MIGRATION POLICY INSTITUTE

Policy Brief

No. 8 September 2013

THE IMPACT OF REMITTANCES ON ECONOMIC GROWTH AND POVERTY REDUCTION

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MIGRATION AND DEVELOPMENT

Executive Summary

Migrants' remittances to their country of origin — which totaled US $401 billion in 2012 and are growing fast — represent a major vehicle for reducing the scale and severity of poverty in the developing world. Besides pure monetary gains, remittances are associated with greater human development outcomes across a number of areas such as health, education, and gender equality. This money acts as a lifeline for the poor, increasing income for individuals and families. Research on the impact of remittances in particular settings shows such effects as lower school dropout rates and increased average birth weights for children born to remittance-receiving families.

There are also positive spillover effects, with some of the expenditures and investments made by remittance-receiving households accruing to entire communities. And unlike other monetary flows, remittances are countercyclical — family members abroad are likely to be even more motivated to give in times of hardship, even if their own financial situation has deteriorated as well. In this way, remittances are a form of insurance, helping families and communities weather external shocks.

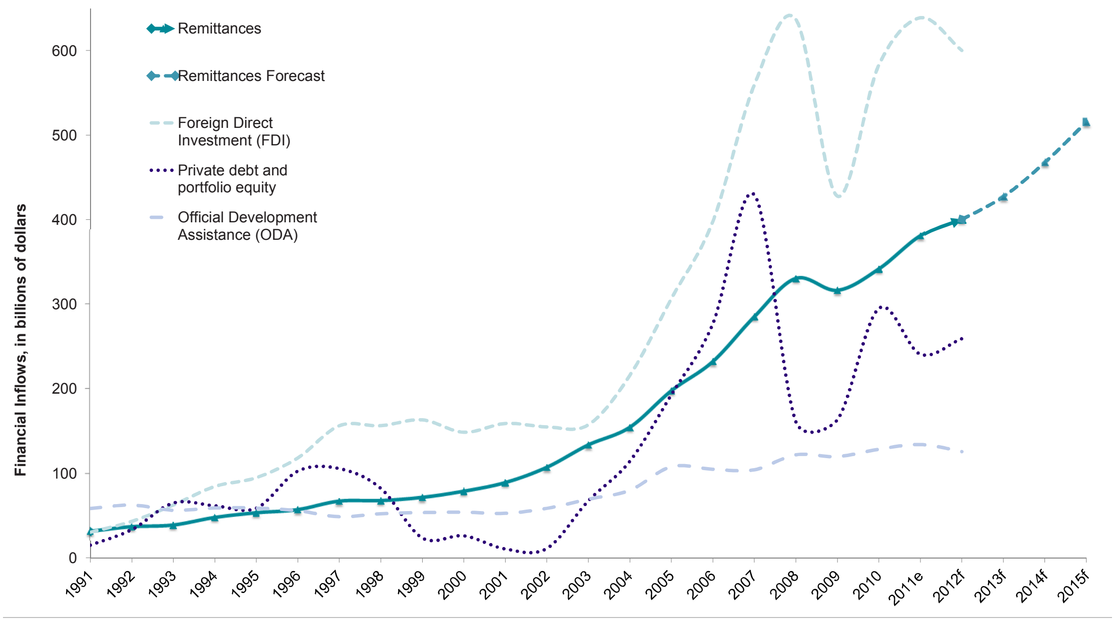
For many countries, remittances dwarf official international aid. The inflow of foreign exchange from migrants increases the home country's creditworthiness and may allow them to secure more favorable terms of debt service, as lenders perceive a lower risk of default. Since 2009, the World Bank has revised its analysis of how much debt a country can carry at various levels of risk to include remittances, so that countries with high remittances inflows can borrow more.[1]

While migration can have both positive and negative economic, social, and cultural implications for countries of origin, remittances are the most tangible and least controversial link between migration and development. Policymakers can do much more to maximize the positive impact of remittances by making them less costly and more productive for both the individual and the country of origin. Migrants pay transaction costs, on average, of 9 percent of the amount they remit.[2] While increased competition among institutions that provide money transfer services has produced substantial progress in reducing these costs in high-volume remittance corridors, prices remain high in low-volume corridors, such as between Japan and Peru.[3] Beyond reducing costs, which puts more money directly into the hands of migrants who send and/or families who receive remittances, measures to ensure that the recipients of these funds have access to other financial services, such as micro insurance (especially health) or education financing would go a long way to boosting development outcomes. The technology for linking remittances directly to such programs exists, but practice has fallen behind because of public policy barriers. While governments cannot tell migrants and their families how to spend their own money, policymakers can put in place sufficient incentives and mechanisms for migrants and their families to invest remittances in capital-accumulation projects (involving both human and physical capital) that are beneficial to the whole economy.

