

Significance of Remittances

Remittances are an important and often overlooked component of global financial flows which have significant impact on development and poverty alleviation. Remittances are money flows which are sent from an individual working in one country back to their country of origin, typically to family members. Remittances are sent across both formal and informal channels, with greatly varying amounts. The World Bank typically classifies remittances as money being sent back to low and middle income countries.

Remittances and the remittance sending industry are quickly growing. In 2018, there was a record high number of remittances sent to low and middle income countries globally at \$529 billion USD (“Record High”, 2020). The countries which currently receive the largest amounts of remittances are India, China, Mexico, the Philippines, and Egypt (“Record High”, 2020).

The major players in the remittance industry are the individuals who send and receive remittances, remittance service providers (RSPs), and governments and financial institutions which set policies around remittances and different forms of money transfers. Another important institution in the remittance industry is the Bank for International Settlements, which sets international regulations and guidelines for remittance transfer prices and protocols.

A major challenge of the remittance industry is the lack of research and consistent data and regulations across countries, regions, time, and different types of RSPs. The lack of data comes from several factors, like the difficulty in accurately tracking and estimating the many small, private transfers that make up remittances. Additionally, different institutions and governments define remittances differently, and have different regulations and policies determining what is permitted.

Systemic Risk and Remittances

The remittance industry is a significant source of systemic risk in global financial markets, as it provides certain opportunities for risk inducing activities, such as fraud.

Money laundering is an example of the ways in which systemic risk is created by remittance sending and RSPs. Money laundering is an economically significant practice, and accounts for around 2 trillion USD per year (“Money-laundering and globalization”, n.d.). The non-bank financial institutions, or money remittance and currency exchange institutions (MRCEs) which make up RSPs are ideal for avoiding the attention and action of legal authorities for a variety of reasons. First of all, these institutions elude strict regulations and tracking because they tend to provide a number of greatly varying services (“Money laundering through”, 2010). The transfers which are provided by RSPs also happen on a variety of different networks, and the transfers tend to be made very quickly in order to accommodate the needs of the recipients of the guest worker’s money (“Money laundering through”, 2010). Perhaps most importantly, they rely on cash and cash based transfers, which are obviously more difficult to

track and accurately record than online transactions (“Money laundering through”, 2010). Even within a country, these MRCEs and the way they function can differ greatly.

The two main ways that remittances and RSPs are involved in money laundering and similar fraud-involving processes are that an RSP is making illegal money transfers without being aware of the illegality, or that an RSP employee is somehow involved with an illegal scheme or transaction (“Money laundering through”, 2010). These illegal transactions and the money laundering which take place through remittance transfers are often extremely well organized and consist of many miniscule transfers, making them even more difficult to detect (“Money laundering through”, 2010). Additionally, criminal organizations also benefit from the fact that data collecting institutions find it difficult to compare data between different MRCEs within a country (“Money laundering through”, 2010).

Another characteristic of the remittance industry which contributes to its systemic risk are the high costs of sending remittances. The average cost of sending money through traditional RSPs to another country is 7% of the amount being sent, an extremely high cost especially when compared with digital transfers which incur no extra costs (Cecchetti and Schoenholtz, 2018). The costs vary across countries and RSPs, but are consistently artificially high (“Remittances in times”, n.d.). According to VoxEU, the high average costs are partially attributed to users lacking the information to be able to choose the lowest cost RSPs, as well as inconsistent regulation between and within countries (Cecchetti and Schoenholtz, 2018).

These high costs, which are financially damaging to many individuals sending money to their country of origin, have been a subject of attention for years (“Remittances in times”, n.d.). Some accountability is provided by the Remittance Prices Worldwide database, created by the World Bank, which makes public data on the prices of sending remittances across 367 “country corridors”, with the aim of “making markets more transparent” (“Remittance Prices Worldwide”, n.d.). Perhaps as a result of the accessible data and subsequent global attention, one of the United Nations Sustainable Development Goals (10.c.1) is focused on essentially having the costs in the next decade and commitments have been made by countries with large inflows and outflows of remittances to enact policies which lower the cost (“Remittances in times”, n.d.).

