CHAPTER 9.

WHAT IS THE MACROECONOMIC IMPACT OF INTERNATIONAL REMITTANCES ON THE HOME COUNTRY?

by

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Introduction

Migration has become a central feature of the current international economy. In the year 2000, around 175 million people were residing outside their country of birth or citizenship – 3% of the world's population.[2] Globalisation has led to the increase in labour movements between labour markets across national borders. In addition, natural disasters and political instability have pushed many more people to leave their countries of origin in search of safer environment. As a result, the scale of international migration has increased and has led to an unprecedented increase in financial flows.

Remitted earnings constitute the most visible consequences of labour migration. The recent World Bank study, *Global Development Finance 2003*, highlighted the fact that remittance flows were the second-largest source, behind FDI, of external funding for developing countries. In 2001, workers' remittance receipts of developing countries stood at USD 72.3 billion or 1.3% of their combined GDP, much higher than total official flows and private non-FDI flows, and 42% of total FDI flows to these countries. Flows of remittances are usually larger than those of official development assistance.

Remittances are also a more reliable and stable source of income, and tend to fluctuate less with economic cycles: for example, they continued to rise during the Asian financial crisis even when flows of FDI fell. In fact remittances tend to increase in times of economic hardship because families depend on them as a principal income source, and because more people are likely to emigrate for work during such times. Better-off migrants who invest in their home countries are also less likely to be discouraged by adverse economic conditions than foreign investors. These remittance figures only refer to official transfers. In some countries it is thought that only around half of remittances

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2. UN Population Division: International Migration 2002 (New York, 2002).

pass through official banking channels, since migrants are discouraged from using them by cumbersome procedures, high fees and poor rates of exchange. Allowing for the funds that do not travel through formal banking channels, the global annual flow of remittances to developing countries probably already exceeds USD 100 billion.[3]

However, there is a huge debate on the impact of remittances in the home countries. Remittances may potentially have similar effects to other windfall revenues such as oil revenue or foreign aid. The main difference is that remittances are received by the households and not by the government. Consequently, they are private transfers, unlike other windfalls where government can decide where and how they may be spent. As such, their impact on the macroeconomy may be different, since they also affect households directly.

To be able to examine the impact of remittances on the macroeconomy, the following questions need to be answered: 1) how much are remittances in absolute terms and relative to exports and GDP? 2) which households, belonging to which segments of the income distribution, are the most affected? 3) what are the amounts repatriated being used for? 4) are remittances used for investment or consumption?

The theoretical macroeconomic impact of remittances

In theory, windfall revenues can lead to the *Dutch disease*, *i.e.* real exchange rate appreciation, inflation and the decline of the traded sector. If the exchange rate is fixed, the conversion of the foreign currency into local currency would increase the country's money supply and pressure from domestic demand would push up domestic prices. This would amount to an appreciation of the real exchange rate which weakens the competitiveness of the country’s exports and hence causes its traditional export sector to shrink. In reality, the extent to which countries experience those symptoms depends on the steps taken by the government to ameliorate those effects. In fact, the impact of remittances varies over time and across countries. In the rest of this chapter the focus will be on the case of Egypt.

The case of Egypt

Egypt has been a major labour exporter since the early 1970s, exporting both educated and uneducated labour – with around 10% of the labour force working overseas, mainly in the Gulf States, or 2-3 million workers at any point in time. After the oil boom of 1973, the Gulf oil-exporting countries found their development plans constrained by labour shortages, and embarked on importing large numbers of workers from neighbouring countries. At the peak, the Gulf States were importing 90% of their labour force. Between 1975 and 1995, 5 million foreign workers have migrated to the Gulf Co-operation Council (see Girgis, 2002). During the 1970s and 1980s, Arab neighbouring countries were the main labour exporters to the GCC. By the end of the 1980s and in the 1990s, Arab workers were replaced by Asian nationals. In the 1990s, Egyptian outflows of workers continued though at a lower scale. Given, the labour and migration laws in the GCC and fixed term contracts, an important feature of migration from Egypt to the neighbouring Arab countries is its temporary nature, thus making Egypt an interesting case study. The high imported labour turnover and the scale of migration have resulted in

3. World Bank estimates, *Global Development Finance 2003*.

huge inflows of remittances to Egypt, and other labour-exporting countries in the region, such as Jordan and Yemen. Estimates of official remittances from the Gulf countries have been around USD 70 billion during the last three decades.

Egypt is amongst the highest ten countries receiving remittances in the world as, is shown in Table 9.1. Remittances to Egypt peaked in 1992, amounting to USD 6.2 billion and have been around USD 3 billion during the last few years.

The state tried to increase the share of remittances entering through legal channels by means of government bonds, incentive rates in banks, "own-exchange" imports and a crackdown on the black market. However, a wide divergence between formal and informal exchange rates has been seen as a disincentive to the repatriation of remittances through official channels in labour-exporting countries. The government's maintenance of multiple exchange rates and restrictions on business access to hard currency until the mid-1980s encouraged the entrance of funds through illegal routes at the black market rate, where migrant workers could obtain at least 30% more for their foreign currency than the official rate of exchange on the open market. However, by the late 1980s, exchange rate reforms had the biggest impact on remittances entering through legal channels. The realignment of exchange rates in 1987 led to an increase in bank deposits of around USD 750 million, the bulk of which were remittances of workers abroad.

In the 1990s, following the implementation of a stabilisation programme, Egypt, managed to build a sizeable cushion of foreign exchange reserves. The high differential between the interest rate on the Egyptian and foreign currencies led to a large surge of capital inflows.

Overall, the experience of Egypt shows that macroeconomic, political and institutional factors in the labour-sending countries are influential in attracting remittances.

