

# **Foreign Exchange Management, Regulation and External Payment Processes in Nepal\***

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# I. Close vs. Open Economy:

- Nepal has always remained an open economy.
- Kirat, Lichchhavi, Malla, Kautilya's Artha Shastra.
- An entrepot trade between British, India and Tibet.
- Sugauli Treaty, various Treaties on Trade and Transit between Nepal and India, Regional Trade Agreements (RTA), Bilateral Trade Agreements (BTA), Multilateral Trade Agreements (MTA)

# Share of International Trade in Goods and Services in GDP (%)

	2001	2006	2011
Exports	22.6	13.5	8.7
Imports	33.2	31.3	32.2
Total	55.6	44.8	40.9

**Source: Economy Survey, 2010/11, Table 1.12, Page 20**

# II. What is an Exchange Rate ?

- Exchange rate is the price of:
  - foreign currency in terms of domestic currency  
eg. one Indian Rupee=Nepali Rupee 1.60  
one US Dollar=Nepali Rupee 78.75
  - or
  - domestic currency in terms of foreign currency  
eg. one Nepali Rupee=0.625 Indian Rupee  
one Nepali Rupee=0.0127 US Dollar
- Exchange rate is the price of foreign currency as (a) consumer price is the price of goods and services, (b) wage rate is the price of labor, and (c) interest rate is the price of capital
- What determines the exchange rate of Nepali currency
  - Demand for and supply of foreign exchange

# Demand for foreign exchange

1. Import of merchandise and services  
(education, health, travel abroad, cost of diplomatic missions abroad)
2. Amortization of principal and interest on foreign loans
3. Miscellaneous

# Supply of foreign exchange

1. Workers' remittances and pensions
2. Exports of goods and services (incl. tourism)
3. Expenses in Nepal by foreign diplomatic missions, INGOs and charity organizations
4. Foreign Aid
5. Interest on investment abroad
6. FDI's
7. Miscellaneous

# Nepal's BOP (in Million Rs)

	2001	2006	2010
Current Account	20148.5	14224.5	-28135.2
Capital Account	6173.1	3107.0	12578.3
Financial Account*	-28522.2	-1324.5	5898.2
Overall BOP	5221.4	25597.8	-3630.5

**\*FDIs, Trade Credits, Loans, Currency and Deposits**

**Source: opcit, Table 6.9 (B) Page 115**

# III. Types of foreign exchange regime

- Fixed vs floating, managed floating
- Purchasing power parity
- Currency board
- Various others

(Talk of current Euro-zone Crisis)



## **IV. Why is foreign exchange rate important ?**

The exchange rate impacts on

- BOP thru X and M of goods, services and investments
- Global competitiveness of domestic products, particularly of tradables
- Inflation

# V. Foreign Exchange Rate and Regime of Nepal

- Printing of currency notes 1945
- Freely floating vs IC until the establishment of NRB in 1957
- Dual currency in circulation until the promulgation of Foreign Exchange Regulation Act in May 1962, and enforcement of Foreign Exchange Regulations in September 1963
- So far there have been two amendments in FERA, the latest being on July 2002; and four amendments in Regulations, and the latest being on October 1994
- The FERA and NRB Acts and Foreign Exchange Regulations are the principal instruments of foreign exchange management in Nepal, and the NRB is the principal agency to regulate foreign exchange
- Until 1960, all of Nepal's foreign exchange used to be placed with RBI.

# VI. Some more on foreign exchange regime

- In the late 1960s, Nepal adopted Exporters Exchange Entitlement scheme. It was popularly known as Bonus Voucher, under which exporters were given certain fraction of export earnings for import. The purpose was to promote exports and diversify international trade. This was abandoned after the carpet over invoicing scandal of late 1970s.
- The EEE was replaced by dual exchange rate under which all earnings from third country exports were exchanged at the second rate which was one-third higher than the basic rates. All imports except essential ones, had to exchange foreign currency at a higher rate.
- For about two years from 1983, NPR was pegged to US\$ and IC was replaced by the basket of currency system.
- For the rest of the period NPR has remained pegged to the IC at the following rates.

# For the 48 years (1965-2012) following rates per Indian Rupee

1966 and 1967 (2 years)	1.02
1968-1971 (4 years)	1.35
1972-1977 (6 years)	1.39
1978-1985 (8 years)	1.45
1986-1990 (5 years)	1.68
1991-1992 (2 years)	1.65
For the remaining 21 years	1.60

**Source: NRB, QEB, July 2009; Table 70, Page 97**

# VII. Liberalization Endeavours

- External sector was the first candidate to be liberalization in the mid-1980s; when except a few (national security and public health related), import controls and licensing was replaced by import auction.
- By the early 1990s, except contraband items all exports and imports were put under OGL.
- On February 1993, Nepali rupee was made fully convertible on current account (except for gold and silver).
- Capital account remains regulated.

# VII. Liberalization Endeavours

- The 2011/12 Monetary Policy has allowed domestic banks (a) to lend in foreign currency in hydropower and (b) to invest in instruments denominated in foreign currency with prior approval from the NRB.
- Equivalent of upto US\$ 1,000 in foreign currency received from relatives and friends resident overseas, and tips received from tourists can be easily exchanged just by showing ID.
- The exchange facility for travelling to third countries has been raised from (a) US\$ 2,000 to 2,500 for one visit, and (b) from US\$ 4,000 to 5,000 per year.
- NRN can open foreign currency account in Nepal.

# VIII. Some Other Issues

- Three type of trading arrangement with India:
  - DRP
  - Payment of convertible currency
  - Border
    - gives scope for arbitrage
- Payment to IOC in Indian currency
- Open border problem
- Refusal by Chinese banks and traders to channelize trade through L/C
- Attack on our forex reserves by fake transactions
- Reluctance of Nepali banks to exchange Indian rupee
- Import and manufacture of fake IC
- Problems created by illegalization of IC 500 an 1,000 denomination currency notes outside of India by the GOI
- Problems in getting remittances from India

**Thank You**