

Impact of Trade Deficit in Nepalese Economy
Deficit in Merchandise Trade

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The aim of this thesis is to find out more information about the economic performance of Nepal and impact on the economy that has been raised by foreign trade. The thesis further studies the causes of trade deficit in Nepal. The main causes of trade deficit are geographical structure, political instability, exchange money rate and remittance. The trade deficit impacts directly on economic performance of the country. It actually has an impact on GDP of the nation, supply side, interest rate, price of commodities and FDI. The thesis furthermore analyses the challenges of trade and PEST analysis of the Nepal. Lack of having a sea port in the country and good infrastructures of development are the major challenges that Nepal has to overcome in terms of trade. The thesis discusses the relationship with the major trading partner of Nepal and other countries as China and Japan. Besides this, quantitative research method is used in this thesis paper. Information in this thesis is collected from secondary source of data.

Key words- International Trade, Trade deficit, Imports, Exports, Remittance, Exchange rate, Wages, GDP and FDI

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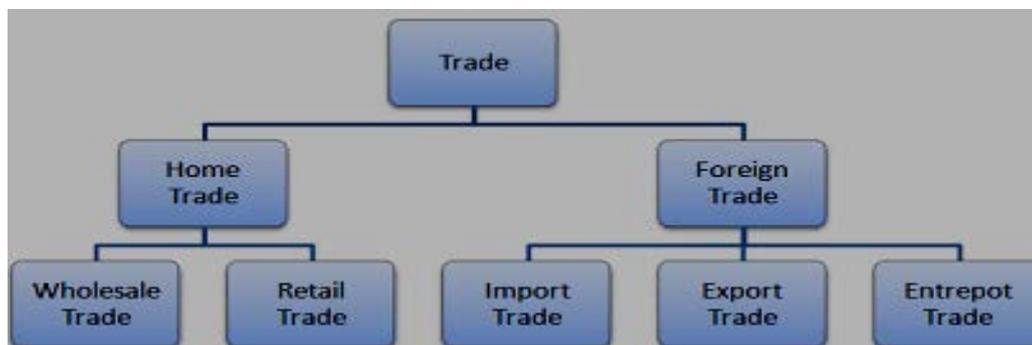
SYMBOLS AND ABBREVIATIONS

- **FTA-** Free Trade Agreements
- **GATT-** General Agreements on Tariffs and Trade
- **WTO-** World Trade Organization
- **SAPTA-** South Asian Preferential Trade Arrangement
- **BIMST-EC FTA-** Bay of Bengal Initiative for Multi-Sectorial Technical and Economic Cooperation-Free Trade Area
- **GDP-** Gross Domestic Product
- **FDI-** Foreign Direct Investment
- **RPI-** Relative Price Index
- **APS-** Average Propensity to Save
- **BoP-** Balance of Payment
- **ADB-** Asian Development Bank
- **SAARC-** South Asian Association for Regional Cooperation
- **TD-** Trade Deficit

1 INTRODUCTION

"International trade consists of transactions that are devised and carried out across national borders to satisfy the objectives of individuals, companies and organization" (Czinkota, I., Ronkainen, I., Moffett, M., Marinova, S. & Marinov, M., 2009, 8). Trade is the process of exchanging of goods and services for money or money's worth. In the trade process, manufacturers produce goods then it moves on to wholesaler, after that retailer and finally it reaches the consumer. Trade can be classified as two, internal and external trade. Internal trade can be said as home trade and it includes wholesale trade and retail trade. External trade which is also known as foreign trade consists of import trade, export trade and entrepot trade. Entrepot trade means the import of goods from other countries and then exporting again the same goods after doing some process. (Akrani, G., 2011.)

Table 1 Kalyan City Life, different types of trade



Source- Kalyan City Life, different types of trade

The thesis studies the impacts of trade deficit in Nepal and in order to support the main idea the chapters also study the causes of trade deficit, PEST analysis of Nepal and direction of foreign trade of Nepal. The relationship of Nepal to the major trading partner country- India and others such as China and Japan has been mentioned because these two countries China and Japan are potential trading partners of Nepal and will be more in the future. Moreover, the thesis aims to provide more relevant information to readers such as the business environment

and trade policy history of Nepal. The more information regarding this thesis objectives has been discussed in chapter four.

Trade is not only an efficient way to exchange labour, capital, culture and technologies but also is a barter of goods and services. (Silwal, 2008.) Trade can be classified as trade surplus and trade deficit. When a country exports goods and services then it produces income which is added to total GDP of country. Alternatively, when a country imports goods and services from other countries, it needs to pay some money to purchase them which disturbs the country's total GDP. Trade deficit can be defined as the situation when import of goods and services is exceeded than exported. (Dr. Econ, 2007.) Trade deficit may come up with several reasons such as low investment, poor technology, and obstacles in movements, political instability, and uncertainty in flow of energy supply, poverty, unemployment, inequality and socioeconomic unrest. (Ghimire, 2010).

Nepal is a land locked country, bordered by the two biggest countries of South Asia- India and China, is one of developing countries and has been included in one of top countries which have diversity of resources. Trading Economics has reported that Nepal has a trade deficit of (\$ 571.06 million) 57106.70 Million NPR in March of 2014.

Nepal Balance of Trade in Million NPR

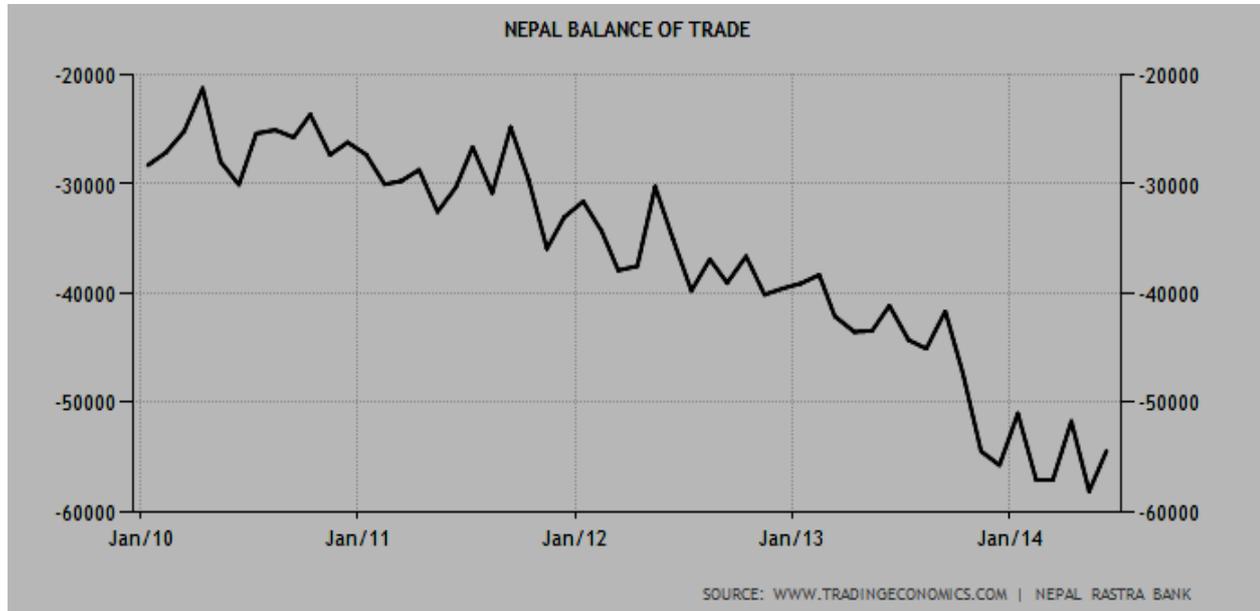


Figure 1 Nepal Rastra Bank, Trading economics, Nepal Balance of Trade

The figure describes the situation of trade in Nepal since 2010. Nepal had suffered trade deficit in the year of 2010. In fact, there was negative figure of trade in 2010 which was approximately (\$ -280 million) -28000 million Nepali rupees and there was certain improved in 2011. The numeric figure actually reached to about negative (\$260 million) 26000 million NPR and the trade situation was becoming worse in 2012. It was about (- \$320 million) - 32000 million Nepali rupees. Likewise, Nepal was still suffering from trade deficit in 2013. Actually the trade deficit amount was rising in term. The amount reached approximately (-\$400 million) negative 40,000 million Nepali rupees in 2013. In July 2014, the amount increased by (-\$144 million) negative 14400 million Nepali rupees compared to 2013. In fact, it reached to about (-\$544 million) -54400 million Nepali rupees. In the future, after analyzing the figure, Nepal will still suffer from more amount of trade deficit if government or relevant organization seriously does not think about it.

2 PEST ANALYSIS OF NEPAL

PEST stands for politics, economy, socio – culture and technology. PEST analysis is used in the environmental scanning components that studies a frame work of macro environmental factors. In order to assess change and to audit its contemporary environment, PEST analysis is done. Besides this, it helps to get the country in better position than its competitors to respond to changes. Moreover, PEST analysis gives overall idea of country's political situation through studies of main figures and government indicators in the country. It provides the information about the economic scenario of the country. PEST analysis assists in providing information about customer demographic in the country by analysing the income distribution and rural – urban split and also health and education. Moreover, by studying PEST of the country it gives overall idea of technological landscape through analysing laws, policies and patent data of the country.

2.1 Political Environment

The study of political environment provides information about the evolution of politics and the relevant information regarding politics of the country. The political situation in Nepal has been rapidly changing since two decades. Nepal was ruled under the executive control of the King until 1990. Till that period, Shah Dynasty ruled from 1726 to 1950 then Rana Dynasty started to rule over Nepal. Nepalese were able to get parliamentary monarchy in 1990 after the end of absolute monarchy and in the parliamentary monarchy the King acts as the head of state and the Prime Minister acts as the head of government. In 1950, Nepal has done Tri - party agreement in New Delhi for the purpose of dawning of democracy. The democratic practice was ended in Nepal by King Mahendra in 1960. After the end of democratic practice in Nepal in 1960, King Birendra installed constitutional Monarchy. The Maoist insurgency started from 1996 to install Republic in Nepal and 2001 became sad year for all Nepalese because of Royal Massacre. King Gyanendra has ended the democratic experiment in the year of 2005. Finally on May 8, 2008, Nepal was announced Federal Democratic Republic.

Nepal was never colonized. The fact is no government in Nepal has survived for more than two years since 1991. In fact, 23 governments changed over last 23 years.

2.2 Economic

Nepal has total GDP of \$19.29 billion in 2013. Its annual growth rate is 3.85% on July 2013 and the GDP per capita has been recorded \$409.04 in 2013 (Trading Economics). Nepal is doing improvements in economic sector. The Nepalese government is highly engaged for the optimum growth of national production and has formulated more liberal economic policies. In order to develop economy position of the country, Nepal government has invested huge percentage of money in infrastructural development. The government also make easy procedures in export for trade development of the nation. Besides this, they are focused on one window policy for development of Foreign Direct Investment (FDI) through investment board. Moreover, the import licensing system was abolished for better trading system in Nepal. Nowadays, the financial sectors are rising in term. Actually rapid financial reforms are seen in Nepal for example enabling JV banks.

