

Remittances and their Role in Development

M. Přívarová¹ , A. Přívara², M. Pitukhina³

¹Faculty of National Economy, University of Economics in Bratislava,
Dolnozemska cesta 1, 852 35 Bratislava (Slovak Republic);
Email : magda.privarova@gmail.com

²Faculty of National Economy, University of Economics in Bratislava,
Dolnozemska cesta 1, 852 35 Bratislava (Slovak Republic);
Email : andy.privara@gmail.com

³Budget monitoring center, Petrozavodsk State University,
Lenin av.33, 185910, Petrozavodsk, Republic of Karelia (Russia)
Email : maria.pitukhina@gmail.com

ABSTRACT

Remittance represents an important capital resource for many countries, particularly for developing countries. In some countries, the remittances reach several tens of percent of the GDP. That is the reason why this phenomenon is becoming the subject of interest of various international organizations, as well as of scientific community. The ambition of this article is to contribute to the ongoing academic discussion related to the determinants of remittances and their impact on the countries which receive them. It aims to analyze the academic discussion based on the substantial scientific work published on the topic concerned and a suggestion of a possible direction of future research. The definition of the theoretical framework is followed by an analysis of the individual determinants, as well as of the effects of remittances on two levels: the microeconomic and macroeconomic level. The authors consider these two approaches to be complementary, and at the same time, they consider it to be a necessary condition for a complex analysis of the important phenomenon of international migration, remittances being certainly one of them.

Keywords: Remittances, development, migration, "Dutch disease".

Journal of Economic Literature (JEL) Classification : J61, D31, O15

1. INTRODUCTION

Remittances are one of the consequences of the international migration of the labour force. They represent the cash flow sent by migrants to their country of origin. The International Monetary Fund (IMF) defines those transfers as: "The household income generated from the reserves saved abroad, usually in the course of a temporary or permanent movement of people." (IMF, 2009, p. 272).

In the course of the last years, the research on the issues related to the remittances has intensified. International organisations, as well as the scientific community, discuss in particular the problems related to the definition of the determinants of the remittances, the ways of realisation of these money

transfers, as well as the economic impact of the given operations on the country of origin of the migrant.

The raised interest in the research on the issue of remittances is undeniably related to the enormous development potential hidden in the remittances (Bucevska V., 2011). One of their advantages is that they represent a more stable capital resource compared to the two other international cash flows: foreign direct investments (FDI) and development aid. Unlike FDI, whose amount increases in upward fluctuations of the economic cycle and decreases during a recession, money transfers from migrants are subject to the economic conjuncture to a significantly smaller degree. The increased resistance of the remittances to the cyclical fluctuations in the migrant's host countries can be accounted for by the protection of his income in the times of the economic recession by the mechanisms protecting the employees (e.g. unemployment benefit).

The ambition of our article is to contribute to the ongoing discussion on the determinants of remittances and their impact on the countries which receive them (for countries with transition economy see Balavac M, 2015). Its aim is an analysis of the academic discussion based on the substantial scientific work published on the topic concerned and a suggestion of the possible direction of future research.

2. DATA SOURCES AND THEIR INTERPRETATION

The recurring problem of remittance scrutiny lies in the collection of the statistic data related to their flows. The problem is caused primarily by the different interpretation of the term by different institutions following their development. The work in our article will be based on secondary data gathered from the World Bank databases. The World Bank calculates remittances in accordance with the methodology designed by the International Monetary Fund, which suggests that the term comprises of three constituents:

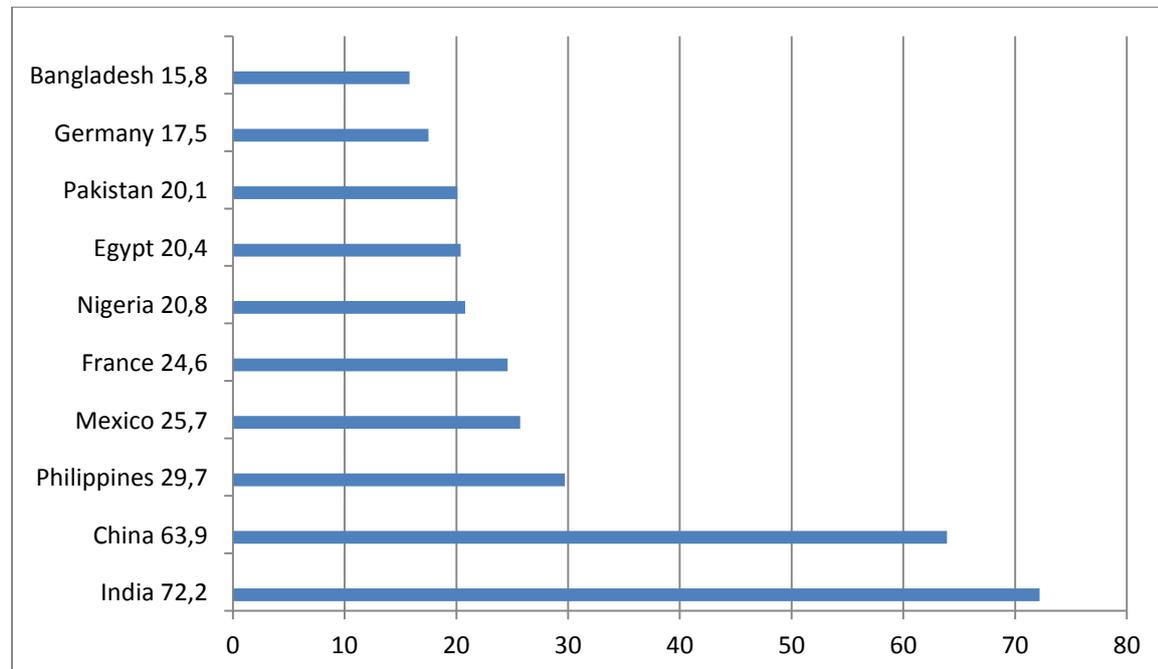
- worker's remittances, i.e. money and merchandise transfers, which are sent by migrants living abroad for more than one year to the country of their origin;
- compensation of employees, i.e. the gross wages of employees living abroad for a period less than 12 months;
- migrant's transfers, i.e. money and merchandise transfers related to cross border migration (e.g. day-to-day commuting abroad).

This methodology however, despite the fact that it is the most commonly used one in various publications on remittances, has its drawbacks. On the one hand, it overestimates real remittance flows; on the other hand, it underestimates them as well. The overestimation is caused by the addition of the amount of the migrant's gross wages to the "compensation of employees". In reality though,

these are not sent to the migrant's country of origin in their entirety – a part of them is spent in the host country. The underestimation of the remittance data calculated according to the methodology of the IMF is caused by the fact that a significant percentage of money transfers by migrants' to their country of origin is realised by various unofficial channels, not shown in the official statistics.

The importance of the remittances as a potential source of economic development, in the case of developing countries in particular, can be illustrated by the data provided in the table 1.

