

Remittances and Their Effect on the Level of Investment in Barbados

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Abstract

The primary motivation of this study is to determine the contribution remittances from the Diaspora have on investment in Barbados. Anecdotal evidence is provided to indicate that remittances helped to improve the Barbadian housing stock with several wooden houses converted to wood and wall houses, and new concrete blocks/wall houses constructed. In addition, it appears that remittances were used to subscribe to savings bonds given the increasing number of applicants to this type of investment over the years. Finally, using a formal econometric technique (Dynamic Ordinary Least Squares) remittances are shown to have a significant positive link with real investment.

Keywords: Remittances, investment, Dynamic Ordinary Least Squares.

JEL: F24, E22, C22

Introduction

A remittance transfer is a sum of money sent from a person who has emigrated from his/her city or country of origin for the purpose of finding employment, to another individual, usually a relative or friend who remains at home. It can be frequent payments of low monetary value or a one-off substantial amount, repatriated for investment, health, education and consumption purposes.

Since the 1950s and 1960s when Caribbean nationals migrated to Panama and the United Kingdom seeking work, remittances have proven to be a critical means of financial support for migrant families. This trend has continued with the migration of Caribbean people to the United States of America (US), Europe, The Bahamas, Bermuda and the Cayman Islands, in search of further employment opportunities. **Recently, this quest for better employment opportunities has carried the negative connotation for small open economies as being the brain drain, where highly educated professional people such as nurses, teachers and policemen seek employment in the more developed countries.**

Today, using remittance flows as a percentage of gross domestic product (GDP), the Caribbean is ranked among the top thirty recipient countries in the world (see Table 1). Barbados, which is the main focus of this study, with US\$418.0 per capita, is the second largest recipient of remittances in the Caribbean behind Jamaica (US\$622.8), and the third largest recipient, surpassed only by Jamaica and Guyana, if a percentage of gross domestic product (GDP) is employed as the yardstick (see Table 1).

Presently remittance flows are considered to be the most stable and the second largest source of external finance in the Caribbean (see Grubel, 2009; World Bank, 2006; Buch and Kuckulenz, 2004; Ratha, 2003). Several writers, for example, Kapur (2003), Dixon (1997) and Wendell (1996), have argued that these flows may contribute significantly to investment growth, the alleviation of poverty, an improved standard of living, and

economic growth and development. Such contributions have been increasingly recognized by beneficiary communities, homeland governments, development practitioners and policy makers.

In fact, the 2008 Manifesto of the Government of Barbados spoke of several of these purposes of remittances and outlined some policies to boost remittances. For instance, it suggests using remittances to supplement the incomes of families to ensure that they do not fall below an unacceptable minimum level. In addition, the Manifesto indicated that residents and non-residents would be able to hold bank accounts in US dollars, Euros, Canadian dollars and the Pound Sterling in unrestricted amounts provided they are not funded by Barbadian dollars. Furthermore, it mentioned that persons working for a registered company under any of the international business legislation, and repatriates remittances to Barbados can have such remittances declared for income tax purposes. Furthermore, the Manifesto stated that timely incentives to encourage greater capital flows in the form of remittances would be implemented through the removal of restrictions on amounts up to BDS\$10,000 remitted by persons in the Diaspora for the purpose of supporting children, parents or siblings. This also applies in the reverse where siblings, children and parents live in the Diaspora and receive capital outflows as remittances from their families in Barbados.

These policy proposals have been suggested on the notion that remittances contribute positively to investment growth, alleviation of poverty and economic growth. Although such hypotheses have been tested empirically on several groups of developing countries (see, for example, Buch and Kuckulenz, 2004; Ratha, 2003) they have not been undertaken for the specific case of Barbados. Indeed, given that the quality of remittance data is not very good (Freund and Spatafora, 2005); more country specific analysis should be encouraged to avoid the difficulty of comparing data across countries that may use different techniques.

