

IMPACT OF REMITTANCE ON ECONOMIC GROWTH IN NEPAL

Suman Bhattarai

ORCID: <https://orcid.org/0009-0004-6899-7473>

University of Economics in Katowice

Faculty of Spatial Economy and Regions in Transition, Department of Labour Market Forecasting and Analysis

1 Maja 50, 40-287 Katowice

E-mail: suman.bhattarai@edu.uekat.pl

***Abstract:** Remittances are one of the major sources of financial flow in developing countries. Nepal is among those who benefit. This study was conducted to determine the relationships between remittance inflows and economic growth, with a particular focus on how increasing remittance inflows affect Nepal's economic growth. The secondary data from legitimate sources such as the World Bank were used for this analysis. Additionally, graphs are used to display data and analyse trends. To complete this study, already published literature was studied and the results were analysed based on those theories. The result shows that there is a positive influence of remittance on GDP, as the rise of GDP coincides with the rise in remittances. Remittances caused high demands for imports causing trade deficits. However, they have also made ease with foreign currency reserves. While remittance hurts unemployment, it acts more as a means of enabling labour migration rather than stimulating local employment, the study shows that they have no direct effect on inflation, but they appear to have helped keep the inflation rate stable.*

***Key words:** Economic growth, remittance, macroeconomic analysis*

***JEL codes:** F24, F63, O11*

1. Introduction

Remittances are the funds that migrants, whether domestic or international, send home to support friends and family back home (Khan, 2024; Mack et al 2023). According to the World Bank, personal remittances comprise personal transfers and compensation of employees. All the financial transfers between resident and non-resident individuals are included in the personal transfers. The term "compensation of employees" refers to the earnings of short-term, seasonal workers working in an economy where they are non-resident.

Remittances are one of the major sources of financial flow in developing countries (Dahal, 2014). Their flows to Low-and Middle-Income Countries are around three times larger

than official development assistance (ODA) and it ranks as the second-largest external financial source after foreign direct investment (FDI) (Ahamada and Coulibaly, 2013). If we exclude China, remittances stand out as the primary external financial source surpassing FDI by 1.5 times (World Bank, 2023). As a consequence, the growing amount of remittance they are becoming an important source of funding for developing countries. Thus, given that the primary goal of developing nations is to achieve high and sustainable economic growth, it is necessary to examine the relevance of remittances in terms of their influence on the receiving country's economic development.

This study will find the connections between remittance inflows and economic growth, concentrating on the effects of rising remittance inflows on Nepal's economic expansion. First, it accomplishes this by identifying the theoretical and empirical connections between remittances and some of the macroeconomic indicators which influence economic growth. Then relevant data will be used to assess the effect of remittance on those factors as a means of study the impact of remittance on Nepalese economic growth.

Literature Review

Remittances have become a significant financial flow for developing countries. It often surpasses foreign direct investment and official development assistance. The impact of these remittances on economic growth has been widely studied, with varying conclusions depending on the economic indicator, methodology, and specific economic conditions of the countries examined.

Several studies have been conducted to better understand the phenomenon of remittance and its impact on both the local and global economies. Few studies found a favourable impact on economic growth, while a few found no impact. Study by Meyer and Shera (2017) suggest that remittances have a positive impact on growth and that this impact increases at higher levels of remittances relative to GDP. Similarly research done by Oteng-Abayie et al. (2020) reveals that remittances had a negative long-run effect on growth and a positive effect on economic growth in the short-run. Meta analysis by Cazachevici et al. (2020) finds the regional differences: remittances are growth-enhancing in Asia but not in Africa. In case of Bangladesh, a positive relationship has been found between remittance with the GDP, gross capital formation, domestic saving, and household final consumption expenditure (Kabir et al. 2018). Dahal (2014) analysed the impact of remittance on the Nepalese economy and discovered mixed impacts as a result showed that positive association with entrepreneurship, but a negative

with manufacturing. Sing and Pradhan (2023) find that there is a long-term relationship between remittances and economic growth.

