

**The State of Remittance Research:
An Overview**

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**Policy Research on Remittances to Latin America and the
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The State of Remittance Research: An Overview¹

This document was prepared for the Inter-American Dialogue Conference, Policy Research on Family Remittances to Latin America and the Caribbean. The document highlights existing research on remittances and other diaspora-related activities that contribute to growth and development. It is not meant to be a comprehensive literature review, but rather an overview of the topics being addressed, as well as the gaps in the current research agenda. Annex A provides a summary of remittance-related research and activities being conducted by conference participants as reported by each organization.

I. Macroeconomics

In recent years researchers have sought to identify the macroeconomic effects of remittances on recipient economies. Research has focused on three key areas: the effects of remittances on growth, financial trends, and domestic currency and pricing. The literature on remittances and growth has generally analyzed remittances as a macroeconomic determinant. Solimano (2003), for example studied remittances as an independent variable, along with exports and public spending, and found that remittances positively affected GDP in Colombia and Ecuador. The World Bank's recent study, "Close to Home: The Development Impact of Remittances in Latin America" (Fajnzylber et al, 2006) also finds a positive though on average modest, impact of remittances on GDP in Latin American and Caribbean countries. Hamilton and Orozco, in a forthcoming USAID report study the impact of remittances on growth in three countries—the Dominican Republic, El Salvador, and Jamaica—using quarterly data in each country for six consecutive years to control for country specific variations. This analysis reveals that the impact on growth of remittances varies by country and highlights the need to further study country specific trends to better understand these differences and inform policy making and development project design.

In addition to analyzing remittances as a determinant of growth, a number of researchers analyze the impact of remittances on production factors such as capital. Fajnzylber et al (2006), study remittances, domestic investment, and aggregate growth volatility. They find that increased domestic investment resulting from remittances accounts for approximately one half of the impact of remittances on growth. They further find that this increased investment is associated with decreased growth volatility. Buch and Kuckulenz (2004) also study the relationship between remittances and capital. They find that remittances are positively correlated with increased official capital inflows and increased capital availability. They also find that remittances are generally a more stable source of financial flows than private or official capital flows. Ratha (2003) also studies the stability of these flows with similar conclusions.

Aggarwal et al (2006) analyze the relationship between remittances, deposits, and bank credit. Using Balance of Payments data they find remittances have a positive effect on both. Guliano and Ruiz-Arranz (2005) study the impact on remittances in developed and underdeveloped

¹ This paper draws heavily from, Hamilton, Eve and Manuel Orozco, "Remittances, Diasporas, and Economic Development," USAID (forthcoming).

financial systems. In the latter they find that remittances promote growth by functioning in lieu of formal financial services, such as credit and insurance. In more developed financial systems this effect is less important and ultimately turns negative.

With increasing concerns about the potential of remittance flows to cause Dutch Disease, a number of studies have analyzed the relationship between remittances and foreign exchange. The Fajnzylber et al (2006) find that remittances are likely to cause an appreciation of the exchange rate in Latin American and Caribbean countries. Loser et al (2006) argue that the results are not clear. Remittances place upward pressure on interest and exchange rates. However, an increase in imports or decrease in exports may counter these trends. Hamilton and Orozco (forthcoming), argue that current research, which uses annual exchange rate variations rather than monthly variations may obscure important differences between exchange rate and remittance flow trends and lead to incorrect conclusions regarding their relationship. Further, most of the research on remittances and exchange rates fails to take into consideration the dollarization effect on exchange rates. When remittances are paid in dollars this puts upward pressure on the exchange rate. The issue then is one of dollarization, not remittance flows per se. The research also fails to take into consideration the changing nature of the productive bases of many remittance receiving economies and the effect that this has on exchange rates independent from remittance flows. For example, in many Latin American countries banks have been investing in construction and real estate at the same time that US realtors have been investing in Latin American countries, increasing property values and appreciating local currency.

Rather than looking at remittances as a macroeconomic determinant, Orozco and Lowell (2005) look at the macroeconomic determinants of remittances. Studying Mexico, Colombia, El Salvador, the Dominican Republic, Guatemala, Ecuador, and Jamaica, they found that remittances respond to inflation and exchange rate changes in countries of origin. Ultimately, as this review suggests, more analysis is needed to understand the complex nature of the relationship between remittances and foreign exchange, including their relationship to other production factors and the productive bases of local economies.

Finally, a few studies have looked at the impact of remittances on poverty. Adams (2004) studied global remittances and poverty trends and found a statistical relationship between the two. He also analyzed household survey data in Guatemala and found that remittances reduced both the level and depth of poverty. Orbe (2006) looked at the relationship between remittances and income inequality. By incorporating remittances into the income equation he found that Gini coefficients declined indicating that remittances reduce income inequality. Fajnzylber et al (2006) find that remittances produce only small changes in Gini coefficients when compared with what would have occurred without these flows.

