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International Remittances and Development: Existing Evidence, Policies and Recommendations

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INTERNATIONAL REMITTANCES AND DEVELOPMENT: EXISTING EVIDENCE, POLICIES AND RECOMMENDATIONS[*]

Ernesto López-Córdova[**]
Alexandra Olmedo

In this paper we survey the recent literature assessing the development impact of international migrant remittances. We begin by arguing that international migration should be fully incorporated in ongoing debates on the impact of globalization. We show that, despite methodological challenges, there is an emerging body of evidence suggesting that migrant remittances can have an important impact on development and household welfare. Remittances appear to help in poverty reduction, accumulation of human capital, investment and saving. Finally, we offer an account of existing policies and recommendations to facilitate remittance flows and to take advantage of their developmental potential.

I. INTRODUCTION

International migration is arguably one of the least understood and most controversial aspects of the globalization of the world economy. Economists and other scholars have dedicated considerable efforts to the study of goods and capital flows across borders. Countries around the globe have greatly liberalized international trade and investment in recent years and have created international institutions with a broad membership whose task is to deepen that liberalization. There is a consensus -not exempt of caveats, exceptions, and outright opposition- that views the free flow of capital and goods as central for economic growth and human development. In contrast, one could say that migration has been relatively under-studied.[1] True, there is an old and active literature that looks at transnational population movements, especially as it pertains to specific flows between any two countries, but the impression is that migration has not been properly understood as yet another manifestation of greater economic integration around the world. Moreover, it seems that the institutional infrastructure in place to regulate population flows and, above all, to protect international migrants and harness the developmental potential of migration, is considerably less developed than in the trade and investment arena. Such an imbalance is to some extent

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[1] A quick search in EconLit, a respected economic bibliography database, shows that, for the years 2000 to 2004, the number of all publication records on the subject of "international migration" (JEL code F230) totaled 831, compared to 2,537 records on "international investment; long-term capital movements" (JEL code F220) or 10,878 records on trade (JEL code F100 to F190).

surprising, as scholars have long recognized the important role played by the international movement of people during the first era of globalization in the late nineteenth century. (*e.g.*, O'Rourke and Williamson [1999]). Recently, however, scholars, national governments, and international organizations are coming to realize that international migration is a central aspect of globalization, one with important -even if yet under-studied and poorly understood- implications for economic development and welfare, both in receiving and in sending nations.

It is probably the case that the growing recognition about the significance of international migration is to a good extent the result of the impressive volume of income transfers from migrants to their families back home -international remittances. In the case of Latin America and the Caribbean (LAC), for example, the Multilateral Investment Fund (MIF) of the Inter-American Development Bank (IDB) estimates that remittance flows reached US$ 45 billion in 2004, exceeding foreign direct investment and overseas development assistance to the region.[2] These figures, which are a substantial improvement over figures based on balance of payment statistics, have helped the IDB take a leading role in advocating for a closer look at the developmental impact of remittances.

To be sure, remittances are not a new phenomenon and scholars have been exploring the subject for at least three decades, pointing to their significant magnitude, studying their developmental impacts and calling for improvements in data collection. But remittance flows have continued to increase hand-in-hand with the rise in the number of migrants around the world -and will likely continue to do so in the coming years. The number of migrants grew from 154 to 175 million between 1990 and 2000 (Docquier and Marfouk [2005]) and is expected to reach 185-192 million in 2005 (IOM [2005]). In the United States, the biggest source of remittances along with Saudi Arabia (Maimbo and Ratha [2005]), the size of the foreign-born population as a fraction of the total population has been rising since 1970 -after six preceding decades of decline- from 4.7% to more than 11% in the year 2000.[3]

Given the growing prominence of remittances, it is natural to ask whether they improve development prospects in migrant-sending regions and, in particular, raise living standards among remittance-receiving households, or whether they may simply be a "new development mantra" (Kapur [2004]), a fad that may soon subside. It is probably safe to say that remittances are not the silver-bullet that, by themselves, will raise receiving countries' development indicators to those seen in developed countries. Yet, as pointed by Rapoport and Docquier [2003], "the marginal value of a dollar of remittances is likely to be quite large", and as such they may help address some of factors hindering economic development. Indeed, remittances may ameliorate some of the problems that plague developing countries, such as credit market failures, inequality in income and in opportunities, income volatility, and poverty. At the household level, remittances help to overcome such problems by supplying the resources necessary to acquire a house, open a business, and pay for education or health expenses, all of which are usually beyond

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2 The IDB estimated that in 2005 remittance flows to Latin America reached US$ 55 billion (IDB Press Release, 3 November 2005).

3 Figures taken from Gibson and Lennon [1999] and U.S. Census Bureau [2003].

the reach of vast segments of the population in recipient countries. At a macro level, the positive financial and social externalities generated by remittances (and migration), which are likely to be large, and offer a stable source of foreign currency that can help prevent balance of payment crises.

In assessing the developmental impact of remittances, two initial issues come to mind. First, is the study of remittances in essence any different from that of migration (Rapoport and Docquier [2003])? Or, more precisely, should we strive to understand the impact of remittances separately from that of migration more generally? And, second, how is the study of the impact of remittances different from studying the impact of any other source of additional income? The first issue arises since the two processes are intertwined: remittances cannot happen without migration. Yet, there are important technical challenges that make it difficult to disentangle the effect of remittances from those of migration. In addition to the scarcity of reliable data, "migrant economic opportunities are in general not randomly allocated across households, so that any observed relationship between migration or remittances and household outcomes may simply reflect the influence of unobserved third factors" (Yang [2005]).

In view of these challenges, McKenzie [2005a] argues that attention should be broader and focus on characterizing the overall effects of migration, instead of concentrating only on remittances. While we agree with McKenzie [2005a] that remittances are part of the larger migration phenomenon and that the international and academic communities should strive to understand migration as a whole, we believe that these do not preclude efforts to understand remittances by themselves. Indeed, one may want to devote particular attention to remittances, as policies aimed at facilitating international income transfers and at harnessing their developmental potential are likely to be more politically palatable than policies seeking to facilitate (or curtail) migration flows. In host countries, migration policy reform is controversial because immigration has a redistributive impact, usually affecting unskilled workers; because of fiscal considerations; because of the fear that an inflow of migrants may tear the social fabric; and, in recent years, because of the fear of international terrorism.[4] In sending countries, fear of losing the most entrepreneurial or best educated members of society is always a consideration in the mind of policy makers. Such considerations -whether justified or not- should not deter the international community from bringing the debate on migration to the forefront. In the meantime, we stress that it may be easier for countries to establish mechanisms and adopt policies in order to take full-advantage of remittances flows, even under the current migration environment.

On the second issue, it is tempting to think that the study of remittances is not different in any substantive way from the study of any other source of income, in particular government transfers. There is an extensive literature in the field of public economics that analyzes the impact of government entitlement programs, especially in developed countries. More recently, developing countries that have adopted conditional transfer programs (*e.g.*, Mexico's *Progresa* or *Oportunidades*, or Brazil's *Bolsa Scola*) have evaluated the effectiveness of such transfers in improving living conditions among recipient households (child nutrition, school attendance, etc.).

[4] Hanson [2005b] offers a recent account of the debate regarding immigration reform in the United States, emphasizing public finance considerations.

Why should we expect that the impact of remittances on, say, school attendance would be any different than that from a government transfer? What is new or different from what we already know from the existing literature? On this issue, we first point out that remittances may be countercyclical or less procyclical than other sources of household income, such as wages or government transfers, allowing households to diversify risk and smooth consumption. Indeed, insurance against income shocks may be one of the reasons for migrating and remitting income. In addition, the way remittances are used may differ to the extent that migration affects who makes spending decisions in the household. Mothers, who are less likely to migrate than fathers, may place more weight on spending on education or on saving.[5] Remittance transfers may be also earmarked for specific uses such as education or housing.

As we try to argue in this introduction, migration should no longer be a secondary consideration in ongoing debates on globalization. Migration and remittances more specifically play an important role in the development process. Understanding their specific impact should be a primary item in our work agenda. In the rest of the present paper we survey some of the main and most recent contributions to the literature with respect to the impact of remittances on household welfare and development in general. We also review policies that have been implemented around the world, with a special focus on LAC countries, or existing recommendations, in order to influence the flow of remittances and harness their development potential. Before we jump into these issues, we briefly review the main trends in remittance flows as regards their volume and costs, as well as the main reasons why remittances may take place in the first place and how recipient households make use of them.

[5] Mexico's *Oportunidades* conditional transfer program is structured in such a way that it is the mother, not the father, who receives transfer payments.

