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The Role of External Debt, Export Trade, Remittance, and Labour Force in the Economic Growth of Nepal: is Nepal Heading Towards Dutch Disease?

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ABSTRACT

This paper, using the most recent data and updated time series analysis technique in annual data for the period of 1990-2019, examines the role of external debt, remittances, exports, and labour force in the economic growth of Nepal. Despite being a unique country with a high demographic dividend, endowed with natural resources, and fast-growing big economies-China and India- in the neighbour, Nepal has been unable to accelerate its economic growth. The results show that external debt and remittances have contributed negatively to the economic growth of Nepal indicating a symptom of Dutch Disease in the Nepalese economy, especially caused by the remittances inflows in the recent decades. The results also suggest that the debt collected after 2014 has indicated a better performance but still the sign is negative and statistically not significant. The results for exports and labour force indicate that governments of Nepal need to focus more on export performance employing the labour force in the country. There is enough room to improve creating more domestic employment to boost the exports for achieving a better rate of economic growth in the country. The proper utilization of debt and remittances inflows should be an immediate concern of the policymakers in the country. .

INTRODUCTION

The roles of external debt, remittances inflow, export performance, and labour force in economic growth are widely discussed in the literature development economics. Most of the developed countries' examples suggest that these variables have worked unitedly for their economic prosperity. Theoretically, it is said that the properly utilized external debt and remittances inflows contribute to facilitating the required capital of the development tasks smoothing the economy-wide activities. Similarly, exports moti-

vate and incentivize doing entrepreneurship to create employment and to increase the national income. The well-equipped labour forces with production skills also contribute to the national income positively. In these regards, generally, the literature suggests that the role of these variables is positive in economic growth, but the impact is found different in country-to-country cases because of various heterogeneous issues and reasons. Particularly the role of debt and remittance inflows are linked with the Dutch Disease story. Therefore, the nexus of these variables with economic growth has a mixed finding.

For example, about the external debt and economic growth, Fosu (1996) states that debt has deterred the economic growth in African Least Developed Countries (LDCs) between 1970 and 1986. Jayaraman and Lau (2009), using the data for six Pacific island countries from 1988 to 2004, suggest that there is a strong relationship of external debt to GDP growth for the short run. Reinhart and Rogoff (2010), employing the data from 44 countries in the panel structure, find that if the debt to GDP ratio reaches above 60 percent that causes to decline in the annual GDP by two percent. This indicates that the higher debt creates a burden for the economy and slows economic growth. Checherita-Westphal and Rother (2012), from an empirical analysis using the data from 12 European countries for 40 years, find that the debt can contribute to the economy through a channel of private saving, public investment, total factor productivity, and sovereign long-term and interest rates.

Similarly, about remittances' role in economic growth, Javid, Arif et al. (2012) state that there is a positive and significant impact of remittances in the economic growth of Pakistan. Cooray (2012) also suggests a positive relationship of remittances inflows and economic growth in the case of South Asia using a panel data set for the period of 1970-2008. Almost, a similar version of the finding is suggested by Feeny, Iamsiraroj et al. (2014) stating that there is a positive association between remittances inflows and economic growth in small island developing states (SIDS). But this is not always the case as we find many of the studies have suggested the negative association of remittance inflows and economic growth, for example, Sobiech (2019) suggest an ambiguous association between remittance and economic growth stating that remittance can contribute to economic growth only when a country has a low level of financial development. Jawaid and Raza (2012) examine the role of remittances in the economic growth of South Korea and the People's Republic of China and find a positive relationship in the case of South Korea but a negative relationship in the case of the People's Republic of China.

