
Remittances and Development

Lessons From Latin America

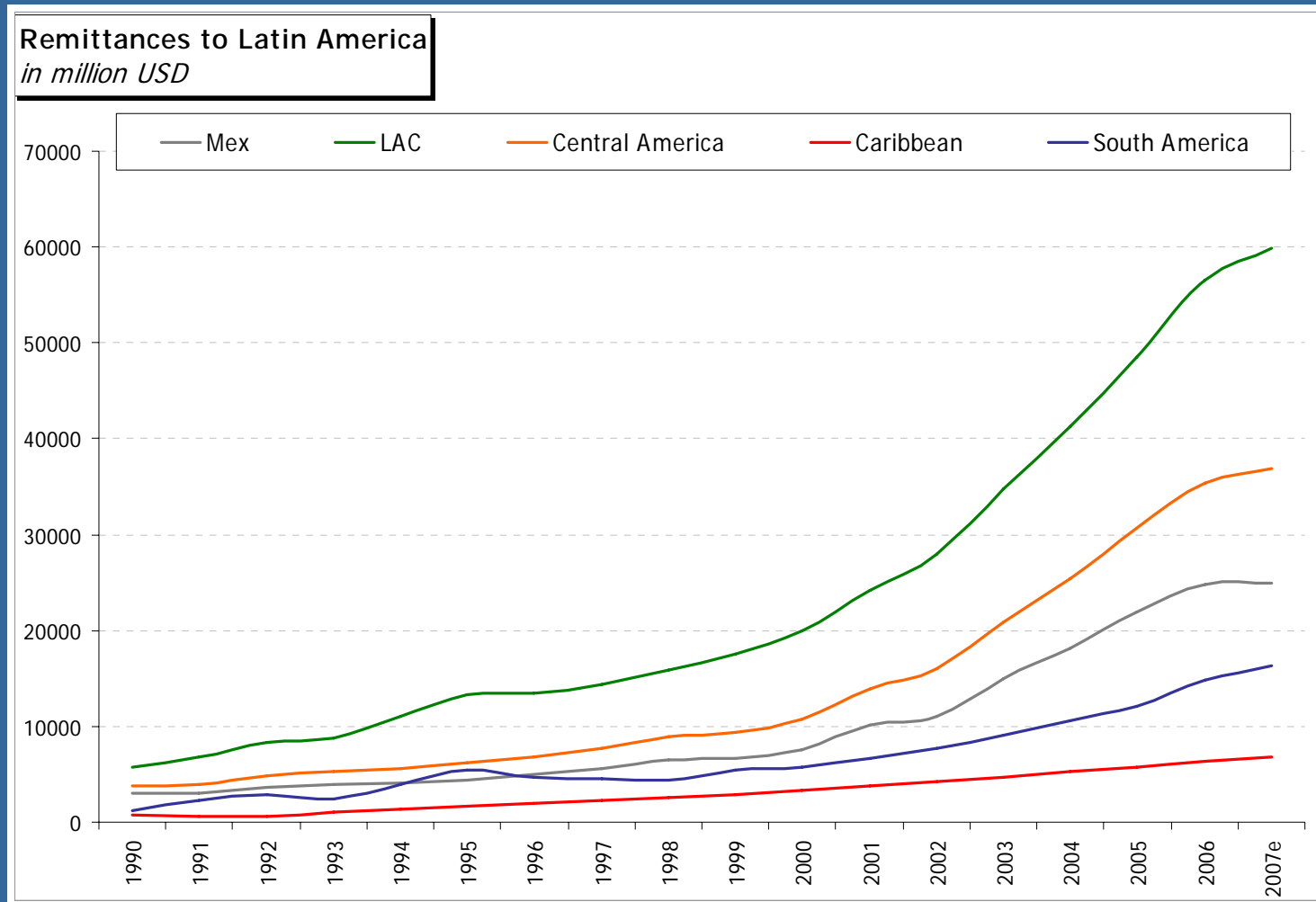
Main Messages (I)

- Remittances have a positive impact on development and should thus be welcomed and facilitated
 - They increase investment and growth, reduce volatility, improve education and health outcomes and reduce poverty
 - For example, in El Salvador, Honduras and Guatemala poverty among recipients is almost half of that found among similar households without remittances
 - In Guatemala, Honduras and Nicaragua, enrollment rates for children aged 12 to 17 whose families receive remittances are about 15 percentage points higher than for families that do not receive them
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Main Messages (II)

