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ISSUE PAPER:

DEFINITION OF REMITTANCES AND RELEVANT BPM5 FLOWS

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1. Background

1. Remittances are an important and stable source of income for households, in particular in developing countries. Analytical studies have shown that the flow of remittances is the least influenced by economic downturn and remains a stable source of income. Remittances have been identified as the third pillar of development as their volume is second to foreign direct investment and higher than overseas development assistance. Analytical studies have shown that remittances contribute to poverty reduction in home countries. These are the reasons why remittances have been receiving increasingly the attention of politicians and analysts. The G7 recently called for improved information of remittances, which still remain weak as compared to other balance of payments components.

2. "Remittances" has now become a commonly used term, which is however rarely defined. Analytical studies define remittances as the sum of selected balance of payments flows. In some studies, the sum of workers remittances and compensation of employees (Anne Harrison 2003 and DFID 2003), in others the sum of the above balance of payments component plus migrants' transfer are used as proxy for remittances.

3. This paper explores alternative definitions for remittances and thereby alternative presentations within the BOP framework, to measure the economic impact from (i) short-term employment; (ii) transactions between resident and non-resident households; (iii) transfers from/to government units and non-profit institutions servicing households (NPISHs) to/from non-resident households; and (iv) current transfers from other institutional units to non-resident NPISHs. It also analyzes the impact on important macro-aggregates of classifying transactions under primary distribution of income account (i.e. compensation of employees) or secondary distribution of income account (e.g. workers' remittances).

2. Relationship between transactions and the concept of remittances in the BOP framework

4. This paper takes the position that the concept of remittances in the BOP framework should e designed to measure the net receipt of households from employment-related flows on the primary distribution of income account and relevant current transfers on the secondary distribution of income account. Consequently, it excludes from the remittances concept the exports and imports of goods and services produced, investment income from external assets and liabilities held by households as well as related taxes.

5. The concept of residence is fundamental for identifying the BOP flows that are relevant for the study of remittances. The concept of residence in BOP is broadly consistent with the concept of residence (long-term migrant) in migration statistics

(except for a few exceptions, such as students and patients and crew, who are considered resident of the home countries even if they change their usual residence for more than one year). Broadly speaking, both economic and migration statistics apply the one year rule. A worker who is employed abroad for less than a year (for example a border worker, a seasonal worker or a short term employee) is classified as a nonresident of the host country in economic statistics.

Narrow definition of remittances

6. In the narrow definition, remittances aim at measuring the economic impact of migration mostly on the home economy. The unit under consideration is the migrant (including also short-term migrant), independently of whether his or her status (e.g. employed or not, legal or illegal, etc.). The aim is to capture the net receipt of transactions between the migrant and the related household in the home country, independently from the source of income (be it wages and salaries, social benefits or any other current transfer) and the use this money is put to in the home country.

7. Neither migration nor economic statistics recommendations provide any indication of when a resident "migrant " ceases to be such and becomes a resident "non-migrant". This has implications on the classification of cross border transactions in the BOP framework.

8. In this context, the following BPM5 flows are particularly relevant for the study of remittances. They encompass both income from labour (i.e. compensation of employees) as well as various types of current transfers.

(a) Compensation of employees of a nonresident worker employed by a nonresident employer operating in a foreign country (not BOP flow)
(b) Compensation of employees of a nonresident worker employed by a resident company
(c) Workers' remittances from a resident migrant worker
(d) Other current transfers from a resident household
(e) Migrants' transfers

9. They reflect an increasing degree of involvement of the migrant in the host economy, with (a) having virtually no involvement in the host country as his or her remuneration is paid by his non-resident employer (this is not even a flow in the balance of payments), (b) being a short term migrant; (c) being a long-term migrant; and (d) ceasing to be a migrant. (e) is a special category and occurs when a person moves from the home to the host country with the intention to stay for at least one year. It represents a shift in the ownership of the migrants' assets from the home to the host economy. The table below shows the various categories of workers in order of degree of involvement in the host economy and the relevant BOP components.

Degree of involvement in the host economy →

	Nonresident worker	Resident worker

	Nonresident employer	Resident employer		
Compensation of employees	(a) Compensation of employees (1993 SNA)	(b) Compensation of employees (BPM5)		
Current transfers			(c) Workers' remittances	(d) Other transfers
Capital transfers		(e) Migrants' transfers		

(a) Compensation of employees of a nonresident worker employed by a nonresident employer operating in a foreign country (not a BOP flow)

10. The compensation of a nonresident employee by his nonresident employer (category 1) is not recoded in the balance of payment as it is a domestic flow. The value of the services provided by the non-resident company will instead be recorded in the balance of payments. Also, the workers' expenses in the host country, such as transportation, accommodation, food, etc. are recorded as travel.