The Remittance Prices Worldwide database releases several annual reports which consist of summary data and urgent policy recommendations for governments around the world. Notably, the reports focus specifically on the G8 and G20 countries (“RPW Report”, June 2020). The G8 was a group of industrially and economically advanced countries, and the G20 is a current group of similarly advanced countries, as well as the European Union. Both groups were formed to provide a vehicle for economic discussion and coordination. Membership is certainly advantageous in terms of opportunity, cooperation, and information, and thus the report is biased against countries without such resources. Interestingly, the June 2020 report does not directly mention Covid-19, but remains important in observing global trends in data and how they are beginning to be affected by the pandemic (“RPW Report”, June 2020). While a takeaway of the report was that global averages in prices are generally on track (“RPW Report”, June 2020). The

first quarter of 2020 noted the lowest International Money Transfer Operators Index ever (“RPW Report”, June 2020).

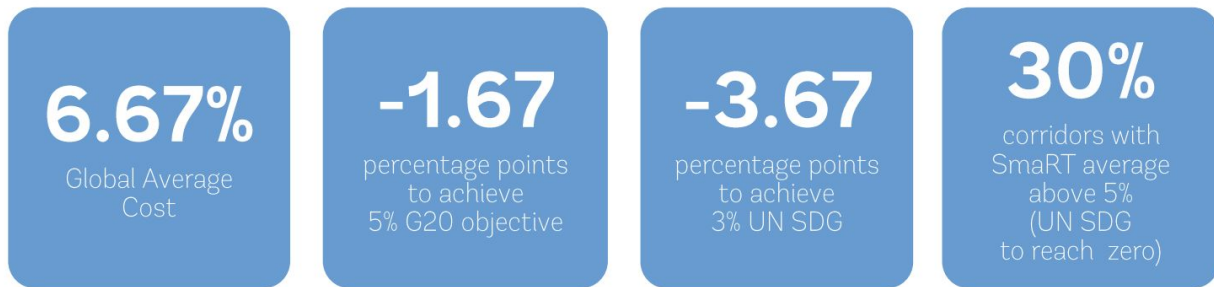


Fig. 1. RPW June 2020 report’s “progress tracker”

Figure 1 represents the RPW report’s “progress tracker”. The report explains that the Global Average Cost remains consistently under 7%, a positive result. The graphic also explains the distance from the G20 goal and Sustainable Development Goal 10.c.1. Finally, it reports progress on the SmarT average, which aims to represent the lowest cost of sending remittances (%) that a well-informed consumer encounters.

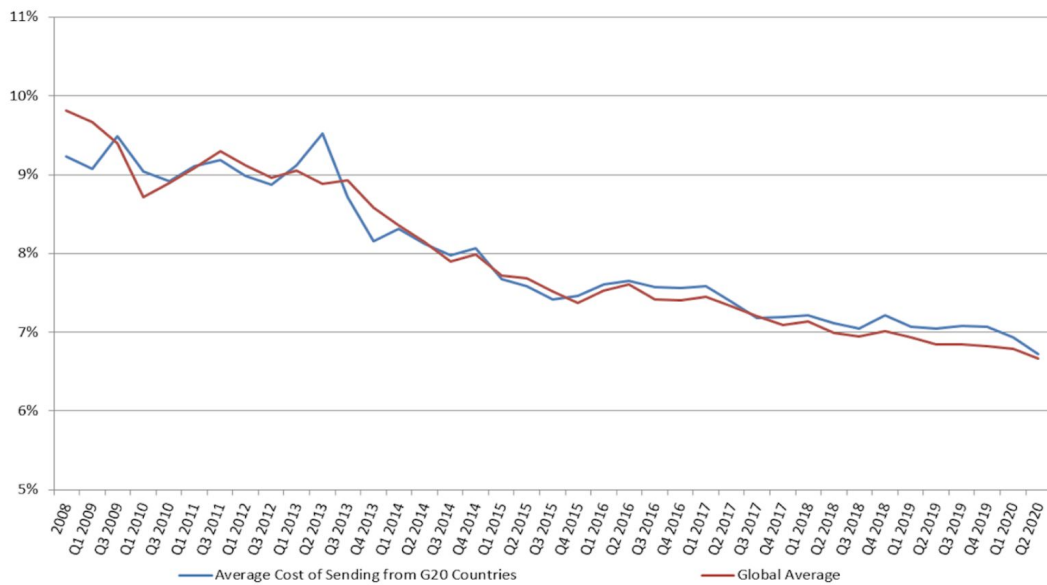


Fig. 2. “Average cost of sending 200 USD from G20 countries”

Figure 2 demonstrates the progress which has been made since 2008 in reducing remittance costs in G20 countries, showing a consistently downward trend in costs with slight fluctuations between quarters.

