



CIUDADANÍA Y VALORES
FUNDACIÓN

II SIMPOSIO INTERNACIONAL DE INMIGRACIÓN
INMIGRACIÓN Y DESARROLLO: LAS REMESAS

Remittances as a Potential for Deepening Development Finance

Youssef El Khalil
Director General de Política Financiera
Banco de Líbano

Madrid, 28 de marzo de 2008

Remittances as a Potential for Deepening Development Finance

Youssef El Khalil
Director General de Política Financiera
Banco de Líbano

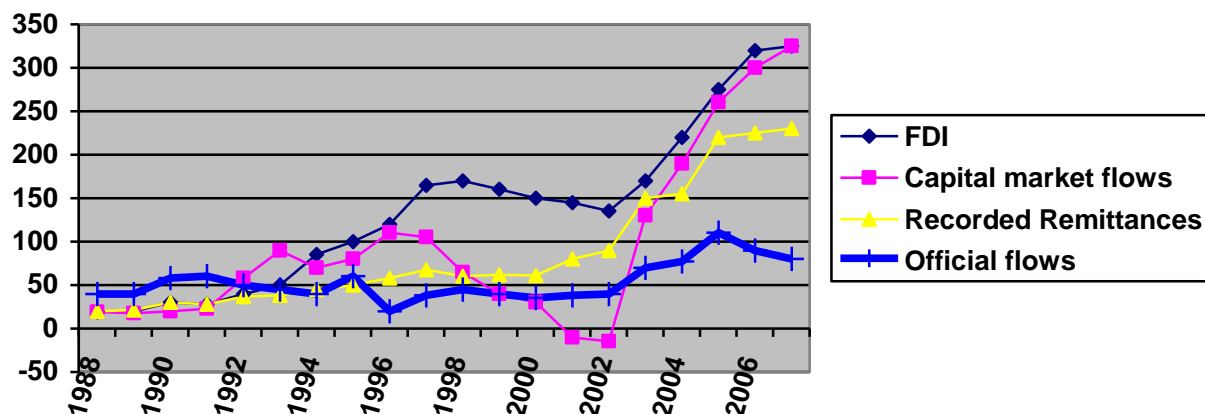
There has been a significant increase in the level of interest devoted to remittances in the media as well as in the academic and financial spheres during the past few years. This surge has revived the debates of the seventies of the past century concerning the benefits and costs of migration.

Remittances are the byproduct of labor mobility from low income regions to richer markets in reaction to poverty and hardship. Migration and remittances have characterized humanity since the early times of civilization as people have been migrating to escape deprivation, wars, and adversity associated to political and economic crises in general. The industrial revolution era was characterized by massive waves of migration from the rural sector to the cities within the market process of allocation of resources. More dramatic waves were witnessed during the Irish potato famine in the mid 18th century or the East- Mediterranean famine at the end of the First World War while the present time daily tragedies endured by the African migrants witness to the human odyssey of suffering within a context of polarized dualism between the rich and the poor.

Magnitudes and Trends

The volume of identified remittances targeting less developed countries is increasing with time and is estimated to have attained \$240 billion in 2007. It has surpassed the volume of official development assistance since 1996, and is rapidly closing the gap with Foreign Direct Investment as a major source of foreign earnings to non oil producing emerging countries for the last ten years.

Figure 1. Remittances and capital flows to developing countries (1988-2007)



Source: Dilip Ratha (1988-2002), Dilip Ratha, Sanket Mohapatra, K.M. Vijayalakshmi, Zhimei Xu (2003-2007)

While some of the increase in the recorded remittances might be caused by more migration due to globalization and to the surge in economic activity in intensive labor importers such as the oil producing countries, an essential part of the recorded increases is probably due to the improvements in the recording of financial transfers by statistical agencies and central banks. Another part of the increase may be attributable to the fact that remittances are now more often than before transferred through formal and regulated channels relying on either the banking or recognized money transfer entities such as Western Union or Moneygram or others.

While remittances, in volume, go mostly to China, India and Mexico, they represent a more significant relative amount to smaller middle and low income countries such as Tonga, Haiti, Honduras and Lebanon where they exceed 25% of GDP. Remittances, and especially for the more dependant countries, can generate important benefits when perceived as participating in closing the savings and foreign exchange gaps as they transfer wealth from the richer countries to the poorer ones through the current accounts part of the balance of payments. This transfer, furthermore, is less volatile than foreign direct investment or portfolio investment and can be perceived as being contra cyclical when stimulated by favorable economic situations in the rich markets at times of economic turbulence or political crises in the labor exporting countries. Taken to an extreme, however, too much migration in dire times can have negative socio-political repercussions. This, and to a large extent, has been the situation in Lebanon where massive migration has been an essential part of a vicious circle where an obsolete political system

produces crises, causing migration which generates income that finances and rejuvenates the crises producing system .In this instance remittances through migration can be perceived as a safety valve and a continuity provider to the system. The literature, of course, states other negative impacts of migration such as “Dutch disease” syndromes where relatively high financial inflows cause an appreciation in the foreign exchange of the national currency and thus a decrease in competitiveness.

