Main points

I. Salient facts

II. Main policy issues regarding remittances

III. Financial sector development and remittances
I. Salient facts

- First, the definition: remittances are defined as workers remittances, employee’s compensation, and migrants transfers (World Bank and IMF 2005)

- Note that data refers to officially recorded flows, albeit unrecorded flows are believed to be just as important. Key sources: IMF WEO April 2005 and World Bank, Global Economic Prospects: Economic Implications of Remittances and Migration, November 2005
World’s Top Remittance Provider Countries

(In billions of US$, 2004)
Main remittance recipient regions

(In billions of US$, 2004)
Main remittance recipient countries by volume (US$ bn, 2004)

- India
- China
- Mexico
- Philippines
- Morocco
- Serbia
- Pakistan
- Brazil
- Bangladesh
- Egypt
- Vietnam
- UK
- Germany
- Belgium
- Spain
- France
Main remittance recipient countries by share of GDP (2004)

- Tonga
- Moldova
- Lesotho
- Haiti
- Bosnia & H.
- Jordan
- Jamaica
- Serbia & M.
- El Salvador
- Honduras
- Philippines
- Lebanon
Remittances are growing faster than private capital & ODA
More facts

- In addition to North-South, increasing importance of South-South corridors, accounting for between 30%-45% of flows (China, Russia, Malaysia)

- Informal remittances can be very large (see graph)

- Remittances are likely to grow further because of age asymmetry between developing and mature economies
Remittance transfer costs can be high

- **Total costs (fees + X spread) can be very high:**
  - Weak competition
  - Exclusivity arrangements
  - Lack of transparency
  - Lack of technology support and payments systems
  - Burdensome regulations

![Graph showing remittance costs in different countries](chart.png)
II. Main policy aspects of remittances

- Understand the size and nature of flows
- Macroeconomic impact of remittance flows
- Government policies affecting remittance flows
- What policies can contribute to reducing the cost of remittance transfers?
- Regulatory framework
Understand the size and nature of remittance flows

- Estimate total flows to include estimated informal flows – an instrument is polling (Latin America)

- Improve official data collection – recommendations by an international working group

- Geographic and demographic characteristics of corridors – both recipient and sender country

- Motivation of sender: family support, start-up business capital accumulation, replacing state-provided social safety net (BiH), or possibly ML
Macroeconomic impact of remittance flows

- **Growth**: no statistically significant long-term impact. However, remittances are proven to alleviate credit constraints and thus can stimulate economic growth.

- **Often most stable and counter-cyclical** source of foreign exchange. As such, it helps
  - Countries cope with external shocks
  - Country credit ratings and thus savings in interest (estimated spread reduction of about 150 to 330 basis points)

- **Dutch disease** (REER appreciation/property price increase): yes, but interestingly not leading to permanent erosion of competitiveness. Why?
  - Remittances are private transfers that do not lead to wasteful spending/corruption
  - No exchange/REER volatility given its stability
  - Evolves over time allowing for economic agents to adjust
Macroeconomic impact of remittance flows

- **Remittance securitization** can help raise external financing

- **Poverty**: strong positive impact, including reducing vulnerability to economic shocks. No impact on inequality

- **Money laundering** – probably not a major risk but needs to be monitored

- **Financial development** (see later in detail)

- **Brain drain**?

- **Impact on fiscal accounts** in sender countries. Various studies have shown that the impact is small.
  - **US**: irregular immigrants impose net cost (education)
  - **UK, New Zealand**: net positive impact
  - **Sweden**: short term net cost longer term positive net benefits;
  - **Germany**: can be positive if the gov. selects for skills.
  - **Special issue**: impact on gov. financed pension schemes: positive in Germany and Spain
Key government policies affecting remittances

Remittance-receiving countries

- Competition (US example)

- Regulatory framework – need for light touch (see later)

- Relaxation of exchange capital controls → very powerful
  - Unification of exchange rates (Bangladesh, reducing the informal *hundi* business)
  - Relaxation exchange & capital controls:
    a. Legal to hold forex deposits (large impact in Africa & South Asia)
    b. Eliminating exchange controls quadrupled remittance inflows in the Philippines the same year
Other important government policies

- Generally no tax (abolishment of such tax in Vietnam, 1997, boosted formal flows)
- Travel & customs privileges for returns and M of goods (Turkey, Vietnam, Tunisia, Pakistan)
- Allowing domestic banks to operate overseas (including microfinance institutions)
- ID cards for migrants, regardless of legal status, which is recognized by sender country banks. E.g. *matricula consular* Mexico; Tunisian *carte consulaire*.
- Support to hometown associations and matching grants to engage migrants in the development of home local communities.
- Loans/pension schemes/bonds targeted at diaspora
Policies in remittance sender countries

