



# Impact of Exports, Imports, Foreign Direct Investment, and Government Expenditure on the Economic Growth of Nepal

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## Abstract

**Purpose:** Nepal is undergoing a phase of trade deficit as the economy is massively dependent on imports with few exports and insignificant foreign direct investment. This study was made to assess the impact of exports, imports, foreign direct investment, and government expenditure on the economic growth of Nepal and to determine the level of impact.

**Methodology:** The dependent variable was economic growth represented by gross domestic product and the independent variables were the exports, imports, foreign direct investments, and government expenditure. Data on dependent and independent variables were collected from secondary sources for the period 2000 to 2022. The collected data was analyzed in SPSS by employing the Ordinary Least Square method and Linear Regression. A regression model was formulated to explain economic development.

**Findings and Conclusion:** The analysis showed that exports have a significant impact on economic growth, however in the opposite direction. The foreign direct investment did not have any impact on the economic development of Nepal as the p-value was greater than 0.05, and government expenditure has a positive relationship with economic growth however the degree of association was not significant.

**Implications:** The findings of the research provide insights into the variables of economic development and may be referred to for crafting development strategies. The results emphasize the complex nature of factors influencing economic development, suggesting the need for policy interventions and further research to fully understand the dynamics at play. Future studies should consider including more variables in the model and analyzing the impact on economic growth to make the research more effective.

## 1. Introduction

Nepal is led to chronic trade deficits and the trade deficit as of November 2023 is recorded at NPR 117063.40 million. The foreign exchange reserve of Nepal as of mid-December 2023 is worth 11717.8 US dollars which is adequate to cover the import of merchandise and services only for 11.8 months. Nepal's export is scattered in 128 countries and territories, however, the exports to 15 countries uphold around 95.56 percent of total export for the fiscal year 2079/80. The exports of the country aggregate to NPR 200.03 billion and NPR 157.14 billion in the financial year 2079/80 and 2078/79 respectively (Department of Customs, 2022/23). Figure 1 shows the pattern of GDP and total exports of Nepal.

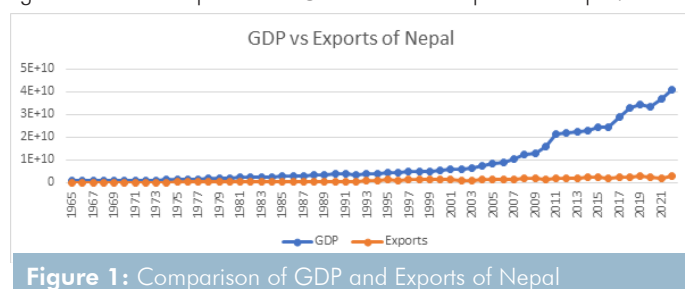


Figure 1: Comparison of GDP and Exports of Nepal



Note: Figure 1 shows trend line of GDP and total exports of Nepal for the period 1965 to 2022.

As per (Shrestha, 2023), Nepal's exports aggregated to NPR 157.140 billion in the financial year 2022/23 as compared to NPR 1.611 trillion worth of imports. The author stressed the need to enhance coordination between government agencies and the stakeholders by fostering domestic innovation and nurturing of productive businesses to increase competitiveness in the global marketplace.

Nepal as a developing country is dependent on agriculture and remittances which contribute to 31.7 percent and 9.1 percent of gross domestic products respectively. It has made substantial progress in economic growth after the economic liberalization since 1950s. Nepal develops a road map for economic development for five years of strategic planning. Nepal is relying on external assistance from developed countries and multilateral organizations such as the Asian Development Bank, the World Bank, and the UN Development Program, in the form of loans or grants. The major import and export partners of Nepal are India and China, which are the two neighboring countries however the volume of the imports surpasses the proceeds from the exports resulting in a negative balance of payments. For the alone financial year 2078/79 the total deficit in balance of payment recorded a high of NPR 1160.98 billion of which the deficit with India and China was worth NPR 864.017 billion. Nepal is open to foreign direct investment however the receipt of the foreign direct investment has also not been satisfactory and for the financial year 2078/79, it has succeeded in obtaining foreign direct investment of NPR 20.56 billion only. Nepal government expended NPR 1170.53 billion for the financial year 2078/79 out of the total revenue collected of NPR 1010.932 billion resulting in a budget deficit of NPR 159.59 billion.

