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Background Paper
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Roundtable 2
Remittances and other diaspora resources: increasing their net volume and development value

Session: 2.1
Improving the formalization of transfers and reducing their cost

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Executive summary

The rapidly increasing level of remittances and its concentration in developing countries in recent decades bring to fore its great potential for use in economic development and poverty alleviation. This potential is maximized when transfer costs are reduced and when remittances are coursed through formal channels

In general, greater competition in the remittance industry is found to be associated with lower costs. Granting exclusive licenses, as experienced in some countries, should be avoided, as it leads to monopoly pricing. On the other hand, partnerships between different stakeholders, such as government agencies, financial institutions, remittance service providers, and technology firms, should be promoted as they enable increased competition and the adoption of newer cost-reducing technology. Recognizing remittance as a separate industry from banking, with different regulatory requirements, may further enhance competition.

Government has an important role to play in setting up shared networks, in accessing new payments technology, and even in the dissemination of information on prices of different remittance services. Bilateral organizations have proved effective in reducing transfer costs by facilitating remittance flows between sending and receiving countries. Multilateral cooperation between governments and including other stakeholders has strong potential to further improve efficiency.

A potentially effective tool to increase formal transfers is to provide migrants financial literacy programs (including pre-departure). In some countries, there is evidence that bulk of remittances come from women. This should be accounted for in the design and targeting of financial literacy programs. Encouraging domestic banks to expand to countries with a high concentration of their migrants, as well as simplifying procedures and reducing fees, will also help formalize transfers.

Other measures to increase formal transfers that have proved effective or have good potential are the issuance to migrant workers of identification cards, relaxing foreign exchange controls, and tax incentives and privileges to remittances.

Suggested future actions to reduce costs and increase formal transfers include the dismantling of monopolies in the remittance industry where they still exist, replicating innovative tie ups, whether between government agencies and technological firms, or financial institutions and non-profit organizations, etc, and easing controls in the foreign exchange market.

A careful study should be made of the profile of the migrants, their level of financial and technological literacy, and financial literacy programs should be designed to tailor them. The practice of publicly disseminating information on prices for different remittance service providers should be institutionalized. Other means of formalizing transfers, such as by paying migrant workers salaries through banks should be explored.

Finally, bilateral agreements in the mode of successful ones already in place should be explored and undertaken by all sending and corresponding receiving countries. This includes possible agreements on access to financial institutions and the acceptance of identification cards for migrants. Likewise, the possibility of multilateral agreements, particularly in setting up region-wide payments infrastructure such as in the EU but also in other regions, such as the South African Development Corridor, ASEAN or ASEAN + 3, etc should be explored.

1. Introduction

Remittances to the world as a whole and to developing countries in particular have risen rapidly in the past three decades. Their very high level and their concentration in developing countries has led many to view it as a very promising vehicle for economic development and poverty alleviation. If mobilized as savings, remittances can relieve credit constraints for low and middle income groups and can also be a tool for modernizing financial and communications infrastructure. The use of remittances can further be harmonized with government development objectives through options, tools and incentives provided to remittances senders and recipients in areas such as relieving hunger, raising access to education at all levels, increasing gender equality, improving rural development and raising health standards (see session 2.2).

The higher the level of remittances, and the greater the proportion of the total that pass through the formal channels, the stronger its developmental potential. For this reason, policy discussions over remittances have been directed towards reducing the costs of remittances and increasing the use of formal channels. The two policy directives are of course not mutually exclusive: whatever will reduce the costs of remittances through formal channels, will also increasingly formalize it.

This paper looks at the policies that have been proposed to reduce remittance costs and direct them towards the formal channels in the recent period as well as actual experiences of countries with these policies. The rest of the paper is structured as follows. The next section looks at recent policies on reducing remittances costs and increasing the use of formal channels that have been discussed in the literature and at specific experiences of countries who have implemented them. The third section summarizes the lessons learned and the outcomes from all these policies. The last section submits proposals for future actions.

