MIGRATION POLICY INSTITUTE

# REMITTANCES AND DEVELOPMENT

## Trends, Impacts, and Policy Options

*A Review of the Literature*

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# Introduction

Previously confined to everyday conversations among migrants and their families, remittances are now on the minds and agendas of most governments, members of the civil society, the international community at large, and, to some extent, even the private sector. In spite of this surging interest in remittances, however, a close review of the current academic and policy literature still suggests a yawning gap in terms of what is known and what could and should be done.

The continued deficiency in our understanding of some of the fundamental aspects of remittances is quite evident in the current literature. Outside of Latin America and some key countries in Asia, what can arguably be considered "basic" questions such as who sends and receives remittances, how much is remitted and received, and how remittance channels actually work on the ground have yet to be answered adequately.

Instead, this review finds that the bulk of the literature has focused more on the impact of remittances on development, particularly their impact on the economy of developing countries. Recent studies have pointed to remittances' generally positive impact on human capital formation, investments, poverty, and macro-economic stability. Although some issues remain highly contested, foremost of which are remittances' effect or lack thereof on growth, inequality, exchange rate, and inflation, by and large, the tone of the economic literature on remittances especially in the last five years or so has never been more optimistic.

There is also a relatively small yet burgeoning literature that considers the impact of remittances on the society and politics of developing countries. Given that development involves not merely economic growth but also social and political transformation, these studies have deepened the current discourse. They have shown that the acts of sending and receiving remittances also hold social and political ramifications at all levels—individual, household, and state—and in both positive and negative ways.

Overall, in light of the rather complex interaction of the economic, social, and political implications of remittances, the literature suggests that ultimately the net impact of remittances on development will still vary from context to context and even affect our understanding of what development entails in the first place. Moreover, remittances' impact will depend on the policies key stakeholders, particularly governments, are willing to adopt.

This review finds two broad policy trends: (1) an increasing consensus on the need to strengthen the infrastructure supporting remittances by reducing transactions costs, addressing challenges at the distribution stage of remittance transactions or the so-called last mile, and facilitating the transfer from informal to formal systems; and (2) a renewed focus on leveraging remittance use for development with, however, a more bottom-up and/or private sector-led approach.

Unfortunately, the effectiveness and applicability of most of these initiatives and recommendations remain unclear. For one, the policy literature on remittances is still mostly descriptive. Evaluations are non-existent, incomplete or unavailable for public consumption. Beyond that, however, a realization that the effectiveness of these policies is still very much conditioned by the investment climate in remittance-receiving countries, migration policies at both ends, and the degree of policy dialogue and coherence among and within governments has emerged.

This review will be divided in four sections. The first section will lay the groundwork with a discussion of how much we really know about remittances at this point. Sub-divided in two parts, this section will first focus on the remittance flows themselves, particularly their magnitude and direction and will then proceed with a discussion of the people behind these financial flows. Basic questions such as who sends and receives remittances, how much is remitted, how are remittances sent, and why migrants remit will be explored. The second section will then delve into the ongoing debate on the impact of remittances on development. It will go beyond a discussion of economic impacts and will also include a consideration of the political and social implications of remittances. After the discussion of impacts, the third section will then focus on the existing policy initiatives and current recommendations on the table. The paper then concludes with a discussion of the challenges facing the current literature and a set of recommendations for future research.

## I. BACK TO THE BASICS

In spite of the surging interest in remittances, a number of "basic" questions have yet to be systematically and adequately explored. The continued deficiency in our understanding of some of the fundamental aspects of remittances is evident in the current literature. The true magnitude and direction of remittance flows remains largely unknown and profiles of remittance senders and receivers and the channels in which they operate are still largely undocumented outside of Latin America and some key countries in Asia. In fact, most of our understanding of remittances, particularly of senders, receivers, and remittance channels are still principally informed by studies from Latin America and the Caribbean (LAC) mostly commissioned by the Inter-American Development Bank (IDB).

## A. Remittance Flows: Magnitude and Direction

While figures vary by source and assumptions, most studies on the magnitude and direction of remittance flows usually arrive at two key observations. First, remittances are considered substantial and increasingly important sources of external finance that are growing not only nominally but also relatively in relation to other transfers to developing countries.[1] Second, even though high-income countries remain the dominant sources of remittances, a non-negligible portion originate from developing countries.

2005 estimates by the World Bank put the official figure of remittances to developing countries at $167 billion,[2] a 73 percent increase from the 2001 figure of 72.3 billion.[3] India topped the list in 2005 with a "spectacular" reported remittance flow increase of $18 billion and is followed closely by China, Mexico, and the Philippines.[4] The World Bank highlights how remittances more than doubled in the past decade with the quantity of remittances going to developing countries doubling in the past five years.[5] Even Sub-Saharan Africa, long at the bottom in terms of remittance receipts, officially registered almost US$ 8.1 billion in remittances in 2005, a 72 percent increase from the 2001 figure of US$ 4.7 billion.

As can be expected, the dominant sources of these global remittance flows are high-income countries, particularly the United States, which recorded almost US $39 billion in outward remittances in 2004.[6] Saudi Arabia used to be the largest source of remittance payments in the world up until the mid-1990s, and it still is the largest source on a per capita basis. Germany, Belgium, and Switzerland are the other top sources cited by the World Bank.[7]

Not surprisingly, the US – Mexico corridor registered the largest remittance flow.[8] Other large flows originate in Saudi Arabia and go to Asian and Arab countries and from the United States to China, the Philippines, India, and Vietnam.

A good proportion of remittance flows also originate in developing countries. The World Bank notes that these so-called South - South remittance flows make up between 30 and 45 percent of total remittances received by developing countries. In fact, remittance flows to poor countries actually originate largely in the middle-income developing countries.[9] China, Malaysia, and the Russian Federation, for example, are among the top 20 sources of remittances. This, according to Ratha, reflects the fact that over half of migrants from developing countries migrate to other developing countries.[10]

Other studies confirm this trend. Carling notes that about one-third of global remittances are estimated to flow between Asian countries with the world's third largest flow of remittances going from Malaysia to Indonesia.[11] African countries also receive more remittances from elsewhere in Africa than they do from other continents. This is particularly true in Sub-Saharan Africa since the inflows from Europe and Asia are concentrated to North Africa. Carling particularly finds Côte d'Ivoire and Angola as important source of remittances, in addition to South Africa.[12] Similarly, Fagen and Bump, looking into Latin America and Caribbean, noted that of the estimated US $32 billion in total remittances in 2002, US $1.5 billion were actually interregional.[13] Another study of migration flows between Costa Rica and Nicaragua also suggests that about one-third of remittances received in Nicaragua are sent from Costa Rica.[14]

## 1. Official Estimates: Challenges

These numbers, however, should be interpreted with caution for two primary reasons. First, these official estimates do not take into account remittances flowing through informal channels, such as those hand carried by migrants on visits home. Second, and even more importantly, there are some known problems in the official data themselves that weaken their credibility.

### 1.1 Unknown Informal Flows

Official estimates do not capture payments made through informal, unrecorded channels. Currently, the extent of these unrecorded flows remains unclear. In fact, the current literature is littered with estimates and guesses about the magnitude of these flows ranging from a third and in some cases, to almost 250 percent of remittance flows.[15] O'Neill, for example, noted that global "parallel transfers" might be between two and ten times greater than officially reported flows while Sanders noted that "informal remittances" are 1.5 times the value of formal remittances.[16] A recent and comprehensive study by El Qorchi, Maimbo, and Wilson even noted a decline in informal remittance flows over the past decades, from 50-60 percent in the late 1980s to around 20 percent in the late 1990s.[17]

Studies looking at specific countries and regions, however, suggest an emerging trend: Countries with weaker financial systems and/or higher intra-regional migration tend to have higher informal flows. Sander and Maimbo, for example, highlighted the case of Sudan wherein informal remittances are estimated to account for 85 percent of total remittance receipts.[18] Likewise, France's report to the European Commission stated that 70 percent of remittances to Mali and Senegal move in informal channels as well as the majority of remittances to the Comoros.[19] Ratha further noted that although not reflected in the official data, outward remittances from India and South Africa are also believed to be large.[20]

A 2003 International Monetary Fund study simulated unrecorded transfers to 15 developing countries that have high rates of out-migration and a history of parallel exchange markets and finds that 40 percent of total remittances were conveyed through informal channels. Considerable variation, however, exists between countries. Informal flows to Algeria, Bangladesh, Iran, Pakistan, Sudan, and Tanzania account for more than half of total remittances while India, the Philippines, and Turkey registered less informal flows.[21] A particularly interesting case is Nepal wherein 90 percent of remittance flows are believed to be unrecorded.[22]

More recently, Freund and Spatafora interpret insights from the literature on shadow economies to empirically estimate informal remittances for more than 100 countries. Using historical data on workers' remittances from the Balance of Payments (BOP), as well as data on migration, transaction costs, and various country characteristics, they find that informal remittances amount to about 35–75 percent of official remittances to developing countries. Akin to the results of the IMF study, Freund and Spatafora also find significant regional variation. Informal remittances to East Asia and the Pacific are relatively low and have been shrinking compared to the rather "extreme" informality in Sub-Saharan Africa, Eastern Europe, and Central Asia.[23]

For Freund and Spatafora, formal channels are utilized mostly in countries with well-functioning financial systems. In some countries with large exchange-rate spreads however, the informal sector may be much larger.[24] Lucas agreed noting that the relative portion of funds passing through informal channels is greater where the black market premium on foreign exchange is higher.[25]

1.2 Partial Formal Flows

The accuracy of current official estimates is weakened further by some problems in the official remittance data themselves, two of which have been noted in the literature. First, according to the World Bank, several countries with significant emigrant populations do not report official data on remittances at all.[26] In fact, many countries have incomplete statistics thus affecting remittance statistics for entire regions or income-level country groups.[27]

For example, Carling noted that out of the 208 economies surveyed by the World Bank, almost half reported no data on inward workers' remittances from 1992-2001 and only a quarter reported data each year. In fact, 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 ten-year period.[28]

This observation is particularly true in countries suffering from severe political instability. An excellent case in point is Somalia. Since no balance of payments data were submitted to the International Monetary Fund, remittances to Somalia do not figure in official estimates of Sub-Saharan Africa. Some authorities, however, estimated that 25 percent of all families in Somalia receive remittances from abroad, while others put the figure as high as 40 percent.[29] According to Montclos and Kagwanja, Somalia receives an estimated US $120 million annually[30] while the Knight, Peat, Marwick Group noted estimates of up to US $1 billion per year.[31] In studies of Somaliland alone, estimates from year 2000 range from US$ 4 million to US $500 million in annual remittances.[32]

Second, even in countries that managed to report official flows to the IMF, the data could be less reliable than desired due to some technical problems in the data collection. The World Bank, for example, noted that reports from banks or money transfer companies often lack the details required to distinguish remittances from other kinds of transfers.[33] Thus, as the World Bank's recent survey of 40 central banks in developing countries revealed, the balance of payment statistics frequently do not cover remittances paid directly by non-bank financial institutions such as money transfer companies, exchange bureaus, credit unions, and post offices.[34]

Specifically, the study finds that in the 20 of 40 countries surveyed, exchange bureaus, credit unions, and other non-bank financial institutions pay remittances, but only 65 percent collect remittance data from those institutions. Even more striking is the finding that in 39 of 40 countries, money transfer companies pay remittances, but only 38 percent of central banks collect data from them. Likewise, post offices pay remittances in 26 of 40 countries, but only 35 percent of those countries collect remittances from post offices. What is even more troubling is that although commercial banks participate in the payment of remittances in all 40 countries surveyed, two countries do not collect remittance data from commercial banks at all.[35]

Another source of technical difficulty is the one-year residency rule in the balance of payments framework that requires migrants to be classified either as residents or nonresidents. This, as the World Bank emphasizes, is often difficult to apply in practice. The model-based estimation methods some countries have developed to counter this problem require good demographic and labor statistics and information on remittances from household surveys which, unfortunately, most developing countries do not have.[36]

Given the perceived importance of remittances in development, countries and international agencies have acknowledged this lack of knowledge and have started working together to improve statistics on remittances and migration. Recently, the World Bank, the IMF, and the United Nations launched a new initiative aimed at providing a practical definition of remittances for the collection of aggregate statistics. It will also utilize knowledge and experiences of countries in the development of guidelines for cost-effective data collection and estimation.[37]

## B. Behind Remittance Flows: Profiles of Remitters, Senders, and Remittance Channels

Given the difficulty in capturing the magnitude and direction of remittance flows, it should not be surprising that even less is known about the people behind these flows. Although a number of studies have dealt with the question of why migrants remit, relatively few have sought to answer more basic questions such as who remits and receives remittances in the first place and through what channels. Interestingly, a number of studies have profiled immigrants and not remitters. Since not all migrants remit, the two groups might be the same in some instances but not all.

Indeed, outside of Latin America and some key countries in Asia, detailed studies profiling remittance senders and receivers and describing the channels they use remain few and far between. Although there are studies of this nature in other regions, such as the World Bank's recently concluded studies on the Serbia - Germany and Italy - Albania remittance corridors, the levels of documentation and analysis have yet to parallel the numerous studies already conducted in Latin America.

In fact, most of what we know on this issue is still largely informed by the findings in the LAC. Given the unique circumstances surrounding Latin American migration, it is not clear how indicative the results of these studies are in describing other remittance corridors. Indeed, even studies within Latin America revealed quite different "demographic snapshots" of remitters depending on their country of destination. This may indeed suggest a high degree of variability in terms of remitter profiles across countries and regions.

## 1. Who Remits?: Latino Remitters in Perspective

A series of studies, mostly funded by the Inter-American Development Bank, reveal different profiles of remitters depending on their country of destination. Surveys revealed that Latino remitters in the United States are in general newly arrived, young Mexican men with low incomes, low education levels, and low levels of financial literacy. Studies of Latino remitters in Japan and those in other Latin American countries, on the other hand, revealed quite different profiles with the former benefiting more financially from migration than the latter.

