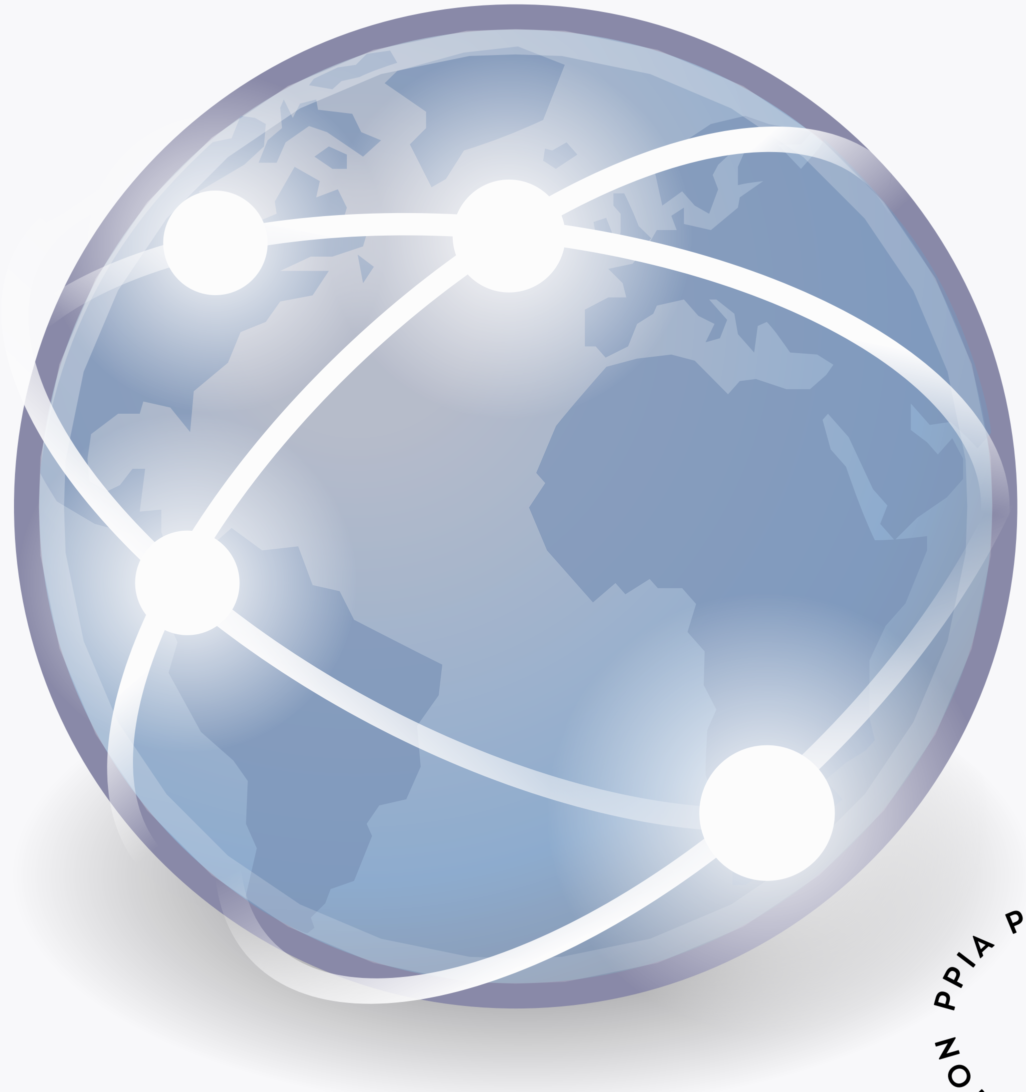
2021

Global Systematic Risk

Remittances: An Analysis of Global Risk Factors and Coping Strategies



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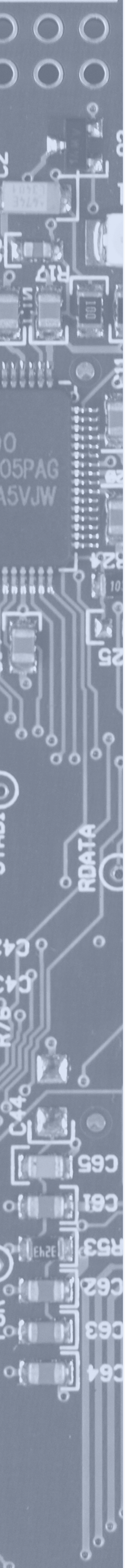

