



## Foreign Trade of Nepal: An Outline of India and Overseas Economies

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### Abstract

**Background:** *This article seeks to explain the current status of Nepal's involvement in foreign trade. The major objective of this research is to look into Nepal's present foreign trade situation with India and the rest of the world*

**Methods:** *The study used a 29-years of time series data related to foreign trade, breaking down global foreign trade, Indian foreign trade, and overseas foreign trade one by one. Graphs, a simple regression model, and a log linear model are used for analysing the data.*

**Results:** *This study found a positive relationship between economic growth and both imports and exports. However, an export equal to one million can generate only 0.00133 million income for Nepal. Also, imports generate only 0.03451 million revenue of Nepal which is very low.*

**Conclusion:** *Foreign trade is essential for Nepal's economic growth, yet it is still a long way off.*

**Keywords:** *foreign trade, export, import, impact, GDP*

### Introduction

In the present day, goods and services are imported and exported by all economies. Economies are unable to meet their own demands by producing all of their necessary goods and services (Meier, 1990). A country imports commodities that are not available and costly to produce in the nation and exports items that are oversupplied and have lower cost of the production in the country (Kafle, 2017).

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Foreign trade has played a critical role in countries' economic progress. Without foreign trade, it would be impossible for backward countries to modernize (IMF, 2018). It aids economic development by enhancing competitiveness, extending market opportunities, and supplying new technology and machinery to the industrial and agricultural sectors. As a result, it is also regarded as a tool for economic progress. From the beginning of time until the Malla dynasty, Nepal's foreign trade was focused on India and Tibet (Devkota, 200). Now Nepal has bilateral and multilateral commercial relations with approximately 120 nations. Nepal sought an open market and liberalized economy after regaining democracy in 1990, signing regional trade agreements such as SAPTA and SAFTA, as well as international trade accords such as the World Trade Organization (WTO) (Dahal, 2005).

Nepal's foreign trade strategy is guided by trade policy as well as bilateral and multilateral agreements. Now, most of the policies are export oriented when import is treated as source of revenue (Kafle, 1981). Nepal is very much dependent on foreign aid and foreign investments. In the development process of Nepal, foreign trade plays a vital role in order to bring in sustainable long-term economic growth. Foreign trade is seen as the engine of growth of Nepal (Panta, 1994).

Nepal's economy is one of the most liberalized and trade-dependent in South Asia (SWATEE, 2007). Natural raw materials account for the majority of exports, which have large volumes and low profit margins. When the indigenous manufacturing industry is in its infancy and the country is reliant on foreign resources for development financing, the costs of liberalization may outweigh the benefits (Sakya, 2001). As a result, foreign trade is fast expanding, but as the entire volume of commerce increases, so does the trade imbalance.

Nepal is grappling with a fast growing trade deficit. Nepal is unable to diversify its trade. Landlocked, low export and high import, low quality goods, improper trade policy, higher cost of production, lack of publicity and advertisement, low production, slow industrial development, lack of trade diversification, and other factors are among the major causes of Nepal's growing trade deficit. Nepal will not be able to minimize its ever-increasing trade imbalance until it improves its trade competitiveness through a variety of strategies. In terms of commodities and destinations, Nepal can also enhance its trading structure (NPC, 2018).

## Overview of Nepal's Foreign Trade

According to Rana (1969), the incentive bonus program allowed for a wide range of exchange rates depending on the commodity sold abroad. The author makes a case for the frequently claimed over-invoicing of exports that is linked to incentive bonuses. In opinion about the exchange rate by Panta (1968), the official exchange rate of twelve Nepalese rupees to one dollar shall be used as the basis for all convertible foreign currencies. It will be usable for international payments, hidden exports, services, capital transfers, and foreign exchange.

Ghani (2011) has looked at the influence of trade liberalization on a group of developing nations' merchandise trade balances. Lewis (1978) has explained that the influence varies depending on the destinations and origins of exports and imports, as well as whether they are from developing or developed countries.

