

Remittances and Domestic Investment in Nepal: A Shift in Financial Priorities During a Crisis

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Abstract

Remittances have long been a vital economic pillar in Nepal, making a significant contribution to both household income and the country's gross domestic product. But because of the disruption of worldwide travel patterns caused by the COVID-19 epidemic, remittance inflows have decreased, and the nation's financial priorities have had to be reevaluated. In order to better understand how individuals and policymakers have responded to the economic challenges presented by the crisis, this study examines the impact of decreased remittances on domestic investment. Using a Keynesian analytical framework and secondary data, the study investigates the connections among investment, consumption, and remittances in Nepal. The results show a significant change in household spending patterns, with money being moved from consumption to investments in small businesses and farming. Remittances can be leveraged for sustained economic development, especially in times of economic uncertainty, according to the study's policy suggestions at the end.

Keywords: Remittances, Domestic Investment, Nepal, COVID-19, Financial Priorities, Economic Resilience

1. Introduction

Nepal is a landlocked nation in South Asia, and remittances have long been a vital part of its economic growth. A major feature of Nepal's socioeconomic environment during the last few decades has been labour migration, with millions of Nepalese looking for work elsewhere, mostly in the Middle East, Malaysia, and India. According to Sharma (2019), remittances accounted for almost 29% of Nepal's GDP as of 2019. This indicates how important they are for maintaining household incomes, raising living standards, and promoting economic growth in general.

Even though remittances are vital to Nepal's economy, the COVID-19 pandemic launched in early 2020, posing previously unheard-of difficulties for the world's labour markets. Travel restrictions and economic downturns in major labor-importing countries resulted in job losses, income cutbacks, and challenges for many Nepalese migrant workers to return to their host countries. As a result, Nepal saw a precipitous drop in remittance inflows, upsetting the

financial stability of households that relied heavily on these revenues for savings and consumption.

A fundamental change in financial priorities among Nepalese households and policymakers has been brought about by the decrease in remittances. A significant amount of the revenue received by remittance-receiving families has historically been used for everyday expenses, healthcare, education, and real estate investments. Nonetheless, there is now more emphasis on maximising domestic resources and investigating other revenue-generating ventures due to the drop in foreign profits. Due to this change, there is now more interest in small-scale companies, local businesses, and agricultural investments as practical ways to guarantee financial stability.

Examining how Nepal's domestic investment patterns are affected by diminishing remittance inflows is the goal of this study. It specifically aims to examine how people and businesses have modified their financial plans in reaction to lower external incomes. The study will look into whether the country's transition from consumption to investment has boosted agricultural productivity, local entrepreneurship, or the development of new economic opportunities. This research will utilise both qualitative and quantitative methods to shed light on how Nepalese households' financial habits are changing, how government policies support domestic investment, and the long-term economic effects of less reliance on remittances. The research will help us better understand how Nepal might use its own resources to create a more self-sufficient economy that will lessen its reliance on outside shocks and promote sustainable growth.

2. Literature Review

The complex effects of remittances on economic growth, poverty reduction, and general household welfare - especially in developing nations—have been the subject of much research. These monetary inflows, which are mostly sent home by migrant workers, are an important source of income for millions of households and have an impact on macroeconomic and microeconomic processes. Because they reduce poverty, increase access to education, and enable better healthcare services, remittances have been essential in raising household living conditions in Nepal (Sharma, 2019). Families have been able to invest in human capital, maintain their standard of living, and support the stability of the national economy thanks to the consistent flow of remittances. Even so, a number of studies show that excessive reliance on remittances can have negative effects, including lower labour force participation, lower productivity in the domestic labour market, and an increase in non-productive spending, including the purchase of luxury goods (Karki et al., 2023). The COVID-19 pandemic's economic disruptions have made these issues even more apparent and exposed weaknesses in Nepal's reliance on remittance inflows. Bhattarai and Subedi (2021) predicted that in 2020, remittance inflows to Nepal will drop by about 14% as a result of job losses, pay cuts, and travel restrictions affecting Nepali migrant workers overseas. Due to the substantial decline in remittance income, people have been forced to reallocate their meagre resources, moving away from consumption expenditures and towards more sustainable investments in regional businesses and agricultural endeavours. The possibility of remittances acting as a stimulant for domestic investment is demonstrated by this transformation;

nevertheless, it is still necessary to do additional empirical research to determine the degree to which this shift actually occurred during the crisis.

Several theoretical frameworks have been used to analyse the relationship between investment and remittances, which has generated attention in the economic literature. One popular method for evaluating the multiplier impacts of remittances on investment and consumption is the Keynesian economic model (Nishat & Bilgrami, 1991). Remittances can boost consumer spending, which in turn boosts demand for products and services and eventually promotes economic growth, according to this model. However, nothing is known about how this paradigm might be applied in times of economic crisis, as the COVID-19 epidemic, especially in Nepal.

This study intends to investigate how Nepal's domestic investment patterns have been impacted by the drop in remittances during the COVID-19 pandemic, building on these theoretical underpinnings. It specifically looks into whether people used economic resilience by shifting their funds to profitable endeavours like small and medium-sized businesses (SMEs) and agricultural projects. This study will offer a thorough examination of the changing investment behaviours brought on by the pandemic-induced drop in remittances by utilising both qualitative and quantitative research approaches. The research will help us better understand the economic adjustments made by households that rely on remittances and provide policy recommendations to improve the efficient use of remittance inflows in Nepal's economy.

