REMITTANCES, DIASPORAS, AND ECONOMIC DEVELOPMENT

ISSUES, LESSONS LEARNED, AND RECOMMENDATIONS FOR DONOR INTERVENTIONS

November 2006

This publication was prepared by Chemonics International Inc. for review by the United States Agency for International Development.

REMITTANCE, DIASPORAS, AND ECONOMIC DEVELOPMENT

ISSUES, LESSONS LEARNED, AND RECOMMENDATIONS FOR DONOR INTERVENTIONS

Contract No. PCE-I-24-99-0000-00
This report was prepared for USAID by Eve Hamilton and Manuel Orozco in collaboration with Laura Chin and Kathryn Sell.

CONTENTS

EXECUTIVE SUMMARY

Remittance flows to Latin America and the Caribbean, which far exceed official development assistance to the region, have significant economic impacts at the regional, country, and household levels. While these impacts vary by country, studies generally conclude that remittances have a positive effect on growth, domestic investment, and poverty reduction. While the greatest share of these income flows are spent on consumption, remittances also foster asset accumulation and wealth generation for both recipients and senders. According to recent studies, access to finance, on the sending and receiving ends, increases remittance flows, savings, and investment. Despite these facts, remittance recipients, as well as senders, frequently lack access to the financial services that would help them leverage the development impact of remittance flows. To increase access to a broad range of financial services, facilitate asset accumulation, and reduce the transaction costs of remittances, evidence indicates that donors can provide MFIs with technical assistance and training to facilitate their entrance into the remittance market and improve their efforts to cross sell products and services to remittance recipients. Evidence also suggests a need for donors to encourage commercial banks, which are important payers of remittances, to see remittance recipients as a viable market for their other financial services.

In addition to remittances, diasporas contribute to poverty alleviation and economic development in their countries of origin through commerce with and investment in their homelands and through collective financing of community development projects. With respect to the former, governments and the diaspora itself use a variety of mechanisms and incentives to encourage or pursue commerce and investment opportunities that contribute to country of origin development with varying degrees of success. These include: diaspora business networks, diaspora investment funds and clubs, government investment promotion schemes, and bonds and foreign currency accounts. A review of these experiences suggests a possible role for USAID in supporting development of country specific diaspora outreach strategies, documenting and disseminating lessons learned and best practices, promoting sound business and investment environments to encourage trade and investment, and other areas.

In recent years, USAID has begun to recognize the important role diasporas can play in local community development and has begun to work in partnership with these groups. Though these partnerships are challenging, experience to date has shown that they can be an effective way to leverage resources for development and strengthen the capacity of local and international counterparts to foster change in their communities of origin.

Final Conclusions and Recommendations. This paper demonstrates that diasporas can contribute to home country economic development through a wide range of remittance, commerce, investment, and philanthropy related activities. And donors have supported many of these activities through a variety of programmatic interventions to good effect. The most appropriate programmatic interventions in any given country will depend on the unique circumstances of that country. Nonetheless, this review of remittance,

diaspora, and economic development issues suggests certain priorities, which we list below.

- Promoting pro-growth macroeconomic and trade policies to encourage growth at all levels and trade and investment from diasporas and other actors
- Building more trustworthy and inclusive financial systems through general institutional strengthening and by assisting and encouraging MFIs and traditional banks to offer transfers and cross-sell their services
- Documenting and disseminating lessons learned and best practices
- Partnering more with the diaspora to learn from and maximize the impact of their knowledge and financial resources

SECTION I: INTRODUCTION

Over the past two decades persistent disparities of wealth and income in the Western Hemisphere have led to increasing labor migration, which in turn has led to ever increasing levels of remittances to migrants' countries of origin. Today, remittance flows far surpass official development assistance to Latin America and the Caribbean and have important impacts on the economic development of countries in the region. However, family remittances are only one of the mechanisms through which diasporas[1] may influence economic development in their countries of origin. Diasporas may also engage in commerce with or investment in their homelands. In addition, diaspora associations send collective donations home to support community development projects.

In this paper we explore the linkages between remittances, other diasporas activities, and economic development, the experience of USAID and other actors in leveraging the development impact of diasporas' contributions, and identify areas for USAID support. The paper is structured around a set of six issues and their corresponding research questions, as requested by USAID (See Annex D: Scope of Work). In Section II we lay the foundation for our analysis of the economic impact of remittances by reviewing remittance trends in Latin America and the Caribbean, focusing on both regional and country specific trends. In Section III we explore the effects of remittances on recipient economies and how USAID might mitigate any negative effects of these flows and promote their positive effects. In Section IV we consider the experience with and lessons learned from microfinance institution (MFI) entry into the money transfer market. We further consider whether there is an ongoing need to strengthen financial institutions and regulators to increase the volume of remittances flowing through them and support financial institutions' efforts to bank the unbanked. In Section V we examine the impact of and potential for migrant related commerce with and investment in countries of origin and the circumstances under which USAID should support these activities. In Section VI we combine two interrelated sets of issues and explore diaspora funded social and productive projects, USAID experience partnering with diaspora groups to achieve development objectives, and whether such partnerships should be important to the Agency in the future. Finally, we conclude with a set of overarching recommendations for USAID programming in these areas.

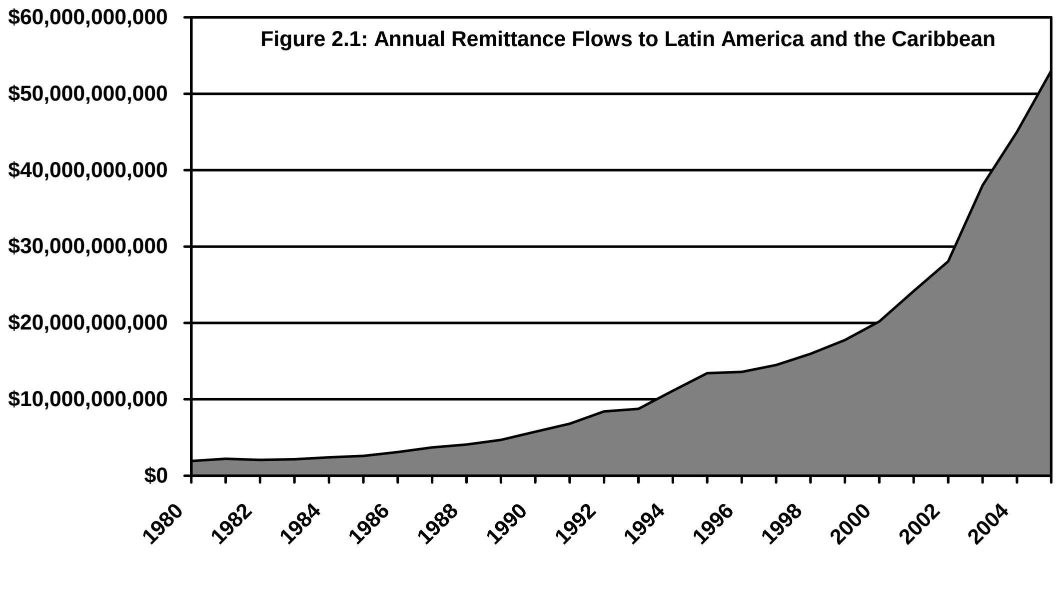
[1] In the context of this paper, the term "diaspora" refers to "ethnic minority groups of migrant origins residing and acting in host countries but maintaining strong sentimental and material links with the countries of origin…" G. Sheffer in Newland 2004, p. 1.

SECTION II: REMITTANCES IN LATIN AMERICA AND THE CARIBBEAN

In the past five years Latin America and the Caribbean have received nearly two hundred billion dollars from migrant workers in the United States, Europe, Japan, and countries within Latin America. This section reviews trends in remittance flows, and their regional distribution, identifies key characteristics of these flows, and discusses their impact in the region.

Regional Remittance Flows: Volume, Sources, Trends, and their Importance

Over the past 15 years the volume of remittance flows to Latin America and the Caribbean has increased from less than six billion in 1990 to over 50 billion dollars in 2005 (see Figure 2.1). This increase is due to a number of factors that include: 1) increased migration to the United States, Europe and Japan, and the region's stronger economies, 2) economic downturns in countries of origin, which have been shown to elicit increased support from family members living abroad, 3) strengthened ties with the U.S., 4) improved competition in money transfers, 5) increased contact between members in a transnational family, and 6) improved accounting of the money received. In 1980, for example, only 17 countries reported flows on remittances; by 2004 the number was 30. Even today's figures for remittance flows, reported by Central Banks, are considered to be conservative estimates.



Source: World Bank Development Indicators, 2006; Central Banks of each country

The money predominantly has come from the United States, however, in the past 10 years there has been an increase in the number of migrants moving to Europe and Japan. This trend is particularly evident in South American countries where migration to Spain has been significant. For example, in the aftermath of the economic crisis in Ecuador in the late 1990s, the number of Ecuadoran migrants to Spain has reached nearly 400,000. Migration to Japan is particularly common among Brazilians and Peruvians, and is estimated at a combined total of 300,000. Moreover, intra-regional migration has also increased in many parts of the hemisphere. This is observed in the movement of Nicaraguans to Costa Rica, Paraguayans to Argentina, and Haitians to the Dominican Republic.

Regional Distributions, Characteristics, and Impacts

The increasing importance of remittances to Latin American and Caribbean sub-regions and countries can be analyzed using a number of indicators, including: remittances as a share of Gross Domestic Product (GDP), per capita remittances, and per capita remittances relative to per capita income. As we shall see, the cost of sending money is also an indicator of the importance of remittances in a given economy. In some smaller economies, remittances represent as much as 23 percent of national income. However in Latin America as a whole, they amount to only 2 percent of regional GDP. The different trends within each country can be observed in Table 2.1, p. 14. Although the average amount sent is around $270 per month, when that figure is compared to per capita GDP, again the results vary. Recipients in Haiti, Honduras, and Bolivia, for example, receive annual amounts that are nearly three times per capita GDP. The cost of sending money also varies across countries and may be associated with volume; in general, the lower the volume entering a country, the more expensive the transfer will be.

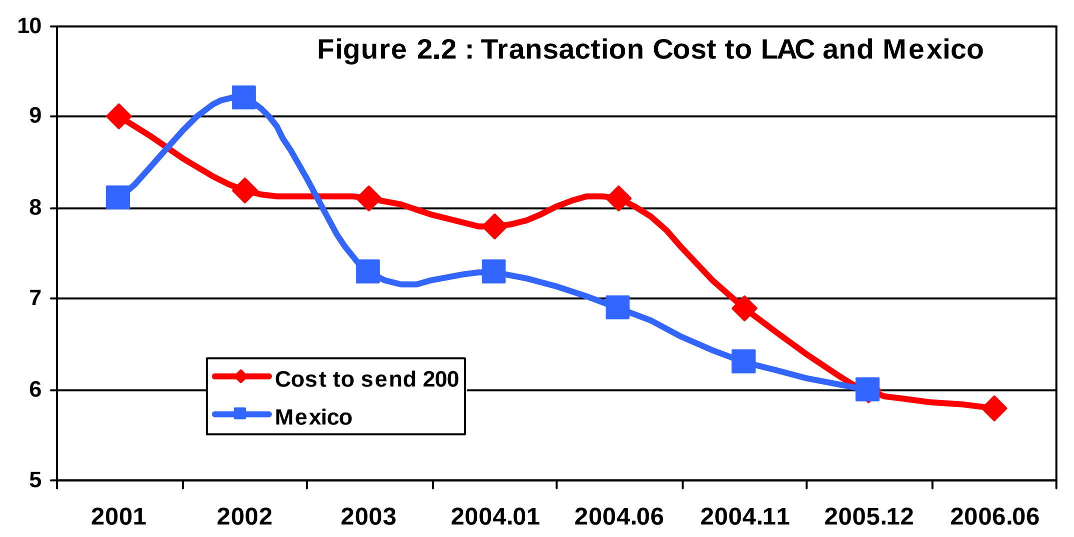
If we divide Latin America into South America, Central America, the Caribbean, and Mexico, we see distinct trends within each region. These tendencies are related mainly to the characteristics of the migration flows of each country, which have responded to different political and economic factors, including civil wars and dictatorships. Therefore, even though Mexico, Central American and Caribbean countries all have a history of sending migrants to the United States, the specific qualities and influence of each flow are quite unique.

In Central America, the effects of remittances on the economy vary from very low in countries like Panama, Belize, and Costa Rica to very high in the rest of the sub-region. For example, in Guatemala remittances total nearly $3 billion annually while in Panama they reach only $200 million. The costs to send money to the three Central American countries with the lowest annual volumes and the lowest share of GDP (Panama, Belize, and Costa Rica) are the highest in the sub-region. We see that in the countries with weaker economies, namely El Salvador, Guatemala, Honduras, and Nicaragua, the share of GDP is higher as are the annual volumes, the average transfer amounts, and the per capita amounts. We also see that the costs of sending are lower in these four countries.

Among Caribbean countries, we see similar trends. In per capita terms, remittances are very important in the Caribbean. Nevertheless, transaction costs to the sub-region are the highest in the Western Hemisphere, even in countries with high volumes like the Dominican Republic, Haiti, and Jamaica. Haiti is an interesting example because its struggling economic performance leads the volume of remittances to be high relative to

GDP, while the per capita amount and the average transfer amount are quite low. Grenada on the other hand receives more than $200 per capita but has an annual volume of only $23 million. In other Caribbean countries, such as St. Lucia, Trinidad and Tobago and St. Vincent and the Grenadines, remittances are nearly irrelevant to GDP, and annual flows are quite low.

Mexico receives by far the highest volume of remittances per year, but remittances represent only 3 percent of GDP. See Figure. 2.2 below. Given that the dollar amount of the average remittance transfer is higher than in other countries, the average transaction fee is relatively low: about 5 percent of a transaction of $400. The average transfer is nearly twice the per capita amount and is high compared to other countries in the region.



Source: Orozco 2006b.

South America provides a broad range of cases on the influence of remittances on the economy. For example, remittances to Guyana represent nearly 37 percent of GDP – the highest percentage in Latin America – but amount to only $270 million, which is low compared to other South American countries, such as Argentina, which receives the same volume of remittances, but they represent only 0.2 percent of GDP. Remittance transfers per capita range from $360 in Guyana to only $1 in Chile. The average transfer per capita for South America is $91. As in other regions, costs of sending money are usually lower for those countries with higher remittance volumes. Brazil has the highest average transfer at $541. An average transfer in South America amounts to $245.

In comparing annual volumes among the sub-regions, we see that the average flows for Central America and South America are very similar at $1.3 billion and $1.4 billion respectively. The total flow for the Caribbean is $6.4 billion with an average flow of $581 million. For Central and South America, the total volumes add up to $9.1 billion and $16.4 billion respectively. None of these flows reach the annual volume of remittances sent to Mexico at $20 billion.

Table 2.1: Remittances and Key Economic Indicators

	Remittance transfers …				
Country	**and GDP**	**Per capita ($)**	**Cost**	**Average Annual Transfer ($)**	**Annual Volume ($)**
Mexico*	2.98 %	187.18	6.0 %	4212	20,034,000,000
Brazil*	1.09 %	30.85	8.13 %	6492	5,750,000,000
Colombia*	4.84 %	90.48	5.0 %	2640	4,126,000,000
Guatemala*	11.42 %	237.54	5.6 %	4356	2,992,770,000
El Salvador*	18.28 %	411.31	5.2 %	4068	2,830,200,000
Dominican Republic*	13.35 %	271.03	6.4 %	2112	2,410,800,000
Ecuador*	6.01 %	136.07	3.9 %	3516	1,800,000,000
Jamaica*	18.33 %	622.78	8.2 %	2508	1,651,000,000
Peru*	3.71 %	89.21	4.6 %	2028	2,495,000,000
Honduras*	23.09 %	244.72	5.8 %	2700	1,762,980,000
Haiti*	34.53 %	115.50	6.7 %	1476	985,000,000
Nicaragua*	19.05 %	154.91	5.2 %	1596	850,000,000
Paraguay*	8.52 %	89.31	9.11 %	3156	550,000,000
Bolivia*	10.17 %	93.66	5.6 %	2820	860,000,000
Costa Rica*	2.11 %	92.44	9.46 %	3612	400,000,000
Argentina**	0.2 %	7	9.02 %	2544	270,000,000
Panama*	1.36 %	61.90	10.50 %	2352	200,000,000
Guyana*	36.89 %	359.52	10.14 %	2148	270,000,000
Barbados	4.3 %	418	11.66 %	2640	113,000,000
Trinidad and Tobago*	0.77 %	70.75	10.41 %	2400	92,400,000
Uruguay**	0.3 %	71	11.28 %	2376	93,000,000
Belize*	3.77 %	148.70	8.78 %	2640	40,150,000
Suriname*	4.20 %	122.49	10.17 %	2640	55,000,000
Grenada**	5.2 %	220		2640	23,000,000
Venezuela, RB*	0.11 %	4.64	17.10 %	1656	124,000,000
Chile**	0.0 %	1	8.90 %	3348	13,000,000
Antigua and Barbuda**	1.5 %	140		2640	11,000,000
Dominica**	1.5 %	56		2640	4,000,000
St. Kitts and Nevis**	1.2 %	86		2640	4,000,000
St. Lucia**	0.6 %	25		2640	4,000,000
St. Vincent and the Grenadines**	0.8 %	27		2640	3,000,000

*Source: Central Banks of each country, World Bank Development Indicators, data collected by the author. Note: * 2005; ** 2003.*

Table 2.2, p. 16, breaks these indicators down even more so that other regional trends become apparent at the level of senders and recipients. We see that in all countries the percentage of female recipients is high, but in Central America it averages nearly 75 percent. However, there are a relatively low number of female senders, 39 percent in

Central America. This is significant because it suggests that women are the primary decision-makers in the majority of recipient households in Central America, which may affect the way in which remittance money is spent. About half of Central American recipients spend money on health and education. We also see that there is a far higher percentage of recipients with bank accounts than non-recipients, with the exception of Nicaragua. These numbers indicate that banks need to do more to entice both recipients and non-recipients to join the formal financial sector. Another indicator of migrant and recipient financial awareness is the percentage that makes investments. We see that throughout Latin America and the Caribbean a low percentage of senders invest. The exception is Haiti with 25.5 percent of senders investing their money. Although the numbers of Central American recipients and senders investing are both quite low, Honduras is unique because the percentages of senders and recipients that invest are equal.

In the Caribbean, the number of female recipients is also quite high. The Dominican Republic has 20 percent more female recipients than Haiti, while Jamaica has the highest number of female senders at 49 percent. A higher percentage of Haitians invest in health and education – over 86 percent. The percentage of recipients and non-recipients with bank accounts in the Caribbean is not so disparate. In addition, this percentage is relatively high, in the 60 to 70 percent range for the Dominican Republic, Haiti, and Jamaica. In the cases of the Dominican Republic and Jamaica, the percentage of senders with investments is quite low.

In looking at the South American countries, we see more variation in the percentage of female recipients with Peru at the low end at 46 percent, and Ecuador at the high end with 74 percent. There are also significant variations in the percentage of females sending remittances to South American countries. Bolivia has 71 percent female senders while Ecuador has only 26 percent. In fact, Bolivia is the only country that has a higher percentage of female senders than female recipients. The percentage of recipients who spend money on education and health also varies greatly among South American countries. In Bolivia, Colombia, Ecuador, and Peru, we also see less of a spread between the percentage of recipients and non-recipients with bank accounts. On the other hand, Colombia, Ecuador, and Guyana have a high percentage of recipients with investments and quite low percentages of senders with investments. Ecuador is an interesting case, with only 1 percent of senders investing and nearly 30 percent of recipients investing. This is the highest percentage of recipient investors in the countries indicated.

In Mexico, the percentage of female recipients is fairly high at 63 percent, especially compared with the percentage of female senders at 17 percent. Mexican banks also need to focus on bringing both recipients and non-recipients into the banking community. We also see in Mexico that over 45 percent of remittance money goes to rural areas, where poverty levels are the greatest.

Table 2.2: Remittances and Other Indicators

	Rural areas	Female Recipients (%)	Female Senders (%)	Recipients who spend in Health and Education (%)	Recipients with Bank Accounts (%)	Non-Recipients With Bank Accounts (%)	Senders With Investment (%)	Recipients with Investment (%)
Bolivia		52	71		44	35	4	
Colombia		68	54	84.14	52	45	5	14.5
D.Republic	40	73	45	38.89	66	58	3	21.1
Ecuador	57	74	28	48.01	46	34	1	29.8
ElSalvador	39.5	72	46	50	31	19	3	10.6
Guatemala		80	29	59.41	41	17	2	5.1
Guyana	40	71	48	22.8	62		8	11.7
Haiti	54	53	32	86.4	68.4		25.5	17.7
Honduras		75	37		34	16	4	4
Jamaica		65	49		65	60	2	
Mexico	45.7	63	17		29	28	2	
Nicaragua	45	72	44	53.92	10	10	3	27
Peru		46			37	35		

Source: Data compiled by Manuel Orozco from multiple surveys.

This data on a regional level clearly indicates that across the board more attention needs to be paid to the special situation of women recipients and senders. The percentage of female recipients has social implications for families and communities. Women are raising children without male support and are typically more economically vulnerable. Thirty percent of female recipients in Latin America and the Caribbean are homemakers without a source of independent income. This sort of social structure also affects the local economy, and it is therefore essential to educate and empower these female heads of household who are making family and financial decisions.

A look at these flows and their manifestations in the Latin American and Caribbean region shows the presence of three distinct groups as they relate to the impact these funds have in each country (See Table 2.3, p. 17). The first group is represented by those countries whose remittance flows have a strong effect in most if not all the indicators mentioned above. This means that remittances have an important impact both on the country's national and per capita income, as well as on household income, with recipients receiving at least twice the average per capita income. They also have a strong social impact as reflected in the high percentage of female remittance recipients. In the second group the effect of remittances is felt in half of these indicators. In the third group remittances have a minimal impact as reflected by the indicators. This distribution is especially interesting because it not only considers the macroeconomic and microeconomic effects of remittances, but it also includes the social effects caused by migration and remittances, namely the effects of gender.

Table 2.3: Impact of Remittances on Latin American and Caribbean Economies

Impact of Remittances		
Strong	**Medium**	**Low**
Guatemala	Paraguay	Dominica
Ecuador	Colombia	Panama
Nicaragua	Peru	Antigua and Barbuda
El Salvador	Dominican Republic	St. Vincent and the Grenadines
Haiti	Brazil	Chile
Honduras	Suriname	Trinidad and Tobago
Bolivia	Costa Rica	Argentina
Guyana	Belize	St. Kitts and Nevis
Jamaica	Grenada	Uruguay
Mexico	Barbados	St. Lucia
		Venezuela, RB

Note: Ratio of remittances: 1: < .66; 2:0.67-1.5; 3: > 1.51; Remittances as percent of GDP:1: < 1 percent; 2: 1 to 4 percent; 3:>4 percent; Remittances per capita: 1<36; 2: 37-100; 3: >100; Remittances cost: 1: > 7.5; 2: 7.6-9.5; 3: <9.5; percent Female Recipients: 1:<50 percent; 2: 50-75 percent; 3:>75 percent.
Source: Orozco 2006e.

As we have seen, money sent from migrants abroad has strong effects in all parts of Latin America and the Caribbean. Remittances play a unique role within each sub-region and indeed within each country. The indicators we have used to analyze remittances and their impacts have interesting implications for policy and development. These implications will be explored in the next section.

SECTION III: THE IMPACT OF REMITTANCES ON ECONOMIES

As the previous section suggested, remittance flows can have a significant impact on Latin American and Caribbean economies. In particular, the sheer volume of these flows has made them an important source of foreign savings that help sustain foreign currency reserves. In many Caribbean and Central American countries, remittances are the most important source of national income and exhibit far more stability than other private or public capital flows. This creates discernible effects on people and on economies.

These flows, not unlike aid, trade, technology transfer or investment, also have varying macroeconomic impacts. In general terms, foreign savings may affect three variables: 1) growth (by decreasing or increasing output), 2) financial trends (by increasing or decreasing financial resources), and 3) domestic currency and pricing (by appreciating or depreciating national currency and consumer prices). Macroeconomically, as a unilateral transfer, the volume of remittances can influence or be influenced by economic growth, foreign exchange reserves, or other macro determinants such as inflation or interest rates. Remittances can also exhibit a multiplier effect at the macroeconomic level as their flows interact with the productive base of the local economy.

