

AGREEMENT ON AGRICULTURE: MARKET ACCESS

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Market access is one of the three main pillars of the AoA – the other two being domestic support measures and export competition. It deals with rules and commitments related to import of goods. Its purpose is to expand trade by preventing various non-tariff barriers and by binding and reducing tariffs. Besides tariffs, other trade policy instruments covered by the market access pillar include Tariff Rate Quotas (TRQs) and Special Safeguard (SSG) as a trade remedy measure.

In the WTO context, “market access” is about both obligations and rights¹⁴. Nepal’s obligation as a WTO member is to provide market access to other Members in return for her “right” of access to others’ markets for Nepalese goods on multilaterally agreed terms. Thus, a balanced analysis of market access provisions would cover both obligations and rights. The focus of this chapter is on the “obligation” side of this equation, i.e. on the likely implications of the market access provisions of the AoA on Nepal’s agricultural trade policies and on the Nepalese agriculture. As Nepal does not have any TRQ commitments, and does not have access to the SSG, the most important instrument for managing imports is applied tariffs, within the limit set by Nepal’s WTO bound rates. Given that these bound rates are already agreed upon, the key question to be asked is: what would be the most appropriate structure of the applied tariffs in order to safeguard the interest of the Nepalese agriculture?

The chapter, organized in four sections, introduces the AoA provisions on market access; discusses some theoretical and conceptual issues on border protection and tariffs to understand why and how the WTO membership matters in this area; analyses Nepal’s applied tariffs on selected major commodity groups drawing upon the experience for recent years and in relation to the corresponding bound rates; and draws some conclusions.

THE AOA PROVISIONS ON MARKET ACCESS

Prohibition of quantitative restrictions on imports

One significant achievement of the AoA was prohibition of border measures other than “ordinary customs duty”. A WTO Member is no longer allowed to limit trade through import bans or quantitative restrictions, or other similar measures, except under such specified situations as safeguards, food safety and adverse balance of payment situation. The only border instrument permitted is “ordinary” customs tariff, which includes *ad valorem* and specific duties. Article 4.2 of the AoA spells in detail the measures that are prohibited, e.g. quantitative trade restrictions,

¹⁴ The FAO Resource Manual on Agreement on Agriculture provides introductory analysis of various market access provisions. See the chapters by Elamin (2000), Pearce and Sharma (2000), Sharma (2000a) and Sharma (2000b), available on-line at www.fao.org/trade.

variable import levies, minimum import prices, discretionary import licensing, non-tariff measures maintained by state trading enterprises, voluntary export restraints and similar border measures other than ordinary customs duty. Table 1 shows the main market access provisions of the AoA.

Table 1: Main provisions of the AoA on market access

Instrument	General provisions	Case of Nepal
AoA Article 4.1 & Schedules	First bindings, and then reductions of the bound tariffs, plus other market access commitments as in the Schedules	Bindings yes, but no reduction required after transition phase, being a LDC
AoA Article 4.2	Prohibition of quantitative restriction on imports; only ordinary tariffs to apply on imports.	Applicable
AoA Article 5	Special safeguard (SSG) provision against import surges (quantity and depressed prices) relative to established triggers	No access to SSG because Nepal did not tariffy
Schedules	Implementation of current and minimum access commitments with tariff rate quotas (TRQs)	Nepal could have but did not open TRQs
Schedules	Tariff reduction schedule – reduction of the bound rates over the implementation period <u>Reduction rates for bound tariffs</u> <i>Developed countries:</i> 36% on average (minimum 15% for all tariff lines) over 6 years <i>Developing countries:</i> 24% average (minimum 10% for all tariff lines) over 10 years <i>Least developed countries:</i> No reduction required	Being a LDC, no reduction required after transition phase (Article 15.2)

Tariff binding and reduction

During the UR negotiations, modalities were developed to convert existing non-tariff barriers to “equivalent tariffs”, which would be the new bound rates (see Sharma 2000a for these modalities). Countries that had non-tariff barriers were required to compute tariff equivalents based on the gap between domestic and world prices.¹⁵ The developing countries could also choose this tariffication process. They also had the option to “offer” what is called as “ceiling binding” of tariffs. That is, they could offer ceiling rates as they chose. If not objected by other WTO Members that would be the WTO bound rates. Most developing countries chose this method to establish the bound rates. They included all South Asian WTO members. In the case of Nepal this choice was not available. Like other newly acceding countries Nepal bound its tariffs through negotiations.

Bound versus applied tariffs

In the WTO terminology, bound tariffs are the rates that a country commits not to exceed at any point in time (except in some specified situations). By contrast, “applied rates” refer to tariffs that are actually applied at any given point in time. The basic rule is: applied rates may be lower but must not exceed the bound rates. Hence bound rates have special significance as they limit the ability of a country to vary tariffs. In the GATT, and now the WTO, tariff negotiations amounted to reduc-

¹⁵ In view of the short time available for verifying these tariff offers by trading partners, many countries, notably developed countries, were found subsequently to have bound tariffs at rates above actual tariff equivalents. This has come to be known as “dirty tariffication” (see Ingco and Hathaway 1996).

ing the bound rates. The experience of the past 10 years shows that applied tariffs of most developing countries are far below the bound rates, while they are closer in the case of the developed countries.

Tariff Rate Quota

Quotas in the ordinary sense of the term were common trade policy instrument for a long time prior to the UR. In the UR, as countries tariffied non-tariff barriers, there was a concern that the resulting ordinary tariffs could turn out to be too high for any trade to take place. Moreover, there were many products that were little traded for various reasons, e.g. prohibitively high tariffs, binding quotas or import restrictions. As a result, it was agreed that there should be “minimum market access” commitment, e.g. 5% of total domestic consumption. This gave rise to the concept of the TRQ to facilitate minimum trade. A TRQ is a two-tired tariff instrument under which imports up to the quota level face low or no tariff while all imports above the quota level face the usual MFN tariff. In the UR, 36 countries made TRQ commitments on agricultural products for a total of 1,370 tariff lines. Although 19 of these are developing countries, the developed countries account for 67% of the TRQs. In the post-1995 period, the (unsatisfactory) administration of TRQs, and the issue of less than 100% quota fill rate, has attracted a great deal of discussion in the WTO.

