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## **Remittances by Emigrants: Issues and Evidence**

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## 1. Introduction

Remittances from migrants are a growing and relatively stable, market-based external source of development finance. Remittances bring foreign exchange, are a complement for national savings and provide a source of finance for capital formation (mainly small scale projects). Through this mechanism remittances can support economic growth in recipient countries. As remittances depend on flows of people that are often less volatile than capital flows, remittances are expected to be more stable than capital flows such as portfolio investment and international bank credit. Remittances are also an international redistribution from low-income migrants to their families in the home country. These transfers act as an international mechanism of social protection based on private transfers. The sustainability of remittances over time depends on various factors such as the anticipated flow of migration and whether the migrants come alone or with their family and how this change over time<sup>2</sup>.

It is also important to recognize that the benefits of remittances for receiving countries have to be compared with the potential costs of emigration for developing countries in terms of losses of scarce human skills that leave home (the so called brain drain phenomena). So we have a certain trade off here between generating an inflow of foreign exchange and external savings through remittances and the outflow of skilled individuals<sup>3</sup>.

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<sup>2</sup> New immigrants may initially come alone to the foreign country, leaving their families at home. Later on, when their employment situation in the host country is consolidated they bring their families. This may have implications for the flow of remittances and their persistence over time, as families are often the main recipients of remittances.

<sup>3</sup> See Ellerman (2003) and Solimano (2002a) for a discussion of these issues.

Remittances are, currently, the second most important source of external finance to developing countries, after foreign direct investment. Moreover, remittances surpass foreign aid. . There are 20 main recipients of remittances and these are 20 low to medium income developing countries that capture around 80 percent of total remittances to the developing countries. The three main recipient countries, in terms of value, are India, Mexico and the Philippines. In turn, the three main source countries of remittances are the U.S, Saudi Arabia and Germany.

The international market for remittances is segmented and inefficient (from a social point of view) as reflected by high costs of intermediation. Money transmitter operators dominating the market charge high fees and use overvalued exchange rates for money transfers. Commercial banks of both source and recipient countries have a low share of the global remittances market. However, the empirical evidence shows that the costs of remittances are lower when sent through banks than through Money Transfer Operators.

There is, however, room for leveraging a greater value for remittances if international money transfers were conducted at lower costs. The amount of remittances is below the socially optimal amount associated with a more competitive cost structure in the market for remittances (therefore, there is a dead-weight loss for both senders and recipients of remittances). The development potential of remittances is then diminished under current market realities in the “international remittances markets”.

The paper is organized in seven sections besides this introduction. Section 2 discusses global and regional trends in remittances flows and their growing importance as a source of external transfer to developing countries. Section 3 examines measurement issues and discusses the main micro-motives for remittances and their implications for their stability across

cycles. Section 4 analyzes the development impact of remittances (effects on savings, investment, growth, poverty, income distribution). Section 5 overviews the international market for remittances and provides evidence on costs of sending remittances to various country groups. Section 6 highlights policies to cut costs of sending remittances and enhancing their development impact. Section 7 concludes.

## 2. Global and Regional Trends in Remittances Flows.

In a world of volatile capital flows, remittances<sup>4</sup> are a stabilizing component of external resources transfers to the developing world. Remittances are the financial counterpart of the outflow of people and migration flows have been growing in the last two decades in response to growing opportunities in advanced economies compared to developing countries. Remittances to the developing world have increased, steadily, from around US\$ 15 billions in 1980 to 80 billions in 2002. This represents an annual rate of increase of 7.7 percent (see table 1<sup>5</sup>). At regional level, the highest rate of increase in the flow of remittances is towards Latin American and the Caribbean with 12.4 percent per annum. Then it follows East Asia and the Pacific with 11 percent per year. The lowest annual rate of expansion in remittances is to Sub-Saharan Africa with 5.2 percent. According to table 1, in 2002, Latin America and the Caribbean has the highest level of remittances with US\$ 25 billions followed by South Asia, US\$ 16 billions, East Asia and the Pacific with \$11 billions and the Middle East and North Africa, MENA, US\$ 14 billions. The lowest level of remittances is to Sub-Saharan Africa, US\$ 4 billions, see table 1.

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<sup>4</sup> See section 3 for statistical issues and definitions on how remittances are measured. .

<sup>5</sup> Since remittances are sent also through informal and un-recorded channels, official data may underestimate actual remittances (see section 3).

In terms of distribution of remittances by income per capita levels, the developing countries as a group received 65 percent of world remittances. In turn, the lower middle income and low-income groups receive a higher proportion than upper middle-income countries (see table 2).

In 2002, for the group of developing countries, workers remittances represented, on average, 1.3 percent of GDP, 55.9 percent of the flows of foreign direct investment and near 140 percent of the aid flows (see table 3). These coefficients vary from region to region. The proportion of remittances to gross domestic product is the highest in the MENA region (3 percent in 2002) and the lowest in East Asia and Pacific region (0.7 percent). Remittances as a proportion of foreign direct investment are the highest in the MENA region (466.7 percent in 2002) and the lowest in East Asia and Pacific (19.3 percent). In turn, the proportion of remittances to foreign aid is the lowest in Sub-Saharan Africa reflecting both lower remittances and high aid flows to this region.

In terms of total resource flows, remittances are the second largest component of external resource flows to developing countries after foreign direct investment (see table 4 and figure 1). Remittances have been larger than aid flows as a source of external development finance since 1997. In 2001, foreign aid represented 18 percent of total external flows of finance and remittances 25 percent. Interestingly, as mentioned at outset, remittances are much more stable than other capital flows -- mainly bank credit and portfolio investment -- that are identified as volatile components of external resource flows. The quantitative importance of these volatile components of private capital flows is still significant (near 30 percent of total resource flows to developing countries, as average, between 1991 and 2000). These components are an important source of macroeconomic

volatility. Many times, private capital flows do *lead* macroeconomic cycles. In contrast, remittances can be even counter-cyclical, as emigrants send money home in bad times as a source of income support.

At the level of individual countries, remittances are relatively concentrated in a group of 20 developing countries that capture around 80 % of total remittances to the developing countries (see figure 2). In turn, the GDP of these 20 countries represent around 60% of the GDP of developing countries<sup>6</sup> The main recipient of workers remittances, in 2001, is India that received an annual flow of US\$ 10 billions, followed by Mexico, US\$ 9.9 billions, and the Philippines, US\$ 6.4 billions. At the lower end of the top 20 developing countries recipients of workers remittances are Thailand, China and Sri Lanka. The country ranking change, however, when remittances are measured as shares of GDP. In this case, the three economies at the top of the ranking are Tonga, Lesotho and Jordan with remittances between 20 and 40 percent of GDP. At the lower end we find Philippines, Uganda, Ecuador and Sri-Lanka that have shares between 7 and 9 percent of GDP (see figure 3).

