ECONOMIC AND PRIVATE SECTOR

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HELPDESK REQUEST

Potential products and policies to leverage productive use of migration and remittances

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Contents

1 Overview[1]

The helpdesk response reviews the empirical literature to present the evidence on the potential products and policies to leverage the productive use of remittances in developed and underdeveloped countries.

It follows on from two previous helpdesk reviews. The first one focused on the effects of remittances and migration on migrant households, communities and countries (Hagen-Zanker, 2014a); the second one was on the risks for migrants in host countries (Hagen-Zanker, 2014b).

From a macroeconomic perspective, remittances provide developing countries with a means of relaxing external constraints on their growth, helping them finance imports and preserve the balance of payments, as well as providing a source of savings. In theory, one would expect positive effects of remittances on economic growth, through the channels outlined above. However, in practice the evidence on the effect of remittances on economic growth is inconclusive, for various reasons (see Hagen-Zanker, 2014a).

The inflow of large remittances flows can also have perverse macroeconomic effects, such as an appreciation of the real exchange rate (Dutch disease) and increase of inflation rates in countries of origin. A fair number of studies reviewed in Hagen-Zanker (2014a) showed that remittances do lead to increases in inflation in countries or origin. However, the evidence on whether remittances cause Dutch disease is mixed (ibid).

Hence, it is clear that remittances do not always have positive effects on the economic development of sending countries. The current reviews proposed products and policies that enable remittances to have more beneficial effects.

1.1 Query

The objective of the research study is to understand the role of remittance and migration in economic development, and poverty reduction in least developed countries by exploring the best practices in this sector that has successfully maximised the impact of remittances. This will be done within three rapid reviews. The current rapid review will cover the following questions:

1. Explore historical volatility of remittances in Nepal and its impact on development and investment especially during the recent financial crisis. Also explore the impact of business cycles in Nepal and the host countries on remittances volatility.
2. Identify products (diaspora funds, foreign employment bonds, etc.) to leverage the productive use of remittances in developed and underdeveloped countries.

1.2 Structure of this report

This review is focused on the <u>potential products and policies to leverage the productive use of remittances</u> in developed and underdeveloped countries. However, before doing so it will explore specific remittance trends in Nepal.

This report has two empirical chapters. The first chapter is focused on Nepal and looks at the trends of remittances sent to Nepal. This chapter will consider the volatility of remittances and how (potential) volatility affected development and investment, particularly during the recent financial crisis. Finally, it will also consider how business cycles in Nepal and host countries affect remittance trends. The chapter will mainly draw

[1] Many thanks to Melissa Siegel, Jennifer Waidler, Yurendra Basnett and Nicholas Mathers for their helpful advice.

on the existing empirical literature, but as this literature is quite limited it will be complemented with primary data analysis.

The second chapter, drawing on secondary literature, considers the products and policies that can be used to leverage the productive use of remittances. This chapter will list policies and products that have been proposed by others, explain why they can be useful in theory and will then show any empirical evidence that exists on the actual effectiveness of these products and policies.

Notwithstanding the often more substantial internal migration flows in many countries, for the purposes of this review, we will focus on *international* labour migration. Remittances are defined as the *monetary* transfers sent from overseas migrants to family and friends back home. These may be sent through formal channels (e.g. international money transfer (IMI) or informal channels (e.g. hundi system).

The next chapter will focus on remittance trends in Nepal. The final chapter in this paper will review potential policies and products to leverage productive use of remittances and will discuss their effectiveness. A brief conclusion will be provided at the end.

The reference list provided at the end should be seen as a resource material for further analysis (it includes all studies referred to in this review including those cited by other authors).

1.3 A brief note on the methodology

This paper is a rapid review that will by no means cover the entire migration literature. The review was rapid and informal and did not follow a systematic structure. Nevertheless a number of tools were used to make the review rigorous, evidence-based and to cover as much of the academic, grey and policy literature, as possible[2]. The first track searched for the academic literature using Google Scholar and specifically searching important journals and websites[3]. The second track consulted involved actively seeking advice on relevant publications from key experts. These suggestions will then be reviewed and I also looked at the reference lists of those publications. This track is extremely useful to get a sense of which literature has been important and influential in the field and to get hold of non-published studies. Finally, I also consulted reference lists of seminal studies and tracked down further relevant studies on the reference list (this process is called snowballing).

The migration literature is vast and it would have been impossible to review the entire literature. Furthermore, a superficial treatment of the literature, would have meant the review had limited practical value. Therefore a number of means were used to keep the review manageable and informative. It has been restricted to the research questions outlined in section 1.1. Furthermore the following inclusion/ exclusion criteria were applied to potentially relevant studies:

- The study was written in English
- I did not assess studies on their research design or quality and included both qualitative and quantitative studies.
- The study focused on low or middle-income countries.
- The study is empirical (so disregarding theoretical studies)
- The study was accessible from ODI

[2] See Hagen-Zanker and Mallett (2013) for further details on the review methodology.
[3] Particularly the World Bank website

1.4 Limitations of the review

There are a number of limitations, which need to be noted in drawing conclusions from this review.

- Given standard time constraints of EPS-PEAKS helpdesk response coupled with the scope of the helpdesk request, I have only been able to review a limited number of studies on the effects of remittances and migration on households, communities and countries of origin. This inevitably required a balancing of the trade-off (breadth vs. depth in the literature search and review).
- I have not assessed the adequacy and quality of research design and analysis of the studies included. This means that I have taken the findings of the authors at face value.
- Wherever, possible, I have located the original papers for papers summarised in review papers, but in some cases I have had to rely on the summary provided by other authors.
- I have given examples to illustrate some of the findings/ discussions in the literature, but in most cases these cannot be directly transferred to other contexts, so they should be reviewed with caution.
- I assume that I have managed to cover the most important studies on any particular topic discussed in this report. I assume that I have successfully summarised these studies.

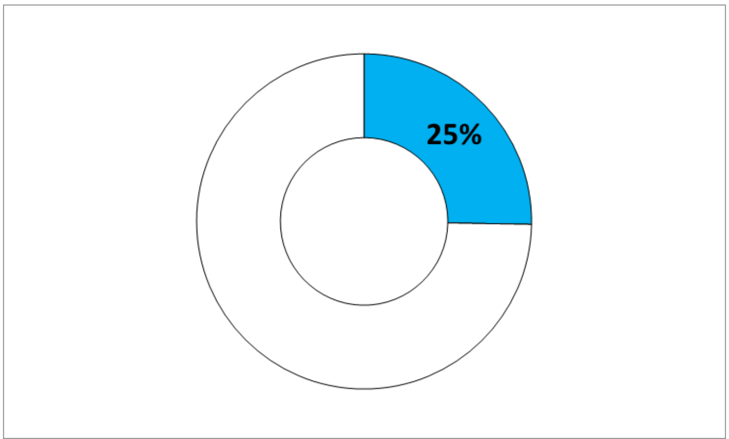
2 Remittances trends in Nepal

This chapter is focused on the Nepal case study. After describing the remittance flows to Nepal, it will consider how business cycles in Nepal and host countries affect remittance trends. Finally, it will also consider the volatility of remittances and how (potential) volatility affected development and investment, particularly during the recent financial crisis. As the Nepal focused literature on these questions seems to be quite limited, the literature review is complemented with some primary data analysis. These questions are in need of further empirical analysis.

