

## The Trend Analysis of Foreign Trade and Economic Growth of Nepal

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### Abstract

*This paper investigates the trend analysis of foreign trade and economic growth of Nepal. It has used the annual data from FY 1975/76 to 2017/18 for analysis. The descriptive method has been used for achieving objective of this study. The analyzed result shows gradual increase in both the trend of foreign trade and economic growth over the period. The composition of foreign trade indicates that the total trade has been increasing. However, the increasing rate of the total trade is not bigger. Similarly, the analysis also reveals that increase rate in both export and import has been the main cause of the growth of the GDP. It means that foreign trade is significant for real GDP of Nepal. However, the trend of export trade is smaller than that of import trade. Hence, the policy implication should be focused on export-led economic growth, rather than import-led economic growth in Nepal.*

**Keywords:** Export, Import, Foreign trade, Economic growth, Nepal

### 1. Background

Nepal, the youngest federal democratic republic, has been passing through a protracted political transition for more than a decade. The country is one of the 48<sup>th</sup> poorest and least developed countries of the world with per capita income of about US \$ 1004 (MoF, 2018). Nepal is heavily dependent on remittances which constitute 26.3 percent of the GDP (MoF, 2017/18). Agriculture is the mainstay of the economy, providing a livelihood for almost two third of the population and accounting for nearly one-third of the GDP (MoF, 2017/18). Industrial activity mainly involves the processing of agricultural products, including pulses, jute, sugarcane, tobacco, and grain. Nepal has considerable scope for exploiting its potential in hydropower, with an estimated 83,000 MW of commercially feasible capacity but only 1044 MW is currently produced (MoF, 2017/18).

Nepal was hit by massive earthquakes in early 2015, which damaged and destroyed physical infrastructure and human lives and set back economic development. Political gridlock in the past several years and recent public protests, predominant in the southern Terai region, have hindered post-earthquake recovery and prevented much-needed economic reform. Additional challenges to Nepal's growth consist of its landlocked geographic location, persistent power shortages (now gradually decreasing), underdeveloped transportation infrastructure, civil strife, labor unrest, and its susceptibility to natural disaster. The lack of political consensus in the past several years has prevented much-needed economic reform. By those reason economic condition of Nepal is not sound.

Economic condition of Nepal is poor due to low rate of economic growth. Economic growth is depends on many factors and one of most importance factor is foreign trade. Foreign trade is the essential factor for economic growth and it is valid fin the context of Nepal also. Trade defined that trade is an activity of purchase and sells goods and service or exchange goods and services on a worldwide arena. Those goods and services are exchanged across borders, this is called foreign trade. If each nation specializes in the

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production of trade commodities in which it has comparative advantage and exchanges part of these for the commodities of its comparative disadvantage each nation can and up consuming more of all commodities than without trade. A nation has a comparative and advantage of those commodities which are produced with a great deal of the nation's relatively abundant and cheap factors of production; then economic development. It is one the essential part of economic in Nepal.

Foreign trade is the major source of national economy of Nepal. Nepal initiated its economic liberalization program in 1990s; and stimulated deregulation of the financial sector, trade liberalization, current account convertibility, abolition of major trade restrictions, several privatization programs and policies, revision of the trade treaty with India, financial reform programs, and downsizing of the role of government. Based on the liberalization policy, Nepal became a member of World Trade Organization (WTO) in 2004 and consequently the foreign trade pattern changed (MoF, 2017).

Nepal has a high opportunity to grow and extend its foreign trade because of its special geographical position being between two emerging economies India and China. The trade deficit is the one of the major problems of Nepal's economy. The growing and persistent mismatch between import and export has resulted in an alarming level of trade deficit. However, foreign trade is still considered as an essential factor for accelerating economic development in Nepal. Over the years, export has almost been stagnated, and the import has been skyrocketed with an increase by NRs 952 billion whereas the export increased by only NRs 12.6 billion. This figure of trade deficit by NRs 939.2 billion in FY 2074/75 (TEPC, 2075) apparently indicates how foreign trade affects economic growth of Nepal. In this regards; this article summarize into problems, objectives, methodology, results discussion and conclusion and policy implication as follows.