On the other side, the top 20 *source* countries of remittances (in 2001) are headed by the United States with US\$ 28.4 billions, followed by Saudi Arabia, US\$ 15.1 billions, and Germany, 8.2 billions (see figure 4). On the lower end of the top 20 senders we find Czech Republic, Venezuela and Norway (all three with US\$ 0.7 billions in 2001).

Let us turn now to the motives for remittances that can shed some light on the empirical behavior of remittances highlighted in this section.

### 3. Measurement, Micro-Motives for Remittances and Cyclical Behavior

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<sup>6</sup> World Bank, 2003.

In this section, we will review: (i) Measurement issues, (ii) The micro-motives to remit and (iii) The stability of remittances during the cycle<sup>7</sup>.

### Definition and Measurement Issues

The economic significance of remittances often goes beyond what is suggested by the official balance of payments statistics in sending and receiving countries. The important concept for measuring the economic impact of remittances is the resource transfer – monetary or in-kind – made by a migrant to his home country. Monetary transfers in dollars directly increase the availability of foreign exchange in the country of origin of the migrant, whereas remittances in-kind save foreign exchange for the recipient country. These distinctions are important, as there are several modalities for sending remittances. Some of them are recorded while some others are not. For example, when remittances are sent through formal channels they are recorded in the receiving country's current account of the balance of payments. Conversely remittances sent informally in cash, for example through couriers, go unrecorded in the official statistics. Remittances can be in-kind, e.g. goods sent to households in the home country. Only part of the later will be recorded as imports. Migrants can also make donations in the host country to institutions like the church and charitable organizations formed by co-nationals. Also they can make several payments (insurance premiums, tuitions for schools, payments for international airfares directly to the airlines) on behalf of relatives or friends from their home country<sup>8</sup>. Although most of these payments should be treated as “remittances” in an economic sense they are rarely recorded as such. In sum, all these

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<sup>7</sup> This section draws, largely, on Solimano, 2003.

<sup>8</sup> See Brown (1997).

considerations should be borne in mind when assessing the true magnitude of remittances transfers based on official statistics, which for the reasons mentioned above tend to *underestimate* their full economic impact.

In general, data on remittances are available from three items in balance of payments reports at country level (this data for different countries is compiled in the IMF Balance of Payments Statistical Yearbook): a) “workers remittances” (money sent by workers abroad for more than one year); b) “compensations of employees” (gross earnings of foreigners residing abroad for less than a year; and c) “migrant transfer”(net worth of migrants moving from one country to another), see Gammeltoft, 2002).

#### Microeconomic Motivations to Remit

The analytical literature<sup>9</sup> on motives for remittances can be summarized in four approaches:

##### *The Altruistic Motive.*

In this view the migrant send remittances back home because he cares about the well being of his or her family in the home country. Under the altruistic model, sending remittances yields a satisfaction to the emigrant out of a concern with the welfare of his family. Furthermore, it is an empirical regularity that the migrants have a higher education level than other family members that stay at home. As the migrant goes to a country in which average wages and per capita incomes are higher than at home, their income level after getting a job can be expected to be larger than comparable workers at home. The main prediction of the altruistic model is that remittances would tend to decrease over time<sup>10</sup>. One reason for this is that family attachment decrease as more time passes in which members are in

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<sup>9</sup> References of this literature are Stark (1991), Brown (1997), Poirine (1997), Smith (2003).

<sup>10</sup> See Stark (1991, ch.16).

different countries. Also the migrant may plan to stay abroad for a long time period (and eventually retire there) bringing along his family. This, of course, reduces remittances. The converse case would be that of return-migration in which the migrant brings fresh funds when returning home, raising remittances, once and for all.

*The Self-interest Motive*

An opposite motivation is to assume that the emigrant is mainly motivated by an economic and financial self-interest, when sending remittances to the home country. The story goes like this: the successful emigrant in the foreign country saves. Then, the need arises on how (in which assets) and where (in which country) to accumulate wealth. An obvious place to invest, at least part of his assets, is in the home country buying property, land, financial assets, etc. These assets may earn a higher rate of return than assets in the host country although their risk profile can be also greater. In turn, the family can administer, during the emigration period, those assets for the migrant, thus acting as a trusted agent. Another motivation to remit is the desire of the emigrant to receive an inheritance from his parents. In this case, those family members that have contributed to increase the wealth of the family (e.g. by sending remittances) become obvious candidates for receiving an inheritance in the future.

*Implicit Family Contract I: Loan Repayment.*

Economic theory has developed explanations of the remittances process that take the family—rather than the individual—as the main unit of analysis<sup>11</sup>. The theory assumes that families develop an implicit contract among those who choose to live abroad, the migrant, and those who stay at

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<sup>11</sup> See Poirine (1997) and Brown (1997) for elaborations on this specification of remittances.

home. The implicit contract has an inter-temporal dimension, say various years or even decades, as a time horizon. The contract combines elements of investment and repayment. In the loan repayment theory the family invest in the education of the emigrant and usually finances the costs of migrating (travel and subsistence costs in the host country). This is the loan (investment) element of the theory. The repayment part comes after the migrant settles in the foreign country and his income profile starts rising over time and is in condition of start repaying the loan (principal and interests) back to the family in the form of remittances. So the family invests in a higher yield “asset ”(the migrant) who earns a higher income level in the foreign country than other family members that live and work at home. This model predicts various time profiles of remittances over time depending upon the length of time it takes for the migrant to get established in the foreign labor market and also on the duration of his stay abroad. The quicker the insertion of the migrant in the foreign labor market, the faster will be the remittances flow. The amount to be remitted will depend, among other things, on the income profile of the migrant. In this model remittances do not need to decrease over time as in the altruistic model.

#### *Implicit Family Contract II: Co-Insurance*

Another variant of the theory of remittances as an implicit family contract between the migrant and those at home relies on the notion of risk diversification. The idea is simple. As insurance markets and capital markets in the real world are incomplete, many risks cannot be diversified by the absence of financial assets that edge risk. In addition, borrowing constraints, particularly serious for poor migrants, limit the ability to smooth consumption or finance investment. Assuming that economic risks between the sending and foreign country are not positively correlated then it becomes

a convenient strategy for the family as a whole, to send some of its members abroad (often the most educated) to diversify economic risks. The migrant, then, can help to support his family in bad times at home. Conversely, for the migrant, having a family in the home country is insurance as bad times can also occur in the foreign country. In this model, emigration becomes a co-insurance strategy with remittances playing the role of an insurance claim. As in any contract there is a potential problem of enforcement (e.g. ensuring that the terms of the contract, are respected by the parties). However, we can expect enforcement is simpler, in principle, due to the fact that these are implicit family contracts, helped by considerations of family trust and altruism (a feature often absent in legally sanctioned contracts).

