The Nexus between Foreign Remittances and Inflation: Evidence from Pakistan

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Abstract:
The inflow of foreign remittances in Pakistan has been an important source of foreign exchange in Pakistan while economy of Pakistan being a consumption oriented society/economy makes it interesting to explore the nexus between foreign remittances and inflation in Pakistan. For this purpose, the present study attempts to examine the impact of foreign remittances on inflation in Pakistan covering a period (1980-2012). Stationary analysis of the model confirms that all the variables used in the model are integrated of order (I), therefore, the study applies Johansen Cointegration technique in order to check the long run behavior of inflation while to test the short run dynamics, the study uses Vector Error Correction Model (VECM). The empirical findings show that foreign remittances have significantly positive impact on inflation thus underlining the need to channelize foreign remittances into productive investment in order to boost up economic growth in order to counter the inflationary impact of remittances in Pakistan.

Key Words: Remittances; Inflation; Cointegration

I. Introduction
The inflow of officially sent back foreign remittances by the factors working abroad is the second most important source of funding for financial development from abroad. While the remittances sent through informal channels have estimated 50% of the total remittances sent through formal channels.

The developing countries are the major recipients of foreign remittances (World Bank, 2011) but the remittances flow to different developing countries strongly differ, since last 30 years. In 2006 the three emerging economies that is china, India and Mexico have received more than one third of the total remittances of the developing countries. In case of Latin America, the Caribbean, East Asia and pacific regions have received major share of foreign remittances than the other group countries at the same year. From African countries only Nigeria accommodate herself in the list of 25 major recipients but
from South Asia three countries India, Bangladesh and Pakistan at a time were present in the list [World Bank, 2011].

In Pakistan, the flow of remittances increased since 1970s, when Gulf corporation council provided large number of jobs to the Pakistani workers in Middle East. The inflow of foreign remittances was continued till 1980s. It was the early 1980s, when the remittances became the biggest source of foreign capital, comprising of 10% of the country’s gross domestic product [Mughal, 2012].

Then the oil prices crises weakened the Arab economies, eventually slowing down the remittance inflows. During the 1990s decade, the foreign remittances volume declined by 36% because of Gulf war and economic sanctions on Pakistan due to atomic explosions in 1998(Ashraf and Asghar, 2004).

The revival period of the growth of the inflow of remittances started as an after effect of the September 11 incident in the early 2000’s. Since then the flow of remittances received as percentage of GDP, has shown a continuous and sustainable increase. It is to be noticed that despite the raise in the trend of remittances, the heights of the remittance inflow experienced in 1980’s have not been achieved yet. Remittance inflow acts like an economy savior, which have been growing from under $1bn in 1999 to over $13bn in 2012 (Various issues of SBP).

![Personal remittances, received (% of GDP) Pakistan 1980-2011](image)

Figure 1. Source: World Bank. World Development Indicators

### II. Significance of the Study

Over the last decade, there is an increasing trend in inflow of foreign remittances in the country. At the same time over the last few years in particular since 2007, inflation rate has been very high in Pakistan. A question arises is there any relationship between foreign remittances and inflation or not. Theoretically as explained above foreign remittances may have an inflationary effect via increasing domestic demand or through increase in money supply. Alternatively, foreign remittance may have deflationary impact
through increase in goods or services provided that remittances are invested in productive
sectors. However, what happens in reality in Pakistan, it is still a question that needs to be
determined. Furthermore, based on the empirical literature in the following section, we
are of the view that there is hardly any study that is supposed to examine the impact of
foreign remittances on inflation in Pakistan. This study therefore, intends to determine the
role of remittances on the inflation rate in case of Pakistan. This study therefore, attempts
to investigate the short run as well as long run behavior of the inflation rate.

The remaining of the study is organized as follows. Section II presents theoretical
back of remittances and inflation, section III comes up with a review of empirical studies;
while section IV discusses in detail the model and estimation. Finally section V comes up
conclusion along with policy suggestion/recommendations.

III. Theoretical Background

This increase in the remittances is expected to have multitude of effects in the
economy. Since remittances bring an increase in personal income, improving the living
standard of the recipients, eventually increasing the demand for consumption goods, and
thus boosting up the economic activity and demand for money. (Cáceres and Saca, 2006)
in this way remittances has an indirect effect on the macroeconomic variables like
inflation. The increase in the consumption pattern with no increase in the real economic
growth of the recipient country lifts up the prices of the commodities, causing upward
pressure on the inflation rate.

