Improving the Development Impact of Remittances

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Hidden in Plain Sight

Call it the case of the missing billions. For decades, millions of migrant workers have been sending billions of dollars back to their home countries to support their families. Yet the impact of these huge international flows of both money and workers is only now beginning to be understood.[2]

More than $45 billion flowed from the rest of the world to Latin American and the Caribbean (LAC) alone in 2004—exceeding the *combined total* of foreign direct investment and foreign aid once again for the entire region (see map 1). And these figures undoubtedly underestimate the actual totals, because of problems in counting and tracking these flows—known as remittances.[3]

[see Table 1 annex]

Moreover, these totals are cash amounts. They do not include periodic transfers of goods such as computers and household appliances. These can also serve as investment goods, especially in informal microenterprises—a major economic sector unit in all developing countries. These so-called in-kind remittances can amount to more than a quarter of the value of monetary transfers in some households and communities.

Money and goods are one side of this international equation. Workers are the other. Workers leave their home countries for higher paid jobs abroad and, through a combination of hard work and thrift, send a portion of their earnings back home to support their families. Today, 1 in 10 people around

country where they migrate to work. Many come from poor areas in their home countries, where their extended families still reside. Many work in low-skill, low profile jobs—jobs that nevertheless are in high demand in their new countries. And they save a far higher percentage of their income than average households in rich countries do, and these savings translate into widening flows of remittances.

Redrawing the Map of Global Labor Markets

Migrants are redrawing the map of global labor markets. More than 25 million Latin American and Caribbean migrants form part of a large and growing global diaspora. Of these, approximately 22 million are in the developed economies of North America, Europe, and Japan, while another 3 to 5 million work in neighboring countries of Latin America or the Caribbean.

For example, there are now significant concentrations of Bolivians in Argentina, Nicaraguans in Costa Rica, Guatemalans in Mexico, Haitians in the Dominican Republic, Colombians in Venezuela, and Peruvians in Chile.

Although, the fastest growing increase in the percentage of remittances to Latin America and the Caribbean is from Western Europe (Spain, Italy, and Portugal), the United States remains by far the foremost destination for migrant workers from LAC. At least 12 million adults from Latin America and the Caribbean—over 60 percent of the total living in the United States are sending money home to their relatives on a regular basis, typically once a month.[5] This ongoing process results in almost $35 billion a year in remittances to this region from the United States.

Within the United States, the map of foreign workers is also being redrawn. In fact, significant amounts (over $50 million) are sent annually from 37 states and the District of Columbia, demonstrating that the absorption of this workforce extends far beyond traditional border states. Migrants in the most recent destinations for Latino workers (Georgia, North Carolina, Virginia, Colorado, Massachusetts, Maryland, Nevada, and Washington) tend to send

"For poor countries to develop, the poor and lower middle classes must be allowed to use their assets in the same way that wealthier citizens do…[these assets] can become more productive and generate capital for their owners, growth for the nation, and markets for industry" (de Soto, 2001, p. 1).

In a similar vein, Professor C.K. Prahalad, author of *The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits*, observes: "If we stop thinking of the poor as victims or as a burden and start recognizing them as resilient and creative entrepreneurs and value-conscious consumers, a whole new world of opportunity will open up" (Prahalad, 2004, p.1).

At the household level, remittances often average half or more of household income. Many migrants send money to more than one household, and 20 million families in Latin America and the Caribbean benefit from these flows. The bulk of remittances—about 80 to 85 percent—are used to cover basic everyday necessities such as food, housing, and utilities. For millions of these families, many living on a few thousand dollars a year, regular remittances and periodic transfers of goods make a huge difference in their standards of living. Yet this channel remains largely undeveloped with respect to providing the poor with more options in using their own resources to benefit their families and their local communities.

Unlike foreign aid, remittances go directly to families in places that are the most difficult to reach with development assistance—such as those living in remote rural areas. Compared to foreign direct investment and other capital flows, remittances also show remarkable staying power—partly because they support household survival back home

Besides their direct impact on current family incomes, remittances provide an essential development impact for another reason: they are also being used to fund investments in the future.

Families use them to pay school fees for children in the home country, thereby investing in human capital for the next generation. Some remittances are funneled into investment goods, such as tools or as a source of operating capital for small businesses.

Indeed, for many poor households with severely limited access to credit, remittances may be their *only* source of finance. Moreover, remittances are used to purchase land or homes, as well as to repair and upgrade homes. Such outlays are beyond ordinary consumption, given the primary importance of housing, as well as the fact that many productive activities take place in the home.