Another important aspect of the RPW data and reports is the data on different types of RSPs, demonstrating the growing prevalence and advantages of digital remittance sending.

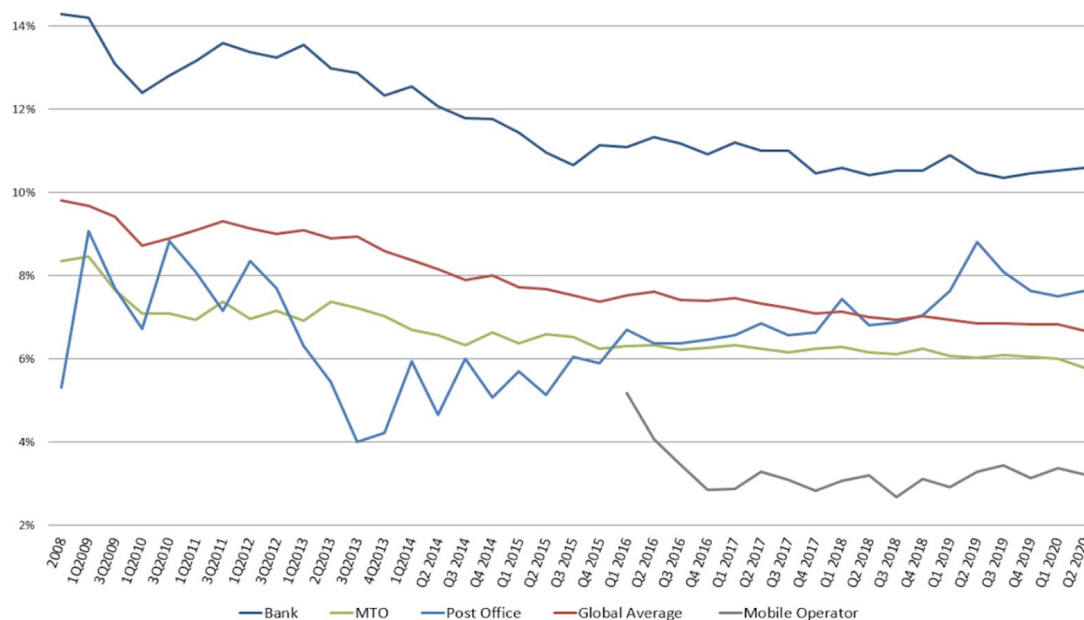


Fig. 3. “Total averages over time by RSP type”

Figure 3 demonstrates that banks are consistently the most expensive RSP and that digital RSPs have been consistently and significantly lower than any other type since their creation. This lower cost is one of the major factors driving a shift away from traditional RSPs and towards digital RSPs.

In a special Covid-19 report, the RPW reported that the pandemic initially drove prices downward, likely due to greater reliance on digital sending methods, but that they have begun rising again and are predicted to continue doing so (“RPW Report Special Issue”, n.d.).

Similarly, an April 2020 World Bank Blog post also emphasized several policy goals and recommendations, while more explicitly addressing the predicted and real effects of Covid-19. These recommendations include promoting national incorporation of digital remittance services, managing exchange-rate shocks caused by Covid-19, support for migrants suffering income insecurity due to Covid-19, and classifying RSPs as essential work (“Remittances in times”, n.d.)

Another aspect of systemic risk to consider in regards to remittances is the instability and inequality worldwide in access to financial resources and information. The Global Findex Database, started by the World Bank and the Bill and Melinda Gates Foundation. According to its surveys undertaken in 2014 and 2017, globally there are 1.7 million unbanked adults, meaning that they lack any type of financial account, whether at a bank or on a digital platform (Demirgüç-Kunt, Klapper, Singer, Ansar, and Hess, 2018). Some obstacles to being banked include the initial cost of opening an account, physical distance from an institution, or not having enough capital to open an account (Demirgüç-Kunt, et.al., 2018). It’s important to note that gender inequality also contributes to the systemic risk that billions of unbanked adults provide to

the remittance industry. 72% of adult men are banked, while only 65% of adult women are banked (Demirgüç-Kunt, et.al., 2018). However, there has been significant growth in regards to being banked worldwide. In the three years between Global Findex Database surveys, 515 million adults who were previously unbanked, became banked (Demirgüç-Kunt, et.al., 2018).