### 1.1 Latino Remitters in the United States

*Undocumented Mexican Men with Low Incomes and Low Educational Levels*

Bendixen and Onge find that the majority of remitters in the United States are Mexican men with low incomes and low education levels.[38] Their findings parallel Ibarraran and Lubotsky's study of the 2000 Mexican Census.[39] Not surprisingly, Bendixen and Onge also find that about 42 percent of remitters are undocumented.[40]

*Young*

The 2002 National Survey of Latinos further revealed that remittance senders tend to be young; those who immigrated at the age of 20 or below have the highest propensity to remit. Suro emphasized that people with this profile send money to either parents or spouses and considered remitting to be a "sacred and intensely emotional duty."[41]

*Newly Arrived*

Recent studies by the Pew Hispanic Center (PHC) and the Multilateral Investment Fund (MIF) of the IDB also find that remittance senders are not evenly distributed across the population but tend to be concentrated among more recently arrived immigrants. At least half of all Latino immigrants who have been in the United States for ten years or less regularly send money home. The study further finds that even though almost a quarter of those who have been away for 20-30 years still send remittances, the tendency to remit generally drops off over time.[42]

In Mexico, for example, Suro noted families with members abroad for five years or less are twice as likely to receive remittances on a regular basis as families with relatives who have been abroad for longer periods.[43] Surveys conducted by Bendixen and Onge also reflect the same findings. They find that the amount and frequency of each remittance decrease once an immigrant has been in the United Stated for more than ten years.[44]

These findings sit well with the current thinking on remittances. As Carling notes, it is generally believed that the remittances of individual migrants tend to decline over time. He cites some studies of survey data showing a clear drop in average remittances after five to ten years, while others have shown a rise during the first years followed by a slow decline. He writes:

> Although some emigrants continue to remit money to their countries of origin after several decades, at the level of the community, however, a process of maturing takes place in which the first generation migrants constitute a gradually smaller share of the community, and that those who have lived in the country of origin as adults eventually become a small minority.[45]

This tendency, Carling warned, can lead to a decline in remittance flows.[46]

*Low Financial Literacy*

The PHC and Kaiser Family Foundation 2002 National Survey of Latinos also revealed low financial literacy among remitters. They find that 43 percent of respondents did not have a bank account and 55 percent did not have credit cards. Of those interviewed in-depth, they find that a large majority do not use checking accounts or credit or debit cards.[47] Suro noted the widespread perception among Latino remittance senders that "bank accounts are not for lower-income people and that they charge too much for the services they do deliver."[48]

For Bendixen and Onge, these results are indeed "surprising." They write:

> … these people, who are poorer than most in the United States and who have fairly low levels of formal education, manage collectively to send

> some $30 billion to their family members in Latin America a year in recent years. … This is a remarkable accomplishment, especially given that the average American saves only about 1.2 percent of his or her annual income."[49]

### 1.2 Latin Americans in Japan and in Other Latin American Countries: Two Ends of the Spectrum

Recent studies on Latin Americans living in Japan and in other Latin American countries, on the other hand, reveal quite different demographic snapshots of remitters.

In Japan, Bendixen and Onge find that the majority of Latin American remitters come from Brazil. Contrary to their counterparts in the United States, about 90 percent have a bank account in Japan, and more than half have bank accounts in their home country.[50] The level of education of these migrants is also considerably higher than for other Latin American migrants in other parts of the world. Almost 85 percent of Latino remitters in Japan have more than a high school diploma, compared to only 17 percent for Latin Americans migrants in the United States. What is even more striking is that the average income of Latin American remitters in Japan is almost US $50,000 a year, approximately two times the average income of migrants working in the United States [51] and comparable to the average income of a typical household in Japan.[52]

On the other hand, the profile of remitters from other Latin American countries is almost the exact opposite of their Japanese counterparts. Fagen and Bump's case studies of Nicaraguans remitting from Costa Rica, Haitians remitting from the Dominican Republic, and Bolivians sending money home from Argentina revealed that these interregional remitters are actually less educated and less skilled than their US counterparts. They are also more likely to come from rural areas and are subjected to a higher level of insecurity. Not surprisingly, they find a lower level of participation of banks and formal financial institutions in these south-south cases.[53]

The implication of Fagen and Bump's observations is stark. If remittances are to make a greater dent in poverty and have an impact on the poorest of the poor, then the focus should not only be confined to migrants in developed countries but also to the South - South migrants who are more likely than not to come from the poorer sections of the migrant-sending society.

## 2. Who Receives Remittances?

Current studies of remittance receivers, on the other hand, reveal quite similar demographic patterns irrespective of where the remittance is coming from. Studies by Bendixen and Onge reveal similar demographic patterns among remittance recipients in

LAC.[54] Recipients in Latin America are mostly women. In Brazil, Mexico, and Ecuador, for example, women make up over 60 percent of remittance receivers.[55]

Even more interestingly, recipients also generally belong to the lower middle-income households. The PHC and MIF studies find that a “significant proportion of adults receive remittances from a family member living abroad.” For Suro, this “dispels the perception that this phenomenon is concentrated among the very poor.” In Mexico, for example, remittance receivers have practically equivalent distribution of monthly incomes and educational attainment as the overall population.[56] Orozco agrees, noting that most recipients belong to the lower middle-income households.[57]

Interestingly, studies from other countries, such as the Philippines and Somalia, reflect the same observations. Go’s analysis of the 1997 Family Income and Expenditure Survey (FIES) and the Surveys on Overseas Filipinos (SOF) revealed that the poorer segments of Philippine society "have been largely excluded from the opportunities provided by migration." Go finds that the “percentages of families at the lower end of the income groups receiving income from abroad tend to be higher in the urban areas than in the rural areas.” This same conclusion also applies to the 1988, 1991, and 1994 FIES.[58]

In fact, migrants come from regions with the lowest poverty incidence such as the National Capital Region, Central Luzon, and Southern Tagalog. Mindanao, which accounts for 20 percent of the total Philippine population, has the highest level of poverty incidence (44.6 percent) and accounts for only 12.3 percent of the country's total overseas workers.[59]

Likewise, a recent study of the food economy of households in Hargeisa in Somalia finds that the “very poor” and “poor” households “have no direct access to remittances from abroad but rely on begging and on gifts from members of their immediate and extended families.” Most of the remittances go to the “better off” and “middle group” households.[60] Indeed, similar to the Philippines, most financial remittances flow to the cities and the middle classes. Hansen writes:

> This pattern is closely linked to patterns of migration and, thus, the socio-economic composition of the Somali diaspora. … This means that only families who already have access to financial resources are able to establish themselves in the West and send remittances from there. Poorer families may not have access to the resources needed to travel even within their own area.[61]

### 3. How Much Is Remitted and Received?

The amounts remitted and received have been found to vary. Recent studies on Latin America, for example, find that most remitters dispatch between $100 and $300 at a time. Bendixen and Onge further note that on average, remitters send approximately 12 percent of their income to their families.[62] A study in Bangladesh, on the other hand, finds a much larger proportion at more than 40 percent of their income.[63]

A number of factors determine the amount of remittances. For example, Brière et al., using Dominican data, find that migrants' destination, gender, and household composition are crucial factors in determining the magnitude of remittances.[64] Durand et al., on the other hand, cited the migrant's wage and job situation, the number of dependents at home, marital status, and age of the migrant as crucial determinants of the amount of remittances.[65] Several microeconomic studies also indicate that the education and the income level of the migrant and his family are the main determinants of the amount of remittances.

A recent study by Orozco et al. suggests that the most important factor behind the amount of monies remitted is actually the recipient. For example, the average amount remitted to a spouse is 44 percent greater than the amount sent to other persons.[66] They also find that having a bank account increases the amount remitted by about 9 percent. In particular, individuals with savings accounts remit nearly one-quarter more dollars, suggesting that financial capacity increases remitting. For Orozco et al., "these markers of integration into the US financial market … are not in conflict with remitting."[67] They continue:

> The fact that US banking behavior appears to be associated with increased remittances suggests that there does not need to be a conflict between investment in financial health in the United States and the support of family abroad.[68]

Orozco et al. also observe an interesting correlation between the number of phone calls between remitters and receivers and the monetary amount remitted. For every ten additional phone calls, the amount of remittances increased by about 4 percent.[69]

Three factors, however, have been widely discussed in the literature—educational level, length of stay in the host country, and gender.

*Educational Level*

A recent study by Faini finds that remittances decline as the share of migrants with a tertiary education goes up.[70] Likewise, rough calculations indicate that Moroccans in the United States remit somewhat less per person than do Moroccans in Europe, despite the very high educational qualifications of Moroccans in the United States.[71] Jellal's study on Tunisia, also finds that the percentage of a migrant's income remitted is negatively correlated with skill level of the migrant.[72] In India, Lucas noted that remittances per migrant may have been approximately comparable from the Gulf and from the United States, despite the much higher education and income levels of those in the United States. [73]

Interestingly, Rodriguez, looking into the Philippines, finds that the amount remitted and the portion of overseas earnings remitted rise with education level of the migrant up through college, but then decline slightly among university-educated migrants. [74]

What accounts for the lower tendency of more educated migrants to remit is still unclear. This could be related to the immigration policies of most receiving countries that allow educated migrants to bring their families.

*Length of Stay in Host Country*

The generational patterns of remittances vary as well. Anecdotal evidence on Mexico as well as Ethiopia suggests that remittances drop off the longer the emigrant has been abroad.[75] A study of Turkish migration and remittances, on the other hand, showed that growth in migrant population and family unification did not reduce remittance flows. In fact, average remittances per worker even more than doubled between 1973 ($1,609) and 1999 ($3,837) despite the fact that there was little new primary migration.[76]

More recently, Orozco et al. also find that every additional year a typical migrant lives in the United States, remittances decline by 2 percent. However, they also find that each year the typical person has been remitting increases the amount remitted by about 8 percent. Orozco et al. conclude that “these are not really conflicting findings.” They explain:

> The over-riding tendency, supported by many other analyses, is for integration to reduce remitting. Yet, for those committed to remitting, the amount remitted increases with successive years, up to a point, mirroring in a way the relationship between aging and remitting.[77]

*Gender*

Carling emphasizes that the sending and receiving of remittances also takes place within the context of certain gender relations.[78] Orozco et al., for example, find that in Latin America, females remit about 9 percent less than males,[79] an observation likewise shared by Rodriguez’s study of the Philippines.[80] Women’s lower earnings, relative to men, may explain this deficit. Carling, for example, notes that women migrants may possibly remit a higher proportion of their earnings than male migrants even though they earn less.[81] Indeed, Rodriguez finds that women contract workers from the Philippines remit a higher portion of their earnings.[82]

*How Much Is Received?*
In most receiving countries in the LAC, remittances account for a significant portion of the average recipient's annual income, which ranges from 18 percent in Ecuador to as high as 43 percent in Brazil.[83] A study by the Refugee and Migratory Movements Research Unit of Bangladesh, on the other hand, finds that remittances among Bangladeshi rural households account for almost 51 percent of their total household income.[84] Studies in Nepal also indicate that, in some areas, households may rely on remittances for significantly more than one-half of their total household income.[85]

Studies in the LAC find that the amount of remittances received increases with the age of receivers and decreases with the recipient's education. A 4 percent increase in the amount of remittances received is associated with each year of the receiver's age. Each year of education, however, reduces the amount received by about 3 percent. Orozco et al. note that this "finding reinforces the more general observation that well-educated persons are least likely to be involved in the remittance phenomenon."[86]

Go also finds that families from the higher income groups "also receive larger proportions of income from abroad than the lower income groups." In marked contrast, Go finds that "the lower income groups derive the largest part of their income from domestic resources." This set of data lead Go to conclude that the "poorer segment of Philippine society has been largely excluded from the opportunities provided by migration."[87]

### 4. How Are Remittances Sent?

A number of scholars emphasize the rather large number of different transfer mechanisms to send monetary remittances.[88] Remittance channels cover a wide spectrum, ranging from formal services such as banks, money transfer operators, currency bureaus, and post offices to informal transfer services such as via bus drivers, couriers, and unregistered money transfer businesses.[89]

It is interesting to note, however, that very few studies examine these channels very closely and with a particular country-based focus. In fact, similar to our understanding of remittance sender and receiver profiles, most of what is know on remittance channels is largely informed by a series of studies looking at the LAC - US remittance corridor, particularly that of Mexico – United States. Recently, however, the World Bank, recognizing the current dearth of data on other parts of the world, released the preliminary results of studies on the Italy - Albania and the Serbia - Germany remittance corridors and is currently planning to initiate 15 more similar studies on other parts of the world.[90]

In the case of LAC, money-transfer service businesses (MSBs) such as Western Union and Money Gram are still widely popular, with 70 percent of senders reporting that they have used such firms.[91] A study by Bendixen and Onge also finds that US senders, particularly Dominicans, Colombians, Guatemalans, Ecuadorians, and Hondurans, rely on MSBs. Quite interestingly, Brazilians were found to be more likely to use the banking systems relative to other Latin American groups.[92]

LAC migrants' heavy reliance on MSBs has clearly signaled the shift toward the use of formal channels. A World Bank study on the Guatemala - US remittance corridor, for example, reveals that only 5 percent of remittances are transmitted through informal channels and a large proportion goes through MSBs, particularly Western Union and King Express.[93] The Encuesta sobre Migración Frontera Norte de México (EMIF) confirmed this observation and noted a modest decline in the proportion of workers remitting via informal means. Their 1999-2000 survey revealed that slightly less than 12 percent remit via informal means compared to 15 percent only six years earlier.[94]

The shift toward formal channels, however, is far from complete. Suro notes that a sizable proportion (17 percent) of remitters still uses informal means such as the mail.[95] Even more importantly, only 11 percent of senders reported using banks. Interestingly, Suro further notes that that even among those with bank accounts, relatively few use banks to send remittances.[96]

Indeed, a survey of 1,000 Latin American immigrants in the United States conducted by the IDB produces roughly the same results. It finds that only 20 percent of Latinos in the United States use the money-transfer service of banks or credit unions while an "astonishing" 29 percent remitted through the mail as well as through voluntary services of people traveling to the destination area.[97]

The Japan - Latin America remittance corridor proved an exception. Unlike remittance transactions from the United States, remittances from Japan are mainly sent through banks via "account-to-account" transfers rather than "cash-to-cash."[98] This led the MIF to conclude that "the Japan to Latin America remittance market is the model for much of the rest of the world."[99] However, given the unique circumstances surrounding Latin American migration to Japan, it is unclear whether this is truly the case. (See Box 1: Japan - Latin America Remittance Corridor: A Model or A Unique Case?)

Not surprisingly, results of studies on other remittance corridors vary. A recent market survey sponsored by the Asian Development Bank, for example, finds that in the Philippines, about 80 percent of respondents remit regularly through banking channels,[100] a finding that is consistent with studies on informal flows mentioned earlier. On the other hand, the World Bank study of the Italy - Albania and Serbia - Germany remittance corridors reveal the continued dominance of informal transfers.[101]

**_Box 1: The Japan - Latin America Remittance Corridor:_**
**_A Model or Unique Case?_**

The figures coming from an IDB-sponsored study on the Japan - Latin America remittance corridor are quite impressive. Latin Americans in Japan not only send more money with each transaction, they remit with a greater frequency compared to senders in the United States.[102] Remitters to Latin America from Japan also send almost 20 percent of their earnings, a level that is about twice that of migrant workers in the United States. Moreover, 30 percent of these remitters send money to more than one relative, a much higher average than other countries.[103]

The IDB also finds that a high percentage of Latin Americans working in Japan have plans to start their own business in the future. An unsurprising finding given that almost 85 percent of remitters reportedly save a significant part of their earnings.[104] At only 3 percent, the transaction costs of sending remittances from Japan are also the lowest to Latin America and perhaps the lowest in the world.[105] Thus, the MIF concluded that "the Japan to Latin America remittance market is the model for much of the rest of the world."[106]

A closer look at the migration flow to Japan, however, supports the idea that the Japan case might be "unique." Latin Americans in Japan are actually first, second, or third generation descendants of Japanese emigrants to Latin America, holding a special work permit that allows them to enter Japan rather easily and stay, albeit on a temporary basis. Not surprisingly, the majority are working legally in Japan. They also have a relatively small population and are comprised mostly of educated Brazilians.

