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Migrants' Remittances and Economic Activity

by Thomas Straubhaar, Berne*

The impact of migrant workers' remittances on economic activity in their home countries was long overshadowed by the manifestly positive balance of payments effect. Only gradually did it come to be recognized that it was not just the scale of remittances but also the way in which they are used that is of crucial significance for the economies of the migrants' home countries. This article estimates the contribution that such remittances made to GDP, private consumption expenditure, saving and imports in Portugal, Spain, Italy, Greece and Turkey in the period from 1960 to 1981.

Economists have shown increasing interest in the international migration of labour since the substantial growth in this phenomenon from the early sixties onwards. One aspect that has come under scrutiny has concerned the remittances that migrant workers send to their home countries.¹

Attention has focussed primarily on the effects remittances have on the balances of payments of the migrants' home countries. They increased the supply of foreign currency, a serious constraint on economic development in these countries, and alleviated the adverse effects of trade deficits. This obvious and easily measured positive effect of remittances was quickly recognized and measures were taken to increase such inflows of foreign exchange.²

The impact on economic activity in the migrants' home countries was neglected at first. Remittances can have a variety of consequences for overall demand in the home country, depending on how they are spent and by whom; the output, employment, inflation and import effects depend upon whether the funds are used to purchase durable or non-durable consumer goods, essentials or non-essentials, home-produced or imported goods. A crucial factor is the extent to which the additional demand induced by remittances can be met by expanding domestic output. The flexibility with which domestic supply reacts to the extra demand will determine whether remittances will have positive employment effects or adverse inflation effects and whether additional imports will be necessary. These various repercussions, which are shaped by the macro-economic features of the countries in question, were long overshadowed by the manifestly positive balance of payments effect. Only gradually did it come to be recognized that it was not just the scale of remittances but also the way in which they are used that is of crucial

significance for the economies of the migrants' home countries.

This report demonstrates the impact of remittances on the Mediterranean and Iberian countries of origin of migrant workers (Portugal, Spain, Italy, Greece and Turkey). It estimates the contribution that remittances made to the increase in gross domestic product, private consumption expenditure, saving and imports in the period from 1960 to 1981.

Under the standard systems of national accounts, individuals are considered to belong to the economy on which their main economic interest is focussed for at least one year. Migrants who work abroad for more than one year are therefore treated as economic subjects of the host country. The economic activities of migrants in the host country are not recorded in their home state. They appear in the national accounts of the latter (as transactions by foreigners) only if they *directly* affect economic activity in those countries. By contrast with the treatment of frontier workers and seasonal workers, only funds sent by migrants to persons remaining in their country of origin are recorded in the statistics (as unrequited transfers), but not the earning and use of income in the host country.

In accordance with the residence principle on which national accounting is based, frontier and seasonal

¹ Remittances should be understood to comprise all sums of money from current income and saving transferred to their home country by foreigners working abroad

² The balance of payments effect of remittances is described at length in T. Straubhaar: Der Zahlungsbilanzeffekt der Devisentransfers ausgewandelter Arbeitskräfte für ihre Herkunftslander, in: Jahrbücher für Nationalökonomie und Statistik, Vol. 200 (1985), No. 1, and in T. Straubhaar: The Significance of Labour Migration for the Workers' Countries of Origin, in: INTERECONOMICS, Vol. 19 (1985), No. 1. These studies found that (a) the strength of the balance of payments effect was determined mainly by the level of development of an economy, it having been shown with a high degree of statistical significance that the more developed an economy the smaller the impact of remittances, and (b) remittances greatly reduced the need for short-term loans to plug widening balance of payments deficits, particularly in Portugal, Yugoslavia and Turkey.

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workers remain residents of their country of origin, as they do not move their place of abode to another country for at least a year, they retain strong roots in their home community and model their economic behaviour largely on the customs and habits of their country of origin. Hence their income from employment abroad constitutes payment of a factor income and mirrors receipts from the sale of domestic factors of production to foreigners. The statistics on gross national product (but not those on gross domestic product) include these factor incomes earned abroad by residents. As the only difference between gross national product (GNP) and gross domestic product (GDP) is the balance on income from employment and capital between residents and the rest of the world (GNP = GDP plus factor incomes from abroad in respect of capital and labour less the corresponding factor incomes paid to other countries), all subsequent remarks will relate to GDP. Findings based on GNP would be easy to derive using the above formula.

