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International Remittances: A Primer

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Summary

The international market for remittances is between $70 billion and $80 billion per year. Of all forms of international capital flows, remittances — or monies sent home by foreign workers overseas — is the most stable, reacting least to international politics or events. For many countries, remittances are a major, and sometimes the primary, source of income for consumption and investment. Moreover, the presence of remittances in the international economy presents several policy concerns for the United States. These range from making remittance services as cheap, and yet as safe as possible to possible implications for U.S. immigration policy. This report will be updated.

Introduction

In a speech to the World Bank on September 22, 2003, Secretary of the Treasury Snow stated that "Remittances from the developed countries to people in poor countries play a crucial role in economic development, with recorded flows reaching over $70 billion per year and far exceeding official development assistance." He further added, "Actual flows are believed to be significantly higher given that remittances often flow through informal channels. The use of informal channels indicates that there is room for improvement in our formal financial systems and that we can reduce the cost of remittances thereby increasing the flows significantly."[1] Unlike private flows or official assistance, remittances are "unrequited," meaning there is no corresponding claim on the assets of the foreign country. The United States is the largest source of remittances, sending around $23 billion in 2002, according to the International Monetary Fund. This represents a very small percentage of the U.S. balance of payments. Any negative economic effect of these outflows on the U.S. economy would be negligible.

In his address to the World Bank, Secretary Snow highlighted two important points: (1) remittances are a major source of capital for developing and less developed countries and (2) a significant amount of global remittances are transmitted through unregulated

[1] Statement by U.S. Treasury Secretary John Snow to the World Bank Development Committee, Dubai, UAE, September 22, 2003.

informal mechanisms, which can be easily corrupted by money laundering and terrorist financing.

International worker migration accounts for around 3% of the global population. At first glance, this might appear a trivial number, yet, according to one study, there are over thirty million immigrants in the United States alone, with most of them sending money back home to their families.[2] According to Wayne A. Abernathy, Assistant Secretary of the Treasury for Financial Institutions, "Remittances are quickly becoming the central source of new capital for many countries."[3] "[S]uch massive private giving — worth almost twice U.S. ODA (official development assistance) is changing the nature of development," states Carol Adelman, formerly with the U.S. Agency for International Development.[4]

Background

One analyst posits two reasons for the migration-remittance cycle.[5] The first is pure altruism. A citizen leaves his country and remits money to take care of those left behind. The other extreme would be pure self-interest. The remitter wants to invest his income in his home country and sends the money to his family to take care of, giving a small amount of it to them as payment for looking after his funds. In between the two extremes are reasons that have come to be known as the New Economics of Labor Migration.[6] This theory sees remittances as an intertwined network between the migrants and those living back home. Sending migrants abroad is often an investment decision and an effort by households to overcome local market failures and constraints. For example, if a developing country cannot employ its population, a household can "invest" its abundance of labor by sending part of the population abroad. The remittances sent back are the "returns on investment" for the family.

The International Monetary Fund and World Bank define remittances as the sum of three components: (1) the money value of transfers sent to their home country from workers living abroad for longer than one year, (2) compensation of border, seasonal, and other nonresident employees, and (3) migrants' transfers, or the net worth of migrants who move from one country to another.

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[2] Manuel Orozco, "Worker Remittances: An International Comparison," Inter-American Dialogue Working Paper, 2003.

[3] Wayne A. Abernathy, "Testimony before the House Committee on Financial Services," October 1, 2003.

[4] Carol C. Adelman, "The Privatization of Foreign Aid: Reassessing National Largesse," *Foreign Affairs*, November/December 2003.

[5] J. Edward Taylor, "The New Economics of Labor Migration and the Role of Remittances in the Migration Process," *International Migration*, Vol. 37, 1999.

[6] Oded Stark and David E. Bloom, "The New Economics of Labor Migration," *The American Economic Review*, Vol. 75, No. 2, May 1985, 173-178.

