The impacts of international remittances on receiving countries at the micro and macro level and policy options for increasing remittance effectiveness: Reviewing the literature

Master Thesis

By

Johanssen N Kaijage

i437514

Maastricht University

Maastricht Graduate School of Governance

Maastricht, 28 August 2008

Supervisor: Dr. Melissa Siegel
Acknowledgements

I would like to thank my thesis supervisor Dr. Melissa Siegel for her guidance, assistance and dedication throughout this study. A word of thanks also goes to Dr. Jessica Hagen-Zanker and Bas Thijssen for their generous assistance throughout this programme. I would also like to thank the Maastricht Graduate School of Governance for nice study conditions, facilities and staff support I have had here. Additionally, I am grateful to the Maastricht University and the Maastricht Graduate School of Governance for financing my studies under the Marathon Scholarship. Finally, I would like to thank my family, especially my wife Ingrid and our children Kenneth and Octavian for their love, patience and encouragement.
Table of Contents

Acknowledgements........................................................................................................................................... i
Table of Contents............................................................................................................................................... ii
List of Figures .................................................................................................................................................... iv
List of Tables ...................................................................................................................................................... iv
List of Abbreviations ......................................................................................................................................... v
Abstract ............................................................................................................................................................ vi
Chapter One ..................................................................................................................................................... 1
  1.1 Introduction............................................................................................................................................. 1
  1.1.1 Focus of the study ............................................................................................................................. 1
  1.1.2 Methodology ..................................................................................................................................... 2
  1.1.3 Structure of the study ...................................................................................................................... 2
  1.2 The concept, definition and trends of remittance flows ........................................................................ 3
  1.2.1 Remittance concept and definition ................................................................................................. 3
  1.2.2 Official remittances flows: magnitude and direction................................................................. 4
  1.2.3 Challenges of estimating informal remittances ............................................................................ 7
  1.2.4 Challenges related to partial formal flows: ................................................................................... 8
Chapter Two ..................................................................................................................................................... 9
  2.0 Key Characteristics of remittances flows ............................................................................................ 9
  2.1 Reasons for sending remittances ........................................................................................................ 9
  2.1.1 Theoretical determinants of remittances ....................................................................................... 9
  2.1.2 Macroeconomic determinants of remittances ........................................................................... 12
  2.2 Senders of remittances ....................................................................................................................... 15
  2.3 Receivers of remittances .................................................................................................................... 18
  2.4 Methods used to send remittances .................................................................................................... 20
  2.5 The cost of sending and receiving remittances ................................................................................ 23
Chapter Three ............................................................................................................................................... 27
  3.1 Impacts of remittances ....................................................................................................................... 27
  3.2 Microeconomic impact of remittances ............................................................................................. 27
  3.2.1 Labour market and entrepreneurship ......................................................................................... 27
  3.2.2 Human capital ............................................................................................................................... 29
  3.2.3 Investment ..................................................................................................................................... 32
  3.2.4 Poverty .......................................................................................................................................... 34
  3.2.5 Inequality ....................................................................................................................................... 37
List of Figures

Figure 1.1: Top remittance recipient countries in US billion dollars, 2007...................... 6
Figure 1.2: Top remittance recipient countries as percentage of GDP, 2006.....................6
Figure 1.3: Top remittances sending countries, 2006.............................................7
Figure 2.1: Remittance costs as percentage of principal amount..............................23

List of Tables

Table 2.1: Remittance types classified by senders and recipients...............................16
Table 2.2: Comparison of remittance transfer mechanisms......................................22
Table 2.3: Cost of sending $200.............................................................................25
Table 4.1: Impact of remittances on country credit rating and sovereign spread...........45
# List of Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>ATM</td>
<td>Automated Teller Machine</td>
</tr>
<tr>
<td>DFID</td>
<td>Department for International Development</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FIES</td>
<td>Family Income and Expenditure Survey</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>HTA</td>
<td>Hometown Association</td>
</tr>
<tr>
<td>IDB</td>
<td>Inter-American Development Bank</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IOM</td>
<td>International Organization for Migration</td>
</tr>
<tr>
<td>LTTE</td>
<td>Liberation Tigers of Tamil Elam</td>
</tr>
<tr>
<td>MIF</td>
<td>Microfinance Institutions</td>
</tr>
<tr>
<td>MMP</td>
<td>Mexican Migration Project</td>
</tr>
<tr>
<td>MTO</td>
<td>Money Transfer Operator</td>
</tr>
<tr>
<td>NELM</td>
<td>New Economics of Labor Migration</td>
</tr>
<tr>
<td>NGO</td>
<td>Non-Governmental Organization</td>
</tr>
<tr>
<td>ODA</td>
<td>Official Development Assistance</td>
</tr>
<tr>
<td>PCH</td>
<td>Pew Hispanic Center</td>
</tr>
<tr>
<td>SWIFT</td>
<td>Society for Worldwide Inter-bank Financial Telecommunication</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
</tr>
</tbody>
</table>
Abstract

In recent years remittances have gained interest among the researchers, policy makers, members of the civil society and the international community due to their increasing size. In this paper I review the current literature on the impacts of international remittances on receiving countries at micro and macro level. I also assess the policy measures to support remittances in order to increase transfer flows and their productive use for development and poverty alleviation. The results from the review suggest that remittances are beneficial at family, community and national level through human capital formation, investment goods, poverty alleviation, and macro-economic stability. However, other studies blame remittances for reducing labour supply and participation decisions, over consumption and less investment, inequality, inflation and lack of effects on economic growth. The policy literature calls for strengthening of the infrastructure supporting the remittances to reduce transaction costs; formalization of the remittance flows; and measures to increase the productive use of remittances. And if these policies are well integrated into broader national development strategies, remittances can benefit poor families, communities and developing countries.

Keywords: remittances; transfer obstacles; impacts; policy measures; developing countries
Chapter One

1.1 Introduction

International labour migration is one aspect of globalisation that has been increasing drastically in recent years mainly due to global economic integration, communication revolution and free movement of labour in many regions. According to the United Nations report on international migration in 2006, about 190.6 million people or 3 percent of the world’s population are living outside their place of birth.

The role of migrant remittances in economic development continues to be an issue in recent years for policy makers, international organizations, bilateral donors and researchers. This is mainly because migrant remittances represent a substantial flow of financial resources mainly from the developed countries which are major migrant receiving countries to migrant sending developing countries. The remittances sent back home as the result of labour migration have reached high levels in recent years especially in developing countries and this is attracting attention on their impact on receiving countries. The World Bank report on Global Development Finance in 2007 showed a huge increase of formal remittances sent to the developing countries from US$116 billion in 2002 to US$251 billion in 2007, representing a change of about 118 percent. These huge amounts of remittances indicate how labour migration if well managed could play a big role on home country development and create an impact on poverty reduction. Indeed, various initiatives are being undertaken around the world to understand the characteristics of international remittances and identify ways of increasing the development impact in remittance receiving countries.

1.1.1 Focus of the study

This paper seeks to review the current literature on the impacts of international remittances on the migrant sending country at micro and macro levels. The paper will also identify the policy options which could be put in place by the receiving countries in order to create conducive environment for increasing the effectiveness of remittances flows so as to speed up economic development and poverty reduction. The specific objectives are to:

- identify key elements and determinants of remittance flows
- examine the impacts of remittances at micro and macro-levels
• identify the obstacles that are hindering the realisation the benefits of remittances
• examine the policy measures which could be considered in order to enhance the developmental potential impact remittances
• provide recommendations on how these constraints to increase the effectiveness of remittances

1.1.2 Methodology

This research is aimed at mastering the key concepts and issues regarding the remittances and based on that insight attempts to address the research problem. The research question is as follows: What are the impacts of international remittances on receiving countries at the micro and macro levels and what are policy options for increasing remittance effectiveness?

Due to time constraint it is difficult to access reliable and up to date data on remittances in order to be able to undertake empirical analysis on this topic. Therefore, the study is based on a thorough review of existing literature. The literature used is mostly found from journals, textbooks, research based reports, articles, publications and documentations from various organisations such as, the World Bank, International Organisation for Migration, Organisation for Economic Co-operation and Development, International Labour Organisation, International Monetary Fund and also web based information.

1.1.3 Structure of the study

The first chapter focuses on general introduction, the concepts, definitions and trend of remittances. Chapter two looks at the key characteristics of remittances flows such as why migrants remit, who are receivers and senders of remittances, methods used and costs involved. Chapters three and four examine the literature on the impacts of remittances at micro and macro levels. Chapter five covers the social and political implications of remittances. The last two chapters examine the existing policy initiatives to improve the remittance effectiveness and present the conclusion and recommendations.
1.2 The concept, definition and trends of remittance flows

1.2.1 Remittance concept and definition

Understanding the phenomenon of remittances is a complex task given the fact that up to now there is no consensus on how remittances are conceptualized or measured and in the literature various authors attach different meanings to the concept (Radha, 2006). This lack of common definition of remittances is a reason why it’s difficult to estimate the total value of remittances transferred to a particular country and region (Taylor and Fletcher 1999).

The remittances can be sent within or between countries. However, in this paper the term remittances will mean international monetary remittances. In most of the literature remittances are defined in terms of cash or financial transfers sent by migrants who left their home country excluding those sent in kind. The term is also confined to migrant worker cash transfers transmitted to their families and their communities back home excluding transfers from refugees and other migrants who do not benefit from legal status of migrant workers (Van Door, 2001, Sorensen, 2004). Remittances are money migrants earn abroad that are sent back home. They represent a private flow of capital from the country of employment to the country of original (Daianu, 2001).

Some analysts have tried to use a broader definition of remittances in order to improve the method of capturing the financial transfers of migrant workers. Remittances are usually defined as the sum of workers’ remittances, compensation of employees and migrants’ transfers in the balance of payments (Ratha, 2003). The most widely used official definition of remittances was developed by the International Monetary Fund (IMF). Remittances are international transfers of funds sent by immigrant workers from the country where they are working to people in the country from which they came from. The literature shows three components to compiling statistics on remittances: The first component, workers’ remittances, is the value of current monetary transfers sent home from workers living abroad for a year or more. The second component, compensation of employees, includes the gross earnings of foreigners residing abroad for less than 12 months (mainly includes earnings of seasonal workers and diplomats). The third component is the migrants’
transfers that are the net worth of migrants who change residence from one country of employment to another (IMF, 1993 and BPM5, 2005). However, there is an argument that these records do not provide a full picture simply because the IMF estimates are based on official worker remittance flows, that is, remittance monies which are transmitted through official banking channels excluding a large part of (and unknown) remittance monies which is transmitted through private, unrecorded channels (Adams and Page 2005).

The recent challenging views against the IMF methodology of measuring remittances came from Chami and others who argue that the methodology is problematic and that by aggregating the three components could result in a serious misspecification and faulty conclusions. They argue in favor of using workers’ remittances alone and pointed out that, a preliminarily examination of data on and definitions of employee compensation and migrants’ transfers reveals that these flows are conceptually different from and behave differently than workers’ remittances (Chami et al, 2008). The authors noted that classification of workers’ remittances most closely captures the generally accepted definition of remittances in the literature and policymaking that remittances are periodic, unrequited, non-market transfers between residents of different countries. Regarding the migrants who after some years of residency in the foreign country decide to go back home with their final accumulated assets, the authors argue that these are equivalent to capital transfers and not remittances and should be recoded as capital transfer. Chami et al suggest that employee compensation should not be treated as remittance transfers since balance of payments accounting attributes these incomes to the staff members’ official countries of residence and if the inclusion is necessary, researchers need to compile a net compensation figure by subtracting from employee compensation that portion of earnings that are spent in the host country and are not transferred to the home country.

1.2.2 Official remittances flows: magnitude and direction

While there is still no consensus on a common methodology for measuring remittances, most studies on the magnitude and direction of remittance flows have since 1995 arrived at two important observations. First, remittances have increased substantially and are recognized as one of important sources of external finance currently second behind Foreign Direct Investment (FDI) and ahead of Overseas Development Assistance (ODA) to developing countries (Sander, 2003, World Bank, 2006). The second important observation
is that the portion of remittances that originate from the developing countries has been rising and could not be neglected (Agunias, 2006).

According to the World Bank (2008), globally the flow of remittances were estimated at $337 billion in 2007, an increase by 11 percent if compared to $303 billion in 2006 and 99 percent from that of 2002. A significant amount of remittances was recorded in the developing countries in the same period at $251 billion compared to $226 billion in 2006, and about 118 percent increase from $116 billion in 2002.

Regional wise, Latin America and the Caribbean were the largest recipient of recorded remittances in 2007 with $61 billion followed by East Asia and the Pacific and Europe and Central Asia with $59 and $47 billion respectively. Flows to Sub Saharan Africa was less compared to other regions at $12 billion, however this was 132 percent increase from a figure of $5 billion in 2002. This picture of remittances in Sub-Saharan Africa is heavily influenced by underreporting or complete lack of data and this leads to underestimate in many countries (World Bank, 2008)

The top five recipient countries of remittances by volume in 2007 (figure 1.1) are India ($27 billion), China ($25.7 billion), Mexico ($25 billion), Philippines ($17.2 billion) and France ($13.8 billion)\(^1\). When remittances are expressed as a share of GDP we see a different picture with almost all top twenty recipients in share of per capita remittance being developing countries. In 2007 the top five recipients of remittances in terms of per capita were Tajikistan, Moldova, Tonga, Kyrgyz Republic and Honduras and in all these countries remittances exceeded 25 percent of GDP (Figure 1.2)

---

\(^1\) The position can fluctuate depending on year, source and methodology used to collect data on remittances by countries
At the global level the higher income countries are top sending countries of workers remittances including United States, Saudi Arabia, Switzerland, Germany, and Russian Federation (figure 1.3). The United States was the largest source of workers remittances with nearly $42.2 billion in 2006; however this data is challenged by some sources with the argument that it is grossly over reported simply because many transactions transfer through accounts of correspondent banks in the United Stated (Sander, 2003 and World Bank, 2006)
1.2.3 Challenges of estimating informal remittances

It is clear based on the arguments in the literature that officially estimated remittance flows do not provide the real picture of payments made due to the absence of information on payments made through informal or unrecorded channels. The estimated figures based on models, guesses and household surveys suggest that these extra flows could range from 30 percent to 250 percent of the remittances (Freud & Spatafora, 2005, Ratha, 2006, Sander, 2006). The studies looking at specific regions have found out that countries with rigid and weaker financial and monetary systems creates barriers to the flow of formal remittances resulting to higher informal flows (Sander and Maimbo, 2003, Freud and Spatafora, 2005). For the case of Africa for example, Sander and Maimbo (2003) argues that the weakness or absence of financial systems on the continent and high proportional of interregional migration is the evidence that the higher portion of remittances is through informal flows. Reported remittances could be enhanced by narrowing the black market premium on foreign exchange, reduction of fees charged for formal transfers and encouraging competition in the transfer market (Lukas, 2005).

