

Analysis of the Role of Remittances on Poverty Reduction in Kenya

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Abstract

This paper analyses the role of remittances in poverty reduction in developing world in particular Kenya. Due to globalization there has been great movement of persons from one country to another in search of green pastures. The opening up of the economies leads to increase of immigrants who leave their home countries and stay in the host countries. Kenya has experienced large movement of its residents to developing countries to look for greener pastures. These immigrants have led to the increase of remittances to their home countries. It is on this foundation this paper sought to establish the relationship remittances and poverty reduction in developing economies in particular Kenya. In this paper data from Africa development indicators from World Bank and central bank of Kenya for a period of ten years are considered for graphical analysis to study the trend and annual pattern of behavior which supports the hypothesis of the paper that remittances growth is important in achieving the goals. It is expected that this study will benefit the government and the parties concern to ensure that the millennium goals are achieved and more so the improving of living standards of Kenyans and academicians in filling the knowledge gap and lay foundation for further research. The study provides insights into the role of diaspora remittances in poverty reduction in Kenya. It provides evidence that attracting diaspora remittances for emerging economies could as well help in mobilizing the much-needed loanable funds for private investment.

KEY WORDS: Remittances, Poverty Reduction, Kenya

Introduction

The remittances flows are accordingly much higher to developing countries. Remittances are financial resource flows arising from the cross border movement of nationals of a country (Kapur, 2004). Remittances come in form of money, assets or informal or non-monetary forms. Non-monetary forms may include clothing, medicine, gifts, dowries, tools and equipment. In 2008, the top 10 remittances-receiving countries were developing countries. In 2007, the total remittances to developing countries through official sources was estimated at \$328 billion and it is likely that billions more are transferred through unofficial sources (World Bank, 2009). Further evidence shows that in 2010, worldwide remittance flows are estimated to have

exceeded US \$440 billion of which US \$325 billion were transmitted to developing countries, an amount that far exceeded the volume of official aid flows and constituted more than 10 percent of gross domestic product (GDP) in many developing countries (Nyamongo *et al.*, 2012). It is also shown that recorded remittances in 2009 were nearly three times the amount of official aid and almost as large as foreign direct investment (FDI) flows to developing countries (World Bank, 2011). For many developing countries, the remittances flow has grown not only in size but also in importance in terms of their share in GDP. In many developing countries, more than 20 per cent of GDP is contributed by remittances. In this context, it becomes important to estimate the impact of remittances on poverty levels in developing countries. International remittances flowing into developing countries are attracting increasing attention because of their rising volume and their impact on recipient countries. In recent years, remittance flows rank behind foreign direct investment (FDI) as source of external funding for developing countries.

Remittances have become significant private financial resources for households in countries of origin of migration. Therefore, one benefit of migration is remittances there has been a 15-fold increase in remittances to developing countries since 1988 with remittances increasing from \$20 billion to \$328 billion in 2007. Migrant economic remittances are an important and growing source of foreign funds for several developing countries. At present, these flows are more than double the official aid received by developing countries (UNCTAD, 2011). This makes it important to continue to analyse the potential of migrants' remittances to contribute to development.

The increase in remittances is partly attributed to the increasing rate of immigration, as well as to the increasing availability of attractive investment opportunities in Sub-Saharan Africa (Adepoju, 2006). Similarly, a number of governments in Sub-Saharan Africa are promoting immigrant remittances by using their embassies to disseminate information about investment opportunities. Though, there is a growing literature on the impact of remittances on development, very few studies have empirically estimated the impact of remittances on development in general, and on poverty in particular, in Kenya. To fill this gap in the literature, this study undertakes impact analysis of remittances on poverty in developing countries in Kenya particularly

Poverty is multi-dimensional. The quantitative approach defines poverty as the inability to meet their basic needs. This approach associates poverty with features such as lack of land, unemployment, inability to feed oneself and one's family, lack of proper housing, poor health and inability to educate one's children and to pay medical bills (Lancaster, 1999). In Kenya the government has put efforts to reduce poverty in its 2030 vision it is also one of the millennium development goals.

This argument notwithstanding, it is not very clear whether remittances from immigrants increase or reduce the level of poverty. There is, however, a need to establish the link between poverty eradication and diaspora remittances. This paper aims to contribute to the extant literature by looking specifically at the effect of diaspora remittances on poverty eradication in

Kenya, by extending the results of existing studies carried out using data from developed economies. This study is timely, because Kenya has been experiencing an increase in migration in recent years, with people moving to developed countries in search of education and employment. There is also growing evidence that immigrant remittances have increased exponentially over time in Sub-Saharan Africa specifically Kenya. Therefore this paper is looking at how globalization has led to increase of remittances and ultimately the link with poverty reduction especially to the developing economy.