The adoption of appropriate theoretical assumptions and methodologies informing the relationship between remittances and their macroeconomic impact is critical to the analysis of the macroeconomic effects of remittances. Unfortunately, economic theory does not offer a specific analytical framework for remittances. There is a small but growing amount of literature on remittances and their intersection with an economy. This literature is based on macroeconomic analyses of aggregate data and, in general, agrees that remittances have positive impacts on growth, finances, or foreign exchange. However, some studies also warn of possible adverse effects related to productivity. This section offers an analytical review of the literature as well as an empirical analysis of the intersection between remittances and macroeconomic trends. It also offers some recommendations on how USAID economic growth programs can approach operations on remittances.

Remittances and Economic Growth

A few studies in the remittance literature have looked at remittances as one macroeconomic determinant. These studies have argued that remittances as a source of national income have a positive effect on economic growth, and generally analyze remittances as a factor influencing the national income.

One of the first studies on this relationship was conducted by Solimano.[2] He looked at remittances in the Andean region and their effect on growth. Using remittances as an independent variable among other factors, such as exports and government expenditure, Solimano found that they have a positive effect on GDP growth in Colombia and Ecuador.

[2] Solimano 2003.

A more recent World Bank report analyzing the effect of remittances on growth in Latin America and the Caribbean found that an increase in remittances from 0.7 percent of GDP in 1991-1995 to 2.3 percent of GDP in 2001-2005 resulted in an increase of 0.27 percent in per capita GDP growth per year.[3]

Loser et al find that the overall outcome of analyzing the macroeconomic effects of remittances is a complex one. In looking at the intersection between production factors and macroeconomic indicators, they find mixed results. As remittances increase, exchange rates and interest rates appreciate. But at the level of the balance of payments, export growth may decrease while import growth increases with higher flows, which may reverse the effects of remittances on exchange rate and interest rates.[4] Overall, they also show the countercyclical nature of remittances, with remittances increasing during economic downturns.

Analyzing the impact of remittances on growth can offer incentives to governments to consider the role of remittances in their economic policies. In many Central American and Caribbean countries where the size of remittances is substantially large, representing at least 10 percent of the country's GDP, it is particularly important to assess their impact on growth in comparison to other factors believed to be more relevant. Some authors have argued, for example, that maquila exports, remittances, non-traditional exports and tourism are the key drivers of economic growth.[5] As Table 3.1 below suggests, these factors, or sectors are significant in Central American and the Dominican economies.

Table 3.1: Central America in the Global Economy, 2005, in Million $

Sector	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica	D.R.
Remittances	2,992.8	2,830.2	1,763	850	362.0	2,410.8
Merchandise Exports (not including maquiladora)	5,028.6	1381.47	875.0	857.9	2,954.0	1,397.9
Maquiladora	352.4	1,920.7	886.4	682.1	4,072.3	4,734.6
Official Development Assistance*	218.4	211.5	641.7	1,232.4	13.5	86.9
Income from Tourism	868.9	542.9	472.2	207.1	1,598.9	3,519.7
GDP	27,400.0	17,244.0	8,000.0	5,000.0	20,014.5	29,333.2
R+X+A+T/GDP	35 %	40 %	58 %	72 %	45 %	41 %

Note: * 2005.
Source: Central Bank of each country.

Following this literature on macroeconomic issues of remittances we test the impact of each sector on growth in three countries – the Dominican Republic, El Salvador, and Jamaica. Unlike most analyses, we do not use several countries' pooled annual data to

[3] Fajnzylber and Lopez 2006.
[4] Loser et al and Lockwood with Minson 2006.
[5] Robinson 2003.

compensate for the number of observations. Instead we use quarterly data for six consecutive years to analyze fluctuations across time in each country, thus controlling for country specific trends and quarterly variations, rather than allowing statistics to work on aggregate mean values (See Annex C, Exhibit A for details of model specification and statistical results).

Our first finding is that the impact of these factors on growth is not even. Even for a strong sector such as maquila in El Salvador, the relationship is negative and not statistically significant. When looking at the effects of remittances on growth, the results also vary across these three countries. Despite the fact that these countries have similar economies and relatively similar remittance to income ratios, the effects of remittances on growth are different. In El Salvador, an increase in remittances has a positive effect on economic growth, whereas in the Dominican Republic there is no statistical significance, and in Jamaica the effect is negative. The findings in the Dominican Republic case may be associated with the country's financial crisis in 2003, which distorted all economic indicators. Jamaica's economy on the other hand may suffer from the effects of an enclave economy that depends on rent seeking resources such as tourism and mining activities.

In summary, using aggregated annual data, most studies show that remittances do have a positive impact on a country's economy. However, when quarterly data is analyzed for countries individually, the results vary in relationship to the local dynamics of the economy in each particular setting and may not necessarily indicate concrete and discernible patterns.

Remittances and Capital

Another strand in the literature analyzes the impact of remittances on specific production factors, rather than on the aggregate income equation. Specifically, economic analyses are conducted on the relationship between remittances and capital inflows. The World Bank study, for example, tested investment and aggregate volatility as other factors affected by remittances. The authors found that remittances are associated with increased rates of domestic investment and a reduction in growth volatility, both directly and by diminishing the impact of external and macroeconomic policy shocks on the economy. What is more, the authors find that about one half of the impact of remittances on growth takes place through increased rates of domestic investment.

In a similar trend of analysis, Buch and Kuckulenz[6] show a positive correlation between remittances and official capital inflows and between official capital inflows and private capital. This means that an increase in remittances supports an increase in official capital flows, making capital more accessible in the country. They also find that remittances, for

[6] Buch and Kuckulenz 2004. The authors employ a model that incorporates remittances into the macroeconomic flows of a country. Their equations integrate remittances into income as well as adding savings from remittances and subtracting remittance-related imports. In terms of expenditure, remittance-related consumption is included. The authors run cross-section regressions that use macroeconomic factors as explanatory variables; dependent variables are workers' remittances and private capital flows, both in logs and relative to GDP. Specifically, they resort to panel data to run regressions using remittances over GDP and remittances per capita as dependent variables.

the most part, behave differently than private and official capital flows over time and represent a more stable inflow of money.

Other analyses highlight the macroeconomic impact remittances have through increases in deposits, with the caveat that such impact is more pronounced in less developed financial systems. For example, using balance of payments data on remittance flows to 99 countries over a 28-year period, Aggarwal et al, find that remittances have a positive and significant impact on both bank deposits and bank credit to the private sector. [7] Similarly Giuliano and Ruiz-Arranz's study using a cross-country data series for 73 countries between 1975 and 2002 shows that, "By relaxing liquidity constraints, remittances have compensated for the lack (or the inefficiency) of the financial system and have helped to channel resources toward productive investments." [8] Therefore, remittances function in lieu of other financial services, such as credit and insurance, to promote growth.

In more developed financial systems, growth from remittances is less important. In fact, Giuliano and Ruiz-Arranz show that in countries with well developed financial sectors, the impact of remittances eventually turns negative. In these environments, demand for financial investments is met through other means such as credit and insurance, and therefore, remittances are used on activities that do not foster growth.

Remittances and Foreign Exchange

Another strand in the literature on the macroeconomic impact of remittances deals with the relationship between remittances and foreign exchange. One of the original studies on this issue was done by El-Sakka who looked at the case of Egypt and the effect of remittances on parallel exchange rates.[9] More recently studies have also analyzed the relationship between these flows and foreign exchange rates within the context of what is known as the Dutch Disease, defined as currency appreciation resulting from increased inflows, which makes the manufacturing sector less competitive, and can even result in job losses.

According to the World Bank's report on Latin America, workers' remittances can be viewed as a capital inflow that can produce the Dutch Disease. Remittances have a positive impact on the incomes of receiving households and therefore tend to positively impact consumption. As a result, remittances may drive up the price of non-tradable goods relative to that of tradables, leading to exchange rate appreciation. In turn, there are some additional macroeconomic effects that can result from a real exchange rate appreciation associated with remittance flows:

- Possible negative impact on the tradable sector of the economy, including the loss of international competitiveness, especially if remittances also fuel inflation, or if the higher prices result in economy-wide increases in wages

[7] Aggarwal et al 2006.
[8] Giuliano and Ruiz-Arranz's 2005. They employ a system generalized method of moments (SGMM) approach that takes controls for the endogeneity of remittances and financial development.
[9] El-Sakka 1999.

- Widening of current account deficit, resulting from an increase in demand for imports added to the loss of international competitiveness of domestic firms
- Weaker monetary control, inflation, and sectoral allocation of investment, particularly in real estate
- Upward pressure on wages may result in job losses in the tradable sector, while in the nontradable sector the increased cost of labor is passed on to consumers through increased prices.

This World Bank report finds that, at least in Latin America remittances are likely to contribute to significant real exchange rate appreciation. The authors argue that in part these problems are part of a natural adjustment process that accompanies any favorable shocks and should not be of particular concern to policymakers. However, they conclude that it may be possible to reduce the appreciations through policies, such as fiscal restraint. [10] Loser et al argue that the countercyclical trend of remittances produces mixed macroeconomic results, which, on balance, do not cause severe distortions in the economy.[11] The World Bank report also considers the impact of remittances on labor force participation, finding mixed results.[12] More research is needed on this topic to better understanding these results.

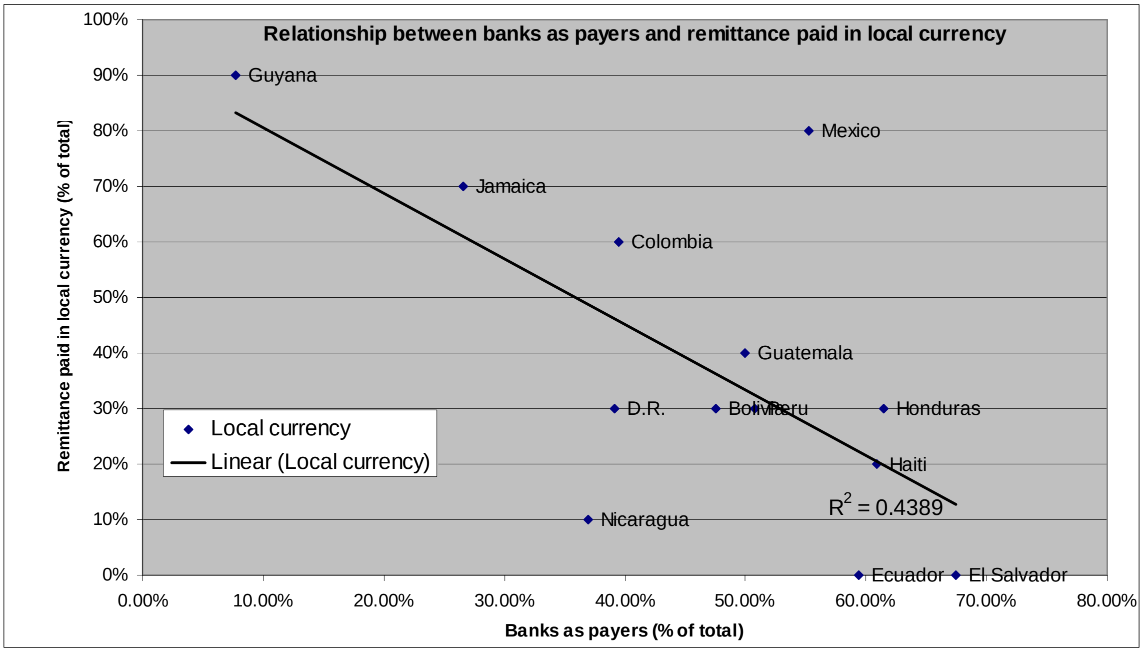
These analyses provide initial cues as to the relationship between remittances and macroeconomic trends. They also pose possible questions as to their explanatory power. For example, can one generalize about exchange rate appreciation by using aggregate annual data? Can this literature and its corresponding analyses control for other factors such as internal handling of foreign currency by banks, or investment in nontradables? Might remittances be responding to rather than effecting fluctuations in inflation or foreign exchange?

First, annual exchange rate variations differ substantially from monthly variations, which are a more realistic reflection of local economic performance. Running a statistical analysis of monthly trends will show different exchange trends that may not be related directly to remittances flows. The charts in Annex C, Exhibit B show the monthly trends among flows of exchange rate fluctuations, which are different from annual trends.

Second, another question is whether these models can explain the internal dynamics underlying the remittance industry in recipient country economies. For example, foreign currency appreciation is related to the extent to which the inflow of money, in this case from remittances, is directly paid in local or foreign currency: Appreciation is more likely to occur when remittances are directly paid in dollars. When they are paid in dollars, the problem is not one simply of remittance inflow but of dollarization. Research on how remittances are paid suggests that banks are more likely to pay in foreign currency, thus increasing the supply of foreign currency in the streets, and putting upward pressure on the exchange rate.

[10] Fajnzylber and Lopez 2006. The authors examine the Dutch Disease phenomenon using a large cross-annual national data set rather than limiting the number of countries, allowing them to test for regional differences.
[11] Loser et al 2006.
[12] Op cit.

Figure 3.1 Relationship Between Banks as Payers and Remittance Paid in Local Currency



Source: Orozco, Manuel. Data compiled by the author.

Third, the changing characteristics of the productive bases of local economies also appear to contribute to substantial variations in local currency appreciation, inflation and effects on non-tradable goods. In local economies where migration has occurred, new forms of economic activity have been adopted that are oriented more toward the services industry than agriculture and manufacturing. Two examples illustrating this reality are real estate investment by the domestic banking industry and foreign realtors. Many Latin American countries have experienced a substantial increase in construction and sales of real estate as the financial sector seeks to invest in non-tradables due to the low profitability of agriculture and manufacturing. Moreover, in Mexico, Central America and the Caribbean, U.S. realtors have invested heavily in property as baby boomers look for retirement places where their dollar will last longer than in the United States. As a result of both trends, the value of property has risen appreciating the local currency.

Finally, could remittances actually be responding to inflation and foreign exchange rates rather than influencing these factors? An analysis of the macroeconomic determinants of remittances by Orozco and Lowell shows that remittances do, in fact, respond to changes in foreign exchange rates or inflationary pressures. [13] Their analysis looked at Mexico, Colombia, the Dominican Republic, El Salvador, Guatemala, Ecuador and Jamaica. All of these nations have been affected by the 2001 recession and drop in tourism after the

[13] Orozco and Lowell 2005, use panel regressions on monthly flows of remittances for six countries from 1999 to 2004 with the log of remittances as the dependent variable, and inflation, interest rates, exchange rates and unemployment in the United States as the independent variables. They found that remittances respond predominantly to price changes. For the present study, the analysis is expanded to monthly trends from 1999 to 2006.

terrorist acts of 9/11 that hit the United States. Mexico has been impacted by unfavorable changes in U.S. demand for imports. The Dominican Republic was hurt by a severe economic recession associated with a decline in tourist revenue but, more importantly, a banking crisis that bankrupted several institutions and affected foreign exchange, savings, and access to capital. Moreover, Latinos in the United States have been severely affected by the recession that started in 2001, increasing their unemployment rates and decreasing their earnings.[14] The periods prior to and after the crises serve as a test to explore whether variations in exchange rate, inflation, or interest rates may affect the decision to send remittances. The analysis employs a multiple regression of pooled cross-sectional and monthly[15] time-series data for those nations for which data is readily available (see Annex C, Exhibit C for model and regression results).

The results show that remittances are sensitive to inflation and/or foreign exchange fluctuations in countries of origin. An increase in inflation or foreign exchange can lead to an increase in remittance flows. This finding is particularly important as it refers to the countercyclical nature of remittances: Although remittances did not have a strong impact on growth during the period of the financial crisis in the Dominican Republic, migrants continued to send money and their flow was statistically significant to changes in prices as well as in foreign exchange. As the economy worsened, Dominicans sent more money.

In summary, analysis of the relationship between remittances and foreign exchange reveals the complexity of that relationship. It raises more questions that require further analysis of their interaction with other production factors and the position of recipient economies in the global economy.

Remittances and Poverty Reduction

In addition to contributing to economic growth, studies have shown that remittances tend to reduce poverty. Richard Adams' pivotal work on remittances and poverty reduction analyzed remittance and poverty trends worldwide and found a statistical relationship between these two variables. His analysis showed that a 10 percent increase in international remittances from each individual will lead to a 3.5 percent decline in the share of people living in poverty. He also conducted a household survey data analysis of income and remittances to Guatemala and found that remittances also reduced poverty in that country. His findings in Guatemala show that international remittances reduce the level of poverty by 1.6 percent and the depth of poverty by 12.6 percent.[16]

Moreover, in his 2006 study on the effect of remittances on distribution of wealth in Ecuador, Mauricio Orbe found that the Gini coefficient dropped from 0.54 to 0.52 as a result of incorporating remittances into the income equation, indicating that remittances reduce income inequality. In general remittances make recipients wealthier across all income groups.[17]

[14] Kockar 2005.
[15] Except for Colombia and Ecuador, which only reported quarterly data.
[16] Adams 2004.
[17] Orbe 2006.

While there is general consensus that remittances reduce poverty, these studies differ in terms of the extent of the impact that they find. These differences are attributable to the type of poverty reduction measures employed by analysts.

Conclusions and Recommendations

Both the literature and existing data suggest that overall remittances have a positive impact on macroeconomic trends. However, there are variations across countries that point to significantly different effects, as well as methodological considerations on data measurement and analysis that pose the need for more refined statistics and economic analysis.

The findings in this section suggest an ongoing need for research on remittances, as well as a need to help countries maximize the productive use of remittances in local economies. In the first case, USAID should consider providing support to Central Banks to improve data measurement and explore analytical devices to improve accuracy in the analysis of the impact of remittances. Specifically, Central Bank and Finance and Economic ministry offices need to understand the interplay between remittances and the local economies not only in terms of the causes of these flows, but also in terms of the absorption of these savings and methods of maximizing their impact. This initiative would include collaborating in the design of economic policies associated with remittances, such as exploring mechanisms to provide incentives to recipients and financial institutions to increase savings and investment ratios of the household and financial institutions.

In the second case, USAID should consider interventions to help link productivity in the local economy to remittance spending and investment. Of particular importance is the provision of technical assistance to identify productive sectors that can leverage the inflow of funds from migrants, including nostalgic commodities, or increasing foodstuff production at greater competitive levels, thus increasing employment in tradable sectors.

SECTION IV: REMITTANCES AND FINANCIAL INCLUSION

As noted in Section II, remittances are a significant, even primary, source of income for millions of low-income households worldwide. The majority of remittances are spent on basic needs, such as food and clothing, health and education. Because these income flows are primarily used for non-productive purposes, some observers question the extent of the development impact of remittances. It is important to recognize, however, first, that without these resources many families would not be able to cover their basic needs. Second, expenditures on health and education in particular lay the foundations for asset accumulation and wealth generation. Moreover, remittances can be an important source of household savings and investment.

In Central America on average 10 percent of remittances are saved or invested.[18] And in Mexico, remittances finance 20 percent of investment in urban microenterprises.[19] Even investments that are considered non-productive, such as investments in property and livestock financed by remittances, can create income generating opportunities directly, or by using the purchased asset as collateral, they can indirectly create these opportunities by facilitating access to credit. In addition, as described in Box 3 (p. 37), recent market research indicates that the longer a family member resides abroad, the higher the percentage of remittances used for productive investments.

Research also indicates that access to finance, on the sending and receiving ends, increases remittance flows, savings, and investment. On the sending end, evidence suggests that when an immigrant has a bank account in the host country, it increases the amount remitted by 9 percent. Moreover, individuals who save in their home country remit nearly 25 percent more dollars, and are 3.3 times more likely to send money to support a business back home.[20]

On the receiving end, remittance recipients are more likely to have bank accounts than non-recipients. In addition, among recipients, those who receive remittances and have a bank account receive 27 percent more[21] and save more than those that do not have accounts. For example, a study of Guatemalan credit union members and non-members that use the institutions' money transfer services found that a much higher percentage of members saved part of their remittances than did non-members.[22] However, despite this clear relationship between remittances, access to finance, and savings and investment, remittance recipients, like low-income populations in developing countries in general, tend to lack access to financial services, which limits their ability to leverage these transfers. In fact, while in most of Latin America and the Caribbean the majority of payers are banks, in general financial intermediation remains low.

In addition, high transaction costs at both the sending and receiving ends of the market reduce the resources available to low-income households for consumption, savings, and

[18] Hastings 2006, p. 9.
[19] Woodruff 2001, p. 1.
[20] Orozco 2006e, p. 5.
[21] Orozco and Lowell 2005 p. 63.
[22] Mesbah-Khavari et al, p. 20.

investment. Donors, such as USAID and the Inter-American Development Bank (IDB), have worked to reduce these costs and increase recipients' access to a broad range of financial services by financing research on the volume, costs, and uses of remittances and working with microfinance institutions (MFIs) to facilitate their entry into the market. Partly as a result of this work, costs have dropped significantly in recent years through increased competition as traditional commercial banks and MFIs[23] have entered the market.

In the remainder of this section we explore further what has been learned to date about remittances and financial intermediation. We also consider what, if any role remains for donors in strengthening financial institutions to facilitate the capture of additional remittance flows in the formal financial system and increase cross-selling. Finally, we look at the potential for financial institutions to leverage remittances to access financing for onlending through securitization of remittance flows. As we shall see, much remains to be done on both the sending and receiving ends to maximize the development impact of remittances.

Microfinance Institutions and Remittances

Donors, including USAID, have shown considerable interest in encouraging a link between remittances and microfinance. This interest is based on the supposition that MFIs are particularly well positioned to provide lower-cost money transfers services to low-income populations and bank the unbanked than are other financial institutions, due to their proximity to remittance receiving households, mission, and successful experience serving low-income populations in general. At the same time, offering transfer services creates opportunities for MFIs to attract new clients, cross-sell their other financial services, and mobilize savings for onlending. Below we first consider the performance of MFIs to date in providing money transfers, whether they can, in fact provide lower-cost services, and their success in cross-selling. We then consider the challenges these institutions face in entering the remittance market.

A number of MFIs do appear to be successfully offering money transfer services using diverse models. For example, USAID is working with MFIs in countries such as Ecuador, Bolivia, Guatemala, and Mexico, with positive results. In these countries, USAID is collaborating with the World Council of Credit Unions (WOCCU) to introduce or strengthen money transfer services in credit unions. Following WOCCU's model, participating credit unions receive significant institutional strengthening support over several years, including assistance in setting up shared branching networks prior to introducing money transfers through WOCCU's remittance platform, IR*net.* As often small, individual credit unions, these MFIs might not be able to achieve the volume necessary to compete in the money transfer market and might have more difficulty negotiating favorable partnerships with a money transfer company (MTC), though a few small MFIs are successfully operating independently. Working collectively, they are

[23] For the purposes of this paper, MFIs include banks, cooperatives, credit unions, non-governmental organizations, and other non-bank financial institutions (NBFIs) that provide financial services to low-income, marginalized populations.

achieving significant volume, and demonstrating that providing remittance services in fact can be an effective way to attract new clients.

USAID began working with the Guatemalan credit unions on money transfers in 2001. By the end of 2004 the 25 participating credit unions had captured 6.7 percent of the remittance market and had distributed approximately $179 million in remittances. In Mexico, Caja Popular Mexicana (CPM), the largest credit union in the country, began offering money transfers through IR*net* in August 2003. Two years later the credit union was processing 20,000 transfers per month worth $6.2 million.[24] And in Ecuador between April 2005 and September 2006, 15 participating credit unions handled 27,000 transfers for a total value of $9.4 million.

Impressive transfer volumes are also being achieved with national transfer systems. The experience of USAID/Bolivia in supporting the development of one such system is described in Box 1. According to the Consultative Group to Assist the Poor (CGAP), domestic transfers represent a promising and an important market for donors and financial institutions interested in serving poorer populations. "Evidence indicates that poorer and more rural migrants tend to move to destinations closer to home—often urban centers within the same country." While they "…earn and remit less than do wealthier international migrants…the amounts of domestic transactions thus tend to be smaller than international transfers, but these transfers are more numerous and flow to many more households." Moreover, efficient domestic transfer services are needed to ensure that international remittances are delivered. Despite their volume and importance to poor households, and relationship to international transfers, to date donors have focused primarily on international remittances.[25]

BANSEFI's *Red de la Gente*, is another model for working collectively with non-bank financial institutions (NBFIs) on money transfers. BANSEFI, the National Savings and Financial Services Bank in Mexico, is a quasi-governmental institution that provides savings services to low-income populations and supports the development of the popular finance sector through second tier activities. To increase the availability of convenient remittance services through the popular finance sector, BANSEFI developed a national remittance platform available to interested NBFIs. In a period of approximately two years,

Box 1: Domestic Money Transfers: An Overlooked Market

In addition to working with credit unions, the USAID/Bolivia mission is working with an MFI to develop a national transfer system. In Bolivia, internal migration from rural to urban areas is greater than international migration. To address the need for secure, rapid domestic transfer, the Foundation for Alternatives in Development (FADES) developed its own software to manage transfers, but needed USAID assistance to implement the business plan. The national transfer system is allowing the MFI to reach very remote rural areas with transfers and bill payment services. In 2005 FADES processed 16,175 transfers worth nearly $2.9 million.

