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THE LEAST DEVELOPED COUNTRIES REPORT 2012

Harnessing Remittances and Diaspora Knowledge to Build Productive Capacities

OVERVIEW

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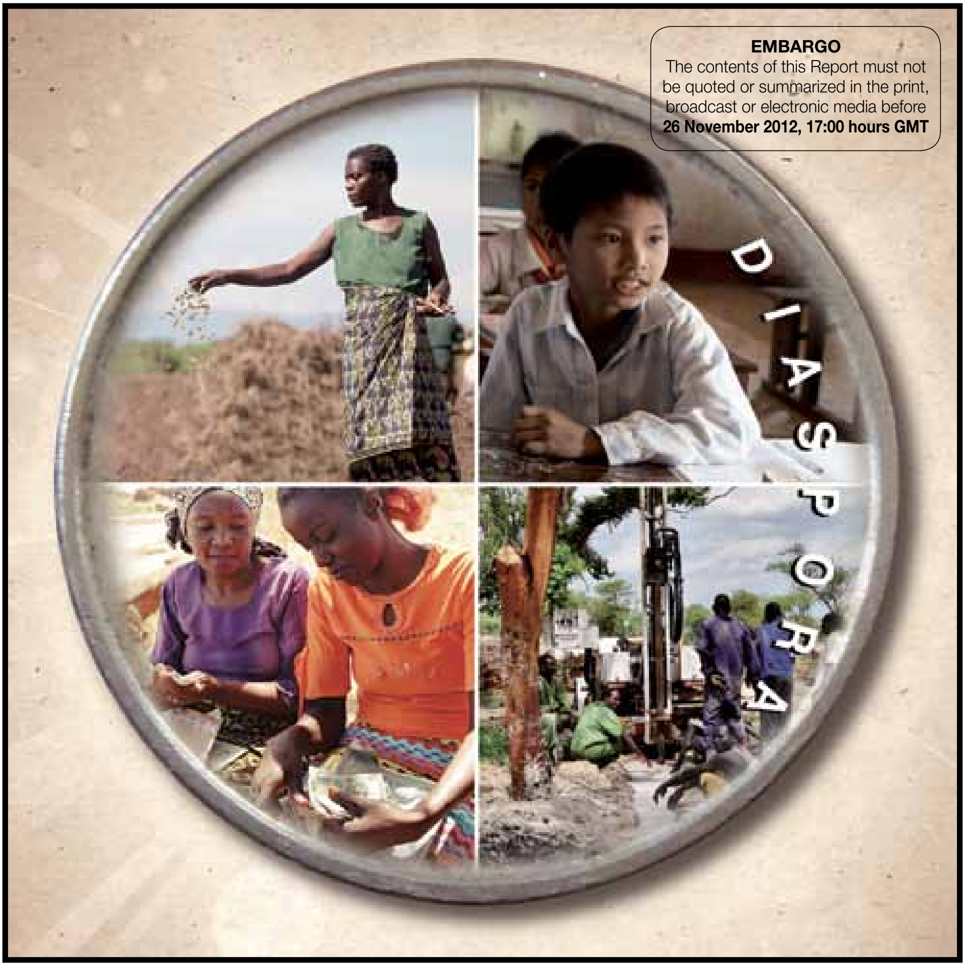

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Overview

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Introduction

The uncertain global economic recovery and the worsening Eurozone crisis continue to undermine those factors that enabled the least developed countries (LDCs) as a group to attain higher growth rates between 2002 and 2008. Despite seeing real gross domestic product (GDP) grow slightly faster in 2010, the group as a whole performed less favourably in 2011, signalling challenges ahead. Indeed, with the world's attention focused on Europe, there is a danger that the international community may lose sight of the fact that in recent years, LDCs have been most affected by financial crises caused by other countries. With less diversified economies, LDCs have neither the reserves nor the resources needed to cushion their economies and adjust easily to negative shocks. Furthermore, if another global downturn hurts the growth prospects of emerging economies, LDCs, as major commodity exporters, will be directly affected. Therefore, LDCs require increased external assistance to better protect their economies against external shocks and help them manage volatility.

In May 2011, Heads of State and Government and Representatives of States gathered in Istanbul (Turkey) for the Fourth United Nations Conference on the Least Developed Countries (LDC-IV) to deliberate on the specific development challenges facing LDCs and agree on a Programme of Action for the Decade 2011–2020. The Istanbul Programme of Action (IPoA) identified eight "priority areas of action" to be implemented by both LDCs and their development partners. One of the eight priority areas is "mobilization of financial resources for development and capacity-building", and the Programme refers specifically to five sources of finance: domestic resource mobilization; official development assistance; external debt; foreign direct investment; and remittances. On the latter, the IPoA states in paragraph 123:

"Remittances are significant private financial resources for households in countries of origin of migration. There is a need for further efforts to lower the transaction costs of remittances and create opportunities for development-oriented investment, bearing in mind that remittances cannot be considered as a substitute for foreign direct investment, ODA, debt relief or other public sources of finance for development".

The Least Developed Countries Report 2012 focuses on the issue of remittances from a wider perspective. It examines the potential role of migrants or diasporas at large from LDCs as sources of development finance and also as channels of knowledge transfer and as facilitators of trade and market access opportunities in the host countries. The Report identifies policies, including policy lessons from other countries that LDCs may wish to consider in designing policy frameworks for harnessing remittances and diaspora knowledge to build productive capacities.

Remittances have attracted increasing attention in the international discourse, partly owing to their significant growth over the last decade. A growing consensus is emerging that remittances constitute a significant source of external financing, whose availability, if managed through appropriate policies, could prove particularly valuable for capital-scarce developing countries (especially those with larger diasporas).