The East Asian Miracle established the role of exports in economic growth replacing the import substitution strategies globally (Paudel 2014). This experience shows that the countries with the priority of exports making the trade-friendly environment in the country adopting suitable policies have performed well in terms of economic growth. Hatemi-j (2002) states that export performance and economic growth has two-way causality in Japan using the data for the period of 1960-1999. Similarly in the Malaysian context, Sulaiman and Saad (2009), using the data for Malaysia for the period of 1960-2005, reveals the export performance has a positive and strong relationship with economic growth for both short-run and long run. Davaakhuu, Sharma et al. (2014), in the context of Mongolia, suggest that export performance has strongly contributed to economic development creating employment opportunities and increasing entrepreneurship in the country. Paudel (2014) states that trade openness with sound governance system helps to accelerate the economic growth in developing countries. Recently, Nguyen (2017) states, analyzing the long run and short-run impact of foreign direct investment and exports on the economic growth of Vietnam using Autoregressive Distributed Lag (ARDL) approach of cointegration in annual data for the period of 1986-2015, that exports have a negative impact in the economic growth of Vietnam.

Labour force is not only one of the factors of production in economics, but also the production function has a compulsory role. Therefore, economic growth is primarily known as the function of labour and capital as discussed in the study of Acemoglu (2012). Sahoo and Dash (2009), using time series data of India for the period of 1970-2006 find that labour force played important role in economic growth. Hicks, Basu et al. (2010) highlight the role of labour forces in the economic growth of China and India in a comparative perspective and suggest that both countries have maintained a reasonable growth which is dominated by the growth in labour productivity. The authors also suggest to India investing in human resources to match with China. But this is not always the case. Some studies report that labour force has a negative contribution to economic growth. For example, Shahid (2014), using time series data from

Pakistan for the period of 1980-2012 concludes that labour force has a negative contribution in the short run.

There are few studies in the context of Nepal discussing the role of different variables in economic growth. Paudel and Shrestha (2006), using annual data from Nepal for the period of 1970-2003, find that external debt has not been utilized properly, and the general assertion of the positive contribution of labour force in economic growth seems untrue in the context of Nepal. However, the study's data seems a bit older and it's to be updated looking for the recent years. Dahal (2014) studies remittances and economic growth of Nepal and suggests a mixed effect of remittances in economic growth. Uprety (2017), using annual data from 1976 to 2013 from Nepal, finds that the increasing trend of the remittances inflows discourages economic growth.

There are two main gaps in the literature review. First, the impact of these variables as an integrated form has not been tested in the context of Nepal. Some studies as stated above have attempted to examine the role of these variables mixing with other variables of their interest but even they are not updated with the latest database. Second, the role of external debt and remittances in economic growth can be with any direction, and these have not been explored in the context of Nepal recently examining the structural shifts that may be in the data.

The major aims of this paper are two folds. First, to document the external debt, remittance, export, and labour force scenario comparing with per capita income growth in the Nepalese context, then to investigate the role of these variables in the economic growth of Nepal so that more credible results can be obtained for the better policy inferences.

Major findings from this paper suggest that external debt and remittances have contributed negatively to the economic growth of Nepal indicating a symptom of Dutch Disease in the Nepalese economy, especially caused by the remittances inflows in the recent decades. The results also suggest that the debt collected after 2014 has indicated a better performance but still the sign is negative and statistically not significant. The results for exports and labour force indicate that governments of Nepal need to focus more on export performance employing the labour force in the country. I recommend that proper utilization of debt and remittances inflows should be an immediate concern of the policymakers in the country.

This article is divided into five sections. The following section highlights the trend of external debt, remittances inflows, exports, and labour force showing their flow with time and direction with per capita gross domestic product (GDP) growth. In section three, I discuss on research methodology. The estimated results have been discussed and interpreted in Section four before concluding in Section five.

External debt, remittances inflow, exports and labour force: trends

If we look at the data for external debt, remittances inflow, export value, and labour force, we feel that they follow a simple increasing trend but at different speeds and slopes. Just comparing the nominal values of these first three variables does not make that impressive sense, therefore, I have analyzed their trend based on their share in GDP expressed in percentage terms.

Figure 1 shows the shares of external debt, remittances inflows, and export values in GDP measured in percentage terms. Also, the same figure includes the data for labour force growth and per capita income growth, both measured in percent. This figure shows some important messages related to the selected economic variables and their association with economic growth. First, while comparing the debt percent of GDP we see that it has a declining trend over the selected period, that is, from about 45 percent in the 1990s, then reaches to above 50 percent until 2000s then declines to record less than 20 percent since 2010. In 2019, it has slightly increased to reach above 21 percent.

