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“Migrations, remittances and local development in Southern countries: Dutch Disease or Residential Economy?”

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Abstract

In developing countries, the contribution of the growing amount of migrant remittances to development remains an unsettled issue.

At the macroeconomic level remittances do represent an external flow way above official aid, and often in line with FDI. Hence a widely shared optimistic view about this, until now, “hidden source of development finance”. At the microeconomic level remittances raise incomes and have an impact on consumption expenses and therefore on welfare. They can also, albeit in a lesser degree, finance investment in productive assets, such as physical capital but also, and more conspicuously, human capital through education and health expenses. It seems generally admitted that remittances on the whole have an impact on poverty abatement but this impact can vary widely between different case studies.

At the meso-economic level the relevant data show that migration and remittances concentrate in specific places thus raising the issue of their contribution to local development of concerned, mostly rural, areas. Staying at the meso level, we will compare, to assess the contribution of remittances to local development, two “macroeconomic” models which have been used at place level, albeit tentatively.

- Dutch disease approach, in its sub-national version which features the impact of remittances on real exchange rate.
- Residential economy approach which rest on the use of a Keynesian export multiplier applied at an area level to an “economic base” which can be productive but also residential, remittances being considered as a component of this residential basis.

Their analysis can allow for the identification of key factors of remittance capability to shape a local development path. To achieve that, we shall draw from the huge literature on remittances relating to various countries as well as public statistical data bases.

Key-words: Migration, remittances, Dutch disease, residential economy, local development.

The contribution of the growing amount of developing countries migrant remittances to their development remains a hotly debated issue.

At the macroeconomic level remittances do represent an external flow way above official aid and often in line with FDI. Hence the widely shared optimistic view about this, until now, “hidden source of development finance”.

At the microeconomic level remittances raise incomes and have an impact on consumption expenses and therefore on welfare. They can also, albeit in a lesser degree, finance investment in productive assets, such as physical capital and, more conspicuously, human capital through education and health expenses. They can therefore improve the resilience of concerned household livelihoods, although it is not granted that remittances necessarily accrue to the poorest households. It seems however generally admitted that remittances on the whole have an impact on poverty abatement but this impact can vary widely between different case studies. (Adams and Page, 2005; Acosta et al., 2008)

At the meso-economic level, however, relevant data show that migration and remittances concentrate in specific places, and that migration networks link couples of areas respectively in origin and destination countries. This characteristic will be our starting point as it straightforwardly raises the issue of their contribution to the local development of concerned, mostly rural, areas. Actually migration can have an impact on local productive systems through productive investments in various local activities supposedly financed by remittances. On this matter picture remains however rather contrasted with contradictory results from various case-studies(Durand et al. 1996; Guzman et al., 2009; Adams and Cuecuecha, 2010; Woodruff and Zenteno, 2006, etc.).

However we intend to focus on local development from another standpoint: we shall concentrate on the transferability at place or territorial level, defined as a sub-national space whose characteristics give it some kind of idiosyncrasy, of macroeconomic models of analysis.

We will therefore compare in this paper two models which have been used, albeit tentatively, to assess the contribution of remittances to development.

- Dutch disease approach, which features the impact of remittances on real exchange rate, at the national level. It can be applied however at a sub-national level, and, even at a national level, it is considered more suitable to small open economies, often small also at a geographical level.
- Keynesian export and external income multiplier analysis, which do have a territorial version under the form of “residential economy” approach which rests on the definition at an area level of an “economic base” which can be productive but also residential, remittances being considered as a component of this residential base.

The selection of these two approaches is not arbitrary, nor is their comparison. Although they draw on different paradigms, namely a neoclassical and a Keynesian one, and their predictions are rather opposite, they deal with the same economic mechanism, global demand. Our hypothesis is that this comparison is likely to provide clues as to whether remittances are able to boost local development or not.

To fulfill this objective we shall first get back to the territorial dimension of migration and remittances. Then we shall scrutinize the Dutch Disease approach, by recalling its main features and by contemplating its application to remittances and the possibility to develop it at a territorial and sub-national level. Finally we shall refer to residential economy approach of remittances to see in what measure the conditions of the applicability of Dutch Disease to the local impact of remittances allow to delineate the realm of validity of its predictions. By doing that we shall underline the importance of migration in establishing specificity of the local development it may trigger.

