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The Remittance Economy

Dr. Mahesh U. Daru
Head of Accountancy Department
Smt C.D.J Rofel Arts &Smt I.S.R.A Rofel Commerce College, Vapi (Gujarat)

Abstract : Remittances are a significant portion of external financing. Remittances are transfers in the form of goods or money that migrants send back home to their families. Studies have shown that people at the low income, poverty, or unemployed level often migrate to different countries to work and send their earnings back home. Many people in the developing countries depend upon the remittances received from their families abroad. It is one of the important source of external financing, after Foreign Direct Investment. "Remittances is the least volatile source of foreign exchange earnings for developing countries. (Ratha). "According to World Ban the magnitude of remittances in many developing countries has surpassed official development assistance (ODA), private equity flows, and foreign direct investment (FDI), and their rate of growth has outpaced that of official and private capital flows". Every year, millions of people from India, Bangladesh, and Nepal migrate to the Middle East, Japan, and Korea; and people from Central and South America migrate to the United States. On the positive side, remittances are believed to reduce poverty, as it is the poor who migrate and send back remittances. But same time it is argued that remittances may increase inequality, because it is the rich who can migrate and send back remittances, making recipients even richer. The majority of developing countries offer tax incentives to attract remittances. The side effect of such incentives, of course, is that remittances may then be used for tax evasion and money laundering. Also, a number of governments provide matching funds for remittance-backed projects.

Keywords: Remittance, Remittance economy, External financing, Foreign Exchange

Introduction

Remittances are funds transferred from migrants to their home country. They are the private savings of workers and families that are spent in the home country for food, clothing and other expenditures, and which drive the home economy. For many developing nations, remittances from citizens working abroad provide an import source of much-needed funds. In some cases, funds from remittances exceed aide sent from the developed world, and are only exceeded by foreign direct investment (FDI). Each year, billions of dollars are sent by migrant workers to their home countries, with some estimates putting the total value of remittances at more than $200 billion. For some countries, remittances make up a sizable portion of GDP. (http://www.investopedia.com)

Remittances in the context of India's balance of payments include funds that flow through formal channels, such as banking, postal, money changers and transfers in kind. According to the Compiler's Guide of the IMF, remittances are derived from mainly two components in the balance of payments – (i) personal transfers and (ii) compensation of employees. In India, private transfers, which are termed as personal transfers by the IMF, are considered as remittances and the compensation of employees data are separately presented under income account. Millions of migrants send remittances to their families and communities of origin. In many developing countries, remittances are an important source of family (and national) income and are the largest source of external financing The size and potential impact of the remittance inflows is large. Remittances increase the recipient country's foreign exchange reserves. Remittances support financial sector development through a strong and positive impact on bank deposits and credit to the private sector. Remittances sums regularly surpass foreign aid, and they represent a more stable form of foreign capital flow than debt and private equity to many developing countries. In India, for instance, remittance was greater than the earnings the country collectively took in from IT services. With remittances becoming such a pillar of some developing economies, the World Bank has also been pushing for greater recognition of remittances in credit ratings to help stabilize developing countries and help them access other forms of capital flows. Many countries are also now exploring the idea of diaspora bonds, which are exactly what they sound like—bonds marketed by governments to their respective diasporas. African countries have been particularly early adopters of this form of fundraising.

Importance of Remittances

Remittance transactions are a huge business in itself and it is getting more popular as more remittances are being sent between countries. They contribute to the expansion of wire transfers and courier companies as well as money exchanges. For example, Western Union, a money transfer agency, is a $4 billon industry. Also, besides consumption, households save excess money in banks and that money can be used for investment purposes. Remittances often provide a significant source of foreign currency, increase national income, finance imports and contribute to the balance of payments. Following are the benefits of remittances:

- targeted to meet specific needs
- finance the purchase of basic consumption goods, housing, and children's education and health care
- provide capital for small businesses and entrepreneurial activities
- pay for imports and external debt service
- used by banks to raise overseas financing using future remittances as collateral
- to be more stable than capital flows
- tend to be counter-cyclical