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ABSTRACT

In this paper, we discuss the importance of remittances in terms of their actual value for both the receiving and sending countries and their importance as measured by the percent of GDP composed of remittances (for the receiving country). We explore the benefits and risks of remittances such as economic stagnation. Our findings indicate that remittances can reduce labor supply and create a culture of dependency that inhibits economic growth in the receiving nations. In order to diagnose this problem, we research three case studies: the United Kingdom and Nigeria, the United States and Mexico, and Saudi Arabia and Lebanon. The policy solutions we offer are to lower transaction fees and establish economic support measures that will benefit migrants and service providers.

Introduction

Remittances are vital to the economic growth of developing countries as they exceed direct foreign investment in size (World Bank Predicts Sharpest Decline of Remittances in Recent History, 2020). Given the importance of remittances for developing countries, understanding how to reduce the cost of remitting is of interest to policymakers. One large cost contributing to the amount of global remittance flows are transaction fees. Studies indicate that migrants are at times charged with a fee of up to 10%-15% of their principal remittance amount by remittance service providers (Ratha, 2006). Moreover, the cost of sending remittances tends to be regressive, disproportionately affecting lower-income migrants. A typical low-income migrant sends about $200 or less per transaction. These smaller remittances sent by poor migrants cost more per remittance and hence result in their regressively (Towards Human Resilience, 2011, p.135)).

Remittances can also cause a culture of dependency on this form of income, limiting the economic growth and diversification of nations and individuals. This dependency factor facilitates the economic growth of individuals that receive remittances, but limits their potential economic growth (De Haas, 2010). It is important to create reliable sources of income for those that are dependent on remittances so that they can rely on their own economic output for their daily life functions.

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Case Study: United Kingdom & Nigeria and United States & Mexico

