

5. Harnessing Remittances for Access to Finance

Remittances to Pakistan are estimated at around \$16 billion and have experienced considerable growth in recent years. International flows (through both formal and informal channels) total \$9 billion, with domestic flows at approximately \$6.95 billion. These remittance flows play a valuable role in supporting the economy by providing foreign exchange and improving the balance of payments and external debt position. They also offer significant potential to support incomes of poor and vulnerable groups. The lion's share of remittances is transferred by banks (80 percent), with a further 17 percent accounted for by Exchange Companies (ECs) and a small share by the Pakistan Post Office. Banks operate a fully automated system that runs seven days a week, has excellent urban and some good rural coverage, and usually can deliver within 24 hours. The majority of remittances are received in less than one week, although service tends to be slower in rural areas. Pakistan Post has a large rural network and is the most common channel for domestic remittances, but services remain relatively inefficient. Home consumption constitutes the largest use of remittances.

SBP has taken various measures that have significantly increased remittances through formal channels, though a large share of domestic remittances continues to be transferred informally. SBP has been encouraging the private sector to provide mobile banking solutions. The mobile coverage (about 90 percent of the population of Pakistan), and the success of mobile money transfer solutions in other countries, suggests that mobile phone banking offers significant potential to scale up access to financial services in Pakistan. There is already a lot of activity in this sector and both banks and mobile phone companies are working to structure viable models.

5.1. Overview of the Remittance Markets⁶⁷

Recorded remittances have increased fivefold since 2001. This impressive growth has been driven to some extent by the increasing efforts of SBP to bring remittance flows into the formal net. Ten years ago, about 15 percent of international remittance flows came through formal channels, compared with over 70 percent currently. This achievement is impressive. Yet a considerable share of remittances remains in the informal markets. There are no official data of the overall size of the market. Various estimates of international informal remittances put *hawala* flows at around the \$2.5 billion mark, in an overall international flow of \$9 billion. In addition, household consumption survey results indicate evidence that the domestic remittance market is, if anything, of comparable size to the international one, but might involve many more transactions of smaller value. Unofficial estimates put the overall remittance market at over \$16 billion. To gain a comparative perspective of the size of remittances relative to the economy, consider foreign exchange reserves, which stood at \$5.7 billion as of September 2008, total credit to the private sector at \$34.8 billion, and stock market capitalization at \$44.7 billion.

Remittance flows are a potent lever for the Pakistan economy, and a significant source of foreign exchange, as well as a considerable help in improving Pakistan's external debt situation, building the foreign exchange reserves, strengthening the balance of payments, and preserving the value of the rupee. Moreover, remittances can potentially form a large part of income for poor and vulnerable groups (not yet the case in Pakistan), helping lift this population out of poverty. This chapter attempts to understand the structure, players, and clients of the remittance market, including domestically and within the informal sector, in order to help co-opt more of the flows into the formal net, make them accessible to the poor and underserved, and achieve the above-noted desirable goals.

In absolute terms, recorded international remittances surpassed \$6.45 billion during fiscal 2008, an average annual growth of 29 percent from 2001 (Figure 5.1). Worldwide, international formal remittance flows to

⁶⁷ The text does not take into account recent effects of the global financial crisis, instead analyzing the data as of 2007-08. Recent events have caused remittances to drop drastically.

developing countries were \$265 billion in 2007, and unrecorded flows were estimated at another \$80 to \$185 billion (World Bank 2008a). Compared with other countries in the region, Pakistan is at par with Indonesia and Bangladesh in absolute terms, while India is far ahead with over \$25 billion received in 2006, although the figures are comparable given the size of the economies (Figure 5.2). Remittances in other South Asian countries are even larger in relative terms. In Nepal, remittances exceed export receipts and tourism, while in Sri Lanka, remittances of \$2.7 billion are greater than tea exports. In Bangladesh, remittances are five times the level of foreign aid.⁶⁸

Figure 5.1 : International Formal Remittances

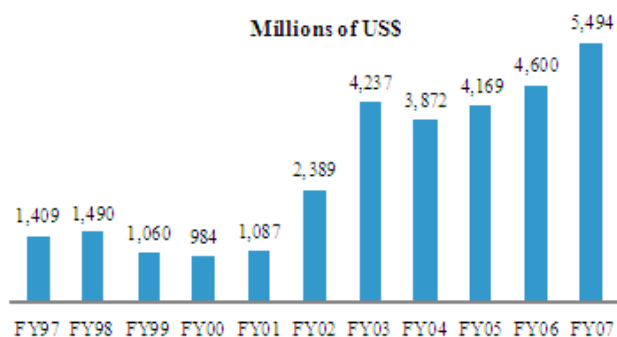
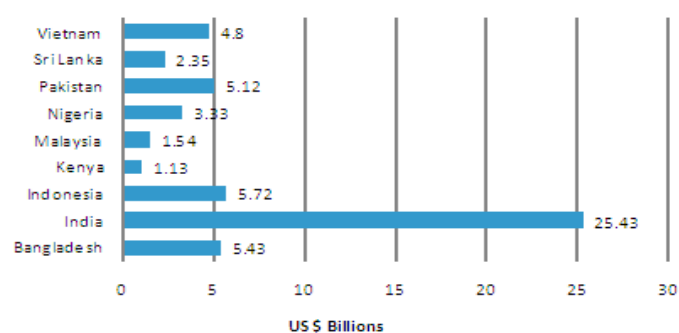


Figure 5.2 : Remittances : International Comparison



Sources: SBP 2007 <http://sbp.org.pk/ecodata/index2.asp>; World Bank Migration & Remittances Factbook 2008

5.2. Market Players

The main players in the formal remittance market are banks, ECs, and Pakistan Post, while informal channels consist of *hawala* or money carried by hand. Except for ECs, which by law cannot operate domestic money transfers, all players provide domestic and international remittance services.

Table 5.1: Snapshot of the Main Channels of International Formal Money Transfer

[Table content is obscured by a black box]

Source: SBP 2007

The banks account for 80 percent of international remittances coming through formal channels into Pakistan, given their long history in the sector (Table 5.1). The formation of exchange companies in 2002 has significantly increased flows as hundreds of small moneychangers have been brought into the regulated sector and now account for 17 percent of international formal remittances. Both banks and ECs have multiple

⁶⁸ Source: Dawn Economic and Business Review, March 31st, Karachi, Pakistan.

correspondents and relationships abroad. The breakdown of international formal remittances by sector (detailed time-series) is available in Annex Table A5.1. Pakistan Post accounts for almost 2.5 percent of the international remittances received, exclusively via an agreement with Western Union. Money transfer organizations (MTOs) (mainly Western Union), have an estimated share of about 15-20 percent in intermediating international transfers. Sections 5.2.1–5.2.4 discuss transfer service providers in the formal international sector.

Domestic remittances are dominated to a larger extent by informal flows, relative to international transfers. We estimate domestic remittance flows at \$6.95 billion, based on household survey estimates of the share of foreign and domestic remittances in monthly household income as per the latest Household Income Integrated Survey (2005–06). The main formal channels for domestic remittances are the Post Office and interbank transfers. Pakistan Post is the main player in transferring domestic remittances to rural areas, though the five big banks also have a presence in rural areas. Microfinance entities still play only a minor role in remittances. Section 5.2.5 overviews the limited data available on (mostly formal) domestic transfer services.

Discussions with various stakeholders suggest that the estimated size of the *hawala* market is \$2 to \$4 billion. The informal market is discussed in more detail in section 5.2.6.

5.2.1 Banks

The main players in the banking sector are the five big banks of Pakistan: Habib Bank Limited (HBL), United Bank Limited (UBL), National Bank of Pakistan (NBP), Muslim Commercial Bank, and Allied Bank Limited, which also have an international presence. They have been given special incentives by the SBP for fast and secure delivery of home remittances to recipients in Pakistan. These banks have specialized home remittance cells at their respective head offices and collaborate to speed up remittance transfers among their branches. Furthermore, they *do not charge* international customers for remitting money through their network, as SBP reimburses them.⁶⁹ This step by SBP helped to significantly boost remittances coming through banks. Initially, in 2002, when reforms were being taken to regulate the remittance market, these banks were given the incentive of getting R 1 for each dollar that was remitted through their network. However, this policy was dropped and replaced with fee reimbursement. Over the last year, international formal remittances coming through banks increased by 13.4 percent.

An analysis of national household survey responses shows a positive perception of bank remittance services by domestic and international remittance users. Bank branches using one's own account are found the most accessible remittance channel nationwide (by 29.5 percent of the population), among formal and informal channels alike. Bank remittance services using one's own account are also considered the least-risky channel (by 38.7 percent of the population), while bank remittances via another person's bank account, are perceived as the riskiest money-transfer method (by 47.9 percent of the population). Interestingly, rural areas consider banks, but not the Pakistan Post, risky, and urban areas exhibit exactly the opposite perceptions.

Habib Bank Limited

The largest player in the banking sector is HBL. It accounts for \$1.2 billion in international formal remittances for fiscal 2007 or a market share of 22 percent, overall. It has 40 international branches with operations in 25 countries and is also the largest private sector bank in Pakistan with over 1,400 domestic branches (Box 5.1). HBL also has a large network in rural areas, with almost 50 percent of its branches located there. Hence, HBL's outreach in the rural areas is impressive and allows it to reach recipients in far-

⁶⁹ SBP has given all banks the incentive to not charge international customers for wiring money, and it reimburses them for each transaction.

flung areas quickly. About 30 percent of foreign remittances coming through HBL go to rural areas. The median transaction amounts for remittances received through HBL are \$500 to \$700.