Our main source will be the rather huge literature which addresses the economic impact of migration and remittances in various countries or continents as well as the available statistical data bases delivered by various international organizations.¹

D) North-South Remittances: a territorial issue

We shall first recall the weight of remittances within the bulk of financial flows accruing to developing countries, before stressing the geographical concentration of remittances and giving the main tenets on the debate on remittances and local development

I-1 General elements on the importance of remittances

Migrant remittances to developing countries have steadily grown since two decades: they have triplicated between 2002 and 2011 (Ratha et al., 2007; Mohapatra and al. 2011) and they now represent for these countries an external source of finance largely overpassing aid and loans and comparable to FDI in many countries. Moreover they have proved less unstable in their evolution than other source of finance and therefore rather counter-cyclical².

Although big receivers are usually large countries, the top receivers being China, India, Mexico and Philippines, as far as the share of GDP of remittances is concerned, the highest percentages are to be found in small countries. But remittances patterns can be very different among large as well as small countries: Mexico for example receives a level of remittances comparable to those of China or India although it is at least ten times less populated; likewise only some small countries display high percentages. At a nation level remittances appear concentrated and their origin is also concentrated, as shown by corridors of remittances and migration (see map).

¹ Although literature is huge, it is not evenly distributed between continents. Latin American cases, and especially the case of Mexico, are widely analyzed and this bias will be reflected in our references.

² Their behavior during the last world financial crisis of 2009-2010 is telling. Contrary to some dire predictions regarding their fall, they have just suffered a mild abatement before picking up in 2011 (Mohapatra and al., 2011)

This is also true as a sub national level, and it raises the issue of the concentration or remittances on various geographical areas.

I-2 the concentration of remittances:

Within countries, migration and remittances concentrate in specific areas and regions. These regions display, when data is available, a relative weight of remittances to local GDP quite similar to the highest numbers found at the national level in small countries.

We can quote some examples of this regional concentration taken from various countries, such as for example Mexico, Ecuador, Mali or India.

- In Mexico, despite the surge of migrants from poor southern states such as Oaxaca or Chiapas, the bulk of migration is still provided by four central states, who were the first to send migrants to the USA a century ago (Woodruff and Zenteno, 2006). When looking at data concerning *municipios*, provided for example by the Mexican institute of statistics for 2000, one can see that migratory intensity varies greatly between *municipios* belonging to the same state, particularly in rural areas. As a matter of fact remittances are particularly important in rural areas, even if rural remittances are not always the main component of remittances.
- In Ecuador international migrants come mainly from two areas, one being specialized in migration to the USA, and the other in migration to Europe. (Gray, 2009)
- In Mali as well, international migrants (mostly to Europe) came from the Kayes area which receives more than 40% of all remittances, while 43% of individuals of the area live in a household which benefits of such transfers; there is another area specialized in migration, around Mopti, but mostly geared towards other African countries which means that it retains only 16% of total remittances, while 36% of individuals live in a remittance-receiving household. (Gubert and al., 2010)
- In India, most gulf migrants come from Kerala, with a special weight of some rural areas. Migrants from other places such as Hyderabad go the US and are mostly educated (Kannan and Hari, 2002, ESCAP, 2003)

- In Cape Verde, where the two thirds of households do receive remittances, there are three main destinations for migrants: Portugal, United States (mostly New England) and France. These three destinations connect to specific islands of the archipelago: Fogo for example, formerly home of skilled whale hunters, sends its migrants mainly to the United States (Carling, 2009; OIM, 2008).

The local concentration of remittances is therefore a general feature and concerns also destination countries (from here the importance of migration networks): migration corridors relate to remittances corridors. This concentration of remittances raises the question of the impact of these hefty flows on rather small (meaning price-taking) economies, whether at a national level, for small countries, or at a regional level for larger countries with specific migration areas.

I-3 Remittances and local development:

At a macroeconomic level remittances are mainly seen as another external financial flow, along with aid or FDI, contributing to the balance of payments equilibrium. The caveat should be that remittances are part of current balance while aid and FDI do appear in the balance of capital. But impact on development processes is generally discussed at a more local level, as remittances, unlike aid or FDI, accrue directly to individual households.

Although the issue is hotly debated, it seems that in some cases remittances can boost the development of local productive systems in rural areas. Some contributions isolate a specific impact of remittances on local productive investment, even if it is less conspicuous than the impact on consumption (Woodruff and Zenteno, 2006). Guzman and al. (2009) describe the existence of a cheese cluster in Zacatecas, which is mainly financed by remittances, and cater to the needs of the diaspora.

The impact on investment in human capital is far more documented. The investment in education can even be considered in some cases as an investment in migration, considered as an economic export of workforce (as in the case of Cape Verde). Migration can be therefore views as a local productive specialization. We intend to call upon macroeconomic models of the relationship between exports, external balance and growth to deal with this issue at the local level, taking into consideration that these models have been mainly developed to address Developing countries balance of payment issues.

