

Harnessing Remittances for Productive Use in Nepal

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Abstract

Remittances contribute largely to the national economy. The remittances sent home by the migrants affect development at both the household and national levels. At the household level, remittances help to reduce poverty, improve standard of living and attain higher educational levels. At the macro level, remittances could be used for entrepreneurship and productive investment which in turn increases job opportunities and income of the people. At the same time, remittance inflows help to augment foreign exchange reserves and improve the current account position. This paper suggests that workable policies and programs need to be developed by Nepal's policy makers for encouraging the utilization of remittances for productive use in order to promote longer-term growth.

I. BACKGROUND

Since the end of the 1990s, there has been a renewed interest in the financial resources that migrants send back to their countries of origin. The main reason for the renewed attention is the growing volume of official remittances to low income countries and their potential contribution to the economic development of the receiving regions.

According to IMF (2009: 272), remittances denote “household income from foreign economies arising mainly from the temporary or permanent movement of people to those economies. Remittances include cash and noncash items that flow through formal channels, such as via electronic wire, or through informal channels, such as money or goods carried across borders. They largely consist of funds and noncash times sent or given by individuals who have migrated to a new economy and become residents there, and the net compensation of border, seasonal, or other short-term workers who are employed in an economy in which they are not resident.”¹

Until the global financial crisis of 2007-09, remittances had proven to be a dependable source of income for households in developing economies, with robust growth regardless of the state of the business cycle. However, as the real-sector spillovers from the financial

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¹ IMF (2009) also discusses the standard components in the balance of payments (BoP) framework pertaining to remittances, including compensation of employees, personal transfers as well as supplementary items related to remittances.

crisis were quite severe, and had a deleterious effect on developed and energy-exporting countries, the principal sources of immigrant remittances, the total quantity of remittances dropped in 2009 for the first time in decades. The World Bank estimated that remittance flows to developing countries reached US\$ 307 billion in 2009, a decline by 5.5 percent in contrast to the growth of 16.7 percent in 2008. Because of improved prospects for the global economy, however, remittance flows to developing countries are expected to rise by 6.0 percent in 2010 and 6.2 percent in 2011 (Mohapatra *et. al*, 2010).

Remittance, as a source of development funding, are directly linked to migration. In many instances, particularly in the vulnerable countries, this migration has been forced either by civil conflict, political persecution or economic hardships. For people from the least developed countries (LDCs), migration is often a case of running away from a very difficult situation, rather than a matter of preference. The irony of it is that having escaped their countries, migrants then assist in sustaining the economies of those very countries through remittances.

Remittances can contribute significantly to local, regional and national economic development in migrant-sending countries and also play an instrumental role in reducing poverty as they flow mainly to poor and marginalized families. In many instances, remittances form a significant percentage of total household income, acting as a substitute for earned income lost to unemployment, illness, retirement, emigration, falling wages and crop failure, among others, and ultimately protect poor families against the erosion of what are already basic household assets.

Remittances can generate a positive effect on the economy through various channels such as savings, investment, growth, consumption, and income distribution. These inflows can also contribute to stability by lowering the probability of current account reversals. Since they are a cheap and stable source of foreign currencies, remittances are likely to stem investor panic when international reserves are taking a downward trend or external debt is rising.² 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.

A significant portion of relevant literature on remittances argues that they are primarily spent on consumption, housing and land, and are not utilized for productive investment that would contribute to long-run development. In this context, the distinction between “productive and non-productive” uses of remittances needs to be reexamined. The recognition that only a small proportion of remittances are utilized to establish small businesses, improve agricultural practices, or on other forms of ‘productive’ investment created disillusionment over the development impact of remittances among researchers and policy makers in the 1970s and early 1980s. In recent years, the distinction between consumption and investment has been criticized by researchers that expenditure on

² These beneficial impacts are particularly strong for countries where remittances are above 3 percent of GDP as illustrated by Bugamelli and Paterno (2006).

'consumption' items such as health and education should be understood as investment in human capital. As an example, in both the short and long run, investment in education denotes an improvement of the educational infrastructure of the labor exporting economy. Migrants, in combination with high productive physical capital, yield returns that are normally much higher than they would have been if the migrants were employed in their home country. The migrants' family members, that stay behind in their home country, enjoy a higher standard of living through the migrants' savings. Hence, expenditure on consumption and housing produces indirect multiplier effects, which encourage investment and output in related industries. Thus, making a distinction between the productive and unproductive remittances seems quite blur, and both contribute to livelihoods and development, with productive uses contributing more.