I. Scale and Reach of Migrant Remittances

It is difficult to overstate the size and importance of remittance flows to developing countries. The World Bank estimates that migrants remitted US $401 billion in 2012, and projects that by 2015, this figure could grow by another $114 billion.[4] To put the known volume of remittance flows into perspective, in 2011 migrants sent approximately three times more to developing countries than these countries received in official development assistance; and they sent an amount equal to about half of foreign direct investment (FDI) in these countries (see Figure 1).[5] In some countries, remittances represent more than 20 percent of the gross domestic product (GDP).[6] And this is just what we can measure. Actual amounts may be much higher, as money sent through informal channels often goes unrecorded.[7]

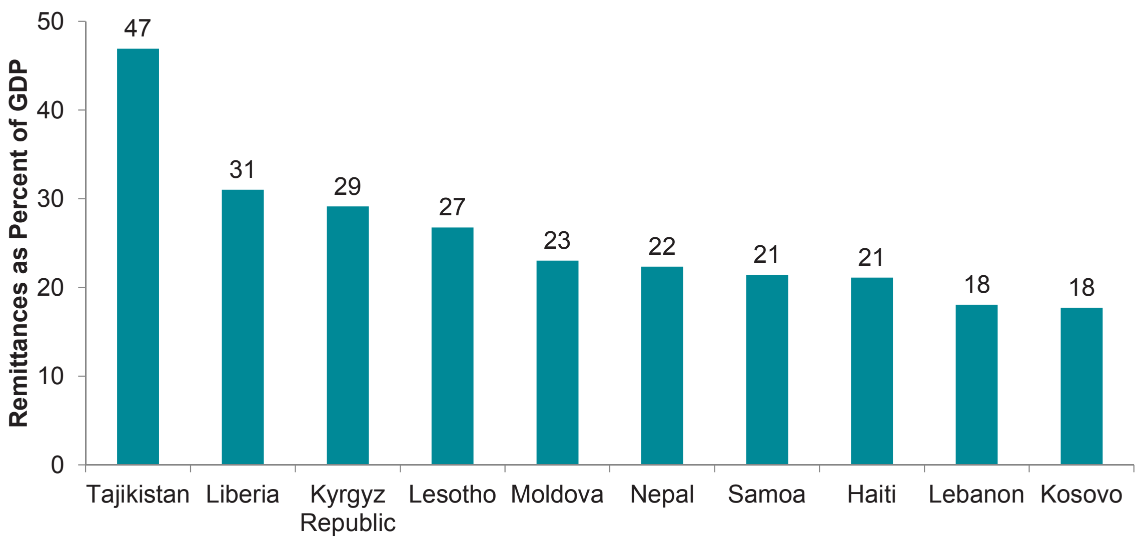
Figure 1. Remittances to Developing Countries in Perspective, 1991-2015



Note: e=estimate; f=forecast.
Source: Dilip Ratha and Hans Timmer, "Outlook for Migration and Remittances 2013-15," (PowerPoint presentation of the World Bank Development Prospects Group, Washington, DC, April 19, 2013), www.knomad.org/powerpoints/MandD-Brief20-and-the-KNOMAD-April19-2013.pptx.

