



SCHOOL OF  
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# **From Remittances to Development: Exploring Nepal's Path to Progress**

A Comprehensive Analysis of Remittances and Their Impact on Nepal's  
Development

by

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## **Abstract**

Nepal is one of the largest recipients of remittances compared to the size of the economy, reaching 30,1% of GDP in 2018. This makes understanding them, their effects, and how to positively impact that an important policy tool. Additionally, remittances outpace both Official Development Aid and Foreign Direct Investments for Low- and Middle-Income countries. It has become increasingly apparent for most actors with a vested interest in development that remittances are an important tool when trying to improve livelihoods in poor countries.

Therefore, this paper explores the effect of remittances on development in Nepal and examines the different ways to increase the positive impacts by suggesting concrete policy reforms and areas of interest to focus on when harnessing remittances. Although the literature on remittances is vast, most of it is either broad in its scope and focus or narrow case studies conducted for individual countries or communities within. While these are beneficial for the literature, and likewise useful for understanding remittances, this paper examines these findings in the context of Nepal, aiming for specific solutions applicable to the context Nepal finds itself in. By doing that, this thesis finds concrete avenues of improvement that policymakers should focus on supporting to increase the positive impact of remittances on development. Some of the positive effects are poverty reduction, increased resilience against volatility, increased consumption expenditure, particularly on education and health care, which results in higher weight-for-age and height-for-age for children in recipient households, and even knock-on effects on deforestation.

The quality of the institutional framework in place plays a large part in the impact of remittances. Tailor-made policies can be implemented to amplify the positive effects of remittances. The suggested areas for policymakers to focus on include human capital, taxation, financial inclusion through access to banking, and promoting investment. Similarly, increasing not only the effect but the flow will lead to an overall increase in the positive effects of remittances. Reducing the costs of transactions for remittances will encourage greater inflows of remittances.

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## List of Abbreviations

ADB	Asian Development Bank
CPI	Corruption Perceptions Index
FDI	Foreign Direct Investment
FLFP	Female Labour Force Participation
GCC	Gulf Council Countries
GDP	Gross Domestic Product
IMF	International Monetary Fund
LMIC	Low- and Middle-income Countries
NELM	New Economics of Labour Migration
ODA	Official Development Aid
SDG	Sustainable Development Goals
UN	United Nations
WMW	Women Migrant Workers

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## 1. Introduction

Remittances refer to “the money and goods that are transmitted to households by migrant workers working outside their origin countries” (Adams 2008)

Remittances are the foremost source of external finance for LMICs, excluding China, since 2015, exceedingly even FDI and ODA. Remittances are expected to reach \$639 billion in 2023 for LMIC (Ratha et al. 2022). Remittances are of such vital importance for development that they're included in the Sustainable Development Goals. Target 10.c of the SDGs is the goal of reducing the transaction costs of remittances to less than 3% by 2030. This will allow for a greater inflow of remittances in recipient countries and aid development since research shows that a 10% increase in remittances can lead to a 3,5% reduction in the number of people living in poverty (Adam & Page 2005).

In 2018 remittances when compared to GDP accounted for 30,1% in Nepal, the fourth most of any country in the world and the most of any country in South Asia (Chhetri et al. 2020). There has been a steady growth in remittances as a share of GDP in Nepal. The ratio increased from 10,7% in 2001 to 13,5% in 2007. Showcasing a steady growth in the share of remittances to GDP and increasing importance. Additionally, in 2019 the number of remittance-receiving households reached more than 50% in Nepal (D. Adhikari 2020). It is important to note that this is also only the formal remittances that are captured, numbers suggest that as much as 10% to 50% of total remittances are in fact through informal channels, depending on the country and the ease with which one can transfer remittances, often measured by the cost of doing so (Ratha 2004). This in itself presents a problem for capturing the ‘true’ size of remittances, which furthers the need to understand their effect on Nepalese society and development effects.

Lastly, to stave off any concerns of remittances being a way to siphon off wealth from the countries they are sent from, like a zero-sum game, research shows that growth of real GDP in the region is strongly associated with that of remittance outflows from the GCC (oil and gas producing countries). Thus, remittances are not only beneficial for Nepal but also for the greater area in which remittances are sent, or at least have a positive relationship with GDP growth (Ilahi & Shendy 2008).

Remittances offer a valuable contribution to Nepalese development on both the macro- and microeconomic levels. More than 56% of households are remittance recipients. According to the Central Bureau of Statistics in Nepal, the poverty rate has fallen from 41,8% in 1995 to 25,2% in 2011 (CBS 2019). Remittances are considered a major contributor to this reduction in the household poverty rate (Pant 2008). Demonstrating the importance of understanding them and their effect on development to support their beneficial impacts.

Whilst remittances are an important tool for development, even dubbed by the UN as the ‘key to helping world’s poorest countries’, it is, therefore, of great importance to understand them and how to harness their beneficial development effects (UN 2021), specifically how each country may help to facilitate them to do so.

### 1.1 Problematization

Remittances are a great tool for development, although one shouldn’t rely entirely on either ODA or FDI as a strategy for development, the same is true for remittances. Shocks in the flow of remittances might otherwise leave households vulnerable to poverty.

Remittances remain an important driver for development. They have the possibility of boosting growth in countries with less developed financial systems by providing an alternative way to finance investment and helping overcome liquidity constraints (Giuliano & Ruiz-Arranz 2009). Remittances in Nepal have also been found to be positively correlated with expenditure on food and education, and negatively correlated with expenditure on tobacco and alcohol (Mishra et al. 2022). Additionally, research shows that remittances have a positive association with financial development and human capital in Nepal (Sharma et al. 2014).

Nepalese households rely heavily on remittances. Almost 2/5 of rural households are recipients of remittances. At the same time, almost 1/5 of households live below the poverty rate. Research from Nepal shows that remittance-receiving households are 2,3% less likely to end up in poverty compared to non-remittance-receiving households. Furthermore, to build upon Adam & Pages’ findings, more recent studies for Nepal find that a 10% increase in remittances decreases poverty by 1,1% for Nepalese households (Byanjanakar & Shakha 2021).

## 1.2 Research Problem

Remittances play a significant role in the economy of Nepal, contributing to household income, poverty reduction, and overall development. However, despite the substantial inflow of remittances, the country still faces numerous challenges in effectively harnessing its potential for sustainable development. Therefore, a research problem that arises is how to optimize the development impact of remittances in Nepal through effective policy interventions.

Focusing on this area can provide valuable insights into the challenges and opportunities associated with remittances in Nepal and guide policymakers in designing effective interventions that maximize the development benefits of remittances, encourage economic growth, and promote sustainable development in the country.

## 1.3 Aim of the Study

Following the premise that remittances contribute to Nepalese development and the research problem laid out, this study aims to discuss the effects of remittances on developmental outcomes in Nepal, investigate how Nepal might increase remittances and optimize their effects, by investigating and collating previous research to learn and adapt to their findings.

