Policy brief

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Remittances in the time of COVID-19

Challenges and opportunities for growth in developing countries

In brief

- The COVID-19 pandemic has placed unprecedented restrictions on travel, trade, and economic activity, triggering a global economic crisis. Remittances to developing countries are falling sharply as a result. Migrant workers and their families, many dependent on the remittance flows sent from abroad, are expected to suffer acutely.
- This brief underscores the importance of remittances to developing countries. For the families of migrant workers, they offer much needed income to support consumption, access to healthcare, and education. In many countries, they represent a sizeable portion of financial inflows which support macroeconomic stability.
- In the short-term, the authors recommend accelerating data collection on remittance flows and recipients, supporting migrant residence and employment, keeping financial services open, and bringing costs down through financial competition and mobile money.
- In the post-pandemic environment, where economic recovery will be the priority but there will be fewer remittances to support it, the authors recommend exploring ways in which the development impact of remittances can be magnified. This could come from financial innovation, education, and digital services.

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The role of remittances in developing countries

Across the world, international migration and remittances have increased significantly in recent decades. Since 2000, the migrant stock increased by 50% and in 2017, close to 258 million people lived outside their home country. In 2019, total remittances flows amounted to USD 714 billion, close to 1% of global output. Remittance inflows, both in nominal terms and as a percentage of GDP, tend to be higher in low- and middle-income countries and were larger than foreign direct investment (FDI) in 2019 (World Bank, 2020). India is the largest remittance-recipient country, amounting to USD 83 billion (Shrestha, 2019).

Households in migrants' origin countries use remittances for various purposes. Migrants send remittances to repay loans taken to finance education or migration. Households use remittances to support income, purchase assets, and invest in businesses. There is also evidence that remittances encourage entrepreneurial activities (Woodruff and Zenteno, 2001; Yang 2008b). Remittances thus enhance household welfare through either consumption smoothing or in a sustainable way through investment (Ajaero, 2018; Kangmennang, 2018). In addition, remittances act as insurance for recipients when they are experiencing some sort of economic shock, increasing when recipient income falls (Yang and Choi, 2007; Yang, 2008a). Evidence from Bangladesh also suggests that the welfare impacts are higher for international remittances than domestic ones (Wadood and Hossain, 2017; Kamal and Rana, 2019).

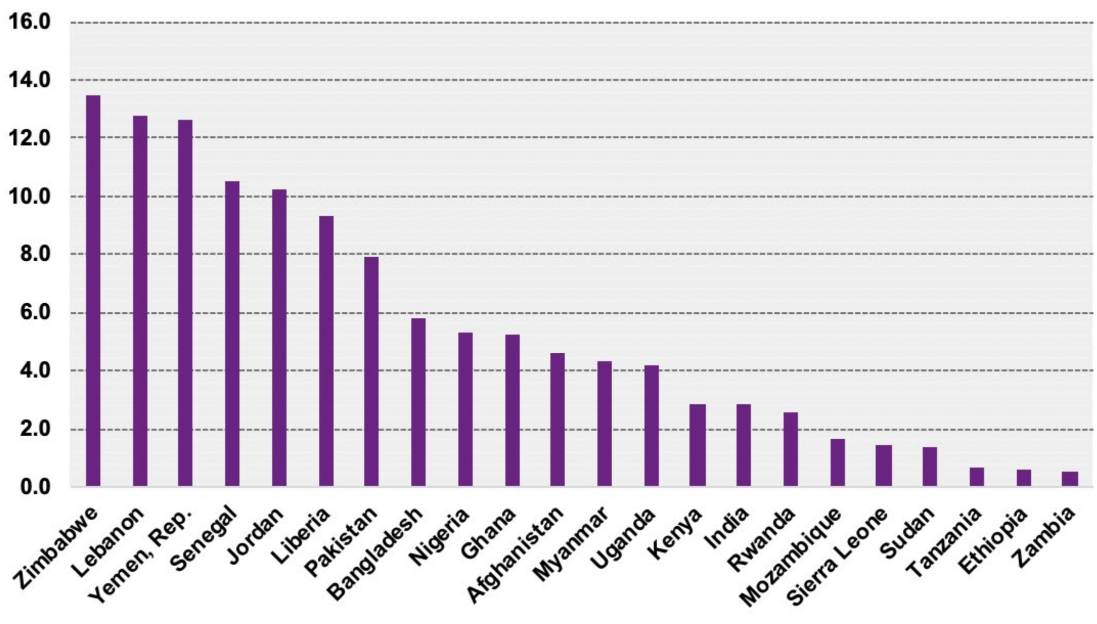
At a macroeconomic level, research has struggled to identify a clear relationship between remittances and economic growth in origin countries (Yang, 2011; Clemens and McKenzie, 2018). This may be due to measurement errors, insufficient statistical power in analysis, and the contractionary effects of migrant labour leaving origin countries (Clemens and McKenzie, 2018). International remittances often account for a large share of foreign exchange earnings and help countries that are facing foreign exchange shortages (Meyer and Shera, 2017; Feerny et. al., 2014). The inflow helps to finance development and reduce macroeconomic volatility, thereby encouraging more investment (Gapen, 2009). Remittances contribute to higher consumption spending and the accumulation of physical capital and productive capacity by reducing the cost of capital (Imai, 2014; Gapen, 2009). Remittances promote human capital development by removing information and liquidity constraints. Evidence shows that migration helps to fill information gaps on the importance of education and remittances help liquidity constrained households to send children to school and keep children out of the labour force (Acharya, 2014; Salas, 2014; Yang, 2008b). Azizi (2018) also finds that health expenditure and school enrolment increases as a result of remittances, as well as raise educational investment for girls relative to boys.

