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Trade Relations Between Nepal and India : Scope for Economic Integration

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Introduction

In addition to the socio-cultural ties, Nepal has been keeping a traditional trade relationship with India, since very long time. Until 1904, when British India and Tibet signed a peace treaty and new trade routes were opened between them, there used to take place trade between British India and China (including Tibet) in Nepal. After the opening of the new trade routes Nepal lost considerable amount of trade with China (Tibet). In 1923, Nepal and British India signed a trade treaty, and as a result Nepal's imports from British India and third countries were liberalised. As they were all duty free imports, their inflow began to increase and consequently, the local products were virtually displaced. The subsequent treaties of trade and transit between India and Nepal (1950, 1960, 1971 and 1978) had allowed partial free movement of goods and almost common external tariff between them. The volume of trade with India during 1950-78 had undergone some changes, but its structure had not changed at all. Even until late seventies, India's share in the total trade of Nepal was more than sixty percent, whereas Nepal's share in the total trade of India was less than two percent.

The purpose of this paper is to sketch historical developments that had taken place in the Indo-Nepal trade relations before and after 1947. It also analyses the important clauses of the various trade treaties from the viewpoint of free trade and customs union. Finally, an attempt has also been made to explore the possibilities of establishing a customs union or common market between Nepal and India.

Trade Relations with British East India Company

Nepal's trade relations with India dates back to the time immemorial. Since the trade routes with India were relatively easily accessible than that with Tibet, the volume of

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trade with India was always much larger. Besides, for a long time,Tibet was also an important hinterland for the *intre pot* trade of Nepal.

British India was interested in establishing trade relations with Nepal in order to expand its trade with Nepal as well as with Tibet. Despite various attempts, Nepal, for a long time, did not liberalise trade with British India in order to safeguard its own trade and industry on the one hand, and on the other, politics.

Hussain (1970) writes "For their part, the Rajahs of Nepal sealed off the Nepalese border because they thought that trade would be followed by soldiers and political penetration".[1] No significant trade or other relationships developed with a government in the Nepal region until and after Prithvi Narayan Shah united Nepal under his rule in 1769. From that time to mid-nineteenth century Nepal-British East India company relations remained unsettled. In 1770, the British East India company made an attempt to improve trade relations with Nepal, and in this connection James Logan was sent to Nepal. But he ended up with his involvement in internal politics of Kathmandu, and it was a complete unsuccessful trade mission Before James Logan, Capt. Kirloch with small force was also sent with the same view to revive Indo-Nepalese trade relations but his expedition was never accomplished. In fact, Capt. Kinloch was supposed to provide aid to the Rajahs of Kathmandu to defend themselves against the Gurkha King Prithvi Narayan Shah, and that would be expedited by the British India commander's help to promote trade relations with Nepal. During the time of Prithvi Narayan Shah, he maintained friendly official relation with British India but at the same time keeping them at arm's length. He was, in fact, very much reluctant to encourage foreigners to enter into his kingdom.

British East India Company during the tenure of Governor-Generel Hastings, Cornwallis, Shore and Wellesley worked to maintain peaceful relations and achieve increased trade with Nepal. But, during the Tibet-Nepal War, when China was on Tibet's side, Nepal asked for British India's help. The Governor - General did not decline the request, nor he wanted to bring on trouble with China by joining Nepalese side. Rather he decided to play a peace-making role, and as a result Col.Kirk Patrick's mission was sent. However, Nepal and Tibet had already entered into a peace pact under Chinese dictation before the mission headed by Col. Kirk Patrick reached Nepal. As per Tibet-Nepal Treaty of 1792, Tibet and Nepal were two brothers loyal to the fathernation China, and were supposed to send presents to the Chinese Emperor every five years.[2] Nevertheless, the treaty had permitted Nepalese subjects to travel, to put up factories, and to carry on trade within the jurisdiction of Tibet and China. Besides, Nepal was also assured that China would help if any foreign power invaded Nepal.