To attain that aim, this thesis poses the following question:

What are the developmental outcomes of remittances in Nepal and how can the effect of them be increased?

The research question is explanatory in its essence, by examining remittances in a Nepalese context, looking into historical roots and trends, whilst holding it up against a collated selection of previous research and studies, the question intends to explore how Nepal can benefit from remittances and how to increase the associated positive effects. Additionally, the second part of the research question aims to analyse how Nepal can optimize its in-flow of remittances to reap the most benefits possible from them.

## 1.4 Scope of the Study and Relevance

The scope of this research is the case study of remittances in Nepal. This particular case was chosen due to the interesting case of Nepal in itself, one of the world's leading recipients of remittances and the foremost of all Asian countries as a share of GDP. Analysing an



exceptional case like Nepal can provide valuable lessons regarding remittances elsewhere in Asia and the world.

Additionally, with the impact of Covid-19 on the world economy and SDG goals that are only 7 years away, wherein remittances are directly addressed but also play a part in many other targets and goals due to their beneficial effects on livelihoods of families and households, the relevancy for delving into remittances to understand, nurture, and promote them becomes apparent.

## 1.5 Delimitation

As for most case studies, the research is limited in its external validity. The findings of this study are specific to the chosen case, in this case, Nepal. With that said, some of the insights gathered might prove useful in a wider regional context for other Asian- and low- and middle-income countries regarding policy recommendations and how to tailor them to increase the positive impact of remittances.

Although this study focuses on remittances, the available data on remittances at a micro-level in Nepal is scarce. Research has been conducted for certain regions and areas, but replicating those studies by collecting the data itself was outside of the scope of this thesis. Similarly, little data on a macroeconomic scale for remittances is available for Nepal. The greatest limitation to what I set out to research was data availability or in this case the lack thereof. Therefore, this paper focuses on collecting previous research learnings and applying them to a contemporary understanding of the Nepalese context.

## 1.6 Outline of the Thesis

This thesis is outlined as follows: I will begin by providing some background information regarding remittances in Nepal and other parts of the world and countries to put the study into context. I will then go on to review the literature on remittances, presenting the findings of previous studies that act as a facilitator for my research. This will be done in three steps by focusing on the general theoretical findings of the literature, the findings in Nepal, and lastly the theoretical framework necessary to understand remittances and their effects. Then I will introduce the methodology employed to contextualize Nepal's conditions by looking at previous research. Subsequently, I present the findings of my research and discuss the results, connecting them to the findings of the existing literature. The thesis finishes off with some concluding remarks summarizing the results.

## 2. Background

In this section, I will show the previous literature which leads to my thesis regarding remittances in Nepal. The previous research provides the background information that puts my work into an academic setting and simultaneously justifies the methodological and theoretical choices adopted in the research. Showing how the thesis draws its conclusions from the materials it is built upon. The literature review combined with the next segment on theory and previous research will provide the necessary depth and understanding to show where this thesis fills a gap in the literature with its practical implications for policymakers in Nepal.

As has been mentioned previously in this thesis, the scope of remittances in Nepal is enormous and contributes greatly to household consumption. A recent study in Nepal found that remittances are positively correlated with expenditure on food and education, whilst there's a negative association with expenditure on tobacco and alcohol. The same study also examines the importance of the gender of the recipient and finds that the results don't statistically differ between genders, whatever the gender of the head of the family receiving remittances the household consumption expenditure patterns stay consistent (Mishra et al. 2022). Other literature on the subject includes studies of the effect of remittances on the Nepalese economy. They've found that remittances have a positive association with financial development, and human capital in Nepal but a negative association with international trade (Sharma et al. 2014; P. Dahal 2014).

Focusing more specifically on only the economy itself, some studies have found it to be detrimental for it. One study found an increase in remittances to cause a decrease in agricultural production, boost consumption, and have no impact on investment, arguing that remittances, thus, lead to a deteriorating GDP per capita, and concluding that remittances are detrimental to the economic growth of Nepal (Uprety 2017). Similarly, one of the first studies on the macroeconomic impact of remittances in Nepal found that remittances are associated with a decline in the trade sector, leads to an appreciation of the real exchange rate, and concludes that remittances may lead to Dutch disease effects in Nepal (Sapkota 2013). Whilst this may very well be the case, some of the findings must also be looked at critically. Whilst the findings of Sapkota seem to be of great interest for understanding remittances, it did not use any empirical models to support these findings. Although more recent empirical-based studies find contrary results. One of those studies finds that remittances significantly increase

money supply and prices while also appreciating the real exchange rate, similar to Sapkota, but find no link with GDP output (S. Dahal 2022).

More important, perhaps, is the role of remittances. David Malpass, the president of the World Bank Group, wrote an article titled “Remittances Are a Critical Economic Stabilizer” last year. Herein, he agrees with recent studies claiming remittances to be a vital lifeline for people in developing countries. Additionally, a World Bank publication from 2008 on the lesson learned from Latin America on remittances and development found that remittances contribute positively to economic development by reducing poverty and inequality, and also increase investment and growth in recipient countries (Fajnzylber & Lopez 2008, p. 2). Furthermore, remittances act in a countercyclical fashion, reducing volatility when facing shocks, similar to the arguments echoed by David Malpass nearly 15 years later. On a smaller scale, remittances provide recipients with the ability to increase savings, increase expenditure on consumption and human capital, and improve children’s health and educational outcomes. The authors find that children from remittance-receiving families are more likely to stay in school and have a higher weight-for-age and height-for-age than households not receiving remittances (Fajnzylber & Lopez 2008, pp. 149-158). This shows the importance when keeping in mind the scale of remittances, the flow of which is both greater than FDI and three times the size of ODA (Malpass, 2022).

## 2.1 Thesis’ Contribution to the Discussion

Previous research suggests that the remittances are multi-faceted and that the reasoning for pursuing migration to send transfers home to a household cannot be boiled down to one simple cause, it is very context dependent for each country. Although this is the case, research has shown that the primary motivations for remittances are loan repayment, altruism, insurance, bequest, and exchange (Hagen-Zanker & Siegel 2007). Similarly, the effects of remittances are as situational dependent as the rationale for pursuing them. Looking through previous empirical studies, the development effects of remittances can be boiled down to having a positive impact on poverty and health, and a negative one on labour supply, education, and economic growth (Adams 2011). Whilst this may be the case in general, further research and understanding of the Nepalese context for remittances and development is needed to ascertain whether the same holds true for Nepal.

Similarly, as addressed above, most research is either fairly specific case studies of relatively narrow scope in Nepal or at a greater regional or international level. Whilst these are of great interest, this study aims to add to the literature by amassing the knowledge of remittances, with the specific case of Nepal in mind and what research has already been done there, to contribute to specific policy recommendations and how to go about organizing efficient inflows of remittances that aid in increasing the positive effects on development while keeping aware of and reducing any negative side-effects that can occur. Thus, remittances should be supported, facilitated, and welcomed wholeheartedly.

