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The impact of foreign remittances on poverty in Nepal: A panel study of household survey data, 1996–2011

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ABSTRACT

Using data from the longitudinal panel surveys of 1996, 2004, and 2011, this paper examines the dynamics of foreign remittances and their impact on poverty in Nepal. The intent is to explore how foreign remittances have evolved and impacted poverty and economic well-being of households. Focusing on a consistent set of households across the three survey rounds in a balanced panel format helps examine the effect of foreign remittances with appropriate controls. Results from methodologically consistent, random-effects regressions that correct for potential attrition and heterogeneity bias support significant poverty-reducing and, more accurately, economic well-being-enhancing effects of foreign remittances especially when originating in countries other than India. This and other findings are valuable to the assessment of policies on utilizing foreign labor migration and remittances as a vehicle to reduce poverty in Nepal.

1. Introduction

Nepal has experienced a rapid growth in foreign labor migration and remittances during the past two decades. The number of migrant workers employed abroad has increased tremendously, with thousands of unemployed youth leaving the country every day.[1] Not every migrant worker becomes successful in finding employment as promised or expected neither does every migrant worker remit money back home. But foreign employment has been encouraged by the government even as an active labor market strategy with remittances evolving as a major source of income for households, communities, and the nation today. The size of foreign remittance income relative to gross domestic product of Nepal increased from one percent in 1995 to close to almost one-third by 2015 (World Bank, 2017). While money received in foreign remittance is sure to improve household economic well-being, to what extent this has occurred and whether or not this effect has changed over time are valid policy questions to answer for a country increasingly reliant on it.

This paper explores how foreign remittances impact poverty among recipient households by using panel data from the 1996, 2004, and 2011 rounds of the Nepal Living Standard Survey (NLSS). The goal is to provide insights into how poverty statuses and levels have changed among households during the period and how foreign remittances are linked with such changes in household poverty. While most studies of poverty in Nepal have been either qualitative or cross-sectional, this analysis expands the coverage of survey-based analyses like those of Acharya and Leon-Gonzalez (2012), Bhatta and Sharma (2006), Loskhin, Bontch-Osmolovski, and Glinskaya (2007), and Wagle (2012) to a panel and longitudinal analysis covering a period of 15 years. Given that foreign labor migration occurs more systematically than randomly, appropriate research strategies and controls are applied to mitigate the potential endogeneity and self-selection bias. Findings will be valuable to understand how households are participating in foreign labor migration and benefiting from remittances to improve economic well-being and reduce poverty, an experience widely shared across many developing countries today.

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[1] According to a government report, the absentee population—defined as living away from Nepal for at least six months—increased by 150 percent since 2001 to close to two million in 2011 (Ministry of Foreign Employment, 2014). While not all of this amounts to foreign labor migration, this report also finds that the Government of Nepal issued almost one-half of a million permits for foreign employment in 2013/2014 alone, a figure more than twice that for 2008/2009.

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2. Literature review

Foreign labor migration and remittances provide monetary as well as nonmonetary benefits to recipient countries, communities, and households. Most directly, there is ample research to support that they help improve the economic well-being of recipient families and reduce poverty (Adams, 2005; Adams, Cuecuecha, & Page, 2008; Gustafsson & Makonnen, 1993; Du, Park, & Wang, 2005). How remittance affects household well-being, however, depends on who sends workers for foreign labor migration in the first place. Theoretically speaking, sending workers for foreign employment is a household strategy to maximize economic gains and diversify sources of income (Ellis, 2003; Rakodi & Lloyed-Jones, 2002; Thieme & Wyss, 2005; Vargas-Lundius, Lanly, Villarreal, & Osorio, 2008). The widely known push and pull factors of migration necessarily enter the equation, with a lack of opportunities allowing households to send their members for foreign employment (IOM, 2010; Massey, et al., 1998). The economics of labor migration postulates that the decision to seek foreign employment depends on the rational calculation of risks and benefits (Stark, 1991; Stark & Bloom, 1985).

Household members make the decision to seek foreign employment collectively since the payoffs go to the entire households. This notion of collective decision applies to almost all cases of migration as the necessary preparation requires significant investment of time, energy, and resources. To what extent one has access to information on the process of migration as well as other networks and social contacts needed to succeed during and after migration are also important (MMN & AMC, 2012; Thieme, 2006; Wagle, 2012). Migrant workers often go through complicated legal processes both at home and in destination countries, with illegal migrants facing more daunting challenges during travel, at work, and in daily lives (MMN & AMC, 2012; Mon, 2010; Brees, 2008). Given that the degree of preparation and investment increases with the expected payoffs, households with poor, rural, and illiterate backgrounds often cannot afford to send their members to countries or regions that offer higher employment payoffs (Cohen, 2005; de Haan, 1997; Latapi, 2012; Wagle, 2012). Because the extent to which the poor participate in foreign labor migration and remittances depends on maturity of the migration process, the history of labor migration affects the way benefits of remittance reach the poor. Wagle's (2012) study shows that the benefits of foreign migration and remittances may go disproportionately to those with significant financial assets.

