

DID THE RECENT ECONOMIC CRISIS IMPACT REMITTANCES? EVIDENCE FROM TRANSITION COUNTRIES

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Abstract

Remittances, funds transferred from migrants to their home country, are a very important source of income for households and small businesses in most transition countries. The paper documents the recent downturn in migrant's remittances to selected transition countries due to the recent global economic crisis. The research concentrates on the Eastern Partnership countries: Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine representing important sources of migrants. The paper shows how the global economic downturn affected remittance flows sent to the selected set of countries. In particular, the paper questions whether migration, thereby remittances, work as a transmission mechanism or important regional or global economic.

Keywords: *International Migration; Remittances; Financial crisis; Eastern Europe; Eastern Partnership*

JEL Classification: F10, F23. C22

1. INTRODUCTION

Any kind of flows across borders deepens global interdependence and interaction; hence migration has become a popular topic during the last decades. The mobility of people is strongly connected with other significant flows as movement of capital and goods. The most important type of capital flows related to migration is remittances - money sent by international migrants to their countries of origin (home countries). Efforts to quantify these money flows have intensified during the last decade, mainly after September 11th 2001, when the terrorist attacks were followed by an increased political will to track these significant and difficult to control money flows (Ruiz et al., 2010). It is beyond doubt that remittances have a significant impact on developing countries. These flows rise to high amounts compared to other capital flows. Moreover, contrary to foreign direct investments

and other capital flows, remittances are difficult to control, therefore less likely to be subject to corruption and ineffective use by local governments.

The current global economic crisis appears to have deeply affected migration and remittance trends in transition countries from Eastern Europe and Central Asia. The paper concentrates on a group of countries which are involved in a recent European Union project - The Eastern Partnership. The project was launched in Prague during the presidency of the Czech Republic in May 2009. It represents a cooperation initiative with six countries from Eastern Europe (Belarus, Moldova, and Ukraine) and South Caucasus (Armenia, Azerbaijan and Georgia).¹ These countries' selection as subject of research is explained by their position in European Union's future cooperation plans. After the fall of the Soviet Union they became a traditional source of migrants. The paper will search at what extent the recent economic crisis affected them.

2. LITERATURE OVERVIEW

Early approaches to remittances were elaborated by Stark and Bloom (1985), Russell (1986). Later, the study of remittances divided into various directions. Most studies are focused on the impact of remittances on development in migrant sending countries (macroeconomics, health, education, poverty, etc.). It is not rare that these studies come to different conclusions. Chami (2003) for example concluded that remittances have a positive impact on economic growth, while Solimano (2003) came to an opposite conclusion. Adams and Page (2003) showed that remittances had a great impact on poverty reduction. Remittances and entrepreneurship were studied by Massey and Parrado (1998), Maimbo and Ratha (2005), etc. The impact of remittances on education is another popular subject (Yang, 2005, Woodruff et al., 2001). There are also studies that deal with the techniques of collecting remittance data (Reinke, 2007, Kapur, 2004). Much work concerning remittances and migration is being done by the World Bank, which has made attempts to examine both official and unofficial remittance flows (Maimbo et al., 2005).

The transmission mechanism of the economic cycles from migrants receiving countries towards migrants sending countries via remittances is a relatively new research area. There are studies that deal with the recent downturn in remittances

¹ This initiative aims at deepening the cooperation of the EU with these countries especially in the areas of political cooperation and economic integration. The Eastern Partnership should not be understood as a promise to enter the European Union; it is a project offering deeper integration of the partner states with the EU structures "by encouraging and supporting them in their political, institutional and economic reforms based on EU standards, as well as facilitating trade and increasing mobility between the EU and the partner states" (Eastern Partnership Community, 2011).

(Ruiz et al., 2010, Mohapatra et al., 2010), but deeper research will be possible when the economic crisis comes to an end and full sets of data to be interpreted will be available.

Most of researchers focus on developing countries from Africa, South Asia and Latin America (see for example Garg et al., 2010, Jha et al., 2010), while the Eastern Europe and Central Asia are somehow forgotten; therefore the amount and quality of empirical studies related to countries from this region is rather modest in comparison with other regions. Nevertheless, certain studies are already available (O'Hara et al., 2009, Dietz, 2009, etc.).