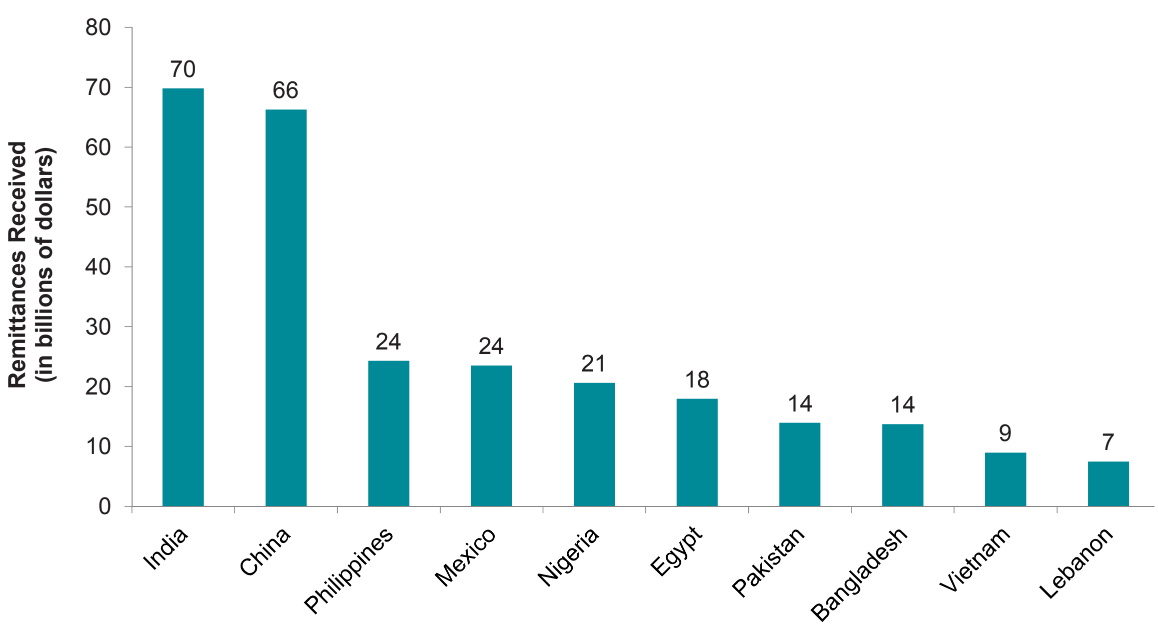
While remittance inflows to developing countries declined modestly — 5.27 percent — with the onset of the global financial crisis in 2009, they proved to be far less volatile than FDI, which fell off by 32.94 percent the same year. Remittances continue to be far more resilient than private investments. By 2011, FDI to developing countries had barely regained its 2008 toehold — having increased by a sluggish 0.59 percent over a three-year period. In contrast, remittance inflows to developing countries rose 25.29 percent from 2009 to 2011.

Figure 2. Remittances as Share of Gross Domestic Product (GDP), 2011



Source: Ratha and Timmer, "Outlook for Migration and Remittances 2013-15."

Figure 3. Top Remittance Recipient Countries, 2012



Source: Ratha and Timmer, "Outlook for Migration and Remittances 2013-15."

II. The Evidence: Impact of Remittances on Development

A. Impact of Remittances on Education and Health

One frequent criticism leveled against remittance income is that it is not sustainable because recipients "squander" these funds on consumption. However, the evidence disputes this view, showing that families spend remittances disproportionally on human capital-building areas, compared to how they spend other forms of income.[8] Numerous household surveys reveal that on average, remittance-receiving households make higher investments in health care and education than those households that do not receive this type of income.

Research has shown that the presence of remittance income in a household strongly and significantly corresponds with positive health outcomes, especially for children. Infants in remittance-receiving households in Mexico and Sri Lanka have been found to have higher birth weights. Remittance-receiving households also have lower rates of infant mortality and children with higher weight levels during early childhood, as well as higher health-related knowledge than similar households that do not receive remittances.[9] Visiting and returning migrants may also bring back health-improving practices, such as safe drinking water and better sanitation, to their communities of origin.[10]

