



Remittances and savings in migrant-sending countries

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Brown and Foster find that the official aggregate data on remittances, income and savings provide a highly misleading picture of the actual extent and forms of such flows and their uses. Their work indicates very little support for the remittance decay hypothesis. Instead, data demonstrate that remittance levels do not decline with length of absence away from the migrant's home country and a significant factor for migrants to remit is the accumulation of assets and investment in the home country. These findings open the way for Pacific island governments to increase and manage the flows of remittances to the benefit of their economies.

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The economies of a number of Pacific island countries have become increasingly dependent on the remittance of migrants. A series of recent International Labour Office research projects in the South Pacific focused on two countries—Tonga and Western Samoa (Brown 1994). Recommendations from these insights serve as a basis for a policy dialogue with the financial authorities of Pacific island countries and representatives of the international and regional financial and development organisations.

Economic policy in the past has been primarily concerned with the development process and coping with the effects of unanticipated events, such as natural disasters, largely through public sector initiatives. The problem of containing any inflation arising from these events and

processes has been a concern to policy-makers, involving consideration of the volume of liquidity. But, as argued here, in such countries liquidity and cumulative saving can be of similar magnitudes if the non-bank sector is underdeveloped. Action must be taken soon to ensure the best possible use of both remitted funds and domestic savings to safeguard economic sustainability.

The ILO South Pacific research projects

Within Pacific island countries, and in international organisations serving those countries, there is inadequate information on remittances and their use, and hence on their real and potential contribution to economic development. Much of the

available information on remittance flows suggests that increases in remittances lead directly to increased imports of consumption goods with little impact on generating productive investments at home. These conclusions are often based on studies that are primarily overviews of the fragmentary literature available on remittances (Ahlburg 1991; Connell 1991; Forsyth 1992).

Between November 1992 and March 1994 the ILO sponsored a series of research projects on migration and remittances in the Pacific. Research was focused on two main areas

- factors affecting the supply and use of remittances by migrants and recipients
- the macroeconomic policy and the financial and institutional environments affecting the patterns of savings and investment out of migrants' remittances.

Fieldwork and preliminary data analysis have so far been completed for three sub-projects

- a household income and expenditure survey among Tongan and Western Samoan households, with the objective of compiling and analysing primary data on the amounts, forms, uses and impacts of remittances, both official and unofficial, as seen from the receiving end (Brown and Connell 1993b)
- a pilot survey among Pacific island migrant communities from Tonga and Western Samoa in Brisbane, Australia, with the objectives of compiling and analysing primary data on the magnitudes, channels and determinants of remittances, as seen from the remitting end (Brown and Walker 1994)
- a preliminary study, based on available secondary material, of the financial sectors, financial intermediation and financial policies affecting the mobilisation and use of investible funds in all five of the above-mentioned Pacific Island economies (Foster 1993).

Results

A number of important findings emerged from these studies. It has become apparent from the study of Tongan and Western Samoan recipients of remittances that the official aggregate data on remittances, income and savings provide a highly misleading picture of the actual extent and forms of such flows and their uses. Remittances do appear to be making a substantial contribution towards savings, but this is not reflected in the official data, both because of the form in which these are often held, and also because of the inadequate, inconsistent and sometimes quite inappropriate manner in which aggregate savings/dis-savings rates are calculated and treated in most existing macroeconomic analyses.

The study, which is based on a pilot survey of Tongan and Western Samoan migrants in Brisbane, Australia, indicates very little support for the 'remittance decay hypothesis'. Cross-sectional data from this survey provide strong support for the view that remittance levels do not decline with length of absence away from the migrant's home country and a significant motivating factor for migrants to remit is the accumulation of assets and investments in the home country.

The econometric evidence from the third study supports the view that remittances in Tonga and Western Samoa are sensitive to interest rate considerations because of the desire of migrants to hold assets, either in financial form or as a personal debt. There is support for the view that, as migrant income grows, these types of remittances also grow and that they will grow much faster if favourable interest rates are on offer. The evidence shows little sign of remittance decay, which in other studies may have been confused with the effect of slowing income growth in New Zealand. The evidence concerning

saving suggests that migrant income is the key factor and that interest rates have a role to play. As incomes rise, saving behaviour appears to become more important in determining remittances in both countries.