While the percent of remittances going to such uses may be relatively small, given the total size of these flows, these cumulative amounts are significant. At the country level, remittances serve as an important source of foreign exchange, facilitating imports that cannot be funded from domestic sources. At the same time that official development assistance and foreign direct investment has slowed or fallen in many developing countries, remittance provide a reliable alternative source of foreign exchange that can compensate for diminishing inflows.

Remittances also act as a cushion against shocks, such as hurricanes, earthquakes and other natural disasters. Remittances are also a buffer against economic meltdowns caused by significant financial sector problems, or political instability. For low-income migrants and their families, remittances act as a kind of safety net and as a form of insurance.

Given the magnitudes of these flows, remittances represent an enormous range of potential opportunities not only for individual families, but also for local communities and national economies. At the macroeconomic level, remittances can have a powerful impact through the multiplier effect—on

The Next Challenge: Financial Democracy

Five years ago, very little was known about remittances beyond anecdotal information. Five years later, we now have a much more accurate accounting and understanding of LAC remittances flows and their development potential.[6]

Indeed, in 2004 the issue of remittances was front and center at three major international forums: The Summit of the Americas (January), the European Union/Latin American and Caribbean Summit (May), and the G-8 Summit (June). In 2005, numerous efforts are underway around the world to better understand remittances and to improve their development impact. The World Bank is taking the lead on improving data collection, through work with central banks, and numerous bilateral donors are involved with various aspects of remittances, as well as several non-governmental organizations, foundations and universities.

Five years ago, the average cost of sending remittances to Latin America was more than 15 percent of the value of each transaction, underscoring the reality that it is indeed expensive to be

and ex patriot investors, and collaborating on the resolution of practical issues with home governments.

Financial democracy requires not only new partnerships and new initiatives to leverage the money; it requires new approaches and new attitudes toward handling it. Public authorities are used to regulating and taxing money. Development institutions such as the World Bank, the IMF, and the Inter-American Development Bank (IDB) are used to putting conditions on the money they lend.

Remittances are different. They are private transactions between private parties. The money is family money: earned by work hard and at considerable sacrifice. These family transfers represent the ultimate in family values: hard work, thrift, sacrifice, and hope for a better future. Underlying all of them is one basic fact: *It's their money*. The money rightly belongs to them and their families.

Recognizing Reality and Moving Ahead

Remittance flows, a major consequence of migration, are now a fixture of the international economic and financial landscape. Between 1975 and 2000 the world's population increased by 50 percent, while the number of migrants almost doubled. Today, the number of people having migrated for economic reasons would alone constitute the sixth most populous country in the world (Martin, 2004). While only 15 percent of the world's population live in developed countries, 60 percent of migrant workers reside there.

Migration, as part of a process of global integration, spawns new interrelated labor markets and transnational networks comprised of families and individuals, including migrants who return home, businesses and investors who continue to forge connections across borders These networks benefit from liberalization and technology and their growth creates markets for goods and services. This process is well underway in the Americas.

2004 (Bendixen and Associates, 2005). Pooling and coordinating such small amounts for illegal uses would be a highly inefficient way to direct or accumulate funds for such purposes.

Another confusion at the political level involves the suggestion by some that remittance flows justify the reduction or elimination of foreign assistance to those countries receiving significant remittances. Here again, it needs to be understood that these flows are neither charity nor foreign assistance. Remittances are derived from the payment for services rendered by migrant workers.

However, many of the studies that question the benefits of remittances tend to minimize several basic issues. First, while remittances are *no cause for celebration, they are not the cause of underdevelopment*. The hard reality is that remittances exist because many countries cannot provide adequate employment and income for their citizens. Hence, people move “North” by the millions, and money moves “South” by the billions. These flows have become a major source of income for millions of families. Indeed, it is impossible to envision social conditions in the absence of these resources.

Secondly, remittances do not typically produce optimal economic outcomes in recipient countries – but neither do other flows and economic activities in environments where *poor economic incentives and weak institutions discourage households, businesses, and investors from saving, investing, and*

local microfinance institutions, home mortgages, and even the securitization of bonds for on-lending to local small businesses.

