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The Development and the Side Effects of Remittances in the CIS Countries: the Case of Ukraine

Olga Kupets

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MIGRATION POLICY CENTRE

CARIM-East
Creating an Observatory of Migration East of Europe

Research Report

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The Development and the Side Effects of Remittances in the CIS Countries: the Case of Ukraine

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CARIM-East – Creating an Observatory East of Europe

This project which is co-financed by the European Union is the first migration observatory focused on the Eastern Neighbourhood of the European Union and covers all countries of the Eastern Partnership initiative (Belarus, Ukraine, the Republic of Moldova, Georgia, Armenia and Azerbaijan) and Russian Federation.

The project's two main themes are:

(1) migration from the region to the European Union (EU) focusing in particular on countries of emigration and transit on the EU's eastern border; and

(2) intraregional migration in the post-Soviet space.

The project started on 1 April 2011 as a joint initiative of the European University Institute (EUI), Florence, Italy (the lead institution), and the Centre of Migration Research (CMR) at the University of Warsaw, Poland (the partner institution).

CARIM researchers undertake comprehensive and policy-oriented analyses of very diverse aspects of human mobility and related labour market developments east of the EU and discuss their likely impacts on the fast evolving socio-economic fabric of the six Eastern Partners and Russia, as well as that of the European Union.

In particular, CARIM-East:

- builds a broad network of national experts from the region representing all principal disciplines focused on human migration, labour mobility and national development issues (e.g. demography, law, economics, sociology, political science).

- develops a comprehensive database to monitor migration stocks and flows in the region, relevant legislative developments and national policy initiatives;

- undertakes, jointly with researchers from the region, systematic and *ad hoc* studies of emerging migration issues at regional and national levels.

- provides opportunities for scholars from the region to participate in workshops organized by the EUI and CMR, including academic exchange opportunities for PhD candidates;

- provides forums for national and international experts to interact with policymakers and other stakeholders in the countries concerned.

Results of the above activities are made available for public consultation through the website of the project: http://www.carim-east.eu/

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EXECUTIVE SUMMARY

Remittances flowing from Ukrainian migrants working in high-income countries to Ukraine are an increasingly important source of extra income for migrants' families. Given the increasing size of aggregate remittance inflows, they are also expected to be a potential source of funding for the social and economic development of Ukraine as a whole. If remittances enhance investment in physical and human capital and thus boost productivity, they can help mitigate the possible negative economic effects of rapid population decline and the aging of the Ukrainian population. Yet the potential benefits of remittances are likely to be matched by potential costs. Thus, two main issues are of interest with regard to remittances in Ukraine:

- what are their benefits and costs for migrants' families, local communities, the Ukrainian economy and society; and
- how to harness their development potential while limiting any counterproductive side effects.

This paper directly addresses these two questions. It does so by reporting first results from an ongoing effort to assess the potential development and unwanted side effects of remittances in Ukraine. These results come from a survey of the empirical literature in Ukraine and other transition economies and are supported, where possible, by the author's contributions. The purpose of this work is to draw out evidence-based policy implications.

Given that data on migration and remittances in Ukraine is incomplete and unreliable, we make use of all existing data sources on private transfers sent to Ukrainian households: data quality is consistently poor, but, we assume that it has similar biases over time. And we focus our analysis on relative changes in remittance inflows over time rather than on their absolute magnitude.

What are the Main Characteristics of Remittance Flows?

- Personal remittance inflows to Ukraine were estimated by the National Bank of Ukraine (NBU) at about US$ 5,862 bln. in 2010, or 4.2% of GDP. Alternative expert estimates, some of which lack hard data, vary from US$ 1.7 bln. to 54 bln.;
- the share of the net compensation of employees increased from 37.4% in 2007 to 57% in January-September 2011, whereas the second component of personal remittances – personal transfers – lost its relative importance;
- although bank accounts remain the major transmission channel for personal remittances to Ukraine, since 2007 they have been losing ground to international money transfers that accounted for about 40% of all transfers from January to September 2011;
- Russia, the US, Germany, Greece and Cyprus are the top five source countries of officially registered personal remittances to Ukraine. Whereas important destination countries for Ukrainian labour migrants such as Poland, the Czech Republic and Hungary are either at the bottom of the NBU list of countries or missing altogether. This may be explained, in part, by the informal nature of most transfers between migrants and their households in these countries. There is also the question though of the relatively small scale of total remittances transferred from this region compared to other countries. In these other countries cross-border transfers are not always related to migration, but rather to the minimization of income tax liability in off-shore zones;
- total remittance inflows to Ukraine are very responsive to changes in inflows from Russia that point to the heavy dependence of the Ukrainian economy on Russia. This is true not only in terms of international trade and finance channels but also in terms of remittances;
- over half of all remittance-receiving households in Ukraine are concentrated in western Ukraine. Densely populated and industrially developed eastern regions that have a common border with Russia, make up less than 20% of all recipient households (as of 2007). Most

remittance-receiving households belong to the middle and lower middle class (subjectively judged) and are to be found in urban areas, but not in the capital city;

- Ukrainians working relatively close to their region of origin and frequently visiting their household members are more likely to bring part of their earnings when they come back to Ukraine rather than sending money from abroad;
- female, unmarried, young, highly-skilled individuals whose families live in urban areas have a lower propensity to remit than their counterparts (based on a univariate analysis);
- labour migrants use a wide array of formal and informal mechanisms to remit money, ranging from electronic transfers through banks, money transfer companies and post offices to hand deliveries by the migrants themselves, friends/ relatives or by a third party (couriers, bus drivers and train stewards). The relative importance of theses differs from country to country. The proportion of remittances sent to Ukraine through informal channels is estimated at from 15% to 200% of reported remittances.

How are the remittances used?

- Overall, remittances received from Ukrainian migrants are predominantly spent on essential consumption needs, the purchase of durable goods, improving housing conditions (either via purchase or the repair of a house/flat), education, and, less often, on repayment of debt, accumulation of savings, and medical treatment. Very few of the remittances received by households is channelled into business investment. We expect that investments in productive capital by household members and return migrants may increase only after the households' more-pressing consumption needs are satisfied and the Ukrainian business and investment environment has significantly improved;
- there are significant differences in the use of remittances depending on the age and gender of migrants and their household type (urban/rural). In the trade-off between current and future consumption young migrants and their household members tend to discount future earnings, preferring current over future utility. Unlike older migrants who can be eligible for publicly-provided pension provisions and other insurance-based payments, many young migrant workers are not insured by the state against future adverse conditions. At present, they tend to "free ride" at the expense of local taxpayers, putting an additional strain on public finances.

What are the positive effects of remittances?

- Personal remittances are found to be pro-cyclical because of the economic crisis in the main source countries of remittances to Ukraine (particularly Russia and the EU). They reacted, however, less violently to the economic downturn in Ukraine than profit-driven private capital flows. Furthermore, due to the substantial depreciation of the hryvnia against the US dollar in the wake of the 2008-2009 crisis, remittances in the hryvnia and as a percent of GDP have actually increased during the crisis;
- as a sizable and increasing element in the Ukraine's balance of payments officially recorded personal remittances helped counteract depreciation pressure from a growing trade deficit, that considerably widened during 2005-2008, because of increasing prices in imported oil and gas, domestic demand growth exceeding output growth and eroding competitiveness. However, taking into account that remittances are an unsolicited, non-market, cross-border private transfers which often move through informal channels, their role as a source of foreign exchange should not be exaggerated;
- remittance-induced demand for consumer goods and real estate contributed to the growth of such sectors as the retail trade, construction, transport, financial mediation and insurance, real estate and legal activities, household and personal services, the food industry, the

manufacturing of furniture and construction materials, and thus this demand facilitated the restructuring of the Ukrainian economy;

- despite the fact that remittances are mainly used for consumption, they proved to be a powerful driver of Ukraine's GDP growth before 2006. However, they are less responsible for GDP growth than macro-economic stabilization and structural reforms, the recovery of output lost in the 1990s, in terms of trade gains and investment. Simulation results of the computable general equilibrium model reveal that the hypothetical Ukrainian economy in 2004 would have lost about 7.1% of potential GDP and private consumption would have contracted by 18%, had the amount of remittances been reduced by 70%, had the domestic labour supply increased by 5% and had total factor productivity declined by 10%. But these outcomes are very sensitive to input parameters assumptions;
- remittances have a considerable impact on financial development in Ukraine, at least through induced financial literacy among remittance-receiving households and the development of the formal financial system across the country. But their potential in expanding the supply of funds to the domestic banking system *via* saving accounts and, therefore, in fuelling growth through lending support to the SME sector is greatly underexploited due to low confidence in the banking system;
- remittances have positive effects on the welfare of recipient households: augmenting their income, financing essential human and housing needs, improving access to education, health care and other under-provided public goods, easing liquidity constraints, and insuring households against income shocks. As remittances were initially in foreign currency, they helped cushion remittance-receiving households against household insolvency in the wake of the 2008 crisis;
- remittances helped reduce poverty, particularly in backward areas that received the bulk of remittances. But strong economic growth in Ukraine in 2000-2008 and expansionary fiscal policy reflected in rapidly rising public-sector wages and social transfers since 2004 were the most important factors in reducing poverty;
- income earned abroad which was invested in education contributed to an increase in enrolments in higher education and an increase in the share of privately financed students. How these changes will affect the quality of human capital and labour productivity, given over-education and the skills mismatch in the Ukrainian labour market, is still an open question.

What are the negative effects of remittances?

- Remittance inflows in foreign currency (US dollars, Euros and Russian roubles) were, in part, responsible for the growing dollarization – both official (foreign currency accounts and loans in the banking system) and unofficial (household cash savings in foreign currency) – of the Ukrainian economy before the 2008 crisis. High dollarization is a reason for concern because it limits the effectiveness of monetary policy. It intensifies the negative consequences of fiscal deficits, and magnifies the vulnerabilities in the banking system in the event of an economic crisis and currency depreciation. The recent banking crisis in Ukraine confirms our line of argument: the high proportion of long-term foreign currency loans coupled with the depreciation of the local currency triggered an increase in non-performing loans that resulted in severe liquidity constraints in the banking system. This, in turn, set off a pronounced and ongoing credit crunch that held back the rapid recovery of the Ukrainian economy;
- remittances have played a decisive role in creating an inflationary spiral through their effect on household demand for consumer goods. Heavy remittance investment in real estate brought about a sudden increase in house prices in the remittance-receiving regions. As a result, active migrants have been forced to stay abroad longer to save more money than they had initially

planned, while households not having access to remittances have come under increased pressure to send family members abroad;

- remittances combined with the long-term absence of family members have negative social externalities such as poor school performance and psychological disorders in those children left behind; erosion of emotional ties between family members; the redistribution of gender roles, and often family disintegration; and social stratification in local communities;
- as the use of remittances for investment in higher education is often risky and unreasonable (moral hazard problem), it often adversely affects youth employability and contributes to a substantial skills mismatch in the Ukrainian economy. This, in turn, can have a long-lasting, adverse effects on human-capital formation in Ukraine, as it reduces the present stock of human capital through brain waste. But it also negatively affects the accumulation of human capital in the future by reducing private incentives to invest in education;
- remittances pose a "public moral hazard" problem by reducing political will to undertake necessary reforms and in miring Ukraine in a policy trap, with rent-seeking behaviour, state capture, weak rule of law, widespread corruption and a poor investment climate at its core.

Policy recommendations

- Here at the outset, we see that the development effects of remittances in Ukraine are often contradictory and contingent upon many factors, and there is still much that we need to know about the impact of remittances on Ukraine.
- There is the need to improve the data on remittances and to make it available to researchers, investors and other interested parties. Determining the scale of remittances is essential for making optimal policy decisions.
- There is a need to go beyond short-term desk studies and to invest in longitudinal and in-depth research on various aspects of remittances.
- The real challenge for policymakers is to design policies which harness the development potential of remittances, while limiting their counterproductive side effects. But primary efforts should be spent on breaking up the policy trap which is partly induced by growing remittance inflows. It would also prove wise to focus on:
    - encouraging remittance flows through formal channels;
    - introducing incentives for the productive investment of remittances and other incomes;
    - strengthening engagement in active policy debates on reducing legal barriers to labour mobility between Ukraine and EU countries and coordinating efforts in effective migration management, including such important issues as undocumented migration, cross-border human trafficking, the mutual recognition of professional qualifications, skills matching between migrant workers and jobs abroad, and the portability of pension, health, and other social benefits.

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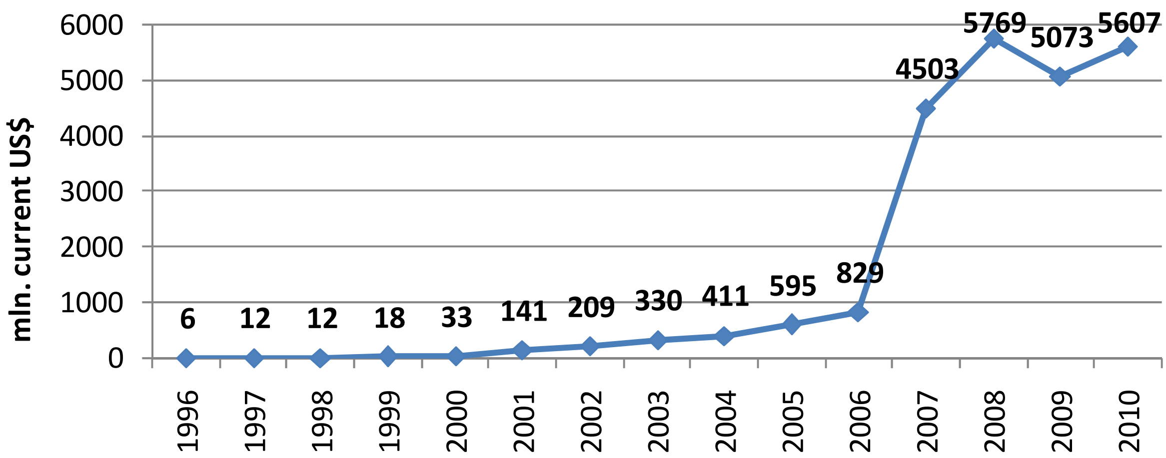
Introduction

Over the two decades since Ukraine's independence and its transition to a market economy, barriers to the cross-border movement of people have significantly fallen away. Like many other emerging economies with delayed and inconsistent transition reforms and relatively low incomes, Ukraine has experienced the emigration of many workers. These have responded to the lack of decent and productive employment opportunities at home and to the opportunities for working abroad.

Remittances – the money that migrants send home from foreign economies to their households – have also increased rapidly, particularly over the last five years. According to World Bank data (Figure 1), remittance inflows to Ukraine increased by a factor of almost seven between 2006 and 2010 (from US$ 829 million to US$ 5,607 million). This huge increase in remittances may, of course, reflect improvements in the central bank's remittance recording system, rather than changes in migrants' remittance behaviour. And data on remittances in the CIS region is generally criticized for the poor reliability of said information (Shelburne and Palacin, 2007). However, it is an undeniable fact that migrant remittances contribute to family welfare as an extra source of income, and a booster to higher living standards and human capital formation, particularly by improving access to education and health. Furthermore, remittances are an increasingly important external source of capital for the social and economic development of Ukraine. Unlike FDI and other capital flows these do not generate future repayment obligations and they are less likely to rapidly flow out of the country with economic turmoil. Productivity gains that might be achieved through the effective use of remittances in Ukraine can be a powerful force in addressing growth constraints caused by natural population decline, emigration and aging populations.

Figure 1. Remittance flows to Ukraine (in mln. current US$, 1996-2010)



Source: World Development Indicators (based on IMF Balance of Payments Statistics Yearbook and data files).

Note: Data here is the sum of three items defined in the fifth edition of the IMF's Balance of Payments Manual (BPM5): workers' remittances, compensation of employees, and migrants' transfers.

Over the past years, partly because of the sharp, registered increase in remittance flows, a wide range of issues related to migration and remittances have become the subject of political debate in Ukraine. Although the migration process has been extensively studied by Ukrainian and international researchers, much less attention has been given over to remittances as a multi-faceted and complex phenomenon. Remittances, as the literature clearly shows, generally have a positive impact on key aspects of development, but remittances can also have negative side effects on the remittance-receiving country. There is a lack of knowledge of the benefits of remittances in development and of the available policy options to maximise these benefits. There is also a lack of public goodwill towards international migration. Both of these factors reduce the ability of Ukrainian policymakers to implement a coherent win-win strategy on labour migration and remittances.

This paper seeks to help fill the existing knowledge gap in this area by undertaking a comprehensive study of the pros and cons of remittances in Ukraine in terms of negative side effects and development. Ukraine is the largest country among the Eastern partners and a country which has recently made the significant step of negotiating an EU Association Agreement (EC, 2011). It is also an attractive laboratory for the study of the migration-remittances-development nexus in the Eastern Partnership region.

It is necessary to note, however, that despite the existence of several data sources on international migration and remittances in Ukraine, a rigorous evaluation of the micro- and macro-economic impact of remittances applying the most recent econometric techniques is problematic due to the limits inherent in transition economies: the statistical system on international migration is not sufficiently developed, long time-series for macro-economic variables are not generally available due to the relatively short period of Ukraine's independence and ongoing changes in the methodology of collection and statistical data processing. Household surveys on migration issues are not, meanwhile, regularly conducted and they lack many important remittance-related variables. Nor are their results completely reliable due to sample-size problems. Given this, our study will draw extensively on the existing literature on remittances and their effects in Ukraine and in other transition economies with similar adjustment paths.

The specific objectives of the paper are:

- to ascertain the scale of remittances to Ukraine according to different sources and to describe the main characteristics of remittances, both at macro- and at micro-levels;
- to present an extensive review of existing studies on various direct and negative side effects of remittances in CIS countries and in Ukraine in order to determine what is known and what should be done;
- to offer policy options aimed at maximising the benefits of remittances and at reducing their negative side effects in Ukraine.

The paper is organized as follows. Chapter 1 summarizes the potential benefits and costs of remittances for migrants' families and their countries of origin based on the survey of the relevant economic literature, with a particular focus on transition economies in the CIS region. Chapter 2 investigates the size of remittance flows to Ukraine, the main remittance sending countries, the use of formal and informal channels, and the profiles of remittance senders (migrants) and receivers (their families). Chapter 3 addresses the economic and other impacts of remittances in Ukraine. And Chapter 4 discusses "a remittances policy trap" and summarizes the policy options for leveraging remittance use for development.

Chapter I: Remittances and their Role in the Development of Transition Economies; Empirical Evidence in the CIS Region

Widening interest in the development potential of remittance flows over the last decade has resulted in a mushrooming of the scientific literature, which has been extensively reviewed in several studies (see, e.g. Agunias, 2006; Chami et al., 2008; Ghosh, 2006; OECD, 2006; Rapoport and Docquer, 2006; World Bank, 2006). The overall tenor of these studies is that remittances benefit the economy. Indeed, these studies, describe the effect of remittances on migrant-sending countries as a relatively stable source of foreign exchange and income and as a safety net for the poor. However, it is also recognised that these positive effects can be somewhat neutralized. This is the case, for example, when remittances lead to: demand-pull inflation and income inequality; a real appreciation; or a delay in the depreciation of local currency – a variant of the so-called Dutch disease – that may hamper a country's competitiveness and economic growth, and increase the vulnerability of remittance-dependent countries to sudden external shocks. Furthermore, it is usually argued that remittances are not a panacea and that they cannot substitute sound economic policies and the structural reforms necessary for broad-based development in developing countries. Various channels transmitting the positive impact of remittances on development and their possible side effects are summarized in Table A.1 in the Annex.

The migration and development challenges in the post-Soviet countries are different from those faced by developing countries in Latin America, the Caribbean, North Africa and Asia: studies in these particular countries are most often cited in the literature on remittances and development. This is so not least because the post-Soviet nations have witnessed a painful transition since 1991 together with a sudden increase in cross-border migration after the elimination of restrictions placed on the movement of people by the Soviet system. Hence, we focus our review of the empirical evidence on links between remittances and various economic and social indicators in remittance-receiving countries of the Commonwealth of Independent States (CIS).1 Therefore, the sample of CIS countries used in the study excludes Russia and Kazakhstan which are net senders of remittances (Table 1). What is more, it omits Turkmenistan and Uzbekistan which do not provide balance of payments data consistent with the IMF methodological procedures.

1.1. Remittances as a source of foreign exchange

For many resource-poor countries in the region, such as Armenia, Georgia, Moldova, the Kyrgyz Republic, and Tajikistan, remittances are vital. Indeed, large inflows of remittances serve as a key source of foreign exchange for narrowing the substantial current account deficit of these nations (Mansoor and Quillin, 2006; EBRD, 2004-2008). In fact, a substantial increase in remittances before the global economic crisis helped cushion the adverse impact of increasing energy prices on current accounts (Iradian, 2007).

Table 1. Remittances and current account balance in the CIS, 2010 (in millions of current $US)*

Country name	Workers' remittances and compensation of employees			FDI, net inflows	Net official development assistance and official aid, received*	Net trade in goods and services	Current account balance
	paid	received					
		mln. US$	% of GDP				
Armenia	156.6	995.8	10.7	570.1	527.6	-2,274.8	-1,373.2
Azerbaijan	961.4	1,432.4	2.8	563.1	232.3	17,997.5	15,039.6
Belarus	105.3	376.1	0.7	1,402.8	98.1	-7,425.6	-8,492.7
Georgia	50.2	806.1	6.9	548.8	907.9	-2,038.1	-1,122.1
Kazakhstan	3,021.0	290.6	0.2	9,961.0	297.9	21,828.4	4,319.0
Kyrgyz Republic	296.7	1,275.4	27.6	233.6	314.7	-1,429.4	-188.0
Moldova	116.7	1,369.9	23.6	194.3	245.1	-2,299.8	-522.9
Russian Federation	18,795.5	5,263.7	0.4	42,868.4	–	122,484.2	70,599.0
Tajikistan	855.8	2,254.5	40	15.8	408.9	-1,817.1	-382.8
Ukraine	24.0	5,607.0	4.1	6,495.0	668.0	-3,850.0	-2,884.0

Source: World Development Indicators, based on IMF balance of payments data.

