

Migration's New Payoff

Every day, migrants working in rich countries send money to their families in the developing world. It's just a few hundred dollars here, a few hundred dollars there. But last year, these remittances added up to \$80 billion, outstripping foreign aid and ranking as one of the biggest sources of foreign exchange for poor countries. Following a boom in the 1990s, this flow of money is lifting entire countries out of poverty, creating new financial channels, and reshaping international politics. | By Devesh Kapur and John McHale

What is the most reliable source of foreign money going to poor countries? What is the principal source of foreign capital for small family businesses throughout the developing world? How do most people in collapsed states like Afghanistan, Haiti, Liberia, and Somalia manage to survive? What is the common factor that has financed internal conflict in settings as diverse as Northern Ireland, Sri Lanka, and Rwanda? How do economically weak countries like Armenia and Eritrea sustain belligerent foreign policies and disastrous border conflicts?

The answer to these wide-ranging and complex questions is remittances—money that migrants earn while working abroad and then send back to their fam-

ilies living in their home country. "Mother's milk for poor nations," is how one Asian newspaper described the phenomenon. That statement is no exaggeration. As nations increasingly opened their borders to foreign workers in the last two decades, remittances to developing countries have soared from \$17.7 billion in 1980 to \$30.6 billion in 1990 to nearly \$80 billion in 2002. Remittances have emerged as an important source of foreign exchange for poor countries. In 2001, they were double the amount of foreign aid and 10 times higher than net private capital transfers (which is the bottom line after deducting all financial outflows, such as profit repatriation and interest payments). The principal beneficiaries are lower middle-income countries (those with a gross national income per capita between \$736 and \$2,935), which receive nearly half of all remittances worldwide.

As such, remittances have emerged as the latest cause célèbre among governments, foundations, and multilateral institutions. The Inter-American Development Bank (IDB) sponsored a special investigation

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of strategies that would help workers living in the United States send their wages to Latin America and the Caribbean, where remittances totaled \$32 billion last year alone (20 times the amount of U.S. foreign aid sent to the region). The U.S. Agency for International Development is spending \$500,000 on a similar program on behalf of the 20 million Mexican workers who last year sent home nearly \$10 billion, which is twice the value of Mexico's annual agricultural exports and over a third more than Mexican tourist revenue.

Governments in developing countries are also

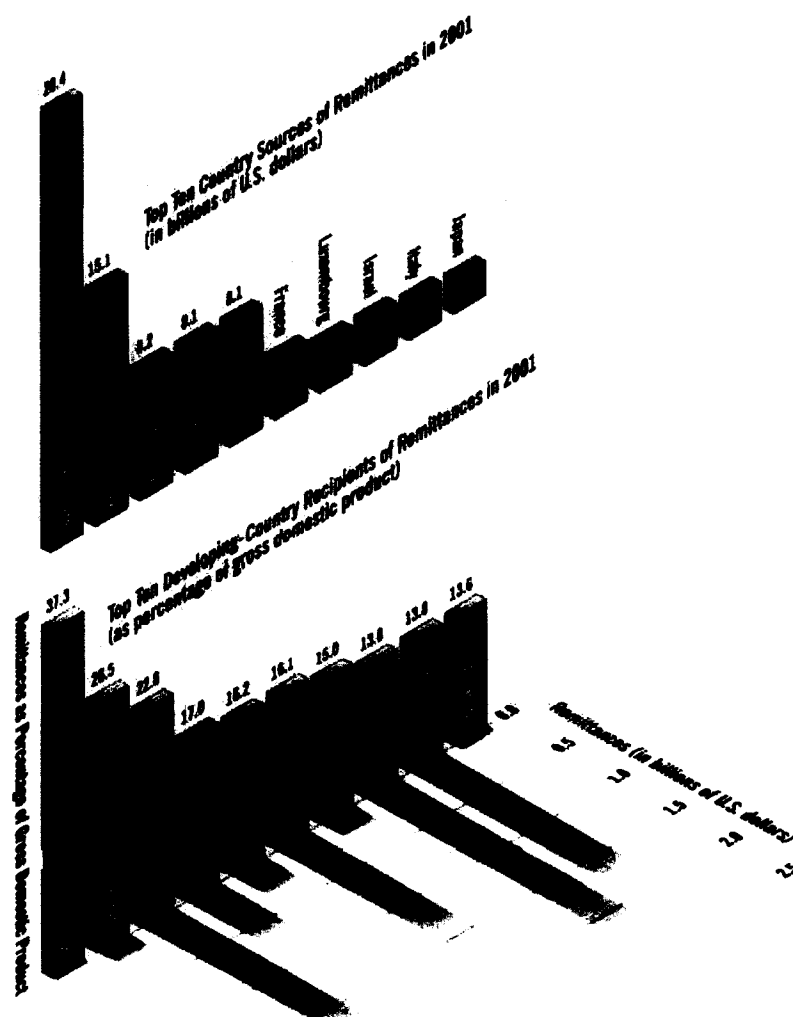
doing whatever they can to keep the money flowing. In Pakistan, where remittances are expected to reach a record \$4.5 billion in 2003, the government unveiled a plan last July to "export" an additional 200,000 workers. "This export of manpower would bring relief to 200,000 families in the same way as the construction of four dams and two highways in different parts of Pakistan would bring employment and relief to 500,000 families," observed Pakistan's labor minister.

