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# Remittances and Development: issues and policy opportunities

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## Introduction

Remittance transfers by migrants to their families, estimated at US$264 billion in 2006, are an important trend reflecting the impact of migration on globalization. These numbers, however, are an aggregate component of a much more complex dynamic in labor mobility and family ties across different world regions, with policy implications for development.

The main units of analysis in remittance transfers are the sender and the recipient, followed by the intermediating agent facilitating the (outbound and inbound) flow and the regulatory environment that oversees that process. The aggregate volume of these flows and its interplay with the economy is another unit of analysis. From a policy perspective these flows have an effect on keeping people out of poverty and offer important ingredients to further enhance development.

This briefing reviews the fundamentals of remittance transfers by identifying the characteristics and dynamics of its units of analysis, the policy solutions to problems, and opportunities to deepen or advance development through these flows. This document should serve as a basis for discussions on ways to enhance the positive impact of remittances on development - reaching beyond the sole recipient in the countries of origin.

## 1. Trends and patterns of remitting

Migrants and their family are the main protagonists of international money transfers. Although migrants throughout the world send money home, the percentage of migrants that remit varies by region. In most industrialized nations of the West, less than 70% of migrants remit back home compared to those working in South East Asia, Russia or the Gulf countries, where the percentages can be as high as 90%. Their average amount sent also varies predominantly in relationship to their income and their family needs back home. In Canada, the United States, Western Europe and Japan migrants remit an average of US$5,000 a year to their relatives, whereas migrants in Russia and the Gulf countries remit less than half that amount, and migrants moving to regional places such as West Africa, South America, or Central Asia remit less than US$1,000 to predominantly rural areas. The length of time remitting also varies from one to seven years depending on where one is sending money from. Moreover, migrants are predominantly low income and financially disenfranchised with little access to the banking system, including the lack of owning bank accounts (bank account ownership varies from 10% to 50%, African migrants in Africa having the lowest percent). This condition curtails their ability to improve their material circumstances. Paradoxically, most migrants show a correlation between remitting and owning bank accounts, both in the host and home country, as well as a correlation with investing in businesses back home: the demand for financial services is thus unmet by a poor supply of financial intermediation.

These remittances are sent through either official or licensed channels (money transfer operators, banks, postal unions) or informal mechanisms. In most industrialized countries, about 60% of migrants use predominantly licensed mechanisms. In Africa, intraregional flows are predominantly, if not exclusively, informal because laws do not allow outbound international transfers of individuals except in extreme circumstances and through the ownership of bank accounts.

Either method employed by migrants carries a transferring cost. The cost of remitting ranges from 2% to 10% depending on which part of the world a person is remitting from and to. Transfers from Russia to the Community of Independent States is 2.5% the value of the amount sent, 2% from Spain to Latin America and the Caribbean, 5.5% from the United States to Latin America and the Caribbean, 8% from Japan and 6% from Singapore and Hong Kong to South East Asia and 10% to most African countries from Europe, or the United States. The causes of informality and costs are often related to the infrastructure available to transfer flows to the home country, the regulatory environment in the home country restricting payments only to banking institutions (for example, excluding MFIs, and small savings banks), the economies of scale of the transfers, the extent of interdependence between the migrant’s home and host countries, and the level of private sector competition across corridors. In Bangladesh, almost 54% of remittances are transferred through informal channels like Hundi, friends and relatives and hand carried.

The regulatory environment, particularly in the industrialized countries, has increased monitoring of transactions, but has also increased costs for companies that provide training for and implement oversight programs, often affecting informality. Businesses are concerned not only about increased operating costs, but also that the stringent identification requirements for both senders and recipients will lead to greater utilization of informal services by individuals who would rather use an unlicensed business than provide extensive information. This problem has particularly been more acute after September 11, 2001, whereby governments have required that MTOs and financial institutions apply strict requirements such as tightened

Know Your Customer guidelines, the Bank Secrecy Act and the Patriot Act. These requirements have made the internal costs of regulatory compliance soar, some companies to go out of business (specially minority owned businesses), and in turn hurting migrants who are faced with going to more expensive outlets or informal networks. Moreover, many banking institutions which maintain accounts of MTOs to ensure their financial transfer operations have closed these accounts arguing that government regulators in the U.S. and U.K. deem them as high risk. This situation has made problems greater to MTOs in their quest to increase competition and has caused some to go out of business.