Remittances in Kenya

Remittances have increased systematically over time, with the number of Kenyan migrants having increased over time (Lucas, 2005). Remittances from Kenya citizens abroad continued to impact favorably on the balance in the services (CBK Report 2012).

Table 1: Remittances to Kenya in Dollars

YEAR	Amount in US Dollars in Millions
2003	321
2004	338
2005	382
2006	407
2007	573.6
2008	611.2
2009	609
2010	642
2011	891
2012	1,170

Source: World Bank. World Development Indicators

Statement of the problem

Poverty is multi-dimensional. The quantitative approach defines poverty as the inability to meet their basic needs. This approach associates poverty with features such as lack of land, unemployment, inability to feed oneself and one's family, lack of proper housing, poor health and inability to educate one's children and to pay medical bills (Lancaster 1999). Remittances are the cross-border earnings that migrants send to their countries of origin/ home country (Kapur, 2004). Remittances are one of the most visible, as well as beneficial, aspects of how international migration is reshaping the world today. Remittances are quietly transforming societies, countries and regions it increases household income and are therefore a powerful ant poverty force in developing nations (MPI 2013). Indeed, migrant's remittances are more important than public aid flows (more than twice as large as the official aid received by developing countries, according to the World Bank \Global Economic Prospects 2006) and represent a significant part of their GNI. In Kenya the volume of remittances keep on increasing year in year out (Nyamongo *et. al.* 2012). To examine the impact of remittances on poverty,

micro level analysis is important as it may reveal useful insights in terms of channels through which the impact of remittances on poverty levels is transmitted.

There are no enough literature especially regarding the developing world and linkage to poverty reduction and in particular Kenya. Hence given the importance attached to remittances in African countries and in the light of ambiguity in terms of its impact on financial development and growth, it is important to examine its linkages to poverty reduction so as to facilitate effective policy oversight. This study therefore seeks to contribute to the existing knowledge by making the following contributions by looking at the channels and the role played by remittances on poverty reduction.

Objectives of the study

The major aim of this study is determine the role of remittances in poverty reduction in developing.

Specifically, the study shall

- 1) Investigate role remittance play on household welfare in Kenya
- 2) Establish the channels the household access remittances

Significance of the Study

The study will contribute to policy regarding remittances in Kenya and how the policy makers will make policies to positively benefit the economy. Further it will provide a basis for further research on remittances in various counties in Kenya.

Theoretical framework and literature review

There are two main approaches leading to analyzing remittances. The first is the “portfolio” approach (Markowitz 1954) and the altruism approach (Margolis 1982). The portfolio approach sees remittances as a self- interest controlled capital transfer to diversify the migrant’s savings. Portfolio motives come out of investment opportunities and saving differentiation while the altruistic approach sees remittances as a transaction that benefits the receivers who were “left behind’ by the migrant without any demand on the receiver from the remitter. That the sender benefits less on none at all but the receiver does. Households support their own members especially the young and those in school. When the young grow up and when those in school complete their schooling they are expected to support others in order to repay the “debt”.

Altruistic motives have therefore been explained as either repayment of an old loan or some kind of aid to the receiver. The altruism or livelihood school considers remittance to be an obligation to the household and remittances are sent out of affection and responsibility towards the family (Chimhowu *et al*, 2003). Therefore, drawing upon the altruism model Lucas and Stark (1985) argue that migrants remit funds to their home countries to take care of those left behind. In Sub-Saharan Africa, it is common to find migrants remitting to their home countries based on the motive of altruism. Indeed, there is an abundance of empirical research on the effects of remittance on immigrants’ home countries.

Remittances are likely to affect the economy regardless of whether they are sent with the intentions of a portfolio investment or altruistic helpfulness. Capital for portfolio investment may increase the economic activity since investments are done with the intentions to generate profits and productivity, in the same manner as foreign direct investment does. Capitals sent in the mind of altruistic helpfulness do not bring any demand for profits or productivity. Households are free to use the remittances as they deem fit. If altruism dominates remittances, it may be the case that the inflow will have smaller effect on the economic activity. The effect could even become negative depending on whether the capital makes the receiver less productive than the productivity the capital generates from being used.

