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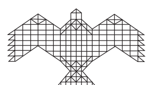
Economics of Migration and Remittances

A Review Article

Puja Guha

August 2011



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Abstract

The economic discourse on migration and development has swung from the neo-classical developmentalist optimism of the 1950s to a somewhat pessimistic hypothesis of lost labour and brain drain of the 1970s, to a more nuanced view of the new economics of labour migration (NELM), which looks at the gains arising out of resource transfer from migrants in the host countries to their respective countries of origin. Not only has there been a paradigm shift in the discussions, there has also been a change in the approach to understanding the migration-development nexus. From the Lewisian dual economy model of rural-urban migration for factor price equalization, there has been a shift to, and a recent boom in, empirical work on remittances, which are viewed both as a return from the migration process and as an important source of development finance. The aim of this paper is to analyse the different generations of migration theory and remittances from the development economics perspective, examining in particular the dichotomy between economic and social theory in explaining the nexus between migration and development.

Keywords: Migration Theory, NELM, Development Throey, Remittances

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1. Introduction

Over the last century, the developed nations have witnessed a surge in immigration, largely from the developing nations. While this has facilitated industrial development in the former countries, it has also had a diverse impact on the socio-economic structures of the latter. The process of migration and its effects on the economy and the society as a whole, of both the host country and the country of origin, have been studied from a range of development economics perspectives. The earlier theories on migration were more inclined towards explaining the process of labour movements from labour-rich low income countries to labour-scarce high income countries, with the help of several models like the wage differential model, push-pull factors, etc. The recent literature on migration, however, focuses more on the effects of such labour movements in both the sending and the receiving countries, and more importantly on the debate over the sustainability of international migration.

In economics literature, the studies on migration have emerged within the purview of development economics. The prevailing theories of migration have swung from being optmistic to highly pessimistic; recently, they have begun to take a more nuanced view, looking at *net* gains of migration on both sides in terms of lost labours and gained resources. The first discussions on migration in the early 1950s drew on the neo-classical view of rural to urban migration, which was seen as arising out of the resource differences in the two regions. The neo-classical models of migration proposed that labour moves for better opportunities, when they can expect wages that are relatively higher at the destination place than in the place of origin. While the theories of rural to urban migration have added significantly to the theories of growth and industrialisation, in the late 1960s and the early 1970s, the neo-classical model of labour migration was challenged by the structuralists. They viewed migration as a net loss of productivity for the sending nation through loss of skilled manpower, and hence, brain drain. In the 1980s there was a paradigm shift in the way migration was viewed, with the advent of the 'New Economics of Labour Migration' (NELM). This theoretical framework presented a more nuanced view, taking into account both the costs of migration due to labour moving out as well as the benefits of reverse flow of resources from migrants, such as remittances coming into the home countries. NELM has since steered the modern literature on migration.

The studies on migration were not just limited to economics; there were significant contributions from other social science disciplines, which helped the emergence of branches like Migration Studies and Transnational Studies, under the broader purview of Development Studies. While the economics literature focused on cross-border movement of labour and other resources, transnational studies examined the networks between individuals and the receding economic and social significance of boundaries between nation-states. Given the wide spectrum of studies on migration, there is very little common ground linking the different fields of study. As Castles (2008) points out, the research on migration fails to build on shared concepts and questions, and fails to accumulate knowledge, thus making the field narrow and fragmented. Indeed, a closer inspection of the literature on migration shows that there are diverse theoretical approaches, developed in different disciplines, which do not have a common thread. As Massey, et al (1993) rightly put it:

> At present, there is no single, coherent theory of international migration, only a fragmented set of theories that have developed largely in isolation from one another, sometimes but not always segmented by disciplinary boundaries (1993: 432).

Such fragmentation of literature largely arises from the dichotomy between micro- and macro-level migration studies. While micro-level studies investigate the causes of migration and the benefits

for an individual or a household, macro-level studies look at the developmental impact of migration on the community, region, or a country as a whole. Besides, there is a tendency to study the cause and impacts of migration as two discrete aspects, independent of each other, which also contributes to the disconnect between different theories of migration.

There is also a disjuncture between the different disciplinary approaches to migration theory. While economics has advanced theoretical structures and modelling techniques to predict individual behaviour, they are subject to the simplifying assumptions of rationality and utility maximisation (Boswell 2008). Similarly, sociological theories are well grounded in terms of considering actual individual behaviour, but they often lack the mathematical elegance of theoretical modelling. The different aspects of the migration process can be understood only by using tools drawn from different diciplines, and analysing the problem at different levels, on the basis of various assumptions and from multiple perspectives. This paper reviews the different generations of the discourse on migration and remittances only from the perspective of development economics, in order to clarify the prevailing concepts and theoretical approaches within one disciplinary area. However, it makes an attempt to highlight the differences between economic theory and sociological theory in explaining the nexus between migration and development. While the following section traces the evolution of migration theories, section three explains the nexus between migration and development by drawing on the economic and social theories of development. Section four looks at the literature on gains from migration, i.e., the economic remittance flows, and reviews the key themes in these studies. Section five summarises and concludes the paper.

