide. Duty-free access of these goods

imported from Nepal into India was allowed only up to a specified quota limit, beyond which MFN tariff is applicable. The quota, however, has remained grossly underutilised (Table 11). For example, in 2007-08, the utilised quota was 45.3 per cent for copper products, 47.5 per cent of vegetable ghee, 20.3 per cent for acrylic yarn and zero for zinc oxide (Taneja and Chowdhury, 2010). In 2017, the utilised quota was 23 per cent for acrylic yarn, 12 per cent for copper products and zero of vegetable ghee and zinc oxide (Table 11). In 2001-02, these “TRQ products” accounted for 29.7 per cent of India’s imports from Nepal but by 2016, the combined share of these products has decreased to just 5 per cent.

Table 10: India’s Imports of TRQ Products from Nepal (Metric Tonnes) and Quota Utilisation (%)

Items	2010		2012		2014		2015		2017	
	Volume	Quota used*	Volume	Quota Used*	Volume	Quota Used*	Volume	Quota Used*	Volume	Quota Used*
Veg Fats	0	0%	0	0%	0	0%	0	0%	0	0%
Acrylic	1600	16%	200	2%	2700	27%	4600	46%	2300	23%
Zinc Oxide	0	0%	0	0%	0	0%	0	0%	0	0%
Copper Product	2800	28%	1000	10%	2000	20%	2200	22%	1200	12%

Source: Author’s calculations using World Integrated Trade Solutions

Note: *The applicable quotas (in Metric Tons): Vegetable Fats – 100,000 MT, Acrylic Yarn – 10,000 MT, Zinc Oxide -2,500 MT, and Copper Products – 10,000 MT (2500 MT after 2009)

Given the low quota utilization rates India may consider removing the quota requirement.

(iii) High ROO Criteria under Trade Treaty

India’s imports from Nepal are governed by two preferential agreements: The Treaty of Trade between the Government of India and the Government of Nepal and the Duty-Free Tariff Preference (DFTP) Scheme for LDCs. Under the Treaty of Trade, Nepalese exports to India are subjected to a change in classification, at four-digit HS Level and that the total value of materials, parts or produce originating from non-Contracting Parties or of undetermined origin used, does not exceed 70% of the FOB price of the articles produced. Under the DFTP Scheme, the imports from Nepal have to go through a change in tariff heading at the six-digit HS level between the imported raw materials and the finished products. In addition, the process should have generated a value addition of 30% in the exporting country. Thus while the domestic content requirement is the same under both the Agreements, the change of heading requirement at a 4-digit HS classification level is more stringent than the requirement of a change in tariff heading at the 6-digit level under the DFTP scheme.

On comparing India’s preferential treatment to Nepal with that offered by China, it is found that China, under the Duty-free Treatment, subjects Nepal to either a change of tariff classification at four-digit HS level or an ad valorem percentage of no less than 40%. It does not apply both the criteria simultaneously as in case of India. Whereas the goods listed in the “Product Specific Rules” (PSR) are not subject to the said criterion. If goods have not been wholly obtained or produced in the beneficiary country, but meet the product-specific rules

issued by the General Customs Administration of China, they are considered to originate from the beneficiary countries. So far, no such rules have been issued (UNCTAD, 2016).

Nepal has been demanding a relaxation of India's stringent Rules of Origin criteria of domestic value addition to a maximum of 25% based on the 10th WTO Ministerial Conference held in Nairobi in 2015. The Nairobi Decision on Preferential Rules of Origin for LDCs sets out a set of multilaterally agreed guidelines to help make it easier for LDC exports to qualify for preferential market access granted by WTO members in favour of LDCs. One of the decisions regarding requirements for the assessment of sufficient or substantial transformation requires members to consider allowing the use of non-originating materials up to 75% of the final value of the product. These mutually agreed guidelines are to be further discussed in following conferences and are yet to be made mandatory for countries.

(iv) Non-Tariff Measures Facing Nepal's Exports to India

Nepalese exporters have often complained about facing non-tariff barriers while accessing the Indian market. Based on the survey of existing literature, we find that exporters do not find it difficult to meet standards but there are problems related to information flows and procedural and infrastructural bottlenecks. We list down the following key impediments that reportedly hamper Nepal's exports to India⁴:

Lack of Awareness- For agricultural items such as medicinal plants, it has been found that neither exporters in Nepal nor importers in India are aware about the requirement or the regulations related to pest risk analysis.

Dependence on Government Laboratories for Testing: Even though there are several National Accreditation Board for Testing and Calibration Laboratories (NABL) accredited and the Food Safety and Standards Authority of India (FSSAI) notified private laboratories in India, for cross border trade there is dependence on only Government laboratories. This results in undue delays in testing and adds to the transaction costs.

Lack of Testing Facilities: There are limited number of testing facilities, particularly close to the land borders. As a result of this, samples have to be sent to Kolkata which adds to the transaction cost and time of trading.

Lack of EDI Facilities: So far, EDI is operational between India and Nepal only in Jogbani and Raxaul. Single-window systems at national levels have enabled greater coordination among agencies, thereby reducing transaction costs for traders. The FSSAI has been included in the single-window system and has introduced risk profiling to enable the system to identify high-risk consignments electronically. In general, EDI can enhance risk profiling and are a prerequisite for single-window systems. Thus, the absence of EDI and Single Window inhibits

⁴ The impediments discussed in this section are based on Taneja (2018) that examines NTMs in exports from Nepal to India in selected products of significance such as tea, cardamom, and medicinal and aromatic plants.

risk profiling and random checking of consignments which is a major infrastructure impediment.

