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Migration as a Possible Substitute for Foreign Direct Investment – The Case of Nepal

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Abstract

In this globalized world, Foreign Direct Investment (FDI) and international migration are two vital external factors shaping a country's economy. FDI is believed to offer several benefits to developing countries such as addition to the capital stock; transfer of expert technology, knowledge and skills; enhancement of productivity of domestic firms; and creation of export markets. In the South Asia region, Nepal has comparatively lagged behind in attracting FDI, which contributes to just over 2 percent of its GDP. This is in sharp contrast to Nepal's engagement in international migration, the remittances from which constitute 25 percent of its GDP. Considering the high level of migration and the low level of FDI in Nepal, it is important to understand if these two phenomena are related. Using data from existing literature, this study suggests that migration is a key factor responsible for Nepal's inability in attracting FDI. Migration acts as a substitute for FDI in Nepal through five channels: by creating labour shortages; by raising labour costs; by creating a dearth of skilled human capital; by encouraging policy laxity; and by deteriorating institutional quality.

Introduction

In this globalized world, Foreign Direct Investment (FDI) and international migration are two vital external factors shaping a country's economy. They constantly work towards integrating a country into the world economy. Statistics show that there has been an upward trend, globally, in FDI inflows and migration in the last two decades. The world FDI inflows have increased sevenfold from 1990 to 2012 (US$ 200 billion to US$ 1351 billion) (UNCTAD, 2013b) and the world's inward FDI stock stood at about US$ 23 trillion in 2012 (UNCTAD, 2013d). Similarly, the number of international migrants has almost doubled from 154 million in 1990 to 232 million in 2013 (UNDESA-OECD, 2013). And the remittances resulting to developing countries from work related migration have increased five fold from 2000 to 2013 (from US $81 billion to around US $414 billion[2]) (World Bank, 2011b; World Bank, 2013b).

FDI is believed to offer several benefits to developing countries such as addition to the capital stock; transfer of expert technology, knowledge and skills; enhancement of productivity of domestic firms; creation of export markets; etc. that can contribute to the economic growth of the host country (Savant et al., 1993). These positive effects are the

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2 An estimated figure for 2013 by World Bank (2013b).

reason why many developing countries have been competing to attract FDI (Kok & Ersoy, 2009). The last two decades have seen a dramatic rise in the share of global FDI received by developing countries. In 1990, developing countries attracted 16.7 percent of global FDI but in 2012 the share more than tripled to 52 percent of global FDI inflows (UNCTAD, 2013b). However, these FDI inflows have been directed towards only a limited set of countries. For example, in Asia, most of the FDI has been attracted by three countries – China (30 percent), Singapore (14 percent) and India (6 percent) (UNCTAD, 2013b). In contrast, Nepal got a meager share of 0.02 percent of total FDI inflows to Asia in 2012. According to the World Investment Report (2012), Nepal is one of the worst performers in the world in terms of its ability to attract FDI, with a rank of 175 out of a total of 182 countries (Adhikari & Sijapati, 2012). Similarly, in the inward FDI Potential Index, Nepal is ranked 150.

There is longstanding literature analyzing the effect of various factors on FDI. These determinants include political instability (Bennett and Green, 1972; Azzimonti and Sarte, 2007), growth rate (Mottaleb, 2007; Culem, 1988), taxes (Cassou, 1997; Hines and Rice, 1994), market size (Tsai, 1994), etc. However, the literature examining migration as a potential determinant of FDI is fairly recent. Most of the literature on this subject looks at migration and FDI as being either substitute for or complement to each other. When both are substitutes, one phenomenon leads to the discouragement of the other, thereby decreasing the incentive for it. On the other hand, when both phenomena are complements to each other, one phenomenon facilitates the other.

In their study of 55 countries (excluding Nepal), Kugler and Rapoport (2007) concluded that there is contemporaneous substitutability as well as dynamic complementarity between migration (to the US) and inward FDI (from the US). Gheasi et al (2013) found complementary effects of migration from 27 countries (excluding Nepal) to the UK on inward FDI to those countries from the UK by using data from 2001 to 2007. While these are broad studies that examined the relationship between migration and FDI using data from multiple countries, there have been very few studies that have focused on a specific country. For instance, in a case study of Mexico, Aroca and Maloney (2005) have found a relationship of substitutability between migration and FDI. Christova-Balkanska (2011) argues that a relationship of complementarity exists between migration and inward FDI in the case of Bulgaria. The scarceness of country-specific studies is surprising given the influence these studies can have on policy decisions.