The recent increase in global recorded remittances is attributed to a combination factors. In the literature some new developments observed regarding informal remittances flows between the early 80s and early 2000s. In countries with improved financial systems, the
informal remittances have been shrinking from some 50 percent to 70 percent of the total during the 80s to around 20 percent at the end of the 1990s (IMF, 2003).

1.2.4 Challenges related to partial formal flows

In the literature two important technical problems are cited as the cause of inaccuracy of estimated formal remittances flows in most of the countries. First, most countries provide less reliable data due to technical problems associated with data collection. In most cases reports from the banks or money transfer companies do not provide details required to distinguish remittances from other kinds of transfers (World Bank, 2006). Martinez and others conducted a World Bank study of central banks in 40 developing countries and found out that the coverage of remittances in balance of payments statistics is partial because remittances paid directly by non-banking financial institutions such as money transfer companies, exchange bureau, credit unions, and post offices are frequently not covered in balance of payment statistics (Martinez et al, 2005).

Second, most countries with a significant number of migrants do not report official data on remittances at all or they report in other balance payments entries (World Bank, 2006). For example, Carling noted that out of the 208 economies surveyed by the World Bank, almost half reported no data on received workers’ remittances from 1992-2001 and only a quarter reported data each year. Among the 42 low and middle income countries in Sub-Saharan Africa with more than a million inhabitants, nearly half reported no remittance statistics during the same year period (Carling, 2005, cited in Agunias, 2006)

Countries with the political instability and lack of reliable financial institutions such as Afghanistan and Somalia do not submit balance of payment data to IMF (Sander, 2003). Somalia is a good example whereby remittances are an important factor in the livelihoods of many people and it is estimated that 25 percent of all families receive remittances from abroad, other estimate higher as 40 percent (Hansen, 2004)
Chapter Two

2.0 Key Characteristics of remittances flow

2.1 Reasons for sending remittances

2.1.1 Theoretical determinants of remittances

There is a large body of literature regarding the motives behind the migrants’ decision to remit money to relatives back home. Most of the theories which are offered in the literature tend to give same reasons as for motivation to remit. The earliest papers remittances mention altruistic motivations for remittances. Lucas and Stark in their study “Motivations to Remit: Evidence from Botswana (1985) argues that much of the literature before their study considered only pure altruism as the only motive to remit. They argued that household arrangements within extended family may be considerably more complex and studied remittances at household level. They hypothesized three models depending on remittances main determinants: pure altruistic theories, pure self – interest models and tempered altruism or enlightened self-interest (1985)

Altruistic feelings of the migrant may be a motivation for transfer income to family and relatives left behind. With altruism, the utility function of the migrant depends not only on her/his own consumption, but also on the utility of the relatives left behind (Lukas and Stark, 1985). Much of the literature on causes of remittances has been based on altruism as a main cause of decision to send money back home. The migrant thus cares about poverty and other family shocks and consequently sends remittances and in this case a family can be regarded as playing the role of an insurance company that provides members with protection against income shocks by diversifying the resources of income (Stark, 1991). The study in Guyana, by Aggarwal and Horowitz (2002) provides evidence suggesting that that migrants motivated by altruism to send remittances back home.

The theories that have focused on the idea that there can be self-interested reasons for remitting are also centered on family which is seen as a business or as nexus of contracts that enables the members to enter into Pareto-improving arrangements (Chami et al, 2003). Self -interest theory assumes that the migrant is mainly motivated by economic and
financial interests when sending remittances to the home country with aspiration to inherit, to demonstrate laudable behavior as an investment for the future in fixed capital, public assets or to be eligible to other resources in the community. Lucas and Stack (1985) suggest that migrants may have investments that need to be tendered while they are away; in this case they need family members to act on their behalf as trusted agents. The remittances sent by the migrant are used to care for the migrant’s interests, but they also contain some compensation for the agents (Chami et al, 2003).

Another argument in the literature is that pure altruism or pure self-interest alone can not provide adequate explanations of the extent of remittances and its variability through time and across persons. They suggest a tempered altruism and enlightened self-interest theory whereby remittances are viewed as a part of inter-temporal, mutually beneficial contractual arrangements between the migrant and the family at home country. The contractual arrangements could be co-insurance, loan repayment and exchange of services.

De Bruyn and Wets (2006) suggest that other reasons to remit involves social pressure from the family in the country of origin, where the migrant feels obliged to remit to satisfy the needs of his or her family in the country of origin and pride, whereby the migrant wants to let his or her entourage in the destination country and in the country of origin know that she or he can provide financial resources.

Another important aspect of remittances as a family contract between migrant and those at home relies on the notion of risk diversification. The New Economics of Labour Migration (NELM) hypothesis states that due to market failures with economic risks in the source country, it becomes a convenient strategy for a household member migrates to a non-correlated labour market to diversify economic risks by entering a type of contract agreement with the household left behind. Conversely, for the migrant, having a family in the home country is insurance as bad times can also occur in the foreign country. In this model, migration becomes a co-insurance strategy with remittances playing the role of an insurance claim (Stark, 1991, Agarwal and Horowitz, 2002). The argument is supported by Amuedo-Doranates and Pozo (2002) who investigated whether remittance flow serve as insurance for Mexican migrants and found that remittances are, in part, transferred to the home country to purchase family-provided insurance and self-insurance and they find that increases in income risk significantly increases both the propensity and the proportion of
labor earnings sent home for family-provided insurance as well as for self-insurance. On the other hand, remittances are seen as premium for future risks and therefore can serve as a diversification strategy or risk-sharing strategy. It is argued that in this case remittances allow both senders and receivers to secure livelihood in invent of external shocks and in this regard remittances are seen as a mutually beneficial and enforceable contract between both parties (Chimhowu et al, 2004)

The study in Morocco by Bouhga-Hagbe (2004) regarding a theory of workers’ remittances, found out that the level of workers’ remittances depends on how great are their degrees of altruism and attachment to their home country, and also depend on interest rate differentials between the home country of residence if portfolio diversification motives are significant in the decision to remit

The New Economics of Labour Migration (NELM) economic theory explains remittances based on family as a unit of analysis. According to the theory families tend to develop a contract among those who choose to migrate and those who choose to stay home. The contract combines elements of investment and loan repayment. In the loan repayment theory the family invest in the education of the migrant and usually finances the costs of migrating (travel and subsistence costs in the host country). The repayment of the loan comes after the migrant settles in the foreign country and his income profile starts rising over time and is in a condition to start repaying the loan (principle and interest) back to the family in the form of remittances (Poirine, 1997). Once settled in the host country, the migrant might also become a lender by financing other migrant family members, which increases overall remittances (Hangen-Zanker, Siegel, 2007). If remittances are effective, a repayment of past expenditure by family in the migrant’s education, the level of remittances can be expected to be positively related to the migrant’s educational level (Lukas and Stark, 1985). Ulku (2008) study on the determinants of remittances and savings of Turkish community in Berlin Germany provides more evidence that other reasons than pure altruism are positively related to migrant’s decision to remit. The results show that although remittances sent to poor recipients are significantly higher; there is no relationship between the amount of remittances and the recipients’ employment status or income and the use of remittances. The results also show no impact on remittances of the migrants’ status of residence and degree of integration in Germany. He concludes the remittances of the
Turkish households are mainly driven by enlightened self-interest or inter-temporal family arrangement motivations.

Bouhga-Hagbe (2006) provides empirical evidence of altruism as a motive to remit after analyzing selected countries in the Middle East and central Asia. His findings suggest that in the long run remittances tend to be negatively correlated with Agriculture GDP which was used as an indicator of hardship in the study. He argues that altruism could be playing a big role in migrants’ decision to remit to the countries analyzed.

From the discussion in this section it is evident that migrants’ decisions to remit are influenced by various factors in the remittance receiving and sending countries. The main reasons in the literature are could be summarized as altruism; altruism and self-interest and co-insurance.

2.1.2 Macroeconomic determinants of remittances

Macroeconomic factors are also singled out in the literature as determinants of remittances. The migrant’s propensity to remit, and especially the effective levels of remittances, is 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 (Ghosh, 2006). Most of the studies on remittances have found out that indicators of economic activity in the host countries are significantly associated with the movements in remittances. Remittances are higher due to improved economic conditions in the host country which creates employment prospects and better wages and this allows the migrants to send more money home (Gupta, 2004, IMF, 2005). Remittances are also found to be counter cyclical, that is higher during the periods of negative outputs, employment and wages in the home (Gupta, 2004, IMF, 2005). For the case of Somalia, Omer argues,

“the flow of remittance varies from year to year as it is influenced by the prevailing economic conditions of any particular year. Livestock bans, droughts, natural and man-made disasters, and the closure of borders by neighboring countries all impact on the amount of monies remitted to the Somali economy. The worse the problems that confront the Somali people the more monies are remitted, the better the conditions for the Somali people the less money is remitted” (Omer 2002).
According to Ratha (2003), migrants may increase remittances in times of economic hardship, especially in low-income countries where their families may depend significantly on remittances as a source of income and may live at close to subsistence levels. He also argues that economic downturns may also encourage workers to migrate abroad and thereby begin to transfer funds to families left behind. He further argues that while capital flows tend to rise during favorable economic cycles and fall in bad times, remittances appear to react less violently and show remarkable stability over time.

Remittances are perceived to be responsive to economic policies, institutions and macroeconomic instability in the home country. In situations of exchange rate restrictions black market premiums, high inflation or overvaluation may discourage remittances from being sent or shift away from formal channels by sending remittances through the informal and unrecorded channels (IMF, 2005). According to IMF (2005) countries with a well developed financial sector, by making remittances easier and cheaper to send or receive, may stimulate remittances.

Köksal (2006) observes that two main variables that seem to explain the determinants of remittances in Turkey are, first, the dynamics of family ties, which are related to factors such as the social status, well-being and risk —sharing by migrants and their relatives and second, the macroeconomic stability, which implies factors such as inflation, growth, interest rate differential and exchange rate. He noted that, the dramatic increases of remittance flows between 1970 and 1974 can be explained by the consecutive devaluations of the Turkish Lira during that period. Later on, bad economic conditions in all European countries ended in a decrease in remittances by 25% from 1975 to 1976.

The risk factors in the home country such as political instability, lawlessness and higher crime my hinder remittances flows especially those for investment purposes. Improved investment climate and availability of investment opportunities in the home and host country are likely to influence remittance flows. In the case of great potential return to assets in the host country (as opposed to the home country), migrants might be encouraged to invest to the host country and affect negatively remittances for investment purposes in the home country (IMF, 2005).
Elbadawi and Rocha (1992) during the empirical analyze the flows of workers remittances in six labor exporting countries of North Africa and Europe, divides the literature on causes of workers remittances in two important categories. First, the endogenous approach in which the decision to remit is based on the economics of the family, the wages received in the host country, migrant saving behavior and other factors. The suggested empirical framework comprise a set of factors essential for determining the level of remittances which include the composition of the family at home and abroad, the level of disposable income in the host country, family ties, and anticipated length of stay. Second, the portfolio approach which is differentiated to family ties and based on the migrant making decisions on how to allocate the resources. In this case the decision could be to maintain savings in the host country or to remit them back home in the form of remittances or real assets. The portfolio approach is influenced by portfolio factors in the macroeconomic environment in the remittance receiving and sending country. Elbadawi and Rocha (1992) findings indicate that remittances are closely correlated with income cycles and the stock of migrants in the migrant host country. They also find that official remittances are negatively and substantially affected by the raising black market premium and the rate of inflation in the receiving countries.

The study by El-Sakka and McNabb (1999) estimated a macro model for total inflow of remittances through official channels in Egypt and found that levels of income in both host and home countries have a positive impact on the inflow of remittance to the home county. The results showed that remittance flows are highly responsive to black market premiums and the interest differentials at home and abroad have a negative impact on the inflow of remittances through official channels. The results are confirmed by Yang and Martinez (2006), who examined the impact of the exchange rate shocks during Asia’s financial crisis in the 1990’s and finds that an appreciation of the currency in the destination counties relative to the Filipino Peso leads to an increase in remittance received by the related households. Katseli and Glytsos (1986) provide more empirical evidence after analyzing the data from Greece for the period 1961 to 1983. They find that remittances per migrant are positively related to income per capita in sending (host) country and negatively related to income and the real interest rate in receiving country Greece. They also find remittances are negatively related to inflation in the receiving country.
There is no consensus in the literature regarding the motives behind remittances. Carling (2005) warns of the danger in overlooking the cultural dynamics behind remittances. He argues that, in many societies of origin, the obligation to remit is firmly rooted in a culture of migration, and emigrants who fail to fulfill this obligation are frowned upon. He says that, complying with the expectation could, in economic terms, be seen as an act of self-interest. However, ethnographic studies of the complexity of relations between migrants and non-migrant relatives indicate that seeing motivations to remit as a two-dimensional continuum from altruism to self interest is overly simplistic.

2.2 Senders of remittances

Very little information is found in the literature regarding the classification of senders of remittances. Most of available studies provide information on individual migrants’ remittance senders and less is known about other types of senders of remittances. In Table 2.1. Carling (2005) show four types of senders of remittances depending on types of remittances sent to the receiving country. According to Carling the senders of remittances are grouped as follows:

Firstly, are individual migrants who could send remittances in four different ways including personal deposits or investments; intra-family transfers in which remittances are sent to family members, relatives and friends; charitable donations in the home country; and by paying government taxes or levies either voluntary or mandatory such as in Eritrea where the migrants in the large Diaspora have been required contribute 2 percent of their incomes to the government since 1991. A second group includes collective migrant senders who through their organizations contribute and transfer funds to their home communities to support investments and other development initiatives. Carling (2005) provides an example of Mexican hometown associations (HTAs) which have been receiving remittances from the migrants’ organizations in the United States for investment and development projects and the Mexican government has been supporting the initiatives by matching the received remittances with one dollar each from federal, state and municipal governments. A third group include governments in remittance sending countries or country of migrant employment that transfers social security benefits for former employees who have returned in their countries of origin after retirement.

The final group includes former employers or pension fund organizations responsible for social security benefits. These also transfer pensions or social security benefits to former
employees who are entitled to retirement benefits and have returned to their countries of origin or moved to other countries after retirement

Table 2.1: Remittance types classified by senders and recipients

<table>
<thead>
<tr>
<th>Sender</th>
<th>Recipient</th>
<th>Non-migrant(s)</th>
<th>Collective</th>
<th>Government</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Migrant</td>
<td>Personal deposits or Investment</td>
<td>Intra-family transfers</td>
<td>Charitable donations</td>
</tr>
<tr>
<td>Migrant</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collective</td>
<td>Non-migrant(s)</td>
<td>Charitable donations</td>
<td>HTA development projects</td>
<td>Social security transfers</td>
</tr>
<tr>
<td>Government</td>
<td>Non-migrant(s)</td>
<td>Charitable donations</td>
<td>HTA development projects</td>
<td>Social security transfers</td>
</tr>
</tbody>
</table>

Source: Carling (2005)

A series of studies have looked at remittance senders’ behavior and profiles and findings reveal different characteristics of remitters depending on various factors. Funkhouser (1995), for example, examines Salvadoran and Nicaraguan international migrants. He hypothesizes that income, length of stay abroad, and family residential patterns will shape the likelihood of remitting. Migrants with higher incomes and longer residence are more likely to remit while migrants with family members in the United States are less likely to remit. He finds that for both Salvadorans and Nicaraguans, the employed are more likely to remit than the unemployed. Salvadorans were more likely to remit when they left an immediate family member in El Salvador. Among Nicaraguans, the more educated were less likely to remit than were less educated respondents. Older migrants were more likely to remit than younger migrants. The Nicaraguans also see a decline in remittance behavior with longer periods of residence in the United States. Controlling for the other factors, Salvadorans were more likely to remit than Nicaraguans.