After the Tibet-Nepal Treaty (1792) Nepal was not very enthusiastic to receive any British representative. Nevertheless, one positive result came from Kirkpatrick's mission, and that was the commercial treaty with Nepal, signed on 1st March 1792.[3] It was a 7 clauses trade treaty, and as per which exports and imports of goods between thc countries would be subject to 2.5 percent custom duty on reciprocal basis.[4] The treaty reflected the British interest to expand their exports to Nepal. But, unfortunately, it was never enforced. Despite various British attempts to implement the treaty, Nepal was not prepared to do so.

A treaty of friendship was, however, signed in October 1801, but it was not meant for the trade expansion and thus did not affect much to trade relationships between the two countries.Later,in 1804,the treaty was abrogated by Lord Knox as he saw it was not possible to keep it going from political reason. The relations between Nepal and British India between 1804-1836 was very much troublesome. During 1814-1816, they had war between them. Nepal signed a peace treaty with British India on 2nd December 1915, as dictated by British. Since the world war still not over they signed another peace treaty at Segowlee in March 1816 to end it up. Both the treaties were political. First British resident was also appointed in 1816 and some goods of British origin started to enter Nepal since then.[5]

During the rule of Jung Bahdur Rana, the trade was never liberalised. Jung Bahadur maintained a protective trade policy with firm opposition to the entry of Europeans into Nepal for trade. No any treaty regarding trade took place during his regime. Nevertheless, an engagement was signed on 6th November 1839 to regulate the commercial relations between British India and Nepal.

Girdle stone (1876)[6] writes that as Nepal being a hilly country, its roads and trade routes were very primitive and naturally any great increase in trade from British India or from any place was not practicable. Transport was by carts, coolies and in some cases river boats. Most of the border roads had custom houses to check the export and import of goods. Major exports of Nepal were spices, opium, rice, forest products, chemicals and medicines, hides, fures, sandal wood, timber, and main imports were clothing materials, shoes, rifles, shawls, rugs, silks, brocade and embroidery both India and European and many consumer goods. Trade was under barter system, although British (India) Rupees and Nepalese *mohurs* were commonly used side by side. Nevertheless, Jung Bahadur's commercial policy was protective. But it was more to do with the revenue collection rather than the economic development. Nepal experienced a sudden set back in its trade with Tibet, right after the Anglo–Nepal Peace Treaty of 1904, which opened several new routes for Tibet–India trade. This is also evident in the conversation between Maharaja Chandra Shumshere and Lord Morley at Mortimer House on 11th May 1908 4 p m. during his visit to England.[7]

"Formerly almost the whole of the southern trade with Tibet used to pass through Nepal and now, since the opening of Darjeeling route, is being nearer route, the bulk of trade which formerly belonged exclusively to Nepal has passed on to that side".

Thus, from the opening of the new routes to India from Tibet, the old trade routes via Tatopani, Rasua, Kuti and Kyerong lost their business.

Besides, in 1923, Nepal and British India signed a new trade treaty. The article VI of the treaty assured British free trade with Nepal, which reads as follows:

"No customs shall be levied at British Indian ports on goods imported to that country provided that a certificate from such authority as many from time to time be determined by the two Governments shall be presented at the time of importation to the chief customs Officer at the port of import setting forth that the goods are the property of the Nepal Government, are required for the public services of the Nepal Government, are not for the purpose of any state monopoly or state trade, and are being sent to Nepal under orders of the Nepal Government ....."[8]

This encouraged the free inflow of British goods into Nepal, and affected the indigenous industries to a larger extent. The treaty reflected the drive of British India to incorporate Nepal into the colonial economy; and that it led Nepalese cottage industries to a virtual collapse.[9] The treaty of 1923 would have been advantageous to Nepal, if imports were regulated in the interest of domestic industries. But, instead, free inflow of factory made goods displaced all the hand-made products.