2. Theories of Migration

One of the earliest scholarly theories of migration was proposed by Ravenstein (1885), who explained the phenomenon through 'Laws of Migration'. Ravenstein, a geographer by training, stated that migration is a process of absorption and dispersion, whereby people move into nearby growing towns, creating gaps which are instantly filled by migrants from distant areas. Thus migration flow produces a compensating counter-flow. He also suggested that economic factors are the main causes of migration. Ravenstein's laws of migration, in a nutshell, contained the essence of the subsequent spatial distribution theory of migration – the rural-urban migration or the push-pull factors of migration theory – thus laying the ground for later research on the subject.

Classical literature on migration has its roots in the 'dual sector model' of Lewis (1954), who defined migration as the movement of labour arising due to demand and supply differences. His model is situated in the context of rural to urban migration, a process that itself is central to economic development theory, where labour moves from a labour-surplus, traditional, agricultural sector to a labour-deficient, industrialised, urban sector. The process continues up to a point when full employment is reached in both the sectors and the wages in the two sectors are equalised. Harris and Todaro (1970) elaborated the basic two-sector model and stated that the migration decision is based on 'expected' income differentials between rural and urban areas rather than just wage differentials, i.e., migration happens due to a higher expected wage differential between the sending and the receiving regions (Todaro and Maruszko 1987). Thus, even in the context of high urban unemployment, rural-urban migration would still occur if there is a higher probability of finding a high-wage job in the urban areas (Todaro 1969). The Harris-Todaro model of migration has formed the basis of neo-classical migration theory.

Similar to the Lewisian dual economy model is the 'push-pull' model of Lee (1966), which describes the decision to migrate as being determined by the following: 1) factors associated with the area of origin; 2) factors associated with the area of

destination; 3) intervening obstacles (distance, immigration laws, etc.); and 4) personal factors. Lee suggests that migration happens through well defined streams which are directed towards localities with more opportunities. Also, migration is selective, i.e., migrants are not a random sample of the population at the place of origin. Instead, migration depends on the response of the individual to different factors at the origin and the destination and on the individual's capability to overcome the obstacles to migration (Lee 1966: 56).

As in all neo-classical theories, individual choice is the essence of the neo-classical literature on migration theory, particularly the dual-economy and the push-pull models. Individuals supply labour and maximise their utility through consumption of goods and leisure. The assumption is that individuals make rational decisions to maximise their utility, subject to the conditions of the job market, wages and other factors like distance from the home region, costs involved, etc. The mobility of these rational actors thus decreases the spatial and economic distance between the developed and developing regions through factor price equalization. The neo-classical approach takes a micro-level view of migrants as rational actors, assuming they have full market information, i.e., it ignores any information asymmetry among the individuals and considers the markets to be perfect with no structural constraints. This is usually the point of criticism of the neo-classical approach, which is regarded as too simplistic.

The neo-classical migration theory has been challenged by the structuralist theory of migration, which contributes to the dominant view of 'brain drain' associated with the migration process. The structuralist theory views migration as an escape strategy to evade the poverty which is caused by global capitalist expansion. Hence, rather than being a panacea, migration is seen as aggravating problems of underdevelopment (de Haas 2008). Originating in Marxist political theory (Castles and Miller 2003), the structuralist theory, also known as the the neo-Marxist approach associates movement of labour with loss of factors of production, called the 'lost labour' hypothesis. It suggests that migration causes a loss in the positive production contribution that the migrant would have made in the sending country if he/she had not migrated. This loss can be mitigated only if the migrant owns a large proportion of capital and leaves it behind in the country when he/she migrates. But often no migrant holds this huge capital stock. Hence, given the inelastic supply of resources in the domestic economy, migration is seen as a net loss to the sending country (Berry and Soligo 1969).

The loss of labour due to international migration is also used to explain the sectoral imbalances in a country. For a country with two primary sectors of production – traded and non-traded – it was initially observed that often the labour is lost from the traded sector (Kenan 1971; Bhagwati and Rodriguez 1976). But, with diversification of the services sector, it is argued that there is a loss of labour even from the non-traded service sectors like construction and transportation services. Rivera-Batiz (1982) finds that a major proportion of skilled labour migration from Less Developed Countries (LDCs) is from the health sector. He proposes that given the dichotomy between traded and the non-traded goods migration leads to a decrease in the productive capacity in the non-traded sector, even under fixed terms of trade, resulting in higher prices in this sector. This eliminates the possibility of internal exchange of traded for non-traded goods existing between migrants and non-migrants, giving rise to a deterioration of economic welfare in the sending country.

