THE ECONOMICS OF REMITTANCES: THEORIES AND ISSUES

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Outline:

Section I - Introduction
Section II - Conceptual issues in remittances
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Introduction

Remittances consist of goods or financial instruments transferred by migrants living and working abroad to residents of the home economies of the migrants. It is limited to transfers made by workers that had stayed in foreign economies for at least one year while transfers from migrants that are self employed are excluded (IMF, 1999).

Formal remittance flow worldwide in 2007
- estimated at US$318.0 billion, up from US$268.0 billion in 2006
- US$199.0 billion was remitted to developing countries
- $47.0 billion to low income countries (World Bank 2007).
Empirical studies have shown that:

- remittances have impacted on the economic lives of the recipients and the economies of receiving countries.

- the economics of remittances highlights the relationship between remittances and the various economic variables such as growth, saving, income inequality, social indicators, e.t.c.
Introduction contd.

- Remittances
  - results from the migration of people
  - Part of migrants wages send home from abroad

- Propensity to remit is based on:
  - real wage differentials between countries of origin and home country
  - the employment conditions
  - cost of living in the host country
  - channels, cost and speed of transferring remittances,
  - opportunities for integration and settlement and possibility of the inclusion of migrants in the politics and society of the country of origin..etc
Introduction contd.

- Uses of Remittances
  - the day-to-day maintenance of recipient household to cover food, clothing, health care and other basic subsistence needs
  - building or improving houses (investments).
  - improving the welfare of migrant families and thereby alleviate poverty
The issues raised by the definition of remittances created two distinct schools of thoughts.

- Optimistic view
  - Remittance is positive to the receiving households/countries, it could alleviate poverty and promote economic development and ease pressure on governments faced with large external deficits to engage in difficult structural reforms.
Introduction contd.

Pessimistic View

- that remittances should not be encouraged
- it is detrimental to the growth and development of the recipients/receiving countries.
- It is responsible for “excessive” consumption, import dependency or “unproductive” investment in housing and land. It exacerbates the dependency of receiving communities.

Both views served as the backbone for the development of theories on remittances.
Conceptual Issues

- The concepts of remittance had been linked to the theory of migration.
- Its definition however can be linked to its motives, effects, uses, kind of transfer and the channel of funds transfer.
- Berhane Tewolde (2005) remittance as monetary and non-monetary items that migrants earn while working abroad and sent back to their families living in their homeland.
- Ratha (2003) migrants’ capital transfers, which are assets that a migrant brings into or takes out of the country.
Conceptual Issues Contd.

- **International Organization for Migration (IOM 2006)**
  - broadly defined remittances as the financial flows associated with migration, in other words, personal cash transfers from a migrant worker or immigrant to a relative in the country of origin.

- **International Labour Organization (ILO), 2000**
  - the portion of migrant workers’ earnings sent back from the country of employment to the country of origin.
Conceptual Issues Contd.

5th edition IMF Balance of Payments Manual (BPM5)

- “workers’ remittances is defined as an item under current transfers by migrants who are employed in new economies and considered residents there,“

- while a migrant as “a person who comes to an economy and stays there, or is expected to stay, for a year or more.”

- “workers’ remittances often involve related persons.”

- are “transfers made by migrants who are employed by entities in economies in which the workers are considered residents.”
Conceptual Issues Contd.

Sub-Categorization of Remittances

- Remittance-in-kind:
  clothing items, books, toiletries, etc.

- Social Remittance:
  ideas, practices, identities and social capital

- Collective Remittance:
  contributed by Diaspora groups for specific purpose

- Forced Remittance:
  part of migrant wages are collected by government to ensure migrant return home or for specific projects

- Terrorist Remittance
  to fund Terrorism
Conceptual Issues Contd.

Channels of Remittance Transfer
- The formal Channel
  - where transaction go through the formal financial system and are documented e.g. through banks, MTOs, Post offices using traveler’s cheques, telegraphic transfers, postal orders, account-to-account transfers etc

– The Informal Channel
  - Transactions may or may not go through the formal channel, and documented for formal use, It refers to the transfer of funds outside the international or national legal foreign exchange transfer framework e.g. Hawala, Hindu
Conceptual Issues Contd.

