Remittance Inflows to Nepal: Economic Impact and Policy Options

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Remittances are generally thought to contribute to savings and investments thus leading to economic growth. In 2004, officially recorded remittances flows to developing countries were greater than US$ 125 billion. The rise in remittances, that are less affected by economic cycles in the recipient country, are taking place at a time of declining official development assistance which adds more significance to the remittance debate and research. The various uses of the remitted funds vary in their potential to reduce poverty and create economic security for the household and community. In Nepal’s case, in more recent years, remittances have been playing a pivotal role in the country’s economic development by relaxing the foreign exchange constraints and strengthening the balance of payments, among others. Although a gamut of policy measures have been taken by the concerned authorities for encouraging remittances through the banking channel, more needs to be done.

I. INTRODUCTION

Development economics has traditionally taken into account foreign savings as the key to augmenting a nation’s capital output ratio. Factors such as foreign direct investment (FDI), official development assistance (ODA), foreign trade, the transfer of technology and, more recently, remittances have been incorporated into these studies.

The macroeconomic effects of remittances enjoy a strong theoretical tradition dating back to Adam Smith, David Ricardo and the labor theory of value and comparative advantage. It advanced right up to the endogenous growth innovation in the 1980s assigning human capital a crucial role in modern production and exchange.

Generally, remittances refer to that portion of migrants’ earnings sent from the migration destination to the place of origin. Even though they can also be sent in kind, the term ‘remittances’ is normally limited to denote monetary and other cash transfers transmitted by migrant workers to their families and communities.

International migrant remittances have become an important source of external finance in developing countries. Remittances to developing countries from overseas

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resident and nonresident workers are estimated to have risen by 8 percent in 2004, reaching US$ 125.8 billion, making them the second largest source of development finance after FDI. That rise followed a 17 percent increase in 2003. Much of the 8 percent increase in 2004 happened in low-income countries, where remittances soared by 18 percent. Since 2001, remittances to developing countries have augmented by almost 50 percent. Low-income countries constitute almost half of the increase: the share of remittances flowing to low-income countries catapulted from 28 percent in 2001 to 35 percent in 2004.\(^1\)

The major portion of the $41 billion increase in remittances to developing countries from 2001 to 2004 was concentrated in South Asia ($17 billion), Latin America and the Caribbean ($13 billion), and to a lesser degree, East Asia and the Pacific ($7 billion). The increases in remittance flows have been especially strong in China, India, Mexico, Pakistan and the Philippines.\(^2\)

The upsurge in remittances flows over the past couple of years can be ascribed to a variety of causes. There have been noticeable reductions in remittance sending costs in some countries—for example, by 60 percent in the U.S.—Mexico corridor since 1999. Growing migration also play crucial roles. The sizable depreciation of the dollar against most other major currencies over the past three years has raised the dollar value of nondollar remittances over time. Some portion of the rise in remittance flows can be attributed to improvements in data recording by central banks.

While the development community continues the search for additional resources to finance the Millennium Development Goals, remittances—pro-poor and cyclically stable, compared to other capital flows—seem to be a promising source. In this context, a number of remittance initiatives are underway.\(^3\)

Against the foregoing background, this paper first attempts to summarize some concepts and measurement pertaining to remittances followed by an investigation into the

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\(^1\) These data taken from World Bank (2005) denote officially recorded remittances, which are sometimes estimated. Flows through informal channels, such as hundi, are not captured in the official statistics but are assumed to be rather large.

\(^2\) The remittance flows to these countries are presented below:

<table>
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<tr>
<th>Country</th>
<th>2001</th>
<th>2003</th>
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<tr>
<td>China</td>
<td>1.2</td>
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<tr>
<td>India</td>
<td>11.1</td>
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<td>Mexico</td>
<td>9.9</td>
<td>14.6</td>
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<tr>
<td>Pakistan</td>
<td>1.5</td>
<td>4.0</td>
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<tr>
<td>Philippines</td>
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\(^3\) For instance, the Sea Island G-8 Summit in June 2004 called for better coherence and coordination of international organizations working to enhance remittance services and increase the development impact of remittance earnings. The World Bank, the International Monetary Fund (IMF) and the United Nations have constituted an interagency, intergovernmental technical group to improve remittance statistics. The Bank for International Settlements and the World Bank have set up a special task force on international retail payment systems to improve transparency in remittance transactions. Regional development banks, bilateral aid agencies and other international agencies have also begun ambitious programs to collect information and facilitate remittance flows. For more on the remittance initiatives, see Maimbo and Ratha (2005).
different theories for remitting. This is preceded by the general impact of remittances together with the use of remittance income. The impact of remittances on the Nepalese economy is then scrutinized followed by an analysis of the various initiatives undertaken by the concerned officials for encouraging remittance inflows through the official channel. Before concluding, the paper attempts to provide some policy options for increasing remittances through the official channel as well as some measures to use remittance income productively.