11. The actual flows sent by a nonresident worker from the host country to his home country (country of residence) are not recorded as such in the BOP, but the recordings are based on rerouting and imputations.

(b) Compensation of employees of a nonresident worker employed by a resident company

12. Compensation of employees is defined in the BPM5 as:

> *"Comprising wages, salaries and other benefits (in cash or in kind) earned by individuals- in economies other than those in which they are residents-for work performed for and paid by nonresidents of those economies. Included are contributions paid by employers, on behalf of employees, to social security schemes or private insurance or pension funds to secure benefits for employees. Employees, in this context, include seasonal or other short-term workers, (less than one year) and border workers who have centers of economic interest in their own economies. Because embassies and consulate are considered extraterritorial to the economies in which they are located, the compensation received by local (host country) staff of these institutional entities is classified as paid to resident entities by nonresident entities"* (BPM5 para 269).

13. Compensation of employee is a gross concept. "Personal expenses made by non-resident seasonal workers in the economies in which they are employed are recorded under travel. Taxes paid, contribution made to pension funds, etc. in those economies are recorded as current transfers" (BPM5 para 271). The actual flows sent by a nonresident worker from the host country to his home country (country of residence) are therefore not recorded as such in the BOP. The recordings are based on rerouting and imputations.

14. This treatment of compensation of employees impacts macro-aggregates in the home and host countries of the workers. It increases the gross national income (GNI) of the worker's country of residence by the amount of compensation of employees and it increases gross national disposable income (GNDI) by the net of the compensation of employees and the current transfers back to the host country. This could be reworded by saying that GNDI increase by the sum of actual remittances (flows that actually reach the home country) by the worker and the travel costs, if we assume no other flows and no saving. This is further illustrated in Figure 1 below.

(c) Workers' remittances from a resident migrant worker

15. Workers remittances are defined in BPM5 as:

> *"current transfers by migrants who are employed in new economies and considered residents there. (A migrant is considered a person who comes to an economy and stays, or is expected to stay, for a year or more). Workers remittances often involve related persons."* (BPM5 para 302)

16. In the case of a migrant worker, compensation of employees is not recorded in the balance of payments, his expenses in the host country are treated as household final consumption expenditure of the host country, and taxes and social security contributions are treated as domestic flows within the host country. The GNI of the worker's country of origin is not affected by this recording, while GNDI will increase by the amount of the workers' remittances. The effect on GNI therefore differs from a situation where the worker is classified as nonresident.

(d) Other current transfers

17. BPM5 defines other current transfers as:

> *"those transfers for distribution to relieve hardships caused by famine, other natural disasters, war, etc. and regular contributions to charitable, religious, scientific and cultural organizations. Also covered are gifts, dowries, and inheritances; alimony and other support remittances; ticket sold by, and prizes won from, lotteries; and payments from unfunded pension plans by non-governmental organizations "* (BPM5 para 304). ''*…social security contributions and ...social benefits* (BPM5 para 305).

18. The category other current transfer of the standard presentation of the BOP in BPM5 includes an assortment of transfers. However, the outline of the revision of balance of payments manual, fifth edition (April 2004) reflects the additional detail of the standard components of the BPM5 as part of the standard components of the BPM6, albeit in a different presentation: current taxes on income, wealth, etc., social contributions, social benefits, other current transfers (excluding workers remittances).

19. The 1993 SNA is even more explicit in defining other current transfers It includes "current transfers to NPISHs (donations in cash or in kind, para 8.94), "current transfers

between households" (i.e. gifts, dowries, inheritance, etc., para 8.95), "fines and penalties" (i.e. compulsory payments, para 8.96), lotteries and gambling (para 8.97) and payments of compensation (alimony, compulsory payments for personal injury or damage to property, para 8.98).

(e) Migrants' transfers

20. BPM5 defines migrants' transfers:

> *"They are contra-entries to flows of goods and changes in financial items that arise from migration (change of residence for at least a year) of individuals from one economy to another. The transfers to be recorded are thus equal to the net worth of the migrants".*

21. Migrants' transfers is an imputed one time flow recorded at the time of migration as capital transfer in the capital account which reflects the net value of assets and liabilities of a household that changes status from nonresident to resident. There are no actual transfers that take place. Migrants' transfer should not be mixed with the concept of remittances, which is based on actual transactions between residents and non-residents.

22. The macro effects of migration on economic aggregates are illustrated in Figures 1 and 2, which provide two fictitious examples that show the different treatments according to the residence status of the worker (category (b) and (c) above). We assume that the compensation of employees from employment is 100, taxes paid to the host country are 10, social security contribution paid to the host country is 5, social benefit as pension is 5, and the workers' expenses in the host country are 45. The actual amount that flows to the migrants' (short or long-term) home country is 40. We assume no saving[1].

