International Remittances: Issues for Action

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The flow of funds from migrant workers back to their families in their home country is an important source of income in many developing economies: for some individual recipient countries, remittances can be as high as a third of GDP. Many families in receiving countries depend on remittances to cover day-to-day living expenses, to provide a cushion against emergencies, or as funds for making small investments.

Over the last few years, this phenomenon has received growing attention, and international remittances have been put at the top of the agenda of the international debate on financial sector development. The World Bank has taken a leading role in the field, undertaking numerous initiatives, including research, policy work, standard setting, and dissemination and training. This article presents some of the most relevant issues in international remittances — issues which require immediate action to achieve central public policy objectives: that international remittance services should be safe and efficient. For this to happen we must develop access to payment services and ensure that the markets for remittance services are contestable, transparent, accessible and sound.

Improving financial inclusion

Remittances can be seen as one financial service among many that have the potential to improve the quality of life for the poor. Just as it helps to receive transfers from a migrant relative in a safe, efficient, and low-cost way, it helps to have access to savings, loans, insurance, and broader payment services. Together with other financial services, remittances are a tool to reduce risks to the poor. What makes remittances special when compared to other financial services is twofold. First, remittances are often the only financial service people use, which makes it a natural entry point for many individuals into the financial arena. Second, remittances are dependent on the conditions prevailing in several jurisdictions and geographical locations, and often on an international infrastructure. This creates competitive dynamics that require a different role by both the public and the private sector when compared to other financial services.

Because of these dynamics, remittance services can be used to create a more inclusive financial sector and expand financial services to the poor. In particular:

Where there are remittance service providers, there is financial infrastructure. These providers vary greatly in sophistication but are likely to have at least some of the following potential. They will have structures to handle cash. They are used to accounting and handling financial computer systems. They know how to operate financial communications. They provide other services that can be integrated with a wider financial services offering. If one is looking for a point from which to increase the financial services to a small community, the remittance service provider (which may be no more than a one person operation), is a place to look twice, and national remittance disbursement networks can provide a building block in the backbone.

Where there are remittance recipients, there is financial capacity. The users of remittances have already been introduced to the financial system. Very frequently, the only option for a remittance recipient is to retrieve cash and bring it home. If other options can be provided at the place of disbursement, the recipient is likely to at least consider them. Also, the place of disbursement is a natural focal point for building capacity about other financial services. Giving remittance users the option to save, build a credit history, buy insurance, and make electronic payment, can bring a higher level of welfare. In the coordinated market that is remittances, this capacity can be found and expanded on both sides: the remittance sender can learn about financial services (before migrating or while abroad) and help educate the recipient on the other side.

Remittances can be used as an opportunity to enhance trust in financial institutions, at both ends of the market. The end users of remittance service will only use formal financial institutions if they trust such institutions, and if they see the benefits of using the formal sector. Often when end users choose informal providers, they do so because they lack trust in the formal system. Conversely, many banks may view migrants as low balance, high-risk customers, unlikely to use other services. In some jurisdictions, banks are reluctant to function as settlement agents for remittance service providers because they perceive such
contracts as too risky. Bank and other financial institutions can only respond appropriately if they understand the cultural factors that make some migrants avoid the formal financial sector, and in some cases, partnerships between traditional and non-traditional institutions may help build trust. Financial institutions should have incentives to engage with the users of informal services, in order to build overall trust in the financial market.

**Alleviating risks**

If we look at remittances as an isolated service, there are two main strategies to improve that service: alleviating risks and decreasing prices. Substandard remittance services create risks to the individual in several ways. First, cash-based transfer mechanisms create physical risks. These risks appear not only in the infrastructure – getting the cash to the pick-up point – but also when the recipient retrieves cash, transports the cash home, and stores the cash to save or smooth consumption. Second, remittance service providers without proper risk management systems create a credit risk for the individual. Remittances transported in a taxi or by a courier may never arrive, and paper-based instruments, such as checks, mailed through third parties, pose reliability issues. Lack of proper accounting or receipts may lead to disputes of whether or how much remittances are due. Deferred access to remittances due to long transfer time may lead to suboptimal capital allocation.

When the remittance environment in a country meets international standards, such as the General Principles for International Remittance Services, many of these individual risks are mitigated. Such an environment provides efficiency balanced with consumer protection, which is particularly important in industries where the end users have limited resources to defend their interests.

In addition to the risks to the individual, international money transfers can pose a risk to the community. Where there is lack of oversight, a weak legal foundation, opaque market structures, and little risk management, there is a possibility that remittance services could be used to finance terrorism or launder money. Addressing this community risk creates yet another risk: the more requirements that are placed on the industry, the higher the cost to the end user, and the more likely is it that a non-compliant market will prosper. Therefore, the best way of addressing community risk is a well-balanced regulatory regime.

