

## **Nepal's Foreign Trade: Present Trends**

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**Abstract:** This paper examines the trends in Nepalese foreign trade and the major reasons for trade deficit with India. Foreign trade plays a very important role in the economic development of a country. It promotes economic development by improving competitive capacity, expanding market, and providing modern technology and machineries for industrial and agricultural sector. Therefore, it is considered as the vehicle of the economic development. Before 1951 AD, Nepal's foreign trade was only with India and Tibet. But after 1951 AD, Nepal's trade relation expanded with many other countries of the world. Economic liberalization and reforms was initiated in mid 1980's. Since then, Nepal's foreign trade is rapidly increasing but the rate of increase in import is higher than export, which is regarded as a major problem of Nepal's foreign trade.

**Keywords:** Economic development, Export, Foreign trade, Import, Nepal.

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### **Introduction**

Foreign trade plays an important role in the development of a nation. Countries today are involved into foreign trade to create employment opportunities, increase foreign exchange earnings, etc. Nepal, a landlocked nation located between two giant and fast growing economies, is aiming to integrate fully into the global economy. Nepal has been the member of World Trade Organization (WTO) in year 2004. Nepal is also founding member of South Asian Free Trade Agreement (SAFTA) and is a signatory in different multilateral and bilateral trade agreements.

Nepal has trade relation with India and Tibet only before 1951 AD. The fall of Rana Regime and Introduction of democracy in year 2007 BS was a turning point for Nepalese foreign Trade. Then after, Nepal foreign trade volume is increasing year after year and the number of countries that Nepal trades is also increasing. Nepal has started economic liberalization, trade liberalization and policy reforms, encouragement of private sector participation in economic development, foreign account convertibility in mid 1980's. However, Nepal is facing serious trade deficit problem as imports are continuously raising and exports are falling. Despite being member of various trade organizations and trade agreements with many countries, Nepal lacks a favorable business environment that encourages manufactures and exporters to exploit full opportunity created by such memberships and agreements.

### **Literature Review**

Many studies have been undertaken to analyze the trends and patterns of foreign trade of Nepal, few of them are as follows:

Prasai (2014) studied Foreign Trade Pattern of Nepal: Gravity Model Approach. In this study, gravity model is applied with comprehensive panel dataset for 29 years time period covering Nepal's 94 trading partners. The results appear robust to specification, time period and trade determinants. Following a convention in this field, this study separates exports and imports instead of using total trade turnover. The empirical results are found consistent with the fundamental of gravity model as the study reveals positive coefficients for economic size and negative coefficients for distance. No significant structural break is found in the determinants of trade after economic liberalization. The results from simulation while comparing actual trade with predicted trade show that Nepal's trade is not distorted by political decisions such as economical sanctions imposed by other countries. The results also suggest that trade with India in comparison to China is quite substantial. The results suggest that Nepal needs trade diversification in general and trade agreement with China in particular to reap the benefits from the trade.

Sharma & Bhandari (2005) studied the effects of foreign trade on Nepal's economic development. They identify export growth, capital stock, labor force, average propensity to save (APS), relative price index (RPI), and ratio of government development expenditure to GDP (Gross Domestic Product) as factors that can affect international trade.

Singh and Khanal (2010) studied Indo-Nepal trading patterns after 1990. They found that the rising proportion of exports to and imports from India in Nepal's total trade has increased its dependency on this neighboring country for trade. The paper does not suggest any possible solutions based on the empirical findings as to how to reduce trade dependency on India.

Basyal (2011) examined how the full implementation of a liberal trade agreement can contribute to the growth of the exporting sector and its significance for the economy of Nepal. The paper recommends that measures to reduce the inflation rate in Nepal could considerably improve trade competitiveness. The recommendations made on how to improve trade are vague and are not supported by empirical results.