Lack of Coordination among the Agencies: While NABL had accredited laboratories in Nepal, FSSAI has not notified these laboratories. Lack of coordination among regulatory agencies has led to this problem.

We can infer that most of the issues arise from lack of information on regulations and standards and inadequate infrastructure for measuring and certifying quality, rather than protection by India. It therefore becomes necessary to address burdensome NTMs by distinguishing between real and perceived complaints, thereby focusing the attention of policy makers on genuine issues; dealing with the misperceptions of traders; and, ultimately, bridging the gap between perceptions and objective evidence.

4. Physical Barriers to Cross-Border Movement of Goods

India has 27 trading points with Nepal along the Indo-Nepal border. However, the Land Customs Stations at these border points lack adequate infrastructure which acts as an impediment to the Indo-Nepal bilateral trade. Logistic bottlenecks have long caused delays and inefficiencies for freight transport between Nepal and India. These barriers impact both countries.

Even as infrastructure plays an important role in facilitating bilateral trade, only a limited number of studies have been conducted to gauge the gaps. Out of 27 trading points identified in the India-Nepal treaty (2009), limited studies have been carried out covering only two land customs stations namely Panitanki-Kakarbhitta and Raxaul-Birgunj. By contrast, there have been a number of studies which have been carried out on Nepal's transit through India covering containerised rail cargo. The detailed studies have helped the two governments of India and Nepal to resolve a number of issues related to transit trade.

A study by CUTS (2016) analysed the infrastructural bottlenecks present at the Panitanki–Kakarbhitta LCS. At the LCS trade is conducted by traditional processes with no trade-supporting infrastructure like weighment bridge, cold storage, etc. Lack of capacity, adequate personnel, coordination and cooperation between various agencies and outdated infrastructure hampers the overall performance. The LCS also lacks testing facilities which necessitates test to be done in faraway Kolkata.

At the Raxaul-Birgunj border an Integrated Check Post for handling road cargo became operational in 2018. Bose (2018) points out that while this has led to shorter queues of trucks at the outskirts of Raxaul town, cargo clearance continues to get delayed as the shipping bills reach a few days after the arrival of cargo. There is ambiguity about the old LCS, as Bose (2018) reports that some cargo carrying oil and cement continues to get cleared at the old LCS, necessitating movement of trucks through Raxaul town. Also it is not clear whether the new ICP has adequately addressed all the infrastructure problems.

Thus, of the 27 trading points there is not enough information on the infrastructure gaps at these points. It is important to examine the trade flows through these points, assess the adequacy and quality of infrastructure at these points and suggest how these can be upgraded.

5. India's FDI in Nepal

India was amongst the only investors in Nepal during the 1970s and 80s, when total FDI flows to Nepal were minimal or even negative, averaging \$0.5 million annually. India's investments stepped up significantly in the 1990s, although total flows remained small, averaging \$8.3 million per annum during 1990-2000. Indian FDI fell during the 2000-2009 period, but increased nearly three times after 2010. The total FDI into Nepal also increased from a US\$ 19.1 million per annum during 2001-10 to average around US\$ 92 million per annum during 2011-17 (UNCTAD, 2018a).

India has been the largest source of foreign direct investment in Nepal accounting for nearly 30% of total FDI received. As per the Reserve Bank of India, Nepal received a cumulative FDI of US\$ 98 billion from India for the period of 2007-08 to 2017-18 (Table 12).

Table 11: India's Cumulative FDI in Nepal (Values in USD million)

Years	FDI Value
July 2007-08	4.07
2008-09	4.70
2009-10	6.39
2010-11	9.08
2011-12	14.38
2012-13	17.46
2013-14	9.76
2014-15	2.37
2015-16	5.38
2016-17	3.08
2017-18	20.92

Source: RBI Overseas Investment Data

As far as the origin of FDI is concerned, Nepal has received FDI from 39 countries until 2016 (Nepal Rastra Bank, 2018). Apart from West Indies (a tax haven through which investments are routed), the largest portion of the total FDI stock is from India, followed by China and Singapore (Table 13). But in recent years, Chinese FDI in Nepal has been growing significantly. As per reports released by Department of Industry, China has overtaken India in terms of its FDI commitment in Nepal in the last two consecutive fiscal years, 2016-17 and 2015-16. According to DoI Statistics, China contributed to around 87 percent of FDI commitments received by Nepal during the first 10 months of the fiscal year that began in mid-July 2017. FDI commitments from India stood second followed by commitments from United States, Japan and South Korea.

