Migration, remittances and development

The money that migrants send back home is an important source of revenue for families, but also for developing economies. How can the productive use of these remittances be enhanced? The ILO is studying the options.

Judith van Doorn
Social Finance Programme
ILO

Throughout the world, labour migration has become a major source of support for poor families in developing countries. Substantial amounts of remittances move between regions, through different mechanisms. Remittances are migrant workers' earnings sent back from the country of employment to the country of origin. Taken together, these small money transfers, between US$250 and US$300 per transaction, repeated eight to ten times a year,[1] amount to over US$105 billion (1990).[2] These numbers in themselves are very impressive. Yet in fact, they only reflect the tip of the iceberg, since they do not include remittances sent through informal channels (e.g. handcarriage, family, friends, money couriers or networks of transfer agents).

It is impossible to determine the value of informal remittances globally, since data on these transactions are obviously difficult to obtain. One can, however, get an impression of these transfers from the findings of selected studies. In Egypt, Pakistan, the Philippines and Sudan for example, informal remittances were found to be at least double or triple the recorded figures.

By the end of the 1990s, Egypt, India, Mexico, Portugal and Turkey were the main remittance-receiving countries. India received US$9.4 billion in 1998, Mexico US$5.6 billion, Turkey US$5.4 billion, Egypt US$3.5 billion and Portugal US$3.2 billion. Other major remittance-receiving countries include Bangladesh, Dominican Republic, El Salvador, France, Jordan, Morocco, Nigeria, Pakistan, Spain and Yemen. Together, these countries composed the "top 15" remittance-receiving countries in 1998.

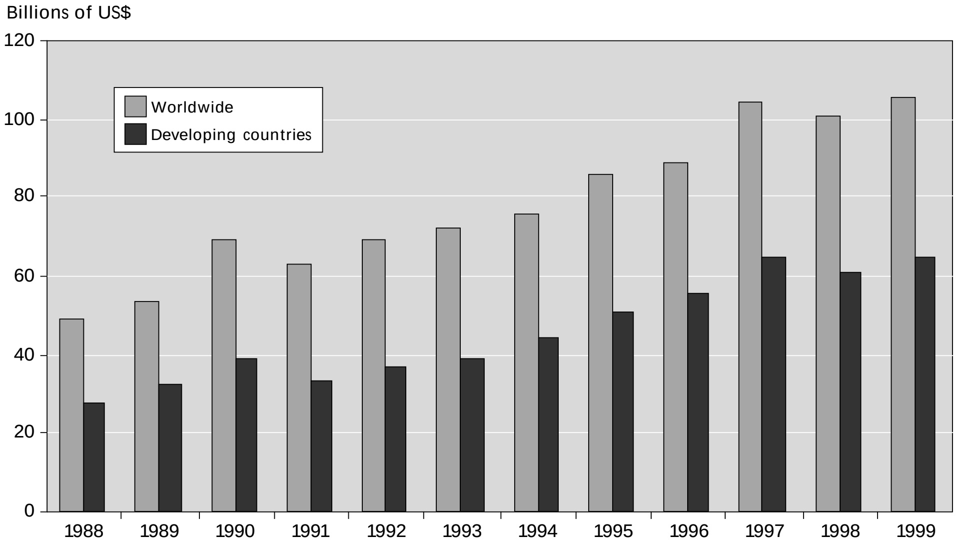
A good measure of the weight of remittances is their proportion to a country's population, its gross national product (GNP) or other income-generating activities like merchandise exports and tourism. In Cape Verde, for example, remittances exceeded the country's exports by 16 to one in 1994. In the same year, remittances made up over 75 per cent of merchandise exports in Egypt, El Salvador and Jordan, and 25 per cent or more of merchandise exports in Bangladesh. A study of Bangladesh further revealed that in recent years, remittances financed around 43 per cent of the development budget.

Remittances and development

Remittances have the potential to create positive outcomes for the migration source areas. Their scale is considerable, as can be seen when looking at the total amount of remittances compared to official development assistance (ODA). In 1999, developing countries received US$65 billion in official remittances, exceeding the US$54 billion of ODA in the same year.[3]

Remittances can contribute to reducing inequalities resulting from globaliza-

Figure 1. Trends in remittances (in billions of US dollars)



Source: http://migration.ucdavis.edu/Data/remit.on.www/remittances.html

tion, in particular since almost two-thirds of all remittances are sent to developing countries.

Attractive investment opportunities in the country of origin can capture remittances for the stimulation of production and employment. Furthermore, for migrant workers it is important that the transfer of funds takes place in a cost-effective and safe way, and should not be subject to policies and regulations that direct the use of remittances. There are some issues that need to be resolved to ensure that migrants, their families and the economy as a whole can fully benefit from these financial transfers.

Firstly, interesting investment alternatives are mostly absent, and remittances are hardly used as a leverage to access other services. Secondly, there are some suboptimal conditions in the money transfer market. Services may be unsafe, and markets may be monopolistic and non-transparent. High transaction costs in remittances mean money lost to the workers. Thirdly, some governments impose the use of (expensive) transfer mechanisms, or otherwise reduce the migrants' free choice in channeling remittances.

