

Migrants' Remittances and Development

*Myths,
Rhetoric
and
Realities*



IOM International Organization for Migration



The Hague Process
on Refugees and Migration

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Established in 2000, The Hague Process on Refugees and Migration (THP) is a global initiative to advance the refugee and migration agenda through a multidisciplinary and complementary approach. It seeks to promote consensus on key issues affecting migrants, refugees, asylum seekers and other displaced persons through discussion and dissemination of information and advice.

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Preface

The close relationship between economic development and migration has been recognized for some time. In recent years, however, there has been a shift in thinking about the relationship between migration and development. Traditionally, migration was seen as a problem with negative implications for development. Today, there is a growing recognition that migration and migrants can enhance a country's development. One of the factors which contributed to this change in thinking is the growing recognition of the importance of remittances.

In 2003, gross flows to developing countries amounted to US\$ 142 billion, compared to US\$ 18.4 billion in 1980. The annual average figure increased from US\$ 7.8 million in 1975-79 to a recorded total of US\$ 98 billion in 1998-2003. According to the World Bank, international remittances received by developing countries are expected to reach US\$ 167 billion in 2005 – a more than ninefold increase over the past 25 years.

Given the importance of this topic, IOM is pleased to be able to co-sponsor the publication of this new study by Bimal Ghosh with The Hague Process on Refugees and Migration. The current study is one of a series of research reports that IOM has published on this important theme in recent years. IOM has recently completed a study, including a household survey on remittances to Albania – *Competing for Remittances* (IOM Tirana, 2005). Several studies have also been conducted recently in Colombia and Guatemala: *Encuesta sobre Remesas 2005 y Microempresas* (2005); *Encuesta sobre Impacto de Remesas Familiares en los Hogares Guatemaltecos* (2004), *Encuesta Nacional sobre Remesas Familiares* (2003), and *Remesas en Colombia: Desarrollo y Marco Legal* (2004). In 2005, IOM published the *Dynamics of Remittance Utilization in Bangladesh*.

Another study by IOM, based on focus group and key informant interviews, has looked at remittances to Moldova, including issues relating to access and obstacles to use of formal remittance channels and patterns of remittance use.

Frank Laczko

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Introduction

Migrant remittances are an old issue in the migration debate. And yet, it has become a focus of heightened attention in recent years. One obvious reason for this is the sharply rising flows of remittances into developing countries (Table 1). In 2003, gross flows to developing countries amounted to US\$ 142 billion, compared to US\$ 18.4 billion in 1980. The annual average figure jumped 12 times from US\$ 7.8 billion in 1975-79 to a recorded total of US\$ 98 billion in 1998-2003.¹ Provisional World Bank figures for 2004 suggest a further sharp rise in remittances amounting to US\$ 160 billion. If confirmed, this would imply a 66 per cent increase in developing countries' gross receipt of migrant remittances between 2001 and 2004. Preliminary indications at the time of writing are that this upward trend may well have continued in 2005, with the total amount nearing US\$ 167 billion – a more than ninefold increase over the past 25 years.

Total gross remittances are now the second largest source, behind FDI, of external financial flows to developing countries and, compared to other resource flows, they have remained rather stable in recent years, moving within a narrow range of 1-1.6 per cent of these countries' GDP throughout the 1980s and the 1990s. Not surprisingly, this has sharpened interest in remittance flows in the policy debate on development and poverty alleviation in less affluent countries. At the Sea Island Summit in June 2004, leaders of the Group of Eight (G8), for example, called for more coordinated international efforts to enhance the development impact of remittance receipts. Attempts to juxtapose the benefits of remittances against the losses that the poor countries suffer from large-scale skill emigration have added to the intensity of the debate. Increasingly, remittances are also engaging attention from the perspective of the benefits that developing countries can reap from a relaxation of rich countries' current restrictive immigration policies.

Another interesting development is that in financial institutions the private sector is taking a more active interest in remittances than in the past. Some

major banks and financial agencies have begun to view remittances not only as a source of potential profits generated by a rising level of cross-country money transfer business and from their securitization, but also as a promising channel to reach migrants as regular customers in the future. According to one estimate, in 2001 banks and other transfer agencies may have collected some US\$ 12 billion in transfer fees (Maldonado and Robeldo, 2002). Western Union alone moves about US\$ 35 billion across 15,000 currency corridors, yielding US\$ 4 billion in annual revenues.² Updated remittance figures for 2003 suggest that by securitizing these resource flows, developing countries could have raised up to US\$ 9 billion in the international capital markets (World Bank, 2005). This has no doubt opened up prospects for closer cooperation between the public and private sectors in both migrant sending and receiving countries to harness the development potential of remittance flows.

Despite, or partly because of, this widening interest in remittances, the debate on the subject continues to be complex, and not infrequently confusing. For less affluent countries remittances hold significant potential for the promotion of family welfare and development, but excessive reliance on them also entails pitfalls. In the past, the development role of remittances has often been downplayed, and today the trend seems to be in the opposite direction. Clearly, an overemphasis either on the promises of remittances or on their pitfalls makes the debate unduly confusing and adds to the dilemma of policymakers.

The present study, prepared at the request of the Hague Process on Refugees and Migration (THP) and the International Organization for Migration (IOM) highlights the ways in which the development potential of remittances could be most effectively used, while avoiding the possible risks. In doing so, it seeks to help promote a more balanced approach to the issue of remittances and development, which, as indicated above, is now high on the global economic agenda.

In focusing attention on the nexus between remittances and development, the study uses a narrowly circumscribed frame of reference. Obviously, remittances cannot be separated from migration; and migration no doubt entails both benefits and costs, which, it is widely recognized, are shared differently both between and within the sending and receiving countries. Remittances are an integral part of the welter of these benefits and costs.³ However, these latter and much wider issues of migration are not taken up in this short study as they remain outside its scope. Also, even in examining the impact of remittances on development in this limited context, the study essentially deals with migrant-sending developing countries.

The study is structured as follows. Chapter 1 discusses the level of remittances, both formal and informal, and their geographical distribution. It also discerns types and personal characteristics of migrants as remitters. Chapter 2 examines the various ways in which formal remittances to developing countries can be increased, covering such questions as migrants' remittance behaviour, cost of transfer, effectiveness of incentives and regulatory measures, and the importance of political and macro-economic environments. Chapter 3 describes the economic and social impacts of remittances, and this is followed by a more critical and relatively detailed appraisal of the development potential of remittances as well as of the possible pitfalls involved. Chapter 5 examines the role of three major non-state actors, namely migrants' associations, the diasporas and the corporate sector.

This short study does not include an executive summary. Instead, its main findings are summed up in Chapter 6 under the heading "An Overall Assessment". A summary can hardly capture the exact flavour and full tenor of a detailed discussion on a complex subject. However, since the assessment dovetails much of the discussion in the previous chapters, it may be found useful by readers, especially those who may be hard pressed for time.

The two sponsoring organizations of the study – the International Organization for Migration and The Hague Process on Refugees and Migration – have been closely following, and actively participating in, the current debate on remittances and development, with an abiding interest in its outcome and follow-up action. Pursuant to the publication of the report of the Global Commission on International Migration in November 2005 (which underlines the importance of remittances) and in the run-up to the United Nations High-level Dialogue on International Migration scheduled for September 2006, the two organizations considered it useful to jointly sponsor and issue the present study as an input to the debate.

The views expressed in it are, however, the author's own, and should not be ascribed to either of the organizations or its members. The author, like the sponsoring organizations, will feel the effort in bringing out this study amply rewarded if it can make, even in a small measure, a useful contribution to the on-going debate on the subject.

1

The Complex Configuration of International Remittances

Measuring the level of remittances: A baffling exercise

The confusion in the debate on migrants' remittances and their impact on development starts with the very estimates of remittances. Comprehensive and reliable statistics about these flows are difficult to come by. The official flows are reported in the IMF's balance of payments statistics under three different headings: transfers from workers staying abroad for one year or more ("workers' remittances" shown under the heading "current transfers"); transfers from persons staying abroad for less than one year ("compensation of employees", prior to 1993 dubbed "labour income" recorded under the "income" sub-category of "current account"); and flows of goods and financial assets linked to the migrants' cross-border movements ("migrants' transfers" reported under "capital transfer").⁴

However, a general tendency in much of the migration literature is to focus exclusively on the first category, "workers' remittances" (Ghosh, 1997). Consistent with its own definition of a migrant (absence from home country for one year or more) the United Nations generally does the same. This, however, fails to capture the overall size or the full impact of remittances associated with cross-border movements of people, including those of shorter duration.

This creates confusion not just because other recorded components are excluded, but also because the distinction between them is often blurred owing to the mix-up in the methods in which different governments record these flows. Adding to the complication is the fact that a good many migrants themselves subsequently change their mind about the previously planned duration of their stay abroad. A few years ago the IMF, for example, reclassified as "workers' remittances" an amount of US\$ 5 billion that had originally been reported as "labour income" (now called "compensation of employees") (IMF, 1987). The situation makes a strong case for looking at the

Table 1 **Workers' remittances to developing countries, 1990-2005**

	US\$ billion										Change (%) 2005-2001
	1990	1995	2000	2001	2002	2003	2004e	2005e			
Developing countries	31.2	57.8	85.6	96.5	113.4	142.1	160.4	166.9	73		
Lower middle income	13.9	30.0	42.6	47.4	57.3	72.5	83.5	88.0	86		
Upper middle income	9.1	14.5	20.0	22.3	23.0	27.8	33.0	33.8	52		
Low income	8.1	13.3	22.8	26.8	33.1	41.8	43.9	45	68		
Latin America and the Caribbean	5.8	13.4	20.1	24.4	28.1	34.8	40.7	42.4	74		
South Asia	5.6	10.0	17.2	19.2	24.2	31.1	31.4	32.0	67		
East Asia and the Pacific	3.3	9.7	16.7	20.1	27.2	35.8	40.9	43.1	114		
Middle-East and North Africa	11.4	13.4	13.2	15.1	15.6	18.6	20.3	21.3	41		
Europe and Central Asia	3.2	8.1	13.4	13.0	13.3	15.1	19.4	19.9	53		
Sub-Saharan Africa	1.9	3.2	4.9	4.7	5.2	6.8	7.7	8.1	72		
World (developing and industrial)	68.6	101.6	131.5	147.1	166.2	200.2	225.8	232.3	58		
<i>Pro memoria</i>											
Outward remittances from developing countries ¹	6.1	12.5	12.1	14.3	18.7	20.2	24.1		
Outward remittances from Saudi Arabia ²	11.2	16.6	15.4	15.1	15.9	14.8	13.6		

¹ Excludes Gulf Cooperation Council countries (GCCs).

² Saudi Arabia is now classified as a high-income country, although structurally it continues to share most of the characteristics of a typical developing country.
Source: World Bank staff estimates based on IMF BoP-Yearbook 2004 and country sources.

Table 2 **Remittances and other resource flows into developing countries**
(US\$ billion)

Resource inflows	1995	2004
Migrants' remittances (gross)	58	160
FDI	107	166
Private debt and portfolio equity	170	136
Official development assistance	59	79

Source: World Bank, *Global Development Finance 2005*.

totality of migrants' remittance flows. Another major problem is that many countries do not report data on remittances for the IMF balance of payments statistics, or do so only partially; and sometimes the reporting suffers from a confusion between migrant remittances and other resource flows, such as tourism receipts and non-resident deposits.⁵ Also, some of the small transfers, though sent through formal banking channels, are not always recorded in official statistics, nor are all transactions through post offices and other money transfer agents (de Luna Martinez, 2005).

Much of the literature and policy debate on migrant remittances focuses on inflows of remittances to developing countries. This is at least partly due to some of the reasons mentioned above, but there is a real danger if this leads to losing sight of the overall situation. Although the world's migrant stock continues to be concentrated in a relatively limited number of countries, today almost all major regions of the world are hosting migrants. Alongside an increasing interpenetration of labour markets across countries, migration now takes place not only from South to North, but also, though on a much smaller scale, from North to South, just as there are important North-North and South-South migration flows. Thus, both developed and developing regions are recipients, just as they are senders, of migrant remittances. In 2003 worldwide gross inflows of remittances amounted to US\$ 200 billion, of which US\$ 58 billion went to industrial countries and US\$ 142 billion to developing countries (Table 3).

However, when these gross inflows of remittances (or credits) to developing countries are adjusted against the recorded outflows (or debits), it would be seen that in 2003 developing countries had a net credit of US\$ 121.9 billion (Table 3). Put differently, the *net* receipts of developing countries was less than 86 per cent of their gross inflows, or roughly 60 per cent of gross global remittance inflows – far less than what is widely assumed. Unfortunately, however, recorded data for outflows are even less complete than those for inflows.⁶ Some preliminary estimates by the World Bank seem to suggest that between 30 and 45 per cent of total remittances to developing countries

Table 3 **BoP remittances,¹ 1990-2003** (US\$ billion)

	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003	Average 1998-2003
Advanced economies											
Total credit	37.4	43.7	44.3	47.6	44.8	48.6	45.9	50.6	52.8	58.1	50.1
Total debit	46.7	66.2	70.6	68.9	71.2	75.8	75.5	84.5	87.5	96.0	81.7
Total net	-9.4	-22.4	-26.3	-21.3	-26.4	-27.2	-29.6	-33.9	-34.8	-38.0	-31.6
Gulf Cooperation Council²											
Total credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total debit	13.2	20.0	18.8	18.5	18.7	18.0	19.6	19.7	20.3	19.7	19.3
Total net	-13.1	-19.9	-18.8	-18.5	-18.7	-17.9	-19.5	-19.7	-20.2	-19.6	-19.3
Developing economies											
Total credit	31.1	57.8	62.8	72.0	74.2	78.4	85.6	96.5	113.4	142.1	98.4
Total debit	6.1	12.5	13.0	13.4	13.8	10.7	12.1	14.3	18.7	20.2	15.0
Total net	25.1	45.3	49.8	58.6	60.4	67.8	73.4	82.2	94.8	121.9	83.4

¹ BoP remittances are the sum of compensation of employees, workers' remittances, and migrants' capital transfers.

² Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

Source: World Bank staff estimates based on IMF *Balance of Payments Statistics*.

may originate in other developing countries. There is little doubt that the importance of South-South remittances is seriously underestimated in the currently available official figures.

In any case, the failure to distinguish between *gross* and *net* flows of remittances could be a source of worrisome confusion. When gross figures are used, as is often done in many analyses to highlight the importance of migration-related remittances, especially in relation to official development assistance (ODA), it leads to misleading results (see Box 1). In assessing the real impact of remittances in terms of transfer of resources to developing countries as a group, the outflows from these to the rich countries, as well as the transfers that take place between developing countries, must be taken into account. Credits need to be adjusted against debits.

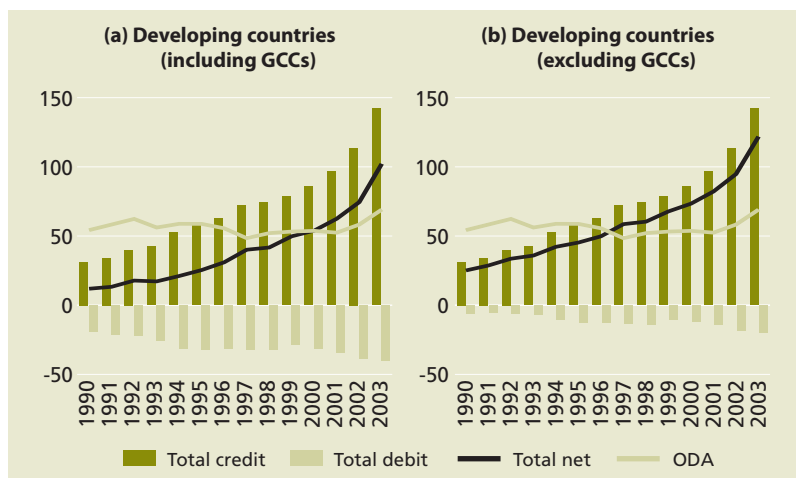
It is worth noting that if the outflows from the Gulf Cooperation Council countries (GCCs) to labour-sending developing countries are considered as transfers within the developing world, then the total net inflow for the latter – even on the basis of the currently available (and seriously underestimated) official outflow figures – amounts to no more than US\$ 102 billion, or roughly one half of the global inflows of US\$ 200 billion for 2003, as shown in Figure 1.⁷

Informal remittances and the guessing game

On the other hand, the actual remittances to developing countries far exceed the amount officially recorded since a significant part of the funds is often sent through informal channels.⁸ It has long been recognized that in some Asian countries, such as India, Indonesia, Pakistan, the Philippines and Sri Lanka, perhaps as much as 30 per cent of total remittances did not get recorded in official accounts. An extreme case in Africa was Sudan where in 1983 about 90 per cent of the transfers did not come through official channels (Choucri, 1985). A recent study of the available estimates made between 1970 and the early 1990s for 11 different countries showed that unrecorded remittances could vary between 8 and as much as 85 per cent of total flows. Based on these figures, the average was estimated at 36 per cent (Puri and Ritzema, 1999).

More recently, the IMF simulated unrecorded transfers to 15 countries with high rates of emigration and a history of high black market premium on exchange rate (El Qurochi *et al.*, 2003). The simulation showed that in 15 selected countries probably 40 per cent of the remittances were, on

Figure 1 **Gross and net remittance inflows and net ODA transfers to developing countries, 1990-2003** (US\$ billion)



average, sent through informal channels during 1980-2000. The proportion however varied between countries. For instance, while for Algeria, Bangladesh, Iran, Pakistan, Sudan and Tanzania more than half of the remittances might have been informally transferred, the proportion, according to the study, was much lower for countries like India, the Philippines and Turkey.⁹ Household surveys reveal similar variations between countries in the proportion of transfers that take place through informal channels – from 1 per cent for the Philippines to 80 per cent for Uganda (Freund and Spatafora, 2005). Estimates by Page and Plaza (2005) suggest that the share of unrecorded remittances in total remittances averages 48 per cent worldwide, with significant regional variations (for example, 73% for sub-Saharan Africa). And, most recently, based on econometric analyses and available surveys, the World Bank estimated that unrecorded flows might add 50 per cent or more to total recorded remittances (World Bank, 2005).

But no one can be sure of the exact situation. This is not just because of the difficulty in tracking down the informal flows but also because they could be extremely volatile, depending on the actual and anticipated political and economic changes in the countries concerned, including, in particular, exchange rates. In Pakistan, for example, remittances nearly tripled from June 2001 to June 2002, as many migrant workers using underground channels were afraid of being caught in the US-led investigations into terrorist financing. Meanwhile, the narrowing of the difference between official and market rates for the Pakistani rupee to less than 1 per cent also helped the process of transfers through formal channels. The finding of the above-

mentioned 2003 IMF study, which purposely selected countries with active parallel exchange markets, seemed to confirm that an erosion of the black market premium on the exchange rate was likely to be accompanied by a declining level of informal remittances (for further discussion see Chapter 4 and Box 2).

Informal transfers apart, an important complication in assessing the actual volume of remittances lies in the fact that a part of the remittances can, and often does, take the form of transfers in kind instead of cash, but remains largely unrecorded in official statistics. In the case of the Philippines, for example, Rodriguez (1996) notes, based on the 1991 Survey of Overseas Workers, that “regular cash transfers account for about 26 per cent of total transfers; most of the rest is cash brought home on return”. Some put the figure as high as 35 per cent (or 42% including in kind transfers) (Puri and Ritzema, 1999). Also, even when the funds are transferred through formal channels, the banks or the transfer agency may not always report the receipt of foreign exchange in order to be able to use it for unauthorized purposes. Determination of the actual volume of remittances, though not easy, should continue to be a priority concern for purposes of policy formulation.

Remittances are not necessarily a net addition to the household budget or the economy. The opportunity cost of emigration – the possible earnings forgone by the migrant in the home country and the output loss to the economy – needs to be taken into account. A study made in Mexico in 1987 showed the average earnings of an irregular Mexican worker in the US at US\$ 974.96, but the earnings forgone in Mexico were US\$ 411.25 (Taylor, 1987). Even when the migrant is replaced by an unemployed member of the family, a cost is almost invariably implicit in remittances – the cost of replacing the migrant in the production system. For the economy as a whole, however, the loss of output could be offset by the high multiplier effect of remittance expenditure (discussed later in Chapter 4). The real net value of remittances thus starts at a point where it exceeds a critical threshold roughly equal to the value of the output the migrants would have produced had they stayed home (Djajic, 1986).

Further, for the highly skilled workers the cost of emigration needs to take into account not just the private return but also the social return forgone.¹⁰ This is because the highly skilled workers help train other workers, impart new ideas and are often a source of innovation, and thus their social return is higher than their private return. None of this, however, takes into account the non-economic costs, implicit in the separation of the individual from the original home and hearth, including possibly the family, and the familiar socio-cultural surroundings. These costs are not easily measurable, but they are no less real.

Geographical directions of remittance flows – major senders and receivers

As one would expect, high-wage countries, most of which are at the same time major migrant receivers, are the main sources of gross flows of remittances. Average figures for 1990-2003 show that, in absolute terms and for the world at large, the US and Saudi Arabia were the largest sources of total remittances; other top source countries were Germany, Switzerland, France and Belgium (IMF, 2005).¹¹ In absolute terms, India, Mexico, the Philippines, Egypt and Turkey were the five leading recipients of remittances in the developing world during the same period.

There could, however, be significant year-to-year variations. For example, provisional figures for 2005 seem to suggest that inflows to Mexico could jump from the previously estimated US\$ 16 billion to US\$ 20 billion for the whole year: indeed, for the first ten months in 2005 the total had already reached 16 billion.¹² Also, not infrequently, figures issued previously are updated and revised by national authorities. China, for example, has recently released new figures showing remittances in excess of US\$ 21 billion for 2004, compared to an earlier estimate of US\$ 4.6 billion. India, too, has reported a sharp rise in remittance receipts from US\$ 13 billion in 2001 to over US\$ 20 billion in 2004. Thus the latest (and revised) World Bank figures for 2004 showed China, India, Mexico, France and the Philippines as the five top recipients. In addition to France, several industrial countries – Spain, the United Kingdom, Germany, Belgium and the US – were on the list of top 20 receiving countries (Figure 3) (World Bank, 2005).

Of 34 developing countries that received remittances in excess of US\$ 1 billion in 2004, 26 countries registered over 30 per cent growth during 2001-2004: Algeria and Guatemala reported more than a tripling of remittance inflows; Brazil, China, Honduras, Nigeria, Pakistan, and Serbia and Montenegro reported growth in the range of 101-170 per cent.¹³

Though, as discussed below, not fully free from uneven distribution, migrant remittances are more widely spread than the other main resource inflows to developing countries, such as private capital flows and foreign direct investment (FDI). In 2001, the top ten remittance recipient countries received 60 per cent of total remittances to developing countries, well below the top ten countries' share of GDP (68%), exports (72%) and FDI (74%) (Ratha, 2003).

This, however, does not imply that remittances are quite evenly distributed across countries and regions. IMF figures (Figure 3) for gross inflows

to developing countries showed that only two of the least developed countries (LDCs), Bangladesh and Yemen, were among the top 20 recipients of remittances in 1990-2003 (IMF, 2005). In absolute terms most of the remittances flow into middle income and low income countries. Thus, in 2003, southern and southeastern Asia received nearly 25 per cent, and Latin

Figure 2 **Developing countries: 20 largest recipients of remittances, 1990-2003 average**

In absolute terms, India, Mexico, and the Philippines are the largest recipients of remittances. However, there are many small economies (typically small islands or enclaves) where remittances amount to 5 per cent or more of GDP.