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II. FLOWS AND COSTS

Most available data on remittances present two types of problems: under-reporting and lack of homogeneity among countries. The first problem is mainly due to the fact that a large part of the transfers take place through institutions outside the formal financial sector that do not report their transactions to the national central bank or concerned ministry. Other transfers occur through new financial products, such as dual debit cards, making it difficult to know if a transaction involves a transfer from the migrant to his family or a retrieval made by a tourist. Finally, a non-negligible part of the money circulates through people traveling to their home country or in letters posted through the mail. The second problem concerns the flows that are actually recorded in the balance of payments and refers to the discrepancies that exist in the compilation of the data among the countries. The consequence is that the data are neither comparable nor equally reliable across countries.

Data on remittance flows to LAC (henceforth) have been much improved in recent years thanks to the leading role of the MIF of the IDB.[6] For the past three years, the MIF has financed surveys among migrants in the United States, Europe, and Japan to learn about their remitting behavior and to offer estimates about the magnitude of remittance flows. The MIF calculates that remittances to LAC for 2004 surpassed US$ 45 billions, up from US$ 32 billion and US$ 38,5 billion in 2002 and 2003, respectively, for an annual growth close to 20% on average (in nominal terms). Table 1 presents MIF estimates of remittance flows to LAC countries. MIF survey-based remittance data exceed official figures on remittances to LAC by approximately 20%.

6 A compilation of some of the work sponsored by the MIF appears in Terry and Wilson [2005].

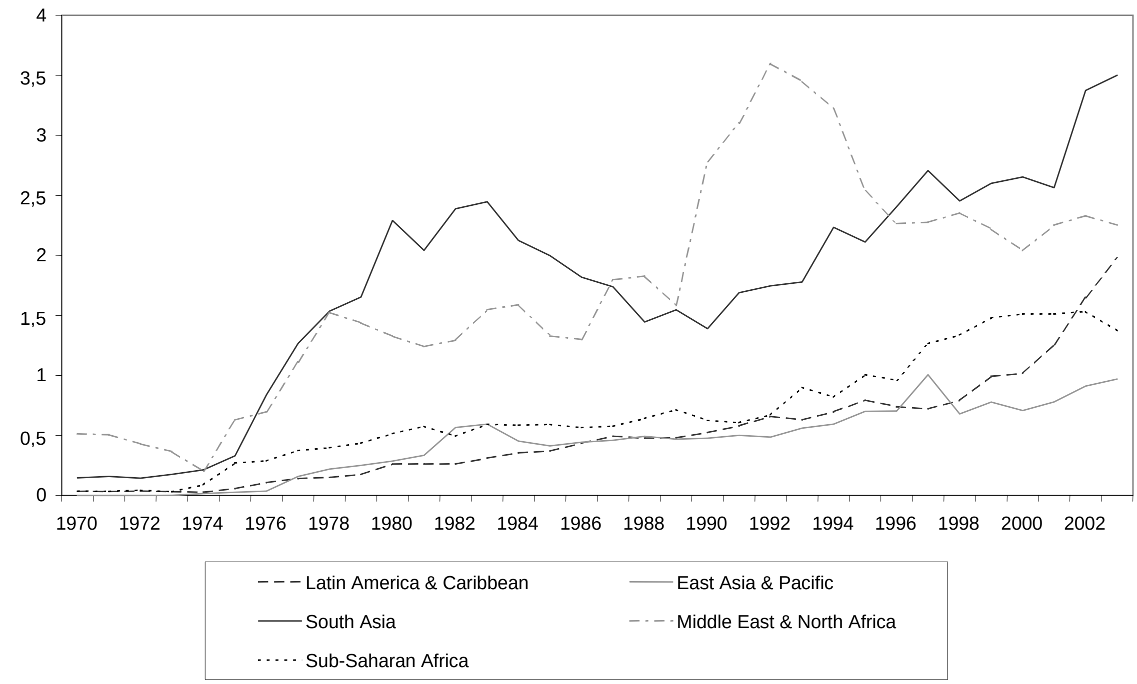
TABLE 1
REMITTANCE FLOWS TO LATIN AMERICAN AND CARIBBEAN COUNTRIES

	2001	2002	2003
Argentina	100	184.0	225.0
Belize	-	-	73.0
Bolivia	103	104.0	340.0
Brazil	2,600	4,600.0	5,200.0
Chile	-	-	-
Colombia	1,756	2,431.0	3,067.0
Costa Rica	80	134.0	306.0
Dominican Republic	1,807	2,111.0	2,217.0
Ecuador	1,430	1,575.0	1,656.0
El Salvador	1,911	2,206.0	2,316.0
Guatemala	584	1,689.0	2,106.0
Guyana	90	119.0	137.0
Haiti	810	931.0	977.0
Honduras	460	770.0	862.0
Jamaica	968	1,228.0	1,425.0
Mexico	8,895	1,050.2	1,326.6
Nicaragua	660	759.0	788.0
Panama	-	-	220.0
Paraguay	-	-	-
Peru	930	1,265.0	1,295.0
Surinam	-	-	-
Trinidad & Tobago	41	59.0	88.0
Uruguay	-	-	42.0
Venezuela	136	235.0	247.0
All of LAC	-	*32,040.0*	*38,047.0*

Source: IDB-MIF (*http://www.iadb.org/mif/remittances*)

Despite their limitations, one must rely on official remittance figures in order to make international comparisons or to trace flows over time. In Figure 1 we present remittance inflows as a fraction of Gross Domestic Product (GDP) by world region over the last three decades. In 1970, regional averages stood at less than 0.5% of GDP. Remittance transfers to South Asia and to the Middle East and North Africa began increasing rapidly in the mid-1970s. For South Asia remittances began representing more than one point of its GDP in 1976 reaching a peak of 2.5% of GDP in the mid-80s. During this time, remittances represented 1.5% of GDP for the Middle East and North Africa region growing up to 3.5% at the beginning of the 1990s. In LAC, remittances grew steadily since the 1970s but did not reach more than 0.5% of GDP until the 1990s. By 2002, remittances to LAC represented almost two percent of GDP. Table 2 presents figures of remittances *per capita*, GDP *per capita* and remittances as a fraction of GDP in a sample of countries.[7] Among the 16 countries for which remittances represent more than 10% of GDP, we find six Central American (Guatemala, Nicaragua, El Salvador and Honduras) and Caribbean countries (Jamaica and Haiti). Among LAC countries remittances *per capita* varies between US$ 6 in Argentina to US$ 480 Jamaica. In Mexico, the country receiving the largest flow of remittances in LAC, remittances *per capita* are US$ 131 and represents 2.3% of GDP.[8]

FIGURE 1
REMITTANCES AS A PERCENTAGE OF GDP, BY REGION



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[7] We chose countries in which GDP *per capita* is less than US$ 10,000 and with positive remittance flows.

[8] One should bear in mind that these figures are likely to be an underestimate of remittance flows as explained before.