Given these "unique" circumstances, it is unclear whether the Japan - LAC corridor is instructive for other remittance corridors, particularly the US - LAC. The differences in the population and conditions surrounding their stay might suggest quite different policy implications.

*Irrational Remitters?*

Given the still heavy reliance on informal and "ostensible riskier modes" of transmission in Latin America as well as in other parts of the world, Pozo explores the question of whether remitters are acting in irrational manner. For Pozo, the answer is clearly in the negative. She argues that migrants are sensitive to risks and take concrete steps to reduce their exposure to them. When immigrants opt for more risky modes of money transmission, they do so because they lack alternatives.[107] For example, many who persist in remitting via informal channels do so because they send money to rural, poorer areas and regions of countries that are underserved by banks and other formal money-transmitting institutions.[108]

Also several other factors influence the choice of transfer mechanism. Carling, for example cites cost, speed, and ease, limiting requirements, familiarity, trust, awareness, and niche services.[109] Indeed, in terms of cost, studies indicate that informal channels are usually cheaper than formal ones. Freund and Spatafora note that the transaction costs using official channels is estimated at approximately 13 percent of the remittance value, a far cry from the less than 2 percent Hawala and Hundi report transactions reportedly charge.[110] For the informal remittance channels as a whole, Sander reports that the average cost of remitting is at 3-5 percent globally, although they can be higher in specific cases.[111] Swanson and Kubas report costs of less than 1 to 5 percent. Similarly, remittances through friends, taxi drivers, and the like, are also low-cost channels compared to formal ones.[112]

Martinez notes that costs remain high for formal services in many corridors amidst an overall decline in fees in recent years brought about by increasing competition and the emergence of new financial products allowing electronic money transfers at low cost.[113]

Aside from cost, another critical factor is the accessibility of the transfer service at both the sending and the receiving end.[114] Sanders, for example, emphasizes that banks can be intimidating to some people.[115] As Freund and Spatafora noted, unlike banks, informal channels do not require the customer to have a bank account or any knowledge about operating one.[116] Further, many of the remitters need to send money to locations with often weak or no financial infrastructure and where banks of their host country have little or no other business volume or connection. As Sander observes, rural regions tend to be much less well serviced by the financial industry, unlike capitals and other urban centers that enjoy fairly good financial service availability.[117] This explains why banks predominate in some sub-regions in Bangladesh, for example, while informal channels remain more popular in other regions.[118]

Indeed, recent studies from the World Bank seem to suggest that access is more important than cost in determining the choice of remittance channel. As will be discussed later, the preoccupation of policy with reducing transfer costs, although a worthwhile end it itself, may not be the best option if the ultimate goal is to initiate a shift from informal to formal transfers, particularly to banks. Ease of use and reliability are also important determinants of remittance service choices.

## 5. Why Remit?

Unlike the more basic questions of who sends and receives remittances, there is surprisingly a vast body of theoretical and empirical literature explaining why migrants remit money to their relatives at home. Lucas, in reviewing these studies, roughly divides the findings into two broad categories: (1) micro-economic determinants related to circumstances of migration and the migrants' connection with the home setting, or (2) macro-economic determinants related to economic conditions and policies in both the home and host countries.[119]

### 5.1 Micro-Economic Determinants

A number of authors, in reviews of literature on this topic, categorize three or four different types of motivations behind the sending of remittances. Carling's categorization is particularly helpful: altruism, self-interest, and insurance.[120]

Altruism implies that migrants remit money home simply because they care about the well-being of the receivers. Self-interest, on the other hand, take into account other "self-interested" reasons, such as whether remitting makes them eligible for inheritance or other resources in the community of origin. The third view highlights how remittances can be motivated by informal contracts of insurance in which family members in different locations reduce collective risk by sharing a portion of their income. [121]

The first two types receive most attention from scholars. A number of researchers "tested" the altruistic versus the self-interested motives of remitters by correlating home economic conditions to the level of remittances. As can be expected, the findings are rather mixed. Not only were the results different across countries, evidence supporting both motives exist within individual countries As Van Dalen et al. conclude, "One cannot clearly pinpoint motives of altruism or self-interest as the sole driving forces behind remittances."[122]

Schrieder and Knerr's findings, for example, lend support to the self-interested model. They find that migrants remit money to Cameroon to keep their sizable inheritances.[123] Looking at Guyana, Aggarwal and Horowitz, on the other hand, point to evidence suggesting that migrants are motivated by altruism.[124]

More recently, Pozo studied per emigrant remittance flows in the LAC based on data collected from 1980 onward. The study finds both altruistic and self-interested motives as relevant determinants of remittances. Migrants in her study tend to remit more during declines in home country per capita income and at the same time postpone remittance if the home country's currency depreciates against the dollar.[125] She notes that "of course, altruism is an important motive underlying the transfers of monies from immigrants to families. But in many cases, the immigrant is also 'insuring for a rainy day.'"[126] Indeed, as Maggard observed, "today, most theories hold that altruism is a partial motive in remittance decisions as opposed to a 'pure' motive."[127]

### 5.2 Macro-Economic Determinants

Several macroeconomic factors have also been singled out in the literature. Remittances are perceived to be responsive to changes in the interest rate differential between home and host country, government policies, the level of economic activity both in the host and the home country, wages, political risk factors in the sending country, and the rate of inflation.[128]

Orozco et al.'s data analysis of Mexico, Colombia, Dominican Republic, El Salvador, Guatemala, and Jamaica, for example, reveal that economic conditions directly affecting daily activities, such as price changes, influence remittance decisions. In particular, their study finds that a 1 percent increase in the Consumer Price Index is associated with a threefold increase in remittance volume.[129] Interest rates are also found to be relevant. An increase in the interest costs of lending lowers remittances as do unfavorable exchange rates.[130]

A review of earlier studies on the macroeconomic determinants of remittances, however, finds a lack of solid consensus in the literature.[131] Buch and Kuckulenz, after looking at Straubhaar and Sayan's separate studies on Turkey, Nayyar's study of India, and Lianos' study of Greek guest workers, conclude that there is no clear connection between the volumes of remittances and so-called traditional variables such as the level of economic development, economic growth, and proxies for the rate of return on financial assets.[132] They write:

> One likely explanation for this finding is that worker remittances share features of private and official capital flows, which in turn are driven by quite different factors. In other words, worker remittances are to a large extent market-driven, but social considerations play an important role as well in deciding how much money to remit. [133]

Carling's writings reflect the same observation. Commenting on the burgeoning literature on micro-economic determinants of remittances, he warns of the "danger" in "overlooking the cultural dynamics at hand." He contends 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 continues:

> 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.[134]

Amuedo-Dorantes et al. agree. They note that just as a multitude of motives underlie the migration decision, many different motives similarly exist for remitting. For them, as long as the prevailing goal is to choose one motive to the exclusion of all others, the debate over what motivates remittances will probably remain unsettled. "In all likelihood, all the motives for remittances that have been suggested are at play for different subsets of migrants and their families."[135]

## II. REMITTANCES AND DEVELOPMENT

Recent years have seen an explosion in studies exploring remittances' impact on economic development. There is also a relatively small but burgeoning part of the literature looking at the impact of remittances on the more intangible realms of the social and the political. By and large, the tone of the majority of studies has never been more optimistic, although, there are some well-thought-out caveats.

As Nurse aptly puts it:

> The new literature is essentially calling for a rethink[ing] of the dynamics of the migratory process and is questioning whether the conditions evident in the contemporary phase of globalization (e.g., the transport and information and communications revolution) and the changing socio-political context (e.g., multiculturalism and immigration control) can facilitate a deeper development impact than previously presumed.[136]

## A. Economic Impacts of Remittances

The World Bank, in a book published in 2005, concludes that remittances appear to have a positive impact on the development and welfare of the migrant-sending countries.[137] Rapoport and Docquier, in an extensive and widely cited review of current economic literature on remittances, conclude similarly.[138] Indeed, the overall tenor of studies focusing on the economic impact of remittances is surprisingly clear — remittances clearly benefit the economy in non-negligible ways though, of course, not without some solid reservations.

Specifically, recent studies have shown that remittances facilitate human capital formation mainly by improving access to education and health. They also lead to an increase in investments and the reduction of poverty, particularly within recipient households. Remittances have also been critical sources of foreign exchange for the national accounts and have been found to promote macroeconomic stability.

However, the debate on the economic impact of remittances is far from settled. There are still lingering areas of concern that empirical studies have yet to address completely. Remittances' effect on growth, inequality, exchange rates, and inflation are still contested topics awaiting more conclusive empirical studies.

### 1. Remittances and the Micro-Economy

From a microeconomic perspective, exploiting a wage differential clearly benefits the individual and the household to which he or she belongs. Indeed, an increasing number of studies show that the overall impact of remittances on access to basic yet critical services such as education and health is quite positive.[139] Contrary to previous studies, today there is increasing recognition of the rather positive impact remittances have on investments as well as an almost universal recognition of their positive impact on poverty reduction, at the very least among recipient households.

#### 1.1 Education and Health

Lopez-Cordova, for example, observes greater literacy levels and higher school attendance among 6-14 year olds in Mexican municipalities receiving more remittances.[140] He finds that illiteracy among children within this age group falls by 3 percent after a 1 percent rise in households receiving remittances.[141] Similarly, Hanson and Woodruff, using Mexico's 2000 Census data, find that children in migrant-sending households are able to attend school for significantly more years.[142] Cox Edwards and Ureta likewise note that remittances lower the likelihood of El Salvadoran children leaving school.[143]

Remittances also play an important role if the public health care system is unable to provide universal health insurance or adequate treatment and preventative care. Lopez-Cordova, for example, finds that remittances are associated with reduced infant mortality in Mexico.[144] Specifically, he finds that a 1 percent rise in the portion of households receiving remittances reduces by 1.2 lives the number of children who die in their first year.[145] Lopez-Cordova notes that remittances may reduce infant mortality by enabling mothers to stay home and care for the newborns and by improving housing conditions and access to public services such as drinking water.[146]

A more recent paper by Hildebrandt and McKenzie also concludes that children in migrant households have lower mortality rates and higher birth weights.[147] Duryea et al. also suggest that remittances have a positive effect on infant survival through improvements in living conditions.[148] Frank and Hummer likewise show that membership in a migrant household reduces the risk of low birth weight.[149]

A study by Kanaiaupuni and Donato, however, finds acute infant mortality rates among communities with historically high record of emigration to the United States.[150] Lopez-Cordova, in looking at this study, however, warns that they only looked into 27 communities in five Mexican states. He further notes that the authors did not address potential endogeneity problems.[151]

Indeed, endogeneity is quite a difficult challenge to overcome in studies aiming to establish causality. As Ozden and Schiff observed, "most studies in the literature suffer from a severe endogeneity bias."[152] In most cases, the direction of causality can be quite ambiguous. Studies that involve truly exogenous changes in migration or remittance flows are quite hard to come by. One clear exception, however, is Yang's study of the Philippines. The depreciation of the peso caused by the 1997 Asian Financial Crisis provided an opportunity to ascertain how an increase in remittance flow affects households.

Interestingly, Yang finds that the unanticipated increases in remittances lead to substantial improvements in child schooling and declines in child labor in the Philippine households. Yang's empirical study reveals that "for children aged 17-21, a rise in remittances equal to 10 percent of household income leads to a 10.3-percentage-point increase in the fraction who are students and a decline in mean hours worked of 2.9." He also notes that remittances have more beneficial effects when recipient children are male, and when the overseas workers are older, have been away for shorter periods, and are the mothers of the children in question.[153]

From a development standpoint, the results of the aforementioned studies are clearly very promising. Since the increased investments in education and health contribute to human capital formation, it is likely that remittances may benefit developing countries' long-term growth prospects.[154]

1.2 Investments

Another key issue addressed in the current literature is remittances' impact on productive investments. Earlier studies took a largely negative tone with most concluding that remittances are typically consumed and are not utilized to finance productive activities. Recently, however, some researchers have come to the opposite conclusion.

*Consumption or Investment?*

Since the 1970s, remittances have been generally perceived to be largely spent on houses, food, cars, clothes, and important consumption goods, not on investments in productive enterprises. As De Haas aptly puts it, "migration and remittances are therefore thought to lead to a passive and dangerous dependency on remittances."[155]

Recent studies do show that remittances are mainly used to cover basic necessities. Orozco et al., for example, find that across Latin America, more than 80 percent of remittance recipients reported using the money to cover basic costs. An even higher percentage relied on remittances for household necessities in Guatemala, El Salvador, Nicaragua, Cuba, and Guyana. In particular, between 9 and 10 percent of Colombian and Ecuadorian remittance receivers reported using remittances to enjoy what the authors call "life's 'good things.'"[156] Cohen's study of Oaxaca, Mexico, suggests that only about 8 percent of remittances are spent on business start-ups or investments while the rest went to daily and household expenses.[157] Similar patterns are also found among migrants throughout the world. Examples include Hansen's study in Somaliland,[158] Seddon's review of South Asia,[159] and Banjoko's survey in Africa.[160]

Recently, however, an increasing number of studies suggest that remittances have been increasingly used for investment purposes in developing countries, especially in low-income countries. Adams, for example, finds that in Guatemala, the majority of remittance earnings are not spent on consumption goods. At the mean level of expenditures, households without remittances spend 58.9 percent of their expenditure on consumption goods compared to 55.9 percent on the part of households receiving international remittances.[161] He explains that households receiving remittances tend to view their remittance earnings as a temporary stream of income thus discouraging them from spending more on consumption. For example, at the margin, households receiving international remittances spend 58.1 percent more on education than households that do not receive remittances.[162]

Some studies likewise find that remittances may alleviate credit constraints in the recipient community, thus stimulating entrepreneurial activity. A study in urban Mexico, for example, finds that almost one-fifth of the capital invested in microenterprises was made possible by remittances from the United States.[163] This percentage reaches 40 percent in states with a high number of immigrants to the United States.[164]

Similarly, Mishra's study of 13 Caribbean countries reveals that a 1 percent increase in remittance inflows increases private investment by 0.6 percent.[165] Glytsos' analysis of seven countries in the Mediterranean also reveals that in six countries, investments increase with remittances. [166] Remittances are also found to be a source of investment in Egypt.[167]

Leon-Ledesma and Piracha's study of Eastern European countries during the 1990s likewise produced similar results. An interesting aspect of this particular study, however, is the predominance of short-term migration to Western Europe. The authors suggest that the temporary nature of migration flows could have accounted for the rather productive use of remittances.[168]

Yang's study on the Philippines also suggests that an increase in remittances raise household investment in entrepreneurial activities.[169] Specifically, he finds that remittances raise hours worked in self-employment and lead to greater entry into relatively capital-intensive enterprises by migrants' origin household.[170]

More recently, Taylor and Mora have used data from the Mexico National Rural Household Survey of 2003 and find that expenditure patterns between migrant and non-migrant households significantly differ in, as the authors put it, "surprising ways." Their study reveals that households with international migrants have large marginal budget shares for investments, health, and consumer durables and small marginal budget shares for food and housing.[171]

These recent findings complement earlier studies suggesting that remittances have been critical to the capitalization of migrant-owned businesses. As early as 1990, Escobar and Martinez suggest that 31 percent of migrants surveyed in Guadalajara used US savings to set up businesses.[172] Cornelius's study located in three rural Mexican communities suggests an even higher percentage of businesses founded through remittances.[173]

These rather promising results led to a general change in the tone of current discussions of remittances and investment. De Haas, for example, includes the perception that remittances are mainly spent on conspicuous consumption and non-productive investments as one of the “myths” in the migration and development literature.[174] He writes:

> … there is increasing evidence that this pessimistic perspective is founded on a rather poor empirical and analytical basis. Methodological shortcomings, exaggerated and unrealistic hopes of migration as a development engine, and narrow and arbitrary concepts of development partly explain why “prior work has been unduly pessimistic about the prospects for development as a result of international migration.”