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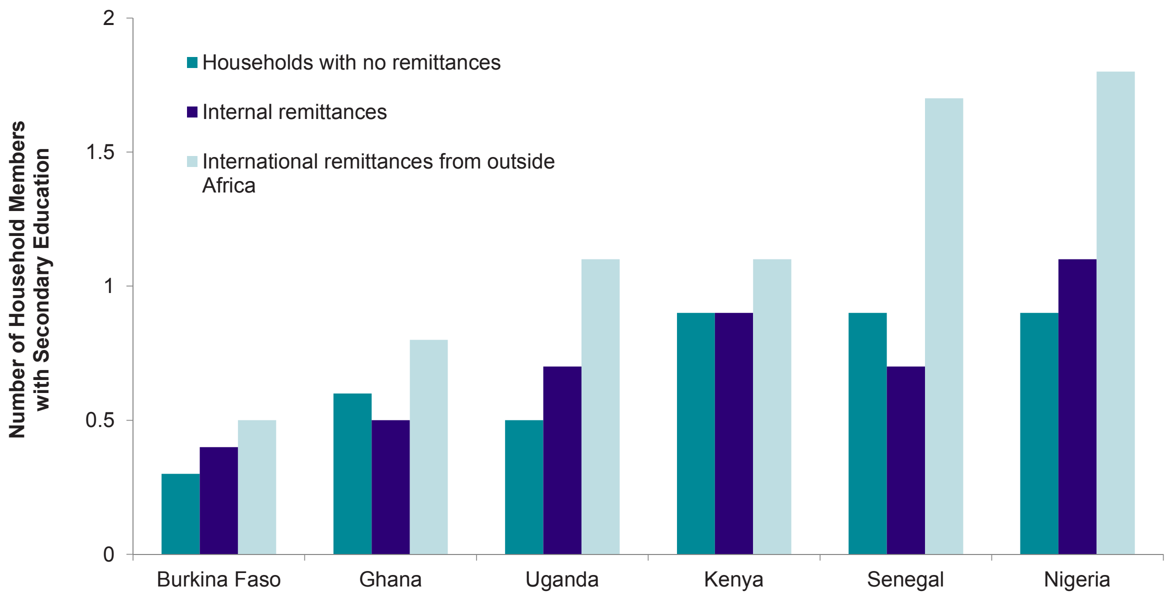
Migration has also been seen also to increase educational attainment for households in the sending country. Households that receive remittances invest more heavily in child education than non-remittance-receiving households, as has been seen in Ethiopia and Sri Lanka — where children of migrants are more likely to be enrolled in private education as opposed to their counterparts.[11] One study from rural Pakistan suggests that temporary migration is associated with higher school enrollment among sending households, especially for girls. Similar trends have been observed in Ethiopia, Ghana, and India — though in this case, the study looked at remittances sent by internal rather than international migrants.[12] A cross-country comparison of six sub-Saharan African nations shows a strong and positive correlation between the average number of household members with a secondary education and receipt of international remittances from outside the continent (see Figure 4). In El Salvador and the Philippines, the children of migrants have been found to be less likely to drop out once they are enrolled in school.[13] However, having a parent migrate may also impose psychological costs on children and parents;[14] the total balance of costs and benefits is something that each family must calculate for itself.

Figure 4. Average Number of Household Members with Secondary Education



Source: Dilip Ratha, "Migration and Post-2015 Development Agenda," (PowerPoint presentation to Joint Reflections on Migration and Development, The Graduate Institute, Geneva, May 30, 2013).

B. Impact of Remittances on Poverty

Remittances increase household incomes and are therefore a powerful anti-poverty force in developing countries. Unlike some publicly funded social safety nets, remittance receivers can identify their own greatest needs and can allocate the remittance income accordingly.

Evidence from around the globe shows that households that receive remittances are financially better off across multiple dimensions relative to similar households that do not receive them.[15] Remittance-receiving households have higher incomes and levels of consumer spending and lower incidences of extreme poverty relative to similar households that do not receive remittances.[16] One cross-country study of 71 developing countries found that a 10 percent increase in per capita official international remittances would produce a 3.5 percent decline in the share of people living in poverty.[17] Other research conducted in Nepal showed that a dramatic increase in remittances was responsible for one-third to one-half of the overall reduction in headcount poverty rate in the country, which declined from 42 percent in 1995-96 to 31 percent in 2003-04.[18] Notwithstanding this example, broader trends indicate that international remittances may have the greatest impact in reducing the severity of poverty rather than its scale (i.e. the total number of people who live in poverty).[19]

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Since remittances are countercyclical financial flows, meaning that the flow of money increases when financial markets decline, they behave very differently than private capital flows. Historically, remittances have tended to rise in times of economic downturns, political and civil crises, and natural disasters because migrants living abroad send more money to help their families in response to their increased need. Remittances have become an even more important source of external financing in many developing countries as other forms of monetary inflows have declined. Because they are a large and stable source of foreign currency, remittances are also likely to curtail investor panic and prevent sudden current account reversals during a crisis.

