

Development Impact of Remittances

Financial Sector Development, Cross-Border Banking,
and Policymaking

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Development Impact of Remittances: Size and Importance

- Growing volume of worldwide remittance flows -a source of foreign savings with development potential:
 - From \$132 billion in 2001 - \$268 billion in 2006 (World Bank 2006)
 - LAC is the largest remittance receiving region in the world, in nominal dollar terms; estimated flows of \$53 billion in 2006; 70% of FDI, 5 times > than Development Assistance (World Bank 2006)
- Potential impact:
 - Financial: Deepen financial markets, promote financial intermediation
 - Economic: Economic and investment growth, poverty reduction, foster entrepreneurship
 - Social: Encourage investment in education and health care, improved housing conditions, improved access to public services

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Prospects for the Industry and Implications for Financial Sector Development

- Remittances are not a substitute for reforms needed to handle structural and institutional challenges
- Current trends:
 - Decline in transaction costs- for \$200 from 15% in 2000 to 5.6% in 2006 -as a result of increased competition (entrance of new MTOs and banks; e.g. Wells Fargo/ Harris Bank in Mexico -costs below market average, Orozco 2006)
 - Growing interest by banking institutions in the U.S. and LAC
 - Tightened government regulations (e.g. anti-money laundering)
- Challenges:
 - Transforming senders into banking clients
 - Limited financial intermediation for recipients
 - Remittance illiteracy
 - Tightened regulatory environment
 - Attitude toward banking the "poor"

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Impact of Remittances on Financial Sector Development: World Bank Regional Study 2006

- Positive relationship between remittances and financial development, using BOP statistics 90 countries, 1975-2003 (Aggarwal, Demirguc-Kunt, Martínez-Peria 2005)
- Financial sector chapter: comprehensive analysis of impact on financial development (Martínez-Peria, Mascaró, Moizeszowicz, 2006, using Aggarwal et al. data)
 - Positive impact; lower in LAC (larger impact on overall credit in the economy)
 - 19 household surveys, 11 countries: positive effect on deposits, no clear effect on credit
 - Municipalities in Mexico (similar effects for El Salvador): >% of recipients, higher # branches per capita, no clear effect on credit
- Case studies of Colombia and Guatemala (ad-hoc surveys and interviews): High growth potential for banks on money transfer services, savings, and credit
 - Increasing interest of banks on the deposits and assets side
 - Rapid growth in the remittance distribution business
 - Elimination of obstacles and development of competitive advantages
 - Identification of limitations on growth and plans to take action
 - "Unbanked" remitters and recipients interested in using financial services
- Research on financial products designed by LAC institutions to meet needs of senders and recipients

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Remittances and Financial Sector Development (World Bank Regional Study 2006)

	Variables	Major Findings
Macro	Impact of remittances on financial sector development: LAC/non-LAC	Positive, but lower in LAC Larger impact for credit
Micro	Impact of remittances on the use of financial services (deposits or credits); Evaluate if the proportion of households that use financial services differs between recipients and non-recipients.	Recipient households more likely to use deposit accounts; No evidence on use of credit
Micro *	Probability of having accounts, demand, and receive credit	Positive for deposits; no evidence for credit
Micro**	Illustrate increasing interest of banks in LAC, challenges, new products	Municipalities with a >% of recipients, have more branches per capita, no effect on credit

(Martínez-Peria, Mascaró, Moizeszowicz, 2006)

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Key Factors Affecting Impact on Financial Development

- Limited use of banking services by migrants in the U.S. possibly linked to less educated population (lowest % of migrants in the world with a saving account in the U.S., high illiteracy, World Bank Regional Study 2006, Chapter 2)
- Frequent and severe crises bring distrust in financial institutions (episodes per # of countries, avg. fiscal costs, avg. duration, avg. output loss, highest % of fiscal costs in the world)
- Limited physical bank presence, some evidence of low geographic penetration (lowest # of branches in the world per 1,000 square km, not in per capita terms)
- High cost of using banking services (opening and maintaining accounts, lending fees; highest costs in the world except for Southeast Asia and Africa)
- Legal rights and contract enforcement [along with Southeast Asia lowest rating on legal rights index (collateral and bankruptcy laws facilitate lending), highest # days needed to enforce contracts (Doing Business)]

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The Case of Mexico: Impact on Financial Development

- Mexico is LAC's largest recipient of remittances in dollar terms, remittances impact among the strongest in LAC (\$20 billion in 2005, IDB)
- Remittances are 2% of GDP, but they amount to 10% of banking sector deposits and credit.
- At the municipality level:
 - Remittances have a positive impact on deposits
 - Municipalities with a > % of remittances receiving population have:
 - > ratios of deposit accounts/capita
 - > deposit amounts to GDP
 - > # of branches/capita
 - No significant association between remittances and credit/ GDP across municipalities.