In the case of Nepal, both migration and FDI have been issues of concern, independently, over the last two decades. On the one hand, Nepal is experiencing large scale migration with almost 50 percent of the Nepali households having either a migrant living overseas or a returnee (World Bank, 2011a). The rise in work related migration in the last decade has also led to increasing remittances. According to the World bank (2013a), Nepal ranks third in terms of the amount of remittance received (as a share of GDP). On the other hand, compared to other South Asian countries, Nepal is far behind in attracting FDI. In terms of FDI inflow, Nepal is one of the two worst performers in South Asia (the other being Bhutan) (UNCTAD, 2013b). Comparing FDI inflow to remittances, we can perceive a sharp contrast: the FDI received by Nepal is only around 2 percent of the total remittances from migration (UNCTAD, 2013b; World Bank, 2013a).

Considering the high level of migration and the low level of FDI in Nepal, it is important to understand if these two phenomena are related, especially given the attention this relationship has received in the international context. This study provides a preliminary investigation into the relationship between migration from Nepal and FDI into Nepal using

data from existing literature. Specifically, this study attempts to examine the possible ways in which migration can explain, in part, Nepal's inability to attract FDI by acting as a substitute for FDI, that is, by leading to the discouragement of FDI. Since there has been no study examining this relationship in the context of Nepal, this study can pave the way for further research in this direction.

The paper is structured as follows. The second section presents a brief history as well as the current scenario of migration from Nepal. It also discusses the effect of migration on Nepal's economy. The third section details the trend of FDI into Nepal and highlights its effect on Nepal's economy. The fourth section connects migration and FDI by examining the possible ways in which migration can act as a substitute for FDI. This section suggests five different channels through which migration discourages FDI in the case of Nepal. The fifth and final section concludes the paper with a discussion of possible policy implications.

Migration and Nepal's Economy

Migration from Nepal

Migration from Nepal has been going on for at least two centuries. The signing of 1815 treaty between Amar Singh Thapa and British General David Ochterlony (in India) after the Anglo-Nepal war of 1814-15 enabled Nepali men to join the armed forces of the British India (Kansakar, 1984). Lured by this employment opportunity coupled with the close physical proximity with India, several Nepali men, along with their families, began to settle in India and serve in the army. As the Nepali soldiers' community grew, British India attracted many more Nepali migrants, not only as soldiers, but also as workers in other fields, such as the construction sector, tea plantations, etc. (Seddon, 2005). After India got its independence in 1947, Nepali migrants continued to serve in the Indian army. Nepali emigration to India seems to have been further stimulated by the 1950 Indo-Nepal Peace and Friendship Treaty that made it easier for people to move between the two countries as no legal documents (for e.g. passports, visas) were required to cross borders.

While Nepali migration till the early 1980s was predominantly to India,[3] with the enactment of Foreign Employment Act in 1985, Nepali migration took a sharp turn to other countries. This act established provisions for Nepalis to secure employment in countries other than India. Furthermore, in 1990, Nepal saw a change in its political system with the establishment of a constitutional democracy. The resulting change in the administrative structure allowed passports to be issued in the district headquarters so that people did not need to travel to the capital city (Sijapati & Limbu, 2012). This facility and other liberal international travel policies made it easier for people to migrate to countries other than India.

After the passage of 1985 Act, Nepali migrants initially opted for employment in South-East and East Asia. However, the mid 1990s saw a shift in emigration to Gulf countries, a change that could be attributed primarily to their burgeoning economies and high demand for cheap labour (KC, 2008). By 2002, Gulf countries had emerged as the most preferred destination for work (excluding India) and a significant number of Nepalis had migrated to Southeast Asia, East Asia, Europe and North America (Nepal Institute of Development Studies as cited in Seddon, 2005). Since 2001, Malaysia too has attracted a huge number of Nepali migrants as it made it legal for Nepalese to be employed there (Seddon, 2005).