Egypt serves as a powerful example of how migrants provide for their families in times of need, and of the lifeline that international remittances provide. When political instability struck the country during the Arab Spring, investors and donors pulled out while remittances poured in. Between 2009 and 2011, FDI inflows into Egypt vanished, falling from US $9.5 billion to a net negative of $483 million. The country also lost three-quarters of its official development assistance as donations plummeted from $1.7 billion in 2008 down to $410 million three years later. Meanwhile, remittance inflows to Egypt ballooned during this time, rising from $7.15 billion in 2009 to $14.32 billion in 2011 and $20.5 billion the following year.[20]

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The earnings that the migrants send to family members therefore function as a form of household insurance against loss of income and other financial hardships. Research from around the globe has revealed that remittance-receiving households have, on average, greater savings levels and consequently a stronger ability to withstand external economic shocks than similar households that do not have this income source.[21] Recent evidence from Mali confirms that a substantial part of remittances is saved for unexpected events, in effect providing a private safety net for the migrant's family.[22] Remittance-receiving households in Ethiopia used their cash reserves and thus avoided having to sell their livestock to cope with drought.[23] And in Ghana, remittances were found to help households minimize the effects of economic shocks on household welfare.[24]

Migration and the remittances flows it produces should not be viewed as a substitute for official development aid, as this private money cannot fund public projects on the scale required and is not equally accessible to needy populations. Not all poor households receive remittances. The worst-off households often lack the capital needed to migrate elsewhere and therefore do not gain remittance-financed benefits. Official funds are vital to addressing the unmet needs of these vulnerable households. Moreover, cross-country analysis indicates that remittances may be related to increased income inequality in Africa and Latin America, though contradictory evidence has emerged from research conducted on migrant households in the Pacific island nations of Fiji and Tonga.[25] Migration may raise inequality initially, as only the relatively well-off have the resources to send workers abroad and therefore receive remittances. Nevertheless, as migrant networks are established in the destination countries, the cost of migration falls so that less well-off people can also afford to migrate.[26]

C. Impact of Remittances on Sustainable Economic Growth

In cases when remittance income helps to bring families out of poverty, its beneficiaries can exert less time and energy scrambling for their basic sustenance and are more free to engage in pursuits that collectively stimulate sustainable economic growth in the sending community and country. The safety net, or "consumption-smoothing" effect, of remittances allows households to engage in high-risk but possibly more profitable economic activities that reduce poverty, and that in the absence of migration would have been difficult to achieve. The overall national economy may also benefit from the increased investment that remittances facilitate. Research conducted in the Philippines, Mexico, and other countries suggests that receipt of remittances is associated with greater accumulation of assets in farm equipment, higher levels of self-employment, and increased small-business investments in migrant-sending areas. In sub-Saharan Africa, international remittances are correlated with higher levels of computer and Internet access. Migrant remittances raise domestic savings and improve financial intermediation, which can improve growth prospects for the country overall.[27]

Overall, however, the extent to which countries benefit from remittances is closely related to the strength of domestic institutions and the macroeconomic environment.[28] Issuing diaspora bonds or remittance-backed securities can help developing countries relieve financing constraints. In times of crisis, migrant investors are expected to be more loyal than other foreign investors that lack personal ties to the country, and the former may be especially interested in financing infrastructure, housing, health, and education projects.[29] Israel pioneered the diaspora bond in 1951, and has raised $35 billion since its introduction.[30]

The merit of remittance flows might lie more on increasing the level of income for the poor rather than the growth of the economy as a whole.

