

## SUMMARY

Migrant remittances have recently surged to the forefront of development agendas worldwide, but in few places have they grown as spectacularly as in India. India now captures one-tenth of global remittance flows, making it the world's largest single recipient. Total remittances from overseas Indians have grown steadily over the past 15 years, and dramatically in the past 10, skyrocketing from \$2.1 billion in FY1990-1991 to \$24.1 billion in FY2005-2006.

Factors responsible for the growth in reported remittances include the diminishing role of unofficial channels, shifting emigration patterns to high-skilled technology jobs, greater competition in the money transfer market, and the strength of the Indian economy.

However, while remittances exceed total government expenditures in health and education and have a noticeable impact on per capita income in regions of the country with high rates of migration, the Indian government has not instituted any policies specifically aimed at increasing the remittance flow. Policies have instead focused on encouraging deposits into NRI (Non-Resident Indian) bank accounts in India. Thus, while the NRI deposit schemes have received the attention of policymakers, remittances are the real success story of the last decade.

Government policies have also not addressed potential links between remittances and socioeconomic development. Indeed, research and analysis on policies to leverage remittances for development in India are sorely lacking.

The success of NRI bank deposits and bond initiatives in the past proves that the Indian diaspora is responsive to incentives. Offering investment options that are tied to development goals could be a winning strategy for the future.

## The Phenomenal Rise in Remittances to India: A Closer Look

Muzaffar A. Chishti

The phenomenal growth of remittances from migrants to their countries of origin has received considerable attention in recent years. In 2006, the World Bank estimated that remittances worldwide reached a new peak of \$268 billion. What has received less attention is that India accounts for close to 10 percent of this global phenomenon.

The Reserve Bank of India (RBI) has reported that Indian migrants transferred \$24.1 billion to India in fiscal year 2005-2006. India, thus, continues to retain its position as the leading recipient of remittances in the world. World Bank estimates for 2005 put India in the lead at \$23.5 billion, with China and Mexico close behind at \$22.4 billion and \$21.7 billion, respectively.

Yet India's dominant position in remittance receipts is a relatively recent one. In 1990-1991, for instance, RBI reported that remittances from overseas Indians were a modest \$2.1 billion. They have risen steadily in the last 15 years, and dramatically in the last 10 (see Figure 1).

The figures rose to \$12.3 billion in 1996-1997, and then jumped to almost \$22 billion in 2003-2004. Between 2000-2001 and 2003-2004, remittances almost doubled. With a small dip in 2004-2005, the 2005-2006 figures RBI reported suggest that the trend is here to stay. RBI figures reflect remittance flows through formal channels. Thus, the

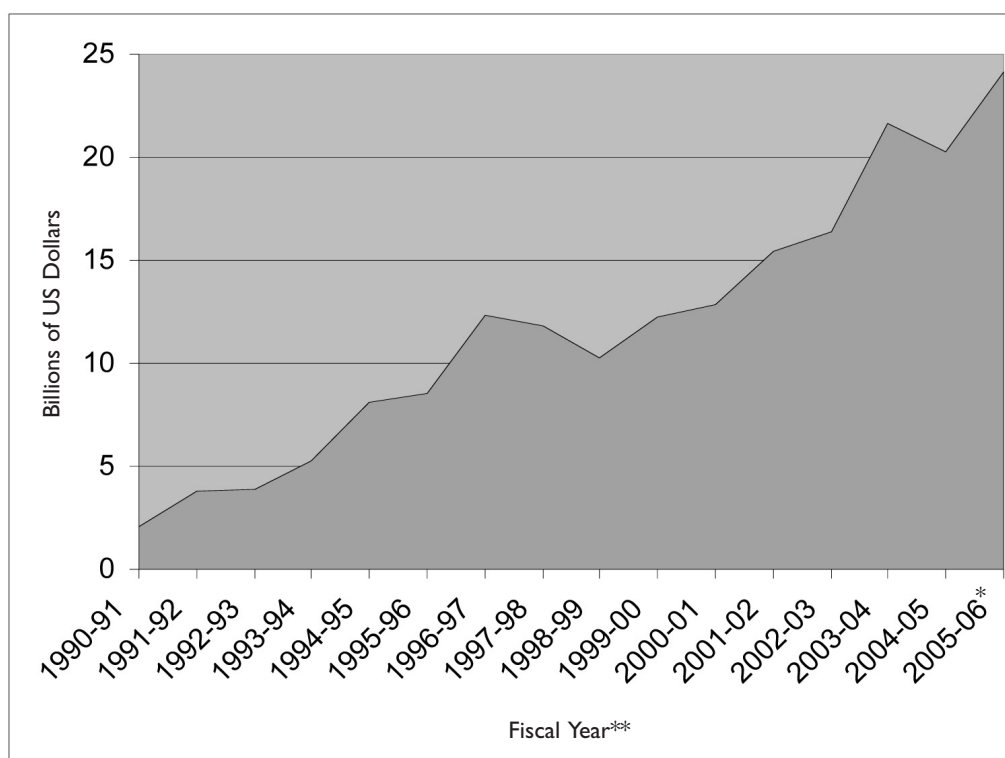
total remittance flow to India may be higher than the RBI reported figures.

