

Economic Impact of Remittances in the Philippines: The Case of Western Union Operations

A quantitative assessment of Western Union Office impacts for recipient countries.

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International Money Transfer Companies (IMTC)

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Overview

- ▶ Controversy exists about *remittances* and *economic growth*
- ▶ Issue is becoming important as:
 - ▶ Remittances grow faster than international trade, FDI, or GDP
 - ▶ Migration becomes an economic development strategy in some countries
 - ▶ Some countries impose *remittance taxes* or fees to fill budget gaps.
- ▶ This study uses quantitative techniques to show effect of remittances, and to identify key underlying assumptions behind different arguments.

Background: Growing Official Transfers

Overview: Remittances are a manifestation of globalization

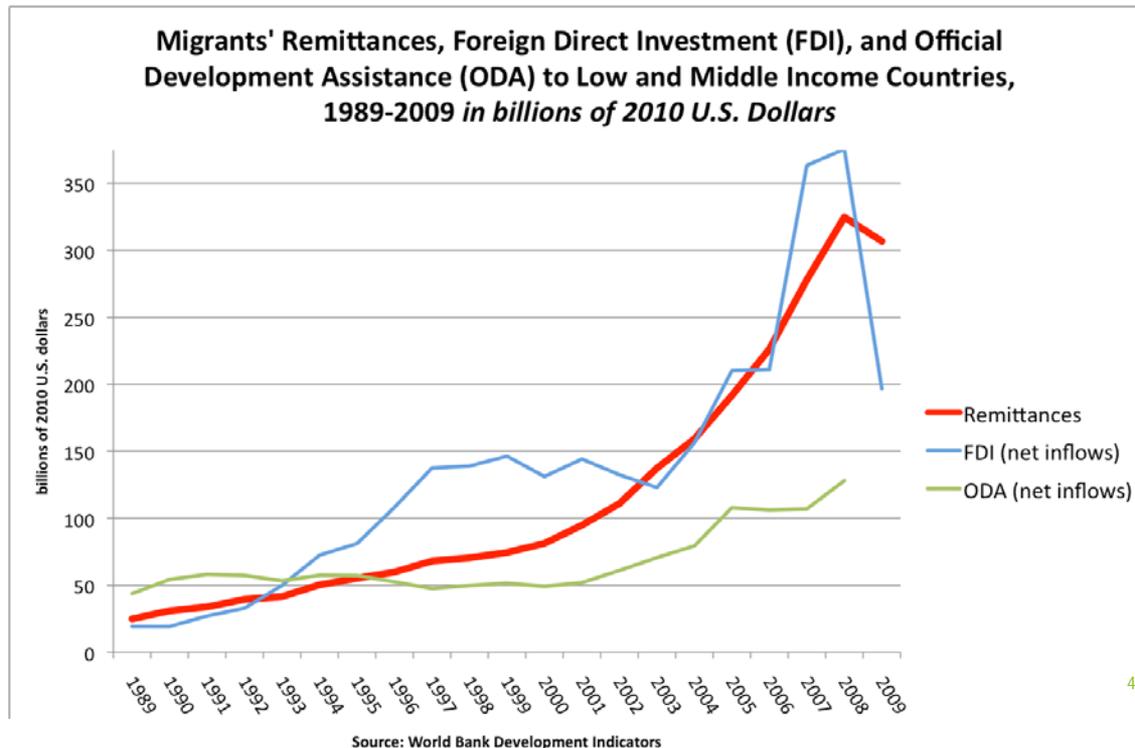
Since 1990 (or 2000):

- ▶ Growing migration
- ▶ Increased globalization
- ▶ Together, these cause: *a sharp increases in remittances*

Remittance Growth

Remittance Trends:

- ▶ Remittances > FDI (for many countries)
- ▶ 1,200% increase in remittances worldwide (1990-2009)
- ▶ 2013 Remittances estimated at \$550 Billion
- ▶ Remittances are increasingly transmitted “formally” (through banks)