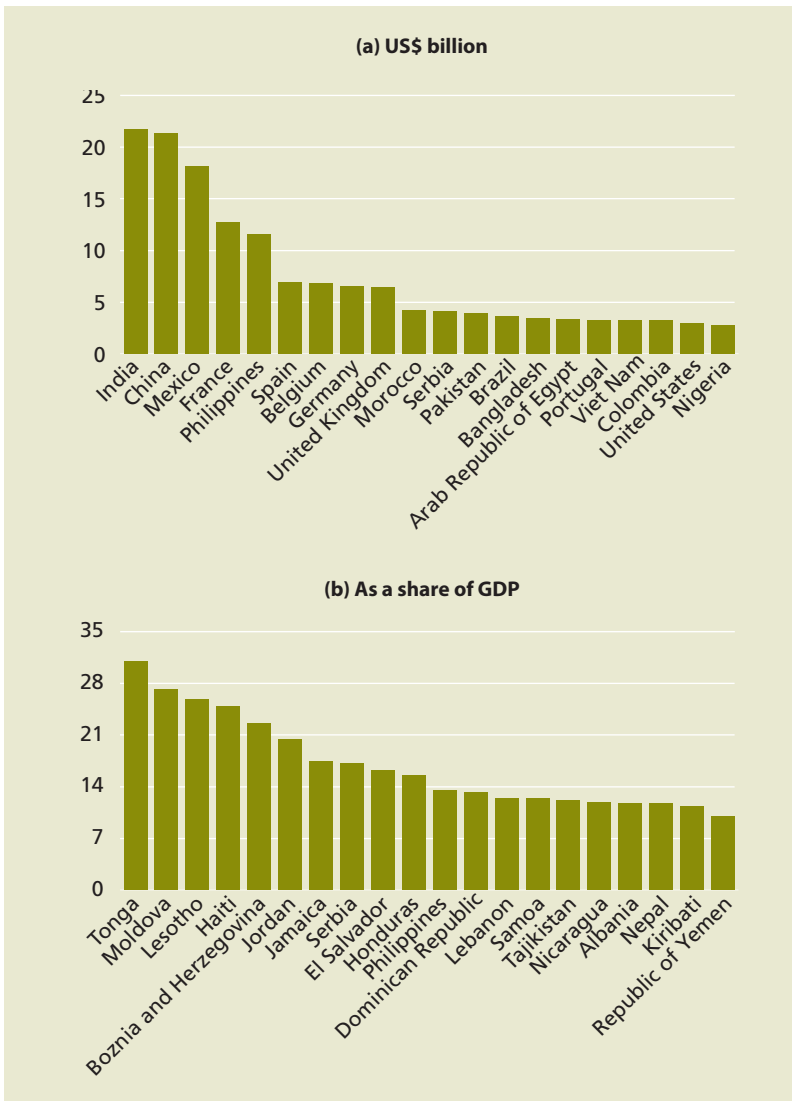
Note: Data refer to the average gross remittances for all available years over the period 1990-2003.
Source: IMF, *Balance of Payments Statistics Yearbook*; and IMF staff calculations.

America and the Caribbean region more than 21 per cent of total global remittances, as against a meagre 4.5 per cent received by sub-Saharan Africa. More recently, estimated figures for 2005 show an improvement in the latter's remittance receipt, with a gross inflow of US\$.8 billion, but hardly any real increase in its share of the global flows (Table 1). These regional and sub-regional variations in remittance receipts are likely to continue in the coming years.

Even more significant are the variations of remittance receipts as a share of GDP and relative to other resource inflows in different countries and regions. In 1980-2002, remittances for sub-Saharan countries, for example, were as low as 0.6 per cent of GDP, compared to 3.1 per cent for North Africa and 1.6 per cent for Latin America and the Caribbean region (UN, 2004, Table IV3).¹⁴ Not surprisingly, for many of the sub-Saharan countries official development assistance (ODA) is a more important source of external finance than remittances. Recorded figures for gross remittance inflows to developing countries in 1990-2003 showed that only six of the 50 LDCs were among the top recipients of remittances as a share of GDP¹⁵ (IMF, 2005). During the same period remittances in 24 countries were on average more than 5 per cent of GDP. As Figure 3(b) shows, in 2004 all 20 top recipients of remittances as a share of GDP were developing countries. Yet only five of the LDCs were among them, and for many poor countries the share of remittances in GDP was indeed meagre.

As noted, the present pattern of geographical distribution of remittance receipts in developing countries is not likely to witness any significant change in the near future. In particular the poorest countries, especially those in sub-Saharan Africa, would probably find it difficult to achieve any substantial increase in their remittance inflows as a share of total inflows to developing countries or of their GDP, despite the fact that the remittance receipts for sub-Saharan Africa may have gone up by 40 per cent between 1999 and 2003 and as much as 72 per cent between 2001 and 2005 (compared to an increase of 73% for developing countries as a whole). The present immigration climate in most industrial countries does not make the outlook optimistic. It is hardly encouraging to note that remittances to this region as a share of remittances to all developing countries has fallen from 8 per cent in 1980 to the current less than 5 per cent.

An important policy implication of the situation is that remittances should not be seen, nor sought to be projected, as a substitute for ODA.¹⁶ As a recent UN report aptly puts it, "...remittances should not be a distraction from the ODA commitments of the Monterrey Consensus of the International Conference on Financing for Development...and the United Nations Millennium Declaration" (UN, 2004).¹⁷ To illustrate the importance of ODA

Figure 3 **All countries: 20 largest recipients of remittances, 2004**

Source: World Bank, 2005, based on IMF BoP Yearbook and World Bank staff estimates.

relative to remittances for some of the world's poorest countries, the report notes "(I)n 2002 Ethiopia received US\$ 1.3 billion in ODA as compared with US\$ 33 million in remittances, Rwanda received US\$ 356 million in ODA and US\$ 7 million in remittances. For the United Republic of Tanzania, the data show US\$ 1.2 billion in ODA and US\$ 7 million in remittances". Given the gathering euphoria in some policy and professional circles over the potential role of remittances in the development of poor countries, the caution sounded in the UN report seems both timely and well taken.¹⁸

The issue of course is not just one of unequal geographical distribution of remittances. There is another, and more basic, reason why remittances cannot be a substitute for development aid to poor countries. While aid is essentially an official transaction negotiated between donor and recipient governments, remittances are purely private transfers. Clearly, the economic, humanitarian, political and security considerations that may lead donor governments to provide aid and the criteria that may be agreed upon between donor and recipient governments for its use are surely not the same as those that influence migrant remittances, for which individuals are the main actors. Although both aid and remittances have the potential to act positively in such areas as poverty alleviation and economic growth, the two sharply differ in their underlying motivations and modalities of operation, including the selectivity of beneficiaries (see Box 1).

Types and personal characteristics of migrants and remittance flows

Migration literature gives considerable attention to types and personal (including family) characteristics of migrants as factors influencing the levels of their remittances back home. It is generally believed that when a migrant temporarily moves abroad with a specific economic target – for example, setting up a business on return, building a house or buying a plot of land – the propensity to remit funds tends to be higher than when the migrant has permanent resident status in the host country. The specific target could also be related to anticipated family events and social obligations such as meeting the expenses of children's education or, in some countries, of a marriage in the family.

The level of remittances is also likely to be relatively high when the migrant is young, but married with family left behind. Mexican migrants, for example, were found more likely to remit when married, under 40 years of age, and had strong social contacts with their home country (Duran *et al.*, 1996). When however the family joins the migrant and as over time the family and social ties in the home country become weaker, the remittances are likely to taper off. In general, as Merkle and Zimmermann (1992) put it, the longer the stay abroad, the lesser are the bonds to the sending country and the lower are the remittances. This would be more so if meanwhile the individual would have acquired permanent resident status in the host country. Migrants on fixed-term contracts, on the other hand, are likely to transfer home a much higher proportion of their income.

Data on the remittances of Indian migrants as fixed-term contract workers in the Gulf States and as permanent settlers in North America, the United

Kingdom and Australia are indicative of this trend. Remittances from the Gulf States in the mid-1980s were some 2.5 times higher than those reported from the second group of countries, although the number of migrants in the Gulf States was smaller (Acharya and Acharya, 1992). Estimates made by Lucas (2005) on the basis of official remittance figures for the mid-1990s, however, showed that transfers per migrant from the two regions were about the same (Government of India, 2001). Even so, the differences in the remittance behaviour were still significant, given the fact that migrants in North America had a much higher level of income on average.

Do the levels of education and salaries of migrants also affect the levels of remittances? The limited information available on the subject seems to suggest that the highly educated and well-paid migrants tend to save and invest more in the host country. True, when a family or extended family bears the costs of education of a promising member, the person may be expected to support the family or repay the implicit loan while working abroad, and thus may remit more at least for a certain period of time. However, it is also quite likely that the majority of the better educated and better paid migrants come from well-off families, with less family obligations (and less pressing need to send money) back home.

Remittances from low-skilled migrants, on the other hand, are believed to be quite significant, although the situation varies. The average contribution from a low-skilled Mexican migrant in the US, for example, is estimated to be US\$ 500 per month, despite the fact that most of them are in an irregular situation.¹⁹ As noted above, Indian migrants in North America, who on average earned more, transferred a lower share of their income than those in the Gulf. The former were also better educated: 80 per cent of Indians in the US, for example, had a college degree, with half of them having post-graduate qualifications (Lucas, 2005). However, the differences in the levels of education and salaries of the two groups may not have been the only factors involved. The fact that Indian migrants in the Gulf States had a fixed-term status while most of those in the US were permanent settlers must also have played a part. Also, educated and well-paid migrants are generally better informed of the investment opportunities in the host country and are more familiar with the characteristics of different investment vehicles. This may also have made some difference.

In general, although the better educated or highly skilled migrants earn more, they are also more likely to move permanently and with their families; both these factors may lead them to remit a smaller proportion of their earnings. This lends credence to Faini's (2002) findings that "(...) remittances decline as the share of migrants with a tertiary education goes up". A 1998 market study of latino households in the US seems to confirm this. It shows

Box 1 **Remittances and ODA**

Migrant remittances are often compared with official development assistance; indeed, in recent years both among politicians and professionals it has become almost fashionable to do so. Presumably, the underlying idea is to highlight the growing importance of remittances compared to ODA flows. However, the comparison, though it creates excitement, could be misleading, especially when this is done in an unqualified or simplistic manner. Worse still, if given the recent increases in their inflows, remittances are seen or projected as a possible substitute for ODA. Although both remittances and ODA have the potential to contribute to development, their characteristics, *modus operandi* and role sharply differ, defying facile comparison.

Remittances are private transfers, ODA flows, which are transactions between governments, are not. This explains much, though not all, of the differences in the impact the two flows can make on development and the manner in which they tend to do so. As private flows most remittances go directly to households, with no intermediary except the agency, formal or informal, transferring the funds. Their macro-economic development impact depends critically on how the resources are used – whether for consumption or investment or both. In any case, unlike for ODA, the decision on these options is made by individuals and families – and the matter rests within the private domain.

The fact that remittances are private money has led some economists and others to insist that the flows should be left alone, with no intervention by state authorities. Some others however take a different view. One of their arguments is that migrants' income (or at least remittances) should be taxed on grounds of "horizontal equity" among citizens (Bhagwati, 1976). True, efforts to tax remittances by home country governments have not been very successful so far. But to argue that remittances should be completely "left alone" seems hardly realistic. Some regulatory measures or incentive schemes are necessary to ensure safety and efficiency of the transfers, lower the unduly high transaction costs and encourage or facilitate productive investment of remittances (see Chapter 2). But even so, there are limits beyond which it would be unwise or impracticable for public authorities to interfere with remittances as a private flow. By contrast, ODA is basically a transfer to the government of the recipient country, and its terms and conditions are negotiated primarily between governments, be it on a bilateral or multilateral basis.

Lower middle income and low-income countries are the major recipients of remittances. Although some of the small countries and island economies are also highly dependent on remittances, the world's poorest countries have a

small share of the global flow of remittances. In 2003 sub-Saharan Africa's share, for example, was just a little more than 3 per cent of the global flows, and the situation in 2005 has remained almost the same. As already noted in this chapter, only a handful of the least developed countries are among the top 20 remittance recipient countries. For most of these poorest countries ODA continues to be an important source of external finance, for which remittance can hardly be a substitute.

Further, although rich countries are the dominant source of both ODA and remittances, the considerations underlying their policies for immigration and development aid are surely not the same. Japan has a restrictive immigration policy but, in absolute terms, it is an important aid donor country.

Despite these and other asymmetries, both remittances and ODA share one common characteristic: they both constitute transfers of resources, and this provides a rational basis for comparing the two flows. However, here the main difference is that (although a few non-OECD countries have concessionary aid programmes) ODA flows are in principle transfers from rich to poor countries, whereas remittance receipts go to both rich and poor countries. Indeed, as mentioned in the main text above, in 2004 France, Spain, the United Kingdom, Belgium Portugal and the US were among the 20 top recipients of remittances. Although much of rich countries' remittance receipts come from within the OECD area, some do originate in developing (non-OECD) countries. There are also relatively significant South-South remittance flows. In 2004 outward remittances from the developing world amounted to a registered total of US\$ 37 billion, and the figure could be much higher if unrecorded outflows are taken into account.

These outward remittances, or "reverse flows", need to be deducted from developing countries' gross receipts if remittances are to be compared with ODA (net aid as registered by DAC), and not the gross remittance receipts, as is often done. "Like should be compared with like: apples with apples and not with bananas".

As mentioned in Chapter 1, when this is done and outflows from GCCs are considered as debits within the developing world, the latter's share falls to 71 per cent of its gross flows and around 50 per cent of the world's recorded total gross inflows of remittances (Figure 1(a)). And if, as mentioned in the main text, the World Bank's tentative assessment that up to 45 per cent of total remittances to developing countries originate in other developing countries is confirmed, the proportion of the resources that are transferred from rich to poor countries through the mechanism of remittances would prove to be even smaller.

that each additional year of a migrant's education reduces the likelihood of his remitting funds home by 7 per cent (de la Graza and Lowell, 2002)

A low-skilled and less-paid migrant on the other hand can be expected to remit a larger *share* of the income (though not the amount in absolute terms) than a skilled and better paid migrant. From the perspective of inward remittances per migrant and, as will be discussed later (see Chapter 4), also from the standpoint of poverty alleviation, the situation seems to provide an argument in favour of fixed-term flows of less-skilled labour migration.

However, two caveats need to be added to the above analysis. First, it must not be forgotten that if rich and educated members of the diaspora, especially those who are successful in business and industry in the host country, are attracted by the business opportunities in the country of origin, they could be, both directly and indirectly, an important source of resource flows to the country of origin (further discussed in Chapter 5). The second caveat, related to the above, concerns the duration of the migrant's stay abroad. Although fixed-term migrants, especially with specific economic targets, generally remit a higher proportion of their earnings than permanent settlers, recent experiences have highlighted the significant contribution that some permanently settled members of the diaspora can make to remittance flows if conditions are favourable in the form of investment capital, though not by way of support to the household budgets.

To what extent does an increase in the migrant's earning in the host country impact on remittances? Scarcity of data makes the answer difficult. However, one study in Botswana showed a positive correlation between rise in migrant's earnings and an increase in remittances. Other things remaining the same, a 1 per cent increase in the migrant's wage was associated with increases of between 0.23 per cent and 0.73 per cent (Lucas and Stark, 1985). There is also some evidence that at a certain point additional increases in wages may not lead to higher remittances. This may happen due to an inverse relation, often discernable, between the duration of stay and the level of remittances. With longer stay in the host country, a migrant's earnings and remittances may both rise, but after a certain period of time greater earning power may be counterbalanced by a diminishing attachment to the home country.

What about gender? Does it make any difference? Available findings based on limited empirical studies in a small number of countries are inconclusive.²⁰ Some analysts report that female migrants from Mexico to the US remit less than their male counterparts (Massey and Parrado, 1994); the same was generally the case in Albania (Gedeshi *et al.*, 2003; King *et al.*, 2003). However, studies in Botswana showed the opposite (Lucas and Stark, 1985). Based on studies in rural Mexico, Taylor (1987) reports no significant difference between

male and female remittance behaviour except in older age groups for which female remittances are significantly lower. Although comprehensive data are hard to come by, according to some analysts remittances from Asian female migrants are less affected by business cycles in the host countries because of the more stable nature of the work in which they are engaged.

Remittances, especially from female migrants, are sometimes split between two families. In Albania, for example, it was found that sons sent more to their parents than did daughters, but this was partly because many of the female migrants were married and were expected to support their in-laws rather than their own parents (Lucas, 2005). Also, even if women remit smaller amounts of money than men, it is less clear that they remit a smaller proportion of their earnings. In fact, in some countries, such as the Philippines, the opposite may have been the case (Rodriguez, 1996); the pattern was the same among female internal migrants in South Africa (Collinson, 2003). Increasing feminization of international migration – worldwide nearly half of all migrants are women – makes this issue a worthwhile topic for further research.

Clearly, economic migrants are expected to remit more than refugees and asylum seekers. Those who are forced to leave the home country due to political persecution, flagrant violation of human rights and other similar reasons are not very likely to remit funds home; nor can they be expected to have enough resources in the host country to be able to do so at least during an initial period. However, when the refugees are fully integrated in the economy of an affluent country and have full, non-discriminatory access to its labour market, they may well be found to remit funds to those left behind in order to help them overcome their difficulties, including facilitating their escape from persecution and violence. Also, temporary refugees, who hope to return home in a not-too-distant future, are more likely to remit funds to their relatives at home. Sometimes such transfers pass through a third country in the neighbourhood. Remittances from refugees abroad should however be distinguished from remittances sent by the established diasporas to refugee-producing or conflict-torn countries. As discussed in Chapter 5, transfers from the latter could be quite considerable.

A striking example of remittances from refugees to their home country is provided by Salvadorans who escaped to the US in the mid-1980s. According to one estimate, although 30 per cent of them were unemployed, the refugees sent an annual average of US\$ 1.4 billion to their relatives, overshadowing US aid and other foreign assistance to the country. The remittances were estimated to provide 60 per cent of the income of the recipient families (Montes, 1989). Refugees as a source of remittance flows however gives little policy choice. Few governments would like to provoke or encourage refugee outflows just to have access to remittances.

2

Increasing Inflows of Remittances to Developing Countries

Better access to rich countries' labour markets

There are two possible ways – and they are by no means mutually exclusive – in which developing countries can secure increased inflows of remittances, costs of transfer and exchange rates remaining the same: one is by encouraging an increase in the average amount of remittance per migrant; and the other is through the access of an increased number of their migrants to labour markets abroad.

As noted above and as will be further discussed in this chapter, the level of remittances per migrant is influenced by a litany of different factors. However, assuming that on average the proportion of earnings remitted home does not decline, it is clear that an increase in the number of migrants will lead to an increase in the total amount of remittances from the migrant-receiving countries and a corresponding increase in inflows to home countries. For a panel of 22 developed countries during the period 1991–2000 the IMF found that a two percentage point increase in the number of foreign workers as a share of the population was associated with a 0.25 percentage point increase in remittance outflows as a share of GDP (Spatafora, 2005). Likewise, Swamy (1981) reports a strong relationship between remittance inflows and the number of emigrants for Greece, Turkey and the former Yugoslavia.

Some estimates have been made of the additional amount that developing countries can gain as a result of a limited relaxation of the rich countries' policies on labour immigration. In 1992 working with UNDP we calculated that if an additional 2 per cent of the 2.5 billion labour force of developing countries (1990 figures) had access to industrial countries' labour markets, there would be 50 million additional migrants (UNDP, 1992; Ghosh, 1991). Assuming that on average each migrant earned US\$ 5,000 a year or a total of US\$ 250 billion, and remitted 20 per cent of their earnings, the extra remittances would amount to US\$ 50 billion, equivalent to the industrial countries' annual official development assistance at the time.

More recently, Dani Rodrik made a similar calculation, but using industrial countries' labour force as a point of departure (Rodrik, 2002). He estimated that temporary admission of developing country workers numbering no more than 3 per cent of rich countries' work force would yield an income of US\$ 200 billion for the citizens of the developing world. Rodrik envisages that after 3-5 years these workers would return home, bringing their savings, skills and dynamism and be replaced by a new wave of similar migrants.²¹ The remittance receipts in this case would be substantial, given that, in addition to the regular or periodic remittances during their stay abroad, returning migrants are likely to bring back all or a good part of any savings and investment they may have made in the erstwhile host country.

The gains from wider access of developing country emigrants to the labour markets of the industrial countries are of course not one-sided, limited to the sending countries alone. A more efficient allocation of labour would generate gains to the world economy from which in principle all countries should benefit. The World Bank estimates that a rise in emigration from developing countries equal to 3 per cent of the labour force of high income countries (as in Dani Rodrick's hypothesis) could lead to a global output gain of US\$ 356 billion by 2025. This is about twice the global gain from full merchandise trade liberalization, using the same model and similar assumptions. Of the increase of US\$ 356 billion in global real income those in developing countries would gain US\$ 143 billion and their migrants US\$ 162 billion (adjusted for differences in purchasing power between the high income and developing countries) (World Bank, 2005).

Any such liberalization of immigration will of course have other economic and social consequences, positive as well as negative, for both host and home countries, the discussion of which is beyond the scope of this study. It is important to note however that when migrants have a legal status in the host country, they normally earn more and have better access to opportunities for upgrading their skills and earnings. Relative to irregular migrants, and other things remaining equal, they are therefore likely to send more funds back home and the flows can also be expected to be more predictable. It is also likely that irregular migrants use informal, unrecorded channels more frequently. From the perspective of policy formulation, this makes a strong case for removing barriers to immigration that allows for legal entry of immigrants, especially into countries where unmet labour demand is causing pressure for irregular immigration.

It is well known that developing country migrants, especially those who are less skilled, are generally paid at lower rates than domestic workers of comparable skills in rich countries. Even so, since, compared to developing countries, earnings in more affluent countries (including the oil producing

GCCs) are much higher,²² migrants working in these countries can be expected to earn more and send on average a much higher amount of remittances than those working in less affluent countries, other things remaining the same. For example, Lucas (2005) estimates that the average remittance per migrant in developing countries was US\$ 160 in 2000, compared to US\$ 926 in EU-15 countries; it was as high as US\$ 3,988 per migrant in Bahrain and US\$ 3,231 in Belgium and Luxembourg (see Table 4). Not surprisingly, a developing country, anxious to increase its remittance inflows, would be more interested in seeking access for its potential migrants to the labour markets of rich, rather than of low-wage, countries. Whether or not they will actually have such access is of course a moot, but different, issue.

Do remittance outflows hurt host country's economy? Financial implications for host countries

This study, which as already mentioned, seeks to examine how and to what extent remittances can be harnessed to promote development of the migrant-sending developing countries, leaves out any discussion of their effects on host countries. And yet one specific question cannot be avoided even within the limited scope and context of the present study: do outflows of remittances hurt the economy of the host country? The question is important especially because some analysts have explicitly argued that these outflows are indeed a drain on the host country economy, with an adverse effect, in particular, on its external balance of payments.²³ If this view is valid, it could be a powerful argument against remittance outflows, and indeed against additional immigration, especially for host countries (like the US) that are facing balance of payments difficulties.

Remittances are part of the immigrant's earnings which reflect the person's incremental contribution to the host country output. To the extent that remittances are spent on imports from the host (migrant-receiving) country, its trade increases, but its balance of payments remains unchanged. If the remittances are converted to other currencies, for example, to finance imports from a third country, the result will be the same, provided the third country uses the extra earnings on imports from the host country. As long as the external demand resulting from remittance outflows can be matched by migrants' net additional contribution to the production of its tradable items, the immigration country need not be unduly concerned about the strain on its balance of payments.

