

International Migration, Remittances and Development: An Overview

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I. INTRODUCTION ¹

Until very recently, debates on the globalization of the world economy focused primarily on the flow of goods and capital, while population movements across borders had remained relatively under-studied. In the last couple of years, however, scholars, national governments, and international organizations are coming to realize that international migration is a central aspect of globalization, one with important implications for economic development and welfare, both in receiving and in sending nations. It is safe to say that the growing recognition about the significance of international migration is to a good extent the result of the impressive volume of income transfers from migrants to their families back home -international remittances. In the case of Latin America and the Caribbean, for example, the Inter-American Development Bank (IDB) estimates that remittance flows reached 62.3 billion dollars in 2006, exceeding foreign direct investment and overseas development assistance to the region.

Given the growing prominence of remittances, it is natural to ask whether they improve development prospects in migrant-sending regions and, in particular, raise living standards among remittance-receiving households, or whether they may simply be a "new development mantra" (Kapur [2004]), a fad that may soon subside. Remittances of course are not the silver-bullet that, by themselves, will raise receiving countries' development indicators to those seen in developed countries. Yet, as pointed by Rapoport and Docquier [2003], "the marginal value of a dollar of remittances is likely to be quite large", and as such they may help address some of the factors hindering economic development. Indeed, remittances may ameliorate some of the problems that plague developing countries, such as credit market failures, inequality in income and in opportunities, income volatility, and poverty. At the household level, remittances help to overcome such problems by supplying the resources necessary to acquire a house, open

a business, and pay for education or health expenses, all of which are usually beyond the reach of vast segments of the population in recipient countries.

Since remittances could have important implications for welfare in Latin America and the Caribbean, in 2004 the IDB launched a project aimed at assessing the extent to which migrant transfers translate into positive development outcomes. Eight articles, from among almost 50 proposals, received funding from the IDB to explore the impact of remittances on poverty and inequality, human capital, labor markets, investment and savings, among other topics. The emphasis of the project was to apply rigorous econometric techniques on micro-level data to measure how remittances affect development. The papers, published in this volume, were written by scholars at the forefront of the study of remittances and benefited greatly from comments by an academic advisor.² As such, the papers represent, in our opinion, important contributions to our knowledge on the subject.

In assessing the developmental impact of remittances, two initial issues come to mind. First, is the study of remittances in essence any different from that of migration (Rapoport and Docquier [2003])? Or, more precisely, should we strive to understand the impact of remittances separately from that of migration more generally? And, second, how is the study of the impact of remittances different from studying the impact of any other source of additional income? The first issue arises since the two processes are intertwined: remittances cannot happen without migration. Yet, there are important technical challenges that make it difficult to disentangle the effect of remittances from those of migration. In addition to the scarcity of reliable data, "migrant economic opportunities are in general not randomly allocated across households, so that any observed relationship between migration or remittances and household outcomes may simply reflect the influence of unobserved third factors" (Yang [2005]).

In view of these challenges, McKenzie [2005] argues that attention should be broader and focus on characterizing the overall effects of migration, instead of concentrating only on remittances. While we agree with McKenzie [2005] that remittances are part of the larger migration phenomenon and that the international and academic communities should strive to understand migration as a whole, we believe that does not preclude efforts to understand remittances by themselves. Indeed, one may want to devote particular attention to remittances, as policies aimed at facilitating international income transfers and at harnessing their developmental potential are likely to be more politically palatable than policies seeking to facilitate (or curtail) migration flows. In host countries, migration policy reform is controversial because immigration has a redistributive impact, usually affecting unskilled workers; because of fiscal considerations; because of the fear that an inflow of migrants may tear the social fabric; and, in recent years, because of the fear of international terrorism.³ In sending countries, fear of losing the most entrepreneurial or best-educated members of society is always a consideration in the mind of policy makers. Such considerations -whether justified or not- should not deter the international community from bringing the debate on migration to the forefront. In the meantime, we stress that it may be easier for countries to establish mechanisms and adopt policies in order to take full-advantage of remittances flows, even under the current migration environment.

