STATUTED AND TREND OF BALANCE OF TRADE IN NEPAL: IMPACT AND POSSIBLE POLICY GUIDELINES

Sushil Shrestha*, Shiva Chandra Dhakal*

*Department of Agricultural Economics and Agribusiness Management, Agriculture and Forestry University, Chitwan, Nepal

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ABSTRACT

This paper explains the current state, historical pattern, potential root causes, and suggested solutions to Nepal’s trade deficit. As a result of globalization, Nepal’s foreign trade has been expanding quickly, but a fundamental issue with the country’s foreign trade balance is that import growth has been outpacing export growth. It results from Nepal’s trade sector’s incapacity to diversify its commerce in terms of nations and goods. A straightforward statistical method and exploratory data analysis using secondary sources of data served as the foundation for the investigation. The figures amply demonstrate a significant trade deficit, indicating that the international trade strategy requires rapid evaluation and improvement. Export, import, and trade balance yearly percentage changes for 2020–21 were found to be 44.43%, 28.66%, and 27.26%, respectively. The trade deficit expanded from FY 2020/21 to FY 2021/22 by NRs. 380 billion. The trade imbalance is having a detrimental effect on the nation’s GDP and economic expansion. The study also discovered that during FY 2021/22, the import-to-export ratio was 9.60. The trade imbalance in Nepal may be caused by factors like geography, political unpredictability, high production costs, lack of laboratories for quality assurance, lack of resources, etc. The main factors contributing to Nepal’s trade deficit can be addressed through competitive and improved human capital, commodity and market diversity, the creation of a solid legal framework and trustworthy trade act and policy, the offer of incentives for the promotion of export, etc. It is recommended that export-oriented industries have an adequate and appropriate investment program for import substitution and export promotion.

KEYWORDS

Export, Imports, GDP, Economy, Business Cycle, Foreign Exchange

1. INTRODUCTION

The movement of products and services between producers and consumers within or across international borders is referred to as trade in economics. The disparity between a country’s exports and imports over a specific period is known as the balance of trade (BOT). Net exports, trade balance, and foreign trade balance are other terms for the same concept. A positive trade balance is not always enough to assess the state of an economy; we also need to consider economic indicators, business cycles, and other indications. A negative trade balance, commonly referred to as a trade deficit, occurs when a nation’s imports consistently outpace its exports.

19 different commodities were selected by the National Trade Integration Strategy as having export potential. For many years, Nepal’s balance of trade has been unbalanced (NTIS, 2010). Despite an increase in imports, the worldwide recession has not seriously impacted Nepal’s export industry, while the trade deficit has grown. Nepal’s trade balance as a percentage of GDP has been falling because of poor export competitiveness and a lack of product diversity, even though the trade policy was reformed in 2015 with larger goals to minimize the widening trade deficit (Chhetri, 2021).

International commerce is essential to Nepal’s economic success even though it lacks independence in terms of the factors of production, capital goods, and services. One of the most significant sources of foreign exchange income is foreign commerce, which is crucial for importing capital goods as well as other locally produced goods and services and for exporting local surplus production. Participating in international commerce has a variety of advantages for developing nations like Nepal, including efficient resource allocation based on comparative advantage, the use of economies of scale, and increased capacity utilization. Increased domestic savings and foreign direct investment, as well as greater employment, may all result in positive effects. International trade is therefore essential to the health of the world economy (Kafle, 2017).

After joining the World Trade Organization (WTO) on April 23, 2004, Nepal’s economy grew more dependent on imports, resulting in an expanding daily trade deficit. Since the middle of the 1980s, Nepal has started economic and trade liberalization, policy reforms, and increasing private sector involvement in economic development. Nepal has done so in accordance with the WTO’s principles of free trade. Yet, Nepal’s substantial trade deficit issue stems from decades of diminishing exports and rapidly rising imports. Nepal lacks an atmosphere that is conducive to business and a trading strategy that promotes producers, manufacturers, and exporters to fully utilize the resources the nation has to offer. Due to its poor infrastructure and geographical limitations, Nepal must import a wide range of goods in significant amounts every year, contributing to a persistent trade deficit (Mansuri, 2021).

