HIGHLIGHTS from Spotlight 2:
MIND THE SIDE EFFECTS: REMITTANCES AND ECONOMIC STRUCTURE

Key Points

- *Several South Asian countries are among the emerging market and developing economies (EMDEs) with the highest remittance inflows relative to GDP.*
- *While remittances help to reduce poverty and improve household education and health, large inflows can create currency appreciation pressures and international competitiveness losses, with adverse consequences for exports, non-agricultural sectors, and private investment.*
- *Governments can remove obstacles to remittance inflows but offset the associated loss of competitiveness by reducing other cost of doing business.*

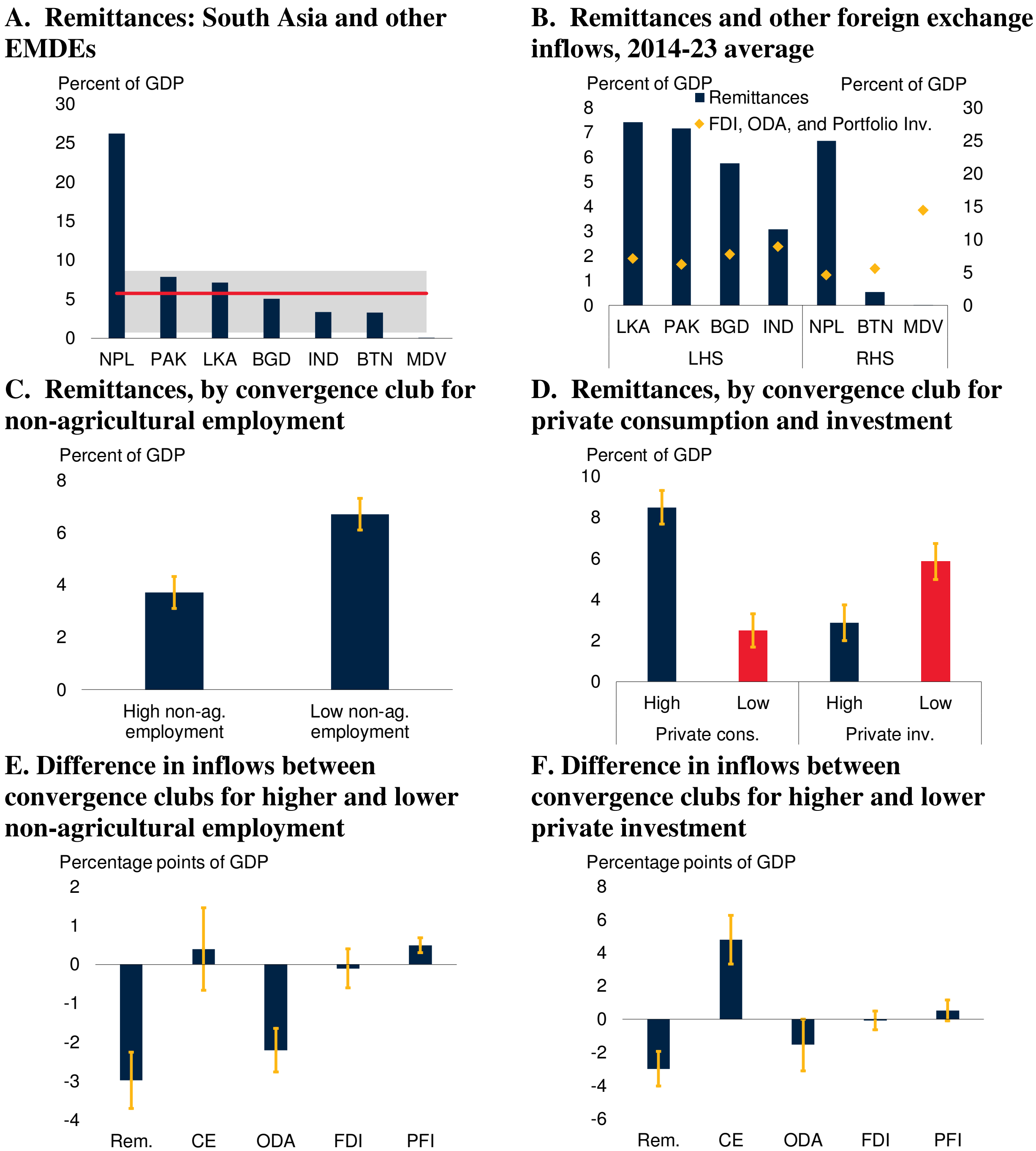
South Asia's large remittance inflows. Four South Asian countries—Afghanistan, Bangladesh, India, and Pakistan—are among the ten largest source countries of migrants in the world. Nepal ranked among the quarter of EMDEs with the highest remittance inflows relative to GDP in 2023, and Pakistan and Sri Lanka received above-average remittance inflows (figure 1). All South Asian countries except Bhutan and Maldives receive more remittances than foreign direct and portfolio investment and official development assistance combined.