Shrestha (2003) is exclusively devoted to studying the Indo-Nepal trade treaty of 1996 in his study *Nepal-India Bilateral Trade Relations Problems and Prospects*. He mentioned the potential for hydroelectric power, the tourism industry, and education and training as some of the main areas. *Indo-Nepal Trade and Economic Relationship*, Baskota (1981) outlines Nepal's treaties with India. According to the author, the Treaty of 1923 effectively put an end to Nepalese trade. He discovered that from 1956/57 and 1969/79, imports outnumber exports, resulting in a negative trade balance.

In his paper, *Nepal's Foreign Trade: Trends and Concerns*, Sharma (1999) aims to examine the present trends and significant issues confronting Nepal's foreign trade sector. The author discovered that Nepal's trade imbalance expanded from 1991/92 to 1996/97, despite the fact that exports climbed at an average rate of 11% per year. The chronically negative international trade balance is one of Nepal's primary hurdles in achieving better economic growth.

In Nepal, Chaudhary (2011) investigated the sensitivity or impact of trade openness. In comparison to agriculture and energy, the manufacturing and service sectors are more open. He claims that Nepal has liberalized trade without enacting the necessary domestic reforms.

In *Nepal's Foreign Trading: the Changing Scenario of Commodity Composition and Direction*, Singh (1999) analyzes that Nepal is a primary product producing country with unfavorable trade terms. They also urge that, as a result of global economic reforms such as liberalization and globalization, the Nepalese economy be made compatible with these developments. They recommended that Nepal increase exports while decreasing imports in order to ameliorate BOP.

Garanja (2000) seeks to forecast the future trend in Nepal's international trade in his article A Note on Prospect of Balance of Trade. Hirschman (1945) assumed that there would be no significant changes in the sphere of international trade. The main source of the trade deficit is a larger ratio of imports to exports. Nepal adopted export diversification and import substitution techniques in the mid-1960s. The government implemented the Dual Exchange Rate System in 1977. A cash subsidy program was established in 1981 to encourage exports (IIDS, 1996).

Panel data analysis was utilized by Santosh and Thirlwall (2004) to estimate the influence of trade liberalization on export trade performance. Reejal (1982) contrasts the share of export, import, and total trade with gross domestic product in his article Nepal's Foreign Trade and Economic Development 1956/57 to 1979/80. S.R. Poudyal (1988) examined the Nepalese economy in his book Foreign Trade, Aid, and Development in Nepal. He seeks to figure out how macroeconomic variables like investment, saving, export, and import behave and what factors influence them.

Shrestha (1994), focuses on the patterns of Nepalese trade and the balance of payment issue. Thirlwall (1994), his research focuses on trade terms and benefits. He strives to identify the country's biggest challenges and propose the most effective remedies. Modigliani (1956) discovered that the benefit of the trade agreements among the countries is that the trade gap begins to decrease as a result making policies and behavior.

The Study of Nepal's Foreign Trade: 1965-1997, by Thapa, was published in 1981. Thapa set three goals for himself: to research Nepal's foreign commerce, assess exports, and investigate imports. She came to the conclusion that Nepal's foreign commerce is not proportional to its GDP.

## **Research Objectives**

The focus of this research is on Nepal's trading ties with the rest of the world. As a result, the research was carried out with the following goals in mind.

- To analyze trend of Nepal's foreign trade.
- To examine the Nepal's economic growth with foreign trade.

## **Research Methodology**

The study attempted to derive a conclusion based on secondary data in order to meet the study's specified objectives. The analysis was carried out using some statistical methods. Published and unpublished research papers, reports of NRB, Trade

Promotion Center, GON, Economic Surveys, National Planning Commission (NPC), CBS, Department of Customs; Foreign Trade Statistics, IMF, International Financial Statistical Year Book, UNCTAD has been collected. This study focuses solely on mercantile trade statistics. Foreign trade data is organized into SITC groupings rather than specific commodities or countries.

The simple linear regression model between exports and GDP is as follows:

$$Y = a_0 + a_1X + e \dots\dots\dots(i)$$

Where, Y = dependent variable (Export), X = independent variable (GDP) and  $a_0, a_1$  = regression parameters.

