Migration and Economic Development
Impacts of Remittances on Sending Countries

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Introduction

Migration has steadily increased, bringing radical changes to society, moving beyond local and national borders and becoming global\(^1\). According to the International Migration Report 2020\(^2\), the worldwide number of international migrants (including refugees) is 272 million, of which nearly two-thirds are labour migrants. The migration process has brought enormous changes to our societies, within both the countries of origin (native country of the migrant) and destination (country where the migrant resides). In this discussion concerning labour migration and development, the role of remittances is an often-highlighted topic. Remittances refer to the money and goods that are transmitted to households by migrants working outside of their origin communities, either in urban areas or abroad. At the start of the twenty-first century these resource transfers represent one of the key issues in economic development\(^3\).

Recent data shows that remittance flows to low- and middle-income countries (LMICs) were expected to reach US$551 billion by the end of 2019, up by 4.7 percent compared to 2018 (figure below)\(^4\). Remittances now account for the largest source of foreign exchange earnings in the Low and Middle-Income Countries (LMICs), excluding China, and comes up to three times more than the amount received as Official Development Assistance (ODA) and significantly larger than Foreign Direct Investment (FDI) flows.

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In this context of ever-increasing size of international remittances, the main objective of this paper is to analyse the various impacts of remittances on the economic development of these migrant sending countries. For this purpose, the paper uses the existing literature on remittances, to analyse the various macro and micro impacts of remittances. In the first section, as a starting point, the paper tries to understand the different motives of migrants behind remitting the money back to the sending countries. In the next section, the paper will closely look at the micro level impacts of remittances on the recipient households, analysing both the positive and negative aspects associated with remittances. Similarly, the macro level impacts are also analysed in the final section, making use of existing literature to understand the effects of remittances on national growth, revenue and institutions.

Remittances: Definition and its motives

A number of empirical studies have examined the reasons why migrants remit. The most common theoretical reasons found in various studies include:

i) ‘Insurance’ motives, whereby migrants remit to insure households against adverse risks and external shocks (part of risk diversifying strategy)\(^6\)

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\(^5\) Ibid p.2
ii) ‘Altruistic’ motives, which assume that migrants remit due to emotional ties to relatives in home countries and with the desire to help them.  

iii) Investment as part of ‘self-interest’ motives, which also include personal consumption and entrepreneurial purposes.  

iv) ‘Contractual arrangements’ and ‘bargaining power’ within a household. For example, the debt payment that the family accumulated as a result of the cost of migration or payment based on an agreement made with the relatives or others before migrating.

Given these reasons, most of the empirical studies find that remittances are motivated by a combination of altruistic, investment and insurance motives. Additionally, as mentioned above, the motives to remit may also change over time based on changing needs, from the direct household consumption to long-term capacity building of households, as well as investment or savings. Studies also find that motivation to remit varies by gender, destination (international vs. internal migration) and household composition. For instance, a study finds that women from rural Mexico remit to ensure and assist the wellbeing of their families, whilst their male counterparts remit for investment purposes. Moreover, over time, the remitter’s decision-making power over the remittance could decrease and in some cases, it might shift towards the recipients, mainly because the decision to migrate and remit are intricate and the needs of remitter and recipient are coexistent. Therefore, from the review of empirical studies, it was found that remittances are embedded in a complex reality and are driven by different kinds of socioeconomic links between the remitter and the recipient, and the motives of remitting too were different from time to time.

Remittances: Micro level impacts  
Remittances as social insurance  
Evidence from various country-based studies find that remittance receiving households generally have higher levels of consumer spending and lower rates of extreme poverty than non-remittance receiving households. Ratha argues that remittances could play an important role as a

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10 Ibid p. 3  
'powerful anti-poverty force' because of their ability to increase the incomes of households in the sending countries\textsuperscript{13}. Another study conducted for the World Bank, analysed 71 developing countries and found a positive relationship between remittances and poverty reduction\textsuperscript{14}. The study statistically demonstrates a 3.5 percent decrease in the share of people under poverty with an increase of 10 percent international remittances from each migrant. At the country level, various studies using household survey data in Nepal\textsuperscript{15} and Ghana\textsuperscript{16}, also observe that remittances lead to reduction in poverty levels.

