Money transfers: do senders and recipients get the best deal?

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The world money transfer sector is dynamic and set to expand at the rate of 10 per cent a year. At least 500 million people are dependent on remittances sent from 200 million migrants. From the UK alone outward remittance flows are estimated by the Department for International Development to be at least £2.3 billion – and of that a greater part is going to the Commonwealth. It is only in recent times that there has been an international focus on this rapidly expanding financial service and a recognition of what it is doing for the world economy. Regrettably economists and trade bureaucrats had failed to appreciate their aggregate impact because the individual sums 'sent home' are comparatively small.

The World Bank is to be congratulated for issuing the report 'Global Economic Prospects – Economic Implications of Remittances and Migration 2006.' This report is largely the work of the senior economist Dilip Ratha, who charted the economics of money transfers by immigrants to their country of origin. At the time he estimated that the value of remittance flows was US$167 billion for the year 2004. Today he reckons that official remittance flows plus the informal sector are much closer to US$1 trillion.

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Of that sum a very large part goes to the Commonwealth. In a good number of smaller poorer countries, remittances amounted to more than 20 per cent of their gross domestic product. Remittances are worth more than tea exports in Sri Lanka – more than foreign direct investment and three times the level of aid programmes. Worldwide, remittances are now growing at 8–9 per cent per annum – and are set to keep on growing.

An example of the impact is Uganda, where remittances have reduced poverty by 11 per cent; likewise in Bangladesh by six per cent, and in Ghana by five per cent. In a broader picture, cross-country analysis confirms this finding, again according to the World Bank, that a 10 per cent increase in per capita remittance flows could lead to a 3.5 per cent reduction in the poor's share of world population. Remittances are associated with increased household investments in education, entrepreneurship, and health, all of which have a high social return in most circumstances.

The interesting fact of remittances is that they tend to flow in a steady stream and are not susceptible to general market trends. Indeed during times of financial crisis in country of origin, be it a natural disaster or political conflict, remittances can rise, and provide a lifeline.

The reasons for this huge remittance flow are due to the vibrant global economy. With this migrants flow to the developed economies. The top destination for migrants is the European Union, currently with 71m people, followed by the US with more than 40m.

A close study of the remittance market which the Commonwealth Secretariat has been undertaking demonstrates that this money has a multiplier effect, boosting disposable income, making education more affordable, and according to the World Bank increasing developing countries' access to bond markets.

The big bonus of this market is that the remittances reach their intended targets, and are not siphoned off into grandiose white elephant projects. It has to be said though that the recipients also need guidance in spending the money, as it does not always flow in the direction that the sender had intended.

Structure of the money transfer operation

The concern of this paper is not so much to examine what happens when the money has arrived, but rather the process in which it does. The real question on our minds at IAMTN is what western policy makers can do to encourage an easier flow of money, which in turn is a major weapon in fighting poverty.

The method of sending money is by a disbursing agent, money transfer operator, or informally (through a grocery store, travel agency, hawala), a bank, credit union, internet portal or payment service, payment card operator, telecom company, utilities or retail company.

The method is normally a message from a sending agent to a disbursing agent. This is done by phone, internet, fax, common database, or in some cases by the remitter mailing a draft issued by the sending agent on the disbursing agent. Developments in technology will undoubtedly enhance the disbursing system through cash machines, at present very varied in availability.

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Costs of money transfer operators

Money transfer operators are largely trustworthy. Inevitably, however, there are those that are not perceived to be 'secure'. This is a factor in governing which money transfer operators are used.

There is a wide variation in money transfer costs. Western Union, which has 13 per cent of the market share, is a respected brand name but costs very much more than its rivals. Moneygram comes next with three per cent of the market.

The fee to send £100 can range from £2.50 to £40. According to the World Bank, however, the average size of a Western Union remittance (covering personal remittances as well as small business-to-business remittances) is around $700, much higher than the average transaction size, which is barely more than $120 to countries such as Nigeria. In general, the cost for small transfers of about US$100 can be $16 or 16 per cent. For $200, which tends to be the average amount that migrants send per transaction, the cost can be nine per cent, i.e. $18.

Costs also vary from country to country. Remittances to Bangladesh via a bank, for instance, can take up to 10 days and range from seven per cent to 35 per cent of the transaction costs. A money transfer operator costs on average £10, with a transfer charge fee of 12 per cent.

