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Audit of the Conventional Wisdom

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The Audit of Conventional Wisdom

In this series of essays, MIT's Center for International Studies tours the horizon of conventional wisdoms that animate U.S. foreign policy, and put them to the test of data and history. By subjecting particularly well-accepted ideas to close scrutiny, our aim is to re-engage policy and opinion leaders on topics that are too easily passing such scrutiny. We hope that this will lead to further debate and inquiries, with a result we can all agree on: better foreign policies that lead to a more peaceful and prosperous world. Authors in this series are available to the press and policy community. Contact: Amy Tarr (atarr@mit.edu, 617.253.1965).

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Remittances: Latin America's Faulty Lifeline

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In recent years, the money that migrants send back to their native countries has become a hot topic in international development circles. Multilateral banks, the governments of migrant-sending nations, the U.S. Government, and international development organizations laud the potential that remittances have to reduce poverty and promote development. Remittances are being exalted as "the new development finance," and a ticket to "high human development," while the migrants who send them are hailed as heroes back home. But the current remittance euphoria is both overblown and troubling when considered in a larger context of international development.

Nearly 40 percent of the $126 billion in remittances sent to developing countries in 2004 went to Latin America and the Caribbean, making it the region with the largest and fastest growing remittance flow. Remittances are more than the combined total of foreign direct investment and official development aid to the region.[1] Not only are remittances a considerable amount of money, but they are a stable source of finance that goes straight to the hands of some of the region's most needy, are immune to the whims of global capital, and even have the unique quality of increasing in times of economic crises back home.

Nevertheless, the remittance hype largely misses the point: Some of the very entities now celebrating remittances as a remedy for underdevelopment prescribed and promoted policies that created the conditions for increased emigration from many countries across Latin America and the Caribbean since the late 1980s. In addition to taking remittances out of their larger context, the current ballyhoo exaggerates their potential and obscures some of their more deleterious effects.

In some studies, migration is mentioned as one result of the neoliberal reforms in the region, but there is a surprising dearth of empirical work linking the so-called Washington Consensus policies and emigration flows. Nonetheless, there is a great deal

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of scholarly literature on the effects of the neoliberal reforms and on the causes of migration. And there are some striking similarities among them.

Coming on the heels of the debt crisis of the 1980s—known as the "lost decade" in Latin America—the neoliberal reforms implemented throughout the region in the 1980s and 1990s focused on reducing state intervention in the economy and integrating the region into the global economy. Some of the pillars of the reforms were the privatization of state industries and services and the liberalization of trade, foreign direct investment, exchange rates, prices, and interest rates.

The expectation was that these reforms would unleash growth, reduce poverty, and improve social conditions across the region. The outcome was far different. While the reforms brought inflation under control and improved macroeconomic indicators, the Washington Consensus failed the region in a number of ways. Growth in the region was sluggish between 1990 and 2003, an average of roughly 2.5 percent per year. While this is moderately better than the 1.6 percent average annual growth during the lost decade of the 1980s, it pales in comparison to the average 5.5 percent annual growth from 1950 to 1980.[2] Poor growth meant scant job growth and rising unemployment rates between 1990 and 2003. Before this time frame, Latin America had never before experienced such a long period of high unemployment, nor an urban unemployment rate as high as the 2003 rate of 10.3 percent.[3]

While the quantity of jobs created was poor, so was the quality. Privatization of state industries and liberalization of trade resulted in a contraction of formal sector jobs and the so-called flexibilization of labor, in which labor relations were deregulated and contracts made more flexible with the goal of attracting investment. The result has been an increase in informal sector jobs, precarious labor relations, and lower social security coverage across the region.[4]

Coping Strategies

Some scholars maintain that migrating was a strategy that an increasing number of Latin Americans used to confront these changes in the labor market. Others point to the quest for retirement insurance or a pension—something absent from informal sector work—as a one of the reasons people migrate.[5]

But no jobs, bad jobs, and a pensionless future aren't the only reasons why people leave home. Researchers have identified as another cause of migration the perception of "relative deprivation" that can arise from uneven income distribution. While inequality has a long and sadly salient history in Latin America, numerous studies have found that inequality increased in the region during the neoliberal era. Another reason why people migrate is to accumulate capital when they lack access to credit. The Washington Consensus emphasis on stemming inflation resulted in higher interest rates, putting credit out of the reach of many in Latin America. While the reforms did achieve their goal of integrating the region more closely to the global economy, this also was a likely contributor to increased migration. According to migration theory, as goods and capital flow more freely into developing countries, they open up the connections and infrastructure that facilitate and even promote labor migration in the opposite direction.

There are certainly enough points of coincidence between the effects of the neoliberal reforms and the causes of migration to identify remittances, at least partially, as fallout of the reforms. That's why it is so unsettling to hear the organizations that prescribed and imposed these reforms as loan conditions celebrating this fruit of failure as a remedy for underdevelopment. It is even more unsettling when one considers that the majority of people who migrate from Latin America do so without documents, risking, and sometimes losing, life and limb along the way.

The issue of what remittances can accomplish is also worth closer examination. Remittance enthusiasts point out that when individuals remit they augment household incomes for relatives back home and provide seed money for microenterprises. When sent collectively by Hometown Associations like the ones set up by groups of Mexican and Salvadoran migrants in the United States, they finance roads, electrification projects, or local businesses. In Mexico and El Salvador, governments have set up matching funds for Hometown Associations that remit collectively for specific types of projects.

