Madrid Conference

September 23, 2005

Workers' Remittances and Economic Development

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Introduction

- Recent explosion of interest in remittances, among both policy and research communities.
  - G8 Summit, June 2004
  - IMF, *World Economic Outlook,* April 2005
  - World Bank, *Global Economic Prospects,* Oct 2005
- Remittance flows much larger than typically realized. Current estimates: around $150 billion
- Can help smooth crises, and foster economic and financial development
- But can also be abused to help launder money and finance terrorism

Key Messages

- Need to understand better:
  - True size and trends in remittance flows
  - Impact of remittances, both macroeconomic, and at household level
  - Determinants of remittances
- Policies must be designed to:
  - Reduce transaction cost of sending remittances
  - Strengthen formal financial infrastructure supporting remittances
  - Use remittances to improve financial access in recipient economies

Remittances to Developing Countries: Some Key Facts

- Rising steadily over time
- Currently, magnitude comparable to FDI flows. Exceed aid or portfolio capital inflows. For many countries, exceed 5% of GDP
- Very stable and smooth
- Not significantly pro-cyclical

Are Remittances Even Larger?

Previous discussion based on *official* data. In fact, *actual* magnitude of remittances unknown, but clearly larger

- Large share of remittances flow through *informal* channels (unregulated money-transfer providers, family / friends carrying remittances in persons)
  - Freund & Spatafora (2005): both model-based estimates and household surveys suggest informal remittances are 35-75 percent of official remittances.
- Even *formal* remittances often unrecorded, due to poor data collection
- Remittances often misclassified as exports, tourism receipts, non-resident deposits, or FDI

Macroeconomic Impact of Workers' Remittances

- Key mechanisms: remittances relax budget constraints, allow increased expenditure on:
  - Consumption
  - Housing
  - Education & health care
  - Investment (incl. starting up small businesses)
- In turn, this could:
  - Reduce volatility
  - Reduce poverty
  - Increase growth

Impact on Volatility

IV regression: Volatility and Workers' Remittances	
Dependent Variable	*Coeff.* on Workers' Remittances
Output Volatility	Negative, 5% sig.
Output Worst Drop	Negative, 1% sig.
Consumption Volatility	Negative, 1% sig.
Investment Volatility	Negative, 5% sig.
Controls: initial income, share of agriculture in GDP, trade openness, real overvaluation, institutional quality	

- Impact quite large: 5 p.p. increase in remittances/GDP associated with 1 s.d. decrease in output volatility

Impact on Poverty

IV regression: Poverty and Workers' Remittances	
Dependent Variable	*Coeff.* on Workers' Remittances
Poverty Headcount	Negative, 5% sig.
Poverty Gap	Negative, 5% sig.
Controls: average income, gini (Ravallion & Chen, 1997). These may themselves be influenced by remittances.	

- Impact small: on average, 5 p.p. increase in remittances/GDP associated with <1 p.p. decrease in share of people living in poverty.
- Adams & Page, 2004, obtain similar results.

Impact on Growth

IV regression: Growth and Workers' Remittances	
Dependent Variable	*Coeff.* on Workers' Remittances
Real Per-Capita Growth	Negative, not sig.
Education	Positive, not sig.
Investment	Positive, not sig.
Controls in growth eq.: initial income, education, life expectancy, investment, inflation, budget balance, trade openness, financial development. Controls in education & investment eq.: initial income, life expectancy, trade openness, financial development.	

Impact on Growth 2

- Growth impact may be hard to detect using macro data: endogeneity, long time-frame
- Detectable impact on certain sectors, e.g., construction
- Micro studies: typically do find impact on education, small-business formation (Woodruff & Zenteno, 2004; Hanson & Woodruff, 2003; Cox & Ureta, 2003; Brown, 1994; ...)

Determinants of Remittances

Magnitude of recorded remittances is largely driven by:

- Number of migrant workers, and their income
- Economic conditions in country of origin (counter-cyclicality)
- Transaction cost of sending remittances
- Economic distortions & restrictions (dual exchange rates, black-market premia, taxation)

Determinants of Remittances 2

Likewise, recent surge in recorded remittances largely reflects:

- Growth in migrant stock and incomes
- Falling transaction costs, and expanding networks in supporting industry
- Changing government policies
- Better data collection

Some Policy Implications

Government policies can increase remittance flows, and promote their transfer through formal channels, by helping to:

- Reduce transaction costs, and distortions & restrictions affecting remittances
- Improve banking access, and technology of money transfer

Transaction costs partly driven by:

- Concentration in banking sector
- Lack of financial depth
- Exchange rate volatility

Conclusions

- Remittances help maintain macro stability, provide safety net, and foster development.
- Can be encouraged by:
  - Stable, disciplined macro policies
  - Few restrictions on payments
  - Low transaction costs
- Growth impact of remittances could be magnified if they were handled through formal financial system, and were used to promote financial development

Conclusions 2

- More work needed on calculating flows through informal sector. In particular, need household surveys in *sending* (not just recipient) countries
- Reminder: make sure to read the World Bank's next *Global Economic Prospects*, to be released next month! Will feature in-depth analysis of remittances

Thank You

September 23, 2005