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Causes and consequences of the downturn in financial remittances to Turkey: A descriptive approach

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Causes and Consequences of the Downturn in Financial Remittances to Turkey: A Descriptive Approach

Giulia Bettin, Seçil Paçacı Elitok and Thomas Straubhaar

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Causes and Consequences of the Downturn in Financial Remittances to Turkey: A Descriptive Approach

Giulia Bettin, Seçil Paçacı Elitok and Thomas Straubhaar

Introduction

For decades, migrant remittances have been a fundamental external source of capital for the Turkish economy. Between 1960 and 1981, remittances covered about 80 % of the Turkish trade deficit and about 60 % of the current account deficit. In these earlier times, Turkey has been one of the top remittance recipients among all countries.¹ Due to the fact that remittances did not lead to an inverse outflow of capital by interest payments or other kinds of repayments, their impact on the balance of payments was more positive than it was with other monetary inflows (such as foreign direct investments [FDI] or loans), which would have the same effect in purely accounting terms.

Since the late 1990s, remittances to Turkey have declined sharply. This article evaluates the causes and consequences of the poor performance of aggregate remittances flows to Turkey in the post-1998 era. It presents an overview of relations between the changes in remitting behavior since the late 1990s to today and the dynamics of Turkish migration from an economic point of view and in its historical context. The paper also analyzes the trends in workers' remittances in the financial crises of 1994, 2000/1 and 2008 and questions the transformation of motives behind remitting decisions in the pre- and post-crises periods.

The rest of this paper is organized as follows. Section 2 presents a brief overview about the changes of remittances to Turkey in the last decades. Section 3 discusses the determinants and the effects of remittances and Section 4

¹ İçduygu (2005 a).

goes into the reasons behind the declining trend in the remittance flows to Turkey after the year 1998. Section 5 concludes.

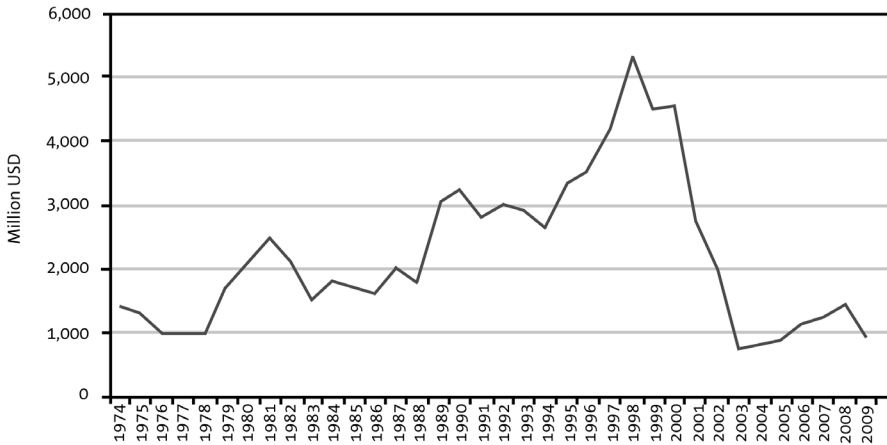
Remittances to Turkey

It is very well known that a large share of private money transfers is conducted via informal channels. This is the case for Turkey as well.² Consequently, the overall dimension of the phenomenon might be underestimated, if only official data are considered. Nevertheless, since estimations of informal remittances are extremely hard to provide, this is a common drawback affecting all empirical studies on aggregate remittance flows.³ In the case of Turkey, one of the most important data deficiencies is the lack of availability of remittance data disaggregated by country of origin. This might increase our understanding of the phenomenon, and be particularly useful to discern, if the fall in remittances is attributable to a different geographic pattern of Turkish emigration in the last decade compared to the previous ones.

Figure 1 presents the amount of remittances flows to Turkey from 1974 to today. The impact of consecutive devaluations in the Turkish economy following the oil crisis of 1974 upon the remittances trend in the 1970s is quite visible in Figure 1. Two factors played a role in the 1980s, namely liberalization in trade/finance following the military coup of 1980 and encouragement programs of Western Europe to promote return migration. The 1999 earthquake in Turkey and the financial crisis after the mid-1990s had remarkable effects on the remittances trend of 1990s and 2000s. Overall, it is sufficient to argue that between 1974 and 1988, with some tiny exceptions, the volume of aggregate remittances increased; whereas, there occurred a dramatic decline after 1998.

² Officially recorded remittances were greatly surpassed by the "luggage trade" made by migrants to Turkey. Non-recorded remittances may have reached six billion USD, surpassing by far the recorded remittances of about 1.2 billion USD; see İçduygu (2008).

³ Freund/Spatafora (2008).

Figure 1: Remittances to Turkey, 1974–2009, Million USD

Source: World Bank staff estimates based on the IMF Balance of Payments Statistics Yearbook.

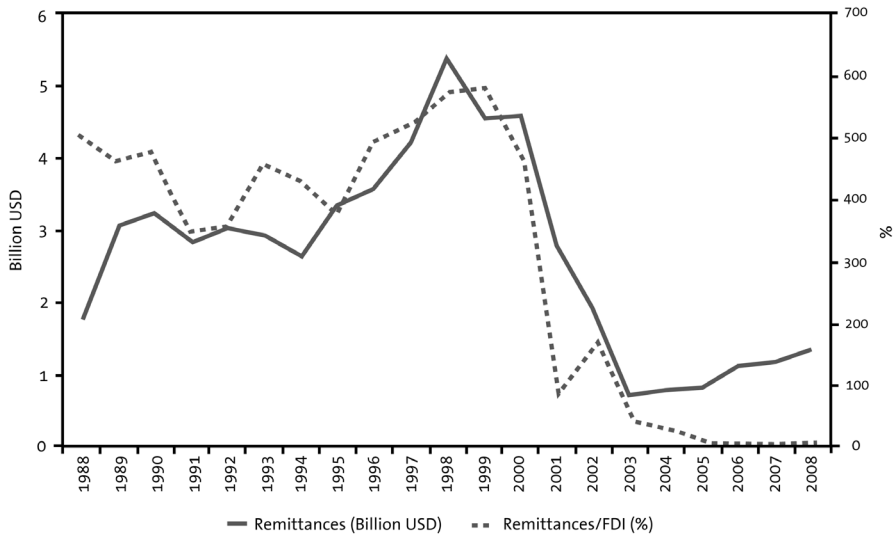
Remittances from citizens living abroad sent to support families and relatives back home have been a very important source of capital accumulation for Turkey. Before the recent decade, they played an important role in feeding the Turkish economy with capital. At that time, the level of remittances was about four to six times higher than the level of FDI (see Figure 2). Today, remittances still are a significant source for the accumulation of capital; however, due to a dramatic increase of FDI, remittances have lost their overall significance and reached only one sixth of the level of FDI in the last six years.⁴