The Global Findex information is available easily to the public, in both a summarized and unabridged form. Access to information on financial inequality like this is a useful tool for policymakers and non-governmental organizations to adjust policies and work towards mitigating the risk that such inequality provides.

It is also key to note that the remittance industry can also mitigate systemic risk in global financial markets. According to dissertation research done at the Ohio State University, remittances can act as an “informal insurance mechanism (Chavez 2004). The Bank for International Settlements also points out that the small amounts typically involved in remittance transfers make the chance of large fraud or shutdown small (Group of Ten, 2007).

Past Shocks and Remittances

The Covid-19 pandemic is not the first major shock that the remittance industry has endured. In 2009, during the Great Recession, there was a 5.5% reduction in global remittance flows (Staff, 2010). There was great regional variation in the effect of the recession. In flows from the Middle East to Southern and Eastern Asia, there was an increase, whereas there was a decrease in flows from the United States to Central and South America (Staff, 2010).

Remittances are also highly responsive to regional shocks. After Haiti suffered a catastrophic earthquake in January 2010, remittance flows increased by 360 million USD (COHA, n.d.). During the crisis in Darfur in 2004, the method of receiving remittances was completely changed as women were no longer able to send and receive money through travelers between Disa and Kutum as they had before, due to government blockades (COHA, n.d.).

Covid-19 and Remittances (and Systemic Risk)

Different institutions which dedicate significant resources towards tracking global remittance trends released their own predictions for the current and future effects of the Covid-19 pandemic on global remittance flows. The World Bank predicted in April around a 20% reduction in global flows (“World Bank Predicts”, n.d.). In the briefing, the World Bank cited reduction in job opportunities and income for guest workers (“World Bank Predicts”, n.d.). A change in remittance spending is also predicted: fewer flows will be spent on secondary goods like education, and more will be spent on pressing issues like hunger (“World Bank Predicts”, n.d.). Beyond predictions for the decline in 2020, the World Bank also predicted a recovery with about 5% growth by 2021, clearly showing the lasting impacts and extended time period that will be necessary for recovery (“World Bank Predicts”, n.d.). Further contributing is the fact that the

harshest lockdowns have been enacted by the countries with the largest remittance outflows, which are the United States, Saudi Arabia, the UAE, the United Kingdom, Canada, Germany, France, Russia, Australia, and Italy, according to an analysis by the Pew Research Center (“Sharp decline”, n.d.). The PRC analysis consulted World Bank predictions, Oxford University’s Coronavirus Government Response Tracker, and Google’s Covid-19 Community Mobility Reports (“Sharp decline”, n.d.). The analysis could have been expanded upon to include regional differences in lockdown requirements, changes in employment and income, and also changes in usage of digital transfer services.

Scholars from the National University of Sciences and Technology in Pakistan and the Islamic Development Bank released a report in June modeling the systemic risk created by Covid-19 in the most severely affected countries. While holding immense worth for policymakers and financial institutions, their models also provide a useful visual overview of the heightened systemic risk created by Covid-19, as shown in Figure 4 .