Box 5.1: A Closer Look at HBL

HBL has achieved its market-leader position through a vigorous marketing campaign in the Middle East. Energetic junior staff stationed in these countries promote HBL services at small exchange companies, banks, and worker camps. HBL has tried to make the process as convenient and simple as possible for Pakistani workers in the UAE, so that they use formal channels instead of *hawala*. Staff in the Middle East visit worker camps on payday and hold special remittance campaigns during the *Eid* (feast) festival. For regular remitters, HBL has created special accounts with options to send money to five different people in Pakistan. Once the account is set, the address and bank details of each recipient is entered into the system. The customer only has to call and give his account number and the name of the person he wants to send money to, and the bank processes the transaction.

HBL has associations with banks and ECs in many countries to facilitate remittances. One of its major partners is Al-Rajhi Bank in Saudi Arabia, through which remittances, free of cost, can be channeled to Pakistan. HBL also has an agreement with Travelex, an MTO based in the United Kingdom. Overseas payments are received by HBL Pakistan through SWIFT. Once in Pakistan, HBL has a fully automated system that allows the bank to credit recipient accounts every hour or issue a draft if the recipient has an account in another bank. HBL's unit dealing with remittances operates seven days a week and thus remittances can reach recipients in most places in Pakistan within 24 hours. HBL calls this service *Fast Transfer* and relies on technology bought from Misys International. Other HBL products include fax money orders and express check remittances. On the recipient side, HBL offers special remittance *Munafa Plus Certificates* available in one-, three-, and five-year terms, which have returns ranging from 7 to 11 percent per year.

Source: DFID

United Bank Limited

The second largest player in the market is UBL, which brought in approximately \$550 million in international formal remittances for the year 2006, giving them an overall market share of 10 percent. They have a network of over 1,000 domestic branches and 15 overseas branches, with a strong presence in the Gulf region. UBL also has many correspondent exchange companies and banks overseas and is constantly striving to form relationships with new ones. Until July 2007, UBL had a contract with Moneygram, whereby money sent through Moneygram franchises overseas could be picked up at UBL branches. However, since August 2007, UBL has been operating a deal with Western Union, and within the first few months, claims to be handling volumes as high as those they handled with Moneygram at peak times. UBL estimates that about 40 to 50 percent of remittances received in their network are for rural areas (Box 5.2).

Box 5.2 Innovative UBL Products

UBL has several remittance products other than the simple wire transfers from international branches. In 2002, it launched **UBL Tezraftar** (a service similar to HBL's Fast Transfer), which offers free remittance service within the country or from abroad to the doorstep of the recipient. This service trebled UBL's remittance business volume as it ensures free delivery of money within 24 hours for most urban areas. It is open to all, even those who are not UBL account holders, and the remittance is delivered at the doorstep of the recipients by an authorized courier or credited to their accounts. At the same time, in the UAE, UBL launched a scheme, which, along with charging no fee for the money transfer, also gave expatriates a bonus of 10 points redeemable for 10 dirhams on their next transfer, if they remitted at least Rs 7,000 (\$114).

UBL also has **online money transfers** from the United States in collaboration with Payquik. With this service remitters can simply send money from a credit card or Internet check to anyone in Pakistan. The money can be credited to an account in any bank in Pakistan or delivered to the recipient at his or her home. The fee for sending money through an Internet check is only \$5; with the credit card, a flat fee of \$10 is charged, plus 2.89 percent of the transaction amount. The average transaction amount of this online money transfer called click n remit is \$750. The reason for the high fee on the credit card is that Visa charges UBL this amount to process the transaction.

Source: DFID

5.2.2 Exchange Companies

The EC framework was enforced in 2002 to bring exchange and remittance businesses under proper financial discipline. With the transformation of authorized moneychangers into formal ECs, a large number of undocumented and cash international transactions came within the formal net. These transactions are required to have proper documentation, record keeping, and adherence to internationally accepted Know Your Customer norms. All EC transactions, exclusively international money transfers, are fully automated and have a real-time online network that can be accessed by any branch to track and make payments. Many ECs have set up call centers where the franchisees can call and check a transaction status.

The EC framework also enabled SBP to substantially narrow the gap between interbank and curb market exchange rates, which has played an important role in improving the inflow of international remittances during the past two to three years. The balance of payments for fiscal 2005 for the first time included the receipts and payments made through the ECs and conveys a more comprehensive and realistic picture of the transactions on the external account of the country. The transformation of authorized moneychangers into formal ECs, however, has posed considerable challenges for SBP in ensuring effective regulatory and supervisory oversight, inculcating corporate culture, good governance, transparency, and proper documentation and record keeping structure.

The network of ECs is comprehensive, covering 100 percent of the urban market and slowly making inroads into rural areas.⁷⁰ International remittances coming through ECs grew by 53.4 percent from fiscal 2006 to fiscal 2007. According to ECs, 90 percent of remittance transactions they handle are between Rs 10,000 and Rs 100,000.

Zarco Exchange

Zarco Exchange is the top EC in the remittances market and has partnered with Western Union (Box 5.3). About \$260 million were channeled through it last year. Zarco Exchange has received numerous awards in the last couple of years, such as Role Model EC from SBP and the Federation of Pakistan Chamber of Commerce and Industry, awarded by the Prime Minister of Pakistan, and the Best Computer Sciences Corporation Management award from Western Union.

Box 5.3 Zarco Exchange: Branching Out, Including Online

Zarco Exchange has a large network of over 660 payment locations. It has an aggressive approach and associations with 15 international MTOs such as Ria and Vigo, in addition to Western Union. It has also opened its own Zarco Exchange branches overseas in areas densely populated with Pakistanis. In Pakistan, it has partnered with many organizations to ensure prompt delivery of remittances. Its partners include Bank of Punjab, which has approximately 300 branches; Utility Stores, of which 100 are involved in paying out remittances; and Punjab Cooperative Bank. In addition, Zarco Exchange has its own branches and payment booths all over Pakistan. It does not have payment booths in rural areas, like most MTOs, as its systems are automated and online and so the minimum requirement of setting up a branch or payment booth is a phone and Internet connection. However, it has strategically set up branches in towns near villages that require remittance services. For instance, it has seven branches in Jhelum (a small city) as many people from the surrounding villages have migrated to Italy for work.

Other than the money-in-minutes service offered in collaboration with Western Union, Zarco Exchange also offers an online transfer service—click n send.

This service takes 2-3 days for payment processing, and money can be paid through credit cards or Internet checks. The transaction can be tracked anytime from the Web and can be paid out as cash, bank draft, bank deposit, or home delivery. The fee for paying with an Internet check is \$3 per \$300, while with credit cards it is a flat charge of \$8 plus 2.9 percent of the transaction amount.

Source: DFID

⁷⁰ Information on individual branches can be found on the website of each EC.

Wall Street Exchange

The main partner of Moneygram International in Pakistan is Wall Street Exchange, based in Karachi. Wall Street has 7–8 other international correspondents, such as U.K.-based Instant Cash. Wall Street Exchange has close to 90 branches and franchise offices in 50 cities across Pakistan, and it plans to open 100–150 more payment locations in the coming year. In 2007, international remittances of \$217 million came through the Wall Street Exchange network, giving them a market share of 23 percent in the EC segment.

The main product offered by Wall Street Exchange is the “money in minutes” service for both inward and outward remittances. It is a fast and convenient service, linked through the Internet and a call center with a toll-free number through which recipients can track their payments. Similar to Zarco Exchange, the basic requirements of Wall Street for opening a payment booth are Internet and phone connection. However, if Internet infrastructure is not available, dial-up connections on wireless phones is used. With the wireless network, Wall Street plans to improve its outreach in small cities and rural areas.

5.2.3 Pakistan Post

Pakistan Post has a network of 13,419 post offices across Pakistan. Recently it started automation of its services and has launched an online Express mail track and trace system. In the future, Pakistan Post plans to offer an Instant Money Transfer service, collection of utility bills from home, a premier courier service, and Tele Centers up to the tehsil headquarter level.

Apart from being a major channel through which domestic remittances are sent to rural areas, it also has an agreement with Western Union to disburse foreign remittances through 1,700 locations. For fiscal 2007, international remittances through Pakistan Post were \$135 million, or a market share of 2.5 percent. Growth in the preceding year was a remarkable 58.9 percent, up from \$85 million international remittances for fiscal 2006.

Out of the 1,700 locations used to disburse remittances from Western Union, about a third are fully automated with a real-time online system. About a third have fax facilities, where once the remittance notification is received, a fax is sent to notify disbursal. About one-third of locations telephone into a call center to check the remittance status and carry out the disbursal.

About 85 percent of the post office branches are in rural areas. Table 5.2 shows the distribution of post offices by province and urban/rural status (Pakistan Post 2005). Only the 80 major general post offices have been automated. All the transactions routed to the other 13,000 post offices go through the general post offices, and so their records are computerized even though the post offices themselves are not automated.

