Remittances as development resource: The experience of Nepal

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The history of Nepalis going abroad for work dates back to at least the early 19th century, when the British began to recruit men (the Gurkhas) from the hill areas into their armed forces. Following its independence from the Britain in 1947, India too started to recruit Nepali men into its military. Nepali workers have been going to present-day India, which borders Nepal on three sides, seeking employment during the dry season for centuries.[2] Following the enactment of the Labour Act of 1985, the first official recognition of the benefits of foreign migration (CBS 2006), foreign employment destinations diversified to include Southeast and Fareast Asia and later the Middle East. But the scale of labour out-migration, especially to overseas countries (other than India), since the late-1990s has been staggering and unprecedented, with the result that remittances have become a veritable mainstay of the Nepali economy.

1. Some facts and figures on Nepali migration

Estimates of the number of Nepali migrant workers in foreign countries vary—at times, by a huge margin[3]—but a recent World Bank-funded survey, Nepal Migration Survey 2009 (NMS) [4], puts the number of at 2.1 million at the minimum. Nepal's population was 29 million in 2009. Officially recorded remittances have been increasing rapidly in both absolute terms and as a percentage of GDP, reaching US$3.5 billion, or 22 percent of GDP, in 2010.[5] Nepal is the second largest recipient of remittances in absolute amounts among least-developed countries (LDCs) after Bangladesh (and ranks 33rd among all countries), and the fifth largest recipient of remittances as a percentage of GDP in the world. [6]

While only 3,605 people left for overseas employment in 1993/94, the figure increased to 55,025 in 2000/01 (Sharma and Gurung 2010). Departures surged after 2001, as an armed conflict intensified and administrative reforms relating to passport issuance were taken. In the last five

[2] The 1950 Treaty of Peace and Friendship between Nepal and newly independent India allows nationals of one country to work in another. Work-related migration occurs in both directions.

[3] Records of the Department of Foreign Employment, Government of Nepal, do not capture migration to India, with which Nepal shares an open border. There is free movement of people across the border with no records maintained. Also, the Department records do not capture migration of workers to overseas countries via India. Its figures are annual flows, not stocks.

[4] The survey was conducted among 3,200 households during May-June 2009. Preliminary findings of the study were presented by the World Bank in 28 June 2011 in Kathmandu. The available findings of the study, when cited in this paper, are attributed to NMS 2009 (Nepal Migration Study 2009).

[5] This figure is from the World Bank's World Development Indicators (WDI) database. The World Bank defines remittance as "Workers' remittances and compensation of employees comprise current transfers by migrant workers and wages and salaries earned by nonresident workers. Data are the sum of three items defined in the fifth edition of the IMF's Balance of Payments Manual: workers' remittances, compensation of employees, and migrants' transfers…" (WDI notes). This does not include most of the remittances from India which are mostly brought in by migrants themselves or sent through relatives and friends (Pant 2008) and those sent through informal channels.

[6] Calculated from Migration and Remittances Data of the World Bank.

years, over 200,000 Nepalis have been departing for countries other than India every year for work through official channel.[7]

While the Government of Nepal recognizes 107 overseas destinations for Nepali migrants, migration is concentrated in a few countries, namely as India, the Gulf (mainly Qatar, Saudi Arabia, UAE) and Malaysia. As per records of Department of Foreign Employment, of the total number of persons who have gone overseas for work through the formal channel until the first eight months of FY 2010/11, 33 percent have gone to Malaysia, 27 percent to Qatar, 20 percent to Saudi Arabia and 12 percent to UAE. South Korea has emerged as an attractive destination (for the relatively skilled) in recent years after the South Korean government provided labour quotas to Nepal under the Employment Permit System (EPS), although the total number of workers who have gone to South Korea remains quite small (less than 14,000).

As per NMS 2009, India accounts for 41 percent of Nepali migrant workers, Gulf countries 38 percent, Malaysia 12 percent, and developed countries (including the US, UK, Australia and Japan) 9 percent. About half of the remittance comes from Gulf countries (NMS 2009). The migrants are mostly male (93 percent). Households with the least wealth tend to send members to India for work (NMS 2009). Almost half of households have at least one absentee abroad or a returnee from abroad (NMS 2009). Going by the NMS 2009 estimate and taking the estimate of adult male population by the Nepal Labour Force Survey 2008 (CBS 2008)[8], about a quarter of the adult male population works abroad. A third of households have at least one absentee abroad (CBS 2011a). Some 23 percent of households receive remittance from abroad (CBS 2008) and remittance from abroad accounts for 80 percent of total remittance (including from within Nepal) received by households (CBS 2011a). The figure was 56 percent in 1995/96.

Migration abroad for work is spread across the country, across five development regions, three ecological belts, and households of different expenditure quintiles. Most of the migrants are young, 20-44 years old. While only 6-7 percent of migrants are female, they on average earn and remit more than men (NMS 2009). Government's restrictions on foreign employment for women (they need a letter of guarantee from a Nepali embassy before being able to go abroad for work legally) have driven them to informal channels of migration, increasing the risks they face. Nepali migrants are employed mostly in manufacturing, construction and hotel/catering. The vast majority of migrants are semi-skilled and unskilled (ADB et al. 2009).

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[7] As per the records of the Department of Foreign Employment (Ministry of Finance, *Economic Survey*, various issues).

[8] The survey, conducted in 2008, enumerated 15,976 households. It estimated the number of people aged 15 and above at 14.42 million (6.45 of them male). It suggests increasing the absolute figures by 15 percent to adjust for the difference between the total population estimated by the survey and the more recent population estimate. The male population of aged 15 and above would then be 7.4 million.

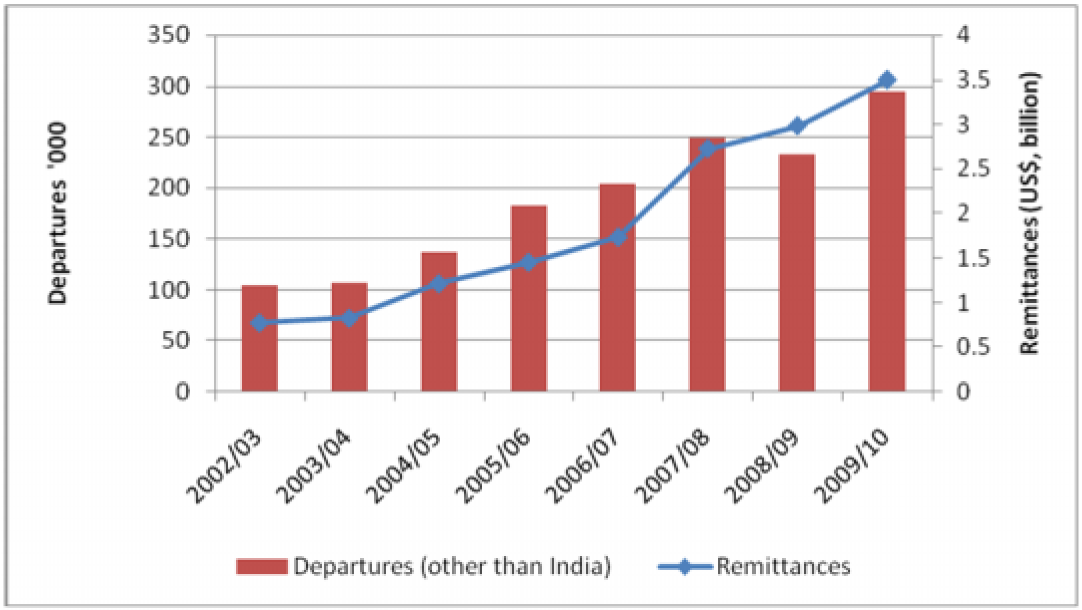
2. Trend, role and importance of international migration and remittances in the Nepali economy

The burgeoning outflow of Nepali workers for foreign employment is occurring amidst a dismal rate of output growth and job creation in the economy. At least 400,000 youths enter the labour force every year; over 200,000 go overseas for work every year, with remittances increasing in tandem with departures (Figure 1). Foreign employment opportunities have served as a safety valve of sorts to release un/underemployment pressures. A conservative estimate puts at least 30 percent of the currently economically active population as being underutilized (CBS 2008). It is worth noting, however, that while at least 2.1 million Nepalis are working abroad, the country also hosts a substantial number of international migrants, almost half that number. Most of them are from India.[9] Migrants from India work in a variety of occupations (unskilled, semi-skilled and skilled, formal and informal), from construction to carpentry to manufacturing (see Gurung 2004).