There are different possible ways in which remittance can have an effect on the
inflation rate in an economy. First is through demand side; with the increase in the
remittances inflow in a country, the purchasing power of recipients’ increases, so demand
of goods and services increases, therefore consumption is boosted. As there is no change
in the real output level of a country, so this increase in demand with no change in the
supply of goods and services will put pressure on the prices of commodities in upward
direction. Therefore, inflation increases with increase in remittance inflow.

Another explanation of the positive impact of remittances on inflation is through
the role of money supply. With the inflow of remittances, the reserves in Central Bank
increase; as the supply of the foreign currency increases in the recipient country. Since
the money supply is a function of reserves and domestic credit, therefore, a rise in
reserves will bring an increase in money supply, and as money supply has positive impact
on the prices, so overall it will rise the inflation rate of economy.

Yet another theory for the inflationary effect of remittances is the appreciation
of domestic currency. With increase in reserves, due to the remittance inflow, the domestic
currency is appreciated. (Silva 2009). The reason of the appreciation is that when reserves
increase, it means supply of foreign currency has increased, and if there is no
increase in demand of foreign currency, then demand of domestic currency appreciates.
The impact of appreciation on inflation can be explained in other way round as
depreciation and devaluation are supposed to lower the purchasing power of domestic
consumer hence resulting in increase in inflation. In the same manner appreciation of
domestic currency means increase in purchasing power of the domestic consumer, which
means lower prices for domestic consumer, therefore, appreciation is supposed to have
deflationary impact on inflation, in other words, exchange rate appreciation caused by increasing foreign remittances is supposed to result in decline of inflation.

Finally, another channel regarding the impact of foreign remittances is that foreign remittances are supposed to result in inflow of capital or saving, if these savings are invested productive investment, it will increase the output of economy, resulting in increasing goods and servicing, thus pushing the inflation rate downwards.

IV. Empirical Evidence

A wide range of literature is available on the determinants of inflation. Since the purpose of the present study is to determine the role of remittances on the inflation rate, so our main focus is on studies that investigate the relationship between remittance and inflation. There are different points of view regarding the role of remittances; such that remittance has a positive impact on inflationary pressure. The theory behind the inflationary impact of remittance is that remittances are spent partly on consumption. This direct effect of remittances on aggregate demand is due to the increase in consumption expenditure of the receiving households (Khan and Islam, 2013). A study by Goza and Ryabov (2010) reveals that when young children are the recipient of remittances sent by their parents, then remittances are mainly directed towards consumption-related activities. Mughal (2012) examines the role of remittances as a development strategy in case of Pakistan, and finds out that remittance has an impact in increasing the demand-push inflation. The study suggests that remittances should be treated as a temporary flow and can used to improve the macroeconomic situation but it should not be considered as long-term strategy.

The study of Balderas and Nath (2008) on Mexican data for the period 1995-2005 shows that remittances have a positive impact on inflation through direct and indirect effects on aggregate demand. Narayan, Narayan and Mishra (2011) investigate the impact of remittances on the inflation rate for a panel of 54 developing countries while using the data period 1995-2005. For estimation purpose, the study uses GMM approach. It shows that an increase in remittances raises domestic prices (by increasing money supply) which could cause an increase in the real exchange rate. The increasing real exchange rate in turn may have implication on the long run growth. Empirical results of the study shows that remittances tends to have a statistically significant positive effect on the inflation rate in developing countries, thus exerting inflationary pressures in the long run as well as short run.

Cáceres and Saca (2006) examines that remittance have an inflationary effect on El Salvador’s economy from time period 1995-2004. Khan, Bukhari and Ahmed (2007) discuss the role of demand side pressure (mainly due to the September 11 incident) in increasing the inflation rate in Pakistan. The remittances increase the domestic demand, which puts pressure on prices in positive direction. The author Mandelman (2012) uses Dynamic Stochastic General Equilibrium (DSGE) model on the data of Philippine for time period 1995-2009 as he wants to detect the evidence that highlights the role of remittances. The increase in remittance decreases labor supply in receiving country, thus increasing real wages along with the increase in consumption demand, which puts pressure on the price of domestic goods, therefore inflation rises. On the other side, findings show the negative relationship between remittance and inflation. Haderi et al. (1999) examine the determinants of inflation using VAR model and argue that the
remittances contribute in reducing the inflation, by having a direct impact on exchange rates and foreign reserves. Another study by Nath and Silva (2012) apply VAR model on the monthly data of Mexico to analyze the impact of remittances on the distribution of prices in receiving countries. VAR model. The outcomes of the research are that if remittances increase in short run, it decreases prices of many consumption items.

