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# *REMITTANCES TO LDCS: CURSE OR PANACEA?* [1]

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ABSTRACT

Remittances directly reduce poverty of recipient households, spur an increase in education and health expenditures, insure against adverse shocks, and finance housing and capital investments. However, they are not focused on the poorest countries or the poorest households or geographical regions as migration costs seem to discriminate against the poorest, and the environments of recipients are key to maximise development potential. Thus, remittances are neither a substitute for development assistance, debt forgiveness nor for public policies targeting the poor households and regions, rather, they can be a useful complement. Development assistance and public policies can be relevant for reaping the potential benefits of remittances; such interventions can be levied at the macro, meso and micro levels. Remittances can be used to secure further access to financial markets through: future-flow receivables securitisation; and, arranging remittance-based future-flow based syndicated medium to long-term loans.

*KEY WORDS:* REMITTANCES, DEVELOPMENT, LEAST DEVELOPED COUNTRIES, POVERTY, INTERNATIONAL COOPERATION

RESUMEN

Las remesas reducen directamente la pobreza de los hogares receptores, estimulan el aumento de sus gastos en educación y salud, les proven un seguro contra shocks adversos, y financian sus inversiones en vivienda y capital. Sin embargo, no se centran en los países más pobres o los hogares y regiones geográficas más pobres, dado que los costos de la migración parecen discriminar en contra de los más pobres, y los entornos de los beneficiarios son clave para maximizar su potencial de desarrollo. Por lo tanto, las remesas no son ni un sustituto de la asistencia para el desarrollo, la condonación de deudas, ni de las políticas públicas dirigidas a las familias y las regiones pobres, sino que pueden ser un complemento útil. La ayuda al desarrollo y las políticas públicas pueden ser importantes para obtener los beneficios potenciales de las remesas, estas intervenciones se pueden realizar en los niveles macro, meso y micro. Las remesas pueden ser utilizadas para asegurar

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el acceso a los mercados financieros a través de: titularización de flujos futuros de remesas, y la organización de préstamos sindicados de mediano a largo plazo basado en las remesas futuras.
*"How could remittances be better harnessed for the development of productive capacities in Least Developed Countries (LDCs)?"*

*PALABRAS CLAVES:* REMESAS, DESARROLLO, PAÍSES MENOS ADELANTADOS, POBREZA, COOPERACIÓN INTERNACIONAL

## 1. INTRODUCTION

The objective of the paper is to develop a conceptual framework for the LDCs with a view to maximise positive while minimising possible adverse impacts of remittances on their economies. The approach is to distil international 'best practices', and explore the lessons learned, in particular, the conditions for success where applicable, in order to review policy and institutional implications for LDCs and for development assistance.

A recent study underscores the importance of remittances to Africa having quadrupled between 1990 and 2010, reaching US$40 billion (2.6 per cent of Gross Domestic Product –GDP–) (Ratha, et al., 2011). The data must be interpreted with some degree of caution, however, as growth rates may be reflecting better data reporting, especially after 9/11. It should also be noted that the upward trend is broken with the world financial crisis of 2008, showing the heretofore remittance flows resilience has its limits.

At the outset it must be mentioned that, on the one hand, enthusiasm for remittances is based on the claim that they are a 'market-led' mechanism capable of reducing poverty and generating developmental impacts on recipient households, communities and countries. While on the other, the impact of remittances has been dismissed by the 'historic structural' approach based on the argument that the motivations to migrate are not made on the basis of a rational economic choice, but rather the result of an expulsion from the hometown due to the absence of economic opportunities, and/or strife and climatic reasons. Based on this line of reasoning, it has been argued critically that remittance flows into the expulsing communities have not managed to spark sufficient growth of employment to the point of stopping the need to continue emigrating. In general, remittances are neither the panacea (a market-led solution to poverty) nor the curse (unable to stop migration) of development as sometimes portrayed, but they do play a critical role for the recipient households, and for the recipient economies where remittances are significant.

By their very nature, remittances are neither focused on the poorest countries nor the poorest households and geographical regions within countries. Migration costs seem to discriminate against the poorest households operating like an entry barrier for the neediest. Ratha, et al. (2011), based on recent household surveys for Burkina Faso, Nigeria and Senegal, show that the probability of a household having an emigrated member is positively correlated to family size, education and wealth. Migrant profiles indicate they tend to be young, relatively well educated, and predominantly male.

In this sense, remittances are not a substitute for development assistance nor for public policies targeting the poor households and regions, be that by expanding coverage of 'universal' and/or 'focalised' programs. Remittances can be a useful complement to such policies provided the environments are conducive to maximising their developmental impacts. Development assistance and public policies are thus relevant for reaping potential benefits from remittances. In short, even if remittances are market-led in the sense that decisions to remit funds are decentralised, their developmental impact should not be purely market-led, as international and national interventions can make the difference regarding their developmental consequences. Both the optimistic and the pessimistic arguments seem to be based on disproportionate claims as to the developmental impact of remittance flows on their own. This paper follows a more balanced and

analytical approach in identifying conditions to achieve the greatest positive developmental impacts of remittances, and cautioning against possible drawbacks.

In general, functioning institutions and a capacity for appropriate policy-making seem to be at the heart of remittances' potential impact on development. However, there is no silver bullet that can bypass what is normally weak and/or altogether missing in LDCs: **institutions** (rule of law, especially contract enforcement; banking regulations and supervision; and banking and micro-finance development among others) and **pro-growth policies** (appropriate macroeconomic policy formulation and execution, public administrative capacity, etc.). But it can be argued that, regardless of the migration motives, since remittances are flowing and many of the costs have already been incurred into, the issue becomes how to achieve the necessary institutional development and policy framework so as to maximise the positive impacts of such remittances, and minimise negative consequences.

Development has long been described by Max Weber as a transit from a rural society governed by 'patrimonialism' (form of government based on the ruler's family households), to a modern society governed by rational legal bureaucracies characterised by technical specialisation and rules (Weber, 1978). Granted, development is a complex and multi-dimensional process, but Weber's typological dimension should be included in the analysis. Developing countries, in general, have not fully accomplished the implementation of the rule of law, such that elements of modernity co-exist side by side with a state limited in its capacity to address 'common good' issues, as policies often remain captured by interest groups. The political economy of development reflects these challenges, and remittances are no exception[3]. Another sociological observation is the rise of the middle class in the defence of a rules base system, as can be observed in India today, which can play a critical role in some historic moments. In addition, to the local political processes, where the press can also play a constructive part, multilateral and bilateral donors, as well as regional and sub-regional agreements can be actors also supporting modern institutional development.

This paper makes suggestions on the direction changes in institutions and policies should take in order to achieve developmental objectives related to remittances, but aware of the complexities involved.

The paper is organised as follows: first, the microeconomic logic of remittance recipient households is explored in determining the expenditure prioritisation and conditions for a greater developmental impact at the household level, as well as some experiences maximising the developmental meso-economic impact at the municipality level, with a view to examine lessons learned. Second, consideration is given to the issue of remittance transactions costs and the rationale for preferring formal or informal transfer channels. Third, from a macroeconomic perspective, emphasis is placed on mechanisms to enhance the developmental financing potential by accessing international capital markets through collateralisation of remittance future-flows and diaspora bonds, as well discussing broader macroeconomic issues posed by remittances, including some general considerations on the relationship between migration and remittances. Finally, there is a summary of conclusions and recommendations.

## 2. MICRO AND MESO-ECONOMIC IMPACTS

### *Microeconomic impacts*

The functionality of remittances to the recipient households has been well documented. They directly reduce poverty[4], spur an

3 For example, formal remittance channels to Sub-Saharan countries are bank monopolies, which also sign exclusivity agreements with international money transfer companies with consequences explored below.

4 Anyanwu and Erhijakpor (2010) find that in a sample of 33 African countries a 10 per cent increase in remittances as a share of GDP led to a 2.9 per cent decline in the share of people living in poverty, with declines also for the depth and severity of poverty (see also Ajayi et al. 2009).

increase in education and health expenditures, insure against adverse shocks and finance housing and capital investments (for ample evidence on Africa, see Ratha et al., 2011).

More analytical studies done for non-African developing countries for remittance receiving households attempt to describe the rational behaviour of recipient households in the allocation of remittances to poverty alleviation, including basic consumption, education and home improvements; productive activities; and even the provision of 'public' goods (water and sanitation). They also conclude there is evidence of income smoothing and risk management with regards to macroeconomic shocks, political strife and climate change consequences. The logic for such effects is explored below in order to introduce the discussion on the conditions under which there is a greater microeconomic-level developmental impact. These refer primarily to public policy lessons.