Source: USAID/Bolivia interview, October 2006

[24] Information provided by the USAID/Mexico mission, October 2006
[25] CGAP 2005, pp. 4-5.

BANSEFI, with support from the Inter-American Development Bank (IDB), established a network of 1,200 distribution centers collectively handling 100,000 transfers per month.[26]

As suggested by the examples above, USAID's current work with MFIs on money transfers has focused primarily on deposit-taking institutions. According to Geoffrey Chalmers, Development Finance Advisor for USAID/Mexico, introducing money transfers is not a priority per se, but should be considered on a case-by-case basis as one of many value added products that an institution can provide. In this context, in its remittance work, the mission focuses on deposit-taking institutions because they offer greater opportunities to bank the unbanked through cross-selling financial products than do credit only MFIs.[27] In contrast to USAID's and WOCCU's recent work with deposit-taking MFIs and money transfers, MFIC, a U.S.-based for-profit company that provides loans and remittance services to Latin American MFIs, works primarily with institutions that have yet to capture savings.

According to Kai Schmitz, Executive Vice President and Chief Operations Officer of MFIC, while deposit-taking institutions can offer more services to clients, helping credit only MFIs become agent distributors of remittances can assist these institutions in growing to the size necessary to become deposit-taking MFIs. While MFIC provides these MFIs with basic technical assistance and training to install and operate its remittance platform, ARIAS,[28] it does find it necessary at time to partner with technical assistance providers to provide the broader institutional strengthening support its partner institutions sometimes need to successfully manage remittances.[29]

In addition to considering the benefits to the MFI industry of working with credit only institutions, in considering whether to work with these institutions, donors should keep in mind that while they do not offer savings services directly, many promote savings among low-income groups through alliances with deposit-taking institutions. In addition, they may be the only financial institution serving the target population. We turn now to a discussion of whether MFIs can offer lower-cost transfers, as a means to compete with other transfer providers and increase the development impact of these income flows.

MFIs and Transaction Costs. Recent work by Orozco and Hamilton indicates that MFIs, in fact, often do provide lower cost transfers than do traditional money transfer companies. Analyzing the performance of 27 MFIs and two associations of credit unions they found that 65 percent charged remittance recipients rates that were below the average market rate. Another 12 percent charged fees equal to the average rate. While this is an encouraging finding on its own, the full cost of collecting remittances includes the time and money spent traveling to and from the remittance distribution point. And in many rural markets in particular the proximity of MFIs to remittance receiving households also reduces these transaction costs.

[26] MigrantRemittances, August 2006, p. 2.
[27] Interview with Geoffrey Chalmers, USAID/Mexico, October 2006.
[28] ARIAS is an online system designed by the company around a major banking application, which allows institutions to provide money transfers with standard personal computers and Internet access.
[29] Interview with Kai Schmidtz, MFIC, November 2006.

Cross-Selling. These examples demonstrate the ability of at least some MFIs to achieve a significant volume of money transfers and/or provide lower cost money transfer services. Cross-selling other financial products to remittance clients has proven more difficult, though there are some encouraging results. In Mexico, 25-30 percent of Caja Popular Mexicana's remittance clients become clients of other credit union services. However, initially only 5-6 percent joined the credit union. To increase the conversion rate, CPM had to invest in training cashiers and branch managers in marketing the benefits of membership.[30]

Based on available data, it would seem that few MFIs have achieved higher than a 30 percent conversion rates to date, and most are considerably lower. Banco Solidario, a successful Ecuadorian MFI is one of the exceptions, with 80 percent of its remittance clients opening accounts with the bank. Banco Solidario's success may be attributed, at least in part, to two related factors. First, the MFI has transnationalized its clientele, targeting both senders and receivers with diverse financial products. Second, the MFI has developed remittance linked products.

Banco Solidario provides money transfer services through alliances with multiple Spanish banks. The institution also offers a package of savings, credit, and insurance products through a special account called "My Family, My Country, My Return" to address the diverse financial needs of immigrants and their families.[31] For example, among its many products, the institution offers immigrants a split disbursement product that allows senders to program a given amount or percentage of their remittance for deposit to a savings account.[32] Banco Solidario's experience, as well as that of other MFIs, demonstrates that demand for financial services exists not only among remittance recipients, but among remittance senders. Moreover, there is a development benefit to be had from targeting both senders and receivers. As noted above, according to a recent IDB sponsored study by Sergio Bendixen and Manuel Orozco of U.S.-based senders from seven Latin American and Caribbean countries, immigrants with savings accounts in their home country send more than those that do not. And they are more likely to send money to support a business in their home country.[33]

Challenges to and Lessons Learned from MFI Participation in the Money Transfer Industry. While there is evidence that MFIs can provide low-cost money transfers and are using these services to bank the unbanked, the number of MFIs that have successfully entered the market to date, particularly on a significant scale, is relatively limited. According to estimates, fewer than 100 MFIs are involved in the money transfer industry.[34] In entering the market, MFIs face a series of challenges related to institutional capacity. In addition, the legal and regulatory environment can pose barriers. As a review of these challenges suggests, there is an ongoing role for donors, such as USAID to play in facilitating MFI entry to the money transfer market.

[30] Interview with Geoffrey Chalmers, USAID/Mexico, October 2006.
[31] Orozco and Hamilton 2006, p. 18.
[32] Hastings 2006, p. 10.
[33] Orozco June 2006e, p. 5.
[34] Op. cit., p. 6.

The legal and regulatory framework in the recipient country establishes whether an MFI 1) must have a license to offer money transfers, 2) will have direct access to foreign exchange, 3) has the legal right to become a distributor for an Money Transfer Company (MTC), 4) has access to the national payment system, 5) has to monitor transactions and report suspicious activities to government agencies, and 6) can pay out remittances in foreign currency.[35] In general, relative to other regions there are few legal and regulatory barriers to market entry for MFIs in Latin American and Caribbean. In fact, creating a regulatory framework for remittances may be an area for donor support in some countries. Nonetheless, compliance with U.S. or receiving country regulations can result in significant costs for remittance providers in some countries.

In Guatemala, for example, institutions offering money transfers must comply with the Law Against Money Laundering and Other Assets. As a result, they must appoint a compliance officer and submit reports on all recipients that receive more than $3,000 per month. In Haiti, Fonkoze had to demonstrate that it knew all of its senders and recipients for an audit of its partner bank in the United States, underlining the importance of a strong management information system (MIS), a topic discussed further below.[36] Helping MFIs develop the capacity to meet requirements such as these may be an area for donor support.

With regard to institutional capacity, MFIs face a number of challenges, the most commonly cited and pressing of which are highlighted here. First, an integrated management information systems (MIS) is critical for efficiently and effectively handling money transfers. As CGAP highlights, these "information systems, must be capable of managing the volume of anticipated transfers, ensuring transaction security, possibly interfacing with other transfer operators, and generating reports to comply with regulations." MIS are an area of weakness for the majority of MFIs, including many deposit-taking institutions. When transfers are introduced, strengthening these systems is essential. Even highly sophisticated financial institutions, such as BancoSol in Bolivia have found it necessary to invest in expensive adaptations of their MIS. The MFI found it necessary to develop a specialized database system to effectively manage information from its multiple partner companies.[37]

Second, handling money transfers involves more complicated liquidity and risk management than do traditional microfinance services. Consequently, MFIs must develop adequate internal controls and liquidity management skills before launching transfer services.

Third, MFIs must have well trained front office staff and customer service practices adapted to the needs and preferences of remittance clients in order to compete with MTCs. They need an effective mechanism for informing clients that a transfer has arrived. And, when working with international partners, they must be able to work

[35] CGAP 2005, p. 17
[36] Hastings 2006, p. 22.
[37] CGAP 2006, p. 45.

effectively with those partners to resolve any customer service issues that arise.[38] Anne Hastings, Director of Fonkoze, highlights the challenges her institution faced in meeting the customer service requirements of its partners. According to Hastings, it was very difficult to make Fonkoze staff appreciate the importance of timely communications with its MTC partner, when, for example, a remittance client could not be found due to incorrect contact information.[39] Finally, long lines may dissuade potential customers from using an MFI to collect remittances. Additional staff may be needed to prevent bottlenecks from occurring as a result of the introduction of this new service.

Fourth, continuous marketing is essential to achieve a critical mass of clients. According to various observers, while "marketing on the receiving side is necessary and effective" it is most critical and the biggest challenge on the sending side. [40] Small MFIs working independently may lack the resources and contacts necessary for mass marketing in the sending country.

Finally, in addition to strong customer service, liquidity and risk management skills, MFIs must possess strong financial analysis capabilities. To ensure that the expenses associated with market entry are justified, staff must also be able to develop and revise financial projections to launch and ensure the ongoing success of transfer operations.[41]

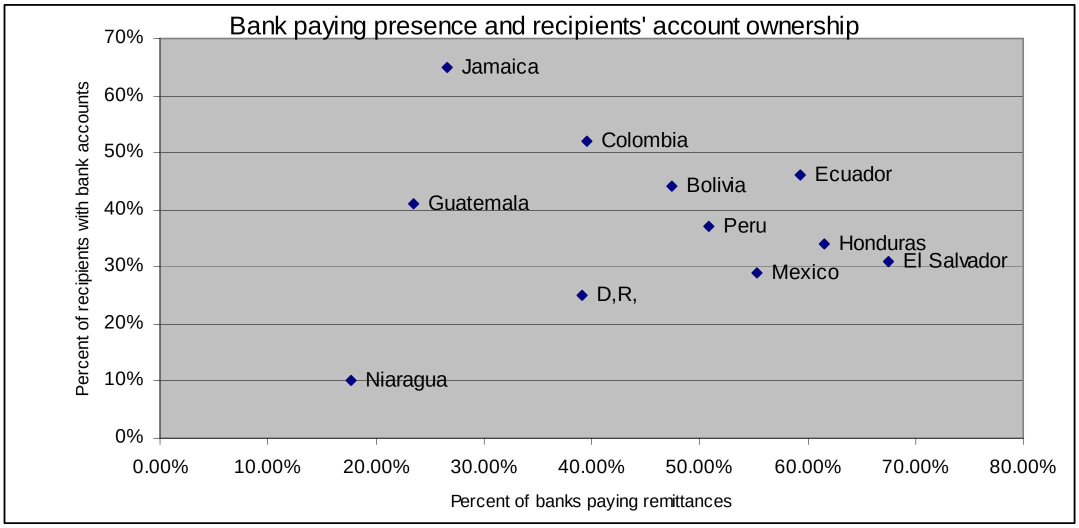
Ultimately, as the discussion of these challenges suggests, before entering the remittance market, investment in strengthening institutional capacity is essential for even the most sophisticated MFIs. Moreover, these challenges refer only to the introduction of transfer services per se. If an MFI wants to maximize its cross-selling potential it faces additional challenges. As the experience of Caja Popular Mexicana's experience demonstrates, cross-selling does not happen automatically. At a minimum, front office staff must be trained to effectively market the benefits of other financial services. And more intensive or extensive marketing strategies are likely to be required. For example, Salcaja, a Guatemalan MFI that has been highly successful in cross-selling, has dedicated tellers for remittance clients. These tellers are trained to explain the benefits of credit union membership to remittance clients and cross-sell products. BancoSol, a Bolivian MFI, has a dedicated sales force that cross-sells to remittance and other clients as they wait in line for a teller .[42] Rural MFIs may have an advantage when it comes to cross-selling because they tend to face less competition then urban MFIs. But both urban and rural MFIs need to design and implement marketing campaigns if they wish to bank a significant portion of unbanked remittance receivers. In addition, MFIs must provide appropriate remittance-linked or traditional financial products if they wish to attract remittance clients to these services. As recent market research by ACCION International suggests, it may be easier to market savings than credit products to remittance recipients (See Box 3, p. 37).

[38] Ibid., pp. 45-46.
[39] Hastings 2006, p. 25.
[40] Ibid., p. 26.
[41] CGAP 2005, p. 18.
[42] Information provided by Maria Fernanda Jaramillo, ACCION International, November 2006.

Traditional Commercial Banks and Remittances

While working with MFIs provides some unique opportunities to bank the unbanked, evidence indicates that there is also an opportunity and a need to work with traditional banks to achieve this goal. As noted above, recent work by the IDB shows that a significant percentage of remittances are collected at banks, primarily serving as agents of money transfer companies.

Figure 3.2. Bank Paying Presence and Recipients' Account Ownership



Source: Orozco 2006c.

A few banks provide money transfers directly and are innovating to reach remittance clients with other financial services. See Figure 3.2 above. Banco Salvadoreño, for example, established itself as a money transfer organization in the United States, and in 2005, made over one million transfers totaling $256 million. Ninety million dollars of the transfers were made directly by Bancosal Inc., the bank's money transfer organization operating in the United States, and 63 percent of these transfers were directly deposited into the accounts of remittance recipient clients. The bank holds strategic alliances with the biggest money transfer organizations, such as Western Union, Bancomer Transfer Services and Bank of New York, which allows it to have a presence in most U.S. states. It is the only bank in El Salvador that has an Internet based remittance service that enables clients to send money from any account in the United States through the bank's Web site. In addition, the bank allows remittance recipients to access loans equal to up to 80 percent of the value of the remittances they have received in the previous six months. Finally, the bank has also opened more than 29,000 savings accounts among recipients and distributed nearly 9,000 "Salvadoreño Emprendedor" debit cards and more than $10 million in loans for Salvadorans living abroad.[43]

[43] Interview with Maria Eugenia Brizuela, Banco Salvadoreno, April 2006.

Despite Banco Salvadoreno's success, traditional commercial banks typically do not see remittance recipients as a potential market for their other financial services. To address this situation, as a donor the IDB sees a critical role for itself in providing these banks, as well as MFIs, with market information to demonstrate the market potential of the remittance receiving population, and help them understand the types of products this market segment wants and needs.[44]

Technological Innovation: Opportunities and Challenges

Increasing competition from new market entrants, such as MFIs, will help to reduce transaction costs further. However, in Latin America prices have almost dropped to the point where additional cost reductions will require new transfer methods.[45] A number of MFIs and other money transfer providers are already experimenting with new transfer technologies to reduce transaction costs on both the sending and receiving sides. For example, as described in Box 2, the USAID/Philippine MABS project has introduced mobile phone banking to rural banks and their clients to facilitate lower cost loan payment, deposits, and money transfer transactions, among other services.

[44] Interview with Gregory Watson, Multilateral Investment Fund, November 2006.
[45] Prices remain high for transfers to the Caribbean, however. Orozco 2005c, p. 28.

Box 2: Mobile Phone Banking and Remittances

Under the USAID Philippines MABS project Chemonics International, in collaboration with Globe Telecom, introduced mobile banking to rural banks. The technology, which allows subscribers to send and receive cash via text messaging, is proving to be cost effective for participating banks, their clients, and immigrants sending money home. The text message technology called G-Cash, which was introduced by Globe Telecom in 2004, has numerous applications, including bill payment, deposit-taking, funds transfer between cell phones, and domestic and international remittances. The MABS project worked with Globe to create the Text-a-Payment (TAP) application, which allows microfinance clients to make loan payments using G-Cash, and Text-A-Deposit (TAD), and introduced the technology to rural banks and their low-income clients.

To pay a bill or a loan, or to buy goods using their cell phone as an electronic wallet, customers purchase G-cash at a Globe outlet or department store. Once purchased, the outlet or store "loads" the amount to the customer's cell phone through a text message. The customer can then text message the loan payment to their bank or use their G-Cash to purchase goods at participating retail stores. For international money transfers, the sender remits the desired amount at a participating money transfer company or bank, with instructions to transfer the funds to a recipient's cell phone, to be cashed out at a bank, Globe outlet, or department store in the Philippines. Or, alternatively, using the diverse G-Cash applications the sender can program a part of their remittance to pay a recipient's bills directly, another for direct deposit into a bank account, and a third part to be cashed out or spent according to the recipient's needs.

In addition to working with Globe to develop the TAP and TAD applications, the MABS project provides rural banks with technical assistance and training to develop the policies, procedures, and internal controls necessary to manage the mobile services and comply with regulatory requirements designed to prevent money laundering. The project also provides assistance to rural banks in marketing mobile banking services to clients, most of whom are new to G-Cash and mobile banking and its various applications.

For the rural MFIs offering mobile banking services, the technology facilitates outreach to remote areas, increases operational efficiency, and reduces risk of theft and robbery related to collection and money transfers in the field. It also saves time and money for clients since they no longer have to travel to a bank branch to make loan payments, and is a lower-cost and convenient way to send and receive remittances.

Source: Owens and Bantug-Herrera 2006 and interview with Anna Bantug-Herrera, November 2006.

There is also growing interest in use of card based technologies to reduce transaction costs through further automation of money transfers, which reduces overhead and operating costs associated with these transactions, and by expanding the network of sending and distribution outlets, bringing transfer services closer to clients. There do appear to be cost savings from this technology. Estimates suggest card based transactions are approximately 10 percent cheaper than wire transfers. And there do appear to be increasing opportunities to introduce this technology. For example, debit and credit card usage among immigrants, which have traditionally been low, are on the rise, suggesting potential receptivity to this technology among senders. In addition, many of the MFIs and other financial institutions entering the money transfer market are interested in card based products. In 2004 USAID worked with the Jamaica National Building Society (JNBS) to introduce swipe card technology. The JNBS, through its subsidiary JN Money Services Ltd., provides Jamaicans in Canada, the United States, and the United Kingdom with remittance services. By introducing the cards, along with point of sale devices in retail shops and ATMs, 25 percent of JNBS's remittance clients now receive their remittances through the card product. Moreover, using these payment solutions JNBS banked 50 percent of its remittance clients.[46]

[46] Source: Interview with Earl Jarred, CEO, Jamaica Building Society, October 2006.

Despite the success of this project, barriers to card-based solutions remain. These technologies are still only marginally cheaper than wire transfers. Companies or institutions offering these products will need to reduce their costs further to be more competitive. Perhaps more importantly, though on the rise, the number of immigrants using card based products is still small.[47] This low level of card usage is associated with low levels of banking access among immigrants. When the percentage of immigrants with access to finance increases, the potential to introduce card based solutions will increase, as well.[48]

On the receiving end, the limited availability of ATMs outside capital cities poses a challenge. But more importantly, there are few point of sale terminals (POS), which ultimately as payment instruments are more useful than ATMs because they allow customers to use cards for activities other than depositing or withdrawing funds. This problem highlights the importance of providing financial access to merchants that typically serve remittance recipients. Encouraging merchants to adopt modern electronic payment systems could increase the demand for card transfers reducing cash in the street while increasing electronic payments.

[47] Orozco 2005b, pp. 111-115.
[48] Orozco 2006d, p. 10.

Box 3: Cross-Selling and Product Innovation – Opportunities and Challenges

In 2004 USAID began collaborating with ACCION International and the Inter-American Development Bank on a project to increase both the volume of remittances processed by partner MFIs in 5 countries and their cross-selling of financial services. Participating MFIs include: Banco Caja Social in Colombia, BancoSol in Bolivia, FAMA in Nicaragua, MiBanco in Peru, and Sogesol in Haiti. The project, which ends in July 2007, has three components: 1) introducing the MFIs to money transfer companies and helping them to negotiate partnerships, 2) market research on the financial needs and product preferences of immigrants and remittance recipients, and 3) piloting innovative remittance-linked products, which will take place in Nicaragua and Haiti. The market research component, which as of October 2006 had been completed for all but Peru, has produced critical findings regarding the potential for and limitations of cross-selling financial service to bank the unbanked. These findings are summarized below.

First, not all remittance recipients are entrepreneurs. The majority are housewives, parents, or children. Remittances are often the household's primary or only source of income, and are used principally to cover basic needs. Consequently, a significant portion of the remittance receiving population is unlikely to be creditworthy, at least in the short to medium term. The research shows, however that savings and eventually mortgage and insurance products have greater potential.

Second, and related to the first finding, the goals and financial needs of immigrants and remittance recipients change considerably over time. To respond effectively to these changing needs, MFIs must segment the market. In the first couple years after migration, the immigrant is establishing him or herself in the host country. During this period remittances tend to be used mostly for consumption. The challenge, then, is to develop cost effective ways to bank recipients during these early years, when savings balances will be low and accounts are therefore costly for the MFI to manage. Once the immigrant is well established in the host country, and the family has accumulated some savings, an increasing percentage of remittances are used for investments in land or the purchase or construction of a house, and to a much lesser degree for small businesses. During these subsequent stages the opportunities to cross-sell a more diverse range of products increases.

Third, cross-selling takes time. It does not occur with the first transfer a client collects from the MFI. Rather, MFIs must dedicate time and resources to building relationships of trust with remittance clients. In addition, because not all recipients will be creditworthy, or willing and able to use other products, a high volume of remittances is needed for effective cross-selling. Finally, to achieve that volume, MFIs must be able to compete with money transfer companies with respect to cost and convenience. In some cases, this may mean adapting hours of operation or providing packaged products to attract remittance recipients. It also requires promotional efforts.

Based on these and other findings from their market research, ACCION and its MFI affiliate in Nicaragua, FAMA, are piloting a remittance-linked home improvement credit product. The product is targeted at recipient households whose sole income source is remittances, and it is designed around an innovative methodology to evaluate the repayment capacity of these households based on their remittance receiving history. In January 2007 ACCION will also pilot a programmed savings product with its Haitian partner, Sogesol. The product will allow clients to automatically channel a percentage of each remittance into a savings account. By building a savings history, clients of these products will be able to demonstrate their payment capacity over time in order to eventually access credit products.

Source: Interview with Maria Fernanda Jaramillo, Director of Remittances, ACCION International, October 2006. A more comprehensive analysis of ACCION's market research findings will be available in a forthcoming ACCION publication.

Securitization of Remittances

Securitization of remittances allows banks to borrow funds on international markets using future remittance flows as collateral, thereby increasing the financing available for onlending. In simple terms, the bank transfers its claim on these future flows to an off-shore account that issues the bond. A collection agent, serving as a trustee, handles the payments of principal and interest to bond holders with the remaining funds paid out to the bank. While investment grade countries like Mexico have used remittance-backed bonds (see Box 4), one of the principal

Box 4: Select Securitization Deals

Banco Nacional de Mexico:	$300 million (1998)
Banco Cuscatlan El Salvador:	$ 25 million (1999)
Banco de Credito de Peru:	$100 million (2001)
Banco do Brasil:	$300 million (2001)

Sources: UNDP 2003 and PRNewswire 1999.

advantages of this mechanism is that it allows investment grade banks in below investment grade developing countries to borrow at a lower cost and for longer terms than would be possible otherwise. For example, in 2001 Banco de Credito Peru was able to raise $100 million through securitization of remittance flows at a time of significant political uncertainty.[49]

The higher rating also gives banks access to a broader pool of investors and helps banks to establish a credit history that can facilitate future access to capital market financing at a lower cost. According to World Bank estimates, developing countries could raise as much as $7 billion through securitization of remittances.

Despite this potential, increasing securitization faces a number of challenges. Structuring these deals is complex, costly, and time consuming. In addition, developing countries often lack experience with this type of financial instrument. Nonetheless, the benefits can outweigh the costs and donor agencies can play a role in facilitating more securitization deals.[50]

Conclusions and Recommendations

Migration and consequently remittance flows are likely to continue as a result of global demand for labor and poverty. Given this reality, and the trends highlighted in this section, there is both an opportunity and a need for ongoing donor support to lower transaction costs and increase financial integration, banking the unbanked on both the sending and receiving ends.

Facilitating the entry of MFIs into the remittance market can benefit immigrants and their families, and financial institutions. It can help both senders and receivers save more and give them access to other financial products and services that promote investment and reduce the vulnerability of low-income households. And it can help MFIs expand their client base, cross-sell products, and increase revenue. What is more, encouraging remittance flows through these institutions may result in spillover effects that benefit remittance recipients and non-recipients alike. MFIs that are able to capture a portion of remittances as savings, can onlend those savings to the benefit of the entire community in which they operate. Similarly, the institutional strengthening that will likely accompany the introduction or strengthening of money transfer services will likely benefit all clients.