Families receiving remittances may represent up to thirty percent of all households in some countries where labor mobility is more fluid such as in Central Asia, Central America and South Caucasus, but in most cases the average percent of households receiving remittances is 15%. Within this context is important to recognize that remittances both inform and are informed by gender: A farm worker remitting to his mother in Zacatecas or a young Tajik construction worker in Moscow significantly influences the limits of expenditure his mother can afford. Similarly, a young man from El Salvador working in the cleaning industry assesses both his needs in the U.S. and those of his siblings in El Salvador according to his social condition and income, and then decides what to prioritize in the transnational household. A female Filipino, Indonesian or Paraguayan domestic worker or a Dominican, Russian or Cuban entertainer and single mother in Milan will also consider certain priorities and conditions for remitting, including remitting to the person who can take care of their children, and explore whether to send less for basic needs and increase amounts for a small business. While women senders may range between 30 and 80% of all remitters (in Africa and Central Asia the majority of remitters are males, whereas in South East Asia are women, and in the industrialized world are split), two thirds of recipients are predominantly women, with flows representing at least 70% of all household earnings. This fact raises important policy perspectives to leverage gender and remittances for development

As with migrants, receiving families are financially disenfranchised. However, the earnings received allow them to stay out of poverty and contribute significantly to build assets; in most countries, remittance recipient families exhibit a positive relationship between remittance reception and financial activities. The more transfers are received, the higher the number of families with bank accounts, savings and other financial obligations. When the supply of financial services meets the demand the local economy is able to better absorb these flows. In highly migrant areas in Mexico where there is a Microbank, an important part of remittances are saved (about 14% in the Microbanco Pahuatlán, in Puebla State) creating a sustainable financial basis that the Microbank uses to finance the productive activities of its members. In turn these activities -when the economic infrastructure is not too deteriorated by depopulation, aging, and the productive base is relatively competitive- generate income, jobs and some development leading to less migration and more capital in the community that can be saved in the Microbank for future lending.

On an aggregate level the impact of remittances has demonstrated an effect in helping reduce poverty, increase growth and strengthen financial systems. Under certain conditions, when the productive base of the local economy is unable to absorb these foreign savings, macroeconomic imbalances can result, such as local currency appreciation, real state and land appreciation. However, overall these flows exhibit a greater potential to enhance the quality of life of society at large, migrants and their families in particular. Their potential can be realized provided that solutions are presented to several constraints people face.

## 2. Problems and solutions to enhance the development impact of remittances

The transfer of remittances by migrants experience different problems associated to the presence of informal transfers, the cost of remitting, the lack of access to financial institutions, incomplete knowledge about the total volumes received in some countries, lack of enabling environments that can further capitalize on these flows, or mitigating economic policies to adverse effects these flows can have on local currencies. Irregular and undocumented migrants may further avoid formal challenges due to fear of legal action or deportation. Solutions to some of these problems are varied and depend on the conditions in each sending and receiving areas. However, two common threads to these solutions include a rural and gender based approach to leveraging remittances.

Here, we identify initiatives where policy can be critically important to promote the leveraging of remittances through funds and migrant capital management. The initiatives are not exhaustive but reflect the public policy debate over these issues.

*a) Reducing informality, improving competition and reducing costs*

First, policy must address the money transfer market by reducing informality, improving competition and reducing costs as well as offering incentives to improve money transfer technology. Most migrant associations stress that cost reduction needs to be addressed and their solutions vary from sanctions or profit reinvestment schemes to enhanced competition to disclosure and information monitoring.

The existence of informal networks often results from the absence of a significant number of competitors that can pay transfers in the most remote areas. Because in most developing countries governments stipulate that only banks are allowed to pay remittances, many rural areas are neglected and in turn adopted by small informal entrepreneurs. This legal constraint restricts consumer access to other financial institutions that could offer that service. Reviewing legislation that allows non-banking financial institutions, such as microfinance institutions, to pay remittances will help reduce informality and increase competition.