But it's not just the volume of money that has governments and multilateral organizations excited.

Remittances have also emerged as the most stable source of financial flows. Unlike foreign aid, the flow of remittances is not subject to the whims of donating governments, or held hostage by onerous conditions imposed by multilateral lending institutions. And in contrast to foreign investment or loans, remittances are insulated from the herd behavior of private investors and money managers. During economic crises, when developing countries most need the money, it is not powerful wealthy countries or sophisticated financial markets that they can depend on, but rather the millions of otherwise powerless working class emigrants. In financial terms, remittances are a free lunch. While other sources of capital carry a cost for the receiving country, be it interest payments for loans or profit repatriation for investments, remittances require no fees or services.

Within the development community, remittances strike the right cognitive chords. They fit in with a communitarian, "third way" approach—neither inefficient socialism nor savage capitalism—and exemplify the principle of self-help. People from poor countries can just migrate and send back money that not only helps their families

There and Back Again



Source: *Balance of Payments Statistics* (Washington: International Monetary Fund, 2002)

but their countries as well. Immigrants, rather than governments, thus become the biggest provider of foreign aid. On the sending side, remittances need no costly government bureaucracy, and on the receiving side, the money is unlikely to be siphoned off by corrupt government officials.

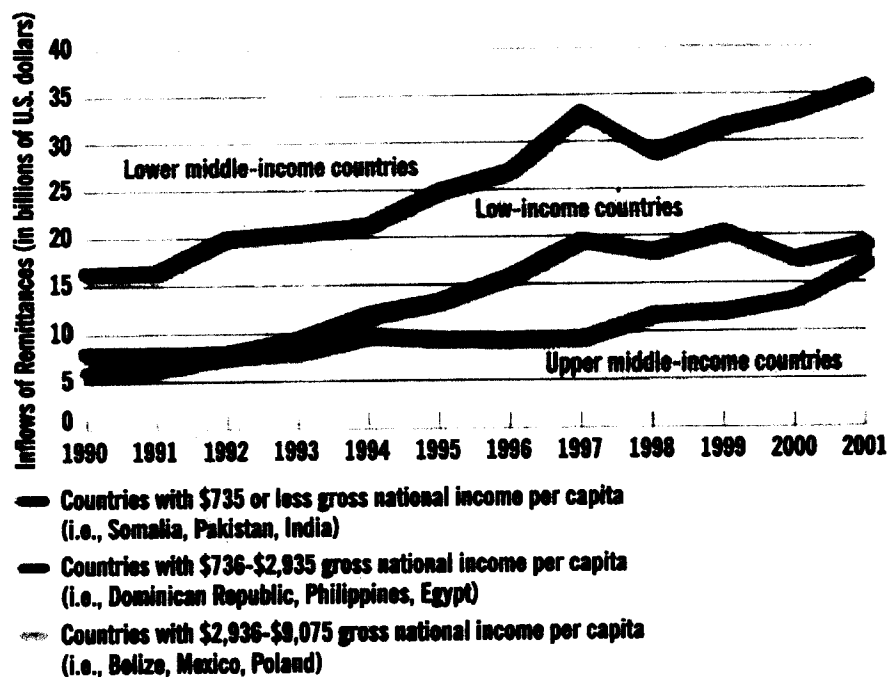
At the simplest level, remittances are about helping individual families. A couple of hundred dollars sent home every month can make the difference between abject poverty and food on the table. At another level, these small transactions, repeated thousands of times every day across the world, are quietly binding the fates of nations. The growing number of people working abroad is reshaping the debate over immigration in industrialized countries and forcing developing nations to embrace dual citizenship, which helps their citizens find better jobs and send home even more money. Politicians seeking financial support for their election campaigns increasingly must tend to the needs and priorities of their countries' swelling diasporas. And policymakers seeking to cut off the flow of money to terrorist groups are struggling to learn how to distinguish "good" money from "bad" in the murky informal system of financial transfers that has kept citizens in failed states like Somalia from total humanitarian disaster. As with other drivers of global integration, remittances present a challenge of regulating informal forces in ways that harness their vast benefits while seeking to minimize their unwelcome side effects.