2. Methodology and Data

Data for this analysis are from secondary data which is accessible from reliable sources such as the International Monetary Fund (IMF), the World Bank, the Asian Development Bank, and the Government of Nepal. It mostly covers the twenty-two-year span from 2001 until 2022. It explores the relationship between remittances and macroeconomic indicators (GDP, Inflation, Unemployment and, Trade balance) by analysing macro-level statistics using tables and graphs. Because no statistical methods were used to analyse the data, the correlations between elements are reliant on assumptions from existing literature.

Analysis and Findings

Overview of Nepal

Nepal is a small landlocked country located between China and India, two economic giants of Asia. Nepal comprises 7 provinces and has a total population of 29 million. With a total of 147,181 square kilometres of total area, geographically it is divided into three regions: the Himalayan region, the Mid-hill region, and the Terai region (Nepal et al, 2020). The Himalayan region contains eight of the world's top ten highest mountains. Nepal's geography is diverse and naturally beautiful but complex as the majority of the land area is in Himalayan and hill regions which causes difficulties in expanding the road network around the country.

After the declaration of the Federal Democratic Republic by its constitution of 2015, it was further divided into 753 local levels including 6 metropolises, 11 sub-metropolises, 276 municipalities, and 460 village municipalities (CBS, 2018) (Pradhan, 2019). According to World Bank data around 78.55 percent of the total population lives in rural areas of Nepal, while only 21.45 percent lives in urban areas (World Bank, 2022) (Macrotrends, 2022).

Political instability is always at its peak after the civil war and the abolishment of the monarchy in 2006. Agricultural sectors are backward, industry sectors are in poor shape, and the majority of the population lives in poverty in urban as well as rural areas. Unemployment in all sectors is expanding rapidly, price levels are inclining, and inflation is skyrocketing (Pradhan, 2019). These issues not only push Nepal towards the list of developing countries but also push much towards the underdeveloped economy.

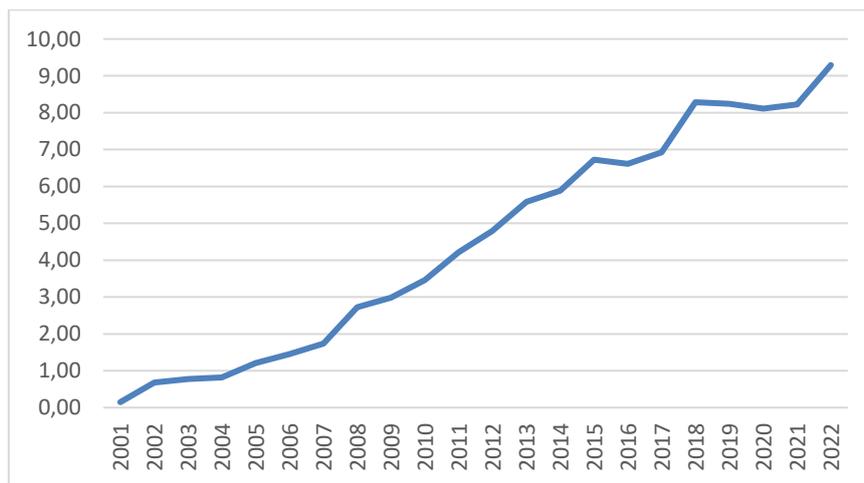
Remittance in Nepal

Remittances have been a significant source of income for Nepalese households. In Nepal, the proportion of remittance inflows to GDP was only 2% in 2000 and currently, it is 22.76% (World Bank, 2023). According to the World Bank, Nepal is the fifth highest remittance-recipient country as a percentage of GDP.

Every year approximately 350,000 Nepalese are migrated for work through formal channels (DoFE, 2023), and they send money to their families. However, the data on remittances is not disaggregated in terms of migrant workers and other inflow of remittances (such as from students abroad who work part-time or emigrants who send money home to their parents). As work permits are not required to work in India, these data exclude the number of Nepalese who moved to India for work.