#### Stability of Remittances in the Economic Cycle.

As mentioned in the previous section workers remittances are more stable than portfolio investments and bank credit. Remittances can even be counter-cyclical. The different motives to remit just reviewed can shed some light in explaining this behavior. In the model of remittances as altruism migrants can increase their remittances back home when there is an economic downturn in the home country (as the incomes of their families decline). In this case, remittances would be the equivalent of a private “welfare payment” sent from abroad to help smoothing consumption of the recipients at home. However, business cycles may be internationally synchronized. The growing economic interdependencies of globalization make this a more plausible case. In this situation, a recession in the receiving country may be positively correlated with a recession in the source country, so the ability to send remittances by immigrant workers may be hampered by economic conditions in the host country. This is a real possibility,

although the sender may also draw on existing savings to maintain a steady flow of remittances

If remittances were driven by the portfolio decisions of the migrants (remittances driven by investment), again the relevant issue would be the correlation between the rate of return of assets in the host country and the rate of return on assets at home. Here the international correlation of business cycle matter as well as the degree of financial integration between source and receiving countries. In the models of remittances as a co-insurance mechanism, risk diversification may call for a steady flow of remittances if business cycles are not fully positively correlated between source and receiving countries.

#### 4. The Development Impact of Remittances

Remittances have a potential, positive, impact as a development tool for the recipient countries. The development effect of remittances can be decomposed into effects on savings, investment, growth, consumption, and poverty and income distribution. The *impact on growth* of remittances in receiving economies is likely to act through savings and investment as well as short-run effects on aggregate demand and output through consumption. Also the indirect effect of migration on output depends on the productivity level of the emigrant in the home country before departure. The *total saving effect* of remittances comes from the sum of foreign savings and domestic savings effects. Workers remittances are a component of foreign savings and they complement national savings by increasing the total pool of resources available to investment. Part of the savings effects of remittances takes place in “community”. In fact, migrants associations, often called Home Town Associations (HTAs) in the United States, organize migrants from various Latin American countries such as El Salvador, Guatemala, Honduras,

Mexico and the Dominican Republic. HTAs regularly send *donations* to finance investment for community projects and local development in the home countries<sup>12</sup>. Migrants associations from El Salvador send home donations of about U\$ 10,000 per year. These are small numbers but in the recipient countries those sums can still have an impact. Mexican migrant associations send home between U\$ 5,000-U\$ 25,000 per year, (see Ellerman, 2003). In the Mexican state of Zacatecas, the Federal and local government match every dollar donated to local projects by HTAs (it may be a two- for- one or three –by- one) oriented to small infrastructure projects: water treatment, schools, roads, parks, etc. Through this program, more than 400 projects have been completed in eight years in Zacatecas<sup>13</sup>. The total investment made by migrants on those projects amount to around 4.5 million dollars (World Bank, 2002). In this way public savings are mobilized along with remittances to finance small community projects.

The previous discussion suggests that the direct effects of remittances on *investment* are bound to be on small community projects. Ratha (2003) cites positive effects of remittances on investment in receiving countries such as Mexico, Egypt, and Sub-Saharan Africa. In these countries, remittances have financed the building of schools, clinics and other infrastructure. In addition, return-migrants bring fresh capital that can help finance investment projects.

Remittances also finance consumption; thus, private savings will increase less than proportionally than an increase in income from external remittances. A study of remittances for Ecuador (Bendixen and Associates, 2003) shows that around 60 percent of remittances in Ecuador are spent on food, medicines, house rents and other basic commodities. The study shows

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<sup>12</sup> See the chapter by Micklewright and Wright, (2003) for this project on the role of private donations, mainly from foundations and other vehicles, as a source of development finance.

<sup>13</sup> It would be also relevant to know the proportion of those projects that are maintained.

that less than 5 percent of remittances are used in the acquisition of residential property.

The combined effects of remittances on investment and consumption can increase output and growth. The sustainability of this effect is an open discussion. If remittances are a response to recent migration, remittances may be transitory and thus their effects on investment, consumption and growth can be more of a temporary basis. In contrast, if migrants form associations and their commitment to their home country becomes “institutionalized” then, their positive developmental effects of remittances may become more permanent.

The indirect growth effect of remittances on *growth (or output)* depends on the type of emigrant that left home, the state of labor markets and the productivity of the emigrant. If the emigrant was an unskilled worker of low productivity, or an unemployed person, reflecting slack and excess supply in the labor market, then the effect of emigration on output in the home country is bound to be small. In contrast, if the emigrant is a highly skilled worker, an information technology expert or an entrepreneur with a high direct and indirect contribution to output, the adverse growth effect of high-skills emigration is bound to be large, (see Solimano, 2001, 2002).

A possible negative effect of (large amounts) of remittances is the possibility that they produce a “Dutch disease” effect<sup>14</sup>. For countries that receive important sums of remittances, there is a tendency for the real exchange rate to appreciate, penalizing non-traditional exports and hampering the development of the tradable goods sector.

Remittances may also have a *poverty reducing and income distribution effect*. As mentioned before the recipient of remittances are often low-

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<sup>14</sup> This effect is extensive to all kinds of transfers not only to remittances.

income families whose offspring left the country to work abroad. In a way, emigration is a response to escape poverty at home<sup>15</sup> and improve the income-earning capacity of the emigrant by attempting to enter foreign labor markets in richer countries. At the same time, remittances serve to alleviate poverty of the family of migrants in the home country by supporting their income through transfers. The negative side of this is that remittances may create also a certain “culture of dependence” on remittances’ incomes. This, in turn, can impair efforts to escape from poverty through education and work by the recipients of remittances. The *distributive effect of remittances* is another dimension of the development effects of remittances.<sup>16</sup> Stark (1991) studies the effects of remittances on *domestic* inequality in two Mexican villages near the border with the U.S. in which villagers engage both in internal rural-urban migration and migration to the United States. The study found that remittances from internal migration are more correlated with schooling years than remittances from international migration to the United States, as the later often go to low skills, labor-intensive jobs. Stark (1991) generalizes that the inequality impact of changes in remittances depend on the location of remittances recipients in the village’s income distribution, the share of remittances in villages incomes and the distribution of remittances themselves. These variables, in turn, depend on the distribution of human capital (education and skills) among villagers and the distribution of migration opportunities in the villages. Another piece of evidence is provided by Ratha (2003) who reports that, for Pakistan, a household data survey shows that the share of income originated by external

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<sup>15</sup> However, extreme poverty may also impede emigration, as the very poor may not be able to finance the costs of migrating to a foreign country.