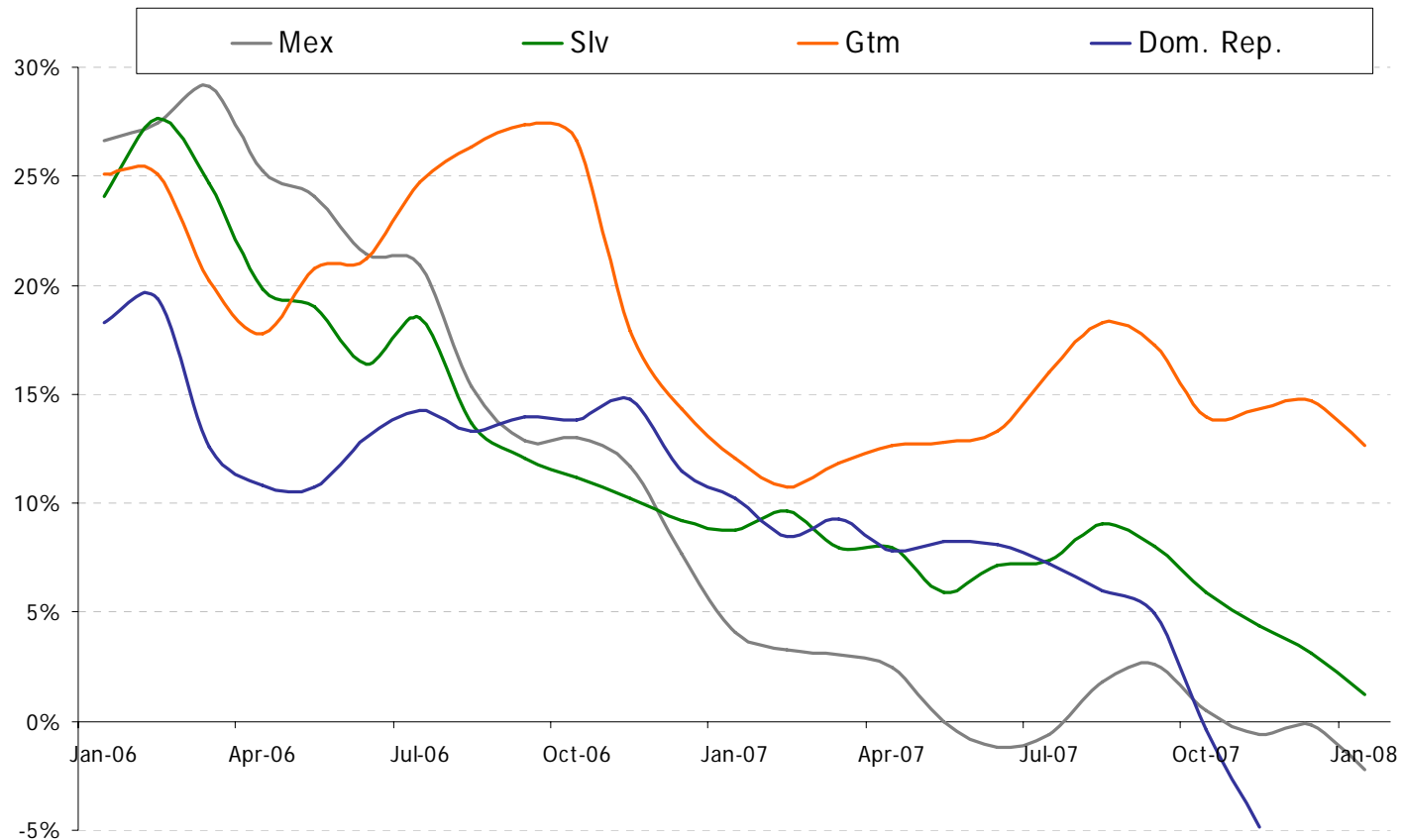
- Remittances also entail some costs and policy challenges, some of which acquire special importance in the context of the US economic slowdown
 - Reductions in labor supply, exchange rate appreciations
 - Challenge of reducing the costs of remittances transfers and linking them to the provision of financial services
 - Remittances do not substitute for sound economic policies
 - Countries with better investment climates exhibit higher positive effects of remittances on investment and growth
 - High remittances flows actually increase the importance of tackling traditional development challenges
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Motivation: six-fold increase in remittances to LAC since 1993 (US\$60 bi in 2007)



But concern with lower growth during 2007: e.g. remittances to MEX, DR, SLV

Remittances to Latin America
% variation YoY on 3 month moving average



Why should a lower growth in remittances be a concern for LAC countries?

