No. 64
July 2009

TRÉSOR-ECONOMICS

How vulnerable are the emerging and developing countries to a drop in migrants' remittances?

This study was prepared under the authority of the Treasury and Economic Policy General Directorate and does not necessarily reflect the position of the Ministry for the Economy, Industry and Employment.

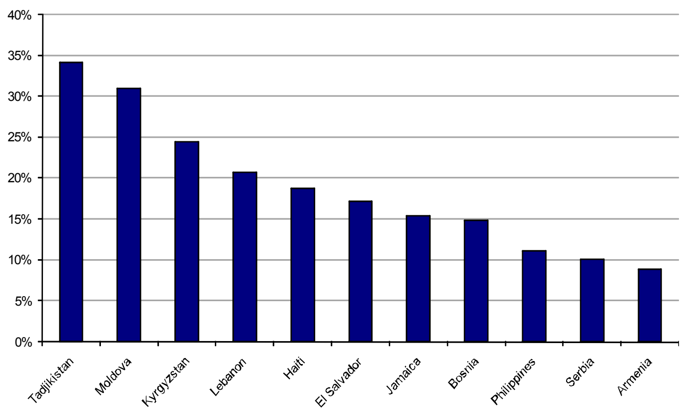
- Emerging countries' payments balances have come under severe pressure since the onset of the crisis in Autumn 2008, as widespread deleveraging has led to massive capital outflows from these countries. In earlier crises affecting the emerging countries migrants' remittances proved resilient, acting as a stable source of financing. This appears to have been less the case in the present crisis, however, the migrants' host countries having equally been affected by the crisis.

- Falling migrants' remittances have dented the macro financial position of the countries concerned, especially given that these were a prime source of financing during the previous growth cycle (especially in cyclical sectors such as property, etc). The adverse impact on activity has also impacted other sources of hard currency, leading to a rise in these countries' borrowing requirements.

- The emerging countries that are a priori most vulnerable to a reduction in transfers share a number of characteristics: they are small, their current accounts are heavily dependent on incoming remittances, and they are linked to a source country whose macro financial situation and/or where the situation of migrants is deteriorating. This concerns the CIS countries, Central America and the Caribbean, and certain Eastern European countries such as Romania, and Asia (e.g. the Indian subcontinent and the Philippines).

- Some of these countries already appear to be suffering badly in the first quarter of 2009. The worst affected countries were those of the CIS, where the year-on-year drop in remittances amounts to 30%. The reduction comes to around 10% over the year in Central America and the Caribbean for the first quarter, but the decline is accelerating. The Asian countries, particularly Pakistan, Bangladesh and the Philippines, on the other hand, have been spared for the time being and transfers are proving resilient.

Selected countries' dependence on migrants' remittances (% of GDP)



Source: Worl Bank

DIRECTION GÉNÉRALE DU TRÉSOR ET DE LA POLITIQUE ÉCONOMIQUE

1. Whereas migrants' remittances have customarily been a staple source of financing in most of the crises experienced by the emerging countries, the global nature of the present crisis is squeezing them[1]

Emerging and developing countries have grown accustomed to viewing migrants' remittances as an "automatic stabiliser" in times of crisis over the past 25 years. That is because the crises experienced were inherent to them while the host country economy might well remain dynamic during that period. Migrants' remittances thus served to cushion the impact on the current account adjustment process of a sudden interruption in capital flows. Migrants' remittances played a partially stabilising role, attenuating the pro-cyclical effects of capital flows and imprudent economic policies that sometimes resulted in brutal tightening in a crisis.

The current crisis is very different from these previous episodes, since it originated fundamentally in the developed countries. **As in earlier crises, it has resulted in a contraction of capital flows (since October 2008), but it is also been accompanied by a reduction in migrants' remittances** under the combined effects of the crisis in the developed countries and in certain other regional centres of migration (such as Russia, Kazakhstan and the Gulf States). While the World Bank is forecasting a still limited decline of 7.3% (from USD 328 billion in 2008 to USD 304 billion in 2009), these aggregated projections could well mask sharp regional disparities.

