



Remittances

"The money of the migrants"

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Migrants' remittances

In the course of globalisation and liberalisation, international and domestic migration is a phenomenon of increasing importance. Globally, around 200 Mio people are migrating yearly (Orozco, 2003), most of them workers - predominantly male - moving towards towns or countries with better income opportunities than in their place of origin. The phenomenon is well known in Europe and is part of daily life in developing countries. Domestic and international migration has become a strategy for individuals and families in developing countries to cope with poverty and economic crisis. Migrants attempt not only to improve their own livelihoods abroad but they send a considerable share of their earnings back home to their families. These funds sent back home to families are called remittances. Remittances are thus interlinked with migration, and often a cause for migration. Historically, also in Europe, remittances played a role in sustaining and developing societies and regions. Current interest in remittances is high because they are seen as the "new development finance" (Wimaladharmasiri et al. 2004). Questions to look at are: What are volumes and scope of global and regional remittances? What is the development role of remittances? How is this money used? How does the market for transfer of remittances function? What is the interest of remittances for donors?

Two main types of remittances can be distinguished: workers remittances and communal or collective remittances. Worker remittances are funds transferred from one individual or household to another at international or domestic level. Studies from Latin America showed that remittances are transferred frequently and in relatively small amounts. The majority of Latino migrant workers in the US for instance transfers money to their families at least once a month whereby most remitters dispatch between \$100 to \$300 at a time (Suro 2003). Receiving households are more likely to be headed by a single female e.g. 63% for Latin America or by older family members. Communal remittances are funds

sent by migrant associations or church groups to their home communities, usually with an intended use in the home community.

Volumes of remittances

The global flow of remittances has been growing fast and steadily in the last decade. In 1991 workers' remittances back to developing countries reached \$33 billion; 2002 it mounted up to \$80 billion. Taking the informal and domestic flows of remittances, which are not recorded in statistics, the volume is estimated to be as high as \$200 billion yearly. Looking at the official figures, remittances have become the second largest capital inflow to developing countries behind foreign direct investments (FDI), which are accounting for \$180 billion and ahead of official development assistance (ODA), which accounts for \$53 billion (Ratha 2003). By region, remittances contribute most significantly to total capital flows to the Middle East (72%), North Africa (54%), the Caribbean (51%) and South Asia (51%) (Sanders, 2003a). In Sub-Saharan Africa, ODA is with 50% still the most important source of international money flows. For many of the low- and middle-income countries, remittances represent a significant percentage of the total gross domestic product (GDP). The five top receivers by percentage of GDP are Tonga (South Pacific) (37%), Lesotho (27%), Jordan (23%), Albania (17%), Nicaragua (16%). In absolute figures, the five top receivers are India (\$10 billion/a), Mexico (\$9.9 billion), Philippines (\$6.4 billion), Morocco (\$3.3 billion), Egypt (\$2.9 billion). The United States (\$28.4 billion/a) and Saudi Arabia (\$15.1 billion) are the largest source of workers' remittances to developing countries. Other top sources are Germany, Belgium and Switzerland, which account for about \$8 billion each. (Ratha 2003).

Compared to FDI, ODA and stock markets, remittances were one of the least volatile sources of foreign exchange earnings for developing countries in the 1990s. While FDI, ODA and earnings from stock markets tend to rise during favourable economic cycles and fall in bad

times, remittances show more stability over time or even rise during crisis (Ratha, 2003).

Development role of remittances

Remittances increase the foreign exchange earnings of the countries as well as the income of the receivers. The sheer volume of remittances of selected countries indicates that remittances do have a positive effect on the receiving households in terms of improved standard of living, which triggers a positive effect for the local economy due to increased consumption and investments. However there is no consensus to what degree remittances contribute to economic growth and employment creation. The example of Mexico shows a clear multiplier effect; for every dollar received from workers' remittances the GNP is estimated to increase by almost 3 dollars (Ratha 2003). On the other hand, Sanders (2003a), Orozco (2003) and Suro (2003) demonstrate that generally there is little multiplier effect of remittances in the receiving countries.

Most studies reveal that up to 80% of remittances are used for basic household consumption and 5-10% are used to invest in human capital such as education, health, and better nutrition. Third important turned out to be investments in land, housing and livestock, often seen as (future) assets of the emigrants themselves. Smaller portions of remittances are spent on socio-cultural events, for loan repayments, savings and generally only little is invested in employment and income generating activities other than agriculture and livestock (Sanders 2003a and Suro 2003).

Nevertheless, other examples in rural Mexican areas show that remittances spent on productive assets such as land, cattle and equipment allowed rural households to continue the agricultural activities and thus to strengthen their livelihoods. A study on micro-enterprises in Mexico revealed that remittances were responsible for 27% of the capital invested in micro enterprises (Orozco 2003) and a survey in Albania found that 17% of the capital to establish enterprises came from remittances (Sander

2003a). However, the rate of investment into productive activities depends on political stability and sound economic policy of the country.