Table 4 **Recorded remittances by source country and per migrant**

	US\$ million		Remittances per migrant (US\$)		
	Workers' remittances	Compensation of employees	Workers' remittances	Compensation of employees	Total
World total	56,626	45,219			
World total where migrant stock is known	56,626	38,679	340	232	572
EU-15	9,489	14,994	359	567	926
Austria	280	383	370	507	877
Belgium Luxembourg	431	2,932	414	2,817	3,231
Denmark	0	662	0	2,178	2,178
Finland	0	100	0	746	746
France	2,693	1,093	429	174	603
Germany	3,191	4,234	434	576	1,010
Greece	205	251	552	470	1,022
Ireland	4	105	13	339	352
Italy	541	1,960	331	1,200	1,531
Netherlands	522	925	331	587	918
Portugal	173	127	742	545	1,288
Spain	1,325	414	1,052	329	1,381
Sweden	34	488	34	491	526
UK	0	1,320	0	328	328
Other Western Europe	1,703	6,346	805	2,999	3,804
Bahrain	1,013	0	3,988	0	3,988
Kuwait	1,734	0	1,565	0	1,565
Oman	1,451	0	2,128	0	2,128
Saudi Arabia	15,411	0	2,933	0	2,933
Hong Kong, Special Administrative Region of China	0	7	0	3	3
Japan	2,259	272	1,394	168	1,562
Republic of Korea	227	51	380	85	466
Malaysia	0	490	0	352	352
Singapore	0	0	0	0	0
Australia	0	592	0	126	126
New Zealand	124	0	146	0	146
Canada	0	0	0	0	0
US	18,610	8,210	532	235	767
Developing countries	4,606	7,717	60	100	160
Africa	1,474	860	107	63	170
Asia	1,093	1,512	65	90	154
Europe	243	1,458	7	45	52
Middle East	501	3,422	60	407	466
Americas	1,295	465	245	88	333

Sources: Lucas (2005), based on IMF *Balance of Payments Statistics 2002* and UN (2002).

Note: Figures both for remittances and migrant stock used in this table are incomplete and non-updated. For example, updated World Bank figures for total remittances show an amount of US\$ 131.5 billion in 2000 (see Table 1) compared to US\$ 95 billion mentioned in this table. However, it does bring out the wide disparities in remittances per migrant in different countries hosting migrants.

It is possible however that all of the remitted funds is not spent on imports from the host (migrant-receiving) country and that part of the funds are saved by the home (emigration) country, creating a deficit in the host country's current account with the latter. But given the availability of additional tradable items, there is no absolute reason why the host country will not be in a position to balance the deficit by increasing its earning from additional exports to other countries. It is also possible that the home country itself will invest some of its current account surplus in the host country, which would imply a reverse transfer of funds through its capital account.

In an alternative, but related, scenario, the host (migrant-receiving) country may even improve its external payments situation despite the remittance outflows. If, for example, the immigrants bring in labour and skills that were previously unavailable in the host country, the latter may find it profitable to produce some of the goods and services that it had imported in the past, thus reducing its external account debit. Furthermore, the change in the output mix may even give the host country a comparative advantage in exporting new tradable items and thus increase its foreign exchange earnings. The net result may imply an improvement in the host country's balance of payment position despite the remittance outflows.²⁴

We could also ask a related question: do remittances by immigrants have an effect on inflation in the host country, helping or hindering the host country's exports? As already noted in Chapter 1, labour migrants, especially temporary labour migrants, normally save a relatively high proportion of their earnings; not infrequently they do so in order to be able to remit funds home. Their high propensity to save, which in most cases is also helped by significant real earnings differentials between home and host countries, normally have an anti-inflationary effect in the migrant-receiving country. In any case, as long as the immigrants' remittances coupled with their local savings (kept in the host country) do not indicate that the overall saving rates for immigrants are lower than for total population, immigration does not add to the inflationary pressures at the macro level of the host country economy. Furthermore, to the extent that immigrants effectively satisfy an unmet labour demand in the host country, they restrain cost-push inflation and help exports, as was evidently the case in West Germany during its "economic miracle" in the years following World War II.

Migration motivations and the migrant's remittance behaviour

Discussion in Chapter 1 has shown how both the type of migration²⁵ and the personal characteristics of migrants affect the level of remittances. Some

analysts have also tried to examine remittance flows from the perspective of the motives of migration, and have conceptually grouped the motivations into two distinct categories: *altruism* and *self-interest*. The first refers to situations where the migrant sends money home to help those left behind; the second to situations where promoting the migrant's self-interest (for example, to invest in the home country or to inherit remittance-based assets) is the basic motivation. Some others have made a similar distinction between "fixed remittances" that are geared to the already known family obligations at home and "discretionary remittances" that may vary depending on such factors as the financial risks and rewards on saving and investment in the home and host country (Wahba, 1991). The latter (discretionary remittances) is quite consistent with the "portfolio" approach to remittance behaviour under which remittances are basically driven by an investment motive. Still another approach is based on the notion of "exchange", which suggests that remittances are effectively paying back the family or relatives for investments made in connection with the migrant's education or travel abroad (Cox, 1987).

These various approaches are however not mutually exclusive in all cases. For example, remittances related to altruism and self-interest often go hand in hand. Helping the household and relatives at home, though often an important motivation to remit, can well be combined with the migrant's desire to promote his own interest. In many cases, this takes place within the household, with those left behind taking care of the migrant's investment or farms jointly owned by them. Migration specialists have long recognized the role that family household thus plays in influencing the migrant's remittance behaviour, especially in traditional rural societies. The so-called "new economics of labour migration" explores this further and is more articulate in defining this relationship. It sees the relationship as a mutually beneficial contractual arrangement (though often of an informal nature) which plays a specific role in providing credit for production at home and mutual insurance against temporary loss of either party's income, thus overcoming market failures or structural deficiencies that constrain production. The idea of an informal contractual arrangement is consistent with, and can embrace, the notion of exchange or paying back the household or relatives the investment previously made by them on the migrants' education or journey abroad.

New economics of labour migration sheds useful light on these household-based income and risk insurance aspects, although it fails to cover migrants' remittance behaviour in all situations. For example, with the weakening of the structure of the extended or joint family system especially in urban and semi-urban areas and the rapid erosion of the solidarity that used to bind its members in the past, the mutually beneficial contractual arrangement within the household is losing at least some of its significance. The emergence of

micro-finance and cooperative institutions has started replacing the role of the extended family in overcoming the constraints of credit and mutual insurance. Also, altruistic motives such as helping family members and relatives may be less relevant for migrants belonging to middle and upper class nuclear families in urban areas. And yet these migrants may make some remittances to their bank accounts in the home country for various reasons – in anticipation of a future return to the home country, higher interest and better income on investment, emotional links with the country of origin or a combination of them.

While new economics of labour migration focus on the mutually beneficial contractual arrangement within a household as a basis for remittances, a recent paper by Chami and others (Chami *et al.*, 2003) assumes that altruistically motivated remittances are intended to compensate the recipients for economic misfortunes or bad times. There is therefore an inverse relationship between the level of remittances and the level of income of the recipients from other sources: one rises as the other falls. Admittedly, there is some empirical evidence that in bad times in the home country remittances tend to increase rather than fall, with a consequent counter-cyclical impact. However, when remittances are meant to enhance the joint interest of the migrant and the family at home (as assumed in new economics), there is no absolute reason why an improvement in the fortunes of the family and those of the country will lead to a fall in remittances.²⁶ On the contrary, the improved economic outlook may encourage the migrant and the family to adopt riskier strategies and technologies or new ventures. The point is discussed in further detail in connection with the investment and growth impact of remittances in Chapter 4.

The migrant's propensity to remit, and especially the effective levels of remittances, are often influenced also by various external factors such as the cost of transfer, regulatory measures and incentive schemes, and the overall political and economic climate in both host and home countries, including in particular exchange and interest rates and investment opportunities. Questions related to the transaction costs as well as incentives and regulatory measures are discussed below, while some of the other factors involved are taken up in the context of the volatility of remittances in Chapter 4.

While, as discussed above, the determinants of migrants' remittance behaviour vary widely, one thing remains certain. No matter what these determinants are, migrants' remittance behaviour directly influences the manner in which they are used, and thus the nature of its economic and social impact, which is examined later.

Why should the transfer costs be so high?

High costs of transfer of funds, a market traditionally dominated by money changers and transfer services, coupled with the lack of reliable banking facilities, reduce both the effective volume and the development impact of the flows. It is not just that the transfer cost is high – often between 10 and 20 per cent of the principal (World Bank, 2005). Even more worryingly, the cost is disproportionately high for small amounts which hits the poor migrants and their families particularly hard (Figure 4). The situation also encourages transfers through informal channels which often charge much lower fees.

The true cost of transfer is quite small. It is the lack of competition and market imperfection coupled with inefficiency that accounts for the high fees charged by the transfer agents. Restrictive regulatory frameworks, including high collateral requirements, deter potential competitors from entering the remittance market. New entrants are often handicapped when large and influential transfer agents make exclusive arrangements with banks or similar institutions with extensive networks in developing countries and others are denied access to these distribution networks.

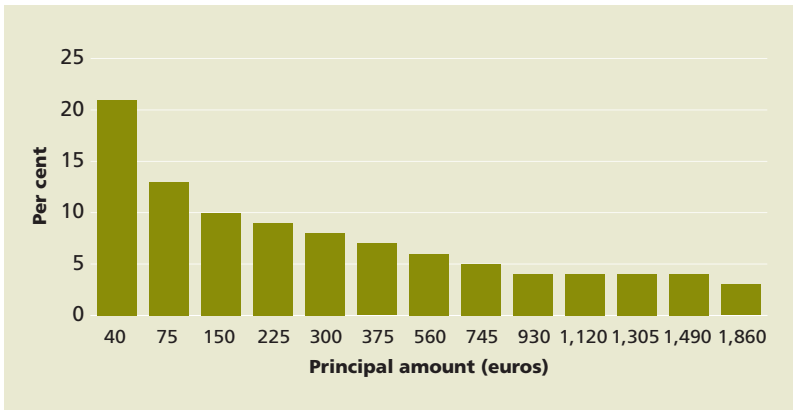
A survey was recently made of the transfer cost from six remittance sending countries – France, Germany, Saudi Arabia, South Africa, the United Kingdom and the US – to 14 receiving countries in Africa, South Asia, Latin America and southern Europe (Orozco, 2003). It confirmed that the cost of transfer charged by different formal agencies was very high for small amounts; it also varied significantly, depending on the type of agency. The mean value of the charge to send US\$ 200 was 6 per cent through national money transfer companies (“ethnic stores”), 7 per cent through banks and 12 per cent through international money transfer companies.

However, more recently increased competition among private financial institutions and closer attention to the problem by governments and development banks have to some extent improved the situation (Figure 5). At the same time, the opening up of rapidly increasing opportunities for remittance-related business has encouraged commercial banks and other financial agencies to intensify their search for improved efficiency of the modes and mechanism of their transfer operations. This too has contributed to the trend towards reduced cost.

In Latin America, for example, there has been some significant progress in reducing the transfer cost. As part of this effort towards lowering the cost the Inter-American Development Bank (IADB) is trying to clear regulatory, economic and other barriers that prevent new agencies from entering

remittances transfer business. The average cost, which until recently was more than 15 per cent, has now come down to 8 per cent. However, as of 2000 average cost of transfer was still more than 10 per cent of each US\$ 200 transaction for Jamaica and over 12 per cent for Cuba. The IADB is seeking to lower the cost further to 4 per cent by 2010.²⁷ In fact, this may already be happening in certain transfer corridors.²⁸

Figure 4 **Remittance costs as percentages of the principal amounts**



Note: Cost of sending money from Brussels using a major money transfer operator, excluding foreign exchange commission.

Sources: Ratha 2003, based on cost figures obtained from various Western Union branches in Brussels and Paris.

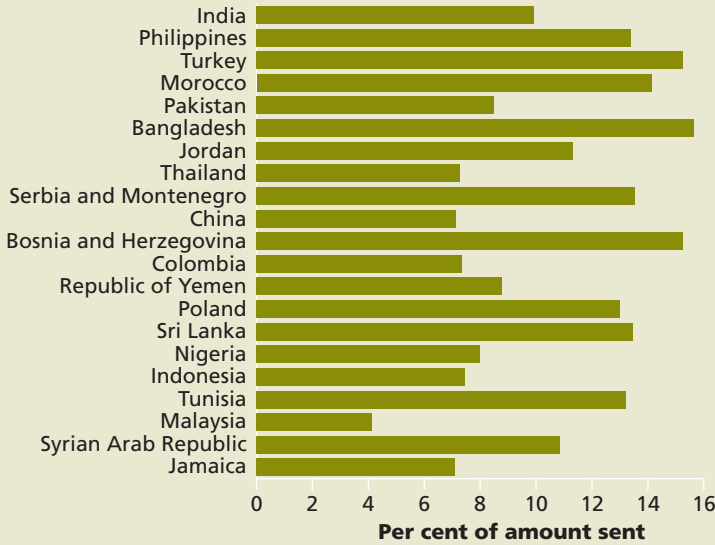
Technological innovations and inter-institutional links are helping the process. In Mexico BBVA Bancomer, which has already established links with Wells Fargo bank and with a number of transfer services in New York and with the US Postal Service, has just planned to launch a pre-paid debit card to the US-based migrants that can be used by their families back home even if they have no bank accounts. Another bank, Banamex, has planned to launch a single account that can be operated on either side of the border. As its chief executive put it, when the momentum of lower cost arrives, "families divided by geography will be united by bank accounts."²⁹ In Durham, North Carolina, one credit union signed up Mexican immigrants at a poultry plant as clients. These migrants can now deposit funds in accounts that their families can access in Mexico by using ordinary ATM (Automated Teller Machines) cards (Iglesias, 2001).³⁰

The introduction of Poni card, which Mexicans can buy in groceries of several US cities, is another interesting development. The card looks like a phone card, comes in various denominations and has a 16-digit PIN code which is concealed in the back, but becomes visible when the foil is scratched. A Mexican who has bought the Poni card and is armed with the PIN, can

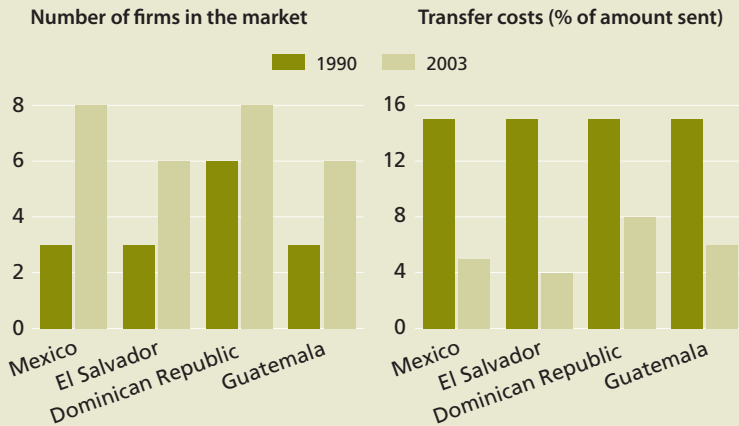
Figure 5 **Cost of sending US\$ 200 in remittances from the United States**

The cost of sending remittances displays significant variations across countries. Over the past 15 years, competition has increased and costs have been reduced – but in some cases remain very high.

**Transfer costs to some leading recipient countries¹
(ordered by total remittances inflows)**



Competition and transfer costs to Latin America



¹ The cost of sending remittances is calculated as the percentage difference, as of February 2005, between the value of US\$ 200 in a country's local currency, converted using official exchange rates, and the actual payout from Western Union net of all service fees and exchange rate charges.
Sources: Western Union; Women's World Banking; and IMF staff calculations.

withdraw that amount from an ATM. Each PIN can be used only once and the ATM responds only to the PIN. The card's backers think that its key advantage, compared with a bank account, is that it maintains anonymity.³¹

Electronic transfers and related innovative devices hold enormous potential to increase remittance flows at low cost. These can also increase the security of transfers, the importance of which was brought into focus by the findings of a recent study suggesting that in the past as much as 46 per cent of remittances might have been hand-carried to Mexico. Figures for the first eight months in 2003 suggest that overall 85.7 per cent of recorded remittances to Mexico were sent electronically, compared with 43.7 per cent a decade ago, while the proportion sent by money order declined from 46.6 to 12.6 per cent and that by hand (as cash) from 8.2 to 1.6 per cent during the same period.³² But electronic transfers presuppose the existence of appropriate institutional and technological links. Governments can play a part by providing recognized money transfer agencies easier access to state-owned service networks for remitting funds. They can also encourage the development of credit unions and community based micro-finance institutions to extend the financial network to rural areas.

Thriving credit unions as seen in Spain and Portugal today were built largely on remittances sent home by migrants in other European countries in the 1960s and 70s. In Latin America and the Caribbean, where an estimated 70 per cent of remittances flows into areas with limited or no formal banking or micro-finance institutions, the Inter-American Development Bank, through its Multilateral Investment Fund, is trying to promote credit unions and micro-finance institutions by helping them acquire the technological platform needed to operate efficiently and securely with their counterparts in developed countries where migrants reside. Meanwhile, the International Remittance Network launched by the World Council of Credit Unions has started offering safe transfer services at low cost. Under the programme migrants have the option of making a transfer (a) from a credit union agent to a credit union payer, (b) from a credit union agent to a non-credit union payer or (c) from a non-credit union agent to a credit union payer. The current network provides service to countries in Latin America, Asia, Africa, Europe and Australia. It has, for example, linked credit cooperatives of agricultural workers with Citibank branches in the US, Mexico and several Central American counties (Ratha, 2003).³³

In some Asian countries, notably Bangladesh, micro-finance institutions are quite well developed, with extensive networks in rural areas. So far, however, they have been less actively involved in remittance-related activities. While this is partly because the institutions already have a heavy work programme, regulatory constraints may also be partly responsible for the situation.

They seem however to have a significant potential role to play not only in transferring remittances to poor people in rural areas at low cost, but also in channelling them to productive activities. Judging by the experience in Latin America and elsewhere, it would be worthwhile for governments to encourage and enable the Asian micro-finance institutions to be more actively involved in remittance-related activities.

Some progress is being made in reducing the cost of transfer from Europe to Africa, although the process remains slow. For example, three banks in Paris – the Banque de l'Habitat du Sénégal, the Banque de l'Habitat du Mali and the Banque des Ivoiriens de France – have set up a special scheme for remittances to Côte d'Ivoire, Mali and Senegal with significantly lower costs than money transfer agencies. By 2002 they were handling more than 400 transfers a day (IOM, 2003; Enogo, 2002).

Compilation of statistics showing the recent declining trends in transfer costs as well as the varying current costs of cross-country transfers through different financial agencies would encourage healthy competition and generate wider public awareness of the importance of the issue³⁴ (for additional discussion see Chapter 5, "The Corporate Sector").

Incentives and regulations: When do they work?

When remittances move through informal or underground channels they do not contribute to official foreign exchange reserves, nor can they be geared to the development policy and priorities of the country. In periods of economic and financial instability this also helps uncontrollable capital flight. Even more disquietingly, informal remittance systems also provide a convenient channel for money laundering and funding criminal and terrorist activities and civil wars (Kapur, 2004).

In the past, governments of a number of countries, including Bangladesh, India, Lesotho, Pakistan, the Philippines, the Republic of Korea and Sri Lanka, have tried to encourage transfers through official channels by means of regulatory measures or by launching incentive schemes or both. Lucas (2005) groups them under four main categories: mandatory remittance requirement; financial incentives offering preferential exchange and interest rates and tax breaks, and regulation of informal intermediaries.

Several of the above countries, for example, Bangladesh, India and Pakistan have allowed their migrants to open foreign currency accounts that paid

preferential interest and to convert the holdings into local currencies at premium rates. Some governments, India for example, issued special foreign currency bonds targeted at their respective diaspora communities. A number of other countries, including Bangladesh, China, Eritrea, Israel, Lebanon, Pakistan and the Philippines, have issued similar premium bonds for their diasporas. Under the Bangladesh wage-earner scheme, the migrants could sell the remittance-based foreign exchange receipts at a premium through public auction, and the buyers were allowed to import certain goods authorized by the government. Some other countries, including Pakistan and the Philippines, introduced similar incentive schemes. In the Philippines, for example, the overseas worker was allowed to spend up to US\$ 2,000 in tax-free stores within two weeks of return to home country and in Pakistan migrant remittances of US\$ 2,500 or more through official channels would provide certain privileges such as allowances for duty-free imports and issuance and renewal of passports free of charge.

As for regulatory measures, the Republic of Korea required its migrants to remit 80 per cent of their earnings through the state bank, while the Philippines required 50-70 per cent and Bangladesh a minimum of 25 per cent of the earnings to be repatriated in a similar manner. Lesotho made arrangements with the South African government for 60 per cent of its migrant workers' remittances to be withheld and repatriated on the migrants' behalf. Attempts at similar regulatory requirement for transfer of part of the earnings through formal channels were also made by countries like Pakistan and Thailand.

These measures, especially the regulatory ones, have however not met with great success in all cases. As already noted (see Box 1), some specialists are critical of any kind of regulatory intervention simply on the grounds that remittance flows are private transfers and that individuals – both migrants and recipients – should be allowed to decide and act freely on how the funds should be used. In other words, they should be left alone. This however seems to be an extreme position. Some regulatory measures may be needed precisely to widen the choice of the individuals regarding the mode of transfer and use of the funds. Such measures may be unavoidable, for example, to introduce reforms in the banking and financial services in a way that ensures safety and efficiency of the transfers, promotes competition and lowers transaction costs and encourage productive investment of remittances through, for example, leveraged credit.

A more pragmatic consideration relevant to both regulatory and incentive systems lies in assessing whether or to what extent (a) they are realistic in the context of the surrounding circumstances and (b) the government has the administrative capacity to manage and oversee the measures with efficiency

Box 2 Why do migrants use informal channels to transfer funds?

No one can be absolutely sure about the exact proportion of migrant remittances that are sent to developing countries through informal channels. But the reasons why they do so are fairly clear. These reasons are however of a varied nature and are therefore discussed in their wider contexts in different chapters of this study. It is felt however that a synoptic overview of these various reasons, as presented below, may be found useful.

An obvious reason why migrants in many cases are obliged to use informal channels is the absence of banking facilities or similar financial services connecting the remittance sending and receiving areas. The only other alternative is to carry the cash to the migrant's home country. However, even when safe, it is hardly a practical solution if remittances are to be made on a regular, for example, monthly, basis to support the household budget. The non-availability of organized banking or similar financial services continues to be a serious problem for many remittance-receiving families and those living in refugee camps in remote rural or other isolated areas in the developing world.

The existence of formal institutions at both sending and receiving ends is by no means enough to ensure that transfers can take place through these channels. As discussed in this chapter, lack of effective networking arrangements and inter-institutional links between them due to legal constraints or practical and technological difficulties, may rule out the feasibility of making transfers through them and drive the migrants to informal channels. Nor does the mere existence of formal institutions mean that the migrants have easy access to them. In Germany, for example, new legislation, introduced to combat money laundering, requires the remitter to have an account with the bank from which money is transferred.

Procedural complexities such as the requirement of personal identification documents or of maintaining a minimum credit balance may discourage poor and less educated migrants to open accounts with banks, and make use of their transfer services. Some of them are afraid that the failure to produce valid papers at a bank could jeopardize their possibility to stay in the country, while some are put off by the cumbersome and delaying paperwork involved.

When, by contrast, migrants have easy access to bank services they tend to send money through formal banking channels, as illustrated by Mexican

migrants in the US who benefited from the *matricula consular* under the US-Mexico agreement and by Filipino migrant workers in Europe following the extension by the Philippine National Bank of its services to several west European countries (further discussed in Chapter 5).

Migrants in some cases prefer to use the informal channels also because they find the formal institutions slow, less efficient and less trustworthy. It should not be forgotten that many traditional informal channels are based on long-standing mutual trust, and well established (even if unwritten) ground rules, with a solid reputation for reliability. More important, informal channels are often cheaper and generally much faster. For instance, the *hawala* system, which is widely used in South Asia and is based on mutual trust, charges 1.25 to 2 per cent of principal amount, requires no official identification documents, and is well organized in the migrants' home countries and thus quick on delivery. The *hundi* system in India operates on a similar basis.

As the discussion in this chapter shows, until recently the cost of transfer through formal channels, especially for small amounts, has been high, even as high as 20 per cent, although the actual cost, according to the World Bank, could well be 5 per cent. For some transfer corridors the cost continues to be exorbitantly high.

