AN ASSESSMENT OF TRADE OPENNESS AND ITS IMPACT ON ECONOMIC GROWTH: A STUDY OF NEPAL

By

Pradyumna Prasad Upadhyay

THESIS

Submitted to

KDI School of Public Policy and Management

in partial fulfilment of the requirement

for the degree of

MASTER OF PUBLIC POLICY

2014

AN ASSESSMENT OF TRADE OPENNESS AND ITS IMPACT ON ECONOMIC GROWTH: A STUDY OF NEPAL

By

Pradyumna Prasad Upadhyay

THESIS

Submitted to

KDI School of Public Policy and Management

in partial fulfilment of the requirement

for the degree of

MASTER OF PUBLIC POLICY

2014

Professor Jungho Yoo

AN ASSESSMENT OF TRADE OPENNESS AND ITS IMPACT ON ECONOMIC GROWTH: A STUDY OF NEPAL

By

Pradyumna Prasad Upadhyay

THESIS

Submitted to

KDI School of Public Policy and Management

in partial fulfilment of the requirement

for the degree of

MASTER OF PUBLIC POLICY

Committee in charge:

Professor Jungho YOO, Supervisor Jungho Yoo

Professor Siwook LEE

Professor Chrysostomos TABAKIS

Approval as of May, 2014

ABSTRACT

AN ASSESSMENT OF TRADE OPENNESS AND ITS IMPACT ON ECONOMIC GROWTH: A STUDY OF NEPAL

By

Pradyumna Prasad Upadhyay

The analysis of imports, exports, liberalization indicators and GDP growth of Nepal provided enough evidence that open trade policy gives boost to economic development. The study proved that higher the trade openness higher with be the growth. Continuing open trade policy measures by Nepal government will make positive impacts on economic development however; efficient production, competitive environment, technology transfer and knowledge spill-over are preconditions. The study covers a distinctive country's trade behaviour. Nepal is between two giant markets: China and India. However, India's geographical proximity has been a major influencing factor for a greater trading with India. Nepal is landlocked with few chances of better transit routes. Nevertheless, membership in WTO and Nepal's initiation for new regulations for better trade relations are positive aspects as well. In recent years, the open trade measures provided positive outcomes for the economic growth.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

I. INTRODUCTION

1.1. Background of the study

Countries using their resource base and goods of comparative advantage engage themselves in international trade. They formulate their trade policies to get maximum returns from international trading with other countries. From history of civilization, trade has been the determining factor of human progress and prosperity. Experiences show that greater the trading activities, better the economic status of the country. Because of scientific and technological advances trade has become easy and globalized these days.

Performance in trade of countries indicates their overall economic performance. Those countries performed well through free market and trade grown faster. According to Fontagne and Mimouni (2000), although less perfect competition and other good situations give the possibility of welfare by managing better trade policies, on average opening up is better than having no trade (pp.2). Obviously, trade gives spark to economic growth to the country, however, up to which level can be seen by observing other factors affecting economy of the country such as state's relations in international political economy, country's production capacity and resource base.

On multilateral trade, most of the countries joined World Trade Organization and started opening up their economies to gain maximum benefits from international trade. However, all did not achieve the goal of attaining higher benefits since increasing exports and expanding the production base with adequate infrastructure was a challenging task for them. Although, open trade has many benefits, but making trade as major contributor to economy, other policies that effect trade be given appropriate importance.

1.2. Concept of trade openness

Countries use trade openness as one of the policy measures. If the trade policy is neutral on trade activities, it is said as open trade policy. Harrison (1994) mentions that a good trade policy has the capacity to measure the differences between neutral, inward looking or export promoting one (pp. 421). If a country is highly exports oriented than it can be inferred that it will not be impartial towards its all domestic industries because that country can have the incentives to the production of export oriented goods.

Whether the trade of any country is open or not can be measured by simply observing actual trade flows. By adding imports and exports we get the trade flow share in GDP (Gross Domestic Product) of countries. Although, there are other factors which affect the trade, such as size of the country, and capital inflows (Harrison, 1994). As Learner (1987) points that openness is a function which shows the extent of deviation of actual trade from the deviates from the pattern of trade. One of the ways of measuring trade openness can be tariffs and non-tariffs of any country in its trade.

Basically, trade openness can be calculated into two main groups. They are: i) trade volumes measures and; ii) trade restriction measures. Yanikkaya (2003) in a research constitute these measures and established hypothesis on relation between economic growth and open trade. It was found that the increase in trade volume and economic growth of a country has positive relations, particularly of a developing country (pp.58).

In the history of trade, open and globalized trade tremendously helped the countries to utilize resources optimally around the globe. It seemed trade openness is a good solution for global prosperity. However, the structure of international trade and openness is decided by powerful nations. National interests and goals are given top priority. The chance for free international trade comes subsequently. If national interests are well supported by free market activities and free flow of goods and services, it is allowed. And it is obvious, if the trade openness helps to boost national interests and prosperity it becomes a priority, or else; there comes any state controls and other controlling mechanism such as tariffs and non-tariff barriers.

1.3. Objective of the Study

Objective of this study is: to find out the relationship between open trade and growth of a developing country economy. Up to what extent the open trade policy contribute growth of developing economy such as Nepal. The researcher explores the relationship between these two factors comparing the outcomes before trade liberalization and after trade liberalization period. The research is based on the following research questions:

1.4. Research Questions

1) How trade openness contributes economic growth in developing countries like Nepal?
2) Are trade restrictions on various goods and services promoting economic growth of Nepal?

1.5. Methods of analysis

Both quantitative and qualitative methods of analysis are used to find out answer to the research questions. Secondary data regarding Nepal's exports and imports, trade barriers such as tariff and non-tariff barriers and Gross Domestic Products (GDP) of previous years are analyzed. Previous researches on the issue are reviewed. Relevant documents such as official statistics, annual reports, government documents, books, journals and other types of publications are reviewed to ascertain conclusions. To validate the claim and hypothesis, literature review on related topics carried out. The findings from inferential statistical tools are interpreted and drawn out the conclusion.

II. LITERATURE REVIEW

2.1 Theories of International trade

Trade occurs when individuals in both sides gain something from the transaction. Countries trade with each other like individuals. Only the scale differs. Thus, nature of trade for countries is similar to that of individuals. But there are some different aspects as nations have their sovereign powers with collective and political decision making process. Thus, trade issue covers the state power structure and the government decision making process. Krugman and Obstfeld (2009) agree on that matters of international economics come from interaction between world states as of special problems they face(p.4). However, it depends upon the situations of the countries as they differ in various kinds and this difference gives certain powers to the government and the state to do as per the need of the time and the interests of the nation.

Economists agree on that the most powerful argument for countries to trade internationally is because of gains from international trade. Krugman and Obstfeld (2009) held the same opinion, the exchange of goods and services to each other by the countries has always mutual benefit effects (p.4). International trade has greater benefits than generally expected. However, the benefits usually goes to more productive and efficient countries as they can easily absorb most of the benefits from trade with their technological know-how, large capital base and proper allocation of resources.

There are opposite arguments as well. Even though, it is true that those countries with adequate resources, good human capital, efficient know-how, research and development activities and having more capital to be invested can be ahead in trading in international sphere but it should not be forgotten that there are examples of countries such as South Korea which gained enormously through trade and export promotion, however, it was not having adequate resources in the early stage of development. Balakrishnan (2004), emphasized that implications from international trade have many dimensions in any country's domestic market, particularly in the developing countries as it intensifies interdependence which results to the domestic economic development.

This kind of interdependence at one side pushed for more competition to domestic businesses of developing countries at the same time developing countries could not get the maximum positive outcomes because of policy negligence towards businesses and industries for the international market. Because of the globalization effect most of the developing countries opened up their economies to the international market as far possible to get the positive outcomes from the global market, however, reaping the benefits from world market reach seeks better policy environment.

According to Grieco and Ikenberry (2003), with the best utilization of resources through improved production and consumption, the countries can improve the overall welfare using free trading activities. Likewise, the countries can obtain better goods and services from other countries (pp 19-56). However, the production capacity should be considered. It is true that trade creates the win-win situation for both sides. Those gains depend upon their trading capacities. Nevertheless, trade is good for both the states. Thus, greater the production better the trade and consumption. Production is needed for consumption. Extra production that remains after consumption should not be wasted. The things remaining can be sold to get the other essential goods through trade. However, it is obvious the opposite side should be in need of those goods and services remaining. The benefit of trading is that it ascertains mutual benefits for both the sides.

In the global scenario, countries trade for their best mutual benefits. They open their markets for their best mutual gains. It is a fundamental and simple truth. Various economists and scholars have been developing various theories on open markets and international trade. Some of the theories on international trade are relevant to be discussed. They provide more clear view on opening trade and its impact on particular country's economic growth.

Harrison (1994) points out that open trade provides a number of benefits ranging from access to imported things, which helps entering innovations and technologies, increases the size of market for producers, which gives high return to investments and innovations and ultimately helps to lead country towards research intensive productions (pp.419-420). However, it's a human nature that if it is easy to get new goods and services with fewer efforts, people depend more on others and their productive and innovative capacity reduces. It implies on country level as well.

