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The Impact of Workers' remittances on Economic Growth: Evidence From Kenya

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ABSTRACT: ***Over the past decades, the levels of workers' remittances have grown to become one of the largest sources of foreign income to developing countries. It is an important source of income for households in the developing countries. Economists do agree that workers' remittances are crucial in the long run growth of a country. Empirical studies have been done for various countries and although most results show a positive relationship between workers' remittances and economic growth, other studies reveal negative and neutral relationships. In many of these studies, majority of which have been done from a regional or global perspective panel data has been used to estimate the impact of workers' remittances on economic growth with a few studies done using time series to cover a specific country. This study employs time series econometric techniques to investigate the impact of workers' remittances on economic growth in Kenya using annual time series data for the periods 1970 to 2010.Time series regressions results show a positive and highly significant impact of workers' remittances on economic growth, indicating that higher economic growth in Kenya is related with higher flow of workers' remittances in to the country. In addition the results indicate that gross capital formation and change of exchange rate regime from fixed to floating has a positive and significant impact on economic growth in Kenya. However, exports, private capital flows, final government consumption and elections appear not to have meaningful impact on the economic growth in Kenya. The government should therefore formulate policies which create incentives for Kenyans in the diaspora to continue investing in the country and also a conducive macroeconomic environment to support investment and growth.***

Key words: Workers' remittances, Economic Growth, Kenya, Time series Regression.

INTRODUCTION:

For many years workers' remittances have grown to become a significant source of foreign exchange in many developing countries. Indeed, it is almost becoming a substitute for foreign direct investment (FDI), official development assistance (ODA), debt relief or other public sources of finance development. Workers' remittances receipts in Sub-Saharan Africa stood at $US0.22 billion in 1970 compared to $US20 billion in 2009. Further Evidence shows that in 2010, $US325 billion was the amount of workers' remittances transmitted to the developing countries. These remittances were indeed more that 5 percent of the gross domestic product (GDP) in the developing countries and almost at par with foreign direct investment (FDI) (World Bank, 2011).

This upward growth of remittances has made them to be considered crucial to the economy unlike in the past. It is important to note that remittances resulting from migration are more influential in enhancing socioeconomic condition of the people living in the country migrated and boost economic development (Khan 2005). Nyamongo*et al (*2012),in their study on the role of remittances on economic growth in a panel of 36 countries in Africa using a panel econometric framework found out that remittances appear to be an important source of economic growth while its volatility appears to have a negative effect on growth. They also found out that remittances appear to be working as a complement to financial development but the importance of financial development in boosting economic growth appears weak among the countries understudy.

Although for a long time literature has detailed several sources of economic growth, there has been an endless debate on the same. Most of the literature already documented seems to associate economic growth more so in the developing countries with the most obvious factors like increasing physical capital, adopting appropriate technology, development assistance, investment in human capital,

expanding volume of exports, political stability among others.

The model, developed by Robert Solow (1956), was the first attempt to model long-run growth analytically. This model shows that the role of technological change is more crucial to economic growth. Technology improves, the steady state level of capital increases, and the country invests and grows. The data does not support some of this model's predictions, in particular that all countries grow at the same rate in the long run, or that poorer countries should grow faster until they reach their steady state. Also, the data suggests the world has slowly increased its rate of growth.

Lewis regarded economic development as anything but multidimensional. In his monumental theory of economic growth (1954) he relates economic development to the will to economize, economic institutions and human knowledge prior to discussing capital as a generator of economic growth. Lewis' main focus was on the reallocation of labor until the turning point is reached, i.e., the time when labor reallocation has outstripped population growth long enough for dualism to atrophy and the economy to become fully commercialized.

Chenery and Strout (1966) argue that growth in developing countries is restricted by one limiting factor in every period. Such a gap, e.g., national savings, foreign exchange, human capital, or technological knowledge, can be removed by foreign assistance, which thereby fosters economic growth. Denison (1967) in his study why growth rates differ, point out that the overall convergence in productivity growth rates in the long run is conditional to the existence of high initial levels of technological congruence, social capability and facility for structural change

Most of studies reveal economic growth and development is likely to occur due to increasing capital, investment in human capital, expanding volume of exports, adopting appropriate technology, development aids, political stability and many others. Paul Romer (1986) presents a model in which economic growth in the long run occurs not because of exogenous technological progress, but because the accumulation of capital generates externalities that compensate for diminishing returns. Robert Lucas (1988), another pioneer of the new growth literature, introduces a model in which human capital plays a fundamental role in perpetuating economic growth and preventing diminishing returns to physical capital accumulation.