Salvadorans also proved more likely to remit than another large immigrant population, Filipinos (Menjivar et al. 1998). This study focused solely on Los Angeles County and primarily on Salvadoran and Filipino immigrants who resided in high concentrations of their co-ethnics. The authors find that higher income migrants from both countries are more likely to remit and that said Salvadoran households had lower average incomes than did
Filipino households. Increased household income did not spur a linear increase in remittances. Instead, a 10 percent increase in income leads to a 4 percent increase in the amount remitted.

The authors also identify several immigration factors that shape the likelihood of remitting. Learning English is positively related to remitting and naturalization is negatively related. As was the case in the Funkhouser study, migrants with close relatives in the country of origin were more likely to remit. Unlike the other study, older immigrants were less likely to remit than were younger migrants.

The study by DeSipio (2000) who examines the remittance behavior of Latino immigrants in the United States, focusing on who remits and the predictability of remitting reveal some characteristics of remittances senders. Through examination of three studies that track several demographic factors, he finds that there is a steady decline in the likelihood of remitting among migrants who make permanent home in the United States. He also noted that those migrants with higher occupational skills to be able to take the advantage of opportunities in United States were less likely to remit.

Lozano-Ascencio (2005) analyzed the factors that influence behavior in the United States of Latino American Immigrants using the data from the National Survey of Latinos conducted in 2002. The findings confirm previous research findings with one additional observation which contradict previous results, that those migrants who have bank account are likely to transfer remittances than those who do not have one. He argues that having a bank account in the country of destination-regardless of their migration status has allowed migrants to better administer their economic resources, has increased their likeliness of sending remittances to their countries of origin, and has helped them with their process to consolidate their economic citizenship in the United States.

The studies by the Inter-American Development Bank through its Multilateral Investment fund (IDB-MIF) and the Pew Hispanic Center (PHC) found that majority of adult, foreign-born Latino people living in United States send remittances regularly and about another 10 percent send remittances occasionally. The remittance senders tend to be concentrated among those more recently arrived immigrants. The findings also revealed that about a quarter of those with long tenure (20–40 years) still send money back home to their
relatives even though the tendency to remit generally drops off over time (Inter-American Development Bank, 2004, Suro, 2003). According Suro, in Mexico for example, families with members abroad for five years or less are almost twice more likely to receive remittances on regular basis than families with relatives who have been abroad for longer periods.

The findings from Japan by Bendeixen and Onge (2005) indicate that the majority of Latin America remitters come from Brazil. The results show that the migrant remitters are more educated with almost 85 percent having more than a high school diploma compared to that of 17 percent for Latin American migrants in United States. About 90 percent have bank accounts in Japan and more than half in their home country. Their average income also is at almost US$50,000 a year, which is approximately two times higher than their counterparts in United States. The researchers also noted that remittances from United States and Japan to in Latin America are in most cases siblings transmitting to one another such that one sibling will go abroad to find work, while another stays in Latin America and looks after the family and home. They also noted that more men than women are remittance senders. They observed that by 2004 the majority of Mexican remitters were young undocumented immigrants (42%), with low income and low education level.

The information about the characteristics of senders of remittances is not conclusive given the fact that few studies have been undertaken globally and most of them have been concentrated in some countries Latin America. The evidence from these studies shows that the characteristics of remitting migrants are different depending on the country of origin and the host country. For example, while remitters from Japan to Brazil are well educated and highly paid, the majority remitters from United States to Mexico are young, undocumented immigrants with low income and less educated. The common thing from the studies is that in most cases remittances are sent to families and siblings.

2.3 Receivers of remittances
Few studies provide detailed profiles of remittance receivers. Most of available studies have been looking at the profiles of remittance receivers at the household level and little is discussed about other receivers of remittances. Carlings (2005) provide a following classification of receivers of remittances by distinguishing between transfer types: Migrants
are receivers of remittances when they transfer money for their own use either by depositing in banks account in country of origin or transferring their savings abroad; Family members in the receiving country, either on regular basis or on special circumstances such religious festivals or in times of hardship; collective or communal recipients who receives migrants’ donations or transfers from migrant organizations for investment in community development or crisis relief; and governments also are receivers of remittances either in the form of taxes collected from migrants or as specified proportion of voluntary remittances transfers (2005).

According to Carling (2005) the migrants’ transfers to family members in the receiving country are what usually thought of as remittances and probably the most important flow in monetary terms. The studies on remittances in Latin America provide some social-economic and demographic characteristics of migrants’ family members who are remittance receivers in that region. The findings from the 2003 studies show that a significant number of adult populations are receiving remittances with the majority being women. The results also indicate that the social-economic status of major remittance receivers is not uniform among the studied nations, with Mexico showing even distribution among the general population and regions while in other countries they are more concentrated among the lower status population (Suro, 2003).

Inter-American Development Bank-Multilateral Investment Fund (2004) findings indicate in Latin America, nearly every county studied woman are more likely to receive remittances than men. For example in Brazil, Ecuador, and Mexico, women make up over 50 percent of remittances receivers. The results also show that the majority of remittance receivers in Latin America have bank account ranging from Ecuador (44%), Central America (77%) and Mexico (64%). The also noted parents, offspring and spouse.

Vary little information is found in the literature regarding the receivers of remittances. The findings from Latin America show that remittances are received by adult family members of senders and in most cases women receive remittances than other groups. Other receivers of remittances are the migrants through retuning migrants or transfers for savings and investments; collective recipients such as local community organizations and the governments through taxes. Future studies will be important to be able to capture the share
of remittances received by each receiving group and this information could be used to make policy decisions.

2.4 Methods used to send remittances

The literature emphasizes the existence of a large number of different transfer mechanisms to send remittances. The common remittance channels cover the spectrum from formal to informal transfer services. According to Sander (2003) the formal channels include services such as banks (commonly electronic transfers between accounts), money transfer operators-MTOs (such as Western Union, Money Gram), forex or currency bureaus and post offices. The informal transfer services include services providers such as shop owners, buses, travel agents, couriers, unregistered money transfer businesses and personally carrying the remittance either oneself or sending it with a family member or a friend. In addition, more advanced Hawala in Pakistan and Hundi in India systems allow faster transfers, relying on network of agents that transfer money quickly (Orozco, 2003, Freund and Spatafora, 2005)

The choice of the mechanism to transfer remittances is influenced by several factors. These could include cost, speed and ease, limiting requirements, proximity and outreach, familiarity, awareness and niche of services (El-Qorchi and Maimbo, 2003; Carling, 2005). The accessibility of transfer services at both sending and receiving points is also another important factor which influences the choice of the mechanism to transfer. According to Sander (2003), many remitters need to send money to locations with weak or no financial infrastructure and where banks of their host country have little or no other business volume or connection. He also argues that while capitals and other urban centers have fairly good financial service availability, rural regions tend to be much less well serviced by the financial industry.

The preferred method of sending remittances varies by country. Informal channels tend to be used more where the financial sector is either missing (e.g. in conflict or post-conflict countries), weak or mistrust (Sander, 2003). The author also noted that, forex controls generally leads to a higher use of informal channels, while the use of formal channels increases in stronger, more liberalized economies with stronger financial sector. For example in Africa and other developing countries, Orozco (2003) noted that the common method of sending remittances is hand delivery by the migrant themselves or by a courier.
He also argues that until recently there were few money transfer businesses. However, other studies such as data from Latina America indicate that about 10 percent of all remittance transfers to those countries are hand carried by immigrant and 7 percent by ordinary mail (Suro 2003).

The common informal mechanism of money transfer by the Asian migrants is hawala (Hawala in Pakistan and Bangladesh, Hundi in India, fei ch’ien or chits/chops in China). According to El-Qorchi and Maimbo (2003), the hawala transaction is an operation that consists of making financial transfers that are made by customers, CA and CB respectively, located in countries A and B, through hawala service providers (hawalanders HA and HB) in their respective countries. Through informal transactions, HA receives funds from CA and asks HB to advance the amount to CB in the local currency equivalent. They also observe that the hawala system is so popular due to its speed, cultural convenience, versatility (adaptable to conditions of wars, civil unrest, conflict and economic crisis), and potential for anonymity. Another advantage of this mechanism is that, although the remittance is immediately transferred, the liability the hawalander in country A has to his counterpart in the country B is set through various mechanisms of compensation occurs at different moments and often does not involve direct payment between the two hawalandars.

According to Carling (2005) lack of bank accounts by senders or receivers of remittances is one of the limiting factors to the formal channels of money transfer transactions. He also argues that, some mechanisms require identification documents while others do not which creates a limited choice of transfer mechanisms for non legal residents in the country of employment. Table 2.2 presents a comparison of remittance transfer mechanisms in terms of requirements and service delivery.
Table 2.2: Comparison of remittance transfer mechanisms

<table>
<thead>
<tr>
<th></th>
<th>Cash-based Transfers</th>
<th>Card-based transfers</th>
<th>Smart card transfers</th>
<th>Account-to-account transfers</th>
<th>Informal value transfer systems</th>
<th>Hand-carried cash</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Requirements and limitations</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sender must have a bank account</td>
<td>—</td>
<td>✓</td>
<td>—</td>
<td>✓</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Receiver must have a bank account</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>✓</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Only available for certain countries</td>
<td>—</td>
<td>✓</td>
<td>✓</td>
<td>—</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Service dimensions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost</td>
<td>—</td>
<td>+</td>
<td>+</td>
<td>—</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Proximity and outreach</td>
<td>+</td>
<td>—</td>
<td>—</td>
<td>O</td>
<td>O</td>
<td>O</td>
</tr>
<tr>
<td>Speed and ease</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>—</td>
<td>+</td>
<td>O</td>
</tr>
<tr>
<td>Service dimensions are roughly classified as follows: + = good, – = poor and O = medium or variable.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Carling (2005)

The studies by the World Bank on Germany–Serbia and Italy–Albania remittance corridors in 2006 indicate that the use of informal channels still important channel used by Albanians and Serbs to transfer money home. The observed obstacles limiting the growth of formal channels are constraints to access to bank services, lack of trust to banking system, limited competition and higher fees, black market for foreign exchange and the culture of using cash (Hernandez-Cos, 2006; Martinez et al, 2006).

For the case of Turkey which is one of the major remittance receiving countries in the world, the banks have monopoly in the field of migrants’ remittances and the Turkish Central Bank provides special incentives only to migrants and Turkish citizens residing abroad to open accounts and offers higher interest rates than the other Turkish commercial Banks (Köksal and Liebig, 2005; Köksal, 2006). He also argues that, despite the
government policy to encourage formal transfer of remittances, a large part of the overall remittance flows appear to be still transferred by informal means in Turkey. Other studies like a survey by Suro (2003), on remittance senders and receivers observed a shift toward the use of formal channels for those sending money from United States to Latin America and the Caribbean. He noted that Wire transfer companies such as Western Union and Money Gram accounted for about 70 percent of dispatched remittance, with banks used by 11 percent and informal channels 17 percent such as the mails and individuals who carry the funs by hands.

2.5 The cost of sending and receiving remittances

The cost transferring money varies greatly from country to country, among institutions and according to the method of transfer. Most studies indicate that informal channels are cheaper than formal ones and the cheapest transfer methods being self hand –carriers and ordinarily post but of course involve the risks of being stolen. The study by El-Qorchi and Maimbo (2003), estimates the costs of a Hawala transaction to be on average between 2 and 5 percent and Orozco (2003) estimates are even lower at less than 2 percent. The World Bank (2005) estimates the charges to send money through money transfer agents to be 13 percent to 20 percent on average. Figure (2.1) show that the cost is high for those sending small amount which implies that the poor are the most affected. For example, the total remittance cost to send 150 euros per month for a period of six month is 90 euros at 10 percent compared to 4 percent or less than 40 euros if the entire 900 euros is sent in one transcription.

Figure 2.1: Remittance costs as percentage of principal amount (in euros)

Note: Cost of sending money from Brussels using a major money transfer operator (Euros)

Sources: Ratha, 2003
The study by Sander (2003) gives a global picture for the costs of informal remittances and provides the average informal services charge at about 3 to 5 percent, although they can sometimes be higher or even free of charge. Sander also argues that as studies estimating transaction costs only look at the direct costs which include commissions/fees and forex losses, they actually are still not full of transaction costs reflection costs. The other important costs are indirect or hidden costs including: getting to or from a point of sale such as a bank branch; phone calls; lower or unfavorable forex rates often used by banks or money transfer operators compared to either forex bureaus or the black market; and maintaining a minimum balance or account fees (in the case of account- based transfers) (Sander, 2003).

Formal transfers are considered to have lower transfer risks, but are also costly if compared to informal transfers. It is estimated at approximately 13 percent of the remittances value is charged for remitting money across boarders using official channels (Freund, Spatafora, 2005). A study by Orozco (2003) made a comparison involving the costs of formal money transfers for sending of small amounts of money (US$200) from four EU countries, Saudi Arabia and United States to 14 countries in Southern Europe, South Asia, Africa, and Latin America. The findings indicated that the mean value to transfer the money was 6 percent through ethnic stores, 7 percent through banks and 12 percent through the money transfer companies operators like western union, Money Gram or Thomas Cook.

