Asia-Pacific Research and Training Network on Trade
Working Paper Series, No. 98, April 2011

# Rules of origin in GSP schemes and their impact on Nepal's exports: a case study of tea, carpets, pashmina and handicrafts products

*by*

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* D.R. Khanal is the Founder Chairman of the Institute for Policy Research and Development (IPRAD). This paper was prepared as part of the ARTNeT initiative. The technical support of the United Nations Economic and Social Commission for Asia and the Pacific is gratefully acknowledged. The opinion figures and estimates are the responsibility of the author and should not be considered as reflecting the views or carrying the approval of the United Nations, ARTNeT, or Institute for Policy Research and Development. Any remaining errors are the responsibility of the author, who can be contacted at email drkhanal@gmail.com

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# Executive Summary

Rules of origin (ROO) define a condition under which preferential access to the product of an exporting country may be granted. Under the rules, a product must satisfy the fixed originating criteria they lay out. These rules are applied to determine whether particular exported products are eligible for preferential treatment based, for example, on the generalized system of preferences (GSP) when developed countries import the products.

The objective of this study is to find out how preferential rules of origin are applied to Nepalese exports and examine the effects of rules of origin criteria in augmenting carpet, pashmina, handicrafts and tea exports from Nepal to the EU, Japan and the USA under duty free quota free (DFQF) facilities, a special category of preferential non-reciprocal trade treatment granted to least developed countries (LDCs). For implementation of these facilities, so-called “preferential” rules of origin are used. [1]

Different forms and schemes of rules of origin are used by WTO member countries to implement the Generalized System of Preferences (GSP) in general and DFQF in particular. The European Free Trade Area (EFTA), European Union (EU) and Japan use the process criterion [2] (European Union and Japan use a percentage criterion for certain products, such as processed foods, chemicals, and machinery), while those of Australia, Canada, New Zealand, and the United States use the percentage criterion.

Nepal enjoys duty free and quota free (DFQF) preferential treatment from the EU, Japan and the USA. This study assesses the impact of rules of origin criteria on the Nepalese exports of selected commodities to these countries. The commodities included in the study are carpet, pashmina, handicrafts and tea. These commodities compose Nepal’s most crucial exports. Their share in total exports in 2008/09 was about 35 percent. Their role in terms of backward and forward linkage effects in production is also significant due to spill over effects on income and employment.

The study opens with a short review of Nepal's trade policy. It finds that Nepal’s trade policy is highly liberalized. Indeed there are no non-tariff barriers applied to exports, indicating the compliance of Nepal’s trade policy with WTO multilateral trading rules.

The study continues with a brief review of rules of origin and related practices adopted by the EU, Japan and the USA. It finds that the criteria followed by these countries are not exactly the same. On the other hand, despite three quarters of Nepal’s export enjoying preferential market access, utilization is still low either because of the imposition of quotas or the strict rules of origin. Nepal is

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[1] Preferential Rules of origin are at the core of every reciprocal preferential trade agreement, bilateral or plurilateral (e.g. SAFTA). However the focus of this study are non-reciprocal (i.e. unilaterally granted) preferential rules of origin which are to be found in many special preferential schemes for LDCs.

[2] Goods, the production of which involved more than one country, shall be deemed to originate in the country where they underwent their last, substantial, economically justified processing or working in an undertaking equipped for that purpose, resulting in the manufacture of a new product or representing an important stage of manufacture. This basic concept is interpreted as process criterion, percentage criterion, or a combination of these two criteria in determining the country of origin. A detailed discussion on these and related issues is made in Chap IV.

one of the least developed countries (LDCs) deprived of the US DFQF treatment for garment exports after the expiry of the MFA. African countries, on the other hand, enjoy such advantages in the US market.

The methodology of this study focuses on using surveys of manufacturers and traders. However, the study also employs quantitative techniques using primary survey data. in the form of build-up and build-down methods to determine the qualifying level exportable commodities like carpets, pashmina, handicrafts and tea, considering the range under both criteria.

The findings of the study indicate the necessity of reforms in rule of origin criteria as well as verification procedures so as to ensure export benefits under preferential trade agreements to least developed countries like Nepal. The study also finds areas in which internal policy reforms will be required to enhance the incentive structure facing exporters.

# Chapter I: Introduction

## 1.1 Research Problem

Nepal is one of the most liberalized countries in the South Asian region. Both applied tariff rates and openness indicators corroborate this (Khanal, 2008). Despite such a liberalized trade regime, Nepal is increasingly facing the problem of diversification of trade, both in terms of partner countries and commodity diversification. More than two thirds of Nepal's trade is conducted with India. There has been no commodity diversification in trade even in the post-liberalization period that began in the early 1990s. Since 2003-4 there has been a continued deceleration in commodity exports in relation to GDP. The share of commodity exports declined to 7.29 percent of GDP in 2008-9, compared to 10.9 percent of GDP in 2003-4. During this period, exports of several products suffered. For example, jute, historically a major export industry, is on the verge of collapse. After phasing out the Multi-Fiber Agreement (MFA), the garment sector is also facing problems of survival. Ready-made garments were a major export industry, particularly to the United States. At its peak in 2001 it employed 50 thousand workers. By 2006, the number of workers employed fell to 5 thousand (UNDPRC, 2007). Other products like pashmina and woolen carpets which used to be major exports are now dwindling. Although there has been serious effort given to diversifying the export commodity structure by promoting agricultural-based exports, no major breakthrough has taken place so far (MoF, 2008). This also means that in spite of Nepal enjoying duty-free and quota-free facilities from many countries as a least developed country, it has been unable to reap the benefits.

Amidst a fragile or declining base of exports, the vulnerability of the Nepalese economy has increased in the aftermath of the global financial crisis and recession. Inflows of remittances reached about Rs 210 billion in 2008/09 (NRB, 2009). Indeed, the marked rise in remittances contributed to the development of the banking system. Remittances helped increase consumer demand which in turn pushed up imports and led to higher tariff revenue mobilization by the government given the high dependency on international trade based revenue (Khanal, 2009). The global financial crisis, however, adversely affected remittance inflows due to the decline in the outflow of migrant workers. This led to massive rise in the current account deficit and negatively impacted the balance of payments as recent data from Nepal Rastra Bank indicate. They show that both commodity and services exports were also partly affected adversely (Khanal, 2010). Thus the financial crisis and its contagion have indicated that unless production sectors are augmented through development strategies which prioritize industrialization, the vulnerability of LDCs like Nepal might increase further. However, the country's huge export potential must be harnessed as part of this drive toward industrialization. Nepal's rich biodiversity and competitive advantage in some key areas indicates such a possibility (GoN, 204). But for a country like Nepal in its early stage of development, special preferential treatment in global markets will also be crucial. For the same reason, duty free and quota free market access facilities are of special importance for Nepal. This assessment on the effectiveness of DFQF in promoting exports is critically important for Nepal in forming Nepal's position in future trade negotiations.

## 1.2 Research Questions

a. Why was there a sharp decline in Nepalese exports to countries other than India since the beginning of the $21^{st}$ century?
b. Is the utilization of duty free and quota free market access constrained by Rules of Origin and other related administrative procedures?
c. Are there differences among the US, Japan and the EU in the application of preferential rules of origin?
d. What are some possible means to ensure full utilization of DFQF market access facilities by LDCs like Nepal for increasing exports of key products like tea, carpet, pashmina and handicrafts?

## 1.3 Scope of the Study

a. Examines the overall trend of exports with a special focus on major commodity exports to countries other than India.
b. Analyzes the rules of origin applied by the USA, the EU and Japan to Nepal's exports in general and tea, carpets, pashmina and handicrafts in particular.
c. Estimates the additional cost of preferential rules of origin and related administrative procedures in tea, carpets, pashmina and handicrafts and makes a comparative assessment with non-preferential rules of origin.
d. Assesses the impact of preferential rules of origin on the export of tea, carpets, pashmina and handicrafts, and
e. Derives some useful policy recommendations from the point of view of international trade negotiations and sustainable development.

## 1.4 Structure of the Report

After this introductory chapter, chapter two is devoted to review of the literature. Chapter three concentrates on discussing the trade policies pursued by Nepal especially after 1990. In the same chapter, trends in the major commodity exports are also presented. In chapter four, various forms of rules of origin and their application to Nepal's exports are discussed with a focus on the practices of the EU, Japan and the USA. The same chapter is devoted to examining the rules of origin applied by the EU, Japan and the USA to tea, carpet, pashmina and handicraft products. In the fifth chapter, the results of the survey highlighting the perceptions of entrepreneurs and exporters of the specified products are presented. In the same chapter, the results of the quantitative analysis using the total value content approach are given. The last chapter provides conclusions and recommendations.

## 1.5 Limitations of the Study

The survey covers a limited number of entrepreneurs and exporters. Similarly, a more exhaustive comparative analysis distinguishing products enjoying duty free and quota free protections and products not having access to such preferential treatment would have been useful. In place of the build up and build down method, the use of other robust methods would have been useful in providing more extensive insights. But data unavailability and time and resource constraints prevented such a possibility.

# Chapter II: Literature Review

Rules of origin define the conditions that a product must satisfy to be deemed as originating in the country from which preferential access to the importing country is being sought i.e. they are used to determine the "nationality" of goods traded in international commerce. Rules of origin are divided into two categories: (i) rules relating to preferential treatment and (ii) those relating to non-preferential treatment. The former is divisible into rules on general preferential treatment for developing countries and those relating to regional trade agreements.

Preferential rules of origin are used for giving preferential treatment to imported goods. These rules are applied to determine whether particular products are exported from countries that are given preferential treatment based, for example, on the generalized system of preferences (GSP) when developed countries import the products. In addition, in regional groupings such as NAFTA and the European Economic Area (EEA), preferential rules of origin are used for giving preferential treatment to goods that originate in the region. In relation to preferential rules of origin, each Member is required to notify the WTO about the contents of these rules in accordance with the Agreement.

GATT Article XXIV made it possible for GATT/WTO members to use discriminatory trade policies based on formation of Free Trade Agreements (FTAs) and Customs Unions (CUs) under special conditions (specified in this Article). Use of FTAs and CUs commanded also adoption of rules of origin as an instrument to monitor and ensure that benefits are conferred to the partners targeted through such agreements. As FDI is linked to the trade flows, ROO are also seen as playing a significant role in FDI pattern.

Imports from a trade partner which are produced using materials or components from a third country will not qualify for preference unless they comply with the ROO. Countries treat imported goods differently according to their origin. When a product is wholly produced in a single country, it is automatically granted the origin of that country. But when the production process takes place in different locations or uses inputs imported from different countries, it is difficult to determine the origin of the final good. Determining preferential ROO is also crucial to avoiding trade deflection that results from imports to countries with high tariff rates trying to penetrate partner country markets with low or no tariff barriers (Nagarajan, 1998). The liberalization of services under the General Agreement for Trade in Services (GATS) revealed the importance of using ROO to determine the origin of services provided by different countries. ROO are also used to determine the nationality of firms producing traded goods. This is useful for identifying those firms that are granted certain incentives (Hoekman and Sauvé, 1994).

On the other hand, the non-preferential rules of origin are those used in non-preferential commercial policy instruments such as most favored nation tariffs, anti-dumping and countervailing duties safeguard measures, origin marking requirements, and any discriminatory quantitative restrictions or tariff quotas. The non-preferential rules also include those used for government procurement and trade statistics.

Conceptually, there are two basic criteria to determine origin. The criterion of “wholly obtained or produced”, where only one country enters into consideration in attributing origin; and the criterion of "substantial transformation", where two or more countries have taken part in the production process. The first criterion applies mainly to commodities and related products which have been entirely grown, extracted from the soil or harvested within the country, or manufactured there from any of these products. Such products acquire origin by virtue of the total absence of the use of any second country components or materials. Even a minimal content of imported components will imply losing its qualification of "wholly produced". Most countries have adopted the above definition contained in the Kyoto convention. The "substantial transformation" criterion is the second concept recognized by the Kyoto Convention as a basis on which origin of goods may be determined. The Kyoto Convention does not offer a single approach for defining substantial transformation.

Preferential ROO play a major role in the new trading system and are an integral part of all trade agreements. The PTAs established under Article XXIV of GATT were associated with the adoption of trade differentiating policies; as a result, preferential ROO have become an important instrument used to monitor and ensure that benefits are confined to the targeted partners. They are also considered a powerful tool that determines the direction of Foreign Direct Investment (FDI) and trade flows.

Thus, multilateral agreements on trade in goods under the World Trade Organization (WTO) system have an agreed framework in which Most Favored Nation (MFN) treatment and national treating are the most important principles. In the WTO system, the MFN principle says that a member country may not discriminate against goods from different trading partners by imposing differential tariff rates. There are two major areas of exceptions to the MFN clause: first, when offering preferences in bilateral or regional trade agreements, and second, on imports from developing countries (ITC/CS, 1999). Preferential offers in bilateral or regional trade agreements are reciprocal in nature, which means all parties to the agreement provide different trade preferences to one another that are superior to MFN preferences applied to other countries outside such an agreement. But preferences offered for developing countries are non-reciprocal in nature. Non-reciprocity signifies that developing countries do not need to provide any preferences in return to the developed country that is offering these trade preferences (Gillies and Moens, 1998).

Preferential rules of origin have been under consideration by the WTO since the introduction of the duty-free, quota-free (DFQF) initiative in the 1996 Singapore Ministerial Declaration. The function of rules of origin referring to provisions for duty-free quota-free market access for Least-Developed Countries (LDCs) is to reduce trade diversion and trade deflection to a minimum, which may be achieved by having rules of origin which are simple and transparent. Generally, rules of origin eliminate opportunities for trade deflection, as non-beneficiary countries cannot transship their products to preference-giving countries through preference-receiving countries in order to evade the tariff. Stringent rules of origin also ensure that substantial processing occurs in preference-receiving countries so that products from non-beneficiary countries do not enjoy the main benefits of tariff reduction due to the mere processing of a considerable amount of imported products in a beneficiary country (Productivity Commission, 2004). It is also argued that domestic content requirement rules of origin can protect intermediate good industries of LDCs from import competition (Grossman, 1981). But LDCs may not be able to take advantage of preferential market access provisions if the rules of origin associated with the preference scheme are so strict as to preclude trade taking place.

Despite some studies indicating that preferential as well as non-preferential rules of origin are sometimes used as neutral tools of trade (Harilal and Beena, 2003), there is enough evidence that they are widely used as trade barriers, designed specifically to protect domestic producers (James 1997). Developed countries often use rules of origin for developmental purposes which in some cases act as non-tariff barriers. The North American Free Trade Agreement (NAFTA) is a case in point, wherein for the automobile sector different percentages of the regional value content were laid down for various phases. For instance, 56 percent between 1998 and 2002 and 62.5 percent thereafter were fixed as value content for some categories of motor vehicles *(*Das, 2004).

Stricter rules of origin lower the possibility of net trade creation. Higher the compliance cost of rules of origin, lower will be the incidence of such trade creating impulses. In fact, because of high compliance costs, efficient producers within the FTA might even choose not to claim the privilege of preferential tariffs. Higher compliance costs would limit the FTA's ability to reach potential levels of trade creation. Strict regimes of rules of origin might also add to the trade diversion effects of the FTA (Harilal and Beena, 2003). According to Hoekman (1993) such Rules of Origin regimes – especially in the form of local content requirements – could lead to cascades of protection along the production chain. For resource-constrained countries like Nepal**,** such rules of origin will probably not be favorable because most raw materials are imported from abroad and then processed for export. Preferential rules of origin, therefore do not allow trade in such finished goods. So, this kind of agreement is not considered an effective promoter of development and trade for least developed countries.

There is evidence from different studies that in many cases most significant export items of LDCs have been subject to restrictive rules of origin by developed countries to such extent that often those products can not benefit from trade preferences. Studies show that developed countries try to protect some sensitive domestic industries in the guise of using rules of origin. In the context of non-reciprocal trade preferences for LDCs, Hoekman (2005) criticizes the criteria of trade preference schemes in the US and the EU. He identifies rules of origin as an obstacle that reduces the value of trade preference, as associated administrative requirements and red tape result in the reduction of investment in spite of trade preferences. Productivity Commission (2004) found empirical evidence that rules of origin have a 'major independent impact on trade and market access', as it 'reduces the utilization of available preferences under' preferential trade schemes and diverts 'resources from their most efficient uses. Moreover, the inconsistent nature of rules of origin across the different non-reciprocal trade preference schemes of developed counties has been observed by Hoekman et al. (2005) as a barrier to making decisions to building industries supportive of the export sector. Beneficiary countries might get preference under the particular rules of origin of one country, which would not be possible in the case of a different set of rules of origin in another developed country due to the absence of industries supportive of the export sector. Complex rules of origin requirements in developed countries' trade preference schemes hinder the advantages of exporters from LDCs by increasing their costs, as such requirements enforce the additional costs of sourcing inputs and designing production structures to ensure compatibility with the rules of origin. Brenton and Ikezuki, 2005 list these as "the costs of demonstrating conformity with the rules, in terms of documentation, accounting, and obtaining the relevant certificate." Brenton (2005) observes that despite its offering of duty- and quota-free access to LDCs' products, the EU scheme has very restrictive and complex product-specific rules of origin applied to identify the originality of products from LDCs. This leads to low exploitation rates of preferences by beneficiary countries as these countries divert their exports to countries where rules of origin are less restrictive.

Studies by Brenton and Manchin (2003) and Brenton (2003) have found that, LDCs under the non-reciprocal trade preference scheme of the EU prefer to pay MFN tariff to avoid the compliance cost associated with using preferential tariffs. Brenton (2003) shows that out of the total eligible preferential access to Africa, Caribbean and Pacific countries, only 50 percent of EU imports come from the preferential route. He adds that to obtain the anticipated welfare from preferential trade, simple, consistent, predictable, non-varying and non-protectionist rules of origin are required. Lloyd (2003) proposes that products from developing countries should get tariff preference in developed countries if substantial value added in production is added by producers of developing countries by using inputs from developing countries. In a study, Brenton (2005) argues that a value-added rules of origin requirement reduced from the present requirement of 40 to 50 percent to as low as 10 percent might be simpler, more transparent and easier to manage by authorities in the preference-giving countries.

A review of the studies by Nhara (2006) shows that the cost needed to comply with administrative requirements of preferential rules of origin in developed countries could be up to 3 percent of the value of the goods concerned. The same review shows that in highly competitive sectors with small profit margins, this may be sufficient to offset any advantages from the preferential margins. Studies also indicate that obstruction through rules of origin to utilize most competitive inputs would have higher economic cost in LDC countries (Mold, 2005).

Similarly a UNCTAD study (2003) shows that the benefits of the African Growth and Opportunity Act (AGOA) passed in 2000 by the US Congress would be about five times greater if exporting countries were not subject to the restrictive rules of origin imposed by the United States. Such obstructions are in addition to many other non-tariff barriers.

A study by Cadot, Maleo and Perez (2006) on the implications for the ASEAN free trade area of the EU and US experiences shows that should free trade agreements (FTAs) of ASEAN follow in the footsteps of the EU and US and adopt similar rules of origin, trading partners in the region would incur unnecessary costs. The study finds that depending on the sample used, a 10 percentage point reduction in the local value content is estimated to increase the utilization rate of preferences by between 52.5 to 58.2 percent if the initial utilization rate is 50 percent.

In the case of non-reciprocal PTAs such as the GSP, which is meant to promote exports from developing country or LDC beneficiaries, higher the compliance cost of rules of origin, the lower would be the utilization of the tariff margin by the beneficiaries. Many studies on GSP schemes have pointed out the restrictive role played by the rules of origin (Brenton and Manchin 2003, Inama 1995). In many affirmative preferential arrangements, poor countries, who are meant to be helped, find it extremely difficult to meet the origin requirements (Harilal and Beena, 2003). Since most LDCs do not have their own highly developed industries, and their imports constitute the bulk of their value addition in LDCs' exports, they find it difficult to fulfill the stringent ROO requirements. This results in the failure of LDCs to utilize the preferential market access granted them.

During the South Asian Preferential Trading Arrangement (SAPTA) negotiations, member countries were concerned about the possibility of ROOs working as obstacles to intra-regional trade flows. It was felt that diluted origin-rules facilitate intraregional trade, as the lack of adequate natural resources as well as intermediate and capital goods makes these economies importdependent, in turn preventing them from meeting the local-content requirements of the ROO system. (Das, 2004). Moreover, preferential market access, though a short term solution, cannot be considered a panacea, not least because they are likely to be eroded. Firstly, the reduction in MFN tariffs could result from the ongoing industrial tariffs negotiations at the WTO. Secondly, due to a spate of bilateral and regional trade agreements the EU and the USA have been signing with several developing countries, more favorable market access terms are available to the countries signing such agreements with these economic superpowers at the cost of conventional preference-receiving countries (Adhikari, 2005).

The differences in preferential arrangements from one FTA to another create complication and inefficiency for the business sector since manufacturers in an exporting country must adjust their production operations to different sets of arrangements in order to benefit from tariff preferences under those FTAs. [3]

Nepal's excessive reliance on three export markets –India, Germany and United States –has made the country's trade extremely vulnerable. India has long been Nepal's major trading partner and that trade is governed by preferential arrangement. At the same time, an open border and the free exchange of Indian currency in the Nepalese market contributes to this reliance. Similarly, the garment quota provided by the US also encouraged exports from Nepal, as well as a gradual increase in exports of other products. Germany was a major importer of carpets from Nepal which made Germany another one of the major export destinations.

When compared to other LDC apparel-exporting countries, Nepal is probably the only country to have experienced an immediate impact resulting from the termination of the MFA quota system in the form of a severe drop in its exports to the United States[4] There were many domestic factors responsible for Nepal's export breakdown. The external factors were much more dominant compared to domestic factors (Shrestha, 2009). There was no specific in-depth effort during the accession negotiations of Cambodia or Nepal to assess the very complex costs faced by these countries. Particularly, Nepal's landlocked position and related cost-escalating effects on trade were not properly looked into (Sauvé, 2005).

