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REMITTANCES AS A SOURCE OF EXTERNAL FINANCING -GLOBAL AND REGIONAL TRENDS

Abstract

Remittances are an important source of external financing for developing countries. Migration movements of the population from less developed to developed countries, in addition to a strong migration base, created the conditions for rising global remittance inflows. When it comes to developing countries, the above is particularly important, given that remittances represent a relatively stable source of inflow of foreign currency funds that partly improves the external imbalances in these countries. Also, these funds are of non-refundable nature, which means they do not increase the external indebtedness. The Western Balkan countries are the largest recipients of remittances among the developing countries in Europe. In addition, the share of remittances inflows in GDP is much higher in the Western Balkan countries compared to the EU member countries. The subject of research in this study is based on identifying the role of remittances as a source of external financing in developing countries. According to the subject of research, the aim is to establish the importance of remittances compared to other sources of external financing (foreign direct investment and official development assistance), with a special focus on the Western Balkan countries.

Key words: *remittances, external financing, developing countries, foreign direct investments*

JEL classification: *F 24, F32*

ДОЗНАКЕ КАО ИЗВОР ЕКСТЕРНОГ ФИНАНСИРАЊА – ГЛОБАЛНИ И РЕГИОНАЛНИ ТРЕНДОВИ

Апстракт

Дознаке (лични трансфери) представљају веома значајан извор екстерног финансирања за земље у развоју. Миграциона кретања становништва из мање развијених ка развијеним земљама, поред јаке емиграционе базе створила су услове за растући прилив дознака у глобалним оквирима. Из перспективе земаља у развоју наведено је посебно битно, обзиром да дознаке представљају

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релативно стабилан извор девизног прилива који обезбеђује финансирање екстерне неравнотеже. Такође, реч је о бесповратним средствима, која не генеришу пораст спољне задужености. Земље Западног Балкана се налазе међу највећим примаоцима дознака када је реч о европским економијама у развоју. Поред тога, учешће прилива дознака у бруто домаћем производу је далеко веће у земљама Западног Балкана у поређењу са осталим европским економијама укључујући и земље Европске уније. Предмет истраживања у овом раду базира се на идентификовању улоге дознака као извора екстерног финансирања у земљама у развоју. Сагласно предмету истраживања, циљ истраживања је да се установи важност дознака у поређењу са другим изворима екстерног финансирања (страним директним инвестицијама и званичном развојном помоћи) са посебним освртом на земље Западног Балкана.

Кључне речи: дознаке, екстерно финансирање, земље у развоју, стране директне инвестиције

Introduction

The limited productive capacities of developing countries, exhibited in insufficient home capital accumulation, created the need for the external sources of finance. The persistent gap between savings and investments, that is, production and consumption, has been replaced by the import of foreign capital. However, finding the suitable source of financing abroad is a very delicate task. Foreign borrowing is the most frequently used external financing mechanism in case of developing countries. The primary shortcoming of this source of financing is reflected in the fact that it cannot be used indefinitely, since it increases the external debt of the country. The rising and uncontrolled foreign borrowing can lead to a debt crisis. The restricted borrowing could be desirable from the development point of view, in case funds are distributed to their productive uses. On the other hand, if borrowing is used to finance consumption or pay off mounting debts, the aforementioned could worsen the country's external macroeconomic position.

The business internationalization and the global capital mobility have placed the foreign direct investments (FDIs) as a significant external financing source for developing countries. During the last two decades, FDIs have had an important role in financing the external imbalance of the underdeveloped economies. The FDI inflows do not generate an increase in external indebtedness, but they can trigger an increase in the outflow of income abroad, due to the profit repatriation. Also, FDIs are characterized by very high level of volatility, especially during economic crisis. The experiences of developing countries during the first two decades of the 21st century imply that the excessive reliance of these countries on the FDI inflows during the economic crisis was counterproductive when compared to the periods of regular economic conditions.

Unlike FDIs, remittances (personal transfers) are more constant source of external financing. These are the funds that the migrants send to their home countries and include workers' remittances, pensions and social benefits, aid and gifts sent to individuals (relatives). Migration movements during the second half of the 20th century, as well as the rise of the globalization, have influenced remittances to become one of the most important sources

of external financing at the global level. From the developing countries point of view, it is important to note that these are non-refundable funds which, combined with their low variability, makes them an attractive source of external financing.