In the late 1980s and 1990s, the 'New Economics of Labour Migration' (NELM) literature emerged, which was an improvement over the neo-classical migration theory. It rejected the individualistic approach of neo-classical theory and placed the behaviour of the migrants in a larger social context. The NELM theory was pioneered by Oded Stark

(Stark and Bloom 1985) and endorsed by, among others, Douglas S. Massey (Massey 1988) and Edward J. Taylor (Taylor 1999). While the early literature did not take into account the monetary transfers, which are usually associated with the migration process, NELM, in its migration models, views migration as a form of monetary insurance for the sending families, necessary for their economic survival. The returns from migration are viewed as helping to balance market imperfections by creating demand and even stimulating local production. Whereas the brain drain perspective concentrates on the cause of people moving out of a region/country, the NELM theory focuses on looking for ways to effectively manipulate the migration phenomenon so as to turn it into a vehicle for national development. It advocates the need for good policies to retain the desirable returns of migration while eliminating its undesirable consequences, rather than doing away with migration per se (Stark 1980, 1982).

3. Migration-Development Nexus

The neo-classical models explained the migration-development nexus through the migration-expected income framework. But this does not take into account the several agents and events that shape the pattern of migration, which eventually emerges as a process rather than a phenomenon. Thus, while the early studies conceptualised migration as a static, linear process, the newer generations of migration studies consider it as a dynamic system, capable of changing the shape and course of the development process.

There have been attempts from different disciplines to model the dynamism of the migration development process. One such study in the field of geography is by Zelinsky (1971). He adopts a spatial temporal approach to revisit the laws of migration, calling it 'mobility transition'. He states that there are five stages of mobility transition – (1) the pre-modern traditional society (very little migration); (2) early transitional society (massive rural to urban migration as well as emigration to foreign destinations); (3) late traditional society (slacking off of rural-urban migration); (4) advanced society (vigorous movements between cities); and (5) future super-advanced society (more skilled migration). When superimposed on Rostow's stage theory of growth (Rostow 1960), the stages of migration process can be directly linked to the stages of development of an economy.

At this point it will be most appropriate to link the mobility transition theory to the theory of 'migration hump' of Martin (1993) and Martin and Taylor (1996), who argue that the migration process gives rise to a temporary increase in migration. In the early stages of development, with increasing wealth and access to resources, more people are able to migrate and selectivity in migration decreases. This results in a peak in the total population of migrants. Over a period of time, in the later stages of development, emigration decreases as labour supply stabilises between the two regions.

But while putting the theories of development and migration together, one is compelled to think of Castle's question: 'development and migration – migration and development: what comes first?' (Castles 2008). At the first instance this question may seem superfluous as both are part of the same process, constantly interacting with each other. But the question becomes relevant when seen in the broader context of development studies. While migration studies includes diverse disciplines, development is usually defined within the narrow framework of economic parameters, which often ignores the social and cultural aspects of development.

4. Remittances – Gains from the Migration Process?

While the literature on migration dates back to late 19th century, studies on remittances are relatively new, though the latter can be seen as an offshoot of the former. The NELM theory views

remittances as 'gains from the migration process', which contribute towards the development of the migrant's home country. The introduction of remittances in assessing the gains of migration has led to a paradigm shift in migration studies as it has resulted in much emphasis being given to empirical studies aimed at testing the 'positive' effects of migration through remittance flows.

Economic remittances are defined as household level transfers made by the migrant member to his/her family, primarily meant for consumption purposes. At a micro level, remittances are studied from two angles – what are the factors that create them, and how are they used? The decision to migrate is seen not as an individual decision, but as a group or a family decision. It has a contractual basis where the returns from the migrants are shared by the migrant as well as the non-migrant family residing in the sending country. At a macro level, remittances are viewed as a source of foreign exchange transfer, having a direct impact on the balance of payments of the country. The very nature of these capital flows, absence of any quid pro quo arrangement, their tendency to be less volatile than other capital flows, and often their pro-cyclic nature, makes them an important source of development finance in the developing countries.

Studies on motivation of the migrants to send remittances delineate the factors instrumental in creating these transfers. While the motivations can be attributed to those who have migrated, they are often governed by the needs of his/her family back home. It has been found that in developing economies most of the remittances are used to meet the needs of the family. Hence there is often a strong altruistic motivation attached to sending remittances back home (Stark and Bloom 1985), and such altruistic behavior arises from the fact that a migrant's utility function not only depends on his own consumption but also on the consumption levels of the extended family of non-migrants (Johnson and Whitelaw 1974). Thus, given the quantum of remittances, the lost labour cost of migration can be very well compensated.