And, if the high transaction fees charged by money transfer agencies drives many migrants to informal channels, the existence of dual exchange rates, with a high premium on the host country currency in the black market, makes the attraction of these channels even more powerful. A large part of the remittances is lost when the transaction cost is high and the home country currency is over valued. In such situations migrants can reduce the transaction cost and make a gain on the exchange rate by turning to the informal channels. Athukorola (1993) shows that funds are more likely to be transferred through informal channels to countries with a high black market premium, an underdeveloped financial market and a low real interest rate. There is little doubt that the existence of a dual exchange rate and the high cost of transfer are among the most important factors that encourage the use of the informal channels. (See Chapter 1). Indeed, according to some studies (e.g. Freund and Spatafora, 2005), if transaction costs were reduced to 2-5 per cent and dual exchange rates eliminated, remittances through formal channels can go up by 50 per cent or more (see Chapter 5).

and honesty. Where the government lacks in such capacity the rules and regulations could be counter-productive, creating bureaucratic delays and obstacles and lead to official corruption. Regulatory measures in Bangladesh, the Philippines, Pakistan and Thailand requiring labour migrants to remit a minimum percentage of their earnings through the banking channel have failed (Abella, 1992). Clearly, when much of the labour migration takes place outside of government control or monitoring and especially when the black market exchange rate carries a high premium, it is difficult to enforce such regulations.

Compulsory transfers or forced remittances under regulatory arrangements, whether of a bilateral or unilateral nature, also raise an ethical question. The home government may be interested in such arrangements to ensure transfers of funds through formal channels and their productive use in domestic economy. For the host government these could be a powerful means to induce temporary labour migrants to return home following the termination of contracts. However, any such arrangements without the free and explicit consent of the migrant are clearly a violation of the principle of wage protection enshrined in the ILO Convention No. 95 (1949) and also in the domestic labour legislation of many countries. If they are unethical, they are not, experience suggests, fully effective either.

Some of the incentive schemes, on the other hand, have been more successful. The Indian initiative to sell “resurgent Indian bonds” to expatriates under attractive conditions – free from exchange rate risks, exempt from Indian wealth and income tax and carrying attractive interest – had a remarkably positive response, just as the facilities offered by several home countries to open non-resident accounts abroad in national banks have had some success in increasing transfers through official channels. Pakistan’s experience with similar schemes has been rather mixed. While the scheme introduced in 1985 was quite successful in the first three years, the two successive initiatives in 1992 and 1998, respectively, much less so. The 1992 scheme was undermined by the financial scandal and the closing of an erstwhile influential bank – Bank of Credit and Commerce International. The 1998 issue was the victim of the adverse international response to Pakistan’s nuclear bomb test which forced the government to freeze foreign currency accounts and led to a sharp fall in public confidence in the formal banking system and in the promises made by the government. In the event, overseas remittances through banks dropped from US\$ 150 billion per month to US\$ 50 million (Passas, 1999).

An important limitation of foreign currency bonds and accounts is that by their very nature they are attractive mainly to better educated and high-income groups of migrants and hardly an adequate response to the

leakage of remittances into informal channels (Puri and Ritzema, 1999). True, although the bonds are in foreign currency, it is likely that some of the funds would remain in the home country even after they have reached maturity. However, foreign currency bonds hardly address the causes that lead to the diversion of remittances into informal channels.

Several governments have provided direct and indirect incentives for individual migrants and/or their associations to channel remittances to productive investment (discussed in Chapter 5). To the extent that the incentive schemes are both sound and attractive, a requirement of prior evidence of transfers through official channels could encourage increased flows of official remittances. India for example offered preferential access to imports of capital goods and raw materials to encourage returning migrants to set up or expand business firms. Pakistan has had a similar scheme aimed at encouraging its migrants to set up business firms in backward areas and export processing zones. In the past, however, such schemes have not always worked well. In the case of India, for example, the impact of the schemes, as Puri and Rizema (1999) noted, has been rather insignificant. A potential drawback of such schemes is that preferential access to capital goods (and the consequent distortion in factor costs) might encourage capital-intensive production inhibiting job creation in countries suffering from unemployment.

This risk, however, seems limited, given that most of the firms are likely to be small in scale and the level of technology relatively low. Admittedly, however, preferential exchange and interest rates to encourage remittances through official channels do carry in general a risk of factor cost distortion.

Abolition of exchange rate and capital market controls increased remittances through formal channels to several countries in Asia and Africa. Following liberalization of the exchange rate in 1991, India saw a decrease in the use of illegal channels of transfer to the state of Kerala. Bangladesh could curb the informal *hundi* transactions significantly following the adoption of a similar measure in 2002 (Siddiqui, 2003), and the Philippines quadrupled its formal remittance receipts by abolishing exchange controls in the same year (Buencamino and Gorbunov, 2002). Wahba (2005) notes that Egypt tried to increase official remittances through incentives such as government bonds and higher interest rates and by a crackdown on the black market, but a wide gap of some 30 per cent between the official and informal exchange rates made them ineffective. However, the realignment of exchange rates in 1987 led to an increase of around US\$ 750 million, the bulk of which were remittances from migrants abroad.

Turkish authorities designed special programmes linked to remittances and return in order to promote employment and economic growth. These

include: establishment of workers' joint stock companies, creation of village development cooperatives, and organization of mixed enterprises with public and private capital, including migrant remittances. However these initiatives have not met with great success. Workers' companies, for example, have run into difficulties involving project identification, financial and technical planning and management and effective communication (Içduygu, 2005). For Greece, Glytsos (2005) notes that although some private and official initiatives, such the operation of Greek banks in host countries have attracted more official remittances, incentives for increased use of remittances for productive purposes such as subsidization, tax allowances and privileged treatment of migrants' production cooperatives had only a very limited appeal.

In Africa, a few home country governments have provided incentives, in some cases together with the authorities in the host country, to encourage migrants and their associations to invest in their communities of origin. In some cases the authorities of the host country are actively involved in such initiatives (see also Chapter 5).

Some analysts believe that one particular reason for the mixed achievement so far of the remittance-supported productive projects in Africa relates to the difficulties in ensuring their effective management from a distance. The problem could be particularly acute for business projects launched by individual migrants with their own remittances. Immigration restrictions in many host countries discourage resident migrants to pay periodic visits to the home country or make a tentative return to the country. At the same time, many are reluctant to hand over the management of these projects to people in which they have limited confidence. One way of mitigating the drawbacks of long-distance management would be for the host country to devise an immigration policy that allowed resident migrants to return home for the period needed to set up productive projects, and to travel back and forth building up more assets and improving their skills (Gruber, 2005).

It would be worthwhile to make a critical review of the reasons why the regulatory and incentives systems have been more effective in some cases and not in others, highlighting the practices that worked best and discerning the positive and negative lessons to be learnt.

In the post-September 11 climate governments need to be particularly careful that the expansion of the transfer services network is not abused by criminals. But, equally important, they should also ensure that regulatory measures are proportionate to the potential risks and sensitive to the possible impacts on those who rely on remittances. The challenge is to strike a balance between preventing the financing of terrorism and other

criminal acts and ensuring freer flow of remittances (UK House of Commons, International Development Committee, 2004).

The importance of the political and macro-economic environment

While the various factors mentioned above are clearly important, what also matters in the last analysis are political and macro-economic (including exchange rate) stability, absence of corruption and an investment-friendly climate in the remittance-receiving country (DFID/World Bank, 2003). Cross-country comparison reveals a close statistical relationship between these factors and the level of official remittances. As discussed below, this is more so for investment-oriented remittances.

Drawing on the existing literature, Spatafora (2005) lists five broad groups of external variables that could affect remittances either changing the migrant stock abroad or the average remittances per migrant: (a) **Economic activity in the host country.** Improved economic conditions in the host country allow existing migrants to send more remittances and may also trigger greater emigration from the home country, increasing future remittances. An economic downturn would have the opposite effect. (b) **Economic activity in the home country.** Negative economic shocks in the home country may encourage existing migrants to send more remittances and push more people to migrate. (c) **Economic policies and institutions in the home country.** The presence of exchange rate restrictions and black market premiums or general macro-economic instability may discourage migrants from sending remittances, or shift away from formal channels. (d) **General risks in the home country.** Political instability, including low levels of law and order and risks of expropriation, may discourage remittance inflows. (e) **Investment opportunities.** Higher political returns on host country assets may induce migrants to invest their savings in the host country rather than remitting them home.

This is a fairly exhaustive list of external variables that affect remittance flows. And regression studies for a panel of 87 countries during 1980-2003 were found to confirm their importance in influencing the flows. It should not be forgotten however that the effect of these different external factors on the mode and amount of transfer may significantly vary depending on the intended purpose of remittances; the two tend to interact with each other. The level of corruption and exchange rate stability, for example, may have a stronger effect on the volume of recorded remittances when they are geared to business investment than when directly related to household

consumption and the family budget. Although hard evidence showing a direct causal relation between corruption and low level of remittances is difficult to come by, some analysts have suggested that this probably explained why during 1996 and 2000 formal remittance receipts averaged 0.5 per cent of GDP in countries with higher than median-level corruption (as measured by the index of the International Corruption Research Group), compared to 1.9 in countries with lower than median level corruption (Ratha, 2003).

Likewise, variations in the exchange rates are likely to have a more important impact on business-related remittances than those intended mainly to support the household budget or for similar altruistic purposes. Nevertheless, the effects of exchange rates on the latter should not be completely discounted. Depreciation of the exchange rate of the home country currency, without a corresponding rise in the domestic prices, makes it cheaper in foreign currency to provide the same level of real support to those at home. The situation provides the migrants with different options. They may maintain the same level of real support by using less of their foreign currency incomes, as the Greek migrants in Germany may have done between 1960 and 1982 (Gylstos, 1988). Alternatively, they may remit the same amount of their foreign earnings, thereby increasing the real support to those at home; or may even decide to increase their foreign currency remittances in order to take advantage of the depreciation of the home country currency – for example to repay a loan, make a new investment or provide additional real support to the households left behind. The latter was experienced, for example, in the Philippines following depreciation of the Filipino pesos during the Asian financial crisis in the late 1990s (Yang and Martinez, 2005). Likewise, devaluation of the Egyptian pound in 1987 and of the Turkish lira in 1980 led to increased remittances to the home countries. Increased remittances in such a situation may also be influenced by other surrounding factors such as migrants' improved earnings or wealth in the host country. Depending on the volume, increased remittances can of course contribute to the appreciation of home country currency.

To the extent that migrants are interested in investing their savings, interest rate differential between home and host countries may similarly influence the migrants' remittance flows. El Sakka and McNaab (1999) found that remittance inflows to Egypt were lower during 1967-91 when the rates of return were higher in other Arab countries. If the interest rate is higher in the home country, and other things remain the same, more funds are likely to be remitted for investment. The problem is that other things seldom remain the same. For instance, despite its higher rate of interest, migrants may be less inclined to remit for investment in the home country if an actual or anticipated depreciation of the exchange rate is likely to offset the gains from

the interest rate differential. Concern over actual or anticipated depreciation of the exchange rate is one of the important reasons why, despite their higher interest rates, developing countries are generally unable to attract more remittances for local currency investment.

And, while these financial variables and migrant motivations are important, they could be overshadowed by sudden and powerful political changes in the home country or abroad. As the experiences of Pakistan in 1992 and 1998 (discussed above) clearly showed, a decline in confidence in the government can nullify the effect of financial incentives on remittance inflows. Likewise, based on his analysis of the remittance flows from Germany to Turkey during 1963-1982, Straubahaar (1986) concluded that Turkish remittances responded more to changes in government in Turkey, and hence to political confidence, and the consequent safety and liquidity of savings, rather than to real exchange rate or difference in interest rates. In Albania political instability seriously affected the level of remittance flows in 1999 at the height of the Kosovo crisis (Lucas, 2005).

What conclusions can be drawn from the discussion in the preceding sections as well as in Chapter 1 about the determinants of the level of remittances? A complex litany of factors is involved, but they can be grouped in three broad categories: first, personal characteristics and types, including legal status of the migrants, all of which can evolve over time; second, the original motives to migrate – the motivation can well be a mixed (composite) one and this, too, can change over time and, third, political and macro-economic (including in particular interest and exchange rates) settings in both home and host countries as well as the global financial and political environment.³⁵ The discussion has also shown that the various factors within and between these categories are largely interrelated and often interact with one another.

From a policy formulation perspective, it is important to understand and analyse this complex matrix of causes and conditions because they influence not just the level of remittances but also the manner in which they are used, and thus the economic and social impact they make in the country of origin.

3

Economic and Social Impact of Remittances: A Litmus Test

Remittances are widely regarded as a litmus test of the sending country's benefits from migration.³⁶ Their beneficial effects on the national economy can be differentiated from those that relate directly to the migrants' communities and their households.

Effects at the household level

The positive effects of remittances at the household level are clear, although not always undisputed. Unlike government to government aid, most remittances go directly to the family budget and are often used for basic subsistence needs and better housing. They thus contribute to family welfare and higher levels of living. ILO case studies show that in Bangladesh remittances counted for more than half of household income of recipient families; in Senegal the share was as high as 90 per cent (ILO, 2004) and in Turkey 80 per cent of the remittance-receiving households spent the funds on daily expenses (Kocks and Onan, 2001). In Latin America and the Caribbean, 18 million households and more than 50 million people are estimated to be supported by remittances (IADB, 2004). Increased expenditure on food and housing and rising levels of living, combined with better knowledge on health and hygiene, often lead to improved productivity and development of human capital, as was found for example in Pakistan and the Pacific Islands.

Remittances have also raised the levels of children's education, a key factor in future human capital development, in a number of countries, including Jordan, Thailand and the Philippines. In Mexico, children from migrant-sending families completed between 0.7 and 1.6 more years of schooling than children from families without any migrants abroad. It was also found that an increase in the share of households receiving remittances in a municipality led to both better health and schooling (Duryea *et al.*, 2005).

In the Philippines, increased remittances led to increased educational expenditure, more child schooling and reduced child labour (Yang, 2004). In the small town of Intipuca in El Salvador it was found, based on a study by the University of Michigan, that children in remittance-receiving families were healthier and stayed in school longer. Indeed, the effect of remittances on retention of children in schools in urban areas was estimated to have been ten times higher than the effect of other sources of household income and 2.6 times higher in rural areas (Cox-Edwards and Ureta, 2003). Wahba (2000) notes that households with migrants are more likely to invest in education and less likely to send their children to work.

However, it is not always clear whether remittances increase schooling or whether households with migrants are more likely to use additional income for children's education. Probably in many cases both play a part in explaining the co-relationship between remittances and more child schooling. In the Philippines, for example, unanticipated increases in remittances following the 1997-98 Asian financial crisis were found to lead, *inter alia*, to enhanced child schooling, which seems to suggest a causal relation between remittances and children's education (Yang and Martinez, 2005).

Effects on the community and local areas

Increased household consumption, especially in the form of expenditure on health, education and family welfare, also contribute to human welfare and capital development at the community level. But remittances are not spent only on current household consumption. They also contribute to the construction of modern houses, the upgrading of farm production and the growth of income-generating small business enterprises. As discussed in Chapter 2, by providing income and risk insurance for the household, they encourage the use of improved technology and production inputs as well as new ventures. In several Asian countries, including Pakistan and Thailand, families left behind by migrants used remittances to hire labour and purchase farm equipment, leading to output growth (Stahl, 1986; Kerr, 1996). In some cases, however, remittances could indeed be "compensatory" in nature and replace existing farm production. This happens when remittances make it unnecessary for the family left behind to live from that production. Reductions in agricultural production associated with migration and remittances have been registered, for example, in the Caribbean and the Pacific islands. Glytsos (1998) notes a similar experience in Morocco where remittances had a negative impact on agricultural output because some farmers were able to live from remittances and abandon cultivation. Several other analysts (Lipton, 1980; and Palmer, 1985) take a similar view.

However, when the main cause of an immediate fall in output is the shortage of family labour due to emigration, the situation, as the experience in several Asian countries shows, generally changes over time. This happens as remittances are eventually used to deploy hired labour and new equipment, and in some cases this may even lead to farm modernization. Experience in Africa suggests a similar trend. For instance, although in the neighbouring countries supplying labour to South African mines emigration initially reduced domestic crop production, investment from remittances over time led to higher crop production and accumulation of cattle (Lucas, 1987). In China, remittances were found to have a positive impact on crop yields (Taylor, Rozelle and de Brauw, 2003).

Remittances can also contribute to local development through the promotion of new small-scale enterprises in the non-farm sector, as was found in several countries including Egypt, (McCormick and Wahba, 2003) and Mexico (Cornelius, 1990).³⁷ Indeed, based on a survey of more than 600 small firms in 44 urban areas Woodruff and Zenteno (2001) claim that remittances from the US financed much of the micro-enterprise development in Mexico. Such activities are likely to be helped by the relaxation of credit constraints benefiting remittance-receiving households. A stable stream of remittance income even in times of economic downturn enhances the credit worthiness of the household, making it easier for it to have access to loans from financial institutions (see also the discussion on remittances, investment and growth in Chapter 4). Access to credit through overseas savings and human capital accumulation are claimed to have a significant positive impact on entrepreneurship among returning educated migrants in Egypt.

One of the striking contributions of remittances concerns the creation of new community assets and services. In a number of countries in Africa and Asia, as in Latin America and the Caribbean region, there are long traditions of remittances being used to build social assets and facilities such as schools, medical and community centres, roads and small irrigation projects. Often migrants pool their resources and transfer them to their homelands for such purposes. Such investments in social assets and physical infrastructure contribute to the welfare and economic fortunes of small communities. As further discussed in Chapter 5, in recent years the growth of migrants associations in host countries has given a new momentum to these collective activities, especially in sub-Saharan Africa and Latin America, placing the remittance flows on a stronger institutional basis. To the extent that poor people have access to these new community assets and services their positive effect on poverty alleviation could be significant (see Chapter 4).

Effects at the macro-level

At the macro-level, too, remittances can help development, especially in countries where remittances are an important source of foreign exchange, and an important addition to gross domestic product. As Figure 2 shows, average yearly remittances for 1990-2003 accounted for more than one-third of Lesotho's GDP and at least 10 per cent for some 15 other countries, including Tonga, Lebanon, Samoa, Jordan, Bosnia and Herzegovina, Kiribati, Cape Verde and Albania; and more than 5 per cent for 24 countries (Spatafora, 2005). A special case was that of war-time Lebanon which in 1980 relied on remittances for half of its national income (Choucri, 1985).

The World Bank's most recent estimates show that recorded remittance receipts were equivalent to nearly 6.7 per cent of developing countries' imports and 7.5 per cent of domestic investment. They were larger than total merchandise exports in 11 countries (Albania, Bosnia and Herzegovina, Cape Verde, Gaza, Haiti, Jamaica, Kiribati, Lebanon, Nepal, Samoa, Serbia and Montenegro, and Tonga), while in 28 countries they were larger than the most important foreign exchange earning export item (World Bank, 2005).

Access to foreign exchange earnings can provide valuable support to balance of payments accounts and help development through essential imports. Whether or not the foreign exchange will actually be spent on imports essential for development is, of course, a key issue. The additional foreign exchange earnings can be squandered away through government spending on luxury projects or on conspicuous private consumption

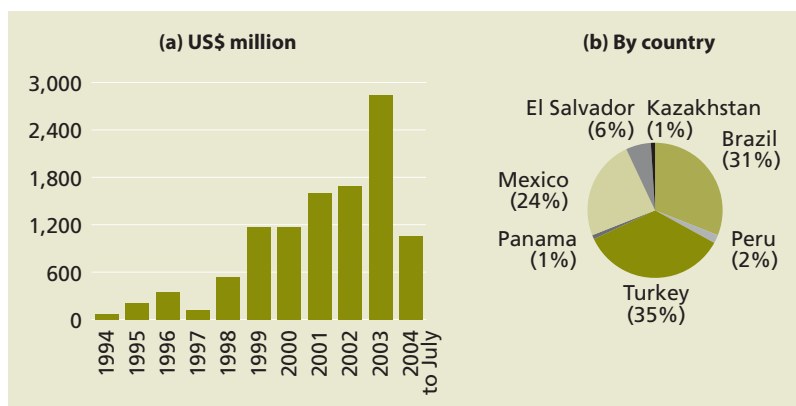
Countries may find them helpful – as India did in the early 1990s – in tiding over temporary foreign exchange difficulties following trade liberalization, although it is doubtful if remittances serve as a propelling force for trade policy reform or economic openness. India decided to liberalize in 1991 when its foreign exchange had dwindled to a level that could support only three weeks' import bill. Economic liberalization in Indonesia started in similar conditions under President Suharto. However, once a decision has been taken in favour of liberalization, actual and anticipated remittance flows are certainly a help during the transition.

In a number of migrant-sending developing countries remittances as additions to GDP can more than offset the loss of public revenues due to emigration. For instance, the loss of India's tax revenue linked to emigration to the US was estimated at 0.24 per cent to 0.58 per cent of the Indian GDP in 2001 (Desai, Kapur and McHale, 2001) but remittances amounted to at least 2.1 per cent of GDP in the same year (Ratha, 2003).

Taxing remittances to raise public revenue seems however to be more problematic. Some governments have tried this, but with little success as it had mainly resulted in diverting the remittances to unofficial channels. In 1997 when Viet Nam removed its 5 per cent tax on remittances, the flow of remittances through formal channels increased (World Bank, 2005). In Tajikistan the removal of state tax on cross-border bank transactions in 2003 seems to have helped raise remittances from US\$ 78 million in 2002 to US\$ 256 million in 2003 (IOM, 2003). Since the bulk of the individual transfers are from low-wage migrants to their families, the tax, unless carefully designed with exemptions for small remittances and household incomes, could be regressive and unpopular. In 2002, Sri Lanka announced the levy of a 15 per cent tax on remittance flows, but in the face of massive opposition the proposal had to be quickly withdrawn. On the other hand, if all remittances, including large ones, are exempted from tax, this may increase the flows but is also likely to increase income inequality. From a policy formulation perspective, these divergent considerations need to be carefully weighed in the context of the country-specific situation and its overall fiscal system. An alternative, but no less debatable, approach might be to work out bilateral or plurilateral arrangements under which tax revenues collected from the immigrants in the host country would be shared between the home and host country governments.³⁸

Remittance-receiving countries can use the flows to raise additional funds in the world capital market. In recent years several countries, including Brazil, El Salvador, Mexico, Panama and Turkey, have used the future flows of remittances as a collateral to raise funds in the international capital market (Figure 6). In Latin America alone, since 1994 there have been about 40 issues of remittance-backed bonds, amounting to a total over US\$ 5 billion (Spatafora, 2005).

Such securitization could give developing countries' access to external finance at lower cost than borrowing on sovereign credit. As shown in Table 5, for a number of developing countries, when remittances are included in assessing credit worthiness it improves their credit ratings and reduces the cost for borrowing in the international capital market. Based on the remittance figures for 2003 and assuming a collateralization ratio of 5:1, one estimate suggested developing countries could raise about US\$ 7 billion a year (Ratha, 2003).³⁹ Given the recent upward revision of the remittance figure for 2003 and using a collateralization ratio of 8:1, which is more in line with many recent transactions, the potential amount that developing countries as a group could have raised in the capital market would now seem to be some US\$ 9 billion, including 3 billion for low income countries. (World Bank, 2005)

Figure 6 **Securitization of remittances, 1994-2004**

Source: World Bank (2005) based on Fitch, Standard and Poor's, Moody's Investor Services.

Table 5 **Remittances' positive effects on credit rating and sovereign spread**

Country	Remittances as % of GDP, 2004	Rating excluding remittances	Rating including remittances ¹	Spread saving (basis points)
Serbia and Montenegro	7	B+	BB-	150
Lebanon	14	B-	B+	130
Haiti ¹	28	CCC	B-	334
Nicaragua ¹	11	CCC+	B-	209
Uganda ¹	5	B-	B	161

¹ Calculated using a model similar to Cantor and Packer (1995), see also Ratha and De (2005).
Sources: Standard and Poors; and World Bank staff calculations.

