

## Remittances - A Bridge between Migration and Development?

For decades the migration debate has focused on the impact of immigration on destination countries. Very recently, however, attention has increasingly turned to the situation in the countries of origin, developing countries in particular, with a focus on the interplay between migration and development. Three compensatory mechanisms offer migrants' countries of origin a possibility for avoiding the permanent loss of knowledge and qualified labour due to migration (i.e. *brain drain*) as well as a means for escaping the poverty trap. Firstly, circular migration – the practice of migrating back and forth between the countries of origin and destination – can create, at a minimum, the potential for increased knowledge exchange, if not gain (*brain gain*). Secondly, diaspora communities can serve as a conduit for developing trade connections, increasing transfer of capital and exchanging technology. Finally, the steady growth of remittances from migrants to families back home can help to significantly reduce poverty in recipient communities.

The goal of this policy brief is the critical examination of remittances as a link between the migration and development debates. It begins with an account of the procedures and motives for such transfers as well as an overview of current trends and figures. It then addresses the importance of remittances with respect to poverty reduction, income distribution, spending habits, education, health, investment and growth as well as the national balance of payments in developing countries. Finally, the conclusion addresses the question of whether migration and the resulting flow of funds could evolve into a springboard for development in these countries.

### What does the term remittance mean?

Remittance refers to the portion of migrant income that, in the form of either funds or goods, flows back into the country of origin, primarily to support families back home. The greater share of these largely monetary flows benefits developing countries. In the last few decades the volume of migrants' remittances worldwide has risen steadily (in nominal and relative terms) and currently represents a substantial source of revenue for many poor states.

### How does the money flow?

From the use of banks, credit institutions or money transfer companies like Western Union and MoneyGram to the personal transportation of cash or goods during trips back home, various means exist for transferring remittances to the recipient country. Information concerning cross-border money flows is only available on funds sent through formal channels, as these are the only channels that national banks are able to monitor. Experts estimate that undocumented transactions via informal channels are, in fact, well above officially documented figures.

Informal methods of transferring money differ from country to country. In addition to the personal transport of funds, money can be sent through the mail or via a third party. One variant of a transfer system involving third parties is the professionally-run Hawala system in South and Southeast Asian countries. In this system, middlemen, so-called Hawaladars, residing in both source and recipient countries use a code to communicate a sum of money, which is then given to the payee in the country of origin, without the money actually being transferred. Instead of payments being made between both Hawaladars, the account is usually settled through other means of compensation. For migrants and their relatives back home, this method is advantageous for two reasons. First, it allows for an immediate transfer of funds to the home country without having to register the transaction officially. Unregistered channels are often pursued, either because undocumented immigrants generally do not have access to banks, or because many developing countries lack nationwide banking networks, making it difficult to transfer money to outlying areas.

The second reason for relying on such an informal channel is the lower cost. Money transfer via Hawala costs the remitter a mere 1 to 2% of the transaction sum, whereas banks charge an average of 7%, and Western Union up to 12%, in the form of commission or fees. The fixed base fee charged by money transfer companies is made even more disadvantageous by the fact that many migrants send money in small monthly instalments, on average US\$200, instead of sending a higher amount annually. The unofficial niche markets are comprised of countless independent, small providers and can thereby cover a wide geographical radius. For example, a current study by the International Labour

Organisation (ILO) estimates that, in Bangladesh, 40% of all remittances are transferred through Hawala.

### Why do migrants remit?

It is difficult to explain migrants' motives for remitting, as few reliable sources of information on these migrants exist. Furthermore, the scope of family support varies greatly according to culture and the economic conditions in source and recipient communities.

Though three apparently separate motivating factors can be observed, in reality, these often overlap. The main driving force is often considered to be altruism, in other words, concern on the part of migrants toward family members still in the country of origin. It is still usually the case that only one family member migrates; spouses, children and parents are left behind and rely on the support of this migrant, who assumes the role of provider. Beyond the altruistic care of relatives, self-interest can also be a significant motive to remit. Family may, for example, look after any property the migrant has left behind, compensating them in this way for any remittances. Also, the migrant may hope to become the beneficiary of an inheritance. In addition to these two motives, an implicit agreement can exist between migrants and the relatives they leave behind. Relatives often cover the high cost of moving and settling abroad and are later repaid once the migrant has established himself in the destination country. This arrangement can be considered an informal loan agreement or as a kind of co-insurance. This theory follows the observation that financial assistance increases in cases of economic or natural crises back home. This anti-cyclical behaviour is supported by the findings of a Botswanan study showing that allowances to households with migration connections were considerably higher during periods of drought.