However, entering the money transfer market may require significant investments on the part of financial institutions in market research and institutional strengthening. Further, ACCION International's market research shows there may be greater challenges to linking remittances to credit than initially thought. At the same time, it clearly shows that there is an unmet need for diverse financial products among remittance senders and receivers. Donors, such as USAID, can help financial institutions meet that need. Finally, securitization of remittances may increase access to capital in capital constrained

[49] Barham 2002.
[50] UNDP 2003.

markets. As discussed below, USAID could play a role in facilitating securitization deals through use of Development Credit Authority (DCA) guarantees.

To strengthen the linkages between remittances, financial intermediation, and poverty alleviation USAID should consider interventions in the following areas:

1. ***Increasing the institutional capacity of MFIs.*** To develop the institutional capacity needed for successful provision of money transfers USAID can provide:

    - Support for staff training in areas such as customer service, marketing, and financial projections
    - Technical assistance to develop or adapt effective MIS
    - Support for designing or implementing marketing campaigns for money transfer services and cross-selling in both sending and receiving countries
    - Technical assistance to improve internal controls and liquidity management

2. ***Promoting appropriate regulation of remittances and MFIs.*** Just as USAID has advised governments on the tenets of effective MFI regulation, there is a potential role for USAID in helping governments, including the U.S. government through dialogue with the Treasury Department, to design and implement regulatory frameworks for money transfers. This will help to avoid unnecessarily limiting competition through excessive regulation, while at the same time ensuring safeguards against mismanagement, money laundering, or terrorist financing.

3. ***Encouraging commercial banks to develop and market their services to remittance clients***. As suggested by the Inter-American Development Bank, donors have a role to play not only in facilitating MFI entry into the remittance market, but in demonstrating to commercial banks that remittance clients are a viable, untapped market for other financial services. USAID should consider working with these financial institutions to improve their understanding of the market, and, as suggested below, to develop new products targeting this clientele.

4. ***Developing domestic transfer systems.*** Support to develop or introduce domestic transfer networks can help poorer migrants and their families leverage the development impact of their hard earned wages. USAID is already working in this area, helping credit unions create shared branching networks in various countries, as part of larger institutional strengthening and international remittance projects, as well as with FADES on an exclusively domestic transfer system in Bolivia.

5. ***Supporting new product development and technological innovation.*** USAID should continue to support the design, piloting, and ultimately replication of successful remittance-linked products and new transfer technologies, such as the G-Cash mobile transfer technology developed under the USAID Philippine MABS project and the remittance-linked products being developed with ACCION International.

6. ***Leveraging the Development Credit Authority (DCA).*** The DCA could be used in several ways to leverage the development impact of remittances. First, it could be used as a credit enhancement to reduce the collateralization requirements for securitization deals. The USAID DCA office is already considering this possibility. However, opportunities to use the DCA for this purpose in Latin America and the Caribbean may be limited since a number of securitization deals have already taken place in the region without the DCA, and the mechanism is meant to encourage activities that would not otherwise take place.[51] Yet if used to reduce collateralization requirements, the DCA could enable a broader number of financial institutions to enter into securitization deals. Therefore, USAID may still wish to consider this option. Second, USAID could leverage its resources by providing DCA guarantees in parallel to securitization deals supported by other donors. The increased resources for onlending that securitization of remittances provides do not necessarily benefit low-income or marginalized populations directly. A DCA guarantee could be used to help interested financial institutions use part of those resources to move down market to micro, small, and medium-sized enterprises. Finally, portfolio guarantees could be used to help financial institutions introduce new remittance-linked products.

[51] Interview with Jennifer Dostert, USAID Office of Development Credit, October 2006.

SECTION V: DIASPORA COMMERCE AND INVESTMENT

The most direct and visible way in which diasporas contribute to home country development is through family remittances. However, in recent years there has been increasing attention given to other mechanisms through which immigrants contribute to growth in their homelands. In this section we explore the impact of or potential for migrant commerce with and investment in countries of origin. We begin by reviewing the theory behind this interest and enthusiasm. We then discuss the available data on the socio-economic impact of the diaspora in Latin America and select countries around the world, and lessons learned in fostering diaspora contributions through a variety of mechanisms and incentive schemes. These mechanisms include: diaspora business networks, diaspora investment funds and clubs, government investment promotion schemes, diaspora bonds, and foreign currency accounts. We conclude this section with recommendations for USAID and other donors considering support for diaspora-oriented development initiatives. While additional studies are needed to better understand the results of some of the incentive schemes discussed here, a key conclusion of this section is that donor efforts to maximize diaspora-linked commerce and investment can be a worthwhile complement to efforts focused on facilitating remittances and their productive investment.

Diaspora Commerce and Investment: The Potential

According to Lev Freinkman, transitional and developing countries have a comparative advantage when they have a large and economically influential diaspora to provide investment finance and bridge the cultural divide between host countries and countries of origin.[52] The reasons given for this are numerous. Diasporas can fulfill the role of first movers, jump-starting trade and investment in or with a particular country or sector, and attracting others to follow suit. It is argued that this is due, in part, to their sentimental ties to their countries of origin, which may motivate them to invest in or trade with their homelands while others remain wary. A study of U.S.-based Armenian, Cuban, Iranian, and Palestinian diasporas' interest in investing in their respective countries of origin supports this claim. According to the study, 1) altruism and cultural similarities have a positive effect on investment interest and, 2) business impediments did not appear to affect the investment interest of respondents.[53] In addition to their sentimental ties, diasporas' cultural knowledge and personal and business ties in their countries of origin may greatly facilitate market entry. Aside from serving as first movers, diasporas may also help broker trade and investment deals, and transfer managerial and professional skills through direct investment or return migration. Finally, they may lobby for reforms that improve the trade and investment environment for diaspora and non-diaspora alike.

To what extent is the commerce and investment producing potential of the diaspora being realized? While more research is needed to quantify the impacts of diaspora involvement in their countries of origin, diverse authors find that diasporas can have a significant impact on trade and investment. For example, a study of U.S. bilateral trade with 47

[52] Freinkman, Lev, 2001, p. 3.
[53] Gillespie et al 1999 in Gevorkyan, Aleksandr, 2003, pp. 16-17.

countries found that a 10 percent increase in immigrants to the United States increases exports to the country of origin by 4.7 percent and imports from that country by 8.3 percent.[54] Diasporas have also been found to have a significant impact on foreign direct investment (FDI), with China as perhaps the most impressive example. In 2002 the Chinese diaspora accounted for approximately 50 percent of the country's FDI.[55]

One of the ways in which diasporas stimulate both exports from and investment in their countries of origin is through nostalgic trade. Nostalgic trade refers to the export of traditional home country products, such as tortillas, rum, coffee, tamales, and sweets, resulting from demand for these items among immigrants in host countries. Studies by Manuel Orozco indicate that 70 percent of Latin American and Caribbean immigrants consume products such as these from their homelands and that 10 percent of exports to the United States from El Salvador and various other Latin American countries are nostalgic goods.[56] As suggested above, there is a link between nostalgic trade and migrant capital investment. Demand for nostalgic goods has motivated some migrants to invest in home-country export businesses. For example, a U.S.-based immigrant from El Salvador opened franchises of Roos Foods, Inc. in Nicaragua and El Salvador to produce and sell processed milk products in Central America and to Central American and Mexican immigrants in the United States.[57]

While these examples demonstrate the positive impact that diasporas can have on trade and investment, it is clear that some diasporas contribute more than others. The reasons for this may relate both to home country policies and the diasporas themselves. China's success in stimulating investment from its diaspora, for example, is attributed to two key factors: a long-standing governmental diaspora outreach strategy, including investment incentives, and economic liberalization, which made investment more attractive to all potential investors.

The characteristics of a given diaspora or diaspora segment would also seem to play a role in determining the form or extent of their contributions to countries of origin. For example, there are divergent views on whether high or low-skilled migrants are more likely to invest in home country enterprises. Various cases of trade and investment fostered by high skilled diasporas have been documented. The role of the diaspora in India's IT industry is well known. In the 1980s Indian engineers in Silicon Valley convinced senior management of the companies they worked for to subcontract with Indian companies at a time when investment in India was considered risky, thereby jump starting the Indian IT industry.

A 2002 survey by Saxenian, focusing more broadly on the Asian diaspora working in Silicon Valley, found that one half of foreign born entrepreneurs in this high technology area "maintain business relations" in their home countries. [58] Eighteen percent invested or

[54] David Gould 1994 in Rauch 2003, pp. 5-6.
[55] Newland 2004, p. 5.
[56] Orozco 2005b, p. 66.
[57] Ibid., p. 67.
[58] Saxenian 2002, p. 43

currently invest in start-ups or venture funds in their countries of origin.[59] Finally, the case of Thamel.com (See Box 5, p. 44.) demonstrates both the potential of the diaspora as a market for home country goods and the role a return migrant can play as first mover.

This is not to say that lower skilled or low to middle income diaspora do not foster trade or invest in their countries of origin. Nostalgic trade, for example, is fostered by diasporas of diverse socio-economic status. However, as discussed in Section IV, they may invest in ways that are not captured as foreign direct investment, investing in small businesses through remittances to their family members or purchasing residential property.

As the examples described here suggest, there is significant potential for migrant generated trade and capital investment, some of which is currently being realized. We turn now to a detailed discussion of the mechanisms through which diaspora-linked commerce and investment may occur.

[59] Ibid., p. 29.

Box 5: Thamel.com: Harnessing the Buying Purchasing Power of the Diaspora

Thamel.com (TDC) is a Nepalese marketing and development company that exemplifies the business knowledge that a returned expatriate can provide countries of origin and the potential to overcome barriers to diaspora commerce in those countries through the use of relatively simple IT. TDC, the first and most successful e-commerce company in the country, has played a first mover function in the Nepalese economy, stimulated small enterprise growth and an improved business environment in part by attracting diaspora business. Founded in 1999, TDC has five business divisions: an online Gift Shoppe that targets the diaspora, an e-commerce division that helps local companies start their own e-commerce sites, an as of yet small export division that targets the diaspora and other markets, a financial services division that provides remittance transfers, insurance and other products through an alliance with a local bank, and an international division focused on replicating the model in other countries. By tapping into what the company refers to as “the sentiments and resources of the Nepalese diaspora,” TDC is successfully promoting enterprise growth at the base of the pyramid. Vendors selling through the online portal include microenterprises that operate without phones, computers, or Internet, and whose owners have minimal to no English skills.

Online sales from the Gift Shoppe, through which a Nepalese in Kansas, for instance, can purchase a locally produced gift for delivery to a loved one in Nepal, represent on average 5-10 percent of participating enterprises’ total annual revenue. And that percentage is growing. During holidays the percentage can be as high as 50 percent. In addition to increasing business revenue – and employment – TDC is changing the way business is done in Nepal. TDC has not only jump-started the e-commerce industry (there are now 11 e-commerce sites), but has improved business practices among participating enterprises. Vendors are required to sign a contract that among other things obligates them to exchange, rather than repair, any expensive items, such as TVs or refrigerators, improving customer service, which has helped to overcome wariness to purchase online. TDC’s success in spurring local growth has also led to government support and improvements in regulatory and IT infrastructure.

TDC’s success can be attributed to a number of key factors. Aside from the first mover advantage, co-founder Bal Joshi was an expatriate in the United States before creating TDC and brought knowledge of diaspora communities to the venture. As noted above, the company is addressing the local business deficiencies as well as the mistrust of clients and customers regarding the service. In addition to guaranteeing replacement goods, TDC provides customers with a digital photo of their gift being delivered. Addressing the transnational nature of diaspora communities, TDC provides the Western style service the diaspora has come to expect in their host countries. At the same time, TDC taps into the psychology, customs and traditions of the diaspora. All TDC goods are produced locally and grounded in local contexts and cultures. The Web site provides cultural information on local festivals for which the diaspora purchase gifts for family and friends, and products are marketed with a focus on their cultural rather than product specific qualities. It also only carries brand names, which appeals to the Nepalese diaspora’s desire to demonstrate its good fortune and upward mobility. Finally, TDC adapts its marketing strategy to the sometimes low level of Internet use of diaspora communities and the particularities of those communities in different countries. For example, in Hong Kong, TDC distributes print catalogs at restaurants frequented by the diaspora.

Sources: Paul, John. “What Works: THAMEL.COM Diaspora-enabled Development,” World Resources Institute, December 2005 and www.thamelintl.com.

Diaspora Commerce and Investment Mechanisms and Incentives

Governments and the diaspora itself use a variety of mechanisms and incentives to encourage or pursue commerce and investment opportunities that contribute to country of origin development. These include: diaspora business networks, government investment promotion schemes, diaspora investment funds and clubs, and bonds and foreign currency accounts. As we will discuss below, these mechanisms and incentives target diverse migrant market segments with varying degrees of success. While foreign direct investment in countries of origin provides a wide-range of benefits, it is most feasible for the wealthier, better connected, and entrepreneurial segment of the diaspora. Investment funds, bond instruments, and foreign currency accounts can target a broader cross-section of the diaspora market.

Diaspora Business Networks. As noted above, diasporas can have a significant impact on host country economies through direct investment, as brokers, by transferring market and cultural knowledge, or through similar means. The overarching question not only for this section but for this study then, is how to maximize that impact. In this section we consider the role of diaspora business networks.

In his paper on diasporas and development James Rauch reports that membership in diaspora associations appears to positively affect a diaspora's contribution to country of origin development. While these associations may begin as social clubs, in some cases at least they evolve into professional associations that facilitate members' international business activities.[60] Among other activities, diaspora business networks can create trade and investment opportunities by disseminating information on market conditions and host country business regulations, helping to match investors with projects through online matching services, and/or organizing conferences and other business events to bring diaspora and country of origin businesspeople together. As the examples presented here demonstrate, diaspora business networks may be based in a home or host country, and/or be transnational in nature. They may also be organized by country of origin entrepreneurs or representatives of the diaspora, and may or may not involve governmental participation.

Lebanon Business Network

As stated on their Web site, the "Lebanon Business Network (LBN) is a non-profit, business development vehicle. Featuring an online marketplace and a business matching database, it identifies opportunities and creates links between Lebanese entrepreneurs, expatriates, and international businesses." Established initially in 2000 under the name of Lebanese International Business Network with technical assistance from USAID, the network has been redesigned and expanded under its current name to meet the evolving needs of its membership. The Lebanon-based network, which is funded and administered by the Indevco Foundation, also received free technical assistance, business information, advertising, and other support from a publishing and market research company, InfoPro, demonstrating the potential for public-private partnerships in developing networks of this nature. The LBN does not track member communications but staff estimate that approximately 15 percent of communications facilitated by the network produce "positive results." [61]

Armenian High Tech Council of America (Armentech)

Armentech was founded in 2000 in Boston Massachusetts by Armenian-American entrepreneurs and executives in the high tech industry dedicated to supporting the development of the IT sector in Armenia. In 2003, with support from the World Bank, USAID, and the SETA Corporation, the network launched a Web portal SiliconArmenia. The portal was intended to serve as a, "common platform for cooperation, collaboration and coordinated action…" among Armentech, the Union for Information Technology Enterprises, the Armenian Development Agency, and other IT-oriented public and private

---

[60] Rauch, James, 2003, pp. 16-17.
[61] Johnson and Sedaca 2004, p. 36 and www.lbn.com.lb/LBN/LB_LearnMore.asp.

sector entities. [62] To achieve that goal, the portal provided news and event listings, advice on doing business in Armenia, e-learning and other skill development opportunities, and a list of registered businesses. The site was also meant to list business opportunities with Armenian enterprises as part of its E-Marketplace. However, the portal has not been updated since late 2004, shortly after donor funding for maintenance of the portal ended. Asked if the mission would consider support for a diaspora business network Web site in the future, given this experience, Rolf Anderson, Acting Director of the USAID/Armenia Economic Restructuring and Energy Office, noted that while Web sites, "…can be a very valuable tool, and we do support them in many versions through our program… it goes back to the principle if a Web site is for an industry, the industry group (say the IT association) should be the champion and bear the operational costs from the outset."[63]

South African Diaspora Network (SADN)

The SADN established in 2001, also received support from the World Bank to facilitate networking between South African and diaspora business people, provide market information, and reduce the transaction costs associated with South African start-ups. To maximize the impact of the new initiative, the network chose to focus on a relatively small group of "high potential" South African entrepreneurs seeking export opportunities and exclusively on highly successful members of the diaspora. In analyzing the pilot phase of the project, however, the network organizers concluded that it would have been more effective to target a broader audience. Taking a broader approach, it was thought, would have likely stimulated a higher number of "hits," and generated the larger membership base needed for sustainability.[64]

As this selection of networks suggests, Latin America does not appear to have formal transnational business networks, though there are a number of professional or digital diaspora networks dedicated to knowledge and technology transfer in the region. Why this is the case is not entirely clear. As Kathleen Newland suggests in her analysis of the role of diasporas in poverty reduction, the mechanisms through which diasporas may contribute to country of origin development may vary. "Diaspora communities often reproduce the divisions of class, ethnicity, religion, political affiliation, language and region that are found in their countries of origin. Such differences within and among Diaspora groups will influence the nature and scale of their capacity (and willingness) to act as agents of poverty reduction."[65] This is not to say that diaspora business networks are not an option for the region, but rather that additional, country specific analysis may be beneficial to better understand this gap and that efforts to promote such networks should take social, political, and cultural factors into consideration.

Diaspora Investment Funds and Clubs. In this section we explore the potential for privately administered diaspora investment funds and clubs, as well as the potential role for donors in supporting these initiatives. Direct diaspora investment in countries of

[62] Email interview with Diana Avetyan, USAID/Armenia, October 2006.
[63] Email interview with Rolf Anderson, USAID/Armenia, October 2006.
[64] Johnson and Sedaca 2004, p. 38. More information on the SADN experience is available in the *South African Diaspora Network: Final Report,* World Bank, 2003.
[65] Newland 2004, p. vi.

origin requires an entrepreneurial spirit and business acumen, and may require strong ties to local movers and shakers or significant expenses in time and money to overcome impediments to doing business. Consequently, FDI is limited to a great degree to large-scale investors. For the non-entrepreneurial investor, or where investment risks are particularly high, institutional investment vehicles, such as investment funds, may be an effective mechanism for broadening the investor base to include mid-sized, portfolio investors. The potential for such funds has generated considerable discussion over the last five years.

According to Gevorkyan and Grigorian, diaspora-oriented institutional investment vehicles, like direct entrepreneurial investors, can serve as first movers, improve corporate governance – if set up as holding companies – and deepen financial markets through the introduction of new financial mechanisms. If led by diaspora managers, these managers may also provide hands-on training in investment banking.[66]

Despite these apparent benefits, at the time this document was drafted, the authors were unable to confirm any examples of active diaspora investment funds. The Armenia SME Fund launched by the IFC in 2002 was defunct by 2004. To jump start the fund the IFC pledged up to $5 million and it was expected that the diaspora would provide at least another $15 million. That goal was never realized and the IFC withdrew its funds. The apparent reason for the lack of interest on the part of the Armenian diaspora was the belief that the government was not fully committed to the initiative.[67]

Since 2004 at least two African diaspora funds have been launched or proposed. The Kenyans Abroad Investment Fund (KAIF) was proposed in June 2004 by the Kenyans Abroad Association, an international diaspora association. The African SME Investment Fund was proposed by the African Investment Advisory. Unfortunately, no information is currently available on the progress of these initiatives. The fact that this option has not been proven yet, and that there has been one failed fund, should not discredit investment funds as a potentially viable mechanism for diaspora investment. It may, however, suggest that a less ambitious pilot or model may be in order.

Traditional investment funds might be suitable for only mid- and upper-scale investors willing and able to assume the associated risk. The Indigo Project, however, involves a new investment fund model that may be successful in reaching further down the diaspora market on a more modest scale to provide investment finance for SMEs in countries of origin. The project, currently in its initial stages, proposes to create sustainable Hometown Association (HTA) micro-equity investment funds through an arrangement with a new, innovative money transfer company, Indigo.[68]

Indigo has developed and piloted a mobile prepaid ATM moneycard remittance service. Under the proposed investment fund scheme, HTAs—generally informal U.S.-based associations of immigrants from the same community in their country of origin—would

[66] Gevorkyan and Grigorian 2003, p. 22-23.
[67] Roberts and Banaian 2004, p. 50.
[68] The company will soon be renamed m-VIA.

operate as retail distributors for Indigo, collecting a fee for each remittance transaction, which would capitalize the HTA's micro-equity investment fund. At the same time, the fees charged by Indigo would be used in part to capitalize a fund to match seed capital investments proposed by HTA investing circles through their micro-equity investment funds.

While the piloting of the financial infrastructure is complete (the mobile remittance technology), much remains to be done to launch the equity investment fund model, including: additional promotion of the equity fund concept, financial literacy training for HTA pilot groups so they can source enterprises for equity investments, identification of host country counterparts (MFIs, community groups, etc.) and training of those counterparts to enable them to assist in overseeing the investments.[69]

Finally, the New Horizons Investment Club (NHIC) provides another private sector diaspora investment model. Founded in 2000 by 10 Garifuna Honduran immigrants the NHIC had 100 members by the end of 2005. Originally, the group was formed to learn how to invest in the U.S. stock market, but has since diversified its investments to include tourism projects in Honduras through an alliance with the National Garifuna Tourism Chamber. [70] While formation of the group was a grassroots initiative, development agents have helped the group maximize its investment impact. The Multilateral Investment Fund and IFAD provided funding for a feasibility study for the Club's tourism investment.[71]

Government Investment Promotion Schemes. Over the years a number of governments have implemented investment promotion schemes targeting immigrants and return migrants. In this section we review two such programs in Mexico and efforts by several Asian countries in order to identify lessons learned and best practices for governments wishing to implement similar programs and donors wishing to support them.

The first program, *Mi Comunidad* (My Community), is interesting both for its successes and deficiencies and is an example of how governments and diaspora associations can facilitate investment on the part of small savers. Launched in 1996 in the Mexican State of Guanajuato, the objective of the program was to encourage immigrant investment in the start-up of *maquiladoras.* It was originally designed as a co-investment scheme with the government and immigrants providing a minimum investment of $60,000 each. Local investors also participated but to a more limited degree. The design was ultimately modified, however, converting the government's financial contribution into a loan. Interestingly, loans were taken out for only 2 of the 21 enterprises initiated. Immigrants preferred to increase their capital contributions, rather than borrow funds, even low cost loans, demonstrating the potential that exists to mobilize diaspora investment.[72] In addition to credit, the government provided technical assistance to develop the *maquiladora* business plan and two months' wages and training for enterprise workers.

[69] Interview with Margarita Quihuis September 2006.
[70] Orozco 2006b, p. 20. .
[71] Smith 2005.
[72] CEPAL 2001, pp. 12-13.

The program was promoted through the Casas Guanajuato, cultural and community centers run by diaspora volunteers in the United States that were created with a combination of local community resources and support from the State of Guanajuato. By mid 2000 there were 12 maquiladoras in operation employing approximately 500 people, with 9 more underway. Immigrants' capital contribution amounted to approximately $2.2 million.[73]

Despite the apparent successes of the program, there were also a number of serious deficiencies. These included an exclusive focus on *maquiladoras,* rather than a broader range of business opportunities, problems with the technical design of at least some of the enterprises, and weaknesses in the business plan, particularly the marketing component. In some cases the diaspora investors were highly active in resolving the problems and in two cases investors relocated to Mexico to administer the businesses, demonstrating the potential of diaspora investment to transfer organizational and managerial skills to countries of origin. Commitment on the part of diaspora investors was one of the key success factors for the project. That commitment was partly the result of the extensive and costly promotional and marketing effort conducted both to organize the Casas de Guanajuato and to sell the investment program, which were concurrent activities. This is a factor that anyone interested in designing a similar project should bear in mind. Ultimately, the design deficiencies and the exclusive focus on maquiladoras, enterprises that are highly vulnerable to changes in the competitive landscape of the international garment industry, resulted in the closure of almost all of the businesses. The lessons learned, however, remain. Other key lessons learned include the following:

1. The diaspora has financial resources. Lack of capital may be less of a problem than training and technical assistance for project development and sound business management.
2. Investment interest exists, but the diaspora needs investment ideas and opportunities.
3. Diaspora associations, such as HTAs, are an effective channel for marketing investment opportunities. However, the transaction costs of investment promotion schemes working with HTAs are high in terms of organizing and communicating with the associations, as well as communications between the HTA investors and the enterprises in which they invest.[74]

Por Mi Jalisco (For My Jalisco) is another state government program to promote diaspora investment in employment generating productive projects in areas of out migration. Through the *Por Mi Jalisco* trust immigrants living in the United States can receive technical support for feasibility studies and business plan development to start enterprises in their home state of Jalisco. They can also receive financing for up to 30 percent of the cost of starting and running the business for three years,[75] within a $300,000 ceiling (or up to $500,000 in exceptional cases.[76] Unlike *Mi Comunidad, Por Mi Jalisco* support is not limited to one type of enterprise, but rather is available for diverse business projects deemed viable based on studies.

