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# **Literature Review on Migration and Remittances Development**

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## **ABSTRACT**

In this article I have presented the kernel of the migration literature on remittances. I started from their three most debated features: stability, cyclicalness and sustainability. I then moved to the motives driving remittances and, finally, their relationship with development. Both sustainability and cyclicalness are the most controversial issues, as they are probably the most critical in terms of economic development. The former is fundamental from an endogenous point of view. In terms of dynamic convergence, if sustainability holds, less financially developed countries could redeem themselves fostering riskier and more productive investments, 'substituting' their liquidity constraints with pro-cyclical remittances. On the other hand, from a 'brain gain' perspective, if the inverse relation between the time spent abroad and intention to remit is going to be confirmed in future works, the 'brain circulation' could be beneficial both from a human capital and a remittances point of view.

Keywords: migration, diaspora, remittances, development, household, transnationalism

## INTRODUCTION

Migrants' remittances commonly refer to certain transactions that are initiated by individuals living or working outside their countries of birth or origin and related to their migration. However, if I want to provide a more formal definition (World Bank 2006), three items under which remittances are encountered (OECD 2005) into the IMF Balance of Payments Statistics Yearbook (IMF 2004) need to be considered. These are compensations of employees, workers' remittances and migrants' transfers (Straubhaar 2005). The first category belongs to the subsection income and comprises wages, salaries, and other benefits earned by individuals in economies other than those in which they are residents, for work performed for and paid for by residents of those economies. The second one, belonging to the sub-category current transfers, covers current transfers by migrant (World Bank 2005) who are employed in new economies and are considered residents there. Finally, the third one that is accounted into the capital transfers arises in correspondence to the migration of individuals from one economy to another (Mannan & Kozlov 1997). It is made up of three components: the flow of goods (personal effects) accompanying the migrant, his flow of financial assets and the change in the stock positions due to the change in his residence status (IADB 2006). All these data, like all the other components contained into the balance of payments framework, are compiled by relevant statistical authorities in member countries such as the central

bank or the national statistical office who then report them to the Statistics Department of the IMF, where global tables are compiled and published in the annual report.

Nevertheless, the data contained in the BOPSY are far from being perfectly estimated so that any data comparison and aggregation have to be approached with caution (Giuliano & Ruiz-Arranz 2006). First of all, aggregate data are subject to variations of compilation on a national basis as a consequence of a variety of concepts and methodologies that are not uniformly applied across all countries. With regard to this, the definition of residence is one of the most critical since some countries still consider their nationals working abroad for a year or longer as national residents and therefore their earnings as compensations of employees, simply because they maintain strong linkages with their home country. Secondly, data sourcing and compilation is better in some countries than others, leading up to the fact that some of them do not report all the items to the Fund or, at worst, they do not send any data at all.

Apart from terminological issues, in most of the cases, data lacknesses and omissions depend on the difficulties in obtaining all necessary data (World Bank 2006). The system through which remittances can be transferred is, indeed, multidimensional. The broadest distinction is between formal and informal channels, whose regularity depends on the possibility that the flows can be systematically and formally

collected. The former include hand deliveries by the migrant himself or by a courier, ordinary mail, informal geographical systems such as hawala (in Pakistan and Bangladesh), hundi (in India and Nepal) or mulas (in Cuba), and ethnic stores. Even if the way of naming the system of transferring money differs from one country to another (and among the systems mentioned, 'feich'ien' (in China), 'chits/chops' (in China) have to be added too) the mechanism is almost the same everywhere: the trust (Puri & Ritzema 1999). It involves two intermediaries. The first intermediary (called the 'hawaladar' or the 'mula') in the sending country (country A henceforth) receives funds in one currency from a person from country A to be transferred to another person in the recipient country (country B henceforth). The person in country A receives a code for authentication proposes. The hawaladar then instructs his correspondent in country B to pay an equivalent amount in local currency to the designated beneficiary, who needs to disclose the code to receive the funds. According to the IMF there is a positive correlation between the limits of a country's financial capacity and the degree of informality of its transfer system (IMF 2005).

However, comparative costs of transfers (IMF 2002) have also to be mentioned as contributors to a fertile environment where informal channels can develop. As far as the tradeoff between them and formal channels is concerned, migrants often prefer to risk more instead of sending their money through regular ways (Roberts & Morris 2003). The latter encompass postal services, banks, credit unions and money

transfer companies. Migrants behave very differently with respect to them. The Mexican migrants in the United States, for example, are sceptical as regards the banking system and so prefer sending their money home through international wire transfer services (NELM 2003), such as Isterm Union (OECD 2005) or Money Gram, even if it is much more expensive (Leon-Ledesma & Piracha 2004). The costs related to the fees or the minimum balance the intermediaries fix to transfer remittances, plus the nature of passive consumers of the Latin migrants with respect to technology, and the legal status that prevents them from using this kind of service (Suro et al 2002), contribute to this.