These issues touch upon the rights of migrant workers. Some ILO Conventions refer to the importance of facilitating migrant workers' remittances. They also state that migrants should be able to remit funds voluntarily to their families back home, and that arrangements should be made to encourage voluntary forms of thrift. Finally, they emphasize that productive investments should be increased in those countries that are characterized by a lack of employment opportunities and a shortage of capital.

The ILO follows three approaches to maximize the benefits of remittances to migrants, their families and the wider community:

- Follow-up to ILO labour standards, to ensure that migrant workers have the right to transfer (part of) their earnings and savings through their preferred channel;
- Improvement of remittance services, to reduce leakages in the transfer process;
- Introduction of market-conforming investment opportunities to increase the development potential of remittances.

Follow-up to ILO labour standards

In most countries, remittances can be transferred freely and through channels preferred by migrants and their families. Yet some governments regulate remittance transfers, with the objective of earning foreign exchange or taxes. Several countries have established limits on the amount that can be transferred without the obligation to declare the transaction. In Brazil and Colombia, international money transfers are controlled by government regulations. In Brazil, international transfers must go through Banco do Brazil, resulting in a time-consuming and expensive process. In Colombia, money transfers are restricted to a maximum of US$7,500 at any time. Residents of Colombia are also charged a 3 per cent tax on the money received. Other countries differentiate between transfer of currency by migrants for permanent settlement and by those for temporary stay. Sri Lankan legislation states that citizens of Sri Lanka employed abroad are obliged to remit a part of their earnings in foreign exchange. The legislation in Viet Nam is even stricter. It states that its nationals working abroad for a limited period of time are required to pay 30 per cent of their earnings to the Government. The Overseas Workers' Investment Fund in the Philippines, on the other hand, does not direct the use of remittances, but rather encourages overseas nationals to participate in official remittance schemes and to reduce the country's debt burden, on the basis of an incentive scheme. The Government of Mauritius emphasizes the importance of the status of the migrant. It allows migrants to transfer freely any amount on the condition that they are in possession of a work permit. Some of these regulations encourage migrants to shift to informal transfer services.

Improving remittance services

The quality and reliability of remittance services varies widely across the world, and research on this issue is limited. Yet it appears that the main concerns pertain to the risk involved in the transaction, the transparency of the transfer costs, and the speed and efficiency of the service.

Naturally, the first issue is the most worrying. Money may get lost in the transfer process. Anecdotal evidence reveals that this risk is considerable in the case of hand-carriage. Migrants may be robbed, or may have to pay large bribes to get their money across the border. Similar concerns arise when the money is given to a friend or acquaintance. In this case, trust is also a major issue. This risk not only concerns informal transfer mechanisms; formal transfer systems can also be quite risky. An ILO study on remittances in Bangladesh revealed that ten out of 100 remittance-receiving families faced problems with the *hundi* (illegal banking channels) transfer agent system, whereas 19 people encountered problems with official transfer methods.

The costs of transfer and transparent information on these costs are another concern. Some markets are being monopolized, and information on the transfer costs (in particular the exchange rate and the costs at the receiving end) is often not well communicated. In the United States, migrants' associations have initiated legal action against international money transfer agencies like Western Union and MoneyGram. They claim that commissions, fees and exchange rates are not always clearly communicated to remitters, and that the international money transfer sector is characterized by limited competition and low transparency. As a result of increased monitoring and competition in some Latin American countries, international transfer agencies have become more accountable and transparent in their operations.

The speed of transfer services is also an issue. The ILO study in Bangladesh found that the minimum time required to transfer the remittances was one hour (*hundi*) and the maximum time was 25 days (bank draft). Some interviewees reported on "speed money" (i.e. bribes) that could speed up the process. Anecdotal evidence from China showed that some people, who were expecting remittances from relatives through the post office, had to wait one year to cash the money.

It thus appears that there is considerable scope for improving these remittance services. As can be learnt from the example of Mexican migrants in the United States, the migrants themselves (through their associations or other representative bodies) can take a lead role in addressing these issues. Yet in some countries, notably in the Middle East, migrants are not allowed to organize themselves, and naturally this complicates matters considerably.

One idea would be to engage employers in the transfer of remittances. This could address concerns of costs and duration of the transfer. Employers could also pool several transactions to reduce costs, and to ensure the safety and efficiency of transfers. These funds could be sent either to the employee's home account, or to another person, as indicated by the migrant. The ILO study on remittances in Bangladesh identified one case where a migrant in the United Arab Emirates (UAE) did not receive any salary. Instead, his family collected his salary from the employer's parents every two months. This is an example of a rather informal system, but obviously, more formal and systematic transfer mechanisms initiated by the employer can also be explored.

Market-conforming investment opportunities

Research on the use of remittances shows that a large part of these funds are used for daily expenses such as food, clothing and health care.[4] Funds are also spent on building or improving housing, buying land, cattle or durable consumer goods and the repayment of loans for migration. Generally, only a small percentage of remittances is used for savings, education and "productive investments". Despite the small percentages of these investments, they still add up to large amounts in absolute terms, due to the vast size of total remittance transfers.

