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Remittances and Income Inequality in Croatia

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Abstract

The objective of this case study is to analyze the impacts of remittances on income distribution in Croatia. The thesis is based on the balance of payments data and the data from national household surveys. The results suggest that remittances have contributed to an equalized income distribution in the country over time. Moreover, the remittance flows have had a small effect on the level of poverty, but a larger impact on the depth and severity of poverty. The main form of remittances to Croatia has been investments in real estate and human capital. Accordingly, the money flows represent an important and stable source of income for the domestic economy, which has caused GDP growth through means of the multiplier effect and a more developed financial market.

Keywords: remittances, migration, investment, income inequality, poverty

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List of Abbreviations

BOP	Balance of Payments
BPM5	Balance of Payments Manual, 5 th edition
CNB	Croatian National Bank
COE	Compensation of Employees
CROSTAT	Central Bureau of Statistics in Croatia
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HBS	Household Budget Survey
IBAN	International Bank Account Number
IMF	International Monetary Fund
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
PPP	Purchasing Power Parity
SNA	System of National Accounts
TSG	The Technical Sub-group
US	United States
USD	United States Dollars

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1. Introduction

1.1 Background

Traditionally, Croatia has been a labour exporting country, from the late ninetieth century up until modern day. One consequence of labour emigration are remittances. Remittances can be defined as all current transfers in cash or kind, sent or brought from non-residents to resident households.¹ These money transfers account for large flows of capital worldwide. Currently, remittances are the second largest well of foreign exchange in the aggregate, both as a percentage of Gross Domestic Product (GDP) and in absolute terms.² For many remittance-receiving countries, remittances are the main source of foreign exchange.

The Former Yugoslavia has had a long tradition of emigration and receiving remittances, the earliest data is from the 1960s. From the beginning of the 1970s to the 1990s, Yugoslavia received more private transfers than any other Mediterranean countries, almost double the amount than other large recipient countries in the region. Private transfers constituted 58% of merchandise imports in the 1990s.³ The Republic of Croatia has continued to receive remittances even after its independence from the Former Yugoslavia.

At the moment, Croatia has nearly four and a half millions inhabitants. Besides that, about two and a half million Croats live abroad. Therefore, it is expected that the inflows of remittances are significant for the Croatian economy.

Until recently, the importance of remittances was dismissed or only the negative effects were emphasized. It was argued that money remitted back by emigrants was consumed rather than invested in productive activities that would stimulate growth in recipient countries. Nowadays, the benefits are also recognised, such as improved living standards, indirect economic growth through the multiplier effect and improved balance of payments (BOP) of the recipient country.

There is no official study on remittances in Croatia. The goal of this essay is to raise more knowledge about the subject as well as to encourage further research.

¹ Zlotnik 2005, p. 13

² Giuliano and Ruiz-Arranz 2005, p. 3

³ Glytsos 2002, pp. 10-13

1.2 Purpose

The purpose of this essay is to evaluate the implications of remittances on the income distribution in Croatia. The questions that will be answered are:

- *What does remittances pattern look like in Croatia?*
- *How are remittances distributed?*
- *What role do remittances play for income inequality?*

1.3 Data and Limitations

For the purpose of this study, data on remittance flows to Croatia, household budget surveys and data on economic indicators are required. Data on remittances was collected from the Croatian National Bank (CNB) and is available for the years 1997-2005. Also economic indicators for the same time period were collected from the Croatian National Bank.

Household budget surveys were provided by the Central Bureau of Statistics in Croatia (CROSTAT). They are carried out every year and available for the years 1998-2004. Unfortunately, this data only exists for the national level, which makes it impossible to study remittances on a regional level.

The time period for remittance flows is 1997-2005 since these were registered from year 1997 and the latest available data is for 2005. Household surveys are available for the years 1998-2004, although remittances from surveys can only be traced for the period 2001-2004.

1.4 Disposition

The thesis is organised as follows. Firstly, a theoretical background of remittances is described. The next part examines the development of remittances in Croatia. In the background of the ongoing discussion on definition of remittances, the case of Croatia is discussed. Part four is approaching household surveys to analyze remittances on a micro level. Part five examines the distributional effects of remittances on the households' economy. The last part summarizes the main results.

2. Theoretical Framework

There is no well-developed general theory of remittances. Research within the subject provides evidence and results from empirical studies, but only to partially explain, and is distinguished by particular geographical, socio-cultural and temporal limitations.⁴ Remittances play a significant role for a country's economic development. It is believed that they are as important as foreign direct investment (FDI) and other capital flows.⁵

2.1 Motives to Remit

In order to understand how remittances are used and invested, the motives behind remitting should be investigated. The earliest literature on remittances claims that the reasons for remittances are pure altruistic ones. Lucas and Stark introduce an altruistic utility function where the migrant's utility emboldens the consumption of the other household members. Recent studies have also focussed on the fact that self-interested reasons for remitting exist. This theory still puts the family in focus since it regards the family as a business or a network of contracts that empower the members to engage in Pareto-improving arrangements. If migrants have investments that need to be looked after while they are abroad, they will employ family members in the home country as their agents. In this case, remittances are used for managing migrants' interests as well as some compensation for the agents. Furthermore, the family may have the role of financial intermediary. Stark (1991), as well as Agarwal and Horowitz (2002) and Gubert (2002), claim that the family can act as an insurance company that protects its members against income shocks by verifying the sources of income. On the other hand, Poirine (1997) and Ilahi and Jafarey (1999) portray the household as a bank that finances migration for its members. The borrowers remit to pay back the loans that are put towards more loans to promote the interests of other household members.⁶

Migrants are risk averse and sensitive to political and economic situation in their home country when remitting. Glytsos suggests that money flows determined by these characteristics

⁴ OECD 2006, p. 145

⁵ Chami, Fullenkamp and Jahjah 2005, p. 55

⁶ Ibid, p. 57

are “desired” remittances, whereas transfers that are of a more obligatory character for family support are “required” remittances.⁷

The motives to remit may be a combination of altruism and self-interest, so called “tempered altruism” or “enlightened self-interest”. Despite the motives, the magnitude of remittances is to be decided by the income of the remitter. The higher the income, the larger the remittances into the recipient country. This has to be complemented by the income of the receiver. If the motives to remit are altruistic ones, remittances are larger the lower the income of the recipient.⁸ On the other hand, if the motives to remit are self-interest ones, the determinant factor for the magnitude of remittances will be the migrant’s return on investment in the home country, and the difference between this return and the return in the emigration country.⁹

Even though remittance arrangements seem to be truly self-interested at first sight, the mechanism on which they rest upon may be an altruistic one. A migrant might be expected to live up to her obligations or family’s expectations whose members are the counterparties to the agreement. Research has shown strong evidence that family ties which rest upon altruism justify much of the remittances. Altruism in this sense is the migrant’s concern about income or consumption levels of its’ family in the home country.¹⁰

2.2 Determinants of Remittances

Russell (1986) uses a framework for analysis of the determinants of remittances and their implications. The following elements are supposed to have a positive impact on remittances: number of workers abroad; economic activity in host and origin country; facility of transferring funds and the marital status of the migrants (married migrants tend to send more remittances to their family members). The factors that have negative influence on remittance flows are political risk factors in source countries (the larger the risk, the smaller the willingness of remitting); the ratio of females in the population in host country (the larger the ratio of females, the lesser the remittances); the number of other employed people in the household; the level of education and the occupational level of migrants (it is assumed that poorer households tend to send individuals with lower education and skill levels abroad, and consequently have a greater propensity to

⁷ Glytsos 2002, p. 14-15

⁸ Lucas and Stark 1985, pp. 904-906

⁹ Addison 2004, p. 7

¹⁰ Chami, Fullenkamp and Jahjah 2005, pp. 58-59

remit). Lastly, there are factors that may have a positive or negative impact on remittance flows, depending on the individual country/ household structure: wage rates, exchange rates, relative real interest rates and years since out-migration.

The decision-making for remitting appears as follows. Several factors determine migrant's foreign earned disposable income and generate a "pool of remittances". The most important factors determining the disposable pool of remittances are the number of workers, foreign country's wage levels and economic activity in the host and source country. Given the pool of remittances, the migrant has to make a decision whether to send remittances or keep them in the source country. The migrants' decision is affected by relative interest rates, exchange rates, facility in transferring funds, income level of household, ratio of females in population in host country, time passed since outward migration and political risk factors in the recipient country. When a migrant has decided to remit, the next question is whether to do so via formal or informal channels. This is determined by relative interest rates, exchange rates, facility in transferring funds and migrant's level of education. The amount to remit will be determined by the number of years since out-migration, the income level of the household, employment of other members of the household, marital status, and the migrants' occupational and educational level. Then, the migrant or/and receiving household has to decide if the remittances are to be consumed or invested/saved. Once again, this decision will be influenced by the same factors as the amount being remitted.¹¹

2.3 Implications of Remittances

Remittances result in an inflow of foreign exchange into the receiving country. They can be seen as a source of financing imports and capital inflows as well as they can contribute to reducing the balance of payments deficit.¹² This might result in increased money flows put in circulation with no impact on the inflation rate and stronger domestic currency. Yet, the situation might give rise to Dutch Disease, which means that large inflows of capital can lead to an appreciation of the real exchange rate and worsened competitiveness of the sectors exposed to international competition, which in turn can prevent the development of a dynamic export sector.¹³

¹¹ Ramamurthy 2003, pp. 65-66

¹² Glytsos 2002, p. 7

¹³ Bourdet and Falck 2006, p. 268

The inflow of remittances is expected to lead to increased demand for goods and services, increased consumption and a spurring of the receiving economy.¹⁴ There is a potential risk of inflation generated by increased demand and an unresponsive supply. The inflation can rise to such a level as to offset the positive effects on development. This would result in an increased gap between sending and receiving countries, as the former would experience losses in the form of inflation and increased imports and the latter would enjoy all the benefits. Researches have proved that remittances have impelled inflation in some countries leading to rising imports.¹⁵

A negative impact of remittances is that they create a potential dependency for the receiving country. Governments in the recipient countries may view remittances as a stable source of income to count on.¹⁶ Accordingly, remittances may cause governments to relax and even rely on these flows financing deficits and thereby not adopting long-term economic policies to create a competitive domestic market. Glytsos and Katseli (1989) argue that constant remittance flows may deprive a country of a more diversified industrial structure and reinforce the balance of payments deficit. Due to increased imports caused by remittance flows and increased balance of payments deficit, some researchers compare the phenomenon to drug addiction, increasing rather than decreasing the need for the foreign exchange. Therefore, remittances may distort development and even cause economic decline. Recent studies on the subject in some Mediterranean countries point out that remittances may have negative impacts on growth.¹⁷