It is also clear from these studies that the existing financial systems and related policies are not conducive to attracting remittances into financial assets in the migrant-sending economies. Real interest rates have been negative, or at very low positive rates. This has encouraged recipient families to invest such funds in other non-interest bearing assets such as housing or consumer durables. Migrants may, quite rationally, choose to hold their savings abroad, perhaps to be remitted 'home' and invested there at some point in the future.

Policies to stimulate remittances

There is substantial scope for policy intervention on the part of Pacific island governments wishing to increase the flows of remittances to their economies. All the evidence suggests that migrants' remittances would be responsive to financial incentives of 4ly Australia, New Zealand, Hawaii and mainland United States (California). Savings and investment decisions of the migrant family can be likened to those of a multinational corporation (Bertram 1986; Bertram and Watters 1985; Marcus 1981). Until such time as the financial authorities in Tonga and Western Samoa offer internationally competitive real interest rates to savers, migrants may choose to hold their savings elsewhere.

There has been virtually no concerted effort by government in the South Pacific to offer incentives for migrants to remit more through official channels and to induce more investment of remittances in productive activities. There is scope for a careful consideration of policies, such as the

transfer of pension rights, directed towards maximising the benefits of international migration in most countries in the region.

Remittances are driven by family and community (such as the Church) need and the savings/investment objectives of migrants and their families. Remittances are strongly affected by the level of income in the destination countries, rendering them prone to recessionary developments. There is little that can be done concerning such fluctuations except to be aware of their existence and make some provision for their occurrence. In other words, a national security strategy is required to ensure that sufficient buffer stocks of financial assets exist to provide reserves in such situations for families to draw upon.

Our focus is a strategy to attract and retain stocks of migrant savings available for investment purposes. In recessions, it is likely that it is remittances for saving/investment which are reduced rather than funds for family consumption. It is therefore imperative that stocks of savings are built up to maintain business investment in such periods. It appears that considerable amounts of viable small business investment is funded through family networks. When destination country recession lowers the level of funds available, there will continue to exist viable projects which can be funded from institutional sources, provided that skilled project evaluation is undertaken by banking officials.

Only by seeking to channel migrant savings away from destination country financial assets to home country assets can such security be provided. Thus, our strategy for attracting remittances boils down to one which encourages international savings flows. Our concern is not to affect the level of remittance flows *per se* but to provide a strategy which can deal with situations where they fall below normal.

Policies to foster savings and investment

All the evidence reported in this study suggests that it is neither the availability of savings nor an unwillingness to invest on the part of those in receipt of private remittance transfers that explains the relatively low growth performance of the Tongan and Western Samoan domestic economies (see Yusuf and Peters 1985).

To the extent that this is the case, then it appears that the problem is more one of resource use and investment allocation than one of savings generation. In this context the role of financial institutions, and the issues of financial intermediation and financial deepening in these economies become very relevant.

Something of a myth has developed in the literature concerning bank lending possibilities in developing countries. It is generally felt that the absence of adequate collateral precludes safe lending. However, it has been demonstrated in India and other countries that it is possible to achieve a low default rate in cases where the only collateral is the capital equipment purchased, provided that the business prospects of the borrower are carefully assessed. Traditionally, the poor in developing countries have viewed money-lending as a rent-seeking activity designed to prey upon those who must borrow in desperation. Equally, managers of credit cooperatives of various types have often engaged in practices which have enhanced their wellbeing at the expense of the cooperative. Credit availability can potentially be used as a political lever in poor communities and only strict adherence to prudential practices, supervised by outsiders, can guarantee successful banking operations.

It has been argued that financial institutions could play a more active role in mobilising investible funds by providing stronger incentives to individual savers

through more attractive real interest rates. However, family security and development priorities should, wherever possible, be kept separate. In our view, economic development projects should, as they are now, be funded mainly through foreign aid and kept quite distinct from commercial lending for normal purposes, using proper prudential assessment of risk. It is essential that development-related lending, typically with a very low repayment probability, should not be undertaken using migrant balances held for current and future family security—in no sense is our proposal one to substitute migrant funds for aid flows in the development process.

The findings reported here do not necessarily indicate that remittances should be directed towards domestic investment and that the migrants (or their families) would necessarily make the best entrepreneurs. Some migrant families have evolved into investing entrepreneurs, spread over a number of countries in the region. Where opportunities arise, remittances are used for investment and can be investment-motivated (Brown and Connell 1993a). This raises the broader issue, relevant to all labour-exporting countries, concerning the general investment climate. Even where the migrant does possess the necessary entrepreneurial potential, if the general investment climate in the remittance-receiving economy is not conducive to entrepreneurial ventures it cannot be expected that the migrant will be willing to risk his or her savings in an investment in the domestic economy when much safer alternatives exist elsewhere.