Trade Relations with India Since 1947

The treaty of 1923 governed Indo-Nepal trade until 1950 when it was replaced by the Treaty of Trade and Commerce between Nepal and India (July 1950).[10] The new treaty had two main commendable provisions. Firstly, it recognized the full and unrestricted right of Nepal to commercial transit of all goods and manufactures through the territory and parts of India, without paying any duty at Indian ports. Secondly, as per the treaty both the governments agreed to assist each other by making available commodities which were essential to each other's economy. They also agreed to promote contacts between the trade interests of the two countries and to facilitate the use of routes and method of transportation which were most economical and convenient. Nevertheless, there were several criticisms about it. The first one, was the whole procedure which was rather practically difficult and cumbersome. And, other criticisms were on the very nature of the treaty itself. The Article V of the treaty reads as follows:

"The Government of Nepal 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 agrees 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 favourable than those goods produced or manufactured in India which are subject to central excise duty."[11]

Precisely, the Article V meant that Nepal was required to follow Indian Tariff Policy in the case of imports from and exports to the countries other than India. And, it had to levy export duties on all its exports to India which were subject to Indian Central Excise duty in line with the Indian price level so as to prevent their sale in India. From this clause, it becomes obvious that Nepal was denied to pursue its own independent tariff policy with due respect to its trade and industry.[12] "These provisions practically shielded Indian exports to Nepal from third country competition and also served as a prophylactic against the potential breach in her tariff walls through the deflection into India of Nepal's imports from third countries."[13] The treaty (1950) extended its scope to reflect India's interest in influencing Nepal's trade with third countries. The 1923 treaty provided duty free imports from third country, but the 1950 treaty abrogated it.

In 1923 it was necessary to promote British exports to Nepal. Since India was under British Rule there was no reason to be worried about its impact on Indian trade and industry. But, later in 1950, soon after the independence India was more concerned with her own industrialization and trade promotion, as such it had adopted rather highly protective policy. And, as the border between Nepal and India was open, India had to be worried about this probable leakages of Nepal's imports from third countries into Indian economy. Besides, India still appeared to be rather interested in integrating Nepal into the realm of Indian economy irrespective of what impact it would create on Nepalese economy. Looking at the provision of free movement of goods and common external tariff policy it seems that it was also a drive to form a common market. But 'this sort of unilateral subordination does not confirm with the spirit of international trade relations through various devices such as free trade area and common market'.[14] It may have been acceptable if the common external tariff was adopted by opening each other's market without any barriers and from a mutual consultations in respect to common interests of both the countries. But, which India was at liberty to adopt its own tariff policy in respect to third countries, Nepal was just required to follow it irrespective of the fact that the conditions of trade and industry and other economic situations in Nepal were different from those of India.

The article V, thus would not be compatible to the main objective of the treaty itself which was for "facilitating and furthering trade and commerce between the two countries."

Nevertheless, the 1950 treaty was replaced by another trade treaty in 1960 (effective from 1st Nov. 1960). The article II of the treaty reads:

> "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 exempted from customs duties and other equivalent charges as well as quantitative restriction."[15]

The Article II thus provided free trade between the two countries. If it was intended towards free trade or customs union or even common market, there could not be any eruptions, rather competition would be the rule where efficient industries survive at the cost of less efficient ones (save for the transport cost).

However, as per the note exchanged between the two governments, it was specified that 'HMG/Nepal, having regard to their requirements of raising resources for the economic development of Nepal may continue to levy existing import and export duties on goods imported from and exported to India; and 'in order to assist Nepal's industrial development, the Govt. of India agrees that HMG/Nepal may impose protective duties or quantitative restrictions on such goods as may be produced by newly established industries in the country'.[16] Thus, it appeared that Nepal could now develop industries behind the protective tariff wall. If India was sincerely abided by the 1960 treaty Nepal could also promote export-oriented industries since market was no problem. May be it would have been difficult at the outset for Nepal to produce and compete with existing industries in India, but certainly it would have been a good start. Indeed, transport cost would have been another problem for the competitiveness of Nepalese products with the corresponding Indian goods. Although, it could be said that in some cases, the probable high transport costs could be lowered to some extent by locating such industries at the border areas.