According to Orozco (2003) the costs of transferring money from United States to other countries are relatively high and few foreign banks were found to be offering money transfer. He noted that, the State bank of India and the Bank of Philippine Islands were the only banks offering a range of options to transfer remittances, such as the direct deposit in an account in the country at a cost below 5 percent. Table 2.3 shows the cost of sending US$200 from the United States to nine different countries are significantly lower when using banks than money transfers companies, and somewhat lower compared to sending from ethnic stores.
Table 2.3: Cost of sending $200

<table>
<thead>
<tr>
<th>United States to</th>
<th>Bank as Bank as</th>
<th>Ethnic Store/ Exchange House</th>
<th>Major MTO</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Bank MTO</td>
<td>MTO</td>
<td>MTO</td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>8.00%</td>
<td>6.20%</td>
<td>10.10%</td>
<td>10.30%</td>
</tr>
<tr>
<td>Greece</td>
<td>13.80%</td>
<td>13.80%</td>
<td>13.80%</td>
<td>13.80%</td>
</tr>
<tr>
<td>India</td>
<td>7.00%</td>
<td>8.30%</td>
<td>12.20%</td>
<td>14.00%</td>
</tr>
<tr>
<td>Pakistan</td>
<td>0.20%</td>
<td>16.80%</td>
<td>13.10%</td>
<td>13.10%</td>
</tr>
<tr>
<td>Portugal</td>
<td>13.80%</td>
<td>13.80%</td>
<td>11.90%</td>
<td>11.90%</td>
</tr>
<tr>
<td>Turkey</td>
<td>13.10%</td>
<td>13.10%</td>
<td>13.10%</td>
<td>13.10%</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>11.90%</td>
<td>11.90%</td>
<td>15.10%</td>
<td>15.10%</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>8.00%</td>
<td>9.20%</td>
<td>15.10%</td>
<td>15.10%</td>
</tr>
<tr>
<td>Ghana</td>
<td>7.50%</td>
<td>7.50%</td>
<td>7.50%</td>
<td>7.50%</td>
</tr>
<tr>
<td>Total</td>
<td>6.20%</td>
<td>7.7</td>
<td>14.20%</td>
<td>9.40%</td>
</tr>
</tbody>
</table>

Source: Orozco, 2003

The policy and regulatory aspects of the sending country have tremendous effects on remittances flows and channels used. Orozco (2003) argues that foreign banks offer limited transactions to transfer remittances if compared to other channels in United States due to the stiff regulations restricting foreign banks from opening branches in the country. He gives an example of Germany and France which have been able to put in place successful policies that allow foreign banks transactions, remitting to Greece, Turkey and Portugal and in this way the larger part of remittances to these countries is transferred though the banking system. Gosh (2006) noted that the higher fees charged by the transfer agents are mainly due to the lack of competition and market imperfection coupled with inefficiency. He argues that restrictive regulatory framework, including high collateral requirements; deter potential competitors from entering the remittance market. Sander (2003) argues that the measures focusing on detecting and prevent the misuse of the world financial system for money laundering or terrorism have made many banks to be very cautious before entering into remittances transfer business due to the burden of compliance and associated costs. This has introduced additional hurdles or barriers for migrants and MTOs in accessing banking services.

The studies regarding the remittance channels and sending costs are instrumental in raising the awareness of remittances issues and in this way creates the demand for various stakeholders, especially the financial institutions, researchers, Diaspora and policy makers to be engaged in finding the better ways of improving money transfer services. It is argued in the literature that remittances which are transferred through informal means are less effectively used because they do not contribute to the receiving country’s foreign reserves.
and also are not included in the development initiatives and priorities which could benefits the individual receivers and the nation at large. In the developing countries where few remittance receiving households possess bank accounts, formalization of remittance flows would not only reduce the risks and costs of remittances, it would also could help them to save and in this way raise the national savings rate (Kapur, 2004).

Another critical issue regarding the informal remittance channels is that, they provide a convenient way for money laundering and funding criminal and terrorist activities (Kapur, 2004, Gosh, 2005). Understanding the operations of informal and underground remittance channels could help countries to put in place well coordinated measures for monitoring and information sharing to prevent money laundering and financing of terrorist activities.

Improving remittance transfers would require studies on remittances behavior on how they respond to social, political and economic changes of receiving and sending countries. That information could help policy makers in these countries to design policies aimed at improving the banking and financial services. However, the biggest challenge is how these financial institutions would prevent illegal transactions, ensure safety and efficiency of transfers and at the same time be able to reduce transactions costs of remittances.
3.1 Impacts of remittances

There is a huge literature contributing on the impacts of remittances on migrant sending courtiers. The on going debate is on how migrant remittances are often used by the recipients and in what ways they contribute to economic development of migrant sending countries. Much of the earlier studies on migration and development were concerned with the division of remittance expenditure between investment and consumption. The realization that only a small proportion of remittances are used to set up small businesses, improve agricultural practices, or on other forms of ‘productive’ investment created disillusionment over the development impact of remittances among researchers and policy makers in the 1970s and early 1980s (Carling, 2005).

However, recent studies have shown evidence that the bulk of remittances is used for consumption as well as investment in human capital such as education, health and better nutrition within the recipient households (Sander, 2003, Agunias, 2006). According to the World Bank in a book ‘International Migration, Remittances, and the Brain Drain’ (2005), remittances appear to have positive impact on development and welfare of migrants in developing countries. The same conclusion was reached by Rapoport and Docquier (2003) in their review on current economic literature on remittances as they pointed out that migration and associated remittances tend to have an overall positive effect on origin countries’ long-run economic performance.

3.2 Microeconomic impact of remittances

3.2.1 Labour market and entrepreneur ship

Various studies have highlighted the impact of migrant remittances on the labour market of receiving countries. It is claimed in the literature that remittances could create disincentive to work and lead to a decline in labour participation for members of receiving households due to the preference for leisure consumption. Fankhouser (1992) supports this claim by suggesting that the higher income component of remittances could lead lower labour force participation of the remaining household members. Using data on migrants from El Salvador in the 80s, he finds that remittances have strong negative effects on labour force
participation among males and females. However, he finds negative income effect from remittances dominating all other effects among males than females. Similar evidence is provided by Zakaria et al. (2001) who show that labour participation rate in Kerala, India is higher for non-migrants households by 55 percent compared to migrant households 31 percent. The also show higher unemployment rate of 20 percent amongst migrant households compared to 21 percent for non migrant households.

A recent study by Hanson (2007) use data from 1990 and 2000 Mexico census population and housing to examine differences on labour participation and labour hours worked across individuals in rural households according to their exposure to emigrate. The results show those in households that receive remittances from abroad men are 11 percent less likely to and women are 2.2 percent less likely to work outside the home. He also noted that, individuals in migrant households tend to supply fewer hours of labour than individuals in non migrant households. However, he raises methodological concern regarding the quality of the result suspecting unobservable characteristics influencing the decisions to work less or inability to wok. He suggests that other studies need to use longitudinal data on households in order to be able to examine changes in within households’ migration behaviour over time.

The study by Acosta (2007) in El Salvador confirms evidence from other studies that remittances have negative effects on labour participation rate. Using data from El Salvador household survey for 2000 he analyzes the labour participation among males and female according to remittances receipts status while controlling for unobservable characteristics of adults. The results show that remittances reduce labour force participation rate among males and females, in rural areas by 4.6 and 9.7 percent and in urban areas by 5.7 and 10.7 percent, respectively. The results also show lower participation rates in terms of hours worked for remittances recipient household with stronger effects among females in both rural and urban areas.

There exists evidence in the literature on the positive effects of remittances on entrepreneurship. Woodruff and Zenteno (2001) use a data set of more that 600 small firms in the urban areas of Mexico to examine the effect of capital constraints on investment levels of micro-enterprises by focusing on remittances. Their results show that remittances represent an important source financing of investment with almost 20 percent of the capital
investment in micro-enterprises throughout urban Mexico. They also argue that the impacts of remittances are spread well beyond the rural areas from which most of migrants originates which suggest that investments in productive activities may be larger in the urban areas. Similar evidence is from Kule et al. (2002) who analyzed the causes and consequence of emigration from Albania in the 1990’s. Their findings indicate that half of the money sent home was used for consumption and the rest was either saved or invested in various economic activities. The results also show that remittances contribute about 17 percent to the cost of establishing business in Albania.

Another important study on remittances and entrepreuriship is that of Acosta (2007) who used a dataset from a national household survey for El Salvador to test if international remittances flows can help to overcome borrowing constraints and help to finance micro-enterprises and self-employment. The author used econometric methods in a setting that addresses potential endogeneity of remittances flows. The results show that remittances receipts are positively and significantly related with business ownership in all groups except urban male. He argues that remittances have stronger effect among females in the rural areas and who are usually more vulnerable to borrowing constraints.

3.2.2 Human capital

The findings from a number of studies indicate that migrant remittances transfers improve education and health outcomes in recipient households. Cox and Ureta (2003) used the data for El Salvador to examine the effects of remittances from abroad on households’ schooling decisions. The choice of El Salvador was based on the fact that the since the end of the civil war in 1989 country has significantly expanded its school attainment. The authors also noted that remittances from abroad are significant source of household income and in 1997 about 14 percent of rural and 15 percent of urban households reported to have received remittances from abroad. The study findings indicate that among other things remittances increase schooling and those remittances have larger impact on reducing the chances of dropping out of school with the effects of about 10 times higher in urban and 2.6 times in rural areas than that of other incomes. Similar evidence are provided by Hanson and Woodruff (2003) use the 2000 Mexican Census dataset to examine the impact of household migration behavior on the education attainment by evaluating the effects of remittances on years of schooling among 10 to 15 years old while controlling for potential endogeneity of having a migrant in the household by using historical state migration rates and household
characteristics. Their findings indicate that having a migrant member in the household is associated with an increase of years of schooling by 0.7 to 0.89 for 10 to 15 year old girls whose mothers have low education levels. They argue that the results prove the idea that remittances received by low income households can help to ease household credit constraints and raise education attainment of children.

Yang (2004) studies the effects of exchange rate shocks during 1997 Asian financial crisis on human capital investment by analyzing the children for ages 10-17 in 1997 in the Philippines and his findings are positive. The evidence from the study indicate that the appreciation of a migrant’s currency against the Philippine currency leads to increases in household currency and this raised investment in human capital.

The study by López-Córdova (2005) which used data for Mexican Municipalities (over 2400) with large and those with lower inflows of remittances shows that as the fraction of household receiving remittances in a given Municipality increases by 5 percent starting from zero, the illiteracy rate among the children between 6-14 years old drops by 34 percent. However, the findings indicate that among the 15 and 17 years old the probability of dropping out of school increases. Acosta (2006) using a data set from a 1998 cross-sectional household survey in El Salvador to estimate the impact of remittance on school attendance for children between 11 and 17 years old provides similar evidence that remittances increases the likelihood of staying in school for children of recipient household. However, the author suggests that the methodological problems need to be taken into consideration when analyzing remittance data due to potential sample selection bias and the endogeneity of remittances receipt. He argues that after distinguishing for demographic subgroups, the results show that while girls and young boys (11-14 years old) seem to benefit from remittances in terms of higher enrollment rate, in contrast the number of those dropping out of school is higher among the boys aged between 15 to 17 years old.

Remittances are important source of income needed for household health expenditures in countries with weak public health care systems which are unable to provide universal health insurance coverage to the majority of the population. Most of the recent studies in this area are from Latin America especially Mexico. The first assessment regarding the impact of migration on health outcomes was by Kanaiaupuni and Donato (1999) who use data from five Mexican states drawn from the Mexican Migration Project and find mixed
effects of migration on infant mortality, suggesting that infant mortality increases in the early stages of the migration process before later declining cited from Hildebrandt and Mackenzie, 2005). According to Hildebrandt and Mackenzie, both Kanaiaupuni and Donato (1999) and Frank and Hummer (2002) choose to treat migration and remittances as exogenous, and as a consequence, it is likely that their estimated effects of migration are contaminated by selection bias (.Hildebrandt and Mackenzie, 2005)

A study conducted by Frank and Hammer (2002) using a nationally representative sample of Mexican households, found that the risks of low weight infant was reduced for pregnant women living in households that receives remittances from abroad. They argue that the economic remittances improve infant health by raising standards of living and by giving rise to technological and structural advancement in the community that leads to improved health outcomes. A similar study by López-Córdova (2005) considers the impacts on infant mortality rates in Mexico by taking the advantage of variation in the rates of remittances receipt by the Municipalities. After controlling for other determinants of infant mortality rate and the endogeneity of remittance receipt with health outcomes he also concluded that infant mortality across Mexican Municipalities decline as the percentage of remittances receiving households rises.

A study by Hildebrandt and McKenzie (2005) uses data from the 1997 National Survey of Demographic Dynamics in Mexico to address the robustness of previous studies whether differences in child health outcomes between migrant and non-migrant households are result of migration or whether are caused by external conditions affecting both migration and child health, or they are simply a reflection of differences in the observable and unobservable characteristics of these households. Their findings confirm that migration from Mexico to the U.S. improves child health outcomes in Mexico, resulting in lower rates of infant mortality and higher birth weights. A recent study by Amuedo-Dorantes, Pozo and Saiz (2007) compares remittances with other sources of household income on health care expenditure in Mexico. Their findings indicate that health care (hospitalization, non-prescribed medicine and primary care) expenditures increases with additional income received from international transfers. The result also indicates that compared with other sources of income, the effects of an increase of remittances income on household health expenditure is considerably higher than non-remittances income.
3.2.3 Investment

The impact of remittances on investment is one of important issues addressed in the literature. There are mixed conclusions among the researches with most of earlier studies taking a negative side that remittances are utilized only for consumption and recently some researchers indicating that remittances are used to finance productive activities. Another important debate among researchers is distinction between consumption and investment. Critics argue that expenditure on ‘consumption, items such as health and education should be seen as investment in human capital and also that, increased consumption by poor families is often equivalent with poverty alleviation, which is a goal in its own right (Carling, 2005).

Adams (1991) in a study examining the effects of international remittances on rural Egypt using a sample of 1,000 households from three villages show that retuning migrant do not devote large shares of their earnings to personal consumptions. He observes that households of former or with migrants have higher marginal propensity than non migrants to allocate expenditures to investments such as, housing, land, agricultural equipments, vehicles and small businesses. He argues that from the perspective of the individual, housing expenses should be classified as an investment since new and improved housing offers possible future economic returns to the individual.

Glytsos (1993), using Greek household survey analyzed at the sector level the remittances effects on consumption, production, imports, employment and capital formation. His study came up with findings that challenged the previous studies claiming lack of developmental impact on the household, local community and the nation levels. His findings indicate that remittances increase the living standards of individual by spending on consumption goods, education, health and leisure and also the remittances benefits were felt in the all community through the multiplier effects. Their standard of living rose from 81 percent below rural average to just above the average. At the Macro level the results indicated that, migrant remittances spending generated about 4.1 percent of total gross production in the economy with about 1.7 multiplier effects and in about one third of industries the multiplier was about 2 percent. The employment also grew due to remittances effects by 4.7 percent in 1971. The capita generated by remittances in the manufacturing sector grew by 8 percent. The production induced by the production of investment goods consists of 17.3
percent of investment products in contrast to only 2.9 percent of investment products induced by production of consumer goods. He noted that, despite the high proportion of imports induced by remittances the imports represents only 4.9 percent of Greece’s imports, which could not lead to trade deficit.

The findings from the studies by Adams (1991) in Egypt and (1998) in Pakistan indicates that a larger share of earnings from international remittances is used for investment purposes. In Egypt the results show that only 12 percent of remittances earnings are spent on consumption and the remaining is invested mainly in construction or reconstruction of houses. Adams argue that once abroad migrant tend to view their remittance earnings as temporally stream of income, one not be squandered on consumer goods. In Pakistan, also he find that the availability of remittance income helps to increase investment in rural assets by rising the marginal propensity to invest for migrant households, a very significant effect being on accumulation of irrigated and rain-fed land.