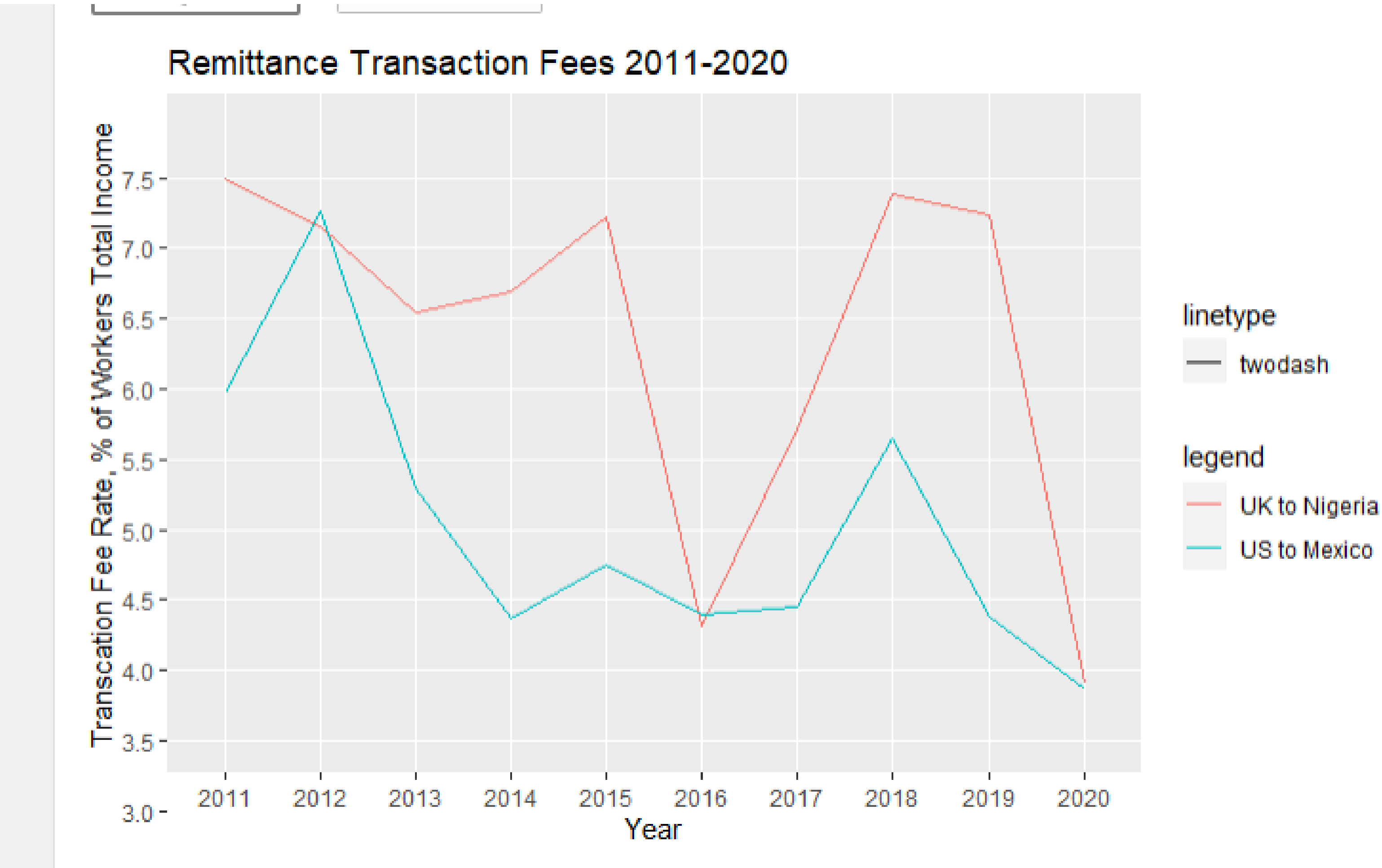
Reducing remittances fees would increase the disposable income of poor migrants, as well as elevate their incentives to send more money . By helping poor immigrants from being targets of hidden and excessive fees charged by remitting companies, countries help them save some cash that could then be used by them as a source of investment and future savings in their new home country. Reducing remittance fees would also increase the funds available to individuals in developing countries relying on those remittances. Reduced remittance fees increases the amount received by the immigrant's family back home, who rely on that money for food, housing, and education. Therefore, any reduction in remittance transfer price would result in more money remaining in the pockets of migrants and their families.

However, there are several systemic risks that significantly affect remittance costs globally. These risks include the regulatory and administrative policies in the sending and receiving country, the transfer mechanism (formal or informal transfer channels), the receiving country's financial infrastructure, and the level of market competition (in both the sending and receiving country). In addition, the exchange rate used in the transaction can significantly affect the cost of the remittance. Hence, if any of these factors are altered in one country, it has a significant impact on the level of remittances transmitted to the receiving country (Ahmed et al., 2021).

The increased interconnectedness of remittance service providers and increased focus on efficiency to reduce costs also raises concerns of global systemic risks. As pointed out by Centeno et al., as a system is more interconnected, the risk of an accident increases. Modern systems rely on increasingly interconnected and hence complex systems, and the cause of the risks is often due to the structure of the system itself. These complex modern systems put an emphasis on efficiency, which may come at the expense of long-term gains and other vulnerabilities (Goldin and Mariathasan, p. 32). This is the case with remittance service providers, whereby remittance transfers occur on a multitude of different networks and hence are more complex and prone to negative externalities (Disparte, 2019). Moreover, remittance transfers often occur rapidly in order to increase the efficiency of the service provider's practices ("Money laundering through", 2010). As pointed out by Goldin and Mariathasan (2014), an increased focus on efficiency can lead to systemic risks resulting from increased uncertainty and specialization, which impedes on resiliency, the ability to deal with unexpected risks when they occur, and can cause contagion.