Chami, Fullenkamp and Jahjah agree with the proposal above, questioning whether remittances lead to economic development.¹⁸ They show a negative correlation between remittances and GDP growth, suggesting that remittances are compensatory in nature. Remittances become compensating for poor economic performance instead of acting as capital for economic development. Further, a model investigating effects of remittances on the incentives of recipients is created, showing that money is substituting for labour income. Recipients use remittances to reduce labour supply and labour market participation.¹⁹ Giuliano and Ruiz-Arranz,

¹⁴ Ramamurthy 2003, p. 11

¹⁵ Glytsos 2002, p. 18

¹⁶ Chami, Fullenkamp and Jahjah 2005, p. 78

¹⁷ Glytsos 2002, pp. 7-8

¹⁸ Chami, Fullenkamp and Jahjah 2005, p. 55

¹⁹ Ibid, p. 77

on the other hand, criticize these findings and claim that there is no cross-country macroeconomic analysis that supports their inference.²⁰

As mentioned before, remittances can be seen as a substitute for labour income. The problem of moral hazard arises when the receiving individual takes advantage of the remitter by making this substitution. Remittance transfers may therefore have negative effects on effort. Chami and Fischer (1996) present similar results in a model where the information between the agents is asymmetric in the context of insurance markets. Moral hazard will exist, unless altruism is mutual and strong enough so that every individual values the other's utility like their own. This would result in lower effort and an adverse insurance market reaction. Furthermore, as long as the incomes of the remitter and recipient are not identical, strong symmetric altruism is not enough to reduce the problem of moral hazard.²¹

2.4 Use of Remittances

The remittance-receiving individuals are expected to act rationally, spending their remittances to yield higher profits.²² The majority of remittances are aimed at easing the financial situation of the households receiving the money. Therefore it should not be surprising that remittances are mostly used for consumption or needs such as housing, food, health care and the acquirement of consumer durables. These needs might be considered as important investments in terms of human capital. However, problems can arise in poor economies that have to import durables to be able to meet this new increased demand, as it will have a contrary impact on the balance of payments.²³

As the majority of remittances are spent on consumption, they are not considered as being spent on productive investment and development. This fact does not take into account that education is classified as consumption and that expenditure on education is investment in human capital. In both the short and long run, investment in education implies an improvement of the educational infrastructure of the labour exporting economy. Migrants, in combination with high productive physical capital, yield returns that are usually much higher than they would have been if the migrants were employed in their home country. The migrants' family members that remain in their home country, enjoy a higher standard of living through the migrants' savings, which

²⁰ Giuliano and Ruiz-Arranz 2005, p. 3

²¹ Chami, Fullenkamp and Jahjah 2005, pp. 61-63

²² Glytsos 2002, p. 19

²³ Ramamurthy 2003, p. 67

may be the absolute purpose of any investment. Hence, expenditure on consumption and housing generates indirect multiplier effects, which encourage investment and output in related industries.²⁴

Since remittances go immediately to household and individuals, they can directly improve their living standards through consumption, investments and savings. Asch explains why remittances should be considered being used in productive ways and contributing to economic development:

- Firstly, the household receiving remittances does not need to invest remittances directly to consider this money being invested. Financial intermediaries loan the deposits of household members receiving remittances to those who do invest.
- Secondly, even if the household does not deposit the remittances with a bank and instead spends all of the money on the consumption of a good, the good-producer might deposit its revenues with a financial intermediary who may loan the money to an investor.
- Thirdly, remittances if consumed may contribute to reduced poverty, the satisfaction of basic needs and an increase in health as well as the productivity of recipients.
- Fourthly, the division of investment and consumption is indistinct. For example a family that buys a car from the remittances might use this car for both personal needs as well as for transportation for the family business.
- Lastly, remittances may provide recipients credit when credit is not available from other sources and thus free up other recipients resources that may finance direct investment.

In sum, whether remittances are used for productive or unproductive aims, the issue of how remittances are conducted by recipients is an empirical question.²⁵

For a long time it was believed that remittances would motivate the growth of labour-intensive small and medium-sized enterprises in exporting areas. This didn't turn out to be the general case for several reasons. The main one is that labour migration occurs usually due to inappropriate possibilities for employment and entrepreneurship in the home country. The reasons are inadequate policy and institutional frameworks, unequal distribution of assets, inappropriate economic structures or incentives and other elements harmful to economic development.²⁶ Hence, remittances by themselves or the magnitude of them can affect exports in both a positive

²⁴ Glytsos 2002, p. 15

²⁵ Asch 1993, pp. 13-14

²⁶ Ramamurthy 2003, p. 12

and a negative way. The positive impact is that the country may get enough of foreign currency through remittances, which may diminish the pressure to bring forth foreign exchange through exports.

Even if remittances are not considered being invested to increase productive capacity in the recipient economy, the investment in human capital might achieve the goals that any investment may be expected to attain. What is more important is that this is done without sacrificing current consumption for investment and with none home country physical capital.²⁷

²⁷ Glytsos 2002, pp. 15-16

3. Remittance Patterns and Development in Croatia

3.1 A matter of Terminology

3.1.1 Methodological Problems

Currently, the statistical community is developing better measures for remittance flows. A main question is which items to include and what to exclude when calculating remittances. Although research in the field of remittances is advancing, the large problem is to find data. The main constraint is the methodology. Furthermore, there exists a problem in measuring remittances as many of these are not channelled through the official payment system, which implies that they do not appear in official statistics. The lack of a common methodological and statistical coordination between the countries hinders general inference on the subject.²⁸

To be able to assess the size of remittances on a micro-level, household surveys should be analysed and compared with balance of payment data. To make this comparison possible, definition from these two sources should be harmonized. In 2005, The Technical Sub-group (TSG) on the Movement of Persons agreed on coordination of the Balance of Payments elements related to remittances to the 1993 System of National Accounts (SNA) transactions. Moreover, TSG directed that the difference between compensation of employees and workers' remittances should be maintained. Furthermore:

- a) Personal transfers should replace workers' remittances in the Balance of Payments Manual, 5th edition (BPM5).
- b) Personal remittances should be defined and introduced in the balance of payments as a memorandum item.²⁹
- c) Registration of migrants' transfers should change in the balance of payments.³⁰

a) Personal transfers

²⁸ Chami, Fullenkamp and Jahjah 2005, p. 64

²⁹ In the balance of payments, memorandum item is mandatory to compile compared to supplementary item whose compilation is recommended but not mandatory

³⁰ Definition of personal remittances in the balance of payments context 2005, p. 2

TSG suggested the definition of personal transfers in BPM6 corresponding to the 1993 SNA definition of current transfers between households (1993 SNA para 8.95):

“Personal transfers consist of all current transfers in cash or in kind made, or received, by resident households to or from other non-resident households.”³¹

Personal transfers would embrace components workers’ remittances and other current transfers (other household to household transfers) classified as in BPM5. Replacement of workers’ remittances by personal transfers and corresponding the definition of personal transfers with the definition of current transfers between households (1993 SNA para 8.95) will make comparison between household surveys and the balance of payment data easier. Furthermore, shortcomings and irregularities of both remittance sources will be revealed easier.

b) Personal remittances

According to TSG personal remittances should be defined as:

“Personal remittances consist of current and capital transfers in cash or in kind, made or received, by resident households to or from non-resident households and net compensation of employee from persons working abroad for short periods of time (less than one year).”³²

The difference between this definition and the above one on personal transfers is that personal remittances include capital transfers and net compensation of employees. Hence, personal remittances should be derived as the sum of net compensation of employees, personal transfers, and household-to-household capital transfers.³³

c) Migrants’ transfers

TSG has suggested that migrants’ transfers should not be enclosed in the definition of personal remittances. The recording of these transfers will no longer be registered as transactions in the

³¹ Ibid, pp. 3-4

³² Ibid

³³ Ibid

balance of payments. Instead they will appear in the other changes in financial assets and liabilities account.³⁴

3.1.2 Definition of Remittances

According to Zlotnik, the most commonly used official data on measuring remittances are the International Monetary Fund (IMF) estimates: workers' remittances, migrant transfers and compensation of employees.³⁵ Workers' remittances are money sent to the home country by emigrants who have lived abroad for more than one year. Migrant transfers are net worth of migrants. Compensation of employees is money sent by migrants who have lived abroad for less than a year.³⁶

Harrison, Britton and Swanson suggest that remittances should be measured as the sum of workers' remittances and compensation of employees. Migrants' transfers should be excluded from the definition.³⁷ The World Bank and Balance of Payments Statistics Yearbook 2005 issued by IMF also use this definition of remittances.³⁸

A third alternative for measuring remittances calculates remittances as the sum of compensation of employees, workers' remittances and other current transfers of other sectors. Hence migrants' transfers are replaced by the item other current transfers of other sectors. According to the Organization for Economic Co-operation and Development (OECD), this method is the most appropriate one since it overcomes the usual shortcomings when measuring remittance flows. However, it may overestimate the real size of remittance flows.³⁹

There are several shortcomings about definitions of remittance estimates. Problems with compensation of employees are high thresholds, different methods in transferring money, the presence of foreign illegal workers and the time period of one year which is difficult to use in practice (since the difference between compensation of employees and workers' remittances is not distinct).⁴⁰ The same problem is present for workers' remittances.⁴¹ Furthermore, compensation of employees is the gross income of migrant workers that can be spent in the host

³⁴ Definition of personal remittances in the balance of payments context 2005, pp. 4-5

³⁵ Zlotnik 2005, p. 15

³⁶ Ramamurthy 2003, p. 64

³⁷ Britton, Harrison and Swanson 2005, p. 11

³⁸ Balance of Payments Statistics 2005, p. 12

³⁹ OECD 2006, p. 141

⁴⁰ Hussain 2005, p. 5

⁴¹ Damia 2005, pp. 9-12

country and never remitted. Also, this item includes wages of non-migrants, for example local staff of embassies and consulates, and international organisations.⁴² An additional shortcoming of workers' remittances is, for instance, if a Bosnian migrant in Sweden sends money to his family members that are settled in Croatia, this money will not be registered as remittances according to the definition of BPM5. Furthermore, when a migrant retires but continues to remit to his family in the home country, these remittances will not be recorded. In addition, the difference between the item workers' remittances and the item other private current transfers is sometimes unclear.⁴³ The item other current transfers of other sectors is facing the same problem, as these transfers are difficult to distinguish from workers' remittances. Lastly, migrants' transfers are many times not separately recorded in the capital account by central banks.⁴⁴