The macroeconomic impact of remittances in Egypt

Table 9.2 shows that remittances have been a major source of foreign currency in Egypt. Remittances have had a substantial impact on the Egyptian economy over the last three decades.

Egypt experienced typical symptoms of *Dutch disease* in the 1970s and 1980s. Appreciation of the real exchange rate, expansion of the non-traded sector and a decline of non-oil tradeable were all features of those two decades. High inflation rates were also a problem. However, overall, remittances provided a huge flow of foreign currency and helped to reduce the balance of payments deficits.

On the other hand, the issue of remittances use by migrants has attracted the greatest interest and debate. Some argue that remittances are used primarily for the purchase of land and housing, and general household consumption, rather than "productive investment", and conclude that remittances thus do little to stimulate development in the home country. Others believe that migrants do save and invest, that expenditure on land and housing are rational under prevailing conditions (they frequently offer better rates of return or are a better store of value than other available investments), and that expenditures on housing and consumption have positive multiplier effects on the whole economy. In evaluating the impact of remittances, it is important not to treat all consumption as necessarily unproductive. To the extent that remittances are spent on improving poor housing, such expenditure is an improvement in capital stock. In addition, expenditure on education and health is investment in human capital. Wahba (2000) shows that households with migrants are more likely to invest in education for their children and are less likely to send their children to work. In other words, remittances encourage investment in children's human capital. To sum up, it needs to be remembered that individuals are rational and act in their own self interest when using remittances which might not coincide with the social interest or the social benefit.

Entrepreneurship and investment in Egypt

International migration can affect the economic prospects of the origin countries through at least two main channels. First, emigrants may accumulate savings while overseas that, given the low wages and capital market distortions prevailing in many least developed countries (LDCs), might not have been possible without migrating. Second, overseas work may enable emigrants to acquire new skills and/or enhance human capital accumulation. Both channels can provide crucial inputs to start a business, or otherwise enhance earnings, on return.

Most of the empirical literature on migration and access to entrepreneurship concentrates on return migrants because of the availability of data sets on return migrants that are relatively rich, often including information on pre and post-migration wealth distribution and on the savings accumulated abroad. This has led to analysis of the occupational choice of return migrants and in particular self-employment and entrepreneurship. Those studies show that remittances and overseas savings have a potentially strong impact on access to entrepreneurship.

Based on micro-data, a number of important findings are worth noting:[4]

First, it is clear that overseas employment opportunities have significant effects on the probability of those returning migrants becoming entrepreneurs in the origin country. Overseas savings play a crucial role in access to entrepreneurship. Also, time spent overseas has positive and highly significant effects on being an entrepreneur on return. In addition, savings matter more than human capital acquisition for the probability of entrepreneurship of illiterate Egyptian return migrants. However, for the educated returnees, both access to credit, through overseas savings, and human capital accumulation are significant determinants of entrepreneurship upon return (McCormick and Wahba, 2001).

Second, there is growing evidence that remittances have been used in investment and productive activities in Egypt. Return migrants are responsible for 15% of the capital invested in small enterprises and 15% of the associated employment generation. In addition, comparing the businesses of migrants to those of non-migrants, the majority of enterprises are small-scale with less than five employees – 86% of returnees and 85% of non-migrants. The findings also support the view that returnees' enterprises are better than those of non-migrants. Returnees are more likely – by almost 30% – to create good jobs, measured as jobs that offer paid leave. There is a strong and positive relationship between being a return owner of an enterprise and that enterprise being engaged in services. Return migration does not have a negative impact on the formality status of the enterprise, *i.e.* returnees are as likely as non-migrants to establish formal sector firms.

4. See McCormick and Wahba (2001) and Wahba (2004). Those studies use the October 1988 special round of the Labour Force Sample Survey (LFSS), which was carried out by the Central Agency of Public Mobilisation and Statistics (CAPMAS) in Egypt.

Another important impact of return migration is on employment generation. An enterprise belonging to a return migrant is associated with 19% more jobs. Also, return migration has a positive, significant influence on the value of capital invested. Not surprising and supporting the hypothesis that overseas migration plays a critical role in reviving the credit constraint, the findings indicate that the value of capital invested is 17% more if the enterprise is owned by a return migrant.

Conclusion

Remittances can play an important role in the economy. However, they are private transfers. Thus, the government has to manage the economy to reduce any potential negative impact of those flows. More importantly, to attract remittances through the formal channels, the government needs to provide a sound economic and political environment. In addition, the state needs to provide the right investment climate to encourage both migrants and non-migrants to mobilise their savings into investment.

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Table 9.1. Top and lowest net recipient countries: conditioned on the extent of net migration

Highest net remittance receipts relative to net migration	Lowest net remittance receipts relative to net migration
India	China
Mexico	Israel
Philippines	Kazakhstan
Turkey	Pakistan
Russian Federation	Indonesia
Egypt	Ukraine
Jordan	Bulgaria
Yemen	Romania
Rwanda	Czech Republic
Morocco	South Africa

Source: Lucas (2005).

Table 9.2. The relevance of remittances

Country	Remittances as % of exports	Remittances as % of ODA	Remittances as % of FDI	Remittances as % of GDP
Egypt	80	282	303	4
Greece	16		149	1
India	27	779	500	3
Pakistan	12	155	353	2
Portugal	13		50	3
Philippines	15	1 047	298	8
Turkey	17	1 403	464	2

FDI: Foreign direct investment.
ODA: Official development assistance.
Source: Orozco (2003).

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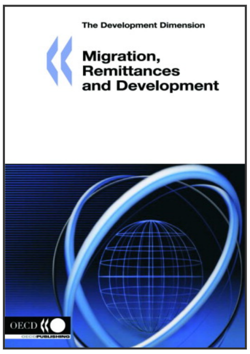

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