Opinion **The FT View**

Record high remittances are not without risks

Better use of funds could prevent a low growth, high emigration trap

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Investing in education and job creation at home is the best way to reduce dependence on remittances © Alamy

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Rising migration has an often forgotten byproduct for the world economy: surging worker remittances. Remittance inflows to emerging market economies are on track to overtake foreign direct investment as the largest source of foreign financing this year. They already swamp official development aid by a factor of three. As a series of reports by this newspaper has highlighted, this brings benefits and risks to receiving countries. Given the rising flows, the risks should be better managed, and efforts to use remittances to promote economic growth stepped up. Work on lowering the costs of these transfers should also be accelerated.

Remittances are the human face of global capital flows — expatriate workers sending money to families at home. Inflows swelled to $689bn in 2018 from just over $100bn two decades ago, reflecting the huge increase in the number of economic migrants. India, China, Mexico and the Philippines are among those with the highest inflows in US dollar terms last year. Togo has the highest share when measured against gross domestic product El Salvador and Honduras are also sizeable.

Remittance flows, often directed towards rural areas, have improved the wellbeing of millions of people around the world by reducing poverty and raising consumption. Education, housing and healthcare sectors have also benefited in recipient countries, helping to strengthen the economy as a whole.

These targeted micro-flows bring important macroeconomic benefits. Unlike FDI, remittance flows are a component of the current account. Inflows, therefore, provide an important offset to any trade deficit and wider external vulnerabilities. Given the ties that individual workers have to their home countries they are also seen as a stable source of financing. The result is higher sovereign ratings and lower borrowing costs for governments and companies. Budgets benefit where remittances are spent on taxable goods.

Remittances are no panacea, however. Research has found increasing evidence that remittances can lead to an entrenched low-growth, high-emigration economy. One important reason is that in contrast to FDI, which can boost the capital stock and promote productivity gains, remittance spending is heavily skewed towards consumption. Financial support from abroad can also reduce the motivation to work, delay incentives for necessary reforms and weaken competitiveness through both higher prices and exchange rate appreciation. Rising global capital flows increase cross-border transmission of economic shocks. Any downturn in richer economies can quickly see remittances pared back, hitting consumption and growth in the receiving economy.

To divert remittances away from going only into consumption, incentives to promote entrepreneurship and microbusinesses should be encouraged. Governments of recipient countries should invest more in technology and productivity gains to improve competitiveness, and avoid a temptation to encourage emigration. Investing in education and job creation at home is the best way to reduce dependence on remittances.

The cost of money transfers — which average about 7 per cent but are often higher in poorer countries — should also be addressed. The UN's 2030 sustainable development goals aim to reduce the cost to 3 per cent, but this should be accelerated. Increased competition and new technologies can help. Since remittances now play such a key role in low-income countries, it is important to ensure that not too much ends up in the hands of financial intermediaries.