A study back in 2005 (Mariano and Massey), attempted to test expectations consistent with the New Economics of Labour Migration and the historic structural approach to migration based on household surveys in Mexico, the Dominican Republic, Nicaragua and Costa Rica. The analysis focused on three explanatory variables: household composition, family members abroad and community context. The New Economics of Labour Migration assumes an implicit contractual arrangement between the migrant and the family members in which remittances are to be used for productive investment and risk diversification. The alternative approach assumes that migrants are 'expelled' from their native countries for lack of opportunities and migration becomes a survival strategy. In such a strategy, recipient households use remittances for family maintenance or as income supplements for household needs. The results show weak and moderate regression coefficients for the expectations of both models in all four countries. However, results became much more significant once the Mexican and Dominican households were analysed separately.

Mexican remittances seem consistent with the New Economics of Labour Migration logic as a household strategy of risk diversification, whereas Dominican remittances seem to follow the historic structural approach of lack of opportunities and household need. Mariano and Massey (2005) argue that the Mexican patriarchal and cohesive family structure is more conducive to New Economics of Labour Migration based migratory decisions. Migrants are mostly male, temporary, goal oriented and likely to honour contractual arrangements. Remittances are positively associated with the degree of development of households, and negatively associated with the number of businesses in the local community. The Mexican family setting, relatively cohesive and stable, seems to follow the New Economics of Labour Migration logic, and remittances can be predicted by strategies of risk diversification and productive investment, and the business environment in their communities. In the Dominican Republic, remittances receipts are negatively correlated with household development as they reflect a survival strategy serving as income supplements or even the main source of income. Family structure is matri-focal and unstable, and migration is more likely to be long-term or permanent.

More research on the determinants of migration and remittances in LDCs is desirable, but Mariano and Massey (2005) offer interesting hypotheses based on how cohesive and stable are the families of migrants as explanation for the migration motives being either economic development or survival strategies. The developmental impact on the recipient families would thus be strikingly different. Productive investment and risk diversification would be associated with more cohesive family structures already enjoying some degree of economic development, whereas unstable families with low levels of development would probably use remittances for survival consumption.

Mandelman and Slate (2010) conclude, based on a simulation of the United States and Mexican economies, in the absence of labour mobility restrictions, the insurance role of remittances in consumption smoothing. Migration would be determined by the New Economics of Labour Migration logic. Under such

conditions, migrants would exploit the ups and downs of the business cycle in the destination economy, migrating during the expansion period and returning to their origination during the downturn. The destination country also maximises accumulation if it does not introduce mobility restrictions to migrant labourers. Such restrictions would limit the availability of unskilled workers when they are needed, wages would rise and accumulation slow. Under mobility restrictions the opposite effect would materialise during the downturn as migrant workers would be deterred from returning to their originating country, thereby reducing wages of native unskilled workers.

Anuedo-Dorantes and Pozo (2012) also find evidence for income smoothing consistent with the New Economics of Labour Migration approach for the majority of households, but for a significant fraction of households remittances may increase volatility. For the cases of increased volatility, however, the determinants are the same for remittance recipients and non-remittance receiving households, and as such, unrelated to remittance flows. The authors find significant variables associated with income volatility include: the number of children in the household (greater volatility), the educational attainment of household members (lower volatility), and the location as rural residents implies higher volatility regardless of whether they receive remittances. While other variables impact differently remittance recipients and non-recipients such as: the gender of the household head (greater volatility for female headed households not receiving remittances), the number of elderly in the household (reducing volatility in non-remittance receiving households, but not in recipient households), and family size (reducing volatility when receiving remittances). In short, based on family conditions the motives for receiving remittances may differ, and, consequently, in some cases income smoothing may not always be the result, on average however for this Mexican study income smoothing would be the result for the majority of remittance receiving households.

Another study in Oaxaca Mexico offers interesting conclusions on the conditions under which remittances may or not lead to greater productive investments (Cohen, and Rodríguez, 2005). The methodological approach includes both a household survey and ethnographic research in 12 rural communities in the central valleys of Oaxaca. The authors find community characteristics determine whether a relatively larger percentage of remittances received would be used for investments. For example, communities near an urban centre like Oaxaca City and access to fertile agricultural lands would enhance prospects of households investing part of the remittances received, while communities lacking the resources and further removed from urban centres would tend to invest less.

Evidence from Mexico (Adidas and Girod, 2011), but also from Yemen (Chaudhry, 1989), shows remittances are used to fund recipient household's access to clean water and drainage. Governments are expected to provide access to these public services, but in conditions of insufficient public infrastructure, household-driven methods of access funded by migrants include the appropriation by and empowerment of households of technologies to access public utilities. In the case of clean water, a combined method has developed with government-funded provision of water distribution networks and household-funded access to the public infrastructure. In the case of drainage, households turn to septic tanks for sanitation. These developments underline a significant long-term health improvement linked to remittances, which could be enhanced by public authorities in remittance recipient communities. Municipal governments can provide the clean water networks, and un-package the connecting technology for household access solutions, thereby increasing the amount of households served. Education and training on the construction and adequate maintenance of septic tanks can also support household driven solutions to sanitation.

In conclusion, although based on studies not necessarily done in LDCs, conditions and motivation for emigration are associated

with different developmental impacts at the household level. In particular, there would tend to be greater income smoothing and investments when households follow the New Economics of Labour Migration logic on the decision to migrate, whereas, when such a decision is more survival motivated in a context where the migrant is 'expelled' from the community, chances are there would be less income smoothing and investment. Other household conditions, size, age of family members, gender of the household head, etc. may also influence remittances results. But very interestingly, conditions in the communities can impact whether remittances are used for investment, such as location (near an urban centre) and resources (fertile land). A policy implication of this latter conclusion is that improving conditions in the communities of remittance recipients, such as access roads and productivity inducing investments, e.g., irrigation, could contribute to enhance the developmental impact of remittances. Additionally, remittance recipient households have funded access to clean water and drainage. Local governments can enhance the empowerment of household methods to access these public services and thereby increase total coverage.

*Meso potential*

The Mexican "Programa Tres por Uno" is an interesting public policy initiative attempting to harness and prioritise efforts by the organised diaspora community. It has been designed to maximise the impact of migrant organisations' commitment to their communities of origin through a system of matching public funds. Despite critiques for its complexity, lack of participation of the recipient communities, political manipulation, and limited funding among others, the "Programa Tres por Uno" has attracted considerable attention for its attempt to integrate joint investments between migrant organisations and the three levels of government (federal, state and municipal) to finance basic infrastructure (public goods) in the communities of origin of migrants through matching funds to the migrant organisations' contributions. Other governments and/or migrant communities already implementing or considering variants of the Tres por Uno include: El Salvador, the Philippines, Peru, Colombia and Ecuador.

García Zamora (2007) argues the Programa has evolved from a first phase of 'clubs' financing 'superfluous' works such as church reparations, soccer fields, parks, etc., to a second phase of organized processes enhancing transnational communal cohesion to include more ambitious projects of basic infrastructure: water, electricity, drainage, streets and roads. In its third phase the Programa's investments include social infrastructure: schools, clinics, computing centres, scholarships programs both in Mexico and the United States, environmental projects and residencies for the elderly. Currently, some of the better organised federations of migrant organisations, such as those from Michoacán and Zacatecas, are attempting to move into productive investments aiming to generate income and employment in their communities.

In spite of the known Mexican bureaucratic capacities, the Tres por Uno has been challenging as it requires the coordination of four actors in three different levels of government and a civil organization abroad to bear fruit in jointly financed projects within the constraints of a fiscal year. García Zamora (2007) suggests the need to avoid over-regulation and not to exclude migrants not formally organised as clubs and federations.

Another line of critique of the Tres por Uno is its lack of focalization on the poorest communities. The program is based on a methodology of self-selection of projects and municipalities by the organisations of migrants. This process does not correlate with the poorest municipalities as migration has a non-linear relationship with poverty and marginality. Consequently, poorer municipalities would tend to receive less public grants or not at all.

The design of Tres por Uno is meso and is not designed to attend macro considerations. The self-selection bias of Tres por Uno, in a context of a macro poverty reduction strategy, should be taken into account in its design, to

ensure geographical equity in the allocation of public funds. In this sense, a macro program aimed at geographical equity encompassing meso interventions of matching grants should take into consideration actions such as: i. earmarking funds to the poorest municipalities; ii. capping the maximum per capita income for beneficiary municipalities of Tres por Uno; and, iii. making the public matching funds proportional to poverty levels in the municipality.

The Tres por Uno is an interesting model to encourage and maximise developmental impact in communities of origin of migrants. The bureaucratic, fiscal and regulation requirements are, however, high and could be challenging for LDCs. Finally, the program would have to take into account the self-selection bias in its design, in order to ensure not all available funds are channelled to the exclusion of the poorest communities.