From the equation no (i) can be changed in to log linear form of the following equation:

$$\ln Y = a_0 + a_1 \ln X + e \dots\dots\dots(ii)$$

Where,  $\ln$  = natural log

Again simple regression equation model between imports and GDP has been used as under:

$$Y = a_0 + a_1Z + e \dots\dots\dots(iii)$$

Where, Y = dependent variable (Import), Z = independent variable (GDP) and  $a_0, a_1$  = regression parameters.

From the equation no (iii) can be changed in to log linear form of the following equation:

$$\ln Y = a_0 + a_1 \ln Z + e \dots\dots\dots(iv)$$

Where,  $\ln$  = natural log

### Analysis of Overall Foreign Trade

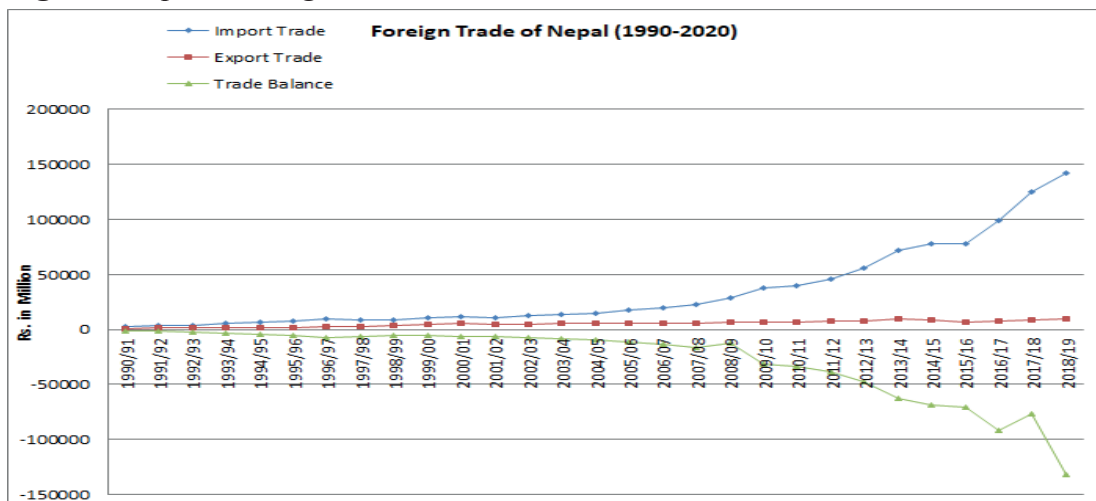
Nepal implemented state-led industrialization and import substitution initiatives from 1960 to 1990. Poverty, inequality, low labor productivity, and a significant reliance on a few items in Nepal's trading structure define the country's least developed status. The country's diplomatic outreach to the rest of the globe is still in its early stages. For a variety of reasons, a battle between Tibet and Nepal erupted. Nepal established its first five-year plan in 1956, and has since completed fourteen five-year plans. The fifteenth five-year plan is now being implemented. Nepal's exports were valued at 95.47 million rupees in 1956/57. It climbed to 9711 million rupees in

2018/19, representing in total export during a sixty three years.

Our export value climbed by 13.14 times between 1990/91 and 2018/19, whereas our import value climbed by 61.06 times, as seen in the figure 1. In 2018/19, however, the value of imports is 14.60 times that of exports. In 1990, Nepal had a total trade deficit of 15839 million rupees. Our trade imbalance grew to -132142.58 million rupees over 29 years, or nearly 13.60 times the value of our exports. Although the trend in Nepal's foreign trade over the last few years has been encouraging, the size of our trade imbalance is discouraging.

Higher imports against tiny exports are the primary cause of Nepal's growing trade deficit. The following reasons contribute to a deficit trade balance: a small base of exportable production, a young industrial structure, and a low level of quality.