Barro (1991) shows that the growth rate of real per capita GDP is positively related to initial human capital and negatively related to the initial level of real per capita GDP. Countries with higher human capital also have lower fertility rates and higher ratios of physical investment to GDP. Growth is inversely related to the share of government consumption in GDP, but insignificantly related to the share of public investment. Growth rates are positively related to measures of political stability and inversely related to a proxy for market distortions. In his 2003 paper, "Countries", he argues that, for given per capita GDP and human capital, growth depends positively on the rule of law and the investment ratio and negatively on the fertility rate, the ratio of government consumption to GDP, and the inflation rate. He also argues that growth increases with favorable movements in the terms of trade and with increased international openness, but the latter effect is surprisingly weak.Several other researchers like Owens (1987), Sen (1999), and Kaufmann *et al* (2007) have also focused on the impact of institutional factors such as the role of political freedom, political instability, voice and accountability on economic growth.

It's worth noting that, workers' remittances has not been given a big recognition as a source of economic growth. Adams and Page (2005) explains that remittances contribute to poverty alleviation because the poor who are also economically disadvantaged receive it directly. However despite the positive contribution of remittances to economic growth, literature also documents that remittances may have a negative effects on the economies. Majority of the emigrants may be educated or the highly skilled in the country and this causes "brain drain" and this may slow down economic development for developing countries because home country invested time, effort and money on their education. Leon-Ledesma and Piracha (2004) shows that international migrations bring about dependence on remittances. This dependence distorts development and income inequalities in the country. Other researchers like (Amuedo-Dorantes $ Pozo, 2004; Chami*et al.* (2003) shows that because the remitter may not have a direct influence on the use of the remitted fund some of the funds may not be used for investment projects. In addition some recipients may increase their leisure activities if they treat the remittances as a substitute for the labor income a situation which affects labor productivity.

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STATEMENT OF THE PROBLEM

Remittances in Kenya continued to show an upward trend in the past. Official estimates from the Ministry of Foreign Affairs in Kenya indicate that there are about 3 million Kenyans in the Diaspora, approximately 8% of the country's population; therefore the growth of remittance flow seems endless. In the recent times, migration has also been a result of business opportunities, especially in countries neighboring Kenya (Ngugi, 2011).Most researchers have conducted empirical studies on the impact of remittances on economic growth and their results are diversified with some getting a positive relationship and others negative relationship. Majority of these studies are done from a global or regional perspective with a few being done on an individual country. It's also worth noting that the few country specific studies have analyzed the impact of remittances on several socio economic phenomena like consumption or poverty with no clear focus on the impact on economic growth. Most of these studies make use of panel data and a few using time series.It is therefore common that the impact of remittances on economic growth for a specific country is usually obtained through generalization. This is because most of the panel data studies use one coefficient for all the countries. Using one coefficient to measure the impact of several countries may not bring out well the impact to a specific country. This study will therefore undertake a case study of Kenya which will be a more micro-level analysis to estimate impact of remittances on economic growth. It will utilize time series data of workers' remittances to Kenya from 1970 to 2010. Furthermore, there are well known difficulties with cross section country data and so there is need for more longtime series on the subject, (Jawaid*et al* 2012).This will contribute towards having specific and relevant policy on remittances for Kenya.

2.0 LITERATURE REVIEW

2.1 Economic growth

In this study we used real GDP per capita as a proxy for economic growth. GDP per capita is gross domestic product divided by midyear population. GDP is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources. Data is in current U.S dollars. (African Development Indicators 2011)

2.2 Workers' remittances

Workers' remittances and compensation of employees comprise current transfers by migrant workers and wages and salaries earned by nonresident workers. Data are the sum of three items defined in the fifth edition of the IMF's Balance of Payments Manual: workers' remittances, compensation of employees, and migrants' transfers. Remittances are classified as current private transfers from migrant workers resident in the host country for more than a year, irrespective of their immigration status, to recipients in their country of origin. Migrants' transfers are defined as the net worth of migrants who are expected to remain in the host country for more than one year that is transferred from one country to another at the time of migration. Compensation of employees is the income of migrants who have lived in the host country for less than a year. Data is in current U.S. dollars,(African Development Indicators 2011).The coefficient of workers' remittances is expected to have a positive sign.