Table 5.2 Percentage Post Offices by Province and Rural/Urban Areas

	Rural	Urban
Federal Capital & AJK	0.9%	5.0%
Sindh	3.8%	10.6%
Baluchistan	1.3%	1.7%
NWFP	1.4%	15.7%
Punjab	7.5%	52.0%

Source: Pakistan Post Annual Report 2004-05

The remittance products offered are money orders, postal orders, postal draft, urgent money order, and fax money order. The main product used for domestic remittances to rural areas is the money order, which is

issued up to a maximum value of Rs 10,000. For higher denominations, up to Rs 200,000, postal drafts are issued.

Urgent and fax money orders transfer money the same day, but these services are only available in a limited number of cities (204 cities are served by urgent money orders and 49 cities by fax money orders). The charges for these services are nominal. A 5 percent commission is charged for the regular money orders; urgent and fax transfers have an additional flat charge of Rs 30 applied on top of the 5 percent commission.

Post office services are perceived as the least-expensive formal method of remitting funds, according to household survey results. Informal methods remain less expensive, with 25.6 percent of the population citing money sent via family or friends as the least costly, 21.5 percent citing check with family or friends, and 15.2 percent citing a check that is hand-carried. This contrasts with perceptions of the high cost of other formal remittance channels. The ECs are considered the most expensive (by 40.7 percent nationwide). Interestingly, over half of rural respondents complained about the cost of post office transfers.

The paperwork for sending the money orders is straightforward and simply requires the addresses of the sender and the recipient. In cities, the money order is delivered in 1–2 days; however, in rural areas it takes 3–5 days officially. In practice the money orders might take longer, and anecdotal evidence suggests that in very small villages, postmen might hold on to the money for personal use and deliver it when they “feel like it.” Officially, the sender is supposed to receive a signed receipt from the recipient once the money order is delivered, but in reality it is generally never delivered.

Evidence from the national household survey also points to the relatively slow service of post office money orders compared with other domestic and international remittances services. Informal remittance channels score just as well as formal ones on speed, with 23.6 percent of the population citing money sent with family or friends as the fastest transfer, while 21.4 percent and 20.3 percent point to ECs (Western Union) and electronic bank transfers, respectively. The post office is considered the slowest delivery channel by more than half of respondents (51.8 percent).

5.2.4 Money Transfer Organizations

The worldwide market share of Western Union in the intermediation of remittances is 15 percent, and in Pakistan it probably has a share of 15–20 percent. Its cash-to-cash anywhere in the world model is very convenient, as is a real-time service. It has partnerships with several organizations in Pakistan, including Pakistan Post, UBL, NBP, Faysal Bank, and Zarco Exchange, which in turn has its own partnerships with Bank of Punjab, Utility Stores, and Punjab Cooperative Bank. These associations translate into more than 5,000 payment locations for Western Union across Pakistan. Western Union has an office in Islamabad with a full team that handles operations in both Pakistan and Afghanistan. The company does not offer online remittance services to Pakistan from the United States (USA) like it does to Mexico and Brazil.

The worldwide market share of Moneygram is 7–8 percent, though it does not have a significant presence in Pakistan. It has partnered with few companies, of which only two are well known—Wall Street Exchange and Bank Al-Falah. Moneygram handles business in Pakistan via its Dubai office. This explains the lack of marketing and an aggressive expansion strategy in Pakistan.

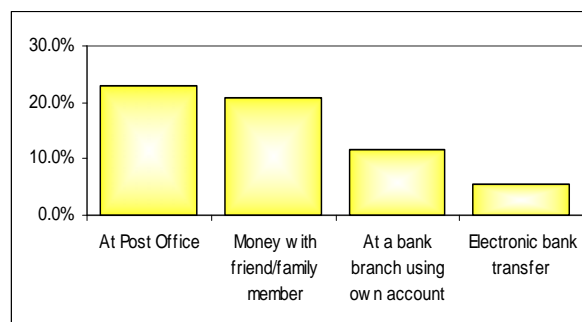
Overall, sending money through MTOs is very convenient as they are well located internationally, and pick up of funds within Pakistan is easy. Furthermore, as seen below in section 5.5, the service offered by MTOs is very reasonably priced.

5.2.5 Domestic Remittances

Data on domestic remittances are much less readily available than comparable figures on international transfers. This shortcoming precludes policy action towards encouraging an efficient and accessible sector, in the manner in which international remittance services have developed thanks to SBP efforts. We estimate domestic transfer volume at \$6.95 million, roughly 90 percent of international remittance flows in Pakistan. While domestic remittances used to represent a higher share than foreign remittances in monthly household income in Pakistan, national household income and consumption expenditure data for fiscal 2006 showed a reversed trend, most probably due to the faster formalization of foreign remittance flows. Rural areas continue to rely slightly more on domestic remittances than on international transfers (Federal Bureau of Statistics [FBS] 2006: Table 11). However, according to the national household survey conducted for this report that corroborates Pakistan Social and Living Standards Measurement Survey (PSLM)⁷¹ 2004–05 data, domestic remittances are more frequently used by Pakistanis. In fact, there are 2.5 times more domestic remittance users among Pakistani households than foreign remittances users. The regional distribution of remittances is discussed in section 5.3.

Figure 5.3 presents the most frequently used domestic remittance channels, based on results from the Pakistan Access to Finance (A2F) household survey. The popularity of the post office for domestic remittances is confirmed by national household survey results, which place the post office as the most commonly cited channel for domestic remittances, especially in rural areas, more than money or in kind through friends of family, or bank services (via a branch or electronically).

Figure 5.3: Top Domestic Remittance Channels



Source: A2F Survey

The main formal channels for domestic remittances are interbank transfers and the post office. Informal channels include hand-carrying the cash, or asking a relative or friend to do so. Pakistan Post transferred \$297 million through money orders and another \$0.32 million through postal drafts in fiscal 2005. About \$56 million were also transferred through urgent and fax money orders but they were purely urban transfers because these services are not offered in rural areas. Annex Tables A5.2 and A5.3 present a breakdown of money order and postal draft transfers by province.

Table 5.3: Proportion of Rural vs Urban Bank Branches

	% Rural Branches	% Urban Branches	Total Branches
Foreign Banks	0	100	49
Five Big Banks	41	59	5448
Private Banks	7	93	1575
Islamic Banks	0	100	93
Specialized Banks	33	67	539

Source: SBP, "Building Inclusive Financial Systems", 2007

The banks with a rural presence in Pakistan are the five big banks: HBL, NBP, UBL, MCB, and Allied Bank Limited. MCB and HBL have the best rural branch networks. ZTBL is another bank with significant rural presence since its aim is to provide financial services to rural clients and in agricultural development. The

⁷¹ PSLM is a nationally representative household survey carried out by the FBS.

proportion of rural versus urban branches, according to SBP, is as given in Table 5.3. The provincial rural split of banks is given in Annex Table A5.4.

Within the banking industry, the five big banks are primarily responsible for rural-urban transfers. These banks are moving from paper- to e-banking, and this trend has considerably shortened the time it takes to transfer money to real-time transfers. The total proportion of branches that are online was 61 percent by the second quarter of fiscal 2008. Some banks offer free online transfers, while others charge up to Rs 200 per transaction.

SBP has allowed Microfinance Banks (MFBs) to engage in remittance services as well; however, First Microfinance Bank Limited is the only MFB currently offering this service. It launched this remittance service in 2003 and, in the 12 months ending May 2005, it increased the monthly volume of transfers from \$3.46 million to \$7.5 million. The number of transactions increased from around 3,000 in May 2004 to around 6,500 in May 2005. The bank's typical transfer customers are low-income traders, but they get walk-in customers as well. The fee charged is between 0.055 and 0.2 percent, depending on the transfer amount (DFID [U.K. Department for International Development] and USAID [U.S. Agency for International Development] 2005). The median transaction amount for this service is \$1,100.

5.2.6 Informal Channels

In Pakistan, as across the world, money has been transferred through an unofficial system known as *hawala*, which is based on trust. No receipts are given, but the transfer is cheap, fast, and secure. The reason is that *hawaldars* (people who do *hawala*) have very low overheads, they can offer a better exchange rate than that offered by banks, and there is no red tape. The service is generally reliable, convenient, and offers anonymity.

World Bank (2008a) notes that informal remittance costs tend to be much lower than formal charges (about three times lower in Bangladesh, for example). *Hawala* fees are only 0–1.5 percent of the transaction amount, while in formal channels they may be as high as 20 percent (Passas, 2004). Furthermore, the fees are quite flexible and depend on the relations between the *hawaldar* and the client, the ultimate destination, and the frequency and regularity of payments.

Service to remote areas is easier and faster and is commonly delivered to the doorstep, which is very important in Pakistan, where women in rural areas are not very mobile due to cultural and social factors. The main reason *hawala* is popular in Pakistan is because of the lack of banking facilities in rural areas, as well as due to the doorstep delivery, so that the women or older people do not have to travel long distances to receive payments. The market size estimates of the informal remittance sector from our discussions are around \$2 to \$4 billion, including *hawala* and self-carried money.