On the second issue, it is tempting to think that the study of remittances is not different in any substantive way from the study of any other source of income, in particular government transfers. There is an extensive literature in the field of public economics that analyzes the impact of government entitlement programs, especially in developed countries. More recently, developing countries that have adopted conditional

cash-transfer programs (e.g., Mexico's *Progresa* or *Oportunidades*, or Brazil's *Bolsa Escola*) have evaluated the effectiveness of such transfer in improving living conditions among recipient households (child nutrition, school attendance, etc.). Why should we expect that the impact of remittances on, say, school attendance would be any different than that from a government transfer? What is new or different from what we already know from the existing literature? On this issue, we first point out that remittances may be countercyclical or less procyclical than other sources of household income, such as wages or government transfers, allowing households to diversify risk and smooth consumption. Indeed, insurance against income shocks may be one of the reasons for migrating and remitting income. In addition, the way remittances are used may differ to the extent that migration affects who makes spending decisions in the household. Mothers, who are less likely to migrate than fathers, may place more weight on spending on education or on saving.⁴ Remittance transfers may be also earmarked for specific uses such as education or housing.

This article presents an overview of the main and most recent contributions to the literature on the development impact of remittances. The goal is to put into context the rest of the papers in the present volume. We also review existing policy recommendations aimed at influencing the flow of remittances and harnessing their development potential.

II. THE DEVELOPMENT IMPACT OF REMITTANCES

In this section we review some of the existing studies that aim at assessing the impact of international migrant remittances on development. We pay particular attention to findings regarding household welfare. We should note that we do not attempt to survey a vast and often old literature, but choose to concentrate instead on more recent studies. In part this is the case because the latter often tend to rely on more comprehensive datasets, representative of larger segments of society, and apply advances in econometric techniques that yield more conclusive evidence on the subject at hand.

One must recognize from the outset that in drawing conclusions about the impact of remittances on household welfare one must deal with a number of challenging issues. First, there are data limitations arising from the inability of official sources to account for transfers using informal channels, affecting remittances statistics based on balance of payments and household surveys. Leaving aside the fact that remittance data are often inaccurate, it is the case that nationally-representative household surveys rarely contain detailed information on migratory patterns or remittance income. For example, they may capture only recent migration behavior without specificity about the identity of the migrant member of the household. Moreover, national household surveys typically consist of a cross-section of households which are rarely followed over time, preventing researchers from analyzing changes in behavior in response to changes in migratory and income transfer patterns. Although there exist surveys that collect extensive information on migration and remitting patterns for a sample of households, they typically focus on high-migration areas and are therefore not nationally representative. In addition, some of these surveys rely on retrospective information provided by respondents to obtain individual migration histories and are therefore subject to inaccuracies. Despite these limitations, studies based on this subject provide a wealth of useful information on the impact of remittances.

A second challenge that researchers must grapple with is disentangling the effect of remittances on a given aspect of household welfare or development, from that of migration more broadly, as suggested earlier. The latter has an impact on development and household

welfare through channels other than remittances, such as the disruption of family life, effects on the labor market, the so-called "brain drain", or the acquisition of knowledge in the host country that is then transferred to the sending region. Indeed, remittances and other aspects of migration could either reinforce each other or work in opposite directions. For example, overseas transfers relax income constraints that in turn allow families to invest in the schooling of children. On the other hand, the disruption of family life from migration of one or both parents or a reduction in the cost of emigrating for youths as networks of migrants are created could reduce the incentives for children to continue their education. Isolating the specific impact of remittances is made difficult not only by the data limitations discussed before, but by the fact that remittance-receiving families are typically the ones in which a family member has emigrated. In the context of an econometric exercise, the latter is bound to result in multicollinearity problems that make it difficult to draw reliable inferences.

A third issue has to do with the difficulty in identifying a causal relationship from remittances to household well-being. In all likelihood, causality runs in both directions. While the cost of emigration are not trivial and therefore prevent the poorest members of society from migrating, the perceived need to improve their families' living conditions is one of the factors that drives migrants to move to another country and to send remittances back home. In addition, there may be unobserved reasons -such as pressing medical needs, for example- why households may opt to send one of its members to work abroad or why an existing migrant may decide to remit some of its income back home. It follows therefore that the decision to emigrate or to remit may be heavily influenced by the living conditions of the household and that migrants and remitters do not constitute a random sample of the larger population. This poses important hurdles to empirical researchers who want to understand how remittances, and migration more broadly, affect household welfare. A strategy to deal with that problem is to find a variable that is correlated with remitting behavior, but not with the outcome of interest -an "instrumental variable", using the terminology of econometricians- in order to identify the causal impact of remittances on the outcome of interest. Unfortunately, finding such instrumental variables proves not to be trivial and much of the recent work on the subject, as in much of current applied econometric work, revolves around the search for the best identification strategy.

Keeping in mind the challenges that researchers on this subject must face, we now turn to summarizing some of the findings regarding the impact of remittances on development and household welfare.