TABLE 2
REMITTANCES AND GDP *PER CAPITA*, 2003

Country	Remittances *per capita*	GDP *per capita*	Remittances as % of GDP	Country	Remittances *per capita*	GDP *per capita*	Remittances as % of GDP
Serbia and Mont.	337.61	1,199.60	28.14	Guinea	14.04	430.74	3.26
Jordan	373.21	1,801.07	20.72	India	16.26	510.81	3.18
Haiti	96.09	467.14	20.57	Cambodia	9.33	313.37	2.98
Albania	245.53	1,392.04	17.64	Egypt, Arab Rep.	43.83	1,622.27	2.70
Bosnia and Herz.	208.90	1,225.18	17.05	Mexico	130.96	5,792.05	2.26
Jamaica	480.39	3,156.23	15.22	Azerbaijan	18.72	865.23	2.16
Cape Verde	196.05	1,289.81	15.20	Suriname	48.16	2,256.99	2.13
El Salvador	322.25	2,128.64	15.14	Georgia	13.10	729.05	1.80
Tajikistan	29.66	208.25	14.24	Costa Rica	76.40	4,409.69	1.73
Honduras	123.47	926.63	13.32	Belize	60.37	3,635.37	1.66
Nepal	30.75	240.89	12.76	LAC	59.29	3,764.61	1.57
Liberia	14.91	122.62	12.16	Peru	31.68	2,130.67	1.49
Yemen, Rep.	66.23	552.73	11.98	Paraguay	19.40	1,407.22	1.38
Guinea-Bissau	14.46	135.35	10.68	Burkina Faso	3.38	252.88	1.34
Nicaragua	80.07	766.88	10.44	Ghana	3.15	275.86	1.14
Guatemala	171.16	1,674.73	10.22	Poland	51.08	4,634.42	1.10
Dom. Rep.	235.79	2,412.60	9.77	Bolivia	10.73	1,017.27	1.05
Morocco	120.01	1,277.87	9.39	Indonesia	6.93	781.27	0.89
Moldova	34.63	369.66	9.37	Ethiopia	0.68	102.42	0.66
Guyana	83.37	942.20	8.85	Mozambique	1.59	254.87	0.62
Ecuador	118.35	1,367.65	8.65	Ukraine	3.83	812.49	0.47
Sudan	36.32	433.26	8.38	Lesotho	2.10	530.40	0.40
Sri Lanka	73.52	920.56	7.99	Turkey	10.31	2,976.88	0.35
Togo	22.89	291.86	7.84	Armenia	3.05	883.62	0.35
Senegal	35.64	485.45	7.34	Brazil	11.43	3,510.23	0.33
Kyrgyz Republic	19.87	304.57	6.52	Iran, Islamic Rep.	5.11	1,715.20	0.30
Mongolia	25.23	423.83	5.95	Philippines	2.90	1,046.63	0.28
Bangladesh	23.03	395.38	5.83	China	2.59	1,067.35	0.24
Tunisia	126.36	2,214.49	5.71	Lithuania	9.61	4,077.52	0.24
Lebanon	223.03	3,925.08	5.68	Madagascar	0.48	233.18	0.21
Pakistan	26.70	546.07	4.89	Uruguay	9.41	5,235.28	0.18
Uganda	11.67	276.54	4.22	Kazakhstan	2.58	1,673.15	0.15
Macedonia, FYR	69.74	1,740.02	4.01	Estonia	6.78	4,841.44	0.14
Barbados	358.11	9,255.77	3.87	Namibia	2.38	1,844.98	0.13
Syrian Arab Rep.	42.74	1,135.17	3.77	Russian Fed.	2.09	2,138.33	0.10
South Asia	18.69	497.08	3.76	Argentina	6.42	7,164.96	0.09
Croatia	177.01	4,750.60	3.73	Hungary	3.83	5,103.34	0.08
Sierra Leone	4.83	141.23	3.42	Malawi	0.08	157.29	0.05
Colombia	68.64	2,017.00	3.40	Romania	0.64	1,963.22	0.03

Note: Countries for which the percentage is above 0, and with a GDP *per capita* under US$10,000.

Source: Based on World Development Indicators data.

Data on remitting costs are scarce. A notable exception is the work by Orozco [2001], Orozco [2004] and the MIF (IDB-MIF [2004a]), which regularly survey remittance companies in the United States (US) to assess the cost of money transfers to LAC. The main conclusion from those reports is that the cost of making a transfer has declined since the 1990s by around fifty percent due to increased competition in the remittances market. Since 2003 the average cost of sending remittances has fallen from 12.5% to 7%.[9] In 2004, transfer cost were as high as US$ 24 for a US$ 200 transfer to Cuba and as low as US$ 10 to Ecuador. The difference is explained by the fact that in countries where it is more expensive to send money, the remittances markets is less competitive and market restrictions are tighter. There are also cost differences between companies and across US cities (Orozco [2001], [2004]). For instance, according to De Luna [2005], the cost of sending US$ 300 to Mexico from New York City with Citibank was of US$ 5 in February 2005, compared to US$ 15 with Western Union and US$ 25 with MoneyGram. One should add that those fees correspond solely to what the company charges in the United States. The cost to transfer money includes three different components: the fees that the sender pays, the exchange rate spread, and the fees that the beneficiary pays. In the references cited above, little is said about the third cost component. Regarding exchange-rate costs, Orozco [2001] shows that companies use different exchange rates from the official rate. The difference between the official rate and the rate used by the company is, not surprisingly, in detriment of the consumer. The foreign exchange fee can be particularly high in countries with exchange controls with a large difference between the official and the parallel exchange rate, reaching as high as 40%, for example, in Venezuela in early 2004 (Maimbo and Ratha [2005]).

9 IDB Press Release, 3 November 2005.

III. MOTIVATION AND USE

Contents

The microeconomic literature identifies six different motives, not mutually exclusive, on why migrants transfer income to their families in their countries of origin: altruism, exchange, insurance, investment, and inheritance.[10] The first motive, altruism, refers to situations in which the migrant sends money home to meet the needs of his/her family, and in which the transfer does not entail any present or future compensation nor does it represent payment for any past debt. Remittances based on pure altruism will increase with the migrant's income and decrease with the recipient's (pre-transfer) income. The exchange motive describes the case in which remittances are sent to pay for concrete services or to repay for loans. Situations describing the payment of services are those where the migrant left behind children (or elderly parents) or assets (*e.g.* land) that someone is taking care of, while repayment of loans refers to money borrowed by the migrant to cover his/her migration costs or education. The main prediction of the theoretical model is that remittances will increase with the recipient's income, which is in clear contrasts with the prediction of the altruistic model. Insurance is one very common motivation to remit specially in rural areas of low-income countries where environmental factors create a high volatility of income and market failures prevent any type of credit or insurance. In this context, migration of one (or more) member of the family (or the village) occurs in order to ensure, a priori, a less volatile flow of income. As with the altruistic model, remittances are supposed to decrease with the recipient's income. The main difference between these two frameworks is to be found in the frequency the migrant sends money, which is expected to be more irregular than in the altruistic model. The investment motive responds to the will of the household to enlarge its current wealth, which is not subject to uncertainty unlike in the insurance motive. The principal conclusion of this model is the existence of an inverted U-shaped relationship between remittances and the recipient's pre-transfer income. Finally, inheritance, or more precisely, the threat to be left with no inheritance, appears more to be like an enforcement device to the motives of exchange or insurance in those cases where altruism is not enough to respect an implicit contract between the migrant and the remittance-receiving household.

In practice, it is not easy to clearly differentiate one motive from another as the reasons that push a migrant to remit may encompass several of these dimensions. What scholars have been doing in order to distinguish among the different theoretical motives is to regress remittances on a set of different variables suggested by existing theoretical models. Such variables include the levels of current and expected pre-transfer incomes of the migrant and the household, the migrant's education and gender, income volatility at home and destination, number of heirs and migrant members for a given household, assets of the household, current and expected level of unemployment at home and destination, among others. Authors then conduct tests of one hypothesis (or motive to remit) against another, an extremely difficult task due to technical and data considerations.

There is little support in the literature for the altruistic motive to remit. One exception is the study of Bouhga-Hagbe [2004], which suggest that altruism or solidarity could be the main long-run

[10] Rapoport and Docquier [2003] offer an excellent and comprehensive study on remittances and it is from their work that we build our brief review on the theoretical motives to remit.

determinants of workers' remittances in Morocco. Lucas and Stark [1985] study in Botswana found evidence consistent with the exchange and investment motives to remit as results show that remittances increase with the migrant's earning and with the household's pre-transfer income. Inheritance seems to be present also in this remitting behavior as results show that males remit more than daughters when the household possesses large herds. This last result is also supported by Hoddinott [1992]'s study in Kenya as evidence shows that sons' remittances increased when parental land holdings were larger. This effect is found to be more pronounced when there is more than one migrant son. Both Cox, Eser and Jimenez [1998] and Ilahi and Jafarey [1999] find evidence consistent with the exchange motive although in the Cox, Eser and Jimenez [1998] study (conducted in Peru) it is the education repayment loan argument that sustains the hypothesis while in the Ilahi and Jafarey [1999]'s study (conducted in Pakistan) it appears to be the repayment of the international migration costs. Durand, Parrado and Massey [1996a]'s study in Mexico also lends support to the investment and exchange motive where migration cost repayments seem to explain the exchange mechanism. De la Brière *et al* [2002] show that in the Dominican Republic the insurance motive appears to be the main motivation to remit for female migrants who emigrate to the United States. The same holds true for males but only when they are the sole migrant member of the household and when parents are subject to health shocks. Investment seems to be gender neutral and only concerns immigrants in the United States. Additional evidence of the insurance mechanism through remittances is provided by the studies of Paulson and Miller [2002] in Thailand, Lambert [1994] in Côte d'Ivoire, and Gubert [2002] in Western Mali. The investment motive finds some support in the studies of Glytsos [1997], on Greek immigrants in Germany and in Australia, and Ahlburg and Brown [1998], on Tongan and Samoans in Australia, although both studies make clear that this mechanism is conditional on the estimated duration of migration. That is, when migration is considered to be permanent, the level of remittances is substantially lower.