Thapa (2012) has used gravity model to estimate the trade potentiality of Nepal using only 19 trading partner countries for 2009. In the paper, trade potentiality is simply calculated with the help of the ratio of predicted trade to actual trade. Similarly, Acharya (2013) has used the gravity model to identify the determinants of international trade of Nepal. In the paper, the author used country specific fixed effect which reveals that time invariant factors are significant as one of the determinants of the trade. In two papers Acharya (2013) and Thapa (2013), they also used the gravity model to discuss the determinants of trade. This paper is different from those two papers in respect of using comprehensive data sets (29 years data), all trading partner countries (94 countries) of Nepal, division of data into two sets to see structural breaks (before and after liberalization), simulation of results (Actual Vs Predicted) and use of other most important variables such as Linder (to see whether trade is based on comparative advantage or product differentiation), Per Capita GDP, WTO, landlocked, etc in the model.

Sharma & Bhandari (2005) studied foreign trade and its effects on Nepalese economic development. Having with the objectives of understanding the effects of foreign trade on the economic development process of Nepal, this paper attempts to deal the role and the impact of export and import along with many other pertinent factors. The determining factors that have been considered along with export are: capital stock, labor force, average propensity to save (APS), relative price index (RPI), ratio of government development expenditure to GDP. Moreover, GDP, PCI, and growth rate of GDP are the assumed development indices. These macro variables are introduced through the application of various econometric models. The empirical results have been estimated by applying annual data for the period of 1974/'75 to 2002/'03. The different models in linear and log-linear forms have justified that exports growth leads to economic growth. Therefore, the policy of adequate investment in export oriented industries that embody a 'proper mix' of export promotion and import substitutions is suggested.

### Objectives of the study

The objectives of the study are as follows:

1. To analyze the trends and patterns of foreign trade of Nepal.
2. To analyze the reasons for trade deficit, particularly with India.

### Research Methodology

The data for the study has been collected from secondary sources. These sources include publications from Trade and Export Promotion Centre, Nepal Rastra Bank, National Planning Commission of Nepal, Economic Survey Report, Newspaper, Magazines, etc. Times series data from fiscal year 1974/75 to 2016/17 has been used to analyze the growth of Nepalese foreign trade. To analyze the composition of Nepal's foreign trade, commodity trade by Standard International Trade Classification (SITC) for FY 2015/16 has been taken. Finally, to analyze the direction of foreign trade of Nepal, export and import data from fiscal year 2011/12 to 2015/16 has been considered. In order to analyze the data and draw conclusions in this study, use of charts, diagrams, tables, etc has been made.

### Findings and Discussion

#### Growth of Nepalese Foreign Trade

Before 1951 AD, Nepal's trade relation was only with India and Tibet. The decline of Rana regime in 1951 AD was the turning point of Nepalese foreign trade. After this, foreign trade of Nepal has run systematically with many countries of the world and the volume of trade has also increased. During the fiscal year 1975/76, the total export of Nepal was equivalent to Rs. 1185.8 million and total import was equivalent to Rs. 1981.7 million. But nowadays, it has increased thousands of times.