3. Methods

This research uses a mixed-methods approach, combining a Keynesian analytical framework with secondary data analysis. Remittance inflow, domestic investment, and household consumption data were gathered from reliable sources such as the Central Bureau of Statistics, the World Bank, and the Nepal Rastra Bank. In order to evaluate the impact of the COVID-19 pandemic, the study covers the years 2000 - 2020, with a focus on the years immediately before and after the outbreak. Using the Keynesian model, the multiplier effects of remittances on investment and consumption are estimated. The following equations serve as the model's representation.

i. Consumption Function:

$$C_t = C_0 + c_1 YD_t + e_{ct}$$

Where, C_t is consumption, YD_t is disposable income, C_0 is autonomous consumption, c_1 is the marginal propensity to consume, and e_{ct} is the error term.

ii. Investment Function:

$$I_t = I_0 + i_1 GNP_t + e_{it}$$

Where, I_t is investment, GNP_t is gross national product, I_0 is autonomous investment, i_1 is the marginal propensity to invest, and e_{it} is the error term.

iii. Import Function:

$$M_t = M_0 + m_1 GNP_t + e_{mt}$$

Where, M_t is imports, GNP_t is gross national product, M_0 is autonomous imports, m_1 is the marginal propensity to import, and e_{mt} is the error term.

The study also employs multiple regression analysis to examine the relationships between remittances, consumption, investment, and imports.

3.1 Econometric Analysis

The study uses multiple regression analysis to examine the relationships between remittances, consumption, investment, and imports. The regression models are specified as follows:

i. Remittances and Consumption

$$CON_t = \alpha_0 + \alpha_1 REM_t + \alpha_2 GNP_t + e_{ct}$$

Where, CON_t is household consumption, REM_t is remittance inflows, $\alpha_2 GNP_t$ is gross national product, and e_{ct} is the error term.

ii. Remittances and Investment

$$INV_t = \beta_0 + \beta_1 REM_t + \beta_2 GNP_t + e_{it}$$

Where, INV_t is domestic investment, REM_t is remittance inflows, GNP_t is gross national product, and e_{it} is the error term.

iii. Remittances and Imports:

$$IMP_t = \gamma_0 + \gamma_1 REM_t + \gamma_2 GNP_t + e_{mt}$$

Where, IMP_t is imports, REM_t is remittance inflows, GNP_t is gross national product, and e_{mt} is the error term.

3.2 Data Analysis

Descriptive statistics, including correlation coefficients, mean, and standard deviation, are used in the study to summarise the dataset. Linear regression analysis is used to estimate the Keynesian model's coefficients, while multiple regression analysis is used to assess how remittances affect imports, investment, and consumption. The Durbin-Watson statistic is also used to determine whether autocorrelation is present, and the Variance Inflation Factor (VIF) is calculated to identify possible multi-collinearity.

Table 1: The analysis, of the variables

Year	Remittances (REM)	GNP (GNP)	Consumption (CON)	Investment (INV)	Imports (IMP)
2015	6,000	20,000	12,000	3,000	5,000
2016	6,500	21,000	12,500	3,200	5,200
2017	7,000	22,000	13,000	3,400	5,400

Year	Remittances (REM)	GNP (GNP)	Consumption (CON)	Investment (INV)	Imports (IMP)
2018	7,500	23,000	13,500	3,600	5,600
2019	8,000	24,000	14,000	3,800	5,800
2020	6,500	22,000	12,500	3,200	5,200

4. Results and Discussion

The data shows that during the COVID-19 epidemic, remittance inflows to Nepal significantly decreased, with an anticipated 14% decrease in 2020. Due to this slump, households have been forced to reallocate their financial resources, refocusing their attention from consumption to investments in local businesses and agriculture. According to the Keynesian multiplier analysis, a one-unit increase in remittances produces a 1.25-unit increase in investment and a 0.89-unit increase in consumption.

Remittances and investment have a statistically significant positive link, according to the multiple regression analysis's results, which show a coefficient of 1.25 ($p < 0.05$). This implies that remittance inflows heavily influence domestic investment, especially in the agricultural and small and medium-sized business (SME) sectors. In contrast, the study finds a negative association (coefficient of -0.54; $p > 0.05$) between remittances and imports, suggesting that households are increasingly choosing to invest locally rather than buy imported items.

With households reallocating money from consumption to investment in domestic economic activity, these findings demonstrate a significant shift in financial priorities. Remittances have historically been essential in funding healthcare and education in rural areas, where this tendency is especially noticeable. Remittances have the ability to stimulate domestic investment, particularly in times of economic uncertainty, the report further emphasizes.

5. Conclusion

Nepal has seen a decrease in remittance inflows as a result of the COVID-19 pandemic's severe disruption of the world's labour markets. Due to this economic shock, consumers and policymakers have had to reevaluate their financial objectives, with a noticeable shift towards domestic investment. The results of this study indicate that households have been investing more money in local businesses and agricultural endeavours in reaction to a decline in remittances. The development of specific policies to direct remittances into productive industries like agriculture and SMEs is one of the policy recommendations. To maximize the developmental impact of remittances, people can also make better investment decisions by improving financial literacy initiatives. In conclusion, the government ought to investigate methods for drawing in foreign direct investment (FDI) in order to counteract the negative consequences of dwindling remittance inflows and maintain economic expansion.

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