Special Safeguard Measures

This is another innovation of the AoA (Article 5). It is specific to agricultural products only. The general WTO trade remedy measures like anti-dumping apply to all products, including agricultural products (for details, see the chapter on import surges by Gautam et al in this volume). The SSG is a temporary measure that permits an importing country to charge duties higher than the WTO bound rate when faced with import surges. The SSGs are available only to those products that were “tariffied” and for which the right to resort to the SSG was reserved by placing the label “SSG” in country Schedules. There are two types of surges that trigger the SSG: (i) when import volumes surge beyond some defined threshold and (ii) when import prices fall below a previously defined threshold. The extra duty applicable depends on the extent of the surge, relative to the defined thresholds. In the UR, 38 WTO Members reserved right to the SSG measure for selected products. As the majority of the developing countries did not tariffy, and offered “ceiling bindings”, very few of them have access to the SSG.

In the case of Nepal, as shown in the last column of Table 1, the provision prohibiting all non-tariff measures applies. As a LDC, however, Nepal would not be required to reduce bound tariffs once the transition phase of the WTO accession process is complete. But applied rates cannot exceed the bound duties. Nepal does not have access to the SSG while there was no need for opening TRQs, which Nepal did not. There is a provision in the WTO rules called “initial negotiating rights” (INR). In Nepal’s tariff Schedule, some countries have been designated as INR holders for some products. This means that in future if Nepal wants to revise bound tariffs upwards, this must be first negotiated with the INR holder.

ECONOMIC AND POLICY ISSUES ON TARIFF PROTECTION

Nepal's WTO Bound Tariffs and Other Market Access Commitments: The Issue and the Context

At the time of the WTO accession, Nepal committed to bind all, i.e. without exception, agricultural tariffs, and all of them in *ad valorem* form. The simple average of the bound rates for agricultural products is 51% initially, and 42% by 2006¹⁶. About 80% of the bound tariffs are concentrated in the 30-50% range, with tariff on 90% of the tariff lines being at least 30%. So, for all practical and analytical purposes, the average bound rate may be assumed to be in the 30-50% range for most commodities. As said above, there are no other specific market access commitments other than that the general rules applying to a LDC also apply to Nepal.

A question that was frequently raised in Nepal was whether this was a "successful" negotiation for Nepal, or did she give in too much? This section discourses on that question at a conceptual level from two viewpoints.

First, by comparing Nepal's market access commitments with other 19 new Members that joined the WTO after 1995 following the same accession process. Table 2 summarises the commitments for these countries. Only three out of the 20 countries have access to the SSG measures. Thus, Nepal does not have much to complain on this account. The other commitment is on TRQs. Twelve out of the 20 new members do not have access to this provision, including Nepal. From a trade policy standpoint, this is not as important as, for example, the SSG and high bound tariff are. For Nepal, as is the case with most other developing countries, the level of the bound rate is the most important trade instrument, as will be discussed below.

Table 2 shows that Nepal's simple average bound tariff rate of 42% is twice that of the new 20 countries. From this standpoint, this was a very successful negotiation.¹⁷ One could still argue that Nepal's average bound tariff is lower than the global average (about 62%) and the rates for other South Asian countries. While this is so, it is appropriate to compare Nepal's case with those countries which became WTO Members through the accession process, not with the original WTO members.

A second way to assess the level of the bound tariffs would be to examine whether these rates provide necessary policy space to maintain some level of protection and to vary applied tariffs (upwards) when needed, for example to respond to import surges. One way to analyse this is to compare the bound rates for individual major commodities with applied tariffs for recent years. If the applied rates for recent years are consistently much lower than the corresponding bound tariffs, one could conclude that the bound rates do provide enough policy space. This aspect is discussed below with examples from Nepal.

¹⁶ See www.wto.org/trade_topics/accession for details on Nepal's bound tariffs and Annex 2 of this chapter for selected commodities.

¹⁷ Some analysts argue that having high bound rates is not necessarily a positive outcome; they would favour lower bindings on the ground of efficiency and trade predictability.

Table 2: Market access commitments of new WTO Members

Sr. No.	Member	Accession Year	Average Bound Tariff ^{1/} (%)	TRQs Number of tariff lines	SSGs
1	Ecuador	1996	26	17	- ^{2/}
2	Bulgaria	1996	35	90	21
3	Mongolia	1997	20	-	-
4	Panama	1997	28	57	6
5	Kyrgyz Republic	1998	12	-	-
6	Latvia	1999	34	4	-
7	Estonia	1999	18	-	-
8	Jordan	2000	25	-	-
9	Georgia	2000	12	-	-
10	Albania	2000	11	-	-
11	Oman	2000	31	-	-
12	Croatia	2000	10	9	-
13	Lithuania	2001	16	4	-
14	Moldova	2001	12	-	-
15	China	2001	15	46	-
16	China, Taipei	2002	18	117	32
17	Armenia	2003	n. a.	-	-
18	Macedonia	2003	8 ^{3/}	-	-
19	Cambodia	2003	31	-	-
20	Nepal	2003	42	-	-
<i>Memo Items</i>					
	Bangladesh	1995	200		
	India	1995	114		
	Pakistan	1995	102		
	Sri Lanka	1995	50		
<i>All original 128 WTO Members</i>			62	1366	6072

1/ Simple averages of all agricultural tariff lines

2/ A dash (i. e. -) indicates that the Member does not have this commitment.

3/ Average bound tariff for both agriculture and non-agricultural products.

Source: Compiled from various WTO sources.

To illustrate this point, Table 3 shows average bound and applied rates for a good cross section of developing countries. It is to be noted that applied rates are much lower than the bound rates for most countries. There are some exceptions too, for example Thailand, where the gap is very small. For these 32 countries, the simple average applied rate is 20% while the average bound rate is four times higher, or 84%.¹⁸ A number of factors explain this. First, most developing countries went through a series of trade policy reforms prior to the conclusion of the UR and had consequently eliminated most non-tariff barriers and reduced applied rates considerably, capping them unilaterally and, probably in more cases, as part of the loan conditionality. By contrast, the bound rates which were typically set as ceiling bindings during the UR were on the higher side, but not so for all countries.¹⁹ Second, in several cases, applied rates were low because the Common External Tariffs of customs unions were set relatively low. Third, for many developing countries, especially with large populations at or near-poverty levels, it is not politically feasible to maintain high domestic prices on basic foods that high tariffs lead to.