### Which factors determine the remittance amounts?

A strong correlation can be drawn between a migrant's duration of stay abroad and the size of payments. Temporary migrants who leave their families in the country of origin tend to remit the highest sums relative to their incomes. Permanent emigrants, in contrast, generally migrate with their family members; over time, they have less and less contact to remaining relatives at home, which gradually results in reduced remittances. Residency permit status directly influences the amount remitted. A change in status from undocumented to legal often leads to a rise in the value of remittances, due to improved wage levels. However, this increase in remittances declines again as the migrants integrate themselves into the host society.

Gender and education level are sometimes considered factors that affect remittance amounts. Women, especially, are attributed with the tendency to provide stronger support to relatives back home. This hypothesis, however, cannot be generalised. A study of Filipino migrant behaviour, for example, drew a contrary conclusion and showed that men remit higher sums, because they are paid better

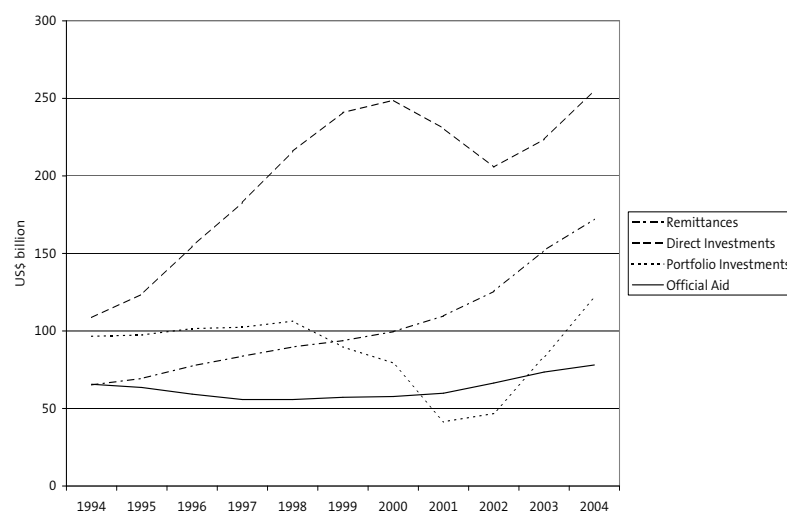
wages.

With regard to educational background, it is often assumed that workers with lower qualifications send back a higher percentage of their (lower) incomes. This assumption is due to the fact that, as a rule, less qualified migrants only stay abroad temporarily, leaving their entire families behind to rely on their support (see above). Highly skilled migrants, on the other hand, tend to settle permanently in the host country, along with their dependents (spouses/children). For this reason, they could be expected to remit less. However, the highly skilled may owe greater debts to their families (parents/relatives) on account of higher education costs, which may lead them to repay the debt through higher remittances. Clear remittance patterns based on gender or education level are, therefore, not identifiable, because they vary from case to case and are dependent on the immigration and integration policies of host countries as well as the cultural backgrounds of the migrants and families in question.

## Figures and trends

Along with foreign direct investments<sup>1</sup>, remittances represent the most significant flow of capital into developing countries. According to figures recently published by the International Monetary Fund (IMF), remittances totalling US\$172 billion flowed into developing countries in 2004, approximately 13% more than the previous year.<sup>2</sup> This dramatic rise can be traced back to a growing number of migrants, an increase in the use of official transfer mechanisms<sup>3</sup> and a weaker dollar. The relative share of remittances in the total capital flows<sup>4</sup> to developing countries has increased steadily in recent years, from around 20% in the 1990s to about 28% in 2004. By contrast, direct investments accounted for 41%, portfolio investments for 19% and official development assistance for 12% of capital flows by 2004. In Figure 1, the anti-cyclical nature of remittances can be seen as well. While direct and portfolio investments fell dramatically between the end of the 1990s and 2002, because

Figure 1: Inflow of Capital to Developing Countries<sup>5</sup>



Source: IMF 2005 and World Development Indicators 2005

of the financial crisis in Asia (1997/1998) and the September 11th terrorist attacks, remittances increased significantly during that time.