2. Recent and current policies and programmes on reducing costs and increasing formalization of remittances

2.1. Reducing transfer costs

Policies to reduce transfer costs have taken four main forms: a) *enhancing market competition*; b) *helping remittance providers access new payments technology*; c) *disseminating information* to both remittance senders and receivers; and d) *bilateral negotiations* between governments.

Among policies that are said to enhance market competition is the encouragement of postal systems and other state-owned distribution alternatives to open their networks to multiple partnerships with Money Transfer Operators (MTOs) on a non-exclusive basis. There is an emphasis on non-exclusivity because otherwise it may lead to increased fees because of the monopoly power obtained by whoever gets the license (World Bank 2006). A World Bank (2005) study finds that transfer fees are substantially higher in countries where MTOs have an exclusive relationship with the post office.

Another policy to enhance competition is to allow or encourage partnerships between the government, financial institutions and MTOs. In the Dominican Republic, commercial banks partner with a transmitter, such as the arrangement for Banco Popular Dominicano and Banco del Progreso to distribute for MoneyGram through branches and ATMs. Wells Fargo, according to a news release, has made inroads to China and Vietnam by partnering with the Agricultural Bank of China (31,000 branches and thousands of ATM terminals) and the Industrial and Commercial Bank of Vietnam (700 branches and 400 ATM terminals). In Vietnam also, another MTO, First Remit in UK has an agreement to remit money with the Orient Commercial Joint Stock Bank based in Vietnam. In the Philippines, the Philippines National Bank has teamed up with 7Eleven and Citibank in Hong Kong to provide remittance services. PNB is also said to be partnering with an Indonesian Bank to provide transfer mechanisms to Indonesian workers in Hong Kong. According to the European Commission (2006), the German government is promoting retail banking in Balkan states; and in Italy, the government has several programs with non-profit organizations. The government of Spain, in the framework of the Initiative Against Hunger and Poverty (IHT), has engaged with the Spanish financial sector to partner in facilitating remittance flows with overall objective to improve their development impact.

Another policy suggested to enhance market competition is to recognize remittance as a self-standing industry different from banking, and thus subject it to different capitalization and reporting requirements. Although regulations for anti-money-laundering and countering the financing of terrorism (AML/CFT) are necessary for security reasons, they should not make it difficult for money service businesses to operate accounts with correspondent banks. For instance, in January 2004 Austria changed its legislation regarding money transfer services so that capital requirement is 36,000 Euros for a limited company and 72,000 Euros for an incorporated entity. In addition, the number of managing directors needed was reduced to one from two previously. Still, the new entities are subject to the same anti-money laundering rules that banks are subject to. Ratha and Riedberg (2005) argue that by not making available a remittance license separate from a full banking license, market conditions are severely impacted. In the US, the regulations are different for banks and remittance companies in terms of licensing, anti-money laundering, ID requirements, and reporting. Money transmitters are regulated under the Money Transmitter Act, while banks operate under the Banking Act.

Governments could also help to reduce transfer costs by helping set up shared networks and assisting remittance service providers in accessing new payments technology. An example of a shared network set up to reduce remittance cost is the US-Mexico automated clearing house (Fed-ACH). On the receiving end, the Mexican government also made efforts to establish a payment network to be shared by savings banks, credit unions, and microfinance institutions operating in poor and remote areas (World Bank 2006). Another shared network, set up in 1999, is the International Remittance Network (IRnet), which was established to facilitate remittance flows from the US to Latin America. This was done by the World Council of Credit Unions (WOCCU), based on the urging of member credit unions from El Salvador, Guatemala, Honduras, Nicaragua, Mexico and Jamaica, and is said to have resulted in lower fees charged by the IRnet compared to major MTOs – a flat rate of $10 to send up to $1,000. (World Bank 2006).