True, such securitization calls for an appropriate legal framework especially as concerns guarantees about pledged assets; and admittedly, the fixed costs of legal, banking and credit rating services involved could be high. However, as the success in the recent securitizations in several developing countries suggests, these constraints are by no means insurmountable. The support of the host countries in the industrial world by way of guarantees to back the remittance-based bonds, as suggested in a recent report to the UK House of Commons, could of course be valuable (UK House of Commons, 2004).

Some analysts have also argued that remittances, unlike official aid or natural resource revenues, do not have a systematic adverse effect on a country's competitiveness, including in its labour-intensive and tradeable sectors (Rajan and Subramanian, 2005). This may partly be due to the fact that, since migrant remittances go to private individuals and not to governments, they

do not carry the same potential risk of encouraging corruption or wasteful spending. There is little doubt that, compared to financial flows from natural resources, such as oil reserves and mines, remittances are widely distributed and have a more positive effect on low-income groups. It has also been suggested that the relative stability of remittance flows help avoid real exchange rate volatility or the need for difficult adjustments in other tradeable sectors that often become unavoidable in the case of fluctuations in natural resource exports.

Are there links between remittances and economic performance?

However, despite their impressive contributions to foreign exchange earnings and national income in quite a number of countries and their other positive features, remittance inflows seem to have a rather limited impact on growth and development at the macro-level. Hardly have they proved to be the prime mover for an economic take-off or sustained growth for the economy as a whole. Even high emigration and remittance-receiving areas or regions within a country have not always been able to use remittances as a means to launch a process of dynamic economic growth. For instance, although remittances to Kerala, a leading remittance-receiving state in India, have helped improve welfare of the migrants' households and raised levels of economic activity in construction, trade, transport and personal services, their "contribution to the state's economic growth in terms of agriculture and industry has been extremely small" (Nair, 1998). Based on much of the available theoretical and empirical evidence for Africa, Gubert (2005) concludes that despite their positive role as welfare safety nets for those left behind and in alleviating transitory poverty, the windfalls of remittances alone "cannot create the right conditions for genuine development and are often criticized for their low impact on the structural causes of poverty".

The past experience of Italy has not been much different. The north, which enjoyed a superior investment climate and a more consistent set of development policies, benefited most from large remittance flows during the early stages of the country's industrial development. But in the central and southern regions, where the investment climate was less favourable, the benefits were more limited. "Important as it was to reduce poverty, malnourishment, usury, and to increase consumption, it was not sufficient to create a self-sustaining path of economic growth" (Settimo, 2005).⁴⁰

Indeed, there is little hard evidence to confirm any causal relationship between inflows of remittances and economic performance, although

they may well be correlated. Some countries receiving large amounts of remittances (e.g. the Philippines, Ecuador and Yemen) have done rather poorly. And yet some others with large remittances inflows (e.g. China, India and Thailand) have performed rather well (ILO, 2004). One recent study covering 101 developing countries and an extended period from 1970 to 2003 finds no direct link between remittances and per capita output growth (Spatafora, 2005).

Some of the reasons why, despite their positive effects, especially at the household and local area levels, migrant remittances do not automatically lead to sustained national economic growth or guarantee better overall economic performance are discussed in the next chapter.

4

Remittances are Not Without Pitfalls: A Critical Appraisal of their Impact

Perils of excessive reliance on remittances

Remittances are not an unmixed blessing; they also have their downside. The positive effects of remittances on household welfare and foreign exchange can be somewhat neutralized when remittances lead to ostentatious consumption in remittance-receiving households, and encourage imports of luxury goods adding to pressure on the country's import bill. At the same time, remittances can dampen the country's exports if they lead to an appreciation of the external value of its currency – a variant of the so-called Dutch disease. Albania, for example, has greatly benefited from remittances as a source of income and foreign exchange and as a safety net for the poor and needy, but this has also postponed depreciation of its currency and thus potential export growth (Lucas, 2005). For Moldova, he notes that although in 1999-2001 remittances yielded major economic benefits, they also probably contributed to poor export performance (Ibid). An estimate made by Amuedo-Dorantes and Pozo (2004) shows that in a panel of 13 Latin American and Caribbean countries a doubling of remittances leads to a real exchange rate appreciation of nearly 22 per cent. Also, Bourdet and Falck (2003) think that increases in remittances accounted for most of Cape Verde's 14 per cent real appreciation over the past decade. The appreciation of the currency can make exports more expensive in foreign markets and shifts resources from tradable to non-tradable sectors, which can slow down growth in employment and lead to further pressure for emigration. There is some evidence from Egypt, Portugal and Turkey that lends credence to such concerns.

However, but for small economies or exceptional cases, it is not certain that remittance flows necessarily inhibit growth or competitiveness. The negative effects of currency appreciation have remained marginal in most observed cases and situations (McCormick and Wahba, 2003). In the case of the Philippines, Lucas notes "growth in remittances has been significantly correlated with appreciation of the real effective exchange rate over the last two decades. Yet exports have grown rapidly in times when the real

exchange has been appreciating quickly" (Lucas, 2005). In many cases, at least part of the remittances is spent on new imports, lessening the upward pressure on the exchange rate of the national currency. And imports of critical inputs can be used to improve firm productivity and competitiveness in the external market. Access to remittance flows should also make it easier for governments to strengthen the infrastructure for the export sector and enhance its competitiveness. Moreover, as noted above, to the extent that the remittance flows are stable, adjustment to any upward appreciation in the exchange rate should be manageable with less difficulty. This, however, also implies that in the case of any significant changes in remittance flows authorities must be ready to accept a greater degree of exchange rate flexibility (Spatafora, 2005).

But could increased imports (made cheaper in home markets by exchange rate appreciation) lead to the opposite effect of creating trade account deficits? It is doubtful that remittance-induced imports cause any serious problem of such nature. In fact, limited evidence from south European countries shows remittance-induced imports between 1960 and 1981 accounted for a minimum of 1 per cent in Spain and Italy, and a maximum of 6.2 per cent in Portugal, with Greece showing an increase of 4.9 per cent (Glystos, 1993; Straubhaar, 1988).

Excessive reliance on remittances to finance development can be self-defeating if the necessary, but often politically painful, structural reforms are postponed or avoided, as may have happened in some of the remittance-receiving eastern Mediterranean countries in the 1960s and 1970s (Körner, 1987). They may bring distortions in the economy through inefficient allocation of resources, depress production of tradeable goods and export-driven growth, and lead to further dependence on remittances, creating a vicious cycle and storing up trouble when remittances decline.

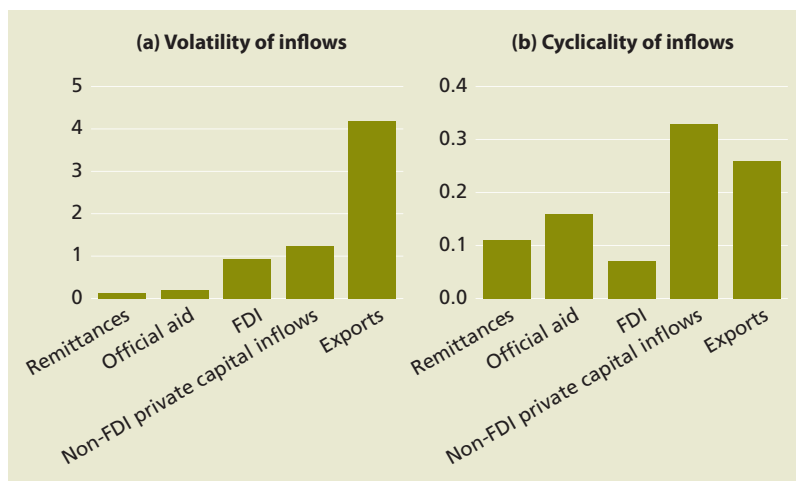
Too much dependence on remittances also makes the economy unduly vulnerable to sudden changes in remittance receipts, as discussed below. Albania has sent a quarter of its population abroad in the past 15 years or so, and its economy has in many ways greatly benefited from remittances. But as Nikas and King (2005) note, a sudden decline in their size due to an economic downturn in the immigration countries, could be devastating for the Albanian economy. How real are such risks?

Remittances as a stable resource flow, but how stable?

True, at the aggregate level, remittances have proved to be more stable than most other forms of resource inflows to developing countries in recent years (Figure 7). As mentioned above, this makes it possible for countries to raise external funds even by securitizing future flows. They also have a counter-cyclical economic effect in the remittances-receiving countries, since, as already discussed, the flows tend to increase in times of economic hardship, especially when these are the principal sources of family income, and the motivation for remitting is altruistic. Following the economic crisis in the late 1990s in Ecuador, inward remittances more than doubled from US\$ 643 million in 1997 to 1.4 billion in 2001, equivalent to 10 per cent of the country's GDP (Kapur, 2004), although much of the increase was due to increased migration abroad during the period.

Compared to private capital flows they may also be resilient in the face of an economic downturn in the host country. A recent IADB/Pew Center study in five Central American countries, for example, showed that remittances were barely affected by the economic downturn in the US between 2001 and 2002. Nor surprisingly, the World Bank recently called remittances as an important and stable source of external development finance (Ratha, 2003).

Figure 7 **Remittances and other external resource flows: volatility and cyclicity,¹ developing countries, 1980-2003**



¹ Volatility is defined as the standard deviation of the ratio of the relevant inflow to GDP, and cyclicity is defined as the correlation between the de-trended relevant inflow and de-trended GDP.

Notes: (i) Estimates are based on the latest figures available to IMF at the time and are not updated;

(ii) the resource flows refer to foreign exchange transfers appearing in BoP statistics.

Sources: IMF, *Balance of Payments Statistics Yearbook*; and IMF staff calculations.

Even so, it would be unwise for developing countries to take this stability for granted and rely heavily on the flows, especially as investment capital. As a recent UN report (2004) puts it, the outflow of remittances “has been positively correlated to growth” of the host country, and that they are affected by its economic cycle. Indeed, contrary to the findings of IADB/Pew Center on remittances to Central America, mentioned above, a recent IADB survey revealed that, following September 11 attacks, over half of the Latin American immigrants (that the Bank polled) had sent home less money; a quarter reported their income had fallen and 7 per cent had lost their jobs. It has also been found that total remittances from two of the world’s largest source countries – the US and Saudi Arabia – increased during periods of high economic growth and declined during periods of recession (UN, 2004). Likewise, the downward trend in remittances from the Middle East in the mid-1980s has been generally attributed to the recession in the wake of the collapse of the oil prices, although they picked up soon. A sharp drop in mining jobs in South Africa led to a collapse in remittances to Lesotho from more than 50 per cent of GDP in 1991-1992 to less than 20 per cent in 2003-2004 (Spatafora, 2005).

The negative impact of host country’s economic downturn on remittances may however be counteracted, at least partly, in countries where migrant workers’ income is protected under social security or unemployment insurance schemes (Taylor, 2000). But even in such cases there could well be a fall in the migrants’ income and the amounts they are likely to remit in times of host country’s economic downturn. Another reason why an economic downturn of the source country may not be reflected in an immediate decline in the remittance flows could be that, as many migrants return home, or are obliged to do so, they bring back their entire savings, as may have happened in India during the 1990-1991 Gulf crisis (Ratha, 2003).

Clearly, remittance-dependent countries are vulnerable to sudden external shocks and the consequent volatility of remittances, especially when the bulk of the funds comes from temporary migrants. Turkey’s 1973-77 Five-Year Plan which had anticipated an export of 350,000 labour migrants was in a shambles as Western Europe put a sudden ban on labour recruitment in the mid-1970s. Unexpected repatriation of 1.5 million Egyptian workers and their dependants during the 1991 Gulf crisis threw the country’s budget out of gear; just as the sudden return of Indian migrants put the economy of the Indian state of Kerala, home to a large number of the returnees, under strain. Likewise, serious economic difficulties were faced by Jordan and Yemen when their migrant workers were forced to return and remittances suddenly stopped. Although migrants’ remittances continued to rise during the Asian financial crisis (at least partly to lessen the hardship it caused at home), there is little doubt that the Indonesian economy badly suffered as a result of the

sudden return of many of its migrant workers; and the level of remittances to the Philippines became sharply volatile. Political turmoil in host countries – the Iran-Iraq war in the mid-1980s and the Gulf crisis at the start of the 1990s – slowed down the rise in remittance flows to Bangladesh, although there was no sharp decline (Afsar *et al.*, 2002). The economic downturn in host countries like Germany partly explains the declining trend in remittance inflows to Turkey in recent years (Içduygu, 2005).

El Salvador provides still another example of the vulnerability of remittance-dependent economies. Excessive dependence on remittances from the US was largely responsible for the Salvadorian government to plead with the US not to return large numbers of Salvadorans whose temporary protection was coming to an end (Mahler, 2002; Castillo, 1994). Given the vulnerability of remittances to external shocks, it is not surprising that the migrants themselves sometimes tend to look upon them as a transitory flow that can suddenly stop or suddenly change its course (which could encourage saving). To illustrate, Alderman notes that in Pakistan “unlike domestic remittances, international remittances appear to be treated as income shocks” – a reason why households save virtually all of international remittances (Alderman, 1996).

It is true that the remittance inflows often have a counter-cyclical effect in the recipient country as they tend to rise rather than fall in times of economic downturn or crisis, and in doing so they help smooth consumption and alleviate human hardships. The same seems to happen in the wake of natural disasters or internal conflicts. For example, studies in the Caribbean, a vulnerable region to natural disasters, show that, a 1 per cent decrease in real GDP due to such disasters is associated with about a 3 per cent rise in remittance flows, although this happens with a two-year time lag (Mishra, 2005).

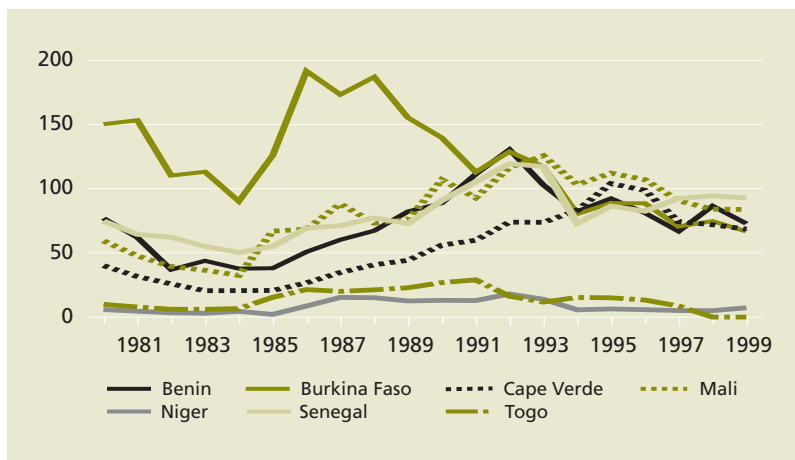
However, if the remittance inflows are to be counter-cyclical, they cannot at the same time be highly stable. In fact, the more they move counter-cyclically, the more they gain in potential volatility. It should not be forgotten that from the point of view of output stability the counter-cyclical behaviour of remittance itself contains a potential downward risk. Counter-cyclicity assumes that remittances increase when the home country's output is weak or declining, thus contributing to a migrant-sending country's output stability. By the same token, however, a sharp fall in remittances due for example to sudden shocks should have a negative impact on the country's output stability.

The earlier discussion has shown that a degree of volatility of remittances is also associated with the type and structure of migration flows. Although remittances intended mainly for consumption by the family back home

tend to be more stable (except for counter-cyclical movements to smooth consumption), it is also well known that as migration matures, family reunification is completed and migrants' ties with the country of origin tend to weaken, family-related remittances then tend to taper off, and the national economy can no longer count on the same level of remittances, unless of course there are new streams of migrants. Economists often assume that any fall in remittance receipts during economic shocks or downturn in the home country would be compensated by new outflows of migrants. But the tricky question is: will they have legal access to the labour market in the destination countries? Will they be paid fair wages? In reality much depends on the immigration climate prevailing in the destination countries at the time. As for investment-related remittances, these could be highly volatile depending on the macro-economic situation, business prospects and the political climate in the host and home countries (further discussed below in this chapter).

In short, despite their relative stability at the aggregate level, remittance inflows to individual developing countries could show, for various reasons (including their counter-cyclical behaviour), a high degree of volatility and unpredictability. In Africa, for example, the standard deviation from the annual averages of remittance flows for the years 1980 to 1999 ranged from 17 per cent in the case of Egypt to 50 per cent in the case of Cameroon, Cape Verde, Niger and Togo. In Botswana, Ghana, Lesotho and Nigeria it exceeded 100 per cent (revealing a high degree of volatility) (see Figure 8).

Figure 8 **Volatility of annual official remittances to selected African countries, 1980-1999** (US\$ million)



Source: IOM 2003, based on World Bank (2001).

Remittances, investment and growth: A false debate?

An old criticism of remittances is that they do not generally find their way into investment, but are spent on consumption, often of a conspicuous nature. For example, one study cited in Chandavarkar (1980) maintains that remittances are “frittered away in personal consumption, social ceremonies, real estate and price escalating trading”. The criticism is largely flawed for several reasons. Remittances in themselves are not capital flows; in general they are primarily a contribution to the family budget. Given the socio-cultural and educational background of the majority of migrant households in developing countries, it is not surprising that in general they feel unaccustomed and ill-equipped to be involved in risk-taking activities. Absence of well developed capital markets and other suitable investment opportunities and lack of familiarity with investment instruments in the corporate sector are other important constraints. Interestingly, Taylor finds evidence that remittances to some farmers in Mexico increased their investment in cattle, which was the main investment opportunity (Taylor, 1992). In Africa, similar constraints led a recent West African ministerial conference on migration and development (Dakar Declaration, 2000) to suggest a series of remedies, including the establishment of a stock of viable business projects attuned to the local needs and conditions.

Significantly, evidence from some countries shows that the pattern of expenditure of remittance-receiving and non-receiving households in the same income and socio-cultural groups does not vary widely. As some analysts have put it, if Mexican families spend part of their remittances on festivities and religious ceremonies, this is no different from the consumption pattern or expenditure behaviour of the rest of Mexican homes with similar incomes. Also, field observations on remittance expenditure in several African countries have revealed that even in rural areas remittance-receiving families tend to take rational decisions under prevailing social and economic conditions and legal systems. For example, an official survey in Swaziland found that income from increased maize production cannot be retained by women as their own earnings, and women therefore invest remittance income in non-agricultural activities that yield income over which they can have control (Palmer, 1985). In Zambia remittances have been an important means of financing agricultural inputs, but if women spent a larger proportion of remittances as capital for these inputs that was because women were less likely to be granted government-sponsored agricultural loans (Chilivumbo, 1985).

More significantly, recent studies in Pakistan have shown that in the late 1980s and early 1990s the marginal propensity to save was higher for income from

international remittances than from internal urban-rural remittances or rental income (Adams, 2002 and 1998). In Guatemala, remittance-receiving households were found to have lower marginal propensities to consume with a higher propensity to invest in education, health and housing than other households (Adams, 2005). Some other studies have also revealed that, except for the lowest income groups, the migrant-receiving household's marginal budget share for consumption is quite low.

This is further confirmed by figures for several countries in Asia showing high levels of savings out of remittance incomes. They range from 15 per cent in the Philippines to 44 per cent in Sri Lanka and 58 per cent in Thailand (Puri and Rizzema, 1999). It has already been noted in the previous chapter that remittances from the US accounted for a good part of the capital invested in micro-enterprises in urban Mexico (Woodruff and Zenteno, 2001). Likewise, data from 1980 to 2002 for 15 Caribbean countries indicated that remittances have a statistically and economically significant impact on private investment. Relative to GDP, a one percentage point increase in remittances was found to increase private investment by 0.6 per cent (Mishra, 2005). Based on a survey of Filipino households, Yang and Martinez (2005) find that unanticipated increases in remittances contributed not only to enhanced human capital accumulation, with less child labour and more child schooling in remittance-receiving households (as noted in Chapter 3) but also a higher rate of participation in capital-intensive enterprises. Since the latter was found more among low-income than among higher income households, the positive effect is linked to alleviation of credit constraints. Glystos (2002) comes to a similar conclusion on the basis of a study which shows that in six of the seven Mediterranean countries he analyses investment increases with remittances. Leon-Ledesma and Piracha (2004) note analogous results for eastern European countries in the 1990s.

It has already been emphasized that even when a significant proportion of the remittances is spent on consumption, it often contributes to improved health, education and human capital, enhancing both private and public welfare. True, in many cases a significant part of the remittance-related investment increases stock of wealth of the migrant household in the form of land, housing and jewellery. However, even when the direct impact of remittances on investment is relatively limited, their positive, though indirect, macro-economic effects on development should not be ignored. They provide a monetary base for the supply of credit that can be used as investment capital. Whether or not the supply of additional credit will actually be used for investment purposes depends on the policy of the banking system and of the government and, more generally, on the overall economic climate. As will be further discussed in Chapter 5, when remittances are made through credit cooperatives or community-based micro-finance institutions

they provide a valuable capital for small-scale business and could be an engine for growth.

Remittances have a related, but distinctive type of positive effect on development in rural areas. Lack of effective demand is often a serious constraint on economic growth, especially in the countryside of developing countries. As surveys in several migrant-sending countries have revealed, a large part of the remittances is almost invariably spent on locally produced goods and services. In Pakistan, for example, massive, mostly low-skilled, labour migration to the Gulf States in the 1980s led to an extensive grass roots transformation of the rural economy. New demands for a variety of goods and services, largely from a class within society that had previously little purchasing power had a powerful impact on economic growth, production of labour-intensive goods and services both tradeable and non-tradeable, land markets and construction and rapid spread of banking and commerce (Addleton, 1992).

When this happens the stimulus given to local industry, through better utilization of installed capacity or creation of new productive units, far exceeds the value of the initial rounds of expenditure. By generating a multiplier effect they put the aggregate demand, output and income on an upward swing. Even housing, which, unlike industrial investment, does not constitute a continuous process of production, uses a very high proportion of local inputs. Increasing returns to production inputs in one sector can further boost the multiplier effects through their intersectoral impact (that is, the expansion of one sector increasing the optimal size of other sectors).

Analyses of the dynamic macro-economic impact of remittance expenditure, for example in Greece, Egypt, Mexico and Pakistan have shown that its multiplier effect on GNP could be as high as 1:2 or 1:3. In other words, a remittance of 1 million US dollars could in such cases increase the country's GNP by more than 2 million dollars (Glystos, 1990 and 1998; Kandil and Metwally, 1990; Nishat and Bilgrami, 1991; Adelman and Taylor, 1990). Remittances in Bangladesh are estimated to have a multiplier effect of 3.3 on GNP, 2.8 on consumption and 0.4 on investment (Van Doorn, 2003). In Latin America, the over-all multiplier effect, according to IADB, was 1:3 in 2002. Glystos' analysis (1990) for Greece shows that even remittance-financed house construction had a multiplier effect of 2:0 on local production and involved virtually no imports.

Some caveats should however be added to the multiplier effect of remittances. When, for example, remittances lead to increased transactions of existing goods, such as houses and land, without any increase in output or improvement in productivity, the expenditure may increase the stock of

wealth and investment of the family, but not of the country. True, except in cases where the supply of production inputs is inelastic and factor mobility seriously limited, increased demand due to remittance expenditure should over time lead to increased growth and employment, even if it creates inflation in the short term (discussed below). Nonetheless, the slow or constrained response of agricultural supplies could well be a real problem, reducing the multiplier effect of remittance expenditure on income and output.

Further, if in the face of rising inflation at the local level a government decides to impose a tighter monetary policy at the national level, it may offset some of the local multiplier effect by stifling demand elsewhere in the country. Several studies show that when agricultural supplies are inelastic, the multiplier effect of remittances on household incomes in rural areas is considerably smaller (Taylor, 1999).⁴¹ To illustrate, for a Mexican micro-area covering several villages and a town, Yunez-Naude and others (1998) find that the multiplier effect of a US\$ 100 increase in exogenous income (remittances) dropped from an estimated US\$ 115 to US\$ 33 for the villages and from US\$ 23 to US\$ 6 for the town due to constraints in agricultural supplies.