### 3. Theory and Literature Review

#### 3.1 General Theoretical Background

Although the level of poverty reduction provided by remittances is not precisely agreed upon, the literature agrees that it helps alleviate it and so to do big development actors like the IMF, World Bank, and the UN. A 10% increase in remittances (as the share of remittances in a country's GDP) will lead to a poverty reduction estimated to be 1,6% or 3,5% depending on the study used to measure the effect (Ratha 2009; Banga & Sahu 2010; Adam & Page 2005). Suffice it to say, that no matter the actual level of poverty alleviation an increase in remittances leads to, contemporary literature suggests that remittances have a positive impact on poverty reduction. Thus, the most important theoretical pillar of this thesis is built upon, the fact that remittances are beneficial for development can be solidly confirmed. Furthermore, studies have also found that increases in remittances can lead to a permanent increase in GDP as well, with a 10% increase in remittances leading to a 0,66% increase in GDP (Francois et al. 2022). It can seem trivial, but the findings imply that remittances can then be positively linked to economic growth. Thus, remittances can be viewed as drivers for development (Tu et al. 2019). This is exactly what has been preached by international organizations such as the World Bank in recent years stressing the importance of remittances.

Examining the case of whether remittances lead to economic development, some of the early literature disagrees, the present consensus was more hotly debated. The effect on long-term growth was contested, and although it remains a part of the discussion much of the early criticism has evaporated. Research suggests that the early discussion was caused by not taking into consideration one critical aspect of remittances, the quality of institutions in the recipient country. Doing so explains why there were differing findings on the effects, simply because the long-run economic development effect of remittances is positively linked to the quality of institutions and must be accounted for (Catrinescu et al. 2009). This has policy implications, which the thesis will explore further in the discussion section.

In that vein, Kapur (2003) finds that long-term poverty alleviation might not be the main contribution from remittances. Combating structural poverty requires economic transformation and a solid financial structure in place for remittances to have a positive impact. Although that might require more work, the immediate effect on transient poverty caused by shocks, both at a national and household level, is a problem more suited to be affected by the flow of remittances (Kapur 2003).

On the other hand, the pro-development of remittances accurately predicted the path remittances would take to increase development. Taylor (1999) argues that new economics of labour migration could increase development by reducing economic constraints on households and increasing their investment and production income-growth linkages. This was in stark contrast to many of his contemporaries, who had a more pessimistic view of remittances' effect on development. Taking a NELM approach the author finds that remittances may have a positive impact on economic development (Taylor 1999). Lastly, as with much of the literature, Taylor acknowledges the policy implications of his findings and suggests economic policies that create the conditions for remittances to increase their contribution to income growth for recipient households.

To quantify this effect into a more easily understood indicator and show the importance of remittances on poverty reduction, Pernia (2008) finds that they are responsible for reducing the number of people living in poverty in the Philippines by almost 2,5 million people. Arguing that remittances do not affect development with those findings can seem foolish. Pernia (2008) shows that remittances increase average incomes across all levels of income, but more so for richer households than poorer ones. The author's analysis shows that remittances lead to higher household savings, expenditure on education and health, and reduce poverty. Lastly, the research finds that remittances also contribute positively to regional development (Pernia 2008).

Building upon those findings and continuing in the same vein, it is of great interest to study the relationship between remittances and investment. A study by Bjuggren et al. (2010) examined data on the remittance flow to 79 developing countries which lead the authors to conclude that remittances in collaboration with good institutional and financial frameworks encourage investment. Interestingly enough, the authors further find that the marginal importance of remittances as a source of investment decreases the better the institutional framework and the more developed the credit market is (Bjuggren et al. 2010). This may tie neatly to the findings that remittances may be scarcer, the poorer and more conflict-ridden a country is, although the importance of them is amplified in turn. This underlines the importance of understanding remittances for all poor countries, no matter the level of flows, and stresses the significance of creating a conducive environment for the development created by remittances.

As an interesting side note, the findings of Gammeltoft (2002) suggest that the more refugees a country produces, the smaller the inflow of both aid and remittances will be. While

that is the case, it also stresses that what little aid and remittances they do get is of even greater importance. Especially when compared to the relative size of their economy. This underlines the importance of understanding remittances for all LMICs. Moreover, it is also found that during conflicts in the recipient country, migrants will increasingly divert their remittances to neighbouring countries instead of their home country (Gammeltoft 2002).

### 3.2 Previous Research in Nepal

Remittances have been an increasingly important part of the Nepalese economy for the last two decades. They both support the foreign reserves at a macro level with household consumption at a micro level (Paudel & Bhusal 2021). This shouldn't come as a surprise with the numbers already presented for Nepal, but the increasingly important part of the economy stresses the need for understanding the effect of remittances better.

One such way of doing that is through examining the scope of remittances, and answering questions such as how many people they affect within Nepal. Previous studies have found that the share of remittances in household income is 62,5% for migrating households (Khanal et al. 2014), and another study found them to contribute 35,6% to the total expenses of remittance-receiving households (B. Adhikari 2016). It is clear that remittances play a key role for the households receiving them in Nepal. While multiple studies have shown that although remittances have an overall positive effect on the economy and development in general, they also have their downsides. In the case of Nepal, remittances were found to have a negative impact on agricultural productivity in Manapang Village when studying the effect of remittances in rural areas (Khanal et al. 2014).

When looking further at the ability of remittances to reduce poverty, studies in Nepal show that remittance income has a statistically significant positive impact on household per capita income and consumption. Likewise, there's a negative relationship between remittances and the proportion of the poorest people and, conversely, a positive relationship between remittances and the richest people. Lastly, the study found that there's an inverse relationship between remittance recipients and the poverty headcount ratio and poverty gap. All of this indicates that on average remittances help to reduce poverty (Bam et al. 2018).

The increase in migration to the Gulf and Malaysia and the associated remittances from those countries account for 40% of the poverty reduction experienced in Nepal during 2001-2011. (Shrestha 2017). Additionally, large-scale migration rates of 10% in villages have been found to increase wages by 25% and labour force participation by 4%-points. This is

due to an increase in female participation in non-agricultural sectors and an increase in male participation in them. Higher wages for both females in the non-agricultural sectors and males in the agricultural sector drive the wage effect (Shrestha 2017). While these findings are great in themselves, the important part to point out is an increase in FLFP, empowering women whilst reaping economic development for the entire community.

Despite the more obvious benefits of remittances such as poverty reduction, less apparent factors can also be positively impacted. Remittances were even found to have a beneficial knock-on effect on deforestation. During 2001-2010 remittances were found to have reduced deforestation by 4,2%-points, or negated 1/9 of total deforestation in that period. Remittances had this effect by shifting the demand of households for timber and fuelwood toward non-wood alternatives for both housing construction and cooking (Li et al. 2022).