Cost reduction in recent years has stemmed largely from increased competition among money transfer operators. In Latin America and the Caribbean costs have dropped substantially, as well as in other areas of the world such as Russia to Central Asia and the South Caucasus, Europe to South East Asia and West Africa. One major challenge to competition, which prevails in many parts of the world is MTO exclusive agreements. Exclusive agreements are legal contracts between MTOs and agents (in both origination and distribution) which restrict agents from negotiating or contracting with other MTO for at least a five year period. The end result is that many MTOs are excluded from fairly competing and often informality ensues. In Nigeria, for example, there are less than five major MTOs operating in the country partly because only banks are allowed to operate and these banks in turn seek to secure an appropriate volume with a major MTO. In turn however the major MTO expects exclusivity, closing down any chance from allowing other companies. As a result three quarters of payers are operating with only two money transfer operators.

However, more needs to be done. In some cases cheaper costs have come at the expense of the payment institution, which often receives 20% of the revenue per transaction. In rural areas where infrastructure is deficient and security is critical, paying institutions face higher costs than the revenues obtained, therefore mitigating strategies are necessary to palliate the challenges in rural communities.

Further efforts to decrease costs involve greater transparency, improving the environment for MTO competition (including monitoring businesses on full pricing and service level) disclosure, supporting small money transfer businesses to participate in the market) and introducing alternative means to transfer money such as prepaid cards or mobile phone technology. Recent regulatory complications in the remittance originating countries have caused banks to grow wary of doing business with MTOs, and subsequently many banks have ended their banking relationships with MTOs. This obstacle has created a difficult operating environment for MTOs, the majority of which are minority owned businesses and thus hurts the end user.

Moreover, new technologies can allow for cheaper account-to-account transactions, but all players in the market must learn how to best use these technologies. In terms of recipients, this requires increased financial education in addition to an adjusted behavior in the way money is collected. Now nearly 30% of remittance recipients use debit or credit cards; this number is as high as 50% in some countries.

An important example of this is the experience of the Jamaica National Building Society (JNBS). Through its subsidiary, JN Money Services Ltd., JNBS serves Jamaicans living in the diaspora by facilitating remittance services in Canada, the USA and the UK. In partnership and cooperation with USAID, JNBS chose to automate the process of sending and receiving money transfers through swipe card technology. As a result it now has over 70,000 cards users. 50% of remittance recipients have been brought into the formal banking system, with 40% of those receiving their remittances through a card product which is then used to make purchases at small businesses that accept debit cards. On a related note, the majority of the bank's small business clients also benefit from making remittance payouts through increased access to both credit and remittance receiving customers. Rates of saving have increased considerably, not only through direct deposits to savings accounts, but also by reducing the amount of cash in circulation and through the increased use of electronic transactions.

Policy incentives to reduce costs and improve competition and technology include reducing identification impediments on migrants, offering tax breaks or other incentives to those banks and MTOs that import technological devices for money transfers, such as point of sale (POS) devices.
The experience the United States and other countries in allowing migrants regardless of their legal status to choose what method to use to remit (whether an MTO or bank) is telling. Wells Fargo's initiative to recognize the Mexican consular identification as a means to allow migrants to open bank accounts increased banking access for more than half million Mexicans. The experience of Indonesians remitting from South Korea, Singapore and Hong Kong is similar: immigrants can open bank accounts regardless of their legal status and enjoy not only possibly lower costs, but access to other financial products. This issue is particularly important because governments draw a line between business and migration policy: Remittance service providers are not immigration and tax police.

Technology plays an important role in the effective and efficient delivery of remittances. These POS devices are an opportunity to enhance the effects of remittance spending by allowing for electronic payments and reducing the use of cash in the street as well as increasing savings and positively influencing revenue streams for banks and MFIs. Access to technology can be expensive for financial institutions or vendors. Therefore policy solutions such as tax breaks or incentives related to improved technology should be implemented.