For poorer households, remittances can be a source to build up savings. Suro (2003) shows that an average of 6% of the remittances go into savings in Central America. The world council of credit unions (WOCCU) estimates that 10% of the money transfers through their remittances network (IRNet) goes into savings and as a result, some receivers open a bank account and thus become bankable (Sander 2003a). Furthermore, remittances have an insurance function for vulnerable households (Orozco 2003).

Collective remittances are more often used for investment in the village or town, that improve living conditions of community members i.e. schools, churches etc. Examples are the large remittances that hometown associations mobilized after the hurricane Mitch in Nicaragua or the construction of the University of Hargeisa financed by the Somali diaspora (Sander 2003a).

However, there are also risks and possible negative effects of remittances. Higher income of households through remittances can remove pressure from governments to implement economic and social reforms. Further questionable effects that have been observed are inequitable growth at the community level. Very poor households can often not afford to send a family member to work abroad. Moreover, a study from Pakistan shows that the richest households usually receive more remittances, which increases the income gap (Ratha 2003). Extensive land purchases by remittance recipients can lead to higher prices for land, which affects poor households in the agriculture sector. Other authors argue that there is a risk for recipients of remittances to develop a culture of dependence, which does not favour self-initiative (Bagasao, 2004). Further concerns express that through migration a drain of skilled labour and taxpayers has a negative impact on a country's development. Other researchers

state that the inflow of remittances offsets the losses that a developing country suffers from emigration (Ratha 2003).

The money transferring market

The choice of the right provider for remitting money depends on an interplay of factors at both the senders and the receivers end. The main criteria for the choice of remittance channels are accessibility (familiarity, proximity, talk the language of the client), costs and quality of the service (quickness, trust, reliability). The choice of service is often limited at the receiving end due to the lack of an outlet near the receiver's home, especially in rural areas, which tend to be much less serviced by the financial institutions. Thus, accessibility of a service is often as important as the costs.

The formal channels are represented by commercial banks, money transfer operators (MTOs) and to some extent by postal banks. Sending money by banks is reliable but expensive, slow and sometimes difficult to access in receiving countries due to scattered branch networks. Further, banks require bank accounts on both ends, thus interest of rural populations is limited, while better off segments of remitters use more often banks. MTOs (e.g. Western Union, MoneyGram, VIGO) are well accessible in many centres in both senders and receiving countries, fast and reliable but expensive (Orozco 2003). Surveys proved that MTOs are the most popular among the formal channels (Suro 2003, Sander 2003b), especially in countries with a weak banking sector.

Examples of informal channels are the so-called Hundi or Hawala transfer systems, which build on trust relationship. The sender conveys the money to an agent, who communicates by phone, email or fax with another agent in the receiving country, who then pays the amount to the receiver. Agents can be import-export traders, travel agents, foreign exchange bureaus, etc. These services proved to be reliable, cheap, fast and accessible also in rural areas. In the aftermath of September 11 such informal services experienced pressure for regulation and supervision

because they are seen as instrumental for criminal money transfers (Maimbo & Passas 2004). Other informal channels such as transfer via relatives and friends or by ordinary postal service seem to be used by 17% of all remittance senders (WOCCU 2004). Average cost to remit money is about 13% of the remittance value, usually MTOs being the most expensive before banks. Cheapest options are informal channels usually charging 3-5% of the value.

As for domestic and regional transfers micro finance institutions do have a potential to engage in the remittances market. Cases of credit unions, postal banks, micro finance banks, rural development banks, etc. in Africa and Latin America doing remittances business are documented (Sander 2003b). It shows that most of these MFIs are fully licensed banks and many are in a sub-contract relation with an international MTO, e.g. Kenya Post Office Saving Bank partnering with Western Union. MFIs' comparative advantage is proximity to clients and outreach. The emerging information technology even in rural centres makes them more competitive. An interesting initiative from the World Council for Credit Unions (WOCCU) is the international remittances network IRNet, which facilitates remittance distribution through credit unions by partnering with VIGO, the third largest MTO worldwide. This system joins the advantages of both the credit unions' proximity to clients especially in the receiving countries, and the MTO's transferring experience and dense network in the sending countries (WOCCU 2004). Other examples of MFIs engaged in remittances are the National Microfinance Bank of Tanzania, Uganda Microfinance Union, Centenary Rural Development Bank in Uganda and Teba Bank for mineworkers in South Africa. In Latin America there are examples such as the Banco Solidario in Ecuador and PRODEM in Bolivia. The Microfinance Bank in Kosovo is also engaged in remittance transfers (Sander 2003b).

Important readings

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