Table 1: Key Economic Indicators of Remittances*

Country	Remittance Transfers ...(2005/06)				
	Percent of GDP	Percent of per capita GDP	Cost	Average transfer	Annual volume
Mexico*	2.98%	187.18	6.0%	351.00	20,034,000,000
Brazil*	1.09%	30.85	8.13%	541.00	5,750,000,000
Columbia*	4.84%	90.48	5.0%	220.00	4,126,000,000
Guatemala*	11.42%	237.54	5.6%	363.00	2,992,770,000
El Salvador*	18.28%	411.31	5.2%	339.00	2,830,200,000
Dominican Republic*	13.35%	271.03	6.4%	176.00	2,410,800,000
Ecuador*	6.01%	136.07	3.9%	293.00	1,800,000,000
Jamaica*	18.33%	622.78	8.2%	209.00	1,651,000,000
Peru*	3.71%	89.21	4.6%	169.00	2,495,000,000
Honduras*	23.09%	244.72	5.8%	225.00	1,762,980,000
Haiti*	34.53%	115.50	6.7%	123.00	985,000,000
Nicaragua*	19.05%	154.91	5.2%	133.00	850,000,000
Paraguay*	8.52%	89.31	9.11%	263.00	550,000,000
Bolivia*	10.17%	93.66	5.6%	235.00	860,000,000
Costa Rica*	2.11%	92.44	9.46%	301.00	400,000,000
Argentina*	0.2%	7.0	9.02%	212.00	270,000,000
Panama*	1.36%	61.90	10.50%	196.00	200,000,000
Guyana*	36.89%	359.52	10.14%	179.00	270,000,000
Barbados*	4.3%	418	11.66%	220.00	113,000,000
Trinidad and Tobago*	0.77%	70.75	10.41%	200.00	92,400,000
Uruguay**	0.3%	71.0	11.28%	198.00	93,000,000
Belize*	3.77%	148.70	8.78%	220.00	40,150,000
Suriname*	4.2%	122.49	10.17%	220.00	55,000,000
Grenada**	5.2%	220.0		220.00	23,000,000
Venezuela, RB*	0.11%	4.64	17.10%	138.00	124,000,000
Chile**	0.0%	1.0	8.9%	279.00	13,000,000
Antigua and Barbuda**	1.5%	140.0		220.00	11,000,000
Dominica**	1.5%	56.0		220.00	4,000,000
St. Kitts and Nevis**	1.2%	86.0		220.00	4,000,000
St. Lucia**	0.6%	25.0		220.00	4,000,000
St. Vincent and the Grenadines**	0.8%	27.0		220.00	3,000,000

Source: Orozco (2006). N.B. - * 2005; ** 2003

* Note remittances are defined as compensation of employees (the wage, salaries and other benefits earned by migrants who have lived abroad for less than one year)

This paper therefore examines the significance of remittances to private investment in Barbados. Section 2 reviews some anecdotal evidence and selected literature on the positive impacts of remittances while section 3 looks at the negative influences of remittances and features that lead to inefficiencies in the remittance market. Section 4 presents the results of the Dynamic Ordinary Least Squares (DOLS) econometric model of remittances on private investment in Barbados over the period 1970 to 2002. Conclusions are made in the final section.

2. Positive Impacts of Remittances

Generally, the economic literature suggests that remittance flows contribute to investment growth, the alleviation of poverty, an improved standard of living, and economic growth and development. In terms of the standard of living and poverty, 70% of migrant workers in the US remit funds on a regular basis and three out of five migrant workers are in the working poor category, while 50% of that migrant workers population is under the age of thirty-five years (Biller, 2007). Most of these remitted funds are for family related issues, educational expenses or altruistic reasons. They are spent on food, clothing, housing and health care. Remittances are held to foster a sense of financial democracy and they are non-reciprocal in that they are one-way financial flows with no anticipation of return or reimbursement. They represent a flow of income for families who might not otherwise receive assistance.

Remittances are a stable form of external finance and often increase during times of economic hardship (Biller, 2007).. Furthermore, in countries that experience economic and financial crises, warfare and unrest, or unexpected short falls, remittances expand at an increasing rate to provide a monetary safety net. In addition, remittances assist under-developed countries and provide a mobile labour force to more developed countries. Remittances are also used as a means of emergency resources and to strengthen the balance of payments by providing foreign exchange (see Dixon, 1997).

Burnside and Dollar (2002) stated that the impact of aid flows on the rate of growth of the recipient economy depends on whether that particular money transfer is invested or consumed. If it is invested, it is likely to positively affect growth, whereas if it is consumed it may have a negative or no impact. Incentives to invest remittances and any returns on investment and its subsequent productivity, depends on the policy environment that exists. A good policy environment will increase the returns on investment and raise the opportunity cost on consumption, while on the contrary, a bad policy environment will reduce the returns on investment and lower the opportunity cost of consumption.