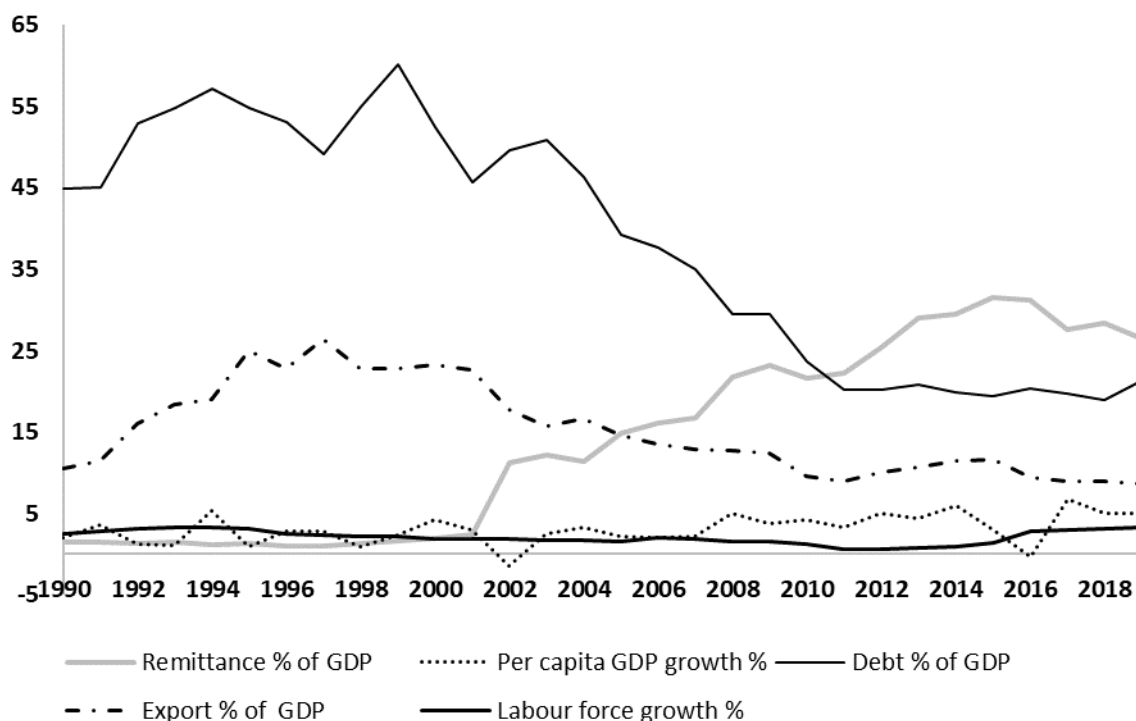


Figure 1. Debt, remittances, exports, labour force, and per capita income scenario, 1990-2019

Source: World Bank (2020)

The same figure shows the trend of remittance inflows percent of GDP. The data shows this share has been nominal until 2001, then starts increasing fastest among all stated variables. Until 2001, it shows less than two percent of GDP, then has a sharp increase in 2002 reaching above 11 percent just in one year. Picking the momentum, it reaches to above 31 percent in 2015, then there is a slight decline to reach about 27 percent in 2019. This means the remittances inflow has started a declining trend, which may be a good symptom for the national economy if the employment opportunities are created for the unskilled and semiskilled labour force in the country. A point to note is that domestic employment rather than remittance would create sustainable growth in the long run as the literature suggests discussed earlier. But it may be too early to hope in that direction until the manufacturing sector progresses, the employment for unskilled and semiskilled labour force becomes a difficult task of the economy.

The exports percent of GDP seems in the faster-declining trend touching the low base and debt percent of GDP also started a sharp decline since the same time when the remittance inflows started increasing. This point is very important when Nepal's economy shifted towards remittance based. The exports percent of GDP reached above 26 in 1997, then it had a gradual decrement until 2001. Then, this number declined to below nine percent in 2019 (Figure 1). Notably, this share was just above 10 percent in 1990, when the democratic system was restored.

