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THE EFFECTS OF REMITTANCES IN CENTRAL ASIA

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INTRODUCTION

International remittances in Central Asia have increased dramatically during the last two decades. Two Central Asian states, Tajikistan and Kyrgyzstan, are among five countries of the world where remittances equal or surpass 25% of GDP. The sheer size of remittances point to their importance for the recipient economies' development. However, while there is a significant body of research that studied the impact of remittances around the world, the effects of remittances in Central Asia remains under-researched. Such gap needs to be addressed because the way remittances affect migrant-sending countries may differ. The nature of remittances' effect on local economies may depend on the peculiarities of migration flows, the quality of institutions, the level of economic development or the state of democracy in both in remittance-sending and remittance-receiving countries.

In this policy brief, I will compare and discuss the impact of remittances on migrant-sending countries around the world and Central Asia. This is not an easy task as the effects of remittances on the receiving economies are complex because of multiple channels through which remittances affect recipients' behavior. The extant body of research shows that remittances are not an unmitigated boon for recipient economies. Therefore, countries that receive significant remittance flows need to integrate strategies for harmoniously incorporating remittances into their overall development plans. I will also touch upon policy implications of these effects considering the unfolding situation with Covid-19.

MICRO-LEVEL ANALYSIS

One of the main benefits of remittances is that they can contribute to the household budget in developing countries, thereby improving living conditions, reducing poverty, and increasing well-being. Evidence from research around the world suggests that recipient households generally have higher levels of consumer spending and lower incidences of extreme poverty than their counterparts who do not receive remittances. For example, analyzing 71 developing countries, Adams and Page (2005) found a relationship between remittances and poverty reduction, statistically demonstrating that a 10 percent increase in international remittances from each remitter will lead to a decrease of 3.5 percent in the share of people under poverty. The results of empirical research focusing on Central Asia also find evidence that both international migration and remittances significantly reduce poverty in the Kyrgyz Republic, Tajikistan and Uzbekistan (Murodova, 2018).

Many studies focusing on Latin America and the Philippines find that households are likely to invest part of remittances in small business. This takes place as remittances ease the credit constraints faced by households that lack access to financial markets and, as a result, can facilitate the accumulation of assets and business investments (Woodruff & Zenteno, 2007; Yang, 2008). In a similar vein, research that focuses on the impact of remittances on the financial constraints of small businesses in Uzbekistan shows that households that receive remittances invest in family businesses only when this inflow is supplemented with sufficient income or savings (Kakhkharov, 2019). As Figure 1 shows, the remittance-recipient households at higher income brackets, which are assumed to have accumulated greater savings than those at lower income brackets have, are also more likely to own family business.

A contested area of research in remittances is household expenditure on food, non-food items, housing, land, education, and health. These effects are important because if remittances finance enhancements in human capital, education, health outcomes, or small business development, their contribution to economic growth is maximized. However, if remittances are spent primarily on the consumption of status-oriented goods, their effect may not be productive to the economy as a whole.

The literature offers two opposite conclusions concerning the remittance-recipient households' expenditure patterns. One argues that remittance-receiving households tend to spend remittances on the consumption of goods, rather than on investments in human capital (Jahjah, Chami, & Fullenkamp, 2003). Another perspective maintains that at least part of remittances goes to investments (physical or human) that may contribute more to economic development (Yang, 2008).