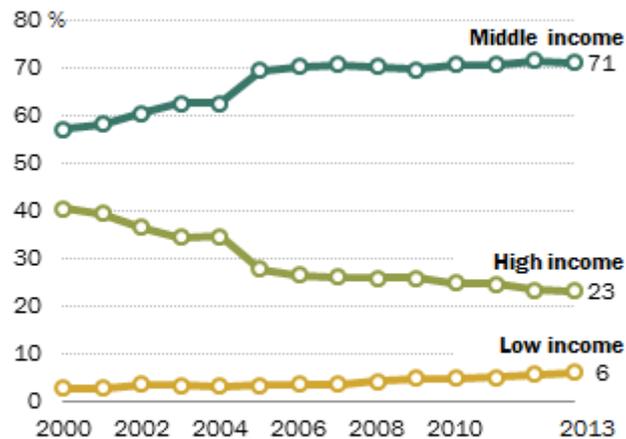
Remittance Patterns

Remittance Trends:

- ▶ Most remittances go to middle-income nations
- ▶ Although only 6% goes to low-income nations, those remittances represent a much larger share of GDP

Remittances Increasingly Sent to Middle-Income Nations

% of total world remittances by receiving countries



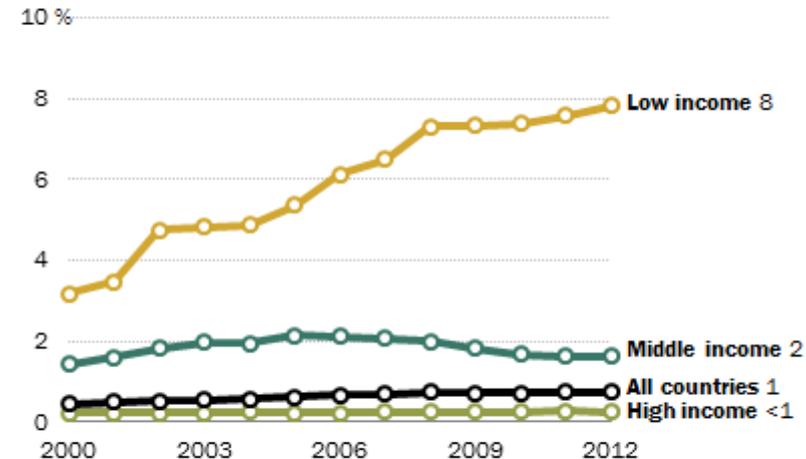
Note: Based on 137 countries with data for all years, which account for 93% of remittances in 2013.

Source: World Bank

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Remittances as Share of GDP

% of receiving countries' GDP



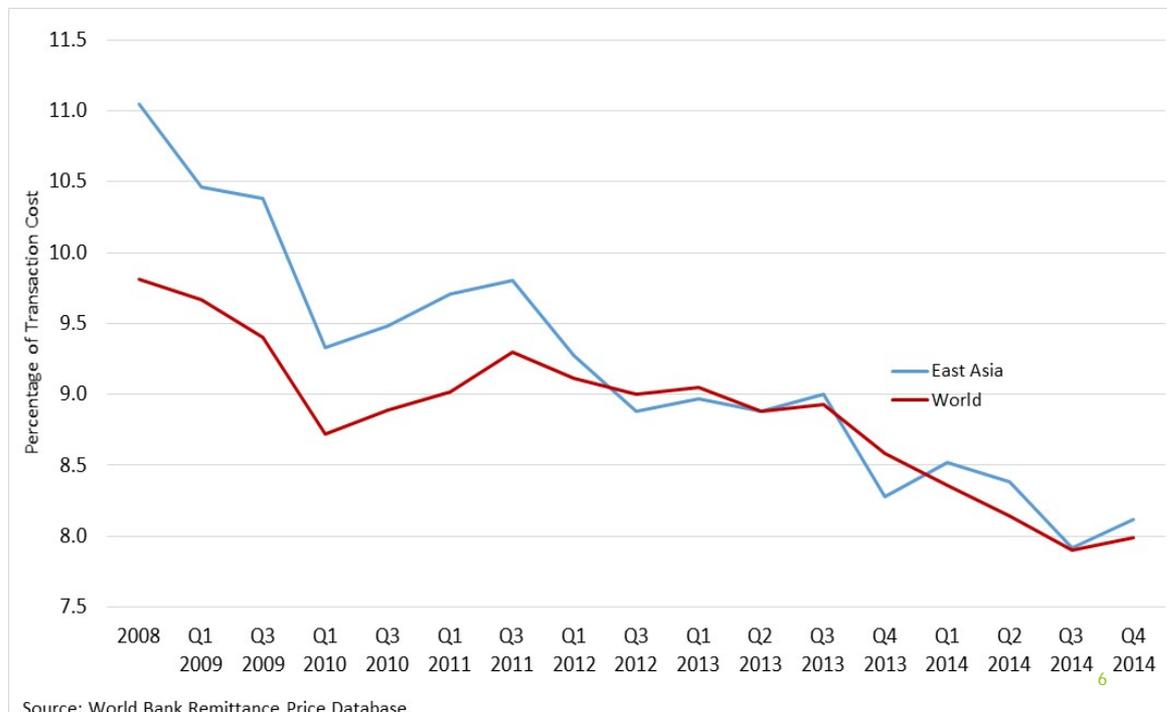
Note: Includes 137 countries with data for all years.

