TRENDS, DETERMINANTS AND MACROECONOMIC EFFECTS OF REMITTANCES ON INDIA

Rakesh Kumar Singh*

ABSTRACT

The amount of remittances flowing into developing countries has increased significantly since 1970. More recently remittances have outpaced direct aid flows to developing countries. Remittances can provide a very useful source of cash flow to developing countries like India by providing a source of income that households can use more resources on consumption and investment purposes. This can perhaps help proxy for foreign direct investment in these countries and lead to higher economic growth and better economic development outcomes in the long run. In this paper I am looking at the trend of remittances in India and its impact on macroeconomic variables like consumption, gross domestic capital formation, gross domestic saving.

Keywords: Remittance inflows, Gross domestic capital formation, Gross domestic saving

INTRODUCTION

Remittance flows are largest source of external funding for many developing countries, especially South Asia (Ratha, 2003). Conventional wisdom tells us that foreign remittances by non-resident workers are good news, and that dollars be welcomed with open arms. But from the vantage point of the macro economy, do remittances have an unequivocally positive impact on macroeconomic variables like GDP, consumption and Investment? The other important question that arises to one's mind is that what is the impact of remittances on growth of an economy? Broadly, these are the question that is sought to be addressed in this paper.

REMITTANCES IN INDIA

India is currently the highest remittance (in absolute terms) receiving country in the world. There has been a tremendous growth in private transfers to India which was just about USD 2 billion in 1989-90 to about USD 52 billion in 2009-10. The significance of remittances can be easily emphasized by the fact that even in 2007-08 when India had recorded net FDI inflows; private transfers were still over 1.2 times the Net FDI to India. The growth in remittances can be followed from the fact that remittances account for only 0.8% of GDP in 1991 but in 2008 it accounts for 5.63 % of the entire GDP of the country. Remittances have played a major role in offsetting India's merchandise trade deficit to a large extent, thereby helping India in keeping current account deficits to significantly lower levels through the 1990's which was testing time for Indian economy. Remittances have been one of the least volatile inflows in either the current or capital accounts of India's BOP. There has been a lot of work done on impact of FDI on Indian economy compared to remittances. Importantly, remittances play a larger part in counter cyclical

*Assistant Professor, Department of Commerce, Ramanujan College, University of Delhi, Delhi.

events such as flood or earthquakes which helps an economy to emerge from the adverse effect of these events.

OBJECTIVES OF THE STUDY

The specific objectives of this study are:

- To examine the long term trend of remittances to the Indian economy and discuss its impact on the macroeconomic variables.

REVIEW OF LITERATURE

Positive Macroeconomic Impacts of Remittances

Academic literature on remittances can be broadly classified into three main groups: (i) Analyses of the main reasons behind remittance or private transfers to home country which has been mainly due to altruism, insurance, exchange, investment, and inheritance (Cox *et al.*, 1998; Ghosh, 2006; IMF, 2005; López-Córdova and Olmedo, 2006; Rappoport and Docquier, 2005; Solimano, 2003); (ii) based on transferring channels, transferring costs, or policy options used for reducing these costs (see, for instance, IMF (2005), Orozco (2006), and Orozco and Fedewa (2006)); and finally (iii), a large volume of literature has been written on the impact of remittances on development in receiving countries, mostly highlighting macroeconomic effects and human capital.

NEGATIVE IMPACTS OF REMITTANCES

There are two possible losses that may be incurred by the sending region – Labor losses and Capital losses. If the sending region has surplus labor, then the opportunity cost of the migrants is low or zero. However, if there is labor shortage in that economy, then migration imposes a positive opportunity cost and production falls. Similarly, migrants may take away stocks of human or financial capital with them which would afflict productivity in the source economy. Theoretically, therefore, migrant remittances therefore act to mitigate the negative labor and capital effects of migration (Taylor, 1999). However, not all economists have concluded a positive result of migration and remittances upon economic growth.