## **2. Statement of the Problems**

The foreign trade is an engine for economic development of every nation. It has greater role to create the employment, increase savings, increase foreign exchange earnings, and raise the productivity of investment. It is evident that developed countries have achieved prosperity through international trade. On the other hand, in many developing countries, trade is the primary vehicle for realizing the benefits of globalization. Nevertheless, many developing countries and least developing countries are unable to achieve greater benefits from international trade because of import penetration as compared to export. If import is rationalized, it brings additional competition and variety of domestic markets benefit the consumers. Benefiting business, foreign trade gives firms access to improved capital inputs such as machine and tools and boosts productivity as well. Foreign trade nurtures the redistribution of labor and capital in relatively more productive sectors. In particular, it is worth reviewing relevant research works about the foreign trade and economic growth conducted in the various contexts.

Foreign trade refers to the exchange of goods, services and intellectual property rights (IPRs) between countries (Todaro & Smith, 2003). In the absence of international trade, it seems impossible for the world community to live a happier and prosperous life with a high degree of standard. Foreign trade is considered an essential factor for accelerating the path of economic development. International free trade, known as "engine of growth", propelled the development of today's economically advanced nations during the nineteenth and early twentieth century.

Kafle, (2017) analyzes the trends and patterns of foreign trade of Nepal and the reasons for trade deficit, particularly with India. To analyze the composition of Nepal's foreign trade, commodity trade by

Standard International Trade Classification (SITC) from FYs 2011/12 to 2015/16 was taken. The study shows that there is huge trade deficit due to increased imports and decreased exports, which have been a major problem in Nepal's trade for years until now. For the last few years, imports have been increasing rapidly and exports have been stagnant. Economic liberalization initiated in mid-1980s has failed to encourage export diversification and to reduce the trade deficit. However, the research does not consider the trend of foreign trade and economic development.

Within the total foreign trade export volume is smaller than import trade. The range of exports of Nepal is concentrated in a narrow basket of manufactured and agricultural products, such as carpets, readymade garments, pashmina, handicrafts, pulses, jute goods and palm/vegetable oil. Export market concentrated in limited markets such as India, China, and United States of America and European countries. However, import trade volume has been bigger than that of export and consequently most of the time Nepal suffered from trade unbalance.

The previous study showed that foreign trade is importance for economic growth however; the overall economic condition and trade related indicators are not satisfactory level in Nepal. According to Global Competitiveness Report 2013, showed that the quality of overall infrastructure of Nepal 132<sup>th</sup> out of 142 countries and quality of road 117<sup>th</sup>, quality of overall infrastructure 123<sup>th</sup> and quality of railway only 108<sup>th</sup> rank within 142 countries. The road networks, is only 69,000 km in 2017 (NPC). Same as Nepal's productive capacity ranks 108<sup>th</sup> among 141 countries in Global Competitiveness index 2019 (World economic Forum). The World Bank logistic performance index of Nepal, 114<sup>th</sup> the ranks within 160 countries with overall score 2.51 in 2019. Nepal's Trade performance on most indicators is weaker, its average score is 0.68 (OECD, 2019). Total foreign trade ratio to GDP is 37% only (2074/75). The trade deficit is the one of the major problems of Nepal. The trade deficit in 2075/76 Rs. 1321.4 million whereas in 2074/75 Rs. Only 1163.7 million (TEPC,2019). Those overall report shows that the economic as well as trade scenario is not satisfactory.

In this context of previous study as well as different report, shows foreign trade as a crucial factor for economic growth. Most of the study based on relationship between the trade and economic growth; there is no one the trend of trade and economic growth within 1974/75 to 2017/18 periods. So, this study is aims to analyze the trend of foreign trade and economic growth of Nepal.

### **3. Objectives of the Study**

As in most of the previous studies, there is a dearth of literature on understanding the relationship between trade and economic growth in Nepal over the periods from 1974/75 to 2017/18. This study is carried out to bridge the literature gap with the following five objectives.

- To analyze the history of foreign trade of Nepal
- To analyze of trend of export trade and GDP over the periods.
- To analyze of trend on import trade and GDP over the periods
- To analyze of relationship trend of trade and GDP over the periods
- To find appropriate suggestion for trade promotion and economic growth of Nepal.