Based on the above analysis, the major thrust of this study is to recommend measures for the productive use of remittances. The rest of this paper is planned as follows. The next section examines some general policy measures for employing remittances into productive use preceded by the experiences of South Asian countries in Section III. While Section IV discusses the impact of the growing remittances on the Nepalese economy and lists some measures initiated for attracting more remittances through the official channel, Section V spells out some policy alternatives for mobilizing remittances and using them productively. The last section concludes the study.

II. GENERAL POLICY MEASURES

There are a few policy instruments the government can employ to improve development impact of remittances and enhance the flow through the formal channel. Which policy instruments the government opts depends on the desired goal it intends to achieve. First, if the government's objective is to capture a portion of remittances for development purposes, then the policy instrument could be to impose taxes or levies on remittance transfers, or to explore voluntary check-off for charitable purposes. However, taxing remittances may be counterproductive as this could redirect remittances from the formal channels to informal channels, thus, worsening the balance of payments (BoP). Second, if the government's objective is to stimulate transfers through formal channels and to stimulate capital availability, then the policy instruments could focus on the sale of remittance bonds, opening of foreign currency accounts, premium interest rate accounts, promoting transfers through microfinance institutions, promoting financial literacy, and banking the unbanked. Foreign currency accounts and bonds have proven to be a feasible technique of raising funds. This should be targeted at the Diasporas' middle-to-upper income members.³ Moreover, if the goal is to stimulate investment of remittances, then the government could reach out to remittance receivers through micro finance infrastructures. The government could also reach out to its migrants abroad through migrants' service bureaus, and tax breaks on imported capital goods by migrants.

³ For example, India and Pakistan maintain interest rates on foreign currency accounts that are higher than domestic or Euro-currency deposits.

Since a long time, governments of migrants' home countries have employed a large variety of policy measures that target different elements in the system. Multilateral agencies such as the World Bank and the IMF and bilateral development agencies such as the Department for International Development of the UK have also analyzed different policy options and recommendations. Based on this array of experiences, a list of policy measures, including the ones mentioned earlier, is illustrated in Table 1.

Table 1
Policy Measures to Enhance the Development Impact of Remittances

Objective	Measure
<i>Capturing a share of remittances for development purposes</i>	Taxation of emigrants Duties or levies on remittance transfers Voluntary check-off for charitable purposes (or transfer forms)
<i>Stimulating transfers through formal channels and/or stimulating capital availability</i>	Remittance bonds Foreign currency accounts Premium interest rate accounts Promoting/enabling transfers through microfinance institutions (MFIs) Promoting financial literacy/banking the unbanked
<i>Stimulating investment of remittances</i>	Outreach through MFI infrastructure Outreach through migrants' service bureaus Tax breaks on imported capital goods SME schemes (financial, infrastructural, or innovative) Training programs
<i>Outreach to migrant collectives/ Hometown associations (HTAs)</i>	Matched funding Public-private ventures Competitive bidding for development projects
<i>Influencing consumption patterns</i>	Promoting consumption of local goods & services Enabling migrants to spend on their relatives' behalf

Source: Carling (2004).

A few examples as how to tap the skills of the Diasporas are displayed in Box 1 below.

Box 1 : Tapping the Diaspora

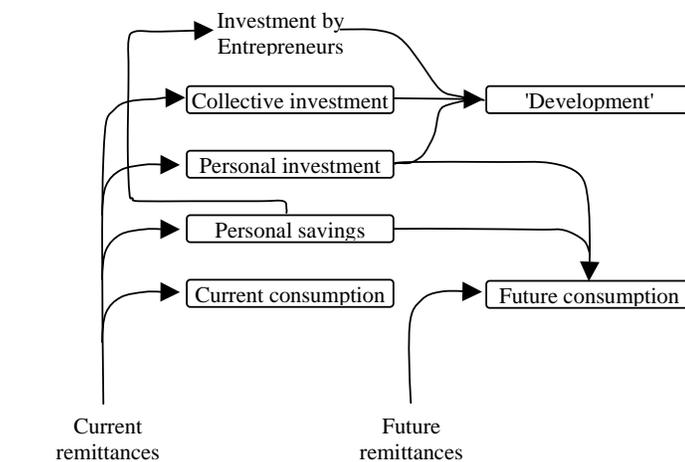
Efforts have been undertaken to tap the skills, networks, funds and savings of the Diaspora population. The Chinese Diaspora and Indian information-technology specialists have either reinvested in their countries of origin or have gone home to set up their own businesses; some have even established a commercial presence in other countries. Other government initiatives targeted at assisting the reintegration of returning migrant workers and stimulating investment include the provision of facilities for importing capital goods and raw materials, business counselling and training, access to loans, and encouraging entrepreneurship for development.

Sending governments could consider the following mechanisms to mitigate the adverse effects of brain drain: requiring migrants to perform public service for critical occupations such as those relating to health care and education; bearing a partial cost of their education if they do not complete the mandatory domestic employment requirement; encouraging return migration by acknowledging their training abroad and giving them visiting scholar positions or other honorary positions and encouraging them to serve as trainers.