Table 1. Remittance flows to developing countries to reach \$240 billion in 2007 (\$billion)

INFLOWS	2002	2003	2004	2005	2006	2007	Change 2002-07
Developing Countries	116	144	161	191	221	240	107%
East Asia and the Pacific	29	35	39	47	53	58	97
Europe and Central Asia	14	17	21	29	35	39	175%
Latin America and the Caribbean	28	35	41	49	57	60	115%
Middle East and North Africa	15	20	23	24	27	28	86%
South Asia	24	30	29	33	40	44	81%
Sub-Saharan Africa	5	6	8	9	10	11	116%
Developing Countries	116	144	161	191	221	240	107%
Low-income countries	32	39	40	46	56	60	88%
Middle-income countries (MICs)	84	105	121	145	166	179	114%
Lower MICs	55	68	76	90	102	112	103%
Upper MICs	29	37	45	55	63	67	136%

Source: Dilip Ratha, Sanket Mohapatra, K.M. Vijayalakshmi, Zhimei Xu, *Remittance Trends 2007*

The volume of the sent back earnings depends strongly on the counties of destination of migrants. A specific region of destination for instance is the Gulf where migrants see limited chances of future integration and would thus aim at sending more remittances aiming not only for supporting home families but, as well, for their future return to their country of origin. In general; migrants to industrially advanced countries tend to be more easily assimilated to their countries of destination than those who migrate to less developed nations or to countries of strict integration policies. This might be of special importance in the future as richer economies are adopting more restrictive policies which favor the settlement of the skilled, thus leading to a situation where remittances would more and more be produced by the unskilled and target the poorest households in the countries of origin.

The Developmental Potentials of Remittances

The developmental impacts of remittances in general ought to be placed within the dualistic structure of the global economy. International migration should be perceived as a rational strategy of survival of individuals and families in poor countries to cope with poverty and adversity, leaving a less lucrative market to a more promising one.

While the effects of remittances on the macro level and the Balance of Payments are rather obvious and are put within the context of closing the Savings and the Foreign Exchange gaps, they become more controversial when put within the recipient families context as they manifest economic implications with respect to capital formation, production and the development of the poorest segments of society.

The debated questions relating to the developmental impact of remittances on families address their effect on education, health, and the accumulation of capital. The suggestion that the migrant builds up skills to be invested back home upon return is often challenged on the basis that migrants do not acquire much valuable skills when working in the lower segments of the developed economies' markets or that when acquiring skills, those would not be adaptable to the original countries production structures. Questions are also raised with respect to whether remittances encourage dependency on behalf of the receiving families and might then be discouraging investment. Worries are formulated, furthermore, that remittances can increase income disparity and cause inflation in the zones of poverty.

Such questions are of special importance since remittances are sent by workers who are often the main bread earners of the family and are always endowed with enough energy and risk taking qualities that enable them to endure migration, and thus the opportunity cost of their choice to their families should be accounted for in a proper cost benefit appraisal of remittances earning.

The positive returns of remittances are reflected on different levels. The World Bank estimates that a 10% increase in the ratio of remittances to GDP in a given country leads to a 1.6% drop in the share of people living under poverty. The direct effect is an increase in the standard of living of the recipient families as more than two thirds of remittances are assumed to be spent on consumption. In second position comes spending on improving human capital through spending on education and health services. Studies in Latin America and Asia have shown that children from remittance receiving families enjoy a lower school dropout ratio. It is assumed that a 10%

increase in remittances in the Philippines leads to a 1.7% increase in school attendance.(Coss, 2006) The remaining goes on acquiring physical assets such as land tools, machinery equipment or livestock, a proportion goes on home improvement or on financing the traveling costs of other willing to migrate members of the family On an extra household level, remittances often serve collective or community based projects and tend to increase in times of natural disasters and wars.

Using Remittances for Development Finance and Integration

While the effects of remittances on the development of households with respect to spending on consumption, education, health and community services is relatively clear, more focus is being given to the effects of remittances on savings and investment. Remittances have a great potential on increasing the financial and economic integration of the recipient families and the sending persons. Remittance receivers in Latin America and the Caribbean are 10% more likely than non recipients to have a bank account (Coss).In Mexico and Albania remittances are responsible for 27% and 17% respectively of capital invested in micro enterprises, while the World Confederation of Credit Unions estimates that 10% of remittances channeled through them go into savings (Berne, 2004).