## 4. Methodology

To achieve the aforementioned objectives, secondary data from 1974/75 to 2017/18 of Nepal Rastra Bank retrieved through the E-views software have been analyzed. Basically, the real GDP has been treated as dependent variable, and export and import trades as independent variables. Thus, the study is based on both qualitative analyze. Within the qualitative analysis, it has used mainly the review of literatures and descriptive analyzes as well as percentage and ratio. Those methods have been under taken for getting the setting results.

## 5. Results and Discussion

### 5.1. History of Foreign Trade of Nepal

Nepal's trade was done through barter system based on an informal trading system without rules and regulations. The foreign trade partners of Nepal were limited to Tibet and the East India Company. The trade was also smaller in terms of volume and price. Nepal provided transit passes between India and Tibet during medieval times. The treaty of peace and commerce was signed with Tibet during the time of King Pratap Malla. The Treaty of Thapathali which was signed on 4<sup>th</sup> April 1856 discontinued taxation of trade and opened the Nepali Bhardar office at Lhasa, establishing the Nepalese trademark in Lhasa, expressing amity and peace for both sides. This was a milestone of foreign trade of Nepal.

The foreign trade between Nepal and India occupied 95% of total trade during the Rana period. Nepal signed the treaty of friendship with British India in 1923. The import trades were basically industrial and manufactured goods and exports were based on agricultural goods. Alainchi Kothi in Patna and purchasing office in Kolkata were established to facilitate bilateral trade. The trade volume with India is increasing every year; however, the import trade is alarmingly higher than export trade.

Under the renewable of bilateral trade treaty with India in 1997, Nepali goods entered India under duty free and quota free basis. As a result, exports to India grew for four years, from 1997 to 2001, at an average rate of 42% a year. The most recent India-Nepal Treaty of Trade, signed in March 2002, continues to allow Nepali manufactures to enter the Indian market on a nonreciprocal, preferential, or duty-free basis, with rules of origin less restrictive than the international norm (Nepal's manufactures can have up to 70% foreign content instead of the international norm of less than 50%). However, it places quotas on four sensitive imports: vegetable fats, yarn, copper products, and ferrous oxide, all at volumes lower than recent Nepali exports to India.

Currently, total trade accounts contribute to almost 38% of the GDP (MoF,2019). However, the gap between the country's import and export is soaring, putting stress on the balance of payments. The share of exports to the total trade decreased from 28.2% in 2004/05, the year Nepal joined the WTO, to 14.5% in 2010/11. On the other hand, import increased from 71.8 percent to 85.9 percent during the same period. The big gap between exports and imports in the proportion of 1:6 is not only creating a huge trade deficit but draining the foreign currency reserve of the country. The volume of trade deficit increased by 5 times reaching almost 4 billion US dollars in 2011 compared to the year 2004. In addition, Nepal's trade is highly concentrated on a few limited items and markets. Only ten major export items cover more than 40 percent of the country's total trade.

The service sector is the main driver of economic growth in Nepal at present. The service sector is now the largest sector in the economy in terms of share in GDP, contributing almost 49.8%, which is mainly

due to rapid growth in telecommunication, tourism and financial services. Nepal is undertaking serious efforts to facilitate international trade.

**Table: 1: Total Trade by Countries in Fiscal Year 2017/18 (Value in billion RS.)**

Country	Export		Country	Import	
	Export Value	Percentage		Import	Percentage
India	46.66	57.37	India	812.55	65.25
U.S.A	9.17	11.27	China P.R	159.98	12.84
Turkey	4.68	5.75	France	20.98	1.67
Germany	3.14	3.86	Vietnam	13.53	1.08
U.K	2.85	3.5	Thailand	13.23	1.06
China P.R	2.44	2.99	U.A.E	13.21	1.06
Italy	1.28	1.57	Indonesia	12.47	1.00
France	1.23	1.50	Argentina	10.23	0.82
Bangladesh	1.08	1.33	Korea R	10.16	0.81
Japan	1.04	1.27	Malaysia	10.15	0.81
U.A.E	1.01	1.23	U.S.A	9.89	0.79
Canada	0.86	1.05	Saudi Arabia	9.01	0.72
Australia	0.64	0.79	Canada	8.01	0.64
Vietnam	0.62	0.75	Germany	7.89	0.63
Other Countries	4.64	5.7	Others Countries	134.19	10.76
<b>Grand Total</b>	<b>81.33</b>	<b>100</b>	<b>Grand total</b>	<b>1245.19</b>	<b>100</b>

