

EDRE

Development Research
Department
Office of the Chief Economist, ECON

Impact of Global Financial Crisis on Remittances Flows to Africa

Subha Nagarajan*

Introduction

According to official statistics, the recorded migrant remittances to Africa in 2007 were USD36.9 billion. The amount was expected to increase to USD 40.1 billion in 2008 (see Table 1). Despite the scarcity of information and the fact that most statements on migration and remittances to Africa still need to be qualified, studies indicate that remittances play an important role in reducing the level and severity of poverty. They also contribute to levelling consumption of the poor. Research shows that remittances have had a significant role in raising the income of poor households, and they contribute to economic growth through indirect multiplier effects. Given their importance to household welfare and poverty reduction, understanding how the global financial crisis will influence remittance flows and, by extension, poverty and economic growth, needs to be explored.

Motivation

The global financial crisis is expected to reduce capital inflows to the developing world from developed countries. These include typical foreign exchange receipts like foreign direct investment (FDI) and official development assistance (ODA), as well as receipt of remittances from overseas Diasporas. While the commodity boom tripled foreign investment in resource-rich African countries from 2000 to 2006, the fall of commodity prices and the drying up of liquidity in international financial markets will threaten these private investment flows and undermine the commercial viability of new and existing investments that had begun production/extraction just before the crisis. With the proposed stimulus packages required to bail out donor country economies, donor countries are expected to re-allocate budgets. This could reduce

ODA anywhere from 20 to 40 percent, as seen during past banking crises.¹ Though remittance flows will likely decrease as a result of the financial crisis,



¹ A positive correlation between banking crises and shrinking ODA was found for all donor countries over the past 30 years. In the year of the crisis, average ODA dropped by one percentage point, with a cumulative drop of four percentage points by the following year, and thirty percentage points by the fifth year (Raja, K. Financial Crisis Will Put a Damper on ODA Flows, UNCTAD policy brief no.7, March 16, 2009.)

they are thought to be more resilient to economic and financial pressures as compared to FDI and ODA. For this reason, remittance flows could be an important source of external financing for Africa during and after this financial crisis.²

The World Bank has revised its original 2009 remittance flow forecasts published in November 2008 to reflect the impact of a protracted financial crisis. The low-case scenario suggests a sharper decline in remittance flows than originally ascribed to the 2009 base-case

scenario projections. The implications are a 7.9 percent decrease in remittance growth rate in the low case forecast for sub-Saharan Africa, versus the original projection of a 4.4 percent reduction in growth rate in the base case forecast.³

Table 1: Forecasts for remittance flows to Africa, 2009-2011

| Migrant remittances (USD millions) | 2007 | 2008e | Base case forecast | | | Low case forecast | | |
|------------------------------------|--------|--------|--------------------|--------|--------|-------------------|--------|--------|
| | | | 2009f | 2010f | 2011f | 2009f | 2010f | 2011f |
| Central Africa | 193 | 193 | 190 | 199 | 213 | 186 | 191 | 200 |
| East Africa | 4,681 | 4,875 | 4,620 | 4,733 | 5,024 | 4,467 | 4,447 | 4,597 |
| North Africa | 18,240 | 20,356 | 19,415 | 19,207 | 19,551 | 19,415 | 19,207 | 19,551 |
| Southern Africa | 1,919 | 1,943 | 1,785 | 1,846 | 2,018 | 1,746 | 1,769 | 1,898 |
| West Africa | 11,817 | 12,767 | 12,320 | 12,791 | 13,631 | 11,812 | 11,801 | 12,147 |
| Africa | 36,850 | 40,134 | 38,331 | 38,777 | 40,438 | 37,627 | 37,415 | 38,393 |

Immediate Consequences of the Financial Crisis

The reduction in remittance inflows can be attributed to two factors: (1) Reduced ability of the Diaspora to send money home, and (2) Return migration as migrants lose jobs and are forced to return home. This latter effect will be mitigated to the extent that some immigrants are properly integrated in their destination countries and have secured legal residence.

The global recession is expected to most negatively affect migrants employed in construction, manufacturing, finance, services, retail, and tourism sectors. The ability of origin communities and countries to absorb the newly unemployed will determine the extent of the additional burden of unemployment presented by returning migrants. To the extent that they can be productively and gainfully employed, the returning skilled migrants could introduce an opportunity for origin communities and countries to harness their skills for future growth and economic turn-around. Appropriate policies will need to be in place to properly identify and use the skills they bring along.