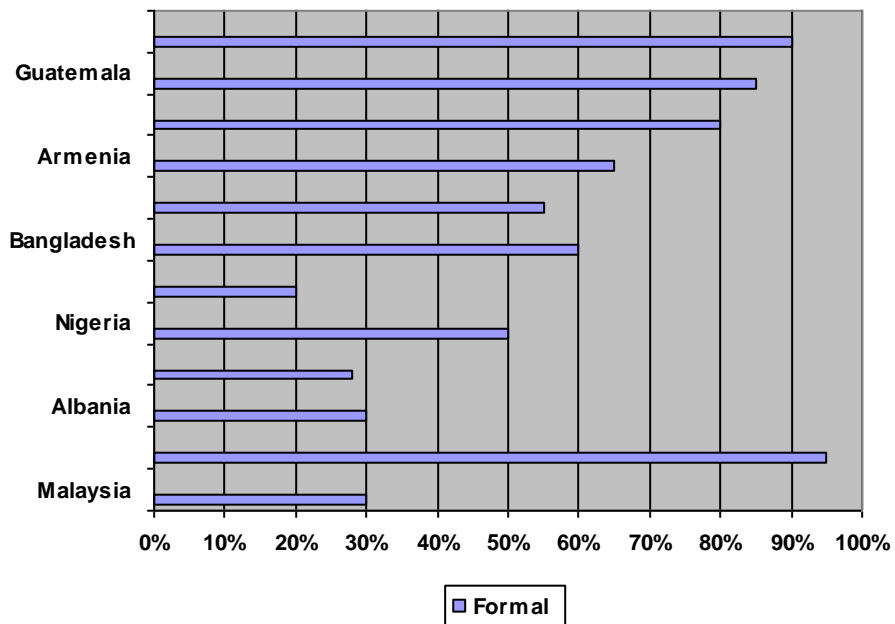
The most active remittance service providers within the formal channel are the commercial banks and MTOs and precede postal banks and credit unions. The attractiveness of this formal corridor to the remittance community is mainly based on risk aversion amongst senders. Banks can provide cash to cash, account to cash or cash to account services and are usually used by the higher income bracket group members and by legal migrants. Their costs are generally higher and require the ability of senders and receivers to be able to surmount the legal, financial and geographical obstacles to opening accounts.

By contrast, the informal remittances service providers are cheaper, however less institutionally secure and rely on trust. The Hundi, Halal and other money transferring channels can use basic communication systems such as letters, telephone communication or faxes, relying on small operators such as traveling agents, foreign exchange dealers, community shops and others. Operations in the informal sector are getting more difficult however with the rising security concerns pertaining to the international flows of capital and should favor the flourishing of the formal service providing channel.

Commercial banks have been slow in adopting aggressive policies with respect to remittance providing services given the fragmented nature of the market and are more attracted to standardized larger amounts of transfers while the legal status of migrants constitutes a major worry. The trend, however, is changing, especially in Latin America where more and more products are sold to small depositors from both the sending and receiving sides. It is to be noted here that a major boost of the formal remittance channeling sector in the American continent has been the acceptance of the U.S. authorities that Mexican workers can open accounts based on their Mexican issued ID's rather than on US migration issued papers. Thus has allowing non permanent immigrants to join in the formal channels (figure 2).

New money transfer operators are slow to join in because of strict regulation and a perceived high cost of establishment. Requirements pertaining to capital adequacy and safe banking supervision standards and the prices of licenses are often seen as prohibitive by potential entrants. The BIS, among others, encourages more dialogue and the adoption of international agreements in order to improve the remittance transferring channels. (Coss, 2006).

Figure 2. Estimated Use of Formal vs. Informal Transfer System

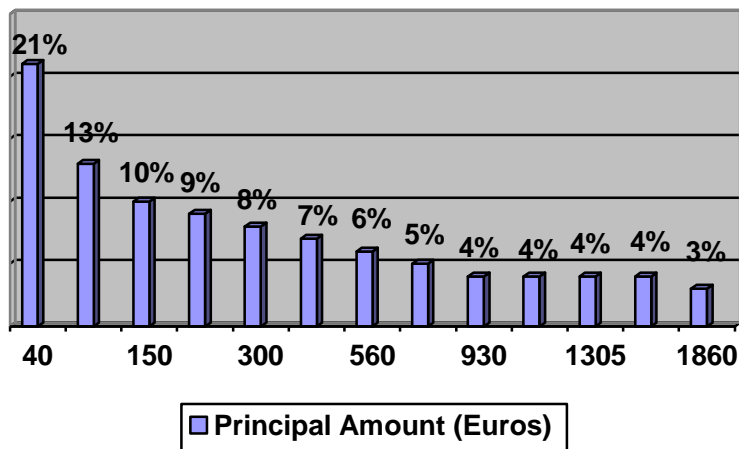


Source: Coss, Raul-Hernandez, *Observations in Remitting and Receiving Countries*, September 2006

Encouraging development finance through remittances requires the understanding of the cost structure and concerns from both the remittance sender-receivers and the service providers sides. While the service providers' concerns dwell on regulatory frameworks, technological choices, legal constraints and economic prospects, the senders' concerns focus on cost, speed and the reliability of services. A fragmented market and rigidities are causing relatively high market prices.