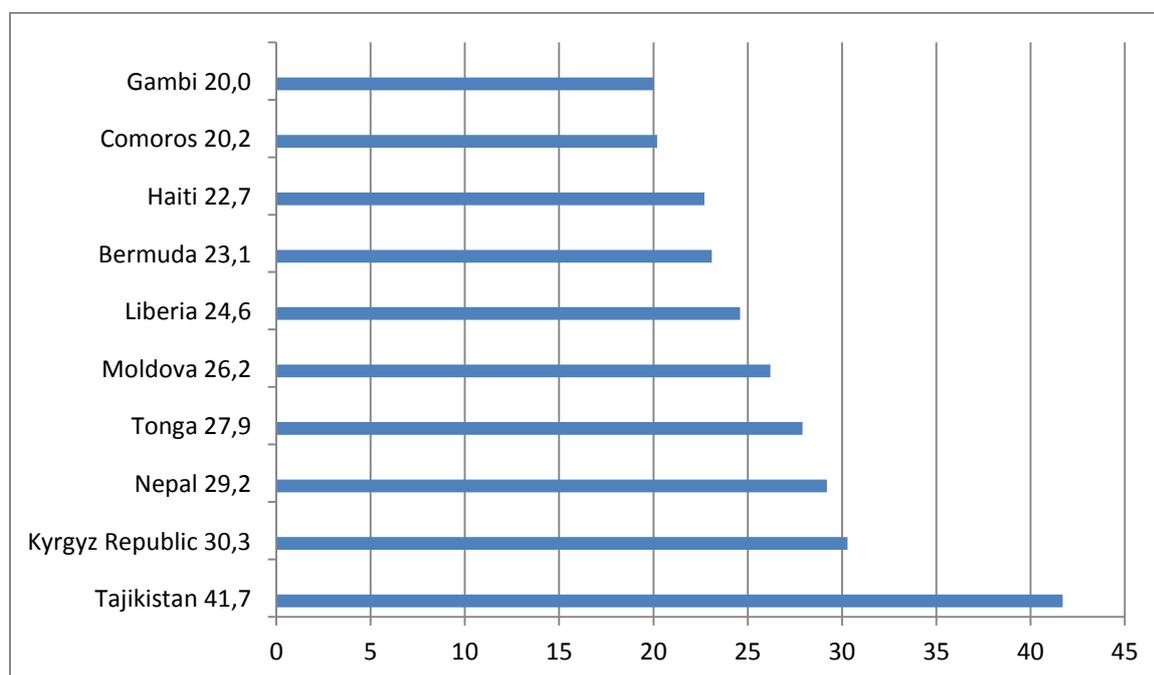
Table 1 – Top Remittance – Receiving Countries, 2015, USD billions



Sources: Development Indicators Group, Migration and Remittances Factbook, World Bank 2016

The data provided in Table 1 refer to the absolute values of the current main remittance flows. For a more detailed image on their importance, particularly from the aspect of the potential risk of the development of dependency of the country concerned on remittance inflow, we suggest taking into account the contribution of remittance to the GDP as well (Table 2).

Table 2 – Top Remittance – Receiving Countries, 2014, percent of GDP



Sources: Development Indicators Group, Migration and Remittances Factbook, World Bank, 2016

3. THE DETERMINANTS OF REMITTANCES

It is possible to analyse the factors influencing the amount of remittance flows on both a microeconomic and macroeconomic level. These two levels of analysis are not mutually isolated; they overlap and complement each other in some ways.

3.1. Microeconomic approach to the scrutiny of the determinants of remittances

The microeconomic approach to the scrutiny of the determinants of the remittances is based on an analysis of motives, which lead a migrant to the decision to save a part of his income and send it to the country of his origin. Works focusing on an analysis of the motives of such behaviour usually distinguish between altruism and a personal interest of the migrant.

Behavioural models of migrants based on the presumption of **altruistic motive** emphasize strong bonds between the migrant and his family. The scrutiny of its influence on the amount of remittance takes into account various variables, e.g. the migrant's family situation. In this context, we assume

that married migrants feel a higher degree of responsibility towards their families; hence they remit a lot more than the single ones.

The main variables in Stark's model (Stark, 1991) are income and time. The model is based on three hypotheses:

- a) The amount of remittances is proportional to the migrant's income;
- b) The amount of remittances decreases at the rate of increase of the household's income;
- c) The amount of remittances decreases at the rate, in which the family bonds weaken. At the same time, it is assumed that the family bonds weaken proportionately and pro rata temporis.