A foreign exchange reserve is one of the fundamental reserves a country should park which facilitates international transactions, manages various economic challenges, and maintains stability in the local currency. Maintenance of foreign exchange reserves is a sign of the development stage of a country. Economies that can accumulate international reserves are in a better condition to maintain their status as developed countries while the countries having foreign currency reserves below average could not grow as desired due to its effect on the balance of payment (Canto & Andy, 2018). Exports viz., transfer of goods and services produced within the economy to other countries, are considered the oldest source of foreign exchange earnings. Imports, viz. bringing the goods and services from out of the country, have the effect of decreasing the foreign exchange reserves as payments outflow. Foreign direct investment, remittances, foreign assistance, and tourism also generate foreign exchanges (Kaphle, 2021). Exports ease the pressure on the balance of payments and create employment opportunities within the economy. Foreign exchange reserve positively impacts economic growth (Kruskovic & Maricic, 2015).

Under an export-led growth strategy, producers are provided with incentives through economic and government policies for exporting

their goods and services. It also aims to increase the capability of producing goods and services that can compete in the world market, to use advanced technology, and to provide foreign exchange needed to import capital goods. Exports provide opportunities for local traders to integrate their production into the world economy and reduce external shocks to the domestic economy (Abou-Stait F., 2005). Experiences of Asian and Latin American economies provide good examples of the importance of the export sector to economic growth and development, which led economists to stress the vital role of exports as the engine of economic growth.

An increase in imports hinders economic growth in the short run which however encourages local industries to innovate and restructure themselves to compete in the global arena. This catalyzes investments in new technologies, increases productive efficiency to compete with foreign rivals, and builds capacity for gathering foreign exchange (Kim et al., 2007).

Foreign direct investment is the investment made by firms operating in other countries that seek investment opportunities in the country in question. Foreign direct investment brings the necessary foreign exchange to fund its operation, which adds up to the foreign exchange reserve of the host country. It is generally believed that FDI results in capital accumulation and knowledge spillovers which leads to economic growth (Herzer et al., 2006).

Earlier studies establish the importance of macroeconomic factors such as exports, imports, foreign direct investment, and government expenditure on economic development however, less is explored in the context of Nepal. The impact of exports, imports, FDI, and government expenditure on economic growth may vary across countries, regions, and sectors due to differences in institutional frameworks, economic structures, and policy environments hence the contribution of these factors to the overall economic development of Nepal remains unknown. As economic development is dependent on these factors amongst numerous other factors, a study of the contributions of these factors in economic development will be an ice break to the policymakers and the government and a guiding tool for developing five-year strategies in the future.

The present research work aims to analyze the effect of exports, imports, foreign direct investment, and government expenditure on the financial growth of Nepal. The purpose is to describe the association between economic growth and exports by keeping the GDP as the dependent variable and export and government expenditure as the independent variables. The data for the study was collected from published statistics for the period 2000 to 2022 and the data analysis was made by using the OLS methodology.

The research questions are as follows:

Do macroeconomic factors such as exports, imports, and foreign direct investment have a relationship with economic development?

Can the government expenditure define the economic development?

What is the relationship between these variables and economic development?

## 2. Literature Review

### 2.1 Exports and Economic Growth

In a study on the applicability of export-led growth “ELG” in the context of Egypt by employing cointegration analysis, Granger causality tests, and unit root tests, coupled with vector autoregression (VAR) and impulse response function (IRF) analyses (Abou-Stait, 2005) revealed that export of goods is one of the important sources of economic growth. The authors further stressed the need to ensure quality and prices so that the product may be able to compete in the international market besides favorable government policies for stimulating exports.

