
# The Malaysia Indonesia Remittance Corridor

## Making Formal Transfers the Best Option for Women and Undocumented Migrants

Expanded Summary

May 2008

BANK DUNIA | THE WORLD BANK

Financial Market Integrity Unit

East Asia Social Development Unit


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Printed in May 2008

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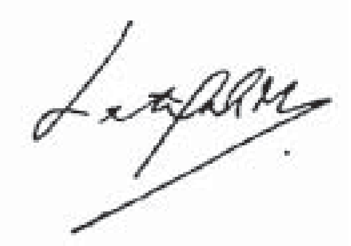
# Foreword

The partnership between the World Bank's Financial Market Integrity Unit and the East Asia Social Development Unit brings together two different perspectives on the transfer of remittances from Malaysia to Indonesia. The Bank has been at the forefront globally in research on remittances - and the Financial Market Integrity Unit brings a particular focus on analysis of defined bilateral remittance corridors, with attention to integrity issues and specific incentives influencing the choices of channels to send money home. The regional Social Development team's research on the vulnerability of female migrant workers and their use of remittances brings a unique human perspective. Both perspectives are reflected in the *Malaysia–Indonesia Remittance Corridor: Making Formal Transfers the Best Option for Women and Undocumented Migrants.*

The number of Indonesian migrants in Malaysia has increased rapidly in recent years, and female migrants outnumber men. The corridor is also marked by a substantial flow of undocumented migrants. Despite this, remittance flows from Malaysia to Indonesia through formal channels have declined since 2002. Migrant workers make the choice of how to transfer and use the remittances they send home, and their choice at the moment is with the informal sector. Research shows that more formalized systems could improve financial sector development and enhance poverty reduction by providing greater security and reliability, reducing costs, and improving migrants' options for investing in better outcomes. However, major changes in approach will be needed to attract migrant workers back to the formal sector.

Meanwhile, the important role of the informal sector in providing easily accessible solutions is recognized. Greater regulatory oversight of this sector, while an important element, must be proportionate to the risks involved in order that migrants are not driven towards greater informality of transfers. Regulations should focus on enabling markets to function and encouraging solutions, and migrant workers need to be recognized for their important contribution to the economy and empowered to engage with these markets. The remittance market can also benefit from greater incentives to the private sector which can generate customized services for migrants given new data on the potentially large and lucrative market for financial products and services.

An encouraging development has been that new analysis from this report has already generated policy dialogues between the authorities in Indonesia and Malaysia. These efforts will address the important challenges of developing the remittance markets that can efficiently meet the varied needs of migrant workers in a safe and secure environment.



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# Abbreviations and Acronyms

| | |
|---|---|
| AML/CFT | Anti-Money Laundering/Combating the Financing of Terrorism |
| AMLA | Anti-Money Laundering Act |
| ATM | Automated Teller Machine |
| BI | Bank Indonesia |
| BNI | Bank Negara Indonesia |
| BNM | Bank Negara Malaysia |
| CGAP | Consultative Group to Assist the Poor |
| CIMB | Commerce International Merchant Bankers |
| FDI | Foreign Direct Investments |
| FDIC | Federal Deposit Insurance Corporation |
| FIU | Financial Intelligence Unit |
| GDP | Gross Domestic Product |
| GNI | Gross National Income |
| ID | Identification |
| IDR | Indonesian Rupiah |
| IMF | International Monetary Fund |
| IOM | International Organization for Migration |
| IT | Information Technology |
| MEPS | Malaysian Electronic Payment System |
| PBI | *Peraturan Bank Indonesia* (Bank Indonesia Regulations) |
| PPATK | *Pusat Pelaporan dan Analisis Transaksi Keuangan* (Indonesian FIU) |
| PPTKLN | Directorate General of Overseas Employment Development (Indonesia) |
| RM | Malaysian Ringgit (currency abbreviation) |
| Rp | Indonesian Rupiah (currency abbreviation) |
| TKI | *Tenaga Kerja Indonesia* (Indonesian overseas migrant worker) |
| UK | United Kingdom |
| US$ | United States dollar |

The exchange rate conversions for all amounts used in this report are as follow, as of June 20, 2007:

US$ 1 (United States dollar) = RM 3.4320 (Malaysian Ringgit)

US$ 1 (United States dollar) = Rp 8,940 (Indonesian Rupiah)

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# Key Statistics of the Malaysia-Indonesia Remittance Corridor

**Table ES1: Economic Indicators for Malaysia - Indonesia**

| | Malaysia | Indonesia |
|---|---|---|
| **General** | | |
| Population (million, 2006) | 25.8 | 223 |
| Population Growth (annual%, 2006) | 1.6 | 1.1 |
| GDP Growth Rate (annual %, 2006) | 5.9 | 5.5 |
| GDP(US$billion, 2006) | 148.9 | 364.5 |
| GNI (US$billion, 2006) | 141.4 | 315.8 |
| GNI per capita (US$, 2006) | 5,490 | 1,420 |
| Foreign Direct Investment, net inflows (balance of payment, US$ billion, 2005) | 3.97 | 5.26 |
| Official Development Assistance and Official Aid (US$ billion, 2005) | 0.03 | 2.52 |

*Source*: World Development Indicators database, April 2007

**Table ES2: Remittance Data***

| Remittances | Amount | Source |
|---|---|---|
| Total Remittance Inflows to Indonesia from all countries (US$billion,2006) | 5.6 | BI |
| Formal Remittance Inflows to Indonesia from all countries (US$billion, 2005) | 1.9 | BI |
| Total Remittance Outflows from Malaysia to all countries (US$billion, 2005) | 5.7 | DSM** |
| Formal Remittance Outflows from Malaysia to all countries (US$billion, 2006) | 2.1 | BNM |
| Total Remittance Inflows to Indonesia from Malaysia (US$billion,2006) | 2.7 | BI |
| Formal Remittance Outflows from Malaysia to Indonesia (US$billion, 2006) | 0.26 | BNM |
| Formal Remittance Outflows from Malaysia to Indonesia (US$billion, 2006) | 0.24 | BI |
| Informal remittances as % of total remittance inflows for Indonesia | 80% | BI[a] |
| Informal remittances as % total remittance inflows to Indonesia from Malaysia specifically | 90% | BI[b] |
| Remittances Inflows to Indonesia as % of Indonesian GNI (2006) | 1.8 | BI |
| Remittance Inflows to Indonesia as % of Indonesian GDP (2006) | 1.5 | BI |
| Average remittance amount range (anecdotal surveys, US$) | 115-150 | |
| The Country Providing Indonesia with the largest remittance inflow | Malaysia | BI |
| The Country Receiving Malaysia's Largest Remittance Outflows | Indonesia | BNM |
| **Remittance Operations** | | |
| Main Transfer Mechanisms | Cash-couriers, Electronic Transfers | |
| Estimated annual average Transfer Fees (through bank channels), to send from Malaysia (US$) | 7 | |
| Estimated annual average Transfer fees (through bank channels), to receive in Indonesia (US$) | 20 | |
| Total Yearly Average Remittance Transfer Costs (US$)[c] | 27 | |

* The data for the categories in which the sources has been left blank is calculated by FPDFI and EASSO units, World Bank, for the sole purposes of this report

** *Department of Statistics, Malaysia* (DSM).

[a] Formal remittance estimates by BI using BI statistics; these statistics have been derived from monthly reporting of Indonesian banks and remittance service providers rather than BI's estimation in balance of payment statistics; the latter procedure would have suggested informal flows to be about 70 % (1.9⁄5.7 times 100).

[b] (.24⁄2.732 times 100) = approximately 90 percent of informal flows.

[c] Annual average transfer fees are based upon the assumption that workers remit twice a year through bank channels.

**Table ES3: Migration Data***

| Migrants | | |
|---|---|---|
| Estimated Number of Indonesian Migrant Workers in Malaysia (documented, 2007) | 1.3 million | MHAM** |
| Estimated Number of Indonesian Migrant Workers in Malaysia (undocumented, 2007)[a] | 700,000 | MHAM** |
| Average Annual Salary Range of Indonesian Migrant Workers in Malaysia (US$)[b] | 960-2040 | MHAM** |
| Range of Annual Cost of Migration on average (US$) | 343-475 | |
| Range of Total Annual Migration and Transfer Costs (US$) | 370-502 | |
| Migration and Remittance Transfer Costs as Percentage of Indonesian Migrant Workers Salary (averaging total cost range and salary range, US$) | 29 | |
| Percent of Salary Sent back as Remittances (on average) | 45% | BI |

* The data for the categories in which the sources has been left blank is calculated by FPDFI and EASSO units, World Bank, for the sole purposes of this report.