2.3 REMITTANCES AND ECONOMIC GROWTH

There are many studies which have contributed to the large amount of theory and empirical literature on remittances and its effect on different aspects of the economy. Most of these studies cover the role of remittances on several socio-economic phenomena such economic growth, consumption, poverty, investment, financial development among others.

Nyamongo*et al* (2012) in their study on the role of remittances and financial development on economic growth in a panel of 36 countries in Saharan Africa over the period of 1980-2009 found out that remittances appear to be an important source of growth for these countries in Africa during the period under study. They further established that volatility of remittances appears to have a negative effect on the growth of countries in Africa and that remittances appear to be working as a compliment to financial development.

Jawaid*et al* (2012) in their study to investigate the relationship between workers' remittances and economic growth by using 7 years average annual data of 113 countries from the period 2003 to 2009 indicate the positive and significant relationship between workers' remittances and economic growth. The study shows that the workers'

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remittances are more contributing in high income countries as compared to low and middle income countries.

Imai *et al* (2011) examined the effect of remittances and its volatility on economic growth by using the panel data of 24 Asian and Pacific countries from the period of 1980 to 2009. They a positive relationship between workers' remittances and economic growth but the volatility of workers' remittances was found harmful for economic growth. However they got a significant negative relationship of workers' remittances with poverty.

BichakaFayissa& Christian Nsiah, (2010) while exploring the aggregate impact of remittances on the economic growth of 18 Latin American Countries within the conventional neoclassical growth framework using an unbalanced panel data spanning from 1980 to 2005 found that remittances have a positive and significant effect on the growth of Latin American Countries where the financial systems are less developed by providing an alternative way to finance investment and helping overcome liquidity constraints. This concurs with the findings of their further study in 2011.The study estimated the macroeconomic impact of remittances and some control variables such as openness of the economy, capital/labor ratio, and economic freedom on the economic growth of African, Asian, and Latin American-Caribbean countries using newly developed panel unit-root tests, cointegration tests, and Panel Fully Modified OLS (PFMOLS). The results show that remittances, openness of the economy, and capital labor ratio have positive and significant effect on economic growth for all regions as a group and in each of the three in study.

Ivakhnyuk, I., (2006) found out that workers' remittances which are closely related to migration have a positive impact on economic development. In addition, in their study to examine the effect of workers' remittances on economic growth in a sample of 39 developing countries using panel data from 1980–2004 resulting in 195 observations Pradhan*et al* (2008) found out that remittances have a positive impact on growth.

Ramirez and Sharma (2008) examine the impact of remittances on economic growth in 23 Latin American and Caribbean countries using panel data from 1990 to 2005. Results from the estimation show that there is a positive association between workers' remittances and economic growth. The paper presents evidence of negative growth in the absence of remittance receipts in those countries.

Within a theoretical framework, Mundaca (2009) analyzes the effects that both workers' remittances and financial intermediation have on economic growth. He found, among other things, that remittances can have significant positive long-run effects on growth. He confronts the implications of the theoretical model proposed with panel data for countries in Latin America and the Caribbean. After considering the effect of long-run investment and demographic variables, and controlling for fixed time and country effects, the empirical analysis indicates that financial intermediation tends to increase the responsiveness of growth to remittances. The overall conclusion is that making financial services more generally available should lead to even better use of remittances, thus boosting growth in these countries. Thus this leads us to our first hypothesis.

Ho_1: Remittance has no impact on the economic growth in Kenya.

3.0 MATERIALS AND METHODS

The study employed mainly explanatory research design to show the causal relationship.

Data was collected for the periods 1970 to 2010.These periods are specifically important since they comprise both pre and post reform periods for the Kenyan economy. Selection of the period is based on availability of data.

This study relied purely on secondary annual time series data. The data was obtained from the World Bank database: African Development Indicators. Data on remittances as a ratio of GDP is the sum of three items defined in the fifth edition of the IMF's Balance of Payments Manual: workers' remittances, compensation of employees, and migrants' transfers. Remittances are classified as current private transfers from migrant workers resident in the host country for more than a year, irrespective of their immigration status, to recipients in their country of origin. Migrants' transfers are defined as the net worth of migrants who are expected to remain in the host country for more than one year that is transferred from one country to another at the time of migration.