In practice, future trends in remittances will depend on several factors, some of which will only be possible to verify empirically *a posteriori*. Among these:

- trends in migrants' income from work in the host country, linked to their rate of employment and wages (with different dynamics in the formal and informal sectors).
- migrants' behaviour with regard to saving: they could decide to provide greater support to their families, which would help to smooth remittances, or on the contrary they might prefer to increase their precautionary savings rather than remit them.
- the return of immigrants to their country of origin: this can be a favourable factor in the short term, if accompanied by repatriation of their savings, but it would lead to the drying up of this source of remittances in the medium term. Voluntary returns are also occurring, as in the EU, where people are free to move around.
- Increasing instability in the recipient country's banking sector, which could encourage migrants to delay transfers or to send the money via more informal channels.

2. Along with the African countries, the countries of Central Asia, Central America, the Caucasus and Eastern Europe are those most vulnerable, a priori, to a reduction in migrants' remittances.

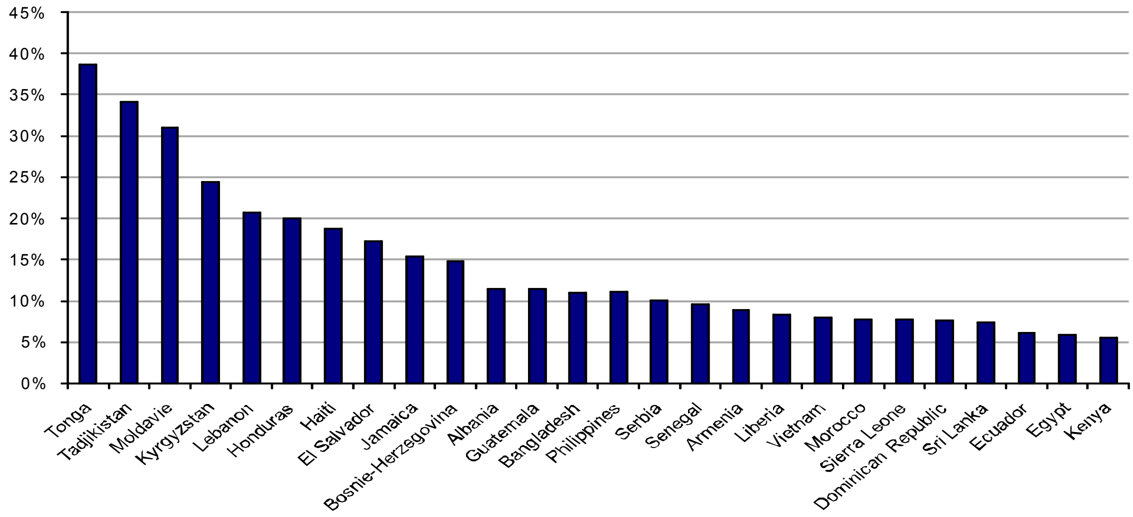
Not all emerging and developing countries are equally vulnerable, theoretically, to a reduction in migrants' remittances. Their *ex-ante* vulnerability depends: 1) the degree to which emerging countries are dependent on these flows, 2) the probability that these flows will diminish, and 3) structural or cyclical tensions in the balance of payments, independently of these remittances.

2.1 The countries most dependent on migrants' remittances are small ones, particularly in Africa and Central America, and frequently among the less developed

In the first place, a country's dependence on migrants' remittances is directly dependent on their share of GDP. Chart 1 shows that many of these countries are small. Some countries are additionally vulnerable because of factors such as a history of armed conflict (as with Lebanon), recurring political problems (Moldova or Haiti), or because of being an island (Tonga or Haiti). These are the cause of very substantial migratory flows, which means migrants' remittances can be very significant.

(1) Migrants' remittances are recorded in the current account. While they take the form of foreign exchange resources, they are nevertheless not counted in capital flows.

Chart 1: Migrants' transfers as a proportion of GDP (%)



Source: World Bank

2.2 The recipient countries' degree of vulnerability also depends on the extent of the crisis in the countries providing migrants' remittances. The CIS countries look particularly vulnerable on this score

Not all of the countries that depend heavily on migrants' remittances are equally likely to see these remittances affected by the crisis.

Simplifying somewhat, there is a considerable risk of a fall in these remittances if the source countries are significantly affected by the crisis[2] **and if these transfers are easily reversible**. The potential reversibility of migrants' remittances is estimated in the light of the growth in funds remitted over the past three years (between 2004 and 2007). This is because the new transfers that have emerged in recent years may be considered to be the least stable: these new transfers are attributable to migrants not yet institutionally established in the country, and this type of migrant tends to work in highly cyclical sectors such as construction, which are particularly hard-hit in the present crisis.