II. CONCEPTS AND MEASUREMENT

Remittances fall under the group of items classified as transfers in the balance of payments (BOP). In the fifth edition of the balance of payments manual (BPM5), transfers are defined as offsetting entries for real sources or financial items provided, without a *quid pro quo*, by one economy to another. Putting it in another way, whenever an economy does not receive or provide recompense in the form of real resources of financial items for goods, services or financial items supplied to or received from another economy, it becomes a transfer for the purposes of BOP accounting.

Two kinds of transfer are identified in the BPM5: current transfers and capital transfers. While current transfers are recorded in the current account, capital transfers are recorded in the capital account.

Current transfers are categorized on the basis of the sector of the compiling economy into two main groups: general government and other sectors. General government transfers encompass current transfers, in cash or in kind, between governments and international organizations. Current transfers between other private sectors of the economy and non-residents consist of those occurring between individuals, between non-governmental institutions or organizations (or between the two groups) or between non-resident government institutions and individuals or non-governmental institutions. Moreover, the category of workers’ remittances encompasses current transfers by migrants who are employed in other economies and considered residents there.

Standard measures on remittances are based on three items in the BOP reports (as incorporated in the IMF Balance of Payments Statistical Yearbooks). These are in the form of: a) workers’ remittances (money sent by workers living abroad for greater than one year); b) compensation of employees (gross earnings of foreigners living abroad for less than one year; and c) migrant transfer (net worth of migrants moving from one country to another).

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4 It should be mentioned at the outset that internal remittances (defined as the money and/or goods sent to rural areas from urban areas by migrant workers) are equally important from a development perspective. For instance, Adams (1997) has demonstrated that in Pakistan while external remittances have a positive and significant impact on the accumulation of land, internal remittances have a significant and positive effect on the accumulation of agricultural capital. DeWind and Holdaway (2005) have also made a comprehensive analysis on the importance of internal remittances.
III. MOTIVES FOR REMITTING

According to the literature on remittances, a number of theories have emerged to explain the causes behind the migrants’ decisions to send funds (cash and goods) to their relations back home.\(^5\) An important research on the motivations to remit has been developed under the framework of the ‘new economics of labor migration’ or NELM.\(^6\) Families in migrant-sending areas, particularly rural communities, have indulged in migration by sending one or more members off as migrants (normally, sons and daughters of the household head), who subsequently share part of their earnings with the rural household, through remittances. The NELM theory states that imperfections in rural credit and risk markets (for instance, farmers’ inability to obtain credit and insure against income loss) generate incentives to participate in migration by sending family members to work in the city or abroad. Migrants function as financial intermediaries, substituting for the missing rural bank or insurance institution. Once they are set up at their destinations, migrants provide the family members at the origin with required capital through remittances, and with income insurance, or simply the promise to remit if the origin household suffers an adverse income shock.

Generally, the motives behind remittances can be grouped under three headings: a) the altruistic motive, b) the self-interest motive, and c) implicit family contract: loan repayment and co-insurance.

**Altruistic Motive**

According to the altruism or livelihoods school of thought, remitting is an obligation to the household. A model of pure altruism would envisage that as migrant incomes rise, a portion of the incremental income is passed on to the origin household through remittances. Remittances are dispatched owing to affection and responsibility towards the family. The altruistic model states that sending remittances brings satisfaction to the migrant out of a concern for the welfare of his family. When motivated by altruism, remittances can vary based on the number of household members that migrate and the poverty status of the receiving household, although it has been shown that poorer households obtain a larger proportion of their total income from remittances than do non-poor ones.