II) Remittances as a source of Dutch Disease: from national to local

Dutch disease approach has already been used to determine the impact of remittances at the national level for some small countries (El Salvador for example) prone to migration. We will first recall the general presentation of the Dutch Disease model before transferring it to the local level.

II-1 the elements of the Dutch Disease approach

Dutch Disease approach includes hypothesis on the structure of concerned economies, the central role of a critical variable and two mechanisms determining the impacts of this variable

Dutch Disease approach (Corden and Neary, 1982) concerns small open economies, which means that these economies are price-takers on the international markets with a high share of external trade in their GDP. Furthermore they are often specialized in the exportation of raw materials coming from natural resources.

The distinction between “tradable” and “non-tradable” appears therefore as the main characteristic of the structure of economies prone to the Dutch Disease: tradable can be sold or bought on external markets; non-tradable are only bought and sold on the national market, which means that the local producers of these goods do not feel external competition. Although the frontier between the two categories are not always easy to draw, some goods such as those related to space (local transport, real estate) are usually seen as non-tradable, as well as personal services, as they entails an interaction between seller and buyer by definition performed where buyer is located. It can therefore be said that, even at this stage, place anchoring emerges as a characteristic of non-tradable. Tradable on the contrary are likely to suffer the impact of an external price shock. However it has to be pointed out that the definition of a tradable sector hit by such a shock is not necessary to build a model of Dutch Disease, as the existence of a shock on an external flow of transfer is enough to support the idea of an external shock on the balance of payments triggering the Dutch Disease effect, as shown by the impact of aid (Rajan and Subramanian, 2009).

The real exchange rate is the main variable of the model as it governs the effects of the shock. It is defined as nominal exchange rate divided by the ratio of domestic to foreign price index

and can thus be considered as the relative price of tradable in non-tradable. The effect of Dutch Disease resulting from a positive shock on the price of a non-tradable good is double: the “spending effect” and the “resource transfer effect” as consequences of a boom of external revenues linked to a tradable sector.

- The spending effect results from the rise of effective demand due to the flow of external revenue accruing to the concerned tradable sector and passed on through the corresponding distribution of income. This will translate in a tension on the price of non tradable goods as no foreign competition is likely to fill the gap between supply and demand.
- The resource transfer effect rests on the consequence of the higher profitability of the non tradable sector which attracts factors such as labor and capital from other sectors. Obviously the tradable sector under shock is not concerned but other tradable are the victims of these resource transfer effect. The competitiveness of these tradable on foreign markets is at risk as factor prices are on the rise and these sectors might shrink as corresponding imports grow. Resource transfer is likely to soften the tension on non-tradable supply, but not enough, as incomes from the exporting sector and the rise of factor prices fuel demand and non-tradable supply does not feel the pressure of foreign competition.

Although Dutch Disease models retain typically three sectors, non-tradable sector, tradable sector prone to price shock (usually a natural resource exporting sector such as mines or oil) and other non-tradable mustered in a unique one, we can witness a variation of the number of sectors retained: instead of three in the case of classical export boom such as raw material ones, they can be only two (tradable and non-tradable) when the boom concerns transfers and not export prices as in the case of aid for example. (Rajan and Subramanian, 2009)

II-2 the transfer of Dutch Disease approach to the analysis of the local impact of remittances

The applicability of Dutch Disease model at a local or territorial level stems from the fact that local areas can be considered as very small and very open economies as far as their trade with the external world is concerned. From this starting point it rests on two conditions: the

relevance at the local level of the definition of non-tradable goods and the possibility of a definition of a real exchange rate.

Regarding the first condition, we have stressed that many non-tradable refer to a spatial link to the national economy. At the local level there is therefore some sort of non-tradability for those goods and services which have a special link to place, either physical or patrimonial. This is particularly the case for “amenities” which attracts residents and tourists and has been underlined by the literature on local development based on place qualification (Pecqueur, 2001): territorial qualification of goods is related to specific assets and means non tradability with other similar goods from other places.

Regarding the second condition, although nominal exchange rate is equal to one between regions belonging to the same monetary zone and has no practical relevance, real exchange rate can still be defined at the local level taking into consideration the difference in the price evolution of local non-tradable and the general national price index (at least theoretically as statistical data can lack to compute it effectively).

Regarding the definition of the three Dutch Disease sectors in local areas, and particularly in local rural areas, agriculture in rural areas would play the role of manufacturing in traditional Dutch Disease models; migration could be considered as an exportation of a tradable resource, or a tradable “production” if there is an investment in human capital for example. Non-tradable would muster all non-transferable local services or activities linked to localization, such as construction linked to local real estate, which must be performed locally, personal services, petty trade, etc. Furthermore their non-tradable character can be reinforced by the link of these non tradable activities with territorial specific assets, such as local amenities. Migration can also and maybe more accurately be cast in a two sector model with transfer shock where Dutch Disease model is only linked to external income and not exports, as we have seen with the case of aid: remittances would be in this case another kind of external transfer.