¹⁸ By contrast, applied rates are closer to the bound rates for developed countries.

¹⁹ There are several exceptions, e.g. Egypt, Sri Lanka as well as several countries in Latin America have relatively low bound rates. This is also the case for new WTO Members.

Table 3: Average bound and applied tariff rates on agriculture: 32 developing countries

Number	Country	Tariff Rate (% <i>Ad valorem</i>)		Ratio (%) Applied/Bound
		Bound	Applied	
1	Argentina	35	13	37
2	Brazil	36	11	31
3	Colombia	87	22	25
4	Costa Rica	42	17	40
5	Ecuador	26	16	62
6	El Salvador	41	13	32
7	Guatemala	49	11	22
8	Mexico	63	20	32
9	Nicaragua	61	11	18
10	Panama	43	12	28
11	Paraguay	35	10	29
12	Peru	30	13	43
13	Uruguay	32	13	41
14	Venezuela	52	15	29
<i>Average of 14 countries</i>		45	14	31
<i>Coefficients of variance (14)</i>		36	25	70
1	Bangladesh	200	35	13
2	India	114	26	23
3	Fiji	50	15	30
4	Indonesia	48	16	33
5	Korea, Republic of	66	50	76
6	Pakistan	102	22	22
7	Philippines	34	19	56
8	Sri Lanka	50	20	40
9	Thailand	36	32	89
<i>Average of 9 countries</i>		78	25	32
<i>Coefficients of variance (9)</i>		69	43	62
1	Egypt	28	19	68
2	Kenya	100	17	17
3	Malawi	125	18	14
4	Morocco	65	19	29
5	Mozambique	400	21	5
6	Tanzania	240	28	12
7	Tunisia	110	35	32
8	Zambia	125	19	15
9	Zimbabwe	150	27	18
<i>Average of 9 countries</i>		145	23	15
<i>Coefficients of variance (9)</i>		74	27	36
<i>Average of 32 countries</i>		84	20	23
<i>Coefficients of variance (32)</i>		92	43	46

Notes: Bound and applied rates are simple averages for all agricultural products. Bound rates are mainly for 2004; applied rates are the latest available (mainly 1999 and 2000). The coefficient of variation is standard deviation/mean (%).

Source: Sharma (2002).

Analytical Issues on Bound Tariffs and Applied Rates

Before reviewing the structure of Nepal's applied tariffs for major product groups, it would be useful to note some arguments made for and against high WTO bound rates, as well as for a particular structure of applied rates. What are some of

the main arguments made for having higher bound tariffs? Alternatively, one could ask what does a country lose if tariff bindings are low?

Arguments in favour of high tariff binding

Protection: The primary purpose of a tariff is protection, i.e. keeping the domestic price above world price as an incentive to producers, albeit at the cost of consumers. The bound rate determines the maximum protection that is feasible – higher the rate, greater the scope for such protection. In practice, however, many developing countries are not known to provide protection to agriculture, at least not much.²⁰ Nepal's situation on this is not known for lack of studies. In the case of India various analyses have shown that domestic prices are generally below world prices for a majority of agricultural products, implying taxation (Gulati and Kelly 1999). If relative agricultural prices in Nepal are similar to those in India, as is often found, it is likely that the Nepalese agriculture is also not protected.

Safeguard: Many developing countries do not use tariff to protect agriculture. But they routinely vary tariffs (up to the WTO bound level) to safeguard domestic markets from external shocks, especially against import surges and/or depressed world prices. For example, India varied applied rates on palm oil in the range of 15-65% within a short period of two years (1999 and 2000) as world prices fell continuously and India faced the threat of import surge. India could raise applied tariffs because the bound rate for palm oil is 300%. Had the bound rate been only 45%, as is the case for soybean oil, this option would not have been feasible. The developing countries in particular find tariffs attractive for safeguard purposes mainly for two reasons. First most of them lack the capability to resort to general WTO trade remedy measures. Second a majority of them do not have access to the SSG, the simpler response measure.

Future negotiations: As successive GATT/WTO negotiations are about tariff cuts, many countries would like to maintain the bound tariffs on the higher side, so there is something to reduce in the next round of negotiations. This is understandable as many countries with lower bound rates are already facing this dilemma in the Doha Round. This would not have been a big issue had the tariff rates of all WTO members were similar. In view of this, trade negotiators take it as a challenge to maintain the current bound rates, or not to reduce them too much. In the case of the LDCs, no reduction was called for in the UR. The same principle is maintained in the draft negotiating modalities for the Doha Round. Yet, no one can predict the modalities that will be adopted in future negotiating rounds.

Some arguments against high tariff bindings

The trade predictability argument: Many trade economists and traders agree that trade and investment decisions are negatively affected by uncertainty and unpredictability of trade rules, like the variation of applied tariffs in an *ad hoc*

²⁰ According to the famous multi-country study of the World Bank (Krueger, Schiff and Valdes 1988), developing countries were in general found to tax their agriculture, rather than protect. Although this was for the 1970s and 1980s, and it is known that the situation has changed for recent years, it is unlikely that the agricultural sector is protected either.

way (Francois and Martin 2002 provide an analytical exposition on this). Therefore, it is recommended that tariffs should be both low and uniform across commodities and sub-sectors. One way to do so is to keep the bound WTO tariffs at lower rates. The typical experience, on the other hand, has been the opposite.

Curbing rent-seeking activities: It is claimed that governments more often yield to pressures from constituents (mainly industries) that lobby for tariff protection, than otherwise. The protection may benefit the industries but at costs to consumers and economic efficiency. Many studies have documented that “rent seeking” has been an important reason for such protection, more so in the developing countries. With low bound rates, there is little incentive for rent-seekers to lobby for tariff protection.