Poverty

While different people and communities define poverty differently, but poverty was invariably associated with inability to meet/ afford sustain basic needs (Ong'anya *et. al.*, 2012). Poverty is multi-dimensional. The quantitative approach defines poverty as the inability to meet their basic needs. This approach associates poverty with features such as lack of land, unemployment, inability to feed oneself and ones' family, lack of proper housing, poor health and inability to educate one's children and to pay medical bills. In their study (Ong'anya *et. al.*, 2012) they found out that poverty in Kenya is caused by lack of land, HIV-AIDS, insecurity, disability, lack of social infrastructure, bad governance among others. Poverty is one of the MDGs and the government of Kenya has in its vision 2030 the importance of eradicating poverty.

Types of Remittances and Channels

Remittances may be channeled through official or unofficial channels. Official channels involve transfers using the banking system and money-transfer organizations. Unofficial channels involve sending remittances through mainly cash or in-kind transfers through carriers, such as family members, friends or other carriers; money or goods taken by the migrant on his/her seasonal visits to his/her homeland and; funds remitted through unlicensed money transfer operators using traditional networks such as hawala (Nyamongo *et al.*, 2012).

According the World Bank (2011) more than 50 percent of the remittances to Sub-Saharan Africa is through the informal channels. Therefore this poses a major challenge in getting a near accurate estimate of the magnitude of remittances. Further evidence shows that even if all the remittances are channeled through the formal channels there are still issues. As shown by Barajas *et.al.* 2010), the World Bank maintains one of the most reliable and often-used databases on remittances. The data considered as remittances comprises of three distinct categories of transfers.

(1) Workers' remittances category which records current transfers to nonresidents by migrants who are employed in, and considered a resident of, the countries that host them. (2) Employee compensation category is composed of wages, salaries, and other benefits earned by individuals in countries other than those in which they are residents for work performed for and paid for by residents of those countries. (3) Migrants transfers category comprises of contra-entries to the

flow of goods and changes in financial items that arise from individuals' change of residence from one country to another, such as movement of accumulated savings when a migrant returns permanently to the home country.

Role of Remittances on Poverty Reduction

Literature reveals that in the poor countries remittances can greatly help in the reduction of poverty. The results of the earlier section show that remittances can reduce poverty in the developing countries.

In their studies remittances Adams, (2004); Adams & Page, (2003, 2005); Gupta, *et. al.*(2007) are geared to supporting the welfare of those relatives left behind and therefore contributes to the poverty eradication of the recipient. However, as shown by Carling (2004), poorer and lower-skilled households may get marginal benefits from remittances as a result of prohibitive costs of migration and the stringent immigration policies in advanced economies which tend to favor skilled workers. As a result, it is argued remittances may improve the per capita income of the recipient country but may worsen income inequality in the receiving country. This may result in urban-rural inequality, as remittances are mainly used to finance investments in urban areas. Chami *et al.*, (2003), argue that remittances may reduce recipients' motivation to work, creating permanent financial dependency, and slowing down economic growth. Pant (2008) argues that, whether remittances are utilized for consumption or purchasing houses, or other investments, they produce positive impact on the economy by stimulating demand for other goods and services.

Remittances represent a source of savings and capital for investment in education (Yang, 2008) health (Anton, 2010) and entrepreneurship (Yang, 2004; Woodruff & Zenteno, 2007; Woodruff, 2007; Massey & Parrado, 1998), all of which have an effect on productivity, employment and ultimately on economic growth and development. (Aggarwal *et. al.*, 2010), remittances may influence the growth of financial development in recipient countries. This is premised on the notion that some remittance recipients may be persuaded to convert their remittances into deposits with financial institutions when these remittances are channeled through the banking system. This may result in more funds becoming available for lending by commercial banks to the private sector.

Remittances may improve a country's credit worthiness for external borrowing. This is because remittances are included in the exports of goods and services. Higher remittances will therefore improve the country's debt to exports ratio, an indicator that is critical in the assessment of a country's credit worthiness. As shown by (Chami, *et.al.*, 2009; Ratha 2003), remittances tend to rise in times of economic downturns thus smoothing household consumption. This phenomenon has been observed in a number of countries during the just ended financial crisis period. Studies examining the relationship between remittances and GDP growth show mixed results. Faini (2002, 2003) finds a positive relationship between growth and remittances using cross-country data

Some countries, as shown by (Ketkar and Ratha, 2001) take advantage of the stable time profile of remittances and have come to accept remittances as collateral against which both public and

private sector entities may borrow in international capital markets longer dated debts at relatively lower rates. Remittances enhance foreign exchange inflows in a country. Large inflows of foreign exchange into small open economies, such as those in Africa, may lead to exchange rate appreciation and lower export competitiveness (IMF, 2005).

