Remittance inflows and economic development in Rwanda

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CHAPTER TWO

2.0 Literature Review: Remittances and Economic Development

There is a growing interest in understanding how remittances impact development outcomes in developing countries, however, their contribution remains poorly understood theoretically and empirically in the literature. This chapter presents an extensive review of the theoretical and empirical literature on the relationship between remittances and economic development. The review of the literature enlightens our understanding about the development impact of remittances. The literature emphasizes the indispensable role of remittances in development. This review sheds light on the fact that migration and remittances are potentially complementing factors for broad-based development endeavors. However, they are not a panacea for the entirety of broad-based development, because their development impacts depend on other underlying factors, which have been underestimated in the remittances and development discourse. This thesis contributes to this scholarship. This chapter opens with definitions of the key concepts of this thesis, remittances, consumption per adult equivalent, and the concept of economic development. The concept of economic development is discussed in detail to situate and delimit the scope of this thesis. Three main contrasting views about the development impact of remittances are reviewed. The chapter provides a synthesis of the different theoretical and empirical narratives of the existing scholarship and discusses the gaps that still exist.

The review of literature finds that the optimistic, the pessimistic and the pluralist views have influenced empirical debates about remittance and development. They have informed the three dominant theoretical approaches about the remittance-development impact, the national account model, the endogenous growth model, and the NELM. The NELM is considered as a theoretical improvement of the early theories, establishing a theoretical bridge between migration and economic development. Remittances are considered returns on migration, influencing development outcomes in the countries of origin. Both the national account model and the endogenous growth models bring the macroeconomic implications of remittances into perspective. The national account model claims that the macroeconomic outcomes of remittances manifest through two optimistic and pessimistic channels, direct and indirect channels. The endogenous growth approach argues that the growth and development effect of remittances is pronounced when remittances interact with the factors of production to finance human capital development and technological diffusion in the recipient economy, thus promoting growth and development. This effect is manifested at both the micro and the
The review of these theories shows that they are compatible and complementary rather than mutually exclusive in explaining the development effect of remittances. However, neither theory describes the effect of remittances on development outcomes in the origin country systematically and comprehensively, from the micro level to the overall macroeconomic outcomes. Moreover, the role of institutional and policy environment in causally mediating different mechanisms through which remittances affect development outcomes remains unaddressed.

Therefore, the review of the literature about the growth and development impact of remittances is guided by the following research questions: What is the contribution of remittance inflows to the development outcomes and how can the development effects of remittance inflows best be measured and explained? Under what conditions do remittances affect development outcomes and how can these effects be maximized?

In line with the above questions, the three dominant strands of the empirical discussions are reviewed to inform the theoretical and empirical framework of this study: the macroeconomic implications (the remittance-growth effects), the mediating role of institutions in conditioning the growth and development effects of remittances, and the effects of remittances on microeconomic outcomes. The review of these empirical debates finds two contradicting empirical stands about the impact of remittances, namely the effects of remittances on micro-development outcomes and the effects of remittances on macro-development outcomes. The macro level is most pronounced. Lastly, the chapter reviews the mediating role of institutions in conditioning the development effect of remittances.

2.1 Definition of Key Concepts

This chapter reviews the theoretical and empirical relationship between remittances and economic development by employing the key concepts of remittances, consumption expenditure per adult equivalent (as one of the measures of poverty), and economic development. The latter two are used to estimate the development effect of remittances, particularly in Chapter Six and Seven. For the purpose of delimiting the scope of this study, the definitions and explanations of these concepts explicitly focus on the linkage between remittances, institutions and economic development.

2.1.1 Remittances

The concept of remittances in this study is used mainly as the independent variable influencing development outcomes at both macro and micro levels. In simple terms, remittances are defined as transfers (both in cash and in kind) sent by migrants living outside
their country of origin. Different scholars, policy makers and development actors have used different data for remittance inflows based on different definitions of remittances, which affects the quality of data used in research and policy making. The International Organization for Migration (IOM n.d.) defines remittances as monies earned or acquired by non-nationals that are transferred back to their country of origin. A large amount of literature in the field relies on World Bank definitions and data. Remittances are defined as the sum of workers’ remittances and compensation of employees, are expressed as percent of GDP to capture the importance of remittance flows to national output. Both the IMF and World Bank define total remittances as the sum of workers’ remittances, compensation of employees (the wage, salaries and other benefits earned by migrants who have lived abroad for less than 1 year) and migrant transfers (financial items that arise from the migration of individuals from one economy to another) (see Ahamada and Coulibaly, 2011). Data on remittances are also taken from World Development Indicator. In the World Bank Migration and Remittances Factbook (Ratha et al. 2011), remittances are defined as the sum of workers’ remittances, compensation of employees, and migrants’ transfers. Recently, the World Bank has adopted conceptual definition of personal remittances, which is also used in this study. Personal remittances comprise personal transfers and compensation of employees. This definition of remittances was developed in the sixth edition of the IMF’s Balance of Payments Manual (BPM6), published in 2010, and encompasses the comprehensive aspects of remittances. The terms “remittances” and “international remittances” are used interchangeably throughout this thesis.

2.1.2 Consumption Expenditure per Adult Equivalent

The concept of consumption expenditure per adult equivalent is employed in this thesis as a measure and an explanatory variable influenced or explained by other independent variables, including remittances. Scholars of poverty analysis suggest different measures of poverty/ wellbeing (such as income, consumption and nonmonetary dimensions) of the household, society or population. Each of these measures have strengths and weaknesses. Consumption expenditure per adult equivalent is one of these indicators (beside income and consumption per capita) recommended by most poverty and other development outcome analysts. The recommendation of consumption is based on three main factors: First, consumption is a better outcome indicator than income; Second, consumption may be better measurable than income; and Third, consumption may better reflect a household’s actual standard of living and ability to meet basic needs (see Bouoiyour and Miftah, 2015; Christiaensen et al. 2002). Mostly if the analysis is based on the household survey data.
Consumption as a measure of poverty includes both goods and services that are purchased and those that are provided by one’s own production (in kind) (Haughton Jonathan et al. 2009). The consumption expenditure per adult equivalent considers the different individual needs and economies of scale in consumption, household size and demographic decomposition. In this regard, Akampumuza and Matsuda (2017) note that, “scaling household consumption expenditure by adult equivalent units rather than per capita terms allows researchers to adjust for differences in expenditure needs due to the demographic composition of households, which could otherwise account for part of the observed consumption differences between treatment and control households respectively.”

Numerous studies (see Randazzo and Piracha, 2014; López-Videla and Machuca, 2014) exploring the impact of remittances on poverty reduction using household survey data recommend the use of consumption expenditure as a measure of income status and household welfare rather than income due to the fact that income is difficult to determine. This thesis is based on the definition of poverty and consumption expenditure as a measure of poverty and welfare employed by the National Institute of Statistics of Rwanda during household survey and analysis (see Rwanda Poverty Profile Report, 14) whose data are used in this study.

2.1.3 Economic Development

The concept of economic development is employed in this study as a dependent variable influenced by control variables, including remittances. Economic development is defined as a relative measure of economic and social welfare. Many empirical narratives explain economic development as an increase in the Gross National Product (GNP) of a country, measured as per capita growth. The concept has been defined differently by different scholars depending on their field and to some extent the context. Mainstream economists argue that economic development implies the growth of national output and per capita income. Others define development as a process whereby an economy’s real national income increases over a long period of time. It is worth observing that this conceptual definition of development is explicitly biased to the macroeconomic side of development. This affects the way the overall performance of the economy is understood, mostly in terms of comprehensive measurement of development outcomes. As such, the concept remains contested among scholars and development actors, including policy makers, with no single satisfactory definition.

Sociologists and political scientists have expanded on the above definition of development to include the qualitative aspect of development and factors mediating overall development outcomes. In the field of Sociology, Pritchett et al (2013:3) define development as “a
transformational vision of entire countries, where transformation is sought across the four dimensions of polity, economy, social relations, and public administration”. Specifically, Pritchett et al argue that, ideally developed societies would have political systems that represent the aggregate preferences of citizens, economic systems that grow through enhanced productivity, social relations that fairly extend rights and opportunities to all individuals, and public organizations that function according to meritocratic standards and professional norms. In the context of political science, development is thought in terms of state legitimacy and capacity to provide public goods and social benefits to all citizens. In this regard, Reyes (2001:1) emphasizes that “governmental systems have legitimacy not only in terms of the law, but also in terms of providing social benefits for the majority of the population.”

What we are learning from the literature is that the definitions of development continue to evolve, shaped by the theories of development (modernization, dependency, world system, and globalization) and affected by the contextual gap in the theoretical framework and the ongoing critiques about measurement of development. Which is linked to the lack of comprehensive measurement of development. Some mainstream economists, for example Stigliz et al. (2009) have refuted the concept of measuring economic development using GDP per capita indicator, arguing that GDP is an inadequate metric to gauge wellbeing over time, particularly in the aspects of economic, environmental and social dimensions. A better understanding of how development is reflected at all levels of the economy is required. This includes the macro and micro aspects of development, the distribution of growth benefits across different sectors of economic activity, and the socio-economic layers in society.

In view of the above, advocates of the quantitative implication of development, mostly macroeconomists, tend to define economic development based on the aggregate annual increase of national output and per capita income. Although this provides the macroeconomic implication of development outcomes, it ignores the social implications of the realized quantitative growth. Research from the 1950s-1960s already showed that many countries realized their economic growth targets, but the standard of living of the people did not change. Today we still observe an average annual GPD per capita growth in developing countries, but a prevalence of mass poverty, a poor distribution of development benefits, inequality, illiteracy, unemployment, institutional inefficiency and ill health continue to affect these countries. Advocates of the qualitative implication of development prioritize broad-based improvement in the quality of life. For instance, in his definition of development, Sen
(1985:) promotes the capability functions, arguing that “an ideal society would provide individuals with both the freedom and the opportunity to choose a lifestyle they value.”

It is evident in the theoretical and empirical narratives that the concept of development needs to extend beyond the quantitative measurement of GDP per capita growth to consider social, contextual (in terms of national and cross-national realities), environmental and institutional mechanisms that are necessary for large-scale improvements in the standard of living of the masses (Stigliz et al. 2009). Indeed, Viterna and Robertson (2015:3) assert that “we know little about how well these measures reflect the on-the-ground reality of individuals.”

There has recently been a paradigm shift in measuring the concept of development, based on the context and estimation of development outcomes. Increasingly, the focus lies on development outcomes based on microeconomic outcomes with some emphasis on the contextual aspects. The strength of this framework is derived from its ability to estimate development outcomes based on the contextual and microeconomic outcomes under study. In support of this analytical framework, some scholars Banerjee and Duflo (2011, cited in Viterna and Robertson, 2015:10) argued that, “instead of wrestling with the big questions of macroeconomics, scholars should focus on a set of concrete problems that can be solved one at a time.” For example, development economists might investigate how to fight diarrhea, how best to get students into schools, or how to ensure farmers get the fertilizer they need. By understanding the specific barriers that lead to specific problems, they argue, scholars can intelligently and economically address development issues, one intervention at a time (Viterna and Robertson, 2015).

In line with the above, recently, randomized control trial techniques have attracted the attention of development economists and sociologists studying development issues in developing countries. This has led to the introduction of a different empirical framework in microeconomics, the randomized control trial (RCT) techniques. The RCT is a methodological technique whereby researchers choose an intervention group (treatment group) and intervention site and a non-intervention group (control group) and control site to study a development problem. The two groups are compared before and after development intervention (Viterna and Robertson, 2015; Ravallion, 2009a). The results of these interventions inform policies and rolling out of the program/intervention to another area. Scholars studying the development implications of remittances in developing countries have also begun to adopt these techniques. The techniques allow the researcher to depict the development impact of interventions with minimized risks of contextual issues.
This study adopts the analytical framework of RCT to address heterogeneity issues related to the development impact of remittances on the cross-national level of SSA countries and the country level of Rwanda. It addresses the methodological issues related to selection bias and endogeneity in the field of remittances and development. The application of the RCT analytical framework (specifically PSM) is discussed and employed in Chapter Seven of this thesis.

Another issue that still affects the conceptual definition of development is the mediating role of institutions in conditioning economic performance. Recently, this has been brought to the attention of economists, sociologists and political scientists in the development discourse. There is consensus that institutions matter in shaping the economic performance of any country or society. For example, Engerman and Sokoloff (2008, cited in Viterna and Cassandra, 2015:9) assert that “institutions matter and that they are the dynamic products of changing political, economic, and geographic environments.” The question remaining is how best to measure the quality of these institutions. Promoters of the new institutional economics claim that economic performance is influenced by institutional systems, norms that shape the behavior of market and human behaviors. In this regards, Acemoglu et al. (2001, 2002, cited in Viterna and Robertson, 2015:10) conclude that “economic development requires inclusive political institutions that protect individual rights, secure property, and encourage entrepreneurship, thus promoting growth.” Rodrik (2003 notes that institutional development is characterized by better governance and human capital improvement (health and education), which need to be well distributed for development to take place. There is a feedback effect between institutional and human capital “quality” and successful development. However, the concept of institutions is still affected by measurement issues, specifically by the question of how to measure the quality of institutions. Ultimately, we need to know how institutions (rules, human behaviors and institutional framework) shape economic performance in developing countries and to what extent they do so. The unit of analysis thus matters.

