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# MIGRATION AND REMITTANCES FOR DEVELOPMENT IN ASIA

MAY 2018



**WORLD BANK GROUP**





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#### Photos on the cover:

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*Top row, from left:* A Pakistani money dealer counts United States dollar notes at money market in Islamabad. Experts warn that job losses abroad and global credit crunch could soon slash remittances and affect the country's economy (photo by Aamir Qureshi); Software platforms automate and simplify manual processes of compliance by eliminating errors and increasing efficiency for business. The use of technologies will enhance potential of remittance outreach (photo by Fahad Mateen).

*Middle row, from left:* An ADB loan helped Uzbekistan set up a microfinance institution. Microfinance institutions can be an important intermediary to delivery remittances to households (photo by Eric Sales); Banks and financial institutions play an important role in remittance development. Promoting formal remittance services can lead to productive investments of remittances (photo by Luis Ascui).

*Bottom row:* Many women left behind rely on remittances for their survival. Affordable and secure remittance transfer services should be promoted to help reduce women's vulnerability, and care should be taken to ensure that these services allow women to easily and securely collect money. Financial literacy training will help women to access safe and reliable remittance services (photo by UN Migration Agency, International Organization for Migration).

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# Foreword

Globalization and economic integration call for greater circulation of people. In response to this, more people have sought opportunities beyond their countries' borders. Asia and the Pacific region has seen a significant rise in migration during the last few decades: about one in three migrants comes from Asia according to migration data from the United Nations.

Remittances resulting from this migration are a significant source of foreign exchange earnings for many low- and middle-income countries in Asia and the Pacific region. They are relatively stable compared with other foreign exchange inflows such as foreign direct investment and tend to be countercyclical, and therefore support macroeconomic stability in these remittance-receiving countries. Remittances to developing Asian countries stood at \$244 billion in 2016. These are nontrivial for some countries: for instance, nine countries—Armenia, Georgia, the Kyrgyz Republic, Nepal, the Philippines, Samoa, Tajikistan, Tonga, and Tuvalu—posted remittances equivalent to or over 10% of their respective gross domestic product.

Migration itself brings about positive effects in home countries. It contributes to reducing poverty. While it may vary by labor market conditions in the home country, out-migration would also release the pressure from unemployment and could increase wages. Furthermore, returning migrants or diaspora could contribute to economic development—through generating investment and trade, transferring know-hows and technology, strengthening business networks, and returning with strengthened human capital.

Migrants themselves also gain. According to United Nations data, poorest migrants, on average, experienced a 15-fold increase in income, a doubling of school enrollment rates, and a 16-fold reduction in child mortality after moving to a country with higher standards of living than their home countries (Kaplan 2011).<sup>1</sup> Empirical evidence also suggests remittance-receiving households spend more on housing, health, and education than those with no remittances. Remittances also helped receiving households to smooth out consumptions and enable them to better cope with disasters or sudden economic distress.

However, migration poses challenges as well. Migration can bear implications for gender roles (for instance, in child-rearing) and family cohesion. It could also have spillover effects on political attitudes. Whether these can be considered positive or negative vary by household, by community, and, more broadly, by country. As to migrants themselves, they (especially the low-skilled) tend to be exposed to fraudulent labor contracts, unlawful labor practices (abuse and exploitations), and risks to inflict emotional distress or trauma. These suggest the need

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<sup>1</sup> H. R. Kaplan. 2011. More than Talk: Why Dialogue Is Not Enough. *The Myth of Post-Racial America: Search for Equality in the Age of Materialism*. R&L Education. January.

to have policy responses in place in both home and host countries in order to address these negative aspects of migration.

Remittances have been contributing greatly to maintain balance of payments in surplus as well as overall poverty reduction in many of the region's low- and middle-income countries. However, the economic benefits of remittances have not yet fully materialized. Receiving households tend to spend remittances on necessities, education and health and have little left to invest in financial instruments or other income-generating opportunities. This is largely due to overall financial sector underdevelopment, lack of suitable financial instruments, and insufficient knowledge and financial literacy among migrants and their families. Remittances, if channeled through the formal financial system, can be significant resources for the countries' growth and development; and effective measures to leverage remittances for productive investments should be explored.

This report aims to update emerging issues in migration and remittances and provide policy options for migrant-sending countries to promote safe and gainful migration as well as leverage remittances' economic benefits for the countries' growth and development. It is based on discussions at the international Forum on Promoting Remittances for Development Finance held on 18–19 March 2015 at the Asian Development Bank (ADB) headquarters.

The report is a collaborative work between ADB and the World Bank's Global Knowledge Partnership on Migration and Development (KNOMAD). This report incorporates the World Bank's earlier work on migration and remittances. Chapter 3 is based on "Remittances over the Business Cycle: Theory and Evidence" (S. De et al., 2016, *KNOMAD Working Paper* No. 11, The World Bank). Chapter 5 draws from "Diaspora for Development in Africa" (D. Ratha and S. Plaza, 2011, *Migration and Development Brief* 24, The World Bank), and Technology and Remittance Costs background paper for the Digital Dividend (2016, *World Development Report*, The World Bank). The collaboration was highly useful in bringing insights from the two organizations together and sharing lessons from other regions.

We hope the report can provide useful information and policy options on migration and remittances, a vital and rapidly evolving trend in Asia and the Pacific region.

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This report is a collaborative work among experts on migration and remittances, and jointly produced by the Asian Development Bank (ADB) and the World Bank. This report production was guided by Bruno Carrasco, Director, Public Management, Financial Sector, and Trade Division, South Asia Department, ADB; and Dilip Ratha, Head, Global Knowledge Partnership on Migration and Development, and Lead Economist, Migration and Remittances, at the World Bank. Dilip Ratha also contributed a chapter to the report. Other authors comprised Supriyo De, Senior Economist, Social Protection and Jobs Global Practice, the World Bank; Akira Murata, Lecturer, Chiba Keizai University; Mayumi Ozaki, Senior Portfolio Management Specialist, South Asia Department, ADB; James P. Patti, Partner, Mayer Brown; Sonia Plaza, Senior Economist, Trade and Competitiveness Global Practice, the World Bank; Erica Paula Sioson, Research Associate, Asian Development Bank Institute (ADBI); Soonhwa Yi, Senior Economist, Social Protection and Jobs and Global Practice, the World Bank; and Seyed Reza Yousefi, Economist, Fiscal Affairs Department, International Monetary Fund. The report reviewers—Shikha Jha, principal economist, Economic Research and Regional Cooperation Department, ADB; and Aladdin Rillo, senior capacity building and trading economist, ADB—made valuable inputs to the report. Pamela P. Gutierrez and Ma. Virginia Panis, South Asia Department, ADB, provided essential assistance during the report’s preparatory process. Andrew Perrin, Maricris Jan Tobias, Rodel Bautista, and other members of the Department of Communications, ADB, also made special contributions in producing the report.

# Abbreviations

ABS	-	asset-backed securitizations
ADB	-	Asian Development Bank
AML	-	anti-money laundering
ASEAN	-	Association of Southeast Asian Nations
BLA	-	bilateral labor agreement
BRAC	-	Bangladesh Rural Advancement Committee
CDD	-	customer due diligence
CFT	-	combating the financing of terrorism
DPR	-	diversified payment rights
EAP	-	East Asia and the Pacific
EPS	-	employment permit system
FLC	-	financial learning campaign
FDI	-	foreign direct investment
GCC	-	Gulf Cooperation Council
GDP	-	gross domestic product
IMF	-	International Monetary Fund
IPO	-	initial public offering
IT	-	information technology
KYC	-	know your customer
LCCU	-	Latino Community Credit Union
MFI	-	microfinance institution
MNO	-	mobile network operators
MOU	-	memorandum of understanding
MTC	-	money transfer company
MTO	-	money transfer operators
NGO	-	nongovernment organization
NRCO	-	National Reintegration Center for OFWs
ODA	-	official development assistance
OECD	-	Organisation for Economic Co-operation and Development
OFW	-	overseas Filipino worker
OWWA	-	Overseas Workers Welfare Administration
POEA	-	Philippine Overseas Employment Administration
POS	-	point-of-sales
ROI	-	return on investment
ROS	-	rotating savings
SMEs	-	small and medium-sized enterprises
SPV	-	special purpose vehicle
SWIFT	-	Society for Worldwide Interbank Financial Telecommunication
UNIFEM	-	United Nations Development Fund for Women

# Contributors

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Sonia is also a co-chair of the Diaspora Thematic working group of Global Knowledge Partnership on Migration and Development (KNOMAD) of the World Bank. She was born in Lima, Peru. Her father had a construction firm, so some of her earliest childhood memories are of traveling with him to poor areas, including Ayacucho where he was working on projects. This is how she was first exposed to development work, and it shaped her. She wrote Chapter 5 of the book, *Africa’s Silk Road: People’s Republic of China and India’s New Economic Frontier*, which covers trade facilitation, technology, and skills transfer, and regional trade agreements. Sonia advises many universities on the transfer of skills and tapping into their diasporas. Sonia attended the University of Lima and earned a degree in Economics, after which she joined Chase Manhattan Bank, and was then invited to join the Peruvian Ministry of Trade as a manager responsible for counter trade and debt swap agreements. She also has a dual degree from Yale University and the University of Pennsylvania in International Economics and Development. She was Professor of Economics (International Economics) at the Peruvian School of Foreign Service and at the University of Lima in Peru, and was adjunct faculty (Microeconomics and Macroeconomics) at The American University in Washington, DC. Her research interests include international migration, labor mobility, trade, and the future of labor. She joined the Institute for the Study of Labor as a Research Fellow in February 2010.

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Dilip is the focal point for the World Bank’s Migration Working Group and the Diaspora Bond Task Force, and a co-coordinator of the (G8) Global Remittances Working Group. According to the *New York Times*, “No one has done more than Mr. Ratha to make migration and its

potential rewards a top-of-the-agenda concern in the world's development ministries." Besides migration and remittances, Dilip's research reflects a deep interest in innovative financing for poor countries: diaspora bonds, future-flow securitization, shadow sovereign ratings, and South-South foreign direct investment. He is currently the chair of the Consortium Advisory Group (and previously the founding CEO) of the Migrating out of Poverty Research Consortium based in the University of Sussex. Prior to joining the World Bank, he worked as a regional economist for Asia at Credit Agricole Indosuez, Singapore; as an assistant professor of economics at the Indian Institute of Management, Ahmedabad; and as an economist at the Policy Group, New Delhi. He has a PhD in economics from the Indian Statistical Institute, New Delhi, where he also worked as a visiting lecturer and helped build a Computable General Equilibrium model of the Indian economy. Dilip hosts People Move, a popular blog and can be followed on Twitter at @DilipRatha. His TED Talk "The hidden force in global economics: sending money home" has been viewed over a million times.

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## CHAPTER 1

# Introduction and Overview

*Mayumi Ozaki*

## 1.1 Background and Objective of the Report

Asia and the Pacific region experienced a dramatic rise in migration during the last few decades. The wave of migration increased from the 1970s when the oil price surge provided the impetus for the oil-producing Middle East to scale up their infrastructure investments. From the mid-1980s, countries in the region, such as Singapore and the Republic of Korea, started receiving migrant workers. While the region sent out a significant number of highly skilled workers, the majority of migrants from the region are low-skilled or semiskilled workers.

There were over 247 million stock of migrants in the world in 2013. Of the total migrant stock, 80 million, or about 30% of the total migrants, were from Asia and the Pacific region. The top three migrant origin countries are the People's Republic of China, with emigrant population of 13.8 million; India, 9.6 million; and Bangladesh, 7.5 million. In terms of the percentage of the population, the top three are the Pacific island countries of Samoa, with emigrant population of 60.2% of the total population; Tonga, 53.6%; and Tuvalu, 39.3%. Major migrants' destination countries include the United States and other high-income Organisation for Economic Co-operation and Development countries, as well as Middle East countries such the United Arab Emirates, Saudi Arabia, Kuwait, and Qatar. The region also has significant numbers of intraregional migrations such as from Bangladesh to India, from Myanmar to Thailand, and from Indonesia to Malaysia.

Corresponding to the rise of migration, remittance inflow to Asia and the Pacific region also drastically increased. The total remittance inflow to the region increased from \$104 billion in 2006 to \$244 billion in 2016, and reached \$252 billion in 2017.<sup>1</sup> The top three remittance-receiving countries are India with \$72.2 billion; the People's Republic of China, \$63.9 billion; and the Philippines, \$29.7 billion. In terms of the percentage of gross domestic product (GDP), the Kyrgyz Republic was expected to receive 37.1%, followed by Tajikistan with 28.0% and Nepal with 27.2% in 2017.<sup>2</sup> However, those are officially recorded figures and, if informal remittances—that is, remittances channeled through informally—are included, the actual amount of remittances is considered to be much higher. For many developing countries in the region, remittances are the lifeline of the economy and the most important foreign exchange source.

The region's growing migration and remittances are expected to continue as long as significant income disparities exist between migrants' home countries and host economies. However, to

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<sup>1</sup> Projection. KNOMAD Data. <https://www.knomad.org/data/remittances>.

<sup>2</sup> Projection. KNOMAD Data. <https://www.knomad.org/data/remittances>.

date, efforts to understand migration's dynamics and remittances' effect on the countries' long-term development are rather limited.

The Asian Development Bank (ADB) hosted an international forum on Promoting Remittances for Development Finance on 18–19 March 2015.<sup>3</sup> The Forum's objective was to increase the knowledge on migration and remittances in the region, and maximize remittances' potential for the receiving economies' growth and development. The Forum identified key policy recommendations. To enhance the benefits of remittances, the countries should (i) enhance access to formal remittance services while bringing informal remittance flows into the formal financial system, (ii) leverage remittances by channeling to productive public and private investments, and (iii) improve impact of remittances by developing innovative remittance-linked financial products.

This report intends to provide updates on emerging subjects on migration and remittances and offers insights on how to maximize the economic benefits of remittances while minimizing the social costs of migration. The remittance-receiving countries' continued policy attentions on the issues of migration and remittances are essential to capture the benefits of remittances and improve the welfare of migrant workers.

## 1.2 Organization of the Report

The report consists of eight chapters on the different aspects of migration and remittances across the regions. The key highlights are as follows:

*Appropriate policies can enhance the economic benefits of migration for both sending and receiving countries (Chapter 2). Remittances that migrants send can stabilize both household and national incomes (Chapter 3). To better mobilize this resource, however, migrants and their family members who are left behind would gain from financial literacy programs (Chapter 4). More cost-efficient and accessible financial transfer mechanisms would further improve their welfare (Chapter 5).*

*Majority of Asian migrants are low-skilled, and the small amounts of money that they send back home tend to be used largely for consumption. However, given the large numbers of migrant workers overseas, the total amounts they send add up to large sums. Channeling these remittances to public investments in recipient countries will contribute to their economic growth, expand employment opportunities, and promote overall living standards. This would require effective rules and regulations and necessary infrastructure for financial development (Chapters 6 and 7).*

Chapter 2 focuses on the impact of migration and remittances as well as rules and regulations governing labor migration. It assesses on low-skilled labor migration issues that hamper bringing economic benefits to both sending and receiving countries. This chapter argues that, despite the general perception, low-skilled worker migration can contribute to the economic growth if the host countries' policies and environments are flexible and accommodating to the migrant worker inflow. The chapter provides policy recommendations on managing

<sup>3</sup> ADB k-Learn. <http://k-learn.adb.org/learning-events/forum-promoting-remittances-development-finance>.

the worker migrations, while protecting the workers' rights and welfare with the aim of enhancing economic gains from migration.

Chapter 3 analyzes the behavior of remittances over the business cycle in comparison with other inflows such as foreign direct investment (FDI), portfolio equity, and official development assistance. It also examines the remittance behavior during the sudden stops and financial crisis. The author reviewed the cyclical features of remittances for a set of 109 countries for the period 1980–2012. The chapter found that remittances are acyclical in comparison with FDI and portfolio and equity, but stable during the time of sudden economic shocks and financial crisis. The chapter indicates remittances can be a stable source of income for receiving households even at the time of economic distress.

Chapter 4 introduces examples of financial literacy programs targeting migrants and remittance recipients and empirical findings on impacts of financial literacy programs on people's financial behavior. Based on these empirical findings, the chapter summarizes good practices for better financial literacy programs. The chapter argues that lessons from good practices could be used to improve financial literacy programs to increase the positive impacts on the financial behaviors of migrants and their families.

Chapter 5 identifies the issues in the traditional banking system in extending access to remittance services to migrant workers. It introduces various online platforms and solutions which can provide cost-efficient and accessible mode of remittances for migrant workers. The chapter also describes diaspora bond and future flow securitization as means to mobilize long-term financing through remittance inflows.

Chapter 6 discusses on the measures to channel remittances for productivity enhancing investments. The chapter identifies key areas of support to promote remittances for investments, including (i) conducive regulations, (ii) payment system that can support technology-based remittance services, (iii) linkages to microfinance institutions (MFIs), (iv) remittance-linked investment instruments, and (v) information and financial literacy. The chapter comments on how to provide incentives for migrant workers to channel remittances through, and invest in, the formal financial system.

Chapter 7 provides details on the future flow securitization of remittances to raise long-term financing for various types of investments. Remittance-receiving countries can potentially raise a large sum of money by selling rights of remittances' future flow. The chapter explains the basic structure, benefits, and required legal and regulatory framework for financial institutions to structure such transactions.

Chapter 8 summarizes the chapters and provides recommendations on (i) safe and efficient migrations beneficial to both sending and receiving countries; (ii) regulatory, institutional and policy measures to promote financial inclusion and financial sector development to leverage remittances for public investments; and (iii) effective financial literacy training programs for migrant workers and their families.

## CHAPTER 2

# Magnitude and Pattern of Migration and Remittances

*Dilip Ratha, Soonhwa Yi, and Seyed Reza Yousefi*

## 2.1 Introduction

Migrants from Asia stand at an estimated 70 million, accounting for one-third of the total international migrants. Migration patterns reflect the wide income and demographic disparities within the region and with other parts of the world. While Asia is a major source of skilled migrants to advanced countries, most Asian migrants tend to be low-skilled. And all migrants contribute to the economic development within Asia as well. Remittances resulting from migration—estimated at \$250 billion in 2016—represent more than half of the total remittances to developing countries. These remittances support macroeconomic stability, as well as contribute to reducing poverty and building human capital.

Key destinations of most Asian workers, especially the low-skilled, tend to be within Asia including neighboring countries. While facing strong competition of its talents with the Russian Federation and other developed countries, Kazakhstan has attracted low-skilled workers from neighboring Kyrgyz Republic and Uzbekistan. While the Russian Federation is still a predominant destination, Tajiks are increasingly turning their feet toward Kazakhstan. While most South Asian low-skilled workers go to the Middle East region, India is a magnet for Nepalese. Thailand is a host of most people from Myanmar, the Lao People's Democratic Republic, and Cambodia who fill agriculture and fishery jobs. Malaysia and Singapore remain a key destination for Indonesians, e.g., occupying plantation and manufacturing jobs in Malaysia. Filipinos, who have been globe-trotters, have established a dominant presence in neighboring Hong Kong, China, Singapore, and other East Asian countries as well as in the Middle East. Thanks to skill upgrades, Filipinos increasingly work in the health sector in Japan and in other advanced economies in the world—a development supported by aging population in these destination countries.

This chapter focuses on the impact of this dynamic migration and resulting remittances as well as rules and regulations governing labor migration.<sup>4</sup> Given that the impact of migration and remittances has been widely explored, this chapter adds value to the literature by discussing policies related to low-skilled labor migration, as barriers to such migration flows hamper economic development of both labor-receiving and -sending countries. Unlike public perception, the benefits of low-skilled labor migration can outweigh costs in host economies as long as labor and capital markets are flexible enough to adjust to inflows of migrants (Dadush 2014).

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<sup>4</sup> This chapter is adapted from an earlier work, "Migration and Development: The Asian Experience," in *Routledge Handbook of Immigration and Refugee Studies*, 2015, edited by Anna Triandafyllidou.

Labor migration policies of host countries in Asia remain geared toward attracting skills and filling labor shortages, in part owing to aging population. Their migration regimes vary by skill level: skilled, semi-skilled, and low-skilled. While offering skilled migrants the opportunities to resettle, they accept low-skilled labor migrants on a more temporary basis, despite their positive contributions to the economy. This temporary migration system aims to fill labor shortages through circulating labor between sending and receiving countries, but existing irregular migration problems (including overstays) that host economies face seem to suggest that the system is ineffective in controlling inflows and helping workers to return in time. Evidence suggests that more work is needed to curb irregular migration as it could lead to eroding social protection.

On the other hand, origin countries in Asia tend to have the youth population bulge and have been proactive in promoting overseas employment of workers and in protecting their labor rights. Workers have actively pursued overseas employment to earn higher income. Nonetheless, governments and workers alike face challenges associated with high migration costs and ensuring workers' rights and safety abroad. Out-migration brings in foreign exchange earnings (remittances), which supports macroeconomic stability and economic growth through augmenting migrant-household's income, increasing expenditures on human capital accumulation, and raising investments. On the other hand, it can weaken the countries' competitiveness through real exchange rate appreciation and, possibly, increased skills mismatch.

Key emerging policy recommendations are as follows: countries, especially sending countries, should strengthen institutional capacity to tighten up enforcement of migration-related rules and regulations and, as a result, to reduce migration costs and to improve migrant worker protection. Receiving countries should increase labor market flexibility to allow timely adjustments of inflows of migrant workers through better collection of migration data and labor market analyses. Sending countries should focus on formulating coherent migration-related policies and regulations to address market failures in migration.

This chapter is organized as follows. Section 2.2 reports stylized facts on migration and remittances. Section 2.3 reviews the impact of migration and resulting remittances on both host and origin countries. Section 2.4 describes policies associated with managing labor migration. Section 2.5 concludes with policy recommendations.

## 2.2 Labor Migration—Stylized Facts

### 2.2.1 Drivers of Migration

International migration can be broadly classified into long-term and short-term migrations. Long-term migration encompasses permanent labor/investment migration, repatriation, marriages and family reunions, and refugees/asylum seekers. Short-term migration includes temporary or circular labor migration, traders, and students. This chapter largely focuses on short-term labor migration.

From a demand-side perspective, the different demographic trends and the increasing demand for personal services (such as health care) in advanced economies appear to be the major force for labor migration in Asia. The United Nations population projections (2013)

indicated that the labor force of many advanced economies will decline substantially (for example, 1.3 retirees for every worker in Japan by 2050), while their neighboring developing countries still have birth rates above replacement levels (four workers for every retiree in the Philippines).

With many forces at play, on the supply side, economic opportunities drive people to work abroad. In Viet Nam, nine out of 10 migrants responded that they went to other Asian countries to earn more income (Belanger et al. 2010). For instance, Vietnamese workers in the Republic of Korea can earn at least 11 times as much as they would in their own country. Bangladeshi and Nepali returnees responded “attain financial solvency” and “low income and savings,” respectively, as key factors leading them to work abroad (Asia Foundation 2013). The primary reason why low-skilled workers chose to migrate to Kazakhstan is higher “labor earnings” (40% of survey respondents; Sadovskaya 2009).

Non-economic factors also explain why people migrate. Nepali returnees pointed out “favorable conditions abroad” as a key determinant (Asia Foundation 2013). Filipinos chose to work abroad, among others, for “better future for children/family” (Asis 2005); a sample of high-skilled Filipino migrants in New Zealand and Australia revealed that key motivations for migration included career advancement, better quality of life, social service, and work–life balance (Siar 2013).

While case studies show that the friction of distance has become minor, some Asian countries attract workers from neighboring countries, such as from Myanmar, the Lao PDR, and Cambodia to Thailand. For instance, Kazakhstan attracts workers from countries that are geographically close. Sadovskaya (2009) reported that about half of the survey respondents chose to migrate to Kazakhstan because it is easier to go home and visit families and relatives, and less costly to drive up home. Furthermore, knowledge of the Russian language, cultural affinity, and history contribute to shaping migration flows in central Asian countries (Ryazantsev and Korneev 2014).<sup>5</sup>

Migrant networks add values in all stages of migration. Empirical evidence shows the presence of chain migration. As family or relatives migrate, information flows back to the origin country, which reduces the constraints to migration for the next migrants. A case study has shown that migration of Bangladesh women is highly associated with the past flow of migration (Sultana and Fatima 2017). In addition, diaspora networks help migrants find accommodation and return to the country of origin.

### 2.2.2 The Magnitude of Migration

Globally, some 70 million migrants are from Asia, accounting for one-third of the international migrant stock. The majority of South Asian migrants have lived in the Gulf Cooperation Council (GCC) states. For instance, the United Nations (2013) estimated that half of all Indian migrants worldwide lived in the GCC, especially in Saudi Arabia and the United Arab Emirates. Azeez and Begum (2009) argued that the oil industry in the GCC has been hiring Indian migrants, low-skilled migrants in particular, since 1970. Unlike South Asia, the East

<sup>5</sup> Language or cultural affinity appears to be also highly associated with migrant protection and their integration in the host society. For instance, low-skilled Tajik migrants in the Russian Federation who have a low level of local knowledge and weak Russian language skills are exposed to abuse, poor living and working conditions, and exploitations (Jones et al. 2007, p. 9).

Asia and the Pacific (EAP) region has seen more out-flow migration to the United States (US) (Table 1), partly owing to historical ties with the country. Since the end of the Vietnam War, for instance, a key destination of Vietnamese migrants has been the US. Nonetheless, both regions in Asia have seen dynamic migrant circulations within each region as shown in Table 2. This is due, to some extent, to income and demographic disparities within the respective region as well as political instability (e.g., Myanmar migrants in Thailand).

**Table 1: Destination of Migrants from Asia (stock, million, 2013)**

	From East Asia, Southeast Asia, and the Pacific	From South Asia
<b>Total</b>	<b>31.4 million</b>	<b>38 million</b>
East Asia and the Pacific	20%	1%
Middle East and Northern Africa	0%	6%
South Asia	3%	28%
Gulf Cooperation Council	14%	43%
United States	22%	7%
Rest of the World	41%	15%

Source: United Nations (2013) *International Migrant Stock*.

In general, the scale of labor migration inflows in Asian countries has been growing in recent years. Table 2 shows that, in 2000, Singapore had about 686,000 labor migrants (or 29% of the labor force) and, in 2014, it hit the 1.3 million mark, accounting for about 40% of the labor force. Albeit from a lower base, the Republic of Korea remarkably expanded the share of its foreign labor force, from 0.1% in 2000 to 3% in 2014. To put it in a different context, one-fifth of labor force growth during 2000–2014 owed to foreign labor migrants.