3 According to the 1981 Nepal Census, 93 percent of the total migrants from Nepal were in India (as cited in Sijapati & Limbu, 2012).

Presently, Gulf countries and Malaysia are the most attractive destinations, after India, for employment, accounting for 24 percent of the total work related migration from Nepal[4] (NIDS & NCCR, 2012 as cited in Jones & Basnett, 2013).

Apart from the increase in migration to the above mentioned countries, the overall (official) work related migration trend has also shown a steady rise in the last two decades. There was a steep increase in migration during 1996/97 that coincided with the beginning of the People's War. The political and economic instability that resulted from the war could account for this increase. Migration has been continuing unabated since then. The only notable exception was a decline in 2008/09, which can be attributed to the Great Recession. Overall, the number of migrants increased from 3000 in 1994 to around 400,000 in 2012 , with Qatar and Malaysia as top destinations (DoFE, 2013). Economic reasons such as poverty and lack of appropriate employment opportunities are driving people away from their home country. At the same time, higher pay and high demand for labour in the receiving countries are also attracting migrants. According to the latest estimates provided by the Department of Foreign Employment (DoFE) in 2013, around 1500 people leave Nepal each day for work abroad (UNCTN, 2013). This figure is an underestimate for total work related migration from Nepal as it does not take the emigration to India into consideration. The migration to India is largely undocumented because there are no legal formalities that the migrants have to undergo to enter India. It is estimated that there are more than 2.8 million Nepali work migrants residing in India (NIDS & NCCR, 2012 as cited in Jones and Basnett, 2013). There is another reason why the figures provided by DoFE does not reflect the true scenario of migration. DoFE keeps count of migrants who go through formal channels, that is, they have the official permission to be employed overseas. But these figures do not include the migrants that use informal channels to go overseas. Sharma (2008) conjectures that if the informal channels are included, the total migrants actually leaving for overseas would be double the numbers provided by DoFE.

Migration destinations vary according to the skill level of the migrants. For example, unskilled migrants mostly head to developing countries such as India,[5] GCC countries and Malaysia (Bhattrai, 2007). These migrants are usually employed in construction sector, hotel or catering industry and domestic services (World Bank, 2011a). Skilled migrants, on the other hand, mostly prefer to go to developed countries such as Japan, the USA and the UK (Sharma, 2008). For instance, a study by Phuyel (2013) found that migrant doctors from Nepal mostly go to the USA and the UK.

Effect of Migration on Nepal's Economy

The most pronounced effect of international migration on Nepal's economy is through remittances[6]. Remittances refer to the money transferred by the migrants working abroad to their home country. These remittances have been increasing parallel to the growing migration levels. Remittances to Nepal have increased by nearly 100 times from 1993 (US$ 55 million) to 2012 (US$ 4,793 million) (World Bank, 2013a). From 2002 to 2012,

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4 India accounts for 72 percent of total migration from Nepal (NIDS & NCCR, 2012 as cited in Jones & Basnett, 2013)

5 The term unskilled refers to an education level below tertiary. Tertiary education refers to the Bachelors degree or above.

6 Heretofore "migration" will refer to work related migration only.

remittances have increased at an average annual rate of around 23 percent.[7] In terms of the share of GDP, Nepal is currently the third highest remittance receiving country in the world with the remittances accounting for 25 percent of its GDP (World Bank, 2013c).

At the macroeconomic level, remittances have played a crucial role in Nepal.

As a percentage of GDP, remittances are the largest income that Nepal receives from the external sector. In fact, since 2005/06 the income from remittance has exceeded the combined sum of the income from tourism and exports (MoF, 2013). Since remittances are a part of the current account of Balance of Payments, they have also contributed to the current account surplus and thereby to Balance of Payments surplus over the past decade. The contribution of remittances to the current account almost doubled, increasing from 34 percent in 2002/03 to 60 percent in 2011/12[8] (MoF, 2013).