Recently, also remittance outflows from Turkey to the neighborhood have become more important. An increasing number of workers from the Black Sea area and the Middle East have come to Turkey to get a job that is better paid

⁴ While in the times of the “Gastarbeiter” system most of the remittances were either consumed (for buying a car, apartment or house) or invested in trade (bazaar shops) or transportation facilities (taxis), more recently remittances have more and more been used to build up construction sites, farms or small manufacturing enterprises. This is especially true for the use of Anatolian capital. Companies in Anatolia, such as Kombassan, Büyük Anadolu Holding, Yimpaş, Endüstri, Sayha, İttifak and Jet-Pa, were founded primarily with the savings sent by workers abroad (see Ömer, Acar and Toprak, *Anatolian Tigers*). Some of the Anatolian Tigers went through legal investigation and it is legally proven that these companies used workers’ remittances outside of its collection purposes. It is also very well known that some of these firms have strong links with Islamic foundations, media and press. Most of these firms, also named as Islamic capital or green capital, bankrupted and were accused of cheating migrants. It is also important to keep in mind that there are also some successful examples among Anatolian firms who functioned very efficiently and had no Islamic ties.

than at home. They remit parts of their income to their family members left behind in their region of origin. These economic activities have come to be known as the “suitcase trade”, due to the fact that not only money but also goods of all kinds have been sent back home. Along with the remittances sent home from Turkey, a growing number of joint ventures and Turkish FDI into the neighborhood have appeared.⁵

Figure 2: Remittances and FDI to Turkey, 1988–2008, Billion USD



Source: World Bank: Quick Query Database.⁶

The Determinants and the Effects of Migrants' Remittances

The level of remittance flows depends on both the migrants' ability (income and the savings from income) and the motivation they have to remit savings back to the home country. The propensity to remit depends also on the duration of migration (whether it is temporary or permanent), the family situation of migrants (the partner, children) and the connections they have in the home

⁵ Kirişçi/Tocci/Walker (2010, p. 19).

⁶ “Remittances (R) compared to FDI” means: if value =1, then R = FDI, if >1, then R > FDI; if < 1, then R < FDI.

(whether migrants move alone or with other family members, and whether they keep attachments to those left behind).⁷

Why Do Migrants Remit? Some Theoretical Expectations

When looking at the motives that migrants have to remit, no general theory of remittances exists, as Stark (1991) highlights. The studies that analyze this topic provide descriptive evidence and empirical results that are limited to a certain geographical, socio-cultural and temporal context. The literature usually distinguishes between pure altruism, pure self-interest and informal agreements with family members left in the home country and portfolio management decisions. Pure altruism refers to the fact that migrants care about relatives left behind and derive utility from the welfare of his/her relatives. The altruistic model predicts that the amount of remittances should increase with the migrant's income⁸ and decrease with the domestic income of the family. Remittances should also decrease over time: the attachment to the family gradually weakens and migrants may decide to settle permanently in the host country followed by their family members.⁹

The second motive for remitting money may be pure self-interest. Migrants may remit money to their parents driven by the aspiration to inherit, if it is assumed that bequests are conditioned by behavior. Moreover, remittances could ensure migrants that relatives left behind take care of the assets they still own there.¹⁰ The intention to return home may further promote remittances for different types of investment (real estate, financial assets, public assets, social capital): migrants that experience a "return illusion" are shown to remit more than those experiencing a "permanent settlement syndrome".¹¹

A more eclectic model labelled "tempered altruism" and "enlightened self-interest" by Lucas and Stark (1985) sets remittances in a family framework of decision-making, as a component that is endogenous to the migration process. At the household level, to allocate certain members as migrants might well represent a Pareto-superior strategy, and remittances represent the mechanism for redistributing the gains in terms of both risk-spreading ("implicit co-

⁷ Munshi (2003).

⁸ Lucas/Stark (1985).

⁹ Lowell/de la Garza (2000).

¹⁰ Brown (1997).

¹¹ Glytsos (1988, 1997).

insurance agreement”) and investment in the education of young family members (“implicit family loan agreement”).

In the implicit co-insurance model, at the beginning the migrant plays the role of the insured while the insurer bears the initial costs of the migration project. The potential migrant is hardly expected to be able to cover all the expenses alone. Later on, he might become an insurer for the family members back home when he finds secure employment, and has high enough earnings to remit.¹² By receiving remittances, the family will then have the opportunity to improve its consumption, to undertake investment projects including much more risk and thus reach a higher level of utility. In the loan agreement model, remittances are assumed to be the repayment of an informal and implicit loan contracted by the migrant for investment in education and migration costs. In a second stage, remittances become loans made by migrants to young relatives in order to finance their education until they are themselves ready to migrate. Finally, in the third stage, before returning to the country of origin, migrants use remittances to invest in assets at home. Later, the next generation of emigrants repay the loan to the former emigrant lenders, who may have retired in the home country. Given the nature of the loan, remittances cannot consequently be reduced over time – as the co-insurance or altruistic theories predict – and are mainly used for consumption purposes.

Migrants could also have a saving target; thus, they want to return home with a certain amount of savings. Remittances are part of a bargaining process between the migrant and the family left at home. The claim of the family on a migrants’ income can be considered as the demand side and the ability of the migrant to remit (income and savings) represents the supply side for remittances. The migrant wants to reach the saving target and to minimize the drain from his income, be it in the form of consumption expenses in the host country or remittances to the family. The family, on the other hand, wants its income to be larger than that of the neighbors in order to justify the decision to send some family members abroad. In this set-up, the amount of money remitted depends on the migrant’s income, the per capita income in the home country and the bargaining power of the two sides. The remittance behavior might be different whether migrants move for permanent settlement or just temporarily. Incentives to remit could be higher for temporary migrants¹³ since

¹² Lucas/Stark (1985).

