Remittance Flow and Impact on the External Sector of Nepalese Economy

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Abstract : *This paper investigates remittance flow to Nepal during last ten fiscal years in absolute term and relative to GDP, export earning and foreign exchange reserve. It also tries to investigate relation of remittance with current account balance and balance of payment surplus. In addition, it also makes comparison between remittance inflow and foreign exchange reserves. The external sector macroeconomic variables show the positive relation between remittance growth and increasing trade deficit. The empirical studies carried out across the nation have also suggested that remittance has more causality on the consumption pattern as well as the import pattern, and less on investment pattern. Furthermore, with available literatures, this paper discusses the implications of channelizing the remittance flow into productive capital.*

Key Words: *GDP, Remittance, Import, Export, Foreign exchange, Balance of payment, Current account surplus, Dutch-disease, LDCs etc.*

1. Introduction

Remittance is the portion of migrant workers' earnings sent back from the country of employment to the country of origin (ILO, 2000). Remittance is the financial flows associated with migration (IOM, 2006).It includes cash or non-cash items, and could arrive in the country through formal and informal channels. According to 5th edition of IMF Balance of Payment Manual (BPM5), "Workers' remittance is defined as an item under current transfers by migrants who are employed in new economies and considered residents there."

Nepal introduced trade and economic liberalization policies in the mid-1980s. With the policies adopted, the international labor market opened to the job-seeking Nepali youths. During the liberalization process, Nepal eased tariff and non-tariff barriers of international goods and services privatized public enterprises and joined the World Trade Organization (WTO). In other words, economic liberalization accessed the international labor market at one side and eased the International trade of goods and services, on the other side. As a result, thousands of young manpower migrating every year to work abroad is also kept on increasing alarmingly. Such an emigration rose remittance inflow sharply in the recent years (Bhatta, 2012). However, the income received from remittance is seen mostly spent on consumption with a very little spending on productive sector (Thagunna & Acharya, 2012). Thus, Nepal observed significant rise of migration

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of the young population in the recent years and resulted to a sharp rise in remittance inflow exceeding all other source of foreign currency income. Human capital is the wealth of nation and its importance has tremendously increased in recent years, as unskilled, semiskilled and skilled people have shown keen inclination towards foreign employment resulting in substantial growth of economy (Karna, 2008).

The foreign employment has been covering a wide space of the world. Especially least developed countries at present are seen as the labour exporting countries. The foreign employment and their remittance have been significantly contributing to socio-economic transformation and at the same time it has been posing challenges as well. The productive utilization, controlling illegal outflow of labour, illegal transfer of remittance, job security, low paying risky jobs are major problems of foreign employment (Acharya,2070). Hence, increasing dependency on remittances has resulted in a number of negative consequences for the Nepalese economy, making it a parasitical economy suffering from the 'Dutch-disease' type effects. (Pandey & Shrestha, 2012).Dutch disease is the apparent relationship between the increase in exploitation of natural resources and a decline in the manufacturing sector (or agriculture). The term was coined in 1977 to denote the deindustrialization of a nation's economy that occurs when the discovery of a natural resource raises the value of that nation's currency, making manufactured goods less competitive with other nations, increasing imports and decreasing exports. The term originated in Holland after the discovery of North Sea gas. (http://www.investorwords.com/1604/dutch_disease.html#ixzz2uPjfem4q)

Nepal's major exports are labour and most of the rural households now rely on at least one members earning from abroad. An increasing larger share of remittance now comes from countries other than India. The upsurge in remittance had led to a surplus in the current account of Balance of Payment (BoP), thereby strengthening the overall BoP position. The families of migrant workers should be encouraged and trained to run small business that will pave way to channelize the productive use of remittance. Eventually, this will generate new jobs and help to improve the domestic economy (Pant, 2011).

2. Methodology

The main objective of this paper is to discuss the trend of remittance inflow to Nepal and find out its impact on the relevant macroeconomic variables of external sector of the economy. To fulfill the objectives, the relevant data such as remittance size, foreign exchange reserve, import, export, trade deficit, current account balance, balance of payment position etc. are collected from secondary sources. The paper is prepared on the basis of available literature survey within the content area. They are tabulated in logical way so as to draw inferences regarding their impact in the economy.

3. Theoretical Perspectives on Remittance

Remittance has taken a central place of debates amongst the academia, policy makers and development experts in the present world. The renewed debate started particularly after 1990s. The developmentalist and neoclassical thinkers during 1950s and 1960s had maintained optimistic views on remittance believing that capital and knowledge transfers of migrants would help achieve development needs of least developed countries in the world. The same views have taken incarnation in the present world.