2. LITERATURE REVIEW

A worrisome trade deficit has developed in Nepal as a result of the
continuing disparity between import and export values. Exports practically reached a standout in a short period, while imports jumped from 3 times exports 10 years ago to 9 times in the current situation (NPC, 2020). Regarding its trade balance, Nepal’s extremely sluggish export development continues to be a major source of worry. For the past ten years, the average annual growth in exports was 4.2%, whereas the average annual rise in imports was 18.2%.

According to Nepal’s foreign commerce was restricted to the region between India and Tibet up to 1951 AD. Before 1951, Nepal’s only trading partners outside of India and Tibet were Japan, the United States, Germany, Bangladesh, Vietnam, Korea, and Thailand (Kafle, 2017). Nevertheless, as economic links with these countries have grown over the years, Nepal’s trade deficit has also widened.

Economic size and distance are, according to who used the gravity modeling approach to analyze Nepal’s international trade patterns, positively and negatively connected (Prasai, 2014). The analysis failed to identify any distinct structural shift in the variables influencing commerce following economic liberalization. The simulation results show that Nepal’s commerce is unaffected by political measures like sanctions imposed by other nations when the actual trade is contracted with the expected trade. The findings also suggest that Nepal has to diversify its trade to gain from trade and that a trade agreement with China is necessary given that trade with India is larger than trade with China.

This investigated how foreign trade affected Nepal’s economic growth (Sharma and Bhandari, 2005). Export growth, capital stock, workforce, relative price indices (RPI), the average propensity to save (APS), and the proportion of government development spending to GDP have all been found to have an impact on international trade (Gross Domestic Product).

After 1990 AD, examined the pattern of trade between India and Nepal (Singh and Khanal, 2010). They discovered that Nepal’s reliance on its neighbor for trade increased as the proportion of exports and imports from India in the country’s total commerce increased. Since 1993/94, India’s share of Nepal’s total exports has climbed, and since a specific number of years following 1996/97, India’s share of Nepal’s total imports has increased. India’s increasing proportion of Nepal’s total exports and imports indicates that Nepal’s reliance on India for trade grew during the period between 1990 and 2000.

It has been examined the impact of the free trade agreement’s implementation on the expansion of the export sector and its applicability to the Nepalese economy (Basyal, 2011). The authors also examined Nepal’s macroeconomic weaknesses and slow economic growth as a result of its double-digit inflation rate. The article makes the point that actions to lower Nepal’s inflation rate can greatly increase trade competitiveness. The suggestions provided for enhancing the trade balance are ambiguous and unsupported by any empirical findings.

According to low exports and high imports, being a landlocked nation, low quality and low volume production, an ineffective trade policy, a lack of advertising and publicity, an underdeveloped industry, a lack of insight and impact diversification from export-promoting nations, among other factors, are the main causes of Nepal’s growing trade deficit (Shrestha, 2021). Until Nepal adopts new policies to improve its trade competitiveness, he continued, the nation will not be able to minimize its expanding trade imbalance.

Foreign trade policy needs to be reviewed and changed in light of the expanding trade deficit. Increasing our exports is the only way to lower the trade deficit. Fast advancements in technology and the economy create interdependence and bring nations closer together. In comparison to industrialized nations, developing nations seem to be the weakest competitors in the global market. With renewed vigor, all industrialized nations are beginning to modify their export regulations. Nepal needs to change its trade policy right now, resolve all barriers, including taxes and complicated concerns, and provide an environment that will encourage future investments that are competitive and effective on the market both national and global (Ghimire, 2010).

Using Philip Hanson’s modified ordinary least squares cointegration model, examined the effects of trade liberalization on Nepal’s international commerce before and after liberalization (Iupri, 2012). According to the study’s empirical findings, trade liberalization had no appreciable positive effects on exports, imports, or the trade balance, either in the years before and after liberalization or in the immediate aftermath. Also, the analysis demonstrates that trade liberalization has no beneficial effects on economic expansion or the balance of payments.