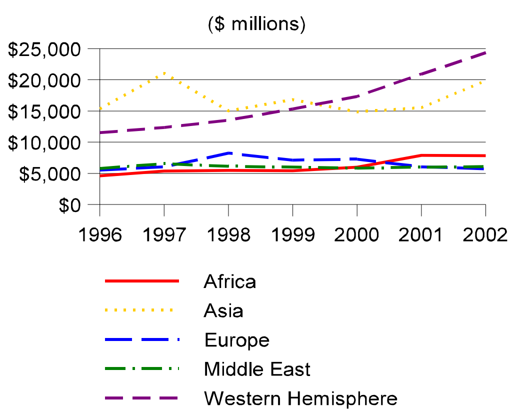
This definition does not include informal transfers, which some estimate account for up to 50% of total remittances.[7] According to one expert, "[w]hile it is difficult to measure accurately the total volume of financial activity associated with the system, it is estimated that, at a minimum, tens of billions of dollars flow through *hawalas* and other informal value transfer systems on an annual basis."[8]

Some analysts think that the official statistics may be becoming more reliable as the United States and other governments have cracked down on informal money transfer systems. For example, Pakistan recorded $2.4 billion in remittances in 2002 compared to $1.1 billion in 2001. This increase could reflect a true increase in the nominal amount of remittances, or rather a shift toward the formal sector.[9] For the most part, the collection of remittance data is an inexact science, with many countries not reporting flows.

Trends in Global Remittances

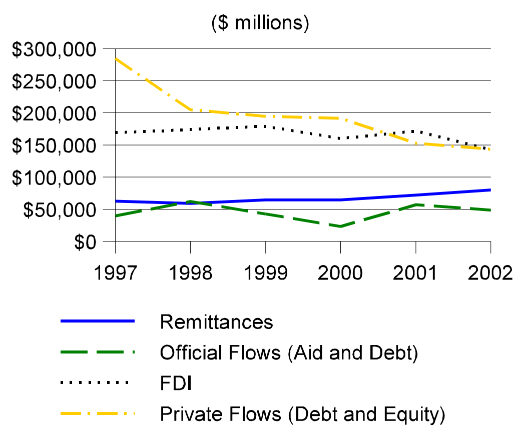
Total 2002 remittances were around $75 billion, with Latin America the largest recipient by far. Since 1996, the Western Hemisphere, primarily the countries of Latin America, has seen more than a 200% increase in remittances, from $11.5 billion in 1996 to $24.4 billion in 2002.[10] While Asia saw a spike in remittances around 1997 due to the Asian Financial Crisis, following the crisis's resolution, remittances returned to pre-crisis levels and are only now, returning to their 1997 high. **Figure 1** charts global worker remittances by region from 1996 to 2002.

Figure 1. Global Remittances



Source: IMF

Figure 2. Developing Country Capital Flows



Source: IMF and World Bank

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[7] Dilip Ratha, "Workers' Remittances: An Important and Stable Source of External Development Finance," *Global Development Finance 2003*, World Bank, 2003, pg. 171.

[8] Testimony of David Aufhauser, General Counsel, Department of the Treasury, before the Senate Judiciary Committee, Subcommittee on Terrorism, Technology, and Homeland Security, June 26, 2003, pg. 9, "Hawala" translates from Arabic as "transfer" and is a money transfer system popular in the Middle East and South Asia.

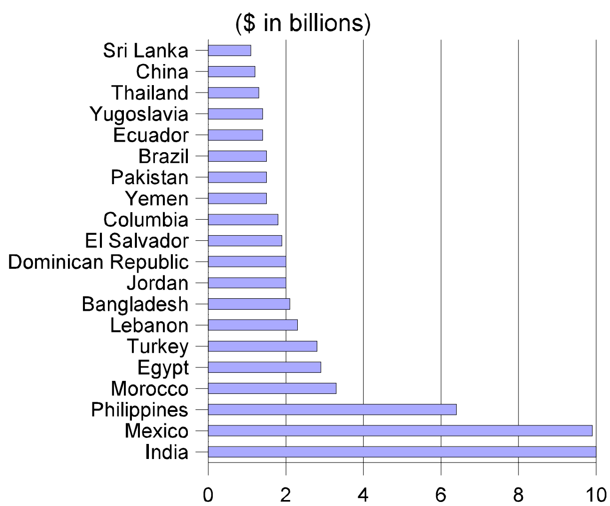
[9] Ratha, 171.