Arguments on Applied Tariffs

Besides the arguments on the level of the bound tariffs, there are also arguments on applied tariffs to be noted. One position favoured by a majority of economists is to have a low and uniform applied tariff structure. The main arguments made in support of this include the following.

The first-best policy argument: Trade theory is very clear on the cost of tariff protection. First, the theory of optimum tariff invariably points to very low or zero tariff for small economies that are price takers in the world market as the optimum tariff. Moreover, for several types of domestic problems tariff is not considered to be a first-best policy compared with, for example, domestic taxes or subsidies or other forms of assistance. A tariff distorts the allocation of resources in both production and consumption.

The case for uniform tariff: The literature on trade also argues that tariffs should not only be lower, but also uniform (same) across commodities. Uniform tariff means similar incentives to all sectors. Unless there are compelling reasons, the government should not discriminate among commodities and sub-sectors. A uniform tariff structure also avoids some of the problems in trade facilitation, notably in customs administration where goods are often misclassified to evade higher tariffs.

The case for uniform effective protection: This is also a common trade policy advice. Here, the policy objective is to maintain uniform effective protection²¹. It often requires different tariffs on outputs and raw materials. While a better policy than uniform nominal tariffs, in practice decision makers lack information necessary for maintaining uniform effective protection rates across so many commodities and sub-sectors. Due of this constraint, in practice, uniformity is often sought in nominal tariffs (e.g. in Chile).

The above discussion reveals the complexity of the issues involved. Many developing countries also lack necessary data and analysis for an informed debate on this issue. While economists typically argue for low and uniform tariffs, enforced by WTO commitments (i.e. low bound rates), others - like trade negotiators, politicians and officials – often seem to take the opposite view. A bone of contention is

²¹ See Box 1 for an introduction to the concept of effective protection and its application to sugar.

somewhat like this. How much to trust politicians and officials in doing a good job in determining a tariff structure that is best for the economy. There are several examples where governments have picked up “winners” in providing tariff protection. But there are more cases where governments have failed in this task.

In brief, the level of agricultural protection is believed to be very low, if not negative, in a majority of the developing countries. Hence, higher tariff bindings appear irrelevant. Nevertheless, they have proved to be handy tools for safeguard purpose, when needed. High bound rates also provide a leeway for tariff cuts in future negotiating rounds. In the same way, it is very difficult to document with precision the cost of high and dissimilar tariff structure and of rent seeking activities.

Some of the arguments above would not apply to a majority of the new WTO Members. Their bound tariffs are already fairly low to start with. There is no scope for higher (and variable) applied rates. Nepal did better than others in keeping higher bound rates. The next section discusses Nepal’s applied rates in relation to the bound rates.

THE CURRENT STRUCTURE OF NEPAL’S APPLIED TARIFFS

The Financial Act 1996 empowers the Government to apply and modify import tariffs. For setting tariffs, Nepal uses Harmonized System classification code 2002. Applied tariffs are generally low on agricultural products for several reasons. First, the Nepalese market is fairly open to Indian products for reasons such as proximity, porous border and bilateral agreement. Second, as the border is open and porous, enforcement of high tariff is difficult as it encourages smuggling except where it is easier to detect the smuggled goods, like vehicles. Third, Nepal applies fairly low tariffs on imports from third countries also, as one objective is to diversify trade. Fourth, many domestic industries depend heavily on imported raw materials whose tariffs have to be kept low. Fifth, the political economy reasons for maintaining low prices in the domestic market in view of the high incidence of poverty. Finally, for these very reasons, higher tariffs do not necessarily yield higher revenue. In fact, lower tariffs at times have been associated with increased customs revenue. In the coming years also, it is very unlikely that the situation would change markedly. Therefore applied tariffs in Nepal most probably will continue to be on the lower side, more or less similar to the rates seen for recent years.

The rest of the section reviews MFN applied tariffs for recent years vis-à-vis the WTO bound rates for cereals, meats, dairy, sugar, fruits and vegetables. These are important products for Nepal both in terms of production as well as food security and livelihood. Tariffs are generally analysed in a number of ways. One is to look at these from the standpoint of tariff escalation. The other would be to examine the gap between applied and bound tariffs, as this indicates the extent of policy flexibility. Other considerations include revenue, incentives to the use of domestic raw materials by industries and effective protection to industries.

Cereals cluster

Applied tariff on cereal grains have always been low in Nepal (around 10%). There are two reasons for this – the porous border with India (most cereals trade is

with India) and preferential trade relationship, and domestic food security reason, i.e. to maintain affordable prices. In contrast, tariffs on cereal-based processed products are higher, typically in the range of 15-40%. This is called tariff escalation. Many wheat products show this pattern (one exception is wheat gluten), while tariff de-escalation was found for malt (lower tariff than on barley). It seems that tariff rates on wheat gluten and malt (5% only) were driven by the interest of processing industries that use these products as raw materials. Similarly, while there is tariff escalation on maize products, rice and its products face uniform tariffs.

These applied tariffs are significantly lower than Nepal's bound rates, which are in the 40-60% range. Notably, the bound rates on cereals and cereal-based products vary in the 40-60% range with 60% on rice, wheat and maize. In general, the bound rates for many products are several times higher than currently applied rates, although there are some exceptions, e.g. processed waffles and biscuits, in that bound and applied rates are similar. Thus, on the whole, there is a considerable scope for Nepal raising applied rates to the bound levels when faced with, for example, depressed import prices and/or import surges, without the need for resorting to safeguard measures.

Dairy cluster

Tariffs on dairy products (generally 15%) are mostly higher than on fresh milk (10%), but not by much. Among the dairy products, the highest level of tariff protection is for ice cream, which is regarded as a luxury item. The WTO bound rates on milk and milk products range from 40 to 50% although with some exceptions, which means that the bound tariffs are around 3 to 5 times higher than tariffs applied in recent years. Thus, besides some protection for processed products, there is a considerable scope for raising applied rates when needed.

Meat cluster

Applied tariffs on live meat-animals, meat and meat products are generally low (10%) as well as uniform. Meat products including sausages face somewhat higher tariffs, about 15%. But the bound tariffs on meat products vary in the range of 30-60%, i.e. 3 to 5 times the applied rates, which provide considerable policy space to vary tariffs. As with cereals and dairy products, livestock economy plays an important role in the Nepalese agriculture. In particular, pig and poultry farming is important for socially backward classes and small and marginal farmers. In this regard, these products are particularly sensitive for Nepal for livelihood, in the sense of the "Special Products" being discussed in the Doha Round negotiations.