The impact of COVID-19 on international remittances

The COVID-19 pandemic has disrupted the global economy in a multitude of ways. Because of domestic containment measures and the subsequent economic downturn, the World Bank estimates that international remittances are projected to fall around 20%. For low and middle-income countries, remittances are projected to fall around 19.7% to USD 445 billion (World Bank, 2020). Migrant workers are expected to experience a substantial fall in their wages and employment, causing severe distress to the livelihoods and economies of their countries of origin.

International remittances depend primarily on the ability of migrants to move and work. Due to domestic containment measures and the economic downturn, the demand for migrant labour is expected to fall. This will reduce remittance flows and may force migrants to return to their country of origin, whether voluntarily or by losing their residence status. This will cause a drop in remittances as well as add surplus labour back into the country of origin, worsening already strained employment and wages. It is unlikely that migrant employment will rebound quickly to pre-pandemic levels and the extent of recovery will depend partly on how national governments in the country of destination protect their employment and residency status.

Figure 1: Remittances as a share of GDP in selected countries



Source: World Bank (2020): Migration and Remittances data

Effect on financial inflows

For many low and medium-income countries, international remittances account for a large proportion of financial inflows. Where remittances are very high, such as Zimbabwe, Lebanon, and Yemen, a 20% decline in these flows will lead to a significant deterioration in fiscal and trade balances, on top of the welfare effects experienced by the recipients themselves. This will threaten macroeconomic stability as these countries will find it difficult to finance their obligations, exacerbating the economic crisis. In other countries where the share of remittances is low as a percentage of GDP, such as Tanzania, Ethiopia, and Zambia, the macroeconomic effects will not be as severe. However, remittance recipients will still experience a substantial fall in income and living standards.

Remittances play an important role in providing low-cost deposits in the financial sector of the remittance-receiving country. As these flows reduce, banks will find it increasingly difficult to extend credit to other economic actors, such as the government or firms. In many low- and middle-income countries, small and medium businesses already find it difficult to access credit. With the cost of finance expected to increase, they will find it even more challenging alongside a constrained demand environment. As the pandemic spreads in low-income countries, disruptions in the channels of remittances transfers are expected. Domestic containment strategies may limit the ability of recipients to access their funds.

Impact on households and migrants

Households that rely on remittances for income are at risk of seeing their living standards deteriorate. Welfare will decrease and it is possible that investments in education and health will also fall. This will worsen social and economic conditions in recipient countries, which are likely already suffering due to the fallout of COVID-19. There will be a greater burden placed on already overstretched national governments to respond to this, whether through larger social protection programmes or provision of other public services. Lower remittances may also depress productive capacity insofar that investment will be curtailed by the self-employed or SMEs that receive them.