2.3 Socio – Cultural Environment

Nepal with the area of 147,181 square kilometre is the 93rd largest country in the world by its land mass. Nepal is the land locked country and the neighbouring countries are China to the north and India to the south, east and west. Nepal is known for splendid Himalayas and its capital city is Kathmandu. The 2011 census has recorded that Nepal has population of 26,484,504 - 49% of male composition and 51% of female composition. The population growth rate of Nepal is 1.35%. Geographically, Nepal has three different regions which are mountain (6.73%), hill (43%) and terai (50.27%). Nepal's literacy rate is 75.10%. Nepal consists of 101 ethnic and caste groups. Nepalese culture is the collection of music, art, religion and literature and music is associated with every event in Nepal. Culture

defines its own uniqueness in life style, language, customs, rituals, food, dress and jewellery or ornaments. Moreover, traditional values and norms have been impacted on business practices. There are some obstacles created by socio-cultural environment. The businesses which are operated against the cultural values will not be for long lasting. Nowadays, these kinds of barriers and obstacles are getting diminished with the help of modernization and rapid improves of information and technology. Besides this, cultural aspect created still more impacts on business such as beef products are restricted in Nepal because Nepali pray Cow as a God according to their culture. Furthermore, the major source of Nepalese income is tourism which is highly influenced by socio-cultural aspects.

2.4 Technological Environment

The education systems and technology in Nepal are being changed in Nepal. The way of providing education to the people is improving in term. Moving to the history pages of education systems in Nepal, Nepalese were first introduced modern science education in 1919 in Tri Chandra College. Likewise in 1948, people got bachelors of Science degree from the same College named Tri Chandra College. The education systems in Nepal became stronger as the time passed. Masters of Science was introduced in 1965 in Tribhuwan University. The government at that time started adding more subjects in the curriculum and they received educations such as medicines, engineering, forestry and agriculture from Tribhuwan University in 1973. In the sixth five year plan of Nepal (1980 – 1985), science and technology activities were included for economic development. Furthermore in 1976, National Council of Science and Technology (NCST) has been established. Moreover, the policy related to science and technology was made in 2005 in order to improve infrastructure of development and research and development (R & D). For further science and technology development many centres and institutions has been established such as Research centre for Applied Science and Technology (RECAST) in 1977, Nepal Academy of Science and Technology (NAST) in 1982, Ministry of Science and Technology in 1995, National Agriculture Research Centre in 1991, Department of Forest Survey and Research in 1963 and Department of Plant Resources in 1957.

Nepal has been upgraded the major development sectors in the recent years and new policies for development sectors such as improving education, technology, politics and socio- cultural development has been formulated and implemented as well. The improving situation in these sectors create ease business environment in Nepal because people get favourable business policy, high technology and latest equipment to operate business. Besides this, Nepal has huge diversity of natural resources which people can utilise it in the effective way. One of the major factors that impact FDI in the country is political situation. In context of Nepal, political situation is getting improved when we compared it to 1980s but further improvement is still necessary to get more investment from outside countries and to improve the economic performance of Nepal. It is obviously true that Nepal is agro based countries and is producing higher amount of cash crops like wheat and maize by using the latest technology but many farmers who are producing the cash crops in the country have lack of education about the use of technology. Farmers in Nepal are still using the traditional equipment in cultivating the field for example plough (a tool which is used in farming for initial cultivation of soil). So, government needs to organize awareness programme in every corner or rural part of Nepal. It is also known as a rich country of culture and there are different kinds of feast and festivals that people celebrate. In order to gain more percentage of tourists in Nepal it is required to improve cultural aspects of nation by making effective policies. The historical places and monuments which reflect the identity of Nepal should be utilise properly and the culture that Nepalese follow since their ancient time should be practised in the future.

3 RESEARCH OBJECTIVES AND QUESTIONS

All research has done for certain objectives and goals. Likewise, I have come up to get my thesis objective by analysing and studying the books and materials that have already been published. The main purpose and goal of the thesis is to sort out the principal cause of trade deficit and its impact in Nepalese economy and also to analyse the trade scenario between Nepal and India. Different recent data and figures are included to reveal clear body of thesis objectives. Hence, the research paper aimed to receive the answer of following research questions.

- (i) How does the trade deficit impact in Nepalese economy?
- (ii) What kind of relationship does Nepal have with its main trading partner India in exchanging purpose?

3.1 Data and Methodology

Secondary sources of data and information are used in this thesis. Some of the major sources that are used in this research paper are World Bank, Nepal Rastra Bank (NRB), World Trade Organization, Consulate General of India and Ministry of Finance Affairs (Nepal). Concerning the methodology, it is based on exploratory data analysis. The comparison has been done in this research paper with major trading partner and some others cross countries among South Asian Countries.

4 NEPALESE ECONOMY STUDIES

Many authors and researchers have done several studies on the country's weaker economy performance of Nepal. There are some authors who expressed the impacts of trade deficit in Nepal such as (Silwal, 2008) - cause of trade deficit in Nepal, (Sharma & Bhandari, 2005) - Foreign Trade and its Effect in Nepalese Economy Development, (Bhatta, 2013) - Remittance and trade deficit nexus in Nepal, (Adhikari 2013) - Economy: Huge Deficit, (Ghimire, R., 2010) - Direction of foreign trade in Nepal, and others. They have created arguments on the economic problems of the nation. There are many causes of trade deficit in Nepal such as lack of competencies, real exchange money, external shock, politically instability and conflict. Trade deficit has impacted on the economic growth, interest rate, capital stock, GDP of the country, per capita income, labor force, Relative Price Index (RPI) and propensity to save (APS). (Sharma & Bhandari, 2005.)

4.1 Review of the Concept of International Business

International business is the transactions which are carried out in order to meet the objectives of individuals, companies and organizations. These transactions are often interrelated that takes on various forms. Import- export trade and Foreign Direct Investment (FDI) are taken as primary types of International business and other types of international business are licensing, franchising and management contracts. It provides companies the new market. International trade and investment have increased at the faster rate in comparison to domestic economies. Trade enables the flow of ideas, services, and capital across the world which helps to rise of innovation, more efficient use of human capital and improving access to financing in the country. Moreover, it provides challenging employment opportunities by facilitating the mobility of factors of production. Consumers are benefited by higher selection of goods because of it, but the competition leads to improved quality with lower price. Besides this, It has brought global reorientation in production strategies. Firms are connected to each other

through international trade agreements and joint undertaking in research and development. (R. Czinkota, A. Ronkainen & H. Moffett 2004, 3-7.)

A deficit occurs when the residents of a country are paying non residents more than they are earning (Ball, McCulloch, Frantz, Geringer & Minor, 2004, 183). Deficit is also called negative Balance of Payment (BoP). BoP is the survey of the cash flow between the people of one nations to another and it has been dividing into the current account, the capital transfer account and the financial account (Hulleman & Marijs 2004). International environment can be defined as the interaction between domestic and foreign environmental forces or between sets of foreign environmental forces of two countries when one country does business with customers in another. International business is the business in which the activities are carried out across the nation. There are five main drivers that leads the international firms into the globalizations of their operations and the drivers are political, technological, market, cost and competitive. For example, political driver helps to maintain trade agreement, technological assists to bring advances in communications technology, market is the one that maintain relationship between global firms and global customers, cost helps to reduce the costs of products because of globalization of product lines and production by achieving of economic scales and finally competitive is important drivers for international business environment which helps the firm defending their home markets from foreign competitors by entering the foreign competitors market. (Ball, McCulloch, Frantz, Geringer & Minor 2004, 18-21.)

In the very early age when there was no existence of foreign trade, Nepal government has applied for the membership of the General Agreements on Tariffs and Trade (GATT) in May 1989. Finally World Trade Organization (WTO) which is known as third economic pillar of worldwide dimension, Nepal has been able to join GATT from 1 January 1995. Nepal has been listed as 147th member of the multilateral trade body and it acceded to the World Trade Organization in 2004. WTO is considered as one of the major economic pillar after IMF and World Bank. Under certain rules and agreement, trade has conducted in smooth way between the countries. As agreements in WTO, Nepal will get help from other member

nations to integrate with the global system and the special provisions of WTO will help to maintain stable trading environment for Nepalese SMEs. Likewise, the national treatment provision guarantees that Nepalese goods and services are equally treated as the goods and services from importing countries. (Thapa, B. 2010.) Moreover, the government of Nepal has taken further actions in order to mobilize more in trade. Nepal is able to list as a member of the South Asian Preferential Trade Arrangement (SAPTA) and the Bay of Bengal Initiative for Multi-Sectorial Technical and Economic Cooperation-Free Trade Area (BIMST-EC FTA) and the purpose of joining in these organizations is to pursue effective and meaningful regional trading arrangements and to boost the trade of the country. Nepal became member of BIMST-EC FTA in Feb 2004 for Multi- sectorial Technical and Economical Corporation. Likewise, Nepal did the agreement on SAPTA in Dec 1995 in order to reduce the trade barriers among the South Asian Association for Regional Cooperation (SAARC) member countries. Bhutan, India, Nepal, Pakistan, Bangladesh, Maldives and Sri Lanka are listed in SAARC.

4.2 Empirical Studies of Nepal's Trade Deficit

Nepal has suffered trade deficit since 1970s up to date. Trade deficit in Nepal is a major problem and is rapidly increasing in term, with the exceeding import of petroleum, oil and lubricants. Nepal imports remittance from other countries and paying excessive amount for importing luxurious goods. Karobardaily online Nepali newspaper has stated that the current ratio of foreign trade export and import is 1:7. This clearly clarifies that the consumption of foreign commodities and services is seven times higher than consuming domestic products. Nepalese are more dependent on the products that are imported from outside of the countries. It is also stated that Nepal, agricultural based country, used to export food and grains, now enforced to import food grains worth over (\$ 1 billion) Rupees 100 billion a year. Nepal has huge amount of trade deficit with two border countries, India with whom 65% of total foreign trade is done, and rest with China.

Nepal is geographically surrounded by the two biggest countries in Asia which are India to the south and China to the north. Nepal imports \$4.96B whereas it exports \$581M of amount in 2012. Nepal imports highest percentage of goods and services from India and China which is approximately 90%.

The below chart describes the import rate of Nepal in percentage form. Nepal imports 51.15% of total imports from India and 39.23% from China. And the remaining about 10% from other countries like Singapore (1.5%), Hong Kong (1.1%), Thailand(1.1%), Japan(0.82%), Germany(0.54%), Malaysia (0.53%), Switzerland(0.43%), Australia(0.41%), South Korea (0.38%), France(0.30%), Netherland(0.27%), Sweden(0.24%), United States(0.22%), Italy (0.21%), United Kingdom(0.21%), Indonesia(0.19%), New Zealand(0.12%), Belgium- Luxembourg(0.12%).