New payment systems technology and instruments that have potential to reduce costs include card-based instruments, internet remittances, and remittance through mobile phone. In the Dominican Republic, Quisqueyana, Mercantil, and Visa International produced a product called Cashpin, the only card product in the Dominican remittance marketplace (Suki 2004). Efforts towards internet remittances are being done by Envios Boya also in the Dominican Republic, which has a near-virtual model distributing for traditional off-line and online companies, among which is Xoom.com (Suki 2004). In the Philippines, mobile phone-based remittance system is employed by Smart, Inc. and recently by Globe Telecoms who both allow remitters to transmit money by using their beneficiaries' mobile phones (GEP 2006; Migrant Remittances 2007). Many cell phones in the country are operated by pre-paid cards, which are effectively stored value cards. It is possible to use the money stored on these cards in many stores. In Kenya, a similar means of remitting is also in place with the M-Pesa, or mobile money, which allows subscribers to send cash to other mobile phone users via SMS. The service is provided by Kenya's largest mobile phone service operator. The Philippines' Overseas Workers Welfare Administration partnered with Microsoft for an electronic remittance system called One Follow Me that uses wireless and desktop-based internet platforms. The remittance service allows an Oversea Filipino Worker (OFW) to send money from virtually anywhere in the world and uses the existing TeleMoney remittance service of Rizal Commercial Banking Corporation (RCBC), which can be availed through over 250 RCBC TeleMoney centers overseas. However,in many developing countries, the necessary infrastructure is not yet in place. Here, donor agencies may be of help by providing loans and technical assistance for projects supporting the development and installation of technologies used for the payment of remittances in developing countries (Ratha and Riedberg 2005). This is already happening as, for instance, the International Fund for Agricultural Development (IFAD), the European Commission, CGAP and other partners have launched a global technical assistance facility to introduce or refine existing money transfer services.

Another means by which government can help reduce transfer costs is to disseminate or facilitate the dissemination of information on prices of remittance services, especially for the most important remittance corridors. According to the World Bank (2007) the following means of dissemination could be considered: (1) use of ethnic media, especially press and radio; (2) financial media; (3) national associations and private sector consumer bodies, using printed material and web pages; and (4) overseas consulates and embassies of receiving countries. In the Philippines, the Bangko Sentral ng Pilipinas issued a circular in June 2005 requiring bank and non-bank financial institutions to post the charges for their various remittance products including cost classifications. This is partly to address the non-response of service fees despite the decrease in costs incurred because of automation in the remittance process. In Mexico, the publicizing of the information on costs has been done through the Procuraduría Federal del Consumidor (PROFECO) initiative. The Sri Lankan government is also said to actively play a role in collecting and disseminating information on the available remittance products for sending remittances from the Middle East, the country's main source of remittances (de Luna Martinez 2005). The website www.sendmoneyhome.org provides detailed and comparative information on the range of products available for remitting money in many countries. It is managed by Profile Business Intelligence and financially supported by the Department for International Development (DfID).

Bilateral negotiations, especially upon the initiation of governments of migrant-sending countries, can also help reduce transfer costs by improving access to financial institutions in the migrant-receiving countries. For instance, the Philippines' Department of Finance has entered into bilateral negotiations with the US Treasury Department with the intent of reducing remittance costs. The means by which cost reduction is to be achieved is through the granting of rights to local banks to form agreements with their counterparts in the US, thereby enhancing access to the formal transfer systems and at the same time ensuring compliance with regulations concerning financial flows. A Memorandum of Understanding has been signed for the purpose (de Luna Martinez 2005). Bilateral agreements between the Philippines and Japan as well as Malaysia are also already in effect which aim to facilitate remittances from the two countries and to improve access to financial institutions (ADB 2006). India is engaged in a policy dialogue with Canada to reduce remittance fees. Colombia, Mexico, and Turkey also have active dialogues with their counterparts in remittance source countries to facilitate remittance flows (De Luna Martinez 2005). The dialogue between Colombia and the US is on access to bank services of migrants. Between the US and Mexico, the negotiation was between the connectivity of payments systems and the recognition of the "matricula consular" as bank identification document. The central banks of Mexico and the US have signed an agreement that allows banks to to transmit electronic fund transfers from the USA to Mexico through the Federal Reserve Banks' Automated Clearing House. Between Germany and Turkey, the dialogue was about the taxation of migrant remittances. De Luna Martinez (2005) found that corridors in which there is active dialogue between sending and recipient countries are those with the lowest remittance fees. The UK also has bilateral co-operations with remittance receiving countries to support their financial sector development, which include the support of mobile banking technology in Kenya and elsewhere in Eastern Africa, and the development of a debit card infrastructure in South Africa (European Commission 2006).