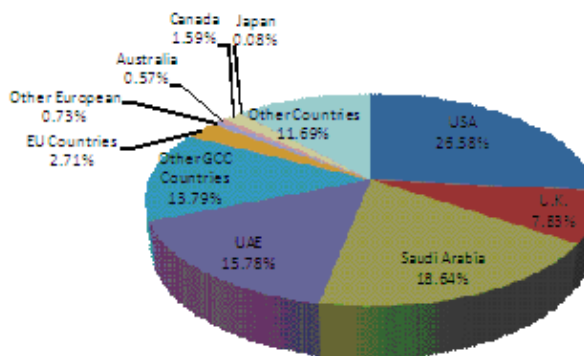
Besides *hawala*-type systems, informal channels can take a variety of forms: ethnic stores, travel agencies, moneychangers, counter services, or hand delivery. Another informal remittance channel is in-kind remittances, which is the sending or carrying of remittances in the form of goods for personal use or for resale in the informal market. Kazi (1989) notes that this practice is quite widespread—he estimates in-kind remittances at about 16 percent for urban migrants and 11 percent for those returning to rural areas. In-kind remittances have become more significant since introduction of liberal import policies allowing duty-free imports. However, goods brought in under personal baggage are not recorded as remittances or imports. The estimated share of in-kind remittances is around 10–15 percent of overall remittances (Kazi 1989).

5.3. Distribution of Remittances by Region and Income Level

5.3.1 International

Figure 5.4 displays the distribution of international remittances by source country. The distribution of remittances from countries abroad is given in Figure 5.4. The largest source country for remittances to Pakistan is the USA, with Saudi Arabia in second place, followed by the United Arab Emirates (UAE) and other Gulf countries, and the United Kingdom in fifth place. From the UAE, the largest contributor is Dubai, and from the Gulf countries it is Kuwait. From the European Union the main contributor is Germany. The countries that have experienced the greatest growth in remittances through the Pakistan corridor since 2001 are the USA, Canada, and Italy, probably because of an increased effort by these countries to crack down on the terrorist network, encouraging senders to go through formal channels (see detailed breakdown by country of origin in Annex Table A5.5). Historically, the bulk of remittances have come from the Gulf region, as it is closer and easier to migrate to. Only after the events of September 11, 2001, did the USA become a major remittance-sending country. However, if informal flows are taken into account, the remittances coming from Gulf countries would far exceed those coming from the USA.

Figure 5.4 Remittances by Country



Source: SBP Annual Report 2006-07

5.3.2 National

The two provinces with a significant share of remittances are North West Frontier Province (NWFP) and Punjab. Together they account for over 85 percent of both domestic and foreign remittances. Furthermore, the rural areas in these provinces receive the bulk of the flows. Table 5.4 shows the overall distribution in the provinces and gives the split by rural/urban area.

Table 5.4: Regional Distribution of Remittances

Province		Domestic Remittances	Foreign Remittances
Punjab	Urban	17.0%	19.3%
	Rural	39.7%	19.4%
Sindh	Urban	1.9%	2.4%
	Rural	1.3%	1.2%
NWFP	Urban	4.5%	8.5%
	Rural	31.2%	39.1%
Baluchistan	Urban	0.3%	0.7%
	Rural	1.1%	2.8%
AJK	Urban	0.5%	1.7%
	Rural	2.2%	4.5%

Source: PSLM CWIK 2004-05

After Punjab and NWFP, Azad Jammu and Kashmir (AJK) receives 6.2 percent of foreign remittances, with 4.5 percent going to rural areas. With over 60 percent share of the foreign remittances for rural areas of Punjab and NWFP, it is clear that remittances are not only going to major cities but are also available in villages, where traditionally formal access has been limited. Sindh and Baluchistan receive only a trivial amount of remittances. It is interesting to note that only 17 percent of the population of Pakistan resides in NWFP, but it receives the largest proportion of foreign remittances, 47.5 percent.

Divergent quality and accessibility of services nationally are reflected in differences in provincial perceptions on various channels of remittance transfers. In NWFP, money in person is a risky remittance method (perceived as such by 57.5 percent of the NWFP adult population); in AJK, money transfers via friends is risky (38 percent); in Baluchistan, using bank transfers is perceived as unsafe (38 percent), and in Sindh and Punjab, using someone else’s bank account is considered riskiest by 25 percent and 50 percent, respectively.

The pattern of regional remittance distribution follows the migration pattern as noted in Ara (2003). Using the 1998 census data, she writes that Punjab and Sindh were the main destinations for domestic migration. For Punjab, much of the urban immigration was from rural or other urban areas of Punjab. In contrast, urban immigrants in Sindh (predominantly in Karachi) were mostly from other provinces of Pakistan. There was very little emigration from Sindh to other provinces. NWFP, on the other hand, was a major source of migrants to all provinces, particularly to Sindh.

Gazdar (2003) notes that the pattern of migration in Pakistan—from labor-abundant areas of NWFP and Punjab to urban centers of Punjab and Sindh—conforms to a basic poverty-migration linkage. The regions of emigration are, indeed, those parts of the country where agricultural incomes are low and volatile. And the economic gap between areas of emigration and immigration is clear enough. Wages of casual daily laborers can range from around Rs 40 in southern Punjab to around Rs 150 in Karachi.

5.3.3 Poverty and Remittances

It is well recognized that remittances play a beneficial role in reducing poverty. Remittances help families increase spending on basic needs, such as food and clothing, as well as health and education. Certain studies suggest that about 10 to 20 percent is also put in savings and investment (IFAD 2006).⁷² Adams and Page (2005) find that a 10 percent increase in remittances leads to a 3.5 percent decline in the share of people living in poverty. Yang and Martinez (2005) determine that remittances not only lead to a decrease in poverty of migrant families, but also have spillover effects on nonmigrant families. Total remittance inflows to Pakistan from fiscal 2002 through fiscal 2006 have amounted to over \$19 billion. About one-third of this significant inflow of money is towards rural areas, helping to relax budget constraints and allowing increased expenditure on health, education, and consumer durables, contributing to poverty alleviation.

However, remittances do not appear to make a significant share of household income for the poorest quintile (Table 5.6). Only for NWFP do remittances form a significant share of income—over 12 percent in both rural and urban areas. For Sindh and Baluchistan, the share of remittances in household income is less than 3 percent. In Punjab, for urban poor the share is just 3.6 percent and for rural poor it is 8.8 percent. NWFP received significant remittance flows after the October 2005 earthquake.

Table 5.5: Share of Remittances in Household Income for the Poorest Quintile (%)

By Province	Punjab		Sindh		NWFP		Baluchistan	
	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural
Domestic Remittance	1.86	8.01	0.36	1.42	5.36	10.1	0	0.25
Foreign Remittance	0.81	0.7	0.69	0.22	7.27	2.75	0	2.55

Source: Household Integrated Economic Survey 2005, Federal Bureau of Statistics, Government of Pakistan

Interestingly, we find that remittances form a larger share of household income for the richest two quintiles (Annex Table A5.6). For the richest quintile, on average, foreign remittances are 5.5 percent of rural household income while for the poorest quintile, foreign remittances are only 1.9 percent of rural household income. However, across all quintiles, domestic remittances are the same proportion of household income, around 3.5 percent. In conclusion, foreign remittances are much more significant for the well-off households.

⁷² World Bank (2008a) quotes estimates in Ghana, where 70 percent of remittances are spent on current expenditures and less than 30 percent on investments such as land, cattle, or construction. In Mali, 80 to 90 percent is spent on consumption. In the Philippines, 68 percent is spent on debt repayment and current needs, 13 percent on consumer goods, 1 percent on education, 5 percent on business capital, 3 percent on land and buildings, and 1 percent on personal savings.

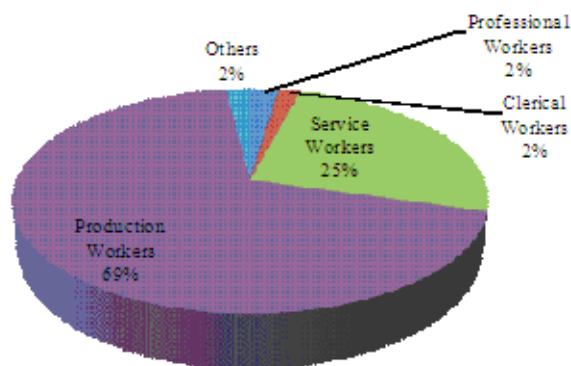
In contrast with the four provinces in Table 5.6, in AJK, 25 percent of the households are found to receive remittances, which are their primary source of income (Suleri and Savage 2006). *Hawala* is the most common mode of money transfer that is used. The study also found that households whose livelihood included international remittances appeared less vulnerable to the earthquake's effects and also showed more resilience after remittances were re-established.

A study undertaken by Oda (2007) in the Chakwal district of Punjab finds that external migration helps in poverty alleviation when compared with internal migration, as a high ratio of poor were found in the group of internal migrants, and a low incidence of poverty among external migrants.⁷³ Furthermore, remittances from external migrants were twice as high as those from internal migrants in absolute terms. The results of this study are corroborated by a study in Ghana by Adams (2006).

5.4. Determinants of Remittances and Historical Trends

There are roughly 3.7 to 4 million Pakistani workers overseas, and over 90 percent of them are production workers, like laborers, or service workers such as cooks and operators (Figure 5.5). Pakistan has a higher percentage of low-skilled migrant labor when compared with countries like India and Philippines, which have 20–25 percent professional migrants, but similar to the levels in Bangladesh or African countries.