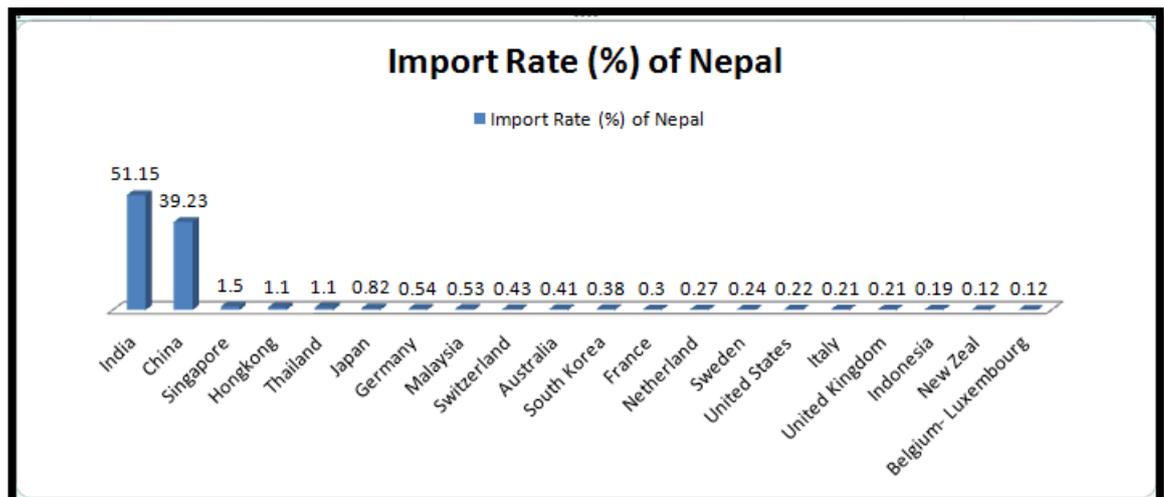


Figure 2 Observatory of Economic

Likewise, Nepal mainly exports its goods and services to India which is 51.45% of its total trade. Then, United States got the second position in export trading. In fact 12% of total goods and services are exported to United States. Similarly, Nepal export goods to many other countries such as Germany(6.8%), China(5.0%), United Kingdom(3.5%), France(2.8%), Japan(2.6%), Turkey(1.9%), Italy(1.9%), Canada(1.5%), Switzerland(1.2%), Netherland(1%), Aus-

tralia(0.87%), Singapore(0.65%), Spain(0.62%), Hong Kong(0.58%), Austria(0.58%), Belgium-Luxembourg(0.51%), Denmark(0.43%), Czech Republic(0.30%).

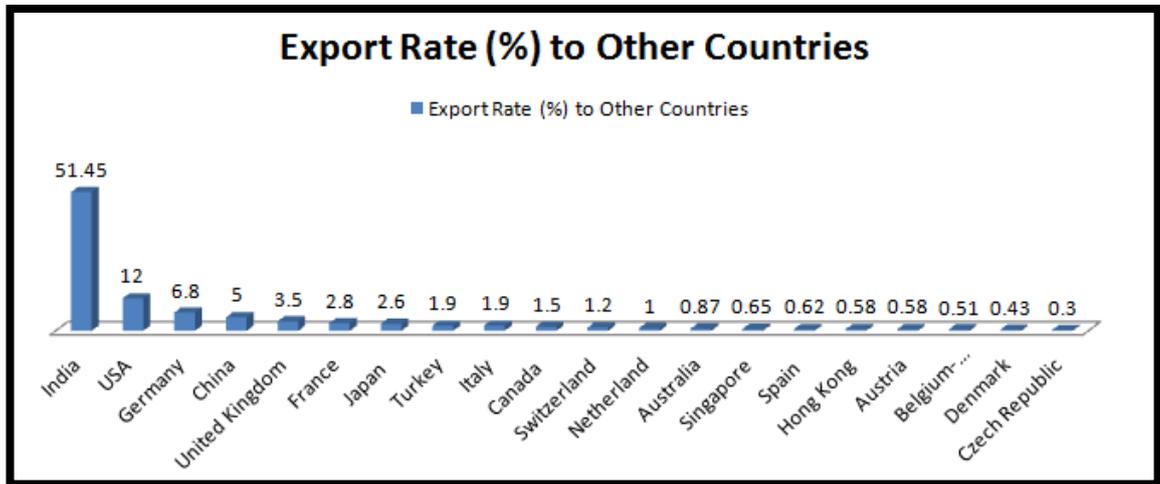


Figure 3 Observatory of Economic

4.3 Top Five Products Imported and Exported by Nepal

Nepal has huge difference between the import and export ratio in 2012. It actually has imported goods of USD 4.98 billion in 2012 and exports just USD 581 million of goods. Refined Petroleum is the highly imported goods which covers 16 percentages of total while Knotted Carpets is the most exported goods that is 15 percentages.

Nepal has highly imported refined petroleum products followed by Knit Men's Suits. In fact, it imports 16% of refined petroleum and 7.2% of Knit Men's Suits. However, the least imported products are Non- Knit Men's Coats. In other hand, Nepal exports the highest percentage of Knotted Carpets which is followed by flavored water. It exports 15% of knotted carpets and 6.9% of flavored water to other countries.

Table 2 Observatory of Economic, Major five goods traded in 2012

Products (Imported)	Imported %	Products (Exported)	Exported %
Refined Petroleum	16	Knotted Carpets	15
Knit Men's Suits	7.2	Flavored Water	6.9
Knit Women's Suits	4.4	Other Plastic products	6.2
Petroleum Gas	4.4	Other small Iron Pipes	5.3
Non- Knit Men's Coats	3.6	On-Retail Synthetic Staple Yarn	4.9

Source- <http://atlas.media.mit.edu/profile/country/npl/>, Observatory of Economic, Major five goods traded in 2012

4.4 Nepal's Import and Export Figure in Total- 2004-2011 (in NRs billion)

The table reveals the scenario of trade of Nepal between the year 2004 and 2011. After looking at this table, it could be concluded that the trade flows negatively. In fact, import rate was more than export in all years. There was about 14 percentages of differences in import from the year 2004 to 2011. Moreover, the import percentages were 71.8 in 2004/05 and it rose up to 85.9 percentages in the last year- 2010/11.

However, export was significantly lower in comparison to import of the nation. The percentages of export fell down from 28.2 in 2004/05 to 14.1 in 2010/11 which was almost half of the difference between these two numeric figures.

Table 3 GoN, Ministry of Finance, Economic Survey 2010/11 and Nepal Rastra Bank.

Year	Total	Export		Import	
		Volume	%	Volume	%
2004/05	208.2	58.7	28.2	149.5	71.8
2005/06	234.0	60.2	25.7	173.8	74.3
2006/07	254.1	59.4	23.4	194.7	76.6
2007/08	281.2	59.3	21.1	221.9	78.9
2008/09	352.2	67.7	19.2	284.5	80.8
2009/10	435.2	60.8	14.0	374.3	86.0
2010/11	459.46	64.56	14.1	394.9	85.9

Source: GoN, Ministry of Finance, Economic Survey 2010/11 and Nepal Rastra Bank. Tab (II)

The export percentages of Nepal have been steadily decreased and the rate of import to Nepal has increased as the year passed which result a country suffering from huge deficit. The government of Nepal should emphasize on the factor of goods production and reduce the cost of production which inspired producers and investors to produce the goods in huge percentages. The Ministry of Finance of Nepal should provide necessary loan and reasonable interest rate to investors in Nepal.

5 IMPACTS OF TRADE DEFICIT IN THE ECONOMY

Nepal is a developing country and known as one of liberal state among South Asia countries. Trade deficit in Nepal seriously influenced on its economy. Economy performance is getting upside down and the result of it impacts on the people of the nation. Nepalese GDP is adversely affected because of hugely growth of import ratio. Not only that but also they faced higher price on goods and services. Besides this, FDI rate in the country is decreasing because of political instability and lack of good infrastructure. Moreover, increasing import of goods and services brings negative impacts on supply side.

5.1 Impact of Trade Deficit on National Income

National income is the sum of current account and national expenditure. The difference between national income and investment results current account. (Econ, 2007.) Trade deficit occurs as the increasing consuming power of goods and services. The limited resources in many developing countries as Nepal could not fulfill increasing demand and needs of people so the country has to import the required goods and services from other countries. Mathematically, one of the renowned economists Keynesian proved with formula that more import certainly creates deficit that influences national output. According to him, National Income Accounts Identity = $G + C + I + (EX - IM)$.

Where, Y stands for total national output, G is equal to government consumption, C is for private consumptions, I is equal to Investment expenditure, EX stands for exports and IM equals import. If G, C, I and EX increases then Y (total output) gets accelerated but if (IM) import exceeds then there is negative influence on national output. Furthermore, if imports increased more than export, it is trade deficit (IM-EX). (Griswold, 2011.)

5.2 Impact of Trade Deficit on Gross Domestic Product (GDP)

Deficit impacts on the income of the country and GDP is said as the way of measuring the wealth of nation's economy. Gross Domestic Product (GDP) is one of major component of trade balance. Trade surplus helps to raise it but deficit leads to reduces it. Valentino Piana said, "If this impact is strong enough, it gives rise to the traditional Keynesian multiplier effect with consumption moving in the same direction" Income deficit for a country is derived when a nation paid comparatively higher amount for wages, rental, interest and profit to other countries than it gets from other countries.

The adverse effect on GDP rises because of exceeding imports demands rather than exports earning. Extreme growth of trade deficit in the nation leads to decrease demands of overall domestic goods and services. As a result, it leads to lower income for domestic producers, lower demands that impact on GDP by the multiplier effect. Besides this, trade deficit occurred in a country if GDP growth is faster than its trading partners because imports are elastic to GDP and their growth rate is more than proportionally.

5.3 Impact of Trade Deficit on Supply Side

Trade liberalization is one of the main causes of trade deficit and it has impacts on supply side which means effect on the stock of the productive capital and the structure of production. The productivity capacity of the nation is based on the investment. So, the effect of trade deficit on the investment leads to effect on the productive capacity of the country in the future. On the other hand, growth in import efficiency can help the nation by creating competing industries and investment in exportable goods because of improved incentives. Some studies also pointed that a typical liberalization package brings impact on investment, from decreased aggregate demand to high interest rate and increase competition in the market from cheap imports. Besides this, devaluation in the currency is the cause of trade deficit. It creates impact on supply side, particularly on national net capital flow. As a fact that investor do not want to invest in the country where a country has instability economic situation and is facing deficit which cause rise

in capital flight- the rapid withdrawal of capital from the country. So, this brings loss in financial account surplus. (Czinkota, Ronkainen & Moffett, 2004, 184.)

5.4 Impact of Trade Deficit on Interest Rate

Deficit decreases net external claims. Interest rate increases as the deficit increases. When a country faces higher debt, it directly impacts on interest rate because capital provider demands higher rate of interest for new loans. Another reason behind increasing interest rate is because of decreasing value of national currency. (Hulleman & Marijs, 2004.) Loans and interest are closely related to each other. Long lasting trade deficit in the nation leads to foreign debt on which the nations has to pay interest. Sustainable deficit happened if the country highly depends on the import from other counties and comparatively lower exports than imports at the same year. As a result, currency crisis can be happened, if this debt is judged by market agents as unsustainable. (Piana, V. 2006)

5.5 Impact of Trade Deficit on Price of Commodities

General prices of goods and services are affected by trade deficit. Trade deficit normally followed when imports is exceeding in higher ratio which cause inflation. It is also called cost push factor that occurred when there is persistence of high prices despites low growth. Shortage of products creates higher demands and demands invites import and exceeding import rates in the country presence trade deficit. Normally inflation and purchasing power is indirectly related to each other. When the ratio of purchasing power is falling down then inflation rate is increasing and when the ratio of purchasing power increases then inflation decreases.