Over the last decade, remittances have also been a significant contributor to foreign reserves. For example, in 2002/03, remittances contributed 42.2 percent to the foreign exchange reserves, and in 2011/12, the contribution increased to 62.08 percent[9] (MoF, 2013). During the same period, foreign reserves have increased by more than 400 percent. Since 2004, contribution of remittances to foreign reserves has exceeded the total contribution of exports, tourism and foreign aid. By contributing heavily to the foreign reserves, remittances have helped cover the trade deficits, which have increased (as a percentage of GDP) from 13 percent in 2001/02 to almost 25 percent in 2011/12 (MoF, 2010; 2013). Hence, remittances have been a significant factor in maintaining Balance of Payments stability over the last decade. Testing the effect of remittances on Nepal's GDP, Majagaiya's empirical study found that remittances have the ability to raise the GDP considerably (Majagaiya, 2009).

Remittances can also contribute to government revenue. Remittance transfer requires the services of many organizations such as money transferring agencies, commercial banks and other financial companies. It is estimated that the Nepal government received NRs 170 million through taxes from these organizations in 2008/09 (NIDS & NCCR, 2011). As the remittances have been increasing each year, it can be safely assumed that remittances will contribute even more to government revenue in the coming years.

At the microeconomic level, remittances have helped in augmenting the household income. The money from remittances accounts for 25 percent of the income of all households in Nepal, and over 60 percent of the income of households that receive remittances (World bank, 2011a). The households spend highest share of these remittances on daily consumption (around 63 percent) (CBS, 2011). With the remittances flowing in there has been an increase in the expenditure capacity of the households thereby increasing consumption (Kharel, 2011). This increase could have contributed to the doubling of nominal per capita consumption from 2003/04 to 2010/11 (CBS, 2011). By increasing the income and spending capacity of the households, remittances have also helped in the reduction of poverty in Nepal. An empirical study by Lokshin et al. (2010) found that remittances could explain 20 percent of the poverty reduction in Nepal from 1995 to 2004. The study also claimed that poverty would increase and expenditure would decrease without migration. According to Sijapati and Adhikari (2012), the increase in remittances is the main factor responsible for the reduction of poverty by 16 percent from 1996 to 2011.

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7 Calculated from data provided by World Bank (2013)

8 Author's calculation using Balance of Payments data from MoF (2013).

9 Author's calculation using data from MoF (2013)

On the flip side, as the purchasing capacity of the households has increased due to remittances, they are consuming more imported goods, thereby increasing imports. Bhatta (2013) examined the relationship between remittances and imports in the context of Nepal using data from 2001 to 2011. This empirical study concluded that income from remittances are mostly spent on consumption of imported goods thereby increasing imports in the long run. This result is also corroborated by the fact that imports (as a percentage of GDP) have increased from 23 percent in 2001/02 to 30 percent in 2011/12 (MoF, 2010; 2013). Given the decreasing trend of exports,[10] the increase in imports would lead to wider trade deficits that could disrupt the Balance of Payments situation. Considering this, the Ministry of Finance has warned against dependence on remittances for macroeconomic stability in the long run. (MoF, 2013).

Foreign Direct Investment in Nepal

FDI occurs when an individual or a firm (a Multinational Enterprise or MNE) from one country owns 10 percent or more of the ordinary shares or voting power of an enterprise located in another country. The foreign direct investor should have significant control over the management of the enterprise in the host country for the investment to be considered FDI (IMF, 1993). FDI can take place through acquisition of the firms in the host country, mergers, joint ventures or setting up of a new facility for production, distribution, etc.

FDI is an important source of finance for developing countries. FDI assists the developing economies in meeting their financial requirements, increasing employment opportunities by bringing in new jobs, enhancing human resource development, bringing technological advancement through technology transfer, improving organizational and managerial practices, etc. (Savant et al., 1993).

FDI Trend in Nepal

Compared with migration, FDI is a fairly recent phenomenon in Nepal. Nepal began to receive FDI in the early 1980s. From 1980 to 1989, FDI flows were very low, with an average annual FDI inflow of a meager $0.5 million (UNCTAD, 2003). In the 1990s, Nepal introduced various liberal trade policies such as Industrial Enterprises Act 1992 (amended in 1997), Foreign Investment and Technology Transfer Act (amended in 1997), and Foreign Investment and One-window Policy Act 1992. These policies could explain the ten-fold increase in the FDI levels during the 1990s as compared to 1980s (UNCTAD, 2003). From 1990 to1999, the annual average FDI inflow grew to $11.7 million.[11] However, for a few years, from 2000 to 2006, Nepal experienced negative inflows indicating withdrawal of investment, which could be attributed to the loss in investor confidence due to political insecurity caused by the People's War. From 2007, FDI increased substantially (except for in 2008, owing to the Great Recession). For the year 2012 (the latest available data) FDI inflow was at $92 million (UNCTAD, 2013b).