Figure 1

Trend of overseas departures and remittances

[9] Estimating the size of foreign migrants in Nepal is difficult mainly because of the free movement of people through the open border with India and national treatment in most matters of business and employment to Indian nationals. Possible sources of underestimation of foreign migrants in the national population census or labour force surveys include misreporting by respondents and the situation when foreign nationals have obtained Nepali citizenship (illegally). After Indian nationals, the largest group of foreign migrants is most likely Bhutanese refugees, numbering over 100,000 at one point, but their numbers are declining with the implementation of third-country resettlement deal. Nepal Labour Force Survey 2008 estimates the total number of foreign migrants in the country to be 993,000, while The Migration and Remittances Factbook 2011, of the World Bank, puts the figure for 2010 at 945,900. For reasons specified above, these are likely to be conservative estimates.



Source: Author's calculation based on WDI for remittances and Department of Foreign Employment data for departures.

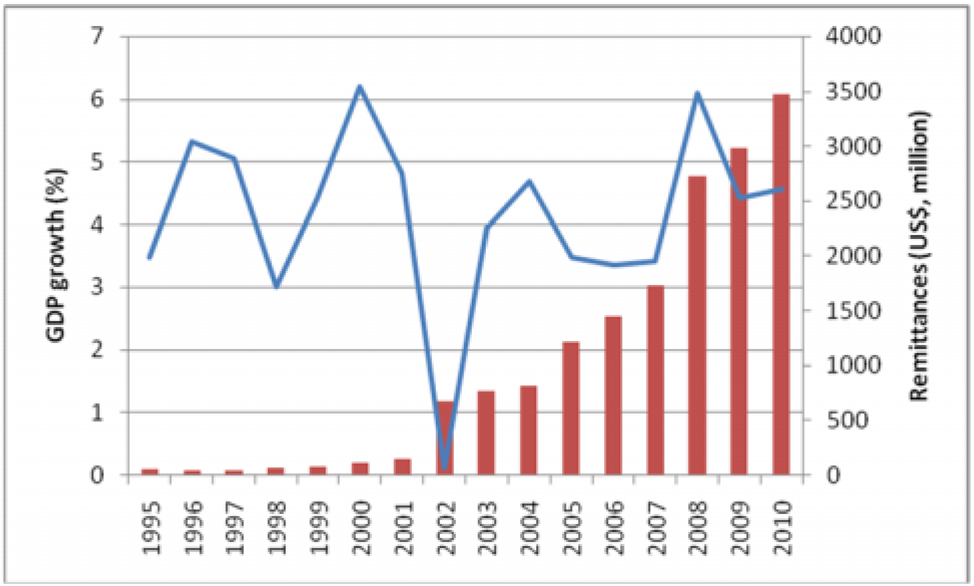
Nepal is the slowest growing economy in South Asia, particularly in the last decade. Its compound annual GDP growth rate was 3.87 percent during 2000-2010, and per capita GDP growth was 1.8 percent during the same period. While remittances have been growing robustly, GDP growth has been low and erratic, touching 6 percent only once after 2000 (Figure 2).[10] With a per capita GDP of US$524 (or PPP$1,189) in 2010, Nepal is the poorest country in South Asia.[11] In a period of depressing growth performance, remittances have proved to be countercyclical. With GDP growth sluggish but remittances booming, the ratio of remittances to GDP has been increasing, from 2 percent in 2000 to 22 percent of GDP in 2010 (Figures 2 and 3)[12]. Such a huge remittances-to-GDP ratio means that per capita gross disposal personal income (GDPI)—which includes remittances—is a more relevant measure of per capita income, as a proxy for living standards, than is per capita GDP or even per capita gross national income (GNI) for Nepal.

Figure 2: GDP growth and remittances

[10] Increased use of formal channels for remitting money also played a role in the growth of officially recorded remittances.

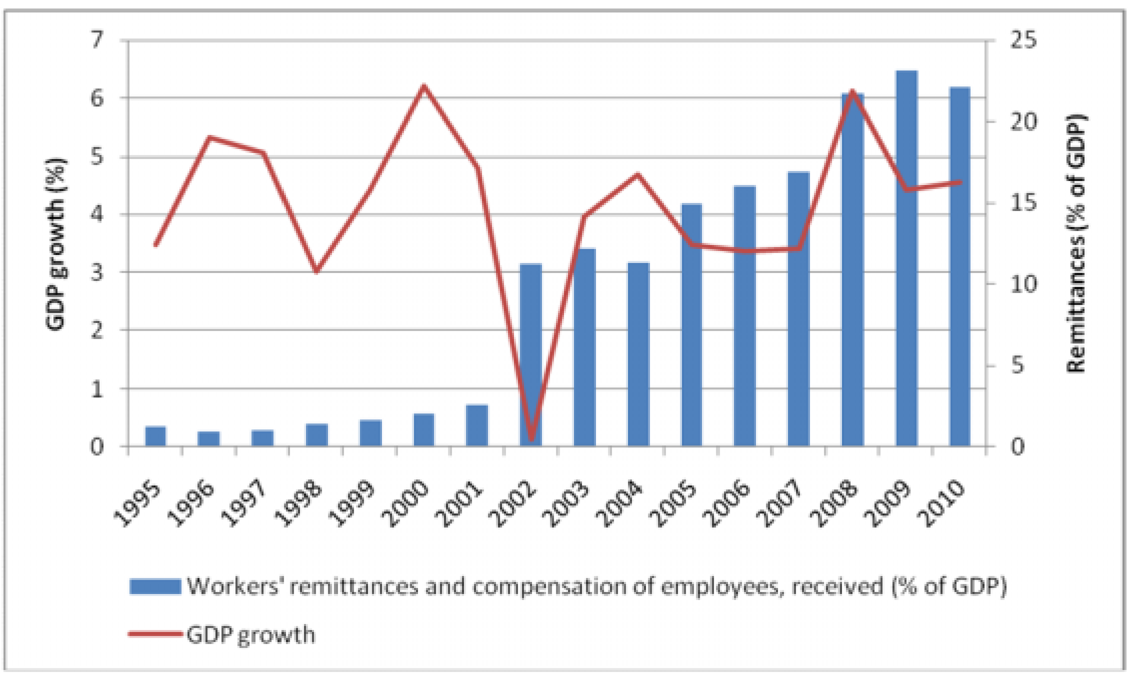
[11] Data are from WDI. Afghanistan's per capita GDP for 2010 is not available at WDI.

[12] An estimate puts remittances from India, which mostly come through informal means, at one fourth of remittances from the rest of the world, or 4 percent of GDP (NMS 2009).



Source: Author's calculation based on WDI.

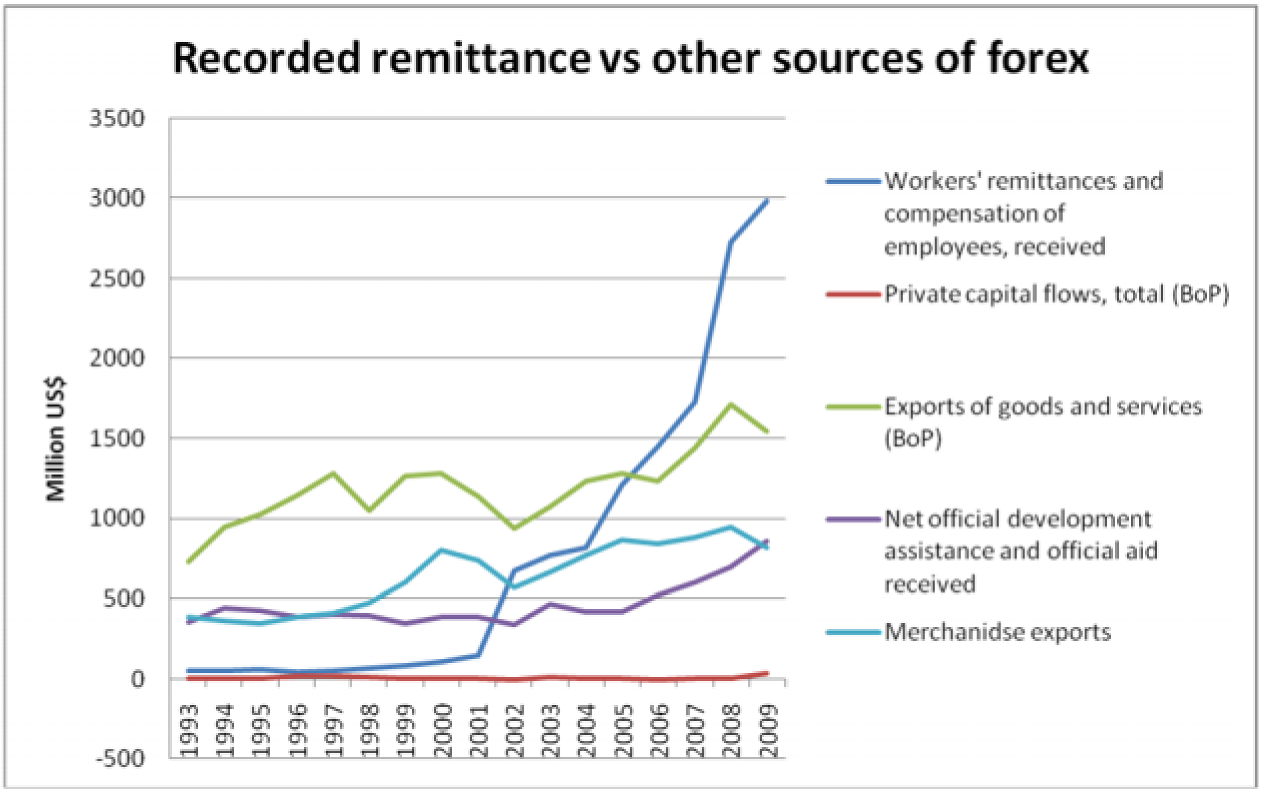
Figure 3: GDP growth and remittances



Source: Author's calculation based on WDI.