Compared to previous crises, the COVID-19 pandemic is exceptionally troubling for the flow of international remittances. The global nature of the shock sees worsening economic conditions everywhere, meaning that the traditional nature of remittances serving as a counter-cyclical flow or insurance mechanism is compromised. During downturns, it is often economic activity in the migrants' country of destination that plays the largest role in determining the level of migration and subsequent remittance flows (World Bank, 2009). This was witnessed during the global financial crisis in 2009 and the oil price decline in 2014. Additionally, a downturn can worsen outcomes for migrants and often lead to long-lasting political backlash and discrimination against immigrants (Hatton and Williamson, 2009). Evidence suggests that the COVID-19 pandemic has fuelled hostility against foreigners (Bartos et. al, 2020), suggesting that future immigration policy could be affected.

Short- to medium-term policy priorities

Understand and identify remittance flows more effectively: The role of household surveys

Enhancing the collection and quality of migration and remittances data is imperative for evaluating and monitoring policy decisions related to the economic impact of remittances. This will be crucial for governments to design effective policy that mitigates large and sudden shocks, whether that is macroeconomic, financial sector, or social protection policy.
The main source of remittances data is Balance of Payments (BoP) data which is compiled by financial institutions like national central banks and the IMF. These datasets include aggregate information about remittances inflow and outflow, and analysis of remittances trends and projections. Another source of remittances data is household surveys which are often preferred to BoP data.

Remittance records of financial institutions capture only a portion of the actual remittance flows. This is primarily because remittances are often sent through informal channels, such as in-person transfers, and because formal transfers are not always recorded as remittances. In addition, the diversity and complexity of migration-related financial transfers raises many questions about which transfers should be regarded as remittances. (Brown et. al, 2014). Aggregate data are also subject to the variations of compilation on a national basis. Concepts and methodologies are not applied uniformly across all countries. (IMF, 2007).

Surveys, and in contrast to aggregate data, provide microdata on individual use of remittances and transactions. They can explain how remittances are distributed across the receiving population and identify the consumption and investment channels they are used in. Moreover, surveys allow for the collection of complementary categorical information that makes it possible to analyse determinants or impacts of remittance flows.

There are three basic designs with respect to the geographical perspective of data collection:

- Sending-side surveys are conducted in the migrants' 'destinations among potential remitters'.
- Receiving-side surveys are conducted in migrants' 'areas of origin among potential recipients'.
- Matched-sample surveys are conducted at both the receiving and the sending end among members of the same households or families (Brown et. Al, 2014).

Tracking migrants' home country households can be difficult and expensive and therefore such studies are rare. Due to the urgent need in low- and middle-income countries to understand the severity of the COVID-19 pandemic, there has been a huge effort to collect data on various economic indicators. Questions on remittances should be included in survey designs both now and in the future.

Maintain the flow: Migrant residency and financial services are essential

Remittances have declined in the first quarter of 2020 and this trend is expected to continue throughout the year. As the COVID-19 pandemic started to unfold globally at the end of February, global economic activity was brought to a near standstill. Millions of migrants lost their jobs or had their income reduced, were stranded, and left with little to no support from their country of destination. The closing of banks and financial services operators in both the countries of origin and destination left the families of migrants at home with no access to remittances, a lifeline for many.

The health and socio-economic crises wrought by the COVID-19 pandemic are unprecedented. Previous research indicates that remittances are more resilient to economic crises than private capital, FDI, or foreign aid flows as migrants often maintain their remittances even if the economic conditions deteriorate in the country of destination (Ratha et al., 2008). Although remittances declined in 2009 as a result of the financial crisis, the decrease was by a modest 5.2%, in sharp contrast with the declines seen in global private capital flows (World Bank, 2012). However, migrants need the essential financial services that allow them to send remittances. As restrictions are slowly being eased and countries around the world are starting to reopen their economies, there are several measures that can be put in place in the countries of origin and destination to help migrants and their vulnerable families back home.

