

A Literary Overview of the Socio-Economic Impact of Remittances

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Abstract

Remittances, defined as the transfer of money or resources by migrants to their home countries, have become a significant topic of interest in the field of economics and development studies. This qualitative literature review provides an overview of positive impact of remittances and the challenges in international remittances. Based on the findings of the research, author has proposed some recommendations to overcome the challenges in remittances. Some of the prominent recommendations include, reduced transfer charges, transparent and competitive exchange rates, promoting digital platforms and mobile money, education on financial literacy etc.

Keyword: Remittance, Income, Poverty, Cost, Regulation

Introduction

Remittances refer to money transfers made by migrant workers to their home countries or communities. These funds are typically sent to support families and loved ones, covering expenses such as daily living costs, education, healthcare, and investments in small businesses or property. Globally, in past few years, there has been impeccable growth in remittances. As the practices of remittances are age old and ample research with empirical findings has already been done, this research paper focuses on doing the literary analysis of socio- economic impact of remittances and the challenges that lies in it.

Benefits of Remittances

According to Adams Jr, R. H., & Page, J. (2005) remittances are an essential source of income for many families in developing countries, particularly in rural areas. They help reduce poverty by providing households with additional resources for basic needs such as food, education, healthcare, and housing. Remittances have been found to have a greater impact on reducing poverty than foreign aid or foreign direct investment (FDI). They reach directly to households and are often used for immediate consumption or investment, providing a more significant poverty-alleviating effect. Ratha, D., et. al. (2016)

Remittances contribute to economic growth by increasing household income and consumption. This, in turn, stimulates local businesses and creates employment opportunities. Ratha, D., et. al. (2016). Remittances can also support investment and entrepreneurship in receiving countries, leading to the development of small and medium-sized enterprises (SMEs) and promoting economic diversification. Ponsot, F., et. al. (2017).

Remittances contribute to improved access to education by providing funds for school fees, books, uniforms, and other educational expenses. They enable children from remittance-receiving households to attend school, reducing dropout rates and enhancing educational attainment. Edwards, A. C., & Ureta, M. (2003) Remittances can help alleviate economic pressures on families, reducing the need for child labor. As a result, children can attend school instead of working. Yang, D., & Choi, H. (2007) demonstrated that remittances led to a reduction in child labor in the Philippines.

Remittances can increase household income, allowing families to afford better healthcare services, including medical treatment, medications, and preventive measures. A study by McKenzie and Rapoport (2007) titled "Network effects and the dynamics of migration and inequality: Theory and evidence from Mexico" found that remittances were associated with increased healthcare expenditure in Mexico. McKenzie, D., & Rapoport, H. (2007) Remittances can be channeled towards healthcare infrastructure development, such as building hospitals, clinics, and improving healthcare facilities. This investment enhances the overall healthcare system and improves access to quality healthcare services. A study by Azam and Gubert (2006) titled "Migrant remittances and economic development in Africa: A review of evidence" highlighted examples of healthcare infrastructure development funded by remittances in countries like Senegal and Ghana.

Remittances can positively impact dietary patterns and nutritional intake. Increased income from remittances enables households to access a more diverse and nutritious diet, especially in areas where food security is a concern. A study by Adams R.H. (2004) titled "Remittances and poverty in Ghana" showed that remittances were associated with a reduction in poverty and improvements in nutrition among recipient households in Ghana.

Remittances can affect the exchange rates of receiving countries, as they increase the supply of foreign currency. In some cases, this can lead to currency appreciation, which may impact the competitiveness of other sectors, such as exports and tourism. Guha, P. (2013).