** *Ministry of Home Affairs, Malaysia.*

[a] The Ministry of Home Affairs, Malaysia (MHAM) assumes that the 700,000 undocumented workers listed in table are nearly all TKI *(Tenaga Kerja Indonesia,* Indonesian migrant workers).

[b] Yearly salary calculated by taking the average monthly salary times 12; average monthly salary information provided by the Ministry of Home Affairs, Malaysia (MHAM).

# Expanded Summary

The main objective of this report *Malaysia–Indonesia Remittance Corridor: Making Formal Transfers the Best Option for Women and Undocumented Migrants* is to contribute to policymakers' efforts to increase the impact that remittances have on economic growth and poverty reduction in Indonesia, and investigate options for attracting more migrants to use the formal financial sector. The report provides a descriptive overview of the Malaysia–Indonesia remittance corridor and suggests some policy avenues for improving access to formal remittance transfer channels; increasing the transparency of the flows and the cost structure; and facilitating the transfer of remittances, particularly for undocumented and female migrant workers.

## GLOBAL MIGRATION AND REMITTANCE PATTERNS

More than 190 million people, approximately 3 percent of the world's population, are living in countries in which they were not born.[1] Global remittances have increased steadily over the last decade and recorded remittance flows to developing countries in 2006 are estimated at US$204 billion. However, the true size, including unrecorded flows through formal and informal channels, is believed to be significantly larger.[2]

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1 World Bank, *Atlas of Global Development: A Visual Guide to the World's Greatest Challenges* (Washington, D.C.: HarperCollins and World Bank, 2007)

2 World Bank, *Global Economic Prospects: Economic Implications of Remittances and Migration 2006*, (Washington, D.C.:World Bank, 2005).

## EAST AND SOUTH ASIAN MIGRATION AND REMITTANCE TRENDS

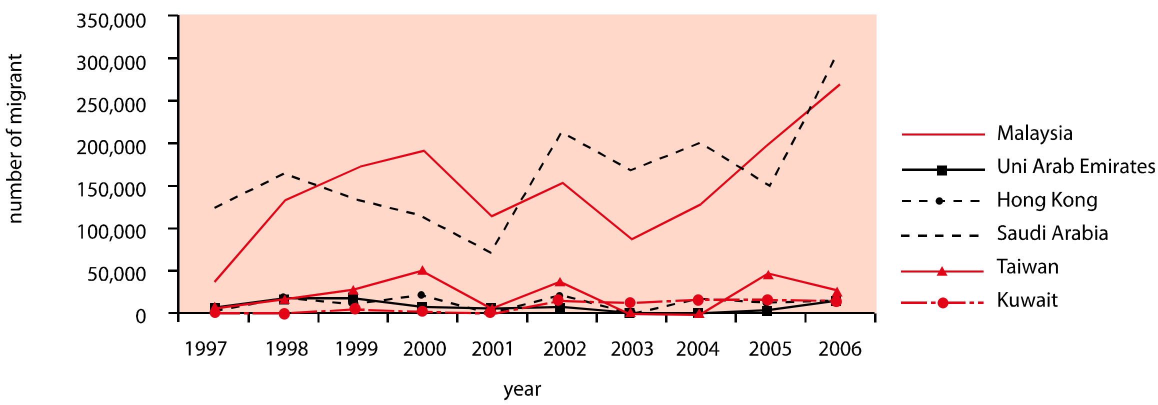
One-quarter to one-third of the total international migrant stream comes from the nine largest Asian immigrant-exporting countries—the Philippines, India, Bangladesh, Pakistan, Indonesia, Thailand, China, Sri Lanka and Myanmar.[3] According to IMF balance of payment data from 2005, the East Asia and Pacific Region as a whole accounted for US$45 billion, 17 percent of global recorded remittance inflows. The 2005 International Organization for Migration (IOM) study noted three important trends in Asian migration**:** (a) increasingly, more South and East Asian migrants are finding employment closer to home; (b) these regional migrant labor flows also seem to be increasingly undocumented workers; (c) lastly, more and more South and East Asian migrants are women.[4]

## INDONESIAN MIGRATION AND REMITTANCE TRENDS

In 2006, 680,000 Indonesian migrant workers traveled overseas with contracts to work in other countries.[5] The number of Indonesian migrant workers abroad is thought to be around 4.3 million. Migration has been steadily increasing since the early 1980s, and female migrants have consistently outnumbered men.

**There has been a rapid and steady increase in migration to Malaysia from Indonesia since 2003 (Figure 1).** Of the Indonesians that were approved to work overseas in 2006, 85 percent of went to Saudi Arabia and Malaysia.[6] Almost 80 percent of all the migrants leaving in 2006 were women, and 88 percent of these women went to work in the informal sector overseas. Migrant workers tend to come from specific regions in Indonesia such as West Java, Central Java, East Java, East Nusa Tenggara, West Nusa Tenggara, South Sulawesi, and Lampung. Hence remittances to Indonesia also tend to be concentrated in these provinces.

**Figure 1. Indonesian Migrants, Major Destination Countries (1997-2006)**




*Source:* Ministry of Manpower and Transmigration, Indonesia.

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3 *World Migration Report* (IOM,. Geneva, 2005).

4 *World Migration Report* (IOM,. Geneva, 2005).

5 National Authority for the Placement and Protection of Indonesian Overseas Workers and Ministry of Manpower and Transmigration

6 Directorate General of Overseas Employment Development (Indonesia)

**In 2006, IMF balance of payments records US$5.7 billion in remittances to Indonesia from all over the world.** This figure is calculated from stock of migrants and survey estimates of contract amounts and percentages of remittances sent home. This methodology was introduced in 2005 when it was recognized that the US$1.9 billion reported by banks[7] and non-bank financial institutions[8] was a substantial underestimate of the total amount. Using the new methodology the 2005 figure was revised to US$5.3 billion, and has risen steadily since then. [9]

**Only about 10 percent of the districts in Indonesia send significant numbers of migrants overseas.** Hence, while the level of remittances may appear small relative to total GDP, these inflows may be highly significant in a local context. In certain provinces of Indonesia, remittance inflows are greater than total local income.[10] For example, in the first quarter of 2007, it is estimated that migrants from the province of East Java remitted over Us$90 million to East Java specifically, accounting for nearly 62 percent of total incoming remittance inflows to the country (Figure 2).[11] In fact, nearly 90 percent of all remittances to Indonesia flow into the populous island of Java.

The majority of migrants are from the rural areas where poverty is greatest; hence an impact on poverty reduction would be expected. However, there is no information on the macroeconomic impact of remittances on economic growth, net effect on poverty alleviation, and the extent to which such flows have influenced social welfare indicators in the beneficiary community. Moreover, qualitative research indicates that there is significant room for improving both the quantity and the quality of investment of remittances in order to achieve sustainable social welfare outcomes.

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7 From a total 138 resident banks, 104 report foreign exchange transactions.

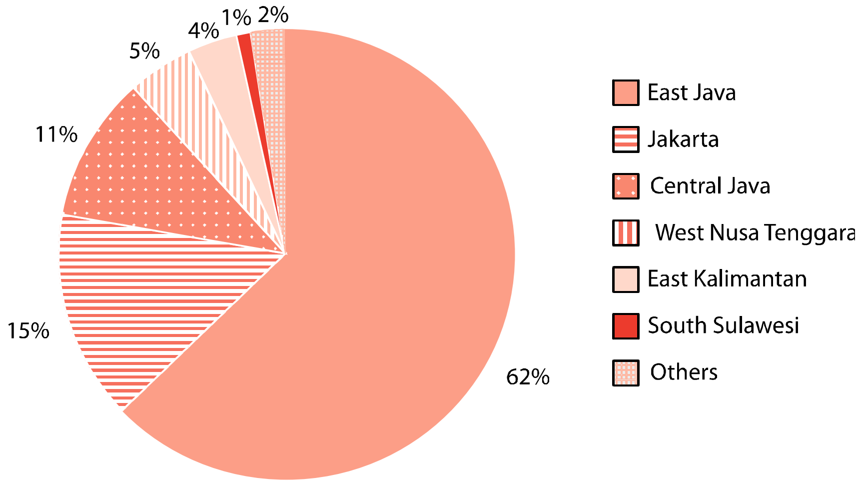
8 Non-bank financial institutions are: securities, insurance, finance and trust companies.