On the other hand, Turkish banks, such as the Turkiye Is Baankasi or the TC Ziirat Bankasi, are the most important channels for the transmission of remittances from Germany to Turkey (OECD 2005). They are estimated to account for more than a half of all remittance transactions. This is especially due to quite low fees. Finally, the migrants from the MENA (Middle East and North Africa) countries and East Europe in both Italy (Mannan & Krueger 2002) and Spain usually use postal services to send their money back home. From the Nineties the Eurogiro, which is a collaboration network of postal banks, has operated in direct cooperation with the Universal Postal Union to promote new solutions for postal financial organizations worldwide (Mannan & Kozlov 2003). Its strength has been its new, close, and friendly approach to migrant customers and the fact to have become quite widespread all over Europe. It indeed

operates in more than 30 countries (including the European Union).

After having said what remittances are and how they can be transferred by migrants, I portray their geographical distribution. In most cases remittances, relative to other macroeconomic indicators, are significantly higher in low and lower middle income countries than in the other developing countries (El-Sakka & McNabb 1999). They follow two main directions. The first one is that from developed to developing countries, in other words they move from the North to the South. While the second one is between developing countries, hence from South to South. The top receiving continent is Asia with its 40-46% of the annual total flows, the second one is the Latin America and Caribbean Area with their 17-22% of total flows and finally Central and Eastern Europe (15-18%). For countries instead, the first three recipients are India, China and Mexico in total terms and Bosnia and Herzegovina, Haiti and Lesotho in relative terms (as a share of national GDP). Finally, as far as sending countries are concerned, the World Bank has estimated that the United States and Saudi Arabia are the main pools of origin (Quibria 1997).

The scholars have spent much of their work discussing and testing three features related to remittances: stability, cyclicity and sustainability. They all describe remittances' behaviour through time and space but from different points of view.

## **MIGRATION AND REMITTANCES**

Stability, in the sense of low volatility (World Bank 2004), consists of being less

affected by the impact of favourable and unfavourable shocks than other capital flows (Mannan & Krueger 2004). In other words, they would suffer less from any sharp withdrawal or euphoric surge that characterize foreign direct investments and development aid towards emerging markets (Terry et al 2004). The rationale is behind the trend of the finance for development as a whole in the last twenty years. So if I compare their components, remittances have not only had a positive (or much more positive than ODA's) trend but it has also been much more stable (World Bank 2004) than the others'. According to the OECD, while FDI and capital market flows fell sharply from 2000 due to the recession in the high income countries, migrants' remittances continued to grow, reaching USD 149.4 billion in 2002 (Lucas 2004). And for the World Bank they would have amounted to \$ 167 billion in 2005, up from \$ 160 in 2004. In several recipient countries, remittances in 2004 largely exceeded the volume of ODA, and in certain case even that of the FDI or of income from the export of good and services. But what is striking is not only their positive trend but also their steady way of reacting to unexpected economic events (Mannan & Kozlov 1995).

This would be due to two peculiar characteristics that distinguish them from FDI and ODA. They are private and characterized by altruism and solidarity motives that are supposed to remain stable. So if I look at the figures provided by the International Organization for Migration (Ghosh 2006), I can see that from 1995 to 2004 remittances have grown from 58 to 160 US \$ billion, FDI from 107 to 166 US

\$ billion, while ODA to 59 to 79 US \$. And, even from 1998 to 2001, when private capital flows declined in the wake of the Asian financial crisis, remittances to developing countries have continued to rise. Furthermore, if I consider the allocation of remittances, those intended for consumption would be less volatile than those intended for investment. Migrants may indeed increase remittances in times of economic hardship, especially in low income countries where their families may depend significantly on remittances as a source of income and may live at close subsistence levels. And even when the purpose behind is investment, remittances are less likely to suffer from those up and downs that characterize portfolio flows to emerging markets. This depends on migrants' stronger propensity to invest in their home country despite economic adversity than foreign investors' (Orozco 2004).

In addition, even when exceptions could be made to remittances' response to dramatic changes in economic activity in recipient countries, the decline of remittances and volatility have been smaller than those of other capital flows, meaning they are affected by the investment climate in recipient countries in the same manner as capital flows, though to a much lesser degree. In the Philippines, for example, remittances rose steadily as the investment climate improved in the early Nineties, becoming more volatile following the financial crisis in the late 1990s (Burgess & Haksar 2005). Similarly, Turkey's remittance receipts increased for most of the 1990s but suffered a decline as the economy slipped into the crisis in 1999 and

2000. Estimates from the World Bank confirm such a trend after cross countries comparisons of workers' remittances receipts relative to some key indicators as corruption, inequality, financial development (M2/GDP), openness (trade/GDP), domestic debt (debt/GDP) and country risk (institutional investor rating).