When it comes to how remittances are used in Nepal, it has been found that a 1% increase in remittance income would increase household consumption by 0,5%, where the largest share of that consumption increase would go towards food (Shrestha 2017). Looking further into the usage of remittances provides interesting insights, such as the case that who the remittances come from affects how they are spent. When looking at remittances from immediate family, those within the household, and those from non-household members, research shows that the latter has a greater effect on agricultural productivity. A 10% increase in what the authors dub ‘unearned’ remittances, the non-household members, leads to as much as a 19,2% increase in agricultural productivity, significantly more than what is found for remittances received from household members, or ‘earned’ remittances (Ghemire & Kapri 2020). The increase in productivity has policy implications in so far as productivity in the agricultural sector is linked to higher living standards and economic growth.

It can be difficult to comprehend the effect of remittances on the extent of migration, to put into perspective the scope, 243.000 Nepalese youth migrated abroad for employment in the fiscal year of 2018/2019. Before COVID-19 hit Nepal, there was approximately 1.500 Nepalese youth leaving the country every single day to go abroad for work (M. Adhikari 2020). This may adversely affect economic growth, but it is dependent on the type of migrant that leaves Nepal, the state of the national labour market, and the productivity of the ‘lost’ migrants (Pant 2008). Policy implications will depend on what is found on migrants leaving, but it is an important aspect to keep in mind when designing labour market policies.



Some of the differences in the measured effects of remittances could perhaps stem from the different usage of said remittances. If remittances are used for productive investment, they are found to have a long-term effect on poverty reduction, which leads to less vulnerability for individuals, households, and on community levels, and might even lead to a reduction in inequality between households. On the other hand, if remittances are instead used for consumption, the effect may be limited in its duration or even increase inequality (Pant 2008). More recent studies found remittances to build resilience for recipient households, for example by contributing to stronger housing, and with the ability to manage the consequences of disasters and the associated losses (Ratha et al. 2022). As has been observed in recent shocks, such as the COVID-19 one, remittances tend to remain stable throughout crises. The same was the case after the Financial Crisis in 2008 when the entire world experienced an economic downturn. Similarly, Lubambu (2014) finds that remittances were an important part of household income and act as a way of risk mitigation. Furthermore, remittances remain a more sustainable source of foreign currency for developing countries than FDI or ODA (Lubambu 2014). This illustrates an important aspect of remittances, besides the poverty reduction effect, the increase in resilience to shocks leads to less vulnerability for households.

Another interesting aspect of remittances and their flow is that some countries leverage the expectation of a continued, or even increased, flow of future remittances to secure loans by showing creditworthiness through these flows (Guarnizo 2003). This illustrates the large ramifications associated with remittances, not just their size and impact on households at a micro-level, but their impact on a macro-level for countries and economies.

Although we've seen an explosive rise in remittances, as seen in the share of them to GDP in Nepal going from 10,7% in 2001 to 30,1% in 2018, research by Jha et al. (2010) concerning the 1997 Asian financial crisis suggests it is unlikely we will keep on seeing such explosive growth in remittances in the long run. The authors argue that as the uncaptured share of total remittances shrinks, due to better recording of remittances and greater use of electronic transfers, the rapid growth in remittances will taper off. Although the growth rates will be smaller, they will still be on a positive trajectory (Jha et al. 2010). This is important to keep in mind when analysing the growth in the flow of remittances. Possible increases may partly be changes in the data from uncaptured to captured remittances of which data is now available.

This may affect possible conclusions on the effect of remittances and should therefore be kept in mind when studying them.

To further the understanding of the interconnectedness between remittances and financial sector development, studies have explored the relationship. Researchers looking into the ratio of bank deposits and credit to GDP found a positive and significant relationship between the two. This suggests another avenue from which remittances may improve development in the receiving countries (Aggarwal et al. 2011). Similarly, research by Sander and Maimbo (2003) shows the importance of bringing down barriers to flows of remittances to increase the effective investment of them. This is done by creating beneficial financial and monetary policies, such as ones that facilitate foreign exchange transactions, provide investment incentives, and increase savings and investment options by making it easier to gain access to financial services and products.

### 3.3 Theoretical Approach

The sections above have attempted to provide a foundation for the knowledge of remittances that is needed to make informed decisions and qualify the discussion and analysis of remittances in Nepal and how to increase their effect on development. Hopefully, they've been successful, and the rest of the thesis will draw upon the previous literature and its findings to substantiate the debate and provide reasoning for the ultimate suggestions and conclusions reached here.

Doing this while drawing on the sparse available data for remittances in Nepal, trying to set that into the development context and current knowledge of remittances we have is not an easy task. It is necessary to acknowledge some of the differing findings on the effects of remittances and attempt to reconcile them within a Nepalese context. Empirical findings will be shared and put into context through the theoretical framework followed.

Much of the theoretical approach is grounded in an understanding of macroeconomics, the effect remittances have on issues such as inflation, the balance of trade, and competitiveness. Whereas it is economic drivers that are the dominant cause for remittances, the underlying premise that migration is possible, and the push and pull factors involved in the process, are perhaps even more interesting for many on a global political scale. Paradoxically, one of the detrimental effects of remittances, the 'brain drain' suffered in the home country of migrants, is not necessarily viewed as a positive effect in the countries that attract migrants.

The combination of those two aspects of remittances, migration and (economic) development is often referred to under a single term that combines the issues and acknowledges their interdependence coined the 'migration-development nexus' (Nyberg-Sørensen 2002). Although that is an extremely interesting angle to pursue, it warrants a separate study to do so adequately. Migration effects associated with remittances will be studied in the sending country and not dealt with it from the point of view of the destination countries. This is done to narrow the scope and focus exclusively on the development aspects of remittances and not the associated effects in the destination countries.

Lastly, much of the literature and understanding of the effects of remittances build upon the theoretical framework of Acemoglu, Johnson, and Robinson (2001) and their seminal work on institutions, viewing them as the fundamental cause of long-run growth in Africa. Whilst this is a different setting with less focus on the long-run growth theory introduced by the authors, the institutional influence and their importance for remittances cannot be understated. Much of the covered literature so far has focused extensively on institutions, both as a determinant for the success of remittances in helping development and also as an avenue to affect change and increase the gains from them. Therefore, the important theoretical framework for institutions as determinants and drivers of economic development is useful in understanding the implications of remittances and how to use them as a driver for development.

Just as there was a development-migration nexus, so too is there a remittances-financial development nexus. Disregarding whatever term is given to the relationship between the two, the important part that this paper focuses on is the fact that there is a feedback effect between remittances and financial development. One might increase the other, but so too should an increase in financial development spur higher levels of remittances. Research has shown that there exist causal directions going both ways between financial development and remittances, a sort of symbiotic relationship. With that in mind, it seems clear that a policy tool and recommendation must be to increase financial development through improving the financial sector to encourage growth in remittances. Likewise, encouraging flows of remittances more directly will, in turn, help financial development (Bolarinwa & Akinbobola 2021).