Policymakers in countries of destination should focus on employment retention and promotion policies. Measures for economic reactivation with a job-rich approach would protect migrant workers and incentivise them to remain in the country of destination . Amongst the most affected migrants are the ones engaged as household workers and those working in construction, manufacturing, and agriculture (ILO, 2020). Drawing on the migrant workers' experiences after the financial crisis in 2008, many refused to go back to their countries of origin out of fear that it might be difficult to return to their jobs and communities in the country of destination when the economy recovered. Demonstrating a high level of resilience, migrants reprofiled and turned from sectors that were declining, such as construction, to other sectors that were facing labour shortages, like retail trade and agriculture (Ruiz, Vargas-Silva, 2010). With targeted measures in place to support migrant workers and ensure they have access to healthcare and social protection, a similar transition to cover labour gaps post-lockdowns would benefit both the economies of the destination and origin countries.

Next, it is vital for migrants to be able to send money home and for their families to be able to receive it. An immediate intervention would be to recognise remittances as essential services. This needs to be complemented by longer-term solutions, such as digitising payments and leveraging innovations in technology, ensuring that everyone can access formal financial services and reducing the costs of sending and receiving remittances.

Reduce costs: Competition matters

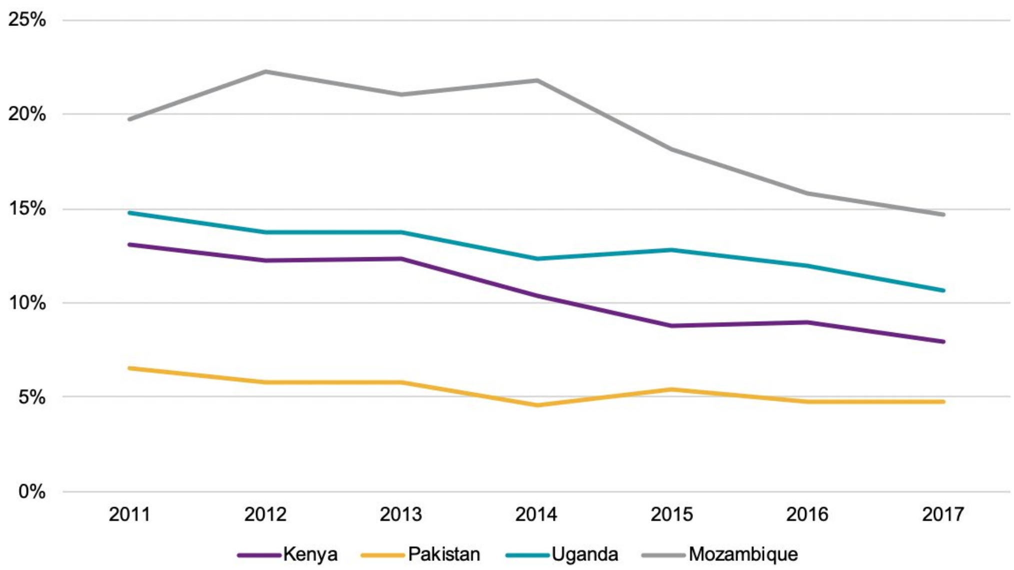
Sending and receiving remittances is expensive. According to Remittances Prices Worldwide (RPW), the global average cost of sending remittances was 6.8% in the first quarter of 2020 which is more than double the 2030 SDG target of 3%. Sub-Saharan Africa continues to have the highest regional average (8.9%), followed by East Asia and Pacific (7.13%), Middle East and North Africa (7%), and Europe and Central Asia (6.48%). Costs by the type of remittance service provider (RSP) indicates that bank transfers have the highest cost (10.5%), followed by Money Transfer Operators (MTO) (6%), Post Office (7.49%), and Mobile Operators (3.37%).

Reducing the costs of remittances could bring substantial benefits to recipients and their countries. According to the IMF, if the cost of sending remittances could be reduced by 5 percentage points, remittance recipients could receive over USD 16 billion more each year. Moreover, studies suggest that remittances have high cost elasticity, so that lowering costs will lead to a more than proportionate increase in remittances received by households. (Gibson et. al, 2006)

Research also suggests that reducing remittance costs impacts migrants' decisions in regard to the amount of money they send home and how frequently they do it. Temporary discounts lead to substantial increases in the number of transactions and total amount remitted during the discount period and are persistent up to 20 weeks after expiration of the discount (Ambler, Aycinena, and Yang, 2015).