It is the purpose for which remittances are employed that determines the impact they will have on economic activity in the migrants' home countries. An individual has basically the following options:

☐ to accumulate savings,

☐ to purchase consumer goods,

☐ to purchase capital goods.

In macro-economic terms, saving is merely a precursor to the other two options. Saving represents postponed consumption or future investment. If saving takes the form of capital formation or precautionary saving, the foreign exchange is available to the economy as bank deposits or equity capital. The hoarding of cash is a special case of limited duration with no point of contact with economic activity: Only when the money is spent on consumption or is invested does it produce economic effects.

Another possibility that cannot be ruled out is the use of money from abroad as a substitute for income from employment. The remittances allow greater leisure time and enable the recipient to reduce accordingly the time spent in gainful employment.

If remittances are received primarily by members of the lower income categories, they are probably used mainly to satisfy basic needs. (Remember the operation of Engel's and Schwabe's laws.) To the extent that the material well-being of those remaining in the home country is improved, the use of remittances for such purposes should not be dismissed as simply unproductive. Although it differs in form and intensity

Table 1
Migrant Workers' Nominal and Real Remittances to Portugal, Spain, Italy, Greece and Turkey
between 1960 and 1981, in Absolute Terms and Percentage Rates of Growth¹

Periods	Portugal		Spain		Italy		Greece		Turkey	
	R ⁿ	R	R ⁿ	R	R ⁿ	R	R ⁿ	R	R ⁿ	R
1960	0.05	0.12	0.06	0.19	0.38	1.00	0.09	0.20	0	0
1973	0.74	0.99	1.19	1.64	1.54	1.91	0.74	0.92	1.18	1.65
1981	2.85	2.30	0.99	0.61	3.35	2.20	1.08	0.75	2.49	1.91
Ø 60-73	0.24	0.43	0.44	0.93	0.80	1.42	0.29	0.47	0.23	0.39
(s=)	(0.22)	(0.31)	(0.32)	(0.45)	(0.39)	(0.40)	(0.19)	(0.23)	(0.35)	(0.54)
Ø 74-81	1.74	1.58	0.98	0.80	2.07	1.72	0.94	0.76	1.49	1.25
(s=)	(0.88)	(0.63)	(0.11)	(0.23)	(0.86)	(0.34)	(0.17)	(0.04)	(0.56)	(0.40)
Ø 60-81	0.78	0.85	0.64	0.88	1.26	1.53	0.52	0.57	0.69	0.70
(s=)	(0.91)	(0.72)	(0.37)	(0.38)	(0.86)	(0.40)	(0.37)	(0.23)	(0.75)	(0.64)
Ø GR 60-73	25.6	18.9	27.5	20.1	13.0	5.77	18.2	13.1	30.8	25.2
(s=)	(17.8)	(14.2)	(23.8)	(26.7)	(12.8)	(12.3)	(12.5)	(12.4)	(36.5)	(41.0)
Ø GR 74-81	17.6	12.3	-1.60	-11.1	13.7	3.27	5.36	-1.90	11.7	5.81
(s=)	(24.5)	(25.9)	(12.5)	(10.2)	(31.1)	(19.0)	(11.1)	(11.4)	(31.4)	(27.8)
Ø GR 60-81	22.9	16.7	16.4	8.19	13.3	4.82	13.3	7.36	24.1	18.4
(s=)	(20.1)	(18.5)	(24.6)	(26.6)	(20.9)	(14.8)	(13.4)	(13.9)	(35.2)	(37.4)

¹ Rⁿ: nominal remittances (in billions of US dollars).

R : real remittances, at 1975 prices and exchange rates (in billions of US dollars).

Ø : average for the period indicated (in billions of US dollars).

(s=) : standard deviation of annual values from average for the period.

Ø GR: average growth rate for the period (in %).