However, even though FDI inflow has increased from one decade to another, the overall FDI to Nepal has been very low. Considering Nepal in the context of South Asia, Nepal received the least FDI (0.27 percent) (except only for Bhutan) while India took home the highest share (76 percent) in 2012 (UNCTAD, 2013b). According to the World Investment

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10 The exports (as a percentage of GDP) have decreased from 10.2 percent in 2001/02 to 4.8 percent in 2011/12 (MoF 2013; 2010)

11 Author's calculation based on data from Athukorala and Sharma (2006) and UNCTAD (2013b).

Report 2012, Nepal is one of the worst performers in the world in terms of its ability to attract FDI, with a rank of 175 out of a total of 182 countries (as cited in Adhikari & Sijapati, 2012).

Distribution of FDI in Nepal

The distribution of FDI can be seen in two ways: sector-wise distribution and country-wise distribution.

Sector-wise Distribution of FDI.

Among all the sectors in Nepal, the manufacturing sector has received the largest share (32 percent) of FDI inflows till 2012/13,[12] followed by service sector (24 percent) and energy based sector (21.3 percent) (DoI, 2013). However, in terms of employment intensity,[13] the agriculture sector seems to be most capable of generating employment in relation to the FDI it receives, followed by the manufacturing sector. In terms of the scale of industry, the largest number of industries attracting FDI are small scale industries (80 percent) followed by medium (11 percent) and large scale industries (9 percent) (DoI, 2013).

Country-wise distribution of FDI inflow.

Considering the source of FDI, India has been the largest contributor, accounting for almost 40 percent of total FDI inflows till 2012/13 with its presence in 566 industries (DoI, 2013). The second and third highest contributors are China and South Korea, with shares of 11 percent and 7 percent respectively. One of the factors that can explain India's large contribution is that it can take advantage of low tariff and non-tariff barriers (Athukorala & Sharma, 2006). Moreover, the treaties (Indo-Nepal Treaty of Trade, renewed in 2009), agreements (BIPPA- Bilateral Investment Protection and Promotion Agreement) and an open border between the two countries have strengthened their relationship and encouraged investment.

Effect of FDI on Nepal's Economy

In 2012, FDI stock in Nepal accounted for 2.4 percent of GDP indicating that the contribution of FDI to GDP is not substantial (UNCTAD, 2013c). Yan and Majagaiya (2011) tested the correlation between FDI inflow and economic growth in Nepal in terms of GDP by analyzing data from 1987 to 2007. The study concluded that FDI inflow has no influence on GDP. Additionally, from 1996 to 2012, FDI inflow has contributed on an average merely 0.97 percent to the Gross Fixed Capital Formation (GFCF) per year[14], indicating that the country could hardly rely on FDI to finance its capital formation. Even when Balance of Payments is considered, FDI makes insignificant contribution to the financial account receipts (MoF, 2013). Thus, FDI inflow doesn't have a significant positive effect on Nepal's economy because of its low levels.

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12 These FDI inflow figures are for the approved FDI and not the actual FDI inflow since the Department of Industry does not provide data for actual FDI inflow. The actual FDI inflows have been lower than the approved FDI (Adhikari, 2013). Nepal Rashtra Bank provides the data for the realized amount of FDI inflow but it does not provide any data on the distribution of FDI.

13 Employment intensity of a sector is calculated by dividing its share of total employment by the share of total FDI it receives.

14 Author's calculation using data from UNCTAD (2013a)

Comparing the contribution of FDI to Nepal's economy with that of remittances, the contrast is obvious. While remittances have a substantial impact on Nepal's economy, FDI, owing to its low levels, does not. An empirical study by Majagaiya (2009) compared the effect of FDI and remittances on Nepal's GDP. The results of the study showed that FDI's ability to raise the GDP was significantly lower when compared to that of remittances. Similarly, a study by Adhikari and Sijapati (2012), using FDI and remittance data from 1990 to 2010, concluded that FDI inflow has been so low that it serves only as an insignificant source of development finance in Nepal whereas remittances serve as a major source.