So remittance receipts averaged 0.5% of GDP in countries with a higher than median level of corruption, compared to 1.9% in countries with lower than median corruption. Countries that are more open or more financially developed (Giuliano & Ruiz-Arranz 2006) also received larger remittances. On the other hand, stability is sometimes tested through the evidence of altruistic motives behind the decision to remit (Bouhga-Hagbe 2004; 2006) seeming reasonable that these motives remains firmly fixed. This can be captured in the following way: a negative long run correlation of remittances with wage in the home country, or a negative correlation between transfers and real GDP in the home country, or a positive correlation between remittance and income in the country of residence. It is important to remark that stability can be also intended in the sense of resistance to the sending country's economic activity. As regards to this, the nexus between US business cycle and workers' remittances have also been studied, leading again to a steady reaction as far as the latter are concerned (Suro et al 1999).

Since much more work needs to be done to compare remittances, FDI and ODA, but everybody seem to agree on the reliability

of the results, it is worth mentioning what the IOM is worrying about stability. First of all, they claim that gross inflows of remittances should be adjusted against the recorded debts in the balance of payments framework, especially for those countries that are at the same time recipient and sending ones. Otherwise, overestimation can be a possible biased result. Secondly, they suggest migrants remittances are not considered a substitute for ODA, that are transactions between governments, hence bound to projects to be implemented in the recipient country.

The starting point for defining cyclicality is a recent work (Kaminsky et al 2004) in which this property is described as the correlation between the cyclical components of net capital flows into a country and its output. The migration literature has then borrowed this definition for depicting the relationship between the cyclical components of remittances and recipient countries' level of GDP growth. So, remittances are said to be countercyclical when the correlation between their cyclical components and output is negative (positive), in other words, the economy would borrow from abroad in bad times (remittances in/out) and would lend (borrow) in good times (remittances out/in). On the other hand, they are a cyclical when the above correlation is not statistically significant, meaning that the pattern of international borrowing and lending is not systematically related to the recipient country's business cycle. The reason why the debate among scholars is so heated on this issue depends on the possibility for countries of using or intending to use future potential

remittances as collateral for international loans in periods of economic downturn in order to overcome liquidity constraints.

As for stability, the critical starting point for dealing with cyclicality are the assumptions behind the decision to remit (Mannan & Kozlov 1999). As a matter of fact, the literature is divided into two streams of thought depending on the prevalence of consumption smoothing or portfolio motives. If the former is assumed, counter cyclicality is straightforward. Remittances would be compensatory in the sense that they would compensate for poor economic performance in the home country. On the other hand, pro-cyclicality would be linked to a search of investment opportunities, because migrants would tend to send their remittances when the economic situation in the country of origin is favourable.

Moreover, three other variables need to be considered. First of all, the passage of time, since it may change the cyclical properties of remittances. Then the economic situation in the country of destination needs also to be encountered. Regarding to this, even if remittances move counter cyclically with the output in the home countries of migrant workers, the cycle in home and host country economies may move together in synchrony, thereby making it difficult for migrant workers employed in a crisis-struck economy to help out family members facing similar conditions back home (Sayan 2006). Finally, the average level of remittances on which the recipient country can count matters a lot.

The formal way cyclical nature of remittance receipts can be tested consists of evaluating the country correlations between the cyclical components of remittances and GDP. First of all, the trend within each series need to be removed to identify stylized facts of business cycles and analyze cyclical nature of remittance receipts. De-trending each series by removing the estimated trend makes it possible to separate fluctuations around the trend of each data series, making examination of the statistical properties of the co-movements of deviations of output and real remittances from their respective trend. When respective trends are properly filtered out from real remittances and output series for each country, the remaining cyclical components would be stationary with zero mean for each variable. Then, contemporaneous and asynchronous cross correlations between the cyclical components of respective series can be calculated to identify cyclical characteristics of remittances. Pro-cyclicality of remittances in this context refers to the tendency of real remittances to move above its trend, whenever the corresponding real output variable is above its respective trend. In the absence of such a tendency, remittances and output are said to be a cyclical.

A step beyond cyclical nature has been recently made in order to assess if financial development smoothes or amplifies the cyclical nature of remittances (Giuliano & Ruiz-Arranz 2006). Assuming portfolio motives behind the decision to remit, the authors try to address if more developed financial systems are associated with more or less pro-cyclicality. The a priori paradoxical result suggests that remittances

are more pro-cyclical in countries with shallow financial systems, namely that migrants tend to seek more investment opportunities in countries with less developed financial sectors, while, on the other hand, remittances are more countercyclical in countries with deeper financial systems. If these results are going to be confirmed the macroeconomic consequences would be of great value (Kireyev 2006).

Sustainability implies the relationship between migrants' duration of stay in the destination countries and the level of remittances sent back home (Mannan & Krueger 1996). One of the oldest and influential article on remittances already used to deal with this third and last remittances' feature, highlighting an inverse relationship between the two variables (Lucas & Stark 1985). The rationale for the negative sign is related to the diminution and at worst the cease of the remittances transferred to the home country as time goes by. In particular, it is argued that this is a feature that would manifest after five year of permanence abroad.