¹³ Galor/Stark (1990).

the attachment to the home country declines over time.¹⁴ On the other hand, the longer the time spent in the host country, the higher the wages, so in principle migrants could have the chance to remit more, if interested. Lucas points out that remittances may initially rise, and then decline with duration of stay, which “would suggest an optimal length of stay to maximize remittance flows, balancing greater earning power against diminishing attachment”.¹⁵

All the models mentioned so far refer to the individual motives to remit rather than to macroeconomic dynamics of these flows, which certainly reflect individual decisions at an aggregate level. Anyway, there might be some macroeconomic factors, both in the host and home country, which may significantly affect the size of remittances. Part of migrants’ savings may be remitted for reasons of relative profitability of savings/investing in the home country, and can be explained in the framework of a portfolio management choice where relative macroeconomic factors in the host and home country play a key role: among the others, interest rates, exchange rates, inflation and relative rates of return on different financial and real assets.

Taking this into account, governments of migrant-sending countries used to implement incentives schemes (i. e., premium exchange rates, foreign exchange deposits with higher returns, etc.) in order to attract remittances, but they were not really successful. As far as Turkey is considered, empirical analyses for the period 1963–1982 show that neither variations in exchange rates (reflecting the will to attract remittances by premium exchange rates), nor changes in the real interest rates (reflecting the intention to attract remittances by foreign exchange deposits with higher interest rates) seemed to significantly affect the size of remittance flows. Remittances towards Turkey were much more affected by the prospect of political stability rather than actual economic returns.¹⁶

It should be rather clear that these different hypotheses concerning remittance behavior are not mutually exclusive since some or all of them could work at the same time and the predominant element might change between periods and individuals. A universal framework therefore is the challenging task to be reached.¹⁷

¹⁴ Merkle/Zimmermann (1992).

¹⁵ Lucas (2004, p. 13).

¹⁶ Straubhaar (1986).

¹⁷ El-Sakka/McNabb (1999).

The different hypotheses attempting to explain remittance motivations – pure altruism, pure self-interest, implicit family agreements, the migrant's saving target and portfolio management decisions – complement each other. Some or all of these motives together may simultaneously drive remittances, each one explaining a part of the amount remitted or a period of remitting practice. One motive can predominate over the other for a period or for a sample of migrants with the same characteristics, and their roles can be interchanged. This illustrates that the remittance phenomenon is a very complex one, and explains the difficulty in developing a universal theory of remittance determination. A very important recent assumption regarding the contribution of remittances in compensating the human capital loss of migrant-sending countries is that migrants' propensity to remit diminishes with education. There is little empirical work regarding this issue (an exception is Faini [2002]), but if confirmed by future research, the results would be outstanding. It would imply that high-skilled workers do not compensate (or compensate less) for the loss they induce to the economy they are leaving.

Which Effects from Remittance Inflows?

The literature about the impact of remittances in receiving countries is recent, but it has grown rapidly in the last years. Most of the analyses focus on three main issues. The *first* topic discussed is the direct impact of remittances on income distribution, poverty alleviation and individual welfare.

Migrant remittances unquestionably produce welfare effects in developing countries such as poverty alleviation, education and health improvements. At the national level, several studies¹⁸ show that even if the impact on poverty incidence is small, the reduction in the severity of poverty, measured by the poverty gap, is substantial. Many families that receive remittances are still below the poverty line, but their income level is much closer to the threshold than what it would be otherwise. Remittances contribute to increase households' disposable income, relaxing liquidity constraints; this can sort positive effects on educational choices for children. Yang (2008) considers the increase in remittance flows received by Philippine households after the appreciation of foreign currencies against the Philippine peso due to the 1997 Asian financial crisis. These positive income shocks enhance human capital accumulation, raising schooling enrollment rates and reducing therefore child labor. Cox, Ed-

¹⁸ See Adams (2004) for Guatemala and Taylor et al. (2005) for Mexico.

wards and Ureta (2003) find that remittances have a significant impact on school retention while other studies on the Mexican case¹⁹ document that remittances are associated with substantial health improvements, namely reduction in infant mortality and increase in birth weight.

Empirical contributions on the income distribution effects of remittances mainly use the Gini index and results are mixed. Although some scholars²⁰ found confirmation that remittances have an equalizing effect on income distribution, other studies show that remittances increase inequality as measured by the Gini coefficient.²¹ As a matter of fact, wealthier families, being more able to pay for the costs associated with international migration, may also be those who benefit the most from migrants' remittances. By means of a dynamic model of rural income distribution in two Mexican villages, Stark, Taylor and Yitzhaki (1986, 1988) similarly found that the distribution effect of remittances depends ultimately on the migration history, and on the degree to which migration opportunities are distributed across households. When the migration process begins, information about destinations and employment possibilities is still limited and only wealthier households can afford to send migrants abroad. Consequently, wealthier families are the first to benefit from remittances, causing income inequality to rise. Later, as the chance to migrate spreads over a greater range of income classes, poorer households can benefit from remittances, too, and there is an equalizing effect on income distribution.

Clearly, to evaluate the overall effect of remittances on income distribution there are some factors to be taken into account: the level of initial inequality can vary according to the different environments, and disparities in results may be caused by differences in the empirical methods applied.²²

The *second* part of the literature discusses the effects of remittances on the economy as a whole, and specifically the impact on employment, productivity and growth. While there is little doubt concerning the positive microeconomic effects deriving from remittances, the mechanisms behind the macroeconomic consequences for the receiving countries are more complex. The magnitude of the development impact of remittances was assumed by

¹⁹ Hildebrandt/McKenzie (2005), Duryea et al. (2005), Lopez Cordova (2005).

²⁰ Taylor/Wyatt (1996), Taylor (1999).

²¹ Adams (1991), Rodriguez (1998), Adams (1998).

²² Rapoport/Docquier (2005).

many scholars to crucially depend on how this money was spent: consumption, housing, purchasing of land, financial saving or productive investment.

To the extent that remittances are channelled into investments, they can directly affect employment and growth on a long-term basis. Inflows of workers' remittances add to domestic sources of income to finance capital accumulation and, at the same time, they can contribute to lowering the cost of capital in developing economies via an improvement of the creditworthiness of domestic investors (collateral function). Glytsos (2002) for example shows that investments rise thanks to remittances in six out of the seven Mediterranean countries in his sample. In the same line, Leon-Ledesma and Piracha (2001) find a positive effect of remittances (through investments again) on productivity and employment for eleven transition economies in the period 1990–1999.²³

When remittances are used to fund consumption expenditures, short-run effects on economic output depend on different factors: purchased goods might be produced in the country, but also imported from abroad; moreover, an unexploited national productive capacity is needed to fulfill the increase in the internal demand of goods deriving from a higher household purchasing power.²⁴ One remittance dollar spent on basic needs may stimulate retail sales, which stimulate further demand for goods and services, which then stimulates output and employment.²⁵ In this line of reasoning, remittances might represent a possible offset to the decline in output as a result of emigration.²⁶ In the case of Central and Eastern European countries, Straubhaar and Wolburg (1999) showed that remittances do not compensate the welfare loss due to the emigration of the high-skilled workers to Germany.