9 Bank Indonesia, *Balance of Payment Statistics, 2004-2006*, Balance of Payment Summary Chart (Jakarta, 2007).

10 This is the case in West Nusa Tenggara, which received remittances totaling over 300 billion rupiah in 2002, well exceeding the 61 billion rupiah local revenue in 2001. Sukamdi, Elan Striawan, and Abdul Haris, "Impact of Remittances on the Indonesian Economy," in Aris Ananta and Evi Nurvidya Arifin (eds), *International Migration in Southeast Asia* (Institute of Southeast Asian Studies, Singapore 2004), p 155.

11 National Authority for the Placement and Protection of Indonesian Overseas Workers.

**Figure 2. Total Remittances Inflows to Indonesia by Region, January – April 2007**




*Source*: Institution Service for Indonesian Migrant Workers in District Area

## MALAYSIA AS A REMITTANCE SENDER COUNTRY

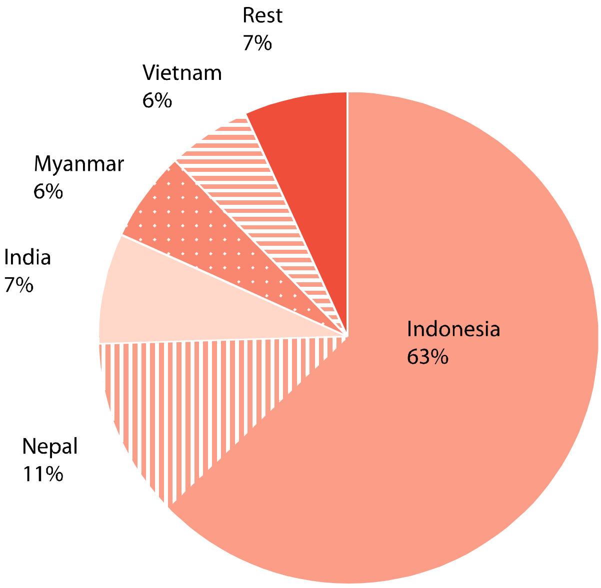
Bank Negara Malaysia (BNM) recorded US$1.8 billion total outflows in 2005 through banks and remittance service providers. However, alternative calculations based on sampling survey undertaken by the Department of Statistics, Malaysia, indicate total remittance estimated outflows US$5.7 billion in 2005.

## INDONESIAN MIGRANTS IN MALAYSIA

**Indonesian migrant workers constituted the largest group of migrant workers in Malaysia, accounting for more than 60 percent of the total migrant labor force** (Figure 3)**.**[12] Malaysia is an attractive destination for Indonesian migrants because of the geographical proximity and cultural familiarity between the two countries makes Malaysia a relatively convenient destination for migrant workers. Figure 4 shows the male and female breakdown of the migrants to both Malaysia and Saudi Arabia through the formal sector. Flows to both countries are now majority female migrants with a higher percentage of migrants to Saudi Arabia being women (90 percent) compared to Malaysia (60 percent). Organized migration between Indonesia and Malaysia has been strengthened by Memorandums of Understanding signed in 2004 and 2006.

[12] Ministry of Home Affairs. Malaysia

**Figure 3. Foreign Workers in Malaysia by Nationality, December 2006**




*Source:* Ministry of Home Affairs, Malaysia

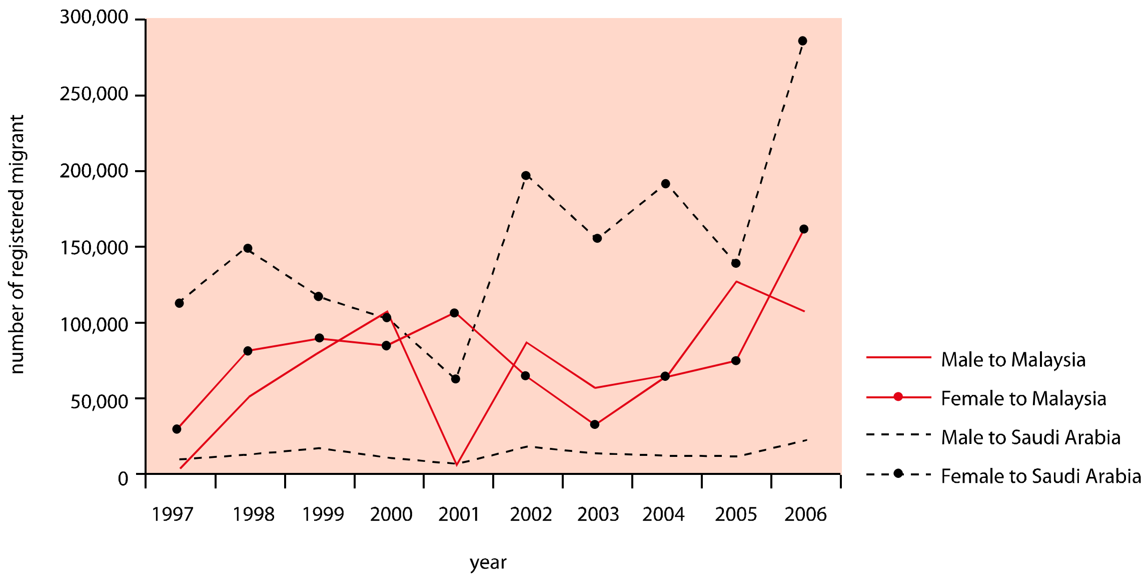
**Best estimates are that there are 1.2 million undocumented workers in Malaysia, of which 60 percent are Indonesian.**[13] Undocumented migrants tend to work on plantations, in construction, agricultural farms, fish ponds, and service industry. Undocumented workers essentially have no legal protection and in some cases, employers take advantage of their immigration status when hiring them.

## COSTS OF MIGRATION, WAGES, AND REMITTANCES

There are significant costs associated with migration such as administration fees, placement fees, pre-departure accommodation and living costs, and transportation. Migrant workers have to take out loans to cover these costs; though with limited access to the formal financial sector, they are often forced to turn to informal loan providers, including the migration recruitment agents themselves who will deduct the money from their salaries. The average wage of migrant workers in Malaysia is between US$90 and US$200 per month, and there is little difference between the salaries paid to male and female migrant workers. Estimates from surveys carried out by Bank Indonesia (BI) indicate that about 45 percent of migrant worker salaries are remitted back to Indonesia.

[13] "Southeast Asia," *Migration News*, Vol 14, No. 3, July. www.migration.ucdavis.edu.

**Figure 4. Flows of Indonesian Migrant Workers to Malaysia and Saudi Arabia (1997-2006)**




*Source:* Ministry of Home Affairs, Malaysia

## ESTIMATES OF REMITTANCE FLOWS IN THE MALAYSIA-INDONESIA CORRIDOR

According to Bank Indonesia, total remittances coming into Indonesia from Malaysia were around US$2.7 billion in 2006, calculated using their new methodology. Bank Indonesia also estimates that approximately 9-10 percent of remittances to Indonesia from Malaysia flow through formal systems. Specifically, it estimates that approximately US$0.26 billion was transferred into Indonesia from Malaysia through formal systems in 2006 (based on reports through banks and remittance service providers). Table 1 presents both official remittance figures of the Malaysia–Indonesia corridor and updated BI estimates of Malaysian inflows using newer methodology. For the purposes of this report, the study team recognizes that Bank Indonesia's total remittance estimates of nearly US$2.7 billion in 2006 in the Malaysia–Indonesia corridor as probably being the closest estimate of the amount of remittances being transferred to Indonesia from Malaysia.

**Remittances from Malaysia to Indonesia through formal channels decreased by over 30 percent from a high of nearly US$387 million in 2002, to US$262 million in 2006** (Figure 5). This is despite the significant increase in the number of migrants going to Malaysia. The implication is that migrant workers increasingly choose alternative means of transferring remittances back. Reasons for this are discussed in the following paragraphs.