Sugar cluster

Applied tariff on sugar (cane sugar as well as beet sugar) is 40%, compared with 10% on sugarcane and some other sugar products. The tariff structure on sugar products does not follow the usual pattern of tariff escalation. Some products are highly protected, e.g. sugar and chewing gums which are domestically produced. The bound rates on sugar are 60% and that on sugar products 40%. The bound rate on sugarcane, despite being a raw material, is also high, at 30%. There are somewhat different views on the tariff structure on sugar versus sugarcane.

One argument is that Nepal should facilitate the import of sugarcane with low or zero tariff in order to support the processing industry where a great deal of investment has been made in recent years. The other view is that Nepal has recently seen imports of sugarcane – some even call it a “surge” – to the detriment of sugarcane farmers in Nepal. A policy dilemma here is that sugar is increasingly produced in the world market at lower costs, and so it may not be a sound policy to try to maintain positive effective protection to this product, at least in the longer run (see Box 1 for an analysis). Moreover, there are good substitute crops to sugarcane growing in Nepal.

Fruit and vegetables cluster

The applied tariff on primary products like fruits and vegetables is at 10% level. Tariff escalation is observed in some product groups, but not in the majority of cases. For example, potato (seed potato, table potato) and potato products (frozen potato, potato flour, meal, powder, flakes, granules, pellet, starch) face a uniform tariff of 10%, with an exception of higher tariff on prepared or preserved potato. It seems that this type of tariff structure – where duties are higher on products that are imported in larger quantities – is motivated by revenue consideration, although the escalating tariff argument also applies in some cases.

In the case of tomato, tariff escalation is particularly strong, e.g. 10% applied rate on fresh tomato, 25% on prepared or preserved tomato and 40% on tomato juice. Similar pattern is observed for citrus fruits and apple and their processed products. The reason as noted earlier is to support domestic processing industry.

The bound tariffs on fruits and vegetables are in the 40-60% range. Bound tariffs on apple and apple products are uniformly 40% whereas that for orange and mandarin is 50%, and 60% for some tomato products. So, the scope for policy flexibility in this product cluster appears somewhat limited as applied rates on many processed products are on the higher side. Nepal is often considered to have a strong comparative advantage in fruits and vegetables, in part these being very labour intensive activities, but also due to agro-ecological diversity that suits these products. But given the high transport costs, it will be sometime before this advantage turns into actual trade gain.

In brief, this review of the structure of applied tariffs and bound rates shows four features worth noting. First, it is clear that in general there is a modest degree of tariff escalation, which favours processing activities and value addition in the country. Second, the counter argument to tariff escalation is that primary products are less protected, which means that farmers face greater import competition than processors. In some cases, this also implies some bias against the use of domestic raw materials by Nepalese industries, as imported raw materials are cheaper (for details see chapter 13 of this volume on backward linkages). Third, in some product groups, revenue consideration also seems to be the key motive. Fourth, based on the gap between applied rates for recent years and the bound rates, there is a considerable degree of policy flexibility for a majority of agricultural products, i.e. tariffs can be raised to higher levels in response to external shocks without breach-

ing WTO commitments. This is useful for Nepal as it will be some years before her capability is developed to resort to the general WTO safeguards.

Box 1:

The concept of effective protection rate and its application to sugar for Nepal

The Effective Protection Coefficient (EPC) is defined as the ratio of value added by a commodity/sector in distorted prices (i.e. prices actually paid and received by producers) to value added in world prices (or reference prices, or free trade or undistorted prices). The EPC indicates the extent to which trade policy distortions on inputs and outputs magnify the level of nominal protection to the final product being considered.

$$\text{More formally, an EPC} = \text{VAD/VAR} = [P^D - \text{Sum}(a_j P_j^D)] / [P^R - \text{Sum}(a_j P_j^R)]$$

Where,

P^D and P^R are domestic and reference prices of the commodity in question

P_j^D and P_j^R are domestic and reference prices of the j^{th} tradable input

a_j is input-output coefficient, i.e. the quantity of the j^{th} tradable input used to produce the product

The VAD and VARs are value added in domestic and reference prices

The numerator gives value added at domestic prices while the denominator measures value added at world reference price.

The concept is illustrated using the case of sugar in Nepal. Recent statistics show that the domestic mill-gate price of sugar is Rs 22 per kg and the reference price is Rs 17 per kg. The major tradable input is sugarcane (there are some other inputs that are ignored here). Sugarcane prices are Rs 1.35 per kg in domestic market while reference price (c.i.f. for import from India) is Rs 1.27 per kg. The quantity of sugarcane used to produce one kg of sugar (the input-output coefficient) is 10.31 kg (i.e. a recovery rate of 9.7%).

Prior to computing the EPC, it is useful to measure Nominal Protection Coefficient or NPC. The NPC is defined as the ratio of domestic price to the reference price, i.e. P^D/P^R . With the above prices, the NPC for sugar is 1.29 (22/17), which is greater than one and so indicates that there is a tariff protection in Nepal for sugar. The NPC for sugarcane can be computed similarly, which comes at 1.06 (1.35/1.27), also showing small protection, but lower than for sugar. This follows from higher tariff applied on sugar (40%) than on sugarcane (10%). Why this is done is not obvious. It could be that the government seeks to protect the processing industry. Some others may say that this is the result of a more successful "lobbying" by the industry, e.g. Sugar Millers' Association, than by the farm group, e.g. Sugarcane Growers' Association.