[73] World Bank 2002, p. iii.
[74] Ibid.
[75] Monterrey County Herald 2006.
[76] Estado de Jalisco Periodico Oficial 2006.

The program is advertised through HTAs and has been successful in attracting investors. As of September 2006, *Por Mi Jalisco* had supported the start-up of 13 enterprises employing 205 people in 16 municipalities.[77] The success of the enterprises themselves depends on the entrepreneurial skill of the investor and economic conditions.[78]

Finally, countries such as India and Pakistan have attempted to promote investment by immigrants and returnees, often with a focus on manufacturing enterprises or special economic zones, by offering reduced duties on imports of machinery and equipment or raw materials, or by making all investment proposals convertible to repatriable equity. The results of these efforts are not well documented, however, but may merit further study.[79]

Diaspora Bonds and Foreign Currency Accounts. A variety of governments have attempted to use sovereign bonds and foreign currency accounts to attract foreign savings and increase remittance flows. In this section we highlight their experience, strengths, and limitations of these instruments.

Sovereign Bonds

For countries with adequate domestic savings to service the debt and a reasonably stable macroeconomic environment, targeted sovereign bond issuances can be an effective means of generating development finance from the middle and upper income diasporas looking for a lower risk means to invest in their homelands. Aside from being a low-cost and non-inflationary means of raising public finance, these bonds offer a variety of additional advantages over other public financing options: they can smooth or de facto delay debt service, extend the maturity of debt, are non-distortionary, they have a lower potential roll-over risk and have proven to be a successful means of attracting foreign exchange under less than optimal market conditions, due in part to their patriotic appeal.[80]

Though this does not appear to have been an instrument used by Latin American and Caribbean countries to date, countries such as Israel, India, the Philippines, Pakistan, Lebanon, China, and Bangladesh have all used sovereign bonds to good effect. Relatively little has been written about these countries' experiences, however. An in-depth, comparative study of these cases would be beneficial to identify the lessons learned and success factors in order to facilitate their replication in other countries and regions where appropriate. Two of the best known cases, those of Israel and India, highlight the importance of the emotional appeal and aggressive marketing generally to the successful launching of diaspora bonds.

When the state of Israel needed financing for infrastructure development in the 1950s it issued a sovereign bond that raised $52.6 million in one year despite the risks associated

[77] Op. cit.
[78] Orozco 2005b, p. 25.
[79] Puri and Ritzema 1999, p. 24, and Menen 2006.
[80] Gevorkyan and Grigorian 2003, p. 27.

with investing in the newly created state. The release was accompanied by an extensive marketing campaign, launched by then Prime Minister Ben-Gurion, with a strong emotional appeal involving rallies throughout the United States.[81] More recently, in 1998, India used patriotic marketing and premium interest rates to attract $4.2 billion exclusively from its diaspora for infrastructure development in the wake of international sanctions resulting from the country's nuclear testing. India followed this successful issuance with another in 2000 that attracted $5.4 billion from the diaspora.[82]

Foreign Currency Accounts

A number of countries have offered foreign currency savings accounts with premium interest rates and premium foreign exchange rates to attract remittances in order to raise foreign exchange reserves and increase the resources available for public and private finance. Findings regarding the success of these incentives are mixed. Two studies (Swamy 1981 and Straubhaar 1986)[83] suggest that these incentives are not particularly effective in increasing remittances, finding instead that factors such as cyclical changes in the host country, the number of migrants and their length of stay abroad were more significant. Puri and Ritzema argue, however, that while these incentives may not have a significant effect on total remittance flows, they may be effective in diverting informal remittances to formal channels, which is key to increasing their development impact.[84] Estimates suggest that as much as 50 percent of remittances remain unrecorded, flowing through informal channels.

While foreign currency accounts are considered less effective than diaspora bonds in capturing migrants' savings, there is some evidence that these accounts can be effective. In India, fixed term foreign currency accounts do appear to have been popular with Non-Resident Indians (NRIs), and have successfully increased foreign currency reserves.[85] India's experience suggests that these incentives may be useful for increasing formal remittance flows while a country is in the process of creating an economic, institutional, and political environment more conducive to foreign investment. Ultimately, it is critical to get the core policies and infrastructure right—rational exchange and interest rate policies, appropriate fiscal policies, and financial regulation and infrastructure that support competition and financial inclusion are all needed. Special incentives, such as those mentioned here, are a second best, but potentially viable interim option for attracting foreign savings.

Conclusions and Recommendations

Diasporas can have a significant impact on development in their countries of origin through foreign direct investment, portfolio investment, trade promotion, and advocacy for economic or institutional reform. To date, there has been little USAID or other donor programming promoting diaspora commerce and investment, though one example is presented in Section VI. Their focus instead has been primarily on reducing the

---

[81] Johnson and Sedaca 2004, p. 50.
[82] Ibid., pp. 51-52, Newland 2004, p. 6, and Acquista and Ly 2005.
[83] In Puri and Ritzema 1999, pp. 13-14.
[84] Ibid., p. 14.
[85] Singh 2004 and Sultan Uddin 2006.

transaction costs of remittances and banking the unbanked. As described in Section IV, there are significant benefits to be had from focusing on these goals, and much remains to be done. Nonetheless, it is recommended that USAID consider continued or expanded programmatic interventions to support diaspora commerce and investment as mutually reinforcing economic development strategies.

Donor support for building a stronger industrial base and entrepreneurial middle class through these initiatives can have a greater impact on poverty reduction in the long-term than an exclusive focus on remittances and financial intermediation or increasing the number of diaspora funded productive projects of diaspora groups, a topic discussed in Section VI. Increased investment and commerce resulting from diaspora networking and matching vehicles, government investment incentives, bond issuances, foreign currency accounts, and similar initiatives, do not automatically translate into poverty alleviation. Though as we have seen, initiatives such as Thamel.com and *Mi Comunidad* can benefit small enterprises and generate employment for lower skilled populations in the short or medium term. And revenue from sovereign diaspora bonds may finance public infrastructure needed to create economic opportunities for remittance receivers to invest these flows. However, these initiatives can stimulate the growth needed to create investment and employment opportunities for the poor.

In the remainder of this section we present a series of programmatic opportunities for USAID. The appropriateness of or priority that should be given to each of these initiatives will depend on the specific circumstances of each USAID partner country.

1. ***Supporting Development of Country Specific Diaspora Outreach Strategies.*** It is important that USAID support strategies grounded in a thorough understanding of the characteristics and preferences of the diaspora in each partner country. For example, historically, the Chinese diaspora has been largely entrepreneurial, while the Indian diaspora was originally largely professional. Newland observes that this explains why remittances are higher in India and diaspora investment is higher in China.[86] It also illustrates the need for country specific diaspora policies to maximize their contribution to the local economy. Helping partner countries to study the characteristics and preferences of their diasporas and to design appropriate outreach strategies may be an important area for USAID programmatic support.

2. ***Documenting and Disseminating Information on Diaspora-Linked Commerce and Investment Initiatives.*** In general, there is a need for research on diaspora commerce and investment. The lack of complete documentation and analysis of the mechanisms and incentives used to foster and pursue diaspora-linked commerce and investment hinders replication of successful models and more generally design of effective diaspora strategies. In-depth analysis is needed of the design and contextual factors of successful initiatives, the lessons learned, and the results of initiatives such as those discussed in this section. As mentioned above, several diaspora investment fund initiatives appear to be just getting under way. Documenting their progress can reveal if or under what circumstances investment funds can be successful, as suggested by

[86] Ibid.

the theory surrounding them. Analysis of government investment promotion schemes could foster their successful replication. Similarly, diaspora bonds have generated substantial resources in a number of countries. A comparative analysis of these experiences could help additional countries design similar issuances or determine their feasibility.

3. ***Promoting Sound Business and Investment Environments.*** As various authors have pointed out (see for example, Johnson and Sedaca[87]), a reasonably sound business and investment climate is necessary to attract business and investment from the diaspora and non-diaspora alike. At the same time, evidence has shown that the diaspora is willing and able to engage with countries of origin when others are not and that this engagement can help to create a more attractive environment. Depending on the level of development of a given country, democracy and governance, trade and competitiveness, and/or financial sector strengthening projects may be necessary precursors or, alternately, effective complementary measures to USAID diaspora-related support projects. To determine which is the case, it may be wise to start with small pilot projects or initiatives such as diaspora business networks before attempting broader scale initiatives such as investment funds.

4. ***Strengthening Diaspora Business Networks.*** As suggested by the examples provided, while diaspora business networks may emerge organically, donors can assist networks in more rapidly attaining a greater level of sophistication and scale than they could on their own, in order to increase their impact and generate the committed membership needed to achieve sustainability. This support could take a number of forms, including:

   1. Technical assistance to design or maintain Web sites or networking databases, and
   2. Co-sponsorship of trade and investment conferences or other networking events

   Donors might also wish to consider, "Providing seed funding to establish and develop a network to the point that its membership is large and willing to pay a levy to sustain the network."[88] However, as USAID/Armenia's experience indicates, before providing support for network activities, the sustainability of those activities must be carefully analyzed, and appropriate exit strategies for donor support should be incorporated into their design.

5. ***Supporting Government Investment Promotion Schemes.*** The experience of *Mi Comunidad* and *Por Mi Jalisco* highlight the importance of well designed technical assistance for the design of sound investment projects. They also highlight the importance and high costs of the communications (promotional and supervisory) and organizational efforts necessary to make these projects successful. The costs of organizing and communicating with the diaspora may be even higher for other countries other than Mexico that do not enjoy the advantage of having a large percentage of their diaspora concentrated in one country. Given the success that these

[87] Johnson and Sedaca 2004, pp. 43-44 and 53-54.
[88] Ibid., p. 46.

programs may enjoy, USAID may wish to consider support for governments in designing public sector investment promotion schemes. This could take the form of direct technical assistance or dissemination of lessons learned and best practices through study tours to successful programs. The Agency may also wish to consider support for training and certifying a cadre of technical advisors to support these programs, and/or assistance in designing or implementing communication strategies.

6. ***Working with Diaspora Investment Funds and Clubs.*** While the promise of diaspora investment funds has not been realized yet, USAID may wish to consider providing technical advising, seed capital, and/or marketing assistance to diaspora organizations interested in creating pilot investment funds, or provide support for an existing initiative. Another, less risky option would be to provide technical assistance for feasibility studies and business plan development for diaspora investment initiatives, such as those of the New Horizons Investment Club. Finally, USAID should consider support for literacy training for host country counterparts and/or HTAs to support diaspora investment initiatives such as those of the Indigo Project. While USAID traditionally finances only activities in host countries, the transnationalization of society suggests a need to consider a more inclusive approach to defining key development partners. Alternately, USAID should consider partnering with organizations that can provide support to U.S. based development actors, such as HTAs, to better leverage their development contributions.

7. ***Promoting Bonds and Foreign Currency Accounts.*** Many countries and financial institutions may be able to replicate the success of these incentives simply with information on the experiences of other countries or institutions. For less advanced countries and financial institutions, there may be a role for USAID in assisting financial institutions in the development of a foreign currency savings product with optimal incentives, in marketing that product, or providing technical assistance for a successful bond issuance.

SECTION VI: USAID, DIASPORAS, AND DEVELOPMENT PARTNERSHIPS

In Sections IV and V we explore the important contributions that diasporas can make to their countries of origin through family remittances, commerce, and investment, and the ways in which USAID has and can enhance their impact on economic development. In this section we consider the potential for and value of USAID-diaspora partnerships on productive and social projects to leverage diaspora resources to achieve mutual development goals, and the challenges and lessons learned from working with diasporas. In most cases in Latin America, these partnerships have emerged around leveraging donations raised collectively by immigrant groups to finance community development projects. In other regions, partnerships have facilitated skills transfer through volunteerism or informed the design of development efforts through consultative processes.

Partnerships on Social and Productive Projects

In recent years, USAID has begun to recognize the important role diasporas can play in local community development and has made the decision to work in partnership with these groups. As noted in USAID's 2002 report, *Foreign Aid and the National Interest*, "by 2010, even with the projected increases in U.S. official development assistance through the Millennium Challenge Account… personal remittances will still be twice U.S. government aid. This eclipsing of foreign aid calls for new thinking by USAID on partners in development aid."[89]

The Bureau for Latin America and the Caribbean, the Global Development Alliance Office, and a few missions around the world have all begun to explore partnerships with nontraditional partners, including diasporas, though such partnerships are still new and appear to be few in number. Below we highlight specific projects and activities, both within and outside of the Latin American and Caribbean region, where USAID and diasporas have worked effectively in partnership. These partnerships can be divided into two categories: partnerships on social projects and partnerships on productive projects. While the lessons learned and recommendations gleaned from partnerships on both types of projects are similar in many respects, there are also important differences which are drawn out in the section on challenges and lessons learned. We begin our analysis of USAID-partnerships with a discussion of diaspora association-funded social projects.

Social Projects. Within many diaspora communities, immigrants, generally from the same area of their countries of origin, form Hometown Associations (HTAs) or similar immigrant community organizations. These associations provide a venue for social activities that help immigrants maintain their cultural ties to their countries of origin. They have also become small-scale development agents, raising funds to support community development projects in their homelands. Typically, HTAs finance health, education, and infrastructure projects, such as road construction or electrification. Though small-scale, HTA projects often make possible investments in the social and

[89] USAID 2002, p. 145.

economic infrastructure needed to create productive opportunities, without adequate roads, for example, access to markets is limited. Research on Mexican HTAs, perhaps the most active diaspora organizations, suggests that the financing provided is limited, generally under $10,000 per year. However, these donations may represent as much as one fifth or more of the total budget for public works of the municipalities in which the primarily poor, rural beneficiary communities are located. Consequently, they can have a significant impact on local poverty. [90]

As noted above, HTA projects often focus on improving education in communities of origin, whether through the provision of school supplies, equipment, or other interventions. To leverage diaspora resources for educational purposes in July 2004 USAID/El Salvador entered into its most ambitious donor-diaspora partnership to date. The project, called ALCANCE (Alianza de Comunidades Apoyando la Niñez y su Continuación en la Educación), was modest in terms of resources and timeframe ($463,000 from USAID over 12 months). Nonetheless, the project remains the largest USAID-funded public-private partnership involving diasporas in Latin America and the Caribbean to date, bringing together 21 HTAs, the Pan-American Development Foundation (PADF), the non-governmental organization World Vision, a Salvadoran educational organization, local HTA counterparts, and financing from two banks. The objectives of the project were threefold: improve education among poor, rural primary schoolchildren, leverage immigrant resources, and develop sustainable mechanisms for transnational support for rural education in El Salvador.[91]

To achieve these objectives, the project operated under two modalities. Under the first, original modality, (Model A), HTAs contributed resources for mini-scholarships of school supplies and small infrastructure support, while World Vision supported teacher training and workshops for parents and children for communities in a pre-determined area of operation. Under the second modality, (Model B), the interventions varied from community to community. ALCANCE provided a one-to-one matching fund of HTA contributions to support interventions selected, designed, and implemented by HTAs in collaboration with their local counterparts, schools, and parent-teacher associations. In both cases, PADF coordinated the activities of the diverse partners and provided training to HTAs to strengthen their project design and management capacity.[92]

The project has demonstrated that partnering with HTAs is a viable way to increase the resources available for social projects, in this case rural education. In fact, HTAs contributed considerably more resources to the project than an initial viability study indicated they would ($10,500 in cash and in kind per HTA vs. $750). In one year the project helped over 12,000 children and 77 schools.[93] Anecdotal evidence points to increased school enrollment, reduced absenteeism, and higher test scores, as well as increased involvement of parents in their children's education. Some HTAs participated in educational projects for the first time through ALCANCE, others expanded their involvement. The needs assessment conducted by PADF during phase 1 of the project

---

[90] Orozco 2003.
[91] PADF 2005b, p. i
[92] Ibid., p. ii.
[93] Ibid., p. iii.

proved a useful instrument for helping HTAs establish their funding priorities. And the project's intermediary role helped strengthen coordination between HTAs and their local counterparts and helped HTAs fund projects in communities where they previously lacked strong local liaisons. Finally, the training HTAs received from PADF is thought to have strengthened their project selection and management capacity.[94]

In addition to the ALCANCE project in El Salvador, USAID is working with diasporas on social projects in other countries and regions, including Iraq and the Sudan. In Iraq, USAID has collaborated with members of the diaspora and return migrants on education reconstruction efforts. In a briefing on these efforts in June 2003, USAID officials noted that they were working with trained educators from the diaspora. In addition they noted that returned migrants were a source of "useful advice as to who to talk to, who to trust, what information to trust."[95]

In the Sudan, USAID is promoting volunteerism among the diaspora. Recently, three members of the Sudanese diaspora "returned to Sudan as volunteers, and are working to pass on their knowledge to their professional counterparts through the pilot phase of USAID's Diaspora Skills Transfer program." John Zachariah Abdullah, a microbiologist living in London, Fred Wani, an internist based in Zimbabwe, and Elias Nyamlell Wakoson, a professor of literature and language living in Texas, teamed up with USAID's implementing partner, the Academy for Educational Development (AED), this summer to give back to their country of origin. "The diaspora program enables skilled, educated Sudanese living outside Sudan to return to assist the development of human and institutional capacity in health and education. Volunteers serve for 1 to 12 months in sites throughout Southern Sudan in an effort to build local capacity to sustain long-term reconstruction and service delivery." [96] AED works closely with diaspora organizations to identify potential volunteers.[97]

Productive Projects. While the majority of HTA projects have been social in nature, increasingly, these groups are also financing productive projects through larger investments. In 2002, USAID again in collaboration with PADF, initiated an 18-month program to strengthen the capacity of immigrant associations to engage in productive projects. The program, the first of its kind for the Agency, sought, "to determine whether with better organizational skills, clearly defined strategic goals, and well-targeted local community activities, these groups could serve as instruments for creating economic opportunities in impoverished areas, particularly if their efforts could be effectively fused with other public and private sector initiatives."[98] The program consisted of three pilot projects, one each in Haiti, Mexico, and El Salvador, involving income generating agribusiness activities supported through coordinated efforts among USAID, PADF, HTAs in the United States, local NGOs, and private sector organizations.

[94] Ibid., pp. 18-21.
[95] USAID 2003a.
[96] USAID/Sudan 2006.
[97] http//cit.aed.org/forecast_sudan.htm.
[98] PADF 2005a. p. 1.

In Haiti USAID and PADF partnered with the National Organization for the Advancement of Haitians (NOAH), a Washington D.C. based immigrant organization and two local farmers' cooperatives to produce and market environmentally friendly fruit trees. In Mexico, they partnered with an HTA of Oaxacan immigrants, *Migrantes por Ayoquezco (MIGPAO),* a local producers' group, a local foundation, and others to organically produce and market nopal, an edible cactus. And in El Salvador, USAID and PADF teamed up with the United Salvadoran-American Civic Committee (USACC) HTA, the Confederación de Federaciones de la Reforma Agraria Salvadorena (CONFRAS), and local cooperative to produce, process, and market organic fruits and vegetables for the domestic and export markets.[99]

In each project immigrants provided financial and in-kind resources. While HTAs provided collective donations in Haiti and El Salvador, in Mexico HTA members invested in the collective project, with each member receiving a share "proportional to their investment."[100]For its part, PADF leveraged financial resources and provided HTAs with training workshops and manuals on fundraising, institutional strengthening, project planning and design, monitoring and evaluation, budgets and financial management, and importing nostalgic goods to the United States. The Foundation also provided a resource guide on supporting transnational development, and a Web site with training manuals, project profiles, information on funding sources, and other resources for immigrant associations interested in supporting development projects in their homelands. Finally, PADF engaged the HTAs in all aspects of project design, implementation, and monitoring to ensure partner buy-in and capacity building.[101] As a result of this support, the capacity of all three HTA partners to develop income-generating projects was increased, with 30 HTA representatives trained in the areas mentioned above.[102]

All three projects appear to have been successful and demonstrate that USAID can effectively partner with diaspora associations. Despite setbacks resulting from political unrest and hurricanes, the Haitian project all but met its production targets, established local nurseries, and generated enough profit for further investment. Under the Mexico project, with PADF support MIGPAO set up a U.S.-based investment corporation and initiated a joint venture factory to produce and sell nostalgic goods in Mexican and U.S. markets—for which the HTA procured $600,000 in risk capital. In addition, this was the first project in Mexico to achieve organic certification for its members, with roughly half obtaining this certification. Finally, the Salvadoran project benefited 240 people through training in organic cultivation, processing, and marketing, built a small processing plant, and raised 79 percent of direct participants' (44 of 48 individuals) income from $1.90/day to $4.57/day, an increase of 241 percent.[103]

[99] Ibid., p. 2.
[100] Email communication from PADF, November 2006.
[101] PADF 2005a, pp. 2-3.
[102] Ibid., p. 5.
[103] Ibid., pp. 9-10.

In addition to the results achieved during the short project timeframe, the Mexican HTA raised approximately an additional $9,000 to support project-funded activities after the USAID-PADF involvement ended. Similarly, El Salvador raised another $15,000.[104]

A different approach to USAID-diaspora partnerships can be seen in the USAID-funded Serbia Local Government Reform Program (SLGRP), which helped to facilitate and establish the Chicago-Belgrade Sister City program in 2005. “This agreement reflects the dream of many Serbs living in Chicago, as well as their relatives and business associates in Serbia, to see Belgrade and Chicago (the home of one of the largest concentrations of Serbian diaspora in the United States) become sister cities…Such a relationship forms a key part of the city’s policy agenda to foster economic growth through the strengthening of international trade and recognizes the cultural significance of such ties.”[105]

Challenges and Lessons Learned

As the examples in this section suggest, there are many benefits to be had from supporting diaspora projects. Moreover, it is clear that USAID has had some initial successes in effectively partnering with diaspora groups. However, partnering with these groups also involves a number of challenges. In this section we review those challenges, as well as the lessons learned to date from USAID-diaspora partnerships.

Geography. Many diaspora groups have a highly localized area of operation. This is particularly true of HTAs. By definition, Hometown Associations use the town or rural area as their primary unit of organizing. Programs limited to one HTA and one hometown are straightforward. Scaling up from this model is challenging in part because interested HTAs may not correspond to communities in the target area while other communities in the target area may have no corresponding funder. ALCANCE confronted this problem during its collaboration with World Vision in El Salvador. For this reason, PADF introduced its second operating model—the matching fund—open to HTAs operating in any rural community.[106] In addition to the challenge of the limited geographic focus of many diaspora associations, as a number of observers have pointed out, coordinating the activities of a large number of dispersed communities and HTAs to scale up their activities can be time consuming and costly.

It is important to note, however, that not all diaspora organizations limit their geographic focus. For example, Guyaid, a Washington, DC-based NGO supported by the Guyanese community, targets vulnerable populations throughout Guyana, as well as in DC. Moreover, though a minority, ALCANCE found that 26 percent of HTAs interested in working with the project would consider helping communities other than their own.[107]

Respect Diasporas Knowledge and Networks. The introduction of Model B, the matching fund, under ALCANCE not only addressed the challenge of pairing communities and HTAs, but gave HTAs a greater role in project selection and design,

---

[104] Email communication from PADF, November 2006.
[105] USAID undated.
[106] PADF 2005b, p. 8.
[107] Ibid., p. 6.

building on their experience and communities ties. Luis Felipe Romero, Executive Director of Comunidades Unidas Salvadorenas (CUS), an HTA NGO that participated under this Model, noted that CUS had prior experience with education projects and a network of community relationships when ALCANCE began. The matching fund allowed CUS to draw on these relationships and knowledge of community needs, and supplement the organizations own financial resources for greater outreach. While working with PADF and USAID under this flexible Model helped the HTA achieve its goals, the NGO was not interested in participating under Model A, with its pre-defined package of interventions and geographic focus, which would have required CUS to change the way it was already working.[108] As this suggests, USAID-diaspora partnerships should be based on flexible, demand-driven models that complement diasporas' experience, operational approaches, and goals, without distorting the latter.

