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THE ROLE OF INTERNATIONAL REMITTANCE IN ECONOMIC GROWTH, POVERTY, AND INEQUALITY: A REVIEW

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Abstract

This paper reviews the impact of remittance on economic growth, poverty, and inequality. Both theoretical issues and empirical findings are discussed. The macroeconomic impacts of remittance on growth depend on demand side shocks, exchange rate effects, effects on the balance of payment, composition of traded versus non-traded goods, accumulation of physical and human capital, labour force participation, etc. Microeconomic impacts work through household income and wealth, household consumption, investment in physical and human capital, etc. Majority of the studies have found the positive role of remittance in reducing poverty, although they have acknowledged its inequality-raising impacts.

Keywords: International migration, remittance, development, poverty, inequality, impact evaluation

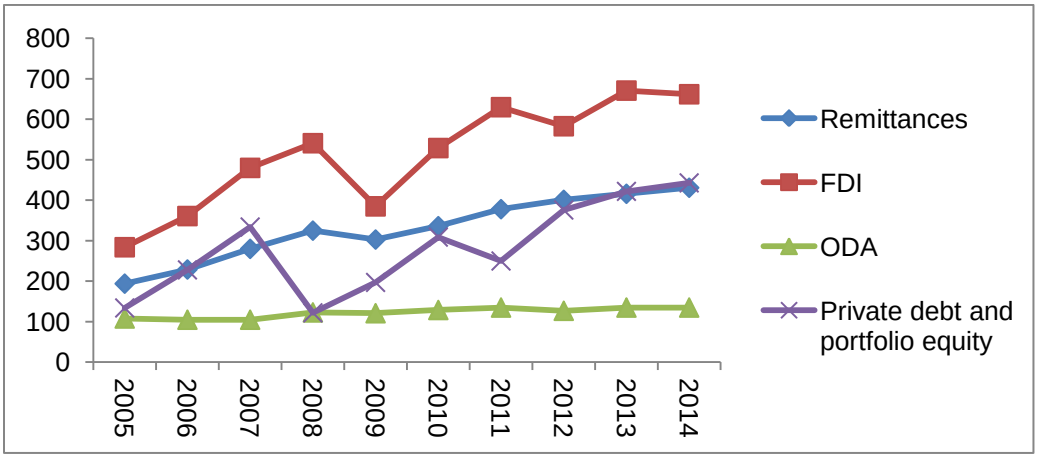
INTRODUCTION

Remittance is the income sent by the international migrants to their home countries. Migrants send remittance as cash or in-kind transfers and using variety of formal and informal channels (Yang, 2011). Remittance is an important source of national income in many developing countries. It constitutes about 30% of total financial flows to the developing countries (Gibson et al., 2009).

According to United Nations, the number of international migrants including refugees was an estimated 258 million in 2017, which increased from 172 million in 2000. In other words, number of international migrants increased by 50% during 2000-2017 period. Out of 258 million

migrants, 18.5 million were refugees (about 7%). International migrants constitute about 3.4% of total world population (World Bank Group 2018). In 2017, the volume of international remittances in low-and middle-income countries reached at US $466 billion, an 8.5% increase over the previous year, after two years of consecutive decline (see Annex Table 1). The size of the international remittances is about three times larger than the Official Development Assistance (Figure 1). The amount of remittance flows would be significantly larger than the FDI flows if China is excluded. It is also a relatively more stable and less volatile source of foreign exchange earning than other types of external flows (World Bank Group 2016, 2018).

Figure 1: Remittance and other resources flows to developing countries (US $ billion)



Source: World Bank Group, 2016

OBJECTIVES AND RATIONALE

Given the background cited above, several questions are important in the academic discourse – what are the micro and macro considerations of remittance? What guides the migrants' sending remittance to their home countries? What are the impacts on recipient households and their national economies? Does it increase consumption or investment? Does it increase income of the recipient households or their national economies? What impacts does it have on different sectors of the economy? Does it reduce or increase inequality? Who are the potential winners and losers? (Yang, 2011; Rapoport & Docquier, 2005).

The main objective of this study is to review the impacts of remittances on the recipient countries. More specifically, the study is aimed at reviewing the theoretical issues and empirical evidences on –

i) the relationship between remittance and economic growth, and

ii) the impact of remittances on poverty and inequality.