3.1.3 Measurement Problems

Remittances can be sent through formal and informal channels. The formal ones are bank transfers, postal money orders and money transfer organisations; the informal ones are mostly through family and friends but even cash or kind through money couriers.⁴⁵ Official statistics on remittances only include remittances sent through formal channels. These statistics are primarily collected and reported through the Balance of Payments framework, but they are incomplete in many countries, may underreport remittance flows, and are often not comparable.⁴⁶

Remittances sent through postal orders do not have the information of whether the sender has lived abroad for less or more than a year. Therefore, it is difficult to register this money in any of the categories workers' remittances, migrants' transfers or compensation of employees. These amounts may not be included in any of the categories or arbitrarily in one of them.⁴⁷

Shortcomings in statistics of personal imports are migrants' duty free imported goods or goods brought along as personal luggage or gifts and savings that are brought home to be converted into domestic currency at local banks.⁴⁸ Furthermore, remittances in-kind (such as clothes and other consumer goods, jewellery or through hawala) are not registered in the official amounts.⁴⁹

⁴² OECD 2006, p. 141

⁴³ Hussain 2005, p. 5

⁴⁴ OECD 2006, p. 141

⁴⁵ Ramamurthy 2003, pp. 63-64

⁴⁶ International Technical Meeting on Measuring Remittances 2005, pp. 3-4

⁴⁷ Ramamurthy 2003, p. 64

⁴⁸ Ibid

⁴⁹ OECD 2006, p. 141

Nobody knows the exact percentage of unrecorded flows but it is estimated that they can add up to 50% of the official amount.⁵⁰

3.2 The Case of Croatia

3.2.1 Migration

The decision to emigrate is driven by a cost-benefit analysis of migration. For the emigrant, the benefits are better employment opportunities, increased income, improved standard of living, training and skills advancement, and the opportunity of other socio-cultural ways of life. For those left behind the benefits include the possibility of receiving remittances.⁵¹

It can be assumed that remittances have followed the migration patterns in Croatia. Croatian emigration dates from more than hundred years ago; however, for this essay emigration from 1940s until today will be looked upon. In the 20th century Croat-born diaspora migrants amount to two and a half million. The overall net migration is negative amounting to 1 300 000.⁵² There are about 230 000 Croatian citizens working abroad.⁵³

The first emigration phase began in the 1940s when about a quarter of a million Croats fled the Yugoslav communist regime. More than 80% of these were working in Germany. The second emigration phase occurred in the 1960s when many Croats went abroad as temporary economic migrants or political refugees. Up to the year 1990, there was half a million Croats in the Western European countries. Guest-worker remittances boosted the Yugoslav economy and industry significantly. The third emigration phase began in 1991 due to the war in Croatia. During that period and the following years, about one million Croats left their country.⁵⁴ There is ongoing emigration at the moment where highly skilled and professional people are leaving the country. This trend is predicted to intensify in the future.

Australia is the dominant receiving country of the Croatian diaspora. About 300 000 Croats are to be found there. As the majority of the emigrants to Australia were low skilled, many of them got employed as production workers. The United States (US) was another popular

⁵⁰ Ratha 2003, p. 171

⁵¹ Ramamurthy 2003, p. 25

⁵² interview with Mesaric-Zabcic, 2006-11-09

⁵³ CROSTAT

⁵⁴ Mesaric-Zabcic 2002, pp. 5-6

destination of emigrants. These migrants were skilled and educated. The motives for their emigration were better work opportunities and living conditions. It is estimated that 170 000 Croat-born persons live in US today. Canada has been, and still is, a popular emigration country. Today's emigrants are highly educated and the situation might become that of a brain drain for the country. At the moment there are 75 000 Croats living there. The rest of Croatian diaspora overseas can be found in New Zealand, South Africa and Argentina.⁵⁵

In Western Europe, the largest communities are to be found in Germany with more than 200 000 Croats; in Austria live 130 000 of whom 50 000 are guest workers; in France 50 000; Sweden 30 000 and Italy 15 000 (the amount is underestimated). Many Croats in Europe work as merchants within small enterprises but there are many professionals and skilled ones as well.⁵⁶

The real number of the Croatian diaspora is probably higher due to irregular workers, unregistered migrants as well as migrants that chose not to keep their Croatian citizenship. It can be assumed that they remit in the same way as other emigrants but their transfers will not be emboldened in the remittance statistics. Unfortunately neither CNB nor CROSTAT have any estimation on this. Hopefully a part of these remittances can be traced through household surveys.

3.2.1.1 Migrant Motives

Motives for the Croatian emigration were better economic conditions and escape from the communist regime. From the 1960s until the fall of Yugoslavia, the emigration was encouraged and driven by the state. The government considered emigration as a way to generate foreign currency and alleviate the high level of unemployment.⁵⁷ During the first half of the 1990s, Croats migrated escaping the armed conflict and its consequences such as feeling unsafe and loosing their homes.

Contemporary motives behind the Croatian emigration towards developed countries are mostly socio-economic ones. Still, emigrants are pursuing improved life conditions, such as higher expected living standard, better work opportunities and increased political and cultural freedom.⁵⁸

⁵⁵ Mesarić-Zabčić 2002, pp. 8-10

⁵⁶ Ibid, p. 14

⁵⁷ Ragazzi 2006, p. 15

⁵⁸ Mesarić-Zabčić 2002, p. 18

3.2.1.2 Migrant Profile

Emigrants can be characterized according to following estimates: urban-rural place of origin; educational level; employment status; skills and other perceptible and imperceptible characteristics.⁵⁹

The majority of Croatian migrants were guest workers and political exiles. In the beginning, the emigrants came mostly from rural, agricultural regions. They were usually unemployed, low-educated, low-skilled, single, young men. Well abroad, they performed hard physical work (often working overtime to save as much money as possible) and worked in the industry, manufacturing and building sectors. In the middle of the 1970s, guest workers reunited with their families by bringing them abroad. After that period, ones that were skilled with expertise knowledge and/or highly-educated emigrated from Croatia.⁶⁰ From 1991, the emigrants from Croatia are highly skilled, educated, young people from urban areas.⁶¹ Generally, it is presumed that the typical migrant is 20-40 years old and more educated and skilled than the average inhabitant in Croatia.⁶²

Conclusively, Croatian emigrants usually have strong ties to their country of origin, the Croatian identity abroad is very strong and the diaspora has supported Croatia economically continuously.

3.2.2 Definition

In this essay remittances are calculated as a sum of migrants' transfers, workers' remittances and compensation of employees. The choice of including all three components is to capture seasonal and temporary emigrants' remittances and thereby embolden all (by CNB) registered flows from abroad. Especially the item compensation of employees might be significant since Croatia borders three members of the European Union (EU). Remittances for community or social purposes, which are sent to organisations instead of households, are not within this essay defined as remittances. This is not the best way to measure remittance flows but in lack of better measurement tools, it will do.

The Croatian National Bank's terminology is in accordance with IMF's BPM5. The problem with the Croatian National Bank's terminology is that national and international remittances in

⁵⁹ Asch 1993, p. 24

⁶⁰ Rados 2006, pp. 175-176; Rados 2005, p. 1

⁶¹ Mesaric-Zabicic 2002, p. 11

⁶² interview with Mesaric-Zabicic, 2006-11-09

items workers' remittances, migrants' transfers and compensation of employees are added together.

About 12% of the Croatian labour force was guest working abroad for more than a year in 2001.⁶³ Commuters account for some 16% of the total population.⁶⁴ Their income and benefits are captured by the item compensation of employees. Nevertheless these border workers may import duty-free goods or bring home remittances in kind, but these will never appear in the official statistics. Since Croatia borders five countries of which three are EU-members, there might exist a large hidden number of commuter's unrecorded remittances.

3.2.3 Remittance Flows

Remittances are usually expressed as a percentage of GDP or percentage of merchandise exports.⁶⁵ For most countries, remittances account for about 1% of GDP.⁶⁶ As a percentage of merchandise exports, the relative share for developing countries ranges from 25-50%. Both allow for large fluctuations.⁶⁷ The remittances' share of GDP in Croatia has on average been 3.1% for the examined period. The higher percentage than the average can be supported by the fact that Croatia is a small economy having large remitting diaspora. A better measure to express remittances might be remittances per capita as it shows how much money each individual receives. OECD rates Croatia within the top ten countries with the highest remittances per capita received in year 2002.⁶⁸ As a percentage of merchandise exports, remittances accounted for about 12%.

Examining remittance flows for the period 1997-2005, Croatia has experienced a stable inflow increasing for every year. From the beginning to the end of the period, remittances have doubled. The only exception is in year 1999 when Croatia experienced a decrease in remittances from the previous period. This is probably due to the banking crisis and recession in 1998, which lasted until the end of 1999. For the period 1999-2002, Croatia experienced its fastest rise in remittances. The reason is probably the economic recovery. From 2002, remittances slowed down remarkably compared to the previous up rise but the inflows are still increasing.

⁶³ CROSTAT

⁶⁴ Tepus 2005, p. 238

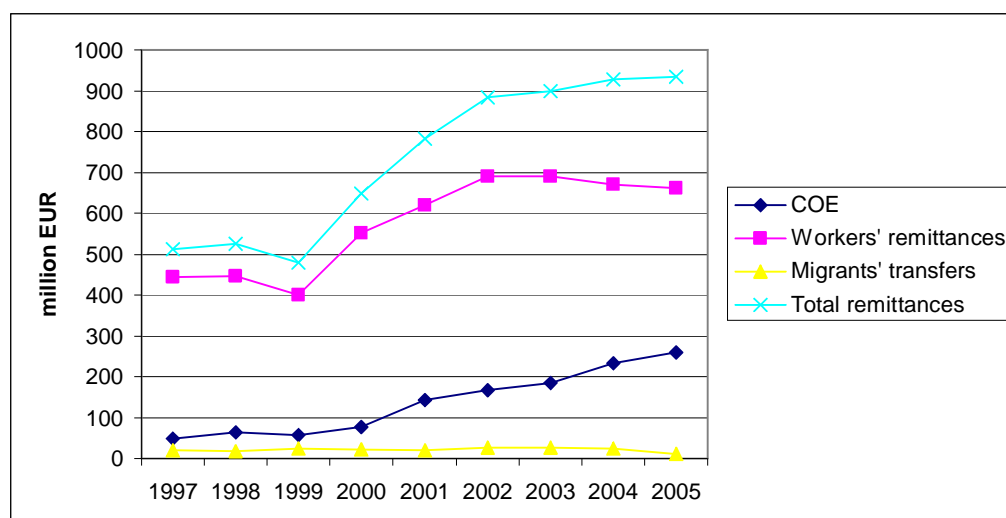
⁶⁵ Ramamurthy 2003, p. 26

⁶⁶ Britton, Harrison, and Swanson 2004, p. 15

⁶⁷ Ramamurthy 2003, p. 68

⁶⁸ OECD 2006, p. 144

Diagram 3.1 Remittance Flows to Croatia for the Period 1997-2005



Source: Compilation based on data from CNB

If considering the components of total remittances, a few things can be said. Workers' remittances account for 80% of total remittances and both followed the same trend until year 2000. Thereafter, the gap between these two is diverging and the negative development of workers' remittances is offset by the fast increase of compensation of employees (COE). Item COE is characterized by a stable positive trend amounting just over five times the initial amount. As the flow of Croatian workers abroad has remained at the same level, the trend has probably been reinforced by the nominal wages increase of these (and non-resident workers). Migrants' transfers represent a very small part of the overall remittances. In 2005 they were about half the initial amount and were practically insignificant to the total amount.