Spending effect would stem from remittance expenses at the local level and resource transfer effect would be determined by the departure of migrants from some local “export” activities such as agriculture towards for example tourism or migration.

This is however conditional to an implicit assumption that unemployment does not exist in agriculture, which is debatable, and that migration or tourism is a substitute for agricultural

employment, which is also debatable: migration is often a household choice which bears on specific members of the household (young, male, educated, etc...) and cannot be extended to the whole household.

The spending effect is far less debatable. It can concern non-tradable or imported tradable and in both cases it is a factor of loss of competitiveness and growth. However it has to be recalled that consumption patterns are not always impacted by remittances, and that education and health expenses, which are usually boosted by remittances, are non-tradable, but have also a positive impact on productivity.

These cave-ats shows us that the transferability of Dutch Disease to the local level raises questions about the substitution effects between sectors that it features. Reference to the more Keynesian approach of residential economy can allow us to answer these questions.

III) Remittances and residential economy; what relevance?

As we have seen, “spending effect” refers to the impact of global demand on the remittance-based local economy. This impact is channeled through demand which is addressed by beneficiaries of income from the sector under positive price shock. This is clearly a multiplier effect, much akin to a Keynesian framework. As price shock does impact a tradable sector or external transfer, relevant reference would be Keynesian export multiplier.

It has to be recalled that the main hypothesis regarding the effectiveness of export multiplier on a national economy is the hypothesis of a “specialized economy”, that is to say that there is no substitution on the international market between export and import goods. Specificity is not just in this case a characteristic of non-tradable but also a characteristic of tradable as there is no substitution between export tradable and import tradable.

The transfer of Keynesian export multiplier at the local level constitutes the heart of base theory and “residential economy”. In every place or territory can be defined an economic base which attract an external demand and results in the creation of income (wages, interests) being distributed by firms catering to this external demand. The spending of these incomes entails successive waves of income creation and spending, according to the usual multiplier

effect and allows for the development of “domestic” economic activities. The size of local economy is therefore determined by the initial base impulsion.

Base theory approach identifies four types of economic basis which can apply to specific places:

- A productive base, stemming from the “exportation” of goods outside the territory.
- A residential base, stemming from the local spending of incomes earned outside the territory by local residents. It comprises all forms of income received by local residents as well as external incomes (wages or interests).
- A public base, stemming from the incomes linked to government activities localized in the territory as well as transfers to local governments or public entities.
- A social base, stemming from social transfers to local residents (social security, unemployment compensations, etc.)

Actually the main divide is between the first and the three others as frontiers between these last ones are rather fuzzy: remittances, by example, are private transfers, but with a social impact and at the same time are wages. Transfers to local governments can fund social programs, etc. Moreover a “presencial” base can join the residential one, corresponding to the local spending of external incomes by tourists or people present for a short period of time.

To validate a strict correspondence between initial impulsion and the size of the economy one must validate the specialized economy hypothesis for a local territory, meaning that local “imports” are a given percentage of local incomes. In other terms substitution between domestic activities and external ones should not exist. It is of course a bold hypothesis for very small territories unless they can boast a form of specificity which would affect a significant share of local activities. Territorial qualification which would mean in the “basket of goods approach” a Lancaster-type characteristic (Lancaster, 1966) shared by a basket of good produced locally can provide for that and is clearly linked to “amenities” attracting residence and presence. There is therefore a link between this approach and the usual local productive system approach and reference to Dutch Disease allows revealing this link.

The main issue in terms of local development policy is therefore to protect “spending effect” encompassing the relationship between base and domestic activities from the interference of resource transfer effect. The stability of consumption patterns is an argument for the

definition of stable propensities to consume and thus to the existence of remittances multiplier effect.

The main factor in the case of migration would be its historical and cognitive anchoring in specific places which would allow for the mitigation of price shocks. But the attachment of migrants to their community, should they not go back to them, is an important element of specificity based on amenities.

Conclusion

Dutch Disease and residential economy approaches are relevant to study the impacts of migration, mainly because migration and remittances are geographically concentrated, thus giving them a “macroeconomic wield” at a territorial level.

In this respect migration should be seen as a competitive advantage of some places and be treated accordingly by public policies. This is what some countries have begun to do, especially those small countries, like Cape Verde (Carling, 2008), which rely very much on remittances and where migration and diasporas can even be considered as an element of national identity. In larger countries where some regional areas are concerned by migration, the role of local public policies should be adamant to boost spending effect and its residential impact, while limiting resource transfer effect.

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