Seen from the standpoint of the source countries, the combination of hefty outward flows, gloomy growth prospects and the rapid rise in remittances in recent years points to a high risk of a decline in flows of migrants' remittances to the recipient countries. **Table 1 shows that recipient countries in the CIS are at risk of a significant decline in savings remittances**, since the migrants' two main host countries, Russia and Kazakhstan, are affected by the crisis:

- **Russia combines the second-largest annual outward flow of migrants' remittances (USD 17.7 billion in 2007), with a 241.5% growth in the outflow in three years and a forecast negative GDP growth of –6% in 2009. The countries for which this represents a risk are the recipients of these remittances, and that includes virtually all of the CIS countries, particularly the countries of Central Asia, the Caucasus and Moldova.**
- **Kazakhstan has witnessed a 217.9% growth in remittances of funds to other countries in the space of three years.** Annual outflows of migrants' remittances are relatively small (USD 4.3 billion), but most of them go to neighbouring countries such as Kyrgyzstan and Tajikistan, which are both highly dependent on these flows and which have received IMF assistance.

Other countries providing remittances are also suffering from the crisis, though to a lesser extent, which is affecting other regions such as Latin America and Eastern Europe:

- **Spain and Italy** have large annual outflows of migrants' remittances, which have grown significantly over the past three years. Most of the remittances from Spain go to Latin America, while those from Italy go primarily to Eastern Europe (including Romania and Moldova).
- **The United States** is the leading source of remittances by a wide margin, with USD 45.6 billion, but these remittances are more structural than elsewhere (and they have grown by only 16% over the past three years), which suggests that remittances from the United States could prove more resilient. However, these countries could suffer from the recent deterioration in working conditions for Mexican and Central American migrants (in connection with measures to combat the swine flu or A(H1N1) epidemic).

(2) The growth outlook is that contained in the latest IMF World Economic Outlook, April 2009, revised in June.

Table 1: Growth outlook in the 15 main providers of remittances, and "vulnerability" to a reduction in remittances[a]

	Migrants' remittances in 2007 (in USD Bn)	Migrants' remittances, outflows (growth between 2004 and 2005)	Forecast GDP growth for 2009 (World Economic Outlook, April 2009, revised in June)
United Stes	**45.6**	**16.0%**	**–2.6%**
Russia	**17.7**	**241.5%**	**–6.5%**
Switzerland	16.3	25.9%	–3.0%
Saudi Arabia	16.1	18.5%	–0.9%
Spain	**14.7**	**111.1%**	**–3.0%**
Germany	13.9	14.8%	–6,2%
Italy	**11.3**	**104.8%**	**–5.1%**
Luxembourg	9.3	54.7%	–4.8%
Netherlands	7.8	55.6%	–4.8%
Malaysia	6.4	26.1%	–3.5%
United Kingdom	5.0	70.7%	–3.8%
France	4.4	2.8%	–3.0%
China	4.4	111.5%	–7.5%
Kazakhstan	**4.3**	**217.9%**	**–2.0%**
South Korea	**4.1**	**63.0%**	**–3.0%**

a. Data shown here stop at 2007, because 2008 brought a first downturn in some countries in the course of the year, but this downturn does not permit correct identification of the most substantial risk factors.

Sources: World Bank and IMF

2.3 A more detailed analysis, by factor of vulnerability to a reduction in migrants' remittances, reveals the weakness of the small CIS countries and that of those in Central and Eastern Europe, Central America and certain Asian countries

Among countries receiving substantial migrants' remittances and at risk of a sharp downturn in these transfers as a result of the crisis, the most vulnerable are those also experiencing balance of payments difficulties. Two situations can be distinguished in this regard:

1. Countries whose balance of payments is structurally dependent on migrants' remittances

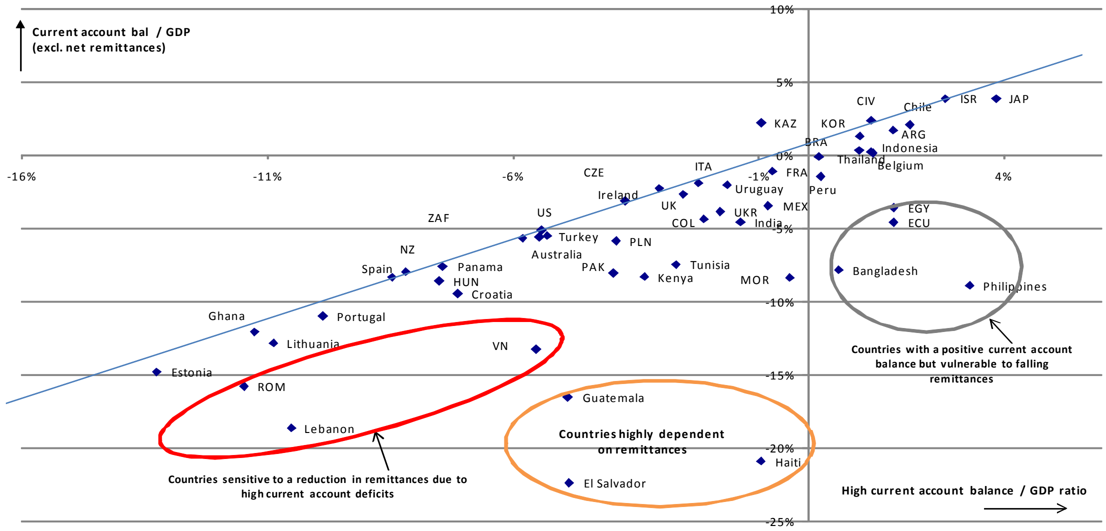
2. Those with a cyclically adverse balance of payments on the eve of the crisis.

The higher net migrants' remittances are as a share of the balance on current account transactions and the higher the current account deficit, the greater will be the structural dependence of the balance of payments on migrants' remittances. This can be identified by means of a "simple" comparison[3] of two indicators, namely the ratio of current account balance on transactions to GDP, and the same ratio adjusted for net migrants' remittances. This serves to identify those countries whose external balances could deteriorate significantly with the crisis as a result of dwindling migrants' remittances. **Here our view of vulnerabilities is structural, since the two ratios are calculated as averages over the last five years available.**

The Latin American countries, especially El Salvador, Guatemala and Haiti, are very much concerned by the dependence of their balance of payments on net migrants' remittances. Other countries are highly vulnerable because their current account deficits are already large, a situation further aggravated if they are even relatively mildly dependent on remittances. Countries in this position are Bulgaria, Romania, Lebanon and Vietnam, whose deficits are widening. By extension, it is worth noting that while the Philippines, Bangladesh, Ecuador and Morocco are in surplus on their structural current accounts, a pronounced downturn in net remittances would tip them significantly into deficit.

(3) Indeed this comparison suggests that net remittances could cancel each other out entirely, which is clearly highly unlikely.

Chart 2: Countries whose structural payments balances are most vulnerable to a downturn in migrants' remittances[4]