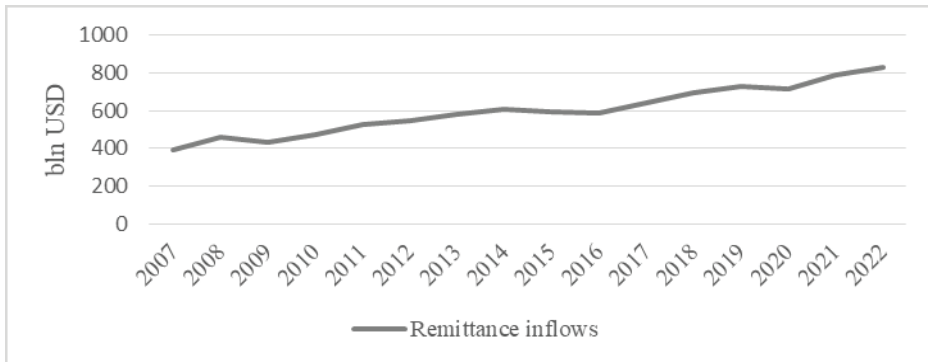
The paper deals with the identification of global and regional trends in remittance flows. The primary goal is to determine the level of importance of remittances as a source of external financing for developing countries in global context. On the other hand, the secondary research goal is to analyse the remittance flows in the Western Balkan countries as a way to carry out a comparison with other sources of external financing, primarily FDIs. The paper consist of four parts. The first part deals with the role of remittances as a source of external financing in developing countries. In the second part an analysis of remittance flows from a global perspective is carried out. The third part examines the role of remittances as a source of external financing in the Western Balkan countries.

The role of remittances in external financing of developing countries

The global expansion of remittances during the last two decades of the 20th century resulted in the fact that in many developing countries they represent the largest single source of foreign currency, exceeding export flows, official development assistance, FDIs and other types of private capital inflows (World Bank, 2017). The main causes can be found in high poverty rates in developing countries, large disparities in income and wealth in those societies and the development gap between them and developed countries. Due to all of the above, remittances proved to be a more stable source of foreign currency income compared to FDIs and the other private capital inflows (Stojanov et al., 2019). One of the reasons for the lower variability of remittance flows at the global level is the geographical dispersion of the source countries. Although the role of remittances in economic development has not yet been sufficiently studied, several significant positive effects on poverty reduction, consumption, investments, exchange rate movements and exports can be distinguished (Nikolić, 2006). On the other hand, there are some studies that proved that remittances can have negative effects on economic activity (Perez-Saiz et al., 2019; Hien et al., 2020).

The globalization created conditions for greater mobility of factors of production, including labor. The low standard of living and political and socioeconomic instability in developing countries have encouraged population migration towards developed economies. Furthermore, intensive migration flows since the second half of the 20th century have positioned remittances as one of the most important sources of financing for developing countries. From a global perspective, a rising trend of remittance inflows is evident. As can be seen from Figure 1, remittance inflows have more than doubled in 2007-2022 period, from 395 to 831 billion dollars. The continuous increase in the remittance inflows was briefly interrupted during 2009 and 2020, due to Global financial crisis and the Covid-19 pandemic. The absence of fluctuations in the remittance inflows in the observed period implies that it is a source of financing resilient to global economic shocks (EMN, 2020).

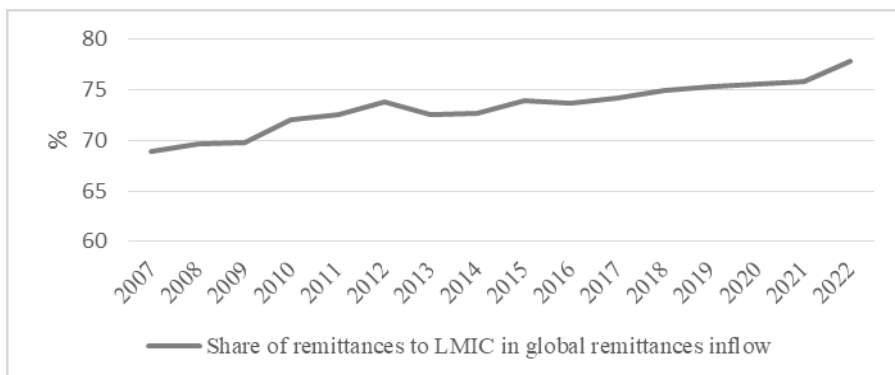
Figure 1. Remittance inflows, 2007-2022 (in USD billions)



Source: World Bank – Knomad (2023)

However, high transaction costs of sending remittances (around 5 to 10 percents of the amount sent), long payment periods, foreign currency restrictions and burdensome administrative procedures contributed to the fact that a large part of these transactions took place through informal channels in the past, which made the task of gathering relevant information and examining the remittance effects difficult (Freund & Spatafora, 2008; Ahmed et al., 2020). On the other hand, lowering of long-distance remittance transfer costs triggered by technological innovations in the banking sector enabled the inclusion of previously unregistered money transfers in the official statistics and banking flows (Nikolić, 2006). These statements coupled with the non-refundable nature of remittances confirm their importance in terms of developing countries financing (Yoshino et al., 2020). After all, this group of countries accounts for the the largest share of remittance inflows, as can be seen in Figure 2. Approximately two thirds of the global remittance inflows are directed to low- and middle-income countries (LMIC). Also, an increase in the share of developing countries in the global remittance inflows is recorded in the observed period, from 68.9% in 2007 to 77.9% in 2022.