2.1 Remittance flows

Nepal is one of the major remittance receiving countries amongst low-income countries. Remittances have increased steadily over the past decades (see Figure 2 below) and are now the biggest contributor to foreign reserves. As a share of GDP, remittances have far outgrown foreign direct investment and official development aid (Sapkota, 2012). In 2012, remittances were estimated to account for 25% of GDP, see Figure 1. In 2010, Nepal was the fifth-highest recipient of remittances (as a share of GDP) (World Bank, 2011a) and the largest recipient out if the countries with a population above 10 million (World Bank, 2011b).

Figure 1: Remittances as share of GDP in 2012 (%)



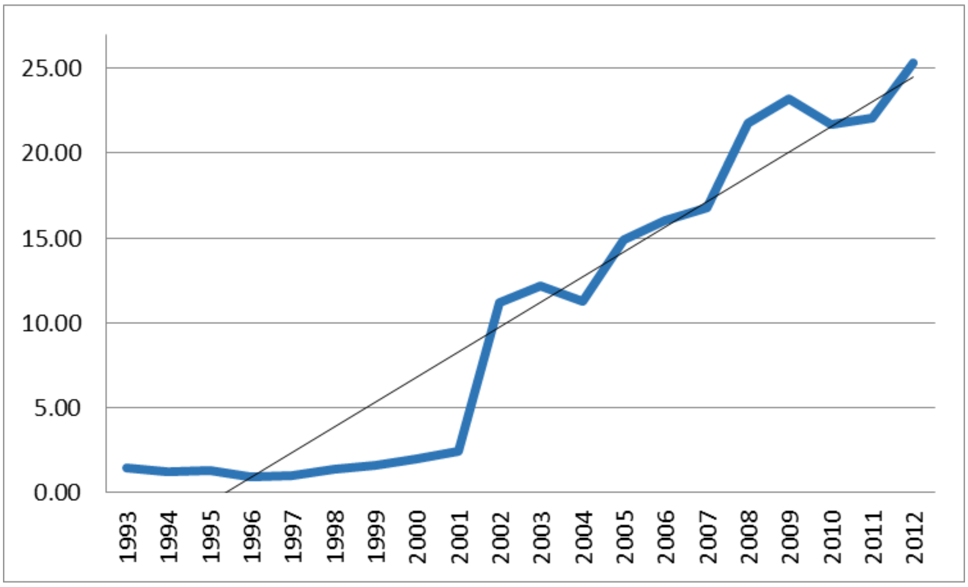
Note: This data only measures formal remittances. Previous surveys have estimated that as much as 80% of remittances to Nepal are sent informally (CBS, 2011).

Source: World Development Indicators, remittances based on IMF Balance of Payment

From a macroeconomic perspective, remittances have been considered to boost foreign exchange reserves – hence ensuring macroeconomic stability - and maintain the balance of payments, despite an increasing trade deficit (Sapkota, 2012). According to Ministry of Finance data shown in Shrestra (2008), remittances increased from 3.3% of foreign exchange earnings in 1990/91 to 62.1% in 2005/06.

So have remittances been volatile and if yes, to what extent? In nominal terms, remittances have been growing on an annual basis since the 1990s and at increasingly faster rates since about 2000 (Shrestra, 2008). However, when considering remittances as a share of GDP, it is clear that remittances have been somewhat volatile (Figure 2). The trend line in the figure shows that remittances have been on an increasing trend between 1993-2012. In the 1990s, remittances at a share of GDP were still at a low level (1.3% on average) and fairly steady. From 2001 onwards, remittances have been increasing steadily, but have also been much more volatile.

Figure 2: Remittances as share of GDP, 1993-2012 (%)

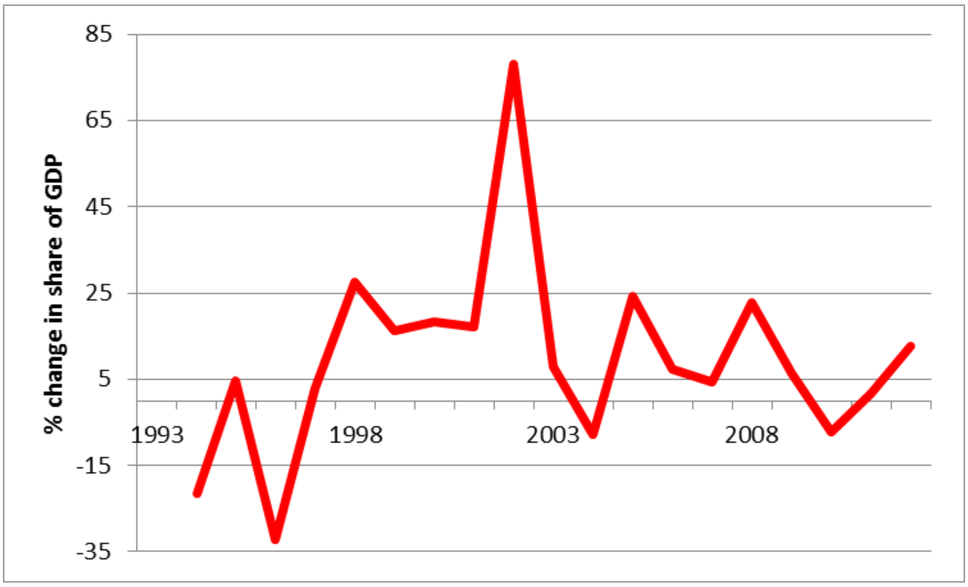


Note: This data only measures formal remittances. Previous surveys have estimated that as much as 80% of remittances to Nepal are sent informally (CBS, 2011).

Source: World Development Indicators, remittances based on IMF Balance of Payment

When looking at the change of remittances (as a share of GDP), it can be seen that remittance growth has not always been positive (Figure 3). In 1996, 2004 and 2010, remittances as a share of GDP declined by 32.2%, 7.2% and 7.1% respectively. Figure 3 also confirms that remittances have been fairly volatile, especially since 2000.