<sup>16</sup> The distributive effects of remittances in the home country are more ambiguous. The issue is investigated in Barham and Boucher, 1998.

transfers increase with income levels, (the households with the highest incomes receive the largest shares of their income from remittances). So remittances might appear to be increasing local inequality. However, *income distribution between countries* may eventually improve with remittances as income is redistributed from higher income, source-countries to lower income per capita, and receiving-countries. As we saw in section 2, remittances represent a very significant share of GDP in several low-income countries.

A final remark here: the development effect of remittances depends on the “life-cycle” of the whole migration process at the level of countries. In fact, where receiving countries have growing economies with rising per capita incomes, differentials in incomes per head across countries will narrow-down, reducing the incentives for emigration. Therefore the relative importance of remittances is likely to decline as a country moves up in the development ladders. This is valid mainly for remittances from low-skill migration, however. In the case of high-skills, well-educated individuals migration flows are likely to continue at high per capita income levels, a feature we observe within the European Union or between Europe and the U.S. In this case remittances may continue although the economic effects of those remittances are probably quite different than those discussed here for the case in which the recipient of remittances are developing countries.

## 5. The International Markets for Remittances.

Remittances are channeled through financial entities such as Money Transfer Operators (MTOs), post offices, travel agencies, hand-delivery through couriers, informal financial institutions, etc. MTOs owned and run

by immigrants (or naturalized citizens of the same ethnic or national group) are denominated as “ethnic stores”. Commercial banks are also in the remittances business, but they are not, in general, important players. These financial intermediaries often charge fees for money transfers that are well above the marginal cost of those transfers (see Orozco, 2003). The most important MTO at global level is Western Union with branches in many countries, followed by MoneyGram and Thomas Cook. The less competitive, more concentrated and more segmented the market for remittances, the higher are the costs of remittances. There are a number of reasons why the international market for remittances tends to be a thin and poorly competitive (e.g. a few players dominate the market and costs of intermediation are high). First, the legal status of the migrants that send remittances is not always regularized. Some migrants have resident (working) visas, others are waiting for their visas to be processed and others are simply “illegal”. Commercial banks are reluctant to enter in the market of financial services for low-income migrants that often have a non-regularized immigration status<sup>17</sup>. The result is less competition in the market, besides migrants are not well integrated, as costumers, in formal banking circuits. Second, it is important to note that workers remittances are of small scale. In Latin America, the typical remittances per migrant person are in the range of U\$ 200- U\$300 per month<sup>18</sup>. As individual transactions (remittances) are small, service standardization is needed for the remittances market to be a profitable activity at competitive fees. In this context, high

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<sup>17</sup> In the United States, banks request people (migrants) a Tax Identification Number, TIN, as a requisite to open a bank account. In addition, recently some banks accept consular identification cards for opening bank accounts. Many migrants are fully compliant with tax payments even though their immigration status is not fully regular.

<sup>18</sup> See Orozco, (2002), Solimano (2003).

fees may compensate for the cost of small transactions<sup>19</sup>. Finally, other factors that affect the market for remittances are: exchange rate risk, government regulations for foreign exchange transactions in the receiving country and regulations in the sending country such as licensing costs.

### *Costs of Remittances*

Let us turn now to the efficiency of the market for remittances to the Andean region. If the costs of remittances are above the marginal cost (included a normal return to capital) of sending money then the amount of remittances is below the socially optimal level. As a consequence of this, there are foregone consumption, investment and output opportunities in the receiving country that could not be realized.

The work by Orozco (2001, 2002) highlights two main cost components in sending remittances:

Total Charges for remittances = explicit fee + exchange rate spread.

Companies charge a (explicit) fee that can be a percentage of the amount remitted or a fixed amount (often in dollars). The fee usually depends on the services offered, (speed of delivery, home delivery, etc). The exchange rate spread is the difference between the exchange rate applied by the money transmitter company to convert dollars into local currency and the market (e.g. inter-bank) exchange rate. Money transfer companies usually offer a less favorable exchange rate to the sender than the market rate. This is an additional source of profits for the money transmitter companies and an additional cost component for the user.

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<sup>19</sup> In the aggregate, however, this is a sector that mobilizes a large volume of resources: aggregate remittances for Latin America were on the order of 32 billion dollars in 2002 for the main 12 recipient countries in Latin America, (see MIF, 2003).

The average cost of sending US\$ 200 of remittances through commercial banks to selected non-Latin American countries is 7 percent compared to 12 percent of sending money through main Money Transfer Operators such as Western Union and MoneyGram (see table 6)<sup>20</sup>. Clearly sending money through banks is less expensive than sending it through MTOs. Banks also offer a variety of money transfer services and charges decline substantially when deposited in accounts of the same bank in the source and destination countries. Foreign exchange spreads represent around 14 percent of the total costs of remittances for non-Latin American countries. However, country averages mask significant cross-country differences in the costs of sending remittances. For example, according to table 10 drawn from Orozco (2003), the costs of sending money through banks are the lowest for Pakistan and the highest for the Philippines. These costs are much more uniform, but also higher, when money is sent through major MTOs (in the range of 9.5 percent and 13.5 percent).

Regarding the costs of sending money from the United States to Latin America, they are in the range of 8 to 9 percent for (see table 11). Interestingly, the component of exchange rate spreads, as a share of the total costs is twice as high for sending remittances to Latin American than for sending to non-Latin American countries (compare table 11 with table 9). In fact, the exchange rate spread component is around 14 percent of total costs for sending remittances to non-Latin American countries and near 28 percent for Latin American recipient countries. Finally, let us look at the costs of remittances for the Andean countries of Latin America (Bolivia, Colombia, Ecuador, Peru and Venezuela). Table 12 provides the average cost or charge

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<sup>20</sup> Table 7 reports the countries and companies studied to determine the costs of remittances according to major source/destination countries and type of financial operator.

of sending remittances for the five Andean countries for remittances of \$200, \$ 250 and \$300 dollars. The data is based on a survey of MTOs and ethnic stores in the United States that are engaged in the remittances industry with the Andean countries. The survey was conducted in January of 2003<sup>21</sup>. Table 12 provides the costs of sending money to be delivered in dollars and in local currency. The percentage charges are systematically lower across countries for remittances to be sent in dollars than in local currency, a difference that can range from 3 to 5 percentage points. There is a wide range of costs in a range of 5.6 percent to 13.8 percent (for remittances in the range \$ 200 to \$ 250) and 5.1 percent to 12.7 percent for remittances of \$ 300. In general, charges decline with the amount remitted. For individual countries we find significant differences among them. The lowest charges are for Ecuador and the highest for Venezuela. An important factor explaining the lower charges for money remitted to Ecuador is that the exchange rate spread component of the total costs (for the sender) disappears since the country uses the US dollar as the official currency. This is an important result: the Andean economy that adopted the U.S dollar, Ecuador, faces lower costs of remittances than an economy with a national currency<sup>22</sup>.

