**Introduction To Remittances**

By [Brent Radcliffe](http://www.investopedia.com/contributors/242)

Each year, billions of dollars are sent by migrant workers to their home countries, with some estimates putting the total value of [remittances](http://www.investopedia.com/terms/r/remittance.asp) at more than $200 billion. For some countries, remittances make up a sizable portion of [GDP](http://www.investopedia.com/terms/g/gdp.asp). How do remittances work, and what are some of the pitfalls that developing countries face when dealing with such large inflows of cash?

Remittances are funds transferred from migrants to their home country. They are the private savings of workers and families that are spent in the home country for food, clothing and other expenditures, and which drive the home economy. For many developing nations, remittances from citizens working abroad provide an import source of much-needed funds. In some cases, funds from remittances exceed aide sent from the developed world, and are only exceeded by [foreign direct investment](http://www.investopedia.com/terms/f/fdi.asp) (FDI).

**Remittances and Developing Nations**  
Many developing countries have difficulty borrowing money, just as a first-time home buyer might have difficulty obtaining a mortgage. Developing nations – the sort that are most likely to rely on remittances – tend to have less stable governments and are less likely to repay the debt or not go into default. While organizations such as the [World Bank](http://www.investopedia.com/terms/w/worldbank.asp) can provide funding, these funds often come with strings attached. For governments in the developing world, this may simply be too much of a step on sovereignty, especially if power is being held by a thread.

Remittances give countries the ability to fund development their own way; however, like a teenager flush with cash from a first job, developing countries first have to understand just what it takes to effectively use remittance funds. If it is to efficiently use these funds the country must first develop policies that promote smart, stable growth, and to ensure that growth is not solely concentrated in the cities.

**Country Effects**  
It is difficult to track how remittance funds are spent because they are private transfers. Some economists believe that recipients use the funds to purchase necessities such as food, clothing and housing, which ultimately won't spur development because these purchases are not investments in the strictest sense (buying a shirt is not the same as investing in a shirt production factory). Other economists believe that funds from abroad help develop a domestic financial system. While remittances can be sent through [wire transfer](http://www.investopedia.com/terms/w/wiretransfer.asp) businesses, they can also be sent to banks and other financial institutions. Depending on restrictions on the movement of capital around the country, these funds can not only help individuals pay for the consumption of goods and services, but can also be used to make loans to businesses if they are saved rather than spent. Some banks may even seek to establish branches abroad to make the transfer of remittances easier.

Research has also shown that migrants returning from working abroad have a higher propensity for developing their own business. They have seen how businesses are run in developed countries, and are able to recognize trends within their home country and create a company to take advantage of opportunities.

The inflow of money from remittances has been compared to the windfall that countries with high-demand resources, such as oil, receive. The governments of these countries, flush with cash, often spend lavishly on social programs or poorly-planned projects, and find themselves in trouble when demand for a particular commodity slows down. Unlike oil revenues, which are typically held by the state, remittances are sent to individuals who are in charge of spending.

**Remittance Problems**While remittances are an important lifeline in many developing countries, they can also foster a dependency on outside flows of capital instead of prompting developing countries to create sustainable, local economies. The more a country depends on inflows of funds from remittances, the more that it will be dependent on the global economy staying healthy.

Remittance flows can be negatively impacted by a downturn in the global economy. Workers employed abroad may lose their job if they are in heavily-[cyclical industries](http://www.investopedia.com/terms/c/cyclical_industry.asp), such as construction, and may have to stop sending remittances. This has a two-pronged effect. First, the home country may see a significant portion of its income dry up, and thus not be able to fund projects or continue development. Second, workers who moved abroad may move back home, exacerbating the problem by increasing the demand for services on an already strapped economy.

**Macroeconomic Effects**  
Large inflows in foreign currency can cause the domestic currency to appreciate, often referred to as [Dutch Disease](http://www.investopedia.com/terms/d/dutchdisease.asp). This in turn makes the country's exports less price competitive, since goods become more expensive to other countries as the domestic currency rises. Because the domestic currency is valued higher, consumption of imports begins to rise. This can snuff out the domestic industries of developing countries. The inflow of cash, however, can also help the recipient country reduce its balance of payments.

It is important to note that migrants do not only travel to the largest world economies for work; instead, they go where the likelihood of work is the highest. While construction-related jobs are often considered the job of choice, many workers flock to countries that are developing their economies as well. Commodity-rich countries have a high demand for labor as the prospect of rising commodity prices continues to remain a constant.

According to a report by the [Organization for Economic Co-Operation and Development](http://www.investopedia.com/terms/o/oecd.asp) (OECD) approximately 3% of the world's population resided outside their home country in the year 2000. A more integrated and globalized world has allowed labor movements between countries to become more fluid, with more and more workers moving abroad to seek ways to provide for their families. Thus, immigrants who seek to send back remittances have become an integrated part of the economy.

The funds immigrants send home keep wire transfer companies in business and allow the home country to purchase imports. Immigrants consume the goods and services provided by domestic workers. The presence of foreign workers can help alleviate labor shortages. The role of these workers is more of a partnership, with immigrant workers helping developed countries continue to expand while sending a portion of their incomes home as remittances. In addition, the social networks created by foreign workers can increase the reach of developed countries, and can foster a more integrated cultural understanding through interactions with the local population.

**Conclusion**  
Immigration is often a hot-button topic in domestic politics, and parsing out fact from fiction when it comes to the economic effect of foreign workers can be difficult. The bottom line is that remittances are an important factor in the global economy, and help drive growth both at home and abroad. It is important for the developed world to provide guidance on the prudent use of those funds, and for developing countries to develop policies that will ensure that growth is efficient and well planned.