DATA AND METHODOLOGY

The method of estimating remittances in this study is direct. In the balance of payment statistics published by the Reserve bank of India (RBI) in *'Handbook of Statistics on Indian Economy'*, remittances can be identified as credit in the current account as 'net private transfer'. In addition to that, *'IMF's Balance of Payment Statistics'* is also one of the important sources. The RBI's data on private transfers are available for the period 1990-2008, and the IMF's data are available for 1975-2008. However, this study is focused only on the aggregate remittances from RBI only.

One of the biggest limitations of the reported data for the remittances is the underestimation of the actual remittance influx due to lack of credible data for the remittances sent via informal channels. These types of transactions are often known as "hawala" .In India these flows are estimated to be very high prior to 1990's but due to increase in the access to formal channels in the 1990s, the problem of underestimation has diminished significantly.

Table 1: Net Private Transfers (Remittances) and net NRI deposits to Indian Economy (Rs. Cr.)

Year	Net Pvt. Transfers (Remittances)	Net NRI Deposits	GDP at MP (Constant Price 1999-00)	Remmittances as percentage of GDP
1971-72	104	0	525584	0.02
1972-73	99	0	522698	0.02
1973-74	146	0	540045	0.03
1974-75	229	0	546443	0.04
1975-76	441	36	596428	0.07
1976-77	755	167	606301	0.12
1977-78	1102	200	650311	0.17
1978-79	1093	156	687435	0.16
1979-80	1754	162	651430	0.27
1980-81	2125	178	695361	0.31
1981-82	2025	206	737078	0.27
1982-93	2417	383	762622	0.32
1983-84	2637	709	818288	0.32
1984-85	2967	879	849573	0.35
1985-86	2701	1767	894041	0.30
1986-87	2976	1650	936671	0.32
1987-88	3499	1840	973739	0.36
1988-89	3841	3636	1067582	0.36
1989-90	3798	4000	1131111	0.34
1990-91	3712	2756	1193650	0.31
1991-92	9382	1008	1206346	0.78
1992-93	11226	6097	1272457	0.88
1993-94	16514	3780	1333123	1.24
1994-95	25417	539	1421831	1.79
1995-96	28660	3821	1529453	1.87
1996-97	43969	11894	1645037	2.67
1997-98	43765	4325	1711735	2.56
1998-99	43242	4060	1817752	2.38
1999-00	53132	6709	1952035	2.72
2000-01	58811	10561	2030711	2.90
2001-02	73633	13127	2136651	3.45
2002-03	79229	14424	2217133	3.57
2003-04	99165	16869	2402727	4.13
2004-05	91971	4439	2602065	3.53
2005-06	108565	12457	2844942	3.82
2006-07	134608	19574	3120031	4.31
2007-08	167501	706	3402716	4.92
2008-09	203209	20431	3609425	5.63

Source: RBI Handbook of Statistics on the Indian Economy, 2009-10

Remittances and its significance with macroeconomic variables

Apart from micro level activities at household level, remittances influence macro level activity through multiplier effect arising as a result of household consumption and investment activity. Remittances that are invested in productive activities by the households directly contribute to the output growth i.e. GDP growth of the country. This section analyzes the size of remittances flow with the dimensions of macro-economic aggregates, such as national income, consumption, savings and investment.

Remittances as Percentage of (macroeconomic variable)