**Self-Interest Motive**

A divergent motivation is to assume that the migrant is primarily stimulated by an economic and financial self-interest, when sending remittances to the home country. The argument supporting this line of theory is that at every point in time, the successful migrant in the foreign country saves. Subsequently, the migrant wants to know how (in which assets) and where (in which country) to accumulate his wealth. The home country is the obvious place to invest, at least part of his assets, by purchasing property, land and

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\(^5\) For an elaborated discussion, see Addison (2004) and Solimano (2003).
\(^6\) The NELM theory is examined in Stark and Bloom (1985).
financial assets, among others. These assets could generate a higher rate of return than assets in the host country though their risk profile can also be greater.

Implicit Family Contract: Loan Repayment and Co-Insurance

Economic theory has devised explanations of the remittances process that take the family—rather than the individual—as the major unit of analysis. According to this theory, families seem to develop an implicit contract among those who opt to reside abroad, the migrant, and those who stay at home. The implicit contract consists of an inter-temporal dimension, which could last for many years or even decades, as a time horizon.

The contract is a combination of the elements of investment and repayment. As per the loan repayment theory the family invests in the education of the migrant and usually finances the costs of migrating (travel and subsistence costs in the host country). This is the loan (investment) element of the theory. The repayment part happens after the migrant settles in the foreign country and his income profile begins to rise over time and is in a position to begin repaying the loan (principal and interest) back to the family in the form of remittances. This implicitly connotes that the family invests in a higher yield ‘asset’ (the migrant) who obtains a higher income level in the foreign country than other family members that live and work at home. The amount to be remitted will however be governed by various factors such as the income profile of the migrant.

A variant of the theory of remittances as an implicit family contract between the migrant and those at home is based on the notion of risk diversification. If it is assumed that economic risks between the sending and foreign country are not positively correlated, then it becomes an opportune strategy for the family as a whole to send some of its members abroad (often the most educated) to diversify economic risks. The migrant can then help to support his family in worsening times at home. Conversely, for the migrant, having a family in the home is insurance as bad periods can also take place in the foreign country. In this model, migration is a co-insurance strategy with remittances playing the part of an insurance claim. Analogous to any contract there exists a potential problem of enforcement (for instance, ensuring that the terms of the contract are respected by the parties). Still, enforcement seems to be simpler, in principle owing to the fact that these are implicit family contracts, helped by considerations of family trust and altruism.

Whatever the motivation to migrate and remit, the different uses to which the remitted funds are applied vary in their potential to reduce poverty and create economic security for the household and community. Remittances that form part of productive investment seem to have an effect on long-term poverty reduction, leading to less vulnerability at both the household and the community level. There could also be a reduction in inter-household inequality. Conversely, if remittances are utilized in domestic consumption, the impact could be only of short duration and may lead to a rise in inter-household inequality.

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7 For an extensive illustration on this issue, see Poirine (1997).
8 It should be noted that the theories pertaining to the motives for remittance transfers indicate that it is only in the altruistic case that there is a no ‘quid pro quo.’ Transfers take place solely out of concern for the family and fits into the standard definition of transfers in the BOP sense. The other
IV. ECONOMIC IMPACT OF REMITTANCES

Remittances can generate a positive effect on the economy through various channels such as savings, investment, growth, consumption, and poverty and income distribution. Workers’ remittances flow in as a component of foreign savings and as such complements national savings by increasing the total pool of resources available for investment.

Remittances constitute an integral part of household livelihood strategies. They make a direct contribution to raising household income, while broadening the opportunities to increase income. They also permit households to increase their consumption of local goods and services.

At the community level, remittances create multiplier effects in the domestic economy, producing employment opportunities and spurring new economic and social infrastructure and services, especially where effective structures and institutions have been set up to pool and direct remittances. Where these have been set up and encouraged, and where the state is cooperative, remittances can bring about a change, especially in remote rural areas where state resources have not been effective.

The poverty reducing and income distribution effect of remittances is also significant. This case is based on the fact that the recipients of remittances are often low-income families whose offspring left the country to work abroad. In this situation, migration is taken as a response to escape poverty at home and improve the income-earning capacity of the migrant by attempting to enter foreign labor markets in richer countries. Again, remittances assist in alleviating poverty of the family of migrants in the home country by supporting their income through transfers.