This policy brief first explores the relative importance of these remittances in India's economy, then identifies factors responsible for this exponential gain, focusing on the effects of government and commercial bank policies, the profile of recent emigrants, and the strength of the Indian economy.

## Relative Importance of Remittances

It is generally assumed that in a large economy like India's, the impact of remittances is negligible. Compared to some key economic and fiscal indicators, their relative importance is significant.

Figure 1. Remittances to India in Billions of US Dollars, 1990-1991 to 2005-2006



Note: \*Projected amount for 2005-2006.

\*\* In this brief, unless otherwise noted, references to yearly remittances are to fiscal years.

Source: Reserve Bank of India, "Balance of Payment Statistics," *RBI Bulletin* December 1997, January 1999, January 2000, January 2001, December 2002, December 2004, January 2005, February 2006, March 2007.

Today, remittances represent 3.10 percent of the country's GDP — a sharp rise from 0.7 percent in 1990-1991 (see Table 1). In 2005-2006, remittances were higher than the \$23.6 billion in revenues from India's software exports, which is particularly impressive since software exports increased 33 percent that year.

In 2004-2005, the state and federal governments in India combined spent less money on education than India received in remittances (see Table 2), according to the figures available

from India's Ministry of Finance. And, in the same year, combined state and federal government expenditures on health care came to less than half of the remittance flow (see Table 3). The impact of remittances is more pronounced in parts of the country that have experienced higher volumes of emigration. In the southern state of Kerala, which sends a high proportion of emigrants to the Gulf states, remittances constitute 22 percent of the state domestic product. Experts on Kerala's economy found that per capita income in Kerala is much higher than the national figure because of

Table 1. Remittances to India as Percent of GDP, 1990-1991 to 2005-2006

Year	Remittances (US\$ billions)	Percent GDP
1990-1991	2.1	0.7
1995-1996	8.5	3.22
1999-2000	12.07	2.72
2000-2001	12.85	2.84
2001-2002	15.4	3.29
2002-2003	16.39	3.39
2003-2004	21.61	3.69
2004-2005	20.25	3.03
2005-2006	24.10	3.10 (P)

*Note:* (P) notes that a projected GDP value was used in calculation. For the purpose of conversion, it has been assumed that US\$1 = 45 Indian rupees. Figures for years prior to 1999 are shown to indicate trends.

*Sources:* Reserve Bank of India, *RBI Bulletin*, December 1997, December 2004, January 2005, February 2006, March 2007; "Invisibles in India's Balance of Payments," *RBI Bulletin*, November 2006; Reserve Bank of India, "Handbook of Statistics on the Indian Economy 2004-05," September 2006.

**Table 2. Remittances as a Percentage of Total Indian Government Expenditures on Education, 1990-1991 to 2004-2005 (US\$ billions)**

Year	Remittances	Education	Percent of education
1990-1991	2.07	3.8	55.47
1995-1996	8.51	7.19	118.36
2000-2001	12.85	14.9	86.24
2001-2002	15.4	15.13	101.74
2002-2003	16.39	16.11	104.9
2003-2004	21.61	17.95	120.39
2004-2005	20.25	18.97	196.75

*Note:* For the purpose of conversion, it has been assumed that US\$1 = 45 Indian rupees. Figures for years prior to 2000 are shown to indicate trends.

*Sources:* Reserve Bank of India, *RBI Bulletin*, December 1997, December 2004, January 2005, February 2006. Economic Survey 2004-05, Government of India, Ministry of Finance, Economic Division.

**Table 3. Remittances as a Percentage of Total Indian Government Expenditures on Health, 1990-1991 to 2004-2005 (US\$ billions)**

Year	Remittances	Health	Percent of health
1990-1991	2.07	1.62	127.78
1995-1996	8.51	3.14	271.02
2000-2001	12.85	6.21	206.92
2001-2002	15.4	6.35	242.52
2002-2003	16.39	6.99	234.48
2003-2004	21.61	8.19	263.86
2004-2005	20.25	8.97	225.75

*Note:* For the purpose of conversion, it has been assumed that US\$1 = 45 Indian rupees. Figures for years prior to 2000 are shown to indicate trends.