V. Estimation Strategy

The relationship between inflation and remittances is tested here by using time series data. The estimation technique used in this paper is VAR-based Cointegration tests using the methodology developed by Johansen (1991). The long run equilibrium will be computed by using Johansen Cointegration Test. It is used because model has more than one variable and the test helps in determining more than one long run relationship while Error Correction Mechanism (ECM) determines only one short run relationship in the model.

5.1. Co-integration Relationship

A long run equilibrium relationship between the variables having same or different order of integrations is said to be a co-integrating relationship. Various co-integration methods are used namely Engle-Granger technique, auto-regressive distributed lag (ARDL) model or Johansen technique which are based on the order of integration of the variables in the model. When all the variables are integrated of order one in the model then Johansen Juselius approach is used for establishing a co-integrating relationship.

5.2. Johansen Juselius (JJ) Co-integration Approach

When there are more than two variables there is possibility of more than one co-integrating relationship. JJ approach allows this possibility and uses maximum Eigen value and trace of the matrix to test for the number of co-integrating relationships among the variables (Johansen and Juselius, 1990). The maximum Eigen values tests the null hypothesis of \( r_0 = r \) against the alternative \( r_0 > r \) while the trace test is conducted under the null hypothesis of \( r_0 \leq r \) against the alternative \( r_0 > r \). Here \( r \) is the rank of the co-integration which shows the number of co-integrating relationships. The long run relationship between the variables can be shown by the general model as follows;

\[
INF_t = \alpha_0 + \alpha_1 M_t + \alpha_2 REM_t + \alpha_3 REER + \alpha_4 GDP + \mu_t
\]

Where \( INF \) stands for inflation, \( M \) indicates money supply, \( REM \) indicates personal remittances, received (% of GDP), \( REER \) shows real effective exchange rate index, and \( GDP \) shows real gross domestic output growth rate whereas \( \mu \) denotes error term.

5.3. Vector Error Correction Model

After establishing the long run equilibrium relationship there is a need to estimate the short run behaviour as well. The short run dynamics are given by the restricted VAR i.e. VECM (vector error correction model) with the restriction that long run relationship exists between the variables concerned. This model also gives the error correction term which links the long run and short run behaviour of the relationship. A statistically significant and negative error correction term shows that the model has a tendency to
converge towards long run in case of any shock in short run. The magnitude of this term gives the speed of convergence. The VECM representation for the above stated model will be of following form:

\[
\begin{align*}
\Delta \text{INF}_t &= \alpha + \sum_{i=1}^{n} \beta_{1i} \Delta \text{INF}_{t-i} + \sum_{i=1}^{n} \beta_{2i} \Delta \text{REM}_{t-i} + \sum_{i=1}^{n} \beta_{3i} \Delta \text{REER}_{t-i} + \sum_{i=1}^{n} \beta_{4i} \Delta \text{GDP}_{t-i} + \lambda_{EC} \Delta \text{EC}_{t-i} + \mu_{t} (1) \\
\Delta \text{M}_t &= \alpha + \sum_{i=1}^{n} \beta_{1i} \Delta \text{INF}_{t-i} + \sum_{i=1}^{n} \beta_{2i} \Delta \text{REM}_{t-i} + \sum_{i=1}^{n} \beta_{3i} \Delta \text{REER}_{t-i} + \sum_{i=1}^{n} \beta_{4i} \Delta \text{GDP}_{t-i} + \lambda_{EC} \Delta \text{EC}_{t-i} + \mu_{t} (2) \\
\Delta \text{REM}_t &= \alpha + \sum_{i=1}^{n} \beta_{1i} \Delta \text{INF}_{t-i} + \sum_{i=1}^{n} \beta_{2i} \Delta \text{REM}_{t-i} + \sum_{i=1}^{n} \beta_{3i} \Delta \text{REER}_{t-i} + \sum_{i=1}^{n} \beta_{4i} \Delta \text{GDP}_{t-i} + \lambda_{EC} \Delta \text{EC}_{t-i} + \mu_{t} (3) \\
\Delta \text{REER}_t &= \alpha + \sum_{i=1}^{n} \beta_{1i} \Delta \text{INF}_{t-i} + \sum_{i=1}^{n} \beta_{2i} \Delta \text{REM}_{t-i} + \sum_{i=1}^{n} \beta_{3i} \Delta \text{REER}_{t-i} + \sum_{i=1}^{n} \beta_{4i} \Delta \text{GDP}_{t-i} + \lambda_{EC} \Delta \text{EC}_{t-i} + \mu_{t} (4) \\
\Delta \text{GDP}_t &= \alpha + \sum_{i=1}^{n} \beta_{1i} \Delta \text{INF}_{t-i} + \sum_{i=1}^{n} \beta_{2i} \Delta \text{REM}_{t-i} + \sum_{i=1}^{n} \beta_{3i} \Delta \text{REER}_{t-i} + \sum_{i=1}^{n} \beta_{4i} \Delta \text{GDP}_{t-i} + \lambda_{EC} \Delta \text{EC}_{t-i} + \mu_{t} (5)
\end{align*}
\]