Similarly, there is growing interest in the role that migrants, especially skilled professionals, can play as "development agents" linking home and destination countries. While concerns about the adverse impact of brain drain remain valid, as discussed in detail in this Report, the focus of the recent debate has to some extent shifted to how to engage with the diaspora and maximize its potential contribution to development, "turning brain drain into brain gain". In this respect, the emphasis has been placed not only on diaspora members' saving and investment potential, but also on their latent role as "knowledge brokers" who could facilitate the emergence of new trade patterns, technology transfer, skills and knowledge exchange. This calls for a pragmatic, context-specific policy approach to diaspora engagement.

In general, the effective mobilization of a diaspora for development depends on the existence of a critical mass of migrants in a given destination. In some cases, however, the diaspora need not be large to generate a positive development impact. Even a small number of highly skilled expatriates can create enormous benefits, in particular in poor economies with severe shortages of skilled professionals. Nevertheless, the onus of mobilizing the diaspora and transferring specialized knowledge and technology should not be placed wholly on the diaspora. Rather, the latter should be viewed as a potentially important complement to a country's development strategy; one which could be mobilized strategically within the framework of broader policy initiatives to support the financing and development of productive capacities.

Harnessing remittances for increasing productive capacities requires that these resources be considered pragmatically, with the recognition that ultimately these are private sector resources, and that due account be taken of each country's specificities, while avoiding characterizations of this phenomenon as either a "curse" or a "new development mantra". The jury is still out on whether or not they are the most stable and predictable source of development finance. While some unresolved questions remain as to their macroeconomic impact, substantial evidence suggests that remittances contribute to poverty reduction and improved health care and education. LDCs will likely be hard hit by the global economic slowdown. This will require rethinking alternative sources of development finance and the potential for tapping into LDCs' diaspora knowledge networks as sources of knowledge, entrepreneurship and trade links.

Recent economic trends in the LDCs

In 2011, LDCs grew by 4.2 per cent, 1.4 percentage points lower than the preceding year, mirroring the slowdown of growth worldwide (from 5.3 per cent in 2010 to 3.9 per cent in 2011). Given their high dependence on external economic conditions, LDCs were unable to escape this broad-based slowdown, and the rate of deceleration was similar to that of developing countries (1.3 percentage points) and advanced economies (1.6 percentage points).

In terms of country group performance, both African and Asian LDCs experienced a slowdown in 2011, and both grew by similar rates at around four per cent. For the Asian LDCs, however, the slowdown was more pronounced (over two percentage points). By contrast, GDP growth of the island LDCs (at 7.1 per cent) was much higher, compared with both the previous year and the LDC average.

The poor performance of oil-exporting LDCs in 2011 (-1.6 per cent) had a negative impact on overall LDC performance. Compared with oil exporters, LDCs specializing in exports of other products such as manufactures (6.0 per cent), services (5.7 per cent), minerals (5.8 per cent), agriculture and food (5.9 per cent) or mixed exports (5.4 per cent) fared much better. However, in terms of resource gap, indicating the extent to which countries rely on external resources to finance their domestic investment, non-oil-exporting LDCs have performed poorly. While the resource gap for LDCs as a whole fell from 6.5 per cent of GDP in 2000 to 3.9 per cent in 2010, for non-oil-exporting LDCs, it increased from 10 per cent 2000 to 13 per cent just before the global crisis and hit 14.8 per cent in 2010. One result of the increasing resource gap in non-petroleum-exporting LDCs has been a growing balance of payments vulnerability. In 2011, thirteen LDCs had current account deficits of more than 10 per cent of GDP, while five had deficits of over 20 per cent of GDP. Only five LDCs reported current account surpluses.

If this pattern continues, along with slow global recovery, it may damage employment prospects in LDCs. The significance of employment for LDCs cannot be overemphasized. The relatively young demographic structure of LDCs means that increasing cohorts of young are entering the labour market and will continue to do so. Even during the 2002–2008 boom, LDCs faced an employment challenge because of lopsided growth concentrated in resource-extractive sectors which resulted in weak job creation. This also resulted in growing informality in LDCs, even when rates of open unemployment did not increase.

The longer it takes for GDP growth to return to its pre-crisis level, the greater the likelihood of long-term unemployment and underemployment, with all of their detrimental effects on the population. Governments should thus bear in mind that additional measures are needed to minimize the adverse effects of the global crisis, and that employment creation should be at the top of their national development agendas.

Gross fixed capital formation increased slightly from 20.7 per cent of GDP in 2005–2007 to 21.6 per cent in 2008–2010. Throughout the first decade of the 21st century, it has increased slowly but surely (by three GDP percentage points). While this is positive, it compares less favourably with other developing countries (ODCs), whose gross fixed capital formation reached 30.1 per cent of GDP in 2010. If current investment trends continue, it is unlikely that LDCs will be able to catch up with ODCs in the near future. The gross domestic saving rate for the LDCs as a group was 18.9 per cent of GDP in 2005–2007, and fell to 17.7 per cent in 2008–2010.

The LDCs' trade balance improved from a deficit equivalent to 6.1 per cent of GDP in 2010 to 5.7 per cent in 2011. The value of merchandise exports from LDCs increased by 23 per cent in 2011, surpassing the pre-crisis level. The total value of merchandise exports in 2011 ($204.8 billon) was twice as high as five years ago. On the downside, merchandise exports for LDCs as a group have remained highly concentrated in a few countries. The top five exporters (Angola, Bangladesh, Equatorial Guinea, Yemen and Sudan) account for 62 per cent of all exports from LDCs. The value of merchandise imports rose sharply in 2011 (20.6 per cent) to $202.2 billion, also doubling in the last five years.

Overall trends in merchandise trade shifted the merchandise trade balance into surplus in 2011 after two years of deficits. This is important to emphasize since prior to 2006, LDCs had continuously recorded merchandise trade deficits. Yet the positive result for the group was due entirely to the African LDCs and their surplus of $21.4 billion — which in turn is driven by only a small number of countries, most notably Angola. Asian LDCs, by contrast, recorded a merchandise trade deficit of $17.5 billion in 2011, and island LDCs a deficit of $1.2 billion. Merchandise exports have continued to be dominated by petroleum, at slightly over 46 per cent of total exports.