**Figure 1** *Nepal's Foreign Trade*



Source: Nepal Rastra Bank, *Quarterly Economic Bulletin/Economic Survey, 2020.*

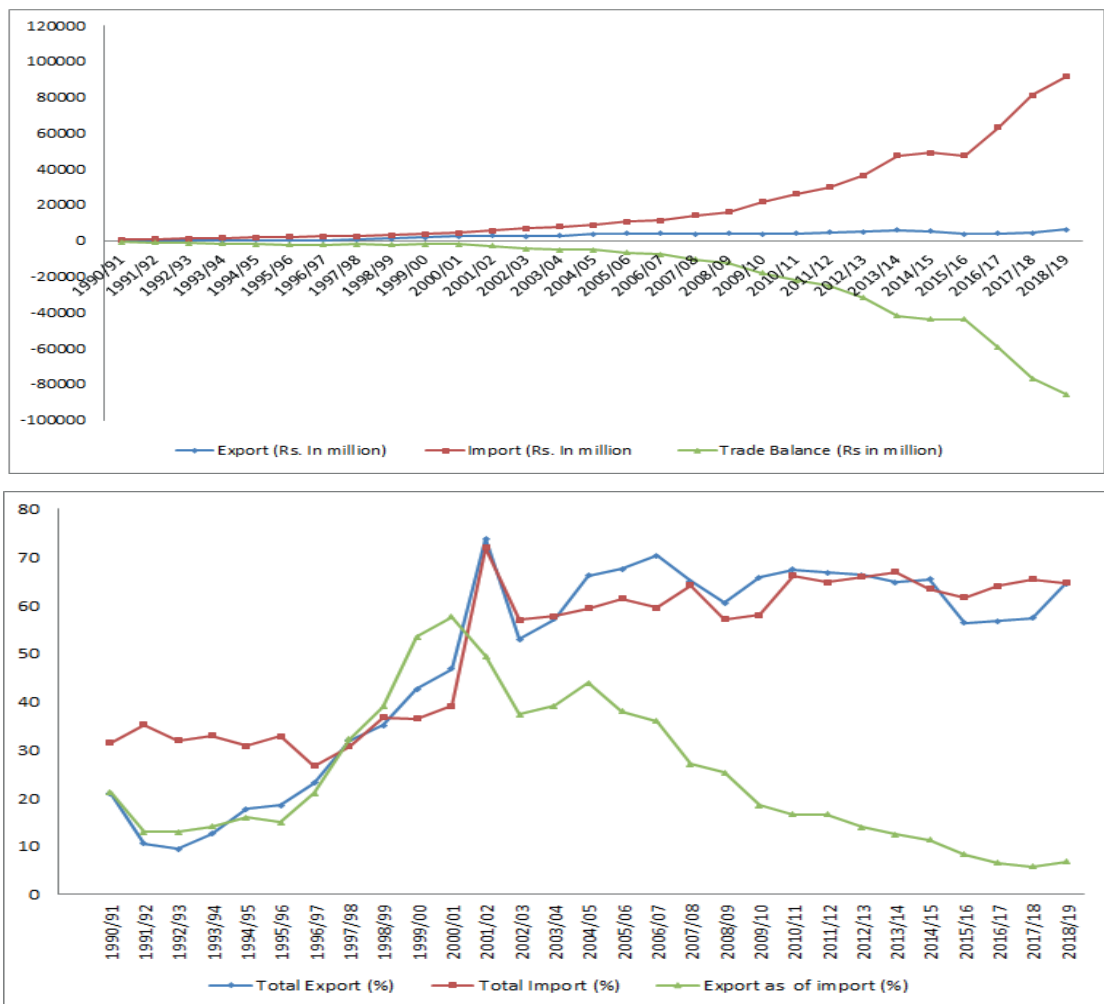
### Analysis of Foreign Trade with India

Until 1970, India accounted for 99 percent of Nepal's entire export and 88 percent of its entire import commerce. Table 5.1 demonstrates that, while the value of exports is increasing, the trade deficit with India is worsening. The trade deficit with India increased from -5770.9 million rupees in 1990 to -85517.75 million rupees in 2018/19, a 14.81-fold increase over the research period. There has also been a significant increase in the value of imports. From the beginning of the study period, in 1990/91, through 1995/96, the share of exports in overall commerce with India appears to be falling. However, beginning in 1996/97, the

percentage of exports increased steadily until 2000/01. In 2001/2002, India's proportion of overall trade exports nearly doubled, reaching 73.8 percent. India's share of overall commerce fell again in the next season, though it still accounted for 64.59 percent of overall trade in 2018/19.