Limitation of Remittances

While remittances are an important lifeline in many developing countries, they can also foster a dependency on outside flows of capital instead of prompting developing countries to create sustainable, local economies. The more a country depends on inflows of funds from remittances, the more that it will be dependent on the global economy staying healthy. Remittance flows can be negatively impacted by a downturn in the global economy. Workers employed abroad may lose their job if they are in heavily-cyclical industries, such as construction, and may have to stop sending remittances. This has a two-pronged effect. First, the home country may see a significant portion of its income dry up, and thus not be able to fund projects or continue development. Second, workers who moved abroad may move back home, exacerbating the problem by increasing the demand for services on an already strapped economy.
(www.investopedia.com/articles/economics/10/introduction-remittances.asp#ixzz4NoSJLbGG)

Following are the limitation of remittance:
- Labor shortage created by emigrating workers
- Appreciation of real exchange rate and makes economy less competitive internationally
- Remittances create dependency. It undercutting recipients' incentives to work, slowing economic growth
- Human cost: family separation, exploitation of laborers in foreign countries (hard labor, low wages), job risk, etc.
- No investment - remittances tend to be more compensatory in nature
- Remittances often transferred through unofficial channels - therefore statistics are false and misleading

Instruments of remittance

The main instruments used by the migrant workers to send remittances to India include Electronic Wires/SWIFT, Drafts, Cheques, Debit/Credit cards, Money Orders and Direct Transfers to Bank Accounts. Apart from these instruments, few banks recently provide online remittance transfer facilities which are both cost effective and less time consuming.

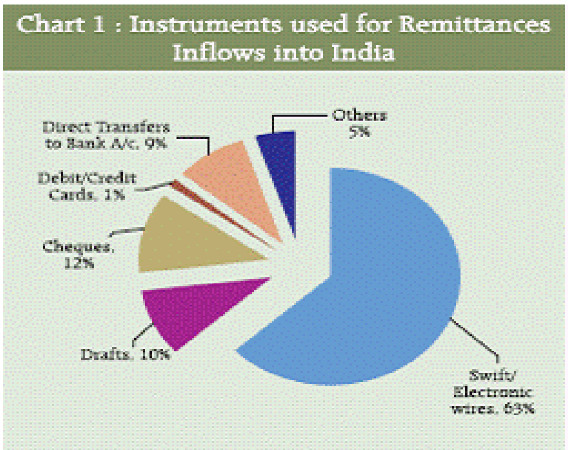
For example, State Bank of India is facilitating SBI EXPRESS REMIT to remit to India from USA /

UK with services 24 X 7 without visiting any branch/bank. This facility is provided with best conversion rates and nil or nominal transaction fee.

Similarly, ICICI Bank also provides web based wire transfer facilities called Power Transfer to remit money to India in as short a time as 48 hours. It eliminates the errors associated with a normal wire transfer by giving remitters a printed wire instruction form and a tracking number to track the remittance online.

The survey, based on the information received from major Authorized Dealers (ADs) branches spread across 12 cities reveals that electronic wires/SWIFT has been used as a dominant mode of transferring remittances from abroad by the overseas Indians.

Although it is argued that the SWIFT/wire transfer is a costlier means of transfer for small value remittance transactions and more cost effective for the higher value trade and other transactions, a higher use of this mode can be attributable to a relatively wider network of the Indian bank branches abroad to provide electronic fund transfer and less penetration of money transfer operators (MTOs). The higher use of swift vis-à-vis the other modes of transfers can also be attributed to the minimum time taken in remitting the funds as compared to other means of transfer. The traditional banking modes of remittance transfer i.e., drafts and cheques continue to be other major means of remitting money to India. All India average share of remittance transfer through drafts and cheques works out to 22 per cent.