Another global systemic risk relating to remittance is the lack of regulation. Due to the increased complexity of global networks and unregulated remittance links, worries of undetected fraud from remittance service providers have been heightened. Currently, many remittance service providers work with cash transfers, making instances of fraud hard to identify ("Money laundering through", 2010).These cash transfers allow remittance transfers to be more subject to abuse, money laundering, and sometimes terrorist financing.

One way to assess progress towards lowering remittance transaction fees is by tracking the remittance transactions fees over the past ten years charged in some of the largest remittance countries. Amongst the largest remittance countries are the United States (ranked as the largest remitting country) and the United Kingdom (ranked as the fourth largest remitting country) ("Migration and Remittances Data", 2021). Aside from being two of the largest remittance countries globally, they also tend to remit to different regions with the U.S. remitting mostly to Latin America (primarily Mexico) and the United Kingdom remitting mostly to Africa (primarily Nigeria). Here, we have tracked the remittance fees in these two respective countries over the past ten years to assess progress.



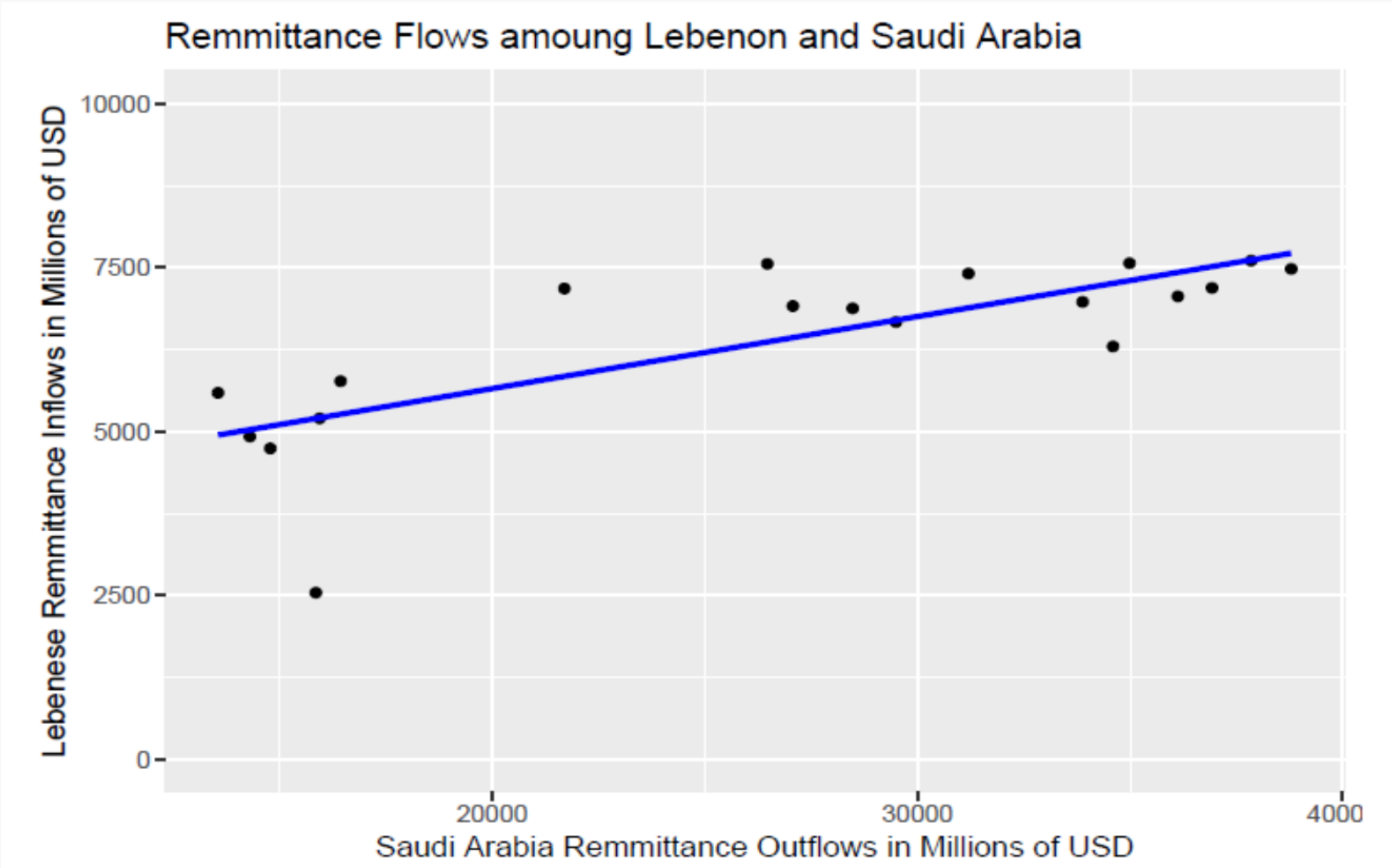
Year	Average Remittance Fee in the United States	Average Remittances Fee in the United Kingdom
2011	5.97	7.49
2012	7.26	7.16
2013	5.29	6.54
2014	4.37	6.69
2015	4.75	7.22
2016	4.40	4.32
2017	4.45	5.72
2018	5.65	7.39
2019	4.39	7.24
2020	3.87	3.91