Remittances' multiplier effect on the general economy is also influenced by the nature of linkages between the remittance-receiving villages and towns and the national economy. When remittances are concentrated in limited areas, as is often the case, and the market linkages are weak, the growth impulses of the multiplier are not likely to be transferred to the national economy – an important reason which circumscribes the development effect of remittances at the macro-level. However, to the extent that the remittance-receiving towns and villages are integrated with outside markets, a good part of the benefits of remittances tends to be transmitted to other parts of the country, mostly in regional urban centres. As the positive effect of remittances in such cases is spread to, and shared with, these other parts of the country, the overall development effect of remittances cannot be fully assessed by focusing on the remittance-receiving communities alone.

Research findings on the links between remittances and growth at the macro-level vary considerably. Based on cross-country data Faini (2002, 2004) finds a positive relationship between growth and remittances. But, as noted in Chapter 3, a standard cross-country growth regression analysis by Spatafora (2005) reveals no statistically significant direct link between real per capita output growth and remittances. The analysis however recognized the measurement difficulties: a negative correlation between remittances and growth may well be due to the fact that remittances may rise when growth is weak. By contrast, Chami and others (2003) see a negative relationship between remittances and growth and question the view that remittances can be an important source of external development finance. Their basic

argument (as already mentioned in Chapter 2) is that remittances would lead to a fall in labour force participation, which in turn would cause a decline in output.

In line with Chami's arguments it is also conceivable that a fall in aggregate labour input would adversely affect growth due to the loss of the benefits of inter-firm linkages and economies of scale. Indeed, in the rural areas of some countries (for details see Chapter 2), remittances have indeed led to a fall in farm production since the receiving household no longer needs to depend on such production. However, this happens when the household's demand for income is highly inelastic (with a high preference for leisure substituting labour). Earlier discussion has indicated that by providing capital and risk coverage remittances may encourage the receiving household to use improved technology and new business ventures. The statistically significant negative correlation between GDP growth and inflows of worker remittances (compensation to employees is excluded) found in the model (presented by Chami and others) has also been questioned on methodological grounds. As Lucas observes, "it can be exceedingly difficult disentangling whether remittances cause slower growth or whether slower growth causes more migration and possibly greater remittances per migrant" (Lucas, 2005).

Also, some of the channels involved in transmitting the growth impulses, for example those operating through human capital development, are such that the effects may be detectable only over long periods of time. The ambiguity about the impact of remittances on growth at the macro-level also stems from the nature of the market links between remittance-receiving local areas and other parts of the country. As discussed above, the higher the degree of market integration, the greater is the spread effect of the growth multiplier on the economy as a whole.

Notwithstanding these ambiguities, those who are anxious to look at migrant remittances as a stable source of productive investment or external development finance must face a real dilemma. As the discussion in the previous sections has revealed, if the flow of remittances shows less pro-cyclical volatility in remittance-receiving countries, this is largely because much of it serves as an essential support to the family budget (its altruistic character), especially to smooth consumption. The more it assumes the role of investment capital, the more sensitive it is likely to be to changes in the business environment or ups and downs in the economy. To put it differently, a trade-off between the counter-cyclicality of the flow and its primary role as investment capital seems embedded in the situation.

Empirical evidence confirms this. In the 1990s as low-income countries liberalized their current and capital accounts and relaxed exchange restric-

tions, remittance receipts rose sharply, but so did the volatility of the remittances, presumably because much of these remittances were used for non-consumption (investment) purposes (Ratha, 2003). In Turkey and the Philippines, for example, remittances became more volatile in the 1990s than in the 1980s. In a study covering a sample of 12 remittance-receiving countries during 1976-2003 Sayan (2005) finds evidence showing counter-cyclicality of remittances in Bangladesh and India as they served mainly to smooth household consumption; however they were pro-cyclical in Jordan and Morocco where remittances were more investment-oriented. It is unrealistic to think that even diasporas' home bias in their investment behaviour could make a big difference in the situation. Their home bias may be real, but as long as the return to investment is their primary motive, the bias must have its limits.

From the perspective of saving and investment, stability in remittances, even when they are intended to support household budget, presents another dilemma. As noted, when remittance flows are viewed by the households as being transitory, they are more inclined to save and invest. However, when they are considered permanent and predictable, the households are more likely to spend rather than save and invest, undermining its role as development capital. (Of course, as already noted, to the extent the remittance expenditure is on health and education, it does contribute to human capital development increasing both private and social return.)

To sum up, remittances can contribute to investment and output growth, but this is not automatic, and should not be taken for granted. Much depends on the migrants' remittance behaviour and the way in which the funds are actually used. Overarching these factors (and assuming that their volume is of sufficient importance) remittances can make a positive impact on output growth and overall economic performance under two general conditions. First, the economy should be sufficiently integrated, with a flexible labour force and adaptable productive structure, making it capable of responding positively to the stimuli of remittances from abroad. Second, the country should have sound macro-economic policies, political stability and good governance and an investment-friendly environment, including an efficient public administration and financial system.⁴² Remittances, in and by themselves, cannot create these conditions. Many of these conditions are amenable to public policy intervention, but as will be discussed in Chapter 5 several other stakeholders, notably migrants and their associations, the diasporas and the corporate sector, too have an important role to play. However, prior to taking up this discussion, it is useful to examine several other economic and social issues that affect the development impact of remittances. This is done in the following three sections.

Can remittances be a source of inflationary pressure?

Experiences in a number of countries across regions have shown that remittances can fuel demand-pull and cost-push inflation in sectors where supplies are inelastic. Rise in land prices and construction costs in remittance-receiving communities is quite common, as was found in Egypt, Greece, Pakistan, Yemen and several Caribbean countries. In one community in the Dominican Republic land speculation by migrant households was estimated in 1982 to have contributed to a 1,000 per cent rise in land prices over a 15-year period. Likewise, in several countries in the eastern Mediterranean region, the Caribbean area, South Asia and southern Africa, remittances seem to have contributed at least partly to inflationary pressures in the consumer goods sector.

It is misleading however to make a sweeping generalization. Simulation studies on the effects of a doubling of remittances on the Egyptian economy, for instance, have shown that increases in remittances were not inflationary (Choucri and Lahiri, 1983). The state of Kerala in India accounted for about a third of the country's total remittances and about 20 per cent of Kerala's net domestic product. And yet prices in the state's remittance-receiving districts did not increase any more than in other districts; nor did prices in Kerala rise any faster than in other parts of India (Lucas, 2005; Nayyar, 1994). Much depends on total size of the remittances relative to internal markets and the degree of flexibility in the economy to permit a quick reallocation of resources to the production of goods and services in response to increasing demand. Admittedly, supply-side inelasticity, or shortage of production inputs, in the face of rising demand can generate an inflationary pressure in certain sectors and local areas. It is equally true, however, that in most cases an adjustment takes place over a period of time and a new supply-demand equilibrium is reached and inflation tends to be contained.

As for the imported goods financed through remittances, if these help meet actual or potential demand, price inflation of the goods may well be held in check. In Turkey, for example, by allowing increased imports of spare parts and new machinery remittances reduced the inflationary pressure of additional demand (Martin, 1991). However, the time lag between the opening of letters of credit and the actual arrival of goods may temporarily create, as was found in Bangladesh, an inflationary impact. On the other hand, to the extent that remittances may strengthen the national currency, import prices should decline.

Remittances, poverty and inequality

Can remittances help in alleviating poverty? The issue has become a focus of attention in the context of a heightened concern over alleviation of world poverty as reflected in the United Nations Millennium Development Goals (MDG).

The debate however has often been marked by a lack of coherent thinking. Since poverty is a relative concept, and could be perceived from different perspectives, its threshold (and other characteristics) need to be clearly defined before the effects of remittances on poverty can be properly measured.⁴³ Further, although in recent years at least in five important resolutions or similar declarations the United Nations has singled out poverty as a major factor in international migration, the conventional view is that poor people do not migrate. If this premise is valid, then it is difficult to see how migration can make a direct contribution to the alleviation of poverty: one does not sit comfortably with the other. Its contribution then has to be of an indirect nature – through the trickle-down effect of growth generated by the use of remittances. Put differently, the rising tide of remittances is to lift all boats, including those carrying loads of poor people. But the trickle-down effect on poverty is not likely to take hold unless the social structure is sufficiently flexible with high spatial and occupational mobility of labour and the economic environment is friendly enough for the poor to move forward. And even in such circumstances the process is likely to be slow.

The reality in any case is somewhat different for several important reasons. First, despite their poverty or lack of resources, poor people, as the UN statements maintain, do move across borders, although much of such cross-border movements take place between neighbouring countries or within the same or nearby regions (Ghosh, 1998). Some of these movements of the poor are towards markedly more affluent countries such as those between Mexico and the US, between North Africa and Western Europe or between SADC countries and South Africa.

But many other poor people, too, move to countries which, though not markedly affluent enjoying high levels of income and wages, are likely to offer at a given time far better income and economic opportunities than those available in the home countries. And not infrequently, they do so for mere survival (Ghosh, 1998). In due course, these migrants too become remitters of funds to alleviate household poverty back home. Many such movements remain unrecorded except when they take the form of a crisis such as mass expulsion. Even so, some 40 per cent of the world's migrant stock is recorded to be in less affluent countries⁴⁴ and, although precise

statistics are not available, tradition and anecdotal evidence, including eye witnesses, converge to suggest that many of them come from poor families, often pushed by economic hardships caused or exacerbated by a sharp decline in commodity prices, crop failure or famine in the wake of droughts, floods, civil conflicts and other disasters, whether natural or man-made; often many of these act in combination.

Second, even if in the initial stage migrants may come from less poor households, as migration matures and networks develop with the passage of time subsequent streams of migrants from the same country tend to come from poorer families. In Mexico, for example, in the past the majority of migrants had not come from the municipalities with the highest poverty rate. And yet, by the year 2000 the situation was different: out of the 100 municipalities with the highest remittances per person, 50 were very poor (Escobar Latapi, 2005). Furthermore, the 2000 national census showed that the poorest groups in Mexico depended on remittances for their income a little more than the middle or the highest income groups, although recent research by Mexico's ministry of social development throws some doubts on the positive impact of remittances on poverty.⁴⁵ Significantly, Mexico's 2003 National Rural Household Survey suggests that international remittances reduce rural poverty more than internal remittances do and that the larger the share of households with migrants, the more positive the effect of increased remittances on poverty (Mora and Taylor, 2004). This is confirmed by Lopez Cordova (2005), who notes from a sample of 2,400 observations covering all municipalities in Mexico, that areas with a larger share of households receiving remittances have lower levels of poverty. In Pakistan, according to Burki (1984), international migration played a decisive role in alleviating absolute poverty in many poor regions.

Third, even in some of the countries where household surveys showed the predominance of migrants from non-poor families in the streams of migration prevailing at the time, at least a significant proportion of migration was found to have come from poor households. Using household survey data from Sri Lanka, De and Ratha find (2005) that the poor income deciles have significant overseas migration. In Albania, on the basis of a living standard measuring survey in 2002, it was found that although non-poor households were more likely to receive remittances from abroad, the numbers of poor or extremely poor households benefiting from remittances were not insignificant (de Zwager, 2005). As Lucas notes, "emigration and remittances have offered a lifeline out of poverty for many families (in Albania) and perhaps especially for those from the poorest high emigration areas" (Lucas, 2005); and De Soto *et al.*, (2002) noticed that living conditions of those households which did not receive remittances in Albania were very bad.

Analyses of the available survey data show that remittances are correlated to declines in poverty discount ratio in several low-income countries – for example, 11 percentage points in Uganda, six in Bangladesh and five in Ghana. In Guatemala, the severity of poverty may have been reduced by as much as 20 per cent (World Bank, 2005).

It is important in this connection to make a distinction between poverty head count (or the number of people below the poverty line) and the depth and severity of poverty. There are many cases where remittances may not be able to lift poorest people out of poverty, but may nonetheless significantly reduce the hardship or severity of their poverty.

Several recent studies confirm this multifaceted link, although the degree of causality may be less clear. For example, one study covering more than 70 low and middle-income countries indicated a positive co-relationship between remittances and poverty alleviation. According to its findings, a 10 per cent increase in the share of remittances in country's GDP would lead to a 1.2 per cent decrease in the percentage of persons living on less than US\$ 1 a day; and it would also reduce by 2.0 per cent the depth or severity of poverty (Adams and Page, 2003). The study also shows that a 10 per cent increase in the share of migrants in a developing country's population and the attendant inward remittance flows would lead to 1.6 per cent decline in its poverty head count.⁴⁶

More recently, by using a new set of data from 71 developing countries Adams and Page (2005) came to similar conclusions. The calculation shows that, depending on the variables used, a 10 per cent increase of people in the share of migrants in a country's population will lead to a decline of between 2.1 and 3.5 per cent in the share living on less than US\$ 1 a day.

Separately, a cross-country IMF study confirms a strong link between poverty, whether measured using poverty headcount or the poverty gap, and remittances. The study showed that on average a 2.5 percentage point increase in the remittances/GDP ratio is associated with less than a 0.5 percentage point decrease in the share of people living in poverty. The impact may well be greater if changes in average income and inequality are taken into account (Spatafora, 2005).⁴⁷ Similarly, based on a survey of 7,276 urban and rural Guatemalan households, Adams (2004) found that remittances reduced the level of both severity and depth of poverty. Conversely, Gustafsson *et al.* (1993) estimated that in Lesotho if all remittances were removed the head count poverty ratio would rise from 52 to 63 per cent.

Fourth, when remittances account for the largest share of income of the household and when a significantly high proportion of the remittance

income is spent on food and other basic needs, there can be little doubt that remittances play an important role in alleviating the hardships of poverty. And, as already noted in Chapter 3, this is indeed the situation in a number of countries including Bangladesh, Senegal and Turkey. In Albania, findings based on a household survey in 2000 showed that remittances were the most important source of income for 61.5 per cent of the receiving rural households (Germeij *et al.*, 2002). And, in Latin America, a survey made by the UN Economic Commission for Latin America and the Caribbean (ECLAC) indicated that in countries like El Salvador, Guatemala and Nicaragua 80 per cent of family remittances are spent on food.⁴⁸ In such situations the impact of remittances on poverty alleviation is clear. At a more general level, the impact of remittances is especially wide among poor households, since these are subject to more credit constraints (Spatafora, 2005).

There is still another important, if indirect, way in which remittances, especially collective remittances through migrant associations, can reduce hardships of poverty, although this has received little attention in the specific context of poverty alleviation. This happens when pooled remittances are invested on creating or improving community assets such as fresh water wells, clinics, schools, roads and small irrigation projects, and the poor have access to some of the basic services and facilities which may otherwise be unavailable to them (further discussed in Chapter 5).

How do remittances affect equality? The evidence of the impact of remittances on income distribution or equality is inconclusive. Some studies show that remittances may have had an equalizing effect on income distribution in Mexico (Taylor, 1999). Simulating multiplier effects of remittance expenditure in Mexican villages Adelman *et al.* (1998) concluded that remittances equalize income distribution across families within a village. De and Ratha (2005) note that in Sri Lanka, the Gini coefficient is reduced from 0.46 to 0.40 as a result of remittance receipt. For Pakistan, Gilani *et al.* claimed that no other net inflow of resources “has historically been as equally distributed over the national population as remittances (Gilani *et al.*, 1981).

On the other hand, migrants from rural Mexico, holding US resident visas, were found to monopolize scarce local resources in the areas of origin – land, cattle, and commercial enterprises – strengthening economic asymmetry and social stratification (Rubenstein, 1992). Some studies in Egypt also suggested that remittances increased rural-urban inequality as they led to increased investment in urban areas (McCormick and Wahba, 2003). Even within the rural sectors of Egypt and Pakistan, remittances were found to increase inequality (Adams, 1991, 1998). Similarly, Milanovic (1987) found no evidence from (former) Yugoslavia’s national data for several years in

the 1970s-80s that the multiplier effects of remittance expenditure had any positive effect on income equality.

At least part of the explanation for these conflicting findings lies in the original income levels and location of the migrant households. Adams finds that it is the variations in the number of migrants produced by different income groups, and not differences in either migrant earnings abroad or migrant propensities to remit, that cause migration to have a negative effect on rural income distribution (Adams, 1991). As discussed above, in the initial stage of migration when *officially recorded* migrants generally come from households with higher incomes, remittances can be expected to show increased income inequality. And if they are mostly from urban areas, it is likely that remittances would exacerbate rural-urban income disparity. However, as migrants from poorer households join the migratory process and gain access to labour markets abroad, helped by the development of migration networks, better information flows and easier travel, remittances can have a positive effect in restraining further increases in inequality, as was noticed in Pakistan as well as in Mexico (Stark, Taylor and Yitzhaki, 1988). Not surprisingly, McKenzie and Rapoport (2004) find that (as in the case of poverty) remittances reduced inequality for Mexican communities that had a tradition of relatively high levels of migration. This is consistent with the findings of the 2003 Mexico National Rural Household Survey, referred to above, which indicates that international remittances have an equalizing effect on incomes in high migration areas, but not in low migration ones.

Differences in the methodologies used may also partly account for the divergence in the findings of the various studies mentioned above. For instance, in calculating the income of the migrant some studies include the earnings foregone by the individual in the home country. When this is done, migration and remittances tend to show an increase in inequality. If, on the other hand, the migrant's lost domestic income is ignored, remittances may show an equalizing effect in the community, as was found in Nicaragua (Barham and Boucher, 1995). For purposes of policy formulation affecting new migrants, the earnings foregone in the home country cannot be ignored. On the other hand, the consideration is less important in the context of the existing migrant stock which no doubt is the more important source of remittances (than the new emigrants).

When migration enhances income inequality, it may contribute to a feeling of relative deprivation among the non-migrant households in the local community, fuelling further migration (Stark and Taylor, 1989, 1991; Ghosh, 1998). The perception of relative deprivation gains ground when individuals and families, although not necessarily poor, feel that others are doing better and that they are constrained to be laggards. If remittances from the new

migrants, in turn, increase inequality and enhance relative deprivation, migration could at least in theory become self-perpetuating. However, as already argued, increased participation of poorer households in migration is likely to restrain both income inequality and the feeling of relative deprivation, and thus reduce the pressure for migration.

How is it then that countries with a skewed income distribution and higher inequality seem to have a smaller share of remittances in national income? The World Bank notes that during 1996-2000 remittances were nearly twice as high (1.5% of GDP) in countries that had relatively even income distribution (as reflected in Gini index) than in other countries (0.9%) (Ratha, 2003). This seems to suggest that income equality and remittances are correlated, even if there is not enough evidence of a direct causal relation between them.

One possible explanation of the seeming paradox is that with an even distribution of income in the country more people can afford to cover the cost of travel; also being better equipped to migrate, they on average could possibly earn and remit more per head. Moreover, with increased participation of poor households in international migration their income could rise and thus the trend towards less income inequality can gather further strength and momentum. In other words, migration itself can at that point contribute to better income distribution.

Do remittances sharpen social stratification and weaken family ties?

Do remittances create a new layer of social stratification? It is sometimes believed that they do create a new division between migrant and non-migrant households in local communities. The stratification, based on migrant status, could be strengthened if remittances increase wealth and income inequalities. The increased earnings of the remittance-receiving households and the sudden visibility of their relative affluence have been found to exacerbate social division in some areas. It is also possible that in some communities emigration and remittances have the effect of weakening social obligations and social cohesiveness. However, experience also shows that the possible negative effects are countered when migrants and their associations take an active interest in community-friendly affairs, invest funds to build community assets and services for common welfare and maintain a continuing dialogue with the local community in other ways. In the absence of such community friendly collective initiatives on the part of migrants abroad, remittances could indeed breed social divisiveness. In Mexico, for

example, communities which have no hometown associations and where remittances go straight to families show social tension in striking contrast with the situation in communities which have hometown associations abroad and benefit from the support in building community assets and services leading to improvement of the quality of life (see Box 3).

It has been noted that the changing consumption pattern of the remittance-receiving households almost invariably leads to improvement of family welfare and human capital. However, when this entails conspicuous consumption, with excessive expenditure on foreign luxury products and sophisticated household appliances to show off the newly found wealth, this may not only contribute to social division but may also lend an enhanced prestige value to foreign products, alongside a psychological downgrading of domestic goods.

On the other hand, when remittances are associated with the infusion of new and progressive ideas through closer interaction with the transnational diasporas or returning migrants, they could bring in more openness and increased social mobility and strengthen democratic values in traditional and rigid societies, even if the process may entail some tension in the initial stage.

Male migration and remittances may also affect family structures and cultural values. And these in turn often have a significant impact on labour market participation, levels of production and demographic trends in the home country (Ghosh, 1996).⁴⁹ Research in an Egyptian village showed that women left behind became more involved in cultivation, management of financial affairs and household decision making (Khafagy, 1983). The experience however varies, sometimes even within the same country, depending on the local circumstances. For instance, in another Egyptian village, Taylor (1984) finds no significant change in the productive roles of migrants' wives following male migration.

Such differences were noticeable across countries and regions as well. A study made in the Taiz province of the Yemen Arab Republic showed increased seclusion of women left in the care of male relatives (Mynitti, 1984). Also, in some Caribbean countries male emigration did not lead to an active involvement of women in production because of legal and social constraints, and may have led to a fall in small-scale or family farming. By contrast, in some African countries emigration of male members enhanced the role of women both in the family and in the production system (although this did not prevent a temporary fall in agricultural output). In cases where migration and remittances entail greater empowerment of women, with more control over spending, it is likely that more is spent on health and education and a

Box 3 Social effects of remittances: contrasting scenarios

When migrants abroad take an active interest in the affairs of their communities of origin, maintain close contact with them and send collective remittances through their associations to develop community assets and services for common welfare, the action helps avoid social divisiveness which remittances may otherwise create in the home communities. A recent press report highlights this by contrasting the situation in two small communities in Mexico – Jumiquillo and Los Haro. The former benefits from collective remittances through migrants' hometown associations (HTAs), the latter does not. In Juminaquillo "the roads are well paved and most buildings are in good repair. The small church has been refurbished with the help of migrants in the US (Its) immaculate streets are testimony to the power and coordination of its migrant community in the US, who have channelled their dollars into useful projects". . . . "Los Haro, a few miles from Juminaquillo, sits amid fields of dead and dying peach trees . . . Its roads are unpaved and degenerate into muddy puddles, and there are no well-kept public buildings. Instead, remittances go straight to families – some houses are brightly painted, with well-watered green lawns and satellite dishes on their roofs. Others are made of adobe bricks with corrugated iron roofs. Divisions persist even after death. In the local over-grown cemetery, the deceased from remittance-receiving households lie in grandiose mausoleums. The rest have simple tablets" (*Financial Times*, 3 March 2004).

possible decline in child labour, as it happened, for example, in Bangladesh, where, according to one study, a large part (56%) of remittances from female migrant workers in the Middle East was spent on health care, education and current consumption (INSTRAW and IOM, 2000).

What about the impact on family relationships? Again, caution is needed against sweeping generalizations as the situation varies widely. In Sri Lanka, for example, investigations among returnees showed that 99 per cent of males and 92 per cent of females believed that family relations had been strengthened (Gunatilleke, 1991). Bryant (2005) found that alongside remittance-led improvement in the children's health and schooling, the involvement of the extended family mitigated some of the social costs of a parent's migration. On the other hand, a study of 74 families in Jordan concluded that labour migration had a negative effect on family ties (Kamiar and Ismail, 1991). In the Philippines, the children of migrant parents from Luzon area were found to perform worse in school and less socially adjusted, especially if the mother had migrated, than with both parents at home (Battistella and Conaco, 1996).