In order to comprehend the actual extent of remittances, one must take into account that the balance of payments completely disregards money transferred by informal means. Expert estimates put this cash flow well above that of official channels.

### Data analysis

According to the definition of the International Monetary Fund (IMF), migrants' remittances are reported in the balance of payments statistics under three categories:

- *Compensation of Employees*, i.e. gross earnings of workers residing abroad for less than 12 months;
- *Workers' Remittances*, i.e. the value of monetary transfers sent home by workers residing abroad for more than one year; and
- *Migrants' Transfers*, i.e. the net wealth of migrants who move from one country of employment to another.

Many central banks, however, do not follow the IMF's definition and report migrants' remittances under other categories as well, most commonly as *Other Transfers of Other Sectors*.<sup>6</sup> In its report entitled *Global Economic Prospects 2006*, the World Bank identified a number of countries where migrants' remittances fall under this category: Algeria, China, Gambia, Iran, Kenya, Lebanon, Malaysia, Mauritius, Nigeria, Serbia and Montenegro, and Vietnam.<sup>7</sup> Therefore, in the case of these countries, the authors of the World Bank publication added the category *Other Transfers of Other Sectors* to the *Compensation of Employees*, *Workers' Remittances* and *Migrants' Transfers* categories in order to estimate the overall size of remittance flows. However, the World Bank estimate does not take into account that a lot of transition countries (e.g. Bulgaria, the Czech Republic, Hungary, Poland, Romania, Russia, Slovakia, Ukraine) and some industrial countries (e.g. Germany<sup>8</sup> and the UK<sup>9</sup>) also report migrants' remittances completely or partly under *Other Transfers of Other Sectors*.

There are several problems linked to estimates of international remittance flows and to comparisons between countries. First of all, estimating migrants' remittances as the sum of *Compensation of Employees*, *Workers' Remittances* and *Migrants' Transfers* definitely underestimates the real flows (see above). However, by adding *Other Transfers of Other Sectors*,<sup>10</sup> money flows are included that are definitely not linked to workers' remittances, e.g. humanitarian aid from NGOs, pension payments, insurance and reinsurance benefits, transfers to and from investment funds or to and from savings accounts held in banks outside the country of residence, and even some transfers from illegal activities. In this policy brief, we define remittance flows as the *Compensation of Employees* plus an estimated fraction of the "total private current transfers" (i.e. the sum of *Workers' Remittances* and *Other Transfers of Other Sectors*).<sup>11</sup> Based on the analysis of the balance of payments statistics of numerous countries, we assume workers' remittances to account for 50% of the private current

transfers in the case of high-income countries and for 80% of the private current transfers in the case of middle and low-income countries, which have less liberalised financial markets and thus less in- and outflows of other transfers.

Second, some small industrialised countries like Luxembourg and Switzerland have labour markets extending into bordering regions of neighbouring countries. As a result, a considerable part of the work force consists of commuters residing in a neighbouring country. Consequently, these countries report high flows of *Compensation of Employees* going to other countries. In order to correct for this "cross-border commuter effect", we exclude these flows from the calculation of migrants' remittances for these two countries.

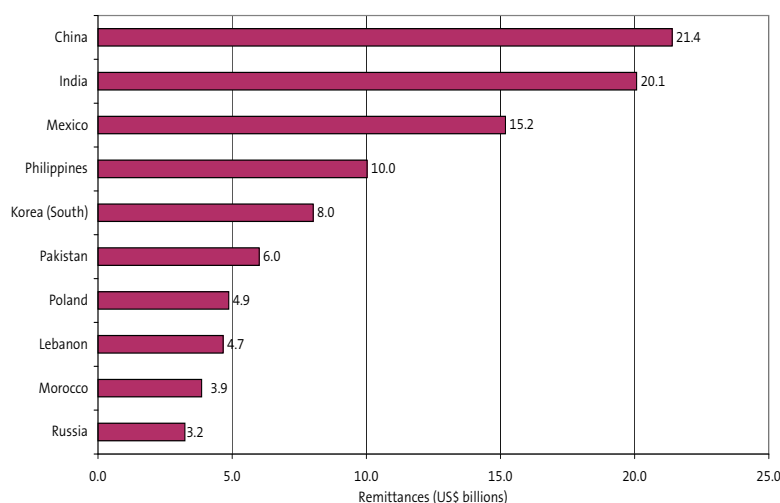
Finally, the total migrants' remittances outflows worldwide do not match with the total migrants' remittances inflows worldwide. Following the definition described above, in 2004 the total migrants' remittances outflows worldwide amounted to US\$225.1 billion while the total migrants' remittances inflows worldwide amounted to US\$278.6 billion. This is mainly due to the fact that source countries and destination countries of remittances count private transfers under different categories of their balance of payments (e.g. as a foreign investment outflow in the source country, but as a workers' remittance inflow in the destination country).