An important aspect to consider when trying to shape policy is the potential opposition to doing so. Policy reform can be hampered by the moral hazard problem remittances

themselves may pose. As has already been covered, remittances have a positive impact on the resilience against shocks, this unfortunately creates a paradox for those receiving remittances and those not doing so. Remittances risk disincentivizing households to pressure the government for reforms since they are less affected by them. This may lead to a delay in public infrastructure improvements since public demand for them is reduced and combined with the fact a potential crisis that would necessitate such reforms is also less likely to happen (Fullenkamp et al. 2008).

With the theoretical framework in place for examining the development effects of remittances, it enables an understanding of the previous literature and allows the research to find policy recommendations that apply to a context in Nepal through the analysis. The setting created by the thesis' focus on theoretical findings applicable to a Nepalese context will allow for drawing conclusions that can be used to implement policies in Nepal that increase the development effect of remittances.

## 4. Methods and data

Although there's a distinct lack of data readily available on remittances, it was instead decided to include indicators from the World Bank and Transparency International, showing the trend in development indicators linked to remittances, to illustrate the economic reality of Nepal while showcasing the need for careful policy consideration to increase them to ease the flow and effect of remittances.

Despite that, the focus of this thesis has shifted to a much more theoretical approach. In doing so, it has become clear that the existing literature presents the core of the findings in this paper. Collating literature on Nepal and remittances is an exercise intended to go beyond individual studies and collect their findings into broader implications for Nepal and how to pursue development through remittances. This is not possible without the data and findings of previous literature on which my findings are built.

The literature review provides the main findings. The literature review conducted involves reading, evaluating, and summarizing the previous literature. In doing so, it allows for synthesizing the findings, applying them in the context of Nepal based on the analysis of the scope of remittances, and providing new insights that are useful for understanding remittances, their effects, and how to increase them.

Using the literature that has been covered above as a foundation, helps support the contextual analysis provided and allows for creating new insights into remittances and their effect in Nepal, enabling the policy implications that this thesis concludes with.

## 5. Analysis

Whilst this study is mainly a literature review that aims to increase the understanding of the effects of remittances in Nepal, it is complemented by data to contrast the theoretical findings with the macro-level situation in Nepal, aiming to showcase the theoretical knowledge in practice and support the findings and conclusions of this thesis.

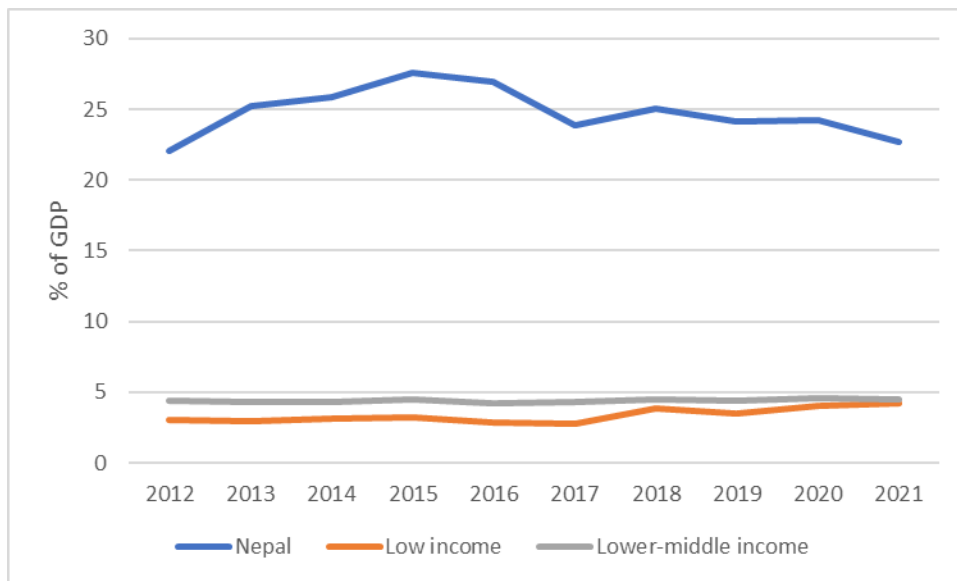
Finding usable data proved infinitely harder than expected. The original idea was to lean more heavily on quantitative methods to help explore the impact of remittances on development especially on a household level. Without data to pursue that approach, it was instead decided to focus on a broader perspective that aims to provide clarity for decision-makers on how to approach the subject of remittances and harness their impact on development through effective policymaking. That has resulted in an expanded focus on previous and contemporary literature and their findings, putting them into a Nepalese context and enabling decisions to be made based on a well-informed foundation and thus qualify the debate.

The following segments will provide an understanding of remittances and their extent in Nepal. It's been created based on the data available, however scarce and accessible it may be. The aim is simply to show the trend over the last 10 years or however much time there is data available. By looking at a more recent period than a lot of the early and influential work conducted on remittances, the aim is to add to the literature and understanding of where Nepal is at this point and where they can go from here.

### 5.1 Scope of Remittances

One of the main reasons for choosing Nepal as the case study for remittances was the vast extent of their flow into the country. Although Chhetri et al. find the extent of remittances to be 30,1% of GDP in 2018, the numbers from the World Bank are slightly lower, with remittances amounting to 25% of GDP in 2018 and 22,7% in 2021 as shown in Figure 5.1 below, the most recent years they have data for. Although that is smaller than what the previous literature has found, it still significantly outpaces most other developing countries.

Figure 5.1 Personal remittances, received (% of GDP)