Source: World Bank: Remittance Prices Worldwide.
https://remittanceprices.worldbank.org/en

The results suggest that both the UK and the US have made large strides towards reducing their average remittance transaction rates towards Nigeria and Mexico ,respectively as a proportion of workers income. There has been a general downward trend in rates over the past ten years. In particular, after the commencement of COVID in 2019, we see transaction remittance rates in both countries drop dramatically reaching as low as in the high 3% for the first time. This trend may be attributed to increased availability and reliance on technology to transmit remittances (Ashoka, 2015). This new development may provide promise in advancing towards meeting the UN's reduction of transaction fee goal of 3% not only among the high volume remitting nations, but globally. These findings are of particular importance considering how lower transaction fees from migrants will contribute to the robustness of the remittance system.

Case Study: Saudi Arabia and Lebanon

Lebanon is highly reliant on remittances and arguably, could not have survived the COVID-19 pandemic without remittances from other Gulf countries, especially Saudi Arabia. The following graph shows how correlated remittance inflows into Lebanon are with Saudi Arabian remittance outflows.



Source: World Bank: Remittance Prices Worldwide. https://remittanceprices.worldbank.org/en

In fact, remittances averaged about 20 percent of the country's GDP annually over the past 10 years — with an estimated 60 percent coming from Gulf countries (The Washington Post, 2017). Lebanon's main source of capital inflows which serve as a social safety net, compensate for the lack of essential public goods and alleviate poverty. Cash transfers to Lebanon mainly originate from Gulf countries, where more than 400,000 Lebanese work and live (Arabian Business, 2020). Lebanon is the 22nd largest recipient of remittances in the world and the 16th largest among developing economies (Arabian Business, 2020). Lebanon is very dependent on remittances because it has been going through a severe economic and financial crisis due to a shortage in the central bank's foreign reserves. This eventually led to the collapse of the local currency and alongside widespread inflation and the loss of thousands of jobs following the outbreak of COVID-19(Arabian Business, 2020). People in Lebanon have come to rely heavily on family members who work in foreign countries, because local banks are restricting withdrawals of Lebanese pounds and completely halting withdrawals of dollars (Feature, Xinhua Net, 2021).

As the global network continues to evolve, smaller states depend increasingly less on the handful of previous colonial powers. That said, remittance structures show the same pattern. The case of Saudi Arabia and Lebanon provides the perfect example to illustrate how remittance power dynamics are shifting away from the centralized powers of North America and Europe. Lebanon is estimated to have received nearly 33% of its GDP in the form of remittances.