The economic growth of nations has always been greatly influenced by international trade. Without international trade, developing nations would not be able to modernize. By boosting competitiveness, increasing markets, and providing new machinery and technological advances to businesses and agriculture, it fosters economic development. Thus, it is viewed as a tool for economic progress (Acharya, 2019).

According to Nepal’s commercial integration into the world economy is a necessary but insufficient condition for the sustainability of poverty reduction over the long term (Pant, 2005). Only an integrated strategy, encompassing the formulation of macroeconomic and trade policies, private sector participation and development, financial management, infrastructure development, and other supply-side initiatives, will be able to do this. Regional integration, by multilateral trade laws, can be a crucial first step for Nepal’s integration into the global economy and can improve the legitimacy and transparency of policy reforms, which will make liberalization more effective.

3. RESEARCH METHODOLOGY

This study is descriptive in nature. It is based on secondary data. In understanding the trade scenario, import and export value, and the trade deficit of Nepal, data were collected from the various publications of the Ministry of Finance, Department of Customs, World Bank, Nepal Rastra Bank, Trade and Export Promotion Center, different journals, governmental reports, institutional websites, articles, and other documents. Based on the problem, issues, and objectives, detailed information was collected to describe and analyze the research objectives. The description of the situation of the Nepalese foreign trade and trade deficit is all in quantitative data. Simple statistical tools: ratios, percentages, trend lines, pie-chart, and bar-chart have been used to analyze data.

4. RESULTS AND DISCUSSIONS

4.1 Some Macroeconomic Indicators for 2020/21

Its impact on economic growth has come under scrutiny because of the recent dynamism of international trade and its expanding influence on international economic relations. Trade, growth, and development are all interdependent (Nástás, 2015).

The gross domestic production based on the current price for FY 2020/21 was NRs. 4277.3 billion and based on constant price was NRs. 2381.31 billion. The annual percentage change in GDP (constant price) was 4.25%. The annual percentage change in export, imports, and trade balance was found to be 44.43%, 28.66%, and 27.26% respectively. For the same period, export, import, and trade balance contribute 33.3%, 36%, and 32.7% of gross domestic production respectively (MOF, 2021).

4.2 Trend of Trade Balance

A region’s trade balance displays the difference between the revenue it receives from exports and the cost of imports. The situation of a “trade deficit” is indicated if this value is negative, that is if a country’s total imports exceed its total exports of goods (Bloomenthal, 2020). A trade imbalance typically indicates two things: First, the home output is unable to meet demand in the domestic economy. Second, a deficit reflects a lack of industrial competition in the region (Mishra, 2019). The trend of Nepal’s trade balance is shown below.

![Figure 1: Trend of trade deficit in Nepal](image)
4.3 Export and Import

Two significant barriers to both domestic and foreign trade in Nepal are the nation’s landlocked status and its dispersed landscape. Large transportation distances, reliance on transit routes for trade activities, poor transit logistics and infrastructure, challenging and expensive customs clearance procedures, a lack of effective management, and inadequate transit logistics and infrastructure all seem to be issues in Nepal. The closest port is in Kolkata, India, which is 1,056 kilometers distant. Since transportation costs for Nepal’s tradeable goods are among the highest in the region, efforts to boost international trade and boost the competitiveness of the nation’s exports are hampered (Kafle, 2017). Nepal exported commodities of NRs. 200 billion in FY 2021/22 and imported goods worth NRs. 1920 billion, according to the department of customs. Consequently, in a single year, there was a trade deficit of about NRs. 1720 billion. The following charts show the gradual rise in the import, export, and trade deficit over 11 years. (Department of customs, 2011/12-2021/22).

Nepal mainly exports tea, pashmina, medicinal and aromatic plants, carpets, footwear, ginger, honey, and large cardamom (Trade and Export Promotion Center, 2021). Its major export partners include India, USA, UK, Germany, Turkey, etc. Total exports in the fiscal years 2011/12 and 2021/22 totaled NRs. 72 billion and NRs. 200 billion respectively with a worth of NRs.128 billion difference within the 11 years (Department of customs, 2011/12-2021/22).