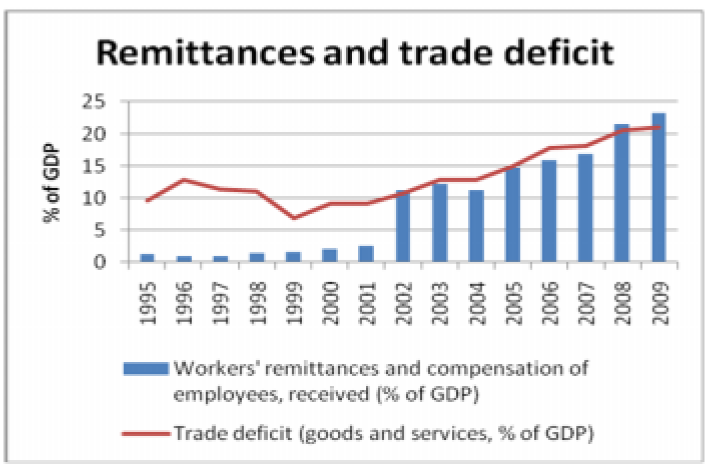
In the last one decade, remittances have emerged as the largest source of foreign exchange earnings of the country (Figure 4). In 2009, remittances were greater than all other sources of foreign exchange combined (exports of goods and services, foreign aid and a very small amount of private capital inflows, including FDI), and in the last couple of years remittances have been enough to meet the entire deficit in trade in goods and services, which has been increasing rapidly (Figure 5).

Figure 4: Recorded remittance vs other sources of foreign exchange



Source: Author's calculation based on WDI.

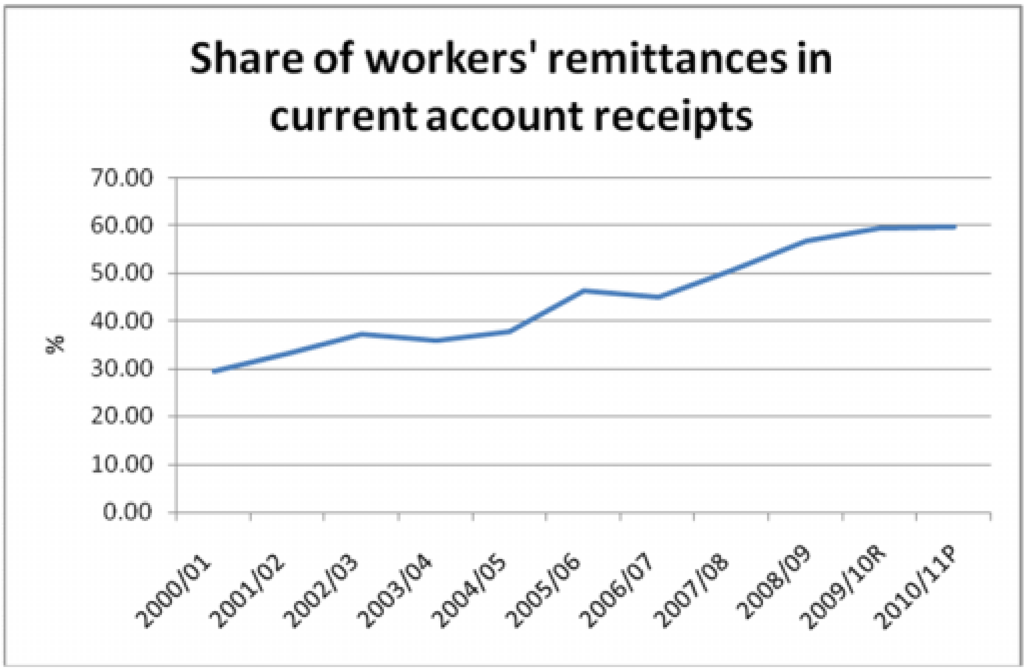
Figure 5: Remittances and trade deficit



Source: Author's calculation based on WDI.

Remittance inflows have been the key factor behind the current account and the balance of payments registering a surplus almost every year in the last one decade. The share of remittances in current account receipts has almost doubled in the last decade to be nearly 60 percent in 2010/11 (Figure 6).

Figure 6: Share of remittances in current account receipts



Source: Author's calculation based on Nepal Rastra Bank's balance of payments data.

The global financial and economic crisis beginning 2008 saw Nepal's exports fall in absolute value (in 2009) while remittance growth rate fell (along with a decline in the number of workers going overseas in FY 2008/09 compared to FY 2007/08). The number of overseas departures rebounded in 2009/10 but the growth rate of remittances in 2009/10 and 2010/11 remained lower than in the previous two years. As imports surged and remittance growth slowed, the current account and the blance of payments turned negative in 2009/10. Althought the trend was quickly reversed, Nepali migrant workers returned home after losing their jobs in Gulf countries and Malaysia as the global financial and economic crisis took its toll (Sharma and Gurung 2009), serving as a reminder of the risks of overreliance on foreign employment and remittances.

A sharp depreciation of the Nepali Rupee vis-à-vis the US dollar (due to depreciation of the Indian currency, to which the Nepali Rupee is pegged) could be contributing to a surge in remittance inflow in second half of 2011.[13] Remittance inflows from mid-July to mid-October 2011 grew by 28 percent, double the growth in the corresponding period in 2010.[14] The depreciation might have created incentives for migrants to increase transfers as the recipients would get more in terms of local currency. [15]

People across wealth levels and regions go for foreign employment, and remittances are helping boost consumption. Consumption amounts to 93.3 percent of GDP (in 2010/11).[16] The share of consumption in GDP increased from an average of 86.6 percent during 1990/91-1999/2000 to 90.4 percent during 2000/01-2010/11. Real average per capita consumption, based on household survey data, grew by 3 percent per annum during 2003/04-2010/11 and 4.54 percent during 1995/96-2003/04 [17] -- a higher rate than per capita GDP growth during the same period. Similarly, national accounts data show real total final private consumption expenditure growing by 5.1 percent as opposed to real GDP (at producers' prices) growth of 3.7 percent during the decade 2000/01-2010/11. During 2003/04-2010/11, per capita consumption of the poorest decile grew at a faster rate than that of the richest decile (CBS 2011b). Remittance is mostly spent on consumption (CBS 2011a). About 79 percent of remittance is spent on daily consumption, 7 percent to repay loan, 4.5 percent on household property, 3.5 percent on education, and only 2.4 percent on capital formation (CBS 2011a).

Because of high consumption and the consequent low gross domestic savings (6.7 percent of GDP in 2010/11), the gross domestic savings-investment (gross capital formation, GCF) gap is negative and high (-23.6 percent of GDP in 2010/11). However, remittance inflow, even as it fuels consumption, has been so large that the gross national savings (GNS) have exceeded GCF (as also reflected in the form of current account surplus) in all but two years since 2000/01. Gross national savings were 32.3 percent of GDP in 2010/11, 2.6 percentage points higher than gross capital formation. Nepal received net ODA amounting to 6 percent of GNI on average during 2000-2009.[18] Also, foreign aid accounted for about 18 percent of government expenditure

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[13] The Nepali Rupee depreciated vis-à-vis the US dollar by 9 percent between mid-July to mid-October 2011, from 70.95 to the dollar to 78.1. The depreciation continues, with the rate 82.35 on 2 December 2011. (Source: Nepal Rastra Bank's "Recent Macroeconomic Situation" updates, available at www.nrb.org.np)
[14] See note 13.