Taylor and Mora were led to the same conclusion. They find that the “criticisms of migration for not stimulating productive investments may be misplaced; they may be more a result of modeling and data limitations than actual differences in expenditure patterns between migrant and nonmigrant households.”[175]

*Consumption versus Investment: A False Distinction?*

Even more interestingly, a number of authors also question the distinction between the so-called productive and non-productive uses of remittances. De Haas, for example, criticized the tendency to denote “expenditures on housing, sanitation, health care, food and schooling as unproductive and non-developmental.”[176] Indeed, the 2005 OECD International Conference on Migration, Remittances and the Economic Development of Sending Countries held in Marrakech labeled this distinction “artificial.”[177]

Seddon reflects the same sentiment. He noted the need to “challenge the notion that the use of remittances for private consumption necessarily conflicts with the promotion of more socially useful ends and wider development.” He continues:

> Firstly, improved consumption itself directly contributes to improved living standards and poverty alleviation. Secondly, consumption stimulates demand, and may help create markets and employment. Thirdly, investment in human and social capital is now more widely recognised as promoting the social basis for economic development. Thus, there is a need to reconsider theoretically and to investigate empirically the contribution that remittances make to the security and resilience of livelihoods, as well as to their enhancement, and the wider contribution of the deployment of these funds to local community social and economic development.[178]

Indeed, the discourse on remittances and investment is now being reframed. The interest has started to shift away from just knowing whether remittances are invested in a certain country or region. Rather, some scholars are interested in understanding why remittances are invested in some cases and not in others. As Taylor and Mora contend,

> … under the right circumstances, then, a significant percentage of migrant remittances and savings may be devoted to productive enterprises. … Rather than concluding that migration inevitably leads to dependency and a lack of development, it is more appropriate to ask why productive investment occurs in some communities and not in others.[179]

Interestingly, results of earlier studies are instructive in this regard. Durand et al.'s 1996 study of 30 Mexican communities, for example, shows that remittances are more likely to be spent on productive activities if there is an *ejido* (production cooperative) in the village or if the recipient households have access to land and housing ownership.[180] For Rapoport and Docquier, this suggests that "less unequal communities at origin" would, on average, "tend to channel remittances towards more productive uses."[181]

Durand and Massey's 1992 study of Mexico also finds that "highest levels of business formation and investment occur in urban communities, rural communities with access to urban markets, or rural communities with favorable agricultural conditions."[182]

Recently, Ratha surmised that the relaxation of foreign exchange controls in the 1990s as well as general improvements in policies may have facilitated the use of remittances for investment. According to him, remittances are often invested in countries with sound economic policies.[183]

Ruiz-Arranz, likewise, noted that investment opportunities in the home country impact the volume of remittance flows. In two-thirds of developing countries, remittances are believed to be "profit-driven." They have been found to increase when the economic conditions at remittance receiving countries improved. Ruiz-Arranz further suggests that remittances are used for investment especially in cases where the financial sector is unable to provide the credit demands of local entrepreneurs.[184]

Interestingly, some have proposed that a gender dimension might also be at play. A study of the LAC region, for example, finds that slightly more women than men report using remittances for investments, savings, and businesses.

### 1.3 Poverty

The expansion of the remittance economy in the last decade or so has led some to question how these flows impact poverty reduction. There is growing evidence that remittances have reduced the incidence and severity of poverty in several low-income countries. The claims of poverty relief from the impact of remittances are as Lucas puts it, "fairly universal."[185]

In a widely cited study of 71 developing countries, Adams and Page find that 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.[186] An IMF study using a sample of 101 countries for the period 1970–2003 reflects similar findings.[187]

A number of studies with a country or community-wide focus have turned out promising results as well. Not surprisingly, Mexico received the most attention. Taylor, Mora, and Adams, using data from a 2003 survey, find that international remittances account for 15 percent of per capita household income in rural Mexico. Thus, they conclude that an increase in international remittances would reduce both the poverty headcount and the poverty gap.[188]

Bugamelli and Paterno noted that positive results are also found by Esquivel and Huerta-Pineda and Lopez-Cordova using a Mexican household survey and a cross-section of Mexican municipalities, respectively.[189] Lopez-Cordova's study on Mexico, however, noted that remittances have very little impact on the incidence of extreme poverty. For Lopez-Cordova, this finding clearly reflects the high cost of migration that keeps households below a given income level from migrating.[190]

Wodon et al., looking specifically into two southern Mexican states, Guerrero and Oaxaca, find that the share of the population living in poverty is lower by 2 percentage points due to remittance income. They further argued that this poverty effect is similar in magnitude to that of many government programs in poverty reduction, education, health, and nutrition.[191]

Adams's study on Guatemala likewise produced positive results. He finds that remittances reduce the level, depth, and severity of poverty in Guatemala. However, he noted that the extent of poverty reduction is largely dependent on the measure of poverty used. For example, the inclusion of remittances in household expenditure actually increases the level of poverty by 1.6 percent if the poverty headcount measure is used. However, when poverty is measured by indicators focusing on the depth and severity of poverty, such as the square poverty gap, remittances reduced poverty by almost 22 percent.[192]

Evidence outside of Latin America turned out to be promising as well. Using a large dataset from the Overseas Filipino Survey, Yang and Martinez find that an appreciation of the Philippine peso during the 1997 Asian Financial Crisis led to an increase in remittance flows, which then contributed to the reduction in poverty.[193] Yang and Martinez surmised that the direct transfers from remittance-receiving households to households not receiving remittances as well as the overall increase in economic activity driven by remittance flows caused the broad decline. Indeed, they find spillovers to households without migrant members.[194]

Maimbo et al.'s study on South Asia also find that remittances clearly reduce the level of poverty once the estimated values for unofficial remittances are added to official remittance figures. Specifically, they find that, on average, a 10 percent increase in total remittances reduce the poverty incidence by almost 1 percent.[195]

Given that unofficial remittances are more likely to be earned by the poor, Maimbo et al. emphasized that the impact of remittance transfers could be underestimated if only official remittances are studied. This observation is argued to be particularly relevant to regions where large shares of remittance monies have tended to flow informally, such as South Asia.[196]

More recently, Adams, using a large nationally representative household survey, analyzed the impact of internal and international remittances on poverty in Ghana. He finds that aside from one exception, both types of remittances reduce the level, depth, and severity of poverty in Ghana. As in Guatemala, Adams finds that the magnitude of poverty reduction depends on how poverty is being measured.[197] More sensitive poverty measures, such as the poverty gap and the squared poverty gap, will register a higher reduction in the poverty rate. For example, using the squared poverty gap as a yardstick, international remittances reduce the severity of poverty by 34.8 percent.[198]

According to Adams, "when the 'poorest of the poor' households receive international remittances, their income status changes dramatically and this in turn has a large effect on any poverty measure — like the squared poverty gap — that considers both the number of poor households beneath the poverty line and how far below it they fall."[199]

Adams further observes that countries near major labor-receiving areas recorded the largest effects of remittances on poverty. This is particularly true for developing countries close to the United States or Europe. Apart from receiving more remittances, the remittance-receiving households in these countries are also spread more evenly among the population.[200]

He emphasizes, however, that countries with the highest levels of poverty — such as those in sub-Saharan Africa — do not produce many international migrants and therefore receive fewer remittances.[201] As will be discussed later in this review, this clearly presents a dilemma for policymakers and institutions, especially those with a keen interest in poverty reduction.

### 2. Remittances and the Macro-Economy

The impacts of remittances are felt beyond the household and affect the national economy. High levels and/or large increases in remittance flows can have direct as well as indirect repercussions on the macro-economy. Remittances, specifically, have been acknowledged as critical sources of foreign exchange and macro-economic stability.

2.1 Source of Foreign Exchange

International data reveal that workers' remittances are a major source of foreign exchange in many developing countries. Almost every discussion of remittances includes at least a reference to the fact that they make up for the shortfall in foreign direct investment, portfolio investment, and even exports in a number of developing countries. As Lucas notes, for countries burdened either with debt overhang, severe and chronic trade imbalances or low foreign direct or financial investors, remittances' contribution to economic growth can be substantial.[202]

Rapaport and Docquier comment on how common it is to see countries receiving remittances flows equal to about half the value of their exports or 10 percent of their GDP. This is true not only for traditional labor-exporting countries such as Egypt, Turkey, or Pakistan but is also the case for relatively small Caribbean and Pacific countries.[203] Indeed, during the 1990s, official remittances alone, not including the flows in the informal sector, accounted for almost 44 percent of total FDI and were about 17 percent higher than official development assistance.[204]

Remittances contribute considerably to the balance of payments of a number of countries, especially in Africa. According to Sanders, during the 1980s, remittances covered 80 percent of the current account deficit in Botswana, almost three quarters (70 percent) of total commodity export earnings in Sudan, and more than half of the foreign exchange earnings in Lesotho. As share of exports and of GDP, remittances were also substantial in Eritrea (194 percent and 19 percent), Cape Verde (51 percent and 12 percent), the Comoros (24 percent and 6 percent), and even Egypt (26 percent and 4 percent) and Morocco (18 percent and 5 percent).[205] Remittances during the mid-1980s were also very high in the Philippines. In fact, Rodriguez notes that during this period remittances completely financed all trade deficits and, after 1988, have also remained large enough to cover almost two-thirds of the deficits in the balance of trade.[206]

More current figures are no less striking. Ratha, looking at 2004 estimates, notes that remittances were equal to about 6.7 percent of developing countries' imports and 7.5 percent of domestic investment.[207] Remittances were also larger than public and private capital inflows in 36 developing countries.[208]

Specifically, Ratha finds that remittance receipts were larger than total merchandise exports in Albania, Bosnia and Herzegovina, Cape Verde, Gaza, Haiti, Jamaica, Kiribati, Lebanon, Nepal, Samoa, Serbia and Montenegro, and Tonga. They were even larger than the earnings from the most important commodity exports of 28 countries. For example, remittances dwarf FDI in Mexico, tea exports in Sri Lanka, and tourism receipts in Morocco.[209]

2.2 Promote Macro-Economic Stability

The interest in remittance flows stems not only from their magnitude but also from their "good" features, as Bugamelli and Paterno put it.[210] Remittances, for example, have been categorized as "free lunch" in financial terms because, unlike debt financing or foreign direct investment, they do not generate any future financial obligations for the receiving countries.[211]

More importantly, remittances are also characterized as a more stable and less cyclical form of capital flows, making them a good candidate to lower the risk of macroeconomic instability in the receiving country.[212] The Report of the Inter-American Dialogue Task Force on Remittances, for example, emphasized how remittances promoted a "steadily increasing stream of capital" to Latin America and the Caribbean since 1998. The report writes:

> This contrasts with the extreme volatility of most other capital flows to the region. That volatility, incidentally, has been a prominent cause of Latin America's erratic economic performance in the past decade and the origin of several devastating financial crises in the region. … In the past decade of great financial volatility in Latin America, remittances have become a vital safety net, particularly for the region's poor citizens.[213]

Indeed, remittances have been found to rise when the recipient economy suffers a downturn in activity or macroeconomic shocks due to financial crisis, natural disaster, or political conflict. By making up for foreign exchange losses due to these shocks, remittances may smooth consumption and thus play a part in maintaining the economic stability of recipient countries.[214]

A number of studies further revealed that a natural disaster, conflict, or an economic downturn are followed by an increase in remittance inflows.[215] Mishra, for example, looking at 13 Caribbean countries from the period of 1980-2002, finds a 3 percent increase in remittances two years after a 1 percent decrease in real GDP.[216]

Natural disasters in Bangladesh, Dominican Republic, Haiti, and Honduras were also followed by an increase in remittance flows.[217] Yang's empirical study finds that within a year of a hurricane, 13 percent of lost income is compensated by the increase in remittances. Within four years, this figure jumped to 28 percent, a higher percentage compared to ODA and FDI that make up for roughly 26 and 21 percent, respectively.[218]

Ratha noted that although remittances decreased during the initial phase of the conflict in Albania, the flows quickly recovered soon after. Remittances even increased in the year of the conflict in Sierra Leone.[219]

Remittances also responded positively to the financial crisis in Mexico in 1995 and in the Philippines, Indonesia, and Thailand in 1997, following the East Asian Financial Crisis.[220]

More recently, Bugamelli and Paterno find that remittances can help reduce the probability of current account reversals. The authors describe how the great stability and low cyclicality of remittances relative to other private capital flows made foreign investors less likely to suddenly flee emerging markets and developing economies.[221] However, Bugamelli and Paterno emphasize that a threshold does exist. The mechanism they point to is much stronger when remittances are more than 3 percent of the GDP.[222]

It is also important to note that remittances do respond to dramatic economic changes in recipient countries. As Ratha notes, remittances rose steadily in the Philippines during the early part of the 1990s, due to improvement in the investment climate only to become more volatile a few years later in the wake of the 1997 financial crisis. Similarly, as Turkey's economy slipped into crisis in 1999 and 2000, remittances decreased after a recording a steady increase in the early 1990s. Ratha, however, emphasizes that in both cases, the decline in remittances, and the volatility, was smaller than those of capital flows.[223]

## 3. Bones of Contention

The preceding overview should not obscure the fact that current discussions on the impact of remittances on the economy are not entirely positive. Areas of concern that current studies have yet to completely address remain; four of which have been extensively discussed in the literature: (1) growth, (2) inequality (3) exchange rate effects, and (4) inflation.