Multilateral cooperation among governments and including other stakeholders such as the remittance service providers and even NGOs could also help facilitate remittances and thus reduce costs. The DfID says it will support the creation of an EU-wide infrastructure for the provision of payment services, thus decreasing transaction costs in the EU. In Ireland, an idea is being developed to build a global remittance network that brings together like-minded pro-poor financial institutions, community banks, and microfinance institutions that would provide technologies to enable international funds transfer services and remittance capability (Hastings 2006). The network is envisioned to allow microfinance institutions from around the world to enter the market and reduce costs.

2.2. Increasing the use of formal channels

Policies to increase the use of formal channels have taken 5 main forms: a) *financial literacy programs*; b) *increased access* of migrant workers to *banks* either by introduction of *basic bank accounts* or issuing them *identification cards*; c) *relaxing exchange controls*; d) *formalization* of previously *non-formal channels*; and e) *granting tax incentives* and other preferential privileges.

A major impediment to directing remittances to formal channels is the low level of financial literacy and experience with banking of many migrants and their families. Of African migrants in the UK, only 35 percent are reported to use banks and money transfer operators, while over 40 percent would rather have cash or goods transferred through the informal channels (Samuel 2005). In general, different ethnic communities are found to exhibit varying degrees of trust in the banking system (European Commission 2006). Governments of remittance-receiving countries can try to address this problem through financial literacy programs for their migrant workers. There is scarce data on remittances by gender but data from Sri Lanka and the Dominican Republic appear to indicate that majority of remittances come from female migrants, and this may have to be taken into account in the design and targeting of financial literacy programs. In the Philippines, workers going overseas are provided orientation seminars that include topics on remittance including the opening of a bank account pre-departure for the purpose of remittance later. Financial literacy programs are also staged in coordination with the Oversea's Workers Welfare Administration (OWWA) to make migrant workers aware of the various bank instruments and other investment opportunities available to them. The very rapid rise in remittance figures in the Philippines in recent years is partly attributed to the increasing use formal channels by migrants, which may in turn be attributed in part to these literacy programs. The joint project between OWWA and Microsoft Philippines called *Tulay*, where OFWs and their families and dependents receive training on basic computer applications including email and web functionalities increases not just the financial but technological literacy of the migrants. Likewise in the Philippines, RuralNet, a cooperative venture of rural banks has been established to provide interconnectivity between rural banks and other players in the formal remittance market. This is seen to potentially address the "unbanked problem" (Melly, 2005).

