On the “Productive” Use of Remittances and their Significance for Asset Building[1]

Among many works on remittances, there is a common reference to the fact that these flows “are primarily spent on consumption, housing and land, and are not utilized for productive investment that would contribute to long-run development.”[2]

This statement points to three assumptions:

1. **Remittances are non-fungible and are kept separately from other sources of income;**
2. **Consumption is a problem;**
3. **Investing remittances ‘productively’ is a step in the right direction to correcting the problem.**

Here we consider and problematize these issues and their policy implications. In most cases, these three assumptions reflect value judgments rather than informed opinions based on empirical testing. These value judgments have to do more with a moralistic opinion against remittance recipients than with data analysis.

Remittances and Total Income

Some researchers and policymakers assume that remittances are somehow kept and spent separately from all other sources of income.[3] However, fieldwork and regular engagement with remittance recipient households show that remittances are fungible.[4] That means that remittances are part of the total pool of household income from which expenses are then paid.

For example, data from interactions with actual remittance recipients in 13 countries shows that remittances represent on average 37% of all income in the household. There are variations across different countries, but the pattern is one in which someone in the household earns a living and remittances complement their earnings.

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[1] **Manuel Orozco, February 2015.**

[2] Bhubanesh Pant, “Harnessing Remittances for Productive Use in Nepal,” 2011. http://red.nrb.org.np/publications/f:/webcrysis/ecorev/Economic_Review_%28Occasional_Paper%29--No_23,_April_2011+1_Harnessing_Remittances_for_Productive_Use_in_Nepal%5BBhubanesh%20Pant,%20Ph.D.%5D.pdf; http://iussp2005.princeton.edu/papers/52493;

[3] Just as an illustration, see Chapter 9 of “A Study on Remittances and Investment Opportunities for Egyptian Migrants,” International Organization for Migration, 2010. http://www.egypt.iom.int/Doc/A%20Study%20on%20Remittances%20and%20Investment%20Opportunities%20for%20Egyptian%20Migrants%20%28English%29.pdf.

[4] Zarate Hoyos, German. New Perspectives on Remittances from Mexicans and Central Americans in the United States. Kassell University Press, 2007, see chapter 2.

Table 1: Income Dependence on Remittances

	Percent of income dependence on remittances				
	Under 35% of income	Between 35 and 50% of income	Between 50 and 70% of income	Over 70% of income	Ratio R/Y
Georgia	25.9%	15.8%	13.8%	44.5%	0.58
Paraguay	45.5%	5.6%	11.3%	37.6%	0.16
Mexico	33.0%	14.1%	21.8%	31.1%	0.45
Azerbaijan	41.4%	15.3%	13.3%	30.1%	0.47
Moldova	39.5%	23.2%	15.9%	21.4%	0.37
Armenia	39.3%	19.0%	20.6%	21.1%	0.41
Guatemala	60.0%	6.8%	12.9%	20.3%	0.38
Tajikistan	56.0%	12.0%	15.8%	16.2%	0.24
Nicaragua	50.5%	18.1%	18.7%	12.8%	0.34
Jamaica	60.6%	15.1%	15.8%	8.5%	0.28
Kyrgyzstan	65.2%	14.7%	12.1%	8.1%	0.22

Source: Data from financial education programs in various countries performed by Manuel Orozco with the Inter-American Dialogue and Developing Market Associates. Sample size 93,000 clients.

Is Consumption a Problem?

Second, interviews with households about their regular expenses show that people know the sources of their income and pool their resources to manage their income and expenses. The management of their resources suggests in fact that their funds are spread along various expenses (see a sample budget of a Kyrgyz remittance recipient in the Appendix). It is hard to argue that expenditures related to better nutrition, education, and healthcare constitute a problem.

Moreover, when remittance recipients are compared to non-recipients, in most cases, recipients as a percent of their cohort tend to save as much as non-recipients. What these numbers suggest is that, first, expenses are not irrational, and second, that after expenses, remittance recipients manage to save.