- Remittances have had positive development effects:
 - Lower poverty
 - Better education and health indicators
 - Lower income volatility
 - Increases in remittances after macroeconomic external shocks: about 1% of GDP per year during the four years following a currency crisis
 - Faster growth
 - More than tripling of remittances as % of GDP in 1991-2005 responsible for an additional 0.27% in annual p/c GDP growth
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Remittances counter-cyclical w.r.t. output of recipient countries, pro-cyclical w.r.t. to sending countries

Cyclical Behavior of Workers' Remittances in Latin America: Panel Data Evidence

Sample of 26 LAC countries, 1970-2004 (Annual Data)

Dependent Variable: Fluctuations in the Workers Remittances as a percentage of GDP

Sample / Filter	Recipient GDP growth	Emmisor GDP growth
II. Instrumental Variables (IV)		
2.1 Using "Distance" Foreign GDP Growth		
First-Difference cyclical components	-1.1575 ** (0.475)	1.7269 (1.277)
Band-Pass Filter cyclical components	-1.2913 ** (0.573)	2.1792 ** (1.028)
Hodrick-Prescott Filter cyclical components	-1.1293 * (0.586)	1.9001 * (0.988)

* (**) implies statistical significance at the 10 (5) percent. Our regression equation includes fluctuations in the real output of the remittance-receiving and remittance=sending country, as well as a deterministic time trend and the lagged value of the dependent variable.

Note:

Real output of sending countries approximated by growth of top destinations of migrants weighted by the inverse of the distance between sender and recipient countries. Similar results obtained using weights based on share of migrants in each country.

Impact of US recession on remittances and growth of recipient countries (preliminary)

Estimated reduction in remittances: from 6.4% to 3.74% of GDP for average LAC country (upper bound, assuming no other transmission channels from US to LAC growth)

change in US growth due to the SubPrime crisis

$$\underbrace{(\hat{y}^{US} - \hat{y}^{US*})}_{(3\% - 1.6\%)} \quad \underbrace{\hat{\beta}}_{\substack{\text{Effect over} \\ \text{LAC average}}} = \Delta(R / GDP) = 2.66$$

Indirect growth effect on average LAC country: reduction of 0.12% in annual growth rate (12 basis points)

$$\Delta \ln(R / GDP) \quad \underbrace{\hat{\gamma}}_{\substack{\text{Effect of R/GDP} \\ \text{over GDP}}} = \hat{y}^{LAC} = 0.12$$

(0.54) (0.226) = 0.12

Impact on poverty rates in recipient countries (assuming reduction in remittances from 6.4% to 3.74% of GDP)

Moderate poverty rates increase by 17% among recipients:

$$\begin{array}{rcc} \Delta(R / GDP) & \hat{\gamma} & = \quad \% \Delta P^{LAC} \\ (2.66) & \underbrace{\hspace{1.5cm}} & \\ & \text{Elasticity of recipient poverty w.r.t. (R/GDP)} & \\ & (6.6) & = 17.5 \end{array}$$