NOC (Nepal Oil Corporation) eroded by higher world prices and depreciation

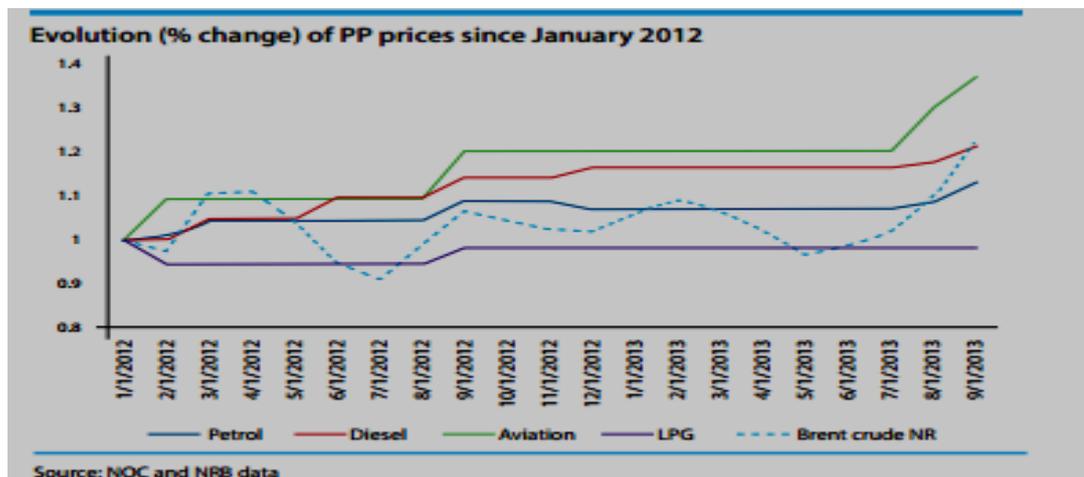


Figure 4 The World Bank Group, Nepal Development update, 2013

Note- IOC export prices for petrol and diesel are adjusted daily routine and those products like kerosene, aviation fuel, LPG, are done on a monthly routine.

The figure describes that the depreciation in the value of national currency that leads to affect the financial life of key public sectors enterprises. And In context of Nepal, key public sectors enterprises are mostly notably the oil corporation and the Nepal electricity authority. NOC actually purchase petroleum products from India Oil Corporation (IOC). The changing of currency value influenced the price of petroleum products such as diesel, LPG, aviation and petrol. In Nepal, the depreciation in the rate of rupees cost higher amount in importing petroleum products that also lead increment in transportation cost as a result inflation occurred.

Inflation in Products in Percentages

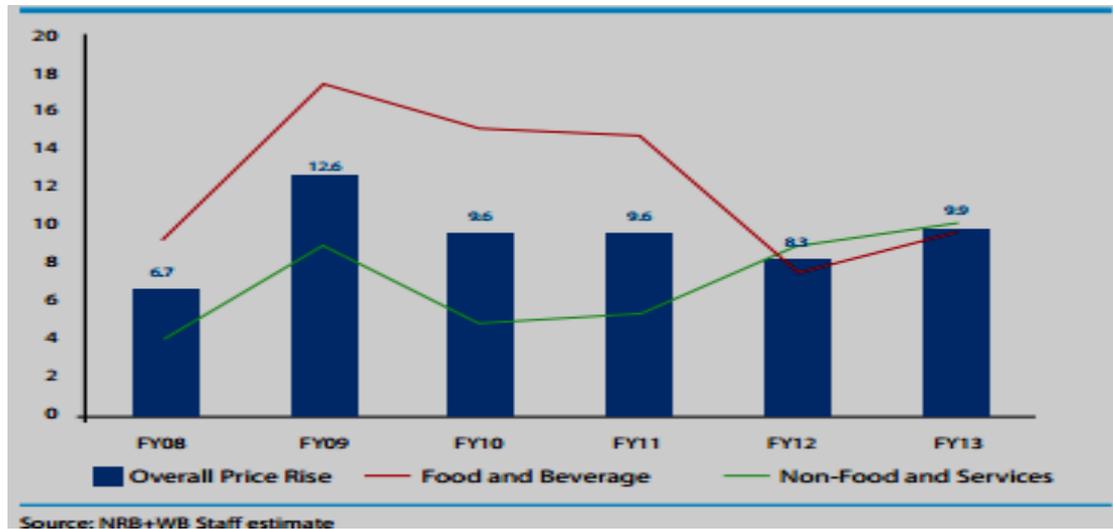


Figure 5 The World Bank Group, Nepal Development update, 2013,

The figure describes the inflation in production which is measured in percentages form. The disappointing harvest in the year 2013 resulted pushing the price of foods which was increased by 9.7 percentages and was closely followed in 2012 which was 7.6 percentages. While, nonfood prices also have risen by 10 percentages in 2013 compared to 9 percentages in 2009.

There is some reason why the price is increasing in goods and services. It actually is because of structural factors- supply side rigidities and adverse development such as increasing price in petroleum products that raised transportation cost and the other reason is the situation of national currency depreciation against major convertible currencies, affect the price of imported goods and domestic cost of productions through imported inputs and raw materials.

5.6 Impact on Foreign Direct Investment

Foreign Direct Investment is becoming popular especially in developing countries and it becomes an important source for them. The reason of being popular in developing countries like Nepal is because of having plenty of resources and these countries suffer lack of sufficient finance, technology and competitive management. FDI is the one which can introduce technology, competitive practice, knowledge and skills in the recipient economy of the country. (KC, 2011.) An inflow of Foreign Direct Investment (FDI) can push to higher imports rate if financial transaction is particularly intensive and autonomous and also because of revaluation of currency leads to trade deficit. (Piana, V. 2006.)

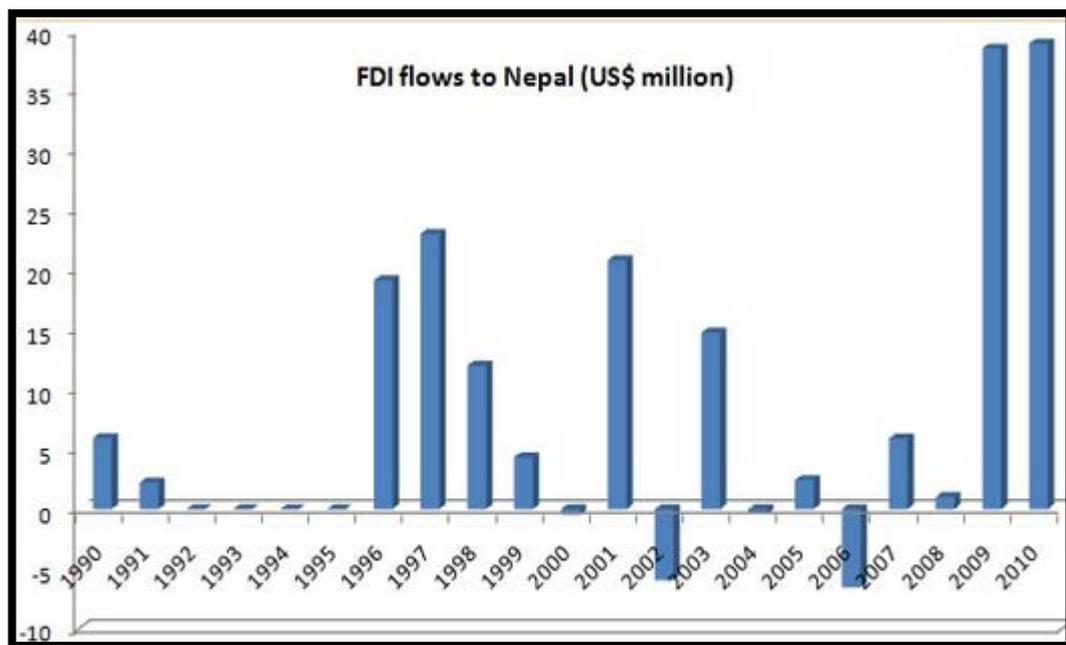


Figure 6 - World Investment Report 2011

This figure describes the FDI inflows to Nepal from abroad countries. In 1990, the amounts of FDI inflow was US\$ 5.94 million then the amount decreased to the ground level till 1995. There was flow of FDI of US\$ 19.16 in 1996. And in 2000, the amount of FDI flows was getting negative. In fact, the amount was negative

US\$ 0.48 in 2000. In the year 2009 and 2010, the amount of FDI inflows was almost similar at about US\$ 39 million.

Trade deficit bring adverse effect in the nation. It destroys jobs, decreasing salary and wages and hurting competitiveness. As a result, those who have lower income have to face struggling life because of cutting wages and destroying jobs. The people who have lower income and do not have job could not save for the future and it reduces national savings because national saving is the saving of people of the nation. It furthermore impacts on the national investment on research and development. (Robert E. Scott, 1998.)

On the other hand, some positive impacts of trade deficit in developing countries like Nepal. Trade deficit is not always bad but sometimes it acts positively in economic reform. Actually, consumers could enjoy with low price and variety of goods and services. It helps in accelerating competition, innovations and productivity gains among producers. A growing trade deficit is significantly not a bad sign for the economy; it fuels domestic demands for goods and services and also rising investment and a larger inflow of foreign capital to finance it. Keynesian has argued that the more demands of goods and services, the more factories, offices, retail outlets will be established to meet the demands. And a result, more workers need to supply demands goods and services which creates employment opportunity. (Griswold, 2011) Global business brings global competition in the world market and global competition is mounting that results huge rise in import penetration, add the massive amounts of overseas investment. (Ball, McCulloch, Frantz, Geringer & Minor 2004,20.)

6 CAUSE OF TRADE DEFICIT

Nepal after being one of the liberalized countries since 1980s, trade deficit comes along with international trade. It means that the importing ratio since that time always leads the export ratio of the country. Many Nepalese are studies the causes of trade deficit. Many of them are noticed that some of the cause factors are remittance, currency exchange rate, geographical structure, political instability.

6.1 Remittance

The remittance has been considered one of the interesting topics in international financial literature over a decade. Worker's remittance is one of the most important sources of external finances for developing countries as Nepal. After Nepal introduced liberal trade and economic policies, it eased the access to International labour market; the trend of going abroad for working purpose is increasing in term where many of them are young people. The percentages of remittance flow to Nepal has upgraded in the recent years because of growing demand for Nepali workers in foreign countries. Over 200 years ago in Nepal, people already started working abroad and sending money back home. In the early 19th century, Nepalese men migrated to Lahore for joining army of Sikh ruler and still the men who serve abroad as an army are called 'Lahure'. They are still recruited for British Army and this term was started since 1815/16.

Remittance plays major role in trade balance. There are many macro-economic variables that influenced aggregate expenditure of external economy. The variables such as oil price, consumer confidence, economic policy and climate impact on eternal economy. The remittance of the country as Nepal is easily impacted by the economic performance of outside countries. When the economic crisis occurred in foreign countries their demand of labours form other countries reduce. Likewise, the flow of remittance will decrease when outside countries where Nepali goes for job have economic crisis. Nepali moves to abroad as a

blue collar worker which means those who performs physical work or manual labour (small business). Nepal remittance will reduce more when outside countries do not demand blue collar labours from other countries. Remittance also plays significant role to GDP of the nation. (Thagunna, K. S., & Acharya, S. 2013.)