Governments can also increase formal transfers by increasing the access of migrants to bank services. For instance, this maybe accomplished by encouraging or helping domestic banks and microfinance institutions expand to countries where they have a significant number of migrant workers residing. The Fonzoke of Haiti has expanded its US-based clientele in partnership with the City National Bank of New Jersey (World Bank 2005). Having people in the remittance service provider who speak the language of the remitting nationality is a necessity if access is to be expanded. Several Philippine banks have branches in other countries that have a large number of overseas Filipino workers. Indonesia has more than 20,000 workers in Qatar and the agreement between Doha Bank and PT Bank Central Asia Tbk, Indonesia enables its workers to avail of web-based remittance services. Increasing access to bank services can also be facilitated by simplifying procedures and lowering fees. The Groupe Banques Populaires offers low fees, simple procedures and other nonfinancial services to Moroccans abroad and as a result has picked up 66 percent of total remittances to Morocco (Amin and Freund 2005). The European Commission reports that the UK government requires banks to introduce basic bank accounts, and to make them widely available and accessible to immigrants. To further shift remittances to the formal channel, it also grants tax benefits and credits to bank accounts Post Office Card Accounts and basic accounts available through the Post Office.

Access of migrant workers to bank services can also be increased by issuing them identification cards. In Tunisia, the ID cards are used to expedite domestic services for their emigrants. The Tunisian card, *carte consulaire* is used for special customs clearance, reduced airfares and the opening of foreign currency bank accounts. Mexico issues identification (ID) cards to migrants to help increase migrants' access to banking facilities and services. Mexican migrant workers can obtain a photo-identification card in the form of a *matricula consular* from their local consulates. These can be used to open accounts in many U.S. commercial banks. (World Bank 2006).

Since this might in some cases be incompatible with international binding provisions protecting refugees and asylum-seekers, alternatives have to be found to consider more flexibility in minimal access to banking services to all migrants irrespective of their legal stay in the host country, without neglecting the necessary Know Your Customer (KYC), Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) concerns.

Relaxing exchange controls and allowing more financial institutions to engage in foreign exchange transactions is also viewed to increase formal transfers (Orozco 2002). In Africa, it was observed that a large increase in formal remittances followed the policy of permitting residents to hold foreign currency deposits using remittances (Siddiqui 2004). Nevertheless, in Zimbabwe, where it is mandatory that remittances are converted to the local currency, but where the official and the black market rates differed by a factor of six, there is great unwillingness of remitters to transfer funds through the formal channel (CGAP). Relaxation of exchange controls was reported to have caused a surge in formal remittance for the Philippines in 1995, whereas currency controls in Pakistan and Vietnam in 1998 and 1996, respectively, resulted in massive declines in remittances (CGAP). The policy of allowing remitters to have the freedom to choose the currency of remittance, because it allows remitters to be better protected against currency fluctuations, is also seen to increase formal transfers (Suki 2004). This is held to be the case for Dominican Republic where the drastic depreciation of the local currency in 2004, resulted in substantial switching to US dollars. De Luna Martinez (2005) in a survey of 40 countries found, however, that in practice most developing countries already allow their citizens to open accounts in US dollars or any other international currency, thus universal adoption of this policy may not have that big an impact. In his survey, 32 of the 40 countries allow their citizens to open accounts in US dollars or other major foreign currencies, while two countries (Ecuador and El Salvador) were dollarized.

The formalization of widely used existing non-formal channels is another means to increase formal transfers. In Pakistan, the government converted informal Money Changers, which cornered a large share of remittances, into Exchange Companies in order to encourage remittances through this new formal sector. Its objective was to expand the operations of these companies to increase franchises, specialized payment booths, and encourage agency arrangements with major remittance service providers. Pakistan permitted another category of Exchange Companies with lower capital requirements to deal only in the buying and selling of foreign exchange.

The granting of tax incentives and other preferential privileges is given to migrant workers to further encourage formal transfers. In Guatemala, a migrant is given a once-a-year tax-free remittance of any commodity valued up to US$500 (World Bank 2006). In Tunisia, migrant workers are entitled to import, tax-free, goods or services up to a customs value of TD 1,000. Returning migrant workers from Tunisia as well as from Pakistan are also allowed to bring a private vehicle, furniture, and other home equipment tax free. In Egypt, bank institutions give tax break up to ten years to their migrant remittance customers (de Luna Martinez 2005). In Turkey, foreign currency deposits of migrant workers are given special rates, and the migrants themselves are given import privileges. In the case of India and Sri Lanka, for instance, such accounts offer competitive or higher interest rates and tax exemptions on interest revenues earned therefrom (Orozco, 2003; de Luna Martinez, 2005).