Other examples include arrangements that require some compensation from host countries for every foreign worker taken in; exploring the possibility of inviting some of their own experts, practitioners and specialists to conduct training on the advances in the field on a regular, short-term basis as a form of compensating for the loss of skilled workers; establish a special visa scheme to ensure the temporariness of the workers' employment and stay in the host country, thus ensuring return migration.

Source: Puri (2007).

To pinpoint possible policy options for augmenting the benefits of remittances, it is important to take into account the links between remittance usage now, and development and consumption in the future (Figure 1). In this model, 'development' denotes remittance-independent development, that is, future livelihoods that are not dependent on future remittances.

Figure 1: A Model of Remittance Use and Development Impact

Source: Carling (2004).

If remittances today are just spent on consumption, future consumption needs to be financed by future remittances (or other sources of income). However, if remittances are saved or used for investment, this could assist in financing future consumption. Collective investment in development projects will not result in direct future returns to the individual investors; however, this would directly benefit the community. When remittances are saved in financial institutions, this augments credit availability and can enable entrepreneurs to realize investments that have a positive impact on development. This could be a more realistic way of stimulating investment of remittances than promotion of entrepreneurship by migrants or remittance receivers themselves.⁴

III. POLICIES IN SOUTH ASIA

It is growingly acknowledged in South Asia that foreign labor migration helps promote national economic growth, eases the pressure of unemployment, brings in much-needed foreign exchange through remittances and increases consumption, savings and investment at both the household and macro levels.

The Governments of Bangladesh, India, Pakistan and Sri Lanka have devised a legal framework encouraging their citizens to send foreign remittances into their countries of origin. Generally, the non-resident citizens of these countries are granted the following facilities, among others: a) maintenance of bank accounts in both foreign and local

⁴ Moreover, there is always a possibility that investors will direct funds into uses with high yields, which could be different from uses with high development impacts. When migrants do invest, their emotional attachment to their regions of origin can help compensate for the disadvantages of these regions in the eyes of purely profit-seeking investors. For details, see Carling (2005).

currencies without tax implications; b) investments in securities/shares, and deposits with local firms/companies; and c) investments in immovable properties in the respective countries. Again, most of the South Asian Governments have established special institutions such as migrant workers welfare funds and have appointed community welfare officers/attaché in embassies in the receiving countries to promote and protect the interest of migrant workers.

India has witnessed an upsurge in returns and investments of its Diaspora population especially after 2006 when it introduced registration certificates called Overseas Citizens of India for persons of Indian origin. They are analogous to green cards, and allow non-resident Indians (NRIs) most of the benefits of citizenship while maintaining their foreign passports. They cannot, however, obtain an Indian passport, vote in Indian elections, own agricultural and plantation properties in India or work for the Indian government. Incentives for returnees include attractive job opportunities, particularly in the areas of software and other information-technology-related jobs, finance, telecommunications, pharmaceuticals and research and development. Many programs have also been launched to attract NRI intellectuals and professors to Indian universities.

India has a wide-ranging package of activities and incentives that accords top priority on building stronger links with its Diaspora communities. These are all orchestrated by the Ministry of Overseas Indian Affairs (MOIA) that was set up in 2004. The MOIA seeks to persuade its Diaspora to invest in long-term ventures, rather than just sending wire transfers and short-term remittances. For meeting this goal, in 2008 the Government launched an Overseas Indian Facilitation Centre, a one-stop shop to help overseas Indians invest in India. Some other initiatives being undertaken by the MOIA include the following:

- Setting up an ICT-driven Diaspora Knowledge Network to draw on India's Diaspora knowledge resources as well as to provide impetus to projects in the Public-Private Partnership mode;
- Establishing a single window for overseas Indian investments to function as a single point contact;
- Operationalizing the electronic remittance facility for overseas Indians that combines the qualities of economy, speed and convenience;
- Launching the scholarship programme for children of overseas Indians to study in India;
- Expanding the Know India programme so that the Diaspora youth would bond with and gain knowledge about India;
- Fully operationalizing a new Overseas Citizenship of India scheme (UNCTAD, 2009).

Because of these and other facilities provided to its non-resident citizens, India has been able to attract enormous remittances from their respective non-resident citizens and has been the world's top remittance earner for more than a decade. It was the largest recipient in 2009 with US\$ 55.0 billion, followed by China at US\$ 48 billion and Mexico with US\$

26 billion (Ratha *et. al*, 2010). The 2009 figure of US\$ 55.0 billion was up seven percent from US\$ 51.6 billion in 2008, and just two billion dollars a year in the late 1980s.

