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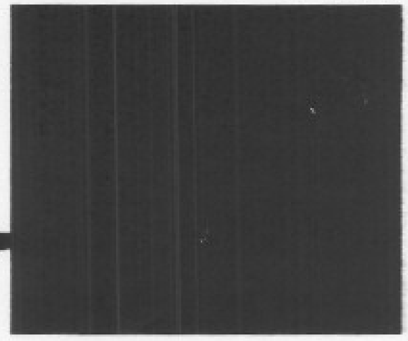

Development

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. ■

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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).