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The Case of Mexico: Selected Initiatives

- Declining transaction costs of sending \$200 from 8.8% in 2001 to 6% in 2005: (Orozco 2006)
 - Increase in electronic transfers (governmental initiatives -Matrícula Consular)
 - Strength of a competitive MTOs environment (>than100 MTOs, compared to 5 in 1995)
 - Increased use of technology (ATMs,debit/credit cards, prepaid cards)
 - Example: "Directo a Mexico"- ACH developed by the Fed and Bank of Mexico
- Government sponsored programs:
 - Infrastructure: "Tres por Uno" (federal, state, and local government funding)
 - Business start-ups: "Invierte en Mexico" launched by NAFIN & IDB
 - Financial education: The New Alliance Task Force (NATF) launched by FDIC and Consulate General of Mexico
 - Financial intermediation: BANSEFI-supported by IDB-networking model that links financial intermediaries and helps achieve economies of scale
 - Established with MFIs and credit unions a network of over 1200 distribution centers- Red de la Gente- to act as a remittance payer
 - Agreements with MTOs-Vigo, MoneyGram, Via America, etc.
 - In 2006, project grew to 100,000 transactions/month from 25,000/month in 2005

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Role of Cross-Border Banking

- Cross-border banks are increasingly interested in the profitable industry;need to overcome challenges:
 - Competition from MTOs, distrust in banks, suspicions in pricing, limited financial awareness
- Banking in the sending country:
 - Increase efforts to bank the "unbanked abroad" (1/3 of homebuyers in recipient countries influenced by relatives)
 - Promotions, financial training, products of interest to the migrant community (mortgage loans, health insurance policies)
 - Lower costs of sending (alliances between MTOs & banks, banks in North America and LAC, use of debit card technologies)
 - Offer especially-designed products (and language)
- Banking in the recipient country:
 - Tailored financial products, success cases:
 - Ecuador, Banco Solidario : gained market share through product adaptation (alliances with saving banks in Spain, no transfer fees, innovative mortgage and loans)
 - Guatemala, Banco Industrial: tailored services, promotions
 - El Salvador, Banco Salvadoreño: opened branches in the U.S. to reach senders (alliances with MTOs)
 - Systemically analyze transactions to design tailored products (>use of information systems)

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Potential for Leveraging Remittances: Role of Financial Intermediaries

- Great opportunities for partnerships between MTOs, credit unions, banks, and the private sector (Wal-Mart offering retail banking in Mexico in 2007-role of a community bank)
- Indicators measuring success of financial institutions at leveraging remittances for expanding financial intermediation (Orozco and Fedewa 2006)
 - Remittance market service coverage
 - Provision of competitively low cost remittance transfers
 - Availability of financial services

Institution	Coverage	Cost	Financial Services
BANSEFI (Mexico)	<ul style="list-style-type: none"> ✓ Strong network with broad nation-wide presence, especially in rural areas ✓ Educational campaigns targeted at diaspora 	<ul style="list-style-type: none"> ✓ Competitive fees, below market cost (Vigo, Money Gram, Via America, etc. ✓ FedACH International Mexico Service ✓ L@ Red de la Gente 	<ul style="list-style-type: none"> ✓ Bank- to- bank account transfers ✓ Cross-markets remittances with other products
Wells Fargo (US-Mexico)	<ul style="list-style-type: none"> ✓ Widespread and well-placed global presence ✓ Bundled services designed as "relationship building" products 	<ul style="list-style-type: none"> ✓ Competitive fees, below market cost 	<ul style="list-style-type: none"> ✓ Transnational account-to-account service through Intercuenta Express ✓ Cross-markets remittances with other products ✓ Specialized attention, focused on building trust

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Role of Policymakers: Government/IFIs

- Role of IFIs important to modernize financial infrastructure while addressing needs of "unbanked" recipients (Examples: IDB supported- BANSEFI, FEDECASES, Banco Solidario, CPSS-WB General Principles on International Remittance Services 2007)
- Partnerships between governments to increase financial access:
 - Valid forms of identification (Matricula Consular), financial literacy (Institute for Mexicans living Abroad), reduction of costs of sending remittances through banks (ACH system)
- Governmental policies:
 - Ease the regulatory environment (opening branches, allowing role of credit unions, etc.)
 - Allow for non-traditional means of delivery (e.g. mobile banking, CGAP study on Money Transfers 2006)
 - Accelerate financial intermediation projects with credit unions and MFIs
 - El Salvador- FEDECACES (supported by IDB)- federation of credit unions targeted recipients as potential members of the credit union (25% of recipients are also clients)
 - Promote alliances with non-financial firms (e.g., post offices, retail stores, and cooperatives; U.S. postal service expanding DineroSeguro in 2007)
 - Improve collection and analysis of information
 - Stimulate financial sector competition
 - Information on size and structure of the market to increase bank interest
 - Clarity in the pricing of transfers
 - Reform weak creditor rights laws, inefficient contract enforcement mechanisms, lack of collateral, government crowding.

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Thank you!
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