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A Note On Nepal's Foreign Trade

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Nepal's trade deficit shows a consistently upward trend. During the first two months of the financial year 1977/78, the trade defict amounted to Rs. 144.3 million and during the first four months it rose to Rs. 326.4 million. The mounting trade deficit is the outcome of declining exports and rising imports. Exports to India exhibit a falling tendency while exports to overseas countries are subject to no consistent trend. The steady tendency of exports to fall can hardly be neutralised by occasional decline in imports since they are at most marginal.

India is Nepal's leading trading partner. Exports to India by major commodity groups are Food and Live Animals, Taboceo and Beverages, Crude Materials, Minea~ral Fuels and Lubricants, Animal and Vegetable Oils and Fats, Chemicals and Drugs, Manufactured goods classified chiefly by materials, Machinary and Transport component of exports, rice accounting for sixty percent of total exports to India.

The most important item of Nepali imports from India is manufactured goods consisting primarily of textiles and other items of daily consumption. Among other items of imports are food including live animals, machinary and transport equipments and chemicals and drugs.

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Nepal exports primarily raw jute and jute goods to overseas countries Among other items the imtportant ones are curio goods, hides and skins, bristles and musk and other miscellaneous items. Major item of import from overseas countries are ma-chinary and raw materials, readymade garments, building materials, vehicles and agricultural implements.

The mounting trade deficit is a serious concern for Nepal and hence it appears that nibbling with exchange rate alone to take care of the payments position is hardly adequate since by all indications trade deficit is tending to become woven inextricably into the very fabric of the Nepalese economy. The present trends in trade are the outcomes of the past and should better be viewed as structural rather than transient and marg-inal. Stagnant or declining export earvings pose serious problems for a developing economy since an increasing share of investment, in that case, will fequire an increase in the domestic production of the capital goods which constitute the investment. Whether the planners have implicitly assumed a closed economy or a situation of declining export carnings through in elasticity of export demand is difficult to find out from a reading of the current five year plan. If so, there might have been some indications in the form of a provision for a growing capital goods sector in production. After all, for a developing economy, one of the ways of procuring capital goods is inevi-tably the possibility of transformation through trade. This is a missing aspect in the Nepalese investment strategy.

. In a major policy shift, Nepal has recently abolished the incentive bonus scheme and introduced a dual exchange rate system for all convertible foreign currencies. The incentive bonus scheme allowed for many exchange rates depending uppon the commodity exported overseas. While recognising the export-diversifying impact of this scheme, the economists are of the view that the scheme tended to be hard on efficie-ncy but soft on inefficiency and, also that most of the goods imported under the scheme were 'luxury items' since the propensity to earn greater profits out of import entitle-ments was not kept in bash by restricting the use of such entitlements. The second of these aspects showed up in an explosive fashion in the form of the so-called 'carpet scandal' in which all the over-invoiced items were carpets.

It is a bit strange that while passionate outcries have condemned the scheme, little in the way of a comparative analysis of alternative promotional instruments such as add valorem subsidies, devaluation etc. has been undertaken. After all there is no denying the fact that export earnings can be increased by making exports profitable. The scheme also serves to remove 'elasticity pessimism' which characterises thinking and polities in developing economics. It also serves, by bringing a whole new range of products into the field of export, to offset increasing cost disadvantage of traditional exports and even sometimes manage to get export performance off the hook which an overvalued exchange rate constitutes. It is necessary, of course, to find out (i) whether the scheme was an efficient way of couutering the effect of the overvaluation of the exchange rate on exports, (ii) whether it was efficient in stimulating the working of a flexible exchange rate system and (iii) whether efficiency also suffered on account of the differential nature of the effective subsidisation granted under the Nepalese regime.

Another aspect of the incentive bonus scheme to which attention must be paid is the often-alleged over-invoicing of exports. It is to be noted that the incentive to over-invoice exports arises when the effective export subsidy exceeds the black-market premium charged for illegal foreign exchange. It is in this perspective that one should try to find out whether over-invoicing of exports is necessarily harmful. It may be argued that the effects on the balance of payments position will not necessarily be disadvantageous and may in fact be beneficial if the effect is to bring into legal channels the foreign exchange that might otherwise have been in the illegal market and used for illegal and hence for non-priority areas (such as capital flight). It is also necessary to examine the possible impact of over-invoiced entries in the balance of payments records on the aid inflow into the country.

There is another short-term implication of such over-invoicing. The over-invoiced part of the declared value has to be secured from illegal sources. This is likely to take time if the exporter wishes to find out the cheapest source for illegal perchase of foreign exchange. More important, the exporter can avoid altogether any interest change on the cost incurred by the purchase of illegal foreign exchange by putting it off till the very end of the permissible period between exports and the surrender of the exchange earned therefrom. Hence the exporter has an incentive, as long as the interest

rate is positive, to defer the return of the over-invoiced part of the export earnings. This will, therefore, increase, ceters paribus, the average lag on total export earning. In so far as this happens, further, the time-profile of receipts of foreign exchange will undoubtedly be affcted and the result may will be a net deterioration in the immediate availability of foreign exchange to the country.

Finally, the incentive to over-invoice sometimes lead exporters to send out shoddy goods with faked, higher-priced dec'arations, which are cleared in the foreign market at 'what they can fatch'. At a time when the tempo of a country's immediate and long-term export drive has to be mereased, the build up of goodwill is quite important. This is precisely what is geopardised by the practioners of over-invoicing. This aspect, therefore, holds out the danger of encouraging the entry into the export trade of moving trades, in search of quick profits, whose primary objective is short-run, immediate profit maximisation.

The dual exchange rate system just introduced is expected to provide some relief to exportes. They will be paid for the amounts they are entilled to receive in convertible foreign currencies in accordance with the second rate of exchange of the U. S. Dollar, fixed at 16 Nepalese rupees to a dollar. The second rate of exchange will be applicable to all imports except "development goods and material". The basic exchange rate of all convertible foreign currencies will be based on the official exchange rate of the U. S. Dollar of twelve Nepalese rupees to a dollar. The basic rate will be valid for overseas payments for invisible exports, services, capital transfers and for foreign exchange provided for services and travel. The basic rate will also be valid for development goods like petroleum products, fertilizers, certain raw materials and machinary.

There are doubts regarding the implications of the dual exchange rates and the import policy announce in March. All these measures appear to be patchwork measures. The chronic shortage of Indian currency from which Nepal has been suffering can be wiped out only by boosting exports to India. Besides, Nepal is also required to adopt a long-term policy on the judicious use of the huge foreign exchange reserves she has Accumulated. The dual exchange rate system must be under careful

vigilance since there is the dangerous possibility that Indian currency may be perchased and taken to India for buying dollars which in turn can be transferred elsewhere or registered in Nepal as export earnings. Such malpractices would result not only in a loss for Nepal in terms of every dollar under the dual exchange rate but also in Indian currency reserves which Nepal as badly needs.

The joint trade and transit treaty between Nepal and India which has recently come into force has great promises which should be harnessed carefully in order to reap fully the beneficial effects that are likely to follow. It spells out clearly India's desire to surrender residual colonial privileges and instead re-establish relations on the foundations of equality and goodwill. There has also been no attempt on the Indian side to inflate with exaggerated value and make the redressal of historical imbalances and then claim gratitude as reward for righting the wrong. The facilities to be provided by India to Nepalese exports of industrial goods would go a long way in bringing about a new dimension in Indo-Nepalese trade, provided, the impetus to industrialisation leads to immediate action on the Nepalese side. It is also likely that the long predominance of illegal trade along the border will be successfully countered resulting in trade gains for both the countries.