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## THE IMPACT OF REMITTANCES ON ECONOMY OF KYRGYZSTAN

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### Abstract

Data of the worker's remittance flow in the period of 2000-2010 were employed to analyze the impact of remittances on macroeconomic indicators of the Kyrgyz Republic. To study the underlying issue, linear correlation method was used.

Results showed that great portion of remittances has been directed into consumption rather than to investment. Moreover, remittance spending is channeled into consumption of imported goods, thus raising the trade deficit of a country. Their impact on economic effectiveness of Kyrgyzstan presents that given the low propensity to invest, they finance consumption and cause high consumption ratio with respect to investment ratio.

**Key words:** remittance, labor migration, macroeconomic indicators, linear correlation method, investments, economic effectiveness

**Ключевые слова:** денежный перевод, трудовая миграция, макроэкономические показатели, метод линейной корреляции, инвестиции, экономическая эффективность.

### 1. Introduction

Remittances — funds sent by migrant workers to their relatives in home countries — are an increasingly important source of external finance for low income countries especially for the many small economies. The officially recorded inflow of remittances to developing economies has grown from \$56 billion in 1995 to \$334 billion in 2010 (World Bank 2010). For some countries, remittances can be as high as a half of GDP. Remittances also now account for about a third of total global external finance; moreover,

the flow of remittances seems to be significantly more stable than that of other forms of external finance.

The concept of remittances derives from the theories of migration of various economic though (developmentalists, structuralists, New Economics of Labor Migration), that have different viewpoints on migration and remittances. Given framework of the above mentioned theories a great deal of academic studies had been conducted on impact of remittance on economy.

The participation of Kyrgyzstan in labor migration process with CIS and other foreign countries is aligned with export of labor. The process of labor migration in Kyrgyzstan emerged as a result of transformation process into market economy. According to different estimates there are more than 950 thousand Kyrgyz citizens are working overseas. Official central bank statistics show significant amounts remittances being transferred—up to 28.8% of GDP in the Kyrgyz Republic.

However, very little is known about the structure of remittance flows in terms of channels of remittance transfers and, perhaps more importantly, effects of remittances on economy. This lack of information prevents both governments and financial institution from responding with policy changes to increase remittance inflows and their positive effects on socio-economic development and poverty reduction.

The research analyzes the volume of remittances of Kyrgyz migrant laborers made from abroad and their impact on macroeconomic indicators of the country. The key question of concern for study is: Do remittances contribute to sustained improvements in economic development of the Kyrgyz Republic?

## **2. Literature review on macroeconomic impact of remittances**

Perhaps the most common reason for skepticism on migration and development has been the widespread belief that migrants rarely invest their money in productive enterprises, but instead spend it on consumption or non-productive investments (Massey 1998; Adams 1991; Taylor 1999; Woodruff and Zenteno 2007). Besides, if spent on imported consumer goods rather than locally produced ones, the potential multiplier effect may decrease while simultaneously increasing import demand and inflation. This has the effect of making exports less competitive, while stimulating imports. However, most studies seem to suggest that households receiving international remittances have a higher propensity to invest than non-migrant households when controlling for income and other relevant household variables. Other case studies indicated signs that remittances may indeed have served to accelerate investment in Morocco and perhaps in India. More generally, Glytsos (2001) estimates a simple dynamic, simultaneous model of aggregate investments, consumption, imports and the feed-

back of these components through GDP, for seven Mediterranean countries from about 1969 to 1993. Simulating the direct and indirect effects of remittances on incomes and hence on investment through this framework, Glytsos finds that over a six year period investment rises with remittances in six out of the seven countries, and in four of these investment rises by more than the initial amount remitted.

The impact of remittances can be explored along pricing of goods. Sudden riches can create many problems for an economy, and remittance-driven gains are no exception. Remittances are foreign-earned money that can raise the cost of goods in the recipient-country. The recipient country has not increased production, yet there is more money in circulation owing to the remittances; hence, prices rise. If the nation-state is seen in isolation, then such price increases owe themselves not to any improvement in the economy, but to an exogenous—arguably false—increase in purchasing power (Erza Rosser, 2008). Recipient economies flush with remittance money become vulnerable both to inflation, particularly harmful to those not receiving remittances, and, through labor reduction, to falling exports as the economy reacts to the increased remittances. Large remittance inflows, like any large influx of foreign currency, can lead to appreciation of the local currency. Hence, an appreciation of the exchange rate generates a resource allocation from the tradable to the non tradable sector. This phenomenon is usually labeled as the «Dutch disease» (Ghada Fayad, 2010; Loser, 2006; Rajan, Subramanian 2005).

