

Global Economic Prospects

Overview and
Global Outlook

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Overview

THE THEMES OF this year's *Global Economic Prospects* are international remittances and migration, their economic consequences, and how policies can increase their role in reducing poverty. International migration can generate substantial welfare gains for migrants and their families and for the countries involved (countries of origin and destination). The money that migrants send home—remittances—is an important source of extra income for migrants' families and for developing countries: in aggregate, remittances are more than twice as the size of international aid flows. However, migration should not be viewed as a substitute for economic development in the origin country—development ultimately depends on sound *domestic* economic policies.

Over the past two decades, barriers to cross-border trade and financial transactions have fallen significantly, while barriers to the cross-border movement of people remain high. Despite its economic benefits, migration remains controversial and, for some people, threatening. In part, this is because migration, like trade and capital movements, has distributional consequences, whereby net gains for society may mask important losses for some individuals and groups. But migration also sparks resistance because the movement of people has economic, psychological, social, and political implications that the movement of goods or money do not.

This publication has two goals. The first is to explore the gains and losses from international migration from the perspective of developing countries, with special attention to the money that migrants send home. The second goal is to consider policy initiatives that could improve the developmental impact of migration, again with particular attention to remittances. Our focus (for economic purposes) is on international migration from developing countries to high-income countries. Despite their importance, internal migration, migration among developing countries, and the political and social impacts of migration are beyond the scope of this work.

It is important to keep in mind three basic principles. First, migration is a diverse phenomenon, and its economic impact in one location or another depends heavily on the particular circumstances involved. Second, basic data on migration and remittances are lacking, so predicting the impact of policy changes can be problematic. This underlines the need for better data and more research. Third, migration has social and political implications that may be just as important as the economic analysis provided here. These are ably and comprehensively discussed in the recent report of the United Nations' Global Commission on International Migration. For all of these reasons, the analysis and policy recommendations for migration must remain qualified. This report draws conclusions where they can be

supported by adequate data and points to an agenda for research where they cannot.

Global economic prospects

The slowdown among industrial economies that began in the second half of 2004 continued in 2005, with GDP growth expected to come in at 2.5 percent, down from 3.1 percent the year before. The pace of the expansion in the high-income countries is forecast to increase slightly over the next two years, with acceleration in Europe offsetting a modest slowing in Japan and stable growth in the United States. Economic activity also slowed in developing economies during 2005. Higher oil prices, domestic capacity constraints, and slower demand for their exports brought GDP growth down from a very strong 6.8 percent in 2004 to an estimated 5.9 percent this year. While GDP growth has remained robust, higher oil prices have sharply slowed real income growth among oil importers from 6.4 to 3.7 percent. Looking forward, continued high oil prices, coupled with inflationary pressures, are expected to restrain growth in most developing countries over the next two years. Nevertheless, GDP in these economies should expand by around 5.5 percent—much more quickly than during the past two decades.

This relatively positive outlook is subject to important downside risks. The outlook for oil prices is particularly uncertain. Low excess capacity has introduced a risk premium into oil prices and will make it more difficult to contain the impact of a future supply shock, should one arise. As a result, a significant supply disruption could slow global growth, with large negative consequences for global economic prospects. The future path of interest rates, which despite recent increases are still low, is another source of uncertainty. Persistent global imbalances, signs of rising inflation, and concerns about the sustainability of government finances in industrialized countries are all factors that could push rates higher and possibly provoke a much more serious slowdown.

The impact of remittances and migration

The impact on migrants

The bulk of the economic gains from migration accrue to migrants and their families, and these gains are often large. Wage levels (adjusted for purchasing power) in high-income countries are approximately five times those of low-income countries for similar occupations, generating an enormous incentive to emigrate. Moreover, to the extent that migrants devote a portion of their income to remittances, the gains are even greater. Essentially migrants can earn salaries that reflect industrial-country prices and spend the money in developing countries, where the prices of nontraded goods are much lower. Migrants, however, incur substantial costs, including psychological costs, and immigrants (particularly irregular migrants) sometimes run high risks; many suffer from exploitation and abuse. The decision to migrate is often made with inaccurate information. Given the high costs of migration—including the risks of exploitation and the exorbitant fees paid to traffickers—the net benefit in some cases may be low or even negative. There are costs, too, for family members left behind—particularly children—although these costs must be balanced against the benefits of the extra income that migrants send back home to their families.