Note: * Net official development assistance and official aid refers to 2009.

[1] The CIS is not used here to refer to the institutional arrangement. It is rather used to label the regional grouping of twelve former republics of the Soviet Union: not including though the Baltic states.

Remittance inflows add up at the national level, surpassing 10% of GDP in four countries (Table 1). As such they represent far larger and far more stable sources of foreign exchange than other types of foreign exchange inflows: official development assistance, foreign investment and loans. Furthermore, remittances offer a relative advantage because they do not entail the creation of external debt with future repayment obligations. They are generally not tied to the variety of political and economic conditions with which the recipient country must comply (as in the case of official development assistance and conditional loans). And remittances are less volatile in the face of an economic downturn in the recipient country. On the other hand, remittances are private funds like other sources of household income. Therefore, they should not be viewed by the State as a substitute for official development assistance or direct foreign investment in addressing balance of payments issues and in driving economic development. This explains why the authorities in the CIS region, including Moldova (Marandici, 2008), focus their policies on attracting foreign investment rather than on taking advantage of migrants' remittances.

It is also evident in the literature on remittances and development (e.g. Ghosh, 2006; World Bank, 2006; Mansoor and Quillin, 2006) that remittances, as a significant and relatively stable source of foreign exchange, can improve a country's creditworthiness for external borrowing. With innovative financing mechanisms such as securitization of future remittance flows they can expand developing countries' access to external finance at lower costs and longer maturities than borrowing on sovereign credit. But there are significant obstacles to using this mechanism in the CIS region, including: a great deal of uncertainty for remittance flows coming through the formal channel; high-fixed costs associated with securitization transactions; long lead times; and the absence of an appropriate legal infrastructure that would minimize risks of fraud and default on securitized debt. Moreover, extreme caution is needed when considering the securitization of remittances during today's global financial crisis. According to the World Bank (2006), Kazakhstan is the only country in the CIS region which used the securitization of remittances in 2004 to raise the financing necessary for its infrastructure and development projects.

Despite these potential benefits, however, large and sustained remittance flows have been perceived as posing macro-economic challenges for recipient countries, particularly when there is the danger of a remittances-led "Dutch disease": the appreciation in the equilibrium real exchange rate that would tend to undermine the international competitiveness of domestic production, particularly that of cost-sensitive tradables. The recent empirical evidence provided by Barajas *et al.* (2010), which is based on applying a panel cointegration analysis to annual data from 1980-2007 for a large set of countries, is worth exploring here. The data is consistent with an appreciation of the real equilibrium exchange rate in response to a sustained inflow in workers' remittances in the sample of low- and lower-middle-income countries; which includes the CIS countries under investigation here. But the scale of this effect is small, between one and three hundredths of one percent, depending on the regression. Furthermore, for low- and lower-middle-income countries that are relatively closed (either in trade or in capital account terms) this effect is found to be larger and more robust to specification changes. On the other hand, for more open countries the effect tends to be smaller and much more uncertain.

Symptoms of Dutch disease have been found in Moldova and Armenia (World Bank, 2011; Roberts and Banaian, 2004). Meanwhile, in Tajikistan – a country with remittances making up among the highest percentages of GDP in the world – the impact of remittances on the exchange rate is found to be ambiguous. Strong appreciation pressures that emerged in early 2004 are mainly attributed to inappropriate monetary policy rather than to substantial remittance inflows (Kireyev, 2006, p.11).

There is another challenge related to remittances as a source of foreign exchange, which is particularly relevant to the CIS countries, but which is rarely mentioned in the general literature reviews. This problem is that large remittance inflows in US dollars or Euros contribute to the dollarization/euroisation of the receiving economies. In most CIS countries, foreign currency has been extensively used in both cash and deposit form. As Havrylyshyn and Beddies (2003) argue, this can be attributed, in part, to inertial lack of confidence in the local currencies: because of macro-economic instability, high inflation, and the depreciation of the local currency in the 1990s. However, it can also be explained by a lack of instruments for portfolio diversification in underdeveloped financial markets. Of course, some level of dollarization may be good for transition economies, as this promotes the development of domestic financial markets and may mitigate foreign exchange rate risks for foreign investors. But high dollarization remains a matter of concern. After all, it limits the effectiveness of monetary policy, increases balance-sheet risks that result from currency mismatches in banks' balance sheets. It also magnifies the vulnerabilities of the banking system in the event of an economic crisis and currency depreciation, particularly in the case of foreign-exchange lending to unhedged borrowers. Isakova (2010) has found that FSU countries with large inflows of remittances are among those with the highest levels of deposit dollarization, whereas deposit dollarization is positively correlated with loan dollarization.

Finally, remittance-driven household consumption, mostly in imported goods, seems to have contributed to a marked rise in import demand in resource-poor CIS countries and persistent trade deficits in goods; though increasing imported oil and gas prices and credit boom were more important factors (EBRD, 2007-2009; Atamanov *et al*., 2009). The substantial trade deficits which were only partly counterbalanced by inflows of remittances and FDI, combined with high foreign currency debt and capital flight following the crisis-induced global recession at the end of 2008. Together they exerted a downward pressure on local currencies and triggered significant deterioration in the economic and financial situation in the region.

1.2. Remittances and growth

Large inflows of remittances fuelling domestic demand have frequently been mentioned as important drivers of strong economic growth in the CIS region 2001-2008. According to EBRD Transition reports in 2004–2008, remittances, through their direct impact on private consumption and investment in property, played a particularly important role in economic growth in many small countries of the region, namely in Armenia, the Kyrgyz Republic, Moldova, and Tajikistan.

Iradian (2007) used the panel regression approach and analyzed an extended set of explanatory variables compared to previous empirical studies on the determinants of growth in transition economies. This included the output recovery index, workers' remittances, terms of trade, and the EBRD market reform index. In doing so he found that the remittances to GDP ratio was positively related to *per capita* real GDP growth and total factor productivity growth in the transition sample. For the CIS as a whole, remittances were estimated to have accounted for about 0.9 percentage points of the 5.2 percentage points predicted change in growth rates between 2001–2006 and 1996–2000. Whereas 2.6 percentage points are due to an improvement in macro-economic stabilization and reforms and 1.1 percentage points are due to investment (Table 6 in Iradian, 2007). In Moldova and Tajikistan remittances appear to be even more important than macro-economic stabilization/ reforms and investment in explaining growth changes between 2001–06 and 1996–2000. Whereas in the Kyrgyz Republic and in Ukraine they are as important as investment. The positive, albeit mild, impact of remittances on *per capita* GDP growth is also found in Mansoor and Quillin (2006) in a joint sample of developed and developing economies.

There was another cross-country study of the determinants of growth in the eleven CIS countries (excluding Russia) in 1997-2008 (Alturki *et al*., 2009). This study found that, although remittances are important determinants of growth in the countries under investigation here, their effect significantly differs depending on the region of origin. Remittance growth variables indicate that a 10 percentage point increase in the real growth of remittances from Russia is associated with an 0.3 percentage point GDP growth increase in all CIS countries, and with an 0.4 percentage point increase in oil-importing CIS countries: i.e. all countries except for Azerbaijan, Kazakhstan and Turkmenistan. At the same time, the real remittance growth rate from European countries does not have a strong and significant impact. Although the effect of remittances from European countries to the CIS as a percentage of GDP is statistically significant, in one specification for oil-importing countries, it is about one-fifth of that for Russian remittances. The authors conclude that remittances from Russia are strongly associated with growth rates in CIS oil-importing countries, even more than the other two channels, namely trade and financial flows. Therefore, Russian growth shocks are associated with sizable effects on GDP growth in Belarus, Tajikistan, and to some extent in Georgia, and the Kyrgyz Republic.

Thus, cross-border remittances were a powerful driver of growth in the CIS region before the 2008 global economic and financial crisis. They increased, however, the vulnerability of dependent countries to external shocks by being one of the transmission channels of the recession from the source countries of remittances, particularly from Russia, Kazakhstan and the EU (EBRD, 2009 and 2010). Due to the worsening external environment and due also to a sharp contraction in remittances, real GDP growth decelerated sharply in the Kyrgyz Republic and Tajikistan in 2009 and became negative in Armenia and Moldova. The economies of Ukraine and Georgia also contracted sharply in the wake of the global crisis. But their contraction was not directly linked to a decline in transfers from workers living abroad.

These objective measures of the impact of the crisis associated with remittances are supported by households' subjective assessment according to the EBRD Life in Transition Survey in 2010: a reduction in remittances has been the third main type of shock experienced by households in transition economies (reported by almost 15 percent of households), especially in countries with large numbers of migrant workers abroad. This, in turn, had a statistically significant and sizeable effect on both overall and base consumption response indices (EBRD, 2011a and 2011b).[2] Early indications in 2010-2011 show that, after the Russian and Kazakh economies had returned to growth in 2010, remittances to Armenia, Moldova, the Kyrgyz Republic and Tajikistan picked up and helped the economies bounce back (EBRD, 2010-2011a; World Bank, 2011).

Our analysis presented in this section shows that although remittances have been instrumental in improving the short-run economic performance of many countries in the region, remittance-led growth in smaller economies has been found to be fragile and difficult to sustain. This supports the findings of the studies from other developing countries where over-reliance on remittance inflows increases domestic business cycle volatility and threatens to weaken the economy's long-term growth potential (Chami *et al*., 2008). Since growth models based on remittances such as windfall gains may not be sustainable in the medium to long term, it is necessary to identify and develop other engines of economic growth. One example of this might be more diversified exports of goods and services: in Moldova as suggested by the World Bank (2011). After finding no strong evidence that remittances contributed to economic growth in the emerging economies, Barajas *et al*. (2009) suggested that policymakers reconsider their optimistic views of remittances and think carefully about institutions that can help remittance recipients turn into entrepreneurs and channel their transfers to investment. Similarly, Calderón *et al*. (2008) suggest taking complementary policy actions in four major areas namely education, institutions, the financial sector, and macro-economic distortions to enhance the growth impact of remittances.

1.3. Remittances, investment and financial development

According to the literature on the relations between remittances, investment and growth, remittance inflows may positively affect economic growth in the receiving economy through their effects on the growth of the economy's technological capacity. Inflows may also positively affect growth through its effects on the rate of capital accumulation (i.e., the level of domestic investment), and on the efficiency

[2] The "overall response" index includes the impact on all consumption categories, as well as stress responses such as loan defaulting, selling an asset, and relocating. "Base consumption" response index looks only at the reduction of basic goods and services consumption, including essential services such as medical care, but excluding luxury goods, car use, vacations or training (EBRD, 2011a).

of the allocation of new capital (Barajas *et al*., 2009; Chami *et al*., 2008). In other words, remittances can contribute to economic growth through investment growth. But much depends here on the remittance behaviour of migrants and the way in which remittance inflows are actually used. Various studies from the CIS region[3] show that most remittances are spent by households on food and basic subsistence needs, better housing and sometimes better education for children. Only small amounts are spent on business investment or saved in bank accounts: this is, in part, due to a poor investment climate, absence of suitable investment opportunities and a lack of familiarity with investment instruments in the corporate sector. Remittances are, therefore, used for short-term coping strategies by households with the social consequences of the protracted transition process. They tend not to be used for laying down foundations for long-term prosperity via the efficient use of current transfers.

The propensity of remittance-receiving households to save is found to be closely related to the stability of remittance flows and therefore to the type of migration (short-term vs. long-term vs. permanent) and the type of relations with those who send remittances. For example, a study of remittances in Armenia (Roberts and Banaian, 2004) distinguishes between remittances from temporary workers, savings brought back by temporary workers, remittances from emigrants ("new" diasporans), savings brought back by returning emigrants, and remittances from "old" diaspora relatives. This study argues that regular remittances are more likely to be consumed and, therefore, that they are less likely to be saved and invested than savings brought back by returning migrants.

Nevertheless, there is indirect evidence that in countries with an underdeveloped financial system and high-interest rates remittances help alleviate a lack of credit and also that they compensate for inefficiencies in financial markets. In this light, an EBRD survey of 1,272 micro, small and medium-sized enterprises in the trade and manufacturing sectors in four countries – Bulgaria, Georgia, Russia and Ukraine – conducted in 2005 is particularly interesting. This survey showed that loans from family and friends (supposedly with the bulk financed by remittances from abroad) were the second important financing source – after internal funds and retained earnings – for the working capital and fixed assets of small firms that did not have access to bank loans (EBRD, 2006).

Furthermore, growing evidence shows that remittances help strengthen the banking system and stimulate financial development, something which is particularly important for transition economies (Brown *et al*., 2011; Kireyev, 2006). In particular, remittances promote the financial literacy of the population by bringing more people into contact with the formal financial system and by fostering competition and innovation among banks, money-transfer operators and other financial institutions. Although only a small proportion of remittances are usually saved in bank accounts due to a lack of confidence in the formal banking sector and a high propensity to consume, even these amounts seem to have helped to improve access to credit by SMEs.

1.4. Remittances and employment

There is no doubt that spending remittances on investment in physical capital and entrepreneurial activity has a direct positive effect not only on growth, but also on employment. Often a substantial portion of remittance receipts is used for consumption purposes and not saved or invested. But, even in these cases, remittances generate positive multiplier effects stimulating the development of a retail trade, transport, construction, the manufacturing of consumer goods and various services. This, in turn, should stimulate job creation and the further reallocation of labor from the military and heavy industrial sector inherited from the Soviet Union to the modern service sector and the production of consumer goods.

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[3] See e.g. Mansoor and Quillin (2006) based on a World Bank survey of returned migrants in Georgia, the Kyrgyz Republic, and Tajikistan; Hristev *et al*. (2009) based on CASE Rural Migration Survey in Moldova; ETF (2007) based on ETF survey of return migrants in Moldova; and Clement (2011) based on Living Standards Measurement Survey in Tajikistan. The spending behaviour of Ukrainian remittance-receiving households will be analysed later.

Available data on the changes in employment composition by sectors and employment to population ratio in the CIS region during the 2000s (Table 2) shows that most countries in the region experienced the anticipated reallocation of workers from agriculture and industry to services along with increases in the employment to population ratio. Georgia and Tajikistan moved, though, in the opposite direction. Even if Armenia and Azerbaijan are becoming more service-oriented they are doing so at a very slow rate. Moldova faced a sharp decline in its employment to population ratio. Therefore, remittances, which account for over 10% of GDP in Armenia and for 40% of GDP in Tajikistan, do not bring a significant impulse for the development of modern service industries and the creation of jobs. The reasons for this phenomenon need to be further investigated.

Table 2. Employment by sectors and the employment to population ratio in the remittance-receiving CIS countries

Country	Year*	Share of total employment (%) in:			Employment to population ratio (15+, %)
		agriculture	industry	services	
Armenia	2002	45.3	17	37.8	45.3
	2008	44.2	16.8	39	46.9
Azerbaijan	2000	41	10.9	48.1	59.4
	2008	38.4	12.7	48.9	59.5
Georgia	2000	52.1	9.8	37.9	56.8
	2007	53.4	10.4	36	55.2
Kyrgyz Republic	2000	53.1	10.5	36.5	60
	2008	34	20.6	45.3	62
Moldova	2000	50.9	13.9	35.2	54.3
	2008	31.1	19.7	49.2	47.2
Tajikistan	1997	46.2	17.4	29.1	46.7
	2004	55.5	17.9	26.2	55.2
Ukraine	2000	23.4	20.8	55.8	51
	2009	15.8	23.4	60.7	54.3

Source: World Development Indicators

Note: Data on the employment structure in Belarus is not available. *The first entry (the year 2000 by default) is replaced by the earliest possible year with complete information on employment structure. The second entry refers to the most recent year available in the WDI database.

On the other hand, remittances may adversely affect aggregate labour supply and employment if remittance recipients rationally substitute unearned remittance income for labor income and, therefore, reduce labour effort: the "moral hazard" problem at micro-level. The household-level data for Moldova gives only weak support for this hypothesis but the remittance effect on the economic activity of those household members left behind appears to change non-monotonically with the size of remittances: "adults from households obtaining small or average remittances tend to be employed less frequently than members of households not receiving any funds from abroad. Then the relationship reverses and the employment rate for groups receiving high and very high remittances is as high as in non-receiving households. This change of relationship's direction may be related to the fact that households obtaining large remittances tend to be on average more educated and younger" (Hristev *et al.*, 2009).

Remittances can also contribute to employment reduction on the labour demand side if remittance inflows induce the consumption of more imported goods and fewer domestic goods. Another alternative – the remittance-induced transition of local producers to more capital-intensive technologies – is very unlikely in the CIS region, given the spending pattern of remittances by receiving households. Comprehensive analysis of the impact of remittances on the domestic labour markets in the CIS region is an important research task ahead: at present, though, we lack the necessary studies.

1.5. Remittances and inflation

Remittances can also adversely affect domestic prices, particularly in sectors where there is higher investment among receiving households. There is evidence in some CIS countries that remittances have contributed, at least partly, to inflationary pressures in the non-tradable sector, significantly affecting land and house prices and private sector wages (EBRD, 2007; Kireyev, 2006; World Bank, 2011). Analysing determinants of house prices in the FSU countries (except for Kyrgyzstan, Turkmenistan, and Uzbekistan) during 1994-2009, Stepanyan *et al*. (2010) found that remittances and foreign inflows (defined by the authors as domestic banks' investment liabilities other than FDI) were significant drivers of house prices in the region. Their estimates for two separate subsamples of countries suggest that foreign inflows play a significant role in the Baltic countries, Kazakhstan, Russia, and Ukraine, while remittances are an important determinant in smaller and poorer countries. These findings are open to criticism. The authors try to associate changes in average house prices in capital cities (in eight out of the twelve observed countries) with remittances. It is well established though that remittances most often go to rural and underdeveloped urban areas rather than capital cities and their hinterlands.[4]

Increasing house prices, predominantly in cities and coastal areas, have fuelled expectations about future prices and potential capital gains, leading to increased speculation in the house market (EBRD, 2007). Sky-rocketing prices, in turn, have made housing less affordable to many poor households who wished to improve their housing conditions and who forced active migrants from such households to stay abroad longer and thus to save more money than they had initially planned.

1.6. Remittances and human capital formation

Taking into account the potential forward linkage between remittances and human capital (when remittances finance the education and the health needs of the next generation), there are a growing number of studies on the impact of migration and remittances on the education and health-care of children left behind in Central Asian countries (Tajikistan and Kyrgyzstan) and Moldova. However, the results of these surveys are rather mixed.

Nakamuro (2010), employing a micro-econometric analysis in Tajikistan and Albania, found strong positive effects of remittances on schooling attendance: all things being equal, children in an average remittance-receiving household are more likely to attend school than their counterparts from households that do not receive remittances.

On the other hand, Brown *et al*. (2008) showed that school absenteeism in Tajikistan increased in remittance-receiving households and concluded that, given the limited demand for highly-skilled migrants from Tajikistan, most Tajik households did not invest in education if they were not sure that there would be a positive return. Anderson and Mirkasimov (2010) found that migration and remittances in Tajikistan have no impact on pre-school and secondary school enrolment or, indeed, on improvement in the health of young children. They do though have, their results suggested, positive effects on older children (18-23) in migrant households or remittance receiving households. These children are more likely to complete secondary school and so to enrol in higher education and are less likely to suffer from poor health. Their analysis also shows that overall expenditure on education *per* child increases in migrant households (more on books, food, and school premises and less on gifts to

[4] According to Mansoor and Quillin (2006, Figure 2.8), the share of remittances going to households living in the capital city is less than 15% in Tajikistan and the Kyrgyz Republic and slightly above 25% in more urbanized Georgia and Armenia.

teachers and fees) and that educational effects are significant only for boys, whereas health effects are similar for boys and girls. Kroeger and Anderson (2011) found similar gender differences in the Kyrgyz Republic. Young girls there suffer with respect to educational and nutritional outcomes: household resources are reallocated from girls to boys when male migrants remit because investment in the human capital of female family members is often regarded as less important than investment in boys.

Hristev *et al*. (2009) found that Moldovan rural households receiving remittances are likely to spend more on education and health than households without remittances. But the total share spent by them on health, education and culture is smaller than the share spent on clothing, regardless of the size of the average monthly remittance inflow. This finding supports the hypothesis about conspicuous consumption, with excessive expenditure on foreign luxury products and sophisticated home appliances to show off newly-found wealth. This is something that creates a new division between migrant and non-migrant households in local communities and that sharpens social stratification (Ghosh, 2006).

1.7. Remittances, poverty and income inequality

Labour migration provides a "way out" from declining employment opportunities on the home labour markets and decreasing household incomes. Remittances sent by labour migrants in the CIS region, meanwhile, have acted as a form of social insurance helping family members finance the purchase of life's necessities and pulling many of them out of poverty. For example, it is estimated that the presence of a migrant increases the household expenditure of a poor Moldovan household by up to 40 percent. And remittances seem to be even more effective in reducing poverty than the government's social protection programs which are mostly untargeted (World Bank, 2011).

