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POLICY BRIEF

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The Role of Remittances in the World's Economy

World Bank Study Concludes Remittances from Foreign Workers Play an Important Role

Remittances – money immigrants and foreign workers send abroad to their families – exert a key positive influence on the global economy, concludes a new report by the World Bank. The report carries implications for everything from U.S. policies on temporary workers to international development assistance.

More Plentiful and Valuable Than Foreign Aid?

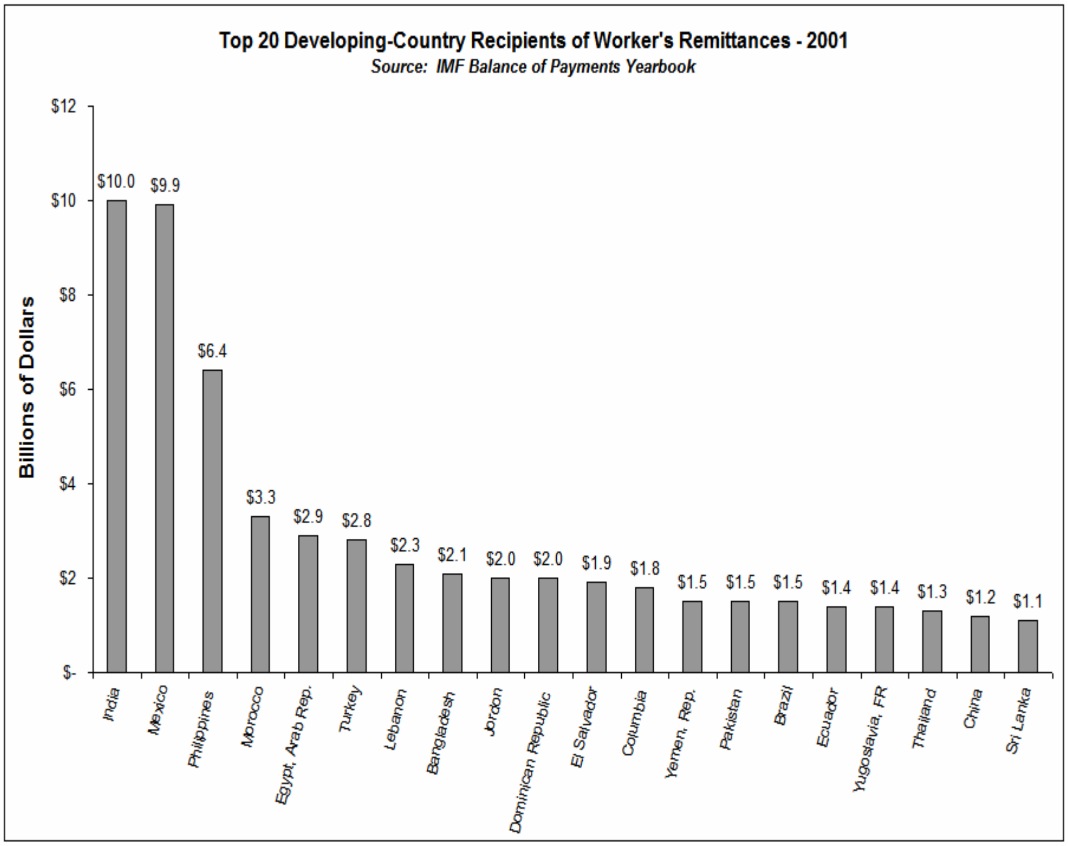
According to a report by economist Dilip Ratha in *Global Development Finance 2003*, an important annual World Bank publication, workers' remittances back to developing countries reached $72.3 billion in 2001 and generally exceed official development assistance given by governments directly to low-income countries or through multilateral institutions.[1] (For the full report see: http://www.worldbank.org/prospects/gdf2003/.)

An estimated $18 billion of remittances to individuals in developing countries came from the United States. Saudi Arabia, followed by Germany, Belgium, and Switzerland are other top sources of remittances. Saudi Arabia was the largest source of remittance payments until the mid-1990s, when its economic boom ended. It continues to be the largest source on a per capita basis.

For those skeptical of government-to-government foreign aid a key strength of remittances is that money goes directly to individuals, thus avoiding bureaucracies that may be corrupt or, at least, inefficient. "Remittances are often invested by the recipients, particularly in countries with sound economic policies," writes Ratha. "Improvements in policies and relaxation of foreign exchange controls in the 1990s may have encouraged the use of remittances for investment."[2]

Some may see remittances as a "loss" to the United States, since the money is leaving the country. However, such criticism misunderstands the workings of global markets and the flow of money internationally. Simply put, when dollars are sent abroad, they represent a type of claim on U.S. goods or assets. The dollars come back to the U.S. economy in the form of individuals buying American goods abroad or investing in the United States directly or via financial institutions that invest the money. There is no "loss" to the U.S. economy.

Remittances are also a sign of family values, a part of human nature. They are a form of helping one's family, a desire that has existed for many centuries. Modern technology has allowed this help to take the form of electronic money transfers. Moreover, the desire to help one's family, spurred by limited economic opportunities in an individual's native country, may be the key reason a person seeks employment abroad. Remittances represent money individuals earned and are choosing to dispose of as they see fit.



Economic Benefits

Remittances are important at both the macro- and micro-economic level. They increase both the income of the recipient and the foreign exchange reserves of the recipient's country. "If remittances are invested, they contribute to output growth, and if they are consumed, then also they generate positive multiplier effects," notes Ratha. A 1990 study found that Mexico's Gross National Product (GNP) rose by between $2.69 and $3.17 for every dollar Mexican households received from workers in the United States.

Remittances to India in 2001 came to 2.1 percent or more of the country's Gross Domestic Product (GDP), while remittances to Nicaragua and El Salvador respectively totaled at least 16.2 percent and 13.8 percent of GDP.[3] Last year, when the President of El Salvador discussed the need for continuing Temporary Protective Status (TPS) for Salvadorans in the United States, it brought home to many the significance that remittances carry in certain nations' economies. "Remittances are more stable than private capital flows, which often move pro-cyclically, thus raising incomes during booms and depressing them during downturns," notes Ratha. "By contrast, remittances are less volatile – and may even rise – in response to economic cycles in the recipient country."[4]

Transaction Costs

A significant impediment to remittances becoming more beneficial to the global economy and the individual recipients is transaction costs. Some studies indicate the costs of remittance transfers from the United States to Central and South America range from 13 percent to 20 percent or higher. The World Bank estimates that reducing these costs to even 10 percent would save workers and their families up to $3.5 billion a year. Citibank has become involved in remittances in El Salvador, Guatemala, and Mexico and appears to be successful in providing lower transaction costs.[5]

Conclusion

From a U.S. taxpayer perspective, remittances are preferable to government-to-government foreign aid. In fact, they appear more effective than foreign aid since remittances help the world economy by allocating resources efficiently through private means. While lowering transaction costs will help, "facilitating international labor mobility is an even more crucial" way of increasing remittance flows. In sum, the World Bank report concludes, "Greater international migration could generate substantial benefits to the world economy."[6] Remittances are one part of this equation.

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[1] Dilip Ratha, "Workers' Remittances: An Important and Stable Source of External Development Finance," *Global Development Finance 2003*, World Bank, 2003, p. 157.
[2] Ibid., p. 157.
[3] Ibid., p. 159, 164.
[4] Ibid., p. 157.
[5] Ibid., pp. 164-165.
[6] Ibid., p. 158.