CHAPTER **8**

Financial Remittances and Development

Remittances are financial flows arising from the cross-border movement of a country's nationals. In their narrowest sense, they refer to "unrequited transfers," meaning primarily money that migrants send to family and friends without attaching any claims to it (in contrast to other financial flows such as debt or equity). In our opinion, the definition should also include two categories that are recorded separately in a country's balance of payments statistics: "migrant transfers," which arise from the migration (change of residence for at least a year) of individuals from one economy to another and are equal to the net worth of the migrants; and "compensation of employees," which are funds sent back by temporary workers (who work abroad for less than a year).[1]

This broader definition is not without problems. In practice, it is difficult to distinguish between persons whose earnings are classified as compensation of employees and migrants who have become residents of economies by virtue of being expected to live there for a year or more. Since compensation of employees includes contributions paid by employers, on behalf of employees, to social security schemes or to private insurance or pension funds, it overstates the resources transferred to the country of origin. On the other hand, these amounts exclude unrecorded and in-kind transfers, which are likely to be substantial.

1. The World Bank (*Global Development Finance,* 2003, statistical appendix to chap. 7) appears to have recently adopted this practice as well.

Table 8-1. Remittance Flows, 1970–2001: Percentage of Cells for Which No Data Are Available[a]

Year	*1970–79*	*1980–89*	*1990–99*	*2000–01*
Inflows	77	53	39	34
Outflows	77	52	43	45

Source: Global Development Finance (2003).
a. A cell is a country-year data point.

They also exclude funds sent through the capital account by overseas residents (for example, via special savings accounts), which are then withdrawn in local currency.[2]

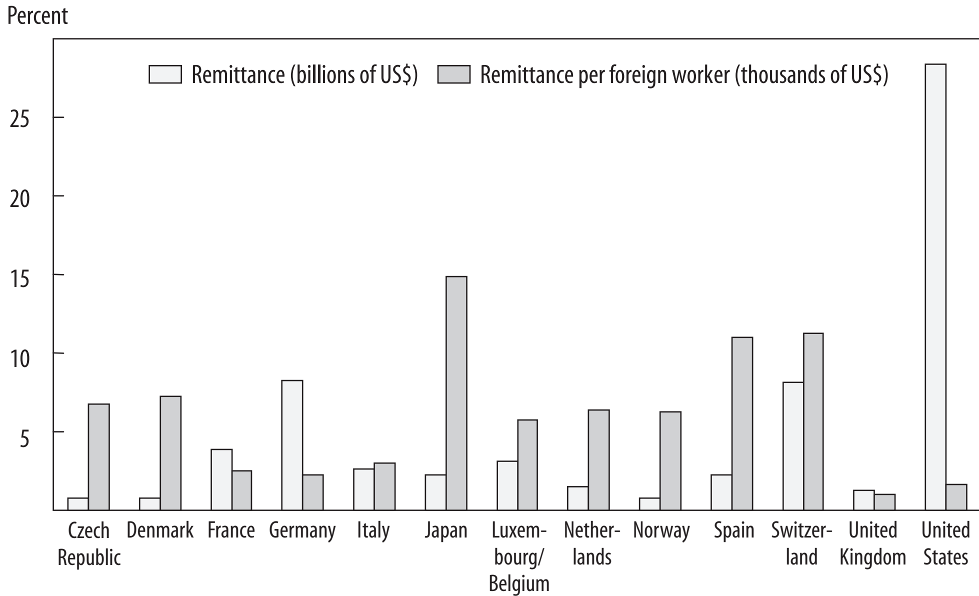
Despite the volume and importance of remittances, data regarding this phenomenon are of poor quality and limited availability, the principal source being the International Monetary Fund's information on balance of payments. IMF figures come from member countries but contain many gaps in the area of remittances. Even for countries with a population of a million or more, a good deal of this information is either missing or unreported (table 8-1).

Given that a considerable volume of remittances passes through unofficial channels, while those transferred through official channels incur high transaction costs, one might reasonably expect more outflows (from the sending countries) to be reported than inflows. The figures actually show the opposite. Countries like Cuba, Liberia, Haiti, and Vietnam show zero remittance inflows, while Hong Kong, Singapore, and Canada also show zero or very small outflows, despite large immigrant populations in all cases. Many countries have sudden surges, which are inexplicable under most plausible scenarios. And there are large variations in remittances across countries per foreign worker (see figure 8-1). High remittances from Belgium/Luxembourg and Switzerland are a puzzle and could simply reflect the fact that all three are banking centers, so remittance outflows may simply be masking money laundering. Alternatively, low tax rates may be luring multinational companies to set up offices in these financial centers.

The great uncertainty surrounding remittances is reflected in the varying numbers recorded by the sources: according to the Inter-American

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

Figure 8-1. Variation in Remittances per Foreign Worker



Source: For remittance data, see Global Development Finance (2003, p. 160, figure 7.5). For stock of foreign and foreign-born labor, see OECD (2002) and *Trends in International Migration: SOPEMI* (Paris: OECD, 2002, table A.2.3). All figures are for 2000, except for Spain, Belgium, and the Netherlands.

Development Bank's Multilateral Investment Fund, for instance, remittances to Latin America reached $40 billion in 2004 whereas the World Bank put the figure at $36.9 billion. By contrast, data on international financial flows are more abundant and of better quality, because data-gathering techniques have improved tremendously over the decades. The concepts there have been systematically refined, the data are timely, and the coverage of countries and issues has become broader and deeper. The World Bank's Global Development Finance (formerly World Debt Tables), the IMF's International Financial Statistics, the Bank for International Settlements, and the Organization for Economic Cooperation and Development (OECD) are the standard sources of data on international financial flows. Their attention to detail is not too difficult to understand. The institutional channels through which financial capital flows from north to south have a strong interest in maintaining good data. Creditors are fewer in number and have the capability as well as the power to ensure that data mandates are adhered to. Moreover, poor data

on international financial flows have been implicated in numerous financial crises, be it the Latin American debt crisis or the various financial crises of the 1990s. Since these crises have repercussions for source countries, mainly the industrialized countries, each systemic crisis has resulted in an improvement in data quality. It is far harder to track down the numerous individual sources of remittances, while the recipient countries—developing countries—lack the capability and perhaps even the incentive to compile better data.

Financial Remittances: Size, Sources, and Destinations

Official interest in remittances is on the rise, however, owing to a number of their features.

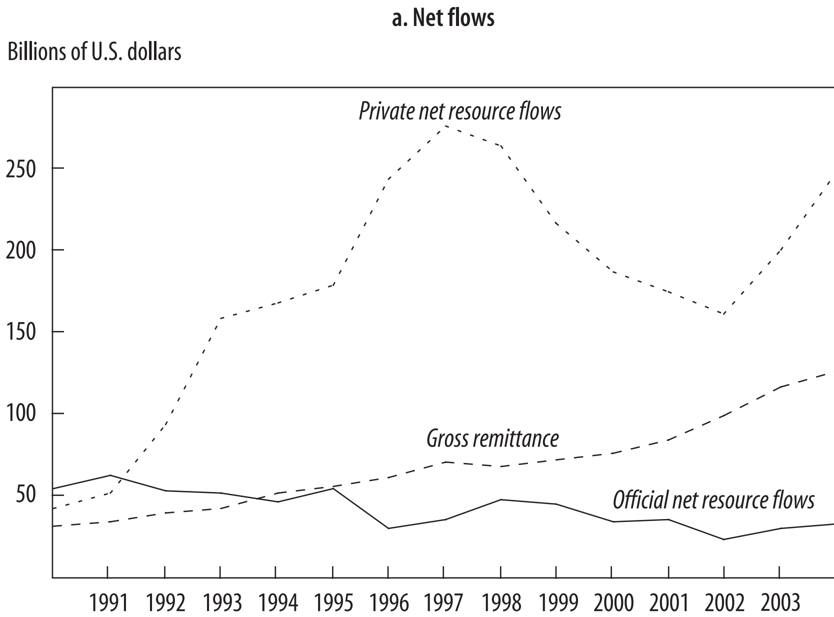
First, remittances have become a significant source of external financing for developing countries, emerging as their second largest source of net financial flows over the past decade (see figure 8-2a).[3] By contrast, *net official flows* (aid plus debt) over this period have stagnated, if not declined. The total volume of remittances to developing countries in 2004 was $125.8 billion, nearly four times net official development assistance in that year ($32.9 billion) and *net private flows* (foreign direct investment [FDI] plus debt flows) of nearly $247.7 billion (table 8-2). But if instead one examines the figures for *net transfers* (figure 8-2b)—which is the bottom line after deducting all payments including profit repatriation, interest payments, and remittance outflows (since most developing countries have some outflows as well)—then the significance of remittances for developing countries is much more apparent.