Finally, macroeconomic variables such as the exchange and interest rates and inflation are also found to have an influence in the remitting behavior of international migrants. El-Sakka and McNabb [1999] estimation using data on Egypt show that remittances flows are highly responsive to the differential between the official and black exchange rates. Also, the differential between domestic and foreign interest rates has a negative and significant impact on the inflow of remittances circulating through official channels. Finally, domestic inflation is found to have a positive and significant impact on the inflow of remittances. Fiani [1994] used macro data on Morocco, Portugal, Tunisia, Turkey and Yugoslavia for the period 1977 to 1989, and found that a real depreciation in the home country leads to an increase in remittances. Higgins, Hysenbegasi and Pozo [2004] looking at data from nine LAC countries found that real home country income *per capita*, host country unemployment rates and the level of uncertainty in the real exchange rate are determinants of the immigrant's decision to remit. Results suggest that a one standard deviation increase in exchange risk reduces remittances per migrant by 10%; a one percent rise in the US unemployment rate reduces remittances by eight percent; and, a ten percent increase in *per capita* income in the home country raises remittances by twenty-one percent. Finally, Spatafora [2005] regressions on a larger panel of countries show that world output as well as home country output has a statistically significant positive impact on remittances. In contrast, multiple exchange rate, black market premium and restrictions on holding foreign exchange deposits have a significant negative impact on remittances.

Having discussed why migrants may remit income to their families, we turn now to how recipients use remittances or how senders expect the money to be spent. International evidence indicates that remittances cover, first and foremost, current or daily expenditures, followed by education and health care expenses. Surveys sponsored by the MIF[11] in a number of LAC countries show that daily household expenses (food, rent, utilities) absorb between 46% (Brazil) and 84% (El Salvador) of remittances; education expenses take between 2% (Ecuador) and 17% (Dominican Republic); investment in a business use between one percent (Mexico) and 10% (Brazil, Guatemala) of remittance income. Remittances going to saving can reach as high as 11% (Guatemala) and those for acquiring property 7% (Brazil). Regarding the intended use of remittances, Amuedo-Dorantes and Pozo [2004] report that in Mexico the main (declared) reason migrants send money back home is to cover health expenses (46% of remitters), food and maintenance (30%), construction or repair of the dwelling (8%), and debt payment (6%).[12] Cerrutti and Parrado [2005] study on Paraguayan migrants in Argentina also show that remittances are intended to be spent primarily on household expenditures, education and health care, with the category `household expenditures' being the largest.

The fact that existing evidence consistently shows that only a small fraction of remittances is used for enterprise financing has led some to question the ability of remittances to serve as a catalyst for development. Such views are unfounded, in our opinion, as spending on education, nutrition or health, for example, are important investments that may promote long-term economic growth. As we will see in the next section, there is a growing body of evidence that remittances indeed help promote investment in human capital, as well as having a positive impact on other development areas.

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[11] See Bendixen and St. Onge [2005], Table 3.2, for a summary.

[12] Amuedo-Dorantes and Pozo [2005] use data from the Mexican Migration Project, which may not be nationally representative.

Contents

IV. DEVELOPMENT IMPACT

In this section we review some of the existing studies that aim at assessing the impact of international migrant remittances on development. We pay particular attention to findings regarding household welfare. We should note that we do not attempt to survey a vast and often old literature, but choose to concentrate instead on more recent studies. In part this is the case because the latter often tend to rely on more comprehensive datasets, representative of larger sectors of society, and apply advances in econometric techniques that yield more conclusive evidence on the subject at hand.

One must recognize from the outset that in drawing conclusions about the impact of remittances on household welfare one must deal with a number of challenging issues. First, as mentioned in section II, there are data limitations arising from the inability of official sources to account for transfers using informal channels, affecting remittances statistics based on balance of payments and household surveys. Leaving aside the fact that remittance data are often inaccurate, it is the case that nationally-representative household surveys rarely contain detailed information on migratory patterns or remittance income. For example, they may capture only recent migration behavior without specificity about the identity of the migrant member of the household. Moreover, national household surveys typically consist of a cross-section of households, which are rarely followed over time, preventing researchers from analyzing changes in behavior in response to changes in migratory and income transfer patterns. Although there exist surveys that collect extensive information on migration and remitting patterns for a sample of households, they typically focus on high-migration areas and are therefore not nationally representative. In addition, some of these surveys rely on retrospective information provided by respondents to obtain individual migration histories and are therefore subject to inaccuracies. Despite these limitations, studies based on this subject provide a wealth of useful information on the impact of remittances.[13]

A second challenge that researchers must grapple with is disentangling the effect of remittances on a given aspect of household welfare or development, from that of migration more broadly, as suggested earlier. The latter has an impact on development and household welfare through channels other than remittances, such as the disruption of family life, effects on the labor market, the so-called "brain drain", or the acquisition of knowledge in the host country that is then transferred to the sending region. Indeed, remittances and other aspects of migration could either reinforce each other or work in opposite directions. For example, overseas transfers relax income constraints that in turn allow families to invest in the schooling of children. On the other hand, the disruption of family life from migration of one or both parents or a reduction in the cost of emigrating for youths as networks of migrants are created could reduce the incentives for children to continue their education. Isolating the specific impact of remittances is made difficult not only by the data limitations discussed before, but by the fact that remittance-receiving families are typically the ones in which a family member has emigrated. In the context of an

[13] The Mexican Migration Project (*http://mmp.opr.princeton.edu*) database, constructed through an ethnosurvey questionnaire applied since 1982, is a widely used example of this kind of data. Durand and Massey [2004] offer a compendium of articles written under the Mexican Migration Project.

econometric exercise, the latter is bound to result in multicollinearity problems that make it difficult to draw reliable inferences.

A third issue has to do with the difficulty in identifying a causal relationship from remittances to household well-being. In all likelihood, causality runs in both directions. While the cost of emigration are not trivial and therefore prevent the poorest members of society from migrating, the perceived need to improve their families' living conditions is one of the factors that drives migrants to move to another country and to send remittances back home -the "altruistic" reason described in section III. In addition, there may be unobserved reasons -such as pressing medical needs, for example- why households may opt to send one of its members to work abroad or why an existing migrant may decide to remit some of its income back home. It follows therefore that the decision to emigrate or to remit may be heavily influenced by the living conditions of the household and that migrants and remitters do not constitute a random sample of the larger population. This poses important hurdles to empirical researchers who want to understand how remittances, and migration more broadly, affect household welfare. A strategy to deal with that problem is to find a variable that is correlated with remitting behavior, but not with the outcome of interest -an "instrumental variable", using the terminology of econometricians- in order to identify the causal impact of remittances on the outcome of interest. Unfortunately, finding such instrumental variables proves not to be trivial and much of the recent work on the subject, as in much of current applied econometric work, revolves around the search for the best identification strategy.

Keeping in mind the challenges that researchers on this subject must face, we now turn to summarizing some of the findings regarding the impact of remittances on development and household welfare. As in the rest of this paper, we focus on studies on Latin American countries.[14]

A. Poverty and Inequality

A first question that naturally arises is whether remittances lead to reductions in poverty among recipient households. Such question goes beyond mere academic interest, as it is the subject of debate in policy circles.[15] Despite its importance, few authors have ventured into analyzing the subject. Existing findings suggest however that remittances unambiguously reduce poverty but that their impact is small, with its magnitude depending on how poverty is measured. Adams [2004] and Adams and Page [2005] use three different measures of poverty calculated relative to definition of the national poverty line:[16] the poverty headcount index or incidence of poverty, that is the share of the population whose income or consumption is below the poverty line; the

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[14] We also emphasize research that has been funded by the IDB, keeping in mind the disclaimer at the beginning of this paper.

[15] For example, representatives from the Mexican Ministry of Social Development have argued that remittances have a minimal impact in reducing poverty, based on the observation that poor households receive only a modest fraction of the overall transfer of income to Mexico ("Remesas no disminuyen pobres.- Sedesol", *Reforma*, 20 June 2005)

[16] The poverty line is defined by the World Bank as the annual cost of purchasing the minimum daily caloric requirement of 2172 calories per person plus non-food items such as health and education. In Adams and Page [2005], the authors refer to an international poverty line set as US$ 1.08 but they do not specify if this includes only food expenditures or also non-food items.

poverty gap index or depth of poverty which provides information regarding how far off households are from the poverty line; and the squared poverty gap which measures the severity of poverty by taking into account not only the distance separating the poor from the poverty line, but also the inequality among the poor.[17] Although the two studies differ in that they use different data sources -with Adams [2004] using national survey data on Guatemala and Adams and Page [2005] macro-data for a panel of 74 low- and middle-income developing countries- they reach similar conclusions, except for the poverty line. Both studies show that international remittances have a statistically significant impact on the poverty headcount index albeit the magnitudes are small. In the country panel study, a 10% increase in the share of international remittances in a country's GDP leads to a decline in the incidence of poverty of 1.6%. In Guatemala, international remittances actually increase the level of poverty by 1.1%. However, in both studies international remittances have a much larger impact on reducing both the depth and severity of poverty. In Guatemala, the severity of poverty (the squared poverty gap) is reduced by 20% when remittances are included in household expenditures. When considering the country panel the authors show that both poverty measures decline by 2%.