Furthermore, the contextual aspect has been underestimated in the previous theoretical and conceptual definition of development. Recent theories of institutions and economic development emphasize the importance of context in order to localize the mediating effect of institutions in development. To maximize our understanding of how institutions affect development, Viterna and Robertson (2015:10) affirm that, scholars are increasingly eschewing one-size-fits-all explanations and calling for more in-depth analyses of the different functions, forms, and practices of institutions as they vary over time and across nations. In this regard, the contextual specificity matters in explaining development.
outcomes. This allows us to understand specific institutional rules and behaviors and how they influence development outcomes. These rules and behaviors play out differently in different developing countries. Existing research on the quality of institutions in SSA countries shows varying levels of institutional variables within the SSA region. This thesis considers the heterogeneity of institutional variables in the SSA region and addresses the latter gap by customizing the analysis to the country level of Rwanda.

The conceptual definition and scope of development is thus wide, complex and continuing to evolve. It is influenced by theoretical approaches, measurement issues and context. The evolution of the concept is also due to the urge to cater for other key determinants of development, such as institutions and the measurement approach of development. The literature shows that institutions do matter in shaping the nations’ and society’s development path. However, there is still work remaining to better understand the mediating role of institutions in development. On the measurement aspect, both macro and microeconomic approaches remain important and relevant for the study of economic performance in a systematic and holistic analytical framework. A causal mechanism (influenced by the prevailing institutional and policy environment) is however required in the context of remittances and development to determine how the institutional and policy environment causally condition remittance inflows and their deployment to affect microeconomic and macroeconomic outcomes.

In the context of this study, each of the above conceptual issues matters in studying the development implication of remittances. Remittances are external financial inflows and their effects are expected to be evident at both the macro and the micro level. The preposition of this study is that the overall development effects of these inflows are influenced by the prevailing institutional environment. Hence, it is imperative to develop a comprehensive analytical framework to better understand the development impact of remittances. In this context, remittances affect the development and wellbeing of those receiving them. Development is defined as a condition that enables individuals and society to enjoy a healthy quality of life, be free, have opportunities for upward mobility, and improve their material circumstances. Development encompasses a better standard of living that includes education, asset building, and health (see Orozco, 2013). Therefore, in this thesis, the concept of economic development is used as the dependent variable influenced by remittances and other independent variables. The proposition is that, all other things being equal, for remittances to influence economic development, the institutional environment is critical to causally condition this development process. Thus, the contributing role of institutions in mediating
the development impact of remittances in the origin countries is of paramount importance and the study therefore needs to be customized to the country’s realities.

This thesis employs the following operational conceptual definitions of economic development: as “a process whereby low-income national economies are transformed into modern industrial economies, involving qualitative and quantitative improvements in the country’s economy”. Indeed, Kindleberger (1958) argues that, “economic development implies both more output and changes in the technical and institutional arrangement by which this output is produced and distributed.” Singer and Ansari (1977) define development as “an increase in the GNP of a country and a decrease in poverty at an individual level”. Therefore, economic development encompasses economic growth and the “social and institutional” arrangements that ensure poverty reduction and improvements in the standard of living. This study therefore employs a concept of development that incorporates the quantitative growth and its distribution dimensions, and improved social welfare, as well as human capital quality. Informed by these conceptual definitions, I consider the concept of economic development to reflect the following three aspects of the economy: increase of annual national output/national income (proxy of GDP per capita), social development (specifically, poverty reduction and increase of social welfare/standard of living), and lastly, an improved institutional arrangement, which provides development opportunities and distributes resources/wealth and their benefits.

2.2 Linking Remittances to Development

Remittances are linked to development as financial inflows that improve the financial capacity of recipient households and countries to affect their development outcomes. However, there is ongoing theoretical and empirical debate about the relationship between remittances and economic development. These debates date back to the 1960s. Since then, three theoretical schools of thought have emerged: First, the developmental optimistic view, which promotes the positive development impact of remittances. In particular, those in favor of optimistic view, claim that international migration contribute to development in the South through transfer of capital (including remittances), investments, knowledge and technologies from the North. In turn, Beijer (1970) notes, “increase in international remittances would in long run stimulate capital-constrained economies to effectively take off in a sustainable fashion.” In support of the optimistic view, the NELM theory asserts that migration is a household strategy to deal with poverty, risk sharing and local market failures, while
Clemens and Ogden (2014) claim that migration itself is an investment strategy, and remittances are returns on investment.

Second, those who hold development pessimistic views about the development impact of remittances claim that the net effect of migration and remittances does not foster sustainable development (Adenutsi, 2010). Instead, it is based on the negative effects of migration and remittances and institutional and structural challenges within recipient countries that affect the remittance-development impact. Pessimists argue that factors such as brain drain, a vicious cycle of dependence on remittances by recipient households, a lack of an enabling institutional environment, and markets and infrastructure failures for remittances negatively affect the impact of remittances. Other studies have claimed that remittances are consumed and only a small portion is saved and invested in property, which does not have substantial effects on growth and development in the recipient economies. However, the issues the pessimistic view notes may well be attributable to the structural and institutional constraints that affect the productive use of remittances to impact development outcomes in the recipient countries.

The last view is the pluralistic one, which opts for a pragmatic understanding of the development impact of remittances. The promoters of this view put forward a flexible understanding about the development impact of remittances and consider the two other views to be static in dealing with the complex realities of remittance inflows and development (Adenutsi, 2010). Accordingly, Adenutsi argues that this understanding (the pluralistic view) provides more dynamic approaches to understanding the relationship between migration, remittances and development, connecting the positive and negative outcomes of this relationship.

In a nutshell, the three contrasting views (optimistic, pessimistic and pluralistic) consider the development impact of remittances based on the factors affecting remittance-development impact. None of these views explain how remittances affect development outcomes and how structural and institutional factors affect remittance-development outcomes. The optimistic and pessimistic views are static and linear. Their theoretical grounds about the relationship between remittances and development focus explicitly on remittances and growth or remittances and poverty, without considering other dynamics or mechanisms (such as the institutional policy environment and the contextual aspect) that are of paramount importance in influencing the development impact of remittances. The optimistic and the pessimistic view thus provide only a partial picture of the remittance-development impact and they lack the theoretical ground to validate their claims. Neither theory has been able to come up with a
conclusive theoretical approach explaining the relationship between remittances and economic development. The pluralist view goes a bit further and adopts a flexible theoretical approach in terms of explaining the causal link between remittances and development. It argues that context matters in defining and explaining the development impact of remittances, because the development impact of remittances depends on different dynamics within the recipient economy and countries differ in terms of structural and institutional factors that causally influence remittance-development outcomes.

Therefore, the mixed views about development impact of remittances is an empirical matter which determines the successful approach to development while considering the context in which remittances work. The institutional, structural and policy environment of remittances affect development. We also need to look at a broader picture of development, the causal mechanisms between micro and macro interactions, using a broad definition of development (discussed above). I thus adopt a pluralist view and will develop it to incorporate other dominant theoretical approaches that empirically put remittances and development into perspectives of development, namely the national accounts model, the endogenous growth theory, and the NELM. These theories are discussed below.

2.3 Theoretical Approaches

There are three dominant theoretical approaches to the development impact of remittances. Each is inspired by the optimistic, pessimistic and pluralist theoretical schools of thought. The three dominant theoretical approaches can be divided into macroeconomic and microeconomic theories based on their theoretical frameworks regarding the relationship between remittances and development. Both the national account model and the endogenous growth model explicitly focus on how remittances affect macroeconomic development outcomes, while the NELM theory focuses on the micro implications of migration, determinants of migration (at household level), and how remittances come into play as an investment return to migration for the immigrant-sending household. Most of the empirical narratives about remittances and development have been shaped by the latter theoretical approaches. This section concludes with a synthesis and discussion of theoretical gaps that remain unaddressed in the field and that this thesis contributes to.

2.3.1 The Macroeconomic Approaches

Although remittances are private inflows transferred directly from the sender to the recipient or households, they affect the aggregate economy through their effects on GDP, balance of payment accounts, financial sector deepening, and human capital, to mention but
few. The literature documents two dominant theoretical approaches that demonstrate the macroeconomic impact of remittances. These two theoretical approaches rest on both optimistic and pessimistic theoretical views and focus on the macroeconomic effects of remittances. Those who hold the optimistic view claim the positive effects of remittances on macroeconomic behaviors and the aggregate economy using both the national account model and the endogenous growth theory. Those with pessimistic views argue for the negative effects of remittances on the overall economy, using the same theoretical approaches. The two models’ main challenge is that they are biased to the macroeconomic effects of remittances only, without considering the broader effects of remittances on development or other aspects that condition the growth and development effect of remittances, such as the institutional environment, development factors and the context. They can thus be criticized for being rather narrow. In this section, I review the two theoretical models in detail in relation to their theoretical frameworks and the macroeconomic effects of remittances, based on Kireyev (2006).

2.3.1.1 The National Account Model

This theoretical model puts migration and remittances into perspective by demonstrating how remittances affect macroeconomic outcomes of the recipient economy. The national account model demonstrates that remittances affect macroeconomic outcomes through their direct and indirect effects on the balance of payment, trade deficit, exchange rate and inflation (Kireyev, 2006; Winters and Martins, 2004; World Bank, 2003). Theoretically, those who hold the optimistic view focus on the direct channel through which remittances affect the national account. They claim that remittances are an integral part of the national account, while those who focus on the indirect channel (pessimists) argue that remittances affect macroeconomic behaviors through their effects on the exchange rate and relative prices.

Similarly, the proponents of the optimistic view claim that remittances have a more positive impact on the balance of payments than other capital inflows (such as financial aid, direct investment or loans) do, because their use is not tied to particular investment projects with high import content, bear no interest and do not have to be repaid. In addition, they are a more stable source of foreign exchange than other private capital flows and, for certain countries, they exhibit an anti-cyclical character (Buch and Kuckulenz, 2010; Nayyar, 1994; Straubhaar, 1988, cited in OCD, 2006). Those who support this school of thought argue that, unlike aid, which comes into the economy through the official accounts, remittances, as
private flows, can be saved, consumed, or invested, each of which affect development outcomes.

In the same vein, Amuedo-Dorantes and Pozo (2006) and Woodruff and Zenteno (2007) postulate that remittances promote growth by providing additional foreign exchange and financing business investment. To this end, the majority of the literature argues that remittances affect economic growth by increasing consumption, savings or investment. Indeed, studies find that remittances increased and affected investments in Morocco, Pakistan and India, and in seven Mediterranean countries (see Lucas, 2005; Glystosos, 2002). Several empirical findings claim that remittances argument income of individual recipients and if invested, they contribute to the output growth, and consumed, they generate positive multiplier effects (see for example Ratha and Riedberg, 2005; Stahl and Arnold, 1986). For instance, for every dollar Mexico received from migrants working abroad, its GNP increased by between $2.69 and $3.17, depending on whether remittances were received by urban or rural households (Adelman and Taylor, 1990). Adelman and Taylor further argue that, in the case of unskilled workers who emigrate to escape unemployment, remittances are likely to prove an even clearer net gain to the developing country. Fayissa and Nsiah (2010) find remittances impact economic growth and development in Africa; they find that a 10% increase in the remittances of a typical African economy would result in an about 0.4% increase in the average per capita income. Similarly, Adams and Page (2005a) find that a 10% increase in per capita official international remittances will lead to a 3.5% decline in the share of people living in poverty.

In contrast, the pessimists, who stress the indirect channel, claim that remittances affect macroeconomic behaviors through their effects on the exchange rate and relative prices. A significant portion of the literature on this theoretical model argues that large remittance inflows in a country with no capacity result in an appreciation of the exchange rate and inflationary pressure, the “Dutch Disease” phenomenon. Several studies have argued that remittances negatively affect macroeconomic variables such as balance of payments, exchange rates, inflation and exports, leading to the appreciation of real exchange rates, inflation and a non-competitive export sector. Remittances are also argued to increase imports, leading to a balance of payment deficit (Biller, 2007).

