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Raj Kumar KC, PhD, Affiliated Honorary Research Fellow, Fil. Dr. Jan-U. Sandal Institute, Finstadjordet, Norway

ORCID ID: 0009-0003-3195-7921

e-mail: provost@janusandal.no

### Impact of Government Policy on Nepal's Foreign Trade and Its Causal Relationships with Poverty Alleviation

**Abstract. Introduction.** This study attempts to examine the impact of the government policy on Nepal's foreign trade and its causal relationship with poverty alleviation. It acknowledges that, like many developing nations, Nepal has been grappling with the challenges in aligning its policies with foreign trade to stimulate economic growth and reduce poverty.

**Purpose.** The study based on the literature review admits that an effective trade policy can significantly influence a country's exports, which ultimately contributes to poverty reduction by fostering entrepreneurial activities, increasing employment, and stimulating growth.

**Results.** The analysis focuses on key government initiatives, particularly the National Trade Integration Strategy (NTIS) - 2023, and examines historical and contemporary trade policies from 1991 to 2023.

The study is mainly focused on how the Trade Policy-2009 has contributed to the growth of export trade and the scale of poverty alleviation. It employs a mixed-methods approach with the blend of both qualitative and quantitative analyses of secondary data, policy documents, and stakeholders' perception.

The studies show that there is no significant difference between average GDP growth 'before and after the implementation of the Trade Policy-2009'. It provides insights into the relationships between the Trade Policy-2009, export trade, economic growth and the rate of poverty alleviation with targeted interventions to address structural barriers responsible for hindering export trade and slowing down the pace of poverty alleviation.

**Conclusions.** The study has triggered an urge for a policy review in the context of Nepal's WTO membership as well. In totality, this study seeks to generate awareness among policymakers and researchers about the Trade Policy-2009 and its impact on narrowing down the level of poverty.

**Keywords:** Foreign Trade; Government Policy; Poverty Alleviation; Nepal; Economic Growth; Trade Liberalization.

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Радж Кумар К.К., доктор філософії, почесний науковий співробітник, Інститут Яна-Урбана Сандала, Фінстадйордет, Норвегія

### Вплив державної політики на зовнішню торгівлю Непалу та її причинно-наслідкові зв'язки з боротьбою з бідністю

**Анотація.** У роботі досліджено вплив державної торговельної політики Непалу на розвиток зовнішньої торгівлі та зниження рівня бідності у 1991–2023 роках. Особливу увагу приділено Торговельній політиці 2009 року та Національній стратегії торговельної інтеграції (NTIS-2023). Використано змішаний методологічний підхід на основі аналізу політичних документів, статистики та оцінок зацікавлених сторін. Результати показали, що після впровадження Торговельної політики 2009 року не зафіксовано суттєвих змін у темпах зростання ВВП, проте виявлено її значення для стимулювання експорту, зайнятості та подолання структурних бар'єрів. Дослідження підкреслює необхідність перегляду торговельної політики в контексті членства Непалу в СОТ та орієнтується на підвищення обізнаності щодо її впливу на скорочення бідності.

**Ключові слова:** зовнішня торгівля; державна політика; подолання бідності; Непал; економічне зростання; лібералізація торгівлі.

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**Formulation of the problem.** Nepal, predominantly a landlocked country with an agrarian economy, has been

grappling with multiple challenges in leveraging its foreign trade as a tool for economic development. Undoubtedly, government policies play a vital role in shaping a country's trade dynamics. The relationships between government policy, foreign trade, and poverty alleviation in Nepal is a complex and multifaceted issue. As a developing country, Nepal's economic growth is significantly influenced by its trade policies, which in turn affect poverty levels [15].

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**Analysis of recent research and publications.** Nepal's foreign trade has been advancing from a limited engagement primarily with India and Tibet to a broader spectrum involving various global partners. It has further accelerated following Nepal's accession to the World Trade Organization (WTO) in 2004 [2].

In addition to that Nepal's entry into the South Asian Free Trade Area (SAFTA) and Bay of Bengal Initiatives for Multisectoral Technical and Economic Cooperation (BIMSTEC) has also contributed to Nepal's foreign trade. Studies reveal that since Nepal joined the WTO, BIMSTEC, and SAFTA, its overall trade volume has grown, accompanied by a rising share of imports. However, Nepal continues to face a persistent trade deficit, primarily due to low export performance (due to lack of export diversification – both in terms of product and destination) and high import reliance. The trade deficit has been exacerbated by the export of low-value raw materials and a lack of diversification in trade commodities and partners.