Nepal's 2006 MFN duty‐free exports (overall) were just 9.8 percent of the total exports to the world, much lower than the regional (26.4 percent) and low‐income group (44.6 percent) averages[5] Though the exports of apparel especially garments to the US have declined, the situation has reversed in the case of the other Quad countries[6], where exports have increased modestly between 2000/01 and the first 10 months of 2005/06. The increase in exports to Quad [7]countries

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[3] From the proceedings of a four day workshop on preferential rules of origin for SAARC held in Colombo on 23-26 February, 2009 for senior trade officials of SAARC member countries. It was organized by ADBI in collaboration with the Office of Regional Economic Integration (OREI), ADB headquarters, Manila; ADB Sri Lanka Resident Mission (SLRM), Colombo; United Nations Conference on Trade and Development (UNCTAD), Geneva; ASEAN Secretariat, Jakarta; and Ministry of Finance, Government of Japan. (See: http://www.adbi.org/event/2798.workshop.preferential.roo.saarc/)

[4] See: www.unescap.org/tid/publication/tipub2500_pt2chap7.pdf.
[5] See :http://info.worldbank.org/etools/wti2008/docs/brief135.pdf.
[6]EU, Canada and Japan
[7] US, EU, Canada and Japan

other than the United States is probably due to preferential market access granted by those countries to Nepal under their GSP schemes. However, one of the reasons for the decline in Nepal's share in the United States market has been attributed to the absence of equal opportunity in the American market, as Nepal's garment products do not enjoy United States preferential market access. The Canadian and Japanese preferential schemes are also valuable to Nepalese apparel exporters, as both initiatives have granted duty-free and quota-free status to clothing, with relatively flexible rules of origin requirements[8] In addition, Nepal has lost its level playing field after the US provided duty free access to the clothing made in poor sub-Saharan countries under the AGOA Bill (Shakya, 2005).

A study by the South Asia Watch on Trade, Economics and Environment (SWATEE) and Action Aid Nepal (2007) also concluded that EU rules of origin imply that apparel exports to EU from Nepal cannot fully benefit from the market access facilities provided. For example, in 2003 preferential trade in women and girls' cotton blouses and shirts was 68.7 percent and women's trousers and breeches was 69.4 percent. This means that despite Nepal enjoying duty-free and quota free facilities from many countries as being one of the least developed countries, Nepal has been unable to reap the benefits of the facilities.

The strategy for the US market should be intensified lobbying for duty-free market access to offset the high prices of duty advantages, as Nepali exports face high average tariffs in the United States. For the European and Canadian markets, which offer duty-free access to Nepali garments, the strategy should be to lobby for a continuation of the favorable rules of origin (Dahal, 2006). Besides, access to the EU market requires that Nepalese companies work on a market entry strategy. An aspect that needs cautious attention is the fact that the European Market is differentiated, with specific demand and supply needs varying from one European country to the next (SPACHIS, 2009).[9]

Amidst a fragile or declining base of exports, the vulnerability of the Nepalese economy has indeed increased in the aftermath of the global financial crisis and recession. For instance, more than 250 hand-knotted woolen carpet firms have closed their operations in the aftermath of global financial crisis of 2008/09. Therefore, unless Nepal harnesses its huge export potential by ensuring duty free and quota free market access in developed countries without hurdles such as rules of origin and related administrative barriers, it will be extremely difficult to minimize its growing economic vulnerability and enhance inclusive and sustainable development.

A brief review on the concept of rules of the origin indicates that they are associated with preferential treatment to imported goods. These rules are applied to determine whether particular products exported from countries under preferential market access have fulfilled the set criteria or not. Many studies carried out indicate that despite preferential market access facilities provided by the developed countries, LDCs have been unable to reap the expected benefits. As various studies indicate, obstructions created through different means have been especially responsible for this. Limited studies carried out in the Nepalese context also indicate such a possibility. This underscores on the necessity of in-depth study in this area in the Nepalese context.

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[8] See: www.unescap.org/tid/publication/tipub2500_pt2chap7.pdf.
[9] Based on Seminar/Workshop on Pursuit of Economic Diplomacy: Prospects and Problems , organized by Association of Former Career Ambassadors of Nepal

# Chapter III: Trade Policies and Trends in Major Commodity Exports

## 3.1 An Overview of Trade Policy of Nepal

Wide-ranging policy and economic reforms coincided with democratic change in Nepal in 1990. Starting from a largely controlled regime, Nepal moved fast toward a more open and liberal economic regime. The content and sequence of reforms was guided by the IMF's ESAF program which Nepal introduced in 1992[10].

Nepal's reform began with an attempt to synchronize policies with India given the open border and their especially strong trade relations. Following a step by step approach, the Nepali rupee was made fully convertible against the current account in February 1993. The Foreign Exchange Regulation Act of 1962 has been amended twice: in 1992 and 2002. However, one of the unique features of the exchange rate system is that Nepal has adopted a pegged exchange rate system with the Indian currency. Hence, the movement of the Indian currency's exchange rate with other convertible currencies affects the exchange rate of the Nepali rupee with these currencies.

At the same time, steps have been taken to continuously bring drastic reforms in tariff structure through a two pronged approach. Not only was there a drastic reduction in tariff rates, but equal priority has also been given to rationalizing tariff structure to reduce the disparity in rates. The peak tariff rate has been reduced to 80 percent now from as high as 300 percent a few years ago. Along with lowering tariff rates, the number of schedules has also been substantially reduced: from more than 100 rates (categories) before reform to 13 in 1992/93 and further down to 5 in 2001/2002. Minor changes have often been made thereafter. Some additional duties charged on third country' imports have been fully abolished.

An additional feature of Nepal's tariff structure is preferential treatment for imports from India. The un-weighted average tariff rate in 1990 for imports from India was substantially less than half of the MFN rate, at 14.1 percent as compared with 39.8 percent. This reflects a reduction in the preference for Indian imports since 1990 (GoN, 2004).

Nepal's trade with India and accompanying trade facility, concessions or rebates are governed by the trade treaties between Nepal and India. It is worth noting that unlike the past treaties, the 1996 treaty was a landmark from the point of view of facilitating more liberal trade with India and promoting Nepal's exports to that country. Under this treaty, the provision of value addition was removed and was replaced by a system that required a certificate of origin issued by the Federation of Nepalese Chamber of Commerce and Industries (FNCCI). Similarly, the negative list was substantially reduced to include only such items as alcoholic liquors, beverages and their concentrates, perfume and cosmetics and Non-Nepalese/Non-Indian brand cigarettes and tobaccos. The non-reciprocity market facility for Nepalese manufacturing products was most progressive clause included in the treaty. However, the Nepal – India trade treaty renewed in 2002 and 2009

10 For the details see Khanal et al (2005).

has many regressive clauses in which both quantitative restrictions and value added clauses are reintroduced. Through quantitative restrictions, quotas have been imposed on Nepal's export of vegetable ghee, acrylic yarn, copper and zinc oxide. The renewed treaty also made Nepalese exports to India subject to countervailing duties to make prices of Nepalese exports comparable with their Indian counterparts.

Apart from the above, a 10 percent rebate of the customs duty is available for imports from China that enter Nepal through Tibet. This also does not include goods for which specific duties apply. There are evidently preferential rates available for qualifying imports from SAARC member states. This is done through the 10 percent concession on basic duties applicable for all countries. With the implementation of SAFTA from 2006 a process of further liberalizing tariff structure to promote free trade with the SAARC countries is continuing.

Since 2005 after joining WTO in 2004, gradual reduction in the levies and charges has been started in a way to fulfil WTO obligations[11] as these discriminate against foreign trade similar to general tariffs. They are not levied on domestic production.

On the other hand, there is no major tax on exports. The export levies have been reduced to 2, 1.0 and 0.5 percent from the fiscal year 2004/05. The export service charge has been fully eliminated. Similarly the value added tax on exports is levied at zero percent. . In order to release exports from burden of duties, the export duty drawback system has been in operation since 1987. The bonded warehouse scheme introduced in October 1988 under which certain industries are entitled to get back funds paid in the form of taxes on imported raw materials is being continued.. For promoting exports, establishments of export-processing zone are also planned. There are virtually no export related policies that could distort export trade. There is no subsidy for exports. Similarly, no other special support measures contradicting WTO rules are in place (SAWTEE, 2005).

On the whole, there has been a nearly complete dismantling of quantitative restrictions on trade in Nepal (World Bank, 2004). However, there are some serious problems in the existing tariff system. It encourages a cascading tariff system as a result of non-uniform rates and bands which are imposed depending upon the stage of production of the good or its degree of fabrication. This means that the highest rates are levied on final goods, lower rates applied to intermediate goods and the lowest rates to raw materials and capital goods. Such a tariff system is detrimental from the point of view of encouraging production and trading of high value added products that also could generate more employment opportunities (GoN, 2004). Such a tariff structure is also harmful from the standpoint of promoting forward and backward linkages within industries that use domestic resources (Khanal et al, 2005).

## 3.2 Total Trade and Related Trends

In 1999/2000, Nepal's total commodity exports were in the order of Rs. 49.82 billion. They reached Rs 67.70 million in 2008/09, hardly increasing by 36 percent in entire nine years period. During this period, exports to India almost doubled. But exports to other countries indeed declined over time and declined to Rs 26.70 billion in 2008/09 from Rs 28.6 billion in 1999/2000. In terms of

11 The special charges of 0.5 percent imposed on imports have been abolished. Similarly, the development levy on agriculture commodities has been reduced from 10 percent to 8 percent (MOF, 2005).

export share to India and other countries, a significant change took place during the same period. The share of exports in total trade was 31.5 percent in 1999/2000 and it declined to 19.2 percent in 2008/09. As a result, a phenomenal rise in trade imbalances is taking place in Nepal. During this nine year period, the trade deficit increased 3.7 times. The trade imbalance with India has been a cause of particular concern. It went up almost 6.6 fold during the period 1999/2000 to 2008/09 (Appendix I).

## 3.3 Major Commodity Exports to India and Other Countries

A closer review on the composition of the export shows that in 2000, pulses (4.6 percent), jute goods (5.2 percent), tooth paste (10.7 percent), polyester yarn (3.0 percent), medicine (2.4 percent), soap (5.1 percent), vegetable ghee (12.9 percent), pashmina (16.7 percent), thread (5.5 percent), copper wire rod (3 percent), pipe (2 percent) and plastic utensils (1.4 percent) were Nepal's major exports to India. Miscellaneous categories consisted of around 18.3 percent of total exports to India. Thus, of the major exports, pashmina was the principle export, followed by vegetable ghee and tooth paste. In 2009, the composition of major exports changed slightly. The share of jute goods and tooth paste declined to 3.1 percent and 2 percent respectively. Almost zero exports of vegetable ghee were recorded in 2009. Similarly, the export share of pashmina was reduced to almost nothing in 2009. On the other hand, the export share of zinc sheet, GI pipe, textiles and juice steadily increased to reach 6.9, 2.7, 7.8 and 4.8 percent respectively in 2009, from 0.3, 0.7, 0.7 and 1.1 percent respectively in 2000. Similarly, the share of miscellaneous exports increased substantially to reach 38.5 percent by 2009. The revised treaty with India in 1996 which imposed restrictions on exports of products like vegetable ghee had some adverse impacts on exports to India, resulting in some change in export patterns (See Appendix II).

**Figure 1.1 Major Commodities Exports to India in FY 2000**

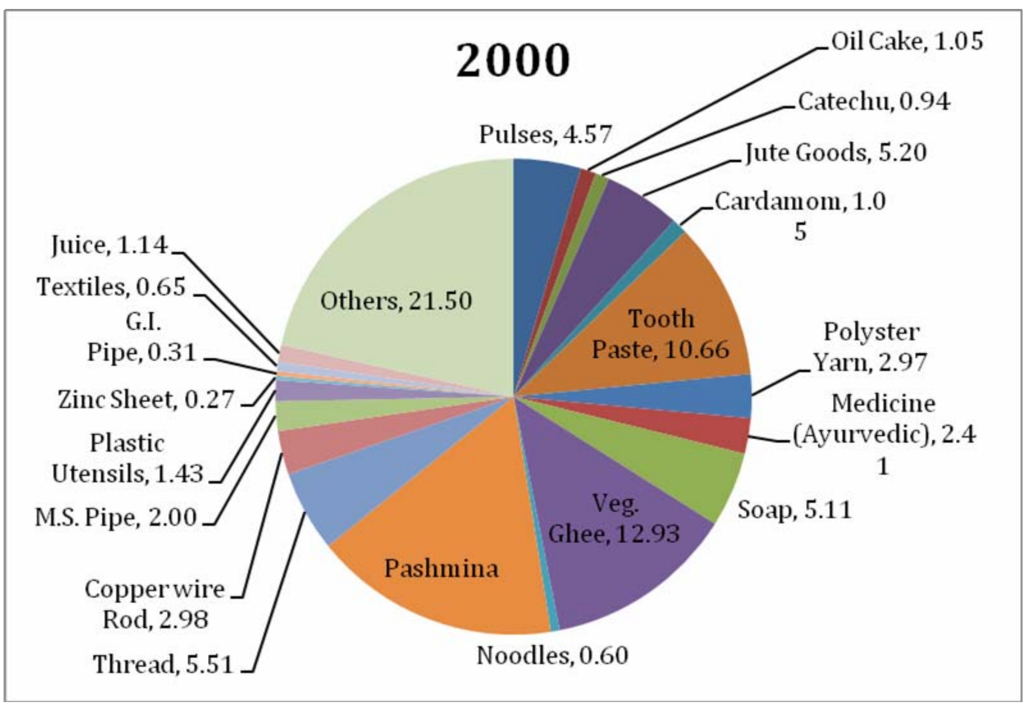
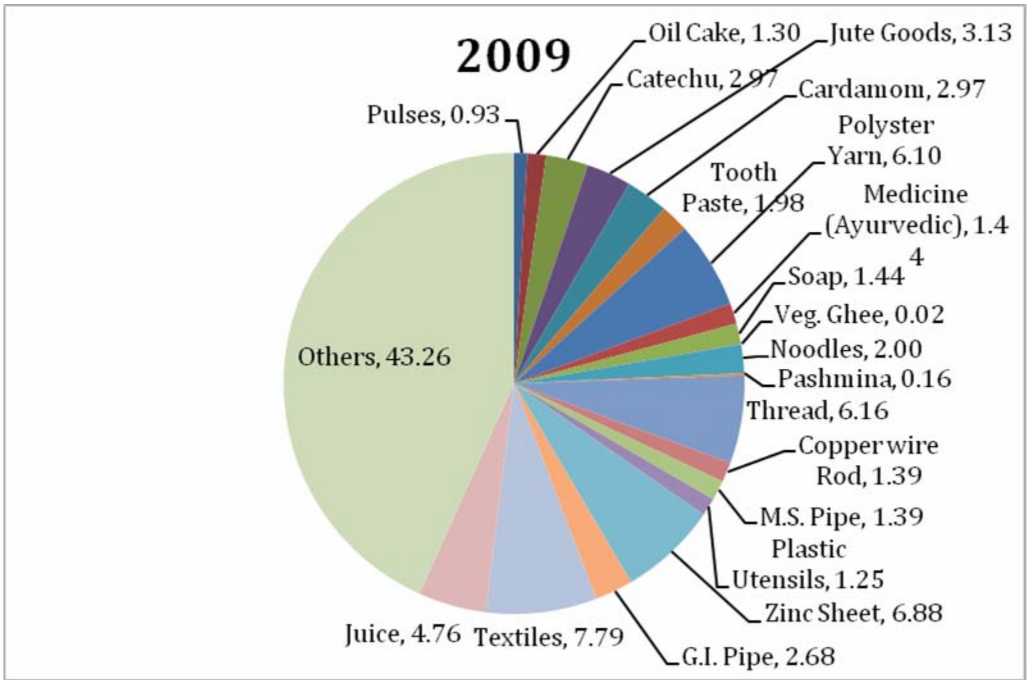
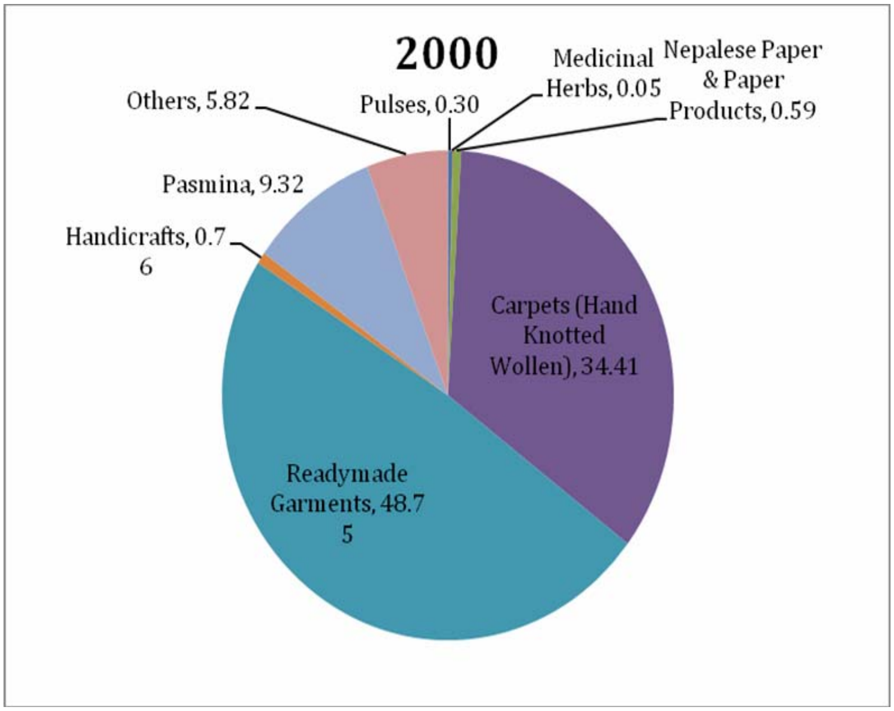


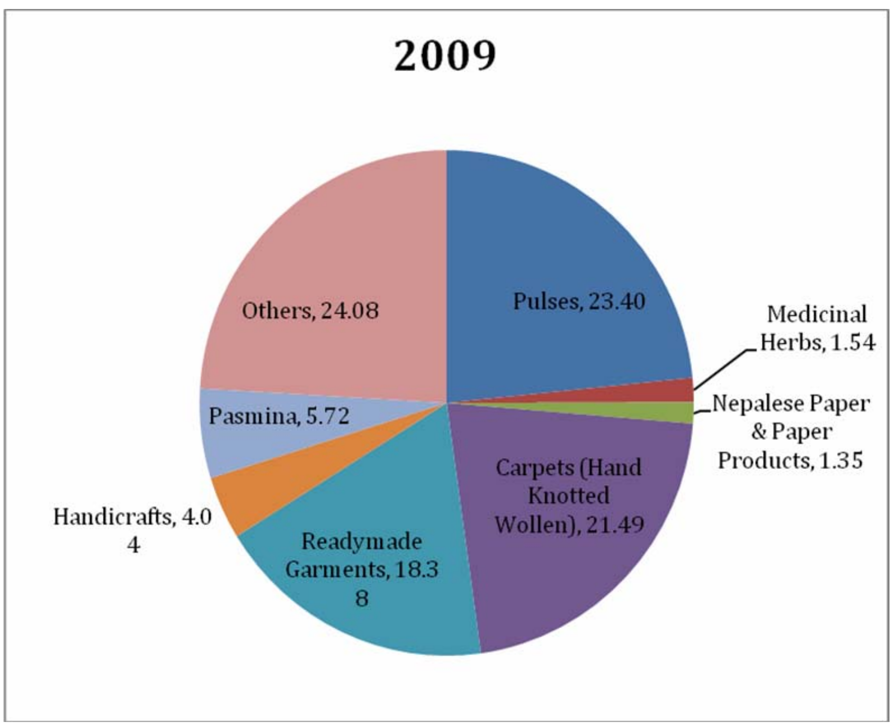
**Figure 1.2 Major Commodities Export to India in 2009**




Only few commodities are exported to countries other than India. In 2000, readymade garments were the single largest exportable commodity, and their whole share was as much as 48.75 percent of total exports. This was followed by carpets (34.41 percent) and pashmina (9.32 percent). In 2009, a big compositional shift took place along with a drastic reduction in total exports to other countries. In 2009, pulses emerged as the major export product with 23.40 percent share in total. This was followed by carpets (21.49 percent) and readymade garments (18.38 percent). The share of miscellaneous categories in total exports also jumped up to 22.56 percent in 2009 from 4.37 percent in 2000. With the phasing out of quotas for garments, the garment industry is in the verge of collapse, pervasively negatively impacting total exports. Carpets, which were previously heavily demanded by Europe, are now facing big market problems, especially in Germany. Market problems are now also being faced by pashmina as well, partly due to copying of trademarks by other countries and partly due to the absence of an enabling environment for the industry. Although, export of pulses has increased, the increase is not sustainable (See Appendix III).

**Figure 2: Major Commodities Exports to Third Countries in 2000 and 2009**



## 3.4 Trends in Exports of Tea, Carpet, Pashmina and Handicrafts in EU, Japan and USA[12] add some graphs

The trends in major exports aggregated by overseas countries (as destinations) also indicate that along with wider fluctuations, the share of carpet exports to the EU has drastically declined, from 70.6 percent in 2003 to 49.3 percent in 2008. Indeed, such a reduced share has been partly compensated for by the increase in exports to the USA, which has gone up to 40.9 percent from 23.2 percent during the same period. This was due to rise in carpet exports despite a lack of preferences for garment products in the aftermath of phase out of MFA status. The export of carpets to Japan has remained insignificant throughout the period under consideration.