Sources : Calculations by the author on the basis of OECD: National Accounts, Vols. I and II, Paris, various issues from 1979 onwards; OECD: Balances of OECD Countries 1960-1977, Paris 1979; OECD: SOPEMI (Continuous Reporting System on Migration), Paris, various reports from 1973 onwards (including national correspondent reports available as mimeographs).

from real capital formation, it is productive in the sense of human capital formation and therefore makes a positive contribution to development.

Growth of Remittances since 1960

Before embarking on a description of the growth of remittances, it should be noted that only money remitted by means of direct bank or postal transfers can be recorded with any degree of reliability. There are no figures on undeclared sums of cash sent by post or taken home by the workers themselves, compensation paid by private employers, insurance payments and social security benefits from the host country to workers who have returned home or, in some cases, money transfers below a certain amount. The scale of unrecorded transfers depends particularly on the difference between the official exchange rate and that determined by actual supply and demand – the black market rate. Besides a multitude of socio-economic factors (length of stay, trips home, geographic distance between the host and home countries, etc.), it is therefore probably mainly controls on capital inflows and outflows in the host and home countries that determine the level of remittances that go unrecorded.

The balance of payments statistics resort to estimates owing to these gaps in the official statistics. The German Federal Institution for Labour believes that the statistical errors could be largely eliminated and the "exact" data calculated with a 10 % deviation in either direction if suitable random samples and methods of calculation were used.³

The *recorded* volume of migrants' remittances to European Mediterranean countries between 1960 and 1981 is shown in Table 1. Only in the case of Italy was the flow of transfers of any significance in 1960. Italy being a member of the EEC, Italian workers enjoyed greater geographical mobility than foreigners from non-EEC countries. The amounts transferred increased rapidly in the sixties and early seventies as the demand for foreign labour grew. The rate of increase in remittances averaged more than 25 % a year, so that by 1973 they were running at more than US \$ 1 billion in the case of Italy, Spain and Turkey and three-quarters of a billion dollars in the case of Portugal and Greece.

This growth was checked after 1973-74 by the economic difficulties in the host countries. Restrictions on immigration and the large numbers of workers returning home led to a sharp reduction in the average annual rates of growth in remittances. In Portugal the

rate declined by about one-third, in Turkey and Greece by around two-thirds. In the case of Spain it swung from 27.5 % to -1.60 %. Only in the case of Italy, whose nationals were unaffected by the immigration restrictions imposed by EEC host countries, did the rate of growth between 1974 and 1981 remain practically the same as between 1960 and 1973.

These nominal figures overestimate the actual *real* rates of growth in transfers. Adjusted for price and exchange rate changes, real growth rates were below the nominal rates by one-fifth in Turkey, by one-quarter in Greece, Spain and Portugal and by more than one-half in Italy even in the period from 1960 to 1973. The discrepancy widened between 1974 and 1981. Whereas in nominal terms the flow of remittances rose by an average of more than 10 % a year in Portugal, Italy and Turkey and 5 % in Greece and declined by only 1.6 % a year in Spain, in real terms there were average reductions of 11 % in Spain and 2 % in Greece. Italy and Turkey recorded growth of only 3.3 and 5.8 % respectively. Only in the case of Portugal did transfers of foreign exchange rise by more than 12 % a year even in real terms.

The following section estimates the *real* impact that remittances – which by 1981 were running at a nominal annual rate of about US \$ 1 billion in Greece and Spain, about US \$ 2.5 billion in Turkey and Portugal and around US \$ 3.3 billion in Italy – had on

- ☐ national income (Y),
- ☐ private consumer expenditure (C),
- ☐ saving and investment (I) and
- ☐ imports (M).

Impact on National Income

Table 2 shows that between 1960 and 1981 migrants' remittances to the Mediterranean countries raised national income by amounts ranging from less than 1 % in the case of Italy and Spain to around 4 % in that of Portugal. In the case of Italy and Spain, whose economies are more highly developed in terms of GDP, the increases of 0.74 and 0.95 % were far smaller than in the less developed economies of Turkey (1.89 %), Greece (2.63 %) and Portugal (3.89 %).