THE USE OF REMITTANCES

International evidence indicates that remittances cover, first and foremost, current or daily expenditures, followed by education and health care expenses. Surveys in Latin America and the Caribbean show that daily household expenses (food, rent, utilities) absorb between 46% (Brazil) and 84% (El Salvador) of remittances; education expenses take between 2% (Ecuador) and 17% (Dominican Republic); investment in a business use between one percent (Mexico) and 10% (Brazil, Guatemala) of remittance income. Remittances going to saving can reach as high as 11% (Guatemala) and those for acquiring property 7% (Brazil).⁵

Regarding the intended use of remittances, Amuedo-Dorantes and Pozo [2004] report that in Mexico the main (declared) reason migrants send money back home is to cover health expenses (46% of remitters), food and maintenance (30%), construction or repair of the dwelling (8%), and debt payment (6%).⁶ Cerrutti and Parrado's study on Paraguayan migrants in Argentina, included in this volume, also shows that remittances are

intended to be spent primarily on household expenditures, education and health care, with the category "household expenditures" being the largest.

The fact that existing evidence consistently shows that only a small fraction of remittances is used for enterprise financing has led some to question the ability of remittances to serve as a catalyst for development. Such views are unfounded, in our opinion, as spending on education, nutrition or health, for example, are important investments that may promote long-term economic growth. As we will see in the next section, there is a growing body of evidence that remittances indeed help promote investment in human capital, as well as having a positive impact on other development areas.

POVERTY AND INEQUALITY

A first question that naturally arises is whether remittances lead to reductions in poverty among recipient households. Such question goes beyond mere academic interest as it is the subject of debate in policy circles.⁷ Despite its importance, few authors have ventured into analyzing the subject. Existing findings suggest, however, that remittances unambiguously reduce poverty but that their impact is small, with its magnitude depending on how poverty is measured. Adams [2004] and Adams and Page [2005] use three different measures of poverty calculated relative to the definition of the national poverty line: the poverty headcount index or incidence of poverty, that is the share of the population whose income or consumption is below the poverty line; the poverty gap index or depth of poverty which provides information regarding how far off households are from the poverty line; and the squared poverty gap which measures the severity of poverty by taking into account not only the distance separating the poor from the poverty line, but also the inequality among the poor.⁸ Although the two studies differ in that they use different data sources-with Adams [2004] using national survey data on Guatemala and Adams and Page [2005] macro-data for a panel of 74 low -and middle-income developing countries- they reach similar conclusions, except for the poverty line. Both studies show that international remittances have a statistically significant impact on the poverty headcount index albeit the magnitudes are small. In the country panel study, a 10% increase in the share of international remittances in a country's GDP leads to a decline in the incidence of poverty of 1.6%. In Guatemala, international remittances actually increase the level of poverty by 1.1%. However, in both studies international remittances have a much larger impact on reducing both the depth and severity of poverty. In Guatemala, the severity of poverty (the squared poverty gap) is reduced by 20% when remittances are included in household expenditures. When considering the country panel the authors show that both poverty measures decline by 2%.

Looking at the case of Mexico, Esquivel and Huerta-Pineda use the national household survey on income and expenditures for the year 2002 to investigate the impact of remittances on poverty. The authors use Mexico's official definition of poverty, which is based on whether households can afford three different baskets of goods and services, distinguishing between urban and rural areas. The first basket considers only expenditures in food; the second includes food, health and education expenditures; while the third one adds in expenses in dressing, home and public transportation. Their results show that remittances recipients households are less likely to be poor.

López Córdova [2005] uses a cross-section of Mexican municipalities and studies the correlation between the fraction of households whose income is below two alternative thresholds -less than two or less than one times the minimum wage- and the percent of remittance-receiving households. Those thresholds roughly coincide with

official figures on the incidence of poverty and extreme poverty, respectively. He finds that as more households in a given municipality receive remittances, the incidence of poverty declines, although extreme poverty remains unaffected. The latter results are consistent with the idea that the poorest families cannot afford to defray the cost of emigration and therefore do not benefit from overseas income transfers.

An understanding of the impact of remittances on poverty would be incomplete without knowledge on how the former affect the distribution of income and/or assets in the receiving country. This is particularly true for Latin America and the Caribbean, where income distribution is worse than in any other region of the world. The IDB [1998] estimates that poverty in Latin America would be significantly lower if the distribution of income were similar to that of other regions. Inequality also affects poverty levels to the extent that it hampers growth and, further, to the extent that it reduces the marginal impact of growth on poverty abatement [De Ferranti *et al.* [2003]]. Therefore, remittances may affect poverty to the extent that they change distributional patterns in the receiving country.

