

## REMITTANCES AS DEVELOPMENT FINANCE

### Increased interest in remittances

The last two to three years have seen an upsurge of interest in workers' remittances as a source of financing for development, led by the World Bank, the Inter-American Development Bank and USAID. The issue was on the agenda of the 2004 G8 meeting at Sea Island, Georgia, United States, and the Spring 2004 meeting of the IMF/World Bank Development Committee "noted the growing importance of migration and, with it, of workers' remittances and called for further work to improve understanding of their determinants and to create a supportive environment to enhance their development impact."

### Source, coverage and quality of data

Most studies of remittance flows rely on raw data from the IMF Balance of Payments (BoP) Yearbook. Recent work has tended to combine the data under three BoP items, covering the remittances of migrant and temporary workers and migrants' capital transfers.<sup>20</sup> There are many problems and inconsistencies in these underlying data. Reporting practices vary from country to country and from year to year and the absence of exchange controls hinders precise identification of the source and purpose of funds being transferred. Undercounting arises from failure to collect data (*e.g.* on hand-carried currency or goods), or from failure to identify some current transfers as remittances. Overcounting can result from misidentifying imports as remittances and from the absence of a deduction for the amount that temporary employees spend in their countries of employment. At best the figures can only be regarded as estimates.

### Comparing remittances with aid flows

It is often stated that remittances to developing countries – estimated by the World Bank at USD 72 billion in 2001 and USD 93 billion in 2003 – significantly exceed global aid flows (roughly USD 52 billion and USD 69 billion in the respective years). From some points of view, this comparison is misleading. First, the remittance figure is the total receipts of all low and middle-income countries, including Russia and other central and eastern European countries that are not eligible to receive ODA. Second, remittances are counted from all sources, including other developing countries. According to a recent OECD study,<sup>21</sup> less than half the remittance flow to developing countries is from DAC donors. Third, remittance flows are measured gross, *i.e.* for each country the inflow of remittances from its workers

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20. "Workers' remittances" are shown at item code 2391 under the BoP heading "current transfers"; "compensation of employees" (which covers the income of border, seasonal and other non-resident workers) is given at item code 2310 under the "income" category of the current account; migrants' capital transfers are at item code 2431 under "capital transfers" in the capital account. This selection of data is used in D. Ratha, "Workers' remittances: An important and stable source of external development finance", in *Global Development Finance 2003*, World Bank, Washington, where it is discussed at p. 171f. Ratha argues that remittances are less affected by economic cycles in both source and recipient countries than other private flows. The apparent steadiness of remittance flows may be partly an artefact of constructing the data based on numbers of workers, but Ratha also points to stabilising factors such as social security systems in host countries (*ibid.*, pp. 162-3).

21. Harrison, A., T. Britton and A. Swanson, (2004), "Working Abroad – the Benefits of Nationals Working in other Economies", OECD Round Table on Sustainable Development, Paris.

abroad is reported “raw”, without deduction for the amount sent out of the same country by foreign workers. By contrast, aid flows are usually quoted net, in the sense that recipients’ repayments of principal on ODA loans are deducted.

Thus, from the point of view of DAC donors, it may be more relevant to compare ODA with the flow of remittances from DAC countries to ODA recipients. Based on IMF data used in the OECD study just mentioned, this amounted to about USD 34 billion in 2000, somewhat more than half of DAC ODA. The flow was heavily skewed to a small number of countries, especially India, Mexico, the Philippines and Turkey. Central American and North African countries also received above-average flows. Flows to sub-Saharan Africa were negligible – of the order of USD 1 billion, compared to total gross ODA inflows approaching USD 20 billion. The United States was by far the largest source of remittances to developing countries, accounting for about USD 22 billion, with western European countries accounting for about USD 7 billion (see Table 2.3).

Table 2.A1.1 **Estimated remittance flows by source and destination in 2000**

(USD billion)

<b>Destination:</b>	<b>Source:</b>	<i>USA</i>	<i>Japan</i>	<i>Germany</i>	<i>France</i>	<i>Canada</i>	<i>Other</i>	<i>Total DAC</i>
<i>India</i>		1.0				0.2	0.2	1.4
<i>Mexico</i>		7.6						7.6
<i>Philippines</i>		1.2	0.2			0.2	0.1	1.7
<i>Turkey</i>		0.1		1.2	0.2		0.5	2.1
<i>Central America and the Caribbean</i>		4.6				0.1	0.1	4.8
<i>North Africa</i>		0.2			1.4		0.8	2.3
<i>Total above</i>		14.7	0.2	1.2	1.6	0.5	1.7	19.9
<b>Total developing countries</b>		<b>21.8</b>	<b>2.5</b>	<b>2.5</b>	<b>2.7</b>	<b>1.1</b>	<b>3.3</b>	<b>34.3</b>

Note: Japan’s major remittance flows are to Korea (USD 1 billion) and Brazil (USD 400 million).

Data source: IMF, OECD Round Table on Sustainable Development.

### Are remittances developmental?

This simple question is not easy to answer. In the early years of DAC statistics, the only private flows that were counted were transactions recorded in the BoP capital account. This included investment and long-term lending by banks and firms, but excluded all private transfer payments recorded in the BoP current account. The exclusion partly reflected data problems, but was chiefly motivated by doubts about the developmental impact of private transfers.

