

An assessment of developmental potential of remittances inflow in India

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Abstract

Background: Recently India has been receiving the highest amount of workers' remittances which accounts nearly three-fourth of her trade deficit. The international movements of labour and the resultant remittances have assumed significance in economic literature. Yet their full potential in the developmental task of the source country has not been studied and reaped. This paper discusses the rationale as to how migrants' remittances can play a crucial part in boosting the tempo of investment and growth in the economy.

Method: The present study is analytical and review in nature going to explain the phenomenon with the help of available data. Mostly secondary sources of data published in government reports especially RBI Occasional Papers have been used. Besides, weight of scientific arguments of the experts in their documented works was the basis to substantiate the evidences.

Results: From the analysis, it was found that India has been witnessing a steady flow of migrants' remittances. The magnitude of the unprecedented inflows constitutes the potential to spur investment and growth. It was shown that inward remittances had positive impact on wealth creation and accumulation through higher consumption and investment.

Conclusion: The study concludes that Indian diaspora and their massive remittances posses substantial growth potential. The conclusion drawn underlines the need for policy initiatives in order to maximize developmental benefits, and also hints for future research on the subject.

Key words: remittances, migration, private transfers, globalization.

1. Introduction

The financial flows from the migrant workers have assumed considerable economic importance for many developing countries like India. The emergence of migrants' remittances as a major source of finance is of recent origin. It was particularly during the decade of 1980s that remittances accelerated as a result of oil-boom in Gulf region and further grew in 1990s responding to information technology revolution. These sustained flows placed India as a highest remittance receiving country in the world [1]. The steady monetary inflows have reduced India's reliance on external aid and lent support to the trade deficit to a large extent. The analysis of migrant's remittances and their role in the development process of the source country is crucial at this juncture. There is a plethora of research works highlighting the determinants of remittances on the micro aspect. As mentioned in different studies, educational/skill level, motive/s to remit, wage differentials, cost and flexibility in the migration system are among the important factors influencing the process of migration and consequent remittances. To cite a few studies, remittances serve as insurance against risk [2], altruism as an important motivation for remitting towards family members [3], time horizon viewed by the migrants to effect formation of savings [4], as repayment to the family who financed migration [5], [6]. These studies explain the nature and factors influencing remittances and their impact on income distribution at the micro level. However, evidences on macroeconomic analysis of the workers' remittances are limited. There is a general dearth of literature to assess their developmental impact on the receiving country [7]. Another stream of literature which details how macro environment affects remittance flows deserves special mention. For instance, Faini [8] indicated that real exchange rate was a significant determinant of remittances flows. Real earnings of the migrants [9], political stability and consistent government policies [10], cost and efficiency of the banking system [11], inflation, interest rate differentials [12], [13] were found significantly affecting the flow of remittances. However, evidences on macro analysis of the workers' remittances are inconclusive. In a study, Straubhaar [14] reveals that remittance flows were neither affected by the exchange rate nor the real rate of return

on investment. Swamy [9] found that interest rate differentials between the host and the destination countries and the exchange rate were not significant variables of remittance flows. Similarly, Freund and Spatafora [15] demonstrated that service fee and dual exchange rate are important determinants of workers' remittances to developing countries. Some studies on NRI inflows in Indian case concluded that repatriated deposits grew at faster rate in response to interest rate differentials [16], [17]. The existing empirical works on the impact of interest rate and exchange rate variations on the remittance flows does only provide mixed results. The focus of the available literature was to understand how macroeconomic and intuitional factors influence remittance flows.

2. Objective

The present study is an attempt to analyze how the recent surge in the remittances flows to India constitutes an aggregate potential in facilitating developmental efforts. The paper also tries to comprehend the ongoing structural changes in the flows, highlight their role for investment and socio-economic growth and suggest some policy initiatives in this regard. Mostly secondary sources of data available in the government publications are used in the study. The information retrieved from the documented works and weight of scientific arguments of the experts form the basis to corroborate the research question whether the consistent remittance flows constitute the potential in promoting India's growth process. The paper has also analyzed current trends in composition, source and behavior of the total flow of remittances in the wake of globalizing Indian economy.