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4.0 RESULTS

Descriptive Statistics

Table 4.1 Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
GDPPC	41	415.7542	31.14335	291.1721	468.6997
WR	41	.0212892	.0176621	.0028493	.0583036
PCF	36	.0042796	.0060934	-.0025348	.0245361
GCF	41	.2057467	.0364635	.1500382	.2976002
GC	41	.1718579	.0134694	.1447996	.1980338
X	41	.2715608	.0420356	.2016926	.3890363
Dummy 2	41	.4390244	.5024331	0	1
Dummy 3	41	.195122	.4012177	0	1

Where GDPPC is real Gross Domestic Per Capita, WR is Workers' Remittances, PCF Is Private Capital Flows, GCF is Gross Capital Formation, GC is Final Government Consumption, X is exports and Obs is the number of observations.

From the Table 4.1, the GDP per capita for Kenya has a mean of 415.7 with a standard deviation of 31.1 over a period of 41 years. From 1970 to 2010, GDP per capita had a maximum value of 468.69 and a lowest value of 291.17. Workers' remittances over the same period had a mean of 0.021 with a standard deviation of 0.18. This variable had a maximum of 0.058 and a minimum of 0.003 with 41 observations. Private capital flows had a mean of 0.004 with a standard deviation of 0.006. With 36 observations the variable had a maximum of 0.003 and a minimum of -0.003.Gross capital formation had a mean of 0.205 with a standard deviation of 0.036. It had a maximum value of 0.29 and a minimum value of 0.15 with 41 observations. Government consumption had a mean of 0.172 with a standard deviation of 0.013. It had 41 observations whereby the minimum value was 0.145 and the highest value was 0.198. Finally, exports had a mean of 0.272 with a standard deviation of 0.420. Out of the 41 observations, the minimum value of the exports was 0.201 and a maximum value of 0.389.

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Table 4.2: Time Series Regression Results

Number of obs = 36, F (7, 28) = 6.75, Prob> F = 0.0001, R-squared = 0.5419,

Root MSE = 15.464

The Dependent Variable is GDPPC

Variable	Coefficient.	Robust Std. Error.	t-Statistic	p>t	[95%confidence interval]	
WR	1301.444	270.5811	4.81	0.000	747.184	1855.705
PCF	430.5975	383.3665	1.12	0.271	-354.6932	1215.888
GCF	218.1426	116.6588	1.87	0.072	-20.82216	457.1073
GC	-11.60902	268.8928	-0.04	0.966	-562.4109	539.1929
X	-46.18083	77.42833	-0.60	0.556	-204.7856	112.4239
D2	-24.59334	12.99997	-1.89	0.069	-51.22258	2.035893
D3	7.617603	5.509003	1.38	0.178	-3.667078	18.90228
_CONS	372.1236	60.50578	6.15	0.000	248.1831	496.0641

The regression was done using robust standard errors to cater for serial correlation

Where GDPPC is real Gross Domestic Per Capita, WR is Workers' Remittances, PCF Is Private Capital Flows, GCF is Gross Capital Formation, GC is Final Government Consumption, X is exports and Obs is the number of observations.

From the Table 4.2 depicting the OLS regression results, the F statistic is 6.75 with a P value of 0.0001 implying that the independent variables, that is, Workers' remittances, Private capital flows, Gross capital formation, final Government Consumption, Exports, dummy for exchange regime and dummy for electoral cycles jointly explains the dependent variable, GDP per capita.

The R squared which is a measure of goodness of fit is 0.5419 and a root mean standard error of 15.464 implying that 54.19 percent of the variations in the real GDP per capita are explained by the independent variables; Workers' remittances, Private capital flows, Gross capital formation, final Government Consumption, Exports, dummy for exchange regime and dummy for electoral cycles.

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We found a positive and highly significant relationship between workers' remittances and real GDP per capita, indicating that higher economic growth is related with higher remittances. The coefficient of Workers' remittances, 1301.444, is statistically significant with a P value of 0.0001 implying that a one unit change in the percentage of workers' remittances to GDP will lead to 1301.444 unit change in Kenya GDP per capita. These results seem to support the findings of other studies like Nyamongo*et al* (2011), Fayissa and Nsiah (2010) and Igbal and Satter (2005) who also found a positive and significant impact of Workers' remittances on economic growth.