Another study by Adams and Cuechuecha suggests that remittances have a higher impact on reducing the severity and depth of poverty, rather than on reducing its scale\textsuperscript{17}. In support, a study analysing remittance flow from 33 African countries during the period 1990-2005, finds a decline in the depth and severity of poverty as a result of the remittance flow\textsuperscript{18}. Furthermore, studies reveal that migration and remittance flow are often a part of the risk-spreading strategies adopted by households and arise as a 'safety net' or 'social insurance' for the families in sending countries especially in times of political and economic crises\textsuperscript{19}. This dependence on remittances as a 'social insurance' mechanism reinforces the households' capabilities of resisting external shocks. Egypt during the Arab uprising demonstrates how the remittances from the migrants played an important role in supporting the families during times of political instability. When the FDI and ODA between 2009-2011 saw a decline, remittances inflows saw a sharp rise, which helped to sustain the communities\textsuperscript{20}.

However, these positive effects have been contrasted by some other empirical findings, which highlight the tendency to overvalue the effect of remittances in poverty reduction. Some studies have argued the ability of remittances to create a culture of dependency within migrant

sending households by undermining the recipient family members motivation to work, since remittances are received at assured intervals. A survey based study in Angola observed that 16 percent of households completely rely on remittances as income\(^\text{21}\). Similarly, such over reliance might halt progress in the local economy, and a decrease in remittances from the migrant due to various factors might deepen the vulnerabilities of recipient households. Another important factor to consider is that the ability to migrate and remit might not be available to all vulnerable sections of society. Not all vulnerable or poor households will have the initial capital and ability to bear the costs and risks associated with migration. This remains as a barrier for the poorest section of society\(^\text{22}\).

In this regard, the unlikeliness of the poorest migrating might result in increased inequality between migrant and non-migrant households \(^\text{23}\). Also due to the economic behaviour of recipient households, the prices of goods and services in the local market might increase resulting in disadvantage for non-recipient households. Additional studies on Mexican migration highlight how migration and remittances deepen inequalities within home countries and also between peripheral and central regions in the country\(^\text{24}\). However, in contrast to the previous argument, studies also show that consumption behaviour among the recipient households could positively impact, via the multiplier effect, the local economy and the incomes of non-recipient households\(^\text{25}\). These views suggest that non-migrant households too can benefit indirectly from the retail and investment activities of recipient households (housing and construction sector, development of enterprises). It must be noted that all these studies and findings reviewed in the section have been inconclusive. However, the development potential of remittances has been largely agreed upon, and in order to effectively harness the benefits of remittances, the local governments also have a key role to play, which needs to be emphasized in discussions regarding remittance-development.

**Remittances as a means for investment**

Several household survey results observe that remittance-receiving households make relatively higher investments in health care. This is evident from various studies conducted (in Sri Lanka and Mexico) where recipient households were observed to have higher birth weights,

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\(^{23}\) Ibid p .3


lower rates of infant mortality and higher health awareness\textsuperscript{26}. Similarly when it comes to the impact of remittances on education in sending countries, findings suggest a positive correlation where remittance flows have resulted in higher school attendance rate and educational achievement\textsuperscript{27}. A cross-country analysis of six sub-Saharan African nations shows a strong positive correlation between the average number of household members with a secondary education and the receiving of international remittances\textsuperscript{28}. In accordance, another study finds that remittance inflows tend to reduce the liquidity constraints of households, further allowing them to increase educational expenditure\textsuperscript{29}. This argument has been found evident in several country-based studies, including those in the Philippines and Guatemala\textsuperscript{30}.

Remittances are also said to allow recipient households to build their assets, both in terms of liquid (cash) and fixed (property), enhancing access to investment opportunities and financial services\textsuperscript{31}. This argument is established based on findings in Mexico and the Philippines which suggests that remittance inflows have yielded greater accumulation of assets in farm equipment, increased level of investment in small business and higher levels of self-employment in migrant sending areas.