During the same period, the total value of imports from India surged by about 11 times. From 1990/91 to 2000/01, the share of imports from India appears to have been quite stable, averaging 33%. However, since 2001/02, the percentage share of imports has climbed dramatically, reaching 72 percent in 2001/02 and 64.70 percent in 2018/19.

**Figure 2** *Nepal's Trade with India*



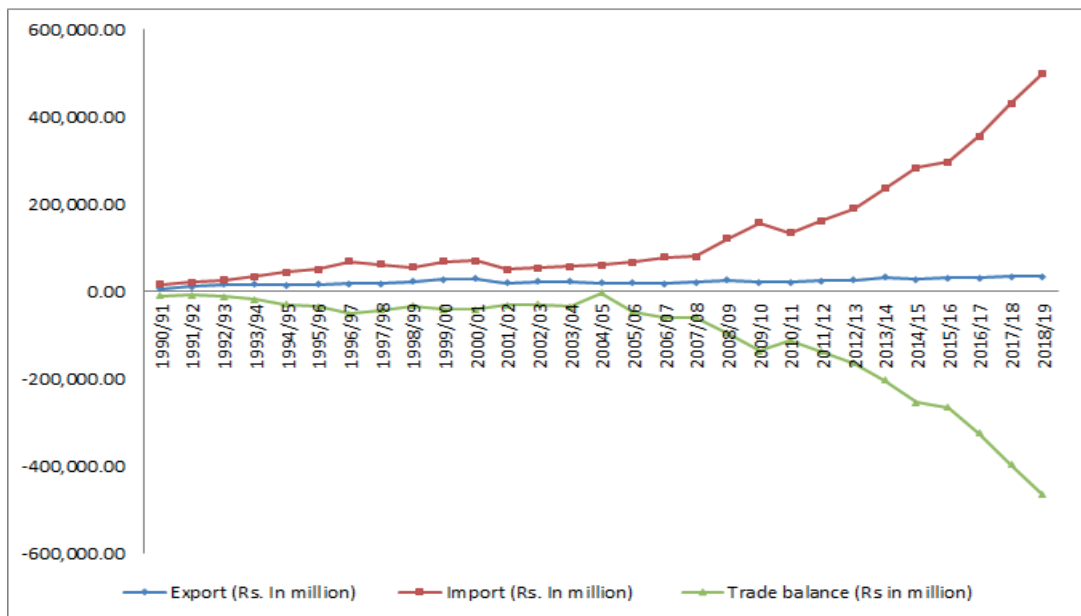
Source: Nepal Rastra Bank, Bulletin/ Economic Survey 2020