Figure 5.5 Overseas Workers By Category



The main determining factors of remittances include economic activity in the sender and recipient countries. Swamy (1981) finds that 70–

Source: Bureau of Emigration & Overseas Employment 2006

95 percent of variation in remittances is explained by economic activity in the sending country. Until recently, strong growth in Pakistani equity markets, as well as significant economic growth at 7 percent a year, had attracted significant investment from overseas. Remittances are also determined by strong local needs such as natural disasters. Western Union's remittances to AJK increased by 400 percent after the October 2005 earthquake (Shah et al., unpublished).

Table 5.7 displays the annual trend of workers' remittances from 1997 to 2007. Workers' remittances fell to \$983 million in fiscal 2000 from much higher levels in the preceding decade. The main reason for the decline in remittances through the banking sector was that people started to prefer the *hawala* channel for its efficiency, low cost, and outreach. Furthermore, following the nuclear testing in May 1998 the foreign currency accounts of residents and expatriates were frozen, which created uncertainty and a severe loss of confidence in the government. Remittances fell by almost 29 percent in fiscal 1999 and further declined 7.2 percent the following year.

Table 5.6 Remittance Growth

	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07
Workers' Remittances (Billion US\$)	1.41	1.49	1.06	0.98	1.09	2.39	4.24	3.87	4.17	4.60	5.49
Growth of Remittances		5.7%	-28.8%	-7.2%	10.5%	119.9%	77.3%	-8.6%	7.7%	10.3%	19.4%

Source: SBP (2007); <http://sbp.org.pk/ecodata/index2.asp>

⁷³ See Annex Table A5.7 for the contribution of remittances to household income and poverty ratio in the sample from the study.

In the 2000s, SBP has been trying to curb money laundering and informal means of money transfer, which may have caused a reversion to formal banking channels and MTOs. The main reasons for remittances coming through the formal channels include the conversion of the moneychangers to ECs, which were in the formal net, the reduced exchange rate spread between the bank and curb rates, and incentives given by the Government of Pakistan (GOP) and SBP to banks and expatriates. All these efforts supported a 400 percent increase within six years. Remittances continued their significant growth in fiscal 2002 and 2003, by 119.9 and 77.3 percent, respectively. In fiscal 2004, the remittances decreased by 8.6 percent, the decline coming mainly from the UAE for the two following reasons: (1) the Hajj Sponsorship Scheme⁷⁴ was cancelled, which explained half the decrease, and (2) investment in real estate was opened up to foreigners in Dubai, giving Pakistani expatriates an alternate attractive investment option.

In fiscal 2005–08, remittances increased by 7.7, 10.3, 19.4, and 14.9 percent, respectively, mostly because of increased economic activity in the Gulf countries (a result of higher oil prices) and in the USA. The earthquake disaster prompted many Pakistanis overseas to send increased financial support to relatives back home. The growth is further attributable to increased investment in the Pakistani asset markets, particularly the equity market in fiscal 2007. The increase from the UAE for fiscal 2007 was \$146.5 million; this can be attributed to rising construction activity during the real estate boom and increased economic activity as a result of the oil boom (SBP 2007c).

Econometric analysis suggests that education, employed status, and regular cell phone use are individual-level demand determinants for sending and receiving remittances (Annex Table A5.8). Interestingly, women, rural areas, agricultural workers, household members other than the head, and participants in the informal sector are not less likely to be remittance clients. Higher income levels also have a higher chance of being associated with access to remittances than the poorest quintile, confirming the poverty impact analysis in section 5.3.3. This could reflect the fact that the poorest households may have less opportunity to send a family member abroad and receive foreign remittances.

5.5. Usage Patterns and Service Fees

The national household survey highlights relatively short delivery times for remittances in Pakistan: it takes a week or less for the majority of respondents to get cash remittances within and outside Pakistan. Only a fifth of recipients of international remittances report delivery delays of more than a week. This is more pronounced in rural areas, where a quarter respondents note delays of over a week. The typical frequency for receiving domestic or international remittances is monthly or more frequently. The national survey also reveals that home consumption constitutes the largest use of remittances across for all income groups, rural/urban areas, and gender. Other top uses of remittances after home consumption include health and child care, education, and business/land purchase related-purposes.

The limited presence and outreach of Pakistani banks abroad is the main problem facing Pakistani banks in increasing remittances through their networks. For senders, the most easily accessible banks are their local banks, however, sending money through them takes time and is expensive. Table 5.8 gives an overview of charges from four cities that have a significant share in remittances to Pakistan.⁷⁵ The local bank charges vary considerably depending on the speed of transfer (urgent vs normal), ultimate destination, and the amount sent. These charges are comparable with those for India; however, the fees charged for other countries such as Brazil and Mexico are higher from the UAE and Saudi Arabia and lower from the USA and United Kingdom. The rates for Western Union and Moneygram are quite similar but the network of the former in

⁷⁴ This scheme was introduced to facilitate the Islamic Pilgrimage (Hajj) to Mecca. In the 1990s, there was a shortage of foreign exchange and people who had relatives abroad could ask them to sponsor the Hajj for them.

⁷⁵ For Western Union and Moneygram, the charges are based on sending cash.

Pakistan is far more extensive. The remittance charges for Internet checks are \$3–10 while for credit cards a flat fee of \$8–20 is charged plus 2.5–3 percent of the amount remitted. A competitive online transfer service in real time at a fee of \$2 is offered by Doha Bank in Qatar, which has partnered with HBL and Askari Bank in Pakistan.

Table 5.7: Cost of Sending \$300 to Pakistan through Various Channels

	U.S. (New York)	U.K. (London)	U.A.E. (Dubai)	Saudi Arabia (Riyadh)
Western Union	\$10	\$18.30	\$6.80	\$6.70
Moneygram	\$10	\$20.30	\$5.50	\$5.30
Foreign banks	\$35 to \$60	\$40 to \$80	\$6.8 to \$27	\$16 to \$24
Pakistani banks	Free	Free	Free	Free

Source: Author's own research

For MTOs, fees charged at the sending end are divided between three parties; the sending agent keeps 15–20 percent, the MTO keeps 50–60 percent, and the receiving agent keeps 25–50 percent (Passas 2004). The receiving agent will give a share to the franchise for handling the actual disbursement. The commission paid to franchises in Pakistan by ECs is 5 percent of the amount disbursed.

5.6. Outreach and Scope of Remittance Technologies

Roughly 64 percent of the population of Pakistan resides in rural areas; however, only 33 percent of the banking network is in these areas. Limited access to banking in rural areas requires innovative solutions to scale up outreach (Box 5.4 presents one such solution for India). Internationally, several new remittance technologies have been in use, such as transferring money on prepaid cards or mobile phones; however, in Pakistan only online transfers are available. One significant advantage of financial services via mobile phones is their ability to conveniently bring banking to women, who for cultural and social reasons do not go out frequently.

Box 5.4: Indian nongovernmental organization (NGO) Helping Domestic Remittances

In India, the NGO Adhikar is piloting a domestic money transfer service for the large number of migrants who travel from the eastern state of Orissa to work in the western state of Gujarat. Adhikar's comparative advantages in money transfer services include knowledge of customer needs and preferences, as well as the ability to service clients in remote locations.

When designing its transfer system, Adhikar decided to leave the actual transmission of funds to Corporation Bank, which has branches in both Orissa and Gujarat and the infrastructure to make timely, secure transfers. Although bank transfers take place regularly between Orissa and Gujarat, most migrants do not have bank accounts and find it costly to visit a bank branch. Adhikar centralizes the collection and dissemination of these small transfers and routes them through one account at the bank. This process spreads transaction costs over a larger number of transfers, bringing down the per-transaction fee. Adhikar is now looking to leverage the system by involving NGOs that serve other districts in Orissa as distribution agents, lowering per-transaction fees even further while enabling the NGOs to earn a new source of revenue to support their work.

Source: Consultative Group to Assist the Poor (2005)

Through the issuance of the “Guidelines for Mobile Banking Operations of MFBs/Institutions”, SBP has been encouraging the private sector towards providing mobile banking solutions. This shows strong potential as both the banking and telecom sectors are among the most vibrant in the country. In addition, Microfinance Institutions (MFIs) are growing at a robust rate and can support increased outreach as 60 percent of their network is in rural areas, although only MFBs are allowed to remit money domestically.

The network of ECs in Pakistan is broad and covers all high-volume areas. The ECs analyze where remittances are flowing to and open franchises/payment booths accordingly, in nearby towns or small cities. However, as the systems of the ECs are automated and the minimum requirement for them to set up a branch is to have a phone connection and Internet, they have technically not opened branches in rural areas, but in cities near villages that receive remittances.

The best strategy for increasing financial access of the poor is to introduce mobile phone platforms. The outreach of the telecom sector is considerable—the mobile network in principle covers about 90 percent of the population of Pakistan. The total consumer base reached 89.3 million by July 2008⁷⁶; the provincial breakdown of the mobile consumer base is given in Figure 5.6 (Pakistan Telecommunications Authority 2007).

