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Remittances: The New Development Mantra?

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PREFACE

The *G-24 Discussion Paper Series* is a collection of research papers prepared under the UNCTAD Project of Technical Support to the Intergovernmental Group of Twenty-Four on International Monetary Affairs (G-24). The G-24 was established in 1971 with a view to increasing the analytical capacity and the negotiating strength of the developing countries in discussions and negotiations in the international financial institutions. The G-24 is the only formal developing-country grouping within the IMF and the World Bank. Its meetings are open to all developing countries.

The G-24 Project, which is administered by UNCTAD's Division on Globalization and Development Strategies, aims at enhancing the understanding of policy makers in developing countries of the complex issues in the international monetary and financial system, and at raising awareness outside developing countries of the need to introduce a development dimension into the discussion of international financial and institutional reform.

The research papers are discussed among experts and policy makers at the meetings of the G-24 Technical Group, and provide inputs to the meetings of the G-24 Ministers and Deputies in their preparations for negotiations and discussions in the framework of the IMF's International Monetary and Financial Committee (formerly Interim Committee) and the Joint IMF/IBRD Development Committee, as well as in other forums.

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REMITTANCES: THE NEW DEVELOPMENT MANTRA?

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Abstract

Remittances have emerged as an important source of external development finance for developing countries in recent years. This paper examines the causes and implications of remittance flows. It first highlights the severe limitations in remittance data, in sharp contrast to other sources of external finance. It then examines the key trends in remittance flows, and their importance relative to other sources of external finance. The paper subsequently analyses the many complex economic and political effects of remittances. It highlights the fact that remittances are the most stable source of external finance and play a critical social insurance role in many countries afflicted by economic and political crises. While remittances are generally pro-poor, their effects are greatest on transient poverty. However, the long-term effects on structural poverty are less clear, principally because the consequences of remittances on long-term economic development are not well understood. The paper then concludes with some policy options. It suggests a role for an international organization to intermediate these flows to lower transaction costs and increase transparency, which would both enhance these flows and maximize their benefits.

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REMITTANCES: THE NEW DEVELOPMENT MANTRA?

Devesh Kapur

I. Introduction

Remittances are emerging as an important source of external development finance. They have been growing in both absolute volume, as well as relative to other sources of external finance. Perhaps even more important, they are the most stable source of external finance and are providing crucial social insurance in many countries afflicted by economic and political crises. But, as with all substantial external resource flows, the effects of remittances are complex.

The paper examines this growing external resource flows to developing countries. It first highlights the severe limitations in data, a sharp contrast to other sources of external finance. It then analyses (based on this limited data), the key trends in remittance flows. The paper then examines the many complex economic and political effects of remittances. It highlights that while the effects of remittances are greatest on transient poverty, the long-term effects on structural poverty are less clear, principally because the consequences for economic development in general are not well understood. The paper then suggests some policy options to enhance these flows and maximize the benefits. Finally it concludes with some suggestions for future work.

II. Limitations of remittance data

Remittances are financial resource flows arising from the cross-border movement of nationals of a country. The narrowest definition – "unrequited transfers" – refers primarily to money sent by migrants to family and friends on which there are no claims by the sender, (unlike other financial flows such as debt or equity flows). In contrast to many previous analysis of remittances, data in this paper includes two additional categories that are recorded separately in a country's balance-of-payments (BOP) statistics: "migrant transfers", which arise from the migration (change of residence for at least a year) of individuals from one economy to another and are equal to the net worth of the migrants; and "compensation of employees", which are funds send back by temporary workers (who work abroad for less than a year).[1]

This more encompassing definition is not without problems. The distinction between persons whose earnings are classified as "compensation of employees" and migrants who have become residents of economies by virtue of being expected to live there for a year or more is difficult in practice. Since "compensation of employees" includes contributions paid by employers, on behalf of employees, to social security schemes or to private insurance or pension funds it overstates the resources transferred to the country of origin. On the other hand the data excludes unrecorded and in-kind transfers, which are likely to be substantial. It also excludes funds sent through the capital account by overseas residents, such as special savings accounts, which are then withdrawn in local currency.[2]

Considering their volumes and relative importance, the quality of data on remittances is quite poor. The principal source of this data is the IMF's Balance of Payments (BOP). The most striking feature of a basic table of remittance inflows and outflows by country and year, is the number of zeros – an indication of missing or unreported data in most cases. Even considering only those countries with a population greater than a million, (since the absolute volume of remittances is likely to be modest for the small countries), the lack of data is unusually severe even today (table 1). The IMF's BOP data – which it gets from member countries – has many gaps in the matter of remittances. The most troubling gaps in data are in precisely the countries (like Afghanistan, Haiti and Liberia), where economic collapse has rendered remittances as a critical source for household consumption and social insurance. Even countries like Cuba and Viet Nam show zero remittance inflows while Hong Kong (China), Singapore and Canada show zero or very little outflows, despite the large diasporas of the former and migrant workers in the latter. A majority of receiving countries have incomplete data for several years over the last two decades, making it difficult to do rigorous analysis. Different countries use different techniques to capture remittances, and it is unclear how comparable the reported data are. Given that a considerable volume of remittances is transferred through unofficial channels, while those transferred through official channels incur high transaction costs, one might reasonably expect that reported remittance outflows (from the sending countries) would be considerably greater than reported remittance inflows. The figures actually show the opposite. Many countries report sudden surges, which are inexplicable under most plausible scenarios. At the same time, there are large variations in remittances per foreign worker across countries (see figure 1). High remittances from Belgium/Luxembourg and Switzerland are a puzzle and could simply reflect the fact that all three are banking centres and remittance outflows may simply be masking money laundering. Alternatively, they could be the result of tax arbitrage, with

Table 1

REMITTANCE FLOWS: PERCENTAGE OF CELLS FOR WHICH NO DATA IS AVAILABLE

	1970–1979	*1980–1989*	*1990–1999*	*2000–2001*
Inflows	77	53	39	34
Outflows	77	52	43	45

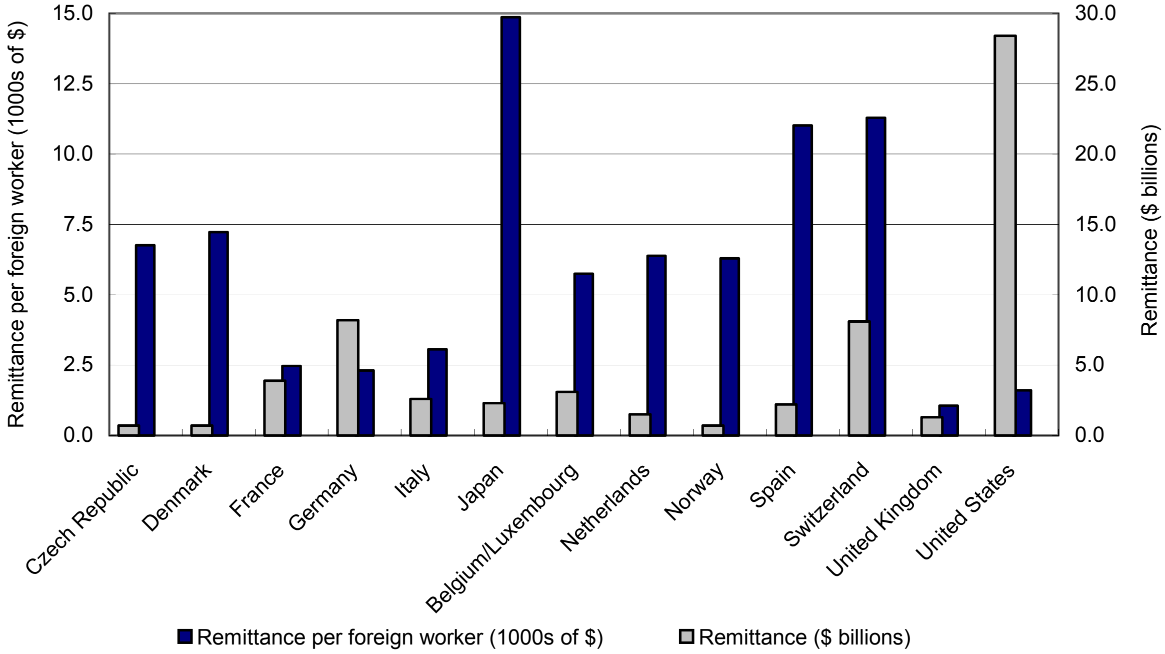
Note: A cell is a country-year data point.

multinational companies setting up offices in these financial centres attracted by low tax rates. Data from multilateral institutions also differ. Thus the Inter-American Development Bank's Multilateral Investment Fund, shows remittances to Latin American to be $32 billion in 2002 and total remittances to developing countries at $103 billion, which is substantially greater than those reported by the World Bank ($25 billion and $80 billion respectively).