Where \( \mu_{it} \) are the serially uncorrelated error terms and \( EC_{t-1} \) is the error correction term from the long run relationship which shows the possibility of convergence and speed of convergence towards equilibrium relationship in case of any shock in short run.

VI. Data and Variables:

Since the research is based on the secondary data, so the data for all economic variables of the model come from the World Development Indicators (WDI). For our study, we use annual data for the time period 1980-2012. Since the research is based on the secondary data, so the data for the Inflation is consumer prices (annual %), Money and quasi money (M2) as percentage of GDP, Personal remittances, received (% of GDP), Real effective exchange rate index (2005 = 100) and annual percentage of GDP growth have been collected from the World Development Indicators (WDI). For our study, we use annual data for the time period 1980-2012.

VII. Estimation Results:

To test the possibility of the long run relationship, time series data is being used as discussed previously. The first step in this regard is to check whether the concerned variables are stationary or not.

a) Stationarity and Order of Integration

The order of integration can be checked by applying unit root test. The results of augmented dickey fuller test for each variable are reported as under.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Level</th>
<th>Lags</th>
<th>First difference</th>
<th>Lags</th>
</tr>
</thead>
<tbody>
<tr>
<td>INF</td>
<td>-1.00459</td>
<td>0</td>
<td>-6.9941***</td>
<td>0</td>
</tr>
<tr>
<td>GDP</td>
<td>-2.9518</td>
<td>0</td>
<td>-7.0042**</td>
<td>2</td>
</tr>
<tr>
<td>M2</td>
<td>-0.3777</td>
<td>0</td>
<td>-4.4070**</td>
<td>7</td>
</tr>
<tr>
<td>REER</td>
<td>-2.3389</td>
<td>3</td>
<td>-2.8203**</td>
<td>1</td>
</tr>
<tr>
<td>REM</td>
<td>-1.2208</td>
<td>0</td>
<td>-5.4377***</td>
<td>0</td>
</tr>
</tbody>
</table>

*10%, **5%, ***1% level of significance.
The above table shows that all the variables are non-stationary at level. At first difference inflation rate, domestic credit and remittances becomes stationary with 1% significance level while remaining variables becomes stationary at 5% level of significance. Thus all the variables here come out to be I(1) i.e. integrated of order one.

b) **Optimal Lag Length**

Next step in time series is the selection of lag length for the VAR specification. The different criterions can be used like sequential modified LR test statistic, final prediction error (FPE), Akike information criterion (AIC), Schwarz information criterion (SC) and Hannan-Quinn (HQ) information criterion. However, we use Schwarz information criterion (SC) and Akike information criterion (AIC) in our case.

<table>
<thead>
<tr>
<th>Lag</th>
<th>AIC</th>
<th>SC</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>33.672</td>
<td>33.955</td>
</tr>
<tr>
<td>1</td>
<td>27.764</td>
<td>29.745*</td>
</tr>
<tr>
<td>2</td>
<td>27.584</td>
<td>31.262</td>
</tr>
<tr>
<td>3</td>
<td>5.837*</td>
<td>31.211</td>
</tr>
</tbody>
</table>

* Indicates lag order selected by the criterion calculated using Eview 5
AIC: Akaike information criterion
SC: Schwarz information criterion

So, optimal lag is first lag, as we select the Schwartz Information Criterion (SC) value because it has least parameter and its result is best.

c) **Johansen Co-integration Test**

To test the presence of any long run relationship co-integration technique is used. Since here all the variables came out to be I(1) by ADF unit root test therefore the appropriate method is Johansen Juselius co-integration. The maximum Eigen value and trace test is used to check the possibility of co-integration. The results are as follows:

The Unrestricted Cointegartion Rank Test (Trace) shows that there are 3 cointegrating equations at 0.05 significance level, while on the other hand, unrestricted Cointegration Rank Test (maximum Eigenvalue) indicates 2 cointegrating equations at 0.05 significance level.