Improved export performance by many LDCs in 2010 and 2011 was largely due to higher international commodity prices. After slumping in 2009, prices recovered rapidly, in some cases to levels higher than before the crisis. For example, food prices started to rise again in 2010 and 2011, topping pre-crisis levels. In the summer of 2012, food prices, in particular for maize and wheat, were once again on the rise due to drought in major producing countries. This will affect many poor people in LDCs, who generally spend 50 to 80 per cent of their income on food. The situation in some parts of Africa is critical, as food insecurity threatens the lives of hundreds of thousands. Governments in LDCs and their development partners must act urgently to prevent rising food prices from spiralling out of control, risking the sort of crisis experienced in 2008. In the long term, the root causes of food price increases and the issue of agricultural production in LDCs must be tackled by increasing investment in the sector and designing policies to improve productivity, in particular among small-scale farmers.

Regarding foreign investment, UNCTAD recently revised the data on inflows of foreign direct investment (FDI) to LDCs, which show that in the last decade, FDI inflows have been smaller than remittances. Unlike FDI, remittances kept increasing even during the crisis and are forecasted to grow in the medium term. In 2011, remittances to LDCs reached $26 billion. The decline in FDI inflows to LDCs for three consecutive years (from a little less than $19 billion in 2008 to $15 billion in 2011) has been largely due to disinvestment trends in Angola, tied to the oil investment cycle in that country. In the rest of the LDCs, FDI has remained relatively stable.

Official development assistance (ODA) disbursements, together with net debt relief to LDCs from all donors reporting to the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD/DAC), reached a record level of $44.8 billion in 2010, an 11 per cent increase over 2009. In nominal terms, aid inflows to the LDCs were 3.5 times higher in 2010 than in 2000. As noted in *The Least Developed Countries Report 2011*, ODA has played an important countercyclical role in the wake of the global crisis, cushioning the impact of retreating private financial flows. While data for 2011 are still not available, there are signs of a decrease in ODA from some donor countries.

The LDCs' total debt stock reached $161 billion in 2010, only marginally higher than in 2009. Their debt service decreased slightly from $8.2 billion in 2009 to 7.6 billion in 2010. The experience of the LDCs in the last ten years shows that the key to debt sustainability is development of productive capacities. High, sustainable GDP growth and rapid expanding exports increased the debt-servicing capacity of many LDCs. While external financial resources, in particular ODA and remittances, have recently been increasingly available to LDCs, there is no guarantee that this will continue to be the case. The recent sharp decrease in FDI is instructive in this respect. Consequently, a progressive shift from reliance on external sources of finance to domestic ones to reduce their external dependence and vulnerability to external shocks and uncertainties is a major challenge for LDCs.

Sadly, given the fragile global economy, the outlook for 2013 is highly uncertain. As of mid-2012, economic activity was decelerating in a synchronized fashion in many parts of the world. The downside risks are numerous and include escalation of the Eurozone debt crisis, a rise in global energy prices due to geopolitical risks, deceleration of growth in large developing countries and fiscal retrenchment in the United States scheduled for 2013, which could have a strong negative impact on overall growth.

Against this background, the outlook for LDCs in the short- to medium-term is not encouraging. Given the growing danger that the world economy might be entering a lengthy period of stagnation and deflation, LDCs have to prepare for a relatively prolonged period of uncertainty, with possible escalation of financial tensions and real economic downturn. Trade and investment of developing countries, which are often intermediated by US and European banks, have already suffered setbacks. Prices of some commodities started to fall, in some cases abruptly, in the second quarter of 2012, partly due to slowing demand for commodities from emerging economies. If the current tendency of economic deceleration continues, commodity prices could suffer pronounced falls. Thus, LDCs may once again be exposed to external economic shocks and have to deal with a crisis that originates elsewhere. Recognizing this may allow for more effective preparation. It also lends added urgency to the need for rethinking remittances policies and the role that diasporas could play in knowledge transfer and as catalysts of industrial development and structural transformation in home countries.

Patterns of LDC emigration

Emigration from LDCs grew rapidly in 1990–2010. With 27.5 million emigrants in 2010, LDCs as a whole accounted for 13 per cent of global emigration stocks, or some 3.3 per cent of the LDC population. Over 2000–2010, the increase in emigrant stocks was fastest for African LDCs. The destination of LDC emigrants varies across regions, but most go to South Asia, the Middle East and Africa. High migration within sub-Saharan Africa probably reflects the facts that (a) much of African migration is forced (refugee flows) and by poor people, as a result of which proximity is crucial; and (b) Africans generally face great difficulty entering other countries. Among the high-income regions, only the Gulf States have a high share of South Asians, and no country has a high share of Africans. The evidence shows that some 80 per cent of LDC migrants migrate within the South, as a result of which LDCs and ODCs are important countries of destination.

In fact, refugees constitute a significant but declining share of total immigrants residing in LDCs. Their share of the total migrant stock in LDCs peaked at 44 per cent in 1995 but then declined rapidly, reflecting improved governance structures in many African countries and lessened conflict and political instability. As with conventional economic migration, when mass forced migration occurs, there is a significant loss of human and financial capital, of labour and skilled workers in the country of origin. The main countries of emigration in 2010 were Bangladesh, with 4.9 million emigrants, and Afghanistan, with two million.

Globally, developed countries tend to accept skilled immigrants but increasingly erect barriers to exclude the unskilled unless there is high demand for their labour in particular sectors (e.g. agriculture or construction).

LDC migrants tend to be younger than those from other countries, with a median age of 29 years, compared with 34 in other developing countries and 43 in the developed countries.