The poor quality of remittance data is in stark contrast to data on international financial flows more generally, where there has been a tremendous improvement in the quality of data over recent decades. Concepts have been systematically refined, data is timely, coverage of countries and issues has both broadened and deepened. The World Bank's *Global Development Finance* (formerly World Debt Tables), the IMF's *International Financial Statistics*, and the BIS and the OECD are the standard sources of data on international financial flows. The reasons are not too difficult to understand. The institutional channels through which financial capital flows from North to South have a strong interest in maintaining good data. Creditors are (relatively) fewer in number, and have both greater capabilities as well as greater power to ensure that data mandates are adhered to. Moreover, poor data on international financial flows has been implicated in numerous financial crises, be it the Latin American debt crisis or the various financial crises of the 1990s. Since these crises have repercussions for global financial stability, mainly the industrialized countries, each systemic crisis has resulted in an improvement in data quality. In contrast the individual sources of remittances are too numerous and the recipient countries – LDCs – lack the capabilities and perhaps even the incentives to

Figure 1

VARIATION IN REMITTANCE PER FOREIGN WORKER



Source: Remittance data: World Bank, *Global Development Finance, 2003*, Analysis and Statistical Appendix: 160, fig.7.5; OECD, *Trends in International Migration*, SOPEMI 2002: 297, Stocks of foreign and foreign-born labour force, table A.2.3, all figures are of 2000 except for Spain and Belgium (1999) and Netherlands (1998).

ensure better data. The data used in the rest of the paper should be interpreted keeping in mind severe limitations with regard to its quality.

III. Financial remittances: size, sources and destinations

Why is there currently so much excitement regarding remittances? There are five features that merit attention.

First, remittances are an increasingly significant source of external financing for developing countries.[3] Over the past decade they have emerged as the second largest source of net financial flows to developing countries (figures 2a and 2b). Their growth is in contrast to *net official flows* (aid plus debt), which have stagnated if not declined. The total volume of remittances to developing countries in 2001 was $72.3 billion, nearly one and half times net ODA in that year ($52 billion) and almost half *net private flows* (FDI plus debt flows) of nearly $153 billion (table 2a). But if instead one examines the figures for *net transfers* – which is the bottom line after deducting all payments including profit repatriation, interest payments and remittance outflows (since most developing countries have some outflows as well) – then the significance of remittances for developing countries is much more apparent. Remittance flows were ten times net transfers from private sources and double that from official sources in 2001 (table 2b). While this reflects in part the large stock resulting from flows of private and official finance in previous years, it is precisely the "unrequited" nature of remittances that makes this big difference – all other sources have a corresponding claim on the receiving country, which can be substantial reflecting the stock of FDI and debt. The welfare and growth effects from these different sources are in all likelihood quite different. How-

Figure 2a

FINANCIAL FLOWS TO DEVELOPING COUNTRIES: NET FLOWS, 1990–2001

(Billions of dollars)

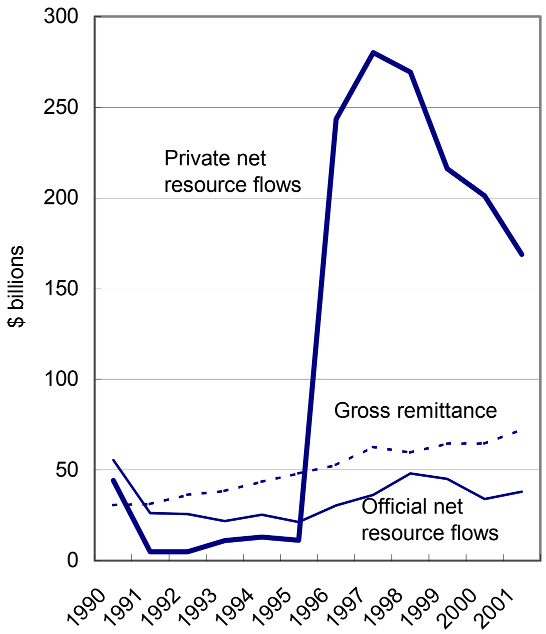
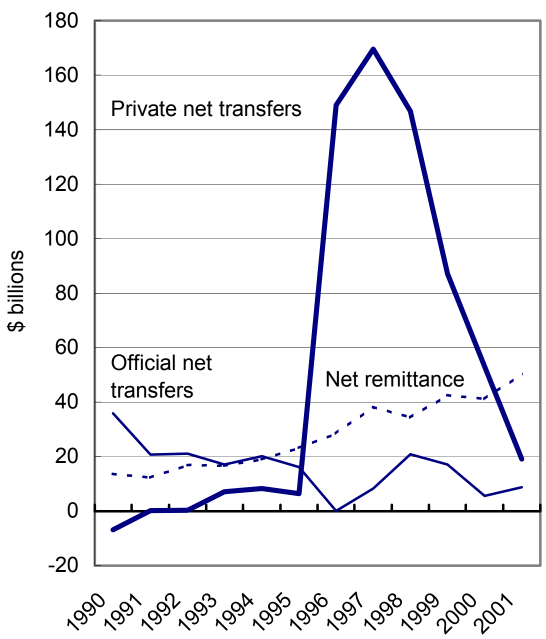


Figure 2b

FINANCIAL FLOWS OF DEVELOPING COUNTRIES: NET TRANSFER, 1990–2001

(Billions of dollars)



ever, if one is interested in the financial bottom line, remittances were clearly the most important source of net foreign exchange flows to developing countries in that year. For reasons discussed in the next section, the growing importance of remittances relative to other sources of external finance is likely to continue. Aid levels have been declining in the 1990s and a more than modest upturn is unlikely. And private capital flows are unlikely to reach the euphoric pre-Asian crisis levels any time soon.

Which countries contribute most to remittance outflows and which are the principal recipients? The ten largest sources and recipients in the last decade include both developed and developing countries (table 3). The United States, unsurprisingly, is the largest source and four Middle-East countries (Saudi Arabia, Israel, Kuwait and Oman) are among the ten largest. Three G-7 members – Japan, the United Kingdom and Canada – do not make this list, the latter two being especially surprising even while several small countries, Belgium/Luxembourg and Switzerland, do.[4]

The general impression is that remittances are a phenomenon affecting poor countries. That is only partly true. Of the ten largest recipients of remittances in the last decade (1992–2001), seven were OECD countries and two of the top five recipients were G-5 countries (France and Germany). Of the $111 billion in total remittances in 2002, about three-fourths (or $80 billion) accrued to developing countries. The share of developing countries has ranged from under half in the late 1980s to about three-fourths in recent years. The largest ten recipients have been quite stable over the decade (except that Morocco has replaced Greece in recent years). While private in nature, remittance flows are less concentrated than private flows. Thus while the top ten recipients of FDI had a share of 70 per cent of FDI flows to LDCs in 2001, the share of the top ten recipients of remittances was 59 per cent.

Second, the bulk of international remittances do not accrue to the poorest countries. Nearly half of all remittances received by developing countries flow to lower middle-income countries while the other half flows about equally to upper-middle income and low income countries (figure 3). Remittances are benefiting some regions more than others, in particular Latin America (especially the Andean countries, Central Asia and Mexico), South Asia, the Middle East and Maghreb and some countries in East

Table 2a

DEVELOPING COUNTRIES: NET FLOWS OF EXTERNAL FINANCE, 2001

(Billions of dollars)

Region	*Private*	*Official*	*Remittances*	*Total net flows*	*Remittances/ net flows (per cent)*
East Asia	36.4	5.7	10.4	52.5	20
East Europe and Central Asia	30.9	10.2	8.9	50.0	18
Latin America	62.8	23.4	22.6	108.8	21
Middle East and North Africa	8.3	2.0	13.1	23.4	56
South Asia	2.9	6.0	14.9	23.8	63
Sub-Saharan Africa	11.6	10.2	2.4	24.2	10

Source: World Bank, *Global Development Finance*, *2003.*
Note: Official flow includes lending from multilateral banks, IMF and bilateral loans and grants. Private flows includes equity (FDI and portfolio flows), and both long- and short-term debt flows.