To date, the empirical evidence of the impact of remittances on economic growth appears mixed. For instance, results for a sample of 39 developing countries covering the period 1980–2004 indicate a positive impact on economic growth. A study examining the aggregate impact of remittances on the economic growth of 18 Latin American countries for the period 1980–2005 found that remittances positively and significantly affected the growth of Latin American economies where the financial systems are less developed by providing an alternative way to finance investment and helping overcome liquidity constraints. On the other hand, empirical assessments on the impact of workers' remittances on growth and poverty reduction in developing Asia-Pacific countries for the period 1993–2003 found that, “while remittances do have a significant impact on poverty reduction through in-

creasing income, smoothing consumption and easing capital constraints of the poor, they have only a marginal impact on growth operating through domestic investment and human capital development”. While not denying the poverty alleviating and consumption smoothing effects of remittances on recipient households, other studies find no impact on economic growth (UNESCO, 2010).

## 2. Economics of Remittances in Kyrgyzstan and its Magnitude

Table 1 - Remittances flow dynamics in Kyrgyzstan (mln. US dollars)

Year	2003	2004	2005	2006	2007	2008	2009	2010
Remittances	112.7	285.4	481.5	730.6	1021.1	1468.7	1072	1379.3

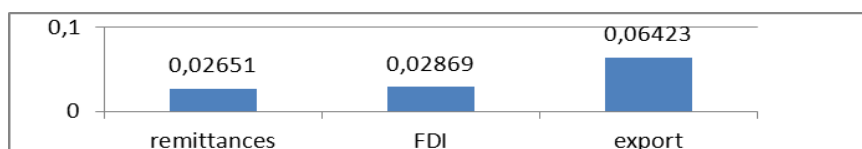
Source: National Bank of Kyrgyz Republic, 2011.

In 2009 remittance flow decreased by 27% due to the world financial crisis, which affected economies of Russia, and Kazakhstan. This data do not take into account informal transfers of funds, which are part of the “errors and omissions” section of Balance of payments. The rapid growth in volume of this section from 2003 is linked to the constant growth of informal chan

Obviously, dynamics and scale of labor migration give rise to issue of remittances, particularly their impact on small economy of Kyrgyzstan current conditions. During aggravating transition period of Kyrgyzstan remittances have adversely affected the overall economic development, although remittances represent safety net on individual households.

The remittance flow for the last decade has been increasing steadily. Moreover, it has been more than doubling annually in average.

neling of remittances (Bespalov, 2009). Although, in the world practice the remittances are being the most stable source of external finance remittance flow in Kyrgyzstan stay volatile to external shocks. The remittances volatility index in 2010, computed as a standard deviation of the ratio of relevant inflow to GDP almost the same as FDI volatility index. It can be explained by the fact that the number seasonal labor migrants by far exceed permanent workers.



Figur 2. Volatility indexes of remittances, FDI and export of Kyrgyzstan

Source: National Statistics Committee and National Bank of Kyrgyz Republic, own calculations, 2010

Besides, remittance flows from Russia to Central Asian countries are increasing with increase in oil prices and expansion in economic activity in the

source region of remittances ( see figure 3). Thus, remittance fluctuation in Kyrgyzstan is to be procyclical, rather than counter-cyclical.