The labour force growth remained largely below three percent and the maximum 3.22 percent recorded for the years 1993, 1994, and 2019. For some years, this has been bigger than per capita GDP growth that has been negative in 2002 in the selected period. The per capita GDP growth reached its peak, that is 6.8 percent, in 2017. The per capita GDP growth was below five percent in most of the years earlier than 2008 (Figure 1).

These data indicate that whatever the fluctuation is seen in debt percent of GDP, remittance percent of GDP, and exports percent of GDP; we cannot say how these ups and down in these variables have a direct impact on per capita GDP growth as the trend seems linear but very unpredictable.

1. RESEARCH METHODOLOGY

As the literature suggests that economic growth is a long-term phenomenon and is the combined efforts of the factors of production, which include, but not limited to, capital, labor force, and technology. The issue of economic growth is a complex one as diverse factors may be contributing to it. Therefore, the variables used for modeling the economic growth are not unique, and the growth model as presented in Solow (1956) has been augmented in many ways including the variables of interests.

This paper uses the variables based on growth literature including external debt, remittance inflows, export performance and labour force, and another macroeconomic variable-inflation in the alternative specification. The robustness check of the results is made employing alternative specifications of the model. To know the time-series properties of the data, first, the structural break test is performed before going to the econometrics.

1.1 Model, variables, and data

This paper employs the Solow-Swan growth model that has widely been used in the economic growth literature for a long time but in augmented form following the standard literature of the field.

Per capita GDP growth (GDPPCG), the dependent variable, is employed as the proxy of economic growth. The independent variables are debt percent of GDP (DEBTGDP), remittance percent of GDP (REMGDP), exports percent in GDP (EXPORTGDP), the growth rate of labour force (LABGROWTH), and inflation (INFL). Our benchmark model is as shown in equation (1):

$$GDPPCG_t = \alpha + \beta_1 DEBTGDP_t + \beta_2 REMGDP_t + \beta_3 EXPORTGDP_t + \beta_4 LABGROWTH_t + \epsilon_t \dots \dots \dots (1)$$

Where, α is a constant term, $\beta_1 \dots \beta_4$ are the coefficients of the independent variables, ϵ is the error term, t refers to the time period, i.e., year as we are using the annual data for the period of 1990-2019. Based on the literature, we expect all of these coefficients to be positive.

The data used in this empirical analysis are collected from the world development indicators as given in World Bank (2020) and are compiled to support the objective of this paper.

1.2 Structural break analysis

The testing structural break is kind of mandatory before estimating the empirical work while using time series data. The reason is that if there is a structural breakpoint and is ignored in the time series analysis, the findings may lead to a wrong decision and inferior inference for the policy recommendation. Noting this importance of structural break analysis, in this study, the structural break test is conducted employing Gregory and Hansen (1996) test for cointegration.

Here,

H0: no-cointegration at the breakpoint

H1: there is cointegration at the breakpoint

Table 1 shows the results for a structural break using the Gregory-Hansen method. The results detect the year 2014 has a structural break as indicated by Zt results at 5% level of significance. The year 2014 is selected as the Zt statics are significant with the lowest absolute value of coefficients where the lags are chosen by the Bayesian Information Criterion (BIC). It would be better to have similar results by all statistics but could not ignore even the H0 is rejected in only one model with intercept shift that suggests the cointegration, that is, there exhibit stable properties in the long-only with a structural break. Hence, further econometric estimations are conducted assuming the structural break in 2014 for all estimations.

Table 1. Structural Break Analysis, Gregory-Hansen Cointegration Test

	ADF		Z _t		Z _a	
	Statistics	Break Year	Statistics	Break Year	Statistics	Break Year
Intercept Shift	-6.96**	2002	-6.91**	2014	-37.07	2014
Intercept Shift with trend	-7.13**	1996	-6.85**	2014	-36.81	2014
Intercept shift with slope	-7.68**	1996	-7.00**	2015	-37.19	2015

Note: 1) **indicates the variables are significant at 5 % level of significance.

2) The results detect year 2014 has a structural break as indicated by Z_t results at 5% level of significance. The year 2014 is selected as the Z_t statics are significant with the lowest absolute value of coefficients.

