

SECTION 4: CONCLUDING REMARKS AND THE ROLE OF POLICY

Despite the rapid growth experienced in the remittance industry in ECA, there remains ample room for further improvement, especially by inducing greater access to the formal sector by remitters and their relatives. Common issues faced by the remittance industry in Easter Europe are (a) the high level of informality of money transfers, (b) the generally low access to formal remittance services by the poorer, and (c) the low capacity of the economies to capitalize on remittance transfers. All are correlated to financial sector development at both the infrastructure and institutional levels.

Remittances channeled through formal institutions have a positive impact on financial intermediation and on financial penetration (including among previously un-banked clients), and vice versa. A number of studies¹⁶ analyzed the effects of remittances on financial sector development and macro and micro policies in other regions of the world. Some of these studies focused on Latin America and showed positive correlations between the levels of deposits and credits to GDP and the level of remittances: analytical results in some developing countries observed increases of 5 percent in the level of bank deposits to GDP per 1 percent increase in remittances to GDP. In the case of Mexico, even though remittances are only 2 percent of GDP, bank accounts and savings related to remittances represent 10 percent of GDP. This is because Mexican banks handle more than 70 percent of the whole remittance transfers, thus indicating a high degree of penetration of banks in this particular segment. Furthermore, studies showed evidence that banks and other intermediaries benefiting from remittance transfers better reach out to un-banked and unknown clients. Lastly, the extent of the financial network of a country has a large positive impact on the choice between formal or informal remittance transfers and the level of intermediation: higher degrees of sophistication and extension of the banking networks are positively correlated with lesser levels of informality in remittances, and higher levels of bankability.

It is thus of paramount importance for policymakers, operators and the donor community to encourage the formalization of remittance transfers and the introduction of migrants and remitters to banking, intermediation, savings and investments, as well as to develop the financial sector infrastructure.

Policy makers could concentrate in the following policies, ranging from those with an indirect to those with a direct impact on remittances:

Improve Data on Remittances

- **Build the statistical frameworks and convey surveys.** Statistics related to immigration and remittances must be strengthened, including the official statistical frameworks and surveys at points of entry, with the diaspora and with

¹⁶ Among others, see ample literature by Beck, Demirguc-Kunt, Martinez Peira in 2005 and 2006; World Bank Report No. 37026 on the impact of remittances in Latin America (August 2006); Orozco and Fedewa (2005); and others.

households. Building better statistics data bases on remittances would indeed not only enable to better understand remittance flows and in particular their impact on the economy and financial intermediation, it would also facilitate the cross-selling of other financial products to remitters and their relatives (see below). For instance, the National Bank of Armenia (NBA) has started strengthening its statistical framework to support its monetary policy formulation and execution. The NBA's objective is to analyze remittance flows and their potential impact on the Armenian system in case of turmoil in the main sending countries (contagion effect of a Russia crisis on remittance flows). The NBA conducted a survey in 2006 with households in both Armenia and the United States, where the largest Armenian diaspora resides¹⁷. At the same time, the IMF has started redesigning the statistical framework for remittances, to support central banks around the world in better assessing the micro and macro impact of remittances. Furthermore, the Central Bank of Russia has started releasing comprehensive historical data on remittances¹⁸.

Promote Formal Remittance Channels

- **Build the financial sector infrastructure.** Efforts to develop the framework and infrastructure for intermediation would improve access to financial services by the population and decrease transaction costs. In turn, better access to banking services would increase intermediation (both deposits and credits) with positive and multiplying effects on the economy.
- **Increase confidence in the banking system.** Increased confidence in the banking system will entice greater use of formal channels for the transfer of remittances. Increasing confidence in the banking system requires adequate banking sector regulation and supervision, as well as a credible regulatory and supervisory body. If well designed, conceived and implemented, a deposit insurance scheme may also help restore confidence in the formal financial systems, especially for remitters and their relatives, who are the first beneficiaries of deposit insurance given their small deposits.
- **Develop the payments system.** Improving the payments systems is also needed to facilitate remittances and money transfers. Efficient payments systems decrease transaction costs, increase the security of payments and enable banks and operators to attract savings and to develop services and products. It is worth mentioning that relatives of migrants and remitters in general can access the services of NBFIs and microfinance organizations in the receiving countries, and the latter do not necessarily need access to the payments system to receive the funds. Banks could still remain the main points of access to the payments system, while NBFIs, microfinance institutions and the post offices could operate as pure delivery entities. For instance, Armenia and Moldova have made strenuous efforts to develop modern payments systems infrastructures, and Kyrgyzstan is currently