Source: Annual foreign trade Statistics, Department of Customs of Nepal (2020)

The trend of export and import trade of Nepal, it is quite change and before the trade liberalization, Nepal was exporting goods agriculture products with limited countries. Indian is a major trade partner of Nepal and Nepal was exporting agriculture related products to India in before WTO member country of Nepal. The current year, we have access to world market for export and import but we don't have enough products to export to other countries. The table 1 shows that some of major foreign trade partner and trade volume in 2017/18. India, USA, Turkey, Germany, U.K China as well as others countries are our major trade partner for export and import trade of Nepal.

After the membership of WTO the foreign trade pattern has been changed. Its total international trade was Rs.1, 030 billion in 2016. In this period, Rs. 74.59 billion (7.24%) was export and Rs. 956.5 billion (92.86%) was import (TEPC, 2017). The share of export in the GDP is quite small, which was just 3.1% in 2015/16, whereas the share of import was 34.4 %, which were 7.3% and 27.2% respectively in 2007/08 (MoF, 2017).

Looked at the fiscal year 2017/18, Nepalese total trade were NRs. 81.33 billion, while total import added up to BRs. 1245.19 billion. The mainly exports woollen carpet, iron and steel products, readymade garments, yams and Pashmina, handicrafts cardamom, tea, coffee, fruit and vegetable juices and medicinal, herbs. Nepal mainly imports petroleum products, iron, and steel products. Transport vehicle,

and their parts, electronics and electrical equipment, gold, pharmaceutical products, cement, fertilizers and chemical. Remittance is the major source of foreign currency earning, which was Rs 665.1 billion in 2015/16 and remittance is significantly dependent on foreign aid for its economic development goals (Jull, 2006). Nepal is trading with its immediate neighbours as major trading partners, which jointly occupied 58.8% (NRB, 2017).

The trend of export and import trade are increasing and trade balance is also be negative and several initiatives have been taken to facilitate trade and reduce trade deficit. Institutional and structural adjustments have been put in place. After Joining WTO in 2004, Nepal has made significant improvement in trade volume, mostly imports, thus contributing to the trade deficit. Internal policies and institutional reforms, and increased participation in the international and regional trade bodies have been geared up to promote trade. However, the trade of foreign trend is still negative and unfortunately it is increasing trend compare to previous years.

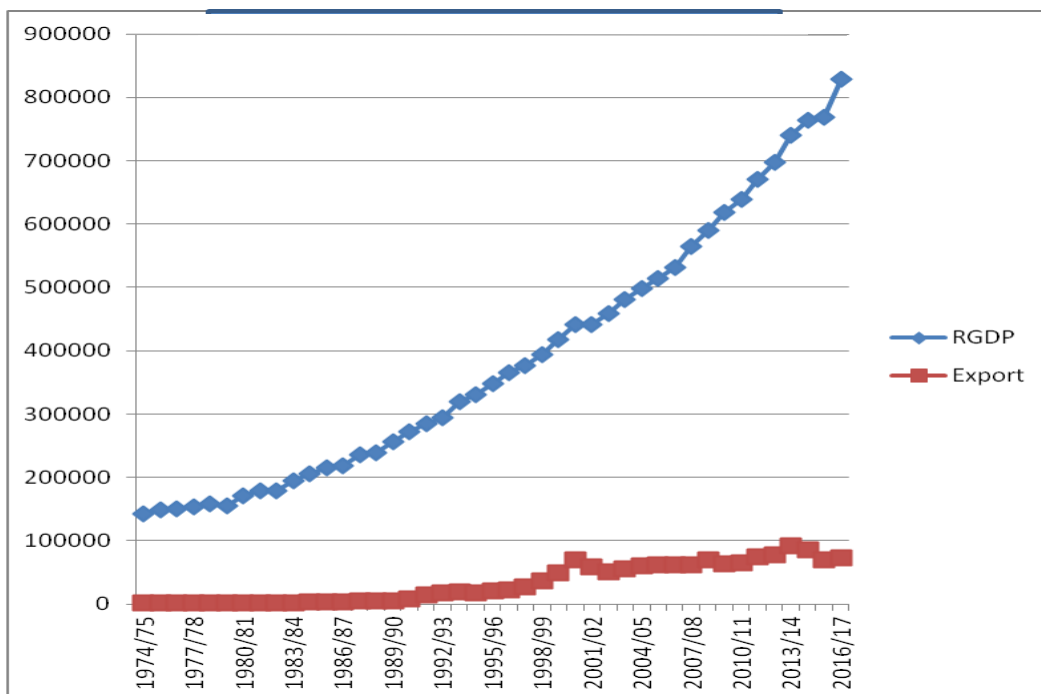
## **5.2. The Trend Analysis of Export Trade and GDP**