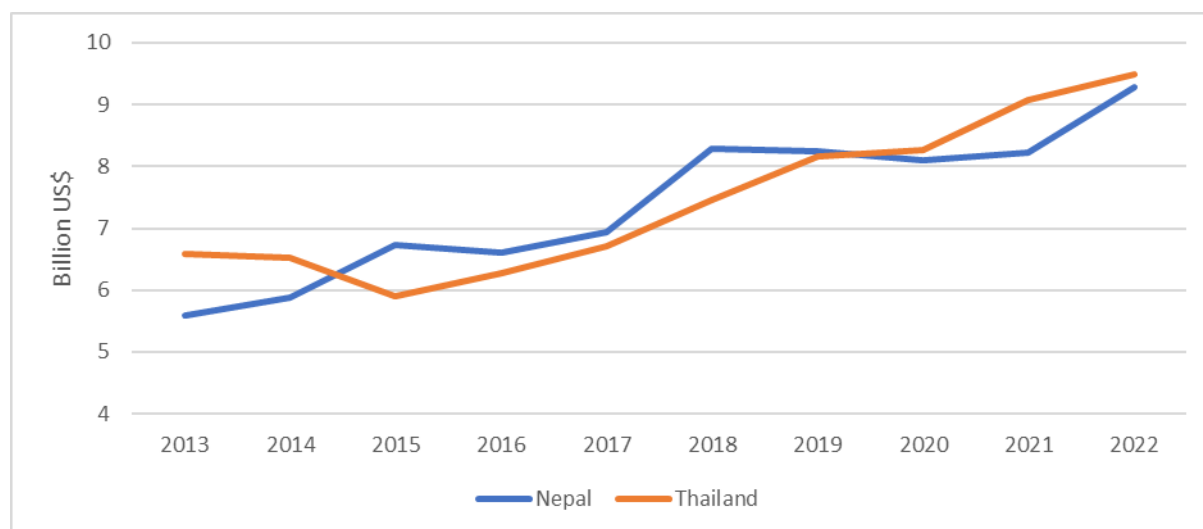


Source: World Bank Open Data at <https://data.worldbank.org/>

The most interesting aspect is how much bigger the flow of remittances to Nepal is compared to other Low- and Lower-middle income countries. Their average is no more than 4,2% and 4,5% respectively in 2021. Nepal's remittances are more than 5 times higher than the average of comparable countries, illustrating the unique case of Nepal when it comes to relying on remittances. The volume and size of remittances in Nepal make the forming of policies that further remittances and their effects of even greater importance for policymakers.

The scope is showcased in Figure 5.1, and although that helps illustrate the significance of remittances, putting into perspective the actual amount allows for an even greater understanding. Figure 5.2 below shows how many billion U.S. Dollars Nepal receives every year in remittances, with data for 2022 reaching 9,3 billion dollars. Since this figure shows current U.S. Dollars, it does not account for either inflation or population size. Therefore, comparing it with Low- and Lower-middle income countries is impossible, as their aggregate size of remittances dwarfs Nepal's. To provide some semblance of comparison Thailand has been included instead. It might seem weird, but it was done to illustrate how Nepal boxes outside of its weight class when it comes to remittances. According to the World Bank Thailand had a GDP of 506 billion US\$ in 2021, almost 14 times Nepal's GDP of 36,3 billion. Some of this is in addition to the difference in population sizes, with 30 million people living in Nepal in 2021 compared to 71,6 million in Thailand.

Figure 5.2 Personal remittances, received (current US\$)



Source: World Bank Open Data at <https://data.worldbank.org/>

Having included Thailand in the figure is meant only as an illustrative example of how dependent Nepal is on remittances and why that can help shape the response to remittances from decision-makers and illustrate the need to focus on them.

## 5.2 Factors Affecting the Flow of Remittances

One of the most straightforward ways of increasing the effectiveness of remittances is the transaction costs associated with remittances, as shown for Nepal in Table 5.1 below.

Table 5.1 Average Transaction Cost of Sending Remittances to Nepal (% of amount remitted)

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
5,6	5,4	4,9	5,0	3,6	4,4	4,7	5,0	4,8	4,5

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
%	5,6	5,4	4,9	5,0	3,6	4,4	4,7	5,0	4,8	4,5

Source: World Bank Open Data at <https://data.worldbank.org/>

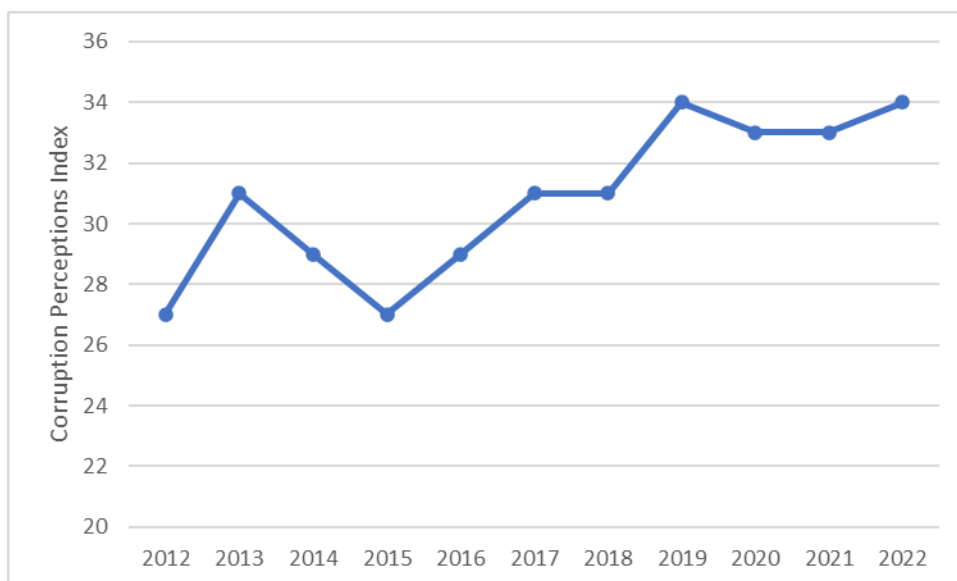
Although there's already been a significant reduction in the transaction cost for Nepalese remittances, the 1,1%-points in 10 years is perhaps not the most impressive decrease. Following that trajectory, Nepal would not reach the SDG's target of a 3% transaction cost by 2030. Although this thesis focuses on what Nepalese policymakers can do to encourage remittances, that is only half of the story when it comes to the cost of remittances. Unless it's a cash hand-off, e.g. if a migrant returns home for the holidays or other vacation in the



recipient country, which is something that would be immensely difficult to fully grasp within our data, remittances are handled by intermediaries that operate between two points, in the case of remittances in two different countries. Even though Nepal might be able to promote policies that encourage businesses to reduce the costs of the transfers, it is not so straightforward if those costs are then absorbed in the other end at the country of origin for remittances. To achieve the target of the SDG's of reducing transaction costs of remittances to less than 3% by 2030 it is necessary to cooperate internationally on promoting cost-efficient ways of and easing the ability to transfer remittances. This is further hindered by the usage of digital channels, which present a faster and cheaper alternative to traditional cash remittance services since they only account for less than 1% of total remittances (Malpass 2022). The transaction costs are just one aspect of remittances but perhaps thrust to the forefront, at least when it comes to data availability and quality, due to its inclusion in the SDGs and the resultant push to be able to measure it reliably.

To illustrate the extent of institutions in Nepal, with both their current effect and potential for improvements, a proxy for institutional well-being in the form of Transparency International's Corruption Perceptions Index 2022. By looking at the change in the CPI for Nepal since 2002 and its relative ranking worldwide. From Figure 5.3 below you're able to see a slight upwards trend of the CPI, increasing from 27 in both 2012 and 2015 to 34 in 2022, an increase of 25% in the 7 years from 2015 to 2022. Although its relative world rank leaves much to be desired, ranked 110 out of 180 countries in 2022, it is still an improvement from 2017's rank where Nepal clocked in at 122.