The recent economic crisis has been followed by a substantial downturn in the volumes of international money flows related to migration. The crisis has not ended yet; some researchers even expect the crisis to reach a new bottom, taking the shape of the letter W instead of V (Hnat et al., 2010). The current situation of the global economy has elicited cardinal questions regarding the impact of the recent economic crisis on remittances and thereby on migrant sending countries. The paper seeks answers to the following questions:

- *Firstly, how do global economic crisis (including the most recent one) affect remittance flows? Is the impact necessarily negative?*
- *Secondly, what was the impact of the current economic crisis on the Eastern Partnership countries? Did remittances work as a transmission mechanism of the crisis?*

Answering the aforementioned issues will not only give a clearer picture of the current situation in the Eastern Partnership countries, but will also serve as a starting point for further research.

3. THE IMPACT OF THE CRISIS

Remittances, private transfers from migrants to family members in the home country, add up to significant amounts annually. The total number of international migrants is estimated to over 215 million in the year 2010. Recorded remittance flows towards developing countries were estimated to be 325 billion USD in 2010, an amount which exceeds the volume of official development assistance and represents over 10% of many developing countries' GDP (World Bank, 2011). "*Immigrant remittances are truly a force to be reckoned with in the global economy*" (Chami et al., 2008, p.1). It is important to understand how remittances differ from official aid flows. While aid flows are government-to-government transfers, remittances represent numerous small transfers between private individuals, often family members (Chami et al., 2008). For many developing

countries remittances are the most important external resource flow, exceeding not only official development assistance but also incoming foreign direct investments. The recent economic crisis had a significant impact on all above mentioned capital flows, including workers' remittances. While remittances towards developing countries have grown between 1997 and 2007 by about 15% per year (from 71 billions USD in 1997 to 281 billions USD in 2007), in 2008 the growth rate dropped to only 8%, from 23% in 2007. In fact, quarterly data show that the global decrease in remittances has started in the third quarter of the year 2008 (Ruiz et al., 2010). After a downturn in remittances in 2009, the year 2010 brought a renewal of the pre-crisis level. The decline of remittances compared to other types of flows (like private debt and equity flows and foreign direct investment) was rather moderate. Ratha (2003) explains why remittances are persistent over time by pointing out that remittances are related not only to new migrants, but mainly to cumulated flows of migrants over the years. The same stock of migrants should always send home the same amount of remittances. Economic downturns might slow down new migration flows, but the stock of migrants remains basically the same. I find two weaknesses in his argumentation. First of all, the recent economic crisis might not have affected the stock of "old" migrants, but it did have a considerable impact on their incomes. Therefore, the amount of cash flow sent by the same stock of immigrants could hardly have remained the same. The second critical moment of his argumentation is that *"remittances are a small part of migrants' incomes, and migrants continue to send remittances when affected by income shocks"* (Ratha, 2003). A migrant's income can be divided into fixed and variable expenditures. Fixed expenditures include housing, food, transport, clothing costs, etc. These fixed expenditures are usually less flexible than the variable ones. On the other hand, variable expenditures as leisure, savings, investments, etc., are more sensitive to changes in income and can be lowered when necessary. It is a question whether remittances don't belong to rather the second group of expenditures. If a migrant's income decreases, he will first cover his fixed (living) costs and will remit a certain part of his income to his home country only if there is a surplus available.

Mohapatra et al. (2010) show on the other hand that remittances do not necessarily have to follow the pattern of the economical cycle. Historically, remittances have been stable or even countercyclical in comparison with the economic cycle and tended to rise in times of financial crises and natural disasters. The explanation is that migrants living abroad send more money to help their families back home cope with the difficult times. Examples are also brought: remittance flows to Mexico had increased after the country's financial crisis in

1995. The same was observed in the Philippines and Thailand after the Asian crisis in 1997 and in Central America after Hurricane Mitch in 1998. Nevertheless, it is important to point out the main difference. Remittances might have a countercyclical behaviour when the most affected area is the country receiving remittance flows. The current economic crisis started in the high income countries which are a typical source of remittances and affected both rich and poor countries; therefore remittances followed the pattern of the global economic cycle and worked as a transmission mechanism.