Migration as a Substitute for FDI

Migration is said to be a substitute for FDI if migration acts as a deterrent to FDI inflows. There are many mechanisms through which this deterrence is created.

Labour Shortage Due to Migration

The first mechanism relates to labour shortages created by migration. The massive outflow of migrants has given rise to acute labour supply shortages in Nepal (Adhikari as cited in Jones & Basnett, 2013; Gupta, 2013). In addition, as the remittances have resulted in an increase in household incomes, they have created a disincentive for the members of the those households to enter the labour market, thereby making the labour shortage persistent. Shishido (2011) points out that members of the remittance receiving households have decreased their participation into the labour force by 15 percent. These labour shortages produced by migration and the availability of remittance money can impede business operations and thus have negative impact on Nepal's ability to attract FDI. Lucas (1990) has argued that a lack of labour force can discourage FDI inflows to developing countries.

Increasing Labour Costs Resulting from Migration

Furthermore, labour shortages have led to an increase in wages (Sapkota, 2013). Indeed, Nepal has the highest labour costs in the South Asian region (International Monetary Fund as cited in Witchell & Symington, 2013). Summarizing empirical research on the subject, ODI (1997) claims that for low-income countries, relative low labour costs have statistically significant positive influence in attracting FDI, especially in labour-intensive industries. Since Nepal is a low-income country, it can be reasoned that the presence of high labour costs resulting from migration is discouraging FDI. High labour costs increase the cost of production and hence decrease the attractiveness of the country for FDI (Ranjan & Agrawal, 2011). Shamsuddin (1994), using data from 36 Less Developed Countries (LDCs), and Schneider and Frey (1985), using data from 51 LDCs, also found that higher labour costs reduce FDI inflow.[15] Thus it can be reasoned that Nepal might be losing FDI to other South Asian countries which have lower labour costs.

Migration of Skilled Human Capital

While the above discussion pertains to both unskilled and skilled migration, there is a channel through which skilled migration in particular can discourage inward FDI. Adhikari (2013) emphasizes that migration of educated people has contributed to a lack of educated human capital in the country. In fact, Nepal has the highest brain drain in the South Asia region (Schwab, 2013). According to CIA World Factbook (2013), Nepal faces an acute shortage of skilled labour force. Skilled workforce is a crucial factor in attracting FDI. Many

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15 Neither of these two studies included Nepal.

scholars have suggested that the availability of skilled workforce promotes inward FDI (see, for example, Hussain & Kimuli, 2012; Dunning, 1997; Sarna, 2005). Noorbakhsh et al. (2001) studied the relationship between human capital and FDI inflows to developing countries. They concluded that the presence of skilled human capital serves as a significant factor influencing the decisions of investors regarding the location for FDI. Moreover, they claim that the availability of educated labour force positively influences not only the volume of FDI but also the quality of FDI. Since Nepal lacks adequate skilled workforce, in part because of migration, both the quantity and quality of FDI coming into Nepal are low.

As MNEs are focusing on being more and more knowledge-, capital- and research-intensive and technologically advanced, they are looking for well educated workforce (in the host country) that can easily adopt new technologies and knowledge (Pfefferman & Madarassy as cited in Noorbakhsh et al., 2001). Many scholars have suggested that a skilled workforce has the ability to assimilate innovative ideas and adopt new skill-intensive and advanced technologies (Nelson & Phelps, 1966; Acemoglu & Angrist, 2000). This ability enables the skilled workforce to adapt efficiently to the business needs of MNEs thereby enhancing their productivity and profitability. Checchi et al. (2007) claims that the presence of skilled human capital makes the investment climate more attractive for investors as skilled workforce is associated to socio-political stability.