Finally, issues of disclosure can be addressed through the implementation of low cost technology initiatives. Introducing a "*Remittance clearinghouse and switchboard*" is a mechanism to inform consumers about the cost of sending among different competitors. The clearinghouse would function as telecommunication switchboard that through one free phone call can identify any remittance transfer provider servicing a particular neighborhood to a particular country offering information about the fee and the foreign exchange offered. The consumer can thus decide before going to one particular outlet which service provider is the most appropriate to her or him.

*b) Accelerating financial intermediation projects with credit unions and MFIs*

Another area is accelerating financial access through projects with microfinance institutions (MFIs), credit unions, and small banks. These alternative financial institutions have demonstrated a key role in banking the traditionally unbanked and in transforming remittance clients into clients of other financial services. Support of these financial institutions by governments and donor countries has been low despite MFI efforts to reach out to remittance recipients. The financial assistance that has been granted has typically targeted financial product design, marketing, and technology. In Moldova, for example, the majority of flows go to families in rural areas where bank presence is more restricted but Savings and Credit Associations have deeper reach, but are not allowed to offer remittance services or supported to reach out to recipients and migrants. Increasing the support and participation of these small financial institutions is of crucial importance to increasing access to financial services and improving financial literacy and assets. Types of assistance include financial product design and marketing, IT development, market research, and regulatory compliance. Another area of assistance is in supporting savings banks, MFIs and Credit Unions to build networks that can allow positive negotiations with remittance transfer companies.

A successful example of cooperation is found in Paraguay, whereby the microfinance El Comercio benefited from a technical assistance from the Inter-American Development Bank and has been able to increase its number of transfers to more than 20,000 in less than two years.

Linking banks in the originating countries to microfinance institution on the destination country is also a winning proposition. For example, Caxia Catalunya, a savings bank in Spain, established agreements with other banks and saving banks which help people to send money at the lowest cost from 1500 cash points to any of the 1000 partners' branches in Morocco, Senegal, Argentina, Bolivia, Colombia, Ecuador, Peru, Brazil, the Dominican Republic, Pakistan, China, Bulgaria and Romania.

*c) Engaging banking institutions to provide broad financial services*

In addition to offering incentives to non-banking financial institutions to reach out to remittance clients, larger banks that offer remittance services should be targets for engagement. Access to banking service remains low despite the very high percentage of payments made by banks, and the revenues resulting from their services: remittance transfer earnings represent 20% or more of their total net income. There should be efforts to increase opportunities for reinvestment in the community. Throughout Latin America and the Caribbean banks make nearly 50 percent of all remittance payments, and in Central Asia, Africa, South Caucasus, Eastern Europe, and parts of South East Asia, the percent is nearly 100 (only to compete with postal services, or some credit unions). However, banks have not taken advantage of this position to offer remittance recipients access to other financial services. Because of banks' roles in distributing remittances in the region, it is particularly important that they move beyond simple remittance payments and offer financial literacy programs aimed at remittance recipients, financial product design or marketing, and modernization of payment systems.

An important example of providing financial services to recipients is in Mexico. The government agency BANSEFI established a network—L@ Red de la Gente—of some 1200 banks, micro finance institutions, and credit unions to serve as distribution centers for remittances. In 2007 BANSEFI had increased its payments to 120,000 transfers and was opening accounts for about one quarter of its payment recipients.

*d) Supporting projects to improve investment opportunities at home and among the diaspora*

Policy initiatives should also focus on improving opportunities for small scale investment to create new businesses thus responding to the demand by migrants and their families to invest. This means, for example, linking investment opportunities to transform subsistence agriculture of remittance recipients into commercial farming and encouraging an environment favorable for investment on the part of migrants. These enterprises also relate to remittances and migration when promoting investing by migrants in terms of tourism and nostalgic trade. One third to half of migrants visit their countries once a year while eight percent import home country goods which contribute to the growth of small businesses. Governments could offer travel opportunities aimed directly at members of the diaspora, who tend to travel frequently to their countries of origin. Moreover governments could also partner with migrants abroad to package these travel services. In terms of nostalgic trade, many businesses succeed by meeting the high demand for goods from the home country. Governments in the host and home country, development agencies, and the private sector could benefit by offering products or services from the country of origin in these businesses abroad. In reaching out to the diaspora, governments target a unique yet important source of funds.