### Analysis of Nepal's Overseas Foreign Trade

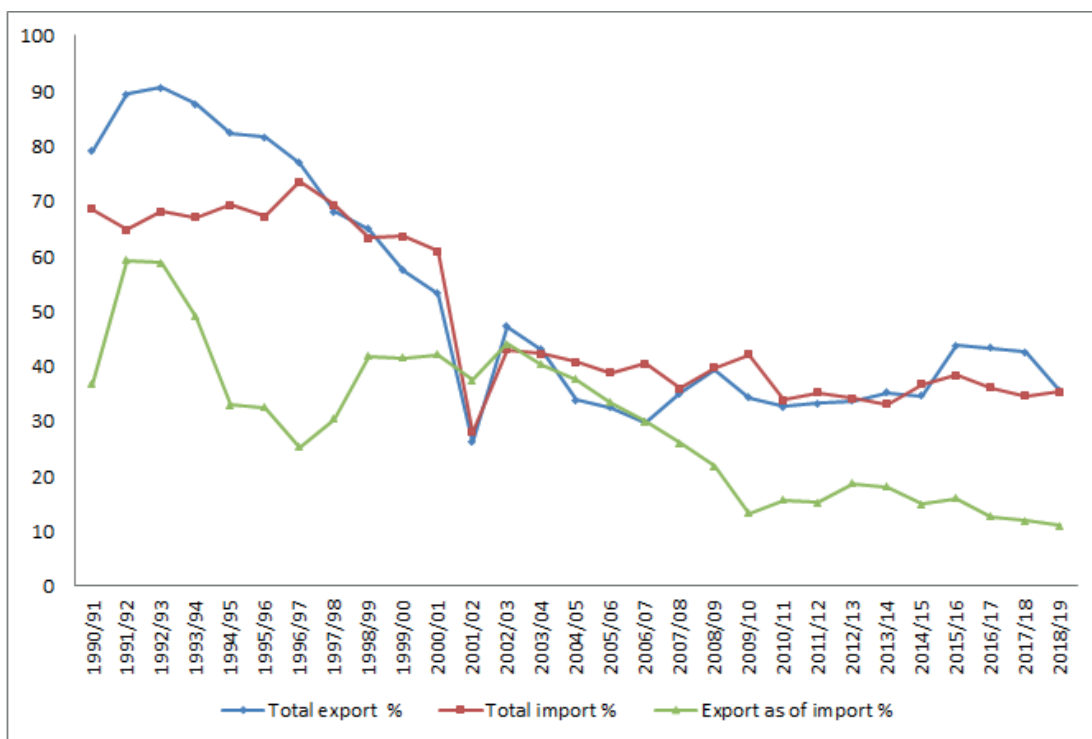
Japan, Germany, Singapore, Hong Kong, and Saudi Arabia are Nepal's significant overseas suppliers. Germany, the United Kingdom, Italy, Japan, and Belgium are the top export destinations for Nepalese goods. Nepal's most important partner is the European Union. The figure shows that between 1990/91 and 2018/19, the total value of export increased 5.89 times, from 5835.3 million rupees in 1990/91 to 34377.7 million rupees in 2018/19. On the import side, the overall volume climbed 3.49 times from 15903.4 million rupees in 1990/91 to 500626.0 million rupees in 2018/19. As a result, there is a virtually equal increase in the value of overseas commerce exports and imports. The trade imbalance in 2018/19 is nearly 4.6 times higher than it was in 1990, when the analysis began.

The largest percentage contribution of overseas trade to total export was 90.6 percent in 1992/93, while the lowest contribution was 26.2 percent in 2001/02. Since 1990/91 to 2018/19, there has been little variation in imports compared to exports.

**Figure 3** *Nepal's Trade with Overseas countries*







Source: Nepal Rastra Bank, Bulletin/ Economic Survey 2020.

From 1990/91 to 2018/19, Nepal's foreign trade seems to be growing steadily. In particular, the growth rate of exports is lower than the growth rate of imports in Nepal's foreign trade. Today we are engaged in trade equivalent to about 22% of GDP. But growth in imports alone has not helped our economic growth much. Our total business started from 3061.40 billion in 1990/91 and reached only 151564.58 billion by 2018/19.

Even today, Nepal's foreign trade is heavily dependent on India. India still accounts for about 65% of foreign trade in both imports and exports. Only the remaining 35% have foreign trade status with other countries. Here, India's share of exports and imports is 6.83%. To this day, our unbalanced trade with India continues to grow at a volume of 85517.75 billion.

Apart from India, we are also in a state of unbalanced trade with overseas countries in which we are unbalanced at -46624.82 billion. Only about 35% of us are in the foreign trade position of overseas countries. Such imbalances in foreign trade have not been able to boost the country's economic development. In 1990/91 the GDP was 12037.02 billion while today by 2018/19 the GDP is only 3458790.00 billion.

## Discussion of the Models

So many things have an impact on Nepalese foreign trade. The magnitude of Nepalese export trade may undoubtedly boost GDP. This section attempts to explore the primary determinants of Nepalese export. Now we have estimated the linear equations to determine the contribution of exports using total volume of export in various time periods as a dependent variable and gross domestic product, agriculture GDP, and non-agriculture GDP as independent variables, with one period lag export considered as an independent variable.