Looking at the case of Mexico, Esquivel and Huerta-Pineda [2005] use the national household survey on income and expenditures for the year 2002 to investigate the impact of remittances on poverty. The authors use Mexico's official definition of poverty, which is based on whether households can afford three different baskets of goods and services, distinguishing between urban and rural areas. The first basket considers only expenditures in food; the second includes food, health and education expenditures; while the third one adds in expenses in dressing, home and public transportation. Preliminary results show that remittances recipients households are less likely to be poor.

López Córdova [2006] uses a cross-section of Mexican municipalities and studies the correlation between the fraction of households whose income is below two alternative threshold -less than two or less than one times the minimum wage- and the percent of remittance-receiving households. Those thresholds roughly coincide with official figures on the incidence of poverty and extreme poverty, respectively. He finds that as more households in a given municipality receive remittances, the incidence of poverty declines, although extreme poverty remains unaffected. The latter results are consistent with the idea that the poorest families cannot afford to defray the cost of emigration and therefore do not benefit from overseas income transfers.

An understanding of the impact of remittances on poverty would be incomplete without knowledge on how the former affect the distribution of income and/or assets in the receiving country. This is particularly true for LAC, where income distribution is worse than in any other region of the world. The IDB [1998] estimates that poverty in Latin America would be significantly lower if the distribution of income were similar to that of other regions. Inequality also affects poverty levels to the extent that it hampers growth and, further, to the extent that it reduces the marginal impact of growth on poverty abatement (De Ferranti *et al* [2003]). Therefore, remittances may affect poverty to the extent that they change distributional patterns in the receiving country.

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[17] The second measure captures the mean aggregate income or consumption short-fall relative to the poverty line across the whole population, whereas in the third higher weight is placed on those households further away from the poverty line.

What is the relationship between remittances and inequality? Theoretically, this relationship should be viewed as a dynamic process, with an early increase in inequality followed by decreases over time. As Mckenzie and Rapoport [2004] argue, when migration to a new destination starts taking place, the cost of emigrating is usually high, implying that, in the presence of liquidity constraints, only high-income members of the population can afford the move. As the number of migrants in that destination increases, however, the cost of emigration declines giving individuals in lower-income households the opportunity to emigrate. This is because migration costs include not only transportation and border-crossing fees, but information costs about the specific destination to choose, the search for a job, shelter and so on. Such information costs are significant and tend to decrease as the size of a network of migrants augments.[18] As a result, over time remittances should accrue to low-income households, thereby reducing income inequality at the origin.

Theoretical and empirical conclusions are not straightforward, however, as the impact of remittances on inequality may be negative even in the long run as other factors come into play (see Rapoport and Docquier [2003]). Studies that find that remittances may lower inequality of household income distribution in the origin country include Stark, Taylor and Yitzhaki [1986] and Taylor [1992]. They both find support for the process described above in that inequality in Mexico, as measured by different Gini indices, decreases with remittances coupled with the village's migration history and, in the case of Stark *et al*. [1986], with the extent to which "migration information" spreads across the village. In addition, Taylor [1992] finds that, over time, remittances allow for the accumulation of productive assets that increase the productivity of the farm, so that the long run impact of remittances on lower inequality is increased.

One criticism to the two studies is that they take remittances as exogenous income that simply adds to the household's current income. Adams [1989] and Barham and Boucher [1998] adopt an alternative approach, which views remittances as a substitute for the labor income that the household would have earned had the migrant stayed home. Their reasoning is that if one does not include in the computation of the Gini index without remittances what the household would have earned had the migrant stayed, then the inequality among households appears to be higher and, consequently, the gap with the Gini index that includes remittances appears to be wrongly larger. Thus, remittances would seem to have a larger role in reducing inequality. Following this approach, Adams [1989] in the case of Egypt and Barham and Boucher [1998] for Nicaragua find that remittances raise inequality in the home country.

More recently, Unger [2005] using a different and more aggregated approach finds a positive and significant relation between *per capita* income growth and the percentage of households that receive remittances across communities. The author concludes that there is convergence in per capita income of the Mexican municipalities that can be associated with remittances.

[18] Munshi [2003] presents empirical evidence about the importance of such social networks, showing that Mexican immigrants from high-migration communities enjoy better labor market outcomes (higher wages, lower unemployment spells) that similar migrants from other regions.

B. Labor Markets

A second question of interest is how international remittances affect the labor market in the receiving country. Aside from other channels through which migration may influence labor market outcomes, remittances would have an effect of their own through their direct impact on the decision of individuals to join the labor force or by facilitating investment in new enterprises that result in net job creation. There can be also indirect effects. For instance, many studies show that remittances increase consumption of non-tradable, in particular in housing. The consequences for employment creation in the construction sector could be significant. Indirectly, remittances could have an effect on labor markets in the longer run through their impact on schooling decisions, although here the effects are more ambiguous.

There exist a handful of studies that investigate the effects of migration in the recipient country labor market, but only few that consider the specific effect of remittances. Funkhouser [1992] used data from a survey in the capital city of Managua, Nicaragua, and found that remittances contribute significantly to a decrease in the labor force participation of women (5.0 percentage points) as well as men, although to a lesser extent (2.1 percentage points). The author also found that remittances increase, albeit slightly, the probability of self-employment, 1.2 percentage points for men and 1.1 for women. Hanson [2005a] uses the 2000 population census survey in Mexico and presents evidence showing that international remittances are associated with lower female labor supply. Again the results for males are similar but weakest, although the author points to potential estimation problems.

Chami, Fullenkamp and Jahjah [2005] set up a model in which remittances give rise to a moral hazard problem: recipient household members use transfers sent by migrants to reduce work effort. The authors go on to argue and to present evidence that such disincentives to work may translate into reduce growth in a cross-country regression. But a reduction in labor force participation could have positive effects. For example, Duryea, López-Córdova and Olmedo [2005] show that the decline in mothers' labor force participation lowers the incidence of infant mortality. In addition, Yang [2003] shows that remittances reduce labor force participation and increase schooling among Filipino children.

C. Human Capital

A particularly important question is whether remittances allow households to increase their investment in human capital, either in the form of greater schooling or health care expenditures, particularly on young children. An answer to this question is relevant as it affects not only today's well-being, but also since it allows future generations to break the cycle of poverty and since human capital improves a country's growth prospects.

Remittance transfers may improve education and health outcomes as they relax income constraints that limit optimal human capital investment. The impact is blurred, however, by other effects on household decisions as migration takes place, as discussed before. Analyzing the impact on schooling decisions is particularly complex as population movements alter the returns to education across countries, as the possibility of emigrating leads people to compare those returns in the sending and host countries, as remittance income may be used instead to defray the cost of emigration, among other reasons. The specific impact of remittances on education is therefore an empirical question and may be in all likelihood country specific, preventing us from extrapolating conclusions from one context to another.

A number of studies indicate that remittances improve educational attainment among children in recipient households. Cox Edwards and Ureta [2003] estimates the hazard (or probability) of dropping out of school in El Salvador and find that remittances, irrespective of the amount, lower the likelihood of leaving school. Interestingly, the authors find that remittances have a much larger impact on reducing the chances of dropping out of school than labor income and that the latter effect is more important in urban than in rural areas. In urban areas, US$ 100 of remittance (the median level in their sample) lowers the hazard of leaving school while enrolled in the 1st through 6th grades by 54% (14% in rural areas). In grades 7^{th} through 12^{th} the hazard is lowered by 27% which is 10 times (2.6 times in rural areas) the effect of other sources of income. Yang [2003] studies the case of the Philippines and finds that for children aged 17-21, a rise in remittances equal to 10% of initial household income leads to a 10.3% increase in enrollment rates. Interestingly, the author uses the exchange-rate turmoil of the Asian crises and differences in the destination of migrants as a source of exogenous variation in remittance income, allowing him to identify the causal impact of remittances on schooling.

López Córdova [2006] shows that illiteracy rates among children 6-14 years old are lower, other things equal, as the fraction of remittance-receiving households in a given Mexican municipality increases. Moreover, he finds an impact on improving school attendance among children aged five, but no such effect on children 6 to 14, and a disincentive to stay in school among teenagers 15 to 17 years old. The latter is consistent with findings by Hanson and Woodruff [2003] and Mckenzie and Rapoport [2005], both looking at the impact of migration more broadly. Hanson and Woodruff [2003] find that migration improves school attendance among boys and girls aged 13 to 15. The result for girls is particularly important as they are usually at risk of dropping out of school.