Migration and remittances have offered a lifeline out of poverty for many families in the CIS countries. However, empirical evidence based on household-level data suggests that relatively better-off households were more likely to receive remittances from abroad than the most vulnerable and needy members of society: see Uzagalieva and Menezes (2009) in Georgia; World Bank (2011) for Moldova; and Mansoor and Quillin (2006) for Armenia, Georgia, the Kyrgyz Republic and Tajikistan. There are several explanations for this phenomenon suggested in the literature on transition economies (Mansoor and Quillin, 2006). First, migration costs, including transportation, visa and work-permit fees, and living expenditures abroad, may be extremely high relative to household income. Second, members of households with higher incomes have, typically, higher education levels and so better access to information. Thus, migrants generally come from households with higher incomes, at least in the initial stage of migration. Third, households which have better opportunities to move may initially also pass on the knowledge and networks they obtain to households that interact with them (the social network effect). Finally, since remittances themselves have an impact on household income, some remittance-receiving households are likely to move up to higher percentiles of income distribution.

Hence, remittances from migrant workers benefit households whose members take up the challenge of working abroad and who have the ability to migrate. In this respect the potential impact of remittances on inter-household income inequality in transition economies is similar to the impact of entrepreneurial income that benefit individuals who had better access to assets, including knowledge, information and start-up capital, and who took advantage and risks of the entrepreneurial opportunities offered by the transition to a market economy.

Experts working in the CIS region intuitively argue that remittances exacerbate income inequality and contribute to rural-urban income disparity. But there is little empirical evidence on this issue because of poor data quality[5] and difficulty in discriminating between the effects of remittances and

[5] See Table A.2 in the Annex for indicators of income inequality, poverty and remittances in the selected CIS countries in 2001-2010.

other income sources on income inequality in the region.[6] Beyond inconclusive results, it is often questioned whether the link between remittances and inequality is all that important as long as remittances through direct and indirect (multiplier) effects contribute to an increase in average income in the country. Now some degree of inequality allows markets to work effectively. And so the existence of inequality can be seen as a natural characteristic of an efficient market-based economy and a democratic society. However, a high degree of inequality in poor countries may restrict economic growth (Barro, 2000). Even more important is the fact that in the CIS transition economies that have accomplished partial reforms, high-income inequality is closely linked to generalised dissatisfaction with the new economic and political system, which is perceived as unfair (Brainerd, 2010). This, in turn, threatens political and economic stability, causes population resistance to necessary reforms in the successful completion of the transition to a market economy, and, therefore, leaves the countries trapped in a partial reform equilibrium.

1.8. Remittances, public moral hazard, informalised welfare and policy trap

Being one of the main drivers of domestic demand in smaller CIS countries, buoyant private foreign inflows from migrant workers have contributed to an increase in tax revenues, particularly from remittance-funded imports and growth in the non-tradable sector. These inflows have thus provided fiscal space to the governments. This, however, has posed a “public moral hazard” problem as these governments have no incentive to effectively use higher revenues from remittances. For example, governments choose not to invest in productivity enhancing infrastructure and new economic activities with higher growth potential. Nor do they maintain prudent fiscal policy or implement the structural reforms necessary for sustainable long-term growth and development.

Furthermore, as the state fails to provide the social protection that the population implicitly demands, enterprises and individuals try to improvise solutions. Very often they make informal payments for what should be publicly-provided services, including education and health care. In such an “informalised welfare" model – typical of most CIS countries (Drahokoupil and Myant, 2009) – remittances constitute an important source of household income. They can be used for informal out-of-pocket payments in the public sector in the form of bribes, gifts, and so-called charitable contributions that act as service fees. Remittances can too complement inadequate retirement benefits and welfare transfers, lifting people out of poverty.

Jobless remittance-led growth and the poor quality of public goods and services, particularly in low-income CIS countries such as Moldova or Tajikistan, encourage more people to vote with their feet and to look for jobs abroad (World Bank, 2011; Kireyev, 2006). Remittances in turn fuel domestic demand, particularly for imported goods and construction. They also help cause a psychological downgrading of domestic goods, which is not likely to be counterbalanced by demand (if any) for these goods by the expanding diaspora abroad. In the absence of an adequate policy reaction, this reduces the international competitiveness of the tradable sector, limits export growth, business expansion, and job creation, creating a policy trap which is characterised by rent-seeking behaviour and state capture at the very centre. To break out of this policy trap and to maximize too the development gains from remittances and migration, governments should refuse the common practice of piecemeal actions to address some of the policy trap’s symptoms. Rather they must switch to a comprehensive and consistent policy capable of systematically tackling the underlying causes of these symptoms (World Bank, 2011).

[6] According to the recent review of studies on wage and income inequality in Eastern Europe and the CIS (Brainerd, 2010), most of the increases in income inequality, particularly in the lower-income CIS countries, is primarily attributed to changes in the wage distribution as income in most countries is largely comprised of wages.

Chapter II: Scale and Characteristics of Remittances in Ukraine

2.1. Statistical sources and definition of remittances in Ukraine

The major source of official data on migrants' remittances in Ukraine, as in other countries, is the annual and quarterly balance of payments records of the National Bank: in this case the National Bank of Ukraine (NBU). These are published on-line[7] and subsequently compiled in the IMF *Balance of Payments Yearbook.*

As defined in the sixth edition of the IMF *Balance of Payments and International Investment Position Manual* (further BPM6; see Appendix 5 in IMF, 2009) and followed by the National Bank of Ukraine (NBU, 2011), personal remittances are derived from two items in the balance of payments framework:

1. net compensation of employees which includes the income of border, seasonal, and other short-term workers, who are employed in an economy where they are not resident, fewer taxes and expenses incurred in the economy of employment, and
2. personal transfers which include all current transfers between resident and non-resident individuals, independent of the source of income of the sender and the relationship between the households.

The distinction between personal transfers and the compensation of employees, when individuals go abroad for employment, is based on the length of stay and the residence status in a host country. Migrants going abroad to work for a year or longer thus become residents of the host economy and their remittances sent to households in another economy are recorded as "personal transfers." Meanwhile, border, seasonal, and other short-term workers are not resident in the economy where they work and their gross income is recorded as "compensation of employees"(IMF, 2009, p.276).

Although it is recognized that personal transfers often originate with migrants sending resources to support their relatives in their economy of origin, personal transfers as defined in BPM6 are not limited to such activities. Therefore, definitions of remittances based on balance of payments accounts are somewhat broader than those resulting from the movement of persons, because they are not based on the concepts of migration, employment, or family relationships.

Personal transfers replaced an item called "workers' remittances" in the standard presentation according to BPM5. But, nevertheless, workers' remittances (i.e. current transfers made by employees to residents of another economy) and other personal transfers are continued as supplementary items in the statistics of the NBU and the IMF to ensure consistency in the time series.

The NBU provides official statistics on personal remittances based on banking institutions' reporting of financial transactions with non-residents of Ukraine and on money transferred through money-transfer operators. The NBU has also provided, since 2007, an estimate of money transferred through informal channels (including family, friends, bus drivers who carry money across borders and unregulated money transfer firms). It is an expert estimate agreed with the technical mission of the IMF in 2008 and it is currently assumed at 15-16% of recorded remittance inflows.

Finally, it is important to note, that, in addition to current transfers by migrants, some other resource inflows that migrant workers may make to their households and economies of origin are of analytical interest in the context of the economic effects of migration. These include investments by migrants abroad (financial investments, notably bank accounts and portfolio investment, as well as investments in real estate) and accumulated income brought by migrants returning home. However, these flows are not classified as remittances in the balance of payments framework. Therefore, data users who are interested

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[7] See http://www.bank.gov.ua/control/en/publish/category?cat_id=37804.

in understanding all contributions made by migrants should seek additional sources of information (e.g. household and individual surveys) to make appropriate additional estimations.

No specific nationwide household remittance survey has been conducted in Ukraine. But results of household and individual surveys on migration issues can supplement official sources based on the balance of payment statistics providing important information on: who remits and who receives remittances; how much and through which channels; and how remittances are spent by receiving households. The only nationwide Modular Population Survey on Labour Migration Issues (with a combined sample of 22,099 households from the Labour Force Survey and the Household Budget Survey) was conducted in 2008. It was carried out by the State Statistics Service of Ukraine and the Ukrainian Centre for Social Reforms with financial and technical support from the Open Ukraine Foundation, the International Organization for Migration, and the World Bank. The second survey was conducted with the support of the European Training Foundation in 2007 and it was targeted at returning and potential migrants. It had, though, a significantly smaller sample than the above mentioned survey: 1,086 potential and 1,014 returning migrants. The main results of these surveys were published in, respectively, UCSR (2009) and ETF (2008).

The ETF defines remittances as transfers of money by foreign workers to their home country, in our case Ukraine. The Modular Population Survey on Labour Migration Issues (further - Modular Migration Survey) which will be extensively used below provides two types of information about remittances:

1) household-level data which refers to all transfers (in cash and in kind) from abroad that households received in 2007 and in January-April 2008 irrespective of the purpose of migration, family relationship and the channel used for transfer;

2) individual-level data which refers to transfers of money from labour migrants of working age (i.e. women aged 15-54 years and men aged 15-59 years) to their households in 2007 and in January-April 2008, irrespective of the channel used for money transfer.[8] Questions in this section cover not only transfers of money to household members, but also other aspects of migrant experiences, including: the method of searching for a job; fees for services related to emigration; legal and employment status; the economic sector and occupation; and earnings and working conditions abroad.

When giving information about transfers received from abroad, remittance-receiving households are asked to choose one of six boxes: up to US$/€ 1,000; US$/€ 1,001-2,000; US$/€ 2,001-3,000; US$/€ 3,001-4,000; US$/€ 4,001-5,000; and more than US$/€ 5,000. Given this limitation and the design of the survey, targeted predominantly at households with labour migrants of working age, data cannot be used for accurate estimates of remittances.

Besides, the final sample of households and individuals provided to researchers covers only those respondents who gave any positive answer in the questionnaire of the Modular Migration Survey. In other words, it excludes a huge number of initially sampled households and individuals who could be used in the analysis of the migration and remittance behaviour as a non-migrant control group. Overall, the survey's results must be interpreted with caution as the survey provides an impressionistic rather than a representative picture of migrants' experiences (UCSR, 2009).

2.2. The scale of remittances in Ukraine

According to the most recent NBU data, personal remittance inflows to Ukraine amounted to US$ 5,862 mln. in 2010 (or 4.2% of GDP) and to US$ 5,126 mln. in January-September 2011. Estimates of

[8] Initial sample of households is defined as a nationally representative and random sample. Respondents answering the individual questionnaire are either labour migrants staying in Ukraine at the time of survey or household members who know migrants' experiences best.

remittance inflows are, according to the World Bank, generally in line with NBU data but are somewhat lower (Table 3), probably because of differences in accounting methods. Before 2007 – when the NBU moved from the BPM5 to the BPM6 framework in collecting remittance statistics and introduced estimates of money transferred to Ukraine through informal channels – World Bank data coincided with NBU data (see Figure 1 above).

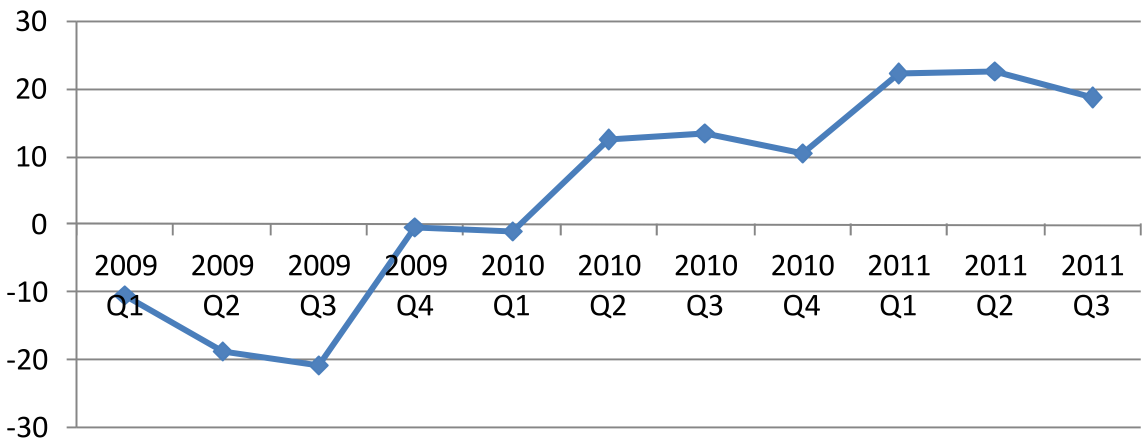
Table 3. Remittance inflows to Ukraine based on balance-of-payment statistics, 2007-2011 Q3

Measure	Definition	Source	2007	2008	2009	2010	2011 Q1	2011 Q2	2011 Q3
Personal remittances (mln. US$)	BPM6	NBU	4,922	6,177	5,370	5,862	1,489	1,792	1,845
Personal remittances (% of GDP)			3.4	3.4	4.6	4.2	4.5	4.5	4.0
Workers' remittances and compensation of employees, received (mln. US$)	BPM5	World Bank	4,503	5,769	5,073	5,607	n.a.	n.a.	n.a.

Source: NBU (on-line reports on remittances); World Development Indicators.

Annual remittance inflows increased by 9.2% in 2010, after they slumped by 13.1% as a result of the recession in the main destination countries for Ukrainian labour migrants (Russia, and the EU) in 2009. Nevertheless, due to substantial depreciation in the local currency against the US dollar (over 50%) and a 15% contraction in GDP in 2009, the role of remittances as a share of GDP actually increased during the crisis from 3.4% in 2008 to 4.6% in 2009, but then declined to 4.2% in 2010. As Figure 2 shows, remittances fell drastically in the wake of the crisis in 2009, but have been gradually recovering since 2010.

Figure 2. Year-on-year change of quarterly remittance inflows into Ukraine, 2009-2011 Q3 (percent change)



Source: Author's calculations based on NBU data.

Note: The period covered is 2009-2011 Q3 because quarterly remittance statistics based on the new methodology have only been published since 2008.

Official statistics on remittances are often blamed for underestimating the actual level of remittance flows. They are blamed because they fail to capture informal remittance transfers and even when funds are transferred through official channels such as bank accounts, the internet or phone cards. And the mechanisms for measuring these flows are, of course, weak. In order to better capture the extent of migrant remittances, independent think tanks and experts use different calculation methods and present their alternative estimates. The International Fund for Agricultural Development

(IFAD) estimated total remittances sent to Ukraine (2006) at US$ 8,471 mln. or 8% of GDP.[9] Assistant to the Vice Chairman of the NBU A. Gaidutski (2007a) employed indirect estimates of emigration from Ukraine (4.93 mln. people). He also made use of the monthly income of Moldovan emigrants depending on destination countries and migrants by the share of sent remittances in total income to arrive at an estimate for Ukrainian remittances.[10] In this way, he came up with US$ 21,268 mln., or one quarter of the country's GDP, for remittances sent by Ukrainians in 2006. Maidanik (2006) from the Institute of Demography and Social Studies of the National Academy of Sciences of Ukraine, using more sophisticated procedures estimated the total income earned by Ukrainians abroad at between US$2.1 bln. and US$11.6 bln., depending on hypotheses about the number of Ukrainian labour migrants (from 1 to 5 mln. people) and their educational profile. However, there is no information here about the amount of money sent back to Ukraine. Alternative estimates for remittance inflows to Ukraine vary from US$7-8 to 54 bln. depending on various experts and Diaspora representatives (Gaidutski, 2007b). These estimates depend on hypotheses about the number of Ukrainians abroad and the average monthly sums they send back home. Annual income and remittances sent back home by labour migrants in 2007 and estimated on the basis of the Modular Migration Survey are equal to respectively € 1.9 bln. and € 1.3 bln. (UCSR, 2009, p. 59-60).

Finally, here is the most recent estimate of annual remittance inflows to Ukraine, given by the Vice-President of MoneyGram International in CIS, Eastern Europe and Israel, P. Hnatiuk at the IOM conference “The future of migration in Ukraine” held in Kiev 12 October 2011. Hnatiuk estimated remittance inflows at about US$ 25 bln. (5-6 mln. migrants send on average US$ 350-500, 6-8 times per year). The reliability of these estimates is open to question.

The other way to estimate the size of remittances to the country is to use data on remittance outflows from the country’s main partners. This procedure requires that data be provided on a bilateral basis. But official remittance data is generally not provided on a bilateral basis, and this is typical for most economies (Shelburne and Palacin, 2007). According to the Second EU Survey on Workers’ Remittances from the EU to Third Countries (EC, 2006), Ukraine was sixth in the total ranking of third countries receiving remittances from the EU in 2004 and first among Eastern European countries. It received € 120.6 mln. in 2004, compared to about € 181 mln. in 2001-2002 and € 144.9 mln. in 2003. Money came predominantly from Portugal, Latvia and Lithuania. In terms of comparison, in the same year NBU reported US$ 151.6 mln. received from selected EU countries (the most important in terms of remittance flows) as compensation for employees and US$ 117.6 mln. in workers’ remittances.

Shelburne and Palacin (2007) found similar inconsistencies in the estimates of bilateral remittance flows provided by the Russian Central Bank, the NBU and the World Bank. According to the NBU, remittance inflows from Russia in 2006 were US$ 67.2 mln., while the Russian authorities reported cross-border transfers to Ukraine through postal offices or money transfer companies of US$ 927 mln. for 2006 and total cross-border payments between physical persons of US$ 1,327 mln. in 2006QII-2007QI. The World Bank reported total remittances from Russia to Ukraine of US$ 308.76 mln. Shelburne and Palacin (2007), meanwhile, estimated bilateral remittance flows through postal offices or money transfer companies from Russia to Ukraine in 2006 at US$ 1,538.8 mln.

In view of the existing inconsistencies in remittance statistics, Shelburne and Palacin (2007) conclude that attempts to improve data on remittances need to be pursued using different methods. In particular, they suggest the better use of anonymous household and individual surveys. On 15-16 March 2011, representatives of the NBU together with colleagues from the Central Banks of other CIS

[9] See http://www.ifad.org/remittances/maps/europe.htm.

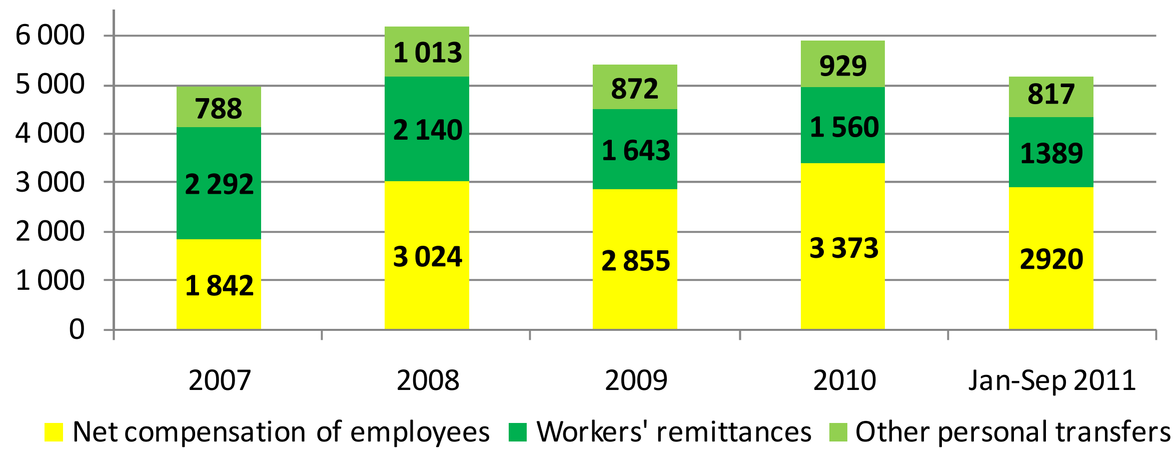
[10] Due to the absence of detailed migration and remittances statistics for Ukraine at that time, the author used Moldovan data assuming a close similarity between the earnings of Moldovan and Ukrainian migrants and their remittance-sending behavior.

countries and a representative from the Statistics Department of the IMF met in Russia (Tula City) to discuss the problem of remittance statistics for their countries. Participants in the meeting stressed the importance of qualitative household surveys to get an estimate of money transferred through informal channels. They also, though, stressed the need for the correct application of the guidelines and principles of remittance accounting in line with BPM6 (IMF, 2009) by all counterpart economies. This would, they hoped, ensure the consistency and comparability of bilateral data (NBU, 2011).

2.3. Characteristics of remittances: components, channels and countries

Analysis of the structure of personal remittances in Ukraine in 2007-2011 (Figure 3) shows that the share of net compensation for employees has increased over recent years and currently amounts to 57%. This might be a sign of the changing nature of labour migration among Ukrainians in favour of short-term and seasonal migration (up to one year). The second component of personal remittances according to BPM6 – personal transfers, i.e. the sum of workers' remittances and other personal transfers – accounted for 62.6% of total personal remittances in 2007, but then fell to 43% January-September 2011. An interesting finding is that the scale and share of workers' remittances has been decreasing since 2007. Other private transfers have, meanwhile, been changing non-monotonically. According to the NBU (2011), the former trend can be attributed not only to the global crisis, but also to the fact that increasing numbers of Ukrainian migrants stay abroad permanently and, therefore, they spend more on their lives there.