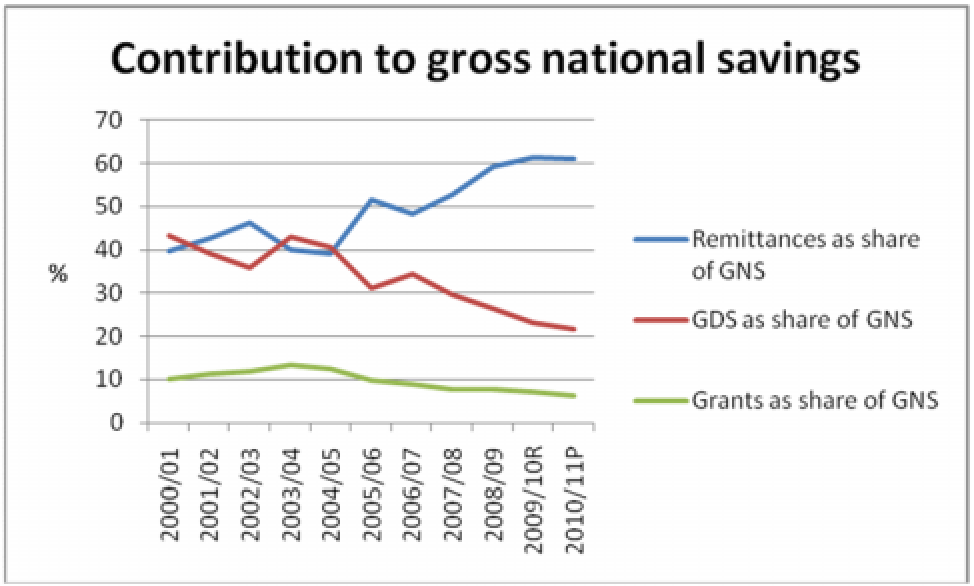
[15] The growth is calculated on remittances in NPR. Converting NPR figures into US$ figures by using the average exchange rate for the two periods indicates a still high 24.5 percent growth.
[16] Ministry of Finance, *Economic Survey*, various issues.

[17] The real per capita consumption growth rate for the first period is calculated in CBS (2005). The same for the second period is calculated by the author by converting the nominal figure for 2010/11 (provided in CBS 2011b) into real terms by using change in value of the GDP implicit price deflator index between 2003/04 and 2010/11 from the national accounts available in the Economic Survey.

[18] Data from WDI.

on average during 2006/07-2009/10.[19] However, remittances' contribution to GNS is now almost thrice that of GDS, increasing from 40 percent in 2000/01 to 61 percent in 2010/11 (Figure 7). The contribution of GDS has been declining and that of grants is quite stable (6 percent) (Figure 7).

Figure 7: Contribution to gross national savings



Source: Ministry of Finance, *Economic Survey*, various issues, Nepal Rastra Bank's "Recent Macroeconomic Situation" updates, available at www.nrb.org.np

This points to domestic resource mobilization by the government being less than the potential. Tax revenue is less than 13 percent of GDP and is mostly generated through indirect taxes, with income tax accounting for only a quarter of tax revenue (2010/11). Among indirect taxes, import-based taxes (including tariff, VAT and excise) accounted for nearly 50 percent of the tax revenue in 2009/10. Tax revenue grew 57 percent faster than actual government expenditure during 1999/2000-2009/10, and half of the growth of tax revenue has been due to growth of import-based taxes. Remittances have fuelled consumption, which, due to weak domestic supply capacity, has in turn fuelled imports, thereby causing robust import tax-based revenue growth. This, together with a relatively comfortable foreign exchange reserve position[20], has helped create a false sense of prosperity.

[19] Data from Economic Survey.

[20] As of mid-July 2011, foreign exchange reserves are enough to cover merchandise imports for 8.4 months and merchandise and services imports for 7.3 months. However, the import capacity has been declining over the last three years, from 12.3 percent and 10 percent, respectively, in mid-July 2009.

Remittances as development resource: The experience of Nepal

Migration and remittances can affect consumption and poverty in a number of ways, including through transfers, higher local wages, and higher demand for services or locally produced goods (CBS 2006). Poverty incidence in Nepal has been on a declining trend: the headcount poverty ratio declined from 41.8 percent in 1995/96 to 30.8 percent in 2003/04 to 25.2 percent in 2010/11 (CBS 2011b).[21] Using a uniform poverty line, the headcount poverty ratio has declined by 30 percentage points in the 15-year period 1995/96-2010/11, or by an average of 2 percentage points per year.

Ex ante, better-off households are less likely to receive remittance but once they receive it are likely to receive more of it (CBS 2006). Households in the second bottom spending quintile tend to receive the largest share of foreign remittances, with 25 percent of households in the quintile receiving remittances, compared with 15 percent in the top quintile, according to a survey conducted in 2006 (Ferrari et al. 2006). Increased worked-related migration (internal and international) and remittances sent home are estimated to have directly accounted for 20 percent of the reduction in poverty between 1995/96 and 2003/04, with international migration contributing about 14.5 percent (Lokshin et al. 2007). In the absence of migration, the poverty rate among households with migrants within Nepal would have been 100 percent higher and that among households with migrants abroad 7 percent higher (Lokshin et al. 2007). Interestingly, the elasticity of poverty reduction is significantly higher for domestic migration than it is for international migration (Lokshin et al. 2007), indicating the potential importance of domestic migration in poverty reduction. Also, the poverty rate among households with migrants abroad was about 10 percentage points higher than that among households with migrants in Nepal in 2003/04 (Lokshin et al. 2007). In addition, international migration is likely to have also contributed to some other factors behind poverty reduction, for example, increase in non-agricultural incomes (through increase in remittance-induced demand) and agricultural wages (through tightening of the labour market) (CBS 2005 and CBS 2006)[22]. Households headed by agricultural wage workers remain the poorest, and households with head self-employed in agriculture also tend to be poor (CBS 2005 and CBS 2011b). Taking account of general equilibrium effects (economy-wide impacts and multiplier effects) of international migration and associated remittances could increase the contribution of international migration and remittances on poverty reduction.

Given the increasing trend of people, of all strata, going abroad employment, a robust growth in remittance inflows, and the abysmal domestic economic growth since 2003/04, there are strong reasons to believe that the decline in poverty during the period 2003/04-2010/11 is, at least in part, attributable to remittances, although this remains a subject for research.

[21] The poverty line is the national poverty line. The poverty rate for 2010/11 is not directly comparable with the rates for 2003/04 and 1995/96 as the consumption basket used to calculate the poverty line in NLSS III is different from the one used in NLSS I (2003/04) and NLSS II (1995/96). The consumption basket was changed to reflect significant shifts in consumption patterns. If the same consumption basket (used in the first two surveys) is used, then the poverty ratio for 2010/11 is much less, about 13 percent. See CBS (2011b).

[22] The other important factors are increased connectivity, urbanization and a decline in dependency ratio due to reduction in fertility rate (CBS 2005 and CBS 2006).

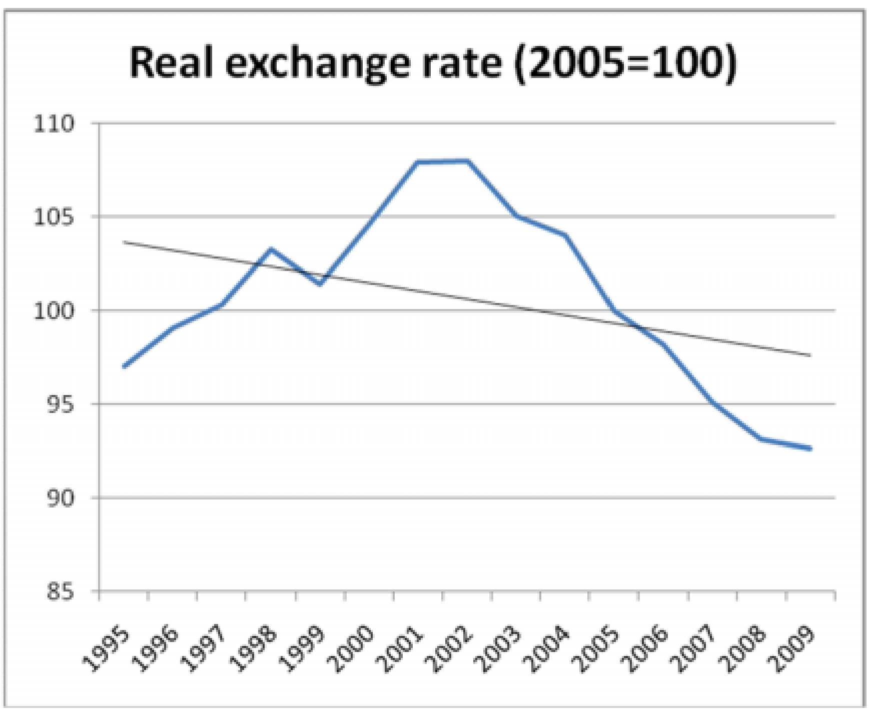
Inequality in consumption, as measured by the Gini coefficient, increased during 1995/96-2003/04 (from 0.32 to .41) but decreased thereafter to 0.33 in 2010/11 (CBS 2011b). Migration, neither internal nor international, was not found to have contributed to the increased inequality during 1995/96-2003/04 (Lokshin et al. 2007).