The utilisation pattern of remittances is another important factor which has consequences on the economic growth of the country. Given the huge aggregated levels of remittance flows to developing countries, the utilisation pattern of remittances also becomes important as it changes the demand structure of the economy and alters the production structure, which in turn redefines the economic growth trajectories of the host country. The utilisation of remittances is to a great extent dictated by the needs of the family, though it is also defined by the existing social and economic structure of the region.

In addition, the literature also shows that the effect of remittances is not limited to the households receiving them, but also has a spill-over effect on other households. Djajic (1986) extended the migration model proposed by Rivera-Batiz (1982) by introducing remittance in flows into it, and found that if the flow of remittances exceeds a certain critical amount, the remaining residents benefit from migration even if they do not directly receive any of the remittances. Thus remittances create a possibility of gain even for the non-migrant households.

Development economics regards remittances in the context of welfare. As they are non-wage income, they are expected to increase the welfare of the receiving households by pulling them out of the poverty trap. It is a stable source of developmental finance which provides a social insurance against the economic and political uncertainties in the developing countries. But as Kapur (2004) points out, while remittances are generally pro-poor, their effects are greatest on transient poverty. Long-term effects on structural poverty are less clear, principally because the consequences of remittances on long-term economic development are not well understood.

A significant consequence of studies on remittances is that it has drawn attention to the differences between disciplinary approaches. Remittances, seen as a return from the migration

process, have an economic impact as well as a social impact on the families and the regions receiving them. But often, the economic and the social impact of remittances are studied in a compartmentalised fashion, with few overlaps. Remittances are mostly classified as economic gains and squarely situated within economic theory. While economic literature mostly deals with the micro and macro aspects of what it considers as purely 'fiscal' remittances, social theory also brings in the perspective of 'social remittances' (Levitt 1998), which considers the transfers not just as monetary flows but also as flows of ideas, practices, identities and social capital from the host to the home country. While economic theory explains the developmental role of remittances through income stabilization and welfare gains of the households, social theory looks at the way the reverse flows generated by migration shapes the political, cultural and economic participation of the households receiving them. Though this disciplinary divide is getting blurred with the increasing complexity of the studies to understand the effect of remittances, it nevertheless continues to exist at some levels, mooting the need for a link between studies on the economic and the social impact of remittances. While remittances do lead to an increase in the welfare of the household, their overall impact on the household and the region should be viewed along with the other prevailing structures of the society, defined by the political, cultural and religious systems. The following section provides a review of the economic studies on remittances, and tries to draw a comparison between the economic and social theory, wherever possible.

4.1 Motivation to Remit

While some of the early literature on remittances views altruism as the primary motive to remit (Johnson and Whitelaw 1974; Stark & Bloom 1985), recent literature argues that although remittances do centre around the family, the motivation is not just altruistic, but also, to a great extent, self-interest. Lucas and Stark (1985) differentiate between purely altruistic remittances and remittances driven by self-interest, and find that motivation lies somewhere in between. They call this impulse 'tempered altruism' or 'enlightened self interest'. They view migration as a 'Pareto superior' strategy, where both the migrant member and the family are better off after migration, through the redistribution of the gains of migration, i.e., remittances. Self seeking motives to remit include an aspiration to inheritance, a desire to explore investment channels through trustworthy family members, and a wish to ultimately return home with dignity.

There is a strand of literature which describes remittance behaviour as an insurance contract between the migrant and his family. The family, which is at the centre of the migration decision, acts as an insurer for the migrants. While remittances from the migrants help reduce variability in family income, the family also provides support to the migrant in times of need (Stark 1991). Thus, the motivation to remit is also linked to the risk sharing nature of remittances (Agarwal and Horowitz 2002). Gubert (2002) used data from Mali and found empirical support for the view that insurance is an important motivation for these transfers.

Remittances also represent an implicit family loan agreement. The family and migrant can be viewed as an informal financial market where these monetary flows are nothing but repayment of the loan that the family member had taken to finance migration. Poirine (1997) classifies the informal financial agreement between the migrant and the family into three stages: In the first stage, emigrants repay the loan taken by them to secure a better education through their remittances. In the second stage, the emigrants make implicit loan payments to their children to finance their education back home. And in the third stage, the next-generation emigrants repay the loan to former emigrant-lenders who are usually retired, and back in the home village. Thus, three 'waves' of loans, repayments, and savings sent by emigrants to family relatives back home make up the remittance flow over time. Ilahi and Jafarey

(1999) also find a similar informal loan payment characteristic of remittances in the case of Pakistan. Such loan repayment is not only restricted to the immediate family members, but also flows to the extended family members.