While the literature on remittances is mostly empirical in nature, there is relative scarcity of review based articles on the pertinent subject. This paper is aimed at bridging the gap thus attempts to make an extensive review and compilation of findings of the existing literature. I have organized the reminder of this paper as follows – the next Section provides a review on the link between remittance and economic growth. This Section presents discussion on the nexus between remittance and economic growth at the macro level; the impact of remittances on growth at the micro level; and the role of remittances in building of human capital (education and health). The following Section provides a review on the link between remittance, poverty and inequality. Finally, the paper ends with Conclusion.

REMITTANCE AND ECONOMIC GROWTH

Remittance-Growth Nexus at the Macro Level

Until 1980s, the macro theoretical literature was primarily focused on the discussion of short run impacts of remittance on growth. Rapoport and Docquier (2005) classified such literature into two broad categories – ***First*** group is termed as the *'standard macroeconomic'* approach. This approach used the Keynesian models to analyse the impact of remittances on growth. Here, remittances impact on growth through the demand side socks. The size of the impact depends on the multiplier as well as the size of transfer and the marginal propensity to consume. An alternative approach in the *standard theoretic* models used the Mundel-Flemming models in open economy macroeconomic contexts. Here, the impact depends on the extent of capital mobility and the exchange rate regimes. In a flexible exchange rate regime, remittances are fully offset by the exchange rate appreciation. In a fixed exchange rate regime, it influences the balance of payment by influencing money supply and thus positively affects the growth of national income (Rapoport & Docquier, 2005). The ***Second*** group is termed as the '*trade theoretic'* approach. This approach analysed the impact on the relative prices of the traded versus non-traded sectors (Dutch diseases effects, etc). It also analysed how the relative size of the transfers affects the welfare of different groups (*'winners versus losers'*) in the economy. Regarding the long run impacts, the debate was traditionally centered on its role in increasing consumption versus investment. Since 1980s, there has been a tendency to analyze the relationship in an endogenous growth framework. Since then the debate has been shifted towards *growth* versus *inequality* impacts (Rapoport & Docquier, 2005).

According to Barajas et al. (2009), there are three channels through which remittance may affect economic growth. ***First,*** remittance influences the accumulation of physical and human capital by providing more financial resources and improving credit worthiness of the recipient households. It influences the capital accumulation by reducing macroeconomic

instability. However, it is not necessarily that these impacts are always positive. Because remittances are typically received by households with high marginal propensity to consume, these might increase consumption rather than investment. Therefore, it may not necessarily translate into growth beyond poverty reduction. ***Second,*** Remittance may influence growth by influencing labour force participation of the recipient households. Because households tend to substitute remittance by their potential labour income, this effect is negative. ***Third,*** remittance may affect growth through various externalities on domestic production activities. For example - (a). it may increase the efficiency of the formal financial sector by improving the quality of funds channeled through the banking system; (b). it may influence the exchange rate thus affecting the competitiveness of the trade sectors; and (c). it may reduce the incentives of private citizens to monitor government activities thus affecting the quality of governance.

To examine the impact of remittances on economic growth, Giuliano & Ruiz-Arranz (2009) conducted a study in a panel of 73 developing countries over the period 1975 to 2002 (which is split over 6 non-overlapping 5-years period). They used the growth rate of real GDP as the dependent variable and a set of explanatory variables including remittance-GDP ratio, inflation, openness to international trade, human capital, govt. fiscal balance to GDP ratio, govt. fixed capital formation to GDP ratio and population growth. They used OLS and controlled for the time fixed effects and unobserved country fixed effects. Apart from this, they also used the system GMM to correct for the possible endogeneity problem. They found positive and significant value of the coefficients of remittance-GDP ratio. However, they found negative and significant value of the coefficient while interacting the remittance-GDP ratio with financial sector development. It implied that the impact of remittance is higher in countries with less developed financial sector. Thus they suggested that remittance boost economic growth by providing alternative source of finance in countries with less developed financial markets via alleviating the credit needs of the population.

Imai et al. (2014) examined the effect of remittances on economic growth in 24 Asia and Pacific countries and utilizing annual panel data over the period 1980 to 2009. They took the growth of real per capita GDP as the dependent variable and controlled for remittance-GDP ratio, lagged per capita GDP, inflation, financial sector development as percentage of GDP, extent of internal armed conflicts, fuel export as a ratio of merchandise exports, capital account openness, and investment GDP ratio. They used fixed and random-effects models, and fixed and random-effects 2SLS models. They found that remittance has significant positive impacts on economic growth. They also found that the volatility of remittance and FDI flows is harmful to economic growth. Their findings suggest that remittance flows significantly contributes to poverty reduction.