Equally important to making sure poor people do not have to foot the bill for over-regulation, is enforcing the regulatory regime. Whether a country decides on licensing or registration or another solution, all market players must be compliant. An even playing field promotes competition on service and costs, and in markets where the non-compliant sector is allowed to thrive, competition among compliant firms will be stymied.

**Developing contestable markets**

The question of how to best foster competition in the remittance field is complex. One of the aspects that make remittances special in the access to finance realm, is that we are just starting to understand the dynamics of the industry and its customers. It appears that end users may be as concerned with trust in the remittance service provider as with pricing (which bolsters the case for applying international standards and trust-building efforts to the industry). Even if there is perfect competition on the sending side, there is no choice for a remittance sender whose family lives in a village where the only existing firm that disburses remittances terminates from only one platform. Effective competition in remittance services requires competition on both sides of the transfer.

The economics of remittances differ from other retail payment platforms. Whereas payment platforms are typical two-sided markets, where cross-subsidizing is central, remittances are not: senders and recipients are in close contact and can coordinate their choice of platform. If a limited, closed platform provides better service at a lower total cost for the two end users, that platform will be chosen over a system where users on the two ends independently choose the service to use.

In developing contestable markets, it is crucial to understand at which level in the payments infrastructure competition is beneficial, where markets work, and where certain market structures may keep costs high. For example, we don’t have competing internets, we just have one (which lowers costs) – but we do have competing internet browser software and merchants selling over the internet (which, again, lowers costs). It is clear that exclusivity agreements on the service side – for example, allowing the postal system in one country to enter into exclusivity agreements with one remittance service provider – is a solution to be avoided.

Where there is cooperation on infrastructure – local, regional, or global – the end users must be the ultimate beneficiaries. In implementing such cooperation, it is important that the integration is stepwise and solid enough to be operationally sound and provide viable business opportunities at every step. When common infrastructure is established, entry of new participants should be stimulated through promoting transparent, proportionate and equal access criteria.

Competition on service lowers costs; still to be determined is to which extent cooperation on infrastructure can do the same. Lowering the cost of remittances has been a key focus in the development community over the last years (see Box 1). Initiatives to lower cost and develop contestable markets, as well as expand access, can be achieved through the private sector or through public-private partnerships. This, however, can only take place if the regulatory and oversight framework is appropriate. In the next section, we will look at the role of regulators in improving the remittance market.
**Improving regulation and oversight of the remittance market**

The regulatory framework for the provision of remittance services should be clear and proportionate. Authorities should always weigh the associated costs and benefits of current and new regulations in the context of the small-value nature of remittance transfers, since the end users will ultimately be paying for regulation. Innovation in the market will be hampered unless remittance service providers are treated equally in terms of the remittance services they provide. This principle applies to both sending and receiving countries. Regulations must be applied to the service (provision of remittance services) rather than the type of service provider (banks, credit unions, licensed exchange dealers). The regulatory regime should meet internationally agreed standards, such as those by the [Financial Action Task Force](https://www.fatf-gafi.org) and the [General Principles for International Remittance Services](https://www.bis.org/).  

In implementing a regulatory and oversight regime, the cross-border nature of remittance transfer requires coordination across borders. The nature of remittance flows involve legal and regulatory framework in both sending and receiving countries for each transaction. This makes it important for authorities in one country to recognize that regulatory impact on the industry is compounded by regulatory regimes in other countries. As with domestic regulations, this cooperation should be based on internationally agreed standards.  

The public authorities should get actively involved in achieving the public policy objectives of safety and efficiency in remittance services. To do this, they must specify clearly their objectives, roles, policies and instruments in this field. Ultimately, it remains the responsibility of public authorities to make sure remittance services are processed through systems that comply with international standards, since the end users will often have little recourse to ensure compliance with the principles without active involvement from the authorities.  

The authorities that are involved in regulation and oversight of the remittances industry will vary from country to country, depending on the institutional framework of each jurisdiction. Established, well functioning frameworks do not need to be changed, as long as the appropriate public action is effectively performed. In those countries where the central bank payment system oversight function has a broad scope and covers retail payments, the central bank is well placed to take the lead. In many developing countries, the establishment of an appropriate oversight framework within the central bank is determining factor in order to meet the objectives on a continuous basis.  

In places where the remittance industry has developed self-regulation, the industry itself may be well positioned to develop regulation in line with international standards, for example by developing binding codes of conduct. It remains the responsibility of the public authorities, however, to ensure that the self-regulation is sufficient: public authorities need to ensure that self-regulatory groups are effective and have adequate representation of all market participants.  