According to the World Bank (2006) remittances are more effective in both raising investment and enhancing growth in countries with higher levels of human capital, strong institutions, and good policy environments. In particular, it is reported that remittance flows have grown significantly as a result of favourable government policies that have improved access to banking, improvements in technology that enhances the processes related to money transfers, better collection of data, concerns of money laundering and terrorist financing, lower and affordable costs of remittance transactions, and a wider network of service providers in the remittance market (see also Julca, 2007).

Recent trends of remittances to Barbados certainly symbolize this World Bank fact as alluded to by the Prime Minister of Barbados, Honourable David Thompson in a speech to the Diaspora in Queens, New York, US, on April 24, 2008. He revealed that, “approximately US\$500.00 per citizen is remitted annually, and that nationals living in the Diaspora should continue repatriating funds to support their families.” Recognizing that investment funds are also acquired through increases in income, inheritances, mortgages, loans, and lottery earnings etc, it can be argued, as done by Gupta et al., (2007) in West Africa, that remittances have helped Barbadians to purchase properties in up-scale development areas as well as improved the housing stock of the poor and middle income earners. **Ultimately, as a result of a constant increasing flow of remittances the price of land and houses could increase as in the case of Jamaica.** Some anecdotal evidence is shown in Table 2 where it is observed that wood and concrete block houses were declining relative to wooden houses while concrete blocks/wall houses were

expanding significantly over the years. Hence, it can be assumed that there is some level of conversion from wooden houses to wood and wall, followed by a total shift from both wooden and wood and concrete blocks houses, to concrete blocks/wall houses. Actually, 72.6% of the total housing stock was concrete blocks/wall houses, while only 27.4% was wooden.

It is noticeable that a substantial portion of remittances are invested in savings bonds by Barbadians living in the Diaspora as well as those that have returned home from England, the United States of America and elsewhere. Table 3 records the number of Barbadians investing in savings bonds between 1996 and 2007, relative to the size of the particular bond issued. It is observed that in 1999 and 2003 when the sizes of the bonds issued were \$12.0 million and \$20.0 million, the number of applicants were 1096 and 1753 respectively. In 2000, when the size of the bond issued was at a low of \$5.0 million, only 853 applicants subscribed to this type of investment. Quite interestingly though, in 1996-1998, 2002 and 2007, when the size of the savings bond issued was greater than the \$5.0 million issued in 2000, the number of applicants were less.

Table: 2 Construction of Houses across Barbados Before 1980 to 2001

Year	Wood	Wood/Concrete Blocks	Concrete Blocks/Wall
1980 or Before	14,273	12,429	21,442
1981-1989	3,382	3,765	8,475
1990-1993	1,582	1,698	3,871
1994-1997	1,596	1,534	3,468
1998-2001	4,259	2,386	7,252
Total	25,092	21,812	44,508

Source: Barbados Statistical Service

Table 3: Barbadian Residents Investment in Savings Bonds 1996-2007

Year of Opening	Size of Bond Issued	No. of Applicants	Year of Maturity
1996	\$7.5 million	581	2001
1997	\$7.5 million	628	2002
1998	\$8.0 million	717	2003
1999	\$12.0 million	1096	2004
2000	\$5.0 million	853	2005
2001	\$10.0 million	892	2006
2002	\$10.0 million	733	2007
2003	\$20.0 million	1753	2008
2004	Not available	Not available	Not available
2005	\$10.0 million	941	2010
2006	\$10.0 million	978	2011
2007	\$10.0 million	828	2012