II. Remittances and Social Welfare

A few researchers have conducted country specific studies on the impact of remittances on social indicators such as educational access and attainment and health. In her January 2007 literature review on remittances and children's right, Cortes notes that the links between remittances and health have not been broadly studied. Several studies have found that remittances reduce infant

mortality. These include Lopez (2005) and Duryea et al (2005). However, while Lopez found that remittances reduced infant mortality in all communities studies, Duryea et al only found this to be the case in large urban centers. Kana'iaupuni and Donatu (1999) analyze the impact of migration on infant survival and child health. They find that the disruption of the family initially caused by the migration of a family member first results in a decline in children's overall health, but that ultimately remittances increase children's access to healthcare. Amuedo-Dorantes et al (2005) also find that remittances increased access to healthcare in origin communities. It is important to note that all of these studies were conducted in Mexico. There is a clear need for similar studies in other Latin American and Caribbean countries to identify potential country specific variations.

Cortes also reviews the literature on remittances and education. Her review reveals diverse results. Hanson and Woodruff (2003) and Whaba (1996) argue that the disruption in family life caused by migration can lead to lower school performance. Cortes maintains, however, that there is little empirical evidence to support their hypothesis. The remaining studies she cites, however, do suggest a tension between the potentially negative impact of migration and the positive impact of remittance income on education. In Ecuador, Pinos and Ochoa (1999) and Mora (2005) find evidence that the educational performance of children left behind has declined. Carling (2005) and others find that the expectation of migration has led an increasing number of youth to lose interest in education. On the other hand, Edwards Cox and Ureta (2003) find that remittances decrease the likelihood of dropping out in El Salvador. Cordova (2006) cites studies showing that illiteracy rates fall as the number of remittance-receiving households increases. And Aberman (2005) finds that remittances increase enrollment in secondary schools in Nicaragua.

Finally, although an increasing number of migrants are women, and women represent more than 50 percent of remittance recipients in many Latin American and Caribbean countries (Hamilton and Orozco, forthcoming), few studies have analyzed how gender affects sending patterns or spending patterns among recipients. With respect to the former, Cortes reports conflicting results in the studies she reviews. For example, Pessar (1986) found the female immigrants from the Dominican Republic were more likely to spend their money on consumer goods than to save for their return or send remittances, while men saved and remitted more. However, Chant and Radcliffe (1992) and Curran and Saguy (2001) found evidence that women tend to remit more of their earnings home than men.

With respect to recipients spending patterns, as Cortes reports, some studies find that women tend to spend more on the family's immediate and basic needs, including food, education, and health, while men often save or invest more. As Ramirez et al (2004) note, the different spending patterns of men and women suggest the need to consider gender roles when designing interventions to increase the productive use of remittances. Finally, there is the issue of how the out migration of men and increasing number of female-headed households affects gender roles and women's empowerment.

III. Remittances and Financial Intermediation

As donors and practitioners seek to increase the development impact of remittances research on the savings and investment patterns of remittance recipients, and how access to finance affects the behavior of both recipients and senders, has increased. Organizations, such as FOCAL (forthcoming), Bendixon & Associates, and the Pew Hispanic Center are conducting or have conducted broad-based country surveys of how recipients use remittances, finding that the majority are spent on consumption, with small percentages saved or invested. Recent market research by Accion International (forthcoming) in Colombia, Bolivia, Nicaragua, Peru, and Haiti, assesses how recipients' spending and investment patterns change over time. This research is being used to inform financial product development and marketing strategies in partner institutions. Case studies of these soon to be piloted and other remittance-linked products are needed to promote innovation and replication throughout the region.

Orozco (2005) studied the relationship between access to finance and savings, finding that a higher percentage of remittance recipients have bank accounts and that those with bank accounts save more. More recent work by Orozco (2006) provides a conceptual framework for analyzing remittances as a means of asset accumulation. He also provides empirical evidence that senders with bank accounts in their host country remit more and those with accounts in their country of origin are more likely to remit funds for a business in their home country.

Among those studying the relationship between access to finance and remittances the potential link between these flows and microfinance has become a topic of study. Few studies have analyzed the actual performance of MFIs in the remittance market. Orozco and Hamilton (2005) present an analytical framework for analyzing the intersection between remittances and microfinance, as well as preliminary performance data for 29 MFIs. Hastings (2006) also looks at the relationship between remittances and microfinance, providing a comprehensive and practical analysis of the benefits to MFIs of offering remittance services, as well as the challenges they face in entering the market. For its part, CGAP has developed a manual to guide MFIs efforts in the sector.