Remittances assist in augmenting national income by providing foreign exchange and raising national savings and investment as well as by providing hard currency to finance essential imports hence curtailing any BOP crisis. Since they bear no interest, do not have to be repaid, and their utilization is not tied to specific investment projects with high import content, they have a more positive effect on BOP than other monetary flows such as direct investments or loans.

V. USES OF REMITTANCES: PRODUCTIVE VERSUS NON-PRODUCTIVE

It has been shown through a community- and family-level approach that remittances enable better health care, nutrition, housing and education. However, spending patterns are governed by a host of factors such as the strength of the migrant’s kinship ties and intent to return to the country of origin. Migrants who wish to return tend to remit than those who are permanently integrated into the host countries; hence, remittances may slow as ties weaken with time. Still, this argument supporting the remittance decay motives behind transfers indicate that there may be a quid pro quo as in the case of implicit family contract, though this may not be immediate or binding.

9 For a comprehensive explanation, see Barham and Boucher (1998).
10 This aspect is delineated in Buch et. al (2002).
11 This has been illustrated by Chimhowu, Piesse and Pinder (2005).
Although it is true that the propensity to remit, that is, the proportion of income remitted by a migrant, may go down over time, it rarely vanishes, since first-generation migrants (and often even second-generation migrants) continue to send money to their original communities. Even if the propensity to remit declines, the remittance volume rises with the sharp increase in income levels of migrants over time.

In many countries, a large portion of remittances are invested in real estate, demonstrating both a desire of migrants to provide housing to families left behind and a paucity of other investment instruments in the recipient. Whether remittances are utilized for consumption or purchasing houses, or other investments, they produce positive impact on the economy by stimulating demand for other goods and services. Moreover, the positive macroeconomic or development impact of remittances could become more effective if migrants form associations and their commitment to their home country becomes ‘institutionalized’.13

While the contributions of remittances can be significant with positive growth impacts, the very act of the citizens migrating can also generate some negative growth impacts. This adverse growth effect will, however, depend largely on the type of migrant that left home, the state of the labor market and the productivity of the migrant. If the migrant was an unskilled worker of low productivity, or an unemployed person, demonstrating slack or excess supply in the labor market, it can safely be argued that the impact of migration on output in the home country will be meager. On the other hand, if the emigrant is a highly skilled worker, such as a medical doctor or an information technology professional with a high direct and indirect contribution to output for instance, then the negative growth impact will definitely be large. The permanency of remittance flows together with the macroeconomic importance would imply, however, that the negative effects of migration might only be a short-term phenomenon.

Still, some argue that remittances are utilized basically for non-productive purposes, and have concluded that they do little to stimulate development in the countries of origin. A few studies undertaken relating to the uses of remittances show that savings produced by remittances are frequently directed to purchases of non-productive assets.14 Remittances were also seen to increase dependency. These inflows are quite volatile in the sense that countries that rely too much on them may encounter economic shocks when the flow is disrupted.15

12 The ‘remittance decay’ hypothesis indicates that the amount of remittances sent by migrants to their countries of origin declines through time. For details, see Greico (2004).
13 An example of such migrant associations is the Home Town Associations in the US, where organized migrants from various Latin American countries such as El Salvador, Guatemala, Honduras, Mexico and the Dominican Republic come together and dispatch donations to finance investment for community projects in their home countries. For more on this, see Ellerman (2003).
14 Evidences from microeconomic surveys demonstrate that purchases of land, housing and other real assets, are the most common uses of remittances in the country of origin. In some instances this led to ballooning prices of these real assets.
15 The Gulf war, for instance, put Jordan, Sudan and Yemen, among others, in difficulty owing to the massive return of emigrants. For details, see El-Sakka (1997).
The emergence of remittances as a central issue for development policy has generated some backlash and confusion among politicians and academicians pertaining to the nature of remittances. Some have cited remittances as promoting migration from poor countries, and hence leading to reduced labor pools, lower per capita incomes, increased income inequality, and negative ‘demonstration effects’.

Others have associated remittances with the so-called ‘Dutch Disease’. This term has been loosely used to diagnose the exchange rate volatility, inflation, loss of competitiveness on international markets, and other effects, such as real estate appreciation, owing to an influx of foreign exchange (including remittances) into a country. Some are of the view that remittances enable governments to avoid reforms, to overspend on the bet of growing future inflows. Still, other researchers are of the view that geographic distance and asymmetric information between remittance senders and receivers lead to problems of moral hazard, whereby recipients may engage in activities contrary to the wishes or interests of senders.