Figure 5.3 Corruption Perceptions Index



Source: Corruption Perceptions Index 2022 at <https://www.transparency.org/>

Transparency International's CPI measures the perceived levels of public sector corruption by compiling 10 measures of public sector corruption from 13 data sources into a single indicator. Although few perfect indicators for institutions exist, it is widely accepted that transparency and levels of corruption are useful proxies to do so through the use of the CPI (van Dureen 2020).

With that, it should be evident that Nepal has lots of work to do on the institutional front, which we know affects the impact of remittances on development, but this also allows us to build upon the already established results of remittances on Nepalese development. While it may present challenges in the form of reticence to adopt policies that combat corruption and eases remittances and direct their usage to development beneficial avenues, it is simultaneously apparent that it equates to an opportunity of reaping an even greater impact of remittances on development through careful policymaking and improving institutions.

Looking further into the economic implications of remittances, Karpestam (2012) authored an interesting paper, where he estimated the short- and long-run dynamic multiplier effects of changes in remittances. It was found in general that there was a positive multiplier. For a \$1 increase in remittances, the paper finds that it increases national income in low-income countries by \$2,39 in 1 year, whereas it is only \$1,33 in lower-middle-income countries. Additionally, low-income countries were found to be more likely to spend their income on consumption and investment than middle-income countries, enabling them to have a greater short-run gain from remittances. Actual gains are found to be higher in lower-middle-income countries since they simply have a greater flow of remittances. The study argues that short-

run effects are bigger on low-income countries than long-run since they are more reliant on imported goods and services (Karpestam 2012). These findings may not seem immediately applicable to Nepal, but they build upon the knowledge that although remittances may be more effective the poorer and less developed the country is, that just increases the importance of creating a conducive environment to facilitate remittances making an actual contribution towards development and not merely a temporary stop-gap solution. Other research corroborates those findings, as mentioned earlier the work of Bjuggren and colleagues find that the marginal importance of remittances on investments decreases in line with the quality of the institutional framework and the degree of development of the credit market.

This suggests that although some of the associated effects of remittances are greatest for countries that have a baseline of remittances that is small will reap greater rewards from an increase in them, it hardly negates the other avenues from which development can be positively impacted. If anything, it illustrates that remittances as a tool of development are important for all LMICs and that the context and circumstances will dictate their effectiveness. It is then up to the decision- and policymakers to mold society and conditions to take advantage of remittances to their fullest.

The general takeaway from what has been covered so far is that apt policies are necessary. In general, the implications for specific policies can be broken up into different categories, similar to the findings of Fullenkamp et al. (2008), most all policies that target incentives to use remittance income in productive ways for the economy are the goal. Those include, but are not limited to, tax policies, where the focus should be on consumption-based taxation instead of taxing remittances since that would lead to a decline in poverty alleviation. Similarly, government budgetary loosening can promote long-run development while maintaining short-term poverty alleviation, this can be achieved if the policy focuses on increasing growth through public expenditure, ideally on public infrastructure and institutions, which may further increase the effect by improving institutions, a vital factor influencing the effect of remittances (Fullenkamp et al. 2008).

Although it may seem tempting to declare a catch-all policy reform or strategy, it is imperative that a balanced approach be crafted to the specific conditions in Nepal. This is in line with the World Bank findings, that growth and development strategies require an individual diagnosis and policy design to reduce constraints on growth. Understanding the effect of remittances on the macroeconomic landscape of Nepal allows for a tailored

approach to policy recommendations in an attempt to keep the positive effects of remittances while limiting the negative ones (World Bank 2005).

All of the sections covered here, both with the empirical observations and figures, and the theoretical findings and framework, combined with the previous literature build the foundation for understanding remittances on which the findings of this study will enhance.

## 6. Discussion

To build upon what has been researched and laid out so far, understanding the complexities of remittances and where there's still research to be done is a necessity to increase the efficiency of remittances and the associated policymaking required to speed up this process.

Even though previous research has found that the consumption effects of remittances don't statistically differ between genders, whatever the gender of the head of the family receiving remittances the household consumption expenditure stays consistent (Mishra et al. 2022). Thinking that remittances and their effects are gender-neutral is a reductive understanding of them. Looking at the consumption pattern of households is not enough to conclude that the effect of remittances and the associated migration is identical for all genders. Like in other avenues of life where female contributions are not included, the often-used example of household chores and how women do a larger share of these than males, when capturing the full social effect of remittances, a more holistic approach is necessary. Focusing on only understanding the financial aspect leaves out the contributions dubbed 'social remittances', which includes the behaviours, identities, knowledge, ideas, and social norms that flow in addition to the financial remittances (Levitt 1998). WMW's contributions are not fully captured without adding this dimension, and by doing so the knowledge required to enact policy can enable it to be more effective (Hennebry et al. 2017). Social remittances can over time lead to changes in the economy, values, and social practices of countries and even entire regions (Levitt & Jaworsky 2007). It doesn't necessarily have to be any drastic change, but to disregard the notion that there's a social transfer nexus between social remittances and both countries would be particularly naïve.

Although this thesis has covered the benefits from remittances, it would be remiss to not share the potential drawbacks as well. Whilst remittances have several key benefits on development such as poverty reduction, it is not a panacea able to solve every issue faced by developing countries such as Nepal.

To that end, the possible downsides of remittances are varied and can be viewed and grouped into a few different avenues.

Most obvious perhaps, is the brain drain suffered in the recipient country. As stated above, 243,000 Nepalese youth left the country in a single fiscal year, which would, all else equal, have an adverse effect on the economy back home through the labour market losing out on

the supply of these people. Additionally, the transfer of foreign currency into the Nepalese Rupee risks weakening competitiveness by reducing exports, and conversely increasing imports, due to an appreciation of the currency (Talba et al. 2017). Moreover, it also adds to inflationary effects, as the additional demand caused by remittances could push consumer prices up. Furthermore, they can also contribute to worsening the trade deficit, since they've been found to primarily finance imports (Kireyev 2006). Although the effects of remittances on poverty and health in developing countries are mostly positive, they can also have a negative impact on labour supply and education. Lastly, remittances can also have a negative effect on education, the supply of labour, and economic growth, although remittances to developing countries are largely found to have a positive effect on poverty and health (Adams 2011). All of these can impact the development of a country negatively and thus must be accounted for when designing how to handle remittances through policies.

While this is important to be aware of it, it is also important to keep the context in mind. Many of the challenges remittances face are not exclusive to their development contribution. Whereas remittances may not result in the optimal desired economic outcome in Nepal or other recipient countries, neither do other avenues, like ODA or FDI. This may be due to factors outside of the flow, such as poor economic incentives and weak institutions, both of which may discourage economic actors from saving and investing, the desired economic outcomes from remittances (Pant 2008).