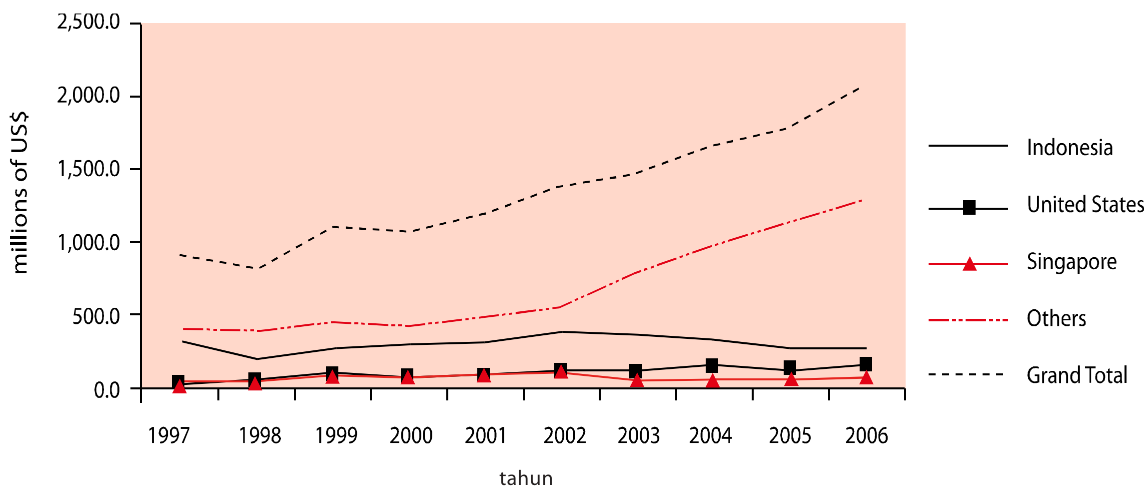
**Table 1. Estimates of Remittances in the Malaysia-Indonesia Corridor in 2006**

| | Reporting from banks and remittance service providers (formal) | Estimates based on sampling or migrant stock | Percentage transferred through formal channels |
|---|---|---|---|
| **Malaysia** Remittances sent to Indonesia | **US$0.26 billion**[a] *Source:* Bank Negara Malaysia | **maximum of US$3.6 billion**[b] *Source:* World Bank rough estimate based on migrant stock and Department of Statistics, Malaysia sampling survey | **Approx 10%** *Source:* Bank Indonesia |
| **Indonesia** Remittances received from Malaysia | **US$ 0.24 billion** *Source:* Bank Indonesia bank and remittance service provider reporting | **US$2.66 billion** *Source:* Bank Indonesia figure, estimate based on migrant stock | |

[a] The US$0.26 billion figure quoted by BNM in 2006 denotes the total financial flows from Malaysia to Indonesia including the employee remuneration and worker remittance categories.

[b] Based on 2005 Malaysian Ministry of Home Affairs data which states that 63 percent of total foreign workers in Malaysia are Indonesian. It is estimated that approximately the same proportion of total balance of payment remittances paid would be going to Indonesia or US$3.59 billion. However, given that there are significant transfers to industrialized countries (United States, United Kingdom, Singapore) likely to be of much greater amounts, this figure is likely to be an overestimate.

**Figure 5. Remittance Outflows from Malaysia (1997-2006)**




*Source:* Bank Negara Malaysia, based on bank and remittance service provider reporting.

## FORMAL TRANSACTION FLOWS

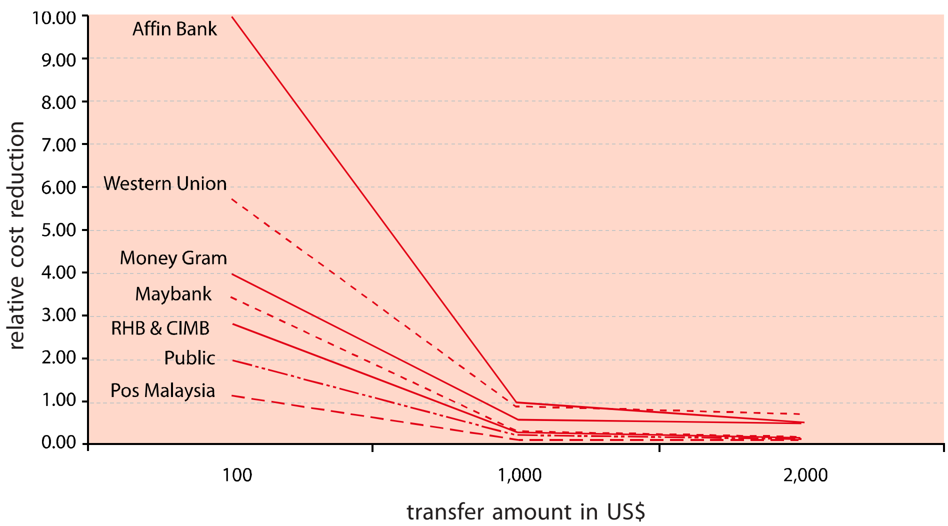
Ninety percent of formal remittance transfers go through banking institutions[14] while the rest channel through non-bank institutions.[15] According to some banks, the average transaction can

[14] 22 Commercial Banks, 11 Islamic Banks, 1 DFI (National Savings Bank), 6 Non-Bank Remittance Operators, 1 Pos Malaysia.

[15] Interviews with BNM officials, April 2007.

range from US$87 to US$146, and remittances are sent at least twice a year. Recent studies by Bank Indonesia have found that Indonesian migrant workers generally remit 40-50 percent of their income, implying much larger flows through informal channels.[16] Fees for remitting funds from Malaysia vary; however, most formal providers have a regressive charge structure whereby the cost of transferring US$100 dollars decreases with the total amount spent (Figure 6).

**Figure 6. Costs per US$100 of Remitting Different Sums of Money, April 2007**




*Source:* Authors' interviews with remittance service providers.

**Requirements for identification could also be a deterrent, especially for undocumented migrant workers.** Since September 11, 2001, the regulatory environment in which the banking sector operates has been tightened to prevent money laundering or financing of terrorisms. New regulations have, among other things, tightened the need for credible identification. For remittance service providers, a national passport is the main identification document for non-nationals to process remittance transfers.[17] For the opening of savings accounts, these institutions require, in addition to national passports, the work permits; and in some cases branch managers are required to approve the opening.

## INFORMAL TRANSACTION FLOWS

The use of informal channels is predominant in the corridor. Informal channels encompass money changers, courier services, hand delivery, and employment agencies. Use of informal channels is inadvertently fostered by the agency system. The broker who introduces the worker to an employment agency may also finance the initial costs of migration. The worker then must send a

[16] Interviews with Bank Indonesia

[17] Including Pos Malaysia.

portion of his/her earnings to the broker to settle the debt. For an additional fee, the broker can also deliver money to the workers' families. They continue to use this "system" even after the debt is cleared. Returning migrants may also carry cash on behalf of others. These remittance couriers, who may or may not be close friends or family members of migrant worker, bear substantial risks of seizures at custom checkpoints and losses due to robbery (Box 1).

**In the case of some informal transfers, funds channel through the hands of middlemen or immigration promoters.** Money changers give the cash to someone who will hand-carry the money back to Indonesia or may use their own bank accounts to transfer funds.[18] A middleman or immigration promoter lends the money to the worker, who will repay the loan through his or her earnings. The middleman will generally travel from Indonesia to Malaysia to collect the sums and may also carry money to be delivered to the worker's family.[19]

**Foreign exchange bureaus appear to play a significant role in this corridor**. Many money changers are formal businesses since they are regulated in their function as foreign exchange agents. However, when money changers serve as remittance channels, the flows are not regulated or measured. Steps are already being taken under the revisions to the Exchange Act to establish criteria that money changers would need to meet to be able to send back remittances.

**Box 1. Risks of Informal Transfers**

"Initially I saved my earnings. When I knew that a friend was going home, I gave her my money to give to my parents. I had met her at my agent's place. I didn't know her that well, but I trusted her. She was a Mutaware woman from Beber Village, not far from Barabali. My parents received the money a month late. I rang my family in the village and told them that I had given her RM 1,450 and they told me that she had only given them Rp 1,000,000 which she had paid in three installments. They should have received the equivalent of RM 1,450 which is about Rp 2,250,000."

