

# Remittance and Nepalese Economy

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## Abstract

*This paper explores the relationship between remittance and economic growth of Nepal during the period of three and half decades till 2010/11. The recent remittance utilization pattern reflects that 78.9 percent of total remittances are spent in daily consumption whereas 7.1 percent in repaying loans, 4.5 percent in household property, 3.5 percent in education and 2.4 percent in capital formation. The result shows that mere increasing remittance income does not support for the economic growth and development of the nation unless it is extensively used into the productive sectors. The Nepalese economy is gradually becoming consumption oriented due to remittance income that naturally leads to dependency resulting in the dearth of resource for investment. Thus, it is recommended to the government agencies for the formulation and implementation of remittance utilization policy for the enhancement of national economy.*

**Key Words:** Capital formation, Economic growth and development, Remittance income, Nepalese economy

## Introduction

Remittance is an important source of foreign income for developing countries like Nepal increasing dramatically in size over recent decades. It is a private income that is regularly or periodically transferred from international migrants to family members in their country of origin. It represents one of the largest sources of financial flows to developing countries. Foreign employment is gradually getting a major source of foreign exchange earnings and sustaining the positive balance of payment in Nepal.

International migrants send their money to the home countries through formal and informal channels. Formal channels are related to the banking channels and money transfer operators. Language barriers and lack of awareness on banking channels for transferring funds, some migrant workers may use informal channels. Therefore, it is necessary to make this sector more systematic and take additional initiative for the flow of remittance through the formal channel. It is a challenge of making institutional arrangement for imparting training and skill for raising the demand for the Nepalese labours at the international level and guides the flow of remittance to the productive sector.

Remittance income has been mostly used on domestic purpose such as managing land and building, children education, health care, entertainment and so-on. Moreover, it is used in productive and commercial sectors in some extent to operate micro and macro level business. Huge amount of capital is needed to the under-developed countries for the enhancement of productivity and bolstering economic development. Remittance income is one of the major sources of capital formation in the context of Nepal. Furthermore, migration of the unskilled workers on return to their home countries acquires practical and useful skills in abroad. The remittances have become a major issue in the international financial literature over a decade because of their increment of size and volume as well as rise in the number of migrants around the world and will likely continue in the future.

Although remittance is a considerable source of foreign exchange as they enhance the level of national income, however, it has negative macro-economic effects as it is generating dependence among the

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recipients, encouraging continued migration of the available labour force, reducing the likelihood of national or foreign investment due to an unstable or untrustworthy workforce and motivating greater inequity among rural communities. Moreover, some emigrants may be educated or highly skilled causing what commonly known as “brain drain” and this is not a good sign in the context of economic development for developing countries because home country invested time, efforts and money on their education. International migration paralyzes home countries making them dependent on remittances. Reliance on remittances distorts development and creates inequalities and disparities among the people within the country.

Nepalese economy is largely based on agriculture, however, the large number of people leaving for foreign employment has been significantly increased due to incredible number of unemployment, poor development of industrial sectors, low level of salary and earnings, lack of business environment and so-on. Millions of youth are compelled to heading for overseas seeking employment due to failure in creating employment opportunities within the country. Statistics for the last three years shows on average 250,000 people leaving the country annually for foreign employment and the number is on rise. Although foreign employment remains a major source of foreign currency for the country, in the long-run it could fall in the remittance trap. It is another challenge of engaging the youths in the nation’s development by creating employment opportunity within the country itself (Economic Survey, 2010/11).

Nepal has been experiencing continuous growth in remittance inflow since last few years and as a result its disposable income has continued to rise as well. The country’s economy is gradually becoming consumption oriented due to remittance income and other factors thereby causing hopeless plunge in savings and investment rates. Consumption to GDP that stood at 88.3 percent in FY 2000/01 has gone up to 93.3 percent by FY 2010/11. As a result, the rate of domestic savings has come down to 6.7 percent from 11.7 percent during this period. Consumption oriented economy naturally leads to dependency resulting in the dearth of resource for investment. Hence, it is another challenge of creating the foundation for economic growth through enhancement of saving and investment levels by discouraging unnecessary consumption (Economic Survey, 2010/11).

The number of companies dealing with remittance has reached to 53 where as 385 money changer firms are providing services in the country. Total number of money changer firms in Kathmandu valley has reached 193. As of mid march 2011, firms licensed to conduct forex transactions total 3,197 comprising 280 hotels, 1,126 trekking, 1,381 GSA/PSA of foreign airlines, 293 cargo couriers, 66 various organizations and 51 domestic and international airlines. Nepal Rastra Bank Remittance by-laws, 2010 has been put into practice from September 16, 2010 with the objective of making the remittance transactions more transparent and simple in regards to safely bringing in earnings of Nepalese abroad in simple, economic and secured manner (Economic Survey, 2010/11).

The objective of the study is to analyze the impact of workers' remittance on economic growth in the case of Nepal during the study period from 1974/75 to 2010/11. Foreign employment in the context of Nepal has been considered as a major economic phenomenon; however there is a major question of sustainability of Nepalese economy with the remittance economy. There are also some critical issues regarding the remittance and economic growth in the Nepalese scenario that poor utilization of remittance, excessive investment in unproductive sectors, low economic growth, limited job opportunities and the trend of brain-drain that need to be answered. The empirical findings of this study will act as a guiding instrument to the policy makers of developing countries like Nepal.

## **Review of Literature**

In a study conducted by IMF (2005) regarding the impact of remittances on growth over an extended period (1970-2003) for 101 developing countries found no statistical link between remittances and per capita output growth, or between remittances and other variables such as education or investment rates. However, this inconclusive result attributed to measurement difficulties arising from the fact that remittances may behave countercyclical with respect to growth.

Pant (2006) explored remittance inflows to Nepal: Economic impact and policy options. The remittances have been an important avenue of support for family members remaining at home. As the number of workers going abroad for employment continues to rise, the corresponding growth of remittances has become a critical flow of foreign currency into Nepal. This has been partly the result of measures undertaken by the concerned officials to streamline financial systems, dismantling controls and creating incentives, with the aim of attracting remittances particularly through the official channels. Economic growth, interest rate and exchange rate policies are crucial determinants of remittance inflows. In order to further encourage the inflow of remittances to the country through official channels, and to promote the tendency to exchange these remittances of foreign exchange into local currency, it is imperative that these policies be conducive to the inflow of remittances.