Remittance flows were 11 times net official transfers and 1.6 times net private transfers in 2004 (table 8-2). While this reflects in part the large stock resulting from flows of private and official finance in previous years, it is precisely the "unrequited" nature of remittances that makes this big difference—all other sources have a corresponding claim on the receiving country, which can be substantial in view of the stock of FDI and debt. The welfare and growth effects from these sources are in all likelihood quite different. However, if one is interested in the financial bottom line, remittances were clearly the most important source of net foreign exchange flows to developing countries in that year. For reasons discussed in the next section, the growing importance

3. We are grateful to Dilip Rath of the World Bank for the data used in this section and discussions related to the same. See also Rath (2003).

Figure 8-2. Financial Flows to Developing Countries, 1990–2004

a. Net flows



b. Net transfers

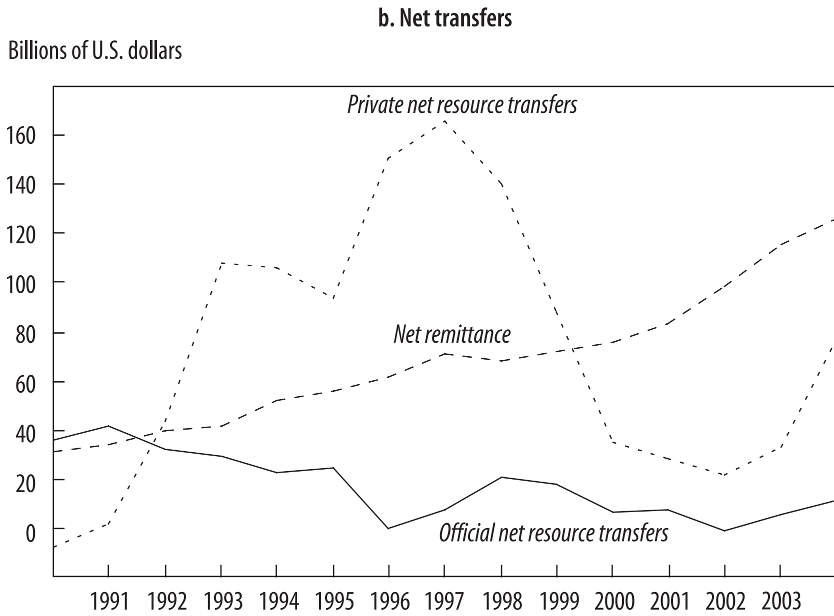


Table 8-2. Net Flows and Transfers of External Finance for Developing Countries, 2004
Billions of dollars

Region	*Private*	*Official*	*Remittances*	*Total (net)*	*Remittances (net %)*
Flows					
East Asia & Pacific	62	–4.5	17.6	75.1	23
Europe & Central Asia	67.1	4.4	10.4	81.9	13
Latin America & Carribean	41	2.3	29.6	72.9	41
Middle East & North Africa	4.8	1.6	13	19.4	67
South Asia	11.1	2.2	18.2	31.5	58
Sub-Saharan Africa	13.2	22.9	4.1	40.2	10
Transfers					
East Asia & Pacific	20.2	–9.8	17.6	28	63
Europe & Central Asia	22.1	–0.7	10.4	31.8	33
Latin America & Caribbean	–11.7	–4.3	29.6	45.4	65
Middle East & North Africa	–0.9	–1.6	13	10.5	123
South Asia	1.9	0.3	18.2	20.4	89
Sub-Saharan Africa	1.7	21.4	4.1	27.2	15

Source: Global Development Finance (2005).

a. Private flows include equity (FDI and portfolio flows), and both long- and short-term debt flows. Private transfers include equity (FDI and portfolio flows), and both long- and short-term debt flows.

b. Official flows include lending from multilateral banks, the IMF, and bilateral loans and grants. Official transfers include lending from multilateral banks, the IMF, and bilateral loans and grants.

of remittances compared with other sources of external finance is likely to continue. Aid levels declined in the 1990s, and a more than modest upturn is unlikely. Furthermore, private capital flows are unlikely to reach the euphoric levels that preceded the Asian crisis any time soon.

The 10 largest sources and recipients of remittances in the last decade include both developed and developing countries (table 8-3). Not surprisingly, the United States is the largest source, and 4 countries of the Middle East (Saudi Arabia, Israel, Kuwait, and Oman) are among the largest. Three G-7 members—Japan, the United Kingdom, and Canada—do not make this list, which is especially surprising when the small countries Belgium/Luxembourg and Switzerland do.[4]

The general impression is that remittances flow mainly to poor countries. That is only partly true. Of the 10 largest recipients of remittances

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

Table 8-3. Largest Sources and Recipients of Remittances, Annual Average, 1992–2001

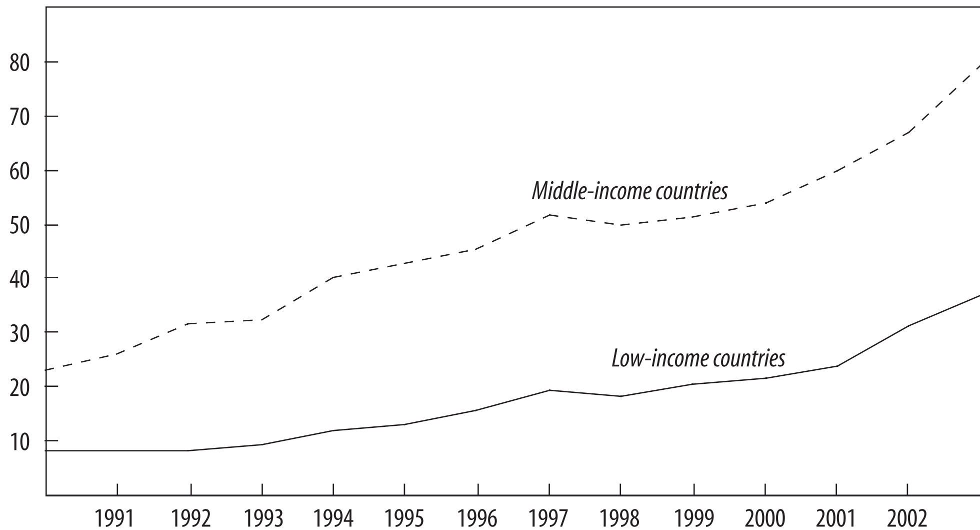
Source country	*Billions of dollars*	*Recipient country*	*Billions of dollars*
United States	20.7	India	7.7
Saudi Arabia	15.4	France	6.9
Germany	8.8	Mexico	5.7
Switzerland	8.1	Philippines	5.0
France	4.9	Germany	4.1
Italy	2.2	Portugal	3.8
Israel	2.1	Egypt	3.8
Belgium/ Luxembourg	1.8	Turkey	3.7
Kuwait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

Source: International Monetary Fund, balance of payments statistics.

between 1992 and 2001, 7 were members of the OECD, and 2 of the top 5 recipients were G-5 countries (France and Germany). Of the $173 billion in total remittances in 2003, about two-thirds (or $116 billion) accrued to developing countries. The share of developing countries has ranged from less than half in the late 1980s to about three-fourths in recent years. The largest 10 recipients have been quite stable since the early 1990s (except that Morocco has replaced Greece in recent years). Although private in nature, remittance flows are less concentrated than private flows. Thus whereas the top 10 recipients of FDI accounted for 70 percent of FDI flows to developing countries in 2001, the top 10 recipients of remittances accounted for 59 percent of those flows.