In the context of other Asia-Pacific countries, Saith (1989) questions the wisdom of adopting policies in the belief that the migrant-saver can be converted to a migrant-investor. It would make better sense for policy to be geared more towards the majority of migrants with a view to at least encouraging them to become more active in the domestic capital markets as a

saver-renter. As suggested earlier, this would necessitate the governments in the Pacific island economies offering savers competitive real interest rates. The loanable funds accumulated in this way could then be invested either in larger domestic projects, or, where no suitable opportunities exist, they could be held as overseas assets denominated in foreign currency, and the best possible rate of return. Direct financial incentives can also be provided for the investment of remittances in development projects, such as national Development Bonds that can be organised in relation to activities of national Development Banks. Such an initiative has not yet been seriously contemplated in the region although there were attempts in Western Samoa at the start of the 1980s to encourage skilled migrants to invest in housing and thus increase their commitment to the country.

The accumulation of financial assets abroad would provide the necessary income security to the migrant households, and a protective buffer against adverse developments both in the labour-sending country (such as cyclones) and elsewhere (such as recessions and rising unemployment levels). Indeed, two Pacific island countries, Kiribati and Tuvalu have such buffers in place. Kiribati set up a Revenue Equalisation Reserve Fund (RERF) in 1956 as a trust fund to be built up from the profits from its main, non-renewable phosphate exports. Tuvalu established the Tuvalu Trust Fund (TFF) along similar lines in 1987. These Funds are invested abroad and have achieved high rates of return, which in the case of Tuvalu, averaged 19 per cent in the first four years of operation. Revenues from the funds are used by government as a source of revenue.

The experience of Tuvalu and Kiribati suggests that, as yet, little progress has been made in the management of buffer stocks of financial assets for the benefit of families and enterprises. Both of these countries have accumulating trust fund

balances, which are for the purpose of providing national financial security. Yet both countries are experiencing significant socioeconomic difficulties and have no clear strategy for mobilising this asset in a way which can promote socioeconomic well-being while, at the same time, avoiding attendant reductions in much-needed aid. It is a dilemma that is confronted by most Pacific island countries and must be solved given the precariousness of aid-dependency.

The accumulation and dispersion of loanable funds into viable investment projects has been hampered by past government policy which has emphasised both development and monetary policy. Fostering investment requires the formation of an independent financial institution which operates 'best practice' methods in attracting funds from migrants and in lending these domestically and internationally. Such a strategy need not diminish the need for aid for infrastructure development or to alleviate poverty or to provide interest subsidy on commercial borrowing rates when they drift well above average because of world financial conditions.

Monetary policies

To attract remittances the governments of migrant-sending countries need to implement monetary policies which result in the maintenance of interest rates which are positive, on average, in real terms and are internationally competitive. Without positive real interest rates, individuals and families cannot be expected to hold savings assets, except in the very short term. Clear differences in the propensity to save were discovered for Western Samoa and Tonga, in line with the differences in prevailing real interest rates. Given the concern for equity which characterises the cultures in these countries, there is a moral obligation for the relevant authorities to ensure that real interest rates are never negative, since

this constitutes an unfair redistribution of wealth from savers to borrowers.

If it is felt that real lending rates should be kept low or negative for reasons relating to development policy, then this is something which must be addressed through interest rate subsidies and guarantees. Rules for granting subsidies and guarantees must be formulated for all lending, not just for loans provided by aid-supported development banks, which already use interest subsidy strategies. If some loanable funds cannot be lent domestically, this need not be a problem. It is recommended that legislation be suitably drafted so that all financial institutions can hold, at their own discretion, overseas assets, denominated in foreign or local currency. With regard to savers, both domestic and migrant, it is in their best interests that institutions secure the best possible rate of return and, of course, the recycling of migrant savings into overseas investments also secures profits for the institutions in question. To ensure the latter are not expatriated, the relevant financial institutions would be run as independent State corporations, along the lines of existing national provident funds.