3. Costs, risks and challenges

Macro level

Along with the growing importance of remittance in the economy, symptoms of the Dutch disease are being seen, although one cannot argue that the phenomenon is happening and hurting growth and competitiveness conclusively. Nepal maintains a fixed exchange rate with the Indian Currency (IC), not revised since 1992, and the exchange rate between NPR and other currencies are determined by the exchange rate of IC with these currencies. Even as NPR depreciated vis-à-vis other currencies and its peg with IC remained unchanged, NPR witnessed continuous *real* appreciation since 2002 (Figure 8) due to rising inflation.[23]

Figure 8: Real exchange rate

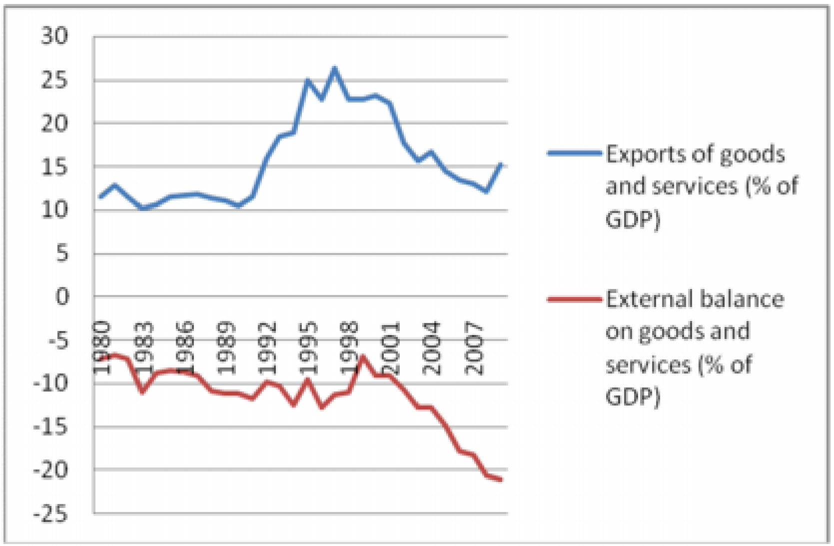


Source: Author's calculation based on WDI.

[23] While calculating the real (effective) exchange rate, the exchange rates of NPR with IC and the US dollar are only considered, the rationale being that the majority of Nepal's trade is with India and trade with other countries is mostly denominated in US dollars. The weights for IC and the US dollar are share of India and the rest of the world in Nepal's exports, respectively.

Coexisting with rising remittances has been a weak export performace. Exports of goods and services as a percentage of GDP decreased from 26 percent in 1997 to 15 percent in 2009, while imports are burgeoning, taking the trade deficit to 22 percent of GDP (Figure 9).

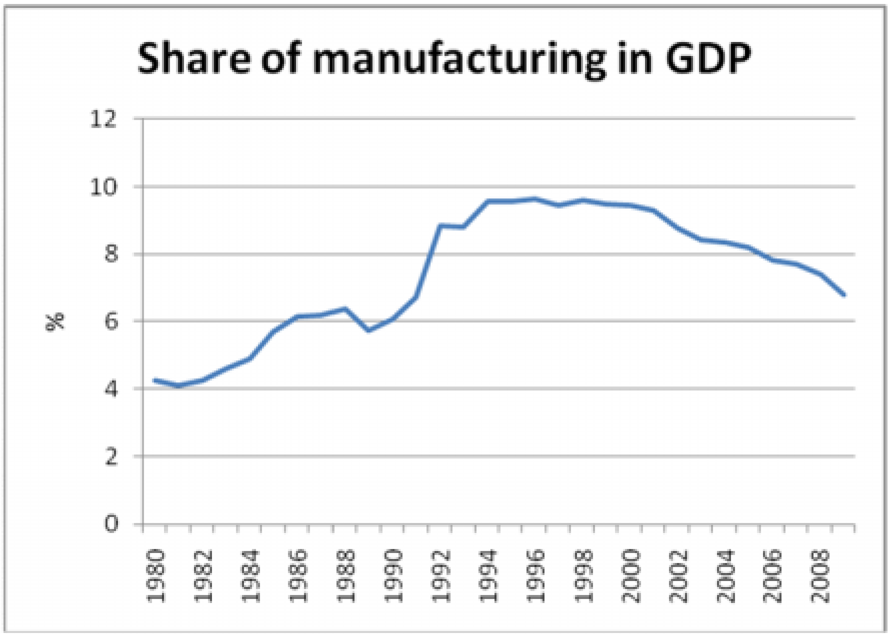
Figure 9: Export performance



Source: Author's calculation based on WDI.

Manufacturing has grown at a dismal rate of less than 0.7 percent per annum (compounded) during the decade 2000/01-2010/11. While Nepal's manufacturing value added has never touched 10 percent of GDP (during 1980-2009), the ratio followed an increasing trend in the 1980s and the early 1990s before stabilizing at 9.5 percent in the rest of the decade, but it started to fall continuously after 2000 (Figure 10).

Figure 10: Share of manufacturing in GDP



Source: WDI.

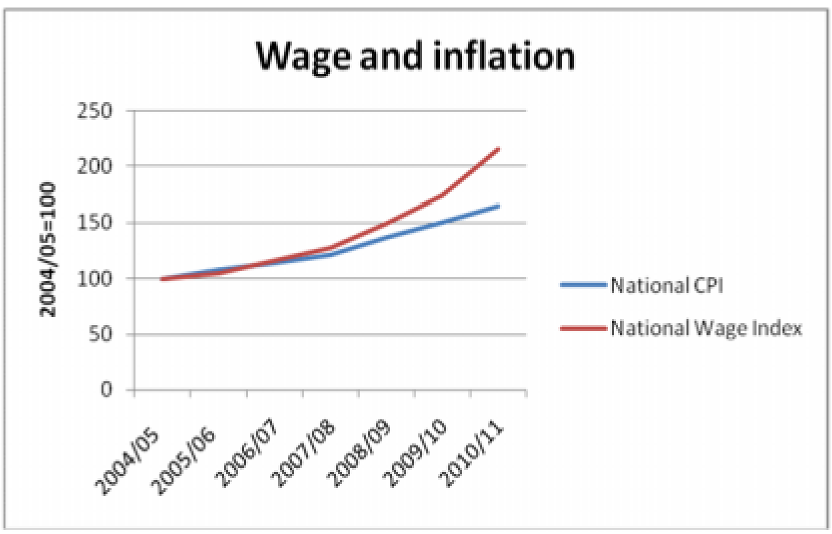
The share of agriculture in GDP has declined continuously to 33 percent in 2010/11, but continues to employ as much as 74 percent of the currently employed labour force (CBS 2008). Services[24], mostly of non-tradable variety, grew faster than agriculture and manufacturing, at 4.5 percent per annum (compounded) during 2000/01-2010/11 and accounted for 52 percent of GDP in 2010/11. The largest services sectors (in 2010/11) are wholesale and retail trade (25 percent), transport, storage and communication (19 percent), real estate, renting and business (16 percent), education (13 percent), and financial intermediation (8.6 percent). The structure of the Nepali economy has thus shifted from an agriculture-dominated one to that of a non-tradable services-dominated one, with the manufacturing sector faltering. This is not to suggest that remittances are the sole and the most important factor for the dismal performance of the manufacturing and export sectors. Indeed, it must be noted that the first half of the new millennium witnessed an escalation of an armed conflict while the second half, even after the an official end of the Maoist insurgency, has been marred by political instability[25], deterioration of law and order[26], proliferation of other armed outfits, strikes and shutdowns, and worsening industrial relations. These, in addition to the binding constraint of inadequate and poor infrastructure, have hurt the business and investment climate, and partly explain the poor growth performance (ADB et al. 2009). Moreover, the increase in consumption demand fuelled by growing remittance inflows is

[24] Excluding construction, and electricity, gas and water. Adding construction takes the ratio to over 58 percent.
[25] There have been four governments since the 2008 elections to the Constituent Assembly.
[26] The “rule of law” component of the World Governance Indicators has deteriorated consistently after 2006 (Kaufmann et al. 2010).

a potential source of economic growth if domestic production and supply response (in turn determined by domestic investment climate) is good.

Out-migration of a signficant portion of the labour force is likely to have helped equilibriate the domestic labour market at a higher wage level. Wages have been increasing rapidly, much faster than the inflation rate, particularly since 2006/07 (Figure 11). Between 2004/05 and 2010/11, the wage index increased by 115.5 percent compared to 57 percent for the salary index and 53 percent for the national consumer price index.[27] Wages of agriculture labour and construction labour have increased the fastest during the period (148 and 90 percent, respectively). Wages of semi-skilled and unskilled labour have grown faster than skilled and high-skilled labour. Wages of industrial labour increased by 73 percent during the seven-year period. While increasing wages, in agriclulture and outside, have contributed to poverty reduction, rising industrial wages could dent the competitivness of, among others, the comatose manufacturing sector. Also, given the sizeable presence of foreign migrant workers in a variety of sectors in the country, part of the benefits of rising wages is likely to have diverted to non-Nepali nationals.