Table 12: Stock of FDI by Countries and Sectors in Mid-July 2016

(Values in Rs million)

S. No.	Countries	Agriculture	Industry	Service	Total
1	West Indies	-	-	62,780	62,780
2	India	104	16,905	10,245	27,254
3	China	-	9,201	1,643	10,844
4	Singapore	113	6,286	736	7,135
5	Ireland	-	-	5,805	5,805
6	Australia	-	-	3,832	3,832
7	South Korea	16	2,770	119	2,905
8	Bangladesh	-	-	2,510	2,510
9	UK	-	223	2,108	2,331
10	USA	127	785	1,416	2,328
11	Others	35	4,449	5,473	9,956
	Total	395	40,618	96,666	1,37,678

Source: Nepal Rastra Bank (2018)

Looking at the sector-wise composition India's investments in Nepal, 65% of the total was invested in the services sector and 33% in the manufacturing sector. Indian investment in the agriculture sector has continued to be negligible. To assess the trend in the sectoral-distribution of FDI, we analyse the data on FDI flows from 2008 to 2018, by dividing into two periods - 2008-09 to 2012-13 (period 1) and 2012-13 to 2017-18 (period 2). We see that within the services sector, Wholesale, Retail Trade, Restaurants and Hotels account for the maximum share at 21% and is followed by Financial, Insurance, Real Estate and Business Services with a share of 17% (Table 14). The manufacturing sector received the second highest investment. However, the share of manufacturing sector actually fell from 39% in period 1 to 26% in period 2 (Table 14). From the firm-level data on overseas investment released by RBI, it can be seen that although the number of firms investing in Nepal was roughly the same in the two periods; the size of investments in period 2 was much smaller (Appendix B). The share of wholesale retail trade and hotels and restaurants also fell by more than half. But the share of financial services grew spectacularly from 1% to 37%, a large part of which can be attributed to the US\$ 14 billion investment made by the State Bank of India in period 2 (Appendix C).

Table 13: India's Sector-wise FDI in Nepal (Values in USD million)

Sectors	Period 1 2008-09 to 2012-13		Period 2 2012-13 to 2017-18		Cumulative 2008-09 to 2017-18	
	FDI	Share (%)	FDI	Share (%)	FDI	Share (%)
Manufacturing	20	39	11	26	31	33
Wholesale, Retail Trade, Restaurants and Hotels	14	28	5	12	20	21
Financial, Insurance, Real Estate and Business Services	0	1	16	37	16	17
Electricity, Gas and Water	5	10	5	12	10	11
Construction	9	16	0	0	9	9
Community, Social and Personal Services	3	6	4	9	7	7
Agriculture and Mining	0	0	1	3	1	1
Transport, Storage and Communication Services	0	0	0	0	0	0
Total FDI	52	100	42	100	94	100

Source: Overseas Investment Data, Reserve Bank of India

Barriers and Opportunities for Investment in Nepal

Until now, the flow of Indian FDI into Nepal was significantly driven by the bilateral trade agreement that incentivised several Indian companies to establish their commercial presence in Nepal to exploit the investment-trade nexus. The geographical proximity as well as shared historical and cultural ties have also made the flow of foreign investment more amenable (Adhikari 2013). The low labour costs and gradual liberalization of Nepal's trade and economic policies resulting in low tariff rate structure have been an added advantage for Indian firms (Jha, 2010).

However, the political uncertainty and slow growing economy posed as disincentives for investments. FDI flows from India to Nepal are subjected to various policy-related barriers like lack of harmony between different FDI governing authorities, problems with respect to land acquisition, disruptive activities of labour unions, tax concerns such as no tax rebates on profits that get reinvested, rampant corruption, infringements of copyright, trademark and patent of international brands and insufficient infrastructure. In 2011, India and Nepal initiated a Bilateral Investment Promotion and Protection Agreement (BIPA). The purpose of the agreement was to stimulate foreign investments by reducing political risks and to enhance bilateral investments. However, the BIPA between India and Nepal was rather seen as a hindrance to FDI investments and was never ratified. In March 2017, India unilaterally denounced the BIT and terminated it (UNCTAD, 2018b). The termination was based on India's decision to bring out a new BIT model in 2015 to replace the existing Bilateral Investment Promotion and Protection Agreements (BIPAs) (Mishra, 2017)

In the last few years, the Government of Nepal has adopted multiple open and liberal policies to lure foreign investors. The Industrial Enterprises Act and Foreign Investment and Technology Transfer Act (FITTA) of 1992 initially paved the way towards inward FDI

throughout the Nepalese economy. However, the FITTA had several shortcomings and was not compatible with the changing scenarios of global FDI investments which prevented FDI flows to reach their potential values. The GoN introduced new Foreign Investment Policy, 2015 by replacing the policy of 1992 with an objective of making the economy more dynamic and competitive. In contrast to the old policy, the new policy has clearly defined the term “foreign investment” and “technology transfer”. There are provisions to facilitate FDI through the access to foreign exchange, facilities and exemptions, access to credit, hiring foreign workers, acquisitions of land, and industrial security and business promotion. It assures equal treatment to foreign investors, no nationalization of the investment, and withdrawal of their principal investment and its earnings. The provision of mediator and dispute settlement has also been incorporated in this policy.

Recently, GON has also adopted the concept of facilitating foreign investment in Special Economic Zone (SEZ) to promote the country’s exports (Special Economic Zone Authority Nepal 2018). *The SEZ Authority Act – 2016* envisions the establishment of SEZ Authority to construct or maintain physical infrastructure in the SEZ; monitor and regulate industries established in the SEZ; and provide one stop service. Foreign investors are allowed and given tax holidays and other concessions to establish, operate and manage the special economic zone.