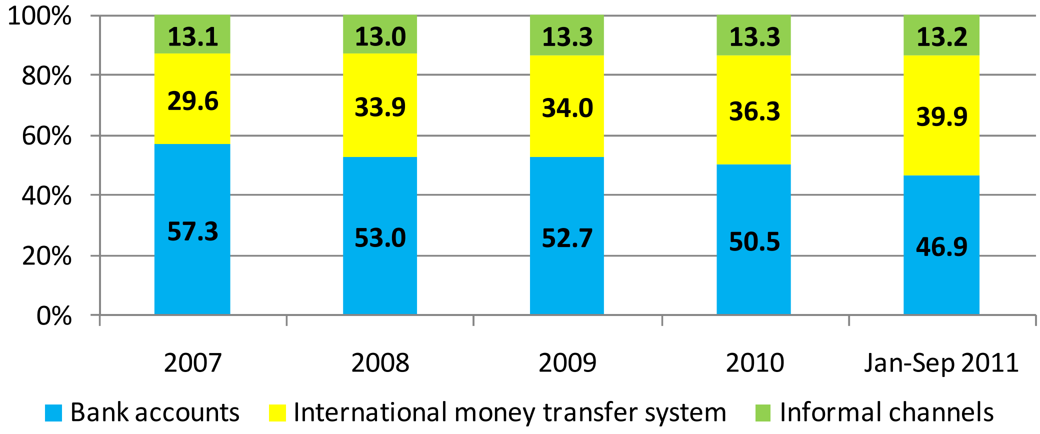
Figure 3. Composition of annual personal remittance inflows into Ukraine by main components, 2007-2011 (mln. US$)



Source: NBU.

Bank accounts have traditionally been the major transmission channel for total remittances to Ukraine, but they have lost their significance from 57.3% of total remittances in 2007 to 46.9% in January-September 2011 (Figure 4). This is probably due to a loss of confidence in the banking system in the wake of the crisis. The international money transfer system, on the contrary, gained momentum and increased its share to 39.9%. Money transferred through informal channels is almost stable at about 13.2% in accordance with the predetermined NBU value (see Chapter 2.1 above).

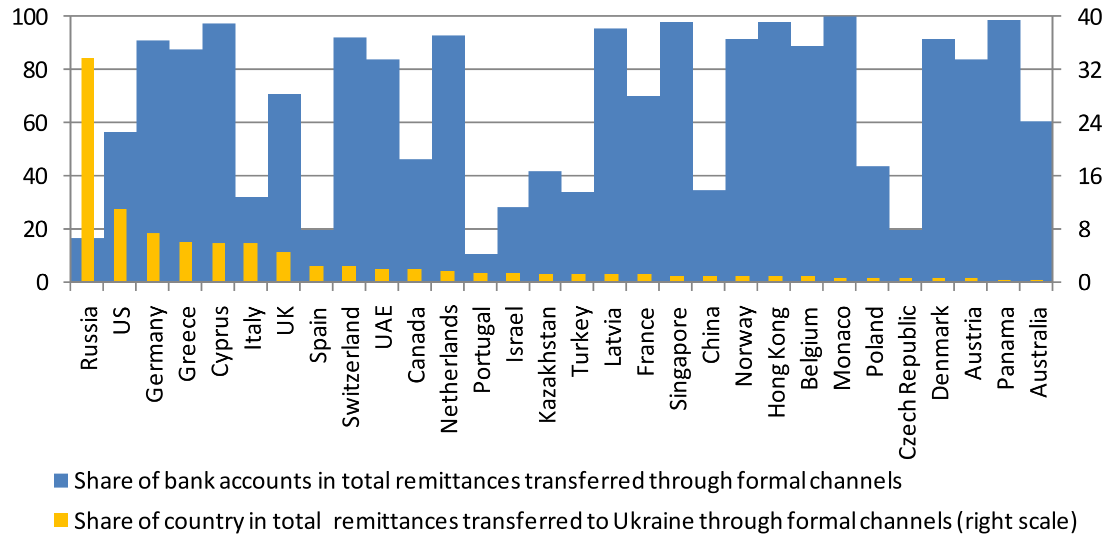
Figure 4. Composition of personal remittance inflows to Ukraine by channels, 2007-2011 (%)



Source: NBU.

However, the importance of bank accounts in transferring personal remittances from abroad is not uniform across the countries. As Figure 5 reveals, bank accounts are predominantly used in those countries with a developed financial system where most Ukrainian expatriates are highly-skilled and legal. The international money transfer system is extensively used in the main destination countries for lower-skilled labour migrants such as Russia, Italy, Spain, Portugal, Turkey, Kazakhstan, Poland, and the Czech Republic. Perhaps these labour migrants do not have access to the banking system in the host countries because of their illegal status, language barrier, financial illiteracy and other reasons. Or perhaps they just prefer an international money transfer system: there is a rapidly developing regional network within said system, both in the host country and in Ukraine, in response to the growing needs of these labour migrants. The international money transfer system is also extensively used by expatriates (not labour migrants) living in Israel.

Figure 5. Remittances through formal channels by major source countries and importance of bank accounts, January-September 2011



Source: NBU.

Note: Data is based on bank statements on transactions with non-residents and the transfers performed using international money transfer systems, and does not include the amounts received through informal channels and money transfer systems created by residents of Ukraine.

As one might expect, Russia is the main source country of remittances for Ukraine accounting for 32.1% of all remittance inflows in January-September 2011 (Table A.3 in the Annex). The other CIS country from which remittances come to Ukraine is Kazakhstan (1.1%). Fifteen EU countries account for 38.2%, and countries in other parts of the world (mainly, North America, Asia and Australia) make up the rest (23.2%). Strikingly, many countries mentioned in the NBU remittance statistics such as Cyprus (5.6%), Switzerland (2.2%), Singapore (1%), China (0.9%), Hong Kong (0.8%), Monaco (0.7%), and Panama (0.4%) are neither popular destination countries for temporary labour migrants from Ukraine, nor countries of residence for the old Ukrainian diaspora. This implies that personal remittances from these countries include transfers originating from individuals who are not migrant workers, presumably for the purposes of tax avoidance and money laundering. Some of these countries may also be staging posts rather than source countries for remittances. It is also possible that resident workers are employed by non-resident employers in Ukraine, but that their wages and other benefits are recorded as cross-border "compensation of employees" (IMF, 2009). At the same time, Hungary which is one of the five most popular destinations for labour emigrants from Ukraine (see Table A.4 in the Annex) is not mentioned among major countries in the NBU remittance statistics, most likely because of the informal nature of transfers between migrants and their households. For that reason, official statistics on remittance inflows should be used very carefully in conclusions about their effects on receiving households and the economy as a whole.

There was a sharp decrease in personal remittances from Russia in 2009 (by 31.6% or US$ 578.4 mln.) which accounted for 81% of the decline in remittances from all countries in the same year. Then there was the rapid recovery or remittances from Russia in 2010 almost to the pre-crisis level (by 29% or US$ 364.3 mln.). This demonstrates the heavy dependence of the Ukrainian economy on the Russian economy, not only in terms of the commonly-mentioned international trade and financial channels, but also in terms of remittances. According to Alturki *et al*. (2009), developments in Russia tend to spill over into Ukraine and other oil-importing CIS countries through these three channels, making domestic business cycles very volatile and long-term economic prospects uncertain.

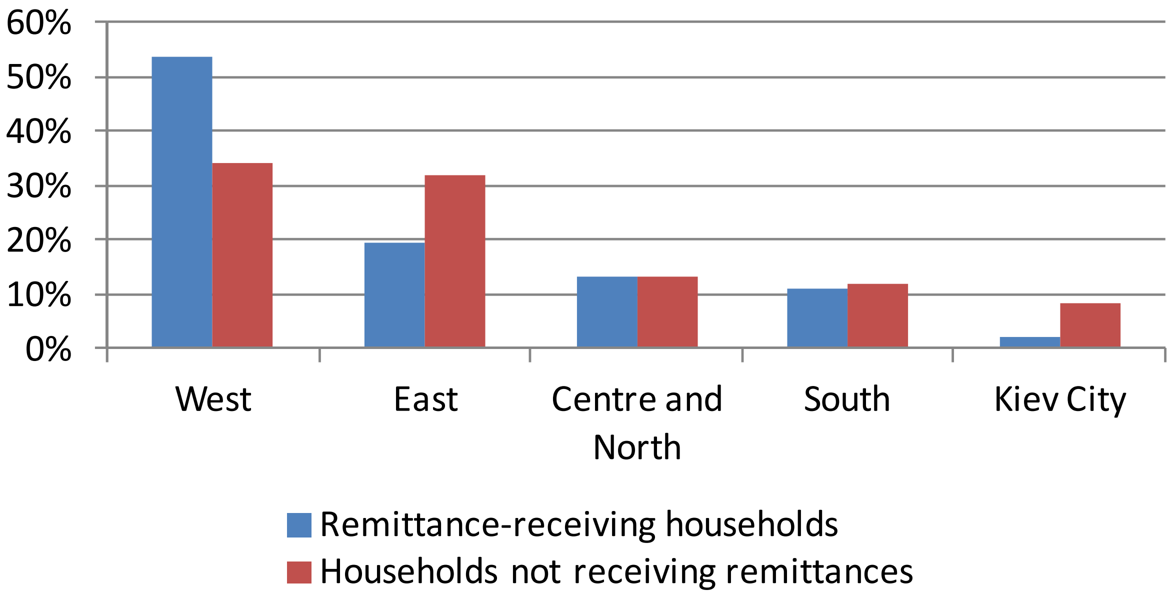
2.4. The microeconomics of remittances: profiles of receiving households and sending individuals

2.4.1. Characteristics of households receiving remittances according to the Modular Migration Survey

According to the Modular Migration Survey (household section), almost every second surveyed household received remittances, i.e. private transfers from abroad in cash or in kind, in 2007-2008 (UCSR, 2009, p. 54). It is necessary to note, however, that the sample of surveyed households includes not all households initially selected for the survey (25,435 households) but only those households that gave any positive answer in the questionnaire of the Modular Migration Survey (2,459 households) (UCSR, 2009, p. 23). Therefore, information about households not receiving remittances which is presented below should be interpreted with caution.

Remittance-receiving households were disproportionately represented in eight Western *oblasts* (Figure 6). This is attributable to the poor performance of this macro-region in terms of economic development and many economic-related components of human development (such as labour-market development, income, living conditions, education, and financing of human development) compared to the other Ukrainian macro-regions. It is also attributable to its geographical proximity to more advanced CEE and EU economies (Kupets, 2009). One in five remittance-receiving household is located in the industrially developed and relatively better-off east, a fact that can be explained by high population density and the proximity of the region to Russia. Kiev City stands out due to its exceptional performance in economic terms and in most aspects of human development (aside from ecological and social environment).[11] High living standards and attractive employment opportunities, a concentration of human capital and investment, high production and overall prosperity attract both internal and international migrants to the capital city.

Figure 6. Ukrainian households receiving and not receiving remittances by macro-region (in % to total), 2007-2008



Source: Author's calculations based on Modular Migration Survey household-level data (weighted with sample weights provided in the data set).

Note: There are 27 administrative units (regions) in Ukraine: 24 *oblasts*, one Autonomous Republic (the Crimean AR), and two cities with a special status – Kiev and Sevastopol. These 27 regions are grouped into 5 geographical macro-regions as follows: West – Volyn, Zakarpattia, Ivano-Frankivsk, Lviv, Rivne, Ternopil, Khmelnytskyi and Chernivtsi *oblasts*; East includes Dnipropetrovsk, Donetsk, Zaporizhia, Luhansk and Kharkiv *oblasts*; Center and North – Vinnytsia, Zhytomyr, Kiev, Kirovohrad, Poltava, Sumy, Cherkasy and Chernihiv *oblasts*; and South – the Crimean AR and Sevastopol, Mykolayiv, Odessa and Kherson *oblasts*.

As Table 4 shows, the bulk of remittance-receiving households belong to the middle and lower middle classes (according to their subjective status) and these are to be found in urban areas.[12] Interestingly, the share of households receiving transfers from their closest relatives (spouse, children, and parents) is much lower among urban households compared to their rural counterparts (64.8% vs. 77.8%) and among poorer households compared to the wealthiest (69.6% vs. 91.4%).

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[11] According to the national methodology, regional human development is analyzed in nine main aspects: demographic development, labor market development, income, living conditions, education, health care, social environment, ecological environment, and the financing of human development (UNDP, 2008).

[12] Although poverty assessments in Ukraine (World Bank, 2005 and 2007a) found that poverty incidence in rural areas is more than twice that of large cities, rural households appear to be on average wealthier than their urban counterparts. This is the case at least according to their subjective answers in the Modular Migration Survey: the share of poor and very poor households is smaller among rural households (12% vs. 12.5% for urban households), whereas the share of households considering themselves as wealthy is larger (1.4% vs. 0.8% for urban households).

Table 4. Remittance-receiving households by source of transfer, place of residence and in terms of subjective status of household wealth, 2007

	Total	Urban	Rural	Wealthy	Middle	Lower middle	Poor and very poor
Number of households, receiving private transfers from abroad, thousand	1,329.8	795.8	534	19.3	607.9	538.7	163.9
Of them received from (%):							
Spouse	30.6	24.6	39.7	43.5	34.4	26.2	29.7
Children	21.9	17.7	28.1	30.6	19.7	22.2	27.6
Parents	17.5	22.5	10.0	17.3	18.1	18.4	12.3
Relatives	25.5	30.1	18.5	8.3	22.5	29.2	26.3
Friends or other persons	4.5	5.1	3.7	–	5.3	4.0	4.1
Average money transfer received by one household during a year, US$	2,207	1,896	2,648	3,420	2,576	1,938	1,565

Source: UCSR (2009), Tables 2.28-2.31.

Out of 1,329,800 households receiving private transfers from abroad in cash or in kind, 1,144,300 thousand reported receiving money transfers. According to the estimates of the UCSR, the average money transfer received *per* household in 2007 was about US$ 2,207,[13] and it was 40% higher among rural households than among urban equivalents (Table 4).

As expected, money transfers from abroad are an important income source for certain households, accounting for an average of 42.6% of household income in 2007; this based on the answers of households about the share of transfers in total household income. In particular, among households considering themselves wealthy, 65.2% reported that remittances accounted for over 50% of their household income. The similar indicators among poorer households varies from 36.6% in the “lower middle” group to 53.1% among the “poor and very poor” (UCSR, 2009). Unfortunately, these subjective answers, which depend on many factors, do not help us to assess the true impact of remittances on household well-being.

2.4.2. Characteristics of labour migrants sending remittances according to the Modular Migration Survey and the ETF Survey

According to the Modular Migration Survey (individual section), 61.1% of labour migrants which had experience of working abroad during the observed period (2007-June 2008), i.e. about 772,000 individuals, sent remittances to other members of their household in Ukraine. But this does not imply that other migrants (39.9%) did not support their relatives at home (UCSR, 2009). The propensity to remit (measured as the share of migrants sending remittances among all labour migrants) seems to be strongly associated with the country of employment, which is an indicator of the geographic distance and wage differentials between Ukraine and this country. The share of migrants sending remittances is larger in long-distance-countries with higher earnings: e.g. Austria, Ireland, Denmark, Brazil, 100%; Israel, 88%; Spain, 81.8%; Italy, 78.6%; and Portugal, 71.3%. But it is significantly lower in

[13] Due to suggested income brackets and two foreign currencies (Dollar and Euro) in the questionnaire of the Modular Migration Survey (see Chapter 2.1), the amounts of remittances *per* receiving household or *per* one sending migrant estimated by the the Ukrainian Center of Social Reforms are very rough.

neighbouring countries where labour migrants earn less and have higher incentives to return home: e.g. Czech Republic, 60.7%; Russia, 58.5%; Poland, 45.8%; and Hungary, 41.8%.[14]

Furthermore, there is a significant difference between those who made one trip (58.4% of them sent remittances) or those who made several trips abroad (63.6%) and those who visited the destination country every month (30.1%) (Table A.4 in the Annex). This finding suggests that Ukrainians working close to their region of origin and frequently visiting their homes are more likely to bring part of their earnings physically rather than by sending money from abroad.[15] At the same time, if they do send money they appear to send, on average, more than their counterparts. Each labour migrant that travelled to the host country every month sent on average US$ 3,471 in 2007 (UCSR, 2009, p.53). For comparison, labour migrants who reported one or several trips abroad sent, on average, respectively, US$ 2,353 and US$ 2,821. This difference may be explained by the commercial nature of labour mobility among frequent movers (UCSR, 2009). Alternatively, it may be explained by the higher costs of living and remitting by migrants moving less frequently between Ukraine and the country of employment; presumably many of these were long-term and illegal migrants.

Long-term migrants (i.e. those who stayed abroad for at least 12 months during the last migration period) are found to have a higher propensity to remit (66.4%) than short-term migrants (about 60-61%). This supports, of course, a strong correlation between the propensity to remit and the type of migration found above. Unfortunately, the design of the Modular Migration Survey does not allow an analysis of the remittance behaviour of Ukrainian labour migrants over longer periods of time and so hamstrings comparison with other countries.[16]

Meanwhile, the legal status of migrants does not have a significant impact on their propensity to remit. The share of remittance senders among workers with residence and work permits is only slightly higher than among illegal workers: respectively 64.6% vs. 63.5% (Table A.4 in the Annex). But there are significant differences between such migrants in terms of the average amount remitted to their families: migrants with residence and work permits sent on average US$ 2,831 in 2007, whereas illegal migrants sent, in the same year, US$ 2,551 (UCSR, 2009). Authors of the report on international labour migration in Ukraine attribute this difference to differences in average monthly earnings (UCSR, 2009, p. 53). But given that, according to the Modular Migration Survey, average monthly earnings differed by US$ 35 in 2007 – US$ 867 for migrants with residence and work permits compared to US$ 832 for migrants without legal status – we would suggest another explanation: due to their illegal status migrants might incur higher costs for sending money home and so they remit less money.

As Table A.4 in the Annex shows, a lower propensity to remit is associated with women and young unmarried individuals with basic or completed higher education whose families live in urban areas.[17]

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[14] According to the Modular Migration Survey, in 2007 the average monthly income of Ukrainians working in most popular destination countries was US$ 745 in Russia, US$ 1,120 in Italy, US$797 in the Czech Republic, US$ 635 in Poland, U$ 535 in Hungary, US$ 1,131 in Spain, and US$ 969 in Portugal (UCSR, 2009, p. 49).

[15] However, there are some exceptions to this rule, e.g. 36.5% of remittance-sending migrants in the US compared to 100% in Estonia and Latvia.

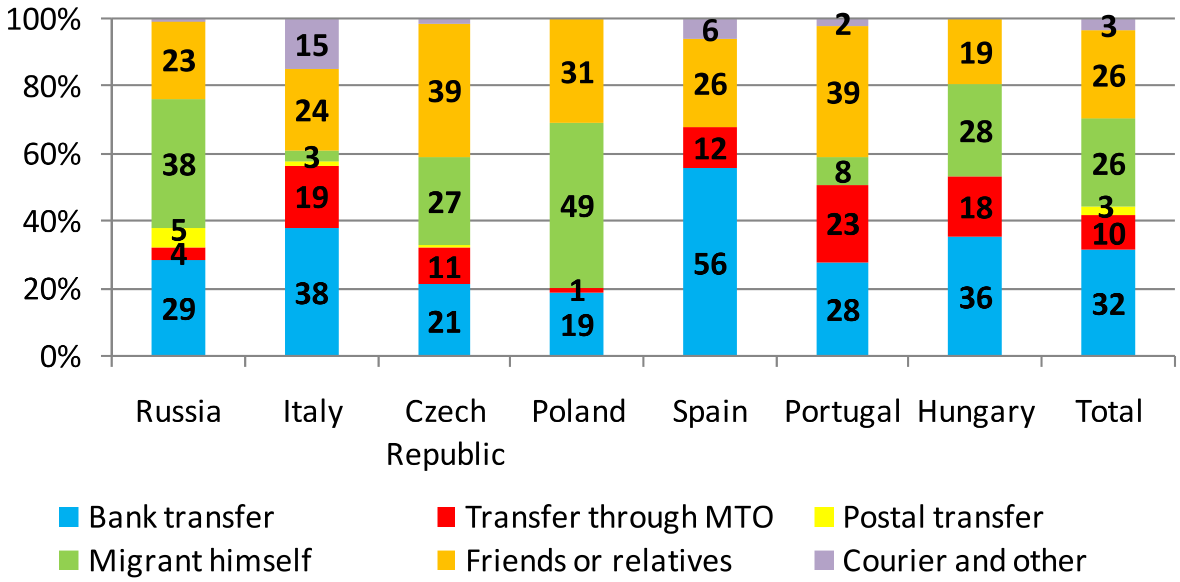
[16] For example, remittance senders among Latino immigrants in the US tend to be concentrated among more recently arrived immigrants, and the tendency to remit generally declines over time, even though migrants continue to remit money to their countries of origin after several decades (Agunias, 2006). In some other countries, propensity to remit shows a reverse U-shaped relationship with the duration of stay in the country of destination: it increases during the first years (usually five-ten years) but then declines steadily, especially if migrants are joined by dependants or marry and settle in the country of employment (Carling, 2005).

[17] According to the ETF Survey (ETF, 2008), gender and education are found to be non-significant determinants of the probability of sending remittances. Migrants working in sectors such as hotels and restaurants, domestic services and manufacturing were more likely to send remittances, while those involved in agriculture, trade or ICT were less likely to remit. Migrants from the EU countries were more likely to send money than migrants from North America and Russia. Approximately half of those respondents who sent money did so at least once a month.