Ratha et al. (2011) mention developed plans in African countries to incorporate diaspora communities as partners in development, including Ghana, Nigeria, Senegal and South Africa. There has been no evaluation yet of these programs.

Finally, it could be argued that encouraging LDC governments to tap into voluntary contributions from its diaspora population for financing public goods involves some degree of transferring government responsibilities to private citizens.[5] In theory, governments should tax their citizens to provide for the provision of public goods. The fact remains that most LDCs governments are unable to provide for basic needs, which would remain unsatisfied for the foreseeable future. Indeed some developmental assistance to LDCs is argued on the basis of human rights, while acknowledging the potential trade-off. Capable efficient institutions are not only at the core of well functioning developed societies, but also form the basis of a functioning social contract. Their absence is one of the determining elements of under-development in an LDC context, and its overcoming should remain as the paramount developmental objective, but in the meantime, third generation human rights cannot await for the pending institutional development.

## 3. REMITTANCES CHANNELS AND COSTS

In general, access to financial services is low in LDCs, particularly in Africa. This is a particularly binding constraint for development, which affects the population directly as access to well functioning financial institutions, in providing households options for savings and credit, can contribute to smoothing out uneven vulnerable economic conditions as well as to offering capital critical for productive and durable investments and, hence for upward social mobility. Indeed many of the poor in LDCs suffer from financial exclusion, especially in the rural areas. A vicious cycle of poverty may thus be broken by improving access to financial services by the poor.

There is a host of institutions which have proven, in Africa and elsewhere, that it is possible, even profitable, to provide financial services to the poor, among them, credit unions, savings and loans cooperatives, post offices, micro-finance institutions, and rural banks. The well-known Grameen Bank in Bangladesh was designed as a credit delivery system to provide banking services to the rural poor. Among its objectives it includes reversing “the age-old vicious circle of ‘low income, low saving and low investment’, into a virtuous circle of ‘low income, injection of credit, investment, more income, more savings, more investment, more income’.” [6] The Grameen Bank concept has branched out into other countries, but it is worth considering a large project to expand the Grameen system and banking practices to LDCs, taking into account the lessons learned about adequate supervision, and the risks posed by poor households requesting multiple credits to several unsupervised micro-finance institutions.

In rural Africa, access to financial services is very limited while most of the population

5 I am indebted to Zeljka Kozul-Wright for raising this issue.

6 The rural poor borrowers of Grameen Bank own 90 per cent of its shares. The government owns the remaining 10 per cent.

live in the rural areas[7]. Micro-finance institutions, credit unions and savings and loans cooperatives have been expanding to communities without financial services. This result is not exclusive to Africa. In United States an estimated 10 million accounts have left the largest banks since 2010. Credit unions[8] have enjoyed a surge as a result, increasing asset levels to record heights (Brown, 2012). The expansion of financial institutions, which are closer to their customer base and less prone to making risky investment decisions than large Banks, could have a resurgence as a result of the world financial crisis, and, in Africa, this would be in addition to their greater ability to expand to the rural less densely populated areas. The challenge then becomes of striking the right balance as to the optimum levels of supervision required, so as not to inhibit growth, but, at the same time, protect small investors and prevent money laundering.

Non-bank financial institutions are, however, barred by regulations in most African countries from channelling remittances. This is a major opportunity lost in terms of the potential for reducing financial exclusion of the poor, and for promoting financial development at a macro level. Remittances present one of the few avenues for the poor to eventually access formal financial services.

The high costs and conditions of the informal financial markets have been well documented, and are one of the mechanisms reproducing the cycle of poverty. Micro-finance institutions, savings and loans cooperatives, credit unions and rural banks compete with informal markets, and while posing supervisory challenges[9], cater to the market segment of low-income households not usually served by the larger banks. Allowing these financial institutions to tap into remittance market would provide remittance recipients with an opportunity to break-away from financial exclusion as these institutions would see the market potential and would tend to also offer savings and credit products. This could result in poverty reduction, financial deepening, and growth.

Gupta, Patillo and Wagh (2009) have argued for Sub-Saharan African countries, that future remittances could be used to secure small business loans. Remittances funded start-up small businesses in need of long-term financing for expansion, in the likely absence of assets, which could serve as collateral, could obtain funding from micro-finance institutions using the future flow of remittances as collateral[10].

A direct consequence in Africa of the regulatory imposed restrictions to entry into the remittance market is the banks' virtual monopoly, which is associated with high fees and lack of branches next to potential customers. Indirectly, another result is the disproportionate use of informal mechanisms to channel remittances, and, more generally, financial services are also provided informally without leveraging savings of households and reinforcing the exclusion of the rural poor from financial services altogether.

One important developmental impact of remittances documented for Mexico is a strong correlation between remittances and greater banking breadth and depth by increasing the number of branches and accounts per capita and the amount of deposits to GDP (Demirgüc-Kunt, Asli, et al. 2011)[11].

In Africa, regulations on money transfers and supervision for financial institutions need to be revised, such that consistent with financial prudence, the role of banks and, especially other micro-financial institutions increase their participation in the remittance market, and,

7 Only 64 per cent of commercial banks are concentrated in rural areas, but 83 per cent of the total population lives in such areas (Orozco, 2010).

8 Credit unions are non-profit, community-minded organizations functioning as cooperatives where customers also are their owners with equal participation in ownership. Normally fees are lower than in larger banks.

9 Informal markets are, by definition, unregulated posing thus even greater risks than micro-finance institutions.

10 It would be a micro replication of banks securitizing remittances in the international capital markets using remittance flows as collateral.

11 These effects are significant both statistically and economically (Demirgüc-Kunt, Asli, et al. 2011).

thereby, improve access to financial services, especially to under-served rural areas. In short, regulatory frameworks should support the participation of multiple financial institutions, including partnerships among them, while excluding exclusivity deals. This could lead to an increase in banking breadth and depth.

Also hindering competition in Africa, banks sign exclusivity agreements with money transfer companies. This practice seems to be particular to this part of the world. Costs of remittances are higher in most LDCs than in other countries also contributing to more widespread use of informal channels[12]. For example, in Sub-Saharan Africa sending remittances cost almost 12 per cent of a $200 transaction, while most other developing regions average 8 per cent (Ratha, et al. 2011). Orozco, based on data collected in 2008 and 2010, shows that remitting costs to Africa are not only higher than worldwide averages, they have remained high while in other regions they have declined. For example, while in Africa costs have remained over 10 per cent in South East Asia declined from around 9 per cent in 2008 to 7 per cent in 2010 and in Central America from over 5 per cent in 2008 to under 5 per cent in 2010. As a consequence, remittance costs are an unnecessary burden on African household recipients and migrants, and are likely to reduce total amounts sent and, thus, their developmental impact as well.

There are, however, promising changes as post offices are increasing their participation in the remittance market. Their increasing competition can have a positive effect on remittance costs, but their developmental impact is low as they lack technical capabilities and offer few savings products. Moreover, the network of post offices covers most of the territory, but in many cases lack the capacity to handle remittances due to ineffective or no connectivity, cash flow constraints and technical training of staff.

Money transfer companies, in particular Western Union, are promoting the use of mobile phones in rural areas to facilitate access to remittances. Although this mechanism is unlikely to lead to greater access to financial services and poses supervision challenges, it is bound to have an impact on remittances costs and efficiency for the recipients. Money transfer companies compete against 'hawala'[13] networks, which cut into their share of the remittance market. In a way, they can be allies for certain reforms promoting an increase in the share of formal markets (including microfinance institutions) vis-à-vis informal markets.

Informal remittance networks play a key role in many LDCs. In general, informal or hawala networks arise as substitutes for highly regulated, corrupt, unenforceable or non-existent formal mechanisms, or where costs are prohibitive. Informal systems are based on trust and characteristically operate in the absence of a third party enforcer. In Somalia, for example, hawala is the only remittance channel (Schaeffer, 2008).

By their very nature, estimates of the amounts transferred through hawala networks are difficult to gauge. A joint International Monetary Fund-World Bank team constructed a model to make such an estimate. While being aware of its limitations, they calculated US$10 to US$35 billion was channelled through hawala per annum from 1981 to 2001. Costs per transaction were 3 to 5 per cent, much lower than formal systems in Africa (El Qorchi et. al., 2003)[14]. Other studies based on surveys of migrants and remittance recipients and other secondary sources quoted by Ratha, et el. (2011) suggest informal remittance flows, which are not included in the IMF estimates, could be equal or exceed official figures for Sub-Saharan Africa.