The transition countries form a specific geographical, cultural and economical area. Not only that they are constantly “somewhere in the middle of their way” from a centralized economical system to capitalism, which can be currently characterized as a “savage capitalism”, but they are also facing numerous problems related to political and economical instability. Immigrants coming from this area are relatively skilled; they have good premises to integrate in the host country both due to their language skills and cultural proximity to both Asian and European cultural environments. The countries taking part into the Strategic partnership do not form a homogenous group. Ukraine is a big country with a relatively functioning economy. It is also the biggest economy with more than 46 millions inhabitants and a GDP over 113 billions USD in 2009. On the opposite side there is Moldova, a small country with a population of slightly over 3,5 million persons and a GDP of 5,4 billions USD. It is also the country with the lowest GDP per capita from the group of six (1500 USD per inhabitant), while Azerbaijan indicates a value of 4 899 USD per capita, Armenia, Ukraine and Georgia oscillate around 2 500 USD per capita. Belarus shows a value of 5 074 USD per capita (though the accuracy of this value is questionable). Besides economic differences, the Strategic Partnership countries have a different cultural background. Ukraine and Belarus are Slavic countries, with very strong cultural and historical links to Russia. Georgia and Armenia are old Caucasian nations with a strong national pride.

Measuring remittances is rather difficult. Official channels are used to transfer only a part of all remittances, it is believed that much higher amounts flow via informal channels. Besides that, many countries do not make any effort to collect data concerning informal channels (De Luna, 2005). It is also important to mention that statistical data from post-communist countries is of limited reliability. After the fall of the communist regime governments had to build new institutions and bodies responsible for official data collection and processing. Many of the old definitions and had to be reviewed; different countries had different understandings of the same process, which makes statistic data less

comparable. Some researchers (Ruiz et al., 2010, Catrinescu et al., 2006) point out that a part of remittances' growth rate in the past decades can be explained by other factors, for example the increased effort in tracking remittances. Furthermore, as transaction costs have decreased in time, an increasing amount of migrants chose official channels to send money home. These facts could distort the picture of the economic crisis' impact on remittances, as the lower growth rate could be in fact partially the result of the more accurate data on remittances during the last years.

When measuring the share of remittances per GDP and foreign direct investments, Armenia and Moldova turn out to be the most dependent countries on financial flows sent by migrants from abroad, Moldova being the absolute leader.

Figure 1: Remittances to the Eastern Partnership countries (selected years)

	1999	2000	2001	2003	2005	2007	2008	2009
Remittances as a share of GDP								
Armenia	5,13%	4,58%	4,46%	5,97%	10,17%	9,19%	8,91%	8,83%
Azerbaijan	1,19%	1,08%	1,82%	2,35%	5,24%	3,90%	3,36%	2,96%
Belarus	1,72%	1,09%	1,21%	1,25%	0,84%	0,78%	0,73%	0,73%
Georgia	12,89%	8,95%	5,63%	5,91%	5,40%	6,84%	5,72%	6,65%
Moldova	9,55%	13,86%	16,43%	24,57%	30,80%	34,03%	31,34%	22,40%
Ukraine	0,06%	0,11%	0,37%	0,66%	0,69%	3,16%	3,20%	4,47%
Remittances growth rate								
Armenia	2,4%	-7,6%	7,9%	28,0%	14,6%	28,5%	25,6%	-27,6%
Azerbaijan	765,8%	4,8%	82,3%	-5,9%	204,7%	58,4%	20,7%	-18,1%
Belarus	-33,9%	-33,2%	7,2%	58,5%	-0,8%	4,2%	25,0%	-19,2%
Georgia	-3,2%	-24,2%	-33,7%	2,4%	14,1%	43,3%	5,3%	-2,4%
Moldova	-10,0%	59,7%	36,2%	50,3%	30,5%	26,8%	26,6%	-36,2%
Ukraine	50,0%	83,3%	327,3%	57,9%	44,8%	443,2%	28,1%	-12,1%