## 6. Policies to Reduce Costs of Remittances and Enhance their Development Impact

As we have documented in this paper that the costs of sending money transfers to developing countries are high, leading to an inefficient level of transfers. How to reduce the costs of sending money abroad? How to

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<sup>21</sup> See Solimano, 2003.

<sup>22</sup> See Beckerman and Solimano, 2002 for an analysis of the macroeconomic and social impact of official dollarization in Ecuador.

increase competition in the international market for transfers? How to enhance the development impact of remittances in receiving countries? Measures are needed at both the sending side as well as the recipient side.

### *The Sending Side*

The “formalization” of the legal status of the migrant would certainly encourage a greater access by the migrant to a variety of bank services, including remittances services. This should lower the costs of remittances. For example the use of ATM cards for making transfers rather than the more costly methods currently used can be an effective mechanism for reducing costs of remittances.

Another factor that, apparently, is preventing more competition in the remittances business in the U.S is the cost of getting a license for operating as a Money Transmitter Operator. The cost of getting a license for become a money transmitter operator is about \$100,000 per state. Prospective money operators find this cost high.

It is important also to avoid an increase in transaction costs and an increase in regulations of sending remittances due to mounting controls on financial intermediaries to prevent money laundering activities and the financing of terrorism to affect the workers remittances industry.

In sum, we believe that increasing the efficiency of the market for remittances requires:

a) Contain or reduce the costs of licensing for new operators making less costly, and more expedite, the process of certification of new financial intermediaries in the remittances business.

b) Expedite the process of granting residence visas and/or citizenship and avoid long visa processing periods for migrants (that currently takes several years, at least in the U.S). This would help to regularize the

immigrant sector inviting commercial banks to target the financial needs of the migrants.

c) Encourage domestic banks (particularly those with an international scope) to develop new product lines for migrants such as checking or savings account, remittances services, etc. The creation of “banks for migrants” is an idea worth exploring.

The remittance-receiving nations would benefit from a more efficient and less costly market for remittances. Currently, a significant slice of remittances goes to profits of operators rather than to the families of the migrants in developing countries. This has adverse efficiency effects and it is socially regressive.

*The Recipient Countries Side.*

From the viewpoint of recipient countries, leveraging remittances and enhancing their productive use for development are two important issues. There are various mechanisms for leveraging remittances in receiving countries. Governments and local financial institutions can issue bonds for emigrants, who would earn an interest rate, creating a more attractive instrument for channeling remittances.

Another possibility is for domestic banks to offer foreign currency accounts for migrants free of exchange rate taxes and other regulations. In addition, housing and education accounts can be created to channel remittances to various productive uses in the home country such investment in durables (housing) and education (investment in human capital).

The development of alliances between domestic banks in receiving countries and banks, credit-unions and MTOS in sending nations can help to increase the efficiency and reduce costs in the remittances market.

Mechanisms to ensure a productive use of remittances include the mobilization of home town associations (HTAs), that have spread-out in the United States in recent years (Mexican migrants have been very active in creating HTAs and are being helped by their government for this purpose).

Finally, taxing remittances (mainly worker's remittances) in sending countries or in receiving economies does not seem to be a good idea<sup>23</sup>. These are transfers, sent in general by and to low-income groups. So it is doubly inequitable that such flows, based on income that has already subject to the income-tax system of the sending country, should be taxed. . In receiving countries, remittances are a source of foreign exchange, a complement of national savings and a transfer to low to medium income groups. It is unclear the social gain for governments in interfering directly with these income flows in any way likely to diminish them..

## 7. Concluding Remarks.

This paper examines several developmental and financial dimensions of remittances from international migrants. Remittances are currently the second most important source of development finance at global level after foreign direct investment. Also, they are more stable than private capital flows such as portfolio investment and bank credit. Here the sustainability over time of remittances as a source of income for developing countries will depend also on the cycle of migration (recent versus older migration) and the expected flow of migration. Remittances have become a very significant source of development finance for several developing countries: they are a source of foreign exchange; they support consumption levels of low-to-middle-income families and constitute a direct source for funding small,

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<sup>23</sup> Another possibility is to make remittances tax deductible.

community-oriented investment project finance tied to migrants associations that send home donations to fund these type of projects (the so-called “community remittances”). From a social point of view, remittances can have a positive poverty- reducing effect, as many families of the migrants who receive remittances are low-income people, although the syndrome of dependence from remittances’ income by recipients should be avoided. Properly mobilized remittances can contribute to increase investment in basic infrastructure such as water, roads, low-income housing, school-buildings, investment in human capital (education) and help to finance micro and small-scale firms. For remittance-sending countries, remittances represent a market-based international transfer to developing countries that, indirectly, reduce the demand for official development assistance.

Still, we have to consider that earning foreign exchange through remittances entail an implicit trade-off with the outflow of skilled nationals and manpower from sending countries.

Currently, the potential development impact of remittances is in part impaired by the existence of a costly, concentrated and poorly competitive international market for remittances. The empirical evidence shows that the costs of remittances are above the marginal costs of (electronically) transferring funds provided those electronic transfers can be made.. Although the involvement of commercial banks in the remittances business is still low, the evidence shows that the costs of sending remittances tend to be lower if send through banks rather than through international money operators. In addition, there are differences in the costs of sending remittances to non- Latin American countries compared to Latin American countries. The exchange rate spread component of the costs of remittances is higher for remittances send to Latin American countries compared to non-

Latin American countries. Our empirical analysis, based on a detailed survey of money transmitter operators based in the U.S and operating with the Andean region of south-America shows that the total cost of sending remittances for these countries vary in a wide range that goes from 5 to 12 percent of the value remitted depending on the type of currency that is delivered, the destination country, the type of financial operator involved and other factors. Reducing by, say, 5 percentage points the costs of sending remittances could increase by a few billions the amount of remittances received by the developing countries.

What can be done to increase competition and reduce costs in the remittances market? In sending countries, facilitating the process of opening bank accounts for immigrants would be an important step for incorporating the migrant community to the financial system of the host country. This should increase competition in the remittances market and reduce costs of sending remittances. On the other hand, the costs of licensing for new operators and other regulation for bank and non-bank intermediaries wishing to provide financial services for migrants should be minimal to avoid creating barriers to entry in this market. Also the control of money laundering and the financing of terrorism should not unnecessarily increase the costs of sending remittances home by emigrants. On the recipient side, the issuance of remittance bonds, opening of foreign currency accounts for migrant workers in the home country, the creation of facilities for voluntary donations for projects are all measures to leverage remittances for development. In turn, the creation of education and housing accounts at home for migrants could help to encourage the productive and social use of remittances proceeds. Also attracting the return of emigrants that can bring

fresh capital, new ideas and international contacts can be a promising way to attract remittances for growth and development in receiving countries.