Figure 2. The share of remittance inflows in LMIC in global remittances (in %)

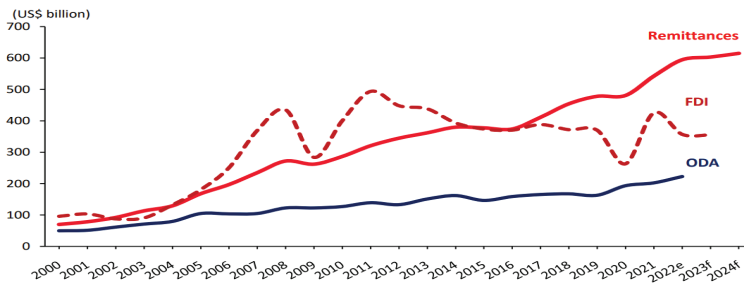


Source: Authors' calculation

As previously mentioned, developing countries mainly rely on external sources of financing, due to insufficient home savings. The gap between high investment demand and low domestic savings must be compensated by the import of foreign capital, including foreign borrowing. However, over the past few years, FDIs have become an attractive source of external financing for developing countries for several reasons (Saurav & Kuo, 2020). From the maturity aspect, they are labeled as the long-term inflows, so country's external imbalance is financed by long-term sources, which creates positive implications for its sustainability. Additionally, FDIs do not trigger the rise of the external indebtedness, since no increase in external financial obligations occurs. Also, FDIs improve the technological intensity of exports, and if they are directed towards the tradable goods sectors, conditions for the exports growth and the additional foreign currency inflows could be created, which contributes to the external imbalance reduction (Kutan & Vukšić, 2007; Popovici, 2018). However, the positive effects would not materialize if major part of FDI inflows is routed to non-tradable goods sectors, which limits the possibility of increasing exports and reducing external imbalances.

Despite the positive effects of FDI inflows, remittances have become the most important source of external financing of developing countries in the last few years. At the same time, if China is excluded from the group of developing countries, since it accounts for the largest share in FDI inflows, the role of remittances as a source of external financing is further highlighted. By looking at Figure 3, it can be concluded that since 2017 developing countries (except China) have recorded a far greater remittance inflows than the FDI inflows. Also, the remittance inflows and the official development assistance (ODA) fluctuates much less in the observed period compared to the FDI inflows which experienced frequent ups and downs. This confirms the greater stability of remittances as a source of financing compared to FDIs.

Figure 3. Remittances, FDI and ODA flows to LMIC (excluding China) (in USD billions)



Source: World Bank – Knomad (2023)

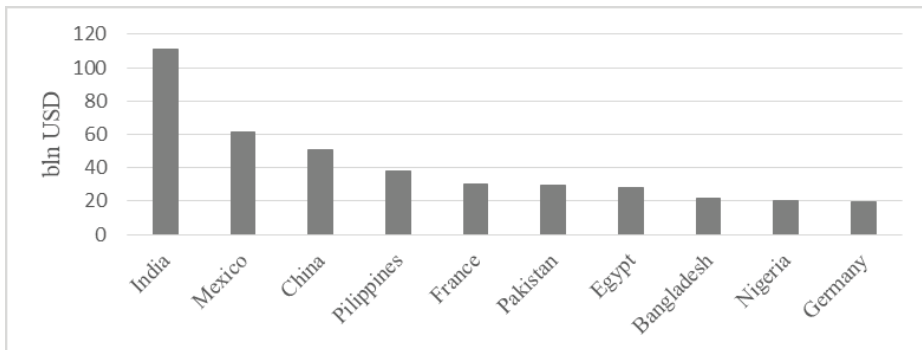
When comparing remittances and FDIs as sources of external financing, it is important to note that the net effect of FDIs can differ significantly from the size of their inflows, while this is not the case with remittances. By starting a business activity in home country market, foreign investors seek to make profit. Some portion of the profit is reinvested in the home country, while the remaining part is repatriated abroad, to foreign parent company. The developing countries experience shows that an increase

in FDI inflows also leads to the increase in the FDI income outflows, which worsens the balance of primary income account and creates pressure on the external imbalance (Kovačević, 2022). The above does not pose a problem as long as the FDI inflows are greater than the FDI income outflows. However, the question arises about the ability of the developing country to continuously achieve the increase in the FDI inflows, in order to avoid the situation where the annual FDI income outflows exceed the annual FDI inflows. In such circumstances, FDIs are no longer a source of external financing, but rather create additional pressure on the country's balance of payments position. With remittances, this possibility is excluded.