The short-run impact of remittances on aggregate output has been estimated through a simple Keynesian multiplier effect. Glytsos (1993) calculates a remittance multiplier of around 1.77 in gross output for Greece,²⁷ while the es-

²³ See also Drinkwater et al. (2003).

²⁴ When the demand deriving from remittances falls on non-tradable goods, and the economy cannot meet this demand, remittances may generate an inflationary effect. The price for agricultural land in Egypt rose by 600 % between 1980 and 1986 due to remittances (Adams [1991]).

²⁵ Lowell/de la Garza (2000).

²⁶ Quibria (1997) shows that if low-skilled migrants emigrate, and remittances are in excess of the domestic income loss, then the welfare of the source country rises. If, on the other hand, migrants are high-skilled workers and/or if emigration is accompanied by capital, remittances have a welfare-increasing effect for the non-migrants only when the capital/labor ratio remains unchanged or rises in the country of origin. If the capital/labor ratio falls, the welfare effect is indeterminate or even negative.

timated value is around 3.2 for Mexico.²⁸ Ratha (2003) estimates that every remittance dollar spent in Mexico increased GNP by 2.69 USD in the case of urban households and by 3.17 USD in the case of rural households.

A further channel through which remittances may affect growth is the labor force participation of recipient households. Chami et al. (2005) underline that remittances take place in a context of asymmetric information due to the long distances between migrants and recipients. Therefore, remitters do not have the chance to monitor the final use remittances are destined to and moral hazard problems could induce recipients to decrease either their labor effort or the participation in the labor force, diverting additional income to the consumption of leisure.²⁹ Using panel methods on a sample of 113 countries, they show that a change in the remittance/GDP ratio is negatively related to economic growth confirming that the moral hazard problems in the use of remittances are severe. Clearly, in this context higher growth rates in developing countries might stimulate more conspicuous remittance flows. Therefore, the endogeneity of remittances needs to be addressed and the subsequent literature dealt with this problem showing contrasting results.

In two cross-section studies conducted by the IMF (2005) and Faini (2006) the coefficient on the remittance-to-GDP ratio in the growth regressions was positive but statistically insignificant. Acosta et al. (2008) instead analyzed a panel of 67 countries in the period 1991–2005 and found that remittances have a positive albeit modest influence on economic growth. These positive results were also confirmed through the studies on Latin American and Caribbean countries by Ramirez and Sharma (2008) and Mundaca (2009).

Other studies showed that, on average, remittances have either no significant influence on growth or, when significant, their effects are positive but very limited in magnitude.³⁰ However, things change when remittances are considered together with other determinants of economic growth: if interacted with a measure for financial development³¹ or with indicators for the qual-

²⁷ It is interesting to highlight the result that spending on consumption and investment produced similar multipliers of respectively, 1.8 and 1.9 in Greece. And contrary to common opinion, expenditure on housing was found to be very productive, with a multiplier of 2.

²⁸ Adelman/Taylor (1990).

²⁹ Gapen et al. (2006) using a dynamic general equilibrium model with remittances show that these flows reduce labor supply and lead to greater output volatility.

³⁰ Giuliano/Ruiz Arranz (2009), Catrinescu et al. (2009).

³¹ Giuliano/Ruiz Arranz (2009), Mundaca (2009).

ity of institutions³² in the second one, remittances prove to contribute significantly and positively to economic growth.

The *third* part deals with the contribution of remittances to the balance of payments. If remittances are a further income for the receiving household at a microeconomic level, they also represent an addition to the receipt side of the balance of payments at an aggregate level, giving a substantial contribute to ease crucial restraints imposed on the economic growth of developing countries. Remittances might help to offset chronic deficits by reducing the shortage of foreign exchange. When compared to other monetary inflows, i. e., financial aids, direct investments or loans, they show numerous positive aspects because their use is not linked to specific investment projects with high-import content, they bear no interest and do not have to be repaid. In addition, remittances are more stable than other private capital flows as a source of foreign exchange and empirically it has been proven that in some specific cases they exhibit an anti-cyclical behavior.³³

However, as mentioned before, this positive effect on the balance of payments may also come together with additional imports (and/or adverse inflation effects), if the additional demand induced by remittances cannot be met by expanding domestic output. Thus, a “boomerang effect” might occur in the case that remittances induce an increase of imports and trade balance deficits in the receiving country. Evidence shows that in Southern European countries the effect was small and remittance-induced imports between 1960 and 1981 accounted for 1 % in Spain and Italy, 4.9 % in Greece and 6.2 % in Portugal.³⁴

The demand for imported tradable goods stimulated by remittances can also lead to an appreciation of the real exchange rate. This latter aspect is linked to the so-called “Dutch Disease” effect. A large inflow of capital, be it in the form of foreign aid or remittances, might cause an appreciation of the real exchange rate, with negative consequences for the tradable sector in terms of international competitiveness (exports on foreign markets become more expensive while imports on the domestic market become cheaper).³⁵ Rajan and Subramanian (2005), however, give evidence that private-to-private flows (hence remittances), unlike aid inflows, do not have systematic adverse effects

³² Catrinescu et al. (2009), Calderón et al. (2008).

³³ Straubhaar (1988), Buch et al. (2002), Buch/Kuckulenz (2004).

³⁴ Glytsos (1993), Straubhaar (1988).

³⁵ Amuedo-Dorantes/Pozo (2004), Lopez et al. (2007), Lartey et al. (2008).

on external competitiveness and empirical evidence from Egypt, Portugal and Turkey, although supporting such fears showed that the “Dutch Disease” effect remained marginal in most of the cases.³⁶

Some Empirical Evidence for Turkey

The existing empirical evidence for the determinants of migrants’ remittances to Turkey can be categorized into two groups.