An investigation on the validity of the ELG theory in five golf countries, Bahrain, Kuwait, Oman, Saudi Arabia, United Arab Emirates, (Kalaitzi & Chamberlain, 2020) reached diverse conclusions. In the case of Bahrain, results did not support the hypothesis that exports cause economic growth while in the case of other countries exports result in economic growth. Similarly, (Hogskolan i Halmstad, 2009) while studying the effects of exports on economic growth in Poland and Sweden, exports of Sweden had a positive effect on economic growth while the reverse was true in the context of Poland.

Many scholars viz., (Emery, 1967); (SANN, 2017); (Fosu, 1990); proves strong logical and empirical grounds supporting the view that rising exports lead to economic growth. The authors stress that emphasizing exports raises productivity as investment could be concentrated in more efficient sectors of the economy.

(Tivatyi et. al, 2022) failed to validate the export-led growth hypothesis for South Africa in the long run but provided support for the exports-led growth hypothesis in the short run. On examining the impact of international trade on the economic growth of Nigeria, Adeleye et al. (2015) concluded that export has a positive impact on economic growth in the long run.

### 2.2 Imports and Economic Growth

(Mishra, 2012)while examining the data on imports of India for the period 1970 to 2010 using the VAR model, concluded that there is a relationship between imports and economic growth in the long run. (Ali & Li, 2016) has the same finding in the case of Pakistan. The findings of (Velnampy.T, 2013) also show a significant impact of imports and exports on the economic growth in the context of Sri Lanka. (Kim et al., 2007) states that imports promote productivity to compete in the international market as advanced technologies are adopted which leads to economic growth in the long term.

(Bakari & Krit, 2017) on the other hand, has proved that economic growth is not dependent on imports in the case of Mauritania. The

findings of the research by (Millia et al., 2021) also concur with the view that imports affect economic growth negatively. Similarly, the Granger non-causality test performed by (Toda & Yamamoto, 1995) shows that there are no causal effects between imports and economic growth which proves that causality does not exist between imports and economic growth.

### 2.3 Foreign Direct Investment and Economic Growth

The studies exploring the relationship between FDI, and economic growth have been debatable in literature. (Akiri et al., 2016) used the data for 1981 to 2014 and applied VECM to determine a positive association of inward FDI in the economic growth of Nigeria. There is a significant endogenous relationship between FDI and economic growth and FDI promotes economic growth both directly and indirectly through its interaction terms (Li & Liu, 2005). FDI encourages the adoption of new technologies in the production process and stimulates the transfer of knowledge, which contributes directly or indirectly to economic growth (Mahembe & Odhiambo, 2014).

(Mamingi & Martin, 2018) analyzed the relationship between foreign direct investment and economic growth in OECS countries by using the generalized method of moments (GMM) model and concluded that FDI negatively affects growth in the short term and positively in the long term. (Herzer et al., 2006) find evidence of negative short-run effects but positive long-run effects in Columbia, Sri Lanka, and Egypt while having long-term effects of FDI in Ecuador. Likewise, (Carkovic & Levine, 2005)found that FDI does not exert a robust, positive impact on economic growth.

On the contrary in their study on the impact of FDI on growth using the time-series data for the period 1972–2011 in Bangladesh by applying a multiple regression model, (Tabassum & Ahmed, 2014) found FDI to be insignificant in influencing economic growth. (Borensztein et al., 1996) that FDI productivity is only true when the host country has a minimum threshold of human capital.

### 2.4 Government Expenditure and Economic Growth

The Keynesian economists argue that increasing the public expenditure results in economic growth. There is a positive and significant relationship between government expenditure and economic growth (Dhungel, 2022); (Gupta, 2018)and (Rahman, 2023).

(Sharma, 2012) posits that government expenditure is an important determinant of economic growth, however, the growth is further dependent on the effective use of capital expenditure, size, and spending capacity. In Nepal due to weak governance situation and political instability capital expenditure has not been able to influence economic growth.