Current effect of Remittance Inflow in Nepali Economy

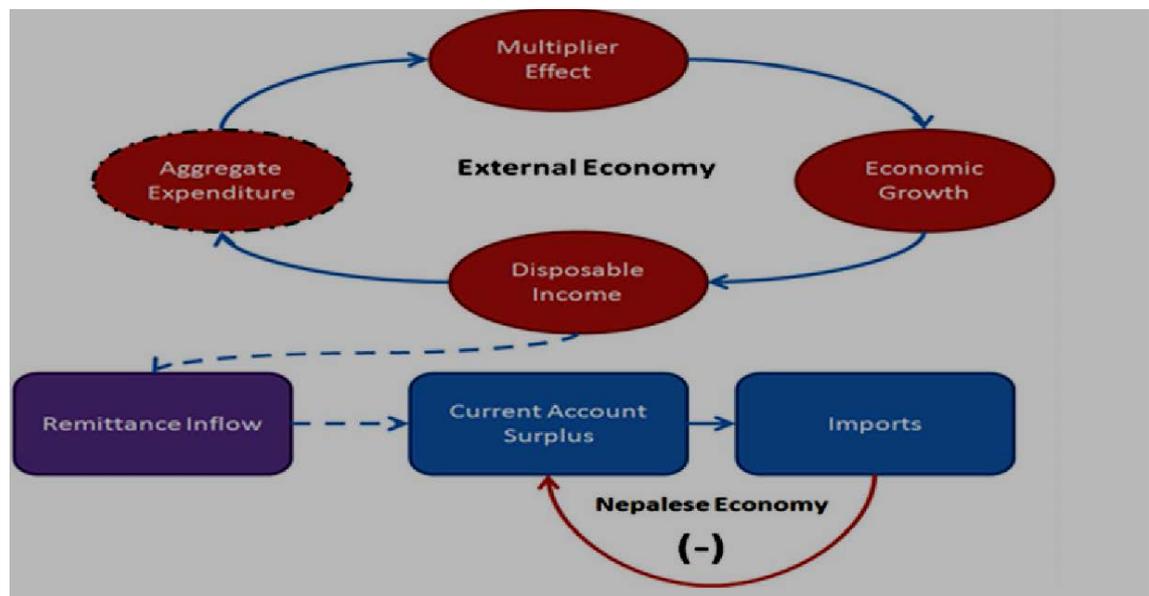


Figure 7 Empirical analysis of remittance inflow: The case of Nepal. International Journal of Economics and Financial Issues. Thagunna, K. S., & Acharya, S. (2013). 3(2), 337–344.

According to Simkhada, S. R. 2013, annually 450,000 new workers enter into the Nepal's labour force and out of the number, 100,000 are skilled. However, because of political instability, violent conflict and high unemployment rate, they are forced to go abroad for searching job. Actually, the remitters or workers working abroad transferred funds to their home country and it certainly helps increasing in flow of remittance in country that also assist improving living standard of people and minimise the poverty in the country. However, it might cause worse situation in trade balance that cause higher rate in demanding

consumable goods and most of them are imported in Nepal. The number of work immigration rate to abroad excluding India, rises from approximately ten thousands in early 1990s to more than three hundred thousand in 2010. As a result, the emigration helps to contribute the rise in remittance to GDP in the country from 2 percent in early 1990s to 23 percent in 2009. (Bhatta, 2013) That brings the overall payment of balance in strong position and its share in current account receipts. It brings sustainable development in the economy and also high flow of remittance in the country minimizes the poverty and inequality.

Remittance is becoming one of major sources of income for Nepal. The instability of political situation and high unemployment rate in the country force people to go abroad for working and they support their family in home with their income earning in foreign countries. They actually transfer money to their home countries from foreign countries which are called remittance in economic term. The rate of remittance in Nepal is increasing annually. The remittance support GDP of Nepal by 10 percentages in 2002 and it went to similar ratio till 2005. But between the year 2002 to 2005, the percentages of trade deficit was not same. In fact, trade deficit percentages in 2002 was 10 whereas it increased by around 5 percentages in 2005. In 2013, the percentages of remittance to Nepal were dramatically increased compared to the initial year 2002. The percentages of remittance was more than 20 in 2013 whereas just 10 percentages to the counterpart. It says that the number of Nepalese people moving to across the border countries for job is increasing annually.

Remittance, Reserve, Current Account and Trade Deficit (% of GDP)

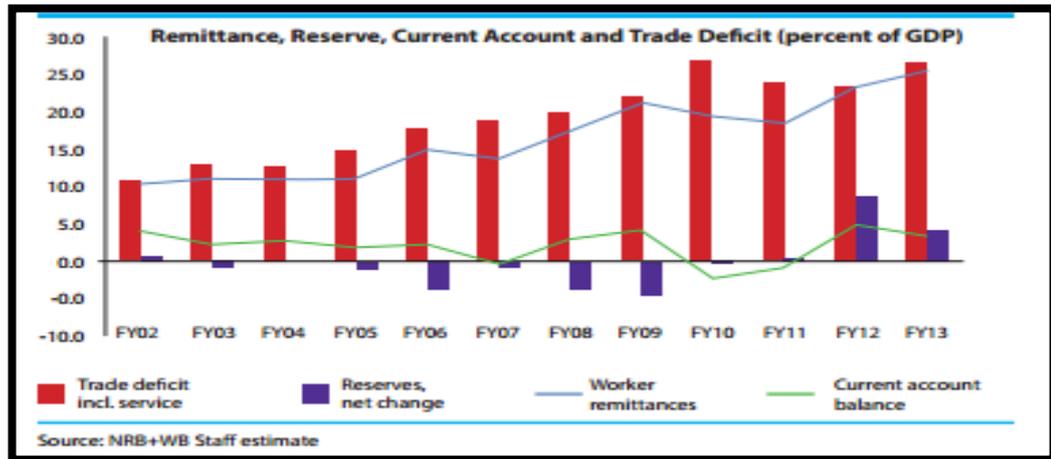


Figure 8 The World Bank Group, Nepal Development update, 2013,

6.2 Devaluation of Currency and Trade Deficit

In the today's world, exchange rate is able to get attention of the economists and policy makers. The devaluation of currency of the nation brings impact on trading major. It actually makes export cheaper and import relatively expensive. The reason of being inelastic in demand of import and export would cause further increase trade deficit because of devaluation. In order to make equal balance of payment in the time of devaluation it is necessary to increase export trade volume so that the expensive import due to devaluation can compensate with cheap export. If the currency value depreciates then the value of import will increase and that will become heavy burden for trade balance of the country. Moreover, the depreciation of the national currency affected the higher cost in purchasing goods and services from foreign countries.

The trade deficit expanded as the value of currency fall down. The exchange rates and trade deficits with several key countries are also heavily influenced by other countries' economic policies. (Scott, 1998.) Exchange rate acts an important role to determine the relative price of domestic goods and foreign goods that creates the influences on amount of trade between two countries. So, the current account balance is affected by exchange rate.

Income of Convertible Foreign Exchange (in NRs 10 million)

Table 4 GoN, Ministry of Finance, Economic Survey 2010/11, Nepal Rastra Bank QEB.

Year		2004/05	2010/11
Total		123,226.8	31,165.70
Merchandise Trade	Volume	2,085.20	3,844.80
	Per cent	16.9	12.34
Service Trade	Volume	7,688.40	27,320.90
	Per cent	62.4	87.66
Remittance	Volume	6,178.50	23,296.20
	Per cent	80.4	85.27
Tourism	Volume	1,181.50	3,100.00
	Per cent	15.4	11.35
Investment	Volume	328.4	924.7
	Per cent	4.3	3.38

Source: GoN, Ministry of Finance, Economic Survey 2010/11, Nepal Rastra Bank QEB.

The above mentioned table shows the income of convertible foreign exchange of the year 2004/05 to 2010/11. Different source of income are mentioned in the table such as Merchandise trade, service trade, remittance, tourism and investment. After analyzing the table, merchandise trade accounted for 16.9% of total income of Convertible Foreign Exchange earnings in the period 2004/05 whereas it fell down and reached to 12.34 in the period 2010/2011. Similarly, income was increasing from 62.4% in 2004/05 to 87.66% in 2010/11 in service trade sector. Furthermore, remittance was also going upward direction. In fact, it rose from

80.4% in 2004/05 to 85.27% in 2010/2011. However, in case of investment it was sloping downward direction. In fact, the percentage was decreasing from 4.3% in 2004/05 to 3.38% in 2010/11.

6.3 Geographical Structure

Nepal is geographically land locked country which is located between the two biggest countries India and China. Because of being a land locked country, the country is based on the availability of transit system and trade corridor in order to lead in the international market. The traders in the country are unmotivated and affected by the geographical factors because they are facing lack of good and proper transportation system. The country's economies are affected by the high freight cost and high unpredictability in transportation time that cost imports to be overcharged and exports to decline in their value results to a smaller trade volume (Silwal, 2008).

6.4 Political Instability

The unbalancing reason of political situation in Nepal truly impacts on import and export factor. It influenced in local market of the nation. The local market could not compete with outside markets because of political instability reason that cause trade deficit. The local investor and producer get affected by political instability because the cost of production go upward direction and productivity become less because of trouble created by politicians and as a result Nepal is continuously facing trade deficit. Furthermore, Nepalese produced products could not be delivered at time Trade balance can reflects as political balance of power. In particular, price and non-price competitiveness is relevant. If the price goes down because of external pressure force at which a nation sells its export, then it happened trade deficit.

7 DIRECTION OF FOREIGN TRADE OF NEPAL

Nepal is trading the highest percentage of goods with India in term of import and export. Almost more than 50 percentages of trade is done with India and remaining percentages are done with other countries. This chapter studies the movement of trade and the trade deficit with India. It has also presented the major challenges of Nepal's foreign trade. Besides this, the trade relationship with China and Japan has been discussed.

Nepal's foreign trade scenario from 1990 to 2009

Table 5 Direction of Foreign Trade in Nepal

Year	1990/91		2008/2009		Increased by (times)
	Rs. Ten Million	Ratio	Rs. Ten Million	Ratio	
Export to India	60	9%	4101	61%	68
Export to Other Countries	584	91%	2669	39%	5
Total	644	100%	6770	100%	11
Import from India	732	32%	16244	57%	22
Import from Other Countries	1590	68%	12203	43%	8
Total	2322	100%	28447	100%	12
Trade Deficit with India	672	40%	12143	56%	18
Trade Deficit with Other	1006	60%	9534	44%	9
Total	1679	100%	21677	100%	13
Total Trade with India	793	27%	20344	58%	26
Total Trade with Other	2174	73%	14872	42%	7
Total	2966	100%	35217	100%	12

Source: Economic Survey, 2010

Source- Source- Ghimre, R. 2010, Direction of Foreign Trade in Nepal

The figure shows the trade scenario of Nepal with India and other countries. The comparison was done based on the two periodic years, 1990/91 and 2008/09. The import and export ratio with India was higher than other countries. In 2008/09, Nepal had done export of (\$6 million) Rs. 600 million with its major trading partner India and it increased by 68 times in 2008/09. In the same periodic gap of these years, the export done with other countries grew just by 5 times which is comparatively 63 times less than with India. However, imports ratio increased by 22 times in 2008/09 compare to 1990/91. Deficit generally gives the figure of difference between import and export. The deficit amount for Nepal with India in 1990/91 was (\$67.2 million) Rs. 6720 million and (\$100.60 million) Rs. 10060 Million with others countries. The deficit percentages increased by 18 times with India in 2008/09 and 9 times with other countries in the same year.