Therefore, contrary to the general perception that LDC migration is a South–North phenomenon, the pattern of migration emerging has acquired a South–South dimension in recent decades. In 2010, high-income OECD countries (namely North America and Europe) accounted for 20 per cent of the LDC emigrant stock, while some 80 per cent were in the South. Moreover, most LDC South–South migration tends to take place between neighbouring countries, where wage differentials are in general much smaller than in South–North migration. Thus, the main LDC emigration corridors are in the South.

Concerning high-skilled migration, the majority of emigrants who have attained tertiary education tend to migrate to developed countries. In fact, Haiti (83 per cent), Samoa (73 per cent), the Gambia (68 per cent) and Tuvalu (65 per cent) have the highest emigration rates of tertiary-educated LDC population.

There are several reasons and motivations driving migration from LDCs. However, the following patterns and observations are worth noting:

- First, given the youthful demographic structure of most LDCs, young adults typically move more than older adults. This is partly due to life-cycle differences between age groups and educational levels.
- Second, men migrate more than women on average in LDCs (particularly in Asian LDCs), due to the persistence of particular gender roles in most rural societies where women have primary responsibility for child-rearing and domestic tasks. This often limits opportunities for women to migrate, the key exceptions perhaps being young, unmarried women from households where they can be absent (i.e. households where several older women already reside) or women migrating to join their partners at the destination. However, female migration has been increasing recently. When they do migrate, women migrant workers are generally employed in service activities (including the care economy), while male migrants are more likely to be found in manufacturing production and construction sectors, in addition to some services.
- Third, in LDCs migration is an important livelihood strategy and largely operates within a context of temporary (seasonal or circular) migration. The migrant remains part of the household, and is expected to send remittances home.

- Fourth, some migration occurs as a survival strategy, while some is based on a rational income-maximizing strategy to take advantage of regional or international wage differentials, irrespective of conditions at home. Educational qualifications and skills make such migration more feasible for youth.

The LDCs with the highest share of emigrants as a percentage of total LDC emigrant stocks in 2010 were Bangladesh (19 per cent), Afghanistan (8 per cent), Burkina Faso (6 per cent) and Mozambique (4 per cent). These countries were also part of the main migration corridors: Bangladesh — India, Afghanistan — Iran, Burkina Faso - Côte d'Ivoire, Yemen — Saudi Arabia and Nepal — India. Asian LDCs like Bangladesh, Afghanistan, Yemen and Nepal tend to have India or the Middle East as a first or second country of destination. For African LDCs, the key emigration corridors are within Africa.

Inhabitants of Asian and Pacific LDCs appear to have higher propensities to migrate to non-LDCs than those of African LDCs, which recorded the highest share of emigrants residing in other LDCs in 2010. The main sources of intra-LDC migration during 2010 were in sub-Saharan Africa, particularly Eritrea, the Democratic Republic of the Congo and Sudan.

Improved international cooperation on migration and development in LDCs is needed to optimize migrant contributions at all levels. Thus, at the bilateral and regional levels, further progress is required to strengthen international cooperation.

Remittances to LDCs: Magnitude, impact and cost

Worldwide, the value of remittances began to accelerate markedly, nearly doubling between 1990 and 2000, and then tripling once again in the following decade, touching $489 billion in 2011 despite the global financial crisis. While all regions have witnessed significant expansions in remittance receipts, the rise in global remittances is chiefly driven by the surge of inflows to developing countries. Correspondingly, the developed economies' share of world remittances has been steadily declining.

As for LDCs, remittance receipts climbed from $3.5 billion in 1990 to $6.3 billion in 2000, subsequently accelerating further to nearly $27 billion in 2011. These inflows are unevenly distributed across LDCs, even more so than FDI and export revenues. Over the past decade, the top recipient, Bangladesh, expanded its share of total LDC remittance inflows from 31 to 44 per cent. During the same period, the top three LDC recipients (Bangladesh, Nepal and Sudan) also increased their overall share from 44 per cent to 66 per cent of LDC total inflows. Besides these well-known large recipients, other LDCs obtaining sizeable sums through remittances include Cambodia, Ethiopia, Haiti, Lesotho, Mali, Senegal, Togo, Uganda and Yemen.

Notwithstanding the uneven distribution, the sustained dynamism of remittance inflows to LDCs was quite general. In all but a handful of LDCs for which data are available, remittance inflows increased markedly over the last decade, growing at an annual average of 15 per cent in the median LDC. Admittedly, in the wake of the global financial crisis of 2009, remittance receipts slowed in most LDCs, even though they continued to increase with a few exceptions.

Despite some heterogeneity across countries, the value of remittances relative to GDP or export revenues has historically been much greater in LDCs than in other regions. In the median LDC, they account for as much as 2.1 per cent of GDP and 8.5 per cent of export earnings, as compared with 1.6 per cent and 4.5 per cent respectively for ODCs. This prominence is noticeable for an array of LDCs, ranging from small economies like Lesotho or Samoa, where remittances represent over 20 per cent of GDP, to traditionally large recipients such as Nepal and Haiti, where they largely exceed export earnings.

Similarly, for a number of LDCs, remittances constitute a key source of foreign financing. Over 2008–2010, recorded remittances exceeded both ODA and FDI inflows in nine LDCs, and surpassed FDI but not ODA in another eight LDC economies. Whereas by their very nature remittances are distinct from capital flows, they clearly play a significant role in providing foreign exchange for a large number of LDC countries. Consequently, it is important that LDC development strategies fully reflect the relevance of these resource flows, their intrinsic characteristics, and their underlying potential.

South–South remittance flows are particularly important for LDCs, consistent with the fact that the majority of LDC migrants actually move to other developing countries, often neighbouring ones. In 2010, it was estimated that as much as two-thirds of recorded remittances to LDCs originated in other Southern countries. Distinct regional patterns emerge, however, with respect to remittance corridors. India and the Gulf Cooperation Council (GCC) countries represent key sources of remittances for Asian LDCs; "subregional hubs" (such as Côte d'Ivoire, Kenya or South Africa) play a similar role for African LDCs, along with former colonial powers; while Pacific Islands derive the bulk of their remittances from neighbouring developed economies.