Global Risk

As showcased by the cases presented, the system of remittances is highly robust. The COVID-19 pandemic affected many global systems such as finance, trade, and travel, yet the Remittances systems effectively resisted the shocks stemming from the pandemic while maintaining its primary functions. These shocks specifically account for the financial burden that people faced as a result of losing their employment or working fewer hours due to COVID. The primary function of the system, the flow of money from individuals that work in a wealthier, usually developed country to their relatives in need in underdeveloped countries.

According to the world bank, the robustness that this system has experienced can be accredited to fiscal stimulus that resulted in better-than-expected economic conditions in host countries, a shift in flows from cash to digital and from informal to formal channels, and cyclical movements in oil prices and currency exchange rates (World Bank, 2021). Individuals were able to share their wealth from stimulus payments with their less fortunate relatives residing in nations incapable of cashing checks for the needy during the pandemic. The stimulus checks removed economic burden from many families, allowing them to have capital to send to their relatives. Making the flow of cash accessible for these relations has also been a reason for the robustness of the system. A smooth formal process of sending money, allows individuals to send more money to their relatives abroad. The cases presented not only reflect the robustness that the remittances system has, but also the importance of assuring the system's potential.

If these individuals in need of capital from their relatives wouldn't have received it, their situation would be far worse. In times of crisis, it is important for these individuals to have secured income from remittances since the ones on the receiving end of remittances usually live in very poor conditions. Additionally, the economies of those nations that receive large influxes of remittances depend on the system to remain robust in order to operate properly, especially in times of crisis like a global health emergency. Individuals in nations like Lebanon, Nigeria, and Mexico who receive remittances from relatives living abroad operate their daily lives using this income. Their contribution to the economy is in part motivated by the remittances they receive. These individuals and countries are heavily dependent on remittances.

To address the problem of systematic risk and the hardships associated with high cost of remittances, the United Nations Department of Economic and Social Affairs has recently adopted a goal of reducing transaction fees for remittances to less than 3 percent with the aim of increasing income to developing countries and reducing economic inequality. Some studies have found that a 1% drop in the cost of transferring remittances is associated with as much as a 1.6% increase in remittance inflows (Ahmed et al., 2021). Indeed, researchers have found that a reduction in remittance cost from the current average global rate of 7% to the target rate set by the U.N. of 3% would almost double the amount of remittances sent to developing countries (Ahmed et al., 2021). However, the cost of sending remittances remains high, with reasons ranging from the lack of competition in the market to regulatory obstacles to a lack of transparency. According to the World Bank report, the average cost of sending US $200 amounted to 6.8 percent of the total cost in the first quarter of 2020, more than double the UN target.

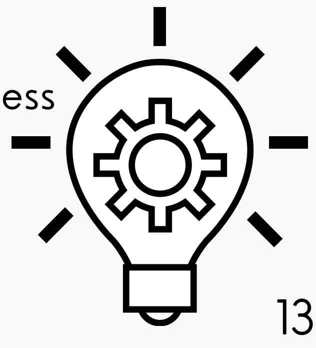
Policy Solutions

The policy issue caused by remittances is the high dependency that some nations have developed on this form of income