Source: Central Bank of Barbados

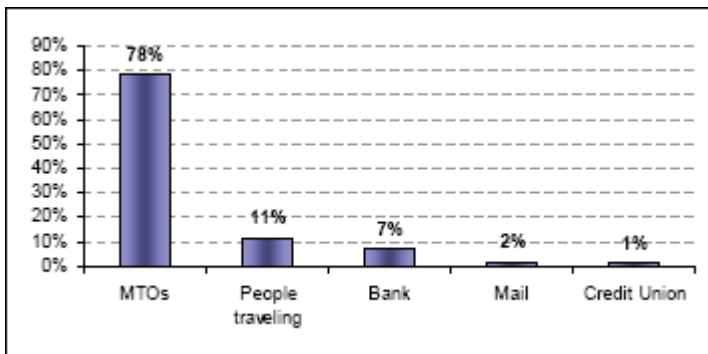
3. Negative Impacts of Remittances

A remitter in a foreign country with limited use or understanding of the language of that country may be unable to investigate alternative avenues for money transfers that are less expensive. These individuals may also be vulnerable to corrupt service providers if they are not aware of the actual exchange rate between currencies. Corrupt service providers were also known to be involved in fraud, terrorist financing, money laundering and other criminal activities (Biller, 2007). Remittances can also deteriorate the balance of trade by stimulating an increase in imports (Biller, 2007). Remittances also have the tendency to create demand for leisure and reservation wages that as a consequence can reduce the participation of persons in the productive labour force, thus reducing the labour supply (Fajnzylber and Lopez, 2007).

Figure 2 shows that Money Transfer Operators (MTOs) account for the majority of remittance transactions that have evolved from labour intensive physical transmissions

and courier services of cash-to-cash wire transfers. The channel for Money Transfer Operators accounted for 78% of the service, while people traveling, banks, mail, and credit unions accounted for 11%, 7%, 2% and 1% respectively.

Figure 2: Channels for Sending Remittances to Latin America and the Caribbean (2004)



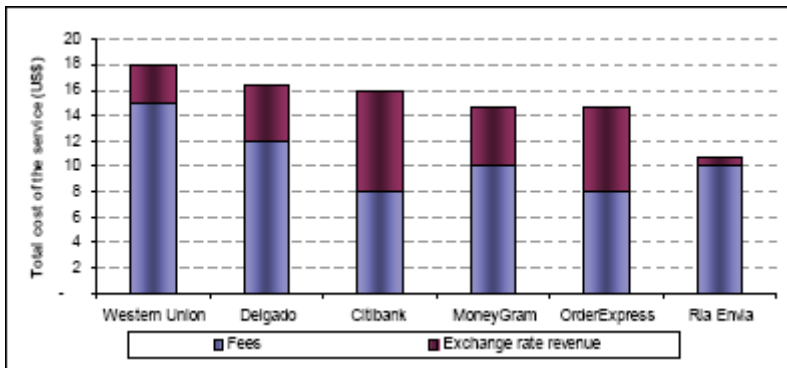
Source: Fajnzylber and Humberto Lopez (2007)

PURPOSE OF ABOVE

The transaction costs to transfer remittances through formal channels are very high.

Figure 1 shows fees and exchange rate costs for service with respect to repatriating remittances in 2006. Western Union is approximately US\$18 inclusive of service costs and exchange rate costs to the remitters and revenues for the service providers. Delgado, Citibank, and Money Gram followed closely with fees and exchange rate costs of US\$16.5, US\$16 and US\$14.5 respectively. **HOW DO WE KNOW THESE ARE HIGH??**

Figure 1: Fees and Exchange Rate Costs²



Source: World Bank (2006b); Fajnzylber and Humberto Lopez (2007)

3.1 Features that Lead to Inefficiencies in the Remittance Market

The World Bank (2006) identified five features that led to inefficiencies or abuses in the remittance market.