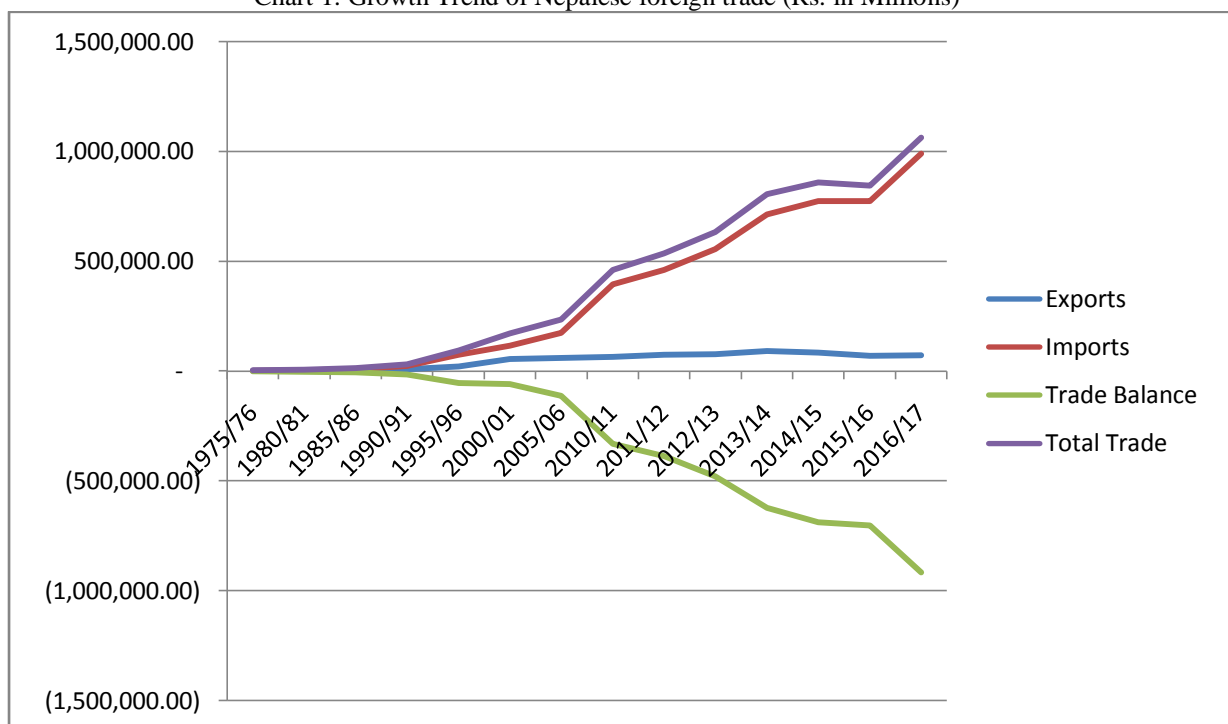
Table 1: Growth Trend of Foreign Trade of Nepal (Rs. in Million)

Year	Exports	Exports Growth Rate	Imports	Imports Growth Rate	Trade Balance	Total Trade	Total Trade Growth Rate
1975/76	1,185.80	-	1,981.70	-	(795.90)	3,167.50	-
1980/81	1,608.70	35.66%	4,428.20	123.45%	(2,819.50)	6,036.90	90.59%
1985/86	3,078.00	91.33%	9,341.20	110.95%	(6,263.20)	12,419.20	105.72%
1990/91	7,387.50	140.01%	23,226.50	148.65%	(15,839.00)	30,614.00	146.51%

1995/96	19,881.10	169.12%	74,454.50	220.56%	(54,573.40)	94,335.60	208.15%
2000/01	55,654.10	179.93%	115,687.20	55.38%	(60,033.10)	171,341.30	81.63%
2005/06	60,234.10	8.23%	173,780.30	50.22%	(113,546.20)	234,014.40	36.58%
2010/11	64,338.50	6.81%	396,175.50	127.97%	(331,837.00)	460,514.00	96.79%
2011/12	74,261.00	15.42%	461,667.70	16.53%	(387,406.70)	535,928.70	16.38%
2012/13	76,917.10	3.58%	556,740.30	20.59%	(479,823.20)	633,657.30	18.24%
2013/14	91,991.40	19.60%	714,365.80	28.31%	(622,374.40)	806,357.20	27.25%
2014/15	85,319.10	-7.25%	774,684.20	8.44%	(689,365.10)	860,003.30	6.65%
2015/16	70,117.10	-17.82%	773,599.10	-0.14%	(703,482.00)	843,716.30	-1.89%
2016/17	73,049.10	4.18%	990,113.20	27.99%	(917,064.10)	1,063,162.30	26.01%

(Source: Economic Survey)

Chart 1: Growth Trend of Nepalese foreign trade (Rs. in Millions)