In the case of pashmina, the total value at current prices has increased slightly during the period 2003 to 2008. Although the EU's share has remained high, there have been wider fluctuations. The share of pashmina exports to Japan has been reduced continuously, from 11.8 percent in 2003 to 3 percent in 2008. The share of pashmina exports to the USA jumped to almost 30.7 percent and 30.6 percent in 2007 and 2008 respectively, up from 19.7 percent in 2003. Trends in the export of tea are also in flux, with deceleration in recent years. The EU has been the major market for tea, with the EU's export share reaching 68.6 percent in 2005. There was a downward trend in 2006, but it picked back up in 2008. The export share of Japan has remained quite low, suggesting a stagnating trend.. With respect to the US, there has been great fluctuation, with the export share reaching at 9.9 percent in 2008 from as low as 1.5 percent in 2006. This share was 13 percent in 2003. Total exports of handicrafts reached a high in 2006 from 2003. But handicraft exports declined in both 2007 and 2008. Exports to Japan have remained relatively low and constant whereas the export share to the EU has remained high, with large variations from one year to another. Handicraft exports to US are also relatively high at 25.4 percent in 2008.

The wide fluctuation in exports of the individual products under consideration amidst decline in the level of exports underscores the necessity of closer investigation of the role of rules of origin in augmenting or constraining exports in the context of duty free and quota free facilities granted by the EU, Japan and the USA.

[12] Trade Promotion Centre figures vary from the Central Bank figures. They give information on exports by specific countries. For these reasons data of Trade Promotion Centre have been used here.

## Table 3.1: Trends of Carpet Export of Nepal 2004-2008

| | **Values in million NRs** | | | | | | **Growth Rate** | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2004** | **2005** | **2006** | **2007** | **2008** |
| Total | 5333.06 | 5549.71 | 5996.92 | 5916.06 | 5303.24 | 5578.86 | 4.1 | 8.1 | -1.3 | -10.4 | 5.2 |
| Japan | 31.95 | 49.59 | 25.67 | 38.26 | 89.90 | 21.55 | 55.2 | -48.2 | 49.0 | 135.0 | -76.0 |
| EU | 3766.51 | 3558.20 | 3633.55 | 3202.04 | 3055.81 | 2752.18 | -5.5 | 2.1 | -11.9 | -4.6 | -9.9 |
| USA | 1237.18 | 1360.74 | 1825.95 | 2126.88 | 1639.83 | 2282.78 | 10.0 | 34.2 | 16.5 | -22.9 | 39.2 |
| Sub-total | 5035.64 | 4968.53 | 5485.17 | 5367.18 | 4785.54 | 5056.51 | -1.3 | 10.4 | -2.2 | -10.8 | 5.7 |
| **Share in Total** | | | | | | | | | | | |
| Japan | 0.6 | 0.9 | 0.4 | 0.6 | 1.7 | 0.4 | | | | | |
| EU | 70.6 | 64.1 | 60.6 | 54.1 | 57.6 | 49.3 | | | | | |
| USA | 23.2 | 24.5 | 30.4 | 36.0 | 30.9 | 40.9 | | | | | |
| Sub-total | 94.4 | 89.5 | 91.5 | 90.7 | 90.2 | 90.6 | | | | | |

***Source: Nepal Overseas Trade Statistics (Various Issues), Trade Promotion Centre, GoN.***

## Table 3.2: Trends in Pashmina Exports 2003-2008

| | **Values in million NRs** | | | | | | **Growth Rate** | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2004** | **2005** | **2006** | **2007** | **2008** |
| Total | 1077.07 | 1085.53 | 1042.47 | 1106.53 | 1116.71 | 1206.35 | 0.8 | -4.0 | 6.1 | 0.9 | 8.0 |
| Japan | 127.42 | 67.34 | 67.30 | 86.61 | 67.12 | 35.65 | -47.1 | -0.1 | 28.7 | -22.5 | -46.9 |
| EU | 552.50 | 537.17 | 533.86 | 544.54 | 433.49 | 586.41 | -2.8 | -0.6 | 2.0 | -20.4 | 35.3 |
| USA | 212.28 | 231.56 | 220.64 | 234.66 | 341.23 | 332.46 | 9.1 | -4.7 | 6.4 | 45.4 | -2.6 |
| Sub-total | 892.20 | 836.07 | 821.79 | 865.81 | 841.83 | 954.52 | -6.3 | -1.7 | 5.4 | -2.8 | 13.4 |
| **Share in Total** | | | | | | | | | | | |
| Japan | 11.8 | 6.2 | 6.5 | 7.8 | 6.0 | 3.0 | | | | | |
| EU | 51.3 | 49.5 | 51.2 | 49.2 | 38.8 | 48.6 | | | | | |
| USA | 19.7 | 21.3 | 21.2 | 21.2 | 30.6 | 27.6 | | | | | |
| Sub-total | 82.8 | 77.0 | 78.8 | 78.2 | 75.4 | 79.1 | | | | | |

***Source: Nepal Overseas Trade Statistics (Various Issues), Trade Promotion Centre, GoN.***

### Table 3.3: Trends in Tea Exports 2003-2008

| | Values in million NRs | | | | | | Growth Rate | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2004** | **2005** | **2006** | **2007** | **2008** |
| Total | 56.32 | 121.82 | 120.73 | 99.74 | 123.64 | 58.05 | 116.3 | -0.9 | -17.4 | 24.0 | -53.1 |
| EU | 30.92 | 19.07 | 65.56 | 34.04 | 34.37 | 37.67 | -38.3 | 243.8 | -48.1 | 1.0 | 9.6 |
| Japan | 3.42 | 3.51 | 2.55 | 2.63 | 2.89 | 1.94 | 2.8 | -27.3 | 3.0 | 10.0 | -32.8 |
| USA | 6.99 | 2.74 | 6.37 | 1.46 | 13.67 | 5.76 | -60.8 | 132.5 | -77.1 | 835.4 | -57.8 |
| Sub-total | 41.33 | 25.32 | 74.49 | 38.13 | 50.93 | 45.37 | -38.7 | 194.1 | -48.8 | 33.6 | -10.9 |
| **Share in Total** | | | | | | | | | | | |
| Japan | 6.1 | 2.9 | 2.1 | 2.6 | 2.3 | 3.3 | | | | | |
| EU | 54.9 | 15.7 | 54.3 | 34.1 | 27.8 | 64.9 | | | | | |
| USA | 12.4 | 2.2 | 5.3 | 1.5 | 11.1 | 9.9 | | | | | |
| Sub-total | 73.4 | 20.8 | 61.7 | 38.2 | 41.2 | 78.2 | | | | | |

***Source: Nepal Overseas Trade Statistics (Various Issues), Trade Promotion Centre, GoN.***

### Table 3.4: Trends in Handicraft Exports 2003-2008

| | Values in million NRs | | | | | | Growth Rate | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2004** | **2005** | **2006** | **2007** | **2008** |
| Total | 416.52 | 650.37 | 643.13 | 699.72 | 421.49 | 347.15 | 56.1 | -1.1 | 8.8 | -39.8 | -17.6 |
| Japan | 29.22 | 29.09 | 42.88 | 22.16 | 24.70 | 18.01 | -0.5 | 47.4 | -48.3 | 11.4 | -27.1 |
| EU | 144.67 | 148.16 | 182.04 | 277.90 | 155.47 | 110.74 | 2.4 | 22.9 | 52.7 | -44.1 | -28.8 |
| USA | 113.15 | 131.90 | 127.01 | 149.24 | 81.57 | 88.01 | 16.6 | -3.7 | 17.5 | -45.3 | 7.9 |
| Sub-total | 287.05 | 309.16 | 351.93 | 449.32 | 261.746 | 216.765 | | | | | |
| **Share in Total** | | | | | | | | | | | |
| Japan | 7.0 | 4.5 | 6.7 | 3.2 | 5.9 | 5.2 | | | | | |
| EU | 34.7 | 22.8 | 28.3 | 39.7 | 36.9 | 31.9 | | | | | |
| USA | 27.2 | 20.3 | 19.7 | 21.3 | 19.4 | 25.4 | | | | | |
| Sub-total | 68.9 | 47.5 | 54.7 | 64.2 | 62.1 | 62.4 | | | | | |

***Source: Nepal Overseas Trade Statistics (Various Issues), Trade Promotion Centre, GoN.***

# Chapter IV: Rules of Origin and Their Application to Nepal's Export

## 4.1. Generalized System of Preferences (GSP)

The GSP is a unilateral tariff preference scheme offered by developed countries for eligible products originating in designated developing countries. The GSP rules of origin have played a key role in implementing GSP schemes for more than 35 years (UNCTAD, 1999). After the 35-year operation of the GSP system, the basic structure of rules of origin remains the same (UNCTAD, 1970). The main elements are presented in box 1.

However, GSP rules of origin differ substantially from one scheme to another. For example, the GSP schemes of the European Free Trade Area (EFTA), European Union and Japan use process criteria (The European Union and Japan use a percentage criterion for certain products, such as processed foods, chemicals, and machinery), while those of Australia, Canada, New Zealand, and the United States use the percentage criteria. Each scheme uses different definitions and requirements, as can be seen in box 2.

Box 1. Main elements in GSP rules of origin

a) Origin criteria
(i) List of wholly produced goods
(ii) List of minimal processes that do not confer country-of-origin states
(iii) Process criterion
(iv) Percentage criterion

(b)Direct consignment

(c)Documentary evidence

(i) Combined declaration and certificate of origin
(ii) Consignment of small value
(iii) Verification of form A
(iv) Exhibition and fairs

(d)Sanctions

(e)Mutual cooperation between preference-giving and preference-receiving countries

(f)Special facilities in favor of preference-receiving countries

(i) Cumulative rules of origin (cumulation)

(ii) Donor country content rule

Source: United Nations Conference on Trade and Development (1970), Report of the Third Working Group on GSP Rules of Origin, Special Committee on Preferences, TD/B/AC.

Box 2. Some important GSP rules of origin

1. European Union
Goods, the production of which involved more than one country, shall be deemed to originate in the country where they underwent their last, substantial, economically justified processing or working in an undertaking equipped for that purpose, resulting in the manufacture of a new product or representing an important stage of manufacture. This basic concept is interpreted as process criterion, percentage criterion, or a combination of these two criteria in determining the country of origin.

2. Japan
The country-of-origin status is given to the country where the last substantial process or operation resulting in the manufacture of new characteristics took place. Japan has a shortlist of product-specific rules on selected products.

3. United States
In the case of GSP rules of origin, the United States applies the percentage criterion. The cost or value of materials produced in the preference-receiving country and the cost or value of any article incorporated in the eligible article that has resulted from substantial transformation of any imported materials into a new and different article of commerce, plus the direct cost of processing operations performed in the preference-receiving country must not be less than 35 per cent of the appraised value of the merchandise in the United States. In short, a minimum 35 per cent local content rule is observed.

Source: Ujiie (2006).

Over the course of last four decades, developed nations offered several GSP schemes, with those sponsored by the United States and the European Union playing more significant roles. The available literature indicates that, in general, the GSP schemes had been less advantageous for recipient countries than they were touted to be at their inception and were more advantageous, sometimes advantageous exclusively for a particular class of countries and products. The GSP schemes were largely directed more at advanced developing countries, often at the expense of the Least Developed Countries (LDCs), which needed preferential trading schemes the most (Dowlah, 2008).

## 4.2. Rules of Origin – General Principles

ROO is expected to reduce the costs of doing business in international trade. It will act as a trade policy instrument, promote outsourcing, expand foreign direct investment (FDI) and export processing zones (EPZs), among other functions. However, ROO are sometimes used for protectionist ends: origin rules that are too restrictive or are enforced arbitrarily can improperly expand the coverage of trade restrictions. It has been increasingly frequent in recent years for the rules to be formulated and administered in an arbitrary fashion in an attempt to achieve protectionist policy objectives. Moreover, unnecessary complications and confusion arise when the same product may have several different countries of origin depending on the country for which it is destined. In general, rules of origin have not been adequately addressed at the international level. For example, for many years, the GATT contained no specific provisions on rules of origin other than Article IX, which deals with marking requirements (i.e. "marks of origin").

The general principles of rules of origin include:

a. Its equal application in all purposes of non-preferential treatment;
b. It must be objective, understandable, and predictable;
c. It must not be used directly or indirectly as an instrument to pursue trade objectives; and

d. It must not, in and of itself, have a restrictive, distorting, or disruptive influence on trade.

In addition to above elements, India includes the following two elements as a requirement to ensure smooth functioning of the Rules of Origin:

e. As far as possible the rules should be consistent across products. The greater the derogations from general criteria, the greater the complexity of the system of rules of origin both for companies and for officials administering the Agreement.
f. There should be some mechanism to institutionalize cooperation between the exporting country's agencies issuing preferential certificate of origin and the importing country's Customs authorities, so that the clearance of preferential goods can be facilitated.

## 4.3 Rules of Origin Implemented by the European Union, Japan and United States for Nepal and other least developed countries

### 4.3.1 United States of America

The United States (US) provides different types of preferential treatment to developing and least developed economies including GSP, The African Growth and Opportunity Act (AGOA), the Caribbean Basin Initiative (CBI) and the Andean Trade Preference Act (ATPA).

The US GSP program was instituted in 1976 and has been renewed periodically since then. While the level of preferences is the same for all countries, the product coverage is greater for LDCs. The ROO for the US GSP are in principle much simpler than the EU rules, requiring that 35% of the value of goods be derived from originating materials or value added in the beneficiary country, as well as that the good be a "new and different article of commerce" as compared to the imported materials . These requirements are constant across products. The cumulation provisions in the US GSP, like the EU GSP, identify regional groupings of countries within which cumulation are permitted. Material inputs originating from the US are also cumulable. As such, exports from SAARC member countries are eligible for the US GSP under regional cumulation i.e. they are treated as one country for GSP ROO requirement.

Currently, the US GSP preferences are available to more than 10,000 products—about approximately 5,500 products or product categories (defined at 8-digit level in the Harmonized Tariff Schedules of the United States) are eligible for duty-free entry from more than 140 designated GSP beneficiary countries and territories. As such, Nepal is entitled to duty-free exports to the USA under two types of product categories: (i) products eligible for GSP from Least-Developed Beneficiary Developing Countries (LDBDCs) only; and (ii) products eligible for GSP from BDCs. James (2006) reveals that the utilization rate of Nepal was consistently lower from 2004 to 2006, not exceeding 4 percent. Only larger developing Asian countries like India, Indonesia and Thailand have been able to diversify their exports, resulting in relatively high GSP utilization ratios.

The other reasons for such dismal utilization rates relates to the administrative and technical problems of compliance with the rules of origin requirements. The United States Trade and Development Act, for example, requires that beneficiary countries assemble apparel articles from US-made fabrics. But technological progress and globalization have led to increasing fragmentation of the production process into different stages or tasks in different locations such that the compliance with the stringent ROO has been rendered difficult.

**US ROO Criteria:** The country of origin of an imported product is defined in U.S. law and Customs regulations as the country of manufacture, production, or growth of any article of foreign origin entering customs territory of the United States**.** Preferential ROO schemes vary from agreement to agreement and preference to preference (Jones & Martin, 2008). U.S. importers are responsible for declaring the correct country of origin of imported goods. The elements of the GSP's origin rules (for goods that are not wholly obtained from a beneficiary country or territory) can be summarized as follows: (1) substantial transformation of foreign materials and local materials and/or direct processing cost-added of 35 percent of the appraised value; (2) dual substantial transformation of foreign materials possible; (3) full and regional cumulation possible among members of certain free-trade associations; and (4) direct-shipment rule. [13]

### 4.3.2 Japan

Japan originally established its Generalized System of Preferences scheme (GSP) on August 1, 1971, just one month after the European Community (EC's) introduction of its GSP, in July 1971. Four decennial GSP schemes have been established: the first from August 1971 to March 1981; the second from April 1981 to March 1991; the third from April 1991 to March 2001; and the fourth and current scheme from April 2001 to March 2011. The current GSP scheme is provided under the Temporary Tariff Measures Law and the Implementing Regulations of this Law.

The GSP scheme includes a general preferential treatment (GPT) and a special preferential regime (SPT). Under the former, preferential tariffs are applied to imports of designated items from GSP beneficiaries. Under the latter, duty free treatment is granted to imports of designated items from least developed countries (LDCs).

Japan grants preferential tariff treatment under its GSP scheme to 141 developing countries and 14 territories. Of these, as of December 2007, 105 are general GSP beneficiaries and 50 are LDCs. Advanced beneficiaries are excluded from the list of GSP beneficiaries under the annual review. This process of "graduation" begins with "partial graduation," if applicable, in order to mitigate its impact on these "graduating" economies. Moreover, it allows free access to majority of the products exported from LDCs.[14]

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13 Direct-shipment rule: The rules of origin provide that an article must be shipped directly from the beneficiary country to the United States without passing through the territory of any other country or, if shipped through the territory of another country, the merchandise must not have entered the commerce of that country en route to the United States. In all cases, the invoices must show the United States as the final destination.

[14] See: http://www.customs.go.jp/english/tariff/2010/index.htm

Nepal is granted LDC status by Japan and thus enjoys zero duty for its exports to Japan under the special preferential regime. However, the ROO must be fulfilled to enjoy the privilege of zero duty and quota free treatment. To receive this preferential tariff treatment, Nepalese goods must be accompanied by a GSP Form A which is issued either by Nepal Trade Promotion Centre or by other bodies, such as chambers of commerce, provided that they are registered with the Japanese customs authorities.

The LDC-specific duty free scheme was ostensibly an important concession provided by major developed countries including Japan. In practice, however, the scheme does not grant substantial benefits to LDCs. Instead of LDCs, MFN countries (e.g., Korea; U.S.A; Australia, Taiwan) and general GSP beneficiaries (inter alia, China and ASEAN GSP countries) were the main suppliers of these goods. The main reasons for such a low utilization rate are the strict requirements for compliance with origin certification for imports from LDCs whose infringement gives rise to strict verification and possible sanctions.

**Japan's ROO Criteria:** In order for the goods exported from a preference-receiving country to be eligible for preferential tariff treatment, they must be recognized as originating in that country under the Japanese GSP scheme's origin criteria and transported to Japan in accordance with its transportation rules.

Japan's donor country content rule permits flexibility in origin criteria by providing preferences to countries that import materials from Japan and use them in the production of goods exported back to Japan.

**Content Rules**:

(1) For goods produced in a preference-receiving country wholly from materials imported from Japan, or those produced in a preference- receiving country entirely from materials wholly obtained in the preference-receiving country and materials imported from Japan, such goods will be regarded as being wholly obtained in that country.

(2) Any goods exported from Japan which have been used as raw materials or components for the production of any goods produced other than those goods as provided for in the above-mentioned paragraph (1) shall be regarded as wholly obtained in that country.

However, with regard to some products obtained in a preference-receiving country, special treatment will not be granted (UNCTAD, 2006).

### 4.3.3 European Union

Under European Union (EU) regulations, a product processed in two or more countries originates in "the country in which the last substantial process or operation ... was performed ... resulting in the manufacture of a new product or representing an important stage of manufacture."

In order to benefit from the EC GSP upon importation into the EC, three conditions must be fulfilled:

The products have to originate in beneficiary countries according to EU GSP ROO.

a. Proof of originating status.
b. The goods must be transported directly from the beneficiary country to the EU. (Transportation via third country is only acceptable under restricted conditions and special circumstances)

Products originate in a particular beneficiary country if they are:

**Wholly Obtained Good**s: Goods are entirely produced in the beneficiary country (e.g. mineral products, vegetables harvested there, live animals born and raised there)

**Sufficiently Worked or Processed Goods**

Products manufactured from inputs from other countries (industrial products)

Criteria that determine sufficient working/processing

i. Value added criteria: - percentage of the *ex-works price of the products is given which must be greater than the value of the non-originating inputs used in its production.

For example: **HS No. Products Origin Criterion**

2833 Aluminium sulphate - Manufacture in which the value of all the materials used does not exceed 50% of the ex-works price of the product.

*Product X*
Value of imported inputs = US $ 2.00
Value added in the beneficiary country = US $ 4.00
Ex-works price (ex-factory price) = US $ 6.00

The product is eligible for GSP benefits

ii. Change of heading criteria: - A product is considered to be "sufficiently" worked or processed when its 4 digit HS nomenclature is different from that of all of the non-originating inputs that it is manufactured from.

**HS No. Products Origin Criterion**

Chapter 69 Ceramic products - Manufacture in which all the materials used are classified within a heading other than that of the products. (Imported inputs which are classified under HS No. 69 should not be used to manufacture the ceramic products to be qualified for GSP treatment)

**Rules regulating change of HS Headings have been relaxed.**

Imported inputs under the same heading may be used, provided that their total value does not exceed 10% of the ex-works price.

E.g. A doll (classified HS No. 9502) will qualify under change of HS heading origin criteria if it is manufactured from any imported materials which are classified in different heading.

Doll's eyes are classified under HS heading 9502. It is allowed to use the imported doll's eyes

iii. Specific process criteria (Double process origin criterion): A specific operation or stage in the production process of the final product has to be carried out in the beneficiary country.

**HS No. Products Origin Criteria**

6205 Men's or boy's shirts (woven) manufactured from yarn
6105 Men's or boys shirts, knitted or crocheted manufactured from yarn
Imported yarn - knitted/woven fabric - shirts

(stage 1) (stage 2)

Knitted gloves, socks, tights etc. should be manufactured from fiber.

3. **Cumulation of Origin:** Inputs from other countries are treated as originating in the exporting country.

**Bilateral Cumulation ( Donor country contents)** :- Inputs originating in the EU, Norway or Switzerland which are further worked or processed in the beneficiary country claiming the GSP benefit are considered to originate in that particular country.

The import of inputs from a Donor country must be proved by producing a specific form which is called the EUR1. It is issued by the authorities in the above countries when the inputs are imported to the beneficiary country.

**Regional: -** This is an instrument which is designed to encourage regional co-operation amongst those countries which are both GSP - beneficiaries and members of a regional grouping recognized by the EU.

EU has recognized four regional groupings:

a. The Association of South-East Asian Nations - ASEAN ( Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand, Vietnam)
b. The Central American Common Market - CACM (Costa Rica, Honduras, Guatemala, Nicaragua, Panama, El Salvador)
c. The Andean Community (Bolivia, Colombia, Ecuador, Peru, Venezuela)
d. The South Asian Association for Regional Co-operation - SAARC (Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka)

The EU's recognition of SAARC took effect from 31st October 2000, allowing it as a regional grouping to enjoy the benefits of regional cumulation of origin.