Susi, 28 years old, Barabali Village, Central Lombok

## DECIDING BETWEEN FORMAL AND INFORMAL TRANSFER OPTIONS

In theory, a migrant worker has several different kinds of remittance service providers from which to choose. There are regulated and unregulated providers in the Malaysia–Indonesia corridor: banks, money changers, the post office, money transfer operators, account mediators, or middlemen. Because of the geographical proximity of the two countries, sending money home with family members or relatives may also be a convenient option. Figure 7 below describes the overall remittance market between Malaysia and Indonesia. It details the major formal and informal remittance service providers in Malaysia, their lowest transfer fees, and their associated partners on the Indonesian side.

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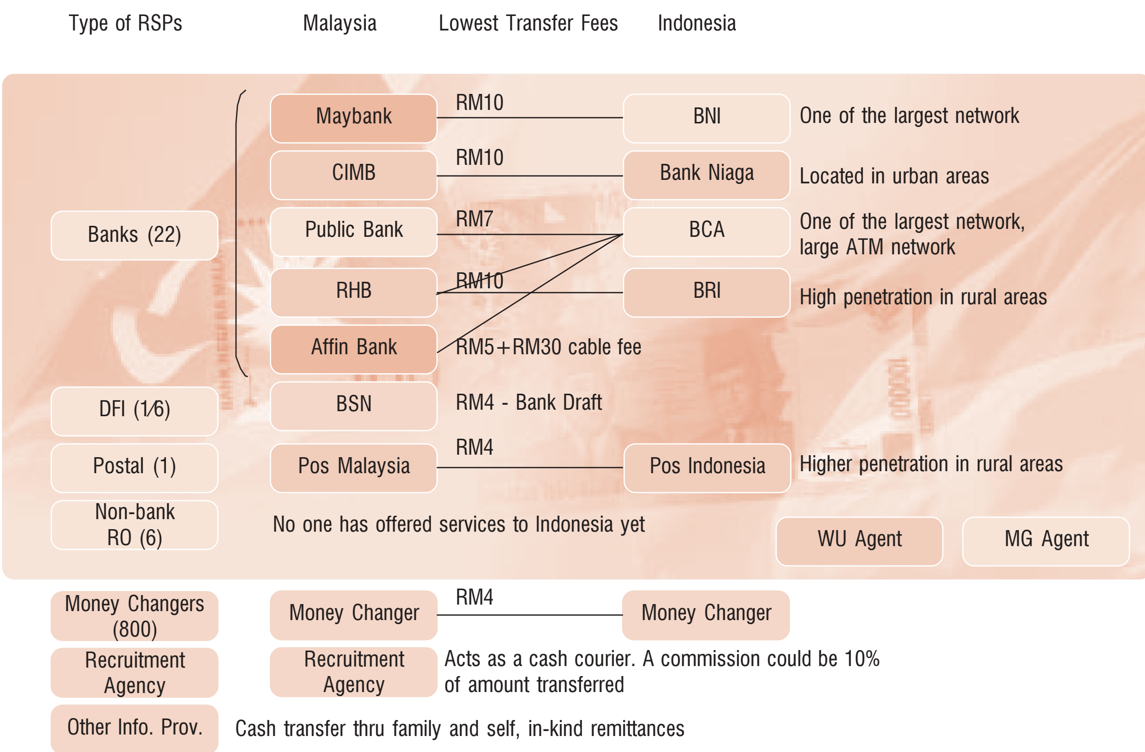
[18] Although this is a formal bank channel, it is considered informal remittance transfer because the recipient is not known or recorded. It is unclear how remittances sent through money changers are distributed once they arrive in Indonesia.

[19] Based upon interviews with middlemen and TKI by World Bank staff

**Figure 7. The Remittance Market between the Two Countries**




*Source:* World Bank interviews.

Several factors influence the choices made by the migrant workers including:

- ***Physical access.*** The ease with which the migrant worker can physically access the point of entry in Malaysia. This could be restricted by distance and the ability of the migrant worker to leave the workplace during opening hours.
- ***Institutional access.*** the ease with which the migrant worker can deal with the administration required, and also the user-friendliness or the approachability of the point of entry.
- ***Regulatory access.*** The degree to which regulations and requirements might restrict access.
- ***Cost.*** There is a wide variance in the costs associated with transferring funds.
- ***Competition.*** The extent to which other sources provide easier and cheaper access.
- ***Financial literacy.*** Many recipients do not know whether administrative fees are deducted from the amounts they receive through banks. Foreign exchange rates also play a key role in optimizing the amount of money received by *Tenaga Kerja Indonesia* (TKI or Indonesian migrant workers) beneficiaries. From the report team discussions with returned migrants, it seemed that their experiences abroad had given them a general understanding of

financial mechanics learned through either their own or others' (unfortunate) experiences. However, increasing financial literacy before migration may prevent some of these unfortunate experiences from occurring.

The major incentives of using different formal and informal transfer mechanisms for TKI are compared in Table 2.

**Table 2. Comparing Incentives Facing Undocumented Migrant Workers**

| Incentives | Bank | Postal (money order) | Money transfer operator | Money changer | Informal channel |
|---|---|---|---|---|---|
| **Access without ID** | no | no | no | yes | yes |
| **Geographic coverage in Malaysia** | limited | good | limited | unknown | good |
| **Relative price of fees** | variable | inexpensive | expensive | inexpensive | unknown |
| **Speed** | moderate-slow | slow | fast | fast | variable |
| **Language barrier** | variable | variable | variable | variable | none |
| **Minimal paperwork** | no | no | no | yes | yes |

*Source:* World Bank based upon interviews with TKI and remittance service providers

## REMITTANCE DISTRIBUTION IN INDONESIA THROUGH FORMAL TRANSFER MECHANISMS

The Indonesian financial sector is large and diverse, spanning three tiers of banking service providers. The state-owned bank, *Bank Rakyat Indonesia*, is the primary provider of banking services to lower-income households and is making profits. Operating through 4,600 village units, the bank has 30 million account holders, making it the largest bank (by number of accounts) in Indonesia. In addition, the *Bank Perkreditan Rakyat* has an estimated 6 million account holders. The customers of *Bank Rakyat Indonesia* and *Bank Perkreditan Rakyat* are estimated to make up as much as two-thirds of all bank customers. However, banking penetration remains low with 20-30 percent of adults estimated to have a savings account.[20]

**The distribution of remittances received in Indonesia through formal regulated channels is concentrated in the banking sector.** The cost of opening and maintaining an account is comparatively high, and fees charged by banks in Indonesia are higher than those charged by Malaysian banks. Pos Indonesia (postal service) coverage is limited with only 50 branch offices capable of disbursing remittances quickly. Also, even in the formal system customers are not necessarily protected from scams with fake commissions and "facilitators" adding to the costs.

[20] Genesis Analytics, Implementing FATF Standards in Developing Countries and Financial inclusion: Findings and guidelines (Forthcoming).

## REMITTANCE DISTRIBUTION IN INDONESIA THROUGH INFORMAL TRANSFER MECHANISMS

Convenience and accessibility issues with banks nurture the role of account mediators and facilitators, increasing the cost of collecting remittances. The mediator will retrieve the cash from his own account into which it was deposited from Malaysia, and bring it (courier service) to the recipient. Facilitators are trusted with different activities, some of them are only "messengers" informing the recipients that they have received a remittance; others queue in banks' lines on behalf of the recipient or exchange hard currency outside bank premises at a better conversion rate. The "account mediator" is the one that plays the most critical role in the distribution of remittances.

**In December 2006, Bank Indonesia issued a new regulation allowing remittances agents to conduct remittance transfers.**[21] The new regulation opened up the market for new remittance service providers different from banks, recognizing the role of informal operators on transferring funds. The regulation aims to prevent remittance channels from being abused by money launderers. It also aims to optimize the consumer protection on money remittance activity. Well-managed operators through appropriate legislation would provide legal protection, guarantees, and security for both remitters and beneficiaries. Other benefits of regulating remittance service providers include enhanced recording of remittance flows for balance of payment purposes, allowing the Government to maximize the monetary potential from remittance flows, and increasing investment in the remittance recipient areas for small and medium enterprises.[22] The information gathered on remittance transfers can be utilized to promote payment services and to improve the economy in general.

**Bank Indonesia has adopted a gradual transition from registration to licensing for the remittances agents.**[23] The transition period provides an opportunity to those entities that are currently operating informally to register by December 31, 2008.[24] During 2008, Bank Indonesia expects to issue a circular detailing the licensing process for both newly applying agents as well as for already registered agents, based on experience with the current registration process. After January 1, 2009, all new agents are required to apply for a license. The shift from registration to licensing obligation will take place after Bank Indonesia has gained a picture of the readiness of remittances agents.