In the case of the EPC, the above statistics give the following results:

$$\text{VAD} = 22 - 10.31 \times 1.35 = 8.08$$

$$\text{VAR} = 17 - 10.31 \times 1.27 = 3.91$$

$$\text{EPC} = \text{VAD/VAR} = 8.08/3.91 = 2.07$$

An EPC greater than one means that the domestic sugar industry is effectively protected, the level of protection being 107%, which is quite high. More importantly, the EPC is much higher than the NPC on sugar (1.29, noted above). Given this, the policy questions asked are: i) should Nepal grant such a high effective protection to sugar (in comparison with other sectors)? and ii) why should the "sugarcane" sector contribute (to some extent) to maintaining the high effective protection on sugar? Some may further argue with this type of result that an effective protection for sugar without adequate protection for sugarcane basically protects inefficiencies in the sugar industry and does not encourage domestic production of sugarcane. Here in lies the advantage of policy indicators like the NPC and EPC – they not only reveal the real state of protection but also show how this comes about. Obviously, the debate on the structure of the applied tariffs becomes much more informed and sound where these information are at hand.

Source: The concepts of NPC and EPC are widely used in applied trade policy analysis. See Tsakok (1990) for an introduction, and Pursell and Gupta (1998) and Virmani (2003) for applications. The application on sugar in this box is fresh work of the authors.

Effectiveness of the MFN Tariffs in the light of the Bilateral Trade Agreement with India

The main focus of this paper is on the WTO bound tariffs and MFN applied rates because of the multilateral, WTO context of this study. However, Nepal imports more than 60% of agricultural products from India, most if not all of this duty-free within the framework of the Nepal-India Trade Treaty. At the same time, the long and porous border with India and the relative sizes of the two economies means that commodity prices in Nepal are strongly influenced by prices in India. In addition, Nepal also gives rebates on customs duties to other countries with bilateral agreements. Given this situation, the question asked is how relevant are the MFN applied tariffs in influencing trade and in determining the level of protection to import competing sectors in Nepal?

The simple answer to that question is that for over 60% of the total agricultural products imported by Nepal, the MFN tariffs play relatively small role in influencing the level of protection to import competing sectors. In the case of products that India produces and can export to Nepal, it is unlikely that imports will take place from third countries as long as the world market price plus the MFN applied tariff exceed the price in India plus transaction costs involved in exporting the goods to Nepal, which is the more likely scenario. This rule will not work only in the case of differentiated products, e.g. Thai fruit juice and Indian fruit juice, where Nepalese consumers would be willing to pay higher prices. To the extent that the share of differentiated agricultural products in total import demand is small, the influence of the MFN tariffs in the Nepalese economy would be lower.

In addition to the free trade arrangement with India for primary agricultural products, Nepal also grants rebates and concessions on duties on industrial products. Thus, goods produced in and imported from India are granted a rebate in the chargeable *ad valorem* rate of customs duty by 20% up to the tariff of 40%, and by 10% rebate on tariffs above 40%. In practice, since the MFN rates on processed agricultural products hardly exceed 40%, the applicable rebate in most cases is 20% (some taxes are imposed on these products as agriculture development and security fees). On goods imported from the Tibet Autonomous Region of China, and goods produced in and shipped from SAARC countries other than India, the applicable rebate is 10% on the chargeable customs duty. In addition, a 5% rebate is granted to goods produced in and imported from countries enjoying MFN treatment provided that the Letter of Credit is opened there and invoices and other documents are prepared in the country receiving the MFN treatment from where the shipment is made. Nepal has such bilateral relations with 17 countries.²² These rebates are given for showing special trade relations, and in India's case in the context of the Protocol to Article V of the Nepal-India Trade Treaty.²³

Although Nepal benefits considerably from duty free access to the India market, one implication of the above analysis is that it will be very difficult for Nepal to protect its agricultural sector by way of tariff. Even if there were no free trade with

²² To the extent that these measures discriminate against other WTO Members, some of these provisions are not likely to be WTO compatible.

²³ For details, see the paper by Nepal on Nepal-India Trade Treaty in this volume.

India, the open, porous border imposes a binding constraint on the level of market or farm price that can prevail in Nepal, which is the Indian price plus transaction cost in exporting to Nepal. This constraint will most likely continue to be binding even if trade with India is on a MFN basis, although the transaction cost of exporting to Nepal without paying the duty (which makes it a smuggling cost) would be higher now. The main point being made here is that MFN tariffs beyond certain levels (which will differ by commodity) will continue to have limited role in influencing relative prices in Nepal. Notwithstanding this limitation, it is important that Nepal maintains higher bound tariffs so that it can match India's applied rates if and when trade with India takes place on a MFN basis. Otherwise, given India's relatively higher bound rates, India's applied tariffs could be higher than Nepal's, which would not be in the interest of Nepal's agricultural sector. Thus, the WTO bound tariffs are of strategic significance for Nepal even though they do not seem to be that relevant currently for day-to-day trade policy.²⁴

CONCLUDING REMARKS

In addition to introducing the main provisions on market access of the AoA, this chapter identified and discussed some issues on tariff protection and safeguard as two key components of market access. It raised several questions and answered some of them. These questions are repeated below to facilitate discussion:

- What does Nepal's WTO bound tariff structure imply for tariff protection and safeguard for agricultural products?
- What is a desirable structure of applied tariffs? Should these tariffs be "low" and "uniform" across products/sectors or "high" and "varied"? Or, should the government strive for uniform nominal tariff or uniform effective protection? Or should there be some differentiation, e.g. on the ground of infant industry protection?
- How effective are the MFN bound and applied tariffs given that about 50% of agricultural imports are from India with zero tariffs?

The main conclusions are as follows. On the issue of tariff protection, given that Nepal has now WTO bound tariffs and there is little that can be done about it, the key policy concern is determining the structure of applied tariffs that is best for the Nepalese agriculture. This is not a WTO matter as long as bound tariffs are respected, but of a trade policy. To this end, a number of criteria and issues on tariff structures were discussed. Some of the options identified are:

- Tariff structure based on tariff escalation (perhaps the most common tariff structure in both developed and developing countries, and also the dominant structure in Nepal).
- Uniform nominal tariff rates (e.g. in Chile, Mongolia).
- Different nominal rates aimed at uniform effective protection rates for all products/sub-sectors.

²⁴ This would also be the case also with SSG, if Nepal had access to it – it is just not feasible to resort to the SSG if that leads to the price difference exceeding the transaction cost.

- Tariff structure with “peak” features, i.e. only a handful of selected products/sectors receive high protection, while the rest of the tariff lines have low and uniform rates aimed at generating revenue rather than protection.