Future flows of remittances can be used as collateral by governments and private-sector entities in developing countries to raise financing in international capital markets. These innovative financing mechanisms can be used to raise funds for development projects such as low-income housing or water supply. Factoring the remittance inflows correctly into macroeconomic analysis is also likely to improve remittance-receiving countries' credit rating and external debt sustainability. Changes to the World Bank-International Monetary Fund (IMF) Debt Sustainability Framework starting in 2009 allow countries that receive large flows of remittances — equivalent to more than 10 percent of their GDP and 20 percent of exported goods and services — to carry a higher level of debt.[31]

Still, the merit of remittance flows might lie more on increasing the level of income for the poor rather than the growth of the economy as a whole.[32] The primary gap in evidence regarding remittances' development impact is the lack of research supporting their positive impact on economic growth. In general, the inconclusive results of the impact of remittances on economic growth are largely due to the difficulty of separating the cause from the effect: if remittances react countercyclically to growth, then the negative relationship between the two is a result of reverse causality running from growth to remittances, not vice versa.[33]

Some studies have found remittances to have negative impacts on currency valuation and labor market participation. Empirical evidence from Latin America and Cape Verde suggests that remittances can lead to exchange rate appreciation, which can reduce the competitiveness of the tradable sector, the so-called "Dutch Disease."[34] Still, remittances are less likely than natural resource windfalls to result in persistent exchange rate misalignment, while the exchange rate implications of relatively stable remittance flows are likely to be easier to manage than a comparatively abrupt shock due to a natural resource windfall.[35] Overall, studies focusing on the labor supply response of the remittance-recipient households tend to find that remittances lower work efforts and hence reduce long-term growth.[36] Yet, other studies find that remittances improve financial access and financial development and therefore stimulate growth.[37]

III. Conclusions and Recommendations

The development community can further enhance the impact of remittance flows for development by making them cheaper, safer, and more productive for both the migrant-sending and the receiving countries. An "International Remittances Agenda" would involve the following:

- ***Better data and monitoring.*** Being able to attach concrete figures to the volume of remittances has revolutionized migration and development policy; but there is still much we do not know because of the volume of money that travels through informal channels, and flaws in the way that remittance income is recognized.
- ***Lowering costs.*** Costs of transferring remittances have been falling, but there is no reason they should be substantially greater than zero. The real cost of money transfer in the electronic age is very low, and transfers by mobile phone are reaching even remote areas. Migrants should be able to pay a flat, low fee to remit their money rather than a percentage. Policymakers can improve retail payment systems by encouraging the use of better technologies and enacting appropriate regulatory changes.
- ***Linking remittances to financial access at the household level.*** Research indicates that remittance-receiving households are more likely than others to have bank accounts. More could be done to link remittances to financial products such as savings vehicles, access to credit, education accounts, and health insurance. The benefits of remittances could be increased if migrants were able to use them to hedge against future hardship, rather than relying on them once hardship strikes.
- ***Leveraging remittances for capital-market access at the institutional or macro levels.*** The governments of remittance-receiving countries, donor governments, and international financial agencies can work together to develop the technical means to create new channels for productive uses of remittances and migrants' savings, both at the household level and the national level. Instruments such as remittance-linked loans, diaspora bonds, securitization of remittance flows, and efforts to include remittances in calculating sovereign credit ratings are all measures that can raise the benefits of remittances to national economies.

ENDNOTES

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Acknowledgments

The author is grateful for the assistance of Susanna Groves, Natalia Banulescu-Bogdan, and Rameez Abbas of the Migration Policy Institute in structuring and editing this policy brief.

This policy brief series is supported by the Government of Sweden, Chair-in-Office of the Global Forum on Migration and Development (GFMD). It is designed to inform governments on themes that have been discussed in the GFMD and that will also be covered by the upcoming UN High-Level Dialogue on International Migration and Development in October 2013. The series was produced in coordination with the Center for Migration Studies (CMS), and was made possible through the generous support of the MacArthur Foundation and the Open Society Foundations.

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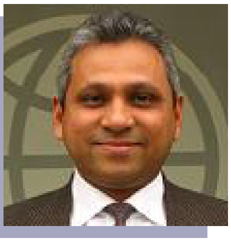

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Cover Design: April Siruno, MPI
Inside Layout: Rebecca Kilberg, MPI

Suggested citation: Ratha, Dilip. 2013. *The Impact of Remittances on Economic Growth and Poverty Reduction*. Washington, DC: Migration Policy Institute.

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