Global trends in remittance flows

By looking at the geographic structure of remittance inflows in Figure 4, it can be observed that the largest remittance recipients in 2022 were developing countries, mostly Asian economies, while the list also includes two European developed countries, France and Germany. India is the largest remittance recipient in the world, followed by Mexico and China. It is interesting to note that India reported almost an identical value of remittance inflows in 2022 as China and Mexico combined. For most of the observed economies, the United States is the most important source of remittance inflows (Solimano, 2003; Chovdhuri, 2011; Abbas et al., 2017).

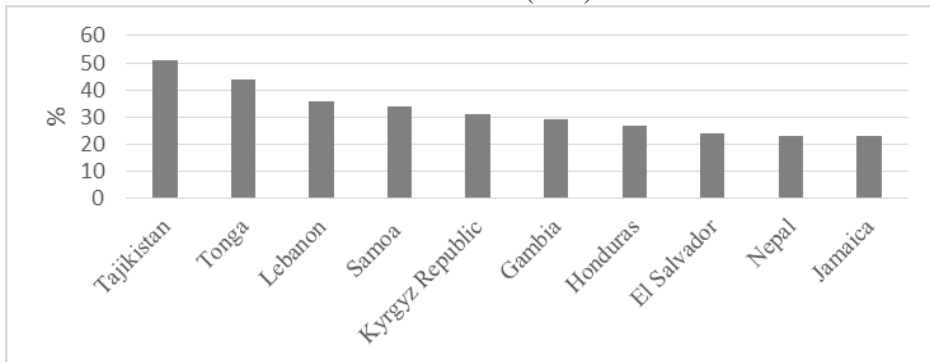
Figure 4. The top ten remittance recipients in the world in 2022 (in USD billions)



Source: World Bank – Knomad (2023)

Besides the absolute value of remittance inflows, the share of remittance inflows in GDP can also serve to highlight their importance in developing countries. As can be seen from Figure 5, Tajikistan is the country with the largest share of remittance inflows in GDP, approximately 51%, followed by Tonga and Lebanon. In the rest of the observed countries, the share of remittance inflows in GDP is smaller, but certainly significant, in the interval from 25% to 33%. These high values can be attributed to the fact that these are very small economies with low absolute values of GDP.

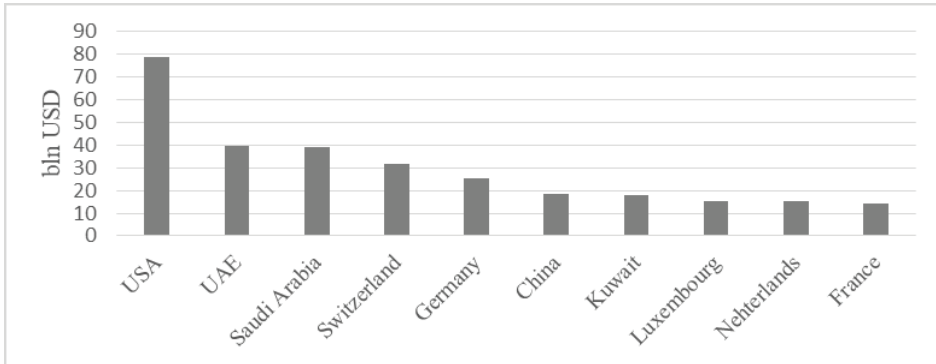
Figure 5. The top ten countries with the largest share of remittance inflows in GDP in 2022 (in %)



Source: World Bank – Knomad (2023)