6. Policy Recommendations

From the above assessment of the trends and issues facing trade and FDI flows, it can be seen that India has been Nepal’s closest economic and commercial partner, but emerging issues need to be addressed in order for the two countries to engage beneficially in future. The following recommendations could help the two countries:

The following is a summary of the main recommendations for the way forward:

Recommendations for Enhancing Trade:

- a. ***Address the Ambiguity under SAPTA:*** The concessions under SAPTA were to cease following the completion of the SAFTA process. As Nepal is yet to complete the tariff liberalization process under SAFTA, it leaves the status under SAPTA ambiguous. This ambiguity needs to be addressed.
- b. ***Address the Anomaly in Tariff Concessions between Bilateral Agreement and SAFTA:*** India can negotiate with Nepal to seek concessions on items in which the tariff duties are higher under the bilateral treaty than under SAFTA.
- c. ***Remove the TRQ:*** India should consider removing the TRQ on four items namely acrylic yarn, vegetable fats, zinc oxide and copper products as the quotas are underutilized.
- d. ***Acceding to Request by Nepal for Minimum 25% Value Addition May be Postponed:*** The WTO is in the process of reviewing the use, and application of preferential rules of origin for LDCs. In June 2018, the WCO has published a practical guide on the Nairobi Ministerial decision on rules of origin for LDCs. India should examine these developments before acceding to Nepal’s request.

- e. ***Change the CTC Requirement from 4-digit to 6-digit under Bilateral Treaty:*** India should consider changing the requirement for change of tariff classification under the bilateral treaty from a 4 digit to 6 digit change of tariff heading. The change of tariff heading at the 6 digit level is a less stringent requirement and India is already offering it under the DFTP scheme.

Recommendations for addressing Non-Tariff Barriers faced by Nepal:

- f. ***Bridging the Information Gap:*** India could initiate information campaigns and workshops to reduce information asymmetry that presently exists in areas such as Pest Risk Analysis (PRA) on agricultural products.
- g. ***Spread Awareness about Accredited Laboratories:*** India could spread awareness among exporters, importers, and regulators about all of the available public and private accredited laboratories in India- especially in states neighbouring Nepal. Governments can develop marketing and communication strategies to familiarize traders with the various NABL-accredited and FSSAI-notified laboratories.
- h. ***Establish a Non-tariff Barrier Resolution Mechanism:*** India and Nepal should establish a nontariff barrier resolution mechanism to enhance transparency.
- i. ***Establish a Bilateral Institutional Mechanism:*** India and Nepal should establish a bilateral institutional mechanism to coordinate and expedite the FSSAI's notification of the partner country laboratories accredited by the NABL. This process would help ensure that food products imported into India are tested only on a random basis and help catalyze food trade, particularly agricultural trade.
- j. ***Implement Trade Facilitation Measures:*** Introduce electronic data interchange, risk management systems, and single windows at border points to enable realization of potential gains from coordination and efficiency.

Recommendations for Addressing Non-Tariff Barriers Faced by India:

- k. ***India Should Become a Member of PIC and PIC/S:*** The Indian Department of Pharmaceuticals should apply for membership of the Pharmaceutical Inspection Convention (PIC) and the Pharmaceutical Inspection Co-operation Scheme (PIC Scheme), commonly referred to as PIC/S. The aim of PIC/S is the global harmonization of health and regulatory inspection procedures through the establishment of common GMP standards and the provision of training opportunities for inspectors. The Nepalese authorities recognize pharmaceutical products without tests produced in countries that are PIC/S members. Thus, becoming a member of the PIC/S would allow India to export to Nepal without the need for the DDA, Nepal to conduct inspections and tests of Indian manufacturing facilities. This will make the process of exporting pharmaceutical products simpler, more efficient and less time-consuming.
- l. ***Harmonise Standards and Regulations:*** India and Nepal should harmonise their standards and regulations to avoid ambiguity. The inconsistency in standards Mandated by Nepal Bureau of Standards and Bureau of Indian Standards has had repercussions on

India's exports of cement to Nepal. The aligning of standards in future to international best practices will facilitate higher exports.

Recommendations for Upgrading Infrastructure:

- m. *Address Infrastructure Gaps at Land Customs Stations:*** There are major infrastructure deficiencies at the Panitanki LCS with no provision for weighment bridge, cold storage or EDI facilities. Even though the Integrated Check Post has become operational at Raxaul, it is not clear whether it addresses all the infrastructure deficiencies which were there at the old LCS at Raxaul.
- n. *Need for Gap Assessment in Infrastructure at the LCS along the India Nepal border:*** To enhance the infrastructure at the 27 LCSs that India has with Nepal, it is imperative to conduct a thorough study of the existing infrastructure and conduct a gap analysis of both hard and soft infrastructure. The existing studies do not cover all elements of infrastructure and are also limited in their coverage as this limited information is available only for two LCSs namely Raxaul-Birgunj and Panitanki-Kakarbhitta.

Recommendations for Enhancing FDI from India to Nepal

- o. *Bilateral Investment Treaty:*** India should sign a bilateral investment treaty as the current bilateral investment treaty stands terminated.
- p. *Capitalize on Trade-Investment Nexus:*** There is a need to incentivise more trade-creating investment from India into Nepal. More FDI from India, especially in manufacturing sectors can help increase the export capacity and potential for Nepal to export to India and to rest of the world. This will also help Nepal in lowering its trade deficit with India.
- q. *Develop SEZs in Nepal:*** Nepal's SEZ Act has opened the door for Indian investors to set up and develop SEZs in Nepal. Indian investors can choose to set up SEZs near the Indo-Nepal border in order to establish proximity with the Indian states (KNN, February 2016). Further, SEZs can be established near existing ICDs with Nepal to enhance the movement of goods between the two countries (SEZ Brochure, GON). Developing SEZs in Nepal would help to attract Indian investors with ample incentives to make exports from there. Prospective Indian investors can also utilise the provision to acquire a six-month non-tourist visa to conduct a research or a feasibility study for an SEZ. Indian investors can receive a residential visa if investments are more than USD 10 million in the SEZ (Nepal Investment Guide, 2018).
- r. *Establish Dispute Resolution Mechanism:*** An innovative and well-defined dispute settlement mechanism must be put in place to build a strong business environment between the two countries.