Table 3.1 Remittances per Capita for the Period 1997-2005

Year	Received Remittances in million EUR	Remittances/Capita in EUR
1997	512, 4	112
1998	526, 1	117
1999	479, 7	105
2000	649, 4	148
2001	783, 2	177
2002	882, 9	199
2003	899, 6	203
2004	928, 2	209
2005	933, 4	210

Source: Calculations based on data from CNB

The remittance trend per capita is seen in the table 3.1. The trend is expected to reflect the general aggregate trend as the population has remained at almost the same level during the period, whereas the inflows have increased for every year. In 2005, the amount of remittances received per capita was 210 euro.

Migration Information provides data on remittances to Croatia and when compared to this essay's calculations, the amounts are nearly converging.⁶⁹ This is not surprising since both CNB and Migration Information use the same estimates to measure remittance flows. On the other hand, according to OECD, Croatia has received 1 325 million euro remittances and 303 euro per capita in the year 2002.⁷⁰ The data is differing to this essay's since the OECD has substituted item migrants' transfers with current transfers of other sectors, which is probably the reason for the overestimation of remittances.

The World Bank provides different data than all of the above. The Bank measures remittances as the sum of workers' remittances and compensation of employees. The existing data for Croatia is from 2000-2004.⁷¹ Remittance data by the World Bank is compared with CNB's data for the same items and the same period. The result shows that the pattern of remittance flows is similar, with the exception of higher amounts by World Bank. In the beginning of the period, the World Bank's amount is 65 million Dollars (USD) higher to be nearly USD 100 millions higher in year 2004. Amounts tend to converge slightly if the World Bank data is compared to remittances as defined in this essay (when including item migrants' transfers). Still, there exists a gap between these two since migrants' transfers are relatively low. The question is why there exists a gap of approximately 9% unrecorded remittances by the Croatian National Bank as they and the World Bank seem to use the same methodology. The explanation is probably data differences due to backward updates done by the CNB.⁷² Another explanation might be the use of different methodological definitions in combination with exchange rate deviations.

An increase in remittances encourages capital accumulation through its influence on domestic saving and investment.⁷³ This fact, in combination with the improved financial situation of the emigrants, might explain remittances' growth in Croatia. Since item worker's remittances include diaspora's acquirement of real estate, an increasing economic and political stability might have

⁶⁹ Migration Information

⁷⁰ OECD 2006, pp. 143-144

⁷¹ The World Bank

⁷² interview with Madzarevic-Sujster, 2007-01-08

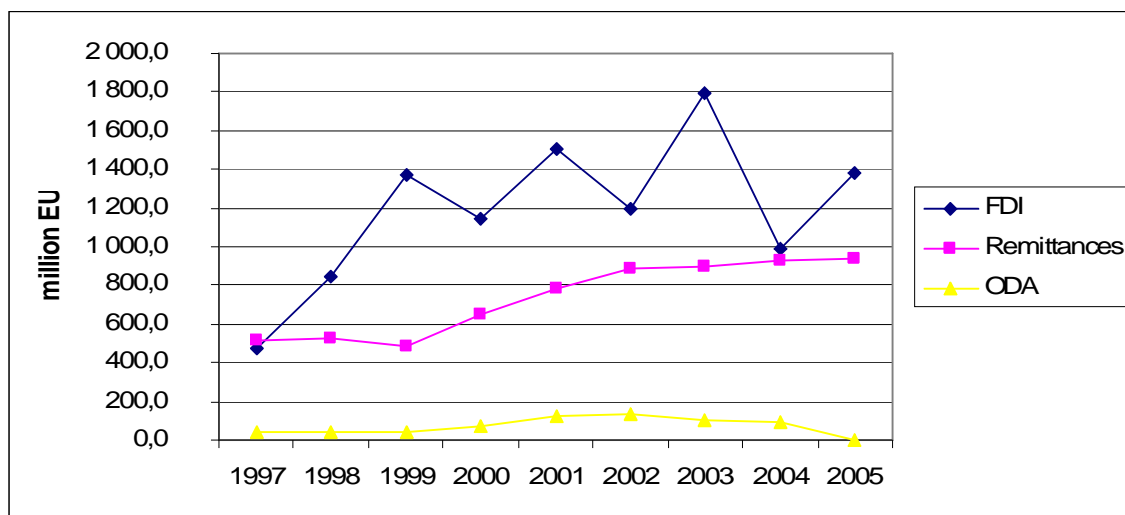
⁷³ Bourdet and Falck 2006, p. 272

implied the larger inflow of “desired” remittances whose purpose seem to have been savings and investment. On the other hand, “required” remittances might have decreased with increased economic and political stability.

3.2.4 Remittances and Other Sources of Foreign Exchange

The major sources of foreign exchange flowing to Croatia are tourism, FDI and workers’ remittances.⁷⁴ During the period of examination, tourism de-facto diminished due to the Kosovo conflict whereas FDI fluctuated due to perceived domestic credibility by investors. Despite this, the findings suggest that remittances have not been significantly affected by the political and economic occurrences in the region.

Diagram 3.2 Capital Flows to Croatia for the Period 1997-2005



Source: Compilation based on data from CNB and OECD

Official Development Assistance (ODA) to Croatia is relatively small and declining⁷⁵, constituting for 10% of the remittance flows. The results give support to evidence that remittances have been the most stable source of foreign exchange into the country.

In summary, remittances have been more important than ODA, but not as important as FDI. Despite that, the remittance pattern shows a more stable and reliable pattern than FDI over time.

⁷⁴ see Croatia Country Assistance Evaluation 2004

⁷⁵ OECD

3.2.5 Determinants

Freund and Spatafora (2005) argue that the level of migration is the main driving force behind remittance flows. Nevertheless, while the number of migrants affects the level of remittance flows, the desire to remit influences the migration level.⁷⁶

Human capital theory suggests that educated and skilled people tend to migrate to a greater extent as they enjoy higher earning opportunities in labour-receiving countries.⁷⁷ The migrants' education level relative to the population in the home country affects remittance flows adversely. In other words, migrants from worse-off families seem to be remitting more to the family members that are left behind.⁷⁸ Moreover, if a large proportion of migrants are educated, they are more likely to earn a higher income and thereby remit more. At the same time, educated migrants tend to come from better-off families who rely less on remittances for their living. Accordingly, educated migrants can easier obtain legal residency in the destination country and bring their families with them, which would decrease the incentives to remit money.⁷⁹

It is presumed that the length of the migrants' stay in the host country influence its tendency to remit to the country of origin. As time goes by, the migrant considers herself as a permanent resident in the new home country and has shaped her own independent household.⁸⁰ With less contact with family members that are left behind, the flows of remittances may be expected to decrease as the ties become weaker.

On the other hand, as Croatia has many guest workers abroad it can be assumed that they as temporary migrants remit more to their families at home due to strong family ties. It may also be hypothesized that these migrants often live in poorer conditions and work longer hours to save as much as possible to be able to bring home much of their earnings for the life after returning.

Aggarwal et al (2005) show that the level of remittances has a positive impact on the financial sector development of recipient countries.⁸¹ This is based on the concept that money remitted through financial institutions paves the way for recipients to demand and get access to other financial services and products that they might not have otherwise. Furthermore, providing transfer services for remitting introduces banks to un-banked recipients or recipients with limited

⁷⁶ Niimi and Ozden 2006, p. 5

⁷⁷ Adams and Page 2003, p. 16

⁷⁸ Ramamurthy 2003, p. 16

⁷⁹ Niimi and Ozden 2006, pp. 4-7

⁸⁰ Chami, Fullenkamp and Jahjah 2005, p. 58

⁸¹ Niimi and Ozden 2006, p. 7

financial intermediation. For instance, remittances might have a positive impact on the development of the credit market if banks become more willing to extend credit to recipients as the remittances are perceived to be a significant and stable source of income.⁸²

3.2.6 Implications

The foreign exchange to Croatia caused by remittances could be seen as a source of financing imports. The Croatian kuna has been stable since 1997, fluctuating hardly around the euro. The inflow of remittances might have caused the appreciation of the kunas real exchange rate, which could explain the increasing amount of imports as the competitiveness of export sectors might have deteriorated. The Dutch Disease situation might have been reinforced by increased purchasing power caused by remittances. If the Croatian economy was unable to meet consumers' additional demand, the unresponsive supply could explain obtained increased imports. Also, the unresponsive supply can be explained by the large presence of state-owned enterprises, the inefficiency of these and low competition in the goods market. Hence, remittances might have worsened the Croatian trade balance as well as they paradoxically might have helped financing the domestic trade deficit. Furthermore, as the domestic supply seems to have not been flexible enough to react to the increased demand, this in turn has not benefited local sectors in the form of increased employment opportunities as unemployment has not decreased significantly.

GDP growth in Croatia is, among other things, based on workers' remittances.⁸³ This gives support to the fact that economic growth was most likely driven by higher aggregated demand which was caused by the multiplier effect, which in turn was induced by large remittances. As the major part of remittances seems to have gone to savings and investment, it can be argued that remittances have lead to sustainable economic growth in Croatia. In addition, it may be argued that economic growth encouraged migrants to invest more as they believed in the home market, which in turn have induced larger remittances to the home country.