From the sender's point of view, the price of the acquired service should be perceived as: $P = \text{explicit fee} + \text{exchange rate spread} + \text{value date differentials}$. Minimizing the price of remittance transfer services requires the minimization of the components of its charges. Most importantly, the charged explicit fee can be decreased with more competition. The limited number of suppliers (three major MTOs) and the scarcity of interested banks are making the major service providers enjoy a monopolistic position thus charging fees that are higher than their Marginal Costs. New entrants, on the other hand are attracted by the market of remittances when able to serve a large number of clients which would enable the bundling small amounts of money into bigger packages thus minimizing average costs (figure 3) while enabling standardization in the transfer operations through more efficient economies of scale. More competition in the US, triggered by facilitating the legal access of migrants to banking accounts, has allowed fees to decrease by 55% between 1999 and 2004 (Ratha et al., 2007). This remains a strong indication that formalizing the legal status of migrant encourages greater access to formal channels and increases efficiency and safety.

Figure 3: Remittance costs are high, and regressive



S

Source: Dilip Ratha, *Why should we care about workers' remittances? And what should we do?* January 2004

Economic efficiency requires, as well, the dissemination of information to market agents. Studies pertaining to remittances and the factors affecting their flows by sources, destinations (the so called corridors), skill levels of senders and uses of receivers are increasingly well documented. More should be undertaken and circulated with respect to the profitability of formal remittance servicing. More information should also be distributed to the remittance senders/receivers community with regards to costs, risks and byproducts linked to remittance sending and the benefits and leverages obtained when opening banking accounts.

The entry of new Money Transfer Operators should be encouraged through redesigning regulation aiming at striking a balance between capital adequacy and anti money laundering concerns on the one hand, and facilitating the channeling of remittances through cheaper, more secure structures that can enhance the development of parallel products on the other. Questions must be answered with respect to capital adequacy ratios for non position taking MTOs and to whether small scale remittances can actually be of significant threat to anti money laundering concerns. Coordination between source and destination countries to harmonize compliance would help into standardizing the requirements.

An important segment of the remittances industry shares a lot of characteristics with the microfinance industry. The small fragmented amounts, together with the income levels of the targeted recipient families and the potential for investment in micro enterprises can create important opportunities for synergies between commercial banks, Money Transfer Organizations and other institutions from the formal channels on the one hand, and microfinance institutions and other community based organizations in the informal channel on the other. Unable to serve fragmented amounts in remote or poor areas, banks and MTOs can develop contractual relations with MFIs, NGOs, or rural development banks and others to use remittances as leverage for encouraging savings, investment in micro enterprises as well as other consumer based products.

Such partnerships are starting to emerge globally and are made more feasible with the new technologies in payment systems and telecommunication. Mobile banking companies, smart cards issuers, cell phone companies and local community organizations are starting up promising partnerships in Asia, Latin America and Africa. The GSM association and Western Union have announced a project for channeling remittances through mobile phones. Vodaphone and

Citigroup have initiated a mobile banking project involving the UK-Kenya corridor of transfers. In India Visa has partnered with the major banks to offer payment services through mobile phones.

The potential for expanding remittances linked facilities for better serving the financial potentials of the recipient families is real and growing. Focus should be given, however, for more dialogue and coordination between the stakeholders in both the sending and receiving countries to provide for more workable regulations and better access to information which would encourage more penetration and competition in the market. A higher degree of penetration is possible through the building of promising relationships between actors in the fields of money transferring and development finance from both the formal and informal sectors.

Bibliography

Berne, Intercooperation, SDC's Backstopping Mandate Finance, "Remittances the money of the migrants", *Swiss Agency for Development and Cooperation*, May 2004.

Coss, Raul Hernandez, "The Impact of Remittances: Observations in Remitting and Receiving Countries", *Discussion Paper prepared for the G24 XXIII Technical Group Meeting*, September 2006.

Icard, Andre, "International Remittance Systems", *XLII Reunion de Gobernadores de Gobernadores de Bancos Centrales del Continente Americano*, April 2005.

Pozo, Susan, "Immigrants' Remittances", *Employment Research*, July 2007.

Ratha, Dilip, "Why should we care about workers' remittances? And what should we do? , *World Bank*, January 2004.

Ratha Dilip, Sanket Mohapatra, K.M. Vijayalakshmi, Zhimei Xu, "Remittance Trends 2007", *World Bank*, November 2007.

Solimano, Andrés, "Remittances by emigrants: issues and evidence", *United Nations Economic Development Division*, October 2003.