There is the additional concern that the global financial crisis will further lead to a

reduction in the amount of remittance flows sent through formal banking and non-banking channels.⁴ The high cost of sending money in SSA was already a deterrent to sending money through formal channels even before the financial crisis. It will impose an even greater financial burden on the disposable income of remitters' residing in countries suffering from the economic downturn. Unfortunately, aside from anecdotal evidence and isolated studies, there is insufficient information regarding the role of remittance service providers and the frequency and amount of remittances

certain types of migrants choose to send. As a result of money being channelled through informal means, the amount of remittances tracked through central banks is under-reported, leading some policymakers and decision-makers to mistakenly under-value this source of external financing. Without credible estimates of migration flows and remittance inflows, it will be difficult to: (1) Fully appreciate the extent to which remittance plays a role in development, and (2) create and garner support for innovative tools that would secure these flows and tap into the Diaspora wealth.

The Africa Migration Project

The Africa Migration Project will address these gaps in knowledge regarding the impacts of migration and of remittances on development. The key objectives are twofold: (1) Improve the understanding of flows of migration and remittances in Africa and their impacts on growth and poverty reduction; and (2) Strengthen the capacity of policy makers, researchers, banks, non-bank financial institutions, and donor agencies in Africa to enhance the development impact of migration and

remittances. The study will broadly cover three key themes: Remittances, brain drain, and mobilising Diaspora resources. It will investigate the reasons that make some African countries important sources of migrants, significant destinations, the relative importance of South-South migration versus South-North migration, the main obstacles (including government policies and regulations) for migration, and the importance of migrant networks in reducing the costs and risks.

² Pre-financial crisis remittances were greater than ODA in Botswana, Cote d'Ivoire, Lesotho, Mauritius, Swaziland, and Togo. Similarly, remittances were greater than FDI in Lesotho, Mauritius, Swaziland, and Togo (Ratha, D., Mohapatra, S. and S. Plaza. Beyond Aid: New Sources and Innovative Mechanisms for Financing Development in sub-Saharan Africa, Policy Research Working Paper no. 4609).

³ Ratha, D and S. Mohapatra. Revised Outlook for Remittance Flows 2009-2001: Remittances Expected to Fall by 5 to 8 percent in 2009, Migration and Development Brief no. 9, March 23, 2009.

⁴ Pre-financial crisis, 73 percent of remittances to sub-Saharan Africa were sent through unofficial channels (Page, J. and S. Plaza. Migration, Remittances and Development: A Review of the Global Evidence." Journal of African Economies 15(2): 245-336).

Policy Recommendations

Recommendations for policymakers

- 1) Encourage remittance receipt through formal channels:
 - a) Improving access to banking for remittance senders and recipients, which can also reduce costs associated with remittance transfers.
 - b) Strengthening competition in the remittance service provider industry to reduce money transfer costs.
- 2) Tap into wealth and investor savvy of the Diaspora:
 - a) Diaspora bonds and innovative financial products, which involve securitisation of future remittance flows.
 - b) Leveraging private transfers with public funds for community development initiatives.
 - 3) Strengthen financial, legal, and regulatory frameworks that govern financial flows and facilitate transparency and competition within the banking sector.

Implications for Bank operations

- 1) Advising on Financial Sector Development for Africa:
 - a) Securitisation of future remittance flows through Diaspora bonds. This debt instrument can be issued by a country or sub-sovereign entity.⁵ The ability to issue these instruments is constrained by SSA countries that are unrated and have weak or non-transparent legal systems for contract enforcement.⁶
 - b) Advocating for domestic financial deepening, including increasing access to the banking system.
 - c) Multi-lateral guarantees that leverage official financing for mobilising private capital.
 - d) Pooling mechanisms to better leverage private transfers with public funds to use toward public-private partnership activities.
- 2) Making microfinance work:
 - a) Incentivising remittances use for entrepreneurship and enterprise activities.
 - b) Extending access to finance to rural households.
 - c) Supporting growth and competition in remittance service provider industry.

⁵ South Africa launched a project to issue Reconciliation and Development Bonds to both expatriate and domestic investors, and Ghana has begun marketing the Golden Jubilee Savings Bond to the Ghanaian Diaspora in the US and Europe (Ratha, D., Mohapatra, S. and S. Plaza, Beyond Aid: New Sources and Innovative Mechanisms for Financing Development in Sub-Saharan Africa, Policy Research Working Paper no. 4609).

⁶ It is believed that properly accounted for hard currency remittances may be able to improve a country's risk rating, and therefore (1) improve the country's sovereign rating and access to capital market access, and (2) encourage unrated countries to obtain credit rating from major international rating agencies (Ratha, D. 2006. Leveraging Remittances for Capital Market Access, DEC Working Paper).

Comments and suggestions can be sent to:

Leonce Ndikumana
Abdul B. Kamara

**Development Research Department
African Development Bank**

BP 323, 1002 Tunis Belvedere, Tunisia – Tel.: +216 71 102 876 – Fax: +216 71 103 779 – E-mail: economic-research@afdb.org – Web: www.afdb.org

The views expressed in the Development Research Brief are those of the authors and do not necessarily represent the views of the African Development Bank, the Board of Governors, the Board of Directors or the Governments they represent.

*Subha Nagarajan is a Senior Research Economist in the Development Research Department AfDB.