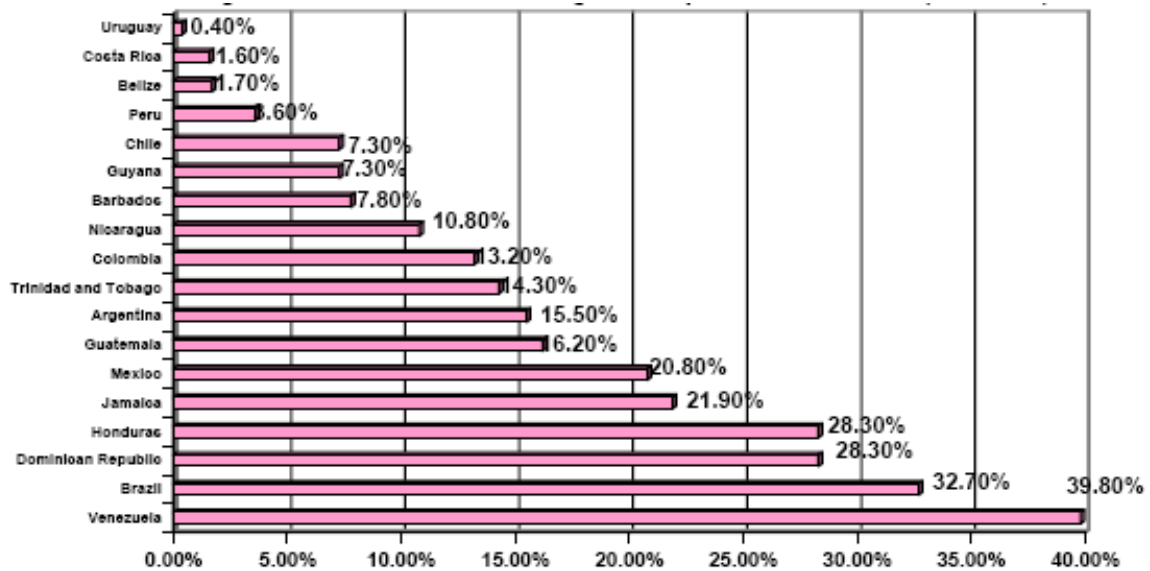
- (i) Lack of transparency or understanding on the part of the user.
- (ii) Weaknesses and inefficiencies in the payment system infrastructure used to provide the service-fees and exchange rate costs.
- (iii) A regulatory and legal framework that is unpredictable, unconscionable, and discriminating.
- (iv) The absence of competitive market conditions and
- (v) The absence of appropriate governance and risk management practices.

Some of the inefficiencies in the remittance market specific to service fees and exchange rate costs are shown in Figures 3 and 4 for several Caribbean countries. In Figure 3, with respect to weaknesses and inefficiencies in the payment system infrastructure used to provide the service-fees and exchange rate costs, Barbados' commission in the exchange

²Based on a US\$300 remittance from New York to Mexico calculated with data as of March 6, 2006. The exchange rate cost was calculated using the differential between the exchange rate applied by each RSP and the average inter-bank exchange rate of the same date (MXP 10.5958 per USD \$1)

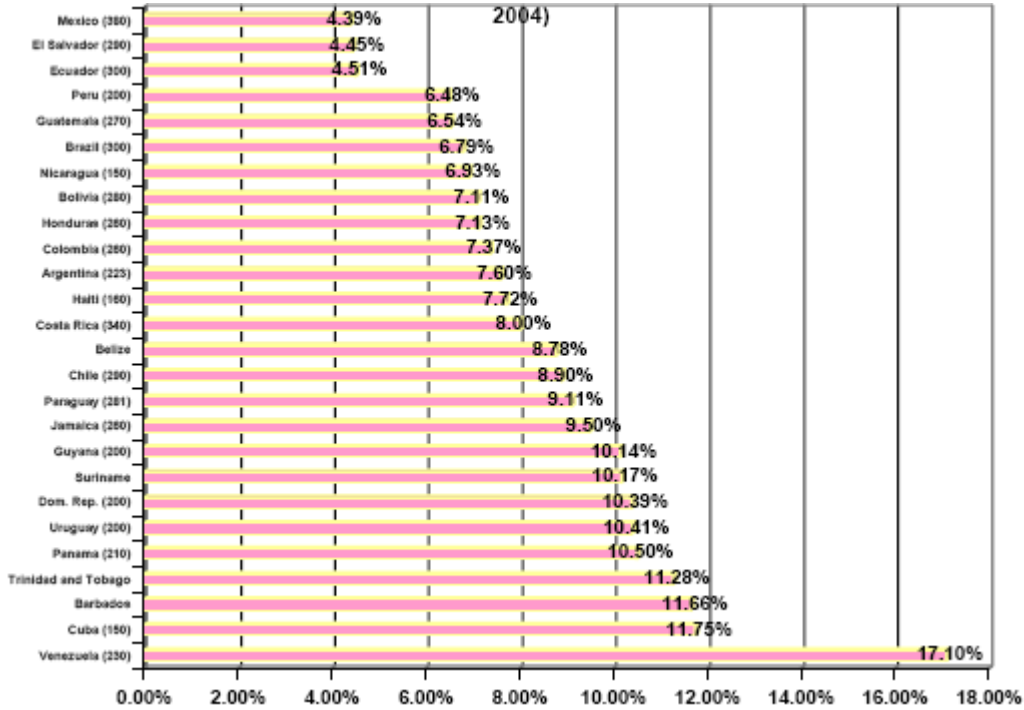
rate as a percentage of total costs was approximately 7.8% in June 2004, below Trinidad and Tobago (14.3%), Jamaica (21.9%), and Venezuela (39.8%), respectively. Figure 4 reveals that the cost of sending money transfers from the US on average to Barbados in June 2004 was 11.66%, Trinidad and Tobago, 11.28%, Jamaica, 9.5%, and Venezuela, 17.1%. **AND WHAT?**

