Potential of Remittances for Rural Development

IFAD's approaches and experiences

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Of the world's total remittances of approximately US$ 350 billion a year, nearly one-third finds its way to the rural areas of the developing world (based on IFAD 2010). This figure is small in percentage terms (considering that nearly 80 per cent of all migrants originate from rural areas), but the magnitude is hugely significant for rural economies, which have traditionally been squeezed out of resources allocated for urban and industrial development. Rising emigration and remittance flows are rapidly redefining the rural landscape in many ways, for example through changes in the composition of the labour force, expansion of economic activities, and larger private investment in development of the rural sector. With significant numbers of people from developing countries migrating every year to other countries and regions, development practitioners need to consider the impact and potential of remittances for overall rural poverty reduction in poor countries.

Impact of remittances on rural economies

Remittances are private funds; as such, they are not readily available for financing development activities. However, in recent years, liberalisation of financial and currency markets have created conditions for the formal financial sector to mobilise remittances and bring them into the realm of development finance.

Over 500 million people (nearly 8 per cent of the global population) depend on remittance income for their livelihood (IFAD 2008). For 30 countries or more, remittances account for about 10 per cent of gross domestic product (GDP). Inflows to Africa in 2010 were reported as US$ 40 billion – almost double the inflows for 2005 (IFAD 2003b). Nevertheless, views on the importance of remittances (and of migration, which is the other side of the story) differ.

On the one hand, there is evidence of a positive impact of remittances on income and poverty for recipient households (Wodon et al. 2002; Huang and Zhan, 2005; Taylor et al. 2005; Adams 2006; Siddique et al. 2010). Migration and remittance earnings are seen as a part of household strategies to rise out of poverty and ensure a better livelihood; to overcome risks and adverse situations (Lucas 2005); to acquire skills; to promote education and health; and to build capital and diversify economic activities. Yang and Martinez (2005) show that in the Philippines, remittances not only reduced poverty in migrant families but also had spill-over positive effects on non-migrant families; and in Albania, remittances led to increased investment in the livestock and non-farm sectors.

The other view is that migration and remittances impede rural and agricultural development by creating critical labour shortages, shifting investment away from rural areas and from productive sectors (such as from

agriculture to housing), draining rural areas of skills, inducing excessive consumption relative to investment (Huang and Pieke 2003; Ananya 2006), creating inflationary pressures, and creating excessive income and asset inequality.

The reality is perhaps somewhere in between and depends on the context and policy environment. Furthermore, different types of remittances, for example, family, collective, and entrepreneurial remittances, have been seen to have different roles in development (Rahman 2006).

A development approach to remittances

The International Fund for Agricultural Development (IFAD), as the poverty fighting fund of the United Nations, is of the opinion that used properly, remittances can become more important for rural development than official development assistance. IFAD's interventions towards harnessing and augmenting the positive impacts of remittances are directed towards four main areas.

Advocacy and awareness building

To develop greater awareness on the implications of remittances for welfare and rural development, IFAD analysed remittances and rural development from a global perspective as well as at the regional and country levels. Working together with the World Bank and other institutions, the Fund has conducted research on how the positive impacts of remittances could be amplified (IFAD 2003a,b). In 2004, a round table on remittances and rural development was held during IFAD's Governing Council, with the participation of migrant representatives, international experts, non-governmental organisations, and government representatives (IFAD 2004).

To sensitise a wider audience, videos on the potential of remittances in reducing poverty (also taking negative impacts of remittances into account) have been broadcast through global media (BBC).

IFAD's advocacy approach has emphasised the need to strengthen efforts in the lagging regions, with special attention directed towards Africa, where institutions for promoting productive use of remittances are less established than in other regions.

Building institutions for harnessing the potential of remittances – working with communities

During the past five years, IFAD has been engaged in a process to formally incorporate migrant associations in the design frameworks and financing of some of its projects and programmes.

Recently, with the support of IFAD, representatives of Salvadoran women migrants working in different European countries have established direct links with groups of poor rural women in communities targeted by ongoing IFAD-financed projects in El Salvador. The aim is to identify productive activities to be co-financed with remittances.

IFAD is developing a partnership to support rural poverty reduction in Somalia, establishing a dialogue with migrant communities to assess their interest in investing in productive and job-creating activities in their communities of origin so that their financial and technical support can have greater and longer-term returns.

IFAD also carries out knowledge development projects to help Home Town Associations and other community-based migrant organisations manage, promote, and implement rural development projects in their home countries.

Linking remittance-related activities with other development and poverty reduction activities

Twelve projects currently being implemented in eight Latin American countries (Bolivia, the Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Mexico, and Paraguay) are promoting efficient remittance transfer methods as well as financial products, such as loans for housing and health insurance. One of the projects involves a Paraguayan microfinance institution that offers remittance transfer services as one of the two authorised Western Union agents in the country. More than 20 IFAD projects in other regions (Africa, Asia Africa, eastern Europe, and the Near East) have included efforts to widen the benefits of remittances (Vargas-Lundius and Villarreal 2008).

Developing innovative financial instruments

Recently IFAD has created a multi-donor financing facility of US$ 18 million for financing remittance-related activities. It is designed to increase economic opportunities for the rural poor through the support and development of innovative, cost-effective, and easily accessible international and/or domestic remittance services. The facility's main objective is to support projects and activities that:

- reduce the transfer costs of remittances;
- develop institutional partnership;
- provide needed banking services for rural populations;
- promote innovative remittance and financial services;

- promote productive rural investment of migrants' capital in their countries of origin.

In April 2004, IFAD and the Multilateral Investment Fund (MIF) of the Inter-American Development Bank (IDB) launched a joint programme to help senders and recipients of remittances increase their access to financial services and invest in projects for generating employment and income (since less than 5 per cent of established small enterprises receive loans from commercial banks). This programme also supports rural development projects in remittance-receiving communities, supported both by the destination and origin countries, and fosters alliances among migrant associations, savings and credit institutions, and immigrant communities in countries of origin. It presents a series of microcredit options – ranging from microenterprise to credit cards and housing loans – as well as a range of savings accounts. IFAD/MIF technical assistance is also supporting the design of financial products that are attractive to remittance recipients in the communities of origin.

IFAD works with eligible financial institutions (e.g., microfinance institutions, credit cooperatives, and credit unions) to support the development of banking systems that provide an array of services to the population not currently covered by commercial financial institutions, thus paving the way for their access to the formal financial sector.

Concluding remarks

Formal financial intermediaries and development practitioners face the same challenges:

- How to compete better with informal intermediaries (by developing new instruments, reducing costs, and developing incentive packages for mobilising remittances)?
- How to ensure the welfare of migrant families?
- How to tackle the adverse impacts of emigration on the labour market?
- How to use the mobilised funds for sustaining overall rural development?

Governments can fully exploit the enormous potential of remittances for rural development and rural poverty reduction by creating a facilitating environment, with support from Home Town Associations, other migrant groups, and agencies like IFAD. Activities that can help create this environment include facilitating the development of financial instruments and intermediation, financing projects and programmes to link up with other rural development activities, promoting policies, up-scaling innovative experiences, transferring experiences across countries and regions, and supporting countries and regions that lag behind.

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