Whatever the configuration of public authorities and private associations that may be involved in developing an appropriate framework, a coherent, safe, and reliable environment can only be ensured if there is sufficient cooperation between these actors.  

**Enhancing Cooperation, Domestic and International**

Public policy objectives and principles in the realm of remittances would normally fall under the responsibility of different public authorities: payment system overseers, anti-trust authorities, consumer protection authorities or organizations, the Ministry of Finance, financial supervisors, anti-money laundering authorities, etc. Whatever the institutional framework and regardless of which authority is assigned a leading role, all authorities must cooperate effectively. Such co-operation can be organized in a structured form, where written procedures formally allocate responsibilities.  

International cooperation should take place on three levels: 1) **Bilateral corridor cooperation**: In order to ensure timely harmonization of regulations, countries that make up the ends of major remittance corridors should work together to develop common policies and regulation, adhering to global standards. Compatible and consistent policies and regulations create a better business environment and lower barriers to entry, which again increases competition. Public policy will be more effective in lowering remittance prices when coordinated between the sending and receiving countries of a corridor. 2) **Regional cooperation**: To the extent there is migration between countries in a region, substantial benefits may arise from extending bilateral cooperation to regional forums. 3) **Global cooperation**: On the level of international standard-setting, cooperation should be global in order to disseminate best practices and ensure compatibility and interoperability between remittance systems and frameworks as new migration patterns emerge.  

**Next Steps**

In this article, we have discussed many areas where developmental action is needed to improve remittance services and expand access to finance. Who is best placed to initiate this action will depend on country and topic, and may include public authorities, the private sector, industry and migrant associations, donors, and international financial institutions.  

International financial institutions (IFIs, such as the World Bank, regional development banks and the International Monetary Fund) will need to support authorities and market participants in applying international principles and best practices. The actions of the different IFIs must be coordinated and effective.
With regards to the CPSS-World Bank General Principles for International Remittance Services, the multilaterals involved in their preparation are currently developing detailed Guidelines for the application of the General Principles as well as a stocktaking methodology, which will be released by the end of 2006.

Countries can use this methodology to evaluate their remittance systems against the General Principles. Such evaluations should lead to policy recommendations, which can be implemented by authorities, service operators, and other stakeholders. In order to take stock of the framework for, and performance of, remittance services both within and among countries, existing tools can be used, such as regional initiatives in payments systems, WHF, CISPI, API, FSAPs, etc. In order to apply the General Principles, partnerships are being established; one example is the Latin America and the Caribbean program developed by the World Bank, the Inter-American Development Bank, and the Centre for Latin American Monetary Studies (CEMLA). The World Bank is involved in assessments under this program as well as in other regional initiatives, and will be open to support the implementation of action points coming out of the assessments.

**Box: Reducing prices**

The cost structure of a remittance operation can be complex, and given the multitude of platforms and business models, there is no single cost model for a remittance operation (which again makes it impractical to estimate the no profit cost of a transfer from country A to country B). Since the private sector is the primary player in the field of remittances, increasing competition is the single best way of fostering innovative cost-reducing solutions. There are already good indications from the industry of what eventually can reduce prices to the remitters.

Costs can be reduced through using less capital intensive business models (getting rid of physical footprint), integrating the remittance payment networks with other networks (such as cell phone networks), cooperating on the scale-driven elements of the infrastructure, using non-paper instruments, and ensuring that compliance with anti-terrorist and money laundering regulation take place at the appropriate level, can be done with off the shelf technology, and that responsibilities for such compliance is very well defined.

Limited access to payment instruments and channels leads to hidden transaction costs. A recipient of remittances without access to a bank account must pick up the remittance, which means going to a location to receive the payment instrument. This might not be in the place where the remitter lives, which incurs transportation and opportunity costs. Perhaps the instrument has to be taken to another place to be converted into a meaningful payment instrument for the individual, such as cash. On the other hand, a recipient with a bank account and a debit card (or a cell phone used as a payment device) never has to pick up the remittance – the funds are instantly available.

As with expanding instruments and channels, integrating remittances with other financial services can yield cost savings to the individual. One example is banks that offer no-fee remittances for their customers. This only provides a cost saving if the implicit pricing (e.g., account fees) is lower than the explicit pricing of a comparable service. An additional benefit to such cross-selling of services is that it may motivate the non-banked to also use other banking services. Such integration, on both sides, is an illustration of how remittances can be used to expand access to finance in a broader sense.

1. Source: World Bank and Inter-American Development Bank. Officially recorded flows were measured as being USD 232bn worldwide in 2005, of which USD 167bn was to developing countries. However, given measurement uncertainties, notably about unrecorded remittances, actual flows may be much higher – perhaps by 50% or more (see Global economic prospects for development, World Bank, 2006).