Changes in the market will occur when banks and other financial institutions, money-transfer companies, and other businesses recognize what Prahalad calls "the fortune at the bottom of the pyramid": the largely untapped market in lower-income households in developing countries. As the power of this market is better understood, a range of new competitive products and services aimed at migrants and their families will emerge in both host countries and countries of origin.

For families, increased capacities in the form of higher financial literacy will be needed to respond to new incentives that arise from reforms in the regulatory and institutional framework. A challenge for governments and civil society will be to improve financial literacy among transnational families while at the same time undertaking the institutional changes necessary for lowering the risks and costs (in time and money) facing thehls f4 and

After a broad process of consultation with the Task Force, the MIF devised the following recommendations, called Core Principles, to help organize and focus priorities on the collective effort to improve the potential of these flows (MIF-IDB 2004b). Each principle is a worthy subject for further research, and all have been discussed to some extent in various chapters of this book. These Principles address deficiencies, barriers, and bottlenecks in the three major areas that are critical to leveraging the huge scale of remittances: remittances institutions, public authorities, and civil society.

Core Principles for the Remittance Market in Latin America and the Caribbean

REMITTANCE INSTITUTIONS:

IMPROVE TRANSPARENCY

Remittance institutions should disclose in a fully transparent manner, complete information on total costs and transfer conditions, including all commissions and fees, foreign exchange rates applied, and execution time.

PROMOTE FAIR COMPETITION AND PRICING

Remittance institutions should compete on the basis of fair and non-discriminatory contractual arrangements. They should refrain from unfair pricing and the use of high exchange rate margins.

APPLY APPROPRIATE TECHNOLOGY

Remittance institutions should apply cost effective technology and deploy innovative platforms to cut costs, improve speed and security, and create new products. Such systems can also help to reduce money-laundering and other illicit activities.

SEEK PARTNERSHIPS AND ALLIANCES

Remittance institutions should seek partnerships and alliances, including linkages between N7ery-3(p)-4(wr)-1ancsfer compncnr and ipdaceial nsttst-2(e)-4(i) Norder nrv-3(n)1-5(rg

CIVIL SOCIETY:

LEVERAGE DEVELOPMENT IMPACT

Civil society and private sector organizations should systematically identify obstacles to leveraging the development impact of remittances, and engage with all relevant stakeholders to address and remove such obstacles.

SUPPORT SOCIAL AND FINANCIAL INCLUSION

Civil society and private sector organizations should support the social and financial inclusion of transnational families into their communities, and develop innovative partnerships to promote training and local productive opportunities.

