ICIMOD Working Paper 2018/1

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# Approaches to the Productive Use of Remittances in Nepal

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# Approaches to the Productive Use of Remittances in Nepal


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# Acronyms and Abbreviations

| | |
|---|---|
| ADBL | Agricultural Development Bank Limited |
| BFI | Banks and financial institutions |
| CEDAW | Convention on the Elimination of all Forms of Discrimination Against Women |
| CBS | Central Bureau of Statistics |
| DOEF | Department of Foreign Employment |
| FESB | Foreign Employment Savings Bonds |
| FY | Fiscal year |
| GDP | Gross domestic product |
| GON | Government of Nepal |
| ICIMOD | International Centre for Integrated Mountain Development |
| IFAD | International Fund for Agricultural Development |
| IMF | International Monetary Fund |
| MFI | Microfinance institutions |
| MOF | Ministry of Finance |
| NBL | Nepal Bank Limited |
| NEPSE | Nepal Stock Exchange |
| NGO | Non-governmental organization |
| NRB | Nepal Rastra Bank |
| NRN | Non-resident Nepalese |
| RBB | Rastriya Banijya Bank |
| RRSP | Registered retirement saving plan |
| SCC | Savings and credit cooperatives |
| SCG | Savings and Credit Group |
| SEBON | Security Board of Nepal |
| SFACL | Small Farmers Agricultural Cooperative Limited |
| SFDBL | Small Farmers Development Bank Limited |

# Executive Summary

Migration is an age old phenomenon in Nepal. Until the 20th century, migration was either internal or cross border to India. But with the opening up of migration for employment to Gulf countries and South-east Asian countries, there was a rise in the trends and patterns of people migrating to these countries. Increasing numbers of youth are also migrating overseas to Western countries for employment and education purpose. Remittances sent by these migrant workers have diverse implications for socioeconomic development in Nepal. With these realities in mind, this study has tried to identify appropriate, workable approaches for promoting the productive use of remittances through a review of the rural investment policy, schemes, and products in South Asia.

Remittances are not only very large, but continue to grow and remain relatively stable. They can, potentially, provide a cushion for economic shocks and have direct benefits for households, and so remittance flows and their productive use are of crucial policy concern in Nepal. Migrant workers and their families primarily use of remittances for consumption purposes. If this current trend of remittance use continues, the hard-earned money sent by migrants abroad will not be used productively, and cannot contribute to economic growth and development. Thus, there is a need for the government to formulate effective and efficient public policies to motivate Nepalis to send money home, and to devise mechanisms that channel such money into productive activities. Productive use of remittances calls for systematic efforts to divert them, and requires initiative from government to encourage investment, generate employment, and expedite national economic growth.

As far as policy to promote productive use of remittances is concerned, government efforts are mostly concentrated on increasing formal remittance flow. Some of the government interventions for promoting formal remittance transfers include:

- reimbursement of the remittance fee charged to migrant workers for remitting money through formal channels;
- financial literacy education for foreign employees and their family members; and
- allowing migrant Nepali workers to invest in the capital market, and in national priority projects.

Other policy support initiatives include introduction of foreign employment savings bond, providing rebates on customs duties and other taxes; allowing special facilities for certain goods imported by migrant workers when returning from foreign employment; and giving returnees special deductions on customs duties and taxes for importing machinery for enterprise establishment. Support has been provided to expand formal channels for remitting money through banks, financial institutions, and money-transfer agencies in rural areas. Nepal Rastra Bank (NRB) has made provision to provide 15 paisa per USD as commission to licensed private firms, in addition to the prevailing buying rate, and promulgated a remittance regulation to grant licenses to private sector organizations for inward remittance business. There has been greater emphasis on increasing the participation of microfinance institutions and financial cooperatives in remittance business.

Based on the review, this study suggests approaches to be followed at macro-, meso- and micro-levels to tap remittances for rural investment. Initiatives proposed include FESB, promoting official channels for remittance flow, pension schemes, promoting investment in hydropower projects and other national projects of national priority, a financial literacy campaign, use of remitted money for income and employment generation. These interventions could potentially be instrumental in attracting more remittances from migrant workers, and will help to boost rural investment for local economic development.

# Introduction and Rationale

## Background

Migration and remittances have been critical socioeconomic forces in Nepal since early 2000. Remittances have become an important source of income for migrant households and the nation as a whole. Although agriculture continues to be the major contributor to gross domestic product (GDP), accounting for almost 30%, Nepal also received remittances equivalent to almost 30% of the country's total GDP in 2016 (MOF 2016). This reality means that migration and the remittances that flow from it have been acknowledged as one of the main pillars of the Nepali economy. The contribution of the remittance flow in the transformation of Nepali society is quite remarkable, and is evident in the change in trends and patterns of consumption and use of consumer durables. Taking cognisance of the contribution of remittances in the Nepalese economy and its potential implication in the transformation of the Nepalese informal economy, the Government of Nepal (GON) has introduced various plans, policies, strategies, and approaches to direct remittances through legal channels, and various proposals have been made to use them productively. In spite of the notable and potentially large contribution of remittances to the Nepalese economy, issues and challenges pertaining to their contribution to the long-term economic development of the country have not been properly addressed.

Remittances mainly flow to poor and marginalized families living in rural and remote areas. A household with a remittance surplus will tend to migrate, initially temporarily and later on permanently, to emerging market towns or urban areas. Thus, remittances can potentially contribute to local, regional, and national economic development in migrant-sending countries and enable poor and marginal families to break the vicious cycle of poverty (Adams and Page 2005; Gupta et al. 2007; World Bank 2006).

In migrant households, remittances form a significant percentage (as high as 60%) of total migrant household income (CBS 2012), and act as a substitute for earned income lost because of unemployment, illness, retirement, falling wages, and crop failure, among others, and they eventually protect poor families against erosion of their basic household assets (CBS 2012).

A number of channels exist — such as savings, investment, growth, consumption, and income distribution — through which remittances can generate a positive effect on the economy. Remittance flow can potentially contribute to economic stability, supporting a current account surplus through growth in foreign exchange earnings. Remittances are one of the cheap and stable sources of foreign currencies. The beneficial impacts of remittances are particularly strong in countries where remittances are above 3% of GDP, where international reserves are taking a downward trend, or where external debt is rising (Bugamelli and Paterno 2006). By promoting productive use at the local level, remittances can potentially generate income and employment opportunities, and spur new economic and social infrastructure and services. However, proper pooling and use of remittances in the productive sector require effective structures and institutions (IMF 2009).

Making remittances cheaper, safer, and productive for both the migrant sending and receiving countries are necessary conditions to enhance the impact of remittance flows for income and employment generation, growth, and development (Bugamelli and Paterno 2006; IMF 2009). Individuals in remittance-receiving countries are more likely than others to have bank accounts, a prerequisite for sending remittances through formal channels (IMF 2009). The quantity of remittance flow through formal channels could be increased if remittances are linked with financial products such access to finance (saving, credit, insurance, money transfer, and leasing), education accounts, and health insurance. The benefits of remittances could be increased if migrants were able to use remitted money against future hardship, rather than relying on them once hardship strikes (Pant 2008; UNCTAD 2009).

Promoting the productive use of remittances is arduous and challenging. It requires concerted efforts from government and other agencies (bilateral and multilateral) to create a new channel for productive use of remittances and promote migrants' savings, both at the household level and the national level. Countries in South Asia and elsewhere have used several instruments to raise the benefits of remittances to the national level. Some of the instruments used include remittance-linked loans, diaspora bonds, securitization of remittance flow, and efforts to include remittances in calculating sovereign credit ratings (Ratha 2013).

With the growth in numbers of people taking part in foreign migration and a corresponding increase in the volume of remittance flow, there has been renewed interest and effort by GON to promote the productive use of remittances in Nepal. Against the above backdrop, this paper seeks to identify workable approaches suitable for promoting productive use of remittances in Nepal, with the ultimate goal of sustaining the benefits of remittances received by the migrant households, as well as by the local and national economy.

## Objective

The overall objective of this study was to identify approaches that are suitable and workable for promoting the productive use of international remittances through a review of the rural investment policies, schemes, and products in South Asia.

The specific objectives of the study were

- to undertake a detailed desk review of rural investment policy, schemes, and products; and of successful approaches to the productive use of remittances in South Asia; and
- to finalize an approach that is workable and bankable for tapping remittances for rural investment.

## Scope

The scope of the study was to include

- commencing a detailed desk review of rural investment policy, schemes, and products in the South Asia;
- carrying out a detailed review of successful approaches to the productive use of remittances in South Asia;
- undertaking face-to-face or virtual communication interviews with key persons involved in remittance investment, particularly in rural areas;
- developing an approach for tapping remittances for rural investment in Nepal;
- sharing the preliminary findings of the study with key stakeholders through a stakeholder consultation meeting; and
- finalizing an approach that is workable and bankable for tapping remittances for rural investment.

## Methodology

To achieve the objectives of the study, the following methodology was adopted:

### Literature review

Most of the information used in this report has been obtained through a review of published and unpublished information on different aspects of the productive use of remittances in Nepal, South Asia, and other parts of the world. The literature review primarily focused on gaining an understanding of the trends and patterns of remittance flow, and identification of approaches and modalities of productive use of remittances in different countries. Analysis of the literature review focused on assessment of the policies and institutional mechanisms related to the productive use of remittances vis-á-vis promotion of rural investment.

### Analysis of national-level data

The existing database of the Department of Foreign Employment, Population Census 2011, Nepal Living Standards Surveys, annual Flash Reports released by the Department of Education, Nepal Migration Survey 2009, and databases available in different agencies were reviewed and analysed. These data were used to analyse the historical trends and patterns of Nepali workers migrating overseas, and make the projections. The main focus has been on undertaking time-series trend analysis, which makes projections for the future.