Figure 11: Wage and inflation



Source: NRB (2011), and Nepal Rastra Bank's "Recent Macroeconomic Situation" updates, available at www.nrb.org.np

In addition, while most of the migrants are unskilled or semi-skilled, with virtually no prospect of getting permanent residency, and they account for the bulk of the inward remittances, the highly educated and the skilled and highly skilled (including medical doctors and engineers) are

[27] Data on wages are from Nepal Rastra Bank, 2011, *Quarterly Economic Bulletin* 45(3), Mid-April, Kathmandu, and from Nepal Rastra Bank's "Recent Macroeconomic Situation" updates, available at www.nrb.org.np

also increasing going abroad for work (GoN and ADB 2010).[28] The latter, when they migrate to developed countries (the US, Australia, among others), are most likely to opt for permanent residency status along with their dependents if given the choice. Permanent migration is associated with less remittance transfer in general (World Bank 2006). Theoretically, what appears to be a brain drain could be turned into a gain for the economy as a well-educated diaspora can, among other things, improve access to capital, technology, information, foreign exchange, and business contacts for firms in the country of origin (World Bank 2006). But high-skilled emigration also may reduce domestic growth through a number of channels (see World Bank 2006). When such migration turns into an exodus, there could be a net loss for the country. The loss is almost certainly positive when people educated and trained with public resources migrate (e.g., medical workers and engineers). Of course, even if the domestic economy grows at, say, double digit rate, migration abroad (whether of the skilled or the unskilled) will continue so long as opportunities abroad are better, as has been the experience of other developing countries (e.g., India). However, this may also result in an vicious circle, with poor domestic business and investment and climate pushing high-skilled people abroad and the lack of high-skilled workers contributing to the poor investment climate and limiting the supply response to reform (World Bank 2006). The sense of prosperity derived from international migration and associated remittances (from increased consumption levels to increased imports-based revenue for the government) could lead to complacency about the state of domestic economic affairs.

As deposits in financial institutions soared[29] on the back of a remittance boom[30] and as the number of financial institutions exploded[31], credit to real estate (land, housing and apartment) surged. This resulted in a property bubble and a dangerous exposure of the financial sector to real estate.[32] As banks with high loan exposure to real estate started having serious trouble, the

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[28] Available data are dated, but in 2000 the emigration rate of tertiary education population is estimated at 5.3 percent and the emigration rate of physicians trained in the country 3.3 percent (World Bank, The Migration and Remittances Factbook 2011).

[29] Commercial bank deposits increased at a compound annual growth rate of 15 percent during 2000 (July)-2010 (July).

[30] As noted above, remittances have become the most important source of foreign exchange. And the increase in net foreign assets (mostly composed of foreign exchange) accounted for about 88 percent of the increase in the reserve money (the monetary base) during 2000 (July)-2010 (July).

[31] The number of financial institutions more than doubled to 305 during 2000 (July)-2011 (April), with development banks recording the largest increase, from just 7 to 87 in 11 years.

[32] Central bank data show that as of July 2011, the outstanding loans of commercial banks to the real estate sector amount to NPR 82.5 billion, or 16 percent of the total outstanding loans of commercial banks. The actual figure is said to be much bigger when loans channeled to real estate indirectly are also considered [for an anecdotal evidence, see Uttam Maharjan, n.d., http://www.gorkhapatra.org.np/rising.detail.php?article_id=59678&cat_id=7). Although there is no readily available database on the loans from other financial institutions to real estate, such loans are said to substantial. The deposits in development banks and finance companies came around 25 percent of the deposits in commercial banks in July 2010.

central bank belatedly tightened credit to real estate, in 2009. To be sure, the crux of the problem is regulatory/supervisory failure. But the phenomenon also points to the challenge of judiciously mobilizing liquidity in the economy—remittances being a major contributor—for increasing domestic production activities and employment generation. Compared to mere purchase and sale of land, the construction sector is labour-intensive and has backward linkages with the manufacturing sector (mainly production of construction materials). However, the construction of buildings (particularly residential ones), despite these benefits and despite being counted as part of gross fixed capital formation in the national accounts, does not contribute to the economy's productive capacity or the production of goods and services (particularly tradables) on a sustainable basis, which is what is needed for an economic tranformation.

As the largest source of foreign exchange earnings, remittances may also be indirectly financing capital flight. A UNDP study estimates that capital flight from Nepal was at least US$8 billion during 1990-2008, or 8 percent of GDP on average (the ratio was 4.8 percent for LDCs as a group), and over US$4 billion during 2000-2008 (UNDP 2011). The bulk of the capital flight (87 percent) is attributed to trade mispricing, i.e., overvaluation of imports and undervaluation of exports. The huge recorded foreign exchange earnings from remittances ease foreign exchange constraints on capital flight that takes place through import transactions recorded in the balance of payments. Additionally, remittances sent through the *hundi* system, although its incidence is declining, do not add to the national foreign exchange reserves, and hence are another mechanism of capital flight.[33]

Household level

While international migration and the associated remittances have contributed to increase household income and consumption and reduce poverty, there are also associated human, social and financial costs at the household level. There are adverse effects on family life (due to separation). Migrant workers face the risk of exploitation in terms of working conditions and pay, among others, and abuse, often because of the malpractices of recruiting agencies.[34] Women are especially vulnerable. The initial financial cost of going abroad for work is substantial, with layers of intermediaries and associated commissions. Dependence on informal credit sources that charge exorbitant interest rates to fund migration increases indebtedness. The average cost of getting a job in the Gulf or Malaysia, where earnings are on average substantially higher than in India, is estimated at US$1,430 (NMS 2009), nearly thrice the per capita income. On average, half of the cost is met through loans from money lenders and another 22 percent from friends and

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The size of total investment in housing and apartment sector is said to be Rs 200 billion ("Urban housing home in high rises", New Business Age, June 2011, http://newbusinessage.com/Cover%20Story/379).

[33] For anecdotal evidence, see "40pc remittances still coming through hundi: NRA", *Republica*, 20 June 2011.

[34] Nepali workers go overseas mostly through private recruiting agencies. See Gurung (2004) for details of malpractices.

relatives, with interest rates as high as 30 percent (NMS 2009). This, together with the fact that the probability of migration to India decreases with wealth status, suggests that cost is a critical barrier for the poor to get overseas employment and that overcoming the barrier through loans leads to significant indebtedness.

Informal channel dominates the transfer of remittance. More than two thirds of households receiving remittance receive it (69 percent) through informal channels, with family and friends being the most common delivery mode (Ferrari et al. 2006). Poorer households also prefer informal channels, which are used by 86 percent in the bottom quintile compared with 29 percent in the top (ibid.). Surveys show very low use of *hundi* channel but anecdotal evidence suggests it's still large.[35] Remittance from India has the highest incidence of coming through the informal channel (hand-carry, personally or through friends or relatives, rather than *hundi*)—estimates vary, from two thirds of (NMS 2009) to 97 percent of workers (NRB 2007). Surprisingly, 30 percent of workers in developed countries appear to do the same (NMS 2009). Nepali workers returning home with cash from India risk being robbed in India (Gurung 2004). However, overall remittances have been increasingly flowing through official channels in the last decade, with the help of measures taken by the central bank (Pant 2008).[36]

The cost of remitting money through formal channel varies, but due to stiff competition amongst money transfer companies, the cost of remitting money through formal channels has reduced substantially and is one of the lowest in the world (GoN and ADB 2010). Since money transfer operators entered the market in 2001, remittance services have improved substantially, with remittances being delivered in a day or two at relatively low cost, even in remote areas (Ferrarri et al. 2006). Among formal channels, money transfer operators/remittance companies are the most popular channel (almost thrice more popular than transferring money to one's own bank account) (Ferrari et al. 2006). In Qatar-Nepal corridor, the cost is among the lowest, with major money transferring companies are charging 1.9 percent of the transfer amount, followed by banks (0.9 percent) and other companies (1.5 percent) (World Bank study quoted in GoN and

[35] "A typical hundi transaction involves the remitter, the recipient, and two intermediaries. The remitter makes payment in local currency in the sending country to a service provider. The provider contacts a partner service provider in the receiving country, who arranges payment in local currency to the recipient in exchange for a reference code given to the remitter by the provider in the sending country." (Ferrari et al. 2006).
Money send through the *hundi* system does not add to the foreign exchange reserves of the country. For anecdotal evidence, see "40pc remittances still coming through hundi: NRA", *Republica*, 20 June 2011.

