# Remittances in

## A Lifeline to Poor Countries

Dilip Ratha

REMITTANCES, funds repatriated by migrant workers to family and friends back home, provide the most tangible link between migration and development. But only 3 percent of the world's population (just over 200 million people) has migrated to another country, so migration cannot substitute for domestic development and job creation except in tiny countries.

Because remittances are unilateral transfers—gifts, if you will—they do not create liabilities. And they usually come with advice—from migrants who have seen better—on how to best use them. Thus, remittances are not simply money, but value-added money.

Officially recorded remittances to developing countries reached $330 billion in 2008. The true size, including unrecorded formal and informal flows, is believed to be significantly larger. Remittances total at least three times official development assistance and are the largest source of external financing in many developing countries. In India, remittances exceeded $50 billion in 2008, surpassing all official and private capital flows. In Mexico, remittances are larger than foreign direct investment inflows. They exceed tourism receipts in Morocco, revenue from tea exports in Sri Lanka, and the revenue from the Suez Canal in Egypt. While the volume of remittances in dollar terms tends to be larger in big countries such as India, China, and Mexico, the share of remittances in gross domestic product (GDP) tends to be higher in smaller and poorer countries. In 2008, remittances exceeded half the GDP in Tajikistan and Haiti, and over 10 percent of GDP in 23 countries.

Remittances tend to be a stable, and often countercyclical, source of foreign exchange earnings. Migrants usually send more money when the family back home experiences hardships, for whatever reason, and therefore remittances act as insurance against economic adversity.

Remittances have been remarkably resilient during the global economic crisis. Newly available estimates show that remittances fell by 6 percent in 2009—compared with a one-third drop in foreign direct investment and a near-total collapse of private portfolio flows. Remittances have provided a lifeline to the poor in conflict countries such as Afghanistan, Haiti, and Somalia.

Remittances help reduce poverty. In Nepal, the poverty headcount declined by 11 percentage points between 1995 and 2004, with a third to a half attributable to remittances, many from India, another poor country. Household surveys have shown that remittances may have reduced the share of poor people in the population by 11 percentage points in Uganda, 6 percentage points in Bangladesh, and 5 percentage points in Ghana. Cross-country analyses have shown that a 10 percent increase in officially recorded per capita remittances may lead to a 3.5 percent decline in poor people.

Remittances are associated with increased household investments in education, entrepreneurship, and health. Studies based on household surveys in El Salvador and Sri Lanka found that children of remittance-recipient households have lower school dropout rates and that these households spend more on private tuition for their children. In Sri Lanka, children in remittance-receiving households have higher birth weight, suggesting that remittances enable households to afford better health care. Several studies also show that remittances provide capital to small, credit-constrained entrepreneurs.

Remittances reduce poverty, increase welfare, and provide foreign currency that enables countries to pay for essential imports and service external debt. That in turn improves access to international capital markets. Commercial banks in several countries—including Brazil, Mexico, El Salvador, and Kazakhstan—have used future flows of remittances as collateral to raise billions of dollars in financing at cheaper interest rates and longer maturities.

There are critiques of remittances. At a macroeconomic level, large and sustained remittance flows may lead to currency appreciation, with adverse consequences for exports. Some researchers say remittances allow governments to delay public investments (such as in schools or roads) or push off long-term economic reforms. There is little empirical support for this position, mainly because of methodological difficulties associated with reverse causality: poor countries with weak institutions and low economic growth tend to receive large remittances. The chain runs from weak institutions to large remittances, not the reverse.

Some analysts say remittances dampen growth because recipients may become dependent on them and work less. Evidence is inconclusive, in part because remittances have their greatest impact during economic downturns when jobs decline and in part because any effect on permanent behavior takes root over a long time. On the other hand, because remittances finance education and health and alleviate credit constraints for small entrepreneurs, they may enhance growth. To the extent that they increase consumption, remittances may increase individual income levels and reduce poverty, even if they do not directly improve growth. ■

*Dilip Ratha is Lead Economist in the World Bank's Development Prospects Group.*

POINT

COUNTERPOINT

# Development

## A Wobbly Crutch

*Ralph Chami and Connel Fullenkamp*

MANY economists are optimistic that remittances can be a major contributor to economic growth and development, and it is impossible to deny that remittances help lift millions out of poverty. But remittances do not represent a first-best solution to the problems of poverty and development. Far from it. They are costly to those who receive them and are difficult to channel into activities that lead to economic growth and development. They also have unintended consequences that may even make them obstacles to development.

Remittances aren't cheap for those who earn them. One or more family members—usually those most important to the family's well-being, such as the head of household—must make a long, expensive, and often dangerous trip, remaining apart from their family for months or years at a time. This places a tremendous burden on those left behind, economically but also emotionally. Children of remittance-receiving families often grow up without the benefit of close contact with both parents, and the entire family's stress level is heightened by the absence of one or more members. For example, involvement in gangs by children left behind by remitting parents has been reported in several countries. All of these factors make the pursuit of remittances a costly, risky investment for families. Who would want to make this investment, other than the truly desperate?

These transfers are intended to provide for people's basic need for food, clothing, and shelter. The effort to lift people out of poverty is laudable, and numerous survey studies on the use of remittances have concluded that remittances have always been overwhelmingly directed toward consumption and not investment activities. But we should not expect remittances to be engines of growth in the same way as foreign direct investment.

Even when remittances are "saved" by households, this typically means that the household uses the funds to purchase land or a better home or for home improvement. This generates very little new capital or other economic activity. Research on the effects of remittances on growth finds, at best, no robust, positive effect on economic growth and often reveals a negative effect (Barajas and others, 2009). For years, many countries have received huge amounts of remittances, relative to their gross domestic product, but there is not one example of a country that has exhibited remittance-led growth. Where is the remittances success story?

Remittances also have many unintended consequences because they are gifts rather than earned income. Recipients may not look as hard for work or put as much effort into schooling if they know they can count on remittance income to supplement or replace their wages. Researchers have found evidence that recipients of remittances reduce their labor force participation. To the extent that people do make investments with remittance income, they have an incentive to take on riskier projects, because they are betting with other people's money. Many remittance-receiving regions report anecdotal evidence of local real estate price bubbles funded in large part by remittances. Thus, remittances can distort asset prices and actually exacerbate poverty by pricing many poor families out of the real estate market—not to mention the adverse consequences for everyone after the price bubble bursts.

An even more insidious effect of remittances on economic development and well-being is their impact on institutions and governance. A remittance-receiving household no longer has to care as much about the quality of the government and its ability to provide infrastructure and institutions that facilitate growth. If conditions are bad at home, families send more members abroad and use remittance income to compensate for the lack of government services. They lose interest in pressuring the government to deliver better services. The government, for its part, does not feel compelled to provide these services because it realizes that these households can fend for themselves, and the quality of government declines even further.

Remittances are not the highway to a better future. They are a wobbly crutch that millions of people must rely on because there are no better ways to support themselves in their country. The vast expansion of remittances should not be taken as a positive sign of better times ahead, but as a reprimand to policymakers, who should be working harder to improve opportunities for their citizens at home. ■

*Ralph Chami is a Division Chief in the IMF's Middle East and Central Asia Department, and Connel Fullenkamp is Associate Professor of the Practice of Economics at Duke University.*

*Reference:*

*Barajas, Adolfo, Ralph Chami, Connel Fullenkamp, Michael Gapen, and Peter Montiel, 2009, "Do Workers' Remittances Promote Economic Growth?" IMF Working Paper 09/153 (Washington: International Monetary Fund).*