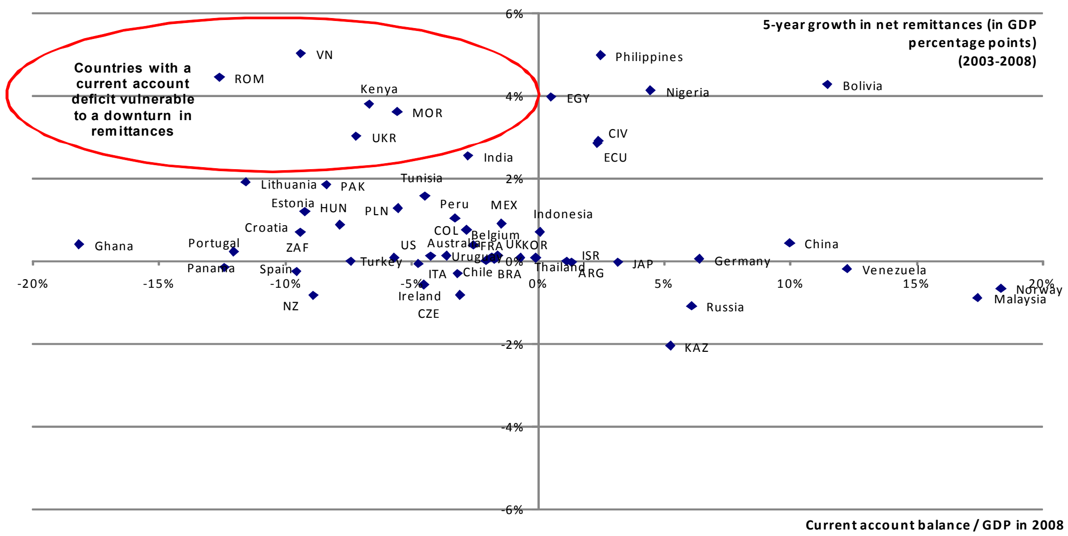


Interpretation: the countries at bottom right are dependent on incoming remittances, while those at top right send remittances to the rest of the world. The current account balances of countries to the right do not depend on net migrants' remittances. Reading along the abscissa, we can see that Guatemala has a current account deficit of 5% of GDP and, reading along the ordinates, that this deficit would rise to 16% of GDP in the absence of migrants' remittances. The vertical distance between and the right and the point on the graph represents the ratio of net remittances to GDP, or 11% of GDP in the case of Guatemala.

Sources: World Bank, IMF

Without necessarily experiencing structural balance of payments strains, some emerging countries may have experienced a cyclically negative balance of payments on the eve of the crisis making them vulnerable to a downturn in migrants' remittances. This cyclical vulnerability can be detected by crossing the current account deficit for the last year in question[5] with the risk of a severe decline in migrants' remittances, assumed to be higher in the case of recently arrived migrants (see above). These elements are crossed with each other in the figure that follows, suggesting that among countries with a cyclically vulnerable balance of payments are Romania, Vietnam, Bangladesh, the Philippines, Morocco, Kenya and Ecuador.

Chart 3: Countries with a balance of payments deficit before the crisis, whose dependence on migrants' remittances is exacerbating vulnerability



Interpretation: reading along the abscissa, Romania has a current account deficit of 14% of GDP, while along the ordinates, we find that the ratio of net migrants' remittances to GDP increased by 4.5 percentage points over the last five years.

Sources: World Bank, IMF

(4) Data are calculated over the medium term, i.e. averages between 2004 and 2008.

(5) I.e. 2007, since net remittances can only be calculated up till 2007 (since the World Bank provides no information on outgoing remittances for 2008).

3. First available data for 2009 suggest that migrants' remittances are down sharply in the CIS countries, and more moderately in the countries of Central America and the Caribbean

Trends in the various regions receiving migrants' remittances have differed since the beginning of the year. First available data, both national and from the World Bank, provide a picture of recent developments in the different geographical regions.

3.1 Worst affected by falling migrants' remittances are the CIS countries

The Russian economy has been deeply affected by the crisis, with GDP declining by 10.1% (year-on-year) in the first half of this year. Thus the *ex ante* factors of vulnerability referred to above (i.e. remittances representing a high proportion of GDP, strong growth in flows of remittances in recent years, and very sharply negative growth in the migrants' host country) have materialised very clearly in the CIS recipient countries, and the decline in migrants' remittances observed in early-2009 is contributing to the hard landing in the economies concerned. Further, the fact that remittances to these countries are in roubles and their external debt in dollars means that the rouble's slide against the dollar has exacerbated their balance of payments deficit.

Under these conditions[6], migrants' remittances to Tajikistan, Armenia and Moldova fell by around 30%, year-on-year, in the first quarter of 2009. While these three countries are among the most vulnerable in the CIS, it looks as if the entire region is at risk from a reduction expected to exceed the World Bank's March 2009 forecast for the Europe-Central Asia zone in 2009, i.e. a 10% drop in migrants' remittances.