1.3 Econometrics

For the econometric estimation, once the structural break is detected, the standard procedure is to conduct the cointegration test to find out the coefficients so that the relationship between dependent and independent variables can be explained. As we have the time series data with structural break and order of integration is different, the variables included in the equation (1) will be analyzed using a cointegration test based on autoregressive distributed lag (ARDL) approach, which provides both the long-run and short-run relationship of dependent variables with the independent variables irrelevance of the order of their integration (Pesaran, Shin et al. 2001, Paudel and Jayanthakumaran 2009).

Therefore, equation (1) has been modified as in equation (2) to incorporate the structural break year (SBY) and its interaction with independent variables. The SBY is a dummy variable that takes the value 0 until the year 2014 and 1 after then, and it has interacted with the independent variables. The notable point here is that the structural break story is only for the long run. In the short run, the structural break is irrelevant. Therefore, the dummy variable and interaction with independent variables are not to be included in the ARDL model for error correction model (ECM) version.

$$\begin{aligned}
 GDPPCG_t = & \alpha + \beta_1 DEBTGDP_t + \beta_2 REMGDP_t + \beta_3 EXPORTGDP_t + \beta_4 LABGROWTH_t + \beta_5 SBY_t \\
 & + \beta_6 SBY_t \times DEBTGDP_t + \beta_7 SBY_t \times REMGDP_t + \beta_8 SBY_t \times EXPORTGDP_t \\
 & + \beta_9 SBY_t \times ILABGROWTH_t + \epsilon_t \dots \dots \dots (2)
 \end{aligned}$$

The ARDL version of Equation (2) is presented in equation (3):

$$\begin{aligned}
 \Delta GDPPCG_t = & \alpha + \beta_1 GDPPCG_{t-1} + \beta_2 DEBTGDP_{t-1} + \beta_3 REMGDP_{t-1} + \beta_4 EXPORTGDP_{t-1} \\
 & + \beta_5 LABGROWTH_{t-1} + \sum_{i=1}^{30} \gamma_i \Delta GDPPCG_{t-i} + \sum_{i=1}^{30} \delta_i \Delta DEBTGDP_{t-i} \\
 & + \sum_{i=1}^{30} \theta_i \Delta REMGDP_{t-i} + \sum_{i=1}^{30} \varphi_i \Delta EXPORTGDP_{t-i} + \sum_{i=1}^{30} \lambda_i \Delta LABGROWTH_{t-i} \\
 & + v_t \dots \dots \dots (3)
 \end{aligned}$$

where, β_s refers to the coefficients of each interaction term of dummy variable and independent variable. Equation (3) captures the dynamic impact in the form of the Auto Regressive Distributed Lag Model. In the model, Δ stands for the first-order differential variable. In the equation, α is a intercept, $\beta_1, \beta_2, \beta_3, \beta_4$ and β_5 are

the coefficients of first-order variables. Similarly, $\gamma_i, \delta_i, \theta_i, \varphi_i$ and λ_i are the parameters of the error correction model, and v_t is a vector of random error.

2. RESULTS, DISCUSSIONS, AND INTERPRETATIONS

The estimated results are presented in Table 2. These results provide the base to explain the long-run relationship for the growth model of different specifications in columns (1), (2), (3), (4), and (5). Table 3 presents the results for ECM model in a similar way. These tables show the long-run and short-run coefficients of ARDL with different lags as shown in their headings for the given model. Schwartz-Bayesian Criteria (SBC) is selected due to the relatively small size of the data series. In both tables, the first column presents the results for the benchmark model in the rest of the columns for the alternative specifications of the model. In all the specifications for the long-run relationship, the F-statics (Bound) results show that the values are higher than that of the upper bound of the critical value indicating that the long-run relationships exist in all specifications.

The results in Table 2 column 1 presents the results for our benchmark model. The results show that external debt (DEBTGDP) has a strong long-run relationship indicating over the period that a one percent increase in the DEBTGDP causes to decline the per capita GDP growth on average by about 0.10 percent holding other variables in the model constant at 5 percent level of significance. Against the normal expectation, it can be summarized that the external debt has not been utilized targeting for generating income and there are rooms to improve the proper utilization of available funds in the development tasks. However, the results suggest that the contribution of debt after 2014, as indicated by the coefficient of SBY x DEBTGDP, has improved but still room to improve on the issue.