Table 2b

DEVELOPING COUNTRIES: NET TRANSFERS OF EXTERNAL FINANCE, 2001

(Billions of dollars)

Region	*Private*	*Official*	*Remittances*	*Total net flows*	*WR/net flows (per cent)*
East Asia	-9.1	-2.7	10.3	-1.5	695
East Europe and Central Asia	10.9	3.0	6.7	20.6	33
Latin America	5.8	14.6	20.9	41.3	51
Middle East and North Africa	-5.4	-1.6	-3.6	-10.6	34
South Asia	-0.5	3.6	14.8	17.9	83
Sub-Saharan Africa	3.5	8.6	1.3	13.4	9

Source: World Bank, *Global Development Finance*, *2003.*
Note: Official transfers includes lending from multilateral banks, IMF and bilateral loans and grants. Private transfers includes equity (FDI and portfolio flows), and both long- and short-term debt flows.

Asia (especially Philippines and Indonesia). The fact that sub-Saharan Africa receives the least amount of reported remittances and (unlike trends in other regions) has shown virtually no growth in remittances in the last five years, is a sobering indication that this source of finance is unlikely to be contribute significantly in ameliorating the external financing problems of the region.

The limited remittance inflows to Africa, reconfirms that geography does matter. There are large migrations from African countries, but the civil strife in that region sends migrants across borders to other impoverished African countries rather than to rich countries. Geographical contiguousness to rich countries is clearly important, especially for illegal migration. This privileges Mexico and Central America

Table 3

LARGEST SOURCES AND RECIPIENTS OF REMITTANCES

(Annual average, 1992–2001)

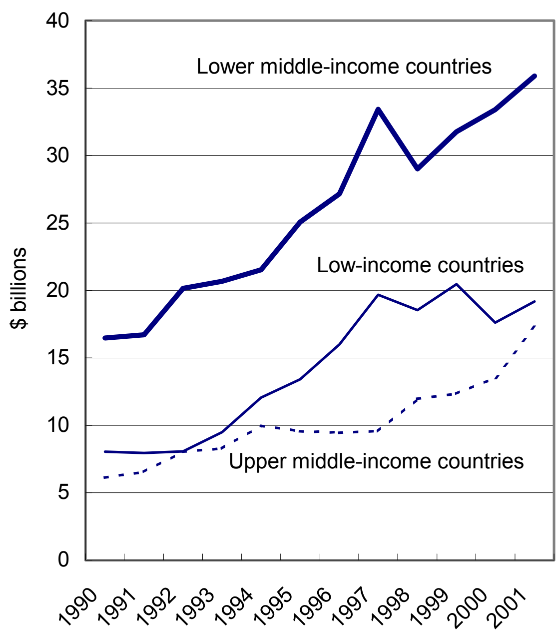
Source country	*\$ billion*	*Recipient country*	*\$ billion*
United States	20.7	India	7.7
Saudi Arabia	15.4	France	6.9
Germany	8.8	Mexico	5.7
Switzerland	8.1	Philippines	5.0
France	4.9	Germany	4.1
Italy	2.2	Portugal	3.8
Israel	2.1	Egypt	3.8
Belgium/Luxembourg	1.8	Turkey	3.7
Kuwait	1.4	Spain	3.0
Oman	1.4	Greece	2.7

Source: IMF, BOP statistics.

Figure 3

REMITTANCE INFLOWS, 1990–2001

(Billions of dollars)



Source: World Bank, *Global Development Finance*, various years.

and the Maghreb. The lack of geographical proximity is less of a hindrance to nationals of Latin American countries who have access to EU labour markets because of the prior history of migration from the latter to the former. With the Middle East likely to witness increasing curbs on net migration, South Asia, which receives a large volume of remittances from that region, will witness a decline unless compensated by migration to other regions.

The two countries with largest global migrations, China and India, report substantial differences in remittances. Surprisingly, China receives comparatively little remittances – about one billion dollars annually in the last decade (1992–2001), about one-eighth of India's receipts (\$7.7 billion annually over the same period). These large differences are probably less the result of fundamental differences in the characteristics, size or vintage of oversize migrants from the two countries, and more the result of differences in incentives (especially tax policies) and economic opportunities in the two countries. In contrast to the remittances figures, the figures for diaspora FDI in the two countries are the reverse, with overseas Chinese investing between ten and twenty times more than overseas Indians (the figures vary considerably depending on the status of investments from Hong Kong (China) and assumptions regarding the magnitude of round tripping). However, a large fraction of FDI in China – about a quarter – is invested in real estate (Tseng and Zebregs, 2002). Since this type of investment is common to the deployment of remittances as well, it reinforces the suspicion that there is a not inconsiderable statistical overlap between remittances and FDI. If the two (i.e. remittances and diaspora FDI) are combined, financial inflows from emigrants from the two countries are more comparable – with inflows into China being between 2–4 times that into India.

Third, remittances have emerged as the *least unstable* source of financial flows for countries afflicted by "shocks" and constitute the single most important source of insurance for many poor countries. Remittance flows are much more stable than private capital flows, which exhibit strong herd like behaviour, amplifying the boom-bust cycles in many emerging markets (figures 2a and 2b). Consequently, remittances can be viewed as a self-insurance mechanism for developing countries whereby a country's overseas migrants help in diversifying its sources of external finance. This role is strengthened by the low risk correlation between the country of residence and the country of origin and is especially important for poor countries since (much like poor people) they find it difficult to get insurance. It is therefore not surprising that remittances have emerged as a critical insurance mechanism for residents of countries afflicted by economic and political crisis (Lebanon during its civil war, Haiti), those hit by natural disasters (such as Central America in the aftermath of Hurricane Mitch), or pressured by international sanctions (such as Cuba), or where state authority has crumbled (so called "failed" states such as Somalia).

For example, in the late 1990s Ecuador experience its worst economic crisis in the century. The resulting political chaos and social upheaval and economic collapse led to the largest out migration in the country's history (particularly to Spain). In just two years, more than quarter million Ecuadorian left the country. Remittances jumped from $643 million in 1997 to more than $1.4 billion in 2001 (10 per cent of GDP), emerging as the second largest source of foreign exchange after petroleum exports (Jokisch and Pribilsky, 2002). Cuba's attitude towards remittances changed at the onset of Cuba's economic growth and collapse occurred in the aftermath of the collapse of the Soviet Union in the early 1990s leaving the country without any geopolitical benefactor to prop up its economy. Not only did overseas assistance dry up, but also the output and prices of its principal export (sugar) collapsed in global markets even as the United States tried to tighten its embargo of the island. Until then the country had curbed overseas remittances from its rich diaspora, which was (in large part) deeply hostile to the regime. For the first time the Cuban Government took steps to attract remittances offering a slew of incentives to residents receiving dollars. By 1995 remittances were approximately $530 million (from just $50 million in 1990). At a time when foreign aid and FDI combined were only about $100 million and exports just $1.1 billion (Eckstein, 2003) and an acute foreign exchange crisis threatened to take the country down the route of the Democratic People's Republic of Korea, remittances provided a crucial lifeline.

Fourth, for the many small countries – especially island economies, be it in the Caribbean or the Pacific – remittances, along with foreign aid and tourism, have become the only viable sources of income. For a small island economy like Cape Verde, around two-thirds of families receive money from abroad. For many families, remittances offer the only source of income, not surprising for a country where in 2000 only 435,000 people lived on the island and twice as many abroad (IMF and IDA, 2002). Such high levels of migration and remittances might well indicate that these countries are simply unviable economic entities, but given political realities they will continue to exist – surviving to a considerable extent on the labours of their overseas population.

Fifth, as with the euphoria with private capital flows in the mid-1990s, the attractiveness of remittances is in part a reaction to previous failed development mantras. Development thinking has been as prone to fads and fashions as private capital flows are alleged to be. Remittances strike the right cognitive chords. They fit in with a communitarian, "third way" approach and exemplify the principle of self-help. People from poor countries can just migrate and send back money that not only helps their families, but their countries as well. Immigrants, rather than governments, then become the biggest provider of "foreign aid". The general feeling appears to be that this "private" foreign aid is much more likely to go to people who really need it. On the sending side it does not require a costly government bureaucracy, and on the receiving side far less of it is likely to be siphoned off into the pockets of corrupt government officials. It appears to be good for equity and for poverty and yet imposes few budgetary costs. What could be better? Are these hopes valid?