<table>
<thead>
<tr>
<th>Hypothesized No. of CE(s)</th>
<th>Trace Statistic</th>
<th>Max Eigen Statistic</th>
</tr>
</thead>
<tbody>
<tr>
<td>None *</td>
<td>131.2122</td>
<td>47.0613</td>
</tr>
<tr>
<td></td>
<td>(0.0002)**</td>
<td>(0.007)**</td>
</tr>
<tr>
<td>At most 1 *</td>
<td>84.15092</td>
<td>35.26374</td>
</tr>
<tr>
<td></td>
<td>(0.0024)**</td>
<td>(0.0345)**</td>
</tr>
<tr>
<td>At most 2 *</td>
<td>48.88718</td>
<td>20.79611</td>
</tr>
<tr>
<td></td>
<td>(0.0399)**</td>
<td>(0.2887)</td>
</tr>
<tr>
<td>At most 3</td>
<td>28.09108</td>
<td>15.92919</td>
</tr>
<tr>
<td></td>
<td>(0.0776)</td>
<td>(0.229)</td>
</tr>
<tr>
<td>At most 4</td>
<td>12.16189</td>
<td>9.395758</td>
</tr>
<tr>
<td></td>
<td>(0.1493)</td>
<td>(0.2547)</td>
</tr>
<tr>
<td>At most 5</td>
<td>2.766129</td>
<td>2.766129</td>
</tr>
<tr>
<td></td>
<td>(0.0963)</td>
<td>(0.0963)</td>
</tr>
</tbody>
</table>

*denotes rejection of null hypothesis at 0.05 level of significance.
The tests reject the null hypothesis of no cointegrating equations and shows that relationship exists between explanatory and dependent variables.

d) **Long run estimates**

The tests above confirm the presence of long run relationship. The long run estimates\(^1\) of the model shown by equation (1) using Johansen approach are tabulated as follows:

The results reveal that remittances have a positive impact on the inflation in case of Pakistan. The coefficient has positive sign and t-statistic is significant. The result is according to the theory i.e. with increase in remittances, the purchasing power of the recipient’s increase, therefore their demand increases which lead to an increase in the overall price level, eventually rising the annual percentage of inflation. Our results are consistent with previous studies of Bashir et al. (2011), Khan and Aslam (2013).

### Table-5: Long run estimates

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficients</th>
<th>Standard error</th>
<th>T- statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>REM</td>
<td>1.159073**</td>
<td>0.27809</td>
<td>4.16797</td>
</tr>
<tr>
<td>REER</td>
<td>-0.067187**</td>
<td>0.01648</td>
<td>-4.07688</td>
</tr>
<tr>
<td>M2</td>
<td>0.020863</td>
<td>0.11901</td>
<td>0.17530</td>
</tr>
<tr>
<td>GDPG</td>
<td>-0.436788*</td>
<td>0.24785</td>
<td>-1.76230</td>
</tr>
</tbody>
</table>

**significant at 5%**

* Significant at 10 percent

Likewise, real effective exchange rate tends to have significantly negative impact on inflation rate indicating that the increase in real effective exchange rate denotes appreciation of the local currency\(^2\), so this shows that if real effective exchange rate is depreciated, it will lead to a rise in the inflation rate. In other words, with depreciation of the domestic currency, the imports become expensive. This result in interesting and important as in a country like Pakistan, major share of our imports consists up import of fuels and machinery being items of low elasticity, thus increase in the price of imports will have a large impact on the overall economy, as the oil prices have an impact on almost all the sectors. So the rise in oil prices will lead to inflation rate. The results are consistent with the studies of Moser (1995), Kim (2001), and Kamin and Rogers (2000).