The subsequent literature, except for the initial piecewise increasing behaviour, has been firmly confirming the same conclusions. And what is more important is that any assumption related to the motives of remitting (either altruistic or self-interested) is not conditional (Gerard-Varet et. al 2001). So, for example, if pure portfolio motives are present, the migrant would remit since he expects to come back home sooner or later. But if at the end he does not, pure self-interested motivations



would have no sense and remittances would start to decrease or cease (Mannan & Wei 2008). This is why an interesting analysis could be conducted exploring the relationship between the circulation of the highly skilled people and the intention to remit (Docquier & Marfouk 2004).

The result, meaning a positive relationship, could lead to another conclusion in favour of the so called 'brain circulation' (Desai et al. 2001). On the other hand, if altruistic reasons are present, the ties with the home country can become less stringent in time (Stark 2005). Finally, even in presence of what are called 'enlightened self-interested' motives the negative relationship holds. What is assumed behind this last case is the presence of an 'informal contract' between the migrant and the family left in the country of origin (Mannan & Wei 2007). So the intention of the former, for example, would be that of repaying the latter for the costs due to his human capital formation incurred before the departure, but once they have expired the level of the transfers would tend to fall (Mannan & Kozlov 2001).

The IOM has recently argued that a crucial moment towards the negative relationship between the time spent abroad and the intention to remit, is the change in the legal status of the migrant or the acquisition of an open-ended labour contract, since they would accelerate the weakening of the bonds with the sending countries. As regards to this, I could perform the nexus between the number of permanent visa issued by a country of destination and the change in the amount of remittances in the respective countries of origin of the migrants. I should

expect a negative coefficient if the lack of sustainability holds.

Concerning the definition of sustainability but taking in consideration just the propensity to remit of the highly skilled migrants, a remarkable step forward as far as both the brain drain and the remittance literature are concerned has been taken in the last few years (Faini 2006; 2005; 2004; 2002). Given that skilled migrants tend to stay longer in the host country and are more likely to family reunifications, the inverse relationship between the time spent abroad and the intention to remit holds whenever the so called 'reunification effect', meaning the intention of the migrant of living with his family in the host country, is stronger than the so called 'wage effect', the potential increase of the amount remitted due to the higher skills embedded by the migrant. In addition to this, I have also to say that the fact that the brains usually come from relatively healthier families can matter and so needs to be controlled (Commander et al 2003).

I could question whether a negative sustainability associated to a steady increase of the total amount of remittances can be considered a contradictory result. In our opinion, this is not. If I, indeed, consider the figures of the total migration flows in the last two decades, I can see that despite the restrictive policies adopted by recipient countries, numbers have continued to rise (Fargue 2006), strongly conditioning remittances' trend more than a still vague remitting behaviour.

When considering a micro approach to remittances, the question why migrants

decide to give up fractions of their disposable income to send them back to their country of origin needs to be answered. I first deal with the most general framework that can be assumed considering jointly what the New Economics of Labour Migration (NELM), the life course's argument and the articles on social networks have separately dealt with, and then I shift from it to a more specific and rigorous classification of the remitting decisions (Taylor 1999; Mannan & Krueger 1998). The rationale is that, behind the most common motives encountered by the literature on remittances (Rapoport & Docquier 2004), different kinds of human beings are present, and beyond them an unevenly influential background made up of many components. These can be classified in the following way:

The level of education of the migrant, his language skills, his level of integration in the host country and the role of the social networks are crucial variables. Regarding the last one, three approaches have been proposed (Piotrowski 2006): social networks of migrant in the destination country, social networks spanning destination and origin communities created by circulation of migrants, household's social networks at origin. In particular, as far as the third one is concerned, measures from sibling and rice harvest help networks can be used (Munshi 2003).

Employment of the migrant (fixed or open-ended contract), level of income in the host country, level of income of the household in the home country, needs-tested transfers received by the migrant in the country of

destination (LoIlli & DeLa Garza 2000), and income risk belong to this economic component. In particular, the last variable can be studied either from a migrant's (host economy's risk variables) or from his household perspective (origin country's income risk).

The time spent abroad by the migrant, the nature of the migration decision (endogenous or exogenous), which kind of laws concerning family reunion are present in the destination country, how is the procedure for obtaining the legal status there, and the state of the naturalization status of the migrant matter a lot (Devorets & Vadean 2005). It is reasonable to expect that there are some macroeconomic factors, both in the host and in the home country, which may significantly affect the migrant's portfolio management choice, hence the flows of remittances (Gupta 2005). They can be the following ones: interest rate differential, the level of inflation, the financial spread, the black market premium, exchange rates, and national policies implemented as incentive schemes, political stability (Tunkay et al 2005).