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## **ANNEX**

**Table 1**  
**Remittances Received by Region, 1980-2002.\***  
 (billions of US\$ dollars)

<b>Countries</b>	<b>1980</b>	<b>1985</b>	<b>1990</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002**</b>	<b>Annual Rate Growth (%) 1980-2002</b>
East Asia and Pacific	1.1	2.3	3.6	8.3	9.5	14.2	8.3	10.6	10.3	10.4	11.0	11.0
Share of Remittances in Developing Countries (%)	7.1	12.7	12.4	17.3	18.1	22.6	13.9	16.4	15.9	14.4	13.8	
Europe and Central Asia	2.1	1.7	3.2	5.5	6.2	7.1	9.2	8.1	8.7	8.9	10.0	7.4
Share of Remittances in Developing Countries (%)	13.5	9.4	11.0	11.5	11.8	11.3	15.5	12.5	13.5	12.3	12.5	
Latin America and the Caribbean	1.9	2.6	5.7	12.8	12.8	13.6	14.8	16.9	19.2	22.6	25.0	12.4
Share of Remittances in Developing Countries (%)	12.3	14.4	19.6	26.7	24.3	21.7	24.9	26.1	29.7	31.3	31.3	
Middle East and North Africa	3.8	4.6	9.3	8.6	9.1	9.4	10.3	10.5	10.9	13.1	14.0	6.1
Share of Remittances in Developing Countries (%)	24.5	25.4	32.0	18.0	17.3	15.0	17.3	16.2	16.9	18.1	17.5	
South Asia	5.3	5.8	5.6	10.0	12.3	14.6	13.3	15.1	13.5	14.9	16.0	5.2
Share of Remittances in Developing Countries (%)	34.2	32.0	19.2	20.9	23.4	23.3	22.4	23.3	20.9	20.6	20.0	
Sub-Saharan Africa	1.3	1.1	1.7	2.7	2.7	3.8	3.6	3.5	2.0	2.4	4.0	5.2
Share of Remittances in Developing Countries (%)	8.4	6.1	5.8	5.6	5.1	6.1	6.1	5.4	3.1	3.3	5.0	
<b>Developing Countries</b>	<b>15.5</b>	<b>18.1</b>	<b>29.1</b>	<b>47.9</b>	<b>52.6</b>	<b>62.7</b>	<b>59.5</b>	<b>64.7</b>	<b>64.6</b>	<b>72.3</b>	<b>80.0</b>	<b>7.7</b>
<b>Industrial Countries</b>	<b>N.A.</b>	<b>N.A.</b>	<b>N.A.</b>	<b>37.2</b>	<b>35.7</b>	<b>40.5</b>	<b>41.0</b>	<b>40.2</b>	<b>40.1</b>	<b>39.3</b>	<b>N.A.</b>	<b>N.A.</b>
<b>All Countries</b>	<b>N.A.</b>	<b>N.A.</b>	<b>N.A.</b>	<b>85.1</b>	<b>88.3</b>	<b>103.2</b>	<b>100.5</b>	<b>104.9</b>	<b>104.7</b>	<b>111.6</b>	<b>N.A.</b>	<b>N.A.</b>

Note: N.A. : Non Available

\* : Remittances are calculated as the sum of "workers' remittances" and ""compensation of employees"

\*\* : Estimate

Source: IMF Balance of Payments Statistics Yearbook (2003).

**Table 2**  
**Remittances Received by Country Groupings, 1995-2001.\***  
(billions of US\$ dollars)

Countries	1995	1996	1997	1998	1999	2000	2001
<b>Upper middle income</b>	13.7	13.6	14.3	16.3	15.7	16.6	17.2
Share of Remittances in all Countries (%)	16.1	15.4	13.8	16.2	15.0	15.9	15.4
<b>Lower middle income</b>	20.7	21.2	24.2	24.1	27.2	28.3	30.0
Share of Remittances in all Countries (%)	24.3	24.0	23.5	24.0	26.0	27.0	26.9
<b>Low income</b>	13.5	17.8	24.2	19.1	21.8	19.7	25.1
Share of Remittances in all Countries (%)	15.9	20.2	23.5	19.0	20.8	18.8	22.5
<b>All Developing</b>	<b>47.9</b>	<b>52.6</b>	<b>62.7</b>	<b>59.5</b>	<b>64.7</b>	<b>64.6</b>	<b>72.3</b>
Share of Remittances in all Countries (%)	56.3	59.6	60.7	59.2	61.7	61.7	64.8
<b>Industrial Countries</b>	<b>37.2</b>	<b>35.7</b>	<b>40.5</b>	<b>41.0</b>	<b>40.2</b>	<b>40.1</b>	<b>39.3</b>
Share of Remittances in all Countries (%)	43.7	40.4	39.3	40.8	38.3	38.3	35.2
<b>All Countries</b>	<b>85.1</b>	<b>88.3</b>	<b>103.2</b>	<b>100.5</b>	<b>104.9</b>	<b>104.7</b>	<b>111.6</b>
Share of Remittances in all Countries (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: \* : Remittances are calculated as the sum of "workers' remittances" and ""compensation of employees"

Source: IMF Balance of Payments Statistics Yearbook (2003).

**Table 3**  
**Remittances Received by Developing Countries\***  
**1996-2002**

<b>Countries</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002**</b>
<b>East Asia and Pacific</b>							
as% of GDP	1.0	1.3	0.7	0.8	0.7	0.7	0.7
as% of FDI inflows	16.2	22.8	14.4	21.7	23.4	21.3	19.3
as % of Aid flows	125.0	215.2	103.8	112.8	128.8	152.9	N.A.
<b>Europe and Central Asia</b>							
as% of GDP	1.4	1.3	1.4	1.1	1.0	0.9	1.0
as% of FDI inflows	38.0	32.6	35.4	28.6	29.8	29.6	34.5
as % of Aid flows	89.9	126.8	131.4	84.4	90.6	97.8	N.A.
<b>Latin America and the Caribbean</b>							
as% of GDP	1.3	1.2	1.1	1.1	1.2	1.3	1.4
as% of FDI inflows	28.8	20.6	20.2	19.2	25.3	32.6	59.5
as % of Aid flows	232.7	302.2	328.9	359.6	505.3	434.6	N.A.
<b>Middle East and North Africa</b>							
as% of GDP	3.4	3.0	3.1	2.9	2.8	3.0	3.0
as% of FDI inflows	1300.0	151.6	137.3	328.1	436.0	238.2	466.7
as % of Aid flows	171.7	195.8	219.1	244.2	294.6	335.9	N.A.
<b>South Asia</b>							
as% of GDP	3.7	3.8	3.1	3.2	2.6	2.6	2.6
as% of FDI inflows	351.4	298.0	380.0	487.1	435.5	363.4	320.0
as % of Aid flows	236.5	339.5	271.4	351.2	321.4	252.5	N.A.
<b>Sub-Saharan Africa</b>							
as% of GDP	1.4	1.7	1.4	1.3	0.7	0.7	1.1
as% of FDI inflows	62.8	46.9	55.4	43.2	32.8	17.4	57.1
as % of Aid flows	18.0	28.6	27.1	28.7	16.4	18.9	N.A.
<b>Developing Countries</b>							
as% of GDP	1.6	1.7	1.4	1.4	1.3	1.3	1.3
as% of FDI inflows	41.2	37.0	34.1	36.1	40.2	42.1	55.9
as % of Aid flows	101.3	134.5	118.3	123.5	127.9	139.0	N.A.