Much of the past studies on the social and cultural impact of emigration and remittances have related to male migration. As already suggested in

Chapter 1, given the increasing feminization of international migration, further research on the subject, incorporating the social effects of its fast-changing gender configuration, should be rewarding.

If public policies are aimed at increasing remittances inflows to developing countries, their demographic effects cannot be ignored. A high level of emigration can mean a moderate growth of population, despite continuing high fertility rates among the non-migrants. In the Caribbean, for example, net migration resulted in offsetting 52 per cent of the natural increase of the region's population during the period 1960-70. Age selectivity of migration and the youth of the female cohorts can also mean ageing of the local population, as happened in certain areas of Greece following substantial emigration to the Federal Republic of Germany in the 1960s and 1970s. Today one often witnesses such situations in some remittance-receiving communities in Latin America. The small community of Jumiquillo in the Mexican state of Zacatecas is one such example. As a recent newspaper report noted, although migrant remittances have made the community look affluent, "there are many signs of absence. The place is virtually deserted, populated almost exclusively by the very elderly."⁵⁰ In El Salvador, the small town of Intipuca in the eastern province of La Unión a similar scenario has been taking shape since the 1960s, when political turmoil first triggered large-scale emigration from the locality. In such situations high dependency ratios could imply an eventual fall in the fertility rate in principal emigration areas, and if it leads to an exodus with signs of "absence and emptiness" it cannot but have its negative consequences.

Age selectivity however is not the only factor that matters. The education and skill levels, cultural profiles and other characteristics of the emigrants could also affect the home country's fertility rate. In Jordan, for example, the selectivity of migration favouring the educated and high-level professional groups with a lower fertility rate meant that the non-migrants had a higher than the pre-emigration average level of fertility for the population as a whole, but of course in this case the very elderly were not the only non-migrants.

5

The Role of Non-state Stakeholders: What More They Can Do and How

The discussion in the preceding chapters has shown that harnessing the full development potential of remittances requires concerted action by several major actors. While the remittance behaviour of individual migrants and government policies in home and host countries are of crucial importance, the role played by other actors, such as the migrant associations, the diasporas and the corporate sector, cannot be minimized. In harnessing the development potential of remittances these various stakeholders have their individual and distinctive roles to play. But more often than not, they also need to join hands with one another and act in concert.

The role of migrants' associations

Migrants' associations in host countries are now playing an increasingly active role in financing projects to improve living conditions and promote development in their home communities in different regions of the world. In Africa, this has been part of a long tradition of community and ethnic solidarity. As mentioned earlier, in recent years the establishment of migrant associations in host countries has lent a new momentum to these efforts. Condé and others (1986) noted that a significant proportion of African migrants' savings accumulated in France was channelled through migrant associations to finance community assets in the village of origin, including construction of schools and health facilities. A striking feature of the new initiatives is that migrant associations are mobilizing funds from external sources in the host country leveraging their own, collectively pooled, remittances to support community-level development projects. These activities can range from the supply of consumer goods and purchase of farming equipment to income-generating business ventures. And, sometimes migrants from different neighbouring countries, but working in the same host country, join hands, forge inter-institutional links and plan collective action (for additional details, see Box 4).

Female migrants from Africa have also been active in setting up associations within the wider framework of *Organisation de solidarité internationale* issue

de l'immigration (OSIM). In France, for example, there are several hundred Africa-oriented OSIMs. Initially focused on migrant integration and welfare in the host country, they are now more concerned with economic cooperation and development and serve as valuable links between host and home countries. These activities could range from fund raising and canvassing for external aid to hands-on participation in skills transfer to home countries. African female migrants have also been active in another organization, *Initiatives des femmes africaines de France et d'Europe* (IFAFE). Founded as an association in 1993, it was reconstituted as a federation in 1996 bringing together 23 member associations. Despite its limited resources, in recent years IFAFE has embarked on a variety of economic cooperation and development programmes, such as supply of medicine and school equipment, rural development, including building wells in the Democratic Republic of Congo, Gabon and Cameroon, vocational training for orphans, and provision of micro-credit for women engaged in farming and business who lost their livelihood following natural disasters (IOM, 2005).

Under its Co-Development Programme, the French government provides technical and financial support to associations of migrants, notably from Mali, Mauritania Morocco and Senegal, in their development activities in the country of origin. These include: construction of schools, health centres and rural housing, promotion of rural tourism and small-scale enterprises, training and research (see also Chapter 5). Although the programme is yet to make a major impact, it has opened up new avenues of action under the government policy of development cooperation. A process of close cooperation involving public authorities, migrant associations, NGOs and the private sector, emphasis on local development and the role of local authorities and greater attention to training and capacity building are among the promising features of the new approach.

In Latin America, similar institutions, dubbed "hometown associations" (HTAs) are growing fast. Migrants from the Dominican Republic, Guatemala, Haiti, Mexico and El Salvador, for example, have set up hometown associations in the US to pool their financial and social resources for improving conditions in home towns. In the US there are about 700 such groups of Mexican immigrants alone. Although collective remittances through HTAs currently account for no more than 1 per cent of total remittances in Central America, the indications are that these could rise to 3 to 5 per cent in ten years if their institutional and management capacity improves and the present trend continues (IFAD, 2004).

Although some of these groups in Mexico raise up to US\$ 100,000 a year, a significant number of them have a small resource base, with an annual income of around of US\$ 10,000. However, even with such limited resources,

they generally make a significant impact on the local receiving communities. This is because many of them are active in small rural towns which have small populations, low per head income and inadequately developed public services and poor physical infrastructure, in some cases lacking even a commercial centre (Orozco, 2005).

In some cases the government provides matching funds to encourage such investments by migrant associations. Some states in Mexico, for example, offer a “three-for-one-deal”: for every peso that migrants contribute to community development funds, the federal, state and local governments will chip in two pesos. By 2002 the programme had established projects worth US\$ 43.5 million, two-thirds of which benefited labour-intensive farming activities in four high emigration states (IOM, 2005). In 2000, groups of migrants from Zacatecas in northern Mexico invested US\$ 6 million in new roads, schools, churches, water systems and parks. In the period 2002-04 more than 3,000 such projects were benefiting some 1 million inhabitants in 23 Mexican states (IADB, 2004). Sometimes, such partnership is used to promote commercial ventures. The state of Guanajuato in central Mexico, for example, encourages migrants’ associations to invest in small clothing factories at home and covers some of the start-up costs (Lowell and de la Garza, 2000).

In El Salvador, the government provides matching funds for local development projects under partnership arrangements worked out with hometown associations. Within the framework of such partnership the Social Investment and Development Fund, for example, has supported a number of projects at an average cost of US\$ 278,689 per project, with the hometown associations contributing on average 16 per cent of the project cost, in cash and kind (Orozco, 2004).

Guyanese hometown associations based in Canada and the US, undertake welfare activities similar to those in Mexico and Central America, and these could include provision of services. For example *Guyana Watch*, based in Queens, New York, provides an outreach medical service, staffed by 20-25 doctors and nurses, to cities in Guyana and work at a clinic for one day attending to between 2,500 and 3,000 people (Ibid).

Initiatives for building community assets are also being taken by Asian migrants abroad, although the extent of the activities has so far been relatively limited. Some governments, too, are actively encouraging such asset building in local areas. In the Philippines, for example, the government has launched a programme, dubbed *Lingkod sa Kapwa Pilipino* (LINKAPIL), encouraging migrants abroad to support development projects at home leading to improvement in infrastructure, education and health. Bangladeshi

migrants in the US and the UK have set up a number of associations or trusts through which they pool funds and collectively decide on how these should be used for the benefit of the communities they come from. Funds are generally spent on projects related to health care, education and construction or repair of roads, culverts and mosques (Siddiqui, 2004). These associations also contribute to relief and reconstruction work following natural disasters affecting their communities of origin.

Admittedly, over all, the contributions of migrant associations across regions have been relatively small so far. But activities initiated or supported by collective remittances hold considerable potential for revitalizing many small and remote communities through physical improvements, new social services and a changing economic landscape. In many cases the associations give ownership of the projects to the communities. When this happens, they can reduce the hardship of the poor by giving them access to new community assets and services. The improvement of physical and social infrastructure and infusion of new financial and social resources can also pave the way to the growth of small businesses and modernization of agriculture. These activities often help in building close and creative two-way links between migrants abroad and their communities and areas of origin. An important positive consequence is that the process helps those migrants who wish to return, making their reintegration much easier. Lessening the risk of tension that return sometimes causes, it also helps the returnees to contribute to the development of their communities with new ideas and approaches which are likely to be accepted with less resistance.

The experiences in Zacatecas and Guanajuato provide useful insights into the ways in which the social and financial resources of migrants can be mobilized within a transnational framework for local and regional development in the home country. Iskander (2005) believes that by bringing together the state and the Zacatecan communities on both sides of the border and seeking to use their combined resources to promote development, the Zacatecan initiative has generated a process of social learning and innovative institutional development. By contrast, the Guanajuato programme is shaped more by a market-oriented strategy. According to Iskander, it would be rewarding to cull the strengths of the two strategies and synthesize them into one.

These initiatives, however promising, are not without possible pitfalls. For instance, embarking on income-generating business ventures, even if seemingly attractive, carry some serious potential risks. They may not achieve much success unless the projects are designed carefully to ensure their long-term viability, technical and organizational support is available on a regular basis from competent public or private services (including NGOs), and the business environment is sufficiently friendly for start-up ventures.

As concerns the grant of matching funds, a potential pitfall is the diversion of scarce budgetary resources to projects selected mainly or exclusively at the behest of the expatriate nationals who may have their own set of priorities. When the core membership of the associations in the host country determine the home town needs to be addressed, as is generally the case, for example with HTAs for Mexico, it may be difficult to avoid the risk.

This however is not an argument against providing matching funds, but for making sure that the local community groups (including resident families of migrants) in the home community play an active part in selecting the projects and that these respond to their genuine needs. What is particularly important even for business ventures is that the benefits of such projects are widely shared and are not monopolized by a small, relatively affluent, minority, contributing to inequality and social divisiveness. There is a danger that a few individual migrants may try to dominate the whole endeavour, undermining its democratic and participatory nature. Another danger is that the search for positions of leadership and prominence by individual migrants may lead to a proliferation of organizations, with many leaders but few members. No less real is the potential risk that the involvement of the state in the programme might lead to its politicization with different political groups trying to manipulate it to gather influence and enhance their political interest. Both to preserve the social and institutional values of the programme and to ensure its economic success these pitfalls need to be scrupulously avoided.

A related problem is the possible diversion of scarce resources from other regions with a greater need of assistance. It should not be forgotten, however, that the idea behind the provision of matching funds is to encourage collective self-help to promote local development and that in most developing countries high emigration areas do not always have excessively high levels of income, especially relative to rich counties. The problem nonetheless can be worrisome in countries suffering from sharp regional economic disparities, and in such cases it may be more expedient to address it through a wider package of carefully crafted pro-active measures to reduce such disparities rather than denying or stopping matching funds to emigration areas.

Transnational diasporas

While remittances and other forms of support from hometown associations or similar bodies relate to the collective action mainly (though not exclusively) of recent migrants, the discussion on diasporas focuses on earlier (starting with the first generation) migrants, with permanent residence in the host

Box 4 **Migrants' associations and remittances-related development activities in communities of origin in Africa**

Based in a deep sense of village and community solidarity, African migrants have traditionally contributed to the development of their home community through transfers of funds. More recently, through the creation of migrants' associations abroad, they have been doing this in a more innovative and organized manner. These associations collect and channel migrants' funds and use them to finance, wholly or in part, a variety of productive projects in their home communities. For example, the *Réseau des Associations de Développement de la Vallée du Fleuve Sénégal*, a network of associations, which unites immigrants originally from Senegal, Mali and Mauritania and now settled in France, has been financing the construction of mosques, schools, health centres and hydroelectric projects. The result is an important improvement in living standards in the home communities.

Likewise, the *Gidimaxa Jikké Association*, an organization of immigrants from the Kayes region in Mali, now living in Seine-Saint-Denis in France, is contributing to the improvement of infrastructure, including roads for transportation, thus facilitating the development of markets in the region.

Migrant associations in some instances collaborate more directly with the residents of their villages of origin and become strategic actors and mediators in promoting community projects and ensuring their sustainability. The process helps to maintain close and continuing relations between the emigrant population and the residents in the home community. Another dimension of migrant associations' mediating role concerns the mobilization of funds in the host country, leveraging their own remittances to support development projects. For instance, "Migration and Development", an association created in 1986 by immigrants of Maghrebin origin, now settled in Haute Alpes, France, mobilized funds from a variety of partners for this purpose. Such partners included the European Union, the French Ministry of Foreign Affairs, the *Fonds d'action sociale pour les travailleurs immigrés et leur familles* and the *Comité catholique contre la faim et pour développement*. Migrant associations' mediating role can sometimes extend to private enterprises interested in initiating joint economic projects, as witnessed, for example, in the Senegal River Valley region.

No doubt, the potential role of migrant associations in promoting development of their communities through remittances-related activities critically depends on their credibility based on organizational integrity, transparency and effectiveness. Equally important are the policies and attitudes of both host and home country governments, including the status and legitimacy they are willing to accord to the associations.

Source: Based on a statement by Bimal Ghosh, Scientific Co-ordinator, Inter-regional ministerial conference on migrants' participation in the development of their countries of origin (Dakar, October 2000).

country, many of whom may also be well established and successful in business, skilled professions or other fields of activity.⁵¹ They may take, individually or collectively, an active interest in their original homelands; and they may do so for emotional reasons, often combined with considerations of their professional or business-related interest. The countries of origin, too, may find it useful to benefit not only from their financial investment but also from their talents, expertise and their business (including capital market) links in the outside world. Not surprisingly, transnational diasporas' possible contribution to the development of the country of origin has thus become a favourite theme of discussion in contemporary migration literature. How justified is this newly found interest?

Experience shows that when a developing country reaches the point of an economic take-off, and there is a general feeling of resurgence and optimism among its people, members of the diasporas become more interested in re-establishing links with their countries of origin through more frequent visits or even permanent or semi-permanent return. And if the business environment is favourable and friendly, many of those in the diaspora communities who have the resources become interested in participating in the country's growth process. The objective in such cases is often threefold: emotional satisfaction of helping their country of origin on its way to development; receiving recognition in their original homeland, and making personal financial gains at the same time.

A combination of such objectives may have led 55 million overseas Chinese to invest an estimated US\$ 60 billion in their ethnic homeland (ILO, 2004). Taking advantage of the opportunities opened up under the country's new economic policy, the Indian diaspora in the US has played a pioneering role in the spectacular growth of India's information technology (IT) sector. They brought into the country not only financial remittances but valuable technical and entrepreneurial skills, while, in many cases, continuing to make use of their business and capital market contacts already established abroad. They also helped in the process of outsourcing by foreign firms. In some instances, Indian diasporas holding high executive positions in western multinationals saw the advantages of setting up operations in India and were instrumental for their companies deciding to do so (Ghosh, 2000, 2005). In the Caribbean, the diaspora links are being used to build networks for trade, tourism and investment promotion; to draw on its knowledge, skills and assets and to attract its increasingly efficient forms of remittance (Mishra, 2005). Diasporas of Indochinese origin, primarily a result of the refugee outflows in the 1970s and 1980s, have been an important source of remittance inflows to Laos, Cambodia and especially Viet Nam (Hugo, 2003), although these may have been underreported in IMF balance of payment statistics.

Transnational diasporas can thus be a source not only of financial and business-related resources, but also of social capital in terms of new and innovative ideas and progressive values through networking. If properly harnessed, all these can enhance economic growth and at the same time contribute to social and cultural enrichment of the countries of origin. Arrangements for double nationality for members of the diaspora would facilitate this whole process. The growing concerns over national security should not prevent governments from giving serious consideration to this matter (further discussed below)

Remittances for investment from the diasporas should not, however, be taken for granted. And it would be unwise to be euphoric about their possible contribution to development in an unreserved manner. The fact is, so far only a few developing countries have benefited from large-scale investment from their diasporas, and even where this happened, the impact, however spectacular, has so far generally been confined, as in the case of India, to certain specific sectors.

Building transnational diaspora links, especially for attracting large-scale investment, is a two-way process. For many members of the diaspora, emotional bonds with the original homeland and the nostalgia associated with it are real and important, but this is hardly sufficient for attracting profit-oriented investment when the risks are too high. To make this happen, the home country must provide, in addition to a reasonable degree of market openness, macro-economic stability, good governance, basic infrastructure and a flexible labour force; in other words, most of the same basic conditions as are needed for a country's sustainable growth and development. If in Taiwan Province of China (hereinafter, Taiwan), the success of the Hsinchu Science-Based Industrial Park was mainly due to the money and efforts of the overseas Chinese from Taiwan,⁵² it should not be forgotten that the government provided a favourable environment and specific incentives, including planned infrastructure, to companies relocating to the area or establishing new ventures there. India could develop its IT industry with the help of its diaspora only after it embarked on its policy of relative openness and economic reform.

Revamping and re-establishing relations between homelands and diasporas may not always be smooth or free from tension. India, although it has benefited from its diasporas, is a case in point. For quite some time there was a feeling of resentment among many Indians abroad that they were being neglected by the Indian government. This was fuelled by a perceived notion, widely shared among the Indian expatriates, that the government was mainly interested in tapping their financial and other resources. On the other hand, some Indians at home were no less resentful that special privileges, to which

they had no access, were being extended to those who had left the country. Since then the provision for granting double nationality status (overseas citizens of India, ODI) to Indian diasporas in selected countries seems to have helped in removing much of the tension and placing the relationship on a more stable basis, which augurs well for the future.

Another point worth noting in this connection is that all financial flows from the diaspora communities are not necessarily in the nature of migrant remittances. For example, firms which are owned by diaspora members or of which they are important shareholders may decide to make capital investment in the home country either on their own or jointly with local enterprises. Such capital inflows are more likely to be seen as foreign direct investment than migrant remittances. On the other hand, when diaspora members bring in their savings as they decide to return to the home country, or provide funds to support and participate in development projects initiated by migrant associations, these could be included as part of remittance inflows. Admittedly, in some cases the distinction becomes somewhat blurred – as may have happened in China where, according to some analysts, a part of the migrant remittances may have been misclassified as FDI by overseas Chinese.

When diasporas can unsettle development

Diaspora-led remittances have another kind of impact on the home country, which is quite different from what is discussed above. Analysts have indicated that remittances and other forms of support by diasporas may have an unsettling effect on development when these are used to support civil wars and similar conflicts in the country of origin. The existence of a large and influential diaspora often helps in prolonging or even encouraging such conflicts. This is likely to happen especially when there is already some rivalry or actual conflicts between groups within the country due, for example, to ethnic or religious differences, conflicting economic and political interests, and discrimination, whether actual or perceived, against one or more of such groups (Collier, 2000; Anderson, 1999). Just as diasporas can contribute to conflict resolution and post-conflict reconstruction, their financial support can also aggravate the conflict or increase the risk of renewed conflicts. Diaspora-led remittances and coalitions abroad are considered to have played an important part in supporting conflicts in such diverse places as Somalia, Sri Lanka and Kashmir (Kapur, 2004). In addition to providing direct financial support to the warring groups, they often provide global linkages through which local minerals and other resources are sold and arms and

essential supplies bought (Duffield, 2001), prolonging the conflicts or adding to their ferocity, or both.

True, when the financial flows and other forms of diaspora-led support are geared to restoration of freedom, human rights and democracy, this could unleash new energy and enthusiasm and in the long run help development, but the immediate effect nonetheless could well be unsettling for development. Furthermore, the diaspora funding may be directed to achieving an opposite, more repressive, political and ideological objective; or the diaspora community itself may be divided, channelling funds to each of the warring groups at home. When there is an inter-ethnic conflict in the country of origin, different diasporas might be pitted against one another, as it happened in Bosnia and Herzegovina.

From a remittance-related policy perspective, the challenge is to make innovative efforts to encourage the diasporas to channel their funds and political influence in a positive direction, such as prevention or peaceful resolution of conflicts and post-conflict reconstruction and development (Sorensen *et al.*, 2002). In cases where the diasporas have an active involvement in the home country conflict it may be strategically important to have a constructive, if discreet, dialogue with the diaspora leaders as part of the conflict resolution and peace building process.

The corporate sector

In earlier chapters of this study mention has already been made of the financial sector's increasing interest in remittance flows, with special attention given to the question of transaction cost in Chapter 2. The discussion has also thrown some light on the sector's multifaceted role in the area of remittance-related development. These can be summed up as follows: (a) it can promote increased use of the formal channel for money transfer and encourage a more productive use of the funds; (b) it can enhance its own business interest, including that of its shareholders, by increasing its market share in the remittance business and by widening its clientele among the migrants, and (c) it can also promote its own interest while contributing to poor countries' development, through participation in remittance-related productive activities, including business enterprises, through development of operational links with micro-finance institutions and credit unions in remote areas, as well as through securitization of remittance flows.

It has been noted that lack of reliable, efficient and easily accessible banking or other money transfer services, especially in remote rural areas, high costs

of transfer and the presence of black market exchange rates, are among the main reasons that discourage migrants from using banks and other formal channels. Working with migrant associations and public authorities in host and home countries, as appropriate, the corporate sector can take forward-looking initiatives in easing many of these constraints.

Empirical evidence and household surveys confirm that, given the existence of a well-developed financial sector, migrants, especially large remitters and regular remitters, are less likely to use the informal channel. The establishment of branches of home country financial institutions, such as commercial banks and insurance companies, in host countries should encourage the migrants to use the formal channel to remit funds and eventually open savings accounts as regular customers. The positive impact of a special service introduced by the *Banque de l'Habitat du Sénégal* to facilitate migrant remittances from France has already been noted in Chapter 2. Similarly, Russell notes (1991) that the Philippines saw a sharp increase in the remittance inflow almost immediately after the Philippine National Bank extended its services in Germany, Italy, the Netherlands and Spain in 1990. Trust in the financial institutions is of course an essential precondition for this to happen, enabling the formal sector to have an increasing share in the remittance market and expand its business. But migrants' trust in the formal system cannot be expected to take hold unless they become convinced of the efficiency, honesty and dependability of the financial institutions.

Even when the banking services are available, migrants may be unable to use them because of the requirement for the account holder to maintain a minimum credit balance and produce satisfactory identification credential. Providing identity cards to migrants to access banking facilities such as the bilateral arrangements made for Mexican migrants in the US under *matricula consular* could help open opportunities for transfers through formal channel.⁵³ Press reports suggest that the effect of the *matricula* cards was immediate. Wells Fargo bank, for example, reported that 400,000 migrants used the cards to open accounts with its branches. The cards also intensified competition with other banks such as City Group, Bank of America and HSBC, offering remittance services. Mention has been made in Chapter 2 of the positive effect the introduction of a special service by the *Banque de l'Habitat du Sénégal* has had on migrant remittances from France.

In many cases lack of familiarity with banking procedures, especially if cumbersome, is also an important reason for migrants to be averse to using bank intermediation for remitting funds. Migrants in such situations need to be provided with information, both prior to their departure and following their arrival in the host country, on the role of banks and their procedures and practices.

Cost of transfer is of course a vital issue. Based on conservative estimates, the World Bank suggests that the cost of transactions – labour, technology, setting up networks, and rent – add up to US\$ 5 or less per transaction, far below the fees paid by the migrants. As discussed in Chapter 2, increased competition, helped by congruent public policies and regulatory measures, leads to substantial reductions in the transaction costs. It has also been noted how the financial sector in both host and home countries can make a special effort to reduce the transaction cost through the introduction of modern and innovative measures such as the use of electronic devices, transfers based on credit/debit cards, strategic inter-institutional alliances across countries, including establishing functional links with post offices and other public or semi-public networks already existing in rural areas.