The rise in remittances in 2009 came despite the global economic slowdown which had been expected to affect migrant labor. The Reserve Bank of India attributed the higher remittances to India being perceived as a relatively safe option during the financial crisis, a rise in interest rates on non-resident deposits and new investment products.

Other factors have also been responsible for the surge in remittances to India. The Government of India eased regulations and controls, and eliminated the black-market premium on the rupee and created convenient remittances services. The Indian and international banks have systematically shifted some remittances from the informal “hawala” channels to formal channels. Indians abroad have also responded to several attractive deposit schemes and bonds offered at home. Again, the Indian Investment centre has devised mechanisms that assist Indian companies to collaborate with NRIs (see Box 2).

Box 2 : Indian Diaspora's Investment Potential

To facilitate the development of enterprises in India, the Indian Investment Centre has developed mechanisms that enable Indian companies to collaborate with NRIs to identify sources of capital and technology. The agency maintains an industrial information service that provides the status of industries and profiles for potential industrial projects. Furthermore, the agency’s website provides nonresident Indians with answers to an expansive list of investment questions on bank accounts, repatriation of profits, and investments in securities, shares, company deposits, and property. The site also offers special facilities to NRI investors repatriating funds.

Source: Azad (2005).

With regard to **Bangladesh**, the Bangladeshis working abroad sent home a record US\$ 10.72 billion in 2009, as remittances continued to scale new heights despite the global meltdown. This figure was 19.4 percent higher than what the country's more than six million workers had remitted in 2008.

To ensure productive use of remittances, the government, Bangladesh Bank and Schedule Banks designed a number of savings and investment schemes for wage earners abroad. These included the following:

- A migrant can open a non-resident foreign currency deposit (NFCD) account in any branch of Bangladeshi and foreign banks that possess an authorized dealership license. The account can be opened for different periods and are renewable and can be maintained for an indefinite period even after the return of the wage earner.
- The remittances of Bangladeshi migrants abroad can be invested in Bangladeshi currency in five-year wage-earner’s development bond which is also renewable. The profits are investable in Bangladesh and principal is freely transferable abroad in foreign currency.

- US Dollar Premium Bond and US Dollar Investment Bond are also available at attractive interest rates.
- The non-resident Bangladeshis are granted permission to invest in 'Industrial Development Bond' scheme of the Agrani Bank, one of the nationalized banks of Bangladesh.
- A non-resident Bangladeshi can purchase shares in both primary and secondary markets including the debentures of Bangladeshi companies. A 10 percent reserve quota has been fixed for a non-resident Bangladeshi in initial public offering (IPO) of the local companies.
- Foreign investors including the non-resident Bangladeshi do not require any approval to set up a new industrial unit, but only have to be registered with the Board of Investment. They receive priority in obtaining industrial facilities like procurement of land, electricity, gas and sewerage connections, import of capital machinery and raw material and tax rebate, among others.

Another aspect that calls for discussion in the case of Bangladesh is the Migrant Welfare Fund (MWF) that was set up from the subscription charges levied on migrants before they leave the country. Passport renewal fees and attestation fees also accumulate in the MWF. Some of the aims of the Fund include the following: a) provision of hostel-cum-briefing centre for the prospective migrants; b) provision of orientation briefing; c) welfare desk at Dhaka Airport; d) burial of dead bodies and providing help to the family of the deceased; e) providing assistance and treatment to the handicapped laborers; and f) establishment of clubs in destination countries.⁵

In Bangladesh, the institutional mechanisms for dealing with remittances are quite exhaustive and have performed their tasks efficiently (Box 3). In order to inform the migrants in host countries effectively and timely with information pertaining to the available remittance service and savings and investment options, the following information and communication channels have been employed:

- Pre-departure briefings for migrant workers by the government's Bureau of Manpower Employment and Training (BMET).
- Migrant worker briefings in social events and meetings in host countries, supported by the labor wings of embassies of Bangladesh.
- Press releases/advertisements in print and electronic media channels popular with the migrant worker Diasporas in host countries and also in Bangladesh for information of families/beneficiaries of migrant workers.
- Information booklets/brochures/pamphlets in hard copy made available through banks in Bangladesh and their clearing arrangement counterparts abroad.
- Websites of the government, central banks, commercial banks and embassies abroad.

⁵ For other details on the MWF, see Murshid *et. al* (2002).

Box 3 : Managing Overseas Employment in Bangladesh

There are five government ministries dealing with international labor migration in Bangladesh, the Ministry of Expatriates' Welfare and Overseas Employment being the principal one. The others include the Ministries of Home Affairs, Foreign Affairs, Finance and Civil Aviation, and Tourism. The Bureau of Manpower, Employment and Training (BMET) is the executing agency of the Ministry of Expatriates' Welfare and Overseas Employment in charge of processing labor migration. In particular, the BMET is responsible for a wide range of functions, including control and regulation of recruiting agents, collection and analysis of labor market information, registration of job seekers for local and foreign employment, development and implementation of training programs in response to specific labor needs for national and international labor markets, and resolving legal disputes among key stakeholders.