However, on the other, a negative channel from remittances to growth also exists in the literature. The proponents of the negative effect of remittances on growth contend that, first, remittances occur in the context of information asymmetry, in which case the remitter lacks control of the usage of transferred funds by the recipient, thus, the recipient may not use the remitted funds for the investment projects or as productively as originally intended.

Second, since remittances are largely transferred to households for consumption smoothing besides investment, the recipients may consider the remitted funds as a substitute for labor income and increase their leisure activities, which is likely to negatively affect labor productivity and growth.

Third, while remittances enhance foreign exchange flows, the resultant appreciation of the exchange rate may erode the competitiveness for countries depended on the tradable sector (Amuedo-Dorantes & Pozo, 2004; Chami, et al. 2003).

Methodology

The study used documentary analysis design.

Study Area

The study was concern with Kenya which is a developing nation and one of the countries which has increasingly received remittances from its immigrants (World Bank reports). Kenya is found in the East part of Africa with a population of above 40 million (Census report 2009).

Sources of Data

The sources of data for the study were secondary, which were obtained from the Central bank of Kenya, World Bank report, IMF and UNCTAD reports. The other data was obtained from the published journals.

Instruments of data collection

The study adopted a document analysis to collect and analyze the data.

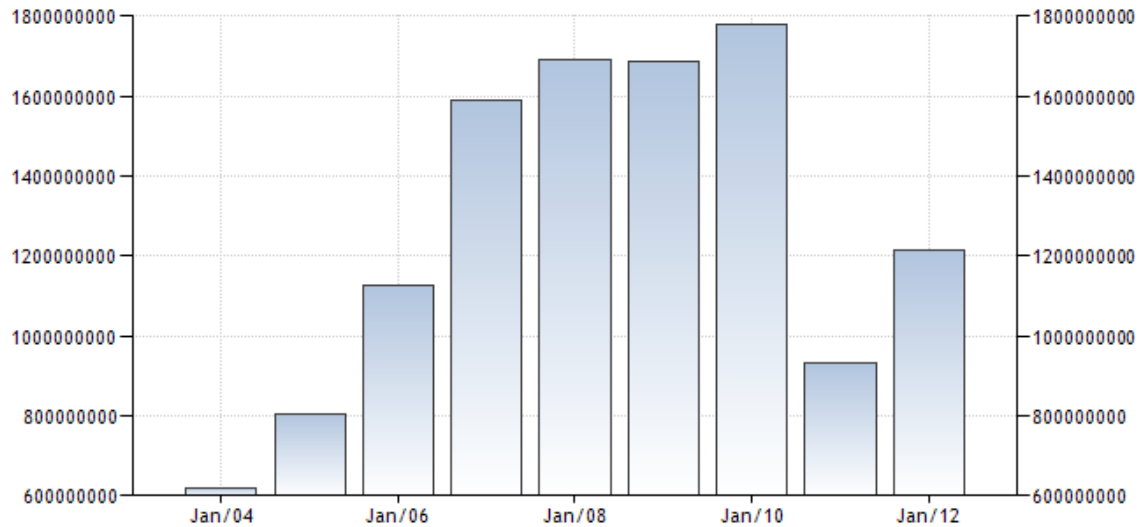
Data analysis

Data will be analyzed using descriptive statistics and presented in tables and graphs.

Results

Remittances have been on upward trend in the recent years. It increased by 55% from 2005 to 2012 (World banks Survey 2012).

The majority of Kenya's remittances are from North America and Europe (World bank survey 2012).



Source World Bank indicators (2012)

Data are the sum of three items defined in the fifth edition of the IMF's Balance of Payments Manual: workers' remittances, compensation of employees, and migrants' transfers. Remittances are classified as current private transfers from migrant workers resident in the host country for more than a year, irrespective of their immigration status, to recipients in their country of origin.

The remittance to Kenya is remitted through both formal and informal channels. The reasons for informal channels are because of the cost of transactions.

Uses of remittances in Kenya

It supports the capital account of BOP and domestic and increases flow/buffer during crisis or natural disasters.