All data on migrants' remittances, including those in this policy brief, must be therefore interpreted with caution.

### Where does the money go?

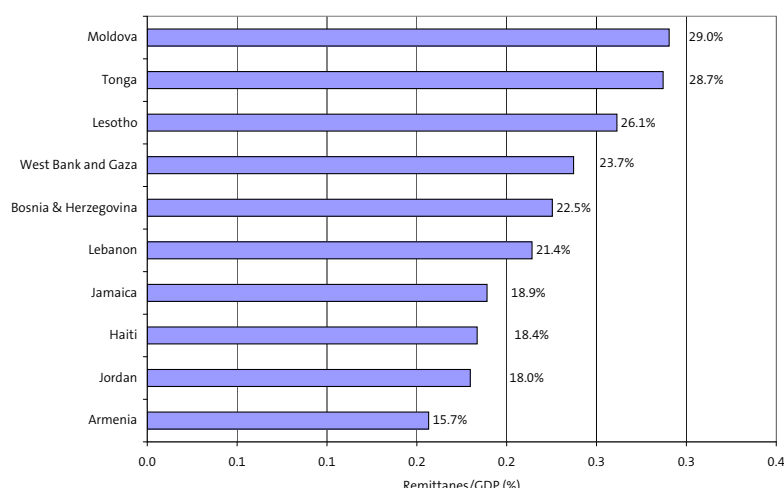
In terms of nominal amounts, China (US\$21.4 billion), India (US\$20.1 billion) and Mexico (US\$15.2 billion) were the main recipients of remittance payments in 2004. However, the Philippines (see Box 2), with migrant labourers spread worldwide, also registered a noteworthy sum of US\$10.0 billion. Populous India and China have the largest diaspora communities, which are based in numerous countries, whereas emigration from Mexico is mainly directed at the USA. Remittance payments from migrants tend to represent a more significant percentage of the gross domestic product (GDP) in small or low-income national economies.

Figure 2: Top 10 Remittance Receiving Countries in 2004 (nominal)



Source: IMF 2005 and the Central Bank of India

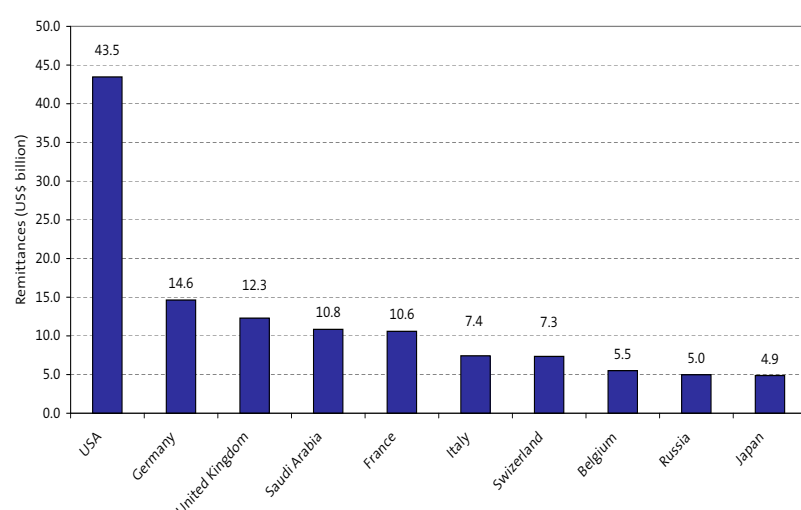
**Figure 3: Top 10 Remittance Receiving Countries in 2004 (percentage of GDP)<sup>12</sup>**



Source: IMF 2005, the Central Bank of India and World Development Indicators 2005.

