# Recent trend in remittances flow economics essay

Economics

# INTRODUCTION

Remittances which are transfers in form of cash or kind by migrants to their family members who reside in the country of origin, have been perceived as an integral source of finance that plays a crucial role in the economic development of remittance-receiving nations (Comstock et al, 2009). It shows working labour in global economy, partially explains the link between growth and integration with the world economy, and has the potential to impact positively in the development of recipient countries (Solimano, 2003; Adison, 2004). These transfers have been argued to be almost the triple of the official development assistance (ODA) (see figure 1), single most important source of insurance for poor countries and the second largest external source of finance to developing countries when compared to other financial sources including foreign direct investment, and have been more stable in recent times (Kapur, 2005; Ratha and Mohapatra, 2007; Gosh, 2006). According to the World Bank report (2012), the total global remittances were estimated at $514 billion in 2012, and projected to grow to $608 billion in 2015, while the remittances to developing countries were estimated at $401 billion in 2012, which is about 11 percent increase of the reported amount in 2011, to grow by 6. 7 percent in 2013 and reach $515 billion in 2015. Considering the outstanding increase in remittance flows over the years, it have been rediscovered as a potential source of development finance and is recently gaining attention and drawing interest of scholars, policy makers, international organisations amongst others. More importantly, are the very essential role of remittances for family welfare promotion and increase in economic development of developing countries; however,

extreme dependence on them can have negative effect on development. Hence, this study intends to show the ways by which remittances can assist in financing development, most especially in developing countries. The study is organized as follows. Section 2 presents the recent trend in remittances across region and countries. Section 3 discusses the developmental impact of remittances both on micro and macro level using relevant literatures and empirical evidence as well as highlighting its positive and negative effects on development. Section 4 will explore how to leverage remittances for financing development. Section 5 will conclude the study with the provision of policy recommendations.

## Recent Trend in Remittances Flow

Generally, the real sizes of remittances to developing countries have been very difficult to estimate based on the fact that they are mostly transferred through informally channels. Thus, reports have suggested that often times, remittances to developing countries are very much over the officially recorded amount. For instance, it is suggested that out of the total recorded remittances globally and in sub Saharan Africa, about an average of 48 percent and 70 percent account for the share of unrecorded remittances, respectively (Page and Plaza 2005). In countries such as India, Indonesia, Pakistan, Philippines and Sri Lanka, it is estimated that about 30 percent of total remittances are not officially recorded (Ratha, 2007). Similarly, a house-hold survey has shown that about 80 percent of transfers to Uganda are done through informal sources (Freund and Spatafora, 2005). Remarkably, World Bank (2005) estimates that unrecorded remittances could add nothing less than 50 percent to the total recorded remittances. However, World Bank

(2013) suggests that the major by which transfer cost will be reduced is through market competition for providing remittance services. They found that prices are much lower where there are more providers serving the same routeRemittance flows to developing countries have significantly increased over the years as shown in table 1 below. It accounts for 78 percent of the total world remittances in 2012 reported estimate. These flows were estimated to have reached $401 billion in 2012 and grew at 5. 3% from 2011. However, they are projected to reach $515 billion in 2015, growing annually at an average of 8. 8 % for the next three years. Consequently, table 1 show the distribution of remittances across developing countries across regions. Given that high income and developed countries are the major destination of migrants, often times, and more remittances flow into middle income countries than the others. Nonetheless, out of the total remittances to developing countries in 2011, East Asia and Pacific (EAP) received almost 28 per cent, Europe and Central Asia (ECA) got 25 percent, while Latin America and the Caribbean region received 11 percent, and Sub-Saharan Africa received 7 percent. The East Asia and Pacific (EAP) region received an estimate of $109 billion in 2012, which is 2. 5 percent higher than the amount in the 2011. However, it is suggested that this region experienced lower growth in remittances as a result of the 1. 8 percent fall in China’s remittances in 2012. In Eastern Europe and Central Asia (ECA) remittances fell by 3. 9 percent in 2012, and this reduction is attributed to the depreciation of the euro against the US dollar in 2012. For Latin America and Caribbean (LAC) region, there was a minor increase with remittances reaching an estimated $62 billion in 2012. Meanwhile, Mexico is the largest recipient receiving country in LAC, receiving more than four times of the