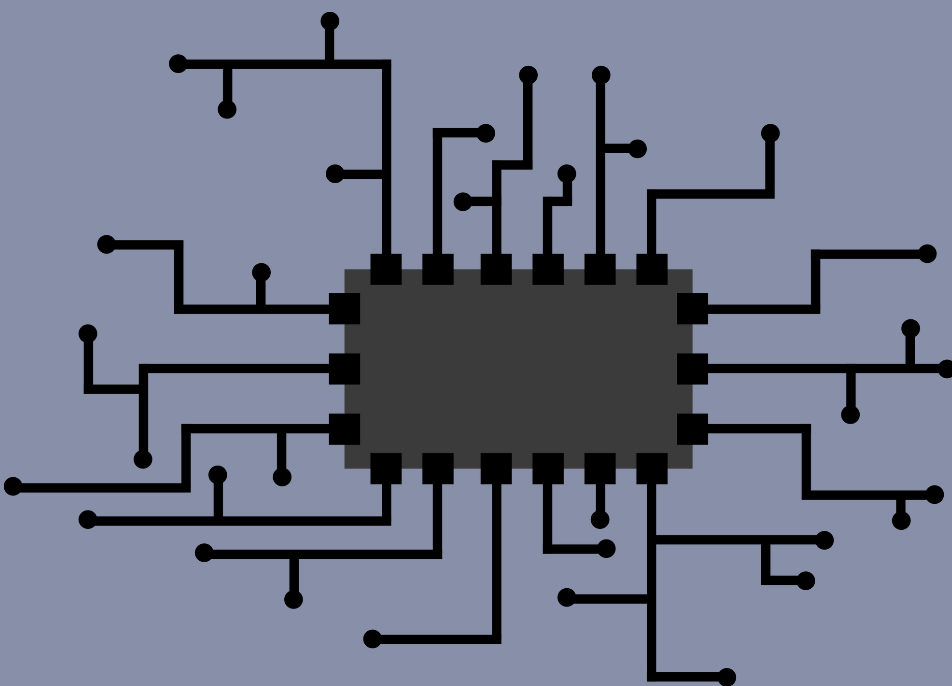
1 | ECONOMIC DEVELOPMENT

2 | LOWERING FEES

.In the book “Return to Sender: The Moral Economy of Peru's Migrant Remittances” Karsten Paerregaard presents the cases of Julio, a young Peruvian migrant in the U.S who supported his daughter and ex-wife in Peru through his earnings from his electrician job (2015). Julio mentions to the author that without his economic contribution, his daughter and ex-wife would not be able to afford rent in Lima, $800 a month. Julio’s situation is one of the many cases of dependency on remittances that exist. To ease the dependency that receivers have on this source of income, fostering local economic growth in the less developed nations is necessary.



Once an individual or nation becomes dependent on remittances the system no longer works to alleviate some economic burden but to entirely compensate for the lack of job opportunities and income faced by the most impoverished. Economic development can help these individuals become less dependent on remittances through employment opportunities and structured economic systems. Economic development in these nations can help tackle issues such as food insecurity so that individuals don't heavily depend on remittances to be able to afford their basic needs. In parts of Nigeria where millions of small-scale subsistence farmers produce food crops in extremely challenging conditions, access to credit, extension, and information can help them overcome food insecurity without being heavily reliant on their family members abroad to put food on the table (Di Falco et al., 2011). Developing credit markets allow farm households to make important investments that contribute to their income.



Additionally, individuals who depend on remittances to be able to operate daily are oftentimes under poverty traps that can be undone through development strategies. Poverty traps describe the "drag" or barriers on low-income or marginalized persons who are trying to improve their economic position (Fajgelbaum, 2017). Low-income persons face many simultaneous barriers to progress; lifting one barrier, even by sheer force, does not necessarily eliminate all of these obstacles. Remittances can help to alleviate one of these, but not all, economic development is needed for this. A strategy that can be implemented is one to make working conditions accessible to men and women (Kazianga et al., 2017). If women are not able to access labor markets it reduces the productive capacity of the economy, causing them to rely heavily on their relatives abroad to compensate for the lack of employment opportunities.

In order to improve and modernize the views that young boys and men have on women and gender roles, compulsory gender issues courses in early childhood should be implemented. It is important for nations with heavy remittance distribution to implement such a program so that women have more accessibility to enter the workforce in an environment that welcomes them, and in turn, they will have higher productivity levels and incorporate their individuality into the firms and occupations they pursue.These courses would educate young boys and men on women's issues and how to better support them, and hopefully change their biases and stereotypes. The policy would look to target this group because it is more likely that these courses could change the opinion of this group, since they would have early access in their lives to these programs, compared to the older population which is more difficult to sway their opinion.