12 Orozco (2010A) concludes, based on his fieldwork, that informal channels represent 27 per cent in rural Africa. Although he mentions estimates by the World Bank which could be as high as 40 to 50 per cent.

13 Hawala means transfer in Arabic. Although in India it has a negative connation meaning bribes to politicians.

14 Countries included in the study: Algeria, Bangladesh, Ecuador, El Salvador, Guatemala, India, Indonesia, Iran, Pakistan, the Philippines, Sri Lanka, Sudan, Tanzania, Turkey, and Zimbabwe.

The reasons making formal mechanisms preferable are many and include maximising the developmental impact of remittances, enabling the monitoring of monetary consequences of such flows, preventing fraud and money laundering, etc., however, these informal, unregulated networks will continue to exist so long as the practical reasons for people using them remain, including factors related to the remittance originating countries such as the lack of access of illegal migrants to formal transfer systems.

It is critical to reduce remittance costs and increase the participation of the formal remittance channels. LDCs should support the process of increasing competition in remittance transactions by creating more of a market. There is a wide range of financial institutions specialised in catering for the rural poor, with success records in reducing their financial exclusion.

The reforms for increasing the use of formal channels would require a multi-pronged attack on the many fronts involved which, on the one hand, make the informal networks attractive, including cost, efficiency, and availability of services in the rural areas; and, on the other, introduce the regulatory reforms needed to promote competition in the remittance market by allowing entry to micro-finance institutions and a healthy financial system, and appropriate macroeconomic policies to avoid exchange rate uncertainty among others. But even after registering progress by the formal sector, these gains can be reversed by deteriorating macroeconomic conditions.

A central policy conclusion is, thus, to open-up the remittance market, particularly by encouraging the participation of regulated finance institutions targeting the poor including efforts to: i. directly increase the range of financial actors involved, especially in the rural areas by changes in regulations to allow such participation, particularly of micro-finance institutions, savings and loans cooperatives, credit unions and post offices; ii. promote partnerships among banks and micro-finance institutions; iii. strengthen post office involvement by improving their Internet connectivity, increasing their technical capabilities and cash resources, and promoting a wider selection of savings products; iv. improve telecommunications infrastructure; v. harmonise banking and telecommunications regulations to enable banks to participate in mobile remittances; v. active promotion of competition through specialised remittances trade fairs; vi. discourage exclusivity agreements between all market participants, in particular, banks and money transfer companies; and vii. promote appropriate macroeconomic policies, and financial regulations and prudential supervision for a healthy financial sector.

Finally, remittance flows data collection[15] needs to be enhanced for reasons key to governments, including: better macroeconomic management; improving quality and reliability of debt indicators; and, achieving more realistic country risk assessment results. In Africa data collection by central banks seems to be limited to banks, while reporting should include other remittance providers as well as money transfer companies, and, in order to attempt to capture informal flows, also use household and emigrants surveys.

## 4. MACROECONOMIC IMPACT

Remittances behave very differently from other private flows as they involve transactions among members of the same household not necessarily driven by the profit motive, unlikely thus to be pro-cyclical to that extent. Moreover, remittances can be countercyclical as they act as a form of insurance in the origin countries. Remittances to Mexico increased during the financial crisis in 1995 and in Indonesia and Thailand in 1998. They have also increased in response to natural disasters and political conflicts. Remittances can also have important balance of payments impacts by helping to stabilise the current account by reducing the volatility of capital flows, even to the point of

15 Ratha, et al. (2011) report that some countries believed to be significant remittance recipients report no remittance data at all, including the Central African Republic, the Democratic Republic of Congo, Somalia, and Zimbabwe.

reducing the probability of current accounts reversals, especially when they exceed 3 per cent of GDP.

Official development assistance (ODA) can be pro-cyclical following donor fiscal circumstances, and tied to the donor priorities. Remittances, on the contrary, are untied and relatively focused on the poor. Evidence from Sub-Saharan Africa also shows remittances have been more stable than both ODA and foreign direct investment (FDI) and private debt and equity flows.

*Collateralisation of remittance future flows*

Remittance flows have proven somewhat stable over the medium-term to longer-term. Having this in mind, these future-flow receivables can, in principle, be used as collateral for securitisations[16] or for long-term loans, and indeed, could represent many LDCs' only possible access to international capital markets, thereby increasing funds available for development.

***Securitisations of remittances***. But perhaps more importantly for governments in promoting this asset class is if undertaken as a preparation to eventually establish international credit-worthiness. In the process of securitising remittances (or any other future-flow receivables) the countries may have to undergo a process of institutional and regulatory strengthening which may also have positive developmental impacts in their own capital markets, and in the international perception of such markets. There would thus be positive externalities emerging from fulfilling the conditions necessary for a successful securitisation of remittance future-flows. Indeed for governments these externalities may be the greatest incentive to promote future-flows deals.

In the process of structuring the deal teams of professionals from investment banks, international law firms and credit rating agencies would spend time evaluating sovereign risk, how it may affect the public or private issuer, and trying to structure it away. In doing so, they would study the investment climate and the legal and institutional environments, particularly the existence and implementation of laws regarding property rights and bankruptcy procedures. Some such transactions when backed by governments may even include legal and institutional reforms.

TABLE 1
HIERARCHY IN FUTURE-FLOW TRANSACTIONS

| |
|---|
| Heavy crude oil receivables |
| Diversified payment rights, airline ticket receivables, telephone receivables, credit card receivables, and electronic remittances |
| Oil and gas royalties and export receivables |
| Paper remittances |
| Tax revenue receivables |

*Sources:* Fitch Ratings and Standard & Poor's, in Ratha et al. 2009.

In general, future-flows receivables can be considered for securitisation. Ratha et al. (2009) have constructed a hierarchy of such flows for potential securitisations from developing countries based on information from credit rating agencies. Remittances are among the top of the list of future flows, only heavy crude oil receivables is considered lower risk.

There is now considerable experience in securitising future-flows receivables, following the Mexican experience with oil (PEMEX) in 1987. Securitisations have now been taking place for over 25 years. The main three rating agencies (Fitch, Moody´s and Standard & Poor's) have actually rated 400 such securitisations amounting to over US$ 80 billion (Ketkar and Ratha, 2009). Confidence on future-flows securitisations has been increasing as they exhibit a near-perfect track record[17]. However,

16 Countries can potentially use future remittances (and other future-flows receivables) as collateral to issue bonds sold in international capital markets.

17 One of the few cases of investor dispute regarding an airline receivable –AVIANCA– was settled out of court.

this must be qualified as the amounts involved still represent a small percentage of total debt. However, there is a documented potential in LDCs for securitising future-flows receivables. Based on 2003-2006 averages Ketkar and Ratha (2009) estimated a potential of US$57 billion new securitisations per annum. For remittances alone they estimated a potential of US$12 billion annually.

A typical example of a future flow remittance securitisation would include a bank in a recipient country establishing an offshore special purpose vehicle, to which future remittances receivables are pledged. This special vehicle issues bonds, which are then placed in the international capital markets. Correspondent banks and/or remittances transfer companies are instructed to channel remittances to an offshore account managed by a trustee. The trustee makes principal and interest payments to bondholders and remits excess funds to the recipient bank. This bank has thereby funded itself in the international capital markets at presumably lower costs than in the domestic market or if it had attempted to access unsecured credit internationally. These raised funds can then be used to finance consumption and investment in the recipient country. Sovereign risk has been minimised by the fact that remittances do not enter the recipient country. Potential instability in remittance flows is covered by an over-collateralisation (ratios vary from 5:1 to 10:1). Recipient country bank failure risk are normally low, as they would normally be 'too big to fail', and it would be in the recipient government's interest to make sure it does not, both for domestic market considerations as for its potential impact on the country's credit-worthiness.

Ketkar and Ratha have developed a methodology to assess the potential for future-flow receivables securitisations. Countries attempting such a process would have to meet the following conditions: i. maximum benefits would be obtained by banks from speculative grade countries B or above, as the securitisations are assumed to reach investment grade by structuring away sovereign risk; ii. only two or three banks (assumed to handle 50 per cent of total remittances) would participate in countries with a minimum remittances of US$500 million per annum; and, iii. an over-collateralisation ratio of 5:1.

Table 2 shows remittances UNCTAD data for LDCs for 2010. Two additional columns indicate the over-collateralisation ratio of 5:1 and the 50 per cent assumption, respectively. As can be seen, Bangladesh is a prime candidate for securitisation of future-flows: Standard & Poors gave a BB- credit rating, and under the 5:1 ratio and assuming that two or three banks control 50 per cent of remittances, such banks could securitise approximately US$ 1.1 billion annually. This figure compares very favourably to total ODA US$1.4 billion in 2010.