Second, the bulk of international remittances does not accrue to the poorest countries. Nearly half of all remittances received by developing countries flows to lower-middle-income countries, while the other half flows about equally to upper-middle-income and low-income countries (figure 8-3). Remittances are benefiting some regions more than others, particularly Latin America (primarily the Andean countries, Central America, and Mexico), South Asia, the Middle East (where, however, they have been growing very slowly compared with other regions) and Maghreb, and some countries in East Asia (especially the Philippines and Indonesia). The fact that sub-Saharan Africa receives the least amount of reported remittances (unlike other regions with little growth) is a sobering indication that this source of finance is unlikely to contribute significantly to ameliorating the external financing problems of the region.

Figure 8-3. Remittance Inflows



Source: Citizenship and Immigration Canada (2002).

The limited remittance inflows to Africa reconfirm that geography does matter. There are indeed large migrations from African countries, but the civil strife in that region sends migrants across borders to other impoverished African countries rather than to rich countries. Geographical contiguousness to rich countries is clearly important, especially for illegal migration. This puts Mexico, Central America, and the Maghreb at an advantage, although nationals of other Latin American countries may have access to European labor markets because of the prior history of migration from the latter to the former. With the likelihood of greater curbs on net migration to the Middle East, its formerly large remittances to South Asia will decline unless compensated by migration to other regions.

The two countries with the largest global migrations, China and India, report substantial differences in remittances. Surprisingly, China receives comparatively little in the way of remittances—the figure was about $1.4 billion a year between 1992 and 2003, or about one-seventh of India's receipts, which amounted to $9.34 billion a year over the same period. These large differences probably have less to do with the characteristics, size, or vintage of their large migrant populations and

more with incentives (especially tax policies) and economic opportunities in the two countries. In contrast to the remittances figures, diaspora FDI in the two countries indicates that overseas Chinese invest between 10 and 20 times more than overseas Indians (the figures vary considerably depending on the status of investments from Hong Kong and assumptions regarding the magnitude of round tripping). However, a large fraction of FDI in China—about one-quarter—is invested in real estate.[5] Since this type of investment is common to the deployment of remittances as well, it reinforces the suspicion that there is a not inconsiderable statistical overlap between remittances and FDI, which, if combined, makes financial inflows from the two countries' emigrants more comparable—with inflows into China being between two and four times those into India.

Third, remittances have emerged as the *least unstable* source of financial flows for countries afflicted by "shocks" and constitute the single most important source of insurance for many poor countries. Remittance flows are much more stable than private capital flows, which exhibit strong herdlike behavior, amplifying the boom-bust cycles in many emerging markets (figure 8-2). Consequently, remittances can be viewed as a self-insurance mechanism for developing countries in that overseas migrants help diversify the home country's sources of external finance. This role is strengthened by the low risk correlation between the country of residence and the country of origin and is especially important for poor countries since (much like poor people) they find it difficult to secure insurance otherwise. It is therefore not surprising that remittances have taken on this role for residents of countries afflicted by economic and political crisis (such as Lebanon during its civil war or Haiti), those hit by natural disasters (such as Central America in the aftermath of Hurricane Mitch), those pressured by international sanctions (such as Cuba), or those in which state authority has crumbled (such as Somalia and other "failed" states). Ecuador was certainly on the list of countries in crisis in the late 1990s, when it experienced its worst economic crisis of the century. The resulting political chaos, social upheaval, and economic collapse led to the largest out-migration in the country's history (particularly to Spain). In just two years, more than a quarter million Ecuadorians left the country. Remittances jumped from $648 million in 1997 to more than $1.4 billion in 2001 (10 percent of GDP), emerging as the second largest source of foreign exchange after

5. Tseng and Zebregs (2002).

petroleum exports.[6] Cuba, too, suffered a sharp economic downturn in the aftermath of the collapse of the Soviet Union in the early 1990s, leaving it without any geopolitical benefactor to prop up its inefficient statist economy. Not only did overseas assistance dry up but the output and prices of its principal export (sugar) collapsed in global markets just as the United States was trying to tighten its embargo on the island. Until then the country had curbed overseas remittances from its rich diaspora, which was (in large part) deeply hostile to the regime. For the first time, the Cuban government took steps to attract remittances, offering a slew of incentives to residents receiving dollars. By 1995 remittances were approximately $530 million (up from just $50 million in 1990). At a time when foreign aid and FDI combined came to only about $100 million and exports just $1.1 billion, and an acute foreign exchange crisis threatened to take the country the route of North Korea, remittances provided a crucial lifeline.[7]

Fourth, for the many small countries—especially island economies, be it in the Caribbean or the Pacific—remittances, along with foreign aid and tourism, have become the only viable sources of income. As much as two-thirds of families on a small island like Cape Verde receive money from abroad. For many of them, remittances offer the only source of income, which is not surprising with a population of only 435,000 in 2000 and twice as many abroad.[8] Such high levels of migration and remittances might well indicate that these countries are simply unviable economic entities, but given political realities they will continue to exist—surviving to a considerable extent on the labors of their overseas population.

Fifth, as with the euphoria over private capital flows in the mid-1990s, the attractiveness of remittances is in part a reaction to previous failed development mantras. Development thinking has been as prone to fads and fashions as private capital flows are alleged to be. Remittances strike the right cognitive chords. They fit in with a communitarian "third-way" approach and exemplify the principle of self-help. People from poor countries need only migrate and send back money to help not only their families but also their countries. Immigrants, rather than governments, then become the biggest provider of "foreign aid." The general feeling is that this "private" foreign aid is much more likely to go to

6. Jokisch and Pribilsky (2002).

7. Eckstein (2003).

8. IMF and IDA, Poverty Reduction Strategy Paper, Cape Verde (www.imf.org/external/np/jsa/2002/cpv/eng/032102,pdf [March 2002]).

people who really need it. On the sending side, it does not require a costly government bureaucracy, and on the receiving side, far less of it is likely to be siphoned off into the pockets of corrupt government officials. It appears to be good for equity and for poverty and yet imposes few budgetary costs. What could be better—if these hopes are valid?

Why Have Remittances Grown?