### Key informant interviews

Key informant interviews were conducted with various stakeholders, such as experts on migration, government representatives, civil society organizations, the private sector, and international organizations. The purpose of these interviews was to collect qualitative information, particularly the new ideas about potential use of remittances and undocumented existing practices. These interviews also helped in analyzing the replicability of existing global practices in Nepalese context.

### Quantitative analysis

Quantitative analysis of trends and patterns of remittance flows was carried out to chart current financial flows and determine the current trends of remittance-induced expenditure in the Nepali economy. Financial highlights and published data of various ministries such as the Department of Foreign Employment, Central Bureau of Statistics (CBS) Nepal, NRB, the Securities Board of Nepal (SEBON), and other bilateral and multilateral institutions were reviewed, and key learning from this information was derived.

### Limitations of the study

This study is mainly based on secondary sources of information owing to time and resource constraints. The quality and utility of this report would have been improved greatly had this study also included some primary sources from a survey of households receiving remittances and those not receiving remittances, for a comparative assessment. Further, practical application of the remittance-linked savings products by the branches of the banks and financial institutions (BFI), and information on attitudes and perceptions of remittance-receiving households, would have benefited the study.

## Report Organization

The report is divided into seven sections. Following this introductory section, Section 2 outlines an overview of the Nepalese economy, especially in relation to remittances and their use. Section 3 deals with the conceptual framework of the productive use of remittances and their significance for asset building. Section 4 make an assessment of the remittance policies and programmes in Nepal, and Section 5 provides a review of products and services to promote productive use of remittances. Section 6 underlines the approach for the productive use of remittances for rural investment in Nepal at macro-, meso-, and micro-levels. The report ends with conclusions and recommendations in the last section.

# Overview of the Nepalese Economy[1]

## Trends in the Nepalese Economy

Global production grew by 3.1% in 2016, and is estimated to grow by 3.5% in 2017, with a recovery in developed economies. Growth in South Asian countries is mixed, amid notable growth in the economies of two giant Asian countries: India and China. GDP at basic price is expected to grow by 6.94% in Nepal in the FY 2017-18 due to favourable monsoon, increase in capital expenditure, energy management, and improvement in investment environment. This is the highest growth rate since FY 1993-94. The economy is in the recovery stage post-earthquake and economic blockages. There has been a notable structural change in the composition of GDP over the decade, with the economy gradually emerging as one that is service led in contrast to the agriculture-led economy. The contribution of agriculture and non-agriculture sectors to GDP are estimated to remain 29.37% and 70.63% respectively in FY 2016-17.

The average share of consumption in GDP stood at 98.18% in the FY2015-16 and estimated to remain high in this FY 2016-17 at 89.7%. The average gross domestic savings in GDP (as a percentage of GDP) is estimated to be 10.25% in the FY 2016-17. The share of gross national savings to GDP is estimated to remain at 43.78% in FY 2016-17 as compared to 39.96% in FY 2015-16. The ratios of gross domestic savings and gross national savings to GDP averaged 10.2% and 38.3%, respectively, in the last 10 years. The sluggish growth in domestic savings can primarily be attributed to a higher consumption ratio, and high inflationary pressure coupled with lower access to financial services. The gross capital formation is expected to grow by 45.8% in the FY 2016-17. The share of gross capital formation in GDP in the FY 2016–17 remained at 33.7% and is expected to remain at 42.5% in FY 2017-18. Similarly, the share of gross fixed capital formation in GDP was 28.8% in the FY 2015-16 and is estimated at 33.8% in the FY2016/17.

Inflation in the FY 2016-17 has remained low as compared to last few years. Growth in agricultural production and improvement in overall supply situation are attributed for low inflation in the current FY 2016-17. Deposit mobilization and credit flow to the private sector through BFI have been increasing over time. Earnings from premiums from life and non-life insurance have also been increasing at a natural rate. The NEPSE Index is fluctuating over the last one decade with several ups and downs.

The devastating earthquake of 25 April 2015, and the aftershocks, resulted in huge loss of human lives, physical infrastructure, and natural resources. Restoring the livelihoods lost by earthquake-affected families, and reconstruction and rehabilitation of the properties damaged by the earthquake, have been added challenges to the already slowly growing Nepalese economy. Post-earthquake reconstruction work has gained momentum in the FY 2016-17 and the economy is also in a recovery phase.

## Trends in Nepalese Remittances

Labour permits issued to Nepalese seeking employment abroad increased by 137% over the period 2008–09 to 2014–15. In 2014–15 around 1,500 people left Nepal daily for various destinations (DoFE 2016). As migration to India does not require any legal formalities owing to the long, open border and a bilateral agreement to that effect, there are no concrete data on the number of people working in India or on remittances they have sent back home.

Nepal is one of the major remittance-receiving members of the world's low-income countries. The country received remittances of NPR 450 billion in the first eight months of the FY 2016–17, and is expected to receive NPR 699 billion in this fiscal year (MOF 2017). This is a growth of 5.3 percent which is much lower as compared to a growth of 15.2 percent in the last fiscal year (MOF 2017). In addition to formal channels, considerable sums of money are transferred through HUNDI, an informal money transfer system without legal status that uses closed networks to transfer remittances from one place to another. In FY 2014–15 the proportions of foreign loans and grants, and

[1] Information provided in this section is extracted from the economic survey 2015–16 of the Ministry of Finance, GON. (see MOF 2017 for detail)

remittances, constituted 5.9% and 29.1% of the GDP, respectively, and remittances were almost five times greater than the total foreign grants and loans received in the country (MOF 2016). The importance of migration and remittances for the national economy and the wellbeing of receiving households is evidenced by the increase in the percentage of households receiving remittances from 23.4% in 1995–96 to 55.8% in 2010–11. The average remittance per recipient household also rose, from USD 262 (26.6% of total household income) in 1995-96 to USD 520 (30.9% of total household income) in 2010–11 (CBS 2012). Remittances are also considered to be a major contributor to poverty reduction, from 42% to 31% between 1995–96 and 2002–03, and down to 25% in 2010– 11 (CBS 2011).

At the macro-level, remittances have been considered to boost foreign exchange reserves and to maintain the balance of payments surplus in spite of a trade deficit, enabling macroeconomic stability (Sapkota 2012). Although in nominal terms remittances have been growing annually since the 1990s, as a share of GDP they have been somewhat volatile and fluctuate in some years (Hagen-Zanker 2014).

Remittance is said to be counter-cyclical in nature, increasing in times of economic downturn and disaster (Mohapatra and Ratha 2010; Sapkota 2013). A comparison between GDP growth and growth in remittance inflows reveals that, in Nepal, remittances also tended to be counter-cyclical but not consistent (Hagen-Zanker 2014). For instance, in FY 1998–99 and again in FY 2002–03, remittances grew as GDP growth slowed, but in FY 2007–08 the growth of both GDP and remittances increased (Hagen-Zanker 2014). Analysis of linkages between the business cycles in host countries and remittance flow in Nepal was found to be inconclusive, which may be owing to lack of the required data (Hagen-Zanker 2014).

The volatility of remittances can affect investment and create additional challenges for macroeconomic management (World Bank 2011). Even when remittances are consistent and large for a long period of time, it is argued that this can lead to complacency on the part of the home government, which may not feel any pressure to increase economic growth, create an adequate investment climate, generate employment opportunities, increase government effectiveness, or control corruption — thus leading to a "vicious policy cycle" (Abdih et al. 2008; World Bank 2011).

The net effect of remittances will, in the long run, depend on their potential contribution to reducing poverty, increasing investment, and promoting growth. However, for remittances to make a significant, positive contribution to development, focused policies and programmes will have to be rolled out. For instance, the remittance earnings would be increased significantly if: (i) the government reaches labour agreements with major destination countries; (ii) the skills of the migrant workers are upgraded; (iii) there is better migration governance; and (iv) there is a clear remittance use and reintegration strategy (MOF 2016). If managed with clear plans, remittances can act as catalysts for development. However, they can also have a negative effect, as evidenced by a number of macro-indicators such as relative wages and prices; market segmentation; government spending; investment and money supply; factor productivity; competitiveness; and real, effective exchange rates. Remittances can have negative potential by driving inflation, boosting spending without increasing productivity.

## Overview of the Nepalese Financial System

The Nepali financial system consists of sectors such as BFI, insurance, capital market, cooperatives, non-government, and informal (for more detail see Maskey and Subedi 2009).

### Banks and financial institutions sector

The BFI sector consists of NRB, which is the central bank, and the commercial banks, development banks, finance companies, microfinance development banks, and cooperatives with limited banking licenses. Nepal Bank Limited was the first BFI, established in 1937. Establishment of the NRB under the NRB Act 1956 was another important milestone for development of the banking system in Nepal. This was followed by the establishment of different categories of BFI, including the Nepal Industrial Development Corporation, Cooperative Bank, Land Reform and Savings Bank, Rastriya Banijya Bank, Agricultural Development Bank Limited, a few joint venture banks, and other private sector BFI.

The banking sector expanded at a rapid pace following the liberal licensing policy and the series of regulatory and supervisory reforms initiated by NRB in line with financial sector liberalization. BFI are classified into four categories: commercial banks, development banks, finance companies, and microfinance development banks. In December 2016 the BFI comprised 28 commercial banks, 60 development banks, 40 finance companies, and 46 microfinance development banks. At that time there were also 15 Savings and Credit Cooperatives (limited licenses), and 27 NGO authorized by NRB to undertake limited banking transactions.