The skilled human capital helps not only in attracting FDI but also enables the FDI to have a positive impact on the economic growth of the host country. Borensztein et al. (1998) claims that MNEs, through FDI, bring in new technologies and through transmission of these technologies increase the rate of technological progress of the host country thereby enhancing its economic growth.[16] However, they insist that a skilled work force in the host country is required for the implementation of new technologies brought by MNEs since an educated work force would be more able to deal with new technologies. Thus, the skilled work force, through the assimilation of new technology, increases the absorptive capacity of the country and helps the country in reaping benefits of technology transfer. Borensztein et al. (1998) tested the effect of FDI on economic growth using the data on FDI inflows to 69 developing countries from 1977 to 1997. Their results indicate that FDI is an important vehicle for technology transfer but it has a positive effect on economic growth only if the host country possesses skilled human capital, that enhances its absorptive capability for advanced technologies. Similarly, a study by Toulaboe et al. (2009) concluded that absorptive capacity of the host country is crucial for FDI to have a positive impact on the economy. Thus the presence of skilled workforce is not only crucial to attracting FDI, it is also necessary if FDI is to have a positive impact on a country's economic growth.

In the context of Nepal, a lack of skilled workers, in part due to migration, can be implicated in the country's inability to attract FDI. Investors in the current era of technologically advanced industries would not see Nepal as a lucrative location. Moreover, the lack of absorption capacity may contribute to less than optimum impact of available FDI on economic growth.

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16 Similarly, Findlay (1978) has emphasized the positive effect of technology transfer through FDI on technological progress of the host country. And Johnson (2005) suggests that technology transfer can positively influence economic growth.

The Impact of Remittances on Policy Making

Apart from the lack of workers resulting from migration, remittances sent by migrants abroad also negatively influence FDI inflow. According to a report by World Bank (2011a) regarding migration from Nepal, the presence of high remittances lead to little pressure on policy makers to improve policy weaknesses. Remittance recipients can often buy better socio-economic services with the money they get through remittance than the ones provided by the government. Hence they have little reason to hold the government accountable for making economic policies to improve such services. This lack of accountability acts as a disincentive for the government to improve the policy making process. In addition, as remittances are an easy source of income for the country and have significant positive impact on Nepal's economy through its effect on balance of payments stability, poverty, government revenue, etc., there will be still lesser pressure on the government to improve the policies related to economic areas other than migration.

Policy laxity can be observed in areas such as FDI and infrastructure. With respect to Nepal's policies relating to FDI, Adhikari (2013) points out that some of the policies work against one another with one designed to attract FDI and another to repel FDI. For example, Foreign Investment and Technology transfer Act 1992 provided financial incentives such as income tax relief that could encourage FDI but the New Income tax Act 2011 did away with such incentives thereby leading to the discouragement of FDI (Adhikari, 2013). In addition, Poudel (2012) highlights the gap between formulation and implementation of FDI related policies. The poor implementation of policies decreases Nepal's ability to attract FDI. Although these drawbacks of policy making process could be explained by other factors, such as political instability, unavailability of resources, etc., it is possible that the policy laxity resulting from high remittances could also be a factor negatively affecting FDI related policy making.

In terms of infrastructure, the World Bank (2013d) notes the lack of attention to making improvements in policies related to infrastructure in the case of Nepal. Poor infrastructure in Nepal hampers the overall business environment by increasing the cost of production and transportation, which in turn decreases the incentive for FDI (Chalise et al., 2013). Wheeler and Mody (1992) found that for developing countries, infrastructure plays an important role in attracting FDI inflows. Using data from 1975-2008 in the case of Pakistan, Rehman et al. (2011) found that improving the infrastructure of the country makes it an attractive destination for FDI. Given that Pakistan and Nepal are both low income developing countries in South Asia with similar poor scores on infrastructure (Schwab, 2013), Nepal could also attract FDI if adequate attention is given to policy improvement in infrastructure.

The Impact of Remittances on Institutional Quality

While the lack of accountability resulting from remittances leads to an inefficient policy making process, it can also lead to worsening of institutional quality in the host country. Abdih et al. (2012) empirically tested the effect of remittances (as a percentage of GDP) on the institutional quality of 111 remittance receiving economies using data from 1990 to 2000. They concluded that high remittances lead to deterioration of institutional quality in the recipient country, especially through corruption. As we have said earlier, because of a lack of accountability arising from high remittances, the government feels less pressure to provide services to the public. In this scenario, the government officials tend to divert resources for their own use rather than spend them on the welfare of the public. Moreover, income from remittances allows households to bear the corruption comfortably, thereby giving rise to

more corruption. As Nepal is one of the highest (as a share of GDP) remittance receiving countries in the world, it is reasonable to assume that such negative influence of remittances would be heightened in Nepal's case. This is supported by Nepal's poor standing (a score of 31 out of 100) in the Corruption Perception Index by Transparency International (2013), an international body that keeps track of corruption levels around the world. Studies by Wei (2000) (using data from 45 host countries) and Ali (2009) (using data from 117 host countries) have found that corruption in the host country leads to a reduction in inward FDI by increasing the cost of business operations.