The government enacted an Overseas Employment Policy in 2006 with the main objectives to: (i) ensure opportunities at reasonable cost for both short-term and long-term migration; (ii) enhance migration opportunities for the skilled and professionals; (iii) manage the recruitment process efficiently; (iv) encourage remittances through formal channels; (v) encourage long-term and short-term migrants to invest in Bangladesh; (vi) assist returning migrants in social and economic reintegration within the country; and (vii) arrange coordination work among related institutions.

Source: Raihan *et. al.* (2009).

As Bangladesh is one of the pioneers in issues involving micro-finance and micro-credit schemes on the one hand, and the successful implementation of linking microfinance institution (MFIs) to remittances in other countries on the other, MFIs involvement in remittances in Bangladesh could be one of the most promising approaches for maximizing the development impact of remittances. MFIs in Bangladesh have operated as distribution agents in remote areas, and administered schemes which support the utilization of remittances for savings and investments for development.⁶ This experience of Bangladesh could be emulated by LDCs such as Nepal.

Pakistan registered a high level of remittance inflows equivalent to US\$ 7.81 billion in 2009, a rise by 21.1 percent compared to their inflows of US\$ 6.45 billion a year earlier. A number of factors were responsible for this state of affairs including the return of some of the expatriates, diversion of remittances partially from informal to formal channels and increased outreach of the banking sector.

In Pakistan, a number of incentives were announced in 2001 reflecting the significance that the government placed on remittances as an instrument for economic development. Linked to a minimum remitted amount (US\$ 2,500 to 10,000), overseas Pakistanis were provided privileged access to higher education, public housing and share offerings as well as free renewal of passports and import duty exemption for US\$ 700 per year.

⁶ A comprehensive examination of the role of MFIs in the utilization of remittances in Bangladesh is provided in Bruyn and Kuddus (2005).

Pakistan introduced a "non-repatriable investment scheme" under which overseas Pakistanis are permitted to import machinery and equipment at concessionary rates of duty to establish manufacturing enterprises. The rate of duty rebate varies, that is, projects in relatively underdeveloped areas are granted a higher rate of rebate. The Investment Advisory Service of Pakistan conducts pre-feasibility studies to facilitate the choice of investment projects. Pakistani migrant workers are also permitted to invest in export processing zones which enjoy complete duty exemptions on machinery and raw material imports.

In order to provide for an ownership structure in Pakistan for remittance facilitation, State Bank of Pakistan, Ministry of Overseas Pakistanis and Ministry of Finance jointly launched the Pakistan Remittance Initiative (PRI) in August 22, 2009. The objective of PRI is facilitating and supporting faster, cheaper, convenient and efficient flow of remittances. The PRI has focused on providing information about the remittance channels and other facilitation to overseas Pakistanis.

Remittances to **Sri Lanka**, on the other hand, increased by 14 percent to US\$ 3.3 billion in 2009 compared to 2008. This increase in remittances can be ascribed to the information and financial education provided to them by the Sri Lanka Bureau of Foreign Employment.

Sri Lanka was the first labor-exporting country in Asia to introduce an entrepreneurship development program for return migrants. The main objective of the program, launched in 1982 by the Sri Lankan Ministry of Labor in collaboration with the Merchant Bank of Sri Lanka, was guiding returning migrants in business creation. Many lessons were learnt from this initiative. First of all, return migrants belonging to higher occupational categories were suitable for an orientation program of this type. Secondly, the possibilities for guiding candidates into business were limited unless accompanied by steps to facilitate the access to capital. Three, the ability to identify and develop a project, together with managerial skills needed to run a business, cannot be imparted just through a program of class instruction.⁷

The government also made it mandatory for those going abroad for employment to open non-residential foreign currency accounts. Again, Sri Lankan domestic aides working in West Asian countries were sent for employment only after signing a legal employment agreement. Moreover, the efforts of the government authorities to hold talks with the labor authorities abroad had made it possible to get salary increments for domestic aides in the respective countries.

In Sri Lanka, the Government has attempted to encourage investment and long-term financial planning by return migrant workers by offering different types of credit schemes. The credit schemes do not focus solely on investment but also cater to other identified needs of migrant workers, making them more realistic in application.

⁷ Details of this program are given in Puri and Ritzema (1999).