While these are studies which look at the motivation to remit from a behavioral and social perspective, there are studies which have tried to empirically model and test the motivations to remit. Elbadawi and de Rezende Rocha (1992) present a detailed review of the literature on modelling the motivation for the workers' remittances. The two approaches to such modelling are the 'endogenous migration approach' and the 'portfolio approach'. The endogenous migration approach looks at the family ties and includes motivation based on altruism. This approach centres around the consumption and savings life cycle of the migrant, i.e., measuring the motivation to remit by phasing out the earnings of the migrant for consumption and savings purposes throughout his lifetime. It uses a utility maximizing framework for the migrant worker to determine his/her optimal path of consumption, savings and leisure (Djajic and Milbourne 1988). Djajic (1989) develops such a model for the savings-consumption rate of the guest migrant worker, given the length of his/her stay. Length of stay greatly affects the savings and consumption path of the worker. For a temporary migrant, the motivations to remit are much higher as compared to a permanent migrant.

The portfolio approach, on the other hand, focuses on the relative rate of return between the home and the host countries, the relative prices, and degree of uncertainty as the determinants of the migrants' motivation to remit. It views remittances as a tool for financial investments, which the worker decides based on the relative rates of return in both the countries. Swamy (1981) presents a simple model for determining remittances, where, after controlling for personal circumstances, she tries to find out the effect of financial leverage opportunity in the host vis-a-vis the home country. Financial leverage could be in terms of the interest rate differential on financial and real assets, exchange rate policies in the host country, or any other policy in the home country that incentivises remittances. She includes variables like foreign exchange deposit schemes with attractive interest rates, special import privileges, premium exchange rates, and special investment schemes for workers living abroad, which have a positive impact on remittances coming into the home country. Factors such as overvaluation of exchange rates, increasing length of stay of migrants, and the increasing number of dependents in the host country, which have negative impact on remittance flows, are also included. Swamy uses the data from Greece, Turkey and Yugoslavia to test the model and finds that demographic factors have far more in influence on remittances than financial variables. Straubhaar (1986) gets similar results as Swamy for Turkish emigrants in Germany where he finds that the interest rate differential between the host and home countries have no effect on remittances. Katseli and Glytsos (1986), on the other hand, find that per capita remittance is related to the interest rate in the host country. According to Chandravarkar (1980), both realistic exchange rates and the existence of an appropriate institutional environment significantly affect remittances.

Elbadawi and de Rezende Rocha (1992) synthesise the two approaches to model motivation to remit by including both demographic and financial variables in their model for North Africa and Europe. As in the previous studies, they find that the number of workers abroad and their length of stay have a significant impact on real remittances. Wahba (1991) also observes that remittance flows are greatly affected by the exchange rate differentials and the black market premium. He points out that the exchange rate differential affects the official channel of fixed remittances and the official channels are not used as long as the real domestic rates are less than the foreign rates, thus adding to the black market premia, and encouraging unofficial transfers. Apart from the financial disturbance, political instability in the home country also acts as a deterrent to the remittance inflow.

To summarise, while the early literature on motivation to remit highlights the altruistic nature of remittances, there is also evidence of remittances acting as an insurance for the migrant worker, or as a source of investment for him/her. Existing literature classifies motivation into different types: (1) altruistic reasons, where family takes the centrestage and remittances are sent mostly to alleviate poverty and improve the socio-economic standards of the non-migrant family; (2) exploring investment possibilities when returns are higher in the home country than in the host country; and (3) a situation where the migrant has family ties but looks at his family as a trustworthy insurer or a bank, on which he/she can fall back when needed, or as an informal contractual agreement between the migrant and his/her family, where the migrant is responsible for paying off his implicit debts to the family.

4.2 Utilisation of Remittances

With increased inflow of remittances, the main question that arises is how these financial resources are used in the recipient countries. Are these used to finance 'unproductive' consumption or are they channelled into productive investments? Do they put the labour sending countries into the vicious trap of dependency or do they actually facilitate development? The pattern of usage of these funds determines the development path of the recipient country.

One strand of literature suggests that a major proportion of these remittances are directly used for personal consumption needs. Oberai and Singh (1980) find that in the case of the Indian state of Punjab, more than three-fourths of the remittances received by the households is spent on food and clothing. Durand et al. (1996) find a similar situation in Mexico, as does Glytsos (1993) in Greece. But all these studies conclude that even though remittances are used for consumption, they indirectly foster overall economic development. Higher levels of consumption lead to an increased demand for goods and services, which in turn leads to increased production through the multiplier effect, thus stimulating growth.