The *first group* of studies is focused on macroeconomic and microeconomic determinants of remittances to Turkey. Van Delan et al. (2005) empirically examine the micro determinants of remittances and the effect of remittances on emigration intentions in a multi-country study including Turkey, Morocco and Egypt. It is shown in this 2005 study that, in all three countries, family ties and the net earnings potential of emigrants have stronger effects in the receipt of remittances than net earnings potential of households in the country of origin. They also conclude that the receipt of remittances has a positive effect on emigration intentions of household members living in the country of origin. With reference to the motives behind remittances, this study states that altruism and self-interest play equally crucial roles as driving forces. Analyzing the determinants of emigrants’ remittances from Germany to Turkey over the period 1963–1982, Straubhaar (1986) showed that flows of remittances towards Turkey have been attracted by the emigrants’ confidence in the stability of the Turkish government much more than by governmental incentives to attract remittances. It is argued that remittances towards Turkey are determined by the wage level in Germany and by the confidence the Turkish emigrants felt in the safety and liquidity of their investments in the country of origin. According to this study, neither interest rate nor exchange rate differentials between the host and home countries have an effect on remittances. Examining the macroeconomic determinants of remittances to Turkey by using time-series methods over the period 1992–2003, Alper (2005) shows that interest rate, price level, income and exchange rate are the main macroeconomic variables behind remitting behavior. It is also presented in the same study that, in the long run, investment motive is effective whereas consumption smoothing plays a role in the short run with respect to workers’ remitting behavior. Aydaş et al. (2004) assess the macroeconomic determinants of remittances in the case of Turkey using an OLS estimate for two periods, 1965–1993

³⁶ McCormick/Wahba (2004), Straubhaar (1988).

and 1979–1993, and conclude that black market premium, interest rate differential, inflation rate, growth, both home and host country incomes and periods of military regime significantly affect remittance flows. Köksal (2006) underlines the importance of Turkish commercial banks and the Central Bank of Republic of Turkey (CBRT) in attracting the remittances to Turkey in her paper analyzing the significance of financial infrastructure, which is rarely touched upon in the literature focusing on Turkey, as one of macro determinants of remittance behavior. Akkoyunlu and Siliverstovs (2007) analyze the influence that workers' remittances might exert on migration decisions via co-integration analysis for the 1964–2004 period. Their study shows the significance of remittances in explaining migration in the short and long run. In his work analyzing the determinants of return migration of Turkish immigrants in Germany, Kirdar (2005) finds that immigrants with a higher savings potential are more likely to return.

The *second group* of studies is centered on the cyclical characteristics of remittances. Sayan (2004) evaluates the business cycle properties of Turkish workers' remittances. Based on the official data set provided by the CBRT, Sayan (2004) constructs a data set based on several assumptions and weights and concludes that remittances are procyclical with the GDP in Turkey and acyclical with the German GNI (Gross National Income). In a related paper, Erdem-Yiğit (2005) presents that the cycles of the Turkish workers' remittances are procyclical against Turkish business cycles and acyclical against German business cycles. Sayan (2006) analyzes the behavior of workers' remittances flows over their respective business cycles. His study covers twelve developing countries over the period 1976–2003 and results for Turkey show acyclical behavior of aggregate inflows of remittances. When looking specifically at the remittances from Turkish workers in Germany, Sayan (2006) claims that remittances are countercyclical from 1987 to 1994 and then they become procyclical. This change in the author's view is mainly due to the financial crisis that has negatively affected the level of migrants' confidence in the home country. In the work of Sayan and Tekin-Koru (2007), it is shown again that remittances sent from Germany appear to be procyclical with the Turkish output. They follow the business cycle in Turkey by a lag of one quarter. Remittances then amplify business cycle fluctuations rather than smoothing them. No significant correlation is found between remittances and German output. Using Deutsche Bundesbank data for the period 1962–2004, Akkoyunlu and Khodolin (2006) provide contrasting results and state that the remittances of Turkish workers

in Germany positively respond to the changes in the German output and do not react at all to the changes in Turkish output.

It can be said that remittances did not turn into employment-creating investments yet failed to create positive externalities in terms of productivity. The strong desire to do self-employed work and to become a kind of an independent economic actor caused a considerable proportion of savings to be invested in small enterprises in the service 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 workers’ societies so that they could invest their savings jointly in industrialization projects rather than individually in the service sector. As they were not motivated solely by expectations of short-term profits but looked more to the maximization 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 plants 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.

Thus, the effects in terms of economic development remained rather limited. Instead, remittances financed Turkey’s current account deficit to a certain extent, while increasing the import capacity. Hence, most of the studies discuss these limited effects and prove the non-productive aspects of remittance flows. Karagöz (2006) applies a time series regression in order to empirically prove the negative impact of remittance flows on economic growth over the period 1970–2005. Köksal (2006) highlights the inflationary effects and the negative influence of remittances on the exchange rate of the Turkish Lira in line with macroeconomic studies that analyze the so-called Dutch disease effect deriving from remittances.³⁷ Among the incentives that the Turkish Gov-

³⁷ Amuedo-Dorantes/Pozo (2004), Lopez et al. (2007), Lartey et al. (2008).

ernment used to channel remittances to productive economic activities, one can list special import privileges, premium exchange rates and high interest rates for foreign currency accounts in the CBRT. Additionally, in the late 1960s, three development projects took place so as to channel remittances towards investment and employment, the village-development co-operatives, workers' joint stock companies and the State Bank for Industry and Migrant Investment (DESIYAB). All of these attempts failed to be successful in the long term due to various reasons, which were deeply discussed in the literature.³⁸

However, one contribution departs from this dominant pessimistic view concerning economic consequences deriving from remittances. Koç and Onan (2004) in their study on international migrants' remittances and the welfare status of the left-behind families in Turkey, based on a 1996 Turkish International Migration Survey (TIMS-96), show that remittances are mainly used by households in order to improve their standard of living and to therefore contribute to reduce poverty and inequality. This approach is along the same lines as de Haas (2005), who underlines the inaccuracy of the idea that remittances are predominantly spent on excessive consumption and criticizes the inclination to denote expenditure on housing, health care, food and schooling as unproductive and non-developmental. De Haas (2005) argues that the impact of migration tends to be highly differentiated across time and space.

Finally, the ECORYS (2006) report on improving the efficiency of workers' remittances devotes one of its sections to the transfers from Germany to Turkey. According to this report, the falling trend of remittances to Turkey can be explained by two factors: the declining number of Turkish migrants (the declining number of remitters) and the weaker attachment of third- and fourth-generation migrants to the homeland. For İçduygu (2005 b), the declining trend of remittances in the first years of the 2000s can be explained through the economic downturn in host countries like Germany that has led to unemployment among Turkish emigrants and settlement of Turkish emigrants in the host countries, which means they send less money home. According to Karagöz (2006), a decrease in the workers' remittance flow since the early 2000s can be explained through the demographic change in Turkish emigrants' sociological structure and their entrepreneurial skills (which cause the drop in investment-oriented remittances). Aydaş (2005) also analyzes the drop in the remittance flow in 1999 (the year of the earthquake) and sees it as evi-

³⁸ See Yüksel (1982), Köksal (2006), Güven (1977), Tatar et al. (1989), Ersun et al. (1997), Martin (1991).

dence showing the dominance of the investment motive (rather than the altruism motive) as the possible reason behind remitting. According to Avcı and Kirişçi (2008), falling emigration and the permanent settlement of migrants are the main reasons behind the shrinking amount of remittances. Erzan (2009) in his paper estimating the direction and magnitude of the global economic crisis on remittances (including Turkey), concludes that the EU slowdown, which will reduce the financial capacity of immigrants, will dominate over the increased need for funds at home, curtailing the remittances received by developing countries. Erzan (2009) argues that the magnitude of this decline may differ considerably across countries due to the fact that the impact of growth at home and in the host country on remittances had been changing over time.