Fig. 1

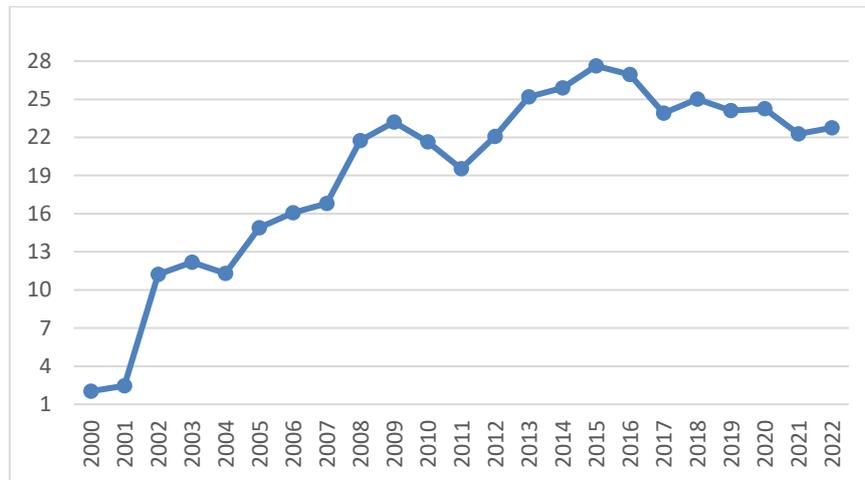
Total personal remittances received (in current billion US\$).



Source 1. (www1)

The inflow of remittances in Nepal has exhibited a significant upward trend over the years. In 2000, remittances accounted for approximately 2.03% of the GDP (Fig. 2), amounting to around 111.49 million US dollars. This amount proliferates by six times in 2002. It peaked during the financial crisis period in 2009, when remittances constituted approximately 27.63% of the GDP, totalling around 2.73 billion US dollars. Subsequently, there was a slight decline in the percentage of remittances to GDP in 2015, but the absolute value of remittances continued to rise. By 2022, remittances still accounted for a substantial portion of the GDP for Nepal. Currently, it is approximately 22.76% of the GDP (Fig. 2), with a value of approximately 9.29 billion US dollars (Fig. 1).

Fig. 2 Personal remittance as a percentage of GDP



Source 2. (www1)

This constant increase in remittance inflows emphasizes the importance of remittances as an essential source of income for Nepal's economy. It contributes significantly to economic growth while also providing an important source of income for many Nepalese households.

Performance of the Economy

Evaluating an economy's performance involves analysing a variety of indicators that provide information about its state, stability, and future development potential. These indicators help to understand an economy's performance and serve as a decision-making tool for businesses, economists, investors, and politicians. An outline of the main techniques and indicators for assessing economic performance is prepared here.

Macroeconomic Indicators

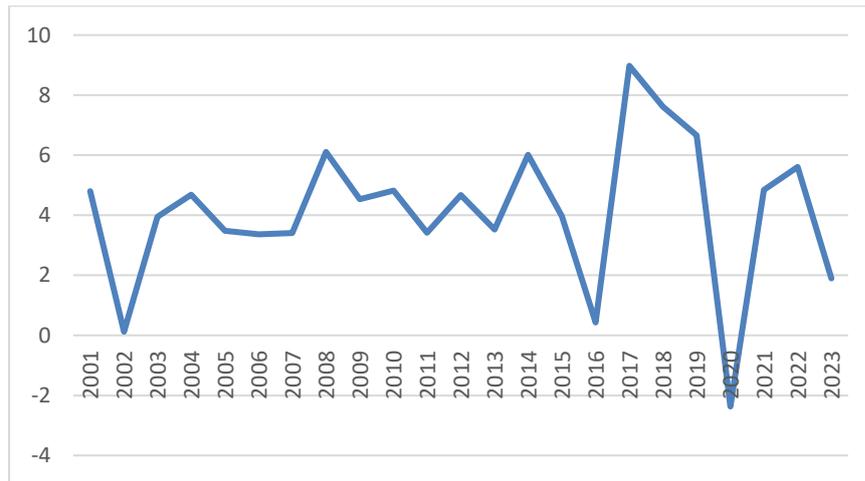
1. Gross Domestic Product (GDP)

Gross Domestic Product (GDP) is the standard measure of the value added generated by a country's production of goods and services over a specific time period (OECD, 2022). It is a crucial and most practised indicator for assessing economic growth. Nepal's GDP growth for 2022 was 5.61% which is below then India (7.2) and Bangladesh (7.1) but above Pakistan (4.7) and Sri Lanka (-7.8).