The most obvious factor behind the recent upswing in remittances is the steady growth of the underlying cause, namely migration, especially to rich countries. Although legal flows of migrants have been uneven, illegal migration and the stock of emigrants have increased steadily. The United Nations estimates that roughly 175 million people were living outside their country of birth or citizenship in 2000, up from 120 million in 1990.[9] An analysis of the 2000 U.S. census reveals that of the foreign population in the United States in that year, nearly half (47 percent) entered the country in just the previous decade. In another notable change, the foreign population of 17 European economies tracked by the OECD rose from 15.8 million in 1990 to 21.7 million in 1998—which amounts to an increase of 37.2 percent.[10] In the oil-exporting Gulf States, foreign workers continue to represent more than 50 percent of their labor force; in Saudi Arabia, they account for 70 percent of the labor force, now 10 million strong.[11]

The frequency and intensity of economic and financial crises in many developing countries over the past two decades has increased the need for social safety nets, amplifying the demand for remittances. Of course, some of the reported increase in remittances is in all likelihood a statistical artifact since the quality of data has improved, and changes in economic policies of many developing countries, especially with regard to foreign exchange controls, have sharply reduced the black market premium for foreign exchange. As a result, part of the increase in officially recorded remittances reflects a shift from informal to formal channels. Nonetheless, remittances continue to go through informal channels in some countries, either because of foreign exchange controls (as in Myanmar and Zimbabwe) or because state machinery is lacking (as in Afghanistan).

9. UNPD (2002); Martin and Widgren (2002).
10. OECD (2001).
11. Martin and Widgren (2002).

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

The exorbitant costs of remittances (about 10 to 12 percent of the estimated $25 billion transferred from the United States) and the implied large profits have brought forth new entrants. The most striking change has been in the strategies of major commercial banks, which had been slow to recognize that the remittance business was a potential source of significant new opportunities. Portuguese banks, realizing this in the early 1980s, established branches in areas with concentrations of emigrants (such as France), offered free transfer services, and arranged to have local agents deliver the funds back home. By the late 1990s deposits from emigrants represented about 20 percent of the total deposits in Portugal. In the Americas, the collapse of the Mexican banking system in the aftermath of the "tequila" crisis of the mid-1990s opened up the Mexican banking sector to foreign direct investment. As major Spanish and U.S. banks began buying Mexican banks, remittances gradually moved to the center of their strategies. They began to buy complementary U.S. assets as well as form alliances with other banks to leverage the remittance business.[12] It soon became evident that users of their remittance service could be drawn into becoming full banking customers—spearheading a large expansion of retail banking to two severely underserved groups on both sides of the border. The banks

12. Thus Spain's Banco Bilbao Vizcaya Argentaria bought Bancomer and then emerged as a dominant player in the electronic transfer business. Its volume grew from 657,000 transactions in 1999 to 12.65 million in 2004, thanks largely to the alliance it started in 2000 with another U.S. bank (Wells Fargo), links with a number of money transfer services in the New York area, and with the U.S. Postal Service. Following Citibank's purchase of Banamex in 2001, it introduced a single account that can be operated on either side of the border, using branches of either Citibank or Banamex. In 2002 Bank of America, the biggest U.S. retail bank, took a stake in Santander Serfin, the third largest Mexican bank, which was controlled by Spain's Santander Central Hispano. The remittance business also drove HSBC's decision to buy Grupo Financiero Bital, a large Mexican retail bank along with Household International, a consumer credit lender with branches across the United States, as a base for the remittance business.

have also been surprised by the relative wealth of Mexican customers. The transfer business is already paying dividends. Bank of America has found that 33 percent of its U.S.-Mexican remittance customers have opened a current account. Citigroup is using its transfer business to attract new customers and some to other products—for example, by lowering fees on transfers between Citigroup accounts in the United States and Mexico. Banks are now extending the products and technologies developed in the Mexico-U.S. remittance business to other Hispanic remittance markets both in the United States and in Spain, as well as the Spanish North Africa remittance market.

Informal Value Transfer Systems

Remittances flowing through informal (and sometimes underground) channels, outside the purview of government supervision and regulation, go back centuries, particularly in Asia. Examples include *hawala* and *hundi* in South Asia, *fei ch'ien* in China, *Phoe kuan* in Thailand, *Hui* in Vietnam, and *casa de cambio* in South America. Informal Value Transfer Systems (IVTSs) flourish in countries with economic controls, political instability, and low levels of financial development. Using rudimentary low-cost technologies, they rely more on trust than violence, riding on the social capital of ethnic groups. These systems transfer "at a minimum, tens of billions of dollars" globally, offering speed, easy access, low costs, and anonymity.[13] Basically, the sender gives money to an IVTS agent (usually in an ethnic neighborhood) who calls or faxes instructions to his counterpart in the region where the money is to be sent. The counterpart makes the payment within a few hours. Settlements are made either with a transfer in the opposite direction or periodic wire transfers or through over(under)invoicing of cross-border trade.

These services transfer funds derived from both legitimate and illegitimate activities, ranging from funds deployed by intelligence agencies to those related to corruption, tax evasion, drugs, and terrorism. However, there is more hype than evidence on the scale of the latter.[14] Attempts by Western governments to regulate IVTS activities have arisen in the context of measures to deter money laundering and most recently terrorist financing.

13. David Aufhauser, General Counsel, Department of the U.S. Treasury, *Hearings before the Senate Judiciary Committee,* 108 Cong. 1 sess. (GPO, June 26, 2003).

14. Passas (1999).

Effects of Financial Remittances

Remittances have complex effects, which are a function of the characteristics of migrants and the households they leave behind, their motivations, and the overall economic environment. Remittances are a form of household transfers motivated by, among other things, altruism as an implicit intrafamily contractual arrangement or as an implicit family loan. The importance of motives appears to vary with the institutional setting.[15]

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

At this point, it is important to dispel one myth surrounding remittances, namely, that they compensate for the brain drain, substituting one scarce factor (financial resources) for another (human capital) that is critical for development. The two are not substitutes, even though emigrants are usually positively selected. The real detrimental effects of the brain drain for developing countries arise from the migration of the upper end of human capital distribution, comprising engineers, scientists, physicians, professors, and so on. This scarce human capital is usually drawn from the upper decile of the income distribution rather than the middle. Although there are exceptions (for example, temporary skilled migrants like the H1-B information technology workers in the United States), for the most part these households are in less need of remittances, unless the country of origin undergoes a major crisis. Indeed, if the brain drain is a response to political repression or economic and political instability rather than simply better economic opportunities abroad, human capital flight and financial capital flight complement each other. Instead of one form of capital outflow being "compensated" by another type of capital inflow, the migration simply precipitates the outflow of financial capital as well. Countries such as Afghanistan, Colombia, Ghana, Haiti, or Venezuela, as well as Cuba in the late 1950s and early 1960s, which have witnessed violent regime changes and civil wars, are examples of this phenomenon. This is not to

15. Foster and Rosenzweig (2001).

say that the brain drain of professionals might not have other benefits for the country of origin, such as business and commercial networks or investment flows and diasporic philanthropy as discussed in chapter 7, but those effects are distinct from financial remittances.