Another strand of literature provides evidence of a part of the remittances being used for savings and investments. In developing economies, the nature of investment is very different from that of a developed country. In most of the less-developed countries, purchase of land and housing forms a major part of the total investment. While some studies consider such purchases of land and house as capital investment, other studies consider them as a part of non-traded consumption. Adams (1991), in his study of the expenditure pattern of migrant households in Egypt, found that these households consider the remittance income as transitory and do not fritter it away in unproductive consumption. Instead, more than half of the remittance income goes towards housing expenditure, which includes building and repair works. Also, a significant proportion of funds is used for investment in land, which is well indexed to the inflation rate. Similar studies have been done in the context of other developing countries. Alderman (1996) uses panel data for Pakistan and finds that remittances are considered as a temporary income shock and are not considered as a permanent income. Similar observations are made by Adams (1998), who develops a framework and methodology to determine the effects of remittances on physical capital accumulation in Pakistan, rather than having a direct impact on consumption. Brown's (1997) study of Western Samoa and Tonga suggests that asset accumulation and investments are the greatest motivations for migrants to remit. Thus a major proportion of remittances is found to be used towards housing expenditure.

While we consider land and housing expenditure as physical investments, the use of remittances as business investments in developing nations is found to be quite low. Sofranko and Idris (1999) find that very little remittances are actually channelled into business investment and it is so only if the migrant's family residing in the home

country has some prior exposure to business. Taylor (1992), on the other hand, observes that remittances in the short run have direct as well as indirect effects on the income of the household, which is usually ignored by analysts. In the case of Mexican farm owners, in the short run remittances influence income from other sources like crop income, and in the long run they are used to finance the accumulation of income producing assets, such as cattle, on the household farms.

Overall, the motivation of the migrant determines, to a certain extent, the nature of use of the remittances. The family, which is the primary decision making body and better aware of the economic conditions in the home country, steers the pattern of usage of these funds, either towards consumption or towards investment in physical capital. Thus, two facts emerge from the literature on remittance utilization. First, remittances have a strong microeconomic characteristic as they are received at the household level and are mostly used for personal expenditure. Hence, to model the effect of remittances it is important to incorporate these micro-foundations of remittances. Second, unlike other capital flows like FDI or portfolio investments, which have a direct impact on the capital account and thus implications for economic growth, remittances are part of the current account and have an indirect effect on economic growth by influencing household and individual behavior.

4.3 The Macroeconomic Approach to Remittances

As remittances are household level flows, most of the studies done on remittances have a microeconomic focus. However, in recent years there has been growing interest in the aggregate macroeconomic effects of remittances. Studies using macroeconomic models to explain the effects of remittances, though limited in number at present, can be classified into two groups: one corpus of literature looks at the socio-economic effects of remittances, focusing on poverty, education, health and the social welfare of a country, while another focuses on larger macroeconomic issues like inflation, exchange rate appreciation, terms of trade distortions and so on.

Remittances have significant social consequences, affecting not only the households receiving them but also the society as a whole. They could play a significant role in reducing the poverty levels (Adams and Page 2005; Acosta et al. 2008), increasing school retention levels, enhancing access to improved health care facilities, etc (Funkhouser 1992; Edwards and Ureta 2003), thereby improving the social conditions of the households and helping the country move up on the human development index (HDI). Remittances also have a direct impact on economic activity through investment and an indirect impact through consumption. They act as an alternate source of income and result in a multiplier effect by provoking increased demand for goods and services, leading to increased production, thus stimulating growth (Durand et al. 1996). Glytsos (1993) uses an input output matrix to calculate the remittance multiplier for Greece and finds the value to be 1.7, i.e., for every unit increase in remittances, the production of the country increases by 1.7 times. Similarly Adelman and Taylor (1990) estimated the multiplier value for Mexico as 3.2.

While remittances have a positive prognosis for socio-economic effects, the impact on the larger macroeconomic parameters raises certain issues. When huge amounts of foreign exchange flow into a country, there is concern over the effect of these flows on the exchange rate of the economy. Studies show that high levels of remittances can give rise to what is called the ‘Dutch Disease’, i.e., an increase in remittances could give rise to higher demand, leading to higher relative prices of non-tradables (given tradable prices are determined exogenously), resulting in an appreciation of the real exchange rate and terms of trade distortions. Many recent studies have used dynamic economic modelling to determine the effect of remittances on the real exchange rate and have shown that remittances often lead to the ‘Dutch Disease’ effect

(Amuedo-Dorantes and Pozo 2004; Chami et al. 2006; Loser et al. 2006; Acosta et al. 2007; Lopez et al. 2007; Acosta et al. 2008; Chami et al. 2008).

This is an important issue as it has a direct impact on the external competitiveness of the country. While the surge in foreign exchange into the country could have some developmental impact, it may be detrimental for the economy as a whole. This triggers calls for a discussion in the existing policy area, on the premise that it is not only sufficient to draw strategies to attract remittances, but there should be appropriate policies to manage these funds as well. An appropriate policy framework may provide for potential channels of investments and other opportunities such that the impact of these flows on domestic consumption demand is reduced, thus minimising the negative impact on the external competitiveness of the country.