According to the theory of dependency, the resources comes from poor states to wealthy states, enriching wealthy states leaving poor states impoverished and rich ones enriched by integrating poor states into the world trading system.[1] Open and free trading thus, on the one hand becomes a tool for integration of world system in favour of rich nations however; they get better than their previous condition. Underdeveloped countries trade with developed countries but their purchasing capacity reduces over time while the rich countries enjoy more raw material

[1] http://en.wikipedia.org/wiki/Dependency_theory

imports and they export less manufactured goods. Nevertheless, this view ignores that open trading uplifts production and consumption of underdeveloped countries.

There have been various researches occurred to find out the relation between open trading and its impact on economic growth of countries particularly developing countries. Those studies show mixed results. In a study, Ann Harrison (1994) concluded that high degree of openness leads to higher growth, although only half of the measures show a robust relationship with GDP growth and tells that causality goes in both directions. However, it's also true that foreign trade sector provides a link between the domestic economy and the outside world. This link acts as a natural channel through which the small but continuous flow of economic benefits can be transmitted. Thus, this kind of link creates a channel of interdependence between economies.

2.1.1 Adam Smith's free market

Adam Smith held that a key determinant of the wealth of nations is the productivity of labour and that labour productivity depends primarily upon the division of labour[2]. The more specialized the labour force, the better productivity, which comes dramatically. Individual differences can have effect on productivity. Smith argues that at birth, everyone is similarly talented; people become more proficient relative to others when they specialize in special activities. It is human behaviour that it learns by doing and becomes better step by step which leads to more efficient and specialized tasks.

Smith further believed that wealth of nations is the flow of goods and proper government policy toward international trade should be the same as that toward domestic trade – giving a

[2] Taken from An Inquiry into the Nature and Causes of the Wealth of Nations by Adam Smith.

place for free marketing of goods in unregulated markets. Smith advocates the policy of laissez faire, which would lead higher levels of well-being in all countries.[3]

To give argument for free trade and individual self-interest, Adam Smith believed that when a person works for his own interest, he helps the well being of society indirectly. In his book Wealth of Nations he wrote, “by pursuing his own interest, the individual frequently promotes that of the society more effectually than when he intends to promote it.” He supposed by keeping down the prices, a free market would benefit society as a whole, and that gives incentive to the society for producing different goods and services.[4]

In the words of Adam:

> “It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own self-interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.”

Countries as being the group of individuals behave like individuals and try to maximize their profits and at the same time social benefits goes up. Free trade on this way is the right path to maximize benefits.

2.1.2 Ricardo’s comparative advantage theory

It is the belief of David Ricardo that if trade is done by using comparative advantage specialization it can provide benefits to all the participants because of the allocation of labour to the most productive uses. And thus a greater production and consumption of goods happens globally (Grieco and Ikenberry, 2003). Free trade not only benefits production and consumption

---

[3] Ibid.

[4] www.wikipedia.org

but gives the ground for technology transfer, new innovations and creates cooperation among the countries for common interests.

Ricardo explained how any country can benefit in international trade by producing comparatively advantageous products. Although, his assumption was that a free market with perfect competition where the capital and labour flows naturally for getting optimum output, every country's individual pursuit leads for universal good as a whole when merged together. Grieco and Ikenberry (2003) citing Ricardo says that trade distributes the labour more accurately and most efficiently and helps increasing the heavy productions by boosting industries and knowledge base, giving benefits to all and pushes all the concerned towards one common interest which ultimately leads making a universal cooperative society (pp. 35).

Ricardian model shows the way to gain more from differences in terms of resources such as knowledge, capital and labour. The model advocates that labour is one major factor of production. Trading countries can be differentiated only on the basis of productivity of labour. Krugman and Obstfeld (2008), explains Ricardian model by asserting that a country can get the benefits indirectly by producing the goods with its comparative advantage, which are the need of other countries and trade it for the other necessary goods for itself.

Heckscher-Ohlin's factor proportions theory

This theory gives emphasis to the interaction between the sizes. The connection of different production factors in the countries and their use ratios in producing goods has deciding role for production. Having a large base of a resource in comparison of other resources is called abundant for any country for that resource. Therefore, it is obvious that the country will produce more products in comparison of other resources by using its abundant resources giving full concentration. And the effect will be, the countries export goods that consume more and more abundant factors (ibid).

International trade effects strongly on distribution as well. Changes in relative prices of goods affects relative gains of resources as well and with the changes in prices income also changes. Likewise, the owners of abundant factors in any country gain a lot from trade, but at the same time who owns scarce factors lose. As Krugman and Obstfeld (2008) held the view that differences in resources alone can explain only the pattern of world trade or world factor prices however, international differences in technology should be acknowledged (pp. 82).

2.1.3 Stolper-Samuelson Theorem

This theorem explains how the returns of a country can be affected with opening up of the economy. The returns of the factors on the basis of comparative advantage and their owners such as workers and capital owners are affected with opening of the trade to other countries. As the country specializes in the goods having efficiency gives emphasize on high production implying the factor of comparative advantage with in the country. And this kind of specialization can give the owner of the abundant good more gains and their income increases, however, the scarce goods owners may lose their real income (Grieco and Ikenberry, 2003). Although, the theorem gives insight on factor owners' relative shifting and have rational choices for protection as they get benefits from the exchange, as Grieco and Ikenberry explains however, from the gains they can offer better compensation to those who lose, thus both parties find themselves better off with trading activities.

However, eventually economists agree on that there are two types of seen benefits from open trade: i) higher consumption and ii) better economic growth. Grieco and Ikenberry (2003) accepts that as a country starts opening its economy with trading to the world, it tends to specialize on few goods with its endowments of factors of production, its demand and other aspects like the state of technological advancements in the world (pp.50).

2.2 Relevant theoretical works on trade openness and economic growth

There are many studies that have examined the relation between trade openness and economic growth of various countries particularly the developing countries. Some studies are examined in this study.

In year 1994, the study titled 'Openness and Growth: A Time-Series Cross-Country Analysis for Developing Countries' studied by Ann Harrison, published in Journal of Development Economics, examined the impact of openness measures on economic growth. The results advocate that greater openness is associated with higher growth. In this study seven openness measures- trade reforms-I, trade reforms-II, black market premium, price distortion, movement towards international prices, trade shares and dis-protection of agriculture of countries are analysed. It found that there was mostly the positive relation between trade openness and GDP growth.

The paper suggests that the existing literature is still uncertain about causality. The results shows the causality between openness and growth goes both ways, although higher the liberalized trade policies better will be the rate of growth. At the same time, it is also true that higher growth leads to more open trading (Harrison, 1994).

In the year 2002, the study, 'Trade Openness and Economic Growth: A Cross Country Empirical Investigation' carried out by Halit Yanikkaya, published in the Journal of Development Economics examined the relationship between trade and economic growth. The study revealed that trade liberalization does not have a simple and straightforward relationship with growth.

The regression results for different trade intensity ratios demonstrated some opposing findings to the thinking on the economic growth effects of trade barriers. The results showed that trade barriers positively related with growth. The findings for trade volumes provide substantial information that trade promotes growth through technology transfer, economy of scales, and comparative advantage (Yanikkaya, 2003 pp. 84).

The study results provide substantial proof that restrictions on trade may have positive impact on growth in developing countries but certain conditions should be there. Thus, it showed that there is no relationship between trade restrictions and growth and the relationship is totally dependent with certain conditions and specifications of the countries. It means restrictions on trade have benefits to a particular country depending on its development, size, big or small and its resources of comparative advantage in the sectors where the protection is provided (ibid).

Likewise, in the year 2001, the study ‘ Trade Liberalization and Growth in Developing Countries’ carried out by David Greenaway, Wyn Morgan and Peter Wright, published in the Journal of Economic Development, researchers argue by using three different indicators of liberalization that liberalization has impact upon growth, albeit with a lag (pp.229).

The researchers tested a model of growth with measures of liberalization and suggested that liberalization impacts positively real GDP per capita. However, it appears to be little and comparatively modest. The study says liberalization is often the first step. With the time passes, economies use more open behaviour on trading side and get even better with the reductions in transportation and communication costs and technological advancements (pp. 243).

2.3 Theories of Economic Growth

Adam Smith in, 'Inquiry into the Nature and Causes of the Wealth of Nations (1776), advocated that division of labour, work specialization and building up of capital gives positive changes in economy and economic growth. Likewise, he further emphasized that the government should not interfere market activities and it should let the market work but a stable legal framework should be maintained to make the market functional[5].

Robert Solow explained that growth depends on capital. More capital leads for better growth. Thus to expand productive capacity of capital goods it should be increased and for capital accumulation, higher savings are needed which can be achieved by postponing consumption in present and allocating the resources for investment. Solow suggested the tools as i) widening of capital which goes with the growth of labour force, ii) deepening of capital which means growing of stocks faster than labour force, iii) quality of capital through improvements gained with research and innovations. A combination of deepening of capital and technological betterment shows trends of economic growth[6].

Endogenous Economic Growth theory holds that the policy measures of governments can impact on long-run growth of economy. Subsidies given to research and development activities and facilities to educational development increase the growth rate by providing the incentive to innovate[7]. Sebastian Edwards (1993) explains that recent developments in the theory of

---

[5] Taken from the web: http://tutor2u.net/economics/content/topics/econgrowth/benefits_of_growth.htm

[6] ibid

[7] Text taken from Wikipedia free encyclopaedia: http://en.wikipedia.org/wiki/Endogenous_growth_theory, retrieved on 6th November 2010.

endogenous economic growth have made important progress towards providing a better conceptual base for trade policies and growth relationship. Where the capital, labour and specialized inputs are used, businesses produce final goods or engage themselves in research and development (Edwards, 1993, pp. 1389).