In contrast, it has also been argued in various studies that remittances do not necessarily lead to long term investment, mostly due to the spending of remittances on consumption or on ‘consumptive’ investments (housing, luxury goods etc.) by the recipient households. A study which analysed the spending pattern of remittances found that a ‘significant proportion, and often the majority’ of remittances were spent on ‘status-oriented’ consumption goods.

**Remittances’: Macro level Impacts**

**Remittances’ impacts on national economic growth**

The academic literature that attempts to empirically assess the impact of remittances on economic growth is significantly growing. However, these studies have not been able to


\textsuperscript{28} Ibid p.5

\textsuperscript{29} Mara, I. et al. (2012) Analysis of Literature on the Effects of Remittances on Education and Health of Family Members Left Behind. 26 March.


establish conclusive evidence as to whether remittances contribute positively or negatively toward economic growth. Some of the empirical studies observe that remittances have had positive impacts on the economic growth of various countries. Another set of studies also establishes the significant positive impact of remittances on both bank deposits and bank credit to the private sector. These studies argue that remittances act as a substitute to other financial means such as insurance and credit, which might not exist in developing countries, necessarily. By stimulating consumption and investment, remittances may have the potential to reduce the rate of recession in specific countries and boost the local economy. Over the daily consumption needs, remittances give the chance for households to invest in better profitable economic and high-risk activities. Empirical Studies by Ratha suggests that remittances raise domestic savings and better financial intermediation, which is capable of improving the growth prospects of the sending countries. Similarly, a study on the developing countries in the MENA region, shows a positive correlation between remittances and the development of financial systems. However, these studies showing positive impact of remittances in sustaining national economic growth have been inconclusive and ambiguous.

In contrast, a comprehensive research covering up to 113 countries from 1970 to 1998, suggests that international remittances have a negative effect on per capita GDP growth. Using a different fixed effects model, the study finds a significant negative relationship between economic growth and international remittances for various groups of countries over different sets of years. Based on these findings, the authors conclude that remittances do not assist as capital for economic growth, but instead as a kind of compensation for countries with poor economic conditions. These contradicting results may also be due to difficulties in identifying the directions of the links between remittances and economic growth using instrumental variables, as it lacks control over endogeneity and reverse causation. However, as a recent study indicates, the net impact of remittances on economic growth strongly relies, on the one hand, on

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34 Ibid p.5
37 Ibid p.9
government policies to enhance their potentials and, on the other hand (and even more importantly), on how recipients use them\textsuperscript{38}.

Another aspect of remittances, which was found in various studies, is the ability of remittances to produce negative incentives if perceived as a permanent source of income. A study to understand the impact of remittances in Haiti, finds remittances to have negative effects on both working hours and labour market participation\textsuperscript{39}. Therefore, in case of overdependence, remittances may reduce the recipient’s prospect to work and increase the private consumption of (generally imported) goods as an alternative to financing domestic investments or savings\textsuperscript{40}. Additionally, some studies have observed that growing consumption among the recipients in sending countries may lead to an increase in the local market price and appreciate the exchange rate\textsuperscript{41}. As a result, this may result in the macroeconomic effect, known as \textbf{Dutch Disease} leading to failure of the tradable sector of the domestic economy, the rising of current account deficit, and inflation with weaker monetary control\textsuperscript{42}. The result of increasing pressure on wages may lead to job losses in the tradable sector, while the abrupt increase of prices can push up labour costs in the non-tradable sector, leading to overall loss of national competitiveness. This effect of remittances has been observed in Cape Verde and many countries in Latin America\textsuperscript{43}. Therefore, in order to minimize such adverse effects of remittances, governments needed to be aware of the pitfalls induced by the consumptive behaviours of recipients and put in place business incentives that will foster long-term investments, which in turn will result in greater benefits for the country as whole.