So far as the third countries trade was concerned, as per the new treaty, it would be "regulated in accordance with the respective laws, rules and regulations relating to imports and exports."If Nepal pursued a policy divergent from that of India, there would be mutual consultations, so as to ensure that there would be no flow of goods into India imported from third countries. Obviously, India still insisted on its highly protective policy with a view to protect its domestic market from the probable leakages of Nepal's trade with third countries. The 1960 treaty had also provided transit facilities to Nepal as the 1950 treaty; as per which goods intended for import into or export from the territories of either contracting party from or to a third country, should be accorded freedom of transit through the territories of the other party. And, traffic in transit had been exempted from custom duties and from all transit duties or other charges imposed in this respect.

The 1960 treaty, however, was still cast within the framework of the two countries having common external tariff and the free movement of goods between them. Nevertheless, friction arose on the interpretation of some clauses of the treaty. For instance, the most significant issue was regarding the sudden growth of stainless steel and synthetic textiles[17] industries in Nepal, geared mainly to Indian market. Both the industries would get raw materials from third countries at nominal import duties, and their products would enjoy the advantage of non-tariff barriers prevailing between India and Nepal as per the 1960 treaty, as such they were more attractive than the local Indian products in Indian market. Indian reaction regarding interpretation of the clause was that free flow of goods between the two countries did not extend to industries based on imported inputs.

The 1960 treaty was replaced by the 1971 treaty.[18] Although the fundamentals of the treaty were similar to that of 1950 and 1960s, the new thing was the inclusion of value-added concept regarding the free flow of goods between the two countries. In otherwords, the 1971 treaty brought about some additional restrictions to safe-guard India's protective structure. The concept of local value-added content in the goods produced in Nepal became an apparent obstacle for Nepal in order to promote its export to India, and take advantage of the trade relations with India as per the treaty as India being the nearest largest market for Nepal. As per the 1971 treaty, the Nepalese products to be entitled to enter Indian market had to contain 90 percent Nepalese (or Indian) materials. Besides, the treaty also had an additional instrument to ensure protection for Indian exports to Nepal as Nepal was obliged not to collect customs duties and like changes on items on which central excise duties were paid in India. Such reimbursement of excise and other excise duties (by India to Nepal) would not exceed import duties and like charges levied by Nepal on similar goods imported from any other country. As regards the transit control, India could stop the flow of goods if in its opinion Nepal was putting difficulties in the effective and harmonious implementation of the treaty.

In fact, the subsequent treaties may be called the compromise between India's interest in preserving as much as possible the status quo defined in 1950 treaty and Nepal's desire for greater freedom to manoveure in trade and industrialization policies. A new treaty was signed in 1978 to replace the 1971 treaty,[19] but basically it was designd in the same way as before providing enough room to India to maintain and preserve its protective structure and to Nepal little freedom to move around in developing its trade and industry. However, the 1978 treaty was split into three separate agreements:treaty of trade, treaty of transit and agreement of cooperation to control un-authorised trade. The most favoured nations clause in relation to Indian exports to Nepal was retained with the same system of excise refund to facilitate duty-free entry for Indian goods into Nepal. However, there were some concessions for Nepal relating to the access of certain Nepalese products into the Indian market. But, they were limited by the fact that they had to fulfill the local materials content criterian-which was not less than 80 percent of Nepalese materials at Nepalese and Indian materials, and partial rebate on custom duties. And, so far as the products of small scale industries were concerned the custom duty was still equal to the excise duty paid by similar units in India. Besides, provision against authorised trade, particularly re-export of imports by Nepal from third countries was retained. Re-export of Nepalese imports from third countries was defined to include those goods produced in Nepal containing less than 50 percent local value-added. The treaty of transit had provided free traffic-in-transit and port facilities for Nepal's imports and exports in Indian territories, but they were subject to the procedure laid down in the protocal. The protocal and memorandum include quite a long import and export procedures which were likely to involve long period of time for the clearance.