Nepal's economy is characterized by traditional agriculture, low value industries, and a significant reliance on remittances [5]. As far as the country's economy is concerned, agriculture still dominates other sectors and remains the backbone of Nepal's economy. Despite a declining share, agriculture still remains a vital sector in Nepal's economy, providing employment to a significant portion of the population and contributing to food security and rural livelihoods [12].

Improving agricultural productivity and diversifying into high-value crops could help increase agriculture's contribution to GDP in the coming years. The share of agriculture in GDP has been steadily declining over the years, from 30.3 percent in FY2013/14 to 24.1 percent in FY2022/23 [11].

According to Nepal Rastra Bank, the central bank in the country, a significant portion of Nepal's GDP, estimated at 30 percent, comes from remittances sent by Nepali workers abroad. The overall trend of this inflow as per the Central Bureau of Statistics (CBS, 2024) can also be taken as one of the crucial factors responsible for promoting household incomes and consumption, helping to alleviate poverty levels [4]. As far as the industrial sector is concerned it is relatively smaller and its contribution to the GDP was approximately 13.45 percent in 2023 year.

By all accounts the contribution of trade to Nepal's GDP is approximately 42 percent. It is the sum of exports and imports of goods and services. This trade-to-GDP ratio indicates a relatively high level of openness to international trade, which is crucial for a landlocked country like Nepal that relies on imports for many essential goods and services while also seeking to expand its export markets [2].

The size of import trade has been continuously increasing with more concentration on India followed by China. Nepal has implemented various policies to promote exports, but there has been a limited success in diversifying exports (both in terms of product and

destination) and increasing competitiveness. The major policy reforms that the Nepalese government adopted were Trade Liberalization Policy, Tariff Structure, Foreign Investment Policy, and Trade Facilitation Policy [17].

**Trade Liberalization Policy-** Nepal has adopted a 'highly' liberalized trade policy since the 1990s, removing non-tariff barriers and complying with WTO rules [11]. However, the policy has not been very effective in improving trade competitiveness. Measures to identify new exportable products and diversify markets were not properly executed because of political instability and lack of public private partnership [8].

**Tariff Structure-** According to Nepal Chamber of Commerce, Nepal's tariff code remains complex, with high tariffs on 'key intermediate inputs' required by exporters. For example, pashmina producers pay a five percent tariff on imported yarn, hurting their competitiveness. Exporters adding value through packaging and branding face even higher tariffs. Tea producers pay 36 percent tariffs plus VAT on imported filter bags.

**Foreign Investment Policy-** So far as the Foreign Investment Policy is concerned, FDI inflows into Nepal are less than one percent of GDP, which is deemed to be much lower by international standards. Restrictive policies include sector caps on foreign ownership, a long list of prohibited activities for FDI, and lengthy processes to repatriate funds and hire foreign workers [18].

Yet other issues that have impacted Nepal's export trade are the lack of competition in services sectors. Lack of competition in crucial services sectors like transport, logistics and telecom increases production costs for exporters. Transport costs account for a third of total costs for some agricultural exporters [20]. To overcome the challenges, Nepal government brought forth a number of trade facilitation measures by simplifying the procedures and reduce transit costs to remove critical behind-the-border constraints on trade.

Despite the government's efforts to liberalize the trade regime, the policy framework has not been effective in boosting export competitiveness [16]. Restrictive tariffs, investment policies, lack of competition, and trade facilitation issues continue to hamper export growth and diversification. A more comprehensive 21st century trade policy is needed to help Nepalese exporters better integrate into global value chains and markets [12].

**Formulation of research goals.** What relationships does government policy have with exports and poverty alleviation? The objectives of the study are to assess the impact of policy on exports and its poverty alleviation.

**Outline of the main research material.** The impact of government policy on Nepal's foreign trade and its relationship with poverty alleviation is a multifaceted issue that encompasses trade liberalization, tariff structures, foreign direct investment (FDI) policies, and broader economic conditions. This literature review tries to synthesize key findings from various studies and reports to provide a comprehensive overview of this topic.

Research Hypotheses

#### Hypothesis 1: Government Policy and Export Trade Performance

H1: It is assumed that there is a positive relationship between the government trade policies and export trade performance.

#### Hypothesis 2: Export Performance and Poverty Alleviation

H2: Improvement in exports performance leads to a reduction in poverty.