However, the Dutch Disease phenomenon has remained a merely empirical tool used by pessimists to claim against positive effects of remittances in the origin countries. Though, the phenomenon lacks clear theoretical and empirical basis showing how remittance inflows would affect the macroeconomic behavior of the recipient economy. For instance, if the
threshold were to be determined as a ratio of remittance inflows to GDP, based on the recent global trends of remittances, the ratio of these inflows to the country’s GDP is still rather small. The only exception is a few small emerging economies, particularly in Central Asian countries and the Pacific Islands, where remittances form the lion’s share of GDP. For example, in Tajikistan remittances are about 49% of GDP and in Tonga they are a quarter of GDP (World Bank, 2015a). These cases are however too insignificant for generalization. And evidences from these countries do no show us that remittance inflows have affected macroeconomic behaviors in these countries. Some studies have indicated a threshold of 5% beyond which remittances would be in position to affect the macroeconomic stability. In a similar vein, Bugamelli and Paternò (2005) have claimed that the effect of remittances is shaped by a clear threshold effect. In particular, when remittances reach 3-4% of GDP, their contribution to financial stability becomes much stronger and neater. The literature remains however inclusive about this threshold, even though it is imperative to avoid empirical speculations and would orient empirical analysis. Empirical evidence shows that large inflows of foreign exchange can have serious consequences resulting from the adverse effects on tradable commodities and on relative competitiveness due to an appreciation of real exchange rates in the receiving country. As a result, large remittance inflows restrict the export performance, possibly limiting output and employment, especially in small economies where remittance inflows are large in comparison to the country’s GDP (see Jadotte, 2009; Catrinescu et al. 2009).

In brief, the national account model provides insights into how remittances affect the macroeconomic outcomes of the recipient economy. It demonstrates two channels through which remittances, as foreign earnings, affect development outcomes. The direct channel or optimistic view emphasizes the positive effect of remittances on different macroeconomic variables. The pessimistic view or indirect channel claims that remittances negatively affect macroeconomic behaviors through their effects on the exchange rate and relative prices. In a situation where the recipient country does not have capacity, this results in an appreciation of the exchange rate and inflationary pressure, which affects macroeconomic behaviors. However, the model remains salient on the rate beyond which remittances (as foreign earnings) will be in a position to affect macroeconomic behaviors of the recipient economy. In this regard, one could argue that, since remittances are external private income to the recipient households and receipts to the balance of payment, their effect depends on the capacity of the recipient economy and how they are utilized in the national economy. This is coupled with the existing institutional environment and macroeconomic factors that enable
the productive use of remittances. However, the effects of remittances do not only have macroeconomic effects, they also affect microeconomic outcomes. It is important to determine what people do with remittances; how they affect human capital. The context in terms of the institutional and policy environment affects remittance-development outcomes. Most of these effects are country specific.

2.3.1.2 The Endogenous Growth Model

The endogenous growth theory demonstrates the macroeconomic mechanisms through which remittances affect growth and development. The theory rests on the economic growth theory that the national output growth is determined by endogenous inputs of TFP, physical capital and human capital under the assumption of constant return. The effect of remittances on growth is detected through factors of production. The model claims that remittances affect economic growth through enhancing human capital or productivity. The effect of remittances on growth is not direct, instead it is factored in through the influence on human capital development. The model has both optimistic and pessimistic proponents, who make contrary claims about the mechanisms through which these inflows affect growth and development. In this section I review the two claims.

Those who hold the optimistic view claim that remittances affect growth and development through their positive effect on TFP and human capital development in the recipient economy. The endogenous growth model demonstrates that the national output growth is determined by endogenous inputs of TFP (technological progress), physical capital and human capital under the assumption of constant return. To put these into perspective, Flabbi and Gatti (2018) assert that “human capital and economic growth are linked by numerous pathways and threads; investing in human capital affects productivity, productivity affects growth and growth feeds back to human capital opportunities.” Then, remittances come into play by contributing to human capital development in the recipient economies. In this regard, the effect of remittances on growth and development is detected through the factors of the endogenous growth model (Romer, 1990; Benhabib and Spiegel (1994, cited in Udah, 2011). It has been extensively documented in the economic literature that the endogenous growth model supports the view that human capital development and technology diffusion promote economic growth and development through their effects on the TFP.

In terms of remittances, the limited literature provides an assessment of the growth effect of the interaction between remittances and human capital development outcomes such as education and health. Most of the existing literature focuses on the impact of remittances on
education and to a certain extent, mostly in the micro studies, on health outcomes. They tend to find a positive effect of remittances on education and health outcomes in the recipient countries. The endogenous growth model bridges this gap by showing that the growth effect of remittances is complemented by the above factors. The central argument of the theory is that remittances impact the rate of economic growth through their mediated effect on the human capital or productivity. The main channel for this is human capital development and technological diffusion. Indeed, Udah (2011) argues that the effect of remittances on growth is not direct, instead it is factored in through its influence on human capital development. The endogenous growth theory becomes relevant because remittances impact economic growth and development through their contribution to the factor productivity and human capital development. The proponents of the theory argue that per capita GDP has a positive relationship with human capital, the interaction of remittances with human capital, physical capital, labor force, technological diffusion and government capital expenditure positively impact socio-economic development. We know from the existing literature that remittances improve human capital by increasing resources for health and education (see Cox and Ureta, 2003; Gitter and Barham, 2007; Amuedo-Dorantes et al. 2008).

Similarly, (Balasubramanyam et al. 1999; Makki et al. 2004, cited in Udah, 2011) found a positive though insignificant interaction between remittances and human capital. In the same vein, Udah (2011) interacted remittances with indicators of human capital development, technological diffusion and found that “remittances have a positive effect on economic development but only within a certain threshold of human capital development.” Rapoport and Docquier (2006) analyzed the link between remittances and education and found that remittances may be seen as repayment of informal loans used to finance educational investments and that the prospect of migration makes education a profitable investment for the family. In other words, migration fosters human capital formation provided that not too many educated individuals emigrate.

Those who hold pessimistic views base their arguments on channels through which remittances negatively affect growth and development. The holders of pessimistic views claim that remittances cause a moral hazard in the recipient economy, which has a negative effect on productivity and growth. Studies in support of this view have argued that in some instances, instead of promoting hard work and productivity, remittances encourage laziness in recipient communities or households since the people involved know that they can finance their consumption through remittances. This affects labor supply and productivity (Chami et al. 2005). Similarly, a study by the International Monetary Fund (IMF) covering 101
countries between 1970-2003 finds no significant relationship between remittances sent by migrants and growth, nor between remittances and variables such as education or investment rates (IMF, 2005). On the side of TFP, there are claims that remittance inflows to the recipient households erode the quality of governance and reduce accountability of government officials Abdih et al. (2012, cited in Clemens and Ogden 2014). These authors argue that remittances could reduce TFP by eroding the quality of governance. Accordingly, Abdih et al note that, “remittances increase a government’s revenue base and reduce the cost of rent-seeking by public officials.” Since, remittance-recipients households know that they will use remittance resources to purchase public services de-incentives them from holding politicians accountable.

In brief, the endogenous growth theory rests on the theoretical claim that remittances affect economic growth and development through their positive interactive effect with the factors of production, particularly human capital and technological diffusion in the recipient economies. The theory demonstrates that the growth effect of remittances is pronounced when remittances interact with human capital by financing human capital development and technological diffusion, hence improving human capital outcomes, overall productivity, and growth. However, the pessimists contradict these claims by arguing that remittances cause moral hazards in the recipient economy, which has a negative effect on productivity and growth. They claim that, remittance inflows affect work and productivity by making recipient households lazy because of assurance that they will finance their consumption through remittances. Others argue that the constant inflow of these financial resources erodes the quality of governance and accountability provided by the government. Instead of demanding government services and utilizing public resources, remittance-recipient citizens rely on remittances to finance their services and ignore government services. However, I would argue that, the willingness and the ability of citizens to account their government for good services depends on the presence of institutional mechanisms of accountability within the country, not the amount of remittance inflows. Second, the theory opts for a macro/growth view about the effects of remittances through human capital development and other factors of production and ignores other channels through which remittances affect growth and development, such as financial sector development and the mediating effect of institutions in the remittance-growth effect. The theory does not really explain the causal mechanism through which remittances improve human capital development to contribute to the TFP or how the mechanism enhances the attraction and utilization of remittances for productive investments to spur growth and development in the local economy. The proposition is that the
framework (institutional and agent-level interactions) allows households to take advantage of remittance inflows as they contribute to the overall growth and development.

It is important to determine how the institutional and policy framework creates mechanisms that allow micro-macro interactions through a casual mechanism to depict remittance-development outcomes. For instance, what do people do with remittances and how do micro effects aggregate in the broader picture? In this casual process, context, such as how the prevailing institutional and policy framework conditions the whole process, matters. The next section thus considers the micro context, using microeconomic approaches.

2.3.2 The Microeconomic Approaches

Remittances strongly exhibit microeconomic characteristics. They are personal financial transfers between an individual migrant to his/her family or friends back in the country of origin. Remittances have microeconomic effects. However, the field of remittances and development seems to have overlooked the microeconomic theoretical framework explaining mechanisms through which remittances affect development outcomes in developing countries. The few that exist focus exclusively on the macroeconomic theoretical frameworks with few micro-theoretical frameworks focusing on the development implications of remittances at the individual/household level. The only theory that does consider these implications is the NELM, which claims that migration is a collective investment strategy (carried out jointly by the sending household and the migrant) and remittances are returns to that investment decision. The next section discusses the NELM theory and other four theoretical views explaining the underlying motivation to remit back home by a migrant.

2.3.2.1 The New Economics of Labor Migration

This review of the NELM theory is motivated by the aim to theoretically understand how remittances contribute to development outcomes (particularly at the household level), to understand the mechanisms and conditions influencing the remittance-development impact, and to better measure this effect. Migration is not a new phenomenon. It has evolved over time and there is no conclusive theory explaining its link with development. Recent scholarship on migration and development has emphasized the positive correlation between migration and development, explained by remittances. Early theories, mostly the neoclassical and the historical-structural theories, emphasized migration patterns, trajectories, and to some extent the determinants of migration in their explanation of the link between migration and development. The NELM theory emerged to bridge the gap between the two. It is a theoretical improvement of the other theories. In the same vein, the NELM has sought to
Theoretical and empirical review of NELM emphasizes its emergence as an improved theory that exhibits strength in explaining or predicting where, when and why migration occurs.

The NELM theory focuses on the determinants of migration and how the outcomes of migration influence economic development. The departure point of this theory is how the decision to emigrate is made. The theory moves the decision to emigrate from the individual labor migrant to a wider social entity referred to as the “migrant household”. In this regard, the decision to become a labor migrant cannot be explained only at the level of individual workers; larger social entities (households) have to be taken into account as well (Stark, 1991). Stark argues that households tend to take risk-avoiding decisions when household income is involved. One way of reducing the risk of insufficient household income is labor emigration of a family/household member. This phenomenon applies in most developing countries, in particular, SSA countries. When it comes to the emigration of the household member, everyone owns the process, mostly supporting the emigrating migrant and expecting returns out of migration, with the prospect of collective benefits for the family.

The NELM theory argues that the decision to migrate is a “calculated strategy” in which a migrant enters into a mutually beneficial contractual arrangement with his/her family, the returns for the family left behind being remittances sent back by the migrant. In support of the theory, Taylor (1999) asserts that “these remittances have a positive impact on the economy in poor sending countries. And patterns of remittances are better explained as an intertemporal contractual arrangement between the migrant and the family than as the result of purely altruistic considerations.” Similar empirical evidence shows that remittances are a positive factor in economic development. Clemens and Ogden (2014), argued that this strategy is a financial strategy for poor households, an investment and insurance strategy where low-income families buffer for income and consumption shocks. These authors claim that households often choose emigration as an investment strategy for future benefits in the form of remittance income from the emigrant family member.

The NELM theory emphasizes that migration is a labor market phenomenon influenced by labor market behaviors, both in the sending and the receiving countries. Stark and Bloom (1985) claims that migration is both a labor market and a non-labor market phenomenon which has contributed to our understanding of the process of economic development. Wage differences between regions or countries is among the main determinants of labor migration.
These theoretical claims are reinforced by practical examples of Ugandan car mechanics currently working in Rwanda or Kenyan and Ugandan English teachers who almost dominate the market for teaching English both in primary and secondary schools in Rwanda. According to these migrant workers, the determinant factor for their migration is employment opportunities and the wage difference between their home countries and Rwanda. Such wage differences are due to geographic differences in labor demand and supply, although other factors, such as labor productivity or the degree of organization of workers, might play an important role (Abreu, 2010). In the context of neoclassical economics, scholars emphasize that countries with a shortage of labor relative to capital have a high equilibrium wage, whereas countries with a relatively high labor supply have a low equilibrium wage Jennissen (2007, cited in Abreu, 2010). The equilibrium wage difference coupled with other pull factors in developed economies encourages international migration from developing countries.

Another factor that determines migration is relative deprivation. The relative deprivation as a determinant of migration was introduced by Stark (1984, cited in Stark and Taylor, 1989; 1991). Accordingly Stark argues that, relative deprivation rests on the hypothesis that potential migrants carry out interpersonal income comparisons with other people within their relevant social settings. Such comparisons, along with their wish to improve their relative position within those settings, constitute the relevant element in the decision-making process. But also, scholars (such as Tadaro and Harris, 1970; Taylor, 1999) have frequently argued that migration decisions are made by individuals and shaped by known or expected income differences between migrant origins and destinations. Migrants move from countries where their earnings or expected earnings are low to countries where their earnings or expected earnings are high. The low earnings in the sending economies are associated with the risks of market failures, risk constraints and an inefficient economic environment, which further influences migration.