Remittances as Social Insurance

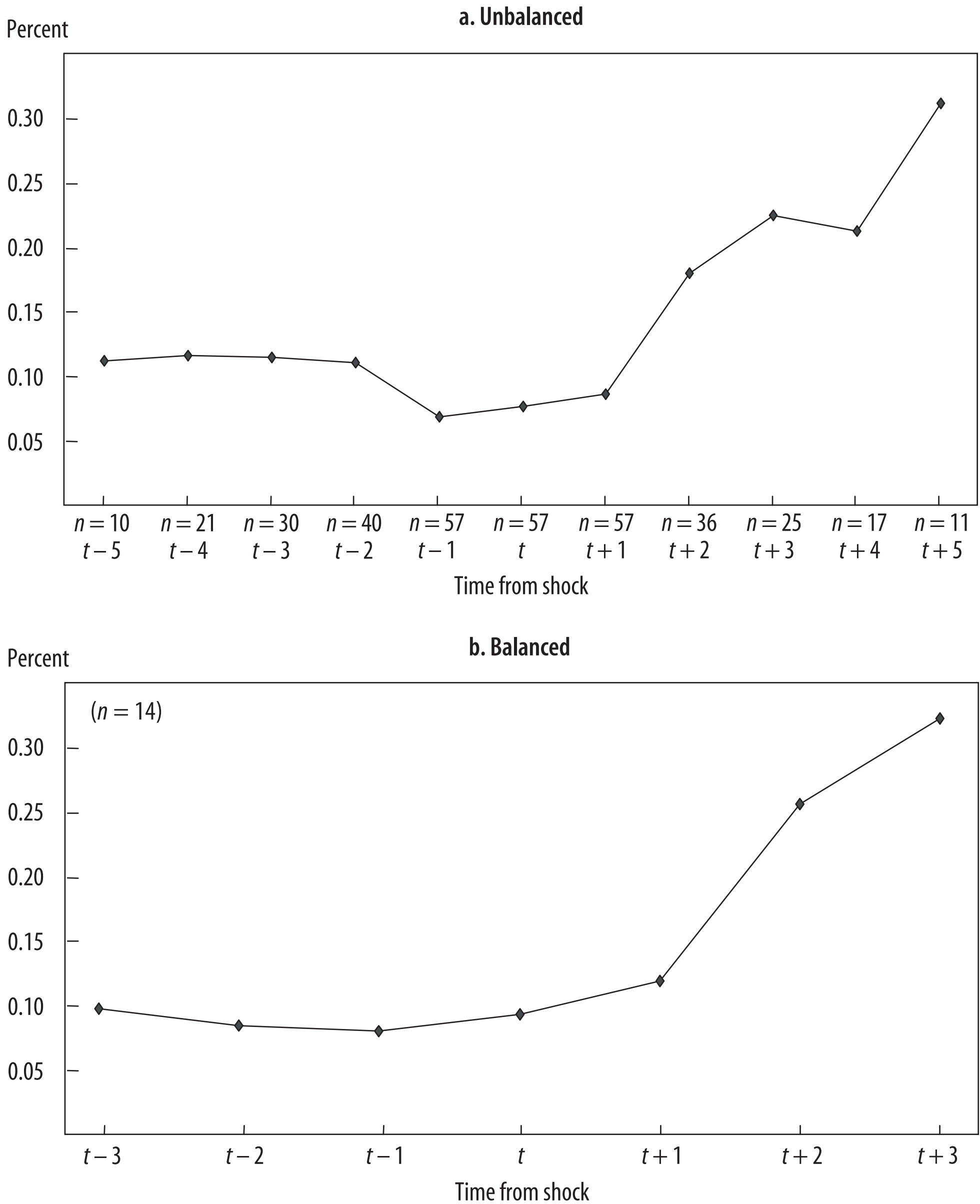
To reiterate, remittances play an important insurance role—and this has a significant impact on both poverty and equity. For people in failed states, remittances are critical for personal consumption. In Haiti, remittances have amounted to between a sixth and a fifth of GDP. In Somalia, following the collapse of a formal government in the early 1990s, remittances from the Somali diaspora based in the Gulf states, several European countries, the United States, and Canada were the sole source of survival for many Somali families, particularly during the harsh years of the 1990s. By the end of the decade, remittances had risen to about 25 and 40 percent of GDP, and some regions, such as southern Somalia, began investing these resources in construction and commerce.[16]

Remittances tend to increase in the aftermath of shocks, whether macroeconomic or natural disasters. The many recent economic and financial crises have resulted in two simultaneous shocks that affect remittances: either a positive income shock to the remitter because of devaluation or a negative income shock to the remittee because of an economic downturn. Both predict an increase in remittances (in domestic currency terms). To study this effect, we looked at countries that had suffered an economic shock (defined as a 2 percent decline in GDP in year t) and examined remittances in relation to private consumption in the years preceding and following the crisis. If the insurance hypothesis holds, we would expect the share of remittances in private consumption to increase. Because it was difficult to obtain consistent annual data on remittances for the countries suffering a shock, we examined this issue in both an unbalanced panel (figure 8-4a) and in a balanced panel (figure 8-4b). In the latter case, annual data were available for a set of countries for three years preceding and following a shock. In both cases, remittances increase sharply if a country suffers a macroeconomic shock.

This suggests that with globalization, factor markets can play a crucial role in alleviating poverty. Households tend to be much more specialized

16. Idil Salah, Som-Can Institute for Research and Development, and Bernard Taylor, Partnership Africa Canada, "Somalia: Peace and Development" (www.web.net/pac/pacnet-l/msg00008.html [September 12, 1999]).

Figure 8-4. Unweighted Average of Remittances as Share of Private Consumption[a]



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

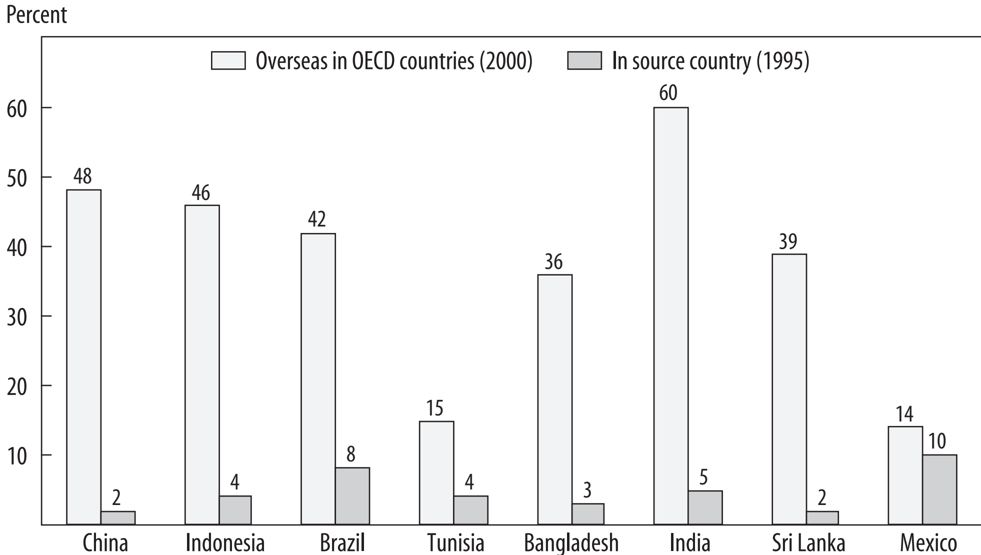
in income (or factor earnings such as land, labor, or capital) than they are in consumption. Hence it is the source of income rather than the pattern of expenditure that affects the poor in relation to the average household.[17] Remittances provide social protection to poor households, which reduces vulnerability to shocks. Since remittances have an immediate impact on transient poverty, which is known to be a serious obstacle to human capital investment, they also have long-term effects that should not be underestimated. Because an income shock's impact on school attendance is consistently larger for daughters than sons, ensuing remittances could have a beneficial effect on human capital investment, especially girls.[18] For this to occur, the remittances should of course accrue to poor households, but that will depend on whether migrants are drawn from such households in the first place.

Equity may also be enhanced by the particular characteristics of who migrates—the so-called selection effects. The distributional consequences are complicated by the uneven access to migration flows across households, ethnic groups, communities, and regions. Households that receive remittances rapidly attain standards of living greater than those that do not have family members working abroad. Should some shock trigger a devaluation and economic downturn, households with more diversified portfolios—both in financial assets and human capital assets—will weather the storm better than those with domestic portfolios. After a devaluation, the income stream from an overseas portfolio increases in terms of the domestic currency, thereby increasing their income compared with that of lower-income groups. If remittances flow to poorer households concentrated in a particular region, this might reduce inequality within the region even while increasing it among different regions.

