

Remittances and Policy Issues

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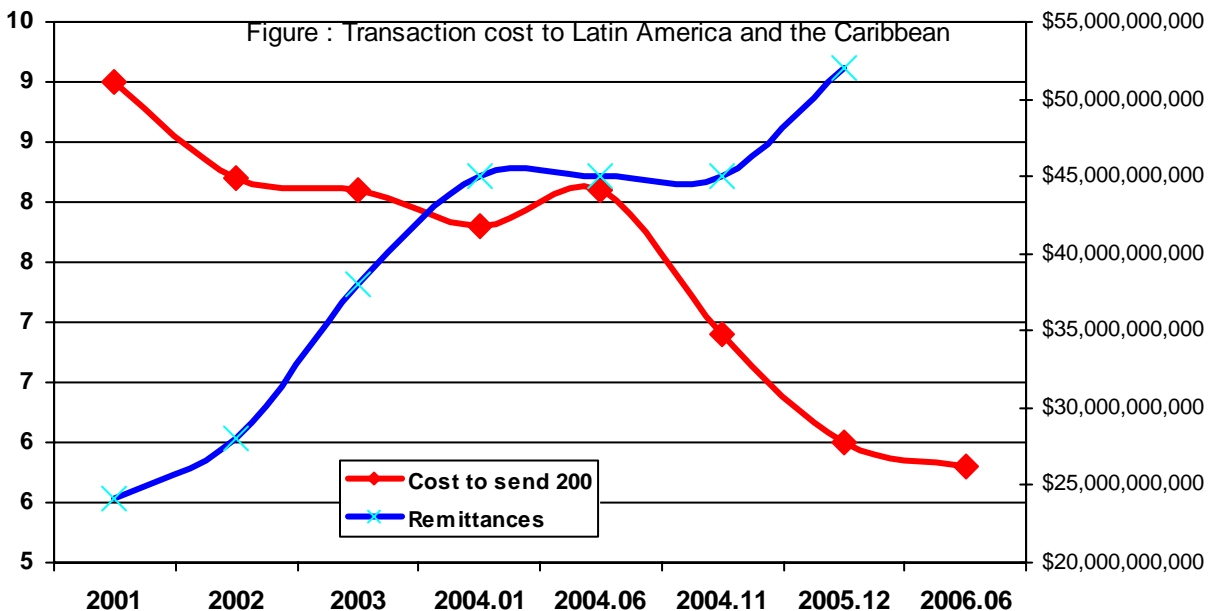
Introduction

The significance of the interaction between remittances and policy has proven essential to improving the development effects of money transfers especially due to the high volume of flows. Despite the steps forward, there are still many policy areas for improvement. Here, we identify initiatives where policy can be critically important to promote the leveraging of remittances through funds and migrant capital management.

These recommendations include improving competition among money transfer operators (MTOs) and reducing transaction costs through incentives for improved technology. In addition, financial access through microfinance institutions (MFIs) and credit unions as well as through banks should be encouraged, especially related to products directed towards remittance recipients. Governments can also promote the investment of remittances in microenterprise or other ventures. Furthermore, this can be linked to the community of migrants abroad through initiatives related to tourism and nostalgic trade. Another policy area includes designing products that offer health and education services by MFIs. Central banks can also team with the private sector to offer financial literacy programs to remittance recipients. Governments are also crucial environment enablers to promote investment and increase productivity and the development effects of remittances. Finally data collection and macroeconomic policy can be improved throughout the region to better reflect flows. These policy options are explored in this paper.

Improving competition and reducing costs

First, policy must address the money transfer market by improving competition and reducing costs as well as offering incentives to improve technology for money transfers. Cost reduction in recent years has stemmed largely from increased competition among money transfer operators. In Latin America and the Caribbean costs have dropped substantially (see figure 1 below), and so has happened in other areas of the world such as Russia to Central Asia and the South Caucasus, Europe to South East Asia and West Africa.