What is the relationship between remittances and inequality? Theoretically, this relationship should be viewed as a dynamic process, with an early increase in inequality followed by decreases over time. As McKenzie and Rapoport [2004] argue, when migration to a new destination starts taking place, the cost of emigrating is usually high, implying that, in the presence of liquidity constraints, only high-income members of the population can afford the move. As the number of migrants in that destination increases, however, the cost of emigration declines giving individuals in lower-income households the opportunity to emigrate. This is because migration costs include not only transportation and border-crossing fees, but information costs about the specific destination to choose, the search for a job, shelter and so on. Such information costs are significant and tend to decrease as the size of a network of migrants augments.⁹ As a result, over time remittances should accrue to low-income households, thereby reducing income inequality at the origin.

Theoretical and empirical conclusions are not straightforward, however, as the impact of remittances on inequality may be negative even in the long run as other factors come into play (see Rapoport and Docquier [2003]). Studies that find that remittances may lower inequality of household income distribution in the origin country include Stark, Taylor and Yitzhaki [1986] and Taylor [1992]. They both find support for the process described above in that inequality in Mexico, as measured by different Gini indices, decreases with remittances coupled with the village's migration history and, in the case of Stark *et al.* [1986], with the extent to which 'migration information' spreads across the village. In addition, Taylor [1992] finds that, over time, remittances allow for the accumulation of productive assets that increase the productivity of the farm, so that the long run impact of remittances on lower inequality are increased.

One criticism to the two studies is that they take remittances as exogenous income that simply adds to the household's current income. Adams [1989] and Barham and Boucher [1998] adopt an alternative approach which views remittances as a substitute for the labor income that the household would have earned had the migrant stayed home. Their reasoning is that, in computing what the Gini index would be in the absence of remittances, if one does not consider what the household would have earned had the migrant stayed, then the inequality among households appears to be higher and, consequently, the gap with the Gini index-cum-remittances appears to be wrongly larger. Thus, remittances would seem to have a larger role in reducing inequality. Following this approach, Adams [1989] in the case of Egypt and Barham and Boucher [1998] for Nicaragua find that remittances raise inequality in the home country.

More recently, Unger [2005] using a different and more aggregated approach finds a positive and significant relation between per capita income growth and the percentage of households that receive remittances across communities. The author concludes that there is convergence in per capita income of the Mexican municipalities that can be associated with remittances.

LABOR MARKETS

A second question of interest is how international remittances affect the labor market in the receiving country. Aside from other channels through which migration may influence labor market outcomes, remittances would have an effect of their own through their direct impact on the decision of individuals to join the labor force or by facilitating investment in new enterprises that result in net job creation. There can also be indirect effects. For instance, many studies show that remittances increase consumption of non-tradables, in particular in housing. The consequences for employment creation in the construction sector could be significant. Indirectly, remittances could have an effect on labor markets in the longer run through their impact on schooling decisions, although here the effects are more ambiguous.

There exist a handful of studies that investigate the effects of migration in the recipient country labor market, but only few that consider the specific effect of remittances. Funkhouser [1992] used data from a survey in the capital city of Managua, Nicaragua, and found that remittances contribute significantly to a decrease in the labor force participation of women (5.0 percentage points) as well as men, although to a lesser extent (2.1 percentage points). The author also found that remittances increase, albeit slightly, the probability of self-employment, 1.2 percentage points for men and 1.1 for women. Hanson (this volume) uses the 2000 population census survey in Mexico and presents evidence showing that international remittances are associated with lower female labor supply. Again the results for males are similar but weaker, although the author points to potential estimation problems.

Chami, Fullenkamp and Jahjah [2005] set up a model in which remittances give rise to a moral hazard problem: recipient household members use transfers sent by migrants to reduce work effort. The authors go on to argue and to present evidence that such disincentives to work may translate into reduced growth in a cross-country regression. But a reduction in labor force participation could have positive effects. For example, Duryea, López-Córdova and Olmedo [2005] show that the decline in mothers' labor force participation lowers the incidence of infant mortality. In addition, Yang [2003] shows that remittances reduce labor force participation and increase schooling among Filipino children.

HUMAN CAPITAL

A particularly important question is whether remittances allow households to increase their investment in human capital, either in the form of greater schooling or health care expenditures, particularly on young children. An answer to this question is relevant as it affects not only today's well-being, but also since it allows future generations to break the cycle of poverty and since human capital improves a country's growth prospects.