Money supply coefficient shows positive relation (similar to the results by Qayum (2006), Bashir et al. (2011) with inflation, but surprisingly the coefficient is insignificant. However, when we included in the model lag of money supply as an independent variable, its impact was found significantly positive indicating that there is a lag between money supply and inflation, in other words, the impact of money supply is not instantaneous rather some time is required in order to have inflationary impact according to our empirical results.

The growth rate of GDP has a negative impact on the inflation annual percentage. The results support the findings of Aurangzeb and Haq (2012) and Bruno and Easterly (1998). In this study, the annual percentage growth rate of GDP at market prices is based on constant local currency, which means it is real GDP growth. Since the GDP growth in real terms means that the increase in the aggregate demand is countered by the increase in

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1. All the estimation including this one is carried out in E-views software.
the supply of goods and services. Since real GDP increases the output level of the economy, so if more goods are produced, it will help in bringing down the inflation rate. Therefore, we can conclude that if the economic growth of a country increases in real term, it will eventually help in decreasing inflation.

e) Vector Error Correction Mechanism (VECM):

After verifying the long-run relationship between variables, now VECM method is used to check for the short run relationship. The coefficients of cointegrating equation 1 should be negative and among (0, -1). In VECM, estimate should imply that INF converges to the long run equilibrium relationship. If INF is above its long term value (ECM > 0), INF must decline and if it is below its long run value (ECM term < 0) then INF should increase for convergence to the long run relationship. Through VECM we estimate the system of equation for short run. So, we select short run equation of INF.

Table 6: Error correction model

<table>
<thead>
<tr>
<th>Dependent variable: Δ INF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coefficient</td>
</tr>
<tr>
<td>INF(-1)</td>
</tr>
<tr>
<td>D(INF(-1))</td>
</tr>
<tr>
<td>D(INF(-2))</td>
</tr>
<tr>
<td>Δ(REER(-1))</td>
</tr>
<tr>
<td>Δ (REER(-2))</td>
</tr>
<tr>
<td>Δ (M2(-1))</td>
</tr>
<tr>
<td>Δ (M2(-2))</td>
</tr>
<tr>
<td>Δ (REM(-1))</td>
</tr>
<tr>
<td>Δ (REM(-2))</td>
</tr>
<tr>
<td>Δ (GDPG(-1))</td>
</tr>
<tr>
<td>Δ (GDPG(-2))</td>
</tr>
</tbody>
</table>

From this table we can see that error correction coefficient term (ECM) is negative and significant, which shows that any deviations of inflation percentage from its long run equilibrium path will adjust it towards its equilibrium path. The inflation rate will adjust rapidly by adjusting 89.9% annually. The empirical results also show that in the short run, inflation is determined by its past values, money supply and remittances.

VIII. Concluding Remarks and Policy Implications

The study examines the long run and short run relationship among inflation rate, remittances, exchange rate, GDP growth rate and the growth of money supply. The Johansen Cointegration result shows that in the long run in inflation rate is positively related to remittances and money supply, while it is negatively related to the growth rate of GDP and real effective exchange rate.

The empirical findings from the error-correction model show that the inflation adjusts to its equilibrium rapidly. In short run, inflation is determined by its past values, and lag values of money supply, and remittances.
In case of Pakistan, remittances of workers, being the largest source of foreign capital and an important component of the balance of payment, have a vital role in boosting up the economy. (Al Khathlan 2012). The consumption pattern of the recipients can be held responsible for the inflationary role of inflation. The study suggests that remittance itself is not an evil, in fact it is the manner in which the received amount consumed which brings inflation in the economy. So it can be concluded that inflationary pressure of the remittances in Pakistan is due to the changes in the demand side and the money supply. Therefore, productive investment is needed to counter the positive impact of the remittances on inflation.

For this purpose, similar to the suggestions by other studies such as Cáceres and Saca (2006) and Balderas and Nath (2005), this study recommends that the government should formulate policies to channel the remittances for productive investments rather than for consumption by diverse means; i.e. through investment in infrastructure and education, and by generating the productive capacity that would satisfy the demand created by remittances. In other words, the government should come up with some incentives and measures to channelize the inflow of remittances to a more productive and useful sectors. The foreign remittances in case of Pakistan may also work as a cushion in term of foreign exchange rates stability, as trade deficit and external payments tend to keep pressure on devaluing the domestic currency. The government therefore, needs to take solid measures in order to ensure steady growth in inflow of foreign remittances along with measures to channelize these remittances to productive investment in Pakistan.

References