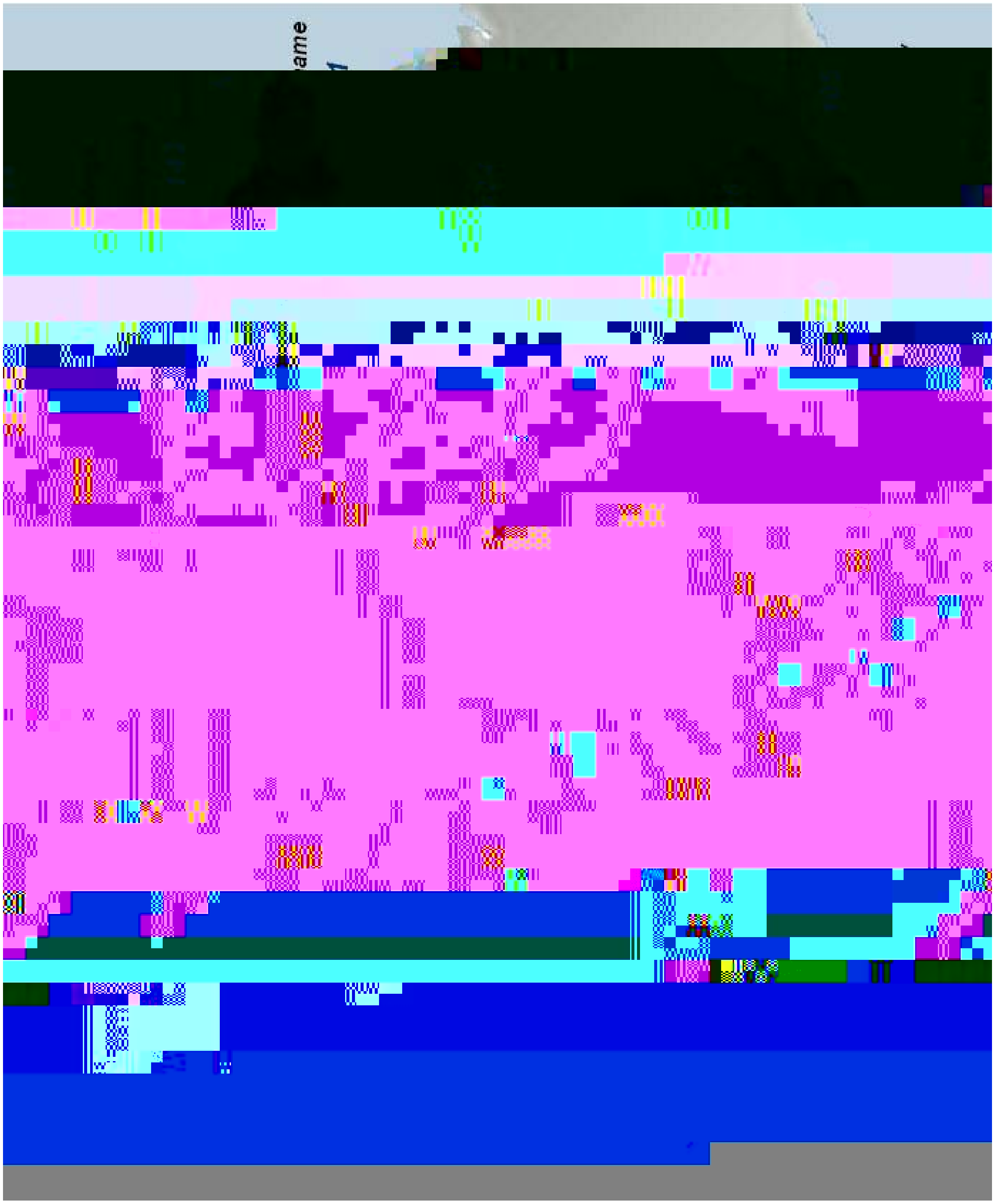
Over the past five years, remittances have undergone dramatic changes. Over the next five years the system can be entirely transformed. Progress on any of these Principles will improve the lives of many migrants and their families, but transforming the economic and social potential of remittances in developing countries will require concerted effort on all. While these Principles are directed at the remittances market in Latin America and the Caribbean, they are sufficiently general to be relevant to remittance markets in other regions.

While the growth in remittances appears assured over the medium term, the longer term outlook will hinge on economic growth in countries of origin, the rate of migrant family unification in host countries, the average age of migrants, and migrants' decisions to remain in host countries, among other variables. Significant changes in these can lead to declines in remittance volumes, such as occurred after many Turkish families were reunited in Germany in the late 1990s.

Moreover, remittances are not a substitute for pro-growth policies, investment in education, or skills formation in labor-exporting countries. However, by changing incentives, governments can improve the economic impact of remittances. The time to enact such changes is while these flows remain robust.