Trust. Working with international donors and home country governments requires trust in these actors on the part of diaspora groups, which may not exist initially. To build the trust needed for effective public-private partnerships, considerable time and energy must be put into constant communication, transparent decision-making, and consensus building. Where immigrant groups are providing capital investments, rather than collective donations, the time needed for decision-making and negotiations may be particularly long. This was the case in Mexico.[109] However, as the examples discussed in this section demonstrate, with adequate time, this trust can be established. For example, while the HTAs that supported the ALCANCE program started out hesitantly, and with limited funds, every HTA was interested in continuing the relationship after they had seen initial successes.[110] With time and repetition of the program cycle, HTAs and home communities can learn to trust each other, to trust donors, and to trust the local government. Success stories also build trust between migrants and the HTA, facilitating fundraising. USAID should factor these considerations into the design of future projects.

On a similar note, in working in Haiti, Mexico, and El Salvador, PADF found that "personal community ties strengthen commitment and accountability." Partners with closer ties to the targeted communities (MIGPAO) were more engaged in the projects than those that were more generally committed to philanthropy in their countries of origin (NOAH and USACC). The former also had an easier time fundraising for the project.[111]

Organizational Capacity. Effective diaspora supported projects require a level of organizational capacity on the part of both diaspora associations and their community counterparts, which is sometimes lacking. First, the association must have a certain degree of capacity to raise funds, to select projects, and for project management. However, most associations are informal, volunteer-based groups with a strong desire to support their communities of origin, but little development experience. While some immigrant associations have the capacity to carry out social projects without outside

[108] Interview with Luis Felipe Romero, Comunidades Unidas Salvadoreñas, November 2006.
[109] PADF 2005a, p. 9.
[110] Interview with PADF September 2006.
[111] Op. cit., pp. 5-6.

support, to design and implement productive projects these associations need more intensive training and technical assistance.[112]

In addition to strong immigrant associations, effective projects require some type of local organization to channel the funds and develop the project on the ground. Jonathan Fox describes a cross-border social investment initiative that failed: "one key issue was the imbalance between the cohesion of the organization in the United States and the shallow social roots in the home communities in Mexico…The social base and entrepreneurial experience with which to organize broad-base community development initiatives was lacking."[113]

Often, the existence of an HTA that wants to do social projects may catalyze the creation of a social organization in the receiving community or strengthen a nascent one. Similarly, a strong community level organization may create requests or proposals for support from diasporas that encourage organizational growth in the sending community. Either way, successful projects will address the institutional capacity of both immigrant associations and their local counterparts.

Sustainability. If sustainability is defined as the continued success of a program through community efforts rather than ongoing donor intervention, many diaspora-funded social projects and programs have already proven to be sustainable. The Comite de Santa Marteños, a Salvadoran HTA in Washington, D.C., is just one example of an HTA that has created sustainable social programs and continues to expand its work without any donor inputs or outside financing. This group has been organizing since the mid-1980s to create a support network in Washington, advocate on immigration issues, and support social projects in Santa Marta, El Salvador. Their current effort is a science lab to add to the Santa Marta high school so that students will have more access to scientific equipment and the opportunity to carry out experiments. All funding for the creation of the lab has come from the HTA. The Comite's projects are financed within the transnational community through the pattern of migration and collective donations. Since the relationship between the HTA and the recipient community fits within the livelihood strategies of the transnational community and because HTA members have a long-term personal commitment to the community, sustainability of this type is relatively easy to achieve and is one of the advantages of HTA funded programs.[114] Successive generations of community members (migrants and non-migrants) are likely to continue supporting the science lab, for example, because they feel a strong level of ownership and commitment to community development. In some cases, including the science lab, they further create sustainability by encouraging government buy-in. For example, the Comite is currently negotiating with the municipal government to take over maintenance of the laboratory

[112] PADF 2005a, p. 6.
[113] Fox 2006, p. 4.
[114] Theoretically, another level of sustainability could exist whereby the HTA supports the creation of a social program and then transitions responsibility entirely to the recipient community. In this model, the local community would sustain the project through user fees, volunteerism, or other mechanisms. However, this may be a false distinction or an unrealistic goal. Considering the transnational community as a unit with a variety of livelihood strategies, analyzing the local community by itself is artificial. Households, markets, families, and even individuals' lives all span the border. In addition, remittances are fungible, so user fees may be paid from received remittances or obviated by collective ones, but the "local economy" never stands alone.

and provide supplies. This is also the case in Mexico where responsibility for public infrastructure projects financed by HTAs is often assumed by the local government.[115] Of course, some HTAs only exist for a short time or fail to meet their goals. Nonetheless, the existence of some HTA funded social programs that are already decades old shows that they can clearly be sustainable.

In cases such as the science lab, we are referring to individual, small-scale projects. Achieving the sustainability of more ambitious projects involving multiple HTAs and counterparts may be more complicated. At the conclusion of the one-year ALCANCE project PADF noted that the project had laid a sustainable foundation by building social capital—a network of ongoing relationships among HTAs, local counterparts, and private sector partners—that would enable the continuation of project activities after the project closed. "Even without any additional outside assistance, both World Vision and almost all the HTAs involved in Model B will continue some level of ongoing support to children and/or the schools that benefited from this pilot program. However, without additional outside support, these initiatives will remain dispersed and small. Additional funding is necessary to scale up these efforts in both quality and quantity." Moreover, they concluded that to achieve sustainability an intermediary organization, operating transnationally, would be needed to, "support simultaneous communication, oversight, and coordination of important players in key sites in the United Sates and El Salvador."[116]

Public vs. Private Sector Responsibilities. One possible negative impact of these programs is decreased state responsibility for public investment in social programs and public infrastructure. Most social projects funded through collective donations cover activities that traditionally fall under the state's responsibility.[117] If HTA funding is able to help meet the critical social needs of a community, it may decrease local pressure on the public sector and further isolate some communities from government agendas. However, this risk can be mitigated through good program design.

For the most part, the absence of adequate state support for social programs and public infrastructure in rural communities results from the lack of government funds for these activities. Regardless of the pressure from citizens or the international community, governments cannot execute successful social programs if their municipalities lack funds. Competition over scarce funds may stymie efforts to improve social services and make infrastructure investments, or may result in poor programs spread over large areas. If some communities are able to meet their own needs through collective donations, this may free up funds for other areas. In this way, well-designed government interventions might use successful diaspora funded projects to fill gaps in public finance or might focus their efforts on the communities without HTA support and ultimately have more impact because there are fewer communities to cover.

[115] Orozco 2003, p. 16.
[116] PADF 2005b, p. 22.
[117] Goldring 2003, p. 14.

In addition, diaspora funded projects and programs may in fact create pressure for further democratization, better governance, and increased attention to communities' needs. HTAs increase civic participation by involving communities in project implementation. Further, in countries such as Mexico and El Salvador that have public sector matching funds for HTA projects, HTAs and their local counterparts work with governments on project implementation. As a result of this collaboration, HTAs in Mexico, for example, are demanding greater transparency and accountability on the part of local governments in exchange for their financial contributions.[118]

Increased pressure on governments may also occur through simple increased awareness of the benefits of healthcare and education. Citizens with basic access to healthcare messages, for example, may begin to demand clean water or will better understand that infant mortality can be prevented through prenatal care. Families that begin to see the benefits of literacy may demand high-school opportunities for their children. Even funded, motivated municipalities face challenges with public education messages. HTA-funded programs have a particular competitive advantage in this area. Migrants are often the most successful members of a community and they hold a natural position of leadership and influence. In addition to remittances, migrants transfer new ideas and values to their families and communities. In this way, the link created by migration can also be used to spread critical messages through personal ties. A migrant that provides funding for a school attendance program is also a family member who calls home regularly and asks how the kids are doing in school.[119] Migrants also teach by example; by virtue of living in the United States, they are likely to send their children to school, to receive immunizations, and countless other behaviors which they model for their home communities. This leverage is something that the state government simply does not have. In place of countless community outreach workers or radio slogans, programs which partner state and HTA efforts can insert their message directly into rural communities and households. Some scholars have described this transmission of ideas as "social remittances" or "technical remittances."[120]

Where the government is unresponsive to citizens, international organizing through HTAs may provide the leverage that communities need. As has been documented by Keck and Sikkink, human rights progress has been impelled through the "boomerang effect" whereby local citizens contact international actors who can pressure the national government to change.[121] This may be the hidden power of HTAs: they are dedicated to local issues, they have democratic values, and they have access to international media. HTAs also inform a U.S. population that forms a small but important constituency in the event of natural disaster or government abuses in Latin America. The implication for donors is that they should remember the Diaspora when designing all programs, not only those that directly involve remittances.

Skills Transfer programs. The success of volunteer based skills transfer programs, such as the Sudanese programs described above, requires sufficient technical and financial

[118] Ibid., p.19.
[119] Interview with Francisco Ramirez, Comite de Santa Marteños, October 2006.
[120] Goldring 2003, p. 3.
[121] Keck and Sikkink 1998.

resources for such tasks as maintaining databases and Web sites, international recruitment, and overseeing volunteers' activities. In addition, given the financial sacrifice inherent in volunteering, it may be difficult to recruit the highest caliber professionals.[122]

Conclusions and Recommendations

Although one of the most challenging activities for USAID related to remittances and diasporas is creating and fostering partnerships with diaspora communities, such partnerships can have important and sustainable development impacts. USAID has begun to recognize not only the importance of vast remittance financial flows, but also the value of reaching out to new partners, including diaspora communities, working together to maximize "collective achievements in improving the economic, social and political conditions of people in the lesser developed world."[123] The examples above demonstrate that diasporas can and do provide critical human and financial resources that benefit their communities and countries of origin. These examples also demonstrate that working in partnership with diasporas provides opportunities to leverage both diasporas and USAID's resources. For these reasons, partnerships between USAID and diaspora communities are important today and will continue to be so in the future. To maximize the impact of diaspora development activities and the effectiveness of partnerships, USAID should consider the following three approaches and activities:

1. ***Working with intermediaries.*** USAID's experience in Haiti, Mexico, and El Salvador demonstrates that working with intermediaries such as PADF or a for-profit development agent can be an effective way to facilitate partnerships, reach greater scale, and control costs. Such intermediaries can help to coordinate the participation of public and private sector actors, including multiple HTAs, community counterparts, and governmental agencies. They can also provide technical assistance and training to diaspora associations to improve their project design and management skills. However, USAID should also consider working more directly with grassroots intermediaries – federations of HTAs or NGOs organized by or specifically for working with immigrants. This may be done through mechanisms such as grants and contracts that go directly to diaspora organizations for projects designed, implemented and organized by these groups. An increased focus on strengthening diaspora associations, as suggested below, should create more opportunities for such partnerships. Regardless of whether donors choose to work with a traditional or grassroots intermediary, they must be prepared to invest time and money in effective communication and coordination.

2. ***Strengthening the organizational capacity of diaspora associations.*** Unlike donor agencies, most HTAs do not include any development experts and they have very limited program management experience. Consequently, one of the ways in which USAID or other donors can bolster diaspora funded projects and promote their sustainability is through the provision of technical assistance and training to

[122] Johnson and Sedaca, pp. 61-62.
[123] USAID 2003b.

strengthen diaspora associations. As PADF's Amy Coughenour Betancourt stressed, it is imperative to look at *transnational communities* rather than distinguishing between diaspora and home communities. Although the focus of this work is economic development in immigrants' countries of origin, in order to achieve the best results in the home communities, programs need to work in both countries. In this way, institutional strengthening of HTAs is more of an intermediate, rather than an end result.[124] Specifically, most associations would benefit from training in needs assessments and proposal evaluation to identify priority projects, project design, monitoring, and evaluation, as well as proposal development to apply for donor funding. Luis Felipe Romero of CUS observed that more comprehensive and in-depth training during the ALCANCE project would have been helpful.[125] Providing this type of training requires a commitment to diaspora partners in time and resources. Given the increasing importance of diaspora associations as agents of development, increasing USAID efforts in this area are justified.

3. ***Providing matching funds.*** By providing matching funds donors can leverage the financial resources and local knowledge of diaspora associations into larger projects with greater impact. USAID should also consider providing financing for needs assessments to inform diaspora project selection.

[124] Interview with PADF September 2006.
[125] Interview with Luis Felipe Romero, Comunidades Unidas Salvadoreñas, November 2006.

VII. FINAL CONCLUSIONS AND RECOMMENDATIONS

As we have shown throughout this paper, diasporas can contribute to home country economic development through a wide range of remittance, commerce, investment, and philanthropy related activities. And donors have supported many of these activities through a variety of programmatic interventions to good effect.

While some countries, communities, or households might experience some negative effects of remittances flows, the studies reviewed here indicate that the benefits of remittances outweigh any potential negative effects. Moreover, as long as poverty and income inequality among countries persists, to say nothing of globalization in general, so too, will migration and remittances. Consequently, USAID and other donors should continue and expand their efforts to leverage the development impact of remittances and other diaspora contributions to growth in order to address the economic disparities that necessitate migration.

The most appropriate programmatic interventions in any given country will depend on the unique circumstances of that country. Nonetheless, this review of remittance, diaspora, and economic development issues suggests certain priorities, which we detail below.

1. ***Promoting Pro-Growth Macroeconomic and Trade Policies.*** As noted above, diasporas may invest in or trade with their home countries when others consider the risks too high, which can induce others to follow suit. However, the diaspora is not always willing to play this role without some improvements in the economic or business environment; economic liberalization was a contributing factor to China's success in attracting foreign direct investment from its diaspora. USAID can encourage trade and investment from the diaspora and non-diaspora alike by assisting partner countries in designing and implementing pro-growth macroeconomic and trade policies. Ultimately, such policies may generate the employment needed to reduce the pressure to migrate.

2. ***Building More Trustworthy and Inclusive Financial Systems.*** As Newland observes, of all the mechanisms through which diasporas may have an impact on poverty in their countries of origin, the most direct and immediate is through family remittances.[126] While access to financial services can increase that impact, a high proportion of both senders and receivers remain unbanked. Due to their market focus and proximity to low-income populations, facilitating MFI entry into the remittance market may be one of the most effective ways to address this problem. As we have seen, some MFIs have successfully entered the market and are beginning to use remittance transactions to bank the unbanked. However, they face significant challenges in doing so and the number of MFIs offering money transfers and effectively cross-selling other financial services remains limited. For these reasons, it is the opinion of the authors of this paper that continued efforts to expand access to low-cost money transfers and other financial services through support to MFIs should

[126] Newland 2004, p. 18.

be a top priority for USAID. Similarly, increasing the awareness of traditional commercial banks of the market potential of remittance clients should also be an important area for USAID programming. Finally, support for developing, piloting, and replicating cost saving remittance technologies, whether through MFIs or other money transfer providers should also be a priority for the Agency.

To build stronger financial systems USAID may also wish to consider support to governments and financial institutions to develop, issue, or market diaspora bonds and/or foreign currency accounts. In addition to bolstering foreign exchange reserves, they can help deepen less developed financial markets through product diversification, and relieve the liquidity constraints that often plague developing country financial systems. Similarly, USAID may wish to consider support for securitization deals. As described in Section IV, USAID could leverage the Development Credit Authority to lower the collateralization requirements of these deals or encourage banks to use part of the capital obtained through securitization of remittances to expand into the micro, small, and medium-sized enterprise market.

3. ***Documenting and Disseminating Lessons Learned and Best Practices.*** While a great deal of literature exists on the importance and impacts of remittances, there are few in-depth analyses of MFIs experience with remittances, remittance-linked product development, and cross-selling, experiences with fostering diaspora-related trade and investment, and donor-diaspora partnerships. As Bernai Velarde, Private Sector Officer for USAID/Ecuador observed, USAID can have the greatest impact by showing countries what models work, which will lead to replication.[127] Though he was speaking about remittances and financial intermediation, this observation is applicable more broadly. Supporting study tours to directly expose stakeholders to successful models can also be highly effective in promoting innovation. Finally, the USAID-DFID *MigrantRemittances* newsletter is a useful tool to disseminate the latest research findings and should be continued.

4. ***Partnering more with the Diaspora.*** As we have suggested, diasporas have a great deal to offer both their countries of origin and donors, including financial and technical resources, language skills, cultural knowledge, and transnational relationships. Consequently, it is no surprise that in recent years USAID has begun to reach out to diaspora groups. While a number of USAID-diaspora partnerships have been fostered by the Bureau for Latin America and the Caribbean or individual missions, the Global Development Alliance Office has also begun to engage the diaspora and is poised to do more. The GDA currently has funding to hire a remittances and diaspora specialist in part to help guide the GDA's work in this area. As they move forward with developing their strategy, the GDA Office should consider partnerships with diasporas in a variety of context, including:

    - Supporting social projects involving HTAs in public-private partnerships, such as the ALCANCE project in El Salvador;

[127] Interview with Bernai Velarde, USAID/Ecuador, October 2006.

- Co-financing diaspora business investments that generate employment for low-income people or advance similar objectives;
- Engaging diasporas in diverse discussions on policy reform to identify priority issues and develop reform strategies.

Annex A: Bibliography

Acquista, Susan and John Ly, “Diaspora Bonds and US Securities Regulation: an interview with Anupam Chander of University of California, Davis Law,” University of California Business Law Journal, University of California, Davis, May 1, 2005. http://blj.ucdavis.edu/article/559/

Adams, Richard, “Remittances and Poverty in Guatemala,” World Bank Policy Research Working Paper 3418, 2004.
http://ideas.repec.org/p/wbk/wbrwps/3418.html

Adams, Richard and John Page, “Do International Migration and Remittances Reduce Poverty in Developing Countries?” World Development, Vol. 33, No 4, pp. 1645-1669, 2005.
http://siteresources.worldbank.org/INTAFROFFCHIECO/Resources/Migration_and_Remittances.pdf

Adams, Richard, “International Remittances and the Household: Review of Global Evidence,” paper presented to African Economic Research Consortium, Nairobi, Kenya, May 2005.

Aggarwal, Reena, Demirguc-Kunt, and M.S. Martinez Peria. “Do Workers’ Remittances Promote Financial Development?” Washington DC: The World Bank, June 2006.
http://siteresources.worldbank.org/INTTOPCONF3/Resources/Do_Workers_Remittances_Promote_Financial_Development.pdf

Barham, John, “BCP’s Leading Edge Remittance-Backed Bond,” Latin Finance, November 2002.
http://media.corporate-ir.net/media_files/NYS/BAP/LatinFinance_BankoftheYear2002.pdf

Buch, Claudia M.; Anja Kuckulenz and Marie-Helene Le Manchec, “Worker Remittances and Capital Flows.” Kiel Institute for World Economics. Keil Working Paper No. 1130, June 2002.

Buch, Claudia M., and Anja Kuckulenz “Worker Remittances and Capital Flows to Developing Countries,” Discussion Paper No. 04-31, (Mannheim: Centre for European Economic Research).
ZEW, 2004.
http://www.zew.de/en/publikationen/publikation.php3?action=detail&nr=2131

CEPAL, “Las Remesas y el Desarrollo Rural en las Zonas de Alta Intensidad Migratoria de Mexico,” Naciones Unidas, Comision Economic para America Latina y el Caribe, December 18, 2001.

http://www.eclac.org/cgi-bin/getProd.asp?xml=/publicaciones/xml/5/9465/P9465.xml&xsl=/mexico/tpl/p9f.xsl&base=/mexico/tpl/top-bottom.xsl

CGAP, "Crafting a Money Transfers Strategy: Guidance for Pro-Poor Financial Service Providers," Occassional Paper No. 10, March 2005.
http://www.cgap.org/portal/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet/Documents/OccasionalPaper_10.pdf

CGAP, "Making Money Transfers Work for Microfinance Institutions: A Technical Guide to Developing Delivery Money Transfers," Draft for Public Review, December 2006.
Chami, Ralph, Connel Fullenkamp and Samir Jahjah. "Are Immigrant Remittance Flows a Source of Capital for Investment?" IMF Staff Papers, Vol. 52, No. 1, 2005.
www.imf.org/External/Pubs/FT/staffp/2005/01/pdf/chami.pdf

Chemonics, "Catching the Technology Wave: Mobile Phone Banking and Text-a-Payment in the Philippines," 2006.

El-Sakka, amd Robert McNabb, "The Macroeconomic Determinants of Emigrant Remittances," *World Development*, Vol. 27, No. 8, 1999

Fagen, Patricia, "Remittances in Crises: A Haiti case study," Humanitarian Policy Group, ODI, April 2006.

Fajnzylber, Pablo and J. Humberto Lopez, "Close to Home: The Development Impact of Remittances in Latin America," The World Bank, 2006.

Fox, Jonathan, "Migration and Development: Encounters and Disconnects," Grassroots Development, Journal of the Inter-American Foundation, Vol. 27, No. 1, 2006.

Freinkman, Lev M. "Role of the Diasporas in Transition Economies: Lessons from Armenia," Paper presented at the 11th Annual meeting of the ASCE, Coral Gables, August 2-4, 2001.
http://groong.usc.edu/ro/ro-20020128.html

Gevorkyan, Aleksandr V. and David A. Grigorian. "Armenia and Its Diaspora: Is There any Scope for a Stronger Economic Link?" Armenian International Policy Research Group, Working Paper No. 03/10, April 2003.
http://www.armpolicyresearch.org/Publications/WorkingPapers/index.htm

Giuliano, Paola and Marta Ruiz-Arranz, "Remittances, Financial Development, and Growth," IMF Working Paper WP/05/234, December 2005.
www.**imf**.org/external/pubs/ft/wp/2005/wp05234.pdf

Goldring, Luin, “Rethinking Remittances: Social and Political Dimensions of Individual and Collective Remittances,” Center for Research on Latin America and the Caribbean, York University, Feb. 2003.

Hastings, Anne H. “Entry of MFIs into the Remittance Market: Opportunities and Challenges,” Prepared for the Global Microcredit Summit, 2006.

Johnson, Brett and Santiago Sedaca. “Diasporas, Emigres and Development: Economic Linkages and Programmatic Responses,” A Special Study of the U.S. Agency for International Development Trade Enhancement for the Services Sector (TESS) Project, March 2004. http://dec.usaid.gov/

Keck, Margaret and Kathryn Sikkink, *Activists Beyond Borders*, Copyright Cornell University1998.

Kochhar, Rakesh, 2005 *Latino Labor Report, 2004: More Jobs for New Immigrants but at Lower Wages*. Washington, DC: Pew Hispanic Center.
http://pewhispanic.org/reports/report.php?ReportID=45

Lowell, B. Lindsay and Stefka G. Gerova. “Diasporas and Economic Development: State of Knowledge,” Institute for the Study of International Migration Georgetown University, September 13, 2004.
http://siteresources.worldbank.org/INTGEP2006/Resources/LowellDiaspora.doc

Loser, Claudio, Caitlin Lockwood, with Adam Minson, and Lucia Balcazar. “The Macro-Economic Impact of Remittances in Latin America- Dutch Disease or Latin Cure?” Washington DC: Inter-American Dialogue, 2006.
http://www.g24.org/lose0906.pdf

Lueth, Erik and Ruiz-Arranz, Marta. “A Gravity Model of Workers’ Remittances.” IMF Working Paper: Washington DC, 2006.

Melendez Salinas, Claudia, “Honey of an idea: Grower finds new use for agave plant,” Monterey County Herald, September 7, 2006.
http://www.montereyherald.com/mld/montereyherald/15458832.htm

Menen, Rajendar, “Riding high on profit,” Gulf News Report, February 19, 2006.
http://archive.gulfnews.com/supplements/investment/more_stories/10019968.htm.

Mesbah-Khavari, Dina with Anna Cora Evans and Janette Klaehn, “Credit Union Remittance Serivces in Guatemala: Expanding the Access of Low-Income Remittance Recipients to Financial Institutions,” Prepared for the U.S. Agency for International Development by WOCCU, April 2005.
http://www.microlinks.org/ev02.php?ID=8392_201&ID2=DO_TOPIC

MigrantRemittances, "Worldwide Trends in International Remittances," Vol. 3, No. 2, August 2006.
http://www.livelihoods.org/hot_topics/docs/Migrant_Remittances_Aug06.pdf

Mishra, Prachi, "Macroeconomic Impact of Remittances in the Caribbean." Unpublished paper. International Monetary Fund, Washington, DC, 2005.