The analysis finds that from 2011/12 to 2020/21, the study period, imports increased quickly while exports grew far more slowly, resulting in a trade imbalance for the nation in each succeeding fiscal year. The significant discrepancy between imports and exports in the nation is leading to a major trade deficit and placing the economy under pressure from foreign exchange.
A trend of Nepal’s trade deficit share continuously increasing. The following graph shows how, as the trade imbalance widens (in billions of US dollars), its contribution to GDP rises but in a negative manner (Macro trends, 2023).

![Graph showing trend of trade deficit as a percentage of GDP]

Data source: World Bank, 2022

**Figure 8: Trade deficit as a percentage of GDP**

### 4.4 Direction of Trade

Nepal is surrounded by India’s 1,690 km long border in the South, West, and East and by China’s 1,236 km border in the North. Nepal is also a landlocked nation, thus its exports are mostly aimed at China and India. The following table provides information on the recent state of international trade with China and India. In 2021/22 AD, around 77.60% of the entire export value is sent to India, and just 0.40% is sent to China. Exports of the remaining 22% go to third countries. In the case of imports, India accounted for 62.49% of the total import value, and China for 13.78%. The remaining portion, or 23.73%, was imported during the fiscal year 2021/22 from other nations (Nepal Rastra Bank 2022).

#### Table 1: Direction of International Trade in Nepal

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>TOTAL EXPORTS</td>
<td>97709.1</td>
<td>141124.1</td>
<td>200031.0</td>
<td>44.4 41.7</td>
</tr>
<tr>
<td>To India</td>
<td>70108.9</td>
<td>106372.1</td>
<td>155222.3</td>
<td>51.7 45.9</td>
</tr>
<tr>
<td>To China</td>
<td>1191.2</td>
<td>1016.1</td>
<td>808.8</td>
<td>-14.7 -20.4</td>
</tr>
<tr>
<td>To Other Countries</td>
<td>26409.0</td>
<td>33736.0</td>
<td>43999.9</td>
<td>27.7 30.4</td>
</tr>
<tr>
<td>TOTAL IMPORTS</td>
<td>1196799.1</td>
<td>1539837.1</td>
<td>1920448.4</td>
<td>28.7 24.7</td>
</tr>
<tr>
<td>From India</td>
<td>735294.8</td>
<td>971603.9</td>
<td>1200152.7</td>
<td>32.1 23.5</td>
</tr>
<tr>
<td>From China</td>
<td>181920.3</td>
<td>233923.1</td>
<td>264783.7</td>
<td>28.6 13.2</td>
</tr>
<tr>
<td>From Other Countries</td>
<td>279583.9</td>
<td>334310.1</td>
<td>455511.9</td>
<td>19.6 36.3</td>
</tr>
<tr>
<td>TOTAL TRADE BALANCE</td>
<td>-1099089.9</td>
<td>-1398713.0</td>
<td>-1720417.4</td>
<td>27.3 23.0</td>
</tr>
<tr>
<td>With India</td>
<td>-665185.9</td>
<td>-865231.9</td>
<td>-1044930.4</td>
<td>30.1 20.8</td>
</tr>
<tr>
<td>With China</td>
<td>-180729.1</td>
<td>-232907.0</td>
<td>-263975.0</td>
<td>28.9 13.3</td>
</tr>
<tr>
<td>With Other Countries</td>
<td>-253174.9</td>
<td>-300574.1</td>
<td>-411512.0</td>
<td>18.7 36.9</td>
</tr>
</tbody>
</table>

Source: Nepal Rastra Bank, 2022

P = provisional
R = revised

In 2021/22 AD, the total export-to-import ratio of 1.04 was discovered. While that for China was only found to be 0.3 and that for India was found to be 12.9. In the same time frame, the ratio of exports to imports from foreign nations was 9.7. China’s part of global commerce was found to be 14.1, while India’s portion was found to be 63.9. It demonstrates how heavily dependent on commerce with two of our neighbors we are (Nepal Rastra Bank 2022).

