

# Remittances and the Macroeconomic Impact of the Global Economic Crisis in the Kyrgyz Republic and Tajikistan

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## Introduction

Several members of the Commonwealth of Independent States (CIS) rely heavily on remittances sent back by migrant workers, mainly in the Russian Federation, to support household incomes and the balance of payments. Tajikistan is the most heavily dependent of the CIS countries on remittances, followed by Moldova and the Kyrgyz Republic (Table 1).

**Table 1. Remittances in 2008 as a Share of GDP and Imports for Five CIS Economies.**

	Remittances US\$ millions	Remittances as Percent of GDP	Remittances as Percent of Imports
Armenia	1062	9	22
Georgia	732	6	12
Kyrgyz Republic	1205	23	25
Moldova	1897	31	39
Tajikistan	2670	52	94

Sources: World Bank and IMF

During the 2000s, remittances have become an important channel through which growth in the Russian Federation is transmitted to other CIS economies, whereas the trade channel, which was traditionally the

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<sup>1</sup> Alturki, Fahad, Jaime Espinosa-Bowen, and Nadeem Ilahi, "How Russia affects the neighbourhood: Trade, Financial and Remittance Channels," *International Monetary Fund*, Working Paper WP/09/277 (2009).

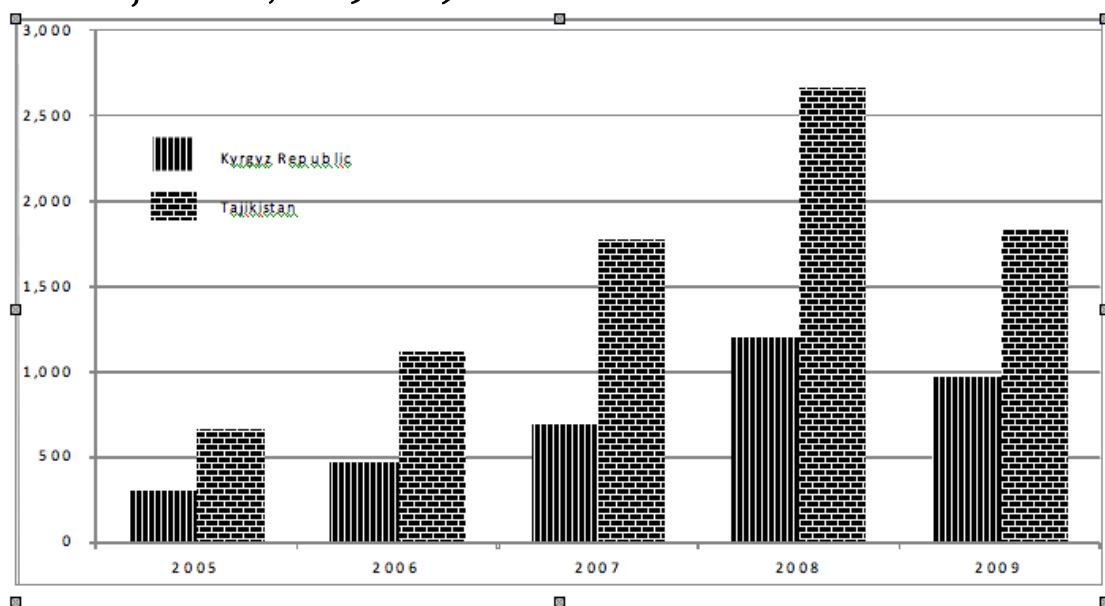
dominant channel of economic integration, has declined in importance. Outward transfers of remittances from Russia rose to US\$25 million in 2008, of which other CIS countries were the destination for 90 percent.<sup>1</sup>

Valued in U.S. dollars, remittances received by CIS countries other than Russia fell by 25 percent in 2009, because of the economic crisis in Russia. This note analyses the macroeconomic impact of the fall in remittances in the Kyrgyz Republic and Tajikistan, the two smallest and poorest (in terms of per capita incomes) economies in the CIS. The following section (section 2) provides some background material on the growth of remittances and the contribution that they have made to the Kyrgyz and Tajik economies. This is followed by the third section which examines how they adjusted to the fall in remittances. The fourth section concludes.