The export trade volume has been smaller than that of import trade for the last few years. The ratio of export trade on GDP was 5.4% in FY 1973/74; however, after trade liberalization policy implemented from FY1989/90, and then the export trade started to increase. The export trade started to decrease from the 60's and it reached 2.8% in FY 2019/20.

In the 90s, the main export commodities were wool products, cardamom, carpets, readymade garments, leathers, tea, plant ghee, handicraft, copper ware, polyesters and pulses. If we see the trend of export commodity in 60's, there was no trend change in export trade in Nepal. If you go to the 70's, the export commodities increased as new commodities like salseed oil and toothpaste were added. Almost 80% weight of export trade of Nepal has been occupied by carpet and readymade clothes before liberalization regimes. Other commodities are similar like previous years, though the trend of export is decreasing every year.

The trend of export trade of Nepal is shown in figure 1 below. The export trade which is represented 12% of the overall foreign trade of Nepal in FY 2018/19. The trend of export trade was increasing from FY 1983/84 to 2001/02. Then, export trade gradually decreased further up to FY 2007/08. If we look at the trend even after FY 2015/16, the export trade significantly decreased due to the massive earthquake in 2015. With the government's effort, the export trade has increased from FY 2016/17 onward, however it is not at satisfactory level because of limited number of export commodities in Nepal.

The trend of aggregate export trade has been increasing from FY1996/97 but from FY 1999/2000 the export trade is decreasing. In FY 2000/2001 the export trade went slightly up, but then one year later it fell again. After FY 2003/04 export trade started to increase and continuously grew up to FY 2016/17. The trend shows that the growth rate of export trade is smaller compared to that of import trade of Nepal.

**Figure 1: GDP and Export Trade**

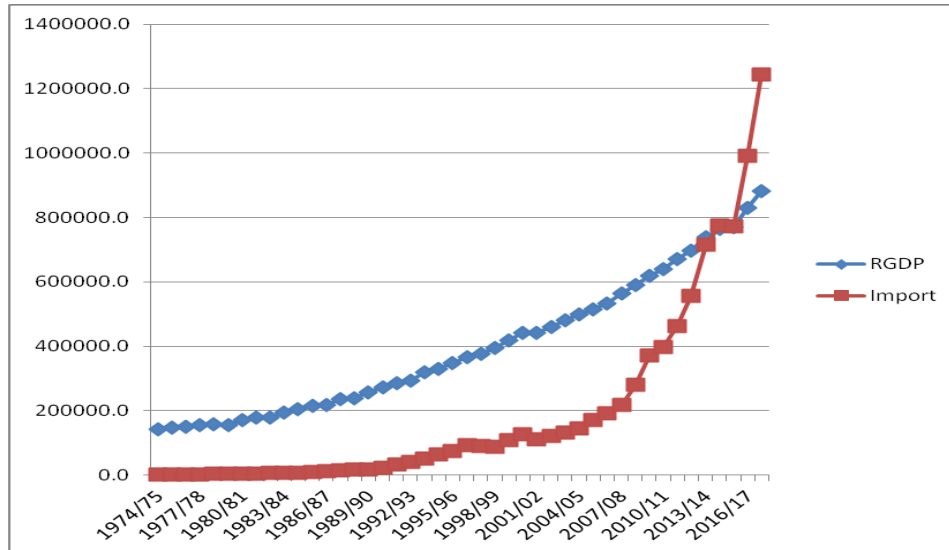
The real GDP was growing simultaneously along the export trade from FY 1974/75 to 1989/90, however rate was smaller. The growing rate of export trade was somehow faster than the previous year till FY 2013/14. After the FY 2014/15, the export volume started to decrease. Looking at the FY 2000/2001, the growth of export was higher and at the same time the real GDP growth rate was also higher. It means that there is a positive association between the growth of export trade and real GDP.