3. Trends in remittances

In recent decades, the remittance flows to India have undergone drastic change in terms of composition, nature and source. These developments are reflective of the structural transformation within the economy as well as its increasing integration with the world economy. The migration pattern from India shifted in terms of skill content to high technology areas and geography. During 1980s, the remittance flows were largely due to oil economies of middle-east employing skilled and semi-skilled Indian workers. The source of flows has changed in 1990s responding to the demand of information technology-learned highly skilled manpower in USA, Canada, Australia and parts of Europe. According to RBI Survey (Nov., 2009), North America continued to be the most important source region of remittances accounting to nearly 38% of the total remittances followed by Gulf region (27%) and Europe (18%), which mirrors the new waves of skilled migration to technology related sectors in developed countries. Workers' remittances to India have shown buoyancy in the recent years and have imparted significant resilience and strength to India's balance of payments (BoP). They have helped in offsetting India's merchandise trade deficit to the extent of around 68% in the first half of 2009-10 [1]. In absolute terms, presently India tops among the remittances receiving countries in the world aggregating an amount of US \$46.9 billion in 2008-09 including gold/silver by passengers and personal gifts/donations [1]. The significance of the remittances can be gauged from the increase in the share of receipts in terms of India's GDP from around 1% in 1980s, 3% in 1990s to 4.1% in 2008-09. The remarkable increase in workers' remittances could be traced to a host of factors. Besides rise in IT migrant workers, the swelling of migrants rank coincided with better incentives to sent and invest money, liberalization of regulation and controls and more flexible exchange rates. Apart from these structural factors, rising trends of remittances can be attributed to the income levels of migrants and ease of transferring funds through formal banking system. The inward flows are counter-cyclical and more stable source of finance due to low sensitivity to interest rate and strong home bias [18]. Workers' remittances to India are observed to be stable flows and have displayed counter-cyclicity particularly during the major macro economic shocks [7], [19]. Remittance to India are mainly composed of two kinds of flows called private transfers; (i) inward remittances for family maintenance, and (ii) local withdrawals from non-resident Indian (NRI) deposits with the banks in India. The said transfers represent unilateral transactions, i.e., that do not have any *quid pro quo* and are recorded in the current account of BoP. Some portion of remittances was channeled through illegal route known as *hawala* which declined in importance following the introduction of market based exchange rate in 1990s. The easing of restrictions on foreign currency transactions can further contain the illegal route. The private transfers contributed by remittances sent by the overseas Indians for family maintenance was over fifty percent in 2008-09. Since 2003-204 there has been relatively rising share of local withdrawal route of inflows which reached the level as high as 44% in the year 2008-2009. The rising trend in local withdrawals could be attributed to higher income level of migrants in the recent past as well as better domestic investment opportunities provided by robust growth of the economy. Though there was a considerable deceleration in the rate of growth of remittance flows since second half of 2008-2009 as a result of global economic slowdown. Notwithstanding this

decline, the gross inflows to NRI deposits and the steady trend in local withdrawals indicate the stability and sustainability of remittance inflows over the medium term [1].

4. Development connection

Workers' remittances and their developmental dimensions are linked to the theory of migration as remittances are a derived product. The developmental perspective of the remittances was provided by the New Economics of Labour Migration (NELM) which considered migration as an integral part of the household objective to enhance income levels, investment capacity and insurance against risk [20]. It is argued that remittances can ease the constraints on investment and production activities in the home economy. Totally different views have endorsed by theories called 'migrant syndrome' [21] and 'implicit loan contract' [5]. The economic development generally undertakes achieving national growth targets including reduction of poverty and unemployment, growth of socio-economic sectors and improving standard of living of the masses. Remittances can influence the household consumption pattern, when exchange rate depreciation increases purchasing power. It creates 'wealth effect' enabling the workers to remit more [22]. Increased income helps families to engage in several investment opportunities like human capital, micro enterprises and durable household provisions. The spill-over effect of remittances has far reaching implications in the economy. Moreover, more remittances and income of the otherwise financially marginal households help raise their credit worthiness and economic welfare. In the available literature, there is, however, no unambiguous answer on the consumption vis-a-vis investment bias and also the growth enhancing impact of the remittances on the source country. It is assumed that the 'multiplier effect' of remittances is significant even if they have inbuilt consumption bias. Some empirical evidences from Bangladesh show that remittances had a multiplier effect of 3.3% on GNP [23]. In an study, Faini [8] found that remittances can contribute to faster growth in the source countries particularly if found a favourable policy environment.

In the Indian context, there are select indicators which exhibit a broad picture about the growth promoting effect of remittances. The statistics reveal that private transfer to India consistently rose during 1990s and most part of 2010s until 2008-09 and moved around 14% of the household savings. The private unrequited transfers in the form of local withdrawals from the non-resident deposits very much influence disposable income of the country. According to an estimate, inward transfer rose on an average of 3% as ratio to disposable income. A case study of emigration from Kerala and Punjab suggests that remittances have not only helped raising the living standard of migrant workers but also led to develop the areas of emigration. [24]. Another expert found the elasticity of per capita income growth with respect to remittances as positive [8]. As stated above, it is as yet difficult to design macro-economic model to establish direct association between remittances and growth. It is argued that economics of workers' remittances has largely been ignored in globalization debate in general and international finance in particular presuming consumption bias and limited aggregative impact on investment and growth [25]. In case of India, the long run growth of per capita income and remittances do not show any direct and clear relationship between the two variables. An improvement in the correlation coefficient (r) between the two variables has, however, been noticed in the recent decades. The value of r improved from 0.11 during 1980s to 0.22 during 1990s. Remittances also reflect a portfolio choice about investment opportunities in the home country. The coefficient on institutional quality is significantly positive and robust [26], [27]. Furthermore, while private transfers consist current account flows from NRIs, a significant flow of funds takes place in the form of capital flows as well. There is close link between the income of migrant Indian workers and inflows in the form of NRI deposits. Non-residents contribute to the foreign exchange inflows in the form of investment. In terms of accounting practice, until the part of NRI deposits is actually withdrawn locally, such deposits continue to be outside the preview of private transfers. Nevertheless, inflows of NRI deposits form a potential of future private transfers when withdrawn. It is therefore pertinent to analyze the broad trends in capital flows to India in the form of NRI deposits. The said deposits have become important component of the capital flows into India contributing about 21% of the total capital flows during 1990s. It may be noted that a major part of outflows from NRI deposits (about 85% in late 1990s) is in the form of local withdrawals. The share declined to 65% in 2007-08 reflecting higher outflows under other deposit schemes (NRE & NRO).