Remittance transfers may improve education and health outcomes as they relax income constraints that limit optimal human capital investment. The impact is blurred, however, by other effects on household decisions as migration takes place, as discussed before. Analyzing the impact on schooling decisions is particularly complex as population movements

alter the returns to education across countries, as the possibility of emigrating leads people to compare those returns in the sending and host countries, as remittance income may be used instead to defray the cost of emigration, among other reasons. The specific impact of remittances on education is therefore an empirical question and may be in all likelihood country specific, preventing us from extrapolating conclusions from one context to another.

A number of studies indicate that remittances improve educational attainment among children in recipient households. Cox Edwards and Ureta [2003] estimate the probability of dropping out of school in El Salvador and find that remittances, irrespective of the amount, lower the likelihood of leaving school. Interestingly, the authors find that remittances have a much larger impact on reducing the chances of dropping out of school than labor income and that the latter effect is more important in urban than in rural areas. In urban areas, US\$ 100 of remittances (the median level in their sample) lowers the hazard of leaving school while enrolled in the 1st through 6th grades by 54% (14% in rural areas). In grades 7th through 12th the hazard is lowered by 27% which is 10 times (2.6 times in rural areas) the effect of other sources of income. Yang [2003] studies the case of the Philippines and finds that for children aged 17-21, a rise in remittances equal to 10% of initial household income leads to a 10.3% increase in enrollment rates. Interestingly, the author uses the exchange-rate turmoil of the Asian crises and differences in the destination of migrants as a source of exogenous variation in remittance income, allowing him to identify the causal impact of remittances on schooling.

Kugler and Lotti also look at the case of Central America. They look at the impact of remittances on human capital in a general equilibrium framework that considers not only remittance-receiving households, but non-recipients as well. In their view, remittances can have two opposing effects. On the one hand, recipients have enhanced schooling opportunities but they may eventually emigrate. On the other hand, non-recipients may see greater schooling incentives, accompanied by increased incentives for consumption and leisure. They conclude that remittances can increase human capital and reduce unemployment when education costs and the brain drain are sufficiently low.

López Córdova [2005] shows that illiteracy rates among children 6-14 years old are lower, other things equal, as the fraction of remittance-receiving households in a given Mexican municipality increases. Moreover, he finds an impact on improving school attendance among children aged five, but no such effect on children 6 to 14, and a disincentive to stay in school among teenagers 15 to 17 years old. The latter is consistent with findings by Hanson and Woodruff [2003] and McKenzie and Rapoport, both looking at the impact of migration more broadly. Hanson and Woodruff [2003] find that migration improves school attendance among boys and girls aged 13 to 15. The result for girls is particularly important as they are usually at risk of dropping out of school.

McKenzie and Rapoport consider how migration affects education inequality in Mexico. This is an important issue, as the literature on inequality has gone beyond looking at the distribution of outcomes, such as income, to emphasizing the distribution of assets and opportunities. As De Ferranti *et al.* ([2003] p. 3) argue, the latter are "crucial determinants of outcomes". Education is an important asset directly linked to future income. Education inequality in Mexico is one of the largest among Latin American countries.¹⁰ McKenzie and Rapoport show that migration reduces educational inequality, especially for girls, by perversely reducing schooling at the top of the education distribution.

Beyond their impact on education outcomes, remittances can play an important role in countries where the public healthcare system is not able to provide universal health

insurance and adequate treatment or preventive care. Latin America is a notable case in this regard, as reflected by the need to rely on out-of-pocket expenditures to finance health care. Latin Americans out-of-pocket expenditures amount to 75% of all private expenditures on health,¹¹ compared to less than 40% in OECD countries; the figures for the Dominican Republic, El Salvador and Mexico, three large remittance-receiving countries, stand at around 90% or more.¹² It is not surprising, then, that migrant surveys show that an important motivation for transferring income to their families in their countries is to cover health expenditures, as we saw earlier.

Amuedo-Dorantes, Pozo, and Sainz look at the role played by remittances in health expenditures in Mexico, where approximately 50% of the population is uninsured. Their results indicate that healthcare expenditures rise in response to the receipt of remittances, and that such expenditures are more responsive to increases in remittance than non-remittance income.