Corruption is only one of the many indicators of institutional quality. The overall institutional quality, which is negatively affected by remittances, can also influence the inward FDI to a developing country (Abdih et al., 2012; Blonigen, 2005). Good quality institutions help reduce transaction costs and production costs for firms (North, 1990), which could be a factor in attracting FDI. On the other hand, low quality institutions can discourage FDI (Lipsey, & Sjöholm, 2010). In the Nepalese context, various national institutions, such as the Department of Industry have not been able to adequately implement policies related to FDI. For instance, under the one-window policy, the DOI is designated as the authority to provide a one-window system to fulfill various needs of foreign investors such as issuance of visa, license, permits and other services such as taxation, financial incentives, etc. However, due to a lack of cooperation between this department and other government institutions, such as the Department of Revenue, foreign investors often have to visit several other ministries to get their requirements fulfilled (Adhikari, 2013). Thus the various services and incentives promised by FDI related policies in Nepal become difficult to materialize as a result of low quality institutions, thus discouraging FDI.

Conclusion

Nepal has been unable to reap the benefits of FDI because of the low levels of FDI it receives. This study suggests that migration is an important factor responsible for Nepal's inability in attracting FDI. To support this point, this study lays out five major ways in which migration from Nepal discourages inward FDI and thus acts as a substitute for FDI.

First, massive outflow of human capital due to migration has led to labour shortages in Nepal. In addition, remittances sent by migrants have also created a disincentive for the members of the households receiving remittances to enter the labour market, thereby worsening the labour shortage problem. These labour shortages impede the business operations and hence make the country unattractive to foreign investors.

Second, labour shortages have given rise to high labour costs. In fact, Nepal has the highest labour costs in the South Asian region. High labour costs increase the production cost, which would in turn increase the cost of doing business in Nepal. This scenario discourages investors from making FDI in Nepal.

Third, the brain drain occurring in Nepal – the highest in the South Asian region – has led to a lack of adequate skilled labour force. Skilled workforce has the capability to assimilate innovative ideas, adopt new advanced technologies, and learn novel management practices. As MNEs are often research oriented and deal with skill-intensive technologies, they look for well educated work force (in the host country) that can easily adopt these technologies and help them make profit. However, the reduction of skilled work force caused by migration has contributed to making Nepal an unattractive destination for FDI.

Fourth, migration has a negative influence on FDI through remittances. Remittance receiving households can purchase better socio-economic services than the ones provided by the government. Hence the remittance recipients do not have to rely on the government to provide such services and have less incentive to hold the government accountable. In the context of Nepal, this lack of accountability leads to policy laxity in FDI related policies and also in other economic areas such as infrastructure, which in turn negatively influences FDI inflow.

Finally, the lack of accountability resulting from remittances also leads to the deterioration of institutional quality in Nepal. Since the government feels less pressure to provide services to the public, government officials may divert resources for their own use rather than spend them on the welfare of the public. Moreover, income from remittances allows households to bear corruption comfortably, thereby impeding any check on corruption. The overall low quality of institutions in Nepal also makes it difficult to implement the various services and incentives promised by FDI related policies.

Till date, there has been no study that has exclusively analyzed the interactions between migration and FDI in the context of Nepal. This study can thus serve as a preliminary framework for future empirical research in this direction. In the present context, this study can provide some helpful insights for policy making. Migrants are leaving Nepal every day in search of better employment opportunities. If Nepal could provide better jobs at home, prospective migrants might choose to stay back. Since FDI can bring job opportunities into the host country it can provide a channel through which such migration pressure could be eased in Nepal. In addition, FDI can introduce new advanced technologies through technology transfer, improve performance of exports, and develop productivity of domestic firms, thus boosting economic growth. Therefore, focusing on FDI related policies could not only provide better reasons for migrants to stay home, but also contribute to more economic growth.

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