Mckenzie and Rapoport [2005] consider how migration affects education inequality in Mexico. This is an important issue, as the literature on inequality has gone beyond looking at the distribution of outcomes, such as income, to emphasizing the distribution of assets and opportunities. As De Ferranti *et al*. ([2003] p. 3) argue, the latter are "crucial determinants of outcomes". Education is an important asset directly linked to future income. Mexico is the country where education inequality is one of the largest among Latin America countries.[19] Mckenzie and Rapoport [2005] show that migration reduces educational inequality, especially for girls, by perversely reducing schooling at the top of the education distribution.

Beyond their impact on education outcomes, remittances can play an important role in countries where the public healthcare system is not able to provide universal health insurance and adequate treatment or preventive care. Latin America is a notable case in this regard, as reflected by the need to rely on out-of-pocket expenditures to finance health care. Latin Americans out-of-pocket

[19] Mexico ranks just second behind Ecuador in eduaction inequality as regards students for 13 to 17 years-old (De Ferranti *et al* [2003] p. 3). In Mexico, in average someone in the lowest fifth of the population has only 3.5 years of school against 11.6 years for someone belonging to the richest fifth of the population.

expenditures amount to 75% of all private expenditures on health,[20] compared to less than 40% in Organization of Economic Co-operation and Development (OECD) countries; the figures for the Dominican Republic, El Salvador and Mexico, three large remittance-receiving countries, stand at around 90% or more.[21] It is not surprising, then, that migrant surveys show that an important motivation for transferring income to their families in their countries is to cover health expenditures, as we saw in Section III.

Amuedo-Dorantes and Pozo [2005] look at the role played by remittances in health expenditures in Mexico, where approximately 50% of the population is uninsured. Their results indicate that healthcare expenditures rise in response to the receipt of remittances, and that such expenditures are more responsive to increases in remittance than non-remittance income.

The studies we are aware of on the impact of remittances on health outcomes look at the case of Mexico and focus on infant health. The earliest study, by Kanaiaupuni and Donato [1999], finds that in Mexican communities experiencing high rates of migration, infant mortality is higher. However, the disruptive effect of migration is ameliorated through remittance's flows. Frank and Hummer [2002] analyze how the migration process affects the risk of low-birth weight -an important indicator of child survival and brain development- and find that membership in a migrant household provides protection from the risk of low birth weight largely through the receipt of remittances. A recent study by Hildebrandt and McKenzie [2005] overcomes some concerns about the robustness and representativeness of the two preceding studies. Hildebrandt and McKenzie [2005] confirm that children in migrant households have a lower mortality rate and higher birth weight, mainly thanks to remittances but also to the spread of information on healthcare that migration involves. Similarly, early findings by Duryea *et al*. [2005] suggest that remittances have a positive impact in reducing infant mortality that may work through better housing conditions, by allowing mothers to stay home and care for their children, or by improving access to public services (*e.g.*, potable water). Finally, López Córdova [2006] shows that infant mortality across Mexican municipalities declines as the percent of remittances-receiving households increase.

D. Investment and Saving

It is often argued that remittances are mainly used for conspicuous consumption and that little is left to undertake productive investments. So far we have seen that remittances help households move out of poverty, lower mortality rates, and increase educational attainments. In addition, empirical studies show that remittances are invested in productive activities when profitable. Not surprisingly, Durand, Kandel, Parrado and Massey [1996b] show that migrants prefer to remit to economically dynamic and entrepreneurial communities than to stagnant areas. Remittances also appear to respond to a community's access to the main transportation network, which is important in order to get products delivered to the market on time. Fortunately, many communities in remittance-receiving countries have the conditions needed to

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[20] According to the World Development Indicators definitions, private health expenditures include direct household (out-of-pocket) spending, private insurance, charitable donations, and direct service payments by private corporations.

[21] Data and definition from the World Bank's *World Development Indicators*.

start a business and, in those where opportunities exists, remittances appear to be invested in productive activities. Remittances have the potential to help entrepreneurs overcome credit market failures prevalent in most migrant sending countries. In the latter, where access to credit by low-income households is often difficult to obtain, (short-term) migration is often the solution to accumulate the necessary capital to start a business.

In a study by Massey and Parrado [1998] focusing on 30 communities in the six largest migrant-sending states of Mexico, an average of 21% of businesses were initially financed with U.S. earnings. At the household level, a unit increase in the log of remittances increases the probability of investing in a business by 16%. Using a survey of more than 6000 self-employed workers and small firm owners located in 44 urban areas of Mexico, Woodruff and Zenteno [2004] show that remittances are a significant source of capital for microentreprises. Estimation results display a much larger impact of remittances on microentreprises development that have previously been estimated in community-level surveys. Finally, although investment in productive activities seems to be larger in urban areas, the results suggest that the impacts spread well beyond the rural areas from which migrants have traditionally come.

Dustmann and Kirchkamp [2001] in a study using data from a survey on returned Turkish immigrants,[22] show that about half of the returning population of immigrants becomes active as an entrepreneur after return, and that the capital for starting a business stems from savings and capital acquired abroad. In this sample, 32% of all returning migrants create jobs through entrepreneurial activity, and 12% of returning migrants employ non-family members as workers. Mccormick and Wahba [2001] also found, for the case of Egypt, that total overseas savings (and time spent overseas) have a positive and significant effect on being an entrepreneur. Finally, Adams [1998] looks at the effects of international remittances on rural asset accumulation in Pakistan and show that remittances have a more important statistical effect on the accumulation of rural assets than total labor income has.

Yet another form in which remittances can facilitate saving is through investment in housing. Parrado [2004] analyzes the impact of remittances on home ownership and housing quality in Mexico. The author cites a report by the *Centro de Información para el Desarrollo* [1991] that confirms, as mentioned above, that the main factor limiting house ownership in Mexico, as in other LAC countries, is "an almost total lack of access to credit or access only at very high interest rates". The latter obviously prevents low- and middle-income families to obtain any type of credit, especially those households that do not possess any assets that may be used as collateral. Under such circumstances, migration may be in part conceived as a strategy to accumulate the necessary capital to buy a house or to improve existing ones. Using data from the Mexican Migration Project, Parrado [2004] shows that having been in the US during the previous year increases the likelihood of home acquisition by 1.2 times. Also, every additional year of work experience in the US rises the likelihood of home ownership by another 2.8%. When looking at the improvement of already owned dwellings, the author finds that migrants' houses back in Mexico are more likely to be in better conditions (as refers to floors) and to have a larger number of rooms regardless of the household size. As suggested above, Duryea *et al.* [2005] find

[22] Note that at the macro level there is not that much difference between remittances and repatriated savings. In fact the two are generally confounded in international statistics.

that improved housing conditions may have an important impact on reducing infant mortality. Interestingly, Parrado [2004] finds that migration increases the likelihood of financing the purchase of a home through a bank loan.

F. Exchange Rate, Exports and Growth

The empirical literature on the effects of international remittances has focused predominantly on microeconomic aspects and there exist very few studies that investigate the macroeconomic impact of remittances. The latter is likely to be significant. When an economy receives such important capital inflows, one could expect to see some effects on the level of the gross national product as well as on other macroeconomic variables, at least in the short-run. Keynesian models, for instance, predict that, under certain conditions, demand shocks such as an inflow of international remittances would have a "multiplier" effect on domestic output.[23] Like any other international capital flow, remittances may affect the real exchange rate and therefore the ability to compete in world export markets.

Durand *et al*. [1996a] estimate a multiplier matrix using data from three rural communities in Mexico. These multipliers were then applied to annual flows of remittances previously estimated by Massey and Parrado [1994]. The authors conclude that the multiplier effect from remittance inflows is especially pronounced compared to other sources of foreign exchange because they go directly to the lowest strata of Mexican society, with a higher propensity to consume. Korovilas [1999] investigates the link between international remittances and economic growth in Albania's economy. His main conclusion is that the (relative) success of the Albanian economy in the mid-90s rested largely upon the inflow of remittances.

Chami *et al.* [2005] analyze a panel of 13 countries and 29 years and find a negative and significant relationship between remittances and per capita GDP growth. Nevertheless, the study may be subject to the criticism that it does not identify a causal impact of remittances on growth, as it could be the case that low-growth countries are the ones receiving remittances. However, Giuliano and Ruiz-Arranz [2005] find that remittances can promote growth in less financially developed countries.