### 5.3. The Trend Analysis of Import Trade and GDP

The trend of import trade of Nepal is presented in figure 2. The trend of import in FY 1974/75 was small in size compared to the GDP and it gradually increased before the liberalization period, FY 1989/90. Then onwards, this trend was continuously increasing on a large scale and when Nepal became a member of WTO in 2004, the rate of import increased immensely. The real GDP, though smaller than import trade, was also gradually increasing during that period. In FY 2016/17, the import which was greater than real GDP affected trade balance and balance of payment of foreign currency of Nepal.

Nepal is importing most of products from India. India's share in Nepal's total imports reached 98.5% and its exports 97.7% in 1960. After that, India's share gradually decreased and share of China's gradually increased. In 1997, India's share in Nepal's total foreign trade reached 25.9%. Based on the annual statistics of FY 2018/19, India's share in Nepal's total foreign trade is about 65%; China's share is about 14% and 21% is the share of other countries.

**Figure 2: Trend of Import & GDP**



Nepal's annual imports accounted for 18.7% of the GDP in FY 1982/83, however the average import was 13.9% in the FY 1974/75. Imports accounted for 33.4% of the GDP in FY 1997/98 with an average import of 27.7% in the 50s and then onwards imports increased significantly and reached 40.9% in FY 2018/19 respectively.

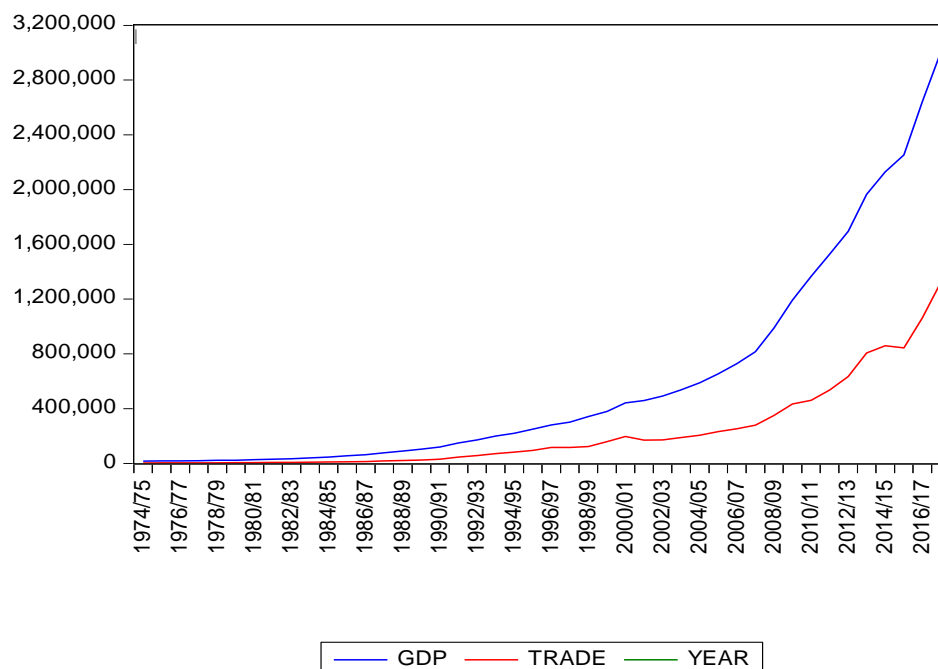
#### 5.4. The Relationship Between the Gross Domestic Product and Foreign Trade

Figure 3 presents GDP and total trade in Nepalese currency in million rupees. The Gross domestic product in FY 1984/85 was 205170.2 million rupees. Furthermore, in FY 1994/95 the Gross domestic product was 330290.8 million rupees. If we look at FY 2000/2001, the GDP was 441518.7 million rupees. Comparing the GDPs from FYs 1974/75 to 2000/2001, it has increased almost by four times. The GDP in real price was 497739.0 million rupees in FY 2004/05. In FY 2009/10, the GDP was 618529.1 million Rupees. If we look at FY 2014/15, the GDP was 764,335.7 million rupees and in FY 2017/18, it reached 881,798.3 million rupees. After Liberation regimes, the GDP in nominal price was increased from Rs. 255847.4 million to Rs. 881,798.3 million from FYs 1989/90 to 2017/18.