Figure 3: Annual change of remittances as share of GDP, 1994-2012 (% change)



Note: This data only measures formal remittances. Previous surveys have estimated that as much as 80% of remittances to Nepal are sent informally (CBS, 2011).

Source: World Development Indicators, based on IMF Balance of Payment

The next section will consider whether business cycles may be one of the determinants of remittance flows. The final sub-section of this chapter will look at how this volatility affects development and investment.

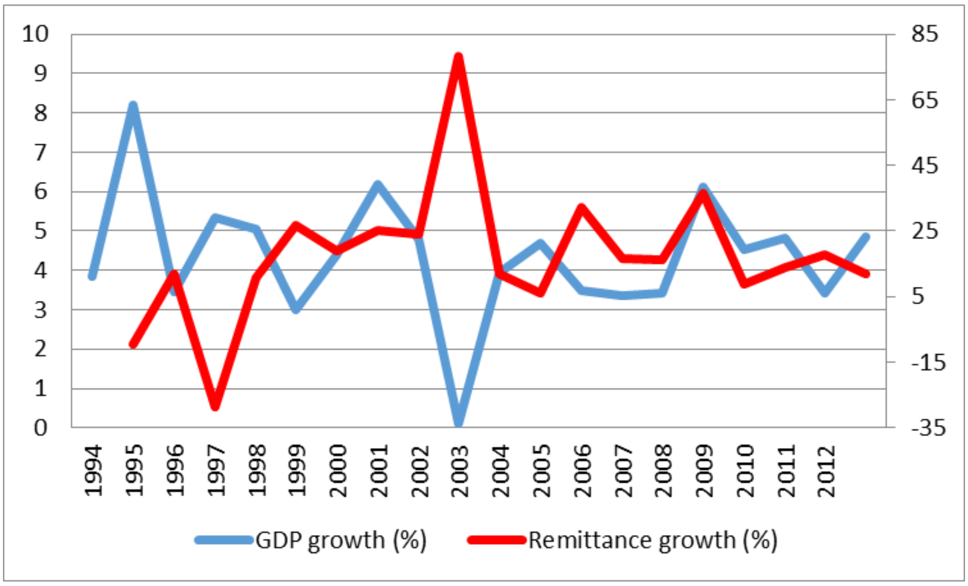
2.2 Do business cycles affect remittance flows?

This section looks at whether business cycles in Nepal and the migrant host countries affect remittance flows to Nepal. It draws on basic primary data analysis and the limited empirical Nepal-focused literature that could be found on the subject. The second half of the section considers how the global financial crisis affected migration and remittance flows to Nepal.

In general, the migration literature shows that remittance inflows tend to be stable or even counter-cyclical in migrant sending countries, rising in times of financial crises or natural disasters as migrants living abroad send more remittances to help their families (Mohapatra and Ratha, 2010). Remittances tend to increase during economic downturn, reducing volatility of economic growth and reducing the likelihood of macroeconomic shocks (Sapkota, 2012). Chami, Hakura and Montiel (2009) show that remittances can also stabilise volatility of economic growth (that is, for an increase in the remittance to GDP ratio the standard deviation of GDP growth goes down).

Looking at the growth of GDP in Nepal and remittance inflows, we can see that in Nepal remittances also tended to be counter-cyclical, but not consistently so (Figure 4). For instance, in 1998-1999, as GDP growth slowed down, remittances grew. In 2002-2003, we can see an even stronger effect. However, this is not always the case: in 2007-2008, GDP growth increased, as did remittance growth.

Figure 4: Annual GDP and remittance growth, 1994-2012 (% change)



Note: This data only measures formal remittances. Previous surveys have estimated that as much as 80% of remittances to Nepal are sent informally (CBS, 2011).

Source: World Development Indicators, Remittances based on IMF Balance of Payment

So how do business cycles in host countries affect remittance flows to Nepal? Figure 5 below shows GDP growth in the major host countries and remittances growth of (formal) remittances received in Nepal. Ideally, GDP growth in the host country should be compared to the remittances sent by Nepali migrants from that particular country, but this data was not available[4]. On the whole it is difficult to discern clear patterns from Figure 5 and this clearly requires further research. The only clear trend is around the time of the global

[4] It would be worth getting hold of this data and investigating this further.

financial crisis, where a decrease in host country GDP, is accompanied with a sharp drop of remittances.

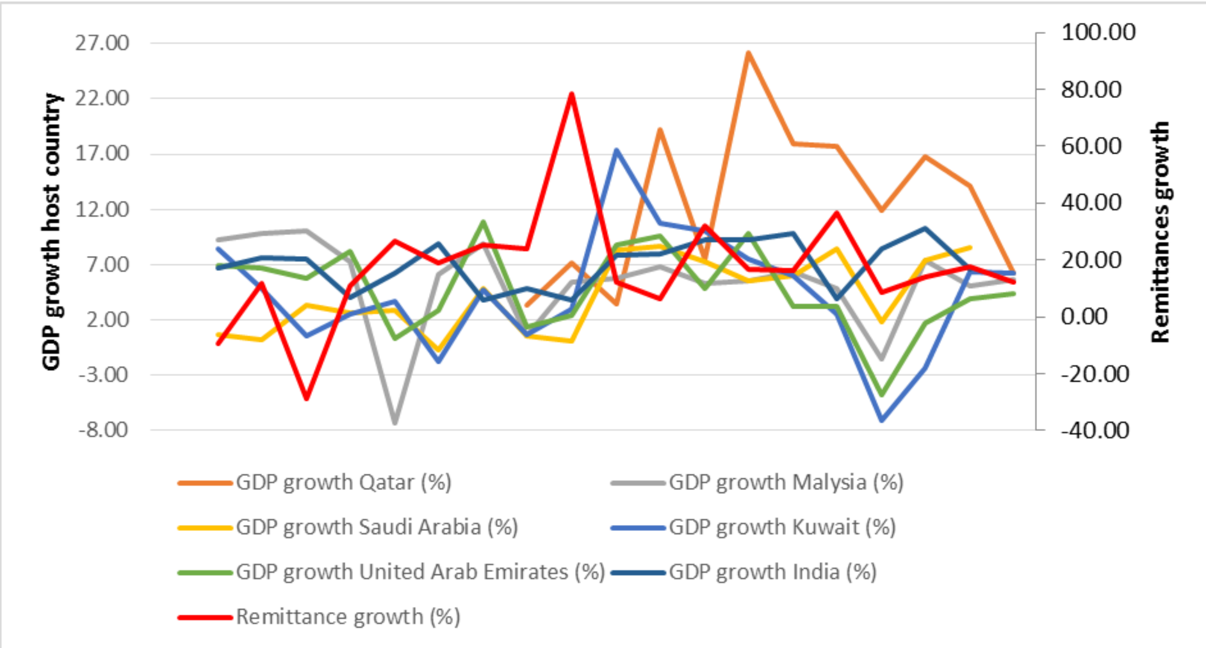
Table 1 shows the correlation coefficient between GDP growth in the major host countries and remittances growth of (formal) remittances received in Nepal. It shows that for all countries there is a negative correlation (that is, as GDP growth in the host country slows down, remittance growth increases), albeit small in most cases. This is counter-intuitive and should be further analysed with better data.