Which of these components is then significant or how some of them can combine together determine the peculiarity of each single micro-framework (Siddiqui & Abrar 2003). The literature distinguishes among pure altruism, self-interested motives, loan repayment and insurance motives. Under the first case, the migrant derives utility from the utility of those left at home since he concerns about them. This is the most intuitive, tested and widespread presumption. It implies that remittances

increase with migrant's income and degree of altruism, and decrease with the recipient's income and, more interestingly, degree of altruism. But, since the parameters concerning the degree of altruism cannot be observed, the main testable implications are those related to the economic and demographic components described above. First, the amount of remittances should increase with the migrant's income. Secondly, transfers cannot increase with the recipient's income. Thirdly, the sustainability of remittances should be inversely related to the presence of key members of the family in the country of destination. Fourth, counter cyclicality should hold.

On the other hand, behind self-interested motives, there is a migrant that considers just the advantage to himself when making decisions, and acts for his own benefit. On this regard, many situations can be thought of. He can remit money as to buy various types of services such as taking care of his assets or relatives (children, elderly parents) at home. Then remittances can be driven by a 'biased altruism' (Lucas & Stark 1985), under which the aspiration to inherit is powerful (Hoddinott 1994), or by the intention of acquiring or enhancing prestige in his country of origin's local community (Massey & Basem 1992).

Finally, remittances can also be instrumental in reaching a predetermined saving target or in investing in real estates (Merkle & Zimmermann 1992). From all these frameworks, it is evident how one of the presumption behind pure self-interest is the migrant's intention to return to his country of origin, hence his strong 'home

attachment'. In this case, testable implications could be again those related to the demographic and the income components but also to the macro framework (Thieme & Wyss 2005). First, sustainability should hold as long as the migrant stays abroad but then, after his departure, should drop at once. Secondly, the amount transferred should increase with the level and the quality of the service to be offered, increase with the level of migrant's income too, but should react ambiguously to an exogenous increase in the recipient's income ((Thieme 2002).

I can reasonably argue that remittances in both the inheritance and the so called 'exchange' (Rapoport & Docquier 2004) perspectives, take place when there is a welfare gain for all the parties concerned. So, except in the case of perfect mutual altruism, some arrangements need to be reached between the senders and the receivers (Djajic 1998; 2001). Two variables generally matter a lot. The first one is the role of the bargaining power, especially in the former framework, while punishment devices and social norms affect the latter one. So, in the first case a testable implication could be the inverse correlation between the unemployment at home and the level of transfers sent home. Since it is assumed that the level of education and the employment condition give more bargaining power to the related party. While, on the other hand, in the second case, the amount of remittances should increase with the remaining household's assets and income, the probability of inheriting, the migrant's health and income, and should decrease with the his own degree of risk aversion.

Since both pure altruism and pure self-interest alone may be inadequate or partially explanatory in describing the extent and the variability of remittances, an alternative theory is therefore provided, viewing remittances as part of an intertemporal, mutually beneficial contractual arrangement between migrant and home (Amuedo-Dorantes, & Pozo 2006). It is important to stress that this theory (called as 'tempered altruism' or 'enlightened interest') is not merely the intersection of pure altruism and pure self-interest but rather offers a quite separate set of hypotheses.

The first hypothesis consists of the endogenous nature of the remitting decision (Agarwal & Horowitz 2002). This means that it is one of the consequences, if not the most important one, of the decision to remit. This originates from the household's evaluation which considers a Pareto-superior strategy to allocate certain members of the family as migrants, and manages remittances as the mechanism for redistributing the gains. The second hypothesis is that arrangement between the migrant and the family are voluntary and thus must be self-enforcing. The third set of hypotheses is related to the prevalence of one of the following components: investment or risk (Mannan & Wei 2006). If the former exists, remittances can be seen as a loan repayment, while in the latter case they become part of an insurance contract.

In the first case, that of a loan agreement model, remittances serve as repayment (once the investment starts to pay off) for both the pre-migration investments in the

migrant's human capital and the migration costs, under the assumption that the 'parent company' (Poirine 1997) has before lent to the future migrant to finance his education in the home country and his establishment in a foreign country, where returns on investment seem higher than in the country of origin (Galor & Stark 1990). There exist even more complicated loan agreement models in which remittances continue to be sent by the migrant even after the total repayment of both the education and migration costs incurred by his family. It is assumed a second stage in which migrant remittances are loans made by migrants to young relatives to finance their education, until they are themselves ready to migrate.

Finally, in a third stage remittances would be either a sort of retirement subsidy paid by this new generation migrant to the old one once having come back in the country of origin, or self-interested transfers made by the old migrant with the intention of ensuring his own assets at home on his return. Since both education and migration are costly I can imagine that just richer families can take advantage from such an investment opportunity, where the richer the family the higher its bargaining power. Testable implications of this framework can be the positive relation between remittances' sensitivity and migrant's income, migrant's education and the distance from the family. At the same time, the adverse short run shocks in recipient economy should positively affect remittance transfers too, but the effect of recipient's long run income is controversial. Finally, higher unemployment at home, increasing the

value of education, should increase the level of remittances from abroad.