The table 1 and Chart 1 show the growth trend of Nepalese foreign trade since the fiscal year 1975/76. In the fiscal year 1975/76, Nepal's export was equivalent to Rs. 1185.80 million, the import was equivalent to Rs. 1981.70 million, the total volume of trade was Rs. 3167.50 million and the trade deficit was Rs.795.90 million. The export has risen sharply since fiscal year 1976/76 to FY 2000/01. However exports declined sharply after FY 2001/01. In FY 2014/ 15 and FY 2015/16, export growth was negative as compared to previous fiscal year. Imports continue to grow at rapid rate in all fiscal years as compared to previous fiscal years except in FY 2015/16. The trade balance is negative for all fiscal years as the volume of import exceeded the volume of export. This shows that Nepal's import, volume of trade and trade deficit are increasing rapidly. But the rate of increase in import is higher than the rate of increase in export. Consequently, Nepal's trade deficit is very high and increasing rapidly every year. The persistent deficit in foreign trade is due to low production of export oriented goods and higher import of consumer goods. In order to reduce this deficit, the production of competitive goods should be increased, which will help to increase export and reduce import.

#### Composition of Nepalese Foreign Trade

Composition of trade refers to the composition of import and export. A study of changes in the composition of foreign trade helps to analyze the economic progress of the country. The table 2 shows the composition of Nepalese foreign trade in the fiscal year 2015/16. In Nepal, commodities traded with foreign

countries are classified according to Standard International Trade Classification (SITC). The SITC includes goods imported and exported in ten headings:

Table 2: Commodity Trade by SITC Group: FY 2015/16

S.N.	SITC Group	Exports		Imports	
		Rs. in Million	In Percentage	Rs. in Million	In percentage
1	Food and live animals	16421	23.42%	109756	14.19%
2	Tobacco and beverage	478	0.68%	6413	0.83%
3	Crude materials and inedibles	2218	3.16%	33392	4.32%
4	Minerals, Fuels, and lubricants	1	0.00%	84088	10.87%
5	Animals and vegetable oils and fats	107	0.15%	21153	2.73%
6	Chemical and drugs	4618	6.59%	103962	13.44%
7	Classified by materials	32666	46.59%	163132	21.09%
8	Machinery and transport equipments	400	0.57%	189764	24.53%
9	Misc. manufactured articles	13205	18.83%	45864	5.93%
10	Not classified	3	0.00%	16074	2.08%
	<b>Total</b>	<b>70117</b>	<b>100.00%</b>	<b>773598</b>	<b>100.00%</b>

(Source: Economic Survey, 2016/17)

The composition of Nepal's foreign trade can be explained by dividing into two headings:

- (i) Composition of export: The major exportable goods of Nepal are woollen goods, carpets (hand knotted woollen), Nepalese product and paper products, readymade garments, handicrafts, ornaments, pasmina, pulses, cardamom, medical herbs, etc. These goods are exported to India and other countries. From the table 2, it is clear that the value of "classified by materials" had occupied first position (46.59%) in the total export in the fiscal year 2015/16. Similarly the value of "food and live animals" has occupied second position (23.42%) and the value of "miscellaneous manufactured articles had occupied third position (18.83%) in the total export in the fiscal year 2015/16.
- (ii) Composition of import: The major goods imported in Nepal are various finished goods, semi finished goods, raw materials of industry, machinery, equipment, chemical fertilizers, petroleum products, gold, electrical goods, readymade garments, etc. From the Table 2, it is clear that the value of machinery and transport equipment had occupied first position (24.53%) in the fiscal year 2015/16. Similarly, the second position (21.09%) was occupied by classified by materials and the third position (14.19%) was occupied by food and live animals.

### Direction of Foreign Trade of Nepal

The table 3 presented below shows the direction of foreign trade of Nepal.