Source: World Bank database and author's calculations

The collapse of communist regime encouraged a massive increase in geographic migration in the Eastern European and Central Asia region, not only international migration, but also internal country movements and cross-border migration within the former soviet countries. As Mansoor et al. (2006) indicate, migration flows in Eastern Europe and Central Asia region tend to move in a largely bipolar pattern. While much of the migration from the Eastern Partnership countries is directed towards the EU, a higher share of migrants head towards other Commonwealth of Independent States (CIS) countries, the main intra-CIS destination being Russia. The number of illegal migrants from the Eastern Europe and Central Asia is believed to be large, but difficult to quantify. In the year 2006 the number of undocumented migrants in the EU was estimated to 3 million and between 3

million and 3.5 million in Russia (Mansoor et al., 2006). The CIS members do not need visa in order to entry the Russian territory for a period of three months. Therefore, there is a large number of illegally working economic migrants that are officially considered tourists. Official data indicate that 3.9 million foreign workers were employed in Russia in 2008, while the amount of illegal foreign workers was estimated to be around 12 million. Most of these workers come from CIS countries, including Armenia, Azerbaijan, Georgia, Moldova, and Ukraine. In order to ask for a work permit, they have to register with the local authorities, but many of them fail to do so. The majority of foreign workers from CIS countries in Russia work in construction, services, trade and agriculture, these industries being amongst the most affected. Examining the destination choice of labour migrants from the Eastern partnership countries, remarkable differences can be noticed. While most economic migrants from Armenia and Azerbaijan move to Russia, 30 % to 40 % of workers from Moldova, Georgia and Ukraine prefer Western destinations (Dietz, 2009). Remittance flows in the Eastern Europe and Central Asia follow the same two-bloc pattern as migration. The EU and the middle-income CIS countries are the main sources of remittances, the EU account for cca. 75% of the total remittances, while the rich CIS countries for 10 percent (Mansoor et al., 2006). Surveys in CIS countries have clearly shown that, during their stay in Russia, highly skilled migrants frequently worked in sectors requiring low qualifications (such as agriculture, transportation, or construction). This problem called brain waste is also observed in the EU countries, but to a lesser extent (Mansoor et al., 2006).

4. CONCLUSIONS

Remittances will most probably continue being more resilient compared to other types of resource flows (foreign direct investment, official aid, private debt and equity flows, etc.) which have experienced a larger decline under the impact of the current financial crisis. There are several reasons for remittances to be less flexible to current downturn in the global economical cycle (OECD, 2011, p. 30). The first one was mentioned in the first section of the present article – the role of the stock of migrants and new migration flows. The highest amount of remittances is sent home by cumulated flows of migrants, new migration flows do not play such an important role, therefore remittances are persistent over time. Economic downturns may temporarily reduce new migration flows, but the stock of migrants remains stable. Nevertheless, the CIS countries have a specific situation. Due to the low barriers to enter the Russian labour market and to the possibility to enter the Russian territory without a visa, the return migration is higher, as these migrants can always return with basically zero migration costs. On the other hand,

return migration from the countries where the migration costs are high (the EU, other OECD countries), they prefer to stay and to wait until the economic situation becomes more favourable. Even cases of “negative remittances” can be observed in some situations, where the families at home prefer to send funds to migrants finding themselves in difficult situations abroad in order to help them to survive abroad and not to return home. On the other hand, remittances may even be counter-cyclical. This is though not the case of the Eastern Partnership countries. Secondly, many high-income OECD countries are already undertaking large fiscal stimulus packages as a response to the financial crisis. A part of this increase in public expenditure is directed to public infrastructure projects, which traditionally employs a high amount of migrant workers. Another argument for remittances to stay resilient is the “safe haven” factor, which may cause remittances for investment purposes to return to the home country during an economic downturn in the host country. I believe that this factor did not play an important role in remittances to the Eastern Partnership countries for the same reasons mentioned before. Migrants heading to Russia come back very often, so the amount of cumulated remittances abroad is very low. On the other hand, remittances coming from the EU or other OECD countries are likely to behave this way.

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