Social expenditure may have a significant impact on growth in the short run, while infrastructure expenditure has less influence. Further current expenditure for productive purposes may exert a positive influence while capital expenditure in this sector exerts a negative influence. (International Monetary Fund, 1989). Recurrent expenditure of the government has a significant negative impact on economic growth while public capital expenditure has a positive impact on economic growth however the relationship is not significant. (Onifade et al., 2020)

The current research builds on the earlier studies made by (Kalaitzi & Chamberlain, 2020) and (Bakari & Krit, 2017). As economic development is a broad topic, multiple variables may be associated with it, however the variables stated in Table 1 have only been considered due to limitation of time and resources and based on a limited literature reviewed as addressed above.

**Table 1:** Variables based on Literature Review

Symbol	Description
GDP (USD Million)	Economic Growth/ Annual Real GDP
EXPORT (USD Million)	Exports made by Nepal
IMPORT (USD Million)	Imports made by Nepal
FDI (USD Million)	Foreign Direct Investments in Nepal
GOVT.EXP	Recurrent and Capital Expenditure made by Nepal Government

**Note:** Table 1 defines and describes the variables and the measurement scale.

The conceptual framework of the study is presented in Equation (i)

$$Y (EG) = \beta_0 + \beta_1(EXP) + \beta_2(IMP) + \beta_2(FDI) + \beta_2(GOVT.EXP) + e$$

.....Eq (i)

### 3. Methodology

Secondary research is useful to provide insights and to draw conclusions and is more cost effective than primary research. Thus, for this study, secondary data was collected for five macroeconomic variables from the official website of world Bank known as World Development Indicator (WDI) and Macrotrends.net, considering the major explanatory variables like exports, government expenditure, and GDP as dependent variable. As the ratio of the trade deficit

**Table 2:** Descriptive Statistics

	EG	EXP	IMP	FDI	GOVT.EXP
Mean	382,410.91	1,793.91	6,895.65	63.91	4,104.36
Std. Deviation	231,774.71	551.04	4,719.63	65.97	3,397.60
Minimum	103,256.00	990.00	1,720.00	-	747.30
Maximum	904,371.00	2,760.00	17,410.00	200.00	10,731.10

**Note:** Table 2 shows the descriptive statistics of economic growth, export, import, foreign direct investment, and government expenditure of Nepal

of Nepal started increasing after the financial year 2004/2005 (Ghimire, 2016), the data were collected for 22 annual years covering the period 2000 to 2022.

We have used "Economic Growth" represented by GDP as a dependent variable. Exports, Imports, Foreign Direct Investment and Government Expenditure are taken as independent variables.

Based on the review of the literature, we develop the following hypotheses:

- H1: Exports have a significant relationship with Economic Growth.
- H2: Imports have a significant relationship on Economic Growth.
- H3: Foreign Direct Investment has a significant relationship on Economic Growth.
- H4: Government Expenditure has a significant relationship on Economic Growth.

In this paper we aim to examine the effect of export and government spending in the economic growth of Nepal. Simple linear regression has been applied for identifying the significant importance of export, import, foreign direct investment (FDI), and government spending toward economic growth. To analyze the effect of exports on economic growth, the following regression equation is developed.

$$Y (EG) = \beta_0 + \beta_1(EXP) + \beta_2(IMP) + \beta_2(FDI) + \beta_2(GOVT.EXP) + e$$

Where,

EG = Economic Growth measured in terms of GDP of Nepal in different financial years

EXP= Export made by Nepal in different financial years

IMP= Import made by Nepal in different financial years

FDI= Foreign Direct Investment in Nepal

GOVT.EXP = Government expenditure of Nepal

$\beta_0, \beta_1$  and  $\beta_2$  = the regression coefficients

e = the error term

### 4. Results and Discussion

The following table shows the descriptive statistics of the variables over the period 2000 to 2022:

The result in Table 2 indicates the mean and standard deviation of the data points. The mean of economic growth is NPR 382410.91 million with standard deviation of 231774.71. The lowest mean is that of NPR 63.91 million in case of foreign direct investment

and it depicts that Nepal has not been able to bring foreign direct investment as anticipated.

Regression analysis was used to analyze the data and the regression model. The summary is presented in Table 3.

