Pruning sensitive list under SAFTA: Case of Nepal

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Nature of Nepal’s sensitive list (SL)

- Two SL
  – For LDCs (1257, under HS2007)
  – For NLDCs (1295)
  – LDC list is subset of NLDC list
  – Items only on the NLDC list number 38, covering Chapters 72, 73, 83 and 84

Nature of Nepal’s sensitive list (SL)

- Agricultural products (including fish and fish products, and tobacco) figure prominently in the consolidated list—all but five chapters in Chapters 1-24 are in the list. It also covers mineral fuels (including petroleum products), and manufactures such as pharmaceutical products, textiles and clothing, footwear, plastics and plastic products, electrical machinery equipment, paper and paper products, articles of iron or steel, and motor vehicles

Methodology

- Secondary data analysis and survey
- Secondary data analyis
  - Data for the years 2005-2007
  - Mirror data
  - Conversion of HS2007 codes into HS2002 codes
  - LDC and NLDC lists considered separately in the first stage and shortlisted items considered together in later stages

Methodology

- Four criteria in secondary data analysis:
  - Value of RCA Index for at least one South Asian partner is greater than unity in all three years
  - Share of South Asia in Nepal's imports is greater than 66 percent in all three years
  - Trade potential between Nepal and at least one South Asian country is positive for all three years
  - Indian products are exempt from basic customs duty (There are 274 such tariff lines under HS 2007, covering Chapters 1, 3, 4, 6-12, 14, 15, 17 and 23)

Methodology

- Survey: Interview with manufacturers and industry associations in select shortlisted items

Trade analysis of SL

Nepal's imports under consolidated sensitive list (in US$ '000)				
Imports from	**Year**	**2007**	**2006**	**2005**
India		820412.47 *(71.56)*	681638.66 *(74.93)*	595005.17 (77.30)
Bangladesh		1228.31 *(0.11)*	625.52 *(0.07)*	822.94 (0.11)
Pakistan		21.84 *(0.00)*	409.99 *(0.05)*	1017.36 (0.13)
Sri Lanka		136.11 *(0.01)*	143.03 *(0.02)*	256.84 (0.03)
Bhutan		0.00 *(0.00)*	0.00 *(0.00)*	35.31 (0.00)
South Asia		821798.74 *(71.68)*	682817.20 *(75.06)*	597137.61 (77.58)
Total sensitive list imports		**1146508.08**	**909670.62**	**769732.70**
Figures in parenthesis are % of total sensitive list imports				

Trade analysis of SL

- Nepal’s average imports under the consolidated sensitive list amounted to US$941.97 million in 2005-07, which accounted for 59.6 percent of Nepal’s total imports
- India dominated imports from South Asia, accounting for over 99 percent of imports from South Asia in the consolidated sensitive list
- India’s median per tariff line share in Nepal’s imports was 83.1 percent for the common list and 98.02 percent for the NLDC-only list

Trade analysis of SL

Nepal's imports from South Asian countries under consolidated sensitive list as % of total imports from them			
	2007	**2006**	**2005**
India	66.32	73.64	71.09
Pakistan	2.71	16.91	31.23
Sri Lanka	74.45	4.01	87.06
Bangladesh	95.37	83.03	95.59
South Asia	66.31	73.23	70.96

On average, sensitive list items accounted for 70.2 percent of Nepal's total imports from South Asia.

First stage secondary analysis results

- LDC list: 256 tariff lines (HS2007)
- NLDC list: 5 tariff lines
- Total first-stage shortlisted items: 261
- These items cover 39 chapters, out of the 57 chapters in the sensitive list.
- They represented 56.6 percent of total sensitive list imports. 97% from South Asia
- Their imports from SA represented 73.27 percent of total sensitive list imports from SA.