## Insurance sector

The Nepalese insurance sector is governed by the Insurance Act 1992, and Nepal Insurance Board regulates and supervises the sector. In December 2016, 27 insurance companies (9 life, 17 non-life, 1 reinsurance out of which 4 were joint venture, 2 government-owned, and 21 private) were established under this Act. Insurance companies offer products relating to endowment, whole life, term insurance, and foreign employment in the life sector; and vehicle, fire, earthquake, and construction in the non-life sector. The sector is characterized by unhealthy competition and systematic risk due to a small market with many players.

## Capital market

SEBON regulates the capital market and NEPSE facilitates stock trading. Venture capital and private equity investments are negligible, owing to the absence of appropriate legislation. Central Depository and Clearing Limited is involved in fully dematerializing the stocks. Mutual funds regulation is enacted and mutual fund investments are now gaining momentum. Credit rating regulations have also been enacted and one rating agency is now operational. There are 50 brokers in the market, and in December 2016 there were 240 companies listed in the capital market.

## Non-bank financial institutions

The non-bank financial institutions Employee Provident Fund, Citizen Investment Trust, Postal Savings Banks, and Deposit and Credit Guarantee Corporation are owned, regulated, and supervised by the government. The latter was created to protect the financial system and is a key player, contributing to financial stability while broadening the financial safety net. Both the Employee Provident Fund and Citizen Investment Trust mobilize long-term funds and mainly deploy them on infrastructure and government projects.

## Cooperative sector

The first cooperative was established in 1956, and the sector gained momentum after the enactment of the Cooperative Act in 1992. The Department of Cooperative, under the Ministry of Cooperatives and Poverty Reduction, regulates cooperatives. The National Cooperative Bank Limited was established in 2003 and has specialized services to provide the primary cooperatives with access to finance. The number of cooperatives exceeded 33,000 by the end of July 2016.

## Non-governmental organizations

NGO receive a limited banking license from NRB under the Act for NGO engaged on Financial Intermediation 1999. Most financial intermediary NGO are in the process of being transformed into a microfinance development bank.

## Informal sector

Informal lenders comprise individual lenders (landlords, merchants, farmer-lenders, goldsmiths, pawnbrokers, friends, and relatives) and groups of informal institutions (Dhukuti, Dharma Bhakari, and Guthi), and both classes coexist in the Nepalese financial market. The informal sector provides credit without procedural complexities, and has flexibility regarding repayments and collateral which does not exist in the formal sector.

# Productive Use of Remittances and their Significance for Asset Building: Conceptual Framework

## Migration Cycle and Remittance Use

Before dwelling upon the issue of the productive use of remittances, it is important to understand the complete migration cycle. Essentially, this consists of three distinct phases: (i) pre-departure; (ii) at the destination; and (iii) return and reintegration. A migrant follows many steps within each phase, and these impact on the outcome of migration.

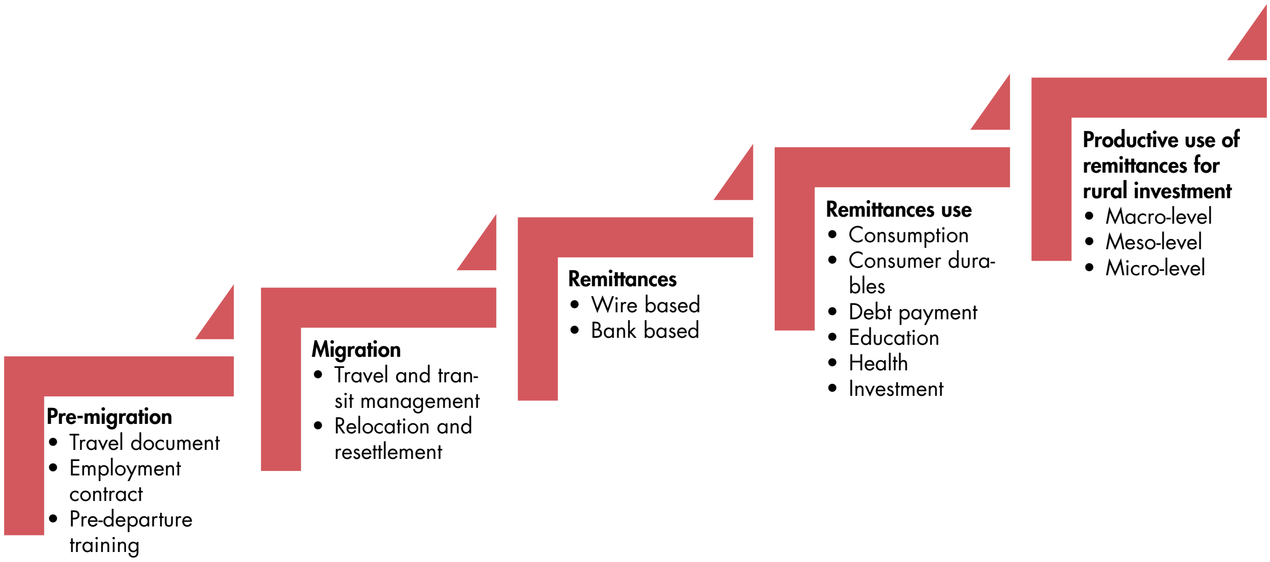
The decision to migrate is itself an important indicator of the savings and investment capabilities of migrants and recipient households. Lack of sufficient employment opportunities available locally to meet the basic need for food, education, health, etc., is a major reason for the migration decision (Maharjan 2010). Some people also migrate with the objective of accumulating capital (Maharjan et al. 2015). When people decide to migrate, they will undergo a preparatory process encompassing preparing travel document, getting an employment contract from employers, and undergoing pre-departure training. All these arrangements incur certain costs, which have implications for the migration outcome, the remittance earnings, and their use at a later stage. After the first step is complete, the people migrate; this involves activities such as travel and transit management, and relocation and resettlement. After people start working in the new destination, they begin to earn. They may decide to send part of their earnings as remittances to their families in the home country, using either a wire-based device or bank-based remittance services. Alternatively, they themselves remit the amount when they return home. The ease or difficulty the migrants experience in settling down to work at the destination has an implication on how much is earned, spent, and remitted back home. This, in turn, influences the savings capacity of the recipient households. After completion of migration, the migrants then return and either reintegrate back home or re-migrate within the same country or to another, more attractive destination, and the cycle continues.

The remittances are used for diverse purposes by the recipient households. The Nepal Living Standard Survey 2011 found that most remittances are used for meeting household daily consumption needs and to repay debts, and that only a fraction (<2%) is used for investment in the productive sector (CBS 2012). This is not surprising, as the findings illustrate a major reason for the migration decision in the first place. However, it is equally important to look at other factors that lead to low investments, such as low earnings, low savings, lack of policy and institutions promoting remittance investment, lack of products for investment, lack of knowledge and skills, and effective policy to promote rural investment. As remittances are received by more than half of households nationally, even small savings could have a significant impact on the local and national economy when converted into investments. Thus, it is important to find ways to promote better saving and investment of remittances at macro-, meso-, and micro-levels, and particularly to promote investment in rural areas, as remittance recipients are spread all over the country in rural, urban, and emerging market towns (Figure 1).

## Remittances Part of the Total Household Income

It is neither realistic to compare remittances with savings (rather, they are as good as salary income for the migrant households) nor true to assume that remittances are kept and spent separately from all other sources of income (for more information see IOM 2010:Chapter 9). The fact is that remittances are part of household income, are fungible and, like other income, potentially used for finance diverse household needs (Zarate-Hoyos 2007). Remittances should be treated as one of the sources of income, and migrants and their families make expenditure out of the total income. Orozco (2015) found that remittances represent on average 37% of all total household income; and in 2010 they represented 31% of total household income in Nepal (CBS 2012). Thus, remittances complement the

Figure 1: **Migraition and remittance journey**




total earnings of the household, and savings depend on the total income pool and on the need and demand for household expenditures.

Typical household expenses include food, rent, utilities, communication, transportation, medicine, clothes, education, and health, which are paid for by households out of the total income source, including remittances. Evidence showing a relationship between better nutrition, education, and healthcare with remittance use is mixed. Some studies in Nepal have demonstrated a positive relationship between remittances and expenditure on food, health, education, and consumer durables of households (Maharjan 2010; Nepal 2013). However, there has not yet been an investigation into the differential savings behaviours of remittance-receiving and non-receiving households. Manuel Orozco (2015) found the savings propensities of remittance recipients and non-recipients to be same in most cases, suggesting that expenses are rational, and that remittance recipients manage to save after dealing with expenses.

