

EFFECT OF REMITTANCE ON INFLATION IN NEPAL

A Thesis

**Submitted to the Department of Economics
Faculty of Humanities and Social Sciences of Tribhuvan University
in Partial Fulfillment of the Requirements for the Degree of
MASTER OF ARTS
in
ECONOMICS**

By

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LETTER OF RECOMMENDATION

This thesis entitled "**Effect of Remittance on Inflation in Nepal**" is prepared by Shriram Pandey under my supervision. I hereby recommend this thesis for approval by the thesis committee.

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We certify that this thesis entitled "**Effect of Remittance on Inflation in Nepal**" submitted by Shriram Pandey to Department of Economics, Prithvi Narayan Campus Pokhara, Faculty of Humanities and Social Sciences, Tribhuvan University, in partial fulfilment of the requirements for the degree of MASTER OF ARTS in ECOMOMICS has been found satisfactory in scope and quality. Therefore, we accept this thesis as a part of said Degree.

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ACKNOWLEDGEMENT

First of all, I would like to express heartfelt gratitude to research project supervisor Associate Prof. Deo Narayan Sutihar, Department of Economics, Prithvi Narayan Campus for his thorough guidance from the very beginning to the completion of this thesis. This thesis would not have materialized to its current form without his guidance, support and advice.

I am also highly grateful to Prof. Dr. Yadav Sharma Gaudel, HOD of Economics for his co-operation, suggestions and encouragement during the course of this thesis preparation. My thanks go to Prof. Dr. Bednath Sharma also for his constructive suggestions and inquisitiveness during viva. I am extremely thankful to Mrs. Sita Ghimire for helping me find out necessary input data that have been used for this research work.

I am highly obliged to my parents, my wife and my colleagues who were constant inspiration and support to me as always.

I am also highly indebted to all those who directly or indirectly contributed to this report by providing necessary materials, data and information.

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T.U. Regd. No.: 6-3-48-2521-2009

April 03, 2014

ABSTRACT

Nepal is a landlocked country sandwiched between China in the north and India in the south, east and west. Economically speaking, growth in GDP for FY 069/70 has remained at just 3.6%. Agriculture occupies about one-third of the total GDP, whereas two-third of the working population are engaged in it. Economic activities within the country have been sluggish thus prompting new working population to go abroad for higher earnings. According to NRB, the remittance inflow to Nepal for FY 069/70 was NRs. 434.58 billion, which is about 25% of the GDP. This shows how substantial remittance is to the economy of the country. On the other hand, the macro economic data published by NRB reveals that inflation for the FY 2010/11 and 2011/12 are 9.6 and 8.3% respectively. Inflation at such high rates not only negates the earnings of the common man but also the interest rates offered by the banks and financial institutions. As mentioned in the title itself, two major economic issues are at the centre of the study here. The purpose of this study is to analyze the causal relationship between remittance and inflation in Nepal on the premise of the theoretical inter-relation. The historical data from FY1990/91 to 2012/13 have been used for the analysis.

Theoretically speaking, remittance contributes to inflation through three linking factors, namely, Demand pull factors, Cost push factors and Money Supply. With increased income, aggregate demand usually goes up. But in absence of increment in supply to match that demand, the price rises through the mechanism of demand pull inflation. Similarly, with higher wage offers at even lower levels in foreign countries, people find it luring to work abroad rather than in Nepal. With increasing tendency of such workers to go abroad, the shortage in labor market forces the Nepalese employers to increase the wage just in order to retain them. That again contributes to inflation through cost-push mechanism. Besides, money supply also increases through remittance creating ample chances for inflation.

Several regression analysis between remittance as independent variable and CPI (base year 2005/06 = 100) as dependent variable showed the following.

Simple regression analysis between inflation and remittance of the same year shows that if the remittance income increases by NRs. 10,000 million rupees then CPI increases by 3.202 points. Regression analysis between remittance of the previous year on the inflation of the following year shows that if the remittance income

increases by NRs. 10,000 million rupees then CPI increases by 3.881 points. Similarly, multiple regression analysis of CPI as independent variable with remittance of the current and the previous year both as dependent variables showed how inflation is influenced. According to the regression equation thus formed, for every million of additional remittance income of a certain year increases the CPI index by 0.000204026 points, keeping remittance of the previous year zero. Similarly, additional remittance income of million rupees in the previous year contributes to CPI index of the following year by 0.000136833 points, keeping remittance income of the current year as zero. If the remittances of the previous year and the following year are both NRs. 10,000 million then the CPI index increases by 3.4 points.

Multiple regression analysis by taking remittance of present and previous year, GDP as well as government expenditure as dependent variables shows that for overall CPI, if the value of all the independent variables is zero, then CPI will be 10.61. For every rupee of remittance income, the CPI changes by 0.000367 and 0.000141, of the same and the previous year respectively. Similarly, CPI varies by 0.0002 and 0.000351% for every unit changes in the GDP and Government expenditure respectively.

There is no doubt that remittance income has been a vital part of our economy especially in the last decade. However there is a dark side to the effects of remittance in Nepal's case. Some economists refer to it as a 'slow poison'. Among the negative effects of remittance, as this research showed, is its effect in inflation. The need of the moment is to create productive investment opportunities where a huge part of remittance that is currently being used in unproductive sectors or luxury purchases can be diverted. Those productive investment opportunities can be in Agriculture, Infrastructure, Tourism, Industries, etc. Now is the high time that all the stakeholders (political parties, entrepreneurs, banks, bureaucrats, public, etc.) should think about creating more investment opportunities and attract remittance money towards it. Once profitable investments are made and the investors start getting return from it, then they do not have to fully rely on remittance income. Our heavy reliance on remittance income makes us equally vulnerable to inherent economic risks of the employing country. If for any reason those countries face economic difficulties then that might be directly felt here in terms of lower remittance inflow. So it is always better to start thinking about tomorrow and plan accordingly instead of lavishly spending just for today.

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ACRONYMS

AD	Aggregate Demand
ALI	Agriculture Labor wage Index
AS	Aggregate Supply
BOP	Balance of Payment
CBS	Central Bureau of Statistics
CLI	Construction Labor wage Index
CPI	Consumer Price Index
FY	Fiscal Year
GDP	Gross Domestic Product
GE	Government Expenditure
GNP	Gross National Product
ICP	Indian Consumer Price
ILI	Industrial Labor wage Index
IPI	Import Price Index of India
IWP	Indian Wholesale Price
M ₁	Narrow Money Supply
M ₂	Broad Money Supply
NC	Nepali Currency
NLSS	Nepal Living Standard Survey
NRB	Nepal Rastra Bank
NTS	Nepal Tourism Statistics
PE	Probable Error
PT	Petroleum Price
Rmt	Remittance
RPV	Relative Price Variability
SE	Standard Error
SSE	Error sum of squares
SSR	Explained sum of squares
TSS	Total sum of squares
VAR	Vector auto-regression
WRI	Wage Rate Index