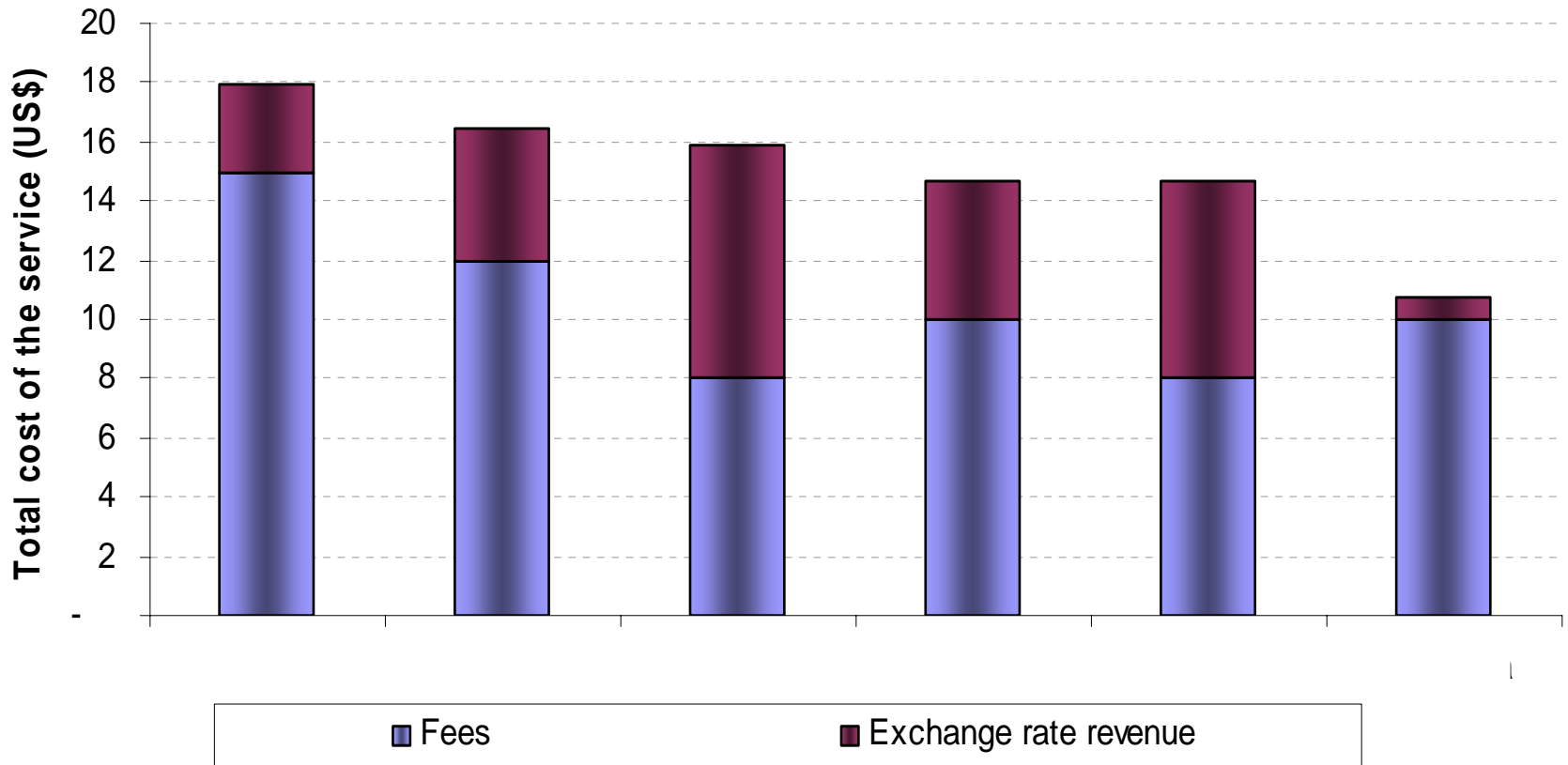
Increase in moderate poverty of 1% at the national level :

$$\begin{array}{rcc} \Delta(R / GDP) & \hat{\gamma} & = \quad \% \Delta P^{LAC} \\ (2.66) & \underbrace{\hspace{1.5cm}} & \\ & \text{Elasticity of poverty w.r.t. (R/GDP)} & \\ & (0.39) & = 1.04 \end{array}$$

What can be done to enhance the development impact of remittances?

- **Promote and facilitate remittances**
 - **Reduce costs of transfers through additional competition, information, etc**
- **Linking remittances to financial services**
 - The impact of remittances on financial development in LAC is smaller than in other parts of the world.
- **Address challenges brought by remittances**
 - Exchange rate overvaluation, decline of labor supply.
- **Improve the investment climate**
 - Remittances have a larger impact in countries with better education, better institutions, and better macro management.