IV. NEPAL'S EXPERIENCES

One of Nepal's major exports is labor, and most rural households now rely on at least one member's earnings from employment away from home. Nepalese workers have sought foreign employment as both the agricultural and non-agricultural sectors struggle to generate new employment opportunities. With limited arable land, landlessness is pervasive and the number of landless households has steadily increased in the agricultural sector. In the nonagricultural sector, the slowdown in growth, especially since 2000/01, due to the Maoist insurgency and exogenous shocks has further retarded the pace of employment creation. The conflict had also, until recently, created difficult living and security conditions, especially in the rural areas.⁸ It had also prompted people to look for overseas employment.

India has been a traditional destination for Nepalese migrants. The primary reasons for this are geographical proximity, historical and cultural links, and a large and open porous border. The 1950 Treaty of Peace and Friendship between India and Nepal formalized free border movement of people. The bulk of these migrants are employed in the private, informal sector. These migrants hold semi-skilled and unskilled jobs in restaurants and factories or are employed as domestic workers, security guards, and maids. However, a significant proportion of the remittances from India are not recorded in the BoP as they are brought in by the migrants themselves or sent through relatives and friends.

An increasingly larger share of remittances now comes from countries other than India, reflecting changing migration patterns and higher earnings in these locations. Moreover, the composition of skills of the labor flows is different among destinations. While migrants to the Middle East are employed mostly as security personnel, chauffeurs, and construction workers, the demand from South East Asian countries is more for employment in industrial enterprises.

Because of the potential positive effect of remittances generally, Nepal has been giving due 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. Currently, more than 50 firms, excluding the commercial banks, are undertaking money transfer businesses.

Some other policy initiatives have also been initiated for encouraging the transfer of remittances through the official channel. For instance, the NRB made a provision to provide 15 paisa per US dollar as commission to licensed private firms in addition to the prevailing buying rate. On top of that, 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 earned under the existing rules.

⁸ This is elaborated in IMF (2006).

A policy arrangement was also introduced whereby 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 the stipulated limits, would be made available directly from the commercial banks.

Again, with an objective to utilize remittances of Nepalis working abroad and bring in the money through the banking channel, in July 2010 the NRB issued a five-year Foreign Employment Bond with an interest of 9.5 percent. The issuance of the bond is expected to facilitate the overseas workers to invest their money in the bond that would be utilized for the government's development programs.

Remittances rose from Rs. 65.5 billion in 2004/05 to Rs. 209.70 billion in 2008/09. Moreover, the share of remittances incoming through the official channel has been going up. For instance, while in 2004/05, out of total remittance income, just about 27 percent flowed into the country through the official channel as against 73 percent through the unofficial channel, in 2009/10, on the other hand, almost 90 percent entered through the official channel and the rest through the unofficial channel.

The upsurge in remittances had led to a surplus in the current account, thereby strengthening the overall BoP position. The share of remittances in total current account receipts, for instance, soared from 38.2 percent in 2004/05 to 56.7 percent in 2008/09 (Table 1). This in turn had enabled Nepal to maintain a very comfortable level of foreign exchange reserves.

Similarly, the remittances to GDP ratio increased from 11.1 percent in 2004/05 to 21.2 percent in 2008/09. These figures clearly indicate that any significant decline in receipts from remittances could disturb the structure of the economy from the macro level. And this is exact what happened in 2009/10, thanks to the delayed impact of the global recession that started to bite the Nepalese economy.

Table 1
Remittances Data

Heading	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10 ^p
Total remittances (in Rs. billion)	65.54	97.69	100.14	142.68	209.70	231.73
Share of remittances to current a/c receipts excluding grants (in %)	38.2	46.7	45.3	51.1	56.7	59.3
Ratio of remittances to GDP (in %)	11.1	14.9	13.8	17.5	21.2	19.6

p - provisional

Source: Nepal Rastra Bank.

As a result, in 2009/10, remittances aggregated Rs. 231.73 billion, a rise by just 10.5 percent compared to its significant growth of 47.0 percent in the previous year. While both in 2007/08 and 2008/09 the upsurge in remittances was responsible for the surplus in the current account and BoP, in 2009/10, the deceleration in the growth of remittances led to a current account deficit of Rs. 32.35 billion, thereby weakening the overall BoP which

also registered a deficit of Rs. 2.62 billion. Analogously, the gross foreign exchange reserves were adequate for financing merchandise imports of only 8.6 months and merchandise and service imports of 10.3 months as at mid-July 2010 compared to 12.3 months and 10.0 months respectively in mid-July 2009. The remittances to GDP ratio fell by 1.6 percentage points to 19.6 percent in 2009/10.