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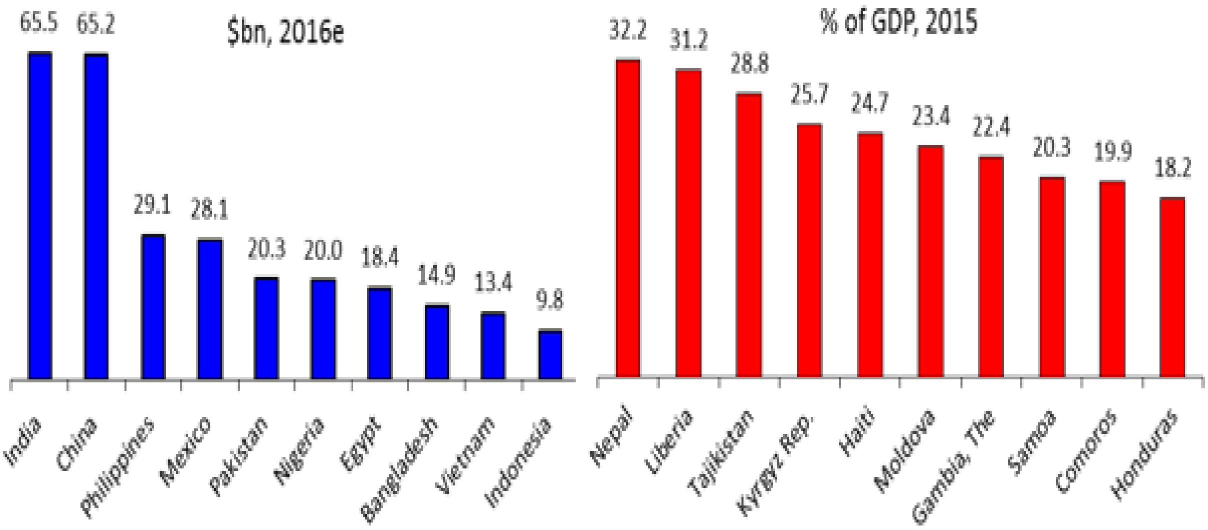
The top recipients of remittances and top five migrant destination countries

"One out of seven people in the world is a migrant, and a quarter of them, international migrants. Migration is intimately linked to the development process," said Dilip Ratha, head of KNOMAD and an author of the MD Brief. "The inclusion of migration and remittances in the SDGs is a welcome step forward." The top recipients of remittances are, in nominal US dollar terms, India, China, the Philippines, Mexico and Pakistan and, in terms of remittances as a share of GDP, Nepal, Liberia, Tajikistan, Kyrgyz Republic and Haitilow. The top five migrant destination countries continue to be the United States, Saudi Arabia, Germany, Russia and the United Arab Emirates (UAE). The top five remittance recipient countries, in terms of value of remittances, continue to be India, China, Philippines, Mexico and Nigeria.

Top Recipients of Remittances

(US$ bn, 2016f)		***(US$ million, 2016f)***		***(% of GDP, 2015)***		
India	65	India	65,450	Nepal	32	32%
China	65	China	65,172	Liberia	31	31%
Philippines	29	Philippines	29,100	Tajikistan	29	29%
Mexico	28	Mexico	28,143	Kyrgyz Republic	26	26%
Pakistan	20	Pakistan	20,300	Haiti	25	25%
Nigeria	20	Nigeria	20,000	Moldova	23	23%
Egypt	18	Egypt	18,400	Gambia, The	22	22%
Bangladesh	15	Bangladesh	14,850	Samoa	20	20%
Vietnam	13	Vietnam	13,351	Comoros	20	20%
Indonesia	10	Indonesia	9,842	Honduras	18	18%



Source: World Bank

Strategies to Enhance Remittances' Developmental Impact

India is the world's leading receiver of remittances, claiming more than 12% of the world's remittances in 2015. Remittances to India stood at US$72.2 billion in 2015, accounts for over 4% of the country's GDP. As per the Ministry of Overseas Indian Affairs (MOIA), remittance is received from the approximately 25 million members of the Indian diaspora.

1. Reduction of transaction costs of remittances transfer and dissemination of information on types of transfer channels to use, as well as establishment of voluntary codes of conduct for fair transfers.
2. Strengthening of the formal financial infrastructure supporting remittances, mainly increasing competition and improving the technology of money transfers and its presence in smaller communities, etc.
3. Improvement of access to financial services in recipient economies as well as in sending economies for migrants and their families back home (ex: ID cards for migrants, allowing domestic banks to operate overseas)

Other Accompanying Policies contributing to enhance their developmental impact

- Tax exemptions for remittance income
- Incentives to attract Diaspora investments with income tax breaks
- Access to foreign exchange and lower duties on imports

Support for migrant associations' projects including matching grants, bonds, loans or pension schemes targeted at the Diaspora.

Conclusion

Millions of migrants worldwide send billions of dollars in remittances each year to their families or communities of origin. In many developing countries, remittances are an important source of family and national income and also are the largest source of external financing. There is a need to strike a balance between a regulatory regime that minimizes money laundering, terrorist financing, and general financial abuse, and one that facilitates the flow of funds between hard-working migrants and their families back home. Reliable data on remittances are key to understanding the impact of development There is tremendous potential for using remittances to encourage development in countries.

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