Newland, Kathleen with Erin Patrick, "Beyond Remittances: The Role of Diaspora in Poverty Reduction in their Countries of Origin," A Scoping Study by the Migration Policy Institute for the Department of International Development, July 2004.
http://www.eldis.org/static/DOC17672.htm

Nii Addy, David, Boris Wijkstrom and Colleen Thouez. "Migrant Remittances – Country of Origin Experiences: Strategies, Policies, Challenges and Concerns," International Migration Policy Programme, UNFPA and ILO, October 2003.
www.livelihoods.org/hot_topics/docs/REMITPAPER.doc

Orbe, Mauricio, *"Capacidad de absorción de las remesas,"* Quito: Ecuador, Research study commissioned by the Inter-American Dialogue, 2006.

Orozco, Manuel, "Hometown Associations and their Past and Future Partnerships: New Development Opportunities? September 2003.
www.thedialogue.org/publications/country_studies/remittances/HTA_final.pdf

Orozco, M. and B. L. Lowell, "Transnational Engagement, Remittances and their Relationship to Development in Latin America and the Caribbean," Institute for the Study of International Migration, Washington: Georgetown University, 2005.

Orozco Manuel. "International Financial Flows and Worker Remittances: Best Practices," Report prepared for the United Nations Population Division, 2005a.

Orozco, Manuel. *Remittances – global opportunities for international person-to-person money transfers.* VRL Publishing Ltd. November 2005b.
http://www.earthinstitute.columbia.edu/cgsd/remittances/documents/Remittances_Global_Opportunities.pdf

Orozco, Manuel. "Migrations and remittances in Latin America and the Caribbean: Intra-regional flows and macroeconomic determinants." Sistema Economico Latinoamericano y del Caribe, Caracas, Venezuela: May 2006a.

Orozco, Manuel. "Diasporas, philanthropy and hometown associations: the Central American experience," Report prepared for the Global Equity Initiative at Harvard University Cambridge, MA: May 10, 2006b.

Orozco, Manuel. “International Flows of Remittances: Cost, competition and financial access in Latin America and the Caribbean- toward an industry scorecard.” Report prepared for the Inter-American Development Bank, Washington DC: May 12, 2006c.

Orozco, Manuel. “Remittance senders, banking access and alternative products: issues and challenges,” Inter-American Dialogue, draft briefing, June 25, 2006d.

Orozco, Manuel. “Development, Migrant Foreign Savings and Asset Accumulation: Conceptual Considerations and Empirical Findings,” preliminary draft prepared for the Brookings Institute /Ford Foundation Workshop on Asset-based Approaches, Inter-American Dialogue, June 2006b.
http://www.brookings.edu/global/assets06/19orozco.pdf

Orozco, Manuel and Hamilton, Eve. “Remittances and MFI intermediation: issues and lessons.” *Remittances, Microfinance and Development: Building the Links, Volume 1: a Global View*. Edited by Judith Shaw, Foundation for Development Cooperation, Brisbane, Australia: 2005.

PADF, “Final Report to USAID on Building Capacity of Immigrants to Serve as Development Actors in Latin America and the Caribbean,” January 26, 2005a.

PADF, “ALCANCE (Alliance of Communities Supporting Children and their Continuing Education): Increasing the Impact of Community Remittances on Education in El Salvador,” produced for review by the United States Agency for International Development, June 2005b.
http://dec.usaid.gov/exphtml/102105.htm

Paul, John, “What Works: THAMEL.COM – Diaspora-enabled Development,” World Resources Institute, December 2005.
http://www.nextbillion.net/files/Thamel%20-%20Final.pdf

PRNewswire, “DCR Rates Banco Cuscatlan’s Series 1999-1 Remittance-Backed Certificates ‘BBB,’” November 4, 1999.
http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/11-04-1999/0001067916&EDATE=

Puris, Shivani, and Tineke Rizema. "Migrant Worker Remittances, Micro-Finanance and the Informal Economy: Prospects and Issues," International Labor Organization Working Paper 21. Washington, DC: ILO, 1999.
http://www.ilo.org/public/english/employment/finance/download/wpap21.pdf

Pyle, Kathryn Smith, “Postcards from IAF’s Roundtables: Grantmaking in the Era of Transnationalism,” Grassroots Development, Journal of the Inter-American Foundation, Vol. 27, No. 1, 2006.

Rapoport, Hillel and Frederic Docquier, "The Economics of Migrant Remittances." Chapter to appear in the Handbook on the Economics of Reciprocity, Giving and Altruism, Forthcoming at North Holland. June 2003.

Rauch, James. "Diasporas and Development: Theory, Evidence and Programmatic Implications," USAID/TESS-funded project August 2003. http://www.tessproject.com/products/special_studies/diasporas.pdf

Roberts, Bryan and King Banaian, "Remittances in Armenia: Size, Impacts, and Measures to Enhance their Contribution to Development," Submitted to USAID/Armenia, October 1, 2004. http://www.usaid.gov/locations/europe_eurasia/countries/am/docs/fsdp/annex_3.pdf

Robinson, William I. "Transnational Processes, Development Studies and Changing Social Hierarchies in the World System: A Central American Case Study." Third World Quarterly 22(4): 529–563, 2001.

Saxenian, AnnaLee. "Local and Global Networks of Immigrant Professionals in Silicon Valley," Public Policy Institute of California, 2002. http://www.ppic.org/content/pubs/report/R_502ASR.pdf

Singh, Gurmukh, "NRIs Cut up with Mother India on Interest Cuts," Hinudstan Times, October 5, 2004. http://www.nriinternet.com/INDIA/IndiaActionTo_betray_NRIs/09_01_04/3_interestRATE

Smith, Geri, "Channeling the Remittance Flood," Businessweek, December 28, 2005. http://www.businessweek.com/bwdaily/dnflash/dec2005/nf20051228_4272.htm

Solimano, Andres, "Workers Remittances to the Andean Region: Mechanisms, Costs and Development Impact." Prepared for Multilateral Investment Fund-IDB Conferenece. Remittances and Development. Quito, Ecuador, May 2003. http://www.andressolimano.com/Remittances%20Andean%20Region,%20manuscript.pdf

Sultan Uddin, Syed, "Strategies to Increase Remittance Inflow," The Executive Times, August 2006. http://www.exectimes.com/diplay_news.asp?conid=982&edid=78

UNDP, "Worker Remittance as an Instrument for Development," December 2003. http://www.undp.org/surf-panama/docs/migrant_remittance.doc

USAID, "Belgrade-Chicago Sister City Relationship Brings Dawn of a New Era in Serbia Diaspora Relations," http://www.usaid.gov/locations/europe_eurasia/press/success/sister_city_relationship.html

USAID, "Foreign Aid in the National Interest," 2002.
http://www.usaid.gov/fani/

USAID, "Transcript: Education Update," June 24, 2003a.
http://www.usaid.gove/iraq/vid_live062403_t.html

USAID, *Congressional Budget Justification FY2004 – Global Development Alliance*, 2003b.
http://www.usaid.gov/policy/budget/cbj2004/cent_prog/central_gda.html

USAID/Sudan, "Diaspora Members Volunteer to Improve Health and Education," Monthly Update, USAID/Sudan, July 2006.
http://www.usaid.gov/locations/sub-saharan_africa/countries/sudan/docs/sudan_monthly7_06.pdf

Woodruff, Christopher and Rene Zenteno, "Remittances and Microenterprises in Mexico," August 14, 2001.
http://sccie.ucsc.edu/documents/working_papers/2001/Remittances_Mexico.pdf

The World Bank, "Migrants' Capital for Small-Scale Infrastructure and Small Enterprise Development in Mexico," January 4, 2002.
http://wbln0018.worldbank.org/ppiaf/activity.nsf/files/C010300-S-MS-ST-MX.pdf/$FILE/C010300-S-MS-ST-MX.pdf

World Bank, "Trends, Determinants, and Macroeconomic Effects of Remittances," Global Economic Prospects 2006, pp. 85-115, Washington: World Bank, 2005.
http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2005/11/14/000112742_20051114174928/additional/841401968_200510319015205.pdf

World Bank, The Development Impact of Workers' Remittances in Latin America. Volume II: Detailed Findings, Washington, DC, The World Bank, 2006.

Annex B: List of Interviews

USAID Missions and Staff

Alice J. Brooks
IR1 Project Manager, Economic Opportunities SOT
USAID/Bolivia

Bernai Velarde
Private Sector Officer
USAID/Ecuador

James Stein, Director, Enterprise, Trade and Environment Office
Liliana Gil, Program Development Specialist
USAID/Guatemala

Geoffrey Chalmers
Development Finance Advisor
USAID/México

Enrique Urbina
Deputy Chief & Food Security Officer
Trade & Agri-Business Office
USAID/Nicaragua

Lawrence Rubey EG
Director, Economic Growth
USAID/El Salvador

Nhu-An Tran
Microenterprise Development Advisor
EGAT/PR/MD

Jim Thompson, Senior Program Analyst
Jerry O'Brien
Denis V. Korepanov, Senior Advisor
USAID Office of Global Development Alliances

Jennifer Dostert
USAID Office of Development Credit

Dino Siervo
USAID/EGAT/DC

Non-USAID Interviews

Amy Coughenour Betancourt, Deputy Director
Dale Crowell, Director of Communications
Corrie Drummond, Coordinator of Transnational Programs
Pan-American Development Foundation

Kai Schmitz
Executive Vice President and Chief Operations Officer
Microfinance International Corporation, MFIC

Jennifer Isern
Lead Microfinance Specialist
Consultative Group to Assist the Poor (CGAP)

Gregory Watson
Consultant, Operations Department
Multilateral Investment Fund

Francisco Ramirez
Comite de San Marteños

Luis Felipe Romero
Executive Director
Comunidades Unidas Salvadoreñas

Margarita Quihuis
Consultant and Technology Entrepreneur

Annex C: The Macroeconomic Impacts of Remittances – Models and Statistical Results

Exhibit A. Model and Regression Results of GDP and Income factors

Model :

$$GDP = Maquila_{t-1} + Remits_{t-1} + Non\text{-}trad\ exp._{t-1} + Tourism_{t-1}$$

Where maquila = exports of maquila;

Remits = remittance transfers;

Non-trad exp: Nontraditional exports;

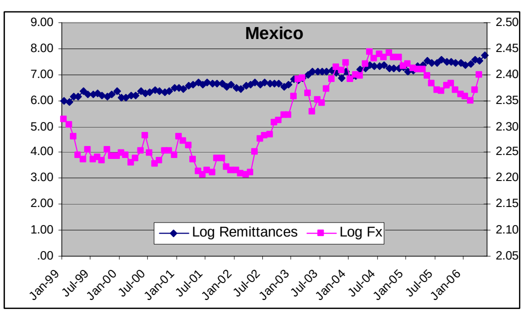
Tourism = earnings from inbound tourism

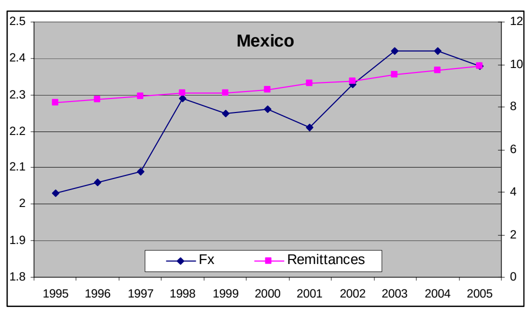
Table 3A1. Regression results of remittances on GDP from January 1999 and May 2005

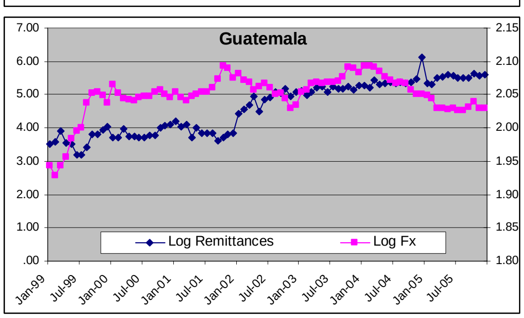
	El Salvador		Dominican Rep.		Jamaica	
Variables	B	Std. Error	B	Std. Error	B	Std. Error
Constant	5.696	.240***	- 15.366	6.875**	9.658	.878***
Remittances	.271	.046***	.147	.319*	-.357	.054
Non-trad. Exp.	.109	.066*	NA	NA	.132	.073**
Maquila	9.338E-02	.017***	2.772	.933***		
Tourism	-3.079E-02	.048	.528	.362*	-.206	.161*

(1) N=28 per country; (2) Model F (3) ***P<0.001, **p<0.01, *p<0.1 (4) r2 = 0.971; 0.594; 0.886 per country respectively.

Exhibit B. Monthly and Annual Exchange Rate Fluctuations and Remittances







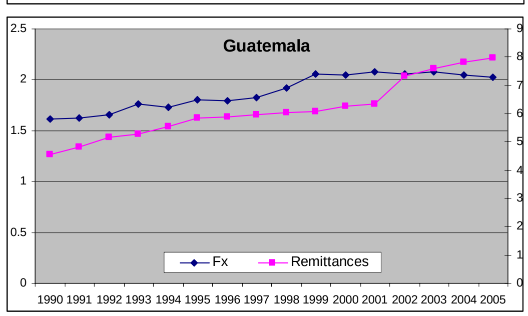


Exhibit B. (continued) Monthly and Annual Exchange Rate Fluctuations and Remittances

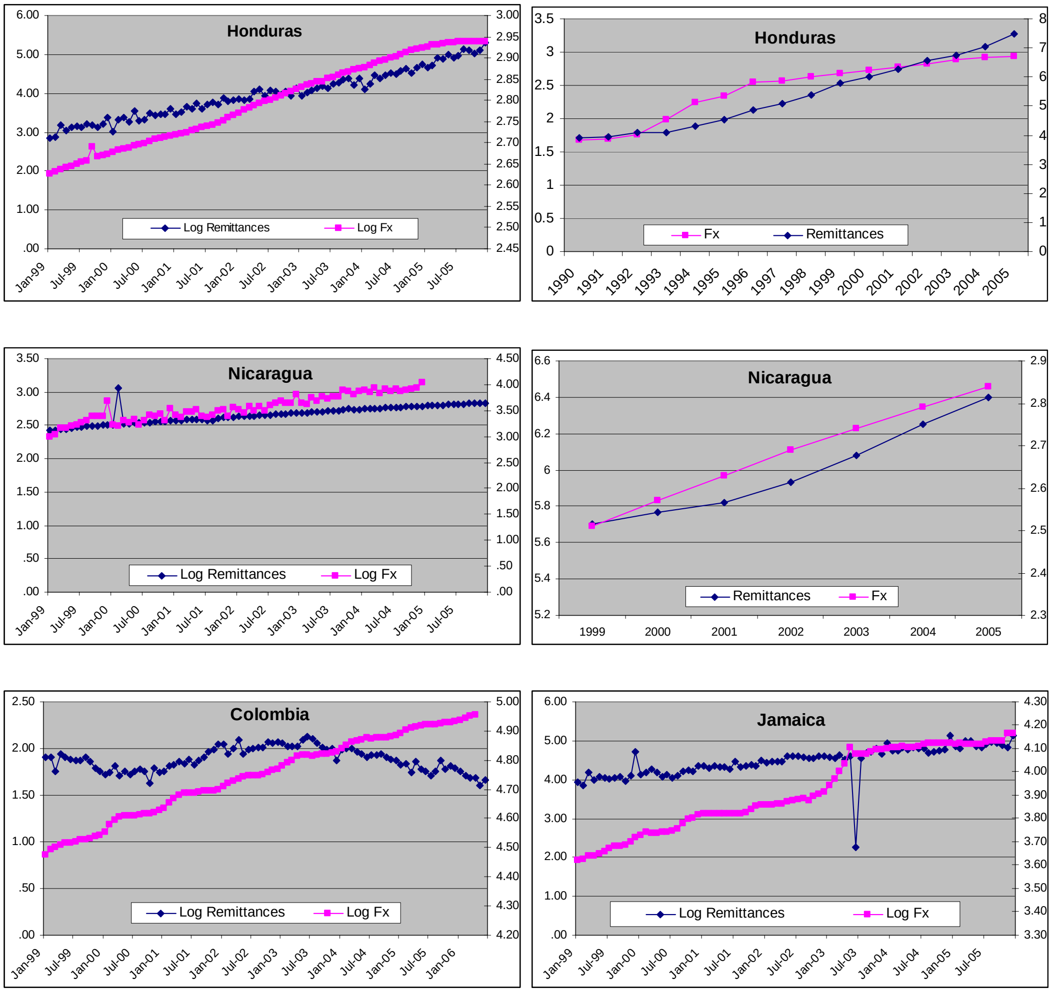


Exhibit C. Regression Results on macroeconomic determinants of remittances

Monthly data was collected from the official sources such as IMF, Central Bank.

Table C1. Data Sources on macro-economic indicators

Variable	Source
Monthly unemployment in the U.S. among	US Labor Dept. (all Latino immigrants)
Per capita total earnings (sum of all weekly earnings over total population)	US Current Population Survey (by nation of birth)
Monthly remittance transfers	Central Banks
Consumer price index	IMF statistics
Foreign exchange	IMF statistics
Interest lending rate	IMF statistics

Two models are run: one for inflation and one for foreign exchange. The main equation is presented as follows:

$$R_{it} = USM_{it} + HspUn_{it} + CPI_{it} + IR_{it}$$
$$R_{it} = USM_{it} + HspUn_{it} + FX_{it} + IR_{it}$$

Where the subscripts refer to i = nation and t = month, and where:

R_{it} = Remittance transfers to each nation
$USM_{i\text{-}2t}$ = Imports of US goods
$HspUn_{i\text{-}t\text{-}1}$ = Unemployment in the U.S., all Latino immigrants
$CPI_{it\text{-}1}$ = Consumer price index in receiving nation
[$FX_{i\text{-}1t}$ = Foreign exchange (nominal) in receiving nation]
$IR_{it\text{-}1}$ = Interest lending rate in receiving nation

The tables below show the results on inflation, Hispanic unemployment, imports of U.S. goods, and lending rate as independent variables. Results for individual nations are examined.

Table C2. Regression Results on Macroeconomic Determinants of Remittances Including Inflation

		Constant	CPI	Hispanic Unemployment	Imports of US goods	Lending rate
Mexico	B	-10.809	4.608	-0.332	-0.41	0.112
	Standard Error	2.382***	.317***	0.24	.202*	0.084
Guatemala	B	-15.315	3.585	0.967	0.598	-0.711
	Standard Error	4.598***	.649***	.259***	.260*	0.525
Jamaica	B	3.854	0.893	-0.389	-0.087	-0.826
	Standard Error	2.938	.273**	0.312	0.263	.384*
El Salvador	B	-8.05	2.77	-0.292	0.249	-0.209
	Standard Error	2.232***	.376***	.152*	.091**	0.131
Honduras	B	-10.134	2.321	-0.198	0.91	-0.469
	Standard Error	1.850***	.212***	0.168	.194***	.206*
Nicaragua	B	-6.097	2.059	0.07	-0.0226	-0.07
	Standard Error	1.113***	.213***	0.095	0.077	0.115
Colombia	B	-5.156	2.751	.164	-.287	0.0615
	Standard Error	1.500**	.317***	.268	.219	.114
Ecuador	B	6.358	.297	-.130	-.203	-.181
	Standard Error	.492***	051***	.126	.097*	.063**
D. Republic	B	2.93	0.456	0.287		-0.215
	Standard Error	0.414***	0.045***	0.148**		0.113**

Table 3C3. Regression Results on Macroeconomic determinants of remittances including foreign exchange

		Constant	FX	Hisp. Unemployment	Import of US goods	Lending rate
Mexico	B	-1.333	2.939	-0.865	0.46	-0.505
	Std. Error	3.011	.340***	.322**	.257*	.084***
Guatemala	B	0.348	3.82	0.438	0.88	-3.175
	Std. Error	2.9	.948***	0.289	.270**	.302***
Jamaica	B	5.547	0.784	-0.558	0.001203	-1.023
	Std. Error	3.292*	.380*	.318*	0.271	.447*
El Salvador	B	741.249	-338.163	-1.263	0.305	-0.813
	Std. Error	143.970***	66.374***	.108***	.103**	.084***
Honduras	B	-11.652	5.998	-0.493	0.00519	-0.0704
	Std. Error	1.426***	.376***	.132***	0.172	0.168
Nicaragua	B	2.118	0.556	0.304	0.298	-0.629
	Std. Error	.974*	.240*	.139*	.101**	.153***
D. Republic	B	4.938	.433	.02		-.384
	Std. Error	.390***	.05***	0.159		.129**

(2) $R2 = 0.75$

Annex D: Scope of Work

Remittances and USAID/LAC Economic Growth Programs
Statement of Work

Objective

To provide USAID an overview of the most relevant issues associated with immigrant remittances and economic development.

Background

Persistent disparities of wealth and income in the Western Hemisphere have caused a significant migration of labor, which in turn has led to an ever increasing level of migrant remittances returning to the countries of origin. The labor migration and the remittances each have important impacts on the economic development of countries in the region. Given the size of these flows of resources, USAID must understand the implications for its programs. This statement of work calls for an overview of the nature of remittances followed by an examination of six sets of related issues.

Overview. Over the past decade migrant remittances have increased substantially in the Latin America and Caribbean region. The Inter-American Development Bank and other institutions provide regular reporting on these flow and the Bank and others conduct research and policy analysis on these remittances and repercussions. The study will lay out the basic information on remittance flows in the region the size and the growth of the flows at the country level (including flows such as Spain to Ecuador) and indicate the availability of data at the state or province level for the larger countries. The study will also identify the institutions that are most active in remittance research and identify their principal areas of interest and recommendations including mention of benchmark studies.

1. There is evidence that there are often serious deleterious impacts on economic development when remittances grow to represent a significant portion of GDP. One problem appears to be that these funds can provide an unfortunate respite from pressures to carry out needed structural reforms. Without the remittances, reforms such as increased fiscal discipline and policies aimed at improving the investment environment or reducing poverty would proceed more expeditiously. Remittances can mask the problems. They appear to rarely represent an element of the solution. A related problem is referred to as resource curse or the Dutch disease. The remittances tend not to contribute to growth and development because they are spent overwhelmingly on consumption. On the contrary, these resources can tend to raise the price housing and other goods and contribute to an appreciation of the real exchange rate creating problems for exporters. Furthermore, remittances may serve as a substitute for labor income and may be used by recipients to reduce their labor supply and labor market participation, obviously having an adverse impact on economic growth and development. This study will address these issues and suggest how USAID economic growth programs might respond.

2. A sizable part of the flow of remittances has involved the sender putting down cash at one window and the receiver picking up cash at another window with one or the other party paying a substantial fee. This is changing rapidly. The increasing volumes of remittances have seen increasing competition among money transfer agents and the fees have fallen significantly. Banks, credit unions, and other financial institutions have gotten more involved, often in alliance with the money transfer agents. These financial institutions see an opportunity to serve a clientele that has tended not to use bank and to sell additional services to them. USAID is involved with several organizations in promoting this sort of integration and expansion of clientele base. Central bank regulations of foreign exchange and of money transfers per se have had to respond to the increased volumes, to the increasing role of electronic transfers, and to increased vigilance for illicit funds transfers, including Know Your Customer legislation in the US. USAID may be involved in some of this work. The question for this study is whether there is additional work to be done to strengthen banks and related financial institutions in the face of increasing remittance flows and can the flows be further utilized to expand the clientele and services of these institutions. Is there a need for coordination among ongoing USAID work and is there a need for additional work in this area.

3. A very small portion of the remittance flow finds it way to investments in productive enterprises, i.e., very little is direct foreign investment. The authors of a recent IMF Staff Paper (Vol. 52, No. 1 – Are Immigrant Remittance Flows a Source of Capital for Development?) find that remittances do not appear to be intended to serve as capital for economic development, but rather as compensation for poor economic performance. The authors also find that there is a negative correlation between immigrant remittances growth and per capita GDP growth and suggest that policies that are predicated on the presumption that remittances have similar uses and effects as other private capital flows may have unintended consequences. There is evidence of some success in attracting immigrant remittances for productive investment. For example, some Philippine local governments have modified tax code to attract immigrant funds for bond issues. Generally, however, investment in an individual's home country will tend to be much more risky than alternative portfolios available in his/her receiving country. Are there any circumstances in which USAID should work with programs that aim to attract remittances into local investment? Housing may be one instance, but it is not devoid of its own issues.