![Graph showing imports to exports ratio]

Source: Department of Customs (2014/15–2020/21)

**Figure 9: Imports to exports ratio (2014/15–2021/22)**
The ratio of import to export is high in Nepal because of low domestic productivity and a lack of proper government policy. According to the Department of Customs, the ratio of import to export for FY 2021/22 was 9.60, which means the import was 9.60 times higher than the total export of the country (Department of Customs, 2011/12-2021/22).

### 4.5 Possible Causes of Trade Deficit in Nepal

There are several causes for the trade deficit in Nepal. Efforts have been made to outline the theoretical framework based on the following determinants. These are discussed below:

a. **Geographical Structure of the Country**

Nepal is sandwiched between two economic powerhouses: China to the north and India to the east, west, and south. It suffers several commercial hurdles as well as high freight and freight expenses because of its landlocked location and lack of direct access to marine routes. As a result of the slowdown in global trade and Nepal's inability to achieve economies of scale, Nepal is in a precarious position (Kafle, 2017).

b. **High Cost of Production**

The majority of raw materials required by industries are imported from other countries. Due to high shipping expenses, customs tariffs, transit insurance, bank fees, etc., sourcing costs are significant when importing. Yet, because there is a shortage of sophisticated equipment, labor costs, and general prices are also high. Increased production costs are the result of all these factors. Because of its small size and limited demand, Nepal's economy cannot take advantage of economies of scale by producing in big numbers. Finally, compared to comparable commodities that can be purchased from overseas, the average cost of goods is quite expensive. Nepal must import items from overseas since they seem to be less expensive, which creates a trade deficit (Chhetri, 2021).

c. **Political Instability**

Political instability is likely to shorten policymakers’ time horizons, resulting in less-than-ideal macroeconomic short-term policies. Also, this could result in more frequent policy changes, which would increase volatility and harm the nation’s macroeconomic performance. Political unrest disrupts trade by directly impacting income and prices and indirectly by affecting investments in physical capital. The unsettling political climate in Nepal has a real impact on import and export variables as well as the local market of the country. Political unrest made it impossible for the local market to compete with those found outside. To stabilize the balance of payments, political stability is more important than economic freedom (Mahat and Kunwar, 2021).

d. **Production of low/average quality goods**

The ability to efficiently manufacture items with low marginal costs of production, or the capacity to produce high-quality goods for the same price, is essential for the success of the trade. Goods of acceptable quality cannot be manufactured in developing nations like Nepal due to a lack of standardized inputs and skilled labor. Poor and illiterate farmers overuse pesticides, resulting in harmful agricultural goods of inferior quality. The quality of many industrial industries’ products suffers as a result of improper ingredient mixing. The willingness to purchase declines as a result of these mistakes and actions, which eventually has an impact on the nation's trade balance (Chhetri, 2021).

e. **Lack of resources**

Nepal lacks resources, qualified and semi-skilled labor, high-end equipment, and cutting-edge technology. Because of this, less merchandise is created than anticipated, which will eventually slow down the speed of recovery and expansion. Owing to a shortage of resources, the nation is unable to create enough goods and must instead rely on foreign trade, which causes an imbalance in our domestic economy (Chhetri, 2021).

f. **Lack of advertisement and publicity**

A "global community" has emerged as a result of increased internet and technological accessibility. With communication, people from all around the world are linked. Individuals use technology for communication with

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Table 2: Share of Neighbor Countries in International Trade