As regulations to combat money laundering and terrorist financing are implemented around the world, concerns have been raised about the potential burden they place on financial institutions and money transfer companies. While relatively little research has been done around the world to study the impact of these regulations on access to financial services, anecdotal evidence in the US suggests that many financial institutions are choosing not to enter the remittance market and that immigrants' access to financial services is being affected by Know-Your-Client requirements, among others. CGAP (2005) outlines the implications of these regulations for financial institutions serving the poor and describes the efforts of various countries and financial institutions to adapt and implement these regulations. The Focus Note also argues for gradual implementation of the regulations, use of risk-based approaches to regulation, and adoption of exemptions for transaction categories that carry low risks of money laundering and terrorist financing to avoid reducing the access of low income populations to financial services. Hastings (2006) highlights the potentially high costs of compliance and the importance of sophisticated management information systems to meet their requirements.

IV. Diaspora Trade and Investment

The majority of research on diaspora contributions to home country development has focused on family remittances. However, a few researchers have focused on diaspora-related trade with and investment in countries of origin. Freinkman (2001) writes about the potential of the Armenian diaspora, largely unrealized—and diasporas in general—to fulfill the role of first movers stimulating trade with and investment in countries of origin, as well as their potential to bridge the cultural divide between host and home countries. Gillespie et al (1999 in Gevorkyan 2003) studied the motivations behind the US-based Armenian, Cuban, Iranian, and Palestinian diaspora's interest in investing in home countries. They found that altruism and cultural affinities positively influence immigrants' investment interest and that they are not deterred by the business impediments that might dissuade other would be investors.

A few studies have attempted to quantify the impact of diaspora trade and investment. Gould (1994 in Rauch 2003) analyzed US trade with 47 countries and found that a 10 percent increase in immigrants to the US from a given country resulted in an increase in exports to that country of 4.7 percent and an increase in imports from that country of 8.3 percent. Newland (2004) reports that 50 percent of China's FDI in 2002 came from the country's diaspora.

The literature raises, but does not answer, the question of whether high or low skilled immigrants are more likely to invest in their countries of origin. The case of the high skilled Indian diaspora's role in jump-starting the Indian IT industry is well known. Saxenian (2002) also surveyed the high technology industry's Asian diaspora in Silicon Valley and found that half of foreign born entrepreneurs had business ties in their countries of origin and eighteen percent invested or had invested in start-ups or venture funds.

With the exception of preliminary research on nostalgic trade, there do not appear to be any studies attempting to quantify the contributions to trade or investment of Latin American or Caribbean diasporas, whether low or high skilled. Orozco (2005) found that 70 percent of Latin American and Caribbean immigrants purchase goods from their homelands. Moreover, 10 percent of exports from El Salvador to the United States consist of nostalgic goods. In at least one case, demand for nostalgic goods motivated a Salvadoran immigrant to invest in franchises in Nicaragua and El Salvador to produce and sell processed milk products in the region and to immigrants in the US.

Ultimately, it is clear that diasporas contribute more to development than just remittances. It is equally clear that some contribute more than others. Understanding why some diasporas contribute more than others is an area for additional research. Country of origin diaspora policies may be part of the answer. As noted above, the specific characteristics of each diaspora—predominantly skilled or unskilled, for example—may also be a factor. Further, relatively little is known about the policies and mechanisms that home country governments, and the diaspora itself use to stimulate or engage in trade and investment, including diaspora business networks, diasporas investment clubs and funds, government investment promotion schemes, diaspora bonds, and foreign currency accounts. Further investigation of these mechanisms and efforts could help to inform policymaking and the design of international development interventions.

V. Collective Transfers

In recent years increasing attention has been given to the development activities of Hometown Associations (HTAs), associations created by immigrants to maintain their traditions, social and cultural ties to their homelands. They have also become small-scale development agents, designing and collectively financing community development projects in their countries of origin. Much of the work on HTAs and collective transfers has been undertaken by Manuel Orozco of the Inter-American Dialogue. In his 2003 study of Mexican HTAs, Orozco finds that these associations have simple organizational structures and are generally philanthropic in nature, typically financing basic health, education, and public infrastructure projects. While their donations are small in absolute terms, they are significant to the recipient communities and may represent one-fifth or more of a municipality's annual budget. Goldring (2003) finds that collective remittances have social and political dimensions as HTAs work with communities of origin and governments to design and co-finance development projects. Orozco (2006a) analyzes the activities of Central American HTAs, and finds that the impact of these community development agents can be leveraged through well designed government policies and programs, as well as through partnerships with other development practitioners.

A few HTAs have begun to invest in productive projects with or without the assistance of governments or other development actors. USAID for example has partnered with HTAs on productive projects in Haiti, Mexico, and El Salvador with some success (Hamilton and Orozco forthcoming). Productive projects, however, require a level of organizational capacity that is not always present in informal, primarily volunteer based HTAs. More research is needed on efforts to promote HTA sponsored productive projects.

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