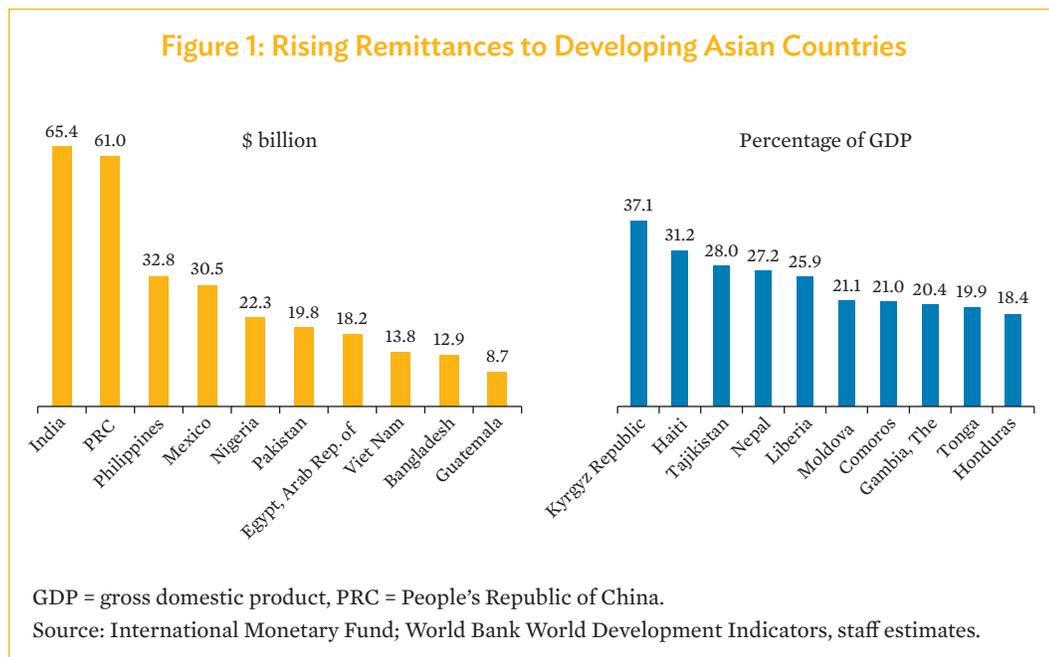
**Table 2: Migrant Workers Represent a Large Share of the Labor Force in Malaysia and Singapore (Number of Foreign Workers Employed)**

	Stock of foreign workers (thousand)		Share in labor force (%)	
	2000	2014	2000	2014
Japan	516	682 <sup>a</sup>	0.8	1.0
Korea, Rep. of	17	896 <sup>b</sup>	0.1	3.3
Malaysia	945	2,320 <sup>c</sup>	9.9	17.0
Singapore	686	1,337 <sup>d</sup>	29.4	38.8
Thailand	664	3,000 <sup>e</sup>	2.0	7.7

Sources: <sup>a</sup> The Japan Institute for Labor Policy and Training. 2014. Migrant stock and labor force share as of 2012; <sup>b</sup> Statistics Korea. As of May 2014; <sup>c</sup> Malaysia Labor Force Statistics. As of August 2014. Share in the labor force as of 2013; <sup>d</sup> Singapore Ministry of Manpower. As of June 2014; <sup>e</sup> Thailand Ministry of Labor. As of May 2014 (2.2 million registered and 800,000 irregular migrants).

### 2.2.3 Remittance Flows

The global top three remittance recipients are in Asia: India, the People's Republic of China, and the Philippines. Developing Asian countries are estimated to have received some \$240 billion in remittances in 2016, accounting for nearly half of the total remittance flows to developing countries (Figure 1). Smaller countries, such as Nepal and the Pacific island countries, are most dependent on the funds as indicated by remittances as a share of gross domestic product (GDP). The rise in remittances reflects increasing out-migration, decreasing cost of remittances, and improved recording of international transfers (Clemens and McKenzie 2014). The International Monetary Fund (2009) argued that, if remittances made through informal channels<sup>6</sup> are also considered, worldwide remittances may increase by 50%.



## 2.3 Impact of Migration and Remittances

Gains from liberalizing labor mobility are far greater than those from further liberalizing goods trade.<sup>7</sup> The gains are larger because differences between countries for price of labor services are larger than for goods trade. Walmsley et al. (2007) found that, if the Organisation for Economic Co-operation and Development (OECD) countries allowed an additional inflow equivalent to 3% of their existing labor force, global real output would increase by \$287 billion. Of this total, \$175 billion owes to migration of unskilled labor and \$112 billion is from migration of skilled labor. Quantifying the effect of a full liberalization of labor mobility, Docquier et al. (2015) estimated that world GDP per worker increases by 11%, and Asia is a

<sup>6</sup> Including cash carried by individuals, known as *hundi* or *hawala* in South Asia and *padala* in the Philippines.

<sup>7</sup> Services trade is not considered since labor mobility is part of services trade (Mode 4 of service delivery - 'Movement of Natural Persons' as defined in WTO General Agreement on Trade in Services).

winner, seeing an increase of GDP per worker by some 2%, primarily owing to a reallocation at the intra-regional level. Once migration network effects are added, income per worker increases by some 7% in Asia.

### 2.3.1 Impact on Host Countries

Asian migrants tend to engage in low-skilled occupations, enabling natives to specialize in higher-skilled jobs. Malaysia underwent a structural change in terms of the occupations by natives—from agriculture and manufacturing jobs to more skilled jobs in the finance and business sectors. In 2013, 96% of employed migrants had less than a secondary education, and were mainly employed in the plantation and manufacturing sectors. This specialization can boost competitiveness, and thus contribute to create further jobs for natives. In Malaysia, every 10 additional migrants in a given industry-region create four new jobs for natives (Ozden and Wagner 2014).

Also, the complementarity between migrants and natives helps reduce the adverse impact of migration on wages and unemployment. Docquier, Özden, and Peri (2010) simulated the wage impact of migration and found that immigration strongly helped the wages of low-skilled workers in Singapore (+6.8%). Peri and Sparber (2008) found a complementarity between migrant and local workers: among less-educated workers, native workers appeared to work in the manufacturing or mining sectors, while migrant workers tended to work in the personal service and agriculture sectors. In Thailand, low-skilled migrants would increase wages of skilled natives (with high school or higher education), while depressing marginally (less than 0.5%) the wages of low-skilled natives (Lathapipat 2014).<sup>8</sup> The Republic of Korea, Malaysia, and Thailand have little evidence that migrants adversely affected employment (Ahsan et al. 2014). Kim (2009) found that, in the Republic of Korea, an increase in the number of foreign workers in the manufacturing sector is associated with a decrease in job changes of native workers, as low-skilled migrants complement natives.

Overall, the costs and benefits of labor migration in migrant-receiving countries depend on economic measures. Empirical studies have suggested that welfare gains from migration critically depend on conducive business environments that facilitate timely labor reallocation and capital stock adjustments in response to inflows of migrants. In Malaysia, a 10% net increase in the stock of low-skilled migrant workers boosts real GDP by 1.16%, real household consumption by 0.42%, employment by 1.47%, and investment by 1.15% (Kanapathy 2011).

### 2.3.2 Impact on Origin Countries

While broadly researched, the literature on the relationship between remittances and economic performance at the country level is inconclusive. At the national level, out-migration helps to relieve domestic unemployment/underemployment pressures and the resulting remittances contribute to macroeconomic stability by financing the current account deficit in a relatively stable manner. Migrant workers can see higher rates of return from their investment in education: for example, a nurse from the Philippines can earn seven times as much in Japan as in the home country (about \$2,000/month in Japan as opposed

<sup>8</sup> When there is no direct competition between low-skilled migrants and skilled natives, the wages and employment opportunity of native workers expand upon the arrival of migrants because of the complementarity between migrants and natives and of increased investment (U. Dadush. 2014. *The Effect of Low-Skilled Labor Migration on the Host Economy. KNOMAD Working Paper*. No. 1. The World Bank).

to \$280/month in the Philippines). This higher income is sent back home as remittances. An increase in remittances helps spur growth and thus reduces poverty via different channels (for information on Pakistan, see Lucas 2005 and De et al. 2015).

Positive impacts of remittances are well documented. First, remittances boost domestic consumption—a key driver of economic growth in the Philippines, and real estate markets in Nepal and Viet Nam. Second, remittances cushion household incomes during bad times or in the aftermath of catastrophic events (such as the super typhoon that struck the Philippines in November 2013). Third, they enhance the welfare of migrant households by lifting their credit constraints, as seen in the Philippines (Yang 2004), thereby contributing to financial development (Aggarwal et al. 2011). In addition, financial inflows also lead to more entrepreneurial activities, increased human capital accumulation, and declining child labor (for information on the Philippines, see Yang 2008).

In contrast, some analyses indicate that migration in Asia might have gone too far. There is the well-known concern of the brain drain effects on migration, depressing the average skill level in worker-sending countries. Likewise, migration can give rise to the degree of domestic resource misallocation owing to a skills mismatch: the prospect of higher wages abroad leads to overinvestment in skills for the overseas market, which, if this market is rationed, remains underutilized in the domestic market (for example, the oversupply of nurses in the Philippines [Tullao, Conchada, and Rivera. 2011]). Furthermore, remittances may increase reservation wages<sup>9</sup> and thus reduce labor force participation of migrant households (Clemens and McKenzie 2014).

Countries with high migration rates appear to have slower economic growth than countries with lower migration rates. While the causality could run from slow domestic growth to high migration, it could also run in the reverse direction, for instance, due to the brain drain and the Dutch disease effects<sup>10</sup> of remittance inflows (Ahsan et al. 2014). Other studies have illustrated that remittances may increase inequality: Rodriguez (1996), for example, found that the upper deciles of households in the Philippines receive greater shares of remittance. Finally, social costs of migration could be substantial—family disintegration and the emotional stress associated with relocation.

## 2.4 Migration-Related Policy Issues

### 2.4.1 Labor Migration Policies in Host Countries

Low-skilled labor migration policies in host countries encourage temporary, rather than permanent, migration while being more lenient on the skilled workers. Asian host economies permit entries of low-skilled labor migrants only on a temporary basis, while offering a possibility to extend labor contracts with a defined total duration, for example, 5 years in Malaysia. Singapore allows skilled, but not low-skilled, migrants to bring their families. In an effort to retain experienced migrant workers and thus increase labor productivity, the

<sup>9</sup> Reservation wage is the lowest wage rate at which a worker is willing to accept a job.

<sup>10</sup> An increase in remittance inflows make a given country's currency stronger compared with that of other countries, resulting in the country's other exports becoming more expensive for other countries to buy, and imports becoming cheaper, making the manufacturing sector less competitive.

Republic of Korea recently revised its Employment Permit System (EPS) to allow a migrant worker to reenter the country per request by the employer and do the same job as before, yet on a temporary basis.

Ongoing efforts of host governments to tackle irregular migration suggest that explicit temporary migration policies achieve little in terms of timely returns of the low-skilled. Malaysia recently instituted an identification card system for legal foreign workers which is color coded by sector of employment. As an integral part of the EPS, the Republic of Korea has provided various skills training courses<sup>11</sup> to migrant workers to increase their job prospects in home countries and assist returned workers with job matching services in their home countries. However, despite all these efforts, the Republic of Korea has seen the number of irregular migrants (including overstays) rise during recent years.

Unrealistic quotas can be a driver of a large number of undocumented migrant workers in host countries. As discussed earlier, migrant workers respond not only to unemployment in home countries but also to the availability of jobs in host countries. Many undocumented migrant workers in Malaysia and in Kazakhstan, for instance, indicate that the existing quotas are static and misaligned with the domestic labor market needs: according to the World Bank's Malaysia Economic Monitor (December 2015), undocumented migrant workers made up 15% of Malaysia's workforce in 2014.

Furthermore, the complexity of migration processes, weak governance over recruitment processes, weak enforcement of labor-protection regulations, and porous borders seem to spur irregular migration. The US Department of State (2017) reported that most migrants entering Thailand did not use the formal mechanism "due to high costs linked to corruption on both sides of the Thai border, lack of information, lengthy processing times and difficulties in changing employers" (p. 391).

Consistent enforcement of migration rules and regulations—not tighter border enforcement—helps to control inflows of irregular foreign workers. Papademeriou et al. (2009) argued that, while migrants are responsive to economic boom and bust cycles in host and home countries, tight border controls may, in fact, deter migrants from returning home, as they fear difficulties associated with returning to the host country. Yue (2011) asserted that Singapore has seen little problems with irregular migration, thanks to the authorities' consistent and strong enforcement of migration laws on employers.

Studies also indicate that individual factors, such as the economic situation and political stability, are the key determinants of whether a migrant returns. For instance, Thailand has seen Myanmar people returning home in response to better economic prospects and political stability in Myanmar.

The increasing importance of labor migration in Asia has raised labor and social protection concerns. Most countries offer, *de jure*, equal treatment between migrants and natives, including minimum wages. In recent years, for instance, Thailand has stepped up its efforts to regulate migrant recruitment practices<sup>12</sup> in order to improve migrant workers' rights, legal status, and labor migration policies to reduce irregular migrant who take up informal jobs and

<sup>11</sup> Migrant workers can choose a training course that they want for free.

<sup>12</sup> Including the requirement that employers pay all migration costs including recruitment fees and transportation associated with bringing migrant workers to Thailand (US Department of State 2017).

thus not fully covered by the government's social protection mechanisms (US Department of State 2017).

Countries prefer a bilateral labor arrangement (BLA) to facilitate labor mobility of the low-skilled between the signed parties, but its effectiveness is unclear as the parties do not necessarily fully implement the signed BLA. BLAs offer flexibility to reflect changes in labor markets and to tailor labor mobility to specific sectors. Under multilateral or regional integration agreements, in contrast, host countries tend to set the degree of labor openness like in the trade of goods; they favor the movement of skilled workers and link investments with skilled labor mobility. Under the General Agreements on Trade in Services of the World Trade Organization, liberalization was limited to intra-firm transferees and professionals. The Asia-Pacific Economic Cooperation region has seen the mobility of architects by agreeing on mutual recognition of qualifications; and the Association of Southeast Asian Nations (ASEAN) aimed to achieve free movement of skilled labor by 2015, but this does not cover the low-skilled who account for the majority of intra-ASEAN labor mobility.

#### 2.4.2 Managing Labor Migration in Origin Countries

Asia has a long history of out-migration. Countries have enacted laws governing overseas employment of workers and have a designated government body which has the primary responsibility for regulating the recruitment process and promoting overseas employment at the national level. Recognizing increasing opportunities abroad, for instance, the Philippines institutionalized the overseas employment process in the 1970s. The Philippine Labor Code (1974) was one of the first codes worldwide that explicitly sought to protect nationals working overseas by securing the best possible terms of employment and to rationalize private sector participation in the recruitment of workers.<sup>13</sup> The Philippine Overseas Employment Administration (POEA) has been proactive in promoting labor protection and equal treatment and in providing predeparture training to prospective overseas workers. The Philippines is often considered in good practice for managing labor out-migration, as shown by mainstreaming various aspects of migration in its medium-term development plan (Philippine Development Plan 2017–2022).

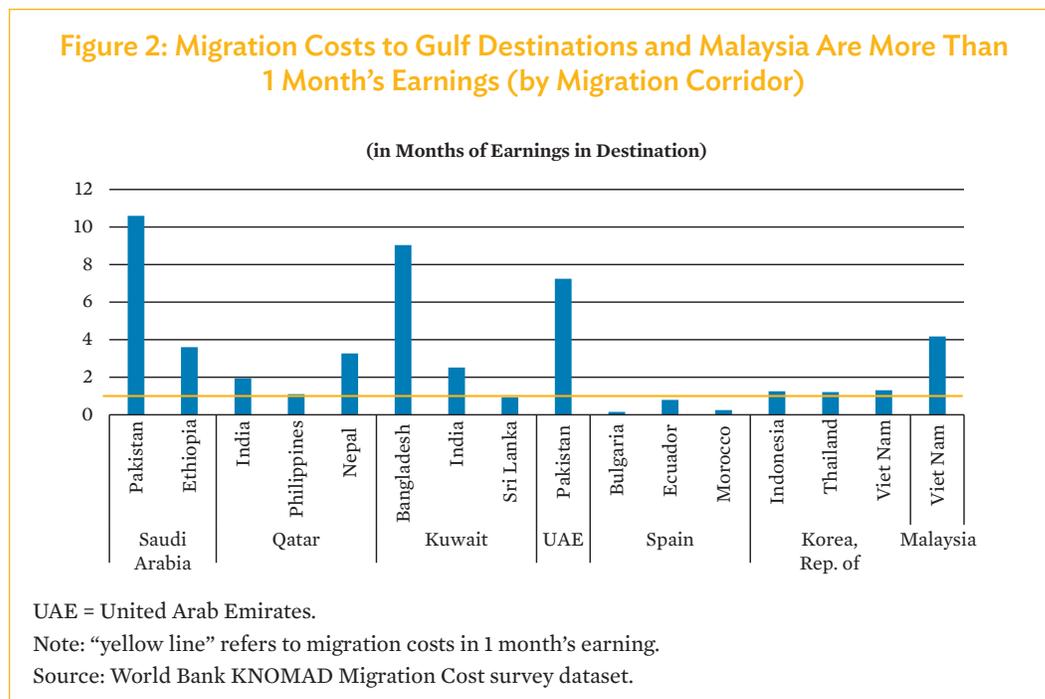
Key challenges in managing out-migration include high migration costs incurred by low-skilled migrants, resulting in undesirable outcomes such as irregular migration (overstays). Migration costs can stem from fees to obtain passports, visas, and other required documents; applying for jobs through recruitment agencies; and traveling to destination countries. A root cause of high migration costs could be national laws of both sending and receiving countries that disallow direct employment (Abella and Martin 2014).<sup>14</sup> As public employment services rarely prove successful (except the Republic of Korea with its memorandum of understanding-signed countries), private recruiters carry out job matching and replacement. This involves multiple layers of recruitment agencies, including individual brokers who travel to villages to share job information and bring workers to the capital. Another cause is visa trading (or *kafala* [sponsorship]) in the Middle East, a practice which is widely documented.

<sup>13</sup> Seven public institutions, including POEA, currently are involved in facilitating and regulating the movement of workers, and in protecting their welfare and rights (Orbeta 2008).

<sup>14</sup> Malaysia attempts to promote direct employment.

Migrant-sending countries have strengthened regulations over private recruitment companies, such as increasing security deposits and setting a ceiling on service fees. For instance, India sets the ceiling to 45 days’ wage to be earned by a migrant worker in the destination country. Sri Lanka developed a rating mechanism to regulate subagents, while Viet Nam introduced self-regulation through developing codes of conducts for its members by associations of recruitment agencies. On the other hand, Pakistan has established a labor-market information system to enhance access to job information.

Despite the governments’ efforts, in practice, migration costs incurred by low-skilled workers of South Asia can be as high as 9 months of wages in the destination country (see Kuwait in Figure 2). In addition, migrants incur high financing costs, as they lack access to the formal banking sector. All considered, total migration costs can be the equivalent of 1 year’s earnings.



Another challenge is to ensure the protection of labor rights in destination countries. A written employment contract is an effective instrument to protect migrant rights, especially in destination countries that have weak enforcement on minimum wages (Ahsan et al. 2014). In view of this, sending governments have implemented regulations which require workers to obtain a labor contract or exit approval from the relevant government bodies prior to their departure. Some foreign employment laws even set out key elements, such as conditions of employment, which a labor contract must have (e.g., Nepal). Going even one step further, the Philippines has mandated prospective migrants not to accept wages lower than the prevailing minimum for the same skills in the host country, unless specified in a bilateral labor agreement or international convention that the host economy is a signatory (Ahsan et al. 2014).

## 2.5 Conclusion

Globalization and technological progress will accelerate the global movement of labor. As Pritchett (2006) highlighted, three forces are at work. First, there is a large and increasing gap in average real wages paid to labor in developing and developed countries.<sup>15</sup> Second, demographic trends are diverging, with the rich countries exhibiting inverted population pyramids that contrast with the expansive population pyramids found in many developing countries.<sup>16</sup> There is a shift in the relative demand for goods compared to services, particularly in developed countries.<sup>17</sup> As services are not tangible, delivery of services across borders (e.g., household service) often requires the international movement of workers.

To maximize benefits of labor mobility, earlier discussions suggest that flexible labor markets, institutional capacity, and policy coherence are crucial. Some key recommendations are as follows:

*Recommendation 1:* Good migration management calls for strong institutional capacity of migration-related agencies and organizations as well as adequate financial resources. Improved institutional capacity would lead to stricter enforcement of migration-related laws and regulation in both receiving and sending countries, e.g., tightening up enforcement toward noncompliant migrant recruiters and employers in receiving countries and toward recruitment agencies in sending countries.

*Recommendation 2:* Better data collection is a must to formulate evidence-based policies and helps increase labor market flexibility. The Republic of Korea's EPS presents good practices in this field: it has a comprehensive data network that is linked with various ministries and agencies involved in the process of low-skilled labor migrant employment. It has set up a permanent, nonpartisan body that carries out regular labor market needs tests utilizing the comprehensive database, and collects information on labor needs by industry. Their analytical results are reflected in the proposals on new annual quotas by country, and the proposals go under scrutiny through rounds of deliberations.

*Recommendation 3:* Sending countries should focus on addressing market failures in out-migration. These include (i) facilitating the private sector to create an online job portal to increase workers' access to foreign job information; (ii) increasing transparency in recruitment costs paid by workers; and (iii) enhancing transparency in out-migration procedures through information campaigns, simplifications of procedures, and the establishment of one-stop shops.

*Recommendation 4:* Migrant workers should be subject to the same minimum wages as their native counterparts, and receive equal social protection such as health care and social security. To motivate self-regulation, receiving governments can devise a mechanism to reward employers who respect rules and rights for low-skilled migrant workers, e.g., giving priority to the employers in the process of allocating foreign labor.

<sup>15</sup> According to Clemens et al. (2008), Filipinos with 9 years of education are estimated to earn 3.5 times more in the US than in the Philippines.

<sup>16</sup> Among other things, this means that the ratio of active workers to dependents is quickly declining in developed countries and rising in developing countries, with huge implications for financing pension.

<sup>17</sup> This, too, is partly a consequence of diverging demographic trends, as an aging population requires proportionally more healthcare services and other low-skill or manual services.

*Recommendation 5:* Cooperation of sending and receiving countries is advantageous to migrant workers. Through cooperation, sending countries maintain a pool of workers who are ready to migrate for work, and manage worker-recruitment process in a transparent manner, including job orders and fees involved. Both sending and receiving countries should ensure that the workers arrive in the destination country with a prior job arrangement. This would contribute to improving migrant protection and reducing worker-paid recruitment costs. Receiving countries, on the other hand, can benefit from better job matching of migrant workers and see a decline in irregular migration owing to lower recruitment costs.

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## CHAPTER 3

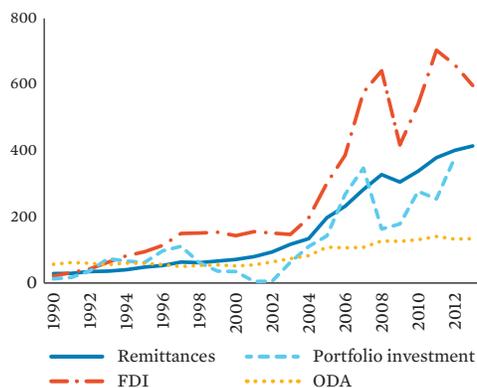
# Dynamics of Remittances<sup>18</sup>

Supriyo De and Seyed Reza Yousefi

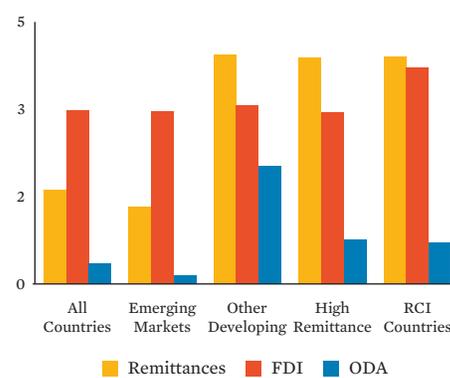
### 3.1 Introduction

Remittances to developing countries since 2000 have been remarkable both as a share of gross domestic product (GDP) and compared with foreign direct investment (FDI) and official development assistance (ODA) (Figures 3a and 3b). Given their size and the fact that they finance consumption needs of the recipients, remittances have the potential to counterbalance adverse output effects during economic downturns and sudden stops in capital flows. However, whether remittances can act as a counterbalance depends on how remittances behave during business cycle fluctuations: if countercyclical, remittances could

**Figure 3a: Remittances and Other Flows to Developing Countries<sup>a</sup>**  
(Current Billion \$)



**Figure 3b: Remittances and Other Flows across Country Groups<sup>b</sup>**  
(% of GDP)



FDI = foreign direct investment, ODA = official development assistance, RCI = remittance and capital flow intensive.

<sup>a</sup> Remittances are based on IMF Balance of Payments Accounts; FDI is foreign direct investment, net inflows; Portfolio investment is private debt and portfolio equity; ODA is Net official development assistance and official aid received.

<sup>b</sup> All Countries includes all countries in the sample. High Remittance refers to a set of countries for which Remittances have been above 1% during 2003–2012. RCI refers to a set of countries for which Remittances and either FDI or Equity Flows have been above the median (1%, 3.5%, and 1%, respectively) during 2003–2012. FDI measures foreign direct investment and ODA covers official development assistance and aid. The sample period is 2003–2012.

Sources: World Development Indicators and IMF Balance of Payments data, and De et al. 2016 estimates.

<sup>18</sup> This chapter is a shorter, modified version of an earlier work: S. De et al. 2016. Remittances over the Business Cycle: Theory and Evidence. *KNOMAD Working Paper*. No. 11.

help smooth macroeconomic fluctuations; on the other hand, if procyclical, they could amplify business cycle fluctuations.

In theory, the behavior of remittances over the cycle is related to why people remit. In a fairly broad categorization, remittances can be driven by either altruism or self-interest (Lucas and Stark 1985, Amuedo-Dorantes and Pozo 2006). In the former case, remittances are believed to be unreciprocated transfers without expectations of personal gain sent to relatives during bad times and tend to be countercyclical. In the latter case, remittances are usually used for investment in the home country (such as buying real estates) and are likely to be procyclical with respect to the business cycle of the recipient economy.

The empirical literature on the cyclical behavior of remittances has been inconclusive. Some studies have found that remittances are largely altruistic and countercyclical with respect to the recipient economy (Frankel 2011; Bettin, Presbitero, and Spatafora 2015). Other studies have challenged these results and have reported that the investment-driven, procyclical tendency may be more prevalent (Lueth and Ruiz-Arranz 2008, Guiliano and Ruiz-Arranz 2009). Durdu and Sayan (2010) documented that, whereas countercyclical remittances flows can mitigate macroeconomic volatility, procyclical flows have the potential to deepen it. The behavior of remittances during episodes of high macroeconomic volatility during current account reversals and financial crises, and their potential to stabilize consumption in response to income shocks, remain understudied in the literature.

Because of the limited research on the dynamic patterns of remittances, many important questions remain unanswered. This paper addresses three main questions: First, what is the behavior of remittances over the business cycle, and how does that compare with the behavior of other inflows such as FDI, portfolio equity, and ODA? Second, how do remittances change during sudden stops and financial crises? Third, can remittances help stabilize consumption? The chapter looks at the macroeconomic aspects of consumption smoothing and abstracts away from microeconomic complications such as differences in preferences between remittance senders and receivers.

This chapter adds to the literature in several ways: First, it provides a broad overview of the theoretical literature on the motives to remit and the implications that these motives have for the behavior of remittances flows over the business cycle. Second, it documents a number of stylized facts about the cyclical dynamics of remittances. More specifically, it revisits the cyclical features of remittances for a widely inclusive set of 109 countries for the period 1980–2012. It also provides a comparison of different methodologies used in the literature to analyze the cyclical features of remittances. Third, it investigates the behavior of remittances during episodes of sudden stops and during financial crises. Finally, it empirically tests whether remittances inflows are correlated with better consumption stability.

The main empirical findings are the following: First, remittances are largely acyclical with respect to the recipient country. In addition, remittances are less volatile than other types of inflows, including FDI and ODA. At the same time, remittances are *less* procyclical than financial flows, but more procyclical than ODA. Second, remittances display resilience during sudden stops and financial crises. Whereas total inflows decline sharply during these episodes, remittances stay stable. Third, empirical analysis does indeed show that remittances have helped counterbalance the effects of volatile financial flows.