The regression is run on data spanning 29 years, from 1990/91 to 2018/19. The regression model's fitted equations are as follows, with the estimations based on constant data. There has been no attempt to address the issue of serial correlation. All statistical values are calculated using Microsoft Excel on a computer.

**Table 1** *Summary Output*

	<i>Intercept</i>	<i>GDP</i>	<i>R<sup>2</sup></i>	<i>Adjusted R<sup>2</sup></i>	<i>S. E.</i>	<i>P-Value</i>	<i>Observations</i>
Equation No.1	4718.265	0.00133	0.242037	0.21396462	2242.425	0.0067129	29
Equation No.2	2.00717	0.33310	0.564415	0.548282794	0.19302833	2.64848E-06	29
Equation No.3	20721.55	0.03451	0.717385	0.706917951	20563.0705	6.91463E-09	29
Equation No.4	0.82564	0.70140	0.853306	0.84787345	0.19183587	9.13462E-13	29

First equation shows that there is significant positive relationship between total foreign export (X) and GDP. The fitted equation is a low fit with  $R^2 = 0.24$  which indicates that only 24% of variation in foreign export (X) is explained by independent variable GDP. The P value 0.0067 is significant at the level of 5 percent and indicating that there is strong association of variables in equation. On an average Nepalese economy one million of export is capable of generating additional income only worth Rs. 0.00133 million.

The elasticity coefficient of the entire concern explanatory variable is less than one telling that total volume of export is quite low responsive to GDP. For equation 2 the adj  $R^2$  are 54.8 Percent total variation is explained by independent variables respectively which can be considered is the best-fitted regression model. The log

linear equation indicates again there is positive relation export with GDP as well as direct relationship occurs in between export to one period lag export. We observe that some independent variables are significant with larger t- value. All variables are significant. Comparing with its tabulated value with  $n = 29$ ,  $P = 2.64848E-06$  at 5% level of significance, we can see P values of GDP is significant indicating that there is strong association of variable in question.

Third equation shows that there is also significant positive relationship between total foreign import (M) and GDP. The fitted equation is an average high fit with  $R^2 = 0.7173$  which indicates that only 71.73% of variation in foreign import (M) is explained by independent variable GDP. The P value  $6.91463E-09$  which is zero and significant at the level of 5 percent and indicating that there is strong association of variables in equation. On an average Nepalese economy one million of import is capable of generating additional income only worth Rs. 0.0351 million.

The log linear regression model for import is indicating near about ten points above the result as its simple regression equation. The elasticity coefficient concern independent variable is depicting that total value of import is quite low responsive to the ratio of GDP. Similarly, import with foreign is highly responsive with regard to country's GDP. We can claim the fitted regression models are best one according to their respective  $R^2$ . The P- value is also highly significant depicting that there is strong relation between all variables in equation.

## Conclusions

Nepalese foreign trade is critical to the country's economic growth and development. The government has implemented many policies and made attempts to properly direct our export commerce. Nonetheless, the outcome was not as expected. Although, around 22% of GDP export trade in particular has deteriorated rather than improved. Total foreign export and import have a considerable positive association with GDP. Import and export trade are highly responsive to a country's GDP. The log linear equation reveals a positive link between exports and imports, as well as a direct relationship. In the average Nepalese economy, one million rupees in exports can only provide Rs. 0.133 million in new income, which is extremely low.

Open borders and open trade between Nepal and India are also major issues. The Nepalese trade scene has been hard due to the country's infant industrial structure, which has a restricted base of exportable production and low-quality products. Nepal has a fundamental trade imbalance and has unfavorable terms of trade with both India

and the rest of the world. The main reason of the trade deficit is a large number of imports compared to a limited number of exports. Decision-making lags and a lack of political will can halt a country's progress.

Nepal may gain a lot of benefits from being a member of the WTO, SAPTA, and SAFTA, including the ability to grow exports, improve trade deficits, and address the BOP condition. The advancement of information technology and the implementation of new technologies in particular industries are encouraging factors in ensuring high-quality, competitive products. Nepal is being courted by a number of national and international organizations, including the NRN. Bringing FDI in to strengthen export-oriented industries has a lot of promise. With the cease-fire, the country is on its way to a political resolution.

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