Classical or developmentalist theory states that large scale capital transfer and industrialization to poor countries would move their economies towards rapid economic development and modernization. It further states that migration leads to a North-South transfer of investment capital and accelerates the exposure of traditional communities to liberal, rational and democratic ideas, modern knowledge and education. Neoclassical theory states that unconstrained labour migration would lead to scarcity of labour, resulting in a higher marginal productivity of labour and increasing wage levels in migrant-sending societies.

The dependency and structuralism theorist, who dominated the decades of 1970s and 1980s, maintained pessimistic view on remittance. They were of the view that remittance never contributes to the development of underdeveloped countries mainly for the reason that international migration encourages brain drain from the developing counties depriving them of the human capital that they need desperately to meet their development goals.

Neo-Marxists theory states that migration and remittance produce and reinforce the capitalist system based on inequalities. Migration and remittance were seen as detrimental as exposure to wealth of migrant families causes change in local taste that increases the demand for foreign goods.

Thus, there is prevailing pessimistic as well as optimistic view regarding remittance. The theories varied from the developmentalist optimism of the 1950s and 1960s to the large scale pessimism which prevailed in the 1970s and 1980s to the optimism of the 1990s

4. Global Scenario of Remittance Flow

Remittance has proven to be one of the significant international financial flows in the recent years. The global remittances experienced a dramatic increase over the years, particularly since 1990 wherein the developing world emerged to be the major beneficiary accounting for 60 percent of the total amount. Workers' remittance has overshadowed all traditional sources such as official aid and private capital (Irfan, 2011). This amount is nearly three times of the amount of official aid and equivalent to foreign direct investment (FDI) flows to developing countries, and remittance income comprises more than 10 percent of GDP in many developing countries(World Bank, 2011). Because of the sheer volume, and magnitude of the remittances, and pre-eminence of these flows compared to the Foreign Direct Investments (FDIs), development assistance and in some cases the trade related transactions, the development practitioners tended to focus and investigate the importance of remittances which are generally regarded as a dependable source for growth, improved welfare and poverty alleviation in the developing world. Given the fact that remittances flows entail wide ranging ramifications both for sending as well as receiving countries, difficult to be generalized, hence empirical evidence has been mounted though lack of consensus is visible (Irfan, 2011).

The increased global integration and the enhancement in information and communication technology have facilitated the movement of labour from one country to another. As a result financial flow from developed country to developing country has been soaring in the recent years. Remittance flows to developing countries have more than quadrupled since 2000. Global remittances, including those to high-income countries, are estimated to have reached $514 billion in 2012, compared to $132 billion in 2000 (World Bank, 2012).The top recipients of officially recorded remittance in 2012 were India ($70 billion), China ($66 billion), Mexico ($24 billion) and Philippines ($24 billion), Nigeria (21 billion), Egypt (18 billion), Pakistan and Bangladesh each (14 billion), Vietnam (9 billion) and Lebanon (7 billion).Remittance sent home by migrants to developing countries are three times the size of official development assistance and can have profound implications for development and human welfare (Table 1).

Table 1: Top 10 Recipients of Remittance in 2012 (in Billion $)

Countries	India	China	Mexico	Philippines	Nigeria	Egypt	Pakistan	Bangladesh	Vietnam	Lebanon
Remittance size (*In Billion $)*	**70**	**66**	**24**	**24**	**21**	**18**	**14**	**14**	**9**	**7**

(Source: World Bank 2012)

The large remittance recipient countries as a share of GDP include Tajikistan (47 per cent), Liberia (31 per cent), Kyrgyz Republic (29 per cent), Lesotho (27 per cent), Moldova (23 per cent), Nepal (23 per cent), Samoa (21 per cent) and Tonga (20 per cent) in 2012, according to an estimation of the World Bank (Table 2).

Table 2: Top recipient of Remittance in the World in Terms of Remittance/ GDP ratio

Countries	Tajikistan	Liberia	Kyrgyz Republic	Lesotho	Moldova	Nepal	Samoa	Tonga
Percent of GDP	47	31	29	27	23	23	21	20

(Source: World Bank 2012)

5. Remittance Flow in Nepal

Remittance has been lifeline Nepalese economy since last couple of years. Nepal stands as the 6th largest economy in the world in terms of the nation's remittance- Gross Domestic Production (GDP) ratio as it is estimated to be about 23 percent ratio of GDP and 2nd behind Bangladesh amongst Least Development Countries (LDCs) (*World Bank, 2012*). Nepal has received remittance Rs.259.6 billion through institutional channels for the Fiscal Year 2068/69 *(Ministry of Finance 2070)*.But informal figure could be twice of this. According to Nepal Living Standard Survey Second, about 55.8 percent households receive remittance.