IV. Why have remittances grown?

What explains the growth of remittances in recent years? The most obvious factor is the steady growth of its underlying cause, namely migration, especially to rich countries. Even though legal annual flows of migrants have grown in fits and starts, illegal migration and the stock of emigrants has certainly grown. The United Nations estimates that roughly 175 million people were living outside their country of birth or citizenship in 2000, up from 120 million in 1990 (United Nations Population Division, 2002; Martin and Widgren, 2002). An analysis of the 2000 United States census reveals that of the foreign population in the United States in that year, nearly half (47 per cent) entered the country in just the previous decade. Elsewhere, the foreign population in 17 European economies tracked by

Box

INFORMAL VALUE TRANSFER SYSTEMS (IVTS)

Despite the growth of formal transfer mechanisms, substantial amounts of remittances continue to flow through informal (and sometimes underground) channels, outside the purview of government supervision and regulation. These transfer mechanisms go back centuries, particularly in Asia. Examples include *hawala* and *hundi* (South Asia), *fei ch'ien* (China), *Phoe kuan* (Thailand), *Hui* (Viet Nam), *casa de cambio* (South America). IVTS systems flourish in countries with economic controls, political instability, and low levels of financial development. Using rudimentary low cost technologies they rely more on trust than violence, riding on the social capital of ethnic groups. These systems transfer "at a minimum, tens of billions of dollars" globally, offering speed, easy access, low costs and anonymity.[1] Basically the sender gives money to an IVTS agent (usually in an ethnic neighborhood) who calls or faxes instructions to his counterpart in the region where the money is to be sent. The counterpart makes the payment within a few hours. Settlements are made either with a transfer in the opposite direction and/or periodic wire transfers or through over(under) invoicing of cross-border trade.

These services transfer funds derived from both legitimate and illegitimate activities, ranging from corruption to tax evasion, drugs to terrorism, and funds deployed by intelligence agencies. However, there is more hype than evidence on the scale of the latter (Passas, 1999). Attempts by Western governments to regulate IVTS activities have arisen in the context of anti- money-laundering measures and most recently terrorist financing.

1 Testimony of David Aufhauser, General Counsel, Department of the United States Treasury, before the Senate Judiciary Committee, 26 June 2003.

the OECD rose from 15.8 million to 21.7 million in 1998 – an increase of 37.2 per cent (OECD, 2001). In the oil-exporting Gulf States, foreign workers continue to represent more than 50 per cent of the labour force in all countries, and 70 per cent of the labour force of 10 million in Saudi Arabia (Martin and Widgren, 2002).

The frequency and intensity of economic and financial crisis in many developing countries over the past two decades has increased the need for social safety nets, amplifying the demand for remittances. Some of the reported increase in remittances is in all likelihood a statistical artifact. For one, data quality has improved (as evidenced by the declining number of zeroes in table 1). Furthermore, changes in economic policies of many developing countries, especially with regard to foreign exchange controls, have sharply reduced the black market premium for foreign exchange. As a result, part of the increase in officially recorded remittances reflects a shift in remittances from informal to formal channels. Where remittances continue to go through informal channels, either because of foreign exchange controls in countries such as Myanmar and Zimbabwe, or because of an absence of state machinery (as in Afghanistan), this problem persists.

There is, however, another less obvious factor driving the growth in remittances – a burgeoning infrastructure that has helped ease the movement of money across borders. For long the remittance business was dominated by money-transfer companies like Western Union. In 2002 alone the company conducted almost $700 billion in transfers and payments worldwide through 68 million customer-to-customer transactions (and another 173 million customer-to-business transactions). In 1994 it had 24,000 agents worldwide, but two-thirds were in North America. By mid-2003 this figures had increased nearly seven fold (to 165,000), of which 70 per cent were outside the United States.

The exorbitant costs of remittances (about 10–12 per cent of the estimated $25 billion transferred from the United States) and the implied large profits, have led to new entrants. The most significant change has been in the strategies of major commercial banks, which had been slow to recognize that the remittance business was a potential source of significant new opportunities. Portuguese banks had realized this in the early 1980s. They established branches in areas with concentrations of emigrants (like France) and offered free transfer services along with arrangements with local agents to deliver at home. By the late 1990s deposits from emigrants represented about 20 per cent of the total deposits in Portugal. In the Americas, the collapse of the Mexican banking system in the aftermath of the "Tequila" crisis in the mid-1990s, opened up the Mexican banking sector to foreign direct investment. As major Spanish and United States banks began buying Mexican banks, remittances gradually moved to the center of their strategies. They began to buy complementary United States assets as well as alliances with other banks to leverage the remittance business.[5] It soon became evident that users of remittance service could be drawn into become full banking customers – spearheading a large expansion of retail banking to two severely underserved groups on both sides of the border. The banks have also been surprised by the relative wealth of Mexican customers. The transfer business is already paying dividends. Bank of America has found that 33 per cent of its United States-Mexican remittance customers have opened a current account. Citigroup is using its transfer business to attract customers for other products – and one way to do is by lowering fees on transfers between Citigroup accounts in the United States and Mexico, and luring new customers. Banks are now extending the products and technologies developed in the Mexico-United States remittance business to other Hispanic remittance markets both in the United States and in Spain as well as the Spanish North Africa remittance market.

V. Effects of financial remittances

The effects of remittances are complex and are a function of the characteristics of migrants and the households they leave behind, their motivations, and the overall economic environment. Remittances are a form of household transfers and its motivations include altruism, as an implicit intra-family contractual arrangement or as an implicit family loan. The relative importance of motives appears to vary with the institutional setting (Foster and Rosenzweig, 2001).

Remittances finance consumption, land and housing purchases and philanthropy; they are an important source of social insurance in lower income countries; and they provide liquidity for small enterprises (in the absence of well functioning credit markets) as well as capital investments – in equipment, land, wells and irrigation works and education – with longer-term implications for economic development.

However, at this point it is important to dispel one myth surrounding remittances – that remittances compensate for the brain drain. It is often argued that while poor countries might loose the scare factor that is critical for development (human capital), they gain another scarce factor, namely financial resources in the form of remittances. The two are not substitutes. Although, as we shall note later, emigrants are positively selected, remittances are not a quid pro quo for the brain drain for several reasons. The real detrimental effects of the brain drain for developing countries arise from the migration of the upper end of human capital distribution, comprising of engineers, scientists, physicians, professors etc. This scarce human capital is usually drawn from the upper decile of the income distribution rather than the middle. Although there are exceptions (e.g. temporary skilled migrants like the H1-B IT workers in the United States), for the most part these households are in less need of remittances, unless the country of origin undergoes a major crisis. Indeed if the brain drain is a response to political repression or economic and political instability, rather than simply better economic opportunities abroad, human capital flight and financial capital flight complement each other. Instead of one form of capital outflow being "compensated" by another type of capital inflow, the migration simply precipitates the outflow of financial capital as well. Countries such as Afghanistan, Columbia, Ghana, Haiti, or Venezuela, as well as Cuba in the late 1950s and early 1960s, which have witnessed violent regime changes and civil wars are examples of this phenomenon. This is not to say that the brain drain of professionals might not have other benefits for the country of origin, such as business and commercial networks or investment flows and diaspora philanthropy, but those affects are distinct from financial remittances.

A. Remittances as social insurance

As pointed out earlier, remittances play a critical insurance role – and this has significant impact on both poverty and equity. For people in "failed states" remittances are critical for personal consumption. In Haiti, remittances were about 17 per cent of GDP. In Somalia following the collapse of a formal government in the early 1990s, remittances from the Somali diaspora based in the Gulf States, several European countries, the United States and Canada, became a critical survival resource for many Somali families. In particular, remittances helped many urban families cope during the harsh years of the 1990s. By the end of the decade with remittances between 25 and 40 per cent of GDP (all figures are very approximate), in some pockets, such as southern Somalia, these resources began to be invested in construction and commerce.[6]

A country that suffers a macroeconomic shock generally receives greater remittances. The many recent economic and financial crises have resulted in two simultaneous shocks that affect remittances: a positive income shock to the remitter because of devaluation and negative income shock to the remitee because of the economic downturn. Both predict an increase in remittances (in domestic currency terms). We looked at countries that suffered an economic shock (defined as a decline in GDP by 2 per cent in year "t") and examined remittances relative to private consumption in the years preceding and following the crisis. If the insurance hypothesis holds true we would expect the share of remittances in private consumption to increase. Due to the unavailability of consistent annual data on remittances for the countries suffering a shock, we examined this issue in both an unbalanced panel (figure 4a) and in a balanced panel (figure 4b). In the latter we have analysed data for a set of countries for which annual data is available for three years preceding and following a shock. In both cases there is a sharp increase in the ratio: remittances increase if a country suffers a macroeconomic shock.