⁸² Aggarwal 2006, p. 2

⁸³ Croatia Country Assistance Evaluation 2004, p. 3

4. Remittances and Household Economy

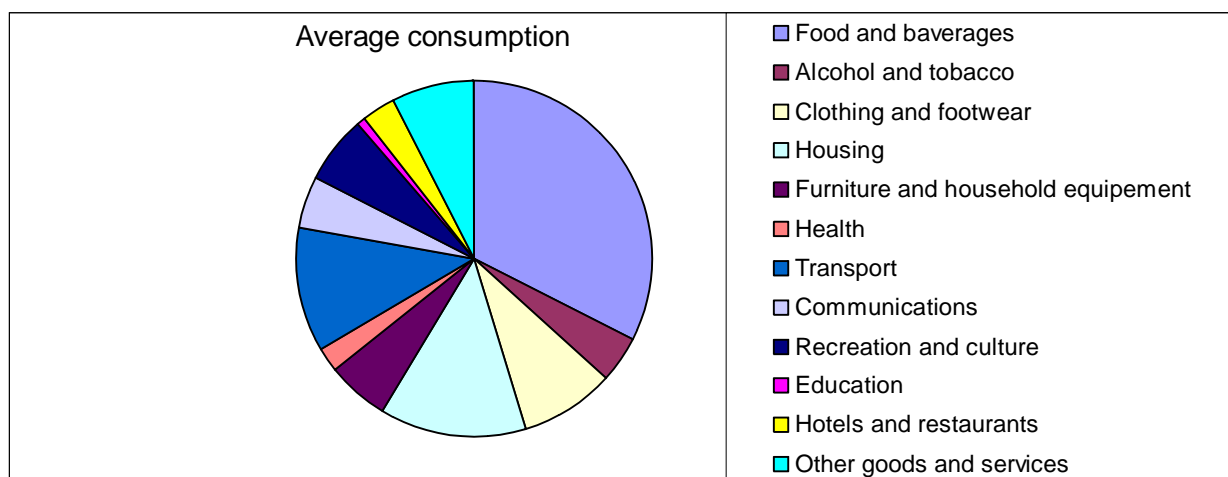
The impact of remittances can be studied at different levels: on a micro level, a community level and a macro level. The direct implications of these money transfers are to be found on the micro level, which is the household income level.⁸⁴

The balance of payment data tends to underestimate real remittance flows as large amounts might be transmitted through unofficial channels or brought back personally in form of gifts, cash or capital goods during visits to the emigrants' country of origin.⁸⁵ To complement data from the central banks, remittance flows can also be traced through household budget surveys (HBS). To compare data from different sources as to examine the impacts of remittances for the families' economy, HBS are to be analyzed.

4.1 Household Consumption

Households are classified according to their income and expenditure. The major expenditure for a family with an average income is food and beverages, accounting for one third of the total available income.

Diagram 4.1 The Average Household Consumption



Source: Compilation based on data from household budget surveys

⁸⁴ Ramamurthy 2003, p. 63

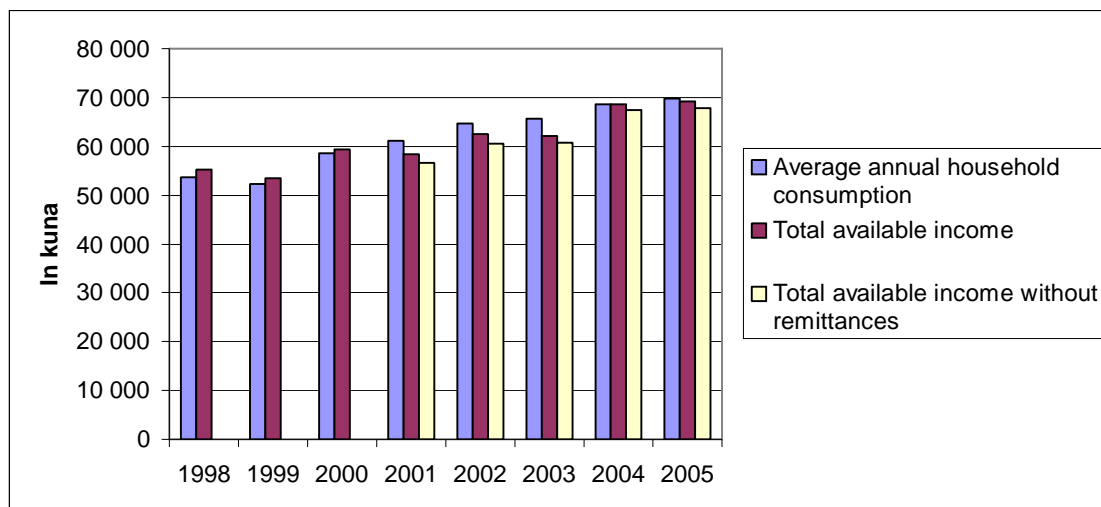
⁸⁵ Ibid, p. 10

The second largest expenditure item was housing to be followed by transport costs (mainly consisting of the purchase of vehicles and the maintenance of these) together accounting for one fourth of the income. Health accounts for some 2% of the total income, whereas expenditure on education amounts to 0.7%. The rest of the income is consumed on clothing and footwear, recreation and culture, furniture and household equipment, hotel and restaurant services, communications and other miscellaneous goods and services.

4.1.1 Remittances and Household Income

Total available household income would have been on average 2.3% lower without remittances. The gap between total available income and total available income without remittances decreased for the examined period, from 3% in 2001 to 2% in 2005. During the same period, the average personal consumption exceeded total available income except for the year of 2004 when these were about the same. Remittances could be seen as a moderate contribution helping households to reach desired consumption levels.

Diagram 4.2 Average Household Consumption and Income With and Without Remittances



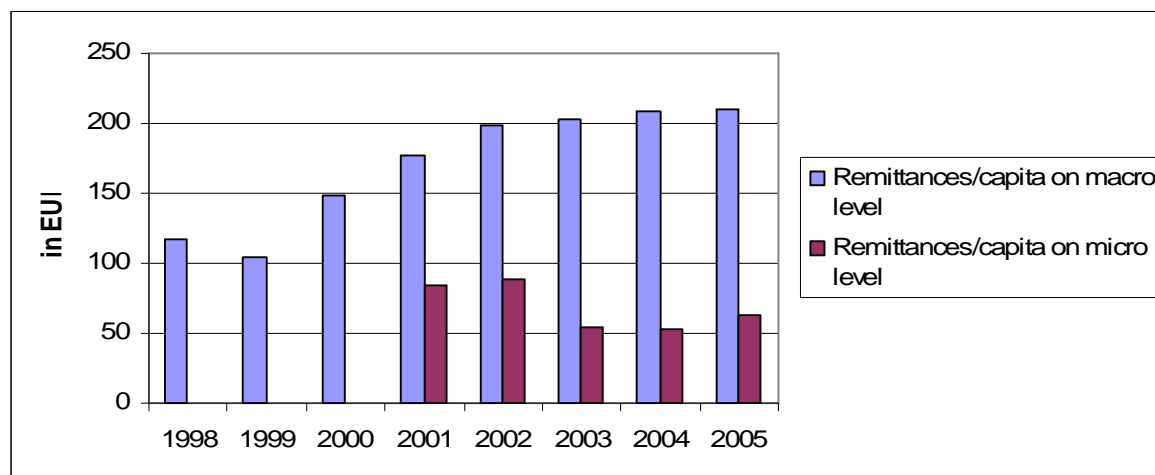
Source: own estimate based on data from CROSTAT

4. 2 Remittances on a Macro and Micro Level

Unlike remittance patterns on the aggregate level, the trend of household transfers has been inconsistent and negative constituting 3.3% of the total income in the beginning of the period to

1.9% in year 2005. The trend might have been reinforced by the increase of real wages due to positive net wages development.

Diagram 4.3 Remittances per Capita on a Macro and Micro Level for the Period 1998-2005



Data for remittances on micro level is missing for 1998-2000.

Source: Compilation based on data from CNB and CROSTAT.

The inconsistency of remittances based on household surveys data can partly be explained by changes that occurred in the sample frame for these. The new frame was adopted from the year 2003⁸⁶, which could explain the fall in remittances from that period and onward. Furthermore, some changes were done in questionnaires, which might have influenced the answers and thereby the registration of the household transfers. Moreover, the changes may limit comparing household transfers over the years and should therefore be bared in mind when analyzing this.

As mentioned before, data on household transfers might be a more reliable indicator on remittances than balance of payment data as household surveys might have captured a part of underestimated remittances through consumption or expenditure surveys. For Croatia, this seems to have been proved wrong. Compared to remittances on a macro level provided by balance of payment data, household transfers have been much lower. The difference can be explained by several reasons. Firstly, there is a risk of the sample size not being representative. Besides that, the households might not have been willing to give appropriate amounts of households' transfers received. Moreover, as the majority of Croatian diaspora is to be found in Europe, large

⁸⁶ CROSTAT

remittance amounts might have been hand-carried personally or via friends on the frequent visits to the country of origin. This hypothesis can be supported by the relatively easy travel facilities, low travel costs and short distances between Croatia and some of the major destination countries for emigrants. Another explanation might be the emigrant's reunification with his or her family and thereby nobody to remit to. Furthermore, the majority of receiving households' consumption needs might have been met, of this low household transfers. Instead, remittances seem to have been redirected towards savings and investments, which could explain large remittance flows on the aggregate level and low amounts on the household level.

4.3 Remitting Channels and Costs

There are five categories of transfer channels used for remitting: banks; non-bank money transfers; post offices; cash and commodities carries and lastly, informal money transfer services. The traditional forms of remitting are hand-carrying and courier services, but these are to be complemented by new vehicles to conduct cross-border money transfers such as prepaid payment cards.⁸⁷ Remitters are interested in low cost transfer methods, but they are at the same time risk averse. The choice of channelling remittances is influenced by the macroeconomic environment in the home country.⁸⁸

Major remitting channels in Croatia are banks and post offices, although large amounts are being hand carried (mostly over the holiday seasons). Some estimates suggest that around 50% of the official amount being brought is in cash directly.⁸⁹ It can be hypothesised that a large share of unofficially transferred remittances are of more supportive character. This is based on the assumption that supportive remittances are often lower amounts remitted by migrants from poorer backgrounds, which in combination with the migrants' interest in lower cost transfer methods influences his or her choice of using the unofficial channels. Furthermore, as the general level of informal activity in Croatia is high (the shadow economy accounted for 25% of GDP in Croatia in 2000⁹⁰), it can be expected that migrants' families are involved in it just like the rest of the population. In that case, a significant part of remittances might have been channelled into the

⁸⁷ Hussain 2005, p. 3

⁸⁸ OECD 2006, p. 149

⁸⁹ interview with Madzarevic-Sujster, 2007-01-08

⁹⁰ Ott 2004, p. 117

informal sector and were most likely transferred unofficially, which would have lowered the officially registered amount.

However, better financial development may result in larger measured remittances either because financial development empowers remittance flows or because a larger percentage of remittances are registered when those are channelled through formal financial institutions. Accordingly, financial development might decrease the cost of transferring remittances, leading to an increase in such flows.⁹¹ Furthermore, remittances have a positive relationship with deposits and credits.⁹²

The evidence of remitting the majority of money via formal channels can be supported by the main remittance motives, savings and investment. As remittances traced through the Croatian Central Bank are larger than the flows traced through household surveys, this indicates that the major purpose of remitting has been depositing and investing money. It should be remarked though that people might distrust the banking systems as it has experienced serious crises in last decades.