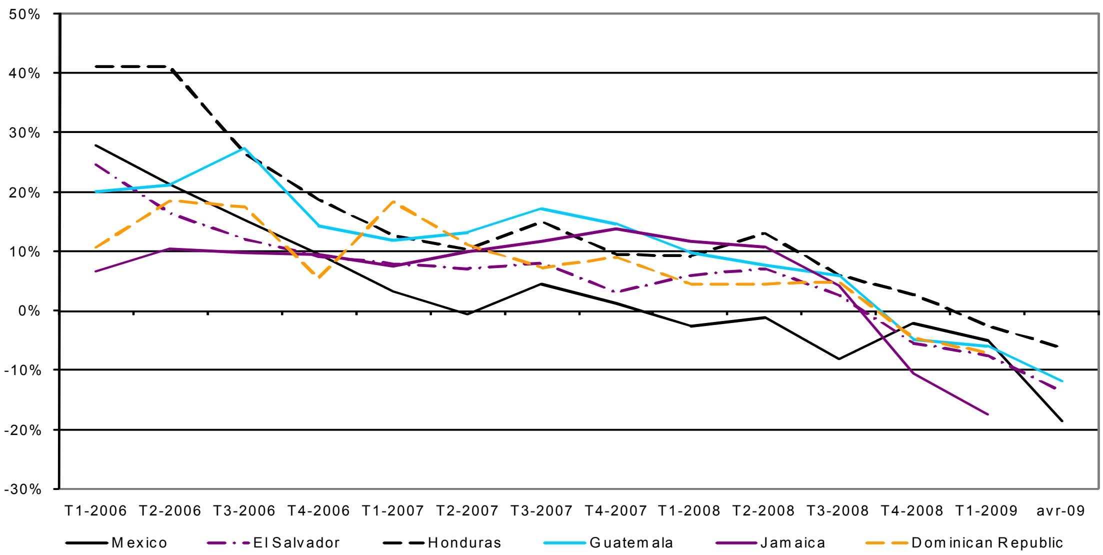
In addition, the difficulties national banking sectors are experiencing appear to be an aggravating circumstance. A study[7] based on the case of Moldova shows that the population is using the banking channel less: whereas in July 2008 20.3% of Moldova's population used a banking channel to remit funds, in March 2009 this proportion had fallen to 15.9%. The population's confidence in the banking sector could therefore have an impact on the scale of migrants' remittances, even if it is quite possible that the proportion of remittances sent via informal channels has increased.

3.2 The countries of Central America and the Caribbean are experiencing a pronounced, though less brutal, decline in migrants' remittances

World Bank data available for the first quarter of 2009 are evidence of a fall in incoming flows of migrants' remittances in Latin America and the Caribbean, though smaller than the changes showing up in national data for the CIS countries. However, if the Latin American and Caribbean countries were to experience a drop of around –7.8% in migrants' remittances in 2009, as forecast in the World Bank's most pessimistic scenario, then the impact would probably be greatest on the smallest countries.

The drop in flows to Latin America is visible in Chart 4, with an 8% fall in Mexico for the first 4 months of the year (year-on-year), among others, though this has gathered pace more recently with the difficulties arising in conjunction with swine flu (A(H1N1 flu) (–19% year-on-year in April 2009) and its still little-documented impact on the employment of Latin American migrant workers.

Chart 4: Change in migrants' remittances to Central American countries (year-on-year changes, calculated on quarterly data)



Source: World Bank

(6) The data used in this paragraph are derived from national sources.

(7) "The Socio-Economic Impact of the Economic Crisis on Migration and Remittances in the Republic of Moldova", *International Organization of Migration, May 2009.*

The reduction in remittances is mainly due to the economic crisis in the United States, where 65% of Latin American migrants live, and which is the source of 75% of inward flows to Latin America. In particular, Latin American migrants are heavily represented in the crisis-hit construction sector. The fact that the remittances are made in dollars softens the impact on the recipient countries, as local currencies such as the Mexican peso have lost ground against the dollar.

The drop in remittances to Central America can also be accounted for by the economic slowdown in Spain, the second-largest source of migrants' remittances to this region. This is especially so in the construction sector, which employs a large number of Latin Americans, as in the United States. Spanish government measures to encourage migrants to return to their country of origin have helped to offset this effect, as migrants have returned home (with their savings).

3.3 The other geographic zones are more resilient

South Asia accounts for nearly a quarter of the world's inward flows of remittances. Despite the global economic crisis, inward flows have increased in Pakistan (+23% in May 2009 relative to May 2008) and in Bangladesh (+21.9% over the same period), while Sri Lanka has experienced a fall of 1.7%. The increase in remittances to Pakistan and Bangladesh may be accounted for by the preponderance of flows from the Arabian Peninsula countries, where work continues on infrastructure projects thanks to the financial reserves built up by the Gulf States when oil prices were high. Remittances to the Philippines continued to grow in the first quarter of 2009 at a year-on-year rate of 2.6%.

Migrants' remittances to Middle Eastern countries (where these frequently represent a substantial source of revenue[8]) are expected to be resilient, according to the IMF. This view is corroborated by the World Bank, which expects a moderate fall in the amount of remittances to the oil importing Middle Eastern countries in 2009 (to USD 29 billion in 2009, down from USD 31 billion in 2008). The bulk of these flows come from the Gulf Cooperation Council States (Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates, and Bahrain), which have accumulated sufficient financial reserves to cope with a temporary drop in oil revenues.