Note: \* : Remittances are calculated as the sum of "workers' remittances" and ""compensation of employees"

\*\* : Estimate

FDI: Foreign Direct Investment

Aid: Aid flows are Official Development Assistance

N.A.: Non Available

Source: IMF Balance of Payments Statistics Yearbook (2003).

**Table 4**  
**Resource Flows to Developing Countries, 1991-2002**  
(Current US\$ Billions and Percent)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002**	Average 1991-2001
<b>Remittances*</b>	33.1	37.2	38.9	44.1	47.9	52.6	62.7	59.5	64.7	64.6	72.3	80.0	52.51
	21%	19%	15%	16%	15%	14%	15%	15%	19%	19%	25%	36%	18%
<b>Aid Flows</b>	49.5	46.4	41.7	48.1	61.0	51.9	46.6	50.3	52.4	50.5	52.0	N.A.	50.04
	32%	24%	16%	18%	19%	14%	11%	12%	15%	15%	18%	N.A.	18%
<b>Others Official Flows</b>	11.4	10.1	11.9	-0.1	8.9	-7.8	7.2	16.2	5	-3	N.A.	N.A.	5.98
	7%	5%	5%	0%	3%	-2%	2%	4%	1%	-1%	N.A.	N.A.	2%
<b>FDI</b>	35.7	47.1	66.6	90	105	128	169	175	179	161	172	143	120.75
	23%	24%	26%	34%	33%	34%	41%	43%	52%	48%	60%	64%	38%
<b>Other Private Flows</b>	26.3	52.2	100.2	85.6	99.1	148.44	131.37	108.75	45.09	65.15	-11.73	N.A.	77.32
	17%	27%	39%	32%	31%	40%	31%	27%	13%	19%	-4%	N.A.	25%
<b>Total</b>	156	193	259.3	267.7	322.3	372.9	417.2	409.3	346.6	338.0	284.3	223.0	306.04
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Note: \* : Remittances are calculated as the sum of "workers' remittances" and ""compensation of employees"

\*\* : Estimate

N.A.: Non Available

"Aid flows" are "official development assistance" and "official aid".

"Other official flows" are total official flows ("official development finance"), net of aid Flows.

"Other private flows" are portfolio flows and bank and trade

Source: Remittances: IMF Balance of Payments Statistics Yearbook (2003). All other flows: World Bank: Global Development Finance (2003).

<b>Table 5</b>					
<b>Countries and Companies Studied</b>					
Receiving Country	Remittances Sent from	Number of companies reviewed			All businesses
		Banks	MTO*	Other	
Philippines	United States	5	14	5	24
Egypt	United States		2		2
Greece	Germany & U.S.	4	2		6
India	Saudi Arabia, U.S., U.K.	7	11		18
Pakistan	Saudi Arabia, U.S., U.K.	7	1		8
Portugal	France, U.S.	3	2		5
Turkey	Germany, U.S.	3	2		5
Mozambique	South Africa, U.S.	1			1
Zimbabwe	South Africa, U.S.		7		7
Bangladesh	U.K.	1	3		4
Ghana	U.K.		7		7

Source: Orozco (2003)

Note: \*: Money Transfer Operators (MTOs)

<b>Table 6</b>			
<b>Average costs of sending money to selected Non-Latin American countries</b>			
Type	US\$ 200		
	FX%	Fee%	Total%
Bank	1.0%	6.5%	7.0%
Major MTO	1.7%	10.9%	12.0%

Source: Manuel Orozco (2003).

**Table 7**  
**Charges to Send US\$ 200 to Selected Countries**  
**by Type of Business**

Type of Business	Bank	Ethnic Store /Exchange House	Major MTO
Country			
Egypt			13.8%
Philippines	8.0%	10.1%	10.3%
India	6.0%	2.5%	13.8%
Greece	6.8%		9.5%
Pakistan	0.4%	3.0%	13.0%
Portugal	3.4%		12.3%
Turkey	3.1%		9.5%
Mozambique	1.0%		
Mean	7.0%	6.0%	12.0%

Source: Manuel Orozco (2003).