Why does this matter? Its importance lies in the emerging consensus that with globalization, factor markets are of crucial importance for poverty alleviation. Households tend to be much more specialized in income (or factor earnings such as land, labour or capital) than they are in consumption. Hence it is the source of income rather than the pattern of expenditure that affects the poor relative to

Figure 4a

UNWEIGHTED AVERAGE OF REMITTANCES AS SHARE OF PRIVATE CONSUMPTION, UNBALANCED

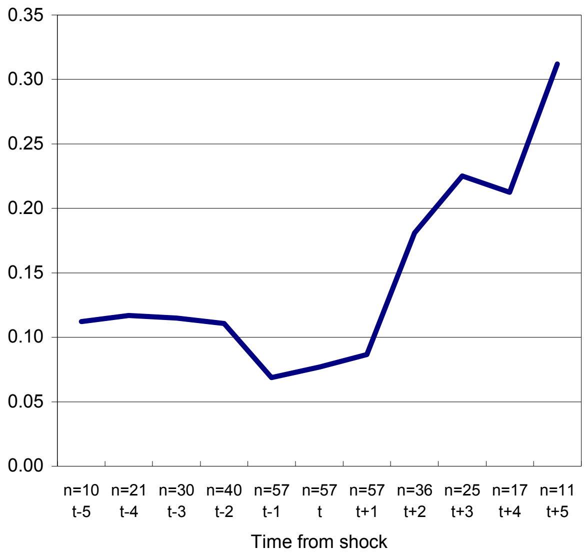
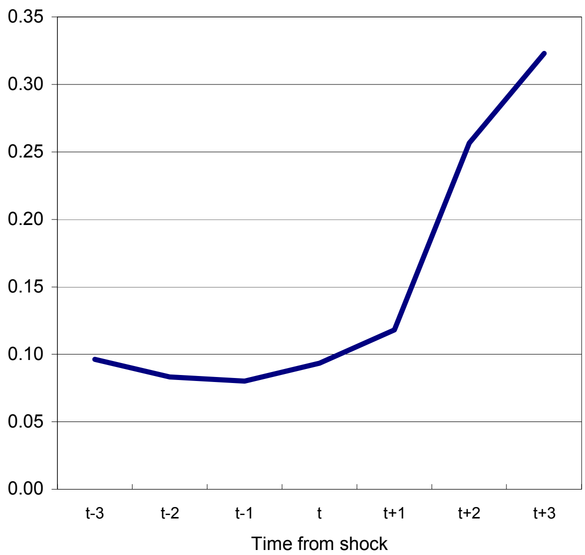


Figure 4b

UNWEIGHTED AVERAGE OF REMITTANCES AS SHARE OF PRIVATE CONSUMPTION, BALANCED (n=14)



Note: Includes Barbados 1988–94, Colombia 1981–97, Comoros 1985–91, Ghana 1983–89, Guinea-Bissau 1988–94, India 1980–86, Jamaica 1992–98, Mauritania 1989–95, Mexico 1991–97, Morocco 1989–95, Panama 1984–90, Trinidad and Tobago 1989–95, Tunisia 1989–95, and Turkey 1990–96.

the average household (Winters, 2000; Reimer, 2002). Remittances provide social protection to poor households, which reduces vulnerability to shocks. Although the immediate impact of remittances is on transient poverty, its long-term effects should not be underestimated. For instance it is now recognized that transient poverty is a serious obstacle to human capital investment. The impact on school attendance of an income shock is consistently larger for daughters than sons (Sawada, 2003). Thus even if remittances impact only on transient poverty, its effects on human capital investment, especially girls, could be quite substantial. But of course for these beneficial effects to occur the remittances should accrue to poor households in the first place, which in turn depends if the international migrants from that country are drawn from such households in the first place.

The particular characteristics of who migrates – so called selection effects – are equally important for equity. While in both cases the eventual effects are strongly mediated by labour market effects of migration, the distributional consequences are more complex given the uneven access to such flows across households, ethnic groups, communities and regions. Households that receive remittances rapidly attain standards of living greater than those who do not have family members working abroad. Households with more diversified portfolios – both in financial assets and human capital assets – will gain relative to those with domestic portfolios in the event of a domestic economic shock that results in a devaluation and economic downturn. The income stream from this overseas portfolio increases in domestic currency terms after a devaluation, thereby increasing their income relative to lower income groups. If remittances flow to poorer households concentrated in a particular region, it might reduce inequality within the region even while it widens it among different regions.

Research in the Philippines shows that households with overseas migrants have done substantially better, following the Asian crisis, than those that had no members abroad. This is to be expected since migration is a form of coinsurance and results in families having diversified portfolios. Indeed, even where households have members who are migrants abroad, those families above a certain income threshold are found to use remittances for investment (in the Philippines case in human capital that would make it easier to migrate abroad), while those below this threshold use it to meet subsistence consumption (Yang, 2003). This is particularly true during a crisis when households face substantial financial and economic stress and resultant pressure on consumption.

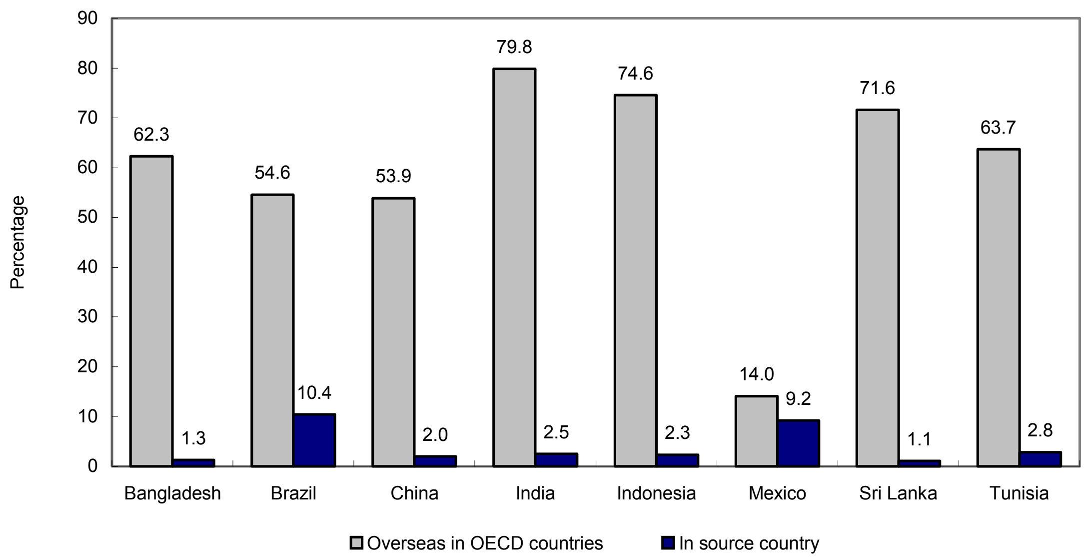
Migrants are rarely drawn randomly from the population pool. Instead they are drawn selectively from specific communities – be it regional, ethnic or religious – as well as educational and income levels. These selection effects mediate between migration, remittances and outcomes in the country of origin, be it on poverty or equity. The average level of education of immigrants is substantially greater than the average level in the country of origin – often substantially so (figure 5). In the Latin American case it has been shown that while only about one-fifth of Latin Americans have completed high school or college, a little over half of the Latino immigrants in the United States have a secondary education or better. Well-educated Latin Americans are at least two and a half times more likely to in the United States than home country population. In their analysis of Mexican migration to the United States, Chiquiar and Hanson (2002) find that Mexican immigrants, while much less educated than United States natives, are on average more educated than residents of Mexico. If Mexican immigrants in the United States were paid as per prevailing wages for those skills in Mexico, they would tend to occupy the middle and upper portions of Mexico's wage distribution. In contrast to earlier work that posits a negative-selection hypothesis (Borjas, 1987), these findings suggest that in terms of observable skills there is intermediate or positive selection of immigrants from Mexico. The results also suggest that migration abroad may raise wage inequality in Mexico.

The fact that migrants are not being drawn from the poorest households in their country of origin means that while remittances are poor-friendly, their direct effects on the poorest groups may be limited. Instead the effects on structural poverty are likely to occur through substantial indirect effects: the demand for labour-intensive services (such as construction workers when remittances are used for home building), and perhaps even redirecting government social expenditures from areas benefiting from remittances to those that are not. Of course these results are likely to be less representative of the many illegal immigrants, who are much more likely to come from poorer households. Large-scale illegal immigration occurs largely where there is geographical proxim-

Figure 5

25+ POPULATION WITH TERTIARY EDUCATION

(Percentage)



Source: CPS, OECD, UNESCO.

ity – for example, from Mexico and Central America to the United States, intra-Asian migration (e.g. Myanmar to Thailand or Nepal to India) and from the Maghreb countries to Europe. In the case of many poor people who do make it across borders, there is strong anecdotal evidence that they incur substantial debt from the upfront cost of making the often illegal journey across borders. In such cases they become indentured labourers who then have to work to pay off the loan (often to criminal syndicates), reducing their volume of remittances. On balance, however, if migrants are low skill or unskilled workers, the beneficial impact on poverty and inequality is maximized for the sending country. It is not just that the ensuing remittances are directed at poorer households, but that the supply of unskilled labour in the source country is reduced, thereby increasing unskilled wages of those left behind.