This finding is in line with our expectations and empirical comparative evidence from other transition economies suggesting that many such migrants intend to settle permanently in the host country and so they invest heavily in their new residence abroad. Alternatively, they have an interest in reaching a saving target in order to return home with a certain amount of money, e.g. to buy property or to start a business. Therefore, they need to minimize any “drains” on income, i.e. consumption expenses in the host country and the money remitted to the family (OECD, 2006).

Ukrainian labour migrants use a wide array of formal and informal mechanisms to remit money, ranging from electronic transfers through banks, money transfer companies and postal offices to hand deliveries by the migrants themselves, friends/relatives or by a third party (couriers, bus drivers or train stewards). In the majority of cases (55.6%) labour migrants employ informal channels for sending remittances, but this trend is not uniform across all countries.

Figure 7. Transfer channels for remittances in the major destination countries*



Source: Author’s calculations based on Modular Migration Survey individual-level data (with sample weights provided in the data set).

Note: * Countries are ranked according to their share in the sample of remittance senders. Together they account for 91.1% of migrants who reported sending remittances.

Figure 7 shows that formal channels dominate in Spain (68.2%), Italy (57.9%), Hungary (53.3%) and Portugal (51.2%), whereas informal channels are more frequently used in Russia (61.9%), the Czech Republic (67.1%), and Poland (79.3%). Moreover, the means of transfer differs radically within these two groups. For example, Italy stands out in terms of the use of couriers by remittance senders (15%). Migrants from Portugal, more often than migrants in the other countries, use transfers through money transfer operators (23%). Meanwhile, very similar migrants in Spain rely heavily on bank transfers (56%). Poland stands out with respect to hand deliveries by migrants themselves (49%). While Czech Republic and Portugal differ with respect to hand deliveries with help of friends or relatives (39%). Finally, Ukrainians working in Russia use postal transfers (5%) more often than migrants in other destinations.

As expected, remittances received by household members were predominantly spent on basic consumption needs, i.e. purchase of food, clothes, basic services, etc.: 72% of respondents in the weighted sample of the Modular Migration Survey (Table 5). 39.3% of respondents reported spending remittances on the purchase of durable goods such as a car, a TV set, a computer, a washing machine, etc. 29.1% spent their remittances on the purchase, construction, reconstruction or repair of a house/

flat. 12.4% spent on education (own or of household members). 10.4% spent remittances on the repayment of debt, 9.7% spent on savings, and 6.5% on payment for medical treatment. Finally, fewer than 1% of individuals reported investing money in agriculture (0.98%) or other ways of spending remittances (0.48%).[18]

The results of the ETF survey on remittance spending patterns are generally in line with those found in the Modular Migration Survey. But in the latter survey the shares of migrants reporting spending on education, business activities, and savings are found to be significantly lower (Table 5). A comparison of the spending patterns of remittances and savings brought back by migrants according to the ETF survey reveals that migrants' savings are predominantly spent on living expenses. However, savings are more often used for the purchase of durable goods, the purchase of real estate and business activities than is the case with remittances.

Table 5. Use of remittances and savings brought back by returning migrants: Modular Migration Survey and ETF survey results (% of respondents who sent remittances/ saved money), 2007

	Modular Migration Survey, Remittances	ETF survey		
		Remittances (1)	Migrants' savings (2)	Difference between (2) and (1)
Essential consumption needs	72	73.4	58.3	-15.1
Purchase of durable goods	39.3	25.8	39.5	13.7
Purchase of real estate	29.1*	11.9	22.8	10.9
Education	12.4	16.6	14.5	-2.1
Repayment of debts	10.4	1	0.8	-0.2
Savings	9.7	26.6	24.6	-2
Medical treatment	6.5	–	–	–
Business activity	1**	3.3	8.7	5.4
Other	0.5	4.5	4.1	-0.4
Rent	–	2.5	1.9	-0.6
Housing repair	n.a.	1.2	2.9	1.7
No answer	–	2.2	3.9	1.7
% of migrants that reported sending remittances/ bringing savings	61.1%	48%	90.4%	–

Source: UCSR (2009), Table 2.26; ETF (2008), Figure 31.

Note: * Purchase of real estate includes the construction, the reconstruction or repair of a house/ flat. ** Business activity refers to investment in agriculture only as there is no other business activity in the Modular Migration Survey.

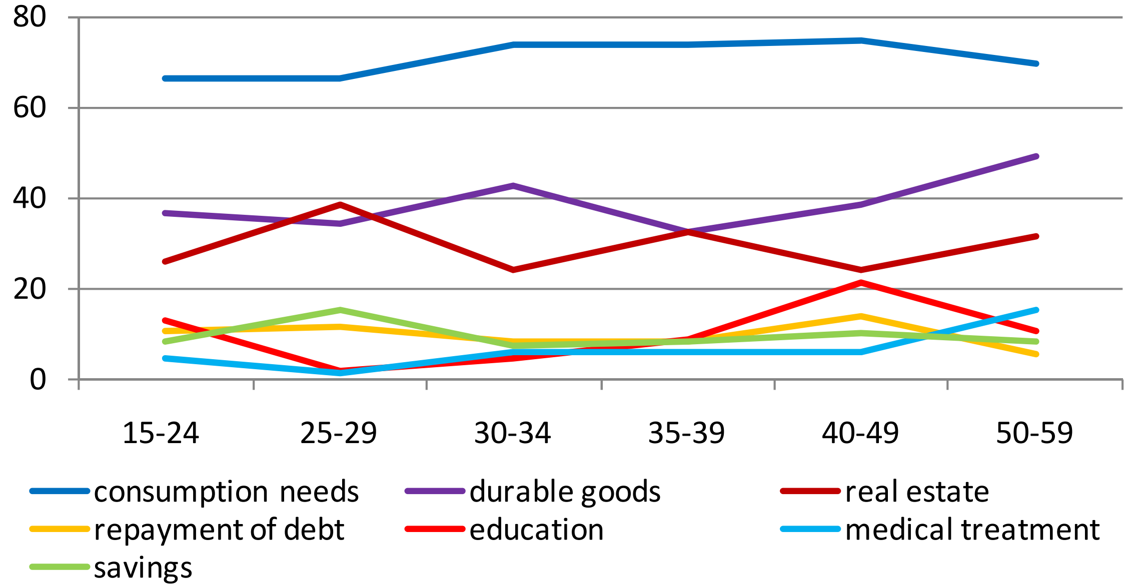
If we compare remittance spending patterns from male and female migrants based on the Modular Migration Survey data (UCSR, 2009), men's money is more likely to be spent on essential consumption needs (74% vs. 68% for women) and durable goods (42.1% vs. 33.4%). Remittances from women are more likely to be spent on education (14.8% vs. 11.2% for men), medical treatment (8.3% vs. 5.7%) and repayment of debt (11.3% vs. 9.9%), probably because women are more attentive to their children and aged parents than men. Rural residents spend more on real estate (35.9% vs. 22.3% for urban residents) and the repayment of debt (11.2% vs. 9.5), while urban residents are more likely to use remittances for education (13.9% vs. 10.8% for rural residents) and for health care (7.7% vs. 5.4%).

[18] Unfortunately, there is no separate entry for "investment in business activity (apart from agriculture)" among suggested alternatives for spending remittances in the individual questionnaire of the Modular Migration Survey.

There are also significant differences in remittance use depending on the age of migrants (Figure 8). Older migrants (50-59 years) send remittances for everyday consumption and for the purchase of durable goods. But they also do so to improve housing conditions and to pay for medical treatment; medical treatment is particularly important for women. Whether they complement their inadequate pensions in such a way or help their dependants (children and parents) is an open question. 40-49 year-old migrants invest heavily in the education of their children, while younger migrants (15-24) are more likely to invest in their own education. Young migrants aged 25 to 29 more often use income earned abroad to save money and buy real estate, thus solving a burning problem for young families. At the same time, their relatively older counterparts (30-34 years) spend more on the purchase of durable goods.

As we can see, most migrants from younger age groups tend to live in the present and they put aside the future in their intertemporal choices. They (or their households) predominantly spend remitted money on consumer goods satisfying current needs rather than thinking of future income and health needs. They work abroad for a long time, often they do not pay taxes, pension and social insurance payments in Ukraine, whereas their social contributions made abroad (if any) are not easily portable. They are, therefore, at risk of not having access to an old age pension and social protection after their return to Ukraine. Besides, by free-riding on local taxpayers they contribute to the under-production of public goods and to the disruption of the welfare state in Ukraine.

Figure 8. Use of remittances by age groups (%of respondents who sent remittances)



Source: Author's calculations based on Modular Migration Survey individual-level data (weighted with sample weights provided in the data set).

Note: Real estate includes purchase, construction, reconstruction and repair of a house/ flat.

Therefore, the earnings of Ukrainian labour migrants sent to household members are not extensively used for investment purposes and are not likely to boost entrepreneurship. But, whether from remittances or other sources, income is spent in a way which responds to the hierarchy of needs. It is certainly reasonable to assume that households will continue to exhibit the same spending patterns until a certain level of wealth is reached in the country (OECD, 2006).

Chapter III: Development Impact of Remittances in Ukraine

3.1. Remittances as a source of foreign exchange[19]

Ukraine has rich endowments, both in human and natural resources, and a favourable geographical location; being at the crossroads of major transportation routes from Europe to Asia and from the Scandinavian states to the Black Sea region. As a result, Ukraine is less dependent on remittances as a source of foreign exchange and income than smaller resource-poor CIS countries such as Moldova, the Kyrgyz Republic and Tajikistan (see Table 1 above). The scale and relative importance of workers' remittances and the compensation of employees have increased markedly since 2007, partly for the statistical reasons explained above. But remittance flows do not exceed export earnings and private capital flows to the Ukrainian economy. On average remittances have equalled: 7.3% of total annual export earnings over the last 4 years; more than one-tenth of goods exported; about 72.5% of FDI inflows; and more than nine times official development assistance (Table 6).

Table 6. Remittances to Ukraine in relation to GDP and selected balance of payments inflows, 1996-2010

Year	Remittances received as percentage of					
	GDP	ODA	FDI	Private capital flows	Exports of goods, services and income	Goods exports
1996	0.01	1.5	1.2	0.8	0.03	0.04
1997	0.02	4.5	1.9	0.5	0.06	0.08
1998	0.03	2.6	1.6	1.5	0.07	0.09
1999	0.06	3.2	3.6	4.5	0.10	0.14
2000	0.11	6.1	5.5	4.5	0.17	0.21
2001	0.4	27.5	17.8	19.5	0.7	0.8
2002	0.5	44.0	30.2	20.2	0.9	1.1
2003	0.7	100.5	23.2	14.5	1.1	1.4
2004	0.6	112.3	24.0	10.9	1.0	1.2
2005	0.7	144.5	7.6	5.8	1.3	1.7
2006	0.8	171.5	14.8	8.9	1.6	2.1
2007	3.2	1071.5	45.5	30.1	6.7	9.0
2008	3.2	934.1	52.9	66.9	6.3	8.5
2009	4.3	759.4	105.3	163.9	8.6	12.6
2010	4.1	–	86.3	55.6	7.6	10.7
Average 1996-2006	1.2	241.7	28.1	27.2	2.4	3.3
Average 2007-2010	3.7	921.7	72.5	79.1	7.3	10.2

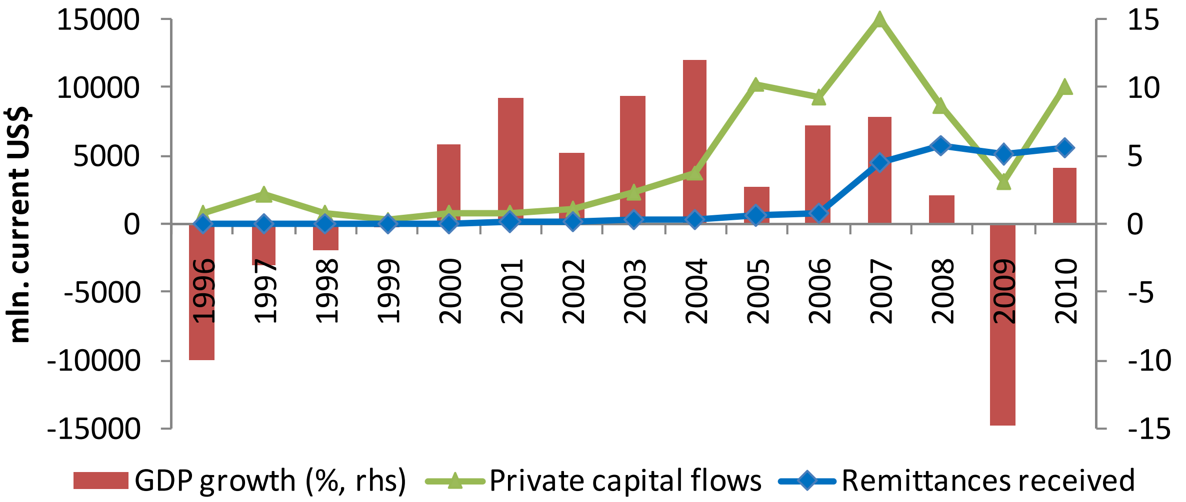
Source: Author's calculations, World Development Indicators (based on IMF Balance of Payments Statistics Yearbook and data files).

Note: Remittances include workers' remittances, compensation of employees, and migrants' transfers. ODA refers to net official development assistance and official aid received. FDI refers to the net inflows of foreign investment (new investment inflows less disinvestment) to acquire a lasting management interest (10 percent or more of voting stock) in Ukrainian enterprises. Private capital flows consist of net foreign direct investment and portfolio investment.

[19] In this chapter we use official remittance statistics despite its drawbacks discussed above. We assume that the data quality is consistently poor with similar biases over time, and focus our analysis on the relative changes in remittance inflows over time rather than on their absolute magnitude.

In addition to highlighting the scale of remittance flows in relation to other international flows, it is often argued, in the general literature on remittances and development, that remittances are conceptually distinct from official development flows and from purely profit-seeking private capital flows. As a result, it is also argued, that they are likely to act as a countercyclical mechanism and an informal "stabilization fund" (see, among many others, Agunias, 2006; Chami et al., 2008; and World Bank, 2006). Analysis of official statistics on remittance flows in Ukraine only partially supports this argument. Remittances denominated in US$ rose steadily until 2008. As the domestic economy and the economies of Russia and the EU – the major regional source for remittances into Ukraine – slipped into crisis they suffered a slight decline in 2009 (Figure 9). However, the decline in remittances and their volatility were smaller than those of private capital flows that increased during good economic times. But then they declined sharply in the wake of the economic and financial crisis in 2008-2009. Thus, remittances displayed a pro-cyclical relationship with domestic output, even though they reacted less violently to the economic downturn in 2009 than private capital flows.

Figure 9. Volatility of remittances received compared to private capital flows, 1996-2010



Source: World Development Indicators (based on IMF Balance of Payments Statistics Yearbook and data files).

Note: Remittances include workers' remittances, the compensation of employees, and migrants' transfers. Private capital flows consist of net foreign direct investment and portfolio investment.

However, if we calculate the amount of remittance inflows in local currency using the average-yearly official exchange rate (Table 7), remittance inflows show positive dynamics. There was an increase from UAH 30.6 bln. in 2008 to 39.7 bln. in 2009 and the numbers rose to 44.3 bln. in 2010. Consequently, the remitted income of migrant workers intended for consumption by recipient households can be seen not only as a relatively stable source of foreign exchange in Ukraine. They are also a regular source of household income that insures consumption against negative shocks in the home country.

Table 7. Selected macro-economic indicators, 2005-2010

	2005	2006	2007	2008	2009	2010
Current account balance (mln. current US$)	2,531	-1,617	-5,272	-12,763	-1,732	-2,884
Net trade in goods and services (mln. current US$)	671	-3,068	-8,152	-14,350	-1,953	-3,850
Net trade in goods (mln. current US$)	-1,135	-5,194	-10,572	-16,091	-4,307	-8,712
Goods exports (mln. current US$)	35,024	38,949	49,840	67,717	40,394	52,191
Goods imports (mln. current US$)	36,159	44,143	60,412	83,808	44,701	60,903
Consumer price index (2005 = 100)	100	109.1	123.1	154.1	178.6	195.4
Real effective exchange rate index (2005 = 100)	100	105	105.6	115.2	96.6	99.1
Official exchange rate (UAH per US$)	5.1	5.1	5.1	5.3	7.8	7.9
Household final consumption expenditure (mln. current US$)	47,732	64,269	84,887	80,777	76,843	–
Gross capital formation (mln. current US$)	19,455	26,681	38,040	45,527	20,084	22,564

Source: World Development Indicators.

Increase in remittance inflows before the crisis helped narrow current account deficits that emerged in Ukraine with the worsening trade balance in 2005-2008 (Table 7). At the same time, there is no direct evidence of Dutch disease from remittances due to their relatively small scale, with the lion's share devoted to imported goods (both fast moving and durable consumer goods). The observed appreciation of Ukraine's real effective exchange rate in 2005-2008, that essentially returned to levels not seen since prior to the 1998 financial crisis, has been attributed to various factors. These included, above all, sharp wage and price increases that caused high inflation in the country relative to its trading partners and the erosion of price competitiveness, giving an almost unchanged nominal exchange rate which has been *de facto* pegged to the US$ since 2000 (IMF, 2008). Taking into account that our simple data analysis is very tentative, a more rigorous empirical approach is required for the assessment of the net effect of remittance inflows on the equilibrium real exchange rate.

3.2. Remittances and growth

Remittances may have a positive impact on growth through their positive effect on investment in physical capital, total factor productivity (via the facilitation of human capital formation), and the financial system of the recipient economy. But they may be counterbalanced by negative effects such as the appreciation of the real exchange rate (Dutch disease), the reduced labour effort of remittance-receiving individuals (moral hazard), and the lost output and earnings missed out on by migrant workers abroad (the opportunity cost of emigration). As our previous analysis shows, remittances in Ukraine fund, above all, current consumption rather than the accumulation of physical capital. But they do not have a Dutch disease effect. Furthermore, remittances fuelling consumption and, therefore, domestic demand may also contribute to economic growth through multiplier and spill-over effects. This is particularly the case if they are spent on locally produced goods and services and if the market linkages between remittance-receiving regions and other areas of the country are relatively strong.

Empirical evidence based on a partial equilibrium model confirms that remittance inflows contributed to pre-crisis GDP growth in Ukraine as well as in other CIS countries (see Chapter 1.2). However, the estimated impact of remittances on average GDP growth in 2001-2006 was less strong in Ukraine than in the smaller CIS economies which are more dependent on remittance inflows from their migrants. Macro-economic stabilization and structural reforms, recovery of output lost in the 1990s, terms of trade gains and investment appear to be far more important factors than remittances (Iradian, 2007).

Given that remittances can affect output through indirect channels which are in most cases difficult to quantify, it would be interesting to look too at the findings of the study based on the computable general equilibrium (CGE) modelling. Atamanov *et al*. (2008) analyse income and distribution effects of migration and remittances in Ukraine and three smaller CIS economies, namely Moldova, Georgia, and the Kyrgyz Republic. Each country study uses a standard computable general equilibrium (CGE) model with traditional neo-classical assumptions, which have been adapted to national circumstances.

In this framework, five simulations have been carried out for Ukraine: the first simulation hypothetically reduces the recent strong growth in total factor productivity (TFP) by 10% (except in small-scale agriculture). The second and third simulations separately describe respectively the impact of a sharp reduction in remittances (by 70%) and an increase in domestic labour supply by 5% (if there is no labour migration). The fourth simulation combines lower remittances and larger labour supply. And the fifth simulation combines three effects: lower TFP, lower remittances and higher labour supply. Simulation results reveal that the pure effects of remittances (second simulation) are quite modest: private consumption declines by 5% from its base value, imports fall by 1.5% and exports increase by 2.9% (all in real terms), resulting in a decrease in real GDP, at market prices, of about 0.2%. The food and light industries, the ICT sector and the public services would have contracted the most (from 1.3% to 3.5%) if remittances were reduced by 70%. While export-oriented industries, such as agriculture, the chemical industry and manufacturing would have grown by 0.5% to 3%.

However, the authors emphasize the results of the fifth simulation which combines all direct and indirect effects of remittances. According to them, the 2004 hypothetical economy would have lost about 7.1% of its potential, private consumption, would have contracted by 18%, and all types of households would have lost from 14 to 21% in overall consumption without migration and remittance-induced effects.

Let's now compare these results to those found in other CIS countries. As one might expect, hypothetical losses in terms of real GDP from reduction of remittances, migration and TFP in Moldova (10.9%), Georgia (13.3%) and the Kyrgyz Republic (13.8%) are much larger than in Ukraine (7.1%).

Notwithstanding the usefulness of the estimated CGE models, they are inadequate when dealing with structural changes and causality as opposed to temporary deviations from equilibrium.[20] Moreover, the comparative-static model simulates the reactions of the economy at only one point in time (2004), and its final results are very sensitive to assumptions about the main input parameters: e.g. it is assumed for Ukraine that reduction of remittances by 70% is associated with an increase of 5% in the labour force and a TFP reduction of 10%; while in Moldova, Georgia and the Kyrgyz Republic the figures stand at 20% each. Finally, the model's complex structure with a large number of variables, input parameters, equations, adjustments and hidden assumptions made by the authors at their discretion is like a "black box" for any researchers who want to replicate results and do their own sensitivity analysis.