Gaudel (2006) pointed out remittance as a major source of foreign currency to the developing nation and it has become a substantial component of making current account surplus in the balance of payments. He argued that many workers from Nepal going abroad for employment are no doubt young, energetic, labourious and enthusiastic and they do hard work for earning large remittance income to support their families. However, the downside of remittances reflects the view that remaining young generation for long time outside without family may increase their vulnerability and ultimately they will have a tendency to leave their homeland. Thus, in order to recover the loss of economically active labour force to the domestic economy, they should be encouraged to come back again with skilled knowledge for utilizing their savings and working experience for development to the productive areas in accordance with the priority of the national development plans.

Srivastava and Chaudhary (2007) explored the role of remittance in economic development of Nepal. The analysis has been carried out with linear and log-linear models under multiple regressions. The impact of remittance has been seen most remarkable in the GDP and GNP both in nominal and real terms. In the nominal GDP and GNP, the remittance shows 61 percent and 72 percent impact respectively while in real term it shows 48 percent and 55 percent respectively. It has also shown positive impact on the PCI but it is comparatively low (four percent in nominal and one percent in real terms). The findings are positive except for labour force, but they are marginal which show that remittance has not been used effectively so as to increase the real growth rates of the economy.

Shrestha (2008) has analyzed the contribution of foreign employment and remittances to Nepalese economy. He concluded that remittances sent by the migrant workers are an effective tool for poverty reduction. Though foreign employment is boon to the economy, the facilities are inadequate to back up the increasing trend of migration. The government should play proactive role to promote foreign employment by inducting and adhering to the policy of economic diplomacy.

Karagoz (2009) has made an empirical research on the remittances and economic growth in the case of Turkey. The study showed that remittance flow has statistically meaningful but negative impact on growth. On the other hand, exports and domestic investments positively affect the economic growth, while foreign direct investment has no meaningful affect. Turkey which met with regular and massive labour migration to abroad after 1960s, is still one of the most remittance gain countries in the world.

Azam and Khan (2011) has empirical analyzed the impacts of workers' remittances on economic growth of Azerbaijan and Armenia's economies. The statistical analysis has been made through simple log linear regression model and the method of least square has been used. The study concluded that worker remittances are significant and have positive impacts on economic growth and development. The findings suggested that the relevant authorities of both the countries need to formulate appropriate policies in order to encourage worker remittances and such remittances must be utilized more efficiently.

Pant (2011) explored the harnessing remittances for productive use in Nepal. He concluded that remittances contribute largely to the national economy. The remittances sent home by the migrants affect development at both the household and national levels. At the household level, remittances help to reduce poverty, improve standard of living and attain higher educational levels. At the macro level, remittances could be used for entrepreneurship and productive investment which in turn increases job opportunities and income of the people. Remittance inflows help to augment foreign exchange reserves and improve the current account position.

Javid, Arif and Qayyum (2012) have analyzed an impact of remittances on economic growth and poverty. The study focused on the importance of remittances inflow and its implication for economic growth and poverty reduction in Pakistan. The empirical evidence showed that remittances affect economic growth positively and significantly. Furthermore, the study also found that remittances have a strong and statistically significant impact on poverty reduction. So, the importance of remittance inflows cannot be denied in terms of growth enhancement and poverty reduction that consequently improves the social and economic conditions of the recipient country.

The study of the literature further reveals that theoretical and empirical evidences on the impact of workers' remittances on economic development and growth have made the issue debatable because some researchers are in favour of remittances positive impacts while some negate its outcomes but a few are of the view that there are no relations between the two. However, comparatively the major portion of literature found is in favour of positive impact of workers' remittances on economic growth and development of developing countries.

### **Data Sources and Methodology**

This paper is based on the secondary data provided by different government institutions. Most of the data employed in this study were obtained from various issues of Economic Survey of Ministry of Finance, Quarterly Economic Bulletin of Nepal Rastra Bank (NRB), Banking and Financial Statistics of NRB, Economic Reports of NRB. The estimation period of three and half decade till 2010/11 has been determined largely by the availability of adequate data on all variables included in the study. Descriptive statistics, trend analysis, correlation matrix and other relevant statistical tools have been applied for the analysis of data.

### **The Remittance and Economy of Developing Nations and South Asia**

There are more than 215 million or 3 percent of the world populations are the international migrants in the world. Recorded remittances received by developing countries, estimated to be US \$ 325 billion in 2010, far exceed the volume of official aid flows and constitute more than 10 percent of gross domestic product (GDP) in many developing countries. The top migrant destination country is the United States, followed by the Russian Federation, Germany, Saudi Arabia, and Canada. The top immigration countries, relative to population, are Qatar (87 percent), Monaco (72 percent), the United Arab Emirates (70 percent), Kuwait (69 percent), and Andorra (64 percent) (The World Bank, 2011).

High-income countries are the main source of remittances. The United States is by far the largest, with \$48 billion in recorded outward flows in 2009. Saudi Arabia ranks as the second largest, followed by Switzerland and Russia. In 2010, worldwide remittance flows are estimated to have exceeded \$440 billion. From that amount, developing countries received \$325 billion, which represents an increase of 6 percent from the 2009 level. The true size, including unrecorded flows through formal and informal channels, is believed to be significantly larger (The World Bank, 2011).

In 2010, the top recipient countries of recorded remittances were India, China, Mexico, Philippines, and France. As a share of GDP, however, smaller countries such as Tajikistan (35 percent), Tonga (28 percent), Lesotho (25 percent), Moldova (31 percent), and Nepal (23 percent) were the largest recipients in 2009.

**Table 1: Top Ten Remittance Recipient Countries in the World**

2008		2009		2010	
Country	% of GDP	Country	% of GDP	Country	\$ billions
Tajikistan	49.55	Tajikistan	35.1	India	55
Tonga	37.73	Tonga	27.7	China	51
Moldova	31.37	Lesotho	24.8	Mexico	22.6
Kyrgyz Republic	27.88	Moldova	23.1	Philippines	21.3
Lesotho	27.33	<b>Nepal</b>	<b>22.9</b>	Bangladesh	11.1
Samoa	25.79	Lebanon	22.4	Nigeria	10
Lebanon	25.05	Samoa	22.3	Pakistan	9.4
Guyana	24.04	Honduras	19.3	Lebanon	8.2
<b>Nepal</b>	<b>21.62</b>	Guyana	17.3	Egypt	7.7
Honduras	20.06	El Salvador	15.7	Vietnam	7.2

Source: The World Bank: Migration and Remittances Fact book 2011.