The same column reveals a more important message about the remittance inflows, that is, a one percent increase in the remittance inflows (REMGDP) causes more than one and a half percent decline in per capita GDP growth employing if the other things remain the same in the model. More importantly, as indicated by SBY x REMGDP, this negative contribution has been increased after 2014. This may indicate a type of Dutch Disease story in the Nepalese economy.

The results for other independent variables, such as exports (EXPORTGDP) and labour force growth (LABGROWTH) are not statistically significant. As can be seen in the same column, the coefficients are positive as expected but not statistically significant, meaning that they have a potential to improve so that a positive contribution for increasing per capita GDP in the future. Yes, there are rooms to improve, even as indicated by our data and Figure 1. Also, the channel of the benefits of labour force growth is linked from the remittance inflows too.

Columns 2, 3, 4 and 5 present the results for alternative specifications of results to check the robustness of the results. Our intention in doing this is to check whether the results are consistent when we add or remove the variables from the model. For this purpose, only EXPORTGDP and its interaction variable SBY x EXPORTGDP have been removed from the model and inflation (INFL) is added, and the results for DEBTGDP remain consistent and REMGDP has lost its statistical significance but still, the sign is negative as consistent with Column 1. Similarly, in Column 3, I removed EXPORTGDP, LABGROWTH, and INFL and their interaction with SBY. In this case, again the results for those main variables of interest remain consistent as of Column 1.

In Column 4, the results are for the regression of DEBTGDP and its interaction with SBY. The results are not meaningfully different, but the coefficient of the interaction term has turned to be negative. Similarly, in Column 5, the results are presented for REMGDP and its interaction with SBY. The results are consistent with the results of Column 1.

Table 3 presents the short-run results based on the error correction model (ECM). In all three specifications of the model, the coefficients for ECM (-1) are statistically significant with an expected negative sign indicating the disequilibrium that occurred in the previous year is corrected in the current year following a short-run shock at a quicker pace if the coefficients are closed to one. I did not find that impressive impact of the variables in the short run, other than REMGDP, which is statistically significant with a

negative sign. This result for REMGDP indicates that, even in the short run, the remittance (REMGDP) has contributed negatively to the per capita GDP growth.

If we check the post estimation statistics, we see that the high value of R-square confirms that the overall goodness of fit of the model is high. The diagnostic test results show that the model passes the tests for serial correlation, functional form, normality, and heteroscedasticity. Further, the stability test results (CUSUM and CUSUMSQ) plotted against the critical bounds of 5 percent level of significance are within the range, indicating that the model is structurally stable (Figures 2 and 3).

Table 2. Long run coefficients of ARDL (1 0 0 1 1 0 0 0 0 0) model for (1) and alternative specifications

<i>Dependent variable: GDPPCG-GDP per capita growth (%)</i>	(1)	(2)	(3)	(4)	(5)
DEBTGDP-Debt's share in GDP (%)	-0.13**	-0.12**	-0.10**	-0.06***	
	(0.051)	(0.055)	(0.026)	(0.022)	
REMGDP-Remittances' share in GDP (%)	-0.04	-0.08	-0.06		0.10***
	(0.063)	(0.076)	(0.071)		(0.033)
EXPORTGDP-Export's share in GDP (%)	0.09				
	(0.080)				
LABGROWTH-Labour force growth (%)	0.04	0.05			
	(0.629)	(0.723)			
INFL-Inflation (%)		0.01			
		(0.073)			
SBY-Structural break (dummy)	-412.92	148.25	46.99**	4.56	23.10**
	(352.562)	(140.653)	(19.842)	(15.134)	(10.950)
SBY x DEBTGDP	1.33	-3.47	-1.067	-0.24	
	(1.770)	(3.919)	(0.700)	(0.760)	
SBY x REMGDP	-1.68**	-2.93	-0.89***		-0.85**
	(0.683)	(2.712)	(0.339)		(0.378)
SBY x EXPORTGDP	32.48				
	(24.664)				
SBY x LABGROWTH	46.09	-1.60			
	(35.922)	(1.339)			
SBY x INFL		1.58			
		(2.540)			
<i>Number of observations</i>	29	29	29	29	29
<i>Root MSE</i>	1.439	1.541	1.447	1.724	1.486
<i>Log likelihood</i>	-43.079	-45.950	-47.180	-53.582	-49.230
<i>R-squared</i>	0.824	0.786	0.767	0.638	0.731

Note: ***, **, and * indicate that the statistics are significant at 1%, 5%, and 10% level of significance. The figures in the parenthesis are the standard error.