Table 2: Savings Capacity of Remittance Recipients

Region	Country	Non-recipients who save (formal and informal methods) (%)	Recipients who save (formal and informal methods) (%)	Formally saving (%)	Stock of Savings ($)
Latin America and Caribbean	Guatemala	70	69	40	900
	Jamaica	77	79	65	1,455
	Mexico	56	59	12	650
	Nicaragua	46	43	17	500
	Paraguay	69	63	19	250
Eastern Europe	Azerbaijan	-	80	23	150
	Armenia	46	47	17	2,468

Region	Country	Non-recipients who save (formal and informal methods) (%)	Recipients who save (formal and informal methods) (%)	Formally saving (%)	Stock of Savings ($)
	Moldova	70	72	19	1,478
Central Asia	Tajikistan	30	33	32	498
	Kyrgyzstan	43	38	14	1,636
	Uzbekistan	-	42	31	980

Source: Data from financial education programs in various countries performed by Manuel Orozco with the Inter-American Dialogue and Developing Market Associates.

Investing Remittances

Third, the argument that people should invest their remittances is problematic, not only because people are not misspending their income, but because investment is not the first step to achieve financial independence. The argument that productive investment will be best for long run development reflects a misconception about how financial independence is attained: not through productive investment, but by building wealth.

Wealth accumulation results from disposable income, and savings generation is the first step. Having financial access to depository institutions is also important because it guarantees that savings will offer greater yields. Wealth accumulation stems from at least five factors or determinants:

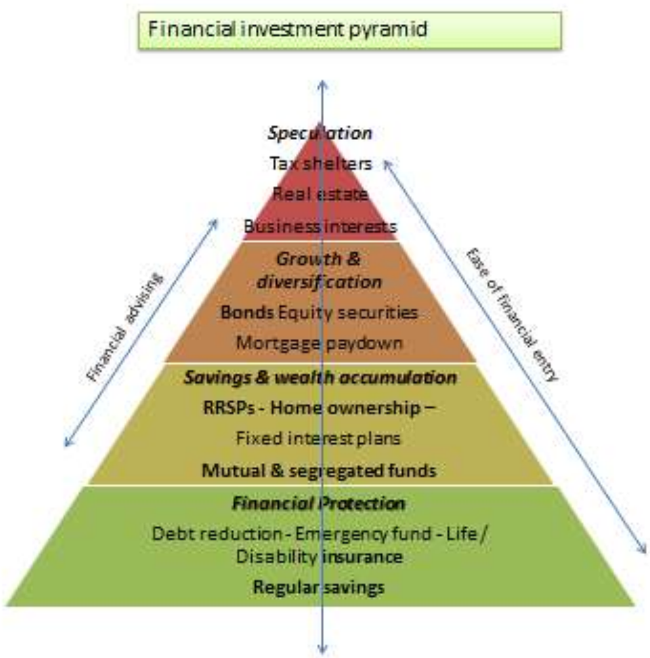
1. Liquidity and asset ownership (savings, fixed assets);
2. An income above cost of living;
3. Financial access;
4. Money management;
5. Enabling environments.

Owning a business and investing in a business alone is not a guarantee that wealth will be accumulated, or that it will promote development; on the contrary, it may lead to greater losses. In fact, one of the causes of high rates of informality is because people can't find a job, not because they want to own a business or invest in one. Promoting productive investments among people can yield the wrong output: certain markets may get saturated, informality may increase, and wages may even be driven down. More importantly, in any society the average person does not manifest entrepreneurial characteristics. It is thus inconsistent to expect remittance recipient households to behave differently from all other sectors of society, especially when what differentiates them is that a member of the family works abroad rather than entrepreneurial attributes.