Research Design

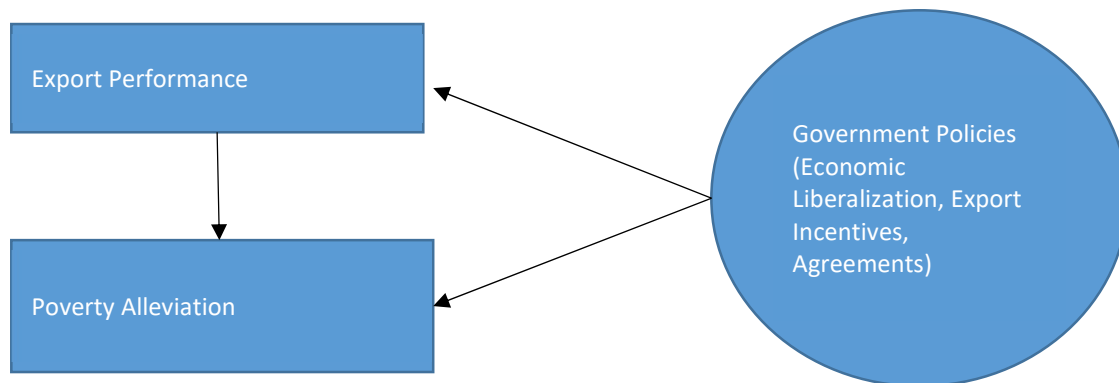


Figure 1 – Trade Liberalization and Policy Framework

Since the early 1990s, Nepal has adopted a liberal economic policy with the aim of integrating into the global economy. This shift has included the removal of non-tariff barriers and significant reduction of import tariffs [2]. However, the outcome of these policies was found to be mixed because of poor implementation caused by the lack of commitment from both public and private sectors [1].

Liberalization has facilitated some growth in trade volume; it has not significantly diversified Nepal's export base or improved competitiveness in international markets [14]. The majority of Nepal's exports remain concentrated in low-value commodities, such as agricultural products and textiles, primarily directed towards neighboring countries like India and China [13].

#### Tariff Structures and Trade Costs

High tariffs on essential intermediate goods have been identified as a barrier to enhancing Nepal's export competitiveness. For example, pashmina producers face a five percent tariff on imported yarn, while tea producers encounter tariffs as high as 36 percent on packaging materials. Based on the statistics, the costs diminish the profitability of domestic production, making it more challenging for the Nepalese firms to compete effectively in global markets. Furthermore, the complexity of the tariff code and the high cost of logistics due to inadequate infrastructure exacerbate the situation, leading to increased production costs and a growing trade deficit.

Another important component that works as an engine of trade is foreign direct investment. FDI plays a crucial role in enhancing trade and economic growth. However, Nepal's FDI inflows are remarkably low, accounting for less than one percent of GDP [5]. This can be attributed to restrictive policies, including ownership caps and lengthy bureaucratic processes that deter foreign investors. It is obvious that the dearth of FDI limits the transfer of technology and knowledge that could

bolster local industries and improve export capabilities. It is said that a conducive investment climate is essential for promoting domestic firms' growth and enhancing their competitiveness in international markets.

#### Relationship with Poverty Alleviation

The relationship between foreign trade and poverty alleviation in Nepal is one of the complex issues in the Nepalese economy. While increased trade can potentially lead to economic growth and job creation, the current structure of Nepal's trade does not significantly benefit the poor [22]. The reliance on low-value exports and the concentration of trade with a limited number of partners restrict opportunities for broader economic participation. Moreover, the trade deficit, aggravated by high import reliance, undermines economic stability and can impede poverty reduction efforts [13].

#### Political Instability and Economic Impact

Like other South Asian nations Nepal has not remained aloof from the perennial political instability. Political instability has not only impaired governance, but also affected the implementation of economic policies, leading to policy failure causing the disruption on trade and investment. Events such as strikes, political unrest, and the COVID-19 pandemic have further complicated trade dynamics, impacting income levels and market competitiveness. This instability can hinder long-term economic planning necessary for sustainable poverty alleviation strategies.

Trade Policy-2015 started embracing the policy of economic liberalization with the restoration of democracy in 1990 providing a much space for the openness of trade. Since then, Nepal's trade policy has been more open and market oriented. The country's trade policy aims to promote trade and increase exports to reduce the trade deficit [8].

Following Nepal's entry into the WTO in 2004, the first Diagnostic Trade Integration Studies (DTIS) was conducted. Nepal Trade and Competitiveness Study (NTCS) was the first study carried out to streamline Nepal's trade. Based on the outcome of Nepal developed the NTIS 2010 with 12 goods and seven services as priority (MoICS, 2023). The NTIS-2016 was created after six years and adopted by analyzing and addressing the challenges and lessons learned from previous strategies. Although the NTIS is reviewed every five years, the new NTIS-2023

was developed after a seven-year gap mainly because of political instability and frequent changes in the government. Following the restoration of democracy in 1990, Nepal initiated trade liberalization policies with the view to making it more compatible with the WTO rules. Obtaining WTO membership in 2004, the process of trade policy review began in 2012 [2]. Some of the major policy departures that have taken place in different period of time have largely contributed to the country's foreign trade domain and are given below.