Nepal is the highest remittance recipient country in terms of percent of GDP in 2009, having 22.9%. It shows the the Nepalese economy is largely dependent on the remittance. Since a large number of Nepalese are employed in foreign lands, a substantial amount of remittance is sent to Nepal. This heavy reliance in foreign employment has shifted the Nepalese economy from an agriculture based economy towards remittance-based economy. As per the size of US dollar (in billions), India is the top remittance recipient country in the South Asia where as Nepal lies in the fifth position and had received US \$ 3.5 billion in 2010.

**Table 2: Top Five Remittance Recipient Countries in South Asia**

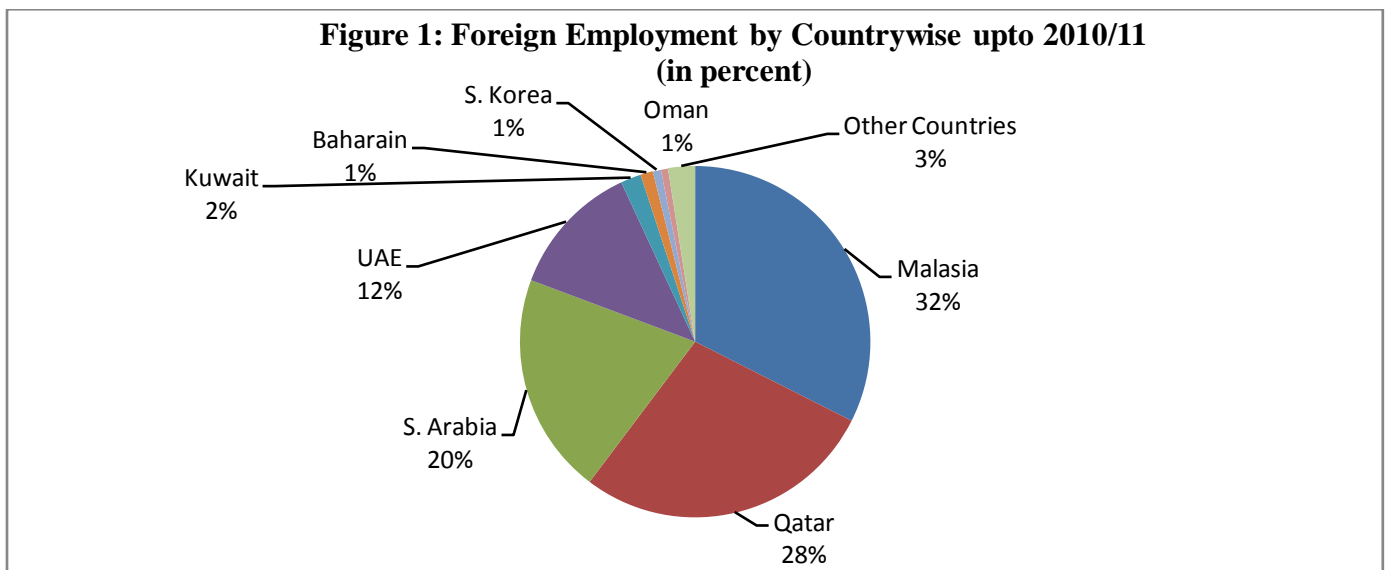
2009		2010	
Country	Percent of GDP	Country	Amount (\$ billions)
<b>Nepal</b>	<b>22.9</b>	India	55
Bangladesh	11.8	Bangladesh	11.1
Sri Lanka	7.9	Pakistan	9.4
Pakistan	6	Sri Lanka	3.6
India	3.9	<b>Nepal</b>	<b>3.5</b>

Source: The World Bank: Migration and Remittances Fact book 2011.

## The Trend of Foreign Employment in Nepal

The country has not been able to generate enough employment opportunities for the labour force entering the labour market every year. This has increased unemployment rate in the country on one hand, while millions of youth are flying overseas for foreign employment on the other. Hence, providing employment opportunities to the available human resource is a big challenge.

Nepalese youth are attracted to foreign employment due to dearth of adequate employment opportunity in the country. The number of Nepalese workers going for foreign employment is growing every year. According to various reports, large numbers of Nepalese workers have gone for foreign employment without securing government permission as well. Based on the official and unofficial records as of now, more than 3 million people have gone for foreign employment. The foreign employment has supported in bringing economic prosperity in rural Nepal and reducing poverty. The contribution of foreign employment to reducing unemployment situation and poverty and enhancing Nepalese economy should be considered significant (Economic Survey, 2011/12).