WIRED FOR MONEY

The most obvious explanation for the growth of remittances in recent years is the steady increase in migration. The United Nations estimates that roughly 175 million people were living outside their coun-

A Rising Source of Income

Selected Inflows of Remittances, 1990–2001



Source: *Global Development Finance* (Washington: World Bank, various years)

try of birth or citizenship in 2000, up from 154 million in 1990. Of this population, 60 percent reside in developed regions. In the United States, where nearly half of the foreign population entered the country in just the previous decade, the number of illegal immigrants jumped from 2.5 million in 1989 to 8.5 million in 2000. Elsewhere, the foreign population in 17 European countries rose from 15.8 million in 1988 to 21.7 million in 1998. Foreign workers continue to represent more than 50 percent of the labor force in the oil-exporting Persian Gulf countries.

Another reason for the relatively sudden growth of remittances in the 1990s is that many developing countries, under the tutelage of the International Monetary Fund, relaxed exchange controls on the purchase and sale of foreign currencies. This policy sharply reduced the black market for foreign exchange and eased restrictions on banks and other financial intermediaries. As a result, the increase in officially recorded remittances partially reflects a shift from informal to formal channels.

There is, however, another, less obvious, factor driving the growth in remittances: a burgeoning infrastructure that has helped ease the movement of money across borders. The most visible manifestation of this is Western Union, a U.S.-based company with

Despite the growth of formal transfer mechanisms such as Western Union and ATMs, substantial amounts of remittances continue to flow through informal (and sometimes underground) channels, outside the purview of government supervision and regulation. These transfer mechanisms—known as Informal Value Transfer Systems (IVTS)—go back centuries, particularly in Asia. Some examples are known as *hawala* (Middle East, Afghanistan, Pakistan), *hundi* (India), *fei ch'ien* (China), *phoe kuan* (Thailand), *hui* (Vietnam), and *encomenderos* and “Black Market Peso Exchange” (South America). Relying on rudimentary, low-cost technologies, these networks may transfer tens of billions of dollars or more around the world each year, offering speed, easy access, low costs, and anonymity. An estimated \$200 to \$500 million was sent back home to Somalia in 2000 through IVTS (compared to \$60 million in foreign aid). Basically, the sender gives money to an IVTS agent (usually in an ethnic neighborhood), who calls or faxes instructions to his counterpart in the region where the money is to be sent. The counterpart makes the payment within a few hours. Settlements are made either with a transfer in the opposite direction, by private couriers, or through periodic wire transfers. Another method of balancing the books is to under-invoice goods shipped abroad, so that the receiver can resell the products at a higher market price.

Following the terrorist attacks on September 11, 2001, Western governments and the media portrayed these informal transfer mechanisms as shadowy networks for funding terrorism. To be sure, these services are sometimes associated with all sorts of criminal activities including bribery, drug trafficking, tax evasion, payments for smuggling illegal migrants, and the black market trade in human organs. But, as a study conducted for the Dutch Ministry of Justice concluded, “IVTS are by no means infested or controlled by criminals. . . [many] resort to IVTS simply to transfer money to their relatives because they follow cultural traditions or services are faster, cheaper, less bureaucratic, and more convenient than any other alternative.”

And the perpetrators of the September 11 terrorist attacks? The hijackers received most of their funds through formal networks such as credit cards, ATMs, and wire transfers.