There is a compelling body of research documenting the positive impact of remittances at the household level, both in terms of poverty reduction and as a risk mitigation strategy to diversify income sources. However, evidence of their developmental impact at a macroeconomic level is far less clear-cut. The relationship between remittances and economic growth is complex and multifaceted. On the negative side, the adverse effect of remittances on labour market outcomes may reduce economic growth, especially if a culture of dependency on foreign transfers becomes gradually entrenched. Moreover, unless properly addressed, the tendency of remittances to trigger appreciations in the real exchange rate may give rise to "Dutch disease" effects, hindering much-needed structural change by undermining the competitiveness of non-traditional tradable sectors.

On the positive side, remittances may support economic growth and productive capacity development through two channels: investment and financial deepening. Indeed, remittances provide a much-needed source of foreign financing that could enhance the pace of physical and human capital accumulation (the "investment channel"). In addition, they tend to increase the availability of funds for the domestic financial system, paving the way for recipient households to demand and gain access to other financial products and services which they might not have otherwise. Besides, remittances may possibly relax financial constraints on recipient households, particularly those in rural areas, which are poorly served by existing financial intermediaries.

Even though the literature is still somewhat inconclusive on how remittances ultimately affect economic growth, there appears to be general agreement that complementary policies and sound institutions play an important role in enhancing their development impact. Governments typically have only limited room to directly affect the allocation of remittance income, since taxation or mandatory remittance requirements have historically proved rather ineffective and in most cases have simply led migrants to use informal channels to remit.

Accordingly, effective mobilization of remittances for productive purposes depends on an array of policy and institutional improvements, aimed at reinforcing both the "investment channel" and remittances' impact on financial deepening.

Overall, the scope for remittances to stimulate both physical and human capital accumulation and financial development tends to be fairly positive, all the more so when a large share of remittance income is received by poor and otherwise credit-rationed households. Here, capital-scarce LDCs clearly have much to gain from remittances' potential developmental impact. Yet LDCs' structural weaknesses make it more difficult to successfully mobilize these sources of external financing for productive purposes. It is therefore essential to design appropriate strategies and policy frameworks for harnessing remittances for economic development.

Moreover, the relative stability and lower procyclicality of remittances compared with other sources of external financing is worth stressing. Due to these characteristics, an increase in the share of remittances to GDP tends to reduce the volatility of GDP growth, even after controlling for other possible determinants of growth volatility. Similarly, remittances appear to reduce the probability of sharp current account reversals, especially when they are larger than three per cent of GDP. These features may be particularly relevant in an LDC context, given that these economies have traditionally been characterized by relatively recurrent growth accelerations but nearly as frequent growth collapses, coupled with heightened balance of payments vulnerability and debt overhang.

At household level, a large body of empirical studies typically show that remittances reduce poverty. The impact of remittances on inequality is less clear-cut, especially given the selectivity underlying the migration process. As prospective migrants incur upfront costs, which are largely dependent on the destination, those belonging to the poorest households are typically unable to afford long-distance international movement or the costly bureaucratic procedures usually required to migrate to developed economies. So it is precisely the poorest who are unable to benefit from the largest differentials in terms of expected wages and consequently remit larger sums.

Migrants typically utilize a whole range of formal and informal channels for remitting, chosen on the basis of cost, reliability, accessibility and trust. Though resorting to informal remittance channels may seem a rational choice from an individual migrant's standpoint, policy-wise, formal remittance systems are preferable, even leaving aside concerns related to security, regulation or supervision. The prevalence of informal flows limits the ability of recipient countries to make optimum use of the foreign exchange sent by overseas migrants. This may limit the effects remittances have on a country's creditworthiness or in stimulating financial deepening, and encourage informal (black market) currency transactions.

Worldwide evidence shows that, as of the first quarter of 2009, the cost of remittances averaged nine per cent of the amount sent. For LDCs, the average cost of remitting was close to 12 per cent of the amount sent, 30 per cent higher than the global average. If North–South remittance costs are high, South–South remittance costs are often significantly higher. The most expensive channels for remitting transfers to LDCs are found within Africa, whereas the least expensive are from Singapore and Saudi Arabia to Asian LDCs. The implications of such high remittance costs may be significant: it is estimated that in 2010, annual remittances sent to sub-Saharan Africa could have generated an additional $6 billion for recipients if the costs of remitting money had matched the global average.

Average remittance costs naturally mask a wide range of elements that vary by corridor and remittance service provider (RSP). In general, lack of competition among RSPs appears to be a significant factor in explaining the high costs of remittances. The regulatory challenges that RSPs face vary by LDC and region, and have led to different characteristics in the respective remittance markets. For example, for the whole of sub-Saharan Africa, 65 per cent of all remittance payout locations are controlled by two money transfer operators (MTOs), namely MoneyGram and Western Union. Similarly, African governments have put into place several RSP exclusivity arrangements limiting the type of institutions able to offer remittance services to banks, thereby reducing RSP competition.

Remittance transfer payments systems in LDCs are evolving and new channels and technologies are emerging. With improving LDC infrastructure and growth in mobile bank branches and branchless banking, both urban and rural clienteles should enjoy better access to financial services. Yet despite the potential of these emerging systems, more traditional forms of RSP provision still dominate in most LDCs.

In general, as shown in this Report, remittances offer LDCs some scope for sustaining the development of productive capacities, by increasing investment in human and physical capital and stimulating financial deepening. Yet the realization of such potential is contingent upon the policy and institutional framework recipient countries put into place. In other words, owing to the intrinsic specificities of remittances as private sector financial flows, their effective mobilization for productive purposes essentially depends on the State's capacity to create a "development-centred" macroeconomic environment while also supporting the establishment of a viable and inclusive financial sector. This, in turn, warrants active engagement by diasporas and support from host countries and international development institutions.