Source: World Bank

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Declining Formal Remittance Costs

Weighted Average Cost of Remittances: Worldwide and for East Asia (2008-2014)



Controversy

Some economists claim remittances are *bad* for growth:

- ▶ Empirical work finds remittance levels and economic growth to be negatively correlated.
- ▶ ..said to cause the *Dutch Disease* , where remittances discourage 'productive' investment (manufacturing, services, etc.)
- ▶ Increased remittances correlated with lower workforce participation.

Remittance Research

- ▶ Findings and Themes:
- ▶ [there are 30-40 reports on remittances]
 - ▶ Barajas, et. al. (IMF/2009):
 - ▶ *"The results show that, at best, workers' remittances have no impact on economic growth"* .

Remittance Research

- ▶ Findings and Themes:
- ▶ [there are 30-40 reports on remittances]
 - ▶ Barajas, et. al. (IMF/2009):
 - ▶ *"The results show that, at best, workers' remittances have no impact on economic growth"* .
 - ▶ .. remittances cause "Dutch Disease"
 - ▶ an influx of foreign capital shifts exchange rates, and
 - ▶ makes exporters less competitive.

Remittance Research

- ▶ Findings and Themes:
- ▶ [there are 30-40 reports on remittances]
 - ▶ Barajas, et. al. (IMF/2009):
 - ▶ *"The results show that, at best, workers' remittances have no impact on economic growth" .*
 - ▶ .. remittances cause "Dutch Disease"
 - ▶ an influx of foreign capital shifts exchange rates, and
 - ▶ makes exporters less competitive.
- ▶ Other (positive) examples:
 - ▶ Mundaca, B.G. (2009):
 - ▶ *"The overall conclusion is that making financial services more generally available should lead to better use of remittances, thus boosting growth in these countries.*

Modeling Remittance Impacts

Using different modeling techniques, the economic effects caused of remittances can be quantified

Examples:

- ▶ Employment supported by spending of remittance money
- ▶ Impact upon regional wages and incomes
- ▶ Effects upon the Consumer Price Index
- ▶ Number of recipients who exit from poverty levels

Example / Template:

- ▶ Results for the Philippines are shown, and act as a “template” to quickly construct similar indicators for other countries.

Government Policy Impacts

The effect of government policies can also be modeled:

Policy Examples:

- ▶ Impact of taxing (formal) remittance transfers
- ▶ Cost of “uplift” fees by banks
- ▶ Effect of lower-cost transfers upon transfer size for recipient countries