### 3.1 Growth

Unlike extensive research on the relationship between growth and other sources of foreign capital, such as FDI and official aid, the relationship between remittances and economic growth has not been adequately studied and therefore remains unclear.[224] The accepted view seems to be skeptical as to whether remittances can in fact lead to growth. As Manolo Abella asks:

> Take a look at the variation in recent development performance of major labour-sending countries — Mexico, Turkey, the Philippines, Pakistan, Yemen, Egypt, Morocco, Lesotho, Burkina-Faso, Jamaica, etc. Which countries have managed to sustain high rates of economic growth?[225]

However, results from studies are mixed. As Ratha emphasizes, recent studies reveal that remittances can enhance growth and reduce poverty largely by promoting financial development.[226] A widely cited study of Chami et al., however, is more skeptical. Using aggregated panel data for 113 countries, the authors find a negative effect of remittances on growth after controlling for the investment/GDP ratio, regional dummies, and other control variables. The authors blame this negative association on the moral hazard problem remittances creates. Income from remittances may permit remaining family members to reduce their work effort that can then reduce the labor supply.[227]

Given the rather provocative results of Chami et al.'s study, a number of scholars have reviewed their findings and expressed some reservations. Ozden and Schiff, for example, note that a decline in labor supply because of remittances may actually lead to higher productivity, as shown by the 1999 study of Rozelle et al. and a much earlier study by Lucas.[228]

Rapoport and Docquier also noted that Chami et al. disregard the possibility that remittances could affect investments and human capital formation. The latter was not even addressed in their analysis. [229] This is an observation likewise shared by Lucas.[230]

Lucas further questions whether the decrease in work effort actually influenced the negative correlation as Chami et al. argues and suggests that it might even reflect the effects of an overvalued exchange rate. He also notes the "exceedingly difficult" task of "disentangling whether remittances cause slower growth, or whether slower growth causes more migration and possibly greater remittances per migrant."[231]

Interestingly, a recent IMF study using data covering 100 developing countries from 1975 to 2002 finds strong evidence that remittances boost growth in countries with less developed financial systems. Remittances, in this scenario, provide an alternative way to finance investment, and thus act as a substitute for the very limited domestic financial system. The study, however, finds no similar effect on countries with well-functioning domestic financial markets.[232] The findings do not sit well within the widely held assumption that remittances, if destined to developed financial systems, such as in some emerging Asian countries, would be treated like any other form of savings and allocated to projects yielding the highest returns. This, apparently, is not the case.

### 3.2 Inequality

The literature is also unclear regarding the impact of remittances on inequality. Some argued that unlike huge, bureaucratic development programs or development aid, remittances can be an effective means to redistribute income. As de Haas puts it, this "'private' foreign aid seems to flow directly to the people who really need it, does not require a costly bureaucracy on the sending side, and far less of it is likely to be siphoned off into the pockets of corrupt government officials."[233] Indeed, there are a number of pronouncements in the literature noting the equalizing effect of remittances.

The Inter-American Dialogue taskforce on remittances, for example, highlights that "remittance streams are an important corrective for Latin America's income inequalities, which are the worst of any of the world's major regions."[234] Keely and Tran[235] argue that "it is difficult to imagine a mechanism for the transfer of so much capital to so many (and often poor) countries and to the benefit of so many of their citizens."[236]

However, amidst these pronouncements, evidence of the impact of remittances on income inequality remains inconclusive. Some studies argue that remittances may have had an equalizing effect as a number of studies on Mexico reveal.[237] Others, however, found either the opposite or no significant effect at all.

Using the 1991 Family Income and Expenditure Survey (FIES) as the main data source, Rodriguez finds evidence that remittances in fact worsen the income distribution in the Philippines.[238] Saith analyzes the same FIES survey and also notes the "clear evidence that, at least as far as the direct effect of migration is concerned; the benefits accrue disproportionately to the richer regions, sectors and classes." He contends:

> The idea that maids would be drawn from the poorest sections of society is somewhat misplaced; field studies show that maids in South-east Asia tend to be relatively better educated than the general female population in the corresponding age groups. No doubt there are exceptions to this pattern, which certainly needs qualification; but these are unlikely to be able to disturb the basic robust conclusion that it is not the poorer section of Filipino society which reaps the sometimes dubious rewards of overseas migration.[239]

Likewise, studies within the rural sectors of both Egypt and Pakistan reveal that remittances sharpen inequality. Adams finds that while the poorest quintile of Egyptian households produces a proportionate share of still-abroad migrants, the second and third quintiles are under-represented while the richest 40 percent of households produce more than their share. He contends:

> It is these variations in the number of migrants produced by different income groups — and not differences in either migrant earnings abroad or marginal propensities to remit — that cause international remittances to have a negative effect on rural income distribution."[240]

Adams's study on Pakistan revealed roughly similar trends. For Adams, the under-representation of poorer migrants may reflect the high cost involved in financing international migration that then explains the lack of remittances sent to poor rural areas.[241]

However, there are also some studies that find no significant effect at all. World Bank research in Guatemala and Ghana, for example, reveal that including remittances in household income resulted in only a "slight increase in income inequality."[242] De and Ratha likewise find that in Sri Lanka, the Gini coefficient, a measure of the inequality in income distribution within a country, drops from 0.46 to 0.40 as a result of remittance receipt. [243]

*Inequality in Context: Short versus Long Term*

Some scholars have hypothesized that remittances from new streams of migration may raise inequality in the short term. Eventually, however, migrants will come from a wider social spectrum as "network effects spread information about migration opportunities and lower the costs of moving." In this long-term scenario, remittances can be equalizing.[244] Stark et al., in particular, argued that remittances would worsen inequality as long as international migration is confined to an elite few.[245]

Indeed, an earlier study comparing a Mexican village with a well-established history of emigration against a village with a fairly recent history of emigration confirms this observation. Stark, Taylor, and Yitzhaki suggest that these inequalities rest upon the differences separating early or pioneer migrants from non-migrants. Early movers are more likely to come from relatively wealthier households due to the higher costs and risks involved. Remittances from these pioneers then further widen the income inequalities in their communities.[246]

More recently, MacKenzie and Rapoport present a model with the same assumption and find empirical support in Mexico. Using two detailed data sets,[247] they find that remittances reduce inequality for communities with relatively high levels of past migration.[248] The relationship of remittances to economic inequality is, therefore, likely to vary over time, exhibiting some sort of a "trickle down" effect.[249]

*Inequality: Why Bother?*

Beyond the contradictory or inconclusive results, Ratha, in a comprehensive study of remittances, also raised the question of whether the impact of remittances on inequality is "really that important." He noted that inequality matters only when it interferes with the functioning of the economy and the political system and badly impacts social welfare. He continues:

> But it should be kept in mind that in the context of remittances, inequality relates to income differences among groups that would all be viewed as relatively poor in an industrial-country context. The rich in developing

countries probably receive little in the way of remittances; the rich who migrate tend to take their families with them.[250]

3.3 Exchange Rate Effects

Another area of concern relates to how the large and sustained remittance inflows can cause an appreciation of the real exchange rate, making the production of cost-sensitive tradables, such as cash crops and manufacturing, less profitable. Although empirical evidence on this so-called remittance-led Dutch disease remains limited, Ratha noted the plausibility that this effect exists particularly in some small economies receiving large inflows of remittances.[251]

For example, Amuedo-Dorantes and Pozo's panel study of 13 LAC countries reveals a 22 percent appreciation in the real exchange rate once workers' remittances doubled.[252] Likewise, Lucas, looking into Albania and Moldova, describes how the massive inflow of remittances caused either a real appreciation or a delay in the depreciation of the exchange rate. For Lucas, this may "impose limitations on export performance which can then readily limit output and employment." Given these rather very strong implications, he expressed surprise in response to the "little attention" given to this issue by the empirical literature.[253]

Other studies, however, conclude otherwise. Rajan and Subramanian, for example, find no systematic adverse effects on a country's competitiveness resulting from remittances.[254] Indeed, some experts contend that unlike natural resource windfalls and other cyclical flows, the Dutch disease effects of remittances should be less of a concern. Ratha, for example, argues that governments receiving large remittances can opt to allocate a larger portion of government expenditures on infrastructure and practice more liberal trade policies. Supposedly, these measures would tend to increase exports and also contribute to improved labor productivity and competitiveness.[255]

3.4 Inflation

It has also been argued that remittances induce inflation generated by an unresponsive supply and an induced rising demand. Glytsos, for example, examining the case of Syria and Egypt, noted that "inflation may rise to such an extent as to annihilate the positive effects of remittances."[256] Haderi et al.'s study on Albania also finds that remittances have a significant impact on the country's inflation.[257]

On the other hand, Lucas's studies in other countries find "little sign" of remittance-driven inflation.[258] In Kerala, for example, Lucas noted no evidence to suggest that remittances had an inflationary impact.[259]

## B. Beyond the Economy: Remittances' Impacts on the Political and Social Spheres

Discussions on the developmental impacts of remittances have mostly focused on their effects on the economy of developing countries. This is understandable, given that remittances are, in essence, financial transactions and, as already discussed at length, have direct impact on the economy.

However, remittances, specifically, the acts of sending and receiving remittances, do have social and political ramifications that do no necessarily figure in measures of economic performance. Indeed, development connotes not just economic growth but also social and political transformation as well as the general improvement of the well-being of migrants and those left behind. Thus, a complete discussion of remittances' impact on development requires a look beyond the economies of developing countries into their political and social spheres.

Not surprisingly, a small but increasing number of studies look into the ideas, practices, identities, and social capital that migrants supposedly remit home. These so-called social and political remittances are argued to alter behaviors at home, both positively and negatively, and transform notions on critical issues such as gender relations, democracy, and the role of the state. Although predominantly anecdotal in nature, the evidence presented is worth noting.

### 1. Remittances and the Political Sphere

#### 1.1 The Good

Remittances, Cohen notes, enable migrants to serve active and important roles in national politics and village governments.[260] National leaders reportedly seek not only financial support from migrants abroad but also in some cases, even their votes as illustrated by recent elections in the Dominican Republic.[261] Indeed, some political parties have been known to organize around migrants for support. Some examples of political parties that have created municipal and regional organizations in migrant communities include: the Mexican Partido Revolucionario Demócrata (PRD), Dominican Partido Revolucionario Dominicano (PRD), Partido de la Liberación Dominicana (PLD), the Brazilian Workers Party, and the Indian Bharatiya Janata Party (BJP).[262]

The Dominican Republic especially has had a long history of political involvement on behalf of its migrants, and those abroad have contributed politically by sending large campaign donations.[263] The extent of this connection can be glimpsed from a survey of 413 Dominicans in New York City that finds that 21 percent have tried to help candidates win office at home and 35 percent were likely to vote in the then impending 2004 Dominican presidential election.[264]

Given migrants' increasingly active role in the politics of their home countries, it is argued that they can, and in some cases, already have pushed for political reforms, as the Kurds reportedly have accomplished in Turkey.[265] The political activism of Mixtecs in California is also argued to directly challenge the power of the Mexican state to define boundaries of the national political community and the rights of its members,[266] patterned on how Jewish Americans influence US foreign policy toward Israel.[267]

Cohen, citing Sagas' work on the Dominican Republic, noted how "the history of caudillism, authoritarianism, and abuse in politics will likely only change as U.S.-based, transnational migrants pressure for changes in their island home country."[268]

Indeed, a study on the voting behavior of Czech and Polish migrants suggests that migration facilitates political and economic changes in countries under authoritarian and interventionist regimes. The results show a strong indication that the voting behavior of migrants is shaped by the institutional environment of the host country.[269]

### 1.2 The Bad

On the other hand, some scholars, particularly from the developing world, have raised concerns on the negative effect of remittances on the politics, and particularly the governance, of developing countries.

*Moral Hazard Problem*

It has been widely argued that remittances serve as a safety valve to a deteriorating economy beset by high unemployment and a tight balance of payments. As Ranis puts it, labor migration "may allow us to postpone painful but necessary reforms that will lead us to the proper growth fundamentals."[270]

Similarly, Aldaba, referring to the Philippines, emphasizes the same "moral hazard" problem at work.

> At the macro level, government "ignores economic imbalances (e.g. trade deficits) and fails to pursue needed economic reforms as it anticipates getting a big slice of dollar remittances every year from migrant workers." They might even "pursue politically beneficial but economically unwise policies" as long as remittances insulate the economy from the negative impact of these policies." With the way politics [are] being practiced in the Philippines, this is simply not far fetched.[271]

Hugo, citing Tiglao, noted how remittances to the Philippines have "insulated a backward agricultural sector from modernization and diverted attention away from the need to attract foreign investments in manufacturing."[272] Hugo agrees, noting that remittances may have "discouraged modernization" in the Philippine agriculture sector. "They diverted attention from attracting foreign investment in manufacturing while other Asian countries made these changes."[273]

Glytsos presents similar observations concerning the Mediterranean. He notes how remittances brought "comfortable finance of deficits" that then "relax" and keep governments from adopting long-term economic policies needed in a changing world economic structure. Referring specifically to Greece, he described how remittances "deprive an economy of a more diversified industrial structure and perpetuate or even accentuate the balance of payments deficit."[274] This is similar to an earlier argument by Banuri in which remittances are thought to "abrogate protectionist policies installed by governments in order to protect investment and profit in the industry sector."[275]

Indeed, the billions of dollars poured every year into the economy of sending countries in the form of remittances can be roughly likened to a continuous IMF bailout without the conditionalities. Remittances could be perceived as a windfall for a government unable or, even worse, reluctant to embark on the economic, social, and political reforms necessary for broad-based development.

However, as Glytsos correctly points out, "there is no way of knowing what policies would have been adopted in the absence of remittances, and neither is there any guarantee that such policies would have been initiated."[276]

## 1.3 The Ugly

*Support of Conflict and Partisan Politics*

Remittances have also been known to support social movements and political groups that may encourage and/or engage in conflicts. For example, Seddon notes that although the Sri Lankan Tamil Diaspora in the United Kingdom "undoubtedly has supported various welfare and development activities in their country of origin," they have also "contribute[d], openly and directly" to the Tamil secessionist struggle, including the militant Liberation Tigers of Tamil Eelam (LTTE).[277] Similarly, a number of extremist groups in India are thought to be receiving funds from some Indian Hindu charities in the United Kingdom.[278] Others have also raised concern that Pakistani-based groups with links to terrorist activities are financial beneficiaries of some Muslim charities in the United Kingdom and the United States.[279]

As Seddon emphasizes, the “dividing line between support for developmental purposes” such as humanitarian aid and other forms of assistance and “support for political purposes is not always easy to draw.” He calls for the need to “examine the mechanisms used by different charitable and welfare NGOs for the collection, transfer and use of resources generated by migrant and immigrant communities overseas, and explore ways in which their potential for harm might be minimised and their contribution to development maximised.”[280]

## 2. Remittances and the Social Sphere

Remittances have also been argued to have critical social implications on remittance-receiving countries. Two particular areas—gender and culture— have received some attention in the literature.