It was, however, agreed in 1970 to count NGO aid in DAC statistics. The United Nations Conference on Trade and Development (UNCTAD), which had played the key role in defining the coverage of aid and flow targets, gave qualified approval to counting NGO flows in 1975, observing that

their inclusion in the 1% target for total flows “would be in the spirit of that definition ...provided that the funds shown under this heading are made available for developmental purposes.”<sup>22</sup>

Recent work has tended to stress the developmental dimension of remittance flows, highlighting its role in developing human capital through education and to a lesser extent physical investment in farms or housing. However, the evidence is largely anecdotal, and still suggests that a prime use of remittances is to finance purchases of food and other consumables. There may, however, be a tendency for remittance flows to concentrate initially on consumption and then to “graduate” towards investment in both human and physical capital once immediate consumption needs are satisfied.

Most of the recent literature on this subject is concerned with promoting the actual or potential developmental benefits of remittances, and there may be a corresponding tendency to over-emphasise the extent to which they fund investment. Even if most remittances still fund consumption, however, they may still make a valuable contribution towards satisfying basic needs and relieving poverty, which many donors see as the key goals of aid.

### **Policies to enhance the developmental impact of remittances**

Several studies have identified means of promoting the use of remittances for developmental purposes, including:

- Promoting competition among money transfer firms to reduce transaction costs.
- Encouraging remitters to shift their business from purely money transfer operators towards broader-based financial institutions that can provide bank account and credit services to recipients.
- Creating innovative financial products that encourage recipients to save part of remittance flows.
- Enhancing the institutional capacity of credit unions and microfinance institutions in remittance-receiving countries.
- Promoting Home Town Associations as a means of channelling part of remittances towards community projects.
- Establishing diaspora business networks to mobilise or facilitate investment in home countries.
- Offering bonds to diaspora workers to raise money for investment in their home countries.
- Encouraging the diaspora to make their intellectual capital available to their home countries through visits, consultancies or internet contacts.

Except for the last item, none of these mechanisms is new, and each of them can already show some “success stories”. But both implementation and awareness are very patchy. Latin America, with its large flow of remittances from the United States, has the best developed transfer systems,<sup>23</sup> although facilities

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22. “The Concepts of the Present Aid and Flow Targets”, UNCTAD Document No. TD/B/493/Rev.1, United Nations, 1975, p. 8, footnote 31.

23. In the 1990s, 50% of the market for transfers from the United States to Mexico was controlled by three firms; this has since risen to eight firms. The increased competition has reduced transfer costs: in 1999, Western Union charged USD 22 to transfer amounts up to USD 200; in 2001 this was reduced to USD 15;

are also improving rapidly for North African workers in Europe. Home Town Associations are well developed in Haiti, El Salvador and Mexico. The Armenian, Indian and Lebanese diasporas have active private business networks, and Armenia and India also have official agencies to promote diaspora investment. India has also emulated Israel's success with bond offerings to the diaspora, while Serbia, other states of the former Yugoslavia and South Africa are especially active in encouraging the diaspora to make intellectual contributions towards their development.<sup>24</sup>

### Remittances and migration policy

The literature on remittances and development focuses on incremental actions. It pays surprisingly little attention to more basic determinants of the flow of remittances, particularly those bearing on the opportunities available for people in developing countries to work in other countries with higher levels of real per capita income.<sup>25</sup>

As already noted, the countries enjoying the largest inflow of remittances are not the very poorest but rather those where poverty is widespread, but not so severe as to prevent families from raising the funds necessary to send one of their members to another country. Such migrants are confronted with a patchwork of regulations in receiving countries. While most receiving countries have arrangements to facilitate the entry of seasonal workers in agriculture, the acceptance of medium and long-term economic migrants is often constrained by entry regulations designed to protect the job opportunities and employment conditions of existing residents. In any case, domestic legislation usually sets wages at levels that exceed market-clearing rates for unskilled and menial labour, so that a pool of unemployed residents already exists in these categories.

There is also a relative dearth of literature concerning the social protection of remittance-sending workers. This issue is overshadowed by the public policy conflict between the interests of border protection and orderly immigration on the one hand and the economic advantages of migration on the other. Such debates over labour migration policy in receiving countries lie outside the scope of this note. However, it is an observed fact that while action to enforce immigration laws may slow the inflow of unskilled labour, it cannot stop it entirely, given current travel opportunities. It is also clear that repression of illegal immigration can have the unwanted side-effect of creating an underclass of illegal workers open to exploitation and abuse.

The continuing rise in international migration has also revived fears of brain drain. The highest remittances come from professionals who have the highest incomes, and these are just the people that

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in 2003, to USD 10. Source: Manuel Orozco, "The future trends and patterns of remittances to Latin America", *Inter-American Dialogue*, Washington, 2003.

24. For more detail and many useful references, see Johnson, B. and S. Sedaca, "Diasporas, émigrés and development: Economic linkages and programmatic responses", USAID/Carana Corporation, Washington, 2004.

25. One recent exception is Adams Jr., R.H. and J. Page, (2003), "International migration, remittances and poverty in developing countries", *World Bank Policy Research Working Paper*, No. 3179, Washington. Adams and Page observe that proximity to a major labour-receiving region (e.g. the United States or western Europe) increases migration and remittance flows. Their analysis, however, is a snapshot based on current data, rather than a trend analysis, so they are unable to determine whether the effect of proximity on migration is falling in line with falling real costs of international travel, as apparent increases in labour migration from China, India and the Philippines would seem to suggest. The authors also find that higher emigration and larger shares of international remittances in a country's GDP "lead to" declines in the shares of population living in poverty. While they quantify these statistical propensities in inter-country comparisons of static data, this does not, of course, show causality over time.

source countries can least afford to lose. Increased professional mobility has deprived countries of physicians, professors and other skilled personnel, and increased the fees that such professionals can command if they remain in their home countries. Possible counter-measures include donor subsidies of professional salaries in the public sector of recipient countries, and new shorter-term semi-professional qualifications focused on the needs of aid recipient regions rather than meeting the requirements for international professional accreditation.