Estimates of the impact of remittances at the household level vary widely. Yet it is acknowledged that remittances can make up a large part of the total household income. Studies of remittances in Senegal showed that 30 to 80 per cent of Senegalese household budgets were comprised of remittances.[5] Similar situations were found in other West African countries. In El Salvador, remittances constitute as much as 61 per cent of the household budget.[6] In Lesotho, dependency on remittances is even more widespread. The average miner was found to support seven people with remittances. In this country, only 22 per cent of households appeared to have other revenues to supplement this form of income support.[7]

The multiplier effect of remittances is considerable, even if they are used for consumption. A study by the Bangladesh Institute of Development Studies, for example, indicates that remittances in Bangladesh have a multiplier effect of 3.3 on GNP, 2.8 on consumption, and 0.4 on investment.

Yet, if geared towards productive investments, their impact can be even bigger. For this reason, some initiatives have been introduced to encourage such investments. Most of these initiatives are based on incentives, but some depend on regulations and compulsory requirements. Such initiatives can be undertaken at three levels:

- the household
- the community
- the wider economy (profit-seeking or socially responsible investments).

The first category, the household level, typically consists of a supplement to the family household budget. Remittances may be used to educate family members, to buy land or production materials or to generate savings. They may also be used to leverage access to credit, for example to support a family business, or to help returning migrants to set up a business upon their return.

Some financial institutions provide special savings services to migrants and their families. Prodem, a regulated microfinance institution in Bolivia, for example, offers migrants' families a premium interest rate if they deposit their remittances with the institution. It also provides easier access to small business loans to leverage remittances as collateral for such services. Banco Solidario in Ecuador has recently established a programme called "My family, my country, my return", which is geared towards Ecuadorian migrants living in Spain. This programme is implemented in cooperation with a Spanish bank (Caja Madrid). It provides a package of loans (to finance the migrants' travel back home or to set up a small business upon their return), money transfer services and savings schemes – for example, towards buying a house or land in their home country.

In India, migrant workers returning to their home countries are given preferential access to capital goods and raw material imports. This will help them to set up new industrial units or to participate in the expansion of existing businesses. Pakistani migrant workers can access a Non-repatriable Investment Scheme upon their return home. This scheme allows them, back in Pakistan, to import machinery and equipment at concessionary rates, provided that these funds are used to establish manufacturing enterprises in the country. As part of the service, the Investment Advisory Service of Pakistan undertakes pre-feasibility studies to facilitate the choice of investment projects.

The second category, the community level, consists of investments for the development of the migrants' community of origin. This type of investment is particularly common among migrants who have set up so-called "hometown" associations. These associations pool part of their savings in order to contribute to the development of their home region. Funds are typically remitted for a specific purpose, to build a school or community centre for example, or to improve water systems. Some governments provide "matching funds" to complement these social investments. One example is a project in the Mexican state of Zacatecas, where each dollar contributed in remittances is matched by three dollars (one from the municipality, one from the state and one from the federal Government). This programme has completed more than 400 projects in eight years, with a total investment from migrants of about US$4.5 billion.

The third category of initiative, those at the level of the wider economy, is the least common. There is probably also the least demand for these types of service, since the bulk of remittances are used to complement the household income, rather than to seek profit or to support small businesses or other "friendly" initiatives in migrants' home countries. Some programmes have been set up to identify suitable investment opportunities for migrants who want to invest in their home country. Yet information on the services provided is limited, as is the success of these services.

Conclusion

Remittances are the result of hard work by relatively poor people. Many of these migrants work under harsh conditions, and are often paid marginal wages. It is therefore crucial to maximize their benefits, and to reduce outside interference in the use of these funds. When planning to enhance their productive use, incentive-based initiatives, rather than regulatory and heavy-handed approaches appear most promising. Migrants and their families should be encouraged to allocate these funds in a way that enhances local development, as well as their individual needs. Current work by the Social Finance Programme explores the relative cost-effectiveness of remittance-promoting policies and the conditions for international cooperation.

Notes

[1] U.O. Osili: *Immigration and home country ties: What does it mean for Chicago?* Indianapolis, Indiana University-Purdue University, 2001; and IDB and IMF: *Remittances to Latin America and the Caribbean: Comparative Statistics*, Presentation at the IADB conference: "Remittances as a Development Tool: A Regional Conference", 2001.

[2] Including compensation of employees (these are remittances by migrant workers who stay abroad for less than one year).

[3] R. Faini: *Development, trade and migration,* Preliminary draft, IMF, University of Brescia and CEPR, 2001.

[4] More than three-quarters of Mexicans who receive remittances spend some part on health care, from *prepared statement of Dr. Susan Martin at Georgetown University,* http://banking.senate.gov/02_02hrg/022802/martin.htm

[5] IOM, 2000.

[6] Taylor et al. 1996.

[7] Sechaba Consultants – South African Migration Project: *Riding the Tiger: Lesotho Miners and Permanent Residence in South Africa,* Migration Policy Series No. 2, Cape Town, Institute for Democracy in South Africa, Queen's University, 1997.