—D.K. and J.M.

about \$2 billion in annual revenue, which allows customers to wire money to any affiliated office. In 1996, the company had 35,000 agent locations worldwide, with just 10,000 outside of North America. By 2002, customers could transfer money to 151,000 agent locations, 95,000 of which were located outside of North America.

Transferring money is expensive. For instance, sending \$200 from the United States to the Philippines costs an average of \$17, plus additional charges, through a money transfer organization like Western Union, and most banks charge similar fees. The exorbitant costs of remittances (about 12 percent of the estimated \$25 billion transferred from the United States) and the promise of large profits have drawn in new players. Recently the World Council of Credit Unions, an organization representing more than 40,000 regional and national credit unions with members and affiliates in 79 countries, launched the International Remittance Network (IRNet) to facilitate transfers from the United States. IRNet does not charge any fees and offers better exchange rates, but as of yet, its services are confined to its members. The IDB is helping to create a common electronic platform throughout Latin America and the Caribbean to settle transactions among various financial intermediaries that handle remittances.

Major commercial banks are also prospecting for remittance gold. Portuguese banks were early adapters who saw opportunities at the beginning of the 1980s to benefit from the large flows of remittances sent by Portuguese workers abroad. They established branches in countries with concentrations of Portuguese emigrants, such as France, and offered free transfer services and made arrangements with local agents to deliver money to families back home. By the late 1990s, deposits from emigrants represented about 20 percent of the total deposits in Portugal's banking system. During the mid-1990s, Mexico opened its banking sector to foreign investment. As major Spanish and U.S. banks began buying Mexican banks, they realized that migrant workers could be drawn in to become full banking customers, spearheading a large expansion of retail banking on both sides of the U.S.-Mexican border. The transfer business is already paying dividends. Bank of America has found that 33 percent of its U.S.-Mexican remittance customers have opened an account.

New products, underpinned by new technologies, have also given remittances a boost. Banks have introduced debit cards for migrants in the United States to send money home to their relatives

in Mexico, even if their families do not have a bank account. Migrant workers make payments into the debit card account in the same way they would make deposits into a checking account. Their families can then either withdraw money from automated teller machines (ATMs) or use the card to pay for goods at large retailers. ATMs themselves, which held a miniscule 0.2 percent share of the remittance market in 2002, are expected to capture 11 percent by 2006. Competition from such banking services caused the costs of wire transfers to drop by more than half in the last few years.

An unanticipated longer-term effect appears to be a strengthening of the weak retail banking system in Mexico. Only about one in five Mexicans has a bank account and much of central Mexico, which sends the most migrant laborers to the United States, lacks bank branches. The lack of formal credit in Mexico has especially hurt microenterprises in small towns, as these companies could not rely on banks to fund their operations. The growth of a strong retail-banking network built on a strong base of remittances, in hitherto poorly served regions, might well prove to be a very positive institutional payoff.

TRICKLE-UP ECONOMICS

Whereas foreign aid to developing countries flows through bureaucratic agencies and nongovernmental organizations, remittances go directly to households. After basic needs such as clothing, food, and health-care are met, remittances are often also invested in land, farm tools, livestock, or even travel expenses to send another family member abroad to work.

More recently, immigrant communities have sought to pool remittances and channel them for public purposes. Mexican immigrants across the United States have organized themselves in the last decade into hometown associations that finance public works projects and small businesses in the towns from which they have migrated. Matching grants from the Mexican government have leveraged these remittances. To what degree these initiatives create jobs and make immigration less necessary is unclear. Perhaps the biggest benefit is that these associations help migrants maintain their personal ties to their hometowns, a connection that becomes increasingly important as migrant families enter their second,



power to the migrants: Filipino activists urge overseas workers to stop sending remittances home as a protest against President Joseph Estrada in November 2000.

even third generations. The children of migrant workers who grew up feeling deprived, seeing part of their parents' wages sent abroad, might otherwise be less inclined to share their own personal wealth.