Scope for Economic Integration Between Nepal and India

Since 1792 attempts had been made to establish free movement of goods between the two countries. Particularly, since the first trade and commercial treaty with India after its independence in 1950, Nepal was, in a way or other, required to follow common external tariff policy adopted by India.

As we have already discussed, the subsequent treaties were just compromise between India's interest to preserve its highly protected market, and Nepal's desire for greater freedom to adopt its own independent tariff policy in order to expand trade and industry sector. Although the objective of the treaties between Nepal and India may be to facilitate and further develop the trade relations between them, it was never mentioned explicitly any where in any treaty that they were meant to form a customs union or common market. Apparently, it seems so as the common external tariff and free movements of goods were allowed as per the treaties. So far as common external tariff is concerned, Nepal has been adopting high import duties on the goods imported from third countries, although most of the goods are not being produced domestically and domestic demand for them is practically high. Nepal's external tariff rates are almost equal to what India has with some exceptions in the case of capital goods and principal raw materials Nepal, in addition, has been adopting lower import duties on the consumer and durable goods imported from India as compared to similar imports from third countries. Following are some examples of discriminatory import duty rates applicable in 1982-83.

Items	India (in percent)	Third countries (in percent)
Toiletries	15	116
Wollen/Synthetic Garments	30	110
Paints	10	26
Wollen yarn	15	22

Moreover, Nepal has been in a situation where she has been buying Indian products. Some of them at prices higher than the international prices; mainly due to the high internal taxes in India. Theoretically, the discriminatory import duty rate for imports from India should be adjusted by the Indian Excise Refund, but in practice, it seems that it is not being equalised that way. Besides, India had total ban on many consumable durables and other goods imported from third countries, whereas Nepal had relatively liberal quantitative controls on them. Electric goods and electronics, watches, readymade garments, cotton and synthetic textiles are relatively cheaper to imports from third countries, and their qualities are also superior to the corresponding Indian products.

As regards free movement of goods, items of the daily necessities have been exempted from custom duties and importation. The people living in the border areas have no alternative other than entering into Indian markets just across the border and buy things for their daily uses if they are not available locally. Similarly, there are markets in the Nepalese side as well, where the Indian people (from across the border) do come and shop around. The fundamental difference is that Nepalese markets do contain imports from third countries.

If one brings in goods in bulk in either side those goods are subject to the prevailing tariff and import regulation. This has been the common practice since 1950. As the border is always open spreading over about five hundred miles, unauthorised trade is bound to happen. In addition to the border securities, another factor to discourage such practices can be the prevailing price level. Nevertheless, the intermediate goods produced in India are always subject to quantitative restrictions for exports to Nepal, for instance, steel, paper, cement. Their quotas are not always sufficient to meet the Nepalese demand for them.

Besides this, India has been adopting more an unilateral trade policy to protect her own industries and at the same time, disregarding the spirit of international trade as far as possible. As in the case of stainless steel and synthetic textiles, India did not like the growth and performance of such items as most of their products used to enter into India where they used to fetch better prices. The subsequent treaties after the incident imposed the criteria of local materials content and value-added. At several custom points Indian government has been displaying a notice in magnum letters that 'do not bring any foreign goods and even stainless steel utensils made in Nepal are illegal to bring along'. For those goods which are based on foreign inputs, it was mandatory to contain 50 percent domestic value added and for those based on Nepalese or Indian materials, 80 percent (previously 90 percent) local materials (Nepalese or Nepalese-Indian materials) content was mandatory to get preferential treatment in the Indian market. Under the preferential treatment in Indian market, the 1978 treaty had provided 12 varieties of goods mainly primary (unprocessed and semi-processed agriculture/ forest products) goods, and more than 64 items of industrial products having not less than 80 percent local materials mainly agro-industrial and forest products, free entry to India. But, those goods which are based on foreign inputs, as mentioned earlier, must contain more than 50 percent Nepalese or Indian materials and labour of the ex-factory price, and they will be allowed into the Indian market only after item by item close scrutiny. Obviously, the provision of non-tariff barriers and free movements of goods is conditional.