- Home Town Associations (HTAs).
  - Associations set up by migrants from the same ethnicity/country to promote their individual and collective interest. They have been responsible for several development projects in their home towns.
  - E.g. Mexican HTAs that have contributed immensely to the infrastructural development in their country
Micro-Economics of Remittances describes the determinants of remittances, its uses and the effects on the recipient. The economic impact of remittance is likely to depend on the propensity of the recipient household to consume or invest. Where remittances is invested it would contribute to the wealth generation of the family and increase their income (Asmellash 2006). Some of micro-economic effect of remittances are enumerated as follows:

- **The Determinant of Remittances (supply and demand)**

Remittance could be initiated by the remitter or migrant family. The critical factor remains the well being of the family back home. The ability of the remitter to send funds largely depends on efficient remitting channels and the associated cost which influences not entirely the will to remit, but the frequency to remit through the formal channels. High transaction cost are detrimental to formal remittances.
Micro-Economics of Remittances Contd.

- **The Uses of Remittances**
  
  - Over 80 per cent of total remittances are used for maintenance (daily expenses such as food, clothing and health care).
  
  - It helps to loosen the budget constraints of recipients and allow them to increase their consumption of both durables and non-durables.
  
  - Recipients have been able to improve welfare through education, improved health care and investing for self and the recipients.
  
  - Generally a small percentage of the remittances are used for savings and productive investments.
Social Welfare
- It provides social security, as most families in most developing countries do not have social security. Most people who are not employed or employable (pensioners, students, retrenched e.t.c) are able to meet their basic necessities through remittances received from their families abroad.

Used as collateral for raising Funds
- As a highly stable and predictable resource, remittance inflows can be used and leveraged to provide access to commercial credit and the capital markets by individuals. In India and Pakistan, remittances have contributed to the sharp increase in agricultural production through the ability of local farmers to purchase tractors and machineries.
Macros-Economics of Remittance explains its growth effects on the community/economies of receiving countries as follows:

- **Source of Foreign Exchange for an Economy**
  - High remittance receiving countries have provided foreign exchange to meet the need of the economy. This is visible in countries such as Bangladesh where it has risen to the second or third foreign exchange earner after foreign direct and portfolio investments. Remittances are incorporated into the national accounts, hence go directly into the expenditure pattern of the economy, saving or investments.
Macro-Economics of Remittance Contd.

- **Infrastructural Development**
  - Remittances serves as additional investments for physical and human capital developments where existing financial system and institutions allow remittances to be well intermediated and freely utilized (Adelman and Taylor, 1990). Mexico programmes such as the 3-for-1.

- **Boost development of the Financial Sector in recipient countries.**
  - This is done through well developed financial products and institutions. Such as the Diaspora bonds, Mortgage, e.g., to attract funds from the Diaspora.
Macro-Economics of Remittance Contd.

- **Poverty Alleviation and Reduction in Income Gap.**
  - Several household studies have concluded that a country at the initial stage of receiving remittances has a high income gap. But subsequently the increase in income attributed to remittances over time reduces the income gap and poverty level.

- **Dutch Disease**
  - Remittances has a potential negative impact where there recipients/country switch from expending the inflow from tradable to non-tradables. There would be an increase in importation of goods and eventually to Dutch diseases.
Theoretical Issues

Theories on remittances had been based on pessimistic and optimist views.

The theories varied from the developmentalist optimism of the 1950s and 1960s to the large scale pessimism which prevailed in the 1970s and 1980s to the optimism of the 1990s.
Classical or Developmentalist theory (1950s and 1960s) states that:

- Large-scale capital transfer and industrialization to poor countries would move their economies towards rapid economic development and modernization.

- Migration leads to a North-South transfer of investment capital and accelerates the exposure of traditional communities to liberal, rational and democratic ideas, modern knowledge and education.

- Developing countries started to actively encourage emigration as it was considered instrumental to the promotion of national development.

- Migrants are seen as agents of change, innovation and investors.
Theoretical Issues Contd.

**Neoclassical Theory**

- unconstrained labour migration would lead to scarcity of labour, resulting in a higher marginal productivity of labour and increasing wage levels in migrant-sending societies.

- Capital flows including remittances are expected to go in exactly the opposite direction as labour migration thus developmental role of migration is entirely realized
Structuralist and Dependency Theories state that:

- Migration would result in dependency on the global political-economic systems dominated by the powerful (Western) states.

- Migration was seen as having ruined traditional peasant societies by undermining their economies and uprooting their populations.

- Migration is detrimental to the economies of underdeveloped countries, but also as the very cause of the "development of underdevelopment."
Theoretical Issues Contd.