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Clearly there is potential for these kinds of projects to improve life in migrant sending communities. But at what cost? Do remittances let governments off the hook for failing to provide individuals and communities with basic services and infrastructure that are squarely within the realm of state responsibility? When local governments match public funds, are they favoring communities where people migrate, and as such, promoting that they do? Some research has shown that remittances have enabled regions of Mexico long deprived of government spending to access public funds. But research also shows that it is not the poorest of the poor who migrate, raising questions about whether these policies of matching remittances actually divert public funds from the neediest areas.

Remittances also raise some questions for the international community: Are these funds seen as a species of privatized development aid when the United States is slashing its already scant development aid to the nations in its backyard?[6] Do they allow the U.S. Government and multilateral banks off the hook for the failures of the reforms by transforming these funds into the social safety nets that the reforms removed? To the extent that remittances are a virtual life-support system for some nations, do they prolong the lives of moribund economies, postponing the implementation of new policies or the election of new leaders?

Consider El Salvador

And what about the downside of remittances? Much of the celebratory literature on remittances in the region focuses on Mexico, the country that sends the most migrants to the United States and the most remittances back home. But if one seeks to examine the impact of remittances, it makes more sense to focus on countries like El Salvador, where remittances have the greatest impact.

The remittances that Mexicans send home are 2.5 percent of the country's GDP. In El Salvador, where studies show that anywhere from 10 to 40 percent of the population has emigrated, remittances are an astounding 16 percent of the GDP. They are 133 percent of all exports, 655 percent of foreign direct investment, and 91 percent of the government budget.[7]

While El Salvador's migration patterns to the United States are usually linked to the nation's bloody civil war in the 1980s, migration rates during the late 1990s and first half of this decade were higher than during the armed conflict. Once celebrated, along with Chile, as the honor roll student of the Washington Consensus, El Salvador went from the country with the second highest growth in region in the early 1990s to the second lowest, behind Haiti, in the second half of the decade.

According to some Salvadoran economists, remittances are not spurring growth and development because they are spent overwhelmingly on consumption. El Salvador's level of private consumption as a percentage of GDP is the seventh highest in the world. But some of the remittance literature says this isn't a problem, maintaining that even when remittances are spent for consumption, they are multiplied throughout the local economy, supporting local industry and creating jobs. Much of the literature describing this "multiplier effect" focuses on Mexico. In a small and very open economy like that of El Salvador, however, remittances aren't multiplying, some complain, because they leave the country as fast as they come in. Since embarking on the reforms, El Salvador's imports have gone from 27.7 percent of its GDP in 1990 to 42 percent in 2004. And when they don't produce new jobs in the home country, remittances actually cause migration, as people try to keep up with remittance-receiving neighbors.

Remittances can, and in some cases already have, caused problems for small economies with flexible exchange rates—incidentally, a key component of the neoliberal reforms. A first cousin of the better-known Dutch Disease, Remittances Disease occurs when a large inflow of remittances appreciates the local currency, rendering exports less competitive. Economists cite Guatemala as an example where this is happening.

In El Salvador, remittances are also said to have distorted the labor market, increasing wages in relation to neighboring countries, even while they have declined in real terms since the nation embarked on the reforms in 1989. High wages in El Salvador make neighboring countries more attractive for investment. And remittances are now provoking a scarcity of labor in some sectors of the economy because they allow many Salvadorans to live better without working at all than they could on the wages paid for agricultural or domestic work. In eastern El Salvador, farm owners are hiring Nicaraguan and Honduran migrants to fill the jobs Salvadorans won't take.

Remittances are an important source of survival for many people throughout the region, and getting migrants in the diaspora involved in the future of their home countries is a noble goal. The danger is not that remittances will make a difference, but that they are becoming a smokescreen to hide the pressing need to address the structural causes of unemployment and poverty in migrant sending nations, to hide the United States' paltry and ever-dwindling interest in and aid to the region, and to hide the negative effects of the neoliberal reforms.

Of course the remittance hype could backfire. A recent United Nations Development Fund report on El Salvador concludes that in order for remittances to stay in the local economy and fuel its growth, this one-time star pupil of the Washington Consensus—which recently signed CAFTA (the Central American Free Trade Agreement) with the United States—needs, among other things, to protect its local industries. The international development community might want to be careful what it wishes for.

article footnotes

1 http://www.iadb.org/mif/remittances.

2 Desarollo Productivo en Economias Abiertas, CEPAL 2004, and Panorama Laboral 2005, Organizacion Internacional de Trabajo.

3 Economic Survey of Latin America and the Caribbean 2004-2005, ECLAC, Ch. 5, and CEPAL 2004, Ch. 9.

4 Panorama Laboral 2005. Organizacion Internacional del Trabajo.

5 For an excellent summary of the different school of migration theory, see *Worlds in Motion*, Douglas Massey et al., 1998.

6 According to an analysis by the Center for International Policy, the Bush Administration's budget request for Latin America and the Caribben represents a 17 percent cut since 2005 in the three major economic aid categories.

7 Statistics on El Salvador come from the United Nations Development Program's Human Development Report for El Salvador for 2005.

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