The rest of the chapter is organized as follows. Section 3.2 provides a broad overview of the theoretical underpinnings of the motives to remit. Section 3.3 documents the cyclicity and volatility of remittances and analyzes the behavior of remittances during sudden stops and financial crises. Section 3.4 shows the effects of remittances on consumption smoothing. Section 3.5 offers some concluding remarks and suggestions for future work.

## 3.2 Cyclical Behavior of Remittances in Theory

In theory, the cyclical properties of remittances are closely related to the motives that drive remittances. At the individual level, these motives have direct implications for the amount, timing, and frequency of remittances. At the aggregate level, they may affect the volume of flows and their variability across economic ups and downs, in both the remittances origin and recipient countries. This section discusses the drivers of remittances and their implications for the business cycle features of remittances with respect to the origin and recipient economies. Remittances are driven by either altruistic motives or self-interest. In the former case, they usually tend to be countercyclical. In the latter case, they are largely procyclical.

### 3.2.1 Motives to Remit

Among motives that drive remittances, the most basic distinction is between altruistic motives and those driven by self-interest. Whereas altruistic motives are not linked to any past contracts or expectations related to personal gain, the self-interest motive implies an exchange in which remittances are a resource belonging to the remitter that is exchanged for goods and services that provide utility to the remitter. A more detailed classification of motives includes *altruism*, *exchange*, *inheritance*, *strategic motive*, *insurance*, and *investment*. The relationship between these motives and possible responses of remittances to changes in remittances-recipient (home) country GDP and origin (host) GDP are presented in Table 3.

**Table 3: Response of Remittances to Gross Domestic Product Fluctuations in Origin and Recipient Economies**

	Altruistic	Exchange	Inheritance	Strategic	Insurance	Investment
Recipient	(-)	(+)	(+)	(-)	(-)	(+)
Origin	(+)	(+)	(+)	(+)	Indeterminate	Indeterminate

(-) = countercyclical, (+) = procyclical.

Source: De et al. 2016.

*Altruistic.* If the motivations are altruistic, remittances would increase when the receiving economy is in a downturn, and vice versa. This would imply a negative relationship between remittances and recipient economy GDP resulting in countercyclicity. Higher GDP in the origin country is likely to increase altruistic remittances, as well as those driven by exchange, inheritance, and insurance, resulting in procyclicity.

*Exchange.* The exchange motive implies that remittances “purchase” certain services such as taking care of property or relatives (elders or children). Improvements in the recipient country’s economy could increase the price of services and the returns the recipients could get from activities other than that mandated by the sender. This would lead to procyclicality with regard to the recipient economy.

*Inheritance.* The migration and remittances process is viewed as an arrangement that involves an informal contract whereby the family finances the migrant with the understanding that a future remittances stream will accrue to them. Potential inheritances act as an enforcement device to ensure that migrants do not renege on their promise or encourages them to send higher amounts in the hope of receiving a favorable share of the bequest (Hoddinot 1994). In this case, higher GDP in the recipient country increases the value of the bequest and prompts more remittances. This would again lead to procyclicality.

*Insurance.* Because of the absence of means to cover risks arising from variability of income and employment in their home countries (such as unemployment insurance), members of a household migrate to a labor market not correlated with the home country. The migrant and the members left behind enter into an arrangement whereby the former sends remittances to cope with hard times while the latter pay for costs of migration. The insurance motive leads to countercyclicality since an adverse shock in the recipient country is compensated for by remittances.

*Investment.* The investment motive implies that families send migrants to increase the family’s income. In this case, remittances are a return on the deployment of human capital. The family members then act as agents managing the funds on behalf of the remitter, and this becomes similar to the exchange model. If investment is the motive, improved economic circumstances in the recipient country would increase remittances, leading to procyclicality.

The cyclical response to changes in sending-country GDP may be indeterminate in the case of insurance- or investment-driven remittances. If migrants retain income opportunities in a downturn, remittances under both motives may increase. This outcome is more likely if returns on assets in the origin country are lower than in the recipient economy. This would lead to countercyclicality with respect to the sending country’s GDP. However, if the migrant loses income opportunities in the origin country because of the downturn, remittances would be procyclical with respect to its GDP.

*Strategic motive.* The strategic motive arises from a view that prospective employers may not be able to initially ascertain the productivity of immigrant workers and, consequently, pay them according to the average productivity of their migrant community or country group. This circumstance induces higher-productivity migrants to send remittances as “bribes” to lower-productivity potential migrants to encourage them to stay in the home country. In this case, decreased income opportunities at home may increase the propensity of those left behind to migrate, so more remittances may have to be sent to compensate them. This would imply countercyclicality with respect to the recipient country’s GDP.

### 3.3 Cyclical Features of Remittances

As remittances continue to increase, economists' and policy makers' interest in this type of foreign currency flow is not only due to their size, but also to their stability over time in comparison with other foreign currency flows. The empirical evidence on how remittances react to business cycle fluctuations in the recipient country, however, remains inconclusive.

This section revisits the question of how remittances behave during business cycle fluctuations and other large macroeconomic shocks. The analysis is carried out in several steps. First, the co-movement of remittances inflows with GDP is analyzed. Second, remittances' co-movement with other foreign currency flows is examined, along with how they differ in volatility. Third, the behavior of remittances during sharp current account reversals, and banking, currency, and debt crises, is studied.

#### 3.3.1 Behavior of Remittances over the Business Cycle

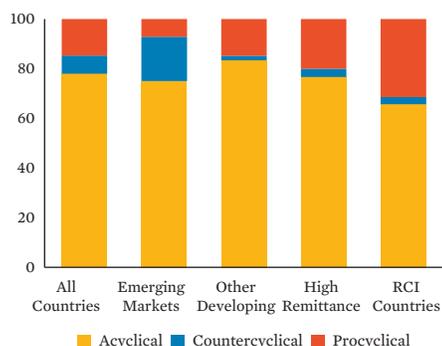
When analyzing the time series properties of variables in macroeconomics, it is common practice to detrend the series by using different filters. The filters eliminate both the long-term trend and any rapidly varying or irregular components, leaving behind only the business cycle variation of the series. Cyclicity is defined here as the correlation between the detrended series of GDP and the relevant flow. Each time series is decomposed into trend and cyclical components using a Hodrick–Prescott filter for the period 1980–2012. Following Ravn and Uhlig (2002), a smoothing parameter of 6.25 is used for annual data. The robustness of the main findings is checked using the Baxter–King filter, which yields similar results.

Foreign currency inflows are classified as (i) *procyclical* if the correlation between output and the cyclical component of flows is positive and statistically different from zero, (ii) *countercyclical* if it is negative and statistically different from zero, and (iii) *acyclical* if the correlation is not statistically different from zero. Figure 4a summarizes these correlations for various country groups, showing that remittances are acyclical in approximately 80% of countries (this holds across country groups). At the same time, on average, remittances are less correlated with the business cycle than FDI and total inflows (Figure 4b).

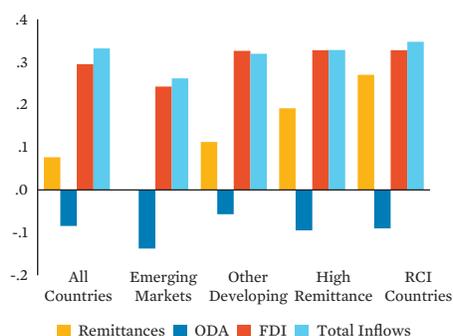
Remittances are not strongly correlated with capital flows either (Figure 4c). More detailed information about these correlations can be found in Table 4. Across different groups, remittances are weakly correlated with portfolio equity flows, total inflows, ODA, and net exports. They do appear to be more strongly correlated with FDI, although not so much so in emerging markets (correlation is zero). Overall, remittances appear to be a more stable (less volatile) source of external resources than financial inflows, including ODA (Figure 4d).

Table 5 shows the proportion of countries that exhibit countercyclical and procyclical foreign currency flows for each country group (the remaining countries exhibit acyclical flows). Remittances are procyclical in 14.7% of the countries, compared with 39.3% for FDI and 48.2% for total inflows. They appear not to co-move with output in about 78% of countries. One further observation from Table 5 is that remittances seem to be considerably more procyclical for high-remittances countries (20.0%) and remittance and capital flow intensive (RCI) countries (31.4%), suggesting that in several countries in those groups, remittances are more prone to exacerbate business cycle movements in the recipient economy.

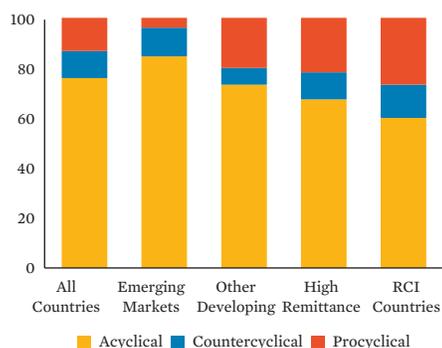
**Figure 4a: Remittances and Business Cycle<sup>a,b</sup>**  
(% of countries)



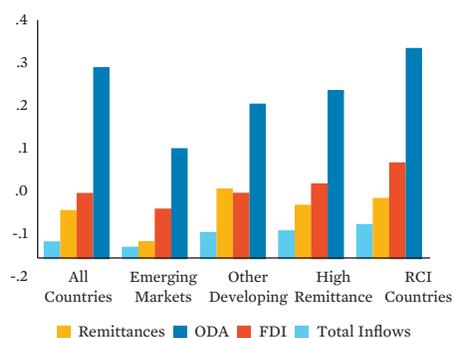
**Figure 4b: Correlation of Remittances with Gross Domestic Product<sup>c</sup>**  
(Median)



**Figure 4c: Remittances and Capital Inflows**  
(% of countries)



**Figure 4d: Volatility of Inflows**  
(Mean Standard Deviation)



RCI = remittance and capital flow intensive.

<sup>a</sup> Cyclicalities are defined as the correlation between the detrended real series of gross domestic product (GDP) and foreign direct investment (FDI), official development assistance (ODA), and total inflows (the sum of FDI, portfolio investment [including equity and debt], financial derivatives, and other investments). RCI refers to a set of countries for which Remittances and either FDI or equity flows have been above the median (1%, 3.5%, and 1%, respectively) during 2003–2012. High Remittance refers to a set of countries for which remittances have been above 1% during 2003–2012. Each series is decomposed into trend and cyclical components using Hodrick–Prescott filter, and the sample period is 1980–2012.

<sup>b</sup> Remittances are considered as (i) *procyclical* if the correlation between the cyclical components of remittances and output is positive and statistically different from zero, (ii) *countercyclical* if it is negative and statistically different from zero, and (iii) *acyclical* if the correlation is not statistically different from zero.

<sup>c</sup> Volatility is defined as the standard deviation of the detrended ratio of the relevant inflow to GDP.

Source: De et al. 2016 estimates.

**Table 4: Business Cycle Correlations**  
(Correlation coefficient)

**A: Correlation of Each Flow with GDP**

	Remit	FDI	Portfolio Equity	Total Inflows	ODA and Aid	Net Exports
All Countries	0.08	0.30	-0.01	0.33	-0.08	-0.27
Emerging Markets	0.00	0.24	0.01	0.26	-0.14	-0.35
Other Economies	0.11	0.33	0.10	0.32	-0.06	-0.15
High Remittance	0.19	0.33	0.04	0.33	-0.09	-0.29
RCI Countries	0.27	0.33	0.03	0.35	-0.09	-0.29

**B: Correlation of Each Flow with Remittances**

	FDI	Portfolio Equity	Total Inflows	ODA and Aid	Net Exports
All Countries	0.15	-0.03	0.04	0.11	-0.05
Emerging Markets	0.00	0.01	-0.03	0.12	0.10
Other Economies	0.31	0.05	0.13	0.09	-0.12
High Remittance	0.31	0.02	0.08	0.09	-0.08
RCI Countries	0.38	0.07	0.12	0.01	-0.13

FDI = foreign direct investment, ODA = official development assistance, RCI = remittance and capital flow intensive.

Notes: Cyclicity is defined as the correlation between the detrended real series of gross domestic product (GDP) and the relevant inflow. Panel A provides the median correlation of each flow with GDP for each country grouping, while panel B reports their median correlations with remittances. FDI measures foreign direct investment. ODA covers official development assistance and aid, and Total Inflows is the sum of FDI, portfolio investment (including equity and debt), financial derivatives, and other investments. RCI refers to a set of countries for which Remittances and either FDI or Equity Flows have been above the median (1%, 3.5%, and 1%, respectively) during 2003–2012. High Remittance refers to a set of countries for which Remittances have been above 1% during 2003–2012. Each time series is decomposed into trend and cyclical components using Hodrick–Prescott filter, and the sample period is 1980–2012.

Source: De et al. 2016 estimates.

How do these results compare with other studies that use cross-country data? As mentioned in the introduction, some studies have found that remittances are negatively correlated with output fluctuations in the recipient economies (Frankel 2011; Bettin, Presbitero, and Spatafora 2015). In contrast, other studies have found that remittances are positively correlated with income in the recipient countries (Giuliano and Ruiz-Arranz 2009, Sayan 2006, Cooray and Mallick 2013). Ruiz and Vargas-Silva (2014) argued that cyclicity of remittances, with respect to the receiving economy, can be country or corridor specific. To answer the question of cyclicity of remittances, this analysis uses the most up-to-date remittances data for a large sample of countries and a robust methodology to define cyclicity. The findings show that remittances are acyclical, with some variations across countries.

To sum up, capital flows such as FDI and debt flows are often procyclical. As such, they can exacerbate output fluctuations and contribute to the volatility of consumption in developing countries when abruptly leaving the country. Although remittances are not necessarily countercyclical, their acyclicity suggests that they have the potential to at least provide some

**Table 5: Cyclicity of Remittances, Capital Flows, and Net Exports**  
(% of countries)

		Remittances	FDI	Portfolio Equity	Total Inflows	ODA and Aid	Net Exports
All Countries	% Countercyclical	7.3	2.4	6.2	1.2	15.7	44.0
	% Procyclical	14.7	39.3	3.1	48.2	4.5	6.4
	Observations	109	84	65	83	89	109
Emerging Markets	% Countercyclical	17.9	7.4	4.2	3.8	25.0	50.0
	% Procyclical	7.1	37.0	0.0	38.5	3.6	3.6
	Observations	28	27	24	26	28	28
Other Developing	% Countercyclical	1.9	0.0	0.0	0.0	11.1	33.3
	% Procyclical	14.8	36.7	7.1	43.3	5.6	9.3
	Observations	54	30	14	30	54	54
High Remittance	% Countercyclical	3.3	2.1	3.2	2.2	13.8	45.0
	% Procyclical	20.0	42.6	3.2	45.7	5.2	3.3
	Observations	60	47	31	46	58	60
RCI Countries	% Countercyclical	2.9	3.2	4.8	0.0	15.2	48.6
	% Procyclical	31.4	41.9	4.8	50.0	0.0	2.9
	Observations	35	31	21	30	33	35

FDI = foreign direct investment, ODA = official development assistance, RCI = remittance and capital flow intensive.

Notes: Cyclicity is defined as the correlation between the detrended real series of gross domestic product (GDP) and the relevant inflow. A series is considered as (i) *procyclical* if the correlation between the cyclical components of the flow and output is positive and statistically different from zero, (ii) *countercyclical* if it is negative and statistically different from zero, and (iii) *acyclical* if the correlation is not statistically different from zero. Total number of countries, percent procyclical, and percent countercyclical are provided for each country grouping. FDI measures foreign direct investment. ODA covers official development assistance and aid, and Total Inflows is the sum of FDI, portfolio investment (including equity and debt), financial derivatives, and other investments. RCI refers to a set of countries for which Remittances and either FDI or Equity Flows have been above the median (1%, 3.5%, and 1%, respectively) during 2003–2012. High Remittance refers to a set of countries for which Remittances have been above 1% during 2003–2012. Each time series is decomposed into trend and cyclical components using Hodrick–Prescott filter, and the sample period is 1980–2012.

Source: De et al. 2016 estimates.

stability for the balance of payments, and hence for the economy more generally, when capital inflows decline. The next section examines whether these broad trends about the relative stability of remittances are preserved during periods of sharp macroeconomic volatility.

### 3.3.2 Behavior of Remittances during Periods of Large Macroeconomic Shocks

The resilience of remittances during business cycle fluctuations is one argument for supporting the stabilizing role that they may bring to emerging market and developing economies. However, the cycles in emerging market and developing economies are often exacerbated by sharp capital flow reversals and financial crises, including banking, currency, and sovereign debt crises. How do remittances behave during these major episodes of macroeconomic and financial volatility?

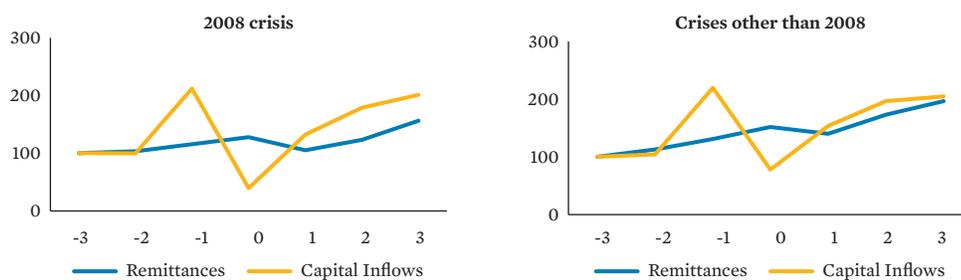
To answer this question, the behavior of remittances during sudden stops and financial crises is analyzed. A sudden stop, defined as a sharp decrease in gross capital inflows, is often associated with increased risk of macroeconomic volatility and financial crises in emerging market and developing economies. The timing of sudden stops can be identified using a variety of methodologies. This exercise follows the methodology of Forbes and Warnock (2012) and identifies a large number of sudden stops during 1990–2012.

The global financial crisis starting in 2008 saw a plethora of sudden stops in capital inflows. In contrast, remittances showed slight above-trend growth during the financial crisis (Figure 5). The same pattern is observed during previous, less severe, and less synchronized crisis episodes, with remittances generally displaying resilience, while capital inflows gyrate. The results are similar for other country groupings, including for emerging markets and RCI economies taken separately (Table 6).

Whereas capital flows, on average, decline about 14.8% during the initial year of a sudden stop episode and continue to fall by another 10% the following year, remittances tend to increase by 6.6% during the first year and another 5.7% in the subsequent year. Moreover, remittances are resilient in emerging markets and RCI economies taken separately, even though the decline in capital inflows for these country groups is often sharper than for other groups. During the first year of a sudden stop, capital inflows to emerging markets fall 25.2%, on average, whereas remittances increase by 6.8% (Table 7).

Remittances also show resilience during financial crises. Using data on crises from Laeven and Valencia (2013), this chapter compares the behavior of remittances during these crises

**Figure 5: Remittances and Capital Inflows during Sudden Stops**  
(Index numbers)



Notes: Values are averages of remittances and net capital inflows for emerging markets and developing economies that have experienced sudden stop episodes. Index numbers are calculated with a base of 100 for the period 3 years before the sudden stop year (-3). Capital Inflows are net, that is, the difference between the amounts brought in by nonresidents and the amounts sent out by residents. The horizontal axis denotes years. Zero (0) refers to the year of the sudden stop episode. More dispersed (Less dispersed) refers to countries with migrant concentrations below (above) the sample median. Migrant concentration is defined as the percentage of migrants in the top destination to the total migrant population. Calculations are based on the 2013 bilateral migration matrix provided by the United Nations Population Division.

Sources: Data from World Development Indicators, World Bank's Global Capital Flows, and De et al. 2016 calculations.

**Table 6: Remittances and Capital Inflows during Sudden Stops**  
(Index Numbers)

Timeline	All Countries		EMs		Other Developing		RCI		High Remittance	
	Remit	Inflows	Remit	Inflows	Remit	Inflows	Remit	Inflows	Remit	Inflows
-2	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
-1	111.7	135.4	118.0	219.3	117.2	201.6	119.6	175.2	116.0	168.1
0	120.9	90.3	131.7	56.6	125.8	128.0	133.7	106.9	125.4	108.8
1	126.2	84.3	136.5	165.3	117.0	66.2	127.2	70.2	123.1	71.5
2	142.7	126.6	160.0	207.1	129.9	99.1	135.9	108.9	136.4	108.6

EM = emerging markets, RCI = remittance and capital flow intensive.

Notes: The timeline is indicated in the first column: -2 indicates value 2 years before the sudden stop, -1 a year before, 0 is the year of the sudden stop, 1 is a year after the sudden stop, and 2 is 2 years after the sudden stop. Values are averages of remittances and net capital inflows for emerging markets and developing economies that have experienced sudden stop episodes. Index numbers are calculated with a base of 100 for the period 2 years before the sudden stop year (-2). Capital Inflows are net, that is, the difference between amounts brought in by foreign entities and the amounts sent out by domestic entities. Data are for episodes after 1990. The group “All countries” denotes all countries in the sample, “EMs” stands for emerging markets, “Other Developing” is developing economies other than EMs, “RCI” stands for remittance and capital inflow intensive economies, “High Remittance” stands for high remittance intensity countries. RCI refers to a set of countries for which Remittances and either FDI or Equity Flows have been above the median (1%, 3.5%, and 1%, respectively) during 2003–2012. High Remittance refers to a set of countries for which remittances have been above 1% during 2003–2012.

Source: De et al. 2016 calculations.

**Table 7: Growth Rates of Remittances and Capital Inflows during Sudden Stops**  
(Growth Rates in %)

Timeline	All Countries		EMs		Other Developing		RCI		High Remittance	
	Remit	Inflows	Remit	Inflows	Remit	Inflows	Remit	Inflows	Remit	Inflows
-2	11.4	7.8	11.7	-3.2	13.2	14.4	12.5	10.0	15.6	11.8
-1	11.7	11.9	17.0	26.0	12.6	16.2	11.2	20.7	14.4	17.6
0	6.6	-14.8	6.8	-25.2	10.6	-25.1	8.7	-25.9	8.5	-21.5
1	5.7	-10.0	7.5	-10.7	7.2	-16.3	2.2	-6.7	4.6	-12.4
2	7.6	-8.5	10.6	-2.0	-0.1	-2.5	5.4	6.0	9.1	-2.0

EM = emerging markets, RCI = remittance and capital flow intensive.

Notes: The timeline is indicated in the first column: -2 indicates value 2 years before the sudden stop, -1 a year before, 0 is the year of the sudden stop, 1 is a year after the sudden stop, and 2 is 2 years after the sudden stop. Values are averages of growth rates of nominal remittances and net capital inflows across relevant country groups. Capital Inflows are net, that is, the difference between amounts brought in by foreign entities and the amounts sent out by domestic entities. Data are for episodes after 1990. The group “All countries” denotes all countries in the sample, “EMs” stands for emerging markets, “Other Developing” is developing economies other than EMs, “RCI” stands for remittance and capital inflow intensive economies, “High Remittance” stands for high remittance intensity countries. RCI refers to a set of countries for which Remittances and either FDI or Equity Flows have been above the median (1%, 3.5%, and 1%, respectively) during 2003–2012. High Remittance refers to a set of countries for which remittances have been above 1% during 2003–2012.

Source: De et al. 2016 calculations.

with that of capital inflows for various country subsamples. Although capital inflows have been feeble, remittances continue to be stable during such crises. Compared with 2 years before a crisis starts, total capital inflows fall, on average, by as much as 65% 2 years after the onset of a currency crisis, whereas remittances appear to be 15% higher. The difference is even starker for banking crises, with capital inflows falling as much as 83%, whereas remittances

increase by 24%. For any crisis, 2 years after the onset remittances increase, on average, by 18% compared with 2 years before the crisis, whereas total inflows fall by as much as 80% during the same period (Tables 8–10). These results broadly speak to a supportive role for remittances during periods of large macroeconomic shocks.

**Table 8: Remittances and Capital Inflows during Currency Crises**  
(Index numbers)

Timeline	All Countries		EMs		Other Developing		RCI		High Remittance	
	Remit	Inflows	Remit	Inflows	Remit	Inflows	Remit	Inflows	Remit	Inflows
-2	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
-1	103.2	95.5	110.5	112.3	104.2	96.7	116.4	182.0	117.4	132.9
0	115.8	43.1	163.3	41.3	101.6	85.8	120.6	57.9	125.1	67.2
1	105.7	32.4	140.4	32.3	100.9	52.9	104.5	17.5	116.3	42.1
2	114.6	34.4	159.0	44.6	109.9	15.0	89.1	14.6	109.4	27.3

EM = emerging markets, RCI = remittance and capital flow intensive.

Notes: Crises are based on Laeven and Valencia (2013). The timeline is indicated in the first column: -2 indicates value 2 years before the crisis, -1 a year before, 0 is the year of the crisis, 1 is a year after the crisis, and 2 is 2 years after the crisis. Values are averages of remittances and net capital inflows for emerging markets and developing economies that have experienced sudden stop episodes. Index numbers are calculated with a base of 100 for the period 2 years before the sudden stop year (-2). Capital Inflows are net, that is, the difference between amounts brought in by foreign entities and the amounts sent out by domestic entities. Data are for episodes after 1990. The group “All countries” denotes all countries in the sample, “EMs” stands for emerging markets, “Other Developing” is developing economies other than EMs, “RCI” stands for remittance and capital inflow intensive economies, “High Remittance” stands for high remittance intensity countries. RCI refers to a set of countries for which Remittances and either FDI or Equity Flows have been above the median (1%, 3.5%, and 1%, respectively) during 2003–2012. High Remittance refers to a set of countries for which remittances have been above 1% during 2003–2012.

Source: De et al. 2016 calculations.

**Table 9: Remittances and Capital Inflows during Banking Crises**  
(Index numbers)

Timeline	All Countries		EMs		Other Developing		RCI		High Remittance	
	Remit	Inflows	Remit	Inflows	Remit	Inflows	Remit	Inflows	Remit	Inflows
-2	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
-1	116.0	128.0	118.8	236.0	141.7	190.1	115.4	104.9	114.7	105.6
0	120.1	72.5	114.6	-97.2	169.7	144.0	119.2	113.6	118.7	86.9
1	116.1	97.7	120.8	5.1	157.2	-1.6	106.4	41.1	112.3	35.0
2	123.9	16.7	132.1	-4.2	173.1	90.4	106.2	52.2	115.0	33.1

EM = emerging markets, RCI = remittance and capital flow intensive.

Notes: Crises are based on Laeven and Valencia (2013). The timeline is indicated in the first column: -2 indicates value 2 years before the crisis, -1 a year before, 0 is the year of the crisis, 1 is a year after the crisis, and 2 is 2 years after the crisis. Values are averages of remittances and net capital inflows for emerging markets and developing economies that have experienced sudden stop episodes. Index numbers are calculated with a base of 100 for the period 2 years before the sudden stop year (-2). Capital Inflows are net, that is, the difference between amounts brought in by foreign entities and the amounts sent out by domestic entities. Data are for episodes after 1990. The group “All countries” denotes all countries in the sample, “EMs” stands for emerging markets, “Other Developing” is developing economies other than EMs, “RCI” stands for remittance and capital inflow intensive economies, “High Remittance” stands for high remittance intensity countries. RCI refers to a set of countries for which Remittances and either FDI or Equity Flows have been above the median (1%, 3.5%, and 1%, respectively) during 2003–2012. High Remittance refers to a set of countries for which remittances have been above 1% during 2003–2012.

Source: De et al. 2016 calculations.