1990/91:	Nepal liberalized its trade and industrial policies, and reduced import duties.
2004:	Nepal's Accession to the World Trade Organization (WTO).
2012:	Nepal's first Trade Policy Review began.
2014:	The New Trade Policy came into being.
2015:	Nepal adopted a new Trade Policy to promote trade and make it internationally competitive.
2016:	Nepal implemented the National Trade Integration Strategy (NTIS) to increase trade competitiveness.
2018:	Nepal completed its second Trade Policy Review.
2023:	Fourth Nepal Trade Integration Strategy (NTIS)

Figure 2 – Trades overview

Source: MoICS

NTIS-2023 and Poverty Alleviation - The Ministry of Industries, Commerce, and Supplies (MoICS) announced the fourth Nepal Trade Integration Strategy-2023 to be implemented for five years starting from 2023 AD to 2028 AD. NTIS-2023 is interconnected initiative aimed at fostering economic growth and reducing poverty. So far as the NTIS-2023 and poverty alleviation are concerned, it seems to be mainly focused on poverty alleviation.

The NTIS-2023 is a strategic framework designed to enhance Nepal's trade competitiveness and economic integration, which can further contribute to poverty alleviation by creating jobs and boosting economic activities. In this regard, Pazzini, Reyes and Varela [14] in their Policy Net-4 entitled "From Evidence to Policy: Supporting Nepal's Trade Integration Strategy" have outlined that the NTIS aims to enhance Nepal's trade competitiveness by addressing issues such as transport, access to finance, and export diversification. This strategy is crucial for creating jobs and reducing reliance on remittances, which have led to real exchange rate appreciation and affected export competitiveness [1].

This strategy according to the MoICS was formulated mainly with the view of addressing the issues of broad-based sustainable development through trade and facilitate Nepal's graduation from LDC status to a middle-income developing country in 2026.

#### Theoretical Review

As far as the issue relating to the impact of policy on exports and poverty is concerned, along with Ricardo's Comparative Advantage Theory (David Ricardo, 1817), H-O Theory, there are other trade theories that examine how opening up an economy to trade can lead to economic growth through improved efficiency,

technology transfer, and competition and ultimately contribute poverty alleviation.

Trade policies have a bigger role in promoting exports that enable firms to access larger markets, achieve economies of scale, and boost national income which ultimately fund poverty reduction efforts, Krugman (1980) [10]. In New Trade Theory Krugman (1980) [10] has laid emphasis on economies of scale for development through trade. Krueger (1998) [8] and Bhagwati (2002) [3] can be cited for having "trickledown effect" to stimulate growth for poverty reduction. However, critics have come up with the view that trade liberalization can widen inequality in the absence of complementary policies. The Stolper-Samuelson Theorem (1941) [21], a major contribution in international trade theory based on the Heckscher-Ohlin model, emphasizes that trade liberalization increases the real income of the owners of a country's abundant factor of production and decreases the real income of the owners of its scarce factor. Empirical studies, of Topalova (2006, 2010) [23] and Helpman et al. (2017), [7] used real-world data to show that trade liberalization often increased inequality, challenging earlier theoretical predictions. In this regard, Sharma (2014) [18] mentioned that trade liberalization in Nepal's case particularly after 1900 is responsible for augmenting inequality. The implementation of new trade policies in recent years has widened the gap between rich and poor [19].

In the same way Structural Change Theory argues that trade policies encourage export diversification and shift resources to more productive sectors, leading to economic growth and poverty alleviation. On the other hand, Lewis Model explains how trade policies promoting industrial exports create opportunities for rural workers

to move to higher-paying jobs in urban areas, reducing poverty over time.

This section outlines the research design and methods used to analyze the impact of government policies on Nepal's foreign trade and their relationship with poverty alleviation.

#### Impact of Trade Policy 2011 on Export Promotion

Data is collected from 1990/1991 to 2023/24. The Trade Policy 2011 captures the trade of 20 years, whereas trade after 2011 covers the period 14 years. Mean export growth before the trade policy is 12.8 percent. The Mean export growth after the trade policy is 8.32 percent, which indicates the growth in exports.

Table 1 **Descriptive of Export Growth**

Category	Group	N	Mean	Median	SD	SE
X_G	1	20	12.8	10.3	21.8	4.88
	2	14	8.32	4.98	19.2	5.12

Levene's Test.