The GDP growth rate has never been steady and upward for Nepal. The growth rate has fluctuated throughout time, mostly impacted by local and national political instability, natural disasters (such as the 2015 earthquake), and foreign influences. We can see a slight downward in 2016 and 2020 which is caused by catastrophic earthquakes and COVID-19. The 2015 earthquakes had a significant impact on GDP due to sluggish post-earthquake rehabilitation and

disruptions in trade and supplies (ADB, 2016). The earthquake disrupted economic operations, particularly in agriculture and industries, leading to slow restoration and rehabilitation efforts. However, in recent years, Nepal's growth trajectory has been rather consistent, thanks to efforts to restructure the economy and construct infrastructure. The Fig. 3 presents the trend of GDP growth rate.

Fig. 3 GDP growth rate per year for Nepal

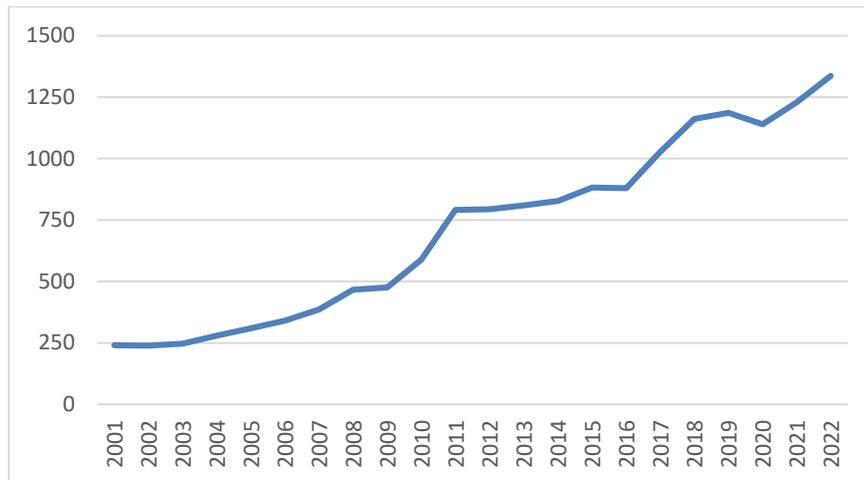


Source 3. Own analysis based on the World Bank Data (www1)

The total value of the GDP has increased from 2001 until 2020 when it declined by 2.37% but rose over consecutive years. COVID-19 hit the world economy and developing countries were the most impacted. GDP for Nepal rose after 2021 but even though it escalated, the real performance was not satisfactory. GDP for 2024 is forecasted to grow by 3.6% and 4.8% in 2025 (ADB, 2024).

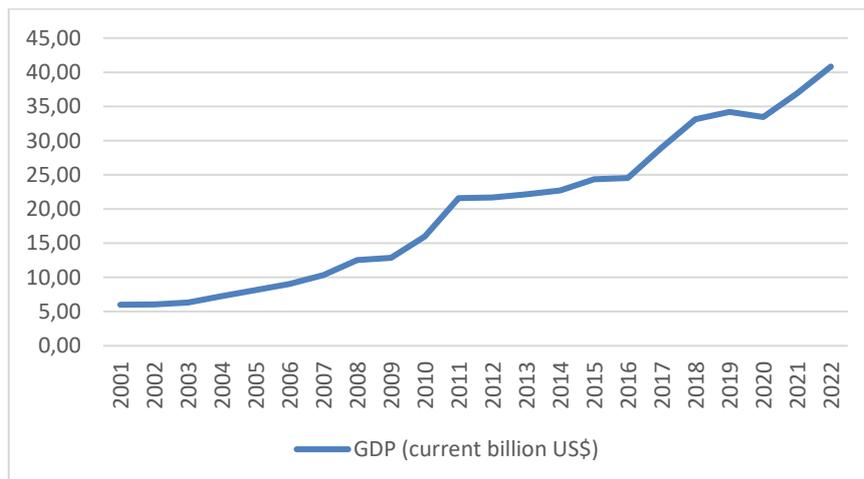
Nepal's GDP per capita trend has been increasing moderately since 2004 (Fig. 4). Such growth is often associated with improvements in industrial and manufacturing sectors, tourism, education, and employment as well as an increase in remittance inflow from Nepalese workers abroad. Remittance played a crucial role in GDP growth in Nepal. Fig. 5 presents the value of GDP over the twenty years, clearly depicting significant growth.