second largest, Brazil. Significantly, the Middle East and North Africa (MENA) region had the world's fastest remittances growth rate of about 14. 3 percent in 2012 as compared to 2011. Over 40 percent of the total remittances to this region go to Egypt. Similarly, with an average growth rate of 13. 8 percent in 2010 and 2011, the estimates in 2012 show that remittance to the South Asia Region (SAR) have increased sharply, growing by 12. 3 percent to reach $109 billion. However, remittance flows to Sub-Saharan Africa (SSA) have been moderate as data shows that the region received an estimated $31 billion in remittances in 2012 which 1 percent higher than 2011 amount. Although global and regional remittances decreased in 2009, more recently, as shown in table 1, it is projected that remittance inflow will continue to rise at an increasing rate both globally and in various regions of developing countries, with low income countries growing at a faster rate of 12. 3 percent. Subsequently as shown in figures 2 and 3, across countries, India ($69 billion), China ($60 billion), Philippines ($24 billion), Mexico ($23 billion) and Nigeria and Egypt ($21 billion each) have been recorded as the leading recipients of officially recorded remittances in 2012. While Tajikistan (47 percent), Liberia (31 percent), Kyrgyz Republic (29 percent), Lesotho (27 percent), Moldova (23 percent), Nepal (22 percent), and Samoa (21 percent), are top 2011 recipients of remittances as a percentage of GDP. Impressively, statistical reports show the increase of flow in various countries and regions of developing nations. For example, data shows that inflows to India has risen from US$ 12 billion in 2000 to an estimated US$ 69 billion 2012. Significantly, remittances to Nigeria have also increased from US$ 1 billion in 2000 to over US$ 20 billion as estimated for 2012. Meanwhile, out of 42 developing countries that

received remittances above US$ 2 billion in 2012, 23 countries registered over 20 per cent growth during 2008-2012: Nepal, Pakistan, Sri Lanka and Egypt reported growth in the range of 82 percent to 136 percent.

## Impact of Remittances on Economic Development

In recent times, remittances have been receiving much attention regarding its role in the development of developing countries. In this light, several studies have evaluated and estimated the size of remittances, its use by migrant families and benefits to the destination countries at large. Migrant transfers serve as a valuable financial source for developing countries, most especially for the poorest (World Development Finance, 2005). The significance of remittances for welfare and a boost for the balance of payment cannot be overemphasized as it also contributes immensely to the gross domestic product and also foreign exchange earnings of developing countries. However, benefits attributed to remittances include but not limited to improve in income distribution and quality of life.

## Micro Level Impact

Various studies have shown that remittances contributes to family welfare and are mostly used for basic subsistence needs such as consumption, health and education, which improves standards of living for emigrant households compared to non-emigrant households (Azeez and Begum 2009; Ghosh 2009). For example, about 90 per cent and 80 per cent of households in Senegal and Turkey, respectively, spent their remittance funds on daily expenses (ILO, 2004; Kocks and Onan, 2001). According to Ghosh (2008), the increase in expenditure and levels of living as a result of remittances creates access to better health and education, which often leads to improved

productivity and development, as it where in the case of Pakistan and the Pacific Islands. The study on the economic impact of remittances in India and Pakistan at national and local level by Ballard (2005), also showed that the standard of living of the people living in migration area where much higher than non-migrant areas. Meanwhile, Duryea et al. (2005) shows that in Mexico, children from migrant sending families completed between 0. 7 and 1. 6 more years of schooling than children from families without any migrants abroad, and also found that an increase in the share of households receiving remittances in a municipality led to both better health and schooling. In addition, Yang (2004) found that increased remittances led to increase in educational expenditure, thereby, granting educational access to more children and in turn reduces child labor in Philippines. Furthermore, Azad (2005) argues that remittances increase household income of migrant families, improves standard of living, increases savings and contributes to national economic growth at large. In addition, Comstock, et al. (2009) points that remittances are additional income with redistributive effect that decreases inequality, instantly reduces poverty and increases household consumption options. Nonetheless, Begum and Azeez (2005) argues that remittances impact more on economic development when remittance-receiving households invest in profitable venture or rather, save. This implies that, increase in bank savings as a result remittance will increase credit availability and access to entrepreneurs in the remittance receiving country, thus, positively affecting development. Interestingly, the effect of remittances also spreads out to communities through its contributing to welfare and capital development. These contributions manifest in terms of social infrastructures, construction of modern houses, farm production