A recent study by Adams (2006) uses the data from a national household survey in Guatemala in 2000 to analyze the impact of internal and international remittances on poverty and investment. He finds no evidence to support the view that remittance receiving households “waste” their increased earnings on “conspicuous” food consumption because the majority of remittances earnings are not spent on consumption goods. The findings also indicate that, at the mean level expenditures, households without remittances spend 58.9 percent of their increments to expenditure on consumption goods compared to 55.9 percent for those households receiving international remittance. Another important aspect of the results is the expenditure on education whereby households receiving international remittances spend 58.9 percent than households that do not receive remittances.

The study by Yang (2005) use data from four linked household surveys consisting of 1,649 households in Philippines in the empirical analysis of households’ response to overseas members’ economic shocks due to the 1997 Asian financial crisis. The study results indicate that the appreciation of a migrant’s currency against the Philippines currency leads to increases in household remittances received from overseas. The results also show that due to an increase in remittances the number of new household investments in entrepreneurial activity in transportation/communication and manufacturing increased. He gives an explanation for the impact of the exchange rate these changes that previous
investment in these activities had been hampered by credit constraints, so positive income shocks provide households with the resources to make necessary fixed investments.

A recent study by Adams et al. (2008) used a nationally representative data from 2005/2006 Ghana household survey model of migration and remittances with 3,941 households to compare the marginal spending behavior of three groups of household: those receiving no remittances, those receiving internal remittances from Ghana and those receiving international remittances. The results show that using the average budget shares, households receiving internal remittances spend more on health and less on housing than households with no remittances; and households receiving international remittances spend more on consumer goods/durables and education, while they spend less on housing and food than households with no remittances. The researchers also came up with another important finding that households receiving remittances spend their remittance income just like any other source of income which is contrary to other studies, that remittances are either spent disproportionately on consumption (food and consumer goods/durables) or investment goods (education and housing).

### 3.2.4 Poverty

The question whether international remittance flows impact on poverty reduction among receiving households is a subject of academic and policy debate at the moment. Few studies have tried to analyze the subject in a specific village, region or country and emerging evidence suggests that remittances have reduced the incidences of poverty but their impact is small and its magnitude depends on poverty measurement the methodology used. According to Adams and Page (2005) no any studies which have examined the impact of international remittances on poverty in a broad range of developing countries. They argue that two reasons making this task difficult are first, lack of poverty data which makes it hard to estimate accurate and meaningful poverty head counts in a broad and wide range of developing countries. The second reason is that few developing countries publish or keep records on migration flows and also available data on international remittances do not include the large and unknown sum of remittances which are transmitted through informal, unofficial channels.
Apart from the methodological and data problems in measuring the impacts of remittances on poverty, most studies conclude that international remittances have reduced poverty either directly or indirectly. Adams and Page (2005) used a new dataset composed of 71 developing countries for which reasonable information on poverty, inequality and international migration and remittances could be assembled to study the effects of international remittances on the level, depth and severity of poverty in the developing countries. In their study they use three different measures of poverty calculated relative to the national poverty line: the poverty headcount index, which measures the percentage of the population living below that poverty line at the time of the survey; poverty gap index or depth of poverty, which measure in percentage terms how far the average expenditures (income) of the poor falls short of the poverty line; the squired poverty gap index, which measure the severity of poverty by taking into account the distance separating the poor from the poverty line. The results show that, after controlling for the possible endogeneity of the international remittances, the head count-measure suggests that on average, a 10 percent increase in per capita official international remittances leads to a 3.5 percent decline in the share of people living in poverty. A similar study by Adams (2004) which was done using national survey data on Guatemala shows that with only one exception, international remittances reduce the level, depth and severity of poverty in Guatemala. According to the poverty headcount measure in Guatemala, including international remittances increases the level of poverty by 1.1 percent. However, international remittances have larger impact on reducing both the depth and severity of poverty, such as the poverty gap and squared poverty gap. For example, the squared poverty gap measure shows that including international remittances in household expenditure reduces the severity poverty (the squired poverty gap) by almost 20 percent. The author also noted that, the extent of poverty reduction is largely dependent on the measure of poverty used.

Taylor et al (2005) using the data from the 2003 Mexico Rural Household Survey find that Migrant remittances represented 16 percent of average per-capita rural income in 2002 and also that the impacts of remittances are more equalizing and have a larger effect on alleviating poverty as the share of households with access to remittance. The results also show that nationally, the rural poverty effect is substantially greater for international remittances using all three poverty measures. For example, using headcount measure poverty decreases by 0.77 percent in response to a rise in remittances from abroad.
The study by López-Córdova (2005) using data of Mexican Municipalities with large and those with lower inflows of remittances examine the poverty levels among the remittances receiving and non-receiving households. His findings indicate that poverty incidences decline the more remittances are received in the household. However, he note that remittances have very little impact in cases of households with extreme poverty which reflects the high costs of migration that keeps the poorest households out of benefits from international remittances.

Yang and Martinez (2006) using a large dataset from the Overseas Filipino Survey analyzes the causal impact of remittances on poverty in migrants’ origin households and remittances receiving areas during 1997 Asian financial crisis. They find that an appreciation of the Philippines currency during this period of crisis led to increases in household remittances receipts, which then resulted to the decline of the poverty rate by 0.6 percent. Their findings also indicate that in regions with a greater number of more favorable mean exchange rate shocks, poverty rates decline even in households without migrant members.

Dimzon (2006) asks whether remittances have alleviated poverty in the Philippines. She refers the study findings from the Asian Development Bank (ADB) in Manila on the remittances of Filipino migrants which pointed out

‘that the migration and remittances, particularly, have failed to help to alleviate poverty and to improve the lives of Filipinos, and that only a small segment of the society, namely the migrants and their families, have benefited from the overseas employment programme. The study suggested that remittances have only succeeded in promoting excessive spending for non essentials, and not in productive endeavors’.

However, she adds that, the author joins the rest of the people who maintain that the multiplier effects of consumption behaviour are themselves indicative of measures of the positive impact of migration, because the increase in the demand for goods and services that they generate, and the production of indirect investment such as on health, education and housing have a major impact on human development. The contradicting arguments from ADB researcher on the assessment of international remittances impact on peoples livelihood show that much need to be done among the researchers and analysts in order to
be able to come up with reliable and comparable concepts, methodologies of measuring and assessing the impact of international remittances on various dimensions.

### 3.2.5 Inequality

The literature is divided regarding the impact of remittances on inequality. Some of the scholars argue that remittances have equalizing effects because they target the real poor and can be an effective means to distribute income. Some scholars oppose that hypothesis by arguing that remittances leads to inequality because the remittances are always received by rich households and this could raise inequality in the short term. Some studies find no significant effect of remittances on inequality.

Those scholars opposing side migration and remittances have a negative effect on income inequality within migrant sending communities and between rural and urban areas (Lipton, 1980). According to Lipton only the better off can afford to incur the costs of future benefits from migration and those left behind loose from this process.

The studies by Adams (1991) in rural Egypt and (1998) in rural Pakistan show that international remittances have a negative effect on income distribution. According to Adams, in Egypt, when remittances are included in predicted per capita income, the ‘Gini’ coefficient, a measure of inequality, increases by 25 percent from 0.233 to 0.290. The findings also indicate that. He argues that, the negative effect which is caused by international remittances is due to the variations in the number of migrants produced by different income groups and not because of differences in either earnings abroad or marginal propensity to remit. Adams also revel the same causes of negative effect on income distribution in Pakistan, that external remittances mainly go to upper income households because the poorer households can not afford the high costs of entry to external migration to be able to earn higher wages.

Rodriguez (1998) uses the 1991 data from the Family Income and Expenditure Survey (FIES) to evaluate emigration-based changes in incomes and in income inequality of all non-migrant households in Philippines. He finds evidence that an increase in household income by 0.06 percent because of remittances, also results in an equally small increase in inequality by 0.032 percent. He argues that if migration is a process that involves
acquisition of information, any negative effects that remittances may have on income distribution would dissipate as the opportunities for migration become more evenly distributed. He explains that, if international migration opportunities are household specific, migration could further accentuate adverse distributional effects by preventing the spread of opportunities.

Other scholars provide evidence to show that the impact of international remittances on income inequality in migrant-sending countries or communities vary depending on types of migration and the community history of migration. Stark et al. (1986) study examine the role of net remittances in village income inequality using household data from one Mexican village with a long history migration against a village with a relatively little migration experience to United States. The authors suggest that at the beginning of migration history when only few households from relatively wealthy households are able to migrate due to higher costs of migration, the distribution of remittances in the community is necessarily unequal. However, they argue that in the log run, inequality will decrease because migrants will come from a wider spectrum due to the valuable information and assistance from early migrants to the new ones which lower the costs of migration.

In the literature regarding remittances and inequality, other studies avoid treating remittances as exogenous income by adopting counterfactual scenarios to get the income of migrants at home if not migrated. Barham and Boucher (1998) uses a dataset collected in 1991 in Bluefields Nicaragua a community with a long history of international migration to examine the net effects of migration and remittances on income distributing by using counterfactual scenarios of no migration and remittances. Their findings confirm (Stark et al, 1986) that remittances reduce income inequality when the effects are measured as if remittances were exogenous income source. However, they also find that when the observed income distribution is compared with two non-migrant counterfactuals where migration and remittances are treated as substitute for home earnings, the potential earnings of migrants at home have amore equalizing effect than do remittances on income distribution indicating that remittances results to inequality.

The hypothesis that relationship between remittances and inequality is a dynamic process is supported by the evidence from McKenzie and Rapoport (2004) who uses two data sets from the Mexican Migration Project (MMP) and the national demographic survey
(ENADID) to examine the effect of migration on inequality in Mexico. They find that migration increases assets and income inequality when new migration start taking place due to lower levels of migration stock at migration destination, and then as the number of migration increase the lower income groups also start to migrate which results to decrease in inequality in the community. They argue that, large networks spread the benefits of migration to members at the lower end of the income and wealth distributions of the community, thereby reducing inequality.
Chapter Four

4.0 Macroeconomic impacts of remittances

In recent years there is a growing interest in the research community of studying the macroeconomic effects of international remittances on receiving countries. Academics and policy makers acknowledge that the effects of remittances are felt not only at the micro level but also affect the national economy. According to the World Bank (2006) the large size of remittances relative to other external flows and to the GDP in many countries suggests that the macroeconomic effects of remittances may be of critical importance in many countries. The World Bank findings show that when remittances are calculated as a share of GDP in 2004 twenty recipients all developing countries, all receive more than 10 percent of GDP as remittance flows.

4.1 Remittances promote macroeconomic stability

Remittances are regarded as being stable source of external finance and that often play a crucial social insurance role in many countries afflicted by economic and political crises (Kapur, 2004). According to the World Bank (2006) remittances have proved to be less volatile, less pro-cyclical and, therefore, a more reliable source of foreign currency than other capital flows to developing countries such as foreign direct investment and development aid. Remittances are also seen to rise when the recipient economy suffers a downturn in activity or macroeconomic shocks due to financial crisis, natural disaster, or political conflict, as migrants send more funds to help their families and friends (World Bank, 2006).

Studies by Yang (2004), Bugameli and Parterno (2005), Ahmed (2000) provides evidence that remittances increases due macroeconomic shocks and that they help to smooth consumption and also contribute to the stability of recipient economies by compensating for foreign exchange losses. Ahmed (2000) show that remittances rose to US$500 million annually around four times of the value of Livestock which is a major exporting commodity in Post-war Somaliland. Another study by Yang (2005) show that receipt from international remittances increased in the Philippines due to the 1997 Asian financial crisis. The results
also show that a 10 percent appreciation of a migrant’s currency against the Philippine currency led to increases in household remittance receipts and a 0.6 percentage point decline in the poverty rate in migrant households. Yang and Choi (2005) show the rise of international remittances due to rainfall shocks in Philippines. Gupta (2005) find that in India remittances are higher when economic conditions abroad are benign, and remittances are also found to be somewhat countercyclical, that is, higher during the periods of negative agriculture growth.

Bugameli and Parteno (2005) analyze empirically the relationship between workers’ remittances and current account reversals and conclude that workers’ remittances help to reduce the probability of financial crisis. They find that high level of workers’ remittances in terms of GDP (more than 3 percent of GDP) reduces the probability of sharp current account reversals triggered by an increase in external debt or decrease in the stock of international reserve. Chami et al (2008) provide more empirical evidence that an increase the workers’ remittances to GDP ratio of one percent lead to a reduction of 0.164 percent in the standard deviation of GDP growth. They suggest that countries with high workers’ remittances to GDP ratios experience significantly lower economic volatility than they would in the absence of remittances.

However, Ratha (2006) cautions that to the extent that remittances are used for investment purposes, are also ‘procyclical’ meaning that they respond to dramatic economic changes in the recipient country like other investment flows. He gives examples of Turkey and the Philippines remittances were more volatile in the 1990s than in the 1980s. However, he concludes that the volatility of remittances is lower than that of private capital inflows and official flows.

4.2 The effect of remittances on growth

A relative small literature considers the impact of remittances on the overall economy. However, from these studies we get mixed results and interpretations. Te scholars who are skeptical as to whether remittances can in fact lead to economic growth provide the following arguments: Despite the fact that microeconomic based researchers have pointed out that even if remittances are totally spent on consumption, there will still be a benefit to the receiving economy through multiplier effect; there is no macroeconomic evidence about
the impact of remittances on the long term growth (Chami et al, 2003). They argue that microeconomic evidence does exist suggesting that remittances may in fact be detrimental to long-run growth. They cite the findings of two studies by Kozel and Alderman (1990) in Pakistan and Itzigsohn (1995) which shows significant negative impact on labour force participation rates.

Chami et al (2003) using the World Bank aggregated panel data for 113 countries over 1970 to 1998, empirically analyze the causes and effects of workers’ remittances. They find a negative and significant relationship between the growth of remittances and the GDP growth rate. They suggest that altruistically motivated remittances intend to compensate their recipients for bad economic outcomes, but also create incentives that lead to moral hazard problem due to reduced labour market efforts or riskier investments which could lead to reduced economic activity. They also find that remittances differ greatly from private flows in terms of motivation and their effects and conclude that remittances do not appear to be significant source of capital for economic development. Remittances can also decrease economic growth through a Dutch disease effect which requires that traded goods sector of a remittance – receiving economy be the source of significant positive externalities that enhance other sectors’ productive capacity and this could cause the real exchange rate to appreciate (Chami et al, 2008). The negative impact of remittances through a Dutch effect is elaborated more in section 4.3 in this chapter.