In the implicit co-insurance model, two kinds of hypotheses are assumed. They imply either being insured from the migrant's point of view from the income risk in the country of destination and being insured from the household's point of view from income risk in the home country. So, in the first step the migrant is the insuree and his household the insurer: the family pays for the migration costs and for possible initial expenses in the destination country. While, in the second one, the inverse holds: migrant remittances insure for unanticipated household's income shortfall (Amuedo-Dorantes & Pozo 2006).

This kind of model is widespread especially in rural areas of low income countries where income volatility, fragmentation of the financial markets and poor insurance markets give rise to a variety of such informal contracts (Freund & Spatafora 2005). Foreign markets shocks are generally uncorrelated to those in the home country, so families think that migration could be a source of income in case of future agricultural drops. As far as the testable implications are concerned, the insurance and the altruistic motives share similar predictions with respect to the sign of the effects of income levels on the amount remitted. However, they differ with respect to the predicted timing of remittances, since remittances for insurance motives are more likely when income at origin is more volatile, meaning they should be sent on a more irregular basis.

Obviously, one should not expect remittances to be driven by a single motive. In reality, a combination of different motives applies, with the exact mixture varying over time and places. This is due not only to the fact that different individuals may be heterogeneous in their motivations to remit, but also that different motivations to remit may coexist within the same individual. However what the evidence seems to confirm is the constant presence of altruistic components behind the migrant's decision to send money back home.

## **REMITTANCES AND DEVELOPMENT**

Following the definition of economic development as a multidimensional approach that takes into consideration not only economic levels but also the distribution of income, welfare and opportunities, the relationship between remittances and development is going to be analysed in this section where households' and the whole country's perspective are treated separately (McKinnon 1973).

From the household point of view, a first important effect is the poverty alleviation (Adams 2002). Actually, the level of domestic disposable income increases since remittances go directly from the migrant to his family or friends. Evidence has shown that both the poverty headcount ratio, and the level of poverty depth (poverty gap ratio) or that of poverty severity can be affected (Ray 1998). Of course, the level of remittances matters a lot in enhancing such an effect. For example, it has been confirmed that the

higher it is the steeper the headcount ratio's increase. At the same time, the initial level of the headcount ratio matters a lot. The higher to start with it is, the stronger the effect of remittances on poverty (Adams 2003). These results have been obtained thanks to poverty simulations, even if one of their weaknesses is the risk of incurring in reverse causality problems. Cross-country regressions have been more efficient in dealing with that, showing a decrease of the poverty gap ratio equal to 3.5% (Adams & Page 2003). The same holds for household surveys, although the lack of proper data on remittances does not allow us to rely on their conclusions.

Strictly linked to the issue of poverty reduction is that of inequality, because income growth is valuable for recipient households but even more important is the distribution of its benefits among different groups in society. Inequality is usually empirically measured by the Gini coefficient (Ray 1998). Household studies have shown opposing results in terms of correlation, either positive or negative, and dynamics, either in favour or not of a U-shape relationship between migration and inequality (Mannan & Krueger 2000). The variety of these conclusions depends on three important factors. The first one is the initial level of inequality, since the higher it is, the stronger is the evidence in favour of a negative relationship.

The second one consists of the nature and the level of the migration costs, where they can depend on the network component and/or the distance between the sending and the receiving country. It has been demonstrated that the higher they are the

lower the probability that the poorest migrate and, consequently, remit. As far as this last issue is concerned, the literature (Rapoport & Docquier 2004) has recently dealt with the so called 'trickle down' effect that is the effect of the increasing migration flows on the reduction of migration costs, hence a widespread possibility to migrate, for the poorest people too (Carrington et al. 1996). If evidence confirmed the validity and the sustainability of such an effect for recipient countries, the results concerning inequality and remittances would be much more homogenous (even because in the last few years the trends concerning migration have been increasing almost everywhere).

The third effect on household income depends on how remittances are spent. They can be indeed consumed, saved or invested. Remittances are an important source of income for many low and middle income households but how this money is used affects in a different, and sometimes opposite way, people's welfare. As far as consumption is concerned, remittances can be good in terms of consumption smoothing, but I will see that on the other side, at aggregate level, an increase of the magnitude of consumption can foster inflation. And even the first effect does not always hold. Positive evidence exists for remittances that are countercyclical (Ozden & Schiff 2006) or pushed by insurance motives (Lucas & Stark 1985), but this could be the case of middle income families, since first of all poor families would not be able to send their individuals abroad, and secondly even in this case, their consumption pattern would remain the same, or would change in a

much slower way (Loth & DeLa Garza 2000).

On the other hand, households can decide to save or invest remittance transfers. According to the World Bank, five factors would condition the prevalence of that. First of all, the household's degree of dependence on remittances. The more households are dependent, the less they save. Secondly, the nature of the recipient, since women are more likely to prefer a smoother consumption path. Third, the existence of a conditional targeted destination upon the transfers. Fourth, the income level of the recipient family or the presence of credit constraints. However, whatever is the reason why households decide to invest, and taking in mind the welfare perspective, according to which an extra dollar of investment is only better than an extra dollar of present consumption if the marginal social value of investment is greater than its marginal private value, investments can be either destined to physical capital or human capital.