## 4.4 Rules of Origin Applied to Nepalese Exports of Tea, Carpet, Pashmina and Handicrafts by the European Union, Japan and the United States

About three-quarters of Nepal's exports enjoy preferential access to markets, including in India, the US and the EU. Preference utilization is still low, either because of the imposition of quotas or the strict rules of origin requirements associated with preferential access. Nepal is one of several LDCs to be deprived of US DFQF treatment for garment exports after the expiration of the MFA. The US provides such a facility only to selected nations, mostly African countries. Nepalese garment exports to the EU still enjoy preferential access under the Generalized System of Preferences (GSP), for which the rules of origin requirements are less stringent. This highlights the inconsistency and discriminatory practices among the preferential treatments accorded to LDC exports in developed country markets. (UNDP, 2007).

### 4.4.1 European Union ROO for Tea, Carpet, Pashmina and Handicrafts

Tea is classified under chapter 9 of the Harmonized Commodity Description and Coding System (HS) along with coffee, mate and spices. However, there is a separate for tea whether flavored or not subheading (0902 - at the four digit level). Nepal exports tea to international markets such as Canada, China, the EU, Hong Kong, Israel, Japan, the Republic of Korea, Pakistan, Singapore, Taiwan, Thailand and the US.[15]

The GSP handbook for the EC (2008)[16] stipulates that manufacture from materials of any heading shall confer originating status for the tea under HS subheading 0902. However, the EC revised proposal for ROO introduced in 2010 has yet to define the ROO criteria for tea[17].

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[15] Adapted from http://www.yomari.com; Cited from Adhikari and Adhikari (2005)
[16] See: UNCTAD (2008). GSP Handbook on the Scheme of the EC, UN
[17] See: http://ec.europa.eu/taxation_customs/resources/documents/customs/customs_duties/rules_origin/preferential/gsp_rev_proposal.

Similarly, carpets exported from Nepal are coded under HS. Code 5701.10. In FY 2007/08, the top six export destinations of Nepalese pashmina products were Germany, USA, UK, Switzerland, Canada and Belgium.[18]

Nepalese carpets are made of the highest quality wool fleece imported from Tibet, New Zealand and Britain. They are therefore manufactured form natural fibers (animal fiber in our case). The production of Nepalese carpet includes: wool sorting and washing, carding, spinning, dyeing, knotting (weaving), trimming, washing and drying, finishing and packing[19] . Under HS heading 57, the handbook specifies that the carpets knotted of Wool or fine animal hair will be conferred originating status if they are made from natural fibers. However, if polypropylene fibers of heading 5503 or 5506, or polypropylene filament tow of heading 5501are used to manufacture the same, the value added criterion becomes applicable, i.e. their total value should not exceed 40% of the ex-works price of the product.

Similarly the revised proposal also talks about either the specific process criterion or the value added criterion so as to confer the originating status to the Nepalese carpet. Under the former, the spinning of natural fibers should be accompanied by weaving while the value added criterion is the same.

Pashmina products, especially shawls, scarves, mufflers, mantillas, veils, made of wool or fine animal hair, are exported under HS code 6214.20. In FY 2007/08, the top six export destinations of Nepalese pashmina products were the USA, the UK, Germany, France, Italy and Japan

The pain staking process by which pashmina is made is done completely by hand. The pashmina production process includes fiber collection, fiber spinning, weaving in hand-looms, mending white pieces, washing white pieces to remove spots and blots., dyeing, fringe and design- making, embroidery, ironing and finally, packing.

The ROO require the fulfillment of either the specific process criteria or the value added criteria in order to confer originating status. For the former criterion, the handbook requires that embroidered Pashmina should be manufactured from unbleached single yarn. If it is made from unembroidered fabric, it should fulfill the latter criteria. This requires that the value of the unembroidered fabric used does not exceed 40% of the ex-works price of the product.

Similarly, the revised proposal also allows either the specific process criteria or the value added criteria to confer originating status to Nepalese Pashmina. Under the former, weaving must be accompanied by making-up (including cutting), while the value added criterion is the same. There is also a third option, which may be seen as a blend of the above two criteria. It requires that making-up be preceded by printing be accompanied by at least two preparatory finishing operations (such as scouring, bleaching, mercerizing, heat setting, raising, calendaring, shrink resistance processing, permanent finishing, decatizing, impregnating, mending and burling). However, this option requires that the value of the unprinted fabric used does not exceed 47.5 % of the ex-works price of the product.

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[18] See: http://www.tepc.gov.np/tradestatistics/major_countries_for_20exports_of_selected_commodities.php
[19] See: http://www.tepc.gov.np/tradestatistics/major_countries_for_20exports_of_selected_commodities.php

As far as Nepalese handicrafts are concerned, there is a vast array of goods that can be classified as handicraft products.[20] The Federation of Handicraft Associations of Nepal (F HAN) classifies the following products as handicraft goods of export interest to Nepal (also including Pashmina and Carpets).

**Table 4.1: Category of Handicraft Products in Nepal and their HS Codes**

| S. No | Category | HS Heading/Chapter No. | Product Description |
|---|---|---|---|
| 1 | Pashmina | Chapter 62 | Woolen/Pashmina Mufflers, Scarves & Shawls |
| 2 | Wooden Goods | Chapter 44<br>Chapter 83<br>Chapter 94 | Wooden Ties, Frames, Boxes Windows, Statues, hangers, picture frames, Furniture, Bamboo and cane products |
| 3 | Handmade Papers and Goods made thereof | Chapter 48<br>Chapter 49 | Handmade Paper, Nepali paper, wall coverings, Envelopes, cards, boxes, packing boxes, Notebooks, letter pads, albums, calendar |
| 4 | Cotton Goods | Chapter 52<br>Chapter 53<br>Chapter 59<br>Chapter 61<br>Chapter 62<br>Chapter 63<br>Chapter 64<br>Chapter 65 | Cotton fabrics, handloom cloth, wall coverings, knitted sweaters, knitted socks, mufflers, gloves, jackets, overcoats, dresses, shirts, pyjamas, shawls, scarves, bags, shoes, nets, caps/hats |
| 5 | Leather Goods | Chapter 42 | Saddles and harnesses, travel<br>goods, handbags and similar containers |
| 6 | Silk Goods | Chapter 50 | |
| 7 | Woolen Goods | Chapter 57<br>Chapter 60<br>Chapter 61<br>Chapter 62<br>Chapter 63 | Wool carpets, floor coverings, crocheted /knitted fabrics, sweaters, knitwear, dresses, shirts, shawls |

20 Handicrafts, also known as craft works or simply crafts, are a type of good in which useful and decorative devices are made completely by hand or using only simple tools. Usually the term is applied to good made by traditional means. The individual artisanship of the items is a paramount criterion; such items often have cultural and/or religious significance. Items made by mass production or machines are not handicrafts. (See: http://en.wikipedia.org/wiki/Handicraf t).

| | | | |
|---|---|---|---|
| 8 | Metal Goods | Chapter 71<br><br>Chapter 74<br><br>Chapter 82<br><br>Chapter 83<br><br>Chapter 92<br><br>Chapter 93<br><br>Chapter 97 | Silver jewelry, artificial instruments, copper utensils, gorkha knives, khukuri, articles of base metals (bells, gongs etc), metal sculptures, statuary and other handicrafts, metal musical instruments (cymbals/Tingshyas, etc.) |

Source: Federation of Handicrafts Association of Nepal (See: http://www.nepalhandicraft.org.np/handicraft_prof.php)

The main export destinations of Nepalese handicrafts in FY 2007/08 were the USA, France, Germany, Italy, Japan, Taiwan and Switzerland.

### 4.4.2 United States ROO Applicable to Tea, Carpet, Pashmina and Handicrafts

Tea is subject to changes in tariff classification criteria that confer it the originating status. This means it may be made from materials of any other subheading than 0902. However, such materials must originate in the preference receiving country for the tea to qualify as originating there.

Nepalese carpets also need to fulfill the change in tariff classification criterion for the ROO. It requires that it be made from materials of any other chapter than 57, except from headings 51.11 through 51.13, 52.04 through 52.12, chapter 54, or headings 55.08 through 55.16. This means that they may not be made from woven fabrics of carded and combed wool or animal hair. They may also not be made from woven fabrics of coarse animal hair, horse hair, cotton sewing thread, cotton yarn, woven cotton fabrics, sewing thread of manmade filaments or synthetic filament yarn (or their woven fabrics).

The ROO for Pashmina also requires a change in tariff classification. Pashmina may be made from materials listed in chapters other than those under headings 51.11 through 51.13, 52.04 through 52.12, 53.10 through 53.11, chapter 54, headings 55.08 through 55.16, 58.01 through 58.02, or 60.01 through 60.06. However, the changed tariff classification criteria for pashmina requires a specific process criterion to qualify for ROO, with the flexibility that the specific process may be carried out in the territory of either Nepal or the US, allowing for cumulation. More specifically, it is required that the good be cut and knitted to shape, and sewn or otherwise assembled in the territory of one or more of the Parties.

For the category of handicraft goods, most wooden goods require fulfillment of the change in tariff classification criteria to qualify under the ROO. There are no exclusions in this case. This implies that goods may be made from any other heading or subheading under heading 44 (for of wooden goods under HS codes 4412, 4414, 4415, 4418, 4420 and 4421), 83 (for wooden goods under HS code 8306) and 94 (for wooden goods under HS code 9403). Handmade papers and goods made from paper also require the fulfillment of similar criteria. However, some paper goods such as handmade Nepali Paper (HS code 4802) and calendars (HS code 4910) may be made from materials from any other chapter; handmade papers (HS code 4810) may be made from materials from any other heading; handmade paper wall coverings (HS code 4814), handmade paper envelopes (HS code 4817), handmade Paper Packing Boxes (HS code 4819) may be made from any other heading outside that group.[21]

The ROO criteria for cotton goods can be classified into three parts; (a) change in tariff classification, (b) change in tariff classification with exclusions, and (c) change in tariff classification with exclusions plus specific process criteria with allowance for cumulation in the territory of one or more parties. For example, handloom cotton cloth (HS code 5308) and cotton shoes (HS code 6405) fall under (a); cotton fabrics (HS code 5208) and cotton wall coverings (HS code 5905), cotton nets (HS code 6505) fall under (b), and cotton knitted sweaters (HS code 6110) and cotton knitted socks (HS code 6115) fall under (c).

Leather goods and silk goods, on the other hand, require the fulfillment of the change in tariff criterion with no exclusions. Almost all wool goods must fulfill either (b) or (c) mentioned above to confer them originating status in the EU.

Finally, metal goods such as silver jewelry (HS code 7113), artificial ornaments (HS code 7117), and khukuri (HS code 9307) require fulfillment of (a) whereas some such as Gorkha Knives (HS code 8211) and metal musical instruments (HS code 9206) requires fulfillment of (a). However flexibility is allowed in this case in the form of regional cumulation. There can be a regional value content of not less than: (a) 35 percent when the build-up method is used, or (b) 45 percent when the build-down method is used to confer originating status (Appendix IV and Appendix V).

### 4.4.3 Japan ROO Applicable to Tea, Carpet, Pashmina and Handicrafts

For MFN and General Preferential treatment, Japan charges a nominal duty of 3% and 2.5% respectively for imports from GSP beneficiary countries. However, special preferential treatments (SPT) in the form of tariff-free and quota-free[22] imports are offered to beneficiary LDCs for all products eligible for GPT treatment. Besides, there are some additional products for which preferences are granted only to LDCs. Nepal thus receives this treatment as one of Japan’s LDC beneficiaries.

Exports of tea to Japan under HS heading 0902 do not require the fulfillment of documentary requirements such as the Certificate of Origin (combined declaration and certificate) Form A to be submitted to the Japanese Customs authorities on importation of the goods into Japan. However, evidence relating to transport is necessary to ensure that the Rules of Transportation (Direct Consignment) are duly followed.

Since the conditions for origin countries are not specifically acknowledged in the handbook for Japan’s GSP scheme, the Nepalese tea should fulfill the 'wholly obtained' ROO criteria. If it is partially obtained, the tea should undergo sufficient working or processing in Nepal (UNCTAD,

[21] When a rule refers to a change in heading or subheading “outside that group,” each Party shall interpret the rule to require that the change in heading or subheading must occur from a heading or subheading that is outside the group of headings or subheadings set out in the rule. (Annex 4.1. Part I. 1 (e))
[22] Preferential imports without ceiling restrictions

2006). Carpets are classified as industrial products under HS heading 57. They are also eligible for GPT and SPT treatment. However, a ceiling system was applied in FY 2005 that allows GPT imports until they exceed the ceiling. After GPT preferential imports exceed the ceiling, GPT treatment shall be suspended, and the MFN duty rate shall apply. Also, GPT treatment shall be partially suspended for a particular product group with reference to a particular preference-receiving country when GPT imports of products originating in that country exceed a maximum country amount equal to one-fifth of the total value/quantity of the ceiling.

Moreover, conditions for origin countries are specifically acknowledged in HS heading 57. It requires fulfilling the change in tariff heading criteria, meaning it should be manufactured from materials of heading Nos. 47.01 to 47.06, or from natural textile fibers, man-made staple fibers or textile fiber waste. These materials are classified under different headings than the carpet itself.[23] Since carpets in Nepal are basically made from animal fiber extracted in Nepal or imported and almost all the processes of its manufacture are carried out in Nepal, they may also qualify under wholly obtained criteria for ROO. Also, all the documentary requirements must be fulfilled in order to avail of the GPT in Japan: both Certificates of Origin (Form A) and the evidence demonstrating compliance with the Rules of Transportation must be submitted to the relevant authority.

As previously mentioned, shawls, scarves and sweaters are Nepal's key Pashmina export products. Aside from these, Nepal also exports stole, capes and blankets made of pashmina wool, also popularly known as Cashmere. The name comes from Kashmir, the Indian state where it was first made before later spreading to world markets.

As such, these goods are classified under HS heading 6214 under the product name Shawls, scarves, mufflers, mantillas, veils and the like.. These may be exported from LDCs to Japan without any restrictions such as duties and quotas. This further implies that no ceiling system is applied to Pashmina products. As of July 1, 2009, the MFN rate for subheadings under HS heading 6214 ranges from 5% to 10% whereas the GPT rate for the same is zero percent [24][25] .

All documentary requirements must be fulfilled in order to confer origin status on Pashmina products exported to Japan. The exporting LDC must fulfill the origin criteria in order to take advantage of Japan's GPT or SPT. The ROO conditions are specifically detailed in HS subheading 6214 in the handbook, which states that they should be manufactured from chemical products, from products of headings Nos. 47.01 to 47.06, or 50.01, or from natural textile fibers (except raw silk), man-made staple fibers or textile fiber waste. As such, the criteria for Pashmina are similar to those for carpet.

Most wooden products require the fulfillment of change in tariff heading criteria in order to obtain originating status for export to Japan, except some such as wooden ties (HS code 4412), wooden frames (HS code 4414), wooden boxes (HS code 4415) for which the originating status is not specifically delineated. This means they must be "wholly obtained" for the purpose of determining

[23] As a general rule, working or processing operations will be considered sufficient when the resulting goods is classified under an HS tariff heading (4 digits), other than that covering each of the non-originating materials or parts used in the production (UNCTAD, 2006)
[24] http://www.mofa.go.jp/policy/economy/gsp/explain.html
[25] However, HS subheading 62149222 has an MFN rate of 4.40% as on July 1, 2009.

their origin. If they are partially obtained, they must undergo sufficient working or processing in Nepal. The same is the case for almost all handmade papers and goods made thereof (of export interest to Nepal) i.e. their ROO are also not specifically acknowledged. The ROO for most of the cotton goods are specifically listed in the handbook, with the exception of cotton net and caps/hats (HS code 6505), for which there is no such listing. Cotton fabrics (HS code 5208), hand loomed cotton cloth (HS code 5308), cotton knitted sweater (HS code 6110), and cotton knitted socks (HS code 6115) must be manufactured from chemical products, from products of headings 4701 to 4706, or from natural textile fibers, man-made staple fibers or textile fiber waste in order to fulfill the ROO. Similarly, goods such as cotton jackets, overcoats (HS heading 6201), over jackets (HS heading 6203), and cotton dresses (HS code 6204) must be manufactured from woven fabrics, felt, nonwovens, knitted or crocheted fabrics, or lace as listed in Chapter 50 to 56 or 58 to 60.

Leather goods under HS heading 4201 must be manufactured from products of different tariff headings (excluding heading 4205). There are no specific criteria to confer ROO for silk goods, so they are generally governed by the ROO for 'wholly obtained' goods. If they are partially obtained, they must have undergone sufficient working or processing in Nepal to qualify. Wool goods such as woolen knitted sweaters (HS code 6110), woolen carpets and floor coverings (HS code 57902) must be manufactured from chemical products, from products listed in headings 4701 to 4706, or from natural textile fibers, man-made staple fibers or textile fiber waste in order to fulfill the ROO. Similarly, goods such as wool dresses (Hs heading 6204) and woolen ladies and gents shirts (HS headings 6204 and 6205) must be manufactured from woven fabrics, felt, nonwovens, knitted or crocheted fabrics, or lace as listed in Chapters 50 to 56 or 58 to 60 (Appendix VI).

Finally, the ROO for most metal goods of export interest such as silver jewelry (HS code 7113), copper utensils (HS code 7417), metal sculptures, statuary and other handicrafts (HS code 9703) are not specifically delineated. However, artificial ornaments under HS heading 7117 must be manufactured from products other than those in heading No. 71.17, excluding chains of metal. Similarly, under HS heading 9307, khukuri must be manufactured in such a way that the value of the non-originating products listed under different tariff headings does not exceed 40 percent of the value of the product obtained, nor may the value of the non-originating products of the same tariff heading exceed 5 percent of the value of the products obtained. This means that khukuri must also fulfill the value added criterion if it is made from non-originating products (Appendix VII).

Documentary evidence is essential for handicraft products mentioned above to take advantage of the Japanese special preferential treatment.

## 4.3: Summary of Rules of Origin of EU, US and Japan

| | European Union | United States | Japan |
|---|---|---|---|
| GSP facilities to Nepal | Duty-free and quota-free facilities under the Everything But Arms (EBA) policy for LDCs. | Duty-free exports under Least Developed Beneficiary Developing (LDBDCs) and Beneficiary Developing Countries (BDCs). | Duty free exports under special preferential regime (SPT). |
| Rules of Origin | Wholly produced or obtained *or* sufficiently worked or processed | Wholly produced or obtained *or* sufficiently worked or processed | Wholly produced or obtained *or* sufficiently worked or processed |
| What is a sufficiently worked or processed good? | Where the last substantial, economically justified processing or working takes place resulting in the manufacture of a new product or representing an important stage of manufacture takes place. | Where the last substantial process or operation resulting in the manufacture of new characteristics takes place. | Where the substantial transformation into a new and different article of commerce with a name, character, or use distinct from that of the article or articles from which it was so transformed takes place. |
| Principle Percentage Criterion Rules | **Numerator**: Customs value of the imported inputs or the earliest ascertainable price paid in the case of materials of unknown, undetermined origin<br>**Denominator**: Ex-factory price.<br>**Percentage level:** Maximum 40% or 50% | **Numerator**: Cost of materials produced in the preference-receiving country plus the direct cost of processing carried out there **Denominator**: Ex-factory price or the value appraised by US customs. **Percentage level:** Minimum 35% | **Numerator:** Customs value of the imported inputs or the earliest ascertainable price paid in the case of materials of unknown, undetermined origin<br>**Denominator**: FOB price.<br>**Percentage level:** Maximum 40% or 50% |
| Specific ROO Criteria | Value added criteria; Change of heading criteria; and Specific process criteria (Double process origin criteria) | Change in tariff classification; Change in tariff classification with exclusions; and Change in tariff classification with exclusions plus specific process criterion with the allowance for cumulation in the territory of one or more of the parties. | Change of heading criteria |
| Derogation from GSP Rules of Origin | Derogation granted to Laos, Cambodia and Nepal (Derogation will cease to apply from 31st December 2010). | No derogation | No Derogation |
| Cumulation of Origin | Donor country content rule applied if inputs originate in the EU, Norway, or Switzerland; and Regional cumulation allowed for ASEAN, CACM, The Andean Community and SAARC | Donor country content rule is not applicable; and Regional Cumulation allowed to the Andean Group, WAEMU, ASEAN, SAARC, SADC & CARICOM. | Donor country content rule applied only if originating from Japan; Regional cumulation applies only in case of goods produced in Indonesia, Malaysia, the Philippines, Thailand and Vietnam referred to as "Five Countries" for the purpose of the application of the rule. |

| | | | |
|---|---|---|---|
| Rules of Shipment | Goods must be transported direct from the beneficiary country to the EU. (Transportation via third country is only acceptable under restricted conditions and special circumstances) | Same as EU | Same as EU |
| Proof of Originating Status | Required | Required | Required |

Unless one investigates how the rules of origin criteria by countries such as the US, Japan and the EU applied at the ground level are made, it is difficult to delineate their shortcomings or weaknesses. Similarly, without examining whether or not the exportable commodities under consideration satisfy the rules of origin criteria, it will not be easy to distinguish the internal factors affecting the exports under DFQF facilities. These subjects are discussed in the next chapter.

# Chapter V: Perceptions of the Impact of Rules of Origin on Exports of Tea, Carpet, Pashmina and Handicrafts

## 5.1 Survey Results

### 5.1.1 Survey Methodology

A small-scale survey was carried out among 40 enterprises[26] covering both manufacturers and exporters to gauge their experience with and views on the Rules of Origin provisions. The objective was to ascertain the effectiveness of duty free and quota free facilities in promoting exports from least developed countries like Nepal. Structured questionnaires including both close-ended and a few open-ended questions were given to the selected stakeholders like the Himalayan Orthodox Tea Producers Association (HOTPA), the Federation of Handicraft Association of Nepal, Central Pashmina Industries Association of Nepal and Central Carpet Industries Association of Nepal. The questionnaires in both cases were filled out by the survey organizers.

### 5.1.2 Types of Firms

Of the respondents, 22.5 percent were manufacturers whereas 77.5 percent were both exporters and manufacturers from small and medium enterprises.. All the enterprises were based in Kathmandu. The types of firms by HS code is provided in Appendix III.