Recommendation for a More Comprehensive Partnership

- s.** The multi-dimensional cross-border flows between India and Nepal have resulted in several bilateral treaties of cooperation that need to be updated periodically. Given that

enhancing trade in goods, hydropower and services as well as foreign direct investment are of equally high importance in future, it is recommended that the various treaties be subsumed into one single Comprehensive Partnership. This will go beyond the existing treaties on trade in goods to include services trade, power trade, FDI, trade facilitation, among others.

References

- Adhikari, R. (2013).** India Nepal Bilateral Trade, Presentation made at the “International Conference on Regional Trade and Economic Cooperation in South Asia”, 2-3 May 2013, New Delhi.
- Armstrong, S. (2007).** Measuring Trade and Trade Potential: A Survey. Asia Pacific Economic Papers.
- Asian Development Bank. (2019).** Identification of Potential Export Items Facing Sanitary and Phytosanitary Measures and Technical Barriers to Trade in the SASEC Subregion: Sub regional Diagnostic Study.
- Bose, R.P. (2018).** Delays continue to plague trade at Raxaul-Birgunj integrated checkpost. Available at <https://www.thehindubusinessline.com/news/delays-continue-to-plague-trade-at-raxaul-birgunj-integrated-checkpost/article24305433.ece>
- CUTS International and Centre for Policy Research. (2016).** Non-Tariff Measures to Food Trade in India: A Case Study of Selected Ports. New Delhi.
- Drysdale, P., Huang, Y. and Kalirajan, K.P. (2000).** China’s Trade Efficiency: Measurement and Determinants’, in P. Drysdale, Y. Zhang and L. Song (eds), APEC and liberalisation of the Chinese economy, Asia Pacific Press, Canberra:259–71.
- IGC. (2016).** Meeting of India-Nepal Inter-Governmental Committee on Trade, Transit, and Cooperation to Control Unauthorised Trade held. Available at <https://www.nicci.org/pdf/Agreed-Minute-on-28-29-June-2016.pdf>
- Investment Board of Nepal. (2018).** Nepal Investment Guide. Government of Nepal. Available at <https://www.ibn.gov.np/uploads/files/repository/Nepal%20Investment%20Guide%202018.pdf>
- Jha, H.B. (2018).** Indian investment in Nepal: Challenges and opportunities, The Himalayan Times, February 25, 2010.
- Kalirajan, K. (2007).** Regional Cooperation and Bilateral Trade Flows: An Empirical Measurement of Resistance. The International Trade Journal, 21:2, 85 – 107.
- Mishra (2017).** India to trade partners: Sign new bilateral investment treaties by 31 March. LiveMint. 11 January 2017.
- Nepal Rastra Bank. (2018).** A Survey Report on Foreign Direct Investment in Nepal. Available at [https://www.nrb.org.np/red/publications/study_reports/Study_Reports--A_Survey_Report_on_Foreign_Direct_Investment_in_Nepal\).pdf](https://www.nrb.org.np/red/publications/study_reports/Study_Reports--A_Survey_Report_on_Foreign_Direct_Investment_in_Nepal).pdf)

Special Economic Zone Authority. (2018). Concept of Special Economic Zone. Available at <https://www.seznepal.gov.np/content.php?id=4>

Taneja, N. and Chowdhury, S. (2010). Role of Treaties in Facilitating Nepal's Trade with India. Economic and Political Weekly, Vol. 45, Issue No. 07.

Taneja, N., Mehra, M., Mukherjee, P., Bimal, S. and Dayal, I. (2013). Normalizing India Pakistan Trade. Working Paper No. 267. Indian Council for Research on International Economic Relations, New Delhi.

The Himalayan Times. (2018). India's budget could adversely affect Nepal's Agro Sector.

UNCTAD (2010). Non-Tariff Measures: Evidence from Selected Developing Countries and Future Research Agenda. Available at https://unctad.org/en/Docs/ditctab20093_en.pdf

UNCTAD. (2016). Handbook on the Special and Preferential Tariff Scheme of China for Least Developed Countries. Available at https://unctad.org/en/PublicationsLibrary/itcdtsbmisc76_en.pdf

UNCTAD. (2018a). World Investment Reports, Geneva.

UNCTAD. (2018b). Investment Policy Hub. Available at <https://investmentpolicyhubold.unctad.org/>

Taneja, N. (2018). A Granular Approach to Addressing Nontariff Barriers: India's Trade with Bangladesh and Nepal. In Kathuria, S. (Ed.) A Glass Half Full: The Promise of Regional Trade in South Asia. South Asia Development Forum. Washington, DC: World Bank.