- Neo-Marxist Theory states that:
  - Migration and remittances produce and reinforce the capitalist system based on inequalities.
  - Migration and remittances were seen as detrimental as exposure to wealth of migrant families causes a change in local taste that increases the demand for foreign goods.
Theoretical Issues Contd.

- New Economics of Labour Migration (NELM) and livelihood approaches (a pluralist perspectives) pioneered by Stark (1991) and, Stark and Bloom (1985)

- The approach models migration as the risk-sharing behaviour of households.

- Individuals and households seem able to diversify resources such as labour in order to minimize income risks.

- Family members are stated to implicitly enter into a co-insurance agreement whereby the family invests in members to allow them to migrate, but however expect a return on this investment from the migrants through repayment of the cost incurred by the migration and assistance they may require.

- Migration plays a vital role in providing a potential source of investment capital, which is especially important in the context of the imperfect credit (capital) and risk (insurance) markets that prevail in most developing countries.
Social Network Theory

- Emphasizes the social rather than the economic role that remittances play in the lives of the migrants and their families.

- Remittances seen as resources which are exchanged between members of a social network where a social network is defined as a set of recurrent association between groups of people linked by occupational, familial, cultural or affective ties.
Social Network Theory Contd.

Resources are deemed transferred to the social network when a migrant sends remittance. Based on the following:

- Transfer maybe reciprocal as the migrant is accumulating social obligation from the people to whom they remit in the form of child care, transfer of goods with traditional or sentimental value.

- The migrant remitting maybe conforming to moral values learn as being a member of the group.

- Remitters increase their social visibility in the sending and receiving countries, in addition to avoiding the sanctions by the social group if they do not remit.
Theories of Motives for a Migrant to Remit

- **Theory of Pure Altruism** states that:
  - Migrants remit money simply because they care about the well-being of the family members by providing them with additional income.
  
  - In a pure altruistic model, remittances tend to increase at any time the income of the potential remitter increases, unless the potential remitter's income is very low, probably below subsistence level.
Theories of Motives for a Migrant to Remit Contd.

- Theory of Self Interest:
  - A migrant would send money home to increase their visibility hence eligible for inheritance, esteem or other resources in the community of origin.
  - Migrants send remittances in order to reimburse the household for past expenditures such as schooling or the cost directly related to migration.
  - In the case of pure self interest, they remit in order to purchase durable goods and invest in housing, land or businesses at home.
Theories of Motives for a Migrant to Remit Contd.

- Theory of Informal Contracts of Insurance:

  Remittance as theorized to provide monetary and in-kind transfers to others against temporary shocks. Thus the family of the migrant in the home country and able to smoothen their consumption pattern. (Lucas and Stark 1991).
Theories of Motives for a Migrant to Remit Contd.

- **Portfolio diversification** Theory states that:
  
  - the decision to remit is sometimes influenced by the offer of a risk-return option to be weighted against local sources of income.
  
  - One of the determinants of the return is the rate of interest that the remitter will receive on funds e.g. positive real interest rate.
  
  - Consideration for interest rate differential on comparable deposit account offered in host and home countries, black market exchange premium, the return on real estate in the home country, inflation rates and other returns.
Challenges to Current Knowledge

- Theoretical work on remittances focused overwhelmingly on international remittances.

- Drought of knowledge on how time affects the propensity of migrants to remit money, and to seek to extend the time frame within which such remittances are maintained.

- Need for proper understanding of significance of macroeconomic or political climate on migrants decision to remit.
More knowledge is required on changes required in poor countries or countries with uncertain economic or political environments, that would enable remittances to be put to effective use.
CONCLUSION

- Remittances could be regarded as a stable and predictable source of external finance for developmental processes, when properly invested. The impact on development varies according to the volume of remittances.

- Productive and sustainable avenues for the investments of remittances when identified along with supporting policies enhances the contribution of individuals/HTAs.

- Theoretical issues in remittances are tightly knitted to migration.

- The theories had expressed optimistic and pessimistic views. However, the current surge in remittance inflow worldwide had led to resurgence in the optimistic view that remittance is a tool for development.
Remittance is only seen as an international transfer between the North and the South. Little knowledge exists in terms of intra-country (remittance) transfer (between the urban and the rural communities in the same country) as well as the growing impact of the South-South transfer (remittances amongst developing countries).
I thank you all for your attention!