Analytical Approach

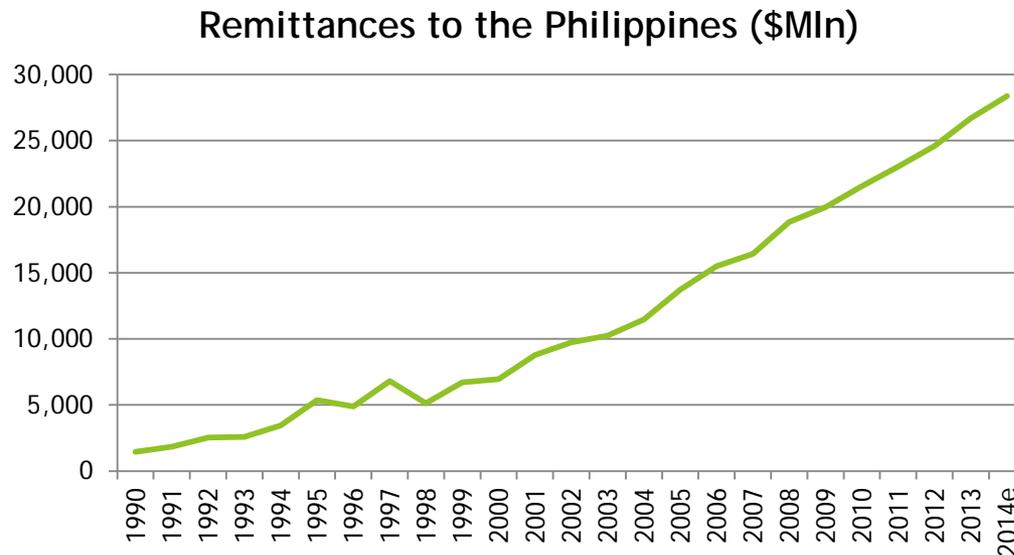
- ▶ Two economic methods are used to quantify the effects of remittances:
- ▶ Input-Output / Multiplier Approach:
 - ▶ To compute impacts related to remittance spending, a *multiplier* model is used.
 - ▶ For each \$1.00 of remittance spending on home improvements, for example, yields \$1.93 of output in the country.
- ▶ General Equilibrium Approach:
 - ▶ Combines national accounts with consumer and firm *optimization* to show how changing prices impact markets and welfare.
 - ▶ Captures the *entire* impact (wages, incomes, output, exchange rates, etc.)

Western Union Transfers

Western Union (WU) supported the research, and supplied micro-data for the target economy (Philippines)

Remittances in the Philippines

Remittances Inflows to the Philippines - Growing from US\$1.4 Billion in 1990 to US\$28.4 Billion in 2014



Source: World Bank Remittance Data.

Western Union Impacts: Philippines

WI	Indicator	Amount	Units
	Total remittances (USD)	\$26,000	Millions of USD
	Total remittances (PHP)	1,092,000	Millions of PHP
	Western Union Remittances:	\$4,700	Millions of USD
	Western Union Remittances:	197,400	Millions of PHP
	# of WU Affiliates:	8,500	Outlets, Nationwide
	Gross national Income	10,564,886	Millions of PHP

Western Union Impacts: Philippines

Employment Impact:

- ▶ Western Union has approximately 8,500 affiliate outlets in the Philippines.
- ▶ Multiplier Effect:
 - ▶ Average remittance flow (per office): 23,223,529 PHP
 - ▶ On average: 85 jobs are supported by transfers from each WU outlet.
- ▶ When combined - WU outlets account for 722,500 jobs nationwide.*
 - ▶ *Results are constructed using employment multiplier analysis for the Philippines economy, using the country's National Input-Output tables.

Equilibrium Impacts: Philippines

Incomes:

- ▶ In the same simulation - incomes for recipients, and non-recipients, can be computed:
 - ▶ Households (2-5) (Recipients Only):
 - ▶ Real Income grows by 83.7%, on average (due to remittance)
 - ▶ Households (6-9) (Recipients Only):
 - ▶ Real Income grows by 17.2%, on average (due to remittance)
 - ▶ Households (1-9) [Middle-Upper Income] (non-Recipients):
 - ▶ Real income grows by 3.4% - 11.1% on average (due to wage & income effects)
 - ▶ Household (10) [Highest Income] (non-Recipients):
 - ▶ Real income *falls* by -1.1% on average (due to exchange rates and capital returns)
 - ▶ *Results are generated by *R-CGE*, an Economic Equilibrium model for Remittances, tailored to the Philippine economy.
 - ▶ Results correspond to a \$4.7 billion USD level of remittances (WU Only)

Western Union Impacts: Causes

Wage Impacts:

How to remittances impact wages?

- ▶ Recipients tend to work less, presumably to attend school, or provide more home-based child care.
- ▶ The reduced labor supply causes upward pressure on wages.
- ▶ Non-recipients are benefactors of this shift - they see their wages increase.

Western Union Impacts: Philippines

Wage Impact: (Western Union Remittances Only)

The same simulation, but only using WU remittances:

- ▶ Labor supply for deciles 2-6 decline by 3.6%, on average (led by recipient labor force exit).