**Figure 3: Commission in the Exchange Rate
as a percent of Total Costs (June 2004)**



Source: Orozco (2004)

**Figure 4: Average Cost to Send From the US to Home Country
(June 2004)**



Source: Orozco (2004).

5. Model, Methodology, Data and Results

5.1 Model, Methodology, Data

This section formally tests the relationship between private investment and remittances using Stock and Watson (1993) Dynamic Ordinary Least Squares (DOLS). The empirical model used as the point of departure is due to Acosta and Loza (2004) and Boamah et al., (2007). The DOLS long-run version to be estimated is:

$$lprivin_t = B' X_t + \sum_{j=-k}^k \lambda_j \Delta X_{t-j} + \xi_t \quad (1)$$

where $lprivin$ is real private investment, $X = [lrextdebt, lrcredit, lrgdp, lremit]$ with $lrextdebt$ being real external debt, $lrcredit$ is real private sector credit, $lrgdp$ is real gross domestic product, $lremit$ is real remittances. All these variables are in logs and deflated by the retail price index. B_x is a vector of β -coefficients, so that B_{lrgdp} , for example, is the

coefficient with respect to *lrgdp*. The inclusion of the leads and lags of the first differences of the I(1) regressors take care of serial correlation and endogeneity issues, making the DOLS procedure an unbiased and asymptotically efficient estimator of the long-run relation, even in the presence of endogenous regressors (Saikkonen, 1991; Stock and Watson, 1993). The equation is estimated with $k=I$, but then a ‘general to specific’ procedure³ is applied to reduce the model to a more parsimonious congruent specification where only significant variables are retained. All the data, which covered a thirty-three year period from 1970 to 2002, were procured from the Annual Statistical Digest of the Central Bank and the International Financial Statistics (IFS) of the International Monetary Fund (IMF). All estimations were done using the econometrics software E-views 6.

In order to investigate the short-run dynamics, the estimates from Equation (1) can be used to formulate a general error correction model (GECM) of the form:

$$\Delta lrprivin_t = \sum_{j=1}^p \phi_j \Delta lrprivin_{t-j} + \sum_{j=0}^p \phi_j' \Delta X_{t-j}^1 + \sum_{j=0}^p \gamma_j' Z_{t-j} + \zeta_j \sum_{j=1}^p (lrprivin_{t-1} - B' X_{t-1}^*) + \varepsilon_t \quad (2)$$

which specifies changes in real private investment as a function of lagged values of the first difference of the non-stationary variables, stationary variables that may have short-run effects (Z), and stationary combinations of the non-stationary variables, which represents the long-run relation between real private investment and the forcing variables. This long-run relation among variables is given by the elements of B and the rate at which real international reserves respond to disequilibrium in the long-run relation is given by ζ . In estimating Equation (2), a general to specific approach will also be used in order to reduce it to a more parsimonious representation.

³ See Campos *et al.* (2005) for detailed expositions on the general-to-specific approach to econometric modelling.

5.2 Empirical Results

The ADF, PP and KPSS unit root tests (see Table 4) were carried out on each variable to test for stationarity and indicated that all the variables are integrated of order one, meaning they need to be differenced once to become stationary. The general to specific search gave the results depicted in Table 5. The diagnostic tests for serial correlation, heteroskedasticity, normality, parameter stability and model misspecification revealed that the models are tentatively adequate specifications of the data generation process. The variable of interest, remittances, suggests that remittances have a significantly positive long-run effect of 25% on private investment and a current short-run impact that is slightly higher, of 29%, confirming the a priori belief that remittances contribute positively to real investment.