The validity of Stark's hypotheses was confirmed by the research conducted by Lowell and de la Garta, who investigated the impact of remittances on the development of Latin America countries (Lowell, de la Garta, 2000).

On the other hand, the hypothesis of the inverse relationship between the duration of stay and the amount of remittances is questioned by Lucas. He admits that the longer migrants live abroad the more the family bonds are weakened. However, on the other hand, the longer migrants live in the host country, the better they are paid. This assumption leads Lucas to the conclusion of an existence of an optimal duration of the migrant's stay abroad. It is a time when the weakening of the family relationships is compensated by the migrant's ability to earn more money, which thereby enables the maximisation of the remittance flows (Lucas, 2004, p. 13).

In his model, Stark considers the migrant's income in the host country to be the most important variable explaining the amount of remittances. According to Funkhouser, this income effect is linear. In other words, there is a proportional relationship between income and the amount of remittances (Funkhouser, 1995).

In contrast, Cox and al., who are testing the relationship between the income and remittances in the Philippines' condition, concluded that the correlation is nonlinear (Cox and al., 2004).

Multiple works focusing on the scrutiny of the microeconomic determinants of remittances underline that money transfers to the family members to the country origin can also be motivated by the migrant's **personal interests**. In this case, the emigrant is motivated to send the finances to the country of his origin in order to invest them in financial assets. The migrant's intention is for his reserves to be transformed into investments with the highest rate of profitability possible. Obviously, in contrast to the remittances destined for consumption, this type of remittance depends on macroeconomic variables such as the interest rate differential, the exchange rate and the inflation rate in the migrant's country of origin.

In some cases, the migrant's personal interest in remittance sending is realised in the form of a purchase of real estate. The modelling method of this type of behaviour is based on a hypothesis

presuming return migration. The migrant decides to return home as soon as a certain sum of money is saved. In order to do so, he attempts to minimize the consumption expenditures in the host country. Empirical research confirming the validity of the hypothesis was conducted by Glytsos in the case of Greek emigrants working in Germany, Australia and the U.S. (Glytsos, 1997) and later in the case of Greek migration to seven other Mediterranean countries (Algeria, Egypt, Jordan, Morocco, Syria, Tunisia and Turkey) (Glytsos, 2002).

It could be stated that the work based on the presumption of the altruistic motives, as well as of the migrant's personal interests, are of a rather theoretical nature. They are supported by certain theoretical constructions represented by hypotheses which they more often than not attempt to verify by means of case studies. However, their results are often contradictory. Furthermore, it is possible that the same reaction is triggered by different motives. As an example, we might mention a situation when the migrant reacts to the rise of the interest rate in the country of his origin by the increase of the remittances. In this case, it cannot be clearly determined whether the motive of his behaviour was pure altruism (credit becomes less accessible for the migrant's family – credit becomes more expensive) or his personal interest (the increase of remittances resulted from the increase of the investment profitability in the country of the migrant's origin).

It can be therefore said that despite the fact that microeconomic motives play a fundamental role in the determination of remittances, the results of their analysis cannot be generalized and utilized for an international comparison. Consequently, in addition to microeconomic research on the determinants of remittances, it is necessary to conduct a scrutiny of their flow reactions on the changes of macroeconomic variables.

3.2. Macroeconomic approach to the scrutiny of the determinants of remittances

Works investigating the macroeconomic correlations of remittances normally consider the number of emigrants working abroad and the level of their qualifications to be the main determining factors. These works prove that the amount of remittances is correlated to the number of emigrants working abroad. With regard to the influence of qualifications on remittance flows, we may speak about an inverse relationship: the higher amount of remittances is sent by the poorer and less qualified workers, as educated migrants originate from richer families with a sufficient amount of financial resources for high quality studies of their children and are not remittance dependent. Educated migrants have a higher chance of receiving a permanent residence permit and consequently they have the opportunity to reunificate the family in the new location (Faini, 2007).