Table 1: Correlation coefficient of growth of remittances received in Nepal and host country GDP growth

Qatar	Malaysia	Saudi Arabia	Kuwait	UAE	India
-0.25	-0.29	-0.055	-0.015	-0.22	-0.36

Source: Own calculations based on World Development Indicators

Figure 5: Annual GDP growth in host countries and remittance growth, 1994-2012 (% change)



Prior to the global financial crisis (2007-2009), remittances proved to be a stable income source for households in low-income countries, with growth regardless of the state of the business cycle of migrant sending countries (Pant, 2011). However, the global financial and economic crisis was quite severe and had strong real-sector spillover on developed and energy-exporting countries, leading to a decrease in the quantity of total remittances in 2009, for the first time in decades (ibid). The World Bank estimated that remittance flows to developing countries as a whole, declined by 5.5% in 2009 (compared to 16.7% growth in 2008) (Mohapatra and Ratha, 2010). They also suggest that the more diverse the migrant destinations, the more resilient are remittances (ibid).

How did the global financial crisis affect migration and remittance flows to Nepal? Nepalese migrants are fairly diversified in terms of their migrant destinations (World Bank, 2011), with the largest share going to India seasonally and another large share going to the Gulf States. On the whole, migrant outflows declined by 11.7% in financial year 2009 (ibid). This was particularly due to migrant workers in the Gulf States losing their jobs (Kharel, 2011). Remittances also slowed down, sharply dropping after in 2008 (Figure 3). This shows that migration and remittances in Nepal are sensitive to global economic trends (Sharma and Gurung, 2009). However, these trends were quickly reversed and by 2010 migration flows increased again, as particularly Malaysia's demand for migrant workers grew (World Bank, 2011). By 2010/2011, remittance growth was positive again.

2.3 Does volatility affect development and investment?

This section considers the evidence on whether the volatility (particularly as a result of the global financial and economic crisis) affects development and investment in Nepal.

Analysis by the World Bank (2011) shows that volatility of remittances can affect investment and led to macroeconomic management problems: they argue that high growth of remittances in the financial years 2008 and 2009 (see Figure 4) have contributed to the formation of a real estate bubble. High remittance growth led to an increase of gross-national disposable income of 7-8%. As investment opportunities are limited in Nepal, much of the additional demand went into real estate, resulting in a 'boom' and speculative activities (ibid). This in turn affected the financial sector (together with poor supervision), as credit was expanded on the basis of inflated real estate prices (ibid). When remittance growth decreased in the financial year 2010 (Figure 3), problems in the financial sector were exacerbated. The slowdown of remittances, combined with increase in imports, then lead to a reserve loss of 8% of total reserves (ibid). Sapkota (2013) explains that this also led to a liquidity crunch and deterioration of the balance sheets of banks and financial institutions. Kharel (2011) states that another consequence was the current account and balance of payment turning negative.

Given that Nepal has had high levels of remittances for long periods of time, there is another challenge that could affect development and investment. A number of recent studies have shown that higher levels of remittances could reduce incentives of policy-makers to implement competitiveness-boosting reforms, such as increasing growth and employment opportunities (World Bank, 2011; Abdih et al., 2008). This is because remittances – being an exogenous stabiliser- temporarily improve competitiveness (Abdih et al., 2008). The authors, controlling for reverse causality, show that countries with higher remittance to GDP ratios, reduces government effectiveness, government control of corruption and rule of law. This can then lead to a 'vicious policy cycle', with high remittances inflows exerting low pressure to improve policy weaknesses (such as inadequate investment climate, low employment opportunities) and hence leading to more migration (World Bank, 2011).

3 Products and policies to leverage productive use of remittances

This chapter, drawing on secondary literature, considers the products and policies that can be used to leverage the productive use of remittances. While this chapter focuses on policies that encourage investment of remittances, it should be kept in mind that it's deceptive to think of remittances expenditure patterns in black and white terms (investment is good, consumption is bad), as consumption has been shown to have positive multiplier effects for communities, and positive effects on households in terms of improving human wellbeing (see Hagen-Zanker, 2014a).

Agunias (2006) proposed that policy options to maximise the benefits of remittances can be grouped in two broad categories: 1) strengthening the remittances infrastructure and 2) leveraging the use of remittances for development. Both sets of policies are important for encouraging the productive use of remittances.

The former includes reducing transaction costs of remittances, addressing 'last-mile' concerns (ensuring recipients in remote/ rural areas are able to receive remittances, and at a reasonable cost) and facilitating the use of formal systems (as opposed to informal systems).

The latter includes government incentives to ensure remittances are spent on development, such as tax breaks, special deposit accounts, matching funds, investment vehicles, and civil society initiatives. These include cross-selling of other complementary financial services, channelling remittances through micro finance institutions and securitisation of remittances.

This chapter will list policies and products that have been proposed by others, explain why they can be useful in theory and will then show any empirical evidence that exists on the actual effectiveness of these products and policies.

3.1 Strengthening the remittances infrastructure

This section discusses policies and programmes to strengthen the remittance infrastructure. These are important in leveraging development impact because transaction costs of remittances remain very high in most contexts. On average, remittances cost in all regions are substantially higher than the 5% transfer fees by 2014 proposed by the G20 (Watkins and Quattri, 2014). Fees to Sub-Saharan Africa (SSA) are the highest at 12.8%, on average, and fees to South Asian countries are lowest, at around 6.5% on average (ibid). World Bank data on remittances costs shows that transfer fees to Nepal are relatively low (Table 2), but higher than for other South Asian countries (Jones and Basnett, 2013). They also take longer to arrive in the country, than in other South Asian countries (ibid).