Mobilizing the diaspora: From brain drain to brain gain

"Brain drain" generally refers to the emigration of high-skilled people with university-level education, such as physicians, engineers, scientists, managers and lawyers, as well as entrepreneurs. The main drivers of brain drain are higher income, better working conditions, career prospects in a host country, the latter's selective migration policies, adverse political and economic situations in one's home country, and lower migration costs. Worldwide, brain drain has been increasing in absolute terms. The number of high-skilled international migrants climbed from 16.4 million in 1990 to 26.2 million in 2000 (the latest year for which data are available). When the 2010 figures are finally released, they are expected to show a sharp increase in the volume of high-skilled international migration. International immigration is skewed towards highly educated people. Twenty-six per cent of all international migrants are tertiary-educated (according to data for 2000), while only 11.3 per cent of the world labour force have tertiary education. In developing countries, university-level workers account for a much lower five per cent of the labour force.

In 2000 (the year for which data are available for LDCs), high-skilled migrants accounted for one-fourth of total emigration from LDCs. This is 11 times higher than their share in the total labour force of these countries, namely, 2.3 per cent. International migration is selective (i.e. it favours high-skilled over low-skilled people), which explains this huge discrepancy. An estimated 1.3 million persons with university-level education had emigrated from LDCs by 2000, and this figure has continued to grow since then. Almost two-thirds of all LDC high-skilled emigrants live in developed countries (especially the United States), while one-third moved to other developing countries (mainly oil-exporting and neighbouring countries). The major regional source of high-skilled LDC emigrants is Asia, home to 45.9 per cent of tertiary educated migrants from LDCs, followed by African LDCs, which account for 40.4 per cent of LDC brain drain.

Brain drain can have both adverse and beneficial effects on home countries, the balance of which primarily depends on the extent of brain drain. This is measured by the brain drain rate, i.e. the number of high-skilled emigrants as a share of all nationals with the same education level. Collectively, LDCs have the highest brain drain rate among the world's major country groups, averaging 18.4 per cent, much higher than other developing countries (10 per cent). Regionally, the worst affected LDCs are Haiti, Pacific Islands and African LDCs. Six LDCs have more high-skilled professionals living abroad than at home: Haiti, Samoa, the Gambia, Tuvalu, Kiribati and Sierra Leone.

The "optimal" level of brain drain (where the net balance of positive and negative effects on the domestic home economies reaches its maximum) has been estimated at 5–10 per cent. Only five LDCs are in this range. By contrast, beyond 15–20 per cent, the likelihood increases that the negative impacts of brain drain will exceed the positive consequences. The actual brain drain rate is "high" in 30 of the 48 LDCs.

What are the main likely adverse impacts of brain drain on LDCs? First, it results in a reduction of their human capital stock and the externalities generated by highly skilled people. This can lead to lower economic and productivity growth, as well as reduced activity in science, technology and innovation (STI). Second, brain drain is especially acute in some sectors, above all health, education and scientific research. LDCs form the country group with the lowest number of doctors per population but have the world's highest medical brain drain rates. These are usually associated with higher infant and child mortality, lower vaccination rates and generally poor health-care services and national health systems. Third, through brain drain, LDC governments forego the taxes that these professional would have paid if they had stayed and worked at home. Fourth, shrinking the skilled human capital base tilts LDCs' relative endowments and comparative advantage away from skill-intensive sectors towards low-skilled activities and, possibly, natural resources. Fifth, some LDC high-skilled emigrants hold jobs with educational requirements below their training, in what is termed "brain waste", since part of their skills are not used. Sixth, the departure of the most skilled persons impairs institution-building in LDCs.

The question is: can LDCs turn brain drain into brain gain? There is evidence to show that notwithstanding the short-term adverse impacts, over the long run, countries can benefit from the additional knowledge acquired by their nationals residing and working abroad. First, it has been argued that emigration prospects may encourage people to obtain further education, which may result in brain gain, i.e. larger human capital endowments. Second, part of the remittances are used to pay for the education of family members, thereby generating brain gain. Third, high-skilled emigrants form a knowledge pool which can be organized as diaspora knowledge networks (DKNs), facilitating flows of knowledge and technology to home countries. These flows work through programmes and initiatives launched by diaspora organizations, international organizations and governments of home and host countries. They generally have positive effects, but the effectiveness of knowledge-sharing initiatives is sometimes hampered by the dispersions of projects, their failure to join actors and efforts, a dearth of resources leveraging and synergy creation, as well as little coherence with national development policies. Harnessing diaspora knowledge by creating networks has huge but still relatively unfulfilled potential for LDCs.

Fourth, the presence of diasporas can strengthen business flows between host and home countries through trade and investment links. In LDCs, diasporas have driven growth of home country goods in what has been termed “ethnic trade” or “nostalgia trade”, i.e. goods exported to be consumed by the diaspora but which can potentially spread to wider markets. LDC diapora members have also propelled the growth of tourism service exports, by visiting the home country or helping to attract other tourists.

Fifth, permanent return migrants can bring with them accumulated savings, knowledge, experience and business networks, although this may depend on their motivation for return, time spent abroad, and local conditions. LDCs that are more advanced in economic diversification, structural transformation and growth have typically been more successful in attracting the voluntary return of qualified migrants who have founded new businesses and introduced economic and social innovation in the fields of science, health, education, services and industry.