## Prerequisites for Investment of Remittances

Researchers, planners, and policy makers continue to debate whether expenditure of remittances by migrant workers on consumption and consumer durables can be considered productive (Orozco 2015). It is often stressed that a higher proportion of remittances is spent on food, education, and healthcare (Adams 2005; Adams et al. 2008; Thieme and Wyss 2005), but these are essential for building human capital, a prerequisite for development. However, when there are savings after meeting the household's consumption requirements, opportunities for investing them are equally important. The argument that productive investment will be the best for long-term development reflects a misconception about how financial independence is attained (Zarate-Hoyos, 2007). In general, financial independence is attained not only simply from productive investment, but also by creating productive asset bases such as buying cattle and goats, and fertile land, and establishing micro-, small, and medium-sized enterprises. Wealth creation stems from at least five factors or determinants (Orozco 2015):

1. Liquidity and asset ownership (savings and fixed assets)
2. An income above the cost of living
3. Access to finance
4. Money management
5. Enabling environment

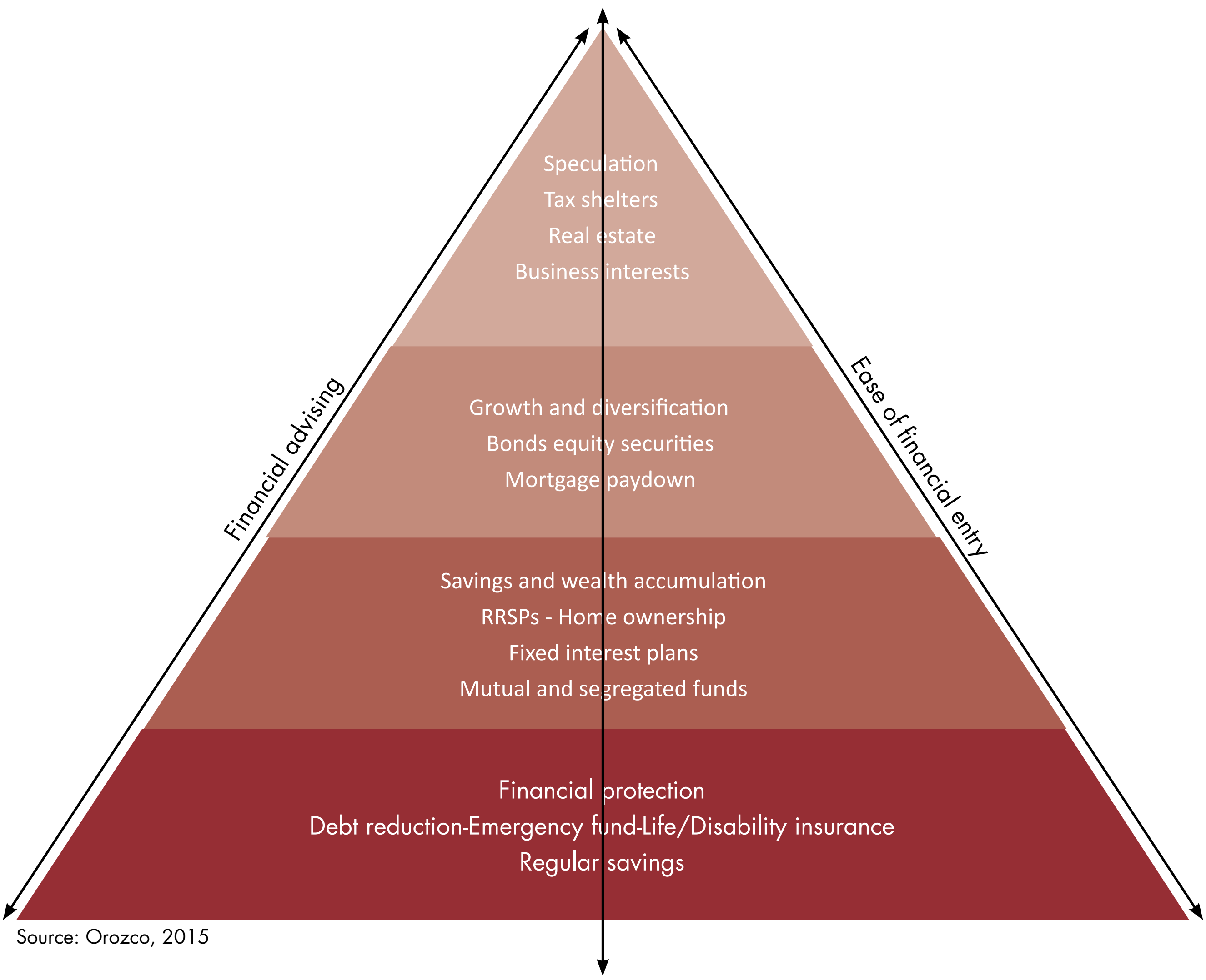
In general, saving and investment is a necessary condition for wealth creation, and access to finance supports the build-up of wealth. If migrants and their families are appropriately oriented to increase their propensity to save part of the remittances, this will potentially lead to promotion of investment and wealth creation. Promotion of investment requires an enabling environment including social mobilization, market linkages, access to finance, skills and entrepreneurship training, business counselling services, and infant industry protection (MEDEP 2015).

Productive use of remittances can best be explained through the financial investment pyramid (Orozco 2015) (Figure 2). The investment demand and pattern varies across the population section, as differentiated through the population pyramid. Two prerequisites for financial investment are: (i) financial advice; and (ii) ease of financial entry. Figure 2 shows that financial investment needs differ across people in different layers of the population pyramid. People at the bottom require financial protection in the form of debt reduction, emergency funds, life or disability insurance, and regular savings; those in the lower middle of the pyramid focus on savings and wealth accumulation in the form of registered retirement savings plans such as home ownership, fixed interest plans, and mutual and segregated funds. People in the upper middle range focus on growth and diversification, encompassing bond equity securities and mortgage paydown; and those at the top demand speculation such as tax shelters, real estate, and business interests.

Remittances can foster investment in the home countries of migrants and factors determining the impact of remittances on investment are outlined in Figure 3.

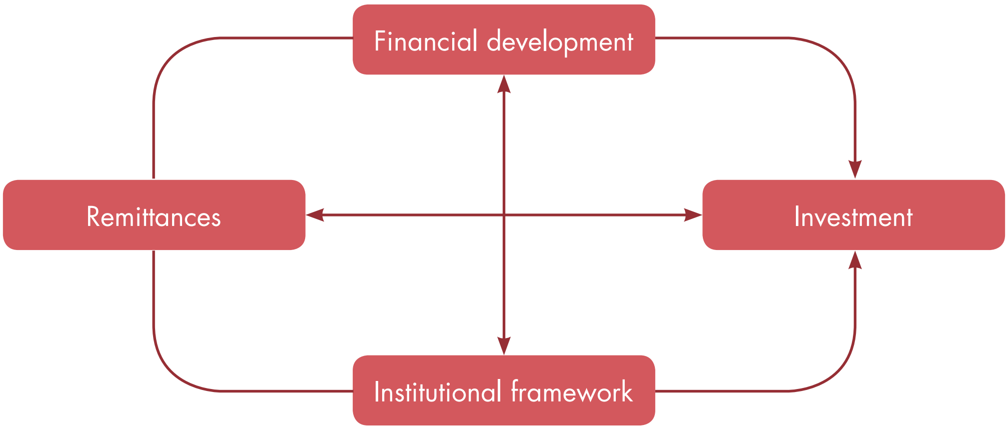
The extent to which remittances stimulate investment and growth is dependent on country context, investment climate, level of development of financial infrastructure, and macroeconomic stability. The prevailing environment influences the use of remittances for consumption, savings, or investment. The level of financial development determines the choice between transferring funds through formal, transparent channels or through informal channels not recorded in official statistics. Financial development and institutional framework are thus very important in the use of remittances for investment in the productive sector (Bjuggren et al. 2010).

Figure 2: **Financial investment pyramid**




Source: Orozco, 2015

Figure 3: **Factors that determine the impact of remittance on investment**




Source: Bjuggren et al., 2010

As discussed already, migrants and their families do not consume all the remittances, and parts are saved. In general remittance-receiving households save and invest more on average than those households who do not receive remittances (Adams 2007). Access to finance from BFI gives additional impetus to transform remittances into investment through matching funds and other complementary services. Further, there is a high multiplier effect of remittance-induced expenses, which will positively augment the promotion of investment out of the remittances received (Lucas 2005).

Therefore, the prerequisites for investment of remittances are

1. inflow of remittances;
2. the quality of a country's institutional framework;
3. the level of development of the financial sector;
4. the investment climate for doing business; and
5. support for entrepreneurship development, etc.

Further successful investment of remittances requires migrants to have formal and informal savings. They must have income above the cost of living, and have financial access and basic financial literacy for money management.

## Challenges to the Productive Use of Remittances

Promotion of the productive use of remittances is neither straightforward nor automatic. There are challenges to the productive use of remittances, such as: (i) making migration outcomes more productive through skilling migrants, bilateral investment, financial goal-setting prior to departure, recognizing the importance of social remittances and their proper use, etc.; (ii) promoting remittance investment in the agriculture and manufacturing sectors; and (iii) the gendered nature of migration, meaning that it is mostly men who migrate (only 13% of total migrants are women; DOFE 2014), leaving women responsible for use of remittances[2] and so leading to a notable reduction in their mobility and pace of empowerment. Another factor is the size of savings per household, which is generally small (Murshid et al. 2002).

[2] As more than 60% of Nepali women are employed in (mostly) non-paid agriculture, they lack decision-making power as well as skills in money management. Gender stereotyping limits their mobility as well as access to resources and information, thereby limiting their potential. Despite these limitations there is scope to equip women to manage remittances for productive purposes by developing their skills. Using remittances positively in this way could lead to gender equity in Nepal, and promote women's economic empowerment.

# Governance of Remittances in Nepal

GON has accepted labour migration as one of the strategies to reduce poverty, but there are no clear plans to help existing and potential migrants, or to facilitate the transfer of remittances and their use at the household level to meet such an objective. GON has yet to plan any further actions beyond a study conducted in 2014-15 to access the feasibility of establishing a labour bank in 2014–15, and issuing FESB since 2010 through NRB. Remittance-receiving families in rural areas are spending and using remittances on an ad hoc basis owing to the lack of a clear plan, policies, and preparedness. Over 70% of remittances is spent on consumption at the micro-level (CBS 2012).

Migration and remittances in Nepal are governed by: (i) a remittance-associated plan; and (ii) remittance-associated policies, acts, and rules. As can be seen from the discussion below, there is no separate remittance plan or policy in Nepal. Broadly, periodic country plans, and foreign employment plans and policies, have incorporated remittance plans and policies as well. The only remittance-focused regulation (NRB Remittance Regulations 2067 [2011]) also focuses only on governance of remitters rather than the use of remittances, so there is a void relating to clear plans and policies to promote remittance investment in rural areas. Brief details of the existing plans, policies, acts, and rules follow.