Remittances and Poverty Reduction

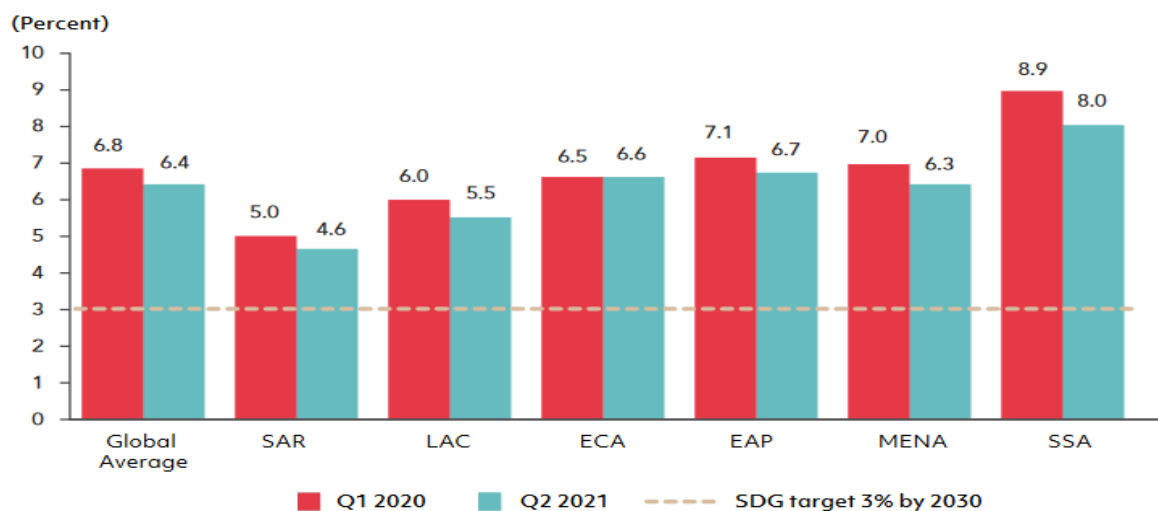
Existing literature indicates the positive impact of international remittances on poverty reduction. (Calaro, 2008; Jongwanich, 2007; Gupta et al. 2009) It increases family income therefore reduces poverty in developing countries. (Ratha, D. 2013) A study on Commonwealth of Independent States (CIS) by Abduvaliev, M., & Bustillo, R. (2019) finds that Remittance flows grow by 1% on average, which results in a 0.25% gain in per capita GDP and a 2% decrease in the severity of poverty.

| AUTHOR (S) | PERIOD OF STUDY | SAMPLE SIZE | FINDINGS |
|-------------------------------------|-----------------|-------------------------|--|
| Connors (2012) | 1985- 2005 | 86 countries | significant impact on poverty |
| Bahmani-Oskooee, And Oyolola (2009) | 1981-2002 | 49 developing countries | Foreign aid reduces poverty |
| Vargas-Silva et al. (2009) | 1988 to 2007 | | 10% increase in remittances would reduce the poverty gap by around 0.7–1.4%. |
| Banga And Sahu (2010) | 1980-2008 | 77 developing countries | Poverty has a significant inverse relationship with remittances. |
| Hossain (2013) | 1990- 2012 | 44 developing countries | Poverty is significantly affected by remittances. |

Table 1: Existing Literature on Remittances and its Impact on Poverty Reduction. Source: Authors compilation

Challenges

Cost of Remittance: One of the major challenges associated with remittances is the high cost of sending money. According to the World Bank, the average global cost of sending remittances was around 6.54% in the first quarter of 2021 Ratha, D., et. al. (2021). High transaction fees, foreign exchange costs, and limited competition among remittance service providers contribute to the high cost. These expenses can significantly reduce the amount received by the recipient, thus limiting the potential development impact of remittances.



Cost to Send \$200? Regional Remittance Costs, 2020–21. Source: World Bank Remittance Prices Worldwide database

Target 10.c of the United Nations Sustainable Development Goals aims to reduce the average transaction costs of migrant remittances to less than 3% by 2030. (United Nations, N.A.) This target acknowledges the importance of lowering remittance costs to support sustainable development and financial inclusion.

Sub-Saharan Africa continues to have a very high cost of remittances (over 8%). Remittance costs are generally greater when remittances are made through banks than through digital channels or through money transmitters providing cash-to-cash services, according to corridor-specific data (given in the regional sections). Ratha, D., et. al. (2021).

International Fund for Agricultural Development (IFAD) report explores the importance of remittances in achieving the Sustainable Development Goals (SDGs) and emphasizes the need to reduce remittance costs. It discusses the negative impact of high fees on remittance flows and proposes policy recommendations to address this issue. Ponsot, F., et. al. (2017).

Access to Financial Services: Many remittance recipients in developing countries have limited access to formal financial services. This lack of access can make it difficult for recipients to receive and manage remittances efficiently. According to the Global Findex database, in 2017, around 1.7 billion adults globally remained unbanked, with a significant proportion residing in developing countries (World Bank, 2018). Lack of identification documents, physical proximity to financial institutions, and inadequate infrastructure are some factors that hinder access to financial services, making it challenging for remittance recipients to utilize their funds effectively.