It is clear from the experience of Kiribati and Tuvalu that governments can handle overseas investments very effectively in conjunction with a reliable agent. However, it is also clear from these cases that government control of such assets is not necessarily the best way of achieving income security at the level of individual families and enterprises. If governments are not able to borrow directly from these financial institutions, investors would be protected from political instability and 'crowding out' of private investment would be prevented. The State would, of course, be free to sell government bonds directly to the public through its central bank, and institutions would be allowed to hold bonds issued by other governments of good standing.

There is little doubt that attractive interest rates induce inflows into savings assets, either directly or indirectly, constituting an advantageous state of affairs. Provided that overseas asset-holding is permitted, there is no danger of a 'liquidity overhang' to concern central banks. In the past, central bankers have been concerned with inflation, however, it is becoming apparent to monetary economists everywhere that there is no simple link between the volume of financial assets and inflation. The inflation experience of the island countries in question suggests that inflation has been related to aid-funded government spending, rises in import prices and natural disasters. There have been no large, persistent, money-financed budget deficits which can result in serious inflation.

Central banks should continue to pressure their governments to avoid persistent budget deficits, but the focus of attention needs to move away from inflation towards the promotion of saving asset growth. Active policy to ensure that there is a build-up of financial assets in a remittance-dependent economy provides necessary insurance for the future. The evidence here offers some indication that migrants alter the composition of their remittances from consumption support to financial asset accumulation, provided interest differentials warrant it, as their incomes rise. Evidence from Brown and Walker (1994) suggests that migrants hold significant quantities of savings in their country of residence, so the potential for savings asset accumulation in the home country clearly exists.

The ILO studies also point to the need for financial policy reforms which take into consideration the real rate of return for the saver in relation to rates of return available to the 'transnational family' in both financial and non-financial assets, both domestically and abroad. The details of these need to be worked out on a country-

by-country basis, taking into account the particular financial, institutional and policy environment of each case, and the forms, channels and determinants of remittance flows from migrants to their dependents, and of savings flows from migrants and their dependents to their various uses.

Policies to curb inflation

Conflict can arise between savings and investment strategies and anti-inflation priorities. However, in the 1990s, inflation has subsided as a central problem in many countries and an opportunity has arisen to reorient economic policy towards providing a macroeconomic and monetary policy which facilitates both growth and sustainability. The proposals we have made concerning saving and investment do not, in our view, pose any threat whatsoever of inflation. Inflation is not caused by the public holding stocks of financial assets, provided these are not lent to government to finance their expenditure and provided that such assets are not used as a conduit for the lending of aid funds with a low probability of repayment. The latter should continue to be managed by development banks or agencies.

It is beyond the scope of this paper to discuss the question of budgetary policy. Although it is obvious that a target of budget balance eradicates a potential source of inflation in such countries, practical development and national security considerations often necessitate budget deficits. In the case of small South Pacific countries, aid flows can cover such deficits, but the danger of inflation is not eradicated since such flows cause liquidity to increase. This may be dissipated into a worsening trade deficit or it may drive up prices, particularly when there is no immediate increase in the supply of goods and services emanating from the associated development spending.

It is this process which undermines savings flows since it drives down real interest rates to low or negative levels. Funds channelled through development banks dissipates into consumption subsidies and reduces the propensity to save in domestic financial assets. In such circumstances, we feel that aid should be used mainly for governmental infrastructure projects which are labour intensive, to generate employment, and for the funding of state pensions for the old and education for the young. The funding of business investment should be, strictly, the province of financial institutions which recycle domestic and migrant savings: government agencies and aid agencies are not competent to do this.

A basis for dialogue

In this paper we have tried to present policy recommendations relevant to a number of South Pacific countries. However, the implication is not that we can automatically generalise findings from Tonga and Western Samoa to others in the region. Indeed, the differences between the financial systems of the countries we have looked at are striking, both in terms of differences in the level of financial development and in institutional structure, conditioned by unique mixes of cultural and colonial heritages. However, to some extent, our findings for Western Samoa and Tonga should be able to provide a financial template of a remittance-dependent economy which can be used as a good starting point for understanding the situation in other small countries in the region.

Some of our conclusions should be viewed as indicative that further in-depth research should be undertaken, rather than firm recommendations. Indeed, the policy recommendations made do not contain sufficient detail to operationalise them in

any particular country: this would require considerable dialogue with representatives of the governments in question.

It is hoped, nevertheless, that the policy prescriptions we have outlined here will serve as the basis and invitation for a dialogue, in this *Bulletin* and other regional fora, among policymakers from the region, representatives of national and international development agencies, and concerned academics.

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