However, the theory remains unable to provide the theoretical mechanisms through which remittance inflows affect economic development in the recipient countries, which is a significant theoretical gap that affects the remittance and development discourse. There are other determinants of migration than relative deprivation, poverty, wage differences and market failures in the sending countries. These are failure of institutional variables such as political instability, regulation failures, or an unfavorable business environment, to mention but a few. The theory remains silent about the mechanisms through which remittances affect

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4 Anonymous interview with Ugandan car mechanics at Nyabugogo Garages in Kigali, 20 December 2017, and personal discussions with Ugandan and Kenyan English teachers in primary and secondary schools in Rwanda.
development outcomes or how agents interact with local institutions to attract remittances and deploy them into productive investments that influence individual and household development outcomes, which in turn determine the aggregate macroeconomic outcomes we observe. A practical illustration of this is the case of Rwanda, which is discussed in Chapter Four. Policy supply and effective institutional delivery sparked remittance inflows and a demand (from the diaspora) for more institutional delivery to productively make use of remittances in Rwanda.

In brief, the NELM theory sheds some light on migration as a collective investment household strategy and remittances being a return to that investment decision, but it remain unable to explain the other factors that influence migration or the mechanisms and channels through which remittances influence development outcomes in the recipient country.

2.3.2.2 Determinants of Migrant Remittance Inflows and Motivations to Remit

Inspired by the NELM theory, Solimano (2003a) put forward four main theoretical schools of thought to explain what motivates migrants to remit: (i) altruistic, (ii) self-interest, (iii) loan repayment, and (iv) co-insurance. These motivations are discussed in this section. Recent work on remittances and development has relied on these theoretical views to explain the remittance-development impact. The review of the related literature indicates that these theoretical views are based on the interaction between the migrant and his/her family and on the socio-economic status of the family. Migration appears to be a collective decision for the future benefit of the family, either driven by altruistic or self-interest motivations.

2.3.2.1 The Altruistic Motive

This theoretical view is built on the altruistic motivation whereby a migrant feels committed to the social welfare of his/her family. The underlying motive is an expression of commitment by the migrant to the household in the country of origin. Elbadawi et al. (1992) argue that this commitment is born out of love for the family and the liability of the migrant worker. The authors emphasize that it is believed that providing remittances to the family members for their welfare gives the migrant a sense of usefulness as the people back home are relieved of economic challenges through remittances. This view is reinforced by personal communication I received from the Rwandan Diaspora (who preferred anonymity). One lives in Norway and another in Belgium. Over the last two decades, they have been supporting their families and relatives and both derive similar intrinsic/self-satisfaction from meeting the needs of their families. They say: “it makes me happy to see improvement in the welfare of these people” (referring to family members and others they supported). Both of them
confirmed that most of the relatives they supported for their education are now self-reliant with their own jobs. The support has improved the socio-welfare of the whole family. The pure altruism hypothesis (Bohra-Mishra and Massey, 2011) suggests that migrants remit to improve the welfare of their households. The probability of receiving remittances is hypothesized to be higher for households that are more deprived or have a lower income (see Rapoport and Docquier, 2005; VanWey, 2004; Lucas and Stark, 1985).

In support of the above, it is frequently argued from Becker (1974) that the migrant derives a sense of usefulness from the consumption by the family. The migrant, thus, cares about the poverty, economic shocks, etc of the family and consequently sends remittances. In this case, according to Hagen-Zanker and Siegel (2007), there is a positive relationship between adverse conditions of the receiving household and remittances sent. However, Hagen-Zanker and Siegel observe that the altruism motivation view is challenged for its inability to measure altruism. They note that, “measuring altruism only by looking at the effect on the giver and on receiver income is controversial.” Another theory discussed in the scholarship of migration and development is, self-interest.

2.3.2.2 The Self-Interest Motive

Human beings are driven by interests. This school of thought argues that economic and financial interests drive remittance transfers to the countries of origin. The argument is that the migrant worker tries to save as much as possible (see Elbadawi et al. 1992). Then, the migrant decides on the type of assets to be bought and in which country the wealth should be accumulated. The home country is considered best and most secure in terms of investments. Though investments in the host country might earn higher profit or interest, the higher risk involved favors investment in the origin country. This motive also considers that the family of the migrant worker could manage and administer the accumulated assets of the worker during the emigration period. This implies that the migrant’s decision to save and to remit is determined by the investment opportunities in the country of origin, by recommendations of the family back home, and by the readiness of the family to take care of these investments. However, the theory remains silent on situations in which the investment climate and opportunities back home are not attractive or profitable or when the family is unable to manage these investments. It is worth observing that the situation in the country of origin may be problematic. It is not clear what happens to remittances in this situation according to the theory.
The potential of a future inheritance or a preparation for the retirement of the migrant also drives the motivation to remit. Existing studies claim that a migrant sends remittances back either for his/her aspiration to inherit, demonstrate laudable behavior, maintain a good reputation in the family, to invest back home in preparation for future return, and household members are the trustworthy agents for informed decisions (see Zghidi et al. 2018). During my interactions with the Rwandan Diaspora (mostly older ones), it became clear that they all would like to have properties and other investments back in Rwanda that will support their retirement. Most of them do not want to retire in the host country. This idea was also expressed by a Ghanaian migrant who has been living in the Netherlands since the 1970s. He is employed and has a formal job. During my discussion with him (18 November 2017) he confirmed that he has been remitting back to Ghana since the 1970s. He has built houses in Ghana and he lets these houses. He further told me that he is waiting for his youngest child to finish their undergraduate degree at university and his retirement age. Then he plans to return to Ghana. He asserts that his plan is to retire in Ghana and his investments there will enable him to live a decent life. These testimonies provide a vivid demonstration of the theoretical view of self-interest.

In support of the self-interest theory, the NELM theory (see Bohra-Mishra and Massey, 2011) claims that self-motivation interest is the second version of the contractual agreement theory. The prospect of inheriting parental property is arguably an implied contractual agreement and may thus induce remitting behavior. The proponents of this theoretical view argue that households with a higher level of inheritable assets prior to receiving remittances will be more likely to attract remittances because migrants will view remitting as an investment to increase their likelihood of inheriting household assets (see Regmi and Tisdell, 2002; VanWey, 2004). The presence of siblings is hypothesized to positively influence remittance behavior among migrants.

Similarly, migrants are motivated by the prospects of returning back home. They therefore find it imperative to maintain a good relationship with household members and secure their investments in the home country. In doing so, they (migrants) invest in property investments and agriculture in their country of origin and thus secure their future (see Lucas and Stark, 1985). It is argued that the likelihood to remit is associated with the level of development of migrant’s home area and the prospects of the migrant to return back in the future. In regards to Rwanda and other developing countries, this motive plays an important role in determining remittance inflows to the country. Therefore, the future plan to return and the growing economic opportunities in the country, coupled with the prestige of having invested in land,
home, livestock or the human capital development of their relatives, drive remittance inflows. There is also the theoretical view that an implicit contractual arrangement exists between the family and the migrant, which motivates migrant to remit. This theory is explained as the loan motive.

2.3.2.3 The Loan Motive

This theoretical view is driven by the contractual obligation a migrant enters into with his/her family to meet the costs related to his/her migration. Migration involves investment costs that require the collective efforts of everyone in the household. Related scholarship on migration and development has noted that the family plays a critical role in providing support for migration of the household member, mostly in covering the costs of emigration, and remittance transfers are a repayment for these costs. According to Elbadawi et al. (1992), the motive to remit is an implicit arrangement among families for members to migrate abroad or stay at home. These contracts often last more than a year with dynamic prospects. The family, according to this theory, invests in the training of the migrant and finances the costs of migration, including the cost of travel and subsistence costs in the host country. Because of this, the migrant is under obligation to send remittances to the family members who stayed at home. The size of remittances also depends on other conditions, such as the income profile of the migrant (Solimano, 2003b).

Another stance in support for this theory sees the motive to remit as a reimbursement of the education costs incurred by the family. When the migrant gets a job abroad or in another area, he/she is inclined to pay back the education costs or the costs involved in the migration. In support of this theory, (Poirine, 1997, cited in Hagen-Zanker and Siegel 2007:7) notes that “a household finances a potential migrant’s education which enables him/her to find a better-paid job in the city or abroad. Over the next period of time, the migrant sends remittances to repay the family for the initial investment (the “payback phase”). At this stage the migrant might also become a lender, by financing other family members’ education, which increases overall remittances (the “loan phase”).” If this contractual arrangement persists with remittances financing the education of more household members, this leads to a multiplicative positive effect on human capital development in the recipient communities. Connecting the value of remittances to the level of education of the remitter could show how education influences remittance inflows. Another aspect left unaddressed is that the motivation to remit is influenced by many other factors, including altruism, self-interest, family related factors, or external factors such as the nature of employment, the status of the
migrant in the host country and the institutional environment in the receiving country. Co-insurance is another theory explaining determinants of remittance transfer.

2.3.2.4 The Co-Insurance Motive

The theory of co-insurance is based on the motivation of risk diversification by the migrant and his/her family, especially the intent to overcome risks of market failure and poverty. Several theoretical views based on the NELM consider migration as a family investment and risk spreading and remittances are outcomes of this investment. For Clemens and Ogden (2014), migration is, among other things, a strategy for financial management in poor households. In an economic sense, this theory considers household members to be assets that generate income for the family, which could be affected by potential local market failures. Therefore, the family takes a rational decision to minimize risks by diversifying assets – that is, the migration of family member – and remittances are important returns on investment. In support of this theory, (Lucas and Stark (1985, cited in Stevanovic, 2012) claim that the decision to migrate occurs within the family. Migration means that the household is able to control risks to their economic advantage by dividing labor production within the household. This strategy allocates certain members as migrants and remittances become the mechanism for redistributing the gains. While some members of the household seek work in local economies, others are sent abroad to work internationally where wages and employment conditions are better than those in the local economies. According to Lucas and Stark (1985), for the household as a whole migration may be a Pareto-superior strategy, either as a means of risk sharing or as an investment in access to higher earning streams.

In line of the above, the migrant adheres to the contractual arrangement with the family left behind by taking care of the family through remittances. Elbadawi et al. (1992) argue that remittances are used as a form of risk diversification as the migrant supports their family members in terms of need, mostly those who financed their migration. In several instances, migrants with investments back home use other family members (as their agents) to take care of their investments. In cases like this, remittances sent by migrant serve the interests of migrants, but also some portion of remittances compensate for the agents (see Lucas and Stark, 1985).

To summarize, the four theoretical views are based on the NELM theory and theoretically assess what drives migrants to remit. Remitting is motivated by altruistic motives to respond to the socio-welfare challenges of the family left behind, self-interest to invest back home for future benefits, paying back the money spent on the migrant’s education
and emigration, and risk sharing and investment opportunities back home. The four theoretical views determining remittance transfers are not mutually exclusive, but are more important than the other theoretical views. However, none of the four theoretical views explain the mechanisms by which remittances transferred home affect development outcomes in the recipient countries or communities at a national, community or household level. Similarly, the role of the institutional and policy framework seems to be underestimated. Both the NELM and the four theoretical views attach the determinants to remit to the status of the family left behind and their relationship with the migrant. My professional experience and the review of the literature inform me that there are other factors that are not linked to the ones explained by the four theoretical views. Factors such as business opportunities, the institution and effective policy environment back home, and the effective policy of engaging migrants by the home country to contribute to development in the recipient country and have recently gained attention. Therefore, an empirical analysis is essential to better understand how these factors influence both the micro and the macroeconomic effects of remittances. This is the topic of the next section.

2.4 Empirical Debates

I believe in the importance of empirical findings in increasing our understanding of developments in the field of remittances and development. This section reviews the dominant empirical studies about the development impact of remittances and how empirical findings relate to the theoretical approaches. The literature shows that the development implications of remittances manifest through different layers of economic development. This is due to the nature of these inflows. Although remittance inflows are personal/household financial and in-kind transfers from migrant to the recipient household or individual, their development effects have both macro and microeconomic implications in the recipient country. These development implications are mediated by the institutional environment, mostly in the recipient country. The literature also documents empirical evidence about the contribution of remittances to the development of local institutions, such as in the financial sector. Related literature shows that local institutions (economic and political) have a conditional effect on how these inflows are remitted and channeled into productive investments that spur development outcomes. The review of the empirical debates about remittances is guided by the research questions of this study:

What is the contribution of remittance inflows to development outcomes and how should the development effects of remittance inflows be measured and explained? Under what
conditions do remittances affect development outcomes and how can these effects be maximized?