*Sources:* Reserve Bank of India: *RBI Bulletin*, December 1997, December 2004, January 2005, February 2006. Economic Survey 2004-05, Government of India, Ministry of Finance, Economic Division.

remittances. Including remittances, Kerala's per capita income in 2002-2003 was 60 percent higher than the national figure, and 34 percent higher excluding remittances.

## Unpacking Indian Remittances

According to RBI, remittances through formal channels include two flows: inward remittances and local withdrawals from Non-Resident Indian (NRI) deposit accounts. The term NRI popularly refers to members of the Indian diaspora, including Indian citizens living abroad and people of Indian origin.

Inward remittances are direct transfers of funds from one person abroad to another in India, typically through a bank or wire transfer agency. Such transfers are generally understood to provide family support.

Indian banks have established NRI deposit accounts exclusively for NRIs. These deposit schemes, which the government of India authorized in the 1970s, have been used to attract foreign capital when the Indian government felt the need to shore up its foreign-exchange reserves.

To make the accounts attractive, NRI depositors are given the choice of holding deposits in foreign currency denominations or in Indian rupees. Depositors in foreign denominations can "repatriate" (transfer abroad) their principal and interest in foreign currency when they choose. Thus, repatriable deposits are treated like a debt.

On the other hand, RBI treats funds that NRIs locally withdraw from rupee-denominated deposits as remittances; to RBI, these transactions cease to be a liability and assume the form of "unrequited transfers."

The relationship between the two components of the remittance flow is important for understanding the remittance phenomenon in India today. Although private transfers — "total remittances" — as a whole have increased by 88 percent since 2000-2001, inward remittances have only increased by 30 percent (40 percent at its highest since 2000 in 2003-2004).

For the last three years, local withdrawals from NRI deposit accounts have exceeded the amount of inward remittances; the difference was \$2.3 billion in 2005-2006 (see Figure 2).

Local withdrawals exceeded inward remittances in 2003-2004 by a ratio of 1.02:1, in 2004-2005 by a ratio of 1.11:1, and in 2005-2006 by ratio of 1.23:1. Thus, some analysts have argued that India's remittance boom "is largely a massive withdrawal surge."

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To lend further credence to this argument, commentators point to two recent special bond schemes aimed at NRIs.

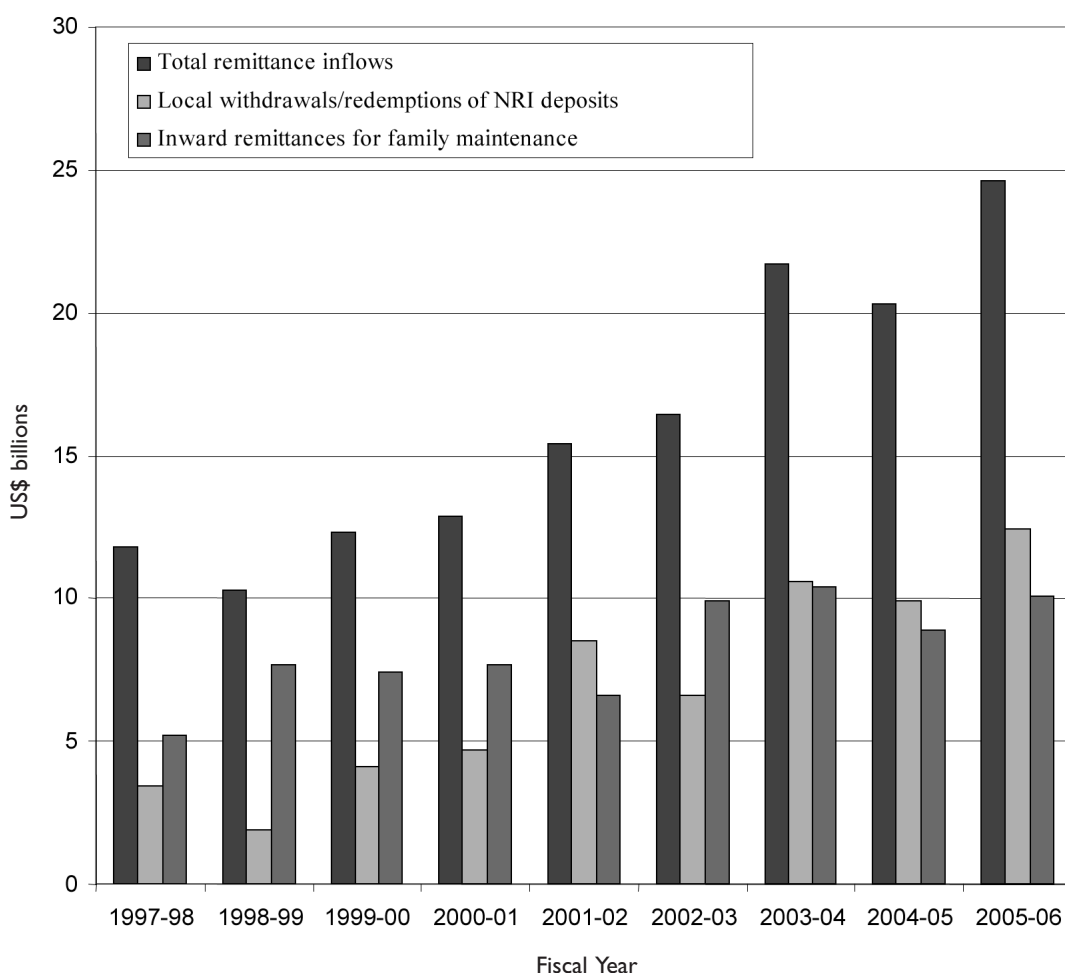
The popular Resurgent India Bonds, launched in 1998, matured in 2003. A sizable portion of the redeemed value of the bonds was retained in India, instead of being repatriated abroad in foreign currency. That retained amount was thus recognized as remittances, resulting in the bulge in 2003-2004.