3.3. Remittances, investment and financial development

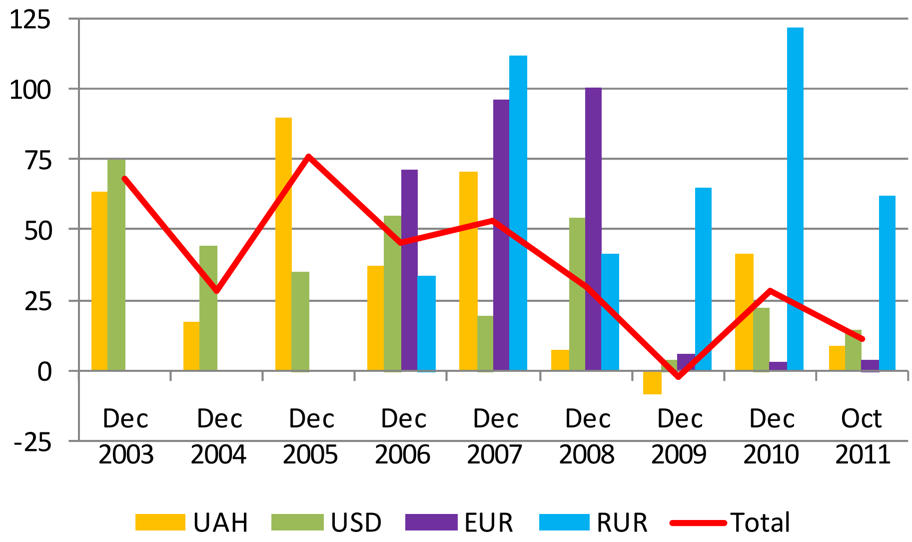
According to official statistics, Ukrainian households and, therefore, the Ukrainian economy annually receive remittances worth over US$ 5 bln. or 4-5% of GDP. However, this additional income is, as we have seen, predominantly spent on current consumption, durable goods and real estate (see Chapter 2.4) and not on investment in business activities. This might be explained by unsatisfied consumption needs, small migrants' earnings and transfers to invest in capital intensive businesses, lack of entrepreneurial ability and professional business skills, not to mention an unfavourable business and investment environment in Ukraine.

[20] The author is grateful to S. Markowski for drawing her attention to the limitations of the CGE models.

Even if households save some part of received income for a "rainy day" or to reach some saving target, the majority of them prefer "to keep cash under mattress" (often in foreign currency) rather than save money in bank accounts or to invest in securities.[21] The major reason for this is generalised mistrust of the banking system and other financial intermediaries. This mistrust dates back to years of volatility in the 1990s and the recent crisis in the Ukrainian banking system induced by the failure of the country's sixth largest bank, Prominvestbank, in October 2008 and by liquidity problems in many other financial institutions. A sharp depreciation of the hryvnia in fall 2008 and lost confidence in the banking system had certain negative effects. There was a mass withdrawal of money from savings accounts (a bank run), especially those denominated in local currency (Figure 10), and further dollarization of household sector liabilities, from 38.8% in December 2007 to 49% in October 2011.

As for the evolution of bank savings accounts held by households against remittance inflows, Figure 10 indicates that significant increases in remittances since 2007 have not resulted in an equivalent increase in amounts of money saved by households in bank accounts. However, a rapid increase in amounts deposited in Euros and Russian roubles, even during the economic crisis, may be a sign of more savings among remittance-recipient households.[22]

Figure 10. Nominal growth rates of savings from households (end-year stock) by currency type, 2003-Oct 2011 (%)



Source: Author's calculations based on the monetary statistics of the NBU on bank savings accounts held by households in the depository corporations except for the NBU.

Note: Growth rates are calculated from amounts of money saved by households in bank accounts at the end of period denominated in millions of hryvnias (UAH).

[21] According to the survey supported by the USAID Capital Markets Project and Financial Sector Development Project conducted by GfK Ukraine in June 2010 (2007 Ukrainians aged 18 and over, from all regions of Ukraine and Kiev City): 42% of the population makes its cash savings in UAH and 11% in foreign currency. Only 7% of Ukrainians currently have savings accounts at banks; and 8% of respondents plan to open such accounts in the near future. In general, only 20% of Ukrainians consider bank deposits attractive, while 37% think investment in real estate is attractive. The attractiveness of securities (shares, corporate bonds and government bonds) is less than 1% (see http://www.finrep.kiev.ua/download/pensionsurvey_press_release_22jul10_en.pdf).

[22] The depreciation of the hryvnia in 2008-2009 was probably the major reason for increasing amounts of money saved in foreign currency-denominated accounts at the end of 2008 and 2009, as all accounts in the NBU statistics are measured in millions of current hryvnias.

In order to better describe the association between remittances and savingsaccounts, we examine here the statistics available from the NBU on household savings by region and currency type at the end of 2008-2010 (Table 8). Our rough estimates for the four macro-regions defined in Chapter 2.4 show that macro-regions, where a larger percentage of surveyed households receive remittances (West and South), tend to have higher household savings in relation to regional GDP and a higher share of foreign currency-denominated accounts in terms of total savings accounts. But they do not, typically, have higher savings *per capita*, mostly due to higher poverty rates and the lower saving rates of resident households compared to those living in more economically developed and richer regions in the Centre, North and East of Ukraine. Furthermore, macro-regions which are more dependent on remittances experienced a larger drop in household savings, particularly those denominated in the local currency between December 2008 and December 2009; and these same households lagged behind in the after-crisis resumption of savings (this particular trend is true only for Western *oblasts*).

Table 8. Selected indicators of bank savings accounts from households by macro-regions*

Indicator	Year	West	South	Centre, North, and Kiev City	East
Share of remittance-recipient households (%)	2007-2008	60	47	45	36
End-year savings account amount *per capita* (UAH)	2008	2,786	3,503	4,255	3,931
	2009	2,595	3,359	4,147	4,044
	2010	3,176	4,619	5,410	5,225
End-year savings account amount as % of regional GDP	2008	23.6	22.3	19.4	15.9
	2009	22.3	20.8	18.9	17.8
Share of foreign currency-denominated savings accounts out of total savings accounts (%)	2008	49.7	52.4	41.0	43.1
	2009	52.4	54.2	42.8	45.5
	2010	46.6	50.1	37.5	41.7
Growth rate in household savings (%)					
Total	Dec 2009 to Dec 2008	-6.6	-4.9	-3.8	1.9
Denominated in UAH		-11.5	-8.9	-7.1	-2.4
Denominated in foreign currency		-1.5	-1.6	0.1	7.3
Total	Dec 2010 to Dec 2009	22.6	36.8	32.0	32.4
Denominated in UAH		37.7	49.4	44.7	43.2
Denominated in foreign currency		9.2	26.2	15.4	20.8

Source: Author's calculations based on monetary statistics of the NBU on bank savings accounts held by households in the depository corporations except for the NBU. Data on regional GDP in 2008-2009 and end-year resident population in 2008-2010 are taken from the State Statistics Service of Ukraine. Share of remittance-recipient households is calculated on the basis of household-level data from the Modular Migration Survey.

Note: *See note to Figure 6 for the definition of macro-regions. Kiev City is included in "Centre and North" because the NBU provides the only joint data for the Kiev *oblast* and Kiev City. All data presented in the table refer to simple averages of regional indicators.

There are no reliable statistics on the exact amount of remittances devoted to savings in bank accounts. But there are signs that remittances are not effectively captured by the banking sector due to its inherent weaknesses and that they are not efficiently employed by the banks to fuel growth through lending support in the SME sector. Nevertheless, there is no denying that remittances have had a considerable impact on financial development in Ukraine, at least through induced financial literacy among remittance-receiving households that has increased households' use of formal bank services for their transfers and other financial transactions and that, therefore, gave a strong impulse to the development of the formal financial system across the country.

3.4. Remittances and employment

Anecdotal evidence from Ukraine suggests that remittances spent on basic needs (food, clothes, home appliances, personal services, etc.) and real estate give a strong impulse to economic activity and employment in such previously underdeveloped sectors as: retail trade, transport, personal services, construction, financial intermediation and insurance, real estate and legal activities, food industry, the manufacturing of furniture and construction materials. They, therefore, facilitate the restructuring of the economy in response to customers' needs. As Table A.5 in the Annex shows, trade and repair, hotels and restaurants, financial intermediation, real estate and municipal and individual services sectors proved engines of employment growth in Ukraine in the 2000s, particularly before the economic crisis in 2008-2009. However, given increased real wages and public transfers and the credit boom in Ukraine during 2002-2008 – a credit boom which depended more on consumption growth than on remittances – it would be erroneous to attribute all the benefits of consumption-driven growth to remittances *per se*.

Given the positive dynamics of aggregate employment that occurs simultaneously with significant population decline – over 3 mln. people during 2000-2010 – in Ukraine, the hypothesis about the moral hazard problem and significant income effect of remittances that caused reduction in labor supply is not generally supported at macro level. Unfortunately, there is no necessary household-level data to test this hypothesis at the micro level by comparing the labor market behavior of individuals who receive remittances from abroad to those who do not. According to the findings of various qualitative studies presented in the mass media and also according to anecdotal cases, remittances do reduce the labour efforts of receiving individuals. But these are then seen in the form of underemployment and less productive employment rather than non-participation in the labour force. Moreover, migration and remittances change the behaviour of many poor households which try harder to send their members abroad rather than allowing them to find decent jobs at home. Likewise, they invest more resources in financing emigration rather than on education and training.

3.5. Remittances and inflation

Expansionary fiscal and incomes policies, high steel prices (which fuelled very strong growth in domestic demand), very rapid money and credit growth pushed the economy beyond its capacity. These factors, together with rising food and energy prices, lifted CPI inflation to over 20 percent in 2008 (IMF, 2008; Kirchner *et al*., 2008). Remittances have not been mentioned by international experts as major determinants of high inflation in Ukraine in the 2000s. However, it is widely accepted that remittances have also played a decisive role in setting off an inflationary spiral through their effect on household consumption, especially in imported goods.

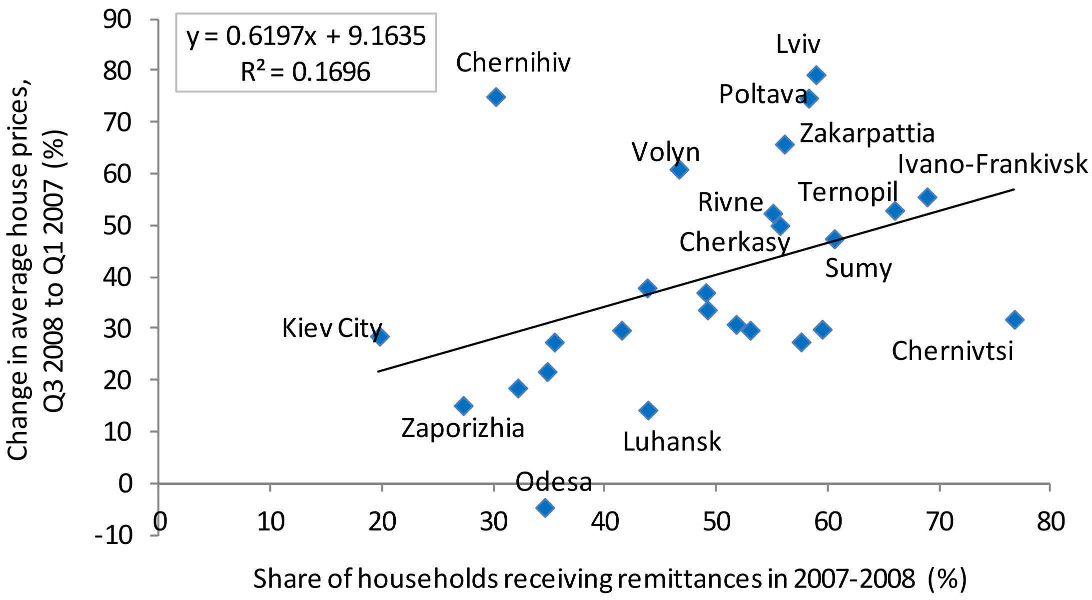
Remittances have often been blamed by experts for their huge impact on the real estate market. But there is no empirical support for this argument due to the lack of reliable data on house prices in Ukraine. According to real estate market specialists, the main drivers of explosive growth in house prices in Ukraine between 2002 and the third quarter of 2008 were: rapid economic growth, a shortage in new housing construction, relaxed mortgage loan rules and property speculation based on interest rate differentials.[23] This argument is also partly supported by the findings of Stepanyan *et al*. (2010). They suggest that real GDP and domestic banks' borrowing from abroad, rather than remittances, are determinants of house prices in the capital city of Ukraine and some other FSU countries: the Baltic countries, Russia, and Kazakhstan.

Here we have employed the available quarterly statistics on average house prices on the secondary market of the main cities in 26 regions. We have correlated these changes in house prices between the

[23] See http://www.globalpropertyguide.com/Europe/Ukraine/Price-History.

first quarter of 2007 and the third quarter of 2008[24] to the share of remittance-receiving households among all households analyzed in the Modular Migration Survey. In doing so we provide some insights into the role played by remittances in the regional growth of house prices before the economic and financial crisis. As Figure 11 shows, house prices have on average grown faster in regions with larger shares of remittance-receiving households. But this effect is very tentative because of poor data quality on the share of receiving households and house prices and needs further investigation in multivariate regressions with better data.

Figure 11. Change in average house prices vs. share of households receiving remittances: evidence from regional statistics in 2007-2008



Source: Author's calculations based on the joint database of the Association of Realtors of Ukraine (change in average house prices) and the Modular Migration Survey of Ukraine (share of remittance-receiving households among all households analyzed in the survey).

Note: Average house prices refers to the average price of one square meter on the secondary market of the main city in the region (in current US$). The share of households receiving remittances is calculated on the basis of the answers of households about transfers (in cash or in kind) from abroad, 2007-2008. The line represents the best linear approximation of the relationship between the two variables, as determined by an OLS regression model.

There are also other concerns mentioned in the Ukrainian literature regarding heavy remittance investment in real estate. First, since remittances often lead to increased transactions in existing houses and land, without any increase in output, this expenditure increases the stock of wealth and the investment of the family. But they do not increase the wealth of the country. Second, the expenditure of remittance-receiving households on the purchase or construction of new housing in depressed areas are often considered "dead capital" as migrants, particularly those who are young and able to work, are not planning to live there after their return. Third, migrants from rural areas tend to buy housing for their children in large cities that encourages the outflow of the young from rural areas (Malynovska, 2011). This, in turn, may damage the human capital endowment and the subsequent development potential of these areas. It also exerts a strain on local governments, public services and infrastructure (including transport, housing, maintenance of law and order, education, health and various welfare provisions) in urban areas.

[24] In the fourth quarter of 2008, house prices denominated in US$ declined sharply due to the crisis-induced credit crunch and depreciation of the local currency.

3.6. Remittances and human capital formation

Another channel through which remittances are likely to have a positive impact on growth and development in Ukraine is *via* the facilitation of human-capital formation. This, of course, assumes that significant productivity spillovers result from the recipients' improved education outcomes (if the acquired skills are not wasted later) and their improved health.

Household surveys on migration issues have showed that expenditure on education (predominantly of children) are the fourth most popular way of spending remittances in Ukraine (see Table 5 above). Moreover, anecdotal evidence and sociological surveys show that the need to finance children's education are among the major motives for labour migration, particularly for women. Unfortunately, these surveys lack the information necessary for a rigorous micro-level analysis of the direct impact of migration and remittances on the education and health outcomes of children left behind, as had been done in Tajikistan and Kyrgyzstan. It is also impossible to analyze the scale and structure of expenditure on education among remittance-recipient households compared to households without private transfers from abroad. Furthermore, it is difficult to empirically measure the effects of remittances on human-capital formation which may occur over a very long period. Given this, we analyze the impact of remittances on human capital formation in Ukraine using secondary information and indirect evidence.

For one, the number of minors living without one or two parents, who work abroad, was estimated by the Ministry of Family, Youth and Sports of Ukraine at about 200,000 in 2008 (IOM, 2010).[25] Empirical evidence in Central Asian countries and Moldova (see Chapter 1.5) suggests that remittances may have a negative impact on the schooling attendance of children left behind. However, this is not typically the case in Ukraine. According to the analysis of attendance rates for upper secondary school-age adolescents (by gender, urban/ rural divide, and wealth quintiles) based on the Demographic and Health Survey conducted in Ukraine in 2007, nearly all adolescents from the examined groups attended school and, for the most part, at a level appropriate for their age, i.e. upper secondary or higher education (UNESCO, 2011, pp. 47-48). The notable exceptions were boys from the poorest households, who were less likely to be in school and to study at the appropriate age level. This analysis and available UNESCO statistics on gross enrolment ratios in primary and secondary education (96.7% in 2010) reveal that Ukraine compares favourably to other countries in the region in this respect. There is certainly no official information that would support the idea that migration and remittances result in lower schooling attendance or school dropouts.[26]

However, the impact of long-term absenteeism on the part of one of the parents, particularly mothers, is found to be negative with respect to school performance, social behaviour and the psychological health of those children left behind.[27] For example, the IOM survey conducted in August 2009 in 24 secondary schools located in the two Western *oblasts* (Ternopil and Chervnisti) found that children left behind are often less motivated to learn. There is, therefore, a fall off in

[25] For example, in Ternopil 25.5% of schoolchildren surveyed in September-October 2005 had one parent working abroad, and 4.8% had both parents abroad. In Chernivtsi *oblast*, the share of schoolchildren with at least one migrant parent increased from 8% in 2004 to 11% in 2008. But there were districts where this share climbed to 28%. Over half of such children lived without one or without both parents for over three years. 47% of them lived with one parent, whereas 43% lived with grandparents, about 4% – with older siblings, 5% – with other relatives, 0.5% – with parents' friends or neighbors, and 0.2% of migrant's children lived alone (Malynovska, 2011).

[26] According to a joint UNICEF-IRC survey of the attitudes of early school leavers in Ukraine conducted in 1999 (UNICEF-IRC, 2000), there are three main categories of school leavers: "teenagers from low-income families solely motivated to earn money, lazy teenagers who do not want to do anything, and children from families with one or two alcoholic parents", but the typical reasons for dropping out of school mentioned by the young persons concerned were problems with studies, teachers, and classmates and low motivation to pursue studies.

[27] According to the survey on migrants' children conducted by La Strada and the Ukraine International Human Rights Women's Centre in 2006, 13% of children left behind could not communicate with their migrant parents for 6-12 months, 7% for 1-2 years, and 5% for over 2 years (IOM, 2010).

learning achievements, a decline in moral values and the dominance of material values due to remittances from migrant parents.[28] This is matched with social behaviour deviations, with aggressiveness and with arrogant attitudes towards other children and teachers and unsociability, distrust, and anxiety disorder issues (IOM, 2010). The positive impact of parents' long-term absenteeism is mainly reflected in increased independence, increased responsibility, and better self-discipline. As regards the attitude of children to money and gifts sent by their migrant mothers, it appears to be rather mixed: though some children like the gifts received, others state that they would much prefer to have their mothers at home.

Other studies on labour migration in Ukraine and its consequences emphasize that parents' migration and remittances often lead to early contact with smoking, drugs, alcohol, gambling and criminality. According to official estimates, families in which at least one adult moved abroad for employment account for 12% of the 180,000 "problem" families registered by the state social services in Ukraine (Malynovska, 2011, p. 17). What is more, remittances are blamed for: their distorting effect on spending decisions; the motivations of children in post-secondary education; labour effort; and career advancement due to the inherent moral hazard problem (IDSS, 2010, pp. 358-360). Therefore, there are the social costs of migration and remittances not only for family members left behind, particularly school-age children, but also for the wider economy and, indeed, for society. And it is not clear yet whether these long-term costs are balanced against the short-term macro-economic benefits of remittances discussed in this chapter.

Meanwhile, the same studies point to fewer social costs and more benefits for remittances with respect to human-capital formation and the development of the education system in Ukraine: at least, if the children left behind are not very young (15 years and over) and if their migrant parents invest in higher education. In particular, it is often argued that remittances induce a rapid growth in demand for higher education that facilitates the development of higher education in Ukraine in terms of the number of institutions and students, particularly in regions with high emigration (Malynovska, 2011, p. 12).

However, regional statistics on higher education institutions in Ukraine supports these arguments only partially. Yes, macro-regions where a larger percentage of households receive remittances (West and South) tend to have higher shares of private institutions and students paying for their studies from private household funds compared to other macro-regions (if we leave aside the capital city, Kiev). But these trends are not very strong for higher education institutions of the third and fourth accreditation levels (Table 9). Furthermore, these macro-regions have witnessed, on average, larger growth rates in student numbers in higher education institutions *per* 10,000 citizens at the end of the 1990s,[29] but this was not true of the 2000s. This implies that remittances play an important role in spurring demand for higher education. But it seems that other factors were the driving forces in increasing enrolment rates in higher education in Ukraine before the economic crisis in 2008: namely the increasing economic and social benefits of higher education combined with growing household income and increasing public expenditures on education (ETF, 2009). Similarly, many other factors in addition to an increase in remittance inflows can explain the growing number of young Ukrainians going abroad to study.[30]

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[28] Having significant financial support from their migrant parents, children tend to believe that "money can buy everything" (IOM, 2010).

[29] For example, the number of students *per* 10,000 citizens increased between 2001/2000 and 1995/1996 by 59.2% in Ternopil *oblast*, and by 63.5% in Ivano-Frankivsk *oblast*.