Table 2: Prices of remittance transfers to Nepal

Operator	Fee for $200 payment (1st quarter 2014)
Saudi Arabia - Nepal	
Bank average	3.58%
Money transfer operator average	3.21%
UAE - Nepal	
Bank average	8.95%
Money transfer operator average	4.93%
UK - Nepal	
Bank average	5.18%
Money transfer operator average	7.41%

Source: Remittance Prices Worldwide database of the World Bank, 2014

These transfer fees come at a cost to development – they represent money that could have been spent on recipient households instead. For instance, Watkins and Quattri (2014) have estimated that for SSA, remittance fees cost the African continent $1.8 billion a year; enough money to pay for the primary school education of 14 million children in the region.

Research has shown that remittances are fairly responsive to changes in the transfer costs. Yang (2011) discusses a number of studies that show reductions in the transfer costs have large impacts on remittance flows, both in terms of number of transfer and amounts sent. Increases in remittances sent are shown to be larger in magnitude than the savings on transfer fees (ibid). Hence, reducing remittance fees are an important policy priority.

Apart from transfer costs, further dimensions of the remittance architecture are the distribution of remittance architecture and the type of system used to transfer remittances. These three dimensions will now be discussed in turn.

Reducing transfer costs

As outlined above, reducing the transaction costs of remittances is critical to increase the remittances available to recipient households. There are a number of (complementary) components to reducing transaction costs. These are:

1. Increasing competition
2. Improving transparency
3. Encouraging innovative money transfer technologies

It is obvious that **increasing competition** can reduce transaction costs, and also improve the quality of the service (e.g. making it more reliable and transfers faster). For instance, in SSA remittances are dominated by a duopoly of money transfer operators (MTOs), an important factor in explaining why transfer fees are highest in SSA (Watkins and Quattri, 2014). In the competitive and well-developed US-Mexico remittances corridor, the cost of remittances has more than halved since 1999 (Agunias, 2006).

How can competition be increased? The literature (e.g. Mohapatra and Ratha, 2011; Ratha et al., 2011) suggest a number of ways:

- Promoting alternative providers such as microfinance institutions, credit cooperatives
- Including financial services in the services provided by post-offices and ensuring they have the facilities to do so (e.g. Internet connection, management information systems)

- Eliminate exclusive partnerships for money transfers and allow multiple partnerships (more on this below)
- Disseminate information about potential channels and costs for remittances – this includes websites, such as the successful Australia remittance cost database or the World Bank remittance costs database[5], but should also be published in other forms (e.g. pamphlets) for migrants that are less literate and without access to the Internet.
- Another proposal is to allow non-bank financial institutions (e.g. MTOs) direct access to clearing and settlement systems, rather than through commercial banks (Agunias; 2006). However, it is unclear to what extent costs would be reduced and if such a system would guarantee integrity of the clearing and settlement system (ibid).

One component of increasing competition of the remittance market is to **improve transparency**. Users of MTOs are often unaware of the different components of transfer fees. For instance, evidence from the UK shows that exchange rate conversion is often a big and arbitrary component of overall costs and this information is often not provided to consumers (Watkins and Quattri, 2014). Furthermore, a number of studies point towards 'exclusivity agreements' between MTOs, agents and banks, as one factor explaining high costs and limited competition (Watkins and Quattri, 2014; Mohapatra and Ratha, 2011; IFAD, 2009). When such exclusive partnerships are eliminated, competition increases and costs are reduced.

Finally, **technological advances** could reduce transaction costs. This includes pre-paid cards that can be used in stores – however these have high requirements in terms of infrastructure in the remittance receiving country. Remittances transactions through mobile phones have been deemed to have more potential, as mobile phone coverage in areas of origin is often very high and reduces the need to build a costly distribution network. Hence, in theory, they have high access, costs are potentially much lower and such systems allow remittances to be sent more quickly (Siegel and Fransen 2013). Examples include the successful MPESA project, which allows the sending of mobile remittances between the UK and Kenya and the G-Cash system in the Philippines (Box 1).

Box 1: G-Cash in the Philippines

The Philippines is one of the most advanced mobile phone remittance users in the world. One of the providers is Globe Telecom, which introduced G-Cash in 2004. Mobile phone subscribers in the Philippines have to register by filling in key personal identification, as do their relatives abroad (Aguinas, 2006). Once registered, the remittance senders can visit an authorised G-Cash outlet, present identification and credit the phone account (ibid). The transaction fee is very small at only 1% (ibid). There are over 18,000 outlets to pick up the transfer, given that about 80% of the Philippine population remains unbanked/under-banked, this is of a huge advantage to consumers. It is deemed a success in the Philippines, as Filipinos are highly mobile-phone literate, due to the geography of the country and as the central bank provided a regularity environment that enabled mobile operators to offer e-money, empowered non-banks to perform cash in/out and providing legal certainty to formalize rules (GSMA, 2012).

However, the cost of mobile transfers is often similar to regular transfers (Ratha et al., 2011). Mohapatra and Ratha, 2011 outline a number of policy measures that need to be in place to enable the growth of mobile remittances:

[5] The websites are: http://www.sendmoneypacific.org/ and https://remittanceprices.worldbank.org/en

1. harmonising banking and telecommunications regulations to enable mainstream banks to participate in mobile money transfers and for telecommunications firms to offer micro deposit and savings accounts;
2. simplifying anti-money laundering/ combating the finance of terrorism regulations for small-value transfers;
3. ensuring that mobile distribution networks are open to multiple international remittance sending institutions instead of becoming exclusive partnerships between an international MTO and country-based mobile money services.

Reaching recipients in remote areas

Much attention focuses on the cost of sending remittances, but comparatively less on how these remittances reach recipients in areas of origin. The so-called 'last mile' – the last stage of distribution can be extremely challenging and is a stage that is often neglected. MTOs are often unwilling to set up operations in rural areas, as the costs would be too high (Aguinas, 2006). For instance, in SSA the reach of banks outside of urban areas is limited (Mohapatra and Ratha, 2011). This means that for remittances receivers in rural areas the transaction costs of reaching institutions where remittances can be collected are much higher (Aguinas, 2006).

What can be done to reduce transaction costs for recipients in remote areas? One solution is to **promote the use of mobile phone remittances transfers**, see previous section. Another suggestion, described by Aguinas (2006), is to **initiate partnerships between registered banks and non-bank financial institutions**, including savings and credit cooperatives, micro-finance institutions and post offices. For instance, a bank could receive the payment and then transfer it onwards to post offices in rural areas. The benefits of such linkages would be that it reaches out to rural, remote, low-income communities that are overlooked by large commercial banks and more specifically opens the financial system to rural, poor remittances recipients, reducing their transaction costs (ibid). Post-offices and micro-finance operators have been particularly promoted as potential partners in receiving areas (e.g. by Ratha, 2011 and Mohapatra and Ratha, 2011). An often-cited example is the World Council of Credit Union's International Remittances Network, which has been credited with reducing transfer costs in Latin American countries (Aguinas, 2006).