The studies we are aware of on the impact of remittances on health outcomes look at the case of Mexico and focus on infant health. The earliest study, by Kanaiaupuni and Donato [1999], finds that in Mexican communities experiencing high rates of migration, infant mortality is higher. However, the disruptive effect of migration is ameliorated through remittances' flows. Frank and Hummer [2002] analyze how the migration process affects the risk of low-birth weight -an important indicator of child survival and brain development- and find that membership in a migrant household provides protection from the risk of low birth weight largely through the receipt of remittances. A recent study by Hildebrandt and McKenzie [2005] overcomes some concerns about the robustness and representativeness of the two preceding studies. Hildebrandt and McKenzie [2005] confirm that children in migrant households have a lower mortality rate and higher birth weight, mainly thanks to remittances but also to the spread of information on healthcare that migration involves. Similarly, findings by Duryea *et al.* [2005] suggest that remittances have a positive impact in reducing infant mortality that may work through better housing conditions, by allowing mothers to stay home and care for their children, or by improving access to public services (e.g., potable water). Finally, López Córdova [2005] shows that infant mortality across Mexican municipalities declines as the percent of remittances-receiving households increase.

INVESTMENT AND SAVING

It is often argued that remittances are mainly used for conspicuous consumption and that little is left to undertake productive investments. So far we have seen that remittances help households move out of poverty, lower mortality rates, and increase educational attainments. In addition, empirical studies show that remittances are invested in productive activities when profitable. Not surprisingly, Durand, Kandel, Parrado and Massey [1996b] show that migrants prefer to remit to economically dynamic and entrepreneurial communities than to stagnant areas. Remittances also appear to respond to a community's access to the main transportation network, which is important in order to get products delivered to the market on time. Fortunately, many communities in remittance-receiving countries have the conditions needed to start a business and, in those where opportunities exist, remittances appear to be invested in productive activities. Remittances have the potential to help entrepreneurs overcome credit market failures prevalent in most migrant sending countries. In the latter, where access to credit by low-income households is often difficult to obtain, (short-term) migration is often the solution to accumulate the necessary capital to start a business.

In a study by Massey and Parrado [1998] focusing on 30 communities in the six largest migrant-sending states of Mexico, an average of 21% of businesses were initially financed with U.S. earnings. At the household level, a unit increase in the log of remittances increases the probability of investing in a business by 16%. Using a cross-section of more than 6,000 self-employed workers and small firm owners located in 44 urban areas of Mexico, Woodruff and Zenteno [2004] show that remittances are a significant source of capital for microenterprises. Estimation results display a much larger impact of remittances on microenterprise development than had previously been estimated in community-level surveys. Finally, although investment in productive activities seems to be larger in urban areas, the results suggest that the impacts spread well beyond the rural areas from which migrants have traditionally come. Woodruff (this volume) expands on the previous study by looking at the connection between migration and microenterprises over time, allowing him to derive conclusions about the causal link between the two. He finds that investment and employment is associated with migration among female-owned microenterprises. For males, evidence about a causal impact of migration on investment and employment is stronger. He also finds that entrepreneurs in high-migration regions of Mexico have higher earnings.

Dustmann and Kirchkamp [2001] in a study using data from a survey on returned Turkish immigrants,¹³ show that about half of the returning population of immigrants becomes active as an entrepreneur after return, and that the capital for starting a business stems from savings and capital acquired abroad. In this sample, 32% of all returning migrants create jobs through entrepreneurial activity, and 12% of returning migrants employ non-family members as workers. McCormick and Wahba [2001] also found, for the case of Egypt, that total overseas savings (and time spent overseas) have a positive and significant effect on being an entrepreneur. Finally, Adams [1998] looks at the effects of international remittances on rural asset accumulation in Pakistan and show that remittances have a more important statistical effect on the accumulation of rural assets than total labor income has.

Yet another form in which remittances can facilitate saving is through investment in housing. Parrado [2004] analyzes the impact of remittances on home ownership and housing quality in Mexico. The author cites a report by the *Centro de Información Para el Desarrollo* [1991] that confirms, as mentioned above, that the main factor limiting house ownership in Mexico, as in other Latin American and Caribbean countries, is "an almost total lack of access to credit or access only at very high interest rates." The latter obviously prevents low- and middle-income families to obtain any type of credit, especially those households that do not possess any assets that may be used as collateral. Under such circumstances, migration may be in part conceived as a strategy to accumulate the necessary capital to buy a house or to improve existing ones. Using data from the Mexican Migration Project, Parrado [2004] shows that having been in the United States during the previous year increases the likelihood of home acquisition by 1.2 times. Also, every additional year of work experience in the United States rises the likelihood of home ownership by another 2.8%. When looking at the improvement of already owned dwellings, the author finds that migrants' houses back in Mexico are more likely to be in better conditions (as refers to floors) and to have a larger number of rooms regardless of the household size. As suggested above, Duryea *et al.* [2005] find that improved housing conditions may have an important impact on reducing infant mortality. Interestingly, Parrado [2004] finds that migration increases the likelihood of financing the purchase of a home through a bank loan.