On the other hand, the United States stands out as the most important remittance source country in the world. As can be seen from Figure 6, in 2022, remittances worth approximately USD 79 billion were sent from the US to the rest of the world. Rising remittance income outflows and the fact that the United States achieve ten times greater outflows than the remittance inflows, result in a negative secondary income account balance. However, from the macroeconomic point of view, this is not an economic growth limitation since the remittance income outflows account for a very small share in GDP (0.3% in 2022). The United Arab Emirates are in the second position as the major remittance source for Asian economies (India, Pakistan, Bangladesh and the Philippines) and Egypt (Khan, 2024). Also, regarding the Asian economies, the list of ten largest sources of remittances also includes Saudi Arabia, China and Kuwait. The remittances from China were primarily distributed to South Korea, the Philippines and Brazil. The positioning of Saudi Arabia among the largest sources of remittances in the world can be explained by the reliance of its economy on foreign labor. At the same time, the dynamics of remittance income outflows from Saudi Arabia are mainly determined by developments in the oil industry (Javid & Hasanov, 2023). Among the most important sources of remittances in the world half of the countries are developed European economies. Switzerland and Germany are the 4th and 5th most important providers of remittances in the world, respectively, and the most important sources of remittance inflows for European transition economies and Turkey (Rossel et al., 2023). On the other hand, the largest part of remittances from France is routed to Belgium, Spain and Portugal, and its former colonies, Morocco and Algeria (Kalantaryan & McMahon, 2021).

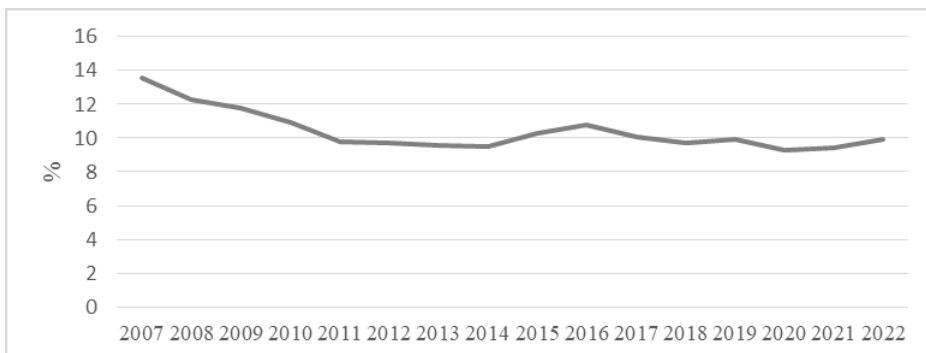
Figure 6. Countries with the highest levels of remittance outflows in 2022 (in USD billion)



Source: World Bank – Knomad (2023)

The United States is the most significant source of remittance for many countries (Bidawi et al., 2022). During the 2007-2022 period, the major part of global remittances were sent from the United States to other countries (Figure 7). This can be explained by the large migrant population living in the United States. At the beginning of the observed period, the share of the United States in total remittance flows was in double digits and ranged between 11% and 14%. However, in the years that followed, the share decreased, as a result of a slower growth rate of remittance income outflows compared to other economies, such as the United Arab Emirates, Saudi Arabia, Switzerland and China (Khan, et al., 2021; Islam & Alhamad, 2023). At the end of the observed period, the outflows of remittances from the United States accounted for almost 10% of the global remittance inflows. Put differently, a tenth of sent remittances worldwide still originates from the United States.

Figure 7. The United States as a major source of remittances, 2007-2022 (in %)



Source: Authors' calculation

The dynamic increase in the remittance outflows sparked a debate in the oil exporting countries and the United States concerning taxing remittances sent by migrants

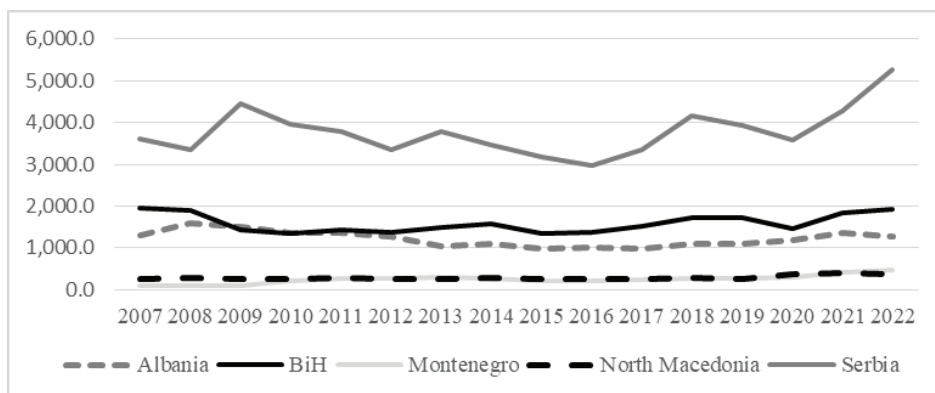
to their home countries (Malit & Naufal, 2016). The aim of this action would be to increase tax revenues and reduce illegal migration. Also, the proposed measures could contribute to the improvement of the balance of payments position of these countries, mainly by reducing the secondary income account deficit. A taxation model has already been developed in Oklahoma, where it is not a traditional tax but rather a 1% fee paid by the sender of funds. This model has prompted other US states, such as Georgia, Iowa and Kansas to introduce similar fees. In 2018, Kuwait's Parliamentary Committee on Financial and Economic Affairs approved bills to impose taxes on expatriate remittances. The initial proposal was to introduce progressive tax rates ranging from 1% for remittances up to 99 Kuwaiti dinars to 5% for amounts above 500 Kuwaiti dinars (Marmore, 2018). World Bank officials state that taxing remittances is not a good idea for several reasons. Firstly, a problem of double taxation occurs, since the migrants have already paid income tax in the country they are working in. The taxation would especially affect the poorest groups within the population of the developing countries, thus creating an additional increase in economic inequalities between developed and underdeveloped economies (World Bank - Knomad, 2017). Ultimately, taxing remittances could encourage the informal channel transfers, while the ultimate revenues side effects of the proposed measures would be highly questionable. Hence, the redirection of remittance transfers from informal channels to formal channels should be based on incentives rather than discouraging remittance senders and receivers, by taxing remittances (Nikolić, 2006).