Fig. 4 GDP per capita for Nepal 'in US\$'



Source 4. Own analysis based on the World Bank Data (www1)

Fig. 5 Total GDP for Nepal 'in billion US\$'



Source 5. Own analysis based on the World Bank Data (www1)

Challenges for Nepal: Despite the upward trend of GDP, the country faces several challenges that affect GDP. Infrastructure comes in first as a country has limited transportation routes and difficulty in developing efficient transportation routes due to geography. Similarly, natural disasters like floods and earthquakes occur repeatedly and it disrupt economic activity. Another major challenge is political instability. Such challenges are major factors that fluctuate GDP growth in Nepal.

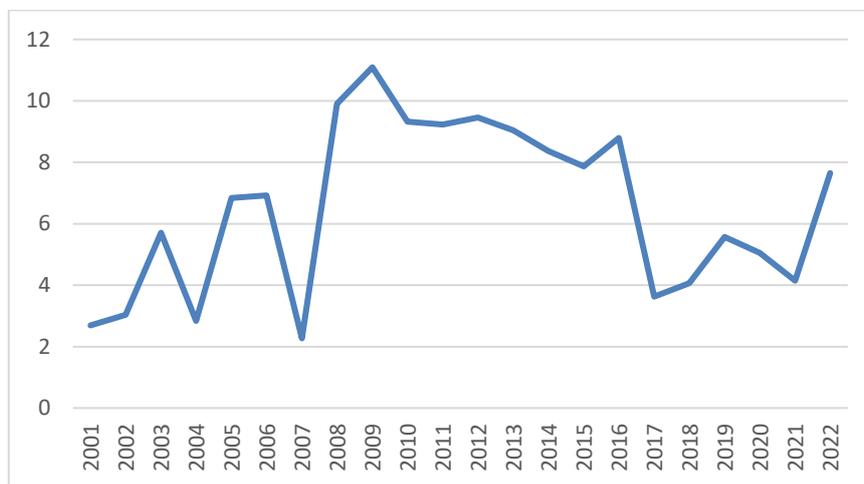
2. Inflation rate

Research on inflation suggests that moderate inflation is a sign of economic development (Chowdhury et al., 2001; Ahmed et al., 2005; Bhatta, 2015; Adhikari, 2014) but high inflation

can lead to economic instability. A balanced approach to monetary and fiscal policies is required to effectively manage inflation.

Nepal had faced high inflation in the past but after 2001 it has been relatively moderate. There has been a slightly high fluctuation between 2009 and 2016. Several empirical research indicates that Nepal's inflation is heavily influenced by Indian inflation (Bhattarai 2017). Nepal Rastra Bank (Central Bank of Nepal) plays a crucial role in managing inflation through monetary policy. The Nepalese rupee is pegged to the Indian rupee and is one factor in controlling imported inflation in Nepal as a high volume of the imports are from India. Compared to other South Asian countries, Nepal managed to have a lower inflation rate in recent years.

Fig. 6 Inflation rate per year for Nepal



Source 6. Own analysis based on the World Bank Data (www1)

Fig. 6 shows that inflation rose dramatically in 2008. In 2007, Nepal had moderate single-digit inflation (2.67%), but it increased to over 10% in 2008 and remained two-digits for the next consecutive year. A sudden rise in global fuel prices in 2008 caused a significant increase in petroleum prices in the local market. This increased the cost of producing domestic products, resulting in higher consumer goods and services costs. The combined effect of the rise in food, commodity, and fuel prices led to spiralling prices starting from 2008. Inflation remained high until the third quarter of 2016.

3. Unemployment rate

The unemployment rate is a critical indicator of the economy and labour market. Nepal maintained a steady unemployment rate throughout the period from 2001 until COVID-19 hit the market in 2020. The unemployment rate increased sharply in 2020 and fell back in 2022. The majority of the labour force is working in the agricultural sector with 53% of the male

labour force and 75% of the female labour force. A larger number of male labourers are employed in the service sector and then industry while for the females it is the opposite (Table 1).