### 2.1 Gender

Accounts vary on how remittances affect gender relations. Remittances have been positively regarded in some studies and negatively blamed in others. Some scholars find that “remittances create options for origin households that allow members more flexibility in their social roles and use of community- and kin-based networks.” [281] This is particularly true for female recipients who are argued to be “empowered as they control how remittances are spent.”[282]

Remittances also reportedly encourage women to take on new roles in community government.[283] Weyland, for example, notes how remittances facilitate the economic independence of women at both ends of a remittance transaction as well as promote women’s involvement in the politics in origin communities.[284] Likewise, Schäfer observes that in Zimbabwe, women receiving remittances often manage household resources and create cooperatives to augment their livelihoods.[285]

Remittances are argued to be even more empowering when women take the traditionally male role of family breadwinner.[286] As Mahler noted, improvements in the social standing of female remittance senders have been observed in some instances. For Mahler, “this is important especially when they are excluded from 'traditional' means of increasing status enjoyed only by males, such as in Thailand where only sons may join religious orders or perform ancestral rites.”[287]

On the other hand, however, some noted the negligible and, in some cases, even negative impact of remittances on gender relations. From their perspective, the receipt of remittances is “multi-faceted phenomena with sometimes contradictory and unintended outcomes for different actors” even within households.[288] In other words, although remittances may benefit receiving households, this does not necessarily mean that the benefits are shared equally *within* the household. A 1993 study by Rudkin for example, notes that remittances tend to go to men rather than women.[289] Sharp and Spiegel likewise observed similar patterns among Bantu migrants in South Africa.[290]

More recently, Mahler describes how access to transnational practices and communication is gendered in El Salvador and how remittance reliance may intensify gendered power structures.[291] Cohen, in reviewing the work of Brettell among others, likewise notes that "younger women who migrate as daughters are often expected to remit regularly and directly to their parents. Often this expectation comes with a requirement to serve sons and relatives who have migrated, and migrant daughters lack the freedoms that those male relatives and siblings enjoy."[292]

Mahler also emphasized that in highly patriarchal societies such as Mexico, female migrants are excluded by government officials from deciding how collective remittances should be invested in local development projects. She further noted how female migrants in the Philippines are "disproportionately blamed for family disintegration while their non-migrant husbands, who often squander remittances, are portrayed as sacrificing for their families."[293]

### 2.2 Culture

Some scholars have also argued that remittances can facilitate the decline of traditional cultural practices. Remittances are argued to incur social costs such as decay of traditional ritual practices and the supplanting of community-based events with family and life-cycle rituals. Cohen, in particular, noted the "tendency for rural Mexicans to adopt immigrant clothing, language, foods, and outlook — a process that Alarcón describes as 'Norteñización.'"[294] Cohen writes:

> While adopting such a life-style is not necessarily a negative, the assumption is made that the process leads to the decline or corruption of local patterns of interaction — and in particular, a decline in kin-based support networks. [295]

## C. Remittances and Development: What Is the Bottom Line?

Sweeping generalizations are clearly unwarranted in the light of the complex nature of remittances' economic, social, and political implications. As the foregoing review has shown, assessments of the developmental impacts of remittances involve critical issues that have yet to be completely explored. Indeed, in understanding the rather complicated remittances - development nexus, the more pressing and intriguing question then becomes what is the bottom line? The literature, as it stands, suggests that the answer to this question will vary from context to context and, even more importantly, on the chosen definition of what development is in the first place.

1. Unfavorable Climate

There is a widely held conviction that the developmental impact of remittances ultimately depends greatly on the political, economic, and social conditions in the home and/or sending country. As De Haas puts it:

> Migration and remittances can potentially contribute to development, but the specific political, economic, and social circumstances in both the sending and receiving countries determine the extent to which this potential is exploited. As both negative and positive effects on development are found to varying degrees, the relevant question is under what conditions are migration and development more positively correlated than under others.[296]

Indeed, a number of scholars have mentioned how an unfavorable investment climate and the lack of political stability and legal security in many sending countries undermine the benefits of remittances.[297]

For example, De Haas, citing Massey et al., emphasized how general developmental constraints mitigate the benefits of remittances. He writes:

> … poor infrastructure; corruption; red tape; a lack of macro-economic stability; the absence of appropriate public policies such as schooling, health care and land reform; market failures; limited access to international markets due to trade barriers; a lack of legal security and a lack of trust in governmental institutions, all play a constraining role on remittance transfers. These so-called unfavorable conditions, prevent migrant households at home from taking the risk of investing socially and financially in their countries of origin and migrants abroad from returning and/or circulating.[298]

As Orozco noted, the "recipient families can only do so much with the money received; they are dependent upon whether their local economy can provide an effective supply of services and products in response to demand."[299]

2. Defining Development

The determination of remittances' impact on development not only varies from context to context, it also depends on how "development" is defined in the first place. Interestingly, most writings on remittances and development seem to share an implicit assumption that there is a clearly agreed definition of development. Indeed, the literature is littered with studies exploring the impacts of remittances on development without clearly establishing what they mean by development in the first place. However, as any introductory course on development will show, the question, "what is development?" is still a matter of serious inquiry. For example, a number of writings that purportedly aims to explore "remittances and development" more often than not end up only discussing economic development.

Since development, as already discussed, might also connote social and political transformation as well as the general improvement of the well-being of migrants and those left behind, the inadequacies of a purely economic perspective should be quite obvious.

*Development as an Expansion of Capabilities*

De Haas, for example, argues that the "improvements in the well-being and human capital of people" brought about by remittances "constitute 'development,' at least if we adopt a broad definition of this concept, which puts improvements in people's actual capabilities and well-being first."[300] De Haas draws heavily on Amartya Sen's widely known concept of "development as freedom." Development, in this view, involves the expansion of human capabilities so that human beings can choose to live lives they have reason to value.[301] This is the very same understanding of development the United Nations eventually adopted in its Human Development Reports.[302] As discussed earlier in this section, remittances have been found to have generally positive impacts on poverty reduction and access to basic yet critical services such as education and health. Clearly, remittances improve, at the very least, the standard of living of households that receive them.

*Development as Growth through Differentiation*

Some scholars, on the other hand, question whether the improvement in living standards brought about by remittances by themselves constitutes development.[303] Adopting Jane Jacobs' concept of development as growth through differentiation, Ellerman argues that remittances are non-developmental. For Ellerman, an "economic settlement made rich by pumping out oil would be 'developed'" using a "living standards definition of development." However, he emphasized that by "Jacobs' definition, it is just a big pipe — an economic conduit — not a tangled bank."[304] He continues:

> Given the difficulties over the last half century with the remittances-may-lead-to-development strategy, there now seems to be some pressure to cut the Gordian knot by declaring that an improvement in living standards *is* development. … There are a number of intermediate positions between the "remittances are development" view and Jacob's ideas about development. What about growth based on the extraction of natural resources? What about Casinos in Indian reservations, military

> bases (and little else) in a congressional district, or a company town in an otherwise rather barren region? While all these would provide local jobs and some growth, Jacobs would argue that none of them are developmental. Indeed, they may be a hindrance for development. [305]

Indeed, development can mean different things to different people and at different times. Seddon's observation of Pakistan's Mirpur region is indicative of the difficulty in traversing this complicated issue:

> Here, remittances have had a dramatic effect on the local economy and society; grand new *pukka* (masonry) houses have been constructed by the thousands, the local bazaars have expanded dramatically, and televisions and videos have arrived in the remotest rural areas. In terms of sustainable development, however, there is "little to show" for all the millions of pounds sterling remitted to Mirpur by Pakistanis living abroad. *It is evident that change is not necessarily the same as development*.[306]

Remittances clearly have brought enormous changes to the countries receiving them. Whether these changes should be perceived as "development" is still a matter of serious inquiry. As already discussed in length, however, remittances clearly have a positive impact on poverty alleviation, at the very least among the households that receive them.

## III. Policy Options

As the heated debate on the costs and benefits of remittances unfolds, key stakeholders have already launched initiatives and forwarded recommendations aimed at maximizing the benefits of remittances. This is hardly surprising given that the ongoing debate on the impacts of remittances is occurring at a time when the perceived developmental potential of remittances has never been greater.

In reviewing these initiatives and recommendations, two broad policy trends can be noted. First, there is an increasing consensus on the need to strengthen the infrastructure supporting remittances through reducing transactions costs, addressing "last mile" concerns and facilitating the transfer from informal to formal systems. Second, there is also a renewed focus on leveraging remittance use for development. However, the focus has shifted away from government-led schemes and onto more bottom-up and/or private sector-led initiatives.

## A. Strengthen the Infrastructure Supporting Remittances

The weaknesses of the infrastructure supporting remittances are widely discussed and acknowledged. There is recognition that: (1) transaction costs in transferring remittances remain high; (2) challenges at the distribution stage of remittance transactions, especially to remote areas or the so-called last mile, have yet to be seriously addressed; and (3) the transition from formal to informal systems is needed both for development and security reasons. Policy prescriptions currently on the table are mostly designed to address these deficiencies.

### 1. Reducing Transaction Costs

The literature is quite clear on the single most important ingredient to reduce transaction costs: competition. Others have also suggested the expansion of access to clearing and settlement systems and the utilization of new technologies that can potentially offer greater efficiency, lower costs, and extended outreach.

#### 1.1 Competition

It is generally agreed that competition can lower costs and make transfers more rapid and reliable. For example, the cost of sending money has more than halved since 1999 in the "competitive and well developed" US - Mexico remittance corridor.[307]

Critical to increasing competition is the participation of banking institutions. MasterCard, for example, predicts a 5 percent decline in the average cost of sending a small remittance through a formal bank. As Wimaladharma et al. note, the entrance of some banks into the remittance market has lowered transaction costs significantly. In the UK, for instance, the Lloyds TSB bank, in collaboration with the second largest bank in India, the IGIGI bank, initiated a pilot scheme that allows non-resident Indians (NRIs) living in the UK to send cost-free remittances to India. NRIs holding accounts both in the UK and India can initiate money transfers between the two accounts, as long as the minimum balance of about £150 (in Rupees) in their IGIGI account is maintained. IGIGI bank has about 540 branches throughout India, and 4,500 ATMs.[308]

Maimbo et al., however, warn that improving the quality of the remittance infrastructure requires the leadership of private formal financial institutions. They cite the case in South Asia where affordable payment systems have yet to take hold even with the existence of an already extensive state bank branch network.[309]

1.2 Access to Central Banks' Clearing and Settlement Systems

Another proposal to lower the cost of remittances has been to extend direct access to the clearing and settlement systems to non-bank financial institutions, such as money transfer companies and credit unions. The World Bank's survey of 40 central banks published in 2005 finds that in almost all countries, non-bank financial institutions must clear and settle their remittance transactions through commercial banks, a practice that allegedly adds to their remittance operation costs. It is argued that granting non-bank financial institutions direct access to clearing and settlement systems would reduce remittance fees.[310]

It is interesting to note, however, that the same survey finds "enormous skepticism" among developing countries about the viability of this proposal. Thirty-five out of 40 countries raised concern about the proposal's impact on the integrity of their clearing and settlement systems. Particularly, there is apprehension among central banks as to whether non-bank financial institutions in developing countries have the adequate technological infrastructure critical to participating directly in clearing and settlement systems. Indeed, relative to banks, the volume of transactions most of these non-bank institutions handle is not that large. Further, central banks are skeptical over how truly significant the reduction in remittance fees will be once these non-bank institutions are granted direct access to the central banks' clearing and settlement systems. According to this survey, only five countries — Azerbaijan, Belarus, Bolivia, Philippines, and Thailand — are seriously considering this proposal, and even among these countries, the interest is mainly on few large non-bank financial institutions, particularly post offices.[311]

1.3 New Technology

Technological improvements in the banking sector could also significantly reduce transaction costs. New banking technologies that can expedite check clearance, reduce exchange losses, and improve disclosure, especially in rural areas in developing countries, can be particularly helpful.[312] As Wimaladharma et al. emphasize, "in all financial services, new technology offers potential for greater efficiency, lower costs, and extended outreach." Indeed, recent years have seen the introduction of a wide range of technological solutions such as satellite telecommunications and enhanced management and wire transfer systems. Innovative financial products such as debit cards and mobile telephony add-on services are also worth noting.[313]

Pre-paid cards, in particular, are quite a new addition with huge potential. A bank, for example, can offer migrants two sets of cards with the same account number. One of the cards will be sent to relatives in the receiving country where it can be used as an on-line debit card in stores or to withdraw money via ATMs.[314]

There is also an emerging technology that enables remittance transactions by mobile phone. Globe Telecom is one of the two Philippine telecom companies that have recently introduced such a product. Called G-Cash, mobile phone subscribers in the Philippines have to register by keying in personal information, including their mother's maiden name for ID purposes. Their relatives abroad can then visit an authorized G-Cash outlet in their neighborhood, fill in a form, present identification, and credit money to the phone account. The fee per transaction is very small at only 1 percent or a minimum of 10 pesos (US$0.20). The money can also be transferred to another phone in the Philippines using the sender's PIN, a simple code, and the recipient's phone number.[315]

Wimaladharma et al. emphasize that the success of these new products requires a healthy regulatory environment that ensures that access to monopoly services such as telephone and electricity infrastructure is available to poor rural users, and is not unnecessarily expensive.[316]

**2. Last Mile Concerns**

Apart from reducing remittance transfer costs, the policy literature is also increasingly recognizing the enormous challenges at the distribution stage of remittance transactions, the so-called last mile. Establishing operations in rural areas have additional costs many banks and/or money transfer companies are not prepared to bear. As a result, many rural people face higher transaction costs and weaker access compared to their counterparts in the city. As Wimaladharma et al. argue, "much attention is paid to international money transfers, but less to how that money reaches rural areas."[317]

<u>2.1 New Entrants: Grassroots and Private Sectors</u>

One of the suggestions to address this problem is to initiate partnerships between registered banks and non-bank financial institutions, such as savings and credit cooperatives, micro-finance businesses and postal offices.[318] A bank, for instance, can extend access by receiving remittance payments through inter-account transfers, and then making an arrangement with post offices in rural areas. An international MSB could likewise link to a national credit union network.[319] These arrangements can open the financial system particularly to the rural poor, give non-bank financial institutions wider access, and reach out to lower-income communities and isolated rural areas traditionally overlooked by large commercial banks.[320]

With hundreds of offices and branches throughout each country, Orozco emphasized that tapping into credit unions and micro-finance institutions can be particularly fruitful. For example, two-thirds of these institutions in Guatemala are found to have links to recipients in remote areas.[321]

An often cited example of this kind of partnerships is World Council of Credit Unions' (WOCCU) International Remittance Network (IRNet). Connected to money transfer companies such as Vigo, IRNet clients reportedly bear lower transaction costs.[322] Ratha, writing in 2003, notes that IRNet, through a partnership with Citibank branches in the United States and in receiving countries such as El Salvador, Guatemala, and Mexico, lowered remittance transfer costs to only $6.50 per transaction, a rate even lower than offered in informal networks.[323]

For Wimalahadharma et al., it is critical for financial sector regulations to foster this type of partnership by not being unnecessarily strict about the type of registration needed for entities to legally provide remittance transfers.[324]

### 3. Shifting from Informal to Formal Transfer Systems

A consensus is also emerging on the need to facilitate the shift from informal to formal transfer systems. It has been argued that remittances diverted through informal means do not have the same multiplier effect as bank deposits and thus have less impact on development. Remittances channeled through banks or financial institutions can also deepen financial systems in the developing world because they can then increase the availability of resources to finance economic activities.[325] The UK Remittance Working Group also points to some initial evidence showing that in some cases more prevalent use of the formal sector has increased the overall volume of remittance flows.[326] Apart from an economic rationale, the shift from informal to formal transfer also satisfies security concerns given that informal transfer systems have been associated with a number of criminal activities from money laundering to terrorist financing.[327]

A number of governments and international organizations have tried to encourage the use of formal remittance services in a number of ways. Legislation banning the use of informal channels and installing legal remittance requirements have been adopted in some cases, albeit unsuccessfully. More recently, the thrust of the policy debate are on: (1) how to encourage banking among migrants and on (2) how to design appropriate and balanced regulatory frameworks for the remittance industry.