**Table 10: Remittances and Capital Inflows during Banking, Currency, or Sovereign Debt Crises**  
(Index numbers)

Timeline	All Countries		EMs		Other Developing		RCI		High Remittance	
	Remit	Inflows	Remit	Inflows	Remit	Inflows	Remit	Inflows	Remit	Inflows
-2	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
-1	110.9	115.9	104.4	158.5	119.4	210.3	100.9	100.5	110.3	101.9
0	100.1	62.5	95.5	-40.4	111.8	160.4	95.7	106.2	102.0	83.4
1	108.2	85.5	106.4	10.1	115.6	18.6	95.7	34.8	109.2	30.6
2	118.3	19.5	122.0	17.5	123.0	109.3	98.1	55.8	114.6	37.7

EM = emerging markets, RCI = remittance and capital flow intensive.

Notes: Crises are based on Laeven and Valencia (2013). The timeline is indicated in the first column: -2 indicates value 2 years before the crisis, -1 a year before, 0 is the year of the crisis, 1 is a year after the crisis, and 2 is 2 years after the crisis. Values are averages of remittances and net capital inflows for emerging markets and developing economies that have experienced sudden stop episodes. Index numbers are calculated with a base of 100 for the period 2 years before the sudden stop year (-2). Capital Inflows are net, that is, the difference between amounts brought in by foreign entities and the amounts sent out by domestic entities. Data are for episodes after 1990. The group “All countries” denotes all countries in the sample, “EMs” stands for emerging markets, “Other Developing” is developing economies other than EMs, “RCI” stands for remittance and capital inflow intensive economies, “High Remittance” stands for high remittance intensity countries. RCI refers to a set of countries for which Remittances and either FDI or Equity Flows have been above the median (1%, 3.5%, and 1%, respectively) during 2003–2012. High Remittance refers to a set of countries for which remittances have been above 1% during 2003–2012.

Source: De et al. 2016 calculations.

### 3.4 Remittances and Consumption Stability

The ability to reduce fluctuations in consumption is an important determinant of economic welfare. Capital flows in the form of short-term foreign borrowing or sales of foreign liquid assets might be used to finance consumption during bad times. Provided that fluctuations in income are not fully synchronized across countries, and financial markets are operating effectively, output uncertainty can be shared across borders through capital flows, thus lowering consumption dependence on domestic output fluctuations.

Not surprisingly, there has been a growing literature studying the effects of financial flows on consumption stability at the macro level. This literature finds only minimal impact of equity flows on consumption smoothing in developing countries. Although the relative stability of remittances over the business cycle suggests that large-scale recipients may be less prone to consumption volatility, the literature devotes little to the stabilizing effects of remittances on consumption fluctuations (De et al. 2016 for empirical details and cross-country regressions).

Through which channels can remittances help stabilize consumption? First, remittances can help stabilize consumption intertemporally by supporting saving. Some studies based on microeconomic data have documented that remittances are an important resource that enable households to smooth consumption over time because they help improve access to financial services and ease liquidity constraints. Second, even if overall remittances do not increase substantially during economic downturns, a greater proportion of remittances receipts is likely to be used for consumption purposes during such periods. Given that remittances, unlike capital flows, are unrequited transfers that do not have to be paid back

and target the portion of consumers that are more likely to be liquidity constrained, they may have substantial effects on consumption stability.

In addition, at the individual level, access to remittances enables consumers to maintain their consumption levels despite illness or other calamity, which may be critical at very low levels of income. Some studies have found that remittances support household consumption following natural disasters or other economic shocks. For example, Yang and Choi (2007) found that overseas remittances serve almost like insurance following rainfall shocks in the Philippines. An analysis of household survey data has shown that Ethiopian households that receive international remittances seem to rely more on cash reserves and less on selling household assets or livestock to cope with drought (Mohapatra, Joseph, and Ratha 2012).

### 3.5 Conclusion

This chapter analyzes the potential of remittances flows to act as a stabilizer during episodes of high macroeconomic volatility. The analysis is carried out in four steps. First, the cyclical properties of remittances in theory are studied. The review of theory shows that these properties are closely related to the motives that drive remittances. Remittances are driven by either altruistic motives or self-interest. In the former case, they usually tend to be countercyclical. In the latter case, they are largely procyclical.

Second, the evidence on the cyclicity of remittances over the business cycle is reviewed for a sample of 109 advanced, emerging market, and developing countries for the period 1980–2012. Third, the behavior of remittances flows during episodes of significant macroeconomic volatility, such as current account reversals and financial crises, is analyzed. Fourth, cross-country regressions are used to investigate the role of remittances flows in smoothing consumption over time (De et al. 2016 for empirical details and cross-country regressions).

This chapter finds that remittances are relatively stable and acyclical. In contrast, debt flows and FDI are procyclical. Stability and acyclicity imply that remittances have the potential to make a critical contribution in supporting consumption in the face of economic adversity. This finding is particularly important in developing countries, where remittances are used to finance household consumption directly.

In addition, remittances have been stable during episodes of financial volatility, including sudden stops and financial crises. Remittances are also associated with smoother domestic consumption growth. Countries with large remittances receipts tend to display less correlation between output and consumption growth over the business cycle than countries with small remittances receipts. Such consumption-smoothing behavior could enhance welfare.

The results reveal certain subtleties of the data that may be helpful to examine in future research. First, there is a considerable degree of heterogeneity in the cyclicity of remittances across countries. Future research needs to investigate the sources of these differences and seek to identify the conditions under which remittances help lower macroeconomic volatility. Second, these heterogeneities have implications for the theoretical literature. In particular, models that take into account remittances flows should be of a general equilibrium nature and need to control for country-specific characteristics.

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## CHAPTER 4

# Financial Literacy Programs for Remittances

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### 4.1 Introduction

Financial literacy is becoming increasingly important in empowering migrants and their families to strengthen their financial management capacities and to achieve financial independence. Financial literacy enables people to know more about financial decision-making, “develop awareness of personal financial issues and choices, and learn basic skills related to earning, spending, budgeting, saving, borrowing, and investing money” (Kefela 2011).

Financial literacy is defined as the knowledge of basic financial concepts and the ability and discipline to make wise individual and financial decisions (Kefela 2011). Financial literacy programs for migrants and their families can enhance the economic potential of migrants’ remittances for the recipients and even the community, as well as the local economy of the migrants’ countries of origin, particularly developing countries. These programs have been conducted and supported by national governments and agencies, financial institutions, and nongovernment organizations (NGOs). The programs vary, ranging from financial awareness and knowledge; “financial skills, such as the ability to calculate compound interest payments; and financial capability more generally, in terms of money management and financial planning” (Xu and Zia 2013).

This chapter aims to introduce examples of financial literacy programs targeting migrants and remittance recipients in migrants’ country of origin and their destinations. Then, some empirical findings on impacts of financial literacy programs on people’s financial behavior will be summarized. Based on these empirical findings, good practices for the idea on better financial literacy programs will be examined. The last section concludes.

### 4.2 Financial Literacy Programs

When it comes to financial literacy programs, Durana (2016) distinguished between remittance-based and non-remittance-based programs where the former pertains to specific products such as various money wiring services. Remittance-based programs include information on how to send money through various formal channels, the transaction costs in using different services, as well as information on the importance of sending through established formal remittance channels. The latter, on the other hand, pertains to information and education which ranges from “simple financial planners” to something as “comprehensive as a multi-week course covering a broad range of personal and small-business financial topics” (Durana 2016, 166). Non-remittance-based products, in contrast to remittance-based products, focus on how to save rather than how to remit. Opening of bank accounts, and understanding insurance schemes and payment options are some of the important programs that are non-

remittance based. Furthermore, seminars on such programs include financial management, savings and investments, and business management. For example, in many financial education seminars, participants are taught how to manage their own finances, learn the importance of saving and investment, and diversify their portfolios.

#### 4.2.1 Remittance-Based Programs

As for remittance-based programs, government banks in some Asian countries have encouraged migrants to send their remittances through formal channels to better monitor the flow of money into the economy. In the Philippines, the Bangko Sentral ng Pilipinas (BSP) (the Central Bank of the Philippines) has encouraged commercial banks to provide migrant workers information on opening bank accounts to access cheaper, easier, and safer money wiring services (Agcaoili 2016). In Nepal, on the other hand, the national government is campaigning for use of formal remitting services, as an estimated 69% of foreign remittances come through informal channels (Ferrari, Jaffrin, and Shrestha 2007). In Bangladesh, for instance, the government has been encouraging international money transfer operators to educate migrants and their families about safe remittance practices and the importance of using legal channels to remit money (Giriyan 2015). In Indonesia, Bank Indonesia in 2006 issued a regulation “allowing remittances agents to conduct remittance transfers” to optimize consumer protection and to prevent abuse by money launderers (Hernandez-Coss et al. 2008, 46).

National governments have also highlighted the need to work with the private sector to improve the remittance-based programs for overseas workers. Commercial banks have also encouraged the use of ATMs in remitting money in a safer and cheaper way. For instance, the Bank Negara Indonesia promotes the use of ATMs “by charging Rp2,500 (or \$0.19) to customers who withdraw cash of less than Rp2.5 million (or \$188) from tellers” (Hernandez-Coss et al. 2008, 81). Another example is the Philippine National Bank which charges fewer fees when wire transfers are done with ATM cards linked with foreign partner banks. In Sri Lanka, the increase in remittances from migrant workers has encouraged private banks to introduce remittance services (Lasagabaster, Maimbo, and Hulugalle 2005).

Banks have also introduced enhanced and more varied products to migrant workers. For example, in Sri Lanka, Lasagabaster, Maimbo, and Hulugalle (2005) noted that, apart from remittance services, commercial banks are also offering foreign currency deposit accounts known as “Nonresident Foreign Currency Account” which is to be maintained by a beneficiary living in Sri Lanka, and the proceeds will be kept in an account called “Resident Foreign Currency Account.” Funds in both accounts are free from income taxes and have competitive interest rates at 1% to 2% over London interbank offered rate, a benchmark rate that some of the world’s leading banks charge each other for short-term loans. Furthermore, commercial banks in the country are also offering life insurance covers for migrants with deposit accounts, as well as loans, and foreign currency accounts for remittance beneficiaries who are considered minors.

#### 4.2.2 Non-Remittance-Based Programs

More than the remittance-based programs, government agencies in Asia are also contributing to improving the financial education of migrants and the overall population by integrating it into their national strategies, and into various programs for migrants such as predeparture

orientation seminars. Further, private companies and NGOs have also been tapped to promote financial education. Migrant-receiving countries are also working to improve the financial outcomes of immigrants. We look at each of these categories in turn.

Countries such as the Philippines, the People's Republic of China, India, and Indonesia have launched national strategies aimed at improving the financial literacy of their population, specifically the migrants. For instance, the Philippines has a national program aimed to improve financial literacy which is implemented through the National Strategy for Financial Inclusion (BSP 2015a). The BSP has been conducting the Financial Learning Campaign (FLC) for overseas Filipinos and their beneficiaries since 2006. The FLCs are conducted using lectures and multimedia presentations such as videos and Microsoft PowerPoint presentation, focusing on topics related to remittances, financial planning, rewards and risks associated with types of financial products, and ways to protect remittances and savings. While the FLCs are conducted as part of its larger campaign for financial literacy, the FLCs specifically target overseas Filipinos and their families to promote a culture of savings and “to encourage the productive use of remittances, not only for consumption or spending for the basic needs, but also for savings in different forms of financial instruments and/or investments such as in small- and medium-sized enterprises or microfinance.”<sup>19</sup> As of March 2017, the FLCs have been conducted 106 times both locally and abroad where the migrants are and have been attended by 13,956 participants (based on an interview with a BSP staff on 19 May 2017).

The FLC provides information on various traditional or nontraditional investments, short-term or long-term investments, and bank or nonbank investments. Traditional investments include savings accounts, and time deposits which are often bank investments (BSP 2015b). On the other hand, nontraditional investments include mutual funds, unit investment trust funds (UITF), variable life insurance and pension funds, and business and real estate investments that are often offered by nonbank entities. Furthermore, because of the National Strategy on Financial Inclusion, various bank and nonbank products have been made more readily available and easily accessible for Filipinos, for instance, starting an investment does not require large amounts of money. Investing in pooled funds, such as mutual funds and UITFs, is made easier and cheaper—initial investments can be as low as ₱5,000 (about \$100). Such nonbank investments are still regulated by the BSP and the Securities and Exchange Commission (BSP 2015b).

In the People's Republic of China, the People's Bank of China has been leading the planning and designing of a National Strategy for Financial Education where one of its major policy thrusts is to protect disadvantaged groups such as migrant labor (OECD 2015). In line with this, the China Banking Regulatory Commission has begun working with other banks to “establish a public education service, provide free financial literacy materials and other resources as well as provide migrant workers with financial education to guard against financial risks” (OECD 2015, 24).

In 2013, India formulated a National Strategy for Financial Education within a 5-year time frame and to target migrant groups. The country's Ministry of Overseas Indian Affairs has launched Mahatma Gandhi Pravasi Suraksha Yojana, a special social security scheme to encourage and enable overseas Indian workers to save for their return and resettlement as well as for their retirement, and to obtain a life insurance (OECD 2015).

<sup>19</sup> Bangko Sentral ng Pilipinas. [http://www.bsp.gov.ph/about/advocacies\\_ofws.asp](http://www.bsp.gov.ph/about/advocacies_ofws.asp).

Indonesia has also launched national policies on financial literacy. Bank Indonesia, through its Indonesia Banking Architecture launched in 2004, has taken the lead in public education on banking. This was further reinforced in 2007 when a blueprint on public education in banking was created (OECD 2015). Efforts were strengthened in the subsequent years. In 2008, it launched *Ayo Ke Bank* (or Let's go to Bank), the purpose of which is to introduce the bank's products and services and promote the intermediary functions of the bank (Bank Indonesia 2012). In 2009, to further strengthen existing initiatives on public education, Bank Indonesia, in cooperation with the Working Group of Banking Education, developed a new theme for promoting an improvement in people's financial literacy, called "3Ps," which stands for *Pastikan manfaatnya* (ensure benefits), *Pahami risikonya* (understand the risk), and *Perhatikan biayanya* (be careful of the costs) (World Bank 2010).<sup>20</sup> Moreover, to improve Indonesians' marginal propensity to save, the National Campaign of Indonesia Saving Movement was launched in 2010, particularly targeting the middle- to low-income population whose numbers ranged from 40 million to 50 million, considered bankable but having no access to banks. To accommodate the needs of the low-income communities to save, Bank Indonesia and the banking industry launched a new savings scheme called *TabunganKu* (or My Saving) in February 2010. This is a saving product with low initial deposit and no monthly administration cost (OECD 2017).

More recently in 2012, Indonesia launched a more comprehensive National Strategy for Financial Inclusion. Financial education is one of the main pillars of this strategy. This program encourages both the poor and nonpoor households to increase the level of knowledge of financial product and services, improve information on consumer protection, and provide information on financial management. Furthermore, in 2013, the country also launched the Blueprint of National Strategy on Financial Literacy to ensure that all efforts to increase financial literacy are structured and systematic. This blueprint helps the authorities in the financial sector, financial institutions, and other stakeholders. As part of the strategy, together with other financial authorities, Bank Indonesia provides training programs on financial education for migrant workers and their families (OECD 2015).

Aside from launching national strategies aimed at improving financial education of their population, national governments have also specifically targeted migrants and their households. National governments have conducted financial literacy mostly as part of predeparture orientation seminars for departing migrants. For example, in Indonesia, such seminars are conducted by the National Board for the Placement and Protection of Indonesian Overseas Workers (BNP2TKI) as "part of a wider government objective of ensuring that more of the \$8.3 billion in remittances last year [in 2015] goes toward boosting the local economy, while also expanding access to formal financial services to the nearly 60% of the population here that lives without them" (Schonhardt 2016).

In Sri Lanka, the Sri Lanka Bureau of Foreign Employment works with the Ministry of Education to conduct seminars and other education services to inform migrants on different banking facilities available for remitting and as to "how such facilities should be utilized to maximize benefits on their earnings" (Lasagabaster, Maimbo, and Hulugalle 2005, 6). In Nepal, on the other hand, in terms of reintegration of returning migrants, the Foreign Employment Promotion Board is taking up the lead (Government of Nepal 2014).

<sup>20</sup> World Bank. 2010. Improving access to services in Indonesia (English). Washington, DC: World Bank.

Another example is the Philippines, where as part of predeparture orientation for departing Filipino workers, the Overseas Workers Welfare Administration (OWWA) conducts financial literacy programs (OWWA 2016). Also, the OWWA provides financial literacy programs through its reintegration programs for returning overseas Filipino workers (OFWs). OFWs are defined as those aged 15 years old and over and working abroad to fulfill an overseas contract for a specific length of time or are presently employed and working full time with and without working visa or work permits (tourist, visitor, student, medical, and other types of non-immigrant visas) (Philippine Statistics Authority [PSA], 2017).<sup>21</sup> The National Reintegration Center for OFWs (NRCO) also promotes the OFW-M3 program, which stands for Mag-Impok Magnegosyo! Movement (Save Start a Business! Movement) and which aims “to empower OFWs toward a culture of savings for investment or entrepreneurship” (NRCO 2016). To make it successful, a financial literacy campaign needs to focus not only on increasing in participants’ literacy levels but more importantly, changing the mindsets of migrant workers and their families. According to the FLC learning videos from the BSP (2015b), the NRCO implements a three-pronged approach: personal reintegration, community reintegration, and economic reintegration. In terms of personal reintegration, the NRCO helps returnees find jobs both locally and abroad, assesses if returnees need more skills training, provides support in starting a business, encourages savings, provides information on microfinance, and provides counseling for those with family problems. Also, the NRCO helps connect returnees who want to help fund certain community projects through local governments and NGOs. And as part of its economic reintegration program, the NRCO provides returnees knowledge on different bank and nonbank savings and investment opportunities.

Where remittance-based programs are mostly managed by banks and money transfer companies, non-remittance-based programs are usually taken up by NGOs working with government agencies (Durana 2016). Embassies and consulates are also conducting and sponsoring such financial literacy programs.

Empirical evidence has shown that the Philippines, compared with other migrant-sending countries in Asia, seems to have more active organizations, both in the public and private sectors, campaigning for financial literacy among migrant workers. To illustrate, PINOY WISE (or Worldwide Initiative for Savings Investment and Entrepreneurship) is a program jointly developed by the Filipino NGO Atikha with OWWA, the Union of Local Authorities of the Philippines, the Department of Agriculture, the Department of Interior and Local Government, and several local government units (Atikha 2016). This program “provides financial education to Overseas Filipino Workers and their families on both sides of the migration corridor, and links financial education to concrete savings and investment programs of selected cooperatives, microfinance institutions, social enterprises, insurance companies, banks and other agencies in the Philippines” (Anonuevo 2011). Another example from the Philippines is the Peso Sense–The Philippines Financial Freedom Campaign executed by the United Nations Development Programme with the Commission on Overseas Filipinos funded by Western Union (Go 2015). It offers different financial modules for students, young adults, professionals, entrepreneurs, homemakers, senior citizens, and retirees.<sup>22</sup>

<sup>21</sup> Philippine Statistics Authority. <https://psa.gov.ph/content/total-number-ofws-estimated-22-million-results-2016-survey-overseas-filipinos>.

<sup>22</sup> For more details, see Peso Sense’s website (<http://pesosense.com/>).

Private companies and NGOs also offer various products and programs to improve financial literacy. In some cases, private companies and NGOs work closely with national governments, as illustrated by the following examples.

In the Philippines, seminars and training programs on financial literacy were conducted not only in the Philippines but also in the different destination countries of Filipino migrants. These seminars and training programs included the Philippines' Philam Life Insurance's BalikBayani Program (Philam Life 2015), and the Bank of the Philippine Islands BPI Inoy Learning Program conducted with OWWA (Bagasao 2013). This also included various financial literacy programs conducted by the Bankers Institute of the Philippines (BAIPHIL 2016), the Center for Agriculture and Rural Development–Mutually Reinforcing Institutions (CARD–MRI 2016) as well as those programs conducted by universities such as the Leadership and Social Entrepreneurship Program for Migrant Filipinos conducted by the Ateneo School of Government of the Ateneo de Manila University.

In Nepal, the NGO Pourakhi, whose members are all former migrant workers, has been helping migrant workers deal with different issues including financial literacy. The NGO Pourakhi notes that most of the remittances are “spent on luxurious items and not invested in productive ways” (Ebrahim 2014).

In Bangladesh, the use of microfinance among migrant workers and the general population is more common than in other migrant-sending countries in Asia. Rahman et al. (2012) have considered Bangladesh a pioneer in adopting the concept of microfinance. The Bangladesh Rural Advancement Committee (BRAC), one of the leading microfinance institutions in Bangladesh, provides premigration counseling to migrants as part of the migration welfare loans it offers. They also provide training programs for potential migrants to improve their financial inclusion (BRAC 2012).

In India, the Rajasthan Shram Sarathi Association is among the NGOs helping migrant laborers improve their financial inclusion. The association “tries to deliver financial services to migrant households, by offering financial services such as Gullak savings, bank linkages, microloans, insurance, pension and financial literacy programmes for migrant households” (Edelgive Foundation 2015).

Migrant-receiving countries have also been promoting financial literacy among immigrants. In many cases, national governments and various government agencies have taken the lead in the promotion of financial literacy. For example, Australia, the United States (US), and the United Kingdom have developed national strategies on improving financial literacy of the general population, including immigrants.<sup>23</sup> These three countries have focused on the importance of coordinating with the private sector stakeholders in improving financial literacy especially among children, young adults, and newly arriving immigrants.

NGOs and private organizations in migrant-receiving countries have also been engaged with financial literacy for immigrants. For instance, the Latino Community Credit Union (LCCU 2008) has been active in providing workshops for members of the Latin community in the US. The thrust behind their activities is the wide wealth disparity between whites and Latin immigrants (LCCU 2008). They conduct their financial literacy campaign through popular

<sup>23</sup> For more details, see International Forum for Investor Education's website (<http://www.ifie.org/>).

education, a term that traces its roots in Brazil and is defined as “education [that is] based on a democratic practice so participants can participate in discussion, debate and decision-making” (LCCU 2008, 11).

Another example is Prosper Canada, a national charity that supports financial education among new immigrants to Canada as a tool for poverty reduction (Prosper Canada 2014). These supports help newcomer immigrants access information on how to manage day-to-day financial difficulties, such as assuming financial responsibility for their dependent family members and sending remittances to their families and relatives in countries of origin (Prosper Canada 2015).<sup>24</sup> Another similar organization is Aidha, an NGO funded by the United Nations Development Fund for Women (UNIFEM), which provides financial education to many domestic workers in Singapore. Aidha conducts workshops on “basic accounting, entrepreneurship, effective communication skills, computer literacy, time management and improving self-esteem” for migrant workers in Singapore, majority of whom are from the Philippines, Indonesia, and Sri Lanka (Sarmiento 2009).

In the United Arab Emirates and Saudi Arabia, Western Union has launched the program “Apna Sapna,” which is translated as “Our Dream” from Hindi and Urdu. This program encourages financial education for migrant workers in these two countries. Apart from the workshops, Apna Sapna also provides free booklets that list a variety of “recognized and legitimate savings schemes” in countries where most of the migrant workers came from such as India, Bangladesh, and Pakistan. As of 2016, a total of 18,500 migrants have attended the trainings since the launch of the program in 2014 (PR Newswire 2016).

#### 4.2.3 Empirical Findings on Impacts of Financial Literacy Programs on Behavior

Not much has been done when it comes to assessing the impacts of financial literacy. Developed countries, such as the US where financial literacy courses are mandatory in high school, have not seen much success. Various studies cannot conclusively say that financial literacy programs definitively lead to better financial education and, ultimately, to better financial behavior (Hathaway and Kahtiwada 2008; Zia 2009; Hastings, Madrian, and Skimmyhorn 2013). The problem with financial education, according to Willis (2011, 431), is that changing people’s financial behavior “requires changing their emotional responses to money.” However, as Hathaway and Khatiwada (2008, 19) pointed out, “it is not that financial education programs could not work, but rather, it is that they do not work, perhaps because they are poorly designed or administered.” Such an understanding makes it pertinent to look at how financial literacy programs are designed and how these differences in designs affect financial behavior.

- (i) ***Impact on information-seeking behavior.*** In terms of information on remittance channels and costs, Gibson, McKenzie, and Zia (2012), using a randomized experiment design to measure the impacts of financial literacy training on migrants in New Zealand and Australia, found that such financial literacy training can cause an increase in financial knowledge, and information-seeking behavior. The migrants who have

<sup>24</sup> Prosper Canada – Center for Financial Literacy. <http://prospercanada.org/getattachment/3ff26769-c2d4-4d9e-82e9-f56467e4eb31/Financial-Literacy-and-Newcomers-to-Canada.aspx>.

undergone training were “more likely to use the internet to compare costs [of sending remittance], with no impact on keeping track of monthly expenses.”

Not only behavior on seeking more information on the costs of sending remittance is affected. Seshan and Yang (2014) conducted a field experiment in Qatar among Indian male migrants whose wives remained in Kerala, India. They randomly sent invitations to a savings-focused financial literacy workshop. After a year since the workshop, they interviewed the migrants and their wives. A total of 200 couples were included in the study. They found that there was information asymmetry between the migrants and their wives in that some migrants did not know how their wives were using the remittances and that the wives, in turn, did not know the amount of savings their migrant husbands had and the various financial products that the husbands could access in the destination country.

The workshop affected the migrants in two ways. First, in terms of information-seeking behavior, migrants expressed wanting to learn more about how the remittances are being managed and used by their wives. They also found a higher propensity among migrants to seek joint decision-making with their wives regarding finances. According to Seshan and Yang (2014), the workshop led migrants to “seek better information on their wives’ savings, which systematically leads to upward updating.” And second, the workshop had impacts on their savings goals especially for low-saving migrants. The workshop led this subsample to increase their savings and the amount of remittances they send back home to their wives.

Furthermore, in a study by Ashraf et al. (2015) on migrant savings, migrants who had the most information about savings in their home country tended to have higher amount of savings than those who had less information and control. They noted that, “if migrants do not share the same financial objectives as family members remaining back home, information asymmetries may prevent migrants from achieving objectives that require the assistance or participation of relatives remaining in the home country” (Ashraf et al. 2015, 332). The flow of resources to transnational household is “large in magnitude” and “may have important aggregate impacts;” therefore, an understanding of financial decision-making in such households becomes all the more important.

- (ii) ***Impacts on mindset and attitudes toward financial institutions.*** Willis (2011) noted that it is hard to change people’s financial behavior and emotional responses when it comes to issues regarding money. How people spend and where people spend money are behavior issues that cannot be easily changed; however, changing perceptions about financial institutions may be one way to improve people’s financial behavior. People are often intimidated by banks and other financial institutions because of the formal culture of many banking institutions (Kring 2008, Paulson et al. 2006, Siddiqui and Abrar 2003).

A study by the Latino Community Credit Union (2008, 9) has noted that interviewees are often “afraid to go to banks” often citing feeling intimidated and uncertainty about the documents the bank would require if they would need to do a transaction.

Similarly, in a news article by *The Wall Street Journal* on Indonesian women migrants (Schonhardt 2015), an Indonesian government agency officer said “some of the migrant workers think that everyone who goes to the bank goes with big stacks of money, that’s

why they don't feel confident." As part of the Indonesian government's predeparture orientation for departing migrant workers, migrants have to attend a course on financial literacy and open a bank account with the state-run Bank Negara Indonesia. Upon opening bank accounts, they claim to have better information on how to use a bankbook and an ATM, technologies which seem intimidating to them at first.