Nevertheless, many of the research studies that question the benefits of remittances seem to minimize several basic issues. In the first place, while remittances are no cause for celebration, they are not responsible for underdevelopment. The hard reality is that remittances exist since many countries cannot provide sufficient employment and income for their citizens. Thus, people move ‘North’ by the millions, and money flows towards ‘South’ by the billions. These flows have become a primary source of income for a large number of families. Indeed, it is impossible to envision social conditions in the absence of these resources.

Two, remittances do not typically produce optimal economic outcomes in recipient countries—but neither do other flows and economic activities in environments where poor economic incentives and weak institutions discourage households, businesses, and investors from saving, investing and undertaking risks.

Still, there are certain regulatory factors that can contribute to attracting or discouraging remittance flows and their investment. The factors that hinder the sending of remittances, particularly through the formal channels include (a) monetary policies, such as foreign exchange restrictions or the channeling of all foreign exchange dealings through the central bank or a state bank and (b) financial sector regulations that impact the availability or outreach of financial services. The factors that obstruct the investment of remittances comprise (a) restrictions on foreign exchange holdings, such as foreign

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16 This term is named for the economic effect on the Netherlands emanating from the discovery of natural gas in the North Sea. According to the Dutch Disease theory, the effects of capital inflows on resource allocation are traced through their effects on the real exchange rate. More precisely, it states that large inflows of capital can give rise to an appreciation of the real exchange rate and eventually a deterioration of the competitiveness of the sectors exposed to international competition, thus preventing the development of a dynamic export sector. For more on the Dutch Disease, refer to Bourdet and Falck (2004).

17 For details, see Chami, Fullenkamp and Jahajah (2003).

18 The regulatory issues pertaining to remittances are discussed at length in Sander and Maimbo (2005).

19 Examples include regulations that require banks to operate full branches rather than allowing for less costly service points or restrictive licensing of money transfer operators that ties money transfer operator services exclusively to banks.
exchange-denominated bank accounts, (b) denial of repatriation of savings, c) indirect taxation of remittances through exchange rate controls or by withholding portions of remittances; and d) administrative hurdles to setting up a business.

VI. REMITTANCE INFLOWS AND IMPACT ON NEPAL’S ECONOMY

In Nepal, much of early migrations were the result of push factors like excessive tax burden, exploitative agrarian relations and political instability. The more formal and temporary migration began after people started to work in the British army following the Sugauli Treaty that was signed on December 2, 1815. This Treaty permitted Britain to recruit Gurkhas for military service.\(^{20}\)

While both the First and the Second World War created a huge demand for young army personnel from Nepal, in recent times the scope for out-migration for military services has declined and more and more people have migrated for other types of job. It was only after the 1990s that policy makers and academicians began to fully acknowledge the importance of remittances send by Nepalese employed abroad for enhancing the livelihoods of the households, including those in the rural regions.

There are basically three methods of measuring remittance inflows. The first technique is through the BOP estimates. The second mechanism is the household surveys of recipients of such flows, for instance, the Nepal Living Standards Survey (NLSS). The third technique is through banks or financial institutions in origin countries, that is, focusing on resource transfer institutions. The size of remittance flows examined in this paper refer to the workers’ remittances under the current account of the BOP data compiled by the Research Department of the Nepal Rastra Bank.\(^{21}\)

Conclusions relating to the impact of remittances can vary depending on the analytical approach adopted. Regardless of the approach employed, studies on the poverty impact of remittances have demonstrated that apart from possibly increasing inequality and dependency, remittances make a pivotal contribution to reducing poverty and vulnerability in most households and communities. In Nepal’s case, the impact of remittances on poverty has been positive as revealed by the Nepal Living Standards Survey (2003-2004) which showed that the poverty level, defined in terms of absolute head counts, declined from 42 percent in 1995/96 to 31 percent in 2003/04.\(^{22}\) Other studies have also supported the government’s findings on the significance of remittances.\(^{23}\)

Remittances have helped to boost individual household consumption and provide temporary financial relief at the household level. A small study conducted by the Research Department of the Nepal Rastra Bank a few years ago, covering 10 districts and