#### 3.1 "Banking the Unbanked": From Cash-Cash to Accounts-Accounts

In most developing countries today, financial systems are primarily serving a very small proportion of the population — the social and economic elite. According to the IDB, an estimated 90 percent of remittance recipients in LAC do not have access to banking accounts, loans, or other basic financial services. For IDB, "the scale and scope of LAC remittances can be a powerful tool to open up these financial systems, and thereby multiply economic impact for millions of families and their communities."[328]

The goal is to move from the current "cash-to-cash" system into the electronic transfer system of "accounts-to-accounts." IDB has emphasized that the "technology is already available" and "what is needed are innovative business plans and appropriate regulatory frameworks." The report continues,

> The costs of sending money can continue to fall. Millions of poor people can be brought into the financial system, and remittances can be leveraged by linking flows to local microfinance institutions, home mortgages, and even the securitization of bonds for on-lending to local small businesses ... Over the past five years, remittances have undergone dramatic changes. Over the next five years, the system can be entirely transformed.[329]

Indeed, being un-banked clearly has several disadvantages both for senders and receivers of remittances. It involves safety risks as a result of conducting all financial transactions in cash, and keeping any savings in the form of cash. Collecting large sums of money and bringing them home can be particularly risky. On top of that are the limited possibilities for taking up loans or depositing savings that could then have an adverse impact on long-term financial stability. Moreover, the un-banked are also burdened with higher costs when accessing basic financial services. For Carling, it is easy to see how "bringing remittance receivers into the banking system will increase the potential development effects of remittances."[330]

*Easing Obstacles*

Toward this end, the focus has been on how to ease the obstacles that are keeping migrants from opening bank accounts. The most cited recommendations include issuance of identity cards for migrants, promotion of financial literacy, and changes within the banking sector itself to make it more "user-friendly."

*Identity Cards*

As already discussed early in this paper, stringent identification requirements have deterred a number of migrants from opening bank accounts. Ratha noted that if this obstacle is eased, immigrants can become the "source of substantial banking business over and beyond wire transfers."[331]

A widely cited example is the Mexican consulates' issuance of a simple official identity card, known as *matrícula consular,* to Mexican citizens living in the United States—legally or illegally. The Pew Hispanic Center noted that just during the first nine months of 2002, about 740,000 *matrículas* were issued in the United States. As of 2003, some 66 banks accept the *matrícula* as a valid identification document.[332] Given the perceived success of this program, Ratha notes that some Central American governments are also considering such cards in order to help their migrant populations obtain bank accounts and use banks to transfer funds cheaply and transparently.[333]

*Financial Literacy*

Improving financial literacy is also a widely held critical component of encouraging banking among migrants. Orozco has argued for disclosure and monitoring of money transfers. He specifically noted recipients' limited familiarity of the costs involved in receiving money as well as their weak access to the few consumer rights institutions that can advocate for change and attend to their needs.[334]

Carling further emphasizes that limited financial literacy adversely impacts not only the individuals or families concerned, but also compromises market operations and competitive forces. For Carling, "promoting financial literacy among remittance receivers can increase the consumption smoothing effect of remittances and enhance the capacity of remittance receivers to use remittances to create sustainable livelihoods."[335]

Orozco, looking at the LAC countries, specifically argues for the "need to increase education, advocacy, and regulation of remittance receiving institutions." In recent years, "financial fairs" have been held to promote remittances and encourage migrant workers to use the formal banking system. Government or non-governmental organizations can also issue report cards on money transfers receivables.[336] The IDB launched its own score card in 2006, which ranked money transfer operators and banks according to a set of pre-determined criteria.[337]

*User-friendly Banking Institutions*

The literature has also recognized that weaknesses in the banking sector itself have markedly contributed to the very low banking participation rate among migrants. As Ratha observes, there is much anecdotal evidence suggesting how 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.[338]

Indeed, a concern persists that the mainstream financial institutions are unwilling to devote the research, product development, and marketing critical in expanding financial services particularly to low-income groups. As Carling argues, "these groups often have particular needs and will respond to products and solutions that are tailored to their situation. Financial institutions may need incentives to pursue research and product development in this area."[339]

Orozco enumerated a number of methods banks can adopt to reach out to un-banked individuals, particularly immigrants. For Orozco, the following strategies can help build confidence among un-banked customers and persuade them to begin relationships with banks.[340]

- Fee-based check-cashing services [with] 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 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."

Orozco also recommended the establishment of low maintenance, small operating branches, such as "mini-bancos" or "bancos ambulantes," that offer other basic services in addition to cashing remittances. The goal is to create trust and banking habits among customers. Another strategy on the table is the introduction of "starter" deposit accounts or "savings-building" accounts that offer favorable interest rates to migrants working abroad.[341]

## 3.2 Appropriate Regulation and Laws

Designing an appropriate and balanced regulatory framework for the remittance industry is another critical aspect in the shift away from informal systems. The debate on this topic, however, has been largely colored not only by development concerns but also by issues regarding national security. As a number of authors have cited, the use of informal channels to finance terrorism have come to the fore particularly after September 11, 2001. International money transfers have come under intense political scrutiny.[342] In particular, Hawala, an informal money transfer system primarily dominant in the Middle East and South Asia, is perceived to be instrumental in international money laundering and in the movement of al-Qaeda funds. This led the G-8 Countries including the United States, France and the UK to curtail international terrorists' funding by creating the Financial Action Task Force (FATF) on money laundering and other bodies. Since its inception, the FATF has already forwarded to governments sets of recommendations on money laundering and terrorist financing.[343]

### *Know Your Customer (KYC)*

One aspect of the regulatory environment is FATF's Know Your Customer (KYC) requirement. It promotes the adoption of formal sector banking standards in the licensing of informal remittance. KYC also requires closer scrutiny of formal financial institutions by financial authorities.[344] In particular, KYC rules encourage financial service providers to adopt more stringent requirements in identifying clients, verifying information, and keeping records.[345] Thus, as Wimaladharma et al. put it, "informal networks that hitherto have escaped much regulation and supervision are increasingly subject to tighter monitoring and control."[346]

A number of authors have raised concern regarding the detrimental impacts of the KYC rules. Sander, for example, highlights how the "necessary development of adequate or updated policies or protocols, new or adjusted systems, manuals, staff training and other related cost are relatively more burdensome to the smaller MTOs [money transfer operators] with narrow margins."[347] Wimaladharma et al. agree, further noting the challenges KYC poses for financial institutions and money transfer companies catering particularly to poor and rural clients, "as they may need to upgrade their client record systems, or deal with clients with inadequate documentation."[348]

These problems are particularly acute in countries at war or in crisis. Fagen and Bump, in a study of a number of countries in these dire situations, expressed similar concerns.

> The regulatory system in place — especially in the US following the Patriot Act of 2001 – was intended to prevent abuses. It may well be serving this purpose … but the costs have been high. Indeed, burdensome regulations challenge the ability of legitimate institutions and businesses to process money lawfully. … The effort to reduce informal in favor of formal mechanisms by means of regulations is proving counterproductive. While this is a general problem affecting transactions to many countries, for obvious reasons, the impacts are greatest on the weakest and most fractious countries.[349]

A number of authors have also observed that that the KYC increases access hurdles to using banks, both for individuals and MSBs. The KYC rule reportedly has changed the way MSBs do business, particularly in terms of how they deal with client identification and on how banks see them as clients. Some raised concern on anecdotal evidence suggesting that banks have become "highly risk averse" and are less inclined to open accounts for MSBs or have "actually asked MSBs to move their accounts to another bank." If true, this development is indeed troubling given that a link into the banking system is an essential part for any MSB operation.[350]

Pieke et al. further observe that the FATC requirement for stricter regulation has been implemented unevenly across Europe. Some countries outlawed informal remittance companies outright and created exchange companies usually regulated by the central bank. Others, however, merely registered Hawaladars.[351]

Norway, for example, continues to forbid non-bank money transfer while Germany has a licensing system in place characterized by high entry barriers in terms of fees and qualifications. For example, a money transfer business would only be deemed trustworthy if run by two managers that are both professionally qualified with managerial experience.[352]

Britain, on the other hand, introduced mandatory registration of money transfer businesses in 2003 as well as an assurance program to check compliance with anti-money laundering legislation. However, Pieke et al. note how the UK government has "refrained from setting-up a more restrictive licensing system." Businesses are required to pay a modest one-time registration fee for each premise and are expected to abide by the Money Laundering Regulations of 1993.[353]

The licensing for MSBs in remittance-receiving countries varies as well. According to Sander, in several cases, agents require central bank permission to operate and are usually licensed as banks. By and large, even foreign exchange (forex) bureaus have to apply for a license to trade, usually granted by the central bank. Various countries even have additional rules, as in the case of India where MSBs are required to create an incorporated company to provide a legal business entity in-country even if all operations are already carried out through a bank as an agent.[354]

Interestingly, Sander further notes central banks' general inclination to grant permission to a bank rather than to a forex bureau. The Forex and Trade Department of Bank of Uganda, for example, is "generally supportive and positively inclined towards granting permission," while the Kenyan Central Bank "seems less keen." Likewise, influenced in part by the difficulty MSBs face in complying with forex control regulations, South Africa prefers banks to deal with money transfers.[355]

Indeed, as Wimaladharma et al. note, "financial regulators and institutions have tended to interpret any ambiguity in the FATF recommendations strictly." They argued:

> This can result in the exclusion of clients who do not posses full documentation (and also those perceived as being risky) from more protected official remittance channels. This disproportionately impacts on poor migrant workers, and those from countries considered as terrorist threats. Whilst there are completely legitimate concerns to safeguard international security and to fight organised crime, a long-term clampdown on remittance systems as a whole would have damaging consequences on the availability and cost of both formal and informal services. A careful balance needs to be struck.[356]

*Solutions Anyone?*

Finding the right balance between development and security concerns is, needless to say, very difficult in practice. As Fagen and Bump put it: "That unregulated transfer systems are open to abuse — ranging from money laundering to support for terrorist activity — is well documented; what should be done about it, however, is highly contested."[357]

Martinez lays out the challenge facing governments quite clearly: Countries "need to issue regulations that strengthen the integrity of the domestic money transfer industry, but do not undermine the future development of this industry or put small firms in competitive disadvantage.[358]

*Two-Pronged Approach*

A World Bank – IMF study of Hawala offered a two-pronged approach. Hawala dealers should be registered in countries where "informal systems exists alongside a functioning conventional banking sector." The regulators should also "address the weaknesses that may exist in the formal sector," such as deficiencies and lack of competitiveness and recognize how excessive administrative requirements can adversely impact the formal industry.[359] On the other hand, the study argued that "in conflict-torn countries without a functioning banking system, requirements beyond basic registration may not be feasible because of inadequate supervisory capacity."[360]

Other recommendations are also quite nuanced. Wimaladharma et al. argue that "licensing should be done with a relatively light touch, and should not be restricted only to larger formal entities, as this would close off (or push underground) more flexible options (often linked to certain regions in receiving countries) offered to poor people from smaller companies or banks."[361]

Pieke et al. agree, noting that "harder approaches tend to criminalize informal remittance companies." They write:

> The softer approach recognizes the important services that such companies provide for migrants, particularly the most vulnerable groups among them, and distinguishes between the remittance companies and their potential criminal abuse. Furthermore, restrictive regulation of money transmitters risks pushing them underground, making it even harder to monitor and regulate their operations.[362]

Wimaladharma et al. also recommend government support of remittance providers, primarily those operating in receiving countries, to meet the cost of conforming with FATF guidelines.[363]

## 3.3 Caveats: Stepping Away from Informality: Common Sense or Not at All?

Although there is clearly an emerging consensus on the importance of shifting from informal to formal channels, it is important to note at this point that some do not see the shift as hands down beneficial for developing countries. Lucas, for example, notes that "the developing countries are coming under increasing pressure to shrink and to regulate the informal transfer system, though such efforts may prove a mixed blessing for the developing countries and their poorer populations."[364]

Pieke et al., in a comprehensive study of the informal systems in Africa, the Caribbean, and Pacific countries, specifically raise the issue of whether attracting remittance flows into informal channels will in fact lead to lower transfer costs and increase the ease and accessibility of money transfer. They argue that there is no evidence that this would be the case. They write:

> Quite the contrary, informal systems usually provide faster, cheaper, more versatile and sometimes even more reliable services. Their curtailment would cause considerable hardship to migrants, their dependants and their areas of origin. Informal remittance systems are adaptive responses to the constraints and opportunities presented by specific migration orders, serving very specific needs of migrants that are not met by conventional financial institutions.

For Pieke et al., "there is no evidence that informal remittances have a developmental impact that is systematically different from that of formal transfers. In other words, the intended use of the money does not seem to determine how that money is transferred."[365]

Pieke et al. further emphasize the mistake in viewing formal systems as "superior simply because the state has a better view of them." They argue that "informal systems are not leftovers of a traditional, even pre-capitalist past" but a "modern, adaptive responses to the constraints and opportunities presented by specific migration orders."[366]

> The legitimate desire of states to regulate and monitor remittance systems should not lead one to conclude that informal systems have to be curtailed and formal ones encouraged. Rather, we should seek ways for informal systems to satisfy the security and law-enforcement concerns of states without, however, restricting their ability to provide the services for which there is such an urgent and widespread need.[367]

Pieke et al. also raise the problem implicit in the very concept of an "informal remittance system." They note how the term is "simply a residual category: everything that is not, on the basis of one or the other criterion, formal." Therefore, the concept can be quite problematic.[368] For one, given shifts in the regulatory environment, "the boundary between formality and informality changes over time."[369] Further, even the "boundary between formal and informal systems is routinely crossed, and quite often more than once." They explain:

> … informal remittance transfers consist of complex sequences of transactions between individual companies or traders, some of which involve bank transactions or the use of the services of formal remittances companies, while others may consist of, for instance, hawala transactions, trade swaps or the couriering of cash.[370]

## B. Leveraging Remittances for Development

Along with the need to strengthen the infrastructure supporting remittances, there is also an increasing consensus on the need to leverage the use of remittances for development purposes. However, the more favored means to do so are increasingly shifting away from government-led schemes and into more bottom-up and/or private sector-led initiatives.