Comparison of the national time-series data for the two divisions of the period under review shows that remittances raised GDP significantly (by a maximum of about 6 %) only in less developed economies, and then only so long as their level of development measured in terms of GDP did not exceed a certain threshold. Once that threshold had been crossed, the importance of

³ Deutsche Bundesbank: Ausländische Arbeitnehmer in Deutschland: Ihr Geldtransfer in die Heimatländer und ihre Ersparnisse in der Bundesrepublik, in: Monatsberichte, Vol. 26 (1974), No. 4, p. 27.

transfers of foreign exchange by migrant workers diminished as GDP increased.⁴

Private Consumer Expenditure

If it is assumed that remittances were used in the proportions indicated by the average consumption, saving and import propensities (c , s and m)⁵, they induced an average increase in private consumer expenditure ranging from a maximum of about 6 % in Portugal to a minimum of around 1 % in Italy and Spain between 1960 and 1981. In the period from 1974 to 1981 the maximum value rose to about 10 % Portugal to a minimum of around 1 % in Italy and Spain between 1960 and 1981. In the period from 1974 arises to what extent the induced growth in consumer spending that was not met by an expansion in domestic output had an inflationary effect or gave rise to additional imports.

In the Greece of the sixties, the low price rises for essential goods (average inflation rate below 2.5 %), the abundance of labour (average registered unemployment rate in excess of 5 %) and the less than full utilisation of manufacturing capacity (average capacity utilisation rate of about 80 % for industrial plant) indicate a shortage of demand for essential consumer goods, the sector mainly affected by remittances. The additional demand of 3 to 4 % therefore generated positive output effects rather than adverse inflationary trends.

High rates of price increase in the seventies indicated excess demand. The average increase of 3.26 % in the demand for consumer goods induced by remittances probably exacerbated this tendency.

In Turkey the main inflationary potential of remittances during the sixties lay less in the induced average increase of 1.54 % in the demand for consumer goods than in their unexpectedly rapid increase. In Turkey's system of indicative planning, a swift adjustment to the increased consumer demand was difficult. Despite idle capacity in some branches of industry, supply was relatively inelastic in the short run and certain prices began to rise. Remittances helped set the inflationary spiral in motion from the demand side.

Towards the end of the decade the Turkish planning authorities completely lost control over price increases. Consumer prices rose by 62 % in 1978, 64 % in 1979

and by as much as 94 % in 1980. Remittances contributed less than 4 % on average to the demand for consumer goods, so that the part they played in fuelling inflation was probably small by comparison with that of other factors.

In Portugal, remittances strengthened demand by an average of 3.81 % in the period from 1960 to 1973. At first, the developing economy had no difficulty expanding output.

After 1973 remittances financed 7 % of private consumption in 1974, 10 % in 1978 and about 13 % in 1979-81. They therefore had not only positive effects on output but also strong adverse effects on inflation. At the same time, the redistribution of incomes towards the underprivileged as a result of the political transformation of 1974 raised the overall propensity to consume. The inflationary spiral began to turn owing to demand pressures, and accelerated as the shortage of foreign exchange closed the import safety valve.

Saving and Investment

As far as capital formation is concerned, Table 2 shows a savings potential for the period as a whole ranging from 8.5 % in Portugal to less than 1 % in Spain. Between 1974 and 1981 the average values were 14.5 % for Portugal, around 6 % for Greece and about 4 % for Turkey, with peaks of over 20 % for Portugal in individual years (1978, 1979, 1980).

In Greece technical factors caused the investment of savings to be concentrated on particular regions and sectors of the economy. Remittances increased the demand for houses and land in the urban centres (especially Athens and to a lesser extent Thessaloniki) by much more than might be expected from Table 2; in 1965 40 % of all building activity in Thessaloniki and up to 80 % in some northern towns was financed by transfers of capital from Greeks living abroad.

In Turkey the average increase of about 2 % in potential demand for land, property and building materials between 1960 and 1974 did not have a particularly marked effect on prices. It was only after

⁴ The correlation coefficient to measure the relationship between the significance of remittances (measured in terms of the expansion in GDP) and the level of development of an economy (measured in terms of GDP) came to -0.804 in the economies under examination over the period from 1960 to 1981, a result that is supported by a high degree of probability.