Remittance trends in the Western Balkan countries

The events during the last decade of the 20th century and the breakup of Yugoslavia accelerated the migration flows from the successor states. The migration movements in the second half of the 20th century created a strong migration base abroad, mainly in the Western Europe countries and the United States. The rising migration outflows created the conditions for remittances to become a significant source of external financing for Western Balkan countries. The importance of remittances is particularly evident if their balances of payments are analyzed. High and stable inflows of funds from this source contribute to surpluses on the secondary income account that partly offset the deficit of the other components of the overall balance of payments (Đukić & Bodroža, 2022). Simultaneously, remittances cover a significant part of the trade deficit, as a key generator of balance of payments imbalance in the observed countries.

Among the Western Balkan countries, the highest remittance inflows in 2007-2022 period was recorded in Serbia, while all the other countries recorded lower inflows (Figure 8). The remittance inflows in Serbia were highest in 2022 (USD 5.26 billion), an increase of USD 1.6 billion compared to the beginning of the observed period. The rise of remittance inflows, albeit of a more modest intensity, was recorded in Montenegro and North Macedonia, while Albania and Bosnia and Herzegovina recorded a slight decrease in the remittance inflows

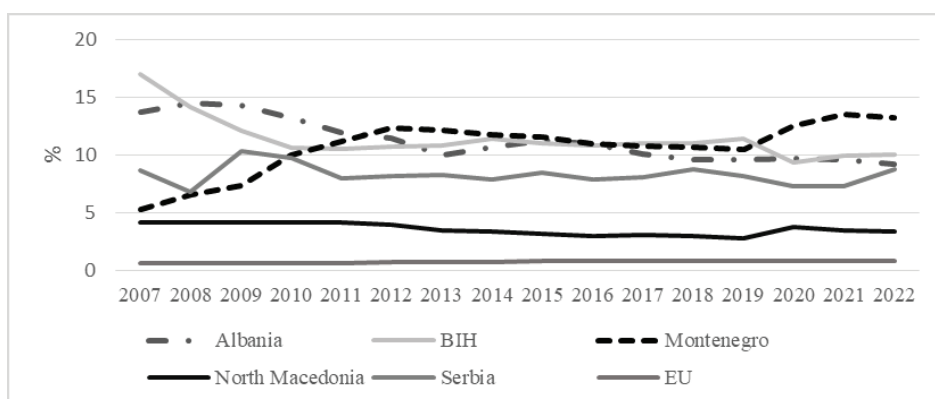
Figure 8. Remittance inflows in Western Balkan countries (in USD millions)



Source: IMF (2023)

The importance of remittances for the Western Balkan countries can be shown by looking at the share of remittance inflows in GDP (Figure 9). In this case, somewhat different conclusions can be drawn. In the initial years of the observed period, the largest share of remittances in GDP was recorded in Bosnia and Herzegovina and Albania (14.2% and 13.7%, respectively). However, both countries recorded a decline in the share of remittances in GDP at the end of the observed period. Since 2012, Montenegro had been continuously recording the largest share of remittances in GDP. Although Serbia recorded a slight increase in the share of remittances in GDP, only North Macedonia had a smaller share of remittances in GDP among the observed countries. Also, the share of the remittance inflows in GDP for all the Western Balkan countries is higher than for the EU (Figure 9).