Figure 5.6: Mobile Consumer Base by Province

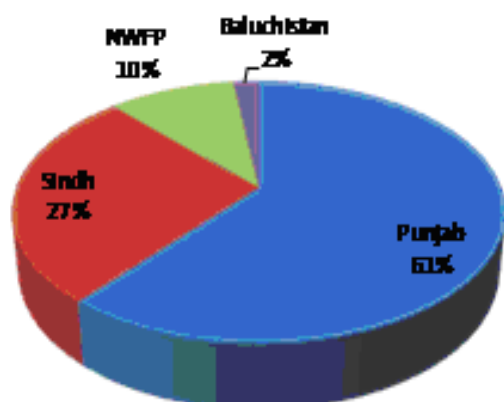
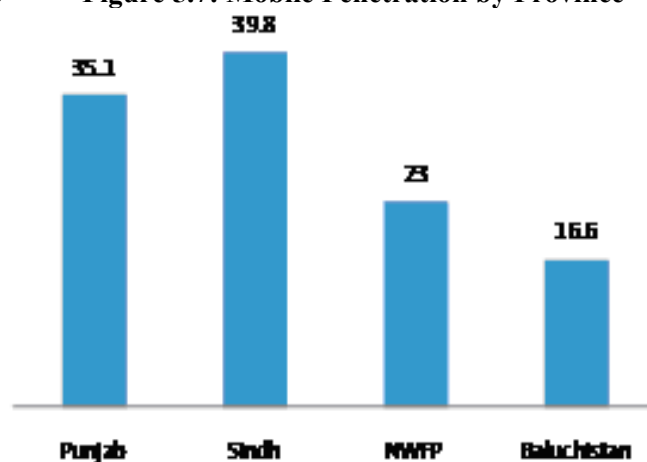


Figure 5.7: Mobile Penetration by Province



Source: Pakistan Telecommunication Authority (2007)

The penetration of mobile services in each province is around 30 percent (Figure 5.7), but this amounts to 80 percent of the total population. However, AJK and Northern Areas are still behind and the population covered is 20 percent, or about 1 million people. This mobile coverage, and the success of mobile money transfer solutions in the Philippines and Kenya (Box 5.5), suggests that mobile banking offers significant potential to scale up access to financial services. Specifically, in the Philippines, the G-Cash model has achieved excellent outreach and can be used as a model in Pakistan to link mobile phones with financial services. Mobile-enabled business models have low operating costs, and if consumers can become savvy with the banking technology loaded onto mobiles, it offers the best way forward for improving outreach of all financial services, including remittances. According to the Consultative Group to Assist the Poor, using a mobile phone can reduce the cost of a typical bank transaction by 80 percent in the Philippines, while Tameer Bank estimates that, in the Orangi slum of Karachi, the setup cost of a bank branch would be 30 times more than the setup cost of an agent. Mobile money transfers have the potential to help lower international remittance costs by up to 75 percent and domestic remittance costs by up to 90 percent, providing direct savings to poor households.

⁷⁶ The cellular density as of July 31, 2008, was 55.6 percent.

Box 5.5: Mobile Banking: G-Cash (Philippines) and M-Pesa (Kenya)

The G-Cash product is a facility linking the user's phone to a "cash" account or "wallet." The customer can deposit or withdraw cash from this wallet as needed, while credit can be transferred between mobile users as well. It operates on a credit basis, where the user initially deposits cash at a designated deposit location such as Globe offices or accredited retailers. This service allows mobile users cashless purchasing at a wide range of shops, direct credit from employer payroll, bill payment, and inward remittance from overseas Filipino workers.

Initially, the user registers through sending a short message service (SMS) and deposits money; there are no charges for registration. Each transaction update is sent by Globe in the form of an SMS. Just as easily as cash is deposited at a deposit location, it can easily be withdrawn; however, an acceptable identity document is required. Retail purchases are possible at several thousand participating outlets. This involves a request from the retailer originating the transaction through his own cell phone terminal and a customer authorization from their own phone. Airtime transfers, prepaid top-up, and bill payments can be carried out with similar ease.

For each transaction, the cost is the standard SMS fee (\$0.02). For cash deposits and withdrawals, the fee charged is 10 percent of the transaction value with a minimum of \$0.19. Globe maintains and operates a clearinghouse facility that records all transactions and arranges settlement between the retailers and the G-Cash customers. This results in Globe having responsibility for the usual banking issues of fraud management and money laundering prevention. However, the cash float from the customer balances is held by the company's usual business bank, although that bank has no knowledge of the individual user activity or account balances. The user has to authorize each transaction by a PIN and the maximum balance that can be maintained by a customer is \$189.

The M-PESA mobile money transfer platform in Kenya is very similar to G-Cash and it specifically targets the unbanked population. These people, who do not have access to convenient or cheap cash transfer services or bank branches, simply register with an M-Pesa agent by providing their Safaricom mobile number and identify card. Once they have done this and deposited money with a local agent, they can send money to other mobile phone users through an SMS even if they are not Safaricom users. This cash can easily be withdrawn at an M-Pesa agent. Banks are now beginning to partner with Safaricom to provide further services. For example, two Equity Bank account holders with Safaricom lines can now credit and transfer cash into each other's account using their mobile phones in real time, subject to the availability of funds. Equity bank clients will also be able to pay their utility bills, purchase airtime, request their bank statements and perform other crucial banking enquiries.

Source: DFID

SBP has issued guidelines for branchless banking, covering three different models: In the first, banks can work with a particular telecom provider to offer services to the current customer base of that company. In the second, a bank can offer mobile phone banking services to customers using mobile connection of any telecom. The third model is a group of banks and telecoms that can join hands to provide a service.⁷⁷ As telecom providers are not themselves prudentially regulated, they are prevented from taking deposits and so cannot themselves provide savings products (a primary need for many poor consumers). This would also hamper their ability to be able to provide loans. Hence, although "pure" telecom provider models can currently be effective for providing mobile payments, there is a need for a banking relationship, or appropriate regulation, to allow access to other financial services beyond remittances through these models.

To further increase outreach of financial services, SBP has provided more options for branchless banking such as to the Post Office, fuel distribution companies and other chain stores. However, except for the Post Office, other players are still not involved in providing financial services.

There is a lot of activity in this sector and both banks and mobile phone companies are working to develop viable models. UBL has launched a product based on the second model called "Orion," accessible only to UBL account holders. The services available through Orion are paying bills, transferring money among other

⁷⁷ Guidelines available at www.sbp.org.pk

Orion users, and buying phone cards. In time, UBL plans to increase the kind of transactions that can be done with Orion, along with adding remittance transfer facilities. Bank Al-Falah is currently testing a mobile banking product with Warid Telecom.

Another player that will enter the mobile banking market soon is Etisalat of the UAE, the major shareholder of Pakistan Telecommunications Company and Ufone. They have signed a contract with Smart of Philippines in the UAE to offer remittance services. The remittance service will allow subscribers of Etisalat to send funds to Pakistan and other countries anytime, anywhere, using their mobile phones. It will also allow tracking of transactions. The only infrastructure required will be cash in/out merchants and perhaps these can ride on the network of mobile phone card providers, which are all over Pakistan.

In the USA, dual automated teller machine (ATM) cards are very popular with Mexican immigrants. In Pakistan, none of the stakeholders contacted had any knowledge of dual ATM cards. However, various Pakistani banks in the Gulf region do provide for dual ATM cards, and they are quite convenient as recipients back home can withdraw money anytime. It is possible that Pakistani expatriates might be giving their families' ATM and credit/debit cards to use in Pakistan, given the large amounts of money processed through ATMs and point of sale (POS).⁷⁸ The Remittance Card Model from India or Visa Giro from Brazil can be adopted (Box 5.6), as electronic banking transactions are on the rise and this model may prove popular for urban areas.

Citibank UAE has recently started a Twin Account Facility for expatriate Pakistanis who have a banking relationship in the UAE but also need to send money to Pakistan. Account holders can transfer money round the clock by phone, online, by ATM, or at branches. Customers in both the UAE and Pakistan will be given checkbooks and debit cards to settle payments worldwide. This service was launched in August 2007.

Ikobo offers prepaid visa card remittances, which are available online and provide convenience and flexibility, and can be used at any ATM or associated machines. However, this requires easy access to ATMs and that the recipients are ATM savvy. Although this service is offered for Pakistan, the extent of its current use is unknown. In Brazil, remittances through Visa are doing well, given the large population that uses credit cards and a good infrastructure to support such a product.

As these examples show, remittances can be used as a key entry point to bringing the unbanked into the formal sector and increasing financial inclusion. That is, money transferred through financial institutions paves the way for other financial products and services to be provided. Remittances are often the first, and sometimes the only, financial service that low-income households use. Providing remittance services allows banks to get to know and reach out to unbanked recipients, build up information on the size and stability of their cash flows, and then offer other financial services such as savings or credit. As remittances are typically lumpy, it makes sense that a remittance receiver may need a secure way to store that money. Increased savings will in turn enable an increase in loanable funds, aggregate credit and wider financial intermediation. Econometric evidence provides strong support for the notion that remittances promote broader financial development in developing countries, via increases in the aggregate level of deposits and credit intermediated by the local banking sector. This is important considering the extensive literature that has documented the growth-enhancing and poverty-reducing effects of financial development (Aggarwal et al. 2006).