Finally, sub-Saharan Africa is expected to experience greater difficulty, given that 80% of migrants' remittances to the countries in this region come from the developed countries. According to the World Bank, remittances to sub-Saharan Africa are expected to fall 8.3% in 2009. Migrants' remittances to the North African countries, chiefly from the European Union (accounting for more than 50% of total remittances to Morocco, Tunisia and Mauritania), meanwhile, are expected to fall by 6% in 2009.

4. The rising borrowing requirements of small countries dependent on migrants' remittances has led to the introduction of controls on the free movement of foreign exchange, and to greater intervention by the IMF

For the countries affected, the fall-off in remittances raises two types of problem, exacerbating their borrowing requirement and damaging their foreign exchange reserves.

4.1 Rising borrowing requirements are forcing the emerging countries to request international assistance on a commensurate scale

Along with reduced capital flows, dwindling migrants' remittances are pushing up the borrowing requirements of countries dependent upon these remittances, forcing them to request international assistance. This assistance is being provided to several countries on a preventive basis, e.g. Costa Rica, El Salvador, Guatemala, Tajikistan and Mexico (all of which have been in receipt of IMF programmes). Assistance has been stepped up to Armenia too, for this reason among others. Other countries, such as Jamaica, Sri Lanka, Moldova and the Dominican Republic, have requested IMF assistance, notably as a result of a larger than expected fall in migrants' remittances.

4.2 Lower migrants' remittances can affect a country's foreign exchange liquidity, sometimes leading to controls on capital movements

A decline in foreign exchange resources exacts a particularly heavy penalty when these remittances provide the foreign exchange a country needs in order to pay for its imports or repay its debts. This phenomenon affects the countries of Central America and the Caribbean in the first place. Remittances to these countries consist of dollars mainly, which are used directly to pay for their imports.

Among these countries, those worst hit by the fall in foreign currency inflows (especially as a result of falling remittances) are those that do not have their own currency, i.e. the dollarised countries. This is the case with El Salvador, Panama, Guatemala and Ecuador, among others. For them, foreign currency inflows are the prime money creating mechanism, since their central banks obviously cannot issue dollars. This problem is made all the more acute by the fact that

(8) Specifically, migrants' remittances represent 20% of Lebanon's GDP, and 14% of that of Jordan.

other sources of currency inflows are drying up at the same time[9].

The shortage of foreign exchange has led certain governments to restrict currency inflows and outflows. Ecuador's banks have been obliged to repatriate USD 1.2 billion out of their USD 3.9 billion in foreign holdings. Venezuela has placed restrictions on foreign currency outflows, cutting the maximum monthly allowance from USD 1,800 to USD 900.

Fabrice BERTHAUD,
Stéphane COLLIAC

(9) In particular, these countries' exports are declining faster than their imports, as the world trade slowdown has combined with falling prices for commodities, their main exports. An additional problem for Ecuador, whose main export is oil, is a default on its public debt, which is barring it from the international markets on which it might otherwise raise some of the necessary foreign exchange. Migrants' remittances to Ecuador are 27% down in the first quarter of 2009 (year-on-year) to USD 554 billion. Altogether, foreign exchange reserves fell from USD 6.5 billion in September 2008 to USD 2.6 billion in May 2009.

Publisher:

Ministère de l'Économie,
de l'Industrie et de l'Emploi

Direction Générale du Trésor
et de la Politique économique

139, rue de Bercy
75575 Paris CEDEX 12

Publication manager:

Philippe Bouyoux

Editor in chief:

Jean-Paul DEPECKER
+33 (0)1 44 87 18 51
tresor-eco@dgtpe.fr

English translation:

Centre de traduction des ministères économique et financier

Layout:

Maryse Dos Santos

ISSN 1777-8050

Recent Issues in English

July 2009

No. 63. The French employment-conditional benefit and its beneficiaries, 2001-2008
Jonathan Duval

No. 62. How does today's US crisis compare with the 1990s Japanese crisis?
Sophie Rivaud, Michaël Sicsic

No. 61. The «Revenu de Solidarité Active» or earned income supplement: its design and expected outcomes
Clément Bourgeois, Chloé Tavan

June 2009

No. 60. China, «laboratory to the world?»
Alain Berder, François Blanc, Jean-Jacques Pierrat

No. 59. Distributable surplus and share-out of value added in France
Paul Cahu

http://www.minefe.gouv.fr/directions_services/dgtpe/TRESOR_ECO/tresorecouk.htm