In the recent years, there has been an increasing demand for the Nepalese workers in the international labour markets. In an average, daily about 2000 youths are emigrating to abroad to seek foreign employment. Based on official and unofficial records, more than 3 million, Nepalese citizens have gone abroad for foreign employment *(Economic Survey, 2070).* Consequently, it was soared the amount of remittance flow into Nepalese economy that showed upward trend of the economy for a decade and half. Thus, remittance has been the largest source of foreign currency inflow in Nepal exceeding the prior sources like tourism income, export and foreign aid.

Remittance inflow has grown more than seven times as compared to fiscal year 2060/61 and 2069/70* data. In the fiscal year 2060/61, it was merely Rs. 58.6 billion and reached to Rs. 430.0 in the first ten months of the fiscal year to 2069/70. Furthermore, remittance-GDP ratio in the fiscal year 2060/61 was 10.9 percent that expected to reach 23 percent in the fiscal year 2069/70. According to remittance- GDP data trend, annually 17.5 percent ratio is contributed by remittance during last ten years (Table 3).

Table 3: Remittance Inflow to Nepal (FY: 2060/61 - 2070*)

Fiscal Year	Remittance Inflow (In Rs. Billion)	Annual Percent change	Remittance as percent of GDP
2060/61	58.6	8.1	10.9
2061/62	65.5	11.9	11.1
2062/63	97.7	49.0	14.9
2063/64	100.1	2.5	13.8
2064/65	142.7	42.5	17.5
2065/66	209.7	47.0	21.2
2066/67	231.7	10.5	19.4
2067/68	253.6	9.4	18.5
2068/69	359.6	41.8	23.1
2069/70*	430.0	19.6	22.4

** Data of the first 10 months of the current fiscal year. (Source: Economic Survey 2070)*

6. Impact of Remittance Inflow

Remittance has impacted in the various sector of the economy. It has its impact on foreign exchange reserve, balance of payment, import, consumption pattern. The available data shows remittance and trade deficit nexus. The empirical studies have also found that most of the remittance proportion is spent on consumption.

6.1 Remittance Inflow and Balance of Payment

External sector macroeconomic indicators also suggest that remittance inflow has been contributing in great deal to maintain balance of payments (BoP). The data of last ten fiscal years suggest that current of BoP is also dependent on remittance inflow. Likewise, the BoP situation is also maintained by remittance in flow as suggested by the data of table 4 given below. Therefore, there is a need to explore alternative ways in order to maintain balance of payment in a sustainable manner. For this, utilization of remittance inflow to productive sector can be an alternative.

Table 4 : RemittanceInflow, Foreign Exchange Reserve, Current Account Balance and Balance of Payment Surplus (FY 2060/61 - 2069/70*))

Fiscal Year	Remittance Inflow (In Billion Rs.)	Foreign Exchange Reserve (In billion Rs.)	Current Account Balance (In Billion Rs.)	Balance of Payment Surplus (In Billion Rs.)
2060/61	58.6	130.2	14.6	16.0
2061/62	65.5	129.9	11.5	5.7
2062/63	97.7	165.0	14.2	25.6
2063/64	100.1	165.1	-0.9	5.9
2064/65	142.7	212.6	23.7	29.7
2065/66	209.7	286.5	41.4	44.8
2066/67	231.7	268.9	-28.1	-3.3
2067/68	253.6	272.2	-12.9	2.2
2068/69	359.6	439.5	76.0	131.6
2069/70*	430.0	453.6	26.5	11.8

** Data of the first 10 months of the current fiscal year. (Source: Ministry of Finance)*

6.2 Remittance Inflow and Trade Deficit

The data of import and export of last ten fiscal year (i.e. FY 2060/61 - 2069/70*) clearly suggest that import is soaring alarmingly and export is not growing significantly and it is seem to be almost constant. This has caused to raise trade deficit that is an extremely vulnerable position of external sector of the economy. The remittance has been boon to strengthen the backbone of the economy. Otherwise, it could have been extremely grave situation. The data of fiscal year 2068/69 clearly shows that import is more than seven times higher than export (Table 5).