Table 4: Results of Unit Root Tests on Variables, 1970-2002

Variables		ADF	PP	KPSS
lrprivin	Level	-3.9751 cv[-3.5578]**	-4.1240 cv [-3.5578]**	0.1248 cv[0.1460]**
	Δ			
lrextdebt	Level	-4.0375 cv[-3.5875]**		0.1254 cv[0.1460]**
	Δ		-5.2445 cv[-4.2846]***	
lrcredit	Level			0.1739 cv[0.2160]***
	Δ	-4.4417 cv[-4.2846]***	-5.8090 cv[-4.286]***	
lrgdp	Level			0.0824 cv[0.1190] *
	Δ	-4.0094 cv[-3.5684]**	-4.5414 cv[-4.2846]***	
lrpricap	Level	-3.7548 cv[-3.6908] **		0.0696 cv[0.1190] *
	Δ		-5.5986 cv[-4.4407]***	
Lremit	Level			0.1147 cv [0.1190]*
	Δ	-5.8855 cv[-4.2846]***	-5.8963 cv[-4.2846]***	

Notes:*, **, and ***are the Mckinnon critical values (cv) for rejection of the null hypothesis at the 10%, 5% and 1% levels, respectively, for the ADF, PP and the KPSS unit tests. These tests determine the stationarity of each variable. A variable is I(0) at level and I(1) at the first difference of the original series which is denoted by Δ in the table.

Table 5: Estimates for Private Investment

Long -run estimates	Coefficients		t-statistics
C	-4.818821	(3.182314)	-1.514251
LRCREDIT	2.257322	(0.411291)	5.488376
LRREMIT	0.245489	(0.093303)	2.631086
LRGDP	2.978441	(0.611830)	-4.868088
Short- run estimates			
D(LRPRIVIN (-1))	-0.290072	(0.125532)	-2.310739
C	-0.007016	(0.053485)	-0.131168
ECM(-1)	-0.835719	(0.153507)	-5.444175
D(LRREMIT)	0.286574	(0.111709)	2.565361
D(LRERMIT(-1))	0.253910	(0.112871)	2.249565
D(LRGDP)	2.120030	(0.881848)	2.404076
D(LREXTDEBT(-1))	-0.776991	(0.299258)	-2.596392
R ²	0.83		
DW	2.531		
AR	2.056 [0.168]		
RESET	1.046 [0.372]		
NORM	0.170 [0.919]		
ARCH	0.047 [0.830]		
HET	0.724 [0.738]		

Notes: Heteroskedasticity and autocorrelation consistent standard errors are in parentheses and *, **, *** indicates significance at the 10, 5 and 1 percent level, respectively. The F-statistic for the respective diagnostics tests are shown and the associated p-value in square brackets. R² is the fraction of the variance of the dependent variable explained by the model. *DW* is the Durbin Watson statistic, *AR* is the Lagrange multiplier test for *p*-th order residual autocorrelation correlation, *RESET* = Ramsey test for functional form mis-specification (square terms only); *Norm* is the test for normality of the residuals based on the Jarque-Bera test statistic (χ^2 (2)). *ARCH* is the autoregressive conditional heteroskedasticity for up to *p*-th order (see Engle, 1982a). *HET* is the unconditional heteroskedasticity test based on the regression of squared residuals on the squared fitted values.

Conclusion

This paper uses DOLS to provide empirical evidence on the impact of remittances on investment over the period 1970 to 2002. The results indicate that remittances have a significant positive short-run and long-run effect on investment, each of the order of 25%. Some anecdotal evidence is also provided to show that Barbados' housing stock has benefited from remittances invested to convert wooden houses into concrete/wall structures over the years. In addition, Barbadians have increasingly subscribed to savings bonds over the review period, and it is assumed that remittances have also contributed significantly to this type of investment.

Additionally, the study discusses the negative influences of remittances on the number of persons actively participating in the labour force, and the real exchange rate appreciation pressures that can result from a positive shock or a surge in remittances. It suggests that remittances contribution to investment and growth in Barbados can be enhanced by improving the functioning of the systems and processes related to the efficient flows of remittances. This can be done through education, institutional quality and regulatory requirements of remittance service providers, and a policy environment that provides a secure and affordable service. Improvements in the network of remittance service providers and their operations should lead to greater transparency, consumer protection and financial security, while the extension of financial services and products to the poor should lead to increased financial democracy. The Government of Barbados, understanding the significance of remittances to investment, the alleviation of poverty, and economic growth and development has identified policy proposals that would continue to propel such development in the future.

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