**Table 5.1: Types of Respondent Firms**

| | Percentage |
|---|---|
| Manufacturer Only | 22.5 |
| Both (Manufacturer and Exporter) | 77.5 |
| Total | 100.0 |

*Source:* Field Survey, 2010.

### 5.1.3 Knowledge about the Rules of Origin

When asked about their knowledge on the Rules of Origin, all the entrepreneur respondents indicated that they knew about it. However, all of them thought that it referred to the country of origin and own country production rather than definition of an exportable product under the Rules of Origin. Most of the firms knew that the Rules of Origin requires a certification of the origin of a product. Similarly, a majority of the firms also knew that countries like Japan utilize a General Preferential System (GPS) rather than ROO.

[26]The survey was conducted among 40 exporters and manufacturers that were involved in the exports of tea, carpet, pashmina and handicrafts chosen by a purposive random sampling technique. Accordingly, for each product, 10 were selected. Out of the 40, 9 were manufacturers and the rest were manufacturers/exporters. The survey was carried out in Kathmandu. Purposive sampling was adopted with limited objective of determining perceptions of exporters that were using DFQF facilities and fulfilling the rules of origin criteria from the US, Japan and the EU. Therefore, it was not a general survey and hence we did not apply a random sampling technique which fixed a minimum number from every corresponding population group of exporters and manufacturers.

### 5.1.4 Main Exporting Country / Niche Market

The surveyed entrepreneurs reported that the European Union (35.7 percent) was their first market, followed by Japan (14.3 percent) and United States (7.1 percent). Of the remainder, 28.6 percent noted that the EU and United States were their markets. Another 14.3 percent stated that they export their products to all three countries simultaneously.

**Table 5.2: Responses of Reforms toward Main Exporting Countries**

| Country | Percentage |
|---|---|
| EU | 35.7 |
| Japan | 14.3 |
| USA | 7.1 |
| EU and USA | 28.6 |
| All three (EU, Japan & USA) | 14.3 |
| Total | 100 |

*Source:* Field Survey, 2010.

78.6 percent of entrepreneurs responded that quota- and duty-free facilities have contributed to the increase of their exports. Only 7.1 percent said that they played no role. A remaining 14.3 said that they were not aware of such facilities.

Of the respondents who indicated positive perceptions of duty free and quota free facilities, 36.4 percent said that they increased their product market especially as a result of delivery on time. Similarly, 27.4 percent expressed that this facility helped to increase both quality and quantity of exportable products. About 18.2 percent said that quota- and duty-free facilities helped to decrease production costs and enhance fair competition, which contributed to the increase in exports.

**Table 5.3: Increase in Market Due to Quota- and Duty-free provisions**

| | Percentage |
|---|---|
| Yes | 78.6 |
| No | 7.1 |
| No Response | 14.3 |
| Total | 100 |

*Source:* Field Survey, 2010.

**Table 5.4: Reasons for the Increase in Exports**

| | Percentage |
|---|---|
| Able to delivery on time | 36.4 |
| Improve on quality and quantity | 27.2 |
| Fair competition | 18.2 |
| Decrease production cost | 18.2 |
| Total | 100 |

*Source:* Field Survey, 2010.

### 5.1.5 Production, Exports and Source of Raw Material Imports

Table 5.1.5 shows monthly production and export of selected commodities. Out of the total production, 72 percent of tea, 55 percent of carpets, 75 percent of pashmina and 86 of percent handicraft products are exported to the international market. The survey results show that handicrafts are the major exported products. Carpets are exported less than other products, as Germany, which is one of the major markets of Nepal, has banned the Nepali carpets on the grounds that child labor is used in Nepal. However, on a per unit basis, Carpets have high unit prices in comparison to the others.

**Table 5.5 Monthly Production and Export by Firms**

| | Unit | **Quantity** | **Price Per Unit (US $)** | **Quantity** | **International Price (US $)** |
|---|---|---|---|---|---|
| Tea | ton | 570 | 5 | 411 | 10 – 20 |
| Carpet | mt | 512 | 90-130 | 283 | 145 – 320 |
| Pashmina | piece | 4300 | 20 | 3250 | 20-50 |
| Handicraft | piece | 2333 | 85 | 2000 | 95-100 |

*Source:* Field Survey, 2010.

The major market of for tea is EU. Only a small amount is exported to the USA. But the border price in US and EU is almost the same.

**Table 5.6 Export of Tea**

| | Unit | Quantity | Border Price (US $) |
|---|---|---|---|
| EU | Kg | 82500 | 7-8 |
| Japan | Kg | - | - |
| USA | Kg | 20 | 7-9 |

*Source:* Field Survey, 2010.

As shown in the table 5.7 below, the EU is the major market for handicraft products, followed by the US and Japan. Japan has higher border prices in comparison to border prices in the US and EU.

**Table 5.7 Exports of Handicrafts**

| | Unit | Quantity | Border Price (US $) |
|---|---|---|---|
| EU | piece | 1100 | 200-250 |
| Japan | piece | 450 | 250-350 |
| USA | piece | 850 | 150-200 |

*Source:* Field Survey, 2010.

USA is the major market for carpets. This is followed by the EU. The border price is almost the same in both countries.

**Table 5.8 Exports of Carpets**

| | Unit | Quantity | Border Price (US $) |
|---|---|---|---|
| EU | mt | 40 | 140-320 |
| Japan | mt | - | - |
| USA | mt | 68 | 140-320 |

*Source:* Field Survey, 2010.

EU is the major market for Pashmina followed by the US and Japan. However, no uniformity was found in border prices.

**Table 5.9 Exports of Pashmina**

| | Unit | Quantity | Border Price (US $) |
|---|---|---|---|
| EU | piece | 2000 | 14-20 |
| Japan | piece | 500 | 18 |
| USA | piece | 1000 | 14-18 |

*Source:* Field Survey, 2010.

More than 64 percent of firms reported that the domestic market is their main source of raw material purchases. 28 percent firms said that the international market is their source of raw materials. Only 7.1 percent of firms said that they purchase raw materials from both domestic and foreign sources. All firms that imported raw materials mentioned that the unavailability of raw materials domestically was the principal reason for raw material imports from abroad.

**Table 5.10 Sources of Raw Materials**

| | Percentage |
|---|---|
| Domestic | 64.3 |
| Foreign | 28.6 |
| Both | 7.1 |
| Total | 100 |

*Source:* Field Survey, 2010.

### 5.1.6 Competitiveness of Exported Products

A majority of firms reported that quota- and duty-free policies help to enhance the competitiveness of these products in the international market. Such a view was expressed by 57.1 percent of respondents. Only 28.6 percent said that such a scheme makes no difference to them.

**Table 5.11 Increased Competitiveness due to Quota- and Duty-Free Concessions?**

| | Percentage |
|---|---|
| Yes | 57.1 |
| No | 28.6 |
| No Response | 14.3 |
| Total | 100 |

*Source:* Field Survey, 2010.

Asked about the reasons for increased competitiveness due to quota- and duty-free facilities, 37.5 percent of firms said that under such schemes it is relatively easy to export to the international market. Similarly, 12.5 percent said that free competition helps to enhance the price competitiveness of their products. They also indicated that such a facility helps to introduce new technology.

**Table 5.12 Reasons for Increase in Competitiveness**

| | Percentage |
|---|---|
| Easy to compete in international market | 37.5 |
| Easy to export | 37.5 |
| Free competition helps price competitiveness | 12.5 |
| Helps to launch new technology to increase production | 12.5 |
| Total | 100 |

*Source:* Field Survey, 2010.

### 5.1.7 Administrative Cost and Problems in Proving Rules of Origin

On the question of yearly administrative expenses on ROO, 42.9 percent of firms said that they have to spend in the range of NRs 500 to 1000 annually. Next, 28.6 percent firm's said that they spend Rs 11000 to Rs 30000 yearly. The remaining 28.6 percent said that they have to allocate Rs 31000 to 50000 for administrative costs. The results showed that the small firms have to spend less on ROO related administrative expenses compared to big firms. The cost ratio reported by the firms shows that the medium-sized firms have to spend more as a percentage than do small and big firms.

**Table 5.13 Yearly Administrative Expenses for Rules of Origin Eligibility**

| | Percentage |
|---|---|
| 500 to 1000 | 42.9 |
| 11000 to 30000 | 28.6 |
| 31000 to 50000 | 28.6 |
| Total | 100 |

*Source:* Field Survey, 2010.

**Table 5.14 Ratio of ROO Expenses by Price Range**

| Range of Price | Ratio |
|---|---|
| 500 to 1000 | 0.001252 |
| 11000 to 30000 | 0.046091 |
| 31000 to 50000 | 0.015477 |

***Source: Field Survey, 2010***

Interestingly, half of the firms surveyed said that they face no problems in confirming ROO in the course of exporting their products. Only 21.4 percent firms said that they face such a problem.

**Table 5.15 Problems in Proving Rules of Origin**

| | Percentage |
|---|---|
| Yes | 21.4 |
| No | 50.0 |
| No Response | 28.6 |
| Total | 100 |

*Source:* Field Survey, 2010.

Asked about the difficulties of collecting information, 71.4 percent of firms responded that they face no problems. Only 14.3 percent said that they face difficulties in the course of information collection.

**Table 5.16 Difficulties in Collecting or Recording Commodity Information**

| | Percentage |
|---|---|
| Hard (Yes) | 14.3 |
| No (Not Hard) | 71.4 |
| No Response | 14.3 |
| Total | 100 |

*Source:* Field Survey, 2010.

### 5.1.8 ROO and Constraints Faced

On the questions of constraints faced under existing ROO, 42.9 percent firms said that they do not face any constraints. Almost 28.6 percent firms, on the other hand, said that they face many constraints under existing arrangements.

**Table 5.17 Constraints Faced under Current Rules of Origin**

| | Percentage |
|---|---|
| Yes | 28.6 |
| No | 42.8 |
| No Response | 28.6 |
| Total | 100 |

*Source:* Field Survey, 2010.

On the question of types of constraints faced by the firms, 60 percent said that documentation processes are complicated. Another 20 percent firms said that they face problems as a result of economic difficulties in the importing country. Finally, 20 percent said that it is difficult to convince importing countries that they are entitled to duty-free and quota-free rules under WTO provisions.

**Table 5.18 Types of Constraints Faced by Firms**

| | Percentage |
|---|---|
| Documentation process is complicated/ difficult | 60 |
| Hard to convince importing country to implement duty- and quota-free rules | 20 |
| Economic difficulties in the importing country | 20 |
| Total | 100 |

*Source:* Field Survey, 2010.

All of the firms (100 percent) said that the three types of constraints faced increase transportation and other costs. This ultimately raises the cost of production of their exports. The respondents opined that this leads to an increase in costs of roughly 20 to 30 percent, which seems fairly high.

On the question of constraints faced in the EU, the USA and Japan on the duty-free and quota-free facilities, 64.3 percent firms said that no country imposes constraints on their exports. Only 7.1 percent firms said that they face some problems in all these countries.

**Table 5.19 Constraints Faced by Duty-Free and Quota-Free Products in the EU, the USA and Japan**

| | Percentage |
|---|---|
| Yes | 7.1 |
| No | 64.3 |
| No Response | 28.6 |
| Total | 100 |

*Source:* Field Survey, 2010.

### 5.1.9 Likely Price Escalation and Export Price Effects in the Absence of Quota-Free and Duty-Free Concessions

When asked about the possibilities of price escalation in the absence of quota and duty free, 42.9 percent said that it will lead to an escalation in prices. But 35.7 percent respondents predicted no price escalating effect.

**Table 5.20 Price Increases due to the Absence of Facilities**

| | Percentage |
|---|---|
| Yes | 42.9 |
| No | 35.7 |
| No Response | 21.4 |
| Total | 100 |

*Source:* Field Survey, 2010.

Regarding the rate of escalation in international market prices, 33.3 percent of respondents expressed the view that the magnitude of price escalation could be about 5 percent. The rest said that the price escalation could be in the rage of 10 to 30 percent.

**Table 5.21 Rate of International Market Price Escalation**

| Rate of Escalation | Percentage |
|---|---|
| 5 percentage | 33.2 |
| 10 percentage | 16.7 |
| 20 percentage | 16.7 |
| 25 to 30 percentage | 16.7 |
| 30++ | 16.7 |
| Total | 100 |

*Source:* Field Survey, 2010.

Asked about obstructions created by individual country interpretations of their own ROO, a majority (57.1 percent) believed that this has no adverse effect. About 28.6 percent of firms perceived that interpretation by individual countries has some adverse effect on exports.

**Table 5.22 Obstruction of Exports due to Country Interpretations of ROO**

| | Percentage |
|---|---|
| Yes | 28.6 |
| No | 57.1 |
| No Response | 14.3 |
| Total | 100 |

*Source:* Field Survey, 2010.

According to the respondents, the imposition of high duties, delays in the timely release of commodities from customs points and registered firm requirements generate complications for exports under the ROO.

**Table 5.23 Reasons for Obstruction of Exports due to Individual Country's Own Interpretation on ROO**

| | Percentage |
|---|---|
| Imposition of high duty | 25 |
| Delays to release commodities from customs | 25 |
| Registered firm requirement | 25 |
| All above three | 25 |
| Total | 100 |

*Source:* Field Survey, 2010.

The respondents were also requested to give their suggestions for overcoming the problems noted above. About 50 percent opined on the necessity of effective implementation of a targeted provision by the WTO. Twenty-five percent suggested that priority should be given to WTO member countries in granting quota- and duty-free facilities. A similar percentage recommended that all countries entitled to quota- and duty-free facilities should be treated on equal footing.

**Table 5.24 Suggestions for Equal Treatment by Individual Countries**

| | Percentage |
|---|---|
| Effectiveness in the implementation of WTO provisions | 50.0 |
| Priority to WTO member countries | 25.0 |
| Every country be treated equally | 25.0 |
| Total | 100 |

*Source:* Field Survey, 2010.

### 5.1.10 The Impact of the Global Financial Crisis

Other questions were asked in order to determine entrepreneurs' perceptions of the impact of the financial crisis.. The survey period was January 2010 to April 2010. The respondents were asked about the effects they experienced in the aftermath of the global financial crisis. About 71.4 percent said that it had adverse effect on the exports. Only 7.1 percent said that they felt no effects

**Table 5.25 Views on the Impact of the Global Financial Crisis**

| | Percentage |
|---|---|
| Yes - Affected | 71.4 |
| No – Not Affected | 7.2 |
| No Response | 21.4 |
| Total | 100 |

*Source:* Field Survey, 2010.

Asked about the reasons for decreased exports, 40 percent said that declining purchasing power in importing countries was the main reason. Demand for cheaper products by importing country markets, decreased commodity demand and high costs in Nepal were other reasons reported by the remaining 60 percent of respondents.

**Table 5.26 Reasons for Decreased Exports after the Financial Crisis**

| | Percentage |
|---|---|
| Demand for cheap prices | 20.0 |
| Decrease in income/purchasing power in importing countries | 40.0 |
| Decrease in demand for commodities in importing countries | 20.0 |
| High prices in Nepal | 20.0 |
| Total | 100 |

*Source:* Field Survey, 2010.

### 5.1.11 Suggestions by Firms

Of all respondents, 14.3 percent suggested increasing export quality to boost competitiveness. Almost 21.4 percent respondents emphasized the need to decrease prices of export products. About 14.3 percent of firms emphasized the necessity of enhancing exports by various means. Priority for SMEs was suggested by 7.1 percent of respondents. At 28.6 percent, a substantial number suggested promoting or establishing new industries which could also contribute to employment.

**Table 5.27 Suggestions for Taking Maximum Advantage from Quota and Duty Free Facilities**

| | Percentage |
|---|---|
| Increase the product quality to enhance international competitiveness | 14.3 |
| Establish new export industries and increase employment | 28.6 |
| Various types of support for exports | 14.3 |
| Reduce the cost prices to increase demand in international markets. | 21.4 |
| Give priority to SMEs for more exports in international markets | 7.1 |
| No Response | 14.3 |
| Total | 100 |

*Source:* Field Survey, 2010.

Respondents were also asked to give general suggestions. About 21.4 percent of respondents suggested giving priority to exportable commodities. The same percentage suggested carrying out trade negotiations with new countries to enhance exports. Creation of a friendly business environment was the suggestion of 14.3 percent firms. Similarly, reduction of imports, government initiatives to facilitate exports, focus on restarting closed industries and duty-free facilities by the government were other suggestions given by 28.4 percent firms in total.

**Table 5.28 General Suggestions and Comments by Firms**

| | Percentage |
|---|---|
| Place emphasis on exportable commodities | 21.4 |
| Negotiate with new countries on a bilateral basis to open new foreign markets to the exportable products | 21.4 |
| Create a friendly environment for exports | 14.4 |
| Create policies to discourage imports and encourage exports of domestic products. | 7.1 |
| Government initiatives to facilitates greater exports to international markets | 7.1 |
| Create an environment suitable for restarting shuttered industries | 7.1 |
| Duty-free facilities by the government | 7.1 |
| No Response | 14.4 |
| Total | 100 |

*Source:* Field Survey, 2010.

On the whole, the perceptions survey results give mixed signals. Preferential arrangements have provided certain incentives to exporters. Such facilities have also enhanced competitiveness to a degree by improving technology used in exports. Yet exporters have not reaped such benefits equally. At the same time, trade certification criteria and procedural matters to qualify for rules of origin have led to added costs though small firms are reported to be bearing less cost than large firms. The survey findings indicate that there is considerable room for improving both criteria and procedures used in rules of origin in order to make preferential arrangements more beneficial to least developed countries like Nepal.

## 5.2 Quantitative Analysis

### 5.2.1 Total Value Content

#### 5.2.1.1 Methodology and Source of Data

The main objective of this quantitative analysis based on total value content criteria is to determine whether or not tea, handicrafts, pashmina and carpets satisfy the rules of origin criteria. This emphasizes the need to explore the issue of raising local content requirements for qualifying exports.

For this quantitative analysis, the primary data were collected based on the survey of the entrepreneurs.. The sample products and specific rules of origin were based on the Harmonized System (HS). The HS classification system uses six digit codes in Nepal like in many other countries. Therefore, the first step was the interpretation of the "rules" to obtain the appropriate code for the goods under consideration.

To verify whether the commodities under consideration qualified as originating goods, the proposed total value content method was used. This allowed the original qualification of goods to be verified. For this both the build-down and build-up methods were used. The build-up method is used to verify the value of originating materials used in the production of goods and hence enables the cross checking of the qualification per the provisions of the rules of origin. Similarly, the build-down method is used to examine the value of non-originating materials that are used in the production process. They also enable the verification of the fulfillment of the ROO provisions. It requires information on the value of the non-originating materials and the originating materials used to produce an exportable product. The total value content percentages were calculated by using two alternative methods based on data obtained in the surveys.

a) **Value of Non-originating Materials (Build-down Method)**

$$TVC = \frac{AV\text{-}VNM\ X100}{AV}$$

b) **Value of Originating Materials (Build-up Method)**

$$TVC = \frac{VOM\ X100}{AV}$$

Where:
TVC is the value content, expressed as a percentage.
AV is adjustable value (Value for customs purposes).
VNM is the value of non originating materials that are acquired and used by the producers in the production of goods. It does not include the value of a material that is self-produced. VOM is the

value of originating materials acquired or self produced and used by producers in the production of goods.

#### 5.2.1.2 Empirical Results

Following more straightforward rules of origin criteria adopted by the US, the qualifying level of Nepal was determined not to be less than 45 percent under the Build-down method., Under the Build-up method, the range was found to be not less than 35 percent as such a ratio is necessary for the exports to the US. These ratios have been taken as bases for the exercise. It is well known that Japan utilizes the GPS system rather than a system based on levels.

The table below shows the results for the qualifying value content of tea, handicrafts, carpets and pashmina. The results indicate that the levels for tea, many handicraft products and carpets are more than 45 percent under Build-down method. This means that these products qualify under the rules of origin scheme. However the level for pashmina was less than 45 percent, meaning does not qualify. Some of handicrafts such as silver jewelry products also mainly depend on imported raw materials. .

Under the Build-up method the sample commodities were found to be greater than 35 percent. This means that the sample goods qualify as goods originating in Nepal.

The calculations thus prove that those firms which rely more on raw material imports do not qualify, and those which use domestic raw materials qualify as originating goods. The results show that only tea uses fully originating Nepalese materials, while carpets, handicrafts and pashmina use both non-originating and originating goods for their raw materials.

**Table 5.29 Qualifying Value Content (QVC)**

| | Build-Down | Build-Up |
|---|---|---|
| Tea | | 85% |
| Handicrafts | 40% | 42% |
| Carpet | 52.6% | 90% |
| Pashmina | 10% | 92.5% |

*Source:* Field Survey, 2010.

When analyzed by country, some variations were found. Handicrafts and pashmina do not qualify under the build-down method in any countries studied (the EU, USA and Japan). Under this method, carpet qualifies for export under the rules of origin. Under the Build-up method, all four commodities qualify in all countries.

**Table 5.30 Country-wise Total Value Content**

| | **Build-Down** | | | **Build-Up** | | |
|---|---|---|---|---|---|---|
| | EU | Japan | USA | EU | Japan | USA |
| Tea | - | - | - | 48 | - | 83 |
| Handicrafts | 40 | 44 | 42 | 38 | 42 | 46.8 |
| Carpets | 47.5 | | 51.5 | 50 | | 66.7 |
| Pashmina | 33.3 | 40 | 30 | 71.4 | 57.1 | 81.0 |

***Source: Field Survey, 2010***

# Chapter VI: Conclusions and Recommendations

## Conclusions

1. The most worrying phenomenon in the Nepalese context is such that despite duty free and quota free facilities enjoyed by major exportable commodities like carpet, pashmina, handicrafts and tea, the over all export performance has deteriorated in recent years.

2. A closer examination of the export trends in carpet, pashmina, handicrafts and tea showed that, indeed, Nepal has not been in a position to reap expected benefits from the duty free and quota free facilities. Even considering only nominal prices, there is sharp decline in the exports of carpets, handicrafts and tea.