[30] According to the UNESCO Global Education Digests (2006 and 2010, 2011), the number of mobile students at the tertiary level from Ukraine – those who study in foreign countries where they are not permanent residents – increased from 25,188 persons in 2004 to 27,214 persons in 2008 and then to 32,882 persons in 2009. The top five destinations for such students are the Russian Federation (12,101 in 2009 vs. 6,841 in 2004), Germany (6,437 in 2009 vs. 7,618 in 2004), Poland (3,210 in 2009 vs. 1,809 in 2004), the US (1,688 in 2009 vs. 2,004 in 2004), and France (1,334 in 2009, not in the list of the top five in 2004).

Table 9. Selected indicators of higher education institutions (HEI) by macro-regions*

Indicator		Academic year	West	South	Centre and North	East	Kyiv City
Number of HEI (I-IV levels of accreditation)	Total number	1995/1996	203	149	221	371	93
		2009/2010	181	119	168	280	113
Students of HEI (I-IV levels of accreditation) per 10,000 population	Average number	1995/1996	237	256	206	343	793
		2009/2010	427	426	354	593	2121
	Average growth rate (%)	2001/2000 to 1995/1996	36.1	41.7	33.4	24.5	47.2
		2005/2006 to 2000/2001	33.9	24.9	39.3	45.3	81.6
		2009/2010 to 2005/2006	-0.6	-4.0	-6.8	-3.0	0.1
HEI (I-II accreditation levels)	Share of private institutions	2007/2008	19.2	17.8	13.8	9.2	38.0
		2010/2011	18.5	17.9	12.9	10.2	44.7
	Share of students with private financing	2007/2008	49.0	49.7	46.3	43.9	52.3
		2010/2011	44.7	42.4	39.4	36.9	55.4
HEI (III-IV accreditation levels)	Share of private institutions	2007/2008	39.1	24.2	22.3	26.0	44.1
		2010/2011	36.2	23.6	20.7	25.5	40.6
	Share of students with private financing	2007/2008	63.6	63.3	63.9	65.3	67.8
		2010/2011	60.0	59.6	57.6	61.2	63.5

Source: Author's calculations based on education statistics of the State Statistics Service of Ukraine.

Note: *See note to Figure 6 for definition of macro-regions. All data presented in the table refer to simple averages of regional indicators, as the beginning of the academic year (i.e. September). TEI of the first and second accreditation levels include technical schools and colleges which provide higher education with a degree of junior specialist and/or bachelor (ISCED 5B), whereas TEI of the third and fourth accreditation levels include universities, institutes, academies and conservatories, which provide higher education with a bachelor, specialist and/or master degree (ISCED 5A).

The significant increase in the number of young people with higher education, partly due to remittances, is a generally positive trend contributing to skill development and human capital formation in the country. However, it also brings challenges that have still not been fully addressed in Ukraine. The most obvious of these problems are the sheer quantity of new graduates compared to the number of highly-skilled jobs being created in the economy, the heavy bias of students toward well-liked professions in economics, social sciences, business, law, education and the services, and the low quality of higher education due to widespread corruption and obsolete curricula (ETF, 2009). This adversely affects youth employability, but also contributes to a substantial skills mismatch in the Ukrainian economy, with labour shortages for blue-collar skilled workers (e.g. welders, electricians, turners, mechanics, painters, salespersons) and technical professionals (such as engineers, technologists, IT specialists) and a massive oversupply of others, in particular economists, accountants, financial specialists, managers, and lawyers.

Many students coming from remittance-recipient households have invested a great deal of their households' resources in higher education. Higher education comes with the promise of upward mobility and a better life compared to parents who were/are working hard abroad to pay for their children's education. However, the shortage of well-paid decent jobs in the local job market forces other outcomes. Many young people take jobs for which they are overqualified, often in the informal economy, withdraw from the labour market[31] or look for any jobs abroad.[32] This, in turn, can have a

[31] The percentage of young people aged 20-24 years who are neither in employment nor in education and training (NEET) increased from 22.6% in 2008 to 28.8% in 2009 (Kupets, 2011).

long-lasting adverse effect on human-capital formation in Ukraine as it reduces the present stock of human capital through brain waste. It also negatively affects the future accumulation of human capital by reducing private incentives to invest in education.

3.7. Remittances, poverty, inequality and social implications

It is well recognized in Ukraine that remittances, as a perfectly targeted income source at the household level, contribute to family wealth and higher living standards. They thus provide financing for essential human needs and housing. They improve the access of household members to education, health care and other public goods.[33] And they alleviate liquidity constraints. What is more, temporary labour migration and income earned abroad help risk-averse households to diversify their sources of income to achieve desirable income flows over a year and to mitigate risks specific to particular income streams. Such risks might include crop failure in the case of agricultural production on a narrow product base or the business failure of the family enterprise due to unexpected changes in small business taxation.

At a macro level, remittances play an important role in reducing the incidence and severity of poverty in Ukraine. In particular, remittances as private transfers from abroad have been mentioned as one of the mechanisms that have contributed to the considerable reduction of absolute poverty in Ukraine since 2001. And migration has been interpreted in terms of household risk management behaviour since it provides alternative sources of income during periods of uncertainty (World Bank, 2005). However, the recent World Bank's report on poverty in Ukraine (World Bank, 2007a) points to real wage growth and an increase in public transfers (in particular, pension, childbirth assistance, housing subsidies, social assistance to poor families, etc.) instead of remittances as the main drivers of declining poverty since 2005.

Here we should quote a recent study of poverty, inequality and remittances in Ukraine based on the Household Budget Survey data and some indirect estimates,[34] Libanova (2011). This study found that private transfers played a role in the reduction of the share of households living below the national poverty line in Ukraine: statutory subsistence minimum which increases in nominal terms over the course of a year.[35] However, as Table 10 shows, poverty decreased 2002-2008, not because of remittances so much as because of economic growth and increasing public transfers. Therefore, though private transfers, including remittance-related transfers, have been instrumental in reducing poverty they cannot replace the welfare state. Interestingly, poverty rates in Ternopil *oblast* declined much more slowly than in other regions: Ternopil is one of the least economically developed *oblasts* in Ukraine with high unemployment, low wages, high poverty and high labour emigration. This suggests that poverty was much more responsive to growth in more industrially developed regions than it was in the poor agricultural areas of the country.

(Contd.)

[32] According to the sample survey of young persons aged 15-34 years conducted in 2010 (IDSS, 2010), 45.4% of respondents reported their intention to find temporary employment abroad if possible. Strikingly, 26% of respondents would take any job abroad regardless of their field of study and acquired profession.

[33] According to the World Bank's report (2007b) the problems in public health and education in Ukraine, the increasing incidence of informal out-of-pocket payments in health and education generate significant barriers in access to these services, particularly for the poor, and this occurs despite the constitutional guarantee of free basic health care and basic education in public facilities.

[34] Indirect estimates are used to distinguish between private transfers from abroad and private transfers within Ukraine that cannot be directly retrieved from the Household Budget Survey data. So, the results of this analysis should be interpreted with caution. "Remittances" are used here as a synonym of "private (family) transfers".

[35] For example, subsistence minimum increased from UAH 894 in the first quarter of 2011 to UAH 911 in the second and third quarters, to UAH 934 in October-November 2011, and to UAH 953 in December 2011.

Table 10. Impact of private transfers on absolute poverty in Ukraine (% of households living below the national poverty line), 2000-2010

		2000	2002	2004	2006	2008	2010
Ukraine	Without transfers	72.0	74.9	54.4	36.9	15.5	21.5
	With transfers	70.6	72.5	50.2	32.9	12.6	16.9
Regions with high outflow of migrants	Without transfers	75.6	80.8	60.7	39.1	17.9	23.8
	With transfers	73.8	78.1	55.9	34.3	14.7	18.8
Ternopil *oblast*	Without transfers	70.9	83.7	60.3	45.8	31.7	36.6
	With transfers	68.7	77.3	54.9	39.0	26.9	31.4
Regions with high inflow of migrants	Without transfers	59.9	62.5	41.4	25.3	7.2	13.0
	With transfers	57.4	59.5	38.8	20.8	4.8	10.5
Crimean Autonomous Republic	Without transfers	77.5	85.5	67.3	43.3	13.5	23.1
	With transfers	75.1	82.5	63.3	36.4	9.0	19.5

Source: Libanova (2011).

It has also been found that private transfers sharpen income inequality in Ukraine, being the fourth important determinant after wages, pensions and entrepreneurial income (Libanova, 2011). According to rough estimates, remittance-receiving households in the lowest income quartile of households stood at 59.9%, compared to 65.3% in the top quartile (Table 11). Private transfers accounted for 4.5% of household income in the lowest quartile, and 6% in the top one. These findings are in line with empirical evidence found in many other countries in the CIS region (see Chapter 1.6) in that remittance-related transfers benefit better-off households more than poorer ones. After all, better-off households are more likely to be able to send household member(s) abroad and to receive larger remitted incomes because of higher educational attainment and better access to information about jobs and living conditions in other countries. Besides, remittances themselves have an impact on household income and, therefore, can change a household's relative position in the distribution of income.

Table 11. Selected indicators for households receiving private transfers by income quartiles, 2010

Indicator	Region	Income quartiles				Average
		I	II	III	IV	
Share of recipient households among all households, %	**Ukraine**	**59.9**	**63.1**	**63.5**	**65.3**	**63.2**
	Regions with high outflow of migrants	61.6	67.4	69.7	70.4	67.5
	Ternopil *oblast*	50.7	55.6	63.9	78.9	60.6
	Regions with high inflow of migrants	57.6	57.3	58.6	60.3	59.0
	Crimean Autonomous Republic	66.6	60.6	59.8	43.6	57.3
Share of received transfers in money household income, %	**Ukraine**	**4.4**	**4.3**	**4.8**	**6.0**	**5.1**
	Regions with high outflow of migrants	5.0	5.1	5.6	9.1	6.5
	Ternopil *oblast*	7.4	5.6	7.3	16.4	9.6
	Regions with high inflow of migrants	4.9	3.5	4.3	5.0	4.7
	Crimean Autonomous Republic	6.2	4.3	3.4	3.7	4.1

Source: Libanova (2011).

For households with private transfers, the inclusion of these transfers causes the Gini coefficient to rise from 27.3% to 29.3% for Ukraine as a whole, and from 25.5% to 26.8% in backward regions with high outflow of migrants (Table 12). At the same time, the inclusion of private transfers do not significantly alter high Gini coefficients established in more developed regions with more employment opportunities and with relatively high incomes: these regions attract workers from other regions of Ukraine and other countries. The uneven spatial distribution of “winners” and “losers” in terms of the transformation process in Ukraine and subsequent economic growth may be attributed to lasting differences between the territories in terms of: their factor endowment and productivity, the concentration of economic activity shaped by various agglomeration forces, the quality of local infrastructure, the policy environment, and regional incentives and subsidies. This, in turn, gives rise to differences in returns on education, skills, business investment and the access of households to asset transfers, through privatization of enterprises, housing and land. These differences are further reflected in the unequal distribution of household wealth and income, both between and within regions.

Table 12. Gini coefficient for household income with and without private transfers, 2009

	Gini coefficient (%)	
	With private transfers	**Without private transfers**
Ukraine	**29.3**	**27.3**
Regions with high outflow of migrants	26.8	25.5
Regions with high inflow of migrants	34.9	34.4
Other regions	28.9	26.2

Source: Libanova (2011).

By increasing wealth and income inequality, remittances not only strengthen economic asymmetry but also exacerbate local social stratification, creating a new division of households in (mostly rural) communities based on remittance-receiving status. This development may have a particularly damaging effect on the children of migrants as they tend to be rejected socially by their peers due to relative affluence (expensive cell phones, computers, watches, clothes, shoes, etc.) combined with aggressive and disruptive behaviour. And a lack of peer relationships among children affects not only the quality of their current lives, but also their future social and professional attainment.

Migration and remittances have positive effects on family wealth and consumption, but their social costs for the relevant families (called ‘transnational’ in the literature) may outweigh, by far, its economic benefits (Tolstokorova, 2009). In particular, the long-term absence of family member(s) because of labour migration compensated by the regular transfers of money and gifts from abroad fosters consumerism among those who stay behind, erodes emotional ties, redistributes gender roles, changes important family functions (including reproduction, the socialization of children, financial management, division of home labour), and increases the risk of divorce. However, our rough estimates based on the Modular Migration Survey data do not support the argument for the negative impact of migration on the relations of migrants with their family members as 73.9% of respondents (in a weighted sample of return migrants) reported no changes in relations with family members.[36] Besides, it is necessary to remember that, yes, migration seems to adversely affect family relations in certain cases. But we must also recall that it is not obvious how these relations would have changed in the absence of targeted remittance inflows that cushion poor families against everyday home problems. The issue of whether the impact of remittances on the receiving family depends on their scale and regularity needs further investigation.

[36] The share of migrants where relations with spouses were affected is 10.3%. The shares of respondents reporting deteriorating relations with children and with other relatives are almost equal (about 4%). The rest did not give a definite answer.

Chapter IV: Policy Implications

4.1. Remittances, public moral hazard, and policy trap in Ukraine

Ukraine is less dependent on remittance inflows than smaller CIS countries such as Moldova and Tajikistan, and, therefore, internal factors – e.g. extra income from economic activities in the shadow economy and generous social benefits that are poorly targeted – are likely to be more important than remittances in reducing the households' incentives to hold the government accountable. Nevertheless, remittances, by acting as a financial buffer for migrants and their families, and thus offering social protection and welfare, also contribute to a public moral hazard problem as observed in other CIS countries. Fairly large remittance inflows in Ukraine provide government with an extra degree of fiscal and monetary freedom which is largely misused, with huge spending on non-productive consumption. This spending includes the maintenance of a large inefficient public sector, transfers to the loss-making Pension Fund and Naftogaz company, and indirect subsidies to selected industries and privileged private companies and on grandiose sport and social objects for Euro-2012, many of which are likely to become "white elephants". Besides, remittances that allow households to "purchase" the public good rather than rely solely on the government to provide that good, seem to facilitate further development of the informalised welfare model in Ukraine.

The government has failed to put in place the policies and institutions needed to allow product and factor markets to operate effectively, due largely to state capture by vested interests and widespread rent-seeking behaviour. As a result, structural constraints and policies have trapped the Ukrainian economy in a partial reform equilibrium (Dubrovskiy *et al*. 2007; Havrylyshyn, 2005). Under such conditions, remittance inflows along with growing household income from internal sources such as wages, entrepreneurial income and social transfers fuel domestic demand. Domestic demand contributes to short-term economic growth, but also to high inflation as happened before the 2008 economic crisis. In the meantime, due to weaknesses in the domestic banking sector and limited investment opportunities for most Ukrainians remittances are not extensively used to finance highly-productive industries and activities. Widespread corruption in public administration at the local and national levels, weak rule of law and a poor investment climate also contribute to the slow emergence of new private activities that must coexist with an over-large and dysfunctional government.

This, in turn, limits business expansion and export diversification. But it also increases macro-economic volatility and the dependence of the domestic economy on imports. Lack of decent jobs, particularly in less economically developed and less attractive for investment regions, poor quality of public goods and services and limited opportunities for influencing the formal institutions in the right direction through the "voice" option lead to disillusionment. Certainly, these factors encourage many Ukrainians to behave more opportunistically and to choose the "exit" options: participating extensively in the underground economy;[37] removing themselves from the labour force (particularly with regular income source such as remittances); or migrating to other countries. Remittances and income from shadow activities lift most households up to an acceptable standard of living and partly compensate for the government's failure to provide public goods and services. They reduce a household's incentives to hold the government accountable and to call for political and economic reforms.[38] This completes a policy trap presented schematically below (Figure 12).

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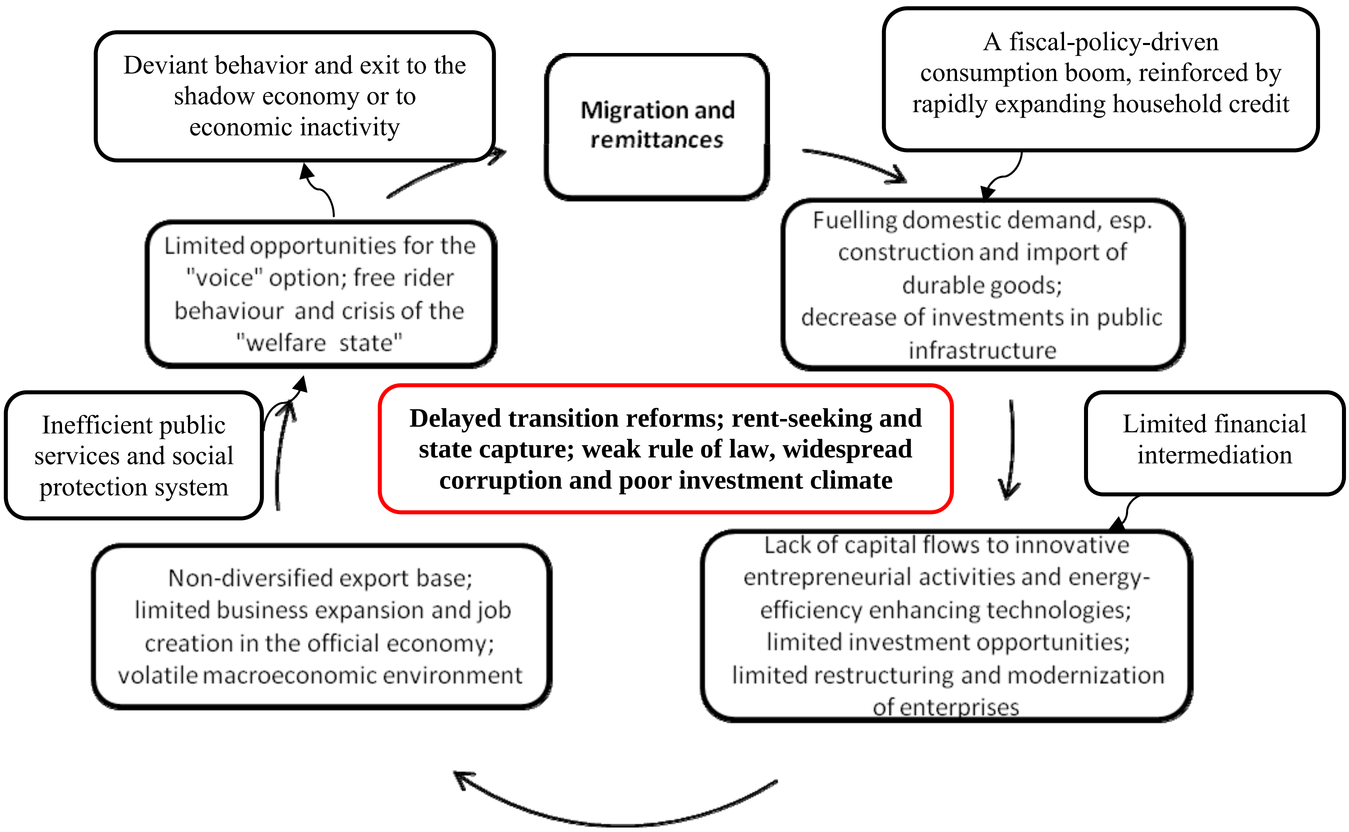
[37] According to Schneider *et al*. (2010), Ukraine is, in terms of the size of the underground (shadow) economy, in the top ten in the world and in the top three in the sample of transition economies. The shadow economy increased from 51.7% of official GDP in 1999 to 58.1% in 2007.

[38] The regional composition of labour migrants in Ukraine and the inherent differences in their choice of destination countries, with the bulk going from pro-European regions located in the western and central part of Ukraine to Europe and from pro-Russian regions in the east and south-east of the country to Russia, means that labour migrants have limited influence. They are quite unlikely to significantly change the attitudes and voting behavior of their household members and other people in their home regions by remitting political changes from abroad. In the meantime, the effectiveness of

Figure 12. Migration, remittances and policy trap in Ukraine



Source: Author's compilation, based on ideas of Moldova's migration-led-growth "policy trap" presented in World Bank (2011).

The resulting vicious cycle, dominated by state capture and disincentives for strategic private investment and employment generation, goes a long way to explaining why remittances in Ukraine have had a limited impact on key aspects of development, including investment, human capital formation, macro-economic stability, spatial inequality reduction, and political change.

4.2. Policy recommendations

The main challenge for policymakers is, first of all, to break up this policy trap and then to design policies which promote remittances and that harness their potential, while limiting or preventing any counterproductive side effects. The predominance of consumption in the end-uses of remittance inflows indicate that they are compensatory transfers as they compensate family members for bad economic conditions. Hence, they compensate Ukraine's economy for its poor performance. We are not talking here of GDP *per capita* growth but, rather, a wide array of indicators important for individuals including inflation, job creation, life quality, access to adequate shelter, public investment in infrastructure, education, and health, government effectiveness, hopefulness, environmental quality, etc. And it is reasonable to expect that an economic and social environment that encourages labour emigration also limits the development impact of remittances. Therefore, to maximise the positive effects of remittances the Ukrainian authorities should concentrate on sound macro-economic

(Contd.)

the old Ukrainian diaspora in defending Western values such as individual rights, property rights, independently functioning democratic institutions and the rule of law in Ukraine and in helping Ukrainians to transform their society from within seems to be marginal. This is perhaps particularly true after V. Yanukovych's victory in the presidential elections in 2010: see http://ukrweekly.com/archive/pdf3/2010/The_Ukrainian_Weekly _2010-30.pdf.

management, institutional reform and economic development strategies involving the whole economy; strategies that can mobilize all resources in the service of development. Otherwise, Ukraine will continue to be burdened by: volatile macro-economic fundamentals; a narrow manufacturing and export base; widespread corruption; weak market-supporting institutions; poor infrastructure; limited employment and growth in the official economy; low life quality; and high emigration and high remittances (unless emigrants acquire permanent resident status in the host country) which remain confined within closely targeted groups.