First stage secondary analysis results

- The shortlist includes two tariff lines representing petroleum products and accounting for a whopping 34.29 percent of total sensitive list imports.
- 148 tariff lines representing agricultural products spread over 14 chapters and accounting for 11.6 percent of Nepal’s total imports under the sensitive list

Second stage: Revenue

- Two sources:
  - Department of Customs data for 2008/09 for 14 tariff lines (including petroleum products)
  - Calculation from COMTRADE trade data (2005-2007) and applied MFN rate (2008/09)
- Taking NRs. 10 million as the cut-off revenue per tariff line: 30 tariff lines representing NRs. 10.19 billion of revenue (39.7 percent of import customs revenue)

Revenue

- 14 tariff lines, including petroleum products and motor vehicles, accounted for the bulk of the revenue, that is, NRs. 9.8 billion
- The 30 tariff lines represent revenue loss (which may be an underestimate) and are not considered further
- From the first-stage shortlist (261), there are now 231 items

Third stage: selection for survey

- The 231 items include:
  - Agricultural products (MFN rate just 10 percent in 119 tariff lines)
  - Products of infant domestic industries
  - Products of SMEs
- Ideally, all should be surveyed. But not possible.

Third stage: selection for survey

- We consider for survey items that attract MFN tariff of 15 percent and higher, and/or where the domestic industry appear “sensitive” and may need protection on infant industry and/or socio-economic (e.g., employment) grounds”
- How organized the sector is, is also a factor for selection for survey

Third stage: selection for survey

- **57 items covering 9 sectors selected for survey**
- Chapter 9 (4): Tea (MFN 25)
- Chapter 17 (1): Cane molasses (MFN 25)
- Chapter 32 (1): Paints and varnishes based on polyester (MFN 30)

Third stage: selection for survey

- Chapter 40 (3): Rubber tubes and tyres (MFN 15-25)
- Chapter 48 (8): Paper & paperboard; art of paper… (MFN 15-30)
- Chapter 60 (9): Fabrics (MFN 15)
- Chapter 61-62 (23): Apparel (MFN 20)
- Chapter 64 (3): Footwear (MFN 20)
- Chapter 73 (5): Line pipes (20-30)

Fourth stage

- Out of the 231 shortlisted items, there remain 174 products, including 135 agricultural.
- 69 agricultural products are important sources of livelihoods, hold potential for greater production and employment , and/or are officially regarded sensitive/having export potential by the government (e.g., milk, poultry, egg, fisheries, honey, cereals, vegetables (potato, cauliflower, etc., oil seeds & oleaginous fruits), coffee etc)

Fourth stage

- Remaining products: 105 (66 agricultural, 39 non-agricultural)
- These do not appear really sensitive given available information, but stakeholder consultation is required for a conclusive determination.

Fourth stage

- What should be done with the tariff lines that are not shortlisted even in the first stage (1034 items). Of these, Nepal did not import 114 items?
  - Based on additional information, including on domestic industry and stakeholder consultation, and better quality trade data (not mirror data that this study uses), these may also be considered for removal.

Survey results: Paper industry

- Paper
  - Nepali handmade paper industry is basically export-oriented, with 80 percent of its output exported and the remaining sold in the domestic market
  - Raw material found in Nepal
  - Women employment high
  - Some competition from India and Thailand
  - “Tariff must not be lowered for at least three years”

Survey results: Leather footwear

- Nepali leather footwear industry accounts for 42-45 percent share of the domestic market. Up from 30 percent some seven years ago
- Raw materials are mostly domestically sourced; the industry is highly labour–intensive, with labour accounting for 16-20 percent of the value of final product

Survey results: Leather footwear

- Nepali products are now competing head-on with Chinese products while Indian products, which were doing well a decade ago, are losing market, though still popular in areas close to the border with India.
- Unfair competition is a challenge
- Smuggling and undervaluation hurting
- “More important than tariff is applying it effectively”

Survey results: Rubber tube/tyre

- Gorakhkali Rubber Udyog Ltd. is the only establishment producing rubber tyres and tubes retreading in Nepal
- 38 % government owned
- Twenty-five different sizes of tyres, covering truck and non-truck tyres, are produced
- Sales are completely in the domestic market in most years.