The evidence regarding the direct impact of remittances on economic development and growth is limited. It is common to hear officials in remittance receiving countries lament that the bulk of remittances are spent on consumption. In the case of poor families, it is hardly surprising that remittances are used to augment subsistence consumption, and therefore little is saved and very little invested in projects that could stimulate economic growth. Nonetheless in so far as remittances finance the consumption of domestically produced goods and services such as housing, there are wider multiplier effects. Moreover additional consumption also increases indirect tax receipts (Desai et al., 2003). There is some suggestion that the propensity to save is higher among remittance-receiving households than in others (Orozco, 2003a, b). If true, it suggests that remittances could be leveraged for broader economic development by helping augment national savings.

To take another example, it has long been recognized that capital and liquidity constraints are critical for small enterprise development, especially in poorer communities with imperfect capital markets. For instance, an analysis of capital constraints on investment levels of microenterprises in Mexico, found that remittances from migration by the owner or family members working in the United States were responsible for almost 20 per cent of the capital invested in microenterprises throughout urban Mexico – an additional cumulative investment capital of nearly $2 billion. Within the ten states with the highest rate of migration from Mexico to the United States, almost a third of the capital invested in micro-enterprises was associated with remittances (Woodruff and Zenteno, 2001). In so far as remittances are driving retail banking strategies of foreign investment in Mexican banks, an inadvertent but potentially far reaching effect of remittances on Mexico could be the transformation of its banking system. Fewer than one in five Mexicans has a bank account and many rural areas of central Mexico, which send the most migrant labourers to the United States, lack any bank branch. Weak formal credit markets have been particularly inimical to Mexico's small and medium enterprises. If the remittance driven post-merger banking strategy in Mexico leads to the transformation of retail banking in Mexico, the potential long-term economic benefits of remittances to the country might be greatest here.

More recently immigrant communities have sought to pool remittances and channel them for public purposes. For instance, in the last decade, Hispanic immigrants across the United States have organized themselves into hometown associations (HTAs) that finance public works projects and small businesses in the towns from which they have migrated. The Mexican Government has taken the initiative to leverage these remittances by creating a "three-for-program" whereby all HTA remittances used to improve infrastructure or establish businesses are matched dollar for dollar by the Mexican federal, state, and local authorities (Alarcon, 2001). This three fold leveraging has had some notable successes at the local level, but the cumulative impact remains limited.

Often communities do not have the resources to maintain what has been built through these contributions. Hype notwithstanding, HTAs have not so far been used significantly to fund direct income generation projects. In particular it is unclear if these initiatives are creating jobs so that Mexicans do not have to emigrate, or instead simply subsidizing future migration through improved training. Perhaps the biggest benefit is that the HTAs become a glue for local collective action in both the sending and the receiving country. For migrants, these associations help maintain ties to their home town, which in turn may help sustain private remittances.

B. What is the problem?

It is interesting that when examining the impact of remittances, micro-level studies (principally by anthropologists), are less sanguine about its effects than more macro-level studies (usually by economists). A common theme in the former is the duality of greater wealth but fewer economic opportunities for those left behind – a Pyrric victory as it were. So-called "migra-villages" in Latin America have in many cases been physically transformed. But often the new handsome houses are empty because their owners live in the United States. Likewise, remittances have helped build better schools, but enrollment has been declining. In these regions if initially remittances were simply a consequence of migration, over time they have emerged as its principal driver. The very money that has increased the material wealth of these villages appears to be gradually undermining their long-term future. What is good for individual migrants and households may not be as beneficial for the communities. Whether economic development is more about the former or the latter, is something that can be reasonably debated.

Even at the household level remittances can have ambiguous effects. Consider the case of homecare workers, for instance, Jamaican nannies in New York or Philippine nannies in Hong Kong (China). In many cases these are mothers who have left their own children behind to take care of children in richer households. The household in the country has a higher consumption due to remittances, but the children of these homecare workers grow up without the presence of their mother. We could take the migration decision of the mother as a "revealed preference" of an improvement in household welfare. Why would she leave otherwise? However, we do not have an independent analysis that this is indeed the case.

In communities heavily dependent on remittances, a culture of dependency often sets in. In a variety of contexts it has been observed that household members simply stop working and wait from month to month for the overseas remittance. Such negative incentive effects – a form of moral hazard – also results in an increase in the reservation wage. Young men prefer to remain unemployed and wait for the possibility that they themselves will migrate, rather than take up jobs at the local market-clearing wage. That remittances increase consumption much faster than production, raises issues of long-term sustainability, given an inevitable decline as migrants settle in new communities and links with their home communities gradually erode. Of course this is moot if most people leave the community in any case.

Similar negative incentive effects can also act at the national level. If remittances are relatively large, and a large share is spent on non-tradeables – housing and land are particularly favoured – the country is likely to suffer Dutch disease effects. Effectively this results in an appreciation of the real exchange rate, rendering exports less competitive. The country's principal export could become the cheap factor – labour – rather than labour intensive products. At an aggregate level remittances constitute a form of rents. Exporting products requires painstaking effort to build the institutions and infrastructure that helps develop the necessary productive capacity. Exporting people, on the other hand, occurs in most cases by default rather than by design. Nonetheless if the latter also results in large foreign exchange receipts, the pressure to undertake reforms needed for export-led growth are considerably attenuated. For instance, countries can maintain larger fiscal deficits in the context of international migration and remittances. In the absence of remittances, high fiscal deficits would imply higher current account imbalances and hence greater reliance on foreign savings (assuming the deficit is not monetized – which is less likely given that central banks are relatively more independent today) resulting in higher capital account inflows.[7] However if remittances are high, current account deficits would be lower, thereby reducing the likelihood that high fiscal deficits will precipitate a balance-of-payments crisis – the most common trigger for economic reforms in LDCs. Thus countries with high levels of remittances can sustain higher fiscal deficits – while at the same time keeping international financial institutions like the IMF and the World Bank at bay.[8] Increasing politicization of these institutions has meant potential borrowers have transitioned from co-insurance through these institutions, to self-insurance in the form of higher foreign exchange reserves and international migration and remittances.

C. *Political effects*

Money buys influence. It should not therefore be surprising that in countries where remittances are important, the political effects are not inconsequential. In countries such as the Dominican Republic (where remittances are 10 per cent of GDP), presidential candidates campaign in the United States. From Mexico to India, the lucre of remittances has led politicians to switch positions vis-à-vis their diaspora from benign neglect to active courtship. Regimes in socialist economies like Cuba and the Democratic People's Republic of Korea, have used remittances to augment scarce hard currency resources to strengthen themselves in the short term. Cuba draws remittances from its United States based diaspora while the Democratic People's Republic of Korea earns remittances mostly from pachinko parlours run by Koreans living in Japan. But in so far as these remittances sow the seeds of economic transformation, they can begin to quietly erode the political system. In Cuba access to remittances has increased inequality in a political system that draws its legitimacy from its commitment to equity. Remittances have a strong racial bias since the diaspora is predominantly white while the island is majority black. The latter gained under Castro and were therefore less likely to emigrate, but as a result they have less access to the emerging cross-border informal dollarized economy. Furthermore, access to remittances is also heavily urban and regional; Havana, with 20 per cent of the island's population, receives approximately 60 per cent of remittances. Therefore rural-urban inequality is also likely to widen.

Secondly, remittances can be viewed as a political weapon of the weak. Rather than simply react to state policies, international migration and remittances has forced states to accommodate new realties. In lieu of political voice, migration becomes an exit strategy and remittances either fuel further exit or empower political voice by making available resources to new groups. In several Latin American countries even as economists debated the relative merits of dollarization, the influx of "migradollars" were in several cases rendering the debate moot.

Nor is the political impact confined to just source countries. In receiving countries, remittances have been quietly reshaping immigration policies. Recently the Mexican Government negotiated with banks and wire transfer agencies in the United States to make it easier and cheaper for immigrants to send money home. The Mexican Government began to distribute "matricula" consular identification cards and persuaded United States banks to accept them as identification cards for the purpose of opening bank accounts, irrespective of the legality of their immigration status.[9] Major United States banks attracted by the high fees and volumes, began to accept these cards. The remittance market was also a good complement to United States banks' strategy of expanding operations in Latin America by buying local banks in the region. After all, if a bank could get a customer to step inside and make a deposit (in the United States) or a withdrawal (in say, Mexico), it might interest him in other financial products. In turn, by simply offering to do business with any illegal foreign resident who got a consular identification card, United States banks have quietly reshaped their country's migration policy towards illegal immigrants from Latin America or Mexico. As Mexican consulates began to be flooded with applications for ID cards, local governments and law enforcement agencies in the United States began accepting these ID cards to get other forms of identification such as driver's licenses, making the lives of illegal migrants less onerous.