Yet benefiting from a diaspora is not automatic. Tapping the potential depends on a series of institutional, economic and political conditions, still absent in most LDCs. Therefore, policy action by home and host countries and by the international community is crucial for fostering or strengthening positive diaspora effects on LDCs. Brain drain from LDCs will likely continue in the foreseeable future, due to very strong push and pull forces. These diasporas are a pool of knowledge, human and financial resources on which LDCs can draw to have them contribute to national development to a much greater extent than previously. LDC governments are at the initial stages of realizing this potential and taking action to harness it. Stronger, more systematic policy action is required in order to strengthen diasporas' contribution to LDCs. To succeed, such policy action requires mobilization and coordination of the efforts and resources of different stakeholders, especially home country institutions and firms, host country government and agents, diaspora organizations and NGOs, international organizations, and bilateral donors. Ideally, such coordination should take place upstream, i.e. at the planning stage, so as to ensure the engagement and coherence of all relevant stakeholders from the start.

Unlocking the LDCs' diaspora potential: A policy agenda for harnessing remittances and diaspora knowledge

Diasporas and capacity-building

Clearly, migration and its varied consequences have become increasingly significant for developing countries in general and LDCs in particular, and these trends are likely to continue into the medium-term future. The main recommendation of this Report for policymakers is to improve the current policy framework on remittances and diaspora knowledge in LDCs in order to better harness them for the development of productive capacities. Furthermore, policies on migration, remittances and diaspora engagement should not be formulated in isolation, but as an integral part of national development strategies. This will require an agency, ideally at ministerial level, to reflect the cross-cutting nature of these issues; ensure policy coherence and consistency across the board; and coordinate potential actors around a set of identified priorities. Governments in LDCs also need to be aware of the actual extent and pattern of cross-border migration, the location, spread and nature of diaspora activities, and the extent and pattern of remittances. Here, the current state of knowledge in most LDCs is relatively poor. Therefore, part of the problem is statistical in nature. There is hardly any official apparatus to report on and monitor many of the facets of migration and its results, and existing mechanisms deal mainly with remittances.

While the specific mix of policies and concrete measures for diaspora engagement will vary for each country, the overall direction should be to provide an enabling environment for development. Also, the issue of trust is crucial. While it is true that diaspora members are not motivated exclusively by commercial interests, their engagement will fail if they are only expected to contribute and receive nothing in return. This applies, for example, if LDCs wish to encourage diaspora entrepreneurs to use their savings or raise capital externally to establish productive activities in home countries. Studies on the role of the diasporas show that in some middle-income countries, entrepreneurial diasporas have been instrumental in developing the productive capacities of their home countries. For example, migrant entrepreneurs have played an important role in building knowledge-based industries in India, China, Taiwan Province of China, Israel and Ireland in the last two decades or so. A lesson from these experiences is that entrepreneurs abroad can help to develop firms at home and also serve as a two-way link for market knowledge, connections and technology transfer across countries. In LDCs, this process may be less promising in the short run because of their more limited base of human capital and venture capital to develop high-tech industries at home. Nevertheless, their entrepreneurial diasporas operating in light industry can help develop similar industries at home through contacts, know-how and other valuable inputs and capabilities developed in the host countries. They can also contribute to upgrading managerial and innovating capabilities at home.

In general, there are at least two conditions that would determine the possibilities of migrants to succeed in establishing thriving firms upon their return. The first is whether they return with more advanced knowledge and skills than before. This Report argues that this probability will increase the longer they stay as migrants in foreign countries and the more entrepreneurial experience they accumulate. The second is the existence of a favourable policy framework in their home country. They would probably need suitable financial support to start a new firm, even if they have accumulated some savings. At the very least, they should be able to obtain a loan from the financial sector under normal conditions.

Yet given the reluctance of financial institutions to extend credit to small and medium-sized enterprises (SMEs), a national development bank with special lines of credit for return migrants might be needed. In addition, return migrants might have accumulated some but not necessarily all of the requisite skills for successful entrepreneurial activity. In this case, they would need technical assistance to upgrade their managerial, technical, financial or other skills required for successfully managing an SME. Governments could provide this type of technical assistance and/or education. They could also extend support to these entrepreneurs by lowering tariffs on imports of machinery and equipment and raw materials to help them start up their businesses.

Facilitating trade-related links with host countries is another channel though which diasporas can help develop home country production and supply capacities. A positive empirical correlation has been found between the degree of international trade in source and destination countries and the size of the migrant community in both nations. The dominance of language, culture and knowledge of customer and supplier markets are all factors that help develop trade relations among nations, and the diaspora communities can be well placed for performing this role. Initially, a distinct niche for LDCs could be to seek an advantage in supplying so-called "ethnic products" or "nostalgia trade". Studies show, for example, that there is a very high participation of migrants in the United States in the market for home-country goods that are difficult to find in the host country. Each migrant spends almost $1,000 per year on nostalgia products, and the total may amount to over $20 billion annually. LDC policies could be designed to help producers become and stay competitive by upgrading their products and adapting them to changes in the final markets, and to enlist diaspora members to help with branding and marketing in the host country. Education and training of producers is crucial if they are to become competitive in foreign markets.

Diasporas as sources of knowledge and learning

Diasporas could also further structural change and economic development, by strengthening the knowledge base in home countries. A useful mechanism in this respect is the diaspora knowledge network (DKN), which consists of groups of highly skilled expatriate professionals who are interested in maintaining contacts and helping to develop their countries of origin. As knowledge is neither costless nor easily transferrable, for this to occur, proactive policies are required that incorporate this potentially key function of diasporas into governments' strategic developmental frameworks.

DKNs are understood as subsets of international knowledge networks governing the transfer of various types of knowledge, such as intellectual property, know-how, software code or databases, between dependent parties, across the economy. As such, DKNs include a platform for knowledge flows and interaction between a diaspora and local actors in a home country.

There is ample evidence from numerous case studies indicating that DKNs have played a critical role in technological upgrading, industrial development and building of productive capacities in source countries. LDCs should learn from countries that have benefited most from DKNs by designing their diaspora strategy as an integral part of industrial policy and the broader national development strategy. DKNs have effectively operated as agents of change in both developed and developing countries. There are successful cases of diaspora networks such as those formed by Indian, Chinese, Korean, Taiwanese, Vietnamese, Turkish and Bangladeshi emigrants, to name but a few.