While some studies have documented the positive contribution of remittances to economic growth, there are also studies which showed contrasting views. The negative view highlights that the remittances are spent on conspicuous consumption rather than being invested in productive sectors. Pradhan (2016) investigated the short and long run impacts of remittances on the economic growth of BRICS countries. He used panel data over the period 1994-2013 and used various dynamic econometric techniques such as panel cointegration test, fully modified OLS, and panel vector error correction model. His findings suggest that there is a long run negative impact of remittances on economic growth of the BRICS countries as a whole. The results of individual country wise regressions suggest that remittance has significant negative impacts on growth in Brazil, Russia and India. Only in China, the effect of remittance on growth is positive and significant. In South Africa, the result is not significant, although positive. In another study, Siddique et al. (2012) examined the impact of remittances on the economic growth of Bangladesh, India, and Sri Lanka using time series data over 1976 - 2006. They used cointegration and Granger Causality technique in a VAR framework. They did not find long run impact of remittances on economic growth, although they found short run impacts of remittance on economic growth in Bangladesh and Sri Lanka.

Remittance and Economic Growth at the Micro Level

Some authors have expressed concern about the credibility of the estimates regarding effects of remittance at the macro levels. This is particularly due to two main reasons – ***first,*** a substantial part of the remittances in the developing countries are sent through unofficial channels. While study findings are mostly based on official data, the findings of the cross country results may not necessarily reflect the complete picture of the effect of remittances; ***second,*** much of the empirical works are based on cross sectional findings. Reverse causation is a major concern in such studies. Even though the reverse causation is not a problem, it is sometimes difficult to separate the effect of unobserved third factors. These unobserved factors may simultaneously affect remittance (explanatory variable) and the outcome of interest (say, economic growth or poverty reduction) in cross-sectional settings (Yang, 2011; Adams & Page, 2005).

Identifying the causal effects of remittance at the micro-level depends on good counterfactual analysis. The distribution of remittance is not randomly allocated across households. Therefore, any estimate of the impact of remittance should take into account the observed and unobserved differences across the migrant and control households. After controlling for this selectivity problem, Gibson et al. (2009) estimated the impacts of Tongan migrants to New Zealand through randomized experiment. The authors assessed the impact of remittances to the remaining household members. They found that the amount of labour income

is reduced due to reduction in the family size as a result of migration. According to them, remittance was not able to recoup the lost labour income thus lowering per capita income of the remaining household members. They suggested that the income of the migrants households were 20-25% lower than their non-migrant counterparts. They also found that migrant households owned less household assets and had less access to financial services than non-migrant households. They suggested that migration causes lower dietary outcomes on the remaining household members.

However, there are some studies which found positive impacts of remittances at micro levels. Yang (2008) estimated the impact of the exogenous exchange rate shock due to the East Asian Financial crises (in 1997) on the migrant households of Philippines. The author used panel household survey before and after the crises (1997 and 1998). The author found that the migrant exchange rate shocks (due to depreciation of the Philippines' peso against the currencies in migrant destinations) led to increased investment in child education, increased child schooling, reduced child labour, and increased self-employment of the household members. The study suggested that the effect of exogenous remittance shock on investment is larger than its effects on consumption.

Remittances may serve as an insurance against shocks and help to maintain investments in productive activities at the time of crises (Yang, 2011). Several studies found that remittances helped households coping with negative weather shocks and smoothing consumption in the developing countries (Townsend, 1994; Urdy, 1994; Ligon et al., 2002; and Fafchamps & Lund, 2003). Remittance may also act as an important source of the startup capital for micro-enterprises (Dustmann & Kirchkamp, 2002).

Remittance and Human Capital Formation

There are a good number of studies which have investigated the relationship between remittance inflow and the development of education in the migrants' home country. Conventional wisdom suggests that remittance improves school attendance by relaxing the credit constraint among the remittance recipient households. However, the empirical evidence on the link between migration and educational development is mixed. While some studies have found positive impacts of remittance on school attainment, there are a few other studies which have found negative or no significant effects.

Alcaraz et al. (2012) estimated the impact of remittances on child labour and school attendance in Mexican immigrants in the USA. They considered the 2008-09 US recession as an exogenous shock on the remittance recipient Mexican households which had resulted significant increase in the unemployment rates among the Mexican immigrants in the USA.

They found that the negative income shock due to recession had considerable short-run effect in increasing child labour and reducing school attendance of children aged 12-16 years old among the recipient households. In another study conducted in the context of migrants' remittances in Ecuador, Calero et al. (2009) found that remittances increased school enrolment and reduced child work especially for girls in rural areas. They argued that remittances improve household's investment in human capital by relaxing credit constraint and reducing vulnerability to economic shocks.