These high costs are a drain on the funds that are hard-earned income to the migrants and the recipients. Reducing migrants' costs would increase migrant savings, and also it would mean more incentives for remittance flows to developing countries – above all, reducing remittance costs would also encourage more flows through formal channels.

Banks

Banks take longer, and are more expensive. But without banks the money transfer system cannot operate. They can be the bridge, the utility service for companies like Visa and Earthport, even if they are not the final server.

Overall, a priority must be to involve increasing banking access of migrants and strengthening competition in the money transfer sector, be they banks or money transfer operators. Banks could make the identification procedure more user-friendly, and certainly be more open for migrants to open accounts in host countries.

Banks in some parts of the world have taken on board the importance of facilitating the remittance market. In particular Citibank has had considerable success in Mexico: with Citibank's Global Transfers migrants can send remittances into a Bannamex account or as a cash transfer for as little as a US$5 fee.

The US and Mexican governments established Partnership for Prosperity (P4P), which has made a huge impact on the remittance sector working towards lower costs, promoting competition and innovation, gathering and disclosing information. Lessons are to be learnt here which could be of real benefit to the Commonwealth countries. Of course the Mexican experience has characteristics of its own that are not necessarily reflected elsewhere.

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Speed

Money transfer operators can and do provide a fast service. It can be 10 minutes (albeit at a higher charge) but normally it takes 24 hours.

Banks, however, can take up to five working days or at the most extreme, 10 days. Continuous pressure will need to be made for a faster service, the belief being that it does not suit the banks to be speedy, as the money is used meanwhile in delivering interest.

According to the World Bank, on a broader level, there is a real role for Central Banks regarding the regulation of entry to new players. Some countries, however, may be tempted to look at the remittance market as a source for tax. This would be a mistake. Tax will already have been paid in the host countries, and it would not be right for recipient countries to look upon these revenues as an extra government source.

Accessibility

The challenge is to assist the recipient in collecting the money. One reason why the informal sector flourishes is due to lack of reach by banks in destination countries.

They have branches in the major towns, but not in the rural areas and certainly not in the villages. In any case, only 5 per cent at most in Nigeria have bank accounts.

Disbursements are largely cash pick-up or hand delivery, direct credit to a bank or a non-bank account or to a store account, delivery of goods and services, payment of bills, creation of a bank account, issue of ATM cards, credit to existing card account. The key is that access for recipients must be manageable and disbursed in a safe manner.

Technologies are rapidly coming on stream such as using stored value cards, prepaid cards, mobile phone such as G-Cash system in the Philippines developed by Paysetter International, Celplay in Zambia allows using a cell phone to transfer money; Visa has instigated the VisaDirect and VisaSend from one Visa card account to another. MasterCard has a similar structure.

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The solution here must lie in assisting credit unions and microfinance institutions operating in the rural areas to help deliver cheap remittance services. There is no reason why a travelling bank bus, or indeed a village elder in his community, could not be trained and allowed the means to provide these services. This is already beginning with some clear success. Interestingly, outside the Commonwealth, a look should be taken at Haiti, where this has been done with success for some years.

Another source of accessibility must be through the post office system, for they go that extra mile beyond banks and other structured organisations. In countries where the post office system is functioning well, this can be a success, as the leading provider, EuroGiro, has discovered. In countries like Nigeria, however, the post office system has broken down, confidence and trust has gone, and it will need the energetic enthusiasm of the next Presidency to rebuild. But we must recognise the difficulties here. Some countries have allowed their post offices to enter into exclusive partnerships with money transfer operators and thus created an environment for increased costs. Networks should be shared, and on a non-exclusive basis.

The informal sector is alive and well. It is largely legitimate in most countries, provided it is not used for financial crime or money laundering. Advantages include accessibility, costs, reliability, trust and simplicity of operation. In some cases, no charge is made for small remittances, the entrepreneur being content with the foreign exchange spread and the fees from larger transactions. The informal system becomes particularly active during periods of instability, be they political or a natural disaster.

If the formal banking or money transfer operator intends to compete with the informal remittance business, it should focus on improving the quality of service and reducing fees and charges. Therefore a longer-term and sustained effort should be aimed at modernising and liberalising the formal financial sector with a view to addressing its inefficiencies and weaknesses.

Money laundering and compliance

There is an awkward dilemma for governments: striking the right balance between measures to counter terrorist financing and money laundering, and facilitating money flows through efficient channels on the other. It does not seem that the right balance is being struck at present.