Resources used for research activities and innovation improve the production capacities. More resources that are engaged to research and development activities help better availability of intermediate inputs with greater benefits from capital (ibid). Edwards points out that if an economy is closed it has to make a large number of intermediate goods and therefore, probable for problems and blocks however, freer trade provide the solution for faster growth (pp. 1389). Basic known factors that affect any country's trade with others are: prosperity abroad, tariffs and exchange rates. There are other common factors especially related with Least Developed Countries. Those include i) capacity of production, ii) political stability, iii) capital requirements fulfilment, iv) technological advancement and v) geographical presence etc.

Contribution of these factors to the economy determines country's trade openness to the world, although, magnitude of any particular factor can be high or low with different countries. It is possible that these factors might contribute the trade openness of developing countries like Nepal in a large or in a small scale.

III. NEPAL'S TRADE, TRADE POLICY AND ECONOMIC TRENDS

In trade liberalization, it generally involves well market functioning for investment flows and other resources to the trade sector. Moreover, openness in trade focuses on lowering reliance on controls and regulations in imports and exports (Shafaeddin, 1995). Trade policy reforms with trade liberalization and economic reforms process was started since 1980s in many developing countries[8].

Nepal's international trade history shows, India has been the major partner for many years. Till 1950s Nepal's trade with India was more than 90 per cent[9]. Although there were a number of reasons behind for large portion of trade with India i.e. geographical proximity, cultural similarity, transit facility from Indian border, easy access to Indian market, friendly political relations and large open border between India and Nepal. These factors are to be explained as major contributors for imports and exports mostly with India. In year 2008/09, Nepal's export to India was around 64 per cent of total export and import from India was 56.7 per cent of the total imports to Nepal[10].

The following figure (3.1) shows Nepal's trade share with India. As explained earlier, geographical proximity basically provided Nepal to trade with India with larger amount.

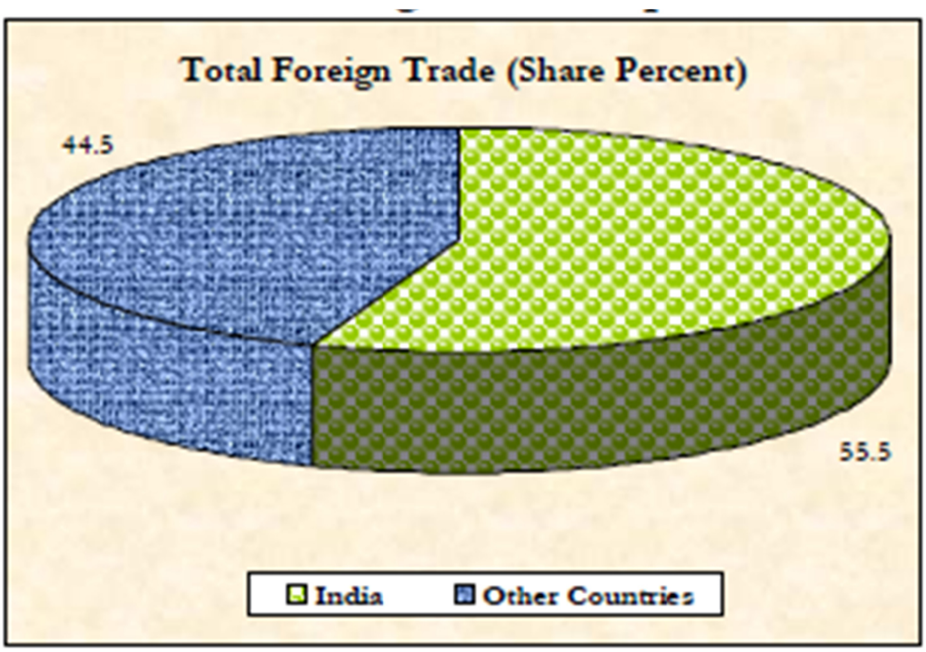
---

[8] Trade Liberalization and Economic Reform in Developing Countries: Structural Change or De-industrialization? Article by S.M. Shafaeddin, published by United Nations Conference on Trade and Development, 2005.

[9] www.nationasencyclopedia.com

10 www.tepc.gov.np

Figure: 3.1 Nepal's total foreign trade share with India and other countries[11]:



Nepal's quest for trade openness was initiated mainly after 1990 with a thought that it will help to reduce poverty of the country[12]. The Trade Policy, 1992 was the base point of Nepal's liberalization process in trade sector which mainly covered export policy and its strategy, import policy and its strategy, regulating foreign exchange, research activities for trade and establishing of Nepal Trade Promotion Organization. However, it seemed not enough to address issues of international trading problems, handling of affiliations with regional and multilateral trading systems, expanding free trade areas, simplifying trade procedures and making a good transit system[13].

UNCTAD publication, Investment guide to Nepal Opportunities and Conditions (2003), mentions that trade liberalization, foreign exchange reforms, banking sector deregulation and

11 Economic Survey, 2009 taken by the Government of Nepal
12 Commerce Policy, 2008, Government of Nepal.
13 Trade Policy of Nepal, 2009 pp. 1

privatization were major reforms in policies of the government of Nepal.[14] The report held that investment on infrastructure and utilities, telecommunications, water and health, road transport, air transport, capital market and insurance sector, accounting and business services, human resources management, work permit easiness, industrial relations, industrial factor costs, labour costs, taxation, export duty reforms and boosting of the private sector were the policy focus areas for liberalized economy.

Nepal joined World Trade Organization (WTO) on 23rd of April 2004. Likewise, it became the member of SAFTA (South Asian Free Trade Agreement) and BIMSTEC (Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation). Nepal's forceful policy towards trade liberalization was one of the strategies that Nepal was trying to get the benefits of global integration, however, as Commerce Policy of year 2008 observes, Nepal's lacking in technology, good human capital, capital mobilization and low information on the identification of its competitive advantageous products in the country is lowering trade benefits.

Trade policy report (2012), discusses that the gap which is seen between imports and exports of Nepal is because of high imports of petroleum. The value of imported petroleum products is greater than the whole total value of all the commodities Nepal exports. Further, the variety of Nepal's exports is very few and the trading happens also with very few countries. Textiles, Pashmina, tea, coffee are Nepal's main items and they are exported mainly to India, USA, Bangladesh, and EU. It shows Nepal's trade is guided by imports of petroleum and export of a small basket of products.

[14] An Investment guide to Nepal Opportunities and Conditions, (2003), published by UNCTAD.

The government declared through Industrial policy 2010 and the Board of Investment Act 2011 that foreign direct investment has main role in trade and development. The government declared five priority areas to attract foreign investment i.e. hydro electricity, infrastructure, agro-processing, tourism and minerals-mines. Likewise, signing of bilateral investment promotion and protection agreements with six countries and double taxation avoidance agreements with major trade partners by the government allows better trading environment. These arrangements provided better ground for more trading activities in the liberalized market.

Here to mention, trade liberalization was one of the pre-conditions for financial support from multilateral financial institutions such as World Bank and International Monetary Fund (IMF) to the developing countries like Nepal. There were trade side prescriptions ranging from removing import quotas, reduction of tariff rates, devaluation of currency and reducing the export taxes[15].

Nepal being the least developed country and a recipient of financial support from these multilateral financial institutions has followed these conditions and liberalized trade sector accordingly.

Likewise, Nepal became the member of World Intellectual Property Organization (WIPO) in 1997 and a party to the Paris Convention on year 2001 and the Berne Convention on 2006. Modernizing the IP offices, developing human resources, providing legal advice on legislations with international treaties and new regulations shows that intellectual property issues are taken with greater.

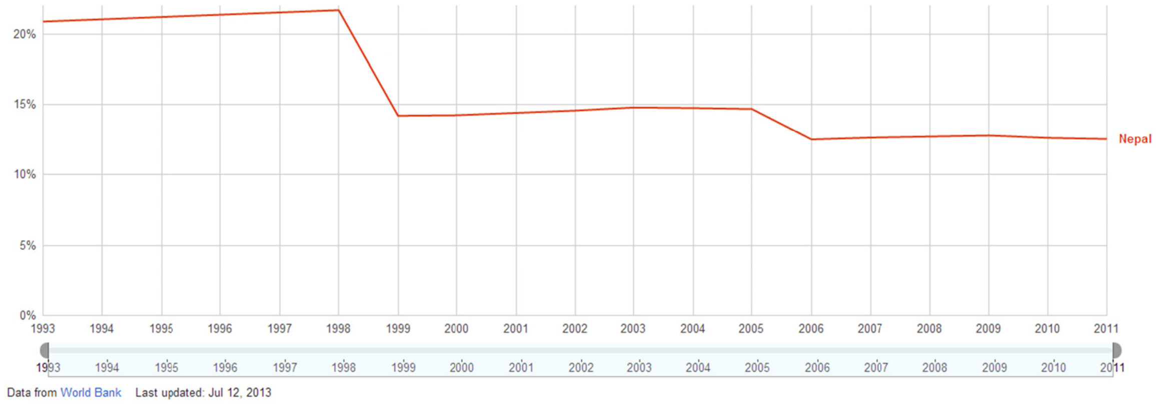
[15] The Impact of Trade Liberalization on Export and GDP Growth in Least Developed Countries, article by Mehdi Shafaeddin, 1995, UNCTAD Review.