On the other hand, in cases where the motive behind remittances was family support, the marginal utility of remittances was most likely higher and thereby encouraged the use of informal channels as these usually imply lower costs. In this case, the decision was a trade off between marginal utility of remittances and transferring costs of official channels.

The costs of transferring remittances can be very high. Evidence indicates that transfer fees and costs can be 10-15% or even higher of the transferred amount.⁹³ In Croatia, the fees differ from 10% for transactions from the USA to smaller transfer costs from the EU.⁹⁴ Reduced transfer costs would probably encourage more remitting via formal channels and thereby make registration easier. This could facilitate creating better policies through which potential welfare gains could be obtained.

A more open economy implies greater incentive to send remittances through formal channels.⁹⁵ In the case of Croatia, the country's openness might have implied remitting via official channels due to the large money inflows registered on the aggregate level as well as the presence of foreign financial institutions, which should have raised the credibility of the financial

⁹¹ Aggarwal 2006, p. 3

⁹² Ibid, p. 15

⁹³ Ramamurthy 2003, p. 14

⁹⁴ interview with Madzarevic-Sujster, 2007-01-08

⁹⁵ Ramamurthy 2003, p. 68

market. At the same time, commuters that cross country borders on a daily basis may have given rise to large unrecorded remittance flows. This would have made data collection difficult resulting in measuring errors and thereby leaving out the accurate amounts.

In 2004, the CNB implemented the use of International Bank Account Number (IBAN) to enable more efficient payment transactions and decrease the remittance costs.⁹⁶ Besides that, the government seems to pay little attention in promoting remitting via formal channels, probably due to a well established banking system. Overall, it appears as the majority of remittances were channelled into savings and investment, which means that the banks either have succeeded in gaining remitters as clients or that channelling remittances via established official institutions have been of the laissez faire character.

4.4 The Characteristics of Remittance Receivers

It can be assumed that different individual profiles have different remitting behaviour owing to various variables such as sex, age and socio-economic background.

Single households without children were major receivers of transfers and other sources of financing, which indicates that these seem to have received most remittances. For single persons aged under 30, transfers and other sources of financing accounted for more than 40% of their income, which suggests that remittances have been an important source of income for these single households. As emigrants are mostly young and skilled/educated, they seem to have left behind a spouse for working abroad and are remitting significant amounts of money to her/him. Since large remittance flows have reached these single households this could partly explain these households' high consumption levels. Accordingly, one purpose of these remittances was reaching higher consumption levels since these households' expenditure were significantly higher than the average household expenditure. Moreover, these persons were better off economically than the average citizen, which indicates that their basic consumption needs have been met, therefore it is expected that savings and investment was another purpose of received remittances.

Another receiver group dependent on remittances were single persons aged over 65 and older. These households had the lowest consumption, especially single women aged 65 or older. Accordingly, single households consisting of a person aged 65 or older belonged to the worst off households. Remittances reaching these persons were of the supportive character, probably sent

⁹⁶ Matejka 2005, p. 30

by children or relatives that have emigrated and were helping out their single parent or relative that is left behind.

In sum, as the younger people have migrated abroad this could explain that the recipient households are mainly biased towards the young and older categories.

4.5 Motives behind Remittances

Motives behind remittances to Croatia can be linked to family and kinship structures and were support to poorer and/or dependent relatives; investment in family house building or rebuilding and as a ‘nest egg’ by emigrants for retirement back home.⁹⁷ In some cases, family members working abroad transferred a part of their earnings to their family, either to meet their full living standard needs or for long-term investments in land and property.⁹⁸

As stated earlier, as remittance data from the central bank exceeded household transfers, it indicates that major motives behind remittances to Croatia have been savings and investment. These investments were probably to be found in buying, constructing and rebuilding family houses or flats as 10% of the household’s total used assets were invested in real estate.

After Croatia’s independence, few housing policies and reforms occurred. The implementation of housing ownership reforms initiated the privatization of the former state owned flats in 1997. The reforms resulted in the perception that living in one’s own flat became a dominant housing status of most families.⁹⁹ The government subsidies for housing in combination with tax deduction seem to have implied a more favourable climate for the reconstruction or purchase of one’s own dwelling. At the same time, the war resulted in damaged and devastated homes, which were to be rebuilt after. Migrants’ remittances can be seen as a way of financing these housing investments.

Furthermore, property prices have been increasing due to high demand and emigrants might be responsible for a part of this demand and its increase. Remittances can be seen as a trade off between returns on savings and investment between the sending and the remitting country. Returns on real estate in Croatia might yield higher profits than investing or depositing money in the host country. Property prices are expected to increase further as they have not reached their peak yet, therefore large amounts of remittances could be expected to be found in real estate. As

⁹⁷ interview with Stubbs, 2006-10-12

⁹⁸ interview with Madzarevic-Sujster, 2007-01-08

⁹⁹ Tepus 2005, p. 253

many Croats abroad seem to have a strong relationship to their homeland, the acquisition of some sort of property should not be considered as unusual. Depositing money for preparing for one's own life after returning or retiring back home might have been another motive behind remitting. Investing in small business, for example tools and equipment, could also have been one of the remittance motives. However, supporting the family's consumption needs have had the lowest priority when remitting. Lastly, strong family ties and solidarity among family members should be mentioned as a possible motive of remitting. This is extremely hard to measure since it is hard to rate human values, rather it should be ascribed to the Croatian culture. Generally, remittances to Croatia seem to have the character of "desired" remittances.

4.6 Use of Remittances

The majority of remittances to Croatia seem to have been invested in real estate and land. As the Croatian diaspora is mainly well off and usually has all family members abroad, there has been little need for the remittances of the family supportive character¹⁰⁰. Instead, remittances money have been deposited in the banks and used when needed. Moreover, favourable investment climate and tax exemptions might have encouraged migrants to undertake entrepreneurial activities in the home country.

4.7 Determinants behind Remittances

There is a general perception that remittance flows decrease with time. As it was not possible to conduct a long time series data for Croatia, it is hard to draw general conclusions about this pattern. What can be said is that if applied to the short term, the perception would not be valid for Croatia, as remittances have nearly doubled for the examined period. The trend during the late 1990s indicates that remittance flows have been inconsistent on a national level during this decade. At the same time, remittances to Croatia have increased every year from 2000 to 2005, and the increase is larger than during the 1990s. The trend has been subsiding though since 2002.

As remittances have not decreased with time, this indicates that the determining factors for remitting have been asset accumulation and investment in Croatia. The trend can be supported by

¹⁰⁰ interview with Vamvakidis, 2006-09-26

the fact that the typical migrant is educated and skilled, which suggests that these migrants have remitted more for financial investments and income generating assets.

A developed financial market is important when remitting via official channels. By 2004, the banking sector in Croatia was 92% foreign-owned.¹⁰¹ The banks are offering favourable deposits in foreign exchange, which probably influences a remitter's decision to use banking channels and deposit the money within. The findings suggest that the financial development in Croatia have partly been a result of large remittance flows as these have been a stable source of foreign exchange with its potential recognized. This have probably lead to a positive spiral resulting in even better financial development encouraging more remittances through formal financial channels, strengthening the financial market and so on.

The results from analysing remittances give support for self-interest theory when remitting. Remittances have been used for benefiting the remitter mainly in form of yielding profits or supporting relatives left behind as a compensation for taking care of remitter's investments.

¹⁰¹ Croatia Country Assistance Evaluation 2004, p. 17

5. Remittances, Poverty and Inequality

According to Ramamurthy, research on the implications of remittances on poverty alleviation has not been presenting any conclusive results. Further, there is empirical evidence that the distribution of income gap in some developing countries has widened due to the remittance inflows.¹⁰² The implications of remittances on poverty and income distribution will be analyzed next.

5.1 Poverty

The majority of migrants are not from the poorest population strata. Having said that, remittances have rather resulted in widened income distribution discrepancies than in the lifting of households over the poverty line.

Poverty can be measured in absolute or relative terms. Absolute poverty is defined in relation to the poverty line as to cover essential physically and socially needs.¹⁰³ In Croatia, the absolute poverty rate is set at USD 5.30 a day per person based on purchasing power parity (PPP). A proportion of the population living on less than that amount was about 10% in 2001.¹⁰⁴ The relative poverty line is defined as a proportion of the national living standard, for example the mean or medium income.¹⁰⁵ The choice of the parameter influences the level of poverty registered due to the special features of the income distribution such as for example asymmetry and long tails. The use of the median income is less accurate and relative as it is based on only a few reference points on income distribution. Thereby, the median income is unaffected in the bottom or the top of this distribution. The major advantage of using the medium income is that the measure is less influenced by the extreme values of income distribution and by sampling fluctuations.¹⁰⁶

To overcome the shortcomings with the median income, the mean income will be used when determining the level of poverty to be able to capture the distribution of remittances in all deciles. Euro stat uses the 40%, 50% and 60% cut-off points in relation to mean income when calculating

¹⁰² Ramamurthy 2003, p. 29

¹⁰³ Bourguignon 2004, p. 1

¹⁰⁴ Bejakovic 2003, p. 90

¹⁰⁵ Bourguignon 2004, p. 1

¹⁰⁶ Eurostat 1998, pp. 16-17

the number of the poor.¹⁰⁷ In this essay, ten income deciles are divided in relation to the relative poverty line, which is set at 60% of the mean income (so to fit in with the average incomes of the deciles). Households belonging to the deciles 1-3 are considered as poor households. Deciles 4-6 are represented by households living just above the poverty line up to the average income line. Deciles 7-10 represent wealthy households.

As for the expenditure groups, the relative poverty line can be calculated as 50% of expenditure per capita or equivalent adult.¹⁰⁸ The relative poverty line for the expenditure groups is set at 50% of the mean value of expenditure per adult equivalent (as to be able to study expenditure on the individual level). This means that households whose expenditure is less than 60% of the average expenditure are considered to be relatively poor. The results based on expenditure data show that 23% of households are estimated to be living below this relative poverty line.

Since relative poverty line is influenced by the income distribution, the latter one is to be investigated next.