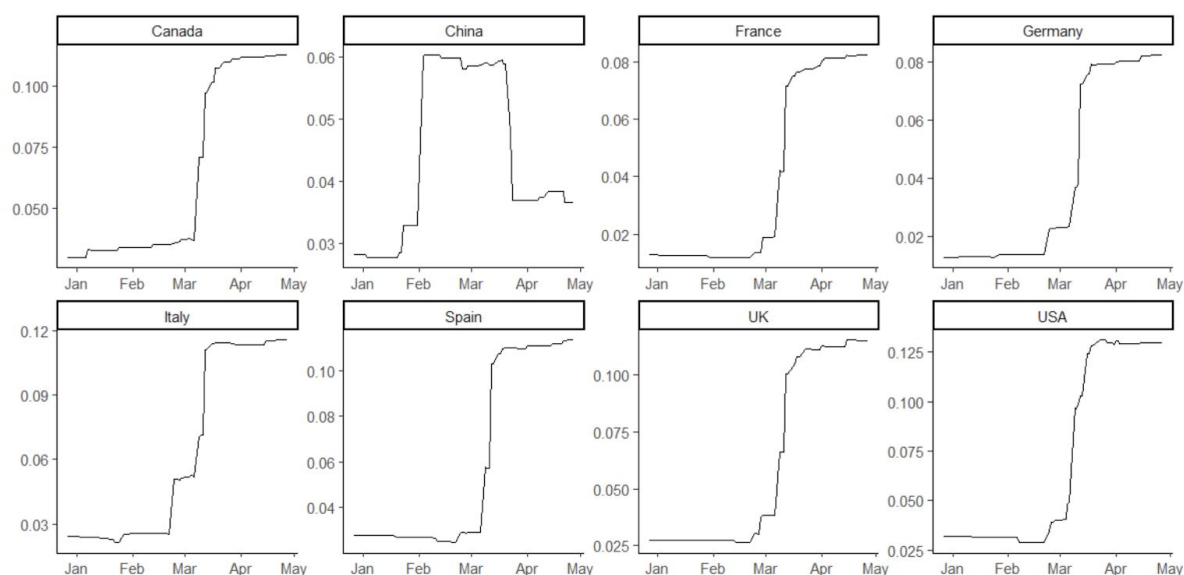


Fig. 4. Calculated systemic risk using a combination of three models

In a June 24, 2020 press release the Bank for International Settlements, a leading institution in remittance policy and tracking, focused on the impact of the Covid-19 pandemic in forcing the remittance industry to speed up the already under-way shift towards online transfers (“BIS encourages”, 2020). They point to fear over the virus spreading through hand-to-hand transfers with cash as one factor in the recent explosive growth of the mobile money transfer market (“BIS encourages”, 2020). A large part of their communication is dedicated to addressing the inequality that currently exists worldwide in regards to access to digital payment capabilities (“BIS encourages”, 2020). The Bank also emphasizes their call to action, strongly encouraging that policymakers educate themselves, keep up with technological advances in the remittance

industry, and work to provide equal opportunity for online transfer students to unbanked groups (“BIS encourages”, 2020).

When examining the remittance industry, it is important to follow the changing remittance technologies as pointed out by the Bank for International Settlements. In the last decade, as smartphones have become a more ubiquitous presence worldwide, the digitization of money in many countries and industries has been rapid. Especially during the 2020 Covid-19 pandemic, benefits of making transfers digitally are made starkly clear. Western Union, the traditionally dominant RSP, has had a 50% increase in the last several months of customers which make their remittance transfers online rather than in person (“Western Union sees”, 2020). Blockchain is a form of online currency with great potential in the remittance market (“The battle”, n.d.). According to Blockdata research, remittance transfers go through almost 400 times faster using Blockchain than through RSPs like Western Union (BLOCKDATA, 2019). Also very importantly, using Blockchain for remittance transfer transactions is significantly cheaper than non-digital methods (BLOCKDATA, 2019). These clear advantages provided by blockchain uses have led to major investment by large RSPs such as Western Union in RSP startups which utilize blockchain technology, like MoneyGram (“Western Union Aims”, n.d.).

Dependence on Remittances

The level to which a country’s economy and social wellbeing relies on remittance is an under researched area. Most remittance data and models focus on the largest remittance channels, as well as the countries which have the largest remittance inflows and outflows, and how these flows match migration. These models are great for understanding general trends and remittance sending methods and hubs. The visualizations of this data are also often overcrowded and difficult to interpret. The most typical indicator used to show a country’s dependence on remittance flows is the percentage of GDP which remittance flows make up. While this indicator is important, it shouldn’t be the sole determinant of dependence. Common models fail to acknowledge factors like how much of a country’s remittance flows come from traditional RSPs and how much come from digital transfers, as well as how a country’s remittance flows tend to be affected by shocks. Another interesting factor to research could be the relationship between an oil economy and remittances. Specific regional analyses of this do exist but global trends and relationships remain undefined.

Conclusion

In order to decrease systemic risk in the remittance industry, especially with the added factor of the Covid-19 pandemic, it seems crucial that policies are created to increase consistent regulation in the industry, increase financial access and opportunity to individuals who are currently unbanked, and to lower costs by continuing the transition away from traditional RSPs and

towards digital RSPs. Also key is continuing to research and provide public data so that remittance senders have the resources they need to be informed consumers. Informed decision making would result in lower-cost RSPs being used, thus bringing down the global average and approaching targets that have been set by institutions like the UN.

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