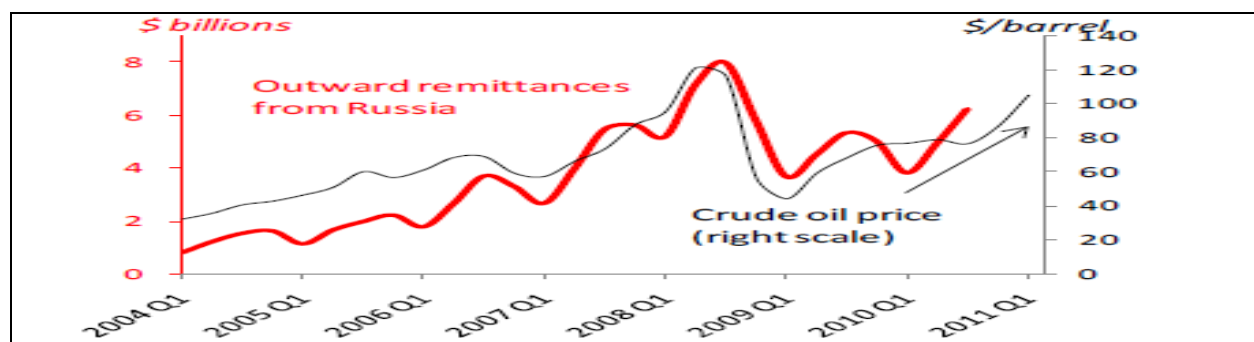


Figure 3. Remittances outflow dynamics from Russia mainly to CIS countries growing in tandem with high oil prices and rising pace of economic activity

Source: World bank, Migration and Remittances Unit, migration and development brief 16, 2011

According to annual report of National Bank of Kyrgyz Republic of 9th month of 2011 remittance flow was remitted from Russia (93, 9%), Kazakhstan (2,4%), and the USA (2,3%).

As it was mentioned, remittances comprise a significant share of GDP. According to World Bank, in 2008 Kyrgyzstan was among top 10

countries with remittances amounting large share of GDP (28 %) and took the forth place followed by Tajikistan, Tonga, and Republic of Moldova. After the recovery of world financial crisis, in 2010, remittances increased and reached 28.8 % as a share of GDP.

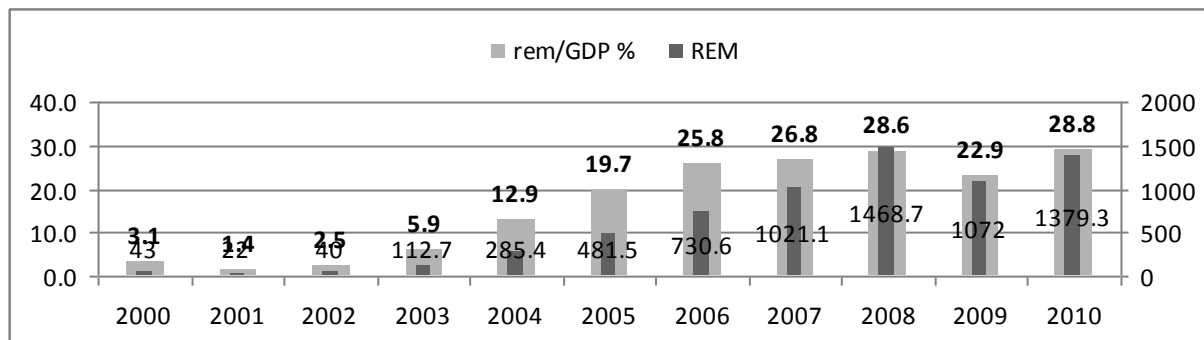


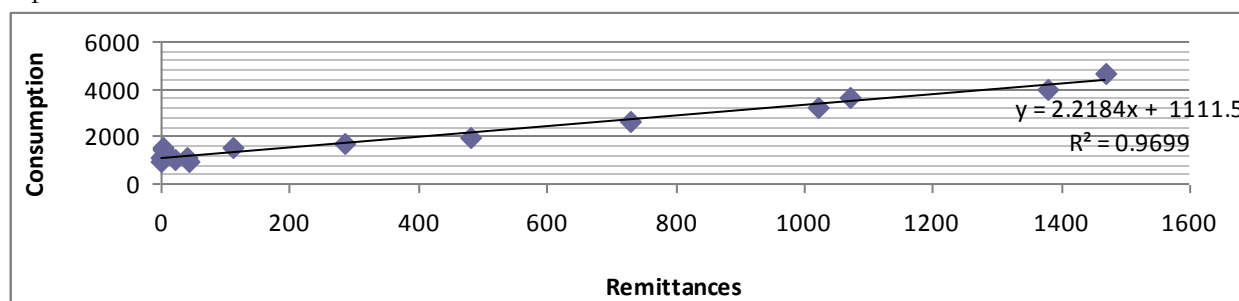
Figure 4. Remittances as a share of GDP (2000-2010)

Source: National Statistic Committee, National Bank, own estimations, 2011.