**Table 8**  
**Average Charges to Send US\$ 200 from the U.S. to Latin America**  
(in US\$ dollars and as%)

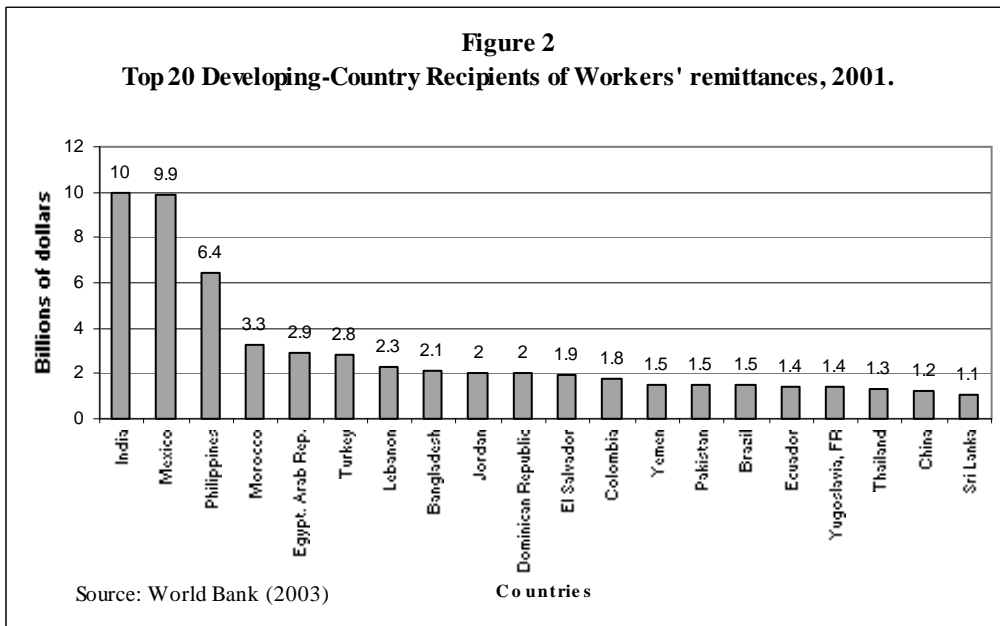
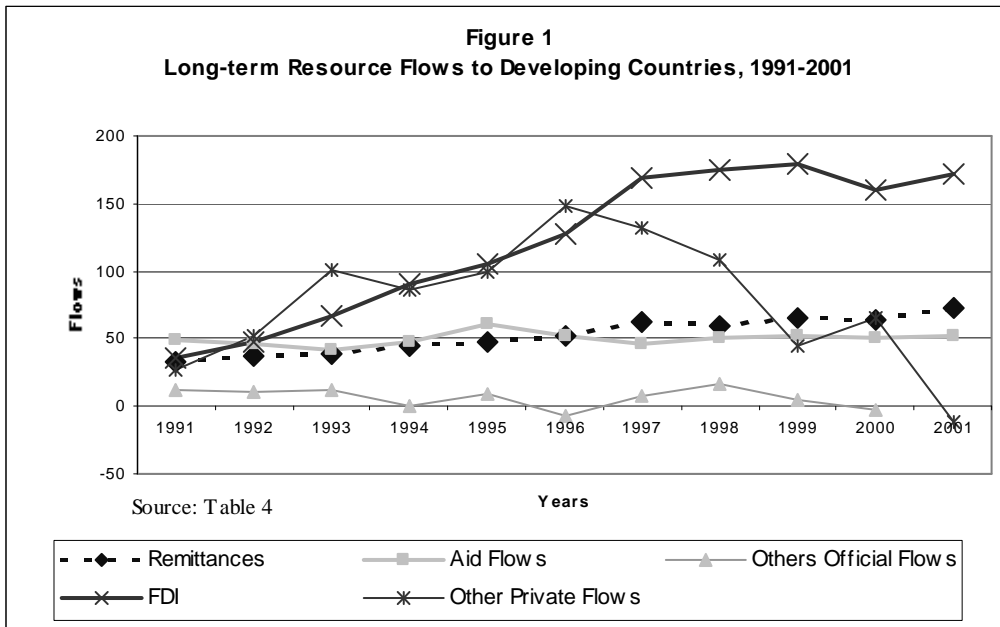
Charges	Nov-01	Percent	Nov-02	Percent
<b>Total Charge</b>	20.06	10.10%	17.02	8.50%
<b>FX Charge</b>	4.73	2.44%	2.97	1.48%
<b>Fee Charge</b>	15.33	7.66%	14.05	7.02%

Source: Manuel Orozco (2003).

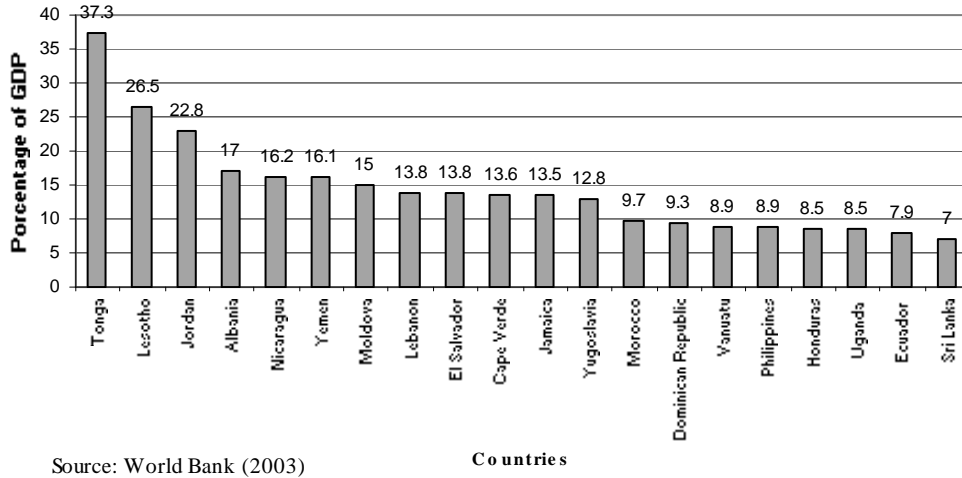
**Table 9**  
**Cost of Remittances from the U.S. to the Andean Countries**  
(in Local Currency vs. US\$ Dollars, averages per Country)

Amount	Country	Currency	Fxchange		Feecharge		Totalcharge	
			Level	%	Level	%	Level	%
200	Colombia	Local	9.30	4.65	10.67	5.33	19.96	9.98
		Dollar	0.00	0.00	12.33	6.17	12.33	6.17
	Ecuador	Dollar	0.00	0.00	11.23	5.62	11.23	5.62
		Local	6.50	3.25	21.00	10.50	27.50	13.75
	Peru	Local	-3.54	-1.77	18.50	9.25	14.96	7.48
		Dollar	0.00	0.00	13.00	6.50	13.00	6.50
	Venezuela	Local	12.04	6.02	15.00	7.50	27.04	13.52
		Dollar	0.00	0.00	21.00	10.50	21.00	10.50
250	Colombia	Local	11.62	4.65	13.25	5.30	24.87	9.95
		Dollar	0.00	0.00	15.39	6.16	15.39	6.16
	Ecuador	Dollar	0.00	0.00	13.96	5.58	13.96	5.58
		Local	8.12	3.25	27.00	10.80	35.12	14.05
	Peru	Local	-4.42	-1.77	22.50	9.00	18.08	7.23
		Dollar	0.00	0.00	16.25	6.50	16.25	6.50
	Venezuela	Local	15.05	6.02	18.75	7.50	33.80	13.52
		Dollar	0.00	0.00	25.00	10.00	25.00	10.00
300	Colombia	Local	13.95	4.65	14.88	4.96	28.82	9.61
		Dollar	0.00	0.00	17.22	5.74	17.22	5.74
	Ecuador	Dollar	0.00	0.00	15.38	5.13	15.38	5.13
		Local	9.75	3.25	27.00	9.00	36.75	12.25
	Peru	Local	-5.31	-1.77	24.00	8.00	18.69	6.23
		Dollar	0.00	0.00	17.83	5.94	17.83	5.94
	Venezuela	Local	18.05	6.02	20.00	6.67	38.05	12.68
		Dollar	0.00	0.00	29.00	9.67	29.00	9.67

Source: Andrés Solimano (2003). Workers Remittances to the Andean Region: Mechanisms, Costs and Development Impact. Paper prepared for the Multilateral Investment Fund-IDB's Conference on Remittances and Development, May 2003, Quito-Ecuador.



**Figure 3**  
**Top 20 Developing-Country Recipients of Workers' Remittances, 2001.**



**Figure 4**  
**Top 20 Country Sources of Remittance Payments, 2001.**