But importance of other complementary actions, e.g. to ensure transparency



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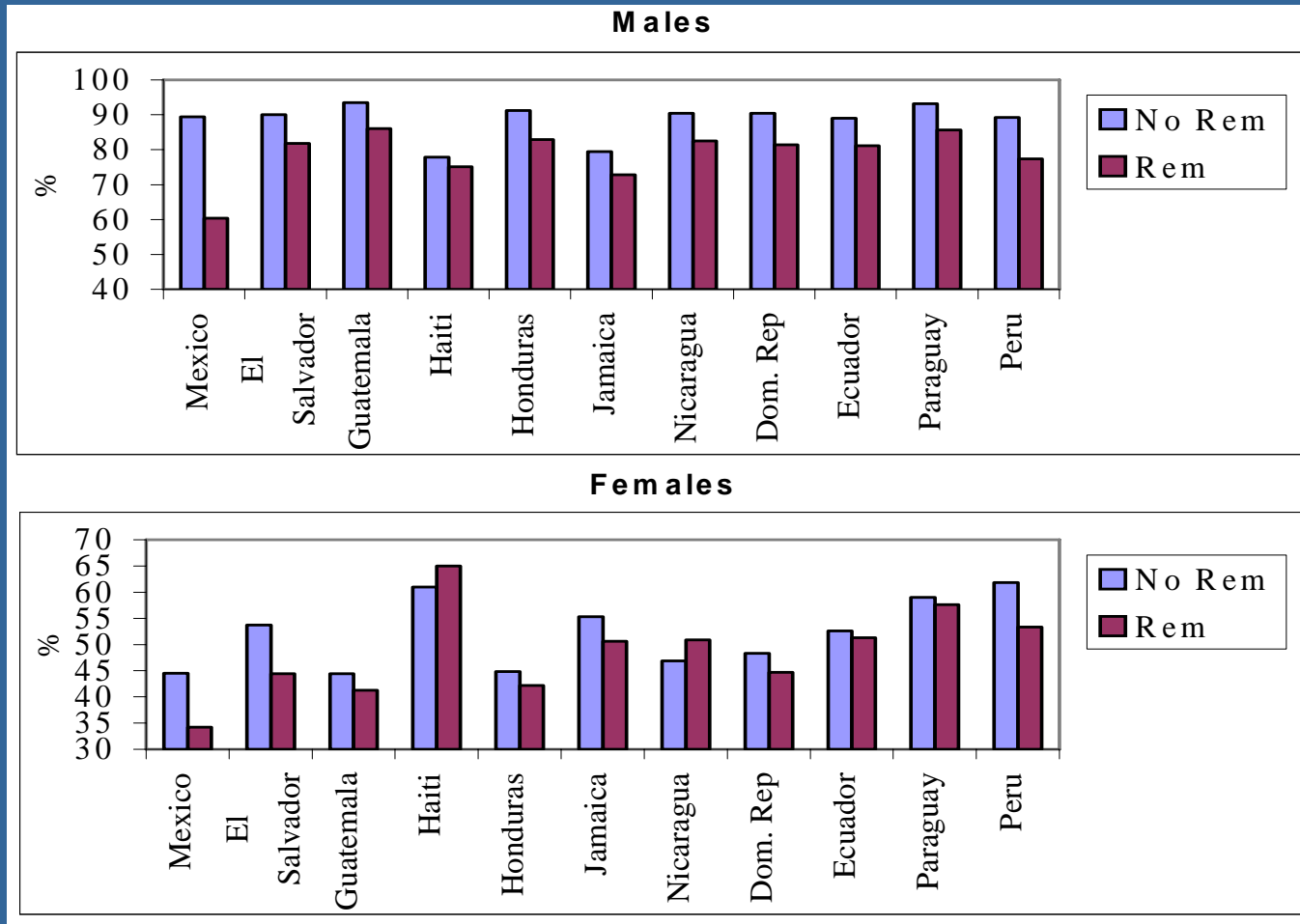
How to increase the impact of remittances on financial development?