The impact on destination countries

Destination countries can enjoy significant economic gains from migration. The increased availability of labor boosts returns to capital and reduces the cost of production. A model-based simulation performed for this study indicates that a rise in migration from developing countries sufficient to raise the labor force of high-income countries by 3 percent could boost incomes of natives in high-income countries by 0.4 percent. In addition, high-income countries may benefit from increased labor-market flexibility, an increased labor force due to lower prices for services such as child care, and perhaps economies of scale and increased diversity.

Nevertheless, there are losers within destination countries. Some workers may see an erosion of wages or employment, although this effect is found to be small in most empirical studies. In the model-based simulation of the impact of increased migration, earlier migrants suffer significant income losses, while the impact on natives' wages is small. (The differential impact is reduced if foreign-born workers are viewed as closer substitutes for natives.) Easing rules that limit labor-market flexibility, and strengthening institutions that provide education and training, will help workers displaced by immigration (both natives and resident migrants) to find work. Note that the simulation results are not intended to incorporate all of the economic impacts of migration, nor do they capture important social and political implications. The goal is not to forecast the overall impact of increased migration, but rather to give us insights into the economic gains that might be expected from changes in policy or circumstances, as well as insights into the channels through which migration affects welfare.

The impact on origin countries

Migration also generates economic benefits for origin countries, the largest being remittances. International remittances received by developing countries—expected to reach \$167 billion in 2005—have doubled in the past five years as a result of (a) the increased scrutiny of flows since the terrorist attacks of September 2001, (b) changes in the industry that support remittances (lower costs, expanding networks), (c) improvements in data recording, (d) the depreciation of the dollar (which raises the dollar value of remittances denominated in other currencies), and (e) growth in the migrant stock and incomes. However, records still underestimate the full scale of remittances, because payments made through informal, unrecorded channels are not captured. Econometric analysis and available household surveys suggest that unrecorded flows through informal channels may conservatively add 50 percent (or more) of recorded flows. Several countries with significant migrant populations do not report data on

remittances at all, even those sent through formal channels, or they report remittances under other balance of payments entries.

Despite the prominence given to remittances from developed countries, South-South remittance flows make up between 30 and 45 percent of total remittances received by developing countries, reflecting the fact that over half of migrants from developing countries migrate to other developing countries.

While the impact of remittances on growth is unclear, remittances do play an important role in reducing the incidence and severity of poverty (with no significant effect on income inequality). Remittances directly increase the income of the recipient and can help smooth household consumption, especially in response to adverse events, such as crop failure or a health crisis. In addition to bringing the direct benefit of higher wages earned abroad, migration helps households diversify their sources of income (and thus reduce their vulnerability to risks) while providing a much needed source of savings and capital for investment. Remittances appear to be associated with increased household investments in education, entrepreneurship, and health—all of which have a high social return in most circumstances.

Measuring the poverty impact of remittances is difficult: data are scarce, and calculating the income gains from remittances requires assumptions concerning what migrants would have earned if they had stayed at home. Careful analyses of the available household survey data indicate that remittances have been associated with declines in the poverty headcount ratio in several low-income countries—by 11 percentage points in Uganda, 6 in Bangladesh, and 5 in Ghana, for example. In Guatemala, remittances may have reduced the severity of poverty by 20 percent. Cross-country regressions and simulations also indicate that increases in remittances help to reduce the incidence of poverty.

By generating a steady stream of foreign exchange earnings, remittances can improve a country's creditworthiness for external borrowing and, through innovative financing

mechanisms (such as securitization of remittance flows), they can expand access to capital and lower borrowing costs. While large and sustained remittance inflows can contribute to currency appreciation, this outcome may be less severe than it is in the case of natural resource earnings, because remittances are distributed more widely and may avoid exacerbating strains on institutional capacity that are often associated with natural resource booms.