The types of communities that benefit from remittances can vary from country to country. In Mexico and Central America, remittances largely go to poor rural households. In other countries, such as the Philippines, Vietnam, and Pakistan, relatively better-off families get the larger share. In part, this discrepancy is a product of geography. Regions that border wealthy countries (as Central America is close to the United States and North Africa is near Western Europe) favor poor migrants, since the travel expenses are much lower. By contrast, impoverished families living in sub-Saharan Africa have fewer options, since neighboring countries are just as likely as they are to suffer from civil strife and economic malaise. A decent paying job abroad can be a hefty investment. In Somaliland, the cost of airfare and an employment visa to go work in the Persian Gulf is about \$3,000. If the destination is Europe or North America, the price tag can be as high as \$5,000.

The number of well-to-do households that send family members abroad is reflected in the education

level of migrant workers. For instance, 80 percent of Indian migrants 25 years and older in industrialized countries have a university degree, compared to only 2.5 percent of that age group back in India. Higher education, however, doesn't guarantee a higher paying job. In Hong Kong, 61 percent of Filipino workers have high school diplomas and nearly 32 percent have university degrees, yet more than 94 percent are employed in low-paying jobs, such as cleaning houses.

The emergence of "remittance communities" creates symbiotic relationships between source and destination countries, sometimes with unpleasant results.

The preponderance of well-educated people who work abroad highlights the concern that developing countries are bartering their most precious human capital in exchange for remittances. There is, however, no real quid pro quo here. The detrimental effects of the "brain drain" for developing countries arise from the migration of the very highest rung of the professional ladder—not simply high school and college graduates, but engineers, physicians, and professors who are critical for institution building. This group occupies the upper 10 percent of income brackets in developing countries, and when they migrate, their households generally do not need remittances.

The larger point is that remittances are helping to lift communities and in some cases, entire countries, out of poverty. Remittances don't directly add to a government's budgetary resources, but they raise the level of national savings and access to foreign exchange. In the Dominican Republic, high levels of remittances in the late 1990s not only contributed to the country's rapid economic growth (the highest in the region) but also helped reduce chronic poverty.

During a financial crisis, remittances are a critical safety net for private consumption. In the late 1990s, when Ecuador experienced its worst economic downturn in the century, more than a quarter of a million people left the country. Remittances jumped from \$643 million in 1997 to more than \$1.4 billion in 2001, accounting for 10 percent of GDP. In Armenia, remittances helped cushion a stunning economic collapse (per capita GDP declined from \$1,590 in 1990 to \$173 in 1994) following the breakup of the Soviet Union and the blockade result-

ing from the country's conflict with Azerbaijan over the disputed territory of Nagorno-Karabakh. Many well-trained Armenians migrated to Russia, and later in the decade, Armenians were receiving as much from remittances as from salaries for legitimate employment at home. Similarly, Cuba was forced to take steps to attract remittances (such as legalizing the possession of U.S. dollars) when world sugar prices plummeted and Moscow cut off economic aid following the collapse of the Soviet Union. By 1995, during an acute foreign exchange crisis when aid and foreign investment to Cuba were only about \$100 million and exports just \$1.1 billion, remittances were approximately \$530 million—up from just \$50 million in 1990.

An unanticipated side effect in that country has been increasing disparities in a political system that draws its legitimacy from its strong commitment to equality: Remittances have a strong racial bias, since the diaspora is predominantly white, while the island's majority is black.

DOLLAR DIPLOMACY

The old political axiom "follow the money" has taken on new significance as workers' wages crisscross the globe. From Russia to India, the lure of remittances has led politicians to alter radically their positions vis-à-vis their diasporas from benign neglect to active courtship. Presidential candidates in the Dominican Republic (where remittances account for around 10 percent of GDP) have campaigned amongst expatriate communities in the United States. Migrants from El Salvador, Guatemala, and Nicaragua may very well determine the outcome of forthcoming elections in Central America, as they tend to finance the campaigns of moderate politicians as opposed to the likes of former Nicaraguan presidential candidate and Sandinista Daniel Ortega. And dual citizenship in the developing world, once an exception, is becoming common. In the Philippines—where a staggering 20 percent of the electorate lives overseas and sends home about \$6.4 billion per year—legislators have passed a new bill that would grant naturalized citizens abroad the right to vote in the upcoming national elections. One of the bill's sponsors sees the legislation as a tool for political reform, since overseas workers "cannot be bought, intimidated, or hoodwinked by unscrupulous politicians." Colombia even allows a representative from the diaspora to be elected to congress.