One implication from international remittances inflows is appreciation of the real exchange rate, which in turn may reduce export competitiveness in the remittance-receiving country. The situation is akin to the classical "transfer problem" debate between John Maynard Keynes and Bertil Ohlin, who focused on reparation payments by Germany after World War I (see Dornbusch, Fischer and Samuelson [1977]). Income transfers from abroad increase the demand for non-traded goods in the recipient country, which in turn raise prices in the non-tradable sector and leads to the appreciation of the real exchange-rate. Although the terms of trade and welfare in the recipient country improve with the transfer, export competitiveness would decline.[24] In the short run, a sudden inflow of remittances could result in increased

[23] In the Mundel-Fleming model, the impact of international remittances on domestic output depends on the exchange rate arrangement of the recipient country and on the degree of capital mobility. International remittances will have an effect on domestic output when the exchange rate is fixed.

[24] In the context of the Dornbusch *et al*. [1977] model, the non-tradable sector would draw labor away from the export sector and exports fall.

unemployment and a fall in output. In the long run, the contraction of the export (tradable) sector would reduce the ability to promote an export-led growth strategy in remittance-receiving countries (see Sachs and Warner [2001]).

Amuedo-Dorantes and Pozo [2004] estimate the impact of remittances on the real exchange rate using a sample of 13 LAC countries over the 1979-1998 period. Their results point to an appreciation of the real exchange rate of approximately 0.2 percentage points following an increase of one percentage point in remittances inflows. Similarly, Bourdet and Falck [2003] also find that capital inflows (remittances and aid) in Cape Verde lead to real exchange rate appreciation.

According to Hossain [1997], in Bangladesh, the increase in the relative demand for non-tradables -due in part to remittances- has brought about a change in both output and employment in favor of the non-tradable goods sector, which has induced the government to adopt populist/protectionist measures that have slowed down the structural transformation process. López-Córdova and Olmedo [2005] specifically investigate whether international remittances hinder export competitiveness by estimating their impact on bilateral exports using a world wide database. Their results show that, on average, a ten percent increase in remittance inflows (as a fraction of GDP) reduces exports between 2 and 4%, depending on the estimation strategy. The study further considers what happens under alternative exchange-rate regimes. It appears that fixed exchange-rate regimes offset the short-run impact of remittances on exports. In countries with a floating exchange rate, the remittance-elasticity of exports is close to minus 0.5.

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V. POLICIES

In this section we review some of the policies that have been used or proposed around the world to facilitate remittance flows and to take advantage of their development potential. We also list a number of recommendations for moving further in these two areas. We rely on a number of sources, particularly on work at the IDB-MIF (see Terry and Wilson [2005]), as well as on Lowell and la Garza [2000] and De Luna Martínez [2005].

A. Influencing the Flow of Remittances

Governments in receiving countries have tried to increase the inflow of remittances and to direct it through official channels since at least the 1970s. Except for a few exceptions, the policies adopted toward that aim have had very little success. As remittances are private flows going to the families of migrants, it is natural to ask why governments should care about influencing their volume or the channel used by senders. One obvious and immediate reason is that benevolent governments may try to make the most of remittance inflows by extending their benefits to other members of society.

Efforts to direct the inflow through official channels are justified by several reasons. First, it has an immediate positive effect on the balance of payment, since this is income entering the country that does not involve any liability.[25] This improves the credit-rating of the country, which could have a beneficial impact on foreign direct investment and access to international credit markets. Second, directing remittances through the banking sector, in particular, could strengthen a country's financial sector and allow private banks to securitize future remittance receipts in order to tap international markets and lend to domestic entrepreneurs.

Regarding policies to increase the volume of remittances, efforts have been made to lower the cost to sending money abroad. Although, the level of these fees has been decreasing in recent years, it still remains high. Mexico's experience is noteworthy. Banco de México, the country's central bank, and the US Federal Reserve set up a system that allows bank-to-bank electronic fund transfers from the US to Mexico through the Federal Reserve's Automated Clearing House, at a cost less than one dollar per transfer. Similar mechanisms between the US and other Western Hemisphere countries are under consideration. In the same vein, Bolivia is contemplating the feasibility of granting access to clearing and settlement systems to a few large non-bank financial institutions (mostly to post offices). Less ambitious but similarly useful are efforts by Mexican authorities to collect and compare the fees charged by banks and money transfer companies every month and disseminate this information through the internet and consulates. This may help foster competition among services providers by bringing valuable information to remitters.

Another widely used incentive consists of the possibility of holding bank accounts denominated in a foreign currency which in some cases may offer a preferential interest rate (rates that can be

[25] Recall that inflows circulating through unofficial channels are not recorded in the balance of payments.

higher than in the country the immigrant works) and/or with interest paid in the same foreign currency. Also, premium exchange rates may be offered.[26]

B. Harnessing Remittances for Local Development

Next we present an illustrative, non exhaustive, list of policies aimed at taking advantage of remittances to foster local development. We organize these different policies in categories according to the sphere of the economy they apply to: infrastructure, entrepreneurship, and finances.

Infrastructure: Mexico has pioneered matching funds initiatives that so far have led to the construction or improvement of paved streets, distribution of drinking water, building of schools, clinics, etcetera. Concretely, the state of Zacatecas began in 1992 a formal tripartite 2-for-1 project. This consists in matching US$ 2 (US$ 1 from the federal state and $US 1 from the government state) for each US$ 1 donated by emigrants. These programs have been expanded to other state but also to other governmental levels. In effect, there exist now 3-for-1 project, in which the municipal government adds another dollar. This type of initiatives also exists in El Salvador. Note, however, that no in-depth analysis has been undertaken to evaluate the impact of this matching fund programs.

Hometown associations[27] have a very active role in their home communities primarily in infrastructure projects destined to improve living standards but also to reconstruct after wars or natural disaster. Some countries count on particular active associations as Mexico, Dominican Republic, El Salvador and Guatemala. Although these are private initiatives, some governments, aware of their potential for local development, have tried to further encourage their expansion and foster their commitment. Mexico has been particularly successful in this strategy and El Salvador and Guatemala seem to follow pace. Examples of such programs in Mexico are the *Paisano* program or the *Programa de Atención a Comunidades Mexicanas en el Extranjero*.

Entrepreneurship: The state of Guanajuato in Mexico works with its immigrant associations in the US to invest in small garment factories in the immigrants' hometowns. Under the My Community program, the state pays up to three months of wages during the start-up period and makes available low-cost loan upon a first minimum investment of US$ 60,000. In Turkey (Swamy [1981]) a successful though modest plan was the formation of companies in that country owned by Turkish workers in Germany and assisted by the German government in the preparation of the projects. These projects contributed to the creation of jobs in Turkey and to the reintegration of emigrants into their home economies upon return.

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[26] Some countries -Brazil, Colombia and Venezuela, for example- do not allow their citizens to hold dollars (or any other) denominated bank accounts.

[27] Hometown associations consist of members from the same town or state in the migrant-sending country. Their first purpose is typically social: these are the well-known soccer clubs or community organizations that host dinners, dances, and other events. Along with their growing numbers, however, has come greater institutional outreach and ties to their home community, reflected in part in collective-remittances.

In Asia (Puri and Rizema [1999]) such policy initiatives have taken basically three major forms: allowing migrants to import machinery and equipment at concessional rates of duty, business counselling and training, and entrepreneurship programs aimed at guiding returned migrants in business creation.[28] In Mexico there exist programs targeting returned migrants. Indeed, a large fraction of migrants return home in working age and they bring with them not only savings but also valuable working experience.[29] The state of Zacatecas in Mexico has a program that assists returned migrants who wish to start a business.

Finances: As previously mentioned a large part of the remittances flows circulates through channels others that the banking system. Using commercial banks not only the benefits individual transfer recipients, but the country's financial markets as well. In effect, remittances constitute for many households a stable and regular source of income that may allow them access to credit and/or other financial services traditionally not in their reach. Although still marginal, some financial institutions in Colombia, Mexico, Peru (or Sri Lanka in Asia) already offer emigrants a wide range of financial services as commercial loans, mortgage products to acquire real state properties, life insurance, etcetera. Yet, one problem with using the banking system is that many migrants are undocumented aliens and thus cannot open a bank account in the host country. Mexico is trying to mitigate this situation by issuing identification cards (*matrículas consulares*) through its consulates that are accepted in US banks to open accounts. Also, remittances circulating through the banking system can increase the availability of loanable funds in the economy, which may have important multiplier effects. Banks in Brazil, El Salvador, Mexico, (and Turkey) offer remittance bonds backed by the money sent by immigrant in the US. For example, Banco do Brazil securitized future remittances flows by an amount of US$ 300 million in 2001, Banco Cuscatlá n in El Salvador issued bonds for a total value of US$ 125 million in 2003, Banamex in Mexico closed a US$ 200 million transaction in 1999.

Finally, remitters can contribute to any particular aspect of their country or community's development by, for example, donating part of the money to charitable organizations. Western Union agreed in recent negotiations with a Chicago court to permit such a voluntary check-off feature on its money-transfers forms (Migration News [1999]).