In order to achieve these goals it is a prerequisite that governments and private sector continue their work to create appropriate conditions for positive investment climate in their country of origin. Any effort to promote investment will not succeed if the business climate is not investor friendly.

*e) Design products that include education and health services*

Education and health expenses are typical investments in remittance recipient families. Nonetheless, adequate education and health services are often not well publicized or not available. One way to provide these services is through partnerships between MFIs and health and education providers that offer financing. In education, this means education funds (savings and loans), tutoring, extracurricular activities, and internet lessons. These types of investments on the part of recipient families will lead to higher educational achievement and also continued investment on the part of the person sending money from abroad. Health products include life insurance, medical insurance, emergency care, body repatriation, and child care. Opportunities for healthcare investment will improve standards of living and understanding of healthcare standards. Migrants should also benefit from these health insurance schemes that can remediate labor related injuries. In Malaysia every year about 100 to 150 Bangladeshi migrants' workers die due to several reasons like sudden death, death due to risky jobs and other causes.

*f) Provide technical assistance on financial and remittance literacy*

The Central Banks of each country in Latin America and the Caribbean lack resources and capacity to provide basic financial literacy to their populations. Educating people about the role of finances is a critical step toward development and is also becoming important among remittance recipients. Financial and remittance literacy, training on skills acquisition, can be established in cooperation with Central Banks and financial institutions to reach out to the millions of remittance recipients. This technical assistance should consider information about the financial value of the transfers as a mechanism to build credit, assets and use of alternative payments through electronic instruments such as debit and credit cards.

*g) Engaging governments and the private sector as environment enablers*

One of the general policy recommendations, perhaps one which should have a major priority and that can be gleaned from the majority of these issues, is that governments need to understand their role as environment enablers. This means in general promoting policies that lead to increased access to the financial system and financial intermediation for remittance recipients.

Moreover, an outreach policy to the community residing abroad is key to any migrant-sending country's economic strategy. Currently no such policy is in place in most countries, and governments could gain significantly from such an approach, while empowering and legitimating the migrant's reality and hardship.

A first step in this direction is the creation of National Commissions on Remittances and Development composed of civil society organizations, migrant based groups, MTOs, financial institutions, government officials and donors. The experience of these types of exercises has been successful in the United States – Latin American and Caribbean context.

*h) Macroeconomic policy*[1]

Policy tools can play a preventive role to mitigate adverse effects of remittances, particularly when these flows affect the productive base of the local economy through an unnecessary or undesired appreciation of the local currency.

[1] Although important, this issue will not be addressed during the session.

## 3. Conclusion

The role of remittances in the lives of so many families is clearly dominant. The policy implications are also extremely relevant. Opportunities include investing in small or large financial institutions to private businesses or public services or teaming up to provide financial education to remittance recipients. Overall the policy effort must aim at modernizing the productive base of local economies while leveraging resources from migrant foreign savings. This means linking investment opportunities, savings creation, local and central government enabling environments, and increased risk propensity among local, national, and transnational entrepreneurs.

This issue is particularly important because at times the discussion of the development impact of remittances is often obscured by inaccurate assumptions. For example, a few argue that remittances need a “productive use” because consumption expenditure is detrimental to growth. Yet there is no metric by which to measure what proportion of personal income should be productive. Moreover, neither would show that remittance recipients have a higher propensity to consume. This latter issue is in fact the opposite: remittance recipients save and invest more, and have more bank accounts than non-recipients.

The social and productive base of an economy defines the ways in which remittances will effectively function. The extent to which such structure of the economy absorbs those remittances is the major policy issue for development practitioners. Thus policy evaluation should focus on the productive forces in an economy, their efficiency, modernization and diversification/concentration levels across economic sectors; about how entrepreneurship operates, what technology tools exist or are missing, and what is the extent to which governments provide an enabling environment to motivate an interaction between investment and production.