As a result, market wages increase:

- ▶ Low-skill wage rates: 5.2% Increase
- ▶ Semi-skilled wage rates: 3.8% Increase
- ▶ Skilled wages: 4.9% Increase

*Results are generated by *R-CGE*, an Economic Equilibrium model for Remittances, tailored to the Philippine economy.

Results correspond to a US\$ 4,700 million level of remittances.

Government Policy Impacts

The effect of government policies can also be modeled:

Policy Examples:

- ▶ Tax upon (formal) remittance transfers
- ▶ “Uplift” fees by banks
- ▶ Both cause a *shift* away from formal remittance channels, back to *informal* remittance methods.

Questions:

- ▶ *How do remittance taxes impact the economy?*
- ▶ *How much money does the government actually yield?*

Impact of Remittance Taxes: Philippines

Impact of Taxation:

- ▶ What happens when (formal) remittances are taxed?
 - ▶ Households to avoid the tax by “informal” (*Hawala*) channels rather than “formal” .
 - ▶ Other households will choose to remit less.
 - ▶ The shift to informal transfers reduces the tax yield.

- ▶ “Cost of Government Funds”: (Marginal cost of funds/MCF)
 - ▶ A useful measure, to compare the excess burden of taxation.
 - ▶ $MCF = \Delta \text{Revenues} / \Delta \text{HH Income}$
 - ▶ A value of $MCF = 1.0$ is an “efficient” tax, because no funds are lost.

- ▶ We use the R-CGE model to compute the excess burden of remittance taxation, and use the MCF as an indicator.

Impact of Remittance Taxes: Philippines

MCF of 5% Tax in Philippines:

- ▶ Task: Compute the revenues, and excess burden of a 5% remittance tax in the Philippines.
- ▶ Formal / Informal Elasticity: 2.0

Indicator:	Benchmark	Scenario	Change
Formal Remittances	157,920	143,238	-9.3%
Informal Remittances	39,480	43,527	10.3%
Total Remittances	197,400	186,765	-5.4%
Formal/Informal Elasticity		2	
Gov. Revenues (PHP '000)		7,162	
Tax Yield (%)		91%	
Change in HH Income (PHP '000)		-9,111	
MCF (Revenues / Income):		-1.27	

Source: Authors calculations using R-CGE model.

Impact of Remittance Taxes: Philippines

MCF of 5% Tax in Philippines:

- ▶ Task: Compute the revenues, and excess burden of a 5% remittance tax in the Philippines.
- ▶ Formal / Informal Elasticity: 4.0

Indicator:	Benchmark	Scenario	Change
Formal Remittances	157,920	129,921	-17.7%
Informal Remittances	39,480	47,988	21.6%
Total Remittances	197,400	177,909	-9.9%
Formal/Informal Elasticity		4	
Gov. Revenues (PHP '000)		6,496	
Tax Yield (%)		82%	
Change in HH Income (PHP '000)		-16,700	
MCF (Revenues / Income):		-2.57	

Source: Authors calculations using R-CGE model.

Impact of Remittance Taxes: Philippines

MCF of 5% Tax in Philippines:

- ▶ Task: Compute the revenues, and excess burden of a 5% remittance tax in the Philippines.
- ▶ Formal / Informal Elasticity: 8.0

Indicator:	Benchmark	Scenario	Change
Formal Remittances	157,920	106,886	-32.3%
Informal Remittances	39,480	58,330	47.7%
Total Remittances	197,400	165,216	-16.3%
Formal/Informal Elasticity		8	
Gov. Revenues (PHP '000)		5,344	
Tax Yield (%)		68%	
Change in HH Income (PHP '000)		-27,581	
MCF (Revenues / Income):		-5.16	

Source: Authors calculations using R-CGE model.

Summary

- ▶ Impact of Remittances *can* be quantified.
 - ▶ Detriments of remittances (growth, Dutch Disease) are outweighed by benefits (spending, welfare, investment)
 - ▶ Recipient households benefit (obviously)
 - ▶ But non-recipients also benefit through wage and employment effects.
 - ▶ Capital owners, exporters are negatively impacted somewhat (exchange rates, capital returns)
 - ▶ Taxes on remittances are categorically un-productive, as senders will shift to Hawala methods.
 - ▶ Government won't get the money anyway
 - ▶ Serious distortions caused in the process

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