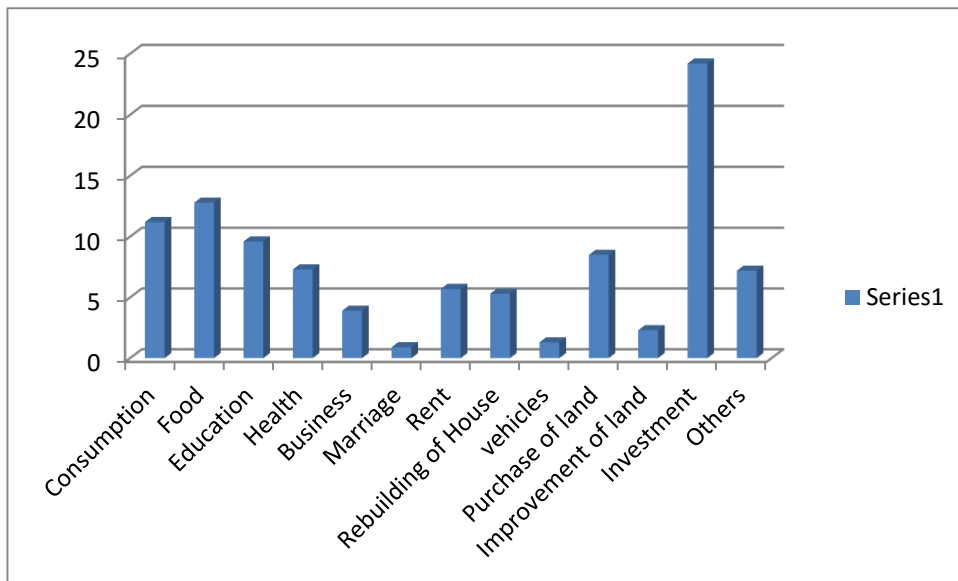
Smoothing of consumption at household levels, it also finances development projects short and long term and through BOP it also supports capacity of importation.

Kenya uses at least 55% and 21% of the remittances on investment and consumption activities respectively (UNCTAD 2012).

Uses	%
Consumption	11.2

Food	12.8
Education	9.6
Health	7.3
Business	3.9
Marriage	0.9
Rent	5.7
Rebuilding of House	5.3
Vehicles	1.3
Purchase of land	8.5
Improvement of land	2.3
Investment	24.2
Others	7.2

Source Central Bank Of Kenya



Most of the remittances were used for investment at 24% and the least was for marriages at 0.9% this indicates that remittances empower people to leave in a better life.

Remittances is an important income to Kenya and the household which receives, it enables the improvement of the lives of the household. It helps to educate and invest the siblings of the immigrants.

Conclusions

Remittances are more stable and predictable as compared to other financial flows and, more importantly, they are counter-cyclical providing buffer against economic shocks. In conflict or post-conflict situations, remittances can be crucial to survival, sustenance, rehabilitation, and

reconstruction. In providing primarily for household livelihoods, remittances are spent on general consumption items in local communities that contribute to local economies by supporting small businesses. A fair share of these expenditures is directed to the construction of homes, health care and education, alongside savings in financial institutions, thereby generating employment in these critical services sectors. Moreover, in contributing to foreign exchange earnings, remittances can spur economic growth by improving sending countries' creditworthiness and expanding their access to international capital markets

For the given level of GDP, a 10 per cent average increase in remittances is found to reduce the poverty headcount ratio by about 3.1 per cent and poverty gap by about 3-5 per cent in developing countries, depending on how poverty gap is measured.

Reasons for preferring informal channels for remittances include considerations of cost, speed, ease of making and receiving the transfer, coverage within the home country, and greater confidence and trust in the service provided.

Recommendations

Diaspora communities can be involved in discussions especially on temporary movement of persons in regard to recruitment, remittances and return such as on encouragement and settlement of migrants, voluntary remittance schemes, and sustainable return and possible investment of remittances.

Also, policy interventions – through national policies and international cooperative mechanisms can be critical in increasing beneficial effects of temporary migration and associated remittances.

Efforts to increase the volume of remittances should also be supported by efforts in channeling the remittances to more productive uses for sustainable reduction in poverty. Apart from providing food security to the households, if remittances are used for improving skills and productivity of the recipients they will have more sustainable impact on improvements of standard of living. Families receiving remittances should be allowed to use future remittances as collateral for procuring loans for education, house building or other activities like procuring fertilizers and machinery for farms.

The government to open Non-residential Kenyans (NRK) desk which gives subsidies and incentives to encourage the migrants to send more monies back home. For insecurity the government to ensure that security of its citizens and investment is of paramount importance to encourage the migrants as safety of their investments is assured.

Lastly the cost of transaction and the speed of which the remittances are processed to be has reduced and hastened respectively.

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