- (iii) **Impact on savings and opening of bank accounts.** As mentioned, studies on the impacts of financial literacy programs on financial behavior may not abound, but that does not mean that empirical studies on the relationship between financial education and behavior do not exist. In the literature, the most common indicator used to approximate financial behavior is opening of bank accounts.

According to a study by Orozco (2009) on migration and remittances, a program on financial literacy performed in Moldova during a 6-month period with 7,000 remittance recipient clients showed that "80 percent of those receiving financial education expressed an interest in acquiring and utilizing financial services." This interest in acquiring financial services and products, as a result of financial literacy programs, is echoed by Kefela (2010, 25), where he stated that "as a result of increased financial education, the likelihood of a household head opening a bank account was 5% and this increased to 12% if they were also illiterate."

Similarly, in a randomized field experiment conducted by Chin, Karkoviata, and Wilcox (2011), they found that providing a *matrícula consular* card (a consulate-issued identification card accepted by many US financial institutions as sufficient proof of identity) to Mexican immigrants in the US facilitated the opening of bank accounts among migrants. It was also found that, with an issuance of this ID card raised the likelihood of migrants to open bank accounts by 36%, and increased their savings as a share of income by 9%. Furthermore, among those migrants who reported not having control on how their remittances are used, the treatment caused a shift from savings in Mexico to the US, larger savings, and higher take-up of US bank accounts.

Seshan and Yang (2014, 11) noted that, apart from addressing information asymmetry and attitudes toward financial institutions, financial literacy programs can encourage people to save. When respondents were asked which aspects of their financial lives were positively affected by the workshop, about 33% of the respondents reported "having regular savings," 31% reported "spending wisely and avoiding excessive expenditures," and 17% responded "managing debt."

The impacts of financial literacy programs on behavior towards opening bank accounts are illustrated in a study conducted by Grameen Foundation and ideas42 (Fiorillo et al. 2014). The study involved clients of CARD Bank, the first microfinance NGO in the Philippines that has evolved into a rural bank. The study used a randomized control trial methodology in which one group of the clients was randomly assigned to a treatment (an intervention package consisting of four components—a new, simpler account opening form; printed savings plan; text message reminders; and a savings calendar). Based on the results of the study, "clients who received [the] treatment when opening a savings account made initial deposits 15% higher than the control group and were 73% more likely to initiate a transaction in the new account" (Fiorillo et al. 2014, 5).

## 4.3 Good Practices

The literature does not provide conclusive evidence that financial literacy programs can greatly affect financial outcomes. This does not mean, however, that financial literacy programs do not have any impact on financial behavior and, as such, should not be conducted. On the contrary, the literature suggests learning from the good practices of others. From the review of the literature, we could glean four important points to consider when designing financial literacy programs: information asymmetry, and the importance of timing, content, and delivery mode.

### 4.3.1 Information Asymmetry

Using a field experiment, which was discussed in detail in the previous section, Seshan and Yang (2014, 25) concluded that “financial education interventions—and many interventions targeted at transnational households more generally—must confront the challenge of asymmetric information in the household.” Many of the existing financial literacy programs involve the migrant members only especially those designed as part of predeparture orientations given to departing migrants or those given while the migrants are in the host countries. While it is good if such programs can encourage migrants to save and invest, it can also encourage them to make unrealistic goals if the needs of the remaining family members in the home country are not taken into consideration. Therefore, as Zia (2009) noted, it is important to involve the family especially when addressing this problem on information asymmetry.

Circumstances of the migrant in the destination country and those of the remaining family in the home country are not always the same—many factors can influence consumption and saving goals. Saving goals for the migrant member might be impractical and unachievable to members in the home country, or conversely, consumption needs for the members in the home country might be hard to understand for the migrant member. The remaining family members, not understanding the saving goals of the migrant member, might use the remittances in a way that will make saving impossible or spend it on consumption goods. Failing to set aside money for investment might result from the remaining family not knowing the circumstances of the migrant member.

Therefore, who should be involved in financial literacy programs? Doi, McKenzie, and Zia (2014) argued that the impact of financial education varies greatly depending on who is trained. Their study involved conducting a randomized experiment in Indonesia which divided female migrants and family members into four groups: a control group, a group where only the migrant is trained, a group where only a family member is trained, and a group where both the migrant and a family member are trained. This experimental study found that training both a family member and the migrant can have significant impacts on financial behavior, knowledge, and savings.

Involving the family in the financial literacy program will help bring everyone on the same page. Furthermore, Seshan and Yang (2014) suggested that joint accounts for physically separated spouses allow both parties to monitor savings, and efforts such as these can help ameliorate problems associated with information asymmetry. Doi, McKenzie, and Zia (2012, 2) noted that gains “will be much larger if the family remaining can be involved too” and,

as Seshan and Yang (2014) echoed, “targeted financial literacy interventions to different populations may lead to better outcomes on average than a single undifferentiated offering.”

### 4.3.2 Timing

In a study conducted by Mandell and Klein (2009), they noted that financial literacy programs did not have conclusive success because it was given when it was not needed. They suggested conducting financial literacy programs for when people would actually need it. Doi, McKenzie, and Zia (2012) also echoed this. In their study of a pilot program on financial literacy for 400 Indonesian overseas migrant workers who were about to leave for Hong Kong, China; Malaysia; Singapore; and Taipei, China, Doi and colleagues found that timing mattered. Their study also underscored the importance of finding the right “teachable moment.”

Deciding on when to conduct financial literacy programs for migrants can be a bit tricky. Following the examples of financial literacy programs in section 4.2, we can see that various financial literacy programs have been, and are being, conducted at different stages of migration. Many migrant-sending governments, such as those of Indonesia and the Philippines, conduct financial literacy seminars as part of their predeparture orientation programs. Also, some private organizations and NGOs conduct financial literacy seminars at the destination countries. Some, on the other hand, couple such seminars with reintegration programs for returning migrants. But when is the appropriate time? Doi, McKenzie, and Zia (2012) suggested that it is best to be conducted before the migrants leave. Tying this with the idea that financial literacy be taught when it is needed, Doi, McKenzie, and Zia (2012, 2) suggested that it is logical to include financial literacy training for migrants in their predeparture orientation, saying that it is this teachable moment which can provide families “with key knowledge just before they are about to start receiving much larger amounts of money than they are used to dealing with, and before they have had a chance to form habits on how they use this money.”

We further suggest that conducting financial literacy programs on-site at the migrants’ destination countries can also be beneficial, since (i) it inculcates in them important habits about financial management while they are earning, and (ii) it can develop in them information-seeking behavior as they would most likely seek more information as to how their recipients are using the remittances. Gibson, McKenzie, and Zia (2012, 20) noted that after conducting financial literacy seminars on various remittance channels and costs among Pacific Island immigrants in New Zealand, “simple financial education training for migrants can change their knowledge about the costs of remitting and lead them to look around more at prices.” Therefore, on-site training can also impart some necessary information to migrants.

Conducting financial literacy seminars as part of reintegration programs for returning migrants, if that alone is offered, might not have as much benefits as conducting financial literacy programs during predeparture orientations. It can be considered late because, as Doi, McKenzie, and Zia (2012) noted, returning migrants may have already formed some financial habits. And as discussed in the previous section, emotional responses to money are hard to change. Therefore, timing is important. If coupled with financial literacy seminars during predeparture orientation and on-site, financial literacy seminars during reintegration might have significant impacts.

### 4.3.3 Content and Varied Interventions

The content of financial literacy programs should be considered, in that topics on “how to save” may be more important than ‘how to remit’” (Doi, McKenzie, and Zia 2012, 2). This suggests that non-remittance-based programs may have more impacts on financial behavior than remittance-based programs. When it comes to remitting, studies have suggested that migrants often consider perceived costs, personal characteristics, convenience, and availability of options as well as a migrant’s legal status (Hernandez-Coss et al. 2008, Siegel and Lücke 2009, Kosse and Vermeulen 2014). Doi, McKenzie, and Zia (2012, 2) noted that impacts from remittance-based programs, which are dependent on such factors listed above that cannot be easily changed (especially those pertaining to physical access and institutional access to remittance channels), might be “much less than the gains from learning how to save and budget and getting migrants and their families to use the money they have more effectively, rather than just savings on transactions costs.”

Though, of course, even opening bank accounts for both remittance and savings already is replete with issues. Gibbs (2010), in his study of the financial inclusion among newcomer immigrants in Northern Ireland, suggested that opening bank accounts may be hard for migrants, on both the demand and supply side, since there are many things to consider when it comes to opening a bank account for new immigrants: proficiency in language, the required documents, banking charges and hours, lack of suitable products, and lack of knowledge about different financial instruments. However, as discussed in the previous section, non-remittance-based programs on financial literacy can have positive effects on mindset and perceptions about financial products, making migrants less intimidated to go to banks and other financial institutions. Furthermore, with the continuous development of financial technology (FinTech), such as, mobile payments based on two-dimensional barcodes, also known as Quick Response (QR) Codes, and innovative and disruptive financial services using blockchain technology, a wider variety of transactions in digital financial assets have become much faster, safer, and cheaper. One good example of the former is WeChat Pay by Tencent and Alipay by Alibaba Group, while a good example for the latter includes the use of crypto currencies such as bitcoin, ripple, and stellar by remittance service providers. Sending remittance through mobile phones has become easier, as noted in a study of remittance-backed programs in the Philippines conducted by Bagasao (2013). What is important to note at this point is that the explosive growth of mobile payments and the groundbreaking development of blockchain-based financial inclusion products goad policymakers to update the contents of financial education.

Willis (2011), in her paper on the fallacy of financial education, noted that the idea of financial education as enhancing the autonomy of a person to address his or her own personal finances is a fallacy. According to Willis (2011, 431), “education programs would need to decide what lessons to teach against a background in which we lack technical and normative consensus on what constitutes correct financial behavior.” Willis (2011, 432) also argued that most financial educators routinely teach students “what mix of investment products to select and what percentage of income to spend on a mortgage,” but that ultimately robs them of their autonomy because they only behave as taught and “are held accountable for outcomes as if they were.”

That being said, it becomes important then to promote the notion of goal setting and financial counseling to address the issue raised by Willis (2011). Goal setting, as Carpena et al. (2015)

noted, can influence the take-up of financial products as well as influence future actions regarding financial behavior. They suggest that combining simple strategies, such as writing down budget, can be adopted to “overcome behavioral barriers such as procrastination and forgetfulness” (Carpena et al. 2015, 5). Financial counseling, on the other hand, can help individualized financial products and strategies. Financial counseling is “key to sustained budgeting behavior” (Carpena et al. 2015, 19).

In a study of CARD Bank clients in the Philippines, Fiorillo et al. (2014) found that goal setting and frequent reminders made clients much more committed to savings. In the study, bank clients in the treatment group—that is, those that received regular text messaging reminders to save, a savings plan, and a savings calendar—made small but frequent deposits rather than those who were in the control group. Furthermore, bank clients, during their center meetings, often talked about their daily financial matters “but not savings towards goals or potential emergencies” (Fiorillo et al. 2014, 13), and this is where goal setting, through the use of savings calendar and savings plan, can come in.

#### 4.3.4 Delivery Mode

In terms of style and format of financial literacy programs that can significantly impact financial literacy, results vary. A good style should enable faster and easier take-up of knowledge, and simplify access and facilitate desired behaviors. Financial literacy programs have been implemented in various formats—from seminars to workshops, to pamphlets and modular formats—as was demonstrated by the examples of financial literacy programs described in section 4.2.

In utilizing mass media for financial literacy, a number of innovations combine education and entertainment (i.e., edutainment). One example is *Nuestro Barrio*, a 13-episode telenovela targeted to Latino immigrants, and the first Spanish language show aired in an English network in the US (Spader et al. 2009). The show teaches financial literacy; however, compared with a traditional course or workshop, the topics are integrated into the story line because the telenovela’s educational impact also depends on the number of viewers it attracts.

Another example is *Scandal!*, a South African soap opera that incorporated a debt-related story line in 2011 in response to the World Bank’s campaign on financial literacy. In 2013, Berg and Zia conducted an evaluation study of the impacts of the show on improving financial decisions among South Africans. They concluded that the show had “significant and favorable impacts on financial knowledge and behavior, which highlights the importance of delivery mechanisms in financial education” (Berg and Zia 2013, 24).

A similar example is a soap opera called “A course that helps you become a millionaire” televised in Mongolia in 2015 and which became the second-most watched show that year (Enkhbold 2016). This television show, the development of which was assisted by the Asian Development Bank (ADB) and the Japan Fund for Poverty Reduction, banked on the idea that “people get hooked on stories” and used this to teach lessons about protecting themselves through saving and financial planning. According to ADB (Enkhbold 2016), the series attracted a wide audience because “the stories were based on real-life experiences and [were] tied to local culture” making the audience able to identify themselves with the many character types from the drama.

The show also utilized many forms of mass media—from newspapers to a teaser about the show being uploaded in YouTube and thus making itself available to more people online. They even utilized text messaging to check the rate of take-up of the lessons being taught per episode. Some 800 text messages were sent every episode to random mobile-phone users about financial literacy issues discussed in a particular episode. They found that “in the beginning most of the answers were wrong, but by the 15th episode the majority of replies were correct” (Enkhbold 2016).

Financial education is also being promoted by private news channels such as ABS-CBN News Channel’s (ANC) *On the Money*, a program launched in 2012 that aims to educate Filipinos on how to save and invest. Finance experts provide answers to questions sent in by viewers through social media platforms (ANC 2017). *Business Nightly*, another program by the ANC, provides news and information on Philippine economic and business trends (ANC 2017). Bloomberg TV Philippines, a business news channel launched in 2015, includes talk shows, newscasts, and various programs aimed at providing information on stock market, business, and investment opportunities (Bloomberg TV Philippines 2009).

Aside from edutainment, other formats are also being taken up. In a study conducted by Fiorillo et al. (2014), they found that “embedding behavioral principles into product design can trigger desired behaviors.” In their field experiment, bank clients were not linking opening of account with continued usage of account with each other. To create that link, Fiorillo and her colleagues interviewed the bank clients about when, where, and how they would be making succeeding deposits, prompting the clients to start planning how to save. Furthermore, during meetings with other bank clients, the members only discussed daily financial matters and not long-term goals regarding savings and investments. Noting that this may be a channel whereby they can influence behavior, they “used social influence to create new expectations about behavioral norms” (Fiorillo et al. 2014, 13).

Putting the signatures of both the client and the bank officer on the savings plan was another strategy used in the study. They remarked that “the dual signatures helped to create the feeling of a commitment” (Fiorillo et al. 2014, 13). Furthermore, the clients had a personalized message from the CARD Bank CEO on their savings calendar. The researchers noted that the “calendar helped reinforce reciprocity, or the idea that people will respond to a favorable action with another favorable action” (Fiorillo et al. 2014, 15).

Another innovation employed in the study was the text messaging reminder that the researchers sent to the clients. The text messages were made “to appear to come from a specific CARD Bank staff person, rather than a computer system, to build upon personalization and the strong relationship clients feel with CARD Bank” (Fiorillo et al. 2014, 14).

## 4.4 Conclusion

There are many financial literacy programs aimed at improving migrants’ financial behavior to better manage their remittances. In section 4.2, we saw a number of these programs conducted and implemented in many countries, both migrant-sending and migrant-receiving. However, impact evaluation studies on financial literacy programs are limited, as described in section 4.3. The varied results in the literature on whether financial literacy can improve financial education and outcomes suggest that policymakers have to step back and examine what have

been done so far. The contrasting arguments in the literature as to whether financial literacy work in the first place should drive researchers to conduct more in-depth studies on how to deliver financial literacy programs to improve take-up of knowledge and financial products.

While the literature suggests that financial infrastructures are in place in many countries in Asia, access still remains a big problem (Rillo 2014). This is confirmed by the findings from the 2016 Brookings Financial and Digital Inclusion Project Report (Villasenor, West, and Lewis 2016), which evaluates countries based on four dimensions: country commitment, regulatory environment, mobile capacity, and adoption. For many of the Asian countries included in the report, performance is low in terms of adoption. As Hathaway and Khatiwada (2008, 19) argued, “it is not that these programs could not work; it is that the programs are poorly designed and implemented.” The question then becomes, how do we improve gaps in existing financial literacy and education programs? We identify three key areas where improvements can be made.

First, integrating financial education into the school curricula is crucial. Compared with the US where financial education is part of the school curricula of many states, financial education is not yet integrated into school curricula in many countries in Asia. While national strategies for financial inclusion implemented by the Philippines and Indonesia, for example, underscore the importance of having financial education classes at the elementary and high school levels, financial literacy and inclusion still remain relatively low. For instance, in 2016, the Philippines commenced the new K to 12 Basic Education Program in which the curriculum included financial education programs for the youth. The Kiddie and Teen Account Program, which allows children aged 0–19 to open bank accounts (“In Trust For” accounts, in the case of children below 7 years old), focuses on encouraging the habit of saving regularly among the youth, with emphasis on continuing long-term saving habits into their adulthood (BSP 2016). The effectiveness of the program and the inclusion of financial education into the elementary education curriculum remain to be seen, particularly on how changes in the curriculum for school-age children can help develop good financial habits that can be sustained into their adulthood.

Second, governments had been focused on “how to remit” rather than on “how to save” or “how to invest.” Financial inclusion rates have relatively improved in many Asian countries due to the promotion on using formal remittance channels by many governments. Easier access, cheaper rates, and faster transfers are among the incentives offered by many formal financial institutions. However, this does not really address the gap between high remittances and low saving rates. One concrete suggestion that this chapter makes is that financial literacy seminars provided during predeparture orientations, which many governments already implement, should include not only migrants but also their family members and put focus on the various traditional and nontraditional saving and investment instruments such as pooled funds, insurance plans, and pension funds that are available to them. Predeparture orientations provide the best opportunity for migrants and their family members to begin developing financial habits before they start receiving larger amounts of money.

Third, financial education requires a significant change in mindset. As discussed earlier, Willis (2011) noted that simply teaching the students the right mix of investments attains nothing; rather, financial education should develop a change in people’s mindset. This is the hardest to address. National strategies often put focus on more tangible forms of financial inclusion, i.e., bank accounts, usage of formal remittance channels, and membership in pension funds.

More than improving financial products, how to use them, how to choose what is best fitted to migrants' and their families' needs and means, and how to be able to set goals and save for the future should be a priority for many governments. In short, inclusion should always be coupled with education. For that reason, we suggest the use of proper evaluation tools to be able to assess whether the programs are making a difference. Proper evaluation tools that outline quantifiable goals can help identify what programs work, what gaps need to be addressed, and what more should be done in the most effective and efficient way to improve financial education.

It is not to say that financial literacy programs have no impact at all. Such good practices noted earlier could improve existing financial literacy programs to increase the positive impacts on migrants' and families' financial behaviors regarding consumption, savings, and investment. As Hastings, Madrian, and Skimmyhorn (2013, 32) noted, "we also should not lose sight of the larger goal—financial education is a tool, one of many, for improving financial outcomes."

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# Leveraging Remittances for Financing for Development

*Dilip Ratha and Sonia Plaza*

## 5.1 Introduction

Remittances have emerged as a major source of external development finance in recent years. Given their large size, governments from developing and developed countries have focused attention on both the development impact of remittances and on regulatory issues in sending and receiving countries (Ratha 2003, Plaza and Page 2006, World Bank 2011). As in the case of migration, reliable data on remittances are hard to come by. While the International Monetary Fund (IMF) publishes statistics on remittances, these data are neither comprehensively reported nor do they capture flows of monies that take place outside of formal financial channels (World Bank 2006, 2016; Plaza and Ratha 2017).

Remittances provide the most tangible link between migration and development and are a large source of funding in many Asian countries. Remittances tend to be relatively stable, and may behave countercyclically—because relatives and friends often send more when the recipient country is in an economic downturn or experiences a disaster. Remittances have been more stable than foreign direct investment, private debt, and equity flows. Nevertheless, even small fluctuations in remittance inflows can pose macroeconomic challenges to recipient countries, especially those with large inflows (Ratha 2003).

Remittances play an important role in reducing the incidence and severity of poverty. They help households diversify their sources of income while providing a much-needed source of savings and capital for investment. Remittances are also associated with increased household investments in education, entrepreneurship, and health—all of which have a high social return in most circumstances. That said, the evidence of the impact of remittances on economic growth is mixed. Many migrants transfer funds to households in origin countries for investment purposes. Data from household surveys show that households receiving international remittances from the developed countries in the Organisation for Economic Co-operation and Development (OECD) have been making such productive investments as buying agricultural equipment, building a house or a business, purchasing land, and improving a farm (Plaza, Navarrete, and Ratha 2011). Even though remittances provide a lifeline to the poor in many developing countries, sending money to them remains costly at about 7.2% (World Bank 2017). Indeed, the average fee for remittances to East Asia is more than 8.4% of the principal, the second highest after Sub-Saharan Africa, among the developing regions. Fees for remittances to the Pacific island countries tend to be even higher. Closing of bank accounts in Australia and New Zealand due to “de-risking” is having an impact on costs. For example, in Australia where three of the four commercial banks closed the accounts of money service providers, the cost of remittances has increased by 2 points in 1 year (Plaza 2014). Concerns over money laundering are keeping costs high by increasing compliance costs for commercial banks and money transfer operators (MTOs), and delaying the entry of new players and the use of mobile technology (World Bank 2017).

This chapter outlines policies to improve the quality of data on remittances, reduce remittance costs, encourage innovative money transfer technologies, promote the use of remittances to improve access to capital markets, and facilitate financial inclusion.<sup>25</sup>

## 5.2 Improving Remittance Data

Data on remittances are far from perfect. Concepts, classifications, and methodologies are not applied uniformly across all countries. Data sourcing and compilation are better in some countries than in others. A global survey of central banks reveals significant heterogeneity in the quality of remittance data compilation across countries (Irving, Mohapatra, and Ratha 2010). Some central banks use remittance data reported by commercial banks but do not adequately capture flows through money transfer operators, post offices, and mobile money transfers. In certain countries, the sources for total remittances are different from those for data on workers' remittances, compensation of employees, and migrants' transfers. Thus, the total remittances figure does not match the sum of the components. In other cases, a country has different numbers for remittances depending if it is the central bank or the minister of finance that reports the number. Better methodologies for compiling remittance data will have an impact on debt burden thresholds (International Monetary Fund and World Bank 2013, Plaza 2013, World Bank 2016).

Central banks and statistical agencies can improve data collection by expanding the reporting of remittances from banks to nonbanks providers of remittance services, using surveys of migrants and recipient households to estimate remittance flows through formal and informal channels; and asking labor ministries and embassies in destination countries to provide estimates of remittance flows. Some embassies and consulates conduct their own survey (World Bank 2016).

## 5.3 Reducing the Costs of Remittances

Remittance costs have been declining over time, but as of the third quarter of 2017, remained high at 7.2% of the amount transferred for all developing countries, and at 8.0% for East Asia, according to Remittances Prices Worldwide. The 2030 Sustainable Development Goals include a target for reducing remittance costs to 3% by 2030. Reducing remittance costs from the average of 8% (in 2015) to, say, 3% would translate into savings of more than \$20 billion annually for migrants and their relatives (World Bank 2015).

Policies to reduce costs by *discouraging exclusive partnerships and promoting competition*—for example, between banks and international money-transfer agencies—would reduce remittance costs, and benefit both migrants and remittance recipients (World Bank 2017). An exclusive partnership between the national post office of either the source or the recipient country and any single MTO reduces competition and allows the MTO to raise remittance fees. The same is also true for exclusivity partnerships involving national commercial banks. Worse, the share of the remittance fee received by the post office or another entity of the state is equivalent to a highly regressive tax on poor migrants and their relatives. This practice

<sup>25</sup> This chapter draws from the Diaspora for Development in Africa book (2011), the *Migration and Development Brief* 24, and Technology and Remittance costs background paper for the Digital Dividend WDR 2016.

directly contravenes the Sustainable Development Goal of reducing remittance costs by 2030, and a similar goal of the European Union–African Union (EU-AU) Valetta Summit agreement with a deadline of 2020. Paradoxically, while many developing countries (e.g., Bangladesh, Ghana, India, Nigeria, Pakistan, and Rwanda) have outlawed exclusivity contracts, most of the large remittance-source countries, especially in Europe, continue to allow this anticompetition practice (World Bank 2006, Ponsot 2011). A simple solution to this problem would be to open the partnerships to multiple remittance service providers.

During the past 3 years, regulations concerning anti-money laundering/combating the financing of terrorism (AML/CFT) have impacted cross-border transfers, including remittance flows. In this context, de-risking includes closing the bank accounts of customers in countries or sectors deemed to pose a high risk of money laundering or terrorist financing. De-risking has created significant challenges, reducing remittance costs and constraining broader development objectives.<sup>26</sup> Meanwhile, the restrictions on regulated and legal remittance providers could divert flows toward informal channels which, in turn, could increase AML/CFT risks.<sup>27</sup> MTOs have faced a reduction in the number of correspondent banks operating in small-volume corridors or in fragile countries. The 2015 World Bank surveys on correspondent banking relationships and a survey of MTO account access showed a decline in the number of correspondent banks with relationships in several key areas (World Bank 2017).

The situation worsened in 2016, according to an International Finance Corporation global survey of banks in emerging markets: 27% of banks surveyed globally—35% in Sub-Saharan Africa—reported a decrease in relationships with corresponding banks (IFC 2017). Banks also reported that they were raising fees and reducing credit lines to their customers. The data points to three primary challenges reported by banks: (i) several requests from multiple regulators; (ii) expensive software and system upgrades; and (iii) lack of harmonization in global, regional, and local regulatory requirements.<sup>28</sup> Banks perceived MTOs as high risk since not all MTOs have a good system of risk management. In the Pacific island countries, MTOs' compliance with customer due diligence requirements was cited as one reason why banks withdraw correspondent banking relationships (Erbenová et al. 2016). In Sub-Saharan Africa, the lack of customer information, including nonexistent national identification cards and the impossibility of verifying addresses in rural areas, was cited as the second-most-important challenge.

Based on the survey results, three suggestions to help mitigate de-risking have been proposed: (i) greater harmonization of regulatory requirements, (ii) a centralized registry for due diligence data, and (iii) assistance in understanding and adopting new compliance

<sup>26</sup> The Financial Action Task Force, the international standard setter on anti-money laundering, defines de-risking as: “the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk (. . .). De-risking can be the result of various drivers, such as concerns about profitability, prudential requirements, anxiety after the global financial crisis, and reputational risk” (<http://www.fatf-gafi.org/publications/fatfgeneral/documents/rba-and-de-risking.html>).

<sup>27</sup> In 2015, the World Bank published results from two surveys on this subject with the support of the Committee on Payments and Market Infrastructure and the Financial Stability Board. Both surveys found that financial institutions were terminating their relationships with respondent banks and remittance companies. The drivers for this behavior were found to vary: bottom-line profitability decisions, perceived AML/CFT risks, or more traditional prudential issues. <http://www.worldbank.org/en/topic/financialmarketintegrity/brief/de-risking-in-the-financial-sector>.

<sup>28</sup> The Asociación de Supervisores Bancarios de las Américas also reported that remittances to the Latin American countries have been affected (about 60% of their members indicated the impact of bank accounts closures).

standards. In the absence of evidence on risks associated with remittances, any solution to de-risking must adopt a two-pronged approach: develop risk metrics, and *recognize that small remittances below certain thresholds do not represent significant AML/CFT risks*. Almost certainly small remittances do not pose systemic risks, especially those going through small and start-up MTOs (Ratha et al. 2011, World Bank 2017).