¹⁷ A summary of the results and findings of the survey are available at: www.cba.am/

¹⁸ Available on the website of the Central Bank of Russia (www.cbr.ru/eng/) under the statistical appendix.

implementing an ambitious program to develop a modern, secure and automated payments system.

Promote Competition and Transparency

- **Eliminate protectionism and promote a diversified financial sector.** Policymakers should also focus on ensuring maximum competition so as to reduce remittance costs, thus eliminating barriers to entry for foreign banks and/or other protectionist policies. Going a step further, financial sector legislation could recognize money transfer companies as a separate category and type of financial intermediary and policymakers could adjust licensing requirements to facilitate entrance. However, it should be noted that policymakers will also have to ensure compliance with AML/CFT policies.
- **Increase market transparency.** Experience in the four reference countries shows that remitters and migrants face a variety of options in sending money to the families and relatives, but information on pricing and general services is generally difficult to access or to thoroughly understand¹⁹. Under these circumstances, the respective central banks and governments should endorse market transparency practices and require banks and MTOs to fully and thoroughly disclose all transaction costs in a readable and understandable manner. The dissemination could take place through newspapers, magazines and other media, a topic also explored under the public awareness point below. Notably, this effort should be coordinated with the governments and supervisory authorities of the sending countries.

Maximize Developmental Impact

- **Encourage investments in home country.** A strong investment climate in a migrant's home country can be an important factor in its decision to remit. Thus, policy measures aimed to improve the investment climate and develop investment opportunities would help attract greater remittance flows. Going beyond this, special incentives for investment could be offered to encourage migrants to send remittances to finance investments. Other than direct contributions through migrant associations, a number of schemes like tax breaks for investments could be explored.
- **Promote the development of specialized products for migrants and the cross-selling of financial products.** Migrants, remitters and their relatives can be

¹⁹ The British Government through the Department of International Development (DFID) has launched a program to assist migrants in the United Kingdom (www.sendmoneyhome.org). The program would enable through a website to assess “the cheapest way to send money home” using formal channels. The website also provides additional information related to timing, the infrastructure in the UK and other major European countries, as well as the receiving countries. None of the reference countries are though listed in the website, which seems to still be at the building stage.

creditworthy clients for banks and intermediaries, provided that intermediaries have sufficient access to historical information on their past and potential cash flows. Furthermore, studies have shown that remittances and personal money transfers are relatively stable and actually increase in frequency during economic downturns. Thus, intermediaries could develop other financial products linked to remittance transfers and lower the cost of remitting money for these potential new clients²⁰ Credit services could include housing and home improvement loans, small working capital loans for trade, credit card overdrafts, but also cash advances to purchase airline tickets and for the first months of accommodation in the receiving countries²¹. To encourage this, policy makers need to continue improving financial information available to financial intermediaries on their clients. In particular, databases on migrants and remitters cash flows and money transfers should be linked to the credit information bureau systems. Access to this information would reduce credit transaction costs for intermediaries (credit assessment and processing), and open a market to generally underserved and unbankable clients.

- **Promote financial literacy and public awareness.** The lack of financial literacy is a severe obstacle to the formalization of remittance flows, especially in Central Asia. Literature is showing that there is strong positive correlation between financial literacy and educational levels, and the total amounts and frequency of remittances and transfers. Furthermore, interviews and surveys on Tajikistan have shown that shuttle migrants (seasonal and short term), which represent 40 percent of the originators of remittances, have increasing difficulties in accessing remittance and money transfer services in Russia. Apart from the impossibility of opening a bank account, most shuttle migrants do not speak Russian and cannot fill up the documents and forms provided by the MTOs. Thus, governments should endorse, facilitate and support public awareness campaigns, which should include information on money transfer costs, requirements and accessibility, as well as the additional services provided by the domestic and international financial sector operators. Public awareness should target seasonal and shuttle migrants and their relatives throughout the travel cycle, from planning to return. Different experiences have been tried in several countries, including flyers at airports, rail stations, department stores, as well as television and newspapers adds during the peaks of the labor migration cycle.

