

Appendix A: Enhancing the Developmental Effect of Workers' Remittances to Developing Countries

Trends in developing countries' remittance receipts

Worker's remittances continued to rise in 2003 to an estimated \$93 billion, up from \$88.1 billion in 2002, when remittances equaled 5 percent of developing-country imports and 8 percent of domestic investment (table A.1).¹ Remittances remain the second-largest financial flow to developing countries after foreign direct investment, more than double the size of net official finance (figure A.1). In 2002, remittances were larger than both official and private flows in 36 developing countries. Latin America and the Caribbean continued as the region receiving the most remittances—it received \$30 billion, nearly a third of remittance flows to all developing countries (table A.2). South Asia and East Asia and Pacific each received \$18 billion. Sub-Saharan Africa received \$4 billion.

Remittances increased more rapidly than forecast in last year's *Global Development Finance*

(World Bank 2003, chapter 7). Weak labor markets and the tightening of border controls in the industrial countries after the terrorist attacks of September 11, 2001, were expected to slow the growth of remittances in 2002 and 2003. Instead, remittances increased by more than 20 percent, especially in the countries that faced heightened security. More remittance flows were diverted from alternative channels to formal channels as a result of efforts to curb money laundering (box A.1). Also, the increased focus on remittances resulted in better reporting of data in many developing countries. And the fear of being deported or investigated may have prompted some migrant workers to remit their entire savings to their home country (box A.2).

The main sources of remittances were the United States and Saudi Arabia, with 2002 payments of \$31.4 and \$15.9 billion, respectively. Remittance payments increased sharply from both

Table A.1 Remittances received and paid by developing countries in 2002

\$ billions

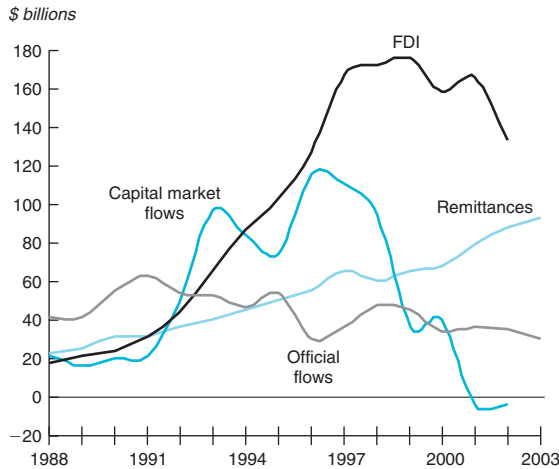
| | All developing | Low-income | Lower-middle-income | Upper-middle-income | High-income |
|---|----------------|------------|---------------------|---------------------|-------------|
| Total remittance receipts | 88.1 | 25.7 | 44.5 | 17.9 | 44.4 |
| as % of GDP | 1.5 | 2.9 | 1.3 | 1.0 | 0.2 |
| as % of imports | 5.1 | 12.1 | 4.9 | 3.2 | 1.2 |
| as % of domestic investment | 8.0 | 14.6 | 5.9 | 14.0 | 35.7 |
| as % of FDI inflows | 66.2 | 388.9 | 49.2 | 51.3 | 8.4 |
| as % of net official finance | 250.0 | — | — | — | — |
| Other current transfers ^a | 38.0 | 9.0 | 22.0 | 7.0 | 83.0 |
| Remittance receipts and other current transfers | 126.1 | 40.2 | 66.6 | 24.6 | 127.4 |
| Total remittance payments | 28.0 | 1.5 | 3.1 | 23.4 | 77.2 |
| excluding Saudi Arabia | 12.1 | 1.5 | 3.1 | 7.5 | 77.2 |

Note: — = not available.

a. Other current transfers include gifts, donations to charities, pensions received by currently retired expatriate workers, and so on. They may also include personal transfers by migrant workers to families back home. See World Bank 2003, chapter 7, data annex.

Sources: IMF 2002 and World Bank 2002 and 2003.

Figure A.1 Resource flows to developing countries, 1988–2003



Sources: IMF, *Balance of Payments Yearbook*, various years, and World Bank staff estimates.

countries from the mid-1970s to the mid-1990s (figure A.2). Since 1995, however, remittances from Saudi Arabia have stagnated, as economic activity has slowed, and also because the country made a decision to slow the growth of the foreign population. By contrast, remittances from the United States since 1995 have nearly doubled, driven by the economic boom and the liberalization of temporary migration (especially in the technology sector, through the H-1B visa).