Following the Asian crisis, for example, Philippine households with overseas migrants did substantially better than those that had no members abroad. This is to be expected since migration is a form of coinsurance and gives families diversified portfolios. Indeed, among Philippine families above a certain income threshold, those with members abroad appear to use remittances to invest in human capital, which would then make it easier to migrate abroad, while those below this threshold use it to meet subsistence consumption.[19] This is particularly the case during a

17. Winters (2000); Reimer (2002).
18. Sawada (2003).
19. Yang (2003).

Figure 8-5. Population 25 or Older with Tertiary Education



Source: Doquier and Marfouk (2004); Thomas, Wang, and Fan (2000); International Bank for Reconstruction and Development (2000).

crisis when households face substantial financial and economic stress and resultant pressure on consumption.

Migrants are rarely drawn randomly from the population pool but instead are selected from specific communities—be it regional, ethnic, or religious—as well as educational and income levels. Selection therefore plays a large role in migration, remittances, and poverty and equity outcomes in the country of origin. The average level of education of immigrants is greater than that in the country of origin—often substantially so (figure 8-5). In Latin America, only about one-fifth of those remaining behind have completed high school or college, whereas a little more than half of the Latino immigrants in the United States have a secondary education or better. Well-educated Latin Americans are at least two and a half times more likely to be in the United States rather than the home country. According to one analysis of Mexican migration to the United States, Mexican immigrants, while much less educated than U.S. natives, are on average more educated than residents of Mexico.[20] If Mexican

20. Chiquiar and Hanson (2002).

immigrants in the United States were paid prevailing wages for those skills in Mexico, they would tend to occupy the middle and upper parts of Mexico's wage distribution structure. In contrast to earlier work that posits a negative selection hypothesis, these findings suggest that in terms of observable skills there is intermediate or positive selection of immigrants from Mexico.[21] The results also suggest that migration abroad may raise wage inequality in Mexico.

The fact that migrants are not being drawn from the poorest households in their country of origin means that even though remittances are poor-friendly they may have only a limited direct effect on the poorest groups. Instead, structural poverty is likely to experience substantial indirect effects, in the demand for labor-intensive services (such as construction work when remittances are used for home building) and perhaps even in redirecting government social expenditures from areas benefiting from remittances to those that are not. Of course, these results may not be the same where immigrants are illegal, since they are much more likely to come from poorer households. Large-scale illegal immigration tends to occur in areas of geographical proximity—for example, from Mexico and Central America to the United States, from Myanmar to Thailand, from Bangladesh to India, or from the Maghreb countries to Europe. In the case of the many poor people who do make it across borders, there is strong anecdotal evidence that they incur substantial debt from the upfront cost of making the often-illegal journey across borders. Many of them become indentured laborers working to pay off the loan (often to criminal syndicates) and have little left to remit. On balance, however, the beneficial impact on poverty and inequality is maximized for the sending country when migrants have fewer skills. It is not just that the ensuing remittances are directed at poorer households, but that the supply of unskilled labor in the source country is reduced, thereby increasing unskilled wages of those left behind.

Although little evidence is available to assess the direct impact of remittances on economic development and growth, officials often lament that the bulk of remittances is spent on consumption. Nonetheless, insofar as remittances finance the consumption of domestically produced goods and services such as housing, there appear to be wide multiplier effects. Moreover, additional consumption increases indirect tax receipts.[22] There is also some suggestion that the propensity to save

21. On negative selection, see Borjas (1987).
22. Desai, Kapur, and McHale (2003).

is higher among remittance-receiving households than among others.[23] If so, then remittances that help augment national savings could be leveraged for broader economic development.

To take another example, it has long been recognized that capital and liquidity constraints greatly affect small enterprise development, especially in poorer communities with imperfect capital markets, such as those in urban Mexico. Thus it is not surprising that remittances from migration by the owner or family members working in the United States have helped in supplying capital for investment in microenterprises throughout urban Mexico. In the 10 states with the highest rate of migration from Mexico to the United States, almost a third of the capital invested in microenterprises was associated with remittances.[24] Insofar as remittances are driving retail banking strategies of foreign investment in Mexican banks, remittances could also have the inadvertent but potentially far-reaching effect of transforming Mexico's banking system. Fewer than one in five Mexicans have a bank account and many rural areas of central Mexico, which send the most migrant laborers to the United States, lack any bank branch. Weak formal credit markets have been particularly inimical to Mexico's small and medium enterprises. If retail banking does radically change these practices, the long-term economic benefits of remittances to the country might be greatest here.

Interestingly, some immigrant communities have sought to pool remittances for public use back home. To this end, Hispanic immigrants across the United States have organized themselves into hometown associations (HTAs) that finance public works projects and small businesses in the towns from which they have migrated. The Mexican government has taken the initiative to leverage their remittances by creating a "three-for-program" in which all HTA remittances used to improve infrastructure or establish businesses are matched dollar for dollar by the Mexican federal, state, and local authorities.[25] This threefold leveraging has had some notable successes at the local level, but the cumulative impact remains limited.

Often communities do not have the resources to maintain what has been built through these contributions. Hype notwithstanding, HTAs have not so far been used significantly to fund direct income-generating projects. Furthermore, it is unclear if these initiatives are creating jobs so

23. Orozco (2003a).
24. Woodruff and Zenteno (2001).
25. Alarcon (2002).

that Mexicans do not have to emigrate or are instead simply subsidizing future migration through improved training. Perhaps the biggest benefit is that the HTAs have become a magnet for local collective action in both the sending and the receiving country. For migrants, these associations help maintain ties to their hometown, which in turn may help sustain private remittances.

So What's the Problem?

In assessing the impact of remittances, micro-level studies (principally by anthropologists) tend to be less sanguine than more macro-level studies (usually by economists). The former tend to see a dual effect: greater wealth but fewer economic opportunities for those left behind—a Pyrrhic victory, as it were. Remittances, they point out, have helped physically transform so-called migra-villages in Latin America, but many of the new handsome houses are empty because their owners live in the United States. Likewise, remittances have helped build better schools, but enrollment has been declining. Though simply a consequence of migration initially, remittances in these regions have now become its principal driver. The very money that has increased the material wealth of these villages appears to be gradually undermining their long-term future. What is good for individual migrants and households may not be as beneficial for the communities. Whether economic development is more about the former or the latter is something that can be reasonably debated.

Remittances can have ambiguous effects even at the household level, as can be seen in the case of homecare workers such as Jamaican nannies in New York or Filipino nannies in Hong Kong. Many of these women are mothers who have left their own children behind to take care of children in wealthier households. The household in the home country enjoys higher consumption because of remittances, but the children of these homecare workers grow up without their mother. The migration decision of the mother could be considered a "revealed preference" of an improvement in household welfare. Why would she leave otherwise? However, independent analysis is not available to confirm that this is indeed the case.

Communities heavily dependent on remittances often develop a culture of dependency. In a variety of contexts it has been observed that household members simply stop working and wait from month to month for the overseas remittance. Such negative incentive effects—a form of moral hazard—in turn cause the reservation wage to increase.

Young men prefer to remain unemployed and wait for the possibility that they themselves will migrate, rather than take up jobs at the local market-clearing wage. That remittances increase consumption much faster than production raises issues of long-term sustainability, for they will inevitably decline as migrants settle in new communities and their links with home communities gradually erode. Of course, this is a moot point if most people leave the community in any case.