Survey results: Rubber tube/tyre

- Sold mostly in the hill region of west Nepal, Gorakhkali tyres are considered relatively flexible and hence better suited to hill conditions.
- About 500 truck tyres were exported to Bangladesh in two or three years.
- Bangladesh demand was due to the tyres' quality in terms of suitability to hill conditions.

Survey results: Rubber tube/tyre

- 40% capacity utilization; lack of working capital constraining utilization
- Imported raw materials account for 90 percent of production cost. About 40 percent of imports is natural rubber, sourced from India and Thailand
- Natural rubber production potential is very high in the Tarai region (southern plains bordering India) which if exploited would help reduce the cost of production.

Survey results: Rubber tube/tyre

- Average share in domestic market for truck tyre:30%
- Indian truck tyres supply 45 percent of the market
- Competition is intense from imports, mainly from India (strength of tyres)
- Price competition from Chinese tyres; some competition from Malaysia

Survey results: Rubber tube/tyre

- Inability to upgrade technology due to lack of capital is severely affecting competitiveness.
- Undervaluation and smuggling of foreign tyres is another factor adversely hurting the industry
- “Removal of tariff will destroy the industry”

Survey results: tea

- Nepal produces both lowland CTC (black) tea, which is consumed domestically and exported in almost equal parts, and highland orthodox (green) tea, which is mainly exported (over 95 percent).
- Nepal is self-sufficient in tea
- Direct employment to around 105,000 people
- Engagement of small farmers
- Priority sector identified by government

Survey results: tea

- Almost the entire domestic market for orthodox tea is supplied by Nepali produce, Darjeeling tea having a marginal share.
- About 90 percent of the domestic market for CTC tea is supplied by Nepali produce, and the imports are mainly from India
- In general, domestically, Nepali tea is lower-priced than Indian tea, in both orthodox and CTC categories

Survey results: tea

- Smuggling of tea from India through the open border takes place
- Stakeholders appear divided over the rationale for protecting the tea sector.
  - One opinion is that though Nepali tea is competitive in the domestic market, it should be protected as it is in a growing phase and its full potential in terms of contribution to export revenue, employment and livelihoods for the rural poor is yet to be realized.

Survey results: tea

- The other view is that since Nepal is more than self-sufficient in tea and is competitive in the domestic market (in terms of price as well as quality), the domestic tea sector will not be hurt by reducing import duties on tea.

Survey results: Textiles/fabrics

- Domestic production is around 100 million metres, less than 20 percent of demand
- Capacity utilization is less than 25 percent.
- There are over 1,000 textile firms, small and large, but 140 are registered with Nepal Textile Industries Association, providing direct and indirect employment to 300,000-400,000 people

Survey results: Textiles/fabrics

- The industry mainly produces polyester textiles. About 90 percent of the yarn required for textile production is domestically produced while 10 percent is imported from India
- 90 percent of production is sold in the domestic market and 10 percent exported to India. Exports to India in 2008/09 to India amounted to NRs. 3.65 billion

Survey results: Textiles/fabrics

- Exports are mainly in the high-end category, namely shirts and suits. Competition in the domestic market is from Indian and Chinese products.
- “Dumping" of products from India and China, smuggling through the porous Nepal-India border and undervaluation of imported goods at the customs are serious issues.

Survey results: Textiles/fabrics

- Industry association does not call for hike in tariffs (from current 15%), but does not want it to decrease further, arguing that it has been brought down significantly over the last 20 years (from as high as 100%), and unauthorized trade is taking place.

Survey results: Apparel (Chapter 61-62)

- Nepal's apparel industry is export-oriented. The industry body, Garment Association of Nepal (GAN), represents firms that basically cater to the international market.
- Firms producing mainly for the domestic market are small-scale producers and not organized, and have very limited market share.

Survey results: Apparel (Chapter 61-62)

- Firms catering to domestic market include proprietorship tailoring enterprises. They may be affected by reduction in tariffs on readymade clothing.
- For exporting firms (under GAN), however, the import tariff on apparel "does not matter".

- Machine-made paper
- Cane molasses
- Paints
- Line pipes