3. A review made on the rules of origin criteria of EU, Japan and US followed by their uses in tea, carpet, pashmina and handicraft products indicates various discouraging practices by these countries. Generally, ROO require the fulfillment of either the specific process criteria or the value added criterion so as to confer the originating status. Despite three quarters of Nepal's exports enjoying preferential market access, preference utilization is low due to various stringent rules of origin requirements. Nepal is deprived of duty free quota free market access for garments after expiration of the MFA in the USA. For tea, the EU has yet to define the ROO criteria.

4. With such a background, the rules of origin and their probable impact on exports of carpet, pashmina, handicrafts and tea to EU, Japan and the USA were examined based on the findings of a survey carried out among the manufacturers and traders. The survey findings showed a somewhat mixed view of the responding firms. A majority of respondents believed that duty and quota free facilities have helped to augment exports. According to them, absent these measures, export prices would have escalated, with adverse effects on the competitiveness and export volumes of their products.

5. However, a sizable number of respondents also said that documentation processes, registered firm requirements, delays in the release of commodities at custom points in the name of rules of origin often constrained exports and added costs to the exportable product. Such added costs have been reported to be in the range of 20 to 30 percent.

6. The survey results also indicate that internal policies and other incentive environments are not suitable to allow merchants to reap benefits from duty free and quota free facilities.

7. The total value content verified under the build down method showed that tea, many handicraft products, and carpet qualify under the rules of origin scheme. In case of pashmina, however, the level was beyond the qualifying range. Under the build-up method, the sample goods were qualified as originating goods of Nepal. When analyzed on a country-basis, some variations were found. Handicrafts and pashmina were found to be unqualified under the build down method in all countries, i.e. the EU, Japan and the US.

Under this method, carpet was found to be qualified for export as per rules of origin. Under the build up method, all four commodities were qualified in all countries.

## Recommendations

1. The value content requirement criteria pursued by the US, Japan and the EU needs to be revised with a more flexible approach in order to encourage exports from least developed countries like Nepal. This is particularly desirable in view of the decline of Nepalese exports despite preferential treatment under existing duty free quota free arrangements. The WTO should consider new initiatives to this end.
2. Similarly, there is a need to remove various cumbersome procedures applied to verify the rules of origin. A transparent and rapid clearance mechanism in a time bound manner with limited paperwork is essential to allow least developed countries like Nepal to reap the benefits of these concessionary measures.
3. The US must provide preferential treatment to Nepalese garment products similar to the facilities it grants to other selected countries. The complete ban on Nepalese carpets by Germany is also unjustified. Alternatively, stringent rules with respect to child labor may be justified.
4. Internally, a revisit of the whole gamut of trade and industrial policy may be required in the Nepalese context as a way to introduce greater incentives for exporters. Tariffs, credit, institutional support and other related policies may require changes and reforms to ensure an adequate incentive structure to facilitate the revitalization of the export sector.

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# Appendices

## Appendix I: Trends in Total Trade

***(Rs in million)***

| Description | 1999/2000 | 2000/2001 | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 | 2007/08 | 2008/09 |
|---|---|---|---|---|---|---|---|---|---|---|
| Export F.O.B. | 49822.7 | 55654.1 | 46944.8 | 49930.6 | 53910.7 | 58705.7 | 60234.1 | 59383.1 | 59266.5 | 67697.5 |
| India | 21220.7 | 26030.2 | 27956.2 | 26430.0 | 30777.1 | 38916.9 | 40714.7 | 41728.8 | 38555.7 | 41005.9 |
| Other Countries | 28602.0 | 29623.9 | 18988.6 | 23500.6 | 23133.6 | 19788.8 | 19519.4 | 17654.3 | 20710.8 | 26691.6 |
| Import C.I.F. | 108504.9 | 115687.2 | 107389.0 | 124352.1 | 136277.1 | 149473.6 | 173780.3 | 194694.6 | 221937.7 | 284469.6 |
| India | 39660.1 | 45211.0 | 56622.1 | 70924.2 | 78739.5 | 88675.5 | 107143.1 | 115872.3 | 142376.5 | 162437.6 |
| Other Countries | 68844.8 | 70476.2 | 50766.9 | 53427.9 | 57537.6 | 60798.1 | 66637.2 | 78822.3 | 79561.2 | 122032 |
| Trade Balance | -58682.2 | -60033.1 | -60444.2 | -74421.5 | -82366.4 | -90767.9 | -113546.2 | -135311.5 | -162671.2 | -216772.1 |
| India | -18439.4 | -19180.8 | -28665.9 | -44494.2 | -47962.4 | -49758.6 | -66428.4 | -74143.5 | -103820.8 | -121431.7 |
| Other Countries | -40242.8 | -40852.3 | -31778.3 | -29927.3 | -34404.0 | -41009.3 | -47117.8 | -61168.0 | -58850.4 | -95340.4 |
| Total Volume of Trade | 158327.6 | 171341.3 | 154333.8 | 174282.7 | 190187.8 | 208179.3 | 234014.4 | 254077.7 | 281204.2 | 352167.1 |
| India | 60880.8 | 71241.2 | 84578.3 | 97354.2 | 109516.6 | 127592.4 | 147857.8 | 157601.1 | 180932.2 | 203443.5 |
| Other Countries | 97446.8 | 100100.1 | 69755.5 | 76928.5 | 80671.2 | 80586.9 | 86156.6 | 96476.6 | 100272.0 | 148723.6 |
| **% Share in Total Trade** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** |
| India | 38.5 | 41.6 | 54.8 | 55.9 | 57.6 | 61.3 | 63.2 | 62.0 | 64.3 | 57.8 |
| Other Countries | 61.5 | 58.4 | 45.2 | 44.1 | 42.4 | 38.7 | 36.8 | 38.0 | 35.7 | 42.2 |
| Export F.O.B. | 31.5 | 32.5 | 30.4 | 28.6 | 28.3 | 28.2 | 25.7 | 23.4 | 21.1 | 19.2 |
| Import C.I.F. | 68.5 | 67.5 | 69.6 | 71.4 | 71.7 | 71.8 | 74.3 | 76.6 | 78.9 | 80.8 |
| **Growth Rate (in per cent)** | | | | | | | | | | |
| Export F.O.B. | | 11.7 | -15.6 | 6.4 | 8.0 | 8.9 | 2.6 | -1.4 | -0.2 | 14.2 |
| India | | 22.7 | 7.4 | -5.5 | 16.4 | 26.4 | 4.6 | 2.5 | -7.6 | 6.4 |
| Other Countries | | 3.6 | -35.9 | 23.8 | -1.6 | -14.5 | -1.4 | -9.6 | 17.3 | 28.9 |
| Import C.I.F. | | 6.6 | -7.2 | 15.8 | 9.6 | 9.7 | 16.3 | 12.0 | 14.0 | 28.2 |
| India | | 14.0 | 25.2 | 25.3 | 11.0 | 12.6 | 20.8 | 8.1 | 22.9 | 14.1 |
| Other Countries | | 2.4 | -28.0 | 5.2 | 7.7 | 5.7 | 9.6 | 18.3 | 0.9 | 53.4 |
| Trade Balance | | 2.3 | 0.7 | 23.1 | 10.7 | 10.2 | 25.1 | 19.2 | 20.2 | 33.3 |
| India | | 4.0 | 49.5 | 55.2 | 7.8 | 3.7 | 33.5 | 11.6 | 40.0 | 17.0 |
| Other Countries | | 1.5 | -22.2 | -5.8 | 15.0 | 19.2 | 14.9 | 29.8 | -3.8 | 62.0 |
| Total Volume of Trade | | 8.2 | -9.9 | 12.9 | 9.1 | 9.5 | 12.4 | 8.6 | 10.7 | 25.2 |
| India | | 17.0 | 18.7 | 15.1 | 12.5 | 16.5 | 15.9 | 6.6 | 14.8 | 12.4 |
| Other Countries | | 2.7 | -30.3 | 10.3 | 4.9 | -0.1 | 6.9 | 12.0 | 3.9 | 48.3 |

**Source: Economic Survey (Various Issues), GoN.**

# Appendix II: Trends in Nepal's Exports to India

***(Rs in million)***

| | | | | | | | | | | | Growth Rate | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Description | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
| Rice (Husked) | 0.0 | 16.6 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 89.90 | | | | | | | | | |
| Maize | 0.1 | 0.0 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | | | | | | | | | |
| Mustard & Linseeds | 29.3 | 37.9 | 10.20 | 46.70 | 37.60 | 44.30 | 47.50 | 23.30 | 35.10 | 21.70 | 29.4 | -73.1 | 357.8 | -19.5 | 17.8 | 7.2 | -50.9 | 50.6 | -38.2 |
| Herbs | 61.2 | 71.5 | 84.10 | 111.90 | 91.50 | 132.40 | 133.50 | 105.60 | 148.60 | 206.60 | 16.8 | 17.6 | 33.1 | -18.2 | 44.7 | 0.8 | -20.9 | 40.7 | 39.0 |
| Ghee | 0 | 470.7 | 60.00 | 54.60 | 76.50 | 83.10 | 103.00 | 110.90 | 101.70 | 106.40 | | -87.3 | -9.0 | 40.1 | 8.6 | 23.9 | 7.7 | -8.3 | 4.6 |
| Dried Ginger | 59.5 | 61.0 | 80.50 | 108.40 | 78.00 | 80.10 | 62.20 | 49.60 | 54.00 | 68.00 | 2.5 | 32.0 | 34.7 | -28.0 | 2.7 | -22.3 | -20.3 | 8.9 | 25.9 |
| Pulses | 969.7 | 713.5 | 1005.70 | 880.40 | 579.10 | 667.10 | 643.20 | 306.90 | 314.80 | 381.60 | -26.4 | 41.0 | -12.5 | -34.2 | 15.2 | -3.6 | -52.3 | 2.6 | 21.2 |
| Kutch | 10.2 | 12.6 | 8.80 | 11.20 | 13.20 | 14.10 | 42.10 | 6.30 | 8.50 | 50.80 | 23.5 | -30.2 | 27.3 | 17.9 | 6.8 | 198.6 | -85.0 | 34.9 | 497.6 |
| Live Animals | 71.9 | 45.8 | 56.20 | 62.50 | 55.10 | 56.00 | 58.00 | 21.70 | 52.20 | 24.40 | -36.3 | 22.7 | 11.2 | -11.8 | 1.6 | 3.6 | -62.6 | 140.6 | -53.3 |
| Flour | 0.0 | 60.8 | 44.40 | 7.10 | 32.20 | 0.40 | 0.00 | 0.00 | 3.50 | 82.40 | | -27.0 | -84.0 | 353.5 | -98.8 | -100.0 | | | 2254.3 |
| Ginger | 161.5 | 161.8 | 207.90 | 315.40 | 287.10 | 161.00 | 275.20 | 541.30 | 543.20 | 335.10 | 0.2 | 28.5 | 51.7 | -9.0 | -43.9 | 70.9 | 96.7 | 0.4 | -38.3 |
| Oil Cake | 222.4 | 212.8 | 302.60 | 311.10 | 324.10 | 317.10 | 291.60 | 318.10 | 405.00 | 532.70 | -4.3 | 42.2 | 2.8 | 4.2 | -2.2 | -8.0 | 9.1 | 27.3 | 31.5 |
| Catechu | 199.3 | 150.0 | 180.40 | 145.40 | 162.50 | 438.70 | 382.40 | 542.80 | 543.70 | 1217.10 | -24.7 | 20.3 | -19.4 | 11.8 | 170.0 | -12.8 | 41.9 | 0.2 | 123.9 |
| Rice Bran Oil | 45.0 | 124.7 | 90.60 | 210.00 | 194.70 | 199.00 | 112.60 | 178.30 | 196.50 | 143.30 | 177.1 | -27.3 | 131.8 | -7.3 | 2.2 | -43.4 | 58.3 | 10.2 | -27.1 |
| Salseed Oil | 51.9 | 0.0 | 1.60 | 1.90 | 0.00 | 0.00 | 0.00 | 0.00 | 0.10 | 0.00 | | | | | | | | | |
| Raw Jute | 0.0 | 113.6 | 8.30 | 0.00 | 0.90 | 0.00 | 0.50 | 1.60 | 31.10 | 146.30 | | | | | | | | | |
| Jute Cutting | 0.1 | 1.1 | 0.00 | 0.00 | 0.00 | 1.30 | 48.20 | 0.00 | 10.80 | 56.70 | | | | | | | | | |
| Jute Goods | 1103.9 | 1294.2 | 1630.10 | 1899.00 | 1882.60 | 2693.50 | 2636.80 | 2756.80 | 2582.50 | 1282.50 | 17.2 | 26.0 | 16.5 | -0.9 | 43.1 | -2.1 | 4.6 | -6.3 | -50.3 |
| a) Hessian | 103.9 | 50.5 | 44.70 | 44.20 | 143.50 | 186.10 | 464.50 | 375.10 | 528.80 | 207.10 | -51.4 | -11.5 | -1.1 | 224.7 | 29.7 | 149.6 | -19.2 | 41.0 | -60.8 |
| b) Sacking | 403.2 | 540.4 | 609.20 | 855.90 | 1056.50 | 1456.20 | 1265.40 | 1408.60 | 1219.90 | 458.80 | 34.0 | 12.7 | 40.5 | 23.4 | 37.8 | -13.1 | 11.3 | -13.4 | -62.4 |
| c) Twines | 596.8 | 703.3 | 976.20 | 998.90 | 682.60 | 1051.20 | 906.90 | 973.10 | 833.80 | 616.60 | 17.8 | 38.8 | 2.3 | -31.7 | 54.0 | -13.7 | 7.3 | -14.3 | -26.0 |
| Cardamom | 223.0 | 298.2 | 359.90 | 469.60 | 451.00 | 607.00 | 608.10 | 848.10 | 1034.80 | 1217.00 | 33.7 | 20.7 | 30.5 | -4.0 | 34.6 | 0.2 | 39.5 | 22.0 | 17.6 |
| Noodles | 126.8 | 136.0 | 227.00 | 309.70 | 259.70 | 369.30 | 414.70 | 237.40 | 522.90 | 803.20 | 7.3 | 66.9 | 36.4 | -16.1 | 42.2 | 12.3 | -42.8 | 120.3 | 53.6 |
| Cattlefeed | 200.9 | 195.5 | 215.00 | 405.90 | 550.90 | 547.40 | 454.60 | 80.90 | 176.90 | 350.50 | -2.7 | 10.0 | 88.8 | 35.7 | -0.6 | -17.0 | -82.2 | 118.7 | 98.1 |
| Tooth Paste | 2262.9 | 2033.4 | 1606.70 | 1002.80 | 1478.80 | 1283.00 | 730.80 | 663.40 | 475.60 | 813.20 | -10.1 | -21.0 | -37.6 | 47.5 | -13.2 | -43.0 | -9.2 | -28.3 | 71.0 |
| Polyster Yarn | 630.3 | 773.6 | 56.50 | 59.60 | 109.00 | 1896.30 | 3476.30 | 2241.00 | 2618.00 | 2499.80 | 22.7 | -92.7 | 5.5 | 82.9 | 1639.7 | 83.3 | -35.5 | 16.8 | -4.5 |
| Medicine (Ayurvedic) | 511.3 | 487.4 | 583.40 | 743.10 | 289.90 | 197.50 | 301.10 | 156.30 | 132.10 | 591.00 | -4.7 | 19.7 | 27.4 | -61.0 | -31.9 | 52.5 | -48.1 | -15.5 | 347.4 |

| | | | | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Soap | 1083.5 | 950.6 | 528.90 | 469.20 | 539.60 | 368.00 | 363.60 | 502.70 | 424.20 | 591.00 | -12.3 | -44.4 | -11.3 | 15.0 | -31.8 | -1.2 | 38.3 | -15.6 | 39.3 |
| Veg. Ghee | 2743.0 | 3560.3 | 7081.40 | 3812.30 | 2959.00 | 4635.90 | 3861.70 | 4136.50 | 2132.30 | 9.10 | 29.8 | 98.9 | -46.2 | -22.4 | 56.7 | -16.7 | 7.1 | -48.5 | -99.6 |
| Pashmina | 3544.2 | 2728.5 | 637.30 | 475.60 | 373.10 | 341.50 | 210.70 | 48.30 | 44.00 | 65.90 | -23.0 | -76.6 | -25.4 | -21.6 | -8.5 | -38.3 | -77.1 | -8.9 | 49.8 |
| Thread | 1169.2 | 1656.9 | 846.90 | 1235.20 | 1637.40 | 2213.70 | 1898.30 | 4055.90 | 4134.80 | 2525.40 | 41.7 | -48.9 | 45.8 | 32.6 | 35.2 | -14.2 | 113.7 | 1.9 | -38.9 |
| Copper wire Rod | 631.5 | 2081.6 | 2620.50 | 356.60 | 200.80 | 530.10 | 305.80 | 206.00 | 617.40 | 571.80 | 229.6 | 25.9 | -86.4 | -43.7 | 164.0 | -42.3 | -32.6 | 199.7 | -7.4 |
| M.S. Pipe | 425.3 | 353.1 | 410.40 | 548.20 | 851.80 | 316.60 | 105.70 | 761.90 | 979.50 | 571.20 | -17.0 | 16.2 | 33.6 | 55.4 | -62.8 | -66.6 | 620.8 | 28.6 | -41.7 |
| Plastic Utensils | 302.5 | 693.9 | 770.90 | 807.70 | 1192.40 | 1361.60 | 808.30 | 415.10 | 302.60 | 513.40 | 129.4 | 11.1 | 4.8 | 47.6 | 14.2 | -40.6 | -48.6 | -27.1 | 69.7 |
| Zinc Sheet | 58.0 | 72.0 | 13.30 | 970.60 | 2785.30 | 3070.30 | 2409.00 | 3579.90 | 4416.90 | 2821.70 | 24.1 | -81.5 | 7197.7 | 187.0 | 10.2 | -21.5 | 48.6 | 23.4 | -36.1 |
| G.I. Pipe | 65.1 | 328.7 | 165.90 | 357.20 | 556.30 | 424.00 | 519.30 | 127.80 | 242.70 | 1098.40 | 404.9 | -49.5 | 115.3 | 55.7 | -23.8 | 22.5 | -75.4 | 89.9 | 352.6 |
| Textiles | 138.0 | 449.3 | 562.50 | 878.20 | 1780.50 | 2996.60 | 2154.60 | 3056.90 | 2114.80 | 3193.50 | 225.6 | 25.2 | 56.1 | 102.7 | 68.3 | -28.1 | 41.9 | -30.8 | 51.0 |
| Juice | 242.8 | 303.5 | 452.90 | 600.10 | 786.80 | 1091.30 | 1139.60 | 1591.30 | 1836.40 | 1952.20 | 25.0 | 49.2 | 32.5 | 31.1 | 38.7 | 4.4 | 39.6 | 15.4 | 6.3 |
| Chemical | 0 | 0 | 87.30 | 148.50 | 610.00 | 1407.50 | 1057.50 | 950.20 | 275.70 | 290.10 | | | 70.1 | 310.8 | 130.7 | -24.9 | -10.1 | -71.0 | 5.2 |
| **Total** | **17344.3** | **20651.1** | **20998.10** | **17815.70** | **21227.40** | **28545.70** | **25656.50** | **28622.80** | **27512.90** | **25222.90** | **19.1** | **1.7** | **-15.2** | **19.1** | **34.5** | **-10.1** | **11.6** | **-3.9** | **-8.3** |
| **Others** | **3876.4** | **5379.1** | **6958.10** | **8614.30** | **9549.70** | **10371.20** | **15058.20** | **13106.00** | **11042.80** | **15783.00** | **38.8** | **29.4** | **23.8** | **10.9** | **8.6** | **45.2** | **-13.0** | **-15.7** | **42.9** |
| **Grand Total** | **21220.7** | **26030.2** | **27956.20** | **26430.00** | **30777.10** | **38916.90** | **40714.70** | **41728.80** | **38555.70** | **41005.90** | **22.7** | **7.4** | **-5.5** | **16.4** | **26.4** | **4.6** | **2.5** | **-7.6** | **6.4** |
| **Share in Total** | | | | | | | | | | | | | | | | | | | |
| Rice (Husked) | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | | | | | | | | | |
| Maize | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | | | | | | | | |
| Mustard & Linseeds | 0.1 | 0.1 | 0.0 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | | | | | | | | | |
| Herbs | 0.3 | 0.3 | 0.3 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.4 | 0.5 | | | | | | | | | |
| Ghee | 0.0 | 1.8 | 0.2 | 0.2 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | | | | | | | | | |
| Dried Ginger | 0.3 | 0.2 | 0.3 | 0.4 | 0.3 | 0.2 | 0.2 | 0.1 | 0.1 | 0.2 | | | | | | | | | |
| Pulses | 4.6 | 2.7 | 3.6 | 3.3 | 1.9 | 1.7 | 1.6 | 0.7 | 0.8 | 0.9 | | | | | | | | | |
| Kutch | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.1 | | | | | | | | | |
| Live Animals | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | | | | | | | | | |
| Flour | 0.0 | 0.2 | 0.2 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | | | | | | | | | |
| Ginger | 0.8 | 0.6 | 0.7 | 1.2 | 0.9 | 0.4 | 0.7 | 1.3 | 1.4 | 0.8 | | | | | | | | | |
| Oil Cake | 1.0 | 0.8 | 1.1 | 1.2 | 1.1 | 0.8 | 0.7 | 0.8 | 1.1 | 1.3 | | | | | | | | | |
| Catechu | 0.9 | 0.6 | 0.6 | 0.6 | 0.5 | 1.1 | 0.9 | 1.3 | 1.4 | 3.0 | | | | | | | | | |
| Rice Bran Oil | 0.2 | 0.5 | 0.3 | 0.8 | 0.6 | 0.5 | 0.3 | 0.4 | 0.5 | 0.3 | | | | | | | | | |
| Salseed Oil | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | | | | | | | | |
| Raw Jute | 0.0 | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.4 | | | | | | | | | |

| | | | | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Jute Cutting | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.1 | | | | | | | | | |
| Jute Goods | 5.2 | 5.0 | 5.8 | 7.2 | 6.1 | 6.9 | 6.5 | 6.6 | 6.7 | 3.1 | | | | | | | | | |
| a) Hessian | 0.5 | 0.2 | 0.2 | 0.2 | 0.5 | 0.5 | 1.1 | 0.9 | 1.4 | 0.5 | | | | | | | | | |
| b) Sacking | 1.9 | 2.1 | 2.2 | 3.2 | 3.4 | 3.7 | 3.1 | 3.4 | 3.2 | 1.1 | | | | | | | | | |
| c) Twines | 2.8 | 2.7 | 3.5 | 3.8 | 2.2 | 2.7 | 2.2 | 2.3 | 2.2 | 1.5 | | | | | | | | | |
| Cardamom | 1.1 | 1.1 | 1.3 | 1.8 | 1.5 | 1.6 | 1.5 | 2.0 | 2.7 | 3.0 | | | | | | | | | |
| Noodles | 0.6 | 0.5 | 0.8 | 1.2 | 0.8 | 0.9 | 1.0 | 0.6 | 1.4 | 2.0 | | | | | | | | | |
| Cattle feed | 0.9 | 0.8 | 0.8 | 1.5 | 1.8 | 1.4 | 1.1 | 0.2 | 0.5 | 0.9 | | | | | | | | | |
| Toothpaste | 10.7 | 7.8 | 5.7 | 3.8 | 4.8 | 3.3 | 1.8 | 1.6 | 1.2 | 2.0 | | | | | | | | | |
| Polyster Yarn | 3.0 | 3.0 | 0.2 | 0.2 | 0.4 | 4.9 | 8.5 | 5.4 | 6.8 | 6.1 | | | | | | | | | |
| Medicine (Ayurvedic) | 2.4 | 1.9 | 2.1 | 2.8 | 0.9 | 0.5 | 0.7 | 0.4 | 0.3 | 1.4 | | | | | | | | | |
| Soap | 5.1 | 3.7 | 1.9 | 1.8 | 1.8 | 0.9 | 0.9 | 1.2 | 1.1 | 1.4 | | | | | | | | | |
| Veg. Ghee | 12.9 | 13.7 | 25.3 | 14.4 | 9.6 | 11.9 | 9.5 | 9.9 | 5.5 | 0.0 | | | | | | | | | |
| Pashmina | 16.7 | 10.5 | 2.3 | 1.8 | 1.2 | 0.9 | 0.5 | 0.1 | 0.1 | 0.2 | | | | | | | | | |
| Thread | 5.5 | 6.4 | 3.0 | 4.7 | 5.3 | 5.7 | 4.7 | 9.7 | 10.7 | 6.2 | | | | | | | | | |
| Copper wire Rod | 3.0 | 8.0 | 9.4 | 1.3 | 0.7 | 1.4 | 0.8 | 0.5 | 1.6 | 1.4 | | | | | | | | | |
| M.S. Pipe | 2.0 | 1.4 | 1.5 | 2.1 | 2.8 | 0.8 | 0.3 | 1.8 | 2.5 | 1.4 | | | | | | | | | |
| Plastic Utensils | 1.4 | 2.7 | 2.8 | 3.1 | 3.9 | 3.5 | 2.0 | 1.0 | 0.8 | 1.3 | | | | | | | | | |
| Zinc Sheet | 0.3 | 0.3 | 0.0 | 3.7 | 9.0 | 7.9 | 5.9 | 8.6 | 11.5 | 6.9 | | | | | | | | | |
| G.I. Pipe | 0.3 | 1.3 | 0.6 | 1.4 | 1.8 | 1.1 | 1.3 | 0.3 | 0.6 | 2.7 | | | | | | | | | |
| Textiles | 0.7 | 1.7 | 2.0 | 3.3 | 5.8 | 7.7 | 5.3 | 7.3 | 5.5 | 7.8 | | | | | | | | | |
| Juice | 1.1 | 1.2 | 1.6 | 2.3 | 2.6 | 2.8 | 2.8 | 3.8 | 4.8 | 4.8 | | | | | | | | | |
| Chemical | 0.0 | 0.0 | 0.3 | 0.6 | 2.0 | 3.6 | 2.6 | 2.3 | 0.7 | 0.7 | | | | | | | | | |
| Others | 18.3 | 20.7 | 24.9 | 32.6 | 31.0 | 26.6 | 37.0 | 31.4 | 28.6 | 38.5 | | | | | | | | | |

**Source: Economic Survey (Various Issues), GoN.**

# Appendix III: Trends of Nepal's Export to Other Countries

***(Rs in million)***

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|---|---|---|---|---|
| Pulses | 87.1 | 501.1 | 216.0 | 214.9 | 280.7 | 106.5 | 191.70 | 488.50 | 1458.40 | 6247.10 |
| Cardamon (Large) | 0 | 21.8 | 71.5 | 125.4 | 231.4 | 205.3 | 109.20 | 129.60 | 65.00 | 63.90 |
| Medicinal Herbs | 15.1 | 25.9 | 25.4 | 33.3 | 48.3 | 54.7 | 19.00 | 43.50 | 97.90 | 412.00 |
| Catechu | 0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.00 | 0.00 | 0.00 | 21.10 |
| Woolen Goods | 0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.00 | 0.00 | 0.00 | 0.00 |
| Nepalese Paper & Paper Products | 168.4 | 196.7 | 200.5 | 262.0 | 279.6 | 239.8 | 257.00 | 190.60 | 347.10 | 361.20 |
| Hides & Skins | 181.9 | 658.4 | 464.7 | 227.3 | 309.0 | 235.8 | 310.40 | 279.10 | 248.70 | 58.20 |
| Carpets (Hand Knotted Woolen) | 9842.1 | 8592.3 | 6212.5 | 5320.0 | 5677.5 | 5868.7 | 5838.70 | 5600.20 | 5048.20 | 5735.50 |
| Readymade Garments | 13942.4 | 13124.7 | 7833.0 | 11890.1 | 9550.0 | 6124.6 | 6204.10 | 5212.90 | 4755.80 | 4904.70 |
| Handicrafts | 218.1 | 233.9 | 233.8 | 352.1 | 626.4 | 644.2 | 430.90 | 250.20 | 194.00 | 1077.80 |
| Ornaments | 232.6 | 211.5 | 274.1 | 347.7 | 368.7 | 363.2 | 282.40 | 325.40 | 269.40 | 262.40 |
| Pasmina | 2665.0 | 4121.2 | 1245.0 | 1157.6 | 1064.1 | 1049.8 | 1577.80 | 931.00 | 643.40 | 1526.90 |
| Total | 27352.7 | 27687.5 | 16776.5 | 19930.4 | 18435.7 | 14892.6 | 15221.2 | 13451.0 | 13127.9 | 20670.8 |
| Others | 1249.3 | 1936.4 | 2212.1 | 3570.2 | 4697.9 | 4896.2 | 4298.20 | 4203.30 | 7582.90 | 6020.80 |
| Grand Total | 28602.0 | 29623.9 | 18988.6 | 23500.6 | 23133.6 | 19788.8 | 19519.4 | 17654.3 | 20710.8 | 26691.6 |
| **Share in Total** | | | | | | | | | | |
| Pulses | 0.30 | 1.69 | 1.14 | 0.91 | 1.21 | 0.54 | 0.98 | 2.77 | 7.04 | 23.40 |
| Cardamon (Large) | 0.00 | 0.07 | 0.38 | 0.53 | 1.00 | 1.04 | 0.56 | 0.73 | 0.31 | 0.24 |
| Medicinal Herbs | 0.05 | 0.09 | 0.13 | 0.14 | 0.21 | 0.28 | 0.10 | 0.25 | 0.47 | 1.54 |
| Catechu | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.08 |
| Woolen Goods | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Nepalese Paper & Paper Products | 0.59 | 0.66 | 1.06 | 1.11 | 1.21 | 1.21 | 1.32 | 1.08 | 1.68 | 1.35 |
| Hides & Skins | 0.64 | 2.22 | 2.45 | 0.97 | 1.34 | 1.19 | 1.59 | 1.58 | 1.20 | 0.22 |
| Carpets (Hand Knotted Woolen) | 34.41 | 29.00 | 32.72 | 22.64 | 24.54 | 29.66 | 29.91 | 31.72 | 24.37 | 21.49 |
| Readymade Garments | 48.75 | 44.30 | 41.25 | 50.59 | 41.28 | 30.95 | 31.78 | 29.53 | 22.96 | 18.38 |
| Handicrafts | 0.76 | 0.79 | 1.23 | 1.50 | 2.71 | 3.26 | 2.21 | 1.42 | 0.94 | 4.04 |
| Ornaments | 0.81 | 0.71 | 1.44 | 1.48 | 1.59 | 1.84 | 1.45 | 1.84 | 1.30 | 0.98 |
| Pasmina | 9.32 | 13.91 | 6.56 | 4.93 | 4.60 | 5.31 | 8.08 | 5.27 | 3.11 | 5.72 |
| Others | 4.37 | 6.54 | 11.65 | 15.19 | 20.31 | 24.74 | 22.02 | 23.81 | 36.61 | 22.56 |
| Total | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| **Growth Rate** | | | | | | | | | | |
| Pulses | | 475.32 | -56.89 | -0.51 | 30.62 | -62.06 | 80.00 | 154.83 | 198.55 | 328.35 |
| Cardamom (Large) | | #DIV/0! | 227.98 | 75.38 | 84.53 | -11.28 | -46.81 | 18.68 | -49.85 | -1.69 |
| Medicinal Herbs | | 71.52 | -1.93 | 31.10 | 45.05 | 13.25 | -65.27 | 128.95 | 125.06 | 320.84 |
| Nepalese Paper & Paper Products | | 16.81 | 1.93 | 30.67 | 6.72 | -14.23 | 7.17 | -25.84 | 82.11 | 4.06 |
| Hides & Skins | | 261.96 | -29.42 | -51.09 | 35.94 | -23.69 | 31.64 | -10.08 | -10.89 | -76.60 |
| Carpets (Hand Knotted Woolen) | | -12.70 | -27.70 | -14.37 | 6.72 | 3.37 | -0.51 | -4.08 | -9.86 | 13.61 |
| Readymade Garments | | -5.86 | -40.32 | 51.79 | -19.68 | -35.87 | 1.30 | -15.98 | -8.77 | 3.13 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Handicrafts | | 7.24 | -0.04 | 50.60 | 77.90 | 2.84 | -33.11 | -41.94 | -22.46 | 455.57 |
| Ornaments | | -9.07 | 29.60 | 26.85 | 6.04 | -1.49 | -22.25 | 15.23 | -17.21 | -2.60 |
| Pasmina | | 54.64 | -69.79 | -7.02 | -8.08 | -1.34 | 50.30 | -40.99 | -30.89 | 137.32 |
| Total | | 1.22 | -39.41 | 18.80 | -7.50 | -19.22 | 2.21 | -11.63 | -2.40 | 57.46 |
| Others | | 55.00 | 14.24 | 61.39 | 31.59 | 4.22 | -12.21 | -2.21 | 80.40 | -20.60 |
| Grand Total | | 3.57 | -35.90 | 23.76 | -1.56 | -14.46 | -1.36 | -9.56 | 17.31 | 28.88 |

***Source: Economic Survey (Various Issues)***

# Table IV: Harmonized Codes and Items Name under Handicrafts Categories by Federation of Handicraft Association of Nepal

| H. S. Code (Eight Digits) | Items Name | Chapter (Two Digits) | Category | Item Description by Chapter Number |
|---|---|---|---|---|
| 7113.11.00 | Silver Jewelry | 71 | Metal goods | Natural or cultured pearls, pearls, precious or semi-precious stones, precious metals, metals clad with precious metal and articles thereof, imitation jewelry, coins |
| 7117.99.00 | Artificial Ornaments | 71 | Metal goods | |
| 7417.00.00 | Copper Utensils | 74 | Metal goods | Copper and articles thereof |
| 8211.92.00 | Gorkha Knives(Khukuri) | 82 | Metal goods | Tools, implements, cutlery, spoons and forks of base metals, parts thereof of base metals |
| 9307.00.00 | Khukuri | 93 | Metal goods | Arms and ammunition, parts and accessories thereof |
| 8306.10.00 | Article of Base Metal(Bells, Gongs) | 83 | Metal goods | Miscellaneous articles of base metal |
| 9703.00.00 | Metal Sculptors, Statuary and Other Handicrafts | 97 | Metal goods | Works of art, collectors' pieces and antiques |
| 9206.00.00 | Metal Musical Instruments (Cymbals/Tingshya etc.) | 92 | Metal goods | Musical Instruments, parts and accessories of such articles |
| 5701.10.40 | Hand knotted Woolen Carpet | 57 | Woolen Goods | Carpets and other textile floor coverings |
| 5702.31.00 | Woolen Carpets, Floor Coverings (Woven) | 57 | Woolen Goods | |
| 6001.00.00 | Crochet/ Knitted Fabrics | 60 | Woolen Goods | Knitted or crocheted fabrics |
| 6110.10.00 | Woolen Sweater, Knitwear | 61 | Woolen Goods | Articles of apparel and clothing accessories, knitted or crocheted |
| 6204.42.00 | Woolen Dresses | 62 | Woolen Goods | Articles of apparel and clothing accessories, not knitted or crocheted |
| 6204.62.00 | Woolen Shirts(Ladies) | 62 | Woolen Goods | |
| 6204.90.00 | Woolen Shirts(Ladies) | 62 | Woolen Goods | |
| 6205.10.00 | Woolen Shirts(Gents) | 62 | Woolen Goods | |
| 6301.20.00 | Woolen Shawls | 63 | Woolen Goods | Other made up textile articles, sets, worn clothing and worn textile articles, rags |
| 5701.10.13 | Certified Handloom & Folklore Products | 57 | Woolen Goods | Carpets and other textile floor coverings |
| 5701.10.10 | Hand knotted Woolen/Silk Carpet | 57 | Woolen Goods | |

| | | | | |
|---|---|---|---|---|
| 5701.90.10 | Hand knotted Silk Carpet | 57 | Woolen Goods | |
| 5701.90.10 | Hand knotted Allo/ Hemp & Other Natural Fibers | 57 | Woolen Goods | |
| 5003.90.00 | Silk Goods | 50 | Silk Goods | Silk |
| 4202.99.00 | Hemp Goods | 42 | Leather Goods | Articles of leather, saddlery and harnesses, travel goods, handbags and similar containers, articles of animal gut (other than silk worm gut) |
| 5208.00.00 | Cotton Fabrics | 52 | Cotton Goods | Cotton |
| 5310.00.00 | Hemp Fabrics | 53 | Cotton Goods | Other vegetable textile fibers, paper yarn and woven |
| 5308.00.00 | Handloom Cloth (Cotton) | 53 | Cotton Goods | |
| 5905.00.00 | Cotton Wall Covering | 59 | Cotton Goods | Impregnated, coated, covered or laminated textile fabrics, textile articles of a kind suitable for industrial use |
| 6110.20.00 | Cotton Sweaters Knitted | 61 | Cotton Goods | Articles of apparel and clothing accessories, knitted or crocheted |
| 6115.91.00 | Cotton Socks Knitted | 61 | Cotton Goods | |
| 6116.10.00 | Cotton Muffler Knitted | 61 | Cotton Goods | |
| 6116.91.00 | Cotton Knitted Glove | 61 | Cotton Goods | |
| 6201.12.00 | Cotton Jacket, Over Coat(Gents and Ladies) | 62 | Cotton Goods | Articles of apparel and clothing accessories, not knitted or crocheted |
| 6203.31.00 | Over Jackets(Gents and Ladies) | 62 | Cotton Goods | |
| 6204.42.00 | Cotton Dresses | 62 | Cotton Goods | |
| 6205.20.00 | Cotton Shirts (Gents) | 62 | Cotton Goods | |
| 6205.90.00 | Rayon Shirts (Gents) | 62 | Cotton Goods | |
| 6206.20.00 | Rayon Shirts(Ladies) | 62 | Cotton Goods | |
| 6206.30.00 | Cotton Shirts(Blouse) | 62 | Cotton Goods | |
| 6207.11.00 | Cotton Shirts | 62 | Cotton Goods | |
| 6207.21.00 | Cotton Pyjamas(Gents) | 62 | Cotton Goods | |
| 6241.10.00 | Cotton Shawls, Scarf | 62 | Cotton Goods | |
| 6305.20.00 | Cotton Bags | 63 | Cotton Goods | Other made up textiles articles, sets, worn clothing and worn textile articles, rags |
| 6405.20.00 | Cotton Shoes | 64 | Cotton Goods | Footwear, gaiters, and the like, parts of such articles |
| 6505.10.00 | Cotton Nets | 65 | Cotton Goods | Other made up textile articles, sets, worn clothing and worn textile articles, rags |
| 6505.90.00 | Cotton Caps, Hats | 65 | Cotton Goods | |
| 4802.10.00 | Handmade Nepali Paper | 48 | Handmade Papers and Goods made thereof | Handmade Papers and Goods made thereof |
| 4810.29.00 | Handmade Papers | 48 | Handmade Papers and Goods made thereof | |
| 4814.20.00 | Handmade Paper Wall Coverings | 48 | Handmade Papers and Goods made | |

| | | | | |
|---|---|---|---|---|
| | | | thereof | |
| 4817.10.00 | Handmade Paper Envelopes | 48 | Handmade Papers and Goods made thereof | |
| 4817.30.00 | Handmade Paper Cards, Boxes etc. | 48 | Handmade Papers and Goods made thereof | |
| 4819.50.00 | Handmade Paper Packing Boxes | 48 | Handmade Papers and Goods made thereof | |
| 4820.10.00 | Handmade Paper Note Books, Letter Pads | 48 | Handmade Papers and Goods made thereof | |
| 4820.50.00 | Handmade Paper Albums | 48 | Handmade Papers and Goods made thereof | |
| 4910.00.00 | Calendars | 49 | Handmade Papers and Goods made thereof | Handmade Papers and Goods made thereof |
| 5702.10.10 | Hand-woven/ Hand loomed Folklore Products | 57 | Handmade Papers and Goods made thereof | Handmade Papers and Goods made thereof |
| 4412.19.00 | Wooden Ties | 44 | Wooden goods | Wood and articles of wood, wood charcoal |
| 4414.00.00 | Wooden Frames | 44 | Wooden goods | |
| 4415.10.00 | Wooden Boxes | 44 | Wooden goods | |
| 4418.10.00 | Wooden Windows | 44 | Wooden goods | |
| 4420.10.00 | Wooden Statues | 44 | Wooden goods | |
| 4420.10.00 | Wooden Goods | 44 | Wooden goods | |
| 4421.10.00 | Wooden Hangers | 44 | Wooden goods | |
| 8306.30.00 | Picture Frames | 83 | Wooden goods | Miscellaneous articles of base metals |
| 9403.40.00 | Wooden Furniture | 94 | Wooden goods | Furniture, bedding, mattresses, mattress supports, cushions and similar stuffed furnishings, lamps and lighting fittings, not elsewhere specified or included, illuminated signs, illuminated name plates and the like, prefabricated buildings. |
| 9403.80.00 | Furniture, Bamboo and Cane Products | 94 | Wooden goods | |
| 5112.00.00 | Woolen Fabrics | 51 | Woolen goods | Wool, fine or coarse animal hair, horsehair yarn and woven fabric |
| 6214.20.00 | Woolen/Pashmina Mufflers, Scarves & Shawls | 62 | Pashmina | Articles of apparel and clothing accessories, not knitted or crocheted |

# Appendix V: Changes in Chapters USA

| S. No | Category | HS Heading/Chapter No. | Product Description | Changes in Chapters |
|---|---|---|---|---|
| 1 | Pashmina | Chapter 62 | Woolen/Pashmina Muffler, Scarves & Shawls | Likewise, the ROO for Pashmina also requires the change in tariff classification to be fulfilled. The good may be made from materials from any other chapters except from heading 51.11 through 51.13, 52.04 through 52.12, 53.10 through 53.11, chapter 54, heading 55.08 through 55.16, 58.01 through 58.02, or 60.01 through 60.06. However, the change in tariff classification criteria for pashmina also requires a specific process criterion to qualify for ROO with the flexibility that such process may be carried out in the territory of either Nepal and/or the US, thus allowing for cumulation. The good may be cut and knit to shape, or both, and sewn or otherwise assembled in the territory of one or more of the Parties. This means that the pashmina must fulfill the specific process criteria even though the materials under exclusion qualify as originating.. |
| 2 | Wooden Goods | Chapter 44<br>Chapter 83<br>Chapter 94 | Wooden Tie, Frame, Box, Window, Statue, hanger, picture frames, Furniture, Bamboo and cane products | Most wooden goods require the fulfillment of the change in tariff classification criteria to qualify for the ROO. There are no. It implies that the good may made from any other heading or subheading under heading 44 (for wooden goods under HS code 4412, 4414, 4415, 4418, 4420 and 4421), 83 (for wooden goods under HS code 8306) and 94 (in case of wooden goods under HS code 9403). Similarly, handmade papers and goods made from paper |

| | | | | |
|---|---|---|---|---|
| | | | | also require the fulfillment of similar criteria. However, some paper goods such as handmade Nepali Paper (HS code 4802) and calendar (HS code 4910) may be made from materials from any other chapter; handmade papers (HS code 4810) should be made from materials from any other heading and lastly handmade paper wall coverings (HS code 4814), handmade paper envelopes (HS code 4817), handmade Paper Packing Boxes (HS code 4819) may be made from any other heading outside that group. |
| 3 | Handmade Papers and Goods made thereof | Chapter 48<br><br>Chapter 49 | Handmade Paper, Nepali paper, wall covering, Envelop, cards, boxes, packing boxes, Note book, letter pads, album, calendar | |
| 4 | Cotton Goods | Chapter 52<br><br>Chapter 53<br><br>Chapter 59<br><br>Chapter 61<br><br>Chapter 62<br><br>Chapter 63<br><br>Chapter 64<br><br>Chapter 65 | Cotton fabrics, handloom cloth, wall covering, knitted sweater, knitted socks, muffler, glove, jacket, overcoat, dress, shirt, pyjamas, shawls, scarf, bags, shoes, net, caps/hats | |
| 5 | Leather Goods | Chapter 42 | Saddle and harness, travel<br><br>goods, handbags and similar containers | Leather goods and silk goods, must fulfill the relevant change in tariff criteria with no exclusions. Almost all woolen goods must fulfill either (b) or (c) mentioned above to qualify for originating status in the EU. |
| 6 | Silk Goods | Chapter 50 | Silk | Leather goods and silk goods require the fulfillment of the change in tariff criteria with no exclusions. Almost all woolen goods |

| | | | | |
|---|---|---|---|---|
| | | | | must fulfill either (b) or (c) mentioned above to qualify for originating status in the EU. |
| 7 | Woolen Goods | Chapter 57<br><br>Chapter 60<br><br>Chapter 61<br><br>Chapter 62<br><br>Chapter 63 | Wool carpets, floor coverings, crocheted /knitted fabrics, sweaters, knitwear, dresses, shirts, shawls | Nepalese carpets need to fulfill the change in tariff classification criterion for the ROO. They must be made from materials of any other chapter than 57 except from headings 51.11 through 51.13, 52.04 through 52.12, chapter 54, or heading 55.08 through 55.16. This means they may not be made from woven fabrics of carded and combed wool or animal hair. They may not be made from woven fabrics of coarse animal hair or horse hair. They should not made from cotton sewing thread, cotton yarn and woven cotton fabrics. Similarly, carpets made from sewing thread of manmade filaments and synthetic filament yarn (also their woven fabrics) are also not permissible. |
| 8 | Metal Goods | Chapter 71<br><br>Chapter 74<br><br>Chapter 82<br><br>Chapter 83<br><br>Chapter 92<br><br>Chapter 93<br><br>Chapter 97 | Silver jewelry, artificial instruments, copper utensils, gorkha knives, khukuri, article of base metals (bell, gongs etc), metal sculpture, statuary and other handicrafts, metal musical instruments (cymbol/Tingshya etc) | Metal goods such as silver jewelry (HS code 7113), artificial ornaments (HS code 7117), khukuri (HS code 9307) require fulfillment of (a) whereas some such as Gorkha Knives (HS code 8211) and metal musical instruments (HS code 9206) require fulfillment of (a). However flexibility is allowed in this case in the form of regional cumulation: there can be a regional value content of not less than: (a) 35 percent under the build-up method, or (b) 45 percent under the build-down method, to confer the originating status. |