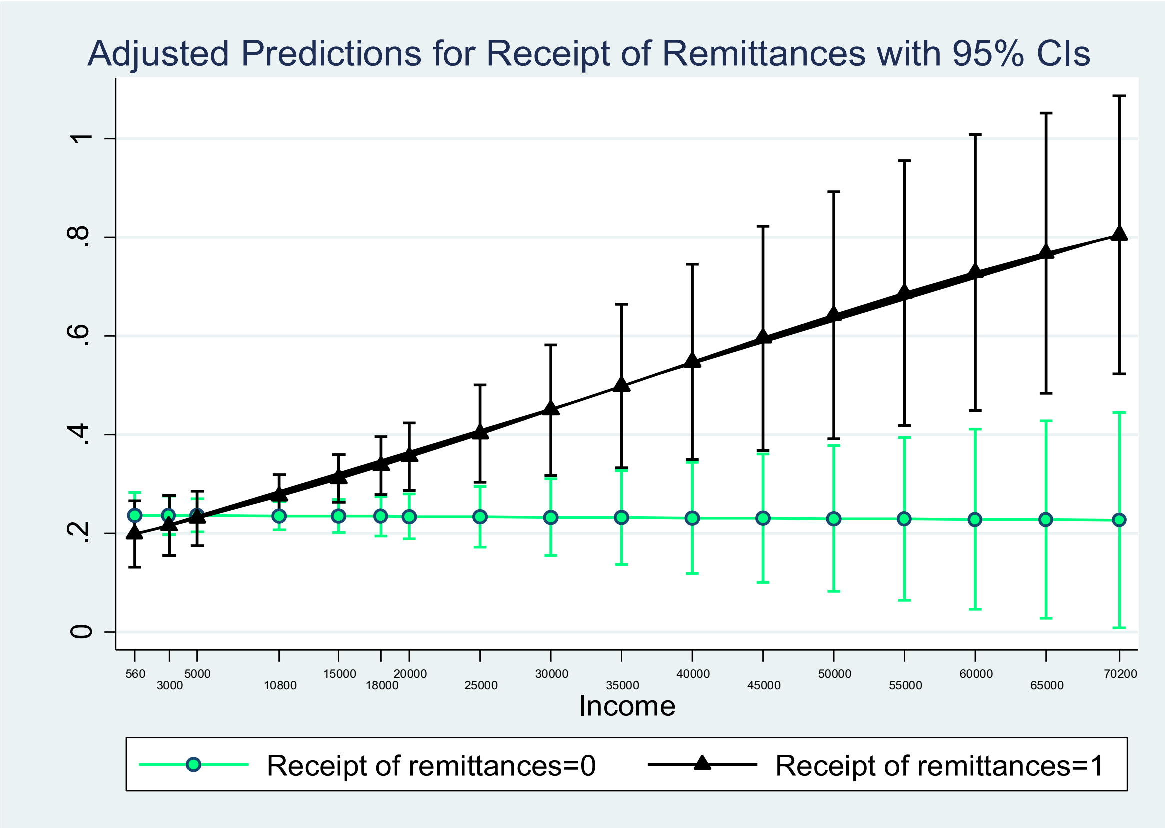

Figure 1. Interaction effects of remittances and income at marginal means of a number of control variables affecting business ownership. Source: Authors estimations using data from the World Bank and GIZ household survey (CALISS) "Uzbekistan Jobs, Skills, and Migration Survey" from 2013.

The research indicates that migrants' remittances are predominantly spent on durable goods, rather than on food. Focusing on Uzbekistan, Kakhkharov, Ahunov, Parpiev, and Wolfson (2020) employ instrumental variable (IV) techniques to address the endogeneity of remittances and find that remittance-receiving households in Uzbekistan spend significantly smaller parts of their budget on food. Also, the results of estimations provide evidence that remittance-receiving households spend a larger portion of their total expenditures on non-food consumption. This finding is in contrast with the studies of South-South remittances in Africa, even though most migration flows from Uzbekistan also take place in South-South migration corridor.

Accumulation of human capital through better health and higher educational attainment is another critical benefit of remittances. While remittances may have a positive effect on educational expenditures, the emigration of a father or mother might have a disruptive impact on the educational attainment of children left behind. For example, remittance flows have been shown to have positive effects on educational investments in children in the Philippines (Yang, 2008). In other instances, researchers have argued that the emigration of household members might lower the incentives to invest in the education of children at home (Cattaneo, 2012). One possible explanation for this is that when the household head migrates, some of the older children might have to quit school and start working to help support the household.

Several studies of the effect of remittances in Central Asia show that remittances do not influence educational spending positively. For instance, a study that focuses on migration and school attendance in Tajikistan concludes that emigration has a negative signaling or demonstration effect on education. In other words, children follow family members' example and pursue the tested paths of unskilled labor migrants instead of concentrating on education (Dietz, Gatskova, & Ivlevs, 2015). Kakhkharov et al. (2020) find that remittances' impact on education expenditures is not statistically significant in Uzbekistan and interpret this as a sign that parents anticipate insurmountable hurdles in the path of their children to higher education, so they are not willing to spend on it. This is attributed to imperfections in the tertiary education system of Uzbekistan, where enrolment rates are among the lowest in the world, with only 9 percent of secondary graduates able to pursue further studies. A World Bank report notes that more than half of the Uzbek students who are enrolled in higher education belong to households in the top consumption quintile, which may suggest financial barriers to tertiary education (Ajwad et al., 2014).

A broad literature has shown how the human capital gains of household members who emigrate and the remittance flows that follow can significantly improve health outcomes. For instance, remittances have been associated with lower mortality rates, higher birth weights, and improved living and sanitary conditions in the remittance-receiving household.

The empirical research in Central Asia also shows a positive impact of remittances on household spending on health care in Tajikistan and the Kyrgyz Republic. However, Kakhkharov et al. (2020) estimations show remittances have a negative impact on health expenditures as a share of the household budget in Uzbekistan. The authors attribute this to the fact that health care is free of charge in Uzbekistan, and most remittance-recipient households may be healthier than non-recipient households.