An important barrier to lowering remittance fees arises from the costs associated with implementing the AML/CFT requirements. Further development at the national level of a risk-based approach to AML/CFT regulation could help reduce these costs. Facilitating the use of more efficient technologies and fostering competition in the remittance market, while still complying with AML/CFT requirements, could reduce overall compliance costs. Presently, however, “de-risking” by international banks has become a major threat to remittance services to all countries in the world, including small island countries and fragile countries (World Bank 2016).

## 5.4 Fostering the Use of Innovative Money Transfer Technologies<sup>29</sup>

The introduction of online and mobile money transfer systems in many developing countries offers new opportunities for more cost-effective means of sending money. Sub-Saharan Africa continues to lead other regions in the take-up of mobile money services, accounting for 130 live mobile money services (Plaza, Ratha, and Yousefi 2015).

Mobile technology can lower the cost of remittances, as it removes the need for physical points of presence and ensures a timely and secure method of transaction (Plaza, Ratha, and Yousefi 2015). Mobile money transfer services, such as MPesa, have transformed the landscape for domestic remittances in several African countries (Ratha et al. 2011). The digitization of domestic remittances has reduced the costs of sending remittances to rural areas.

The use of mobile money technologies in cross-border transactions, however, remains limited, though it has been increased slowly over a period of time. According to the latest GSMA report: “mobile money services (covering 170 million mobile money accounts) offered customers the ability to send money across 45 country corridors, a number which is growing quickly year-on-year. International interoperability of mobile systems and AML/CFT regulations still create barriers to the entering of new players. The regulatory framework should be designed to foster competition, simplify the AML/CFT regulations for low-risk and low-value transfers, and ensure that there are no exclusive partnerships between telecom companies and international MTOs. Regulations such as Know Your Client could be risk-based depending on (i) the size of payments and (ii) the existing information on the source of payments. For instance, the documentation burden faced by a person remitting, say, \$500 from a salary account should be less than a remittance of \$10,000 being deposited in cash (Plaza, Ratha, and Yousefi 2015).

Some of the new technologies include the following:

<sup>29</sup> This section draws from S. Plaza, D. Ratha, and S. R. Yousefi. (2015). “Technological Innovations and Remittances” background paper for the World Development Report 2016 “Digital Dividends.”

- (i) **Virtual currency.** In facilitating e-commerce and accessing digital goods, “BitPesa” uses bitcoin as a token that gets cashed out into local currency.<sup>30</sup> It is scalable, low-cost, secure, and interoperable. Innovation in such platforms as “BitPesa” is in the costing structure, which leverages technology and existing businesses. Like traditional banking services, it complies with AML/CFT and know your customer (KYC) rules (the regulatory guidelines requiring financial entities to have identification and information of their clients), although it is neither licensed nor regulated. This fact has not stopped it from doing business.
- (ii) **Open and secure network connectivity.** Some companies are working on a platform to facilitate network connectivity and to provide the back-end financial infrastructure to reduce silos and friction across different financial platforms (such as different systems across banks, or between bank systems and mobile phones). For example, a person in the United Kingdom can transfer funds to Nigeria through a local remittance company which connects to this network. Through its internal marketplace, the company picks up the best foreign exchange trades. The converted amount is then sent to the receiver’s mobile network in the funds of the receiver’s mobile wallet. The costing structure is a 1% anti-spam cost that is levied for and spread across 300,000 transactions. Documentation complying with KYC standards is required to protect the system and customers against fraud.
- (iii) **Mobile money and money transfer online.** At the end of 2016, there were 46 live international remittance corridors across 21 countries where mobile money was both the sending and receiving channel.<sup>31</sup> WorldRemit, Remitly, and Transferwise are competing with traditional remittance transfer companies and reducing remittance costs. Remitly processed \$2 billion in transfers in 2016, which is essentially double its annualized volume in the previous year; WorldRemit now processes over 500,000 transactions a month; and Transferwise now transfers over £800 million (\$1 billion) a month.<sup>32</sup>

The remittance markets are facing the emergence of alternatives to cash products. Several MTOs are offering senders different options such as credit or debit card-based payments, wire transfers, or mobile transfers. Technological advances that have enabled digital payments and increased their efficiency have contributed to reducing remittance costs in recent years. On the other hand, compliance with AML/CFT requirements seems to have increased the overall costs of remittances and causing a consolidation in the market. Promoting policies that reduce entry barriers, such as mobile licensing and eliminating exclusivity conditions for incumbent providers, would increase competition. Thus, reductions in remittances costs can be supported by financial and regulatory frameworks that facilitate the introduction of new products, interoperability among MTOs, and the establishment of open infrastructure to collect digital payments.

<sup>30</sup> Relying on “block chain technology”, which is cloud-based, open-source, double-crypto-key secure, this technology is employed by the most cutting-edge financial technology companies in the world.

<sup>31</sup> GSMA. 2017. State of the Industry Report on Mobile Money. Decade Edition: 2006-2016. [https://www.gsma.com/mobilefordevelopment/wp-content/uploads/2017/03/GSMA\\_State-of-the-Industry-Report-on-Mobile-Money\\_2016.pdf](https://www.gsma.com/mobilefordevelopment/wp-content/uploads/2017/03/GSMA_State-of-the-Industry-Report-on-Mobile-Money_2016.pdf).

<sup>32</sup> BI Intelligence. 2016. The Digital Remittance Report. <http://www.businessinsider.com/the-digital-remittance-report-2017-7>.

Measures that would encourage the expansion of mobile phones to cross-border remittances include (i) harmonizing banking and telecommunications regulations to enable banks to participate in mobile money transfers, (ii) simplifying AML/CFT regulations for small-value transfers, and (iii) ensuring that mobile distribution networks are open to multiple international remittance-service providers, instead of becoming exclusive partnerships between an international MTO and country-based mobile money services.

## 5.5 Mobilizing Diaspora Savings and Leveraging Remittances for Bond Financing

Practices have shown that diaspora resources can be leveraged to access international capital markets, including through diaspora bond issuance, and mobilized through diaspora savings and philanthropy.<sup>33</sup>

Many international migrants save a significant part of their income in destination countries. New estimates suggest that the annual savings of diasporas (approximated using data on international migrants) from developing countries amounted to \$497 billion in 2013 (Table 11).<sup>34</sup> A large part of these savings is held in bank deposits. A diaspora bond (a low-denomination security with a face value of \$1,000, say, carrying a 3% to 4% interest rate and 5-year maturity) issued by a country of origin could be attractive to migrant workers who currently earn near-zero interest on deposits held in host-country banks. Diaspora bonds could be used to mobilize a fraction—say, one-tenth—of the annual diaspora saving, that is, over \$50 billion, for financing development projects.

The governments of India and Israel have raised over \$40 billion, often during liquidity crises, by tapping into the wealth of their diaspora communities to support balance of payments needs and (in the case of Israel) to finance infrastructure, housing, health, and education

**Table 11: Estimated Diaspora Income and Savings for Developing Regions, 2013**

	Diaspora Stock (million)	Diaspora Income (\$ billion)	Diaspora Savings (\$ billion)
East Asia and Pacific	31	579	116
Europe and Central Asia	32	402	80
Latin America and the Caribbean	34	645	129
Middle East and North Africa	24	275	55
South Asia	38	402	80
Sub-Saharan Africa	23	181	36
<b>All Developing Countries</b>	<b>182</b>	<b>2,484</b>	<b>496</b>

Source: World Bank staff calculations using the latest bilateral migration matrix, data on skill level from the Database on Immigrants in OECD Countries (DIOC), and World Development Indicators database.

<sup>33</sup> This section draws from S. Ketkar and D. Ratha. 2010. Diaspora Bonds: Tapping the Diaspora During Difficult Times. *Journal of International Commerce, Economics and Policy*. 1 (2); and S. Ketkar and D. Ratha. 2009.

<sup>34</sup> The potential for mobilizing diaspora savings for financing education, health care, and infrastructure in countries of origin remains significant (Okonjo-Iweala and Ratha 2011). For estimation of diaspora savings and identification of candidate countries for diaspora bonds, see Ratha and Mohapatra (2011) and Ketkar and Ratha (2009).

projects. Several other countries, including Ethiopia, Ghana, Kenya, Nepal, the Philippines, and Sri Lanka have issued diaspora bonds with varying degrees of success. Nigeria just recently issued a diaspora bond.

While a diaspora bond can be issued by a sovereign government, in theory it can also be issued by reputed private companies. For the borrower, a diaspora bond can provide lower-cost and longer-term financing than would otherwise be available, especially in times of financial stress. A diaspora bond would have a lower interest rate than a sovereign bond sold to foreign institutional investors; because, first, the interest rate benchmark for a diaspora investor would be the deposit rate (zero or low) instead of London interbank offered rate; and second, the risk spread on a diaspora bond would be lower, since the diaspora investors' perception of country risk is lower (except in cases where the diaspora is fleeing the regime).<sup>35</sup> Unlike foreign currency deposits that can be withdrawn at any time, a diaspora bond provides a stable, longer-term financing instrument.

Countries with a large diaspora stock in richer destination countries have a greater potential for successful issuance of diaspora bonds. Conversely, a country with fragile governance may have a lower potential for success. Chances of success are increased when the issuing country has a strong economic program and a portfolio of attractive projects to be financed by the diaspora bond. Understandably, the diaspora's trust in the government is a key factor for successful launching of a diaspora bond.

Among middle-income countries, Mexico has the largest estimated diaspora savings of \$53 billion, followed by the People's Republic of China (\$46 billion) and India (\$44 billion). Among the low-income countries, Bangladesh has the largest diaspora savings (\$9.5 billion) followed by Haiti and Afghanistan (around \$4.5 billion each). Many countries in fragile situations have sizable diaspora savings as a share of their gross domestic product, for example, Somalia (81%), Haiti (53%), and Liberia (29%). These countries could potentially use diaspora bonds for reconstruction and development, if they put in place proper oversight for the use of funds.

A major challenge to the issuance of diaspora bonds has been the perceived high cost of registration with the US Securities and Exchange Commission. Also, retail sale of these bonds is likely to cost more than selling bonds to a handful of institutional or high net-worth investors. In many cases, however, the interest cost saving will likely outstrip such costs.

Diaspora bonds should be available to all investors, not just migrant savers, and be distributed widely, not kept on the books of a few investment banks. That way, by ensuring greater depth and liquidity in the market for diaspora bonds, large sums could be mobilized for development at low, stable interest rates, without diminishing migrant workers' incentive to save.<sup>36</sup>

<sup>35</sup> A diaspora member would be able to use local currency and hence would have a lower perception of devaluation risk. Also, diaspora members are likely to have better knowledge of their country of origin than foreign institutional investors.

<sup>36</sup> Mohieldin and Ratha (2014).

## 5.6 Remittances as Collateral for International Borrowing

The use of future remittances as collateral—future flow securitization of remittances—can lower borrowing costs and lengthen debt maturity. An important element of a future flow securitization structure is the creation of a special purpose vehicle offshore to issue the bond and shield it from sovereign interference. The dollar volume that could be raised via future flow securitization can be very large. No recent data are available on the size of future flow securitization of remittances, but as of 2008, over \$20 billion had been raised by developing country banks using this technique, notably in Mexico, Brazil, and Turkey (Ketkar and Ratha 2009). In a noteworthy transaction, Banco do Brasil raised \$250 million in 2002 through a bond securitized by future flows of remittances from Japan. The bond was rated BBB+, five notches higher than Brazil’s sovereign rating of BB–; the interest rate on this bond was about 9 percentage points lower than the sovereign borrowing rate at the time.<sup>37</sup>

Besides remittances, a wide variety of future receivables have been securitized, including exports of oil, minerals, and metals; airline tickets, credit card vouchers, international telephone calls; oil and gas royalties; and tax revenue. Securitization of diversified payment rights (DPRs), which include remittances, aid, investment, and trade-related payments through the international payments system, is a more recent innovation (Ketkar and Ratha 2009, World Bank 2015).

**Table 12: Securitization Potential in Sub-Saharan Africa**

	Receivable (\$ billion)	Potential (\$ billion)
Fuel exports	182	36
Agricultural raw materials exports	20	3
Ores and metals exports	63	11
Travel services	26	2
Remittances	31	4
<b>Total</b>	<b>322</b>	<b>56</b>

Source: World Bank staff calculations. The data on receivables are based on average values for 2011–2013. The calculation of potential size follows the methodology used in Ketkar and Ratha (2002).

Preliminary calculations show an enormous potential for future-flow securitization in Sub-Saharan Africa (Table 12). However, the absence of securitization laws, especially the confusion surrounding bankruptcy laws, remains a major challenge to the realization of the potential of future-flow securitization in developing countries. And, unfortunately, securitization became a maligned term during the global financial crisis of 2009 although the problem was excessive borrowing and not securitization itself.

<sup>37</sup> See Ketkar and Ratha (2009). During 2002–2004, when Brazil had difficulty accessing international capital markets, many Brazilian banks securitized future hard-currency diversified payment rights (or DPRs, including all hard currency receivables through the international payment system) to raise \$4.9 billion.

## 5.7 Remittances, Country Creditworthiness, and Financial Inclusion

Because remittances are large and more stable than many other types of capital flows (GEP 2015), they can greatly enhance the recipient country's sovereign credit rating, thus lowering borrowing costs and lengthening debt maturity. Recently, the rating agencies have started accounting for remittances in country credit ratings, but given data difficulties, there is still room for further improvement.

The joint World Bank–IMF low-income country Debt Sustainability Framework now includes remittances in evaluating the ability of the countries to repay external obligations and their ability to undertake non-concessional borrowing from other private creditors (International Monetary Fund and World Bank 2013). When remittances are included in the calculation of a key indicator of debt sustainability, the ratio of debt to exports, it improves significantly for countries that receive large remittances, such as Armenia, Guatemala, Lebanon, Nepal, and Pakistan.

At the microlevel, remittance receipts can also be used to judge poor people's creditworthiness. And they can be used to promote microsavings and microinsurance, all to enhance financial inclusion for the poor.

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# Channeling Remittances and Diaspora Savings for Investments

Mayumi Ozaki

## 6.1 Introduction

In the world, there was over \$573 billion remittance inflow to developing countries in 2016.<sup>38</sup> The remittance inflow was three times higher than the official development assistance (\$153 billion), and almost equal to the private debt and portfolio equity (\$443 billion). Asia and the Pacific region received over \$244 billion remittances in 2016, the highest regional total in the world. In the region, 10 out of 35 developing countries receive remittances equal to or more than 10% of gross domestic product (GDP). Those include Armenia, Georgia, the Kyrgyz Republic, Nepal, the Philippines, Samoa, Sri Lanka, Tajikistan, Tonga, and Tuvalu.<sup>39</sup>

Remittances have benefited remittance-receiving households by enabling them to spend more on basic household necessities as well as on health and education. Households that receive remittances are financially better off across multiple dimensions relative to similar households that do not receive remittances.<sup>40</sup> It is also noted that remittance-receiving households make higher investments in health care and education than those household that do not receive remittances.<sup>41</sup> Historical evidence suggests that remittances are countercyclical. When a disaster or economic crisis happens in migrant workers' home countries, migrant workers tend to send more remittances than usual to save their families from adverse economic conditions in such events. Thus, for receiving households, remittances work not only as an additional income source but also as a cushion for negative externalities, which can enable receiving households to smooth their consumptions.

While remittances' benefits for receiving households are evident, there is a larger policy question that is still to be answered—how to channel remittances into productivity enhancing investments to benefit migrant workers' households as well as the economy at large. Some studies have argued that remittances are counterproductive to the economic growth as migration extract labors from the domestic sectors especially in the agriculture sector. Also, continuous flow of foreign exchange will appreciate the currency, weaken its export sector, and, in the long run, reduce their growth potential.

However, in many developing countries, remittances are a significant source of foreign exchange which is unparalleled to any domestic export industry in the country, and if intermediated properly, remittances can enhance the country's development potential. This chapter focuses on how to channel remittances for economic growth and development of

<sup>38</sup> Generally, the term "migrants" is used to refer to people living and working outside of their countries of origin. However, in this chapter, the term "migrant workers" is used to refer to low-skilled and semiskilled migrants.

<sup>39</sup> The World Bank. 2016. *Migration and Remittances Factbook 2016. Third Edition*. Washington, DC / KNOMAD Database. World Bank data.

<sup>40</sup> D. Ratha. 2013. The Impact of Remittances on Economic Growth and Poverty Reduction. *Migration Policy Institute Policy Brief*. 8. 3 September.

<sup>41</sup> D. Ratha. 2013.

migrant workers' home countries. It will explore options to enhance remittances' financial intermediation to maximize remittances' benefit for migrant workers' households, local communities, and the country.<sup>42</sup>

## 6.2 Issues in Channeling Remittances for Development

### (i) Limited Financial Inclusion and Service Outreach

The key issue of remittances in relation to development is that the majority of remittances are spent on consumption and very limited portion is directed to productive investments. However, the definition of “investments” needs some clarification. In recent years, researchers treat spending on health and education by remittance-receiving households as investments in human capital as over the long run, those will improve the skills level of the country's labor force. Also, the growing number of literature indicates remittance-receiving households tend to increase their spending on health and education as they receive higher amounts of remittances. In this aspect, remittances are not only for consumption but also are contributing to the productivity of the country (Plaza, Navarrete, and Ratha 2011).

However, in this chapter, “investments” refers to financial investments, such as savings or securities, in the formal financial system. For the country to benefit from remittances at a macro level, financial resources from remittances should be used to develop greater public goods such as physical infrastructure. Empirical evidence suggests that only a fraction of the remittances into developing countries are invested in financial assets. Generally, the impact of remittances on overall economy is inconclusive, partly because there are very few studies on the linkages between remittances and formal financial intermediation.<sup>43</sup>

Then, a question arises why remittances are not properly intermediated in the financial system. There are two answers to this question. One is that substantial portion of remittances are sent through informal channels and remains outside of the formal financial system. Second, even if households receive remittances through the formal financial channel, they withdraw most of remittances and keep little in banks or financial institutions.

There are multiple and interrelated causes behind those two issues. However, it could be largely attributed to general underdevelopment of the financial system in developing countries and limited outreach of financial institutions to remittance-receiving households, especially those in the rural areas. In an environment where the formal financial system cannot offer services that meet the migrant worker households' requirements, informal remittance services are filling the gap. In many countries, microfinance institutions (MFIs) and cooperatives are filling the gap of formal financial institution and provide services to the

<sup>42</sup> This chapter discusses both remittances and diaspora savings and their implications on public investments. Although a large number of diasporas were originated from the region, this chapter has a relative focus on migrant workers as they are the main source of remittances to the region. While remittances can be used for household consumptions as well as investments in private assets, this chapter discusses mainly financial intermediation of remittances and channeling them into public investments to reflect a growing policy concern of the governments of remittance-receiving countries in the region.

<sup>43</sup> There are various studies on remittances and financial intermediation at the household level. However, only a few studies substantially discuss remittances and financial intermediation nexus for public investments. Such studies include D. Ratha et al. 2011. *Leveraging Migration for Africa—Remittances, Skills, and Investments*. Washington, DC: The World Bank.; United Nations Conference on Trade and Development. 2013. *Maximizing the Development Impact of Remittances*. Geneva.

rural population; however, the majority of them are not engaging in remittance transaction due to legal, technical, or capacity reason. The lack of sufficient knowledge on financial system and products—financial literacy—is also another impediment for migrant workers' households to actively channel and save with the formal financial system.

To increase economic leverage of remittances, the first step is to enhance financial inclusion, or access to formal banking services by the unbanked households while taking measures to reduce informal remittances.

#### (ii) **Ineffective Remittance-Linked Investment Products**

Many countries have attempted to mobilize migrant resources to channel into public investments (Plaza and Ratha 2011). The remittance-receiving countries' governments do so mainly by issuing so-called “diaspora bonds,” or offering special savings and deposit products targeted at migrant workers. Diaspora bonds are a type of government debt that targets members of their nationals abroad and can potentially mobilize substantial amounts of long-term financing (Ketkar and Ratha 2009, 2010). However, issuing diaspora bonds or similar products without addressing the countries' financial sector constraints, clients' incentives, accessibility, and conveniences will not lead to the desired outcome.

The Government of India has successfully issued 5-year maturity, rupee-denominated diaspora bonds and raised a total of \$32 billion in three issues in 1991, 1998, and 2000. However, not many countries have successful diaspora bond issues equal to India (Ketkar and Ratha 2009). Nepal issued diaspora bonds eight times between 2010 and 2016. But the government raised little from those issues because all were hugely undersubscribed ranging from 0.4% to 33.48% of the total issued amounts. In all eight issues, the government raised a bit over NRs300 million (or approximately \$3 million). Considering the remittance volume that the country receives annually, which is about \$6 billion or about 30% of the country's GDP, the total subscription was minuscule.

There are several reasons for the undersubscription. First, the offered yield (about 9% to 10%) was not very attractive, while the commercial banks fixed deposit rates were about 8% to 9%. Second, Nepal's inflation rate moved around from 7% to 12% from 2010 to 2016, making tangible assets such as lands or houses more attractive than securities. Third, there have been limited marketing efforts. The bonds were marketed to migrant workers in Malaysia, Qatar, Saudi Arabia, and the United Arab Emirates. and. But it was not marketed in India, the Nepali migrant workers' major destination. Fourth, there is a general lack of trust and credibility about the government among Nepali nationals abroad (Ratha and Silwal 2011). However, despite the past low performance, the government has not given up issuing the diaspora bond and floated a new issue in March 2017. This time, they included a few corrective measures such as offering a higher yield as well as expanding the countries for marketing.

### 6.3 Promoting Migrant Investments for Development

Promoting public investments from remittances involves not only developing specific remittance-linked investment products, but rather requires much broader interventions. For migrant workers' households to invest more in financial instruments, it requires, among

others, a stable and secure financial sector, efficient payment systems, convenient and low-cost access to service providers, and support to improve their financial literacy and knowledge.

To meet these requirements, there are several areas that policy makers and regulators can pay special attention to promote formal flow of remittances and public investments through remittances, including (i) regulations, (ii) technologies and payment system, (iii) linkages to MFIs, (iv) remittance-linked investment products, and (v) information and financial literacy.

- (i) **Regulations.** Remittance transaction involves multiple institutions including banks, money transfer companies (MTCs), exchange houses, nonbank financial institutions, and agents. Generally, those institutions are supervised and regulated by the financial regulatory authority, or central banks. Laws and regulations which are typically relevant for remittances are Banking Act, Financial Institutions Act, Non-Bank Financial Institution Act, and Foreign Exchange Act. Due to the growing global concern over money laundering and terrorism, recently the regulators are more stringently enforcing anti-money laundering/combating the financing of terrorism (AML/CFT) regulations. Financial regulations are to maintain the financial sector stability, and protect depositors and the general public from financial frauds or other malicious risks. However, strict regulations may have adverse impact on the formal remittance flow.

Generally, migrant workers from Asia and the Pacific region are low-skilled with limited financial literacy. Also, many migrant workers have migrated informally and are undocumented. Requiring stringent customer due diligence (CDD) such as requesting multiple identification documents (IDs), and onerous documentation requirements would deter migrant workers from using formal remittance channels. In such environment, *hawala* type of informal remittance channels may have stronger appeal to migrant workers, especially those with no proper ID documents.

Considering that remittances are relatively low value personal money transfers, in most cases less than \$1,000 per transaction, policy makers and regulatory authorities can adopt more flexible approach, or so-called risk-based approach. In the risk-based approach, the regulatory authority needs to consider the right balance between financial sector security and financial inclusion and apply regulations based on the perceived risk of the remittance transactions. For example, it is not reasonable to apply the same CDD norms for a remittance of \$500 as for the transaction of \$10,000. In the Philippines, the BSP allows registered remittances agents, which are spread all over the country, to conduct know-your-customer checks for e-money and mobile money transactions to provide access to the people in the areas where there are no bank branches.

In 2001, the Financial Action Task Force issued new international AML/CFT standards on remittance transfers and their services providers, and the remittance services providers are now required to be under the regulatory authorities' purview. In connection to this, there is a growing concern over informal remittances and move toward controlling informal remittance services providers such as *hawala* brokers. "For purposes of long-term financial sector development, it is recommended that informal remittance dealers are registered and licensed."<sup>44</sup> However, the undisclosed and implicit nature of informal remittance operations is extremely difficult for the regulatory authorities to enforce

<sup>44</sup> M. Ozaki. 2012. Worker Migration and Remittances in South Asia. *South Asia Working Paper Series*. No. 12. Manila: Asian Development Bank.

the law. Furthermore, unlike formal bank-to-bank transactions, there is often a complex web of transactions in the settlement of informal remittance transactions and such regulations may not be enforceable in all the jurisdictions concerned.

It is also believed that *hawala* type of informal channels is filling the gap of formal financial institutions' services and just banning informal remittances may deprive essential services from the unbanked populations. To regulate informal remittance service providers, the regulatory authorities need to consider providing proper incentives for informal remittance services providers to come under the regulatory oversight.

- (ii) **Technologies and payment system.** Despite the fact that the networks of remittance services providers are rapidly expanding in developing countries, the cost of sending and receiving remittances is still high. The average cost of remittance transaction is 7.4% in 2016, a reduction from 9.11% in 2012.<sup>45</sup> However, the remittance transaction cost is still substantial for most of the migrant workers considering the generally small size of remittance, which is often as low as \$200. Remittance transaction costs through banks are high due to the costs for branches, staff, and securities, and costs for regulatory compliance. In addition to the cost charged by banks, migrant workers and their families have to bear other costs such as transportation costs to go to a branch, costs for producing legal ID documents, or forgone wages due to the time spent at a bank.

The use of technologies for remittances, such as mobile phone, ATMs, and point-of-sales (POS), has a high potential to reduce the remittance costs and expand formal remittances' outreach to migrant workers' households who are not regularly serviced by banks. Technology-based remittance services can be linked to various types of agents, including postal offices, exchange houses, shops, gas stations, and MFIs, to provide easy access to migrant worker households.

Technology-based financial services are expanding rapidly. However, the majority of remittances are still cash based, i.e., remittances are captured as cash at the sending point and disbursed as cash at the receiving end, rather than staying in a bank account or stored as e-money. It is estimated that most of remittances are channeled through money transfer companies (MTCs) (74%), followed by banks (24%). Only a negligible portion (less than 0.4%) is estimated to be transmitted through mobile remittances services.<sup>46</sup>

Cross-border mobile remittance services are still at nascent stage, but many products have already been successfully marketed. Smart Communications in the Philippines has been in partnership with Western Union since 2008 and providing cross-border remittance services. Smart Money users can receive remittances into their mobile phones directly and cash out from the branches and ATMs of Smart's partner commercial banks or Smart Money agents across the country. BRAC Bank in Bangladesh, in cooperation with Western Union and Master Card, launched in 2016 a cross-border remittance service through its bKash platform. Remittance senders abroad can send remittances directly from Western Union agents worldwide into the bKash accounts of recipients

<sup>45</sup> Remittance Prices Worldwide. <https://remittanceprices.worldbank.org/en>.