⁷⁸ According to the SBP Payment Systems Department, from October 2006 to March 2007, approximately \$67 million worth of transactions were processed through ATMs, and similarly \$64 million worth of transactions were processed through POS (SBC Payment Systems Department 2007).

5.7. Policy and Regulatory Framework

Since the early 1980s, SBP has been actively working to support a vibrant remittances market. In the 1980s, it encouraged Pakistani banks to establish branches in Middle Eastern countries to where most Pakistanis had migrated. The foreign exchange regime was liberalized, and the option of opening foreign currency accounts in Pakistan was given to expatriates, allowing the free inflow and outflow of foreign currency.

After September 11, 2001, SBP took further actions to formalize remittances, such as setting up centralized home remittance cells. Banks submitted their remittance targets to SBP and an SBP taskforce ensured implementation. A complaint and monitoring cell was set up to address public complaints. The GOP gave incentives at this time to further boost remittances, such as exemption of custom duties on personal baggage and special immigration clearance counters.

On a governmental level, SBP teams visited and studied several countries to learn from Anti-Money Laundering (AML) laws and successful remittance practices. MFBs were given permission to offer remittance facilities, and SBP is working with all financial institutions to enhance efficiency and transparency. Future government plans include adding new products with a better rate of return to the National Savings Scheme for remittance beneficiaries, to discourage consumer spending and channel savings into productive investments.

On the donor side, the World Bank has supported many initiatives, such as establishing a new framework to improve the quality and coverage of data, or formulating General Principles for International Remittance Services to help improve regulation, foster competition and increase transparency. The World Bank has also cooperated with other international financial institutions to work on remittances, and AML/combating the financing of terrorism measures. It has launched a price and cost database on remittances to enhance transparency and is working on improving payment systems so that they are quick, cheap, safe, efficient, contestable, and transparent.

The International Monetary Fund is helping countries implement Financial Action Task Force (FATF) recommendations for remittance systems. It is undertaking a comprehensive assessment of the AML/combating the financing of terrorism measures along with other International Financial Institutions and is developing an operational guide, as well as offering technical assistance on their implementation. The International Monetary Fund is also working to improve statistics and how they are captured in the balance of payments. Annex Table A5.9 gives a snapshot of donor and International Financial Institution activities to improve the remittance system.

5.7.1 Legal/Regulatory Framework

The legal and regulatory framework governing inward remittance transactions is provided for under the Foreign Exchange Regulation Act, 1947. SBP implemented the Act through general or special directives issued as occasional circulars and notifications. The primary instructions regarding foreign exchange transactions are contained in the Foreign Exchange Manual issued and updated by SBP.

The Foreign Exchange Manual provides that there are no restrictions on incoming remittances. However, financial institutions, banks, and other authorized dealers (including ECs) have to obtain licenses to carry on foreign exchange transactions. All transactions have to be reported to SBP, identifying the amount and the source. Both banks and ECs report on a daily, weekly, and monthly basis. Furthermore, the banks have access to a Real Time Gross Settlement System for low-volume, high-value transactions.

SBP has been moving steadily toward automating the system and providing real-time settlements to keep up with international best practices and national and international requirements. To this end, in 2007, the Parliament enacted a Payment and Electronic Fund Transfer Act, which laid down solid foundations for development and further strengthening of payment systems in the country, implemented by SBP

In collaboration with National Interbank Financial Telecommunications (NIFT), SBP has been implementing the real-time gross settlement system called PRISM (Pakistan Real Time Interbank Settlement Mechanism). An Automated Clearing House has been set up, based on MICR Reader and Sorter equipment with code written in house to facilitate local requirements and changing needs. The automated clearing house can be directly accessed by each branch and plays a role of a central regulating authority. NIFT collects the outward clearing directly from each bank, arranges all processing, and provides the net position to SBP. It provides services to all 42 commercial banks and their branches. NIFT centers have been established in over 80 cities for 4,000 bank branches to provide NIFT Automated Clearing House Services.

SBP is also working on providing all local banks with automated low-cost Society for Worldwide Interbank Financial Telecommunication (SWIFT) connectivity and a local U.S. dollar loop has been set up with NIFT to expedite clearing of dollar transactions. The new system has reduced the clearing time for U.S. dollar checks from three weeks to only four days, along with cost savings to the account holders. At the same time, SBP is also rapidly developing the e-banking infrastructure.

All banks and ECs are subject to both off- and onsite inspections and any violation makes them liable to penalties. Each transaction by the institutions has to be reported on a weekly and monthly basis to SBP and has to be filtered through an in-house AML system. Suspicious transactions—something out of character or inconsistent with the history and pattern of the individual accounts—have to be reported. SBP does the monitoring via supervision units at 16 field offices. A comprehensive inspection manual covering all areas of operations has been developed to help with monitoring. The opening of each new franchise office or payment booth of an EC is carefully scrutinized by SBP, including a background check on the person who is opening the office and a visit to the location to verify the adequacy of the facilities. SBP further conducts mystery shopping by sending undercover staff to ascertain the quality and type of service received.

Know Your Customer regulations are also in force. ECs do not make payments unless the recipient has a national identity card. Furthermore, SBP mandates each bank and exchange company to have a compliance department that monitors accounts and transactions and updates customer information on a regular basis. Proper documentation and record keeping has to be maintained, while correspondent banks have to be carefully chosen after examining their due diligence procedures.

5.7.2 Obstacles

In the rich urban areas of Pakistan, very few obstacles to efficient remittance flows remain. The network of banks and ECs is widespread, the cost is reasonable, and the speed of transfer is prompt. However, similar facilities are not available to low-income and rural areas. SBP has stimulated outreach by its recent branch policy, whereby banks with 100 branches or more are required to have 20 percent of their branches in rural areas. EC expansion in rural areas is severely restricted, because their online systems require phone and Internet connection. However, as mobile and wireless penetration becomes more common, this will improve. A computerized-kiosk system with low-cost ATMs has permitted a considerable expansion of remittance services coverage in rural India (Box 5.7).

Box 5.7: Kiosks to Help Rural Outreach

ICICI Bank, a private Indian commercial bank that evolved out of a national development bank, offers a wide range of financial services, including money transfers sent to India by nonresident Indians. In 2004, the bank's "Money2India" service had over 670 agent locations and recently extended its outreach to remote village centers via computer kiosks.

The computer kiosk system work as follows: a sender remits a money transfer to the recipient's ICICI account, either through an ICICI branch office or a Money2India agent. As soon as the transaction has taken place, the Money2India agent informs the kiosk operator, who in turn informs the recipient. The recipient can then either collect the remittance at ICICI or the kiosk, which is equipped with a low-cost ATM. ICICI estimates that kiosks can be profitably placed in villages as small as 2,000 residents. This option is very attractive for rural recipients, because it eliminates transaction costs involved in traveling to a larger town to visit a bank branch.

Kiosks used by ICICI bank offer a combination of telephone, financial, educational, and other services. Kiosk operators are independent business people, remunerated through commissions paid by service providers and user fees paid by customers. They pay for set-up costs themselves, for which they typically obtain a partial loan from ICICI Bank. Since ICICI Bank does not incur any fixed costs, the system has proven a cost-effective way for the bank to extend its outreach to rural areas.

In mid-2004, approximately 150 kiosk operators offered ICICI services and the bank hoped to increase that number to over 2,000 in approximately 12 months. From an operator's perspective, the business model is only viable if multiple services are routed through a single kiosk. However, experience indicates that the kiosks can become profitable even without the money transfer service, which can easily be added at a later date.

ICICI Bank was able to offer its Money2India service due to a confluence of circumstances: (1) the inventors of the kiosk system were seeking appropriate business applications for it, (2) the technology suited the needs of ICICI, and (3) other nonfinancial service providers, such as companies that offer educational and health information/diagnostic services, also opted to use the kiosks, creating multiservice businesses that ensured operator profits. These circumstances, and therefore the transmission system for Money2India, may be somewhat difficult to replicate in other countries. However, the example of computer kiosks with low-cost ATMs may represent a cost-effective way for financial service providers to expand the outreach of money transfers, as well as other services.

Source: Consultative Group to Assist the Poor (2005)

Pakistan Post has the best network in rural areas, though there is space for much efficiency improvement. HBL had an agreement with Pakistan Post to deliver remittances to rural areas where they do not have branches, but delays in the processing and delivery of money orders led HBL to cancel the agreement.

A further issue remains in formalizing informal remittances, especially domestic flows. A large percentage of people do not consider Pakistan Post or formal banking sector as options because they feel these are too complicated and inefficient.

An obstacle specific to the Gulf area is that most of the immigrants from Pakistan are illiterate and are shy of going to banks to remit money. These people find it much easier to send money through *hawaldars* whom they know and trust. The convenience and simplicity of *hawala* cannot be matched by banks, as remitting money through banks requires a process of first going to the bank, then waiting for the recipient's bank to be credited, and finally the recipient traveling to the bank to withdraw the payment. With *hawala*, the money is delivered to the recipient's doorstep.

An important barrier for mobilizing remittances through formal channels from the USA is that the people who generally send money earn in cash and do not have bank accounts. They are undocumented and unbanked, and it is not possible for them to go to a bank or an MTO. Furthermore, the worker class is also unfamiliar with these organizations and prefers the trust-based mechanism of *hawala*.