On the basis of data provided by the Department of Foreign Employment, the number of workers going abroad for employment increased by 35.4 percent to 294,094 people in 2009/10 compared to 217,164 people in 2008/09.⁹ With the increase in the number of workers, the inflow of remittances should have taken an upswing. However, this did happen.¹⁰

While remittances shielded the economy during difficult situations in the past, the current global economic crisis has brought a new challenge to the role of remittances. Weak global demand for goods and services and slower economic growth, along with consequent rise in unemployment in host countries, has put the demand for Nepali workers and their remittance transfers at risk. With the decline in remittances, there would be a reduction in household consumption and cutbacks in public spending. Spending on basic necessities such as food, electricity, medicine and schools' fees would also decline.

In terms of uses, however, it has been revealed that remittances in Nepal have been used very little for productive purposes. A small study undertaken by the NRB (2002), covering 10 districts and 160 sample households, showed 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.

A few explanations are provided in Box 4 as to why remittances have been used less for productive purposes.

⁹ Out of the total number of people that were given approval for foreign employment, Malaysia was the top destination with a share of 38.5 percent followed by Saudi Arabia, Qatar and the United Arab Emirates.

¹⁰ Major factors could include the lagged impact of sending remittances as well the lack of awareness for sending money through the official channel. Moreover, a large number of manpower agencies hold workers' money for overseas agents that assist them in securing job orders. For details, see *Republica*, September 11, 2010.

Box 4 : Possible Causes for Less Productive Use of Remittances

The following are some of the reasons as to why migrant workers do not invest in productive uses:

- a) Paucity of promotion support in terms of information, advisory, training and other services pertaining to investment in new and potentially successful sectors;
- b) Less risk involved in the purchase of land and construction of houses;
- c) Hardly any knowledge on investment opportunities;
- d) Top priority accorded to household expenditure;
- e) Lack of expertise in the remittance receiving household for undertaking a business; and
- f) Lack of investment-friendly climate.

V. POLICY ALTERNATIVES

Policies need to be devised to encourage the use of remittances for promoting longer-term growth and income security. Nepal needs to formulate policies that (i) send more remittances through official rather than unofficial channel; (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.

The opportunity to promote self-employment and small business formation amongst returning migrants and their relations back home should be acknowledged by the government and schemes must be targeted to support investment in business activities. In this light, microfinance is well-placed to address the demand for remittance-linked financial services, particularly among poor and/or geographically isolated populations. MFIs have revealed a competitive advantage based on a host of techniques that reduce the high transaction costs of outreach to poorer clients. By broadening the remittance-linked services to the 'unbanked', MFIs have the potential to promote broad-based development, as well as expanding the volume of remittance flows mediated through the financial system. Hence, MFIs in Nepal could also expand their micro and small business portfolio, while the government and NGOs could provide services such as training, business advice and marketing assistance for micro and small entrepreneurs.

Pooling remittances in MFIs in terms of deposits enables MFIs to finance a wide range of activities, and generate a potentially greater economic and social impact than what could be viable with special targeted business development programs. Moreover, MFIs themselves can utilize remittances to leverage more funds in the commercial markets to finance their growing lending operations. This will enable the MFIs both to diversify their funding sources and also increase the breadth and depth of their outreach. Over time, with more experience, innovative MFIs will find different ways of turning workers' remittances into a productive business that would contribute to their social mission and profitability. Those who receive remittances may also find that MFIs' involvement will provide better ways to manage their inflows. These improvements in both the supply and demand sides can make a significant contribution to increase the welfare of the poor and low-income households.

Banks could make MFIs their working partners in the rural sector for operating microfinance activities. The MFIs would act as loan service agents, and collaborate with social entrepreneurs to set up greenfield MFIs. Under this arrangement, each bank or group of banks could develop microfinance loan portfolio by accumulating the remittances they receive from migrant workers and establishing a network that could eventually distribute a range of financial services throughout the rural areas. As a result, commercial banks would also benefit from the potential of the microfinance sector.

An increasingly recognized policy route is to provide matching funds to the collective remittances sent by migrant organizations abroad, commonly referred to as Hometown Associations or HTAs. Most frequent examples are from Mexico and El Salvador. The local or federal governments in these two countries allocate US\$ 2 or more for every dollar migrant organizations remit back in their communities. The pooled funds are normally used to finance infrastructure and social projects, such as remodeling churches and schools.¹¹ Hence, this mechanism could also be considered in Nepal's case.

Pre-departure orientation program, coupled with awareness-raising initiatives for both migrants and their families, and information dissemination in the destination countries could address the problem of limited awareness about the costs and benefits of seeking employment opportunities abroad and could also act as a powerful tool in raising awareness about remittance methods and utilization. In the destination country, regular meetings should be organized by the Nepalese mission and information should be disseminated through different media by the Government of Nepal. Moreover, returnee migrants also have an important role to play as they can share their experiences with future migrants and their families. Overall, the involvement of a variety of actors (migrant associations, NGOs and governmental bodies) is instrumental in the success of these initiatives.