Shifting to formal transfer systems

As already implicitly suggested in previous sections, an integral component of the remittances infrastructure is the type of institution used. It is suggested by others that shifting remittances from informal to formal transfers can increase the development impacts of remittances. This is proposed not for the sake of 'controlling' remittance recipients and senders (even though that is an additional incentive, see below), but because formalising remittances can bring other developmental benefits.

These benefits include:

1. **Banking the unbanked**: Demirguc-Kunt and Klapper (2012) show that 59% of adults in developing countries (and two thirds of adults living on less than $2 per day) do not have an account at a financial institution. According to IADB (2005), 90% of remittance recipients in Latin-America do not have access to bank accounts, loans or other financial services. Shifting remittances to formal institutions can thus be a powerful tool to increase access to the banking sector for the unbanked. This will allow them to use basic financial services more cheaply, as well as access other products, such as loans, and may be safer than informal systems.
2. **Deepening financial systems in low-income countries**: as more transfers are channelled through banks or financial institutions, the resources to finance economic activities in the communities of origin increase. This means that formal transfers can have higher multiplier effects (Aguinas, 2006).

3. **Increasing the volume of remittances**: the UK Remittances Working Group (2005) states that in some cases, a shift to formal remittances has increased the overall volume of remittances.
4. **Addressing security concerns**: while this is not a development impact per se, informal remittances are associated with money laundering or the financing of terrorist activities; channelling funds through formal channels would give governments greater oversight.

However, the developmental impacts of shifting to a formal system remains disputed. Pieke et al. (2005) in a wide-ranging review of informal remittance transfer systems in Africa, the Caribbean and Pacific countries, argue that informal systems provide cheaper, faster, more versatile and sometimes more reliable services. Furthermore they argue that there is no evidence that the development impact of informal transfers is systematically different to that of formal transfers, that is, they are not spent any differently.

The evidence shows that legislation banning informal systems outright have not been successful (Aguinas, 2006). Instead, incentives should be put in place to allow the unbanked to access financial institutions. These incentives include issuing identity cards to migrants so that they can access formal banking institutions, promote financial literacy (e.g. at financial fairs) and making the banking sector more user-friendly (Aguinas, 2006).

3.2 Leveraging remittances for development

So what policies can governments set in place to ensure remittances are diverted to productive uses? Remittances are private monies, but can be taxed of course and taxes can subsequently be spent on public goods. However, taxing remittances could be counter-productive, because doing so will incentivise migrants to send them through informal channels, might reduce the incentives to send remittances altogether and are likely to be regressive. A World Bank survey shows that in 2003 only five countries taxed remittances (Colombia, Ecuador, Georgia, Peru and Poland) (de Luna-Martinez, 2005). Past attempts to do so in other countries have failed, with the main effect being the increased use of informal channels (Lucas, 2003, cited in Aguinas, 2006).

Other measures to directly control remittances include the requirement of mandatory remittance requirements, which dictate that a certain share of income is remitted back home (Carling, 2005). Such a requirement was set in place for South Korean migrants in the 1980s and since Eritrea's 1993 independence all adults have been asked to donate 2% of their income to the state, with additional demands being made in some diaspora countries (ibid). However, such transfers rely on a strong sense of social obligation towards the country of origin and are unlikely to be feasible in the long-term or in most contexts.

Instead of direct control, providing incentives to remitters are deemed more effective. Most of these incentives are of a financial/ monetary nature, designed to encourage the sending of remittances and investment of remittances. An interesting exception is the case of Turkey, which reduces the compulsory national service for a specified amount of foreign exchange paid to the government (Carling, 2005).

Table 3 gives an overview of potential measures and policies. The potential measures depends on the policy-makers objectives, e.g. capturing a share of remittances for development purposes, stimulating transfers through formal channels, stimulating investment of remittances etc. Some of these are programmes and policies that can be implemented by the government; others are led by the private sectors or civil society. A number of these measures will now be discussed in more detail: tax breaks, special deposit accounts, channelling remittances through microfinance institutions, diaspora bonds, securitisation of remittances, investment vehicles, collective remittances and matching funds.

Table 3: Overview of policies and programmes to enhance the development impact of remittances

Policymaker's objective	Potential measures
Capturing a share of remittances for development purposes	Taxation of emigrants Duties or levies on remittances transfers Voluntary check-off for charitable purposes (on transfer forms)
Stimulating transfers through formal channels and/or stimulating capital availability	Remittance bonds Foreign currency accounts Premium interest rate accounts Promoting/enabling transfer s through microfinance institutions (MFIs) Promoting financial literacy / banking the unbanked
Stimulating investment of remittances	Outreach through MFI infrastructure Outreach through migrants' service bureaus Tax breaks on imported capital goods SME schemes (financial, infrastructural, or innovative) Training programmes
Outreach to migrant collectives/ Hometown associations	Matched funding Public-private ventures Competitive bidding for development projects
Influencing consumption patterns	Promoting consumption of local goods and services Enabling migrants to spend on their relatives' behalf

Source: Carling (2004)

For some of these policies and programmes there is quite some empirical evidence (e.g. matching funds) whereas for others, not much is known about the effectiveness of policy measures. For many of these, further research is needed.

Tax breaks

Some countries have taken a U-turn and instead of taxing remittances, have given remitters tax breaks to incentivise the sending of remittances. These include the following examples:

- In Egypt, migrants remitting through banks receive tax breaks for up to ten years (Aguinas, 2006)
- Interest incomes of emigrants from India and Sri Lanka are exempted from income tax (Aguinas, 2006)
- Egypt and Moldova have programmes in place to allow migrants to buy land at preferential prices (Aguinas, 2006)
- Ethiopia, Kenya and India exempt interest earnings from diaspora bonds from income taxes (Moreno-Dodson et al., 2012).
- India has exempted interest from special Non-Resident Indian deposit accounts from wealth and gift taxes (Chisti, 2007).

Special deposit accounts

Another prominent policy initiative to leverage remittances for productive purposes is to set up special deposit accounts at commercial banks that give migrants a premium interest rate on their deposits. Sending countries use these deposits as a source of foreign exchange and to increase the stock of savings within the country. The countries include Bangladesh, India and Tunisia (Aguinas, 2006). In some cases, the interest made on these deposits is fully or partially exempted from taxation (see section 3.2.1).