**Under the new regulations, individuals as well as corporate entities will legally be able to act as remittance agents** Written agreements including rights and responsibilities of both parties will be needed for collaborations between agents and money transfer operators. These agreements

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[21] Bank Indonesia Regulation No. 8/28/PBI/2006 regarding money transfer activities

[22] Bank Indonesia Regulation No. 8/28/PBI/2006. Elucidation.

[23] This regulation applies only to remittances agents, and not to money transfer operators such as Western Union and MoneyGram.

[24] Bank Indonesia Regulation No. 8/28/PBI/2006. Article 30.

will be submitted to Bank Indonesia. Requirements for registration and licensing are quite similar. After completing registration or obtaining a license, agents are obliged to, among others, record money transfer transactions, submit periodical and incidental reports to Bank Indonesia, provide information to remitters regarding money transfers, and report suspicious transactions to Indonesia's Financial Intelligence Unit (*PPATK*).

## CONCLUSIONS

Indonesian migrants in Malaysia are increasingly showing a clear preference for informal transfer mechanisms compared to their counterparts in other countries. Despite the increasing flow of migrants, the amount of remittances transferred through the formal sector in the Malaysian–Indonesian corridor is decreasing. Only about 10 percent of the estimated flow of remittances into Indonesia from Malaysia is transferred through the formal system. The extent of the preference for informal sector is unique, as Indonesian migrants in other countries are using the formal sector far more than the migrants in Malaysia.

**As the corridor is characterized by a large presence of undocumented migrants, and increasing percentage of women, the implication is that these two groups of migrants in particular find formal sector transfers either hard to access or inappropriate for their needs**. Possible reasons for this include lack of physical access, identification and other formal requirements that cannot be met, high costs compared to alternatives, and the expansion of more easily accessible informal options. An unregulated industry has arisen to facilitate remittances in this corridor. This industry includes account mediators, migration agents or agencies, and informal channels that are part of formal enterprises (money changers) and is a significant feature of the Malaysia–Indonesia corridor.

### *Formal or informal: The migrants perspective*

From the migrant workers perspective, informal transfers may be more convenient, more easily accessible, or cheaper. For some, especially women, lack of access to pre-departure credit to pay the upfront costs of migration through the formal sector leads them into arrangements with recruitment agents or others. In these situations, the workers are obligated to send money back through the recruitment agent or others to pay off debts even if the arrangements may not be to their best advantage. Undocumented migrants in particular have few alternatives other than the informal sector because of their legal status. However, some of the informal options such as sending money back with couriers may be insecure and unreliable.

**Despite the disadvantages of the informal sector, the formal sector has little to offer the migrant workers in its current state**. It is less competitive in terms of accessibility and provides little added value in terms of access to the much needed pre-departure credit or other instruments that might appeal to the migrant workers, especially women and the undocumented. While some migrant workers do not have access to the formal sector in the first place, the declining formal remittance flow implies that others are simply choosing more preferable alternatives. The formal sector would need to undergo some radical changes in the way they approach migrant workers as valued customers to draw them back to the sector. That said, with a renewed approach that puts the migrant worker needs at the center, the formal sector has the potential to offer considerable advantages and could put the migrant worker back into a decision-making position with regard to how their money is saved or used.

***Formal or informal: The development perspective***

From the development perspective, the issue is how remittances are translated into social welfare improvements and sustainable poverty reduction impact. The substantial amount of remittances to Indonesia and significance of remittances to the economy—especially in migrant sending areas—justifies greater attention to this as a development issue. For reasons discussed, it would appear that there are significant improvements that could be made in this respect. Once again, the formal sector is not offering any added value over the informal sector as there are few savings or investment instruments tailored to the needs of migrant workers, and no efforts to market or educate migrant workers in how improvements could be made, thus not making the contribution it could to overall development impact.

**In this case, it is not whether the formal or the informal sector is chosen that is important, but whether the transfer mechanism of choice offers the instruments that help the migrant workers to invest effectively for sustainable benefits.** If there are informal sector mechanisms that offer ways to reach migrant workers and their families more effectively and with appropriate instruments then these too are valid and need to be recognized.

***Formal or informal: The financial sector perspective***

From the financial sector perspective, the changed global scenario after September 11, 2001, has prompted the need to more effectively monitor money transfers without constraining financial sector development. However, updating a country's regulatory framework, including its Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) policies, could incur additional costs on formal remittance service providers or reduce their accessibility thereby reducing their competitiveness in the eyes of migrant workers. Since the decrease in remittances coincides with the introduction of AML/CFT regulations, this may be a factor in the Malaysia–Indonesia remittance corridor.

**Hence, the formal sector approach needs to balance a well targeted regulatory framework in the financial sector that ensures remittances are not used for illicit purposes, with better instruments and services that attract migrant workers to use formal and regulated transfer channels.** The formal financial sector should view the informal sector as an enormous potential market for formal financial products and services, which, if harnessed effectively, might lead to sustained revenue growth and improved market share for financial institutions.

## OPERATIONAL POLICY RECOMMENDATIONS

The transfer providers, whether formal or informal, therefore need to respond to the needs of the migrant worker, as well as the development and financial sector perspectives. The following recommendations on how this might be achieved are arranged into three areas:

1. Making the formal sector accessible and responsive to migrant workers
2. Facilitating migrant workers access into the formal sector
3. Formalizing and regulating the informal providers while maintaining their accessibility for migrant workers

### 1. Making the formal sector accessible and responsive to migrant workers

***(a) Increasing effectiveness of identification procedures.*** Both Indonesia and Malaysia need to increase the security and reliability of identification, and ensure migrant workers have access to a valid and acceptable form of identification so that it does not constrain migrants' access to the formal sector. This could be done by:

- Strengthening the reliability and credibility of national passports by ensuring that the same number is not issued, and assessing the possibility of using biometric information (fingerprints, etc) so that it is harder to fake passports identities.
- Ensuring that migrant workers have unrestricted access to their passports by amending the Memorandum of Understanding clause that gives the employer the right to keep the passport of the migrant worker.
- Continuing to pursue alternative forms of valid identification such as the Foreign Worker Card being introduced in Malaysia, and expand access for undocumented migrants. For example, in the US, Mexican Consulates in some places are issuing Consular Identification Cards, regardless of migratory status in the United States, and this card is accepted by some of the banks.
- Relax identification requirements for individual transfer of small amounts. This has been done in the South Korea–Mongolia remittance corridor where foreign exchange regulations were relaxed and no proof of legal status was required for transfers of US1,000 each or US$20,000 per year.

***(b) Customizing products and instruments for Indonesian migrant workers.*** There is a huge potential for developing services and instruments that are tailored to the needs of migrant workers. As the flows of migrants and remittances increase, the market potential and business case for doing so is increasing also. In particular :

- Introduce innovative and flexible options for transferring remittances as has been done in the Philippines where the Bank of Philippine Islands offers four types of fund transfer systems to migrants: direct credit to account, branch pick up, door-to-door cash/draft, and credit to another bank's account.
- Provide pre-departure credit that is more readily accessible to informal migrants and at competitive rates, making it more attractive to migrants at an early stage.
- Develop savings instruments either in the receiving country, or through transfers directly to their home country, an instrument could be developed for home purchasing or education funds. This would also give back more control to migrant workers, especially female workers, over how their earned and transferred money is spent.

***(c) Ensuring better assessment techniques of data and regulatory changes.*** Improved information and data gathering and handling would help create better informed policy formulation for facilitating migrants' access to the formal sector. Improvements are needed in the following areas:

- Improve data quality, gathering and reporting of remittance flows in order to help resolve current discrepancies in measuring remittance flows between Malaysian and Indonesian central banks, and provide more accurate figures for the balance of payment data in both countries.
- Monitor and disseminate remittance transfer costs in the remittance corridor to bring greater transparency to cost structures and improve ability of migrant workers to make the best choices for them. In the US–Mexico remittance corridor, a Mexican Government agency known as PROFECO has been working through Mexican consulates in the United States and through its website to distribute information on remittance costs.
- Improve assessment procedures to comprehensively assess market responses to recent regulations enacted in Indonesia that adopted a registration system for new remittance service providers in terms of magnitude of remittance flows and contribution to development feeding into future policy formulation.