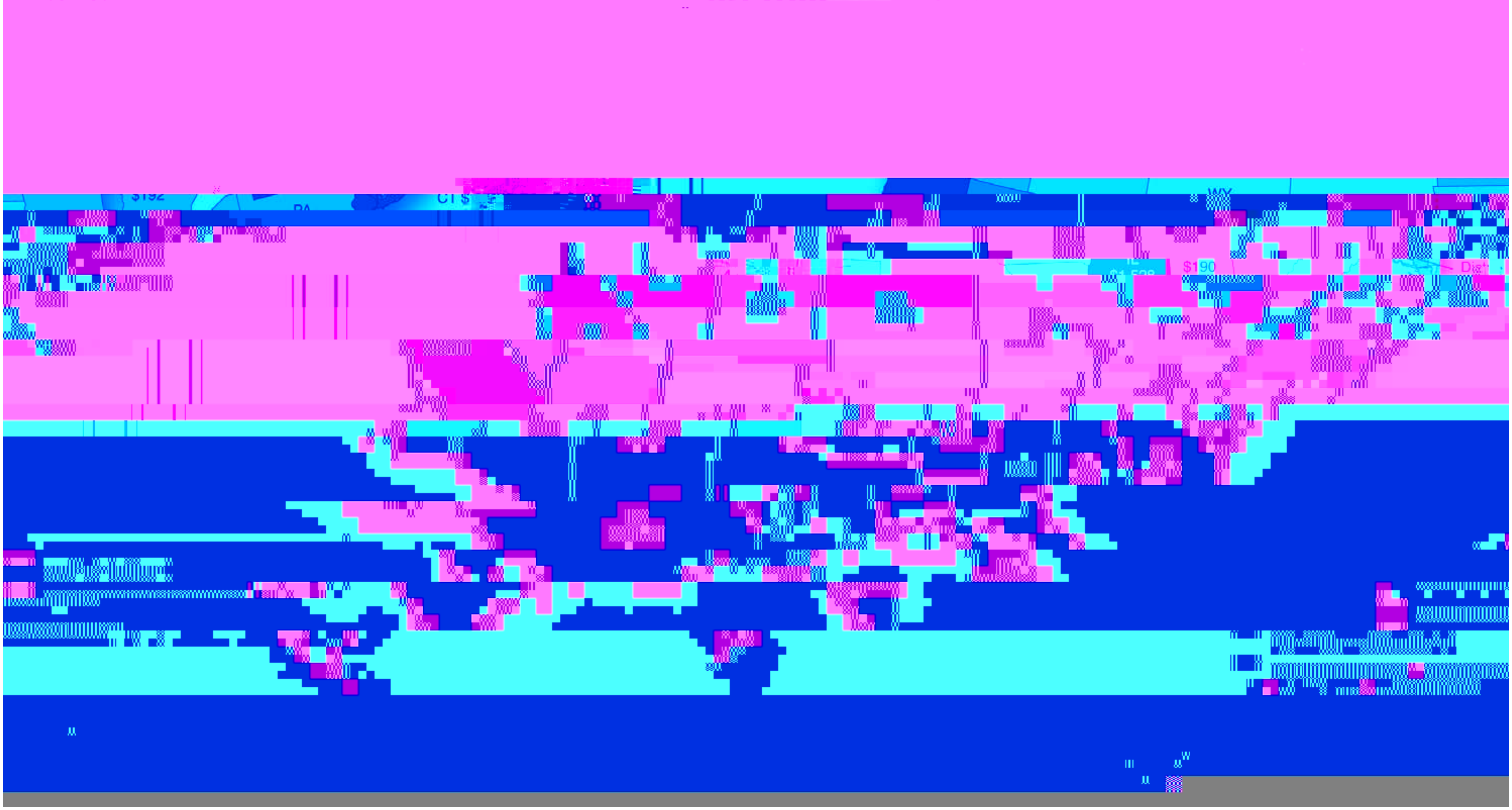
Terry, Donald F. and Steven R Wilson. eds. 2005. *Beyond Small Change: Making Migrant Remittances Count.* Washington, D.C.: Inter-American Development Bank

Annex



Remittances to Latin America from the US - 2004

(in millions)



[1] The author is Manager of the Multilateral Investment Fund of the Inter-American Development Bank in Washington, D.C.

[2] This article summarizes arguments made in the forthcoming book, *Beyond Small Change: Making Migrant Remittances Count*, edited by Donald F. Terry and Steven R. Wilson, and published by the Inter-American Development Bank, Washington, D.C.

[3] Currently there are no internationally comparable data on remittances—unlike other categories of financial flows, trade in goods and services, and various forms of technology transfer that are carefully monitored, documented, and reported. In this volume, various authors use different estimation methods and data sets to derive figures on remittances; these are documented in the respective chapters. The IDB estimates of remittances are based on survey evidence, rather than relying solely on the central bank data that underlies much other international reporting. This choice reflects the unanimous acknowledgement of experts that central bank data severely understate remittance flows. As a result, the World Bank documents "official remittance" flows at about $100 billion worldwide, but estimates that perhaps an equal amount of "unofficial remittances" are uncounted. The World Bank is in the process of developing uniform standards for surveys to be used to estimate remittance flows worldwide.

[4]The estimate of 500 million people is based on the experience in Latin America, where remittances, on average, support 4.5 family members.

[5] Another 2--3 million occasionally send remittances home to relatives.

[6] See the MIF web site at http://www.iadb.org/mif/v2/remittances.html

[7] Researchers have used h4(e)(://www.ia)7(db)3(.3elk a8srve b)3(dwi TcrFb)-5TJ5TJ6(Re 0 C(r)4(w.359 0 T79[nd rem)ze)4(t

[10] Governments, local authorities, and national and international regulators that have an impact on stabilizing the financial sector, sustaining public confidence, or implementing monetary and other policies that have an impact on the functioning of the financial sector.

[11] Civil society includes trade unions, hometown associations and other non-governmental organizations (NGOs).