Another interesting thing hitherto not being specifically spelled out anything in any treaty is the multinational companies (MNC) products. Recently, about three years ago, a Coca Cola plant (Nepal Bottlers) was put up in Nepal. India became very apprehensive about the possibility of its entering into Indian market; and asked Nepal to ban its export to India in which Nepal conceded later on.[20] But, there are number of MNCs products manufactured in India being exported to Nepal for instance pharmaceutical products, toiletries, coffee, tea and many others. Thus, it is obvious from the above that India adopted a highly protective policy against Nepalese MNC products while retaining market opportunities in Nepal for such products of her own.

From the review of various trade treaties and developments in trade relations between India and Nepal; it may be gathered that both the countries have mixed feelings about establishing a customs union or common market in a formal and planned way, although some elements of such integration have been already existing in their trade and economic relationship. "The 1950 and 1960's treaties were concieved as the basis for establishing a customs union between India and Nepal, but this goal was not realised because of subsequent developments".[21] India would be benefitted from a customs union with Nepal, since it could have a consistent and common external tariff policy in relation to final goods imported from third countries, and it could continue to preserve its industry sector from third countries competition. But, it may not be possible for India to protect its market from the possible duty free exports of industrial products from Nepal which will be partly based on foreign inputs and technologies imported from third countries. It may revive the case of stainless steel and synthetic textiles. Because of the high internal taxes and the nature of the industries flourished within the high protective wall, a case of trade diversion may take place.

Nevertheless, a kind of trade creation may also take place, since India has pretty large industrial sector and relatively higher level of technological progress. By virtue of highly developed industrial sector and technology, resources may b more efficiently used in India rather than in Nepal. Besides, transport costs may be another contributory factor in trade creation in favour of India. If the inputs imported from third countries are processed in the places close to the ports, it will certainly save some transport costs, however, it depends upon the nature of the goods and processes involved. At the same time, the disadvantage of high transport costs may be reduced to some extent, if the industries are located in the bor-

Table 1
Structure of GDP

(in percent)

Countries	Agriculture			Industry			Manufacturing			Services		
	1960	1977	1981	1960	1977	1981	1960	1977	1981	1960	1977	1981
Bangladesh	61	55	54	8	13	14	6	7	8	31	32	32
India	50	37	37	20	25	26	14	16	18	30	38	37
Nepal	–	68	59	–	9	12	–	4	4	–	23	29
Pakistan	46	33	30	16	23	26	12	16	17	38	44	44
Srilanka	38	39	28	16	21	28	11	15	16	46	40	43

Source : *World Development Report, 1979* (World Bank, Washington, D. C.)

during areas in Nepal, which may be later balanced by the benefit arising out of technological efficiency, and commodity substitution.

However, it is likely that Nepal might loose much because of the difference in the size of industrial sectors and other economic factors, coupled with its land-locked position. Under such circumstances, some compensatory measures would be necessary. Therefore, it can not be said exactly who will benefit, but as per the spirit and objective of economic integration, both or all the parties should be benefited. This aspect of trade relations between India and Nepal is still unexplored, and needs indepth empirical studies

Moreover, one important thing which probably would worry India is that the difference in the size of industrial sectors between them. In fact, India has the biggest industrial sector in the South Asian region. The following tables give a comparative picture of the size of industrial sectors among the South East Asian countries.