Effective policy-making needs to be based on sound evidence. Therefore, it is recommended that:

- the data on remittances be improved, making them available to researchers, investors and other interested parties. Understanding the actual scale of remittances is essential for making optimal policy decisions;
- short-term desk studies be superseded and greater investment is made in longitudinal and in-depth research on various aspects of remittances, in particular:
    - their economic implications in regard to long-run economic growth, labour-market performance, spatial inequality, the tax liability of temporary migrants and their access to public-good provisions;
    - the opportunity cost of emigration and remittances, i.e. the possible earnings forgone by the migrant in Ukraine and the output loss to the economy as a whole and to the most affected and/or socially important sectors including education, science, health care, sports and culture;
    - the long-term social implications of remittances with respect to migrant workers, their families and local communities;
    - the net benefits of remittances for the Ukrainian economy taking into account the costs of migration-induced HIV/ AIDS and other social diseases brought to Ukraine from other countries as well as the general physical health deterioration of return migrants.

Based on collected data, the following policy options should be considered:

- the encouragement of remittance flows through formal channels by:
    - further reducing transactions costs;
    - easing the obstacles that keep migrants from transferring money through bank accounts or international money transfer operators, e.g. issuing temporary identity cards for illegal migrants, promoting financial literacy of both senders and receivers;
    - reforming the banking sector both in the host country and in Ukraine with the primary goal being restored confidence and banking habits among customers;
    - providing financial incentives, e.g. offering preferential exchange and interest rates.

Under certain conditions, these measures may help channel remittances in the formal banking system, ease banks' liquidity constraints and lessen the credit crunch impact for businesses. An increase in the proportion of remittances sent through formal channels will also improve official remittance statistics;

- incentives for the productive investment of remittances and other income are introduced, for example:
    - leaving the existing system of simplified taxation for sole entrepreneurs without considerable changes, providing special business training courses, and offering preferential access to cheap premises, capital goods and raw materials for return migrants and household members to encourage them in setting up businesses in backward areas;

    - designing reliable mechanisms and instruments which allow remittance-receiving households and return migrants to invest in the capital market without undue exposure to high risk;
- engagement in active policy debates on reducing legal barriers to labour mobility between Ukraine and the EU countries is strengthened with coordinating efforts in effective migration management, including such important issues as undocumented (illegal) migration, cross-border human trafficking, the mutual recognition of professional qualifications, skills matching between migrant workers and jobs abroad, and the portability of pensions, health, and other social benefits.

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ANNEX

Table A.1 Potential benefits and costs of remittances for developing countries

Potential Benefits	**Potential Costs**
Micro-level (households)	
R. improve households' welfare, financing essential human needs, and, like social insurance, help smooth household consumption by responding positively to adverse shocks: e.g. flood, crop failure, job loss, etc.	R. may encourage conspicuous consumption, with excessive expenditure on expensive goods and home appliances, and may sharpen social stratification, particularly among the young.
R. may boost investment in education and health thus contributing to human capital formation and promoting the social basis for economic development.	R. may create disincentives to school attendance and good performance in school among the children left behind, especially if the mother has migrated. Such children may also be less well socially adjusted.
R. may ease liquidity constraints and raise household investment in entrepreneurial activities thus encouraging entrepreneurship and rural development (through the promotion of new small-scale enterprises in the non-farm sector).	R. may enable remaining household members to reduce their labour effort ("moral hazard" problem at micro-level) that may adversely affect the aggregate labour supply, growth and development at macro-level.
R. coupled with increased technology transfers from migrants abroad may also boost investment in innovative production activities.	R. may also create incentives for other households to spend more efforts and resources on financing the future emigration of their household member(s) rather than on human-capital formation or entrepreneurial activity at home.
R. facilitate the economic independence and empowerment of women at both ends of a remittance transaction.	R. may have social externalities such as family disintegration and changing youth behaviours (an increase in drug and alcohol use, criminal activities and risky sexual behaviour) with negative development outcomes.
R. may bring more openness and increased social mobility allowing household members more flexibility in their social roles.	R. may have the effect of weakening social obligations and social cohesiveness.
R. may strengthen democratic values and infuse new and progressive ideas through the closer interaction of remittance-receiving households with the transnational diasporas or returning migrants.	R. may facilitate the decline of traditional cultural practices though the infusion of alien practices and values from abroad.

Table A.1 Potential benefits and costs of remittances for developing countries (cont.)

Macro-level (economy and society)	
Remittances-induced domestic demand contributes to economic growth and development with multiplier effects and it facilitates the restructuring of the economy and employment.	Remittance-fuelled expenditures may lead to increased prices in the sectors with higher investment among receiving households and therefore induce overall inflation.
As a relatively stable source of foreign exchange R. contribute to the balance of payments and play an important role in maintaining the macro-economic stability of recipient countries which suffered a downturn in activity or macro-economic shocks.	R. may cause an appreciation of the real exchange rate and therefore may undermine a country's price competitiveness: the so-called "Dutch disease" which most often refers to the damaging effect of the exploitation and export of natural resources on an economy and takes its name from the crisis in the Netherlands in the 1960s.
	Remittances-driven conspicuous consumption of foreign goods may cause a psychological downgrading of domestic goods and a further increase in imports.
R. tend to improve the sustainability of government debt (debt-to-GDP ratio) and to enhance the ability of debt to act as a shock absorber: if the presence of workers' remittances in an economy makes government revenue and the time path of real GDP more stable.	Increased dependence of the domestic economy on remittances may adversely impact its overall shock-resistance contributing to the "import" of the financial and economic crisis from abroad and increased domestic business cycle volatility.
In countries with an underdeveloped domestic financial system R. help alleviate credit constraints and meet the capital needs of the private sector (mostly SMEs).	Substituting bank loans provided through the formal financial system, R. may create an informal financial market and facilitate the expansion of the shadow economy.
R. may also give a strong impulse to the development of the formal financial system of the home country and its integration with the international financial system.	In extreme cases R. may support social movements and political groups that encourage or engage in conflicts.
R. may improve the country's creditworthiness for external borrowing and expand its access to relatively cheap and long-term financing from the international capital markets *via* innovative financing tools such as Diaspora bonds and remittance-backed bonds (i.e. securitization of remittance flows).	R. may reduce the government's incentive to maintain fiscal policy discipline providing it with the fiscal space and allowing it to consume and borrow more. Thus R. may increase the exposure of the domestic economy to external shocks.
R. may be an effective means to redistribute income and thus reduce income inequality and poverty.	R. may sharpen income inequality in the case of the underrepresentation of the poor among migrants.
R. may positively affect the politics of the home countries and democratic development if migrants and their households push for political and economic reforms.	R. may pose a "public moral hazard" problem by reducing the political will to respond to the burning challenges in economic and political spheres and reducing too the will to implement necessary reforms.

Source: Author's compilation based on Agunias (2006), Chami *et al*. (2008), Ghosh (2006), OECD (2006), Rapoport and Docquer (2006), World Bank (2006) and own ideas.

Table A.2 Remittances, income inequality measures in the CIS countries, 2001-2010

Country	Indicator Name	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Armenia	GINI index	36.2	35.7	33.8	–	–	–	–	30.9	–	–
	Income share top 20%	44.2	44.0	42.8	–	–	–	–	39.8	–	–
	Income share bottom 20%	7.6	7.9	8.6	–	–	–	–	8.8	–	–
	Poverty headcount ratio (%)	48.3	–	–	–	–	–	–	23.5	26.5	–
	Remittances (% of GDP)	4.5	5.5	6.0	12.1	10.2	10.3	9.2	9.1	9.0	10.7
Azerbaijan	GINI index	36.5	–	–	–	16.8	–	–	33.7	–	–
	Income share top 20%	44.4	–	–	–	30.3	–	–	42.1	–	–
	Income share bottom 20%	7.5	–	–	–	13.3	–	–	8.0	–	–
	Poverty headcount ratio (%)	49.6	–	–	–	–	–	–	15.8	–	–
	Remittances (% of GDP)	1.8	2.9	2.3	2.6	5.2	3.9	3.9	3.4	3.0	2.8
Belarus	GINI index	30.7	29.7	–	26.2	27.9	–	–	27.2	–	–
	Income share top 20%	39.1	38.2	–	35.8	36.9	–	–	36.4	–	–
	Income share bottom 20%	8.2	8.5	–	9.4	8.8	–	–	9.2	–	–
	Poverty headcount ratio (%)	28.9	30.5	27.1	17.8	12.7	11.1	7.7	6.1	5.4	–
	Remittances (% of GDP)	1.2	1.0	1.2	1.1	0.8	0.9	0.8	0.7	0.7	0.7
Georgia	GINI index	36.9	40.3	40.4	–	40.8	–	–	41.3	–	–
	Income share top 20%	43.6	46.4	46.4	–	46.6	–	–	47.2	–	–
	Income share bottom 20%	6.4	5.6	5.5	–	5.4	–	–	5.3	–	–
	Poverty headcount ratio (%)	–	–	–	–	–	–	23.6	–	–	–
	Remittances (% of GDP)	5.6	6.8	5.9	5.9	5.4	6.3	6.8	5.7	6.6	6.9
Kyrgyz Republic	GINI index	–	31.7	–	32.9	–	–	33.4	–	–	–
	Income share top 20%	–	40.3	–	41.4	–	–	42.8	–	–	–
	Income share bottom 20%	–	8.4	–	8.1	–	–	8.8	–	–	–
	Poverty headcount ratio (%)	–	–	49.9		43.1	–	–	–	–	–
	Remittances (% of GDP)	0.7	2.3	4.1	8.5	13.1	17.0	18.8	24.0	21.1	27.6
Moldova	GINI index	36.2	36.9	–	35.6	–	–	–	38.0	–	–
	Income share top 20%	43.7	44.1	–	43.3	–	–	–	45.3	–	–
	Income share bottom 20%	7.1	6.8	–	7.3	–	–	–	6.8	–	–
	Poverty headcount ratio (%)	54.6	40.4	29.0	26.5	29.0	–	–	–	–	–
	Remittances (% of GDP)	16.4	19.5	24.6	27.1	30.8	34.7	34.0	31.3	22.3	23.6
Tajikistan	GINI index	–	–	32.6	33.6	–	–	–	–	–	–
	Income share top 20%	–	–	40.9	41.7	–	–	–	–	–	–
	Income share bottom 20%	–	–	7.9	7.8	–	–	–	–	–	–
	Poverty headcount ratio (%)	–	–	72.4	–	–	–	53.1	–	47.2	–
	Remittances (% of GDP)	–	6.4	9.4	12.1	20.2	36.0	45.5	49.3	35.1	40.0
Ukraine	GINI index	–	28.3	–	–	28.2	–	–	27.5	–	–
	Income share top 20%	–	37.4	–	–	37.4	–	–	37.1	–	–
	Income share bottom 20%	–	8.9	–	–	9.0	–	–	9.4	–	–
	Poverty headcount ratio (%)	–	–	18.8	14.0	7.9	–	–	–	–	–
	Remittances (% of GDP)	0.4	0.5	0.7	0.6	0.7	0.8	3.2	3.2	4.3	4.1

Source: World Development Indicators.

Notes: Income share top (bottom) 20% refers to the income share held by highest (lowest) 20% of population. Poverty head-count ratio refers to the percentage of the population living below the national poverty line (based on World Bank's country poverty assessments and country Poverty Reduction Strategies). Remittances (% of GDP) are the sum of workers' remittances, compensation of employees, and migrants' transfers, received by the country and divided by the World Bank GDP estimates.

Table A.3 Personal remittance inflows to Ukraine by the main countries

Countries	Amount (mln. US$)					Share of total, %	Year-on-year change, %		
	2008	2009	2010	Jan-Sep 2010	Jan-Sep 2011	Jan-Sep 2011	2009	2010	Jan-Sep 2011
TOTAL	**5,372**	**4,657**	**5,085**	**3,671**	**4,447**	**100**	**-13.3**	**9.2**	**21.1**
CIS	**1,873.5**	**1,297.6**	**1,668.2**	**1,174.4**	**1,477.1**	**33.2**	**-30.7**	**28.6**	**25.8**
Russia	1,833.2	1,254.8	1,619.1	1,138.9	1,429	32.1	-31.6	29.0	29.5
Kazakhstan	40.3	42.8	49.1	35.5	48.1	1.1	6.2	14.7	35.9
EU	**2,155**	**1,909.6**	**2,032.9**	**1,474.9**	**1,696.7**	**38.2**	**-11.4**	**6.5**	**15.0**
Germany	316.5	336.3	381.7	279.2	308.3	6.9	6.3	13.5	10.5
Greece	248.2	269	303.3	220.6	251.5	5.7	8.4	12.7	14.9
Cyprus	218.7	208.6	242.1	174.1	249.4	5.6	-4.6	16.1	47.0
Italy	340.1	274.2	281.9	204.4	248.9	5.6	-19.4	2.8	24.8
UK	332.9	259.1	254.1	187.1	187.1	4.2	-22.2	-1.9	1.9
Spain	214.9	152.7	146.5	109.1	105.6	2.4	-28.9	-4.0	-2.5
Netherlands	69.3	64.1	75.3	53.7	67.4	1.5	-7.5	17.5	25.8
Portugal	108	84.4	76.6	56.1	59.6	1.3	-21.9	-9.3	7.8
Latvia	81.7	61	64.7	45.9	45.9	1.0	-25.3	6.0	8.6
France	41.6	34	47.2	32.7	43.7	1.0	-18.3	38.8	43.5
Belgium	43.3	41	40.2	28.8	33.7	0.8	-5.3	-1.8	22.8
Poland	34	25.6	26.1	19.4	25.7	0.6	-24.7	2.0	42.7
Czech Republic	30.2	28	27.5	19	25.5	0.6	-7.3	-1.8	70.5
Denmark	35	36.8	35.1	26.8	22.6	0.5	5.1	-4.6	-13.5
Austria	40.6	34.8	30.6	18	21.8	0.5	-14.3	-12.0	-17.3
Rest of the world	**1,222.1**	**1,190.1**	**1,295.6**	**951.9**	**1,031.5**	**23.2**	**-2.6**	**8.9**	**8.4**
US	620.1	545.2	577.9	422.2	460.1	10.3	-12.1	6.0	10.4
Switzerland	149.7	138.9	162.3	121.9	99.1	2.2	-7.2	16.9	-21.0
UAE	68.9	83.8	95.1	69.1	82	1.8	21.6	13.5	22.7
Canada	88.2	109	107.3	81.6	81.7	1.8	23.6	-1.5	-6.9
Israel	72.3	61.5	68.1	49.3	56.3	1.3	-14.9	10.8	15.4
Turkey	52.3	48.6	52.4	38.1	47.4	1.1	-7.1	7.9	25.9
Singapore	34	41.9	48.4	34.8	43.3	1.0	23.2	15.6	24.1
China	35.8	34	40.3	30.4	37.8	0.9	-5.0	18.6	29.4
Norway	27.8	38.2	46.5	33.6	37.8	0.9	37.4	21.6	7.7
Hong Kong	31	39.3	41.4	30	35.6	0.8	26.8	5.2	15.7
Monaco	19.6	27.6	27.6	19.7	31.2	0.7	40.8	0.0	60.6
Panama	22.4	22.1	28.3	21.2	19.2	0.4	-1.3	28.1	-31.9
Australia	26	21.9	24.2	18	18	0.4	-15.8	10.5	0.0

Source: NBU, author's calculations for country groups.

Note: Data is based on bank statements on transactions with non-residents and the transfers performed using international money transfer systems, and they do not include the amounts received through informal channels and money transfer systems created by residents of Ukraine.

Table A.4 Composition of labour migrants by remittance behaviour and by various characteristics*

Category	Category item	Share of migrants which sent remittances in each category item (%)	Composition of migrants (% of total) which:		
			sent remittances	did not send remittances	total
Country (10 most popular destinations)	Russia	58.5	45.3	50.4	47.3
	Italy	78.6	19.0	8.1	14.8
	Czech Republic	60.7	11.8	12.0	11.9
	Poland	45.9	4.9	9.0	6.5
	Hungary	41.8	2.5	5.6	3.7
	Spain	81.7	4.2	1.5	3.2
	Portugal	71.4	3.3	2.1	2.9
	US	36.5	0.9	2.5	1.5
	Germany	28.7	0.6	2.3	1.3
	Belarus	31.5	0.5	1.7	0.9
Frequency of trips	One trip	58.4	32.7	36.7	34.3
	Several trips	63.6	66.3	59.6	63.7
	Monthly trips	30.1	1.0	3.7	2.1
Duration of the last stay abroad	Up to 1 month	60.8	10.8	11.1	10.9
	1-3 months	61.0	35.8	36.3	36.0
	3-6 months	59.4	16.0	17.4	16.6
	6-12 months	59.2	17.4	19.1	18.0
	Over12 months	66.4	20.0	16.1	18.5
Legal status	Residence and work permit	64.6	33.5	28.9	31.8
	Residence permit	63.0	3.5	3.2	3.4
	Temporary registration	56.5	36.3	43.9	39.3
	No legal status	63.5	24.1	21.8	23.2
Gender	Female	58.8	32.3	35.5	33.5
	Male	62.3	67.7	64.5	66.5
Marital status	Married	67.2	65.3	50.2	59.5
	Single	45.7	20.1	37.5	26.9
	Divorced/ separated	63.8	12.0	10.7	11.5
	Widow	72.5	2.3	1.4	1.9
Age	15-24	50.5	12.3	19.0	14.9
	25-29	49.1	11.4	18.5	14.1
	30-34	51.8	12.4	18.2	14.7
	35-39	68.3	16.4	11.9	14.7
	40-49	68.7	33.4	23.9	29.7
	50-59	72.3	14.2	8.5	12.0
Education	Complete higher	53.9	11.9	16.0	13.5
	Basic higher	40.4	0.6	1.5	1.0
	Incomplete higher	58.6	15.6	17.4	16.3
	Complete general secondary	64.0	62.3	55.1	59.5
	Basic general secondary	57.6	8.6	10.0	9.1

Category	Category item	Share of migrants which sent remittances in each category item (%)	Composition of migrants (% of total) which:		
			sent remittances	did not send remittances	total
Place of household's residence	Urban area	56.7	50.0	60.0	53.9
	Rural area	66.3	50.0	40.0	46.1
Macro-region of household's residence	West	63.8	63.2	56.2	60.5
	East	61.0	16.8	16.8	16.8
	Centre and North	55.5	12.0	15.1	13.2
	South	49.9	6.7	10.6	8.2
	Kiev City	63.0	1.4	1.3	1.3

Source: Author's calculations based on Modular Migration Survey individual-level data (weighted with sample weights provided in the data set).

Note: * According to the survey's design, "labour migrants" refers here to individuals of working age (men 15-59 and women 15-54) who had been abroad for employment at least once during 2007-June 2008 or who worked abroad at the time of interview. The table is based on the answers of such individuals (or their representatives) on the question: "Did you send money from abroad to other members of household?" and takes into account only non-missing entries.

West includes Volyn, Zakarpattia, Ivano-Frankivsk, Lviv, Rivne, Ternopil, Khmelnytskyi and Chernivtsi *oblasts*; East includes Dnipropetrovsk, Donetsk, Zaporizhia, Luhansk and Kharkiv *oblasts*; Centre and North consists of Vinnytsia, Zhytomyr, Kiev, Kirovohrad, Poltava, Sumy, Cherkasy and Chernihiv *oblasts*; and South includes Crimean AR and Sevastopol, Mykolayiv, Odessa and Kherson *oblasts*

Table A.5 Employment changes by sectors, 2001-2010

	Annual employment growth rate (%)										Net employment change between 2000 and 2010, thousand people
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	
Total employed	-1.0	0.6	0.4	0.7	1.9	0.2	0.8	0.3	-3.7	0.4	91.0
Agriculture	-5.0	-0.3	-0.7	-2.6	0.2	-8.8	-4.6	-4.7	-5.1	-1.2	-1251.4
Manufacturing and mining	-4.5	-3.9	-2.3	-1.1	-0.1	-0.9	-1.6	-2.6	-8.4	-2.4	-1136.8
Construction	-4.2	-3.1	-0.6	8.9	3.7	4.8	4.4	1.3	-7.4	-2.4	39.4
Trade and repair. Hotels and restaurants	9.6	6.9	2.6	5.8	5.1	5.5	3.6	3.9	-0.3	2.2	1710.7
Transport and communication	-2.1	2.1	0.6	1.0	1.9	2.0	1.7	1.0	-5.3	0.1	34.7
Financial intermediation	3.5	3.5	6.9	13.6	14.7	15.4	20.4	14.7	-11.0	-5.3	166.7
Real estate and other business activities	2.3	1.7	7.9	0.6	5.1	7.8	8.9	1.4	-0.1	0.4	337.3
Public administration	-3.0	1.8	-1.1	-10.3	-2.0	0.5	0.3	3.0	1.0	13.5	25.2
Education	0.7	0.6	0.4	0.7	1.2	1.3	0.2	0.5	-0.2	-0.6	78.6
Health and social work	-1.3	-0.1	0.5	-1.3	0.6	0.0	0.2	0.8	-1.6	-0.5	-38.2
Municipal and individual services	1.1	2.8	3.2	10.6	4.3	-0.5	2.4	0.9	-6.7	0.1	124.8

Source: Author's calculations based on employment statistics of the State Statistics Service of Ukraine.