Remittances, Dutch Disease, or Structural Transformation?

Evidence from Manufacturing, Service Trade, and Relative Prices

Chikafumi Nakamura

Faculty of Policy Studies, Chuo University

Abstract

Remittances are now the largest single source of external finance for the developing world, and where they rise, manufacturing shares tend to fall. That correlation is routinely read as Dutch Disease: transfer income bids up the real exchange rate, and tradables lose ground. That reading infers a mechanism rather than observing one. Using a panel of 93 developing economies, we put that mechanism to the test. The compositional pattern appears in two complementary measures: higher remittances are associated with a lower manufacturing GDP share in the post-2000 sample and a lower manufacturing-to-services ratio over the full sample, although their robustness differs across specifications. The mechanism is another matter. Conditional on a country's own remittance history, neither the real exchange rate nor the domestic price of services relative to manufacturing shows a detectable rise at any horizon, and a mediation decomposition, under its identifying assumptions, finds the exchange-rate-mediated component small relative to the corresponding non-exchange-rate component. The service-trade margin is more telling still: the service-export share rises even as manufacturing loses relative weight, and most of that response lies in non-travel services, so it cannot be explained solely by diaspora visits. Because the broad services aggregates used in empirical work combine internationally traded with domestic services, such a rise can look like the textbook shift toward nontradables even when tradable activity is not uniformly contracting. The pattern commonly read as remittance-induced Dutch Disease is therefore more consistent, in this panel, with broader structural transformation than with the canonical exchange-rate mechanism.

JEL Classification: F24, F31, F43, O11, O14

Keywords: remittances; Dutch Disease; structural transformation; deindustrialization; real exchange rate; service trade