Table 2
Size of Manufacturing Value Added

	Value Added in Manufacturing (in million U. S $)		
Countries	1970	1975	1980
Bhutan	–	–	–
Bangladesh	324	283	1197
India	7093	8280	15909
Nepal	78	–	251
Pakistan	1462	1645	2279
Sri Lanka	208	228	679

Source : *World Development Report, 1979.* (World Bank, Washington, D. C.

The following table shows the trade between Nepal and India:

Table 3
Total Merchandise Trade 1977 (million US $)

	Total Exports	Total imports
India	6222	6593
Nepal	81	168
Nepal with India (percent)	(63)	(69)
India with Nepal (percent)	(0.77)	(1.86)

It is evident from the above table that Nepal's share in the total merchandise export and import of India is 0.77 and 1.86 percent respectively. Whereas India's share in the total merchandise export and import of Nepal is 63 and 69 percent. Even now, the mutual trade shares do not seem to have significantly changed. From the view point of India's prominence in Nepalese foreign trade, the probable benefits from a customs union may be higher in India's favour.

India, in fact, with due regard to the un-authorised trade across the open border consisting mainly re-exports of consumer goods and durables imported from third countries to Nepal, may worry about the probable Nepalese exports of industrial products based on the imports of third countries. For instance, synthetic textiles, electronic goods, watches, and many others. These type of goods, produced in Nepal based on imported inputs and technology from third countries, may easily displace corresponding Indian products not only in Nepalese market but also in Indian market, since, they may be more attractive in terms of quality and price (prices of Indian products may be higher since there are high internal taxes). Summing up the views expressed above, it may be said that there has been a *de facto* economic integration, more like a customs union or common market between Nepal and India, as permitted by the provisions of the existing treaties and open border between them. If the clauses relating to the "exceptions and conditions" are taken out, the treaties can provide almost enough rooms for a *de jure* customs union as well. In other words, the treaties have been providing a conditional customs union a common market type of situation between Nepal and India. In fact, the exceptions and conditions as spelled out in the treaties, reflect the disagreement of India to allow absolute free trade with Nepal. India wants Nepal to impose internal taxes at the rate corresponding to its central excise rate, so that Nepalese produts may not be cheaper in relation to the local products in Indian market. Whereas, Nepal needs to relax internal taxes on the local products as an incentive for the domestic industries to grow. Besides, as India has been levying custom duties, import ban and quantitative restrictions on the imports from Nepal, with some exceptions, free trade in a formal way may not be acceptable to it. This type of common internal tariff policy and quantitative restrictions intended by India are solely designed to protect Indian domestic market from outside competition. They do not contain the spirit of international trade, and do not reflect Nepal's desire to develop its own trade and industry. Therefore, it may be said that India might not be interested in customs union or common market type of economic integration with Nepal, as long as it does not have any problem to preserve its status quo-predominating trade with favourable trade and tariff policy.

On the other hand, whatever may the provisions in the existing treaties both the parties would not deny the fact that in addition to the local purchases of daily necessities which are generally un-taxed and decontrolled at the border custom points, there takes place a considerable amount of un-authorised trade by virtue of the existing open border stretching over more than 500 miles, and likely administrative leakages. These are contributory to the prevalence of foreign trade, apart from the preferential treatment permitted by the existing treaties. Under such circumstances, it may be a better idea to have a customs union type of economic integration and regulate and expand trade and industry in both the countries, which may eventually save administrative expenses and also remove custom leakages, among other benefits as discussed earlier. Nevertheless, another important disagreement may crop up as regards the common external tariff. Since Nepal will be needing some capital and intermediate goods to develop its industrial growth, which India will not. As such, Nepal would prefer lower or nominal tariff on them, whereas India would insist on higher tariff rates because of the differences in the size and the level of industrial development between the two countries.

Some compromising and compensatory measures may be necessary to take up in such circumstances, but it may not rule out the possibility of framing a customs union between India and Nepal.

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