Further efforts to decrease costs involve improving the environment for MTO competition and introducing alternative means to transfer money such as prepaid card or mobile phone technology. Recent regulatory complications have caused banks to grow wary of doing business with MTOs, and subsequently many banks have ended their banking relationships with MTOs. This obstacle has created a difficult operating environment for MTOs.

Moreover, new technologies in general allow for cheaper account-to-account transactions, but all players in the market must learn how to best use these technologies. In terms of recipients, this requires increased financial education in addition to an adjusted behavior in the way money is collected. Now nearly 30 percent of remittance recipients use debit or credit cards; this number is as high as 50 percent in some countries.

An important example of this is the experience of the Jamaica National Building Society (JNBS). Through its subsidiary JN Money Services Ltd., JNBS serves Jamaicans living in the diaspora by facilitating remittance services in Canada, the USA and the UK. In partnership and cooperation with USAID, JNBS chose to automate the process of sending and receiving money transfers through swipe card technology. As a result it now has over 70,000 cards users. 50% of remittance recipients have been brought into the formal banking system, with 25% of those receiving their remittances through a card product which is then used to make purchases at small businesses that accept debit card purchases. What's more, the majority of the bank's small business clients also benefit from making remittance payouts through increased access to both credit and remittance receiving customers. Rates of saving have increased considerably, not only through direct deposits to savings accounts, but also by reducing the amount of cash in circulation and through the increased use of electronic transactions.

Policy incentives to reduce costs and improve competition and technology include offering tax breaks or other incentives to those banks and MTOs that import technological devices for money transfers, such as point of sale (POS) devices. Technology plays an important role in the effective and efficient delivery of remittances. These POS devices are an opportunity to enhance the effects of remittance spending by allowing for electronic payments and reducing the use of cash in the street as well as increasing saving and positively influencing revenue streams for banks and MFIs. Access to technology can be expensive for financial institutions or vendors. Therefore policy solutions such as tax breaks or incentives related to improved technology should be implemented.

Accelerating financial intermediation projects with credit unions and MFIs

Another key policy area is accelerating financial access through projects with microfinance institutions (MFIs), credit unions, and small banks. These alternative financial institutions have demonstrated a key role in banking the traditionally unbanked and in transforming remittance clients into clients of other financial services.¹ Support of these financial

¹ Orozco, Manuel and Eve Hamilton. 2005. "Remittances and MFI intermediation: issues and lessons." *Remittances, Microfinance and Development: Building the Links, Volume 1: a Global View*. Edited by Judith Shaw, Foundation for Development Cooperation, Brisbane, Australia: 2005.