**(d)** ***Enabling strategic partnerships between formal-and-formal and formal-and-informal remittance service providers.*** Some strategic partnerships between formal operators are already being developed in the corridor. Creative partnerships need to be encouraged to reduce remittance transfer times and costs, and improve transparency through more standardized and advanced tracking and monitoring mechanisms. The *HimalRemit* mechanism between Qatar and Nepal in which the Himalayan Bank developed its own Internet-based system for remittance transactions enabling the Bank in Nepal to disburse payments to the beneficiary on receipt of the instruction over the Internet without waiting for the account to be credited financially by the sending institution.

***(e) Expanding the state's role in encouraging formal transfers.*** Research on the use of remittances[25] showed that most migrants are expected to make significant contributions to local governments or religious institutions on their return. This process could be made more transparent, and the development impact of these contributions increased by considering the experience of the "3x1" program in Mexico. In this program, remittances from overseas sent back through formal systems into funds for small-scale development projects are matched with three dollars for every one sent back, from federal, state, and subnational government.

**2. Facilitating migrant workers access to the formal sector**

***(a) Expanding financial education.*** The current pre-departure financial literacy program is carried out by the recruiting agents who have little incentive (and perhaps a disincentive if they are providing the transfer services themselves) to do this well. In some countries the Indonesian consulate is now providing additional training on arrival to migrants, though this may already be too late if the migrant worker is tied to a credit arrangement. Improvements could be made by:

- Collaborating with financial institutions in providing the training and opening competition by inviting different institutions to come and talk about the instruments they offer to migrant workers. In the Midwest of the United States, 55 members of a New Alliance Task Force including banks, community-based organizations, secondary market companies, and private mortgage insurance companies, developed an action plan to educate young immigrants on their financial options and improve access to the US banking system among recent immigrants.
- Providing more information on financial services and options through the Indonesian Embassy in Malaysia, or through the Ministry of Foreign Affairs in Malaysia, for example, when migrant workers are issued their Foreign Worker Card (i.e., work permit).
- Encourage formal sector employers of migrant workers to provide financial literacy training.
- Partner in financial literary training with nongovernmental organizations, cooperatives, or other providers at the local migrant-sending areas to reach prospective migrants, and also the families of migrant workers, and involve village leaders in helping to improve financial literacy in the villages.

***(b) Improving physical and institutional accessibility.*** Physical access either to the place where remittances can be deposited and transferred, or to the place where remittances can be received and withdrawn by the recipient are major considerations in deciding on appropriate options. Improving physical or institutional accessibility needs to:

[25] Use of Remittances Study, (currently draft under preparation by the World Bank)

- Build on the steps already being taken to introduce mobile phone banking and encourage financial institutions to partner with telecommunications companies to develop mobile financial services.
- Develop creative partnerships with informal sector providers that might be able to reach more effectively the migrant workers.
- Improve user-friendliness of the financial institutions for the migrant workers, many of whom, especially the women, may be intimidated by the formality, even more so if they are not treated as a respected and valued customer. This may be done by educating bank staff about the valuable contribution that migrants make to the economy. Training bank staff to provide friendly and helpful service to migrants would help make the institutions less intimidating. Western Union has led the way in many countries in this respect.

**3. Formalizing and regulating the informal providers while maintaining their accessibility for migrant workers**

***(a) Reducing costs by increasing competition.*** Allowing more providers to transfer remittances has been slow to have an impact on the costs of transfers. For example, in much of the Caribbean and Latin America, an initial increase in the number of remittance service providers led to a relative reduction in average remittance costs. As the costs reduced, competition increased and the number of providers declined again. However, it appears that only the more efficient providers stay in the business at the lower costs and hence the costs stay at the lower levels. The decline in average cost of sending remittances was strongly correlated with the increase of remittance flows in the US–Mexico corridor. The causal relationship might run either way, i.e., increased remittance flow allows for lower cost of individual transfer, or decreased costs encourages more remittances to be sent home.

***(b) Licensing and regulating informal providers.*** Both Malaysia and Indonesia are taking significant steps to regulate informal individual and corporate informal providers so that remittances can be better monitored and tracked, while migrants retain their access to these more flexible services.

- Ensure that licensing requirements for money transfer operators are lower than that of banks, given the size and the risk of the industry. If the requirements for the license is high (i.e., high capital requirements), money exchangers may continue to provide remittance services informally.
- Include account mediators as part of the formal channel for distribution as these informal operators often have better access to rural communities. These account mediators could be considered "remittance agents", a new figure under a specially tailored level of regulation.
- Provide training to the account mediators to enhance their financial capacity and governance.

# Concluding Remarks

In the end, it is the Indonesian migrant workers who make the choice of how to transfer and use the remittances they send home, and their choice at the moment is clearly with the informal sector. An underlying assumption in this report is that more formalized systems could improve development and poverty reduction impact by providing greater security and reliability, reducing costs, and improving options for investing in better outcomes. However, major changes in approach are needed in the formal sector if they are to attract the migrant workers. Meanwhile, the important role of the informal sector in providing easily accessible solutions is recognized. And increased regulation of this sector, while an important element, needs to be done carefully in such a way that it does not drive migrants to greater informality of transfers. Regulations need to focus on enabling markets to function and encourage solutions, and migrant workers need to be recognized for their important contribution to the economy and empowered to engage with these markets.