The impact of remittances

At the individual level, remittances augment the income and reduce the poverty of the recipient (Adams and Page 2003). They are largely altruistic, the goal of the sender being to help the recipient meet financial needs for food and clothing,

Table A.2 Regional distribution of remittances, 2001–03

\$ billions

| Region | 2001 | 2002 | 2003 | Increase during 2001–03 (%) |
|-------------------------------|------|------|------|-----------------------------|
| East Asia & Pacific | 13.7 | 17.0 | 17.6 | 28.9 |
| Europe & Central Asia | 10.2 | 10.3 | 10.4 | 1.9 |
| Latin America & the Caribbean | 22.9 | 26.8 | 29.6 | 29.3 |
| Mid. East & N. Africa | 13.2 | 13.0 | 13.0 | -1.2 |
| South Asia | 13.1 | 16.9 | 18.2 | 38.7 |
| Sub-Saharan Africa | 3.9 | 4.1 | 4.1 | 3.5 |
| Total | 77.1 | 88.1 | 93.0 | 20.7 |

Source: IMF, *Balance of Payments Yearbook*, various years, and World Bank staff estimates.

children’s education, medical expenses, and housing. Remittances, therefore, tend to be stable over time and may even rise in times of economic difficulty in the recipient country (Ratha 2003). Remittances are also person-to-person flows, well targeted to meet the needs of the recipient.

At the macro level, remittances are believed to have a favorable effect on growth to the extent that they are used to finance education (Cox Edwards and Ureta 2003) and health expenses. Even when they are used for consumption, remittances generate multiplier effects, especially in poor countries with high unemployment. However, the debate over the macroeconomic effects of remittances is just beginning and will be an important area of future research. Some authors argue that remittances may reduce recipients’ motivation to work and thus slow down growth (Chami and others 2003). Others argue that remittances may raise income inequality in the receiving society. Also, as with all foreign-currency inflows, too great a volume of

Box A.1 Informal transfers

Because a large share of remittances goes unrecorded, the data reported in the main text, which are based on official statistics, underestimate the actual size of remittance flows. One can only speculate about the size of unrecorded remittances. Officials in major fund-transfer agencies argue, based on the volume of funds flowing through their system, that unrecorded remittances may be larger than recorded remittances. A portion of the rise

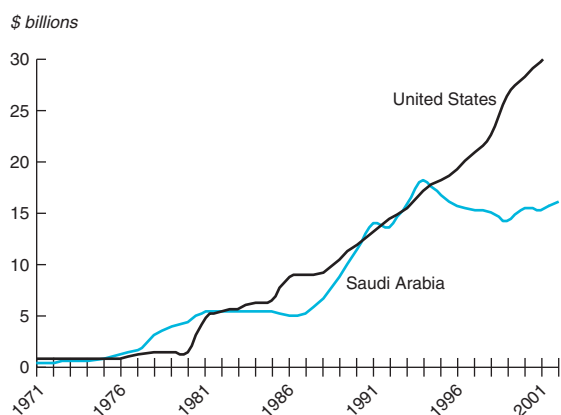
in remittances over the past two years may reflect a switch to more formal channels due to the tightening of controls on informal transfer agents following the September 11, 2001, attacks on the United States. For example, remittances to Pakistan nearly tripled from the fiscal year ending June 2001 to the fiscal year ending June 2003. Similar increases have occurred in other developing countries.

Box A.2 Remittance behavior

Temporary migrant workers tend to remit a larger proportion of their income than immigrants who plan to settle down in their new country of residence. Ties with families left behind in the home country tend to be stronger for recent migrants and for migrants who are planning to return soon. Also, families or relatives left behind need more financial help in the beginning. The propensity to remit (remittances as a share of income) is

believed to decline with time, perhaps as the migrant worker is joined by family. Anecdotal evidence also suggests that the remittance behavior of migrant workers varies with skill and gender. While a skilled worker may earn more and send a larger nominal amount than an unskilled worker, the latter may send a larger share of income. Also, women are believed to remit a larger proportion of income—and more regularly—than men.

Figure A.2 Sources of remittance payments, 1971–2002



Source: IMF, *Balance of Payments Yearbook*, various years.

remittances can result in currency appreciation, which may affect the competitiveness of exports.

Reducing remittance costs

While remittance fees have declined somewhat since 2001, fees charged by money-transfer agents remain high compared to the actual cost of technology, labor, and currency-exchange commission. It is not uncommon, for example, for remittance costs to be as high as 20 percent for small transfers (figure A.3). Developments that may lead to lower remittance costs include:

- Greater competition among money-transfer agents
- Better access to banking services for migrant workers in remittance-source countries and households in recipient countries

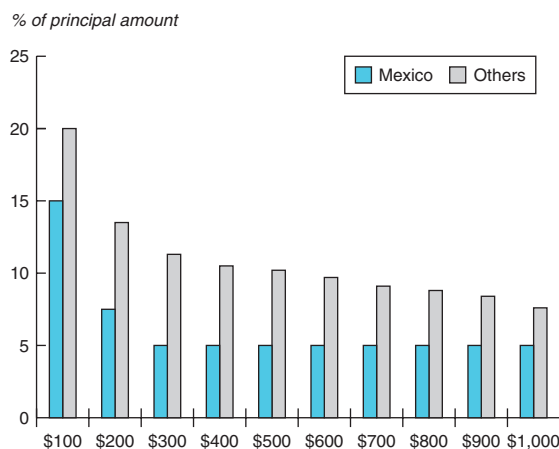
- Harmonization of the financial infrastructure supporting remittances
- Better investment climate in the remittance-receiving country, for example, though removal of foreign-exchange restrictions.