Mckenzie & Rapoport (2011) suggested that migration had significant negative effects on school attendance and attainment in rural Mexico. They argued that the negative effects of migration on educational achievement could be driven by – (a). less parental inputs into educational achievement; (b). children may be required to undertake household work or help mitigate the labour shortage in absence of the migrant family member(s); and (c). low expected returns to education in the desired countries specially in the context of illegal migration (as in the case of Mexican migrants in the USA). In another study, Nguyen & Nguyen (2015) found no statistically significant impact of remittance on school enrolment and child labour, although they suggested that international remittance helps children in their completion of grades.

In a seminal work, Hildebrandt & McKenzie (2005) examined the effects of rural Mexican migration to USA on child health outcomes. They found that children in households with one migrant member had 3 - 4.5% less probability of dying in the first year of birth than children in non-migrant households. They suggested that if the number of migrant household member increased by one standard deviation, the infant mortality rate would decline by 1.8%. Similarly, they found that children in households with at least one migrant were associated with 335 -364 grams of more birth weight. A one standard deviation increase in the number of migrant member increased the birth weight by 140 gram or 0.25 standard deviations. The study claimed that two channels worked for reduced infant mortality and high birth weight in children in the migrant households – increased income /wealth due to migration; and increased health knowledge of mothers due to transmission of knowledge by the migrant members. In spite of these positive findings, the study also found some negative findings on child health outcomes. It found that children in the migrant households had low preventive health care (low breastfeeding, low vaccination, absence of parental care, etc), which would have long term negative consequences on child health.

THE IMPACT OF REMITTANCE ON POVERTY AND INEQUALITY

There is a burgeoning body of literature which claim that international remittances reduce poverty in the migrants' home country. In a seminal work, Adams & Page (2005) examined the

effect of international migration and remittance on poverty in a cross-section of 71 low and middle-income developing countries. They used per capita GDP, Gini coefficient and the regional dummies as the explanatory variables and used a variety of instruments to control for endogeneity. They found that a 10% increase in the share of migrant population leads to a 2.1% decline in the poverty level. They also found that a 10% increase in the per capita official remittance led to a 3.5% decline in the poverty head count.

In another study, Acosta et al. (2008) investigated the effect of remittances on growth, inequality and poverty. They used cross-country data of 59 countries over the years 1970-2000. They found that remittance had significant and positive impacts on economic growth, both in the global sample and in the sample of Latin American countries. However, they found mixed results about the remittance impact of inequality. In the global sample, they found that remittance increased inequality while in the Latin American sample they found that remittance had a slight (or no) effect in reducing inequality depending on specification of the model. Their cross-country regression also suggested that remittance had a poverty reduction effect – a 10% increase in the remittance-GDP ratio would lead to a reduction in poverty, ranging from 0.04% in poorer countries to 0.5 % in richer countries.

To estimate the effect of international migration on poverty and inequality, Anyanwu & Erhijakpor (2010) used a panel dataset of 33 African countries over the period 1990-2005 and conducted a pooled cross-country regression analysis. They used remittance-GDP ratio as the main explanatory variable and controlled for Gini index, per capita GDP, illiteracy rate, trade openness, and inflation rate. Their IV-GMM result dictated that a 10% increase in international remittance led to a 2.9% decline in poverty head count, a 2.9% decline in poverty gap, and a 2.8% decline in squared poverty gap. In a panel study in Nepal, based on nationally representative household surveys conducted during 1995/96-2003-04, Acharya & Gonzalez (2012) found that remittance reduced the poverty head count, poverty gap, and squared poverty gap. However, they found that remittance increased inequality at the national level.

Anyanwu (2011) examined the impact of remittances on inequality in African countries using panel data over the period 1960-2006. The study used OLS and IV-GMM methods and used a set of explanatory variables including international remittance as ratio of GDP, growth of bank credit , initial GDP, initial secondary schooling, inflation rate, government consumption, and trade openness. The study found that a 10% increase in remittance as a percentage of GDP lead to a 0.013 percent point increase in income inequality in Africa.

