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EFFECTS OF REMITTANCES ON POVERTY REDUCTION: THE CASE OF INDONESIA

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Abstract

Remittance has been reported as a tool to fight poverty in some selected countries such as Indonesia. An increase of income through remittance tends to improve the economic status of the migrant's household. Once they get a high salary, they will remit money (remittance) to their household in Indonesia via formal institutions, such as a bank. The migrant's household can fulfil his basic needs and he can use further the remittance for educational investment and productive activities. The education investment aims to educate the children or grandchildren of migrants, which will be beneficial for the future generations of the family, such as getting a more prosperous life. Meanwhile, the productive activity is the additional income that the migrant can earn as backup savings in case of emergency, crisis, or if the migrant returns back to the home country permanently. The poverty rate would be gradually reduced and economic welfare can be achieved. As a mean to alleviate poverty, Indonesia government also has considered sending worker abroad as one strategy. The government has been very pro-active to promote educated workers moving outside their country by providing training. Law No. 39 of the year 2004 is one of the policies that the government created to protect workers abroad. This law aims to increase worker welfare, guarantee worker safety, empower workers, and protect the worker's rights. However, the benefit from this policy is still unclear. Claims that remittance contributes positively to the Indonesia economy are still limited in research. Therefore, in this study, further investigation of the issues would be conducted.

The main objectives of this paper are first to estimate the effects of remittance on poverty for Indonesia from 1983 to 2015 and second, to propose several strategic policies related to remittance and poverty reduction. Other variables considered include inflation, exchange rate, income, income inequality and labour force participation rate.

OLS method used to explore the econometric result and estimated result. The study found that an increase in remittance led to poverty reduction by 2.56%. Inflation and exchange rate have positive and negative effects on poverty, respectively. The small effect of remittance on poverty reduction could possibly be explained by the low educational background of migrants, low wage job, expensive remittance costs, and migrants not knowing how to remit money through formal financial institutions. Hence, to reduce the poverty level, the government needs to first facilitate skills training for the workers so that they could get a better job and earn more, second, lower the transaction cost of remittance, and lastly, provide agents at Indonesian banks overseas to provide better facilities to Indonesian workers to remit money back to the home country.

Keywords: remittance, poverty, Indonesia