Since international remittances are a form of cross-border financial flows, it should not be surprising that they also have international political effects. In many countries the importance and concentration of remittances impact bilateral relationships and foreign policy. While at the local level remittances impact politics, at the macro level causality runs the other way – it is politics that impacts remittances. To the extent that sources of remittances for some receiving countries are heavily concentrated in regions and countries that suffer from political instability, they are especially vulnerable. The emergence of "remittances communities" creates source-destination dyads (table 4), which increases covariant shocks and can become a coercive instrument on the part of migrant destination country. Thus remittances from migrants in Côte d'Ivoire accounted for a quarter of the GDP of Burkina Faso and a civil war in the former rapidly reverberated to the latter.

The oil shocks and the gulf crisis in the Middle East have not only affected oil producing countries but have had a regional contagion effect through their demand for labour. A similar phenomenon was observed in South East Asia during the Asian crisis when the expulsion of Indonesian labour from Malaysia and Thailand exacerbated the crisis in the former, increased tensions between the countries and weakened ASEAN. Following the 1991 Gulf War, the Gulf countries punished workers from Jordan and Yemen and especially Palestinians for supporting Saddam Hussein and expelled them from their countries. In all these cases remittances from family members earning money in the Gulf states were crucial. The heavy price paid then and the continued dependence on remittances from the Gulf, was one factor why some countries were opposed to renewed conflict in Iraq, fearing its disruptive economic effects.

Table 4

SOME PROMINENT SOURCE-DESTINATION DYADS

Source country	*Destination country*
Afghanistan	Pakistan
Algeria	France
Argentina	Italy
Armenia	Russian Federation
Bangladesh	Saudi Arabia
Brazil	Japan
Burkina Faso	Côte d'Ivoire
China	Republic of Korea
Colombia	Venezuela
Dominican Republic	United States
Ecuador	Spain
Ghana	Nigeria (1970s), United Kingdom
Guatemala	Mexico
Haiti	Dominican Republic
India	Gulf countries, United States
Indonesia	Malaysia
Mexico	United States
Mozambique	South Africa
Myanmar	Thailand
Nepal	India
Pakistan	Saudi Arabia
Peru	Chile
Philippines	Hong Kong (China)
Suriname	Netherlands
Turkey	Germany

Control of remittances as a form of economic warfare has been most evident in the Israel-Palestinian conflict. In September 2000, Israel began revoking the work permits of Palestinians because of security concerns. At that time, some 100,000 Palestinian workers from the West Bank and Gaza Strip crossed into Israel every day. By January 2002, only 25,000 Palestinian workers and 8,000 merchants had permits to enter, a number that has continued to drop. In their place, Israel began to import foreign workers (an estimated 230,000), largely from China, Thailand, Africa and the Philippines to work in agriculture and construction. As a result remittance outflows from Israel tripled from less than one billion dollars in the early 1990s to nearly three billion in 2001. The economic effects on the West Bank and Gaza have been devastating. GNI per capita fell by 11.7 per cent in 2001 and a further 18.7 per cent in 2002 while poverty levels jumped from 21 per cent in 1999 to 46 per cent in 2002. The drop in remittances had larger indirect effects as well since the loss of income resulted in depressed demand for Palestinian goods and a sharp decline in imports from Israel – in turn adversely affecting Israel's economy as well.[10]

As with much else in the contemporary world, remittances changed in the aftermath of September 11. For Pakistan, a "front line" state caught in this vortex, where remittances were around $1 billion in 2000 (about a third of their peak in 1982–1983), this proved a blessing. Many Pakistanis with savings in offshore accounts repatriated their funds, fearful of being caught in United States-led investigations into terrorist financing. Under pressure from the United States, the Pakistani central bank tightened controls on the web of money changers (locally know as *hundi* operators), and introduced a law restoring immunity against disclosure of the sources of income for foreign currency account holders. As a result the difference between the official and market rates narrowed (to less than one per cent), and remittances in Pakistan exceeded three billion dollars in 2002.

In contrast, the effects were disastrous for Somalia a country with no recognized government and without a functioning state apparatus. After the international community largely washed its hands off the country following the disastrous peacekeeping foray in 1994, remittances became the inhabitants' lifeline. With no recognized private banking system the remittance trade was dominated by a single firm (Al Barakaat).[11] In 2001 the United States shut down the Al Barakat bank's overseas money remittance channel labelling it "the quartermasters of terror". With remittances representing between a quarter and 40 per cent of total GNP, closure of the channel was devastating. The humanitarian impact of money frozen in transit was considerable. Remittances provided many times what the aid agencies were providing to rebuild the deeply impoverished country. Although evidence of Al Barakaat's backing for terrorism was weak,[12] the effects of the ban on the country's well-being were significant.

VI. Policy options

The Somali case emphasizes two issues. One, there is little doubt that remittances are an important mechanism to fund terrorism, civil wars, and liberation struggles, the nomenclature depending on the beholder. From the support for the revolutionary council of the Free Aceh Movement (or Gam) in Sweden to the LTTE in Canada, to support for the Kashmiri cause in the United Kingdom, there is no shortage of examples. In Somalia itself a large portion of the remittances went to supply arms to the rural guerrillas who toppled the government in January 1991. For the peoples of collapsed states (or so called "failed" states) in Congo, Somalia and Afghanistan as well as for nationalities without states (Palestinians, Kurds, and pre-independence Eritrea and East Timor), overseas remittances are the oxygen essential not just for family survival and household consumption – but also to finance the militant causes and support leaderships that may use the struggle in turn to maintain their own hold. In other cases such as Armenia and Croatia, remittances underwrote long-distance nationalism, boosting hard-line regimes and complicating efforts to resolve regional conflicts.

Second, it illustrates the need for greater international efforts to create an acceptable international money transfer system in the growing number of countries where the state has collapsed, there is acute paucity of international aid, and its nationals are trying to do more for themselves. There is no bigger challenge facing the international community than the challenge of addressing the well being of people living in such states. Currently, the international community is relying principally on a "big stick" approach – proscriptions and sanctions against countries and financial intermediaries. For instance, the United States recently considered sanctions to cut off remittances to the Democratic People's Republic of Korea. The United States and the Paris-based Financial Action Task Force (FATF) are pressuring countries to start monitoring "door-to-door" remittances, fearing that this unregulated flow of money could be used for terrorist activities. New legislation is forcing money transmitters to install expensive new compliance technologies. It is certainly the case, as the United Nations Development Programme (UNDP) found in Somalia, that current money transfer systems in that country do not meet acceptable international standards, and lack the systems to identify suspicious transactions and money laundering schemes. But international efforts will be more meaningful if they are directed to build a financial architecture rather than just to deploy the blunt instrument of sanctions. The UNDP's initiative to work with foreign governments and Somalia's remaining money transfer and remittance companies, to comply with standard financial rules and regulations and help firms institute standard book keeping, auditing and reporting, is an example of such an alternative policy option.

The international community can best address the channels through which remittances are transmitted, by helping construct a financial architecture that reduces the transaction costs of intermediation and increases its transparency. Recently the World Council of Credit Unions launched the International Remittance Network (IRNet) to facilitate remittance transfers from the United States. It does not charge recipients any fee and offers better exchange rates – but as of yet its services are confined to its members. The Inter-American Development Bank (IDB) is helping create a common electronic platform in the region between sending and receiving countries and within receiving countries (Buencamino and Gorbunov, 2002). But there is considerably greater scope in this regard. In particular the international community should fund a much more substantial effort to underwrite the development and maintenance of a common electronic platform (including clearing house and payment systems) that would facilitate remittance transfers. If the facility was maintained under the aegis of a multilateral organization (the UNDP for instance), it could ensure both greater transparency as well as lower transactional costs. Indeed by allowing registered IVTS operators as well as INTERPOL access to such a platform at low costs, it would couple many of the advantages of informal banking with the transparency of such a facility. It should be remembered that public subsidies for such an endeavour would in all likelihood be much less than the higher costs of policing and monitoring, as well as the greater transactional costs, than are being currently incurred.

Another step to help lubricate international remittance transfers would be to work on transforming the role of post offices, the single biggest global distributional channel. The United States post-office began a programme called "Dinero Seguro" (safe money) for sending remittances but with charges at nearly ten per cent of the face amount, it has had little success. Postal "giro" payment systems are widely used in Europe and Japan. Linking the postal giro systems worldwide, would facilitate international postal transfers, parallelling the agreement for the exchange of mail among member countries of the Universal Postal Union (UPU).