All in all, it is essential for nations that are highly dependent on remittances to use modern economics techniques and tools to analyze policies that can improve the lives of the poor and disadvantaged so these individuals don't rely heavily on remittances for their everyday needs.

Conclusion

In brief, the cases discussed previously illustrate an overarching trend in the global economy, nations receiving remittances are increasingly dependent on these funds. This growing dependency matched with accelerating globalization places the entire system at greater risk. Remittances do provide a source of income in relatively weak economic conditions, but one becomes fearful that long term dependence can stagnate potential economic growth.

That said, remittance flows showed an unexpected robustness in the face of the COVID-19 pandemic, but minor fluctuations exposed weaknesses within the system. The robustness observed is likely a result of relatively stronger economic conditions in the host country. For example, stimulus spending in the host nations helped decrease unemployment towards the end of 2020. Early reports show that many immigrant workers continued to remit because they felt sympathetic to family members in countries experiencing COVID-19 with less economic and health protections (Migration Data Portal, 2021). Shifting to system weaknesses, Saudi Arabia's focus on oil production likely led to a decrease in remittances to Lebanon as oil prices fell early in the pandemic.

To combat this dependence and to minimize systemic risk in the future, it is recommended that the following policies be implemented. First, sustainable international economic development should continue to be incentivized. This will give low income nations the ability to foster their own growth and become less dependent on foreign cash flows. The caveat to this recommendation is that investment into these nations focus on self-sustainability and do not simply create an additional channel for risk associated with forein financing. Second, remitting nations and international organizations should work to reduce remittance transfer fees and regulate transfer providers to help stabilize the cost to send remittances. Finally, human rights should be increasingly protected to ensure migrant laborers remain safe and healthy. In addition to the moral argument, it is crucial for migrant worker's families that the employees are able to earn wages and remit back home.

On this note, it is important to remember the people impacted by the policy. Remittances are a lifeline for many families around the world. By reducing their dependence on these funds and reducing risk to remittance chains, these families could have a more certain future.

Data Limitations

As low and middle income countries continue to rely heavily on remittances as a source of income, it is increasingly important that policy makers have accurate and sufficient amounts of data to implement well informed policy interventions. For one, GDP is typically reported annually with some countries providing quarterly estimates. Oftentimes in relatively small nations, GDP figures are not reported for several months. When evolving crises such as the Coronavirus pandemic occur, quick solutions are needed to prevent rapid economic decay. Without recent data on hand, policy makers' may not have the tools to recognize the magnitude of risk a country faces.

Furthermore, remittance inflows are reported only on an annual basis. Similar to the problem with GDP reporting, changes within an individual year are unobservable using annual data. Most literature suggests that remittance flows were not greatly affected by the pandemic, and year over year data verifies that conclusion.(Migration Data Portal, 2021) But, this data may not show the full picture. Some in April of 2020 estimated that global remittance flows to low and middle income nations would be down 20% using then recent data (Migration Data Portal, 2021). By the end of 2020, remittance flows were down about 2%. Despite a positive outlook at the year's end, larger declines in remittance flows during the year were likely compensated for later in the year as the economic situation in remitting nations improved. Considering that remittances are the main source of income for many families in the countries outlined earlier, two months with possibly zero income makes a great difference in their individual lives, even if that lost income is accounted for later in the year.

Data Limitations

Briefly adding to the previously mentioned concerns, the nature of remittance data collection is open to significant error. Much of the remittance information from developing nations depends on self-reported figures which individuals may incompley share due to distrust. Also, personal and cash transfers are not accounted for as they do not appear as remittances when banks disclose their remittance estimates to their federal government. The rise of decentralized payment platforms will continue to make these types of transfers less visible governments. Finally, touching back to the volatility of transfer fees mentioned earlier, the growing number of international money transfer providers prevents accurate measurements of transaction fees. In nations without regulation of these service providers, the collected data is not complete enough to neither monitor nor model what drives volatility of transfer cost (Alvarez et al., 2015).

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