7.1 Movement of Trade with India

7.1.1 Evolution of Nepal Trade with India

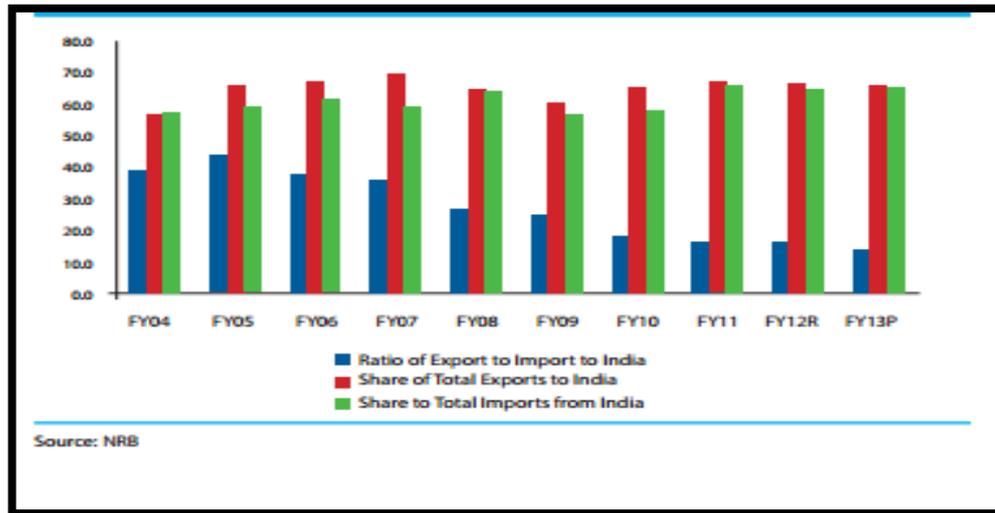


Figure 9 the world Bank Group

Today, India is more than ever a dominant partner for Nepal. The figure reveals the ratio of export to import, share of total exports and share to total imports to India. During the period between 2004 and 2013, the ratio of exports to imports to India was slightly decreasing in term besides in the year 2005. The percentage of ratio of export to import remained almost similar in the three years i.e. 2010, 2011 and 2012 which was above 10 percentages. There was reduced of approximately 30 percentages of ratio of export to Import to India compared from 2013 to 2004. Similarly, the trend of increasing was seen in share of total exports to India that is around 5 percentages from 2013 to 2004 but in the year 2009, it seems like it was slightly decreased in the percentage. At the end, the percentage of share to total imports from India was slowly increased in 2013 that reached to around 60 percentages.

7.1.2 Partners in International Trade

Export can play important role in management if there is analyzation of major trading partners and the nations where it has affiliates. There are many advantages to focusing on major trading partners. Firstly, the business climate in the importing nations is relatively favourable. Besides this, there are no insurmountable in export and import regulations. Moreover, buying that nation's goods are easy because there should be strong cultural objections. And there has already been established of satisfactory transportation facilities. Not only that but also, import channel members like merchants, banks, and customers brokers are experienced in handling import shipments from the exporter's area. Moreover, between the countries, there is available of foreign exchange to pay for the exports. Also, the government of trading countries may apply pressure on importers to buy from countries that are good customers for that nation's exports. For example, the government of the countries like Japanese, Korean and Taiwanese put the efforts to persuade their citizens to buy more American goods. They also sent buying missions to the United States. (Ball, McCulloch, Frantz, Geringer & Minor 2004,64.)

7.2 Trade Deficit in Goods: India

As mentioned by Nepal Rastra Bank in 2012, a leading bank in Nepal, almost half of the total percentage of trade has been done with India. According to the article named, ECONOMY: Huge Deficit, written by Debesh Adhikari on 29 Nov. 2013, Nepal's growing deficit threatens micro-economy stability of the country. The burning issue is Nepal is suffering huge trade deficit with its main trading partner country India. The macro-economic report released by Nepal Rastra Bank (NRB) reveals that the trade deficit with India surged by 14.2% during the review period. Deficit is worrisome issue for country's micro economic stability, as India is the largest trading partner.

In the first quarters, Nepal has been able to made quite good progress in export to India as it has risen by 18% during economic review period. If the deficit is rising in term then the consequences might be getting worse. So, economists are

worried about the situation. Trade should be balanced in context of Nepal because serious problems may occur in maintaining the macro-economic stability in Nepal if the trend continuous. Some of the major products such as zinc sheet, cardamom, juice, herbal medicine, shoes and sandals are exported to India during the review period. The percentage of importing products to Nepal from India is rising in term. In fact, it rose by 14.8%. Nepal Rasta Bank has said that the primary reason of increasing import percentage is because of importing higher percentage of petroleum products, cold-rolled sheet in coil, thread, and vehicles & spare parts, among others. So, in term of minimizing trade deficit with India, Nepal needs to focus on promotion on exports, according to the first quarter report generated by NRB.

7.2.1 Nepal's Trade with India

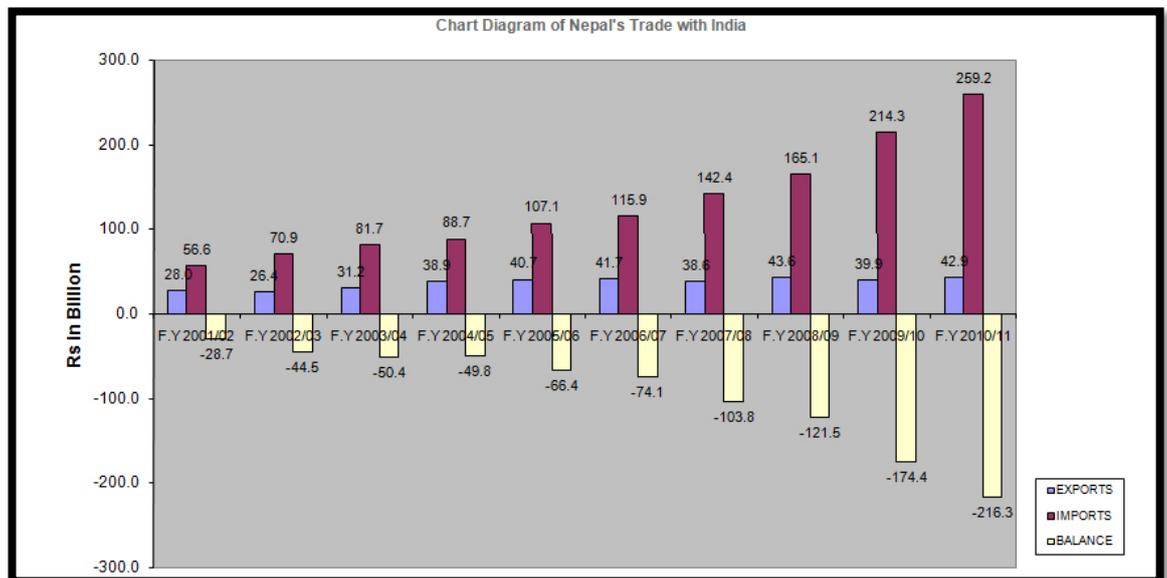


Figure 10 Trade and export promotion center

The chart diagram describes the import and export status of Nepal that was done with India. It represents the trade situation between 2000 and 2011. It can be easily seen that import was higher in every year. In fact, it was rising in term from around (\$0.56 billion) Rs 56 Billion to more than (\$2.59 Billion) Rs 259 Billion and the highest import's amount was in 2010/11. However, export amount was not

more than (\$0.50 Billion) Rs 50 Billion in any year between 2000 and 2011. In fact, the highest export was done in 2008/09 which was Rs 43.6 Billion- less than imports amount of (\$1.215 Billion) Rs 121.5 Billion in same year.

Overall, by analyzing the diagram, it has clearly revealed that the nation is continuously facing trade deficit with India.

7.2.2 Nepal's Main Import from India and Main Export to India

Nepal's total exports to India during 2011-2012 amounted to NRs 49.61 billion (US\$ 0.62 billion) whereas total imports from India during 2011-12 amounted to NRs 299.38 billion (US\$ 3.7 billion). Concerning on the trading with one of the major trading partner India, Petroleum products leads the import list which was 30.8% of total imports. Whereas, textiles were the most exported goods to India that was just 10.2% and closely followed by Threads which was 8.3%. All in all, in order to make equal balance payment, Nepal has to increase their sales up to US\$ 3.08.

Table 6 Consulate General of India

Import Products	Amount in %	Export Products	Amount in %
Petroleum products	30.8%	Textiles	10.2%
Motor vehicles and spare parts	5.7 %	Threads	8.3%
M. S. Billet	6.5%	Jute goods	8.0%
Machinery and spares	2.8%	Polyester yarn	7.3%
Cold rolled sheet in-coil	2.5 %	Zinc sheet	6.6%
Medicines	3.5%	Juice	6.0%
Electrical equipment	2.3%	Large cardamom	6.5%
Coil	2.4%	Others threads	5.2%

Source- Consulate General of India, <http://www.cgibirgunj.org/page/detail/194>

7.2.3 Overall Price Movements are Closely Aligned to India's Industry

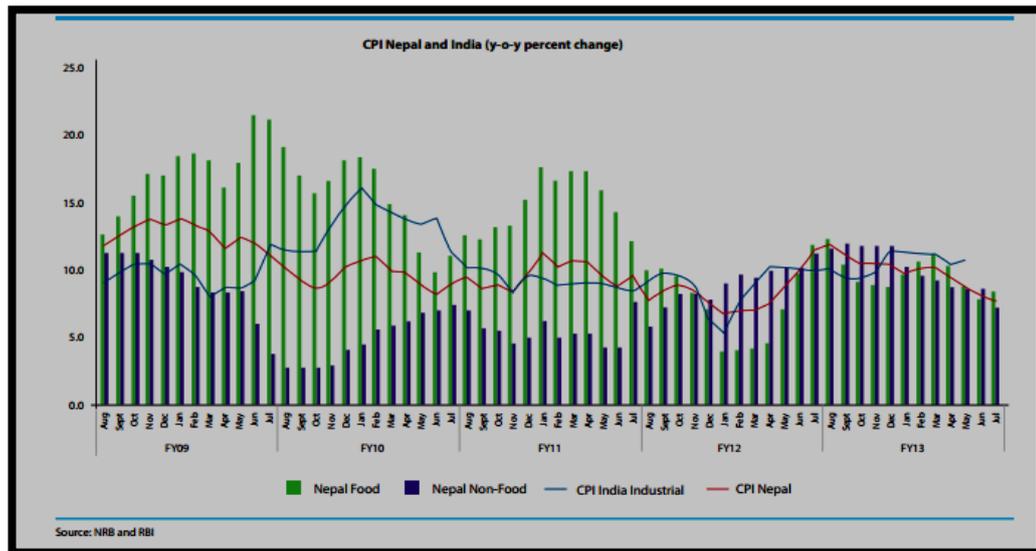


Figure 11 The World Bank Group, Nepal Development update, 2013,

The figure has shown the inflation in Nepal that has been closely followed by the price trends in India because of Nepal's close integration and relationship with India and its currency pegging which means a way of fixing a country's currency to stay at a certain rate below or above another country's currency. Nepal has close link and good relationship with India and they have open border. Because of open border between these two countries, sharp alignment in price especially in food stuffs and petroleum products, resulting increasing in vast scale of informal trade. After analyzing the figure, the price of Nepal food stuffs seems like decreased comparing the price of Nepal food in July 2013 to July 2009. In fact, the price percentages went downwards from 22 percentage to about 12 percentage and between the period 2009 and 2013, the price has not been in constant ratio. Actually, when we see the price index of Nepal food in the month of June and July of year from 2010 to 2012, the percentage was almost same.

When referring Nepal nonfood, the price percentage was decreasing in the year 2010 and 2011. Moreover, in 2012 in June- July, the percentage slightly led to upward direction. In fact, it reached up to about 13percentage. And in the year 2009 and 2013, the price percentage again was being almost same rate.

When we analyze the CPI (Consumer Price Index) percentage rate of industrial sectors in India from the year 2009 to 2013, the percentage was slightly increased in 2013 compared to 2009 which was about 4 percent But during the period, in the end of the year 2010, the percentage has been increased and reached to approximately 15 percentage and it decreased in the year 2011and 12. Finally, in context of Nepal, CPI percentage rate was almost similar in rate from 2009 to 2013 which was almost 12 percentages.