Similarly, the Millennium India Bonds, issued in 2000, matured at the end of 2005. It is likely that the redemption of those bonds contributed to the remittance surge in 2005-2006.

Evidence, however, suggests that the importance of these redeemed bonds should not be exaggerated. For example, even though the overall amount of private transfers somewhat decreased in 2004-2005, a year in which no

NRI bonds matured, local withdrawals still exceeded inward remittances by \$943 million. Similarly, in 2001-2002, before the recent bond redemptions, withdrawals exceeded inward remittances by \$1.9 billion.

Figure 2. Remittances and Local Withdrawals/Redemptions of NRI Deposits, 1997-1998 to 2005-2006 (US\$ billions)



Sources: Reserve Bank of India, “Handbook of Statistics on the Indian Economy,” September 2006; and “Invisibles in India’s Balance of Payments,” *RBI Bulletin*, November 2006; *RBI Bulletin*, March 2007.

Thus it is clear that the increasing importance of local withdrawals, compared to inward remittances, is a developing pattern, not simply attributable to the maturing of NRI bonds.

## The Policy Context

However significant the ratio between inward remittances and local withdrawals, the fact remains that remittances to India have witnessed a dramatic increase. Yet the Indian government has not affirmatively instituted any policies specifically aimed at increasing the flow of remittances.

India has maintained a sharp distinction between the two forms of financial flows from its migrants: remittances and other capital flows, mostly in the form of repatriable NRI deposits, described above. Historically, the degree of policy engagement toward remittances has been close to minimal. Indian economist Deepak Nayyar has described government policy to sustain or increase remittances as “laissez-passer.”

However, in a series of measures from the 1970s to the present, the government has very closely regulated many aspects of deposit schemes. Policy interventions have focused on attracting deposits: offering higher interest rates than those in the international capital markets; making deposits and interest totally repatriable; and exempting deposits from wealth and gift taxes. In addition to determining interest rates and terms of deposits, policies have also sought to reduce the proportion of foreign currency denomination deposits in the total package of NRI deposits.

While policy has emphasized NRI deposits, it is the remittance component of migrant finan-

cial flows that has been growing at a much higher rate. Remittances in FY 1990-1991 were a modest \$2.069 billion, while the net flow (deposits minus withdrawals) into NRI funds was \$2.136 billion (see Figure 3). In 2005-2006, remittances reached \$24.1 billion, while net flow into the NRI funds was \$2.8 billion. Not only have remittances outpaced NRI deposits, they have proven to be a more stable source of financial flows from migrants abroad as they are less sensitive to economic and other national crises. Therefore, despite the policy focus on NRI deposits, the real success story has been remittances.

*Indian migrants transferred \$24.1 billion to India in fiscal year 2005-2006. India, thus, continues to retain its position as the leading recipient of remittances in the world.*

## Factors Responsible for Remittance Growth

What accounts for the phenomenal rise in remittances? A combination of factors explains the trend, including some important government initiatives that were not aimed at regulating remittances but have had significant impacts on their flow.