Similar negative incentive effects can act at the national level. If remittances are substantial and a large share is spent on nontradables—housing and land are particularly favored—the country is likely to suffer Dutch disease effects. The real exchange rate is then likely to appreciate, rendering exports less competitive. The country's principal export—labor—could become the cheap factor, rather than labor-intensive products. At an aggregate level, remittances constitute a form of rents. Exporting products requires painstaking effort to build the institutions and infrastructure that help develop the necessary productive capacity. Exporting people, on the other hand, occurs in most cases by default rather than by design. Nonetheless, if the latter also results in large foreign exchange receipts, the pressure to undertake reforms needed for export-led growth is considerably attenuated. For instance, countries can maintain larger fiscal deficits in the context of international migration and remittances. In the absence of remittances, high fiscal deficits would imply higher current account imbalances and hence greater reliance on foreign savings (assuming the deficit is not monetized—which is less likely given that central banks are more independent today), with a subsequent increase in capital account inflows.[26] However, if remittances are high, current account deficits would be lower, thereby reducing the likelihood that high fiscal deficits will precipitate a balance of payments crisis—the most common trigger for economic reforms in developing countries. Thus countries with high remittance levels can sustain higher fiscal deficits—while at the same time keeping international financial institutions like the International Monetary Fund and the World Bank at bay.[27] With the increasing politicization of these institutions, potential borrowers no longer seek co-insurance through

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

27. For instance, India has maintained exceedingly high fiscal deficits (about 10 percent of GDP) even in the presence of modest inflation (about 5 percent). In part this is because its current account—buoyed by remittances exceeding $12 billion (2.5 percent of GDP)—is positive. For a more detailed discussion, see Kapur and Patel (2003).

these institutions as much as self-insurance, in the form of higher foreign exchange reserves and international migration and remittances.

Political Effects

Money buys influence. Therefore it should not be surprising that in countries where remittances are important, the political effects are not inconsequential. In the Dominican Republic (where remittances are 10 percent of GDP), presidential candidates campaign in the United States. From Mexico to India, the lucre of remittances has led politicians to switch positions toward their diaspora from benign neglect to active courtship. Regimes in socialist economies such as Cuba and North Korea have used remittances to augment scarce hard currency resources to strengthen themselves in the short term. Cuba draws remittances from its U.S.-based diaspora, while North Koreans earn remittances mostly from pachinko parlors run by Koreans living in Japan. But insofar as these remittances sow the seeds of economic transformation, they can also quietly erode the political system. In Cuba, access to remittances has increased inequality in a political system that draws its legitimacy from its commitment to equity.[28] Furthermore, remittances have a strong racial bias there, since the diaspora is predominantly white while the island is mostly black. The latter gained under Castro and were therefore less likely to emigrate, but as a result they have less access to the emerging cross-border informal dollarized economy. Access to remittances is also heavily urban and regional; Havana, with 20 percent of the island's population, receives approximately 60 percent of remittances. Therefore rural-urban inequality is also likely to widen.

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

Nor is the political impact confined to source countries. In receiving countries, remittances have been quietly reshaping immigration policies. Recently, the Mexican government negotiated with banks and wire transfer agencies in the United States to make it easier and cheaper for

28. Eckstein (2003).

immigrants to send money home. The Mexican government began to distribute "matrícula" consular identification cards and persuaded U.S. banks to accept them as identification cards for the purpose of opening bank accounts, irrespective of the legality of the applicant's immigration status.[29] Major U.S. banks, attracted by the high fees and volumes, began to accept these cards. The remittance market was also a good complement to U.S. banks' strategy of expanding operations in Latin America by buying local banks in the region. After all, if a bank could get a customer to step inside and make a deposit (in the United States) or a withdrawal (in, say, Mexico), it might interest him or her in other financial products. In turn, by simply offering to do business with any illegal foreign resident who got a consular identification card, U.S. banks have quietly reshaped their country's migration policy toward illegal immigrants from Latin America or Mexico. As Mexican consulates began to be flooded with applications for identity cards, local governments and law enforcement agencies in the United States began accepting these cards to allow migrants to get other forms of identification such as driver's licenses, making the lives of illegal migrants less onerous.

Since international remittances are a form of cross-border financial flows, it should not be surprising that they also have international political effects. In many countries they are so important and the flows so large that they affect bilateral relationships and foreign policy. While at the local level remittances have an impact on politics, at the macro level causality runs the other way—it is politics that has an impact on remittances. This is particularly the case when migrants are concentrated in countries or regions that become unstable. Source and destination migration dyads (table 8-4) increase the harm resulting from covariant shocks. Indeed, controlling remittance outflows can become a coercive instrument on the part of a migrant destination country. To cite one example, remittances from migrants in the Ivory Coast accounted for a quarter of the GDP of Burkina Faso, and a civil war in the former rapidly reverberated to the latter.

The oil shocks and the Gulf crisis in the Middle East have not only affected oil-producing countries but have had a regional contagion effect through their demand for labor. A similar phenomenon was

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

Table 8-4. Some Prominent Source–Destination Migration Dyads

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

observed in Southeast Asia during the Asian crisis when the expulsion of Indonesian labor from Malaysia and Thailand exacerbated the crisis in the former, increased tensions between the countries, and weakened the Association of Southeast Asian Nations. Following the 1991 Gulf War, the Gulf countries punished workers from Jordan and Yemen and especially Palestinians for supporting Saddam Hussein and expelled them from their countries. In all these cases, remittances from family members earning money in the Gulf states were crucial. The heavy price paid then and the continued dependence on remittances from the Gulf was one reason that some countries were opposed to the second Gulf War in Iraq, fearing its disruptive economic effects.

Control of remittances as a form of economic warfare has been most evident in the Israeli-Palestinian conflict. In September 2000, Israel began revoking the work permits of Palestinians because of security concerns. At that time, some 100,000 Palestinian workers from the West Bank and Gaza Strip crossed into Israel every day. By January 2002, only 25,000 Palestinian workers and 8,000 merchants had permits to enter, and the number has continued to drop. In their place, Israel began to import foreign workers (an estimated 230,000, largely from China, Thailand, Africa, and the Philippines) to work in agriculture and construction. As a result, remittance outflows from Israel tripled from less than $1 billion in the early 1990s to nearly $3 billion in 2001. The economic effects on the West Bank and Gaza have been devastating. Gross national income per capita fell by 11.7 percent in 2001 and a further 18.7 percent in 2002, while poverty levels jumped from 21 percent in 1999 to 46 percent in 2002. The drop in remittances had even larger indirect effects since the loss of income dampened the demand for Palestinian goods, and imports from Israel declined sharply—which in turn adversely affected Israel's economy as well.[30]

Like much else in today's world, remittances changed in the aftermath of September 11. This proved a blessing for Pakistan, a "frontline" state caught in the vortex. In 2000 remittances to Pakistan totaled about $1 billion (about a third of their peak in 1982–83), but after September 11 many Pakistanis with savings in offshore accounts repatriated their funds, fearful of being caught in U.S.-led investigations into terrorist financing. Under pressure from the United States, the Pakistani central bank tightened controls on the web of moneychangers (locally known as *hundi* operators) and introduced a law restoring immunity against disclosure of the sources of income for holders of foreign currency accounts. As a result, the difference between the official and market rates narrowed (to less than 1 percent), and by 2003 remittances in Pakistan rose to nearly $4 billion.