### The Contribution of Remittances to the Kyrgyz and Tajik Economies

Figure 1 below shows annual gross inflows of remittances over the five years to 2009 to the Kyrgyz Republic and Tajikistan. The growth of remittances in the mid-2000s was dramatic. Between 2005 and 2008, the U.S. dollar value of remittances rose fourfold in both Tajikistan and the Kyrgyz Republic. The main forces driving worker migration from the Kyrgyz Republic and Tajikistan are the large wage differentials between them and the Russian Federation; the per capita income of Russia was 17 times that of Tajikistan and 12 times that of the Kyrgyz Republic in 2008. Most migrants work in the construction industry or in service industries.

**Figure 1. Annual Remittance Inflows to the Kyrgyz Republic and Tajikistan, 2005-2009: U.S. Dollar Millions.**



Sources: National Bank of Tajikistan and the World Bank

In the space of half a decade, remittances have become a dominant feature of both the Tajik and Kyrgyz economies. The substantial contribution that they made to household incomes fuelled a consumer boom which in turn boosted real GDP growth. The consumer boom also led to rapid growth in imports and widening trade deficits which were largely funded by remittances. According to 2008 World Bank figures, at least half of the decline in absolute poverty in Tajikistan, from 72 percent in 2003 to 53.5 percent in 2007 is attributed to the growth of remittances. Remittances also contributed to the fall in poverty in the Kyrgyz Republic from 50 percent in 2003 to 35 percent in 2007.

### **The Impact of the Global Crisis on the Kyrgyz and Tajik Economies**

The Russian economy suffered a double blow in 2008; first from the steep drop in world crude oil prices and second, from a reversal of capital account inflows. The fall in national income and the adjustment of the balance of payments (BOP) to the external shocks triggered a steep recession. After recording real GDP growth of 8.1 percent in 2007, growth fell to 5.6 percent in 2008 and then to negative 9 percent in 2009, one of the steepest falls of any major economy. This affected remittances, mainly to other CIS economies, through two channels: first because of a contraction in employment, especially in the cyclically sensitive construction industry<sup>2</sup> and secondly because the depreciation of the Russian rouble, by 51 percent against the U.S. dollar between March 2008 and March 2009, reduced the dollar value of remittances.

Remittances to both the Kyrgyz Republic and Tajikistan began to fall in the final quarter of 2008, by more than can be attributed to seasonal factors alone, with the fall continuing through 2009. Gross inflows of remittances valued in U.S. dollars to the Kyrgyz Republic were 20 percent lower in 2009 than in 2008 while in Tajikistan gross inflows fell by 31 percent in the same period, although remittances were still higher in both countries in 2009 than they had been in 2007 (see Figure 1).<sup>3</sup> Both countries, therefore, suffered a substantial external shock as a result of the fall in remittances in 2009. The Tajik economy incurred a fall in national income of 16 percent and the Kyrgyz economy a fall of 5 percent of their respective 2008 GDPs as a result of the fall in remittances. For the Kyrgyz economy, the shock from the fall in remittances was compounded by a fall in its export earnings of about 6 percent of GDP.

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<sup>2</sup> There were also reports of migrant construction workers not being paid their wages, World Bank (2008), "Migration in Tajikistan" mimeo.

<sup>3</sup> Remittances in 2009 fell by 30 percent in Armenia, 27 percent in Georgia and 20 percent in Moldova from their levels in 2009.

Tajikistan's exports did not fall in 2009, but are far less important as a source of foreign exchange earnings than remittances for its economy.