The impact of potential future-flow securitisation would be very significant for Bangladesh, but there seems to be no other LDC candidate meeting fully the Ketkar and Ratha (2009) test. However, the issue deserves further exploration. The methodology developed is conservative perhaps with the aim of estimating a global figure for the potential remittances offered for securitisation in the developing world. An approach focussed on LDCs and their needs for development finance and the alternative costs of such funds, should relax the assumptions. However, it should be clear that these methodologies only offer indications of a potential, which would have to be verified by more detailed studies. First, the US$500 million cut-off minimum amount is assumed on the basis of fixed costs involved in the securitisation. This somewhat arbitrary amount is argued on the basis of the long lead times taken by investment banks to structure such deals (up to 18 months), and the steep legal costs between US$2 and US$3 million per transaction. As structuring of future-flow receivables have become more frequent, competition among investment bankers has increased, and as a result, there is a trend for developing more of a cookie cutter approach shortening lead times and reducing the input of highly skilled professionals[18]. Second, the 50 per cent rule

18 Ketkar and Ratha (2009) report a clear falling trend in restructuring fees, rating agencies costs per transaction, registration fees, and legal fees particularly for repeat transactions.

of thumb to determine the amount likely to be concentrated on a few banks could also be relaxed as the issue should be empirically determined, such that each individual case should be looked into as one or two banks in one country may have a critical minimum mass, even without reaching the targeted US$500 million. Third, the minimum B credit rating is based on the assumption that sovereign risks may be structured away, such that the transaction may reach investment grade. The potential benefits are obvious in such a case as the bonds could thus be acquired by a wider public, including institutional investors which would tend to hold onto the instruments for the long-haul, even till maturity, and, more importantly, investment grade bonds pay lower interest rates, significantly reducing the costs of funding to a bank situated in a speculative grade country. However, even if investment grade is unachievable for a given transaction, on the one hand, banks may still be interested as the cost of funding differential may still make it attractive to pay the costs of securitisation; but on the other, there is a potential role for development banks.

Development banks could enhance the credit rating of any LDC securitisation transaction by sharing in the sovereign risks with many of the already tried instruments. Some such instruments include: i. direct guarantees to the intermediary reducing exposure to a high percentage of each tranche; ii. indirect guarantees to be provided as counter-guarantees to other intermediaries providing guarantees to bondholders; iii. offering a credit default swap; and, iv. 'wrapping' the transaction by offering credit enhancement in a tranche structured transaction either to junior or senior tranches (Ketkar and Ratha, 2009).

TABLE 2
STOCK OF EMIGRANTS IN MILLIONS AND REMITTANCES IN US DOLLARS AT CURRENT PRICES AND CURRENT EXCHANGE RATES IN MILLIONS, 2010

| | Emigrants | Remittances | 5:1 | 50% |
|---|---|---|---|---|
| Afghanistan | 2.3 | | | |
| Angola | 0.5 | 9 | | |
| Bangladesh | 5.3 | 11050 | 2210 | 1105 |
| Benin | 0.5 | 235 | 47 | 23 |
| Bhutan | - | | | |
| Burkina Faso | 1.5 | 42 | 8 | 4 |
| Burundi | 0.4 | 3 | 0.69 | 0.34 |
| Cambodia | 0.4 | 364 | 73 | 36 |
| Central African Republic | 0.1 | | | |
| Chad | 0.2 | | | |
| Comoros | - | 11 | 2 | 1 |
| Dem. Rep. of the Congo | 0.9 | | | |
| Djibouti | - | 28 | 6 | 3 |
| Equatorial Guinea | 0.1 | | | |
| Eritrea | 0.9 | | | |
| Ethiopia | 0.6 | 387 | 77 | 39 |
| Gambia | 0.1 | 61 | 12 | 6 |
| Guinea | 0.5 | 66 | 13 | 7 |
| Guinea-Bissau | 0.1 | 27 | 5 | 3 |

*Continúa...*

TABLE 2
STOCK OF EMIGRANTS IN MILLIONS AND REMITTANCES IN US DOLLARS AT CURRENT PRICES AND CURRENT EXCHANGE RATES IN MILLIONS, 2010

| | Emigrants | Remittances | 5:1 | 50% |
|---|---|---|---|---|
| Haiti | 1.0 | 1499 | 300 | 150 |
| Kiribati | - | 8 | 2 | 1 |
| Lao People's Dem. Rep. | 0.4 | 1 | - | - |
| Lesotho | 0.4 | 525 | 105 | 53 |
| Liberia | 0.4 | 57 | 11 | 6 |
| Madagascar | - | 10 | 2 | 1.02 |
| Malawi | 0.2 | 1 | - | - |
| Mali | 1 | 385 | 77 | 39 |
| Mauritania | 0.1 | 1 | - | - |
| Mozambique | 1.2 | 117 | 23 | 12 |
| Myanmar | 0.5 | 154 | 31 | 15 |
| Nepal | 1.0 | 3512 | 703 | 351 |
| Niger | 0.4 | 70 | 14 | 7 |
| Rwanda | 0.3 | 91 | 18 | 9 |
| Samoa | 0.1 | 142 | 28 | 14 |
| Sao Tome and Principe | - | 2 | - | - |
| Senegal | 0.6 | 1164 | 233 | 116 |
| Sierra Leone | 0.3 | 48 | 10 | 5 |
| Solomon Islands | - | | | |
| Somalia | 0.8 | | | |
| Sudan | 1.0 | 3178 | 636 | 318 |
| Timor-Leste | - | | | |
| Togo | 0.2 | 302 | 60 | 30 |
| Tuvalu | | | | |
| Uganda | 0.8 | 773 | 155 | 77 |
| United Republic of Tanzania | 0.3 | 17 | 4 | 2 |
| Vanuatu | - | 7 | 1 | - |
| Yemen | 1.1 | 1471 | 294 | 147 |
| Zambia | 0.2 | 71 | 14 | 7 |
| LDC TOTAL | | 25894 | 5177 | 2588 |

**Source:** UNCTAD, UNCTADstat.

In short, having this revised set of less stringent conditions, other potential candidates for future-flow receivables securitisation could include Ethiopia, Haiti, Nepal, Senegal[19] and Sudan. Further analysis is clearly necessary in order to determine whether it is worth proceeding with secured transactions, however, the conditions of LDCs are such that direct support interventions may be necessary as the market would normally tend to gravitate towards the countries with more developed capital markets. The approach would be first to determine whether such a potential does indeed exist; identify bottlenecks; and, define a plan of action[20].

***Remittance as collateral for long-term loans.*** A very interesting financial innovation perhaps offering even more potential than the securitisations for LDCs is the use of remittances as collaterals for arranging long-term syndicated loans. Conditions for arranging remittances backed loans are less stringent than those required for a securitisation, and may offer the greatest potential for most LDCs. Sovereign risk can be mitigated by the remittances, and development banks can offer credit enhancement instruments similar to those mentioned in the case of securitisations. The African Export-Import Bank has experience arranging remittance based future-flow syndicated loans. Indeed in 2001 it launched its Financial Future-Flow Pre-financing Programme to expand use of remittances and other future-flows as collateral to leverage external financing at lower costs and longer maturities. The African experiences include: a) in 1996 co-arranged the first future-flow collateral for a medium-term loan of US$40 million for a development bank in Ghana backed by Western Union remittance receivables; in 2001 arranged a US$50 million Syndicated Note Issuance Facility for a Nigerian entity using Moneygram receivables; and, c) in 2004 it co-arranged a US$40 million remittance backed syndicated term loan facility to an Ethiopian bank using Western Union receivables (AFREXIMBANK, 2005).

In conclusion, LDCs have a limited access to development finance and future remittance-backed securitisations or syndicated loans may not only be an interesting potential source, but more importantly, a building-up approach, both in terms of local institutions and legal framework and of an international track record on sovereign risk, which could eventually facilitate greater access to international capital markets.

From a macroeconomic perspective, the additional funds received either through a securitisation process of remittances or a remittances backed syndicated loan could imply additional pressures on the exchange rate, and hence, on the country's competitiveness. Monetary authorities should always keep this in mind in order to fine-tune policies taking this potential effect into account, although, given the possible magnitudes involved, it is unlikely such an effect would have significant repercussions.