Financial access can promote financial strength through a variety of different products, including savings, insurance, credit, and investment tools.[5] Each of these products is key in the conceptualization

[5] There are a number of services and products that characterize complete financial access. Basic financial services, such as deposit (or checking) accounts, savings accounts and credit services (including credit cards and basic loans) comprise the core of financial access; however, robust financial access also includes more advanced financial services, such as mortgages and home improvement loans as well as a variety of

of complete financial access, building upon each other along the “financial ladder.” Checking and savings accounts are the most basic entrée into the financial system, allowing migrants and remittance recipients to access and save income. Savings are particularly important to migrants and recipients because they represent a step away from financial vulnerability and towards future investment. More sophisticated tools, such as insurance and stocks, business ventures are also important in financial inclusion. However, the utilization of these products is less common among migrant populations and a remittance recipient because the capital stock and skill needed for it is exceeds their capacities.[6]



Policy Significance

By understanding remitting and income behavior, one can then understand financial needs to create assets and provide the tools to help people improve their lot. To that effect, rather than offer normative prescriptions what matters is to identify to what extent can households improve their financial lot with the existing resources available to them.

Therefore, the first order policy approach consists of exploring how adequate the determinants of wealth are in a society and particularly among remittance recipient households and migrants. From that point, strategies to build assets can be developed. Remittance recipients exhibit some of the determinants; they have savings (but informally), typically have income above cost of living, but lack financial access, and struggle to manage their money. Thus, they wont be able to fully capitalize on

insurance vehicles (health, life, agricultural, etc.). Financial literacy, while not a financial instrument *per se*, can provide migrants and remittance recipients with money management tools and information about how to use existing financial products to their best advantage.

[6] Anna Paulson et al., 2006.

those resources without savings mobilization, better income management and financial access. Moreover, other factors such as adequate enabling environments need improvement in order to motivate people to choose how to invest or mobilize their savings. One such need for investment is education.

Table 3: Strategies for Asset Building

Determinants of Wealth Accumulation	**Recipients**	**Non-recipients**
1. Liquidity and asset ownership (savings, fixed assets)	Half of recipients save, stock of savings is higher than non-recipients; savings are predominantly informal	Half of people save. Stock of savings is worth one quarter's income; savings are predominantly informal
2. An income above cost of living	Remittances increase disposable income	Income constrained by low-paid work
3. Financial access	Very limited to transactional activities; recipients tend to visit financial institutions more often than non-recipients	
4. Money management	Poor, more than three quarters of people do not budget; Very few have savings plans	
5. Enabling environments	Savings and business climate is not attractive to migrants or relatives; some institutions do not have rights to reach out to potential clients	Uncertainty, lack of information, missing incentives; some institutions do not have rights to reach out to potential clients

Source: Orozco, Manuel.

Appendix: Typical Budget in Remittance Recipient Household in Kyrgyzstan

INCOME	Amount	Frequency	Annual Income	Monthly Income
Remunerated earnings				
Aleksandra's salary (cashier)	500	Monthly	6,000	500
Parents' rental income	200	Monthly	2,400	200
Personal income				
Dara's earnings (cab driver)	0-90	Variable	10,800	900
Remittances sent by Sam	US$ 50-200	Variable	10,000	833
TOTAL INCOME			**29,200**	**2,433**
EXPENDITURES	Amount	Frequency	Annual Cost	Monthly Cost
Consumption				
Food	20	Daily	7,200	600
Milk for the baby	21	Weekly	1,008	84
Rent	720	Monthly	8,640	720
Electricity and Water	111	Yearly	111	9
Telephone	20	Weekly	960	80
Alma's transportation	3	Daily	1,080	90
Medicine	60	Monthly	720	60
New clothing	30-70	Varies	600	50
Financial obligations			0	
Payment for fixing car	900	Every 6 months	1800	100
School expenses (uniform)	300	Yearly	300	25
Other expenses				
TOTAL EXPENDITURES			**22,419**	**1,818**
NET BALANCE			**6,781**	**615**