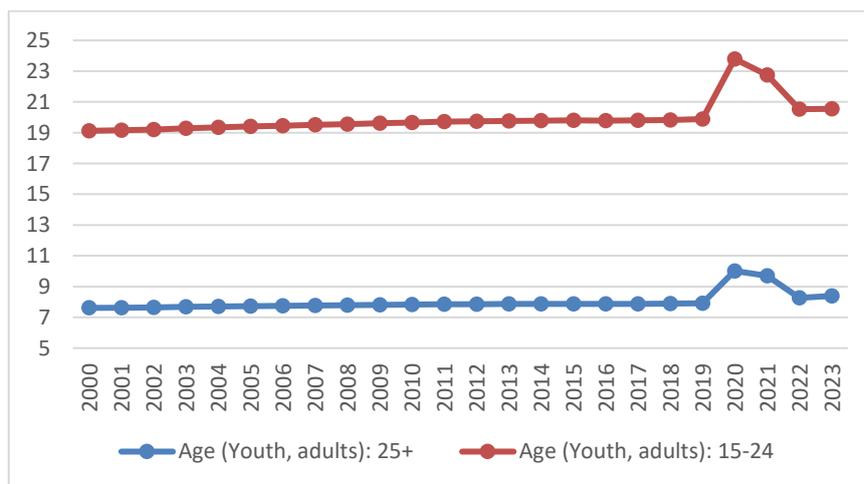
Tab. 1 The proportion of gender-wise employed labour force (modelled ILO estimate)

Indicator Name	Year - 2022
Employment in services, male (% of male employment)	27.52
Employment in services, female (% of female employment)	10.29
Employment in industry, male (% of male employment)	19.17
Employment in industry, female (% of female employment)	14.52
Employment in agriculture, male (% of male employment)	53.31
Employment in agriculture, female (% of female employment)	75.19

Source 7. (www1)

Nepal has a population of 26.5 million which is growing fast, resulting in a young country with 63.7 per cent of the total population below the age of 30. Nepal's unemployment rate for youths (15–29) has 19.2% rate. An estimated 400,000 or more young people are anticipated to enter the workforce annually (www4). The quality of employment is challenging for Nepal as it is primarily found in the informal economy, where wages and productivity are low and working conditions are unfavourable. This, in turn, is manifested in large numbers being underemployed - the so-called working poor. And an important part of the employment challenge is to raise the productivity and earnings of these workers and improve their working conditions (www4).

Fig. 7 Total unemployment rate of Nepal (ILO estimated)



Source 8. (www3)

Fig. 7 illustrate the trend of the unemployment rate in Nepal. Based on age group, there are two main groups of work-force in Nepal. Young people over 25 and those between the ages of 15

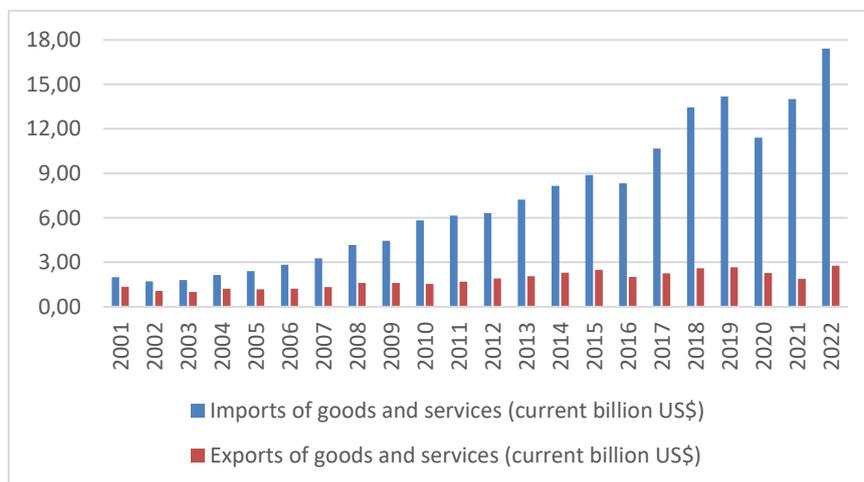
and 24. Most young people in the 15–24 age range are enrolled in higher education, although many are still looking for work. On average 20% of them are unemployed. The percentage is increasing as a result of more students enrolling for higher study each year. A lower percentage of the workforce is unemployed among workers older than 25. Though at a slower rate, this rate is still trending upward.