4. A part of the literature on immigrant remittances casts the net more widely. Manuel Orozco, for example, talks about how immigrants become agents of globalization of their home countries. This occurs through what he refers to as the five Ts' (air Transportation, Tourism, Telecommunications, remittance Transfers, and nostalgic Trade). Others cast the net more even widely, referring to diaspora capital in many forms:

- Social capital – networks, obligations, trust, social relations, goodwill
- Financial capital – remittances, investment (social enterprise, FDI)
- Intellectual capital – skills, IT and brain transfer through return or retrieval
- Political capital – advocacy, dual nationality (as voters abroad, opening up issues of taxation without representation)

- Cultural capital – promoting and supporting the homeland – culture (food, music, dress)

This approach clearly leads us a bit astray from discussing strictly remittances, but the topic is worth attention. It has been a very big issue at times when the diaspora is politically active in the United States (e.g., Armenia, Nicaragua, Cuba). The question for this study is whether there are notable examples where the diaspora and USAID have worked effectively in partnership and is there reason to believe that such partnerships should be important in the future in the region?

5. Migration is oftentimes driven by desperate situations. Immigrants often represent family mired in poverty in villages that offer few opportunities to young people. The family left behind usually clearly needs the help of the funds sent back by the emigrant. Are there programs that are able to provide services to the families left behind on the basis of streams of remittances that come to the families? If so, are the programs of charity, or can they be made self-financing, or even profitable? Such services probably include, but are not limited to, health care and schooling. A related issue is whether working in this area is a distraction from other work should as promoting proper public investment in health care and education so that all poverty families can benefit, not only those that have sent a member abroad. This takes us back to question one.

6. There may be other issues addressed in the literature or that may be obvious that should be addressed. Again, the overall question is: What are the immigrant related issues that are relevant to USAID programs in the LAC region and what are the implications of the issues to these programs? So the question relevant to the study is whether there are other issues that should be considered. If so, please consider them.

Annex E: Summary Report
Remittances, Diasporas, and Economic Development

EXECUTIVE SUMMARY

Remittance flows to Latin America and the Caribbean, which far exceed official development assistance to the region, have significant economic impacts at the regional, country, and household levels. While these impacts vary by country, studies generally conclude that remittances have a positive effect on growth, domestic investment, and poverty reduction. While the greatest share of these income flows are spent on consumption, remittances also foster asset accumulation and wealth generation for both recipients and senders. According to recent studies, access to finance, on the sending and receiving ends, increases remittance flows, savings, and investment. Despite these facts, remittance recipients, as well as senders, frequently lack access to the financial services that would help them leverage the development impact of remittance flows. To increase access to a broad range of financial services, facilitate asset accumulation, and reduce the transaction costs of remittances, evidence indicates that donors can provide MFIs with technical assistance and training to facilitate their entrance into the remittance market and improve their efforts to cross sell products and services to remittance recipients. Evidence also suggests a need for donors to encourage commercial banks, which are important payers of remittances, to see remittance recipients as a viable market for their other financial services.

In addition to remittances, diasporas contribute to poverty alleviation and economic development in their countries of origin through commerce with and investment in their homelands and through collective financing of community development projects. With respect to the former, governments and the diaspora itself use a variety of mechanisms and incentives to encourage or pursue commerce and investment opportunities that contribute to country of origin development with varying degrees of success. These include: diaspora business networks, diaspora investment funds and clubs, government investment promotion schemes, and bonds and foreign currency accounts. A review of these experiences suggests a possible role for USAID in supporting development of country specific diaspora outreach strategies, documenting and disseminating lessons learned and best practices, promoting sound business and investment environments to encourage trade and investment, and other areas.

In recent years, USAID has begun to recognize the important role diasporas can play in local community development and has begun to work in partnership with these groups. Though these partnerships are challenging, experience to date has shown that they can be an effective way to leverage resources for development and strengthen the capacity of local and international counterparts to foster change in their communities of origin.

Final Conclusions and Recommendations. This paper demonstrates that diasporas can contribute to home country economic development through a wide range of remittance, commerce, investment, and philanthropy related activities. And donors have supported many of these activities through a variety of programmatic interventions to good effect. The most appropriate programmatic interventions in any given country will depend on the unique circumstances of that country. Nonetheless, this review of remittance, diaspora, and economic development issues suggests certain priorities, which we list below.

- Promoting pro-growth macroeconomic and trade policies to encourage growth at all levels and trade and investment from diasporas and other actors
- Building more trustworthy and inclusive financial systems through general institutional strengthening and by assisting and encouraging MFIs and traditional banks to offer transfers and cross-sell their services
- Documenting and disseminating lessons learned and best practices
- Partnering more with the diaspora to learn from and maximize the impact of their knowledge and financial resources

INTRODUCTION

In the past five years Latin America and the Caribbean have received nearly two hundred billion dollars from migrant workers in the United States, Europe, and Japan, as well as from intra-regional remittance flows. These flows, which far exceed official development assistance to the region, have significant economic impacts at the regional, country, and household levels. But remittances are just one of the ways in which diasporas can and do contribute to poverty alleviation and economic development in their countries of origin. They also foster development through commerce and investment in their homelands and through collective financing of community development projects. In this paper, commissioned by the United States Agency for International Development (USAID), we review a wide-range of issues surrounding these contributions. Following a brief introduction, the paper is organized into five key sections: 1) a statistical review of remittances in Latin America and the Caribbean, 2) analysis of the impact of remittances on economies, 3) a discussion of remittances and financial inclusion, 4) review of diaspora commerce and investment in their countries of origin, and 5) analysis of USAID partnerships with diasporas. We conclude with a series of overarching recommendations for USAID.

REMITTANCES IN LATIN AMERICA AND THE CARIBBEAN

Remittance flows to Latin America and the Caribbean surpassed $50 billion in 2005. While these flows predominantly originate in the United States, they are increasingly from Europe and Japan. Mexico receives the largest share of the regions remittances, with $20 billion in 2005, followed by South America with $16.4 billion, Central America with $9.1 billion, and the Caribbean with $6.4 billion. Together, these flows represent two percent of regional gross domestic product (GDP). However, for 9 countries remittances amount to more than 10 percent of GDP, and in three countries they represent over 25 percent of GDP. As these numbers reflect, there are significant variations in sub-regional and country level remittance trends.

In addition to looking at total remittance volumes and remittances as a share of GDP, in analyzing the importance of remittance flows at the country level, it is useful to consider remittances per capita and to compare this figure to per capita income. If we analyze Latin American and Caribbean countries according to these indicators, we can divide the region into three groups. The first group is represented by those countries whose remittance flows have a strong effect in most if not all the indicators mentioned above. This means that remittances have an important impact both on the country’s national and per capita income, as well as on household income, with recipients receiving at least twice the average per capita income. This group includes Guatemala, Mexico, Bolivia, and Haiti, among others. In the second group the effect of remittances is felt in half of these indicators. This group includes countries such as Peru, the Dominican Republic, Belize, and Grenada. In the third group remittances have a minimal impact as reflected by the indicators. This group includes most of the island economies.

Finally, it is revealing to consider the percentage of female remittance senders and receivers. In all countries the percentage of female recipients is high, but in Central

America it averages nearly 75 percent. However, there are a relatively low number of female senders, with only 39 percent in Central America. These trends are significant because it suggests that women are the primary decision-makers in the majority of recipient households in Central America, which may affect the way in which remittance money is spent.

THE IMPACT OF REMITTANCES ON ECONOMIES

As the previous section suggested, remittance flows can have a significant impact on Latin American and Caribbean economies. In particular, the sheer volume of these flows has made them an important source of foreign savings that help sustain foreign currency reserves. In many Caribbean and Central American countries, remittances are the most important source of national income and exhibit far more stability than other private or public capital flows. This creates discernible effects on people and on economies. In macroeconomic terms, foreign savings, in the form of remittances, may affect three variables: 1) growth (by decreasing or increasing output), 2) financial trends (by increasing or decreasing financial resources), and 3) domestic currency and pricing (by appreciating or depreciating national currency and consumer prices). The volume of remittances can also influence or be influenced by economic growth, foreign exchange reserves, or other macro determinants such as inflation or interest rates.

With respect to the first variable, most studies find that remittances have a positive effect on growth. A recent World Bank study, for example, found that an increase in remittances from 0.7 percent of GDP in 1991-1995 to 2.3 percent of GDP in 2001-2005 resulted in an increase of 0.27 percent in per capita GDP growth per year. However, most studies on remittances and growth use aggregated annual data in their analyses. When quarterly data is used to analyze the effects of remittances on growth, the results vary across countries. The differing outcomes highlight the influence of other country-specific economic factors, such as the unique characteristics of the productive bases of local economies, on the macroeconomic impact of remittances. They also highlight a need for improved data collection and analysis.

With respect to financial trends, studies find that remittances are associated with increased rates of domestic investment and a reduction in growth volatility, both directly and by diminishing the impact of external and macroeconomic policy shocks on the economy. Studies also find that remittances have a positive and significant impact on both bank deposits and bank credit to the private sector. This impact is more pronounced in less developed financial systems.

With respect to foreign exchange, a number of studies have analyzed the potential of remittance flows to produce the phenomena called the Dutch Disease: a currency appreciation resulting from increased inflows, which makes the manufacturing sector less competitive, and can even result in job losses. The World Bank finds that in Latin American and the Caribbean countries remittances are likely to contribute to significant real exchange rate appreciation. The authors argue that in part these problems are part of a natural adjustment process that accompanies any favorable shocks and should not be of particular concern to policymakers. However, they conclude that it may be possible to reduce the appreciations through policies, such as fiscal restraint. Others argue that the countercyclical trend of remittances produces mixed macroeconomic results which on balance do not cause severe distortions in the economy. Specifically, they argue that as remittances increase, exchange rates and interest rates appreciate. But at the level of the balance of payments, export growth may decrease while import growth increases with higher flows. This may reverse the effects of remittances on exchange rate and interest rates. Ultimately, the relationship between remittances and foreign exchange is a complex one.

Finally, in addition to contributing to economic growth, studies have shown that remittances tend to reduce poverty. Moreover, they have found that remittances reduce income inequality.

The findings in this section suggest an ongoing need for research on remittances, as well as a need to help countries maximize the productive use of remittances in local economies. In the first case, USAID should consider providing support to Central Banks to improve data measurement and explore analytical devices to improve accuracy in the analysis of the impact of remittances. In the second case, USAID should consider interventions to help link productivity in the local economy to remittance spending and investment. Of particular importance is the provision of technical assistance to identify productive sectors that can leverage the inflow of funds from migrants, including nostalgic commodities, or increasing foodstuff production at greater competitive levels, thus increasing employment in tradable sectors.

REMITTANCES AND FINANCIAL INCLUSION

Remittances are a primary source of income for million of households worldwide. While the greatest share of these income flows are spent on consumption, remittances also foster asset accumulation and wealth generation for both recipients and senders. According to recent studies, access to finance, on the sending and receiving ends, increases remittance flows, savings, and investment. For example, multi-country surveys found that immigrants with a bank account in their host country remitted 9 percent more than those that did not have an account. Moreover, individuals who save in their home country remit nearly 25 percent more dollars, and are 3.3 times more likely to send money to support a business back home. On the receiving end, remittance recipients are more likely to have bank accounts than non-recipients, and those with bank accounts save more than those who do not have accounts.

Despite these facts, remittance recipients, as well as senders, frequently lack access to the financial services that would help them leverage the development impact of remittance flows. In addition, transaction costs on both sides of the border, though significantly lower than they were just five years ago, siphon resources away from consumption, savings, and investment activities. One of the ways donors and others have been addressing these issues is by promoting the entry of microfinance institutions (MFIs) into the remittance market both to increase competition in the industry and reduce transactions costs, and to bank the unbanked. It is thought that due to their proximity to remittance receiving households, mission, and successful experience serving low-income populations in general, MFIs are particularly well positioned to provide lower-cost money transfers services to low-income populations and increase remittance clients' access to finance.

A number of MFIs do appear to be successfully offering money transfer services using diverse models. For example, USAID's work with credit unions in a variety of countries has demonstrated that working collectively, MFIs can capture a significant volume of remittances. And in Mexico, the National Savings and Financial Services Banks's national remittance platform processes 100,000 remittances per month through 1,200 distribution centers. USAID/Bolivia is also demonstrating that MFIs can achieve significant volume through domestic transfer systems and extend convenient transfer services and other financial products to poorer migrants who move from rural to urban areas in their home countries. In fact, domestic transfers are greater in number than international transfers, but are an often forgotten market. Evidence also indicates that MFIs can provide lower cost transfers than many of their competitors. Cross-selling other financial services to remittance clients has proven more difficult, however, though there are some encouraging results.

While the evidence demonstrates that at least some MFIs can provide low-cost money transfers and are using these services to bank the unbanked, the number of MFIs that have successfully entered the market to date, particularly on a significant scale, is relatively limited. In entering the market, MFIs face a series of challenges related to institutional capacity. These include: 1) developing adequate management information systems (MIS), 2) ensuring strong liquidity management and internal controls, 3) training specialized customer service representatives and devising customer service practices appropriate to remittance clients, and 4) designing and implementing effective product marketing strategies. In addition, the legal and regulatory environment can pose barriers. MFIs will need ongoing support from donors to address these challenges to market entry.

While working with MFIs provides some unique opportunities to bank the unbanked, evidence indicates that there is also an opportunity and a need to work with traditional banks to achieve this goal. A significant percentage of remittances are collected at banks, primarily serving as agents of money transfer companies. However, traditional commercial banks typically do not see remittance recipients as a potential market for their other financial services. Donors can help to raise the awareness of these financial institutions to the market potential of remittance clients.

Finally, technological innovation holds the promise of further reducing transfer costs and increasing financial access. Much remains to be done, however, to make new remittance technologies viable, including banking remittance senders.

How can USAID respond to these challenges and opportunities? USAID, and other donors, should consider interventions in the following areas:

- Increasing the institutional capacity of MFIs to provide transfers; priority areas include MIS, liquidity management and internal controls, customer service, and marketing
- Promoting appropriate regulation of remittances and MFIs to ensure remittances are neither over nor under regulated
- Encouraging commercial banks to develop and market their services to remittance clients, for example through documentation and dissemination of market research and increased dialogue
- Developing domestic transfer systems to meet the needs of domestic migrants and their families and facilitate international transfers
- Supporting new product development and technological innovation to reduce transfer costs and provide remittance clients with a range of convenient services
- Leveraging the Development Credit Authority (DCA) to facilitate securitization of remittances and new product development

DIASPORA COMMERCE AND INVESTMEN.

The most direct and visible way in which diasporas contribute to home country development is through family remittances. However, in recent years there has been increasing attention given to diaspora contributions through commerce and investment in their countries of origin. Diverse authors find that diasporas can have a significant impact on trade. They have also been found to have a significant impact on foreign direct investment (FDI). One of the ways in which diasporas stimulate both exports from and investment in their countries of origin is through nostalgic trade. According to Manuel Orozco, 10 percent of exports to the United States from El Salvador and various other Latin American countries are nostalgic goods. Demand for these goods has also motivated some migrants to invest in home-country export businesses.

In addition to stimulating nostalgic trade, highly skilled immigrants have had a significant impact on trade and investment, for example, by jump-starting the information technology industry in countries such as India. A 2002 survey of the Asian diaspora in Silicon Valley found that one half of foreign born entrepreneurs in this high technology area “maintain business relations” in their home countries. Eighteen percent invested or currently invest in start-ups or venture funds in their countries of origin. Lower-skilled or low-to-middle income immigrants also invest in their countries of origin. However, they may do so in ways that are not captured as foreign direct investment, investing in small businesses through remittances to their family members or purchasing residential property.

Governments and the diaspora itself use a variety of mechanisms and incentives to encourage or pursue commerce and investment opportunities that contribute to country of origin development with varying results. These include: diaspora business networks, diaspora investment funds and clubs, government investment promotion schemes, and bonds and foreign currency accounts.

Diaspora business networks can create trade and investment opportunities by disseminating information on market conditions and host country business regulations, helping to match investors with projects through online matching services, and/or organizing conferences and other business events to bring diaspora and country of origin business people together. A number of such networks have been fostered by USAID and other donors, including the Lebanon Business Network, the Armenian High Tech Council of America, and the South African Diaspora Network, with mixed results. Latin America does not appear to have formal transnational business networks. This is not to say that diaspora business networks are not an option for the region, but rather that additional, country specific analysis may be beneficial to better understand this gap.

While foreign direct investment is generally the realm of large-scale investors, diaspora investment funds and clubs may be a mechanism for broadening the investor base to include mid-sized portfolio investors. Investment funds can serve as first movers, improve corporate governance, if set up as holding companies, and deepen financial markets through the introduction of new financial mechanisms. Despite these apparent benefits, at the time this document was drafted, the authors were unable to confirm any examples of active diaspora investment funds, though several have been proposed over the last two years. The New Horizons Investment Club, however, provides another private sector investment model that appears to be working. Founded in 2000 by 10 Garifuna Honduran immigrants interested in learning how to invest in the U.S. stock market, with support from the Multilateral Investment Funds and International Fund for Agricultural Development (IFAD), the group has invested in tourism projects in Honduras.

For their part, government investment promotion schemes targeting the diaspora have produced mixed, but encouraging results. The former My Community project in Mexico led to the creation of approximately 12 maquiladoras employing 500 people with approximately $2.2 million in diaspora capital. However, insufficient technical support from the government and the exclusive focus on maquiladoras, rather than a diversified enterprise portfolio, ultimately led to the demise of most of the enterprises. In contrast, the For My Jalisco investment scheme, also in Mexico, has had greater success. Through the program, immigrants interested in investing in their state of origin receive technical assistance to conduct feasibility studies and develop business plans, in addition to financing. Unlike the My Community program, any viable employment generating business investment is eligible for support.

A variety of governments have attempted to use sovereign diaspora bonds and foreign currency accounts to attract foreign savings and increase remittance flows. With respect to diaspora bonds, Israel and India, for example, have demonstrated that they can be effective means for attracting foreign investment under less than optimal market conditions, due in part to their patriotic appeal. A number of countries have offered foreign currency savings accounts with premium interest rates and premium foreign exchange rates to attract remittances in order to raise foreign exchange reserves and increase the resources available for public and private finance. While foreign currency accounts are considered less effective than diaspora bonds in capturing migrants savings, there is some evidence that these accounts can be effective. In India, fixed term foreign currency accounts do appear to have been popular with Non-Resident Indians (NRIs), and have successfully increased foreign currency reserves.

As this review suggests, diasporas can have a significant impact on development in their countries of origin through a variety of mechanisms. To date, there has been little USAID or other donor programming promoting diaspora commerce and investment. Given the importance of diaspora commerce and investment in countries of origin, USAID should consider the following programmatic interventions:

- Supporting development of country specific diaspora outreach strategies; experience in several countries indicates that comprehensive strategies attract more trade and investment
- Documenting and disseminating information on diaspora-linked commerce and investment initiatives to identify lessons learned and best practices and support replication of successful experiences
- Promoting sound business and investment environments to encourage trade and investment from diaspora and non-diaspora alike
- Strengthening diaspora business networks to facilitate trade and investment through matching services and improved access to market information
- Supporting government investment promotion schemes to assist immigrants in identifying and pursuing employment generating investments
- Working with diaspora investment funds and clubs, which might include feasibility studies for fund start-up or for club financed investments
- Promoting bonds and foreign currency accounts through dissemination of information on experiences with these instruments and/or technical assistance

USAID, DIASPORAS, AND DEVELOPMENT PARTNERSHIPS

In recent years, USAID has begun to recognize the important role diasporas can play in local community development and has made the decision to work in partnership with these groups. In most cases in Latin America, these partnerships have emerged around leveraging the collective donations immigrant associations send to their home countries to finance community development projects. In other regions partnerships have facilitated skills transfer through volunteerism and or informed the design of development efforts through consultative processes. These partnerships can be divided into two categories: partnerships on social projects and partnerships on productive projects.

Social projects include partnerships with diaspora associations in collaboration with the Pan-American Development Foundation (PADF), along with local and international counterparts, to leverage collective donations to expand and improve rural education in El Salvador. This pioneering partnership, called the ALCANCE project, helped 12,000 children in 77 schools and demonstrated that partnering with diaspora associations is a viable way to increase the resources available for social projects, in this case rural education.

USAID has also worked with the diaspora and return migrants in Iraq on social projects, where they helped to inform and implement education reconstruction activities. And the

Agency helped set up a diaspora volunteer program in the Sudan, which is building local capacity for reconstruction in the country.

Traditionally, diaspora associations have worked primarily on social projects. Increasingly, however, they are financing productive projects, as well. In 2002, USAID entered into a pilot program with PADF to build the capacity of diaspora associations to engage in income and employment generating projects in three countries: Haiti, Mexico, and El Salvador. The three agribusiness projects helped local counterparts introduce or improve environmentally friendly or organic production methods, process, and market diverse products, and generate profits. As pilot projects they, along with the ALCANCE project, highlighted a number of challenges and key lessons learned regarding partnerships with diaspora associations.

First, many diaspora groups have a highly localized area of operation. Hometown Associations (HTAs), in particular generally focus only on development in the community of origin of their members. Programs limited to one HTA and one hometown are relatively straightforward to administer. Scaling up from this model, as USAID did with ALCANCE, is challenging in part because interested HTAs may not correspond to communities in the target area while other communities in the target area may have no corresponding HTA. One means of addressing this challenge employed by USAID under ALCANCE is to provide a matching fund open to HTAs operating in any rural community, rather than strictly limiting the area of operation.

Second, it is important to respect HTAs knowledge and networks. Diaspora partnerships should be based on flexible, demand-driven models that complement diasporas' experience, operational approaches, and goals, without distorting the latter.

Third, to build the trust needed for effective public-private partnerships, considerable time and energy must be put into constant communication, transparent decision-making, and consensus building. Fourth, effective diaspora supported projects require a level of organizational capacity on the part of both diaspora associations and their community counterparts, which is sometimes lacking. Donors can play a role in building that capacity over time through training and technical assistance for both local counterparts and their diaspora funders.

Fifth, if sustainability is defined as the continued success of a program through community efforts, rather than ongoing donor intervention, many diaspora-funded social projects and programs have already proven to be sustainable. Achieving the sustainability of ambitious projects involving multiple HTAs and counterparts may be more complicated. At the conclusion of the one-year ALCANCE project PADF noted that the project had laid a sustainable foundation by building social capital—a network of ongoing relationships among HTAs, local counterparts, and private sector partners—that would enable the continuation of project activities after the project closed. "However, without additional outside support, these initiatives will remain dispersed and small. Additional funding is necessary to scale up these efforts in both quality and quantity."

Finally, a possible negative impact of these programs is decreased state responsibility for public investment in social programs and public infrastructure. If HTA funding is able to help meet critical social needs of a community, it may decrease local pressure on the public sector and further isolate some communities from government agendas. However, this risk can be mitigated through good program design. In fact, diaspora funded projects and programs may in fact create pressure for further democratization, better governance, and increased attention to communities' needs. HTAs increase civic participation by involving communities in project implementation. Further, in countries such as Mexico and El Salvador that have public sector matching funds for HTA projects, HTAs and their local counterparts work with governments on project implementation. As a result of this collaboration, HTAs in Mexico, for example, are demanding greater transparency and accountability on the part of local governments in exchange for their financial contributions.

Ultimately, although one of the most challenging activities for USAID related to remittances is creating and fostering partnerships with diaspora communities, such partnerships can have important and sustainable development impacts and the Agency should consider additional partnerships in the future. To maximize the impact of diaspora projects and the effectiveness of partnerships, USAID should consider the following approaches and activities:

- Working with intermediaries, be they non-profit or for-profit to facilitate partnerships and help control costs; USAID should also consider providing support more directly to immigrants' grassroots organizations through grants and subcontracts
- Strengthening the organizational capacity of diaspora associations through technical assistance and training
- Providing matching funds to leverage diaspora resources

FINAL CONCLUSIONS AND RECOMMENDATIONS

This paper demonstrates that diasporas can contribute to home country economic development through a wide range of remittance, commerce, investment, and philanthropy related activities. And donors have supported many of these activities through a variety of programmatic interventions to good effect. The most appropriate programmatic interventions in any given country will depend on the unique circumstances of that country. Nonetheless, this review of remittance, diaspora, and economic development issues suggests certain priorities, which we list below.

- Promoting pro-growth macroeconomic and trade policies to encourage growth at all levels and trade and investment from diasporas and other actors
- Building more trustworthy and inclusive financial systems through general institutional strengthening and by assisting and encouraging MFIs and traditional banks to offer transfers and cross-sell their services
- Documenting and disseminating lessons learned and best practices
- Partnering more with the diaspora to learn from and maximize the impact of their knowledge and financial resources