How about other considerations based on specific national objectives and goals? To illustrate this point, Table 4 documents many possible goals and concerns that are often raised when considering the role of any policy instrument, including tariff. The table lists 20 of them.

Table 4: An illustrative list of various objectives and concerns that are typically considered in setting applied tariffs

Domain/issues	Policy objectives/concerns
Border measures	Respecting WTO bound tariffs Minimizing illegal cross border trade
Domestic production	Technical feasibility of domestic production and potentials to expand Maturity of domestic industries (“infant industry” argument) Speed of production restructuring and product modification and diversification Cost of production as compared to c i f price of imported products Stage of production in terms of value addition Efficiency of domestic producers Comparative edge of domestic producers
Domestic demand	Importance of the product for food security, basic needs etc. Consumer affordability considerations By type of the product, e.g. basic needs, luxury goods etc.
Considerations on re-export potentials	Potential for value addition in the country Export potential of value added products Final product or raw materials or products with the scope for value addition Re-exportable commodities
Other issues	Government revenue Domestic pressure groups Balance of economic power and political stability

Given these multiple objectives, the task at hand seems like an exercise on multi-objective optimisation programme, where a given objective function is maximized subject to a set of constraints in order to solve for optimum applied tariffs. For example, the objective function could be minimization of a weighted function of the deviations from the following goals, subject to a number of constraints including that applied tariffs cannot exceed the WTO bound rates.

- Domestic production or value addition in agriculture
- Employment in agriculture
- Government revenue
- Income distribution

In practice, however, it is not feasible to apply this framework to formally derive applied rates. But the message is important, that is: these considerations should be taken into account in determining applied tariff. On the issue of the safeguard, Nepal does not have access to the SSG of the AoA and no TRQs exist to manage imports and Nepal lacks capability to resort to the general WTO safeguards (e.g. anti-dumping). For these reasons also, tariffs will have to play some role of safeguard when faced with import surges, for a number of reasons. This has

also been the experience of many developing countries during the past 10 years of the AoA implementation. As discussed in the preceeding section, Nepal has considerable scope for varying tariffs upwards up to the bound rates for this purpose. The WTO rules do not prohibit this, although it may not be in the spirit of the WTO. One risk is pressure for tariff protection from “rent seekers” which can be minimized by using some objective criteria to vary tariffs, e.g. using the same triggers as in the SSG. At the same time, initiatives should be taken to gradually develop necessary statistical, human, institutional and legislative capability for resorting to the general WTO safeguards.

Reliable statistics, good analysis and debates are essential ingredients for sound and informed policy making, in every area. In the course of this study, it was found that many people interviewed – even analysts – were not clear on the way the government sets and varies applied tariffs. It was also noted that there is a serious lack of good analytical studies on the issues raised in this chapter, e.g. appropriate structure of applied tariffs, effective protection rate, winners and losers of a policy and so on. Becoming an effective WTO member also means implementing sound policies at home, both for efficiency and transparency. Rather than leave this analytical work to donor-driven projects and studies and university dissertations, the government, in particular the MoAC, should take a lead in this area. Within the MoAC, there are institutions/divisions created for this type of work, e.g. the Market Research and Statistical Management Programme or some form of economic analysis unit that may be established. The MoAC needs to reorient its programme so that agricultural trade policy analysis becomes an integral and regular activity of these entities. Besides being useful for policymaking and trade negotiations, this work is also essential for informing the private sector and the public at large.

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List of “sensitive” Nepalese agricultural products that merit in-depth analysis for ascertaining appropriate applied tariffs^{1/}

HS Head	Sub-heading	Commodity/product
2.03	All	Meat of swine, fresh, chilled or frozen
2.04	All	Meat of sheep or goats, fresh, chilled or frozen
2.07	All	Meat and edible offal, of the poultry of Heading 01.05, fresh, chilled or frozen
4.01	All	Milk and cream, not concentrated nor containing added sugar or other sweetening matter
4.02	All	Milk and cream, concentrated or containing added sugar or other sweetening matter
4.03	All	Butter milk, curdled milk and cream, yoghurt, kephir and other fermented or acidified milk and cream, whether or not concentrated or containing added sugar or other sweetening matter or flavoured or containing added fruit, nuts or cocoa
4.05	All	Butter and other fats and oils derived from milk; dairy spreads
4.06	All	Cheese and curd
4.07	0407.00.00	Birds' eggs, in shell, fresh, preserved or cooled
7.01	All	Potatoes, fresh or chilled
7.02	0702.00.00	Tomatoes, fresh or chilled
7.03	All	Onions, shallots, garlic, leeks and other alliaceous vegetables, fresh or chilled
7.08	All	Leguminous vegetables, shelled or unshelled, fresh or chilled
7.09	0709.51.00	Mushrooms of the genus <i>Agaricus</i>
7.10	All	Vegetables (uncooked or cooked by steaming or boiling in water), frozen
7.12	All	Dried vegetables, whole, cut, sliced, broken or in powder, but not further prepared
7.13	All	Dried leguminous vegetables, shelled, whether or not skinned or split
8.03	0803.00.00	Bananas, including plantains, fresh or dried
8.04	0804.30.00	Pineapples
8.04	0804.50.00	Guavas, mangoes and mangosteins
8.05	All	Citrus fruit, fresh or dried
8.08	0808.10.00	Apples
8.10	0810.10.00	Strawberries
9.01	All	Coffee, whether or not roasted or decaffeinated; coffee husks and skins; coffee substitutes containing coffee in any proportion
9.02	All	Tea, whether or not flavoured
9.08	0908.30.10	Cardamoms (alaichi)
9.10	0910.10.10	Ginger
	0910.30.00	Turmeric (curcuma)
10.01	1001.90.00	Other
10.06	All	Rice
11.01	1101.00.00	Wheat or meslin flour
11.04	All	Cereal grains otherwise worked (for example, hulled, rolled, flaked, perled, sliced or kibbled), except rice of Heading No 10.06; germ of cereals, whole, rolled, flaked or ground
11.05	All	Flour, meal, powder, flakes, granules and pellets of potatoes
11.07	All	Malt, whether or not roasted
12.01	1201.00.00	Soybeans, whether or not broken
12.02	All	Groundnuts, not roasted or otherwise cooked, whether or not shelled or broken
12.05	All	Rape or colza seeds, whether or not broken