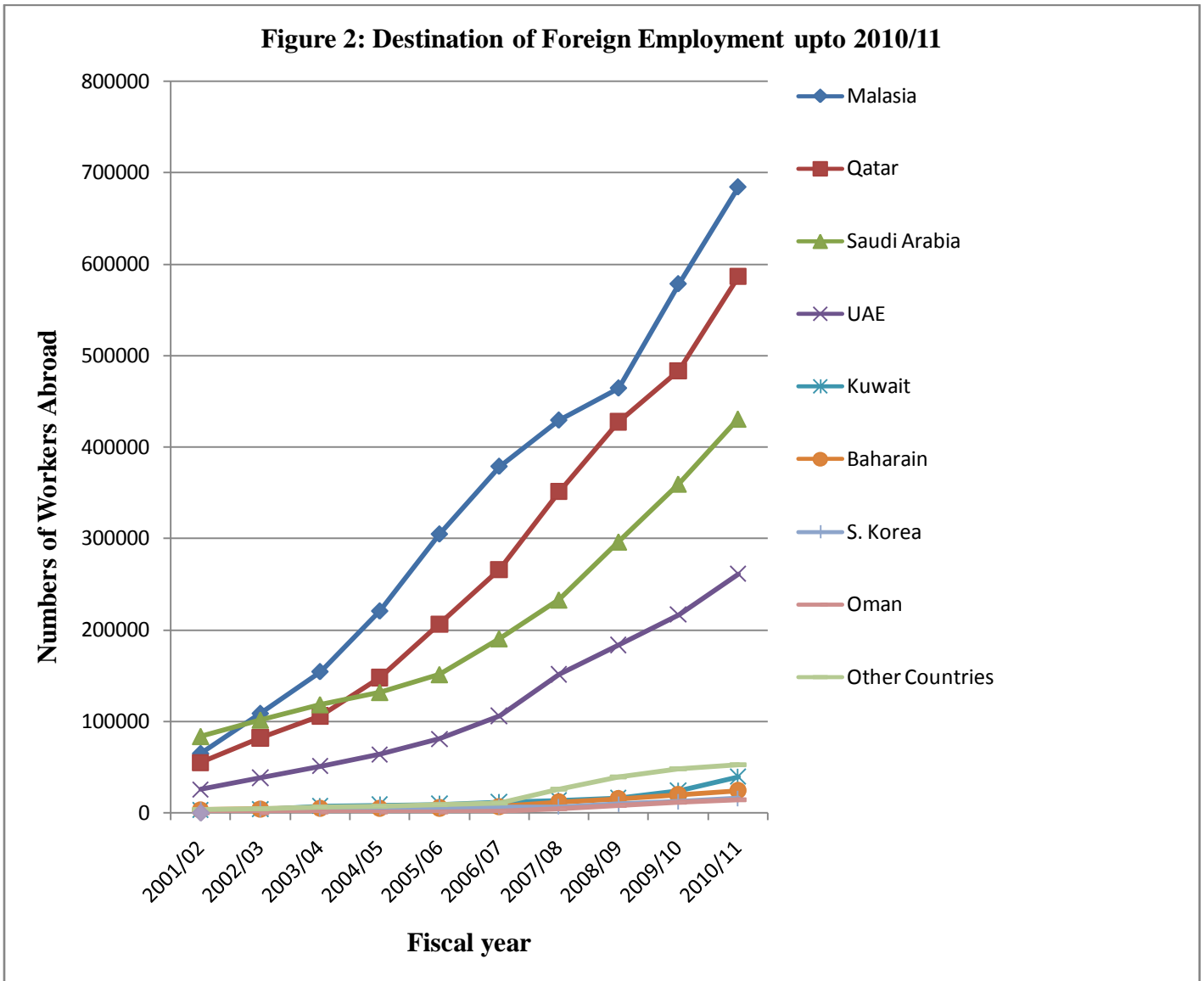


Source: Economic Survey, 2010/11

Of the total 2,358,710 Nepalese workers going for foreign employment, Malaysia happens to be the first destination providing foreign employment to 742,363 (32 percent) Nepalese workers followed by Qatar with 661,555 (28 percent), Saudi Arab with 478,716 (20 percent), and UAE with 301,072 (12 percent). Likewise, 55,222 (2 percent) are in Kuwait, 28,723 (1 percent) in Bahrain, 17,674 (1 percent) in South Korea, 13,944 (1 percent) in Oman and 57,089 (3 percent) in other countries.

The main reasons behind the foreign employment is due to lack of employment opportunities within the nation, political instability, the low salary structure, government liberal policy and higher demand for the labour in the industrialized Asian and middle-east countries. The hordes of Nepalese youth have migrated overseas to seek employment opportunities in Middle East countries, Malaysia, and South Korea and others. Almost all of the blue collar workers and most of educated Nepalese people living and working abroad have immediate family members in Nepal. Blue collar workers, who invariably come from poor family and are sole bread winner, have to send money back home to support their family. Most of Nepalese students who have gone abroad (United States, United Kingdom, and Australia etc) for higher studies have decided not to return back to because of lack of opportunities.