Altogether, remittances amount to 2.2% of the GDP of all developing countries. The Republic of Moldova, the poorest country in Europe, is the country with the highest inflow of remittances as a percentage of GDP (29.0%). However, according to estimates, due to payments made through informal channels and real assets, the remittances are twice as high as the GDP. A large percentage of the population works abroad<sup>13</sup> due to the precarious economic and political situation in the country. Tonga, a small archipelago country in the South Pacific, is ranked second. More than half of its population lives abroad and 28.7% of its GDP is made up of remittances.<sup>14</sup> In terms of remittances as a percentage of GDP, Lesotho (26.1%) and the Palestinian territories (23.7%) rank third and fourth in the world, respectively. This ranking order is not solely based on the value of remittances; the current economic situation in a given recipient country, as reflected by the GDP, is also a crucial factor.

**Figure 4: Top 10 Remittance Source Countries**



Source: IMF 2005

Opposite the recipients are the remittance source countries, which primarily consist of industrialized nations.<sup>15</sup> With a total remittance outflow of US\$43.5 billion in 2004, the USA stands alone as the most significant remittance source country. The majority of immigrants to the US come from Mexico, India and other Southeast Asian countries and the Caribbean. The most significant remittance source countries in Europe are Germany (US\$14.6 billion), the UK (US\$12.3 billion), France (US\$10.6 billion), Italy (US\$7.4 billion), Switzerland (US\$7.3 billion) and Belgium (US\$5.5 billion).

## Effect of remittances on poverty, income distribution and growth

Unlike public development cooperation and foreign direct investment, remittances have grown steadily in recent decades and today serve as an important source of revenue in countless households throughout the developing world. Does financial support from migrants represent a step toward solving the problem of poverty in developing countries? Or does it simply place these countries in a new kind of dependent relationship?

Opinions vary greatly as to how remittances affect the fight against poverty, income distribution, spending habits, education, health, investment and growth as well as the balance of payments in developing countries. This is due, in part, to the lack of accurate data and the variety of research methods used to analyse it.

### Combating poverty

The influence of remittances on individual recipient household incomes can be seen as a positive one, at least in the short term. The principle advantage of remittances is that they are paid directly to individuals and families. Unlike state-controlled development assistance and direct investments from foreign countries, the money does not flow into companies and other organisations. Rather, it raises available household income, which in turn enables families to meet their own specific needs. It must be emphasised, however, that it is difficult to draw a direct comparison between remittances and the above-mentioned sources of development-related financing: Remittances represent a source of private capital, and it is therefore solely at the discretion of the migrants and their families to decide on the money's use.

Mexico's National Population Council (CONAPO) estimates that 1.4 million Mexican households benefited from remittances in 2004. For beneficiaries, this financial influx represents, on average, 47% of the family income. Similarly, the Philippines has come to the consensus that households receiving remittances are financially better off, because they average a monthly income that is 45% above the national minimum wage. In addition to increased



## Collective remittances

An individual migrant's support for his family back home no longer represents the only form of remittance. Monetary flows from immigrant organisations in host countries to communities back home are becoming more commonplace. As connections between internationally scattered diaspora communities increase and their identification with the home country intensifies, support for collective financial strategies increases. In France alone there were 1000 immigrant associations in the year 2000. Such associations have financed the improvement and expansion of infrastructure as well as prestigious projects such as the building of mosques in Senegal, Mali and Mauritania. As a result, remittances have benefited communities and the general public, not simply individual households.

However, the inflow of money from abroad brings with it the danger of creating additional dependency, as the push for development is not endogenous. As a result, many projects are either not carried through or not maintained following their completion.

Having learned from such mishaps, the Mexican province of Zacatecas created a state-run initiative called Tres por uno (Three for One). It attempts to channel remittance funds into productive enterprises. Together with the community, the local and national governments contribute one dollar each for every dollar migrant organisations spend on community projects. The real benefit of this initiative is not simply the mixed financing that results from it, but rather the increasing cooperation between migrant associations (so-called hometown associations) abroad, the community and local government. The co-operation, founded in 1986, has always placed an emphasis on collaboration at the social and political level. They have profited most from the synergies and learning processes that have arisen from meetings between interested parties. Unfortunately, lasting economic growth has not yet been generated, despite the successful realisation of civil works projects.

income, remittances also offer beneficiaries a certain amount of security. While foreign direct investments have been especially subject to fluctuation, remittances have served as a stable, steadily increasing financial inflow to developing countries since 1990 (see Figure 1). Due to their consistency even during economic troughs, remittance payments offer recipients an extremely reliable source of income. Anti-cyclical increases are common, i.e. migrants abroad increase the scope of their family support during times of economic crisis. Such behaviour helped buoy the Philippine economy during the Asian financial crisis. It was possible to avoid a recession solely through a surge in remittances, which sustained domestic consumption and helped the country overcome a slump in exports. Following Hurricane Mitch in 1999, El Salvador's government used this behaviour to its advantage, asking its citizens living in the US to increase support to families back home.