III. POLICY RECOMMENDATIONS

As the previous section suggests, there is ample evidence that indicates that remittances have a positive and significant impact on development outcomes. In this section we present a compendium of policy recommendations made by different international organizations, think-tanks and scholars working on remittances in order to harness the full development potential of remittances. Recommendations are grouped according to the following objectives: lowering the cost to remit; bringing both senders and receivers into the financial system and increasing the benefits migrants can extract from the financial system; increasing the inflow of remittances and its circulation through official channels; counteracting negative macroeconomic impacts; enhancing local development by increasing and directing remittances inflows to particular projects; improving the collection of remittance data.¹⁴

Lowering the cost to remit: Even though costs have fallen substantially in recent years, they remain quite high. The remittances market has some features that make it special. Transactions involve inevitably agents located in different countries; costs are generated in both countries; and, costs are influenced by the exchange rate, a component that agents do not control directly and the level of which is not always known to consumers so that sellers can mask part of their fees behind it. Given this scenario, practically all institutions and authors call for a reduction of fees and deliver advice as how to succeed in the task. De Luna Martínez [2005] argues that efforts to tackle costs down have to be undertaken in both sending and receiving countries and that a common approach and coordination between authorities of both these countries is needed to fight the failures that operate against a reduction in the fees. In general, measures proposed in the literature to lower costs refer to overcoming low competition among service providers (De Luna Martínez [2005], G8 [2004], Spatafora [2005], Kapur [2004], IDB [2004b]); poor information disclosure for senders and recipients (De Luna Martínez [2005], IDB [2004b]); poor payments-system infrastructure that discourage migrants from using formal financial institutions to send money home [De Luna Martínez [2005], G8 [2004], Kapur [2004], IDB [2004b)]; restrictions for cross-border operations (De Luna Martínez [2005], G8 [2004], IDB [2004b]); regulatory impediments, for example, governments should ensure non-discriminatory access to payment systems for the private sector, consistent with strong supervisory standards (G8 [2004], IDB [2004b]); and, to seek partnerships and alliances [IDB [2004b)].

Increasing the use of and benefits from the banking system: With respect to the banking system, political authorities should act not only at the consumer level but also at the banking system level. At the consumer level (remitters and recipients), governments can promote the use of the banking system by increasing financial literacy (De Luna Martínez [2005], IDB [2004b], Spatafora [2005], Lowell and De la Garza [2000]) which entails both raising awareness of the benefits of being banked -for instance access to credit or mortgages- and informing consumers of their rights involving transfer transactions. However, one of the reasons a large part of the population is unbanked in Latin America, in particular, lies within the banking system itself. In effect, not only is there a lack of infrastructure in rural and remote areas, but also they are often less competitive than other available intermediaries. Here, political authorities could encourage financial institutions to enlarge their presence in rural areas as well as the range of services proposed to consumers (Kapur [2004], G8 [2004], IDB [2004b], Puri and Rizema [1999]). In cases where associations are not spontaneous, governments should encourage cooperation

between remittance service providers and local financial institutions as, for instance, microfinance entities and credit unions (G8 [2004], IDB [2004b]). Orozco offers a detailed look at the case of nine financial institutions in the region in order to understand the scope of services they offer to potential remitters.

Increasing the remittance flows: The IDB [2004a] has called on public authorities to do no harm by avoiding to tax or to overregulate remittance flows.¹⁵ Other actors have made proposals that are highly desirable in their own even if no remittances flows are involved. These are to pursue sound macroeconomic policies, in particular with regard to exchange and interest rates (Spatafora [2005], Puri and Rizema [1999], Addy, Wijkström and Thouez [2003]).

Managing macroeconomic impacts: Spatafora [2005] suggests that countries receiving large flows of remittances should accept a greater degree of flexibility of their exchange rate than would otherwise be necessary in order to avoid undesirable effects on their exporting sectors. Kapur [2004] proposes that remittances inflows could be used to securitize future receivables so as to augment foreign credit ratings.