\(^{20}\) A historical perspective on foreign employment in Nepal is also provided by Singh (2006).
\(^{21}\) Since remittances are transmitted through different channels, it is an arduous task to capture the full amount in the BOP statistics. As a result, it is sometimes difficult to come up with strong and valid conclusions on the role of remittances in the economic development of the country.
\(^{22}\) Besides remittances, the other factors responsible for the decline in poverty included, among others, rise in agriculture wages, rise in non-agriculture wages and income, rise in urbanization and a drop in dependency ratio owing to a decline in fertility.
\(^{23}\) For instance, according to the Asian Development Bank (ADB), in FY 2003/04, the economic recovery was led by remittance-driven consumption expenditure. For details, see ADB (2005).
160 sample households, disclosed that the remittance earnings were primarily invested for household purposes, purchase of real estate and house, paying off the loan, purchase of jewellery and as bank deposits.\textsuperscript{24}

Currently, due to the widespread conflict in the country, many workers view foreign employment as their only viable option. Again, paucity of economic opportunities at home and growing employment prospects abroad have also tempted Nepalese to seek employment abroad.\textsuperscript{25} According to the latest statistics of the Department of Labor and Employment Promotion, the number of workers going abroad for employment has increased by 14.7 percent in 2004/05 as compared to 2003/04.\textsuperscript{26} With the increase in the number of workers, the inflow of remittances has also taken an upswing. Moreover, due to policy initiatives undertaken by the concerned authorities for enhancing the inflow of remittances through the official mechanism, the share of remittances incoming through the official channel has been going up.\textsuperscript{27} For instance, in 2000/01, out of total remittance income of Rs. 47.2 billion, just about 20 percent flowed into the country through the official channel and 80 percent is estimated to have come through the unofficial channel. In 2004/05, on the other hand, out of total remittance income of Rs. 65.4 billion, 67 percent entered through the official channel and 33 percent is estimated to have flowed in through the unofficial channel (Fig. 1).

\textbf{FIGURE 1 : Remittances Inflow: Official and Unofficial Channels}

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\includegraphics[width=\textwidth]{figure1.png}
\end{center}

\textsuperscript{24} Details of this study are provided in NRB (2002). Seddon \textit{et al.} (2000) also elaborate on the investment aspect of remittances.

\textsuperscript{25} These causes have been discussed at length by Seddon (2005).

\textsuperscript{26} The number of persons granted institutional permission for foreign employment was 121,769 in 2003/04. This figure was 139,696 for 2004/05. Country-wise data discloses that in 2004/05 Malaysia (47 percent) was the major destination for foreign employment followed by Qatar (30 percent) and Saudi Arabia (10 percent).

\textsuperscript{27} These policy measures are discussed in the next section.
The growing remittances have led to a surplus in the current account, thereby strengthening the overall balance of payments position. The share of remittances in total current account receipts, excluding grants, soared from 27.4 percent in 2000/01 to 38.2 percent in 2004/05. Remittances have relaxed foreign exchange constraints of the country. One of the prime causes for the 6.0 percent growth of convertible currency reserves of the banking system in 2004/05 compared to the previous year has been the rise in remittances. The strong external position has allowed the NRB to build official reserves to high levels, reducing its vulnerability to external shocks.

The impact of remittances on national economy can also be illustrated by the fact that it has surpassed exports as the top contributor in the foreign exchange earnings of the country after 2001/02. While the share of remittances in total foreign exchange receipts was 28.0 percent, 25.9 percent and 31.5 percent in 2002/03, 2003/04 and 2004/05, respectively, the corresponding share of exports was 26.2 percent, 24.4 percent and 28.8 percent. The share of travel receipts in total foreign exchange receipts, on the other hand, went down to 5.0 percent in 2004/05 from 5.7 percent in 2000/01 (Figure 2). Likewise the remittances to GDP ratio increased from 11.5 percent in 2000/01 to 12.3 percent in 2004/05. These illustrations clearly denote that any significant decline in receipts from remittances could disturb the structure of the economy from the macro level, say, exchange rate of Nepali rupee vis-à-vis other currencies of the world to the domestic consumption of a family.