Competition among money-transfer agents

The high costs of remittance reflect the large investments required to enter the formal money-transfer market, including a widespread branch network in both source and recipient countries. High fixed costs impede new entrants to the market, allowing money-transfer agents to charge above the marginal cost of transactions.

Nevertheless, there is some evidence that competitive forces are having an impact on reducing remittance fees. Some nonprofit credit unions affiliated with the World Council of Credit Unions

Figure A.3 Remittance costs from the United States to Mexico and other countries



Source: www.westernunion.com. Fees exclude exchange commission.

and International Remittance Network are able to provide the same service—for example, sending \$1,000 to Mexico from the United States—at a substantially lower fixed fee of \$10–\$15, as opposed to the \$50–\$76 charged by major commercial money-transfer agents. South Africa’s Teba Bank and Canada’s Meli Melo Transfert are able to send cross-border transfers at a fixed fee of \$3 for amounts up to \$400. In Hong Kong, cutthroat competition among money-transfer agents has brought the cost of sending remittances to the Philippines down to a fixed \$2.50 per transaction.

This salutary competitive process would be strengthened if smaller firms could enter into agreements with international banks to use their branch networks to remit funds. Although many major international banks lack sufficient branches in the countries receiving remittances, there may be some potential in easing rules in industrial countries that restrict the ability of local money-transfer institutions to cooperate with foreign banks for the purpose of sending remittances.

Scaling up banking access

Increasing access to banking services in developing countries (and for the poor in industrial countries) would help reduce remittance costs by (a) giving senders more choices in terms of the transfer agent they use and (b) permitting some degree of bundling of remittances so that the average remittance cost could be reduced by spreading fixed costs over a larger amount. Bundling may require new credit facilities in sending and receiving countries to ease liquidity constraints faced by individual remitters. Facilitating the use of the banking system for remittances may also encourage more widespread use of other banking services. It is observed, for example, that 14–28 percent of non-members who came to credit unions affiliated with the World Council of Credit Unions to transfer funds ended up opening an account (Grace 2003).

Harmonizing electronic transfer systems

Harmonizing electronic funds transfer systems could reduce the cost of remittances. Currently, major transfer agents and banks use their own (costly) proprietary systems to send remittances.² If funds were channeled through Fedwire,³ an electronic transfer system developed and maintained by the U.S. Federal Reserve System, the cost per transaction would drop to around 45 cents per

transaction. The SWIFT messaging system used by commercial banks costs less than 15 cents per transaction. If an automated clearinghouse mechanism—similar to the FedACH mechanism agreed to by the United States and Mexico—were arranged between financial institutions, costs of transfers could drop to a few cents per transaction.⁴ Use of debit and credit cards and automated teller machines would reduce labor costs.

Removing exchange-rate restrictions

Moving toward a more liberal exchange-rate regime is a powerful way to encourage remitters to use formal channels. The exchange premium resulting from exchange controls can be a major drain on remittances to developing countries. For example, in the case of the República Bolivariana de Venezuela, which currently has dual exchange rates, nationals who remit funds through official channels may lose more than half of the value, compared with one estimate of the market rate.⁵ A recent IMF-World Bank study (El Qorchi and others 2003) found that informal transfers had fallen substantially since the 1980s with the dismantling of exchange controls and the disappearance of the premium on black-market currency exchanges.

Notes

1. Following the discussion in *Global Development Finance 2003* (chapter 7), remittances are calculated by combining workers’ remittances, compensation of employees, and migrants’ transfers. Although some authors argue that remittances should also include local withdrawal of nonresident deposits (Kapur and McHale 2003; Jadhav 2003), we do not include this item in our definition. Also, our definition may not fully capture remittances in kind, for example, when the recipient receives goods instead of cash. See Ndarishikanye (2003) for a description of such remittances from Canada to the Caribbean.

2. Major transfer systems are Western Union, MoneyGram, eBay’s PayPal, VIGO, and those used by major banks involved in the remittance business, such as Citibank, Wells Fargo, and Bank of America.

3. There are two difficulties with using the Fedwire for fund transfers. First, it can be accessed only by banks, so migrants without a bank account cannot use it. Second, it is a real-time gross settlement system in which payments are final and irrevocable. That finality raises some thorny issues in the context of cross-border transactions. How can a payment be recalled if by mistake it is delivered to the wrong addressee?

4. The automatic clearing house (ACH) between the United States and Mexico began one-way fund transfers to Mexico in November 2003. Two-way transfers are expected to go into operation in the latter half of 2004. The

Philippines has signed a memorandum of understanding with the United States for a similar arrangement.

5. Morgan Stanley used the rate of 2,483 bolivares per U.S. dollar on November 17, 2003, to calculate the MSCI Standard Venezuela Index. The rate was derived indirectly using the price of CANTV stock in the local market, and the price of its American depository right listed in New York. The official exchange rate on that day was 1,596 bolivares to the dollar.

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