These questions propel the examination of how remittances affect economic development, mostly in the developing countries. However, neither a theoretical approach nor an empirical model has thus far been able to conclusively solve this empirical puzzle. Instead, we continue to observe two ongoing empirical strands, the optimistic and pessimistic empirical claims in the literature. This study critically reviews the existing empirical debates through the lens of the dominant theoretical approaches. In particular, how do the theoretical approaches relate to the macro and micro implications and to the interplay of institutions in influencing the remittance-development outcomes?

2.4.1 The Macroeconomic Implications of Remittances

The macroeconomic implications of remittance inflows in developing countries have dominated the remittance and development discourse in the recent years. Though remittances are private inflows transferred directly from the sender to the recipient, their effects are manifested both at the micro and the macro level. A review of related literature shows that most of the empirical debates are biased towards the macroeconomic implications of remittances, inspired by the national account and endogenous growth theoretical approaches. Such empirical narratives assess the effects of remittances on the aggregate economy, that is, through GDP per capita, balance of payment accounts and other macroeconomic outcomes. This leads to either the optimistic or the pessimistic view. In the recent years, the role of institutions has emerged in this scholarship as a mediating factor in the relationship between remittances and economic growth. In this section, I review empirical debates related to the conditional role of institutions in the remittance-growth discourse. The economic growth concept is used as a main dependent variable, representing the macroeconomic implications of remittances and explained by other variables, including remittances and institutional indicators.

2.4.1.1 Remittances and Economic Growth

The effects of remittances on economic growth has been studied by economists interested in the growth effect of remittance inflows. The general question is: What is the contribution of remittance inflows on the growth/development outcomes of the recipient economy? Whether they focus on growth or development outcomes, most scholars opt for economic growth measurements. The scholarship is characterized by optimistic and pessimistic empirical orientations to the remittance-growth effect. Neither theoretical approaches nor
empirical models have reached a conclusive answer to this empirical question. While remittances increase income in the recipient country and help to alleviate poverty, it is not obvious that these inflows increase output and promote long-term economic growth. In this regard, some empirical evidence shows that remittances impact economic growth while other evidence contradicts this. In this section, I review the two contradicting claims by providing the basis of their arguments.

The existing literature identifies a number of channels through which remittances impact economic growth. One of these is their effect on macroeconomic behaviors in the receiving countries, by providing additional foreign exchange earnings and financing business investment (Amuedo-Dorantes and Pozo, 2008; Woodruff and Zenteno, 2007). Another school of thought claims that remittances reduce domestic macroeconomic volatility by encouraging greater domestic investment (Gapen et al. 2009). Similarly, remittances increase credit worthiness of recipient countries. Nyamongo et al. (2012:9) note that “remittances may improve a country’s credit worthiness for external borrowing. This is because remittances are included in the exports of goods and services. Higher remittances will therefore improve the country’s debt-to-exports ratio, an indicator that is critical in the assessment of a country’s credit worthiness.”

Several studies seem to concur on the potentiality of remittances to increase income in the recipient economy, which has an overall positive effect on macroeconomic outcomes such as savings, consumption and investments and in the long run, affects economic growth. To this end, the vast majority of the literature argues that remittance positively affect economic growth by increasing consumption, savings or investment. More so, remittances also compensate for the loss of tax revenues in developing countries. For example, the net fiscal loss associated with Indian emigration to the United States was estimated at 0.24 to 0.58% of Indian GDP in 2001. In their study, Fayissa and Nsiah (2010) find that a 10% increase in the remittances of a typical African economy results in an about 0.4% increase in the average per capita income.

The interaction of remittances and human capital development is another channel that is strongly associated with economic growth in developing countries and the existing literature seems to agree on the role of remittances in promoting human capital development in the recipient countries. The overall claim is that remittances affect economic growth through their interaction with human capital development variables (education and health) in developing countries. It is consistently echoed in the literature that remittances improve human capital by increasing resources for health and education (Amuedo-Dorantes et al.
2008; Gitter and Barham, 2007; Cox and Ureta, 2003) which improves overall productivity and thus economic growth. Rapoport and Docquier (2005, cited in Udah, 2011) also argued that remittances affect investment and human capital formation due to the existence of liquidity constraints. Human capital is thus an important factor that affects growth. Similarly, other scholars, such as (Eller, Haiss and Steiner, 2006; Li and Liu, 2005; Balasubramanyam, Salisu and Sapsford, 1999 and Makki and Somwaru, 2004, cited in Udah, 2011) find positive and significant interaction between remittances and human capital on economic growth and development in the recipient countries. However, despite the positive effect of remittances on human capital development and economic growth, this empirical evidence cannot be reconciled with the pessimistic claims that remittances perpetuate a brain drain in developing countries, because educated leave for countries where there are more opportunities. This creates a vicious circle of dependency on remittances. Moreover, the effect of remittances on economic growth are not a one-way street as some studies claim. Although remittances provide financial support to meet human capital development costs, this is not enough to affect human capital development. There are other factors that matter in the overall development of human capital in developing countries. These are, for instance, factors related to the infrastructure, structural challenges, an effective and inclusive institutional environment and policies that enable the majority to take advantages of remittances for their development. Such conditional factors need to be factored in the remittance-growth empirical model. Unfortunately, this empirical approach continues to be underestimated in the remittance and economic growth discourse.

The existing literature emphasizes stability and the countercyclical potentiality of remittances compared to other international capital inflows. In support of this claim, several empirical studies (Ratha, Mohapatra, and Silwal, 2011a; Hakura et al. 2009, cited in Ratha et al. 2011b) argue that remittances are increasingly stable source of external capital, if well harnessed could improve creditworthiness and access to capital for developing countries such as African countries. They help to sustain consumption and investments, perform the role of a shock absorber, and act as a form of insurance against macroeconomic shocks for origin countries. For instance, remittances rose during the financial crisis in Mexico in 1995 and in Indonesia and Thailand in 1998, and increase with natural disasters and political conflicts (see Ratha et al. 2007; Clarke and Wallsten, 2004; Yang and Choi, 2007). In Sub-Saharan Africa, (Gupta et al. 2009) note that, “where private capital flows have fluctuated considerably from year to year, remittances have been more stable than both FDI and private debt and equity flows.” In support of the latter, (Kapur, 2004; World Bank, 2006, cited in
Grabel, 2008: 25) note that, “there is unambiguous and plentiful evidence that remittances function as a shock absorber in low-income countries by providing critical income support after economic shocks, natural disasters and civil conflict.”

Another avenue by which remittances affect economic growth is through their mediating effect on financial sector development in the recipient countries. There is a growing debate about the effect of remittances on economic growth, revolving around their complementary or substitutional effect on financial sector development. Many studies in this scholarship emphasize the importance of the institutional environment of financial development as a mediating factor to enhance the growth effect of remittances (Catrinescu et al. 2006; Matuzeviciute and Butkus, 2016). The consistent empirical paradox concerns the nature and direction of causality between remittances, financial development and economic growth. That is, whether remittances are a substitute for or complement financial sector development in influencing the remittance-growth effect. Financial sector institutions are avenues through which remittances are transferred (keeping other factors constant; related to the informal transfers) and the effect of these inflows depends on the quality of financial institutions in facilitating the formal transfers and channeling these transfers into productive investments that spur economic growth.

In the same vein, remittances have potentials of promoting both financial development and financial inclusion in the recipient countries. Formal remittances channeled through the official banking system and money-transfer operators increase bank deposits and financial inclusion by remittance-recipients. And encourage the productive use of remittances- by channeling these inflows towards productive investment projects. This may result in more funds becoming available for lending by commercial banks to the private sector (see Nyamongo et al. 2012; Aggarwal et al. 2011; Terry et al.2005). The same authors argue that increase in remittance flows to countries with relatively developed financial markets promotes institutionalization and bankarization, which in turn increases competition, leading to a decline in intermediation costs and ultimately benefitting remittance recipients.

Those who promote the substitution effect tend to argue that remittances affect growth in developing countries where financial sector development is weak by providing access to financing that would otherwise have been provided by formal financial providers. In this perspective, related empirical studies argue that in an economy in which the financial system does not work, remittances give entrepreneurs who lack collateral, credit histories, and connections the instrument to start high-return projects. Therefore, remittances help alleviate credit constraints on the poor, substituting for financial development, improving the
allocation of capital, and thus accelerating economic growth (see Giuliani and Ruiz-Arranz, 2005). Marulanda et al. (2006, cited in Motelle, 2011) claim that remittance receipts help previously unbanked people to gain access to the financial services.

The proponents of complementarity and of the compensatory effect of remittances on financial development claim that the effect of remittances and financial development on economic growth is complementary in nature. In support of this claim, Terry et al (2005) argue that increased financial development help migrants to transfer funds home. In support of the argument, scholars have identified four practical ways supporting compensatory and substitutional hypothesis of the relationship between remittances and financial development: First, as remittance recipients demand financial products such as bank accounts and debit or credit cards, the financial system becomes more consolidated. Second, if the remittances are in excess of immediate needs of the recipients, the surplus may be saved, thereby boosting domestic resource mobilization. Third, the regular flow of remittances into recipients’ accounts makes them eligible for bank credit, which in turn expands the size of the credit market. Fourth, remittance recipients can be seen as a market segment and banks may want to take the largest share of this segment. This encourages competition, reduces transfers costs and results in more remittances (see Mundaca, 2005; Motelle, (2011, cited in Dewan Muktadir-Al-Mukit & Nazrul Islam, 2016:3).

Pessimistic empirical claims about the remittance-growth effect are based on two arguments: First, the negative effect of remittances on macroeconomic behaviors in the recipient countries, which results in what is frequently termed the “Dutch Disease” effect. Most of these studies attribute this effect to the large quantities of remittances inflows to an economy with weak capacity to productively utilize these inflows. Studies that support this claim argue that large remittance inflows of foreign exchange can have serious consequences resulting from the advance effects on tradable commodities and on relative competitiveness due to an appreciation, or a postponed depreciation, of real exchange rates in the receiving country (Jadotte, 2009; Catrinescu et al. 2009). This has the effect of restricting export performance and hence possibly limiting output and employment, especially in small economies where remittance inflows are large in comparison to the country’s GDP (Jadotte, 2009; Catrinescu et al. 2009; cited in Ojapinwa and Odekunle, 2013). Using the OLS and FE instrumental variables regressions models, Gapen et al. (2009) find that “decades of private income transfers remittances have retarded long-run economic growth in remittance-receiving economies”. And the negative effect might be due to the fact that the phenomenon
is generally not intended to serve as investments, but rather as social insurance to help family members finance the purchase of life’s necessities. In such a situation, remittances are used to finance conspicuous consumption that does not have a positive long-run effect on economic performance.

Second argument is the less marginal effect of remittances on financial sector development in the recipient countries. On this point, available empirical evidence suggests that the effect of remittances through financial sector development has a less marginal effect in a developed financial sector. In fact, Giuliani and Ruiz-Arranz (2005) show that in countries with well-developed financial sectors, the impact of remittances eventually turns out to be statistically negative. In such an environment, demand for financial investments is met by other means, such as credits and insurance, and therefore, remittances are used for activities that do not foster growth.

In sum, the review of the empirical literature about remittances and economic growth sheds light on the development impact of remittances through their effect on economic growth. I find that the existing empirical debates are based on the theoretical approaches discussed earlier, mostly the national account model and the endogenous growth theory. However, the literature has yet to develop a conclusive empirical approach to determine how remittances affect economic growth in the recipient countries. This review of the literature shows some of the empirical aspects that could be contributing to the ongoing empirical debates:

First, there is a “contextual gap” in the literature. Most of the existing empirical studies on the remittance-growth impact are cross-national studies and in terms of mediating factors, the institutional environment and other development factors play out differently within and across countries. In other words, they are country specific. These factors matter in the analytical framework exploring the growth and development impact of remittances. Remittances are transferred by human beings who are motivated and influenced by some of these factors. As Rodrik (2004) argues, the policy framework matters in terms of shaping development. Similar policy framework influence (by creating incentives) remittance inflows and how there are channeled into productive investments to influence remittance-growth impact. In other words, human beings respond to incentives and countries differ in institutional and policy incentives. This means that there is no one-size-fits-all approach. Indeed, the evidence from Rwanda shows that, when the institutional and policy framework changed after the genocide against the Tutsi and an effective institutional and policy
environment were put in place, this induced remittance inflows and their deployment in the socio-economic investments in the country.

The second aspect that is contributing to the mixed findings is related to data and methodological issues, mostly in cross-country studies. For instance, it is exceedingly difficult to gain access to reliable and comprehensive data on SSA countries in the field of remittances and economic development. Issues of endogeneity and selection bias, coupled with the ongoing challenge of finding reliable statistical data for instrumental variables, remain a critical challenge to researchers. This affects the discourse, mostly in macro-level analysis.