According to Cecchetti and Schoenholtz (2015), there are two major mechanisms for reducing costs: consumer education (about the cost of alternatives available) and enhancing competition. Expanding mobile technology is helping to displace banks and squeeze remittance costs, an area that we will explore further in the next section. Beck and Peria (2009) analyse transaction costs and found that corridors with a larger number of providers exhibit lower fees. Bank competition in the receiving country seems to be negatively associated with the cost of sending remittances. Corridors with a higher share of banks among providers, on the other hand, exhibit higher average fees.

Figure 2: Costs of remittances in selected IGC Countries



Source: World Bank, Remittances Prices WorldWide.

Scale up the adoption of mobile money services

Mobile money adoption in low-income countries have revolutionised the landscape of financial inclusion and offered viable solutions to issues such as weak institutional infrastructures and high costs of conventional banking. By 2017, mobile money was available in two thirds of low- and middle-income countries (Aron, Muellbauer, 2019). In 2019, the number of registered mobile money accounts surpassed one billion. With 290 live services in 95 countries and 372 million active accounts, mobile money is quickly becoming a global phenomenon and a pathway to financial inclusion in low-income countries (GSMA, 2019).

Mobile money has supported more transparent and cheaper methods of remitting. The impact on international remittances could achieve new highs if issues like poor regulations, inadequate infrastructure, high data costs, and low internet penetration rate are addressed . As remittances will be more important in supporting vulnerable families through COVID-19 and beyond, technological innovations and new product development should be pursued. In order to surpass the main barriers to achieving scale, policymakers, representatives from the private sector, and other relevant stakeholders should engage in constructive dialogue and enhance collaboration.

Lowering costs and resolving key security concerns could attract more international remittances. Security issues present a challenge mainly because of poor compliance to international law in the countries receiving remittances. If the local compliance challenge can be solved, mobile money should facilitate more remittances to fragile states affected by conflict like Somalia, which has 40% of its population depending on remittances (Hammond et al, 2020). Flexible regulation should be used, ensuring that regulation is proportional to the level of risk posed by different mobile money services and the value of transactions (Logan, 2017).

Successful mobile money services

Kenya launched the world's most successful mobile payment service "M-PESA" in 2007. The rapid expansion of M-PESA in Kenya includes the Central Bank of Kenya's regulation to allow the entry of the telecom operators into the financial sector, the user-friendliness and affordability in using M-PESA services, and the high level of the literacy rate and mobile phones penetration in Kenya (Soyres, Jelil, and Cerruti, 2018).

Bangladesh's mobile banking services have rapidly expanded across the country since 2011. The total number of agents is close to 1 million, with 81 million registered customers in 2020 (Central Bank of Bangladesh). The growth of mobile banking services in Bangladesh is due to the benefits of shared goal and information flows (i.e. meetings and quantity of training) between the master and retail agents (Estrin, Khavul, and Pelletier, 2017).

The scale up of mobile money services in developing countries can bring sustainable growth as well as economic opportunities for the large unbanked population (Etim, 2014). Research suggests that households with mobile money accounts receive a greater number and value of remittances in the face of a negative shock than households without mobile money accounts (Jack and Suri, 2014). In the face of a medical health shocks, mobile money users have been able to spend more on medical expenses while also increasing expenditure on food and keeping children in school (Jack, Stoker and Suri, 2012). The COVID-19 pandemic has accelerated global efforts on digitising payments and advancing financial inclusion and resilience via fintech products at an unprecedented speed, but the complexity of the issue requires sustained collaborative efforts from policymakers and the private sector, as well as coordinated international leadership.

Long-term policy priorities

Improve productivity: Do more with less

Enhancing productivity of remittances refers to channelling funds into productive activities. Evidence shows that remittances are positively correlated with consumption, well-being, education, health, entrepreneurial investments, and entrepreneurial income. Further evidence also suggests that increases in remittances lead to improvements in all of these areas, promoting poverty reduction, enhancing education, and encouraging the development of household enterprises. The long-run benefits of remittances can be enhanced through several mechanisms, which are vital for long-run recovery from the effects of the COVID-19 pandemic.