Figure 9. Remittance inflows in Western Balkan countries and EU, as a share in GDP (in %)

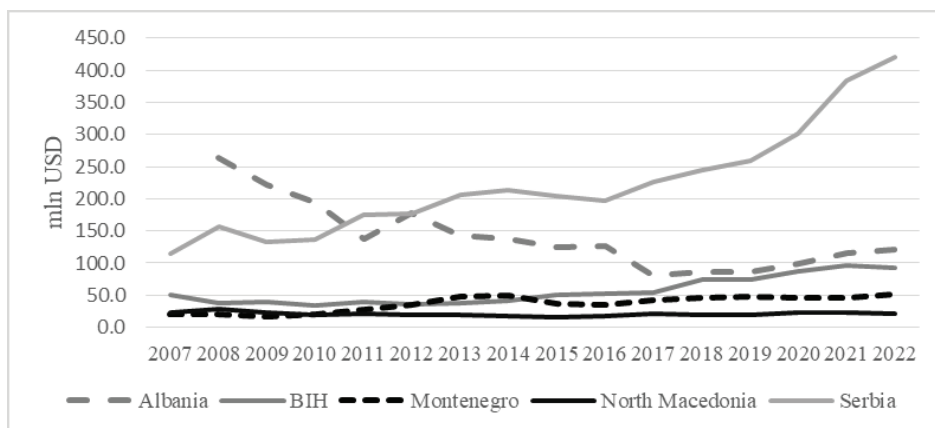


Source: World Bank (2023)

Remittance outflows are much lower than the remittance inflows in all of the observed countries. Although remittance outflows show a slight growth in most Western

Balkan countries, their absolute values are far smaller than the remittance inflows, which leads to secondary income surpluses. An increase in the remittance outflows was recorded in Serbia, Montenegro and Bosnia and Herzegovina, while Albania and North Macedonia reported decrease in the remittance outflows (Figure 10).

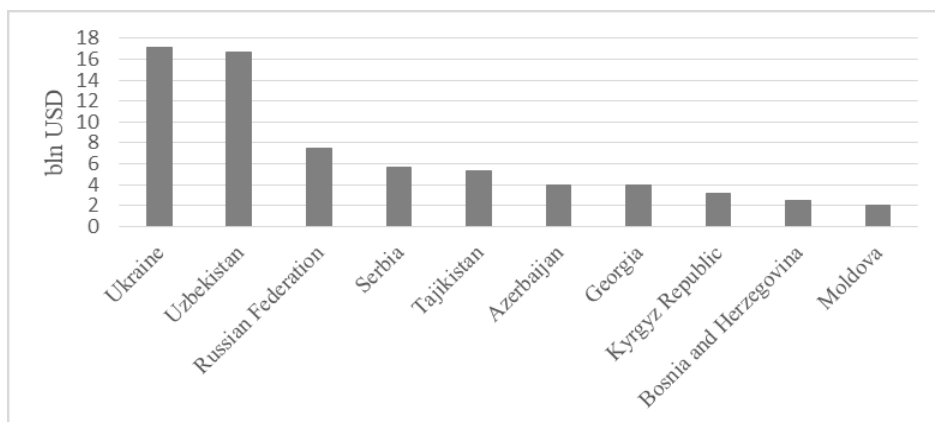
Figure 10. Remittance outflows in Western Balkan countries (in USD millions)



Source: IMF (2023)

By making the comparison with other developing Eurasian countries, it can be stated that the Western Balkan countries are among the largest recipients of remittances. As shown in Figure 11, Serbia was fourth on the list of the largest recipients of remittances among the Eurasian developing countries in 2022, while Bosnia and Herzegovina was ninth. On the other hand, if the share of remittance inflows in GDP is considered, Montenegro (seventh position) and Bosnia and Herzegovina (eighth position) are placed among the top ten Eurasian developing countries (KNOMAD, 2022).

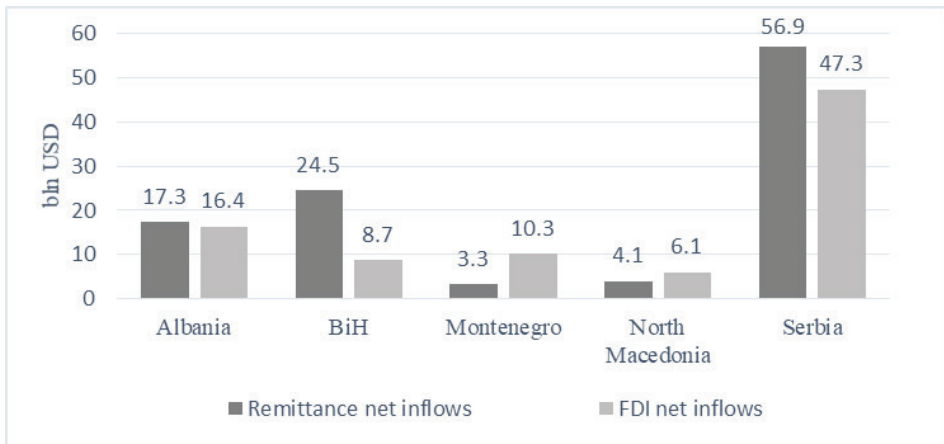
Figure 11. Top ten remittance recipients in Europe and Central Asia (developing countries) in 2022 (in USD billions)