A different perspective from other researchers in regard to the effects of remittances on growth seems to be positive. According to Ratha (2006), recent studies reveal that remittances may promote financial development which could enhance economic growth and poverty reduction. Rapoport and Docquier (2006) are critic of the study by Chami et al. (2003) arguing that it disregard the possibility that, due to liquidity constraints, remittances could affect investments (thus making the investment/GDP ratio endogenous) and human capital formation, and also that the human capital being completely absent from their analysis. They conclude that remittances tend to have an overall positive effect on origin countries’ long-run economic performance.
4.3 The effects of remittances on real exchange rate

The effects of remittance inflows on the recipient country’s real exchange rate is one of the most potential macroeconomic effects of remittances, however, there exist limited empirical evidence regarding the matter (Ratha, 2006). The existing studies are based on Dutch diseases theory which suggest that large inflows of capital can give rise to an appreciation of the real exchange rate and eventually a deterioration of the competitiveness of the sectors exposed to international competition, thus preventing the development of a dynamic export sector (Bourdet and Falck (2006)

Similar evidence come from Amuedo-Dorantes and Pozo (2004) who use a panel data of 13 Latin American Caribbean countries to study the impact of workers’ remittances on the real exchange rate in receiving countries. They controlled other factors that might influence the exchange rate and findings indicate that workers’ remittances have potential to appreciate the real exchange rate in the receiving countries thereby reducing the competitiveness of imported goods in the international economy. The find that a doubling of transfers in the form of remittances result in real exchange rate appreciation of about 22 percent of the countries under the study. They argue that the situation is similar to Dutch Disease or Resource Boom Models where resource discoveries result in real exchange rate appreciation and the subsequent shift of resources from the traded to non-traded sectors of the economy. However, they observe that public gifts in the form of foreign aid do not have a statistically significant impact on the real exchange rate.

Bourdet and Falck (2006) use the data for Cape Verde, a country with estimated shares of recorded remittances and official aid each at 15 percent of GDP to study the macroeconomic impact of remittances on the exchange rate of that country. Their findings confirm the conventional view that an increase in remittance receipts is associated with appreciation of exchange rate. However, they found that, the higher the level of official aid the larger will be the depreciative effect of an increase in remittances (and vise versa).

In contrast with the result that indicate the appreciation of exchange rates due to the increase of remittances, other studies conclude otherwise. Rajan and Subramanian (2005) use a sample of 15 countries during 1990s and found that higher remittance receipts were
not associated with slower growth in manufacturing with higher labour intensity or greater export orientation and did not have adverse affects on country’s competitiveness (cited from Chami et al, 2008). IMF (2005), Ratha (2006) and Bourdet and Falck (2006) contend that remittances tend to be relatively stable, unlike other natural resources windfalls and other cyclical flows, the Dutch disease effects of remittances should be of less of a concern. Governments in countries receiving large remittances can allocate a larger portion of government expenditures on infrastructure and also practicing more liberal trade policies; both these measures would tend to increase exports and also contribute to improved labor productivity and competitiveness (Ratha, 2006).

4.4 Remittances can improve country creditworthiness

The countries receiving lager remittance inflows can have improved creditworthiness and thereby enhance their access to international capital markets. According to Radha (2007), the ratio of debt to exports of goods and services, a key indebtedness indicator, would increase significantly if remittances were excluded from the denominator. He noted that the model-based calculation using debt to export ratios that include remittances in the denominator indicate that including remittances in creditworthiness assessment would improve credit ratings for Lebanon and Haiti by two notches: and result in implied spread reductions raging from 130 to 334 basis points.

4.5 Remittance can help countries raise external financing

Remittance-receiving countries can use the flows to raise additional funds in the world capital market through securitization. In recent years several countries, including Brazil, El Salvador, Mexico, Panama and Turkey, have used the future flows of remittances as collateral to raise funds in the international capital market. For the developing countries such securitization could help to access to external finance at lower cost than borrowing on sovereign credit. As shown in Table 4.1, 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 (Ghosh, 2006)
Table 4.1 Impact of remittances on country credit rating and sovereign spread

<table>
<thead>
<tr>
<th>Country</th>
<th>Remittances as % of GDP, 2004</th>
<th>Rating Excluding Remittances</th>
<th>Rating including remittances</th>
<th>Spread saving (basis points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Serbia Montenegro</td>
<td>7</td>
<td>B+</td>
<td>BB-</td>
<td>150</td>
</tr>
<tr>
<td>Lebanon</td>
<td>14</td>
<td>B-</td>
<td>B+</td>
<td>130</td>
</tr>
<tr>
<td>Haiti</td>
<td>28</td>
<td>CCC</td>
<td>B-</td>
<td>334</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>11</td>
<td>CCC+</td>
<td>B-</td>
<td>209</td>
</tr>
<tr>
<td>Uganda</td>
<td>5</td>
<td>B-</td>
<td>B</td>
<td>161</td>
</tr>
</tbody>
</table>

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.

4.6 The effects of remittances on inflation

Some scholars have argued that remittances could lead to inflation due to increased demand for consumer goods in sectors which can not cope with an induced rising demand. Gosh (2006) reviewed several studies and conclude that the increase in prices of land and construction costs in remittances receiving communities is quite common as found in Egypt, Greece, Pakistan, Yemen and several Caribbean countries.

Elbadawi and Rocha (1992) use panel data to analyze the flows of workers remittances in six labor exporting countries of North Africa and Europe and conclude that remittances have a significant effect on inflation. They argue that the influence of inflation is indirect because it discourages investment and this leads to less remittances flows into the receiving countries. Similar evidence is provided by Katseli and Glytsos (1986) who found remittances are negatively related to inflation in the receiving country.

Other scholars provide different views regarding effects of remittances on inflation. Gosh (2006) cites Lukas (2005) who noted that, 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 no evidence to suggest that prices did rise than in other parts of India to lead to inflation. 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 (Grosh, 2006). The empirical evidence from Chami et al (2008) indicate that all depend on how policy makers select the correct or least distortionary – set of policy instruments when implementing fiscal and monetary policy. They suggest that the ability to enact a consumption tax instead of income tax removes the incentive by the government to use inflation tax and this helps the government to finance its budgetary expenditures with least distortionary impact on economic activity.
Chapter Five

5.0 Social and political impacts of remittances

A substantial body of literature has mostly focused on the effects of remittances on economic development of developing countries and only few studies have been able to find the link between remittances and social-political spheres of receiving countries. Remittances have tremendous impacts on receiving countries not only in terms of economic aspects but also in terms of social and political matters of these countries.

5.1 The positive aspects of remittances

In some major remittance receiving countries there is an increase willingness by politicians to engage the Diaspora in the political affairs of their countries of origin (Levitt and de la Dehesa R, 2003, de Haas, 2007, Cohen, 2005) summarizes several studies and noted that transnational ties between migrants and their countries of origin can reinforce remittances practices. He also found that the linkages and relationships that exist between migrants and their sending households, communities or countries of origin have a positive effect on remittance practices over time. It is argued that such linkages can promote political activism as in the case of the emigrants from, Brazil, Dominican Republic and Mexico who have been able to use their financial power to influence elections and policies in their home countries at the national and community levels (Levitt and de la Dehesa, 2003). For example, migrants from Dominican Republic in United States have been involved in home countries’ politics for a long time by contributing large sums of money to political campaigns and influencing the voters to vote according to their choice (Levitt and de la Dehesa, 2003). The democratic election in Croatia in 1990 was funded by the donations from the Diaspora and a vast majority of them were supporters of the Croatian Democratic Union (HDZ) which was demanding independence from Yugoslavia (Skrbiš, 2007).

The governments of countries emerging from conflict have recognized the potential involving the migrants in the reconstruction and national building process especially through financial transfers in terms of remittances (Van Hear, 2003). For example, since independence from Ethiopia, the Eritrean government has been collecting two percent of monthly income of Eritreans in the Diaspora (Van Hear, 2003; Koser, 2007).
5.2 The negative impacts of remittances

Some scholars are critical of some governments in developing countries of using migrant transfers as a shield to the deteriorating economies and becoming careless or negligent to impose necessary economic reforms. It is argued that remittances can create a *moral hazard problem* where by a government fails to put in place economic measures to solve deteriorating economy due to trade deficit or higher unemployment as it anticipates receiving money transfers from migrant workers (Kapur, 2004; Aldaba, 2004). Similar argument is provided by Abdih et al. (2008) after analyzing the impact of remittance flows on government behavior. They find that remittances flows may have adverse effects on the quality of domestic governance because they make it easy and less costly for government institutions to divert resources to non productive purposes and corruption deals. In this way they argue remittances by acting as a buffer between the government and its citizens, give rise to moral hazard problem, as the government can then free ride and appropriate more resources for its own purposes, rather than channel these resources to the provision of public services.

Remittances from migrants have been found to contribute to political destabilization and conflict perpetuation by providing support for groups under war in the country of origin (Sorensen et al., 2002; Van Hear, 2003). According to Ghosh (2006), financial flows from migrants apart from the developmental objectives, they could also be directed to achieving an opposite more repressive, political and ideological objective and in this case funds are sent to support the warring groups at home.

Kapur (2004) argues that remittances are an important mechanism to fund terrorism, civil wars and liberation struggles. He points out that the support is based on migrant organizations based in different countries such as Sir Lankan Tamil migrants in Canada supporting the militant Liberation Tigers of Tamil Ealam (LTTE); migrants in the United Kingdom supporting Kashmir cause in Pakistan and the Free Aceh movement in Sweden. He also noted how in Somalia a large proportion of the remittances went to supply arms to the rural guerrillas who topped the government in 19991.
Similar observations concerning the migrant remittances role in supporting and sustaining conflicts in their countries of origin are presented by Collier (2000), Fair (2007), Skrbiš, (2007), Sheffer (2007), Bamyeh (2007), Natali (2007), Um (2007). Diaspora (migrant) fund rising for political cause in the homeland is inherently connected with the notion of patriotic duty often mixed with a strong sense of national sentiment (Skrbiš, 2007). For the case of the Sri Lankan Tamil Diaspora, Fair (2007) observes that the institutions they built abroad were in many cases designed to contend with their situation in the homeland and remittances have been important source of funding for LTTE and also remittances have enabled Sri Lankan Tamils to remain in the conflict affected Tamil dominated areas.

5.3 Remittances and gender

The impact of remittances on gender relations has been less covered in the scholarly literature. Few studies which have looked at gender dimensions of remittances. Remittances affect gender relations of senders and receivers of remittances differently. On the positive side, they argue that remittances have the ability of changing the traditional role of women when female migrants assume the role of family supporter or breadwinner (Carling, 2005). Also Mahler (2006) reviewing the work of Fauron and Schiller (2001) show that for poor Haitian immigrant women remittances and gifts elevate their social status back home to an extent previously unimaginable. Similar evidence is provided by Weyland (2004) suggesting that the income from migration has helped Dominican women to support themselves and sending remittances back home their families, in this way changing traditional gender roles and family dynamics. In Morocco, De Haas (2007a) argues that remittances have both pushed and enabled migrants’ wives to establish independent households in newly-constructed houses for their nuclear family, thereby escaping control by in-laws and gaining personal freedom.

Some scholars however, find that remittances do not contribute to change of gender role in families. The study by King et al.(2006) on Albanian migrants in London and in northern Albania find that traditional Albanian gender roles which are based on patriarchal power structures are maintained and not affected by the deployment of remittances. Similar evidence is found in Turkey and Morocco suggesting that in spite of economic progress and increased standard of living due to received remittances the women status has remained the same and the transformation of patriarchal power structures are more likely to take a
longtime (Day and Içduygu, 1997, and De Haas, 2007a). The study by Taylor et al. (2006) in Guatemala also concludes that, migration-related changes to traditional gender and ethnic roles is gradual because migrants, despite their increased earnings and awareness, run into a social structure that resists rapid change.

Mahler and Pessar (2006) citing Luin Goldring (2001) noted that despite the contributions from Mexican immigrant women in terms of remittances to support community projects in their hometowns, the women are excluded from making decisions on how funds should be invested due to the Mexican system which is dominated by male representatives.

It is also noted in the literature that changes in gender roles are not necessarily positive because in many cases are not assumed out of free choice. For example, de Haas (2007a) argues that as this new role is generally not assumed out of free choice, then should not be equated with empowerment in the since of making independent and conscious choices against prevailing norms of gender roles. It is also argued that younger women who migrate as daughters are often required to remit regularly and directly to their parents and often they are required to serve sons and relatives who have migrated and have less freedom that other male relatives enjoy (Cohen, 2005 as cited from Brettell, 2003).
Chapter Six

6.0 Policy measures to support remittances

The chapter looks at the policy measures that are being implemented in some countries or recommended by researchers and other stakeholders with the objective to increase the benefits of remittances. The general picture from the literature indicate that remittances have the potential to improve the livelihoods of receiving households and if well regulated and linked to the countries’ development agenda could lead to development. Some countries, especially those with a large share of their nationals working in foreign countries have recognized the positive impacts of remittances that could lead to improved peoples’ wellbeing and also their potential for economic development if good policies are put in place. There are various factors which impede the effectiveness of remittance flows in both the receiving and sending countries that need to be considered when designing policies and regulation aimed at improving formal remittance flows and increasing their productive use. These factors are well summarized by Russell (2005) including: a stable political environment; low rate of inflation; low black market exchange rates; increases in domestic interest rates; currency devaluation; secure means of transferring remittances; and national banking services in country of employment.

The policy measures and recommendations that are found in the literature could be grouped into the following 4 main areas: measures to strengthen the remittance transfer mechanisms; measures to influence remittances flows; measures to manage remittances for development; and measures to increase productive uses and impact of remittances.

6.1 Measures to strengthen the remittance transfer mechanisms

From the discussion in the literature it is obvious that the costs of remitting money are higher using the formal channels especially with non-bank financial institutions such as exchange bureaus and dedicated money operators (MTOs) which are controlling the formal remittance transfer globally. On average cost of sending remittances are estimated to range between 0.2 percent to about 20 percent of the remittance value depending on amount remitted, services used, and destination (Sander, 2003, Sander and Maimbo, 2003). The costs of sending remittances are even higher for those sending small amounts, as they are charged the minimum fee (Sander and Maimbo, 2003) This situation of course has negative
effects on the recipients of remittances who are faced with a loss of a greater portion of their earnings that would have been used to improve their livelihoods.

Policy measures aimed at reducing the costs of sending remittance are seen as the best approach to increase the number of formal remittance senders and also it’s believed that this could encourage them to remit more. It is argued in the literature that the higher fees are due to market reasons reflecting the need for more investment in money transfer systems including a widespread branch network in both sending and receiving countries (World Bank, 2004). It is also suggested that the government intervention is essential in order to promote competition, transparency, and higher standard for this emerging money transfer industry (Wimaladharma, et al., 2004).

6.1.1 Increase competition among remittance transfer agents

It is believed that increasing the number of operators in the money transfer industry will create competition which could result into lower costs and improved service delivery to attract the customers. A good example of is that of the costs of sending money from US to Latin America and Caribbean countries which dropped from the average of 15 percent in the 1990s to between 5 to 9 % in 2003 due to the competition among service providers (Sander, 2003, Carling, 2005). According to Sander (2003), the sending cost can often be cheaper when funds are sent to a higher volume destination and, especially, when there is competition on the market, either among MTOs or between MTOs and informal services.