In spite of this, some authors emphasize, or even overestimate the positive impact of remittances sent by qualified migrants. They regard them as financial compensation from the loss triggered by the brain-drain (Ratha, 2003; Beine and al., 2003).

The number of working migrants, their qualification and other macroeconomic characteristics alike (economic growth, unemployment rate, inflation rate, interest rate etc.) in the host countries, as well as in the countries of migrant's origin, are undeniably substantial determinants of remittance flows. Despite this, empirical studies conducted in comparable macroeconomic conditions sometimes reach different conclusions. Therefore, it can be said that macroeconomic variables are not sufficient in the scrutiny of the determinants of remittances. The institutional characteristics are important as well.

3.3. Institutional characteristics of the country of the migrant's origin as an important determinant of remittance flows

The political stability / instability of the country and the level of development of the financial sector are the institutional characteristics of the country of migrant's origin which have the most influence on the remittance flows. The political stability of the country of the migrant's origin normally has a positive impact on remittance flows. The influence of political instability cannot be clearly defined: it can trigger both an increase (especially if the migrants are altruistically motivated and want to help their families withstand the politically difficult period of time), and at the same time a decrease in remittance flows (if the motive of money transfers is the personal interest of the migrant who is in doubt regarding the respect of property rights).

The level of development of the financial sector in the country of the migrant's origin has an immediate impact on the transaction costs, i.e. the fees paid for by the migrants to the companies realising the money transfer. The remittances are sent via numerous official and unofficial channels. The money transfer via the bank system is normally the cheapest money transfer out of official channels, in the case that the banks belong to the same financial group.

Multiple studies prove that transaction costs have a minor impact on remittance flows. However, as proved by Freund and Spatafora (who conducted empirical research involving a hundred developing countries), the amount of the transaction costs influences the transaction channels used. The conclusion of their analysis is that annual remittance fluctuations are partially incited by a transition from official channels to unofficial ones and vice versa (Freund, Spatafora, 2005).

The most frequently used unofficial remittance transfer channel is the hawala system (hawala means *trust* in Arabic). Hawala realizes financial transfers via phone or e-mail communication between the members of the network, the so-called hawala dealers. In contrast to official channels, hawala offers minimal administration which is a very attractive factor for the remittent (Zika, 2007, p. 9). The sender has to prove his identity in the case of an official money transfer (usually by his identity card). This represents an insuperable obstacle for illegal migrants, the solution therefore being through unofficial channels.

Innovations of the financial market could represent a kind of solution, enabling illegal migrants to open a bank account (as for example, the “matriculas¹” which would ensure them access to inexpensive transfer services and would by de facto lead to an increase of remittance flows via the formal financial system (Jančíková, 2014, p. 20).

Another form of innovation potentially leading to an increase in remittances sent via official channels is a money transfer via the mobile phone network. However, this means of money transfer involves a risk that the finances will be used for money laundering, for criminal or terroristic activities.

4. ECONOMIC EFFECTS OF REMITTANCES

The impact of remittances on the country of the migrant's origin can be scrutinized on two levels: microeconomic and macroeconomic. The study of microeconomic effects focuses in particular on the immediate impact of remittances on income distribution, poverty reduction and on household economic activities. This research involves a great number of case studies which provide a number of interesting empirical results. However, their specific character does not enable a generalisation nor a conclusion to clear results. The scrutiny of macroeconomic effects is not capable in eliminating this barrier completely, it can, however, lead to an international comparison of results.

4.1. Microeconomic impact of remittances

Case studies aimed at the study of the influence of the finances sent by migrants to the country of their origin on the poverty rate of those countries usually agree that since remittances increase the available household income of the receivers, they also have a positive impact on poverty reduction. With regard to the quantifications of this impact, the differences in the results reached may be accounted for by the specifications of the studied sample. As an example, we might mention a study by Richard H. Adams and John Page. These two authors created a panel of 71 developing countries in which they tested a hypothesis that states that countries with a higher migration rate and remittance receipt report relatively lower poverty rates. They reached the conclusion that an increase of 10% in the level of remittances per inhabitant contributes to a decrease in poverty by 3,5% (Adams, Page, 2005).