One prominent example, described by Chisti (2007) is the case of India. In the 1970s the Indian government first authorised special deposit accounts for Non-Resident Indians

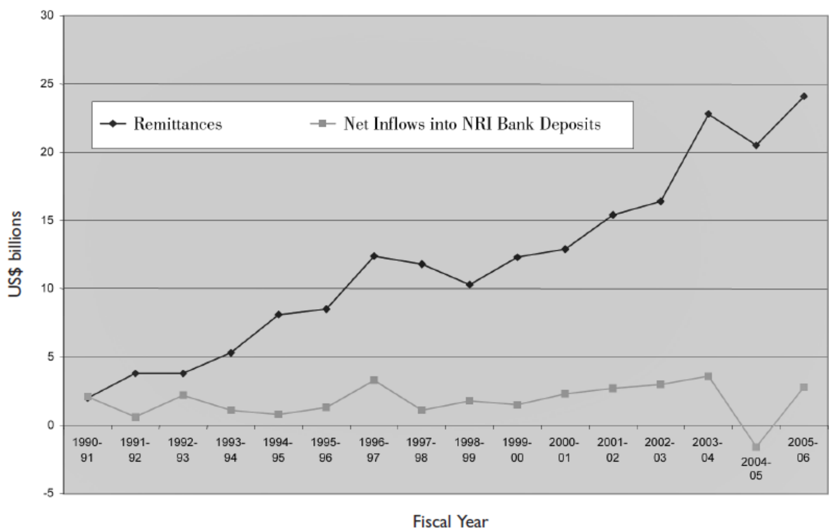
(NRI) – these are either Indians citizens living abroad or people of Indian origin. These were used to increase Indian's foreign reserves.

The Indian government has closely regulated many components of these special deposit accounts in order to attract higher deposits (Chisti, 2007), for example:

- Offering higher interest rates than those in the international capital market
- Making despots and interest totally repatriable
- Giving NRIs the choice of holding the desposit in either foreign currencies or Indian rupees
- Exempting interest from specific taxes (see section 3.2.1)

Figure 6 shows remittance flows to India (directly sent to migrant-sending households) and net inflows into NRI bank accounts (deposits less withdrawals), from 1990-2006. It shows that net NRI bank deposits are large, and were similar to remittances in the early 1990s, but by 2005 remittances outpaced net deposits by far. Furthermore, remittances have been growing at a much higher and generally steadier rate (Chisti, 2007). This is interesting, given that Government of India's policies have focused much more on attracting NRI deposits than private remittances (ibid).

Figure 6: Remittance flows to India and net inflows into Non-Resident Indian (NRI) bank deposits 1990-2006[6]



Note: In US$ billion
Source: Chisti (2007)

In Bangladesh a number of banks offer the possibility of opening up special deposit accounts from abroad. However, due to limited awareness of the banking system in general and the products more specifically, take-up appears to be very low: in 2006 deposits from migrants abroad, accounted for just 1.3% of total deposits in Bangladesh banks, most of which are held in a single bank (Buchenau, 2008). Competition has now increased and banks have started offering so-called ‘parallel accounts’ (ibid). One of the accounts is used to send remittances to the family staying behind and they are given full access to that account; the second account can only be accessed by the migrant and can be used to accumulate funds for later investment (ibid). While it is unclear how successful these schemes have been, such a scheme is quite promising because it pairs the deposits

[6] In India, data on two types of formal remittances are collected: so-called ‘inward’ remittances which are sent directly to recipient households (through MTOs or banks) and local withdrawals from NRI bank account (Chisti, 2007).

of savings and possible future investments by migrants with initiatives to bank the unbanked (i.e. the migrant-sending households). As such, it can potentially have multiple impacts to leverage productive use of remittances.

In addition to special deposit accounts, there have been new developments in terms of cross-selling complementary financial services and products. These can include saving packages, insurance, small business credits amongst others (Aguinas, 2006). However, in the studies cited by Aguinas (2006) it appears that so far most of these do not meet the specific demands of migrant households and offer poor terms and conditions.

Another policy option to leverage remittances to productive use is to channel remittances through micro-finance institutions. Given their wide outreach and accessibility, microfinance institutions are often a more feasible alternative for migrants' investment, compared to commercial banks (Aguinas, 2006). Furthermore, remittances can secure the capital these institutions need to achieve financial sustainability (ibid). Finally, micro-finance institutions can offer business training and other services, which can make investments more effective (ibid). However, their small scale and limited resources constrain micro-finance institutions and most do not meet regulatory requirements to be able to receive international transfers (Carling, 2005) and even if they would, it would be difficult for such small institutions to efficiently manage (often) daily cash inflows.

Diaspora bonds, securitisation and investment vehicles

Another policy option to indirectly encourage remittances and diaspora investment are special government bonds called 'diaspora bonds' that are offered to emigrants and are used to finance public investments. Some countries (Ethiopia, Kenya and India) further incentivise remittances, by exempting interest earnings from diaspora bonds from income taxes (Moreno-Dodson et al., 2012). Diaspora bonds are a good source of government finance that can be spent on development purposes. However, while these are issued in foreign currency, even after maturity, a portion is likely to remain in the country of origin (Moreno-Dodson et al., 2012).

Carling (2005) states that the following countries have successfully issued diaspora bonds: Bangladesh, China, Eritrea, India, Israel, Lebanon, Pakistan and the Philippines. (Moreno-Dodson et al., 2012) state that Israel and India, have successfully raised over $40 billion from such bonds. Chisti (2007) finds that diaspora bonds were an important factor behind the doubling of remittance flows to India between 2002 and 2003 (see also section 3.2.2). In the case of two popular bonds, the Resurgent India Bonds (launched in 1998, matured in 2003) and the Millennium India Bonds (launched in 2000, matured at the end of 2005), a sizeable portion of the redeemed value of the bon was retained in India, instead of being repatriated abroad in foreign currency (ibid).

Nepal has also twice floated a 'Foreign Employment Bond', however the response was poor and only a small fraction of bonds were purchased (Kharel, 2011). The following explanations were cited: lack of publicity and marketing, lack of understanding by migrants about these bonds, short sale period, low interest rates compared to those sold by commercial banks, no Nepali financial institutions that could sell the bond abroad (ibid). Kharel (2011) also points out that Nepal Rastra Bank also had unrealistic expectations of migrant's ability to purchase such bonds, given low wages abroad, given that many migrants have high loans to repay and the need to support their family at home.

Furthermore, governments can also employ the securitisation of remittances, which is essentially the borrowing from international capital markets against future remittance flows. Hence financial institutions can use current and future remittances to access additional capital (Aguinas, 2006). According to a 2003 World Bank survey with 40 central banks, only four countries have securitised their future remittance flows (de Luna-Martinez, 2005). Countries that have successfully used securitisation of remittances are middle-income countries, including Mexico, Brazil, El Salvador and Turkey (Aguinas, 2006).