Moreover, Nepal's central bank's beginning of setting up annual monetary policy regularly since 2003 as part of the liberalization process ascertained autonomy of central bank for financial sector stability. Here, to mention, Nepal's currency pegging with Indian Rupee has been giving the extensive commercial relations with India is recognized as one of the major influential factor for Nepal's foreign trading. The arrangement has been the anchor to macroeconomic stability in the country. Likewise, Nepal's acceptance of the obligations of Article VIII of the Articles of Agreement of the IMF shows a policy framework for better monetary management of the country.

On part of tariffs, they have been adjusted over the last several years regularly. The government has taken initiatives by reducing tariff-slabs and rates, abolishing different non tariff taxes, introducing Value Added Tax, using WTO Customs Valuation Agreement, limiting import restrictions to safeguard health, environment and security. After the liberalization policy implementation, the tariff rate applied, simple mean on all products (in the following figure) was 20.9 percent in year 1993 which was reduced to 14.6 percent in year 2002 and further decreased to 12.6 percent in year 2010[16].

[16] World Bank Indicators.

Figure 3.2 Tariff rate- Simple mean- general



Tariffs change for different goods

How did the tariffs changed differently for different goods can be seen in the following table (3.1) shows MFN applied tariffs of year 2002/03, 2008/09 and 2011/12 after the liberalization policies enacted with greater emphasis after becoming the member of WTO[17]:

Table 3.1 Showing tariff structures of some of the selected products, 2002/03, 2008/09, and 2011/12 (%)

Tariffs	2002/03	2008/09	2011/12
MFN applied Simple average rate	13.8	12.3	12.2
• Agricultural products	13.9	13.0	12.5
• Industrial products	13.7	12.2	12.1
• Manufacturing excluding food, beverages and tobacco	13.9	12.3	12.2
• First stage of processing	9.3	9.4	9.3

[17] Report on Nepal Trade Policy Review 2011, Document WT/TPR/G/257 contains the policy statement submitted by Nepal.

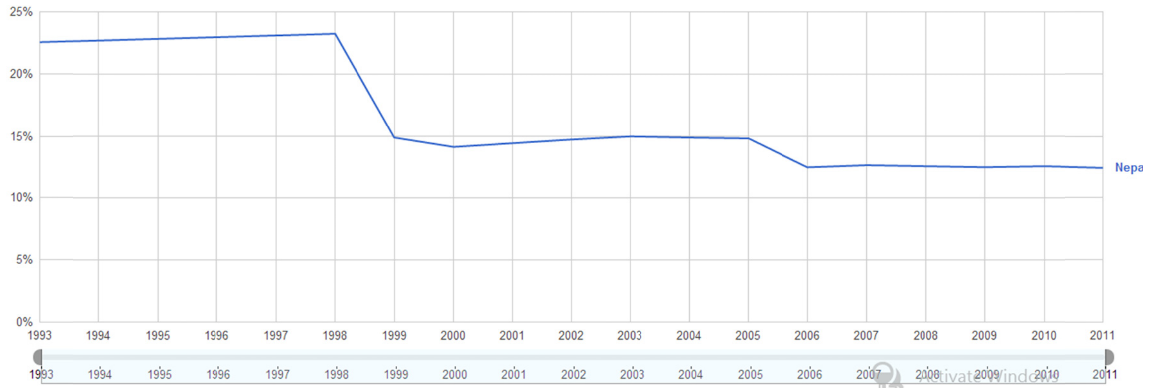
• Semi-processed products	12.2	11.7	11.6
• Fully processed products	15.7	13.3	13.1
• Food, beverages and tobacco	15.9	14.4	13.7
• Textiles	12.8	12.5	12.8
• Clothing	24.5	19.9	19.9
• Petroleum	22.7	20.8	17.9

The above randomly selected tariff structures show that the tariffs were changed differently for different goods as per the trade negotiations with trading partners. However, most of the tariffs are lowered because of the open trade policies of the country and the average general tariff rate is in decline in the review period.

To see how the tariffs changed in a particular area after opening up trading taken into consideration the following graph which indicates average tariff rate of manufactured goods of Nepal (1993-2011) is given[18]:

[18] Taken from World Bank Indicators, World Bank Public Data.

Figure 3.3 Tariff rates-simple-manufactured goods



Between 2002/03 and 2011/12, despite the overall reduction in the simple average MFN tariff rate, the applied MFN tariff rates increased on dairy products, coffee and tea, cotton, and other agricultural products.

Preferential rates

One the way for furthering the liberalization process Nepal signed South Asian Free-Trade Area (SAFTA) Agreement and Nepal applied preferential tariff rates to other SAARC (South Asian Association of Regional Cooperation) members. Nepal also provides preferential rates under the BIMSTEC Free Trade Area Framework Agreement. Products except those included in the negative list of the agreement may be subject to fast or normal track tariff reduction or elimination for developing country parties (India, Sri Lanka, and Thailand) and LDC parties (Bangladesh, Bhutan, Myanmar, and Nepal).

Likewise, under the Nepal-India Trade Treaty, Nepal and India agreed, on a reciprocal basis, to exempt from customs tariffs and quantitative restrictions on imports of primary goods. Nepal agreed to exempt, wholly or partially, the customs tariff on imports from India. Goods produced in and imported from India into Nepal are granted a tariff rebate of 7 percent for tariff rates of up to 30 percent and 5 percent for tariff rates above 30 percent.

Major policy measures that were taken to curb non-tariff barriers are shown below[19]:

Trade facilitation measures

The 2007 legislation of Customs simplified customs procedures in Nepal. Before, numerous documentary requirements and complicated procedures for transit transport, inadequate inter-modal competition in transit movement, and out-of-date transport vehicles were there to delay trading. The number of documents required by banks, Nepalese Customs, and Indian Customs at borders and transit ports was reduced to 10 (down from 15) for imports; and to 9 (down from 14) for exports.

Measures directly affecting exports

In the customs procedures, the same declaration requirements and tariff nomenclature are used for imports and exports. Nepal applies an open de-licensing regime, with a view to reducing government interference in trade. In the case of duty drawbacks, it grants duty drawback on imported raw materials incorporated into exports under Article 15 of the Industrial Enterprises Act 1997, which stipulates that customs duty, VAT, and excise duty levied must be reimbursed.

Measures affecting production and trade

[19] Trade Policy Review of Nepal presented at WTO Secretariat in year 2011. The document WT/TPR/G/257 contains the policy statement submitted by Nepal.

A standard VAT of 13% is applied to most goods and services, both domestically produced and imported. Under the Excise Act, 2001, excise duties are levied on domestically produced goods and imports at same rates. Likewise, Nepal's standards and technical regulations do not create technical barriers to trade. Rather, it is difficult for Nepalese exports to compete in global markets due to its weak standardization and conformity assessment infrastructure. On SPS measures and regulations, Nepal follows international standards in its SPS requirements. Nepal's SPS regulations after liberalization process, which reflect international standards, include the Plant Protection Act 2007 and the Plant Protection Rule 2010, Animal Health and Livestock Services Act 1998, Pesticides Act 1991 and Pesticides Rules 1993 and Directives on Export-Import Inspection and Quality Certification System 2006.

Competition policy

The Competition Promotion and Market Protection Act 2007 and its implementing regulation, are intended to make Nepal's economy more open, market-oriented and competitive, through fair competition between persons or enterprises producing or distributing goods and services. The law has prohibited: anti-competitive agreements, abuse of dominant position, merger or amalgamation with intent to control competition, bid rigging, exclusive dealing, market restriction, tied selling, and misleading advertisements.

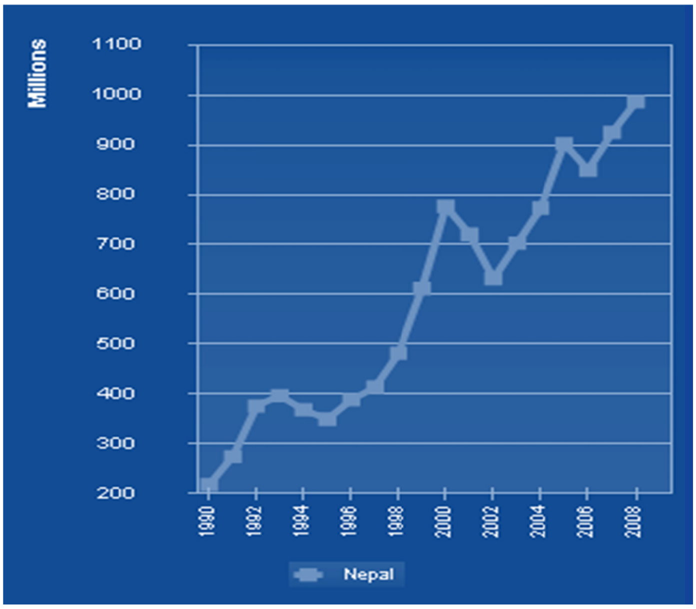
On part of transit facility management policy, Nepal's landlocked status is a major concern. Nepal's imports and exports have to travel via land of India and Bangladesh. A large portion of Nepal's trade has been channelized through transit points neighbouring to India. Transport connectivity, management of borders, customs and transit-traffic management has been the challenges. Transport cost increments as these impediments lessen the trade competitiveness.