The immediate increase of available family incomes is a vital means of support, especially for middle- to low-income households. This added income not only increases recipients' living standards, it also minimises vulnerability during times of crisis or natural disasters.

## Income distribution

A comparison of data from different case studies does not reveal a consistent pattern concerning the effects of remittances on income distribution; in some cases, it even reveals conflicting results. These variations can be attributed, in part, to traditional patterns of migration. As a rule, individuals from the middle class tend to migrate first, as only they can afford the high costs involved. As soon as migration networks are established, the cost of migrating decreases significantly, making it possible for poorer groups of people to emigrate. It is assumed that remittances reflect this migration trend and, therefore, temporarily increase income disparities in the sending countries. At first, remittances from middle-class migrants increase the level of income in middle-class households, widening the income gap, before poorer households are able to improve their income by sending a family member abroad.

## Spending habits

The improved income situation enjoyed by recipients of remittances also brings with it changes in spending habits. Additional financial resources are used primarily for daily expenditures, home construction, land purchase, medical care and education. A smaller fraction of the money is saved and possibly invested. The majority of funds, however, are used to cover ongoing living expenses. For a long time it was believed that spending on consumption did not generate lasting economic development. Current economic studies now tend to deviate from this line. The increase in household spending is now said to stimulate ongoing demand for consumer goods and services, which, in turn, triggers production and results in the creation of new jobs. This theory has already been supported by economic analysis which shows that increases in spending have a multiplier effect (see below).

The second largest expenditure target is home and land ownership. Although this tends to have a positive effect on the construction sector, it may have some negative consequences. In Egypt, for example, the price of land for agricultural purposes increased 600% between 1980 and 1986. This increase in demand was due, in part, to remittances. Such growth in demand for non-tradable goods like property and real estate can lead to a rise in inflation. Similarly, negative effects can occur if domestic production cannot keep up with the increased demand. This can result in an increase in imports and/or an appreciation of the exchange rate, impairing domestic production as exports become more expensive on the international market and, as a result, less competitive. However, strong fluctuations of this sort have not been proven empirically.

## Education and health

Many experts see the main value of remittances in improved education and health. A considerable portion of remittance spending goes to educating young relatives back home. A number of studies have already shown significant improvements in the educational level of younger generations. For example, the increased cash flow to the Philippines during the financial crisis in Asia led to a significant increase in school enrolment, a decline in child labour as well as a general increase in spending on education. Estimates for El Salvador indicate

that remittances, as compared to other sources of income, reduce the likelihood that urban children will quit school early by 10%.

It is difficult to measure the real effect of increased health-related spending. For example, it remains to be seen whether Mexico's migration trends alone are responsible for decreases in child mortality and increased birth weights, or whether this is also due, in part, to other factors. The most important migration-related benefits in the fields of health and education are – in addition to increased financial support – the heightened awareness and knowledge of these issues that migrants gain by living abroad.

### Investment

Another crucial component of sustainable development is the accumulation of real capital, which requires new investments. In this context, remittances could produce the greatest impulse for the creation of capital and labour market expansion in developing countries if they were used to finance entrepreneurial activities. However, this type of spending tends to occur least often. Studies show that in Mexico, for example, 95% of monetary remittances are spent on consumption and a mere 5 to 8% saved for future investments. Despite this low level of savings, remittances do seem to have a positive effect on the creation of new businesses in Mexico. A study conducted on small businesses in urban areas of Mexico revealed that remittances account for nearly 20% of total capital stocks.

However, the relatively widespread criticism that remittances contribute very little to sustaining structural improvements and generating development remains valid. Finding ways to increase the proportion of investment spending is certainly a challenge for the future. At the same time, few migrants seem able to make the career move from worker to entrepreneur. It is up to national governments to create a healthy financial sector and an investment-friendly climate so as to increase personal savings (including from remittances) and investments.