**Table 2. Key Macroeconomic data for the Kyrgyz Republic and Tajikistan.**

	Kyrgyz Republic			Tajikistan		
	2007	2008	2009	2007	2008	2009
Real GDP growth (%)	8.5	8.4	2.3	7.8	7.9	3.4
Trade Balance goods and services (% of GDP)	-26	-33	-20	-48	-55	-40
Exports of goods and services (\$ millions)	2244	3037	2702	385	457	458
Imports of goods and services (\$ millions)	3218	4747	3622	2058	3179	2387
Remittances (\$ millions)	688	1205	967	1774	2670	1833
Private consumption (% of GDP)	78	87	64	112	121	106
Nominal Exchange Rate change (+=depreciation)	7	-1.7	17.4	0	-0.3	29

Sources: IMF Country Documents

How did the fall in remittances affect the macroeconomies of these two countries? Faced with a negative external shock, an economy essentially faces two choices. First, if the shock is expected to be purely temporary, the economy might be able to avoid having to cut expenditure and instead could run a larger current account deficit by accumulating net foreign liabilities, either in the form of foreign borrowing or running down international reserves. The second option is for the economy to adjust to the external shock by reducing imports, thereby avoiding a deterioration of the current account of the BOP and the overall BOP.

The first option was not available for Tajikistan because it did not have anywhere near sufficient international reserves. At the end of 2008, the central bank held gross international reserves equivalent to less than one month's worth of imports of goods and services. It also did not have the creditworthiness to access external capital markets, other than on a very limited scale from official concessional sources such as the IMF. The Kyrgyz Republic was in a somewhat stronger position with reserves equivalent to 4.1 months of imports at the end of 2008; hence it could have funded a modest temporary BOP deficit. However funding a BOP deficit with international reserves would have been a risky strategy to pursue given that the duration of the external shock was, and still is, very uncertain and the Kyrgyz Republic did not take this path.

Consequently, both countries adjusted to the external shock by reducing imports, thereby improving their trade balances, by 13 and 15 percent of GDP in the Kyrgyz Republic and Tajikistan respectively; an adjustment which was facilitated by exchange rate depreciation (see Table 2). Imports valued in U.S. dollars contracted by 24 percent in the Kyrgyz Republic and by 25 percent in Tajikistan. The fall in imports was brought about mainly by a contraction in private consumption, by 23

percent of GDP in the Kyrgyz Republic and 15 percent of GDP in Tajikistan. Hence the burden of adjustment to the external shock was borne by households, not surprisingly as the fall in remittances directly cut their disposable incomes by a substantial amount. Given that the financial sectors in both countries are very shallow and underdeveloped, it is unlikely that households were able to access sufficient credit, or decumulate financial savings, to smooth their consumption in the face of a shock of this magnitude. In both countries, bank deposits provide the main vehicle for household saving in the form of financial assets (there are few other financial assets available to savers), but non government deposits are small as a share of GDP: at the end of 2008 they were 8.6 and 9.3 percent of GDP respectively in Tajikistan and the Kyrgyz Republic. Hence the liquid financial assets which could potentially have been used to smooth consumption in the face of an adverse household income shock were small. It is likely that households invest some of their savings in other assets besides bank deposits, such as residential construction, but these assets are not very liquid and so cannot easily be used to smooth income shocks.

Real GDP growth fell sharply in both countries, but remained positive; unlike most other countries in the CIS, the Kyrgyz Republic and Tajikistan avoided recession, despite the substantial contraction in private consumption and import spending. From the 2008 level of GDP growth, preliminary estimates indicate that real growth decelerated by 6 percentage points in the Kyrgyz Republic and by 4.5 percentage points in Tajikistan. This compares favourably with the average for the CIS (excluding Russia) in which real growth fell by 9.2 percentage points to negative 3.9 percent in 2009.<sup>4</sup> It also compares very favourably with the other small low income CIS economies of Armenia, Georgia and Moldova which all suffered steep recessions in 2009, with real growth of -15.6 percent, -10 percent and -4 percent respectively.<sup>5</sup>

As such, real output of the Kyrgyz Republic and Tajikistan proved rather more resilient to the external shock than most of their regional partners in the CIS. This is surprising in some respects. Both economies are not well diversified and are still dominated by state owned enterprises, which impede flexible supply side adjustment to price incentives. It is worth exploring possible explanations for this conundrum and in particular whether the adjustment to an external shock arising from a fall in remittances might be less disruptive for the real economy than a shock arising from the trade or capital accounts.