World Customs Organisation. (2018). Practical Guide to the Nairobi Ministerial Decision on Rules of Origin for LDCs. Available at http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/key-issues/revenue-package/practical-guide-to-the-nairobi-ministerial-decision-on-rules-of-origin-for-ldcs_en.pdf?db=web

World Trade Organisation. (2015). Preferential rules of origin for least developed countries. Ministerial Conference Tenth Session. 15-19 December 2015 Available at https://www.wto.org/english/thewto_e/minist_e/mc10_e/nairobipackage_e.pdf

Appendices

Appendix A: Top 50 Highest Potential Items at HS 6-Digit Level

HS Code	Product Description	Export Potential (in USD million) in 2016	Included in Sensitive List	SAFTA Rates	MFN	Bilateral Rate of Duty for India (MFN Rate minus Rebate)	Bilateral Rate of Duty - SAFTA Rate of Duty
72071900	Containing by weight less than 0.25 % of carbon	217.43	No	5	5	4.75	-0.25
85171200	Telephone sets, including telephones for cellular	192.21	No	Free	Free	-	-
27101910	Petroleum oils and oils obtained from bituminous m...(kerosene)	131.44	Yes	Per KL Rs. 2000	Per KL Rs. 2000	-	-
27101920	Avaiation Turbine Fuel			Per KL Rs. 2100	Per KL Rs. 2100	-	-
27101930	High Speed Diesel			Per KL Rs. 2000	Per KL Rs. 2000	-	-
27101940	Light Diesel Oil			Per KL Rs. 440	Per KL Rs. 440	-	-
27101950	Feul oil (Furnace oil)			5	5	4.75	-0.25
27101960	Base Oil (to be used in the manufacturing of lubricants)			30	30	28.50	-1.50
27101970	Jute batchng Oil and textile oil			15	15	14.25	-0.75
27101980	Lubricating Oil			30	30	28.50	-1.50
27101991	Spindle Oil			15	15	14.25	-0.75
27101992	Transformer Oil			15	15	14.25	-0.75
27101993	Mineral Turpentine Oil			15	15	14.25	-0.75
27101994	Rubber Processing Oil			20	20	19.00	-1.00
27101995	White Oil			15	15	14.25	-0.75
27101999	Other			30	30	28.50	-1.50
30039010	Other; Homopethic Medicaments (Pure Ayurvedic and Yunani)	101.80	No	9	10	9.50	0.50
30039040	Battisa, Drakshasab, Trifala...			9	10	9.50	0.50
30039090	Other			14	15	14.25	0.25
25231000	Cement clinkers	63.93	Yes	Per MT Rs. 2400	Per MT Rs. 2400	-	-
84295900	Mechanical shovels, excavators and shovel loaders ...	60.36	No	5	5	4.75	-0.25
87032300	Other vehicles, with spark-ignition internal combu...	50.27	Yes	80	80	77.60	-2.40

HS Code	Product Description	Export Potential (in USD million) in 2016	Included in Sensitive List	SAFTA Rates	MFN	Bilateral Rate of Duty for India (MFN Rate minus Rebate)	Bilateral Rate of Duty - SAFTA Rate of Duty
39012000	Polyethylene having a specific gravity of 0.94 or ...	45.62	No	6	10	9.50	3.50
10063000	Semi-milled or wholly milled rice, whether or not ...	42.63	No	9	10	9.50	0.50
88023000	Aeroplanes and other aircraft, of an unladen weigh...	41.51	No	6	10	9.50	3.50
12019000	Other	35.94	No	9	10	9.50	0.50
21069010	Other: Dalmott, Pappad, Salted, Bhujija, Chamena	34.23	Yes	15	15	14.25	-0.75
21069020	Pan masala without tobacco			30	30	28.50	-1.50
21069030	Zintang			10	10	9.50	-0.50
21069040	Concentrates of non-alcoholic soft-drinks			30	30	28.50	-1.50
21069050	Pachak, Rochak and similar goods			15	15	14.25	-0.75
21069060	Kurkure, Kurmure and Lays and similar goods			30	30	28.50	-1.50
21069070	Scented Areca: Nuts without tobacco			Per kg Rs. 50	Per kg Rs. 51	-	-
21069090	Other			15	15	14.25	-0.75
27101210	Petroleum oils and oils obtained from bituminous m... (Motor Spirit- Petrol)			31.74	Yes	Per KL Rs. 15200	Per KL Rs. 15200
27101220	Hexsen (food grade)	Per KL Rs. 15200	Per KL Rs. 15200			-	-
27101290	Other	Per KL Rs. 15200	Per KL Rs. 15200			-	-
39021000	Polypropylene	29.12	No	6	10	9.50	3.50
72083700	Other, in coils, not further worked than hot-rolle...	27.53	No	5	5	4.75	-0.25
10059000	Other	27.47	No	9	10	9.50	0.50
87112010	Motorcycles including mopeds and cycles fitted with an Auxiliary motor or without side cars.....(of unassembled condition)	27.27	Yes	30	30	28.50	-1.50
87112090	Motorcycles including mopeds and cycles fitted with an Auxiliary motor or without side cars.....(Other)			30	30	28.50	-1.50