¹Matriculas (in Spanish „matricular“, which means a register) = cards issued by the Mexican representative Office, used for the identification of Mexican citizens outside the territory of Mexico in the case of their return. The Mexican citizen is obliged to file his birth certificate, Mexican identity card and document confirming his stay in the U.S., e.g. his electricity bill with local address. Some major banks in the U.S. accept these cards as a form of identification for opening an account.

A study by the IMF conducted in 2005 scrutinizes this issue in a sample of 101 countries. According to the results of this study, an increase of remittances rate within the GDP by 2,5% is connected with a decrease of the poverty rate by 0,5%.

Gupta, Patillo and Wagh discovered that an increase of remittance flows by 10% is in the conditions of the Sub-Saharan Africa connected with a decrease of the poverty rate by 1% (Gupta, Patillo, Wagh, 2007). The study of Fajnzylber and Lopez, whose research was aimed at the countries of Latin America, also reached the conclusion that remittances have a direct effect on household income, thereby enabling it to lower income restrictions (Fajnzylber, Lopez, 2008).

The conclusions by different authors significantly differ with respect to the impact of remittances on income inequality. Lisa Chauvet and Sandrine Mesplé-Soms for instance, prove in their article that foreign direct investments increase the income inequalities within the country, whereas money transfers realised by migrants tend to decrease them (Chauvet, Mesplé-Soms, 2007).

On the other hand, according to Azam and Gubert, the impact of the remittances on income inequality is unclear. In their study (Azam, Gubert, 2005) they warn that it is necessary to take the differences occurring in different time periods into account. According to them, the remittances trigger in the short term, an increase of the income inequalities between families who are capable of sending a migrant abroad and consequently receive certain money flows, and the other families who do not have such an opportunity. In the long term, however, emigration costs decrease (especially thanks to networking), which enables the less wealthy families to send their relatives abroad.

Docquier and Rapoport underline the necessity to take income inequality in the introductory period of time into account. They prove that in case of a significant introductory of income inequality, remittances incite its further regression. However, this effect does not occur if the introductory income inequality rate is low (Docquier, Rapoport, 2003).

A very motivating article was published by Christian Ebeke and Maelan Le Goff, who study the impact of the transfers on income inequality in a sample of 80 developing countries in the course of a relatively longer period of time (1970-2000). The conclusion of their analysis was that remittance transfers induce a decrease in income inequality in countries with a relatively high income per inhabitant, in countries which export a low-qualified workforce and in countries characterized by low mobility expenses (Ebeke, le Goff, 2010).

Some authors focus on the potential risk involved in the decrease of labour supply for the receivers' households within the study of microeconomic effects of remittances on the country of the migrant's origin.

Different case studies confirm the direct impact of remittances on the economic activity of the household. Amuedo-Dorantes and Pozo, whose research was aimed at Mexico, found out that women, in country communities in particular, lower their labour supply in proportion to received remittances (Amuedo-Dorantes, Pozo, 2006).

Other case studies prove the existence of an inverse relationship between the money transfers from the emigrants and the labour supply of the receivers' households. As an example, we might mention a case study by Görlich and al. who scrutinized the given correlation in the conditions of Moldavia (Görlich and al., 2007), or Konica and Filer in the conditions of Albania (Konica, Filer, 2009).

4.2. Macroeconomic impacts of the remittances

Out of all of the macroeconomic impacts of remittances on the country of the migrant's origin, it is necessary to mention particularly their direct effect on the amount of investments. Finances sent by migrants to the country of their origin can play a significant role in the incorporation and financing of small businesses, as was proved, for instance, by the study by Woodruff and Zeneto, analysing the situation of multiple sectors in Mexico (Woodruff, Zeneto, 2001).