India's extensive economic reforms of the early 1990s provide an important context. In 1990, India faced a balance of payments crisis. Its foreign currency assets were depleted to the point of near default, and international confidence in India's economy had eroded. In response, the government instituted a set of structural reforms. The resultant economic liberalization, which began in 1991, has been dubbed by some as “India's second independence.” It gradually ended the state monopoly

on a range of industries, allowed foreign capital in most sectors of the economy, lowered taxes and tariffs, and rolled back currency controls. These reforms accelerated India's integration into the world economy and represented a larger change in the Indian mindset.

### The Diminishing Role of Unofficial Channels

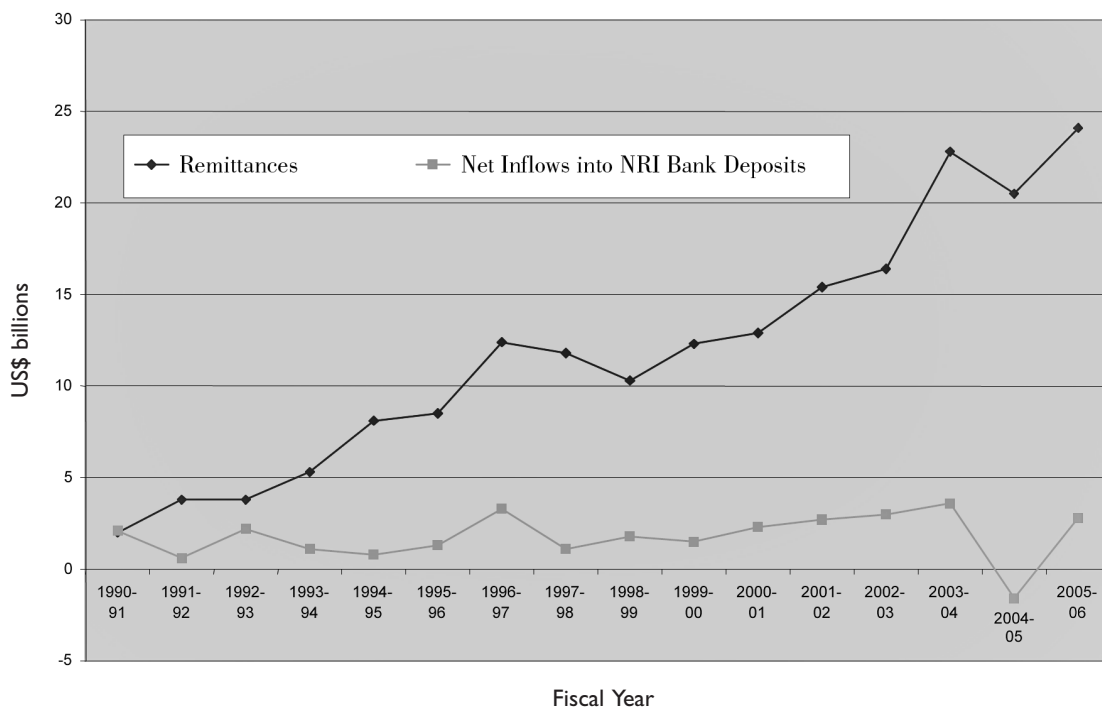
A significant factor contributing to the reported remittance surge is simply the increased use of

official channels for remitting money. Prior to 1993, the government of India strictly regulated the exchange rate of the Indian rupee, creating huge incentives to transfer money through informal, unregulated *hawala* networks.

*Hawala*, a system of money transfer with roots in South Asia, relies less on formal negotiable instruments and more on trust and extensive use of family and business networks.

Frequently, no money physically moves between locations and over time, transactions

Figure 3. Remittances and Net Flows into NRI Bank Deposits, 1990-1991 to 2005-2006 (US\$ billions)



Sources: Reserve Bank of India, "Handbook of Statistics on the Indian Economy," September 2006; and Reserve Bank of India, "Balance of Payment Statistics," *RBI Bulletin*, December 1997, January 1999, January 2000, January 2001, December 2002, December 2004, January 2005, February 2006, March 2007.



in opposite directions cancel each other. The system — which depends on efficient communication between the members of a network of dealers — not only provides quick transfers of money, it also generally pays a premium exchange rate.