**Figure 2: Destination of Foreign Employment upto 2010/11**

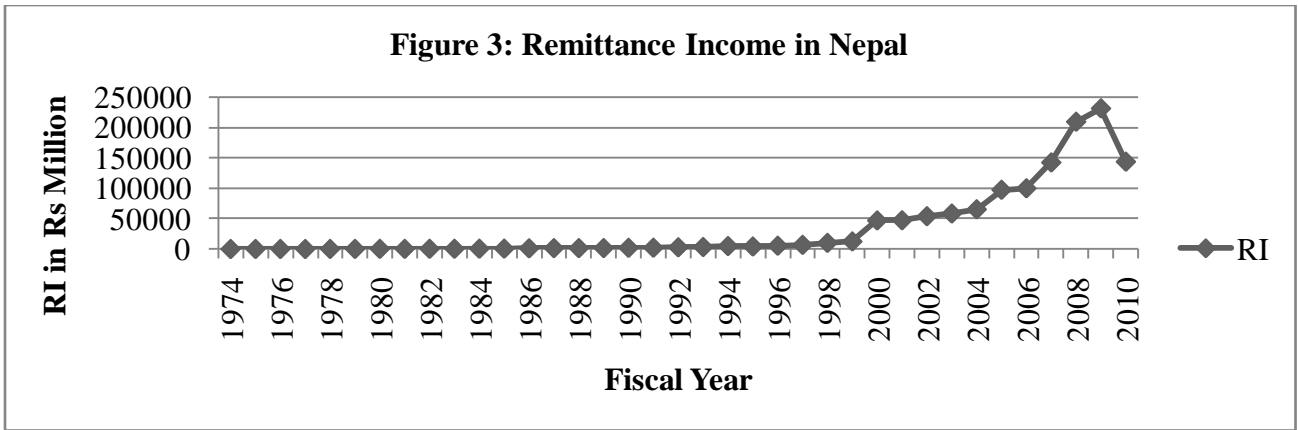


Source: Economic Survey, 2010/11

### The Remittance and Nepalese Economy

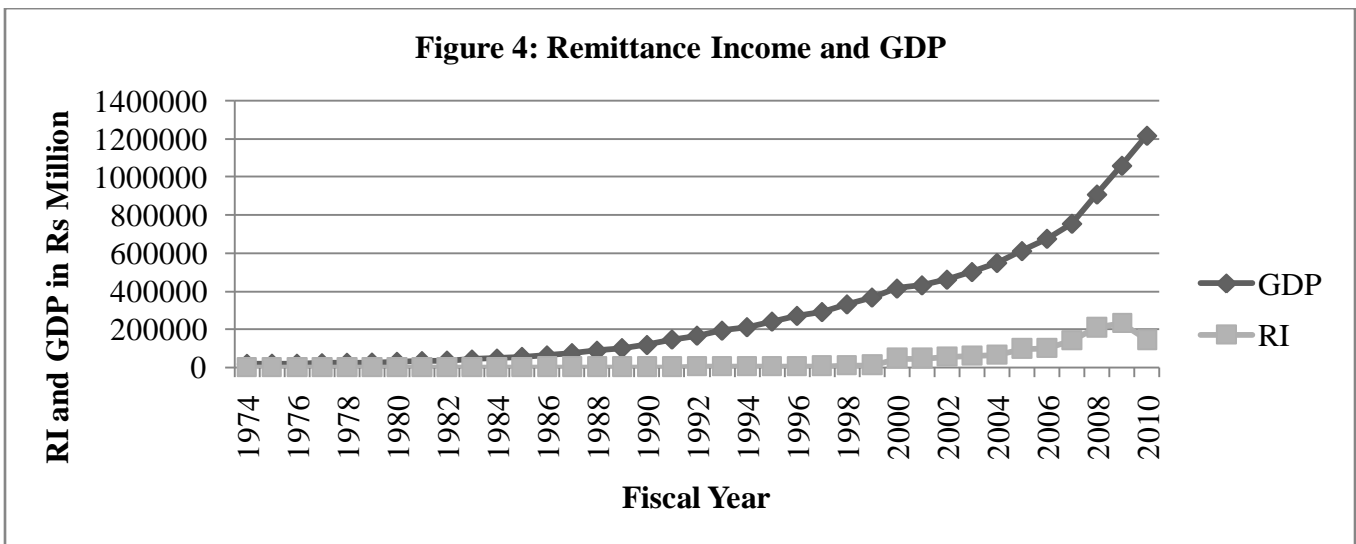
The remittance income in Nepal was Rs. 204.3 million in 1974 and Rs. 809.1 million in 1985. It was drastically increased from Rs. 12,662.3 million in 1999 to Rs. 47,216.1 million in 2000. The remittance income remained below Rs. 50,000 million till the 2001. The trend of remittance income has been dramatically increased over the recent decades till the 2009 but sharply fall in 2010.

The trend of remittance income in Nepal has been depicted through the figure 3. The average remittance income is Rs. 34,223 million and standard deviation is Rs. 60,227 million. The correlation between remittance income with GDP, gross capital formation, total merchandised exports and foreign exchange earned through tourism is significant with positive correlation.



Source: Economic Survey, 2010/11

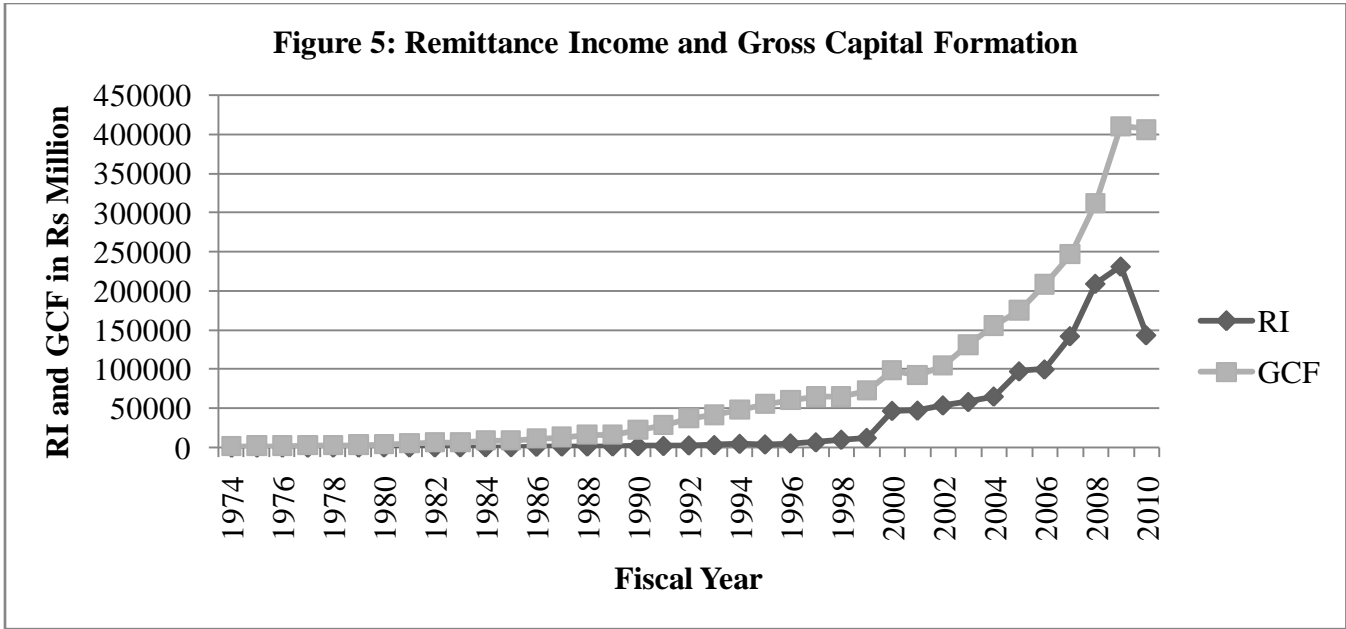
The remittance income and GDP has been depicted through the figure 4. The average GDP is Rs. 2,85,767 million and standard deviation is Rs. 3,15,121 million. The correlation between remittance and GDP is significant.