4.4 Remittances and Labour Supply – The Micro and Macro Synthesis

While remittances may have both microeconomic impact through changes in household consumption pattern and macroeconomic impact through distortions in terms of trade, the channel which bridges the micro and the macro level impacts is the labour supply decisions of the households. Remittances are a form of non-labour income. They are wealth accumulated over and above labour income. The greater the wealth accumulated by a household, the lesser is the tendency of the household to supply labour for economic activity. In other words, remittances add to the income effect of the labour-leisure tradeoff, and the household substitutes leisure for labour.

The literature on the labour effect of remittances is quite sparse. Gong and Zou (2001) study the impact of foreign aid on the domestic labour supply decision and conclude that foreign aid reduces long run capital accumulation and labour supply while increasing welfare, by causing the substitution of labour with leisure. Though Foreign Direct Investment (FDI) is another form of capital inflow, we can draw a similar conclusion for remittances. Rodriguez and Tiongson (2001) examine the effect of migration in the Philippines labour market. Using household survey data they find that migrants reduce the labour supply of non-migrants who substitute income for more leisure. From these studies one can say that capital inflows have a negative impact on the labour supply decision.

In the case of remittances, Amuedo-Dorantes and Pozo (2006) suggest that remittances form a source of non labour income. Based on the neo-classical labour leisure choice model, this income is thought to lift the budget constraint, raise the reservation wage, and, through the income effect, reduce employment in households that receive remittances (Amuedo-Dorantes and Pozo 2006). Airola (2008) made similar observations for Mexico, where the hours of work went down for the recipient household as the amount of remittances increased. Bussolo and Medvedev (2007) examine the impact of remittances on labour supply decisions in Jamaica. They find that remittances reduce the overall labour participation rates by increasing the reservation wage in the economy. Dennis and Iscan (2005) look at the effect of capital flows on sectoral labour participation rates, between the non-traded sector and the traded sector, and find that a shock in external capital flows can lead to labour reallocation provided there exists technological diversity across the two sectors.

4.5 Remittances as a Source of Developmental Finance

The remittance-development nexus in economic theory is usually seen from the perspective of the impact-response framework, i.e., it examines the impact of remittances on demand, prices, output and growth. There are very few studies within economics to understand the socio-political consequences of remittances. One such study is by Russel (1986), who defines remittances as 'the portion of migrant workers earnings sent back from the country of employment to the country

of origin', and uses 'Remittance System' as a heuristic to explain the intermediate relationships between determinants and effects of remittances. In defining the Remittance System, she introduces socio-political factors to explain the cost and benefits of remittances. In other words, in her broader framework, she looks at not just the economic impact of remittances but also the consequences of these flows on the social and political structure of the economy.

Economic theories have established the developmental impact of remittances through various country level studies. Studies on Mexico (Adelman and Taylor 1990), Kenya (Knowles and Anker 1981; Lewis and Thorbecke 1992), Ghana (Addison 2004), India (Oberai and Singh 1980), Bangladesh (Stahl and Habib 1989; Murshid et al. 2002), Pakistan (Adams and Alderman 1992; Burney 1989), and Sri Lanka (Lasagabaster et al. 2005) have shown that remittances have a positive impact on reducing the poverty levels and improving the financial stability of the countries, thereby making for increasing growth.

In development studies, remittances have largely been looked at as a panacea for the underdevelopment in a country. Remittances finance consumption, land and housing purchases and philanthropy; they are, hence, an important source of social insurance. Besides, they provide liquidity for small enterprises. These have long-term implications for economic development (Kapur 2004). However, remittances also raise a range of important political economy concerns. Studies of 'home town associations' suggest that migrants often create a remittance pool, which is used for public projects like providing for health, school, irrigation and other agricultural equipment. Such remittances result in lower state allocations on goods that have traditionally depended on public support, such as infrastructure, and reduced public investments in building human capital and providing social services, reflecting the shrinking political and social accountability of the government (Grabel 2008).

5. Conclusion

The above analysis of the literature on migration, remittances and development suggests that the scholarship on migration has swung between the extremes of optimism and pessimism in viewing the effect of reverse flows on development. In fact, migration has ceased to be seen as a one-way transfer only under the recent developmentalist framework, which suggests that it is a two-way transfer, where the loss of labour from migration is well compensated by the reverse flow of resources. This has brought in a paradigm shift in the policy making arena in developing nations, where policies regarding emigration have been restructured to promote migration, and also to attract more reverse flows in terms of remittances and other types of monetary transfers into the country.