Finally, as mentioned, the evidence in Sub-Saharan Africa seems to suggest the disproportionate use of informal channels for remittances flows to the detriment of banks and micro-financing institutions. This could well be the result of regulatory failures inhibiting micro-financing institutions from participating in the lucrative business of remittances. Given this lack of competition it is not surprising that bank branches concentrate in the big cities, increasing costs to the recipient families, encouraging informal channels, and even, perhaps, discouraging remittances. A consequence of these inefficiencies in the channelling of remittances is a relatively low participation of banks, which however, seem comfortable with big fees. Relatively low formal and bank-channelled remittances reduce the potential for securitisations and/or syndicated loans. Experience elsewhere, e.g., Guatemala, shows that in a relatively more competitive environment, banks would set up branches and

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19 Ketkar and Ratha (2009) also include Senegal in their list of potential remittances securitisations in spite of not reaching the US$500 million cut-off point.

20 In general, a practical approach would recommend not attempting all reforms at once but only those critical to the viability of securitisations, particularly in reference to the bankruptcy law in establishing that assets remain pledged in the event of default.

work with micro-finance institutions in rural remittances recipient regions, as such branches become profitable. But if not subject to competition banks would remain in the big cities and missing out on a substantial part of the remittance market but compensated by the large fees made possible by their regulations sanctioned monopoly.[21] Regulatory reform as well as public policies promoting competition in the formal remittance market is in the interest of recipient households, the countries and even the bank themselves which may have not seen further business opportunities as they are locked in a world of high fees and little competition. One such possibility is raising capital in the international markets at low cost and long maturity made possible by the collateralisation of remittance future-flow receivables.

*Diaspora bonds*

Another source for long-term financing for LDCs could be the issuing of diaspora bonds. Traditionally diaspora bonds are debt instruments issued by a sovereign country to raise funds by placing them among its diaspora population. Diaspora bonds could be issued by a non-sovereign entity and, conceptually, also by a private corporation. The cases of India and Israel offer lessons learned and also illustrate the prerequisites for success.

Israel has issued diaspora bonds since 1951 keeping the Jewish diaspora community interested in this asset class offering a menu of options. Investors of Jewish diaspora bonds have been willing to pay a higher price (accepting lower interests) for patriotic reasons, although it could also be that their knowledge of the sovereign risks is superior to other investors. The Indian government has used this instrument only occasionally when having difficulty in accessing international capital markets (e.g., after the nuclear testing of 1998). Bond prices have been close to market values of non-Indian bonds, however, a premium may have been paid given the fact that access to other sources of international finance were limited at the moment of issuance of the diaspora bonds. Institutionally, the Government of Israel established the Development Corporation to issue diaspora bonds, while India relied upon the government-owned State Bank of India.

Among the factors facilitating the issuing of diaspora bonds are having: i. a sizeable and wealthy diaspora; ii. a strong and transparent legal system for contract enforcement; iii. an absence of civil strife a plus; iv. an earmarking of proceeds for specific projects could help marketability; and v. although not a prerequisite, presence of national banks in the destination countries could facilitate marketing of bonds (Ketkar and Ratha, 2010).

Many LDCs may have a wealthy and numerous diaspora, but would lack most other institutional prerequisites. A case in point is Haiti, needing finance for reconstruction but also characterised by severe institutional and governance weaknesses. Such as Haiti and probably other LDCs, the possibility of issuing diaspora bonds would depend upon the involvement of multilateral and bilateral donors supporting the process with technical assistance and providing credit enhancement options to add credibility to the bond-issuing agency. Management of proceeds from the bonds, earmarked for specific projects, could also gain credibility if supported by an international organisation. Some such projects could be linked to efforts by diaspora knowledge networks.

In total, the LDCs stock of emigrants was 27.5 million representing 3.2 of population in 2010. The majority of which, however, does not migrate to rich countries, and, this fact could limit the potential for a market for diaspora bonds. According to World Bank statistics, the percentage distribution of destinations was: high-income Organisation for Economic Cooperation and Development (OECD) countries (19.2 per cent); high-income non-OECD countries (9.8 per cent); developing countries, of which identified low-income countries (19.3 per cent) and identified middle-income countries (44.0 per cent); and, unidentified (7.6 per cent) (World Bank, 2011). Countries with an emigrant stock of 1 million or more can be seen in Table 2 and the top migratory corridors in Table 3.

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21 Based on an interview with a Western Union executive on the situation of remittances in Sub-Saharan Africa.

TABLE 3
TOP EMIGRATION LDCS AND MIGRATORY CORRIDORS, 2010

| |
|---|
| Bangladesh–India |
| Afghanistan–the Islamic Republic of Iran |
| Burkina Faso, Mali–Côte d'Ivoire |
| The Republic of Yemen–Saudi Arabia |
| Nepal–India |
| Haiti–the United States |
| Uganda–Kenya |
| Eritrea–Sudan, |
| Mozambique–South Africa |
| Bangladesh–Saudi Arabia |

**Source:** World Bank, 2011.

A necessary condition for a successful issuing of diaspora bonds is that the wealthy diaspora must be concentrated in a country with a developed capital market. In this sense, Haiti would appear as the only country satisfying such prerequisite, but, as mentioned, it would require ample support to supplement for other missing conditions. Worth further study, which could be undertaken by the UN, as to the feasibility of issuing diaspora bonds, would be those LDCs (Bangladesh, The Republic of Yemen and Mozambique) having India, Saudi Arabia and South Africa as migrant destinations. An idea worth exploring could be a regional issuance of diaspora bonds by a group of countries supported by a regional bank. This effort would help compensate for the lack of concentration of emigrates from individual countries in any single OECD country. Costs would escalate however as the number of participating countries increases.

In general, LDC governments should consider undertaking actions to maintain loyalty of diaspora communities, conducive to eventually purchasing diaspora bonds and/or participating in organisations to the benefit of origination countries (e.g., knowledge and communal investment promotion).

*Monetary implications of remittances*

As mentioned, from a macroeconomic perspective, remittances have shown to be more stable than other sources of foreign exchange; their movements can be countercyclical; and can improve sovereign credit-worthiness and debt indicators. However, remittances could also contribute to currency appreciation, and in extreme cases, to Dutch disease. The fuelling of real estate bubbles could be related to remittances resulting from personal investments of migrants planning for retirement. Central banks need thus to monitor the additional impact of remittances on the exchange rates and real estate prices, so as to tailor monetary policies to compensate for possible undesirable consequences.

Remittances can have multiple impacts on monetary variables. Vargas-Silva (2009) shows that for Mexico a web of inter-relations can be significant. A direct effect of a positive shock to remittances is an increase on domestic money demand. Remittances behave like any other source of income increase. Households would have an increase in cash possessed for transactions purposes. As expected, positive and significant shocks would also contribute to the appreciation of the local currency impacting the tradable sector negatively. The results also suggest a bi-directional relationship between remittances and the exchange rate depending on the currency recipient households use to purchase goods and services. In this sense remittances would not be strictly an exogenous external flow, but would also respond to changes in the exchange rate, and possibly to other macroeconomic variables in the country of origin.

*Migration issues and remittances*

Migration and remittances corridors are inter-related issues. Migration to OECD countries may be slowing due to both more restrictive policies and increasing unemployment. The long-term demographic trends would indicate that it may well be in both region's (developed and developing) interests to increase migratory flows. However, currently, politics and short-term unemployment issues in the developed world are working against the longer-term rationale. As a result, remittances from OECD countries could tend to diminish over time, or at least not increase at past pre-crisis trends.

As mentioned above, most African international migrants, especially from the poorer countries, go to other African countries reflecting limitations of costs of travel to continents abroad and the skill and education demands of the developed labour markets. As this happens, South-South migration is likely to increase in weaker institutional settings, highlighting a potential increase in human rights abuses, with stricter controls probably also unintentionally promoting informal channels. Public policies and bilateral and regional agreements should address these issues.

In general, Africa is a continent constituted by many small countries, with borders not consistent with ethnic distributions, and the geographic rationale is sometimes also wanting. As a consequence, migratory flows are to be expected. In such a context, regional integration efforts should expand beyond trade to include, among others, the adoption of common or harmonised legal frameworks related to money transfers and migration. Migratory issues include directly related legislation such as the penalisation of human trafficking and temporary work permits, education and training equivalences, and regional professional recognition of competences, etc. Indeed many of the reforms proposed for increasing competition and efficiency in the remittance markets, as well as to facilitate orderly migration, could be undertaken regionally and thereby help circumvent local vested interests. and referred to international best practices and international agreements and treaties of which LDCs may or not be signatories and have or not yet ratified.

## 5. CONCLUSIONS AND RECOMMENDATIONS

Enthusiasm for remittances is based on the claim that they are a 'market-led' mechanism capable of reducing poverty and generating developmental impacts on recipient households, communities and countries. While a pessimistic view of the 'historic structural' approach emphasises that the motivations to migrate are not made on the basis of a rational economic choice, but rather the result of an expulsion from the hometown due to the absence of economic opportunities, and/or strife and climatic reasons. Based on this line of reasoning, it has been argued critically that remittance flows into the expulsing communities have not managed to spark sufficient growth of employment to the point of stopping the need to continue emigrating. In general, remittances are neither the panacea of development (a market-led solution to poverty) nor its curse (unable to stop migration) as sometimes portrayed, but they do play a critical role for the recipient households, and for the recipient economies where remittances are significant.