Securitisation of remittances can have positive effects in terms of improving the quality of investments within the country as it can address information asymmetries in inefficient domestic markets (Aguinas, 2006). It can also improve financial markets in less-developed countries, by diversifying the investor base and providing a reliable source of funding (Plaza and Rath, 2011). Consequently securitisation can also improve a country's credit rating. For instance, in Brazil the remittance backed bonds received higher ratings than Brazil's sovereign currency rating (ibid). However, there are also a number of hurdles (high costs of investment banking, credit rating services and long lead times) and risks (currency depreciation, interest rate decreases, remittances slowdown) (Kharel, 2011).

Other countries have provided incentives to divert remittances into investment vehicles. For instance, Indian emigrants have preferential access to capital goods and raw material imports (Aguinas, 2006). Pakistan has a similar scheme aimed at attracting investment to under-developed regions and export-processing zones, as well as investment and business set-up advisory services (ibid).

Collective remittances and matching grants

Collective remittances are remittances pooled by informally organised groups or registered hometown organisations to be used for a wide range of activities, from humanitarian causes to infrastructure projects to generating income-generating opportunities (Schuettler, 2008). The scope, form and size of these organisations varies, however only a minority of these organisations aims at promoting development in countries of origin (de Haas, 2006). In a review of the literature on the contribution of migrant organisations to income-generating projects, Schuetller (2008) finds that while collective donations, savings, and investment have potential and have shown some positive results, on the whole the investment programmes have mixed results. Collective investments face similar problems as individual investors in the community, such as an adverse economic and business climate, lack of entrepreneurial experience, geographic distance and may not be economically profitable. (ibid).

Collective remittances are obviously private monies, but governments can employ tools to incentivise these and to encourage productive use of remittances. A prominent government tool is to implement matching grants. For these, governments match funds of diaspora or hometown organisation secured through collective remittances. The most cited examples include Mexico and El Salvador, for instance in 1997 the Mexican government launched the 3-for1 programme, in which the local, state and central government all contribute $1 for every $1 of collective remittances to fund specific community development projects. These are mainly infrastructure or social projects, such as churches, schools etc. By 2002, the programme had funded development projects to the sum of $43.5 million (Moreno-Dodson et al., 2012).

Orozco (2002) lists a number of other projects in Mexico, where state governments have cooperated with diaspora/ hometown organisations and subsidised business initiatives. For instance, in Guanajuato, the state has subsidised and supported the Casas de Guanjuato association to manage and fund small garment factories (ibid).

While matching funds are generally hailed as success stories they need to be **considered critically in the context of fiscally constraint governments**. As such, matching finds may divert limited government resources from others – perhaps higher priority – development projects or from poorer regions with a greater need for support (World Bank 2006).

4 Conclusions

The helpdesk response presents evidence on the potential products and policies to leverage the productive use of remittances in developed and underdeveloped countries. It is a broad, rapid overview of the literature in this field and, while summarising seminal studies and reviews, only encompasses a fraction of the literature in this field, but has also highlighted some major gaps in the literature. It should be seen as a resource document for further study and analysis.

Nepal is one of the major remittance receiving countries amongst low-income countries. Remittances have been increasing steadily since 2000, but have been somewhat volatile. There is some indicative evidence that remittances to Nepal are counter-cyclical in response to GDP growth in Nepal, but this requires further and more sophisticated data analysis. The global financial and economic crisis did affect remittances to Nepal, but both recovered quickly.

From a macroeconomic perspective, remittances have been considered to boost foreign exchange reserves – hence ensuring macroeconomic stability – and to maintain the balance of payments, despite an increasing trade deficit (Sapkota, 2012). Analysis by the World Bank (2011) has shown that the volatility of remittances, combined with a real estate boom, has affected investment and led to macroeconomic management problems, but more research needs to be conducted on this.

Recent research has shown that high GDP flows and the subsequent benefits of these may reduce incentives for policy makers to improve macroeconomic deficiencies (such as poor investment climate, low employment opportunities). This can result in so-called 'vicious policy cycles', with high remittances inflows exerting low pressure to improve policy weaknesses (World Bank, 2011).

Agunias (2006) proposed that **policy options to maximise the benefits of remittances can be grouped in two broad categories: 1) strengthening remittances infrastructure and 2) leveraging the use of remittances for development**. Both sets of policies are important for encouraging the productive use of remittances.

Strengthening the remittances infrastructure includes:

- reducing transaction costs of remittances, e.g. by promoting greater competition, improving transparency, and innovative transfer mechanisms)
- addressing 'last-mile' concerns (ensuring recipients in remote/ rural areas are able to receive remittances, and at a reasonable cost), e.g. through partnerships between registered banks and non-financial institutions
- facilitating the use of formal systems (without banning informal systems), as this could help to bank the unbanked and could deepen financial systems in low-income countries.

So what policies can governments set in place to ensure remittances are diverted to productive uses? The potential measures to be used depend on the policy-makers' objectives. These include capturing a share of remittances for development purposes, stimulating transfers through formal channels, stimulating investment of remittances. Some of these are programmes and policies that can be implemented by the government; others are led by the private sectors or civil society.

Remittances are private monies, but can be taxed of course and taxes can subsequently be spent on public goods. However, taxing remittances could be counter-productive, because doing so will incentivise migrants to send them through informal channels, might reduce the incentives to send remittances altogether and are likely to be regressive. **Instead of direct control of remittance flows, providing incentives to remitters are deemed more effective**. Most of these incentives are of a financial/ monetary nature, designed to encourage the sending of remittances and investment of remittances.

This review discussed the empirical evidence on: tax breaks, special deposit accounts, channelling remittances through microfinance institutions, diaspora bonds, securitisation of remittances, investment vehicles, collective remittances and matching funds.

While some countries were fairly successful at employing some of these policies to leverage more productive use of remittances, **we should be realistic about how much governments can do to leverage productive use and increase remittance flows**. Furthermore, as Ratha (2012) argues, **such measures are more problematic than efforts to expand access to financial services or reduce transaction costs**. Tax incentives may attract migrant's remittances, but may also encourage tax evasion of non-migrants (ibid). Likewise, matching funds have been successful in some countries to encourage collective remittances, but could divert resources from other, possibly more important programmes, or more needy regions. In essence, remittances are private monies and should be treated like other income sources. This means that **efforts to improve the productive use of remittances can be achieved more effectively through improvements in the overall investment climate** (which also limit the effectiveness of remittances, like other income sources), rather than a specific focus on measures for remittances (Ratha, 2012).

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