C. Recommendations

This subsection is a compendium of policy recommendations made by different international organizations, think-tanks and scholars working on remittances. Recommendations are grouped according to the following objectives: lowering the cost to remit; bringing both senders and receivers into the financial system and increasing the benefits migrants can extract from the financial system; increasing the inflow of remittances and its circulation through official channels; counteracting negative macroeconomic impacts; enhancing local development by increasing and directing remittances inflows to particular projects; improving the collection of remittance data. Table 3 summarizes the main recommendations in these areas. For the case of

[28] Note that little is known on the success of these different initiatives nor of their impact in the economy's country.

[29] The textile industry in Bangladesh started after Bangladeshi immigrants in India working in the textile industry returned home and put in practice what they have learned overseas.

LAC, the IDB (IDB-MIF [2004b]) recently issued a statement outlining a set of core recommendations to facilitate remittance transfers to the region and to channel those transfers through the financial system; see Box 1.

Box 1
IDB STATEMENT ON REMITTANCES TO LATIN AMERICA AND THE CARIBBEAN

On 27 March 2004, during the Annual Meeting of the Governors of the IDB, held in Lima, Peru, the IDB issued a Statement on Remittances outlining a set of core recommendations to help organize efforts to reduce the cost of remittance transfers and to raise the amount of remittances flowing through the financial system.

The statement calls for actions to be taken by the main (potential) actors involved in the remittances process in order to enhance their developmental impact. These actors are the migrants and his relatives, money transfer companies and financial institutions, public authorities, civil society, and international organizations. Concrete actions will have to focus on three aspects: improving regulatory and institutional frameworks, increasing competition to lower transaction costs, and promoting financial democracy. Two objectives are to be fulfilled by 2010: (1) to reduce the (average) cost of the transfer from the US to LAC by fifty percent, and (2) to increase the flow of remittances circulating through the financial system by having fifty percent of the senders shifting to this channel.

In order to attain the two goals, the statement outlines basic recommendations directed particularly toward three major stakeholders: remittances institutions, public authorities and civil society. Recommendations addressed at remittances institutions refer to two aspects: costs and proposed services. The cost to make a transfer and its different part should be clearly stated and lowered over time to the extent that technology permits. The remittance institutions should seek to expand the offer of financial services proposed to particular remitters / receivers. Recommendations to public authorities concern mainly regulatory issues although pertaining to different areas. With respect to the circulation of remittances they suggest avoiding overregulation and taxes and, to improve the regulatory framework in the financial sector. Also, as regards consumers (remitters/receivers), they suggest political authorities to actively inform them of their rights. The statement stresses the importance of improving data collection and reporting systems, and of the harmonization of international standards. Finally, the IDB recommends civil society to actively leverage the developmental impact of remittances by, on the one hand, identifying and helping to remove potential obstacles and, on the other hand promoting activities in local productive opportunities.

Lowering the cost to remit: Even though costs have fallen substantially in recent years, they remain quite high. The remittances market has some features that make it special. Transactions involve inevitably agents located in different countries; costs are generated in both countries; and, costs are influenced by the exchange rate, a component that agents do not control directly and which level is not always known of consumers so that sellers can mask part of their fees behind it. Given this scenario, practically all institutions and authors call for a reduction of fees and deliver advise as how to succeed in the task. De Luna Martínez [2005] argues that efforts to tackle costs down have to be undertaken in both sending and receiving countries and that a common approach and coordination between authorities of both these countries is needed to fight the failures that operate against a reduction in the fees. In general, measures proposed in the literature to lower costs refer to overcoming low competition among service providers (De Luna Martínez [2005], Group of 8 [2004], Spatafora [2005], Kapur [2004], IDB-MIF [2004b]); poor information disclosure for senders and recipients (De Luna Martínez [2005], IDB-MIF [2004b]); poor payments-system infrastructure that discourage migrants from using formal financial institutions to send money home (De Luna Martínez [2005] Group of 8 [2004], Kapur [2004], IDB-MIF [2004b]); restrictions for cross-border operations (De Luna Martínez [2005], Group of 8 [2004], IDB-MIF [2004b]); regulatory impediments, for example, governments should ensure non-discriminatory access to payment systems for the private sector, consistent with strong supervisory standards (Group of 8 [2004], IDB-MIF [2004b]); and, to seek partnerships and alliances (IDB-MIF [2004b]).

Increasing the use of and benefits from the banking system: With respect to the banking system, political authorities should act not only at the consumers level but also at the banking system level. At the consumer level (remitters and recipients), governments can promote the use of the banking system by increasing financial literacy (De Luna Martínez [2005], IDB-MIF [2004b], Spatafora [2005], Lowell and la Garza [2000]) which entails both, raising awareness of the benefits of being banked, for instance access to credit or mortgage and, informing consumers of their rights involving transfer transactions. However, one of the reasons a large part of the population is unbanked in Latin America, in particular, lies within the banking system itself. In effect, not only is there a lack of infrastructure in rural and remote areas, but also they are often less competitive than other available intermediaries. Here, political authorities could encourage financial institutions to enlarge their presence in rural areas as well as the range of services proposed to consumers (Kapur [2004], Group of 8 [2004], IDB-MIF [2004b], Puri and Rizema [1999]).[30] Finally, in cases where associations are not spontaneous, governments should encourage cooperation between remittance service providers and local financial institutions as, for instance, microfinance entities and credit unions (Group of 8 [2004], IDB-MIF [2004b]).

Increasing the remittance flows: The IDB-MIF [2004b] has called on public authorities to do no harm by avoiding to tax or to overregulate remittance flows.[31] Other actors have made proposals that are highly desirable in their own even if no remittances flows are involved. These are to pursue sound macroeconomic policies, in particular with regard to exchange and interest rates (Spatafora [2005], Puri and Rizema [1999], Addy, Wijkström and Thouez [2003]).

Managing macroeconomic impacts: Spatafora [2005] suggests that countries receiving large flows of remittances should accept a greater degree of flexibility of their exchange rate than would otherwise be necessary in order to avoid undesirable effects on their exporting sectors. Kapur [2004] proposes that remittances inflows could be used to securitize future receivables so as to augment foreign credit ratings.

Enhancing local development: Few international organizations have engaged their efforts to foster the developmental impact of remittances in recipient communities. The IDB's Statement on Remittances (Box 1) stresses the importance of promoting activities in local development. The Group of 8 [2004] advocated for more coherence and better coordination among these international organizations in order to find synergies and also to prevent unnecessary redundancies of efforts. They also recommend creating market-oriented local development funds and credit unions that would offer remittance-receiving individuals larger options to invest in productive activities. Lowell and la Garza [2000] advocates for the support of Hometown Associations and, in particular, their involvement in local development. Both Puri and Rizema [1999] and Lowell and la Garza [2000] propose to pay more attention to return migrants, for instance, through projects that help them to get acquainted with regulations or to select an appropriate area of investment.

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[30] The IDB-MIF has devoted considerably effort in this area.

[31] Kapur [2004], IDB-MIF [2004b] and Spatafora [2005] have recommended that remittances-services providers be appropriately regulated and supervised to minimize the potential risk of money laundering and terrorist financing.

Improving data collection: Numerous international organizations, think tanks and scholars have called for an improvement in the collection of data on remittances. Kapur [2004] goes further and specifically suggest that concerned governmental agencies or ministries should become part of the IMF's Special Data Dissemination Standards to both address the severe problems of consistency and timeliness of remittance data. Also, the author urges political authorities to create a spatial mapping of their overseas communities, not just by country but also by specific geographical location. This would allow financial intermediaries to better target these communities.

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VI. CONCLUDING REMARKS

As we have seen, despite analytical challenges and data limitations, there is an emerging body of evidence indicating that international migrant remittances may have a positive impact on economic development and household welfare. The evidence is not free of controversy and further work is still needed, however. But we believe that the international and scholarly communities should take note of the importance of improving data collection and expanding our knowledge about how international migrant transfers affect the development prospects of receiving countries. More generally, the preceding discussion should support calls for bringing discussions on international migration more vigorously into debates on the globalization of the world economy.

We have also seen that a number of policy initiatives and recommendations have been launched in recent years to address the growing flow of remittances. Remittance institutions, public authorities, and civil society should strive to facilitate and reduce the cost of remittance transfers, mainstreaming remittance flows through the financial sector and leveraging their development impact. The IDB has been at the forefront of these efforts in the Western Hemisphere. We stress that progress in these areas is perhaps more feasible politically than migration policy reform. Thus we believe that remittances deserve specific consideration, without losing sight of the larger potential of international migration to promote development.

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