In the countryside of many developing countries lack of credit is often a major obstacle to the growth of small enterprises and modernization of agriculture. Even if the banks cannot extend their own networks in such remote areas, they can help promote credit cooperatives and other micro-finance institutions and establish functional links with them (see also Chapter 2). Aside from ensuring low-cost and reliable transfer of funds, such institutional links should have multiple other spillover benefits. First, as members of credit unions remittance-receiving families are more likely to save a portion of amounts received than those using non-bank services, such as money transfer agencies. Second, membership of credit unions often leads to more confidence in the modern financial and banking institutions and to the actual opening of deposit accounts. Third, the latter process helps the integration of migrants and the receiving households into the formal financial and banking system, making it easier for households to leverage remittance receipts to obtain better access to financial and related support. These linkages can create a new synergy within the financial sector facilitating a better use of remittances as development finance. Not surprisingly, recent research confirms that remittances can be used to promote financial institutions and enhance development (Giuliano and Ruiz-Arranz, 2005). As discussed in Chapter 2, in countries such as Bangladesh where micro-finance institutions are relatively well established, it would be worthwhile for governments to encourage and assist them to be more actively involved in remittance-related activities and forge links with banks and other financial bodies in the organized sector for this purpose.

There is also scope for the migrant associations to establish closer links with the financial and other business sector enterprises in the host country. This would make it possible for these latter bodies to contribute to the success of remittance-led industrial and other productive ventures in developing countries by providing additional funds (leveraging migrant resources)

and other forms of business support. They can at the same time financially benefit from their participation in such projects.

As transfers through banks and similar institutions become easier, cheaper and more dependable, and as both migrants and remittance receivers develop more confidence in the banking system, it can be expected that remittances through the formal channel should not only rise in volume but also become more stable and predictable. This would widen the possibility of securitizing the remittance flows, giving developing countries access to international capital markets. Guarantees by governments of industrial countries can, as already discussed, improve their credit worthiness and lower the cost of borrowing still further. Access to such low-cost external finance would, in turn, be a great help to capital-short, developing countries in their efforts to achieve higher economic growth and rapid social progress.

6

An Overall Assessment

What then is the overall assessment of the development effects of remittances? Do they do “nothing to convert stagnation to development” (Jacobs, 1984) and serve more as symbols of a “squandered opportunity for development” (Martin, 1991), as some analysts tend to suggest? Or, are they a powerful force for economic development, including poverty alleviation, in less affluent countries, as many others would like us to believe?⁵⁴

The truth probably lies between the two. At the household level, remittances often have a positive development effect. They help improve children’s education, contribute to better health, housing and family welfare, and thus promote future human capital development. Further, they often alleviate the hardship of poverty by supporting family budget and basic consumption, although they sometimes encourage conspicuous consumption with a preference for foreign luxury goods, and denigrating national products.

By easing credit constraints and providing risk insurance for rural households, remittances help in the development of small enterprises and promote entrepreneurial skills, even if emigration of adults sometimes entails a temporary fall in production, especially in the agricultural sector, and failures of remittance-backed small enterprises are not uncommon. Experience across countries and regions also shows that collective remittances can contribute to the development of villages and local communities as they help build social assets and facilities such as schools, hospitals, community centres, feeder roads and various small infrastructure projects and by promoting micro-enterprises. The process, including the involvement of migrants’ associations and returnees, holds the potential of injecting new economic and social impulses into erstwhile stagnant communities, even if it may create in some cases temporary tension.

What about the remittances’ development impact at the national level? Although remittances, especially for some small countries, can be a valuable source of foreign exchange and an important addition to gross national product, their overall development impact at the macro-level has so far been less impressive. They do not necessarily spur nationwide development

nor can they be an adequate response to the daunting challenge it involves (Papadimitriou and Martin, 1991; Ghosh, 1996; Ellerman, 2003; Gubert, 2005). There is hardly any causal relationship between inflows of remittances and economic performance, although they may well be correlated. Some countries receiving large amounts of remittances (e.g. the Philippines, Ecuador and Yemen) have done rather poorly. And yet some others with large remittances inflows (e.g. China, India and Thailand) have performed rather well (ILO, 2004). Weak market, including financial sector, links between migrant-receiving villages and towns and other parts of the country and supply-side constraints partly explain why the remittance-induced growth impulses are not always transmitted to the national economy and remain confined within local areas and more closely targeted groups of people.

Remittances can contribute to investment and output growth, but the process is not automatic. And the promise of remittances is not without pitfalls. Indeed, there is a real danger in overrating its importance or portraying its development potential in an unqualified manner. By giving wrong guidance or lopsided signals, this could lead to faulty policy formulation and make the tasks of promoting sustainable development and fighting poverty more difficult.

This is not to deny that the development impact of remittances can be significantly enhanced by encouraging and facilitating increased use of the official channels at lower transfer costs and a more productive use of the funds.

A significant proportion of total recorded remittances, which may well be between one-third and half of the total, continues to be sent to developing countries through informal channels. These transfers do not add to the official foreign exchange reserves of the country nor can they be easily geared to its development policy priorities. In times of political and financial instability, they encourage uncontrollable capital flight just as they help money laundering and funding of criminal and terrorist activities. Studies show, however, that if transaction costs were reduced to 2-5 per cent and dual exchange rates eliminated, remittances through formal channels can go up by 50 per cent or more (Freund and Spatafora, 2005).

Several of the policy and operational measures that can be taken to achieve this and to enhance the volume and value of remittances in other ways are discussed in the previous chapters. While government action is critical in many of these areas, the role of the other stakeholders should not be minimized. Governments, the corporate sector, including in particular financial institutions, and the migrants themselves have a common stake in ensuring the success of these measures.

There is little doubt that there has been a sharp increase in recorded remittance inflows to developing countries in the past few years. However, the recorded increase is also partly a reflection of improved data collection. In assessing the real value of remittance receipts, the opportunity cost of emigration – the possible earnings forgone by the migrant in the home country and the output loss to the economy – needs to be taken into account. The consideration is particularly important in the context of new outflows of migrants, especially the skilled ones, even if less so in relation to the already existing migrant stock abroad.

Also, when remittances are seen as a form of transfer of resources to a country, it is important to consider not only the inflows but also the outflows of remittances. For the developing countries as a group, the total amount of net remittance receipts is significantly smaller than the gross receipts. The importance of remittances as a mechanism for the transfer of resources from developed to developing countries should be assessed on the basis of the latter's net, and not gross, remittance receipts.

Remittances should not be seen or projected as a substitute for development aid, especially for the world's poorest countries. Although both remittances and aid have the potential to act positively in such areas as poverty alleviation and economic growth, the two sharply differ in their characteristics, modalities of operation and selectivity of beneficiaries. It would be unfortunate if a gathering euphoria over the role of remittances in the development of poor countries serves as a distraction from the ODA commitments of the Monterrey conference. The least developed countries (LDCs), in particular, will suffer.

Through their direct and indirect effects remittances can make an important contribution to poverty alleviation, while reducing child labour. But much depends on the extent to which the positive multiplier effects of remittances reach the poor households. Even more important is the extent to which poor people themselves, who are also generally low-skilled, have opportunities to move abroad. However, the underlying conditions for this to happen are not always available or easily met. From the perspective of poverty alleviation through remittance inflows, there is a strong case for facilitating legal emigration on a temporary basis of workers from poorer households. Although the evidence about the effect of remittances on equality is less conclusive, there is clearly scope for improving their positive impact on equality through appropriate policy and operational measures.

Remittances to developing countries, as compared to other forms of external financial flows, are in general stable and display relatively little pro-cyclicality in host countries. This has led some analysts to regard remittances as an

attractive source of development finance. Experiences show, however, that economic slowdown in the host country and other external shocks can cause serious declines in remittance inflows to individual home countries. Also, an important condition of the stability and counter-cyclical nature of remittance inflows is that the funds were intended to support household budgets, especially to smooth consumption, in the remittance-receiving country. The more the remittances assume the role of development capital the more sensitive they tend to become to changes in the business environment in the home country. There is another hiatus, too. Experience shows that when the receiving households perceive the flow of remittances as being stable and predictable, they are more likely to spend rather than save and invest, weakening its role as development capital. Policymakers would do well in recognizing the significance of these dilemmas.

Clearly, undue reliance on remittances as an engine of development entails some potential risks, such as postponement of essential economic reform, enhancing remittance dependency, vulnerability of the home country economy to sudden external shocks, and distortion in economic priorities. These and other risks are real, but should not be overstated, as done by some. Sound and forward-looking policies and better institutional practices alongside a better awareness of both the potential of remittances as well as the possible pitfalls involved can help avoid or at least minimize many of these risks.

Closer market integration linking remittance-receiving villages and towns with other parts of the country, and increased flexibility in the supply of agricultural supplies and other production inputs should help transmit the remittance-induced growth impulses to other parts of the national economy and reduce the risk of inflationary pressure due to supply constraints in remittance-receiving villages and towns.

Faulty project design and lack of adequate technical, institutional and infrastructure support account for the failures of some of the remittance-backed small enterprises. Governments, the private sector and NGOs can all play a part in addressing these deficiencies and constraints. Creation of one-stop-shops as contact and information centres, but not for specialized advice or services, would be extremely useful. Tying in migrants' remittances with other critical inputs of successful business ventures such as skills, market intelligence and business contacts can be particularly rewarding to spread the development impact of remittances. Alongside increasing global economic integration, recent initiatives by migrants' associations and transnational diasporas in establishing dynamic business, economic and social links in the country of origin have opened up new avenues of action to achieve this.

In addition to increasing financial inflows, these other links and forms of support can enhance the success of a wide variety of remittance-related business activities in developing countries, ranging from skill and knowledge-intensive service industries for both domestic and export markets to income-generating micro-enterprises operating mainly at the local level. The process can pave the way for other private sector actors in both host and home countries to participate in, and benefit from, a new range of business activities.

There is thus a strong case for channelling government support, including official aid, to migrant associations, provided that their accountability, transparency and democratic nature are fully ensured, and that the benefits of the development projects are widely shared within the community, and not monopolized by a powerful few. It is as important to shun the domination of the migrant associations by a few individuals as to avoid politicization of the matching fund programmes as a result of government involvement in them.

Without prejudice to their legitimate security concerns, governments would do well to give serious consideration to possible arrangements for according dual nationality or a similar status to members of the diasporas as potential partners and catalytic agents for development of the countries of origin and their closer integration into the world economy.

Also, as part of efforts to encourage remittance-related productive investment in the home country and eventual return, it may be useful for the authorities in the host country to devise an immigration policy that allowed legally resident migrants to return home for the period needed to set up productive projects, and to travel back and forth building up more assets and improving their skills.

In cases where the diasporas have an active involvement in the home country civil conflicts that impede stability and development, it may be strategically useful to have a constructive, if discreet, dialogue with the diaspora leaders as part of the conflict resolution and peace building process, although much depends on the country-specific situation, and action should be taken with due circumspection.

The corporate sector, especially banks and other financial institutions, can do a lot to increase the volume and value of official flows by reducing the transaction cost, simplifying transfer procedures and by encouraging through various other means the use of the formal financial channels. Compilation of statistics showing the recent declining trends in transfer costs as well as the varying current costs of cross-country transfers through different

financial agencies would encourage healthy competition, improve market performance and generate wider public awareness of the importance of the issue.

In many remote areas it may not be feasible for these formal institutions to operate directly and extend their own facilities to remittance-receiving households. In such cases, they could explore possibilities to promote, and establish strategic links with, public and private institutions, including micro-finance entities and credit unions, that already exist in rural areas and are easily accessible to migrant households.

In doing all this, organized financial institutions can make a much wider, even if indirect, contribution to economic and social development of poor, and largely marginalized countries. They can help the integration of migrants and remittance-receiving households into the modern financial and banking system. This can lead to a better use of remittances as development capital, while enhancing the financial institutions' own business interests. No less important is the role that the organized financial institutions can play in securitizing the remittance flows, thus facilitating capital-short developing countries' access to external finance at low cost and their integration into the world capital market. Alongside the financial institutions, other private sector actors in both home and host countries may also find it worthwhile to take a pro-active interest in supporting remittance-based start-up projects, enhancing their long-term viability and success, from which they, too, can eventually reap benefits.

Regulatory measures are needed to minimize the potential risk of money laundering, consumer fraud and, especially in the wake of recent terrorist attacks, financing terrorism, but they must also avoid stifling remittance flows or raising the cost of transfer. The challenge is to strike a balance between preventing the financing of terrorism and other criminal acts, and ensuring freer flow of remittances.

Regulatory measures for the purpose of increasing official flows of remittances or channelling them to productive investment have not met with great success in the past, although some of the incentive schemes have worked rather well. A critical review of the reasons why the regulatory and incentive schemes have been more effective in some cases and not in others would be useful for future policy guidance.

Policy formulation in this whole area is often seriously constrained by lack of adequate, reliable and standardized data on emigration and remittances, although some improvement in data collection has taken place and a whole, new initiative for further progress is now launched by the International

Working Group set up at the behest of the G7/8 leaders. These efforts should be strengthened and extended to new remittance-related issues, including those concerning female migrants and their role in remittance-based development.

Efforts to increase the official flows of remittances and harness their full development potential as discussed in this study are not likely to make much headway, unless both remittance-receiving and sending countries act in concert within a coherent policy framework. At a general level, remittance-receiving countries need to provide a friendly economic environment through sound macro-economic policies, including stable exchange rates, basic physical infrastructure, improved market integration, reliable financial and other institutions, transparent legal system and good governance – in essence, conditions that can prime the economy for development and equip it adequately to benefit from external stimuli. This is particularly important if remittances are to be attracted and used as development capital.

No less important is the part that the host countries, especially the more affluent ones, can play in the whole endeavour. They can make a direct and distinctive contribution to increasing the volume and value of the official remittance flows to developing countries. This includes creation of additional opportunities for developing country migrants' legal entry into their territory, consistent with host countries' labour market, social security and demographic needs. They are also in a position to facilitate capital-short developing countries' access to world capital markets by providing, in appropriate cases, guarantees for bonds issued by them against remittance flows as collateral.

Industrial countries can concomitantly provide pro-active support to the migrant-sending developing countries' efforts at creating a conducive domestic environment, as outlined above, to harness the development potential of remittances, leading to a declining pressure for disorderly and irregular migration. Both groups of countries have a common and abiding interest in enhancing such cooperation.

Notes

1. At the time of writing, 2003 was the most recent year for which reliable, and centrally registered, IMF Balance of Payment (BoP) statistics were available. Meanwhile, however, some governments have updated their previous figures and the World Bank and IMF have also received some preliminary figures for 2004 and 2005 from a number of governments. To the extent appropriate, these are separately mentioned in the body of the discussion. The increase in recorded remittances in recent years is partly due to improved data collection. See in this connection *Global Economic Prospects: Economic Implications of Remittances and Migration 2006* (World Bank, 2005, Washington. See also endnote 4 below.)
2. *The Wall Street Journal*, 29 November 2005, p.C4.
3. The panorama of benefits and costs becomes even more complex when it is remembered that an increasing number of countries – perhaps more than a quarter of all countries – is now considered as major migrant-sending and migrant-receiving countries at the same time. The data are based on an ILO survey which defines and attributes “major” to a country which had a population of more than 150,000 in 1970 and 200,000 in 1990, and whose labour market or GNP was affected by less than 1 per cent by international labour migration, disregarding asylum seekers and refugees. The successor states of the former Federal Republic of Yugoslavia are not included (ILO, 1994, 1999).
4. Migrants’ transfer refers to cross-border movements of the migrant’s financial assets or ownership thereof along with the movement of the individual; for example, assets brought back home by the migrant on return and the value of stocks and bonds owned by a migrant that is transferred in international accounting from one country to another along with the migrant.
5. As suggested by the G7 finance ministers’ meeting at Sea Island (March 2004), efforts are currently being made by the World Bank and IMF, jointly with the UN, to improve the coherence, comparability and overall quality of remittance statistics. In Latin America, a similar initiative is underway at the Center for Latin America Monetary Studies, with support from the Inter-American Development Bank, the IMF and the World Bank.
6. IMF balance of payments statistics showed US\$ 200 billion as total inflows (credit) as against US\$ 135.9 billion as outflows (debit), implying a discrepancy of roughly US\$ 64 billion, which must be ascribed to inadequate recording of outflows in national BoP statistics.
7. If the World Bank estimates that between 30 and 45 per cent of the gross inflows of remittances to developing countries come from other developing

countries, then the proportion of the net amount transferred to them is further reduced.

8. The informal arrangements operate under different names in different countries/areas: *fei-ch'ien* (China), *hawala* (Middle East), *hui kuan* (Hong Kong, Special Administrative Region of China), *Padala* (the Philippines) and *phei kwan* (Thailand). Cf. Qurochi *et al* (2003).
9. Some analysts have suggested that the informal remittances double or in some cases even triple the total amount of migrants' recorded remittances (Aite Group, 2005; Lowell, 2001). Even if this might have been true in some cases and for certain years, the global average, as discussed below, seems to be lower.
10. These and other costs of emigration from developing countries are outside the scope of this study.
11. Based on figures as available to IMF before updating.
12. Bank of Mexico, cited in *Financial Times*, 1 September and 13 December 2005.
13. Part of these increases reflect improved data collection.
14. Based on figures as available to the UN at the time.
15. Remittances as a share of GDP were also high in a few low income, island or small economies (but non-LDCs) such as Tonga, Samoa and St. Kitts & Nevis. Based on figures as available before any updating.
16. The strength and weakness of remittances as a resource for development finance are discussed later in this paper (see Chapters 3 and 4).
17. See United Nations (2002) *Report of the International Conference on Financing for Development*, Monterey, Mexico, March 2002. According to the OECD's Development Assistance Committee, pledges made by 22 donor countries indicate that the total net assistance should rise from under US\$ 80 billion in 2004 to US\$ 128 billion in 2010, including debt relief.
18. The issue of how to enhance aid effectiveness is of course part of an important, but different, debate and outside the scope of the present paper.
19. Lucas estimates that in 2000 for the countries where both migrants' stock and remittance figures were available the official flows per migrant amounted to some US\$ 572 per migrant (Lucas, 2005).
20. Swamy (1981) found that gender composition of migration flows had a significant impact on remittances in a sample study of three Mediterranean countries covering 18 years.
21. Rodrik does not discuss their annual remittances. However if on average 20 per cent of their income is sent home, it would yield US\$ 40 billion during their stay abroad, in addition to the funds they may bring on return. He does not discuss the problems generally associated with temporary labour migration. A similar estimate made by Terry Walmsley and Alan Winters (2003) suggests that the total global gains from such temporary migration would be of the order of US\$ 150 billion a year.
22. A database compiled by the ILO shows that workers in high income countries earn a median wage that is almost five times the level of that of workers in low income countries, adjusted for differences in purchasing power (Freeman and Oostendorp, 2000).
23. Cf. the following comment by the staff of the US Selection Commission: "Large-scale removal of US dollars in the form of remittances constitutes a drain on the economy and adversely affects the US balance of payments" (Staff Report,

- p. 518) Chapman (1976). See in this connection Julian L. Simon (1989), *The Economic Consequences of Immigration*, p. 161.
24. The discussion here does not take account of the effects of changes in the comparative advantage and terms of trade in home and host countries due to migration. These are influenced by different variables, including in particular the skill profiles of the migrants.
 25. Although in most cases types of migration also reflect the migrants' underlying motivations, classification by motives is based on a distinctive set of criteria.
 26. Unless the recipient's demand for income is assumed to be absolutely inelastic.
 27. Donald Terry, manager, IADB's multilateral investment fund, cited in *Financial Times*, 26 March 2004.
 28. For example, according to a most recent report in *the Wall Street Journal*, a worker in the US sending US\$ 500 home in Mexico pays to Western Union just US\$ 13 for the service – US\$ 8 for the transfer plus 1 per cent of the principal – down from about US\$ 25 in 2000 and 55 in 1995. *The Wall Street Journal*, 29 November 2005, p.C4.
 29. Statement by Manuel Medina Mora, cited in *Financial Times*, London, 4 July 2003.
 30. Enrique Iglesias, President, Inter-American Development Bank, "Sending a lot of money home", *International Herald Tribune*, 13 July 2001.
 31. *Financial Times*, 13 December 2005.
 32. Information provided by Condusef, a government backed financial services watchdog and cited in *Financial Times*, 19 September 2003. The increase in bank transfer may be partly attributable to the improved collection of data.
 33. As a result the cost of transfer, reportedly, has come down to US\$ 6.50 per transaction, significantly lower than the current costs of transfer through formal or informal channels.
 34. In the US the Wire Transfer Fairness and Disclosure Act requires that information, *inter alia*, on fees and exchange rates to be displayed in the offices of money transfer agencies and in their advertising in order to ensure transparency in pricing and wider consumer choice and promote a fair competition.
 35. Global and financial environment includes international measures against money laundering and financing terrorist activities and economic sanctions on a collective basis against a country or countries.
 36. Obviously remittances cannot be separated from migration. However, the wider issue of benefits and costs of migration is outside the scope of this study.
 37. However, according to Cornelius, in three Mexican communities nearly half of the businesses owned by migrants or former migrants were found to depend at least in part on continued inflow of remittances.
 38. The approach, though attractive, especially in the context of the current debate on skill migration, raises several complex issues which are not discussed here.
 39. The estimate was based on the assumption that the annual remittance inflow was about US\$ 70 billion, that half of this amount was channelled through the banking system and that a collateralization ratio of 5:1 was to be applied.
 40. Comparing the situation with Spain benefiting from American gold and silver receipts in the 16th century, Settimo notes "large amounts of money passed through the pockets of beneficiaries, increased their immediate welfare, but failed to translate into durable economic growth".

41. See, for example, Subramanian and Sadoulet (1990) for India, and Lewis and Thorbecke (1992) for Kenya.
42. IMF makes a similar point in suggesting that a good investment climate with a well-established financial system and sound institutions would imply a higher share of remittances is invested in physical and human capital (IMF, 2005).
43. A most common standard relates to poverty headcount or the share of population below a certain level. The depth of poverty measures the average value of the gap between the poverty line and the incomes of those below the poverty line. The severity of poverty measures the average of the squared gaps, thus giving more weight to the poorer households.
44. The fact that in 1995-2000 the net annual migration for developing countries was negative does not detract from the importance of their migrant stock; nor should it be forgotten that the immigrants and emigrants do not necessarily relate to the same groups of persons.
45. Its findings suggest that if all the remittances were to stop suddenly, the proportion of Mexicans living in poverty would rise only from 47.1 per cent to 48.5 per cent. According to a ministry source, the proportion of remittance money going to poor families is also falling (cited in *Financial Times*, 1 September 2005). What is not clear however is whether or to what extent the remittances themselves made some of the erstwhile poor families less poor.
46. Currently, according to the UN figures for 2000, the average annual net migration from these countries represents 0.5 per 1,000 population, or roughly 0.1 per cent of their labour force (United Nations, 2002).
47. The poverty headcount was defined as the share of people below the poverty line; and the poverty gap as the percentage amount by which the poor lie below the poverty line defined as US\$ 1.08 a day at 1993 international prices.
48. The surveys examine remittance expenditure on the assumption that incomes from different sources are perfect substitutes.
49. The discussion in this section draws largely on the author's paper "Economic migration and the sending countries", in Julien van den Broeck (Ed.) *The Economics of Labour Migration*, 1996.
50. *Financial Times*, 3 August 2004.
51. Note that there is no standard definition of a diaspora. The Indian government, for example, considers a person of Indian origin residing abroad to be a member of its diaspora, and a person to be of Indian origin is broadly defined as an individual who was born in India or has at least one grandparent or parent born in undivided India. Originally, the term "Diaspora" referred to the dispersion of the Jews following their exile in 538 BC.
52. According to the Public Policy Institute of California, as of 1999, 82 companies in the park, or 40 per cent of the total, were established by the efforts of returnees from the Silicon Valley in the US.
53. Guatemala has already worked out a similar arrangement while several other Latin American governments are discussing such possibilities for their migrants in the US.
54. [Out of remittances] "a generation or more... have lived better and have more opportunities than conceivable with any other economic development path actually (not theoretically) open to many labor exporting countries" (Keely and Tran, 1989).

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