*Hawala* networks in India were used because of the advantageous exchange rate as well as to circumvent tight controls on the transfer and possession of gold, a commodity highly valued in India. With the liberalization of gold imports, beginning in 1992, the incentive to employ *hawala* networks diminished. In 1993, the government established a market-based exchange rate, further reducing the appeal of *hawala* networks.

Finally, in the wake of the September 11 attacks, there has been heightened interest in tracking and regulating *Hawala*-type networks, reflecting international concern about the financing of terrorist activity. In the United States, these networks came under the money transfer regulations at the end of 2001, and the government froze the assets of at least one “*hawala* conglomerate.”

## The Declining Emphasis on Foreign Currency

The government of India’s change in exchange-rate policies was followed by a change in exchange-control policies. Before 1991, rigid regulations on the conversion of rupees to foreign currency meant that most NRIs chose to keep their money in repatriable foreign currency.

Liberalization of the exchange regime started in 1992, and the highly criticized Foreign Exchange Control Act (FERA) was repealed in

2000. FERA imposed a strict control system on all transactions in foreign exchange, permitting only a limited number of transactions per year, and fixed the rupee exchange rate. FERA was repealed by the Foreign Exchange Management Act in 2000, which relaxed controls on foreign-exchange transactions.

With the gradual relaxation of exchange controls, NRIs are now less concerned about being able to convert rupees to foreign currency. Consequently, NRIs’ reluctance to place money into rupee accounts is declining.

The numbers from RBI are quite striking. In March 1991, foreign currency-denominated deposits formed 72 percent of total NRI deposits; such deposits constituted only 34.7 percent of total outstanding deposits by March 2005. In addition, NRIs are also withdrawing more money for use or consumption in India, which may partly explain the recent increase in the local withdrawal component of the remittance figures.

## The Shift in Emigration Patterns

If the migration of Indian workers to the Gulf states was the dominant story of the 1970s and the 1980s, the migration of information technology (IT) workers, principally to the United States, has been the trend since the mid-1990s.

Indian migration to the United States doubled in the 1990s, mostly through the use of H-1B temporary worker visas, which allow those in

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specialty occupations to work in the country for up to six years with the possibility of receiving permanent residence. Indian software engineers became an important element of the US IT boom.

Even in the Gulf countries, the number of Indian professional and managerial workers is increasing. Thus, the relative number of Indian professional workers going abroad has been growing.

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This new “class” of high-skilled Indian workers has greater purchasing power as well as more savings potential than lower-skilled workers. The recency of their migration also keeps them more connected to India. Plus, the growth of India’s homegrown

IT services industry has helped foster strong business connections between India and Indian IT professionals abroad.

The change in patterns of emigration has led to a significant shift in the source regions of remittances to India. According to RBI, North America has replaced the Gulf states as the most important source of remittances.

RBI estimates that 44 percent of remittances originate in North America, 24 percent in the Gulf region, and 13 percent in Europe (see Figure 4). In contrast, studies show that in 1990-1991, 40 percent of the remittances came from Gulf countries and 24 percent from North America. Indian banking officials

believe the shift began in the late 1990s, with North America solidifying its dominance in 2002-2003.

While not disputing the shift, other experts caution that the sources of remittances are more diversified than RBI figures recognize. Central banks like RBI tend to attribute money transfers from intermediary banks to the countries where those banks are headquartered. As a result, it is possible to overestimate transfers from the United States.

### More Options for Money Transfers

The rise in remittances, in some measure, reflects the increasing number of formal channels for transmitting money to India. Options for transmitting money to India have also become much more competitive; the field is no longer strictly dominated by traditional transfer agents like Western Union.

A survey of commercial banks conducted by RBI in 2006 indicates that 53 percent of remittances were transmitted by electronic wire/SWIFT, making it the dominant choice of overseas Indians.

Although electronic wires are the fastest means of remitting, they can be expensive: There is a 2.5 to 8 percent fee for amounts less than US\$500 (US\$6 to US\$20 to remit US\$250); the cost drops to 0.7 to 2 percent for transfers between US\$500 and US\$1000 (US\$5 to US\$15 to remit US\$750).