It is difficult to believe al-Qaeda would not find easier methods to move funds or have other means of remitting money either informally or through the banking system. Indeed the more recognised method is via import-export schemes, property deals and such like. For all that, it is the small money transfer operator that suffers the most from compliance and regulations.

The US Patriot Act in 2001 severely tightened the ‘know your customer’ requirement for banks and money transfer operators, but in an ambiguous way. American banks anxious of being targeted by the Financial Crimes Enforcement Network have closed the correspondent bank accounts of hundreds of money service businesses. JP Morgan has already decided to cut all ties with money transfer companies and other banks are considering the same step.

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The US is not alone in this. The same is happening in the UK with major banks such as HSBC, Royal Bank of Scotland, NatWest and others following suit. The UK Treasury is now taking note of this chain of problems, and a consultative document has gone out to interested parties requesting full feedback on this.

The European Commission, under the proposed Payment Services Directive and regulations, will impact even further. Much lobbying has been going on, drawing the Commission’s attention to problems that will arise from proposals so far. In their desire to create a ‘level playing field’ between banks and money transfer operators, they are proposing the same degree of operation and capitalisation, even though a money transfer operator is not a bank and does not hold money.

Customer confidentiality is important even when balanced against other needs in countering terrorism. The problem goes further: it has been reported that the CIA now has access to all transactions worldwide that have been made via Western Union, Moneygram, MasterCard, SWIFT and so on. None of the organisations were comfortable with the request, but have had to comply under pressure from the Patriot Act. The real fear is that confidential information could be handed to a third party, in a country with a police state who could target the recipient families.

Implications for Commonwealth Finance Ministers

Overall, it would be helpful for the Conference to examine ways of strengthening the financial infrastructure supporting remittances. There should be a closer connectivity between governments and the money transfer agencies, be they banks or money transfer operators.

One major obstacle for the improvement of remittance systems is the lack of guidance on basic issues like access, transparency, regulation/supervision and others.

The Conference might look at the World Bank's CPSS Task Force on General Principles for International Remittance Systems, headed by Massimo Cirasino. In this they are charged to develop general principles on remittances that:

- Describe key features and functions that should be satisfied by remittance systems, providers and financial intermediaries
- Are clear and universally applicable international standards
- Focus on identifying the main characteristics of the remittance service and the related infrastructures with a view to improving them.

One major obstacle for the improvement of remittance systems is the lack of guidance on basic issues like access, transparency, regulation/supervision and others, necessary to ensure the efficiency, safety and integrity of these services.

There should be more enabling structures to give a wider choice to the remitter both in terms of accessibility and costs.

There does need to be a co-ordinated policy between the anti-money laundering agencies and those facilitating remittances. At present the necessary lightness of touch is lacking: the small remittance sender, with the small money transfer operator, takes the full hit of compliance requirements at a point when terror funding is least likely to occur.

Costs need to be reduced through improved financial systems and infrastructure. This can be done through more transparency and competition, introducing new technology (for instance, electronic cards and ATMs) and improving payment systems.

It is essential to improve the data on remittances and migration. Reliable data on remittances are key to our understanding their development impact. There should be international collaboration on standards and appropriate techniques for data collection. At present such information is very much on an ad hoc basis.

The real incentive must be for the formal sector to be competitive with the informal sector.

The informal sector can be encouraged to become formal in some cases with a manageable means of licensing or registration. To assist the customer, a system should be put in place whereby the operator is awarded a quality stamp of good service.

The real incentive must be for the formal sector to be competitive with the informal sector.

In the long run, making a wholehearted effort to upgrade the money transfer sector will bring wider benefits: not just the cash transaction itself, but better access also to other financial services. A good remittance product increases competition and moves transactions to the formal sector by providing a superior service. It would also help to follow the example of some countries such as Bangladesh, which have established public sector incentives to encourage the use of formal sector transfers by providing tax breaks, higher deposit interest rates and foreign currency deposit accounts where appropriate.

*The **International Association of Money Transfer Networks** (IAMTN) grew out of a two-day international conference in October 2005 at the Institute of Directors in London. The reason was the awareness that this rapidly growing financial sector, embracing trillions of dollars, has been largely overlooked. The time had come therefore to highlight its role in the international economies, and identify the challenges it faces. The Second Global Consumer Money Transfer conference will take place on Monday 30th October, 2006 at the Mandarin Oriental Hotel, Knightsbridge, London. For further information see below for contact details.*

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