![Figure 2: Share in Foreign Exchange Receipts: Remittances, Exports and Travel (In Percent)](image-url)
VII. NEPAL’S EFFORTS TO HARNESS REMITTANCES

Owing to the potential positive effect of remittances, the country has accorded priority in promoting overseas employment and mobilizing remittances so as to maximize the benefits from these transfers. In this respect, effective March 29, 2002, the Nepal Rastra Bank (NRB) had begun granting licenses to private sector organizations interested in remittance-transfer business. As of March 31, 2006, 31 firms excluding the commercial banks are undertaking money transfer businesses as agents. Additionally, in order to make the money transfer business more competitive, the letter of intent has been granted to 83 other firms to conduct this business directly as well as to act as agents.

Other policy initiatives have also been undertaken so that remittances could be directed through the banking channel. For instance, as per its Monetary Policy and Program for FY 2002/03, the NRB had arranged to provide 15 paisa per US dollar as commission to licensed private firms in addition to the prevailing buying rate. Moreover, permission was granted to manpower agencies, engaged in sending Nepalese nationals to work overseas, to open foreign currency account in the Nepalese commercial banks out of the foreign currency income that they realized under the prevailing rules.

Beginning from 2004/05, if a Nepal-based licensed agent/representative of any money transfer company located overseas requires bank guarantee for the purpose of receiving advance payment from the principal company, a policy arrangement of making such facility available, within the stipulated limits, directly from the commercial banks has been introduced. This measure has facilitated the licensed agents in making instant payments of the remittance to the related parties.

As an increase in foreign employment generally leads to an increase in remittances, arrangement for employment is to be made by making the required provisions of training and loans to tackle the problem of unemployment by exploring foreign employment opportunities in FY 2005/06. Training programs that fall under the Council for Technical Education and Vocational Training (CTEVT), Ministry for Labor and Transport Management, Ministry of Industry, Commerce and Supplies and Ministry of Women, Children and Social Welfare would be undertaken to avoid duplication. These programs would be assessed to make them compatible to the requirements of foreign employment opportunities. Moreover, to further encourage foreign employment in FY 2005/06, provisions are to be made to provide loans from the commercial banks for those seeking overseas employment on the guarantee of Credit Guarantee Corporation.

For FY 2005/06, continuity has been made to the arrangement of seed money for foreign employment loan programs targeted at providing loan for those seeking foreign employment. The program will bear up to 80 percent of the total expenditure incurred when seeking foreign employment.

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28 See NRB (2002a) for details on this incentive.
29 This is elaborated in NRB (2004).
30 For details, see Ministry of Finance (2005).
VIII. Policy Options

Policies are needed to encourage the use of remittances to promote longer-term growth and income security. Nepal needs to further devise policies that (i) send more remittances through official rather than unofficial mechanisms; (ii) increase the levels of remittances by encouraging migrants to hold their savings in financial assets in the country rather than holding them abroad (or spending their savings on consumer goods); or (iii) encourage migrants to become investor in productive assets in the country. Elsewhere, governments of labor-exporting countries have introduced a variety of schemes with these policy objectives in mind, namely (a) repatriable foreign exchange accounts to encourage the greater use of official channels, (b) foreign currency denominated bonds to encourage more use of financial assets in the home country31, and (c) self-employment investment schemes to stimulate more direct investment in productive assets.

A favorable interest rate policy, a market-determined and realistic exchange rate and limited restrictions on withdrawals are also important. In building these products, policymakers should keep in mind that migrants and their families form a diverse group, ranging from white-collar workers to the illiterate and poor. Moreover, policies formulated to mobilize remittances should also be preceded by policies to promote other sources of foreign exchange to relieve the pressure on the foreign exchange pools and maintain stable exchange rates. Consistent interest rates should also be accompanied by policies to curb inflationary pressures.32

The opportunity to promote self-employment and small business formation amongst returning migrants and their relations back home needs to be recognized by the government and schemes must be targeted to assist investment in business activities. In order to promote investment of remittances in business enterprises, there is a dire need for the government to provide adequate incentives for migrant workers to invest in productive activities in Nepal. In this context, micro-finance institutions in Nepal could also expand their micro and small business portfolio, whereas government and NGOs could render services like training, business advice and marketing assistance for micro and small entrepreneurs to facilitate matching of funds for development projects.