What can receiving country governments do to enhance the development impact of remittances? For one, they should try and get a better handle on the magnitudes and sources of these flows. In contrast to the massive effort devoted to monitoring and managing foreign aid flows, governments for the most part have paid little attention to these flows. Remittance data should become part of the IMF's Special Data Dissemination Standards (SDDS) to both address the severe problems of consistency and timeliness of remittance data. Moreover, this would also ensure that there was better data on remittance outflows, thus allowing for some cross checks, similar to what is currently done in trade flows. Remittance receiving countries need to create a spatial mapping of their overseas communities, not just by country but specific geographical location. This would allow financial intermediaries to better target these communities.

Second, increasing the long-term productive impact of remittances requires promoting greater competition and using a carrot and stick approach to increase the penetration of formal financial intermediaries, especially banks, in areas with higher levels of emigration. While it is true that *havala*-like informal transfer systems are extremely efficient, in that they provide much needed low transaction and financial cost services, *the net amount of capital they bring in is virtually zero*. The reason is that *havala* can only function if inflows are equal to outflows, which means that the transactions are balanced through capital flight. Thus while remittance receiving households benefit from the operation of *havala* like informal systems, the net financial and foreign exchange gains to the country are significantly less than if the flows came through formal channels. Moreover, if the propensity to save is higher among remittance-receiving households than in others, formal systems are likely to raise national savings rates. This would suggest that the presence of an extensive network of financial intermediaries in these areas could help leverage remittances for broader economic development. Countries with large remittance flows through informal channels, could consider subsidizing the intermediation costs through formal channels as well as offer other incentives e.g. lower cost financial products like life insurance or access to mortgages.[13] Remittances could also be used to securitize future receivables to augment foreign credit ratings (Ketkar and Rath, 2001).

Third, governments also need to more actively monitor and regulate labour market intermediaries, who often fleece potential migrants. Intermediaries lubricate flows – but can also divert a substantial stream of income to themselves. Finally, they should be aware that active government attempts to encourage or require remittances to be invested, are unlikely to have significant economic benefits. The best way for recipient country governments to ensure that a greater proportion of remittances are utilized for productive investments (rather than simply consumption) is to have a supportive economic environment for investment per se. Countries such as India and Turkey have tried to increase remittances by offering various preferential schemes under the capital account. Such preferential treatment, such as tax-free status, inevitably leads to round tripping. Instead governments should direct their efforts to the financial sector.

VII. Conclusion: are remittances a new development paradigm or another destabilizing force of globalization?

Remittances are one of the most visible – and beneficial – aspects of how international migration is reshaping the countries of origin. In a variety of settings they are quietly transforming societies and regions and are the most manifest example of self-help undertaken by poor households in the global arena. Their role is particularly important in augmenting private consumption and alleviating transient poverty in receiving countries. However, their effects on structural poverty and long-term economic development, are less well understood. Given their importance, rigorous data and research on the effects of remittances is surprisingly limited, in stark contrast to the substantial body of literature on the other principal sources of development finance – foreign aid, flows from the Bretton Woods institutions, and foreign direct investment and private debt flows.

Unlike foreign aid, remittance flows do not put any burden on taxpayers in rich countries. Nonetheless, they occur only to the extent that emigrants from poor countries can work in richer countries. It is clear that countries that are *de facto* much more open to immigration are also the principal sources of remittances and in so far as these constitute substantial sources of external finance to poorer countries, should they not be viewed as a country's contribution to poor countries?[14] From this point of view the United States contribution substantially increases (and in proportionate terms that of Saudi Arabia even more), while that of more immigrant resistant countries like Japan falls. The critical difference between foreign aid and remittances is that the former consists of transfers from public entities in the donor country to public agencies in receiving countries and even when it is directed to civil society actors such as NGOs, it goes to organized entities. Remittances of course, simply go directly to households and in that sense their immediate poverty alleviation impact – through increased consumption – can be greater than traditional foreign aid, depending on the income characteristics of the receiving household. The transaction costs are lower and there is less leakage to rent seeking bureaucracies and consultants. However, its long-term impact may be more questionable, especially if few productive assets are being created. Thus, it would appear that remittances are a better instrument to address transient poverty, which arises due to shocks whether at households or national level, rather than structural poverty. To alleviate structural poverty, broad economic transformation may still require external financial resources in the form of budgetary support to governments in many poor countries.

If remittances are to become the principal mechanism to transfer resources to poor countries, it would require more liberal, open-door immigration policies in industrialized countries. Perhaps in the new round of global bargaining LDCs might complement the slogan "trade not aid" with "migration not aid". In the ongoing trade negotiations under the Doha round, LDCs would do well to press for greater levels of temporary migration, and less on foreign aid. That might be better for all sides but it is unclear if either rich or poor country governments have the incentive to do so. Rich country governments loose potential leverage on LDC governments while the many poor country governments loose a source of rents. Indeed, it is likely that foreign aid and bilateral trade agreements will be increasingly used to persuade developing countries governments to check migrant outflows.

Finally it is worth reflecting whether it is the less visible, non-quantifiable and intangible remittances – namely social remittances or the flow of ideas – have a more critical impact than their pecuniary counterpart? The overseas experience has undoubtedly some cognitive effects on migrants. At the same time, the communications revolution has led to an exponential growth of transnational phone calls and emails and a sharp increase in international travel. As a result not just elites but social groups at the lower end of the social spectrum are exposed to the flow of new ideas. The cumulative effect of millions of conversations – akin to filling a pond one-drop at a time – is interesting to speculate on. On the one hand this results in information flows – "deep knowledge" – that is frequently tacit, about what and how to do things. On the other hand it changes expectations and preferences of what is acceptable, be it standards of service or the role of the state, as well as what is not, such as the behaviour of politicians. Perhaps, it is here that the real effects of remittances will be felt. But that is another story.

Notes

1 The World Bank has recently adopted this practice as well. See *Global Development Finance, 2003*, statistical appendix to chapter 7.

2 In the BOP such transactions show up as contra entries – a reduction in the capital account and an increase in the current account. For instance remittances to India increase by more than $2 billion if this is taken into account. This is also a feature of the so-called Dresdner scheme in Turkey.

3 I am grateful to Dilip Rath of the World Bank for the data used in this section and discussions related to the same. Also see Rath (2003).

4 Belgium's data is not reported separately but is usually combined with Luxembourg's.

5 Thus Spain's Banco Bilbao Vizcaya Argentaria bought Bancomer and then emerged as a dominant player in the electronic transfer business. Its volume grew from 657,000 transactions in 1999 to 12.65m last year thanks largely to the alliance it started in 2000 with another United States bank (Wells Fargo), links with a number of money transfer services in the New York area, and with the United States Postal Service. Following Citbank's purchase of Banamex in 2001, it introduced a single account that can be operated on either side of the border, using branches of either Citibank or Banamex. In 2002, Bank of America, the biggest United States retail bank, took a stake in Santander Serfin, the third-largest Mexican bank, which was controlled by Spain's Santander Central Hispano (SCH). The remittance business also drove HSBC's decision to buy Grupo Financiero Bital, a large Mexican retail bank along with Household International, a consumer credit lender with branches across the United States, as a base for the remittance business.

6 Idil Salah, Som-Can Institute for Research and Development; Bernard Taylor, Partnership Africa Canada, http://www.web.net/pac/pacnet-l/msg00008.html; Somalia: Peace and Development, (ymd): 990912.

7 Moreover, the general trend of greater trade openness and increasing domestic liberalization means that excess demand has much less effect on inflation.

8 For instance, India, has maintained exceedingly high fiscal deficits (about 10 per cent of GDP) even as inflation is modest (about 5 per cent). In part this is because its current account – buoyed by remittances exceeding twelve billion dollars (2.5 per cent of GDP) – is positive. For a more elaborate discussion see, Kapur and Patel, 2003.

9 The cards are digitally coded and check an applicant's information against computerized census and voter rolls in Mexico. The accounts will allow immigrants to send ATM cards to relatives back home, so rather than spending $25 to send $200 at a typical money transfer counter, immigrants can give their families access to funds in the United States for about $3 per transaction.

10 http://lnweb18.worldbank.org/mna/mena.nsf/Attachments/Ecomomic+and+Social+Impact.

11 Al Barakat operated in 40 countries, was the country's largest private sector employer, and handled about $140 million a year from the diaspora and in addition offered phone and internet services.

12 By early 2003 only four criminal prosecutions had been filed, and none involved charges of aiding terrorists.

13 This is being attempted in Mexico with the assistance of Fannie Mae and JP Morgan.

14 A new research initiative currently underway by the Center for Global Development and *Foreign Policy* magazine, on the impact of an array of rich country policies on poor countries, does take this into account.

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