Remittance potential for development needs to be put into perspective. By their very nature they are not focused on the poorest countries or the poorest households and geographical regions within countries. Migration costs seem to discriminate against the poorest households operating like an entry barrier for the neediest. In this sense, remittances are neither a substitute for development assistance, nor for public policies targeting the poor households and regions. Remittances can be a useful complement provided the environments of recipients are conducive to maximising their developmental impacts. Development assistance and public policies are thus also relevant for reaping potential benefits from remittances. In short, remittances are market-led in the sense that decisions to remit funds are decentralised, however, international and national interventions can make the difference regarding their developmental impact.

In general, functioning institutions and adequate policy-making capacity seem to be at the heart of remittance's potential impact on development. However, there is no silver bullet that can bypass what is normally weak and/or altogether missing in LDCs: **institutions** (rule of law, especially contract enforcement; banking regulations and supervision; and banking and micro-finance development among others) and **pro-growth policies** (appropriate macroeconomic policy formulation and execution, public administrative capacity, etc.). But it can argued that, regardless of the migration motives, since remittances are flowing and many of the costs

have already been incurred into, the issue becomes how to achieve the necessary institutional development and policy framework, in the context of specific LDCs, so as to maximise the positive impacts of such remittances, and minimise negative consequences.

***Microeconomic impacts.*** The functionality of remittances to the recipient households has been well documented. They directly reduce poverty, spur an increase in education and health expenditures, insure against adverse shocks and finance housing and capital investments.

Although based on studies not done in LDCs, conditions and motivations for sending migrants abroad are associated with different developmental impacts at the household level. In particular, there would tend to be greater income smoothing and investments when households follow the New Economics of Labour Migration logic for the decision to migrate, whereas, when such a decision is more survival motivated in a context where the migrant is 'expelled' from the community, chances are there would be less income smoothing and investment. Other household conditions, size, age of family members, gender of the household head, etc. may also impact remittances results. But very interestingly, conditions in the communities also could impact whether remittances are used for investment such as location (near an urban centre) and resources (fertile land).

***Meso-economic impacts.*** The Mexican Programa Tres por Uno is an interesting model to encourage and maximize developmental impact in communities of origin of migrants. The bureaucratic, fiscal and regulation requirements are, however, high and could be challenging for LDCs. The Tres por Uno program shows how to articulate migrant organisations and the levels of government (federal, state and municipal) through system based on matching grants. However, the program has been designed based on a self-selection mechanism of communities and projects generating a bias against the poorest communities.

***Remittances efficiency and costs.*** In rural Africa, access to financial services, particularly to those offered by banks, is very limited while most of the population live in the rural areas. Micro-finance institutions, credit unions and savings and loans cooperatives have been expanding to communities without financial services. These institutions are, however, barred by regulations from channelling remittances. As a consequence, informal channels are frequently used to transfer remittances and, more generally, financial services are also provided informally without leveraging savings of households. Additionally, banks' virtual monopoly on remittance flows is associated with high fees and lack of branches next to potential customers. Remittances thus pay high fees, rely on informal less secure channels, and many of the rural poor end-up being excluded from financial services altogether.

Not surprisingly, informal remittance networks play a key role in many LDCs. In general, informal or hawala networks arise as substitutes for highly regulated, corrupt, unenforceable or non-existent formal mechanisms, or where costs are prohibitive. Informal systems are based on trust and characteristically operate in the absence of a third party enforcer. In Somalia, for example, hawala is the only remittance channel.

The reasons making formal mechanisms preferable are many and include maximizing the developmental impact of remittances, enabling the monitoring of monetary consequences of such flows, preventing fraud and money laundering, etc., however, these informal, unregulated networks will continue to exist so long as the practical reasons for people using them remain, including factors related to the remittance originating countries such as the lack of access of illegal migrants to formal transfer systems.

Remittances present one of the few avenues for the poor to eventually access formal financial services. The outrageous costs and conditions of the informal financial markets have been well documented, and are one of the mechanisms reproducing the cycle of poverty. Micro-finance institutions, credit

unions, savings and loans cooperatives and rural banks, while posing supervisory challenges, compete with informal markets, catering to the market segment of low-income households not usually served by the larger banks. Allowing these financial institutions to tap into remittances market could provide recipients with an opportunity to break away from financial exclusion as these institutions would see the market potential and would tend to also offer savings and credit products.

In Africa, regulations on money transfers and supervision for financial institutions need to be revised, such that consistent with financial prudence, the role of banks and, especially other micro-financial institutions increase their participation in the remittances market, and, thereby, improve access to financial services, especially to under-served rural areas. In short, regulatory frameworks should support the participation of multiple financial institutions, including partnerships among them, while excluding exclusivity deals. This could lead to an increase in banking breadth and depth.

Remittance flows data collection needs to be enhanced for reasons key to governments, including: better macroeconomic management; improving quality and reliability of debt indicators; and, achieving more realistic country risk assessment results. In Africa data collection by central banks seems to be limited to banks, while reporting should include other remittance providers as well as money transfer companies, and, in order to attempt to capture informal flows, also use household and emigrants surveys.

***Macroeconomic impacts.*** Using remittance future-flows as collateral. Remittance flows have proven somewhat stable over the medium-term to longer-term. Having this in mind, these future-flow receivables can, in principle, be used as collaterals, and indeed, could represent for many LDCs a possible access to international capital markets, thereby increasing funds available for development. But perhaps more importantly for governments in promoting this asset class is if undertaken as a preparation for countries to eventually establish international credit-worthiness.

*Securitisations of remittances.* Potential candidates for future-flow receivables securitisation could include Ethiopia, Haiti, Nepal, Senegal and Sudan. Further analysis is clearly necessary in order to determine whether it is worth proceeding with secured transactions, however, the conditions of LDCs are such that direct support interventions by the donor community may be necessary as the market would normally tend to gravitate towards the countries with more developed capital markets.

*Long-term loans.* The African Export-Import Bank has experience arranging remittance based future-flow based syndicated medium to long-term loans. Indeed in 2001 it launched its Financial Future-Flow Pre-financing Programme to expand use of remittances and other future-flows as collateral to leverage external financing at lower costs and longer maturities. Conditions for arranging remittances backed loans are less stringent than those required for a securitisation, and may offer the greatest potential for most LDCs.

The argument for augmenting the share of formal remittance channels over the informal ones is further strengthened by the potential benefits arising from such increase of funds channelled through the formal financial system, which would increase available collateral for accessing international capital markets.

**Diaspora bonds.** Another source for long-term financing for LDCs could be the issuing of diaspora bonds. Traditionally diaspora bonds are debt instruments issued by a sovereign country to raise funds from its diaspora population. Diaspora bonds could be issued by a non-sovereign entity and, conceptually, also by a private corporation. The cases of India and Israel offer lessons learned and also illustrate the prerequisites for success.

A necessary condition for issuing diaspora bonds is that a wealthy diaspora be concentrated in a country with a developed capital market. In this sense, Haiti would appear as the only country satisfying such prerequisite, but it would require ample support to supplement for other missing institutional and governance conditions.

Worth further study as to the feasibility of issuing diaspora bonds would be those LDCs (Bangladesh, The Republic of Yemen and Mozambique) having India, Saudi Arabia and South Africa as migrant destinations.

**Macroeconomic consequences of remittances.** From a macroeconomic perspective remittances have shown to be more stable than other sources of foreign exchange; their movements can be counter-cyclical; and can improve sovereign credit-worthiness and debt indicators. However, remittances could also contribute to currency appreciation, and in extreme cases, to Dutch disease. The fuelling of real estate bubbles could be related to remittances resulting from personal investments of migrants planning for retirement. Central banks need thus to monitor the additional impact of remittances on the exchange rates and real estate prices, so as to tailor monetary policies to compensate for possible undesirable consequences.

*Migration issues*

Migration and remittances corridors are inter-related issues. Migration to OECD countries may be slowing due to both more restrictive policies and increasing unemployment. The long-term demographic trends would indicate that it may well be in both region's (developed and developing) interests to increase migratory flows. However, currently, politics and short-term unemployment issues in the developed world are working against the longer-term rationale. As a result, remittances from OECD countries could tend to diminish over time, or at least not increase at past pre-crisis trends.