In contrast, the effects were much more disruptive for Somalia, a country with no recognized government and without a functioning state apparatus. After the international community largely washed its hands of the country following the disastrous peacekeeping foray in 1994, remittances became the inhabitants' lifeline. With no recognized private

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

banking system, the remittance trade was dominated by a single firm (Al Barakaat).[31] In 2001 the United States shut down Al Barakaat's overseas money remittance channel, labeling it "the quartermasters of terror." With remittances representing between a quarter and 40 percent of total GNP, closure of the channel was devastating. The humanitarian impact of having money frozen in transit was considerable. Remittances provided many times what the aid agencies could offer to rebuild the deeply impoverished country. Although evidence of Al Barakaat's backing for terrorism was weak, the effects of the ban on the country's well-being were significant.[32]

Policy Options

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

Second, the Somali case illustrates the need for a greater international effort to create an acceptable international money transfer system in the growing number of countries where the state has collapsed, the paucity of international aid is acute, and nationals are trying to do more for themselves. The biggest challenge facing the international community is

31. Al Barakaat operated in 40 countries, was Somalia's largest private sector employer, handled about $140 million a year from the diaspora, and offered phone and Internet services.

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

how to improve the well-being of people living in such states. Currently, it is relying principally on a "big stick" approach—proscriptions and sanctions against countries and financial intermediaries. Along these lines, the United States recently considered sanctions to cut off remittances to North Korea, and together with the Paris-based Financial Action Task Force, is pressuring countries to start monitoring "door-to-door" remittances, fearing that this unregulated flow of money could be used for terrorist activities. New legislation is forcing money transmitters to install expensive new compliance technologies. It is certainly the case, as the United Nations Development Program (UNDP) found in Somalia, that current money transfer systems in that country do not meet acceptable international standards and lack the means to identify suspicious transactions and money-laundering schemes. But international efforts will be more meaningful if they are directed at building a financial architecture rather than just deploying the blunt instrument of sanctions. An alternative policy action of this type has been initiated by the UNDP, which is working with foreign governments and Somalia's remaining money transfer and remittance companies to comply with standard financial rules and regulations and help firms institute standard bookkeeping, auditing, and reporting.

The international community can best serve the channels through which remittances are transmitted by helping construct a financial architecture that reduces the transaction costs of intermediation and increases its transparency. Recently, the World Council of Credit Unions launched the International Remittance Network to facilitate remittance transfers from the United States. It does not charge recipients a fee and offers better exchange rates, but as yet its services are confined to its members. The Inter-American Development Bank is helping create a common electronic platform in the region between sending and receiving countries and within receiving countries.[33] But there is considerably greater scope in this regard. In particular, the international community should fund a more substantial effort to underwrite the development and maintenance of a common electronic platform (including clearinghouse and payment systems) that would facilitate remittance transfers. If the facility were maintained under the aegis of a multilateral organization (the UNDP, for instance), it could ensure both greater transparency and lower transactional costs. Indeed, by allowing registered IVTS operators as well as INTERPOL access to such a platform at low

33. Buencamino and Gorbunov (2002).

costs, many of the advantages of informal banking would be coupled with the transparency of such a facility. It should be remembered that public subsidies for such an endeavor would in all likelihood be much lower than the costs of policing and monitoring as well as the transactional costs currently being incurred.

Another step to help lubricate international remittance transfers would be to work on transforming the role of post offices, the single biggest global distributional channel. The U.S. Postal Service began a program called Dinero Seguro (safe money) for sending remittances, but with charges at nearly 10 percent of the face amount, it has had little success. Postal "giro" payment systems are widely used in Europe and Japan. Linking the postal giro systems worldwide would facilitate international postal transfers, paralleling the agreement for the exchange of mail among member countries of the Universal Postal Union.

What can receiving country governments do to enhance the development impact of remittances? For one thing, they should try to get a better idea of the magnitudes and sources of these flows. In contrast to the massive effort they have devoted to monitoring and managing foreign aid flows, governments have paid little attention to these flows. Remittance data should become part of the IMF's Special Data Dissemination Standards to ensure the consistency and timeliness of remittance data, which would help improve the data on remittance flows but also allow for some cross-checks, similar to those currently done in trade flows. Remittance-receiving countries need to create a spatial map of their overseas communities, showing not just the country but specific geographical location. This would allow financial intermediaries to better target these communities.

To increase the long-term productive impact of remittances, governments need to promote greater competition and entice formal financial intermediaries, especially banks, to expand operations in areas with higher levels of emigration. Although it is true that *hawala*-like informal transfer systems are extremely efficient in that they provide much-needed services at low cost, *the net amount of capital they bring in is virtually zero*. The reason is that *hawala* can only function if inflows are equal to outflows, which means that the transactions are balanced through capital flight. Thus while remittance-receiving households benefit from the operation of such systems, the net financial and foreign exchange gains to the country are significantly less than if the flows came through formal channels. Moreover, if the propensity to save is higher among remittance-receiving households than in others, formal

systems are likely to raise national savings rates. This would suggest that the presence of an extensive network of financial intermediaries in these areas could help leverage remittances for broader economic development. Countries with large remittance flows through informal channels could consider subsidizing the intermediation costs through formal channels as well as offer other incentives, such as less costly financial products like life insurance or access to mortgages.[34] Remittances could also be used to securitize future receivables to augment foreign credit ratings.[35] In addition, governments also need to more actively monitor and regulate labor market intermediaries, who often fleece potential migrants. Intermediaries lubricate flows—but they can also divert a substantial stream of income to themselves. Finally, governments should be aware that attempts to encourage or require remittances to be invested are unlikely to have significant economic benefits. The best way for recipient countries to ensure that a greater proportion of remittances are utilized for productive investments (rather than simply consumption) is to have a supportive economic environment for investment per se. Countries such as India and Turkey have tried to increase remittances by offering various preferential schemes under the capital account, such as tax-free status, but this inevitably leads to round tripping. Instead, governments should direct their efforts to the financial sector.

Conclusion

Are remittances a new development paradigm or another destabilizing force of globalization? They are certainly one of the most visible—and beneficial—aspects of the role of international migration in reshaping the countries of origin. In a variety of settings, remittances are quietly transforming societies and regions and are the most manifest example of self-help undertaken by poor households in the global arena. In particular, they are augmenting private consumption and alleviating transient poverty in receiving countries. However, their effects on structural poverty and long-term economic development are still poorly understood, which is surprising given their importance. By contrast, a substantial body of literature has grown up around the other principal sources of development finance: foreign aid, flows from the Bretton Woods institutions, and foreign direct investment and private debt flows.

34. This is being attempted in Mexico with the assistance of Fannie Mae and JP Morgan.
35. Ketkar and Ratha (2001).

Unlike foreign aid, remittance flows do not put any burden on taxpayers in rich countries. Nonetheless, they occur only to the extent that emigrants from poor countries can work in richer countries. Since countries that are more open to immigration are also the principal sources of remittances, which constitute substantial sources of external finance to poorer countries, should they not be viewed as a country's contribution to poor countries?[36] From this point of view, the U.S. contribution substantially increases (and in proportionate terms that of Saudi Arabia even more), while that of more immigrant-resistant countries, such as Japan, falls. The critical difference between foreign aid and remittances is that the former consists of transfers from public entities in the donor country to public agencies in receiving countries. Even when it is directed to agents in civil society such as NGOs, foreign aid goes to organized entities. Remittances, of course, simply go directly to households and in that sense their immediate poverty alleviation impact—through increased consumption—can be greater than that of traditional foreign aid, depending on the income characteristics of the receiving household. The transaction costs are lower, and there is less leakage to rent-seeking bureaucracies and consultants.

However, the long-term impact may be more questionable, especially if few productive assets are being created. Thus it would appear that remittances are a better instrument for alleviating transient poverty arising in response to shocks, whether at the household or national level, rather than structural poverty. There is as yet no evidence that remittances can catalyze broad economic transformation, the kind that is essential to alleviate structural poverty in the long term.

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