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Are immigrants remittance flows a source of capital for development?: a review

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Are Immigrant Remittance Flows a Source of Capital for Development?[+] – A Review

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I. Introduction

Migrant remittances is that part of international migrant workers earnings (Labour income, wages plus compensation) sent back from the country of employment (host country) to the country of origin (home country). Due to the increasing trend of such flows across nations, some scholars have posited that remittances were good sources of capital to achieve development objectives. This anecdotal evidence led Chami et al to examine these claims by adopting a standard cross section and panel estimation technique for 113 countries over the period 1970-1998. Specifically, the major objective of the paper was to develop a remittance model that would indicate if immigrant remittances were a source of capital flows for development. Their analysis showed that remittance was non-profit driven compensatory transfers that had a negative effect on GDP.

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II. Summary of the Paper

The paper identified two strands of literature that provided an insight on why immigrants decide to transfer funds to their home country. These approaches were the endogenous approach and the portfolio approach. The endogenous approach is rooted mainly on the altruistic motivations of the immigrant for his family. Such motivations could be the relationship between the immigrant and family members in the home country, length of immigrant's stay in the host country, size and level of immigrant's family as well as stock of immigrants in the host country. The portfolio approach, on the other hand, relates to the immigrant's decision to transfer remittances to the home country for investment and or portfolio diversification purposes, defined by financial conditions such as the rates of return on assets, interest rate and incentive differentials. Consequently, proponents of this approach opined that remittances might serve as a form of capital flow. In the paper, the authors emphasized the endogenous approach, by examining if remittances behaved as other capital flows. Their *a priori* expectation was that if it did, then a positive correlation should exist between remittances and output growth. The analytical framework adopted by the authors included a model of remittances, estimation of a remittance- determination equation, as well as the adoption of a standard cross section and panel estimation technique. Preliminary analysis of the data on remittances for over 113 countries revealed a counter-cyclical pattern, showing that remittances do not behave like capital flows used for economic development. The model of remittances aimed to ascertain if remittances did function as capital flows or serve other economic purposes. Basic features and assumptions of the model were:

- The incorporation of the economics of family.
- The existence of a large number of 2-person family
- Remittances are made up of millions of individual, private and non-market income transfers.
- Remittances take place under conditions of asymmetric information due to the long distance between the remitter and the recipient.

- There is an earning of exogenous income in a foreign country by a member of the family i.e. the immigrant
- The immigrants utility, U_I depends on the recipients utility, U_R with the immigrants net consumption defined as his/her exogenous income less transfer to relative.
- The immigrant does not know or observe the recipients' effort level defined by the expected income.
- The utility curve of the recipient is increasing and concave
- The Income in the recipient country is uncertain, reflecting higher risks and production/information inefficiencies relative to the host country.

Solving the model using a backward induction technique, (a dynamic programming technique, used for solving finite and infinite decision problems) the authors found that remittances were compensatory in nature, rising with the level of altruism but reduced as the recipients' wages rise. In other words, an inverse relationship existed between remittances and the recipient's income. Also revealed was that remittances were non-market substitutes for wages, which had a negative relationship with the effort level of the recipients. The effort level of the recipient presupposes those measures taken by him to improve chances of getting a better means of livelihood in the home country. The authors, further, highlighted some uses of the model, to include analyzing the impact of remittances on the macroeconomy, modeling migration decisions as well as the recipients' effort on investment projects.

Testing the implications of their model, the authors, further, estimated the relationship between workers remittances and per capita output growth using a panel and standard cross-section estimation technique. Their analysis showed an inverse relationship between these two variables. Further examination of the correlation between workers remittances and per capita output growth conducted through the estimation of a remittance-determination equation on a group and country-by-country basis also revealed negative and significant relationship between the variables. In conclusion, the authors confirmed that remittances were compensatory transfers for poor economic situations in the home country and demonstrated vividly that remittances were not capital flows, more so with several empirical evidences indicating that capital flows had a positive correlation with output growth.

III. Comments and Lessons for Nigeria

Comments

The analysis was very extensive. Indeed, researchers, the world over, can attest that sourcing and gathering data for 113 countries over a 28-year period is no small feat. Moreover, the adoption of different analytical techniques in providing answers to the research questions is quite commendable, as it leaves no doubt as to the conclusions derived therefrom. However, one would have expected that given the objective of the paper, (which was to examine whether immigrant remittances were a source of capital for development), the authors should have placed more emphasis on the portfolio approach, which was more related to investment/portfolio diversification and considered critical for development. Rather, they emphasized the endogenous approach, which was more akin to family related motivations.

The paper failed to identify which variants of immigrant remittances was being considered. A cursory look at the literature, shows that, in as much as remittances imply the transfer of funds, etc from a host country to the home country as alluded to by the authors, they can be categorized into monetary and non-monetary transfers (E.g. consumer goods, capital goods, skills and technical knowledge) or group remittances (whereby individuals gather together in the form of home town associations to remit money back to countries of origin in support of development projects). These variants of remittances should have been clearly articulated at the onset by the authors; it is only when one reads further that one deciphers the variant of remittances, which was being examined. In addition, the claim by the authors that their study pioneered the use of panel estimation technique to model remittances was quite worrisome as studies by Aredo, 2005 is a typical example of a study that has adopted the panel estimation methodology to examine migrant remittances, shocks and poverty in urban Ethiopia. Furthermore, the assumption that remittances take place under conditions of asymmetric information may not be well founded, given the modern age of ICT, internet, e-commerce, and e-banking, the issue of asymmetries may not be entirely valid.

Lessons for Nigeria

The paper is indeed quite apt for Nigeria, more so with the continuous drive by government requesting Nigerians in diaspora to invest in the country. Before proceeding, an important point to note is that the impact of remittances or any such financial flows for that matter would depend on the structural features (such as consumption and investment patterns) of the receiving country and the country's capacity to manage huge financial inflows. Available data from World Development Indicators shows that as at 2004, remittances to Nigeria was estimated at $2,272.7 million, 44.3 percent more than the official development assistance (ODA) from 2000-2004. However, from anecdotal evidence, it can be deduced that most remittances from abroad are used mainly for consumption purposes (E.g. construction of family/personal houses and attending to family needs). Based on this, lessons drawn for Nigeria would emphasize on how the flows derived from this sources can be maximized and how to maximize the benefits/impacts.

First, there is need for the entrenchment of macroeconomic stability in the form of positive real interest rates, and credible investment opportunities, amongst others. The need to reduce the interest rate differential to the barest minimum is further advocated. This might be done by introducing foreign denominated bonds, with interest rates that would be some percentage points above international rates. In order to maximize the benefits, the use of informal transfer channels for these remittances should be reduced to the barest minimum; otherwise, their effect on economic development would remain low. Hence, there is the urgent need to develop efficient transfer mechanisms that offer services at affordable rates.

As further measures to maximize the benefits, there is need to increase efficiency in investment management, especially those investments that have higher yields. This would transform the investment behavior in the economy. In addition, since some immigrants go back to their country of origin, some form of business counseling and training programme on entrepreneurship development should be instituted to assist them on return. This can be a collaborative effort between the International Labor Organization (ILO), Ministry of Labor and Productivity, the organized private sector and the deposit money banks.

Overall, the need to re-orientate our value system, which has so far been entrenched in consumption, rather than investment activities, is further underscored. Once this is achieved, it creates and stimulates the necessary conditions towards achieving sustained economic growth and development.