However, Nepal's policy on transit requires more backing for the free flow of trade activities. Nepal's policy on transit evolved with the Friendship treaty with British India in 1923. Later on, that treaty was renewed several times and at present a new transit treaty of 1999 has been in work[20].

The above mentioned measures give a picture on Nepal's desire for trade openness. However, these policies do require regular revisits for better trading environment. For starting to examine the impact of trade liberalization policies we need to compare the trading statistics of pre and post liberalization phase. Here, the following chart (figure 3.4) shows Nepal’s export of goods in the time period from year 1990 to year 2008. It shows that the exports are growing with some fall downs because of some externalities.

[20] ECONOMIC POLICY NETWORK Policy Paper POLICY REORIENTATION STUDY ON TRANSIT TRADE OF NEPAL by Vidya Nath Nepal (2006) retrieved from http://www.ncf.org.np/upload/files/546_en_Policy_Reorientation.pdf

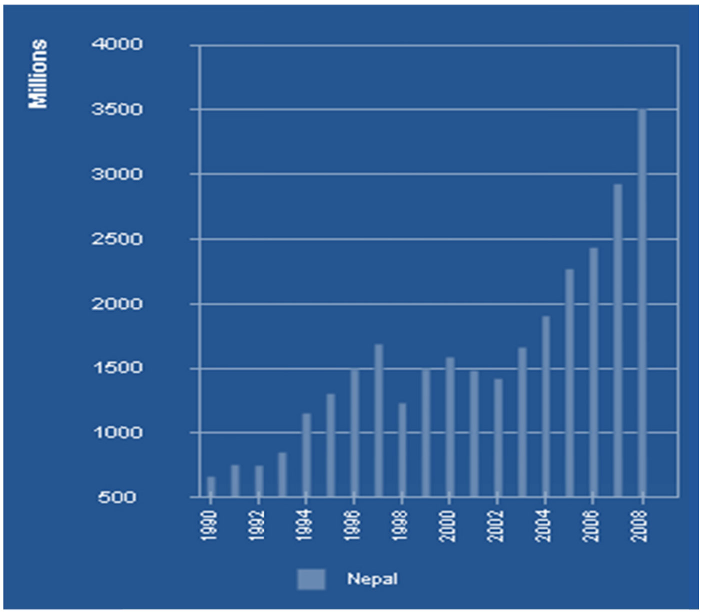
Figure 3.4 Goods exports (BoP, Current US Dollar) 1990-2008 (in millions)[21]



The following chart (figure 3.5) provides the trend of import of goods showing regular increase. The trend shows that the volume of trade during 1990 was less than US $ 500 millions while after liberalization it jumped by seven folds to the height of US$ 3500 millions. Although, there were some years such as in year 1998 and year 2002 there was a slow pace of import of goods. The import graph rapidly arose with more and more openness and market friendly policies of the government in early 2000s.

[21] Source: World Bank Indicators

Figure 3.5	Goods Imports (Bop, Current US $) 1990-2008 (in millions)[22]



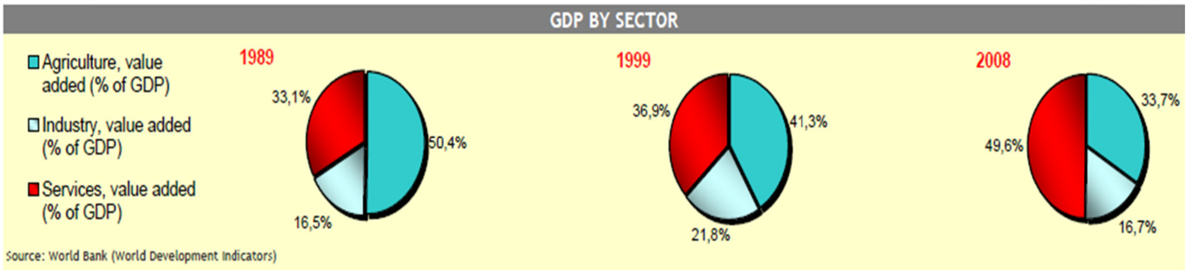
Nepal is said agriculture-based economy. However, the contribution of agriculture to the GDP is around one third. Rest two third of GDP comes from service and trade sector[23]. World Bank Indicators for year 2008 show that trade contributes 16.7 per cent in Nepal's GDP.

In the sector-wise comparison of GDP, we see that in the year 1989 agriculture sector was in the front line with more than 50 percent contribution to the GDP of Nepal but after ten years it was reduced to 41.3 percent and the gap was covered by industry and services equally. However, after ten years we see the change much clear as industry became the top contributor with 49.6 percent while services shrunk with more than 5 percent. It shows the trend of Nepal's ongoing economic situation. After the liberalization policy adoption and coherent globalization policies, the industry sector increased which provides the base for higher international trade for the country.

[22] Source: World Bank Indicators

23 Economic Survey, 2009 taken by the Government of Nepal.

Figure 3.6 Comparison of Nepal's GDP by Sectors in last three decades (1989, 1999 and 2008)[24]



A study[25] by John Cockburn (2001) concluded that trade liberalization in Nepal favours urban households as opposed to Terai (fertile plains) and Hill/Mountain households as of the high initial tariffs in agricultural sectors, however, the impacts of trade liberalization on income distribution appear to be small, some interesting results such as poverty falls in urban areas and appears to increase in rural areas, particularly among the moderately poor as opposed to the very poorest. Thus, it can be inferred from the results of the study that the trade liberalization helped mostly the urban people.

Likewise, a study of the trade openness in Nepal (2011) concluded that Nepal's trade openness in manufacturing and service sector is higher which indicates positive results given by the structural changes in manufacturing output and trade orientation after initiating liberalization programs[26].

It is understandable that Nepal has aggressively liberalized the trade sector since early 1990s to achieve trade benefits through enhanced competitiveness and policy reforms, which in turn,

24 World Bank Indicators: http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113424.pdf

25 The study named Trade Liberalization and Poverty in Nepal: A Computable General Equilibrium Micro Simulation Analysis by John Cockburn conducted in year 2001

26 Sensitivity of the trade openness in Nepal (2011), by Shashi Kant Chaudhary, http://red.nrb.org.np/publications/economic_review/NRB_Economic_Review--Vol_23

after 1990s changed Nepal's trade volume and pattern which begun to change the economic scenario.

According to Bhatta (2011) on the study, The Impact of Trade Liberalization on Exports, Imports and Growth in Nepal, the trade liberalization has not been significantly affecting, but it will be a correct way forward. Furthermore, the study says, through liberalization the imports have penetrating effect on the economy and trade facilitation provided better ground for trade in the country.

A simple comparison of international trade volume of Nepal (table 3.2) which shows before and after trade liberalization period imports and exports provides a scenario of impact in trade by the policy intervention.

Table 3.2 showing the comparison of trade volume as per policy implementation:[27]

Year	Policy	Exports ($'0000)	Imports ($'0000)
1983-84	No liberalization	2125	5625
1992-93	Starting of liberalization	21625	43000
2009-10	After liberalization	76250	470000

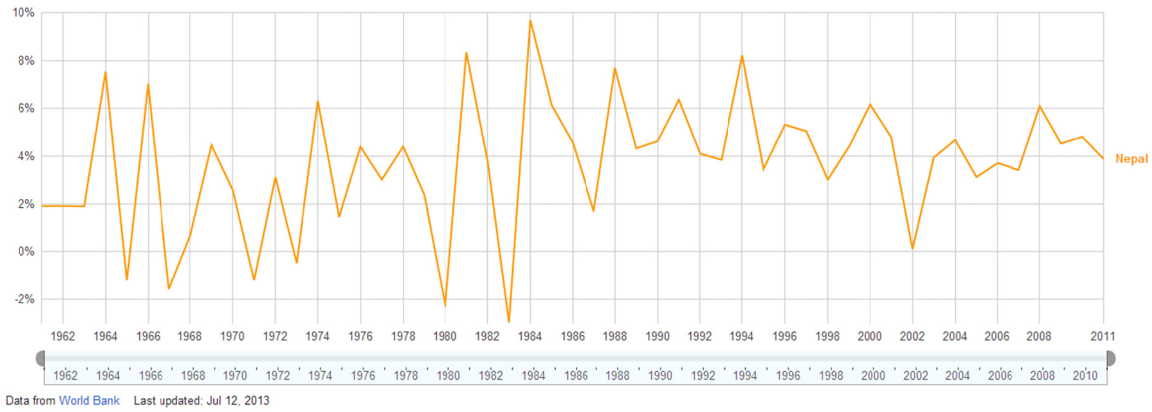
Above table shows international trade of Nepal is affected by the policy of liberalization. Before the policy measures, the trade volume was very low in terms of exports and imports

[27] Trade and Export Promotion Center, Government of Nepal, 2011

however, in year 2009-10, there seen a great increment in both imports and exports showing major implication of liberalization policy in trade sector.