If an economy is unable to produce in a competitive context, its labor force will be depressed and eventually a portion will migrate to take care of their families. But even once they are away and send money, the families may only be able to do so much with that money in so far as the local economy provides an effective supply to the demand of services and products.

Consumers have a demand of a range of commodities and services (economic and financial). If the productive base of the local economy can not provide for that demand, imports of goods will then ensue. None of this is a situation created by remittances, but rather by the structure of the local economy, which is also connected to the global context.

The development challenge for practitioners consists in enabling an environment by which remittances can have a transformative role in a local economy. The challenge for practitioners is to identify and implement policies that enable a leveraging effect of remittances to effectively and positively impact their absorption in the local economy and thus promote development, without telling migrants and their families about what to do with their money, because after all remittances are a private matter. ERCOF thus rightly stresses that “this is precisely why financial literacy training is so important, because it aims to empower the migrant and the remittance beneficiaries with the knowledge and the mindset for financial planning.”

## 4. Some questions to consider:

In looking at the issues identified, what concrete measures and incentives can be proposed to help enhance the development impact of remittances? Are there public - private partnerships that can create a beneficial environment for sending and receiving remittances and thereby enhancing their development impact? What specific role can CSOs and businesses play to make remittances related savings benefit more than their sole communities (ex help build capacity) and look for concrete examples/good practices?

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**Remittance Transfers Fundamentals among Senders and Recipients**

| Sender | Demographic profile | Income | Gender M/F | Legal status | Financial condition | Amount sent | Sending methods | Cost | Length of time sending | Propensity to remit |
|---|---|---|---|---|---|---|---|---|---|---|
| 1. United States and Canada | <30, high school | Under $30K | 50/50 | 40% undoc. | 40% no bank acc. | US$300 x 12 | Licensed: 80% | 6% LAC; 8% Afr.; Asia | 7 yrs | 20-25% |
| 2. Western Europe | <30, high school | Under $35K | 50/50 | 30% undoc. | 30% no bank | US$350 x 10 | Licensed: 70% | 8% Afr.; 6% EE | 7 yrs | 20 – 25% |
| 3. Russia and Kazakhstan | 20-30, high school | Under $10K | 70/30 | Guest worker; overstayer | 20% no bank | US$150 x 10 | L: 70% | 3% CA/Cauc. | 3 - 5 yrs | |
| 4. Asia: Japan, S Korea, Singapore, Australia, Hong Kong | 20-30, less than high school | Under $20K | 30/70 | Guest worker; overstayer | 20% no bank | US$250 x 10 | L: 50% | 10% Jpn; 5% HK/S | 2 - 3 yrs | |
| 5. Arab oil exporting countries | 20-30, less than high school | Under $20K | 90/10 | Guest worker | 20% no bank; | | L: 60% | < 3% | 1 - 3 yrs | |
| 6. Intra-regional markets | 20-30, less than high school | Under $10K | 60/40 | Seasonal undoc. | 10% no bank | US$65 x 8 | L:30% | 10%; | 1 - 3 yrs | |
| 7. Other (emergency, crisis) | | | | Exile, ref. | | | | | | |

| Recipient<br>Origin of flows | 1. Geographic distribution Urban/Rural | 2. Gender % Female | 3. Earnings received | 4. Beneficiaries | 5. Time span | 6. Financial access | 7. Hierarchy of needs | 8. Demographics | 9. Ratio of remittances to income |
|---|---|---|---|---|---|---|---|---|---|
| Industrialized nations | 65%/35% | 65% | US$4,000 | Spouse; Mother | 7 yrs | 30% | Daily needs (food, clothes, rent | 35+, | 60% |
| Regional economic | 65%/35% | 65% | US$3,000 | Spouse; | 3 - 5 yrs | 20% | | | 80% |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| centers | 55%/45% | | | Mother; siblings | | | etc.): 57; Consumer durables (TV, fridge etc.):4 Education (school fees etc.): 5; Health care: 6; Savings & Investments: 5; Housing (repairs, purchase) 13 | | |
| Intra-Regional economic centers | 50%/50% | 50% | US$1,500 | Mother; siblings | 1 – 3 yrs | 10% | | | 90% |