Last but not least is the lack of comprehensiveness in the analysis of the macroeconomic implication of remittances. The remittance-growth effect is theoretically and empirically unable to depict the comprehensive development effect of remittances. More empirical work is needed to better understand the mechanisms through which the effects of remittances lead to aggregate economic growth. How recipients utilize remittances is mediated by the prevailing institutional and policy mechanisms, which affects microeconomic outcomes which ultimately aggregate to the macroeconomic outcomes in the recipient country.

Remittances flow to both rich and poor households. The literature shows that these inflows are biased towards rich recipient households in receiving countries. However, the literature remains silent on how these inflows play out among receiving households of a different socio-economic status. In other words, do remittances affect development outcomes in rich recipient households in the same way as in poor households? These issues have been ignored in the empirical studies examining the growth and development impact of remittances. This demonstrates that the pluralist views about the development impact of remittances have been underestimated in the empirical analysis. The pluralist development view encourages us to adopt a flexible approach to examine the development impact of remittances, taking into account the local realities and context. Therefore, relying solely on the remittance-growth effect analysis leaves other aspects of the development implications of remittance unexplored, leading to the continued theoretical and empirical gaps in the field. With this in mind, I extensively review the mediating role of institutions in conditioning the remittance-growth effect in the next section.

2.4.1.2 Remittances, Institutions and Economic Growth

This thesis investigates the role of institutions in conditioning the remittance-development outcomes in the recipient economies. It is imperative to understand the relationship between
remittances, institutions and economic development to determine the development effect of remittances. In this regard, institutions matter (as Rodrik, 2004) rightly says, “institutions rule”) in conditioning the development impact of these inflows. However, this mediating role of institutions has been underestimated and the little that is out there is empirically contested, influenced by the ongoing debate about the role of institutions in development. This scholarship revolves around whether or not institutions promote economic growth and development and how best to measure that contribution. So far, related empirical studies have remained inconclusive. This can attributed to the dominant theoretical and empirical gaps as put forward by Chang (2011): first, the inconclusive definition of better institutions; second, the best measure for the performance or quality of institutions; third, the institutional framework through which institutions influence development; and fourth, the poor understanding of changes in institutions themselves, which often leads to unduly optimistic or pessimistic positions about the feasibility of institutional reform. In the context of remittances and development, by institutions or the institutional environment, I simply mean the rules, systems and effective policies that encourage and harness remittance inflows and condition the productive use of remittances to affect growth and development outcomes in the recipient country.

Most importantly, scholars put more emphasis on the quality of institutions, how it influences economic performance, and the nature of causality between institutions and economic performance. Rodrik (2004) finds that the quality of institutions overrides everything else and he finds a causal relationship between better institutions and economic performance and income levels. The author further argues that, better institutions and a better protection of property rights increase investment and foster technological progress, thereby raising income levels. In the same line of argument, North (1990, cited in Aron 2000, p.99) said “I wish to assert a much fundamental role for institutions in societies; they are the underlying determinant of the long-term performance of economies.” Rodrik (2004) further argues that better-performing institutions may improve growth by increasing the volume of investment – for example, by eliminating bureaucratic red tape and rent-seeking costs and (more weakly) by improving the efficiency of investment, say, by enforcing well-defined property rights.

With regards to the direction of causality, there seems to be general empirical consensus about the correlation between institutional quality and economic performance, however, the direction of the causality, whether better institutions condition the economic performance or vice versa, remains unclear. Chang (2011:4) argues that “even when we focus on the
institutions to development part of causality, the relationship is theorized in a rather simplistic, linear, and static way.” On this note, Rodrik (2003) reiterates that an increase in institutional quality can produce large increases in income per capita. But long-run economic development requires more than just a boost to investment and entrepreneurship. It also requires efforts to build three other types of institutions (market stabilization, market legitimation and market regulation) to sustain the growth momentum, build resilience to shocks, and facilitate socially acceptable burden sharing in response to such shocks. Rodrik affirms that the manner in which institutional quality is measured in the empirical literature leaves a lot of questions unanswered. In consideration of this empirical gap and in the context of this thesis, a country-specific analysis of Rwanda is adopted to better discuss how institutional mechanisms mediate the development effect of remittances. Immediately after the genocide against the Tutsi, the country was considered a natural experiment about how an effective institutional and policy framework can shape development, particularly remittance-development outcomes. On this matter, Rodrik (2004: 13) claims that what works depends on local constraints and opportunities. He observes that “the best that we can do as analysts is to come up with contingent correlations – institutional prescriptions that are contingent on the prevailing characteristics of the local economy. At the moment we are very far from being able to do this for any but a few institutional areas.” In this regard, Rodrik considers the importance of the local context, which is an empirical gap in the field of remittance and development. Thus, Rodrik contributes to the ongoing inconclusive debate about institutions and economic development and most importantly, how we account for and measure the quality of institutions in the empirical analysis.

The causal mechanism determined by institutional quality remains an indispensable factor for economic development. As Napoleon said in 1815 (Brady and Spence, 2010: 113), “Men are powerless to secure the future; institutions alone fix the destinies of nations”. This is an illustration of how the causal relationship in institutional-economic development matters in development; the local context is part of the equation. However, it remains unclear which determinants or variables influence institutions’ growth and development or how these variables should be measured. How institutional mechanisms condition the growth and development effects of other developmental factors such as remittances also needs further studies. These questions remain the subject of empirical debate, mostly in the context of Sub-Saharan Africa where the quality of institutions is problematic. Studying the case of remittances can improve empirical understanding of how institutions condition the development impact in developing countries. For this case, I review empirically how
institutions condition the remittance-growth effect in the context of SSA countries. I review the conditional role of prevailing institutions for remittances to affect growth and whether remittance transfers affect the demand/supply side of the institutional environment. For example, in Rwanda, right after the genocide, effective institutions and policies were developed, which triggered diaspora interest and remittance inflows to the country.

In line of the above, institutional environment and policy effectiveness matter in terms of encouraging remittance inflows and the productive deployment of these inflows to growth and development. Most studies (Catrinescu et al. 2011; Mundaca, 2005; Radhan et al. 2008; Zazzaro and Brettin, 2008 cited in Baldé, 2009) have explored that mediating effect at either country or cross-country level. Much emphasis is however put on the quality of institutions in the recipient country. Indeed, affirm that, in the presence of good institutions, remittances could be invested in greater amounts and more efficiently, ultimately leading to higher output (Catrinescu et al. 2006). Kapur (2004: 28) notes that if “institutions matter in how remittances are used, then the best way for recipient governments to ensure that remittances contribute to positive economic growth is to foster better quality of institutions, thus ensuring that a greater proportion of remittances is utilized for productive investments.”

Empirical studies have argued that institutions create a level playing field which leverages the development impact of remittances either at the macro or the micro level. For instance, Catrinescu et al. (2011) find that the impact of remittances on economic growth appears to be more positive and statistically significant when institutional variables are considered. In a sound institutional environment, remittances can be invested in greater amounts and more efficiently, ultimately leading to higher output. Indeed, (Knack and Keefer,1995; Acemoglu et al. 2001; cited in Zghidi et al.2018) assert that “the quality of institutions might play an important role in determining the exact impact of remittances on economic growth, because institutions exert substantial influence on the volume and efficiency of private investment.” The literature shows that, in instances where there is institutional quality for example the business and investment climate, the propensity to save and invest remittance income is likely to be the same as that of other capital. In support of this point, Clemens and Ogden (2014: 8) assert that, “if we want to know why most remittances are not invested, we need to ask why most income is not invested, that is, why there are few investment opportunities at the origin”. Authors further claim that remittances appear to be slightly more likely to be invested- in physical investments and human capital development than other forms of income. This empirical stand reinforces the theoretical views of self-interest and co-insurance in support of the importance of the institutional quality of the business environment in the
recipient country. In this regard, this study observes that, in countries where there is progress in economic performance and institutional quality of the investment environment, there is a shift in terms of channeling remittances from conspicuous consumption to savings and investments. This implies that the institutional quality of the investment climate plays an important role in attracting and channeling remittances into productive use like other forms of foreign capital.

The quality of financial institutions matters because of the important role of financial institutions in conditioning the remittance-growth impact in receiving countries. As discussed above, the institutions of the financial sector play an important role in encouraging remittance inflows, but they also condition the growth and development effects of these inflows. The role could be substitution, complementary or compensatory, depending on the context. Accordingly, available empirical evidences point to the importance of remittances in compensating for weak financial system by providing access to finance to the potential entrepreneurs who are unable to meet the criteria of banks. They (remittances) also enhance growth rates in a well-functioning financial system (Giuliani and Ruiz-Arranz, 2005). However, although the mediating role of financial institutions remains undisputable, the question remains whether remittances substitute or complement the existing financial institutions to affect growth.

In contrast, even though a pool of empirical studies argues for the positive and conditional role of institutions in affecting the remittance-growth effect, these claims are challenged by the ongoing debate about institutional quality as an explanatory variable in the empirical analysis and how best to measure it. On this note, Abdih et al. (2008) analyzed the relationship between remittances and institutional quality in the recipient country and found that “an increase in remittance inflows can lead to a deterioration of institutional quality, specifically, to an increase in the share of funds diverted by the government for its own purposes.” This can be attributed to the fact that the government could consider remittance inflows and their effect in the recipient community as a substitute of their funds in which deviation of government funds (or related government interventions) would have no effect to the community.

The SSA region is on average characterized by weak institutions, political instability, strict regulations, government ineffectiveness, a low amount of formal remittances recorded compared to other developing countries, and a high portion of remittance inflows channeled into informal channels, all affecting the development impact of remittances in the region. These institutional challenges are compounded by inconsistent, unreliable data, as well as
measurement discrepancies and information asymmetry. In this case, Nyamongo (2012:2) notes that, “the remitter lacks control of the usage of transferred funds by the recipient, thus, the recipient may not use the remitted funds for investment projects or as productively as originally intended.” Another strand of the literature argues that remittance transfers in developing countries are still characterized by high transaction costs (mostly for banks and money transfer operators), which deters migrants from remitting. Most remittance inflows for example to SSA countries are still informal (over 50% of formal remittances), which affects the productive use of these inflows and their growth effect.

In sum, scholars concur on the conditional role of institutions in mediating the growth effect of remittances. The only empirical puzzle remaining is how to measure the quality of institutions; this is still an ongoing empirical issue with mixed findings. The other question is how the institutional and policy framework causally condition the mechanisms through which remittances affect development outcomes in the recipient economy. The optimistic literature claims that remittances affect economic growth through financial institutions by substituting or complementing the existing financial institutions in the receiving countries. The pessimistic empirical claims oppose this by arguing that the failure to measure the quality of institutions affects the measurement of the growth effect of remittances. In situations where the institutions of the financial sector are developed, the marginal effect of remittances appears to be low.

However, we need to know how the institutional and policy framework create mechanisms that enables agents to productively utilize remittances to affect microeconomic outcomes, leading to the aggregate macro picture. For instance, how do local institutions and policies influence what people do with remittances? Thus, there are empirical and contextual issues which are underestimated in the literature. I review empirical debates about the microeconomic implications of remittances in the next section.

2.4.2 The Microeconomic Implication of Remittances

The macroeconomic literature remains unable to explain the development outcomes of remittances. We therefore need a synthesis of all different channels through which remittances are utilized to affect development. Some of these channels are manifested at the micro/household level. Over the recent decades, the microeconomic implications of remittances have attracted scholarly debates in the field. In the review of this scholarship, this thesis is guided by the underlying empirical question of this study: how do remittances improve socio-economic welfare of recipient households and through what mechanisms? In
addressing this question, most of the related literature embarks on an empirical analysis about the effect of remittances on poverty, human capital development and inequality in the receiving countries. The assumption is that remittances affect development outcomes by reducing poverty, which improves development outcomes such as human capital development variables (e.g. education and health). Remittances are also said to bridge inequality in the recipient countries, but the latter is empirically contested. In reference to the NELM theory, I review different empirical studies about the impact of remittances on microeconomic development outcomes manifested in poverty, human capital development and inequality.

2.4.2.1 Remittances and Poverty

Since remittances are personal private transfers from sender to recipient, their impact is expected to be at the household level in receiving country. The premise is that the microeconomic impact of remittances is expected to be evidenced in their poverty-reducing capacity and improvement in the socio-welfare of recipient households. Related literature provides increasingly mixed empirical findings about the effect of remittances on poverty and welfare in developing countries. This variation seems to stem from the inconclusive effects of remittances on poverty, human capital development, and inequality, as well as from methodological issues.

Recent empirical findings on remittances and poverty (Adams, 2005; Sosa and Medina, 2006 cited in Yaméogo, 2014 and Ratha et al. 2011) claim a positive effect of remittances on poverty and the improvement of the socio-welfare of recipient households. Remittances offer a source of liquidity and income insurance to the recipient households to deal with market failures and increase their productivity. In addition, Taylor (1999) notes that remittances are used by recipient households to overcome market failures that constrain local production. He argues that migrant remittances provide recipient households with liquidity and that they are used to finance new technologies, inputs and activities. Besides liquidity, remittances offer income insurance, by providing households with access to income sources (remittances) that are not or negatively correlated with farm income.