The key drivers of the formalization of remittance flows include cost, ease of access, identity requirements, trust, and financial (and technological) literacy. If formal services can be made cheaper, easier to access, user friendly without prohibitive identity requirements, and with appropriate education to alert people to the

benefits of formal systems and how to use them, then this will significantly help bring informal flows into the formal sector. New technologies, such as branchless banking, offer significant potential to reduce transactions costs and so can allow new business models for previously unreached areas to become viable (as noted in section 5.6 above). They also are convenient and access rural or other hard-to-reach areas where traditional bank branch models are unviable, and so offer great potential towards the key drivers of formalization.

5.8. Suggested Avenues for Action

There are vital roles for both the government and the private sector to play in harnessing remittances for access to finance. The private sector should be fundamentally responsible for providing financial services, and the government needs to ensure to the extent possible that the business and regulatory environment is conducive to the private sector provision of safe, efficient and equitable financial services.

The most comprehensive step to increase access to remittances and potentially to harness access to other financial services would be mobile banking solutions. Over half of the population already regularly uses a mobile phone and econometric analysis has highlighted that remittance users are likely to be regular mobile phone users. Mobile phones are affordable, and the network has expanded immensely in recent years, and mobile payment platforms offer significant potential for lowering cost and increasing outreach for the rural poor.

One concrete way to make progress in the sector would be to form a public-private working group on remittances. This would enable a dialogue between the government and private companies (banks, ECs, and MTOs, as well as telecoms where relevant) to tackle key challenges in the sector. Discussion could focus on, among other things, legal and regulatory issues, market transparency, competition and cost, as well as research and data issues. The UK has had a successful experience in this regard with a Public-Private Working Group on Remittances, which led to the creation of a private sector-led U.K. Remittances Task Force. The World Bank has also convened a similar group at the international level bringing together key actors from the public and private sectors. Pakistan can draw on this considerable experience.

5.8.1. Private Sector Actions

Reducing informality: Informality will decrease upon the introduction of efficient, low-cost, easy-access, user-friendly, and trusted remittance services, without prohibitive identification requirements.

Developing new technology-based models for financial services: Several new remittance technologies, such as transferring money on prepaid cards or mobile phones, are already in use in various countries; however, only online transfers are available in Pakistan.

SBP has issued guidelines for three models of branchless banking: first, where banks work with a particular telecom provider to offer services to the current customer base of that provider; second, where banks offers mobile phone banking services to their own customers using the mobile connection of any telecom; and third, where a group of banks and telecoms jointly provide a service.⁷⁹

New technologies, such as branchless banking, offer significant potential to reduce transactions costs and so can allow new business models for previously unreached areas where traditional bank branch models are unviable. There is a lot of activity in this sector and both banks and mobile phone companies are working to come up with viable models. UBL has launched a product that provides services for paying bills, transferring money between customers, and buying phone cards. Bank Al-Falah is currently testing a mobile banking

⁷⁹ Guidelines available at www.sbp.org.pk

product with Warid Telecom, and Etisalat of the UAE; it has signed a contract with Smart (of the Philippines) to offer remittance services in the UAE. Banks and telecoms companies should work to develop further money transfer and mobile banking services in Pakistan.

Expanding bank presence and service provision abroad: The limited presence and outreach of Pakistani banks abroad is the main problem they face in increasing remittances through their networks. Foreign banks are more easily accessible to remittance senders abroad, but these may provide a slower or more expensive remittance service to Pakistan, and may not have significant outreach in rural areas. New measures should be taken to increase outreach abroad, particularly in the major remittance source countries. These could be new partnerships, or new innovative ways to reach customers. HBL managed to gain market share by reaching out to the workers in the Middle East. A similar strategy could be followed in all countries where a sizeable Pakistani worker community exists. Once these workers, who are the main senders, are part of the process and a system is set up to fit their needs, the volume of remittances will grow further. Moreover, if they are given incentives or bonuses based on the amount they remit, they will become more diligent with sending money. One caveat to keep in mind is that the literacy level is low and so paperwork should be kept to a minimum and technology interfaces should not be excessively complex. In addition, the recipients of remittances are generally women or elder groups, for whom convenience is most important. For this group, models that are based on doorstep delivery would be most suitable.

Forming new partnerships within Pakistan: Within the Pakistani financial market, partnerships and linkages between different institutions should be developed to facilitate access to remittances and other financial services by the rural poor. For example, commercial banks should explore working with MFBs to expand their networks in rural areas.

5.8.2. Government Actions

Creating an enabling environment for the private sector: SBP has taken significant steps over recent years to improve the remittance market in Pakistan. It has in some cases provided more options for branchless banking such as to the Post Office, fuel distribution companies, and other chain stores, or issued guidelines for branchless banking, but the private sector has yet to fully respond to these areas. There may be other barriers or lack of adequate incentives preventing the intended response, and hence the government should talk to the private sector to understand these barriers and work to remove them where possible. Telco-based models such as G-cash and M-Pesa have shown some limitations, most importantly the lack of prudential regulation with the attendant security and supervision shortcomings, as well as the narrow range of services that could be provided by such models. Regulatory reforms that may be required include amendments to the Payment and Electronic Fund Transfer Act and Branchless Banking regulations providing for bank-nonbank partnership and use of agents in money transfer services. A data privacy or security law can facilitate e- or m-payments.

Continuing to bring informal remittances into the formal system, particularly on the domestic front: An enabling environment for the private sector, encouragement for opening of bank accounts, as well as improved postal office efficiency will have an additional effect to continue attracting remittance flows to the formal sector. However, until efficient, cheap, easy-to-access, user friendly without prohibitive identity requirements and trusted methods penetrate throughout the country, including in rural areas, demand for informal remittances, particularly on the domestic front, will be important. Advances in technical and financial literacy will matter as well, with appropriate education to alert people to the benefits of formal systems and how to use them.

Supporting remittance services of Pakistani banks abroad: Further encouragement for Pakistani banks might be required to continue to boost international remittances and forge alliances with international banks. One potential strategy would be to set the reimbursement rate through partner banks higher than those

coming solely through Pakistani bank networks. Alternatively, a small fee could be charged to senders when they use partner banks in international countries.

Pakistani missions abroad could do a survey of options available in their respective markets and disseminate the information to immigrants on the cheapest and best sources of money transfer. For example, the Mexican mission in the USA publishes such information. A further successful policy carried out by the Mexican embassy in the USA is that it has issued a type of identification card (*Matricula Consular*) for their immigrants, and with this card Mexican immigrants into the USA can open bank accounts. Perhaps the GOP can discuss something similar with the U.S. and other authorities.

Encouraging the opening of bank accounts: Another step that SBP should work toward is encouraging people to open bank accounts, as supported by positive perceptions on accessibility and safety of bank branches as a remittance channel. The high share of banks in the international remittance market in Pakistan also indicates that increasing bank accounts should help increase remittances through formal channels. Currently, the minimum account balance of Rs 10,000 is prohibitive for a large segment of the society⁸⁰. To encourage people to open bank accounts, uncomplicated paperwork and less-stringent balance requirements are needed. Banks currently handling remittances can credit accounts within 24 hours; however, delivering money or sending money orders by the Post Office creates unnecessary delays, and the banking sector loses customers to MTOs and informal means of transfer.

Seeking to improve the efficiency of the postal remittance service: Pakistan Post has a significant network and strong outreach in rural areas. However, services can be inefficient. Government should explore ways to improve this service and speed up the automation of postal branches.

Promoting the structuring of international flows into investments: Channeling remittance flows directly into investment in the tradable sectors of the economy has been pursued successfully in the international experience, to counteract loss of international competitiveness associated with elevated remittance flows. International good practices include packaging remittances with payment services (such as Bansefi in Mexico). Successful policies to structure international flows into investments have also focused on organizing and targeting Diaspora networks rather than actual remittances flows. At the macro level, Diaspora bonds issues (for example, in Ghana, India, and Israel) or securitization of future remittances flows (in Brazil and El Salvador) have been used, although securitization has proven costly. At the micro level, governments have facilitated targeted Diaspora funds.

Remittances to Pakistan are of considerable economic importance, including domestic flows, and have grown quickly in recent years, providing foreign exchange, improving the balance of payments and external debt position, and supporting incomes of poor and vulnerable groups. Transmission networks work well in urban areas, though outreach to rural and remote locations are difficult, and services are not sufficiently customized to client needs (such as women who might need doorstep delivery). The large network of Pakistan Post offers promise for the future, but considerable gains in efficiency are required. SBP has taken various measures that have significantly increased remittances through formal channels, though a large share of domestic remittances remains informally transferred. To stimulate outreach to remote locations, SBP has been encouraging the private sector to provide mobile banking solutions. Other solutions from international experience include Indian innovations such as the NGO Adhikar, which developed an efficient domestic customized transfer service, and ICICI Bank, which extended its outreach to remote village centers via computer kiosks. New partnerships among remittance market players and other financial entities both within Pakistan and abroad hold much promise. Further advances in formalizing money transfer flows will bring new clientele and motivation for efficiency gains and customization of services to client needs.

⁸⁰ In an effort to encourage the opening of bank accounts, SBP introduced Basic Banking Accounts (BBA) in 2005 as a new product, with no minimum balance requirements and a minimum opening balance of only Rs.1000.