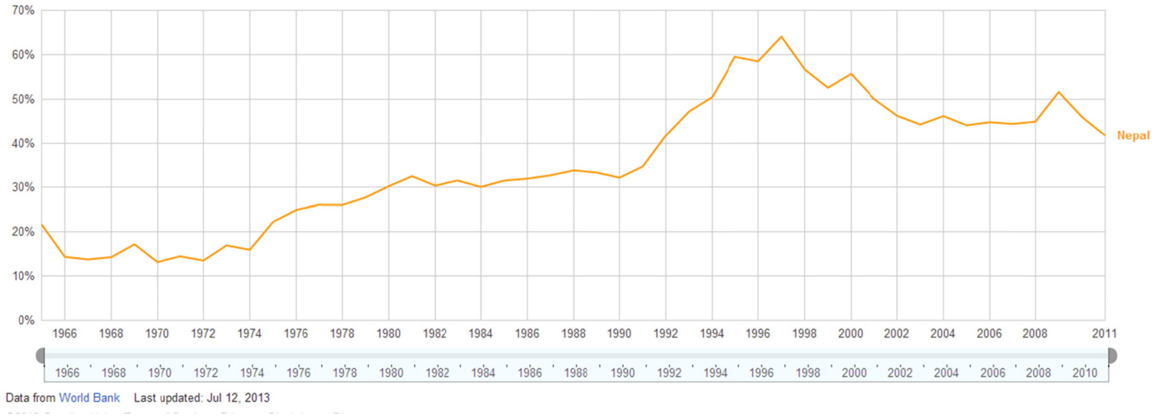
Likewise, to correlate GDP growth and trade growth on pre and post liberalization policy implementation we can look at the following two figures (3.7 and 3.8).

Figure 3.7 GDP Growth of Nepal[28]



[28] World Bank Indicators, Public Data

Figure 3.8 Trade of Nepal (% of GDP)[29]



In the above two figures, after the liberalization process of 1990 although the GDP growth is not stable enough and there are ups and downs, however, in respect of trade growth, it is much higher than the pre- liberalization era with the positive relationship of GDP growth and trade growth. Thus, it is inferred that the post liberalization trading has affirmative impact on GDP growth.

With an analysis and comparison of the data of Government of Nepal, economic surveys of year 2001 and 2012, the impacts on various sectors of economy or GDP after liberalization of trading can be categorized as follows (table 3.3):

[29] World Bank Indicators, Public Data

Table 3.3 showing the comparison of impact of trade liberalization on GDP[30]:

Component	Year 2001	Year 2012	Researcher's Analysis of impacts after trade openness policy implementation
Growth of imports compared with exports in GDP	It was 15 percent of GDP.	It reached 25 percent of GDP.	It shows high growth of imports as of open trade policy. The policy eased the environment for imports. However, Nepal's inability to produce more comparative advantageous goods has hampered the exports side.
Exports of goods and services as percentage of GDP	It was 17.74 percentage	It is 10.34 percentage	Open trade policies did contribute to the exports but Nepal's internal circumstances intervened such as lack of production capacity, lack of competitiveness etc.
Imports of goods and services as percentage of GDP	It was 28.49 percentage	It is 38.79 percentage	Imports grown high. The people start getting better products from different producers in competitive pricing. However, Nepal's trade deficit is increasing with the rise in its share on GDP.
Structure of GDP	Agriculture and industry were the main contributors	Services sector is apparently visible.	The policy intervention led to promote the services sector as well.
Consumption	The share of consumption to GDP was 90.5 percent in current price.	It is 91.7 percent	It shows the open policy gave the consumers more choice on various traded goods.

[30] Date taken from Economic Surveys of year 2001 and year 2012 conducted by the Government of Nepal, Ministry of Finance

Current account	Trade deficit in tradable goods owing to the country's inability to make notable progress in production, promotion and exports.	Trade deficit persists. But the significant amount of remittance income contributed to the current account surplus.	The liberalization policy on services sector proved to be helpful. The remittance income has great contribution in the economy as well.
Nepal India Treaty provisions	India was the major partner in trade both imports and exports	The status remains the same with more than $2/3^{rd}$ of trade occurs with India.	The provisions assured liberal bilateral trade between Nepal and India.
Foreign exchange reserve	Estimated to cover the value of one year's imports.	Estimated to cover the value of 11 months' imports.	Although the size of the economy has increased, still the foreign exchange reserve remains in substantial size. That shows the positive impact of open policy in the economy.
Exchange rate	Pegged exchange rate with Indian currency.	The pegging remains unchanged.	Fixed exchange rate with Indian Rupee gave stability of exchange rate.
WTO membership	National economic policies were not still streamlined and activated for better international trade.	Most of the policies related to investment and trade are streamlined and activated. WTO membership gave a big forum for trade activities.	These policies created better ground for trade with lower tariff rates, higher investment attraction to investors and trade and services sector's growth in the past decade.
Per capita GDP (exchange rate 1$= NRs. 100)	NRs. 19410 (Primary sector contributes: 37.9%, Secondary: 17.1% and Tertiary:	NRs. 62510 (Primary sector: 35.3%, Secondary: 14.4% and Tertiary: 50.3%)	However, the Per capita GDP eventually indicates positive impact of trade openness on economy.

	46.1%)		

For further analysis, we take changes in composition of GDP from year 2001 to year 2012. This will show sector-wise ups and downs because of policy intervention (table 3.4):

Table 3.4 showing the changes in composition of GDP from year 2001 to year 2012[31]

Composition of GDP (in percentage)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Primary Sector	37.9	37.0	36.4	35.7	34.1	33.0	32.3	33.5	35.9	37.4	36.3	35.3
Secondary Sector	17.1	17.2	16.8	16.6	16.2	16.1	16.2	15.3	14.6	14.9	14.3	14.4
Tertiary Sector	45.1	45.9	46.8	47.7	49.7	50.9	51.5	51.2	49.5	47.7	49.4	50.3

The above table shows that in year 2001, tertiary sector which mainly comprised of services sector has grown from 45.1 percent to 50.3 percent while other two sectors have lost their part to that sector. It is the indication of trade liberalization's positive impact on trade in services.

Changes in the composition of international trade

The trend of SITC (Standard International Trade Classification) products during the beginning years of liberalization (table 3.5) provides a picture in which direction the composition of goods going on. The data taken from economic survey of year 2012 by the government of Nepal shows the volume of exports and imports of different SITC products:

[31] Economic Survey, 2012, Government of Nepal, Published by Ministry of Finance.

Table 3.5 showing changes in the composition of exports and imports in the SITC (Standard International Trade Classification) group[32]:

in $'00000

Year	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13 (first 8 months)
Export	**4993.06**	**5391.07**	**5870.57**	**6023.41**	**5938.32**	**5926.65**	**6769.75**	**6082.40**	**6433.85**	**7426.1**	**4408.4**
Food & live Animals	610.09	627.69	699.35	719.20	705.58	1316.49	1914.53	1315.52	1453.18	1593.0	1223.4
Tobacco & Beverage	13.87	5.52	3.16	2.50	2.33	2.43	35.42	1.84	0.17	10.2	14.2
Crude Materials & Inedibles	80.01	71.43	88.16	122.34	136.80	135.07	197.31	246.96	192.33	258.7	202.1
Mineral Fuels & Lubricants	0.55	1.45	0.42	0.32	0.00	0.00	4.17	0.00	0.00	0.0	0.8
Animals & Vegetable Oil & Fats	427.87	337.57	507.03	428.46	445.49	206.20	36.29	26.72	40.90	33.2	11.6
Chemicals & Drugs	327.9	386.59	367.76	368.69	409.16	282.35	308.73	167.69	267.95	273.7	231.4
Classified by Materials	1779.47	2360.17	2859.06	2853.30	3041.22	2964.33	2824.16	3339.52	3349.65	3900.9	1963.1
Machinery & Transport Equipment	20.82	61.95	20.76	120.19	124.09	91.29	62.53	72.50	37.97	27.8	32.5
Miscellaneous Manufactured Articles	1728.15	1538.01	1323.96	1408.16	1073.65	928.17	1385.97	911.65	1091.11	1328.4	729.2
Not Classified	4.33	0.69	0.91	0.25	0.00	0.32	0.64	0.00	0.59	0.3	0.0
Import	**12435.21**	**13627.71**	**14947.36**	**17378.03**	**19469.46**	**22193.78**	**28446.96**	**37433.52**	**39617.55**	**46166.8**	**36056.3**
Food & live Animals	937.05	855.40	982.07	1329.87	1289.59	1583.83	2047.11	2376.55	2926.34	4078.3	3957.3
Tobacco & Beverage	79.22	102.68	101.56	116.18	95.79	123.83	141.28	285.49	216.71	308.2	279.8
Crude Materials & Inedibles	847.93	1055.06	1120.7	1056.23	882.93	836.51	1254.30	1988.89	1948.02	1777.3	1409.8

[32] Economic Survey, 2012, Government of Nepal

Mineral Fuels & Lubricants	1994.41	2190.41	2992.73	3644.70	3636.20	4396.85	4529.37	5678.11	8123.45	10277.1	7561.5
Animals & Vegetable Oil & Fats	775.05	863.44	601.63	1019.66	1213.76	939.91	900.43	932.05	1473.38	1791.8	1196.1
Chemical & Drugs	1431.95	1654.49	1917.97	2475.02	2699.59	2686.33	3157.99	3966.96	4527.21	4901.7	4094.1
Classified by Materials	3488.82	3651.05	3704.74	4060.05	4814.53	5744.84	7607.00	11612.98	9133.78	11478.2	7064.3
Machinery & Transport Equipment	2070.21	2569.42	2626.21	2619.46	3635.74	4800.64	6800.95	8451.72	8533.15	8241.4	6579.9
Miscellaneous Manufactured Articles	658.27	510.38	755.18	1041.78	1175.50	1072.62	1997.73	2136.66	2723.48	3297.2	2198.5
Not Classified	152.30	175.38	144.57	15.08	25.83	8.42	10.80	4.11	12.03	15.5	1715.0

The table (3.5) shows how the composition of SITC group items has been changing in international trade from year 2002 to 2012. The export of Animals & Vegetable Oil & Fats has decreased to a very low point however; the share of Crude Materials & Inedibles is increasing. Miscellaneous Manufactured Articles are in decreasing trend with substantial decline while Food & live Animals exports are growing.