However, a persistent problem in migration studies is the lack of a common theoretical framework. While most theories of migration have evolved in the sphere of economics, due to the absence of a common thread, most empirical work on migration, especially outside economic theory, has largely remained isolated. To reiterate Massey's (1993) assertion,

> … a full understanding of contemporary migratory processes will not be achieved by relying on the tools of one discipline alone, or by focusing on a single level of analysis. Rather, their complex, multifaceted nature requires a sophisticated theory that incorporates a variety of perspectives, levels, and assumptions (Massey et al. 1993: 432)

The literature also suggests that theory often separates the causes and the effects of the migratory process, and studies them in isolation of each other. Thus, the decision to migrate is usually viewed as an individual phenomenon, while the effects of migration are studied with respect to the overall economy or the community. Similarly, another divide in the approach to studying

migration is the micro-macro dichotomy. The decision to migrate or the decision to send back resources is often analyzed through a micro lens, whereas the effect of migration and remittances on development of the country is studied from a macro perspective. The local economy and the overall macroeconomic development processes, to a great extent, shape the individual's decisions regarding migration and remittances. Hence, these decisions cannot be seen in isolation of the local economy and the macro development contexts. As de Haas (2008) suggests:

> Migration is not an independent variable explaining change, but is an endogenous variable, an integral part of the change itself in the same degree as it may enable further change (Haas 2008: 43).

Overall, the discussion presented in the paper highlights two important points: Firstly, the need for a multidisciplinary approach towards research on migration and development; and secondly, the need to remove the macro-micro dichotomy in migration research and integrate macro level analysis with regional and individual level research.

A Multidisciplinary Research Approach

Research on migration and remittances has always been compartmentalised into specific study areas by different disciplines. While the economists analyse migration from the cost and benefit perspective, sociologists focus on the larger social context of mobility including family relations, gender roles, class and racial/ethnic identity, to understand migration and remittance behaviour. Similarly, while the economics literature defines remittances as household level monetary transfers, sociologists also take into account social remittances, which are the ideas, practices, identities and social or cultural capital that flow from receiving to sending country communities. It is important to bridge the gap between these disciplines to understand the migration and remittances behaviour of migrants and their households. For instance, 'social remittances' can be viewed as the local-level counterpart to macro-level global monetary flows as defined by 'economic remittances', and can add to our understanding of who migrates, what motivates them to migrate and how migration modifies the lives of those who remain behind.

Integrating Macro and Micro Level Analyses

Studies on migration, with respect to both who migrates and what comes back, have always been approached through a national level macro perspective. The migration trends of several countries, on the other hand, highlight that a large proportion of international migrants are from the smaller towns or even the rural areas of developing countries. For instance, in India, there is a huge emigrating population from Gujarat, particularly from the rural areas. It is these towns or villages which are the immediate recipients of remittances, which then mostly gets absorbed in the local economy. Extrapolating the effects of remittances on the local economy to the national level may, therefore, result in a substantial loss to our understanding of the actual impact. Thus, it is necessary to focus on the smaller geographical units which are the centres of migration in order to understand who migrates and why, and what he/she sends back.

There has been significant theoretical contribution towards studying the nexus between migration and development, and new paradigms are evolving to facilitate a better understanding of the process of migration. To have an overall understanding of migration as a process, its developmental implications, and also the individual decision making which forms an important part of the process, it is necessary to align the studies not only in different disciplines, but also within a particular discipline. This will help communicate the research in a more streamlined and practical way and, thus bridge the gap between the scholars and the policy makers.

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ABOUT THE PROVINCIAL GLOBALISATION PROGRAMME

The Provincial Globalisation research programme ('ProGlo') explores transnational connections between Overseas Indians and their home regions, especially the effects of 'reverse flows' of resources, including remittances, philanthropy, investments, and knowledge.

The programme consists of five independent but interlinked research projects (three PhD and two postdoctoral) located in three states of India – Andhra Pradesh, Karnataka, and Gujarat. The research will document a broad range of resource transfers by migrants, including economic resources (such as household remittances, investments in land), 'social remittances' (including flows of ideas, support for NGOs), and cultural flows (such as religious donations), and their influence at the regional level.

The PhD projects are intensive studies of three selected regions – Anand District in Gujarat, Guntur District in Andhra Pradesh, and Dakshina Kannada District in Karnataka – focusing on the effects of resource transfers by migrants in the key provincial towns and their rural hinterlands. The two post-doctoral projects will provide macro- and meso-level mappings of transnational linkages and flows at the regional, state, and national levels. By tracing these transnational networks and the modalities and destinations of resource transfers comparatively across three regions, the research programme will provide insights into the economic, social, political, and cultural consequences of Overseas Indians' engagements with India.

'ProGlo' is a five-year collaborative research programme of the Amsterdam Institute for Social Science Research (AISSR), University of Amsterdam, the Netherlands, and the National Institute of Advanced Studies (NIAS), Bangalore, India, funded by the WOTRO Science for Global Development programme of the Netherlands Organisation for Scientific Research (NWO), the Netherlands, initiated in 2010.

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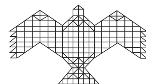

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