4. Trade Balance

Nepal never had a trade balance in positive as the economy relies on imported goods. The majority of the population involved in agriculture, lower industrial capacity, and unskilled manpower caused a small amount of export.

Nepal's top import goods are Refined Petroleum (\$2.24B), LP Gas (\$504M), Gold (\$433M), Rice (\$322M), and Soybean Oil (\$306M), imported mostly from India (\$8.66B), China (\$1.78B), United Arab Emirates (\$374M), Indonesia (\$297M), and United States (\$280M). Nepal's major export goods are Palm Oil (\$184M), Soybean Oil (\$180M), Non-Retail Synthetic Staple Fibers Yarn (\$92.3M), Knotted Carpets (\$90.4M), and Fruit Juice (\$48.6M), exporting mostly to India (\$956M), United States (\$152M), Germany (\$43M), Turkey (\$28.3M), and United Kingdom (\$26.2M) (Source: [www2](#)).

Fig. 8 Trade Balance 'in billion US\$'



Source 9. Own analysis based on the World Bank Data ([www1](#))

The Fig. 8 shows that Nepal's exports never reached the threshold of 3 billion US\$ while imports reached as high as 17.41 billion US\$. Import growth has been steadily expanding since the beginning, although it has accelerated significantly since 2004. Imports are growing rapidly in Nepal since the country relies on them for many essential goods.

3. Discussion and Conclusion

The analysis of the impact of remittance on economic growth in Nepal, using macroeconomic indicators reveals a multifaceted influence of remittance on the country's economy.

The data indicate a positive correlation between remittance inflows and GDP growth. Since the increase in remittance inflows, GDP has consistently risen, even during the global financial crisis of 2008/09. This resilience highlights the significant role of remittance as a stable and critical source of external income for developing countries such as Nepal. Remittances support domestic economic activity, enhance household consumption, and foster overall economic stability.

Regarding inflation, several studies suggest that there is no relation between remittance and inflation rates (Riveva & Tullao, 2020) (Dilanchiev et al. 2020), the situation in Nepal appears to be a similar pattern. The inflation rate in Nepal has remained relatively stable, fluctuating between 4% and 9% for most of the observed period. This indicates that despite substantial remittance inflows, the inflationary pressures have been manageable, possibly due to effective monetary policies or structural factors unique to Nepal's economy.

Conversely, the impact of remittance on Nepal's trade balance has been less favourable since the beginning. The trade deficit in Nepal has been expanding significantly each year. Dahal (2014) attributes this trend to the high remittance inflows to households, which may lead to reduced labour force participation within the country. With fewer people working locally, domestic production declines, and reliance on imports grows. It then augmented the trade deficit. This suggests that while remittance boosts household income, it may inadvertently discourage local employment and production, which leads to a deteriorating trade balance.

Unemployment data presents a complex picture. The analysis shows no noticeable impact of remittance on the unemployment rate. The graph shows that both remittance inflows and unemployment rates have been rising concurrently but the growth rate of unemployment was sluggish. This paradox may be explained by the tendency of remittance recipients to opt out of low-wage jobs in Nepal in favour of seeking higher-paying opportunities abroad. Consequently, the local labour market does not benefit from the potential labour force, and remittance acts more as a means of enabling labour migration rather than stimulating local employment.

In summary, while remittance has positively impacted GDP and maintained manageable inflation levels in Nepal, it has also contributed to a growing trade deficit and has not alleviated unemployment issues. The positive economic growth driven by remittance is thus somewhat

tempered by these negative aspects, highlighting the need for policies that can harness the benefits of remittance while mitigating its adverse effects on trade and employment.

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- (www3) https://rshiny.ilo.org/dataexplorer5/?lang=en&id=NPL_A
- (www4) <https://ilostat.ilo.org/>