The Dramatic Drop of Remittances to Turkey in the Post-1998 Era

Permanent Residency in the Host Country and Loss of "Return" Idea

The change in the demographical structure in the Turkish population in Europe is one of the most important determinants of declining remittance flows to Turkey, according to ECORYS (2006) and Avcı and Kirişçi (2008). The relatively declining pattern of a migrant population of Turkish origin may be explained by the increasing legal restrictions on migration flows generally considered, and specifically on flows from Turkey in some cases, i. e., Germany. These restrictions could force migrants to abandon their plans for temporary migration and to stay on a long-term basis because of the increasing difficulties in being readmitted in the host country. It is possible to observe that long-term migrants with a Turkish background gradually lose the dream of returning eventually to their homeland. This automatically translates into weaker ties of the second and third generation of migrants with the country of origin. The link between the intention to return and the amount of money sent home is rather obvious. When planning to go back, migrants consider their home country as the center of their economic interests and are inclined to remit instead of investing money in the host country. In our case, the remitting behavior of first-generation migrants backed up with the "return to Turkey with the family" dream has lately dissolved and has not been pursued by the new generations that are progressively turning into permanent residents (and

in some case, citizens) of their host country. Reform in the German Nationality Law in 1999 (which came into force in 2000) also played an important role in the amount of remittances to Turkey due to the naturalization of Turkish migrants. The new law, to a certain extent, made it easier for migrants residing in Germany on a long-term basis (eight years with permanent residence) and also for the children of migrants to acquire German citizenship.

Change in Socio-economic Status: the Second and Third Generations as Entrepreneurs Investing in Their Own Business

As migrant entrepreneurship literature showed us, the majority of Turkish migrants are self-employed, and instead of remitting in Turkey, their savings are channeled towards local business in the host country. According to Micro-census 2007, among the self-employed persons with a migration background in Germany the largest group of the entrepreneurs is represented by Turks. In early 2000s, only in Germany, there were more than 50,000 businessmen of Turkish origin providing jobs to over 250,000 persons.

Invisible/Informal Channels: Islamic Foundations and the Corruption of Money Invested by Turkish Migrants

The 1990s were a scene of organizational grouping of Turkish migrants under various Islamic groups some of which with extreme religious tendencies. Differently from the first two decades of Turkish migration to Europe, religion as a founding element of migrant identity became politicized for the first time. This religious uprising was in parallel with the internal political developments of Turkey and most of these organized foundations were representatives or foreign branches of already-existing Turkish head offices. By the late 2000s, both German and Turkish governments increased supervision measures not only on the political activities of these foundations but also on their budgets. Due to the lack of data on the amount of money siphoned away from the Muslim community in Europe, it is difficult to judge its role in the general dropping tendency of post-1998 remittances behavior. However, it is acknowledged that some parts of Muslim migrants' savings were used and corrupted under the name of "donation" via these foundations. Hence, migrants who voluntarily supported these unions financially spared some percent of their money for "mutual aids/solidarity funds" instead of remitting. However, it is

important to keep in mind that these religious oriented migrant networks explain only some part of informal channeling.

Change in Calculations

Some parts of the decline in remittances, especially the sharp declines in the early 2000s, are due to the change in the calculation/classification of remittances by the CBRT. Before 2003, workers' remittances included three main items; namely, foreign exchange remittances converted into Turkish Lira, Turkish Lira conversion from foreign exchange accounts of Turkish citizens living abroad and money they spent during their visit in Turkey. In 2003, the CBRT introduced a new method and reclassified the last two items of workers' remittances under tourism revenues. However, under the new classification, these data do not allow us to see these two items separately under the tourism revenues item. Hence, it is impossible to distinguish the real impact of the new calculation method in the drop of remittances.

In the case of Turkey, in which tourism is one of the leading economic sectors, receiving the tourism incentives from state is very crucial for entrepreneurs. This new method of classification artificially shows a tourism hump, so that the political environment for lobbying for incentive-receiving for tourism activities is eased. In 1992, remittances data became monthly.

Drop in Interest Rate and Rise in Tax

Turkish commercial banks and the CBRT have been playing a crucial role for attracting the remittances to Turkey.

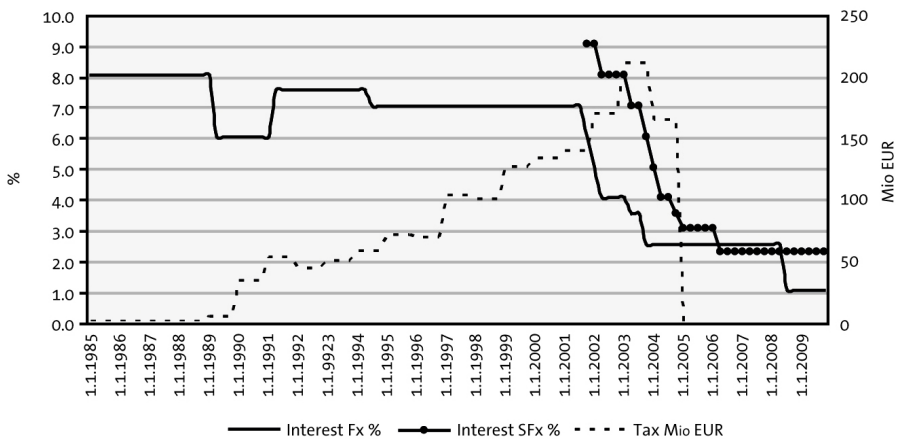
There exist two types of foreign currency bank accounts in which Turkish workers living abroad can open with the CBRT so as to deposit their savings, namely the foreign currency deposit account with credit letter (FXA) and the super foreign currency account (SFXA).³⁹ The crucial aspect of these accounts (introduced in 2011) for the scope of this study is the interest rate that is paid