Our results indicate that Private capital flows have a positive impact on economic growth but its impact is statistically insignificant. This could be explained by the fact that the investment climate in Kenya is not conducive and that the ease of doing business is very low due to corruption, political instability among other issues.

We found a positive and significant relationship between Gross capital Formation and Economic growth in Kenya. The coefficient is 218.1426 as shown in table 4.2. This implies that a one unit change in the percentage of Gross capital formation to GDP will lead to 218.1426 unit change in Kenya GDP per capita.

Final Government Consumption has a negative sign and does not have significant impact on economic growth. This is because most of the government consumption goes into consumption and other expenditure which do not support private sector investment.

Table 4.2 also contains the results for the impact exports to economic growth in Kenya. The results indicate that exports have a negative impact on economic growth although the impact is not significant. This can be explained by the fact that Kenya is a net importer and that the Marshall- Learner conditions do not hold for the Kenyan case.

Dummy variable for exchange rate regime has coefficient of -24.59334 and statistically significant. This implies that the change of exchange rate regime from fixed to floating exchange rate regime had a positive impact on the economic growth. The actual coefficient of this dummy is given as (372.1236-24.59334 =347.53).

The electoral cycles captured by dummy variable had a coefficient of 7.618 and is statistically insignificant implying that elections in Kenya do not affect her economic growth. This may be because voters may evaluate candidates on more micro indicators of performance. The exception is the year 2007-2008 where the economic growth was affected due to the political violence that erupted from the disputed presidential elections.

5.0 SUMMARY OF FINDINGS

In this study we have empirically investigated the role of workers' remittances on economic growth in Kenya using annual time series data over the period 1970and 2010. As evidence by the previous studies, different researchers have found either a positive, negative or neutral relationship between workers' remittances and economic growth. Most of these studies make use of panel data and a few using time series data. The study employed an econometric procedure toanalyze the impact of workers' remittances on economic growth in Kenya.

From the time series regression results, we found a positive and highly significant relationship between workers' remittances and real GDP per capita, indicating that higher economic growth is related with higher remittances. We also found a positive and significant relationship between Gross capital Formation and Economic growth in Kenya. In addition, change of exchange rate regime from fixed to floating exchange rate regime had a positive impact on the economic growth in Kenya. However, we established that although private capital flows, final government consumption, exports and elections have an impact on economic growth, the impact is statistically insignificant. This could be explained by: (1) the fact that the investment climate in Kenya is not conducive and that the ease of doing business is very low due to corruption, political instability among other issues. (2) most of the government expenditure is spent on recurrent expenditure rather than on development expenditure that would lead increased production efficiency hence increasing the GDP per capita. (3) the fact that Kenya is a net importer and that the Marshall- Learner conditions do not hold for the Kenyan case.

5.1 CONCLUSION OF THE STUDY

Workers' remittances have become one of the largest sources of external financing in Kenya. After reviewing the literature it shows a recent revival in interest in workers' remittances largely due to big size of their flows. In this paper, we analyzed the impact of workers' remittances from the period 1970 to 2010. From the time series regression analysis, the study found that workers remittance have a

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positive impact on economic growth. This is in line with the previous results in the literature, for example, (Nyamongo*et al* 2011).Further, the paper found a positive impact of gross capital formation and change of exchange rate regime from fixed to floating on economic growth The paper found out that private capital flows, final government consumption, exports and elections appear not to have meaningful impact on economic growth in Kenya. Remittances in Kenya seem to have been translated to value-added activities and investments which are fundamental sources of development and economic growth.

5.2 POLICY RECOMMENDATIONS

From this study several policy recommendations may be drawn .The government can improve their economic growth performance not only by concentrating on the traditional sources of growth such as promoting technology, human capital, exports, tourism and foreign direct investment, but also by reaping the contributions of workers' remittances by reducing the cost of transactions of sending and receiving money from abroad. This will encourage workers remittance flow into the country through the formal channels and hence more economic growth. The government should also encourage gross capital formation through maintenance of stable macroeconomic climate to encourage savings and investments. Savings rate plays an important role in determining economic growth. Finally, the government should maintain floating exchange rate regime as it positively contributes to economic growth.

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