[10] 2003 Balance of Payments Statistics Yearbook, International Monetary Fund.

Of all the forms of international capital flows, remittances are the most stable. Private commercial capital flows tend to be "pro-cyclical." During times of economic expansion, such as during the 1990s, international investment, especially in the developing countries, increases. When the economy goes into a recession, as it did in 2001, private capital flows contract. Unlike private flows, remittances do not fluctuate with the overall international economy. **Figure 2** compares remittances to other forms of investment. Over the time period shown, remittances fluctuate the least, and are the only source of flows to developing countries that increased throughout the time period shown.

While remittances are larger than official sector flows, they are still substantially smaller than foreign direct investment (FDI) or private capital flows, yet the gap has narrowed in the past five years. The decline in private capital flows is consistent with the economic downturn during this period. One reason — among many — is that a contraction in the money base leads to less money invested in the developing countries, which are often considered riskier than investments in the developed countries.

Figure 3. 20 Largest Remittance Markets, 2001



Source: World Bank

Figure 3 shows the largest global remittance recipients. In addition to looking at the nominal figures, it is interesting to compare the top twenty nominal recipients with the countries where remittances comprise the largest percentage of GDP. The two largest remittance recipients on a nominal basis, Mexico and India, are not even within the top twenty countries when remittances are counted on a percentage of GDP basis. Although the Philippines receive the third most remittances in the world, as a percentage of GDP basis, they rank 24th. For countries such as Tonga, Lesotho, and Jordan, remittances represent between 1/4 and 1/3 of their GDP.[11] For these and other low income countries, remittances represent a much larger component of the economy than countries like India and Mexico that receive more remittances overall.

When remittances represent such a large component of a country's economic activity, if the remittance flows are interrupted, the consequences could be devastating. Following the collapse of the Somali government in 1991, remittances accounted for between a quarter and 40% of Somalia's total GNP.[12] Since Somalia lacked a formal banking sector, these remittances were sent largely through one firm, Al Barakaat. After Al Barakaat was shut down by the United States in November 2001 due to potential abuse

[11] Ratha, 159.

[12] Devesh Kapur, "Remittances: The New Development Mantra?," August 25, 2003, pg. 24, [http://www.wcfia.harvard.edu/papers/795__Kapur.pdf]

by terrorist financiers, Somalia lost $25 million to $27 million per month in remittances.[13] While many other companies have filled the void left by Al Barakaat, the Somali situation underscores a major policy concern for the United States regarding remittances: how to make remittances as cheap as possible for senders, yet also ensure that the system is secure from money laundering and terrorist financing, especially when countries use informal money networks. Moreover, if good money and bad money flow through the same channels, how can you only isolate the bad money to be stopped? By stopping all the flows, a large amount of ill-will and anti-U.S. sentiment is created among the majority of the population that relies on these remittances to survive.[14] Since informal systems are not subject to any systematic supervision, they have traditionally operated outside the purview of international regulators. Unlike banks, credit unions, or formal money transfer systems such as Western Union and MoneyGram, informal value transfer systems are difficult to regulate.

The Effects of Remittances on Developing Countries

Consumption. At its most basic level, remittances fund the consumption of goods and services in the local economy. For those in the developing and least developed countries, monthly remittances of just a few hundred dollars are enough to lift many out of abject poverty. Two examples are Ecuador and Cape Verde. Ecuador suffered a major economic and political crisis in the late 1990s. In 1999 and 2000 more than 267,000 Ecuadorians emigrated (primarily to Europe). Following this emigration, remittances jumped from an estimated $643 million in 1997 to $1.4 billion in 2001.[15] In 2000, the island of Cape Verde, off the coast of Africa had 435,000 people living on the island, with twice as many Cape Verdians living abroad. Approximately two-thirds of the families on the island receive remittances and for many of them it is the only source of income.[16]

Investment. Some analysts express concern that remittances to many countries are used solely for consumption, and thus have little, if any investment effect. Without money being saved and invested in development projects, it is difficult to stimulate economic growth. Other analysts state that if remittances increase the consumption of domestically produced goods and services, there are valuable multiplier effects that reverberate through an economy. Increased consumption can stimulate the local housing market, local agriculture, and textile industries.