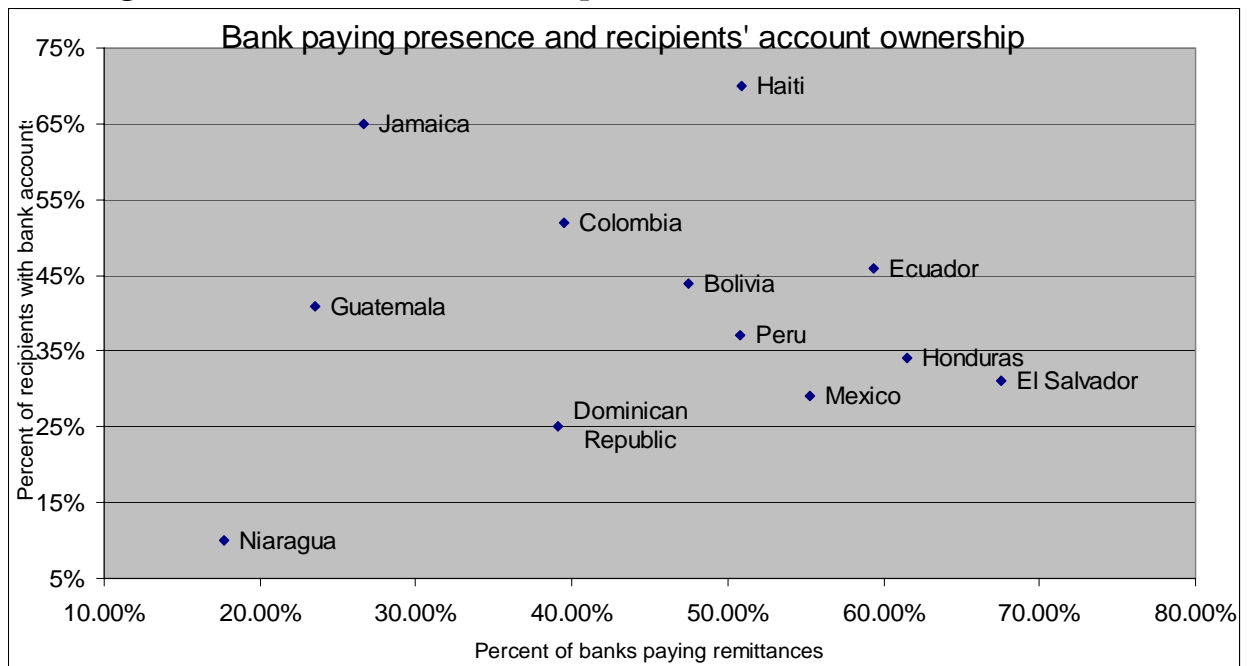
institutions has been low despite their efforts to reach out to remittance recipients. The financial assistance that has been granted has typically targeted financial product design, marketing, and technology. Increasing the support and participation of these small financial institutions is of crucial importance to increasing access to financial services and improving financial literacy and assets. Types of assistance include financial product design and marketing, IT development, market research, and regulatory compliance.

Engaging banking institutions to provide broad financial services

In addition to offering incentives to non-banking financial institutions to reach out to remittance clients, larger banks that offer remittance services should be targets for engagement. Access to banking service remains low despite the percentage of payments made by banks. See Figure 1 for more details. The opportunity costs of banks working in rural areas have yet to be sufficiently explored by governments and donors. Furthermore, there should be efforts to increase opportunities for reinvestment in the community. Throughout Latin America banks make nearly 50 percent of all remittance payments. However, they have not taken advantage of this position to offer remittance recipients access to other financial services. Because of banks' roles in distributing remittances in the region, it is particularly important that they move beyond simple remittance payments and consider strategies such as loan funds and securitization, financial literacy programs aimed at remittance recipients, financial product design or marketing, and modernization of payment systems.

An important example of providing financial services to recipients is in Mexico. The government agency BANSEFI established a network—L@ Red de la Gente—of some 1200 banks, micro finance institutions, and credit unions to serve as distribution centers for remittances. In 2006 BANSEFI had increased its payments to 100,000 transfers and was opening accounts for about one quarter of its payment recipients.

Figure 2: Access of Remittance Recipients to Banks and Bank Accounts



Supporting projects to improve investment opportunities at home and among the diaspora

Policy initiatives should also focus on improving opportunities for small scale investment to create new businesses. This means, for example, linking investment opportunities to transform subsistence agriculture of remittance recipients into commercial farming and encouraging an environment favorable for investment on the part of migrants. These enterprises also relate to remittances and migration when promoting investing by migrants in terms of tourism and nostalgic trade. Governments could offer travel opportunities aimed directly at members of the diaspora, who tend to travel frequently to their countries of origin. See the Table 1 for more details on travel frequency and amount of money spent per visit. Moreover governments could also partner with migrants abroad to package these travel services. In terms of nostalgic trade, many businesses succeed by meeting the high demand for goods from the home country. Governments, development agencies, and the private sector could benefit by offering products or services from the country of origin in these businesses abroad. In reaching out to the diaspora, governments target a unique yet important source of funds. Table 1 indicates the percentage of migrants that buy products from the home country.