upgrades and the growth of income-generating small business enterprises. Like in most countries in Africa and Asia, it is common for migrants to combine resources for the community development by building schools, medical and community centers and other mini projects (Ghosh 2008). Also, families of migrants in many Asian countries, for example, Pakistan, Thailand and China use remittances to hire labour and purchase farm equipment, which positively impacts crop yields and leads to output growth (Stahl, 1986; Kerr, 1996; Taylor, Rozelle and de Brauw, 2003). More significantly is the poverty reduction impact of remittance in communities, such that opportunities and accessibility to these infrastructure and services will be made possible to the community poor.

## Macro Level Impact

Remittance contributes to gross domestic product in most countries as shown in figure 3 above. Given that most of the poor developing countries are highly dependent on the inflow of foreign exchange funds sent by emigrants working abroad, foreign exchange problems of labor sending countries are reduced by remittances, thus improving the current account position of these countries (Azeez and Begum 2009). In addition, remittances as noted by Azad (2005) and Ratha (2007), are a strong source of foreign exchange for labor sending countries which improves the balance of payments and are used for building up of foreign exchange reserves, servicing external debt as well as paying import liabilities. Similarly, Ghosh (2009) states that foreign exchange earnings can provide valuable support to balance of payments accounts, therefore adding to development through essential imports. Importantly, remittances can improve credit worthiness

and also reduces borrowing cost, thereby enhancing the receiving countries' access to international capital market. However, remittance-receiving countries can use the income to raise additional funds in the world capital market. For instance, several countries, including Brazil, El Salvador, Mexico, Panama and Turkey, have used the future flows of remittances as collateral to raise funds in the international capital market (Ghosh, 2009). While considering the reported remittance figures for 2003 and assuming a collateralization ratio of 5: 1, an estimate suggested developing countries could raise about US$ 7 billion a year (Ratha, 2003). In addition, since remittances are counter-cyclical (which means that they tend to increase when the economy of the home country is in crises as migrants would remit more, however, it decreases when the immigration country is experiencing financial crises) and stable in long-run, they can be relied upon in times of economic downturn, and used as relief for natural disasters and against economic shocks. Ola (2013) states that unlike FDI which decreases during economic downturns, remittances often increases in recipient country.. However, it is noted that in times of economic difficulties, migrants tend to transfer more money to families in home countries developed countries For example, , remittances to Central America tends to rise immediately after natural disaster such as hurricanes.

## Negative effect of Remittances on Development

Despite positive impacts and impressive contributions of remittances as discussed above, it is not without pitfalls. Some studies have argued that remittances have limited impact on economic development as a whole. Gubert (2005) argues that besides the poverty reduction potentials and

improvement of welfare, remittances on its own is not enough of drive development in African countries. Consequently, it is argued that it leads to economic dependence as well as unemployment as the drive to work reduces when remittance inflow is stable. Körner (1987) suggests that excessive reliance on remittances to finance development can be self-defeating and often times, politically painful. Studies have shown that increase in remittances increases unemployment levels in beneficiary households, by creating disincentive to work or invest. Thus, it is found that unemployment rate in households that receives remittances is 8. 6 percent as compared to 6. 4 percent in household that do not in El Salvador. In addition, Ghosh (2006) argues that remittances could bring distortions in the economy through inefficient allocation of resources, reduce production of tradable goods and export driven growth, and hence, lead to further dependence on remittances, which creates a vicious cycle and also brings problems when remittances decline. This study also states that high reliance on remittances makes the economy unduly vulnerable to sudden changes such as financial crises in immigration countries, which would negatively impact on a recipient country's output stability. For example, in 1991, the deportation of about 1. 5 million Egyptian workers and their dependents during Gulf crisis had an adverse effect on the country's budget. India, Jordan and Yemen also had similar experiences. In addition, Nikas and King (2005) mentioned that while Albania has benefitted greatly from remittances inflows as about a quarter of its population resides abroad, it would be highly affected if the economies of immigration countries experience downturn or shock .