## 6. RECOMMENDATIONS

In order to maximise the development potential of remittances in LDCs recommendations include: a) improving data gathering; b) developing a research agenda on remittances; c) promoting policy reforms at the micro, meso and macro level; d) in particular, increasing the participation of formal remittance transfer channels, and, e) promoting greater access to capital markets. Following, a summary of recommendations in these areas is presented.

a) **Remittance flows data collection.** Information on remittance flows to LDCs needs to be improved for key reasons, including: better macroeconomic management; improving quality and reliability of debt indicators; and, achieving more realistic country risk assessment results. In Africa data collection by central banks seems to be limited to banks, while reporting should include other remittance providers as well as money transfer companies, and, in order to attempt to capture informal flows, also use household and emigrants surveys.
b) **Research agenda.** At present, research on remittances seems to be disproportionately concentrated on the most developed countries of origin. More research on the determinants of migration and remittances in LDCs is desirable, in particular: a) testing hypotheses on how cohesive and stable are the households of migrants as explanations for the migration motives being either economic development or survival strategies. The developmental impact on the recipient families would thus be strikingly different. Productive investment and risk diversification would be associated with more cohesive family structures already enjoying some degree of economic development, whereas unstable families with low levels of development would probably use remittances for survival consumption; b) mapping the sub-regions of origin of migrants, as public policy should also take into consideration sub-regions with relatively less migratory outflows. Relevant research questions such as: Is it because the economic prospects of families are relatively better off, or the situation so dire migration cannot be afforded?; c) mapping migrant communities organisations in the countries of destination, including diaspora knowledge networks, and the nature of the links they establish with their origination communities and country level organisations; d) treating remittances not

strictly as an exogenous external flow, but also responding to changes in the exchange rate, and possibly to other macroeconomic variables in the country of origin; and, e) analysing the impact of climate change on migratory flows and remittances needs no further justification, as the impact of desertification in Sub-Saharan Africa on potential migration should be underlined; f) making comparative analyses of monetary and competitiveness implications of remittances; and, g) in short, a call for further research, on the one hand, on the economic logic of household remittance recipients' behaviour, community and macroeconomic issues, while the diaspora organisations on the other, is warranted to further specify policy and institutional lessons for LDCs.

c) **Policy reforms to enhance effects of remittances on development**

**Micro-level.** Research has shown that conditions in the communities of origin of migrants are linked to a greater or lesser use of remittances for income smoothing and investment, and that remittance recipient households have funded access to clean water and drainage. To maximise developmental impact of remittances local governments can: a) improve conditions in the communities of remittance recipients, such as access roads and productivity inducing investments, e.g., irrigation; and, b) enhance the empowerment of household methods to access public services and thereby increase total coverage.

**Meso-level.** The known Mexican Programa Tres por Uno shows how governments can stimulate and program local investments led by the emigrant organisations in their communities of origin by a system of matching grants. Evaluations of new experiences in other countries, particularly LDCs, are key to learn policy recommendations outside of the Mexican institutional context.

The design of the matching grants Tres por Uno Mexican program although involving federal, sate and municipality funds is not designed to attend macro considerations. *From a macro perspective and in the context of a poverty reduction strategy, the self-selection bias of Tres por Uno should be taken into account in its design, to ensure geographical equity in the allocation of public funds.* In this sense, a macro design for a successful meso program aimed at geographical equity should also include: a) earmarking funds to the poorest municipalities; b) capping the maximum per capita income for beneficiary municipalities; and c) making the public matching funds proportional to poverty levels in the municipality (not a fixed 3x1 as in the Mexican design).

**Macro-level.** Central banks need to monitor the additional impact of remittances on the exchange rates and real estate prices, *so as to tailor monetary policies to compensate for possible undesirable consequences*.

d) **Increasing the participation of formal remittance transfer channels.** The developmental impact of remittances in LDCs, Africa in particular, is limited by their high costs. This is due to a limited range of financial actors involved, especially in the rural areas. Inefficient informal channels thus play a large role further minimising the developmental impact of remittances. *Policy and regulatory reform is needed in order to promote a reduction in remittances fees, expand the role micro and alternative financial institutions and thereby increase access to financial services, especially to under-served rural areas.* This could lead to an increase in banking breadth and depth. Recommendations include: *i. promoting regulatory changes to enable greater participation of micro-finance institutions, credit unions and savings and loans cooperatives in channelling remittances; ii. strengthening post offices to enable them to handle remittances while increasing their offer of savings products; iii. active promotion of competition through specialised remittances trade fairs; iv. discouraging of exclusivity agreements between banks and money transfer institutions, and v. a multipronged attack to promote greater participation of the formal remittance networks,*

*including cost, efficiency, availability of services in the rural areas, anti-corruption, etc., financial regulations and prudential supervision to promote competition and a healthy financial system, and pro-growth macroeconomic policies.*
But it must be borne in mind that even after registering progress by the formal sector, these gains can be reversed by a subsequent deterioration in macroeconomic conditions, in particular exchange rate complications, and the financial situation.

e) **Greater access to capital markets.** Finally, a set of recommendations is presented aimed at improving LDCs' access to international capital markets by building upon remittances, for which regional integration and ODA could play a useful role.

One path for LDCs to access international capital markets, and in relatively favourable conditions, is through the collateralisation of future-flows receivables, in particular of remittances. LDCs have a limited access to development finance and future remittance-backed securitisations or syndicated long-term loans may not only be an interesting potential source, but more importantly, a building-up approach, both in terms of local institutions and legal framework and of an international track record on sovereign risk, which could eventually facilitate greater access to international capital markets. Interventions by the local authorities and by the donor community would thus be justified in those cases where future remittances flows seem to have potential for collateralisation.

**Securitisation of remittances.** *A detailed assessment is needed to determine first the potential for securitisation by country; and second, to identify the bottlenecks requiring intervention, including:* a) providing technical assistance and seed money for preparing the secured transaction (hiring an investment bank and legal counsel, project design and financial analysis) and adding credibility to its feasibility; b) reducing regulatory capital requirements for bank investors depending on the modality of the credit enhancer offered if the development bank has a triple A rating; and, c) enhancing the credit rating of the transaction thereby reducing its costs by sharing in the sovereign risks with many of the already tried instruments, such as: direct guarantees to the intermediary reducing exposure to a high percentage of each tranche; indirect guarantees to be provided as counter-guarantees to other intermediaries providing guarantees to bondholders; offering a credit default swap; and, 'wrapping' the transaction by offering credit enhancement in a tranche structured transaction either to junior or senior tranches.

**Remittance backed medium to long–term loans.** A very interesting financial innovation by the African Export-Import Bank, perhaps offering even more potential than the securitisations for LDCs, is the use of remittances as collaterals for arranging long-term syndicated loans. Sovereign risk can be mitigated by the remittances, and development banks can offer credit enhancement instruments similar to those mentioned in the case of securitisations.

**Diaspora bonds.** Many LDCs may have a numerous diaspora, but only Haiti has emigrants concentrated in a country with a fully developed capital market. *Haiti could issue diaspora bonds to finance reconstruction but lacks most institutional and governance prerequisites for issuing diaspora bonds. Management of proceeds from the bonds, earmarked for specific projects. Some such projects could be linked to efforts by diaspora knowledge networks.*

*Worth further study is the feasibility of issuing diaspora bonds should include Bangladesh, The Republic of Yemen and Mozambique, which have India, Saudi Arabia and South Africa as migrant destinations.*

*An idea worth exploring could be a regional issuance of diaspora bonds by a group of countries supported by a regional bank..* This effort would help compensate for the lack of concentration of emigrates from any individual country in any single OECD country. Costs would escalate however as the number of included countries increases.

LDCs governments would benefit from maintaining the loyalty of diaspora communities including: offering dual citizenship; ensuring emigrants can vote in the elections; and, supporting the development of diaspora private networks.

*Regional integration efforts should expand beyond trade to include, among others, the adoption of common or harmonised legal frameworks related to migration and money transfers.* Indeed many of the reforms proposed for increasing competition and efficiency in the remittance markets could be undertaken regionally and thereby help circumvent local vested interests.

Remittances and diaspora bonds will neither substitute ODA nor FDI, but synergies should indeed be promoted. In particular, ODA can be used to reduce remittances costs and inefficiencies, and to maximise positive impacts.

*ODA can support policy reform aiming at maximising the developmental impact at the micro, meso, macro and regional levels:* households (promoting productive investments); communities (supporting links of the migrants and their communities of origin, and the establishment of matching grants funds); macroeconomy (support issuing of diaspora bonds, securitisation of remittances, development of financial institutions, and enhancing prudential regulation and supervision); and, regional (supporting convergence of legal frameworks related to migration and money transfers).

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