MULTILATERAL INVESTMENT FUND
INTER-AMERICAN DEVELOPMENT BANK

INVESTMENT OF MIGRANT RESOURCES: REMITTANCES AND DEVELOPMENT

Mexico, D.F.
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Background

Since 2000, the Multilateral Investment Fund (MIF) of the Inter-American Development Bank (IDB) has been working to improve the economic prospects of remittance families by: 1) seeking a better understanding of the scale and scope of remittance flows; 2) promoting the reduction of transmission costs; and, 3) providing migrants with more options to use their own money, thereby increasing the development impact of these flows.

Over the last six years, vast improvements have been made in measuring remittance data and reducing costs. For example, remittances, which were once literally found in the errors and omissions columns of national balance of payment statistics, are now known to have exceeded the combined total of all foreign direct investment and official development assistance to Latin America and the Caribbean (LAC) for the last three years. At the same time, transaction costs have been reduced by almost 2/3.

A new MIF survey of remittance recipients in Mexico estimates that remittances reached US$25 billion in 2006, a number consistent with both the Mexican Central Bank's estimate and information compiled from major money transfer firms such as Dolex, Sigue, and Western Union. Nearly all of these remittances come from the United States, making the U.S.-Mexican market by far the largest remittance corridor in the world.

Compared to a similar survey commissioned by MIF in 2003, Mexican remittances have increased almost 75% over the past three years, as family members living in the United States are sending money home more often and in larger amounts, with lower transaction costs. As a result, there is more money available for savings, education, and investment, particularly in small businesses.

Additional MIF data and analysis also indicates that:

- There are approximately 10-12 million Mexican-born adults currently living in the United States. About 8 million (73 %) of these individuals send remittances home regularly, sometimes to more than one person.
- Over 10 million adults in Mexico (17%), receive these remittances.
- Remittance recipients receive, on average, US$2,250 in remittances annually. (US$225 ten times a year).
- More than four million Mexican families receive remittances. At least 1/3 of those families would be at or below the poverty line without remittance income.[1]
- During 2006, remittances increased Mexican savings by an estimated US$3.5 billion, spending on education by US$3.25 billion, and investment by US$1.25 billion.

[1] Economic Commission for Latin America and the Caribbean (ECLAC), "Social Panorama of Latin America 2005", 106.

Looking Forward

Over the past few years, the issue of migration between Mexico and the United States has received a great deal of attention, and it is still generating increased tension on both sides of the border. Under these circumstances, the question arises as to whether, in future years, Mexican workers will continue to go North and remittances will continue to flow South in such great numbers.

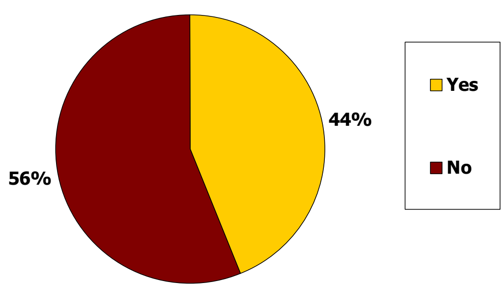
At least in the short to medium-term, the answer is almost certain to be yes, because, at their core, remittances are a manifestation of vast global imbalances in development, demographics, and labor markets.

Why do people migrate? Jobs. What do they do when they get to their destinations? Work. For generations, Mexicans have been migrating from rural to urban areas in search of better opportunities for work. That dynamic has not changed. However, as a result of globalization and facilitated international travel, people from economically depressed areas can now skip over the urban areas in their own countries to fill higher-paying labor needs in the developed world. As long as developed economies, such as the United States, need migrant labor and unemployment in developing countries remains high while wages remain low, migration, and thus, remittances, will increase.

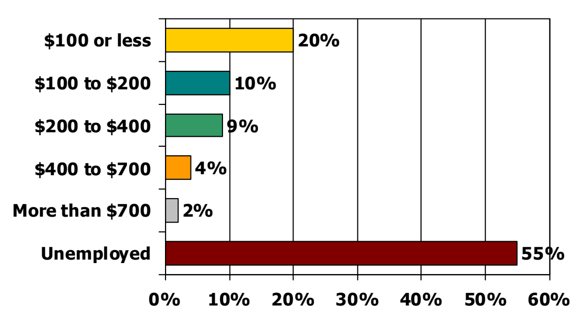
In the Mexican case, a recent MIF survey of remittance senders in the United States illustrates this dynamic:

- More than half of Mexican remittance senders in the United States were not regularly employed before departing for the North, and those that had jobs earned very little.
- After arriving in the U.S., more than half became employed within a month, at an average monthly income of US$900.

Did you have a full-time job in Mexico before you came to the United States?

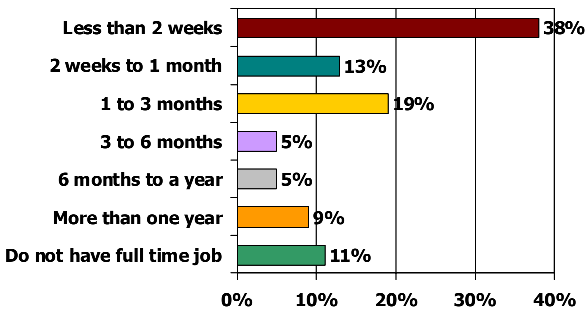


More or less, how much money did you make monthly at your last job in Mexico?