[1] The question of saving may be important for the analysis of poverty, however, assuming that saving is 0 does not have an impact on the analysis above

Figure 1. Transactions of non-resident worker abroad and host economy (category (b))

		<u>As a nonresident</u>			
"Home country"/ "country of origin"	←	**Compensation of employees**	**100**		**"Host country"**
	→	**Travel**	**45**	→	
	→	**Taxes on income**	**10**	→	
	→	**Social security contribution**	**5**	→	
GDP = 0 GNI = + 100 GNDI = + 85 Current account = +40		**Workers' remittances (not recorded)**	**40**		**GDP = 100 GNI = 0 GNDI = + 15 Current account = -40**

Figure 2. Transactions between resident worker abroad and non-resident household (category (c))

		<u>As a resident</u>			
"Home country"/ "country of origin"		**Compensation of employees**	**100**	→	**"Host country"**
	←	**Workers remittances**	**40**		
		Household fin. cons. exp.	**45**	→	
		Taxes on income	**10**	→	
GDP = 0 GNI = + 0 GNDI = + 40 Current account = +40		**Social security contributions**	**5**	→	**GDP = 100 GNI = +100 GNDI = +60 Current account = -40**

23. Although both situations – that of a worker going abroad for less than one year and that of a migrant worker (going abroad for more than a year) - may appear similar, the effects on the GNIs and the GNDIs are different. This is due to the fact that compensation of employees is income from labour and thus affects GNI of the home country. Workers' remittances is recorded as a transfer from residents to non-residents and it only impacts GNDI of the home and host countries. The effects on the current account are the same.

24. There are several issues with the definition of workers remittances in BPM5 that it is worth discussing. The definition:

(a) is linked to employment income, thus it excludes all other transfers that are made from other sources of income received by resident migrants (e.g. social security and assistance benefits (pension, unemployment benefits, family allowances etc.);

(b) is linked to the definition of migrant. When a migrant ceases to be such (when and how this is not clearly defined – see issue paper on universe), the transfers that he or she makes to households in the home countries are classified as other current transfers;

(c) mentions that transfers <u>often</u> involve related persons. It is very difficult to assess whether the receiving household is or not related to the workers who is sending money;

(d) excludes resident to non-resident household transfers other than working migrants. It excludes dowries, gifts, inheritance, alimony and other support remittances, which are included in other current transfers.

<u>Alternative broad definitions</u>
25. Given that our objective is to measure transfers which are received by the household in the home country, the definition of remittances would have to be broadened to include any transactions to the non-resident household. The following three alternative presentations of BOP flows could be proposed.

> *Alternative 1:* Add all resident household-to-nonresident household transfers independently of the purpose, source of income, whether they are from resident "migrants" or " non-migrants". In this case the alternative presentation would involve adding workers remittances with all transfers between resident and non-resident households recorded in other current transfers. This new aggregate could be named "personal remittances".
>
> *Alternative 2:* Introduce a concept of "total remittances" to non-resident households as the net receipt of the sum of compensation of employees, all household to household transfers (alternative 1 "personal remittances"), lotteries and gambling, social security benefits and social assistance benefits (in cash and in kind related to health treatment, pension and unemployment, family allowances, reduction in income, housing and education) from government units, NPISHs and social security schemes minus the sum of social contributions, current taxes on income and travel expenses of non-resident workers.

3. Points for discussion

26. The issues on the definition of remittances in the context of the BOP framework raised in the paper are listed below in the form of questions for discussion during the TSG meeting;

1) Does the TSG agree with the broad definition of "total remittances" as the net receipt of the sum of compensation of employees, all household-to-household transfers (alternative 1 "personal remittances"), lotteries and gambling, social security benefits and social assistance benefits (in cash and in kind related to health treatment, pension and unemployment, family allowances, reduction in income, housing and education) from government units, NPISHs and social security schemes minus the sum of social contributions, current taxes on income and travel expenses of non-resident workers?

2) Does the TSG agree with the narrow definition of "personal remittances", as an all inclusive concept of resident household to non-resident household transfers defined as the sum of workers' remittances and all other household-to-household transfers recorded in other current transfers?

3) Does the TSG agree that the present definition of workers' remittances should be maintained, or should it:

   (a) be clarified by providing a clear guidance of when a migrant changes its status;

   (b) be clarified to clearly delineate the boundary between workers' remittances and other transfers of workers resident abroad;

4) Does the TSG agree that the concept of "net" compensation of employees from/to abroad – defined by deducting taxes on income, social contributions and travel) is useful in the context of defining remittances?

5) Does the TSG agree that "migrants' transfers as defined in the BOP framework should not be included in the narrow and broad definition of remittances?

6) Does the TSG agree that transfers to non-resident NPISHs from any institutional unit should be clearly identifiable in the standard or supplementary presentation of the BOP to allow for a more complete assessment of "remittances?