There is no denying that remittance incomes increase the purchasing power and help improve the economic security of recipient households. A growing body of research focusing on micro-data supports the livelihood strategy hypothesis in that the most fundamental reason that households send their members for foreign labor migration is because they can remit money to support the members at home (Adams, 2005, 2011; Adams et al., 2008; Du et al., 2005; Gustafsson & Makonnen, 1993; Kageyama, 2008). While research conducted by Airola (2007) in Mexico shows the share of food in total consumption to be significantly lower and that of durables, health, and housing to be significantly higher among households with remittance, this is also a sign that remittance helps increase expenditures in basic necessities especially for nonfood consumption. The increased income from remittance is also shown to provide important safety net and to reduce food insecurity, something that remains precarious in much of the least developed world including Nepal (Cohen, 2005; Lacroix, 2011).

A large body of studies using micro and macro data also supports this poverty-reducing effect of foreign remittance. Adams (2011) and UNCTAD (2011), for example, have found a 10 percent increase in foreign remittance to reduce poverty by up to four percent. Even when remittances are not large enough to lift households out of poverty, they help lessen the degree of poverty experienced (Vargas-Silva, Jha, & Sugiyarto, 2009; Wagle, 2016). Focusing on the NLSS survey data from Nepal, Acharya and Leon-Gonzalez (2012) find that remittances decreased poverty headcount ratios by between two and eight percent during 1996 and 2004, with even larger reductions in the depth of poverty. Lokshin, Bontch-Osmolovski, and Glinskaya (2010) also show that migration (internal and foreign) helped reduce poverty by almost 20 percent between 1995 and 2004 in Nepal. Although the specific observation depends on the timeframe as well as other forms of reference—poverty definition and internal vs. foreign remittance, for example—it is almost unequivocal that remittances have had important poverty-reducing effects in Nepal.

How significant is this poverty reducing impact of remittance? The poverty reducing impact can sustain longer only if households manage to invest in business, agriculture, or other income generating activities. For one, the very high rates of expenditures (up to 90 percent) in basic necessities out of remittance money undermine any investment prospects (Airola, 2007; Turnell, Vicary, & Bradford, 2008). While a comprehensive review of literature on the role of remittance conducted by de Haas (2007) in Mexico points to an important multiplier effect of increased consumption spurred by remittance at a broader level, there is no more than anecdotal evidence that remittance money has been put to productive use especially by households that are concerned with making daily ends meet. Similarly, the value added that remittance provides to poverty reduction must heed the possible displacement of existing economic activities by household members once they start receiving remittance (Adams, 2011; Latapi, 2012). Although remittance receiving families may witness increased incomes and consumption, Wagle's (2016) study from Myanmar shows that the role of remittances on economic security may be more limited when household characteristics relevant to determining labor migration and remittances are fully controlled. The real distinction may be in terms of the short-term versus long-term benefits of remittances, the latter of which are not easy to track through household surveys.

3. Hypotheses and data

Exploring the impact of foreign remittances on poverty is highly challenging to say the least. Directly, the additional monetary resources received in remittance would help increase household incomes and consumption and reduce poverty. This suggests that foreign remittance would have significant positive impact on income or consumption and a significant negative impact on poverty. This does not mean, however, that remittances come without cost. Given the necessity of financial and nonfinancial investment to make foreign labor migration a reality, for example, the resource base may be significantly drained when households decide to send members for foreign labor migration. In some cases, emigration of some members also means that households receiving foreign remittance may cut down on their income generating activities at home. The flip side can be that households are able to invest the extra resources from remittance on activities that generate further returns especially when we consider a longer time span. But the most fundamental impact of labor migration is that the emigrating member's potential to generate income at home, otherwise known as the opportunity cost, would be necessarily lost as a result of migration. While the poverty-reducing hypothesis of foreign remittance still holds since the payoff of foreign employment can be significantly higher than what would be possible otherwise, this complexity suggests that the outcomes can be quite different when multiple factors are incorporated. To the extent that these opportunity costs can be incorporated, the hypothesis of poverty-reducing