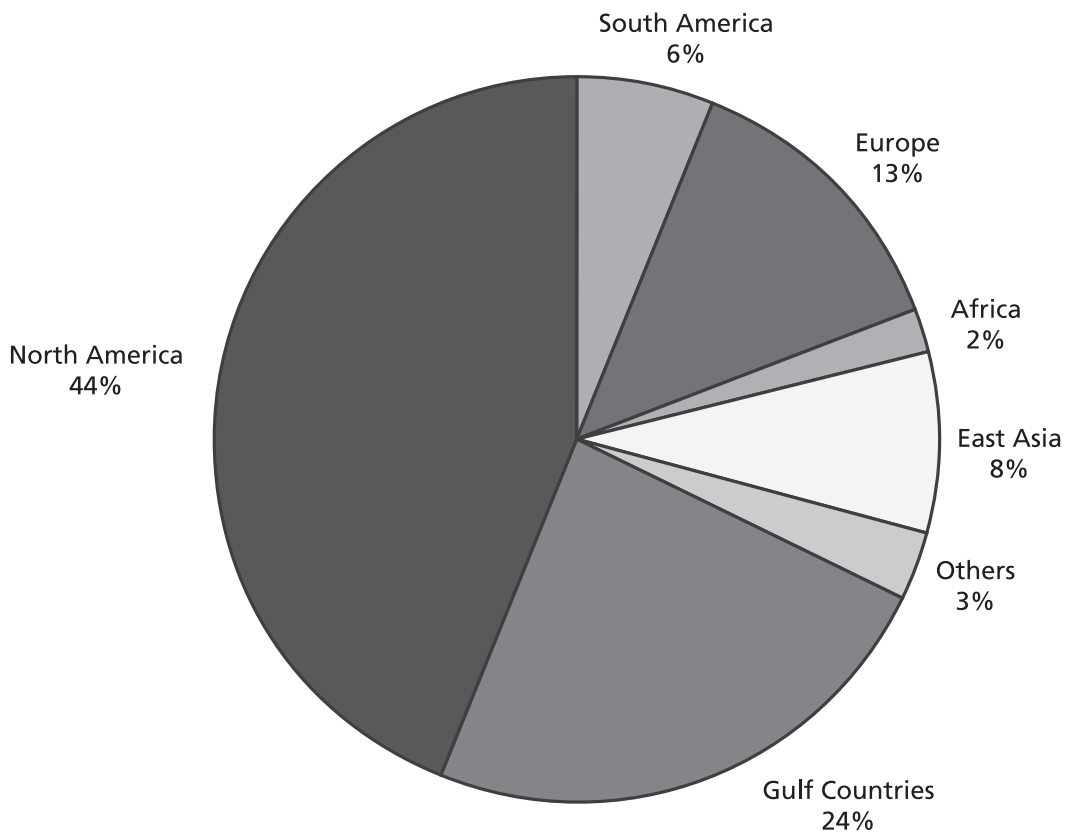
Yet the RBI study indicates that the average size of remittance transfer to India is relatively high. Remittances of \$1,100 and above accounted for 52 percent of the total remit-

tance inflow to India. And within that high remittance category, 63 percent of remittances exceeded \$2,200. Only 30 percent of remittances were for amounts less than \$500. But the system certainly favors the richer end of the remitting spectrum.

For the tech-savvy with Internet access, Internet-based providers have become another

option for remitting money. The popular Remit2India, a collaboration between *The Times of India* and UTI, an Indian bank, led the way in 2001, and others have followed. These services are more convenient and less expensive than conventional methods. For example, Remit2India charges US\$3 to send up to US\$200, while the Bank of India's online system charges a flat rate of US\$8 per transfer.

Figure 4. Source Regions of Remittance Flows to India



Source: Reserve Bank of India, "Invisibles in India's Balance of Payments," *RBI Bulletin*, November 2006.

Western Union is reaching out to the less affluent end of the customer base. It has established an unusual partnership with the Indian Post Office in which the post office's network of 150,000 offices — the largest in the world — provides Western Union potential access to customers in the most remote parts of India.

The global wireless industry is now encouraging the use of mobile phones to remit money,

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especially to those who may not even have a bank account. The GSM Association, in partnership with the State Bank of India, has piloted a project in a small Himalayan village with Airtel, a leading Indian mobile phone company.

India, the world's fastest growing mobile services market, will be an important place to test the reach of this technology.

Lastly, Indian banks, not known for their agility, are now aggressively tapping into the NRI market. Banks like ICICI, the State Bank of India, and the Andhra Bank allow customers who maintain a minimum balance free transfers from a branch abroad to a branch in India. With competition growing at home, Indian banks see the NRI market as relatively virgin territory with strong potential. NRIs, initially attracted by these money-transfer

schemes, are then targeted for other bank products, such as mutual funds, mortgages, and insurance policies.

## Perception of the Indian Economy

The most significant factor in the surge in remittances, ultimately, may be the way NRIs perceive the Indian economy. If the liberalization of the Indian economy in 1991 was a clear benchmark, its real significance has taken time to crystallize.