Within the same period, the total foreign trade was worth 2704.20 in million rupees in FY 1974/75. Similarly, in FY 1989/90, the foreign trade went up to 23526.40 million rupees which was before the end of liberalization regimes of Nepal. In FY 2005/06, the total trade amounted to 233023.20 million rupees and in FY 2009/10, it was 434245.40 million rupees. Correspondingly, in FY 2014/15, the trade was expanded to 860003.24 million rupees and in FY 2017/18; trade amount soared to record high of 1324018.48 million rupees.

During the period between FYs 1974/75 and 2017/18, the GDP increased gradually from 16571.00 million rupees to 3007246.22 million rupees whereas the trade amount in the same period reached 1324018.48 million rupees from 2704.20 million rupees. For a period of five years after the implementation of the liberalization policy in FY1995/96, the GDP has increased by around Rs. 248913.00 million rupees with the increments of a hundred million rupees in each five consecutive fiscal years.



**Figure 3: Trend of GDP and Total Trade**

Similarly, in the year of implementation of liberalization policy, total trade was valued at about 94483.50 million rupees. Total trade has also increased in every five succeeding years but the increase from twenty-three million to forty million rupees was very low when compared to the GDP. Although the trend of foreign trade volume has been found increasing during the study periods, the amount of trade volume is generally lower than that of the GDP volume.

The analysis showed that the trend of foreign trade and economic growth has significantly positive relationship with each other's. When the trade volume increased then GDP is also be increased and vice versa GDP increased than trade volume also increased. It is proven by previous results also. The elasticity of per capita exports with respect to per capita GDP was 10% increase in per capita GDP will result in an increase by 9.6% (NRB 1987). Similarly, Ranamagar, (2021) study on trade and economic based on ARDL model test found that the positive causality between GDP growth rate and export growth rate. If export trade increases by 1 unit, then GDP rises by 0.58 units. It also proved that foreign trade and GDP are associated each other's in Nepal.

## 6. Conclusion and Policy Implication

Based on Comparative Advantage theory, export promotion strategies align countries to make goods they can produce competitively, and trade for goods that other countries produce at relatively lower cost (Golub & Chang, 2000). Consequently, consumers will get products at a competitive price, benefitting from an extended domestic market. However, adoption of export-oriented economic development is a means for achieving sustained and rapid economic growth; it is still relevant in the context of Nepal.

The trend analysis apparently shows that foreign trade and economic growth are found increasing during the study period. The composition of foreign trade also shows that total trade has been increasing. However, the increasing rate of the total trade is not much bigger. The trend of Real GDP of Nepal is increasing during the study period. It is also found that GDP is increasing however the increasing amount is smaller due to low economic growth rate. The growth rate is also very small despite increasing rate of the GDP volume.

The gross domestic product has been found increasing since the implementation of the liberalization policy. Although the foreign trade volume is in the increasing trend during the study periods, the GDP volume is bigger than trade volumes.

The trend of export trade shows that export volume is not creasing rather import trade is increasing which has created trade imbalance. During the corresponding period of FY 2016/17 such a trade deficit was increased by 24.4% and reach up to Rs. 887.88 billion. Despite the increase in both the export and import, the increased rate of imports are higher than that of the export trade causing a great imbalance in the trade history of Nepalse economy. With the cases of exception in a few FYs, import and export have incresed in the same direction with volume and cost. The imports have always been bigger than exports and as consequence of this practice our foreign trade has always been at stake. Therefore, it can be concluded that without much focus on enhancing and increasing export trade, having a sustainable trade balance in Nepal may seem to be a challenging job.

So, the policy implecation should be focussed on export trade promotion for economic growth or export lead economic growth, rather than import lead growth. Reform on foreign trade policy should have focused on export specially comparative advantage of commodities groups for increasing economic growth. Growth enhancing policies by prioritise on comparative advantage products to export for economic growth, which is essential for economic growth. Hence, policy makers should consider some policy initiatives for traders and farmers as well. Lastly, Government of Nepal should play a greater role with high responsibility in focusing on export trade for economic growth of Nepal.

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