As noted above, the immediate impact of the fall in remittances was on household incomes. This was transmitted into a fall in consumer

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<sup>4</sup> Data from the IMF, World Economic Outlook, January 2010.

<sup>5</sup> Data from World Bank ECA Statistical Annexes, September 2009.

demand, for both domestically produced and imported consumer goods. However, the impact on demand for domestic consumer goods (mostly non-traded goods) was muted because of the exchange rate depreciation which had two beneficial effects. First, it meant that the fall in remittances, when valued in national currency, was much less than the fall when denominated in U.S. dollars. For example, remittances fell by 31 percent in Tajikistan in 2009, but the Tajik Somoni value of these remittances, in real terms, fell by only 18 percent. As a result, private disposable incomes in real terms probably fell by only about 1 percent in 2009.<sup>6</sup> Secondly, the depreciation of the real exchange rate encouraged consumers to switch demand from imports to non-traded goods. It is also plausible that imported consumer goods are much more income elastic than non-traded consumer goods; this would be especially likely if some of these imports are purchased directly by migrant workers in Russia and then brought home themselves or by fellow workers when they return to their country of origin. As a consequence, most of the contraction in household consumption which took place appears to have fallen on imports rather than on demand for domestic non-traded goods.

An external shock transmitted through the trade channel, emanating from a fall in export demand or a fall in export commodity prices, which affected several CIS economies, including to a limited extent the Kyrgyz Republic, is potentially much more disruptive than a shock which entails only remittances. A fall in export demand directly affects output in the export industries as well as having second round effects through the impact of fall in incomes in the export sector on private consumption. Real exchange rate depreciation will be ineffective in alleviating the impact of the first channel if the price elasticities of export supply and demand are small.

## **Conclusion**

As a result of their very rapid growth in the 2000s, worker remittances have emerged as one of the most important channels of economic integration within the CIS for its smaller and poorer economies. The economic crisis in Russia, from where almost all remittances originate, triggered a sharp fall in remittances beginning in the second half of 2008. This is due to, first, recession in the industries employing most migrant workers, such as construction; and second, the depreciation of the Russian rouble against major international currencies. Valued in U.S. dollars, remittances to Tajikistan fell by 31 percent in 2009 compared to 2008, while those to the Kyrgyz Republic fell by 20 percent. With limited access to external capital, the economies of these two countries were

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<sup>6</sup> This is calculated as the nominal value of GDP product minus taxes, plus the domestic currency value of remittances, all deflated by the consumer price index.

forced to adjust to the fall in remittances through a reduction in imports, which fell by about a quarter in 2009. The fall in imports was largely matched by a reduction of private consumption. Hence households bore the brunt of the adjustment to the external shock through a contraction of consumption.

Despite the substantial magnitude of the external adjustment, the impact on the domestic economies of the Kyrgyz Republic and Tajikistan was less severe than in most other CIS economies; although real GDP growth fell in both countries in 2009, the fall was smaller than in other CIS economies and they both avoided a recession in output. Three reasons may explain why the sharp fall in remittances did not trigger a recession in the Kyrgyz Republic and Tajikistan. First, in contrast to an external shock emanating from lower export demand or lower export prices, a shock to remittances does not directly affect domestic production; the effects are indirect, mainly through their impact on demand for non-traded consumer goods. Second, the large exchange rate depreciation of the Kyrgyz Som and Tajik Somoni dampened the fall in the real value, denominated in domestic currency, of remittances and hence household disposable incomes. Third, real exchange rate depreciation encouraged consumers to switch demand from imported to non-traded consumer goods. In addition, demand for imported goods by remittance dependent households may be more income elastic than demand for non-traded goods. As a consequence, most of the real fall in private consumption demand fell on imported consumer goods, allowing the domestic non-traded goods sectors escaped recession.

In conclusion, the experience of the Kyrgyz Republic and Tajikistan during the global economic crisis tentatively suggests that remittances may have a role to play in helping to dampen the impact of external shocks on domestic output in the remittance receiving countries, at least when supportive macroeconomic policies are implemented, such as exchange rate depreciation.