Until as recently as 2002-2003, "regular" remittances dominated the flow from NRIs. With the Indian economy growing at an average rate of 8 percent per year in the last four years, NRIs now see India as an "investment destination."

Real estate and equity markets are the principal areas of their interest. These sectors, restricted to NRIs in the past, are experiencing a boom. In 2005, for example, real estate experts believe that in Delhi, 20 percent of all properties worth over one *crore* (10 million rupees or about US\$250,000) were bought or funded by NRIs. Even second-generation Indians are buying property in India.

The new-found interest in the real estate and equity markets is another explanation for the increase in local withdrawals in RBI's remittance figures. NRIs may have finally become "investors" rather than "savers."

## Conclusion

India has clearly achieved a large sustained level of remittances. Policy initiatives by the government and banking institutions have achieved two significant results. First, most remittances flow through formal channels. Second, an increasing number of remitters have moved from being pure “savers” to “investors.”

The Indian government has demonstrated its ability to attract NRI capital through NRI deposit accounts and successive bond issues. The challenge is to channel some of these flows for socioeconomic development.

Unfortunately, research and analysis on policies to leverage remittances for development in India are lacking. Compared to the breadth of research on remittances in other countries, little is known about the consumption patterns of Indian remittance recipients: how they vary by region, by socioeconomic class, or by the amount of the remittance. More research is clearly necessary in order to develop enlightened policies to leverage remittances effectively for development in India.

Nevertheless, there are some promising signs. According to media reports, the state of Kerala has floated a new public-private partnership company called Infrastructure Kerala Limited (Inkel) to attract investment from nonresident

Keralites for infrastructure development purposes. It is expected to raise 74 percent of its equity from NRIs and 26 percent from the state government.

The government of India should follow Kerala’s lead and issue bonds targeted for infrastructure development. Similarly, the government should explore bond schemes for investments in the health and education sectors.

If the government and the banking community are strategic, they could offer higher rates of return on remittance receipts placed in specified assets in the domestic capital market. Investing in microfinance operations would be a good place to start, given their success in India.

The Indian diaspora has proven responsive to incentives. Offering investment options that are tied to development goals could be a winning strategy.

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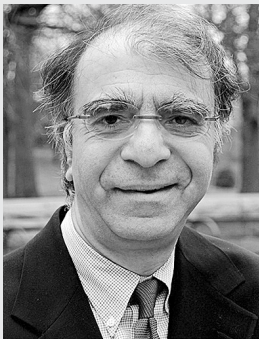
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R. B. Patnaik, adviser, Reserve Bank of India, Mumbai, September 2005.

Jairam Ramesh, member, Indian Parliament, New Delhi, June 2005.

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The Migration Policy Institute (MPI) is an independent, nonpartisan, nonprofit think tank dedicated to the study of the movement of people worldwide. The institute provides analysis, development, and evaluation of migration and refugee policies at the local, national, and international levels. It aims to meet the rising demand for pragmatic responses to the challenges and opportunities that migration presents in an ever more integrated world. MPI produces the Migration Information Source at [www.migrationinformation.org](http://www.migrationinformation.org).

This policy brief is the second in a series from MPI's Program on Migrants, Migration, and Development. Other reports in the series address circular migration, the policy gap between migration and development strategies, and an analysis of the Overseas Workers' Welfare Administration in the Philippines. Previous publications of the program include:

- "Circular Migration and Development: Trends, Policy Routes, and Ways Forward" by Dovelyn Rannveig Agunias and Kathleen Newland, April 2007.
- "Remittances and Development: Trends, Impacts, and Policy Options: A Review of the Literature" by Dovelyn Rannveig Agunias, September 2006.
- "From Zero-Sum to a Win-Win Scenario: A Literature Review on Circular Migration" by Dovelyn Rannveig Agunias, September 2006.
- "Beyond Remittances: The Role of Diaspora in Poverty Reduction in the Their Countries of Origin." A Scoping Study by Kathleen Newland with Erin Patrick for the Department of International Development, UK, July 2004.
- *Special Issue on Migration and Development*. Migration Information Source. February 2007. Online at: <http://www.migrationinformation.org/development.cfm>.

MPI's work on Migrants, Migration, and Development can be accessed at [http://www.migrationpolicy.org/research/migration\\_development.php](http://www.migrationpolicy.org/research/migration_development.php). It is made possible by the generous support of the John D. and Catherine T. MacArthur Foundation, and by a grant from the Multilateral Investment Fund of the Inter-American Development Bank.

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