In countries that host expatriates, remittances have been reshaping immigration policies. Recently, the Mexican government began to distribute personal identification documents called *matrícula consular* (consular registration) cards to migrant workers in the United States, irrespective of their legal status. A number of U.S. banks now accept them as identification for opening bank accounts. Although *matrículas* do not grant legal status to undocumented aliens, they are integrating illegal migrants into U.S. society. More than 800 police departments and 400 cities recognize the card as a valid ID, and 13 U.S. states accept the *matrículas* as sufficient documentation to obtain a driver's license.

Remittances are also influencing international politics. The emergence of "remittance communities" creates symbiotic relationships between source and destination countries, sometimes with unpleasant results. Following the 1991 Gulf War, the Gulf countries expelled workers from Jordan and Yemen, particularly Palestinians, for supporting then Iraqi President Saddam Hussein. India's reluctance to

support a U.S.-led attack against Iraq in 2003 was predicated, in part, on remittances. "Our special interest in the current crisis arises from the presence of millions of our expatriates that live and work in the Gulf region," India's ambassador to the United Nations acknowledged last February. Faced with a sharp economic contraction during the Asian financial crisis, Malaysia and Thailand booted Indonesian workers, exacerbating Indonesia's economic woes and increasing political tensions among the members of the Association of Southeast Asian Nations.

Controls on remittances as a form of economic warfare have been most evident in the Israeli-Palestinian conflict. In 2000, Israel drastically reduced the number of work permits for Palestinians because of security concerns and instead imported roughly a quarter of a million foreign workers, mostly from East Asia and Africa. Palestinians in the West Bank and Gaza saw their gross national income per capita decline by about 30 percent in 2001 and 2002 combined. In contrast, remittance outflows from Israel tripled in the 1990s, to nearly \$3 billion in 2001.

The Money That Makes the World Go 'Round

Selected Annual Flows of Remittances in 2001



Source: Authors' estimates, based on data from the International Monetary Fund, World Bank, Inter-American Dialogue, Nilson Report, U.S. Agency for International Development, and the Consulate General of India in Jeddah.

Note: Estimated annual remittance inflows for the Dominican Republic are between \$1.7 and \$1.9 billion; for North Korea, between \$0.3 and \$0.5 billion.

The dynamics of remittance flows changed drastically in the aftermath of the September 11, 2001 terrorist attacks. For Pakistan, a "front line" state caught in this vortex, where remittances were around \$1 billion in 2000, this event proved a financial blessing. Many Pakistanis with savings in offshore accounts repatriated their funds, fearful of being caught in U.S.-led investigations into terrorist financing; in 2002, remittances in Pakistan exceeded \$3 billion. But the effects of September 11 were disastrous for Somalia, which had become increasingly dependent on remittances after the country fell into anarchy following the hasty departure of peacekeepers in 1994. Absent a functioning central government and a recognized private banking system, the remittance trade was dominated by a single firm, which the

nationalism, which boosted hard-line regimes and complicated efforts to resolve regional conflicts. Typically, the remittances came from the diaspora settled in industrialized countries—be it Irish-Americans making donations to the Irish Republican Army or Sri Lankans in Canada sending money to the Liberation Tigers of Tamil Eelam.

RETURN TO SENDER?

Remittances are quietly transforming the world, mostly for the better. Yet, they risk becoming casualties in the war on terrorism. The United States and the Paris-based Financial Action Task Force on Money Laundering are depriving the very countries that most need remittances by imposing blanket sanctions against

governments and financial intermediaries suspected of funding groups such as al Qaeda. And, as part of the effort to monitor suspicious transactions, Western countries are compelling institutions that transfer money abroad to install expensive new compliance technologies that collapsed states cannot afford. Rather than utilizing such blunt instruments, the international community should build a financial architecture, under the aegis of a multilateral organization such as the United Nations Development Programme, that reduces the costs of sending money and increases transparency to reassure nervous governments. The expenses for such an endeavor would, in all likelihood, be much less than the higher costs of policing monetary

transfers; this initiative would also save money by offsetting the need to send official foreign aid.