\textbf{Remittances: As a Source of Revenue for Local Government}

Both the World Bank and the IMF recognize the benefits of remittances as countercyclical and stable sources of external financing while assessing the limit of debt that low-income nations can safely handle\textsuperscript{44}. With the ability to borrow more when receiving high amount of remittances, the extra borrowing power that comes to states as a result of this could be used to fund investments, which in turn may promote national economic growth\textsuperscript{45}. In practice, the World

\begin{footnotesize}
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\item \textsuperscript{41} Ibid p.9
\item \textsuperscript{44} International Monetary Fund (IMF)/World Bank (2009) A Review of Some Aspects of the Low-Income Country Debt Sustainability Framework. IMF/WB, Washington, D.C.
\item \textsuperscript{45} Lubambu, K (2014) The Impact of remittances on Developing Countries. Director General for External Policies of the Union, Policy Department Study. European Union
\end{itemize}
\end{footnotesize}
Bank-IMF Debt Sustainability Framework launched in 2009 is allowing remittance receiving countries to carry higher levels of debt if the ratio of remittances is higher than 10 percent of its domestic income and 20 percent of exported goods and services.

However, on the other hand, a study by the World Bank has found that remittances can damage the quality of state institutions in the recipient nations mainly due to transparency factor, as they tend to increase the ability of the governments to have more or less expenditures without showing clearly the exact and full cost of government actions. The study uses a cross sectional analysis of 111 countries, in which they observe that a rise in remittances can lead to deterioration of institutional mechanisms and their quality (for example, corruption control mechanisms, rule of law etc.).

Similarly, another study elucidates that the flow of remittances, expanding the national capital inflows, may give a chance for the government to appropriate more resources and distribute among those in power rather than investing in community development projects. Hence a case of moral hazard could emerge because of the risk associated with government effectiveness and corruption. In such an instance, initiatives such as that of the World Bank may appear to be questionable, as there will not be any substantial evidence which supports the argument that much needed fiscal space generated by remittances will be used for development projects benefiting the population. Therefore, it is important to have a mechanism which enables the remittance recipients as well as local communities to access information on government accountability with respect to use of remittances-related revenues.

Conclusion

From the extensive review of literature focusing on the relationship between remittances and economic development in the sending countries, it was observed that migration and remittances are largely a part of the risk mitigating strategies followed by families and households in sending countries. As observed within a broader conceptual framework of migration and development, remittances were observed to have a positive impact in poverty reduction directly (by providing subsistence needs in households, such as housing) and indirectly (by providing a monetary base for asset creation and investments that benefit the overall community), in education, health and to stimulate economic growth. It also was seen as a sort of ‘safety net,’ providing insurance for households against economic downturn in sending countries. However, the outcome of remittances seems to be temporal and conditional at both macro and micro levels. As far as the macro level impact of remittances to the national economy is concerned, there are contrasting empirical studies. Quoting Chami and Fullenkamp, ‘there are many different paths through which remittances affect an economy (...) none of these paths is

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46 Ibid p.10
necessarily active at any given time – that is, many economic and social conditions determine whether any given path is active or significant\textsuperscript{48}. And many of these paths have opposing or conflicting economic effects. Therefore, from the evaluation of remittances on national economy and growth, it was observed to have a wide variety of multifaceted causal links and presents both positive and negative aspects, which may vary depending on the socioeconomic conditions pertaining in each country.

However, it is mistaken to expect and believe remittances to solve the deeply entrenched structural ‘barriers’ to development, such as political instability, misguided macroeconomic policies, corruptive habits, deficient infrastructure and insecure legal environment\textsuperscript{49}. To quote de Haas, ‘if states fail to implement general social and economic reform, migration and remittances are unlikely to contribute to nationwide sustainable development. Migrants and remittances can neither be blamed for a lack of development nor be expected to trigger take-off development in generally unattractive investment environments’\textsuperscript{50}. The most important factor required to harness the complete benefits of remittances is that the governments and authorities of sending countries must elaborate policies that are aimed at maintaining and strengthening political trust, ensuring a stable investment climate and effective market conditions, as well as improving public services and social security. Undoubtedly, these preconditions would result in maximization of benefits of migration and remittances at the domestic and national level.

\textsuperscript{48} Ibid p.11
Bibliography


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