Side effects of remittances. A large body of literature has documented that remittances increase household incomes, education, and health, and help smooth consumption during income shocks. However, as a side effect, remittances also create unique policy challenges. Remittance-reliant EMDEs generally lag in some key engines of growth and development. Over the long-term, they converge toward lower export-to-GDP ratios, private investment-to-GDP ratios, and non-agricultural employment ratios than countries with lower remittances. Conversely, they converge toward higher consumption-to-GDP ratios and import-to-GDP ratios.

Remittances versus other foreign exchange inflows. In contrast to remittances, foreign exchange inflows from FDI and portfolio investment or commodity exports are not associated with convergence toward lower exports or private investment. This is in part by construction, as these inflows are subcomponents of exports and private investment. Official development assistance, however, like remittances, is associated with weaker exports, non-agricultural employment, and private investment (but higher total and public investment).

Policy implications. Since a large literature has established that remittances are a critical foundation of household income in remittance-reliant economies, policies should focus on removing obstacles to remittance inflows. The policy challenge is to offset the related loss of competitiveness by shifting taxation away from trade and payroll taxes and by reducing other cost of operating a business, such as adopting more business-friendly regulations and practices. This approach could also entice households to allocate more remittances for investment, including in their own start-ups and human capital. If more remittances are channeled through the official financial system, they can be intermediated into greater savings and private investment.

FIGURE 1. Remittances and economic structure



Sources: International Financial Statistics (IMF), Macro Poverty Outlook (World Bank), World Development Indicators (database), World Bank.

Note: BGD = Bangladesh; BTN = Bhutan; CE = commodity exports; EMDEs = emerging market and developing economies; FDI = foreign direct investment; IND = India; LHS = Left-hand side; LKA = Sri Lanka; MDV = Maldives; NPL = Nepal; ODA = official development assistance; PAK = Pakistan; Rem. = remittances; RHS = Right-hand side; SAR = South Asia Region (Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka). Afghanistan is excluded because of a lack of data.

A. Figure shows the remittances to GDP ratio for SAR in 2023. Grey shade indicates interquartile range for 133 non-SAR EMDEs in 2023. Red line indicates non-SAR EMDE average. Data for Bhutan refers to 2022. Afghanistan is excluded because of lack of data.

B. Figure shows remittances in percent of GDP and the sum of FDI, ODA, and portfolio investment in percent of GDP for each SAR country. Data is 2014-23 average for remittances and portfolio investment inflows and 2014-22 average for FDI and ODA.

C.D. Bars show average remittances in percent of GDP for each club during 1990-2022. “High” indicates average for convergence club with highest macroeconomic outcome (non-agricultural employment in percent of working-age population [C]; consumption and investment in percent of GDP [D]). “Low” indicates average for convergence club with lowest macroeconomic outcome. Whiskers indicate 90 percent confidence intervals.

E.F. Charts show the average difference in remittances, FDI inflows, portfolio investment inflows, ODA inflows, and commodity exports (all in percentage points of GDP) between the convergence clubs with the highest and lowest non-agricultural employment in percent of working-age population [E], or the highest and lowest private investment in percent of GDP [F]. Whiskers indicate 95 percent confidence intervals.