In imports side of SITC items, Food & live Animals, Mineral Fuels & Lubricants, Machinery & Transport Equipment and Miscellaneous Manufactured Articles have high speed while others have slow but progressive growth of importing

IV. RESEARCH METHODOLOGY

4.1 Hypotheses Development

4.1.1 Research Question One

How trade openness contributes economic growth in developing countries like Nepal?

Nepal being a developing economy, it has small number of industries, businesses and low participation in international trade. With the trade openness policies implementation, Nepal took membership of WTO. That gave Nepal a great potential for trade with other member countries. Nepal's experience in trade after joining of WTO in preliminary years is mixed. Trade liberalization policies were initiated after 1990 and those policies laid the foundation stone for the entry into world trading system although a small presence in the world market. However, the trade openness could not be managed to contribute desirably as expected in Nepal's economic growth. Although, there are some obvious factors such as political conflicts, poor business opportunities and low level of attraction to the foreign direct investment etc.

Most of the literature on trade and economic growth speak that trade openness creates better ground for economic growth of the country; however the factors which make the trade environment positive and conducive are also desirable. In case of Nepal, liberalization towards trade was a great policy leap; however, other desired settings such as political stability, hassle free foreign investment attraction in industrial sector and a business friendly atmosphere must be inculcated. Evidences show that Nepal opened up its economy to the world presuming a wider market for its goods and services; however Nepal's industrial base and business conditions did not comply with the rules of open trade. Static and poor growth in industrial sector, around 1.5 to 2 percent on average for last ten years[33] shows weak industrial performance. Likewise, the time needed for exports was 43 days in year 2004 and it is still 41 days in year 2013 with a small improvement[34] . Further, there were 7 types of government procedures to be completed for starting a business in year 2004 and the same number remained in year 2013 with no decline[35].

Through this hypothesis, it is tried to find out that effects of trade openness to economic growth might be different in the case of Nepal. Thus, the hypothesis one is:

Hypothesis One: If economic growth is related to trade openness, then higher the degree of openness of economy will have a higher growth level.

4.1.2 Research Question Two

Are trade restrictions on various goods and services promoting economic growth of Nepal?

Governments work for the welfare of the society. The government of Nepal's policies on trade and investment show that trade openness as a major tool. They assume that Nepali consumers can get better access to international goods through openness of the market. They emphasize on other benefits from open trade like welcoming new technology, more capital inflows and employment opportunities within the country. However, the government carefully try to control trade with restrictions at the entry and exit with high tariffs and non-tariff barriers. Government wants to generate revenue in a larger amount as tariffs provide a large share in government revenue. At the same time government argue about infant industry protection from

[33] Economic Survey, 2013, Government of Nepal, Ministry of Finance

[34] http://www.doingbusiness.org/Custom-Query/nepal

[35] http://www.doingbusiness.org/Custom-Query/nepal

the competitive foreign firms. In developing world, governments and their policies get influenced by different stakeholders ranging from bureaucrats' interests to business people, NGOs, political pressure groups and civil society within the country. Thus desirably or not knowingly government creates barriers on trade.

Thus, various reasons may be behind the trade restrictions by the government of Nepal. To prove this hypothesis, various studies on trade restrictions and economic growth are compared taking different research issues.

Hypothesis Two: If trade restrictions are related to economic growth, then higher the level of restrictions lower the economic growth.

4.2 Test of Hypothesis One

"If economic growth is related to trade openness, then higher the degree of openness of economy will have a higher growth level".

To test this hypothesis it can be said that there are no effects because of trade openness to the economic growth and essentially, all the effects that come in the way of observing and analysing the trade and growth relationship are due to chance alone. If that the case the hypothesis is nullified.

However, there are other alternatives as well. In fact, trade openness contributed to the economic growth of Nepal. Or, trade openness contributed negatively to the economic growth of the country. In these both cases the alternative hypothesis will be accepted.

4.3 Test of Hypothesis Two

"If trade restrictions are related to economic growth, then higher the level of restrictions lower the economic growth".

To test the above mentioned hypothesis it can be said that there are no effects because of trade restrictions to the economic growth and essentially, all the effects that come in the way of observing and analysing the trade restrictions and growth relationship are due to chance alone. If that the case the hypothesis will be nullified.

But there are other alternatives as well. In fact, trade restrictions contributed to the economic growth of the country. Or, trade restrictions contributed negatively to the economic growth of the country. In those both cases the alternative hypothesis will be accepted.

For testing these hypotheses the qualitative approach of analysis best fits. The following analytical table is used to come to the certain conclusions. This table shows the results of various previous works on trade restrictions and economic growth relation by various economists and researchers.

No	Author	Year	Research Issue
1.	Halit Yanikkaya[36]	2003	The research shows that there is doubt on the conventional view that suggests a robust and negative relationship between trade barriers and growth. There is evidence that restrictions on trade can promote growth, especially of developing countries under certain conditions.
2.	Ann Harrison[37]	1994	In the study, the researcher found that greater openness is associated with higher growth, although sensitivity tests revealed the fragility of many of the results, only half of the measures in

[36] Paper: 'Trade Openness and Economic Growth: A Cross Country Empirical Investigation' published in Journal of Development Economics, 2003.

[37] Paper: 'Openness and Growth: A Time-series Cross-country Analysis for Developing Countries' published in Journal of Development Economics, 1994.

			the study do exhibit a robust relationship with GDP growth. It suggests that existing literature is still unresolved on the issue of causality. The causality between openness and growth runs in both directions. Although, open trade policies do precede higher growth rates, it is also true that higher growth rates lead to more open trade regimes.
3.	Fontagne and Mimouni[38]	2000	There is a positive relationship between economic development and trade development but the relationship is not fully confirmed by the study. The study suggests that poor countries catch up a negative relationship between trade performance and growth. But at the same time it says that specialization matters and trade performance should fuel the growth process, hence two opposite forces should be disentangled in a growth equation (pp. 23).
4.	David Greenaway, Wyn Morgan and Peter Wright[39]	2002	Liberalization may impact favourably on economic growth of real GDP per capita. However, the effect would appear to be relatively modest. Liberalization or open trade is first step for economic growth rather the final step. After the time of course economy become more open partly as a consequence of incremental trade reforms but also due to other factors such as reductions in transportation and communication costs, technological changes and so on. The study clarified that openness does not contribute solely to the economic growth of the country.
5.	Euysung Kim[40]	2000	The study was performed with Korea's 36 manufacturing industries' production performance from 1966 to 1988. In the study, trade liberalization is found to have a positive impact on economic growth (productivity performance) but the productivity increase was not significant because the extent of trade liberalization was not substantial enough in Korea. It shows that adverse macro conditions at times veiled the positive effects of trade reform. Trade liberalization is found to have increased competition and promoted scale efficiency (pp.81.). However, it was true that trade reforms are not only the factors led to Korea's economic development.
6.	Matthew J. Slaughter[41]	2001	In this study, researcher searched for the convergence point among the liberalized and open economies. By using difference-in-differences estimation strategy, the researcher tried to identify

[38] Draft article: Openness, Trade Performance and Economic Development, 2000.

[39] Trade Liberalization and Growth in Developing Countries, article in Journal of Economic Development, 2002.

[40] Paper: Trade Liberalization and Productivity Growth in Korean Manufacturing Industries: Price Protection, Market Power, and Scale Efficiency, authored by Euysung Kim, published in The Journal of Development Economics, 2000.