Financial education can provide remittance receivers with the knowledge and skills to evaluate their options and choose the most suitable financial products, to understand how product features differ, to calculate and compare costs and to determine what they can afford and what products are best suited to their requirements. Financial education empowers the remittance receiver with the knowledge and skills to indulge in a dialogue with the sender about various options for sending remittances through formal channels and how remittances can be used to meet the financial goals of both the sender and the receiver.

It is crucial to encourage migrant knowledge transfer and organization of migrant groups for business development. Diaspora communities are not only a source of funding for projects, but also an important source of human capital, which could well be used in Nepal. Due to their attachment, many migrants could thus be mobilized to assist in

¹¹ Hence, these HTAs could act as a conduit for development projects. At the same time, once set up, the pooling of resources could also be used to finance local entrepreneurial activities, with the advantage that it could offer returns to investors. For further elaboration, see Agunias (2006).

projects in Nepal, not just through financial contributions, but also by offering time and knowledge.¹²

At the point of origin, as the majority of remittances are utilized to repay loans borrowed from money lenders at high interest rates it is important to explore the possibilities of indulging self- help groups to set up a social fund, which would provide loans with lower interest rates and develop access to institutional credit. This would lower the debt burden of households. Other options such as vocational training, increasing and disseminating information flows pertaining to rural investment opportunities, the provision of loans from financial institutions, developing market linkages for at least some selected non-farm products and services should be delved into by government and non-governmental agencies. The development of entrepreneurial competence would definitely enhance investment in productive activities.

The governments of Brazil, Mexico, India and the Philippines had employed an array of inducements to attract remittance funds to specific saving and investment vehicles, including migrant pension plans, preferential loans or grants for business ventures, preferential access to capital goods and raw material imports for recent returnees, and investment and advisory services for business start-ups.¹³ Nepal can learn a great deal from the experiences of these countries.

Likewise, the experiences of South Asian countries in terms of using remittances productively could be very beneficial to Nepal. These include, among others, the incentives provided to its expatriates by the Government of India and the mechanisms devised by the India Investment Centre to help Indian companies collaborate with NRIs, the different savings and investment schemes for wage earners abroad designed by the Bangladesh Bank as well as the role of MFIs for the productive use of remittances, the PRI and the non-repatriable investment scheme launched by the Government of Pakistan and the Sri Lankan Government's entrepreneurship development program for return migrants.

Nepal needs to develop a website to make available information to migrants on remittances transfer mechanisms, prices, and speed and reliability that could improve transparency and further competition in the remittance industry. The website could also provide information on investment opportunities back home, immigration policies in destination countries and links to websites of the Nepal government and non-government institutions that work with the Diaspora, return migrants, micro-credit institutions, and business development.

¹² An example is the case of Algeria where its government realized the potential benefit from human capital, and formed an Algerian transnational network of researchers and engineers; thus students that remain in the host countries (Europe and the US) transform the brain drain into brain gain. The underlying idea is that contributions by these groups of migrants can stimulate small and medium starts-up in high-tech sectors such as biotechnologies for agriculture which is strongly needed to improve productivity. For details, see European Investment Bank (2005).

¹³ These mechanisms of different countries are cited in Sander (2003).

The setting up of a special category of deposit accounts at commercial banks where migrant workers can deposit their money earned abroad is one of the common incentives utilized in many countries to attract money transfers from abroad. These special deposit accounts grant migrants preferential interest rates and the choice to have accounts denominated in foreign currency. Other incentives schemes include special training schemes for migrants to open small businesses back home, and granting premium interest rates on remittance funds.

With regard to the global recession, it is exigent to conduct continued assessment of the impact of the worldwide financial meltdown on the economic situation in those destination countries where there are a large number of Nepali migrant workers. This would assist in forming the basis for estimating job losses for Nepali migrants and the number of returnees.

VI. CONCLUSIONS

Remittance flows are a crucial policy concern since they are very large in size, are relatively stable and provide a cushion for economic shocks, and are unique in providing direct benefits for households. However, remittances do not automatically contribute to national development. To carry out effective and efficient public policies to channel remittances into productive projects, the government has to look at what motivate Nepalis to send money home particularly beyond individual family remittances, and craft its policies to take advantage of it. While the policies and initiatives undertaken so far to augment the impact of remittances are primarily aimed at encouraging the sending of remittances through official channels, the utilization aspect of remittances has been largely ignored by the government authorities.

Hence, directing remittances to productive investments is a challenge for the government. Families of migrant workers should be encouraged and trained so that they are able to undertake small businesses. This will generate jobs and help improve the domestic economy. In the long run, migrant workers can come back and be reintegrated in the country, bringing in better skills and technology.

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