<sup>46</sup> Remittance Prices Worldwide. <https://remittanceprices.worldbank.org/en>.

in Bangladesh. “Recipients can cash out the remittances at over 120,000 bKash agents across Bangladesh, or can use the account balance to make person to person fund transfers, top-up mobile airtime, pay bills and shop in-store.”<sup>47</sup>

To develop technology-based, cross-border remittance services, a well-developed payment system infrastructure is essential. Electronic payment system or automated clearing house is widely used in payment settlements. However, the banking sectors in developing countries generally do not have a common payment platform, and interoperability across different institutions is limited. It is recommended to develop an interbank payment system infrastructure for better accessibility. Also, support to develop agent networks is important. Developing agent networks takes time and cost, and the limited agent network is a key impediment in expanding mobile remittance services outreach. Providing public support in training and licensing agents would be useful. In addition, mobile remittance services’ design and marketing shall match with the target clients’ knowledge and financial literacy. Remittance service providers’ special training on financial literacy and products might be needed to familiarize migrant workers and their families with new technologies. Frequent and continued communications with the clients may also be useful to encourage them to keep enrolled in the services.

- (iii) ***Linkages to microfinance institutions.*** In the Asian remittance market, it is estimated that about 40% of remittances go to rural areas.<sup>48</sup> Involving nonbank financial institutions, such as MFIs, has a significant potential in extending formal remittance outreach particularly in areas where there are no bank branches or MTCs. Many developing countries in Asia and the Pacific region have dense networks of MFIs, including cooperatives, and remittances–MFI linkage could bring to migrant workers’ households other financial services such as savings, deposits, payments, and insurance. According to a study, MFIs that offer remittance services tend to have more savings than other MFIs.<sup>49</sup> This indicates involvement of MFIs would increase savings by remittance-receiving households.

Normally, MFIs cannot conduct remittance businesses independently due to the legal restriction or capacity problem. However, in many jurisdictions, MFIs can be agents of the remittance service providers and various types of banks – MFIs and MTC - MFIs partnerships are operational. TMSS, a microfinance nongovernment organization, and NCC Bank in Bangladesh, in cooperation with Western Union, launched remittance services enabling TMSS’s 900,000 members access to remittance without going to bank branches. TMSS’ members can cash out remittances from TMSS and NCC’s more than 600 retail outlets all over the country.

However, to promote MFIs’ participation in remittance business, MFIs may require special support. Many MFIs lack necessary skills in carrying out remittance transactions and act as bank’s agent especially in CDD process for account openings. The financial regulators can provide training to MFIs before licensing them as a remittance agent.

<sup>47</sup> BRAC Bank. <https://www.bracbank.com/>.

<sup>48</sup> International Fund for Agriculture Development. Financing Facility for Remittances. Remittances and Financial Literacy. <https://www.ifad.org/documents/10180/972b8286-eb3c-4069-87a8-e80a3330a25f>.

<sup>49</sup> R. Mata. 2009. Microfinance Institutions (MFIs) on the Remittances Market: Money Transfer Activity and Savings Mobilization. *CEB Working Paper*. 09/022. Brussels.

Also, MFIs are often required to install the bank's or the MTC's banking system to have a partnership with them, but many MFIs lack basic information technology infrastructure. Generally, MFIs have their own savings programs for its members, and marketing partner bank's remittance and savings products may create a conflict of interest. Banks may have to consider special incentives for MFIs to market their products such as different terms from MFIs' savings products.

- (iv) ***Remittance-linked investment products.*** Aside from promoting access to formal financial services, the financial sector in the remittance-receiving countries needs to develop appropriate financial products to attract investments by receiving households. Various types of remittance-linked financial products have been offered by both the public and private sectors. Typical products include:

*Diaspora bonds.* Generally issued by the governments of migrant origin countries, but can be issued by private entities. Diaspora bonds are issued for specific projects such as construction of public infrastructure (e.g., dam, roads, etc.) or budgetary support for the government (e.g., India, Israel) (Ketkar and Ratha 2009).

*Foreign currency savings accounts, foreign wage earners deposit accounts, etc.* In many remittance-receiving countries, the regulators allow banks to offer migrant workers and diasporas foreign or local currency savings accounts, often with preferential interest rate or tax incentives (e.g., Bangladesh, Sri Lanka).

*Securitization of future flow of remittances.* Banks in remittance-receiving countries can mobilize funding by securitizing future flow of remittances. In a typical future flow transaction, a bank in a remittance-receiving country sells future remittances receivable to an offshore special purpose vehicle (SPV) and then this SPV issues a debt instrument. The proceeds of the securitization can be onlent to various private and public investments such as small and medium-sized enterprise loans (e.g., Kazakhstan).

*Tax incentives and preferential treatment for diaspora investors.* Often, the governments provide preferential treatment for diaspora investors such as a tax waiver or special quota for initial public offering (e.g., Bangladesh).

Social and emotional ties of migrant workers and diasporas can be powerful incentives to invest back home (Plaza and Ratha 2011). However, social and emotional ties alone cannot attract sufficient level of investments, and the countries need to carry out persistent communication and marketing activities to incentivize diasporas to invest back home. In November 2016, the Government of Georgia introduced a "Georgia awaits you" program inviting Georgian diasporas to its embassies to know more about investment opportunities and economic situations in Georgia. The program will be implemented in 73 embassies Georgia maintains abroad and will enable Georgian diaspora to be involved in different projects.

Also, investment products shall be designed and marketed to the right targets. Diaspora bonds are relatively sophisticated products and are more for high-income diasporas rather than low-skilled migrant workers. On the other hand, savings accounts or certificates are more suited for migrant workers who typically return to their home

countries after 3–5 years of employment. Banks and financial institutions can tailor such savings products to meet specific needs of migrant workers, such as offering housing loans tied to their remittance savings.

- (v) **Information and financial literacy training.** Government’s foreign employment departments or private recruitment agencies normally conduct predeparture orientations for departing migrant workers, such as Nepal’s Department of Foreign Employment or Bangladesh’s Bureau of Manpower Employment and Training. However, in many cases, such orientation programs are insufficient in terms of both quality and quantity. They provide some remittances and investment product information, but only limited numbers of banks, i.e., state-owned banks, are invited to make presentations, if it is organized by a public agency.

There should be a comprehensive support to provide the information and training to migrant workers. Predeparture orientations are important opportunities to inform departing migrant workers about available remittance channels, price, investment products, risks in informal remittances, and financial frauds. “Information about various providers of remittance services and disclosing all costs and benefits associated with their services will encourage migrants to direct remittances to the most efficient providers and as such create incentives for the remittance providers to enhance their services.” Information on investment products encourage migrant workers and their households to plan and save for the future.<sup>50</sup>

There are diasporas who are not workers but work as professionals. Professional category diasporas tend to have better knowledge on financial instruments and financial literacy training may not be necessary. However, substantial marketing activities to inform diasporas the available opportunities to invest in their home countries are much important to attract diaspora investments. Recently, various online platforms are available to identify and reach such high-income diasporas.<sup>51</sup>

## 6.4 Conclusion

Channeling remittances into the country’s development projects requires not only devising investment products targeting at migrant workers and diasporas, but also much broader policy interventions. Currently, the major portion of remittances, apart from investing in housing, education, and health, is used for consumption. For remittances to be channeled into investments, remittances have to be captured first in the financial system and intermediated for investments.

There are two important policy objectives in promoting remittances for development: (i) enhancing access to formal financial services to the unbanked population—or financial inclusion, and (ii) promoting migrant workers and their households to invest in financial

<sup>50</sup> M. Ozaki. 2012. Worker Migration and Remittances in South Asia. *South Asia Working Paper Series*. No. 12. Manila: Asian Development Bank.

<sup>51</sup> For example, Movement Capital, a United Kingdom-based investment company (<https://www.wearemovement.com/en>), hosts an online investment platform targeted at diasporas to invest in their home countries. In addition to regular marketing channels (i.e., road show, etc.), Movement Capital uses social network sites and algorithm search programs to identify and reach target diasporas.

investment products. To achieve those objectives, there are specific areas that the governments, regulators, and financial sector should pay attention. First, the country's financial regulations should be accommodating and flexible enough to encourage migrant workers to remit through formal channels. Too stringent regulations may shift migrant workers to informal remittance channels. Second, there should be a well-developed payment system in the country. Cross-border mobile remittance services have a strong potential to extend formal remittance outreach, but require a comprehensive payment system. Third, many migrant worker households are not served by banks but are members of MFIs. Banks–MFIs partnership can provide convenient access to remittances to those who are unbanked. Lastly, it is important for both the public and private sectors to develop remittance-linked investment products that suit remittance-receiving households' needs, and combined with financial literacy training and marketing activities.

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## CHAPTER 7

# Future Flow Remittance Transactions

*James P. Patti*

Francisco, the mayor of a small but growing town near Manila, is losing sleep—how can he raise the \$25 million that he needs to build a new hospital for the citizens of his town? Juan, a pineapple farmer near the town, is celebrating: he has just signed a \$5 million contract to sell all of this year’s crop to a grocer in France. Maria, the founder of a start-up internet company in Manila, is marketing stock in her company to potential angel investors in Australia. Julia, a retiree in Davao City with a son working in the United States (US), is in need of \$250 to repair her refrigerator. Juan, Maria, and Julia are unaware of the mayor’s sleepless nights, but they can help him build the hospital – how?

This chapter will describe how the monies that will be sent for the benefit of Juan, Maria, and Julia from France, Australia, and the United States, along with similar flows to millions of other Filipinos, can fund the building of that hospital through an unheralded benefit of globalization referred to as “future flow” financings.<sup>52</sup> In fact, this chapter will show how “future flow” financings can support significant economic development of every type in every developing country—funding not just hospitals but also ports, railways, housing, schools, airports, hydroelectric dams, and other important needs of the people.

Globalization provides this opportunity by building off of one element of international commerce—the “remittances” that a country’s population receives through payments for exports such as Juan’s pineapples, foreign investment with local entrepreneurs like Maria and, perhaps most importantly for many Asian economies, family support payments sent from workers abroad like Julia’s son. How do we achieve this alchemy of turning thousands of small remittances to individuals into infrastructure that benefits the entire society? Remittances provide this benefit due to one important quality that they possess: their ability to give investors and lenders (such as ADB) (“*creditors*”) the confidence to offer long-term funding to local banks, which the local banks can then use to make loans to fund infrastructure and other needs in their communities.

This chapter will describe the process that has been developed over the past 20 years to enable local banks in countries such as Brazil, Turkey, and Peru to use these incoming flows as collateral for international creditors, who can then be sufficiently comfortable of repayment that they are willing to provide long-term, hard currency funds to the banks at attractive interest rates.

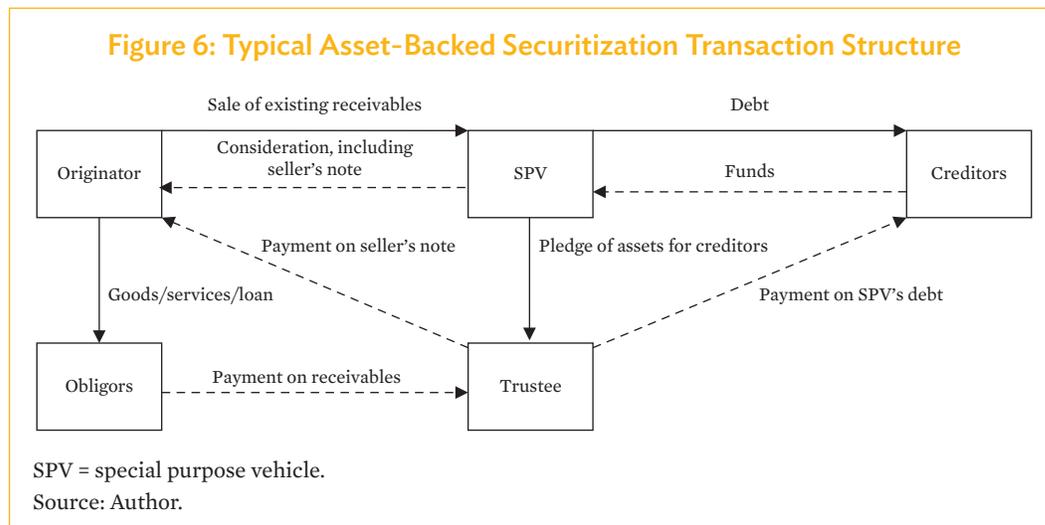
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<sup>52</sup> This article is not and should not be considered as legal advice or a description of law in any jurisdiction.

## 7.1 What Are “Future Flow” Financings?

“Future flow” transactions are one category of “structured finance” transactions. Structured finance transactions are essentially fund-raising transactions that involve a structure that is more complex than a simple promise by a debtor to make repayment—that is, more than a traditional unsecured loan or a senior unsecured bond. At their core, structured finance transactions incorporate some element that helps to reduce the risk to creditors, whether through collateral, insurance, derivatives, or another element to minimize the risk of the debtor failing to repay the borrowing. Without these protections, creditors would either not be willing to provide funds or would charge higher interest rates, which could make the project either impossible or too expensive for the debtor.

To understand “future flow” transactions, it is helpful to describe two other types of financing that sit on either side of these structures: asset-backed securitizations (ABS) and covered bonds. ABS transactions comprise the very familiar securitizations used the world over to create secondary markets for mortgage, auto, and other consumer loans, and provide financing for companies that generate receivables. In an ABS transaction: (a) the owner (Originator) sells these loans, receivables, or other payment rights to a single purpose vehicle (SPV), (b) the SPV then pledges these newly purchased assets in a fund-raising transaction, and (c) the SPV uses the proceeds of the financing to pay the Originator for this purchase. A simple example of such a transaction is reflected in Figure 6 (with dashed lines representing flows of money):



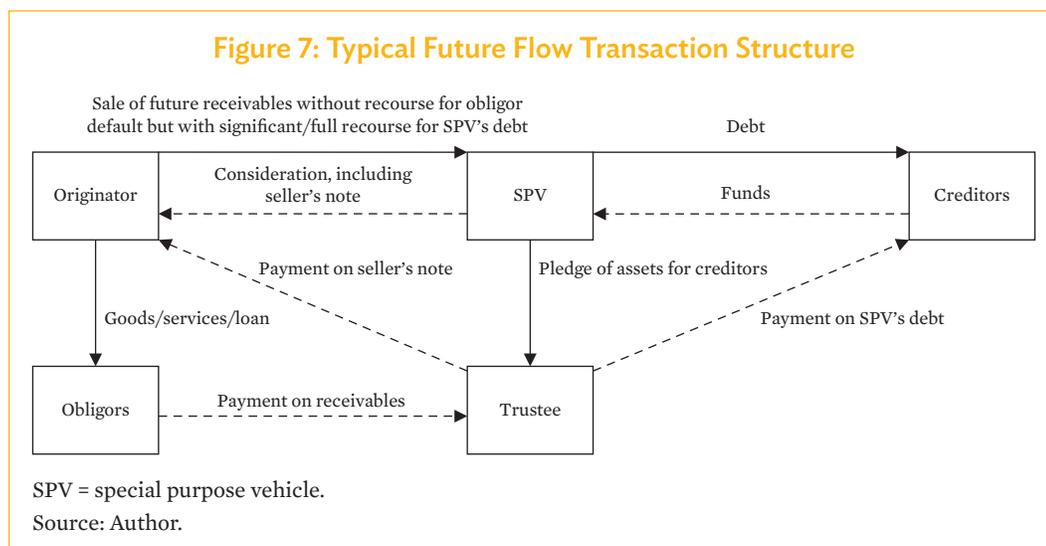
A defining characteristic of ABS transactions is that the Originator transfers the credit risk of the sold receivables to the SPV, and thus indirectly to the SPV’s creditors.<sup>53</sup> The creditors look solely to the SPV’s asset pool (not to the Originator) for repayment of the funds that they have provided, which is why ABS transactions are generally referred to as “non-recourse” to the Originator.

<sup>53</sup> Credit risk in this article refers to whether the borrowers or other obligors under the receivables will comply with their obligations to make payment.

Covered bonds sit on the other side of “future flow” transactions. In these transactions, which are most common in Europe, the Originator does not sell its receivables but rather pledges (or otherwise legally sets aside) such receivables so that they act as security for the creditors’ investment. Covered bond transactions usually adhere to local laws that provide the mechanism under which the pool of collateral (referred to as the “cover pool”) is shielded from being used to pay any of the Originator’s other obligations. While both ABS and covered bond transactions thus benefit from using the receivables as collateral, what most distinguishes covered bonds from ABS transactions is that the covered bondholders have a full claim on the Originator for repayment of the financing, meaning that covered bonds are “full recourse” transactions. In other words, the covered bondholders can be repaid from the Originator and from the collateral (“dual recourse”) whereas the ABS investors are repaid only from the collateral.

“Future flow” transactions blend elements of ABS transactions with covered bonds, combining a sale structure familiar in securitizations with full (or nearly full) recourse to the Originator for repayment of the debt—in other words, they are essentially dual recourse transactions like a covered bond but, like an ABS transaction, segregate the receivables via a sale to an SPV instead of using a cover pool protected by local law.<sup>54</sup> A diagram of a “future flow” transaction is thus essentially identical to that for an ABS transaction except for the level of recourse to the Originator, as evidenced in Figure 7 (the only difference from Figure 6 being the reference to recourse in the top left of the diagram).

Though ABS, covered bonds, and “future flow” transactions use different approaches, all three of these forms of structured finance use the Originator’s receivables to increase the creditors’ expectation of repayment over the risk that they would be taking in making a direct unsecured loan to the Originator. None of these approaches can, however, be successful unless the underlying receivables are themselves creditworthy. To that end, the creditors



<sup>54</sup> It must be noted that this chapter, by necessity, simplifies greatly all of the transactions described herein, with numerous variations being found in the structures of ABS, covered bond, and future flow transactions. For example, members of our firm recently completed the first covered bond transaction in Latin America, which (due to the absence of a covered bond legislation) transferred the assets to a local “guaranty trust” that acted as a guarantor of the Originator’s debt.

must understand these receivables well and be confident that there will be sufficient amounts of collections on the receivables to ensure repayment of the debt.

## 7.2 What Are “Diversified Payment Rights?”

What types of receivables are used in “future flow” transactions? While numerous types could be used in such a structure, this chapter will focus on the one that can help our mayor Francisco—which are sometimes referred to as “remittances” but are generally referred to in “future flow” transactions as “diversified payment rights” (DPRs). As they are a fairly unique type of receivable, we first need to describe what exactly DPRs are.

While payments can move from one country to another via checks and numerous other methods, by far the most common manner of “sending” money internationally is to “wire” the funds through banks that engage in international correspondent banking—that is, banks in one country that communicate with banks in other countries in order to perform financial transactions for their respective customers.<sup>55</sup> Of course, money isn’t actually being physically “sent” from one country to another but rather international remittances involve a bank sending a “payment order” to a correspondent bank in another country. So what is a “payment order” and how does it cause a payment to be made?

Just like money isn’t “sent” from one country to another, similarly a “payment order” is a confusing reference since it is not an order but rather a request. This request from the sending bank asks the receiving bank to make a payment of an indicated amount to a specific company or person (Payee). These payment orders can be sent between correspondent banks in many different manners (e.g., the Society for Worldwide Interbank Financial Telecommunication [SWIFT] network, telex, email, or even via a private communication link between the two banks), with the common characteristic being that the sending bank’s sending of the payment order is an offer to the receiving bank to enter into a contractual agreement to perform the requested transaction.

When the receiving bank accepts this offer (e.g., when it agrees to make a payment to the indicated Payee), a contract is formed.<sup>56</sup> As a result of this contract, the receiving bank: (i) obligates itself to make a payment in the requested amount to the Payee and (ii) acquires a right to receive from the sending bank reimbursement or prepayment for this payment to the Payee. In “future flow” transactions, it is precisely these rights held by the receiving bank that are referred to as DPRs.

Of course, these transactions are not entered into by the banks for themselves but rather to serve their customers—the sending bank’s customer being the sender (Sender) who initiates the process by asking the sending bank to cause payment to be made to a Payee, and the

<sup>55</sup> This term is a legacy of the time when the newest in technology enabled banks to correspond with each other via copper wires, later facilitated by telex machines that improved the process. International “wires” are today largely processed through the global electronic system provided by the Society for Worldwide Interbank Financial Telecommunication (commonly known as “SWIFT”). SWIFT is essentially a very secure e-mail system that allows banks to correspond with each other and, if they have shared “authentication keys,” enter into contracts with each other.

<sup>56</sup> In general, the receiving bank need not affirmatively respond to the sending bank but may accept the offer simply by making the payment to the indicated Payee.

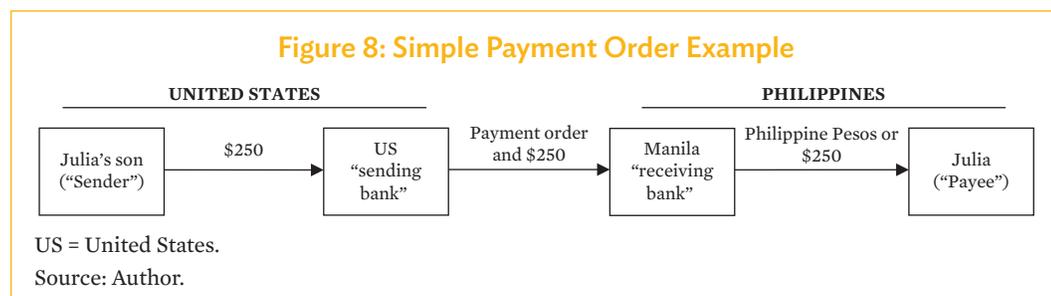
receiving bank's customer being that Payee. The French grocer that needs to pay Juan for his pineapples, the Australian investors that want to invest in Maria's start-up, and Julia's son working in the US are all potential Senders of funds—and Juan, Maria, and Julia are the respective Payees. This is where the structure has most elicited questions: how is it that the receiving bank has any rights in the funds that it can use in a “future flow” transaction? Don't the funds belong to the Payee or perhaps the Sender and not the receiving bank?

Actually, neither the receiving bank nor the Payee has any rights in the monies that are paid by the Sender to initiate the transaction—only the sending bank owns the monies that it has obtained from the Sender. It is essential to keep in mind that a remittance does not involve a Sender or its bank putting the Sender's cash into an envelope and mailing that envelope to another bank for physical delivery to the applicable Payee. The banks are not mere postal services mailing bills and coins around the world. Imagine if a bank in the US were to receive cash from Julia's son and put it in an envelope to send to Julia! While that is possible, it certainly is not how international payments are typically made.

In a remittance that uses a payment order, there are at least three distinct and separate relationships among the relevant parties, which an example can help illustrate:

- The first relationship is between the Sender and its local bank (i.e., the sending bank)—for example, Julia's son working in the US is a Sender and he enters into a contractual relationship with his US-based bank by asking (and compensating) this bank to cause to be made a \$250 payment to Julia through Julia's Manila-based bank.
- The second relationship is between the sending bank and the receiving bank, which relationship is created by the sending and acceptance of the payment order. In our example, the US bank sends a \$250 payment order to its correspondent bank in Manila and requests it to make a payment of \$250 to Julia, which payment order results in a contractual arrangement (and DPR) once the Manila bank accepts this request.
- The final relationship is between the receiving bank and the Payee, involving payment to the Payee not of the same monies delivered by the Sender in the first step but rather an equivalent amount (including even in a different currency) funded by the receiving bank from its own funds. In our example, the Manila bank (potentially even before it has received any compensation from the US bank) delivers to Julia the requested \$250 (or its equivalent in pesos), potentially by crediting Julia's account maintained at the Manila bank.

In this example, Julia's son has no relationship with the Manila bank and the US bank has no relationship with Julia, so each needs to enter into a separate legal arrangement to effect the desired transaction through a third party that can provide the services needed to cause the Payee to receive funds. The chain of such relationships can be seen in Figure 8.



The parties to these three separate relationships have different rights and obligations with their counterparty: (i) the sending bank owns the funds provided by a Sender and promises that Sender that it will cause the requested payment to be made to the applicable Payee (for example, the US bank promises that it will use its correspondent network to cause the requested payment to be made to Julia); (ii) the receiving bank acquires a claim (referred to here as a DPR) against the sending bank and commits itself to make an equivalent payment to the Payee; and (iii) the Payee receives this equivalent amount (potentially less a fee or foreign currency conversion cost) from the receiving bank. In the first of these relationships, the sending bank is performing a service for the Sender and is compensated for doing so, with the second relationship constituting a similar service performed by the receiving bank for the benefit of the sending bank. Without any need for Julia's son to put paper money into an envelope, Julia can now repair her refrigerator!

Of course, the volume of remittances and other international payments will depend upon various factors, including the strength of the applicable economies, exchange rates, and the ability of workers to relocate to where work is available. These factors change over time: for example, if a migrant loses a job or faces higher costs of living, then that worker's ability to send funds home will be lessened. That said, individual circumstances frequently offset each other; for example, if the Gulf Cooperation Council countries require fewer overseas workers due to a decline in oil prices, then those workers (or others) might find greater employment opportunities in countries (such as those in the Organisation for Economic Co-operation and Development) that benefit from declining oil prices—and countries with more stable economies will see less variation than those of higher growth markets.

So far we have described how international payments work from a legal perspective and how a receiving bank acquires a payment right (i.e., a DPR) against a sending bank, but how does that help the mayor's hospital get built? It gets built through the creation by the receiving bank in Manila of a "future flow" transaction that uses its DPRs as collateral for creditors.

### 7.3 Transaction Structure

What do these "future flow" transactions look like? While the transaction structures can take many forms, including secured loans or bilateral arrangements, the most common structure involves a "true sale" of the DPRs from the Originator to an SPV, with the SPV establishing a program that enables it to raise funding from any number of creditors. The below summarizes the "true sale" structure, which is the most desirable in almost every scenario.

**True Sale.** The first concept to understand is what is meant by a "true sale," particularly in the context of DPR or other "future flow" assets. In general, a "true sale" is considered to have occurred when one party transfers ownership of a right or asset to another party in a transaction that cannot be undone in a bankruptcy or similar event of the seller. In the context of most sale transactions, this is relatively straightforward: the sale of a house or a car is generally free of risk of being unwound should the seller enter bankruptcy. The same can generally be true with respect to intangible assets and rights, such as rights under contracts.

As with other assets and rights, receivables can be transferred in a "true sale," such as when a lending bank assigns to another bank a loan it made under a credit agreement or a retailer sells receivables to a factoring company. In fact, this is the basis of most securitizations—the

seller enters into a “true sale” of its rights to receive payments under certain receivables. While there are numerous nuances in such transactions that are too complex for this chapter, market practices in this area have developed to such a degree that such transactions are routinely entered into with great certainty on the strength of the true sale. The billions of US dollars of securitizations each year of mortgage, credit card, and auto loans are prominent examples of the success of the “true sale” concept. This use of securitization is of enormous benefit to society by creating a secondary market for these consumer credits and thereby allowing the creditors to continue to make such loans, thus permitting the local economy to grow. Without a secondary market for these loans, lenders would quickly become capital-constrained and unable to lend, thereby dramatically limiting a country’s ability to develop.

The “future flow” concept was built upon the successful experience with these securitizations, adopting the concept of a “true sale” of existing assets to one that covers payment rights arising in the future. As with other true sales, a key element is that the sale is robust enough to survive any bankruptcy of the Originator. This “future flow” of payment rights might be compared to a revenue stream or royalty rights of the Originator, the future payments under which it is selling. For the Manila bank in our example, these would be its stream of DPRs—payment rights that it has against sending banks such as those who provide this service to the French grocer, the Australian investors, and the laborer in the US in order to cause payments to be made to Juan, Maria, and Julia thousands of miles away.