[41] Paper: Trade liberalization and per capita income convergence: a difference-in-differences analysis, by Matthew J. Slaughter, published in Journal of International Economics, 2001.

			trade liberalization's effect on convergence. The main empirical result shows that trade liberalization did not foster significant, systematic convergence among liberalizers (pp. 225.). Convergence can be used as the indicator of economic growth of certain lower level economies. The study says liberalization is likely to trigger forces both for convergence and for divergence.
7.	Michael B. Devereux[42]	1999	The study concludes that when two or more countries engage in mutual trade liberalization, tariffs must be set so as to maintain each country's incentive to remain on the trade liberalization path. But the presence of differences in national growth rates and the degree of international technological spill-over may imply that the most efficient trade liberalization path is very far from the ideal of reciprocity. Tariffs may differ considerably between countries, and may move in different directions (pp. 795.). It shows that economic growth can be the incentive for further liberalization, however, it is difficult to say that trade openness may not be directly and positively related with economic growth.
8.	Peter Egger, Mario Larch & Michael Pfaffermayr[43]	2007	The study shows that pure liberalization is unlikely the good policy from both an individual country's and the world's perspective. A country prefers a simultaneous trade and investment liberalization if its capital to skilled labour endowment ratio is not too different from the partner country. And, bilateral liberalization is mostly preferable for individual countries with similar capital to skilled labour ratios, irrespective of their relative endowment with unskilled labour. Thus, it is inferred that liberalization or openness can give benefits and growth to the economy of the country but the level of players matters a lot (pp.691.).
9.	Philippe A.A. De Lombaerde[44]	2009	In the study report, the authors seek to test two hypotheses: i) high openness growth does not necessarily generate income growth in any country in the short run; ii) the customs unions scheme performs better than free trade area schemes in terms of income growth. And, both hypotheses are confirmed by the authors. They claim that the relatively low openness rate in US agriculture sector is not only a question of protectionism but reflects geographical conditions (scale, available land, etc.) and to some extent the availability of technology, skilled labour and capital. In addition, protectionism primarily affects imports, not

[42] Paper: Growth and the dynamics of trade liberalization by Michael B. Devereux, 1999, published in Journal of Economic Dynamics and Control.

[43] On the welfare effects of trade and investment liberalization, study report published in the Journal: European Economic Review, 2007.

[44] On the dynamic measurement of economic openness, study report published in the Journal of Policy Modeling, 2009.

			exports; import protection can even go hand in hand with export subsidies (pp. 734.).
10.	Zohre Salehezadeh & Shida Rastegari Henneberry[45]	2002	The study suggests that a higher degree of factor mobility (openness) results in a higher economic growth rate and an improvement in overall economic welfare. The findings of the study support the statement that sustainable recovery in Asia should include freer factor mobility, which results in economic growth by promoting productivity. Such factor mobility allows for increases in efficiency and reduces the economy's reliance on rapid capacity increases financed by unhealthy debt levels to maintain growth. It asserts lowering trade barriers shifts the pattern of production towards the most competitive sectors. Lowering trade barriers is expected to lead to a more efficient distribution of endowment factors among sectors of production, which in turn may result in a higher level of real output. The study further emphasises that even though free trade results in a better performance of the economy, partial trade liberalization with a biased tariff system harms the economy and lowers welfare (pp. 485.).
11.	Francisco Rodriguez, Dani Rodrik[46]	2001	The study estimated that trade restrictions are harmful to long-run incomes and that the effects from those restrictions to trade will be potentially large. (pp. 337)

[45] The economic impacts of trade liberalization and factor mobility: the case of the Philippines, study report published in Journal of Policy Modeling, 2002.

[46] NBER Macroeconomics Annual 2000, Volume 15: In their article titled: Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence

V. CONCLUSIONS

Through the qualitative analysis of various previous trends of Nepalese economy, the government policies on trade and overall economy and with hypotheses tests, the study suggests that Nepal's open trade policy has high and positive impact on Nepalese economy and its growth. The study shows that opening up of trade sector has various benefits to overall economic growth of the country. However, to rectify Nepal's under developed status in trading, policy measures on various areas such as production, technology transfer, human capital improvement, foreign direct investment planning have to be improved for more trade benefits through enhanced trading activities.

With the analysis of articles in various international economic journals and research papers with Nepalese perspective in policy intervention measures of previous years, it is concluded that trade restrictions have negative contribution to the economic growth of Nepal. Elimination of trade barriers would give Nepal more advantages from trade than having barriers and various restrictions. Trade without barriers eventually would lead to the rise of integration of Nepalese economy with the world economy.

Contribution to the existing knowledge: The study covers Nepal's exclusive trade policy implementation in pre and post liberalization period. Having landlocked status with a long run monarchy led government system; Nepal recently came under the democratic system. Nepal's entry into WTO shows its eagerness towards integrating the economy with global market. Although, Nepal's large population rely on agriculture, the open trade policies taken by the government and the impact seen in recent years shows positive signs for further actions of opening process in Nepal's economy.

The study reveals that opening up of trade has great and positive impact on economic development of Nepal. This study thus has significance in existing knowledge of trade and economic development relations. Although, more careful empirical researches are required in the studies of economic development and trade openness relations of developing countries through analyzing all other related aspects of the economy.

REFERENCES

An Investment guide to Nepal Opportunities and Conditions. (2003). UNCTAD.

Balakrishnan, C. (2004). *Impact of Globalization on Developing Countries and India.* Retrieved October 10, 2010 from http://economics.about.com: http://economics.about.com/od/globalizationtrade/l/aaglobalization.htm.

Bhatta, T.R. (2011). The Impact of Trade Liberalization on Exports, Imports and Growth in Nepal. Ministry of Commerce and Supply, Nepal.

Cockburn, J. (2001). *Trade Liberalization and Poverty in Nepal: A Computable General Equilibrium Micro Simulation Analysis.* Canada's Social Sciences and Humanities Research Council

De Lombaerde, P. A. (2009). On the dynamic measurement of economic openness. [Electronic version]. *Journal of Policy Modeling, 31 (2009)*, 731-736.

Devereux, M. B. (1999). Growth and the dynamics of trade liberalization. [Electronic version]. *Journal of Economic Dynamics and Control, 23*, 773-795.

Economic Reports. (2010). Retrieved October 10, 2010 from http://red.nrb.org.np: http://red.nrb.org.np/publica.php?tp=economic_reports&&vw=15.

Economic Survey. (2002).Government of Nepal, Ministry of Finance.

Economic Survey. (2013). Government of Nepal, Ministry of Finance.

Edwards, S. (1993). Openness, Trade Liberalization, and Growth in Developing Countries. [Electronic version]. *Journal of Economic Literature, XXXI*, 1358-1393.

Egger, P., Larch, M., & Pfaffermayr, M. (2007). On the welfare effects of trade and investment liberalization. [Electronic version]. *European Economic Review, 51*, 669-694.

Exports of goods and services (% of GDP). (2010). Retrieved October 10, 2010 from http://data.worldbank.org: http://data.worldbank.org/indicator/ne.exp.gnfs.zs/countries/latest

Fontagne, L., & Mimouni, M. (2000). *Openness, Trade Performance and Economic Development.* [Electronic version]. -: The Trade Performance Index, ITC's Market Analysis Section Under Friedrich von Kirchbach.

Greenaway, D., Morgan, W., & Wright, P. (2002). Trade Liberalization and Growth in Developing Countries. [Electronic version].*Journal of Development Economics, Vol. 67, 229–244*.

Grieco, J. & Ikenberry, G. (Eds.).(2003). *State Power and World Markets* (pp. 19-56.). Norton: W.W.& Company, Inc.

Harrison, A. (1994). Openness and Growth: A Time-series, Cross Country Analysis for Developing Countries. [Editorial]. [Electronic version]. *Journal of Development Economics, 48, 419-447*.

Hypothesis Testing. (2004). Retrieved October 10, 2010 from www.stat.ucla.edu: http://www.stat.ucla.edu/~cochran/stat10/winter/lectures/lect18.html.

Kim, E. (2000). Trade Liberalization and Productivity Growth in Korean Manufacturing Industries: Price Protection, Market Power, and Scale Efficiency. [Electronic version]. *Journal of Development Economics, 62*, 55-83.

Krugman, P. R., & Obstfeld, M. (2008). *International Economics Theory and Policy*. Boston, USA: Pearson Addison Wesley.

Learner, E. E. (1997). *Measures of Openness*. [Electronic version]. Los Angeles: Department of Economics, UCLA.

Nepal International Trade. (2010). Retrieved October 10, 2010 from www.nationsencyclopedia.com: http://www.nationsencyclopedia.com/economies/asia-and-the-pacific/nepal-international-trade.html.

Rodriguez, Francisco. Rodrik, Dani. (2001). Trade Policy and Economic Growth: A Skeptic\'s Guide to the Cross-National Evidence. , 15, 261-338.

Salehezadeh, Z., & Henneberry, S. R. (2002). The economic impacts of trade liberalization and factor mobility: the case of the Philippines. [Electronic version]. *Journal of Policy Modeling, 24*, 483-486.

Shafaeddin, M. (1995). The Impact of Trade Liberalization and GDP Growth in Least Developed Countries. [Electronic version]. UNCTAD Review 1995.

Slaughter, M. J. (2001). Trade liberalization and per capita income convergence: a difference-in-differences analysis. [Electronic version]. *Journal of International Economics, 55*, 203-228.

Smith, A. (2009). *An inquiry into the nature and causes of the wealth of nations* [EBook-3300]. (DX Reader version), Retrieved from http://www.gutenberg.org

Trade Composition. (2010). Retrieved October 10, 2010 from www.tepc.gov.np: http://www.tepc.gov.np/tradestatistics/gl-01-trade-composition.php.

Trade Policy of Nepal. (2009). Retrieved October 22, 2012 from http://www.tepc.gov.np/uploads/files/Trade%20policy%20English%20latest,%2020091818.pdf

Trade Policy Report by Nepal. (2012). Retrieved October 22, 2012 from http://www.mocs.gov.np/uploads/Press%20Release/TPR%20Nepal_Government%20Report.pdf

Yanikkaya, H. (2003). Trade Openness and Economic Growth: A Cross Country Empirical Investigation. [Electronic version]. *Journal of Development Economics, 72, 57-89*.