Informal Channels: Informal remittance channels, such as unregistered money transfer operators or friends and family carrying cash, are prevalent in many regions. These channels may not offer the same level of security, transparency, and legal protection as formal channels. Informal remittances can be vulnerable to theft, loss, or other risks, and they often bypass formal financial systems, making it difficult to track and regulate these flows. Encouraging the shift from informal to formal channels is crucial to improving the efficiency, transparency, and safety of remittances.

Exchange Rate Fluctuations: Exchange rate volatility poses risks to both senders and recipients of remittances. Sudden fluctuations in exchange rates can lead to significant variations in the value of remittances received, affecting the purchasing power of recipients. For example, if a local currency depreciates against the currency in which the remittance is sent, the recipient may receive less value than expected. This can create challenges for budgeting and financial planning, particularly for households heavily reliant on remittances.

Exchange rate fluctuations can be influenced by broader economic conditions, such as inflation, interest rates, and trade imbalances. These factors can impact both the sender's and recipient's countries, affecting the overall value of remittances. For instance, if the sender's country experiences high inflation or a depreciating currency, the purchasing power of remittances may decline for the recipient, impacting their standard of living. Recoveries, M. D. (2021). Exchange rate fluctuations can lead to changes in remittance behavior. When senders anticipate a depreciation of the recipient's currency, they may increase the amount they remit to mitigate the potential loss in value. Similarly, recipients may alter their spending patterns or consumption decisions based on exchange rate expectations, affecting local economies. Rapoport, H., & Docquier, F. (2006).

Regulatory Barriers: Some countries have implemented strict regulations and anti-money laundering measures that can impede the smooth flow of remittances. While these measures are essential for combating illicit financial activities, excessive regulatory requirements can create barriers for remittance service providers, leading to limited access and increased costs. Balancing the need for regulatory oversight with facilitating affordable and accessible remittance services is crucial for ensuring efficient remittance flows.

Recommendations/ Contribution of research

Improving remittances involves making the process more efficient, cost-effective, and beneficial for both senders and recipients. Based on findings of literature analysis, author proposes following recommendations for increased remittances:

- Bringing uniformity in legal and regulatory mechanism. Streamlining and user friendly remittance practices.
- Explore ways to lower transaction fees, which can be significant for smaller remittance amounts. Governments can work with financial institutions to regulate and cap fees.

- Ensure transparent and competitive exchange rates for currency conversion. Hidden fees in exchange rates can reduce the amount received by recipients.
- Promote the use of digital platforms and mobile money for remittances. This can reduce costs and improve convenience, especially for recipients in remote areas.
- Provide education on financial literacy to recipients to help them manage and utilize remittances effectively for long-term benefits.
- Implement clear regulations that facilitate remittance flows while ensuring security and compliance with anti-money laundering measures.
- Encourage partnerships between financial institutions, fintech companies, and governments to develop innovative solutions for remittance services.
- Provide incentives for using formal remittance channels rather than informal ones, which can be less secure and more costly.
- Explore ways to integrate remittances with social services such as healthcare and education to maximize their impact on recipients' well-being.
- Ensure reliable customer support for both senders and recipients to address any issues promptly.
- Improve data collection and transparency on remittance flows to understand trends and make informed policy decisions.

By focusing on these areas, countries can enhance the efficiency, affordability, and impact of remittances on individuals and economies.

Conclusion

Remittances have a large and diverse socioeconomic influence, benefiting both sending and receiving nations greatly. In addition to giving recipients instant cash support, remittances are essential for promoting social stability, economic growth, and the fight against poverty. Remittances economically support fundamental needs including food, healthcare, and education by increasing household income and consumption. Additionally, they support small businesses and create jobs by increasing demand for goods and services, which in turn stimulates local economies. Remittances can supplement national reserves and promote macroeconomic stability in certain situations by acting as a reliable source of foreign exchange earnings.

Remittances raise living conditions and lessen dependency on government support programs, which socially empowers families. They make it possible to receive better healthcare and education, which enhances the growth of human capital. Furthermore, as migrants maintain relationships and support systems across borders, remittances can bolster familial bonds and communal cohesiveness. But there are still a lot of obstacles to overcome, like high transaction costs, risky currency exchange, and reliance on migrant labor. In order to develop more equitable financial systems and lower obstacles to remittance flows, governments, financial institutions, and international organizations must work together to address these difficulties.

In summary, although remittances give millions of families around the world vital lifelines, achieving their full potential as a catalyst for sustainable development depends on removing systemic obstacles and advocating for laws that strengthen their favorable socioeconomic effects.

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