One way of improving the long-run productivity of remittances is through providing migrants and households access to formal financial services, such as savings instruments (Chin Ashraf et al, 2015; Chin et al 2011). This allows migrants and recipients to channel funds into savings, which build long-run resilience. For example, Banco Solidario in Ecuador provides a number of innovative remittance-linked financial services for migrants and recipients. In addition to savings and credit products, Banco Solidario provides mortgages and loans for migrants and their families for improving microenterprises, paying for the costs of migration travel, housing, education, and small investments (Peria, Mascaro and Moizeszowicz, 2008). They also have products that enable migrants to buy mortgages at sales offices abroad, and families back home to buy a mortgage by showing proof of at least three remittance transfers received from abroad (Derham, 2005).

Evidence also shows that targeting remittances to particular input products within an enterprise can improve productivity. For example, a study by Yang and Batista (2013) in Mozambique found enabling migrants to send money directly for buying and delivering agricultural inputs (i.e., fertilisers and seeds) increased the use of fertilisers by remittance receipt, in turn increasing productivity. Matching is also a mechanism that improves the targeting of remittances to productive means and enhances the overall resources available for productive investments. For example, El Salvador has a matching product available that enables migrants to fund education for children with monthly instalments. Analysis showed that this matching fund increased education expenditure and private school attendance as well as reducing youth labour supply (Ambler, Aycinena and Yang, 2015).

Several studies also show that migrants have a preference over how the remittances they send home are used (Ashraf et al, 2015; Ambler et al, 2015; De Arcangelis et al, 2015; Joseph et al, forthcoming). Therefore providing migrants with better monitoring and control over how their remittances are being used by recipients will also enhance the long run productivity of the funds. For example, a study on Salvadoran migrants and their recipients of remittances showed that migrants value and take advantage of opportunities to exert control over savings in their home country (Mckenzie and Yang, 2015). Another important priority is the need to provide financial education that encourages more communication and joint decision-making between migrants and their remittance recipients, which will have a positive impact on household savings and remittance uses (Seshan and Yang, 2014; Ambler, 2015; Doi et al, 2014).

Go digital: Support financial inclusion

Digital adoption through mobile money operators provides a unique infrastructure for remittance flows both internationally and domestically. For example, mobile network operators introduced the mobile-money services M-PESA in Kenya in 2007 and it is now being used by approximately 70% of Kenya's adult population. Customers can deposit and withdraw money with an affordable transaction fee from a network of agents who are grocery stores owners, tailors, and gas stations owners. M-PESA has enabled migrants to send money back to their families in rural areas safely, cheaply, and effectively without the need to send money through relatives, friends, and even strangers who travel to the villages. A study also found that the consumption of households that use M-PESA for remittances remains unaffected while the households without M-PESA accounts experienced a 7% decrease in consumption when they experience income shocks (Jack and Suri, 2014).

In countries that do not have mobile money in place, there are typically more barriers faced in keeping remittance channels open. This is especially the case when large numbers of the population are not bankable, and when the international channels for sending digital money between migrant workers and recipients are limited. A large portion of remittances is also sent through informal, traditional methods using cash, which is restricted due to containment measures and travel restrictions. In the short-run, it is necessary to keep these channels open and to work with providers to ensure people can receive remittances without the burden of high costs. Mobile money can also be used as a vehicle for cash transfers and other welfare initiatives.

For countries that do not have mobile money, there is a need to create an enabling environment that attracts investment into this sector. This requires policies and a regulatory framework that is forward looking and enables investment, but also captures the economic benefits. Essentially mobile money is a gateway to financial inclusion for migrants and their families. Therefore, adopting digital money mechanisms is a way to bank the financially excluded, which provides welfare benefits and also contributes to economic growth. Adoption of mobile money is also dependent on context, requiring evidence and political buy-in to make it happen effectively. Some countries adopt mobile money at a sector-specific level, for example, for the payment of civil service wages. This is an effective way of targeting the benefits of digital adoption to sectors best placed to contribute to long-term economic resilience.

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