# Appendix VI: Changes in Chapters for Japan

| S. No | Category | HS Heading/Chapter No. | Product Description | Changes in Chapters |
|---|---|---|---|---|
| 1 | Pashmina | Chapter 62 | Woolen/Pashmina Muffler, Scarves & Shawls | These are classified under HS heading 6214 under the product name Shawls, scarves, mufflers, mantillas, veils. (See Annex 6 in the handbook). These may be exported from LDCs to Japan without any restrictions such as duties or quotas. No ceiling system is applied to Pashmina products. As of July 1 in 2009, the MFN rate for various subheadings under HS heading 6214 ranges from 5% to 10% whereas GPT rate for the same is zero percent [27][28] .<br><br>All documentary requirements must be fulfilled in order to confer origin status on Pashmina products exported to Japan. But the exporting LDC needs to fulfill the origin criteria in order to use the GPT or SPT in Japan. The country of origin condition is specifically acknowledged for this in the handbook under HS subheading 6214. They should be manufactured from chemical products, from products of heading Nos. 47.01 to 47.06, or 50.01, or from natural textile fibers (except raw silk), man-made staple fibers or textile fiber waste. As such, the explanation similar to carpets also applies to pashmina. |
| 2 | Wooden Goods | Chapter 44<br><br>Chapter 83<br><br>Chapter 94 | Wooden Tie, Frame, Box, Window, Statue, hanger, picture frames, Furniture, Bamboo and cane products | Most wooden products require the fulfillment of change in tariff heading criteria with exclusions to obtain originating status for export to Japan, except some such as wooden ties (HS code 4412), wooden frames (HS code 4414), wooden boxes (HS code 4415), for which the originating status is not specifically delineated. This means they require the fulfillment of the wholly obtained criteria instead. But if they are partially obtained they must undergo sufficient working or processing in Nepal. |
| 3 | Handmade Papers and Goods made thereof | Chapter 48<br><br>Chapter 49 | Handmade Paper, Nepali paper, wall covering, Envelop, cards, boxes, packing boxes, Note book, letter pads, album, calendar | The same process for wooden applies to almost all handmade papers and goods made thereof (of export interest to Nepal) Their ROO are also not specifically listed.. |

[27] http://www.mofa.go.jp/policy/economy/gsp/explain.html
[28] However, HS subheading 62149222 has an MFN rate of 4.40% as on July 1, 2009.

| | | | | |
|---|---|---|---|---|
| 4 | Cotton Goods | Chapter 52<br><br>Chapter 53<br><br>Chapter 59<br><br>Chapter 61<br><br>Chapter 62<br><br>Chapter 63<br><br>Chapter 64<br><br>Chapter 65 | Cotton fabrics, handloom cloth, wall covering, knitted sweater, knitted socks, muffler, glove, jacket, overcoat, dress, shirt, pyjamas, shawls, scarf, bags, shoes, net, caps/hats | The ROO for most cotton goods are specifically listed in the handbook except those for cotton nets and caps/hats (HS code 6505) for which there is no such acknowledgement. Cotton fabrics (HS code 5208), handloom cotton cloth (HS code 5308), cotton knitted sweatesr (HS code 6110), cotton knitted socks (HS code 6115) etc should be manufactured from chemical products, from products of headings 4701 to 4706, or from natural textile fibers, man-made staple fibers or textile fiber waste to qualify under the ROO. Similarly, goods such as cotton jackets, overcoats (HS heading 6201), over jackets (HS heading 6203), or cotton dresses (HS code 6204) must be manufactured from woven fabrics, felt, nonwovens, knitted or crocheted fabrics or lace of Chapters 50 to 56 or 58 to 60. |
| 5 | Leather Goods | Chapter 42 | Saddles and harnesses, travel<br><br>goods, handbags and similar containers | Leather goods under HS heading 4201 must be manufactured from products of different tariff headings (excluding heading 4205 of the products obtained). No specific listing is there for silk goods so the 'wholly obtained' criteria of rules of origin apply. If they are partially obtained they must have undergone sufficient working or processing in Nepal. Woolen goods such as woolen knitted sweaters (HS code 6110), woolen carpets and floor coverings (HS code 57902) must be manufactured from chemical products, from products of heading 4701 to 4706, or from natural textile fibers, man-made staple fibers or textile fiber waste for fulfilling the ROO. Similarly, goods such as woolen dresses (Hs heading 6204), woolen ladies and gents shirts (HS heading 6204 and 6205) etc must be manufactured from woven fabrics, felt, nonwovens, knitted or crocheted fabrics or lace of Chapters 50 to 56 0r 58 to 60. |
| 6 | Silk Goods | Chapter 50 | Silk | |
| 7 | Woolen Goods | Chapter 57<br><br>Chapter 60<br><br>Chapter 61<br><br>Chapter 62 | Woolen carpet, floor coverings, crocheted /knitted fabrics, sweater, knitwear, dresses, shirts, shawls | The condition for the ROO is specifically listed in HS heading 57. It must fulfill the change in tariff heading criterion: it must be manufactured from materials from heading Nos. 47.01 to 47.06, or from natural textile fibers, man-made staple fibers or textile fiber waste. These materials are classified under different headings than the carpet |

| | | | | |
|---|---|---|---|---|
| | | Chapter 63 | | itself.[29] Since carpets in Nepal are basically made from animal fiber extracted in Nepal or imported and almost all the processes of its manufacture are carried out in Nepal, they can also qualify under wholly obtained ROO criteria. Also, all the documentary requirements must be fulfilled in order to avail of the GPT in Japan: both Certificate of origin (Form A) and the Rules of Transportation must be produced.. |
| 8 | Metal Goods | Chapter 71<br><br>Chapter 74<br><br>Chapter 82<br><br>Chapter 83<br><br>Chapter 92<br><br>Chapter 93<br><br>Chapter 97 | Silver jewelry, artificial instruments, copper utensils, gorkha knives, khukuri, article of base metals (bell, gongs etc), metal sculpture, statuary and other handicrafts, metal musical instruments (cymbol/Tingshya etc) | The ROO for most metal goods of export interest such as silver jewelry (HS code 7113), copper utensils (HS code 7417), metal sculptures, statuary and other handicrafts (HS code 9703) are not specifically delineated. However, artificial ornaments under HS heading 7117 must be manufactured from products other than those in heading No. 71.17, excluding chains of metal. Similarly, under HS heading 9307, khukuri must be manufactured in such a way that the value of the non-originating products listed under different tariff headings does not exceed 40 percent of the value of the product obtained, nor may the value of the non-originating products of the same tariff heading exceed 5 percent of the value of the products obtained. This means that khukuri must also fulfill the value added criterion if it is made from non-originating products (Appendix VII). |

[29] As a general rule, working or processing operations will be considered sufficient when the resulting goods is classified under an HS tariff heading (4 digits), other than that covering each of the non-originating materials or parts used in the production (UNCTAD, 2006)

## Annex VII: Comparison of Applicable Rules of Origin

<table>
<tr><th>H. S. Code</th><th>Commodities Name</th><th>European Union</th><th>United States</th><th>Japan</th></tr>
<tr><td>7113.11.00</td><td>Silver Jewelry</td><td></td><td rowspan="8">HS code 7113, 7117, 9307 etc require fulfillment of: a) whereas some such as HS 8211 and HS 9206 requires a regional value content of not less than 35 percent under the build-up method and 45 percent under the build-down method.</td><td rowspan="8">HS 7113, 7417, 9703, 7117, 9307 requires to be manufactured in which the value of the non originating used products of the different tariff heading as the products obtained does not exceed 40 percent of the value of the products obtained and for the non originating products of the same tariff heading as the product does not exceed 5 percent of the value of the products obtained.</td></tr>
<tr><td>7117.99.00</td><td>Artificial Ornaments</td><td></td></tr>
<tr><td>7417.00.00</td><td>Copper Utensils</td><td></td></tr>
<tr><td>8211.92.00</td><td>Gorkha Knives(Khukuri)</td><td></td></tr>
<tr><td>9307.00.00</td><td>Khukuri</td><td></td></tr>
<tr><td>8306.10.00</td><td>Article of Base Metal(Bells, Gongs)</td><td></td></tr>
<tr><td>9703.00.00</td><td>Metal Sculptors, Statuary and Other Handicrafts</td><td></td></tr>
<tr><td>9206.00.00</td><td>Metal Musical Instruments (Cymbol/Tingshya etc.)</td><td></td></tr>
<tr><td>5701.10.40</td><td>Hand knotted Woolen Carpet</td><td rowspan="2">HS 5701, 5503, 5506 and 5501, value added criterion becomes applicable which should not exceed 40 percent of the ex-works price of the product. The spinning of natural fibers should be accompanied by weaving while the same value added criterion.</td><td rowspan="2">HS 5111, 5113, 5204, 5214, 5508, 5516 should not made from woven fabrics of carded and combed wool or animal hair which should not be either made from woven fabrics of coarse animal hair or horse hair. It should also be not made from cotton sewing thread, cotton yarn</td><td rowspan="2">HS 5701 is considered under GPT and SPT treatment. In 2005, a ceiling system was applied that allows GPT imports until they exceed the ceilings. Once GPT preferential imports exceed the ceiling shall be suspended and MFN rate of duty apply. GPT imports of products originating in that country exceed a maximum country amount of one fifth of the total value added or</td></tr>
<tr><td>5702.31.00</td><td>Woolen Carpets, Floor Coverings (Woven)</td></tr>
</table>

| | | | | |
|---|---|---|---|---|
| | | | and woven cotton fabrics and sewing thread of manmade filaments and synthetic filament yarn is also not permissible. | quantity of the ceiling. |
| 6001.00.00 | Crochet/ Knitted Fabrics | | The criterion for cotton goods can be classified into three parts, a) change in tariff classification, b) change in tariff classification with exclusions and c) change in tariff classification with exclusion plus specific process criterion with the allowance for cumulation in the territory of one or more of the parties. | HS 5208, 5308, 6110, 6115 may be manufactured from chemical products, from products of heading 4701 to 4706 or from natural textile fibers, man made staple fibers or textile fiber waste for fulfilling the ROO. |
| 6110.10.00 | Woolen Sweater, Knitwear | | | |
| 6204.42.00 | Woolen Dresses | | | |
| 6204.62.00 | Woolen Shirts(Ladies) | | | |
| 6204.90.00 | Woolen Shirts(Ladies) | | | |
| 6205.10.00 | Woolen Shirts(Gents) | | | |
| 6301.20.00 | Woolen Shawls | | | |
| 5701.10.13 | Certified Handloom & Folklore Products | | | |
| 5701.10.10 | Hand knotted Woolen/Silk Carpet | | | |
| 5701.90.10 | Hand knotted Silk Carpet | | | |
| 5701.90.10 | Hand knotted Allo/ Hemp & Other Natural Fibers | | | |
| 5003.90.00 | Silk Goods | | | |
| 4202.99.00 | Hemp Goods | | | |
| 5310.00.00 | Hemp Fabrics | | | |
| 5208.00.00 | Cotton Fabrics | | | |
| 5308.00.00 | Handloom Cloth (Cotton) | | | |
| 5905.00.00 | Cotton Wall | | | |

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|---|---|---|---|---|
| | Covering | | | |
| 6110.20.00 | Cotton Sweater Knitted | | | |
| 6115.91.00 | Cotton Socks Knitted | | | |
| 6116.10.00 | Cotton Muffler Knitted | | | |
| 6116.91.00 | Cotton Knitted Glove | | | |
| 6201.12.00 | Cotton Jacket, Over Coat(Gents and Ladies) | | | |
| 6203.31.00 | Over Jackets(Gents and Ladies) | | | |
| 6204.42.00 | Cotton Dresses | | | |
| 6205.20.00 | Cotton Shirts (Gents) | | | |
| 6205.90.00 | Rayon Shirts (Gents) | | | |
| 6206.20.00 | Rayon Shirts(Ladies) | | | |
| 6206.30.00 | Cotton Shirts(Blouse) | | | |
| 6207.11.00 | Cotton Shirts | | | |
| 6207.21.00 | Cotton Pyjamas (Gents) | | | |
| 6241.10.00 | Cotton Shawls, Scarf | | | |
| 6305.20.00 | Cotton Bags | | | |
| 6405.20.00 | Cotton Shoes | | | |
| 6505.10.00 | Cotton Net | | | |
| 6505.90.00 | Cotton Cap, Hats | | | |
| 4802.10.00 | Handmade Nepali Paper | | HS 4802 and 4910 may be made from materials from any other chapter; 4810 may be made from materials from any other heading; 4814, 4817, and 4819 may be made from any | |
| 4810.29.00 | Handmade Papers | | | |
| 4814.20.00 | Handmade Paper Wall Covering | | | |
| 4817.10.00 | Handmade Paper Envelop | | | |
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| 4817.30.00 | Handmade Paper | | | |

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| | Cards, Boxes etc. | | other heading outside that group. | |
| 4819.50.00 | Handmade Paper Packing Boxes | | | |
| 4820.10.00 | Handmade Paper Note Book, Letter Pads | | | |
| 4820.50.00 | Handmade Paper Album | | | |
| 4910.00.00 | Calendar | | | |
| 5702.10.10 | Hand-woven/ Hand loomed Folklore Products | | | |
| 4412.19.00 | Wooden Tie | | Most wooden goods must fulfill the change in tariff classification criterion to qualify for the ROO. There are no exclusions in this case. HS 4412, 4414, 4415, 4418, 4420, 4421, 8306 and 9403 imply that the good may be made from any other heading or subheading. | Most wooden products require the fulfillment of change in tariff heading criterion to qualify for originating status in Japan except some such as HS 4412, 4414, 4415, for which the originating status is not specifically acknowledged. This means must fulfill the wholly obtained criterion for the purpose of determining origin. |
| 4414.00.00 | Wooden Frame | | | |
| 4415.10.00 | Wooden Box | | | |
| 4418.10.00 | Wooden Window | | | |
| 4420.10.00 | Wooden Statue | | | |
| 4420.10.00 | Wooden Goods | | | |
| 4421.10.00 | Wooden Hanger | | | |
| 8306.30.00 | Picture Frames | | | |
| 9403.40.00 | Wooden Furniture | | | |
| 9403.80.00 | Furniture, Bamboo and Cane Products | | | |
| 5112.00.00 | Woolen Fabrics | Unbleached single yarn but if it is made from unembroidered fabric, it must fulfill the latter criterion. This requires that the value of the | The change in tariff classification criteria in the case of pashmina must fulfill a specific process criterion to qualify for ROO with the | Exported from LDCs to Japan without any restriction of duties and quotas. This also further implies that no ceiling system is being applied. HS 6214 ranges from 5 to 10 percent whereas |

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| | | unembroidered fabric used does not exceed 40 percent of the exworks price of the product. | flexibility that such specific process may be carried out in the territory of either Nepal and or the US, allowing for cumulation. Pashmina must fulfill the specific process criterion even if the materials under exclusions are shown to be originating in the LDC.. | the GPT rate for the same is zero percent |
| 6214.20.00 | Woolen/Pashmina Muffler, Scarves & Shawls | | | |

# Appendix VIII: List of Interview and Survey Enterprises/Firms

| S. No. | Name of Enterprises/Firms | Types of Enterprises | HS Code | Items |
|---|---|---|---|---|
| 1 | Shrestha Carpet Industry | Manufacturer/Exporter | 5701.10.40 | Carpet |
| 2 | Kamala Carpet Industry | Manufacturer/Exporter | 5701.10.40 | Carpet |
| 3 | City Carpet Industry | Manufacturer/Exporter | 5701.10.40 | Carpet |
| 4 | Saradha Carpet Industry | Manufacturer/Exporter | 5701.10.40 | Carpet |
| 5 | Ambu Carpet Industry | Manufacturer/Exporter | 5701.10.40 | Carpet |
| 6 | Yolmo Rugs | Manufacturer | 5701.10.40 | Carpet |
| 7 | Paradise Carpet Industries Pvt. Ltd. | Manufacturer/Exporter | 5701.10.40 | Carpet |
| 8 | Norkhil Carpet Industry | Manufacturer/Exporter | 5701.10.40 | Carpet |
| 9 | Niru Carpet Industry | Manufacturer | 5701.10.40 | Carpet |
| 10 | Palbu Carpet Industry | Manufacturer/Exporter | 5701.10.40 | Carpet |
| 11 | Himalayan Shangrila Tea | Manufacturer/Exporter | 0902.40.00 | Tea |
| 12 | Nepal Small Tea Production Pvt. Ltd. | Manufacturer/Exporter | 0902.40.00 | Tea |
| 13 | Shreeantu Tea Industries Pvt. Ltd. | Manufacturer/Exporter | 0902.40.00 | Tea |
| 14 | Ilam Tea Producers Pvt. Ltd. | Manufacturer/Exporter | 0902.40.00 | Tea |
| 15 | Everest Tea Pvt. Ltd. | Manufacturer/Exporter | 0902.40.00 | Tea |
| 16 | Muga Tea Estate Ltd. | Manufacturer/Exporter | 0902.40.00 | Tea |
| 17 | Juna Chiyabari (Tea) | Manufacturer/Exporter | 0902.40.00 | Tea |
| 18 | Sagarmatha Tea Ltd. | Manufacturer/Exporter | 0902.40.00 | Tea |
| 19 | Sakhejung Herbal Tea Processing | Manufacturer/Exporter | 0902.40.00 | Tea |
| 20 | Shree Siddha Tea Pvt. Ltd. | Manufacturer/Exporter | 0902.40.00 | Tea |
| 21 | Nepal Pashmina Industry | Manufacturer/Exporter | 6214.20.00 | Pashmina |
| 22 | Dhaulagiri Pashmina Industry | Manufacturer/Exporter | 6214.20.00 | Pashmina |
| 23 | Nepal Pashmina Craft | Manufacturer | 6214.20.00 | Pashmina |
| 24 | Krishna Pashmina Arts | Manufacturer/Exporter | 6214.20.00 | Pashmina |
| 25 | Exclusive Pashmina Industry | Manufacturer/Exporter | 6214.20.00 | Pashmina |
| 26 | Shree Pashmina | Manufacturer/Exporter | 6214.20.00 | Pashmina |
| 27 | K. R. A. Pashmina Industry | Manufacturer/Exporter | 6214.20.00 | Pashmina |
| 28 | Bhashker Enterprises | Manufacturer/Exporter | 6214.20.00 | Pashmina |
| 29 | Classic Pashmina and Handicraft | Manufacturer/Exporter | 6214.20.00 | Pashmina |
| 30 | Neha Export | Manufacturer | 6214.20.00 | Pashmina |
| 31 | Nepalise D Collection | Manufacturer/Exporter | 7113.11.00 | Silver Jewelry |
| 32 | Arnapurna Handicrafts | Manufacturer | 6305.20.00 | Bag |
| 33 | Samasti Handicrafts | Manufacturer | 6305.20.00 | Bag |
| 34 | DRB Handicraft Traders | Manufacturer/Exporter | 9701.10.00 | Paubha/Thanka |

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| 35 | Nepalize Handicraft Industries | Manufacturer/Exporter | 7113.11.00 | Metal Craft |
| 36 | Natural Paper Craft | Manufacturer | 4810.29.00 | Handmade Paper |
| 37 | Namaste Nepal | Manufacturer | 7113.11.00 | Metal Carving, Silver Jewelry |
| 38 | Mustang Handicraft Industry | Manufacturer/Exporter | 4810.29.00 | Handmade Paper |
| 39 | Abhushan Industries | Manufacturer/Exporter | 6204.42.00 | Garment, Kintwear |
| 40 | Yagebdra Shakya Handicraft | Manufacturer | 7113.11.00 | Silver Jewelry |