### Growth

Economic theory considers economic growth, i.e. increase in GDP, a basic prerequisite for escaping the poverty trap. To achieve growth, it is not the size of remittance payments that is important but rather – as argued above – the way in which the additional revenue is put to use. As previously discussed, the effects of savings and investment are greater than that of consumer spending. Nevertheless, consumer spending can also have positive multiplier effects for the economy as a whole. In the case of Mexico, it has been proven that for every dollar entering the country through remittances, the GDP increases by US\$2.69 in urban areas and by US\$3.17 in rural areas.

On the other hand, at the household level, isolated observations reveal that remittances may have a negative effect on growth. For example, Kenyan farmers with additional income from remittances have lower crop yields than those without financial support from abroad. The paradoxical phenomenon can be traced back to a change in incentives. The so-called moral hazard theory supports the notion that families in this situation no longer have an incentive to remain productive themselves, preferring to direct their energies into attracting support from relatives living abroad. Under these

conditions, remittances could lead to a decline in economic growth. However, it is doubtful that such behaviour can be attributed to all individuals. In this regard, it is extremely difficult to gather data concerning this phenomenon.

### Balance of payments

Finally, extreme increases in remittance values have a direct effect on a country's balance of payments. Monetary inflows not only fill the coffers of private households but also lead to an increase in the recipient side of the balance of payments. The entry of foreign currency into the country helps both to reduce foreign exchange shortages and to consolidate the balance of payments. Remittances, in contrast to other incoming payments from abroad, are advantageous, because they neither carry interest nor have to be repaid.

### Targeted emigration policy in the Philippines

There are many calls for political strategies to optimise the development potential of remittances. Up to now, only a few countries have developed official strategies pertaining to migration and remittances. The Philippines are among the few countries that, for decades, have managed emigration. Its „Overseas Employment Program“ has fostered and regulated temporary labour migration since 1974. In the beginning, many workers were sent on labour contracts to the Middle East on account of the oil boom. The goal was to reduce unemployment in the Philippines and to increase the flow of foreign currency into the country. The current rationale behind the program's continued existence is that it helps combat illegal migration and prostitution, and that it improves working conditions in host countries. According to government figures, more than 7.3 million Filipinos lived abroad in 2004, representing 8% of the country's population. Remittances received through official channels amounted to 5.2% of the GDP in that year. Saudi Arabia and Kuwait remain the major destinations for Filipino emigrants; however, private and governmental organisations place migrant workers in various countries worldwide. Since 1990, the government, under pressure from the population and external organisations, has been working harder to protect the rights and welfare of Philippine workers abroad. In order to protect migrant workers from exploitation, additional preparation courses for migrants were introduced to explain working conditions and migrants' legal position in host countries. To encourage increased remittance activity, special identification cards with integrated Visa cards and bank accounts were introduced, making the cost of money transfers more reasonable. Transfer fees amount to less than US\$3 and exchange rates are subject to market conditions.

Views on Philippine emigration policy are divided. Its means of managing temporary migration are considered exemplary, as no other country has managed to generate such organised and protected migration flows. However, critics note that the stated goal of abolishing irregular emigration has not been met; instead, there seem to be two parallel migration movements. Moreover, the cost of brain drain on Filipino society is significant, and even after nearly three decades of this emigration policy, no lasting change can be observed.

## Conclusion and future developments

As globalisation advances, it seems likely that migration flows and the resulting monetary flows to migrants' countries of origin will continue to increase. This trend should provide an impetus to examine the issue of migrants' remittances closely, in order to derive the greatest possible benefits for developing countries. The answers to many questions related to the effect of remittances on development, poverty alleviation, income distribution and economic growth, remain vague and require further exploration.

To this end, particular emphasis will likely need to be placed on improving available data, which are currently insufficient. A binding agreement between central banks and the IMF on standardised definitions and methods for compiling data related to the balance of payments would help improve research results. In order to draw conclusions about actual net gains from migration and create meaningful policy recommendations, sound data are required.

Efforts should also be made to contain the costs associated with cross-border money transfers. Although the rates have decreased markedly in recent decades due to an increase in the volume of transfers, additional reductions are desirable. Increased competition in the remittance market could put more pressure on prices, which would lower fees and, in turn, strengthen the flow of funds to developing countries.

In summarising the current academic discourse, it can be said that additional income from remittances has a positive effect on poverty reduction, consumer spending and investment, in a variety of ways. The effect of remittances on income distribution, however, varies case by case. There is still a consensus that direct investment benefits the economies of developing countries most, because it can generate lasting structural change and economic growth. Nevertheless, the fact that remittances are primarily used to pay for daily living expenses is now being viewed in a more positive light: consumption may generate economic impulses which, in turn, can lead to economic development and enduring structural change. Increasing the use of remittances for savings and investment must be an objective of a broader economic strategy to optimise the investment climate in receiving countries.