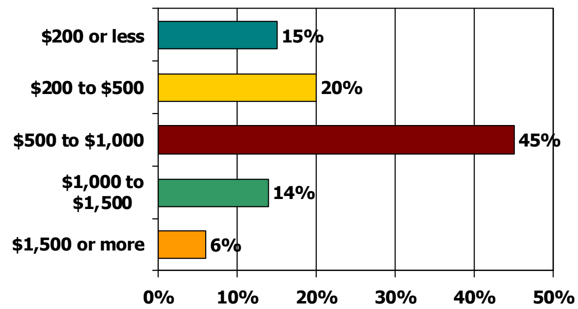
Average: $150 / month

When you first came to the U.S., how long did it take you to find work?



Average: 1 month

More or less, how much did you make monthly at your first job in the U.S.?



Average: $900 / month

The contrasting availability of jobs, and disparity in wages between Mexico and the United States, illustrates the powerful economic forces that contribute to a migrant's decision to make the difficult decision to leave their family in search of a better life.

Leveraging Development Impact

No one should celebrate that Mexico is the largest remittances market in the world. It means that the domestic economy is simply not generating enough jobs. Still, while no "panacea" for development, it is clear that remittances provide much needed income to millions of Mexicans, alleviate poverty, and constitute an important source of savings and investment. However, much more needs to be done to leverage these resources, by providing these transnational families with more options to use their money through access to the financial system. This would create more employment at home, and more opportunities for the families who receive them in the communities in which they live.

When the MIF began looking at the issue of remittances, money transfer operators were criticized for their high prices in the pre-2000 period, which many observers considered an indicator of a failure of market forces in the remittances industry. At that time, 10% or more of each transaction was charged as a fee, and, typically, more than another 5% was charged through an ever-changing system of foreign exchange mark-ups.

After years of increasing awareness and competition among money transfer operators, the average cost to send US$200 in Mexico has been reduced to 6% in 2006, and in major corridors, such as Chicago to Puebla and New York City to Michoacán, it is below 5%. While there is still additional room for lowering transaction costs, the focus is now on increasing the development impact of these flows.

In this context, perhaps the most surprising and provocative indicator revealed by a recent MIF scorecard on the remittance industry deals with the distribution network of remittances. Until now, a common assumption has been that because remittances are generally cash-to-cash transfers outside the financial system, most remittances are distributed through a retail store or money transmitter licensee such as a bodega. This assumption is wrong.

According to the scorecard data, the majority of remittances to Mexico are distributed at some point through a bank, cooperative, credit union, microfinance institution, or other type of deposit institution. Unfortunately, only a very small percentage of remittances are transferred directly into a deposit account. As a result, there continues to be a substantial missed opportunity to put millions of Mexican families on a pathway to credit.

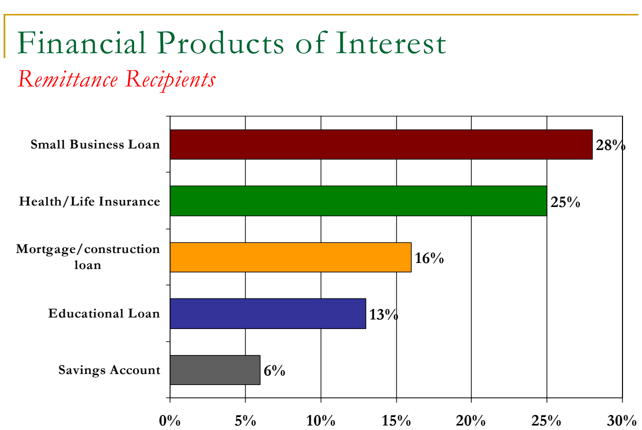
The reality is that in the vast majority of instances where banks are distributing remittances, they serve merely as an agent for a money transfer company. Indeed, remittance operations are often kept separate from other bank operations – sometimes even physically separate from the teller line available to account holders.

In contrast, cooperatives, credit unions, popular banks, and microfinance institutions have a better record of channeling remittances into accounts. Bansefi, for example, is reaching new clients through its Red de la Gente program.

In effect, Mexican financial institutions are often acting as bodegas when it comes to remittances. Each month, several million Mexicans pick up their remittances in cash at a bank branch office instead of depositing them directly in their accounts.

In sum, the Mexican financial system, and its legal and regulatory environment, need to view remittances as financial flows in search of products, and recipients as excellent potential clients when they are given access to products that meet their needs.

The challenge ahead is for Mexican financial institutions is to make a major commitment to substantially increase direct deposit for the remittance market. The demand and the market potential are there. Indeed, the MIF survey demonstrates that remittance recipients are very interested in financial products such as small business loans, life and health insurance, home mortgages, and educational loans, if given the opportunity.



For years, remittances to Mexico existed, uncounted, in the shadows because remittance families, both senders and recipients, were invisible and outside the formal financial system – *they* didn't count. All of that is now changing. Going forward, our challenge is to use the tremendously powerful tool of remittances to bring these hard-working people into the mainstream, give them a voice, and make them count.