### 1. Governments: Direct Incentives Rather than Control

Remittance-receiving governments have initiated a number of policies to divert remittances to more productive uses. Initially, the policy path has been primarily of control. Countries like Brazil, for instance, control remittance flows through foreign exchange rules. All international transfers reportedly have to go through the central bank. Likewise, in Vietnam, the state controls all forex trade and also requires temporary migrants to invest 30 percent of their earnings into a government fund.[371]

Indeed, a number of countries have attempted and failed to redirect remittance spending through taxing remittances. As Lucas notes, "in most cases this has failed with the main effect being to channel the remittances through non-official channels." He specifically cites the case of Sri Lanka that quickly withdrew a measure that would impose a 15 percent tax on the US $1.2 billion remittances the country received each year due to a mass outcry. [372]

As Sander also notes, some countries such as India and Uganda, have moved on from such practices.[373] The World Bank survey of 40 central banks also reflects this trend. It revealed that as of 2003 only five countries tax remittances: Colombia,[374] Ecuador, Georgia, Peru, and Poland. In each case, taxes were applied in varying ways. Remittances heading to Peru, for example, are subjected to a 0.1 percent tax rate while remittances in Ecuador are charged a 12 percent value-added tax. Georgia and Poland, on the other hand, subject remittances to income tax.[375]

*Carrots Rather than Sticks*

Instead of direct control, more governments have opted to provide incentives to remittance senders. Countries such as Bangladesh, India, Korea, Mexico, Pakistan, the Philippines, Thailand, and Turkey have either the state and/or federal government actively engaged in drawing remittances to the country or in introducing incentives for investment.[376] A rather interesting example is a scheme in Turkey that allows for a considerable reduction in the compulsory national service of male emigrants if a specified amount is paid to the government in foreign exchange.[377]

A World Bank survey, however, revealed that the most common policy path is provision of financial or monetary incentives. It finds that 35 percent of respondents have put in place a variety of incentives such as tax breaks, higher interest rates for deposits and investments in local institutions, and even the possibility to purchase land at preferential prices.[378]

### 1.1 Tax Breaks

Instead of taxing remittances, some governments have taken a 180-degree turn and resorted to tax breaks. In Egypt, migrants remitting through banks receive tax breaks for up to ten years. Interest incomes of Indian and Sri Lankan migrants are exempted from income tax. Some governments, such as Egypt and Moldova have programs enabling migrants to buy land at preferential prices. [379]

Colombia also reformed its tax laws to attract remittances. The government ordered the removal of the tax to entice expatriates to remit a larger portion of their salaries to relatives in Colombia. As Wimaladharma et al. find, Bancolombia, a Colombian bank noted for handling about $100 million in remittances annually, has already eliminated a 3 percent tax charged on remittances and money orders coming from overseas.[380]

### 1.2 Special Category of Deposit Accounts

Some developing countries, such as Bangladesh, India, and Tunisia, have also introduced a special category of deposit accounts at commercial banks where migrants can deposit their savings. Holders of these special accounts are given preferential interest rates as well as the option to have accounts denominated in foreign currency.[381] In some cases, interest from such accounts is fully or partly tax-exempt.[382]

### 1.3 Matching Funds

Another increasingly recognized policy route is to provide matching funds to the collective remittances sent by migrant organizations abroad, commonly referred to as Hometown Associations or HTAs. Most frequent examples are from Mexico and El

Salvador. The local or federal governments in these two countries allocate $2 or more for every dollar migrant organizations remit back in their communities.[383] The pooled funds are normally used to finance infrastructure and social projects, such as remodeling churches and schools. Orozco, for example, documents Guatemalan HTAs' involvement, ranging from the purchase of small fire trucks to raising money for crises such as Hurricane Mitch.[384]

In a review of literature, Carling notes that the Mexican matching fund scheme in particular has been referred to in very positive terms. However, for Carling, such programs also "raise difficult questions regarding priorities for the expenditure of scarce public funds in developing countries." He writes,

> In most cases, there will be poorer communities with less emigration and smaller private remittances in other parts of the country of origin. When authorities give priority to investments in infrastructure in areas where HTAs can provide part of the funding, this must be thought through in the light of overall development strategy.[385]

## 1.4 Investment Vehicles

Some governments have also provided incentives to divert remittances into investment vehicles. Indian returnees, for instance, benefit from preferential access to capital goods and raw material imports. Pakistan has had a roughly similar scheme with a focus on attracting investments in backward areas and export processing zones.[386] In collaboration with a foundation, the Pakistani government also offers a non-repatriable investment scheme and investment and business set-up advisory services.[387] Similarly, Thailand's Bangkok Bank provides counseling on local investment opportunities.[388]

Bangladesh, on the other hand, attracts remittances by reducing commission rates and installing monitoring units within banks.[389] As early as the 1980s, the Philippine congress has also been enacting laws that provide investment related incentives and privileges for remitters including the purchases of land.[390]

Special bonds that finance public investments have also been offered to emigrants in a number of countries. Carling names quite a few that reportedly have "successfully" issued these sovereign bonds, including Bangladesh, China, Eritrea, India, Israel, Lebanon, Pakistan, and the Philippines.[391]

*From Direct Investor to Saver-Rentiers*

Instead as direct investors, a number of scholars have also suggested that policymakers should focus more on encouraging migrants to be saver-rentiers.[392] Saith, for example, highlighted the "tendency to treat the migrants almost exclusively as an investor, ignoring the possibility that the returnee might be better off as a saver-rentiers." Saith continues:

> Indeed, given the high rate of attrition in new ventures in small scale trade and industry, the latter channel might be far more appropriate. This invites particular attention to devising reliable and investor-friendly mechanisms and instruments which allow migrants (and other small scale savers) to invest in the capital market without undue exposure to high risk. Such schemes could also be made more purposive, where such finance is directed to such sectors as housing, for instance. Such measures could generate strong backward and forward linkages in the domestic economy.[393]

## 2. Civil Society: Indirect, Bottom-Up, and Private Sector

Members of the civil society and even the private sector have also taken interest in leveraging remittances to more productive uses. Efforts to cross-sell innovative products such as remittance-backed mortgages and remittance-backed education loans and to tap the microfinance industry are clearly attempts to divert remittances to entrepreneurial or investment-related activities.

### 2.1 Cross-Selling

There has been an emerging interest in cross-selling complementary financial services and products along with remittance services. The idea is to design financial products that serve the needs of migrants and their families. Orozco and Hamilton, in a case study of Guatemala, listed some of these products:[394]

a) Saving packages
b) Certificate of Deposits
c) Pension funds
d) Medical insurance
e) Life insurance
f) Housing credits
g) Small business credits
h) Special foreign currency deposit accounts
i) Tourism packages
j) Telephone and telecommunication offers

However, Orozco and Hamilton raise concern that financial markets have seldom offer products that "meet the market preferences of immigrants."[395] Further, even in cases where these products are offered, the terms and conditions can be more attractive. For instance, in the Philippines, the car manufacturer Honda, in partnership with two local banks, offers car loans to migrant households. Called CAREmittance, the program can be prohibitively expensive with charges of 30 percent annual interest on a 48-month car loan and requiring a 20 percent down payment.[396]

## 2.2 Micro-Finance (MFIs)

Another increasingly popular way to leverage remittances to productive ends is through the use of an alternative financial institution such as micro-finance institutions (MFIs). It is argued that MFIs, as Orozco puts it, "could fill a void" by meeting migrant households' financial needs.[397]

MFIs, like other non-traditional alternatives to banks, can play a savings, investment, and insurance function. Indeed, a recent study Mexican MFIs showed that remittances were responsible for 27 percent of the capital invested in micro enterprises and 40 percent of the capital in the major remittance receiving areas of the country.[398]

Reflecting the same observation, Sorensen notes how the channeling of remittances through micro-finance would aid the financing of local investments. She writes:

> While it has proven difficult to convert successful migrants with no prior business experience into dynamic entrepreneurs, it could be argued that it is more realistic to introduce financial intermediaries to capture remittances as deposits, and to channel them into existing small and micro businesses, rather than focusing on migrant specific investment programmes. Besides, tying remittances to micro lending has the development potential to enhance local markets.[399]

Bagasao shares these sentiments. Commenting on the Philippine case, he argues that "linking migrants and their families to microfinance institutions may provide migrant families the business mentoring and access to capital which may precisely what an absentee migrant need[s] to make sure that money remitted is used productively and not wasted on non-essentials."[400]

*MFIs and Remittances: Great Potential and Great Challenges*

Indeed, the rationale behind and the potential benefits that can accrue from linking remittances and microfinance are very obvious. MFIs, given their wider outreach and accessibility relative to commercial banks, provide a particularly attractive alternative to informal systems. Processing remittance transactions can also provide the revenue MFIs need to achieve financial sustainability without sacrificing their objectives of reducing poverty and maximizing impact. It can also be a potent marketing tool to expand their client base. Moreover, migrant households can also avail themselves of the auxiliary training and marketing services some MFIs offer. These trainings can be useful when investing in productive activities at home.[401]

However, the literature is also quite clear on the considerable obstacles MFIs face in the remittance market. Carling notes that most MFIs cannot meet the regulatory requirements to engage in international money transfer services primarily due to their small-scale and limited resources.[402]

Orozco and Hamilton, looking at Guatemala, share similar observations. They describe in particular how maintaining a stable cash flow can be a "very significant obstacle." They write:

> Because most MFI branches do not manage daily cash, they must work to change their system — and guarantee this service — in order to provide an efficient transfer to their recipients. Specifically, the remittance transfer process is very different from issuing microcredit: remittances are transferred in real time. ... This and other differences require additional capacity building, as well as a new communication infrastructure that will ensure that no delays occur in the system.[403]

Thus, it is not surprising to note that majority of MFIs in the remittance market are already registered as commercial banks and often have a history of being agents for commercial money transfer companies such as Western Union.[404] Sander's observations reflect the cautious optimism among many scholars. She writes:

> MFIs are not the panacea either to lower cost and more accessible transfer services or to the integration of low-income remittance receivers with broader financial services. At the same time, the opportunities for MFIs as niche market providers can be there but need to be looked at very carefully, including in terms of sufficient business volume and some promise of continuity over time. As with other products, MFIs wishing to develop money transfer as a product need to look at their institutional capacity as well as the regulatory requirements and the potential market for the service.[405]

### 2.3 Securitization

A number of domestic banks in developing countries have also resorted to securitization of future remittance flows in order to raise external financing. Workers' remittances represent a future flow receivable that financial institutions can collateralize to access additional capital. In other words, securitization enables banks in developing countries to raise hard currencies by selling bonds.[406] As Buch et al. note, securitization can address "information asymmetries in inefficient domestic financial markets and thereby improve the quality of investment in developing countries."[407]

In Brazil, for example, remittance flows contribute positively to the country's credit ratings. The terms surrounding the $300 million worth of remittance-backed bonds Banco do Brasil issued in August 2001, were found to be "significantly more generous than those available on sovereign issues." As Ratha noted, Standard and Poors rated the remittance backed securities BBB+, several levels higher than Brazil's sovereign foreign currency rating BB–.[408]

Other countries have also used future workers' remittance-backed securities to raise external financing. In 1999, Mexico's Banamex closed a $200 million deal while El Salvador's Banco Cuscatlán securitized $125 million four years later. A number of banks in Turkey have also securitized a portion their remittance transactions.[409] Sander and Maimbo also note the growing interest in securitization among emerging markets such as Mexico, the Philippines, and Turkey.[410] Rutten et al. also describe how remittances could be securitized to access low-cost financing for African agriculture, particularly in Ghana.[411]

However, the extent of securitization of remittances among developing countries could be improved. World Bank's 2003 survey of 40 Central Banks finds that only 4 out 40 respondents have securitized their future remittances flows. For Martinez, securitization "remains an unexploited source of additional financing for developing countries." He calls for the more research looking into the factors inhibiting securitization and the ways how to overcome them.[412]

## IV. Conclusion

Far from being exhaustive, the foregoing discussion represents a good sample of the increasing array of policy initiatives and recommendations different actors have taken and/or considered to maximize the developmental potential of remittances.

Recently, the focus has been on strengthening the infrastructure supporting remittances by reducing transactions costs, addressing problems at the distribution stage or "last mile," and encouraging the use of formal systems. Along side that is a renewed interest on leveraging remittance use for development, focusing this time on more bottom-up and/or private sector-led approaches and less on direct government actions.

Unfortunately, the effectiveness of most of these initiatives remains unknown because evaluations are non-existent, incomplete, or unavailable for public consumption. Beyond that, however, is a simmering concern that the developmental impact of these policies is still very much conditioned by a number of factors, three of which have been mentioned in the literature.

First, some are concerned that unless a favorable investment climate in remittance-receiving countries exists, the developmental potential of remittances can be mitigated. Maimbo et al., for instance, argue that to encourage investment of remittances in small businesses, governments have to improve infrastructure through building better roads, telephone systems, and electric grids, and the like.[413] Connel and Brown reflect the same observation, noting that as long as safer and better alternatives can be found elsewhere, "migrants are unlikely to risk their capital in an investment in the home economy."[414]

Second, some authors have highlighted the centrality of migration policies within both remittance-receiving and remittance-sending countries. As Ratha notes, "facilitating labor mobility between source and destination countries is perhaps the most crucial — and controversial — means of increasing remittance flows to developing countries."[415] Carling agrees, arguing that increasing the number of emigrants is the "the first step governments could take to increase remittances."[416] De Haas has voiced similar sentiments, concluding that "ultimately, the impact of remittances, at least its continuity, depends on the immigration policy of migrant-receiving countries."[417]

Ratha raised concern that amid an increasing pressure for more mobility, "the progress of globalization has been slower in the area of migration," particularly if compared to trade and capital flows.[418] Interestingly, even among developing countries, there is no clear consensus toward more emigration. Carling noted that most governments in developing countries have no policy that affects the level of emigration and those that do have such a policy even "seek to *lower* emigration levels and not to raise them."[419]

Lastly, a number of authors have brought up the issue of policy dialogue and coherence among governments. Martinez, for example, noted that financial authorities in recipient countries cannot alone resolve some of the problems deterring the flow of remittances through formal channels. The World Bank survey of 40 Central Banks revealed that only five developing countries engage in active dialogue with their counterparts in sending countries to facilitate remittances flows.[420] As can be expected, lower average remittance fees can be found in corridors where active policy dialogues between sending and recipient countries exist.[421]

Although far from the panacea they are sometimes purported to be, remittances, as the literature clearly shows, generally have a positive impact on key aspects of development, including human capital formation, investments, poverty reduction, and macro-economic stability and, in some cases, even on social and political change. Depending on the policies key stakeholders, particularly governments, are willing to implement, remittances can be a potentially powerful tool for development.

The current policy focus on leveraging remittance use for development and on strengthening the infrastructure supporting them will certainly enhance this potential. However, remittances, just like any other form of capital transfer, do not operate in a vacuum. A sound socioeconomic climate within migrant-sending countries, development-friendly migration policies within both sending and receiving countries, and extensive policy dialogue and coherence within and among governments are critical components that will make remittances work for development.

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