Table 1. Migrant spending on travel and nostalgic trade (%)²

Country	Travels at least once per year	Spends US\$1000 or more per visit	Buys Products from home
Dom. Rep.	69	64	65
Jamaica	69	52	64
Ecuador	51	90	95
Guyana	45	54	84
Colombia	34	61	88
El Salvador	24	61	66
Mexico	23	70	86
Nicaragua	19	27	83
Cuba	13	50	29
Bolivia	13	91	70
Honduras	12	43	74
Guatemala	9	48	50

Design products that include education and health services

Education and health expenses are typical investments in remittance recipient families as shown below in Table 2. Nonetheless, adequate education and health services are often not well publicized or not available. One way to provide these services is through partnerships between MFIs and health and education providers that offer financing. In education, this means education funds, tutoring, extracurricular activities, and internet lessons. These types of investments on the part of recipient families will lead to higher educational achievement and also continued investment on the part of the person sending money from abroad. Health products include life insurance, medical insurance, emergency care, body repatriation, and child care. Opportunities for healthcare investment will improve standards of living and understanding of healthcare standards.

² Orozco, Manuel 2005. Transnational Engagement in Latin America.

Table 2. Monthly Cost of Living, Income and Remittances³

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Cost of living . . .					
Food	219	228	209	201	245
Services (utilities)	60	44	40	43	99
Education	13	32	29	56	98
Health	40	41	34	68	22
Entertainment	27	3	40	35	14
Total	359	348	352	403	478
Income . . .					
Wages	323	303	125	162	295
Total earnings, remittances included	930	501	622	353	320
Monthly remittances amount received	637	331	515	181	247

Provide technical assistance on financial and remittance literacy

The Central Banks of each country in Latin America and the Caribbean lack resources and capacity to provide basic financial literacy to their populations. Educating people about the role of finances is a critical step toward development and is also becoming important among remittance recipients. Financial and remittance literacy can be established in cooperation with Central Banks and financial institutions to reach out to the millions of remittance recipients. This technical assistance should consider information about the financial value of the transfers as a mechanism to build credit, assets and use of alternative payments through electronic instruments such as debit and credit cards.

Engaging governments and the private sector as environment enablers

One of the general policy recommendations that can be gleaned from the majority of these issues is that governments need to understand their role as environment enablers. This means in general promoting policies that lead to increased access to the financial system and financial intermediation for remittance recipients.

Moreover, an outreach policy to the community residing abroad is key to any migrant-sending country's economic strategy. Currently no such policy is in place in most countries, and governments could gain significantly from such an approach.

Data and macroeconomic policy

In some contexts remittances have yet to be measured appropriately, and technical assistance to measure and monitor these flows is needed. Not all countries have adopted appropriate methodologies to measure formal and informal flows and to detect possible fluctuations due to market behavior or criminal activity. Thus, streamlining the methodologies while training officials about migration patterns is an important step towards better calculating remittance flows. Moreover, these flows require the implementation of policy tools that can play a

³ Orozco, Manuel. 2006a. "Between hardship and hope: Remittances and the local economy in Latin America." Report commissioned by the Multilateral Investment Fund of the Inter-American Development Bank. Inter-American Dialogue: Washington.

preventive role to mitigate adverse effects of remittances, particularly when these flows affect the productive base of the local economy through an unnecessary or undesired appreciation of the local currency. The policy instruments may include, among others, incentives to invest and obtain credit and tax incentives on producers to attract remittance recipients. These initiatives will require careful attention among economists and policy makers.

Conclusion

The role of remittances in the lives of so many families in Latin America and the Caribbean is clearly dominant. The policy implications of remittances are also extremely relevant especially given the volumes and the range of policy alternatives that exists. Opportunities include investing in small or large financial institutions to private businesses or public services or teaming up to provide financial education to remittance recipients. Overall the policy effort must aim at modernizing the productive base of local economies while leveraging resources from migrant foreign savings. This means linking investment opportunities, savings creation, local and central government enabling environments, and increased risk propensity among local, national, and transnational entrepreneurs.