⁵ Kindleberger estimates the marginal propensity to consume at 0.8 (0.5 for food, 0.3 for manufactured consumer goods) and the marginal propensity to invest at 0.2, without differentiating between domestic and foreign goods (C. P. Kindleberger: *Europe's Postwar Growth*, Cambridge (Mass.) 1967, p. 97). His assumptions are therefore not far different from our own calculations, which give values of 0.65-0.75 for c , 0.10-0.20 for s and 0.10-0.20 for m . The following quantitative findings with regard to the purpose for which remittances are used are based on empirical studies by the OECD and the ILO in the context of the World Employment Programme and the International Migration for Employment Programme and other studies, whose conclusions are summarised in T. Straubhaar: *Arbeitskräftewanderung und Zahlungsbilanz*, Berne and Stuttgart 1983, pp. 45 ff.

1970 that the steady erosion of the value of money prompted a flight into physical assets. In the major cities remittances contributed to a steep rise in land and house prices.

The strong desire to work for oneself caused a considerable proportion of savings to be invested in small enterprises in the tertiary sector in Turkey. Opening a small trading or service business or buying a van or taxi was expected to lay the foundation for an independent livelihood. The new service firms and workshops therefore began to compete with those already in existence, but this did not lead to a structural improvement in the sense of driving out inefficient firms. On the contrary, it fostered a kind of "bazaar capitalism" of barely viable, marginal firms condemned in the long run to incur debt or to go under.

Investment by workers' societies was an exception. In 1966 Turks working in Germany had formed themselves into workers' societies so that they could invest their savings jointly in industrialisation projects rather than individually in the services sector. As they were not

motivated solely by expectations of short-term profits but looked more to the maximisation of benefits over the long term (such as ensuring permanent jobs for their members upon their return to their native region), these societies invested their funds mainly in underdeveloped industries and regions, such as central and eastern Anatolia, where more than half of the societies invested. Their overall contribution to industrial development was minor. The small plant producing only for regional needs were of limited potential and their orientation towards the local structural set-up ruled out any expansion in their activities from the very outset.

In Portugal, domestic saving declined so sharply after the 1974 revolution that it was no longer sufficient to finance the replacement of plant and equipment. As the already small inflow of long-term private capital from abroad was also reduced to a trickle after 1974, remittances became a crucial source of finance. Between 1974 and 1978 they augmented domestic saving by an average of 10.4 % and financed more than one-third of all private investment. However, this was

Table 2
Significance of Remittances from Migrant Workers in Relation to Macro-economic Indicators
for Portugal, Spain, Italy, Greece and Turkey, 1960-81

Periods	Countries	$\frac{Y+R}{Y}$ (s =)	$\frac{c-R}{C-c-R}$ (s =)	$\frac{s-R}{I-s-R}$ (s =)	$\frac{m-R}{M-m-R}$ (s =)
1960– 1973	Portugal	2.54 (1.15)	3.81 (1.70)	5.06 (3.11)	4.01 (2.08)
	Spain	1.16 (0.29)	1.62 (0.42)	1.07 (0.36)	1.32 (0.36)
	Italy	0.82 (0.11)	1.16 (0.14)	1.15 (0.34)	0.99 (0.13)
	Greece	2.74 (0.44)	3.82 (0.63)	3.89 (1.12)	3.55 (0.69)
	Turkey	1.33 (1.64)	1.54 (1.88)	2.06 (2.76)	1.56 (1.96)
1974– 1981	Portugal	6.26 (2.00)	9.33 (3.48)	14.5 (6.19)	10.0 (3.31)
	Spain	0.60 (0.22)	0.85 (0.28)	0.69 (0.20)	0.71 (0.25)
	Italy	0.60 (0.08)	0.83 (0.13)	1.43 (0.31)	0.81 (0.12)
	Greece	2.44 (0.30)	3.26 (0.46)	5.85 (0.46)	3.39 (0.41)
	Turkey	2.86 (1.03)	3.66 (1.39)	3.89 (1.78)	3.26 (1.20)
1960– 1981	Portugal	3.89 (2.35)	5.81 (3.63)	8.50 (6.37)	6.19 (3.88)
	Spain	0.95 (0.38)	1.34 (0.53)	0.93 (0.36)	1.10 (0.44)
	Italy	0.74 (0.14)	1.04 (0.21)	1.25 (0.35)	0.93 (0.15)
	Greece	2.63 (0.41)	3.62 (0.62)	4.60 (1.34)	3.49 (0.60)
	Turkey	1.89 (1.61)	2.31 (1.98)	2.72 (2.57)	2.18 (1.89)

All ratios as percentages (effective value multiplied by 100).