## Migration and Remittance in the Periodic Plans

The Seventh Plan (FY 1985–86 to FY 1989–90) was the first periodic plan to mention ways of promoting foreign employment. The first Foreign Employment Act 1985 was enacted during this plan period and the first amendment in the Act was made in 1989. The Eighth Plan (FY 1990–91 to FY 1994–95) came up with a more organized way of dealing with foreign employment. The Tenth Plan (2002–07) gave due importance to foreign employment, emphasizing and initiating programmes (such as skills for employment, a pre-departure orientation programme to departing migrant workers, and entrepreneurship training for returning migrants). The importance of foreign employment and remittance flow was increasingly realized in the Three Year Interim Plan (2007–08 to 2009–10). The subsequent Three Year Plan (2010–11 to 2012–13) further reinforced the role of remittances in foreign exchange and balance of payments. The two Three Year Plans (2013–14 to 2015–16) and (2016–17 to 2018–19) further reinforced the role of remittances in foreign exchange, balance of payments, and the need to promote the productive use of remittances. Further, foreign employment was recognized to be a separate topic and remittances were accorded higher significance. Foreign employment was seen to be a source of both employment and remittances; these could become effective tools for poverty reduction and livelihood improvement of poor and disadvantaged groups.

## Remittance-Associated Policies

There is no separate remittance policy in Nepal. Issues related to remittances are dealt with in Foreign Employment Policy 2068 [2012], which is a subset of the Labour and Employment Policy 2006. The Policy addresses current problems and issues relating to foreign employment. It highlights all pertinent elements on migration and remittances; these guide the management of foreign employment and protect the rights of the people engaged in it. The Policy has integrated existing scattered provisions in the foreign employment sector that involve labourers and destination countries, thereby making the process safe and accessible. Amid growing opportunities for youth in foreign employment, along with their contribution in both the domestic and destination countries, the Policy has also acknowledged the need to secure additional safety measures for migrant workers in both areas.

## Remittance-Associated Acts and Rules

Foreign employment and remittances in Nepal are regulated by the Foreign Employment Act 2064 [2007] and Foreign Regulations 2064 [2007]. The first Foreign Employment Act was enacted in 1985 (2043 B.S.) to regularize, control, and organize foreign employment, define the conditions under which private sector foreign manpower agencies could operate, and establish them as licensees. The Act was amended subsequently in 1989, 1992, and 1998. The Act banned recruitment of Nepalese without government permission and made it mandatory to seek the permission of parents or husband for foreign employment of women under Article 12 of the Act. Since the provisions of the Act were against the Convention on the Elimination of all forms of Discrimination Against Women (CEDAW), the regulatory provision of the Act was criticized on the grounds that the issue of migration should be viewed from an empowerment approach rather than a protection approach. Subsequently, various rules and regulations came into existence to help check for irregularities and cheating of workers by foreign employment agencies.

GON promulgated a new Foreign Employment Act 2064 B.S. Exercising the power conferred by Section 85 of the Act, GON then executed Foreign Employment Rules 2008 (2064 B.S). The main objectives of the Act were to: (i) promote foreign employment business; (ii) make foreign employment business safe, managed, and decent; and (iii) protect the rights and interests of the overseas workers engaged in foreign employment, and of the foreign employment entrepreneurs.

### Nepal Rastra Bank Remittance Regulations 2067 [2011]

Exercising the power conferred by clause 12 of the Foreign Exchange (Regulation) Act 2019 the NRB has framed and executed NRB Remittance Regulations 2067 B.S. for an individual, firm, company, or institutions authorized for remittance business under a foreign exchange transactions license. The Regulations detail procedures such as eligibility criteria, supporting document required, and the conditions for inward remittance business. The Regulation clearly sets out the conditions the firm should follow while carrying out the business. The firm must comply with anti-money laundering policies while undertaking remittance business. A careful review of the statutory provision of the Regulations for obtaining the money-transfer license shows that some clauses and regulations are confusing and lack clarity.

## Remittance Policies of Nepal and Some South Asian Countries — A Comparison

Some important aspects of policies focused on remittances in Nepal and some South Asian countries (Bangladesh, India, Pakistan, and Sri Lanka) are presented in Table 1. A common thread among the remittance policies adopted by these five South Asian Association for Regional Cooperation (SAARC) member countries is the focus on three objectives outlined by Carling (2005) in his framework: stimulating remittances for investment, stimulating transfer through formal channels, and use of remittances for development purposes.

Table 1: **Remittance policies in South Asian countries**

| Countries | Remittance policies |
|---|---|
| **Nepal** | • Reimburses remittance fees charged to migrant workers for remitting money through formal channels<br>• Financial literacy for foreign employees and their family members<br>• Five-year Foreign Employment Bond earning 9.5% interest<br>• Allows migrant Nepali workers to invest in shares with attractive investment avenues and in national priority projects<br>• Rebates customs dues and taxes, and has special facilities for certain goods imported by migrant workers returning from foreign employment<br>• Gives special deductions to returnees on customs dues and taxes for importing machinery to start enterprises<br>• Expands formal channels for remitting money (banks, financial institutions, and money transfer agencies) in rural areas and makes their role more effective in remittance business<br>• Provision made by NRB to provide 15 paisa per USD1 as commission to licensed private firms in addition to the prevailing buying rate<br>• Bank guarantee facilities from commercial banks for Nepal-based licensed agent or representative of a money-transfer agency situated overseas for receiving advance payment from principal company<br>• Use of microfinance institutions in remittance business, including savings and credit cooperatives<br>• Promulgated remittance regulation to grant license to private sector organizations for inward remittance business |

Table 1: Cont.

Table 1: Cont.

| Countries | Remittance policies |
|---|---|
| **Bangladesh** | • Saving facilities for non-resident Bangladeshi<br>• Non-resident foreign currency deposit can be opened in any bank operating in Bangladesh for minimum 1 month and maximum 1 year in foreign currency (minimum USD1,000)<br>• US dollar premium bond issued for 3 years in the non-resident's account against remittances from abroad at 7.5% interest rate. Can purchase bond of any amount in multiples of USD500 without a maximum limit, subject to an initial investment of USD10,000. In one instance purchaser receives death-risk benefit<br>• Wage earner's development bond, eligible to wage earners serving abroad and sending remittances. Bond matures on or after 5 years; has an annual interest rate of 12%; any amount can be purchased in multiples of BDT 25,000 without limit; income tax facilities for non-resident Bangladeshis<br>• Remittances transferred by non-resident Bangladeshi through banking channels enjoy full exemption from income tax<br>• No Tax Identification Number Certificate required for purchase of fixed assets<br>• Sources of capital for investment in business, industries, and commerce accepted without query for non-resident Bangladeshi from 1 July 2002 to 30 June 2005<br>• From 1 July 2002 to 30 June 2005 the agricultural processing industry was fully tax exempted<br>• Interest income of non-resident Bangladeshi from non-resident foreign currency deposit is fully tax exempted<br>• Wage Earners Development Bond is exempted from income tax; investment facilities for non-resident Bangladeshi<br>• Industrial Development Bond for non-resident Bangladeshi<br>• Opportunity to invest in both primary and secondary markets including the debentures of Bangladeshi companies; 10% quota in primary public shares reserved for non-resident Bangladeshi<br>• Investment in securities, shares, and deposits with local firms/companies<br>• Several savings and investment schemes designed and marketed<br>• Extensive use of MFI in remittance business<br>• Well-designed information, education and communication materials to inform about available remittance services, and saving and investment opportunities for migrant workers; pre-departure training; briefing in social events; and meeting in host countries |
| **India** | • Introduced registration certificate called Overseas Citizens of India for person of Indian Origin,<br>• Allows NRI most of the benefits of citizenship while maintaining their foreign passport<br>• Attractive deposit schemes and bonds<br>• Operationalizes electronic remittance facility for overseas Indians<br>• Created convenient remittance services<br>• Eased regulation and controls; eliminated the black market premium on the rupee<br>• Establishing a single window for overseas Indian investment<br>• Indian Investment Centre assisted Indian companies in collaborating with NRI<br>• Launched Overseas Indian Facilitation Centre in 2008 to help overseas Indians invest in India |
| **Pakistan** | • For those remitting USD2,500–10,000 there is privileged access to higher education and public housing offers, as well as free renewal of passport, and import duty exemption for USD700/year<br>• Non-repatriable investment scheme under which overseas Pakistanis are allowed to import machinery and equipment at concessional discount rates for establishing manufacturing enterprise<br>• Overseas Pakistanis also permitted to invest in export processing zones with the complete exemption of machinery and raw materials imports<br>• Launched Pakistan Remittance Initiatives for facilitating and supporting faster, cheaper, convenient, and efficient flow of remittances |
| **Sri Lanka** | • Introduced entrepreneurship development programme for returned migrants<br>• Mandatory for those engaging in foreign employment to open non-residential foreign currency accounts<br>• Introduced special credit scheme to encourage investment by returned migrants |

MFI, Microfinance institution; NRB, Nepal Rastra Bank; NRI, non-resident Indians. Source: Pant 2011

# Review of Products and Services to Promote Productive Use of Remittances

## Policies and Programmes to Enhance the Development Impact of Remittances

There are both direct and indirect measures for promoting the productive use of remittances. As remittances are private monies, one direct measure is to tax remittances and use the revenue generated for creating public goods. However, past experience of such a measure reveals it to be counterproductive, as imposing a tax on remittances could incentivize migrants to remit through informal channels or reduce the amount sent altogether (Lucas 2005, cited in Aguinas 2006). Other measures include imposing mandatory remittance contributions. These were implemented by South Korea in the 1980s and Eritrea in 1993, where a requirement was set in place to donate a certain portion of remittances to the state (Carling 2005). The success of such measures is dependent on a strong sense of social obligation towards the country, which might not be possible everywhere, and particularly difficult in the long term. On the other hand, the indirect approach, which provides incentives to remitters through financial, monetary, and social motivations, has been performing at a higher level of success. Such measures include tax breaks, special deposit accounts, investment vehicles, and matching grants.