7.3 Nepal's International Trade

Beside India, Nepal has maintained good relationship with other countries in term of trade of goods and services. Nepal and China has significant relation in term of trading of goods and services. Moreover, the further studies have figured it out that Nepal has been associated as a trade partner with more than 100 countries around the world.

Foreign Trade (Excluding India) in million Nepali Rupees (Rs.)

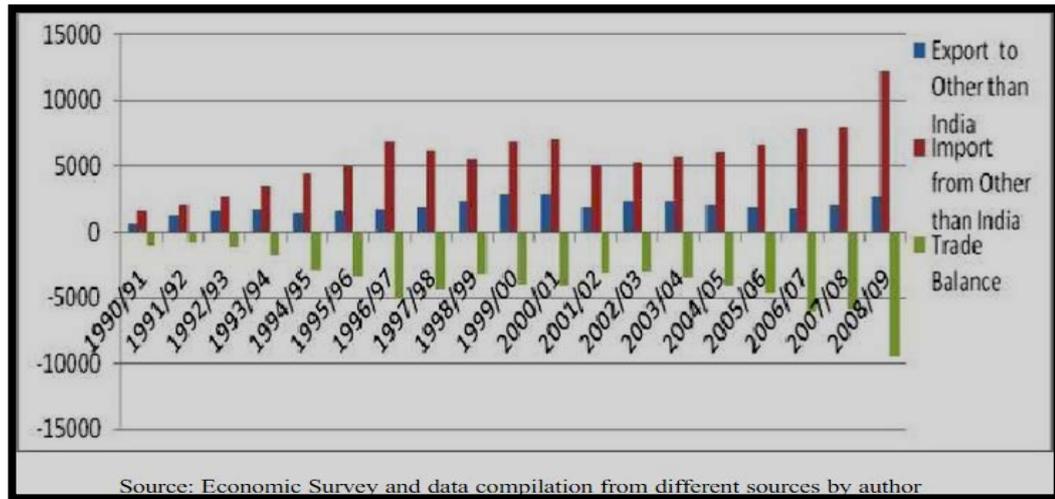


Figure 12 Direction of Foreign Trade in Nepal Ghimre, R. 2010

The figure presents that Nepal has imported the goods of amount Rs. 15900 million (\$159 million) in 1990/91 and the export of Rs. 15840 million (\$158.40) was done in the same year. The import was doubled within three years period but export was increased doubled in the next year. In 1996/97, import was four fold increased. The export was six fold increased in 2000/2001. After 2000/2001, export was started falling downwards slopes and the process continues till 2006/07. In 1990/91, imports exceeded by Rs. 10060 million (\$100.60 million) comparing to export in the same year and it were increased three fold within five years period. Nepal needs to do export promotion and reduce the percentage in imports from others countries which helps to maximize the positive figure in balance of payment.

7.4 Trade Relation with Other countries- China and Japan

Nepal and China have had a stable trading relationship since the first bilateral trade treaties which were signed in 1950's. In April 1960 a peace and friendship treaty was signed between these countries and in the following year 1961, boundary treaty was signed. In ancient period, Nepal had limited international trade with Tibet and India. Nepalese trading agencies in Tibet specified some markets such as Xigaze, Gyirong, and Nyalam, with Lhasa, Xigaze, Gyangze, and Yadong, for trade after 1956. And In 1980, there was agreement between Nepal and China to open twenty one trade routes across the Tibetan Frontier. The passage of both traders and pilgrims in either direction across the border is strictly regulated by the treaty arrangements with China.

Nepal has bilateral relation with China and they have first agreement in October 1956 on economic support. China has been supporting Nepal under bilateral agreement of economic and technical cooperative signed between the two countries, Nepal and China. Besides this, China has been helping Nepal in development sector like health, education and other areas of infrastructure but the way of assisting to Nepal is steady and reliable. The year 2012 is great year for both of the countries because during this year it was announced as 'Nepal-China Year of Friendly Exchanges'. Nepal's trade with China is increasing in term. It is needed to maintain this bilateral relation in sustainable way. Here is the trading scenario with China between the year 2010 and 2013. In all the year from 2010 to 2013, the import amount is higher than exports that denotes trade deficit with China. It is a negative balance of payment.

The Economic Times has stated that China is planning to build high speed Rail link of about 540 kilometer between Tibet – Nepal and the project aims to make more efficient bilateral trade relationship between these two countries and reduce the poverties. The project was expected to be completed by 2020. It would also help to increase the growth rate of tourism. It is further added that Nepal is receiving more help form the government of China in the recent years. In fact, the recent annual aid to Nepal is USD 128 million and before it was USD 24 million.

7.4.1 Nepal's Trade with China

Table 7 Nepal's trade with China

Value in '000 Rs

Year	Export	Import	Trade Balance
2010	996,989,850 (\$9969898500)	41,057,900,250 (\$410579002500)	-40,060,910,400 (- \$400609104000)
2011	761,983,271 (\$761983271)	51,466,423,069 (\$514664230690)	-50,704,439,798 (- \$507044397980)
2012	2,507,993,748 (\$25079937480)	69,910,833,822 (\$699108338220)	-67,402,840,074 (- \$674028400740)
2013	2,042,253,520 (\$20422535200)	68,778,185,554 (\$687781854440)	-66,735,932,034 (- \$667359320340)

Source- <http://www.mofa.gov.np/>

China is one of the top investor countries in Nepal. Most Chinese prefer to invest in water resources and infrastructure of development in Nepal which leads to win-win outcome. Their investment in Nepal creates job opportunities for many Nepalese people. In July 2012, 428 projects were operated under Chinese investment which helps to bring 26,651 different jobs in Nepal.

7.4.2 Nepal Trade Relation with Japan

There is formal relationship between Nepal and Japan in 28 July 1956. Japan is the sustainable friend and development partner of Nepal. The size of trade between these two countries is widely remarkable and growing in term. The relation should be maintained in long lasting way. In order to make effective trading between Nepal and Japan, the government of Japan operate project worth \$ 1.5 with the help of Asian Development Bank (ADB) in May 2014. It assists the government of Nepal by modernizing its customs service's so the customs services can be more effective and efficient. Here is table that reveals the trade situation in number from 2010 to 2012.

Table 8 Nepal and Japan trade scenario

Value in '000 Rs

Year	Export	Import	Trade Balance
2010	599,066,748 (\$5990667480)	5,582,974,739 (\$55829747390)	-4,983,907,991 (-\$49839079910)
2011	684,848,373 (\$6848483730)	3,805,785,844 (\$38057858440)	-3,120,937,471 (-\$31209374710)
2012	1,042,324,897 (\$10423248970)	6,280,797,352 (\$62807973520)	-5,238,472,455 (-\$52384724550)

Source- <http://www.mofa.gov.np/>

The relationship between Japan and Nepal helps to improve the trade of Nepal and also creating many job opportunities to Nepal. Japan is a major investor of Nepal. In July 2012, 167 projects were operated with bigger amount of investment which is Rs. 1220 million (\$12.20 million) and as a result 6986 various jobs were created in Nepal. This is truly a great help and contribution for Nepal.

7.5 Major Challenges of Foreign Nepal Trade

Nepal's economy has close connection with foreign trade. The huge difference between import and export of the country is leading towards huge trade deficit and creating international exchange burden to economy. Besides this, Nepal is facing many challenges and difficulties in trading of goods and services. Some major constraints are long political transition, difficult terrain, geographical location, limited export basket, weak labor relations, inadequate economic and social infrastructure, insufficient skilled human resources, inadequate market information and inadequate trade related assistance.

In brief, long political transition is a major constraint of the country. After the mid-term election Nepal has experienced the serious political instability. Political transition is taking unexpected more longer time, even after the declaration of country as a federal republic in 2008. As a result the problems like revolution, strike, extortion and hurdles in the flow of goods and services occurred. Development process could not go properly because of political instability. Another constraint is difficult terrain. Due to geographical structure- high hills and mountains, most of Nepal's terrain is becoming more difficult and hazardous. Most of the lands are not suitable for commercial farming because of not being arable land. The reason behind of being less trade with neighboring country of Nepal- China, which is the fastest growing and the second largest in world economy, located at northern part of Nepal is because of difficult terrain in northern border. The third constraint goes to geographical location which creates big challenges to promote trade. The long distance from sea port is another big problem in trade which is 660 miles away from Nepal's border. And it adds significant cost in foreign trade which is additional service charges and undue delays. (World Trade Organization, 2012)

7.6 Nepal's Trade Policy History

Nepal is a small mountainous country surrounded by China to the north and India to the east, the west and the south. Nepal has good relationship with one of the main trading partner countries India and trade route to India and overseas world has natural and convenient. However, the Himalayan range creates trade more difficulties and complexity in case of another main countries China.

Nepal is an agricultural country and approximately 88% of people are depending on it. Only one fourth of the total area of Nepal is more likely cultivated or cultivable. It means that after meeting the needs of domestic, there are few possibilities of getting trade surplus. Nepal is facing the problem like local shortage of foodstuffs because of lack of transportation system. Even in different country side, the price of similar quality of same products is differentiated.

Even in some part of country side, inter regional trade is occurred in barter system, and almost all the manufactured goods, equipment, most consumable products and even the daily necessities, are to be imported . Nepal has no sea trade facilities and in order to trade with overseas countries, the country has to transact through neighbour sea ports that provides transit facilities with certain bilateral trade and transit agreement. There are no specified trade agreements between India and Nepal before 1923, and India had provided certain trade and transit facilities to Nepal. The import of goods and services outside from India was substantial. After 1930, with liberalization in Nepal imports policy, after India got Independence in 1947, results a new and comprehensive trade treaty became imperative. In fact, treaty of trade and commerce was signed in July 1950. After overthrow of Rana rule in 1951, Nepal's government had further vision for trade improvement. And Nepal was succeeding to sign Indo- Nepal treaty of trade and transit was signed in September 1960. This treaty provided provision for free trade, maintenance of separate foreign exchange accounts, and better transit facilities for Nepal in India. Actually, this treaty provides Nepal right of trade and transit through India. Nevertheless, even after the agreement, India sometimes restricted to export some goods to Nepal like cement, iron, gold, salt, sugar and

other commodities. At the same time, they denied to import the goods that produced in Nepal like potato, matches and sugarcane, this makes producers loses. Finally since October 1963, India was agreed to abolish bond system on goods in transit to and from Nepal and to simplify the administrator procedure. Thus, Nepal obtained internationally recognised right of unrestricted transit. Nepal made more comprehensive policy of trade liberalization in 1991 when the majority of multi-party restored. Furthermore, the industrial policy was formulated in 1992 in order to encourage national industrial productivity and production. According to the Ninth year plan (1997-2002), the objectives are to maximum utilization of commerce sector for the economic growth and maximizing the advantages of foreign trade to the rural areas. Another objective is to diversified trade and creating stable trade by strengthening of backward linkages. According to the Tenth plan (2002-2007), the objectives are to establish liberal, competitive, market oriented commercial sector and develop the national economy performance by improving internal and external trade sectors. Another objectives of the Tenth plan is to increase GDP of the nation by increasing contribution of commercial sector. (Dr. Pant, B. 2005)

8 BUSINESS ENVIRONMENT IN NEPAL

Nepal is known as one of the least developed countries in the world. The reason behind it is lack of good infrastructure of development, political instability and geographical structure. In context of Nepal, the core industries are operated only by the government such as transportation, electricity and communication. The situation of politics depends on the government of the nation. But now the instability of political situation creates obstacles to the firms and industries.