In Sri Lanka, migrants get free insurance if their accounts exceed a certain threshold and loan facilities are in place to cater to the financial needs of the migrant.

3. Lessons learned from past and current policies/programmes

- Competition should be encouraged whereas granting exclusive licenses should be avoided, as this leads to monopoly pricing.

- Partnerships between government agencies, financial institutions, remittance service providers, and even technology firms should be encouraged. These partnerships are bound to increase competition and raise the level of technology used, thus reducing costs.

- It maybe expedient to recognize remittance as a separate industry from banking and, thus, subject to different operating requirements, as this would allow the entry of more players, enhancing competition and reducing costs.

- Government has a potential role to play in setting up shared networks and in accessing new payments technology. Because of the large fixed costs involved in setting up the remittance infrastructure, there are huge cost benefits to be derived in sharing them. New technologies that have good promise to be widely accepted by remitters include card-based instruments, internet remittances, and remittances through mobile phones.

- Effective dissemination of information on prices of different remittance services can help remitters choose what for him/her is best, taking into account other considerations such as risk, speed, and convenience. Transparency will also discourage remittance service providers from quoting unnecessarily high prices.

- Bilateral negotiations have been effective in reducing transfer costs by facilitating remittance flows between sending and receiving countries. Multilateral cooperation between governments and including other stakeholders holds the potential to make remittance flows much more efficient.

- There is a low level of financial literacy among many migrants and their families. Migrant workers could be provided financial literacy training pre-departure. For some countries, there is evidence that bulk of remittances come from women. Proper design and targeting of financial literacy programs should take this into consideration.

- For migrant sending countries, encouraging domestic banks to expand to countries where they have a high concentration of migrants could help in formalizing transfers. So will simplifying procedures and reducing fees.

- Issuing migrant workers identification cards could help increase formal transfers but alternatives could also be considered.

- Relaxing tight foreign exchange controls can strongly increase formal transfers. But there is some evidence that in most developing countries foreign exchange controls are already quite lax.

- Tax incentives and other privileges provide a means to attract remittances to more formal channels.

4. Proposals for future actions

- Support the implementation of the General Principles for International Remittance Services on transparency, consumer protection, payment system infrastructure, legal and regulatory framework, competitive market conditions, and appropriate governance and risk management practices, as presented in the CPSS-WB Report of January 2007.

- Enhance transparency, competition on the remittances market, notably by dismantling, where they exist, monopolies in the remittance industry in both remittances senders' and recipients' countries.

- Explore other possible tie-ups between government agencies, financial institutions, remittance service providers, non-profit organizations, and technology firms. Examine the components of successful tie ups for replicability, including technological capacities of countries involved taking into account the need for regulation and customer protection.

- Institutionalize the public dissemination of the information on prices for different remittance service providers. Ensure that the medium of dissemination is likely to reach the target group.

- For sending and corresponding receiving countries, explore possible bilateral agreements in the mode of successful previous ones cited earlier. This includes possible agreements on connectivity of payment systems, access to financial institutions and the acceptance of identification cards for migrants.

- Explore the possibility of multilateral agreements, particularly in setting up region-wide payments infrastructure, such as the South African Development Corridor, ASEAN or ASEAN + 3, etc..

- Study the profile of migrants, assess their level of financial and technological literacy, and design financial literacy programs to tailor them. The design should also include consideration of where the education is to be given (whether pre-departure stage or after, in home or destination country, etc.).

- Explore other possible means of formalizing transfers, such as paying migrant workers salaries through banks (with an option to remit a portion to home country).

- Where there are still tight controls on the foreign exchange market, work towards easing them.

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