In general, the design of policy measures and perspectives depends on the objectives of the policy makers. Broadly speaking, their objectives for promoting the productive use of remittances could be: (i) capturing a share of remittances for development purposes; (ii) stimulating transfers through formal channels, or stimulating capital availability; (iii) stimulating investment of remittances; (iv) outreach to migrant collectives and home-town associations; and (v) influencing consumption patterns (Hagen-Zanker 2014). For implementation of these policies to be successful the role of not only the government, but also of private sector and civil society, will be vital.

## Remittance-Linked Products and Services

Global models that have been implemented with success include tax breaks, special deposit accounts, channelling remittances through MFI, diaspora bonds, securitization of remittances, investment vehicles, collective remittances, and matching funds. The salient features of these models are summarized in Table 2.

Table 2: **Remittance-linked products and services**

| Products | Mechanisms | Examples | Sources |
|---|---|---|---|
| Tax breaks | Providing subsidy to migrant workers to motivate them to remit more money through formal channels | Egypt, India, Sri Lanka, Egypt, Moldova, Ethiopia, Kenya | Agunias 2006<br>Moreno-Dodson et al. 2012<br>Chishti 2007 |
| Special deposit accounts | Set up special deposit accounts in collaboration with banking sector at commercial banks that give migrants a premium interest rate on their deposits | Bangladesh, India, Tunisia | Agunias 2006<br>Chishti 2007<br>Buchenau 2008 |
| Cross-selling of complementary financial products and services | Cross-selling complementary financial products and services, including saving packages, insurance, small business credits | Bangladesh, India, Tunisia | Agunias 2006 |
| Channelling remittance through MFI | Channelling remittance flow through MFI and cross-selling of services | Bangladesh, Philippines | Agunias 2006<br>Carling 2005 |
| Diaspora bonds, securitization and investment vehicles | Special government bonds offered to migrants and used to finance public investments to indirectly encourage remittances and diaspora investment | Ethiopia, Kenya, India, Nepal, Bangladesh, China, Eritrea, India, Israel, Lebanon, Pakistan, Philippines, Mexico, Brazil, El Salvador, Turkey | Moreno-Dodson et al. 2012<br>Carling 2005<br>Chishti 2007<br>Kharel 2011<br>Plaza and Ratha 2011 |
| Collective remittances and matching grants | Pooling of remittances by informally organized groups or registered home-town organizations, to be used for a wide range of activities from humanitarian causes to infrastructure projects, to provide income-generating opportunities | Mexico, El Salvador | Schuettler 2008<br>de Haas 2006<br>Orozco 2002 |

MFI, microfinance institutions

# Approach to Remittances for Rural Investment in Nepal

There has been considerable discussion in political, economic, and social circles in Nepal of the implications of remittances on economic growth and development, and ensuring their productive use. Initiatives to ensure the productive use of remittances need to begin from different perspectives. There is a particular need to devise policies to encourage the use of remittances for promoting investment, especially in rural areas. Approaches to tap remittances for rural investment include: (i) promoting better migration outcomes through skill enhancement, better preparedness, reducing costs, etc.; (ii) encouraging migrant workers to send more remittances through official rather than unofficial channels; (iii) increasing 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; and (iv) encouraging migrants to become investors in productive assets in the country, especially in rural areas.

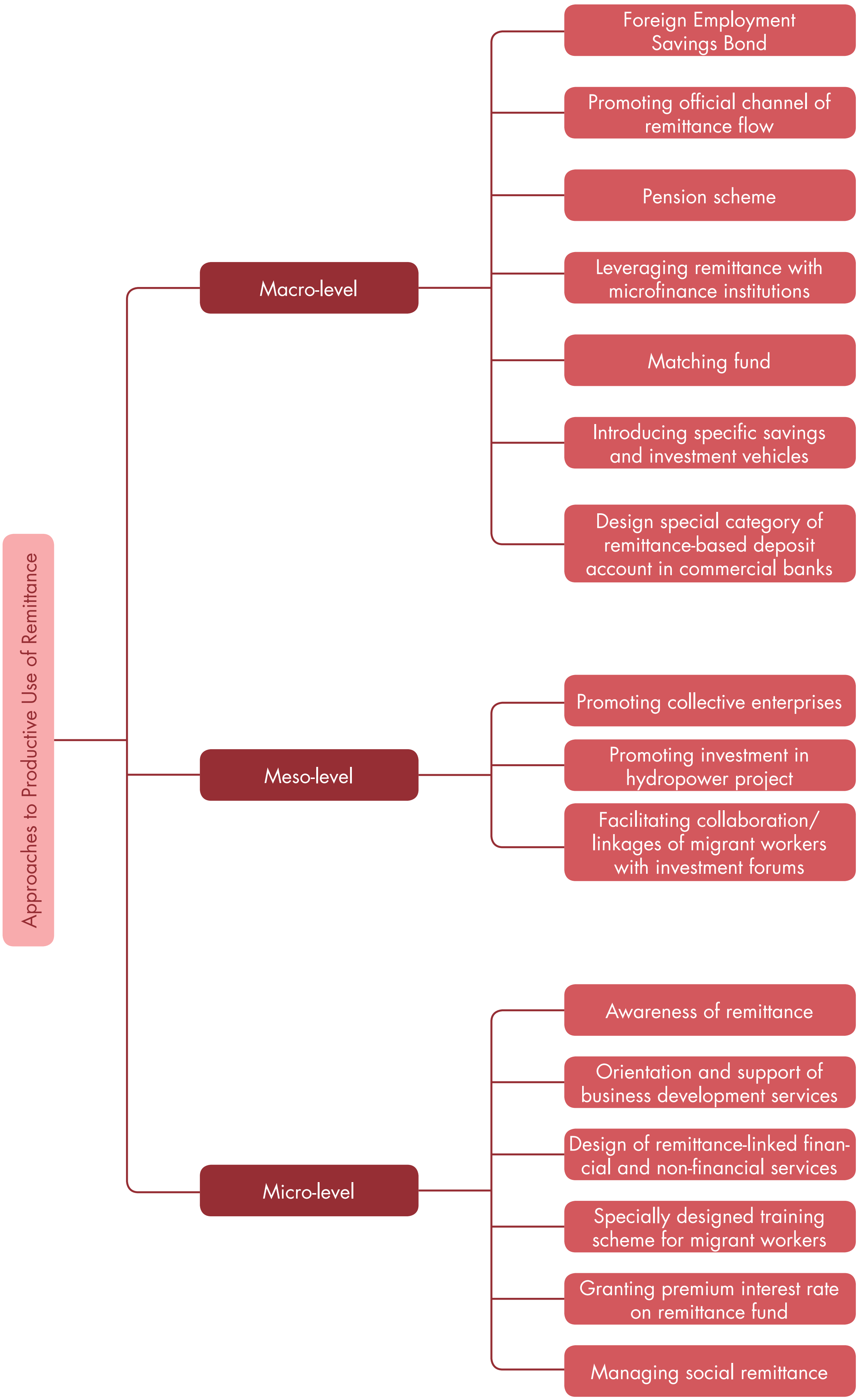
Nepal can learn from other SAARC member nations in developing approaches and products for promoting remittance investment. The relatively successful experiences of India, Bangladesh, Pakistan, and Sri Lanka in various indirect measures of remittance investment could be a good starting point for Nepal. Some successful SAARC experience includes: (i) the Government of India provides incentives to its expatriates, and mechanisms devised by the India Investment Centre help Indian companies collaborate with non-resident Indians (NRI); (ii) the different savings and investment schemes for wage earners abroad designed by the Bangladesh Bank, as well as the role of MFI for the productive use of remittances; (iii) the Pakistan Remittance Initiative and the non-repatriable investment scheme launched by the Government of Pakistan; and (iv) the Sri Lankan Government entrepreneurship development programme for returned migrants to productively use remittances for investment in general and rural investment in particular.

A multi-level approach consisting of various initiatives to be initiated at macro-, meso-, and micro-levels, and meeting the requirements of various migrants and remittance-recipient households (based on their risk-taking, remittance savings, and investments capacities) is outlined in Figure 4 and the details that follow.

An essential component for the investment of remittances is to increase the financial literacy of migrants, returnees, and migrant-sending households. Better financial access and financial inclusion are only possible with improved financial literacy (NRB 2015; World Bank 2009), particularly for poor and marginalized families in rural areas (NRB 2012). It is essential to enhance the financial skills of both receivers and senders with the knowledge and skills to evaluate their options (including how to send and use remittances through formal channels, and how remittances can be used to meet the financial goals of both parties) 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.

Despite access to finance being a fundamental condition for poverty reduction, job creation, income generation, and social protection, it does not alone automatically yield social and economic benefits. For this to happen, workers, entrepreneurs, youth, migrant workers, farmers, and families with working children must be able to make informed choices about when and when not contract debt, how best to save, what to look out for in the small print of an insurance contract, etc. GON, in collaboration with different bilateral and multilateral agencies, has been working to addresses these issues by: (i) improving the provision of financial services available to workers and entrepreneurs; and (ii) enhancing the financial capabilities of potential financial service users. Financial education is an intervention that responds to the latter objective. Financial literacy will help migrants to make an informed decision on the choice of channels for remitting money and use of the remittance money for enterprise development and growth. Reaching the individual migrants and remittance recipients and improving their financial literacy is a daunting task, and it is important to build the capacities of the financial institutions that provide services to them, such as the MFI. These could be the implementers in improving financial literacy of the end users — the migrants and remittance recipients.