Migration has economic implications for origin countries beyond remittances. The small size of migration flows relative to the labor force suggests that the effects of South–North migration on working conditions for low-skilled workers in the developing world as a whole must be small as well. However, in some countries low-skilled emigration can raise demand for the remaining low-skilled workers (including poor workers) at the margin, leading to some combination of higher wages, lower unemployment, less underemployment, and greater labor force participation. Thus low-skilled emigration can offer a valuable safety valve for insufficient employment at home. In the long run, however, developing country policies should aim to generate adequate employment and rapid growth, rather than relying on migration as an alternative to development opportunities.

High-skilled emigration has more complex implications. Like low-skilled migration, it can greatly benefit migrants and their families and help relieve labor market pressures. However, a well-educated diaspora can improve access to capital, technology, information, foreign exchange, and business contacts for firms in the country of origin. The return of expatriates and the maintenance of close contacts with high-skilled emigrants have played an important role in the transfer of knowledge to origin countries. At the same time, large outflows of high-skilled workers can reduce growth in the origin country for these reasons: (a) the productivity of colleagues, employees, and other workers may suffer because they lose the opportunity for training and mutually beneficial exchanges of ideas; (b) the provision of key public services with positive externali-

ties, such as education and health (particularly for the control of transmissible diseases), may be impaired; (c) opportunities to achieve economies of scale in skill-intensive activities may be reduced; (d) society loses its return on high-skilled workers trained at public expense; and (e) the price of technical services may rise. Highly educated citizens, if they stayed in their countries, could help to improve governance, improve the quality of debate on public issues, encourage education of children, and strengthen the administrative capacity of the state—contributions that would be lost through high-skilled emigration.

It is impossible to reliably estimate the net benefit, or cost, to origin countries of high-skilled emigration because data are limited and a myriad of individual country circumstances enter into the calculus of that benefit or loss. We can only offer two rough observations, which reflect the wide variation in high-skilled emigration rates among countries:

- Very high rates of high-skilled emigration are found in countries that represent a small share of the population of the developing world. Many of those countries have poor investment climates that likely limit the productive employment of high-skilled workers. Of course, the loss of high-skilled workers may aggravate the poor investment climate and limit the potential benefits of economic reform.
- Some countries find it difficult to provide productive employment for many high-skilled workers because of their small economic scale or because misguided educational policies have resulted in a large supply of university graduates for whom no suitable jobs exist.

Policies to improve the developmental impact of remittances and migration

Migration policies

Greater emigration of low-skilled emigrants from developing to industrial countries could

make a significant contribution to poverty reduction. The most feasible means of increasing such emigration would be to promote managed migration programs between origin and destination countries that combine temporary migration of low-skilled workers with incentives for return. Temporary programs have several advantages, and some disadvantages, relative to permanent migration. From the perspective of the destination country, managed, temporary migration programs ease social tensions by limiting permanent settlement; they limit the potential burden on public expenditures because immigrants are guaranteed a job and are less likely to bring dependents; and they allow for controlled variation of the number of immigrants in response to changes in labor-market conditions, thus limiting adverse effects on low-skilled native workers. However, temporary migration can be less efficient than permanent migration for firms in destination countries because of high training costs. From the origin-country perspective, managed, temporary migration may be the only means of securing deliberate increases in low-skilled emigration and may raise remittances and improve the skills of returning workers. On the other hand, managed migration programs do not guarantee future access to labor markets (and thus to remittances), because it is easier for destination countries to suspend temporary programs than to expel immigrants. Overall, however, such programs do represent a feasible approach to capturing the efficiency gains from labor migration.

Origin countries that are adversely affected by high-skilled emigration face challenges in managing it better. Service requirements for access to publicly financed education can be evaded and are likely to discourage return; and proposals for the taxation of emigrants to the benefit of the origin country have made little progress. Origin countries can help to retain key workers by improving working conditions in public employment and by investing in research and development. Origin countries can also take steps to encourage educated em-

igrants to return by identifying job opportunities for them, cooperating with destination countries that have programs to promote return, permitting dual nationality, and helping to facilitate the portability of social insurance benefits.