31 For instance, foreign currency denominated bonds for development purposes were issued by the Egyptian Government to which Egyptians residing abroad were invited to subscribe on advantageous terms and conditions. One of the most successful techniques to encourage formal remittances of hard currencies earned by emigrants was the introduction of a special import system called Own Exchange Import System (OEIS). As per this system, importers were provided an import permit if they were able to demonstrate that they could provide the necessary foreign exchange on their own, that is, outside the official foreign exchange pool. The principal source of foreign exchange to the importers was the savings of emigrants. The OEIS was a very successful way of encouraging emigrants to utilize their savings to finance the country’s needed imports from overseas. For more, see El-Sakka (1997).

32 In this context, domestic interest rates need to be quite competitive with those of the outside world. Lower interest rates in the country will provide incentives for the emigrants to put their savings abroad, or to direct their remittances towards non-productive uses with higher speculative intentions, such as investing in land and other real assets.
One of the biggest hurdles to private sector growth in Nepal is the paucity of credit for seed capital and working capital for enterprises, especially small and medium-size enterprises. Pooled remittances can provide such credit, thus supporting the growth of enterprises. Although residing abroad, many Nepalese migrants want to invest in enterprises in their home country, either to employ family members at home, earn additional income or to prepare for their retirement or eventual return. These types of investments on the part of remitters can lower poverty by expanding businesses in their home communities and generating jobs and income that would not otherwise exist.

Pre-departure training for labor migrants is not only important to reduce the human and economic costs of migration, it can also be a powerful tool in raising awareness about remittance methods and utilization. The involvement of a variety of actors (migrant associations, NGOs and governmental bodies) is instrumental in the success of these initiatives.

To end this section, a few suggestions are made for improving the remittance market in terms of the roles to be played by each of the remittance market players: (a) remittance institutions, (b) public authorities; (c) civil society. Institutions conducting remitting business such as banks and money transfer companies should (a) disseminate all the information on total costs and transfer conditions, including all commissions and fees, foreign exchange rates applied, and execution time in a fully transparent way (b) compete on the basis of fair and non-discriminatory contractual arrangements and refrain from indulging in unfair pricing and applying high exchange rate margins, (c) use cost effective technology and deploy innovative platforms to slash costs, improve speed and security, and develop new products, (d) look for partnerships and alliances, including linkages between money transfer companies and financial institutions, in order to leverage capabilities and promote ‘cash to accounts’ services, and other forms of financial intermediation and e) deepen financial markets through inclusive and integrated services for remittance customers, such as current account services, savings, credit and mortgage products, inter alia.

The government and/or the NRB need to (a) facilitate remittance market and avoid attempts to tax, over-regulate or otherwise take actions that retard the remittances flow; (b) improve systems for collecting and reporting remittance market data and help to devise international standards for computing such data; (c) facilitate the mainstreaming of remittances into financial institutions by improving regulatory and financial sector frameworks; and (d) arouse awareness of the benefits of savings and other financial products.

The civil society and private sector organizations, on the other hand, should (a) systematically identify hurdles to leveraging the development impact of remittances, and engage and cooperate with all relevant stakeholders to address and eliminate such hurdles; and (b) support the social and financial inclusion of transnational families into their communities and build up innovative partnerships to promote training and domestic productive opportunities.

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33 A list of suggestions is also delineated in Terry, Wilson and De Vasconcelos (2005).
IX. CONCLUSIONS

Remittances are potentially important stimuli to economic growth. Despite the lack of accurate data on the real volume of funds transferred, there is ample evidence that remittance flows are substantial, stable relative to other forms of development finance, and well-targeted to vulnerable families, both as support during a crisis and as an income-smoothing mechanism.

In Nepal, during the last few years, remittances have been an important avenue of support for family members remaining at home. As the number of workers going abroad for employment continues to rise, the corresponding growth of remittances has become a critical flow of foreign currency into Nepal. This has been partly the result of measures undertaken by the concerned officials to streamline financial systems, dismantling controls and creating incentives, with the aim of attracting remittances particularly through the official channels.

Economic growth, interest rate and exchange rate policies are crucial determinants of remittance inflows. In order to further encourage the inflow of remittances to the country through official channels, and to promote the tendency to exchange these remittances of foreign exchange into local currency, it is imperative that these policies be conducive to the inflow of remittances.

REFERENCES