Under the former case, investments can be fostered by the migrant himself or by his household. In regard to this, remittances can enhance entrepreneurship in the recipient country, being allocated in construction, housing, agricultural production and technology. On the other hand, the latter framework is fundamental especially from an endogenous growth perspective: relaxing liquidity constraints would impinge on human capital formation (education and health). Remittances may be conditional upon a loan agreement, or they can be inserted in a household's forward looking framework.

In the former case, the migrant, after having repaid for the educational expenditures incurred by his family, continues to send remittances in order to provide education to the new young generation. While, in the latter case, the recipient household decides to allocate its new entries in children's education. From this perspective, remittances can be a good instrument in decreasing child labor, too. But, although remittances are fungible and education has a relatively high income elasticity, so one would expect remittances to have a significant positive effect on the educational attainment of children from households with migrant members, a recent sociological argument (Hanson & Woodruff 2002) indicates that the absence of one of the parents can be detrimental on children's schooling achievements when credit constraints are the most binding (Cox & Ureta 2003).. So, at the end, even from an endogenous growth perspective, the conclusions are unclear.

A last but not least effect of remittances on households concerns labor supply. A high dependency degree on remittances, accompanied by economic uncertainty and asymmetric information, would lead households to incur in the so called moral hazard (Chami et al 2003; 2006) problem. Instead of exploiting the possible positive externalities related to remittances, the recipients would prefer to bribe the migrant substituting effort with leisure. This would have negative effects in terms of growth. However, a recent work (Giuliano & Ruiz-Arranz 2006) has argued that the probability of the moral hazard would depend on the level of financial development, too. The higher it is, the

stronger the former would be, as a consequence of the fact that less stringent liquidity constraints would discourage more labor supply.

Linked to the previous arguments is the so called multiplier effect. Either remittances are consumed or invested, they can have an important multiplier effect (Cuc et. al 2005). One remittance dollar spent even for basic needs will stimulate retail sales, which then stimulates output and employment. Some studies have found that one dollar sent from migrants abroad would boost the recipient country's GNP by an increase that ranges from 1.8 to 2.553. However such multiplier effects would occur where output is constrained by insufficient demand. But in many developing countries where unemployment (or underemployment) is widespread, hiring costs are high, and the demand side has increased as a consequence of the new transfers, inflationary shocks are likely to occur, so stifling the growth effects.

Another consequence of the low speed of reaction of the supply side in the recipient country may be a trade balance deficit. It consists of a disproportionate increase of imports in order to neutralize the increased internal demand. Except for the demand for imports towards cheap capital goods that can be used as substitutes for other imports and/or to produce exportable goods, this effect is detrimental for the recipient country's growth.

Similar to the 'boomerang effect' just mentioned, though differently motivated, is the so called 'Dutch disease'. This refers to a steep currency appreciation that the

recipient country sustains as a consequence of a surplus in the balance of payments due to the large inflows of remittances. As a result, once again, the country would suffer of an emerging labor export competitiveness, due to the deterioration of its terms of trade. However, neither empirical results have confirmed the previous effects (OECD 2005), nor theoretically it has been shown (Docquier & Rapoport 2003) that the conditions required for impoverishing transfers to materialize are so lax exchange (Glytsos 2002). It is, indeed, plausible assuming that a developing country's liquidity statement is overdrawn so that remittances can relax its deficit (Brown 1997). Their impact would be immediate since their use is not tied to a particular project with high import content, they bear no interest and they do not have to be repaid (Mannan & Kozlov 2005).

From a financial perspective, the following effects are of great value, too. First of all, credit worthiness can be improved by country's remittances, thereby enhancing the country's access to international capital markets. The World Bank points out that a key indebtedness indicator, such as the ratio of debt to exports of goods and services, would increase significantly if remittances are excluded from the denominator. Two studies concerning Lebanon and Haiti have confirmed that if remittance transfers are included, their credit ratings would increase by two notches. Secondly, another way for the recipient country of collecting international capitals is also through the securitization of future remittances.

Using this structured financial technique, several banks in developing countries have



been able to raise relatively cheap and long term financing from international capital markets. This has happened in Brazil for example and in Turkey, too. Other two important arguments have also been recently proposed. The first one argues that stable and a cyclical remittances, reducing macroeconomic instability, decrease the probability of financial crises in emerging markets (Bugamelli & Paterno 2005). By financial crises, current account reversals are taken into consideration, defined as dramatic adjustments of current account deficit that may be triggered by sudden stops of foreign capital. They, in turn, can be due to foreign investors' loss in the face of worsening fundamentals, such as loIr reserves (decreasing stock of international reserves over GDP) or higher external debt (increasing stock of external debt over GDP).