Figure 4: **Approaches to productive use of remittances – macro, meso, and micro-level**



## Macro-level Initiatives

### Promoting official channels for remittance flow

Because of the potential positive effect of remittances generally, Nepal has been giving due priority to promoting overseas employment and mobilizing remittances to maximize the benefits from these transfers. In this respect, the NRB began granting licenses to private sector organizations interested in remittance-transfer business from 29 March 2002. In 2016, more than 50 firms, excluding the commercial banks, are undertaking money-transfer business. Some other policy initiatives have also been initiated to encourage the transfer of remittances through official channels. For instance, the NRB made a provision to provide 15 paisa per USD1 as commission to licensed private firms in addition to the prevailing buying rate. In addition, permission was granted to recruiting agencies engaged in sending Nepalese nationals to work overseas to open a foreign currency account in Nepalese commercial banks, using the foreign currency income that they earned under the existing rules. A policy arrangement was also introduced whereby if a Nepal-based licensed agent or representative of a money-transfer company situated overseas required a bank guarantee for receiving advance payment from the principal company, such a facility (within stipulated limits) would be made available directly from the commercial banks. Nevertheless, a large proportion of remittances are still being transferred informally, especially from South Korea and India, and this should be streamlined.

### Foreign Employment Savings Bonds

FESB, popularly known as "diaspora bonds", are a long-term debt security issued by the government. The diaspora bond targets Nepali migrant workers with the objective of channelling their remittances into investment in national development infrastructure and programmes. GON finances the development projects through internal borrowing and foreign grants and loans. Diaspora bonds, if successful, could be an important source of finance for GON, and an important investment opportunity for Nepali migrant workers. They are not a new concept, and have been used many times with great success by India and Israel, for example (Chishti 2007; Moreno-Dodson et al. 2012). Based on these successes a number of international organizations, including the World Bank, are promoting the initiative.

Nepal has also tried issuing a diaspora bond, but not with very positive results (Kharel 2011). Despite having an attractive annual interest rate of 9%–10%, the bond was not a success as can be seen from its performance over the years, although by 2015–16 it was doing much better than when it was initiated in 2009 (Table 3).

Table 3: **Overview of the Foreign Employment Savings Bond**

| | Unit | 2009–10 | 2010–11 | 2011–12 | 2012–13 | 2013–14 | 2014–15 | 2015–16 |
|---|---|---|---|---|---|---|---|---|
| Coupon rate | % | 9.75 | 10.50 | 10.0 | 10.5 | 9.0 | 9.0 | 9.0 |
| Issue worth | Billion USD | 1.0 | 5.0 | 1.0 | 1.0 | 0.50 | 0.25 | 0.25 |
| Subscription | Million USD | 4.6 | 3.38 | 8.7 | 42.9 | 76.4 | 83.7 | 81.7 |
| Subscription rate | % | 0.4 | 0.1 | 0.9 | 4.3 | 15.3 | 33.5 | 32.7 |

Source: Nepal Rastra Bank, Foreign Exchange Department

Reasons given for such poor performance include lack of awareness, complicated procedures, short sale period, and concerns about exchange rate risk, as payments are made as per the rate at the time of subscription (Kharel 2011; NEF and ASD 2012; Shrestha 2011). Some suggestions for improving the performance of the diaspora bond include: "improve awareness, plan ahead, structure the bond appropriately, demonstrate governance, increase incentives for financial agents, increase the target market, conduct investor's education program" (NEF and ASD 2012).

### Pension scheme

At present, migrant workers are not eligible to sign up for the pension scheme with the Employee Provident Fund, as enjoyed by salaried workers in Nepal. However, discussions are ongoing about the creation of an Overseas Employees' Pension Benefits Fund in collaboration with the Employee Provident Fund. Although migration to the Gulf countries and Malaysia is typically for 2–3 years, a migration cycle does not complete in one employment but in several, and typically spans 10–15 years. Thus, a scheme targeting the needs of Nepali migrant workers will be highly beneficial, but will face multiple challenges, as the numbers of beneficiaries are huge and migrants are scattered all over the world. However, proper pre-departure orientation and parallel bank accounts could be a way to deal with such challenges. The Philippines has tried a limited version of such a scheme and so could provide useful learning.

## Leveraging remittances through microfinance institutions

The government needs to acknowledge the opportunity to promote self-employment and small business formation among returning migrants and their families back home, and schemes must be targeted to support investment in business activities. In this respect MFI are well placed to address the demand for remittance-linked financial services, particularly among poor and geographically isolated populations. Compared to the other categories of BFI, MFI have a competitive advantage based on a host of techniques that reduce the high transaction costs of outreach to poorer clients. By broadening remittance-linked services to the "unbanked", MFI have the potential to promote broad-based development, as well as expanding the volume of remittance flows mediated through the financial system. Nepalese MFI will need to expand their micro- and small business portfolios, and this could be linked with business development services such as training, business advice, marketing assistance, and skill development to micro- and small entrepreneurs being extended by the government and NGO sector. However, if such a scheme is to be successful, it will be important to first develop the capacities of the MFI themselves so they can better serve their prospective clients.

## Providing matching funds

Nepal could learn from and consider replicating the successful examples of Mexico and El Salvador, which provide matching funds to the collective remittances sent by migrant organizations abroad, commonly referred to as home-town associations. The local or federal governments of Mexico and El Salvador allocate USD2 or more for every dollar that migrant organizations remit back to their communities. The pooled funds are normally used to finance infrastructure and social projects, such as remodelling churches and schools (Agunias 2006). Such collective funds can also be used to finance local entrepreneurial activities that can offer good returns to investors, as seen in Ecuador (Orozco 2002).

## Introducing specific savings and investment vehicles

Nepalese policy makers could learn from the experiential success achieved by the governments of Brazil, Mexico, India, and the Philippines, by employing an array of inducements to attract remittance funds to specific savings and investment vehicles such as 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 (Sander 2003) and replicate these initiatives in Nepal.

## Designing a special category of deposit accounts at commercial banks

Setting up a special category of deposit accounts at commercial banks, where migrant workers can deposit their money earned abroad, is a common incentive used 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. This would be especially attractive to migrants going to the Global North.

## Financial literacy campaigns

Financial literacy, financial education, and financial capability are essential to promote productive use of remittances. In fact, financial literacy is a necessary condition for enhancing access to finance (Chaulagain 2015). Most migrant workers are financially illiterate, and lack the basic skills required for business planning and management. These skills are required to build their confidence in investing in the productive sector. Since most migrant households are from rural areas and disadvantaged groups, microfinance institutions could be appropriate institutions for improving their financial literacy, and this will eventually have an impact on promoting savings and investment of the remittances.

## Meso-level Initiatives

### Promoting collective enterprises

Collective enterprises have gradually been emerging and promoted to capitalize on the small savings and investment capacity of people in rural areas. Under the technical and management support of Small Farmer Cooperatives Limited and the Small Farmers Development Bank Limited, these enterprises have been used to

- build cold storage or warehouses to counter price fluctuations and to promote better and more stable prices;
- add value through simple processing (from drying and conservation to husking and milling) and more complex manufacturing (e.g., tea, cornflakes, milk powder); and
- brand and package goods (by small farmers' cooperatives in different parts of Nepal), bringing processed products close to consumers.

Some examples are given in Box 1.

The models of collective enterprises promoted in different parts of Nepal shown in Box 1 provide evidence that it is possible to promote collective enterprises by pooling remittances from migrant workers. Potentially, this could promote both forward and backward linkages, generate employment for people, and help local economic development, while providing an attractive dividend on investment.

### Promoting investment in hydropower projects

This initiative appeared in the government's policies and programmes for FY 2016–17, and the government planned to implement programmes such as "Hydroelectricity with Investment of People" by channelling remittances

Box 1: **Collective enterprise initiatives of Small Farmers Agricultural Cooperative Limited and Small Farmers Development Bank Limited (SFDBL)**

Small Farmers Agricultural Cooperative Limited (SFACL) in Prithivinagar, Jhapa, has established a tea factory as a collective enterprise. Traditionally farmers were involved in the production of tea leaves, selling them to a local tea factory at the price set by the few tea factories of the region. As tea leaves are highly perishable, the farmers were exploited in terms of price. The factory has enabled farmers to get fair prices for their tea production, as well as to earn additional income from the profits of the factory and local job creation. The factory was built through the modality of grants and farmers' contributions. About 250 tea growing farmers invested NPR 12.5 million in the equity of the factory, GON provided a grant of NPR 32.5 million, SFDBL provided a loan of NPR 20 million, and the deficit NPR 5 million came from SFACL Prithivinagar to provide the factory with working capital for management.

A similar arrangement was reached by SFACL Maharanijhoda, Jhapa, and SFACL in Nawalparasi, Bara, Rupendehi, and Bardia Districts. SFACL Jhapa implemented community-based collective rice farming by pooling 60 ha of land from 55 farm households and starting commercialized collective farming to enjoy economies of scale. The equity investment in this project included NPR15 million from farmers, NPR15 million from SFACL and a loan of NPR10 million from SFACL Maharanijhoda. It may be possible to expand this type of initiative to other parts of Nepal. SFACL in Nawalparasi, Bara, Rupendehi, and Bardia Districts have promoted modern community-owned rice mills, providing the households of hundreds of small farmers with marketing and processing opportunities for paddy. The improved rice mill in Nawalparasi is an initiative of SFACL of Nawalparasi District, and covers around 15,000 small farmer households in the district. Similarly, a rice mill owned by SFACL Dumarwana, Bara District, is under construction and is expected to be completed by the end of 2017. About 7,000 members (households) of cooperatives and another 8,000 families will benefit from this project. The project is estimated to cost about NPR 70 million, of which NPR 20 million is equity financed by the member farmers, NPR 30 million will come from grants, and NPR 20 million from a loan fund. Processes to establish plants of similar capacity in Bardia and Attariya regions are under way as well.

to finance specified projects. One example is Remit Hydro Limited, a fully owned subsidiary of Hydroelectricity Investment and Development Company Limited. Remit Hydro Limited was established to tap the enormous remittance money coming into Nepal every year. The objective of the company is to develop medium-sized hydropower projects, primarily by using remittances as a source of financing and giving migrant workers an opportunity to get involved in development.