These broadly positive impacts have been contrasted by negative consequences that highlight the tendency to overestimate the power of remittances to alleviate poverty. Some have argued that remittances tend to create a culture of dependency within the developing world by undermining recipients' motivations to work. As a result, this reliance may inhibit economic growth in the local economy and, in the case of severe crisis in the country where the remitter works, a sudden stop in the flow of remittances may further deepen the vulnerabilities of recipients (Lubambu, 2014).

Another concern at the micro-level is conspicuous consumption. There are few studies using examples from Central Asia and the rest of the world that show that migrants are more likely to spend remittances on unproductive or ‘status-oriented’ consumption (e.g. Kakhkharov and Ahunov (2020); Tabuga (2007)). More importantly, migration and remittances are not accessible to all needy populations. Not all poor or vulnerable households have the initial capital needed to migrate. Therefore, migration and remittances may increase inequality between migrants and non-migrants. In addition, the economic behavior of recipient households usually tends to increase the prices of goods and services in the domestic market, potentially affecting the entire community, including non-recipient households. Given these adverse effects of remittances, local governments should be aware of the pitfalls induced by the consumptive behaviors of recipients and put in place business incentives that will foster long-term investments, which in turn may yield greater benefits for society as a whole.

What accounts for different results of studies investigating if remittances are spent on investment or consumption? The answer to this question may determine conditions under which remittance-receiving countries may maximize the benefits from this flow. Research in this area suggests that there are several factors that may lead to higher investment rates of remittances:

1. When remittances are seen by the household as transitory, rather than permanent income. Since labor migration in Central Asia is predominantly temporary and seasonal, this should facilitate the investment of remittances.
2. The sender monitors how remittances are spent and requires remittances to be channeled to specific purposes. If the investment environment is right remittance senders would request investing the remittances (e.g. on human capital).
3. When there are promising investment opportunities in the area of origin. This is the area which deserves the attention of policy makers in Central Asia. For example, a study by Durand, Kandel, Parrado, and Massey (1996) showed that high level of inflation increased the odds of Mexican migrants spending remittances on housing, rather than other more productive investments.

MACRO-LEVEL ANALYSIS

On the one hand, micro-level research indicates that remittances are more likely to contribute to recipient households' welfare. On the other hand, the macroeconomic effects of remittances remain under discussion. Since this flow of funds is private, and impacts are multidimensional, economists still do not fully understand how remittances affect the economy. There are many conflicting ways that remittances may impact macroeconomic variables with unclear net effects. Therefore, the appraisal of remittances' impacts on remittance-receiving economies requires investigation of a wide range of multifaceted causal links, each one having both positive and negative aspects, which may vary depending on the socioeconomic factors of each country.

For the most part, remittance flows seem to increase savings, facilitate access to financial institutions, and promote financial literacy and investment in the world (Aggarwal, Demirgüç-Kunt, & Pería, 2011) as well as in transition economies of Central Asia (Kakhkharov & Akimov, 2018; Kakhkharov & Rohde, 2020). However, remittances may reduce the recipients' likelihood to work, and increase the private consumption of imported goods instead of financing domestic investments or savings if the investment climate in recipient economies is unfavorable.

Emigration and remittances appear to have significant effects on the broad types of work that people choose to do, such as formal and informal employment, self-employment, and unpaid work such as caring for family members or contributing labor on a family farm. For example, Amuedo-Dorantes and Pozo (2006) find that remittances reduce the number of hours that men spend in formal work and self-employment, and increase the number of hours spent in informal employment. In fact, remittances increase informality more strongly in Central Asia (Chami, Ernst, Fullenkamp, & Oeking, 2018). This is an essential issue because informal economic activities have a range of detrimental implications for development. Firstly, many informal firms are "parasite firms" The cost advantages of not complying with taxes and regulations allow informal firms to undercut registered small and medium enterprises (SMEs) by adversely affecting their access to loans in economies where the quality of the institutional environment is poor, which subsequently impedes the latter's competitiveness. Secondly, due to informal nature of their operations, informal businesses entirely or partially lose access to public goods and services (e.g. police and judicial protection against crime, banking and capital markets), and these are replaced by specific institutions, such as protection rackets and informal money lenders. This creates fertile ground for organized crime, terrorism, and money laundering. Thirdly, many studies point to a clear link between corruption and the shadow economy, indicating that if officials profit in some way from the informal sector, they may attempt to create an environment that makes informality unavoidable.