³⁹ Individuals eligible for opening Foreign Currency Deposit Accounts with a Credit Letter and Super FX Accounts are real persons over eighteen years of age having residence or working permits abroad or the right thereto as Citizens of The Republic of Turkey (possessing The Republic of Turkey Identity Card/passports) or possessing "Certificates Regarding the Use of Rights Under the Law No. 5203". Persons authorized to work abroad for a long term by the public agencies and those employed at the representative offices and bureaus abroad of the public and private sector organizations are also entitled to open these accounts. Citizens having a Credit Letter and Super FX Accounts may continue their accounts under the prevailing legislation also after their final return to Turkey. Please visit <http://www.tcmb.gov.tr/yeni/eng/> for detailed information on these accounts.

by the CBRT and the amount of tax that is deducted from the overall interest rate payment. Figure 3 presents three indicators; namely, the interest rate on FXA as a percentage, the interest rate in SFXA as a percentage and the amount of tax deducted from the interest payment on FXA and SFXA in total in million euro terms (one-year time deposit account).

As it is presented in Figure 3, there is a declining trend in the interest rate and an increasing trend in the volume of tax. These two opposing trends give us a hint about the dramatic drop of aggregate remittance flows by the end of 1990s. With respect to FXA, the main drop in the interest rate after a steady state since 1994 is in 2001, the year of the global financial crises. Following years witness a drop of almost 1 % each year. A similar trend is applied to the SFXA over the period 2001–2004, when the interest rate fell from 9 % to 3 %.

Figure 3: Interest Rate (%) and Tax (Million Euro) for FXA and SFXA⁴⁰

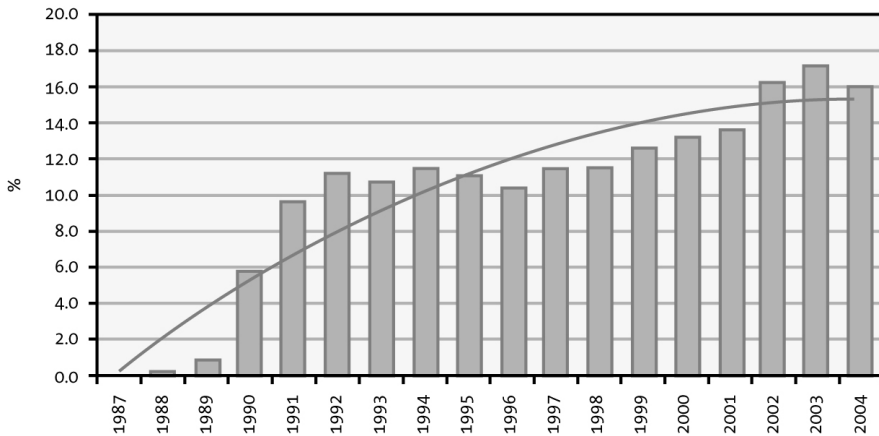


Source: Central Bank of Republic of Turkey, CBRT.

Thus, Turkish migrant workers gradually faced lower interest rates and higher tax ratios, which contributed to the decrease in remittances.

⁴⁰ The reason behind the reaching of the blue line (Tax on FXA and SFXA in million Euro) is the lack of data after 2005.

Figure 4: Tax Applied to Remittances, 1987–2004, Percentage Change



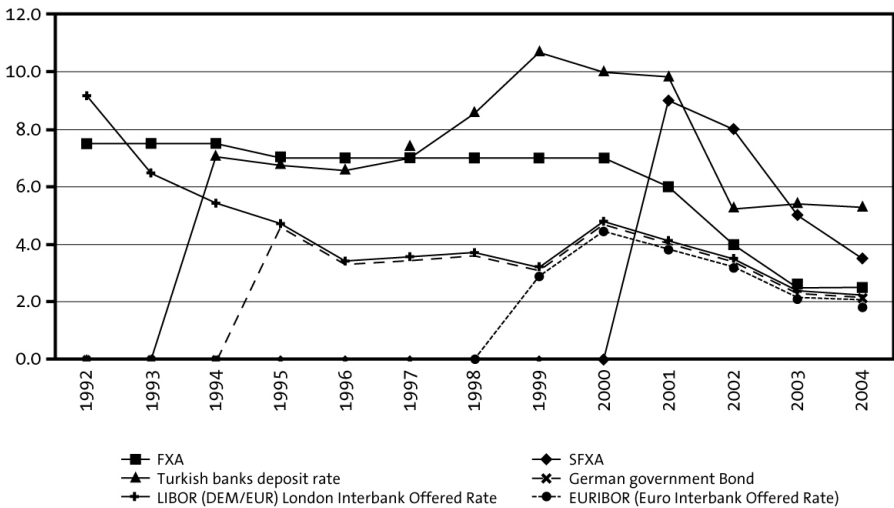
Source: Central Bank of Republic of Turkey, CBRT.

These noticeable declines were not the sole determinants strengthening the negative incentive of workers' remitting behavior. As it is clearly shown in Figure 4, the pattern of tax volume that is deducted from the total interest payments both to FX and SFX accounts has been an increasing trend since the early 1990s. The distinct vault right after the year 1998 is worth mentioning.

At this juncture, it is also crucial to ask whether the Turkish workers' remittances have shifted away from the accounts in the CBRT to German or related European financial institutions. In order to shed light on this question, Figure 5 compares the interest rates of the CBRT, Turkish banks, German government bonds, LIBOR (London Interbank Offered Rate) and EURIBOR (Euro Interbank Offered Rate) – (one-year time deposit account). It can be easily followed from Figure 5 that the CBRT interest rate on FXA and SFXA is above the other Turkish banks, German government bonds, LIBOR and EURIBOR in all periods. Hence, there was no interest rate advantage for workers to remit their savings into better paying options, neither in Germany nor in the rest of Europe. Yet, remittances still did fall and possibly shifted to non-financial instruments.⁴¹

⁴¹ It is crucial to underline the importance of the double taxation issue of Turkish workers' remittances in the case of Germany. Since the interest rate is considered as an income, at the end of fiscal year, migrants are obliged to declare the amount of income that they received due to remitting in Turkey and taxed according to German laws.

Figure 5: Comparison of Interest Rates Applied to Remittances, Percentage



Source: Central Bank of Republic of Turkey, CBRT.