Although remittances have shown themselves to be a great buffer for economic crises in the recipient country. According to the Asian Development Bank, most of the economic recovery Nepal experienced in 2004 was due to remittance-driven consumption expenditure, which was almost exclusively the reason for the GDP growth (ADB 2005).

Taking a look at the pitfalls and vulnerabilities of remittances is not meant to dissuade from reaping the developmental benefits from remittances, it is merely an attempt to further the understanding of them, understand how to increase the gains whilst simultaneously mitigating the dangers.

With that said, it is of the utmost importance to underline that remittances are a valuable tool within the toolbox that is solutions and strategies to promote development through a multitude of avenues, such as poverty alleviation. It is not a sole strategy to pursue for any one country, but with the knowledge of how to benefit from them, optimize their intended effect, and promote growth through them, whilst simultaneously being aware of, and

trying to mitigate, the negative side effects that may occur, it has hopefully been a delve into what avenues to pursue by showcasing how Nepal can further benefit from remittances.

As the existing literature has illustrated, remittances are an important avenue for economic growth and poverty reduction. Although the true scope of the size of remittances may be difficult to get for Nepal, since the data available and the quality of it is lacking, there is no doubt that there's a large flow of remittances. Additionally, it is also a relatively stable alternative to other flows of development finance, as seen from the shock of COVID-19, and the steady support for the crisis in Nepal, as experienced in 2004. Remittances have become an increasingly vital way of supporting family members at home. The increase in migrants going abroad has resulted in a growth in remittances, which has simultaneously become an important part of Nepalese foreign currency flows.

Although officials may have already helped this along through streamlining financial systems, dismantling controls, and creating incentives for remittances through official channels, further policies for economic growth and interest- and exchange rates are needed to keep encouraging the inflow of remittances and support their development effects (Pant 2008). Conducive policies for these areas are necessary to support the beneficial effects of remittances and mitigate the detrimental ones.

Understanding how remittances work and their effects is not enough to answer what this thesis set out to research. It is important to consider how to increase the beneficial gains and limit the negative effects. There are different avenues to approach this from.

Improving the efficiency of remittances on development can be done in different ways. As mentioned previously, lowering the transaction costs associated with remittances is in itself an effective tool, although that amplifies all aspects of remittances, good and bad. To mitigate that and build a robust system that optimizes remittances, other approaches can be utilized. Improving financial inclusion mechanisms, such as access to banking, for example, through the use of mobile and online banking, can help recipients access and use remittances (Ratha & Mohapatra 2012), although it is more of an extension of the previous approach. Another necessary consideration is the challenges households face before receiving remittances. Most of those issues stem from migration, such as social disruptions for children when parents move abroad for work and emotional hardship for the whole household, which may potentially affect the educational attainment of children negatively. Additionally, there's also the loss of potential income, if the immigrant had either worked or taken care of other tasks

that perhaps freed up the partner and other members of the household to generate income (Fajnzylber & Lopez 2008, p. 149).

The empirical findings of the situation in Nepal put the role of remittances into a context through the theoretical foundation. Although it may seem tempting to arrive at broad sweeping conclusions, if anything it's been shown that a cautious approach with sufficient policies angling to increase remittances and improve upon development through them is the move going forward.

That is not to say we cannot come up with policy suggestions and pathways to follow henceforth, but they must be monitored through research into their effect and how changing conditions in Nepal may affect their efficacy.

The way to impact the effect of remittances goes through fostering good quality institutions and a sound economy that guides the flow of remittances toward productive investments that increase development. This is done through careful application of policymaking focusing on incentivizing the allocation of remittances into production, financial development, such as improving credit markets, breaking down barriers to ease the flow of remittances, which can be done by ensuring taxation doesn't happen on remittances themselves but on the consumption they increase or on the dividend of the investments they may lead to, and increasing public expenditure on infrastructure and education which further promotes investment. All of the policy tools aim to increase the effects of remittances as they currently are, similarly, the focus can also be on reducing the costs of transactions for remittances which will encourage greater inflows of remittances, thus increasing the importance of the policy suggestions further.

With that said, the findings of this thesis can be boiled down to a few general rules that can be extended into concrete policy suggestions for Nepal. I won't claim to have a definitive and all-encompassing answer, but throughout this study, it has been the aim to educate and illuminate how remittances can be utilized to their fullest potential, wherever that be, in this case, it is in the context of Nepal.



## 7. Conclusion

Despite the complexity of the task proposed in this thesis, the study has uncovered answers to the questions posed and knowledge useful for understanding remittances and their utilization. Answering the first part of the research question, what are the development outcomes of remittances in Nepal, this thesis finds that remittances have a positive impact on development outcomes in numerous ways, such as poverty reduction, increased resilience against volatility, increased consumption expenditure, particularly on education and health care, which results in higher weight-for-age and height-for-age in recipient households, alongside more unexpected outcomes such as a decrease in deforestation.

Moreover, the second part of the research question focuses on increasing the impact of remittances by asking how the effect of remittances can be increased. Most importantly, Nepal is ripe for the positive effects of remittances to be further encouraged and optimized. Whilst navigating negative aspects of remittances, such as brain drain, those too can be mitigated with careful policy planning. That can be achieved by focusing on improving the framework that supports remittances and increases their effects, specifically the quality of institutions where Nepal has room to improve, but also the financial sector and the development of it play an important role. Carefully crafted initiatives such as economic policies focusing on incentivizing production, developing credit markets, and helping the ease with which remittances flow toward investment opportunities will reap a greater effect on development.

Similarly, increasing not only the effect but the flow will lead to an overall increase in the positive effects of remittances. Reducing the costs of transactions for remittances will encourage greater inflows of remittances, further amplifying the effect of good policymaking.

Lastly, while remittances can and do help poor countries, the policy recommendations are only a part of broad societal transformation. Remittances benefit from sound economic policies, but so too does society in general, so while they may help to channel the positive effects of remittances, they should simultaneously impact development positively without considering migration and development. Remittances are an important tool that should be utilized to the fullest. Nepal must therefore focus on the suggested avenues not only to reap the benefits of remittances but because the necessary policy areas are favourable for the economy as a whole. Taking these steps, even without the knock-on effects, will promote development in Nepal by increasing the positive effect of remittances.

Future research should, if the resources allow for it, focus on how the implementation of specific policies affect remittances and their effects in Nepal. Although this may be a tall order, supporting the continued work of the World Bank on improving the quality and availability of data on remittances can in itself be a starting point for increasing the positive effects of remittances.

In conclusion, remittances are an important development tool for Nepal, and although they are not a universal panacea, remittances remain an important avenue for continued improvement for the country. This is best achieved by promoting the ease of flow into productive avenues, such as investments, through careful policymaking, focusing on key areas. These areas include, but are not limited to, education expenditure, taxation, promoting investment, and financial inclusion through access to banking, all of which require a robust institutional framework that should similarly be supported by policy implementation.

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