<table>
<thead>
<tr>
<th>Heading</th>
<th>2019/20&lt;sup&gt;R&lt;/sup&gt;</th>
<th>2020/21&lt;sup&gt;R&lt;/sup&gt;</th>
<th>2021/22&lt;sup&gt;P&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ratio of import to export</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>8.2</td>
<td>9.2</td>
<td>10.4</td>
</tr>
<tr>
<td>China</td>
<td>9.5</td>
<td>10.9</td>
<td>12.9</td>
</tr>
<tr>
<td>Other Countries</td>
<td>0.7</td>
<td>0.4</td>
<td>0.3</td>
</tr>
<tr>
<td>2. Share in total export</td>
<td></td>
<td></td>
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<tr>
<td>India</td>
<td>718</td>
<td>75.4</td>
<td>77.6</td>
</tr>
<tr>
<td>China</td>
<td>1.2</td>
<td>0.7</td>
<td>0.4</td>
</tr>
<tr>
<td>Other Countries</td>
<td>27</td>
<td>23.9</td>
<td>22</td>
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<tr>
<td>3. Share in total import</td>
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<td></td>
<td></td>
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<tr>
<td>India</td>
<td>6.14</td>
<td>63.1</td>
<td>62.5</td>
</tr>
<tr>
<td>China</td>
<td>15.2</td>
<td>15.2</td>
<td>13.8</td>
</tr>
<tr>
<td>Other Countries</td>
<td>23.4</td>
<td>21.7</td>
<td>23.7</td>
</tr>
<tr>
<td>4. Share in the trade balance</td>
<td></td>
<td></td>
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<tr>
<td>India</td>
<td>6.05</td>
<td>61.9</td>
<td>60.7</td>
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<td>China</td>
<td>16.4</td>
<td>16.7</td>
<td>15.3</td>
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<tr>
<td>Other Countries</td>
<td>23</td>
<td>21.5</td>
<td>23.9</td>
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<tr>
<td>5. Share in total trade</td>
<td></td>
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<tr>
<td>India</td>
<td>62.2</td>
<td>64.1</td>
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<tr>
<td>China</td>
<td>14.1</td>
<td>14</td>
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<tr>
<td>Other Countries</td>
<td>23.6</td>
<td>21.9</td>
<td>23.6</td>
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<tr>
<td>6. Share of export and import in total trade</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export</td>
<td>7.5</td>
<td>8.4</td>
<td>9.4</td>
</tr>
<tr>
<td>Import</td>
<td>92.5</td>
<td>91.6</td>
<td>90.6</td>
</tr>
</tbody>
</table>

Source: Nepal Rastra Bank, 2022

P = provisional

R = revised
which they are mentally rather than physically connected. Technologies make it possible for anyone with an Internet connection to instantly learn what’s happening around the globe. Also, technology makes it possible for individuals and groups to communicate with each other across long distances. The industry in Nepal lacks marketing, advertising, and PR strategies and abilities. Handicrafts, knitwear, knotted carpets, woven garments, and other distinctive items with traditional and socio-cultural qualities are all produced in Nepal. Because Nepal does not promote the qualities, attributes, prices, etc. of its products on the global market, there is little demand for these branded goods. Strategic marketing and extensive exposure aid in creating and maintaining a unique specification, enhancing reputation, luring new clients, and boosting exports of these products (Pant, 2005).

g. Remittance and devaluation of the currency

As disposable income rises as a result of an increase in domestic remittances, purchasing power also rises. This boosts the overall demand for consumer goods and other items, which in turn increases imports. Similarly, currency depreciation lowers the cost of imports while raising the price of exports. The cost of importing goods and services will rise as a result of the national currency’s depreciation, which will have a significant negative impact on the country’s trade balance (Mahat and Kunwar, 2021).

5. Conclusion

Trade is viewed as a growth driver in a nation’s economic development. Due to the ease with which Nepal may acquire products and services imported into and sold to India, more than half of its overall commerce is with that country. A major issue now is Nepal’s ongoing trade imbalance with the majority of its trading partners. The import-to-export ratio in the nation is more than nine times greater. The present political unrest has exacerbated Nepal’s weak infrastructure and unfavorable business climate, which are some of the key causes of the country’s trade imbalance. Nepal should also strengthen the composition of its exports in terms of both items and destinations. After political stability, structural measures that can address the cause of fragility, such as strengthening the banking sector and improving public financial management, should be implemented. The coverage of businesses in public and private investments was facilitated by the stable political environment. Before developing stronger policies to enhance and boost production and export development on the global market, the nation must first identify the potential impediments. The nation ought to work toward specialization, bolstering rural economies, achieving economies of scale, and using business and labor management abilities. This will help to minimize trade deficits or negative trade balances while leveraging the advantages of globalization.

References