Currently, there are no sufficient systematic researches on remittances impact on economy of Kyrgyzstan. There is just few researches conducted regarding remittances. One of them was conducted by Samagan Aitymbetov, “Emigrant remittances: Impact on economic development of Kyrgyzstan”, 2006; the other by Bespalov A.D., “Labor migration as a factor of socio – economic development of Kyrgyz Republic”, 2009. In the first research the data of National Bank of Kyrgyz Republic was used and the main conclusion of which was that remittances have positive impact on economic development and poverty reduction in Kyrgyzstan due to multiplier effect given the high marginal propensity to consume but low marginal propensity to import. Bespalov in his work states that remittances ef-

fect on economy of Kyrgyzstan by positive impact on GDP growth and private consumption, have almost no impact on investment, and have positive impact on socio- economic condition of Kyrgyzstan.

Remittances can have a potential impact on some macroeconomic indices of Kyrgyzstan such as household consumption and import volume. The impact of remittances to household consumption is a measure of the extent to which remittances can be used to finance private consumption of domestic inhabitants. Almost 70% of remittances are spent on consumption (Aitymbekov, 2005). The correlation of remittances with household consumption is 98% (see figure 5).



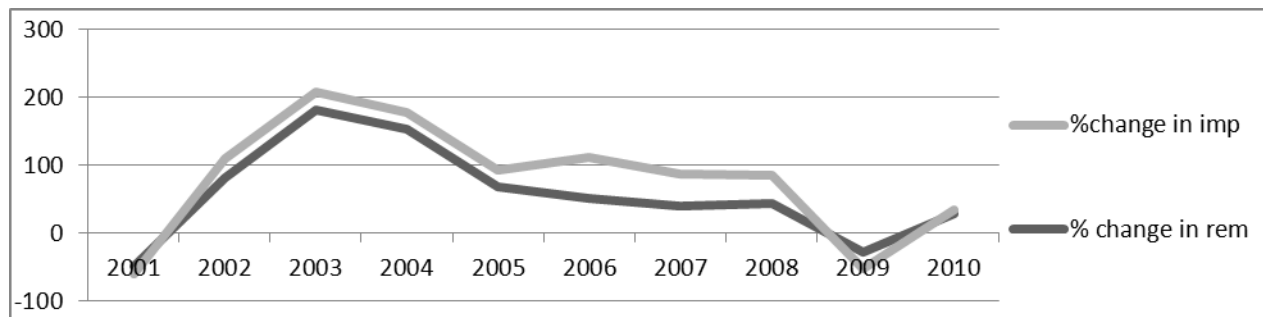
R <sup>2</sup>	0.97
R (correlation index)	0.98

Figure 5. Correlation of remittances with private consumption of Kyrgyzstan (1995-2010)

Source: National Bank and National Statistics Committee of Kyrgyz Republic, 2011, own estimation

It is obvious that the share of imported goods in consumption is very large in Kyrgyzstan. For this reason it is reasonable to conclude that remittances finance imported goods. The same linear correlation method was employed to see the correlation of remittances with import and the corre-

lation index R found to be 98%, meaning that import of Kyrgyzstan is dependent on the remittance flow. Also, the percentage change analysis of remittances and import volumes shows a complete reflection of their correlation (see figure 6).