HS Code	Product Description	Export Potential (in USD million) in 2016	Included in Sensitive List	SAFTA Rates	MFN	Bilateral Rate of Duty for India (MFN Rate minus Rebate)	Bilateral Rate of Duty - SAFTA Rate of Duty
87032200	Other vehicles, with spark-ignition internal combu...	26.94	Yes	80	80	77.60	-2.40
23040000	Oil-cake and other solid residues, whether or not ...	25.88	No	6	10	9.50	3.50
85072000	Other lead-acid accumulators	25.69	Yes	15	15	14.25	-0.75
87011090	Single Axle Tractors (Other)	25.61	No	5	5	4.75	-0.25
27011900	Coal, whether or not pulverised, but not agglomera...	25.10	No	5	5	4.75	-0.25
72083900	Other, in coils, not further worked than hot-rolle...	23.19	No	5	5	4.75	-0.25
85299010	Of Television Receiver	23.17	No	Free	Free	-	-
85299090	Other (Including the parts of Radio-Broadcast Receiver)			5	5	4.75	-0.25
90189000	Other instruments and appliances	22.94	No	5	5	4.75	-0.25
7134010	Lentils (unskinned, unsplit)	22.46	No	9	10	9.50	0.50
7134090	Lentils (other)			9	10	9.50	0.50
23099000	Other	19.55	No	5	5	4.75	-0.25
84713000	Portable automatic data processing machines, weigh...	18.64	No	Free	Free	-	-
31053000	Diammonium hydrogenorthophosphate (diammonium phos...	18.46	No	Free	Free	-	-
87042300	Other, with compression-ignition internal combusti...(G.V.W exceeding 20 tones)	18.36	Yes	30	30	28.50	-1.50
85176900	Other apparatus for transmission or reception of v...	18.23	No	Free	Free	-	-
7031000	Onions and shallots	17.97	No	9	10	9.50	0.50
85176200	Other apparatus for transmission or reception of v...	17.90	No	Free	Free	-	-
79011100	Zinc, not alloyed : -- Containing by weight 99.99 ...	17.61	No	5	5	4.75	-0.25
7133100	Beans (Vigna spp., Phaseolus spp.) : -- Beans of t...	16.59	Yes	10	10	9.50	-0.50

HS Code	Product Description	Export Potential (in USD million) in 2016	Included in Sensitive List	SAFTA Rates	MFN	Bilateral Rate of Duty for India (MFN Rate minus Rebate)	Bilateral Rate of Duty - SAFTA Rate of Duty
87042110	Double Cab pickup principally designed for the transport of goods and having more than 2 seats including driver or the transportation of persons	16.49	Yes	30	30	28.50	-1.50
87042120	Single cab pickup principally designed for the transport of goods and having two seats including driver			30	30	28.50	-1.50
87042190	Other, with compression-ignition....(Other)			30	30	28.50	-1.50
62114200	Other garments, women's or girls' : -- Of cotton	16.35	Yes	20	20	19.00	-1.00
85414000	Photosensitive semiconductor devices, including ph...	16.16	No	Free	Free	-	-
74040000	Copper waste and scrap.	15.97	No	5	5	4.75	-0.25
39011000	Polyethylene having a specific gravity of less tha...	15.96	No	6	10	9.50	3.50
88033000	Other parts of aeroplanes or helicopters	15.74	No	6	10	9.50	3.50
85238010	Discs, Tapes.....(Software)	15.72	No	Free	Free	-	-
85238090	Discs, Tapes.....(Other)			Free	Free	-	-
17011310	Raw sugar not containing added flavouring or colou... (Sakhar -Gud)	15.64	Yes	15	15	14.25	-0.75
17011320	Khanda Sugar			15	15	14.25	-0.75
17011390	Other and Other cane sugar			15	15	14.25	-0.75
26219000	Other	15.63	No	Per MT Rs. 1000	Per MT Rs. 1000	-	-
76072000	Aluminium Foil.....(Backed)	14.71	No	7	15	14.25	7.00
9041100	Pepper : -- Neither crushed nor ground	14.48	No	5	5	4.75	-0.25
72139110	Other : -- Of circular cross-section measuring les...(Not more than 8 mm)	14.11	Yes	5	5	4.75	-0.25
72139190	Other			30 (For LDCs 7.25)	30	28.50	-
84742000	Crushing or grinding machines	13.52	No	5	5	4.75	-0.25
1042000	Goats	13.42	No	9	10	9.50	0.50
19053100	Sweet biscuits; waffles and wafers : -- Sweet bisc...	12.99	Yes	30	30	28.50	-1.50

HS Code	Product Description	Export Potential (in USD million) in 2016	Included in Sensitive List	SAFTA Rates	MFN	Bilateral Rate of Duty for India (MFN Rate minus Rebate)	Bilateral Rate of Duty - SAFTA Rate of Duty
India's Maximum Export Potential for Top 50 Items at 6-digit		1772					
India's Maximum Total Export Potential to Nepal		3715					
Share of the Maximum Export Potential for Top 50 items at 6-digit		48%					

Source: UNCTAD Database WITS; Nepal Customs Tariff Manual

Appendix B: Major FDI investors in Nepal's Manufacturing sector

(Values in USD million)

FDI Value	Period 1 2008-09 to 2012-13	Period 2 2013-14 to 2017-18
Aether Energy Private Limited	0.34	~
Ambey Capital Private Limited	0.50	~
Ambuja Cements Limited	5.17	~
Balaji Agro Pvt Ltd	0.67	0.17
Bhilwara Energy Limited	3.35	~
Gmr Energy Limited	2.18	0.33
Gmr Energy Ltd	0.72	~
II&Fs Infrastructure Development Corporation Ltd.	0.00	~
Kansai Nerolac Paints Limited	2.97	~
Parle Biscuits Pvt Ltd	1.70	0.42
Patel Energy Resources Limited	1.73	0.29
Pest Control (India) Pvt,Ltd.	0.03	~
Pristine Holdings Private Ltd	0.20	~
Sethia Credit P Ltd	0.03	~
Shivashakti Bio Planttec Ltd	0.11	~
Uma Cement International	0.71	0.81
Al Sameer Exports Pvt. Ltd	~	0.16
Avone System And Controls	~	0.06
Britannia Industries Ltd	~	2.09
Corset Wholesale Ltd	~	0.07
Essilor India Pvt Ltd	~	0.15
Future Tyres Private Limited	~	~
Advance Nutritions (P) Ltd	~	2.07
II&Fs Energy Development Company Limited	~	0.46
Kamna Industries Private Ltd	~	0.46
Miraj Business Development Private Limited	~	0.20
Miraj Multicolour Private Limited	~	0.29
MirajTradecom Private Limited	~	0.20
Nams Chemicals Private Limited	~	0.05
Patel Energy Resources Ltd	~	0.09
Power Grid Corporation Of India Limited	~	1.15
R. M. Chemicals Private Limited	~	0.65
Skylark Feeds Pvt Ltd	~	0.31
Starkey Laboratories India Pvt Ltd	~	0.18