Table 3. ECM results, ARDL (1 0 0 1 1 0 0 0 0) model for (1), rest alternative specifications

<i>Dependent variable: GDPPCG (-1)</i>	(1)	(2)	(3)	(4)	(5)
BEBTGDP(-1)			-0.08 (0.079)	-0.09 (0.091)	
REMGDP (-1)					-0.33** (0.144)
EXPORTGDP (-1)	0.19 (0.164)				
LABGROWTH (-1)	0.44 (1.512)	0.286 (1.518)			
ECM (-1)	-1.63*** (0.276)	-1.38*** (0.252)	-1.23*** (0.174)	-1.254*** (0.200)	-1.01*** (0.168)

Note: ***, **, and * indicate that the statistics are significant at 1%, 5%, and 10% level of significance. The figures in the parenthesis are the standard error.

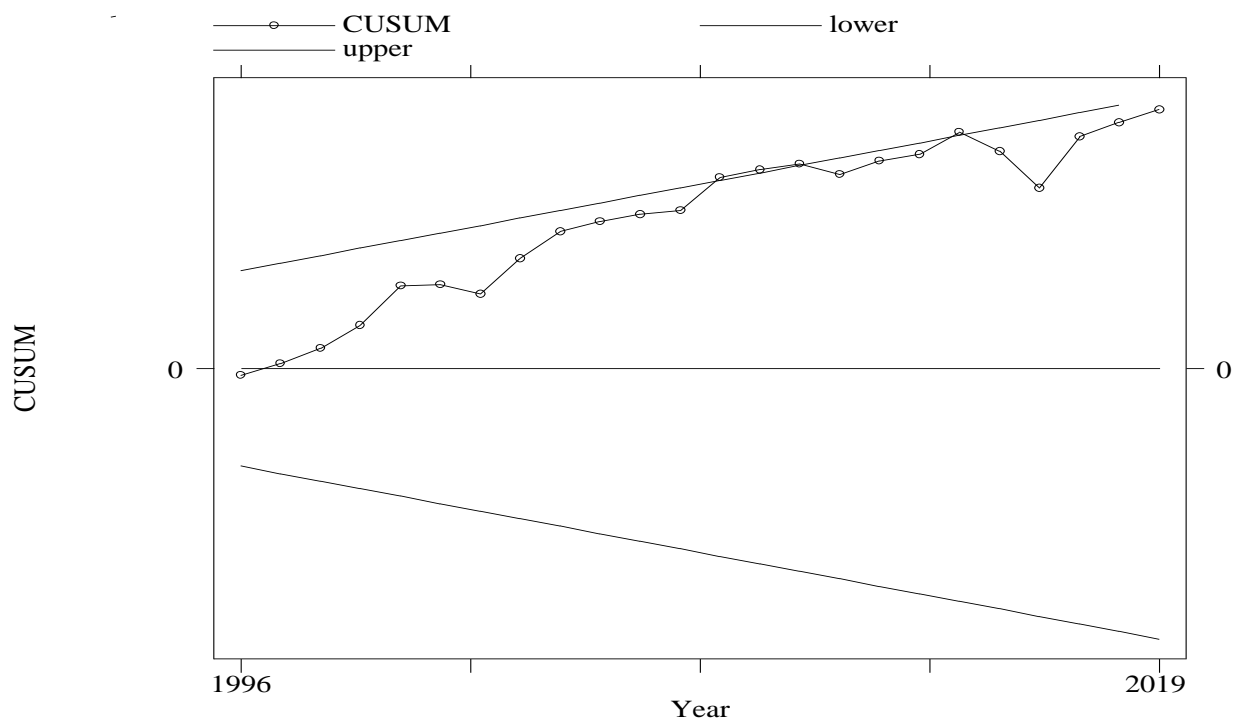


Figure 2. CUSUM upper and lower plot

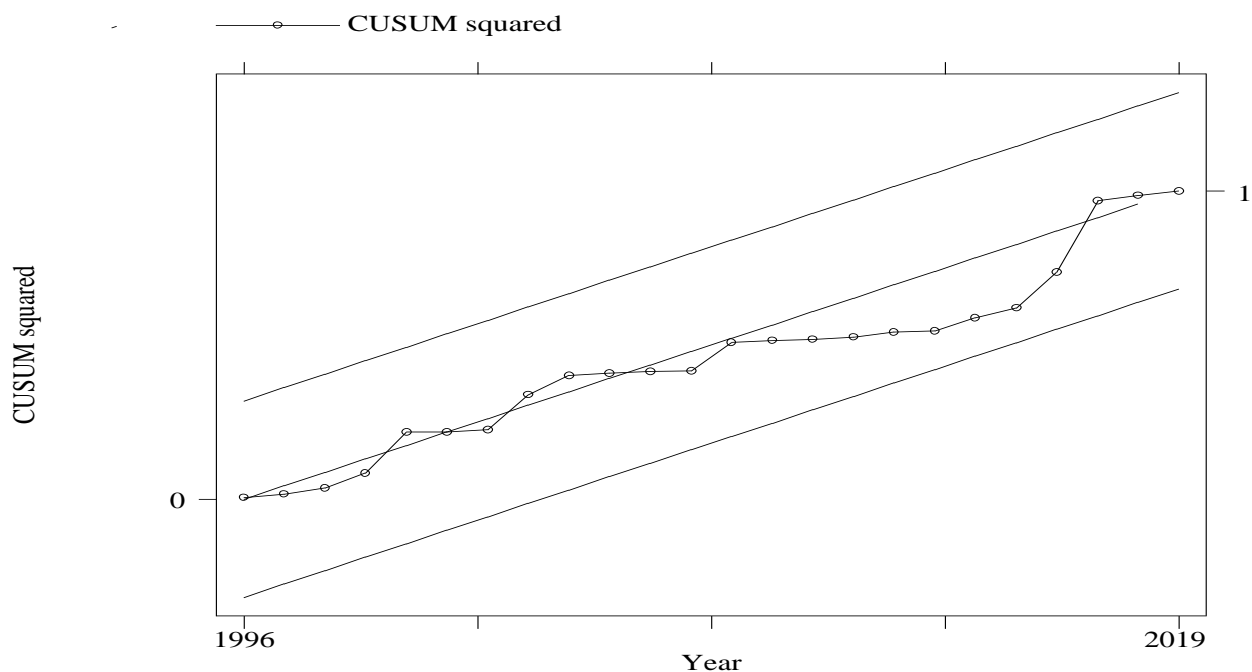


Figure 3. CUSUM squared plot

CONCLUSIONS

This study documents the brief trend of external debt, remittance inflows, exports, labour force growth, and per capita GDP, and then proceed to investigate the role of the first four variables with the last one using the ARDL approach of cointegration with structural break analysis employing a recent dataset for the period of 1990-2019. After conducting the structural break tests, we estimate the model to detect the long-run and short-run relationship among the dependent and independent variables in the model with different alternative specifications.

The external debt has a strong negative impact in the economic growth of Nepal for the period of 1990-2019. However, as suggested by the interaction term, the situation seems to be improved a bit after the period year 2014. The contribution of remittance inflows in economic growth seems strongly negative for the period after 2014. The main policy insight from these results is that Nepal needs a remarkable effort to utilize the available source for development activities so which will contribute to increasing the per capita income. One way of increasing the most effective use of such funds may be to spend in capital expenditure rather than the current expenditure as pointed by many experts and policy discussions in the country in recent years. Also, the other way of advancing the economy may be to focus on domestic employment creation to boost the exports rather than outsourcing the youths for remittance.

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