Countries in the developing world can also do their part to make the most of the remittances they receive. They can more actively regulate labor market intermediaries, such as contractors who hire farm workers, to ensure that migrant laborers are not being deprived of their full share of wages and other forms of compensation. Governments, however, should not try to increase remittances by offering various preferential schemes, such as tax-free status, since these policies inevitably encourage tax evasion as residents take money out of the country and bring it back in the guise of remittances. Instead, countries can get more



Cashing out Somalis relied on the Barakaat Group of Companies to send remittances home, until the U.S. government shut it down in 2001.

United States labeled "the quatermasters of terror" and shut down in 2001, though the evidence later proved to be quite weak. With remittances representing between 25 and 40 percent of Somalia's total GDP, the humanitarian impact on an already impoverished economy was severe.

As the Somali case illustrates, for the people of failed states like Congo and Afghanistan, as well as for stateless peoples (Palestinians, Kurds, and pre-independence Eritreans and East Timorese), overseas remittances are the oxygen essential not just for family survival and household consumption, but also to finance militant causes. Elsewhere, in places such as Armenia and Croatia, remittances underwrote long-distance

bang for the remittance buck by fostering a supportive economic environment that would encourage families to channel their remittances into productive investments, rather than simply basic consumption. Promoting greater competition in the financial sector and ensuring greater penetration of formal financial institutions, especially banks, in areas with high levels of emigration may be the best way to leverage the long-term productive impact of remittances.

Ultimately, if remittances are to become the principal mechanism to transfer money to poor countries, industrialized nations will have to adopt more liberal immigration policies. However, governments in rich countries, already facing a domestic backlash against migrants who supposedly steal jobs and drive down

wages, are unlikely to embark on such a bold initiative. After the September 11 terrorist attacks, U.S. officials informed the Mexican government not to expect immigration laws to change anytime soon. Advocates of more sensible immigration policies—who have long argued that foreign workers enhance rather than undermine productivity—are now adding remittances to their list of talking points, trying to make the case that allowing more migrants to send money abroad is a moral cause akin to debt forgiveness. They deserve credit for striving to give poverty in the developing world a human face, even though industrialized countries are more often comfortable with poverty-reduction schemes that keep those human faces back home. ■■

[Want to Know More?]

This article draws on the authors' forthcoming monograph, *"Sharing the Spoils: International Human Capital Flows and Developing Countries"* (Washington: Center for Global Development, 2004).

For analysis on global immigrant flows, see *"International Migration: Facing the Challenge"* (*Population Bulletin*, Vol. 57, No. 1, March 2002) and *Trends in International Migration* (Washington: Organisation for Economic Co-operation and Development, March 2002). Demetrios Papademetriou refutes the claim that migrants from the developing world impose costs on their rich host countries in *"Think Again: Migration"* (*FOREIGN POLICY*, Winter 1997-98).

Dilip Ratha offers an extensive overview of the impact of remittances in the developing world in *"Workers' Remittances: An Important and Stable Source of External Development Finance,"* Chapter 7 in *Global Development Finance* (Washington: World Bank, 2003). The Multilateral Investment Fund, the private sector arm of the Inter-American Development Bank, and the Inter-American Dialogue have been examining trends in remittance flows from the United States, particularly to Latin America. See, for instance, *"The Developmental Role of Remittances in U.S. Latino Communities and in Latin American Countries"* (Washington: Inter-American Dialogue, 2000) by B. Lindsay Lowell and Rodolfo O. de la Garza and *"Worker Remittances in an International Scope"* (Washington: Inter-American Dialogue, 2003) by Manuel Orozco. Susan Eckstein examines remittances to Cuba in *"Diasporas and Dollars: Transnational Ties and the Transformation of Cuba"* (Massachusetts Institute of Technology: Rosemarie Rogers Working Paper #16, 2003). On possible links between the brain drain and remittances, see Richard H. Adams Jr.'s *"International Migration, Remittances and the Brain Drain: A Study of 24 Labor-Exporting Countries"* (Washington: World Bank Policy Research Working Paper, No. 3069, June 2003).

Nikos Passas's 2003 report *"Hawala and Other Informal Value Transfer Systems: How to Regulate Them?"* is available on the Web site of the U.S. State Department. Cindy Horst and Nick Van Hear explore the impact of counter-terrorism efforts on remittance flows in *"Counting the Cost: Refugees, Remittances, and the 'War Against Terrorism'"* (*Forced Migration Review*, Issue 14, July 2002).

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