The steady trends in local withdrawal could be indicative of growing volume of business activities as a result of better infrastructure and gradual opening up of Indian economy. In other words, the withdrawals might be transformed into domestic savings and investment. In the most likelihood, it promotes investment as the rising consumption demand from the remittance receiving households may give support to the manufacturing sectors thereby igniting growth process. The withdrawn funds move in search of viable investment and business avenues.

The remittances, therefore, potentially create growth motivating effects in the lagged manner. The behavior of cross border flows is also found to be influenced by the growth cycle of host countries, as evident from the slower flows in later part of 2008-09 in the aftermath of global financial crisis. Since a good proportion of Indians are employed in technology-oriented service industries of the advance countries, the future prospects of remittance flows appear promising as India holds a comparative advantage of large pool of skilled manpower.

5. Conclusion

While summing up the foregoing discussion, it is now appropriate to mention the conclusion deduced. As evident from the findings, the unilateral flows of remittances form a sizeable potential to be realized for developmental benefits. The study of determinants of workers' remittances helps to understand the nature, source and composition of the remittances into India. A number of factors responsible for workers migration and their resultant remittances have been identified, such as skill content of the workers, motive to remit, income level and cost and ease of emigration. The statistics of the current remittances indicate that such flows are steady and relatively stable source of external finance. The quantum of workers' remittances touched the level as high as US \$ 46.9 billion constituting 4.1 of GDP in 2008-9. These sustained flows of remittance have reduced India's reliance on external aid and lent support to around 68% of merchandise trade deficit. This strengthens the argument of countercyclical role of such flows imparting resilience to Balance of Payments (BoP) during adverse external shocks. The factors that guided the consistent expansion in the remittances since 1990s include the structural reforms, better growth prospect of the economy, depreciation of rupee, hike in interest rate ceilings on NRI deposits, change in migration pattern to high skilled categories and the uncertainties in oil prices. The recent upsurge in the flow of workers' remittances and their characteristics make them a reliable source of external finance in development process. There is, however, limited evidence in the literature regarding the impact of workers' remittances on the investment and aggregate growth of the economy. Similarly, research on sensitivity of variations of interest rate and exchange rate with cross border flows have only produced mixed results. Though the debate is inconclusive, the present size, behavior and source of the inward remittances do provide a broad picture on the growth enhancing effects of remittances. Besides, the results of some important empirical studies substantiate our arguments. In spite of consumption bias of the remittances, there is lagged inducement for investment and manufacturing to grow. The 'multiplier effect' works to give impetus to the growth momentum. In one study, the correlation coefficient (r) between per capita income and remittances movement was found improved from 0.11 in 1980s to 0.22 during 1990s. Some other relevant researches conducted in developing countries like Bangladesh revealed that remittances had growth promoting effects and led to achieve higher standard of living and over all development of the areas of higher rate of emigration.

Studies prove that cost and efficiency of the remittance transferring infrastructure influence the behavior of the workers' remittances. Since a large share of personal remittances is mostly smaller in size and relatively costlier, improving the formal remittance receiving system in terms of lower transaction fee and time involved will help attract the higher inflows. The finalization of the issue of openness of trade in services under different modes of supply under GATS is likely to have significant impact on the long run flows of workers' remittance. The developing countries including India should, therefore, resist the protectionist approach of the industrialized countries in respect of cross border movement of natural persons for delivering various services. The recent liberalization measures have helped Indians living abroad to transfer their savings to home. A significant portion of NRI deposits is locally withdrawn and could be transformed into investment. Such part of private transfers coupled with gifts and donations consist 2% of the GDP. A conducive institutional and business environment, more liberalized exchange regime, lucrative policy measures in case of rupee denominated deposits and extending the payment infrastructural facilities in remote areas would possibly accelerate global remittances flow to India. Given the conclusions drawn and their far reaching policy implications, the study also underlines the need for more academic attention in future.

6. References

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