Source: Economic Survey, 2010/11

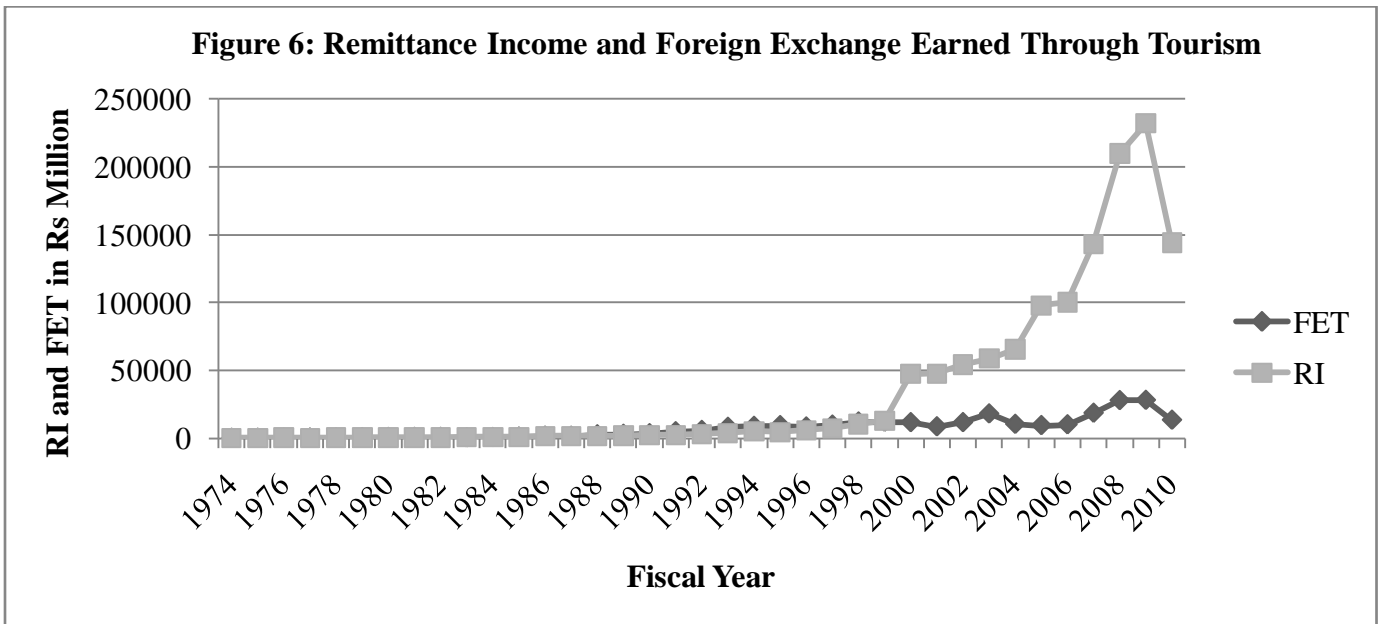
The remittance income and gross capital formation has been depicted through the figure 5. The average gross capital formation is Rs. 80,149 million and standard deviation is Rs. 1,09,294 million. The correlation between remittance and gross capital formation is significant. There is positive correlation between them. Similarly, the correlation between GDP and gross capital formation is significant and positive correlation.





Source: Economic Survey, 2010/11

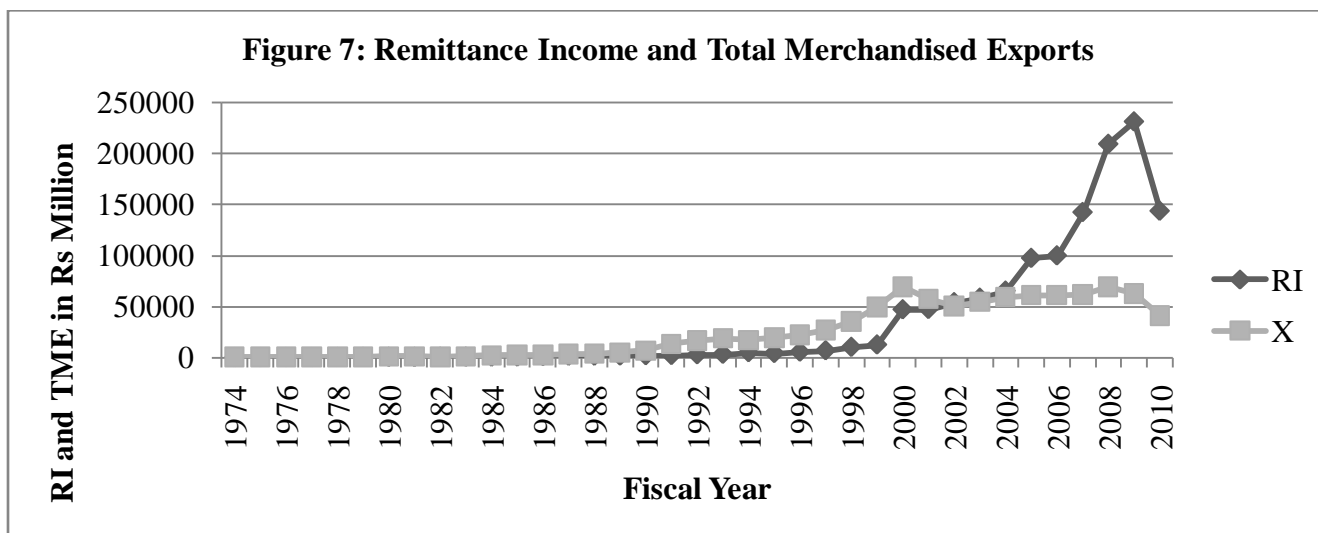
The remittance income and foreign exchange earned through tourism has been depicted through the figure 6. The average foreign exchange earned through tourism is Rs. 7,268 million and standard deviation is Rs. 7,336 million. The correlation between remittance and foreign exchange earned through tourism is significant. There is positive correlation between them. Similarly, the correlation between GDP and foreign exchange earned through tourism is significant and positive correlation.