HS Head	Sub-heading	Commodity/product
12.07	1207.50.00	Mustard seeds
15.06	1506.00.00	Other animal fats and oils and their fractions, whether or not refined, but not chemically modified
15.07	All	Soybean oil and its fractions, whether or not refined, but not chemically modified
15.08	All	Groundnut oil and its fractions, whether or not refined, but not chemically modified
15.11	All	Palm oil and its fractions, whether or not refined, but not chemically modified
15.14	All	Rape, colza or mustard oil and its fractions, whether or not refined, but not chemically modified
16.01	1601.00.00	Sausages and similar products, of meat offal or blood; food preparations based on these products.
16.02	All	Other prepared or preserved meat, meat offal or blood
17.01	All	Cane or beet sugar and chemically pure sucrose, in solid form
19.04	All	Prepared foods obtained by the swelling or roasting of cereals or cereal products
20.01	All	Vegetables, fruit, nuts and other edible parts of plants, prepared or preserved by vinegar or acetic acid
20.02	All	Tomatoes prepared or preserved otherwise than by vinegar or acetic acid
20.03	All	Mushrooms and truffles, prepared or preserved otherwise than by vinegar or acetic acid
20.04	All	Other vegetables prepared or preserved otherwise than by vinegar or acetic acid, frozen, other than products of Heading 20.06
20.05	All	Other vegetables prepared or preserved otherwise than by vinegar or acetic acid, not frozen, other than products of Heading 20.06
20.06	2006.00.00	Vegetables, fruit, nuts, fruit-peel and other parts of plants, preserved by sugar (drained, glaze or crystallized).
20.07	All	Jams, fruit jellies, marmalades, fruit or nut puree and fruit or nut pastes, being cooked preparations, whether or not containing added sugar or other sweetening matter.
20.08	All	Fruit, nuts and other edible parts of plants, otherwise prepared or preserved, whether or not containing added sugar or other sweetening matter or spirit, not elsewhere specified or included
20.09	All	Fruit juices (including grape must) and vegetable juices, unfermented not containing added spirit, whether or not containing added sugar or other sweetening matter
21.03	All	Sauces and preparations therefore; mixed condiments and mixed seasonings; mustard flour and meal and prepared mustard
21.05	2105.00.00	Ice cream and other edible ice, whether or not containing cocoa
21.06	All	Food preparations not elsewhere specified or included
24.01	All	Unmanufactured tobacco, tobacco refuse
24.02	All	Cigars, cheroots and cigarillos, containing tobacco
24.03	All	Other manufactured tobacco and manufactured tobacco substitutes; homogenized or reconstituted tobacco extracts and essences

1/ For Nepal these products are considered to be of sensitive nature. They deserve further analysis in order to determine appropriate levels of applied tariffs based on some of the criteria discussed in this chapter.

Nepal's applied MFN tariffs for 1999/00-2002/03 and bound tariffs for selected commodities

Products (HS code)	Tariff (% ad valorem)				WTO Bound
	Applied 1999/00	2000/01	2001/02	2002/03	
Cereals					
Wheat, flour (1001, 1101)	0	10	10	10	50/60
Wheat gluten (1109)	5	5	5	5	50
Wheat starch (1108), mixes (1901.20)	10	10	10	10	50
Biscuits, waffles etc. (1905, several)	40	40	40	40	40
Maize, maize flour (1005, 1102)	0	10	10	10	50/60
Maize starch (1108)	10	10	10	10	50
Maize prepared foods (1904)	15	15	15	15	40
Rice in husk, milled, semi-milled, flour (1006, 1102)	0	10	10	10	60
Dalmot, papad, bhujjiya etc.	10	15	15	15	40
Dairy					
Milk (0401.10, 0401.20, 0410.30)	0	10	10	10	50
Concentrated milk and cream	10	10	15	15	40
Yogurt, cheese, butter	10	10	15	15	50
Ice cream, edible ice etc. (2105)	25	25	25	25	40
Meat					
Live sheep, goat (0104)	0	10	10	10	60
Other live animals (0102, 0103, 0105)	0	10	10	10	30
Meat of swine, poultry (0203, 0207)	10	10	10	10	40
Other meats (0203, 0204, 0207, 0210)	10	10	10	10	60
Sausages (1601)	15	15	15	15	40
Eggs	10	10	10	10	50
Egg yolks	15	15	15	15	50
Sugar					
Sugarcane (1212.92)	0	10	10	10	30
Cane sugar (1701.11)	35	40	40	40	60
Sakhhar sugar (1701.11.90)	0	10	10	15	60
Chukandar sugar (1701.12.00)	25	40	40	40	60
Various sugar products (lactose, glucose, etc.)	10	10	10	10	40
Chewing gum (1704.10)	25	25	25	25	40
Vegetables and Fruits					
Potatoes, fresh or chilled (0701)	0	10	10	10	50
Flour meal, potato starch (1105)	10	10	10	10	50
Flakes, potato starch (1105, 1108)	10	10	10	10	50
Potato prepared (2004, preserved (2005)	25	25	25	25	40
Tomatoes fresh or chilled (0702)	0	10	10	10	50
Tomatoes prepared (2002.10)	25	25	25	25	60
Tomato juice (2009.50)	40	40	40	40	40
Oranges (0805.10)	0	10	10	10	50
Mandarins (0805.20)	0	10	10	10	50
Vegetables, fruit, nuts etc. (2006.00)	25	25	25	25	40
Jams, jellies, marmalades etc. (2007.91)	25	25	25	25	40
Orange juice frozen (2009.11), not frozen (2009.12), others	40	40	40	40	40
Apples (0808.10)	0	10	10	10	40
Apples dried (0813.30)	15	15	15	15	40
Apple juice, apple juice others (2009.71, 2009.79)	40	40	40	40	40

Source: Applied rates are compiled based on the information from the Department of Customs, Nepal; bound rates are also from government source. The latter is also available at the WTO web site, www.wto.org/trade_topics/accession.