5.2 Income Inequality

No analysis has clearly proved that a particular cut-off point, in relation to mean income, represents the border line between poor and non-poor. The asymmetry of income distribution in relation to the cut-off point could influence the analysis of poverty.¹⁰⁹ The relative poverty line can show rising poverty even though the standard of living of the poor has risen.¹¹⁰ Therefore several indicators to provide a definition of poverty should complement each other as to evaluate the impact of the disparity of the distribution of income. Gini or Atkinson coefficients allow estimates of the concentration of the income data measuring the distribution inequality. On the other hand, the share of the decile or ratios top/bottom shows different patterns in the income distribution.¹¹¹

Comparing income deciles over time suggests that income inequality in Croatia has risen. When adjusting income amounts by the rate of inflation and the rise in the cost of living index, the increase becomes more moderate. The Gini coefficient increased slightly for the period 2001-

¹⁰⁷ Ibid

¹⁰⁸ Gorniak and Katsiaouni 2001, p.13

¹⁰⁹ Eurostat 1998, p. 25

¹¹⁰ Bourguignon 2004, p. 2

¹¹¹ Eurostat 1998, p. 25

2004 and has on average been 0.3. The rise indicates a slight increase in income inequality over time.

The richest 10% of the households had on average thirteen times the income of the lowest 10% during the period of 2001-2004. Total available income for the poorest decile increased by 7% over the time, whereas it increased by 15% for the richest one. The income increase for the poor deciles (1-3) was 11%, whereas it was 17% for the wealthy deciles (7-10). Those who benefited most from changes in relative income are thereby the wealthy and rich families whereas the poorest ones are those who benefited the least.

The forthcoming question is how migration and remittances have influenced the distribution of family earnings. Assuming that poor families received larger remittances then dispersion in income distribution may have been reduced. Conversely, the distribution may have been more dispersed.

5.3 Distribution of Remittances

The migrant profile suggests that the typical Croatian emigrant does not come from the poorest population strata. Instead he/she is skilled and come from a wealthy background. Hence, this implies that remittances were most likely sent to better off households. To test if this holds, the distribution of remittances based on income deciles will be analyzed.

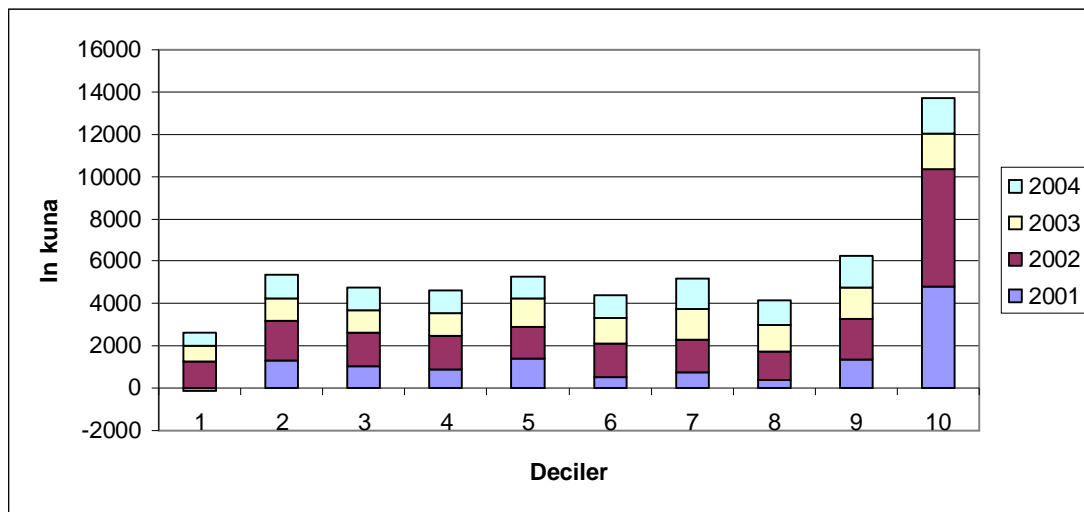
5.3.1 Remittances Distribution in Absolute Terms

The results show that rich households (decile 7-10), especially the 20% richest ones, were the largest receivers of remittances. The richest 20% had on average eight times higher income than the poorest 20%, while they received nearly three times more remittances than the poorest ones. The tenth decile by itself was the largest receiver of remittances accounting for one fourth of the flows.

In the year 2002, when remittances reached their peak, remittances received by the top decile accounted for nearly half of the average income of the poorest decile. This decile, the poorest of the poor, received least remittances with a share of 4% of the overall remittance flows. Among the poor households, the largest share of remittance recipients were to be found in the next poorest decile accounting for the 10% of the overall amount. Average income households (the

sixth decile) received among the lowest share of remittances and the flows accounted for a very small share of their total income.

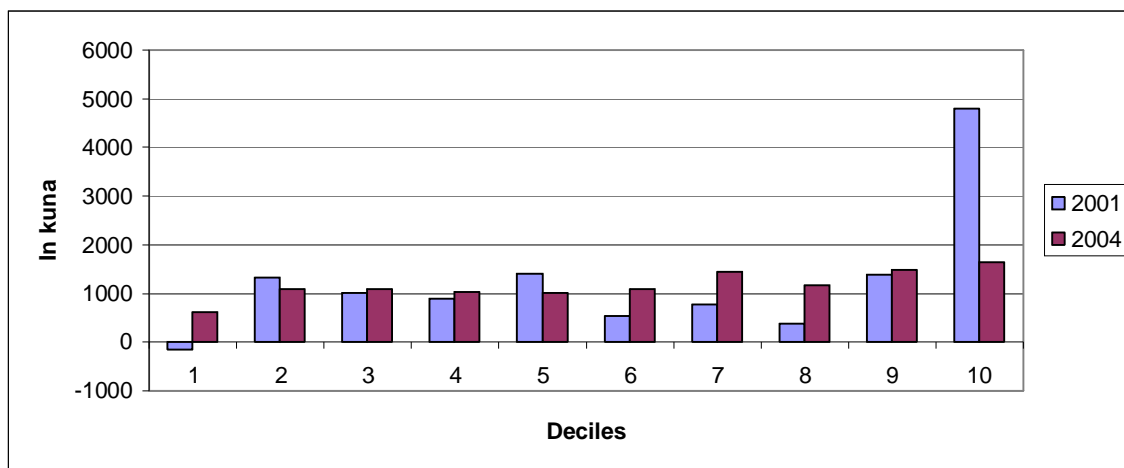
Diagram 5.1 Remittances Distribution in Absolute Terms, by Decile Groups



Source: own estimate based on data from CROSTAT

Those who received least remittances were the poorest ones, middle-income groups and households that were belonging to the eighth decile, the group on the threshold of the richest 20%. For the examined period the difference between the poorest and the richest decile has diminished remarkably.

Diagram 5.2 Remittances by Deciles in Absolute Terms in 2001 and 2004



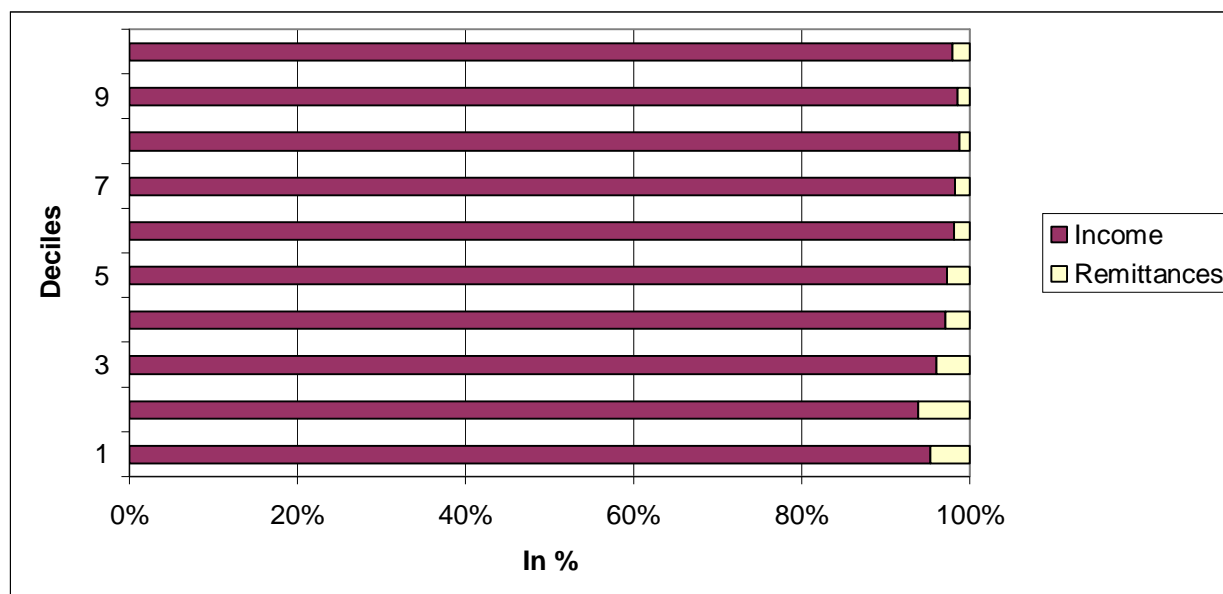
Source: own estimate based on data from CROSTAT

In the beginning of the period, the distribution of remittances was biased in favour of the 20% of the highest income deciles. Towards the end of the period, the remittances trend became more even between the income deciles. Still, the richest decile received the majority of remittances and the poorest one the least. Nevertheless, household transfers do not seem to have contributed to transferring of families from lower income groups in 2001 to higher income groups in 2004.

5.3.2 Remittances Distribution in Relative Terms

If measuring the impact of remittances on household income, the distribution of remittances looks different. The diagram shows that remittances accounted for the largest share of income for the next poorest households. They received 6% of their total household income from remittances. Generally, remittance flows accounted for a relatively larger share of income for the households below the average income line. As the income approached the average income (sixth decile), the share of remittances decreased to increase again for the top decile. Remittances accounted for 2% of the income for this decile.