- Providing basic financial literacy to migrants and remittances recipients
 - Supporting efforts by banks to develop low cost products targeted to migrants and remittances recipients
 - Eliminate barriers for more financial institutions to enter the remittances market – e.g. including credit unions, and microfinance companies
 - Promote competition in the financial sector, minimize regulatory costs for opening branches and other outlets to serve these communities
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Labor force participation rates



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Concluding:

- Remittances have a positive impact on development.
 - As such they should be welcomed, encouraged, and facilitated.
 - There are policy interventions that can enhance their development impact.
 - For more details...
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LESSONS FROM
LATIN AMERICA

Edited by
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THE WORLD BANK

Workers' remittances, a major source of financing for developing countries, are especially important in Latin America and the Caribbean. *Remittances and Development* relies on cross-country panel data and household surveys for 11 Latin American countries to explore the development impact of remittances flows along several dimensions: growth, poverty, inequality, schooling, health, labor supply, financial development, and real exchange rates.

"Family remittances—the money that is sent mainly from poor migrants to their even poorer relatives back home—now represent the largest flow of foreign capital to most Latin American countries. Despite their huge volume in toto, little is known about the effects of these flows on the lives of the people who send and receive them, on the economic and social development of their communities, and on the prosperity of their nations. *Remittances and Development* joins a small number of pioneering efforts to address these critical issues in a careful and systematic way. For years to come, it will surely serve as an essential reference for new research and continuing policy debates on this still largely uncharted territory."

—Peter Hakim, President
Inter-American Dialogue

"This important volume represents a first-rate contribution to the literature on the development impact of international migration and remittances in Latin America and the Caribbean. It fills an important void by providing rigorous analyses in a large number of countries in the region, enabling—probably for the first time—comparisons to be made across a wide variety of experiences. With the increasingly important role of migration and remittances in the global economy, this timely study should benefit analysts and policy makers interested in the improvement of migration policies and their development impact in Latin America."

—Maurice Schiff, Lead Economist
Development Research Group
The World Bank



THE WORLD BANK

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Annex - Reducing Remittances Costs: Possible Bank Demand-Side Interventions

- Increasing Transparency:
 - Remittance Price Databases for key corridors can be a useful tool to help remittances senders make informed choices of providers, thus enhancing competition and ultimately reducing costs.
 - Global price database (ongoing):
 - FPDPR is developing a global remittance price database to cover 115 remittance corridors worldwide. It will be updated twice-yearly, and will go online in June, 2008.
 - In LAC, the database will include Mexico, Guatemala, El Salvador, the Dominican Republic, Honduras, Colombia, Jamaica, Brazil, Haiti, Ecuador, and Peru.
 - Country-specific price databases (some precedents):
 - FPDPR's global database is meant for benchmarking purposes. To increase impact more detailed and up to date databases would have to be developed country by country. FPDPR is preparing a standard methodology to be used as a model for country specific projects. Mexico's Consumer Protection agency's (PROFECO) database is a good precedent.
 - The Bank could provide TA for the implementation of country price databases and their dissemination through information campaigns. Guatemala expressed interest in Bank support.
- Improving consumer protection:
 - Updating consumer protection laws: introducing provisions to protect users of financial and remittances services and expediting dispute resolution mechanisms.
- Financial education programs:
 - Financial literacy: to inform remittances recipients about possible benefits associated with using financial services and about their rights as consumers

Annex - Reducing Remittances Costs: Possible Bank Supply-Side Interventions

- Improving retail payments system infrastructure (ongoing):
 - Promoting the adequate balance between cooperation on infrastructure development and competition on access services to provide broad access to modern payment instruments.
 - The Bank is already supporting LAC countries through the Payments Systems Regional Initiatives and country specific projects.
 - Increasing access of microfinance institutions (MFIs) to payments systems (ongoing):
 - CGAP has an ongoing project in Ecuador to provide back-office services to MFIs so as to facilitate access to payment systems (thus helping them provide remittances services)
 - Similarly the Bank supported intervention (Red de la Gente network) by Mexican development Bank (BANSEFI) providing credit and saving cooperatives access to the payment system.
 - Improving the regulation of Remittances Service Providers (RSPs) and MFIs
 - Introducing licensing and reporting requirements and restricting anti-competitive practices:
 - RSPs could be required to comply with minimum service levels, reporting requirements
 - Laws or regulations could be used to tackle/discourage exclusivity agreements and other practices that block access to core payments infrastructures to competitors.
 - Regulatory and supervisory efforts to increase access to financial services through MFIs
 - Supporting new business models to increase access to financial services among recipients
 - Branch-less banking (ongoing CGAP work in Colombia, project under preparation in Panama)
 - Investments in innovative MFIs (IFC)
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