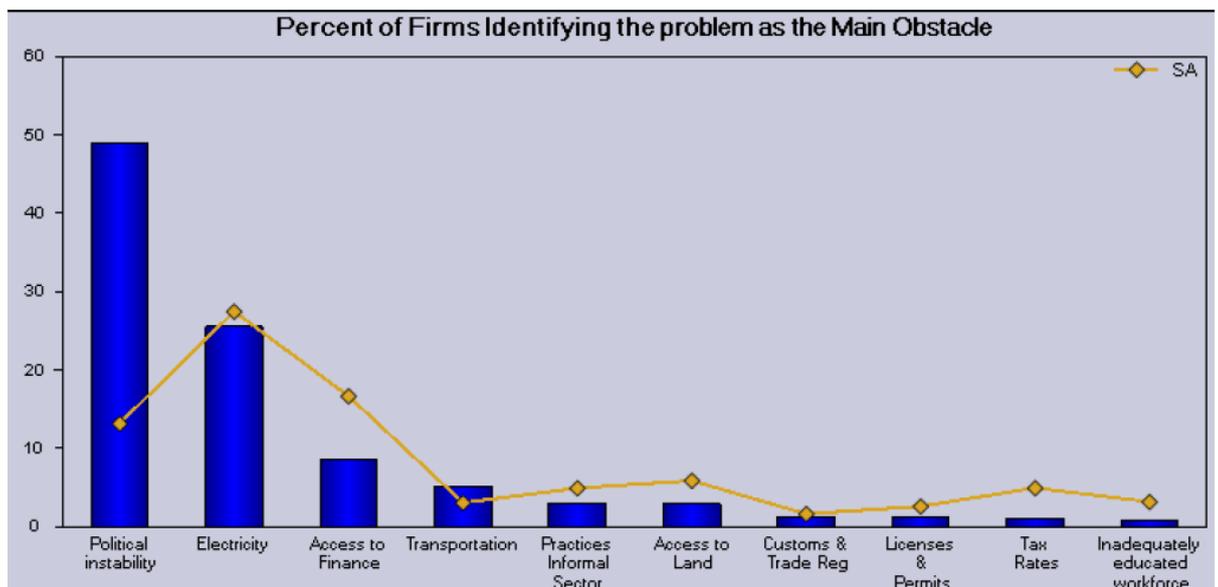


Figure 13 the world Bank Group, Nepal Country Profile 2013

The graph presents the percent of firms identifying the problems as the main obstacles. It also revealed the top ten constraints such as political instability, electricity, access to finance, transportation, practices informal sector, access to land, customs and trade registration, licenses and permits, tax rates and inadequately educated workforce that creates problems for firms. Political instability was the

major obstacles closely followed by electricity that companies and firms have to face in operating business.

There are normally three types of firms which are small firms (1-19 employees), medium firms (20-99 employees) and large firms (100+ employees). The graph presents the main obstacles of different size of firms. Political instability and electricity are major problem that has been seen in all sizes of firms. Among all kind of firms, large firms are the one who has huge impacts of political instability and others small and medium firms has almost same percentages of impact of political instability and electricity. In comparison to others firms- small and medium, large firms has lower impacts of electricity.

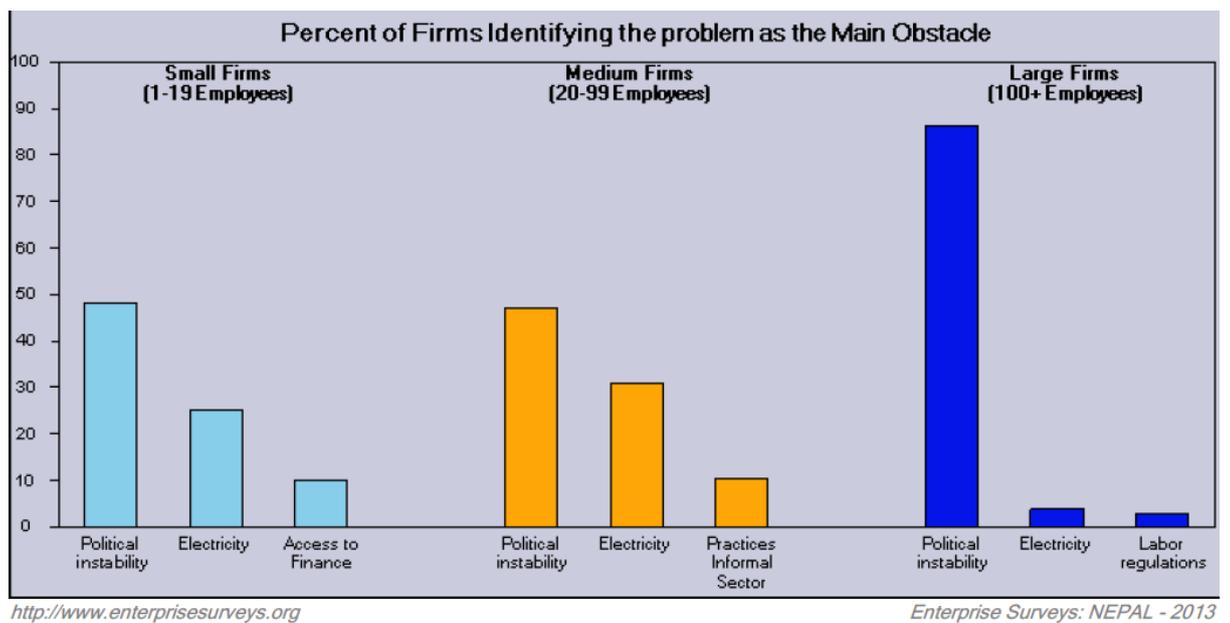


Figure 14 The world Bank Group, Nepal Country Profile 2013

8.1 Doing Business in Nepal

Nepal, a country with the highest mountains and hills, is rich in natural resources. Its diversity of resources and beautiful scenario lured many tourists and investors. Nepal is now ranked in 104th for ease in doing business. Because of its availability of resources and ease process of doing business many investors will to operate the business and projects in Nepal. But the problems like political instability, and good infrastructure of development reduces the number of investors. The government has to take it seriously and effective policies have to be formulated and implemented. FDI contributes huge help in improving economic performance of Nepal. Besides this, it creates thousands of job opportunities to the people.

8.1.1 The Procedures for Start-Up Business in Nepal

It is easy to start up the business. The process and time taken is comparatively more less and easier than in other countries. In order to start up the new business in Nepal, there are normally seven main procedures that need to be considered. The whole procedure will be completed within approximately seventeen days. The first procedure is to verify the uniqueness of the proposed company name and it takes just one day. The next procedure is that a professional verifies and certifies the memorandum and articles of association which takes around 5 days to complete. Likewise, the third procedure is to buy a stamp of the company to be attached to registration form and it normally takes just one day. The fourth procedure is to register at the office of the Company Registrar, Department of Industry and it takes seven days to be done. After that, the procedure is to make a company rubber stamp which takes one day to complete it. The second last

procedure is to register for vat and income tax at the Inland Revenue Office, Ministry of Finance. The final step is to enrol the employees in provident fund which normally takes one day.

Table 9 Doing Business

No.	Procedure	Time to complete	Associated Costs
1	Verify the uniqueness of the proposed company name	1 Day	No charge
2	A professional verifies and certifies the memorandum and articles of association	5 Days	NPR 10,000 (\$100) depending on the professional's charges
3	Buy a stamp to be attached to registration form	1 Day	NPR 5 (\$0.05)
4	Register at the Office of the Company Registrar, Department of Industry	7 Days	NPR 9,500 (\$95)
5	Make a company rubber stamp	1 Day	NPR 275 (\$2.75)
6	Register for VAT and income Tax at the Inland Revenue Office, Ministry of Finance	1 Day	No charge
7	Enroll the employees in the Provident Fund	1 Day	No charge
		17 days (total)	

Source- World Bank Group. Doing Business

8.1.2 Rank in Ease of Doing Business in Nepal

Nepal is ranked in 104th in starting a new business in 2015 and 97th position in 2014. It shows that it is getting difficult to start the business in Nepal as the year passed. Likewise, it is listed in 91th position in dealing with constructions permit, 85th in getting electricity, 27th in registering property, 116th in getting credit, 71th in protecting minority investors, 126th in paying taxes, 171th in trading across the countries, 134th in enforcing contracts, 82th in resolving insolvencies in 2015.

Table 10 World Bank Group, Doing Business

Topics	DB Rank 2015	DB Rank 2014
Starting a business	104	97
Dealing with constructions permit	91	126
Getting Electricity	85	78
Registering property	27	29
Getting Credit	116	111
Protecting minority investors	71	70
Paying taxes	126	120
Trading across border	171	169
Enforcing contracts	134	134
Resolving insolvency	82	78

Source- World Bank Group, Doing Business

Nepal is a small and developing country where variety of resources flora and fauna is found. Nepal is also known as the sandwich between India and China. Because of its natural beauty and geographical attractions many people from Nepal as well as outsiders lured to start up business. The easy procedure and easy business environment helps to attract many investors in Nepal. Furthermore, the country could improve its economic performances if the political situation was stable and effective policies for business are formulated. The availability of resources and increasing demand of natural products in the recent years could lure many investors in Nepal. Many countries already operated projects in Nepal such as Japan and China invest more in infrastructure and resources. One Finnish Telecom company named Sonera has operated the business in Nepal as Ncell (KC, K. 2011). Doing business in Nepal helps people to get job opportunities.

9 CONCLUSION

Nepal, a land locked country with the highest mountains, is bordered by the two biggest South Asian countries India and China and rich in natural resources, has had impacted on its economy performance since it became liberalized in 1980. India is a major trading partner of Nepal and half of total percentages of trade is done with India because of easy access of importing and exporting goods and services to India. The thesis has discussed that instability situation of politics, the geographical structure, exchange rate which are the major causes of trade deficit. And it impacts on GDP of the nation, price of the commodities, supply side, Foreign Direct, Investment. Trade deficit is one of the major causes that leads the national economy to downturn side. Nepal has been suffering imbalance figure in import and export factors. In fact, the national's import ratio leads by seven times to its export. So, in order to maintain balancing figure between these two factors, the government has to increase the export ratio by seven times. Reform in political instability is one of the effective ways to minimize trade deficit. The country is facing domestic war, revolution and as a result government could not focus on creating effective economic welfare policy and development. Stable political situation leads to recover in the both public and private investments. Political stability needs to be followed by structural reforms that could solve enduring source of fragility, including financial sector consolidation, public financial management reforms, investments in climate improvements and a strategy to mention the smooth erosions of Nepal's external competitiveness. Political uncertainty hampered the industrial activity which leads the increment in imports percentage of goods to fulfil domestic needs and demands. Political stability in a country helps to minimize huge importing percentage to Nepal which control deficit. Besides this, the budget announcement in the sector of agriculture and the needed technology could be the effective way to increase national export ratio. Minister of Nepal- Dr. Ram Sharan Mahat has pointed that Nepal could increase the production capacity and is able to compete in international markets if the Nepalese gov-

ernment supply the modern equipment and technology. Finance advisor of Government Chiranjibi Nepal has said that the increase in production leads the overall reform in Nepalese economic performance. The deficit could be minimised if the government could introduce the alternative products for the main imported goods.

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