**Table 3:** Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.599 <sup>a</sup>	.359	.217	205119.444
a. Predictors: (Constant), GOVT.EXP,FDI,EXP,IMP				

**Note:** Table 3 shows the regression model summary

The R square of the model in Table 3 is 0.359 meaning that only 35.9% of the variations of gross domestic product is explainable by the variables in the model. Adjusted R square of was 0.217 meaning

that only 21.7% of variations could have been explained by the model had the sample been drawn from the whole population.

ANOVA table is presented in Table 4.

Table 4 ANOVA<sup>b</sup>

Model	Sum of Squares	df	Mean Square	F	Sig.
1. Regression	4.245	4	1.061	2.522	.077 <sup>a</sup>
Residual	7.573	18	4.027		
Total	1.182	22			
a. Predictors: (Constant), GOVT.EXP,FDI,EXP,IMP					

**Note:** Table 4 shows the ANOVA table

As presented in Table 4, the F-statistic value of 2.522 and p-value (sig) of 0.077 in the ANOVA table which indicates the model is not statistically significant and cannot be relied on to predict economic growth.

For analyzing the reason why, the model is not significant for predicting economic growth, we analyzed the VIF by the coefficient table in Table 5.

**Table 5:** Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics
		B	Std. Error	Beta			VIF
1	(Constant)	899601.478	230720.272		3.899	.001	
	EXPORTS	-.335.384	228.842	-.797	-1.466	.160	8.315
	IMPORTS	-11.276	70.472	-.230	-.160	.875	57.843
	FDI	-1594.473	1073.521	-.454	-1.485	.155	2.623
	GOVT.EXP	64.351	78.991	.943	.815	.426	37.663
a. Dependent Variable: GDP							

**Note:** Table 5 shows the Coefficient Table, t-value, level of significance and Variation Inflation Factor 'VIF'

On analyzing the coefficients value presented in Table 5, we noted that the VIF value of import and government expenditure was 57.843 and 37.663 and the values were greater than 10 hence we noted that the model suffered a problem of multicollinearity.

variable which has the greatest VIF value of 57.843, and reperformed the analysis.

The revised regression model is presented in Table 6.

(Francoeur, 2013) recommends that to minimize the problem of multicollinearity either the sample size must be increased or the variables having VIF greater than 10 must be excluded from the analysis. As the data for the earlier years were not readily available, considering the second condition above, we excluded the import

**Table 6:** Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.599 <sup>a</sup>	.358	.257	199790.537

a. Predictors: (Constant), GOVT.EXP,FDI,EXP

**Note:** Table 6 shows the regression model summary after excluding imports having VIF greater than 10 in the first analysis.

The R square of the model in Table 6 is 0.599 meaning that only 59.9% of the variations of gross domestic product is explainable by the variables in the model. Adjusted R square of was 0.257 meaning that only 25.7% of variations could have been explained by the

model had the sample been drawn from the whole population.

ANOVA table is presented in Table 7.

**Table 7:** ANOVA<sup>b</sup>

Model	Sum of Squares	df	Mean Square	F	Sig.
1. Regression	4.23	3	1.411	3.536	.035 <sup>a</sup>
Residual	7.58	19	3.992		
Total	1.18	22			

a. Predictors: (Constant), GOVT.EXP,FDI,EXP

**Note:** Table 7 shows the ANOVA table

As presented in Table 7, the F-statistic value of 3.536 and p-value (sig) of 0.035 in the ANOVA table which indicates the model is now statistically significant and can be relied on to predict economic growth.

The revised table of coefficients is presented in Table 8.