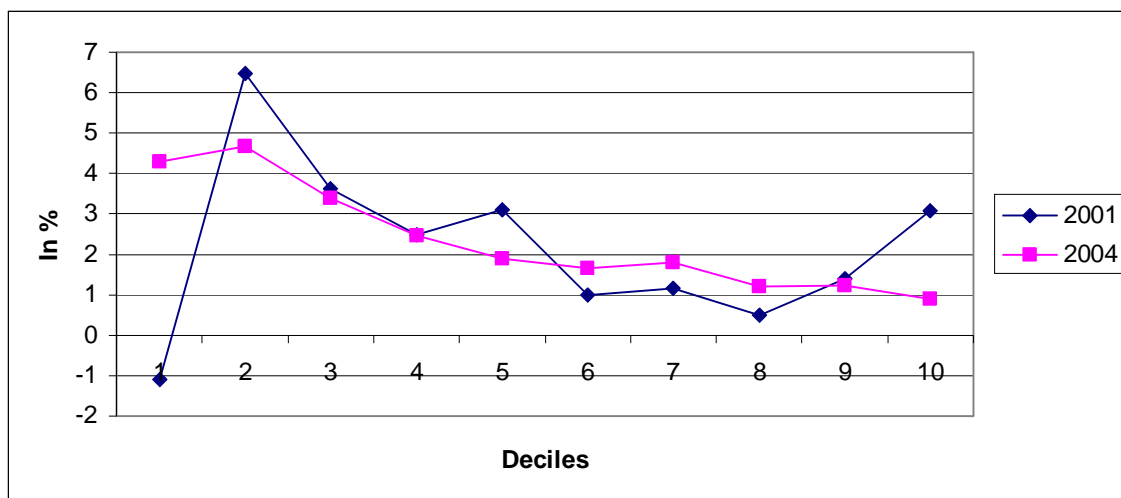
Diagram 5.3 Remittances Distribution on the Aggregate Level as Proportion of Total Available Income, by Decile Groups



Source: own estimate based on data from CROSTAT

During the examined period, the share of remittances in total income has changed in favour of the poorest decile as well as households with average income or some more. For the last examined year, the trend was more consistent than for the previous years. The importance of remittances for the richest families as share of total available income has declined from 3% in 2001 to 1% in 2004. For the poorest ones the situation was the opposite one since the amount of remittances as a proportion of income has increased five percentage points. Hence, the redistribution of remittances has changed as to become more equal between the deciles.

Diagram 5.4 Remittances by Deciles in Relative Terms in 2001 and 2004



Source: own estimate based on data from CROSTAT

As shown in the diagram, the proportion of remittances in total income has increased for the poorest, households with average income or slightly more. The share of remittances has decreased for next poorest ones, families just below the average income and the highest income groups. The level of remittances as a share of income has remained constant for the relatively poor ones, families just over the poverty line and the next richest ones. In sum, the findings suggest that including remittances in the household income has decreased the inequality between the households.

5.3.3 Consumption of the Deciles

The majority of consumption for all deciles went to food and beverages. Almost half of the earnings of the poorest households (deciles 1-3) accounted for this consumption. In absolute

terms, the consumption on food and beverages for the fifth decile was about the same as the total income of the poorest decile. About one fifth of the poor families' income was spent on housing. This was more than 40% above the average households' consumption on housing. Rich households (7-10) spent more than double on health than the poor households. The poorest of the poor spent 0.05% of their income on education whereas the top decile spent 1.2%. In absolute terms, the amount the top decile spent on education was one hundred and thirty times higher than the amount the poorest of the poor spent. The consumption on transport durables and maintenance of these for the richest decile was equivalent to the total income of the poorest decile, whereas the share of the poor deciles accounted for the one sixth (17%) of the average consumption on transport durables and maintenance of these.

5.3.3.1 Remittances and Consumption

The evidence suggests that poor families have spent most remittances on housing and durables, such as cars and household equipment. Middle class and more wealthy families have used remittances principally for housing (mainly for the rental of accommodation for children studying at another place); investments in property (either land or residential) and its maintenance; regular time savings deposits; and for education.

5.4 Remittances and Inequality

The findings support the hypothesis that the majority of remittances have been sent to households that are better off. As the largest share of emigrants are skilled and educated, it may be hypothesized that they belong to better off households, which could explain the results that richer families have received the largest amounts of remittances. The driving forces behind skill intensive emigration for these families have been better employment opportunities abroad. As the majority of migrants are to be found in developed economies with higher earnings than they would have had at home, they could afford to remit home larger amounts, which could explain the level of remittance inequality between the deciles. In other words, the empirical results suggest that remittances increased with the migrants' socio-economic background.

The poorest of the poor have sent less members abroad and have thereby received less remittances. This could be supported by the assumption that emigrants from these families are unskilled or low skilled and that their earnings abroad tend to be higher than they would have

been at home, but still are corresponding to their skill level. Furthermore, unskilled migrants that come from poor backgrounds are prone to remit more, which could explain relatively larger flows to these families as share of their income. Remittances have accounted for a larger share of the poorest families' income, which indicate that these households have been more dependent on the extra income from abroad. The next poorest households have benefited most from remittances as their share of remittances is largest in relation to their income.

The goal of remittances sent by emigrants from poorer background has mainly been for the improvement of the financial situation of the families at home. Worst-off households have relied mostly on remittance transfers, although they were taking less part of these as their share was decreasing, while the share of the richer decile groups was increasing. Generally, the results suggest that remittances have contributed to slightly reduced poverty for the poorest families. Remittances dependency as a source of income have been quite weak for all families as money remitted accounted for a small share of their total available income. Nevertheless, the impact of remittances on the welfare of recipient families has been positive.

The explanation for these findings may be several. Firstly, as migration is driven by a cost-benefit analysis, wealthy households were more likely to be able to afford migration. As the cost for migrating might have been too high for the poorest families, this could explain why the poorest households have received less remittances than the more wealthy households. The poorest families could probably not afford to send their members abroad to the same extent. Secondly, as the Croatian migrants have pursued the standards and living conditions of the destination countries, it might have been easier for educated and skilled ones to emigrate due to more restrictive and selective migration policies of these countries during the past decades. Lastly, there might have existed information bias where households that were better off might have had better access to information about emigration possibilities.

As the distribution of migrants is biased towards skilled and educated, it can be expected that remittances have raised the level of inequality. The results suggest the opposite though, as including remittances in families' income have had a positive impact on income inequality. The distribution of remittances became more equal and consistent during the period, which implies that remittances have had an equalizing distributional effect on the households' disposable income over the time period. Nevertheless, this effect was moderate as the remittance amounts that went to the richest families accounted for one fourth of the total available income of the

poorest ones. Accordingly, the income gap between the rich and poor has increased due to remittances as the poor ones received lower amounts than the richest ones.

The remittance decrease on the household level could be explained by the remittance increase on the aggregate level. The differences were offsetting each other. As Croatian diaspora usually have their family members abroad, this could explain the low inflow of remittances on the micro-level. The basic needs of the households have been met, which indicates less need for remitting to these. This could further be supported by the fact that Croatia is considered as being a developed transition economy with low poverty rates. Instead, remittance flows have been redirected towards savings and investments, which could explain large inflows on the macro level. The findings are in accordance with the self-interested theory as the dominating driving force behind the migrant's remitting behaviour.

In sum, remittances to Croatia have contributed to a mild poverty decrease as well as more equal income distribution but also a bigger gap between the absolutely richest ones and the poorest of the poor ones.

6. Conclusions

Remittances pattern in Croatia show that the inflow on a national level has nearly doubled during the period 1997-2005. The major determinants behind the flows are the characteristics of the Croatian emigrants, the extensive diaspora and the rate of return on financial assets and investment. Other factors that may have played a role are better data registering due to improved methods, more credible financial market, lowered transfer costs and the possible rise of the migrants' earnings.

The findings suggest that the inflow of remittances have lead to a multiplier effect as the majority of remittances have been saved and invested rather than consumed. This could be explained by the fact that the typical emigrant is more educated, skilled and wealthy than the average population, which could support the finding that the majority of remittances have been channelled to better off families. These were not in need of consumer goods; rather they invested the received money in long-term arrangements. Accordingly, self-interest theory dominated migrants' behavioural decision-making when remitting as the money flows were aimed at yielding profits or supporting the relatives left behind as a compensation for taking care of migrant's investment. The results are in line with the optimal usage of remittances, suggesting that channelling these into savings and productive investment should be considered as the most favourable purpose of the money.

Remittance income on the household level has decreased, although it is hard to predict the overall trend as the flows have been fluctuating inconsistently. Generally it can be said that remittances do not seem to have represented a significant source of income for the households. Nevertheless, the remittances have helped the poor families to reach higher consumption in form of tradables and durables, as these households received few percent of their income from remittances.

However, in general remittances have had a negligible affect on poverty reduction. For single pensioners though, the money accounted for a large share of income and has thereby helped them avoiding the sustainable poverty trap. Accordingly remittances have had a great impact on the severity of poverty for these families. As for the poor families in general, they experienced a moderate decrease. In sum, remittances have contributed to a mild decrease in the level of poverty, but a larger impact on the depth and severity of poverty.

Including remittances in households' income have had a slightly equalizing effect on the income inequality in Croatia. The richest have been receiving the majority of the money flows, which has entailed a widened income gap between the rich and the poor families. In the long run, remittances might reinforce the increased income gap as the emigration is biased towards educated, skilled and wealthy individuals. Based on the consumption patterns, the better off families are expected to continue saving and investing their remittances in deposits, real estate and human capital rather than consume on durables and non-financial assets as the poorer families do. The counterargument for the increased income gap is the future EU-membership, which should imply free movement of the Croatian labour force to the rest of the EU. That would give the opportunity to poor and unskilled to emigrate easier and thereby remit more, which in turn could result in the potential of accumulating productive assets. In the longer term, the situation might increase the country's overall welfare, which in combination with the determinant of since-year out migration, should result in less need for remitting. At the same time, the evidence from Greece (a country similar to Croatia with respect to remittance behaviour) has not had remittances decrease, which may indicate a sustainable remittance trend to Croatia.

Compared to other capital flows, remittances have been the most stable source of capital to the domestic economy. The flows were not as high as FDI but far more significant than ODA and other capital flows. Moreover, remittances seem to have been of an anti-cyclical character since they were not influenced significantly by the political and economic incidences.

Since one of the main purposes of remittances was investment, the money might partly have been a complement to FDI. Furthermore, as Croatia is a small economy, remittances have probably made the country dependent on the large inflows of foreign exchange. This might have deteriorated the Croatian trade balance as well as brought about the Dutch Disease. On the other hand, the problem will arise if the remittance behaviour changes resulting in less money flows, which could cause economic decline.

The results indicate that one of the major implications of remittances have been the rise of real estate prices. As the domestic property market is expected to reach a peak, the remittances might diminish or their purpose might change direction. The desirable redirection would be channelling the money into business activities, especially activities that would make receivers less dependent on remittances in the future. This could be a possible scenario due to the ongoing privatization, which offers favourable investment opportunities and is trying to attract the investors.

Other impacts caused by remittances were better financial development and larger deposits in foreign exchange. Lastly, GDP growth has partly been based on remittances, which should have a positive effect on poverty reduction in the long run.

Conclusively, as this case study is the first one on the issue of remittances in Croatia, it seems the phenomenon has not been given much attention. The results from this thesis show that the flows are an important source of money to the country generating multiplier effects, which should encourage the Croatian academics and politicians to address the issue. Until then, remittances seem to have compensated Croatia for the loss of human capital and will probably continue to do so.

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