The Department of Electricity Development decided to award development licenses for two medium-sized run-of-the-river hydropower projects: the 71.5 MW Ghunsa Khola Hydropower Project and the 53.7 MW Sinbuwa Khola Hydropower Project. The combined estimated cost of the projects is NPR19 billion and the company has stated that all funds will be raised from within the country. Remit Hydro Limited  plans to hold a 51% stake in each project, while 24% equity investment will come from migrant workers, 10% from local people, and the remaining 15% will be raised through an initial public offering. To ensure adequate funds come from the migrant workers, Remit Hydro Limited  has planned a scheme in which the workers can buy project shares on the basis of equal monthly installments (Subedi 2016). But the success of tapping remittances so far has not been very successful but potential remains.

### Promotion and regulation of collective investment forums

There is a tremendous potential for investment in Nepal that is supported by a liberal foreign investment policy and the existence of the investment-friendly environment. Opportunities exist in areas such as hydropower, manufacturing, service, tourism, construction, agriculture, mining and minerals, information, and communication (MOF 2016). A collective investment forum has the opportunity to pool remittances while providing reliable, up-to-date information related to business and investment. My Investment Group is one such forum that focuses on promoting productive use of remittances in Nepal. One of its objectives is to tap remittances and channel them for investment. It has established ventures in  Middle Eastern and other countries and has set up the remittance company My Remit Pvt. Ltd to cater to the potential of investing remittances in productive sectors. The group has some interesting concepts as a means of sustaining and leading the market. One of the differentiating key features of My Remit is its insurance policy (paying out NPR10,000 every month) in the case of sudden demise of the remitter using their service. Remitters can also send money to multiple people in a single transaction. Other facilities include online transactions, direct bank deposits, the largest payout channels in Nepal, and home delivery. It also provides the best exchange rates to remitters.

## Micro-level Initiatives

### Awareness of remittances

The awareness levels of migrant workers need to be increased during pre-departure and other awareness-raising initiatives (Bruyn and Kuddus 2005). A pre-departure orientation programme 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 of the costs and benefits of seeking employment opportunities abroad. They could also act as a powerful tool for raising awareness about remittance methods and use. In the destination country, a Nepalese mission should organize regular meetings and use various medium to disseminate remittance-related information. 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 such as migrant associations, NGO, and government bodies will be instrumental in the success of these initiatives.

### Orientation and support relating to business development services

In most instances, self-employment through investment in income-generating activities and in micro-, small, and medium-sized enterprises has been challenging. This has been due to lack of knowledge of the type of business development support needed and its availability nearby. Knowledge of migrant workers, their organization, and receivers of the remittances should be enhanced in business development. Returned migrants are not only a source of funding for rural investment, but also an important source of human capital, which could profitably be used to support the growth and development of micro-, small, and medium-sized enterprises.

## Remittance-linked financial and non-financial services

At the point of origin, and as most remittances are used to repay loans borrowed from moneylenders at high interest rates, it is important that BFI design affordable remittance-linked financial products and services, and loan repayments linked with remittances. This would lower the debt burden of households. Other initiatives that could be supported include vocational training, increasing and disseminating information flows pertaining to rural investment opportunities, the provision of loans from financial institutions, and developing market linkages for at least some selected farm and non-farm products and services. The development of entrepreneurial competence in migrant workers would potentially enhance investment in productive activities.

## Specially designed training schemes for migrant workers

The confidence level of migrant workers needs to be enhanced through entrepreneurship and other development training specifically targeted to them. Such training needs to be focused on enabling them to productively use the skills and knowledge acquired during their stay abroad and to provide on-the-job technical backstopping support to enable them to open a small business back home. The primary thrust of the training support should revolve around building the confidence of the migrant workers and their families to start an enterprise for generating self-employment opportunities.

## Granting premium interest rates on remittance funds

The experience of South Asian countries revealed that provision of premium interest rates on the remittance funds by the BFI has been effective in increasing the amount of remittance flow from formal channels. GON needs to collaborate with BFI to design a deposit account with this premium interest rate, which will motivate migrant workers to send more remittances through formal channels.

## Managing social remittances

Migrants often bring with them social remittances that are shaped by their encounters with and integration into their host societies. Social remittances are the ideas, behaviours, identities, and social capital that flow from receiving countries to sending country communities. Although the role that these resources play in promoting immigrant entrepreneurship, community, family formation, and political integration is widely acknowledged, they are yet to be fully used for local economic development. These ideas and practices should be remoulded in the receiving countries. The mechanisms by which migrants send back social remittances to their sending communities, and the role the remittances play in transforming sending-country social and political life, need to be carefully planned and analysed. Thus there is a need to properly manage social remittances to ensure that the sending country obtains full benefit from the remittances.

Greater efforts must be made to tap into the human capital constituted by migrants. Migrants gain new and valuable skills and knowledge from their destination country. For example, many migrants who were agricultural workers or farmers in their home country work in industrial or service sectors. Many learn entrepreneurial skills and are able to set up businesses. Their experience of new forms of employment provides them with training, skills, and knowledge that they did not have before migrating. Many migrants feel empowered by their acquired skills and experiences, and are eager to share their knowledge with others, especially with their communities of origin. Recognizing that migrants return to their country of origin with increased skills and knowledge, the government needs to take steps to encourage their entrepreneurial tendencies (Rosemary 2004).

# Summary and Recommendations

This study focuses on identifying the approaches suitable and workable for promoting productive use of remittances through a review of the rural investment policies, schemes, and products in South Asia through a review of the secondary information available and consultation with key stakeholders in the sector. Our findings reveal that remittance flows are a crucial policy concern since they are very large, relatively stable, provide a cushion for economic shocks, and are unique in providing direct benefits to households.

Remittances do not automatically contribute to national development. The government should devise schemes and policies that motivate Nepalese to send money home (particularly beyond individual family remittances) and craft its policies to take advantage of remittances, carrying out effective and efficient public policies to channel them into productive projects. The policies and initiatives undertaken so far to augment the impact of remittances are primarily aimed at encouraging migrants to send them through official channels. The relevant government authorities have largely ignored their potential uses, and directing remittances to productive investments will be a challenge. The families of migrant workers should be encouraged and supported to undertake self-employment, creating micro-, small, and medium-sized enterprises for generating income and employment to eventually support an improvement in the domestic economy. In the long term, migrant workers should be supported in reintegrating into the national development initiative, while ensuring proper use of the social remittances they bring. As a result of increased remittance flow, the Nepali middle-class population is growing rapidly, and demand for financial services has been changing. The financial services industry needs to change to accommodate growing changes in Nepalese society and its dynamic financial needs and expectations.

As the numbers of migrant workers has increased, there has been a gradual growth in remittances, which are likely to grow in future. But migrant workers and their families have used remittances primarily for consumption purposes. If the current trend of higher consumption that is led and dominated by remittances continues, the hard-earned money sent by migrants abroad will not be used productively, and cannot contribute to economic growth and development. The productive use of remittances calls for a systematic effort to divert remittances, and requires initiatives from the government to encourage investments, generate employment, and expedite national economic growth.

The Nepalese financial and capital markets continue to evolve, and have great potential with respect to the introduction of the FESB and the mutual fund industry, which is offering significant potential to migrant workers and NRN to invest in the Nepali financial market. Despite offering an industry-average return, and repeated promotion and marketing efforts, FESB have yet to be popular among migrant workers. They do not yet have confidence in FESB and consequent investments in financial and capital markets. In coming years there needs to be critical analysis and understanding of the shortcomings in achieving the FESB promotions target, and a better coordination with government institutions such as the Ministry of Finance, NRB, and SEBON for its success. Aggressive marketing of FESB, coupled with financial education of migrant workers, is no less important for successful implementation of the scheme.

Some of the initiatives for promoting productive use of remittances in Nepal include FESB; promoting official channels for remittance flow; a pension scheme; the project for promoting investment in hydropower; financial literacy; use of remitted money for income and employment generation; and the establishment and operation of collective investment forums.

With respect to policy to promote productive use of remittances, in addition to 5-year FESB, government efforts to increase formal remittance flow include reimbursement of remittance fees charged to migrant workers for remitting money through formal channels; financial literacy programmes for migrants and their family members; and allowing migrant Nepali workers to invest in shares of attractive investments and projects of national priority. Other policy support includes providing returning migrants with rebates on customs dues and taxes (e.g., for importing machinery to start enterprises). Support has been extended to expand formal channels of remitting money through banks, financial institutions, and money-transfer agencies in rural areas, to make their roles more effective in the remittance business; and to provide bank guarantee facilities from commercial banks for Nepal-based licensed agents and representatives of money-transfer agencies situated overseas for receiving advance payments from the principal company. The NRB has made provision to provide 15 paisa per USD1 as commission to licensed private firms in addition to the prevailing buying rate, and promulgated a remittance regulation to grant licenses to private sector organizations for inward remittance business. There has been greater emphasis on using MFI, including savings and credit cooperatives, in remittance business.

The review of policy and practices in remittance use and examples considered in this study have enabled us to suggest approaches for tapping remittances for rural investment at macro-, meso-, and micro-levels. These interventions might be instrumental in attracting more remittances from migrant workers, and will help to boost rural investment in local economic development.

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