Source: World Bank – Knomad (2023)

During the observed period, Western Balkan countries recorded USD 106.1 billion net remittance inflows. More than half of these funds (56.9 billion) were directed to Serbia, which is by far the largest regional recipient of remittances. More precisely, the value of the net remittance inflows in Serbia is higher than in all other Western Balkan countries together (Figure 12). The importance of remittances as an external source of financing for Western Balkan countries can be seen by comparing them with FDIs. In 2007-2022 period, the total net FDI inflows in all Western Balkan countries amounted to USD 88.7 billion, which is lower than remittance inflows by USD 17.4 billion. Remittances are more important source of external financing in Bosnia and Herzegovina and Serbia, while in Montenegro and North Macedonia FDIs prevail. The smallest difference between the levels of these two sources of external financing is reported in Albania.

Figure 12. Remittance and FDI net inflows in Western Balkan countries, 2007-2022 (in USD billions)



Source: Authors 'calculation based on IMF (2023)

Based on the above, it can be said that remittance inflows are significant source of external financing for the Western Balkan countries (Jushi et al., 2021). High net remittance inflows, apart from the fact that they contribute to the secondary income surplus, partly offset the external imbalance in these countries. However, despite high inflows, a small part of these funds is directed to investment activities. Remittances are mostly used to finance consumption, which can significantly reduce the positive effects of such a high inflows (Bukvić, 2016). An additional problem arises if funds based on remittances are used to finance the consumption of imported goods, which would not only affect the deterioration of the exchange rate but also deepen the external imbalance (Trokić, 2009; Čakajac et al., 2023). Stable inflows in the observed period confirmed the role of remittances as a reliable source of external financing in Western Balkans. However, the future of this way of reasoning remains questionable, given the demographic trends in the Western Balkan countries and the fact that their populations are getting older. The aging trend could reduce the potential of these countries to provide source of labor force for the developed Western Europe countries in the future (Kovačević, 2017).

Conclusion

Globally, remittances are among the most important sources of external financing for developing countries. Migration movements since the second half of the 20th century, globalization and the improvements in the payment processing infrastructure have contributed to the continuous increase in the remittance inflows. The importance of remittances as an external source of financing for developing countries (except China) has become evident since 2017, when total remittance inflows exceeded the FDI inflows, which positioned remittances as the most significant source of external financing for these countries.

In comparison with FDIs, remittances have proven to be a far more stable source of external financing. The above was especially evident during crisis periods when the remittance inflows to developing countries fluctuated less than FDI inflows. In addition to stability, the main advantage of remittances is reflected in the fact that they are non-refundable funds that do not increase foreign financial obligations. However, the excessive reliance on remittance inflows can produce negative effects on the overall economic development.

Remittances are an important source of external financing in Western Balkan countries. During 2007-2022 period, these countries recorded higher remittance inflows compared to the FDI inflows, despite significant efforts to attract foreign investors. This is particularly evident in Bosnia and Herzegovina and Serbia, where remittances are larger than FDIs. At the same time, from a regional perspective, disparities can be observed regarding the inflow of external sources of financing since more than half of the sum of FDI inflows and remittance inflows was directed towards Serbia (53%), more than all the other Western Balkan countries together.

Compared to previous research, the main contribution of this paper reflects in emphasizing the role of remittances as the most significant source of external financing for developing countries both from a global perspective and from the perspective of Western Balkan countries. Also, the research results should also be viewed from the perspective of certain limitations. The main research limitation lies in the fact that data on remittance flows only cover formal channel transactions. It is undeniable that a large part of remittances to developing countries is still transferred through informal channels. However, the role and importance of remittances as an external source of financing can be viewed from alternative perspectives, through the implementation of more sophisticated statistical models and methods. The above provides solid grounds for future research.

Furthermore, the research results can be useful to economic policy makers, primarily in the Western Balkan countries. Given the annual levels and the stability of the remittance inflows in the observed period, it seems desirable to create an institutional framework through which the investment potential of remittance inflows could be channelled. The current situation indicates that the investment use of inflow of funds is low, since the remittances are mostly used to finance consumption. Additionally, given the role and importance they hold in developing countries, policymakers should endeavor to facilitate remittance transfers and enhance their effective utilization in the future. This can be achieved by reducing transfer costs, promoting financial inclusion, and providing support for the development of digital money transfer platforms.

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