

Remittances in

A Lifeline to Poor Countries

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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 percent-

age 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. ■

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