Year	GDP at Market Price	Private Final Consumer Expenditure	Gross Domestic Saving*	Gross Domestic Capital Formation
1971-72	0.02	0.26	1.43	1.34
1972-73	0.02	0.23	1.27	1.22
1973-74	0.03	0.28	1.34	1.29
1974-75	0.04	0.36	1.86	1.77
1975-76	0.07	0.67	3.11	3.13
1976-77	0.12	1.11	4.36	4.72
1977-78	0.17	1.41	5.51	5.95
1978-79	0.16	1.28	4.63	4.61
1979-80	0.27	1.90	7.24	7.07
1980-81	0.31	1.90	7.91	7.33
1981-82	0.27	1.57	6.55	6.04
1982-93	0.32	1.71	7.15	6.65
1983-84	0.32	1.58	6.92	6.49
1984-85	0.35	1.61	6.53	6.09
1985-86	0.30	1.34	5.06	4.53
1986-87	0.32	1.31	5.13	4.62
1987-88	0.36	1.38	4.84	4.42
1988-89	0.36	1.31	4.41	3.86
1989-90	0.34	1.15	3.58	3.21
1990-91	0.31	0.98	2.86	2.50
1991-92	0.78	2.15	6.65	6.49
1992-93	0.88	2.29	7.03	6.47
1993-94	1.24	2.93	8.69	8.48
1994-95	1.79	3.90	10.27	9.80
1995-96	1.87	3.81	9.85	9.19
1996-97	2.67	4.96	14.04	13.29
1997-98	2.56	4.53	12.04	11.34
1998-99	2.38	3.86	11.09	10.60
1999-00	2.72	4.24	10.97	10.50
2000-01	2.90	4.39	11.78	11.49
2001-02	3.45	5.02	13.77	14.14
2002-03	3.57	5.11	12.25	12.82
2003-04	4.13	5.83	12.08	13.06
2004-05	3.53	5.00	9.22	9.10
2005-06	3.82	5.28	8.84	8.53
2006-07	4.31	5.83	9.13	8.85
2007-08	4.92	6.45	9.41	9.08
2008-09	5.63	6.98	NA	NA

Source: RBI Handbook of Statistics on the Indian Economy, 2009-10

CONCLUSION

The first part of the study reveals that there has been a continuous increasing trend in the remittances for the period 1971-2008. Post liberalization period has shown a phenomenal increase in remittances which can be partially attributed to the volume of international migration of high skilled labors in countries like USA, UK and Canada. The other reason that can be attributed for the rise in remittances inflow is mainly the shifting from informal channels to formal channels and change in the regulatory framework. Increase in remittances has helped India to maintain foreign exchange reserves to sustainable level despite of large current account deficit. In a capital scarce country like India remittances should be used to finance large capital investment projects which have a greater impact on economic growth. Government should try to implement policy which gives the incentive to an individual to transfer through formal channel.

Second part of the study implies that economic growth is positively influenced by human capital variables such as literacy rate, secondary enrolment rate and external support such as ODA which reaches out directly to the marginal section of an economy. Variables in the model such as economic openness, population growth rate, per capita income and inflation tend to have a significant negative impact on growth. Human capital positively impacts growth thus it gives the government of the developing countries taken in the sample as a reason to invest in education which forms basis for future economic growth

REFERENCES

Aggarwal, Reena, Demirgüç-Kunt, Asli, and Pería Maria. 2011. "Do remittances promote financial development?" 255-264. Journal of Development Economics 96.

Chami, Ralph, Fullenkamp, Connel, and Jahjah, Samir. 2005. "Are immigrant remittance flows a source of capital for development?" 55-81. IMF staff papers 52, No. 1.

Freund, Caroline, and Spatafora, Nikola. 2008. "Remittances, transaction costs, and informality." 356-366. Journal of Development Economics 86.

Giuliano, Paola, and Ruiz-Arranz, Marta. 2009. "Remittances, financial development and growth." 144-152. Journal of Development Economics 90.

Orozco, Manuel. 2003. "Hometown Associations andTheir Present and Future Partnerships: New DevelopmentOpportunities? Report commissionedby the U.S. Agency for International Development

Paris:Organisation for Economic Co-operation and development.

Ratha, Dilip. 2003. "Workers' Remittances: An Importantand Stable Source of External DevelopmentFinance." In *Global Development Finance2003,* Chapter 7. World Bank. Updated in *Remittances and Development: Development Impactand Future Prospects,* ed. Samuel Maimbo andDilip Ratha. Washington, DC: World Bank.

Ratha, Dilip. 2004. "Understanding the Importance ofRemittance Flows." Migration Policy Institute.Migrationinformation source.org

Ratha, Dilip, and Prabal De. 2005. "Predicting SovereignRating: International Capital Market Accessfor Unrated Countries." Background paper forthis report. World Bank

Taylor, Edward. 1994. "International Migration andEconomic Development: A Micro Economy-wideAnalysis." In *Development Strategy, Employmentand Migration*, ed. J. Edward Taylor.