DEMOCRACY, CORRUPTION, INSTITUTIONS

Policies tend to focus mostly on monetary aspects, although the non-pecuniary effects of remittances and migration are also quite significant. Migration and remittances may drive different forms of cultural diffusion and social change, such as ideas, behaviors, identities, and social capital that flow to migrant-sending countries. These transfers play a vital role in promoting immigrants' entrepreneurship, community, and family formation, as well as impact institutions and the state of democracy.

In this regard, Abdih, Chami, Dagher, and Montiel (2012) have found evidence that remittances hurt the quality of institutions in recipient countries because they increase the ability of governments to spend more. By expanding the tax base, remittances enable a government to appropriate more resources and distribute them to those in power. At the same time, remittances mask the full cost of government actions. Remittances can give rise to a moral hazard problem because they allow government corruption to be less costly for the households that receive those flows. Recipients are less likely to feel the need to hold the authorities accountable, and, in turn, the authorities feel less compelled to justify their actions. This reduces the likelihood that the fiscal space created by remittances will be used for productive social investments.

Maydom (2017) finds that remittances from migrants in democratic states are associated with political liberalization and the downfall of authoritarian regimes, but that remittances from migrants in non-democratic states are not. An important causal mechanism is that of protests: remittances from democratic countries fuel protests in authoritarian regimes. The author also finds that financial remittances from democratic countries are accompanied by and reinforce the transmission of social remittances in the form of pro-democratic political norms. Focusing on the internal factors influencing the interaction of remittances and democracy in Africa, Konte (2016) finds that the risk of remittances hindering the development of democracy in sub-Saharan Africa depends on whether the balance of Africa's population tilts more towards individuals who are more concerned about improving their standard of living than rights and freedom. Recipients who chose rights and freedoms as their priority turned out to be as supportive of democracy as non-recipients. But recipients who preferred improvements in their standard of living were found to be less engaged with democratic processes. Since remittances to Central Asia flow mainly from Russia and if most of the remittance senders are primarily concerned with their economic conditions, it may be difficult to expect that remittances will have a positive impact on democracy in Central Asia.

Another issue at the macro-level is the taxation of remittances. Recent hoax in Uzbekistan that authorities intend to tax remittances has faced strong opposition on social media. Although the Uzbek authorities immediately refuted these rumors, this issue may resurface in Uzbekistan and other Central Asian countries as the economic crisis and dwindling of budget revenues continues. Such measures are not recommendable because they could raise transaction costs and incentivize informal channels. In fact, taxation at the migrant's working place and at the recipient's location of the 'same' remittance flows may lead to double taxation, which can deeply undercut the socioeconomic insurance strategy of migrants and their families to overcome poverty and underdevelopment (Lubambu, 2014).

THE COVID-19

The COVID-19 pandemic is going to have a devastating impact in Central Asia. Lockdowns and slowdown in global economic activities accompanied by the decline in remittances are going to deplete the state resources. Only in the first two quarters of 2020 remittances from individuals to the Kyrgyz Republic, Tajikistan, and Uzbekistan decreased compared with the same period of 2019 by 23.5%, 38%, and 13% respectively[1]. Since, as mentioned above, remittances allow the governments to ignore their function of the public services provider and mask their institutional deficiencies, the drop in remittances may reveal these institutional weaknesses and corruption leading to the demonstration of discontent and public protests.

One of the ways developing countries around the world have attempted to tap migrants' funds and remittances into the economic development of migrants' country of origin, which could be instrumental during the current pandemic induced economic slowdown, is by issuing diaspora bonds. Large-scale investment by diasporas contributes to economic growth and employment creation, thereby filling gaps in the economy. These kinds of investments require large amounts of capital and are more likely to be undertaken by wealthier migrants with a good socioeconomic status and access to financial and social resources to carry the risks associated with such sizeable investments. However, it is a stylized fact that that diaspora bonds will not be productive in contexts characterized by poor governance, lack of economic and political stability, and unfavorable investment regulation prevalent in most of Central Asia.

[1] Author's calculations using data from Central Bank of Russia.

CONCLUSION

As private financial flows, migrants' remittances primarily ensure social security for relatives left behind. In fact, a strand of literature warns against policies seeking to directly tap into them, even for development purposes. They must be viewed as a part of the households' strategy to overcome a lack of opportunities in countries of origin. Remittances cannot overcome such barriers to development as political instability, misguided macroeconomic policies, an insecure legal environment or corruptive habits and deficient infrastructure (De Soto, 2000).

In the absence of social and economic reforms, corruption, and unattractive investment environment in Central Asia, migration and remittances are unlikely to contribute to sustainable development. To leverage the positive impact of remittances, it is the responsibility of authorities in the world in general and Central Asia in particular to elaborate policies aimed at creating and maintaining political trust, effective markets, and a stable political and investment climate, thereby leveraging the contribution of migrants' and diasporas' transfers to society as a whole.

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