Remittances can also help ease capital and liquidity constraints faced by entrepreneurs in developing countries. As noted earlier, many developing countries have

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[13] Abdulsamer Omer, "A Report on Supporting Systems and Procedures for the Effective Regulation and Monitoring of Somali Remittance Systems," *United Nations Development Program*, p. 15.

[14] In April, 2004, U.S. agents raided an Eritrean civic center that provided remittance services for immigrants, yet did not fully comply with Patriot Act requirements. See Allan Lengal and Mary Beth Sheridan, "Business For Fund Transfers Raided; U.S. Takes Records At Eritrean Center," *The Washington Post*, April 17, 2004.

[15] Brad Jokisch and Jason Pribilsky, "The Panic to Leave: Economic Crisis and the New Emigration" from Ecuador," *International Migration*, 40 (4), 2002.

[16] Kapur, 10.

weak banking sectors, with poor credit and financial markets. Some analysts contend that remittances can have a multiplier effect by forcing the development of banking and credit sector in developing countries.

The effect on investment is stronger for developing and transition economies. A 2001 study of remittances and migration in Eastern Europe found that remittances had a stronger effect on investment than they did on consumption.[17] In Egypt, a large number of migrants who returned in the late 1990s set up their own businesses using funds that they had earned working abroad.[18] Other analysts are not as sanguine about the effects of remittances. Chami, Fullenkamp, and Jahjah found that since remittances are compensatory (they increase as economic conditions worsen in the recipient country) and since they occur in an environment of asymmetric information (the sender cannot directly observe how the remitted funds are spent) as well as economic uncertainty, remittances can create a sense of dependency and a lack of incentive to increase productivity. Cape Verde, discussed earlier, provides an example of this phenomenon. In the countries they assessed, the authors found that remittances led to decreased output and lower levels of economic growth.[19]

Potential Issues for Congress

To date, Congressional interest has focused primarily on the cost and efficiency of official remittance services that cater to immigrant workers in the United States.[20] As immigrants continue to utilize the informal sector, additional regulation may be needed to insure the safety of these financial flows from money laundering and terrorist financing.[21] Following the September 11th attacks, the Bush Administration and the international community are taking various efforts to improve the informal sector and to make the formal banking sector as attractive as possible both for migrant remitters and for their families in their home country.

There may also be implications for U.S. migration policy. There is the issue of allowing illegal immigrants access to U.S. banking services, in the Mexican case, available by some banks through the *matricula consular* program.[22] U.S. officials may also wish to consider cost-benefit analysis of both the migration-remittance sector and U.S. foreign aid and development programs. These sectors can complement each other and many argue that their relative effectiveness should be assessed.

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[17] Miguel Leon-Ledesma and Matloob Piracha, "International Migration and the Role of Remittances in Eastern Europe, [ftp://ftp.ukc.ac.uk/pub/ejr/RePEc/ukc/ukcedp/0113.pdf].

[18] Ratha, 162.

[19] Ralph Chami, Connel Fullenkamp, and Samir Jahjah, "Are Immigrant Remittances a Source of Capital for Development?" *IMF Working Paper 03/189*, September 2003.

[20] See CRS Report RL31659, *Foreign Remittances to Latin America*, for a study of methods, costs, and policy issues related to U.S. bank and non-bank remittance-related financial services.

[21] See CRS Report RS21902, *Terrorist Financing: The 9/11 Commission Recommendation*.

[22] See CRS Report RL32094, *Consular Identification Cards: Domestic and Foreign Policy Implications, the Mexican Case, and Related Legislation*.