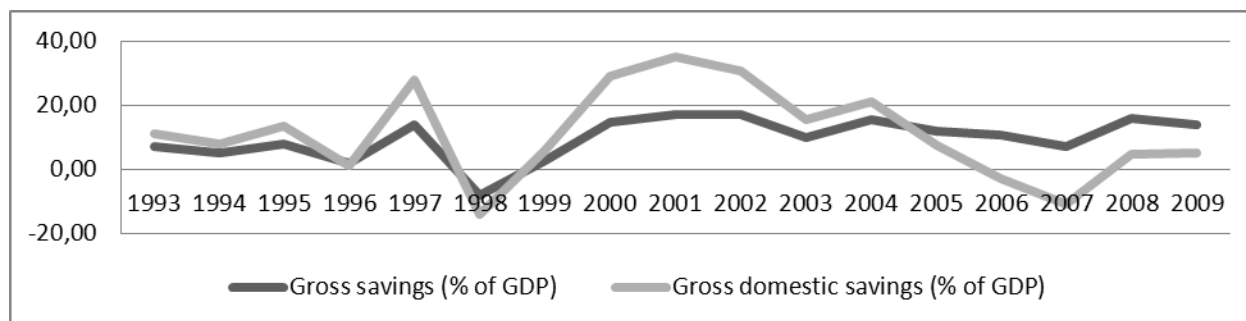


**Figure 6.** Remittances and import dynamics (2001-2010)

**Source:** National Bank and National Statistics Committee of Kyrgyz Republic, own estimation.

Remittances have not much impact on investment. Despite the fact that remittances can be associated with savings in a way that rise in remittances lead to the increase in savings, its increase can not necessarily bring to rise in investment. Most of the households in Kyrgyzstan prefer to save in a way of buying real estate, which

cause rise of apartment's price in Bishkek and Osh in recent years. Besides, quick withdrawals of remitted funds and low level of investing in business by receivers permit to draw a conclusion that the degree of remittances impact on investment stays low.



**Figure 7.** Savings and investment as a percentage of GDP (1993-2009)

**Source:** [www.worldbank.org/statistics](http://www.worldbank.org/statistics)

As it is shown in Figure 6, the domestic savings in Kyrgyzstan roughly fluctuates. This is because of high marginal propensity to consume and because of absence of stable financial system where explored low deposit interests.

Thus, analysis of remittances impact on economic effectiveness of Kyrgyzstan presents that given the low propensity to invest, remittances finance consumption and leads to its higher consumption ratio with respect to investment ratio.

## Conclusion

Analysis of the impact of remittances on Kyrgyz economy enabled to draw a conclusion that remittances have minimal negative spillovers in economies whose marginal propensity to invest is high and they are unlikely to have any lasting impact on growth in countries with high marginal propensity to consume. The latter is peculiar for economy of Kyrgyzstan. A great portion of remittances is directed into consumption rather than in investment. More importantly, remittances use in Kyrgyzstan is channeled into consump-

tion of imported goods, thus raising the trade deficit of a country.

Remittances impact on economic effectiveness of Kyrgyzstan presents that given the low propensity to invest, remittances finance consumption and cause high consumption ratio with respect to investment ratio, thus leading to reduction of economic effectiveness. Although the lack of marginal propensity to save data, low bank consumer deposits and quick withdrawals of remittances; booming imports, particularly in recent years, in parallel with growing inflows of remittances, spent on (imported) consumption suggest that there is almost no multiplier effect. Remittances are not channeled into the production, and hence they do not finance export. Under this approach, the impact of remittances on growth is likely to be small. Thus, more open the economy, the smaller the multiplier and the less significant the impact of remittances on output.

However, labor migration and flow of remittances have played a significant role in increasing consumption and reducing poverty in Kyrgyzstan. This has had a significant impact on the balance of payments and has helped to smooth the economic and social impact of transition. However, given the size of the phenomenon, it also implies some risks, as a large proportion of the labor force has left the country.

Part of the reason why remittances have not encouraged economic development is that they are generally not intended to serve as investments but rather as social insurance to help family members finance the purchase of life's necessities. Remittances lift people out of poverty but they do not typically turn their recipients into entrepreneurs. The intriguing possibility remains that remittances can be channeled somehow into achieving both of these ends, but this will require a better understanding of the role that remittances play in their recipients' lives, and institutions that can help recipients of remittances make the most of the transfers they receive.

The authorities should continue to give careful consideration to the implications of such remittances on the implementation of monetary and exchange rate policies, and in the context of the evolution of the balance of payments. Although the high level of remittances has underpinned a social security, this source of development should not detract the authorities from the urgency of reform. Also, conducting a comprehensive survey to assess the actual scale of remittances and labor

migration would help the authorities to develop a well-defined strategy to maximize the benefits of remittances by increasing the productive investments and minimize any negative consequences. All in all, we should not forget one crucial misconception. Remittances are not a development model – but rather a sign of the failure of development.

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