[36] The central bank, Nepal Rastra Bank (NRB), has taken a number of measures to bring remittances under the official ambit (Pant 2008): i) Since 29 March 2002, NRB has been granting licenses to private sector organizations for remittance-transfer business. As of mid-July 2008, 29 firms besides commercial banks were undertaking money transfer business; ii) Provision for providing 15 paisa per US dollar as commission to licensed private firms in addition to the prevailing buying rate; iii) Permission granted to manpower agencies sending Nepali nationals overseas for work to open foreign currency account in Nepali commercial banks with the foreign currency income they earned under existing rules; and iv) If a Nepal-based licensed agent/representative of a money transfer company situated overseas required bank guarantee for receiving advance payment from the principal company, such facility, within stipulated limites, would be made available directly from the commercial banks.

ADB 2010). However, the average cost of remitting money from UAE to Nepal is estimated at almost 6 percent.[37] Lack of awarness of the formal remittance mechanism, rather than cost as such, appears to be the primary reason why Nepali migrants still use informal channels (GoN and ADB 2010; NRB 2007). Procedural complexities associated with formal banking are another deterrent particularly for workers with low education level (NRB 2007). Furthermore, workers in India are highly likely to send money through formal channels if branches/collection centres of Nepali money transfer operators or better still banks, particularly state-owned banks (which have a wide network across Nepal and are trusted by migrants), are opened in India (NRB 2007). Legal and regulatory constraints in India are preventing this (Ferrari et al. 2006). Inadequate penetration of banking services across Nepal also deters workers from remitting money through the formal channel (NRB 2007; Ferrari et al. 2006).[38]

There are an estimated 735,000 foreign employment returnees in the country (in 2009), with an average age of just under 30 years and three fourths of them below 35 (NMS 2009). As a reflection of the limited job opportunities in the country, 37 percent of the returnees are likely to migrate again in the next 12 months, while 77 percent of recent returnees (those who returned in the last 12 months) are thinking of re-migrating. More than two thirds of returnees are in agriculture (47 percent) or inactive (22 percent).

4. Outlook for remittances in the medium term

Following a rebound in 2011 in officially recorded remittances to developing countries which had taken a hit in the wake of the global financial and economic crisis, the World Bank projects remittances to developing countries to continue at a rate of 7-8 percent annually till 2014. Remittances to LDCs are expected to grow faster than those to developing countries. Persistent unemployment in Europe and the US is affecting employment prospects of existing migrants and hardening political attitudes toward new immigration (Mohapatra et al. 2011). Given Nepal's high dependence on remittances from Gulf countries where high oil prices are driving economic activities and increased spending on infrastructure development continue to provide a cushion for migrant employment and remittances, the major risks to remittance outlook emanate from the uncertainty about the direction of oil prices as the European debt crisis deepens (Mohapatra et al. 2011). The indigenization programs being considered or implemented in the GCC countries (for example, the Nitaqat program in Saudi Arabia) have raised concerns of adverse implications for future remittances and highlight the importance of destination country policy changes for the sustainability of remittance flows, although it is unlikely to affect remittances inflows in the near term (Mohapatra et al. 2011). Although depreciation of the Nepali Rupee vis-à-vis the US dollar has contributed to increased remittance growth in recent months, the unpredictibility of the exchange rate also poses risks to remittances (Mohapatra et al. 2011).

5. Policy interventions and recommendations at the national level

[37] World Bank's Remittance Price Data.

[38] Only 26 percent of households in Nepal have a bank account (Ferrari et al. 2006).

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In order to reduce the human and financial costs of migration at the household level, the government should, *inter alia*, i) effectively implement regulations governing the foreign employment sector, and closely monitor the recruitment practices of recruiting agencies and take prompt action against those engaged in malpractices, as well as increase the efficiency and transparency of the Department of Foreign Employment; ii) provide pre-departure orientation training and financial education to outbound workers; iii) pursue bilateral agreements on migration (covering working conditions, pay, benefits and other related issues) with as many desination countries as possible, and monitor their implementation, and assign labour attaches in all major and emerging destinations[39]; iv) disseminate information on destination countries, job opportunities, employment-related terms and conditions, including pay and benefits, and suchlike areas to prospective migrants; v) maintenance and regular updating of database on the stocks of migrants by destination, and stepping up diplomacy to ensure the safety and welfare of illegal migrants[40]; and vi) augmentation and effective use of the Labourers' Welfare Fund for the welfare of migrant workers, including those forced to return due to external shocks like global economic crisis.[41]

Combining research (on trends in destination markets, demand by sector and skill type, etc) with economic diplomacy, options must be explored for increased job opportunities for Nepalis in destinations and sectors, including new ones, offering higher remuneration and benefits and better working conditions. Based on market research, the government should consider making arrangements for the provision of basic skills, in collaboration with the private sector, to foreign job seekers that would help them earn more.

Remittance services should be improved, fund-transfer (transaction) costs lowered and regulation of remittance service providers strengthened to bring in more remittances through through the formal channel (banking and money transfer agencies). This will increase the contribution of remittances to the national foreign exchange reserves, help control capital flight, and make for better economic policy formulation and implementation. In particular, remittances from India, which are mostly sent informally, should attract urgent attention of policy measures aimed at

[39] Nepal has labour agreements with only United Arab Emirates, Qatar, Bahrain and South Korea. The government had pledged in 2007 to appoint labour attaches in countries with more than 5,000 Nepali migrant workers, and it has appointed labour attaches for Malaysia, Saudi Arabia, Qatar and United Arab Emirates (Sharma and Gurung 2009).

[40] There are an estimated 70,000 illegal migrants in Saudi Arabia alone (Sharma and Gurung 2009).

[41] Following initial losses of jobs by Nepali workers in the Gulf due to the economic crisis, the government announced that it would reimburse 40 percent of the cost incurred in seeking the job overseas in case of returnees who have spent less than six months and 25 percent of such the cost in case of returnees who have spent more than six months and less than a year (Sharma and Gurung 2009). However, they needed to produce evidence that they lost the job due to global economic meltdown, which most workers do not get from their employers (ibid.).

formalizing remittance flows. Diplomatic efforts should be stepped up so that Nepali money transfer agencies are allowed to open branches/collection centres in India.

Promotion of microfinance, with robust supervision, is also a policy option. It has the ability to address the demand for remittance-linked financial services and expand them to the unbanked, and it can help increase the volume of remittance flows mediated through the financial system (Pant 2008).

The supervision of the financial sector should be strengthened to maintain financial sector stability in the face of rising liquidity resulting from rising remittances.

Although high-skilled migration is still very small relative to total migration, a national policy is needed on high-skilled migration, whose scale is likely to increase in future.

Given that there is a sizeable presence of foreign migrant workers in the country and they are largely undocumented, a comprehensive survey/study on work-related immigration into the country, its compliance with national laws, and its effects on the economy, including on employment opportunities for Nepali nationals, is needed.

To mitigate the effects of real exchange rate appreciation, the government must allocate and spend a larger portion of its expenditure on ameliorating supply-side constraints (e.g., infrastructure), which would help improve competitiveness and exports.

There is no denying that remittances will continue to be a crucial driver of the rising living standards of the Nepali people in the foreseeble future.[42] However, international migration and the associated remittance inflow alone cannot be drivers of sustainable development. Hence, the developmental challenge facing the Government of Nepal is to manage remittances and leverage them into kick-starting the domestic economic growth engine and creating productive employment opportunities at home.

Nepal Rastra Bank, the country's central bank, has twice floated "Foreign Employment Bond" since June 2010 as part of the government's strategy to mobilize the earnings of the Nepali diaspora for infrastructure development. But the response has been poor. Although the initial goal was to issue Rs. 7 billion (about US$100 million), Rs. 1 billion was floated in the first round, but only bonds worth Rs 4.5 million were subscribed (GoN and ADB 2010). Agents were unwilling to work for a commission of 0.25 percent and hence the government had to later increase the commission to 0.5 percent (GoN and ADB 2010). Nepali workers in Qatar, Saudi Arabia, UAE, Malaysia and South Korea were eligible the five-year bond from one of seven licensed money transfer operators (including one bank) in denominations of Rs. 5,000 (about $65). Not a single operator showed interest to sell the bonds in South Korea (GoN and ADB

[42] Nepal's growth prospects remain bleak. The IMF forecasts GDP growth of under 4 percent for Nepal until 2016 (International Monetary Fund, World Economic Outlook Database, September 2011).