Yet such transfer of knowledge and learning does not happen automatically: it requires an organized and coordinated diaspora network and a home-country national development strategy backed by industrial policy and active government engagement in diaspora affairs. A proactive diaspora policy is essential for ensuring that DKNs, which are in essence private voluntary networks, gain the trust and confidence needed to remain engaged and ensure that their activities exert a positive impact. As latecomers to industrial development and given their recent experience with deindustrialization, LDCs need to formulate innovative industrial policies that are compatible with both their current conditions and requirements and the rapidly evolving global context. Some LDCs have already designed industrial policies to accelerate economic diversification and structural change.

There are many reasons for promoting networks, not least of which is knowledge diffusion. DKNs can supply new technologies and inform government and other residents of the latest technological developments and those appropriate for domestic industrial needs. They can assist in matching the needs of local productive sectors with specific FDI needed for upgrading local skills and capacities. The significance of the diaspora network for industrial policy is that it makes the shift from hierarchy to search networks an essential component of industrial policy. DKNs help to link up those who want to learn with those that are already learning. Indeed, this shift from hierarchy to horizontal networks has a profound impact on global supply chains and hence on new industrial strategies, where “learning to learn” becomes an essential objective of industrial policy. However, DKNs should not be perceived as a panacea or a substitute for local efforts to build endogenous productive capabilities; rather, their role is that of additional actor in the story of growth based on domestic productive capacities.

In recent years, UNCTAD has repeatedly argued that progressive transformation in economic structure is a prerequisite for LDCs to achieve accelerated and sustained economic growth and poverty reduction. The policies and strategies needed to attain structural transformation will involve, inter alia, (a) the development of a new industrial policy based on a strategic approach that reflects the specific needs and conditions of LDCs; (b) a catalytic developmental State to compensate for the incipient and weak private sector in LDCs; (c) measures to encourage private investment in productive activities and public investment in basic infrastructure, including the development of skills and support institutions; and (d) the promotion of domestic technological learning and innovation and improvements in productivity in both agricultural and manufacturing sectors.

This Report reinforces the case for a new industrial policy in LDCs, arguing further that such a policy should reflect the role of DKNs because they carry a potentially transformative impact on knowledge accumulation, especially in accelerating technological change and direct investment. Failure to recognize this fact may mean that DKNs will remain an untapped resource and a missed opportunity.

Diasporas as sources of development finance

As noted above, one reason for the predominant use of informal channels for remitting to LDCs is the high cost of remitting through formal channels, primarily due to lack of competition. Possible policy actions to open up the remittance market to competition could include the following:

- Directly increasing the range of financial actors involved, especially in rural areas, by changing regulations to allow participation, particularly of microfinance institutions, savings and loans cooperatives, credit unions and post offices;

- Promoting partnerships among banks and microfinance institutions;
- Strengthening post office involvement by improving their Internet connectivity, increasing their technical capabilities and cash resources, and promoting a wider selection of savings products;
- Improving telecommunications infrastructure;
- Harmonizing banking and telecommunications regulations to enable banks to participate in mobile remittances;
- Actively promoting competition through specialized remittances trade fairs;
- Discouraging exclusivity agreements between all market participants, especially banks and MTOs.

These conventional measures could be accompanied by other, more innovative approaches. For example, competition could be intensified by allowing a public sector remittance service provider to operate and compete with private sector providers. This could be done by establishing a public corporation or using existing institutions like a development bank or the central bank. Such an institution would provide the same service as the private sector but would charge a lower cost for remitting. Instead of opening up its own branches, the public corporation could team up with the postal service, helping reach customers in remote areas where private financial institutions have no branches.

Use of new technologies, particularly Internet-based and mobile telephony-driven methods of transmitting funds, can be further exploited. Since the cost of remitting is highest within Africa, there is also scope for regional initiatives to bring it down, for example by coordinating measures via formal regional integration initiatives, or through the good offices of regional development banks (for example, the African Development Bank). While this could be a regional-driven process, it could also be linked to the international goal of reducing remittance costs known as the “5 x 5” initiative.

While policies to increase ease of remitting money and reduce the costs involved are clearly necessary and desirable, they need to be part of a broader macroeconomic framework to enhance the developmental role of remittances. A consistent set of trade, industrial and macroeconomic policies that sustainably foster growth and economic diversification will be crucial in ensuring that remittance flows also boost development rather than simply enhance consumption in recipient families.

At household level, governments could enhance the developmental impact of remittances by giving migrants additional incentives. For example, they could be allowed to open foreign currency accounts in the home country, and the interest rate on deposits denominated in foreign currencies could be exempted from wealth and income taxes; an option to use foreign currency deposits as collateral for obtaining preferential loans could be offered; incentives to migrants to return to the home country once they retire could be provided via double-taxation avoidance treaties with the main host countries where the majority of its migrants work; the creation of education and housing accounts at home for migrants and their families, combined with a higher rate of return on these deposits than on ordinary ones, would provide an incentive to save more out of remittances, for purposes that would encourage productive use of remittances. The appropriate mix of measures would have to be decided by competent authorities depending on the size and degree of diapora engagement.

Diaspora bonds could be attractive options for LDCs because they would increase the pool of sources for development financing. Patriotic motives for investing in diaspora bonds make these instruments at least somewhat less procyclical than other external capital flows, allowing governments to issue them in not only good but also bad times, such as natural disasters or external economic shocks.

Since remittance flows have proved fairly stable over the medium to longer term, these future-flow receivables can be used as collateral for securitization or long-term loans. For some LDCs, this could even represent the only possible access to international capital markets, increasing funds available for development, and could become a stepping stone to establish or improve international creditworthiness.

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