This *current* sale of payment rights that are to be generated in the *future* was initially a challenging concept to envision—how can one sell today something that does not yet exist, particularly in the case of future payment rights that are not generated from an existing contract? When considered in the light of the familiar sales of royalty streams or the sale by farmers of their future (and thus unknown) crop yield, the answer becomes clear: parties generally can agree to sell whatever they wish so long as it can be properly identified. A sale of all future royalties for a particular musical hit, the sale of the next 5 years’ harvests of crops from a particular field (which might be bumper crops or not), and similar transactions are all sales today of a right to receive future assets—in some cases under an existing contract or from an existing asset and, in other cases, just the revenue stream of a business operated by the Originator. Thus was conceived the idea of using a “true sale” in “future flow” transactions such as for a bank’s DPRs.

**Sovereign Risk.** A related question is why an Originator would utilize a “true sale” structure when a covered bond or other simpler secured facility might be possible. In the context of a securitization, the historical reason for choosing a true sale is that such a structure might enable the Originator to remove the sold items from its balance sheet while permitting creditors to take the most secure form of protection and consider the credit risk of the obligors of the sold receivables instead of the credit risk of the Originator. Such considerations generally would not apply for a “future flow” transaction, and a primary reason for a “true sale” in most “future flow” transactions is the desire to remove ownership of the receivables from the jurisdiction of the Originator.

This consideration is relevant when creditors are concerned about the political, financial, or other status of the Originator’s home jurisdiction (so-called “sovereign risk”). In a covered bond or other secured facility, the receivables and/or their owner remain within the jurisdiction of the Originator, which subjects the transaction to the risk that the sovereign might adopt laws or take other actions that could harm creditors. For example, the government

might decree that collections on the sold receivables may not be transferred outside of the country or prohibit the conversion of domestic currency into foreign currency (so-called “transfer and convertibility risk”). Such risks generally mean that a rating agency cannot rate a transaction higher than the credit rating of the sovereign, meaning (for example) that a transaction hindered by such a “sovereign ceiling” generally cannot attain a BBB/Baa2 rating if the sovereign’s rating is BB+/Ba2.

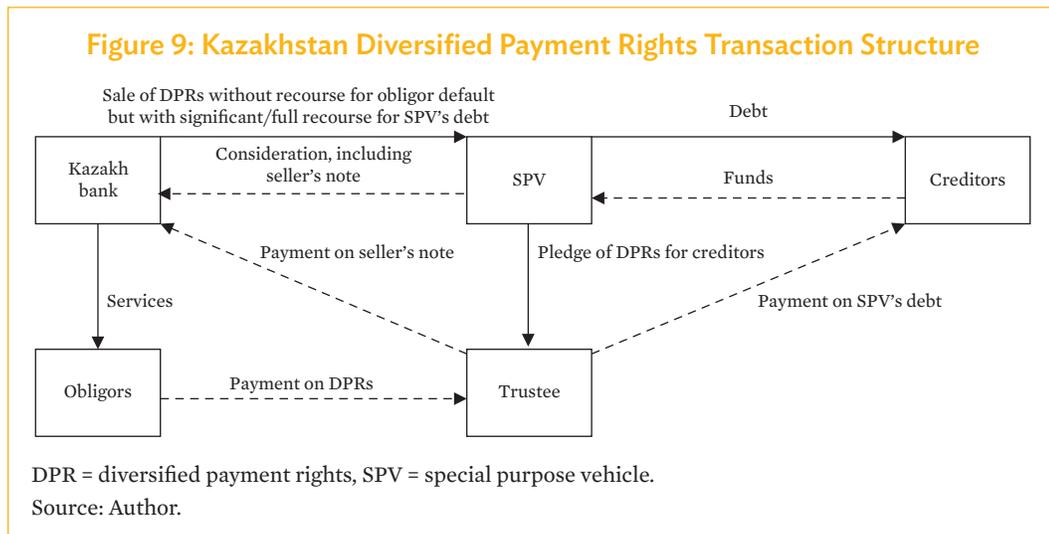
In many cases, satisfactorily avoiding sovereign risk is not possible. Transactions with domestic mortgage, credit card or auto loans or other domestic receivables, or receivables payable in the domestic currency, can never avoid the influence of the local sovereign. And almost no transaction, including “future flow” transactions, can ever fully eliminate the reach of the local government since the Originator does not move its jurisdiction. There are extraordinarily few transactions that can completely avoid all sovereign risk, and there are only a few types of receivables that include foreign currency payments and foreign obligors. DPRs are one type of such receivables, having foreign Senders as obligors, payments that are made in US dollars or other hard currencies and payments made outside of the Originator’s country.

Although DPRs have these positive characteristics and thus enable creditors to have a high degree of confidence that a DPR-secured “future flow” transaction will have limited exposure to sovereign risk, these transactions cannot avoid such risk altogether as the Originator is unavoidably subject to oversight by and the influence of its home government. For example, in a transaction based upon the Originator’s ability to continue generating DPR flows, there is always the risk that the Originator’s operations might be shut down for political or other noneconomic reasons. This risk is real, but it is largely mitigated by the negative impact that closing the doors of a domestic bank would have on the local economy and the citizens that use the services of that bank. Faced with choosing between inflicting potentially dramatic harm on its economy and taking an action that might disrupt the security of a few investors for an amount that represents a very small portion of the local economy, it is expected that a sovereign would choose wisely and follow the least impactful approach.

## 7.4 Example Transactions

While the vast majority of “future flow” transactions have performed very well, it is helpful to reflect upon one example in which three DPR transactions were subjected to significant stress: it is exactly this type of experience that gives creditors the confidence to use DPR transactions to offer funds to banks in countries with limited attractive funding sources. In the mid-2000s, Kazakhstan banks Alliance Bank (Alliance), Bank TuranAlem (BTA), and Kazkommertsbank (KKB) established DPR programs and raised funds from various investors, including an investment by ADB in Alliance’s program. These structures each followed the traditional “true sale” structure with an SPV located outside the country, as reflected in Figure 9.

The strength of these programs was tested when Kazakhstan’s economy, and the Kazakh banking sector in particular, was subjected to severe stress resulting from factors both domestic (e.g., overlending to real estate developers) and external (e.g., the global financial crisis). These negative factors, exacerbated in certain cases by harmful management actions, caused all three banks to experience significant losses in their capital base and suffer



substantial downgrades to their ratings. The turmoil in international markets during the global crisis also resulted in a decline in export-related and other DPR flows to Kazakhstan. Such events resulted in creditors not only being exposed to declines in the DPR flows but also put into question the survivability of these banks and thus their ability to stay in business and continue to generate future DPRs.

The most severe circumstances applied to the Alliance transaction that ADB had invested in. Alliance's capital levels fell well below regulatory requirements, its DPR flows declined significantly, and its customer base shrank sharply as customers fled to banks that were perceived to be safer. Alliance was unable to repay its debts and was nationalized by the government, which attempted to stabilize the bank and resolve its obligations. The government could have terminated Alliance's banking license but, although it was a relatively small bank in the local economy, the government sought to revive the bank to avoid the further negative impact that a liquidation of the bank would have had on the domestic economy.

From the perspective of the DPR program's creditors, this time brought great uncertainty; however, they had a protection that Alliance's lenders and other unsecured creditors did not have: the DPR flows that were continuing to collect outside of the country. While these flows were diminishing in amount as the economy struggled and the bank's customer base shrank, the bank's doors remained open and (as is necessary for any bank operating in the international economy) Alliance continued to receive payment orders for payments to its customers and thus continued to generate DPRs. As the DPR program enabled creditors to have the transaction prepaid from collections on the DPRs upon the occurrence of certain events (such as violation of minimum capital adequacy requirements and nationalization), the DPR collections were used to prepay the SPV's obligations in full.

This full repayment of the DPR creditors confirmed the strength of the "future flow" structure for DPRs in even a particularly challenging circumstance—so challenging that Alliance's unsecured creditors received but pennies on the dollar for their claims.<sup>57</sup> Repayment in full

<sup>57</sup> It should be noted that the Kazakh Payees all received payment in full, which would always be expected in any circumstance as a receiving bank would cease to have customers and receive payment orders were it failing in its commitment to make payments to the Payees.

is, of course, the intended result of any transaction that is secured by some form of collateral, but the DPR structure proved its particular advantages in severe circumstances that affected not only Alliance but the entire country of Kazakhstan. Though afflicted by less negative circumstances, the BTA and KKB transactions similarly protected their creditors against any loss.

Although this Kazakhstan success story is noteworthy in its own right, it highlights the primary benefits of these structures for creditors—and if creditors feel protected, then that provides significant value to banks and their countries when they seek to obtain international funding for their domestic needs. The option to raise monies through a program of this nature enables banks to provide funding to their local economy through loans to entrepreneurs, infrastructure projects, or any other local development need. In countries suffering from lower credit ratings or whose companies are otherwise challenged to raise funding, this option is particularly advantageous.

## 7.5 How Can a Country Promote “Future Flows” to Support Domestic Development?

Recognizing the very significant benefits that can accrue to banks and their home countries by using “future flow” technology, an important topic to discuss is why it has only been used in a few jurisdictions. While some countries are too small or possess too low a rating to be of interest to most international creditors, and some banks have insufficient volumes of DPRs to support establishing a complex program of this nature, many countries have not benefited from these programs due to the self-inflicted wounds of limitations and lack of clarity in their domestic legal environment. Tax, accounting, regulatory, and other considerations frequently derail potential transactions unnecessarily, which negatively impacts the ability of local banks to fund and support local development and jobs.

This is easily fixed, however. Each country has the ability to help itself by implementing a welcoming legal environment for such transactions and thereby encourage banks to establish such programs and creditors to finance them. What can a government do to create a solid foundation for “future flow” transactions?

The first step is to enact a law that specifically permits the application of a “true sale” structure, both for existing as well as future receivables, and ensure that there are no burdensome regulatory or other approvals or conditions that must be obtained or complied with. The second step is to enact clear tax-neutral rules on the taxation of the transactions, from permitting tax-free transfers (including to offshore SPVs) to eliminating any stamp taxes for the documents to minimizing or eliminating any withholding or other applicable taxes. While this can be achieved by way of changes to the various relevant laws and regulations, without doubt the most advisable (and easiest to implement) approach is to enact a single law that (with respect to such transactions) overrides any potentially conflicting current and future law and regulations.

To further strengthen the ability of local banks to raise funds through “future flow” transactions, a country could also implement policies that encourage remittances. For example, any taxes on such payments could be reduced or eliminated, the fees to process remittances could be

reduced (such as by having greater competition in remittance companies or reducing their costs of operation), or encouraging the “unbanked” to open accounts with local banks. With a solid legal structure and a reliable source of incoming payments, local banks would have a greater ability to use a “future flow” structure to attract funds that could be used to support development of the local economy.

## 7.6 Conclusion

While the “future flow” technology provides security to creditors, the primary but underappreciated benefit of these transactions is the enabling of banks to access less expensive and/or longer-term monies that can then be used to fund their balance sheet—a balance sheet comprised of loans to local businesses and individuals working to improve their lives and those of their employees and families. Many billions of US dollars of DPR and similar “future flow” transactions have supported significant economic development in Turkey, Peru, Brazil, and other countries that otherwise would not have been achievable, and this success is available to other countries that perceive the advantages of creating a hospitable environment.

For this to occur, local governments and banks should work together, potentially in coordination with development organizations such as ADB, to implement a clear and favorable legal environment. Certainly, banks should demand this of their governments, but the governments should demand it of themselves in their ceaseless efforts to improve the development of their economies and the lives of their citizens.

Back to Juan, Maria, and Julia, and how their international connections can help the mayor to build the much-needed hospital. As described earlier, their bank in Manila can use the expectation of these flows (and those relating to millions of other Filipinos) to establish a DPR “future flow” program, through which it can raise attractive international funding—and then it can lend those funds for the building of the hospital. While one hopes that Juan, Maria, and Julia will never themselves need the services of this hospital, their international connections can help to provide the financing that funds the hospital that will serve the needs of their friends and neighbors. As for Francisco, the mayor could finally get a good night’s sleep knowing that his community now has access to better health care services.

## CHAPTER 8

# Conclusion—Promoting Migration and Remittances for Development in Asia

*Mayumi Ozaki*

## 8.1 Status of Migration and Remittances in Asia

In 2013, an estimated 80 million people from developing Asia and Pacific countries live and work outside of their countries of origins. Corresponding to the increase in worker migration, remittances flowing into developing countries in the region grew substantially. Remittances are susceptible to the economic conditions in migrants' host countries, as experienced in the decline in 2008–2009 due to the Asian financial crisis as well as that in 2015–2016 due to declining oil prices which negatively affected countries in the Middle East. Nevertheless, overall, remittances into the region have been steadily increasing and were expected to reach \$251 billion in 2017.

It is widely believed that migration and remittances are beneficial to the migrant workers' home countries. At the household level, remittances help migrant workers' households to smooth out consumption and reduce their vulnerabilities to sudden economic shocks and disasters. Remittances also induce more private investments in health and education. At the country level, remittances that are invested in securities or financial instruments can be channeled into productivity-enhancing public investments such as infrastructure development.

The region's developing countries recognize the importance of migration and remittances and took various policy measures to promote migration especially since the late 1970s when the region's out-migration started to grow. Many countries established independent government agencies which provide assistance to migrant workers and supervise recruitment agencies. Examples of such institutions include the Commission on Filipinos Overseas in the Philippines; Bureau of Manpower, Employment and Training in Bangladesh; and Foreign Employment Bureau in Sri Lanka. Governments are also pursuing bilateral labor agreements with the host countries to protect the rights of migrant workers. The Government of Nepal has an agreement with the Government of Qatar, as well as memorandum of understanding with the governments of Bahrain, the Republic of Korea, and the United Arab Emirates.

While the importance of remittances to the economies in Asia and the Pacific region is well recognized, there is still a significant room for maximizing the benefits of remittances for development. To leverage migration and remittances for development, it is important to have policies and regulations to protect the welfare of migrant workers and capture remittances' economic gains. With coordinated efforts by the governments, regulators, the private sectors, and civil societies, remittance-receiving countries can reduce risks and enhance benefits from migration, and channel remittances toward productivity-enhancing activities both at the household and country level. This report provides recommendations on three key areas: (i) migration management, (ii) remittance's financial intermediation, and (iii) training and financial literacy.

## 8.2 Migration Management Policy Recommendations

While Asia is a major source of skilled migrants to advanced countries, most Asian migrants tend to be low-skilled. Empirical studies suggest that, welfare gains from migration critically depend on conducive business environments that facilitate timely labor reallocation and capital stock adjustments in response to inflows of migrants.

Challenges in managing out-migration include high migration costs incurred by low-skilled migrants, resulting in undesirable outcomes such as irregular migration (overstays); and ensuring the protection of labor rights in destination countries.

A country's migration policy varies depending in part on its objectives; nonetheless, the following common policies may be critical to manage out-migration process effectively and ensure labor and social protection:

**Improving institutional capacity.** Good migration management calls for strong institutional capacity of migration-related agencies and organizations as well as adequate financial resources. Improved institutional capacity would lead to stricter enforcement of migration-related laws and regulation in both receiving and sending countries, e.g., tightening up enforcement toward noncompliant migrant recruiters and employers in receiving countries and toward recruitment agencies in sending countries.

**Labor market database.** Better data collection is a must to formulate evidence-based policies and helps to increase labor market flexibility. The Republic of Korea's employment permit system presents good practices in this field: it has a comprehensive data network that is linked with various ministries and agencies involved in the process of low-skilled labor migrant employment. It has set up a permanent, nonpartisan body that carries out regular labor market needs tests utilizing comprehensive database, and collects information on labor needs by industry. Their analytical results are reflected in the proposals on new annual quotas by country; and the proposals undergo scrutiny through rounds of deliberations.

**Information and transparency.** Sending countries should focus on addressing market failures in out-migration. These include (i) facilitating the private sector to create an online job portal to increase workers' access to foreign job information; (ii) increasing transparency in recruitment costs paid by workers; and (iii) enhancing transparency in out-migration procedures through information campaigns, simplifications of procedures, and the establishment of one-stop shops.

**Worker treatment.** Migrant workers should be subject to the same minimum wages as their native counterparts, and receive equal social protection such as health care and social security. To motivate self-regulation, receiving governments can devise a mechanism to reward employers who respect rules and rights for low-skilled migrant workers, e.g., giving priority to employers in the process of allocating foreign labor.

**Country cooperation.** Cooperation of sending and receiving countries is advantageous to migrant workers. Through cooperation, sending countries maintain a pool of workers who are ready to migrate for work, and manage worker-recruitment process in a transparent manner, including job orders and fees involved. Both sending and receiving

countries ensure that the workers arrive in the destination country with a prior-job arrangement. This would contribute to improving migrant protection and reducing worker-paid recruitment costs. Receiving countries, on the other hand, can benefit from better job matching of migrant workers and could see a decline in irregular migration owing to lower recruitment costs.

### 8.3 Remittances for Investment Policy Recommendations

Promoting public investments from remittances and diaspora resources involves not only developing specific remittance-linked investment products, but rather requires much broader interventions. For migrant workers' households to invest more in financial instruments, it requires, among others, a reliable and secure financial sector, smooth and efficient payment systems, convenient and easy to access to service providers, and support to improve migrant workers and their families' financial literacy and knowledge. To achieve those policy objectives, interventions on specific financial sector areas are suggested, including (i) regulations, (ii) technologies and payment system, (iii) linkages to microfinance institutions (MFIs), (iv) remittance-linked investment products, and (v) information and financial literacy.

**Regulations.** Remittance transaction involves multiple financial institutions. Generally, those institutions are supervised and regulated by the financial regulatory authority, under the relevant acts and regulations. However, too strict regulations may have adverse impact on the formal remittance flow.

Generally, remittances are low-value personal money transfers, and policy makers and regulatory authorities can adopt more flexible approach, or the so-called risk-based approach. In the risk-based approach, the regulatory authority needs to consider the right balance between the financial sector security and the financial inclusion, and to apply regulations based on the perceived risk of the remittance transactions.

**Technologies and payment system.** The use of technologies for remittances, such as mobile phone, ATMs, and point-of-sales (POS), has a high potential to reduce the remittance costs and expand formal remittances' outreach to migrant workers' households who are not regularly serviced by banks. Technology-based remittance services can be linked up with various types of agents including postal offices, exchange houses, shops, gas stations, and MFIs to provide easy access.

To develop technology-based, cross-border remittance services, a well-developed payment system infrastructure is essential. It is especially important to develop an interbank payment system infrastructure to enhance interoperability across different institutions. Also, support to develop agent networks is important. Developing agent networks takes time and cost, and the limited agent network is often a key impediment in expanding mobile remittance services outreach.

**Linkages to microfinance institutions.** Involving nonbank financial institutions such as MFIs has a significant potential in extending formal remittance outreach particularly in areas where there are no bank branches or money transfer companies. Many developing countries in Asia and the Pacific region have dense networks of MFIs including cooperatives, and remittances–MFI linkage could bring to migrant

workers' households other financial services such as savings, deposits, payments, and insurance.

**Remittance-linked investment products.** Aside from promoting access to formal financial services, the financial sector in the remittance-receiving countries needs to develop appropriate financial products to attract investments by receiving households. Various types of remittance-linked financial products have been offered by both the public and private sectors. Typical products include diaspora bonds, foreign or local currency savings and deposit, securitization of future flow of remittances, and tax incentives and preferential treatment for diaspora investments.

To attract diaspora investments, countries need to carry out persistent communication and marketing activities to incentivize diasporas to invest back home. Also, investment products should be designed and marketed to the right targets. Banks and financial institutions can tailor such savings products to meet the specific needs of migrant workers, such as offering housing loans tied to their remittance savings. Above all, the appetite of migrants for diaspora bonds critically depends on stable and trustworthy governance, and strong and transparent legislations for enforcing the contracts in home countries.<sup>58</sup>

Securitization of future flow receivables such as remittances can provide a way of raising development for many low- and middle-income countries. Securitization transactions can be structured to mitigate sovereign risk and enable the country to access longer-term financing at lower interest rate than unsecured bonds.<sup>59</sup>

**Information and financial literacy.** There should be a comprehensive support to provide the information and training to migrant workers. Financial literacy training appears to increase financial knowledge and information-seeking behavior of migrant workers.<sup>60</sup> Predeparture orientations are important opportunities to inform departing migrant workers about available remittance channels, price, investment products, risks in informal remittances, and financial frauds. By providing information on types of remittance services, costs, benefits, and risks, migrant workers and their families can make educated choices to channel more efficiently their remittance incomes according to their households' economic objectives.

## 8.4 Training and Financial Literacy Policy Recommendations

Financial literacy programs for migrants and their families can enhance economic potential of migrants' remittances on the recipient and even the community and the local economy of the migrants' countries of origin, particularly developing countries. These programs have been conducted and supported by national governments and agencies, financial institutions, and nongovernment organizations.

<sup>58</sup> N. Okonjo-Iweala and D. Ratha. 2011. A Bond for the Homeland. *Foreign Policy*. 24 May.

<sup>59</sup> S. Ketkar and D. Ratha. 2005. Recent Advances in Future-Flow Securitization. *The Financier*. 11/12.

<sup>60</sup> J. Gibson, D. Mckenzie, and B. Zia et al. 2011. *The Impact of Financial Literacy Training for Migrants*. Washington, DC: The World Bank.

The literature does not provide conclusive evidence that financial literacy programs can greatly affect financial outcomes. However, it does not mean that financial literacy does not have any impact on financial behavior and as such should not be conducted. On the contrary, the literature suggests improving programs and adopting good practices on financial literacy and financial behavior have demonstrative effects. From the review of the literature, we can glean four important points to be considered when designing financial literacy programs: information asymmetry, the importance of timing, content, and delivery mode.

**Information asymmetry.** Many of the existing financial literacy programs only involve the migrant members, especially those programs designed as part of predeparture orientations given to departing migrants or those given while the migrants are in the host countries. While it is good if such programs can encourage migrants to save and invest, it can also encourage them to make realistic goals if the needs of the remaining family members in the home country are taken into consideration.

Circumstances of the migrant in the destination country and those of the remaining family in the home country are not always the same—many factors can influence consumption and saving goals. The remaining family members, in not understanding the saving goals of the migrant member, might use the remittances in a way that will make saving impossible or spend it on consumption goods. Failing to set aside money for investment might result from the remaining family not knowing the circumstances of the migrant member. Therefore, involving the family in the financial literacy program will bring everyone on the same page.

**Timing.** Many migrant-sending governments, such as those of Indonesia and the Philippines, conduct financial literacy seminars as part of their predeparture orientation programs. Also, some private organizations and nongovernment organizations conduct financial literacy seminars at the destination countries. Some, on the other hand, couple such seminars with reintegration programs for returning migrants.

We further suggest that conducting financial literacy programs on-site at the migrants' destination countries can also be beneficial, as it inculcates in them the important habits about financial management while they are earning. It can also develop in them information-seeking behavior as they would most likely seek more information as to how their recipients are using the remittances.

**Content and varied interventions.** Opening bank accounts may be hard for migrants on both the demand and supply side, since there are many things to consider when it comes to opening a bank account for new immigrants: proficiency in language, needed documents, banking charges and hours, lack of suitable products, and lack of knowledge about different financial instruments. However, non-remittance-based programs on financial literacy can have positive effects on mindset and perceptions about financial products, making migrants less intimidated to go to banks and other financial institutions. Also, goal setting can influence the take-up of financial products, as well as influence future actions regarding financial behavior.

**Delivery mode.** In terms of style and format of financial literacy programs that can significantly impact financial literacy, results vary. A good style should enable faster and easier take-up of knowledge, and simplify access and facilitate desired behaviors.

Financial literacy programs have been implemented in various formats—from seminars to workshops, to pamphlets and modular formats.

**Focus on how to save.** Financial literacy seminars provided during predeparture orientations, which many governments already implement, should include not only the migrants but also their family members, and put focus on the various traditional and nontraditional saving and investment instruments such as pooled funds, insurance plans, and pension funds that are available to them. Predeparture orientations provide the best opportunity for migrants and their family members to begin developing financial habits before they start receiving larger amounts of money.

**Evaluation.** National strategies often put focus on more tangible forms of financial inclusion, i.e., bank accounts, usage of formal remittance channels, and membership in pension funds. More than improving financial products, how to use them, how to choose what is best fitted to migrants' and their families' needs and means, and how to be able to set goals and save for the future should be a priority for many governments. In short, inclusion should always be coupled with education. For that reason, we suggest the use of proper evaluation tools to be able to assess whether the programs are making a difference. Proper evaluation tools that outline quantifiable goals can help identify what programs work, what gaps need to be addressed, and what more should be done.

## 8.5 Conclusion

Given their size and importance, global policy leaders are increasingly paying attention to migration and remittances. The United Nations Sustainable Development Goals include the target of reducing to “less than 3 per cent the transaction costs of migrant remittances and eliminate remittance corridors with costs higher than 5 per cent by 2030.”<sup>61</sup> Also, the United Nations General Assembly Summit on “Large Movements of Refugees and Migrants” committed to develop “a Global Compact for Safe, Orderly, and Regular Migration” in September 2016. The Compact is expected to be adopted at a United Nations International conference in 2018.<sup>62</sup>

While migration and remittances are becoming more politically important, many remittances-receiving countries in the region experienced decline in remittance inflow during 2015–2016 mainly due to declining oil prices and weakened economy in the oil-producing Middle East countries, a major Asian migrant worker destination. The impact was especially acute in India, which experienced an 8.9% decline in remittance flows in 2016. This decline in remittance inflow directly led to a decrease in the number of workers migrating overseas. For example, in Nepal, the number of departing migrant workers decreased by 23% during 2015–2016.<sup>63</sup> The decline of the recent remittance inflow is an important reminder that remittances are susceptible to the host countries' economic situations and migrant workers are highly vulnerable in the fluctuating labor demands in those markets.

<sup>61</sup> The Global Knowledge Partnership on Migration and Development (KNOMAD). [www.knomad.org](http://www.knomad.org).

<sup>62</sup> World Bank. 2017. Migration and Remittances: Recent Development and Outlook. *Migration and Development Brief*. 27. Washington, DC.

<sup>63</sup> Government of Nepal, Ministry of Finance. Economic Survey Fiscal Year 2014/2015 and 2015/2016. Kathmandu.

Although the region experienced a steady growth of remittance inflow during the last few decades, it has certain risks to continue relying on remittances as a major source of foreign exchange. Remittances are susceptible to external political and economic conditions. It should also be recognized that working environments for migrant workers, especially for those with low skills, are not necessarily favorable. They often face risky working environment, malicious treatment, as well as risks of fraud and exploitation.

Concerted efforts by governments, the private sector, civil societies, and international development partners are urgently called for to protect migrant workers' rights and welfare and to maximize the economic benefits of remittances. It is essential for the governments of migrant workers' home countries to have a clear vision and strategy on migration and remittances. The government can adopt measures to enhance safe migration, including having bilateral agreements with host countries on migrant worker protection as well as strengthening regulation on migration agencies. The private sector, in cooperation with development partners, can develop payment infrastructure and financial product for remittances, as well as promote financial literacy education. Civil societies can assist in creating awareness on safe migration and help returning migrant workers to reintegrate into the society. More essentially, both the public and private sectors must share a clear vision to leverage remittances to develop viable local industries and generate employment opportunities at home. A goal should be to make migration an option, and not a necessity, as it occurs today in many countries in the region.

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## Migration and Remittances for Development in Asia

Currently, over 80 million people from Asia and the Pacific live and work outside of their countries of origin. Migration and remittances have both positive and negative effects. For the countries, remittances became an important source of foreign exchange. At the household level, remittances enable families to spend more on education and health. However, migration also has a negative social impact, including the exploitation and abuse of workers. This report explores ways to enhance the welfare of migrant workers as well as ways to improve the productive investments of remittances to support the countries' growth and development.

### About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to a large share of the world's poor. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