**Table 8:** Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics
		B	Std. Error	Beta			VIF
1	(Constant)	918715.030	192260.192		4.778	.000	
	EXPORTS	-362.957	146.662	-.863	-2.475	.023	3.600
	FDI	-1587.744	1044.829	-.452	-1.520	.145	2.619
	GOVT.EXP	52.697	29.772	.772	1.770	.093	5.639

a. Dependent Variable: GDP

**Note:** Table 8 shows the Coefficient Table, t-value, level of significance, and VIF.

Table 8 contains the results of the regression model in terms of standardized coefficients (Beta), t-values, and significant levels. It can be observed that exports were negatively correlated with GDP while the FDI and government expenditure were not significant for predicting the GDP. The significance level of the relationship is established by comparing the p-value with 0.005, if the p-value is less than 0.05, it denotes that the relationship is significant at 95% confidence level. We also examined tolerance value and the variance inflation factor (VIF) to investigate multicollinearity problems. Table 6 also presents the tolerance and the VIF values when all the independent variables are entered in the regression analysis. Results indicate that there were no multicollinearity problems among the explanatory variables.

From the regression model output in Table 7, the model is:

$$GDP = 918715.030 - 362.957(EXPORTS) - 1587.744(FDI) +$$

$$52.697(GOVT.EXP) + \epsilon_i$$

Based on the above analysis we now test the hypotheses as follows:

H1: Exports have a significant relationship with Economic Growth.

The results of the analysis show that economic growth is negatively related to exports as  $t = -0.2475$  and  $p < 0.05$ . The finding is unique for Nepal as prior research namely (Hogskolan i Halmstad, 2009); (SANN, 2017) proves a strong positive relationship between exports and economic growth in their research work. Hence, we confirm hypothesis 1 and conclude that exports impact economic growth however in the opposite direction. It may be because, in an import-based economy, an increase in exports leads to higher import demands, worsening the trade balance and thereby reducing economic growth.



H2: Imports have a significant relationship with Economic Growth.

Our study was unable to conclude on the relationship between imports and economic growth as the variable was dropped during the analysis due to multicollinearity problems.

H3: Foreign Direct Investment has a significant relationship with Economic Growth.

Our model concluded that there is no significant relationship between foreign direct investment and economic growth ( $t = -1.520$   $p < 0.145$ ). This finding is in line with the conclusion of (Tabassum & Ahmed, 2014) who argued that foreign direct investment is not an influencing factor for economic growth. This rejects hypothesis 3. The relevance of foreign direct investment in economic growth remains justified if the host countries remain politically stable and develop complementary policies. It may be because of political uncertainty in Nepal and inconsistency in the investment policies the potential impact of foreign direct investment is undermined.

H4: Government Expenditure has a significant relationship with Economic Growth.

No significant relationship was established between the foreign direct investment and economic growth as ( $t = 1.770$   $p < 0.093$ ). This finding confirms the result of the analysis by (Onifade et al., 2020) who posits that public capital expenditure positively impacts economic growth however there is an insignificant relationship. This also rejects hypothesis 4. The result may be due to inefficient government spending or diversion of expenditure towards unproductive sectors, leading to insignificant results in empirical studies.

## 5. Conclusions

The main objective of this study was to test the results of the earlier research findings on the impact of exports, imports, foreign direct investment, and government expenditure on economic development in Nepal. The study used data from 22 points gathered from secondary sources for the period of 2000 to 2022 to test the research hypotheses. The linear regression model was applied to ascertain the relationships between the dependent variable and the independent variables. The findings of the study provide direction for drafting the strategic five-year plan of the Nepal Government.

Based on the results of the study we can conclude that exports significantly impact economic development but in the opposite direction, foreign direct investment could not sustain the test of relationship with economic growth while the level of government expenditure positively impacted the economic growth however the extent of the relationship was not significant. These results emphasize the complex nature of factors influencing economic development, suggesting the need for policy interventions and further research to fully understand the dynamics at play.

## Suggestions

The study encountered the following limitations. The effects of other macroeconomic factors such as inflation, governance, customer price index, foreign employment, agriculture, etc. were overlooked in the study. Further, as the research was restricted to the analysis of gross domestic product as a priori of economic development, other relevant measures have not been considered.

Further studies should be undertaken to incorporate additional macro and micro economic variables for analyzing their impact on the gross domestic product and extend the current research by increasing the time frame of the data collected and taken for analysis.

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**Ethical Statement:** This research did not require ethical approval as it does not involve any human or animal experiment.

**Data Deposition:** The secondary data collected for the study have been used only for this research.

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