Shift to the Euro in the EU and Crisis in Europe

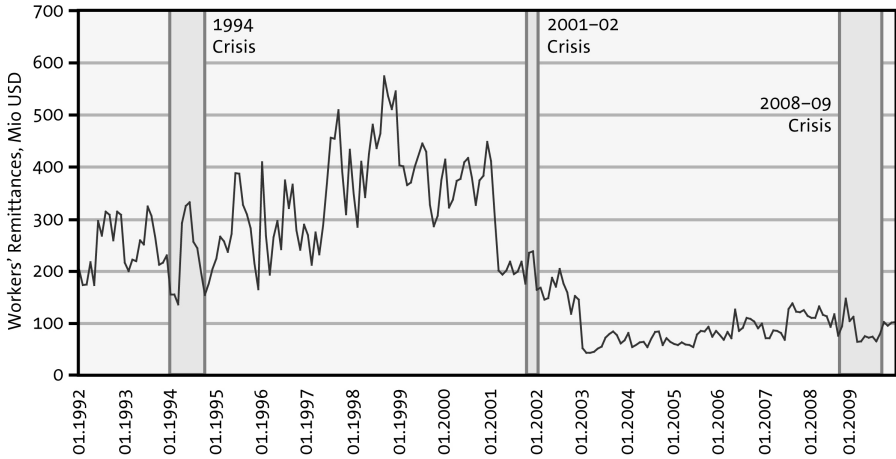
By 2002, the shift of EU to the common currency, the Euro, had both positive and negative impacts on various macroeconomic indicators. It is agreed upon in the literature that for most of the cases, the impact of the new currency on the consumers' purchasing power, especially of migrants as the most vulnerable group, was negative. Particularly in the transition period (1999–2002), the impact on the cost of living was unbearable and this had a negative impact on the savings of migrants, which caused a decline in the remittances potential. This negative effect has been even more aggravated by the economic downturn in Germany and crisis in the EU area in the late 1990s and early 2000s.

Crises in 1994, 2000/1 and 2008/09

The crises that took place in 1994 and 2000/1 were deeply different from the one in 2008 due to their causes and characteristics. These differences are obvious and normal when one takes into account the different economic conjunctures of time periods. The 1994 and 2000/1 crises were financial in nature, whereas the 2008 crisis hit the non-financial sector the most.

The 1994 crisis was a result of a high-risk premium of private banks under a lack of enough supervision of the financial sector. Yet, due to the high fragility of the banking system, Turkish economy ended up with a liquidity and foreign exchange bottleneck.

Figure 6: Remitting Behavior in Crisis Periods, 1992–2009, Monthly Million USD



Source: Central Bank of Republic of Turkey, CBRT.

The 2000/1 crisis were the financial crises that originated from the fragile structure of the Turkish banking system. In November 2000, the crisis damaged state banks most due to the increasing size of “duty loss” accumulation and the necessity to finance them by short-term domestic bank liabilities. In February 2001, private banks were hit hardest because of their sensitivity to exchange rate risk.

In the post-2003 period, the Turkish economy followed a “high interest rate-low exchange rate-cheap import-high external indebtedness” policy. This policy carried the Turkish economy to a real economy crisis in 2008. Another major distinction between the 2008 crises and the previous two is about the duration of them. The 1994 and 2000/1 crises were one-time speculative collapses (temporary) whereas in 2008, the crises are defined as long-term stagnation (permanent).

In managing these three crises, the aim was to exploit remittances as a remedy to cushion the negative effects of the crisis on the Turkish economy but this consideration did not translate effectively enough into policies.

Comparing the patterns of remittance flows in the post-crisis eras gives us hints about the changing motivations of workers in remitting their savings in Turkey.

Figure 6 marks the three periods of consecutive crises from 1992 to 2009. In the post-1994 period, it is possible to observe a distinct increasing trend in the amount of remittance flows to Turkey. However, this trend is dramatically changing after the 2000–2001 crisis. The declining trend, which has already been observable since 1998, has become even stronger and reached its lowest level by the end of 2002. It is difficult to make observations about the post-2008 crisis period, since it is very recent and its effects are still not completely over. However, for the year 2009, we can at least argue that the Turkish economy did not experience any significant increase in the volume of remittances.

Reasons behind this dramatic change in trends are various. Firstly, it can be partly explained by the level of migrants' trust in the future of the Turkish economy. Each crisis made the investment motives weaker due to the instability and fragility of both banking and real sectors. Secondly, this pattern might be further strengthened by a more general shift in the motives to remit from altruism to strategic behavior, concerning the second and third generations of migrants investing in their own businesses in the host country. In the 1990s, Turkish migrants still showed strong family ties with their relatives left in the home country and used to increase the scope of their family support during times of economic downturns. Yet in the 2000s, strategic motives seem to prevail over the altruistic ones and since remittances are used to finance investments, the interest in investing in such an unstable country like Turkey declined.

Conclusion

The results of this paper are not only of academic interest but also carry crucial policy implications. Looking at the early migration history of Turkey, it is possible to conclude that Turkey's approach to the migration issues in the 1960s and 1970s were quite positive. In those years, migration had been considered as an opportunity and there was a common belief that development targets

might be achieved thanks to labor migration to Europe via an efficient use of workers' remittances. However, there occurred an imbalance between the wills and targets and the actual migration policies. Martin (1991) argues that it was not until the 1970s that the Turkish state recognized the importance of migration and began to implement policies about it. However, this recognition coincided with the halting of the recruitment of foreign workers (in Germany) from outside of Europe in 1973. In 1983, the "Voluntary Repatriation Encouragement Act" was introduced through which migrants were provided with financial incentives to return home. Later on, labor migration was accused of failing to have positive effects on the Turkish economy. However, the role of the Turkish state in this failure is rarely touched upon in the literature. Taking lessons from the past, Turkey ought to implement several policy measures in order to pull the amount of remittance flows back to its early 1990s levels. Among them, sound economic stability has the priority since, together with a stable political atmosphere, it would encourage Turkish workers abroad to invest in their home country and plan to return there in the future. Maximization of gains from remittances should stand at the core of policy decisions. Maintaining and advancing these gains will be the main policy challenge in the near future. A necessity for a shift in perceiving remittances as an external finance for the Turkish economy is urgent.

Put together, our analysis suggests that the decline in remittances might be due to different coexisting reasons. New generations of migrants have weaker ties with Turkey and they are progressively moving from the return idea to the willingness of settling permanently in the host country and investing in their own businesses there. At the same time, the contraction in remittance flows after the last two financial crises that hit Turkey in the 2000s shows that even if the investment motives could still play a role in determining remittance behavior, the instability of the Turkish economy and the consequent loss of trustworthiness probably played a key role in negatively influencing migrants' attitude towards remittances.

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