However, it is impossible to come to a general conclusion about the impact of remittances on developing countries. Remittances play a different role in each country, depending on the given economic situation and the time frame in question. The short-term economic impulses and improvements in household income brought about by remittances do not automatically translate into economic development and a lasting means of alleviating poverty among the general population. For this to happen, long-term structural changes are needed.

Is the growing volume of remittances enough to offset the costs of migration, in particular, the loss of highly skilled labour? It is extremely difficult to quantify the amount of development potential lost to a national economy due to brain drain. The more lacking a country is in specialised personnel, the greater the effect. Pessimistic observers do not consider remittances adequate compensation for the loss of human capital, as they do not have the potential to generate as much productivity as the missing workers. Remittances, along with

the gains from cyclical migration and diaspora communities certainly help cushion the loss of workers. However, it remains doubtful whether remittances can fully compensate for the loss or offer something of greater value.

### Footnotes

- 1 'Direct investment' is defined as financial involvement on the part of an organisation (or a person) directed at an organisation in another country and intended, depending on the type and extent of support, to have a lasting impact on the business policy of the recipient. According to the IMF definition, 'lasting impact' is usually expected when the support given amounts to at least 10% of the recipient's total capital. If the support represents less than 10%, the term 'portfolio investment' is used.
- 2 The figures have not been price adjusted. The growth of remittance revenues includes inflation in the remittance source countries (i.e. USA, Saudi Arabia, EU countries, etc.). Changes in currency exchange rates between remittance source countries can also affect remittance revenues. Because all data is represented in US\$, the amounts are lower when the dollar is strong and higher during a weak dollar, respectively. They have been expressed in US\$ for ease of comparison.
- 3 This was due to the increased surveillance of unofficial transfers following September 11th, 2001.
- 4 Defined here as the sum of remittances, direct investments, portfolio investments and official development assistance.
- 5 Data is smoothed by using three-year moving averages.
- 6 Other Transfers of Other Sectors are the second subcategory of private transfers besides Workers' Remittances.
- 7 See World Bank (2006).
- 8 The German Federal Bank reports only cash transfers as Workers' Remittances. It further supplements these data with estimates on the basis of statistics from the German Federal Employment Agency on the number of employed and unemployed foreign nationals who are subject to social insurance contribution (see IMF 2005). This, however, results in a strong underestimation, because neither migrants who have entered into employment without the full social insurance benefits nor those who were naturalised in Germany are included in the statistics. Migrants' remittances transferred by banks and all remittances of naturalised migrants are reported under the category Other Transfers of Other Sectors.
- 9 In the Balance of Payments Statistics Yearbook neither Workers' Remittances nor Other Transfers of Other Sectors are reported for the UK. We estimated the sum of the two by subtracting the General Government transfers from the total Current Transfers.
- 10 As done by the World Bank (2006) for selected developing countries and by Straubhaar and Vadean (2006) for all developing countries.
- 11 Migrants' Transfers have been disregarded in our calculations, because they are not explicitly reported in the Balance of Payments Statistics Yearbook. However, Migrants' transfers currently represent only a very small amount (US\$1.5 billion in 2004; source: World Bank) in comparison to the estimated total remittance flows (US\$225.1 billion).
- 12 Dates for the most recent publicly available information are as follows: 2003 for Haiti, 2002 for Tonga and 2001 for the Palestinian territories.
- 13 The Moldovan Intelligence and Security Service estimates that between 600,000 to one million Moldovan citizens (almost 25% of a population of some 4.4 million) are working abroad.
- 14 See Small and Dixon (2004).
- 15 Unlike in the case of developing countries, only the guest workers' employee compensation and workers' remittances were added. Other private transfers were not credited, since, as a rule, the central banks of industrialized countries add other financial flows to their balance sheets.

## References and Further Reading

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- International Labour Organisation  
<http://www.iom.int/>
- International Monetary Fund  
<http://www.imf.org>
- Migration Policy Institute  
<http://www.migrationpolicy.org>
- World Bank  
<http://www.worldbank.org>

## Additional Information

- Institute of Development Studies  
<http://www.livelihoods.org>

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