Moreover, many related studies find that remittances reduce poverty, mostly in developing countries. For instance, a study on 33 African countries for a period between 1990 and 2005 finds that, a 10% increase in official international remittances as a share of GDP led to a 2.9% decline in the share of people living in poverty, with declines also observed in the depth and severity of poverty (Anyanwu and Erhijakpor, 2010). Similar studies from Burkina Faso
(Lachaud, 1999; Wouterse, 2010), Ghana (Quartey and Blankson, 2004), Lesotho (Gustafsson and Makonnen, 1993), Morocco (Nyberg-Sorensen, 2004), and Nigeria (Odozia, Awoyemia, and Omonona, 2010) conclude that remittances are associated with a reduction in the share of people in poverty and, in some cases, the depth and severity of poverty.

On improvement of human capital development outcomes, several community, country and cross-country surveys find a positive contribution of remittances on improvement of human capital development outcomes such as health and education. In support of this claim, Ratha (2013) suggests that on average, remittance-receiving families spend their income more on investments such as health care and education than those households that do not receive this type of income. Indeed, Adams (2004, cited in Fonta et al. 2016) find that remittances reduce the severity of poverty in Guatemala and remittance-receiving families tend to spend a lower share of total income on food and other non-durable goods and more on durable goods, housing, education and health. Empirical studies tend to concur on the contribution of remittances on human capital development. However, the positive effect is challenged by an ineffective local institutional environment, ineffective policies and brain drain.

The vast majority of literature finds that remittances affect poverty through their contribution to savings and investments, mostly physical investments. The earlier literature frequently claimed that remittances are used for conspicuous consumption, which does not affect development outcomes. However, recent empirical evidence has begun to show that remittances are channeled into savings, business and investment in the receiving communities. For instance, recent empirical studies reveal that remittance-receiving households have, on average, greater savings levels and consequently a stronger ability to withstand external economic shocks than similar households that do not have this income source (see Ratha, 2013). Vast numbers of studies claim that remittances are channeled into physical investments in the receiving communities. Adams (2005 cited in Fonta 2013) finds that remittance-receiving households spend less at margin on consumption goods, such as food, and more on investments items, such as education and housing.

The optimistic literature on international remittances and poverty reduction have extensively covered the effects of remittances on poverty. It has been realized that this effect is a function of how remittances contribute to increasing consumption, savings, human capital development and promotion of investments in remittance-recipient households. Compared to other income, the steady and stable flow of this financial income ensures stable consumption and increases the propensity of recipients to save and make use of these
resources for other business and investment activities. Indeed, the review of the literature indicates that households receiving remittances spend more on savings and investments than non-recipient households.

However, the positive role of remittances on poverty is empirically challenged by some empirical findings suggesting that remittances create or increase inequality in the recipient communities or countries, create laziness among receiving households, and, as a result, affect labor supply and productivity and increase conspicuous consumption. Others argue that, due to the ineffective institutional environment in the receiving countries, remittances are hindered in their effect on poverty. It is worth noting that this empirical narrative discusses the effect of remittances on poverty with less focus on the mechanisms through which remittances affect poverty and other development outcomes in the recipient country. The next section reviews the empirical literature about the effects of remittances on inequality in the receiving countries.

2.4.2.1 Remittances and Inequality

The review of the literature shows that the effects of remittances on inequality is the most contested issue, leading to inconclusive empirical debates. The question is whether remittances affect income inequality by bridging the gap between rich and poor. Several empirical studies from different contexts have examined the effect of remittances on poverty and find that remittances reduce income inequality, while others have contradicting findings. On the optimist side, using an international measure of inequality, Olowa et al. (2013) find that international remittances reduce the level, depth and severity of poverty among rural households in Nigeria. Accordingly, the authors find that, at the poverty line of ₦23,733 per annum (in Nigeria), a 10% rise in the international remittances reduce poverty incidence (PI), the poverty gap and the squared poverty gap (SPG) by 0.86%, 0.62% and 0.62%, respectively. A similar study examined the effect of international remittances on poverty and inequality in Ethiopia using urban household survey data collected in 2004 and counterfactual estimation. The study found that poverty decreased significantly with an increase in remittances, because the remittance-receiving households mainly come from the bottom consumption distribution and the amount they received is large. The findings of the study reveal that headcount ratio fell from 30% to 25%, while the poverty gap and the squared poverty gap ratios decreased from 6.6% to 5.2% and from 2.2% to 1.7%, respectively.

It is the sign (₦) of naira code (NGN) which is the currency of Nigeria.
(Andersson, 2014). Similar findings demonstrate that inequality increased in Ethiopia, although the magnitude is negligible, and the Gini coefficient, a national representative indicator of income inequality, increased from 21.2% to 22.5% (Beyene, 2014). Indeed, several empirical studies find a positive effect of international remittances on inequality in recipient countries (Beyene, 2014; Campos and Palomo, 2002; Taylor et al. 2005; Adams and Mahmoud, 1992; Taylor, 1992).

Furthermore, Gupta et al. (2007) study finds that on average, a 10% increase in the share of remittances in a country’s GDP is associated with an about 1.5% fall in headcount poverty and a 1.1% fall in the poverty gap. Indeed, household surveys conducted by Ratha et al. (2011) found that more than half of households in Burkina Faso, Ghana, and Nigeria and 30% of households in Senegal receiving remittances from outside Africa are in the top two consumption quintiles. Similar findings indicate that recipients of remittances from outside Africa tend to be higher in income distribution than those receiving remittances from within Africa. Koechlin and León (2006) carried out a comprehensive cross-country empirical analysis on the relationship between remittances and income inequality. Their results indicate a positive and significant association between international remittances and income inequality, though they do not seem to be statistically robust.

In contrast, the positive effect is challenged by the pessimistic empirical claims arguing that remittances perpetuate inequality in the receiving countries or communities. These claims stem from the arguments that migration and remittances negatively affect labor force supply and promote the vicious cycle of brain drain in the sending countries. This seems to emanate from the claim that international remittances compensate for the gap created by the loss of skilled emigrants. The continued loss of educated people, coupled with recipient households’ total dependence on international remittances (mostly for conspicuous consumption), creates a vicious cycle of poverty in the recipient economy. Nonetheless, with respect to the NELM theory, one could argue that, assuming that migrants are rational beings, migrating to where their net-wage productivity is positive rather than staying in a country or rural area where their net-wage productivity is negative, is the logical choice, irrespective of other push factors. In this case, in the long term, the economic convergence argued for by economic theories would eventually happen.

Other studies argue that, in some instances, instead of promoting hard work and productivity, international remittances encourage laziness in recipient communities or households since these people know that they will finance their consumption through remittances. This negatively affects labor supply, employment and productivity (Chami et al.
Kozel and Adelman (1990) performed an analysis on the labor force and labor supply of Pakistan using data from the 1986 PIDE survey. They found a significantly negative impact of international remittances on the labor force participation of mostly males. This issue has been extensively discussed in the empirical studies about remittances and development, but the literature remains silent about the underlying factors driving the laziness or unwillingness to work in the recipient communities. The NELM theory shows that, among the push factors of migration are market failures which lead to unemployment and poverty. I argue that, despite their remittance income, recipients are still affected by these institutional factors. These issues might imply that people are not refraining from looking for employment, but, rather, are unable to find it. Remittance income is thus not panacea for poverty reduction and improved development outcomes, especially when institutional and structural challenges are not taken into consideration.

Inequality is another aspect that challenges the effect of international remittances on poverty and improvement of development outcomes. Pessimistic studies claim that international remittances increase inequality in the recipient countries. Das & Sahu (2011) find that remittances increase inequality, as measured by the Gini coefficient. And inequality stems from the claim that richer families are better able to pay for the costs associated with international migration. Similar evidence from Egypt suggests that despite the poverty reduction (because a significant number of poor households do receive remittances), remittances caused income inequality to rise (see Adams, 1991). Similarly, in the Philippines in the 1980s, remittances contributed to a 7.5% rise in rural income inequality, in spite of the low share of remittances in the households’ income (Rodriguez, 1998). Similarly, household survey data from Pakistan reveal that the wealthier income groups benefited most from migrants’ remittances (Adams, 1998). Nevertheless, the empirical literature on this topic tends to follow a similarly static approach by basing the analysis on the Gini coefficient. The empirical literature tends not to consider how remittances increase proportional spending on different development outcome variables among the different socio-economic categories of recipient households. We know that remittances are biased towards richer receiving households. It might be useful to conduct a counterfactual analysis of recipient households to examine the average effect of remittances on them compared to non-recipient households (the control group). This would credibly address the problem of selection bias in the current scholarship.

To summarize, this section reviewed the existing empirical literature about the effect of remittances on poverty, other development outcomes and inequality. Interestingly, most of
empirical studies seem to concur on the impact of remittances on poverty and other development outcomes, mostly studies that use household survey data. We know from related literature that household survey data provide rich and comprehensive information to study such development issues. As Adams (2011:3) notes, “household survey data provide the best means for evaluating the impact of international remittances on developing countries.” He further explains that, household surveys collect disaggregated data on a wide number of variables, including consumption, wages, labor supply and education, making it possible to accurately identify the economic impact of remittances on people in the developing world.

Generally, there seems to be less divergence between empirical studies exploring the microeconomic impact of remittances. There is a tendency of favoring optimistic empirical claims. The optimistic studies argue that remittances affect microeconomic outcomes by contributing to poverty reduction among recipient households, with some spillover effects to the local communities. Remittances provide income that increases the consumption capacity of receiving households, thus promoting human capital development indicators, increasing savings and investments, and bridging income inequality. In contrast, other empirical findings refute the optimistic claims, arguing that, since remittances are biased towards the rich who have the financial capacity to support emigration of their family members and who are thus more likely to receive remittances, remittances increase inequality in the receiving countries. Another argument is that remittances lead to laziness by the receiving family members, affecting labor force supply and local productivity. Most importantly, over the years, remittances are known for encouraging conspicuous consumption rather than the productive use of the income, thus perpetuating the vicious circle of poverty. However, the existing literature does not really explain how remittances affect development outcomes of recipient households in different socio-economic layers. The review of the literature identifies a number of theoretical and empirical gaps which affect this scholarship.

2.5 Synthesis

This section synthesizes the theoretical and empirical narratives about remittances and development reviewed and discusses the theoretical and empirical gaps that form the contribution of this thesis. The review of both the theoretical approaches and the empirical literature increases our understanding of the development impact of remittances. We learn from the literature that these schools of thought are critically important and have shaped the evolution of scholarship on migration, remittances and development over time. The review of these theories suggests that they are compatible and complementary, rather than mutually
exclusive, in explaining the development impact of remittances. Importantly, they have one theoretical stance in common, namely that remittances are a determinant factor for economic development, but not sufficient for the overall improvement of development outcomes in the recipient countries.

The review of this literature finds that the overall gap in the field is related to the disconnect (in terms of alignment) between theoretical approaches and empirical narratives. This seems to be driven by a lack of comprehensive theory explaining the development impact of remittances. Accordingly, the empirical literature provides a wide range of mechanisms through which remittances affect development based on the existing theoretical approaches, but it leaves other aspects unaccounted for. This seems to result from the fact that the literature documents a lot of empirical findings that are not based on comprehensive theory (other than partial theoretical approaches). Conversely, the ongoing empirical debates about the mediating effect of institutions and policies in influencing the growth and development impact of remittances have been ignored in the related theoretical approaches.

The review of the literature identifies two dominant macroeconomic theoretical approaches (the national account model and the endogenous growth model) that demonstrate the macroeconomic impact of remittances. The national account model suggests direct and indirect channels through which remittances affect the macroeconomic outcomes. The direct channel emphasizes the positive effect of remittances as a source of non-costly external capital inflows which improve the capacity of the national account and finance consumption, savings, and investment, hence, stimulating production in the recipient economy. The indirect channel emphasizes the negative effects, arguing that remittances negatively affect macroeconomic behaviors such as the exchange rate and relative prices. In doing so, remittances result in the appreciation of the exchange rate and inflationary pressure, which further affects macroeconomic behaviors, thus leading to a situation of “Dutch Disease”. The endogenous growth theory claims that remittances affect economic growth and development through their positive interactive effect on the factors of production, particularly human capital and technological diffusion, in the recipient economies. The theory demonstrates that the growth effect of remittances is pronounced when remittances interact with human capital by financing human capital development and technological diffusion, hence improving human capital outcomes, overall productivity and growth. However, the two theoretical approaches remain challenged by being biased to the macroeconomic mechanisms only, without addressing other areas that matter in the field of remittances and development. Other aspects that condition the growth and development effect of remittances, such as institutional
environment and the context, are ignored. This invites criticism for being narrow in explaining the remittance-development impact.