- Only a few have active remittance-supporting policies
- Immigration policies
- Greater competition in money market transfers
- ID arrangements to help access
- Support to migrant associations
Lessons from the decline in transfer costs in the US-Mexico corridor

- Cost of sending $300 declined by 60% from $26 to $11 between 1999-2005:

- Competition is greatest factor:
  - Ending exclusivity contracts
  - More bank entry

- ID cards (matricula consular)

- Public sector support and increasing awareness (Mexican-US governments, IADB)

- Result: officially recorded remittances almost tripled from US$6.6 billion to US$19 billion

Source: World Bank 2005
Remittance flows are an important source of external funds for many countries.

Part of such flows may go through informal remittance systems.

Informal remittance providers may pose a risk of misuse for money laundering (ML) and the financing of terrorism (FT).

Need to address ML/FT risks

- The FATF special recommendation for a regulatory framework
  - Bring informal providers into formal arena
  - Do not impede flows nor drive remittance underground

- Correct weaknesses in formal sector and raise competitiveness to attract a bigger share of remittance flows

- Improve information and data on remittance flows and systems
Options for regulatory framework

- **Registration or licensing?** Depends on domestic circumstances and regulatory practices
  - Registration raises few barriers and thus may encourage participation but requires ex post resources for monitoring
  - Licensing may discourage participation, but requires less monitoring and protects integrity

- **Oversight should be flexible and commensurate with risk of misuse**

- Remittance providers should be consulted before regulations/requirements are introduced

- Requirements should be clear and simple

- **Prudential requirements seem unnecessary** → proportionate to risks
Capturing remittances by the financial sector is important for a number of reasons:

- Helps reduce informal flows thus address ML/TF concerns
- Helps private sector development when remittances are considered as part of recipient’s income and can back loans such as mortgages, education, start-up of business
- Banks’ cross-selling of bank products open access to clients who otherwise would not have it due to low income levels (“banking the un-banked”)
• Formalized remittance flows with competition among banks can reduce transfer costs

• Steady flow of remittances can be used to obtain medium and long-term funding either by borrowing directly or through capital markets via issuing “remittance securitization bonds”
To what extent remittances are “banked” today?

- The subject is being discovered
- Depends on region
  - Latin America
  - South Asia
  - Former centrally planned economies – an example of nascent corridors
Annual remittance flows are almost as much as the total stock of bank deposits.

There is a big potential to keep a larger share of remittances in the banking sector.
Similarly, big potential for banking remittances flows
Tajikistan

Annual remittance flows are multiple of total bank deposit stocks

Tremendous potential to “bank” remittance flows

Bank deposits 2004
Change in dep, 2004
Remittance flows, net

(millions of US$)
Results of a bank survey on remittances in the region:

- Banks and money transfer companies are involved in South Eastern Europe, but only banks in former Soviet Union countries
- Products are typically limited to checking accounts or money transfer without opening an account. Very limited securitisation of future receivables, including some remittances
Remittance-related products

- Technical innovations for easy transfer and access
- Remittance-based products
- Remittance-backed funding: a way for banks to borrow by using as collateral the future flow of remittances
  - Allows funding of banks
  - Helps maturity lengthening
  - Gives incentives to banks to reach out and bring more informal remittances under the formal sector
  - With involvement by an IFI, use of funds can be “earmarked” for development purposes
2 types of remittance-backed funding:

(a) **Direct loans to banks.** IFI Bank to lend directly to a bank and secure the loan by assigning the flow of remittances from abroad (e.g. through an off-shore trust)

(b) **Securitized remittance bonds** in the local and international capital markets. In LatAm, 40 remittance securitizations in a an amount of US$6.5 billion (Mexico, Brazil, El Salvador, Peru)
Task Force on best/good practice in remittance transfers

5 General Principles:

1. Transparency and consumer protection

2. Improvements in payments systems to increase the efficiency of transfers

3. Key features of the appropriate legal and regulatory environment for remittances

4. Market structure and the importance of competition

5. Appropriate governance and risk management practices in the remittance industry.

It also addresses the issue of roles and responsibilities of both remittance providers and the public authorities, including central banks.

Consultative Report has been published and available at http://www.bis.org/publ/cpss73.htm.
Overview of Main Policy Issues on Remittances

Presentation at the WBI Conference on Capital Flows and Global Imbalances, Paris, April 6, 2006

Piroska M. Nagy