Enhancing local development: Few international organizations have engaged their efforts to foster the developmental impact of remittances in recipient communities. The IDB's Statement on Remittances (IDB [2004b]) stresses the importance of promoting activities in local development. The G8 [2004] advocated for more coherence and better coordination among these international organizations in order to find synergies and also to prevent unnecessary redundancies of efforts. They also recommend creating market-oriented local development funds and credit unions that would offer remittance-receiving individuals larger options to invest in productive activities. Lowell and De la Garza [2000] advocate for the support of Hometown Associations and, in particular, their involvement in local development. Both Puri and Rizema [1999] and Lowell and De la Garza [2000] propose to pay more attention to return migrants, for instance, through projects that help them to get acquainted with regulations or to select an appropriate area of investment.

Improving data collection: Numerous international organizations, think tanks and scholars have called for an improvement in the collection of data on remittances. Kapur [2004] goes further and specifically suggests that concerned governmental agencies or ministries should become part of the IMF's Special Data Dissemination Standards to both address the severe problems of consistency and timeliness of remittance data. Also, the author urges political authorities to create a spatial mapping of their overseas communities, not just by country but also by specific geographical location. This would allow financial intermediaries to better target these communities.

IV. CONCLUDING REMARKS

As we have seen, despite analytical challenges and data limitations, there is an emerging body of evidence indicating that international migrant remittances may have a positive impact on economic development and household welfare. The evidence is not free of controversy and further work is still needed, however. But we believe that the international and scholarly communities should take note of the importance of improving data collection and expanding our knowledge about how international migrant transfers affect the development prospects of receiving countries. More generally, the preceding discussion should support calls for bringing discussions on international migration more vigorously into debates on the globalization of the world economy.

We have also seen that a number of policy initiatives and recommendations have been launched in recent years to address the growing flow of remittances. Remittance institutions, public authorities, and civil society should strive to facilitate and reduce the cost of remittance transfers, mainstreaming remittance flows through the financial sector and leveraging their development impact. The Inter-American Development Bank has been at the forefront of these efforts in the Western Hemisphere. We stress that progress in these areas is perhaps more feasible politically than migration policy reform. Thus we believe that remittances deserve specific consideration, without losing sight of the larger potential of international migration to promote development.

Notes

¹ The present article is based on a lengthier working paper by López-Córdova and Olmedo [2006].

² Prof. Gordon Hanson, at the Department of Economics of the University of California, San Diego, was the academic adviser.

³ Hanson [2005b] offers a recent account of the debate regarding immigration reform in the United States, emphasizing public finance considerations.

⁴ Mexico's *Oportunidades* conditional cash-transfer program is structured in such a way that it is the mother, not the father, who receives transfer payments.

⁵ See Bendixen and St. Onge (2005), Table 3.2, for a summary.

⁶ Amuedo-Dorantes and Pozo [2005] use data from the Mexican Migration Project, which may not be nationally representative.

⁷ For example, representatives from the Mexican Ministry of Social Development have argued that remittances have a minimal impact in reducing poverty, based on the observation that poor households receive only a modest fraction of the overall transfer of income to Mexico ("Remesas no disminuyen pobres.- Sedesol", *Reforma*, 20 June 2005)

⁸ The second measure captures the mean aggregate income or consumption short-fall relative to the poverty line across the whole population, whereas in the third higher weight is placed on those households further away from the poverty line.

⁹ Munshi [2003] presents empirical evidence about the importance of such social networks, showing that Mexican immigrants from high-migration communities enjoy better labor market outcomes (higher wages, lower unemployment spells) than similar migrants from other regions.

¹⁰ Mexico ranks just second behind Ecuador in education inequality among students 13 to 17 years-old [De Ferranti et al [2003], p. 3]. In Mexico, on average someone in the lowest fifth of the population has only 3.5 years of school against 11.6 years for someone belonging to the richest fifth of the population.

¹¹ According to the World Development Indicators definitions, private health expenditures includes direct household (out-of-pocket) spending, private insurance, charitable donations, and direct service payments by private corporations.

¹² Data and definition from the World Bank's *World Development Indicators*.

¹³ Note that at the macro level there is not that much difference between remittances and repatriated savings. In fact the two are generally confounded in international statistics.

¹⁴ For the case of Latin America and the Caribbean, the Inter-American Development Bank (IDB [2004a]) has issued a statement outlining a set of core recommendations to facilitate remittance transfers to the region and to channel those transfers through the financial system.

¹⁵ Kapur [2004], IDB [2004b] and Spatafora [2005] have recommended that remittances-services providers be appropriately regulated and supervised to minimize the potential risk of money laundering and terrorist financing.

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