In terms of the microeconomic approach, few theoretical approaches explain remittances and development. The NELM theory and its four theoretical determinants of motivation to remit back only do so to a limited extent. It bases its predominance on the determinants of migration and how the outcomes of migration influence economic development. The departure point of this theory is how the decision to emigrate is determined. Remittances come into play as outcomes of migration, affecting the microeconomic outcomes of the families left behind. The theory moves the decision to emigrate from the individual labor migrant to a wider social entity, the migrant household. It identifies four theoretical motivations to remit by the migrant, altruistic, self-interest, loan repayment, and co-insurance. However, these theoretical approaches remain hindered by their inability to provide theoretical mechanisms through which remittance inflows affect development outcomes, either at macro or micro levels in the recipient countries. They also do not explain how institutional, policy and structural issues influence push factors/reasons to emigrate. The same factors positively or negatively affect remittance inflows and their productive deployment to affect development outcomes, either at micro or macro levels. The micro interaction of the institutional and policy environment with remittances and agents to affect development outcomes have thus largely been ignored in the theoretical literature. This has affected the ongoing inconclusive empirical debates in the field.

This chapter reviewed the extensive empirical debates about the effect of remittances on development outcomes (macro and micro) and the conditional role of institutions in mediating the development impact of remittances. These empirical narratives shed light on how remittances affect development outcomes. However, the scholarship remains divided between the optimistic and pessimistic empirical claims about the remittance-development impact. Most of the scholarship is also biased towards the macroeconomic impact of remittances and dominated by cross-country studies. Although most of these empirical debates are embedded in the theoretical approaches discussed in the earlier sections of this chapter, the theories lack comprehensiveness and none unite the different mechanisms through which remittances impact development. As a result, discussions remain inconclusive about the development impact of remittances and the debate continues. A number of theoretical and empirical gaps still affect this field. This thesis contributes to filling these gaps.
First, the field of remittances and development is strongly affected by the definition and measurement of the concept of “development”. The concept of development or economic development has been approached, understood or measured differently depending on the academic or scholarly field of the scholar engaging with it. The conceptual definition of development is also influenced by different theories of development (modernization, dependency, world system, and globalization). Simply put, development means the overall improvement of welfare of the society. However, its measurement goes beyond the measurement of welfare to include the factors that lead to and sustain the overall welfare or development outcomes of the society. This includes institutions or institutional arrangements that condition or are conditioned by the development outcomes, as well as the context in which development is taking place. As discussed at the start of this chapter, the literature is divided about these issues. After the Washington consensus, the yardstick of economic performance has been influenced by economic growth measured by GDP per capita growth – mostly driven by macroeconomists. The latter approach has strongly influenced most of the theoretical and empirical studies about the effect of remittances in development. For instance, none of the theoretical or empirical narratives explain why remittances have positive effects in some economies and not in others and what influences this effect within and across countries. This can be attributed to the continuous reliance on macroeconomic frameworks to study the development impact of remittances, which do not provide an insight into what people do with these remittances or how the institutional and policy environment influence such choices.

On the other hand, there are the microeconomic approaches to development outcomes, such as welfare and inequality in society. There is a growing body of empirical studies examining the microeconomic impacts of remittances – particularly their effect on poverty and inequality (as discussed in Section 2.4). Most of these studies are at the cross-country level and yield mixed empirical results. These studies use either micro or macro approaches to examine the remittance-development outcomes with no linkage or interlinkage between these two methodological approaches. There is lack of the micro-level interactions (between recipients of remittances, their utilization and institutional framework) and a causal story in the whole remittance-development process. In other words, there is a lack of focus on what individuals, households and the diaspora are doing with remittances, what choices they make and how these choices are influenced by the prevailing policy and institutional environment. This agent interaction (remittance-recipient households, investors, the diaspora) is the causal path that actually produces the micro effects on household welfare and signals an
improvement in their development outcomes. These same development outcomes aggregate to produce macro-level effects observed in the country. The choices made by migrants to transfer and to deploy remittances into productive investments that ultimately affect both micro and macro outcomes are thus mediated by the existing policy and institutional environment. Evidence for this claim can be found in Rwanda’s experience of working with her diaspora, which is discussed further in Chapter Four of this thesis. This interlinked interaction and causal path has been poorly explained and sometimes ignored altogether in the theoretical and empirical frameworks. In the end, we need to know where the diaspora and remittance-recipient households channel their remittances and how the institutional environment causally mediates this process and conditions the overall impact. Chapter Four discusses this in detail in the context of Rwanda. What is obvious in the literature in relation to the concept of development and remittances is that the way the concept of economic development is understood and measured by different scholars influences the way the development impact of remittances is conceived and understood.

The conditioning and mediating role of the institutional environment need more attention. Institutions and institutional arrangements have a conditional effect on the performance of individuals, households, firms, governments and the entire economy. They shape the development path of societies and nations, as affirmed by Rodrik (2004) and Acemoglu et al. (2014). It remains equally important to explore the mechanisms through which these arrangements condition the choices and behaviors of agents and the market to affect the overall remittance-development outcomes. Neither macro nor micro theoretical approaches in the field of remittances and development have explained this mediating effect of the institutional and policy framework. A multitude of mostly cross-country, macroeconomic, mixed empirical findings without a theoretical framework persists.

Institutions and institutional arrangements vary across countries and within countries, mostly when it comes to their applications. In the existing literature, particularly for remittances and development, it is evident that institutional variables (say control of corruption, regulatory quality, or property rights, to mention but a few) influence differently remittance-development outcomes (specifically the remittance-growth effect) at a cross-country level. Though I believe in cross-country analysis, there is a theoretical and empirical gap related to the deployment of institutional yardsticks (indicators) as moderating factors in the cross-country analysis without consideration of the context-specific aspects of development. The institutional quality variables may be the same, but institutional arrangements and policies vary across countries and within countries and this has a bearing
effect on the institution-driven remittance development outcomes. Variations in terms of the institutional and policy environment matter, because it is this environment that facilitate agents to utilize remittances productively to stimulate micro and macro development outcomes. Such institutional structures and their deployment play out differently across countries, especially in SSA countries. The institutional environment plays a causal role in influencing the remittance-development outcomes, but it tends to be country-specific. Therefore, cross-country analysis does not provide enough understanding about the mechanisms through which institutions and policies influence remittance-development outcomes.

The dominant literature about remittances, institutions and economic growth (such as Chang, 2011; Rodrik, 2004; Baldé, 2009) shows that a cross-country analytical framework leaves some insights unexplored when it comes to the mediating effect of institutions on the remittance-development impact. Institutional and policy frameworks are not homogenous across and within countries. The literature shows that some countries have put in place institutions with policy frameworks that hinder economic performance. Others have yet to develop traditional institutional quality variables, but they have an effective policy framework that corresponds to their overall development outcomes. In the case of remittances and development, remittances can affect development if both the policy and the institutional environment are conducive to development. This development aspect needs be explained in detail, based on the country-specific analysis.

The country-specific context in terms of development factors matters to increase understanding of the development impact of remittances. The country’s development path influences remittance inflows and the manner through which remittances are productively utilized to affect development. This aspect has been ignored in the theoretical and empirical approaches explaining the development effect of these inflows. Like other external capital inflows, remittance inflows and their development effect (either macro or micro) are influenced by the institutional environment, but also by the country’s level of development and the opportunities presented as result of this development. We know that countries are at varying levels of development or income. The country’s level of development presents opportunities (optimistic or pessimistic) in terms of making use of remittances to impact development. Empirical studies have argued that at a low level of development (proxied by GDP per capita), remittances are channeled into conspicuous consumption with less possibilities of contributing to development. This implies that as the country’s level of economic development increases, it presents avenues and opportunities to make use of
remittances for development. Le (2011) finds that remittance transfers increase when investment outcomes in the recipient country improve. In relation to remittances and investments, migrants are concerned about the overall investment climate in the country, which is strongly related to the overall institutional quality. Le concludes that when the business environment is encouraging and positive, it stimulates remittances for investment purposes. Cooray and Mallick (2010, cited in Ssozi and Asongu, 2016) argue that remittance inflows depend on a country’s investment opportunities and social welfare systems, which in turn depend on its institutional development. Moreover, migrants from a country with oppressive institutions prefer to settle permanently in the host country and as a result remit less to their country of origin. For instance, in Rwanda (as discussed in Chapter Four), remittance inflows and their effect on GDP (in terms of percentage to GDP per capita) increased exponentially after the genocide against the Tutsi when the economy was improving contrary to the previous decades. This seem to imply that remittances complement the ongoing development endeavors in the country, but they are not panacea. And these development factors play out differently across and within countries. Thus, context-specific aspects need to be considered in the theoretical framework.

The scholarship is also affected by methodological issues in studying the development impact of remittances, mostly the methodological problem of endogeneity and selection bias. The underlying issue here is how to estimate the counterfactual income of the remittance-recipient households. The selection bias stems from the fact that remittance recipients and non-remittance recipient households may differ in terms of observable and unobservable characteristics. Bohra-Mishra (2013a) observes that “since remittance-recipient households are not randomly assigned, characteristics associated with the household rather than their status as a remittance recipient can influence their pro-development spending” (something frequently observed in the literature). Hence, the problem of selection bias continues to affect the validity of this scholarship. Different methodological approaches have been suggested both at the macro and the micro level. One of these suggestions is the introduction of instrumental variables to address the problem of endogeneity in the remittance model. However, empirical studies remain inconclusive about the right instrumental variable to address the problem of selection bias and endogeneity. This issue is also complicated by the challenge of obtaining relevant statistical data for such instrumental variables. Promising methodological solutions in the empirical literature are localized randomized control trial techniques such as PSM, which is adopted in this study (see Chapter Seven).
2.5 Conclusion

This chapter extensively reviewed the theoretical approaches and empirical narratives about the development of remittances. The scholarship presents three contrasting theories about remittances and development, the development optimistic view, development pessimistic view and pluralistic school of thought. Those who hold the development optimistic view advance claims about the positive development impact of remittances. The promoters of the pessimistic view claim a negative effect of migration and remittances on development, attributed to different institutional and structural issues. The pluralist view opts for a pragmatic and flexible stance in dealing with the complex realities of remittance inflows and development. These schools of thought have informed the three dominant theoretical approaches (the NELM, the national account model and the endogenous growth model) this thesis is embedded in. The chapter also discussed different empirical findings and the mediating effect of institutions in the remittance-development process.

The literature review increases our understanding of the development impact of remittances. It emphasizes the indispensable role of remittances in development. It sheds light on numerous mechanisms through which remittances contribute to development outcomes. It advances the claim that remittances are potentially complementing factors for broad-based development endeavors, although they are not panaceas. This is because the development effects of remittances depend on the underlying institutional and policy environment, as well as on other development factors in the recipient economy. Remittances have a systematic and holistic development impact, not only on the macro level, but also on the micro level, where it is mediated by the institutional and policy framework, leading to the aggregate macro effects. However, the synthesis of the literature review identifies theoretical, conceptual, empirical, institutional and methodological gaps still affecting this scholarship.

The review of the literature identifies a conceptual gap in defining and explaining the concept of development and its application in the field of remittances and development. The concept of development is defined, understood and explained differently among scholars from different disciplines. These variations affect the way scholars approach and explain the development impact of remittances. In fact, the way we think about development impacts the way the development impact of remittances is understood. Here, I argue that we need to understand the mechanisms through which remittances impact development outcomes. That is, we need to understand how agents interact with the existing policy and institutional environment to productively utilize remittances for productive investments that spur overall development outcomes.
Similarly, the literature points to the consistent underestimation of the role of the policy and institutional framework, as well as other development factors that influence the development impact of remittances. This is combined with a lack of attention to the contextual aspects of remittances and development in the theoretical and empirical discourse. We know that institutional quality and the policy mix are determinant factors of development and that the level of the development of the country is strongly associated with the prevailing quality of institutions. These institutional mechanisms and other development factors play out differently across countries, which has a bearing effect on how the development impact of remittances is explained. The field is also affected by methodological issues. Numerous attempts have been made to address these issues, but a conclusive empirical solution has yet to be reached.

Overall, the biggest theoretical and empirical gap observed in the field is the disconnect between theoretical approaches and empirical narratives. Several empirical findings are based on theoretical approaches (the NELM, the national account model and the endogenous growth theory), which present a biased and narrow framework in their explanations of the development impact of remittances. The field has yet to provide a comprehensive theoretical framework that explains the different mechanisms under which remittances affect development. A range of theoretical and empirical narratives argue for the macroeconomic implications of remittances, but the development effects of remittances go beyond the macro effects. Ignoring other channels leaves information unexplored, thus leaving the field incomplete. We need to be holistic and systematic to better understand the different mechanisms and contexts under which remittances contribute to development. This study contributes to this scholarship by adopting a comprehensive and systematic framework to bridge the identified theoretical, empirical and methodological gaps. This study’s empirical strategies are embedded in the dominant theoretical approaches that have been discussed. The next chapter extensively discusses the conceptual and empirical strategy employed to examine the effects of remittances in development. The chapter also discusses the novelty of this study.