# How to Leverage Remittances for Financing Development

Consequently, remittances are perceived to have more potential beyond the benefits discussed above, which could be explored and leveraged in such a manner that would increase their impact on the economic development of remittance-receiving countries. On this note, this section will review several macro-instruments that are being used or could be used to leverage remittances in developing countries. Firstly, World Bank (2013) notes that the cost of remittance is the main determinant of resource flow to developing countries. Therefore, given that the recipient economies as a whole benefits from remittances, the cost of its transfers must be reduced to encourage more flows through formal channel, which would allow for increase of inflows. For instance, survey estimates of Tongan show that remittances would increase by 0. 22 percent when cost decreases by 1 percent (Gibson, McKenzie, and Rohorua 2006). Similarly, Ratha et al (2008) suggest that a reduction in the cost of transfers from London to Lagos from initial 14 percent to 7 percent would significantly increase remittances by 11 percent, leading to over $1 billion additional inflow of remittance annually. In addition, transfers through formal channel are very important as it would improve a country’s credit rating thereby reducing the financial cost from international credit market which would enable recipient countries access to international finance as well as encourage better institutional oversight of the money flows and incentives to financial inclusion. This would significantly reduce the credit constraints on national governments and hence, enable investment in development-related projects or programs that can increase economic or human development (Comstock et al. 2009). Secondly, remittances can be used in future-flow securitization to access international

markets for external financing, and through this, developing economies will have access to international markets during worsening sovereign risks. Remittance-backed securities has been widely explored and used to raise external finance by countries such as like Turkey, Mexico, Panama, and El Salvador. In 2001, remittances from Brazilian migrant workers in Japan were used as collateral for the bonds worth $300 million issued Banco do Brazil (Comstock et al. 2009). With the assumption that remittances are transferred through formal means, Ratha (2007) states that developing countries could earn $7 billion per year through remittance-backed securitization. Furthermore, Comstock et al (2009) suggests that developing countries can use the flow of remittance as an informal, de-facto stabilization funds in times of volatile foreign investment. Since remittances to developing countries are counter-cyclical, the inflows in times of economic crises can assist in the long run to stabilize a developing country's balance of payments. Hence, with this source of income, the economies of these countries will be more stable. Finally, developing countries can leverage on diaspora bonds to finance development projects and meet economic needs in difficult times. These bonds are long-term stable and attractive alternatives external source of finance that can be used to grow the economies of Diasporas' home countries. For example, India and Israel have successfully show that diaspora bonds can be used to finance development by raising over $35 billion by tapping into the wealth of their diaspora Communities. More than $32 billion was raid in Israel through the Development Corporation for Israel (DCI) issuance of the Israeli diaspora bonds, which was channeled to infrastructural development. While about $11 billion diaspora bonds was raised in India to support balance of payments in

1991, 1998 and 2000. Although, diaspora bond is viable, its full potentials can only be achievable with sizeable diasporas, effective contract enforcement, absence of civil strife, and presence of national banks and other Financial Institutions( Dilip and Ketkar, 2010; Ketkar and Dilip, 2007). Thus, there are more chances that developing counties will be able to issue a substantial amount of bonds when there are more labour migrants abroad(Comstock et al. 2009; Ghosh, 2006).

## Conclusion and Policy Recommendation

This study examined the assistance of remittances as a financial source for development by discussing its significant impact on economic development both in micro and macroeconomic levels, in terms of its contribution to Gross Domestic Product (GDP), reduction of poverty, improving welfare and living standards, increase of foreign exchange reserve and increasing access to capital market, entrepreneurial and productive investment. In addition, this study sheds light on how too much dependence on remittance by many developing countries can negatively impacts their economic growth through unemployment, economic shocks, amongst other. Furthermore this study discusses how developing countries can leverage on remittances inflow to finance and achieve development goals. In light of these, remittance can aid development if the governments of developing countries can implement the following policy recommendations: Improve institutional capacity of credit unions, microfinance and other related financial institutions in remittance receiving countries and most importantly, reduce transfer cost and encourage competition. Establish innovative financial products that will encourage saving by remittance recipients households and encouraging

investments by making funds available to potential entrepreneurs. Facilitate and mobilize funds for home countries investment by offering bonds to diaspora. Keep accountable records of remittance flows for continuous improvement of international credit rating.