By providing authoritative information on migration opportunities and risks, governments could help avoid unfortunate, costly-to-reverse migration decisions and limit the abuse of vulnerable migrants. Labor recruiters can play a valuable role in promoting migration, but emigrants' lack of information often enables recruiters to capture the lion's share of the rents generated by constraints on immigration and imperfect information. Origin countries with effective public sector institutions might consider the regulation of recruitment agents to limit rents and improve transparency.

Remittance policies

Governments in destination and origin countries can sharpen the developmental impact of remittances through the application of appropriate policies. Access of poor migrants and their families to formal financial services for sending and receiving remittances could be improved through public policies that encourage expansion of banking networks, allow domestic banks from origin countries to operate overseas, provide identification cards to migrants, and facilitate the participation of microfinance institutions and credit unions in providing low-cost remittance services. Remittances, in turn, can be used to support financial products—housing and consumer loans and insurance—for poor people.

A second set of promising policies could improve competition in the remittance transfer market and thereby lower fees. The price of remittance transactions is often unnecessarily high for the small transfers typically made by poor migrants. The *cost* of such transactions is often well below the fees paid by customers. Reducing transaction charges increases the disposable income of poor migrants and increases their incentives to remit, because the net receipts of recipients

increase. The overall result would be stronger remittance flows to developing countries.

Competition among providers of remittance services could be increased by lowering capital requirements on remittance services and opening up postal, banking, and retail networks to nonexclusive partnerships with remittance agencies. Disseminating data on remittance fees in important remittance corridors and establishing a voluntary code of conduct for delivering fair-value transfers would improve transparency and reduce prices for remittance transactions. Governments could help reduce costs by supporting the introduction of modern technology in payment systems. Alleviating liquidity constraints by providing a credit line either to the sender or the recipient, based on past remittance activity, would enable senders to take advantage of the lower fee rates available only for larger remittances. Reducing exchange-rate distortions could also lower the cost of remittance transactions. Finally, regulatory regimes need to strike a better balance between preventing financial abuse and facilitating the flow of funds through formal channels.

Several origin countries have attempted to improve the developmental impact of remittances by introducing incentives to increase flows and to channel them to more productive uses. Such policies are more problematic than efforts to expand access to financial services or reduce transaction costs, because they pose clear risks. Tax incentives to attract remittance inflows, for example, may also encourage tax evasion, while matching-fund programs to attract remittances from migrant associations may divert funds from other local funding priorities. Efforts to channel remittances to investment, meanwhile, have met with little success. Fundamentally, remittances are private funds that should be treated like other sources of household income. Efforts to increase sav-

ings and improve the allocation of expenditures should be accomplished through improvements in the overall investment climate, rather than by targeting remittances. Similarly, because remittances are private funds, they should not be viewed as a substitute for official development aid.

Organization of this study

As is customary in this report, chapter 1 reviews recent developments in and prospects for the global economy and their implications for developing countries. Chapter 2 uses a model-based simulation to evaluate the potential global welfare gains and distributional impact from a hypothetical increase of 3 percent in high-income countries' labor force caused by migration from developing countries. Chapter 3 surveys the economic literature on the benefits and costs of migration for migrants and their countries of origin, focusing on economically motivated migration from developing to high-income countries. We then turn to remittances, the main theme of the report. Chapter 4 investigates the size of remittance flows to developing countries, the use of formal and informal channels, the role of government policies in improving the development impact of remittances, and, for certain countries, their macroeconomic impact. Chapter 5 addresses the impact of remittances at the household level, in particular their role in reducing poverty, smoothing consumption, providing working capital for small-scale enterprises, and increasing household expenditures in areas considered to have a high social value. The last chapter investigates policy measures that could lower the cost of remittance transactions for poor households and measures to strengthen the financial infrastructure supporting remittances.