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PAPER

Issues on Private Foreign Remittances Influence on the Economy

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Abstract For the most of developing countries foreign private remittances are not only the most important sources of disposable income forming but also in some cases form more strong channel of foreign currency inflows than participation in the international trade, foreign aid and foreign private investments. Remittances are the form of resource movement from developed countries to developing, significance of which increases every day. They potentially could become a pillar for the development of the financial sector in the recipient country, partly transforming into savings and entering on the financial market through formal credit channels. The study focuses on the main effects created by the foreign remittances and makes an attempt to analyze the short-term and long-term influence on the recipient countries economies.

Keywords Remittances - International migration - Exchange rate – Dutch disease

JEL classification F24

International economic integration is traditionally associated with the growing openness of the goods and services trade as well as with the unprecedented growth of capital flows volume. The integration processes, which take place in the 21st century, are often opposed to the globalization wave, but both of these processes are accompanied with large flows of international migration. It is necessary to mention that the strengthening of international migration flows is the main characteristics of the current globalization stage and the labor movement affects the international economy strongly. As an illustration of this fact we can mention the strong growth of foreign remittances flows to the most of developing countries, which are the main source countries of migrants' flows. The first decade of the 21st century is marked by the increasing role of private remittances in the total international capital flow. For most of the developing countries private remittances represent a significant part of international capital flows, exceeding even incomes from exports, FDI and foreign aid in absolute terms and in a percentage to GDP as well.

Private remittances flows to developing countries have been growing constantly in the recent thirty years and today their volume exceeds 325 billion dollars. As a comparison, in 1975 their volume was 2.9 billion, and in 2003 – about 100 billion. The volume of officially recorded remittances that are directed to the developing countries was larger than the volume

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of ODA and was about two thirds of FDI volume. Besides, according to the 2009 data private remittances are about of 2% of the developing countries total GDP.

Foreign remittances are a multifaceted and extensive phenomenon because of their effects on a wide range of macroeconomic indicators. It is interesting that their influence on the recipient country is ambiguous and predetermined by such factors as the poverty level in the recipient country, its' migration policy, monetary policy regime, currency regime, the level of trade relations liberalization and others.

Private remittances have both negative and positive impact on the recipient country economy. Beyond the positive characteristics we can mention first of all, that remittances affect positively population income in the short-run through the increase of the disposable income of the recipient country households. These benefits extend to the whole economy through the multiplier effect, because at least part of remittances are spent on the goods and services produced in the country[1]. According to the assessments that were made during the researches of the countries that are the biggest recipients of foreign remittances, the value of multiplier in these countries varies from 1.24 (research of Bangladesh by Stahl and Habib[2]) to 3.2 (research of Mexico by Adelman and Taylor[3]).

A cross-country analysis also confirms the fact of positive influence of remittances on poverty level lowering. Adams and Page[4] found out that 10% growth of population results in a 1.9% decrease of the population share that live on less than 1 dollar a day. Also they have discovered that 10% growth of remittances per capita leads to a poverty level lowering to 3.5% due to a multiplier effect on the GDP growth[5].

In contrast to other capital flows private remittances are less volatile and cyclical and demonstrate counter-cyclical behavior in the periods of slump. In the periods of world crises their volumes decrease less than volumes of other capital flows and the processes of recovery after crisis are much shorter.

Remittances lead quite easy to an increase of tax incomes of the state budget, increase of reserves in foreign exchange and to short-run economic growth as well.

But, in spite of all the abovementioned positive characteristics, private remittances have a significant negative influence on the recipient country.

First, they decrease recipients' motivation to increase a labor supply. Individual labor supply decreases because of additional income arising from the remittances. Decreasing labor supply leads to an increase of nominal costs of all the firms. In addition, growth of the aggregate demand, rising from the remittances flows, partly goes to non-tradable goods and services consumption, that, in its turn, creates an inflation pressure on the economy. An increased supply of foreign currency as a result of remittances inflow leads to a nominal exchange rate appreciation. Thus, remittances lead to a real exchange rate appreciation, which, in its turn, affects quite negatively competitiveness of exports and results in a Dutch disease of the economy. The Dutch disease impacts all the spheres of economy, leads to distortions both in a real and money sectors, affects negatively the external competitiveness of the country, decreases the economic growth rates.

1 Chami, Ralph, Connel Fullenkamp, and Samir Jahjah. 2003. "Are Immigrant Remittance Flows a Source of Capital for Development?" IMF Working Paper WP/03/189.

2 Stahl, Charles W., and Ahsanul Habib. 1989. "The Impact of Overseas Workers' Remittances on Indigenous Industries: Evidence from Bangladesh." The Developing Economies, Vol. 27. pp. 269–85.

3 Adelman, Irma, and J. Edward Taylor. 1992. "Is structural adjustment with a human face possible? The case of Mexico." Journal of Development Studies, 26. pp. 387-407.

4 Page, John and Adams, Richard H. 2003. "International Migration, Remittances, and Poverty in Developing Countries". World Bank Policy Research Working Paper №.3179.

5 See ref. 4.

Besides, from the point of view of a of number researchers, the Dutch disease arising from the foreign remittances is the most difficult to manage and overcome as initially it is difficult to manage and govern its cause – foreign remittances.

The issue of the long-run influence of remittances of the recipient country still remains open. Long-run impact of private remittances consists of a mixed set of negative (competitiveness losses as a result of the real exchange rate appreciation and increased labor cost, decrease of the human capital stock because of the "brain drain", postponed structural reforms, increase in the external dependency) and positive effects (raised savings, investment in a real and human capital).

Taking into account all the above mentioned, we can conclude that recipient countries faced an important objective of effective management of remittances flows to maximize the benefits from the positive effects and neutralize and minimize negative ones. It means running such economic policy that will stimulate private savings and investment and facilitate the effectiveness of remittances use. It means that individuals who receive remittances should have stimulus to use them to run new businesses, renew human capital by the increasing expenses on public health and education and making savings through the formal financial institutions.

But it will be possible only in the presence of the corresponding investment climate. And as the investment climate includes tax system, labor market regulation, corruption level, economy monopolization level, property rights and contract enforcement, we suppose that the solutions of problems that arise from migration and remittances requires a complex set of activities that will cover all the above mentioned components. Besides, recipient countries have to run an adequate monetary policy and also a policy in the sphere of production which will have an objective to compensate the exporters' competitiveness losses in a consequence of wages growth and real exchange rate appreciation.

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