Table 5: Remittance Inflow-Import-Export (FY 2060/61 - 2069/70*)

Fiscal Year	Remittance Inflow (In Billion Rs.)	Import (In Billion Rs.)	Import as percent of GDP	Export (In Billion Rs.)	Export as percent of GDP	Trade Deficit (In Billion Rs.)
2060/61	58.6	149.48	25.4	58.71	10.0	-90.77
2061/62	65.5	173.78	25.4	60.234	10.0	-113.546
2062/63	97.7	194.70	26.6	59.38	9.2	-135.32
2063/64	100.1	221.94	26.8	59.27	8.2	-162.67
2064/65	142.7	284.47	27.2	67.70	7.3	-216.77
2065/66	209.7	374.34	28.8	60.82	6.9	-313.52
2066/67	231.7	396.18	31.4	64.34	5.1	-331.84
2067/68	253.6	461.67	28.9	74.26	4.7	-387.41
2068/69	359.6	295.24	26.9	48.56	4.8	-246.68
2069/70*	430.0	360.56	29.0	44.08	4.0	-316.48

** Data of the first 8 months of the fiscal year2069/70.* *(Source: Ministry of Finance)*

6.3 Remittance Utilization Pattern

The empirical studies have disclosed that mostly remittance is used in consumption pattern. According to Nepal Living Standard Survey third (NLSS III, 2010/11), the two most uses of remittances are: "for daily consumption" and "for repaying loans". About 79.0 percent of the total remittance is used for daily consumption while 7.0 percent is used for repaying for loans repayment (TABLE 6).

Table 6: RemittanceUtilization Pattern

S.No.	Description	Percent
1.	Daily Consumption	79.0
2.	Repayment of Loans	7.0
3.	Household property	5.0
4.	Education	4.0
5.	Capital formation	2.0
6.	Other purposes	3.0
Total		100.0

(NLSS III: 2010/11)

7. Discussion and Conclusions

There is up surge in remittance inflow in the recent years in Nepal. The external sector data of Nepal suggest that the lifeline of Nepalese economy is remittance in terms of foreign exchange reserve, current account balance and BoP surplus. There is seen high positive correlation of remittance with foreign exchange reserve and import trend. On the other hand, there is seen negative correlation of remittance with export trend. It suggests that in the external sector the economy is entirely depending on remittance.

External sector macroeconomic indicators also suggest that remittance inflow has been contributing in great deal to maintain balance of payments (BoP). The data of last ten fiscal years discloses the fact that current account of BoP is also dependent on remittance inflow. The data clearly suggest that import is soaring alarmingly and export is almost constant .This has caused to raise trade deficit that is an extremely vulnerable position of external sector of the economy. The empirical study have also disclosed that remittance has high casualty in consumption pattern and extremely low or nominal in capital formation.

The remittance has been boon to strengthen the backbone of the economy otherwise it could have been crashed. The economy is able to afford foreign imports not because of the return from its economic output-through higher level of exports of goods and services-but it simply from the export of labour. Remittance alone covers approximately the one-quarter of GDP. The pertinent question is: what will happen when the vicious cycle takes place in emigrant working economy. In addition, there are many problems connected with foreign employment such as 3 D work(dirty, danger and difficult) in the abroad, problem of social norms, culture, climate, language, exploitation by employer, death in destination(in average daily 3 reported), lack of labor market information, unauthorized agents etc

This is high time for Nepal to explore appropriate policy measures to tap and harness the soaring flow of remittance. Nepal should take lesson from South Korea in order to harness the benefit of increasing remittance inflow. In the 1960s, South Korea had worse economic status than Nepal had, in terms of macroeconomic variables. During this time, South Korea had undergone severe crisis following the war in the Korean peninsula. Due to persistent unemployment problem, Korean youth sought employment abroad, mainly in the Middle East, and Turkey. The South Koreans worked there as minors or as nurse. Most of them even worked overtime. The money sent back home by them eventually contributed to alleviate the foreign exchange reserve constraints. Over the decade, in the 1970s, South Korea economy was booming with around 8.0 percent average annual GDP growth (Thagunna & Acharya, 2012).

Remittance income is emerging as one of the most significant and reliable source of external finance for many developing countries in last couple of years. This has drawn attention of both academia and policymakers in recent years. The ongoing debate is related with its sustainability and harnessing benefit from it. In fact, Nepalese economic growth, due to higher remittance is essentially a "pseudo-growth."Therefore, there is a need to explore alternative ways to harness the benefit of remittance inflow. Nepal should formulate necessary policy measure to divert the remittance income in micro enterprises development and public infrastructure development. This would stimulate the economy for further economic activities, which would pave the way for virtuous cycle of the economy. Otherwise it could be a 'Dutch disease' for Nepalese Economy.

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