Source: Overseas Investment Data, Reserve Bank of India

Appendix C: Major Indian FDI investors in Nepal's Financial, Insurance and Business Services sector in USD million (2008-09 to 2017-18)

FDI Value	Period 1 2008-09 to 2012-13	Period 2 2013-14 to 2017-18
One Ad Display Pvt Ltd	0.06	~
Feedback Ventures Pvt. Ltd.	0.11	~
Storm Communications Pvt. Ltd.	0.03	~
Ceragem India Pvt Limited	0.13	~
Life Insurance Corporation Of India Ltd	~	0.73
Pyro Telecom Solutions Pvt Ltd	~	0.03
Puresoftware Private Limited	~	0.11
State Bank Of India	~	14.31
Care Ratings Ltd	~	0.33

Source: Overseas Investment Data, Reserve Bank of India

LATEST ICRIER'S WORKING PAPERS

NO.	TITLE	AUTHOR	YEAR
380	A STUDY OF THE FINANCIAL HEALTH OF THE TELECOM SECTOR	RAJAT KATHURIA MANSI KEDIA RICHA SEKHANI	JUNE 2019
379	TOTALISATION/PORTABILITY OF SOCIAL SECURITY BENEFITS: IMPERATIVES FOR GLOBAL ACTION	ANWARUL HODA DURGESH K. RAI	JUNE 2019
378	INDIA-MYANMAR BORDER TRADE	NISHA TANEJA TIN HTOO NAING SANJANA JOSHI THIYAM BHARAT SINGH SAMRIDHI BIMAL SAKSHI GARG RIYA ROY MANALI SHARMA	JUNE 2019
377	THE ROLE AND CHANGING PARADIGM OF INDIA'S ASSISTANCE TO NEPAL: CASE OF THE EDUCATION SECTOR	TANU M. GOYAL	JUNE 2019
376	WHAT EXPLAINS INDIA'S POOR PERFORMANCE IN GARMENTS EXPORTS: EVIDENCE FROM FIVE CLUSTERS?	SAON RAY	MAY 2019
375	INCLUSIVE GROWTH IN INDIA - LEARNING FROM BEST PRACTICES OF SELECTED COUNTRIES	SURESH CHAND AGGARWAL DIVYA SATIJA SHUHEB KHAN	MAY 2019
374	STRATEGY FOR FINANCIAL INCLUSION OF INFORMAL ECONOMY WORKERS	SEEMA SHARMA ARNAB BOSE HIMANSHU SHEKHAR ROHIT PATHANIA	MAY 2019
373	BURDEN OF DISEASE AND CLIMATE INTERACTIONS: AN ILLUSTRATIVE STUDY OF SURAT CITY, INDIA	AMRITA GOLDAR MEENU TEWARI FLAVY SEN	APRIL 2019
372	TRADE EFFECTS OF STANDARDS HARMONIZATION IN THE EU: IMPROVED ACCESS FOR NON-EU PARTNERS	ANIRUDH SHINGAL MALTE EHRICH	APRIL 2019

About ICRIER

ICRIER, one of India's leading think tanks, was established in August 1981 as a not-for-profit research organisation to provide a strong economic basis for policy making. Under the current Chairperson, Dr. Isher Judge Ahluwalia, ICRIER has continued and reinforced the pursuit of its original vision and in the process significantly expanded the scope of its research activities.

ICRIER is ably supported by a Board of Governors, which includes leading policy makers, academicians, opinion makers and well-known representatives of the corporate world.

ICRIER's success lies in the quality of its human capital. Led by Dr. Rajat Kathuria, Director & Chief Executive, ICRIER's research team consists of highly qualified professors, senior fellows, fellows, research associates and assistants and consultants.

ICRIER conducts thematic research in the following eight thrust areas:

1. Macroeconomic Management, Financial Liberalisation and Regulation
2. Global Competitiveness of the Indian Economy – Agriculture, Manufacturing and Services
3. Challenges and Opportunities of Urbanisation
4. Climate Change and Sustainable Development
5. Physical and Social Infrastructure including Telecom, Transport, Energy and Health
6. Skill Development, Entrepreneurship and Jobs
7. Asian Economic Integration with focus on South Asia
8. Multilateral Trade Negotiations and FTAs

International conferences, seminars, public policy workshops, public lectures and publications form an integral part of ICRIER's outreach activities. ICRIER maintains a wide network of resource persons from India and abroad. It strives to attract well-qualified researchers, provides them a stimulating and scholarly work environment and encourages researchers to work in teams. ICRIER's research is widely cited by both academia and the popular press, and has over the years provided critical inputs for policy making.