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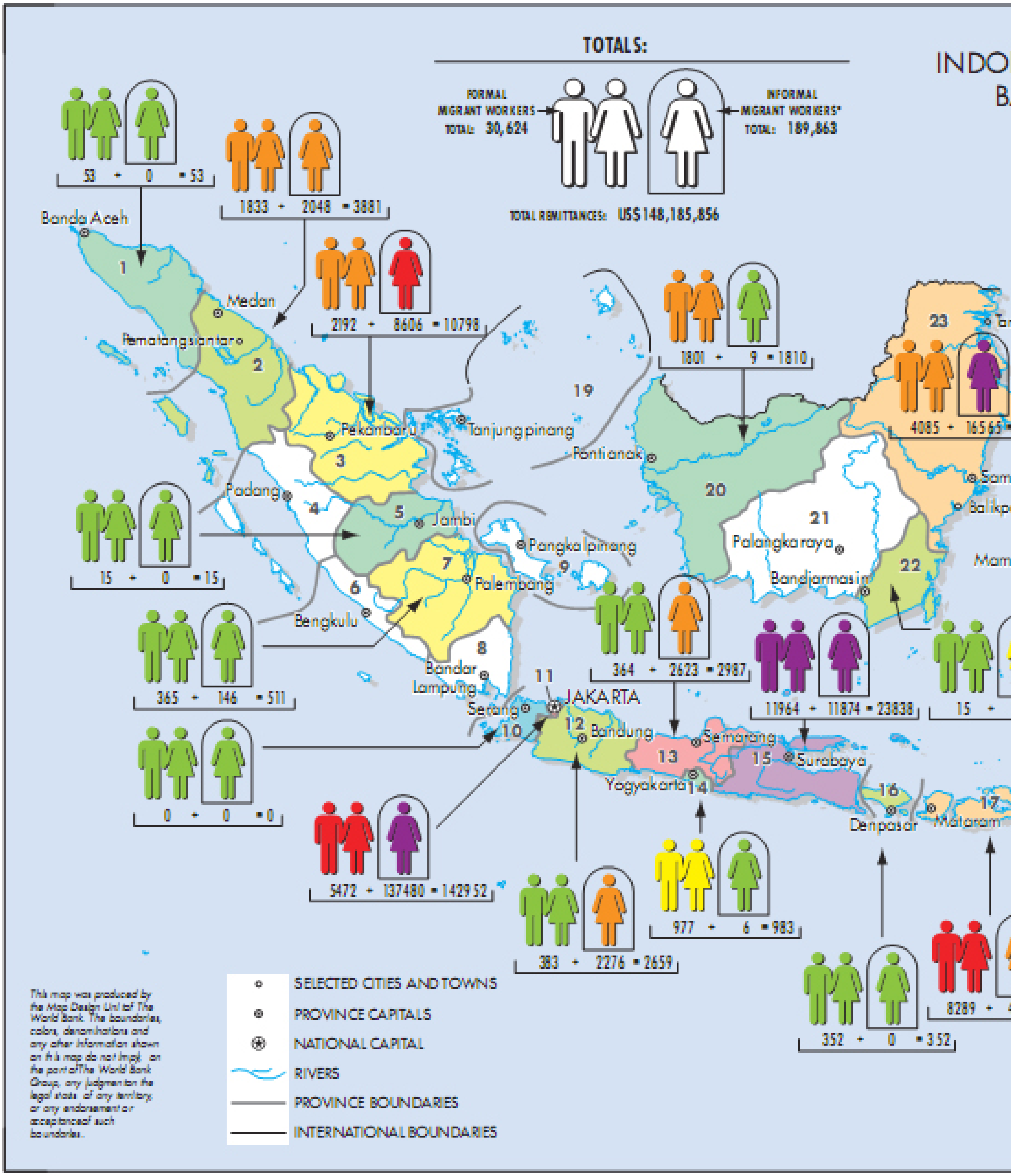
TOTALS:
FORMAL MIGRANT WORKERS TOTAL: 30,624
INFORMAL MIGRANT WORKERS* TOTAL: 189,863
TOTAL REMITTANCES: US$148,185,856
53 + 0 = 53
1833 + 2048 = 3881
2192 + 8606 = 10798
1801 + 9 = 1810
15 + 0 = 15
365 + 146 = 511
0 + 0 = 0
5472 + 137480 = 142952
364 + 2623 = 2987
11964 + 11874 = 23838
383 + 2276 = 2659
977 + 6 = 983
352 + 0 = 352
Banda Aceh
Medan
Pematangsiantar
Pekanbaru
Tanjungpinang
Pontianak
Padang
Jambi
Pangkalpinang
Palangkaraya
Bandjarmasin
Palembang
Bengkulu
Bandar Lampung
JAKARTA
Serang
Bandung
Semarang
Surabaya
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SELECTED CITIES AND TOWNS
PROVINCE CAPITALS
NATIONAL CAPITAL
RIVERS
PROVINCE BOUNDARIES
INTERNATIONAL BOUNDARIES
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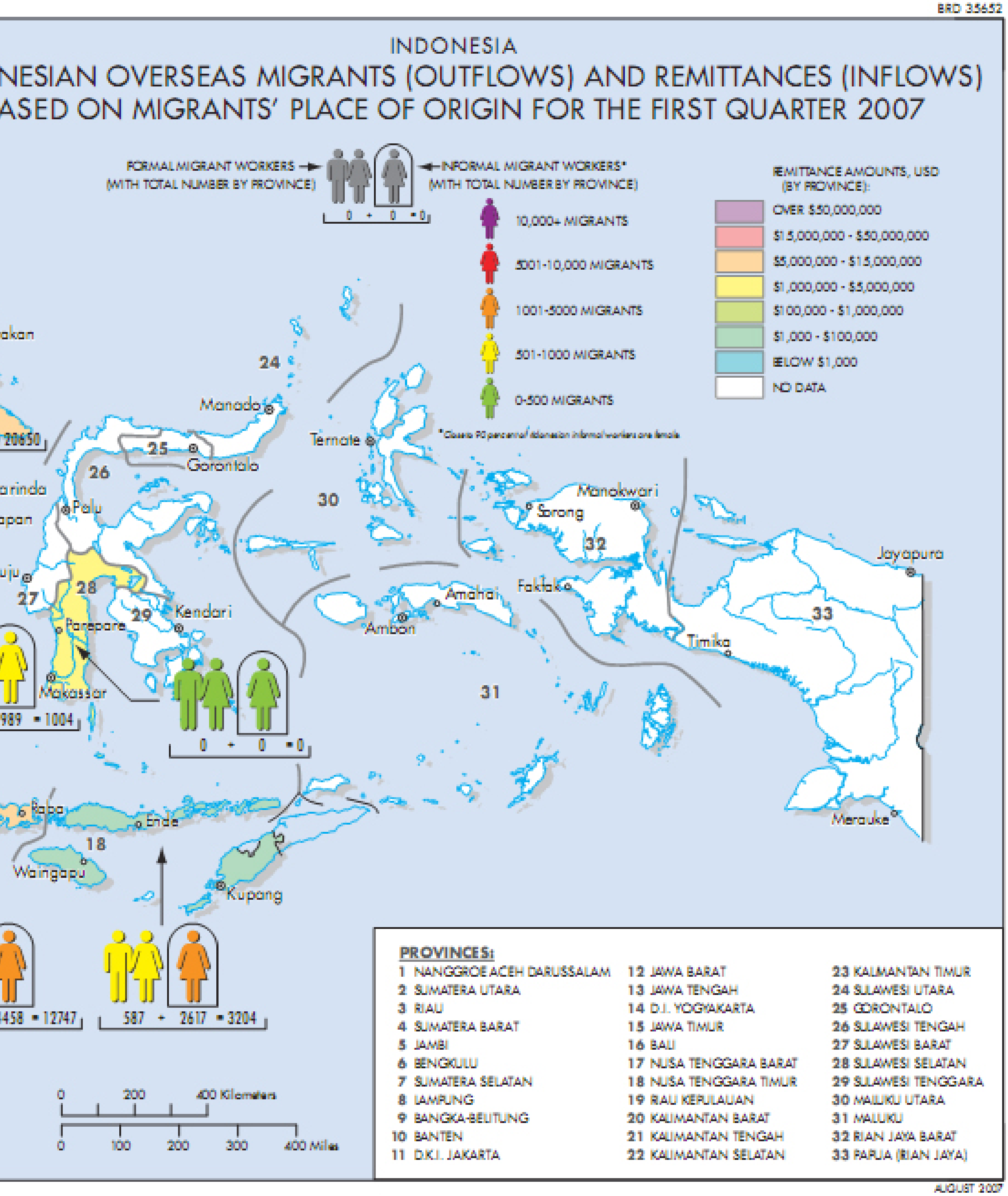
IBRD 35652
INDONESIA
NESIAN OVERSEAS MIGRANTS (OUTFLOWS) AND REMITTANCES (INFLOWS)
ASED ON MIGRANTS' PLACE OF ORIGIN FOR THE FIRST QUARTER 2007
FORMAL MIGRANT WORKERS (WITH TOTAL NUMBER BY PROVINCE)
INFORMAL MIGRANT WORKERS* (WITH TOTAL NUMBER BY PROVINCE)
0 + 0 = 0
10,000+ MIGRANTS
5001-10,000 MIGRANTS
1001-5000 MIGRANTS
501-1000 MIGRANTS
0-500 MIGRANTS
REMITTANCE AMOUNTS, USD (BY PROVINCE):
OVER $50,000,000
$15,000,000 - $50,000,000
$5,000,000 - $15,000,000
$1,000,000 - $5,000,000
$100,000 - $1,000,000
$1,000 - $100,000
BELOW $1,000
NO DATA
Manado
Ternate
Gorontalo
Palu
Kendari
Parepare
Makassar
Manokwari
Sorong
Jayapura
Fakfak
Amahai
Ambon
Timika
Merauke
Raba
Ende
Waingapu
Kupang
20650
989 = 1004
0 + 0 = 0
458 = 12747
587 + 2617 = 3204
18
24
25
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27
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33
0 200 400 Kilometers
0 100 200 300 400 Miles
PROVINCES:
1 NANGGROE ACEH DARUSSALAM
2 SUMATERA UTARA
3 RIAU
4 SUMATERA BARAT
5 JAMBI
6 BENGKULU
7 SUMATERA SELATAN
8 LAMPUNG
9 BANGKA-BELITUNG
10 BANTEN
11 D.K.I. JAKARTA
12 JAWA BARAT
13 JAWA TENGAH
14 D.I. YOGYAKARTA
15 JAWA TIMUR
16 BALI
17 NUSA TENGGARA BARAT
18 NUSA TENGGARA TIMUR
19 RIAU KEPULAUAN
20 KALIMANTAN BARAT
21 KALIMANTAN TENGAH
22 KALIMANTAN SELATAN
23 KALIMANTAN TIMUR
24 SULAWESI UTARA
25 GORONTALO
26 SULAWESI TENGAH
27 SULAWESI BARAT
28 SULAWESI SELATAN
29 SULAWESI TENGGARA
30 MALUKU UTARA
31 MALUKU
32 IRIAN JAYA BARAT
33 PAPUA (IRIAN JAYA)
AUGUST 2007