Source: Economic Survey, 2010/11

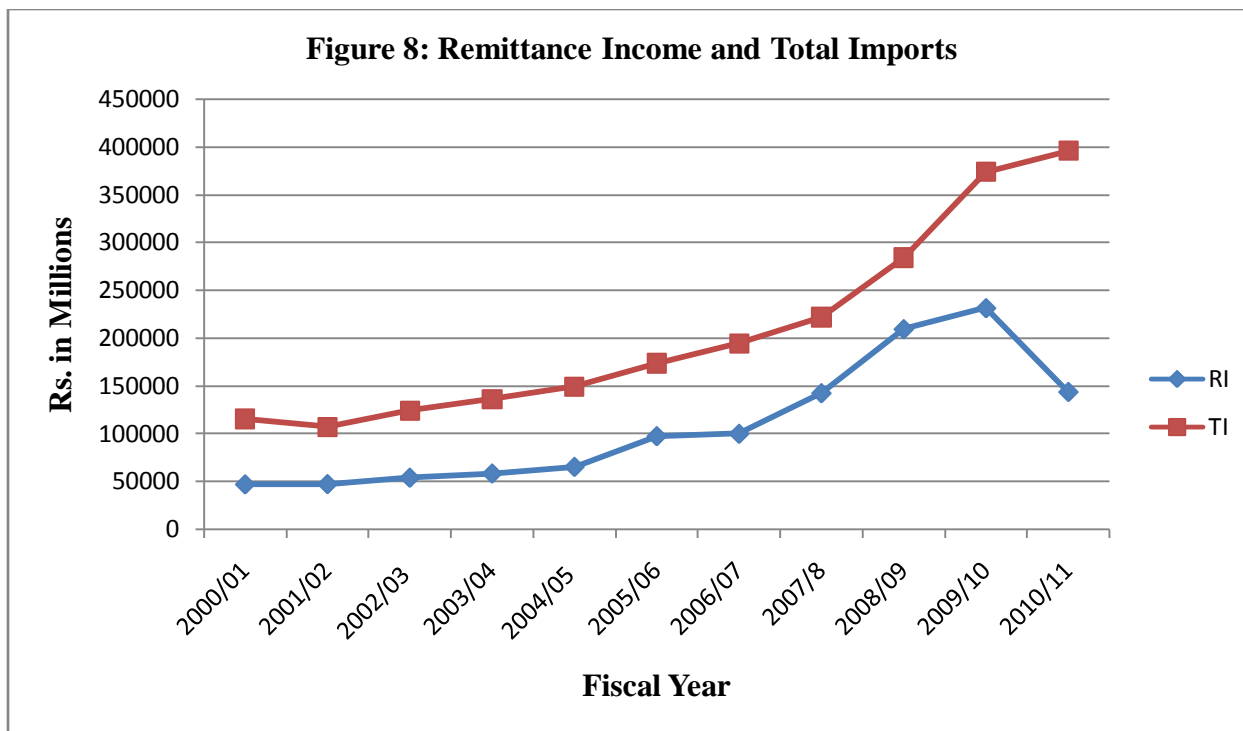
The remittance income and total merchandise exports has been depicted through the figure 7. The average total merchandise exports is Rs. 24,843 million and standard deviation is Rs. 25,485 million. The correlation between remittance and total merchandise exports is significant. There is positive correlation

between them. Similarly, the correlation between GDP and total merchandise exports is significant and positive correlation.



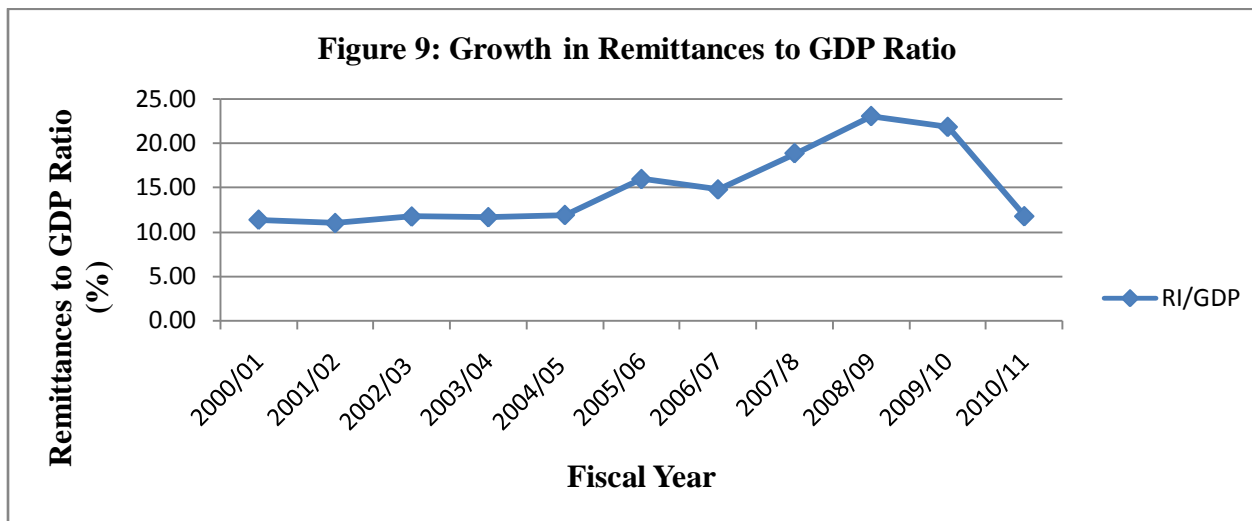
Source: Economic Survey, 2010/11

The excessive liquidity in the financial system due to remittance and lack of other investment opportunities in the nation leads the investment into the unproductive sectors. Remittances are generally not intended to serve as investments but rather as social insurance to help family members finance the purchase of life’s necessities. Remittance led consumption growth in Nepal has also increased our overall import in recent years. As a result, the Nepalese economy has been gradually becoming consumption oriented due to remittance income that naturally leads to dependency resulting in the dearth of resource for investment.



Source: Economic Survey, 2010/11

The remittance and its contribution on national economy can be measured with remittance to GDP ratio that has been presented in figure 9. The contribution of remittances to the GDP has been ranging through 11% to 23% during the period of 2000/01 to 2010/11. The remittance to GDP ratio was higher in 2008/09 (23.06%) but sharply decreased in 2010/11(11.81%). This ratio is relatively higher as compared to other South Asian countries.



Source: Economic Survey, 2010/11

### Investment Climate and Remittance

The inadequate investment climate is one of the factors for decreasing private sector investment and that ultimately confined the job opportunity in the nation. As a result, people are compelled to go for international migration and that enhances the level of remittance income in the home country.