²⁰ For instance, in Kyrgyzstan, retail loans yield 25 percent in one year. We could assume (1) a low probability of default of individuals (non-performing loans in microfinance are about 5 percent), (2) a mark-up of 10 percent by commercial banks or microfinance lenders, at zero recovery, (3) a portfolio increase of 20 percent due to cross-selling, and (d) an increase by 20 percent in operating expenses due to the increased volume of work. A bank or a microfinance company, under these assumptions, would increase its ROE by 12 percent for a portfolio 5 times its capital base.

²¹ As an example, a special purpose second tier mortgage finance company – SHF - was established in Mexico in 2002. SHF raises long-term finance on the domestic capital market. The funds are then on-lent to non-deposit taking mortgage banks (Sofoles) which extend mortgage loans to individuals. This program was extended to blue collar migrant workers in the United States with a view to channeling a portion of their remittances into investment (versus pure consumption). Under this program known as “*Mi Casa*” housing program, migrant workers can borrow up to \$160,000 (or 90% of the value of the house) for a period of up to 20 years with a fixed term interest rate (with the house being used as collateral).

- **Facilitate the securitization of remittance flows.** Remittances can be used as a future receivable and be collateralized by financial institutions to raise additional capital. Such securitization can provide banks with additional resources to finance productive projects. This has been successfully implemented in a number of countries, including Turkey and numerous banks throughout Latin America.

Encourage the use of technological advances

- **Explore the use of cell phones for remittance transfers.** The Philippines stand out in the use of cell phones for remittances as Box 5 further explores. The possibility to rely on mobile phone technologies depend on the ICT technology available in the country at hand, the extent of the mobile phone network, and the penetration of mobile phones in the countries. Furthermore, to cash-out on a mobile phone, a remitter or a receiver needs a Point-of-Sales (POSs), which can cost between \$800 and \$1,500 per piece. Mobile phone operators would also need to partner with mobile operators in the sending countries, in this case Russia.

Box 5: Remittance Transfers By Phone

Another impressive development is happening in the Philippines. G-cash -- a mobile phone operator and subsidiary of Global Telecom in the Philippines, has started offering cardless banking service that allows subscribers to use their mobile telephone device as a payment mechanism or "electronic wallet". G-cash has taken advantage of the large number of Filipinos working abroad who regularly remit funds back to the Philippines. Overseas Filipino workers represent the third largest global remittance market (after India and Mexico) for inbound remittances. The demographics of these workers fit the traditional prepaid mobile profile of cash-based, "unbanked" customers. Only about a quarter of 89 million Filipinos are considered to be "banked," whereas wireless penetration has reached 40 percent of the population. The operator earns revenue on a per-transaction basis, based on SMS traffic. Foreign exchange and other commissions are earned by the banks and agents. When remitting funds from abroad, the funds are transferred directly to the recipient's mobile phone account in the Philippines, which can be "cashed" at selected outlets. SMS based prepaid remittances have also started to develop in other remittance corridors.

Telcel, the Mexican market leader, has established 20,000 points of sale in the U.S. at which Mexican immigrants can send money and airtime home to relatives; Operators in Suriname are looking at the remittance market between Suriname and the Netherlands, etc. Mobile telephone based remittances could become the most efficient (real time) and cost-effective channel for small money transfers in un-banked countries.

Finally, while domestic policies will have to be prioritized according to the individual country characteristics, international co-operation is important in leveraging the advantages of remittances independent of the country context. Domestic policies frameworks and prioritization largely depend on the individual country, with the establishment of a national policy on remittances being a potential jump-starting point. At the international level, a conscious effort will be needed to promote policy dialogue among countries at the ends of remittance corridors and other stakeholders. This dialogue will be necessary in order to promote transparency, improve data compilation and in harmonizing electronic transfer systems.