According to Mckenzie & Rapoport (2007), the micro level impact of international migration and remittances on inequality is theoretically unclear. It depends primarily on two things – the composition of migrants' initial wealth distribution (before migration); and the size of

the cost of migration. When the cost of migration is high, the migrants are drawn from the upper-middle of the wealth distribution. It causes inequality to rise as the beneficiary households become richer by receiving remittances. But if the cost of migration is low, the lower part of the wealth distribution can also be able to migrate, which may cause inequality to decrease over time. Based on a panel study of a sample of rural Mexican migrant countries in 1992-97, the authors predicted an inverted U-shaped relationship between emigration and inequality on the migrant communities at the origin. Adopting an instrumental variable approach, they suggested that remittances may increase inequality in the short run, but once the migrant networks become larger it reduces inequality in subsequent periods.

CONCLUSION

In this paper, I have attempted to make a comprehensive review of the existing literature to reflect on the theoretical issues and empirical findings on the nexus between remittance and development. I have focused on the impacts of remittances on economic growth including issues concerning the micro and macro aspects, and their impacts on poverty and inequality. Based on the analyses and discussions, I can conclude the following.

First, the impact of remittance on economic growth is mixed in both micro and macro levels, both theoretically and empirically. While some empirical studies have found significant and positive effects, others have found negative or mixed results. At the macro level, remittance may impact on growth through demand side shocks; effect on the balance of payment; influence on the exchange rate and the composition of the traded versus non-traded goods; accumulation of physical and human capital; effect on the labour force participation; and influence on the domestic production activities through various externalities. However, establishing credible estimate at the macro level is difficult due to paucity of data, endogeneity problems, etc. The micro level impacts of remittances on growth work through household income; household asset and wealth; investment in health and education of the household; consumption and investment smoothing during crises; etc. Identifying appropriate causal impact depends on good counterfactual analysis and removing sample selectivity problems.

Second, the empirical evidence on the impact of remittance is mixed in the formation of human capital. On the positive side, remittance may impact on reducing child labour and increasing school attainment by relaxing the household credit constraint or reducing vulnerability to economic shock. It can reduce infant mortality rate and increase birth-weight of children by improving income and wealth of the households or by improving health knowledge of the migrant household members through the transmission of better health knowledge. On the negative side, it may influence the educational outcome of children in migrant households

because of less parental involvement, due to greater involvement of those children in household activities to substitute for labour-shortage in the households, etc.

Third, majority of the empirical studies have claimed that international migration and remittance reduce the extent, depth and severity of poverty, although they have mostly noted their inequality-raising impacts. However, the micro-level impacts of remittance on inequality are theoretically unclear.

Overall, it can be said that remittance has both positive and negative impacts. It can promote economic growth and reduce poverty, but it can also increase inequality. It can promote investment but it can also promote luxurious consumption. It can benefit one sector of the economy at the cost of the other sector. It can increase household income but it can reduce household labour force. It can reduce liquidity constraint of the household thus increasing investment in education and health but it can also reduce parental involvement in children education and health care. Therefore, the net effect of remittance is not certain.

Finally, the paper suggests that future researches should pay attention to understand how remittance impacts on economic development via influencing institution and governance. However, since macro level estimates of the impacts of remittance are often susceptible due to inadequacy of official data on remittance, future researches should be directed towards generating more micro level estimates rather than relying heavily on cross-country regressions. To this end, the statistical authorities in remittance-recipient countries should conduct regular surveys to collect data at household and community levels. Moreover, theoretical models should be constructed and empirically tested to convincingly understand the link between remittance and inequality in micro levels.

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ANNEX

Table 1: Remittance flows to low- and middle-income countries (US $ billions)

	2010	2014	2015	2016	2017 (prov.)
Low and middle income	**341**	**444**	**440**	**429**	**466**
East Asia and Pacific	96	121	126	123	130
Europe and Central Asia	38	52	41	40	48
Latin America and Caribbean	57	65	68	74	80
Middle-East and North Africa	39	54	51	49	53
South Asia	82	116	118	110	117
Sub-Saharan Africa	30	37	36	34	38
World	**468**	**598**	**582**	**573**	**613**
Growth rate of remittance (%)					
Low and middle income	**11.2**	**3.8**	**-1.0**	**-2.4**	**8.5**
East Asia and Pacific	19.4	4.9	3.9	-2.6	5.8
Europe and Central Asia	4.9	-5.2	-21.6	-2.4	20.9
Latin America and Caribbean	2.6	4.9	6.1	7.5	8.7
Middle-East and North Africa	18.2	7.2	-5.3	-4.8	9.3
South Asia	9.4	4.5	1.5	-6.1	5.8
Sub-Saharan Africa	9.7	5.0	-2.5	-4.6	11.4
World	**8.4**	**3.7**	**-2.6**	**-1.5**	**7.0**

Source: World Bank Group, 2018