The competition can also be increased if the banks will participate more in offering remittance transfer services. The banks can also introduce special products that can attract the migrants to open an account and be able to transfer money using the banking system at reduced cost. For instance, the Lloyds TSB bank in UK has been able to introduce a pilot project for non-resident Indians living in the UK, which allows them to send remittances free of charge to another bank (IGIGI) in India. The only condition is to hold two accounts one in UK and another in India, and maintain a minimum balance of about £150 (in Rupees) in the IGIGI account which is spread over with about 540 branches and 4,500 ATMs (Wimaladharma, et al. 2004).
The role of the governments in remittance sending and receiving countries should be the creation of an attractive environment of doing business in the money transfer services by designing policies and strategies aimed at reducing obstacles which are making the sector less competitive. Factors of regulatory and policy nature include: reforming the monetary policies such as those related to forex restrictions or channeling of all forex dealings through the central bank; remove regulatory obstacles that affect the availability or outreach of financial services; and the reduction of other legal and bureaucratic barriers to the money transfer market entry (Sander, 2004, Carling, 2005). It is also suggested that, governments should focus on promoting transparency in pricing, consumer awareness and on creating conditions for healthy competition by avoiding market distortions through price control or supporting certain service providers over others (Wimaladharma, et al. 2004).

6.1.2 Increasing the provision of remittance services by banks

It is widely recognized in the literature that low participation of banking institutions in the remittance services have contributed to: higher costs for sending remittance due to less competition; disincentive for a large section of low an middle income remittance senders to open bank account; and also the loss of potential customers by the banks. The banking sector has been slow in recognizing the business potential behind the remittance transfers. Banks have typically overlooked or been dismissive of remittances as a business, focusing on corporate services and money transfer of larger sums of money for corporate clients (Sander, 2003, Orozco, 2003b).

In recent years in some countries the banking institutions have started entering the remittance money transfer business more actively and this has become a very important opportunity to attract the unbanked immigrant population. For example, Orozco (2003b) argues that in the United States, at least 50 percent lack access to banking accounts and yet the overwhelming majority demands various financial services, such as cash checking, automatic bill payment, or money transfers. He noted that U.S. banks such as Bloomberg, Wells Fargo, Bank of America Corp., Citigroup Inc. and other U.S. Banks have realized that by involving in the remittance market they will be able to attract more immigrant customers especially the Hispanic customers who are the majority immigrants in the United States. U.S. banks have entered into the remittances business through modern transfer technologies which offers potential for greater efficiency and lower costs for both the banks and customers. The methods used by U.S. banks for sending money to Mexico include: the offer of debit cards which can be used by the recipient of remittances in ATMs in Mexico;
U.S. banks operating as money transfer agents through arrangements with Mexican banks, c) traditional wire transfer (SWIFT), d) and alliance between banks and money transfer operators (Orozco, 2003b).

Evidence from other countries in the world indicates that remittances sent through banks have lower costs than other formal channels. For example, Orozco (2003a) shows that the costs of sending money through banks from Europe to Turkey, Greece, Portugal, Morocco and South Africa to Mozambique and Swaziland are lower if compared with the other channels of money transfer. He also noted that banking operations are more common and successful in countries with longer history of exporting migrant labour, which is translated into a more established process of remitting. It is evident that establishing the partnerships among the banks in the remittance sending and receiving countries could help to reduce the risks and costs transferring remittances and also increase the benefits to the groups involved in the transaction process.

6.2 Measures to influence remittances flows
Some countries, recognizing that remittances are significant source of foreign currency have tried to influence these flows through policies and strategies. In the literature on remittances common policies that have been implemented to increase remittance flows are the mandatory transfer requirements and the use of incentive measures to attract remittances from abroad.

6.2.1 Mandatory remittance transfers
Countries that have implemented mandatory remittance transfers policies as a toll for attracting remittances require a deduction of certain percentage of earnings of their nationals who are working abroad to be transferred back to their country of origin (Puri and Ritzema, 2001, Carling, 2005 and Kozer, 2007). According to Puri and Ritzema (2001) during the 1980s South Korea was able to implement a successful policy which required the migrant workers to remit at least 80 percent of their earnings through the Korean banking System. However, the authors argues that the effectiveness of the Korean policy is based on the unique characteristics of the labour exporting process whereby almost all migrant workers in the Middle-East were employed by Korean contractors who were also responsible for depositing the employees salaries in Korean banks. Other countries that
have been less successful in implementing similar policies are the Philippines, Pakistan, Thailand, Egypt and Bangladesh (Puri and Ritzena, 2003, Carling, 2005).

After the end of struggle for independence in 1991, Eritrea introduced another kind of mandatory policy which requires all Eritreans in the Diaspora to pay 2 percent of their monthly income to the Eritrean government (Kozer, 2007). For the Eritreans, although the payment is not compulsory, most of them consider it as a duty or responsibility to contribute for the development of their country (2007). The success of this policy could be attributed to the factors which are of unique nature for Eritreans given the fact that sending remittances is a private decision which makes it very difficult to enforce a mandatory approach. As Carling (2005) put it:

‘the remarkable success in mobilizing remittances directly to the state is related to the strong sense of nationalism during and after the fight for independence, and is probably difficult, if not impossible, to emulate in other contexts’

6.2.2 Incentive programmes

The literature on policy initiatives to improve the effectiveness of remittances reveals that many governments in major remittance receiving countries have opted to use incentive programmes to attract remittance transfers rather than control policies that are seen as deterrent to remittances. Countries such as Bangladesh, India, Korea, Mexico, Pakistan, the Philippines, Thailand and Turkey are among remittance receiving countries that are actively engaged in attracting remittances and encouraging their investment in the home country (Sander, 2003).

A World Bank study in 40 developing countries in 2004 reveals that 35 percent of countries covered in the survey have employed variety of incentives to encourage migrants to use formal institutions to remit money in the home countries, such as tax breaks, higher interest rates for deposits and investment in local institutions, and possibility to purchase land at preferential prices (De Luna, 2005).

One of the most common types of incentive is the establishment of a special deposit account that provides migrants preferential interest rates and sometimes the option to have accounts denominated in foreign account (Orozco, 2002, De Luna, 2003). Countries such as Bangladesh, India, Pakistan, Sri Lanka and Tunisia have been able to introduce various
financial products, such as deposit and savings accounts, money market accounts with the objective to attract the migrants to transfer money through their local financial institutions, while working abroad (Puri and Ritzema, 2001, Orozco, 2002 and De Luna, 2005). The results from the World Bank Study in 40 central banks in 2004 show the increase in the number of developing countries offering migrants to open special bank accounts in foreign currency of interest. Of the 40 countries covered in the survey two countries were using US dollars as national currency and 32 other countries already allow residents to open accounts in foreign countries (De Luna, 2005). However, experience has proven that using foreign accounts as a tool for stimulating remittances has a major limitation give the fact that they attract only higher-skilled and professional migrants who earn relatively higher incomes and living a large part of migrants out of an incentive programme (Puri and Ritzema, 2001).

Another type of incentive used by remittance receiving countries to attract migrants to transfer money through formal channels for productive use is the offering of special bonds that finance public investments to migrants. Some of the successful countries in offering these special bonds to emigrant workers are Bangladesh, China, Eritrea, India, Israel, Lebanon, Pakistan and the Philippines (Puri and Ritzema, 2001, Carling, 2005). According to Puri and Ritzema, Pakistan, Bangladesh and India use foreign currency denominated bonds that are similar to repatriable foreign currency accounts because the money invested is repatriable without being subject the foreign exchange regulations. They also noted that compared to repatriable foreign currency accounts, these bonds are considered to be more effective in diverting unrecorded remittances because of the anonymity provided (2001).

Some governments are using tax breaks on remittances as a policy measure to attract migrants to use financial institutions to send money home. De Luna (2005) findings indicate that countries such as Egypt, India, Sri Lanka and Moldova have employed tax exemption or preferential price measures as a way of encouraging migrants to send money home through formal financial systems. For example, Egypt provides tax breaks of up to ten years for those using banks to send remittances; Migrants sending remittances to India and Sri Lanka are exempted from income tax; and Egypt and Moldova offer preferential prices to migrants to buy land (2005). Other countries that have introduced tax measures as a way of attracting more remittances to use formal channels are the Philippines through the removal of tax declaration requirement for the migrant workers and Columbia which has
removed a 3 percent tax charged on remittances an money orders coming from overseas (Sander, 2003 and Wimaladharma, et al. 2004)

6.3 Policy measures to manage remittances for development

There is a consensus among the researchers, policy makers and other stakeholders with interest in migrant remittances that integrating senders and receivers of remittances in the financial system is one of the key factors for better management of remittances for development. As already discussed in this paper a larger part of remittance transactions takes place outside the formal financial systems and also the majority of remittance receivers do not possess bank accounts. Formalization of remittance transfers through the financial system can help new customers to access other types of financial products that would enhance their well being, such as personal loans, credit cards, mortgages, life insurance, etc (De Luna, et al, 2006). Sending remittances through regular financial institutions such as banks enables governments in remittance receiving countries to exercise control over the use of foreign exchange and encourage a more productive use of funds (Sørensen, 2004b).

6.3.1 Encourage banking among unbanked households in the remittance receiving and sending countries

The number of households without bank account is very large in the developing countries and most of remittance receiving households falls in this category. Lacking of a bank account has, of course, a lot of disadvantages. According to Carling (2005) the advantages include:

“First, it involves safety risks as a result of conducting all financial transactions in cash, and guarding any savings in the form of cash. Remittance recipients are at risk when they collect large amounts of cash (by local standards) and carry it home. Second, the un-banked have limited possibilities for taking up loans or depositing savings for long-term financial stability. Third, the unbanked in many countries face much higher costs for basic financial services”

Reducing the number of unbanked migrant workers in remittance sending countries require the introduction of measures aimed at easing the existing obstacles that prevents them to open bank accounts. It is widely mentioned in the literature that immigrants who don’t have
papers in their host country (illegal immigrants) are faced with a problem of identification which prevents them to access financial services, such as opening bank accounts. Opening an account or seeking other services from banks relies on the certifying the identity of clients and others, through means like driver’s licenses or passports, a problem for many immigrants without proper documents (Orozco, 2004a). One of the proposed of solutions in this regard is to expand the acceptance forms of identity used by banks by accepting consular identification from the immigrant’s country and consulate of origin (2004a). For example in United States, where many immigrants from Mexico are undocumented, since 2002 the Mexican consulate has been issuing a simple official identity card with basic information certifying the persons, nationality (Ratha, 2003, Orozco, 2004a). According to Orozco, this form of identification has proved useful in attracting immigrants into financial institutions and allowing them to obtain other services such as driver’s licenses, (2004a). However, those against this policy argue that such cards legitimize illegal immigration and a practical concern that the information in these documents is not verified by the U.S. verification systems (Orozco, 2004a).

Banking the senders of remittances could have the same effects on remittance receivers by stimulating them to open bank accounts. As Carling (2005) noted, reducing the proportion of unbanked households among remittance sending immigrants is positive for individual lives and for the same reasons as in remittance receiving countries. Other proposals include the liberalization of financial sector activities and relaxing bank licensing rules to allow the establishment of well functioning banks with a wider coverage geographical coverage (Sander, 2003, Sørensen, 2004b). It is argued that banks and smaller financial institutions, such as credit unions, post offices and micro finance institutions can deliver convenient and possibly low cost remittance services in developing countries, especially in the rural areas where banks are lacking (Ratha, 2003, World Bank, 2006).

Increasing customer awareness about the availability of services and their advantages is one the options that can be used to reduce the number of unbanked senders and receivers of remittances. Marketing campaigns to increase financial literacy among remittance receivers and senders could be used to encouraging unbanked households to open accounts with financial institution (Orozco, 2004a, Carling, 2005). According to Orozco, (2004b) in the United States, marketing campaigns designed to encourage Latino immigrants to open accounts with banks and credit unions that offer remittance services have been successful.
He noted that, in 2004 about 400,000 new accounts were already opened representing 5 percent of the estimated eight million Hispanic immigrants without bank account. The financial literacy for bank customers is also seen as an important factor for effective market operations and competitiveness (Carling, 2005). Involving the community organizations, NGOs, and other stakeholders is seen as another way of raising financial literacy levels among the unbanked households (Orozco, 2004a, Carling, 2005).

The banking sector itself is being blamed in the literature for being slow to recognize the potential behind the remittance industry and in that way failed to respond in time in designing products that are suited to migrants needs. It is argued that banks tend to make money by holding money, offering high value services and a variety of more complex products, while remittance companies make money on fast payment, low value and relatively simple products (Ratha, 2005, Carling 2005). The complexity of banking system operations and its inflexibility in responding to remittance market needs makes many banks to be seen by migrants as non responsive to their needs and this contribute to their low participation in banking. As Ratha noted, that inefficiencies in the banking system such as long delays in check clearance, exchange losses and inaccurate representation of transaction costs discourage migrants from remitting through banks (Ratha, 2003). Using the experience of United States, Orozco (2004a) proposes a number of measures that could be implemented by the banks in order to attract the unbanked individuals to open bank accounts:

- Fee-based check-cashing services at friendlier operating hours;
- Basic savings accounts including low cost money orders for long distance payments;
- Deposit accounts designed to help accumulate savings;
- Deposit secured loans to individuals whose credit histories would make them ineligible for mainstream credit;
- Partnerships with community based organizations to create social bridges
- Have Latino or Spanish-speaking staff and educating bank staff about cultural diversity.
- Banks “should explore opportunities to provide needed services such as obtaining tax identification numbers, secured credit cards, life and health insurance, and individual development accounts”
6.3.2 Stimulating the provision of remittance services through micro-finance (MFIs)

The literature is increasingly recognizing the use of micro-finance institutions (MFIs) to stimulate the productive use of remittances. It is argued that given the difficulty of converting the migrant workers or remittance receivers to dynamic entrepreneurs, it is more realistic to introduce financial intermediaries that capture migrant remittances as deposits and channel them to existing small and micro-businesses (Puri and Ritzema, 2001, Bagasao 2003). According to Bagasao, linking migrant remittances with micro-finance institutions may provide remittance receiving families the business mentoring and access to capital (2003). It is also argued that due to the absence traditional financial institutions in the rural areas, MFIs which have a wider outreach and easily accessible even in rural areas could fill the gap by providing services to remittance recipients (Orozco and Hamilton, 2005, Carling, 2005). Other advantages of involving MFIs in the remittance market are well summarized by Carling (2005) as follows:

- Remittance transfers as a fee-based product could provide revenue to MFIs and help them achieve financial sustainability without compromising the objectives of poverty-orientation and impact maximization.
- Non-members who receive remittances through a MFI often become members, thereby expanding the client base and reducing the number of un-banked households.
- The auxiliary training and marketing services offered by some MFIs can be used to enhance the capacity of return migrants or remittance receivers to invest the income from employment abroad in productive activities in the country of origin.