Another substantial macroeconomic effect of remittances on the country of the migrant's origin is the rise of aggregate demand. Notwithstanding, whether it is the rise in demand of consumption or investment of goods, it generates (in the sense of the Keynesian investment multiplier) additional incomes. If the production capacities of the country of the migrant's origin are not used to their full potential, its impact on the growth in the GDP and employment is positive. Multiple empirical research agree that multiplier effects may incite a significant growth in the GDP. As an example, we might mention Ratha's study, which claims that each "migradollar" spent in Mexico increases the GDP by 2.69 USD (if the remittance recipients are city households) or even by 3.17 USD (if the remittance recipients are country households) (Ratha, 2003).

Since remittances represent an addition to receiving side of the balance of payments, they can play a major role in the process of its deficit reduction. Their advantage, in contrast to other monetary flows (such as development aid, FDI or foreign loans) is that they are not directly connected to specific investment projects with a necessity of significant imports. Moreover, they are characterized by a much more stable source of foreign exchange than other capital flows (Buch, Kuckulenz, 2004).

In the case of an inflow of an excessive amount of finances abroad, however, other effects might arise as well, which are, unfortunately, negative. Consequently, an assessment of the real exchange rate of the competitiveness of the country concerned will decrease both in the foreign market (the exported products being more expensive) and in the domestic market (the imported goods being cheaper). The situation illustrated may induce a so called "Dutch disease": remittances cause a deformation of the production structure in the country of the migrant's origin and of the relative prices (Bourdet, Falk,

2006). The rise in the unemployment rate and, consequently, of emigration can be the secondary consequences of the “Dutch disease²”. The negative consequences mentioned do not have to arise if the import of cheaper production facilities increases the productivity of labour, as well as the competitiveness of the domestic producers.

5. CONCLUSION

Remittances represent a substantial capital resource for many countries, in particular developing countries. Their flows are normally lower than those of FDI; however, at the same time, they are higher than public development aid. In contrast to FDI, which decreased in the course of the global economic and financial crises, the money transfers realised by the emigrants continued to increase. The empirical data therefore confirm their conjunctural character.

In some countries, financial aid sent by the emigrants to their homeland reaches several tens of percent of the GDP, which equals a considerable amount of money. That is the reason why this phenomenon is becoming the subject of interest of various international organisations, as well as of the scientific community. International organisations emphasize especially the positive impacts of remittances on the country of the migrant’s origin. This attitude is, however, questioned by a branch of the scientific community.

In this article, we attempted to propose multiple aspects of remittances to expose the full extent of the phenomenon, as well as a variety of opinions and attitudes. The discussions on the determinants and the effects of remittances on the country of the migrant’s origin have definitely not come to an end. There is nothing capable of providing clear answers to the questions asked. However, two things are certain:

- a) An effective use of remittances in overcoming economic underdevelopment is conditioned both by the activation of recipients’ households and by a suitable institutional environment in the country of the migrant’s origin.
- b) Remittances cannot be regarded as a panacea for economic underdevelopment. In other words, the economic policy of the developing countries cannot be based solely on remittances.

We assume that in the following years, interest of the academic community in the research of this issue will not fade. The directions of future research are: searching for the possibilities of a decrease

² Formerly, the term „Dutch disease” was used in relation to the situation in which a positive external shock triggers the deindustrialisation of a small open economy, as it happened in the Netherlands after the deposits of oil were discovered on its territory (Neary, van Wijnbergen, 1986). Later, the term „Dutch disease“ was grounded to the framework of the endogenous economic growth to demonstrate the negative consequences of the decrease in the volume of production in the economic sector, which generates the resources of long-term economic growth.

of transaction costs connected with the money transfer to the country of the migrant's origin, and an analysis of the impact of remittances on the production structure of the economies characterized by a high rate of dependency on money transfers realised by emigrants.

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