The authors have found that a high level of remittances, as a ratio of GDP, makes the effects of these shocks less stringent, meaning a loIr probability that foreign investors suddenly flee out of emerging markets. Moreover, a threshold effect of remittances has been provided, since the mechanisms just described would be much stronger when remittances are above 4% of GDP. If I consider the figures provided by the OECD in its last report, the last country among the top 30 with the highest level of remittances received as a share of GDP is Bangladesh with its 6.6 % of GDP. I can reasonably define these two points per cent (at least) as an encouraging perspective as far as macro stability is concerned

On the other hand, the second one is related to the role of pro-cyclical remittances as

financial substitutes in countries with a loIr financial depth (Giuliano & Ruiz-Arranz 2006). The authors back up that, in less developed financial systems, remittances can be used to overcome liquidity constraints, providing the enough collateral to borrow and/or finance their investments. If these results are going to be confirmed by future works, this would be very important from a theoretically perspective since it is as if I stated that from a financial development's point of view, remittances can enhance dynamic convergence. From an endogenous point of view, if I consider countries with a similar level of initial human capital but different income levels, countries with a loIr income per head should grow faster, since the further they are from the equilibrium the faster they should run to catch up.

This is what I mean by dynamic convergence. And from an empirically perspective, too since I would be able to understand why remittances effects are so controversial, hence proceed towards different assumptions. Still from an indirect endogenous perspective, the relationship between remittances and brain drain has been considered (Beine et. al 2001). Unfortunately, until now, not so much work has been done and a few articles have shown that remittances, that could in principle compensate the recipient country for the loss of human capital, do not contribute to this in any way.

Finally, a last detrimental macroeconomic implication of remittance transfers is the possibility that terroristic groups United Nations (2002) could divert these resources from potentially positive uses to suspicious

purposes. This is why more and more attention has to be paid especially to informal transfer channels and why the IMF, during the Second Convention on Hawala in 2004, has pressed for more efficient national supervisory systems.

## CONCLUSION

On the occasion of the High Level Dialogue on International Migration and Development (United Nations 2002), the Secretary General of the United Nations Kofi Annan declared 'I am only beginning to learn how to make migration work more consistently for development. Each of us holds a piece of the migration puzzle, but none has the whole picture. It is time to start putting it together'. I reasonably think that an important piece of this puzzle are migrants' remittances. Because their flows to developing countries have steadily increased in the last twenty years, leaving behind both the Official Development Assistance and the FDI. Because they can play a potential key role for recipient countries' economies both from a micro and macro perspective. And, finally, because empirical evidence has showed so far that their benefits seem to prevail over negative effects.

In this article I have presented the kernel of the migration literature on remittances. I started from their three most debated features: stability, cyclicity and sustainability. I then moved to the motives driving remittances and, finally, their relationship with development. Both sustainability and cyclicity are the most controversial issues, as they are probably the most critical in terms of economic

development. The former is fundamental from an endogenous point of view. In terms of dynamic convergence, if sustainability holds, less financially developed countries could redeem themselves fostering riskier and more productive investments, 'substituting' their liquidity constraints with pro-cyclical remittances.

On the other hand, from a 'brain gain' perspective, if the inverse relation between the time spent abroad and intention to remit is going to be confirmed in future works, the 'brain circulation could be beneficial both from a human capital and a remittances point of view (McCormick & Wahba 1996). This would imply that, from a policy perspective, the countries of origin should become much more and more interested in attracting back home their brains from abroad, meaning implementing sound programs towards this object, such as temporary visa permits, research allowances, benefits bound by the return, bilateral agreements between the two countries or the universities (Mishra 2006).

Cyclicity is much more complicated to deal with, since it is often strongly related to the motives why people remit. But once reverse causality has been addressed, counter cyclicity, a cyclicity or pro-cyclicity, may have distinct but equally important results in terms of development. Pro-cyclicity can boost investments overcoming liquidity constraints. A cyclicity can prevent the country from current account crises and counter cyclicity can provide macro stability. As future work, country analyses need to be conducted, especially because the change in the cyclical components of national

GDP, the amount of remittances a country receives and other macro variables are country specific.

Furthermore, cyclical properties may change through time and migrants' remitting behaviour can be influenced by national migration policies, too. The literature is unevenly distributed with regard to country analyses. A lot of work has been, indeed, done on the Latin migrants living in US but, on the other side, the interest for the MED-MENA migrants who live in the European Union has just began. This suggests future works are oriented towards this geographical perspective.

However, either future work or country policies need reliable data to deal with, and this is not a migration literature's prerogative. If the figures are not able to describe what really happens, or if just one side of the coin is provided, the 'whole picture of the migration puzzle' will be hardly depicted. In particular, as far remittances are concerned, efforts have to be made towards three goals: improving a much more formal and binding definition of migrants' remittances, so that national central banks and statistical offices cannot have any doubts about that; providing banking systems and wire services on a migrant scale, so to stem informal transfers; and, finally, addressing estimations of the irregular flows in the meanwhile (Omarini 2006) price.

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