(s =) indicates the standard deviation.

Source: Calculations by the author on the basis of data from the sources given in Table 1.

not so much productive investment in industrial and manufacturing sectors as the purchase of houses, apartments, land and small businesses in the services sector.

Import Effects

Table 2 shows that over the entire period remittances induced an increase in potential imports ranging from a maximum of between 3.5 % (Greece) and 6.2 % (Portugal) to a minimum of around 1 % (Spain and Italy). In Portugal the effect rose to an average of 10 % in the period from 1974 to 1981. The main factor determining the scale and impact of increased imports on the economies of the migrants' home countries was the character of the foreign trade regulations.

Take the state control and direction of imports in Turkey, for example. Restrictive exchange controls ensured that Turkish imports were mainly raw materials and equipment, with consumer goods accounting for less than 10 % of the total by value. Imports generated by migrants' remittances can be estimated approximately from the official import returns. These show that only 2-3 % of Turkish imports of consumer goods sprang from this source. The transferred funds were therefore used predominantly to purchase domestic products, while the exchange controls ensured that the portion spent on imports was used to buy capital goods or raw materials.

Greece may be cited as an example of the opposite tendency. The demonstration effect of luxury articles brought back by the returnees meant that foreign consumer goods became more highly prized. From the mid-seventies onwards the import propensity of private consumption increased sharply, a development to which remittances greatly contributed, if only via the imitation effect.

Conclusions

The examination of the output, employment, inflation and import effects of remittances shows that:

- The nominal data on remittances greatly overestimate their real value; the difference between nominal and real average growth rates for the period from 1960 to 1981 amounts to between 30 and 40 % in the case of Turkey and Portugal, between 80 and 100 % in that of Greece and Spain and well over 100 % in that of Italy.
- Remittances have a significant impact on gross domestic product only in economies below a certain level of development, the maximum effect being around 6 % recorded for Portugal. It was ascertained with a

high degree of probability that the more advanced the economy, the less marked the effect of remittances.

- In Portugal and Turkey and to a lesser extent in Greece the increase in the demand for consumer goods induced by remittances had positive output effects in the sixties and negative inflation effects at the end of the seventies. However, these effects tend to be overestimated for the economy as a *whole* and underestimated for individual *regions* or *sectors*.
- Remittances increased potential saving by an average of only about 1 % in Spain and Italy, 3 % in Turkey, 5 % in Greece and 8 % in Portugal. In very few cases was this saving used to purchase industrial or artisanal capital goods.
- The "boomerang theory" that remittances greatly increase the demand for imports and therefore flow back abroad without affecting the domestic economy is not substantiated. Only a small portion of less than 6 % was used directly to purchase foreign goods. The overwhelming majority remained within the economy as additional potential demand.

The following conclusions can be drawn from these findings:

The effects of remittances on the economies of migrants' home countries are often adduced to legitimise emigration, but they have probably been grossly overestimated. The undeniably positive balance of payments effect and the positive but weak output effect that may occur in certain circumstances are offset by adverse inflation effects.

The main reason for the absence of lasting positive output effects lay in the inefficient use of the remittances. As long as industrial investment opportunities with more efficient growth effects are or appear to be less attractive than small businesses in the tertiary sector or the purchase of real property or land, productive investment in manufacturing industry will remain an exception. If this misallocation of resources is to be brought to an end, measures must be taken to ensure that appropriate institutions and incentives channel remittances into productive investment on the basis of regional and sectoral development plans. There is a need for state participation (or residual financing) that will encourage investment, support arrangements (special loans at favourable interest rates), state investment in infrastructure, the creation of financing and investment institutions and complementary measures to provide training in business skills and to remove institutional obstacles, such as cumbersome bureaucratic procedures.