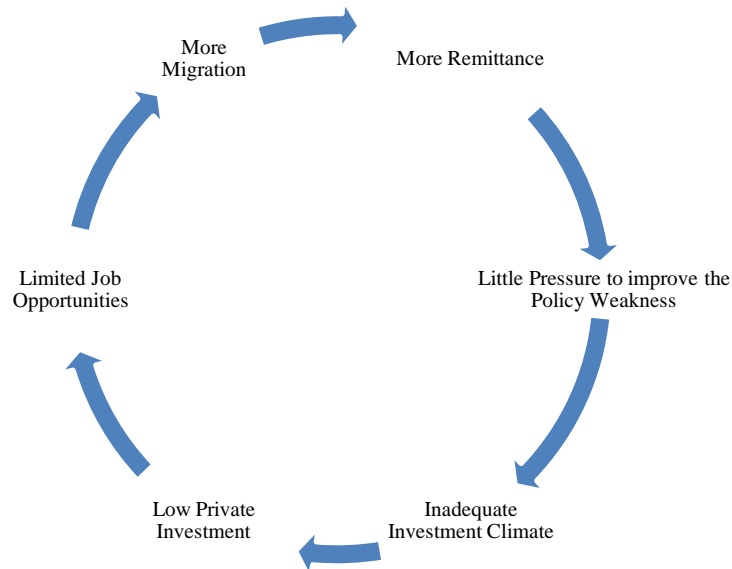
Remittances can produce long term impact only if it is channeled into productive investment. Going with the current trends of consumption in Nepal, if the remittances are soaked up by consumption only and are not turned into investments, the short term boost provided by it in the economy will not be sustainable. Productivity will decline and the economic choices get tougher if the situation is not addressed in time and is stalled being momentarily content with the remittance based income. Unfortunately these remittances are not properly channelized and people have failed to use remittance in a productive manner.

Nepal Living Standards Survey (2011) reflects that 78.9 percent of total remittances are spent in daily consumption whereas 7.1 percent in repaying loans, 4.5 percent in household property, 3.5 percent in education and 2.4 percent in capital formation. This is also largely related to the investment environment of Nepal. It is one of the serious issues for the improvement of the investment scenario of Nepal to encourage more capital formation.

Without remittances being used in capital formation, the symptom of “Dutch Disease” is inevitable. Due to increase in revenues from remittances, the currency of a country becomes stronger compared to that of other nations resulting in exports becoming more expensive for other countries to buy. This can make the manufacturing sector less competitive. Thus, with the increase in the purchasing capacity of households receiving remittance, there is high demand of consumption and imported goods. There has been an appreciation of real exchange rate due to rise in the price of non-tradable with respect to tradable. Furthermore, there has been an erosion of manufacturing sector entailing to their reduced competitiveness. The phenomenon of “Dutch Disease” basically explains a vicious policy cycle as explained by the figure

below and this can be a major challenge for the Nepalese economy in the coming days (Samridhhi, The Prosperity Foundation, 2011).

**Figure 10: Remittance and Investment Climate**



### **Concluding Remarks**

Nepal has been experiencing continuous growth in remittance inflow since last few years and as a result its disposable income has continued to rise as well. As per the Nepal Living Standards Survey (2011) 78.9 percent of total remittances are spent in daily consumption whereas 7.1 percent in repaying loans, 4.5 percent in household property, 3.5 percent in education and 2.4 percent in capital formation. The Nepalese economy is gradually becoming consumption oriented due to remittance income and other factors thereby causing hopeless plunge in savings and investment rates. Consumption oriented economy naturally leads to dependency resulting in the dearth of resource for investment. Consumption oriented remittances have only increased our reliance on imports. Even if a fraction of remittance gets channeled towards productive sectors such as infrastructure development, it can have multiplier effects and push economic growth to a higher level.

The government should develop appropriate training and education programs to assist returning migrants or remittance receipts in making effective investment decision. Moreover, the appropriate infrastructure should be developed to generate favourable investment climate and be complement investments out of remittances. The capital, skills and technology which migrant workers bring back home are among the most valuable gains from foreign employment that should be properly utilized by the government. The result shows that mere increasing remittance income does not support for the economic growth and development of the nation unless it is extensively used into the productive sectors. Thus, it is recommended to the government agencies for the formulation and implementation of remittance utilization policy for the enhancement of national economy.

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**Appendix 1: Data Series Used in the Research.***(In Rs Millions)*

Year	GDP	RI	GCF	FET	X
1974	16571	204.3	2223	170.6	889.6
1975	17394	231.3	2443	209.9	1185.8
1976	17280	268.3	2580	288	1164.7
1977	19732	219.4	3294	363.2	1046.2
1978	22215	303.1	3263	497.1	1296.8
1979	23351	357.3	3681	636.8	1150.5
1980	27307	484.2	4299	773.4	1608.7
1981	30988	427.1	5465	841.5	1491.5
1982	33761	549.7	6576	844.2	1132
1983	39390	614.1	6907	561	1703.9
1984	44441	690	9386	735.4	2740.6
1985	53215	809.1	9431	1071	3078
1986	61140	1292.6	11825	1740.5	3011.4
1987	73170	1608.4	13414	1675.7	4114.6
1988	85831	1628.6	16392	2735.3	4195.3
1989	99702	1747	17002	3121.2	5156.2
1990	116127	2128.3	22780	3587.6	7387.5
1991	144933	2316.5	29277	5016.9	13706.5
1992	165350	2994.3	37278	5966	17266.5
1993	191596	3469.1	42032	8251.7	19293.4
1994	209976	5063.6	48370	8973.2	17639.2
1995	239388	4283.6	56081	9521.2	19881.1
1996	269570	5595	60794	8523	22636.5
1997	289798	6987.8	65375	9881.6	27513.5
1998	330018	10314.6	65269	12167.8	35676.3
1999	366251	12662.3	73324	12073.9	49822.7
2000	413428	47216.1	98649	11717	69788.5
2001	430396	47536.3	93019	8654.3	57983.5
2002	460325	54203.3	105383	11747.7	50760.7
2003	500699	58587.6	131671	18147.4	55228.3
2004	548485	65541.2	155907	10464	59956.1
2005	611118	97688.5	175633	9556	61482.4
2006	675859	100145	208779	10125	61488.4
2007	755257	142683	247272	18653	61971.1
2008	909309	209699	312810	27960	69906.8
2009	1060881	231725	410725	28139	63177.5
2010	1219116	143959	406919	13510	41673

*Source: MOF, Economic Survey, 2010/11.*

## Appendix 2: Correlations between GDP, RI, K and X

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	GDP	RI	K	X	FET	Mean (Rs. Millions)	Std. Dev. (Rs. Millions)
GDP	1	.924**	.984**	.852**	.877**	285767	3.151E+05
RI	.924**	1	.959**	.769**	.858**	34223	6.023E+04
K	.984**	.959**	1	.776**	.854**	80149	1.093E+05
X	.852**	.769**	.776**	1	.859**	24843	2.549E+04
FET	.877**	.858**	.854**	.859**	1	7268	7.336E+03

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*\*\*Correlation is significant at the 0.01 level (2-tailed).*

*Source: MOF, Economic Survey, 2010/11 and authors' calculation.*