Haiti’s Fonkoze, a micro finance NGO with 18 branches in Haiti is one of the most cited models of MFIs remittance services. For example in 2002, Fonkoze received around USD 2.5 million in remittances mainly from individual workers sending money to their families and churches and charitable organizations which send money for community development projects (Sander, 2003, Carling, 2005). Fonkoze partnership with City National Bank of New Jersey (CNB) in United States is one of the factors that contributed to its success in delivering remittance services (Sander, 2003). In other countries such as Guatemala micro-finance institutions are currently exploring the possibility of negotiating agreements with
money transfer companies and this would help them to penetrate into the remittance market (Orozco and Hamilton, 2005).

It also recognized in the literature that, there exist obstacles for MFIs to be able to penetrate into the remittances market. The obstacles could include; ability to compete with other service providers such as banks; ability to manage daily cash flow and be able to transfer remittances in time; ability to put in place new communication infrastructure in order to ensure fast service delivery; and being able to meet the regulatory requirements to engage in international money transfer services, (Orozco and Hamilton, 2005 and Carling, 2005)

6.4 Measures to increase productive uses and impact of remittances

It is clear from the literature arguments that for the most part remittances in many countries are spent on consumption goods and only a small part is left for productive investments. The reasons behind the low level of investment could by summarized as lack of conducive investment climate in many of remittance receiving counties and also the sole nature of remittances being comprised of many relatively small, fragmented sums, owned by a number of people who are not investors or entrepreneurs by professional (Bobeva, 2005). This is why policies to increase productive use of remittances should take into considerations a combination of economic, political and social factors of remittance receiving countries. According to Bobeva, in the context of overall economic policy, the remittances policy may be part of the investment policy. The author observes the experience of countries such as Malta and Estonia, that still receives substantial remittances, have offered a broad range of investment promotions for migrants as part of their Foreign Direct Investment policy. The author also noted that, in other countries, remittance policy is constituted in the framework of SMEs development policy, while other countries have opted for special remittance policy and strategy (2005).

6.4.1 Matching funds for investments in public infrastructure and community projects

Some countries have recognized that designing projects that strengthen the ties between migrants and their home communities is one way of attracting remittances and facilitating their investment in community infrastructure projects. For example, some Latin America countries such as El Salvador, Guatemala, Honduras, Mexico, and the Dominican Republic have been receiving remittances from the migrant associations commonly referred as
Hometown Associations or HTAs in United States to finance investments in community projects (Bobeva, 2005). The author also noted that on average the size of these funds varies from US$ 10,000 per year in Guatemala to US$ 5-25,000 per year in Mexico and are often matched with government funds in the migrants’ countries of origin. One of the most frequently referred matching funds in the literature is the Mexican programme or *Iniciativa Ciudadana*, where the Mexican federal government, the state and the municipal government complement each dollar remitted by Mexican HTAs (Carling, 2005, Bobeva, 2005). The funds are mainly invested in infrastructure and community development, such as construction or refurbishment of health centers, schools, roads, provision of water, sewage, electricity, water treatment and community facilities such as computers (Carling, 2005). It is also argued that the phenomenon of collective investment of remittances is very broader in terms of their organization. For instance Sander (2003) noted that more groupings are found in Africa and can take the form of associations, cultural or church groups, refugee groups, ethnic professional groups and even virtual organizations.

Apart from the widely advertised positive aspects of matching funds to promote the productive use of remittances, other researchers have raised their concern about the viability and sustainability of the projects under these programs. For example, Bobeva notes that such type of policy instrument has a very limited potential to accumulate migrants’ savings given the fact that, funded projects are very expensive and that are based on emotional, such as prestige, community links and charity rather than rational motivations (Bobeva, 2005). The same views are provided by Carling (2005) who argues that the government priority to investments in infrastructure in areas with migrants’ HTAs, raise difficult questions regarding priorities for expenditure of scarce public resources in developing countries as other poor communities without migrants are excluded.

### 6.5 Improving the investment climate and business facilitation

The existence of enabling economic environment, transparency, sound regulatory systems, information and low costs of doing business in remittance receiving countries are crucial factors which influence investment decisions by remittance recipients, returning migrants or migrants working abroad. Costs of starting business are believed to be high in some migration countries with potential investors and by lowering these costs more money transfers from migrant workers could be directed to investment activities. Based on the
World Bank findings in 2004 on the cost of starting business in more than 130 countries around the world, Carling (2005) observes that in many cases, entrepreneurs must undertake more than 10 different procedures, which could take more than three months to complete. Designing policies that are aimed at improve the investment climate in migrants’ home countries could greatly attract a group of potential investors to put their money in productive investment activities.

Some governments in remittance receiving countries design and implement various policies which are aimed at attracting migrants to engage in productive investments such as starting their own businesses. Such policies are for example, business counseling and training; entrepreneurship development; and incentives on investment machinery and equipment imports (Puri and Ritzema, 2001, Sander, 2003, Bobeva, 2005)

6.5.1.1 Business counseling, information and training
The literature on remittances provides some examples of governments that have been implementing business counseling, information and training programs to assist return migrants and remitters to get the required information and knowledge for investment. The government of Korea launched an experimental training program in 1986 for retraining return migrants in new skills so that they can move to other industries or establish their own business. By mid-1986, some 4,000 workers were participating in the scheme (Hyun, 1989). In Thailand, the Bangkok Bank offers advisory services on investment opportunities to its migrant-worker customers. The workers who seek advice are also eligible to obtain supplementary loans from the banks if they have a good savings record (Puri and Ritzema, 2001). Similar initiatives are found in, Pakistan where the overseas Pakistanis Foundation (OPF) is offering investment advisory services on return migrants and the Philippines, through the Philippines Overseas Employment Administration (POEA) since the late 1980s initiated the program to establish business consultancy, information services, training in business management and financial supports for return migrants (Puri and Ritzema, 2001, Sander, 2003)

According to Bobeva (2005) business facilitation policy instruments aim to overcome the main obstacles confronting migrants when deciding to invest such as the lack of information about investment conditions, business opportunities, and the legal and institutional framework. The author noted that evidence from many studies indicate that
migrants expect government attention in order to invest in their home country. To address this concern, the author suggests that government business facilitation should have guides for migrant investors, such as promotional tours around migrant communities abroad.

6.5.1.2 Entrepreneurship development

A range of policies have been employed by some countries to link remittances with enterprise development in order to transform remittance receivers or returning migrants to entrepreneurs. Evidence from the literature regarding the success of these policies in different countries is less conclusive due to the limitation of information to make assessment. In Sri Lanka, since early 1980s the government has been implementing an entrepreneurship program specifically with an objective to guide returning migrants in business creation (Bobeva, 2005). Three important results from the program are: First, more highly qualified migrants were more successful in participating in the program than the unskilled; second, the possibilities for guiding candidates into business are limited unless accompanied by measure to facilitate the access to capita; and third, the ability to identify and develop a project, as well as managerial skills needed to run a business, cannot be imparted only through a program of class instruction (Bobeva, 2005).

The Sri Lankan experience is similar to that of other countries that attempted to implement similar programs. For example, Turkey and the former Yugoslavia in the early 1970s promoted programs for workers cooperatives and joint companies to encourage migrants’ investment in home regions; however, the results did not meet the expectations, for similar reasons (Kok et al., 2001, Bobeva, 2005)

Based on the results of these policy initiatives to promote entrepreneurship among migrants it is evident that it is not easy to convert migrant workers who have limited business exposure or experience and other necessary skills into dynamic entrepreneurs. The policies that are aimed at linking remittances with enterprise development need to have clear goals and be well targeted to the intended groups, and also take into consideration other factors that might influence the policy to fail or be successful. Other researcher such as van Doorn (2001) argue that it is much more realistic to introduce financial intermediaries that capture remittances as deposits and channel them to existing small businesses rather than transforming migrants directly into entrepreneurs.
6.5.1.3 Promotion of the import of investment goods

Some governments have used incentives on imports of investment goods to encouraged migrants to start new businesses. For instance Pakistan has a "Non-Repatriable Investment Scheme" under which allows Pakistanis abroad and those returning permanently to import machinery and equipment at special rates. High preference is given projects in relatively underdeveloped areas which receive a higher rate. Pakistani migrant workers are also allowed to invest in export processing zones which enjoy complete duty exemptions on machinery and raw material imports (Nayyar, 1989; Kazi, 1989 as cited in Puri and Ritzema, 2001). The authors also noted that India also give preferential access to capital goods and raw material imports to retuning migrants who wish to set up a new industrial unit or participate in the expansion of existing business.

6.5.2 Securitization of remittances

The literature has recognized that remittances may be used for future flow securitization along other future receivables. The process of securitization is used by banks in developing countries to borrow hard currencies by issuing bonds (De Luna, 2005, Hughes, 2008). For example, the results from the study of central banks in developing countries show that, Banco do Brazil closed a $300 million dollar securitization transaction in 2001, Banco Cuscatlán in El Salvador closed a $125 million dollar transaction in 2003, Banamex of Mexico closed a $200 million dollar transaction in 1999, and since 1999 several banks in Turkey have securitized a part of their remittance transactions (De Luna, 2005). Similar steps to raise external financing have been taken by other countries such as, El Salvador, Ethiopia, Ghana, Nigeria, the Philippines and Panama (Sander and Maimbao, 2003, Ratha, 2003, Ratha et al, 2008). The European investment banks which are lending money to banks in developing countries are already basing on the expected inflow of funds from remittances as collateral for lending (Bobeva, 2005). Ratha et al (2008) estimate the potential size of future remittance flow securitizations for developing countries. Their calculations indicate that the potential of future annual securitizations of officially recorded remittances is $36 billion for all developing counties, $5 billion for low-income countries and 2 billion for Sub-Saharan Africa.

Despite the huge potential of securitizing remittance flows to access funds for productive investments, few developing countries have been able to use this approach. Ratha et al
(2008) noted obstacles to future-flow securitization in some developing countries, especially for Sub-Saharan Africa countries. These could include a low level of financial development; lack of banking relationships with the banking abroad; high fixed costs of legal, investment banking and credit-rating services; weak legal infrastructure and protection of creditor rights; and volatile macroeconomic environment (Ratha et al, 2008). Apart from the existing barriers for securitization of remittances in some countries, a big picture indicates that the process of securitization is increasingly becoming a very good asset that could help remittance receiving countries to access capital markets to provide financing for development.
Chapter Seven

7.0 Conclusion and recommendation
This paper is set to review the impacts of international remittances on receiving courtiers and policy options for increasing remittance effectiveness. The overall assessment from this literature review is that remittance flows have been steadily growing globally and millions of people in the developing countries are very much dependant on these remittance to secure their livelihoods.

The existing literature on remittance impacts is divided between those analysts who suggest that remittances have no developmental impact but only creates over consumption, dependency and disincentive to work and those who argue that remittances may lead to economic development and poverty alleviation in the developing countries. The big question in this debate is the way the term development has been conceptualized differently by researchers who have been analyzing the impacts of remittances on receiving families and communities. The questions remain: what is real development? What makes development to happen? It is also argued that in most cases remittances are not invested in productive areas and the largest part is consumed. This is true, however it should also be recognized that remittance transfers are of different types with a variety uses and potentials for development, and therefore desegregated data showing different types of remittances on how they are used and why is needed to be able to come up with reliable conclusions that are necessary for policy intervention.

The evidence from various studies that have been reviewed in this paper shows that remittances are beneficial at family, community and national levels. Intra family remittances have been contributing to daily family budgets, investing in housing and financing investments in small businesses, supporting children’s education, health, improve human capital and other family needs. At the community level, collective remittances from the Diaspora’s associations such as hometown associations have been used to finance projects on infrastructure development such as building or repairing schools, health service centers, roads, churches, water wells, etc. At the national level remittances have positive effects on foreign reserves, balance of payments and also securitization of remittances is use by some developing countries to raise external financing.
There are various factors that are listed as reasons for limited impact of remittances to development. It is claimed that a substantial part of remittance flows is underreported in most developing countries and also a significant amount of about 35 to 75 percent of formal remittances is transferred through informal channels and in that way reducing their impact on development (Freund and Spatafora, 2005). Factors that are being blamed for higher informal remittance flows in developing countries include weak financial systems, larger exchange rate spread and higher transaction costs of sending remittance through formal channels.

The literature highlights some measures and policies that have been introduced in remittance sending and receiving countries in order to attract and facilitate the flow of remittances through formal channels. The main focus has been to reduce the transactions costs by; encouraging more institutions to participate in the remittances business market in order to increase competition; strengthen the infrastructure such of information and communication technology and also designing products that fit the interests of the target groups. Evidence from some parts of the world show that increased competition and improved technologies has led to the fall of remittance remitting costs. For example the results from the scorecard of sending remittances in Latin America shows that after many years of increasing awareness and competition among money transfer operators (MTOs), the average cost to send $200 has been reduced considerably from 15% ($30) before 2000 to 5.6% ($11) in 2004 (Inter-American Development Bank, 2006).

Some countries have employed incentive measures to stimulate formal remittances flows and encourage the use of remittance for development. However, some analyst are concern that it will be difficult to have positive results from these targeted policies in remittance receiving countries unless there exits favorable investment climate through political trust and sound micro-economic policies such as improved physical infrastructure and public institutions, well functioning financial systems, improved markets and a transparent legal systems.

There is also a concern that if remittances are not well conceptualized the designed policies are not going to influence remittances to contribute to development as intended. Policy makers are faced with the complexity of remittances being too limited in scope and too
fragmented to be able to remove general development problems on their own. It should also be recognized that remittance are part family strategies which are pursued to cope with various risks with the goal of consumption smoothing and poverty alleviation, therefore, measures to divert remittance flows to specific productive use need to take this into account. Remittance policies need to be integrated into the general government policies which are aimed at economic development and poverty alleviation.

Much of studies on remittances have concentrated in few countries especially those covering remittance flows from U.S to Latin American countries, Philippines and few other countries. Much more research and information sharing on remittance market size, customer characteristics, transaction barriers, financial services, regulation, and technology could be done in other remittance receiving countries in order to learn more about remittances. The findings will provide the public and financial institutions a better understanding about remittance issues and this will help to put in place appropriate measures which are aimed at increasing remittance effectiveness.

Finally, for the majority of remittance receivers around the world, remittances play a big role in improving their livelihoods. Policies to improve the effectiveness of remittance should aim at reduction of transactions costs through improved physical and financial infrastructures, partnership among all stakeholders in the remittance market and provision of incentives to attract remittances for investment. Policy makers should understand that remittances are fundamentally private transfers and policies that are designed to improve the developmental impacts of remittances should take into consideration the interests of receivers and senders of remittances by making distinction between family remittances, collective remittances and remittances for investment.
References