Table 2 **Homogeneity of Variances Test (Levine's)**

Category	F	Df	Df2	p
X_G	0.001	1	32	0.923

*Note.* A low p-value suggests a violation of the assumption of equal variances

Table 2 above shows the homogeneity of variances test. The F-stat is 0.010, and the corresponding p-value is 0.923 ( $p > 0.10$ ). Since the p-value  $> 0.10$ , the t-statistic is not significant even at a 10 percent level of significance.

Thus, variances are equal and suggested to apply student's t test. Hypothesis 1 (H1): There is a significant impact of trade policy on Export Growth (X\_G).

Table 3 **Independent Samples T-Test**

		Statistic	df	p
X_G	Student's t-test	0.621	32	0.539

*Note.*  $H_a: \mu_1 \neq \mu_2$

Table 3 above shows the picture of an independent sample t-test. The value of the t-statistics is 0.621 with a degree of freedom (df) is 32. The corresponding p-value is 0.539, which is greater than 0.10. Since the p-value  $> 0.10$ , the t-statistic is not significant even at a 10 percent level

of significance. So, Hypothesis 1 cannot be accepted. It implies that there is no significant impact of trade policy on Export Growth (X\_G) over the period.

#### Impact of Trade Policy 2011 on poverty alleviation.

Table 4 **Group Descriptive of Poverty Reduction Rate**

	Group	N	Mean	Median	SD	SE
Poverty_Reduction_Rate	1	20	-3.28	-3.71	0.865	0.193
	2	14	-1.86	-1.78	0.290	0.078

Table 4 illustrates the descriptive statistics of the poverty reduction rate. The average poverty reduction

rate before the Trade policy 2011 is -3.28 percent, but after is -1.78 percent.

Table 5 **Homogeneity of Variances Test (Levene's)**

	F	df	df2	p
Poverty_Reduction_Rate	5.63	1	32	0.024

*Note.* A low p-value suggests a violation of the assumption of equal variances

Table 5 above shows the homogeneity of variances test before and after implementation of Trade Policy 2011 on poverty alleviation. The F-stat is 5.63 and the corresponding p-value is 0.024 ( $p < 0.05$ ). Since the p-value  $< 0.05$ , the t-statistics are significant even at 5 percent

level of significance. Thus, variances are not equal and suggested to apply Walch's t test.

There is a significant impact of trade policy on poverty reduction rate.

Table 6 Independent Samples T-Test

		Statistic	df	p
Poverty_Reduction_Rate	Welch's t	-6.78	24.7	<.001

Note.  $H_0: \mu_1 = \mu_2$

Table 6 above shows the scene of independent sample t-test on poverty reduction rate. The value of Welch's t-statistics is -6.78 with degree of freedom (df) is 24.7. The corresponding p-values are less than 0.001. Since the p-value  $< 0.001$ , the t-statistic is significant at 0.1 percent level of significance. So, Hypothesis-2 is accepted. It implies that there is a significant impact of trade policy on poverty reduction rate over the period.

**Conclusions.** Based on the above analysis it can be stated that the magnitude of poverty reduction following the trade liberalization and with the implementation of trade policy is slower in comparison to the implementation of trade policy. There has been a reduction in poverty following the implementation of Trade Liberalization, but the speed has been much slower, triggering inequality. This shows that the Trade Policy being formulated on the ground of trade liberalization has had little or no impact on promoting exports thereby reducing poverty.

According to experts and business leaders who were involved in the discussion on the 'Impact of government policy on trade and Poverty', experts and business leaders are literally not satisfied with what Trade Policies and even NTIS-2016 and NTIS-2023 were supposed to deliver for the reduction of poverty through trade; specially

through export trade based on production and manufacturing activities. However, based on the analysis, it can be affirmed that only a handful of people, especially importers, are reaping benefits in the name of trade. Inconsistencies are taking place between the policies and practices.

A number of theories about how the government policy impacts a country's foreign trade have been propounded so far. David Ricardo's Comparative Advantage Theory, Hecksher Ohlin Theory, has also emphasized the role of trade in minimizing poverty.

The government policy has an impact on trade, and it ultimately impacts poverty alleviation. As far as the impact of policy on trade and poverty alleviation in Nepal is concerned; the trade policy, NTIS following the trade liberalization in 1991 has impacted both trade (both export and import) and poverty alleviation. However, the interesting thing here is that the pace of poverty reduction has been much slower in the aftermath of trade liberalization prompting inequality in society. Hence, based on the empirical results and the qualitative observations, a conclusion can be drawn that trade liberalization has not been effective to stimulate sustainable development and poverty alleviation.

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