Table 3: Direction of Nepal's Foreign Trade

(Amount in Million)

Description	2011/12	2012/13	2013/14	2014/15	2015/16
<b>Export</b>	<b>74,261.00</b>	<b>76,917.00</b>	<b>91,991.00</b>	<b>85,319.10</b>	<b>70,117.00</b>
India	49,616.30	51,000.00	59,614.00	55,864.60	39,494.00
China	-	2,086.00	2,841.00	2,230.00	1,682.00
Other Countries	24,644.70	23,832.00	29,537.00	27,225.00	28,942.00
<b>Import</b>	<b>461,667.70</b>	<b>556,740.00</b>	<b>714,366.00</b>	<b>774,684.20</b>	<b>773,599.00</b>
India	299,389.60	367,031.00	477,947.00	491,659.90	477,213.00
China	-	62,451.00	73,319.00	100,166.00	115,694.00
Other Countries	162,278.10	127,258.00	163,100.00	182,862.00	180,692.00

<b>Total Trade</b>	<b>535,928.70</b>	<b>633,657.00</b>	<b>806,357.00</b>	<b>860,003.30</b>	<b>843,716.00</b>
India	349,005.90	418,031.00	537,561.00	547,524.50	516,707.00
China	-	64,537.00	76,160.00	102,396.00	117,376.00
Other Countries	186,922.80	151,090.00	192,637.00	210,087.00	209,634.00
<b>Total Trade Share (Percentage)</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>
India	65.10	66.00	66.70	63.70	61.20
China	-	10.20	9.40	11.90	13.90
Other Countries	34.90	23.80	23.90	24.40	4.80

(Source: Economic Survey, 2016/17)

Before 1951 AD, Nepal has trade relation with India and Tibet only. India was the major trading partner with about 95% of total trade. Trade with Tibet was around 5% of total trade and trade with rest of the world was nil. The major reason for trade with India was landlockedness of Nepal, similar culture, religion and language with India, etc. But nowadays Nepal's trade relation is with many overseas countries besides India and china. But India is still a major trading partner of Nepal. In fiscal year 1974/75, Nepal's 82.2% trade was with India and trade with other countries was only 17.8%. in the fiscal year 1984/85, the trade with India was reduced to 52.4 percentage. In the fiscal year 1990/91 trade with India was 52.5%. Nepal's trade dependence with India was declining till fiscal year 1996/97. But in the later years, the share of trade with India increased rapidly.

It is clear from data that Nepal's major trade partner is India. Nepal's more than 60 percentage of the trade is with India. It shows that Nepal has not been very successful in the field of country wise trade diversification. Although share of trade with India for last three fiscal years is declining and share with china and other countries are increasing. Nepal has not been successful in commodity wise trade diversification. Nepal's more than 90% foreign exchange earnings from commodity exports come from mere seven commodities: readymade garment, carpet, pulses, handicrafts, leather medical herbs and paper products. In the recent year export of products is also declining.

### Imports Position and Trade Deficit

The table 4 presented below shows the Import position and trade deficit data of Nepal form FY 2012/13 to FY 2016/17.

**Table: 4 Import Position and Trade Deficit**

Fiscal Year	Imports (Percentage)		Trade Deficit (Percentage)	
	India	Other	India	Other
2012/13	65.9	34.1	65.9	34.1
2013/14	66.9	33.1	67.2	32.8
2014/15	63.5	36.5	63.2	36.8
2015/16	61.7	38.3	62.2	37.8
2016/17	59.3	40.8	65.3	34.7

(Source: Economic Survey, 2016/17)

In fiscal year 2016/17, 59.3% goods were imported from India and trade deficit with India was 65.3%. Nepal's trade deficit with India is very high as compared to other nations. The trade deficit has occurred due to many reasons. The major reasons for trade deficit with India are as follows:

- (a) Political Instability: Democracy was re-established in Nepal in year 1990 after the fall of Panchyat regime. Then after government adopted the policy of open economy and private sector was given more importance in economy. The role of government has been limited to facilitator for economic development. Entrepreneurships promotion is needed for the production of daily commodities and services required in the nation. Private sector can play a pivotal role in the promotion of high level entrepreneurship in a nation. To promote entrepreneurship, right acts and policies are needed. For this, political stability is the basic requirement. Due to political instability, frequent changes in government are common in Nepal and economic policies changes with changes in government. Due to this, private sector has been unable to play an instrumental role in economic development. The entrepreneurs have failed to assume the risk while



commodity production takes place and they have shifted towards importing commodities. Most of the entrepreneurs are importing goods from India as shown by above data.

- (b) **Geographical Position:** Nepal is a landlocked nation between China and India. The boarders with China have Himalayas and mountains which makes transportation very difficult. Hence there is only one operational highway connecting Nepal to Tibet, China. On the other side, boarders with India have plain regions and road transportation is well established and connected. The nearest port to Nepal is Kolkata Port in India. Hence majority of goods imported in Nepal also arrives via Kolkata port of India. Furthermore, open boarder exists between Nepal and India and public of both countries can travel without any restriction in both countries. Hence due to geographical position, Nepalese entrepreneurs are importing majority of goods from India.
- (c) **Social and Religious Closeness:** Nepal is a Hindu religion dominant nation and India's majority population religion is also Hindu. Also both Hindi and Nepali language has their origin with Sanskrit Language. The language, culture, and religion that people of both nations follow have very similarities. Due to this, large number of Nepalese people travels to India every year and while they return, they bring goods for private use and commercial purposes which is also a major reason for trade deficit.
- (d) **Employment Destination:** India is a major employment destination for Nepalese unskilled and semiskilled worker since ancient times. The number of Nepalese serving in Indian Army is also very high. These workers and army men while returning home during holidays bring large quantity of commodities with them. Due to this, Nepal's trade deficit with India rises.
- (e) **Lack of Competition:** Similar type of goods imported from countries other countries except India find great difficulty in completion with goods imported from India as goods imported from India has low cost due to several reasons. Due to this Nepal's trade is dependent with India.
- (f) **Lack of export oriented products:** The export to India from Nepal is negligible as compared to Imports made from India. Indian states Uttar Pradesh, Bihar, West Bengal, Uttarakhand boarders with Nepal and more than half Indian population resides in these states. However, Nepalese companies lack export orientation and products manufactured in Nepalese companies are considered to be of lower quality as compared to foreign companies. Hence trade deficit is increasing year after year.
- (g) **Earthquake of Year 2015:** The devastating earthquake that occurred in year 2015 has badly affected the first operational highway i.e. Kodhari Highway connecting Kathmandu to Tibet, China has been damaged severely. As a result, all trade occurring via road transportation has come to halt. The road damaged has not been reconstructed yet. Thus trade with China via Tatopani – Khasa boarder between China and Nepal has declined and trade with India has increased.

### **Conclusion**

Huge trade deficit due to increase in imports and decrease in exports has been a major problem in Nepalese trade. Since last few years, imports have been increasing rapidly and exports have been stagnant. Economic liberalization initiated in mid 1980's has failed to encourage export diversification and to reduce the trade deficit. Instable political environment and frequent changes in government has contributed to frequent changes in trade policy which is responsible for growing trade deficit. India has been the biggest trading partner of Nepal with about 64% of total foreign trade. With Indian economy growth is increasing, trade with India is likely to increase in the future. Nepal's trade with China is also increasing rapidly and it is also likely increase in future. Trade Relations of between China and Nepal is expected to raise as Chinese railway is arriving near Nepal Chinese Boarder in Kerung, Tibet by the end of year 2018. Further the signing of trade and transit agreement between Nepalese and Chinese government in year 2015 and up gradation of facilities at Kerung-Rasuwagadi boarder is likely to decrease Nepal's trade dependence with India which was created largely by landlockedness of Nepal.

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