2010). In 2011, the subsription amount was Rs 3.38 million as against the target of 5 billion despite a longer period of subscription (2.5 months as against two weeks in the first round) (Ratha and Silwal 2011; Shrestha 2011). Workers could susbscribe in their names or in their family members' name. They could also put the bonds as collateral to obtain loans. Bond buyers did not have to pay any additional fees while sending money to Nepal and the subscription amount would be eligible for an income tax waiver (GoN and ADB 2010). The interest rate was 9.75 percent in the 2010 issuance and 10.5 percent in the 2011 issuance. The bonds were sold in foreign currency and the repayment of principal and interest was made in Nepali rupees.

Possible reasons for the poor response are: lack of publicity and marketing and a short period of sale and poor awareness of workers about all aspects of the bonds, limited targeting (except South Korea, migrants in OECD countries, where the average earnings are much higher were excluded), low interest rates offered compared to those provided by commercial banks (although greater than the rates on other government bonds), lack of incentives for money transfer agencies to sell the bonds, unrealistic expectations of migrant workers who earn an average of US$200 per month (barring those in South Korea) and have to repay loans taken to migrate, absence any Nepali financial institutions (except International Money Express (IME) in Malaysia) overseas to carry out bond issuance,[43] and regulatory and compliance issues in remittance-source countries (GoN and ADB 2010; Ratha and Silwal 2011; Shrestha 2011). Although workers in South Korea are more skilled than those working in the Gulf and Malaysia in general and hence have higher earnings, the licensed money transfer operators did not show any interest in selling bonds there partly because the small size of the diaspora there, about 7,000 (GoN and ADB 2010). Another factor behind the poor response concerning South Korea is considered as a regulatory issue of the government of South Korea having not allowed Nepali banks or money transfer agencies to operate in South Korea (ibid.).

A better knowledge of the location of the diaspora and their profile, such as age, education, occupation, sector of work, income, wealth, savings, remittances and investments are key for appropriately structuring and marketing such bonds (Mohapatra et al. 2011). This is where a regularly updated database on the stock of migrants abroad and their profile becomes important. Nepali embassies abroad have an important role to play in raising awareness of migrants about the bonds. They should also be mobilized by the government to have a clear understanding of securities-related laws in the remittance-source countries. The government's strategy should be to issue such bonds for as many remittance-source countries, with sizeable presence of migrants, as possible. The government should negotiate with the governments of such countries for allowing Nepali money transfer companies to establish branches there. Where that is not possible or feasible, it should use international investment banks or other related agencies to issue bonds (GoN and ADB 2010).

Despite the low earnings of workers in the initially targeted countries (barring South Korea), the amount of money raised from them is definitely way below potential. Even a most conservatively estimated potential is 100 times more than what was actually raised (see GoN and

[43] Other remittance companies and banks have been doing business through tie ups with foreign banks and money transfer agents (GoN and ADB 2010).

ADB 2010). *A priori*, Nepalis working in developed countries are more likely to buy such bonds because of higher income levels and better understanding of the bonds and because the interest rate offered would be higher than the rates in their countries of domicile, and the potential amount of funds that can be raised is huge (see GoN and ADB 2010). By issuing bonds to them also, the government can gauge their level of interest in its development endeavours and calibrate its policy towards them. However, the Nepali diaspora in developed countries may be interested to buy such bonds only if the principal and interest are payable in convertible currency. In that case, the government has to carefully weigh the benefits of raising money from them against the cost of incurring a liability in foreign exchange (implications for balance of payments and impact of local currency depreciation, which has been the trend over the years). It should also compare this option with another: securitizing future remittance flows to borrow funds from the international capital market (see World Bank 2006 for details of this innovative mechanism). By mitigating currency convertibility risk, a key component of sovereign risk, the future flow securitization structure allows securities to be rated better than the sovereign credit rating (World Bank 2006). High remittance receiving countries like Brazil, El Salvador, Turkey and Mexico have successfully raised money from international capital markets through this mechanism (ibid.). However, it must be noted that several policy hurdles need to be crossed before securitization deals can proceed—e.g, high fixed costs of legal, investment banking, and credit-rating services and long lead times (World Bank 2006). In addition, the risks posed by currency depreciation and interest rate increases in the case of flexible rate debt should also be taken into account. And it must be ensured that the borrowing entity (e.g., domestic bank) utilizes the money for development activities like infrastructure building.

The government should work towards ensuring that the remittance is taken into account while calculating the ratio of total foreign loan to exports and good services, which could lead to credit rating agencies giving higher score to Nepal, with positive implications for mobilization of funds from the international capital market and also foreign investors' confidence.

The government in 2011 allowed foreign individual and companies, including Non-Resident Nepalis, to buy commercial and residential apartments, houses and buildings. The move was mainly targeted at people of Nepali origin who have acquired foreign citizenship and meant to given a fillip to the real estate sector undergoing a slowdown after the central bank intervened to control a property bubble. Infrastructure being a critical binding constraint on Nepal's growth (ADB et al. 2009), the government's thrust with regard to attracting Nepali diaspora investment should be on critical infrastructure projects such as roads and electricity.[44] The right to purchase houses and apartments could be linked to investment in productive sectors. In addition, policy attention must be paid to channelizing the deposits in the domestic financial system, directly or indirectly fuelled by remittances, away from speculative activities and real estate towards infrastructure and production-oriented sectors.

[44] Load shedding has increased dramatically in the last five years, with power cuts for as many as 16 hours a day during winter. Businesses identify electricity crisis, after political instability, as the main obstacle to the business environment (World Bank and IFC 2009).

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Alongside attempts to increase savings of remitters at the source through the issuance of bonds, there is also a need to take measures to increase the savings of recipient households once they receive remittances and mobilize the same for development work. One option is encourage pooled or collective remittances (e.g., sent through hometown associations) by, inter alia, matching fund schemes, and directing the same into community investment projects, self-employment, including setting up of micro enterprises, for returnees and recipient household members.

Last but not least, the overall business and investment climate must be improved, and other development plans, policies and strategies implemented in war footing to create productive employment opportunities within the country. The increase in aggregate demand caused by increasing remittance inflows is an opportunity for jump-starting industrialization.

6. The Istanbul Programme of Action (IPoA), and the role of development partners

What does IPoA say on remittances?

Recognizing the importance of remittances in the LDCs and the need to reduce the transaction costs of remittance flows and foster the development impact of remittances, the IPoA lists a number of actions to be undertaken by LDCs and development partners.

Action by least developed countries:

(a) Make efforts to improve access to financial and banking services for easy transaction of remittances;
(b) Simplify migration procedures to reduce the cost of outward migration;
(c) Take appropriate measures to better utilize knowledge, skills and earnings of the returning migrants;
(d) Provide necessary information, as available, to workers seeking foreign employment.

Action by development partners:

(a) Resist unfair and discriminatory treatment of migrant workers and the imposition of unreasonable restrictions on labour migration in order to maximize the benefits of international migration, while complying with the relevant national legislation and applicable international instruments;
(b) Consider developing, where appropriate and in accordance with domestic laws, a system of short-term migration, including workers from least developed countries;
(c) Remove unnecessary restrictions on outward remittances and support the lowering of transaction costs;
(d) Consider supporting the least developed countries in establishing the International Migrants Remittance Observatory, on a voluntary basis.

How can development partners helps? Some suggestions

Development partners, notably developed countries, should relax restrictions on short-term temporary movement of labour in the low-/semi-skill category from LDCs. In this regard, it is crucial to implement Paragraph 9 of the LDC Modalities of the General Agreement on Trade in Services (GATS). They should liberalize Mode 4 under the GATS in sectors and categories of interest to LDCs.

Destination countries should respond positively to the pursuit of bilateral agreements on migration by LDCs, and favourably consider LDCs' concerns, interests and priorities.

Destination countries should ratify international instruments and conventions aimed at protecting migrant workers' rights, including the Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families, and agree to a robust enforcement mechanism.

Destination countries should help labour-exporting LDCs regulate recruiting agencies effectively by providing accurate and timely information, as well as take prompt action against recruitment-related malpractices on their soil.

Destination countries should develop and implement proactive remittance-supporting policies, including by supporting migrant associations, facilitating low-cost remittance transfer through formal channel, greater relaxation and competition in money transfer markets, improving access of remittance service providers to national payment and settlement systems, and improving banking access of immigrants (World Bank 2006). They should assist money transfer companies from LDCs to set up branches on their soil, and also facilitate the issuance of development bonds targeted at migrant workers by LDC governments.

Development partners and destination countries should assist LDCs in the establishment and maintenance of bilateral migration database.

Set clear milestones and timeline for the establishment of International Migrants Remittance Observatory.

Destination countries, particularly OECD countries, should assist, through the provision of special aid packages, in reducing the negative impacts and increasing the positive impacts of high-skill emigration from LDCs.

Development partners should, in collaboration with LDCs, explore ways to leverage ODA to increase the development impact of remittance—for example, through the provision of training programmes for unskilled and semi-skilled would-be migrants; supporting self-employment schemes for returnees.

Development partners should provide technical assistance to LDCs on remittance management.

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